the
CHARACTER
group plc

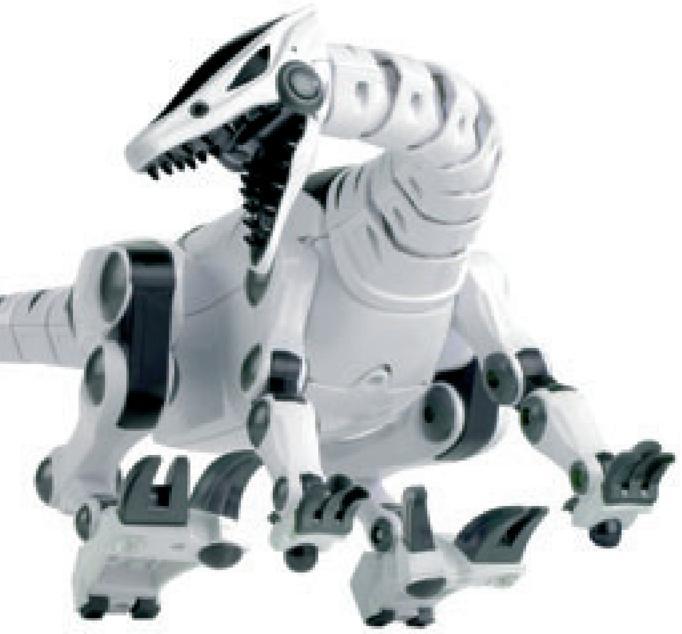
# Annual Report and Accounts

For the year ended 31 August 2006

# Product Highlights.

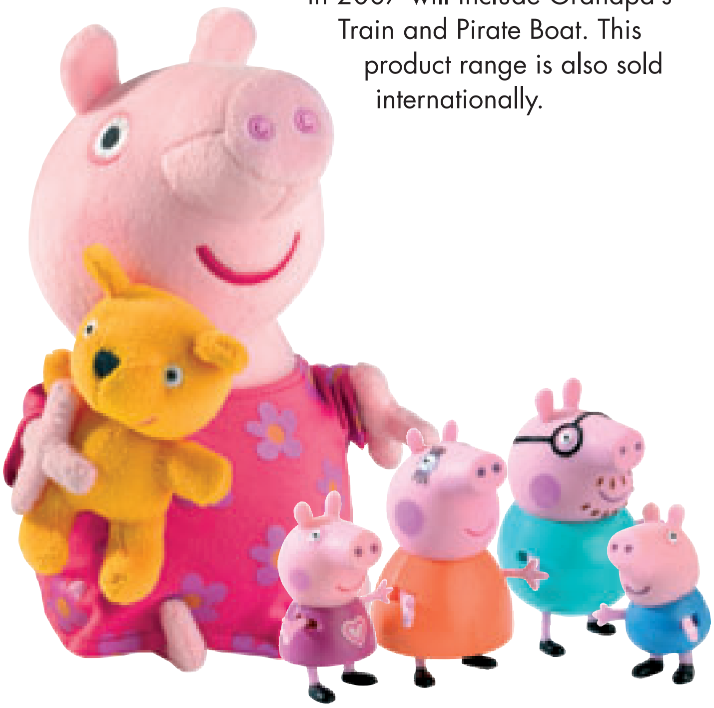
## Roboreptile™

The Roboreptile was a new addition to the Robotic range in 2006. The Robotics category has continued to perform well and the Robosapien V2 introduced last year, won the 2006 Duracell Toy of the Year Award. New exciting products will be introduced in the spring and autumn of 2007. Character has the UK exclusive distribution rights from Wow Wee Toys.



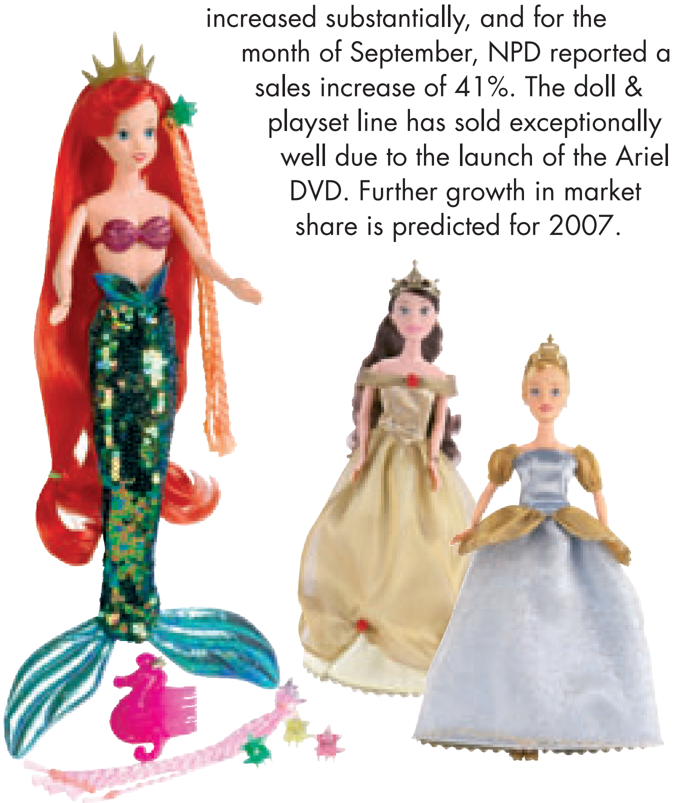
## Peppa Pig™

Peppa Pig pre-school programme is broadcast on Channel 5 and Nick Jr. Character has the master toy licence and has developed in-house a range of both plastic and plush products. Sales are ahead of last year, with the Peppa Playhouse being the star item. New items to be introduced in 2007 will include Grandpa's Train and Pirate Boat. This product range is also sold internationally.



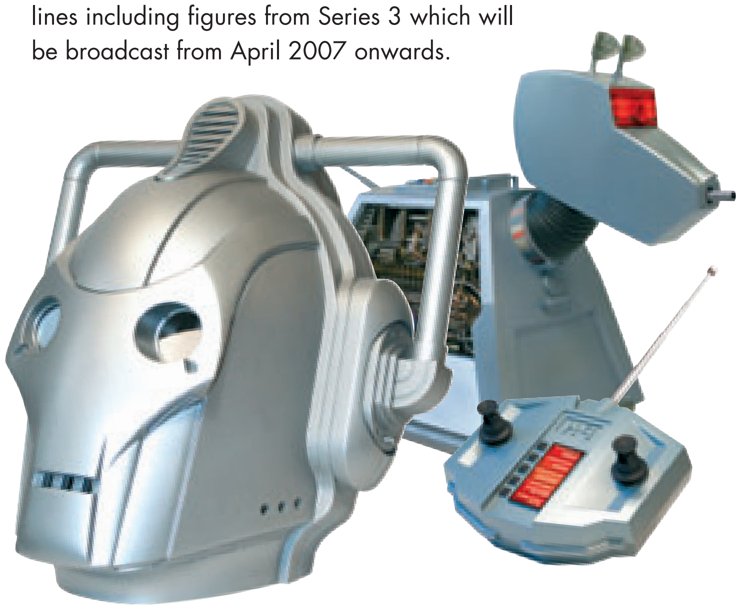
## Disney Princess™

Character has the UK distribution rights for the Disney Princess doll and playset product lines. Sales have increased substantially, and for the month of September, NPD reported a sales increase of 41%. The doll & playset line has sold exceptionally well due to the launch of the Ariel DVD. Further growth in market share is predicted for 2007.



## Doctor Who™

Character is the master toy licensee for Doctor Who. The product line is completely developed in-house and this exciting range is expected to be the top boys' toys concept for 2006. For the month of October, NPD data shows Doctor Who having 3 of the top 5 toys sold in the UK. Cyberman Voice Changer Helmet is expected to be the top selling item in the Doctor Who line up. For 2007, Character will be producing new product lines including figures from Series 3 which will be broadcast from April 2007 onwards.



# CONTENTS



# DIRECTORS AND ADVISERS

*Directors*
R King
K P Shah
J J Diver
J J P Kissane
I S Fenn
Lord Birdwood
D Harris
A B MacKay

*Secretary*
K P Shah FCCA

*Company registration number*
3033333

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London EC1M 4JN

*Stockbrokers*
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25 Luke Street
London EC2A 4AR

*Registrars*
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18 Laurel Lane
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West Midlands B63 3DA

*Bankers*
National Westminster Bank plc
Standard Chartered Bank plc
The Hongkong and Shanghai Banking Corporation Limited

# CHAIRMAN'S STATEMENT

### Introduction

I am delighted to report that, with the Group now focussed on the business of Toys, Games and Gifts, we have produced a very creditable result reporting a pre-tax profit of £6.52 million on the continuing business, compared to a £0.66 million loss for the comparable period last year.

### Financials

The 2005/6 financial year has been one of significant change for the Group both in terms of structure and business focus; this follows the successful disposal of our digital business in the first half.

It is important that these financial results are analysed on a continuing business basis as it gives a much clearer view of what has been achieved in the underlying core business.

Sales in the continuing business of Toys, Games and Gifts in the year ended 31 August 2006 were £69.55 million, against £49.96 million in the previous year, an increase of approximately 39.2%. Operating profit on the same basis was £6.98 million versus a reported loss of £315,000 in 2005.

Group turnover, including the discontinued business, amounted to £95.53 million (2005: £98.79 million), whilst operating profit on the same basis was £3.69 million (2005: £864,000). Reported profit before tax in the period, after an exceptional gain from the disposal of the digital business, was £5.20 million against £161,000 in the comparable period.

Basic earnings per share, on the continuing business in the year under review were 8.49 pence (2005: loss of 1.69p). Allowing for the discontinued business, overall earnings per share were 5.93 pence (2005: loss of 0.39p).

The disposal of the Group's digital business was completed in February 2006 and these results include a contribution to Group sales which amounted to £25.98 million, and produced an operating loss for that business of £3.29 million.

Overheads, as a percentage of sales for the continuing business, were 31.8% (2005: 32.7%).

Stocks at the year-end for the continuing business were some £5.4 million higher than at the same time in 2005, and reflect the build up of inventory to service higher anticipated volumes for this Christmas selling season (2006).

Cash at bank as at 31 August 2006 stood at £7.4 million compared to £10.3 million at the interim stage and £3.7 million as at 31 August 2005. The Group has operated comfortably within its bank and trade finance facilities.

### Dividend

The Directors are recommending an increased final dividend of 1.65 pence per share. This represents a 83.3% increase, which together with the interim dividend of 1.65 pence per share will make a total for the year of 3.30 pence and makes an increase in total dividend of 65% over 2005.

Subject to Shareholder approval at the Annual General Meeting on 17 January 2007, the final dividend will be paid to Shareholders on the Register as at 5 January 2007 on 26 January 2007. The shares go ex-dividend on 3 January 2007.

### Share Buy-Backs

The Group continues to investigate ways to enhance shareholder value, whilst also looking to widen share ownership and improve liquidity.

During the year, the Company purchased 5,190,000 ordinary shares at a total cost of £3,053,000, representing approximately 10.83% of the issued share capital of the Company (excluding shares held in Treasury) at 31 August 2006. Of these shares, 4,065,000 were purchased for cancellation and the remaining 1,125,000 were purchased for and remain held in Treasury.

It remains the Board's stated objective to continue to enhance shareholder value including, where appropriate, through balancing the repurchase of the Company's shares together with continuing to implement a progressive dividend policy.

As at 31 August 2006, the Group had 47,923,909 ordinary shares in issue, excluding the 1,125,000 ordinary shares held in Treasury.

Since the year end, the Group has purchased a further 629,322 ordinary shares which are held in Treasury.

The Board is proposing at the forthcoming Annual General Meeting to ask for shareholder approval to renew its authority to repurchase shares in the Company of up to 25% of its issued capital (excluding shares held in Treasury).

### Review of the On-going Toys, Games and Gifts Business

The year under review includes trading for Christmas 2005, which was widely reported as being another difficult one for the retail trade.

Against this background, the business has made significant progress throughout the year.

The rate of sale of the early *Doctor Who* products and the success of the *Roboraptor* gave us our first real feel of the growth to come, as well as indications from our *Scooby Doo, Gr8 Gear* and other ranges which altogether gave us confidence that our investment in developing more of our own products was indeed the right strategy for growth.

We increased the depth and breadth of our distribution throughout the year which also resulted in an increase in our market share.

Whilst the external indications of success are often measured in increased sales and profits, what is very satisfying to the Directors is the progress made within the Company. During the year, we have recognised the potential and development of some of our key management by appointments to the Board of our trading subsidiary, Character Options:

- Paul Hillier — Finance Director,
- Jerry Healey — Marketing Director, and
- Steve Tull — QA/QC Director.

In order to create a more efficient and productive team we have also integrated the UK development teams into one entity. These changes and appointments have underpinned the strength and depth of expertise within our management team which in its new structure has the capability to handle the growth envisaged for this financial year and beyond.

Within the Far East, we appointed Michael Hyde, a Chinese speaking American with experience of both Toys and the Far East, as Managing Director with responsibility for both our Hong Kong and Shenzhen operations which have been restructured into a more efficient unit and will continue to provide important QA/QC product development, logistics management and customer support for the Group as a whole.

We have also further developed our Character on-line website (www.character-online.com). I would recommend that you visit this site and look at our current product line up, which I am sure will give you a clearer picture of why the Directors are confident of further growth.

## People

I would like to take this opportunity to welcome all those who joined us during the year across the business. Also, on behalf of Shareholders and the Board, I would like to thank all our people for their hard work and commitment, which has played a major part in achieving this creditable result in the financial year being reported.

## Industry Recognition

During this calendar year, Character Options, our principal trading subsidiary was awarded *Best Licensed Toy* and *The Innovation Award* at the 2006 Licensing Awards for its high standards of technical achievement in relation to its own-developed *Doctor Who* Radio Controlled Dalek.

In addition, in the recent Top 60 listings for Christmas 2006, Character achieved six items within the six categories.

*Robosapien V2* was voted Toy of the Year by Duracell.

The Company has also been awarded the Certificate of Excellence Bronze award for the Group's own-developed *Peppa Pig* Playhouse by the Practical Pre-School Foundation.

Recently, we were also recognised for our high level of service by *Toys R Us,* one of our major customers. This was especially pleasing as it is awarded for all aspects of trading including product offering through to quality control, efficiency of administration, logistics as well as marketing and this award clearly demonstrates the continued improvement in our overall performance.

### Current Trading

As our product offering has continued to strengthen, we have simultaneously widened our distribution base and achieved improved penetration for our major product categories at retail.

Sales for our Toys and Games have achieved record levels for the first quarter of the new financial year, with growth coming from across virtually all our major categories.

At the retail level, we have also seen substantial growth in both sales and market share in the UK, with no less than three out of the toy industry's top ten best selling toys at retail in October having been designed and developed by Character in-house.

We expect that by Christmas 2006, we shall have seen solid double digit growth in all our major product categories with the exception of Robotics where it will be hard to beat last year's outstanding record sales.

We have continued to improve our global trading relationships and look forward to seeing increased international sales going forward.

### Looking Forward

At this stage of the year, we have already established our product line-up for 2007 calendar year and commenced previewing our full ranges with our major customers.

Our strategy going forward is to continue the development of our major product categories which include:

- ***Doctor Who***
- ***Biker Mice from Mars***
- ***Scooby Doo***
- ***Robotics***
- ***Disney Princess***
- ***Peppa Pig***
- ***Gr8 Gear***
- ***Gr8 Art***
- ***Games***
- ***Gloe plush***
- ***Novelty Pens***

We are also introducing new product categories such as ***Supermag, Spiderman 3, Bindeez, Planet Earth, Barney*** and ***Disney Racing.*** Additional categories are under discussion and will be announced at the appropriate time.

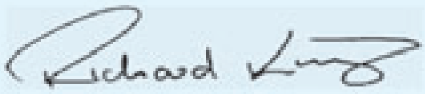
It continues to be our strategy both to develop our own products as well as seek exciting products for distribution.

## Prospects

The new financial year has started very well, with Toys and Games sales in the all important run up to Christmas not only exceeding our earlier expectations but at record levels.

It is very encouraging to see the strong growth across many of our major product categories as they are becoming more established. The trade's response to our new products for 2007 has again been very robust and these factors create a strong base from which to continue to grow both our sales and market share.

The Directors are confident that 2007 will be another good year of growth for the Group.



**Richard King**
Chairman

# DIRECTORS' BIOGRAPHIES

**Richard King** (aged 61), Executive Chairman, has extensive experience in the toy industry and has been involved in importing consumer products from the Far East since 1969. He established the original business of The Character Group plc jointly with Mr Kissane and Mr Shah in 1991 and works in close association with the management to develop and implement Group strategies.

**Kiran Shah** (aged 52), Group Finance Director and Joint Managing Director, is a member of the Chartered Association of Certified Accountants. After initially working in private accountancy practice, he moved into industry and since 1978 has been involved extensively in the toy industry, notably in his role in jointly heading up a successful management buyout of Merit Toys Limited in 1981 and its subsequent sale to Bluebird Toys plc in 1988. He jointly established the original business of The Character Group plc with Mr King and Mr Kissane in April 1991.

**Jon Diver** (aged 42), Group Marketing Director and Joint Managing Director, joined the Group in September 1991 from Rainbow Toys Limited, where he was Senior Marketing Executive. He became Group Marketing Director in August 1994, and has developed close working relationships with the Group's suppliers. He has played a key role in the development and implementation of the Group's marketing strategy.

**Joe Kissane** (aged 54), Managing Director of Character Options Limited, has considerable sales expertise in and outside the toy industry, gained over a period of 30 years, notably with such companies as Nabisco, Lego and Tonka. He is one of the founders of the Group.

**Ian Fenn** (aged 63), Senior Independent Non-Executive Director, joined the Board in May 1995. He has extensive experience in corporate finance gained over many years in stockbroking and merchant banking in the City of London. He is a director of ARM Corporate Finance Limited, which is authorised and regulated by the Financial Services Authority.

**Lord Birdwood** (aged 68), Independent Non-Executive Director, was appointed to the Board in September 1995. He has experience as a director of quoted and private companies. He has particular interests in executive placement and recruitment.

**David Harris** (aged 56), Independent Non-Executive Director, was appointed to the Board in May 2004. He has considerable financial experience gained over a 30 year career in both executive and non-executive capacities. He is currently a non-executive director of Small Companies Dividend Trust plc, Osprey Small Companies Income Fund Ltd and Premier Absolute Growth and Income Trust plc, all of which are quoted companies.

**Alan MacKay** (aged 46), Non-Executive Director, is a senior Partner at 3i Investments plc, one of the world's leading private equity companies. After founding, then selling, a marketing services business, he joined 3i in 1987 and was appointed to the Board of 3i plc in 1994. He currently leads 3i investment activity in the public equities arena. He is Chairman of 3TS Capital Partners, a member of the Strategic Advisory Board of SVG Investment Advisers, and a non-executive director of AIM listed company MDY Healthcare plc.

The directors present their report together with the accounts for the year ended 31 August 2006.

### Directors

The following are the directors that served during the year:

Richard King (Executive Chairman)
Kirankumar Premchand Shah FCCA (Group Finance Director and Joint Managing Director)
Jonathan James Diver (Group Marketing Director and Joint Managing Director)
Joseph John Patrick Kissane (Managing Director, Character Options Limited)
Ian Stanley Fenn (Senior Independent Non-Executive Director)
Lord Birdwood (Independent Non-Executive Director)
David Harris (Independent Non-Executive Director)
Alan Browning Mackay (Non-Executive Director) (appointed 22 August 2006)
Enrico Preziosi (Chief Executive Officer and Managing Director) (resigned 28 September 2005)
Aldo Horvat (Non-Executive Director) (resigned 19 June 2006)

Biographies of the directors are set out on page 7.

### Principal activity

The Group is engaged in the design, development and international distribution of toys, games and gifts. During the year, the Group sold its digital camera business.

### Business review, results and dividend

A review of the business is contained in the Chairman's Statement on pages 2 to 6 and the results are detailed in the consolidated profit and loss account on page 20, the consolidated balance sheet on page 21 and the consolidated cash flow statement on page 23. There was a profit for the year, after taxation, amounting to £3,060,000 (2005: loss £204,000).

An interim dividend of 1.65 pence per share was paid on 28 July 2006. The directors recommend a final dividend of 1.65 pence per share making a total dividend of 3.30 pence per ordinary share (2005: 2.0 pence). If approved, the final dividend will be payable on 26 January 2007, to shareholders on the register on 5 January 2007.

### International Financial Reporting Standards ("IFRS")

The consolidated accounts of the Group must comply with International Financial Reporting Standards (IFRS) for reporting periods beginning on or after 1 January 2007. The Group will therefore adopt IFRS from 1 September 2007.

### Directors and their interests in shares

The directors and their interests (all of which are beneficial) in the shares of The Character Group plc as at 31 August 2006 were as follows:

| Directors | 31 August 2006 Number of Ordinary Shares | 31 August 2006 Ordinary Shares under option | 31 August 2005 Number of Ordinary Shares | 31 August 2005 Ordinary Shares under option |
|---|---|---|---|---|
| R King | **5,345,428** | **250,000** | 5,345,428 | – |
| K P Shah | **5,645,000** | **250,000** | 5,645,000 | – |
| J J P Kissane | **1,462,300** | **415,000** | 1,462,300 | 185,000 |
| J J Diver | **1,690,640** | **415,000** | 1,690,640 | 185,000 |
| I S Fenn | **9,000** | **–** | 9,000 | – |
| Lord Birdwood | **8,750** | **–** | 8,750 | – |
| D Harris | **14,097** | **–** | 14,097 | – |
| A B MacKay | **-** | **–** | – | – |
| TOPS Pension Scheme* | **1,725,000** | **–** | 1,725,000 | – |

(* Each of R King, K P Shah and J J Diver is a trustee and a beneficiary under such pension scheme arrangements.)

Included in the interests of R King are his interests in shares held by Cedarberg Investments Limited, being 1,885,428 ordinary shares at 31 August 2006 and at 31 August 2005. There is also included in the interests of R King his interests in shares held by his spouse, Mrs M H King, being 320,000 shares at 31 August 2006 and at 31 August 2005.

Included in the interests of K P Shah are his interests in shares held by Sarissa Holdings Limited, being 5,620,000 ordinary shares at 31 August 2006 and at 31 August 2005.

Further, Orbis Pension Trustees Limited, the trustee of the Company's employee share ownership trust ("the Trust"), held 285,000 ordinary shares at 31 August 2006 and at 31 August 2005. Each of R King, K P Shah, J J P Kissane and J J Diver is deemed to be interested in such holding by virtue of being within the class of beneficiaries defined by the Trust.

A B MacKay is a senior partner at 3i Investments plc, a subsidiary of 3i Group plc which had a beneficial interest in 11,525,898 ordinary shares at 31 August 2006.

## Employment policies

The Group depends on the skills and commitment of its employees in order to achieve its objectives. Group staff at every level are encouraged to make their fullest possible contribution to the Group's success.

The Group's selection, training, development and promotion policies ensure equal opportunities for all employees regardless of gender, marital status, race, age or disability. All decisions are based on merit.

It is the Group's policy not to discriminate between employees or potential employees on any grounds. Full and fair consideration is given to the recruitment, training and promotion of disabled people and should staff become disabled during the course of their employment, efforts would be made to provide appropriate re-training. The Group places enormous importance on the contributions of its employees and aims to keep them informed of developments in the Group by way of regular meetings, newsletters and publications, together with distribution of the Annual Report.

Employees are encouraged to become involved in the financial performance of the Group through participation in the Group's share option schemes.

## Research and development

The Group's research and development activities are concentrated on the development of new products, new processes and improvements to or developments of existing products.

## Policy and practice on payment of creditors

The Group does not follow any standard code of practice for paying its suppliers but, instead, agrees with each principal supplier the terms of payment for each transaction or series of transactions. The Group's policy is then to abide by those pre-arranged terms for payment. At 31 August 2006, trade creditors of the Group represented an average of 75 days credit in relation to total purchases for the year.

## Statement of directors' responsibilities

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice.

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and Group and of the profit or loss of the Group for that year. In preparing those financial statements the directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the accounts on a going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Group's financial statements are published on the Group's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements which may vary from legislation in other jurisdictions. The maintenance and integrity of the Group's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

### Statement of Disclosure to Auditors

In so far as the Directors are aware:

- there is no relevant audit information of which the Group's auditors are unaware; and
- they have taken all steps they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

### Substantial shareholders other than directors

At 27 November 2006 the following, other than the directors and their family interests, had notified the Company of an interest in 3% or more of the Company's ordinary shares:

| Name | Number of ordinary shares | Shareholding % (excluding shares held in Treasury) |
|---|---|---|
| 3i Group plc | 11,525,898 | 24.05% |
| Sweet Briar Investments Limited | 1,675,000 | 3.50% |

### Changes in Share Capital

During the year, 286,000 ordinary shares of 5 pence each in the Company were issued to various employees on exercise of their share options. Details of such shares issued are given in note 16 to the accounts.

Also, during the year, 4,065,000 shares were repurchased for cancellation, and 1,125,000 shares were repurchased and are held as treasury shares. Details are given in note 16 to the accounts.

### Share option schemes

Details of the Company's share option schemes are given in note 16 to the accounts.

### Charitable and political donations

Payments of a charitable nature made during the year amounted to £31,883 (2005: £27,755). There were no political contributions.

### Annual General Meeting

Notice convening an annual general meeting of the Company is set out on page 41 of this document. Full details of the business to be transacted at that meeting are set out in that notice.

The business of the meeting will include special business proposing the consideration of resolutions to:

- renew the directors' general authority to allot unissued shares in the capital of the Company up to an aggregate nominal amount of £798,730 (15,974,600 ordinary shares of 5 pence each in the capital of the Company). This authority will expire on whichever is the earlier of the conclusion of the annual general meeting of the Company to be held in 2008 or the date falling 15 months following the passing of this resolution. The directors have no present intention of exercising this authority, which represents approximately 33.3% of the issued share capital of the Company at 31 August 2006, excluding shares held in Treasury;

- authorise the directors to offer to allot new shares in the Company to shareholders who elect to accept the same in lieu of any cash dividend entitlement;

- authorise the directors to make purchases of the Company's issued ordinary shares in the market for cancellation, or to be held in treasury, if and when the directors consider that it would be in the best interest of the Company and shareholders generally to do so, up to 11,854,000 shares (representing approximately 25% of the current issued share capital of the Company excluding shares held in treasury). The price at which an ordinary share in the Company may be purchased in exercise of this authority is subject to a maximum price of 105% of the average middle market values of an issued share in the Company in the five business days prior to purchase and a minimum of 5 pence, being the nominal value of an issued share in the Company. The directors intend to exercise this authority if and when to do so will, in the opinion of the directors, enhance shareholder value. If all options granted by the Company (pursuant to the Group's share option schemes particularised in note 16 to the accounts) and subsisting as at 27 November 2006 were exercised a total of 3,372,500 of new ordinary shares would be allotted, representing approximately 6.64% of the enlarged issue share capital of the Company following such exercise (excluding shares held in Treasury). If the authority proposed for the buy-back of shares by the Company was to be exercised in full, then the number of shares to be issued on exercise of the said options would constitute approximately 8.66% of the issued share capital as enlarged by such allotments of shares (excluding shares held in Treasury);

- approve a disapplication of shareholder pre-emption rights to enable the issue of equity securities in connection with any rights issues and/or an offer of issued shares held in treasury by way of rights made by the Company, with certain adjustments to shareholder entitlements to be made for practical purposes to deal with fractional entitlements and overseas restrictions on offers of shares in UK companies and further limited disapplications of these pre-emption rights applying in relation to:

  (i) the allotment for cash of up to an aggregate nominal amount of £239,615 (4,792,300 ordinary shares of 5 pence each in the capital of the Company), representing approximately 10% of the nominal value of the issued ordinary share capital of the Company as at 31 August 2006 (excluding shares held in Treasury);

  (ii)the sale of all or any of the 1,754,322 ordinary shares of 5 pence each in the capital of the Company held in treasury as at 27 November 2006.

### Auditors

A resolution to reappoint HLB Vantis Audit plc as auditors to the Company will be proposed at the annual general meeting, convened by the notice set out on page 41 of this document.

## Corporate Governance Statement

The directors continue to embrace the principles contained in the new combined code of corporate governance issued in July 2003 as applicable to fully listed companies.

### Directors

The Board of directors comprises four executive directors and four non-executive directors, as detailed on page 7. The independent non-executive directors are Lord Birdwood, Mr Fenn (who is the senior independent non-executive director) and Mr Harris. The Board is structured so that no one individual or group dominates the decision-making process.

Board meetings are held at least four times a year and at other times as required to address requirements arising between these scheduled meetings.

During the year, six Board meetings were held. The directors attended as follows:

| | Attendance |
|---|---|
| R King | 6 |
| K P Shah | 6 |
| J J P Kissane | 5 |
| J J Diver | 4 |
| I S Fenn | 6 |
| Lord Birdwood | 5 |
| D Harris | 6 |
| A G Horvat | 1 |

Mr E Preziosi did not attend any board meetings.

Mr A B MacKay did not attend any board meetings, as there were no board meetings held in the period from his appointment to 31 August 2006.

The Board has a formal schedule of matters reserved for its decision. It determines the overall Group strategy; creation, acquisition or disposal of material corporate entities or assets; public announcements, including statutory accounts, significant changes in accounting policy, capital structure and dividend policy; group remuneration policy and Board structure, composition and succession.

The Board delegates to management, through the Executive Directors, the overall performance of the Group which is conducted principally through the setting of clear objectives.

The Board has established an Audit Committee, a Remuneration Committee and a Nominations Committee with duties and responsibilities formally delegated to them. The terms of reference set out each Committee's responsibilities. The terms of reference for the Audit Committee can be viewed at the Company's Registered Office.

### Evaluation of the Board, Board Committees and Directors

The performance evaluation of the Board, its Committees and directors is undertaken by the Chairman and implemented in collaboration with the Committee Chairmen. The 2006 Board evaluation was conducted by way of a discussion between the Chairman and each of the directors. The independent non-executive directors met separately to review the Chairman's performance and provide feedback to him. Following formal performance evaluation, the Chairman confirms that the performance of non-executive directors continues to be effective and demonstrates their commitment to the role.

### Audit Committee

I S Fenn (Chairman), Lord Birdwood, D Harris

The Audit Committee is responsible for ensuring that the financial performance of the Group is properly measured and reported and for reviewing reports from the auditors relating to Group accounts and the Group's internal control systems. The committee is also responsible for the development, implementation and monitoring of the Company's policy on external audit. The committee reserves oversight responsibility for monitoring the auditor's independence, objectivity and compliance with ethical and regulatory requirements. The committee also ensures that key Partners within the external auditors are rotated from time to time in accordance with UK rules. During the year, two meetings were held which were attended by all three members.

### Remuneration Committee

Lord Birdwood (Chairman), I S Fenn, D Harris

The Remuneration Committee is responsible for setting the remuneration of the executive directors and the senior management and for the operation of the Company's share option schemes. The Directors' Remuneration Report is shown on pages 15 to 17. During the year two meetings were held, which were attended by all three members.

### Nominations Committee

R King (Chairman), Lord Birdwood, I S Fenn, D Harris

The Nominations Committee is responsible for considering and recommending to the Board changes in the Board's composition and membership. One meeting was held during the year which was attended by all members.

All non-executive directors of the Company who are members of these committees are entitled to seek, at the Company's expense, independent professional advice in connection with their roles on these committees.

### Internal Control

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable, and not absolute, assurance against material misstatement or loss.

Following publication of the guidance for directors on internal control "Internal Control: Guidance for Directors on the Combined Code", the Board confirms that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. This process has been in place throughout the year under review and up to the date of approval of the annual report and accounts and is regularly reviewed by the Board and accords with the guidance.

The Board has reviewed the effectiveness of the system of internal control. In particular, it has reviewed and updated the process for identifying and evaluating the significant risks affecting the business and the policies and procedures by which these risks are managed.

Key elements of the Group's system of internal control are as follows:

### Control environment

- the setting of appropriate levels of authorisation which must be adhered to as the Group conducts its business
- the implementation of a recognised organisational and management reporting structure within which individual executive directors have responsibility for the day-to-day running of the business
- established and detailed procedures for the setting of annual budgets and monthly forecasts and the ongoing monitoring of actual financial performance against these targets, on a monthly basis, both at operational and Board level
- a clearly defined and well-established set of accounting policies which ensure that the financial performance is recorded on a consistent and appropriate basis throughout the Group's reporting entities.

### Monitoring and corrective action

There are ongoing procedures in place for monitoring the system of internal financial controls. The remit of the Audit Committee includes meeting to review the effectiveness of the Group's system of internal financial controls, and considering reports made to it by the Group's auditors. The Group does not have an internal audit function. During the year the Board has reviewed the need for an internal audit function and continues to believe that the current size of the Group does not warrant the establishment of an internal audit function. The need for an internal audit function will continue to be reviewed on an annual basis.

During 2006, the Directors undertook to review the internal systems and procedures with the Group's internal and external business partners in order to attain the ISO 9001:2000 Quality Management Systems accreditation. As a result, the Company has appointed The British Standards Institute to act as external quality auditors. The Group's aim is to obtain accreditation by the end of 2007.

### Risk management

Management are responsible for the identification and evaluation of significant risks applicable to their areas of the business together with the design and operation of suitable internal controls. These risks are assessed on a continual basis and may be associated with a variety of internal or external sources, including control breakdowns, disruption in information systems, natural catastrophe and regulatory requirements.

Management report to the Board regularly on their review of risks and how they have managed the risks. The Board reviews the key risks inherent in the business and the system of control necessary to manage such risks.

### Liquidity risk

The Group finances itself through a combination of equity and short-term debt. The Group satisfied its liquidity requirements during the period under review. The Group's main working capital facility is provided by invoice discounting. There was also continued use of short-term bank facilities during the period under review. As at 31 August 2006, the Group had committed bank facilities of £16 million, of which £5.6 million was undrawn.

### Interest Rate Risk

The Group finances its operations through a mixture of invoice discounting, trade finance and bank borrowings. All such facilities are at variable rates of interest.

### Foreign currency risk

The Group faces foreign currency exposures on translation of the net assets and results of its overseas subsidiaries and on trading transactions undertaken mainly in US dollars. The Group seeks to mitigate the effect of its currency exposures by buying currency forward when appropriate. The Group does not hedge its resulting translation exposures as these are accounting rather than cash exposures.

Further information on the Group's use of financial instruments and exposure to risk are given in note 22 of the accounts.

### Environmental

During 2006/2007, various new EU Regulations concerning the environment have made a direct impact on the Group's product design, manufacturing and material costs. These include restrictions of certain materials used in electronic and non-electronic product design, and these have had a direct impact on increases to material and recycling costs.

The Regulations are as follows:

- RoHS (Restriction of Hazardous Substances Directive 2002/95/EC)

RoHS concerns the prohibition of certain materials proven to be harmful to the environment used in electronic products which include toys. The prohibited materials are lead, cadmium, mercury, hexavalent chromium, polybrominated biphenyls and polybrominated diphenyl ethers.

Compliance with these Regulations was achieved by the Group by July 2006.

- WEEE (Waste Electrical and Electronic Equipment Directive 2002/96/EEC)

WEEE includes toys, the primary functions of which, rely on electrical power. It states that such products will be recycled to protect the environment from hazardous waste emanating from electronic components and materials. Recycling targets will increase year on year. Certain subsidiaries have registered with VALPAK as agents to ensure full compliance and contribute funds based on tonnage and turnover.

- Phthalate Directive restrictions on the marketing and use of certain dangerous substances and preparations (Phthalate in the use of toys & childcare articles Directive 76/769/EEC).

Certain Phthalates historically used to manufacture toys and childcare articles are now restricted or prohibited.

The restricted materials are:

DEHP, DBP, BBP which shall not be used as substances or as constituents of preparations at concentrations of greater than 0.1% by mass of the plasticised material in toys and childcare articles.

DINP, DIDP, DNOP which shall not be used as substances or as constituents of preparations, at concentrations of greater than 0.1% by mass of the plasticised material, in toys and childcare articles which can be placed in the mouth by children.

The Directive will come into force on 16 January 2007. The Group's current products met the requirements of this Directive by 31 October 2006.

The Group recognises that it can make a difference to the environment it works in and delivers to. With this in mind, the Group will be aiming to achieve, within its quality management system, accreditation to ISO 14001:2004 Environmental Management Systems by mid 2007. The British Standards Institute has been appointed as external quality auditors to certain of the Group's subsidiaries in this regard.

The Group's key quality targets will be to:

- reduce packaging waste.
- recycle more product
- reduce energy consumption in product design and increase its green office practices.

In 2006, the independent Pass Compliance Scheme® run by Product Assurance Limited was introduced to the Group's supplier base which controls the management of hazardous materials within our product ranges.

A subsidiary is a stakeholder representing the toy industry in consultations concerning the EuP Directive (Energy Using Products) which concerns itself with the reduction of energy consumption produced from electronic products such as battery chargers and mains adaptors supplied with toys.

### Relations with shareholders

The Board supports the principle of clear reporting of financial performance to shareholders. Each year, shareholders receive a full annual report and an interim report, with supplementary trading statements issued from time to time where appropriate.

Members of the Board will be available at the forthcoming Annual General Meeting to answer any questions from the shareholders.

### Compliance statement

Throughout the year the Group has fully complied with the provisions of the Combined Code with the following exception

- Code provision A.7.1 states that all directors should be subject to re-election at intervals of no more than three years. The executive directors' service contracts were prepared before the Combined Code was issued, and as such do not contain such re-election provisions. An amendment cannot be made unilaterally by the Company to an executive director's service contract and any such amendment would, accordingly, have to be negotiated in turn with each executive director. Given the significant shareholdings of the executive directors, and the potential cost to the Company of compensating the executive directors for any such amendment to their contracts, the Board considers that the existing arrangements with the executive directors should, for the time being, remain undisturbed in this respect.

### Going Concern

After making enquiries, the Board considers that the Group has adequate resources to continue operating for the foreseeable future and has therefore adopted the going concern basis in preparing the accounts.

By Order of the Board

**K P Shah** FCCA
Secretary

Registered Office:
5th Floor, 4 Chiswell Street
London EC1Y 4UP

27 November 2006

## Directors' Remuneration Report

The Board presents the Remuneration Report for the year ended 31 August 2006.

### The Remuneration Committee

The Remuneration Committee consists of three independent non-executive directors: Lord Birdwood, Mr Fenn and Mr Harris. The policy of the Remuneration Committee is framed to give consideration to the provisions as to best practice set out in the Combined Code.

### Remuneration of Directors

Each executive director is paid a basic salary and is entitled to benefits, namely payments of pension contributions to a suitable scheme of his choice, the option of the use of a company car, fuel and/or mileage allowance and participation in a private health care scheme.

Each of the executive directors is also entitled under the terms of his service contract to a bonus of an amount up to his basic salary in the event that specified performance targets are met or exceeded. These targets require increases in earnings per share in each financial year of the Group, adjusted to exclude certain exceptional non-trading items. Mr Diver is also entitled to a further bonus of 2% of pre-tax profits in the event that a specified target is met.

The basic salaries referred to above are reviewed every year by the Remuneration Committee. The service contracts of the executive directors incorporate notice periods of 12 months.

These arrangements were originally agreed by the Board of directors in May 1995, just prior to the flotation of the Company on the London Stock Exchange, in consultation with their legal and financial advisers and have recently been reviewed by the Remuneration Committee. In originally establishing these arrangements, and in the recent review, due account was taken of other quoted companies of comparable size and business complexity, and in particular of the need to put in place incentive arrangements for each executive director which would be challenging and compatible with sustainable growth in shareholder value, whilst not being over-complicated or manipulable. The Board's policy on pension arrangements is to favour money purchase schemes rather than defined benefit ("final salary") schemes.

The Company believes that share ownership by executive directors and senior executives strengthens the links between their personal interests and those of the shareholders. All executive directors are entitled to participate in the Company's unapproved executive Share Option Plan, details of which may also be found in note 16 to the accounts.

The non-executive directors are appointed for a fixed term expiring at each Annual General Meeting of the Company, when they may offer themselves for re-election. Lord Birdwood, Mr Fenn and Mr Harris are each entitled to fees, currently at the rate of £20,000 per annum (2005: £20,000), plus expenses, without any right to compensation on early termination. Mr MacKay did not receive any remuneration in the year ended 31 August 2006.

The following table shows a breakdown of the remuneration of the directors for the year ended 31 August 2006 and the year ended 31 August 2005.

Year ended 31 August 2006

| | Salary/fees £ | Performance bonus £ | Benefits in kind £ | Pension contribution £ | Total £ |
|---|---|---|---|---|---|
| R King | 167,625 | 167,625 | 5,138 | 58,669 | 399,057 |
| K P Shah | 165,600 | 165,600 | 2,980 | 49,680 | 383,860 |
| J J Diver | 145,180 | 301,182 | 10,941 | 29,036 | 486,339 |
| J J P Kissane | 145,180 | 145,180 | 3,072 | 43,554 | 336,986 |
| I S Fenn (non-executive) | 20,000 | – | – | – | 20,000 |
| Lord Birdwood (non-executive) | 20,000 | – | – | – | 20,000 |
| A G Horvat (non-executive) | 15,000 | – | – | – | 15,000 |
| D Harris (non-executive) | 20,000 | – | – | – | 20,000 |
| A B MacKay | – | – | – | – | – |
| E Preziosi | – | – | – | – | – |
| | 698,585 | 779,587 | 22,131 | 180,939 | 1,681,242 |

Year ended 31 August 2005

| | Salary/fees £ | Performance bonus £ | Benefits in kind £ | Pension contribution £ | Total £ |
|---|---|---|---|---|---|
| R King | 167,625 | – | 3,824 | 58,668 | 230,117 |
| K P Shah | 165,600 | – | 1,949 | 41,400 | 208,949 |
| J J Diver | 145,180 | – | 7,692 | 29,036 | 181,908 |
| J J P Kissane | 145,180 | – | 5,073 | 43,554 | 193,807 |
| I S Fenn (non-executive) | 20,000 | – | – | – | 20,000 |
| Lord Birdwood (non-executive) | 20,000 | – | – | – | 20,000 |
| A G Horvat (non-executive) | 20,000 | – | – | – | 20,000 |
| D Harris (non-executive) | 20,000 | – | – | – | 20,000 |
| E Preziosi | – | – | – | – | – |
| | 703,585 | – | 18,538 | 172,658 | 894,781 |

On 5 February 2003, options over 185,000 new ordinary shares in the Company were granted to each of J J P Kissane and J J Diver. These options have been granted pursuant to the Enterprise Management Incentive Share Option Scheme which was approved by shareholders on 22 January 2003. The options are exercisable at a price of 54 pence per share normally no earlier than three and not later than ten years from the date of grant, subject to the achievement of a predetermined profit related performance target, which has been achieved.

On 11 May 2006, options were granted over 960,000 new ordinary shares in the Company to the four executive directors as follows:

| | Options granted |
|---|---|
| R King | 250,000 |
| K P Shah | 250,000 |
| J J Diver | 230,000 |
| J J P Kissane | 230,000 |

These options were granted pursuant to the 2006 Share Option Plan which was approved by shareholders on 29 November 2005 and adopted by the Company on 22 February 2006. The options are exercisable at a price of 63 pence per share normally no earlier than three and not later than ten years from the date of grant, subject to the achievement of a predetermined profit related performance target.

R King, K P Shah, J J P Kissane and J J Diver are the only directors to whom retirement benefits are accruing under a money purchase pension scheme.

At 31 August 2006 the mid-market price of an issued ordinary share in The Character Group plc was 77 pence and during the year the price ranged from 40 pence to 79.5 pence.

**On behalf of the Board**

**Lord Birdwood**
Chairman, Remuneration Committee
27 November 2006

# INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF THE CHARACTER GROUP plc

We have audited the Group and Parent Company financial statements ("the financial statements") of The Character Group plc for the year ended 31 August 2006 which comprise the Consolidated Profit and Loss Account, the Consolidated Balance Sheet, the Parent Company Balance Sheet, the Consolidated Cash Flow Statement and the related notes. These financial statements have been prepared in accordance with the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our work, for this report, or for the opinions we have formed.

## Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Director's Report includes that specific information presented in the Chairman's Statement that is cross referenced from the Business Review section of the Director's Report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' Report and Business Review and the Chairman's Statement. We consider the implications for our audit report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

## Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

### Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the Parent Company's affairs as at 31 August 2006 and of the Group's profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

**HLB Vantis Audit plc**
Registered Auditors
Chartered Accountants
82 St John Street
London
EC1M 4JN
27 November 2006

# CONSOLIDATED PROFIT AND LOSS ACCOUNT

*for the year ended 31 August 2006*

| | note | Total 2006 £000's | Total 2005 £000's |
|---|---|---|---|
| **Turnover** — continuing | | **69,546** | 49,956 |
| — discontinued | | **25,986** | 48,835 |
| | 2 | **95,532** | 98,791 |
| Cost of sales | | **(66,543)** | (75,110) |
| **Gross profit** | | **28,989** | 23,681 |
| **Net operating expenses** | | | |
| Selling and distribution costs | | **(11,737)** | (9,750) |
| Administration expenses | | **(13,826)** | (12,867) |
| Administration expenses — exceptional | | **–** | (643) |
| Other operating income | | **261** | 443 |
| **Operating profit/(loss)** — continuing | | **6,980** | (315) |
| — discontinued | | **(3,293)** | 1,179 |
| **Operating profit** | 3 | **3,687** | 864 |
| Exceptional item — discontinued activity | | | |
| Gain before goodwill write-back | | **4,053** | – |
| Goodwill charge | | **(1,897)** | – |
| | 3 | **2,156** | – |
| **Profit on ordinary activities before interest** | | **5,843** | 864 |
| Interest | 5 | **(644)** | (703) |
| **Profit on ordinary activities before taxation** | | **5,199** | 161 |
| Taxation | 6 | **(2,139)** | (365) |
| **Profit/(loss) on ordinary activities after taxation** | | **3,060** | (204) |
| **Earnings/(loss) per share** | 8 | | |
| — Basic — continuing | | **8.49p** | **(1.69)p** |
| — discontinued | | **(2.56)p** | **1.30p** |
| | | **5.93p** | **(0.39)p** |
| — Fully diluted — continuing | | **7.97p** | **(1.69)p** |
| — discontinued | | **(2.40)p** | **1.30p** |
| | | **5.57p** | **(0.39)p** |
| **Dividend per share** | 7 | **3.3p** | **2.0p** |
| **Continuing business** | | | |
| **EBITDA (earnings before interest, tax, depreciation and amortisation)** | | **7,524** | 9 |

There are no material recognised gains or losses other than the profit for the year disclosed above.

# CONSOLIDATED BALANCE SHEET

*as at 31 August 2006*

| | note | 2006 £000's | 2005 (restated) £000's |
|---|---|---|---|
| **Fixed assets** | | | |
| Intangible assets | 9 | **400** | 646 |
| Tangible assets | 10 | **1,609** | 1,849 |
| Investments | 11 | **2** | 2 |
| | | **2,011** | 2,497 |
| **Current assets** | | | |
| Stocks | 12 | **10,671** | 9,810 |
| Trade debtors subject to finance arrangements | | **11,813** | 9,053 |
| Factor advances | | **(6,275)** | (6,937) |
| | | **5,538** | 2,116 |
| Debtors — including non-factored trade debtors | 13 | **9,474** | 21,803 |
| Cash at bank and in hand | | **7,369** | 3,748 |
| | | **33,052** | 37,477 |
| Creditors: amounts falling due within one year | 14 | **(23,324)** | (29,009) |
| **Net current assets** | | **9,728** | 8,468 |
| **Total assets less current liabilities** | | **11,739** | 10,965 |
| **Net assets** | | **11,739** | 10,965 |
| **Capital and reserves** | | | |
| Called up share capital | 16 | **2,452** | 2,641 |
| Shares held in Treasury | 16 | **(665)** | – |
| Investment in own shares | 23 | **(908)** | (908) |
| Capital redemption reserve | 17 | **243** | 40 |
| Share premium account | 17 | **11,917** | 11,821 |
| Merger reserve | 17 | **651** | 651 |
| Profit and loss account | 17 | **(1,951)** | (3,280) |
| **Shareholders' funds** | 15 | **11,739** | 10,965 |

The accounts on pages 20 to 40 were approved by the Board of directors on 27 November 2006.

| | |
|---|---|
| **R King** | **K P Shah** |
| Director | Director |

# PARENT COMPANY BALANCE SHEET

*as at 31 August 2006*

| | note | 2006 £000's | 2005 (restated) £000's |
|---|---|---|---|
| **Fixed assets** | | | |
| Tangible assets | 10 | **835** | 875 |
| Investments | 11 | **3,195** | 3,195 |
| | | **4,030** | 4,070 |
| **Current assets** | | | |
| Debtors | 13 | **11,618** | 9,084 |
| Cash at bank and in hand | | **2,887** | 2,527 |
| | | **14,505** | 11,611 |
| Creditors: amounts falling due within one year: | 14 | **(1,657)** | (453) |
| **Net current assets** | | **12,848** | 11,158 |
| **Total assets less current liabilities** | | **16,878** | 15,228 |
| **Capital and reserves** | | | |
| Called up share capital | 16 | **2,452** | 2,641 |
| Shares held in Treasury | 16 | **(665)** | – |
| Investment in own shares | 23 | **(908)** | (908) |
| Capital redemption reserve | 17 | **243** | 40 |
| Share premium account | 17 | **11,917** | 11,821 |
| Profit and loss account | 17 | **3,839** | 1,634 |
| **Shareholders' funds** | 15 | **16,878** | 15,228 |

The accounts on pages 20 to 40 were approved by the Board of directors on 27 November 2006.

**R King**
Director

**K P Shah**
Director

# CONSOLIDATED CASH FLOW STATEMENT

*for the year ended 31 August 2006*

| | note | 2006 £000's | 2005 £000's |
|---|---|---|---|
| **Cash inflow from operating activities** | 19 | 5,995 | 2,870 |
| **Returns on investment and servicing of finance** | | | |
| Interest received | | 76 | 18 |
| Interest paid | | (720) | (721) |
| **Net cash outflow for returns on investments and servicing of finance** | | (644) | (703) |
| **Taxation** | | (228) | (844) |
| **Capital expenditure and financial investment** | | | |
| Payments to acquire tangible fixed assets | | (876) | (868) |
| Sale of tangible fixed assets | | 397 | 25 |
| **Net cash outflow for capital expenditure and financial investment** | | (479) | (843) |
| Equity dividends paid | | (1,258) | (945) |
| **Acquisition and disposal** | | | |
| Sale of business | | 3,178 | – |
| Cash inflow/(outflow) before financing | | 6,564 | (465) |
| Shares held in Treasury (including expenses) | | (672) | – |
| Issue of new shares | | 110 | 34 |
| Purchase of own shares | | (2,381) | – |
| Capital element of finance lease rentals | | – | (4) |
| **Net cash (outflow)/inflow from financing** | | (2,943) | 30 |
| **Increase/(decrease) in cash in the year** | | 3,621 | (435) |
| **Decrease/(increase) in net debt in the year** | 20 | 3,621 | (431) |

## 1 PRINCIPAL ACCOUNTING POLICIES

### Basis of accounting

The accounts have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules. The comparative amounts have been restated to take account of the requirements of Financial Reporting Standard 21 "Events after the balance date" in respect of dividends.

The Company has adopted Financial Reporting Standard 21 'Events after the balance sheet date'. As a result of this, dividends declared for an accounting period after the balance sheet date are no longer recognised as a liability at the balance sheet date.

The principal accounting policies of the Group are set out below:

### Basis of consolidation

The Group accounts for the year ended 31 August 2006 comprise the accounts of the Company and its subsidiaries, all of which are made up to the end of the Company's financial year.

The profit and loss account for the parent Company has not been included, as permitted by Section 230 of the Companies Act 1985. The result of the Company for the financial year dealt with in the consolidated accounts is disclosed in note 17 to the accounts.

### Goodwill

Goodwill arising on acquisitions of businesses and subsidiary undertakings is calculated as the excess of the fair value of the consideration given and costs of acquisition over the fair value of the separable net assets acquired. Goodwill arising on acquisitions before 1 September 1998 was written off against reserves immediately on acquisition. In accordance with FRS 10, goodwill arising on acquisitions on or after 1 September 1998 is capitalised as an intangible fixed asset and amortised over its estimated useful economic life. The goodwill carried in the balance sheet is written off over 20 years, or less if in the opinion of the directors estimated useful economic life is shorter. Goodwill previously written off directly to reserves has not been reinstated on the balance sheet, but written off against the profit and loss reserve in accordance with the transitional provisions of FRS 10.

On the subsequent disposal or termination of a previously acquired business, the profit or loss on disposal or termination is calculated after charging the amount of any related goodwill taken directly to reserves on acquisition and the net book value of any related goodwill capitalised in the balance sheet.

### Investments

Shares in subsidiary undertakings are stated at cost less provision for impairment. Provision is made against investments where diminution in value is considered to be permanent.

### Depreciation

Depreciation is provided on all tangible fixed assets, except freehold land, at rates calculated to write off the cost of each asset evenly over its expected useful life. The following principal rates per annum are used:

| | |
|---|---|
| Freehold buildings | 4% |
| Short leasehold improvements | over the unexpired term of the lease |
| Tooling | 50–100% |
| Fixtures, fittings and equipment | 20–33% |
| Motor vehicles | 20–25% |

### Stocks

Stocks are stated at the lower of cost and net realisable value. Net realisable value is based on estimated selling price less the estimated cost of disposal.

### Factoring and invoice discounting arrangements

Certain subsidiaries have such agreements under which debts approved by the factor company are assigned to them without recourse. Non-refundable advances are made by the factor company. The Company has no obligation and the directors do not intend that the Company will support any losses from factored debts. A linked presentation of the relevant balances is therefore shown on the face of the balance sheet in accordance with the requirements of FRS 5. The factor company has a debenture over the assets of the Company and certain subsidiary companies. The factoring charges are charged to the profit and loss account as they accrue. The amount charged to the profit and loss in the year was £458,000 (2005: £453,000). Of this amount, £197,000 (2005: £276,000) has been charged as interest (see note 5), with the remainder being charges made by the factor company which have been included within administration expenses.

## 1 PRINCIPAL ACCOUNTING POLICIES CONTINUED

### Foreign currencies

In the accounts of individual Group undertakings, transactions in foreign currencies are recorded in the local currency using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains and losses on translation are included in the profit and loss account. In the consolidated accounts, the results and the balance sheets of overseas subsidiary undertakings are translated at the year end exchange rates. Exchange differences resulting from the re-translation of opening net assets are dealt with in reserves. All other exchange differences are dealt with in the profit and loss account.

### Leasing and hire purchase contracts

Assets held under finance leases and hire purchase contracts are capitalised in the balance sheet and are depreciated over their useful lives. The interest element of the rental obligations is charged to the profit and loss account over the period of the lease and represents a constant proportion of the balance of capital repayments outstanding. Rentals paid under operating leases are charged to income as incurred.

### Financial instruments

Financial assets are recognised on the balance sheet at the lower of cost and net realisable value. Debt instruments are initially stated at the amount of the net proceeds after deduction of issue costs. The carrying amount is increased by the finance cost and reduced by payments made in the year. Discounts and premiums are charged or credited to the profit and loss account over the life of the asset or liability to which they relate. The Group has taken advantage of the exemption from disclosure in accordance with FRS 13 available for short-term debtors and creditors.

### Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Group's taxable profits and its results as stated in the accounts that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the accounts.

Deferred tax assets in excess of liabilities are recognised to the extent that in the directors' opinion, it is more likely than not that suitable taxable profits will arise from which the underlying timing differences can be deducted.

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in future has been entered into by the subsidiary or associate.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

### Pension contributions

The Group operates defined contribution pension schemes. Contributions are allocated to the profit and loss account when due.

### Research and development

Research and development costs represent expenditure that is directly attributable to the development of products, and are written off as an expense in the year incurred.

## 2 TURNOVER

a) Turnover

Turnover represents the amount derived from the provision of goods and services which arise from the Group's ordinary activities, stated net of value added tax. An analysis of turnover by geographical market is given below:

| | Continuing 31 August 2006 £000's | Discontinued 31 August 2006 £000's | Total 31 August 2006 £000's | Continuing 31 August 2005 £000's | Discontinued 31 August 2005 £000's | Total 31 August 2005 £000's |
|---|---|---|---|---|---|---|
| United Kingdom: Group | 61,222 | 216 | 61,438 | 42,176 | 3,717 | 45,893 |
| Rest of the world: Group | 8,324 | 25,770 | 34,094 | 7,780 | 45,118 | 52,898 |
| Total Group | 69,546 | 25,986 | 95,532 | 49,956 | 48,835 | 98,791 |

b) Operating (loss)/profit

| | Continuing 31 August 2006 £000's | Discontinued 31 August 2006 £000's | Total 31 August 2006 £000's | Continuing 31 August 2005 £000's | Discontinued 31 August 2005 £000's | Total 31 August 2005 £000's |
|---|---|---|---|---|---|---|
| Turnover | 69,546 | 25,986 | 95,532 | 49,956 | 48,835 | 98,791 |
| Cost of sales | (40,625) | (25,918) | (66,543) | (33,683) | (41,427) | (75,110) |
| Gross profit | 28,921 | 68 | 28,989 | 16,273 | 7,408 | 23,681 |
| Selling and distribution costs | (9,749) | (1,988) | (11,737) | (5,543) | (4,207) | (9,750) |
| Administrative expenses | (12,396) | (1,430) | (13,826) | (10,796) | (2,071) | (12,867) |
| Administrative expenses — exceptional | – | – | – | (643) | – | (643) |
| Other operating income | 204 | 57 | 261 | 394 | 49 | 443 |
| Operating (loss)/profit | 6,980 | (3,293) | 3,687 | (315) | 1,179 | 864 |

The Group's digital activities during the 12 months ended 31 August 2006 are classed as discontinued. The directors consider that the disclosure of further disaggregated information would be seriously prejudicial to the commercial interests of the Group.

## 3 OPERATING PROFIT/(LOSS)

| | note | 12 months to 31 August 2006 £000's | 12 months to 31 August 2005 £000's |
|---|---|---|---|
| Operating profit/(loss) is stated after charging: | | | |
| Staff costs | 4 | 7,231 | 6,717 |
| Principal Auditors' remuneration | | | |
| — Statutory audit services | | 48 | 48 |
| — Financial reporting advisory services | | 10 | 16 |
| — Tax compliance services | | 10 | 20 |
| — Tax advisory services | | 5 | 3 |
| — Further assurance services | | 35 | 12 |
| Other Auditors' remuneration | | | |
| — Statutory audit services | | 25 | 32 |
| — Tax compliance services | | 5 | – |
| Total fees payable to Auditors | | 138 | 131 |
| Operating leases — land and buildings | | 180 | 349 |
| Research and development costs | | 1,274 | 1,143 |
| Depreciation of tangible fixed assets | | | |
| — owned assets | | 528 | 579 |
| — assets held under finance leases and HP contracts | | - | 3 |
| | | 528 | 582 |
| Goodwill amortisation | | 246 | 46 |

## 3 OPERATING PROFIT CONTINUED

**Exceptional item**
The exceptional gain of £2,156,000 is stated after charging goodwill previously written off of £1,897,000 and associated costs on the disposal of the digital operation amounting to £4,384,000. The goodwill charge is an accounting entry required by FRS 10, Goodwill and intangible assets, and a corresponding amount has been credited to profit and loss reserves.

The 2005 exceptional item of £643,000 relates to relocation and restructuring costs of Character Gifts Limited which now operates from the Group's central facility at Oldham, Lancashire.

## 4 DIRECTORS AND EMPLOYEES

| | 12 months to 31 August 2006 £000's | 12 months to 31 August 2005 £000's |
|---|---|---|
| Staff costs including directors' emoluments | | |
| Wages and salaries | 6,433 | 5,990 |
| Social security costs | 431 | 402 |
| Other pension costs | 367 | 325 |
| | 7,231 | 6,717 |
| The average number of employees during the year was: | Number | Number |
| Management and administration | 65 | 78 |
| Selling and distribution | 142 | 173 |
| | 207 | 251 |

Of the total average number of employees, 114 were based in the UK and 93 in Hong Kong and mainland China.

The amount payable to pension schemes as at the balance sheet date was £nil (2005: £33,356).

Details of directors' remuneration and share options are given in the Directors' Remuneration Report on pages 15 to 17.

## 5 INTEREST

| | 12 months to 31 August 2006 £000's | 12 months to 31 August 2005 £000's |
|---|---|---|
| Total interest receivable | 76 | 18 |
| Total interest payable: | | |
| On bank overdraft and similar charges | (511) | (444) |
| Finance leases and hire purchase contracts | – | (1) |
| Factor and invoice discounting advances | (197) | (276) |
| Other | (12) | – |
| | 644 | (703) |

## 6 TAXATION

| | 12 months to 31 August 2006 £000's | 12 months to 31 August 2005 £000's |
|---|---|---|
| **UK Corporation Tax** | | |
| Tax on profit for the period | – | – |
| Adjustments to tax charge in respect of previous periods | – | – |
| Total UK corporation tax | – | – |
| **Foreign Tax** | | |
| Tax on profit for the period | 510 | 355 |
| Adjustments to tax charge in respect of previous periods | (28) | 24 |
| Total foreign tax | 482 | 379 |
| Total current tax | 482 | 379 |
| **Deferred Tax** | | |
| Tax losses utilised | 1,731 | – |
| Origination and reversal of timing differences | (74) | (14) |
| Total deferred tax | 1,657 | (14) |
| Tax on profit on ordinary activities | 2,139 | 365 |
| **Factors affecting tax charge for the period** | | |
| Profit on ordinary activities before taxation | 5,199 | 161 |
| Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2005: 30%) | 1,560 | 48 |
| Effects of: | | |
| Expenses not deductible for tax purposes | 230 | 182 |
| Capital allowances (in excess of)/less than depreciation | 54 | (178) |
| Deduction for employee share options exercised | (68) | — |
| Other temporary differences between taxable and accounting profit | 128 | 93 |
| Overseas income not subject to tax | (1,345) | — |
| Goodwill charge not deductible | 569 | — |
| Lower tax rate on overseas earnings | (561) | (198) |
| Utilisation of tax losses | (1,667) | – |
| Tax losses not utilised | 957 | – |
| Adjustments to tax charge in respect of previous periods | (27) | 24 |
| Remitted earnings of overseas subsidiaries | 652 | 408 |
| Current tax charge for the year | 482 | 379 |

## 7 DIVIDEND

| | 12 months to 31 August 2006 £000's | 12 months to 31 August 2005 £000's |
|---|---|---|
| On equity shares: | | |
| Final dividend paid for the year ended 31 August 2005 — 0.9 pence (2004: 0.7 pence) per share | 473 | 367 |
| Interim dividend paid for the year ended 31 August 2006 — 1.65 pence (2005: 1.11 pence) per share | 785 | 578 |
| | 1,258 | 945 |
| Proposed final dividend for the year ended 31 August 2006 of 1.65 pence per share (2005: 0.9 pence) | 791 | 473 |

## 8 EARNINGS/(LOSS) PER SHARE

| | 12 months to 31 August 2006 | | | 12 months to 31 August 2005 | | |
|---|---|---|---|---|---|---|
| | Profit after taxation | Weighted average number of ordinary shares | Pence per share | Loss after taxation | Weighted average number of ordinary shares | Pence per share |
| Basic earnings per share | 3,060,000 | 51,629,312 | 5.93 | (204,000) | 52,475,156 | (0.39) |
| Impact of share options | – | 3,339,000 | (0.36) | – | – | – |
| Diluted earnings per share | 3,060,000 | 54,968,312 | 5.57 | (204,000) | 52,475,156 | (0.39) |

## 9 INTANGIBLE FIXED ASSETS — GOODWILL

The Group

| Cost | £000's |
|---|---|
| 1 September 2005 and 31 August 2006 | 902 |
| **Amortisation** | |
| 1 September 2005 | 256 |
| Charge for the year | 246 |
| **31 August 2006** | **502** |
| **Net book value** | |
| **31 August 2006** | **400** |
| 31 August 2005 | 646 |

## 10 TANGIBLE FIXED ASSETS

### The Group

| Cost | Freehold land and buildings £000's | Short leasehold improvements £000's | Tooling £000's | Fixtures, fittings and equipment £000's | Motor vehicles £000's | Total £000's |
|---|---|---|---|---|---|---|
| 1 September 2005 | 1,182 | 113 | 578 | 2,030 | 443 | 4,346 |
| Additions | – | 27 | 347 | 359 | 143 | 876 |
| Disposals | – | (17) | (869) | (459) | (215) | (1,560) |
| Differences on exchange | – | (5) | (30) | (18) | – | (53) |
| **31 August 2006** | **1,182** | **118** | **26** | **1,912** | **371** | **3,609** |
| **Depreciation** | | | | | | |
| 1 September 2005 | 314 | 83 | 326 | 1,565 | 209 | 2,497 |
| Charge for the year | 39 | 20 | 169 | 203 | 97 | 528 |
| Disposals | – | (15) | (451) | (380) | (149) | (995) |
| Exchange rate movement | – | (3) | (18) | (9) | – | (30) |
| **31 August 2006** | **353** | **85** | **26** | **1,379** | **157** | **2,000** |
| **Net book value** | | | | | | |
| **31 August 2006** | **829** | **33** | **–** | **533** | **214** | **1,609** |
| 31 August 2005 | 868 | 30 | 252 | 465 | 234 | 1,849 |

### The Company

| Cost | Freehold land and buildings £000's | Fixtures, fittings and equipment £000's | Total £000's |
|---|---|---|---|
| 1 September 2005 | 1,182 | 127 | 1,309 |
| Additions | – | 6 | 6 |
| Disposals | – | – | – |
| **31 August 2006** | **1,182** | **133** | **1,315** |
| **Depreciation** | | | |
| 1 September 2005 | 314 | 120 | 434 |
| Charge for the year | 39 | 7 | 46 |
| Disposals | – | – | – |
| **31 August 2006** | **353** | **127** | **480** |
| **Net book value** | | | |
| **31 August 2006** | **829** | **6** | **835** |
| 31 August 2005 | 868 | 7 | 875 |

## 11 FIXED ASSET INVESTMENTS

### The Group

| Cost | Shares listed in the UK £000's |
|---|---|
| 1 September 2005 and 31 August 2006 | 2 |
| **Amortisation and Provisions** | |
| 1 September 2005 | – |
| 1 September 2005 and 31 August 2006 | – |
| **Net book value** | |
| **31 August 2006** | **2** |
| 31 August 2005 | 2 |

The market value of the listed investments is £1,330 (2005: £1,497).

### The Company

| Cost | Shares in subsidiary undertakings £000's |
|---|---|
| 1 September 2005 and 31 August 2006 | 3,195 |
| **Amortisation and Provisions** | |
| 1 September 2005 and 31 August 2006 | – |
| **Net book value** | |
| **31 August 2006** | **3,195** |
| 31 August 2005 | 3,195 |

## 12 STOCKS

| | **The Group 2006 £000's** | The Group 2005 £000's |
|---|---|---|
| Raw materials | **–** | 4,175 |
| Finished goods for resale | **10,671** | 5,635 |
| | **10,671** | 9,810 |

## 13 DEBTORS

| | The Group 2006 £000's | The Group 2005 £000's | The Company 2006 £000's | The Company 2005 £000's |
|---|---|---|---|---|
| Due from subsidiary undertakings | – | – | 10,846 | 8,326 |
| Trade debtors (non-factored) | 3,760 | 17,098 | – | – |
| Other debtors | 4,435 | 2,430 | 189 | 419 |
| Prepayments and accrued income | 1,279 | 789 | 231 | 205 |
| Other taxation and social security | – | – | 352 | 134 |
| Deferred tax | – | 1,486 | – | – |
| | 9,474 | 21,803 | 11,618 | 9,084 |

### Deferred Tax

The elements of deferred tax are as follows:

| | 2006 £000's | 2005 £000's |
|---|---|---|
| Difference between accumulated depreciation and tax depreciation | — | 143 |
| Other timing differences | — | (245) |
| Tax losses | — | 1,588 |
| | — | 1,486 |

The movements in deferred tax are as follows:

| | 2006 £000's | 2005 £000's |
|---|---|---|
| At 1 September 2005 | 1,486 | 1,472 |
| Profit and loss account | (1,657) | 14 |
| At 31 August 2006 | (171) | 1,486 |

The deferred tax asset of £nil (2005: £1,486,000) is recoverable against future forecast taxable profits within a time horizon that the directors consider more likely than not to occur.

Deferred tax assets have not been recognised in respect of tax losses of £6,932,000 (2005: £2,578,831). At tax rates of either 17.5% and 30%, these losses represent a potential tax asset of £1,541,810 (2005: £773,650). These losses would be recoverable in the event of taxable profits arising in certain subsidiary companies.

## 14 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

| | The Group 2006 £000's | The Group 2005 (restated) £000's | The Company 2006 £000's | The Company 2005 (restated) £000's |
|---|---|---|---|---|
| Trade creditors | 13,809 | 17,275 | – | – |
| Bills of exchange payable | 3,687 | 7,802 | – | – |
| Due to subsidiary undertakings | – | – | 126 | 261 |
| Corporation tax | 578 | 152 | 7 | – |
| Other taxation and social security | 360 | 299 | – | – |
| Accruals and deferred income | 3,540 | 3,481 | 174 | 192 |
| Loan | 1,350 | – | 1,350 | – |
| | 23,324 | 29,009 | 1,657 | 453 |

A bank has a debenture over the assets and undertakings of the Company and certain subsidiary companies. Also, some subsidiaries pledge cash deposits with some banks which provide mainly trade finance facilities, and such amounts are included in cash at bank and in hand. At 31 August 2006, the pledged deposits amounted to £777,000 (2005: £798,000). Further, a major trade creditor who offers trade finance is secured by a debenture over the assets and undertakings of a subsidiary company. As at 31 August 2006 the amount outstanding to the secured trade creditor amounted to £763,000 (2005: £921,000).

## 15 RECONCILIATION OF EQUITY SHAREHOLDERS' FUNDS

| | The Group 2006 £000's | The Group 2005 £000's | The Company 2006 £000's | The Company 2005 £000's |
|---|---|---|---|---|
| Opening shareholders' funds as previously stated | 10,492 | 11,777 | 14,755 | 14,133 |
| Final dividend proposed for the year ended 31 August 2005 (2005: final dividend 2004) | 473 | 367 | 473 | 367 |
| At 1 September 2005 restated | 10,965 | 12,144 | 15,228 | 14,500 |
| Profit/(loss) for the financial period | 3,060 | (204) | 5,851 | 1,639 |
| Write-back of goodwill previously written off | 1,897 | – | – | – |
| Exchange difference taken to reserves | 18 | (64) | | |
| Dividends paid | (1,258) | (945) | (1,258) | (945) |
| Shares issued | 110 | 34 | 110 | 34 |
| Purchase of own shares | (2,388) | – | (2,388) | – |
| Shares held in Treasury | (665) | — | (665) | — |
| Net addition to/(subtraction from) shareholders' funds | 774 | (1,179) | 1,650 | 728 |
| Closing shareholders' funds | 11,739 | 10,965 | 16,878 | 15,228 |

## 16 CALLED UP SHARE CAPITAL (EQUITY)

| | 2006 £000's | 2005 £000's |
|---|---|---|
| **Authorised** | | |
| 110,000,000 (2005: 110,000,000) ordinary shares of 5 pence each | **5,500** | 5,500 |
| **Allotted, called up and fully paid** | | |
| 49,048,909* (2005: 52,827,909) ordinary shares of 5 pence each | **2,452** | 2,641 |

* Including 1,125,000 ordinary shares held in Treasury.

### Share Capital movements in the year

286,000 ordinary shares of 5 pence each (total nominal value £14,300) were issued during the year to employees and ex-employees exercising their share options as follows:

| Date | Number of ordinary shares | Exercise price |
|---|---|---|
| 6 February 2006 | 3,000 | 24.25p |
| 3 May 2006 | 1,000 | 24.25p |
| 3 May 2006 | 1,000 | 54.00p |
| 8 May 2006 | 20,000 | 24.25p |
| 5 June 2006 | 2,000 | 24.25p |
| 4 July 2006 | 35,000 | 24.25p |
| 18 July 2006 | 27,250 | 24.25p |
| 18 July 2006 | 1,000 | 54.00p |
| 19 July 2006 | 8,500 | 54.00p |
| 19 July 2006 | 8,500 | 54.00p |
| 14 August 2006 | 1,500 | 24.25p |
| 21 August 2006 | 117,250 | 54.00p |
| 22 August 2006 | 57,000 | 24.25p |
| 22 August 2006 | 3,000 | 54.00p |

During the year, the Company repurchased for cancellation 4,065,000 ordinary shares of 5 pence each as follows:

| Date | Number of shares | Price | % of the issued share capital immediately prior to cancellation (excluding shares held in Treasury) |
|---|---|---|---|
| 26 June 2006 | 4,015,000 | 58 pence | 7.6% |
| 5 July 2006 | 25,000 | 58 pence | 0.05% |
| 6 July 2006 | 25,000 | 60 pence | 0.05% |

During the year, the Company repurchased 1,125,000 ordinary shares to be held as Treasury shares as follows:

| Date | Number of shares | Price | % of the issued share capital immediately prior to repurchase (excluding shares held in Treasury) |
|---|---|---|---|
| 26 June 2006 | 1,000,000 | 58 pence | 1.89% |
| 1 August 2006 | 125,000 | 68 pence | 0.26% |

### Share options

The Company adopted the rules of an Inland Revenue approved executive share option scheme on 3 May 1995. This scheme terminated on 3 May 2005 but such termination has not affected the status of options granted under it prior to that date. At 1 September 2005, options to acquire up to a total of 910,500 new Ordinary Shares remained outstanding under this scheme. As at 31 August 2006, options to acquire up to a total of 229,500 new Ordinary Shares remained outstanding under this scheme details of which were as follows:

| No. of shares | Date granted | Exercise period | Exercise price |
|---|---|---|---|
| 20,000 | 5 March 1997 | 5 March 2000 to 4 March 2007 | 101.0p |
| 13,500 | 5 December 1997 | 5 December 2000 to 4 December 2007 | 136.5p |
| 196,000 | 15 February 2002 | 15 February 2005 to 14 February 2012 | 24.25p |

The Company adopted the rules of its unapproved executive share option scheme on 2 June 1997. The directors resolved that no further options would be granted under this scheme on or after 22 February 2006 but such resolution has not affected the status of options granted under it prior to that date. At 1 September 2005, options to acquire up to a total of 632,700 new Ordinary Shares remained outstanding under this scheme. As at 31 August 2006, options to acquire up to a total of 206,250 new Ordinary Shares remained outstanding under this scheme, details of which were as follows:

| No. of shares | Date granted | Exercise period | Exercise price |
|---|---|---|---|
| 59,250 | 15 February 2002 | 15 February 2005 to 14 February 2009 | 24.25p |
| 147,000 | 6 February 2003 | 6 February 2006 to 5 February 2010 | 54.0p |

The Company adopted the rules of an Inland Revenue qualifying Enterprise Management Incentive share option scheme with the sanction of shareholders following an extraordinary general meeting of the Company on 22 January 2003. On 5 February 2003, options over a total of 1,131,250 new Ordinary Shares were granted to Group employees at an exercise price of 54 pence per share. At 1 September 2005, options to acquire up to a total of 752,000 new Ordinary Shares remained outstanding under this scheme. As at 31 August 2006, options to acquire a total of 622,250 new Ordinary Shares remained outstanding under this scheme. These options are exercisable during the period from 5 February 2006 until 4 February 2013.

The Company adopted the rules of an Inland Revenue Share Option Plan on 22 February 2006. On 11 May 2006, options over a total of 960,000 new Ordinary Shares of 5 pence each were granted to executive directors at an exercise price of 63 pence per share.

On 15 May 2006, options over a total of 1,093,250 new Ordinary Shares of 5 pence each were granted to Group employees at an exercise price of 63 pence per share.

On 18 August 2006, options over a total of 100,000 new Ordinary Shares of 5 pence each were granted to Group employees at an exercise price of 66 pence per share.

At 31 August 2006, options to acquire a total of 2,149,500 new ordinary shares of 5p each remained outstanding under this scheme, details of which are as follows:

| No. of shares | Date granted | Exercise period | Exercise price |
|---|---|---|---|
| 960,000 | 11 May 2006 | 11 May 2009 to 10 May 2016 | 63.0p |
| 1,089,500 | 15 May 2006 | 15 May 2009 to 14 May 2016 | 63.0p |
| 100,000 | 18 August 2006 | 18 August 2009 to 17 August 2016 | 66.0p |

On 11 July 2006, unapproved options over a total of 165,000 new Ordinary Shares of 5 pence each were granted to Group employees at an exercise price of 63.25 pence per share. Such options are exercisable from 21 December 2007 until 19 December 2014 and remained outstanding at 31 August 2006.

No amount is payable by any grantee of an option at the time of grant under any of the Company's share option schemes particularised above.

## 17 SHARE CAPITAL AND RESERVES

| | Called up share capital £000's | Treasury shares | Capital redemption reserve £000's | Share premium account £000's | Merger reserve £000's | Profit and loss account £000's |
|---|---|---|---|---|---|---|
| **The Group** | | | | | | |
| 1 September 2005 | | | | | | |
| as previously reported | 2,641 | – | 40 | 11,821 | 651 | (3,753) |
| Final dividend proposed for year | | | | | | |
| ended 31 August 2005 | – | – | – | – | – | 473 |
| **At 1 September 2005 restated** | **2,641** | **–** | **40** | **11,821** | **651** | **(3,280)** |
| Write-back of goodwill previously | | | | | | |
| written off | – | – | – | – | – | 1,897 |
| Exchange differences | – | – | – | – | – | 18 |
| Profit after tax | – | – | – | – | – | 3,060 |
| Dividends | – | – | – | – | – | (1,258) |
| Shares issued | 14 | – | – | 96 | – | – |
| Shares cancelled and capitalised | (203) | (665) | 203 | – | – | (2,388) |
| **31 August 2006** | **2,452** | **(665)** | **243** | **11,917** | **651** | **(1,951)** |
| **The Company** | | | | | | |
| 1 September 2005 | | | | | | |
| as previously reported | 2,641 | – | 40 | 11,821 | – | 1,161 |
| Final dividend proposed for year | | | | | | |
| ended 31 August 2005 | – | – | – | – | – | 473 |
| **At 1 September 2005 restated** | **2,641** | **–** | **40** | **11,821** | **–** | **1,634** |
| Profit after tax | – | – | – | – | – | 5,851 |
| Dividends | – | – | – | – | – | (1,258) |
| Shares issued | 14 | – | – | 96 | – | – |
| Shares cancelled and capitalised | (203) | (665) | 203 | – | – | (2,388) |
| **31 August 2006** | **2,452** | **(665)** | **243** | **11,917** | **-** | **3,839** |

In accordance with FRS 10, goodwill previously written off against reserves has not been reinstated and the goodwill has been offset against the profit and loss account reserve. The cumulative amount of positive goodwill written off against reserves is £3,748,000 (31 August 2005: £5,645,000). The goodwill has been eliminated as a matter of accounting policy and would be charged to the profit and loss account on the subsequent disposal of the business to which it related. During the year £1,897,000 was charged to the profit and loss account (see note 3).

### The Company

At 31 August 2006, the Company held more than 10% of the equity of the following principal undertakings:

| Subsidiaries | Country of incorporation and operation | Class of share capital held | Proportion held by the parent undertaking | Nature of business |
|---|---|---|---|---|
| Character Options Limited | United Kingdom | Ordinary | 100% | Design and distribution of toys and games |
| Character Options (Far East) Limited | Hong Kong | Ordinary | 100% | Design and distribution of toys and games |
| Character Games Limited | United Kingdom | Ordinary | 100% | Design and distribution of games and puzzles |
| Character Games (Far East) Limited | Hong Kong | Ordinary | 100% | Design and distribution of games and puzzles |
| Character Gifts Limited | United Kingdom | Ordinary | 100% | Gift importer and distributor |
| World Wide Licenses Limited | Hong Kong | Ordinary | 100% | Design and distribution of digital cameras |
| WWL (Europe) Limited | United Kingdom | Ordinary | 100% | Distribution of digital cameras |

All of the subsidiary undertakings have been included in these consolidated accounts.

## 18 GUARANTEES AND OTHER FINANCIAL COMMITMENTS

a. Financial commitments under non-cancellable operating leases will result in the following payments falling due in the year to 31 August 2006.

| | 2006 Land and buildings £000's | 2005 Land and buildings £000's |
|---|---|---|
| Expiring within one year | 95 | 156 |
| Expiring between one and five years | 99 | 171 |
| Expiring after five years or more | – | – |
| | 194 | 327 |

b. The Group has entered into contracts for minimum royalties in the amounts set out below which are contracted to be paid to licensors irrespective of sales and are not provided for in the accounts as the directors believe that the required level of future sales will be achieved:

| | 2006 £000's | 2005 £000's |
|---|---|---|
| Within one year | 298 | 201 |
| Between one and two years | 23 | 163 |
| Between two and five years | 45 | – |
| | 366 | 364 |

## 19 RECONCILIATION OF OPERATING PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

| | 12 months to 31 August 2006 £000's | 12 months to 31 August 2005 £000's |
|---|---|---|
| Operating profit | 3,687 | 864 |
| Depreciation, impairment and amortisation | 774 | 628 |
| Loss on disposal of fixed assets | 168 | 11 |
| (Increase)/Decrease in stocks | (861) | 2,417 |
| Decrease/(Increase) in debtors | 8,411 | (6,347) |
| (Decrease)/Increase in creditors | (6,225) | 5,361 |
| Exchange movement | 41 | (64) |
| Net cash inflow from operating activities | 5,995 | 2,870 |

### RECONCILIATION OF EXCEPTIONAL PROFIT/(LOSS) TO NET CASH INFLOW FROM EXCEPTIONAL ACTIVITIES

| | 12 months to 31 August 2006 £000's | 12 months to 31 August 2005 £000's |
|---|---|---|
| Exceptional profit/(loss) | 2,156 | (643) |
| Write-back of goodwill previously written off | 1,897 | – |
| (Increase)/Decrease in debtor | (948) | 2,504 |
| Increase/(Decrease) in creditors | 73 | (551) |
| Net cash inflow from exceptional activities | 3,178 | 1,310 |

There was no cash flow relating to taxation in respect of the exceptional items.

## 20 RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET FUNDS

| | 12 months to 31 August 2006 £000's | 12 months to 31 August 2005 £000's |
|---|---|---|
| Increase/(Decrease) in cash in the period | 3,621 | (435) |
| Cash inflow from movement in funds and lease financing | – | 4 |
| Movement in net funds resulting from cash flows | 3,621 | (431) |
| Net funds at 1 September 2005 | 3,748 | 4,179 |
| Net funds at 31 August 2006 | 7,369 | 3,748 |

## 21 ANALYSIS OF NET FUNDS

| | Cash at bank and in hand £000's | Lease finance £000's | Total £000's |
|---|---|---|---|
| 1 September 2004 | 4,183 | (4) | 4,179 |
| Cash flow | (435) | 4 | (431) |
| 31 August 2005 | 3,748 | – | 3,748 |
| Cash flow | 3,621 | – | 3,621 |
| 31 August 2006 | 7,369 | – | 7,369 |

## 22 FINANCIAL INSTRUMENTS

The Group's use of financial instruments is explained under the heading of 'Risk Management' in The Corporate Governance Statement starting on page 13. As permitted by FRS 13, short-term debtors and creditors have been excluded from all financial instrument disclosures.

### a. Exchange risk

The tables below show the Group's currency exposures; in other words those transactional exposures that give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the Group that are not denominated in the operating currency of the operating company involved.

These currency exposures were as follows:

| Net foreign currency monetary assets | At 31 August 2006 Functional currency of Group operation | | | At 31 August 2005 Functional currency of group operation | | |
|---|---|---|---|---|---|---|
| | Sterling £000's | HK$ £000's | Total £000's | Sterling £000's | HK$ £000's | Total £000's |
| Sterling | – | 6 | 6 | – | 6 | 6 |
| US$ | 202 | 1,916 | 2,118 | 1 | 1,400 | 1,401 |
| Euro | 13 | – | 13 | 45 | – | 45 |
| Chinese renminbi | – | 18 | 18 | – | 12 | 12 |
| Total | 215 | 1,940 | 2,155 | 46 | 1,418 | 1,464 |

### b. Fair values

The fair value of all financial instruments at 31 August 2006 and 31 August 2005 was not materially different from its book value.

### c. Borrowing facilities

The Group has various available borrowing facilities. The undrawn committed facilities available in respect of which all conditions had been met at 31 August 2006, were as follows:

| | 2006 £000's | 2005 £000's |
|---|---|---|
| Expiring within one year | 5,642 | 2,665 |
| Expiring between one year, but not more than two years | – | – |
| Expiring in more than two years | – | – |
| Total | 5,642 | 2,665 |

### d. Interest rate risk profile of financial assets and financial liabilities

#### Financial assets

Financial assets comprise cash at bank.

| | At 31 August 2006 | | | | At 31 August 2005 | | | |
|---|---|---|---|---|---|---|---|---|
| Currency | Floating rate financial assets £000's | Fixed rate financial assets £000's | Financial assets on which no interest received £000's | Total £000's | Floating rate financial assets £000's | Fixed rate financial assets £000's | Financial assets on which no interest received £000's | Total £000's |
| Sterling | 4,493 | – | – | 4,493 | 2,459 | – | – | 2,459 |
| US$ | 2,117 | – | – | 2,117 | 1,401 | – | – | 1,401 |
| Euro | 13 | – | – | 13 | 45 | – | – | 45 |
| HK$ | 728 | | | 728 | – | – | – | – |
| Chinese renminbi | 18 | – | – | 18 | 12 | – | – | 12 |
| Total | 7,369 | – | – | 7,369 | 3,917 | – | – | 3,917 |

## 22 FINANCIAL INSTRUMENTS CONTINUED

### Financial liabilities

| Currency | At 31 August 2006 Floating rate financial liabilities £000's | Fixed rate financial liabilities £000's | Financial liabilities on which no interest is paid £000's | Total £000's | At 31 August 2005 Floating rate financial liabilities £000's | Fixed rate financial liabilities £000's | Financial liabilities on which no interest is paid £000's | Total £000's |
|---|---|---|---|---|---|---|---|---|
| Sterling | – | 1,350 | – | – | – | – | – | – |
| Euro | – | – | – | – | – | – | – | – |
| HK$ | – | – | – | – | 169 | – | – | 169 |
| Total | – | 1,350 | – | – | 169 | – | – | 169 |

The fixed rate financial liability comprises a loan. Interest is payable at the rate of 5% per annum.

The floating rate financial liabilities comprises overseas bank borrowings that bear interest at rates based on prime rate.

## 23 THE CHARACTER GROUP plc EMPLOYEE SHARE OWNERSHIP TRUST

The Company's Employee Share Ownership Trust ("the Trust") is governed by a Trust Deed dated 19 June 1998. The Trustees may grant options over such shares in the Company acquired by them or otherwise provide benefits to the beneficiaries, as defined in the Trust Deed. The Trust is required to meet its own costs out of the trust fund but if such fund is insufficient such costs will be borne by the Company. At 31 August 2006 the Trust held 285,000 shares (2005: 285,000) which had a market value of £219,450 (2005: £161,000), and has waived its right to dividend income thereon. The cost of these shares was £908,000. At 31 August 2006, no options had been granted by the Trust.

## 24 CONTINGENT LIABILITIES

The Company has guaranteed the obligations of certain subsidiary companies to their factor companies, trade finance companies, certain banks and others in the normal course of business. The factor company has a fixed and floating charge over the assets of the Company and some subsidiaries. The Company is a member of a Group registration for Value Added Tax purposes.

## 25 RELATED PARTY TRANSACTIONS

During the year the Company entered into transactions with Giochi Preziosi S.p.A., a company of which E Preziosi (a director of the Company until 28 September 2005) is a director. Giochi Preziosi S.p.A. disposed of their interest in the issued share capital of The Character Group plc on 26 June 2006.

Trade was carried out on an arm's length basis and is summarised below:

| | **Period to 26 June 2006 £000's** | Year to 31 August 2005 £000's |
|---|---|---|
| Total net sales to Giochi Preziosi S.p.A. | **1,698** | 2,770 |
| Total net purchases from Giochi Preziosi S.p.A. | **860** | 540 |
| Balance due from Giochi Preziosi S.p.A. | **–** | 1,098 |

# NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN THAT the twelfth Annual General Meeting of The Character Group plc will be held at the offices of Citigate Dewe Rogerson, 3 London Wall Buildings, London Wall, London EC2M 5SY on 17 January 2007 at 11 a.m. to transact the following business:

**Ordinary business**

1 To approve the Directors' Remuneration Report for the year ended 31 August 2006.

2 To receive and adopt the Directors' Report and the accounts of the Company for the year ended 31 August 2006 and the report of the auditors thereon.

3 To declare a final dividend on the ordinary shares in the capital of the Company (other than ordinary shares held by the Company in treasury) for the year ended 31 August 2006 of 1.65p per share.

4 To consider an ordinary resolution of the Company that A B MacKay, who retires in accordance with the terms of his letter of appointment, be and is hereby reappointed as a director of the Company.

5 To consider an ordinary resolution of the Company that Lord Birdwood, who retires in accordance with the terms of his letter of appointment, be and is hereby re-elected as a director of the Company.

6 To consider an ordinary resolution of the Company that Mr I S Fenn, who retires in accordance with the terms of his letter of appointment, be and is hereby re-elected as a director of the Company.

7 To consider an ordinary resolution of the Company that Mr D Harris, who retires in accordance with the terms of his letter of appointment, be and is hereby re-elected as a director of the Company.

8 To reappoint HLB Vantis Audit plc as auditors of the Company (having previously been appointed by the directors to fill the casual vacancy arising by reason of the resignation of Baker Tilly) and to authorise the directors to fix the remuneration of the auditors.

**Special business**

To consider and, if thought fit, to pass the following resolutions of the Company:

**Ordinary Resolutions**

9 That for the purposes of Section 80 of the Companies Act 1985 (the "Act") the directors be and are hereby generally and unconditionally authorised to exercise all powers of the company to allot relevant securities (as defined in that Section) up to an aggregate nominal amount of £798,730, such authority to expire on the earlier of fifteen months following the date upon which this resolution was passed and the conclusion of the Annual General Meeting of the Company next following the date upon which this resolution was passed, unless renewed, varied or revoked by the Company in general meeting provided that the Company may at any time before the expiry, variation or revocation of such authority make offers or agreements which will or might require relevant securities to be allotted after the expiry, variation or revocation of such authority and the directors may allot relevant securities pursuant to such offer or agreement as if such authority had not expired or been varied or revoked. This authority shall replace all existing authorities conferred on the directors in respect of the allotment of relevant securities to the extent that the same have not previously been utilised.

10 That the directors be and are hereby authorised for the purposes of Article 147 of the Articles of Association of the Company, to offer to members of the Company, in accordance with the provisions of the said Article, the right to elect to receive ordinary shares, credited as fully paid, in whole or in part instead of cash in respect of all or any dividends declared or paid by the Company or the directors pursuant to the Articles of Association of the Company at any time after the date of the passing of this resolution and the conclusion of the Annual General Meeting of the Company next following the date upon which this resolution was passed and that the directors be and are hereby authorised to make any such offer on such terms and conditions to such members of the Company, subject always to the provisions of the Articles of Association of the Company, as they shall in their absolute discretion determine.

11 That the Company be and is hereby generally and unconditionally authorised for the purposes of section 166 of the Act to make market purchases (as defined in section 163(3) of the Act) of ordinary shares of 5p each in the capital of the Company provided that:

(A) the maximum number of ordinary shares 5p each in the capital of the Company hereby authorised to be acquired is 11,854,000;

(B) the minimum price (exclusive of all expenses) which may be paid for such shares is 5p per share;

(C) the maximum price which may be paid for such shares is, in respect of a share contracted to be purchased on any day, an amount equal to 105 per cent of the average of the middle-market prices shown in the quotations for ordinary shares of the Company in the Daily Official List of the London Stock Exchange on the five business days immediately preceding the day on which the share is contracted to be purchased;

(D) the authority hereby conferred shall expire at the earlier of the conclusion of the next Annual General Meeting following the date upon which this resolution was passed or 15 months following the date upon which this resolution was passed; and

(E) the Company may contract to purchase its own shares under the authority hereby conferred prior to the expiry of such authority, which will or may be executed wholly or partly after the expiry of such authority, and may make a purchase of its own shares in pursuant of any such contract.

**Special Resolution**

12 That:

(A) the directors be and are hereby empowered pursuant to Section 95 of the Companies Act 1985 (the "Act") to allot equity securities (as defined in Section 94 of the Act) pursuant to the authority conferred on them for the purposes of Section 80 of the Act by an ordinary resolution of the Company of even date herewith and/or to sell equity securities held as treasury shares (within the meaning of section 162A of the Act) for cash in each case as if Section 89(1) of the Act did not apply to any such allotment or sale, provided that this power shall be limited:

(i) to the allotment and/or sale of equity securities in connection with any offer by way of rights to holders of ordinary shares in the capital of the Company (other than to the holder(s) of treasury shares) notwithstanding that, by reason of such exclusions or other arrangements as the directors may deem necessary or desirable to deal with legal or other problems arising in any overseas territory, in connection with fractional entitlements, record dates or otherwise howsoever, the equity securities to be allotted are not offered to all such holders in proportion to the respective number of ordinary shares held by them;

(ii) the allotment (otherwise than pursuant to paragraph (i) above) of equity securities up to an aggregate nominal value of £239,615;

(iii) the sale of (otherwise than pursuant to paragraph (i) above) of equity securities held as treasury shares up to an aggregate nominal value of £87,716.10 (equivalent to 1,754,322 ordinary shares of 5p each in the Company);

(B) the power hereby conferred shall expire at the earlier of the conclusion of the next Annual General Meeting following the date on which this resolution was passed or fifteen months following the date upon which this resolution was passed;

(C) the power hereby conferred shall enable the Company to make an offer or agreement that would or might require equity securities to be allotted and/or sale after such power expires and the directors may allot and/or sell equity securities in pursuance of any such offer or agreement made within the limits prescribed in paragraph (A) above as if the power hereby conferred had not expired; and

(D) this power shall replace all existing powers granted to the directors to allot equity securities as if the said Section 89(1) of the Act did not apply to the extent that the same have not been previously utilised.

By order of the Board,
**K P Shah**
Secretary
12 December 2006

Registered Office:
5th Floor,
4 Chiswell Street,
London EC1Y 4UP

Notes:

1. The register of directors' interests and copies of the directors' service agreements or (as appropriate) their letters of appointment will be available for inspection at the registered office during normal business hours from the date of this notice until the date of the Annual General Meeting and on that day will be available for inspection at the place of the meeting from 9.00 a.m. until he conclusion of the meeting.
2. A member entitled to attend and vote at the Annual General Meeting convened by the Notice above is entitled to appoint a proxy to attend and, on a poll, vote in his place. A proxy need not be a member of the Company.
3. To be valid, forms of proxy must be lodged with Neville Registrars Limited, 18 Laurel Lane, Halesowen, West Midlands, 63 3DA not less than 48 hours before the time appointed for holding the Annual General Meeting. A form of proxy is closed.
4. Completion of a form of proxy does not prevent a member from attending and voting at the Annual General Meeting should he or she so wish.
5. For the purposes of regulation 41 of the Uncertificated Securities Regulations 2001, the members entitled to attend and/or vote at the Annual General Meeting shall be those entered on the Company's register of members at 11.00 a.m. on 15 January 2007. Changes to entries on the register of members after that time will be disregarded in determining the rights of any person to attend and/or vote at the meeting.

# FORM OF PROXY

## THE CHARACTER GROUP plc

For use at the Annual General Meeting of the Company to be held on 17 January 2007 at 11 a.m.

I/We ______________________________________________

(please use block capitals)

of ______________________________________________ (being (a) holders(s) of ordinary shares in the above named company) hereby appoint the Chairman of the meeting

______________________________________________ (note 1)

as my/our proxy to vote on my/our behalf at the Annual General Meeting to be held at the offices of Citigate Dewe Rogerson, 3 London Wall Buildings, London Wall, London EC2M 5SY on 17 January 2007 at 11 a.m. and any adjournment thereof.

Please indicate with a ✔ in the spaces below in either the for or against column how you wish your vote to be cast.

| | FOR | AGAINST |
|---|---|---|
| 1. Ordinary resolution — approval of the Directors' Remuneration Report for the year ended 31 August 2006 | | |
| 2. Ordinary resolution — adoption of accounts for year ended 31 August 2006 | | |
| 3. Ordinary resolution — declaration of final dividend | | |
| 4. Ordinary resolution — reappointment of Mr A B MacKay as a director | | |
| 5. Ordinary resolution — re-election of Lord Birdwood as a director | | |
| 6. Ordinary resolution — re-election of Mr IS Fenn as a director | | |
| 7. Ordinary resolution — re-election of Mr D Harris as a director | | |
| 8. Ordinary resolution — reappointment of HLB Vantis Audit plc as auditors to the company | | |
| 9. Ordinary resolution — authority to allot shares | | |
| 10. Ordinary resolution — authority to allot shares in lieu of cash dividends | | |
| 11. Ordinary resolution — authority to purchase own shares in the market | | |
| 12. Special resolution — disapplication of pre-emption rights | | |

Dated ______________________ Signature ______________________

Notes:

1. You may if you wish delete the words "Chairman of the meeting" and insert the name of the proxy or proxies of your choice in the space provided. Please initial such alteration.
2. If no indication is given as to how you wish your proxy to vote, your proxy will vote or abstain as he/she thinks fit. On any other business arising at the meeting (including any motion to adjourn the meeting) the proxy will act at his/her discretion.
3. In the case of joint holders, the signature of any one of them will be accepted but the signature of the senior of the joint holders shall be accepted to the exclusion of the others, seniority being determined by the order in which the names appear in the register of members of the Company.
4. In the case of a corporation, this Form of Proxy should be executed under its common seal or under the hand of an officer, attorney of other person duly authorised on its behalf.
5. Forms of Proxy signed by other than the registered holder will not be valid unless accompanied by the power of attorney (if any) or other authority under which it is signed or a notarially certified copy thereof.
6. To be effective, Forms of Proxy must be lodged with Neville Registrars Limited, 18 Laurel Lane, Halesowen, West Midlands, B63 3BR not less that 48 hours before the time appointed for the meeting. Completion of this form of proxy will not prevent the holder from attending and voting at the meeting in person should he so wish.
7. As permitted by Regulation 41 of the Uncertificated Securities Regulations 2001, members must be entered on the Company's register of members at 11 a.m. on 15 January 2006 in order to be entitled to attend and/or vote at the meeting in respect of the number of shares registered in their name at such time. Changes to entries on the register of members after that time will be disregarded in determining the rights of any person to attend and/or vote at the meeting.

Second fold

BUSINESS REPLY SERVICE
Licence No. 3865

1

Neville Registrars Limited
18 Laurel Lane
Halesowen
West Midlands
B63 3BR

First fold

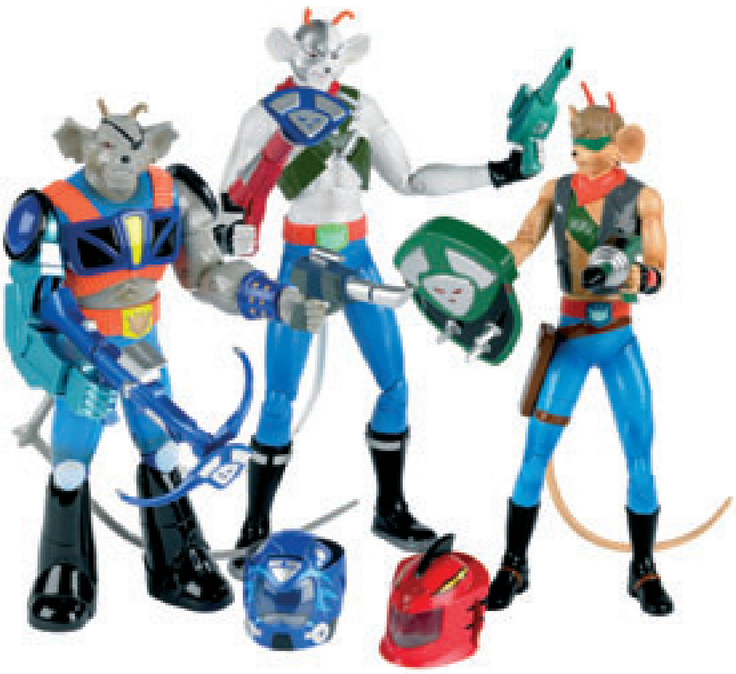
Third fold, then tuck in flap
and tape along edge

This document is printed on paper made from 75% recycled fibre

# Product Highlights.

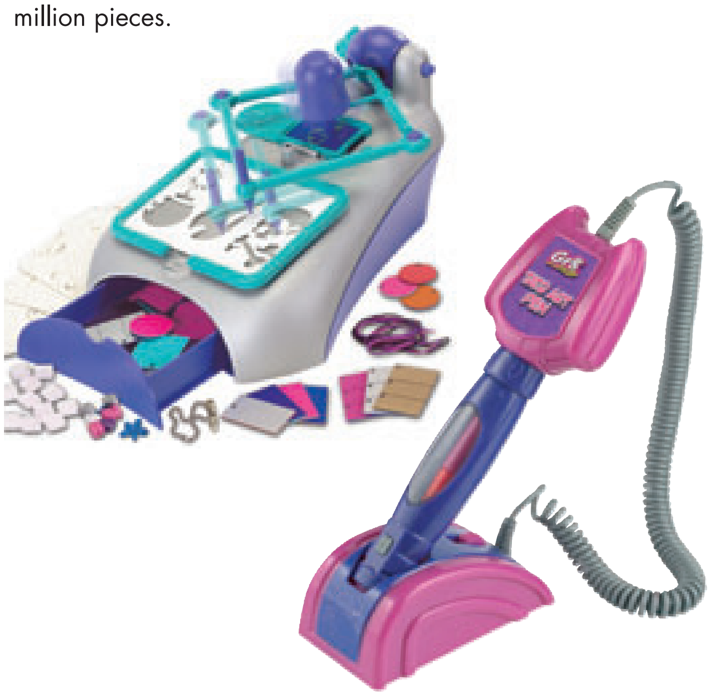
## Biker Mice from Mars™

The screening of this TV programme commenced towards the end of August 2006 on GMTV 1 & GMTV 2. Ratings have been above expectations and current sales are excellent and are growing week on week. Character has exclusive UK distribution rights from Giochi Preziosi S.p.A.



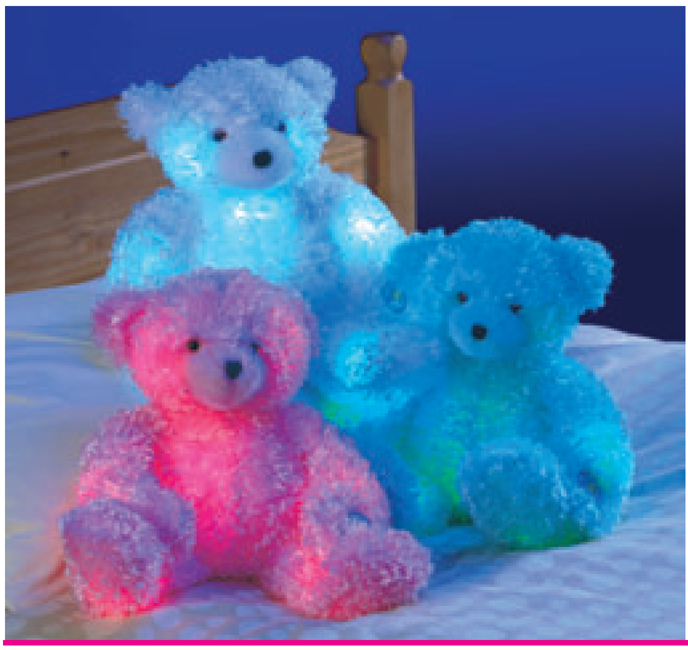
## Gr8 Gear™ /Gr8 Art™ /Gr8 Kit™

The Gr8 brand has 3 categories: Gr8 Gear, Gr8 Art & Gr8 Kit. All categories have enjoyed great success this year, with some exciting new product lines being developed for 2007, particularly in the art area. The GR8 range is distributed worldwide and a notable success is the Tattoo Pen. Combined international sales of the Gr8 range are circa one million pieces.



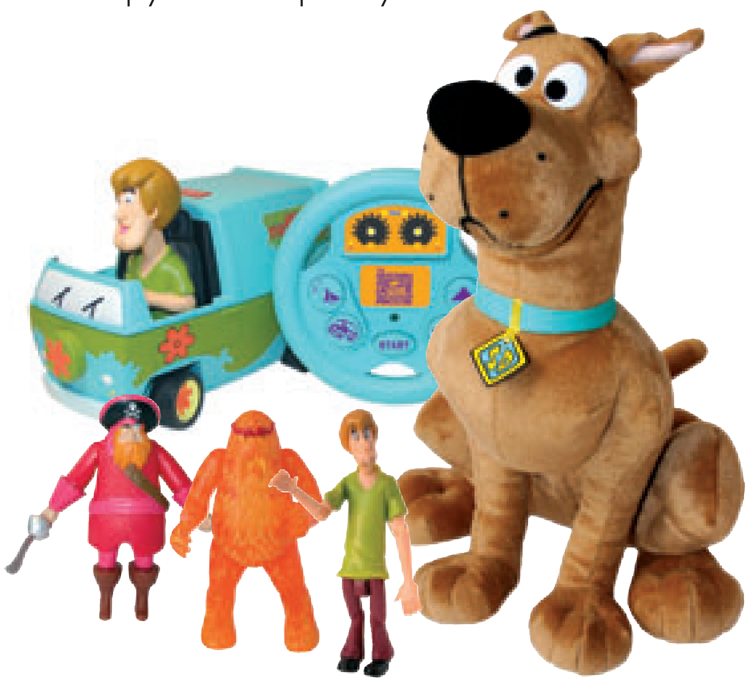
## GloE Bears™

Character has the UK distribution rights for GloE Bears from CEPIA. This product has sold exceptionally well this year with sales in excess of 100,000 units. The range will be extended in 2007 to include other cuddly animals in 12″, 16″ and 24″ sizes. Additionally, colour change light up dress-up outfits in the themes of Princess and Ballerina will be launched at the London Toy Show in January 2007.



## Scooby Doo™

Character is the master toy European licensee for the Scooby Doo toys range. Sales in the UK have substantially increased in 2006, and we are now shipping to several European countries. The product line is being enhanced for 2007 and we are looking to continue the growth we have enjoyed over the past 2 years.



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