

2001 Interim Report

———— *t b e* ————
C H A R A C T E R
———— *g r o u p p l c* ————

Contents

	<i>Pages</i>
Chairman's Letter	1
Consolidated Profit and Loss Account	3
Consolidated Balance Sheet	4
Consolidated Cash Flow Statement	5
Notes to the Accounts	6-7
Independent Review Report to The Character Group Plc	8

The Company has subscribed to UK Equities Direct, an online internet service made available to shareholders free of charge. Shareholders will be able to access financial information, including the Annual and Interim Reports, public announcements and share price data. The web site address is <http://www.hemscott.com>.

CHAIRMAN'S LETTER

On the 24 January this year, I announced that Christmas trading had been disappointing. The difficult trading conditions for the Group have continued for the first half of this financial year and have contributed to an interim net loss of £1.9 million on sales £36.6 million. It is not therefore proposed that an interim dividend will be paid.

Trading for this calendar year started well with overall sales and profits in January on or above our expectations. However, this position deteriorated rapidly as a result of several factors, the most significant being the generally difficult trading conditions in our marketplace, especially in the UK, and a shortage of any really successful toy or character products for the Christmas sales. In addition, even where we had a winning product such as the "*Cool-iCam*" digital camera, we were hit by chip shortages and were unable to satisfy demand. Post Christmas trading remained subdued, with a lack of a blockbuster character, or a winning product. Accordingly, the Group has concentrated its efforts on rationalising its product range reducing costs and improving operating procedures. Against this background, these results, whilst on the surface disappointing, nevertheless show a substantial improvement on the corresponding figures for the same period last year where to the half year to 29 February 2000, we recorded a net loss of £5.96 million on sales of £45 million.

Current Trading

The Group, as a whole, has made steady progress through the year to date albeit at a significantly slower pace than originally envisaged. It is expected that the Group will continue to make progress in the second half of this financial year. However, due to the difficult trading which has been exacerbated by cash constraints caused in part by a reduction in the Group's working capital facilities and the resultant delay in the introduction of new product ranges, it is now expected that the Group will not make a profit for the full year.

By streamlining the operations, we have to date made significant cost savings. We are continuing this program through the second half of this year and estimate that commencing from the start of the new financial year, we shall further reduce our overheads by £1.2 million on an annualised basis. We shall however incur a one off charge of circa £200k in the current period.

Financial Position

The Group's balance sheet has been severely weakened by poor trading results over the past 18 months, and action is being taken to recapitalise it to enable the Group to return to its previous growth pattern. Summary details of the proposed recapitalisation have been announced today.

Prospects

We have every reason to believe that trading for this coming Christmas season will be substantially better than last year and this, combined with a significant reduction in overhead, will enable the Group to improve its trading performance over time.

We are confident that our new product ranges which we shall introduce to the market from June in the UK and the overseas sales of our own rapidly developing "*Cool-iCam*" range of digital products will generate the excitement and sales that we need for profitable growth. I have highlighted separately some significant features of the main product ranges which encourage us to take this view.

The Group has gone through an extremely difficult time, yet the measures taken to focus the product ranges, reduce the cost base, and restore the capital base can only be beneficial to the future performance of the Group.

Richard King, Chairman

29 May 2001

NOTES TO ACCOMPANY THE CHARACTER GROUP'S INTERIM RESULTS ANNOUNCEMENT

Digital Products

World Wide Licenses ("WWL"), the Group's Hong Kong based development and trading company has developed a range of digital cameras which are generally marketed under our "Cool-iCam" brand. The very first product in this range became the no. 2 best selling digital camera in Japan last year in the sub US\$100 range. Our second, "The Pocket-Cam", reached the same elevated position earlier this year, and our third camera – "The Cool-iMicroCam" marketed under the "Che-ez" brand in Japan, launched in April, recently became the 5th best selling digital camera overall and best selling digital camera in the sub US\$100 category. We currently have three products listed in the Top Ten best selling items which is more than any other brand.

This programme of product development is expanding rapidly into a broad range of digital products including megapixel cameras, MP3 players, a digital camera that works through a TV (not requiring a computer thus doubling the size of the potential market), a highly portable karaoke player which comes complete with everything you need in a microphone that simply plugs into a TV, and a range of Personal Digital Assistants ("PDA's") which have built-in cameras.

The Company is building strong international distribution with successes already in Japan, the USA, Canada, New Zealand and Italy.

Giftware

In giftware, Downpace will continue its successful products such as themed shot glasses, angel pins and named socks as well as adding "Bagpuss", "Clangers" and "Magic Roundabout" character giftware to extensions of the "Royle Family", "Simpsons", "Buffy" and the very successful World Wrestling Federation.

In the games category, several new lines are being introduced this year to add to the continuing success of products like character chess sets, "Spin the Bottle" and "Spin the Beetle" electronic games, "Friends" board games as well as sculpture and 2D puzzles. These new introductions include games based on the TV series "Ally McBeal" and the magazine "Inside Soap" and further development of our successful range of the "Wow" series of magic, science and wizardry sets. In addition, as announced, we shall be shortly introducing our gift collection range based on the phenomenally successful "Harry Potter" character both in the UK and Europe. The UK sales of the Character Games products are now handled by Character Options.

Character Options

We are endeavouring to strike a broader balance between branded and character products than in previous years.

In the boys category, in addition to continuing with "Super Soakers", "Stretch Armstrong" and "Ugly Monster", we are adding "Taiyo Edge", an innovative range of radio control vehicles and new fashionable, innovative and exciting robots under the "Johnny Bots" and "Rumble Bots" brands, with the latter designed to encompass both the game play of trading cards and robots, where the trading cards can enhance the powers of the robots, thus giving better all round playability. "Star Command", the animated TV series based on "Buzz Lightyear", also adds a potential winning licensed range.

In the girls category, and following on from the success of "Britney Spears" and "The Powerpuff Girls", both of which continue this year, we have added our own developed range of collectable action singing dolls of "Hear'Say" of Popstars fame, whose record-breaking debut single and album should help us generate substantial sales over the next few months, especially during their UK tour. In the same genre, we have added "N'Style" interactive girls, a range of intelligent dolls that can recognise what they are wearing, as well as an interactive car, they create endless play and could turn out to be some of our best selling product for the year. Added to this is "Star Castles", our range of successful fantasy castles which this year has been combined with a relaunch of the Flying Dolls we marketed so successfully around 1995 under the "Sky Dancers" brand. We believe that this product enhancement should develop into an exciting opportunity for sales and could well turn into a star girls line for the year. These products when added to "Kitty Kitty Kittens", which were launched in December, and our range of "Sabrina" dolls and accessories, together with many additional products in both the boys and the girls sector of the market, provide a very real opportunity for the Group to regain its momentum in the toy area this year.

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Note	6 months to 28 February 2001 (unaudited) £'000	6 months to 29 February 2000 (unaudited) £'000	12 months to 31 August 2000 (audited) £'000
Turnover				
Continuing operations		36,648	45,389	75,856
Discontinued operations		—	—	4,035
		36,648	45,389	79,891
Less: share of joint ventures turnover		—	—	(105)
Group turnover				
Cost of sales		(26,152)	(33,549)	(61,935)
Gross profit				
		10,496	11,840	17,851
Net operating expenses				
Selling and distribution costs		(5,597)	(7,640)	(11,349)
Administration expenses		(6,462)	(9,728)	(19,435)
Other operating income		200	65	308
Operating loss				
Continuing operations		(1,363)	(5,463)	(11,646)
Discontinued operations		—	—	(791)
		(1,363)	(5,463)	(12,437)
Share of operating loss in joint venture		—	—	(188)
Total operating loss including share of joint venture				
		(1,363)	(5,463)	(12,625)
Interest receivable		32	17	76
Interest payable		(604)	(509)	(1,275)
Loss on ordinary activities before taxation				
Taxation	2	(194)	1,818	1,471
Loss on ordinary activities after taxation				
		(2,129)	(4,137)	(12,353)
Loss per share – basic	3	(9.32p)	(19.67p)	(58.56p)
Loss per share – fully diluted	3	(9.32p)	(19.03p)	(58.05p)

CONSOLIDATED BALANCE SHEET

	Group as at 28 February 2001 (unaudited) Note	Group as at 29 February 2000 (unaudited) £'000	Group as at 31 August 2000 (audited) £'000
Fixed assets			
Intangible assets	1,703	1,999	1,748
Tangible assets	2,268	2,766	2,491
Investments	153	903	153
Investment in Joint Venture	—	1	—
	4,124	5,669	4,392
Current assets			
Stocks	7,052	11,392	11,530
Trade debtors subject to finance arrangements	5,017	9,473	11,332
Factor advances	(3,890)	(8,188)	(11,209)
	1,127	1,285	123
Trade and other debtors	4,959	5,862	7,251
Cash at bank and in hand	475	810	1,258
	13,613	19,349	20,162
Creditors: amounts falling due within one year	(15,146)	(14,459)	(19,999)
Net current (liabilities)/assets	(1,533)	4,890	163
Total assets less current liabilities	2,591	10,559	4,555
Creditors: amounts falling due after more than one year	(27)	(44)	(39)
Provision for liabilities and charges			
Investment in Joint Venture:			
Share of gross assets	91	—	91
Share of gross liabilities	(282)	—	(282)
	2,373	10,515	4,325
Net assets			
Capital and reserves			
Called up share capital	1,156	1,052	1,156
Shares to be issued	1,808	2,016	1,808
Capital redemption reserve	15	15	15
Share premium	5,473	3,625	5,473
Merger reserve	651	651	651
Profit and loss account	4 (6,730)	3,156	(4,778)
Equity shareholders' funds	2,373	10,515	4,325

CONSOLIDATED CASH FLOW STATEMENT

	Note	6 months to 28 February 2001 (unaudited) £'000	6 months to 29 February 2000 (unaudited) £'000	12 months to 31 August 2000 (audited) £'000
Cash flow from operating activities	5	(1,832)	(6,350)	(4,173)
Returns on investment and servicing of finance				
Interest paid (net)		(569)	(477)	(1,180)
Interest element of finance lease rental payments		(3)	(15)	(19)
Net cash outflow for returns on investments and servicing of finance		(572)	(492)	(1,199)
Taxation		(146)	(1,492)	(1,550)
Capital expenditure and financial investment				
Payments to acquire tangible fixed assets		(147)	(260)	(881)
Sale of tangible fixed assets		31	94	144
Purchase of shares for Employees Share Ownership Trust		—	(472)	(477)
Net cash outflow for capital expenditure and financial investment		(116)	(638)	(1,214)
Acquisitions and disposals				
Purchase of subsidiary undertakings		—	—	(80)
Net cash outflow for acquisitions		—	—	(80)
Equity dividends paid		—	(971)	(984)
Cash outflow before use of liquid resources and financing		(2,666)	(9,943)	(9,200)
Management of liquid resources:				
Financing				
Issue of ordinary share capital		—	8	1,960
Capital element of finance lease rentals		(27)	(67)	(108)
Short term bank loan		(353)	(102)	(938)
Net cash (outflow)/inflow from financing		(380)	(161)	914
Decrease in cash in the period	7	(3,046)	(10,104)	(8,286)
Increase in net debt in the period	7	(2,666)	(9,935)	(7,238)

NOTES TO THE ACCOUNTS

1. Basis of Preparation

The financial information for the six months ended 28 February 2001 has not been audited, nor has the financial information for the six months ended 29 February 2000. However, the interim report includes a review report signed by the auditors. The comparative figures for the year ended 31 August 2000 do not constitute the company's statutory accounts for that year, but have been extracted from the statutory accounts filed with the Registrar of Companies, and which carried an unqualified audit report. The report has been prepared in accordance with the applicable accounting standards on a consistent basis using the accounting policies set out in the 2000 annual report.

The financial information for the six months ended 28 February 2001 has been prepared on the going concern basis which assumes that the Company and its subsidiaries will continue in operational existence for the foreseeable future.

The Group is at an advanced stage of negotiations regarding the proposed subscription for a £4.6 million convertible loan. In addition the Company is close to finalising the terms of a rights issue. Both the convertible loan note and the rights issue are subject to the approval of shareholders.

The Directors are confident of a successful outcome to both of the matters referred to above and, on this basis, believe it is appropriate for the financial information for the six months ended 28 February 2001 to be prepared on a going concern basis.

2. Taxation

The tax charge for the half year is estimated on the basis of the anticipated tax rates applying for the full year.

3. Earnings per Share

Earnings per share have been calculated in accordance with FRS 14 Earnings per share. The calculations are based on the following:

	6 months to 28 February 2001	6 months to 29 February 2000	12 months to 31 August 2000
Loss for the period after taxation and minority interest	(£2,129,000)	(£4,137,000)	(£12,353,000)
Basic weighted average share capital (number of shares)	22,834,663	21,035,590	21,093,524
Dilutive Shares – share options	—	702,202	185,214
Diluted weighted average share capital	22,834,663	21,737,792	21,278,738

4. Profit and Loss Account

	£'000
At 1 September 2000	(4,778)
Loss absorbed for the six months	(2,129)
Exchange difference	177
At 28 February 2001	(6,730)

5. Reconciliation of operating loss to net cash outflow from operating activities

	6 months to 28 February 2001 (unaudited) £'000	6 months to 29 February 2000 (unaudited) £'000	12 months to 31 August 2000 (audited) £'000
Operating loss	(1,363)	(5,463)	(12,625)
Depreciation, impairment and amortisation	364	670	1,372
Provision in respect of own shares	—	—	757
Loss on disposal of tangible fixed assets	20	23	75
Decrease in stocks	4,478	5,272	5,133
Decrease in debtors	3,820	3,113	4,169
Decrease in creditors	(9,328)	(9,931)	(3,382)
Exchange differences	177	(34)	328
Net cash outflow from operating activities	(1,832)	(6,350)	(4,173)

6. Reconciliation of net cash flow to movement in net debt

	6 months to 28 February 2001 (unaudited) £'000	6 months to 29 February 2000 (unaudited) £'000	12 months to 31 August 2000 (audited) £'000
Decrease in cash in the period	(3,046)	(10,104)	(8,286)
Cash inflow from movement in debt and lease financing	380	169	1,048
Movement in net debt resulting from cash flows	(2,666)	(9,935)	(7,238)
Other non-cash movements	—	—	—
Movement in net debt in the period	(2,666)	(9,935)	(7,238)
Net debt at 1 September 2000	815	8,053	8,053
Net debt at 28 February 2001	(1,851)	(1,882)	815

7. Analysis of net debt

	Cash at bank and in hand £'000	Bank overdraft £'000	Short term bank loan £'000	Lease finance £'000	Total £'000
1 September 1999	9,544	—	(1,293)	(198)	8,053
Cash flow	(10,104)	—	102	67	(9,935)
29 February 2000	(560)	—	(1,191)	(131)	(1,882)
Cash flow	1,818	—	838	41	2,697
31 August 2000	1,258	—	(353)	(90)	815
Cash flow	(782)	(2,264)	353	27	(2,666)
28 February 2001	476	(2,264)	—	(63)	(1,851)

INDEPENDENT REVIEW REPORT TO THE CHARACTER GROUP PLC

Introduction

We have been instructed by the company to review the financial information for the six months ended 28 February 2001 which comprises the consolidated profit and loss account, the consolidated balance sheet, the consolidated cash flow statement and the notes to the accounts. We have read the other information contained in the Interim Report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

Directors' responsibilities

The interim report, including the financial information contained herein, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim report in accordance with the Listing Rules of the Financial Services Authority which require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed.

Review work performed

We conducted our review in accordance with guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. In particular, we draw your attention to Note 1 to the accounts: Basis of Preparation. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with United Kingdom Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the financial information.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 28 February 2001.

HLB Kidsons
Chartered Accountants
Chelmsford
29 May 2001

————— *t h e* —————
C H A R A C T E R
————— *g r o u p p l c* —————

THE CHARACTER GROUP PLC
2ND FLOOR
86-88 COOMBE ROAD
NEW MALDEN
SURREY KT3 4QS
TELEPHONE: 020 8949 5898
FAX: 020 8336 2585
EMAIL: CharacterG@aol.com