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CHAIRMAN'S LETTER

Introduction

At the Annual General Meeting ("AGM") in January, we indicated the markets had remained tough and that we expected our first half performance to be disappointing. On the 12 April 2005, we issued a trading statement indicating that pre-tax losses for the six months ended 28 February 2005 to be in the region of £2.0 million.

In the first quarter of the 2005 calendar year, our markets became even more challenging and competitive. The worldwide digital camera market has seen a fall in anticipated demand resulting in excess capacity which has led to intense pricing competition. In addition, the UK retail market (the principal market for our toys, games and gifts), continues to operate under extreme pressure which has been highlighted by the recent trading updates from major UK retailers and more recently by the closure of both the Index and The Gadget Shop businesses.

At the AGM, we also informed shareholders that we were to consolidate our gift business (formerly known as Downpace) into the Toys and Games Division. Although these actions have recently been completed, the integration of the logistics to Oldham from West London coupled with the relocation of product development and sales to our Head Office in New Malden had an adverse impact on our trading in the period.

Consequently, whilst as a Board we are disappointed with our overall performance, we believe that the worst is behind us and that, despite the difficult trading environment, our businesses will witness an improved performance during the second half, which we expect to continue into the next financial year.

The Board has also reviewed its strategy for growth and succession planning and details are set out later in this report.

Financial Results

Sales in the six-month period under review were £43.4 million compared to £40.9 million in the same period in 2004. In the same period, the Group produced an operating loss of £1.5 million against £2.2 million operating profit in 2004. Losses before tax in the first half were £1.9 million against £2.0 million pre-tax profit in 2004. Basic Loss per share amounted to 3.8 pence against earnings per share of 4.22 pence in 2004.

Administration expenses remained at 15.9% of sales. Stocks at the end of the six-month period remained under control at £8.9 million compared to £12.2 million at the year ended 31 August 2004 (interim 2004:£5.9 million).

Cash at bank as at 28 February 2005 was £3.90 million (29 February 2004: £4.27 million).

The Group was ungeared at 28 February 2005 and had unused bank and trade finance facilities of £11.0 million.

Business Overview

Toys, Games and Gifts

The tough retail environment in the UK leading up to and post Christmas had a severe adverse effect on our trading within this sector. It is pleasing, however, to report that the strength and depth of our overall product offering continues to be well received by the market.

During the first half of the current financial year, despite having achieved notable successes with some of our products, this division experienced a substantial rise in the level of credit notes it issued as well as an increase in marketing support necessary to move products through the market. Whilst this level of support has impacted our performance in the short term as I have reported above, our stocks have continued to fall, with stock write-downs in line with our internal budgets.

At the same time as we were experiencing market challenges, this business was undergoing a restructure of its activities. In January 2005, we fully integrated the operations of Character Games into Character Options. The benefits of this move will begin to feed through during the second half and will be reflected in the next financial year. It is our belief that not only will there be savings in operating costs, but that there will also be major improvements in efficiencies and overall productivity.

The restructuring of Character Gifts (formerly Downpace) was substantially completed by the end of March and this business is now operating from our Oldham facility. We believe that not only will there be operational cost savings but we will see major improvements in efficiencies within this business which will be reflected in the next financial year.

In addition, the strategy of changing our trading focus within Character Gifts from a distributor of third party products to principally a developer of our own products is at an early stage but, we expect momentum to gather pace as we progress with this fundamental change in direction.

It is important to note therefore, that, with the majority of our gift new product introductions for the period leading up to Christmas 2005 not being shipped before August 2005, these new ranges will have no major impact on trading in this financial year. We are confident however that the product line up from August will enable us to achieve the improvements in trading that we envisaged when we took the decision to restructure the gifts business and integrate it within the Toy and Games Division.

Outlook for Toys, Games and Gifts and new Products

For toys and games, our outlook for the remainder of this financial year ending 31 August 2005 and for 2005 as a whole remain encouraging, having secured a number of leading toy licenses including Dr Who, Batman and Disney Princess.

Robosapien, the 2004 UK Toy of the Year, continues to sell very well. This robotic range will be joined by Roboraptor, an animatronic dinosaur, which has already been voted Toy of the Year in Australia, and will be launched in the UK in June, followed later in the year by RoboPet and Robosapien V2. These new additions will help to create a formidable line-up.

Based on the new BBC TV series, we are producing a Dr Who range of toys and gifts including a radio controlled Dalek which will appeal to both new and old fans.

New Batman and Star Wars products are now starting to be shipped to coincide with the release of movies in the UK this summer.

Our own developed intellectual property such as the Gr8 Gear fashion line, Batman, Peppa Pig, Games and Star Wars chess sets, to name but a few, are now being shipped to over 25 different countries.

During the second half, we will be promoting the Gr8 range of remote control vehicles and launching what we believe to be the fastest remote control range of vehicles with a scale speed ratio of nearly 200mph.

Within our Gift business, we believe that we have now established one of our strongest ever ranges. In addition to our earlier gift product line-up, which included The Simpsons, Purple Ronnie, and our in-house developed talking mugs which were first shipped at Christmas, we will be introducing new licensed ranges such as David & Goliath, Tutti Cuti, Jeli Deli and Rachael Hale.

We have also recently agreed terms for gifts relating to the BBC TV Little Britain series which earlier this week received two BAFTA awards. This, together with other gift licenses which are under negotiation and the broader base of distribution created by the integration of gifts into the Toys & Games Division, we are confident of substantial improvement in our trading performance within gifts by the end of 2005 and into the next financial year as a whole.

Digital Division

World Wide Licenses ("WWL")

The performance of this division has been resilient, despite the combined impact of the delay in building our US business, as a result of the loss of the US distributor in

2004 and the subsequent long term repercussions this had on our business, together with the difficult global trading environment in digital imaging.

As a result of the recent substantial increase in our North American trade, WWL is reaching critical mass within its production volumes which will inevitably be reflected in the bottom line.

We have made a number of significant improvements to our R&D, technical expertise and manufacturing processes the resulting effect being that we are now producing a higher quality product. We are also in the process of designing new products which we predict will have a niche position in the marketplace.

Shareholders may be aware that Petters Consumer Brands LLC ("Petters"), the company we appointed as our US distributor in June 2004, is currently in the process of acquiring Polaroid Holding Company, (formerly Polaroid Corporation) with whom the Group has license agreements which expire in the USA in October 2005 and in other territories in December 2005. Following completion of the transaction between Petters and Polaroid, which is expected to take place in the second quarter of 2005, the Group will commence negotiations with Petters regarding future collaboration. Whilst it is too early to be assured of the precise outcome of these negotiations, the Board is hopeful that our business relationship will continue to develop.

Strategic Review

The Directors are mindful that the Board has a duty to improve shareholder value and to prepare the Group for long term growth, particularly at times when the markets in which its businesses operate have become increasingly difficult, more competitive and diverse.

The Board has accordingly undertaken a strategic review of the business and has agreed a strategy to accomplish these goals.

Executive Changes

In order to take full advantage of the Group's market position and continuingly improving product portfolio, the Directors recognise the need to strengthen the executive and operational management teams and position the Group for its next stage of development.

In relation to this, we have begun the process of recruiting a new Chief Executive Officer and a Group Finance Director. Following these appointments, we will make changes to the current Board Structure. Enrico Preziosi, who is Chief Executive Officer and Managing Director will become Non-Executive Vice-Chairman whilst Kiran Shah, Group Finance Director, will become Group Corporate Development Director.

Transfer to AIM

As part of our strategic review, the Board, together with its advisers have concluded that it would be in the best interest of shareholders for the Group's shares to be listed on AIM rather than on the UKLA Official List. There are several potential advantages for this move. AIM will, we believe, provide a more flexible environment in which to achieve the Group's objectives and reduce costs and formalities relating to listing and future transactions. Also, we believe that, by being a larger player in a market more suited to small-cap companies, the Group would be in a better environment to attract institutional and other investors in the future.

The process of transferring from the Official List to AIM will begin as soon as practicable and will formally commence with the issue of an AIM Pre-Admission Announcement issued via the Regulatory News Service (RNS), which will also be posted to shareholders. This announcement will give 20 business days notice of the Group's intention to move from the Official List to AIM.

Looking Forward

As part of our on-going review of our overall business, the Board is considering the possible de-merger of World Wide Licenses and simultaneously seeking an Admission to AIM for WWL's shares in their own right. Whilst there are no immediate plans to make this move, the Board believes that this could better promote shareholder value. Shareholders will be updated with news of any developments in this regard as soon as practicable and appropriate.

Our focus continues to be to improve our operational efficiencies and further develop our product portfolio.

Commercially, the Group has experienced very challenging and competitive markets, but this should not detract from the very strong improvement in our ability to develop our own good quality and saleable product lines both under our own brands as well as under licenses.

By the end of 2005 calendar year, we expect that over 50% of our products within the Toys, Games and Gifts division and over 90% of our digital products will have been developed in-house. This in-house expertise in developing licensed properties and also bringing new products to market quickly is becoming generally recognised and proving to be a major benefit to the Group in attracting and winning strong new licenses.

As a Board, we are confident that through refocusing our efforts and by significantly strengthening the executive team, the Group can leverage its market position and ultimately this will be reflected in our commercial performance and improved shareholder value.

Dividend

The Directors are declaring the payment of a maintained interim dividend of 1.10 pence per share, which reflects the Board's confidence in its future strategy and trading performance.

The interim dividend will be paid to shareholders on 29 July 2005 to shareholders on the Register as at 8 July 2005. The shares go ex-dividend on 6 July 2005.

Richard King
Chairman
20 April 2005

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Note	6 months to 28 February 2005 (unaudited) £'000	6 months to 29 February 2004 (unaudited) (as re-stated) £'000	12 months to 31 August 2004 (audited) £'000	12 months to 31 August 2004 Other £'000	12 months to 31 August 2004 Exceptional £'000 (Note 1)
Turnover		**43,363**	40,903	76,046	74,653	1,393
Cost of sales		**(31,932)**	(26,824)	(54,332)	(51,675)	(2,657)
Gross profit		**11,431**	14,079	21,714	22,978	(1,264)
Net operating expenses						
Selling and distribution costs		**(6,123)**	(5,524)	(9,409)	(9,131)	(278)
Administration expenses		**(6,922)**	(6,488)	(11,389)	(10,919)	(470)
Other operating income		**89**	124	2,761	257	2,504
Operating (loss)/profit		**(1,525)**	2,191	3,677	3,185	492
Interest		**(405)**	(176)	(453)	(453)	–
(Loss)/profit on ordinary activities before taxation		**(1,930)**	2,015	3,224	2,732	492
Taxation	2	**(64)**	(25)	503	589	(86)
(Loss)/profit on ordinary activities after taxation		**(1,994)**	1,990	3,727	3,321	406
Dividend		**(578)**	(728)	(1,093)		
Retained (Loss)/profit	3	**(2,572)**	1,262	2,634		
(Loss)/earnings per share	4					
– basic		**(3.80p)**	4.22p	7.48p		
– fully diluted		**(3.80p)**	4.11p	7.31p		
Dividend per share		**1.10p**	1.10p	1.80p		
EBITDA (earnings before interest, tax, depreciation and amortisation)		**(1,245)**	2,614	4,444		

All activity has arisen from continuing operations

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	Note	6 months to 28 February 2005 £'000	6 months to 29 February 2004 £'000	12 months to 31 August 2004 £'000
(Loss)/profit for the financial period		**(2,572)**	1,262	2634
Foreign exchange differences		**(383)**	(709)	(541)
Total recognised gains and losses relating to the financial period		**(2,955)**	553	2,093

CONSOLIDATED BALANCE SHEET

	Note	**28 February 2005 (unaudited) £'000**	29 February 2004 (unaudited) £'000	31 August 2004 (audited) £'000
Fixed assets				
Intangible assets		**669**	712	692
Tangible assets		**1,680**	1,612	1,599
Investments		**2**	2	2
		2,351	2,326	2,293
Current assets				
Stocks		**8,923**	5,924	12,227
Trade debtors subject to finance arrangements		**4,297**	2,376	8,319
Factor advances		**(3,778)**	(1,864)	(6,785)
		519	512	1,534
Trade and other debtors		**8,291**	9,306	16,024
Cash at bank and in hand		**3,901**	4,269	4,183
		21,634	20,011	33,968
Creditors: amounts falling due within one year		**(15,131)**	(11,979)	(24,484)
Net current assets		**6,503**	8,032	9,484
Total assets less current liabilities		**8,854**	10,358	11,777
Creditors: amounts falling due after more than one year				
Other creditors		**–**	(3)	–
Net assets		**8,854**	10,355	11,777
Capital and reserves				
Called up share capital		**2,641**	2,640	2,634
Investment in own shares		**(908)**	(908)	(908)
Capital redemption reserve		**40**	15	40
Share premium		**11,819**	11,810	11,794
Merger reserve		**651**	651	651
Profit and loss account	3	**(5,389)**	(3,853)	(2,434)
Equity shareholders' funds		**8,854**	10,355	11,777

CONSOLIDATED CASH FLOW STATEMENT

	Note	**6 months to 28 February 2005 (unaudited) £'000**	6 months to 29 February 2004 (unaudited) £'000	12 months to 31 August 2004 (audited) £'000
Cash flow from operating activities	5	**1,486**	2,174	3,326
Returns on investment and servicing of finance				
Interest paid (net)		**(405)**	(172)	(453)
Interest element of finance lease rental payments		**–**	(4)	–
Net cash outflow for returns on investments and servicing of finance		**(405)**	(176)	(453)
Taxation		**(678)**	(334)	(315)
Capital expenditure and financial investment				
Payments to acquire tangible fixed assets		**(376)**	(215)	(510)
Sale of tangible fixed assets		**28**	–	9
Net cash outflow for capital expenditure and financial investment		**(348)**	(215)	(501)
Equity dividend paid		**(367)**	(1,050)	(1,626)
Cash (outflow)/inflow before use of liquid resources and financing		**(312)**	399	431
Issue of new shares		**32**		6
Purchase of own shares		**–**	–	(121)
Capital element of finance lease rentals		**(2)**	(4)	(5)
Expenses on conversion of loan stock		**–**	(58)	(60)
Net cash outflow from financing		**30**	(62)	(180)
(Decrease)/increase in cash in the period	6	**(282)**	337	251
(Increase)/decrease in net debt in the period	7	**(280)**	341	256

NOTES TO THE ACCOUNTS

1. BASIS OF PREPARATION

The financial information for the six months ended 28 February 2005 has not been audited, nor has the financial information for the six months ended 29 February 2004. However, the interim report includes a review report signed by the auditors. The comparative figures for the year ended 31 August 2004 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 2004 Annual Report.

Re-statement

The profit and loss account comparatives for the 6 months to 29 February 2004 have been re-stated by transferring certain items from selling and distribution costs to adminsitration expenses. This transfer reflects the accounting treatment adopted in the year end accounts.

Exceptional Item

The exceptional item for the year ended 31 August 2004 relates to the sum received by World Wide Licenses Limited ("WWL") on settlement of its dispute with Uniden America Corporation ("Uniden"), and the costs incurred by WWL since Uniden terminated its distribution agreement.

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. PROFIT AND LOSS ACCOUNT

	£'000
At 1 September 2004	(2,434)
Loss retained for the six months	(2,572)
Exchange difference	(383)
At 28 February 2005	(5,389)

4. 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 2005 (Loss)/profit after taxation £	Weighted average number of ordinary shares	Pence per share
Basic earnings per share	(1,994,000)	52,407,183	(3.80)
Impact of share options	–	–	–
Diluted earnings per share	(1,994,000)	52,407,183	(3.80)
	6 months to 29 February 2004		
Basic earnings per share	1,990,000	47,110,052	4.22
Impact of share options	–	1,289,706	(0.11)
Diluted earnings per share	1,990,000	48,399,758	4.11
	12 months to 31 August 2004		
Basic earnings per share	3,727,000	49,811,576	7.48
Impact of shares option schemes	–	1,190,106	(0.17)
Impact of convertible loan note	–	–	–
Diluted earnings per share	3,727,000	51,001,682	7.31

5. RECONCILIATION OF OPERATING (LOSS)/PROFIT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	6 months to 28 February 2005 (unaudited) £'000	6 months to 29 February 2004 (unaudited) £'000	12 months to 31 August 2004 (audited) £'000
Operating (loss)/profit	**(1,525)**	2,191	3,677
Depreciation, impairment and amortisation	**280**	423	767
Loss/(profit) on disposal of tangible fixed assets	**7**	–	(7)
Decrease/(increase) in stocks	**3,304**	2,219	(4,084)
Decrease in debtors	**8,755**	8,859	1,843
(Decrease)/increase in creditors	**(8,952)**	(10,809)	1,671
Exchange differences	**(383)**	(709)	(541)
Net cash inflow from operating activities	**1,486**	2,174	3,326

6. RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

	6 months to 28 February 2005 (unaudited) £'000	6 months to 29 February 2004 (unaudited) £'000	12 months to 31 August 2004 (audited) £'000
(Decrease)/increase in cash in the period	**(282)**	337	251
Cash inflow from movement in debt and lease financing	**2**	4	5
Movement in net debt resulting from cash flows	**(280)**	341	256
Net debt at 1 September 2004	**4,179**	3,923	3,923
Net debt at 28 February 2005	**3,899**	4,264	4,179

7. ANALYSIS OF NET DEBT

	Cash at bank and in hand £'000	Lease finance £'000	Total £'000
1 September 2003	3,932	(9)	3,923
Cash flow	337	4	341
29 February 2004	4,269	(5)	4,264
Cash flow	(86)	1	(85)
31 August 2004	4,183	(4)	4,179
Cash flow	(282)	2	(280)
28 February 2005	3,901	(2)	3,899

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 2005 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.

This report, including the conclusion, has been prepared for and only for the Company for the purpose of the Listing Rules of the Financial Services Authority and for no other purpose. We do not, therefore in producing this report, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Directors' responsibilities

The interim report, including the financial information contained therein, is the responsibility of, and has been approved by the directors. The Listing Rules of the Financial Services Authority 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. 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. 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 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 2005.

Baker Tilly
Chartered Accountants
Chelmsford
20 April 2005

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