

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW

During the financial year ended 31 March 2005, the Group attained a turnover of HK\$101.1 million (2004: HK\$19.2 million) and a gross profit of HK\$17.7 million (2004: gross loss of HK\$7.2 million). Net loss for the year amounted to HK\$130.3 million (2004: HK\$19.6 million).

The increase in turnover of the Group for the year primarily resulted from the recognition of revenues derived from the provision of CG animation services and the licensing of the Group's first CG animation production, *Zentrix*TM, which in aggregate contributed HK\$90.6 million, approximately 89.6%, to the Group's total turnover.

On the investment side, the Group disposed of its entire 11.54% interest in Kabushiki Kaisha Mad House to an independent third party and achieved a gain of HK\$7.8 million during the financial year.

Net loss for the year mainly resulted from i) the provision for tax and related expenses of HK\$93.6 million relating to the past festive products manufacturing business that was disposed of by the Group in August 2002; and ii) the share of after-tax loss from an associate of the Group, Boto International Holdings Limited ("BIHL"), which is engaged in the manufacture and sale of Christmas festive products and leisure furniture, of HK\$21.8 million.

During the year, the Group has rapidly expanded through the establishment of a new animation studio. The expanded studio occupies 3 storeys of the same commercial building in Chai Wan with a total area of over 51,000 square feet and is fully-equipped with the latest state-of-the-art technologies and equipment. This expansion, together with the pre-production development of various new projects which will be produced in the new studio, are mainly funded by two fund-raising exercises during the financial year:

- a) a rights issue on 6th May 2004, where 68,936,500 shares were allotted at an issue price of HK\$1.08 per rights share on the basis of one (1) share for every two (2) existing shares held by shareholders on the register of members on 16th April 2004. A total cash consideration, before share issue expenses, of approximately HK\$74.5 million was raised; and
- b) a placing and top-up subscription on 19th July 2004, where 26,000,000 shares were placed and subscribed for and total net proceeds amounted to approximately HK\$39.7 million.

The strengthened financial position of the Group via the rights issue and the placing and subscription transactions has not only enabled the Group to further enhance its animation studio but also allowed it to pool better resources into the Group's strategic business developments in the CG animation industry.

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

CG Animation Pictures

In late 2004, the Group completed the CG animated direct-to-video feature film titled *Digimon*, a co-production with Bandai and Toei. The 80.5 minutes of length *Digimon* film premiered on television in Japan on 3rd January 2005 and the graphics of which especially received applause ratings.

Around the same time, the Group also completed and delivered the 13-episode CG animation TV Series titled *FOTP* which DreamWorks, a top Hollywood animation studio, exclusively engaged the Group for its provision of CG production services since early December 2003. *FOTP* was the first animated TV Series produced by DreamWorks and was first released in August 2004 on prime-time television network NBC of the United States of America. The DVD version of the show has been released in June 2005.

Accordingly, turnover and corresponding costs in relation to the two productions had been recognised in the annual results for the financial year ended 31st March 2005.

In addition to the production services income, the Group also earned royalty income from the licensing of distribution rights over *Zentrix*TM from the United States of America and Canada during the financial year.

Management Consultancy Services

Fee income generated from the provision of management consultancy services by the Group both in Hong Kong and outside of Hong Kong to its associate, BIHL, under a management consultancy agreement remained stable throughout the financial year.

PROSPECTS

The Group's cooperation with world leading studios has given the Group much valued experience and exposure. Building on these gains, the Group's bright future lies in the worldwide release of its proprietary animation films.

The Group has secured the license from Mirage Studios, Inc. and is currently developing the first CG animation movie of the famous *TMNT* franchise. Having entered into global distribution agreements with international film distributors Warner Bros. Pictures, Inc. and The Weinstein Company LLC for the worldwide release of *TMNT*, the movie is expected to give a new visual and aural experience to *TMNT* fans worldwide in early 2007. Warner Bros. Pictures, Inc. is one of the world's leading film distribution companies. The Weinstein Company LLC is a film distribution company founded by Harvey and Bob Weinstein, co-chairmen of Miramax Film Corporation ("Miramax") who led Miramax in distributing countless Oscar winners and successful films. Built on the historical success of *TMNT* in live-action movies, television series and toy collections, and compounded with the Group's proven CG animation capabilities, the Group is confident that the *TMNT* CG animation movie will add another glorious chapter to the success story of the *TMNT* franchise.

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)**PROSPECTS** (Continued)

A top title deserves a world-class production. *TMNT* will be produced in the Group's new over 51,000 square feet studio utilizing state-of-the-art hardware and software. The Group's research and development team has also developed and will continue to develop new software and techniques, such as the life-like muscle and fur systems, in order to ensure that the movie will appear as vivid as it could possibly be. Kevin Munroe, who was ranked as one of Animation Magazine's "Rising Stars of CGI"¹ and has worked on various projects for Disney, Warner Bros., Cartoon Network, Fox Kids, and Nickelodeon, etc., will be the screenplay writer and the director of the *TMNT* film. Munroe will also lead a group of Hollywood artists to spearhead the movie's creative and art direction from the Group's studio in Los Angeles, USA. The Group is confident that *TMNT* will not only be a breakthrough in the production quality of the Group, but will also set a benchmark for Asia's animation industry.

The production of *Highlander SV* is also well under way. The 2-dimensional animated direct-to-video movie will be based on the famous western *Highlander* franchise, which has established an international fan base via its many television series and three live-action movies, including that starred by Sean Connery and Christopher Lambert. Through *Highlander SV*, the Group is creating a new genre of animation film where a well accepted western epic is given life by the artistry of Japanese anime. The East meets West fusion takes place not only in the movie but also in the production of *Highlander*. Director Yoshiaki Kawajiri (*Animatrix*, *Ninja Scroll*) works closely with scriptwriter Adam Abromwitz (writer of the original *Highlander* television series) and producers in the USA and directs the production which the Group has outsourced to leading Japanese animation studio Kabushiki Kaisha Mad House. Distribution agreements have already been entered into for territories of North America, United Kingdom and Japan. This global collaboration is scheduled to embrace worldwide audiences in the second half of 2006.

Concurrent with the development of the above two titles, the Group is sourcing and creating new and exciting concepts and stories that will be developed into new proprietary titles. One of the more advanced stories is a family-oriented movie featuring humanized animal characters. The Group has commenced initial presale marketing to international film distributors and responses have been encouraging.

To fully utilize the resources and diversify into synergistic businesses, the Group has started two new business streams – visual effects and game development.

¹ CGI stands for Computer Graphics Imagery

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

PROSPECTS (Continued)

The application of CG animation and visual effects into live-action movies has been very popular in the film industry. With the Group's established CG animation quality and technology, the Group has ventured into this line of business by way of various contract works from film makers. With initial target market set on Asia, the Group's visual effects business will be undertaken under the Group's subsidiary branding of iDream Production Limited ("iDream"). The first project of which it is responsible for all CG visual effects is a movie made by a renowned Hong Kong film company featuring many award winning actors and actresses slated for release in August 2005. Other projects are currently under discussion with filmmakers who share the Group's prizing for quality. The Group will continue to work with renowned Asian studios to create top quality visual effects that can rival with the best. The same subsidiary branding shall also be applied for Asia-oriented animation projects contemplated by the Group. iDream will work with renowned local creative talents to craft a line of animation projects tailored for the Asian market, with a focus towards the huge market of The People's Republic of China.

With robust research and development support as well as a strong background in CG animation, the Group is also exploring opportunities in the lucrative video game market. The Group is currently discussing with various mainstream international video game publishers in relation to outsourced game development and game publishing arrangements.

With movies set for release in 2006, 2007 and more to come in the future, and a prudent diversification into synergistic businesses, the Group has the will and is confident of its ability to become Asia's top CG animation studio.

LIQUIDITY AND FINANCIAL RESOURCES

The Group generally finances its operations with internally generated cash flows and banking facilities. As at 31st March 2005, the Group had available aggregate banking facilities of HK\$105.7 million. The Group's cash deposits and bank balances as at that date amounted to approximately HK\$139.3 million (of which, an amount of HK\$39.8 million were pledged bank deposits). The Board believes that the Group has sufficient financial resources to discharge its debts and finance its operations and capital expenditures.

Further, the Group has maintained a sound capital structure with a current ratio of 1.6 and a gearing ratio of 0.12% (being total borrowings to total assets) at balance sheet date.

FOREIGN EXCHANGE EXPOSURE

Transactions of the Group are predominately denominated in Hong Kong dollars, US dollars, Euro and Japanese Yen, no hedging or other instruments to reduce the currency risks have been implemented during the year. However, review of the Group's exposure to foreign exchange risk is conducted periodically and derivative financial instruments may be used to hedge against such risks when necessary.

MANAGEMENT DISCUSSION AND ANALYSIS *(CONTINUED)***CHARGES ON ASSETS**

As at 31st March 2005, the Group had no charges on any of its assets.

CONTINGENT LIABILITIES

As at 31st March 2005, except for that disclosed in note 10, the Group had no significant contingent liabilities.

HUMAN RESOURCES

As at 31st March 2005, the Group employed over 340 full-time staff worldwide. Details of the Group's emolument policy is set out on page 23.