



MILKYWAY IMAGE

Milkyway Image Holdings Limited

銀河映像控股有限公司

(incorporated in the Cayman Islands with limited liability)

Third Quarterly Report 2005

CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET (“GEM”) OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE “STOCK EXCHANGE”)

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The Stock Exchange takes no responsibility for the contents of this report, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of the report.

This report, for which the directors of Milkyway Image Holdings Limited (the “Directors”) collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on GEM of the Stock Exchange (the “GEM Listing Rules”) for the purpose of giving information with regard to Milkyway Image Holdings Limited. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: 1. The information contained in this report is accurate and complete in all material respects and not misleading; 2. There are no other matters the omission of which would make any statement in this report misleading; and 3. All opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

CONTENTS

	<i>Pages</i>
Highlights	2
Unaudited Quarterly Results	3
Financial and Business Review	8
Prospects	9
Other Information	10

HIGHLIGHTS

1. Turnover of the Group for the nine months ended 31 December 2005 was approximately HK\$10 million, representing a decrease of approximately 73% as compared with the corresponding period in 2004.
2. Loss of the Group for the nine months ended 31 December 2005 was approximately HK\$14.7 million as compared with the loss of approximately HK\$1.5 million for the corresponding period in 2004.
3. Loss per share of the Group was approximately HK 1.82 cents for the nine months ended 31 December 2005 (2004: HK 0.18 cents).
4. The Board does not recommend the payment of any dividend for the nine months ended 31 December 2005 (2004: HK\$ Nil).

UNAUDITED QUARTERLY RESULTS

The Directors announce the unaudited consolidated results of Milkyway Image Holdings Limited (the "Company") and its subsidiaries (together, the "Group") for the three months and nine months ended 31 December 2005 together with the comparative unaudited figures for the corresponding periods in 2004 as follows:

	Notes	Three months ended 31 December		Nine months ended 31 December	
		2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
Turnover	2	–	2,600	9,977	36,836
Cost of sales		–	(608)	(7,391)	(25,619)
Gross profit		–	1,992	2,586	11,217
Other revenue	2	70	532	207	764
Other operating expenses		(5,836)	(4,450)	(17,032)	(13,422)
Loss from operations		(5,766)	(1,926)	(14,239)	(1,441)
Finance costs	3	(198)	(3)	(451)	(9)
Loss before taxation		(5,964)	(1,929)	(14,690)	(1,450)
Taxation	4	–	–	–	–
Loss attributable to equity holders of the Company		(5,964)	(1,929)	(14,690)	(1,450)
Dividend	5	–	–	–	–
Loss per share (HK cents)	6				
Basic		(0.74)	(0.24)	(1.82)	(0.18)
Diluted		(0.74)	N/A	(1.82)	N/A

NOTES

1. Basis of preparation

The unaudited consolidated results of the Group have been prepared in accordance with the applicable disclosure requirements of Chapter 18 of the GEM Listing Rules. They should be read in conjunction with the Group's annual financial statements for the year ended 31 March 2005. The accounting policies and methods of computation used in the preparation of these unaudited consolidated results are consistent with those used in the preparation of the Group's annual financial statements for the year ended 31 March 2005 except for the adoption of the new Hong Kong Financial Reporting Standard 2 "Share-based payment" ("HKFRS 2").

HKFRS 2 requires recognition as expense the fair value of goods and services received where payment is made in the form of the Company's equity instruments, including share options. The adoption of HKFRS 2 resulted in the recognition of fair value of share options granted during the period of approximately HK\$1,030,000 being included in other operating expenses in the three months and nine months period ended 31 December 2005.

2. Turnover and Other revenue

The principal activities of the Group are the provision of film production services, production of television movies, investment in film productions and worldwide film distribution.

An analysis of the turnover and other revenue of the Group during the reporting periods is as follows:

	For the three months ended 31 December		For the nine months ended 31 December	
	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
Turnover:				
Film production	–	2,600	650	36,836
Film distribution	–	–	9,327	–
	–	2,600	9,977	36,836
Other revenue:				
Interest income	26	1	29	1
Sundry income	44	531	178	763
	70	532	207	764
Total income	70	3,132	10,184	37,600

3. Finance costs

	For the three months ended 31 December		For the nine months ended 31 December	
	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
Interests on:				
Bank loans wholly repayable within five years	62	–	147	–
Other borrowings	131	–	297	–
Finance leases	5	3	7	9
	198	3	451	9

4. Taxation

No provision for Hong Kong Profits Tax has been made for the three months and nine months ended 31 December 2005 (three months and nine months ended 31 December 2004: Nil) as the Group had no estimated assessable profits for the periods. The Group did not generate any assessable profits in other jurisdictions during these periods.

A deferred tax asset has not been recognized in the financial statements in respect of estimated tax losses due to the unpredictability of the future profit streams.

5. Dividend

The Directors do not recommend the payment of any dividend for the nine months ended 31 December 2005 (2004: Nil).

6. Loss per share

The calculation of the basic and diluted loss per share is based on the following data:

	For the three months ended 31 December		For the nine months ended 31 December	
	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000	2004 (Unaudited) HK\$'000
Loss for the periods				
Loss attributable to equity holders of the Company	(5,964)	(1,929)	(14,690)	(1,450)
Number of shares				
Weighted average number of ordinary shares used in the calculation of basic loss per share	805,000,000	805,000,000	805,000,000	790,363,636
Effect of dilutive potential ordinary shares	–	N/A	–	N/A
Weighted average number of ordinary shares used in the calculation of diluted loss per share	805,000,000	N/A	805,000,000	N/A

The computation of diluted loss per share for the three months and nine months ended 31 December 2005 did not assume the exercise of the Company's outstanding share options existed during those periods since their exercise would reduce loss per share. No diluted loss per share for the three months and nine months ended 31 December 2004 were presented as there were no potential dilutive ordinary shares in issue during those periods.

7. Movement of reserves

	Share premium HK\$'000	Share-based		Accumulated losses HK\$'000	Total HK\$'000
		Contributed surplus HK\$'000	compensation reserve HK\$'000		
At 1 April 2004	11,387	10	-	(7,543)	3,854
Issue of shares	4,347	-	-	-	4,347
Share issue expenses	(684)	-	-	-	(684)
Loss for the nine months ended 31 December 2004	-	-	-	(1,450)	(1,450)
At 31 December 2004	15,050	10	-	(8,993)	6,067
At 1 April 2005	15,050	10	-	(15,908)	(848)
Loss for the nine months ended 31 December 2005	-	-	-	(14,690)	(14,690)
Share option scheme - value of employee services	-	-	1,030	-	1,030
At 31 December 2005	15,050	10	1,030	(30,598)	(14,508)

8. Related Party Transactions

- (a) During the period under review, two private companies of which Mr. Law Sau Yiu ("Mr. Law") and Ms. Teng Chia Lin, Chialina ("Ms. Teng"), both executive directors of the Company, are directors and/or shareholders, have advanced loans to the Group. The loans are unsecured, bear interest at commercial rate and are repayable within one year from the date of advances. At 31 December 2005, the aggregate amount of loans was HK\$13 million (2004: Nil). During the three months and nine months ended 31 December 2005, the Group paid interest of approximately HK\$131,000 and HK\$297,000 (2004: Nil) to the lenders.

- (b) During the period under review, Mr. Law continued to provide personal guarantee to a bank to secure facilities granted to the Group. The facility is also secured by listed securities, other than that of the Company, placed by Mr. Law having discounted market value not less than the amount of banking facility utilised by the Group from time to time. No fee in respect of the provision of personal guarantee was paid to him by the Group during the period (2004: Nil). The facility utilized by the Group at 31 December 2005 amounted to HK\$5 million (2004: Nil).

FINANCIAL AND BUSINESS REVIEW

For the nine months ended 31 December 2005, the Group recorded a turnover of approximately HK\$10 million (2004: HK\$36.8 million) and a loss attributable to equity holders of the Company of approximately HK\$14.7 million (2004: HK\$1.5 million).

During the period under review, the Group completed the production of two film projects titled, "The Unusual Youth" [非常青春期] and "Election" [黑社會]. Distribution income recognized for the nine months ended 31 December 2005 in accordance with the Group's revenue recognition policy amounted to approximately HK\$9.3 million (2004: Nil). Apart from the distribution income, revenue in respect of the provision of film production service generated during the period under review amounted to approximately HK\$0.7 million (2004: HK\$36.8 million).

Gross profit amounted to approximately HK\$2.6 million for the nine months ended 31 December 2005 (2004: HK\$11.2 million) with a gross profit ratio of approximately 26% as compared with the corresponding period in 2004 of approximately 30%.

A loss attributable to equity holders of the Company of approximately HK\$14.7 million was recorded for the nine months ended 31 December 2005 mainly due to the significant reduction of turnover from that in the corresponding period in 2004. No turnover was recorded in the third quarter ended 31 December 2005 in accordance with the Group's revenue recognition policy.

During the review period in 2004, three large-scale film projects were completed and delivered and all the production service income was recognized whereas in the current period, distribution income was recognized based upon the delivery of master material to individual customer for exhibition in various regions. Accordingly, only those films with their master material delivered were recognized in current period as revenue and those completed but pending for delivery were recorded as part of the cost of film rights.

During the period under review, the Group utilized the majority of its resources over the investment in its own productions apart from the provision of production services to outsider film companies. As a consequence, it incurred extra amount of marketing and promotion expenses for publicizing the film projects invested by itself during the period which in turn led to an overall increase in other operating expenses. Furthermore, the Group incurred interest expenses in respect of bank loan and loans from related companies. No such interest expenses were recorded in the corresponding period in 2004.

In addition, during the current period, the Group granted option to subscribe for 64,400,000 shares of the Company to Mr. To Kei Fung (“Mr. To”) (being a former director of the Company, currently the chief executive officer, an employee of the Company) under the Company’s Share Option Scheme. The fair value of options granted amounted to approximately HK\$1 million and was recorded as staff cost in the period (2004: Nil).

Regarding film productions, two film projects titled, “The Unusual Youth” [非常青春期] and “Election” [黑社會] invested by the Group itself have completed whereas another film project also invested by the Group is at its post-production stage at the date of this report. A number of film projects to which the Group being engaged to render service are in the course of production whereas several other film projects are in the pre-production phases.

During the period under review, the film, “Election” [黑社會], has entered into the 2005 Cannes International Film Festival as ‘Official Competition Film’ and has been invited as Official Entry to the 2005 London Film Festival, to the 2005 Torino Film Festival, to the 2005 Dubai International Film Festival and as the Closing Film for the 2005 Melbourne International Film Festival. The film was awarded Best Film (Carnet Jove Jury) at the 2005 Sitges International Film Festival of Catalonia whereas the Group’s key film director, Mr. To Kei Fung, was awarded Best Director in this film festival. In the 42nd Golden Horse Awards, the film, “Election” [黑社會], was awarded Best Original Screenplay and Best Sound Effects. It also awarded Best Film and Best Director in the 2005 Hong Kong Film Critics Society.

PROSPECTS

Looking ahead, the Group will continue to focus on its core business of film production and, at the same time, engage in film investment and distribution activities. Several film projects have been contracted or under negotiation. To cope with the increasing number of film projects, the Group has engaged a number of talented film directors to work with the Group’s key film director, Mr. To Kei Fung, in producing top quality films.

Several new customers have been secured by the Group in order to broaden its customer base. Meanwhile, business relationship with existing customers being enhanced. The Group has entered into film production agreements with these new and existing customers.

Apart from the revenue side, the Group will continue to implement cost control measures to ensure a cost-effective operation without compromising the quality of its productions.

With a view to strengthen the Group's growth and resuming the profitability of the Group in the future, the Directors will proactively but cautiously identify every business opportunity to the best interest of the Company's equity holders.

OTHER INFORMATION

1. Directors' And Chief Executives' Interests And Short Positions In Shares, Underlying Shares And Debentures

At 31 December 2005, the interests and short positions of the Directors and chief executives of the Company and their associates in the shares, underlying shares and debentures of the Company and any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), which were notified to the Company and the Stock Exchange pursuant to Division 7 and 8 of Part XV of the SFO (including interests or short positions which they have taken or deemed to have taken under such provisions of the SFO); or which are required to be recorded in the register required to be kept under Section 352 of the SFO; or as otherwise notified to the Company and the Stock Exchange pursuant to Rule 5.46 of the GEM Listing Rules, were as follows:

Long positions in the ordinary shares of HK\$0.01 each of the Company

Name of Director	Personal Interests	Family Interests	Corporate Interests	Other Interest	Total	%
Mr. Law Sau Yiu, Dennis	-	-	370,800,000 (Note)	-	370,800,000	46.06
Ms. Teng Chia Lin, Chialina	-	-	370,800,000 (Note)	-	370,800,000	46.06

Note:

These shares are held by Right Opportune Limited, the entire issued share capital of which is wholly and beneficially owned by Mr. Law Sau Yiu, Dennis. Ms. Teng Chia Lin, Chialina is the spouse of Mr. Law Sau Yiu, Dennis and thus is deemed to be interested in the shares held by Right Opportune Limited.

Outstanding share options

The Company adopted two share option schemes on 2 August 2002, namely, the pre-IPO share option scheme ("Pre-IPO Share Option Scheme") and the share option scheme ("Share Option Scheme"). The principal terms of the two share option schemes have been set out in the note 25 to the financial statements as included in the annual report of the Company for the year ended 31 March 2005.

Pursuant to the Share Option Scheme adopted by the Company and approved by the Company's shareholders at the Extraordinary General Meeting held on 28 October 2005, Mr. To Kei Fung, the chief executive officer of the Company was granted options to subscribe for 64,400,000 shares of the Company's ordinary shares, details of which were as follows:

Name	Date of proposed grant	Date of grant	No. of options granted previously	No. of options granted	Exercise price	Exercise period
Mr. To Kei Fung	16 September 2005	28 October 2005	Nil	64,400,000 (Note a)	HK\$0.04 (Note b)	Between 20 September 2005 to 19 September 2015

Notes:

- (a) 64,400,000 shares representing approximately 8% of the total issued share capital of the Company at the balance sheet date.
- (b) The exercise price represented the higher of the closing price of the Company's shares as stated in the Stock Exchange's daily quotations sheet on 16 September 2005, date of proposed grant, (i.e. HK\$0.04) and a price being the average closing prices of the Company's shares as stated in the Stock Exchange's daily quotations sheets for the 5 Business Days immediately preceding 16 September 2005, date of proposed grant (i.e. HK\$0.04).

Save as disclosed above, at 31 December 2005, none of the Directors or chief executives of the Company or their associates had any interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO), which would have to be notified to the Company and the Stock Exchange pursuant to Division 7 and 8 of Part XV of the SFO (including interests or short positions which they have taken or deemed to have taken under such provisions of the SFO); or which were required to be recorded in the register required to be kept under Section 352 of the SFO; or as otherwise notified to the Company and the Stock Exchange pursuant to Rule 5.46 of the GEM Listing Rules.

2. Directors And Chief Executives' rights To Acquire Shares Or Debentures

Save as disclosed above, at 31 December 2005, neither the Company nor any of its subsidiaries was a party to any arrangements to enable the directors and chief executives of the Company to acquire benefits by means of the acquisition of shares in, or debentures of the Company or any other body corporate, and none of the directors and chief executive of the Company or their spouses or children under the age of 18, had any right to subscribe for the securities of the Company, or had exercised any such rights.

3. Substantial Shareholders

At 31 December 2005, the register of substantial shareholders maintained by the Company under Section 336 of the SFO showed that, other than the interests disclosed above in respect of certain directors, the following shareholders had an interest of 5% or more in the issued share capital of the Company:

Name of shareholder	Number of shares held	% of the Company's issued share capital
Right Opportune Limited	370,800,000 (Note a)	46.06
Grand Sum Assets Limited	59,500,000	7.39
Ms. Lee Po Yi, Shirley Anne	59,500,000 (Note b)	7.39

Notes:

- (a) Please refer to note disclosed above in respect of Directors and chief executive's interests or short positions in shares, underlying shares and debentures.
- (b) Grand Sum Assets Limited is a company wholly and beneficially owned by Ms. Lee Po Yi, Shirley Anne. Accordingly, Ms. Lee Po Yi, Shirley Anne is deemed to be interested in the 59,500,000 shares held by Grand Sum Assets Limited.

Save as disclosed above, at 31 December 2005, the Company has not been notified of any persons (other than the Directors or chief executive of the Company) who had interests or short positions in the shares and underlying shares of the Company which were to be recorded in the register required to be kept under Section 336 of the SFO and/or who were directly or indirectly interested in 5% or more of the issued share capital carrying rights to vote in all circumstances at general meetings of any other members of the Group.

4. Competing Interests

At 31 December 2005, none of the directors, management shareholders and substantial shareholders, or their respective associates had any interests in any business which competes or may compete with the business of the Group pursuant to Rule 11.04 of the GEM Listing Rules.

5. Purchase, Sale Or Redemption Of Listed Securities Of The Company

During the nine months ended 31 December 2005, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

6. Audit Committee

The Company has established an audit committee with written terms of reference in compliance with Rules 5.28 to 5.29 of the GEM Listing Rules. The primary duties of the audit committee are to review and supervise the financial reporting process and internal control procedures of the Group. The audit committee comprises the three independent non-executive directors namely, Mr. Lung Hak Kau, Ms. Wai Lai Yung and Ms. Tsang Kei Ling. The audit committee has reviewed the Group's unaudited condensed consolidated financial statements for the nine months ended 31 December 2005.

7. Remuneration Committee

A Remuneration Committee has been established with written terms of reference in accordance with the requirements of the Code on Corporate Governance Practices. The Remuneration Committee comprises two independent non-executive directors, namely Mr. Lung Hak Kau and Ms. Wai Lai Yung and one executive director, Mr. Law Sau Yiu, Dennis being the chairman of the Remuneration Committee. The principal responsibilities of the Remuneration Committee include recommendation to the Board on the Group's policy and structure for all remuneration of directors and senior managements, the determination of specific remuneration packages of all executive directors and senior managements, and review and approve performance-based remuneration.

8. Compliance With Rules 5.48 To 5.67 of The GEM Listing Rules

The Company has adopted a code of conduct regarding Directors' securities transactions on terms no less exacting than the required standard of dealings as set out in Rules 5.48 to 5.67 of the GEM Listing Rules. Having made specific enquiry of all Directors, all Directors have complied with such code of conduct and the required standard of dealings regarding directors' securities transactions throughout the nine months ended 31 December 2005.

9. Board of Directors

As at the date of this report, the executive directors of the Company are Mr. Law Sau Yiu, Dennis (Chairman), Ms. Teng Chia Lin, Chialina and Ms. Chan Dao Ho; the independent non-executive directors of the Company are Mr. Lung Hak Kau, Ms. Wai Lai Yung and Ms. Tsang Kei Ling.

By order of the Board
Milkyway Image Holdings Limited
Law Sau Yiu, Dennis
Chairman

Hong Kong, 10 February 2006