



MILKYWAY IMAGE

Milkyway Image Holdings Limited

銀河映像控股有限公司

(incorporated in the Cayman Islands with limited liability)

(Stock Code: 8130)

Annual Report 2006

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The principal means of information dissemination on GEM is publication on the Internet website operated by the Stock Exchange. Listed companies on GEM are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website at www.hkgem.com in order to obtain up-to-date information on GEM-listed issuers.

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 collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM of the Stock Exchange for the purpose of giving information with regard to Milkyway Image Holdings Limited. The directors of Milkyway Image Holdings Limited, 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.

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Corporate Information

Executive Directors

Mr. Law Sau Yiu, Dennis (*Chairman*)
 Ms. Teng Chia Lin, Chialina
 Ms. Chan Dao Ho

Independent Non-Executive Directors

Mr. Lung Hak Kau
 Ms. Wai Lai Yung
 Ms. Tsang Kei Ling

Qualified Accountant

Mr. Lee Wai Ming

Company Secretary

Mr. Lee Wai Ming

Authorised Representatives

Mr. Law Sau Yiu, Dennis
 Mr. Lee Wai Ming

Compliance Officer

Mr. Law Sau Yiu, Dennis

Audit Committee

Mr. Lung Hak Kau
 Ms. Wai Lai Yung
 Ms. Tsang Kei Ling

Registered Office

Century Yard
 Cricket Square
 Hutchins Drive
 P.O. Box 2681GT
 George Town
 Grand Cayman
 British West Indies

Head Office and Principal Place of Business

1st Floor, 77 Hung To Road
 Kwun Tong
 Kowloon
 Hong Kong

Company Website

<http://www.milkywayimage.com>

Note: Information contained in this website does not form part of this annual report

Principal Banker

Hang Seng Bank
 The Bank of East Asia

Principal Share Registrar and Transfer Office

Bank of Bermuda (Cayman) Limited
 Strathvale House
 North Church Street
 George Town
 Grand Cayman
 Cayman Islands
 British West Indies

Hong Kong Branch Share Registrar and Transfer Office

Secretaries Limited
 Level 25, Three Pacific Place
 1 Queen's Road East
 Hong Kong

Auditors

CCIF CPA Limited

Legal Advisers to the Company

as to Hong Kong Law
 Gallant Y. T. Ho & Co.

as to the Cayman Islands Law
 Conyers Dill & Pearman, Cayman

Stock Code

8130

Chairman's Statement

On behalf of the board (the "Board") of directors (the "Directors") of Milkyway Image Holdings Limited (the "Company"), I have pleasure in presenting to the shareholders of the Company the 2006 annual report of the Company and its subsidiaries (the "Group").

The financial year ended 31 March 2006 continued to be a difficult year to the Hong Kong film industry. Despite of the recovery of the local economy, the film industry was yet to benefit from it. Infringement of intellectual property rights by ways of piracy of video products and illegal internet downloading of video contents remained an unresolved issue to be faced by peer film-makers. The direct impact of these kinds of illegal activities is the erosion of box office receipts and adversely affects the profitability of investments in film productions and, as a consequence, discourages investor's enthusiasm in putting huge investments in making films.

Notwithstanding the increasing conservatism taken by film investors, the Group, as one of the leading film production companies in Hong Kong, was able to retain its competitiveness niche in its peer group by delivering top quality productions to its customers and to the audience. During the year, the Group produced three film projects which achieved encouraging box office receipts. Among the film projects produced, the film, "Election"「黑社會」not only achieved outstanding box office receipts but received a number of awards and acclaims both locally and overseas which included the awards of Best Film, Best Director, Best Screenplay and Best Actor in the 25th Hong Kong Film Awards and the awards of Best Original Screenplay and Best Sound Effects in the 42nd Golden Horse Awards. I strongly believe that top quality productions by talented film directors and scriptwriters and supported by professional production crew is the only way to survive the film industry and bring a success to the Group.

During the year, the Group employed the talents from new film directors in addition to its core creation team. The films, namely, "The Unusual Youth"「非常青春期」and "2 Become 1"「天生一對」came from the productions of these new film directors which introduced a fresh facet of the Group's productions.

Several new customers have been secured by the Group in this financial year. At the date of this report, a number of film projects with these new customers and existing customers are either in their production stages or in the pre-production stages. To cope with the increasing number of film projects, the Group will continue to employ talents from different film directors and scriptwriters whereas supported by the film producer service from the Group's existing expertise to ensure the quality of the final products.

Apart from focusing on the provision of film production service business, the Group has also commenced investing in its own productions in the previous financial year and revenue from film distribution was recorded in this year. The Group expects its film distribution activity will continue in the future in order to broaden its revenue base.

The Group faced a challenging operating environment in the past year. In view of the recovery of the local economy whereas at the same time the arising of inflation problem, the increasing operating overhead and cost of production will remain a challenge to the Group in the coming year. Looking ahead, the Group will continue to produce quality films in a cost effective manner and explore any business opportunities which are beneficial to its shareholders.

Chairman's Statement

Finally, I would like to thank our board of directors, management, staff and all production crews for their contributions to the Group. I would also like to extend my sincere gratitude to our shareholders, business partners, customers and suppliers for their continued supports.

Law Sau Yiu, Dennis

Chairman

Hong Kong, 26 June 2006

Management Discussion and Analysis

FINANCIAL REVIEW

Financial Performance

The Group recorded a turnover for the year ended 31 March 2006 of approximately HK\$17.3 million (2005: HK\$36.8 million), representing a drop of approximately 53% when compared to that of previous financial year. The drop in turnover was due to the change in composition of revenues this year. In the previous financial year, the Group's turnover was solely derived from the production of films and revenue was recognized in full upon delivery of film negatives to film owners. During the year, more than half of the Group's turnover was derived from the film distribution activity and the corresponding revenue will be recognized based upon the delivery of master material to individual customer for exhibition in various regions. Accordingly, only those distribution incomes from regions where master material have been delivered were recognized in the year as revenue.

For the year ended 31 March 2006, the Group recorded a net loss of approximately HK\$18.2 million (2005: HK\$8.4 million). The increase in net loss this year was partly due to the reduction of turnover recorded and partly due to the fact that the Group incurred extra amount of marketing and promotion expenses for publicizing the film projects invested by itself during the year. Coupled with the increase in financing cost and staff costs, the overall expenditures of the Group increase as a result.

Gross profit ratio also reduced slightly from approximately 25% last year to 22% this year due to the high amortisation of film rights included in the cost of sales.

Liquidity, Financial Resources and Capital Structure

A deficit in shareholders' funds of the Group as at 31 March 2006 amounted to approximately HK\$9.9 million (2005: surplus in shareholders' funds of HK\$7.2 million) was recorded. Current assets amounted to approximately HK\$32.8 million (2005: HK\$21.1 million), of which approximately HK\$3.6 million (2005: HK\$2.9 million) were bank balances and cash. Current liabilities amounted to approximately HK\$54.6 million (2005: HK\$28.9 million) mainly comprised advanced receipts from film companies, bank loan of revolving nature and amounts due to related companies. At 31 March 2006, the Group had bank loan and loans from related companies amounted to HK\$3 million (2005: HK\$5 million) and HK\$15 million (2005: HK\$4 million) respectively. The Group also incepted a new finance lease of HK\$230,000 during the year for the financing of purchase of property, plant and equipment.

The Group generally financed its film production activities and other operations with inflow of advanced receipts from film companies. To cope with the continuous expansion of business activities namely investment in film productions, the Group incepted bank borrowings to provide funds for its general working capital and procured loans from related companies to finance its film production activities. All the Group's borrowings bear interest at commercial rates.

Management Discussion and Analysis

Foreign Exchange Exposure

As the majority of the Group's business transactions for the year ended 31 March 2006 and its assets and liabilities at the balance sheet date were denominated in Hong Kong Dollars and United States Dollars, the risk on fluctuation in exchange rates was considered to be minimal. Accordingly, the Group did not enter into any foreign exchange contract for hedging purpose.

Material Acquisition, Disposal and Significant Investments

For the year ended 31 March 2006, the Group did not made any significant capital investment other than investment in film projects which were recorded as films in progress at the production stage and transferred to film rights upon completion. The Group owns these film rights for future distribution purpose.

Apart from the aforesaid, the Group made no other material acquisitions or disposals of subsidiaries or any other investments during the year ended 31 March 2006.

Employees and Remuneration Policies

As at 31 March 2006, the Group employed a total of 22 employees (2005: 22), including the executive directors. The Group remunerated its employees in accordance with their work performance and experience. The Directors had their discretions in granting share options and bonuses to the Group's employees depending upon the work performance of particular employee and the financial performance of the Group. During the year, the Group granted options to subscribe for 64,400,000 shares of the Company's ordinary shares to the chief executive officer of the Group, Mr. To Kei Fung. No share options were granted in previous year. For the year ended 31 March 2006, total staff costs, including Directors' emoluments, amounted to approximately HK\$11.1 million (2005: HK\$9.5 million).

Charges on Group Assets

As at 31 March 2006, the Group did not have any charges on its assets.

Gearing Ratio

As at 31 March 2006, the gearing ratio, expressed as a percentage of total liabilities over total assets, was 122.2% (2005: 80.1%).

Contingent Liabilities

As at 31 March 2006, the Group did not have any material contingent liabilities.

Management Discussion and Analysis

BUSINESS REVIEW

Segment Information

For the year ended 31 March 2006, the Group's total turnover amounted to approximately HK\$17.3 million, of which approximately HK\$9.3 million or 54% was derived from film distribution and the remaining of approximately HK\$7.9 million or 46% was derived from film production. In prior year, the entire turnover was derived from film production.

During the year, the Group aligned its resources to focus more on investing in its own productions for distribution purpose. As such, services rendered to outsiders have reduced which resulted in reduced revenue from film production.

Film distribution become one of the major sources to the Group's overall revenue during the year as compared to the revenue generated from provision of production services to outsiders. Although the results of the film distribution business, net of attributable costs and expenses, did not bring a positive contribution to the Group's overall results for the year, it was believed that expenses incurred in the year for marketing and promotion can benefit the Group's overall performance in the subsequent year.

For the year ended 31 March 2006, the Group did not produce any television movies. Nevertheless, the Group will continue to explore business opportunities in this segment in the future.

Sales and Marketing

With the aim of raising public awareness and enhancing the sales potential of the films produced by the Group, the Group continued to actively promote and market its films by participating in both local and international film festivals and it became an integral part of the Group's marketing strategy.

Management Discussion and Analysis

The Group has not only earned praises and achieved encouraging box office receipts in local market for the films produced by itself, but has also proven its competitiveness in international film market. For the year ended 31 March 2006, the films produced by the Group received awards and acclaims as set out below:

| Name of Films | Film Festivals | Awards and Acclaims |
|---------------|--|---|
| Election | The 25th Hong Kong Film Awards | Best Film Best Director Best Screenplay Best Actor |
| | The 6th Chinese Film Media Awards | Best Film Best Actor |
| | The 42nd Golden Horse Awards | Best Original Screenplay Best Sound Effects |
| | 2005 Hong Kong Film Critics Society | Best Film Best Director |
| | 2005 Sitges International Film Festival of Catalonia | Best Film (Carnet Jove Jury) Best Director |
| | 2005 Cannes International Film Festival | Official Competition Film |
| | 2005 London Film Festival | Official Entry |
| | 2005 Torino Film Festival | Official Entry |
| | 2005 Dubai International Film Festival | Official Entry |
| | 2005 Melbourne International Film Festival | Closing Film |
| 2 Become 1 | 2005 Udine Far East Film Festival | Official Selection |

Film Investment

During the year, the Group completed the production of two film projects titled, "The Unusual Youth" [非常青春期] and "Election" [黑社會]. The Group owns the film rights of these two films for distribution. The corresponding distribution income was recognized during the year in accordance with the Group's revenue recognition policy. At the balance sheet date, several other film projects to which the Group will solely or partially own the film rights are in the production phases or in their pre-production phases. One of these films, titled "Election 2" [黑社會以和為貴] has completed subsequent to the balance sheet date and has released for exhibition in local cinemas with outstanding box office receipts whereas its overseas distribution pre-sale was also encouraging. "Election 2" [黑社會以和為貴] was selected as the Opening Film (World Premiere) for the 30th Hong Kong International Film Festival and as Out of Competition Official Selection of the 2006 Cannes International Film Festival. The Directors are confident in the Group's productions and believe that by investing in the film projects produced by the itself, the Group is able to broaden its recurrent income base and will benefit the shareholders in the long-run.

Management Discussion and Analysis

Film Production

The provision of film production services remained a crucial income source of the Group during the year. The film "2 Become 1"「天生一對」was completed and delivered during the year. The box office receipts of the film was encouraging. At the date of this report, the Group has entered into production agreements with several film companies, to produce and/or to provide production resources for a number of films. The productions of some of these films have commenced at the balance sheet date.

Future Plans for Material Investments

Save as the aforementioned film investment activity, the Group does not have any future plans for material investments.

Prospects

Looking forward, the Group will continue to focus on its core businesses of provision of film production service and, in the mean time, engage in film investment and distribution activities. The Group will also ensure the full utilization of its existing resources by providing production resources and services for other projects produced by other film production companies.

To cope with the increasing number of film projects, the Group has engaged a number of talented film directors and scriptwriters to work with the Group's key film director, Mr. To Kei Fung, in producing top quality films.

The Group will continue to implement prudent cost control measures to ensure a cost-effective operation. It will also adopt a cautious approach in investment in the film productions whereas at the same time, strive to explore every business opportunities which are beneficial to its shareholders.

Profiles of Directors and Senior Management

DIRECTORS

Executive Directors

Mr. Law Sau Yiu, Dennis, aged 43, joined the Group in October 2003 and was appointed as the Chairman. Mr. Law is currently the managing director of Yu Tai Hing Company Limited which is a well-established private property investment and development group in Hong Kong. He has 17 years of experience in property investment and development. Mr. Law is responsible for overall strategic planning and policy making for the Group. He also acts as film director and producer of particular film projects of the Group. Mr. Law holds a Bachelor of Arts Degree in Communications from Loyola Marymount University of Los Angeles, California in the United States of America.

Ms. Teng Chia Lin, Chialina, aged 41, is a practising dental surgeon. Ms. Teng joined the Group in October 2003. She graduated from Guy's Hospital Medical & Dental School of The United Medical and Dental Schools of Guy's and St. Thomas' (now known as the Guy's, King's and St. Thomas' Schools of Medicine, Biomedical Sciences and the Dental Institute), University of London in the United Kingdom in 1989, with a Bachelor degree in Dental Surgery. She joined The Prince Philip Dental Hospital in 1990, and then started her own private practice in 1991. Ms. Teng also held directorship in a number of property investment companies. She is the spouse of Mr. Law.

Ms. Chan Dao Ho, aged 42, was appointed executive director in August 2002 and subsequently resigned from the office of director in October 2003 but remained as the production executive of the Group. She was re-appointed as executive director in August 2005. Ms. Chan is responsible for overseeing and supervising the administration and film production project of the Group. Prior to joining the Group in May 1996, Ms. Chan worked as an assistant director for Film Workshop Limited and then joined DLO Productions Limited as a production manager. Ms. Chan has over 18 years experience in the Hong Kong film industry.

Independent Non-Executive Directors

Mr. Lung Hak Kau, aged 44, was appointed by the Group in August 2004. Mr. Lung has 17 years of experience in investment management and investment banking. He has worked in several multinational financial institutions. He is a Chartered Financial Analyst and is, currently the President of The Hong Kong Society of Financial Analysts and a fellow member of The Hong Kong Institute of Directors.

Ms. Wai Lai Yung, aged 48, was appointed by the Group in September 2004. She has been a director of Yorkshire Capital Limited, a company providing business consultancy service, since 1993. Ms. Wai is a Certified Public Accountant of the Hong Kong Institute of Certified Public Accountants and a fellow member of the Association of Chartered Certified Accountants.

Profiles of Directors and Senior Management

Ms. Tsang Kei Ling, aged 42, was appointed by the Group in January 2005. Ms. Tsang has been a director of C.L. Management Limited, a company providing secretarial and consultancy services, since 1995. She has been a director of a trading company, Great Party Hong Kong Limited, since 2003.

SENIOR MANAGEMENT

Mr. To Kei Fung, aged 51, is the founder of the Group responsible for overseeing and supervising the Group's film production projects. He also acts as film director, producer and consultants of the Group's particular film projects. Mr. To has over 20 years experience in the Hong Kong television and film industries as a producer and director. Prior to establishing the Group in May 1996, Mr. To had worked as a producer for Television Broadcasts Limited for approximately 15 years. He had also held the position of Chief Operational Officer of China Star Laser Disc Co. Ltd. Mr. To was a former executive director of the Company. He resigned from the office of director in August 2005 and was appointed as the chief executive officer of the Group in August 2005.

Ms. Ho Mei Yee, aged 42, re-joined the Group as assistant to the Chief Operating Officer in September 2004. Ms. Ho was previously acted as an independent non-executive director until her resignation in August 2004. Before appointed by the Group as an independent non-executive director in November 2001, she joined Television Broadcasts Limited in 1987 and was later promoted to the Administration Officer position of the drama division. Prior to joining the Group, Ms. Ho was working as the production services controller at China Star I-Content Limited and has accumulated over 17 years of experience in the entertainment industry.

Mr. Ding Yuin-Shan, aged 31, is the Assistant General Manager – Business Development of the Group and is in charge of the Group's business development and promotion. He received a master degree in film theory from New York University. Prior to joining the Group in November 2001, he worked for China Star Entertainment Group as film coordinator and was responsible for overseeing film festival activities.

Mr. Lee Wai Ming, aged 39, is the Financial Controller and Company Secretary of the Group. Prior to joining the Group in May 2004, he has over 10 years experience in the auditing and accounting fields. He received a Bachelor of Arts Degree in Accountancy from the Hong Kong Polytechnics University. He is also a fellow member of the Association of Chartered Certified Accountants and an associate member of the Hong Kong Institute of Certified Public Accountants.

Corporate Governance Report

CORPORATE GOVERNANCE PRACTICE

The Company is committed to achieve high standard of corporate governance practices to protect the interests of its shareholders. The Company has applied the principles and complied with all the applicable code provisions as set out in the Code on Corporate Governance Practices (the "Code") contained in Appendix 15 of the Rules Governing the Listing of Securities on the GEM of the Stock Exchange (the "GEM Listing Rules") for the year ended 31 March 2006.

Directors' Securities Transactions

The Company has adopted a code of conduct regarding securities transactions by Directors 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. After making specific enquiry to all Directors, it is confirmed by the Company that the Directors had complied with such code of conduct and the required standard of dealings as regarding directors' securities transactions throughout the year ended 31 March 2006.

BOARD OF DIRECTORS

Operation of the Board

The Board, chaired by Mr. Law Sau Yiu, Dennis, is responsible for supervision of the management of the business and affairs, approval of strategic plans and reviewing of financial performance. The Board comprises three executive directors and three independent non-executive directors. The names and biographical details of the Directors are set out in the "Profiles of Directors and Senior Management" on pages 10 and 11 of the annual report.

The positions of the Chairman of the Board and the Chief Executive Officer are held separately by two individuals to ensure their respective independence, accountability and responsibility. The Chairman is responsible for overseeing the function of the Board and formulating overall strategies and policies of the Company. The Chief Executive Officer is responsible for managing the Group's business and overall operations. The day-to-day running of the Company is delegated to the management.

Relationship among members of the Board

To the best knowledge of the Company, save and except that Mr. Law Sau Yiu, Dennis, the Chairman, is the husband of Ms. Teng Chia Lin, Chialina, executive director of the Company, there is no financial, business and family relationship among members of the Board. All of them are free to exercise their independent judgment.

Corporate Governance Report

Number of board meeting held during the financial year

The Board convenes at least four regular Board meetings during the financial year at approximately quarterly intervals in addition to other Board meetings that are required for significant and important issues, and for statutory purposes. Appropriate and sufficient information is provided to Board members in a timely manner to keep them abreast of the Group's latest developments and thus can assist them in discharging their duties.

Independent Non-executive Directors

The Company has appointed three Independent Non-executive Directors. Two of the Independent Non-executive Directors have appropriate accounting or related financial management expertise. The Company complies at all time during the year with the requirements of the GEM Listing Rules relating to the appointment of at least three independent non-executive directors and one of which should have appropriate professional qualifications or accounting or related financial management expertise.

The Company has received, from each of the Independent Non-executive Directors, an annual confirmation of his/her independence pursuant to Rule 5.09 of the GEM Listing Rules. The Company considers all of the Independent Non-executive Directors are independent.

Independent Non-executive Directors have been appointed as directors for a term of one year commencing from their respective date of appointments and will continue thereafter unless and until terminated by either the Company or the respective Independent Non-executive Directors. All Independent Non-executive Directors are subject to retirement by rotation and re-election at least once every three years in accordance with the provision of the Company's articles of association.

Corporate Governance Report

Attendance record at Board Meetings

The following table shows the attendance of Directors at meetings of the Board during the year:

| | Number of meeting attended/ Number of meeting held for the year ended 31/3/2006 |
|---|--|
| Directors | |
| <i>Executive Directors</i> | |
| Mr. Law Sau Yiu, Dennis (<i>Chairman</i>) | 5/5 |
| Ms. Teng Chia Lin, Chialina | 5/5 |
| Ms. Chan Dao Ho (appointed on 16 August 2005) | 3/3 * |
| Mr. To Kei Fung (resigned as Executive Director and appointed as Chief Executive Officer on 1 August 2005) | 1/1 ** |
| <i>Independent Non-executive Directors</i> | |
| Mr. Lung Hak Kau | 5/5 |
| Ms. Wai Lai Yung | 5/5 |
| Ms. Tsang Kei Ling | 5/5 |

* Only three board meetings were held after the appointment of Ms. Chan Dao Ho as executive director

** Only one board meeting were held before the resignation of Mr. To Kei Fung as executive director

COMMITTEES OF BOARD

The Board has established committees, namely Audit Committee and Remuneration Committee to oversee particular aspects of the Company's affairs and to assist in the execution of the Board's responsibilities.

Audit Committee

Composition

The Company formulated written terms of reference for the Audit Committee in compliance with Rules 5.28 to 5.33 of the GEM Listing Rules. The Audit Committee consists of three directors, all of which are independent non-executive directors.

The Audit Committee member and their respective attendance record for the year ended 31 March 2006 were:

| | Number of meeting attended/ Number of meeting held for the year ended 31/3/2006 |
|--------------------------------------|--|
| Mr. Lung Hak Kau (<i>Chairman</i>) | 4/4 |
| Ms. Wai Lai Yung | 4/4 |
| Ms. Tsang Kei Ling | 4/4 |

Corporate Governance Report

Role and Function

The Audit Committee is mainly responsible for supervising the Company's internal control system and its execution, evaluating financial information and related disclosure, reviewing the internal control system, auditing major connected transactions and also communicating, supervising and investigating the Company's internal and external audits.

The Audit Committee reviewed the Group's audited results for the year ended 31 March 2006 with the Company's management and recommended its adoption by the Board.

Remuneration Committee

Composition

The Company has established Remuneration Committee with written terms of reference as stated in Code B.1.3 of the Appendix 15 of the GEM Listing Rules. The Remuneration Committee consists of three directors, of which two are independent non-executive directors and Mr. Law Sau Yiu, Dennis is the chairman of the Remuneration Committee.

The Remuneration Committee member and their respective attendance record for the year ended 31 March 2006 were:

| | Number of meeting attended/ Number of meeting held for the year ended 31/3/2006 |
|---|--|
| Mr. Law Sau Yiu, Dennis (<i>Chairman</i>) | 1/1 |
| Mr. Lung Hak Kau | 1/1 |
| Ms. Wai Lai Yung | 1/1 |

Role and Function

The Remuneration Committee is responsible for ensuring formal and transparent procedures for developing remuneration policies and overseeing the remuneration packages of the Executive Directors and senior management. The Remuneration Committee is mainly responsible for formulating the Company's human resources development strategies and plans, approving the human resources development plans, deciding the remuneration standards of directors and senior management, evaluating the gross salary adjustment plans, reward system and option schemes and also modifying the remuneration system. It takes into account factors such as salaries paid by comparable companies with similar size and trade, qualification of each Directors time commitment and responsibilities of Directors. The Remuneration Committee meets at least once a year.

Corporate Governance Report

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Directors acknowledge their responsibilities for the preparation of the financial statements of the Group and ensure that the financial statements are in accordance with statutory requirements and applicable accounting standards. The Directors also ensure the timely publication of the financial statements of the Group.

In the preparation of the financial statements of the Group for the year ended 31 March 2006, the Directors have taken into consideration that the Group sustained a loss attributable to equity holders of the Company of HK\$18,185,000 during the year, reported net current liabilities of HK\$21,757,000 and net liabilities of HK\$9,782,000 as at 31 March 2006. The Directors also understood that a related company of the Group has confirmed to provide continuing financial support to the Group in the form of interest-bearing loan to the extent of HK\$24 million to enable it to settle its liabilities as and when they fall due. Against this background, the Directors confirm that, to the best of their knowledge, information and belief, having made all reasonable enquiries, they are of the opinion that the Group will have sufficient financial resources to satisfy its future working capital and other financing requirements for the foreseeable future. Accordingly, the Directors are satisfied that it is appropriate to prepare the financial statements on a going concern basis, notwithstanding the Group's financial position and tight liquidity as at 31 March 2006.

INTERNAL CONTROLS

The Board has overall responsibility for maintaining a proper and effective system of internal control of the Group. The internal control system includes safeguard of the interest of shareholders and the Group's assets. The Board has delegated to management the implementation of all relevant financial, operational, compliance controls and risk management function within a defined framework. The Company is conducting a review of its system of internal control to ensure the effectiveness and adequacy of the system.

AUDITORS' REMUNERATION

For the year ended 31 March 2006, the external auditors of the Group provided the following services to the Group:

| | 2006 |
|--------------------|-------------|
| | HK\$'000 |
| Audit services | 220 |
| Non-audit services | 15 |
| | <hr/> |
| | 235 |
| | <hr/> <hr/> |

Directors' Report

The directors present their annual report and the audited financial statements of the Company and its subsidiaries (together the "Group") for the year ended 31 March 2006.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The Group is principally engaged in the provision of film production services, production of television movies, investment in film productions and worldwide film distribution. Details of the activities of its subsidiaries are set out in note 18 to the financial statements.

RESULTS

The results of the Group for the year ended 31 March 2006 are set out in the consolidated income statement on page 26 of this annual report.

The directors do not recommend the payment of a dividend.

FINANCIAL SUMMARY

A summary of the results and the assets and liabilities of the Group for the past five financial years is set out on page 70 of this annual report.

PROPERTY, PLANT AND EQUIPMENT

Details of movements during the year in the property, plant and equipment of the Group are set out in note 17 to the financial statements.

SHARE CAPITAL

Details of movements during the year in the share capital of the Company are set out in note 24 to the financial statements.

RESERVES

Movements during the year in the reserves of the Group and the Company are set out in note 25 to the financial statements.

DISTRIBUTABLE RESERVES

At 31 March 2006, the Company did not have any distributable reserves (2005: Nil).

Directors' Report

CHARITABLE DONATIONS

Charitable donations made by the Group during the year amounted to HK\$2,000 (2005: Nil).

DIRECTORS

The Directors of the Company during the year and up to the date of this report were:

Executive directors:

Mr. Law Sau Yiu, Dennis (*Chairman*)

Ms. Teng Chia Lin, Chialina

Ms. Chan Dao Ho (appointed on 16 August 2005)

Mr. To Kei Fung (resigned on 1 August 2005)

Independent non-executive directors:

Mr. Lung Hak Kau

Ms. Wai Lai Yung

Ms. Tsang Kei Ling

In accordance with article 87 of the Company's articles of association, Mr. Law Sau Yiu, Dennis and Mr. Lung Hak Kau shall retire by rotation; and in accordance with article 86 of the Company's articles of association, Ms. Chan Dao Ho, being director appointed after the annual general meeting held on 12 August 2005, will retire at the forthcoming annual general meeting. These directors, being eligible, offer themselves for re-election.

DIRECTORS' SERVICE CONTRACTS

Mr. Law Sau Yiu, Dennis and Ms. Teng Chia Lin, Chialina, both of whom are executive directors, have entered into service agreements with the Company for an initial fixed term of three years commencing from 9 October 2003.

Under the said service agreements, Mr. Law Sau Yiu, Dennis and Ms. Teng Chia Lin, Chialina are entitled to an annual salary of HK\$1,800,000 and HK\$456,000 respectively, subject to any increment at such rate as the board of directors may at its absolute discretion determine and Mr. Law Sau Yiu, Dennis and Ms. Teng Chia Lin, Chialina shall abstain from voting in respect of the resolution regarding such increase.

Mr. Lung Hak Kau entered into a letter of appointment with the Company on 10 July 2004 for a term of one year commencing on 4 August 2004 and will continue thereafter unless and until terminated by either the Company or Mr. Lung Hak Kau and such appointment is subject at all times to the articles of association of the Company.

Directors' Report

Ms. Wai Lai Yung entered into a letter of appointment with the Company on 24 September 2004 for a term of one year commencing on 28 September 2004 and will continue thereafter unless and until terminated by either the Company or Ms. Wai Lai Yung and such appointment is subject at all times to the articles of association of the Company.

Ms. Tsang Kei Ling entered into a letter of appointment with the Company on 20 January 2005 for a term of one year commencing on 21 January 2005 and will continue thereafter unless and until terminated by either the Company or Ms. Tsang Kei Ling and such appointment is subject at all times to the articles of association of the Company.

Save as disclosed above, none of the directors had any existing or proposed service contract with any member of the Group (excluding contracts expiring or determinable by the employer within one year without payment of compensation (other than statutory compensation)).

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

At 31 March 2006, 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:

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

| Name of director | Personal interests | Family interests | Corporate interests | Other interests | Total number of shares held | % of the |
|-----------------------------|--------------------|------------------|-----------------------|-----------------|-----------------------------|--------------------------------|
| | | | | | | Company's issued share capital |
| 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.

Directors' Report

b) Long positions in shares options

| Name of chief executive | Personal interests | Family interests | Corporate interests | Other interests | Total number of options held | Number of underlying shares |
|-------------------------|--------------------|------------------|---------------------|-----------------|------------------------------|-----------------------------|
| Mr. To Kei Fung | 64,400,000 | – | – | – | 64,400,000 | 64,400,000 |

Save as disclosed above, at 31 March 2006, 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.

SHARE OPTION SCHEMES

Particulars of the Company's share option schemes are set out in note 29 to the financial statements.

ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES

Other than the share option schemes disclosed above and in note 29 to the financial statements, at no time during the year was the Company or any of its subsidiaries a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

DIRECTORS' INTEREST IN CONTRACTS

During the year, private companies of which Mr. Law Sau Yiu, Dennis and Ms. Teng Chia Lin, Chialina are directors and/or shareholders, advanced HK\$15,000,000 (2005: HK\$4,000,000) to the Group. The loans are unsecured, bear interest at commercial rates and are repayable within one year from the date of advance.

Save as disclosed above, no contracts of significance to which the Company or its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

COMPETING INTERESTS

At 31 March 2006, none of the directors, the substantial shareholders nor 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.

Directors' Report

SUBSTANTIAL SHAREHOLDERS

At 31 March 2006, 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:

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

| Name of shareholder | Capacity | Number of shares held | % of the Company's issued share |
|-----------------------------|--|-----------------------|---------------------------------|
| Right Opportune Limited | Beneficial owner (Note 1) | 370,800,000 | 46.06 |
| Grand Sum Assets Limited | Beneficial owner | 59,500,000 | 7.39 |
| Ms. Lee Po Yi, Shirley Anne | Interest of controlled corporation (Note 2) | 59,500,000 | 7.39 |

Notes:

- (1) Please refer to note disclosed above in respect of Directors and chief executive's interests or short positions in shares, underlying shares and debentures.
- (2) 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 March 2006, the Company has not been notified of any persons (other than the Directors and chief executives 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.

RETIREMENT BENEFITS SCHEME

Particulars of the retirement benefits scheme of the Group are set out in note 4(q)(ii) to the financial statements.

Directors' Report

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES OF THE COMPANY

During the year ended 31 March 2006, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's articles of association and there is no restriction against such rights under the laws of Cayman Islands, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

MAJOR CUSTOMERS AND SUPPLIERS

Major customers

The directors are of the view that the film industry in Hong Kong is largely dominated by a few major film companies. The Group's largest five customers accounted for 94% (2005: 100%) of the Group's turnover. The largest customer accounted for approximately 42% (2005: 39%) of the Group's turnover.

Major suppliers

The only raw material required by the Group's operations is film negatives supplied by a number of film manufacturers in Hong Kong.

Total purchases of the Group amounted to approximately HK\$0.70 million (2005: HK\$0.64 million) representing approximately 5.2% (2005: 2.9%) of the Group's cost of sale.

Purchases from the largest five suppliers accounted for 100% (2005: 100%) of the Group's purchases. Purchases from the largest supplier accounted for approximately 66% (2005: 80%) of the Group's purchases.

At no time during the year did the directors, an associate of a director or a shareholder of the Company (which to the knowledge of the directors owns more than 5% of the Company's issued share capital) had an interest in the Group's five largest customers or five largest suppliers during the year.

AUDIT COMMITTEE

The Company has established an audit committee on 2 August 2002 with written terms of reference in compliance with Rules 5.28 to 5.33 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. During the year, the audit committee held four meetings to review the Group's annual report, half-year report and quarterly reports.

Directors' Report

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.

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 year ended 31 March 2006.

SPONSOR'S INTERESTS

As at 31 March 2005, Hantec Capital Limited ceased to be the sponsor of the Company upon expiration of the terms of contract for the period from 26 August, 2002 to 31 March 2005. The Company had no sponsor as at and for the year ended 31 March 2006. Accordingly, no additional disclosure is made.

AUDITORS

The financial statements of the Company for the year ended 31 March 2003 were audited by Moores Rowland Mazars.

During the year ended 31 March 2004, Messrs. Moores Rowland Mazars resigned and Messrs. Deloitte Touche Tohmatsu were appointed as auditors of the Company. The financial statements of the Company for the year ended 31 March 2004 were audited by Deloitte Touche Tohmatsu.

On 10 May 2005, Messrs. Deloitte Touche Tohmatsu resigned as auditors of the Company, CCIF CPA Limited were then appointed to fill casual vacancy and have remained the Company's auditors from that date.

A resolution for the re-appointment of CCIF CPA Limited as auditors of the Company for the ensuing year will be prepared at the forthcoming annual general meeting.

On behalf of the Board

Law Sau Yiu, Dennis

Chairman

Hong Kong, 26 June 2006

Auditors' Report

**CCIF****CCIF CPA LIMITED**37/F Hennessy Centre
500 Hennessy Road
Causeway Bay Hong Kong

To the shareholders of
Milkyway Image Holdings Limited
(Incorporated in the Cayman Islands with limited liability)

We have audited the financial statements on pages 26 to 69 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, 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 as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Auditors' Report

FUNDAMENTAL UNCERTAINTY RELATING TO THE GOING CONCERN BASIS

In forming our opinion, we have considered the adequacy of the disclosures made in note 2 to the financial statements concerning the adoption of the going concern basis, being the basis on which the financial statements have been prepared. As explained in note 2 to the financial statements, in the opinion of the directors, the liquidity of the Group can be maintained in the coming year, after taking into consideration the continuing financial support provided by a related company. The related company has confirmed to provide continuing financial support to the Group in the form of interest-bearing loan to the extent of HK\$24 million. The financial statements have been prepared on a going concern basis, the validity of which depends upon the successful outcome of the raising of funds for the Group and the attainment of profitable and cash flow positive operations, to meet the Group's future working capital and financing requirements. The financial statements do not include any adjustment that may be necessary should the implementation of such measures be unsuccessful. We consider that appropriate estimates and disclosures have been made and our opinion is not qualified in this respect.

OPINION

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 March 2006 and of the loss and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

CCIF CPA Limited

Certified Public Accountants

Betty P.C. Tse

Practising Certificate Number P03024

Hong Kong, 26 June 2006

Consolidated Income Statement

For the year ended 31 March 2006

| | Notes | 2006 HK\$'000 | 2005 HK\$'000 |
|--|-------|------------------|------------------|
| Turnover | 7 | 17,258 | 36,836 |
| Cost of sales | | (13,438) | (27,653) |
| Gross profit | | 3,820 | 9,183 |
| Other revenue | 7 | 529 | 815 |
| Other operating expenses | | (21,854) | (18,327) |
| Loss from operations | 9 | (17,505) | (8,329) |
| Finance costs | 10 | (680) | (36) |
| Loss before taxation | | (18,185) | (8,365) |
| Taxation | 13 | – | – |
| Loss attributable to equity holders of the Company | 25 | (18,185) | (8,365) |
| Loss per share | | | |
| Basic | 15 | (HK2.26 cents) | (HK1.05 cents) |
| Diluted | 15 | N/A | N/A |

The notes on pages 32 to 69 form part of these financial statements.

Consolidated Balance Sheet

As at 31 March 2006

| | Notes | 2006 HK\$'000 | 2005 HK\$'000 |
|--|-------|------------------|------------------|
| Non-current assets | | | |
| Film rights | 16 | 277 | – |
| Property, plant and equipment | 17 | 11,698 | 15,050 |
| | | 11,975 | 15,050 |
| Current assets | | | |
| Film rights, current portion | 16 | 4,982 | – |
| Films in progress | 16 | 6,483 | 9,604 |
| Production in progress | | 12,364 | 2,076 |
| Trade debtors | 19 | 417 | 59 |
| Deposits, prepayments and other debtors | | 4,944 | 6,493 |
| Bank balances and cash | | 3,610 | 2,853 |
| | | 32,800 | 21,085 |
| Current liabilities | | | |
| Trade creditors | 20 | 2,459 | 721 |
| Other creditors and accruals | | 905 | 748 |
| Receipt in advance | | 31,813 | 16,106 |
| Amounts due to directors | 21 | 1,242 | 2,338 |
| Amount due to related companies | | 15,097 | 4,010 |
| Obligations under finance leases – due within one year | 22 | 41 | 8 |
| Bank loan | 23 | 3,000 | 5,000 |
| | | 54,557 | 28,931 |
| Net current liabilities | | (21,757) | (7,846) |
| | | (9,782) | 7,204 |
| Capital and reserves | | | |
| Share capital | 24 | 8,050 | 8,050 |
| Reserves | 25 | (18,003) | (848) |
| | | (9,953) | 7,202 |
| Non-current liabilities | | | |
| Obligations under finance leases – due after one year | 22 | 171 | 2 |
| Deferred taxation | 26 | – | – |
| | | 171 | 2 |
| | | (9,782) | 7,204 |

Approved and authorised for issue by the board of directors on 26 June 2006

On behalf of the board
Law Sau Yiu, Dennis
 Director

Teng Chia Lin, Chialina
 Director

The notes on pages 32 to 69 form part of these financial statements.

Balance Sheet

As at 31 March 2006

| | <i>Notes</i> | 2006 HK\$'000 | 2005 HK\$'000 |
|---|--------------|--------------------------------|------------------|
| Non-current assets | | | |
| Interests in subsidiaries | 18 | 516 | 9,563 |
| Current assets | | | |
| Deposits, prepayments and other debtors | | 112 | 112 |
| Bank balances and cash | | 22 | 86 |
| | | 134 | 198 |
| Current liabilities | | | |
| Other creditors and accruals | | 184 | 223 |
| Amounts due to directors | 21 | 1,242 | 2,338 |
| | | 1,426 | 2,561 |
| Net current liabilities | | | |
| | | (1,292) | (2,363) |
| | | (776) | 7,200 |
| Capital and reserves | | | |
| Share capital | 24 | 8,050 | 8,050 |
| Reserves | 25 | (8,826) | (850) |
| | | (776) | 7,200 |

Approved and authorised for issue by the board of directors on 26 June 2006

On behalf of the board

Law Sau Yiu, Dennis

Director

Teng Chia Lin, Chialina

Director

The notes on pages 32 to 69 form part of these financial statements.

Consolidated Statement of Changes in Equity

For the year ended 31 March 2006

| | Total equity | |
|---|------------------|------------------|
| | 2006 HK\$'000 | 2005 HK\$'000 |
| At 1 April | 7,202 | 10,294 |
| Loss attributable to equity holders of the Company | (18,185) | (8,365) |
| Shares issued for cash | – | 5,957 |
| Share issue expenses | – | (684) |
| Share option scheme – value of employee services | 1,030 | – |
| At 31 March | (9,953) | 7,202 |

The notes on pages 32 to 69 form part of these financial statements.

Consolidated Cash Flow Statement

For the year ended 31 March 2006

| | 2006 HK\$'000 | 2005 HK\$'000 |
|---|------------------|------------------|
| OPERATING ACTIVITIES | | |
| Loss before taxation | (18,185) | (8,365) |
| Adjustments for: | | |
| Interest income | (29) | (1) |
| Gain on disposal of property, plant and equipment | (53) | – |
| Allowance for production deposits | – | 1,950 |
| Depreciation | 3,752 | 3,822 |
| Amortisation of film rights | 7,172 | – |
| Finance charges on finance leases | 13 | 12 |
| Loan interest expense | 667 | 24 |
| Share-based payment | 1,030 | – |
| Loss on disposal of property, plant and equipment | – | 23 |
| Operating cash flows before movements in working capital | (5,633) | (2,535) |
| Decrease/(increase) in film in progress | 3,121 | (9,604) |
| (Increase)/decrease in production in progress | (10,288) | 14,432 |
| Increase in trade debtors | (358) | (51) |
| Decrease in deposits, prepayments and other debtors | 1,575 | 736 |
| Increase/(decrease) in trade creditors | 1,738 | (3,296) |
| Increase in other creditors and accruals | 131 | 101 |
| Increase/(decrease) in receipt in advance | 15,707 | (15,782) |
| (Decrease)/increase in amounts due to directors | (1,096) | 1,333 |
| Cash generated from/(used in) operations | 4,897 | (14,666) |
| Loan interest paid | (580) | (14) |
| NET CASH GENERATED FROM/(USED IN) OPERATING ACTIVITIES | 4,317 | (14,680) |
| INVESTING ACTIVITIES | | |
| Interest received | 29 | 1 |
| Additions of film rights | (12,431) | – |
| Purchase of property, plant and equipment | (117) | (135) |
| NET CASH USED IN INVESTING ACTIVITIES | (12,519) | (134) |

Consolidated Cash Flow Statement *(continued)*

For the year ended 31 March 2006

| | 2006 HK\$'000 | 2005 HK\$'000 |
|---|------------------|------------------|
| FINANCING ACTIVITIES | | |
| Finance charges on finance leases paid | (13) | (12) |
| New bank loan raised | – | 5,000 |
| Repayment of bank loan | (2,000) | – |
| Advance from related companies | 11,000 | 4,000 |
| Proceeds from issue of shares | – | 5,957 |
| Repayment of obligations under finance leases | (28) | (140) |
| Share issue expenses | – | (684) |
| NET CASH FROM FINANCING ACTIVITIES | 8,959 | 14,121 |
| NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS | 757 | (693) |
| CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR | 2,853 | 3,546 |
| CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR | | |
| Bank balances and cash | 3,610 | 2,853 |

The notes on pages 32 to 69 form part of these financial statements.

Notes to the Financial Statements

31 March 2006

1. GENERAL

The Company was incorporated in the Cayman Islands under the Companies Law of Cayman Islands as an exempted company with limited liability and its shares are being listed on the Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The addresses of the registered office and principal place of business of the Company are disclosed in the "Corporate Information" section of the annual report.

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.

2. BASIS OF PREPARATION

The Group sustained a loss attributable to equity holders of the Company of HK\$18,185,000 (2005: HK\$8,365,000) during the year, reported net current liabilities of HK\$21,757,000 (2005: HK\$7,846,000) and net liabilities of HK\$9,782,000 as at 31 March 2006.

Notwithstanding concerns on its liquidity concerns as at 31 March 2006, the financial statements have been prepared on the assumption that the Group will continue to operate as a going concern in the foreseeable future. In the opinion of the directors, the liquidity of the Group can be maintained in the coming year, after taking into consideration the arrangement made subsequent to the balance sheet date.

A related company of the Group has confirmed to provide continuing financial support to the Group in the form of interest-bearing loan to the extent of HK\$24 million to enable it to settle its liability as and when they fall due.

In the opinion of the directors, the Group will have sufficient financial resources to satisfy its future working capital and other financing requirements for the foreseeable future. Accordingly, the directors are satisfied that it is appropriate to prepare the financial statements on a going concern basis, notwithstanding the Group's financial position and tight liquidity as at 31 March 2006.

Notes to the Financial Statements

31 March 2006

3. ADOPTION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

In the current year, the Group has applied, for the first time, a number of new Hong Kong Financial Reporting Standards (“HKFRSs”), Hong Kong Accounting Standards (“HKASs”) and Interpretations (hereinafter collectively referred to as “new HKFRSs”) issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) that are effective for accounting periods beginning on or after 1 January 2005. The adoption of the new HKFRSs has had no material effect on how the results for the prior accounting years are prepared and presented. Accordingly, no prior year adjustment has been required. The adoption of the new HKFRSs has resulted in changes to the Group’s accounting policies in the following areas that have an effect on how the results for the current accounting years are prepared and presented:

HKFRS 2 Share-based Payment

In the current year, the Group has applied HKFRS 2 Share-based Payment which requires an expense to be recognised where the Group buys goods or obtains services in exchange for shares or rights over shares (“equity-settled transactions”), or in exchange for other assets equivalent in value to a given number of share or rights over shares (“cash-settled transactions”). The principal impact of HKFRS 2 on the Group is in relation to the expensing of the fair value of share options granted to directors and employees of the Company, determined at the date of grant of the share options, over the vesting period. Prior to the application of HKFRS 2, the Group did not recognise the financial effect of these share options until they were exercised. The Group has applied HKFRS 2 to share options granted on or after 1 April 2005 and recognised the share option expenses of HK\$1,030,000 in relation to share option granted by the Company for the year.

HKAS 24 Related Party Disclosures

HKAS 24 Related party disclosures has expanded the definition of related parties to include key management personnel of the Group and some other related-party disclosures.

HKAS 38 Intangible Assets

The Group has reassessed the useful lives of its film rights in accordance with the provisions of HKAS 38. No adjustment result from this reassessment.

The Group has not early applied the new standards, interpretations and amendments that have been issued but are not yet effective as at 31 March 2006.

Notes to the Financial Statements

31 March 2006

3. ADOPTION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS *(continued)*

The Group has commenced considering the potential impact of these standards, interpretations and amendments, and determined that the management anticipates the application of these new standards, interpretations and amendments will have no material impact on the Group's financial statements.

4. SIGNIFICANT ACCOUNTS POLICIES

The financial statements have been prepared in accordance with HKFRSs issued by the HKICPA and the disclosure requirements of the Hong Kong Companies Ordinance. The financial statements are prepared under the historical cost convention except that certain financial instruments are stated at fair value. These financial statements also comply with the applicable disclosure provisions of the GEM Listing Rules. A summary of the significant accounting policies adopted by the Group is set out below.

a) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31 March each year.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant inter-company transactions, balances and unrealised gains on transactions within the Group are eliminated on consolidation.

b) Revenue recognition

Income from the production of films and television movies is recognised when the production is completed, which is usually upon delivery of the film negatives to the customers.

Income from the distribution of films is recognised when the master materials have been delivered to customers.

Notes to the Financial Statements

31 March 2006

4. SIGNIFICANT ACCOUNTS POLICIES *(continued)*

b) Revenue recognition *(continued)*

Interest income is accrued on a time basis, by reference to the principal outstanding and at the interest rate applicable.

c) Impairment

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation increase.

d) Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years, and it further excludes items of income or expense that are never taxable and deductible.

Notes to the Financial Statements

31 March 2006

4. SIGNIFICANT ACCOUNTS POLICIES *(continued)*

d) Taxation *(continued)*

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill (or negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity in which case the deferred tax is also dealt with in equity.

e) Property, plant and equipment

Property, plant and equipment is stated at cost less depreciation and any accumulated impairment losses.

Notes to the Financial Statements

31 March 2006

4. SIGNIFICANT ACCOUNTS POLICIES *(continued)*

e) Property, plant and equipment *(continued)*

Depreciation is provided to write off the cost of items of property, plant and equipment over their estimated useful lives and after taking into account their estimated residual values, using the straight-line method, at the following rates per annum:

| | |
|-------------------------|-----------|
| Leasehold improvements | 20% |
| Furniture and fixtures | 20% |
| Machinery and equipment | 10% – 20% |
| Motor vehicles | 20% |
| Office equipment | 20% |

Major costs incurred in restoring property, plant and equipment to their normal working condition are charged to the income statement. Improvements are capitalised and depreciated over their expected useful lives to the Company.

The gain or loss arising from disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the income statement.

Property, plant and equipment held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, the terms of the relevant leases.

f) Subsidiaries

A subsidiary is a company controlled by the Company. A subsidiary is considered to be controlled if the Company has the power directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from its activities.

Investments in subsidiaries are included in the Company's balance sheet at cost less provision for impairment loss, if necessary. The results of subsidiaries are accounted for by the Company to the extent of dividends received and receivable during the year.

Notes to the Financial Statements

31 March 2006

4. SIGNIFICANT ACCOUNTS POLICIES (continued)

g) Film rights

Film rights represent film produced or acquired by the Group and are stated at cost less accumulated amortisation and any identified impairment losses.

The cost of film rights is amortised in the proportion of actual income earned during the year to the total estimated income after taking into account their estimated residual value. Where there is an impairment in value, the unamortised balance is written down to its estimated recoverable amount. The estimated residual value is reported as a non-current asset.

The portion of film rights expect to be amortised within twelve months from the balance sheet date is reported as current asset. The portion of films rights expected not to amortised within twelve months from the balance sheet date is reported as a non-current asset.

h) Production in progress

Production in progress represents films and television series under production and is stated at production costs incurred to date, less foreseeable losses. Such production costs are carried forward as production in progress in the balance sheet and are transferred to film production costs in the income statement upon completion.

i) Film in progress

Film in progress represents films and television series under production and is stated at production costs incurred to date, less any identified impairment loss. Such production costs are transferred to film rights upon completion of production.

j) Leased assets

i) Finance leases

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership of the assets concerned to the Group. Assets held under finance leases are capitalised at their fair values at the date of acquisition. The corresponding liability to the lessor, net of interest charges, is included in the balance sheet as a finance lease obligation.

Notes to the Financial Statements

31 March 2006

4. SIGNIFICANT ACCOUNTS POLICIES *(continued)*

j) Leased assets *(continued)*

i) Finance leases *(continued)*

Payments to the lessor are treated as consisting of capital and interest elements. Finance costs, which represent the difference between the total leasing commitments and the fair value of the assets acquired, are charged to the income statement over the term of the relevant lease so as to produce an approximately periodic rate of charge on the remaining balance of the obligations for each accounting period.

ii) Operating leases

All other leases are classified as operating leases and the annual rentals are charged to income statement on a straight-line basis over the relevant lease terms.

k) Receipt in advance

Receipt in advance represents deposits received from film companies before the completion of production of films and television movies pursuant to the production agreements and will be recognised as income when the production has been completed.

l) Foreign currencies

Transactions in currencies other than Hong Kong dollars are initially recorded at the rates ruling on the dates of the transactions. Monetary assets and liabilities denominated in currencies other than Hong Kong dollars are re-translated at the rates ruling on the balance sheet date. Profits and losses arising on exchange are included in net profit or loss for the year.

m) Related party

Two parties are considered to be related if one party has the ability, directly or indirectly, to control the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence.

Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or entities and include entities which are controlled or under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

Notes to the Financial Statements

31 March 2006

4. SIGNIFICANT ACCOUNTS POLICIES (continued)

n) Provision and contingencies

A provision is recognised when there is a present obligation, legal or constructive, as a result of past event and it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed regularly and adjusted to reflect the current best estimate. Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

Contingent liabilities are not recognised in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. A contingent asset is not recognised in the financial statements but disclosed when an inflow of economic benefits is probable.

o) Cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are also included as a component of cash and cash equivalents for the purpose of the cash flow statement.

p) Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, are capitalised as part of the cost of those assets. Capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale.

All other borrowing costs are charged to the income statement in the year in which they are incurred.

q) Employee benefits

i) Bonuses

The Group recognises a liability for bonuses when there is a contractual obligation and the amount can be estimated reliably.

Notes to the Financial Statements

31 March 2006

4. SIGNIFICANT ACCOUNTS POLICIES (continued)

q) Employee benefits (continued)

ii) Retirement benefit obligations

The Group operates a Mandatory Provident Fund Scheme (the "MPF Scheme") under the Hong Kong Mandatory Provident Fund Schemes Ordinance for those employees employed under the jurisdiction of the Hong Kong Employment Ordinance. The MPF Scheme is a defined contribution scheme, the assets of which are held in separate trustee-administered funds.

Under the MPF scheme, the employer and its employees are each required to make contributions to the scheme at 5% of the employees' relevant income, subject to a cap of monthly relevant income of HK\$20,000. The Group's contributions to the scheme are expensed as incurred and vested in accordance with the scheme's vesting scales. Where employees leave the scheme prior to the full vesting of the employer's contributions, the amount of forfeited contributions is used to reduce the contributions payable by the Group.

iii) Share-based payment expenses

The fair value of the employee services received in exchange for the grant of the share options is recognised as an expense in the income statement on a straight-line basis over the vesting period, with a corresponding increase in equity (Share-based compensation reserve).

The total amount to be expensed over the vesting period is determined with reference to the fair value of the share options granted. At each balance sheet date, the Company revises its estimates of the number of share options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity (Share-based compensation reserve) in the balance sheet will be made over the remaining vesting periods.

The proceeds received, net of any directly attributable transaction cost, are credited to share capital and share premium accounts when the share options are exercised. When the share options are still not exercised at the expiry date, the amount previously recognised in share-based compensation reserve will be transferred to retained profits.

Notes to the Financial Statements

31 March 2006

5. FINANCIAL RISK MANAGEMENT

Exposure to credit, liquidity, interest rate and foreign exchange risks arises in the normal course of the Group's business. These risks are limited by the Group's financial management policies and practices described below.

a) Credit risk

The Group's credit risk is primarily attributable to trade or other receivables. The Group's sales are made to several major customers. To minimize the concentration of credit risk, it has policies in place to ensure that films are only licensed or distributed to reputable and creditworthy customers. Deposits are received in advance from most of the customers. The exposure to these credit risks are also monitored on an ongoing basis.

b) Liquidity risk

The Group manages its liquidity risk by regularly monitoring current and expected liquidity requirements and ensuring sufficient liquid cash and adequate committed lines of funding from major financial institutions and related companies to meet the Group's liquidity requirements in the short and long term.

c) Interest rate risk

The Group's exposure to changes in interest rate relates primarily to the Group's cash and cash equivalents, bank deposits and bank loans. The Group does not use financial derivatives to hedge against the interest rate risk. The Group monitors the interest rate risk exposure on a continuous basis and adjust the portfolio of borrowings where necessary.

d) Foreign exchange risk

The Group mainly operates in Hong Kong with most of the transactions settled in Hong Kong dollars or United States dollars. The Group did not have significant exposure to foreign exchange risk.

Notes to the Financial Statements

31 March 2006

6. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

a) Impairment of film rights

The Group performs annual tests on whether there has been impairment of film rights in accordance with the accounting policy stated in note 4(g). The recoverable amounts of cash-generating units are determined based on value-in-use calculations. These calculations require the use of estimates and assumptions made by management on the future operation of the business, pre-tax discount rates and other assumptions underlying the value-in-use calculations.

b) Trade debtors

The aged debt profile of trade debtors is reviewed on a regular basis to ensure that the trade debtor balances are collectible and follow up actions are promptly carried out if the agreed credit periods have been exceeded. However, from time to time, the Group may experience delays in collection. Where recoverability of trade debtor balances are called into doubts, specific provisions for bad and doubtful debts are made based on credit status of the customers, the aged analysis of the trade receivable balances and write-off history. Certain receivables may be initially identified as collectible, yet subsequently become uncollectible and result in a subsequent write-off of the related receivable to the income statement. Changes in the collectibility of trade receivables for which provisions are not made could affect the Group's results of operations.

c) Useful lives of property, plant and equipment

In accordance with HKAS 16, the Group estimates the useful lives of property, plant and equipment in order to determine the amount of depreciation expenses to be recorded. The useful lives are estimated at the time the asset is acquired based on historical experience, the expected usage, wear and tear of the assets, as well as technical obsolescence arising from changes in the market demands or service output of the assets. The Group also performs annual reviews on whether the assumptions made on useful lives continue to be valid.

Notes to the Financial Statements

31 March 2006

6. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

(continued)

d) Impairment of films in progress

The management of the Group reviews an aging analysis at each balance sheet date, and identify the slow-moving films in progress that are no longer suitable for use in production. The management estimates the net realisable value for such finished goods of the films in progress based primarily on the latest contract prices and current market conditions. In addition, the Group carries out review on each film at each balance sheet date and makes allowance for any films in progress that production no longer proceed.

7. TURNOVER AND OTHER REVENUE

| | 2006 HK\$'000 | 2005 HK\$'000 |
|---|------------------|------------------|
| Turnover | | |
| Film production | 7,930 | 36,836 |
| Film distribution | 9,328 | – |
| | 17,258 | 36,836 |
| Other revenue | | |
| Gain on disposal of property, plant and equipment | 53 | – |
| Interest income | 29 | 1 |
| Sundry income | 447 | 814 |
| | 529 | 815 |
| Total income | 17,787 | 37,651 |

Notes to the Financial Statements

31 March 2006

8. BUSINESS AND GEOGRAPHICAL SEGMENTS

a) Business segments

For management purposes, the Group is currently organised into three operating divisions, namely, film production, film distribution and television movies production. These divisions are the basis on which the Group reports its primary segment information.

Income statement

| | Film production | | Film distribution | | Television movies production | | Consolidated | |
|---|--------------------|------------------|----------------------|------------------|---------------------------------|------------------|------------------|------------------|
| | 2006 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2005 HK\$'000 |
| Turnover | 7,930 | 36,836 | 9,328 | - | - | - | 17,258 | 36,836 |
| RESULT | | | | | | | | |
| Segment profit/(loss) | 1,664 | 9,183 | (320) | (274) | - | - | 1,344 | 8,909 |
| Unallocated operating income | | | | | | | 529 | 815 |
| Unallocated operating expenses | | | | | | | (19,378) | (18,053) |
| Loss from operations | | | | | | | (17,505) | (8,329) |
| Finance costs | | | | | | | (680) | (36) |
| Loss before taxation | | | | | | | (18,185) | (8,365) |
| Taxation | | | | | | | - | - |
| Loss attributable to equity holders of the Company | | | | | | | (18,185) | (8,365) |

Notes to the Financial Statements

31 March 2006

8. BUSINESS AND GEOGRAPHICAL SEGMENTS (continued)

a) Business segments (continued)

Balance sheet

| | Film production | | Film distribution | | Television movies production | | Consolidated | |
|--------------------------------------|--------------------|------------------|----------------------|------------------|---------------------------------|------------------|------------------|------------------|
| | 2006 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2005 HK\$'000 |
| Segment assets | 16,297 | 6,440 | 11,849 | 9,604 | 500 | 1,500 | 28,646 | 17,544 |
| Unallocated corporate assets | | | | | | | 16,129 | 18,591 |
| Consolidated total assets | | | | | | | 44,775 | 36,135 |
| Segment liabilities | 28,466 | 10,714 | 5,806 | 6,113 | - | - | 34,272 | 16,827 |
| Unallocated corporate liabilities | | | | | | | 20,456 | 12,106 |
| Consolidated total liabilities | | | | | | | 54,728 | 28,933 |

Notes to the Financial Statements

31 March 2006

8. BUSINESS AND GEOGRAPHICAL SEGMENTS (continued)

a) Business segments (continued)

Other information

| | Film production | | Film distribution | | Television movies production | | Unallocated | |
|--|-----------------|----------|-------------------|----------|------------------------------|----------|-------------|----------|
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Allowance for production deposits | - | 1,950 | - | - | - | - | - | - |
| Additions of property, plant and equipment | - | - | - | - | - | - | 585 | 609 |
| Depreciation | - | - | - | - | - | - | 3,752 | 3,822 |
| Addition of film rights | - | - | 12,431 | - | - | - | - | - |
| Amortisation of film rights | - | - | 7,172 | - | - | - | - | - |
| Gain/(loss) on disposal of property, plant and equipment | - | - | - | - | - | - | 53 | (23) |

b) Geographical segments

All of the Group's revenue are derived from Hong Kong and all of the Group's assets are located in Hong Kong. Accordingly, no analysis by geographical segment is presented.

Notes to the Financial Statements

31 March 2006

9. LOSS FROM OPERATIONS

Loss from operations has been arrived at after charging:

| | 2006 HK\$'000 | 2005 HK\$'000 |
|--|------------------|------------------|
| Auditors' remuneration | 220 | 220 |
| Contributions to retirement benefits scheme (included in staff costs) | 175 | 186 |
| Amortisation of film rights (included in cost of sales) | 7,172 | – |
| Production cost (included in cost of sales) | 6,266 | 25,703 |
| Depreciation of property, plant and equipment | 3,752 | 3,822 |
| Allowance for production deposits (including in cost of sales) | – | 1,950 |
| Loss on disposal of property, plant and equipment | – | 23 |
| Operating lease rental in respect of land and buildings | 1,800 | 1,800 |
| Staff costs including directors' emoluments | 11,088 | 9,464 |

10. FINANCE COSTS

| | 2006 HK\$'000 | 2005 HK\$'000 |
|---|------------------|------------------|
| Interests on: | | |
| Bank loans wholly repayable within five years | 202 | 14 |
| Other borrowing costs | 465 | 10 |
| Finance leases | 13 | 12 |
| | 680 | 36 |

Notes to the Financial Statements

31 March 2006

11. DIRECTORS' EMOLUMENTS

The remuneration of every director of the Company for the year ended 31 March 2006 and 31 March 2005, disclosed pursuant to the GEM Listing Rules and Section 161 of the Hong Kong Companies Ordinance, is analysed as follows:

| | Directors' fee | | Salaries and other allowances | | Share-based payment | | Retirement benefits scheme contribution | | Total | |
|--|------------------|------------------|-------------------------------|------------------|---------------------|------------------|---|------------------|------------------|------------------|
| | 2006 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2005 HK\$'000 |
| Executive directors | | | | | | | | | | |
| Mr. Law Sau Yiu, Dennis | - | - | 1,800 | 1,800 | - | - | 12 | 17 | 1,812 | 1,817 |
| Ms. Teng Chia Lin, Chialina | - | - | 456 | 456 | - | - | 12 | 17 | 468 | 473 |
| Ms. Chan Dao Ho (note i) | - | - | 450 | - | - | - | 7 | - | 457 | - |
| Mr. To Kei Fung (note ii) | - | - | 1,040 | 3,120 | - | - | 4 | 12 | 1,044 | 3,132 |
| Independent non-executive directors | | | | | | | | | | |
| Mr. Lung Hak Kau (note iii) | 96 | 63 | - | - | - | - | - | - | 96 | 63 |
| Ms. Wai Lai Yung (note iv) | 96 | 49 | - | - | - | - | - | - | 96 | 49 |
| Ms. Tsang Kei Ling (note v) | 60 | 12 | - | - | - | - | - | - | 60 | 12 |
| Mr. Lau Wai Pun, Raymond (note vi) | - | 77 | - | - | - | - | - | - | - | 77 |
| Ms. Ho Mei Yee (note vii) | - | 33 | - | - | - | - | - | - | - | 33 |
| | 252 | 234 | 3,746 | 5,376 | - | - | 35 | 46 | 4,033 | 5,656 |

Notes:

- i) Ms. Chan Dao Ho was appointed as a director on 16 August 2005
- ii) Mr. To Kei Fung was resigned as a director on 1 August 2005 and remain as the chief executive officer of the Group
- iii) Mr. Lung Hak Kau was appointed as a director on 4 August 2004
- iv) Ms. Wai Lai Yung was appointed as a director on 28 September 2004
- v) Ms. Tsang Kei Ling was appointed as a director on 21 January 2005
- vi) Mr. Lau Wai Pun, Raymond was resigned as a director on 21 January 2005
- vii) Ms. Ho Mei Yee was resigned as a director on 4 August 2004

Notes to the Financial Statements

31 March 2006

11. DIRECTORS' EMOLUMENTS (continued)

During the year, no emolument or incentive payments were paid by the Group to the directors as an inducement to join or upon joining the Group or as compensation for loss of office (2005: nil). None of the directors has waived any emoluments during the year.

Each of the executive directors except Ms. Chan Dao Ho entered into a service contract shall continue thereafter until terminated by either party giving to the other not less than six months' notice in writing.

12. EMPLOYEES' EMOLUMENTS

The five highest paid individuals of the Group include two executive directors, one former executive director and one newly appointed executive director whose emoluments before resignation and after appointment are set out in note 11 above. The total amount of the emoluments of these individuals as an employee and the remaining one highest paid individual during the year are as follows:

| | 2006 HK\$'000 | 2005 HK\$'000 |
|--|------------------|------------------|
| Salaries and other allowances | 3,350 | 1,041 |
| Retirement benefits scheme contributions | 25 | 24 |
| Share-based payment | 1,030 | – |
| | 4,405 | 1,065 |

The emoluments of the remaining three (2005: two) individuals fell within the following bands:

| | Number of individuals | |
|-------------------------------|-----------------------|------|
| | 2006 | 2005 |
| Emolument bands | | |
| Nil – HK\$1,000,000 | 2 | 2 |
| HK\$3,500,001 – HK\$4,000,000 | 1 | – |

During the year, no emolument or incentive payments were paid or payable to the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office (2005: nil).

Notes to the Financial Statements

31 March 2006

13. TAXATION

The amount comprises:

| | 2006 HK\$'000 | 2005 HK\$'000 |
|-------------------------------------|------------------|------------------|
| Current tax – Hong Kong Profits Tax | – | – |
| Deferred taxation (note 26) | – | – |
| | – | – |

No provision for Hong Kong Profits Tax has been made in the financial statements as the Company and its subsidiaries have no assessable profits for the year (2005: nil).

The taxation for the year can be reconciled to the loss before taxation per the consolidated income statement as follows:

| | 2006 HK\$'000 | 2005 HK\$'000 |
|---|------------------|------------------|
| Loss before taxation | (18,185) | (8,365) |
| Taxation credit at domestic income tax rate of 17.5% (2005: 17.5%) | 3,182 | 1,464 |
| Tax effect of estimated tax losses not recognised | (3,151) | (1,452) |
| Tax effect of income not taxable for tax purpose | 15 | – |
| Tax effect of expenses not deductible for tax purpose | (46) | (13) |
| Others | – | 1 |
| Taxation for the year | – | – |

Notes to the Financial Statements

31 March 2006

14. LOSS ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The consolidated loss attributable to equity shareholders of the Company includes a loss of HK\$9,006,000 (2005: HK\$8,104,000) (note 25) which has been dealt with in the financial statements of the Company.

15. LOSS PER SHARE

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

| | 2006 HK\$'000 | 2005 HK\$'000 |
|--|------------------|------------------|
| Loss attributable to the equity holders of the Company | (18,185) | (8,365) |

| | Number of shares | |
|---|--------------------|-------------|
| | 2006 | 2005 |
| Weighted average number of shares for the purpose of basic loss per share | 805,000,000 | 793,972,603 |
| Effect of dilutive potential ordinary shares – share options | – | – |
| Weighted average number of shares for the purpose of diluted loss per share | 805,000,000 | 793,972,603 |

The computation of diluted loss per share for the year did not assume the exercise of the Company's outstanding share options existed during the year since their exercise would reduce loss per share (2005: Diluted loss per share is not presented as there were no dilutive potential ordinary shares in issue during the year).

Notes to the Financial Statements

31 March 2006

16. FILM RIGHTS AND FILMS IN PROGRESS

The Group

| | Film rights HK\$'000 | Films in progress HK\$'000 | Total HK\$'000 |
|--|-------------------------|----------------------------------|-------------------|
| Cost | | | |
| At 1 April 2004 | – | – | – |
| Additions | – | 9,604 | 9,604 |
| Transfers | – | – | – |
| At 31 March 2005 | – | 9,604 | 9,604 |
| Accumulated amortisation and impairment | | | |
| At 1 April 2004 | – | – | – |
| Amortised for the year | – | – | – |
| At 31 March 2005 | – | – | – |
| Net book value | | | |
| At 31 March 2005 | – | 9,604 | 9,604 |

Notes to the Financial Statements

31 March 2006

16. FILM RIGHTS AND FILMS IN PROGRESS (continued)

The Group

| | Film rights HK\$'000 | Films in progress HK\$'000 | Total HK\$'000 |
|--|-------------------------|----------------------------------|-------------------|
| Cost | | | |
| At 1 April 2005 | – | 9,604 | 9,604 |
| Additions | – | 9,310 | 9,310 |
| Transfers | 12,431 | (12,431) | – |
| At 31 March 2006 | 12,431 | 6,483 | 18,914 |
| Accumulated amortisation and impairment | | | |
| At 1 April 2005 | – | – | – |
| Amortised for the year | 7,172 | – | 7,172 |
| At 31 March 2006 | 7,172 | – | 7,172 |
| Net book value | | | |
| At 31 March 2006 | 5,259 | 6,483 | 11,742 |
| Analysed as | | | |
| Non-current portion | 277 | – | 277 |
| Current portion | 4,982 | 6,483 | 11,465 |
| | 5,259 | 6,483 | 11,742 |

As at 31 March 2006, there was no impairment loss (2005: Nil) on film rights charged to the consolidated income statement for the year. The impairment loss was determined by management with reference to the net realisable values of film rights as at the balance sheet date in accordance with the Group's accounting policy.

Notes to the Financial Statements

31 March 2006

17. PROPERTY, PLANT AND EQUIPMENT

The Group

| | Leasehold improvements HK\$'000 | Furniture and fixtures HK\$'000 | Machinery and equipment HK\$'000 | Motor vehicles HK\$'000 | Office equipment HK\$'000 | Total HK\$'000 |
|-------------------------------------|---------------------------------------|--|---|-------------------------------|---------------------------------|-------------------|
| Cost | | | | | | |
| At 1 April 2004 | 4,098 | 707 | 16,663 | 459 | 1,728 | 23,655 |
| Additions | – | 9 | 564 | – | 36 | 609 |
| Disposal | (75) | – | (582) | – | (54) | (711) |
| At 31 March 2005 | 4,023 | 716 | 16,645 | 459 | 1,710 | 23,553 |
| Accumulated depreciation | | | | | | |
| At 1 April 2004 | 909 | 175 | 3,064 | 161 | 586 | 4,895 |
| Charge for the year | 819 | 144 | 2,419 | 92 | 348 | 3,822 |
| Eliminated on disposal | (58) | – | (108) | – | (48) | (214) |
| At 31 March 2005 | 1,670 | 319 | 5,375 | 253 | 886 | 8,503 |
| Net book value | | | | | | |
| At 31 March 2005 | 2,353 | 397 | 11,270 | 206 | 824 | 15,050 |

Notes to the Financial Statements

31 March 2006

17. PROPERTY, PLANT AND EQUIPMENT (continued)

| | Leasehold improvements HK\$'000 | Furniture and fixtures HK\$'000 | Machinery and equipment HK\$'000 | Motor vehicles HK\$'000 | Office equipment HK\$'000 | Total HK\$'000 |
|-------------------------------------|---------------------------------------|--|---|-------------------------------|---------------------------------|-------------------|
| Cost | | | | | | |
| At 1 April 2005 | 4,023 | 716 | 16,645 | 459 | 1,710 | 23,553 |
| Additions | – | 9 | 21 | 468 | 87 | 585 |
| Disposal | – | – | – | (459) | (4) | (463) |
| At 31 March 2006 | 4,023 | 725 | 16,666 | 468 | 1,793 | 23,675 |
| Accumulated depreciation | | | | | | |
| At 1 April 2005 | 1,670 | 319 | 5,375 | 253 | 886 | 8,503 |
| Charge for the year | 805 | 143 | 2,418 | 78 | 308 | 3,752 |
| Eliminated on disposal | – | – | – | (275) | (3) | (278) |
| At 31 March 2006 | 2,475 | 462 | 7,793 | 56 | 1,191 | 11,977 |
| Net book value | | | | | | |
| At 31 March 2006 | 1,548 | 263 | 8,873 | 412 | 602 | 11,698 |

The net book values of motor vehicles of approximately HK\$412,000 (2005: HK\$206,000) and office equipment of approximately HK\$602,000 (2005: HK\$824,000) include amounts of approximately HK\$412,000 (2005: HK\$206,000) and HK\$Nil (2005: HK\$9,000) respectively in respect of assets held under finance leases.

Notes to the Financial Statements

31 March 2006

18. INTERESTS IN SUBSIDIARIES

| | The Company | |
|---|------------------|------------------|
| | 2006 HK\$'000 | 2005 HK\$'000 |
| Unlisted shares, at cost | 78 | 78 |
| Amounts due from subsidiaries | 22,638 | 22,685 |
| Allowance for amounts due from subsidiaries | (22,200) | (13,200) |
| | 438 | 9,485 |
| | 516 | 9,563 |

The amounts due from subsidiaries are unsecured, non-interest bearing and have no fixed repayment terms. In the opinion of the directors, the amount will not be repayable in the next twelve months.

The Company has undertaken to provide necessary financial resources to support the future operations of the subsidiaries. The directors are of the opinion that the underlying value of the subsidiaries was not less than the carrying amount of the subsidiaries as at 31 March 2006.

The details of the subsidiaries of the Company at 31 March 2006 are as follows:

| Name of subsidiary | Country/ place of incorporation | Issued and fully paid share capital | Interest held | Principal activities |
|--------------------------------------|---------------------------------------|---|------------------|-----------------------------------|
| Galaxy Image (BVI) Limited | British Virgin Islands | Ordinary shares of US\$10,000 | 100% | Investment holding |
| Inspire Film Distribution Limited | Hong Kong | Ordinary shares of HK\$2 | 100% | Provision of film distribution |
| Luminous Star Limited | Hong Kong | Ordinary shares of HK\$2 | 100% | Assets holding |

Notes to the Financial Statements

31 March 2006

18. INTERESTS IN SUBSIDIARIES *(continued)*

| Name of subsidiary | Country/ place of incorporation | Issued and fully paid share capital | Interest held | Principal activities |
|--|---------------------------------------|---|------------------|--|
| Point of View Movie Production Company Limited | Hong Kong | Ordinary shares of HK\$2 | 100% | Provision of film production |
| Milkyway Image (Hong Kong) Limited | Hong Kong | Ordinary shares of HK\$10,000 | 100% | Provision of film production and television movies production |
| Milkyway Image Limited | Hong Kong | Ordinary shares of HK\$2 | 100% | Holding of film rights |

Galaxy Image (BVI) Limited is directly held by the Company. The other subsidiaries are indirectly held by the Company.

The principal place of operation of the subsidiaries is Hong Kong.

None of the subsidiaries had any debt securities outstanding at the end of the year or at any time during the year.

Notes to the Financial Statements

31 March 2006

19. TRADE DEBTORS

The Group has not granted any credit terms to its customers or dealers. The aged analysis of the trade debtors is as follows:

| | The Group | |
|----------------|------------------|------------------|
| | 2006 HK\$'000 | 2005 HK\$'000 |
| Within 30 days | 125 | – |
| 31 – 90 days | 182 | 20 |
| 91 – 180 days | 1 | – |
| 181 – 365 days | 109 | 39 |
| | 417 | 59 |

The directors consider that the carrying amount of trade debtors approximates their fair values.

20. TRADE CREDITORS

The aged analysis of the trade creditors is as follows:

| | The Group | |
|-------------------|------------------|------------------|
| | 2006 HK\$'000 | 2005 HK\$'000 |
| Within six months | 2,459 | 719 |
| Over 1 year | – | 2 |
| | 2,459 | 721 |

The directors consider that the carrying amount of trade creditors approximates their fair values.

21. AMOUNTS DUE TO DIRECTORS

The Group and the Company

The amounts represent accrued salaries to directors. They are unsecured, non-interest bearing and have no fixed repayment terms.

Notes to the Financial Statements

31 March 2006

22. OBLIGATIONS UNDER FINANCE LEASES

At the balance sheet date, the Group had obligations under finance leases repayable as follows:

| | The Group | | | |
|---|----------------------------|------------------|--|------------------|
| | Minimum leases payments | | Present value of minimum leases payments | |
| | 2006 HK\$'000 | 2005 HK\$'000 | 2006 HK\$'000 | 2005 HK\$'000 |
| Amount payable under finance leases: | | | | |
| Within one year | 59 | 13 | 41 | 8 |
| More than one year but not exceeding two years | 56 | 2 | 44 | 2 |
| More than two years but not exceeding five years | 140 | – | 127 | – |
| | 255 | 15 | 212 | 10 |
| Less: Future finance charges | (43) | (5) | | |
| Present value of lease obligations | 212 | 10 | | |
| Less: Amount due for payment within one year | | | (41) | (8) |
| | | | 171 | 2 |

The average lease term is 5 years and leases are repayable in fixed monthly instalments. For the year ended 31 March 2006, the average effective borrowing rate was 8.3% (2005: 3.5%). Interest rates are fixed at the contract date, and thus expose the Group to fair value interest rate risk. All lease are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

The fair value of the Group's lease obligations approximates their carrying amount.

The Group's obligations under finance leases are secured by the lessors' title to the leased assets.

Notes to the Financial Statements

31 March 2006

23. BANK LOAN

| | The Group | |
|--------------------------------------|------------------|------------------|
| | 2006 HK\$'000 | 2005 HK\$'000 |
| Bank loan | 3,000 | 5,000 |
| Bank loans repayable within one year | 3,000 | 5,000 |

The short-term bank loan was secured by personal guarantee given and listed securities, other than that of the Company, placed by a director, bearing interest at commercial rate and repayable within 3 months.

24. SHARE CAPITAL

| | Number of shares | Amount HK\$'000 |
|---|------------------|--------------------|
| Authorised: | | |
| At 31 March 2005 and 31 March 2006, ordinary shares of HK\$0.01 each | 10,000,000,000 | 100,000 |
| Issued and fully paid: | | |
| At 31 March 2004, ordinary shares of HK\$0.01 each | 644,000,000 | 6,440 |
| Issue of shares on the basis of one offer share for every four shares held | 161,000,000 | 1,610 |
| At 31 March 2005 and 2006, ordinary shares of HK\$0.01 each | 805,000,000 | 8,050 |

On 15 March 2004, the Company proposed to raise approximately HK\$5,957,000 before expenses by issuing 161,000,000 shares of HK\$0.01 each of the Company at a subscription price of HK\$0.037 per share on the basis of one offer share for every four shares held on 2 April 2004 ("Open Offer"). Mr. Law Sau Yiu, Dennis, a director and a controlling shareholder of the Company, has undertaken to subscribe for or procure subscription for 71,400,000 shares of HK\$0.01 each of the Company offered under the Open Offer. The remaining 89,600,000 shares of HK\$0.01 each of the Company offered under the Open Offer have been fully underwritten by Kingston Securities Limited pursuant to the underwriting agreement dated 15 March 2004 entered into between the Company, Kingston Securities Limited and Mr. Law Sau Yiu, Dennis. The Open Offer became unconditional and completed on 22 April 2004.

Notes to the Financial Statements

31 March 2006

25. RESERVES

| | Attributable to equity holders of the Company | | | | |
|-----------------------------------|---|---------------------|----------------------|--------------------|----------|
| | Share-based | | | | Total |
| | Share premium | Contributed surplus | compensation reserve | Accumulated losses | |
| HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | |
| The Group | | | | | |
| At 1 April 2004 | 11,387 | 10 | – | (7,543) | 3,854 |
| Loss for the year | – | – | – | (8,365) | (8,365) |
| Issue of shares | 4,347 | – | – | – | 4,347 |
| Share issue expenses | (684) | – | – | – | (684) |
| At 31 March 2005 and 1 April 2005 | 15,050 | 10 | – | (15,908) | (848) |
| Loss for the year | – | – | – | (18,185) | (18,185) |
| Share option scheme | | | | | |
| – value of employee services | – | – | 1,030 | – | 1,030 |
| At 31 March 2006 | 15,050 | 10 | 1,030 | (34,093) | (18,003) |
| The Company | | | | | |
| At 1 April 2004 | 11,387 | 78 | – | (7,874) | 3,591 |
| Loss for the year | – | – | – | (8,104) | (8,104) |
| Issue of shares | 4,347 | – | – | – | 4,347 |
| Share issue expenses | (684) | – | – | – | (684) |
| At 31 March 2005 and 1 April 2005 | 15,050 | 78 | – | (15,978) | (850) |
| Loss for the year | – | – | – | (9,006) | (9,006) |
| Share option scheme | | | | | |
| – value of employee services | – | – | 1,030 | – | 1,030 |
| At 31 March 2006 | 15,050 | 78 | 1,030 | (24,984) | (8,826) |

The contributed surplus of the Group represents the difference between the nominal value of the shares of the subsidiaries acquired and the nominal value of the shares of the Company issued for the acquisition at the time of the reorganisation of the Group.

The contributed surplus of the Company represents the difference between the nominal value of the shares of the subsidiaries acquired and the nominal value of the shares of the Company issued in exchange pursuant to the reorganisation of the Group.

Notes to the Financial Statements

31 March 2006

25. RESERVES (continued)

In accordance with the laws of the Cayman Islands, the Company's share premium and contributed surplus are distributable to the shareholders of the Company subject to the Company's articles of association and provided that immediately following the distribution of dividends, the Company will be in a position to pay off its debts as and when they fall due in the ordinary course of business.

26. DEFERRED TAXATION

The Group

The followings are the deferred tax liability and asset recognised by the Group and movements thereon:

| | Accelerated tax depreciation | Estimated tax losses | Total |
|-------------------------------------|---|---------------------------------|--------------|
| | HK\$'000 | HK\$'000 | HK\$'000 |
| At 1 April 2004 | 1,973 | (1,973) | – |
| Charge (credit) to income statement | 86 | (86) | – |
| At 31 March 2005 and 1 April 2005 | 2,059 | (2,059) | – |
| Charge (credit) to income statement | (420) | 420 | – |
| At 31 March 2006 | <u>1,639</u> | <u>(1,639)</u> | – |

At 31 March 2006, the Group has unused estimated tax losses of approximately HK\$33,474,000 (2005: HK\$20,511,000) available for offset against future profits. A deferred tax asset has been recognised in respect of approximately HK\$9,369,000 (2005: HK\$11,764,000) of such losses. No deferred tax asset has been recognised in respect of the remaining balance of approximately HK\$24,105,000 (2005: HK\$8,747,000) due to the unpredictability of future profit streams.

The tax losses may be carried forward indefinitely.

The Company

No deferred tax asset has been recognised in respect of estimated tax losses of approximately HK\$2,512,000 (2005: HK\$2,495,000) due to the unpredictability of future profits streams.

These tax losses may be carried forward indefinitely.

Notes to the Financial Statements

31 March 2006

27. COMMITMENTS AND CONTINGENT LIABILITIES

a) Operating lease commitments

At 31 March 2006, the Group had commitments for future minimum lease payments under non-cancellable operating leases in respect of rented premises which fall due as follows:

| | The Group | |
|---------------------------------------|------------------|----------|
| | 2006 | 2005 |
| | HK\$'000 | HK\$'000 |
| Within one year | 1,800 | 1,800 |
| In the second to fifth year inclusive | 750 | 2,550 |
| | 2,550 | 4,350 |

Operating lease payments represented rentals payable by the Group for its office premises. Lease was negotiated for a term of 3 years and rentals were fixed for the period.

The Company had no significant lease commitments at the balance sheet date.

b) Capital commitments

The Group and the Company had no significant capital commitments at the balance sheet date (2005: Nil).

c) Other commitments

At 31 March 2006, the Group had contracted for production service but not provided in the financial statements amounting to approximately HK\$18,480,000 (2005: HK\$18,582,000).

The Company had no other commitments at the balance sheet date.

d) Contingent liabilities

At 31 March 2006, the Group and the Company had no material contingent liabilities (2005: Nil).

Notes to the Financial Statements

31 March 2006

28. RELATED PARTY TRANSACTIONS

- a) During the year, Mr. Law Sau Yiu, Dennis 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 (2005: Nil). The facility utilized by the Group at 31 March 2006 amounted to HK\$3 million (2005: HK\$5 million).
- b) During the year, two private companies of which Mr. Law Sau Yiu, Dennis and Ms. Teng Chia Lin, Chialina, both executive directors of the Company, are directors and/or shareholders, have advanced HK\$15,000,000 (2005: HK\$4,000,000) to the Group. The loans are unsecured, bear interest at commercial rates and are repayable within one year from the date of advance. At 31 March 2006, there was outstanding interest of HK\$97,000 (2005: HK\$10,000).
- c) Compensation for key management personnel, including amount paid to the Company's directors and certain of the highest paid employee, as disclosed in notes 11 and 12 is as follows:

| | 2006 HK\$'000 | 2005 HK\$'000 |
|---|------------------|------------------|
| Salaries and other short-term benefits | 6,988 | 6,330 |
| Retirement benefits scheme contribution | 48 | 58 |
| Share-based payment | 1,030 | – |
| | 8,066 | 6,388 |

Notes to the Financial Statements

31 March 2006

29. SHARE OPTION SCHEMES

Pursuant to the written resolutions of the shareholders of the Company dated 2 August 2002, two share option schemes, namely the pre-initial public offering share option scheme ("Pre-IPO Share Option Scheme") and the share option scheme ("Share Option Scheme"), were approved and adopted.

Share Option Scheme

The major terms of the Share Option Scheme are summarised as follows:

- a) The purpose of the Share Option Scheme is to enable the Group to grant share options to selected participants as incentives or rewards for their contribution to the Group.
- b) The participants include:
 - i)
 - (1) any employee or proposed employee of the Company, any of its subsidiaries or any entity ("Invested Entity") in which the Group holds an equity interest, including any executive director of the Company, any of such subsidiaries or any Invested Entity;
 - (2) any non-executive director (including independent non-executive directors) of the Company, any of its subsidiaries or any Invested Entity;
 - (3) any supplier of goods or services to any member of the Group or any Invested Entity;
 - (4) any customer of the Group or any Invested Entity;
 - (5) any person or entity that provides research, development or other technological support to the Group or any Invested Entity;
 - (6) any shareholder of any member of the Group or any Invested Entity or any holder or any securities issued by any member of the Group or any Invested Entity; and
 - (7) any joint venture partner or counter-party to business transactions of the Group.
 - ii) any company wholly owned by one or more persons belonging to any of the above classes of participants.

Notes to the Financial Statements

31 March 2006

29. SHARE OPTION SCHEMES *(continued)*

- c) The exercise price of a share option shall be a price determined by the directors and shall at least be the higher of:
 - i) the closing price of a share of the Company as stated in the Stock Exchange's daily quotations sheet on the date of grant, which must be a business day; and
 - ii) the average closing price of a share of the Company as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant.

- d) Maximum number of shares:
 - i) The total number of shares which may be issued upon exercise of all outstanding share options granted and yet to be exercised under the Share Option Scheme and any other share option schemes of the Company must not exceed 30% of the shares in issue from time to time; and
 - ii) The total number of shares which may be issued upon exercise of all share options to be granted under the Share Option Scheme and any other schemes must not in aggregate, exceed 10% of the shares in issue at the date of adoption of the Share Option Scheme (the "Limit") provided that share options lapsed in accordance with the terms of the Share Option Scheme will not be counted for the purpose of calculating the Limit.

- e) The total number of shares issued and to be issued upon the exercise of share options granted and to be granted to each participant (including both exercised and outstanding options) in any 12-month period up to and including the date of grant must not exceed 1% of the shares in issue.

- f) The exercisable period should be determined by the board of directors upon grant of the share option but in any event should not exceed 10 years from the date of grant of the share option.

Notes to the Financial Statements

31 March 2006

29. SHARE OPTION SCHEMES (continued)

Details of share options outstanding under the Company's share options scheme and movements during the year were as follows:

| Chief executive | Date of grant | Outstanding at beginning of year | Granted during year | Outstanding at end of year | Exercisable at end of year | Vesting period | Exercise period | Exercise price | Estimated fair value |
|-----------------|-----------------|----------------------------------|------------------------|----------------------------|----------------------------|----------------|--|----------------------|----------------------|
| Mr. To Kei Fung | 28 October 2005 | - | 64,400,000 (note a) | 64,400,000 | 64,400,000 | N/A | Between 20 September 2005 to 19 September 2015 | HK\$0.04 (note b) | HK\$0.016 |

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).

The options outstanding at the end of the year have a remaining contractual life of 9.5 years (2005: not applicable).

The estimate fair value was calculated using The Black-Scholes pricing model. Exceptions of early exercise are incorporated into the model. The inputs into the model were as follows:

| | 2006 |
|---|-------------|
| Share price | HK\$0.04 |
| Exercise price | HK\$0.04 |
| Expected volatility | 17% |
| Expected life | 10 years |
| Risk free rate (based on Exchange Fund Notes) | 4.4% |
| Expected dividend yield | Nil |

Notes to the Financial Statements

31 March 2006

29. SHARE OPTION SCHEMES (continued)

Expected volatility was determined by calculating the historical volatility of the Company's share price over the previous 3 years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non transferability, exercise restrictions and behavioural considerations. Changes in the subjective input assumptions could materially affect the fair value estimate.

Share options were granted under a service condition. This condition has not been taken into account in the grant date fair value measurement of the services received. There were no market conditions associated with the share option grants.

The Group recognised total expenses of approximately HK\$1,030,000 (2005: Nil) related to equity-settled share-based payment transactions during the year.

Pre-IPO Share Option Scheme

The purpose of the Pre-IPO Share Option Scheme is to recognise the contribution of the senior management and independent contractors of the Group to its growth. The principal terms of the Pre-IPO Share Option Scheme conditionally approved by written resolution of the shareholders of the Company dated 2 August 2002 were substantially the same as the terms of the Share Option Scheme described above except that:

- (a) the subscription price per share was HK\$0.01 representing a discount of approximately 96.67% of the offer price of HK\$0.30 under the placement and public offer of the Company's shares on 19 August 2002;
- (b) the total number of shares subject to the Pre-IPO Share Option Scheme was 84,000,000, representing 15% of the total issued share capital of the Company immediately following completion of the share offer and the capitalisation (but before enlargement by the allotment and issue of shares pursuant to the exercise of the over-allotment option and any share option granted under the Pre-IPO Share Option Scheme); and
- (c) save for the share options which have been granted under the Pre-IPO Share Option Scheme, no further share option was offered or granted under the Pre-IPO Share Option Scheme, as the right to do so was terminated upon the listing of the Company's shares on GEM.

Following the exercise in prior years of all the share options granted to option holders, there are no outstanding share options granted under the Pre-IPO Share Option Scheme as at 31 March 2006. In addition, the right to offer or grant further share options under the Pre-IPO Share Option Scheme was terminated upon the listing of the Company's shares on the GEM. Accordingly, the Pre-IPO Share Option Scheme was effectively terminated upon the exercise of all share options by all the option holders.

Summary of Financial Information

For the year ended 31 March 2006

RESULTS

| | Year ended 31 March | | | | 2006 HK\$'000 |
|---|-----------------------------|------------------|------------------|------------------|------------------|
| | 2002 HK\$'000 (Note1) | 2003 HK\$'000 | 2004 HK\$'000 | 2005 HK\$'000 | |
| Turnover | 96,109 | 55,743 | 22,696 | 36,836 | 17,258 |
| Profit (loss) from operations | 8,229 | 3,343 | (11,567) | (8,329) | (17,505) |
| Finance costs | (43) | (22) | (10) | (36) | (680) |
| Profit (loss) before taxation | 8,186 | 3,321 | (11,577) | (8,365) | (18,185) |
| Taxation (charge) credit | (530) | (790) | 789 | – | – |
| Profit (loss) attributable to equity holders of the Company | 7,656 | 2,531 | (10,788) | (8,365) | (18,185) |

ASSETS AND LIABILITIES

| | As at 31 March | | | | 2006 HK\$'000 |
|-------------------------|-----------------------------|------------------|------------------|------------------|------------------|
| | 2002 HK\$'000 (Note1) | 2003 HK\$'000 | 2004 HK\$'000 | 2005 HK\$'000 | |
| Non-current assets | 813 | 17,472 | 18,760 | 15,050 | 11,975 |
| Current assets | 23,876 | 40,655 | 29,241 | 21,085 | 32,800 |
| Current liabilities | 23,834 | 36,267 | 37,668 | 28,931 | 54,557 |
| Non-current liabilities | 131 | 946 | 39 | 2 | 171 |

Notes:

- (1) The results and assets and liabilities of the Group for the year ended 31 March 2002 have been extracted from the prospectus dated 13 August 2002 issued by the Company. These have been prepared on a combined basis as if the group structure on 22 April 2002 had been in existence throughout the year concerned.