



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)

Third Quarterly Report 2006

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

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

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HIGHLIGHTS

1. Turnover of the Group for the nine months ended 31 December 2006 was approximately HK\$49.7 million, representing an increase of approximately 398% as compared to the corresponding period in 2005.
2. Loss of the Group for the nine months ended 31 December 2006 was approximately HK\$7.3 million as compared to the loss of approximately HK\$14.7 million for the corresponding period in 2005.
3. Loss per share of the Group was approximately HK0.9 cents for the nine months ended 31 December 2006 (2005: HK1.82 cents).
4. The Board does not recommend the payment of any dividend for the nine months ended 31 December 2006 (2005: HK\$Nil).

UNAUDITED QUARTERLY RESULTS

The Directors announce the unaudited consolidated results of Milkyway Image Holdings Limited (the "Company") and its subsidiaries (together, the "Group") for the three months and nine months ended 31 December 2006 together with the comparative unaudited figures for the corresponding periods in 2005 as follows:-

	Notes	Three months ended 31 December		Nine months ended 31 December	
		2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Turnover	2	7,188	–	49,729	9,977
Cost of sales		(6,398)	–	(38,027)	(7,391)
Gross profit		790	–	11,702	2,586
Other revenue	2	100	70	403	207
Other operating expenses		(6,342)	(5,836)	(18,265)	(17,032)
Loss from operations		(5,452)	(5,766)	(6,160)	(14,239)
Finance costs	3	(426)	(198)	(1,143)	(451)
Loss before taxation		(5,878)	(5,964)	(7,303)	(14,690)
Taxation	4	–	–	–	–
Loss attributable to equity holders of the Company		(5,878)	(5,964)	(7,303)	(14,690)
Dividend	5	–	–	–	–
Loss per share (HK cents)					
Basic	6	(0.70)	(0.74)	(0.90)	(1.82)
Diluted		(0.70)	(0.74)	(0.90)	(1.82)

NOTES

1. Basis of preparation

The unaudited consolidated results of the Group have been prepared in accordance with accounting principles generally accepted in Hong Kong and complied with accounting standards issued by the Hong Kong Institute of Certified Accountants and the applicable disclosure requirements of Chapter 18 of the GEM Listing Rules.

The accounting policies and methods of computation used in the preparation of these unaudited consolidated results are consistent with those used in the preparation of the Group's annual financial statements for the year ended 31 March 2006.

2. Turnover and Other revenue

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

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

	For the three months ended 31 December		For the nine months ended 31 December	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Turnover:				
Film production	–	–	13,014	650
Film distribution	7,188	–	36,715	9,327
	7,188	–	49,729	9,977
Other revenue:				
Interest income	50	26	96	29
Sundry income	50	44	307	178
	100	70	403	207
Total income	7,288	70	50,132	10,184

3. Finance costs

	For the three months ended 31 December		For the nine months ended 31 December	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Interests on:				
Bank loans wholly repayable within five years	–	62	10	147
Other borrowings	411	131	1,101	297
Finance leases	15	5	32	7
	426	198	1,143	451

4. Taxation

No provision for Hong Kong Profits Tax has been made for the three months and nine months ended 31 December 2006 (three months and nine months ended 31 December 2005: Nil) as the Group had no estimated assessable profits for the periods. The Group did not generate any assessable profits in other jurisdictions during these periods.

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

5. Dividend

The Directors do not recommend the payment of any dividend for the nine months ended 31 December 2006 (2005: Nil).

6. Loss per share

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

	For the three months ended 31 December		For the nine months Ended 31 December	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Loss for the periods				
Loss attributable to equity holders of the Company	(5,878)	(5,964)	(7,303)	(14,690)
Number of shares				
Weighted average number of ordinary shares used in the calculation of basic loss per share	836,500,000	805,000,000	815,538,182	805,000,000
Effect of dilutive potential ordinary shares	–	–	–	–
Weighted average number of ordinary shares used in the calculation of diluted loss per share	836,500,000	805,000,000	815,538,182	805,000,000

The computation of diluted loss per share for the three months and nine months ended 31 December 2006 and 2005 did not assume the exercise of the Company's outstanding share options existed during that periods since their exercise would reduce loss per share.

7. Changes in Equity

	Share capital HK\$'000	Share premium HK\$'000	Contributed surplus HK\$'000	Share-based compensation reserve HK\$'000	Accumulated losses HK\$'000	Total HK\$'000
At 1 April 2005	8,050	15,050	10	-	(15,908)	7,202
Loss for the nine months ended 31 December 2005	-	-	-	-	(14,690)	(14,690)
Share option scheme - value of employee services	-	-	-	1,030	-	1,030
At 31 December 2005	8,050	15,050	10	1,030	(30,598)	(6,458)
At 1 April 2006	8,050	15,050	10	1,030	(34,093)	(9,953)
Issue of shares	1,610	1,932	-	-	-	3,542
Share issue expenses	-	(159)	-	-	-	(159)
Loss for the nine months ended 31 December 2006	-	-	-	-	(7,303)	(7,303)
At 31 December 2006	9,660	16,823	10	1,030	(41,396)	(13,873)

On 14 December 2006, the Company placed 161,000,000 shares of HK\$0.01 each to independent investors at a price of HK\$0.022 per shares.

8. Related Party Transactions

- (a) During the period under review, two private companies of which Mr. Law Sau Yiu, Dennis ("Mr. Law") and Ms. Teng Chia Lin, Chialina ("Ms. Teng"), both executive directors of the Company, are directors and/or shareholders, have advanced loans to the Group. The loans are unsecured, bear interest at commercial rate and are repayable within one year from the date of advances. At 31 December 2006, the aggregate amount of loans was HK\$31.5 million. During the three months and nine months ended 31 December 2006, the Group paid interest of approximately HK\$411,000 and HK\$1,101,000 respectively (2005: approximately HK\$131,000 and HK\$297,000 respectively) to the lenders.

- (b) During the period under review, Mr. Law continued to provide personal guarantee to a bank to secure facilities granted to the Group. The facility is also secured by listed securities, other than that of the Company, placed by Mr. Law having discounted market value not less than the amount of banking facility utilised by the Group from time to time. No fee in respect of the provision of personal guarantee was paid to him by the Group during the period (2005: Nil). No facility was utilized by the Group at 31 December 2006.

9. Share Consolidation

On 5 December 2006, the Board proposed that every ten issued and unissued shares of HK\$0.01 each in the share capital of the Company be consolidated into one consolidated share of HK\$0.10 each. The share consolidation was approved by the Company's shareholders at the extraordinary general meeting held on 10 January 2007.

10. Placing of Convertible Bonds

On 5 December 2006, the Company entered into a bond placing agreement with an independent placing agent to procure independent subscribers for bonds to be issued in two tranches up to an aggregate principal amount of HK\$20 million. Holders of the bonds shall have the right at any time after the date of issue of the bonds to convert any outstanding amount of the bonds at the conversion price of HK\$0.025 (equivalent to HK\$0.25 upon share consolidation becoming effective as referred to in 9 above) into the Company's shares of HK\$0.01 each (shares of HK\$0.1 each upon share consolidation becoming effective as referred to in 9 above). The placing of convertible bonds has been approved by the Company's shareholders at the extraordinary general meeting held on 10 January 2007 and was completed on 30 January 2007.

FINANCIAL AND BUSINESS REVIEW

For the nine months ended 31 December 2006, the Group recorded a turnover of approximately HK\$49.7 million (2005: HK\$10 million) and a loss attributable to equity holders of the Company of approximately HK\$7.3 million (2005: HK\$14.7 million).

During the period under review, the Group completed the productions of three film projects titled, "love@first note" [戀愛初歌], "Fatal Contact" [黑拳], "Election 2" [黑社會以和為貴] all of which have been released for exhibition in local cinemas and overseas distribution. The Group owns the film rights of these films for distribution. Distribution income recognized for the nine months ended 31 December 2006 in accordance with the Group's revenue recognition policy amounted to approximately HK\$36.7 million (2005: HK\$9.3 million). Meanwhile, the Group continued in the provision of film production service to other film companies, out of which the film, "Exiled" [放•逐], has completed and released for exhibition. Revenue generated in respect of film production services during the period under review amounted to approximately HK\$13 million (2005: HK\$0.7 million).

Gross profit amounted to approximately HK\$11.7 million for the nine months ended 31 December 2006 (2005: HK\$2.6 million) with a gross profit ratio of approximately 24% as compared with the corresponding period in 2005 of approximately 26%.

A loss attributable to equity holders of the Company of approximately HK\$7.3 million was recorded for the nine months ended 31 December 2006 (2005: HK\$14.7 million). The improved results are mainly due to the significant increase in turnover from that in the corresponding period in 2005.

Although the gross profit for the nine months ended 31 December 2006 has increased significantly from that in the corresponding period in 2005, the Group's total operating expenses incurred in the period also increased from HK\$17.5 million in 2005 to HK\$19.4 million in 2006. Promotion expenses in relation to film distributions increased commensurately with the increased revenue generated from this segment during the period. Furthermore, finance costs jumped from HK\$451,000 in 2005 to HK\$1,143,000 for the same period in 2006 due to the continued high level of borrowings during the period. Except for the promotion expenses and finance costs, the Group's other operating expenses remained steady during the period.

During the period under review, the Group's production, "Exiled" 「放•逐」, was awarded Best Action Choreography in The 43rd Taipei Golden Horse Award. It was also awarded Best Director in The 13th Hong Kong Film Critics Society Award and granted as Recommended Film in the same event. Apart from that, film projects previously produced by the Group continued receiving acclaims out which the film, "Election 2" 「黑社會以和為貴」, was awarded Best Film in The 13th Hong Kong Film Critics Society Award.

The Group's film directors also received acclaims during the period, out of which Mr. To Kei Fung was granted the title Filmmaker In Focus at the 36th International Film Festival Rotterdam whereas Mr. Law Wing Cheong, film director of "2 Become 1" 「天生一對」, produced by the Group, was nominated as Best New Director in The 26th Hong Kong Film Award.

PROSPECTS

Although the Group's performance during the period under review has indicated an improvement from that in the corresponding period in 2005, the persistence of high level of borrowings that resulted in growing trend of finance costs remained a key concern to the Group. The Group has been adopting cost control measures and operating expenses other than finance costs and promotion expenses remained steady despite of the trend of starting inflation in the local economy. Following the issue of new shares during the period and the placing of zero coupon convertible bonds subsequent to the period end, the Group was able to utilize other cost effective means to finance the operation of the Group.

In view of the encouraging performance of the film distribution segment, the Group will continue its investment in film projects. On the other hand, with the available funds, the Group will make every endeavour in identifying lucrative business opportunities to maximize returns to the shareholders of the Company.

OTHER INFORMATION

1. Directors' and Chief Executives' Interests and Short Positions in Shares, Underlying Shares and Debentures

At 31 December 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:

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

Name of Director	Personal Interests	Family Interests	Corporate Interests	Other Interest	Total	%
Mr. Law Sau Yiu, Dennis	-	-	373,760,000 (Note)	-	373,760,000	38.69
Ms. Teng Chia Lin, Chialina	-	-	373,760,000 (Note)	-	373,760,000	38.69

Note:

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

Outstanding share options

The Company adopted two share option schemes on 2 August 2002, namely, the pre-IPO share option scheme ("Pre-IPO Share Option Scheme") and the share option scheme ("Share Option Scheme"). The principal terms of the two share option schemes have been set out in the note 29 to the financial statements as included in the annual report of the Company for the year ended 31 March 2006.

Details of the share options outstanding under the Share Option Scheme and movements during the nine months ended 31 December 2006 were as follows:

Chief executive	Date of grant	Outstanding as at 1 April 2006	Granted during the period under review	Exercised during the period under review	Lapsed during the period under review	Outstanding as at 31 December 2006	Vesting period	Exercise period	Exercise price
Mr. To Kei Fung	28 October 2005	64,400,000	-	-	-	64,400,000 (Note a)	N/A	Between 20 September 2005 to 19 September 2015	HK\$0.04 (Note b)

Notes:

- (a) 64,400,000 shares representing approximately 6.7% 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 exercise price may subject to adjustment as a result of share consolidation as referred to in note 9 to the unaudited quarterly results above.

Save as disclosed above, at 31 December 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.

2. Directors and Chief Executives' Rights to Acquire Shares or Debentures

Save as disclosed above, at 31 December 2006, neither the Company nor any of its subsidiaries was a party to any arrangements to enable the directors and chief executives of the Company to acquire benefits by means of the acquisition of shares in, or debentures of the Company or any other body corporate, and none of the directors and chief executive of the Company or their spouses or children under the age of 18, had any right to subscribe for the securities of the Company, or had exercised any such rights.

3. Substantial Shareholders

At 31 December 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:

Name of shareholder	Number of shares held	% of the Company's issued share capital
Right Opportune Limited	373,760,000 (Note a)	38.69
Grand Sum Assets Limited	59,500,000	6.16
Ms. Lee Po Yi, Shirley Anne	59,500,000 (Note b)	6.16

Notes:

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

Save as disclosed above, at 31 December 2006, the Company has not been notified of any persons (other than the Directors or chief executive of the Company) who had interests or short positions in the shares and underlying shares of the Company which were to be recorded in the register required to be kept under Section 336 of the SFO and/or who were directly or indirectly interested in 5% or more of the issued share capital carrying rights to vote in all circumstances at general meetings of any other members of the Group.

4. Competing Interests

At 31 December 2006, none of the directors, management shareholders and substantial shareholders, or their respective associates had any interests in any business which competes or may compete with the business of the Group pursuant to Rule 11.04 of the GEM Listing Rules.

5. Purchase, Sale or Redemption of Listed Securities of the Company

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

6. **Audit Committee**

The Company has established an audit committee with written terms of reference in compliance with Rules 5.28 to 5.29 of the GEM Listing Rules. The primary duties of the audit committee are to review and supervise the financial reporting process and internal control procedures of the Group. The audit committee comprises the three independent non-executive directors namely, Mr. Lung Hak Kau, Ms. Wai Lai Yung and Ms. Tsang Kei Ling. The audit committee has reviewed the Group's unaudited condensed consolidated financial statements for the nine months ended 31 December 2006.

7. **Remuneration Committee**

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

8. **Compliance with Rules 5.48 to 5.67 of the Gem Listing Rules**

The Company has adopted a code of conduct regarding Directors' securities transactions on terms no less exacting than the required standard of dealings as set out in Rules 5.48 to 5.67 of the GEM Listing Rules. Having made specific enquiry of all Directors, all Directors have complied with such code of conduct and the required standard of dealings regarding directors' securities transactions throughout the nine months ended 31 December 2006.

9. **Board of Directors**

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

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

Hong Kong, 8 February 2007