

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Review

The Group recorded a turnover of HK\$46,411,000 for the six months ended 30th June, 2005, a 57% decrease from HK\$108,067,000 for the same period of the previous year. Of the total turnover amount, HK\$42,859,000 or 92% was generated from film distribution, HK\$377,000 or 1% was generated from video distribution and HK\$3,175,000 or 7% was generated from production services. The loss attributable to equity holders of the Company for the six months ended 30th June, 2005 was HK\$26,458,000, representing a 33% improvement over the corresponding figure of HK\$39,546,000.

The decrease in turnover for the six months ended 30th June, 2005 was mainly attributed to the rampant piracy and the downturn of Hong Kong made movies which affected the theatre attendance and the sales of video products. In response to the sluggish market, the Group reduces the budgets for its productions and the number of productions in 2005. The Group released 6 new films in the six months ended 30th June, 2005 and 7 new films in the six months ended 30th June, 2004.

The improvement in loss for the six months ended 30th June, 2005 was principally attributed to the decrease in the Group's share of loss of Riche Group from HK\$16,912,000 in the six months ended 30th June, 2004 to HK\$6,507,000 in the six months ended 30th June, 2005.

Dividend

The directors do not recommend the payment of an interim dividend for the six months ended 30th June, 2005 (2004: nil).

Business Review

During the six months ended 30th June, 2005, turnover and segment profit for Hong Kong and Macau amounted to HK\$25,129,000 (2004: HK\$65,142,000) and HK\$746,000 (2004: HK\$5,679,000), respectively. The unsatisfactory results for Hong Kong and Macau were mainly attributed to the downturn of Hong Kong made movies and the growing popularity of "Bit Torrent" which affected the theatre attendance and the sales of video products. In addition, the Group had to maintain large-scale advertising and promotion campaigns for its films in order to increase their publicity, which is crucial for overseas distribution.

Turnover and segment loss for the PRC amounted to HK\$6,266,000 (2004: HK\$13,348,000) and HK\$3,923,000 (2004: HK\$7,272,000), respectively. The decrease in turnover was mainly attributed to the decline in number of new films exhibited from 7 in the six months ended 30th June, 2004 to 3 in the six months ended 30th June, 2005. The deterioration in segment loss was mainly attributed to the decrease in average box office receipts per film, which was resulted from the distributor's inability to obtain favourable cinema locations and screening period as Chinese first-tier cinemas have strong preference for exhibiting Hollywood films following the lifting of foreign film quota restrictions in 2004.

Turnover and segment profit for South-east Asia amounted to HK\$9,880,000 (2004: HK\$17,138,000) and HK\$3,599,000 (2004: HK\$3,132,000), respectively. The decrease in turnover was mainly attributed to the decrease in the number of films sub-licensed during the period under review. The improvement in segment profit was mainly attributed to the costs of certain films had been reduced by impairment losses recognised in previous years.

Turnover and segment profit for America and Europe amounted to HK\$3,092,000 (2004: HK\$9,636,000) and HK\$2,827,000 (2004: HK\$6,752,000), respectively. The decrease in turnover was mainly attributed to the decrease in the number of films sub-licensed. The improvement in segment profit ratio was mainly attributed to the costs of certain films sub-licensed had almost been fully amortised.

To stay competitive in the market, the Group has regularly reviewed its cost structure. During the six months ended 30th June, 2005, the Group had exercised prudence measures on cost policies and reduced its headcount. As a result, administrative expenses (excluding share-based compensation of HK\$12,721,000) decreased to HK\$19,165,000, a 25% decrease from HK\$25,495,000 for the same period of the previous year.

The territory supply agreement entered into between the Group and Riche Pictures Limited, a wholly-owned subsidiary of Riche Multi-Media Holdings Limited, on 5th February, 2002 expired in April 2005. In view of the current market condition in the PRC, both parties agreed not to renew the territory supply agreement. The directors believe that the non-renewal of the territory supply agreement provides a greater flexibility in formulating the Group's distribution strategy.

Liquidity and Financial Resources

The Group funded its operations through a combination of cash generated from operations, convertible loan notes and bank borrowings. As at 30th June, 2005, the Group's cash and bank balances amounted to HK\$97,788,000.

As at 30th June, 2005, the Group had total borrowings of HK\$48,189,000 representing a bank mortgage loan of HK\$16,375,000 which was secured by the Group's investment properties, interest bearing at 2.5% below the Hong Kong Dollar Prime Lending Rate per annum and repayable by 103 monthly instalments; a revolving bank loan of HK\$8,300,000 which was secured by the Group's leasehold land and buildings and investment properties, interest bearing at 1% per annum or Hong Kong Interbank Offered Rate (subject to availability) and repayable on demand; an instalment loan from a bank of HK\$3,514,000 which was secured by a first legal charge over all copyrights on a film produced by the Group in the beginning of 2005, interest bearing at 6.531% per annum and repayable by 13 monthly instalments; and convertible loan notes of HK\$20,000,000 (including equity component of HK\$545,000) which were unsecured, interest bearing at 4% per annum and maturing on 30th June, 2007. The convertible loan notes carry the rights to convert into shares of the Company at a conversion price of HK\$5.83 per share.

Based on the shareholders' funds of HK\$581,418,000 as at 30th June, 2005, the gearing ratio was 0.08. As at 30th June, 2005, the current ratio of the Group was 4.37.

As the majority of the Group's transactions, assets and liabilities are denominated in Hong Kong Dollars and United States Dollars, the exposure to fluctuation in exchange rates was considered to be minimal and no hedge activity were considered necessary.

As at 30th June, 2005, the Group had no contingent liability.

On 15th December, 2004, the Company had conditionally agreed to place 60,765,000 new shares to independent investors at a price of HK\$0.60 per share. The issue of 60,765,000 new shares was approved by the Company's shareholders at a special general meeting held on 21st January, 2005. The placing was completed on 27th January, 2005. The net proceeds of HK\$35,600,000 were intended to be used as to HK\$20,000,000 for production of two movies and as to the balance of HK\$15,600,000 for general working capital of the Group.

In January 2005, certain option holders exercised their option rights to subscribe for an aggregate of 7,969,939 shares at an exercise price of HK\$0.564 per share and an aggregate of 9,800,000 shares at an exercise price of HK\$0.52 per share. The net proceeds from the exercise of option rights amounted to HK\$9,591,000.

On 24th February, 2005, Porterstone Limited, a substantial shareholder of the Company, and Mr. Heung Wah Keung, a substantial shareholder and an executive director of the Company, entered into a top-up placing agreement with a placing agent and a subscription agreement with the Company respectively. Pursuant to the top-up placing agreement, Porterstone Limited and Mr. Heung Wah Keung placed an aggregate of 76,600,000 existing shares to independent investors at a price of HK\$0.50 per share. Pursuant to the subscription agreement, Porterstone Limited and Mr. Heung Wah Keung subscribed for an aggregate of 76,600,000 new shares at a price of HK\$0.50 per share. 76,600,000 new shares issued for the subscription on 7th March, 2005. The net proceeds of HK\$37,300,000 were intended to be used for general working capital of the Group and/or any future possible acquisition which is yet to be identified.

Associates

Riche Multi-Media Holdings Limited

As at 30th June, 2005, the Group held approximately 42.54% equity interest in the group headed by Riche Multi-Media Holdings Limited ("Riche", together with its subsidiaries "Riche Group"). Riche Group is principally engaged in film distribution, sub-licensing of film rights and investments in securities.

As at 30th June, 2005, Riche Group had net assets of HK\$56,285,000. Turnover and loss of Riche Group for the six months ended 30th June, 2005 were HK\$31,573,000 and HK\$15,265,000, respectively. Accordingly, the Group shared a loss of HK\$6,507,000 for the six months ended 30th June, 2005.

On 9th April, 2005, Riche Group entered into a conditional sale and purchase agreement with Leadfirst Limited and Mr. Benny Ki for acquiring 100% of the issued share capital of a company at a consideration of HK\$600,000,000. The company has been appointed as the sole and exclusive service provider for the promotion and introduction of customers to a six-star luxurious cruise ship and the provision of rolling and settlement services for customers of the gaming establishment on board the cruise ship for a term of 3 years with an option to renew for another 3 years. The consideration shall be satisfied by the issue of a convertible note of HK\$500,000,000 and the cash payment of HK\$100,000,000. The cruise ship has arrived at Hong Kong in July 2005 and is under extensive renovation. The acquisition will be completed upon the commencement of the operation of the gaming establishment.

On 7th September, 2005, Classical Statue Limited ("Classical"), a wholly-owned subsidiary of the Company, entered into a placing and subscription agreement with a placing agent and Riche. Pursuant to which, Classical has agreed to place 400,000,000 existing shares of Riche ("Riche Shares") to not less than six independent investors at a price of HK\$0.34 per Riche Share and conditionally agreed to subscribe for 400,000,000 new Riche Shares at a price of HK\$0.34 per Riche Share. The placing and subscription agreement was completed on 20th September, 2005. The Group now interests in approximately 39.24% of the enlarged issued share capital of Riche.

Together Again Limited

As at 30th June, 2005, the Group held 49% equity interest in the group headed by Together Again Limited ("TAL Group"), a company incorporated in British Virgin Islands with limited liability and it indirectly holds 85% equity interest in China Entertainment Group, Inc. (formerly known as China Artists Agency Inc.), a U.S. public company traded on the Over-The-Counter Bulletin Board. TAL Group is principally engaged in the provision of artist management services.

As at 30th June, 2005, TAL Group had net assets of HK\$10,602,000. Turnover and profit of TAL Group for the six months ended 30th June, 2005 were HK\$12,466,000 and HK\$2,786,000, respectively. Accordingly, the Group shared a profit of HK\$1,365,000 for the six months ended 30th June, 2005.

Acquisition of Leasehold Land and Buildings

On 7th July, 2005, the Group completed the acquisition of the leasehold land and buildings from Riche Group at a total consideration of HK\$9,000,000. The consideration has been agreed between the parties based on arms' length negotiations with reference to a property valuation done by an independent firm of professional chartered surveyors appointed by the Group. The acquisition permitted the Group to expand its post-production premises and business on film. The consideration was satisfied by internal resources of the Group.

Signing of a Non-binding Letter of Intent

On 15th September, 2005, the Company entered into a non-binding letter of intent with Mr. Phua Wei Seng, an independent third party, for the acquisition by the Company of an equity interest in a company involved in gaming in Macau. Pursuant to the non-binding letter of intent, a refundable deposit of HK\$20,000,000 was placed by the Company with Mr. Phua Wei Seng. If the proposed transaction does not materialise or fails to complete by 14th December, 2005, the deposit will be returned to the Company.

Employees

As at 30th June, 2005, the Group employed 51 (2004: 74) staff of which 2 (2004: 5) staff are based in the PRC. Total staff costs (including directors' remuneration) amounted to HK\$8,603,000 for the six months ended 30th June, 2005 (2004: HK\$10,319,000). The directors believe that the quality of its employees is the single most important factor in sustaining the Group's reputation and improving its profitability. The staff are remunerated based on their work performance, professional experience and prevailing industry practices. Apart from the basic salaries, pension fund and medical schemes, discretionary bonuses and options are awarded to certain staff according to the assessment of individual performance.

Prospect

With the downturn of Hong Kong made movies and the rampant piracy, the Group has adopted a more cautious approach in producing new films. In addition, the Group will continue to cautiously monitor the business environment and implement a series of cost control measures to ensure a cost-effective operating structure. In view of the difficult market conditions, the Group will seek diversification opportunities in order to broaden its earnings base.