Management Discussion and Analysis

BUSINESS REVIEW

For the year ended 31st December 2005, the Group completed its acquisition of the Anglo Alliance, a leading player in the China media industry with access to the Travel Channel. This acquisition launched the Group into the high growth China media sector. After reviewing the operations and analysing the markets and potentials, we have sought to consolidate and focus the Group's business in this growth industry. During the year under review, the Group reported a turnover of approximately HK$33,691,000 (2004: HK$38,630,000) and a net loss of HK$22,187,000 (2004: net loss of about HK$9,931,000). The loss recorded in the current year was mainly due to the share of loss of the jointly controlled entity and an increase in administration expenses.

Riding on the vast potential of China's media market, and with the tireless efforts made by management on consolidating the Group's businesses, a solid platform has been created and which is expected to help generate material growth in the years ahead. Consistent with its efforts, the Group will continue to strategically focus its operations toward developing the burgeoning China media sector, while placing Anglo Alliance as its core operation.

Below is a review of operations for each division of the Group:

China Media Business

Anglo Alliance is engaged in various media related businesses including investing in movie and television drama productions, serving as an advertising agency and the holding of a joint venture company which owns the operating rights of the Travel Channel. Following its acquisition on 31st May 2005, Anglo Alliance has contributed seven months of revenue to the consolidated accounts of the Group for the year under review.

Capitalising on exponential growth in the TV advertising industry, the "Travel Channel" has become a highlight of the Group's operations. Being one of 31 provincial satellite TV channels with nationwide access, the Travel Channel is well positioned to capture the ever-growing demand by mainland viewers for thematic programming — specialising in travel, lifestyle and entertainment. To better satisfy viewers' diverse needs, the Travel Channel has undergone a major revamp as of 9th January 2006. With fresh, comprehensive content comprising of four categories, namely, reality, variety, fashion and travel, as well as a total of 35 specialised programs, the revamp format has attracted and captivated audiences everywhere.

The Travel Channel, well known for its unique and modern style, holds a distinct identity that is separate from all other TV channels in China. In particular, it is well positioned to attract a niche viewership that is well educated with above average income and corresponding spending power. Thus, the Travel Channel is poised to attract upscale advertisers and stand out from the highly competitive advertising market. The Group is focusing more resources to expand the advertising agency division to capture this high-growth market.

Remaining in the entertainment sphere, the Group is also seeking opportunities arising from the production and distribution of TV drama series and films in China. Accordingly, in 2005, the Group has distributed a number of films such as "Peacock" and "A letter from an unknown woman" and certain TV programs in China and overseas, contributing to a turnover of approximately HK$10 million to the Group. With the leverage on the name and market position of Asian Union Film and Media ("AUFM"), the Group will continue to explore opportunities to invest in the blockbuster movies and popular TV programs.

Building on the solid business foundation of Anglo Alliance, the Group will seek to consolidate all of its businesses and strive to establish an optimum business model. With promising growth in the media sector and a robust economy in China, the Group foresees a bright future in the multimedia and entertainment sectors.

Digital Broadcasting Investment

With the Chinese government promoting and mandating digitalisation in the country, DVN's sales performance improved significantly with increasing STB sales.

The number of DVN produced boxes and DVN licensed boxes increased by over 3 times compared to 2004, to 1,010,128 set top boxes. As a result, during 2005, DVN's revenue increased by 80% to HK$304 million, total gross profit increased by 52% to HK$74.6 million, while EBITDA before provisions reversed to a positive HK$9.0 million. Net loss declined by 33.5% to HK$39.7 million. With continued acceleration of its STB distribution, DVN is optimistic that its financial outlook will continue to improve.

Sales have accelerated as DVN has implemented its pioneering mass digitalisation model in Qingdao. The model has been so successful, that SARFT has nominated Qingdao as the flagship city for full digitalisation and is now encouraging cities and even entire provinces to adopt the Qingdao model. With the government's continued push towards digitalisation, DVN expects sales of STBs to continue to increase. For the first three months of 2006, DVN has already sold 426,295 STBs. DVN expects significant sales from Guangxi, the first province in China to attempt to migrate its entire 3 million subscriber network to digital. Foshan will also continue its forced migration rollouts.

DVN continues to look for new partners, particularly those that could help it expand its territories. DVN believes that the opportunities are enormous and that it makes more sense to partner with other companies that can complement DVN's core strength as a system integrator and provider of software for digital television.

Communication Division

With the aim of aligning operations and directing the Group's strategic focus on developing the media business in China, the management has commenced reviewing the communication side of its operations. Accordingly, the long-term strategy for this area of expertise is currently being mapped out. Turnover for the communication division declined from HK$3,889,000 in 2004 to HK$2,561,000 in 2005 and has contributed a gain of HK$60,000 (2004: a loss of HK$354,000) to the Group.

Securities Trading

The Hong Kong economy continued to generate growth during the year 2005. Capitalising on this improved business environment and positive market sentiment, the Group traded securities in the capital market and recorded a turnover of HK$1,387,000 (2004: HK$16,561,000) and a loss of approximately HK$48,000 (2004: a profit HK$ of 1,249,000) for this segment.

Home Audio Division

Facing intense price competition in the market, the Group will continue to seek ways to expand into higher value products in order to raise profit margins as well as improve overall performance of the business. Concurrently, the Group will review operations and implement a long-term strategy that aligns the business in sync with its media activities in China. This year, the home audio recorded a turnover of HK$19,384,000 (2004: HK$18,180,000) and a loss of approximately HK$3,700,000 (2004: HK$3,092,000) for this segment.

Future Prospects

In the future, the Group expects to see promising growth in China's media sector. While taking advantage of being an early entrant in the industry, the Group will continue to focus on this segment and align all of its existing operations with this core business to achieve further synergies.

Among the media industries that Anglo Alliance is engaged in, advertising has become a focal point due to the strong momentum being generated within that segment. The growth of China's economy is expected to moderate in 2006 but remain robust, boosted by solid investments and export indicators that point to strong consumption. Benefiting from this trend, the advertising industry in China is likely to continue enjoying double-digit growth, and at a more rapid rate than many other Asian countries.

Gross estimates from ACNielsen forecasts that China's advertising market will expand by 29.7% in 2006 versus 19.4% in 2005, contributing to almost 34% (gross value: US$4.8 billion) of the total Asian advertising market (gross value: US$14.2 billion) in 2006. As well, with still more positive developments ahead, including the 2008 Beijing Olympics and 2010 World Expo in Shanghai, China's advertising industry is expected to reap further growth in the years to come.

Among all of the advertising mediums available in China, CVSC-TNS Research has found that 77.98% of advertising expenditures are directed towards TV advertising, amounting to RMB 150.3 billion, with a further 20-30% increase expected this year. Taking such findings into account, AUFM as well as the Group stands to directly benefit as the former is engaged in the production of quality advertisement for top tier companies.

Consequently, the Group views the advertising sector as a major growth driver and will seek to fully tap into this specific area. Especially since the Travel Channel can serve as an ideal platform for attracting upscale advertisers with its niche positioning, thus helping fuel the Group's growth in the TV advertising market.

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Looking ahead, the Group will continue to apply a proactive yet prudent approach to investing in the media field so as to expand its core operations and develop a diversified yet balanced business model. As such, the Management envisions stronger growth potential for its new business and holds the conviction that it will achieve still greater results in the coming years.

FINANCIAL REVIEW

Liquidity and financial resources

As at 31st December 2005, the Group held cash deposits of HK$15,548,000, an increase of 9.9% compared to 31st December 2004. The current ratio increased from 1.07 at the prior year end to 4.5 as at 31st December 2005. The gearing ratio, representing long term liabilities to net worth, increased from 0.093 at 31st December 2004 to 0.18 at 31st December 2005.

There were no significant exposures to foreign currency fluctuations. All borrowings during the year were based on market interest rate. The Group had no long term bank loan and no bank overdrafts outstanding as at year end. The Group did not have any assets pledged or charged as at 31st December 2005.

During the year, the Company issued 654,850,000 shares at HK$0.12 each in February 2005 and raised approximately HK$78 million for general working capital. The Company also issued approximately 5.747 billion shares for the acquisition of Anglo Alliance.

SIGNIFICANT ACQUISITION

During the year, the Group has acquired 100% equity interests in Anglo Alliance. Anglo Alliance indirectly holds approximately 50% of the registered capital in AUFM. AUFM is engaged in various media related businesses, including production of television drama, investment in movie production, advertising agency as well as advertising and content production for the Travel Channel.

The maximum consideration for this acquisition is HK$550.0 million, subject to adjustments. Details of this acquisition are disclosed in the Company's circular dated 13th May 2005.

NUMBER AND REMUNERATION OF EMPLOYEES, REMUNERATION POLICIES, BONUS AND SHARE OPTION SCHEMES AND TRAINING SCHEMES

As at 31st December 2005, the Group employed a total of 10 full-time employees in Hong Kong and a work force of about 33 in the PRC. The Group operates different remuneration schemes for sales and non-sales employees. Sales personnel are remunerated on the basis of on-target-earning packages comprising salary and sales commission. Non-sales personnel including engineering and product development staff are remunerated by monthly salary which are reviewed by the Group from time to time and adjusted based on performance. In addition to salaries, the Group provides staff benefits including medical insurance, contribution to staff provident fund and discretionary training subsidies. Share options and bonuses are also available at the discretion of the Group and depending on the performance of the Group.