

MANAGEMENT DISCUSSION AND ANALYSIS

Financial review

The Group recorded a turnover of HK\$56,042,000 for the six months ended 30th June 2006, a 21% increase from HK\$46,411,000 for the same period in the previous year. Of the total turnover amount, HK\$52,167,000 or 93% was generated from film distribution, the remaining 7% was generated from video distribution and other production services.

The profit attributable to equity holders of the Company for the six months ended 30th June 2006 was HK\$71,002,000, representing a 368% improvement over loss of HK\$26,458,000 in the last corresponding period.

During the period under review, the Group had recognized a gain on deemed disposal of interest in an associate of HK\$62,582,000 from Riche Multi-Media and a gain on disposal of an associate of HK\$21,400,000 from Golden Capital International Limited. The improvement in current period's result mainly attributable to these gain and better performance in film distribution segment. This period, the Group had released 6 new films in the market which was same as last corresponding period, including popular films like "The Shopaholic" and "Election II". In response to the weak market condition of the entertainment industry, especially for the Chinese language films, the Group has adopted cautious measures to secure the revenue and control budget for each new film. These measures were proved effective and better gross profit was achieved.

Dividend

The directors do not recommend the payment of an interim dividend for the six months ended 30th June 2006 (2005: nil).

Business Review

During the six months ended 30th June 2006, turnover and segment profit from Hong Kong and Macau amounted to HK\$34,923,000 (2005: HK\$25,129,000) and HK\$5,642,000 (2005: HK\$746,000) respectively. The achievement in the performance in the market was mainly attributable to the cautious selection in film production and the tight control on marketing and distribution expenses. The marketing and distribution expenses for the six months ended 30th June 2006 was HK\$9,009,000, representing a 31% decrease from HK\$12,964,000 for the last corresponding period.

Turnover and segment profit from the PRC amounted to HK\$8,783,000 (2005: HK\$6,266,000) and HK\$4,012,000 (2005: loss of HK\$3,923,000) respectively. The Group has sub-licensed China theatrical rights to other distributor for a fixed amount of distribution fees, thus securing the revenue and margin received by the Group.

Turnover and segment profit from South-east Asia amounted to HK\$10,817,000 (2005: HK\$9,880,000) and HK\$3,858,000 (2005: HK\$3,599,000) respectively. The performance of South-east Asia market has stable increment.

Turnover and segment profit from America and Europe amounted to HK\$657,000 (2005: HK\$3,092,000) and HK\$15,000 (2005: HK\$2,827,000) respectively. The decrease in turnover and segment profit was attributed to the costs of certain films sub-licensed in last period had been fully amortized.

To stay competitive in the market, the Group has regularly review its costs structure in these years by exercised prudence measures on cost policies and reduced its headcount. As a result, administrative expenses keep at a reasonable level. For the six months ended 30th June 2006, administrative expenses decreased to HK\$17,581,000, a 8% decrease from HK\$19,165,000 (excluding share-based payment expenses of HK\$12,721,000) for the same period in the previous year.

Liquidity and Financial Resources

As at 30th June 2006, the Group had total assets of approximately HK\$816,220,000 and a net current assets of HK\$364,658,000, representing a current ratio of 4.6 (31st December 2005: 4.0). The Group had a total cash and bank balances of approximately HK\$71,870,000 (31st December 2005: HK\$31,500,000). As at 30th June 2006, the Group had total borrowings of HK\$33,798,000 comprising a bank mortgage loan of HK\$14,277,000 which was secured by the Group's investment properties, interest bearing at 2.5% below the Hong Kong Prime Lending Rate per annum and repayable by 91 monthly instalments; an instalment loan from a bank of HK\$87,000 which was secured by a first legal charge over all copyrights on the Group's film, Himalaya Singh, interest bearing at 6.531% per annum and repayable by July 2006; and unsecured convertible loan notes of HK\$20,000,000 (including equity component of HK\$566,000) which is bearing interest at 4% per annum and will mature on 30th June 2007. The convertible loan notes carry the right to convert into shares of HK\$0.05 each in the share capital of the Company ("Shares") at the conversion price of HK\$5.83 per Share as at 30th June 2006. The Group's gearing remained low during the period with total debts of HK\$33,798,000 against shareholders' funds of HK\$702,622,000. This represents a gearing ratio, calculated in the basis of the Group's total borrowings over shareholders' fund of 5%.

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 was considered necessary. As at 30th June 2006, the Group had no contingent liability.

On 17th May 2006, Porterstone Limited ("Porterstone"), Dorest Company Limited ("Dorest"), Mr. Heung Wah Keung ("Mr. Heung") and Ms. Chen Ming Yin, Tiffany ("Ms. Chen") entered into a placing agreement with a placing agent and a top-up subscription agreement with the Company respectively. Pursuant to the placing agreement, Porterstone, Dorest, Mr. Heung and Ms. Chen placed an aggregate 104,105,000 existing Shares to independent investors at a price of HK\$0.33 per Share. Pursuant to the top-up subscription agreement, Porterstone, Dorest, Mr. Heung and Ms. Chen subscribed for an aggregate of 104,105,000 new Shares at a price of HK\$0.33 per Share. 104,105,000 new Shares issued for the subscription on 30th May 2006. The net proceeds of approximately HK\$33,300,000 was intended to be used as to HK\$20,000,000 for future investment and as to the balance for general working capital of the Group.

On 6th June 2006, the Company had conditionally agreed to place in aggregate 80,000,000 new Shares to PMA Asian Opportunities Fund, Diversified Asian Strategies Fund and Asian Diversified Total Return Limited Duration Company at a price of HK\$0.365 per Share. The issue of 80,000,000 new Shares was approved by the shareholders of the Company at a special general meeting held on 5th July 2006. The placing was completed on 7th July 2006. The net proceeds of approximately HK\$29,000,000 was intended to be used by the Group for the proposed acquisition of a hotel in Macau.

Associates

Riche Multi-Media

As at 30th June 2006, the Group had approximately 33.35% equity interest in Riche Multi-Media. The Riche Group are principally engaged in film distribution, sub-licensing of film rights and investments in securities. As at 30th June 2006, the Riche Group had net assets of approximately HK\$432,534,000. Turnover and net loss of the Riche Group for the six months ended 30th June 2006 were approximately HK\$12,762,000 and HK\$1,140,000 respectively. Accordingly, the Group had shared a net loss of approximately HK\$94,000 for the six months ended 30th June 2006 and a gain on deemed disposal of interest in an associate of HK\$62,582,000 from the following transaction.

During the period, the Riche Group entered into a conditional sale and purchase agreement with Northbay Investments Holdings Limited ("Northbay"), pursuant to which the Riche Group would acquire (i) 100% of the issued share capital of Shinhan-Golden Faith International Development Limited ("Shinhan-Golden") and (ii) the debts owned by Shinhan-Golden to Northbay, at an aggregate consideration of HK\$266,064,350 (the "Northbay Acquisition"). The consideration was satisfied by the allotment and issue of 1,330,321,745 shares of Riche Multi-Media at a price of HK\$0.20 per share. Shinhan-Golden's major asset is the 96.7% equity interest in Beijing Jianquo Real Estate Development Co. Ltd. (the "JV Co."). JV Co. is the registered and beneficial owner of a property (the "Property") located at No. 9, Gongyuan Xijie, Dongcheng District, Beijing, the PRC. The Northbay Acquisition was completed on 21st June 2006 and 1,330,321,745 shares of Riche Multi-Media had been issued on the same day. The equity interest in the Riche Group was diluted from 41.07% to 32.64% and a gain on deemed disposal was recognized. Thereafter, the Group acquired a further 0.71% equity interest in Riche Multi-Media in the open market with a total consideration of approximately HK\$7,900,000. As a result, the Group's equity interest in Riche Multi-Media increased to 33.35% as at 30th June 2006.

Together Again Limited

As at 30th June 2006, 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., 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.

The Group shared a loss of HK\$949,000 for the six months ended 30th June 2006 and an impairment loss recognized in respect of goodwill arising on acquisition of an associate of approximately HK\$6,300,000.

Acquisition of Daido Group Limited ("Daido")

On 3rd August 2006, Classical Statue Limited, a wholly-owned subsidiary of the Company entered into a sale and purchase agreement with Vision Harvest Limited and the guarantor, Mr. To Shu Fai for the purchase of 700,000,000 Daido shares for a total consideration of HK\$52,500,000.

The transaction was completed on 11th August 2006. Daido has become an associate of the Company.

Daido and its subsidiaries carries on the business of properties investment and provision of cold storage warehousing including relevant logistic services. A wholly-owned subsidiary of Daido had entered into an agreement with Ever Apollo Limited for the acquisition of an indirect 12% interest in Grand Waldo Complex, a five star resort complex in Macau.

Acquisition of Kingsway Hotel

On 13th June 2006, the Company had entered into agreements in relation to the acquisition (the "Acquisitions") of the entire issued share capital of Triumph Up Investments Limited and Great Chain Limited which indirectly hold in aggregate appropriately 61.5% interest in the issued share capital of Kingsway Hotel Limited for an aggregate consideration of HK\$490,000,000. The principal asset of Kingsway Hotel Limited is Kingsway Hotel, a three star hotel with a total 383 guests rooms located in Macau. The Acquisitions constitute a very substantial acquisition for the Company under the Listing Rules and is therefore subject to the approval of the shareholders of the Company at a special general meeting to be held on 29th September 2006.

Financing for the Acquisitions is expected to come from convertible bonds to be issued by the Company and with the balance from internal resources, although the exact terms of the convertible bonds to be issued have not yet been finalized.

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 Macau gaming business. 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 would be returned to the Company. The parties to the letter of intent had agreed to extend the date to 11th September 2006. As at 11th September 2006, the Company decided not to proceed with the proposed acquisition, the refundable deposit of HK\$20,000,000 had refunded to the Company on 11th September 2006 without interest.

Disposal of Property

On 17th August 2006, China Star Laser Disc Company Limited, a wholly-owned subsidiary of the Company sold one of its property at net book value of approximately HK\$8,124,000 at a consideration of HK\$8,080,000 and made an insignificant loss of approximately HK\$44,000 .

Disposal of Film Library

On 13th September 2006, One Hundred Years of Film Company Limited, China Star Pictures Limited and S&W Entertainment Limited (the "Vendors"), all wholly-owned subsidiaries of the Company, the Company and Fortune Star Entertainment (HK) Limited ("Purchaser") entered into a deed pursuant to which the Purchaser has agreed to acquire from the Vendors the perpetual and worldwide right, title and interest in 100 motion pictures ("Film Library") at a total consideration of US\$18,000,000 (subject to adjustment). Compared to the net book values as stated in the books and records of the Group as at 31st August 2006, the estimated net profit arising from the disposal is approximately HK\$35,000,000.

The disposal constitutes a major transaction for the Company under the Listing Rules and is therefore subject to the approval of the shareholders of the Company at a special general meeting to be convened by the Company.

Employees

As at 30th June 2006, the Group employed 46 staffs (30th June 2005: 51 staffs). 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 staffs are remunerated based on their work performance, professional experience and prevailing industry practices. Apart from basic salaries, mandatory provident fund, medical schemes and discretionary bonuses, share options are awarded to certain staffs according to the assessment of individual performance.

Prospect

The first half of 2006 is challenging for the Group. In last year, the Group had focus to control the budget and quality of film production and at the same time has actively diversified into other business opportunities. The significant improvement in the performance of the Group for the six months ended 30th June 2006 has proved that the Group is in the right direction. The Acquisitions of Kingsway Hotel in Macau and investment in Grand Waldo Complex in Macau through its investment in Daido are expected to bring positive growth to the Group in the long term. These investments are good opportunity for the Group to participate in the growing hospitality business in Macau and expected to stabilize the future income of the Group. The disposal of the Film Library has once again proved the Group's excellent achievement in the film industry and will enhance the liquidity and financial position of the Group.