Management Discussion and Analysis

FINANCIAL REVIEW

The revenue from continuing operations of the Group amounted to approximately HK$76,991,000 for the year ended 31 December 2006, increased for approximately 78% as compared with that for the year 2005. The Group reported a loss for the year from continuing operations of approximately HK$36,530,000 for the year ended 31 December 2006, improved for approximately 89% as compared with that for the year 2005, and a profit for the year from discontinued operation of approximately HK$20,352,000 for the year ended 31 December 2006, as compared to that loss of approximately HK$1,575,000 for the year 2005. Overall, the loss for the year attributable to equity holders of the parent of the Company amounted to approximately HK$15,204,000 for the year ended 31 December 2006, improved for approximately 95% as compared with that for the year 2005.

The increase in the revenue from continuing operations of the Group was mainly come from the success of the Group's strategy of diversifying business, the revenue from the Group's cultural recreation content provision and distribution, the revenue from this business increased by approximately 85% to approximately HK$69,882,000 for the year ended 31 December 2006 as compared with that for the year 2005. This increase was as a result of that the strategy of entering into the business of subcontractor of computer graphic ("CG") creation and production by the Group has been successful. The revenue from property investment and management amounted to approximately HK$7,109,000 for the year ended 31 December 2006, increased by approximately 31% was mainly attributable to the increase in both the monthly rental and occupancy rate.

Cost of sales from continuing operations for the year ended 31 December 2006 amounted to approximately HK$43,920,000 which, comparing with that of approximately HK$42,947,000 for the year 2005, represented an increase of approximately 2%. Despite the significant increase in revenue, the slight increase in cost of sales was mainly due to increase in efficiency in cultural recreation content provision and distribution and save of starting up costs from this new business in the year 2005.

Write-down of production work in progress from continuing operations made during the year ended 31 December 2005 amounted to approximately HK$24,712,000 was on the production costs of an animation movie "Thru the Moebius Strip" (the "Movie"), which has been released in the People's Republic of China (the "PRC", which for the purpose of this report, does not include Hong Kong, Macau and Taiwan) in second half of 2006. No significant write-down was required to make for the year ended 31 December 2006.

The Group made a gross profit from continuing operations of approximately HK$33,071,000 for the year ended 31 December 2006, representing a gross profit margin of approximately 43%. Comparing with that gross loss resulted in the year 2005, there was a significant improvement in terms of both monetary value and percentage to revenue. The improvement was mainly from the result of the success of the Group's strategy of entering into the business of cultural recreation content provision and distribution.

Management Discussion and Analysis

Other income from continuing operations for the year ended 31 December 2006 amounted to approximately HK$9,272,000 (2005: HK$3,724,000), representing an increase of approximately 149%. The increase was mainly attributable to increase in investment income generated by the Group's asset management division, which started normal operation in the second half of the year 2005.

Distribution costs from continuing operations for the year ended 31 December 2006 amounted to approximately HK$6,932,000 (2005: HK$2,535,000), representing an increase of approximately 173%. The increase in the distribution costs was mainly due to costs were incurred during the year for the promotion of the Movie and other films and television drama, and for the new products of digital cinema equipment launched by the digital content distribution and exhibitions business in compliance with the new industrial technical standard.

Administrative expenses from continuing operations for the year ended 31 December 2006 amounted to approximately HK$74,767,000 (2005: HK$95,063,000), representing a decrease of approximately 21%. However, these expenses for the year 2006 and 2005 included expenses upon recognition of equity-settled share based payment of approximately HK$5,937,000 and HK$25,456,000, respectively. Adjusted for this non-cash flow expense, the administrative expenses for this year were approximate to that for the year 2005.

Finance costs from continuing operations for the year ended 31 December 2006 amounted to approximately HK$10,132,000 (2005: HK$6,930,000), representing an increase of approximately 46%. The increase was mainly come from increase in interest on addition funding raised during this year to finance the Group's daily operations as the Group was still in the investment stage of carrying out its strategy of diversifying its business, that most of the divisions required investment of funding and some of them were yet to contribute cash return.

Profit on disposal of partial interests in subsidiaries of approximately HK$1,795,000 for the year ended 31 December 2006 mainly represented the profit on a transfer of 15% interest in GDC Technology Limited ("GDC Technology') to the management of GDC Technology for an aggregate cash consideration of HK$1,600,000. The Board considers that the transfer would lead to GDC Technology's management having personal interests in GDC Technology and it would enhance their commitment and participation in the business of GDC Technology. As their personal investment will be directly affected by the performance of GDC Technology, the Board anticipates that GDC Technology's management would devote more time and be more focused on the business of GDC Technology. This additional commitment will facilitate the development of GDC Technology and in turn the continuous development of the Group. That loss of approximately HK$12,345,000 for the year ended 31 December 2005 mainly represented the loss on disposal of certain of its equity interests in Global Digital Creations Holdings Limited to independent third parties during that year.

Management Discussion and Analysis

During the year ended 31 December 2005, the Group incurred an impairment loss of goodwill arising from acquisition of a subsidiary amounted to approximately HK$191,457,000. During the year ended 31 December 2006, there was no transaction of similar nature.

During the year ended 31 December 2006, profit from discontinued operation amounted to approximately HK$20,352,000. The operation means the finance leasing business the Group operated through South China International Leasing Company Limited ("South China Leasing"). During the year 2006, due to that the Group had induced a new investor to South China Leasing to strengthen its capital structure in order to speed up its development, the Group's interest in South China Leasing, direct and indirect, has been diluted to 50%. South China Leasing was therefore changed from a subsidiary to an associate of the Group. Its net result of operation is disclosed as the discontinued operation. However, the Group would not only continue to operate finance leasing business through South China Leasing, but also speed up the development of the business. The profit was mainly come from profit on disposal arisen from dilution of the Group's interest in South China Leasing.

During the year ended 31 December 2006, net cash used in operating activities of the Group amounted to approximately HK$784,428,000 which included an aggregate amount of approximately HK$772,164,000 representing advances granted to customers which were financed by bank borrowings of approximately HK$794,672,000 in aggregate raised during the year. If the advances granted to customers not being taken into consideration, there was net cash used in operating activities of the Group amounted to approximately HK$12,264,000. During the year 2005, a net cash used in operating activities amounted to approximately HK$156,051,000 was recorded. The significant improvement of operating cash flow was mainly due to that the Group's strategy of diversifying business has won initial success; and operating cash flow was improved to different extent in different business divisions.

BUSINESS REVIEW

The Group continued actualising its strategy of diversifying its core business into businesses other than property investment and management, namely financial service provision and cultural recreation content provision and distribution. Such strategy of diversifying business has won initial success.

Cultural Recreation Content Provision and Distribution

During the year ended 31 December 2006, the Group has launched several movies and television series, such as "Crazy Stone", one of the highest box office income among all movies of similar investment released in the year 2006 in the PRC and the Best Original Screenplay of the 43rd Golden Horse Award, and "In Great Entanglement", number one in the television audience share among all the channels in Shanghai in 2006. Most of the television series produced by the Group have been broadcasted on major television channels in the PRC including China Central Television.

Management Discussion and Analysis

In the CG creation and production division, the Group successfully released the first created-in-China full length CG animation movie "Thru the Moebius Strip" in summer 2006 in the PRC. The public release of this movie filled the gap of the 3 Dimension animation movie domains in the PRC. It has not only marked a new idea for complete 3 Dimension animated films in the PRC, but also explored into a new idea of producing animation production in collaboration with foreign countries, which has substantially enhanced the development of creative industry in the PRC in terms of advanced technology, contents and 3 Dimension animation industry chain. Besides, one of the Group's short films "The Legend of Shangri-la" received the best short film award in the Hansome Monkey Award and the No. 1 in the China Region Award and the Final Award in the Eighth "DigiCon 6" (Tokyo) Contest in 2006 with the use of 3 Dimension technology in creating digital shadow puppet styles for carriers.

In addition, the Group's strategy of entering into the business of contractor of CG creation and production has been proved to be suitable for the Group. For the year ended 31 December 2006, the Group's CG creation and production subsidiary has achieved revenue growth of approximately 519%, the operation expanded dramatically. It is also the first time for the Group's CG creation and production business to have operating cash flow breakeven. Such results is almost unique among large-scale 3 Dimension animation companies in the PRC, Hong Kong and Taiwan, implying that the Group will record profit in the coming year. The Group's results and publicity had undisputedly established the Group's CG production studio as the number one CG animation production studio in the PRC and one of the best in Asia.

The Group's digital cinema subsidiary, GDC Technology completed the development of digital cinema products that supported the latest JPEG2000 and launched its second generation digital cinema ("D-cinema") server at Beijing International Radio, TV & Film Equipment Exhibition 2006 in August 2006. This new model SA2000 DSR™ Digital Film Server is a "hybrid" server allows users to exhibit digital cinema contents on JPEG2000 format, which is in complying with certain specifications adopted by the Digital Cinema Initiatives, LLC ("DCI") and maintains its backward compatibility with the MXF MPEG2 Interop format. In late 2006, a couple of Hollywood blockbusters were also released in JPEG2000 formats to this newly upgraded SA2000 server. Further, the technology of GDC Technology has been applied in a more advanced manner. GDC Technology was selected by a Hong Kong listed company to supply a complete D-cinema solution to its first brand name flagship multiplex including multi-screen cinema, the in-lobby displays such as LCD digital signage, Plasma television monitors and indoor LED video wall which are to be fully integrated into one theater management system.

Management Discussion and Analysis

Financial Service Provision

Finance Leasing

During the year ended 31 December 2006, to strengthen South China Leasing's capital structure in order to speed up its development, the Group induced a new investor to South China Leasing. The Group's interest in South China Leasing, direct and indirect, has been diluted to 50%. South China Leasing was therefore changed from a subsidiary to an associate of the Group. However, the Group would not only continue to operate finance leasing business through South China Leasing but also speed up the development of the business. During the year ended 31 December 2006, South China Leasing's amount of contract signed grew significantly, mainly from finance leasing of aircrafts.

Financial Investment

The Group continued operating the business of financial service through 首方投資管理(深圳)有限公司 ("Capital Steel"). The return of Capital Steel's direct financial investment has been booked during the year ended 31 December 2006. Since the direct financial investment project was successful, Capital Steel is negotiating further cooperation with the partner, including being assumed its financial and asset management consultant.

Property Investment and Management

Hong Kong and the PRC Investment Properties

Both rental income and resalable value of the Group's investment properties have been improving comparing with 2005. The Group was still receiving stable cash flow from rental income.

Beijing Dongzhimen International Apartment Co. Ltd. ("Beijing Dongzhimen")

Beijing Dongzhimen was principally engaged in the provision of serviced apartment services through its ownership of East Lake Villas and was owned as to 44% by the Group. In December 2006, the Group has signed an agreement to dispose its entire interests in Beijing Dongzhimen, details of which are set out in the Group's circular dated 27 December 2006, as the Group preferred to recoup capital investment in Beijing Dongzhimen for developing other businesses, including cultural recreation content provision and distribution, and financial service provision. As at 31 December 2006, the Group's interest in Beijing Dongzhimen was classified as interest in a jointly controlled entity held for sale.

Management Discussion and Analysis

BUSINESS OUTLOOK

In 2006, the Group has lined up each business's management team to focus on executing corporate strategy. The Group's effort and results set up a solid foundation for the Group to grow at a much faster pace next year. The market demands are there and huge, the Group will better execute and improve efficiency in order to harness the financial and market rewards.

Cultural Recreation Content Provision and Distribution

In CG creation and production division, as consumers all over the world demand for greater audio-visual sensations at the movie theaters and in front of the television ("TV") tubes and computers, tremendous business opportunities has been created for digital CG animation audio-visual creation and production. Leading children's channels worldwide have already begun to gradually upgrade their animation programs from 2 Dimension to 3 Dimension, and newly launched High Definition ("HD") channels in the United States of America and Europe are also spending generous amount of funding to commission HD animation TV series in order to attract subscribers. Currently, digital animations content is a fast developing market. Meanwhile, continuous business development and innovation make it inevitable to turn productions to the Asian market. The Group expects to see that more world class clients requesting services and co-production partnership from them, generating a steady and profitable revenue stream in the near term; the existing co-production deals generating moderate upside on back end revenue; their clients will become the creative and world wide distribution partners for their future original content creation effort. At the time of writing this report, the Group can already see solid deals being sealed to fill their existing production capacity, the Group may even has to expand or out-source some of their works this year to fulfill the market demand.

On the other hand, the Group will also focus at producing television series to gain relatively reliable return. The Group will also invest and produce quality movie projects.

In digital content distribution and exhibitions division, since the release and endorsement of DCI specifications by the consortium of Hollywood's major studios, the race for the movie industry to transition from analog (printed film) to digital (data on hard disk) is officially on. All over the world, leading theater operators, cinema equipment manufacturers and cinema service providers have all announced bold transition plan to roll out digital cinema in the next 5 years starting from last year, and the world wide digital cinema installation had jumped from less than 1,000 screens prior to 2005 to several thousands screens by end of 2006. The Group are of the view that such trend would bring ample business opportunities to GDC Technology and considered that it was in the interest of GDC Technology to secure addition funding to expedite the rolling out of its business plan. With the completion of GDC Technology's Subscription, details of which are set in the circular dated 27 December 2006, GDC Technology had addition funding of approximately HK$50 million for business expansion in the PRC and other countries and for enhancement of its research and development activities.

Management Discussion and Analysis

Recently, GDC Technology unveiled its new digital cinema product – SA2100 DSR™ Digital Film Server which is 33% smaller in size and designed to meet DCI specifications. The new SA2100 server supports DCI defined DCP 2k and 4k digital cinema packages, and JPEG2000 and remains backward compatible with the MXF MPEG2 Interop format. This new SA2100 server is designed to work in cinema multiplex with Theater Management System and Network Operations Center which support operations such as scheduling of playlist, content rights management and collection of playout log information. Besides, GDC Technology has also signed a development and supply agreement worldwide with a digital projector supplier to develop its digital cinema integrated projection system. GDC Technology expected that these new products will enhance and expand GDC Technology's role to become the leading supplier of digital content delivery and playback equipment to worldwide customers.

In addition to its D-cinema server, GDC Technology is in a unique position to offer its complete suite of content delivery and playback solutions with DSR™ Network Operations Centre software for customers who run digital cinema, on-screen advertisement and out-of-home advertisement business. Within months of launching these new products, GDC Technology received orders of digital signage solutions to equipment twelve large shopping malls in Singapore, cinema multiplexes in Hong Kong as well as in India.

Besides, the Group has also entered into a cooperative agreement scheme with China Film Group Corporation during the year 2006, whereby not less than 2,000 units of digital cinema integrated projection system will be installed in the next two years. This will highly accelerate the digitalisation of the film distribution industry in the PRC and at the same time, lay a solid foundation for commencing related businesses of the Group, thus enable the Group to become the technology supplier of digital cinema in the PRC as well as the pioneer in related businesses on top of its basis as a provider of digital cinema equipment worldwide.

Financial Service Provision

Finance Leasing

With the expected blooming economy development in the PRC, South China Leasing expects that the finance leasing business in the PRC will further expand. At the same time, as more financial institutions have been approved to enter into this business, South China Leasing will face keen competition. However, South China Leasing has already developed its brand name in this business and its existing operation has received continued support from banks, South China Leasing expects that it can maintain its market shares. Besides, South China Leasing will not only continue focusing on finance leasing of large development projects, such as aircrafts, energy and electricity, etc., but also explore different financing methods to lower its finance costs.

Financial Investment

Since the second half of 2006, Capital Steel continues approaching several financial institutions and culture mass media companies in the PRC to look for investment opportunities, and simultaneously provide financial and asset management services.

Property Investment and Management

The Directors expect investment properties in Hong Kong and the PRC will continue to contribute stable cash return in the foreseeable future.

LIQUIDITY AND FINANCIAL RESOURCES

The equity attributable to equity holders of the Company amounted to approximately HK$212.0 million as at 31 December 2006 (2005: HK$204.4 million). The increase was mainly arisen from derecognition of put option liability of approximately HK$12.8 million and approximately HK$10.1 million increase in translation reserve upon exchange difference on translation of a jointly controlled entity and subsidiaries, netting off with loss for the year attributable to equity holders of the Company of approximately HK$15.2 million.

The Group had bank balances and cash and pledged bank deposits amounted to approximately HK$35.7 million as at 31 December 2006 (2005: HK$36.3 million) which were mainly denominated in Hong Kong dollars and Renminbi. The decrease was mainly from the result of that the Group had reserved approximately HK$14.4 million at 31 December 2005 to restructure/renew bank borrowings and paid the reserve during the year ended 31 December 2006 and that was partially offset by the net cash inflow generated from other areas during the year.

The Group's borrowings amounted to approximately HK$157.9 million as at 31 December 2006 (2005: HK$144.1 million) which comprised approximately HK$53.8 million and HK$104.1 million repayable within and after twelve months after 31 December 2006, respectively. All bank loans bear interest at market rates and are repayable over a period of five years.

Gearing ratio (calculated as borrowings less bank balances and cash and pledged bank deposits divided by equity attributable to equity holders of the parent of the Company) as at 31 December 2006 was approximately 57.6% (2005: 52.7%). The Group's leverage increased was mainly due to that the Group needed additional funds to be invested into its businesses which were developing. The bank borrowings amounted to HK$75.0 million outstanding at 31 December 2006 were secured by investment properties and land and buildings with carrying value of approximately HK$117.7 million in aggregate.

Management Discussion and Analysis

MATERIAL ACQUISITION, DISPOSALS AND SIGNIFICANT INVESTMENT

Other than the acquisition of entire interest in Valuework, transfer of 15% interest in GDC Technology and dilution of effective interest in South China Leasing to 50% as mentioned above and in the audited consolidated financial statements, the Group had no material acquisitions, disposals and investment during the year ended 31 December 2006.

FOREIGN EXCHANGE EXPOSURE

The normal operations and investments of the Group are mainly in Hong Kong and the PRC, with revenue and expenditure denominated in United States dollars, Renminbi and Hong Kong dollars. Considering that the Group will have sufficient foreign exchange currencies to meet its foreign exchange requirement, the Directors believe that the Group does not have significant foreign exchange problems. However, if necessary, the Group will consider using forward exchange contracts to hedge against foreign currency exposures. As at 31 December 2006, the Group has no significant exposure under foreign exchange.

CONTINGENT LIABILITIES

Save as disclosed in note 46 to the consolidated financial statements about litigations proceeding, the Group had no contingent liabilities as at 31 December 2006.

EMPLOYEES

As at 31 December 2006, the Group employed 383 (2005: 410) full time employees (excluding those under the payroll of the associates and the jointly controlled entity of the Group). The Group remunerated its employees mainly with reference to the prevailing market practice, individual performance and experience. Other benefits such as medical coverage, insurance plan, mandatory provident fund, discretionary bonus and employee share option scheme are also available to the employees of the Group. Remuneration packages are reviewed either annually or by special increment.

During the year ended 31 December 2006, the Company and its subsidiaries has not paid or committed to pay any amount as an inducement to join or upon joining the Company and/or its subsidiaries to any individual.