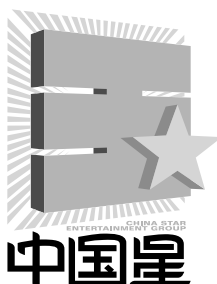


*This announcement appears for information purposes only and does not constitute an invitation or offer to acquire, purchase or subscribe for the securities.*

*The Stock Exchange of Hong Kong Limited takes no responsibility for the contents of this announcement, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this announcement.*



# CHINA STAR ENTERTAINMENT LIMITED

*(Incorporated in Bermuda with limited liability)*  
**(Stock code: 326)**

## **DISCLOSEABLE TRANSACTION: SUBSCRIPTION OF CONVERTIBLE BONDS**

On 12 March 2007, the Subscriber and Milkyway entered into the Subscription Agreement in respect of the subscription of the Convertible Bonds in the principal amount of HK\$25 million due 2012. Completion of the Subscription is subject to the conditions as set out in the paragraph headed “Conditions precedent” in the section headed “Subscription Agreement dated 12 March 2007” below. Detailed terms of the Convertible Bonds are set out in the paragraph headed “Principal terms of the Convertible Bonds” in the section headed “Subscription Agreement dated 12 March 2007”.

The Subscription constitutes a discloseable transaction for the Company under the Listing Rules. A circular of the Company containing, among other things, details of the Subscription Agreement will be despatched to the Shareholders as soon as practicable.

### **SUBSCRIPTION AGREEMENT DATED 12 MARCH 2007**

#### **1) Parties**

Issuer: Milkyway

Subscriber: the Subscriber, a wholly owned subsidiary of the Company

To the best of the knowledge, information and belief of the Directors and having made all reasonable enquiries, each of Milkyway, its controlling shareholder and their respective ultimate beneficial owners is independent of and not connected with the directors, chief executive or substantial shareholders of the Company or any of its subsidiaries or any of their respective associates or its connected persons and is not a connected person of the Company. As at the date of this announcement, the Group is not interested in any Milkyway Share and is not acting in concert with any Milkyway Shareholder in respect of Milkyway.

## 2) Principal terms of the Convertible Bonds

- Principal amount: HK\$25 million which will be issued by Milkyway at the price of HK\$22.5 million, being 90% of the face value of the Convertible Bonds.
- Subscription Price: The Subscription Price of HK\$22.5 million will be paid by the Subscriber at Completion in cash.
- Interest rate: The Convertible Bonds shall not carry any interest.
- Maturity date: Unless previously redeemed, repurchased and cancelled or converted, any outstanding Convertible Bonds shall be redeemed on the date falling on the fifth anniversary of the date of issue of the Convertible Bonds.
- Ranking: The Convertible Bonds constitute general and unsecured obligations of Milkyway and rank equally among themselves and pari passu with all other present and future unsecured and unsubordinated obligations of Milkyway.
- Early redemption: Milkyway shall be entitled at any time while the Convertible Bonds are outstanding to redeem the Convertible Bonds or any part thereof at 110% of the principal amount of the Convertible Bonds (in multiples of HK\$500,000). (unless the amount remaining on exercise of the conversion rights or in consequence of any adjustment pursuant to the terms of the instrument constituting the Convertible Bonds shall be less than HK\$500,000).
- Conversion: Provided that any conversion of the Convertible Bonds does not trigger off a mandatory offer under rule 26 of the Code on the part of the Subscriber, the Subscriber will have the right to convert the whole or part of the principal amount of the Convertible Bonds into Milkyway Shares at any time and from time to time, from the date of issue of the Convertible Bonds in amounts of not less than a whole multiple of HK\$500,000 on each conversion (unless the amount remaining on exercise of the conversion rights or in consequence of any adjustment pursuant to the terms of the instrument constituting the Convertible Bonds shall be less than HK\$500,000).
- Conversion price: The conversion price is initially HK\$0.33 per Milkyway Share, subject to adjustment for, among other matters, subdivision or consolidation of the Milkyway Shares, rights issue, extraordinary stock or cash distribution, and other dilutive events. The conversion price represents:
- (i) the closing price of HK\$0.33 per Milkyway Share as quoted on the Stock Exchange on 9 March 2007, being the last day of trading in the Milkyway Shares on GEM before the date of the Subscription Agreement;
  - (ii) a premium of approximately 24.53% to the average of the closing prices of HK\$0.265 per Milkyway Share for the last five trading days ended on 9 March 2007, being the last day of trading in the Milkyway Shares on GEM before the date of the Subscription Agreement; and
  - (iii) a premium of approximately 26.92% to the average of the closing prices of HK\$0.26 per Milkyway Share for the last ten trading days ended on 9 March 2007, being the last day of trading in the Milkyway Shares on GEM before the date of the Subscription Agreement.
- Voting: The Subscriber will not be entitled to attend or vote at any general meeting of Milkyway by reason only of it being the holder of the Convertible Bonds.

Transfer: With the prior written consent of Milkyway, the Convertible Bonds may be transferable provided always that no transfer or assignment of the Convertible Bonds shall be made to any connected person of Milkyway.

Based on the conversion price of HK\$0.33 per Conversion Share, a maximum number of 75,757,575 Conversion Shares will be allotted and issued upon exercise of the conversion rights attached to the Convertible Bonds in full, which represent: (i) approximately 78.42% of the issued share capital of Milkyway as at the date of this announcement; (ii) approximately 42.90% of the issued share capital of Milkyway as enlarged by the allotment and issue of the conversion shares to be allotted and issued upon the exercise in full of the conversion rights attaching to the December Bonds issued pursuant to the December Placing; and (iii) approximately 30.02% of the issued share capital of Milkyway as enlarged by the allotment and issue of the conversion shares to be allotted and issued upon the exercise in full of the conversion rights attaching to the December Bonds issued pursuant to the December Placing, and the Conversion Shares to be allotted and issued upon the exercise of the conversion rights attaching to the Convertible Bonds in full.

The Conversion Shares will rank pari passu in all respects with the Milkyway Shares in issue as at the date of allotment and issue of the Conversion Shares.

No application will be made for listing of, or permission to deal in, the Convertible Bonds on the Stock Exchange or any other stock exchange. Application will be made by Milkyway to the GEM Listing Committee of the Stock Exchange for the listing of, and permission to deal in, the Conversion Shares.

### **3) Conditions precedent**

Completion is conditional upon the fulfillment of the following conditions precedent:

- (a) the GEM Listing Committee of the Stock Exchange shall have granted the listing of and permission to deal in the Conversion Shares;
- (b) the passing by the Milkyway Shareholders of the necessary resolution at an extraordinary general meeting of Milkyway to be convened and held to approve the issue of the Convertible Bonds and the transactions contemplated thereunder including but not limited to the allotment and issue of the Conversion Shares;
- (c) there being no event existing or having occurred and no condition being in existence which would be (after the issue of the Convertible Bonds) an event of default under the Convertible Bonds and no event or act having occurred which, with the giving of notices, or the lapse of time, or both, would (after the issue of the Convertible Bonds), constitute such an event of default;
- (d) the Subscriber being satisfied in its absolute discretion with the results of the due diligence review to be conducted on the assets, liabilities, affairs and operations of the Milkyway Group;
- (e) the representations and warranties given by Milkyway to the Subscriber under the Subscription Agreement remaining true, accurate and complete in all material respects; and
- (f) all necessary consents and approvals required to be obtained on the part of Milkyway and the Subscriber in respect of the Subscription Agreement and the transactions contemplated thereby having been obtained.

Conditions (c), (d) and (e) are waivable at the discretion of the Company. If any of the above conditions are not fulfilled on or before the date falling 60 days from the date of the Subscription Agreement or such other date as Milkyway and the Subscriber may agree, the Subscription Agreement will lapse and become null and void and the parties shall be released from all obligations hereunder, save the liabilities for any antecedent breaches thereof.

#### **4) Completion**

Completion shall take place on the third business day following the date on which the above conditions are fulfilled.

#### **5) Termination**

The Subscriber may, by notice to Milkyway given at any time prior to payment of the Subscription Price to Milkyway, terminate the Subscription Agreement in any of the following circumstances:

in the reasonable opinion of the Subscriber, the success of the Subscription would be materially and adversely affected by:

- (i) the introduction of any new law or regulation or any change in existing law or regulation (or the judicial interpretation thereof) or other occurrence of any nature whatsoever which may in the reasonable opinion of the Subscriber materially and adversely affect the business or the financial or trading position or prospects of the Milkyway Group as a whole or is materially adverse in the context of the Subscription; or
- (ii) the occurrence of any local, national or international event or change (whether or not forming part of a series of events or changes occurring or continuing before, and/or after the date hereof) of a political, military, financial, economic or other nature (whether or not ejusdem generis with any of the foregoing), or in the nature of any local, national or international outbreak or escalation of hostilities or armed conflict, or affecting local securities markets which may, in the reasonable opinion of the Subscriber materially and adversely affect the business or the financial or trading position or prospects of the Milkyway Group as a whole or materially and makes it inexpedient or inadvisable to proceed with the Subscription; or
- (iii) any adverse change in market conditions (including without limitation, any change in fiscal or monetary policy, or foreign exchange or currency markets, suspension or material restriction or trading in securities) occurs which in the reasonable opinion of the Subscriber is likely to materially or adversely affect the success of the Subscription or otherwise makes it inexpedient or inadvisable to proceed with the Subscription; or
- (iv) any event of force majeure including, without limiting the generality thereof, any act of God, war, riot, public disorder, civil commotion, fire, flood, explosion, epidemic, terrorism, strike or lock-out; or
- (v) any suspension in the trading of securities generally or Milkyway's securities on the Stock Exchange for a period of more than 15 consecutive business days, excluding any suspension in connection with the clearance of the announcement, the circular or other documents in connection with the Subscription; or
- (vi) any material breach of any of the representations, warranties or undertakings contained in the Subscription Agreement comes to the knowledge of the Subscriber.

In the event that the Subscriber terminates the Subscription Agreement, the obligations of all parties under the Subscription Agreement shall terminate forthwith and no party shall have any claim against any other party for costs, damages, compensation or otherwise save for any antecedent breaches.

#### **INFORMATION ON MILKYWAY**

The Milkyway Group is principally engaged in the provision of film production services, production of television movies, investment in film productions and worldwide film distribution.

According to the annual report of Milkyway for the year ended 31 March 2006, the Milkyway Group recorded an audited consolidated turnover of approximately HK\$36.8 million and HK\$17.3 million for each of the two years ended 31 March 2005 and 2006 respectively. The audited consolidated loss before and after taxation and minority interests of Milkyway Group for the year ended 31 March 2006 was approximately HK\$18.2 million. The audited consolidated loss before and after taxation and minority interests of Milkyway Group for the year ended 31 March 2005 was approximately HK\$8.4 million.

As stated in the interim report of Milkyway for the six months ended 30 September 2006, the Milkyway Group recorded an unaudited consolidated turnover of approximately HK\$42.5 million as compared with HK\$10.0 million for the same period in 2005. The unaudited consolidated loss before and after taxation and minority interests of the Milkyway Group for the six months ended 30 September 2006 were approximately HK\$1.4 million. The unaudited consolidated net liabilities value of Milkyway attributable to Milkyway Shareholders was approximately HK\$11.4 million as at 30 September 2006.

The Company understands from Milkyway that Milkyway intends to apply the net proceeds from the issue of the Convertible Bonds of approximately HK\$22 million for financing the future investments of the Milkyway Group which may or may not be in the principal line of business of the Milkyway Group and the general working capital of the Milkyway Group.

### **REASON FOR THE SUBSCRIPTION OF CONVERTIBLE BONDS**

The Group is principally engaged in film production, distribution of film and television drama series, and the provision of post-production services.

The Convertible Bonds are to be issued to the Subscriber at 10% discount to the principal amount. The conversion rights attached to the Convertible Bonds offer the Subscriber a five-year time frame to evaluate the financial performance of the Milkyway Group and the market performance of the Milkyway Shares, and the flexibility to acquire equity interests in Milkyway and an opportunity to enjoy any potential capital gain in the value of the Milkyway Shares. Based on the above, the Directors (including the independent non-executive Directors) consider that the Subscription is entered into on normal commercial terms, fair and reasonable and in the interests of the Company and the Shareholders as a whole.

## SHAREHOLDING STRUCTURE OF MILKYWAY

The shareholding structure of Milkyway as at the date of this announcement, immediately after full conversion of the December Bonds but before the conversion of the Convertible Bonds, and assuming full conversion of the December Bonds and the Convertible Bonds and the Subscriber is restricted to be interested in less than 30% of the issued share capital of Milkyway with any balance of the Conversion Shares being held by the public is as follows:

Milkyway Shareholder	At the date of this announcement		Immediately after full conversion of the December Bonds but before conversion of the Convertible Bonds		Assuming full conversion of the December Bonds and the Convertible Bonds and the Subscriber is restricted to be interested in less than 30% of the issued share capital of Milkyway with any balance of the Conversion Shares being held by the public	
	No. of Milkyway Shares	Approximate percentage	No. of Milkyway Shares	Approximate percentage	No. of Milkyway Shares	Approximate percentage
Right Opportune Limited (note 1)	37,376,000	38.69%	37,376,000	21.16%	37,376,000	14.81%
Subscriber	–	–	–	–	75,682,036 (note 2)	29.99%
Public						
The holders of the December Bonds (note 3)	–	–	80,000,000	45.30%	80,000,000	31.70%
Other public Milkyway Shareholders	59,224,000	61.31%	59,224,000	33.54%	59,299,539	23.50%
Sub-total of public Milkyway Shareholders	<u>59,224,000</u>	<u>61.31%</u>	<u>139,224,000</u>	<u>78.84%</u>	<u>139,299,539</u>	<u>55.20%</u>
Total	<u>96,600,000</u>	<u>100%</u>	<u>176,600,000</u>	<u>100%</u>	<u>252,357,575</u>	<u>100%</u>

### Notes:

- (1) The entire issued share capital of Right Opportune Limited is beneficially owned by Mr. Law Sau Yiu, Dennis, an executive director and the chairman of Milkyway.
- (2) Based on the initial conversion price of HK\$0.33 per Conversion Share, a maximum number of 75,757,575 Conversion Shares will be allotted and issued upon exercise of the conversion rights attached to the Convertible Bonds in full. For illustration purpose, assuming full conversion of the Convertible Bonds on the date of this announcement and subject to the restriction that any conversion of the Convertible Bonds cannot trigger off a mandatory offer under rule 26 of the Code on the part of the Subscriber, the maximum Milkyway Shares that can be converted under the Convertible Bonds will only represent 29.99% of the total issued share capital of Milkyway.
- (3) As at the date of this announcement, none of the holders of the December Bonds will become substantial shareholder of Milkyway upon full conversion of the December Bonds.

As at the date of this announcement, no decision has been made as to whether or when or the extent to which the conversion rights attached to the Convertible Bonds are to be exercised by the Subscriber. The extent of exercise of the conversion rights attached to the Convertible Bonds by the Subscriber will depend on a number of factors such as the future financial position and business prospects of the Milkyway Group and the market performance of the Milkyway Shares.

## **FINANCIAL EFFECTS OF THE SUBSCRIPTION**

At present, the Company intends to fund the Subscription by its internal resources. It is expected that the Subscription would not have any material impact on the financial position of the Group.

## **GENERAL**

The Subscription constitutes a discloseable transaction for the Company under the Listing Rules. A circular of the Company containing, among other things, details of the Subscription Agreement will be despatched to the Shareholders as soon as practicable.

## **DEFINITIONS**

Unless the context requires otherwise, the following terms have the following meanings in this announcement:

“associates”	has the meaning ascribed thereto in the Listing Rules
“Board”	board of the Directors
“Code”	The Hong Kong Code on Takeovers and Mergers
“Company”	China Star Entertainment Limited, a company incorporated in Bermuda with limited liability and the issued Shares of which are listed on the Stock Exchange
“Completion”	completion of the Subscription Agreement
“connected persons”	has the meaning ascribed thereto in the Listing Rules
“Conversion Shares”	the Milkyway Shares which may fall to be allotted and issued upon exercise of the conversion rights attaching to the Convertible Bonds
“Convertible Bonds”	the zero coupon convertible bonds in principal amount of HK\$25 million due 2012 to be issued by Milkyway to the Subscriber pursuant to the Subscription Agreement
“December Bonds”	the convertible bonds in the aggregate principal amount of HK\$20 million and issued by Milkyway pursuant to the placing agreement dated 5 December 2006 and entered into between Milkyway and Kingston Securities Limited, which entitle the holder thereof to subscribe for Milkyway Shares at an initial subscription price of HK\$0.25 per Milkyway Share. To the best of the knowledge, information and belief of the Directors and having made all reasonable enquiries, each of Kingston Securities Limited and its beneficial owner is independent of and not connected with the directors, chief executive or substantial shareholders of the Company or any of its subsidiaries or any of their respective associates or its connected persons and is not a connected person of the Company
“December Placing”	the placing of the December Bonds
“Directors”	directors of the Company

“GEM”	the Growth Enterprise Market of the Stock Exchange
“Group”	the Company and its subsidiaries
“Hong Kong”	Hong Kong Special Administrative Region of the People’s Republic of China
“Listing Rules”	Rules Governing the Listing of Securities on the Stock Exchange
“Milkyway”	Milkyway Image Holdings Limited, a company incorporated in the Cayman Islands with limited liability and the issued shares of which are listed on GEM
“Milkyway Group”	Milkyway and its subsidiaries
“Milkyway Share(s)”	share(s) of HK\$0.10 each in the share capital of Milkyway
“Milkyway Shareholder(s)”	holder(s) of the Milkyway Share(s)
“Share(s)”	ordinary share(s) of HK\$0.05 each in the share capital of the Company
“Shareholder(s)”	holder(s) of the Share(s)
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Subscriber”	Classical Statute Limited, a company incorporated in the British Virgin Islands with limited liability and a wholly owned subsidiary of the Company
“Subscription”	the subscription of the Convertible Bonds by the Subscriber pursuant to the terms of the Subscription Agreement
“Subscription Agreement”	the subscription agreement dated 12 March 2007 and entered into between Milkyway and the Subscriber in relation to the subscription and issue of the Convertible Bonds
“Subscription Price”	HK\$22.5 million, being the subscription price of the Convertible Bonds
“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong
“%”	per cent.

By Order of the Board  
**China Star Entertainment Limited**  
**Heung Wah Keung**  
*Chairman*

Hong Kong, 13 March 2007

*As at the date of this announcement, the Board comprises three executive Directors namely, Mr. Heung Wah Keung, Ms. Chen Ming Yin, Tiffany and Ms. Li Yuk Sheung and three independent non-executive Directors namely, Mr. Hung Cho Sing, Mr. Ho Wai Chi, Paul and Mr. Leung Hok Man.*