# DHX Media Ltd.

Consolidated Financial Statements
**June 30, 2008 and June 30, 2007**
(expressed in Canadian dollars)

September 28, 2008

## Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of **DHX Media Ltd.** have been prepared by the Company's management. The financial statements have been prepared in accordance with accounting principles generally accepted in Canada and contain estimates based on management's judgment. Internal control systems are maintained by management to provide reasonable assurances that assets are safeguarded and financial information is reliable.

The Board of Directors of the Company is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the consolidated financial statements and the accompanying management discussion and analysis. The Board carries out this responsibility through its Audit Committee.

The Audit Committee is appointed by the Board and all of its members are independent directors. It meets with the Company's management and auditors and reviews internal control and financial reporting matters to ensure that management is properly discharging its responsibilities before submitting the financial statements to the Board of Directors for approval.

PricewaterhouseCoopers LLP, appointed as the Company's auditors by the shareholders, has examined these consolidated financial statements and their report follows.

(signed) "*Michael Donovan*"
Chief Executive Officer
Halifax, Nova Scotia

(signed) "*Dana Landry*"
Chief Financial Officer

PRICEWATERHOUSECOOPERS

**PricewaterhouseCoopers LLP**
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September 28, 2008

## Auditors' Report

**To the Shareholders of**
**DHX Media Ltd.**

We have audited the consolidated balance sheets of **DHX Media Ltd.** as at June 30, 2008 and June 30, 2007 and the consolidated statements of income and comprehensive income and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2008 and June 30, 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) *"PricewaterhouseCoopers LLP"*

**Chartered Accountants**

# DHX Media Ltd.

Consolidated Balance Sheets

**As at June 30, 2008 and June 30, 2007**

(expressed in Canadian dollars)

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash | 8,864,776 | 3,433,924 |
| Short-term investments (note 5) | 286,350 | 1,869,245 |
| Amounts receivable (note 6) | 55,158,979 | 33,030,124 |
| Prepaid expenses and deposits | 1,055,065 | 371,499 |
| Current portion of investment in film and television programs (note 7) | 31,418,187 | 30,502,718 |
| | 96,783,357 | 69,207,510 |
| Investment in film and television programs (note 7) | 18,563,015 | 16,522,625 |
| Restricted cash (note 8) | 457,730 | 475,376 |
| Investment in production companies (note 9) | 1,235,167 | 1,210,362 |
| Property, plant and equipment (note 10) | 6,787,081 | 5,856,774 |
| Long-term investment, at cost (note 4(a)) | 2,071,722 | – |
| Intangible assets (note 11) | 6,822,427 | 2,574,942 |
| Goodwill | 11,153,746 | 7,157,541 |
| | 143,874,245 | 103,005,130 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Bank indebtedness (note 12) | 2,670,000 | 500,000 |
| Accounts payable and accrued liabilities | 13,421,538 | 7,132,866 |
| Deferred revenue | 14,421,587 | 13,324,560 |
| Interim production financing (note 13) | 47,489,747 | 33,119,013 |
| Current portion of long-term debt and capital lease obligations (note 14) | 695,904 | 256,104 |
| Current portion of other long-term liabilities (note 15) | 1,275,000 | 480,000 |
| Note payable | – | 400,000 |
| | 79,973,776 | 55,212,543 |
| Long-term debt and obligations under capital leases (note 14) | 2,814,447 | 2,901,350 |
| Other long-term liabilities (note 15) | – | 992,025 |
| Future income taxes (note 18) | 2,705,000 | 1,873,000 |
| Non-controlling interest | 188,129 | 564,611 |
| | 85,681,352 | 61,543,529 |
| **Shareholders' Equity** | | |
| **Share capital and contributed surplus** (note 16) | 59,743,168 | 42,047,061 |
| **Deficit** | (1,550,275) | (585,460) |
| | 58,192,893 | 41,461,601 |
| | 143,874,245 | 103,005,130 |

**Approved by the Board of Directors**

By: (signed) *Donald Wright"*
Director

By: (signed) *"Sir Graham Day"*
Director

# DHX Media Ltd.

Consolidated Statements of Income and Comprehensive Income and Deficit
**For the years ended June 30, 2008 and June 30, 2007**

(expressed in Canadian dollars)

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| **Revenues** | 52,446,847 | 25,970,619 |
| **Direct production costs and amortization of film and television programs produced** | 35,144,598 | 16,237,033 |
| | 17,302,249 | 9,733,586 |
| **Operating expenses** | | |
| Amortization of acquired library | 1,118,924 | 607,620 |
| Impairment in value of certain investment in film and television programs | 2,781,802 | – |
| Development expenses | 431,994 | 403,512 |
| Selling, general and administrative | 12,226,876 | 7,340,714 |
| | 16,559,596 | 8,351,846 |
| **Income before the following** | 742,653 | 1,381,740 |
| Amortization | 1,798,678 | 1,085,499 |
| Costs associated with abandoned acquisition | – | 288,058 |
| Equity income (note 9) | (44,136) | (360,513) |
| Interest expense | 556,203 | 455,758 |
| Interest income | (263,002) | (162,198) |
| Loss (income) from strategic investments | 59,062 | (1,736,761) |
| Non-controlling interest | (375,082) | 21,142 |
| **Income (loss) before income taxes** | (989,070) | 1,790,755 |
| **Provision for (recovery of) income taxes** (note 18) | | |
| Large corporation taxes | 40,000 | 113,000 |
| Current income taxes | (13,000) | (268,000) |
| Future income taxes | 13,000 | 745,000 |
| | 40,000 | 590,000 |
| **Net income (loss) and comprehensive income (loss) for the years** | (1,029,070) | 1,200,755 |
| **Deficit – Beginning of years** | (585,460) | (1,786,215) |
| Adjustment to opening balance on changes to accounting policies related to financial instruments (note 2(a)) | 64,255 | – |
| **Deficit – End of years** | (1,550,275) | (585,460) |
| **Basic earnings (loss) per common share (**note 21) | (0.03) | 0.04 |
| **Fully diluted earnings (loss) per common share** (note 21) | (0.03) | 0.03 |

# DHX Media Ltd.

Consolidated Statements of Cash Flows

**For the years ended June 30, 2008 and June 30, 2007**

(expressed in Canadian dollars)

| | 2008 $ | 2007 $ |
|---|---|---|
| **Cash provided by (used in)** | | |
| **Operating activities** | | |
| Net income (loss) and comprehensive income (loss) for the years | (1,029,070) | 1,200,755 |
| Charges (credits) to income not involving cash | | |
| Amortization of film and television programs | 34,836,595 | 15,229,034 |
| Amortization of acquired library | 1,118,924 | 607,620 |
| Amortization of property, plant and equipment | 717,163 | 458,425 |
| Amortization of intangible assets | 1,081,515 | 627,074 |
| Impairment in value of certain investment in film and television programs | 2,781,802 | – |
| Unrealized loss on short-term investments | 67,333 | – |
| Loss (gain) on disposal of short-term investments | 41,738 | (1,689,035) |
| Stock-based compensation | 904,235 | 370,332 |
| Interest on promissory notes | 13,385 | 15,331 |
| Interest | 117,975 | – |
| Equity income | (44,136) | (360,513) |
| Non-controlling interest | (375,082) | 21,142 |
| Future income tax expense | 13,000 | 745,000 |
| | 40,245,377 | 17,225,165 |
| Investment in film and television programs | (37,546,524) | (41,116,849) |
| Net change in non-cash working capital balances related to operations (note 22) | (7,955,016) | 3,209,373 |
| | (5,256,163) | (20,682,311) |
| **Financing activities** | | |
| Proceeds from issuance of common shares and warrants, net of issuance costs | 15,942,494 | (38,184) |
| Issuance costs adjusted on shares of a subsidiary | (1,400) | – |
| Proceeds from bank indebtedness | 1,873,000 | 495,927 |
| Proceeds from interim production financing | 3,611,199 | 16,589,707 |
| Proceeds from long-term debt | – | 127,397 |
| Repayment of long-term debt and obligations under capital leases | (633,048) | (291,192) |
| Repayment of note payable | (400,000) | (1,282,750) |
| Increase in (repayment of) other long-term liabilities | (675,000) | 1,472,025 |
| | 19,717,245 | 17,072,930 |
| **Investing activities** | | |
| Business acquisitions | (8,165,774) | (146,840) |
| Acquisitions of short-term investments | (183,730) | (683,425) |
| Proceeds on disposal of short-term investments | 1,736,809 | 3,161,645 |
| Acquisition of property, plant and equipment | (495,418) | (611,556) |
| Net cash advances (to) from investees | 149,605 | (787,910) |
| Long-term investment | (2,071,722) | – |
| | (9,030,230) | 931,914 |
| **Net change in cash during the years** | 5,430,852 | (2,677,467) |
| **Cash – Beginning of years** | 3,433,924 | 6,111,391 |
| **Cash – End of years** | 8,864,776 | 3,433,924 |

(expressed in Canadian dollars)

## 1 Nature of the business and significant accounting policies

DHX Media Ltd. (the "Company") is a public company whose common shares were admitted to trading on the Alternate Investment Market (AIM) and the Toronto Stock Exchange (TSX) on May 19, 2006 (symbol DHX). The Company, incorporated on February 12, 2004 under the laws of the Province of Nova Scotia, Canada, and continued on April 25, 2006 under the Canada Business Corporation Act, develops, produces and distributes films and television programs for the domestic and international markets. The address of the head office is 1478 Queen Street, Halifax, Nova Scotia, Canada, B3J 2H7.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

**Principles of consolidation**

The consolidated financial statements include the accounts of DHX Media Ltd. and all of its subsidiaries and all variable interest entities (''VIEs'') for which it is the primary beneficiary with provision for minority interests, and its proportionate share of assets, liabilities, revenues and expenses for jointly controlled operations. Investments in entities over which the Company has significant influence are accounted for using the equity method. Intercompany accounts and transactions among consolidated companies have been eliminated upon consolidation.

**Revenue recognition**

Revenue from the licensing of film and television programs is recognized when:

(a) the Company has persuasive evidence of a contractual arrangement;
(b) the production has been completed;
(c) the contractual delivery arrangements have been satisfied;
(d) the licensing period has commenced;
(e) the fee is fixed or determinable; and
(f) collectibility of proceeds is reasonably assured.

Cash payments received or advances currently due pursuant to a broadcast license or distribution arrangement are recorded as deferred revenue until all of the foregoing conditions of revenue recognition have been met. Revenues from production services for third parties are recognized on a percentage-of-completion basis. Associated production costs are charged against earnings as the revenue is recognized. Percentage-of-completion is based upon the proportion of costs incurred in the current period to total expected costs. A provision is made for the entire amount of future estimated losses, if any, on production-in-progress.

(expressed in Canadian dollars)

## 1 Nature of the business and significant accounting policies (continued)

### Investment in film and television programs

Investment in film and television programs represents the unamortized costs of film and television programs which have been produced by the Company or for which the Company has acquired distribution rights and the Company's right to participate in certain future cash flows of film and television programs produced and distributed by other unrelated parties ("Acquired Participation Rights"). Investment in film and television programs also includes acquired film and television libraries or properties that are in production.

Costs of acquiring and producing film and television programs are capitalized, net of federal and provincial program contributions earned, and amortized using the individual film forecast method, whereby capitalized costs are amortized and ultimate participation costs are accrued in the proportion that current revenue bears to management's estimate of ultimate revenue expected to be recognized from the exploitation, exhibition or licensing of the film or television program. For film and television programs produced by the Company, capitalized costs include all direct production and financing costs incurred during production that are expected to benefit future periods. Financing costs are capitalized to the costs of a film or television program until the film or television program is complete. Capitalized production costs do not include administrative and general expenses, or charges for losses on properties sold or abandoned. For episodic television series, until estimates of secondary market revenue can be established, capitalized costs for each episode produced are limited to the amount of revenue contracted for each episode. Costs in excess of this limitation are expensed as incurred on an episode-by-episode basis. Production financing provided by third parties that acquire substantive equity participation is recorded as a reduction of the cost of the production. Acquired participation costs are recognized initially at the amounts paid or the fair value of amounts due to the counterparty.

For films other than episodic television series and acquired libraries, ultimate revenue includes estimates over a period not to exceed ten years following the date of initial release. For episodic television series, ultimate revenue includes estimates of revenue over a period not to exceed ten years from the date of delivery of the first episode or, if still in production, five years from the date of delivery of the most recent episode, if later. For acquired film and television libraries previously released, ultimate revenue includes estimates of revenue over a period not to exceed twenty years from the date of acquisition.

Ultimate revenue estimates are prepared on a title-by-title basis and are reviewed periodically based on current market conditions. For film, ultimate revenue estimates include box office receipts, sale of videocassettes, and DVDs, licensing of television broadcast rights and licensing of other ancillary film rights to third parties. For television programs, ultimate revenue estimates include licensed rights to broadcast television programs in development and rights to renew licenses for episodic television programs in subsequent seasons. Ultimate revenue includes estimates of secondary market revenue for produced episodes only when the Company can demonstrate through its experience or industry norms that the number of episodes already produced, plus those for which a firm commitment exists and the Company expects to deliver, can be licensed successfully in the secondary market. Ultimate estimates of future revenue involve measurement uncertainty and it is therefore possible that reductions in the carrying value of investment in film and television programs may be required as a consequence of changes in management's future revenue estimates.

(expressed in Canadian dollars)

## 1 Nature of the business and significant accounting policies (continued)

**Investment in film and television programs** (continued)

The valuation of investment in film and television programs (including Acquired Participation Rights), is reviewed on a title-by-title basis when an event or change in circumstances indicates that the fair value of a film or television program or the acquired participation right is less than its unamortized cost. The fair value of the film or television program is determined using management's estimates of future revenues and costs under a discounted cash flow approach. A write-down is recorded equivalent to the amount by which the unamortized costs exceed the estimated fair value of the film or television program or acquired participation right.

**Development costs**

Development costs include costs of acquiring film rights to books, stage plays or original screenplays and costs to adapt such projects. Such costs are capitalized and, upon commencement of production, are added to investment in film and television programs or film and television programs in progress. Advances or contributions received from third parties to assist in development are deducted from these costs. Projects in development are written off as development expenses at the earlier of the date determined not to be recoverable or when projects under development are abandoned, and three years from the date of the initial investment.

**Property, plant and equipment**

Property, plant and equipment are carried at cost, including capitalized interest on major projects, less accumulated amortization. Amortization is provided, commencing when the asset is placed into service, over the estimated useful life of the asset, using the following annual rates and methods:

| | |
|---|---|
| Building | 4% by declining-balance |
| Furniture, fixtures and other equipment | 20% by declining-balance |
| Computer equipment | 30% by declining-balance |
| Post-production equipment | 30% by declining-balance |
| Computer software | 2 years straight-line |
| Website design | 2 years straight-line |
| Leasehold improvements | 5 years straight-line and straight-line over term of lease |

**Intangible assets**

Intangible assets are carried at cost, including amounts of purchase price allocations upon acquisitions. Amortization is provided over the estimated useful life of the assets, using the following annual rates and methods:

| | |
|---|---|
| Production backlog | 2 to 3 years straight-line |
| Broadcaster relationships | 7 to 10 years straight-line |
| Customer distributor and franchise relationships | 10 years straight-line |
| Non-compete contracts and brand | 3 to 9 years straight-line |
| Production software | 5 years straight-line |

(expressed in Canadian dollars)

## 1 Nature of the business and significant accounting policies (continued)

### Government financing and assistance

The Company has access to several government programs, including tax credits, that are designed to assist film and television production and distribution in Canada. Amounts received or receivable in respect of production assistance are recorded as a reduction of the production costs of the applicable production. Government assistance with respect to distribution rights is recorded as a reduction of investment in film and television programs. Government assistance towards current expenses is recorded as a reduction of the applicable expense item.

### Impairment of long-lived assets

Indefinite lived assets, including goodwill, are subject to annual impairment tests under GAAP. Any impairment would be recognized as an expense in the period of impairment.

### Income taxes

Future income taxes are provided for using the liability method whereby future income taxes are recognized for the expected future income tax consequences of all significant temporary differences between the tax and financial statement bases of assets and liabilities.

Future income tax assets are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of the enactment or substantive enactment.

### Foreign currency

Assets and liabilities denominated in currencies other than Canadian dollars are translated at exchange rates in effect at the balance sheet date. Revenue and expense items are translated at average rates of exchange for the year. Translation gains or losses are included in the determination of earnings.

### Earnings (loss) per share

Earnings (loss) per share basic and fully diluted are computed based on the weighted average number of common shares outstanding during the year. Diluted loss per share has not been disclosed since the exercise of the employee stock options, the put options and warrants would be anti-dilutive.

### Goodwill

Goodwill represents the cost of acquired businesses in excess of the fair value of net identifiable assets acquired. Goodwill is not subject to amortization and is tested for impairment annually or more frequently if events or circumstances indicate that the asset might be impaired. Impairment is tested by comparing the fair value of goodwill assigned to a particular reporting unit to its carrying value.

(expressed in Canadian dollars)

## 1 Nature of the business and significant accounting policies (continued)

### Management estimates

The presentation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual results could differ from those reported.

### Stock-based compensation

The fair value of all stock options granted to employees and consultants are recorded in operations or production costs, as applicable over their vesting periods. The fair value of options is determined using the Black Scholes option pricing model that takes into account, as of the grant date, the exercise price, the expected life of the option, the current price of the underlying stock and its expected volatility, expected dividends on the stock, and the risk-free interest rate over the expected life of the option. The resulting fair value of the options is expensed on a straight-line basis over their vesting periods. Cash consideration received from employees when options are exercised and the value of options accumulated in contributed surplus are credited to share capital. Stock-based compensation also includes awards of common shares to certain employees of the company related to the achievement of certain financial benchmarks.

### Financial instruments

Financial instruments, including derivatives, are recorded at fair value on initial recognition except for certain related party transactions. Subsequent measurement depends on the classification of the instrument and is either at fair value or, in limited circumstances when fair value may not be considered most relevant, at cost or amortized cost. Financial instruments intended to be held-to-maturity are recorded at amortized cost.

### Comprehensive income

The Company records in other comprehensive income (“OCI”) temporary unrealized gains and losses resulting from changes in fair value of certain financial instruments outside the net income. The Company has the following classification for financial assets and financial liabilities.

- Cash, restricted cash and short-term investments are classified as held-for-trading and recorded at fair market value. Changes in fair market value for the year are recorded in net earnings.
- Bank indebtedness, interim production financing, accounts payable and accrued liabilities, long-term debt, other long-term liabilities and notes payable are classified as other financial liabilities. After their initial fair market value measurement, they are measured at amortized cost using the effective interest method.
- Amounts receivable are classified as loans and receivables. After their initial fair market value measurement, they are measured at amortized cost using the effective interest method.
- Long-term investment is classified as available-for-sale. As there is no active market for this investment, it is measured at cost. The Company has elected to include transaction costs in the determination of cost for available-for-sale assets.

(expressed in Canadian dollars)

## 2 Changes in accounting policies and future accounting standard changes

### a) Changes in accounting policies:

**Financial instruments**

On July 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook section 1530, "Comprehensive Income", section 3251, "Equity", section 3855, "Financial Instruments – Recognition and Measurement", and section 3861, "Financial Instruments – Disclosure and Presentation".

*Section 1530 "Comprehensive Income"* introduces comprehensive income, which consists of net income and other comprehensive income ("OCI"). OCI temporarily presents certain unrealized gains and losses resulting from changes in fair value of certain financial instruments outside of net income.

*Section 3251 "Equity"* describes the changes in reporting and disclosing equity and changes in equity as a result of the new requirements of Section 1530.

*Sections 3855 and 3861 "Financial Instruments – Recognition and Measurement" and "Financial Instruments – Disclosure and Presentation"* respectively, prescribe when a financial instrument is to be recognized and derecognized from the balance sheet and at what amount these financial instruments should be recognized. It also specifies how financial instrument gains and losses are accounted for. All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions

The Company has adopted the following classification for financial assets and financial liabilities:

- Cash, restricted cash and short-term investments are classified as held-for-trading and recorded at fair market value. Changes in fair market value for the period are recorded in net earnings.
- Bank indebtedness, interim production financing, accounts payable and accrued liabilities, long-term debt, other long-term liabilities and notes payable are classified as other financial liabilities. After their initial fair market value measurement, they are measured at amortized cost using the effective interest method.
- Amounts receivable are classified as loans and receivables. After their initial fair market value measurement, they are measured at amortized cost using the effective interest method.
- Long-term investment is classified as available-for-sale. As there is no active market for this investment, it is measured at cost. The Company has elected to include transaction costs in the determination of cost for available for available-for-sale assets.

Upon adoption, entities have the option to recognize as an asset or liability all embedded derivative instruments that are required to be separated from their host contracts or to select the beginning of a fiscal year ending no later than March 31, 2004 as its transition date for embedded derivatives. The Company has selected February 12, 2004, the date of incorporation, as its transition date for embedded derivatives. The Company does not have any material outstanding contracts or financial instruments with embedded derivatives that require bifurcation.

The Company has applied these standards without restatement of prior years.

(expressed in Canadian dollars)

## 2 Changes in accounting policies and future accounting standard changes (continued)

### a) Changes in accounting policies (continued)

Upon initial application, the carrying amount of short-term investments was increased by $79,255 and related future income taxes were increased by $15,000 for a reduction in the deficit upon adoption of $64,255.

### b) Future accounting changes

The CICA issued new accounting standards: section 1535, *Capital Disclosures*, section 3862, *Financial Instruments - Disclosures*, section 3863, *Financial Instruments – Presentation,* and section 3064, *Goodwill and Intangible Assets*. Sections 1535, 3862, and 3863 are effective for fiscal years beginning on or after October 1, 2007 and, accordingly, the Company will adopt them on July 1, 2008. Section 3064 is effective for fiscal years beginning on or after October 1, 2008 and the Company will adopt it on July 1, 2009.

Section 1535 establishes disclosure requirements about an entity's capital and how it is managed. The purpose will be to enable users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Sections 3862 and 3863 will replace section 3861, *Financial Instruments – Disclosure and Presentation*, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections will place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

Section 3064 will replace section 3062, *Goodwill and Other Intangible Assets* and section 3450 *Research and Development costs.* The standard establishes revised standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets. The provisions relating to the definition and initial recognition of intangible assets, including internally generated intangible assets, are aligned with International Accounting Standard ("IAS") 38, *Intangible Assets*.

The Company is in the process of evaluating the impact on disclosure and presentation of these new standards.

## 3 Variable interest entities

A variable interest entity (''VIE'') is an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or wherein the equity investors lack the characteristic of a controlling financial interest. VIEs are subject to consolidation by the Company if the Company is deemed the primary beneficiary of the VIE. The primary beneficiary is the party that is either exposed to a majority of the expected losses from the VIE's activities or is entitled to receive a majority of the VIE's residual returns or both.

(expressed in Canadian dollars)

## 3 Variable interest entities (continued)

**Production arrangements**

In the normal course of business, the Company enters into production arrangements with third party production, distribution companies and broadcasters related to the production of television series or feature films. The wholly-owned production companies in which these production activities are undertaken, are VIEs as they do not have sufficient equity at risk to finance their activities. The Company has variable interests in certain entities but in certain companies, it is not exposed to the majority of the expected losses and, therefore, does not consolidate these companies. The Company accounts for these entities using the equity method (note 9).

## 4 Acquisitions and long-term investment

During the year ended June 30, 2008, the following acquisitions occurred:

(a) On November 22, 2007 the Company completed a strategic investment in privately-held Tribal Nova Inc. by acquiring a 16.77% interest in the company for consideration of $2,071,722 including transaction costs of $71,722. The Company has accounted for this investment using the cost method.

(b) On December 4, 2007 ("the Effective Date"), the Company acquired all the outstanding shares in Studio B Productions Inc. ("Studio B"), a privately-owned producer of primarily proprietary children's programming, for the consideration as follows:

- An initial cash payment of $8,000,000 on the Effective Date;
- Transaction costs of $36,125;
- An earnout amount calculated as 4.5 times the average "EBITDA" (as that term is defined in the agreement) for the years ended October 31, 2007 ("Fiscal 2007") and October 31, 2008 ("Fiscal 2008") up to a maximum of $20,000,000. The earnout amount is subject to Studio B meeting certain financial performance benchmarks for Fiscal 2007 and Fiscal 2008 and would be paid 30% in cash and 70% in common shares of DHX Media.

The acquisition was accounted for using the purchase method. As such, the results of operations reflect revenue and expenses of the assets of Studio B from the Effective Date. The purchase price has been allocated to the assets acquired (including all identifiable intangible assets arising from the purchase) and liabilities assumed based on their estimated fair value at the date of acquisition as follows:

(expressed in Canadian dollars)

## 4 Acquisitions and long-term investment (continued)

| | $ |
|---|---|
| **Assets acquired** | |
| Cash | 497,043 |
| Amounts receivable | 10,349,292 |
| Investment in production companies | 130,274 |
| Prepaids and deposits | 9,614 |
| Investment in film and television programs | 4,146,656 |
| Property, plant and equipment | 1,006,102 |
| Intangible assets | 4,898,000 |
| Goodwill | 3,607,880 |
| | 24,644,861 |
| **Less: liabilities assumed** | |
| Bank indebtedness | 297,000 |
| Accounts payable and accrued liabilities | 2,741,561 |
| Deferred revenue | 307,857 |
| Interim production financing | 10,759,535 |
| Long-term debt and obligations under capital leases | 912,783 |
| Future income tax liabilities | 1,590,000 |
| | 16,608,736 |
| | 8,036,125 |

The Company will finalize the purchase price allocation upon completion of its review of certain working capital balances. Any future adjustments resulting from its review will be recorded as an adjustment to the purchase allocation.

The purchase agreement includes a contingent payment, based on an earnout amount as described above, consisting of readily available funds and common shares. The purchase consideration and the allocation of the cost of the purchase does not include any amounts related to the earnout amount. The earnout amount is not determinable as the cash component and number of common shares that will be issued and the value attributed to these common shares will only be determined when the earnout amount conditions are met. When the contingency is resolved, any earnout amount due will be attributed to goodwill.

(c) On March 20, 2008 ("the Effective Date"), the Company acquired all the outstanding shares in Bulldog Interactive Fitness Inc. ("Bulldog Interactive" or "Bulldog"), a developer of children's entertainment centres, for the consideration as follows:

- Cash payment of $625,000 on the Effective Date;
- Transaction costs of $6,787;
- 99,333 common shares of the Company valued at $149,993; and
- Earnout amounts payable in cash and common shares of the Company with a maximum potential payout of $1,950,000 and are payable subject to Bulldog Interactive meeting certain financial targets.

(expressed in Canadian dollars)

## 4 Acquisitions and long-term investment (continued)

The acquisition was accounted for using the purchase method. As such, the results of operations reflect revenue and expenses of the assets of Bulldog Interactive from the Effective Date. The purchase price has been allocated to the assets acquired (including all identifiable intangible assets arising from the purchase) and liabilities assumed based on their estimated fair value at the date of acquisition as follows:

| | $ |
|---|---|
| **Assets acquired** | |
| Cash | 5,094 |
| Amounts receivable | 32,454 |
| Prepaids and deposits | 6,159 |
| Property, plant and equipment | 145,950 |
| Intangible assets | 431,000 |
| Goodwill | 388,325 |
| Future income tax asset | 100,000 |
| | 1,108,982 |
| **Less: liabilities assumed** | |
| Accounts payable and accrued liabilities | 168,570 |
| Deferred revenue | 85,469 |
| Long-term debt | 73,163 |
| | 327,202 |
| | 781,780 |

The Company will finalize the purchase price allocation upon completion of its review of certain working capital balances. Any future adjustments resulting from its review will be recorded as an adjustment to the purchase allocation.

The purchase agreement includes a contingent payment, based on earnout amounts as described above, consisting of readily available funds and common shares. The purchase consideration and allocation of the cost of the purchase does not include any amounts related to the earnout amounts. The earnout amount is not determinable as the cash component and number of common shares that will be issued and the value attributed to these common shares will only be determined when the earnout amounts conditions are met. When the contingency is resolved, any earnout amounts due will be attributed to goodwill.

During the year ended June 30, 2007, the following acquisitions occurred:

(d) On December 22, 2006, the Company completed the acquisition of the license for the worldwide distribution rights to 520 half-hours of television programming (“Distribution Rights”) for $2,200,000. As of June 30, 2008, the Company has paid cash of $1,100,000 and is scheduled to pay the remainder through five payments of $120,000 prior to March 31, 2009 and one lump sum payment of $500,000 due March 31, 2009. The fair value of the purchase price at the time of acquisition of the distribution rights of $2,076,961 was included in investment in film and television programs (note 7) under the category Acquired Participation Rights.

(expressed in Canadian dollars)

## 4 Acquisitions and long-term investment (continued)

(e) On July 1, 2006 (the "Electropolis Effective Date") and February 8, 2007 (the "Mighty Jungle Effective Date"), the Company completed business acquisitions and acquired all of the issued and outstanding shares of Electropolis Studios Incorporated and Mighty Jungle Productions Inc. and Mighty Jungle 2 Productions Inc., for cash consideration of $31,852 and $150,000 respectively.

The acquisitions have been accounted for using the purchase method and the results of operations are included in the consolidated statement of operations from the Electropolis Effective Date and Mighty Jungle Effective Date.

The following table summarizes the estimated fair value of the net assets acquired as of the Electropolis Effective Date and Mighty Jungle Effective Date:

| | $ |
|---|---|
| **Assets acquired** | |
| Amounts receivable | 45,041 |
| Investment in film and television programs | 495,496 |
| Prepaid expenses and deposits | 14,787 |
| Future income tax asset | 48,000 |
| Goodwill | 15,513 |
| | 618,837 |
| **Less: liabilities assumed** | |
| Bank indebtedness | 4,073 |
| Accounts payable and accrued liabilities | 33,683 |
| Interim production financing | 159,851 |
| Deferred revenue | 169,202 |
| Long-term debt | 70,176 |
| | 436,985 |
| | 181,852 |

## 5 Short-term investments

| | 2008 $ | 2007 $ |
|---|---|---|
| Guaranteed investment certificate | – | 1,500,000 |
| Other investments, at market | 286,350 | – |
| Other investments, at cost | – | 369,245 |
| | 286,350 | 1,869,245 |

As at June 30, 2008, other investments at cost were $359,559 (2007 - $369,245).

(expressed in Canadian dollars)

## 6 Amounts receivable

| | 2008 $ | 2007 $ |
|---|---|---|
| Trade | 17,988,259 | 9,981,200 |
| Income taxes receivable | 59,984 | 156,694 |
| Goods and service taxes recoverable | 1,048,043 | 490,607 |
| Federal and provincial film tax credits and other government assistance | 36,062,693 | 22,401,623 |
| | 55,158,979 | 33,030,124 |

## 7 Investment in film and television programs

| | 2008 $ | 2007 $ |
|---|---|---|
| **Development costs** | 1,757,410 | 1,193,506 |
| **Theatrical and non-theatrical productions in progress** | | |
| Cost, net of government and third party assistance and third party participation | 30,792,880 | 32,732,961 |
| **Acquired participation rights – theatrical and non-theatrical** | | |
| Cost | 5,720,455 | 5,701,330 |
| Accumulated amortization | (2,208,891) | (1,343,106) |
| | 3,511,564 | 4,358,224 |
| **Theatrical and non-theatrical productions completed and released** | | |
| Cost, net of government and third party assistance and third party participation | 79,641,671 | 36,591,439 |
| Accumulated amortization | (62,940,521) | (27,850,787) |
| Impairment in value of certain investment in film and television programs | (2,781,802) | – |
| | 13,919,348 | 8,740,652 |
| | 49,981,202 | 47,025,343 |
| Less: Current portion | (31,418,187) | (30,502,718) |
| | 18,563,015 | 16,522,625 |

(expressed in Canadian dollars)

## 7 Investment in film and television programs (continued)

The Company expects that 34% of the costs related to theatrical and non-theatrical productions completed and released will be amortized during the year ending June 30, 2009. The Company expects that 75% of the costs related to theatrical and non-theatrical productions completed and released will be amortized during the three-year period ending June 30, 2011. The Company expects that over 84% of the costs related to productions completed will be amortized by June 30, 2013.

The Company has estimated the current portion of investment in film and television programs by reference to production delivery schedules, expected revenues in the next twelve months and the related amortization on a production-by-production basis. These estimates are subject to change as ultimate revenues may differ from estimates. No portion of development costs or Acquired Participation Rights has been reflected as current.

During the fiscal year ended June 30, 2008, interest of $2,425,161 (2007 - $1,689,321) has been capitalized to investment in film and television.

The continuity of investment in film and television programs is as follows:

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| Net opening investment in film and television programs | 47,025,343 | 21,249,652 |
| Productions acquired during the year | 4,146,656 | 495,496 |
| Cost of productions during the year, net of government assistance and third party participation | 36,982,620 | 37,919,943 |
| Increase of acquired participation rights (note 4 (d)) | – | 2,076,961 |
| Increase in developments costs | 563,904 | 512,325 |
| Amortization | (35,955,519) | (15,229,034) |
| Impairment in value of certain investment in film and television programs | (2,781,802) | – |
| | 49,981,202 | 47,025,343 |

## 8 Restricted cash

Restricted cash is the balance of cash on hand in Media Fund (Atlantic) Ltd. The use of this cash is restricted to specified uses related to the production and development of film and television programs.

(expressed in Canadian dollars)

## 9 Investment in production companies

Investment in production companies represents the Company's investment in investee companies which it accounts for using the equity method.

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| **The continuity of investment in production companies is as follows:** | | |
| Opening balance | 1,210,362 | 61,939 |
| Equity income | 44,136 | 360,513 |
| Acquired (note 4(b)) | 130,274 | – |
| Net cash advances to (from) investees | (149,605) | 787,910 |
| | 1,235,167 | 1,210,362 |

The advances to investees are non-interest bearing with no set terms of repayment.

## 10 Property, plant and equipment

| | | | 2008 |
|---|---|---|---|
| | Cost<br>$ | Accumulated amortization<br>$ | Net<br>$ |
| Land | 800,000 | – | 800,000 |
| Building | 4,328,814 | 334,623 | 3,994,191 |
| Furniture, fixtures and other equipment | 2,357,510 | 1,482,330 | 875,180 |
| Computer equipment | 2,195,018 | 1,707,577 | 487,441 |
| Post-production equipment | 1,259,372 | 911,629 | 347,743 |
| Website design | 101,851 | 57,764 | 44,087 |
| Computer software | 506,261 | 461,186 | 45,075 |
| Leasehold improvements | 994,734 | 801,370 | 193,364 |
| | 12,543,560 | 5,756,479 | 6,787,081 |

| | | | 2007 |
|---|---|---|---|
| | Cost<br>$ | Accumulated amortization<br>$ | Net<br>$ |
| Land | 800,000 | – | 800,000 |
| Building | 4,328,814 | 170,781 | 4,158,033 |
| Furniture, fixtures and other equipment | 665,485 | 529,398 | 136,087 |
| Computer equipment | 696,218 | 504,823 | 191,395 |
| Post-production equipment | 1,255,475 | 763,431 | 492,044 |
| Website design | 51,525 | 9,796 | 41,729 |
| Computer software | 324,228 | 290,510 | 33,718 |
| Leasehold improvements | 67,464 | 63,696 | 3,768 |
| | 8,189,209 | 2,332,435 | 5,856,774 |

(expressed in Canadian dollars)

## 10 Property, plant and equipment (continued)

The continuity of property, plant and equipment is as follows:

| | 2008 $ | 2007 $ |
|---|---|---|
| Net opening balance, property, plant and equipment | 5,856,774 | 5,843,757 |
| Acquired in the Studio B acquisition | 1,006,102 | – |
| Acquired in the Bulldog acquisition | 145,950 | – |
| Adjustments to the Decode acquisition | – | (140,114) |
| Acquisitions of property, plant and equipment | 495,418 | 611,556 |
| Amortization | (717,163) | (458,425) |
| | 6,787,081 | 5,856,774 |

## 11 Intangible assets

| | | | 2008 |
|---|---|---|---|
| | Cost $ | Accumulated amortization $ | Net $ |
| Production backlog | 1,033,000 | 318,536 | 714,464 |
| Broadcaster relationships | 4,417,000 | 728,637 | 3,688,363 |
| Customer/distribution relationships | 757,000 | 123,366 | 633,634 |
| Non-compete contracts and brand | 2,007,500 | 570,413 | 1,437,087 |
| Production software | 394,000 | 45,121 | 348,879 |
| | 8,608,500 | 1,786,073 | 6,822,427 |

| | | | 2007 |
|---|---|---|---|
| | Cost $ | Accumulated amortization $ | Net $ |
| Production backlog | 150,000 | 84,267 | 65,733 |
| Broadcaster relationships | 1,910,000 | 306,572 | 1,603,428 |
| Customer/distribution relationships | 545,500 | 61,291 | 484,209 |
| Non-compete contracts and brand | 674,000 | 252,428 | 421,572 |
| | 3,279,500 | 704,558 | 2,574,942 |

(expressed in Canadian dollars)

## 11 Intangible assets (continued)

The continuity of intangible assets is as follows:

| | 2008 $ | 2007 $ |
|---|---|---|
| Net opening balance, intangible assets | 2,574,942 | 3,202,016 |
| Acquired in the Studio B acquisition | 4,898,000 | – |
| Acquired in the Bulldog acquisition | 431,000 | – |
| Amortization | (1,081,515) | (627,074) |
| | 6,822,427 | 2,574,942 |

## 12 Bank indebtedness

As of June 30, 2008, bank indebtedness was $2,670,000 (June 30, 2007 - $500,000). The maximum amount of bank indebtedness for general working capital purposes under the RBC Revolving Credit Facility is $3,500,000 (note 13). A general security agreement over all property of the Company has been pledged as security. The availability of the bank indebtedness portion of the facility is subject to the Company maintaining interest and consolidated indebtedness coverage ratios and certain other covenants.

## 13 Interim production financing

| | 2008 $ | 2007 $ |
|---|---|---|
| Revolving production credit facility (“RBC Revolving Credit Facility”), bearing interest at bank prime plus 0.75% - 2.00%. Assignment and direction of specific production financing and licensing contracts receivable, with a net book value of approximately $65,485,982 (year ended June 30, 2007 - $57,627,594) | 39,287,627 | 33,119,013 |
| Demand production bank loans (assumed on acquisition of Studio B note 4 (b) less repayment subsequent to acquisition), bearing interest at bank prime plus 1.25% - 1.50%. Assignment and direction of specific production financing and licensing contracts receivable, with a net book value of approximately $9,369,672 | 8,202,120 | – |
| | 47,489,747 | 33,119,013 |

(expressed in Canadian dollars)

## 13 Interim production financing (continued)

During the fiscal year ended June 30, 2008, the bank prime rate averaged 5.73% (2007 - 6.00%).

On October 26, 2007, the Company closed the RBC Revolving Credit Facility with the Royal Bank of Canada ("Royal Bank") with a maximum authorized amount of $70,000,000 including bank indebtedness (note 12) reviewable annually from the date of closing. Within the RBC Revolving Credit Facility is a revolving production credit facility with a maximum of $66,500,000 for interim production financing. Substantially all of the Company's assets and certain of its subsidiaries have been pledged as security for borrowing under the RBC Revolving Credit Facility.

(expressed in Canadian dollars)

## 14 Long-term debt and obligations under capital leases

| | 2008 $ | 2007 $ |
|---|---|---|
| Loans payable, bearing interest at Business Development Bank of Canada prime plus 0.5%, maturing in April 2010 and May 2021, repayable in monthly principal instalments of $19,880 plus interest. A first mortgage on the land and building having a net book value of $4,794,191 and a general assignment of rents | 2,901,350 | 3,139,910 |
| Loan payable, repaid during the year | – | 17,544 |
| Loan payable, Royal Bank, bearing interest at Royal Bank prime plus 1.25%, repayable in monthly principal instalments of $15,834 and $12,259 plus interest, maturing August 15, 2008 and August 31, 2008 | 56,669 | – |
| Demand loan payable, bearing interest at 11.5%, compounded annually and payable monthly | 254,925 | – |
| Loans payable, bearing interest at 6.25% per annum, maturing on February 2012, repayable in monthly instalments of $334 including principal and interest | 13,354 | – |
| Loans payable, bearing interest at Business Development Bank of Canada floating base rate plus 3.30%, maturing on September 2012, repayable in monthly principal instalments of $1,365 plus interest | 53,235 | – |
| Obligations under capital leases payable in monthly lease payments of $24,742 bearing interest at 6.7% and 8.4%, maturing from August 2008 to June 2010 | 230,818 | – |
| | 3,510,351 | 3,157,454 |
| Less: Current portion | (695,904) | (256,104) |
| | 2,814,447 | 2,901,350 |

The aggregate amount of principal repayments required in each of the next five years is as follows:

| | $ |
|---|---|
| Year ending June 30, 2009 | 695,904 |
| 2010 | 362,311 |
| 2011 | 262,617 |
| 2012 | 241,793 |
| 2013 | 238,560 |

(expressed in Canadian dollars)

## 14 Long-term debt (continued)

A general security agreement covering all assets of a wholly-owned subsidiary (Studio B) along with guarantees and postponements of claims equalling $2,000,000, a second mortgage on the land and building occupied by Studio B and an assignment of rent have all been pledged as security for the loans payable, Royal Bank.

## 15 Other long-term liabilities

| | 2008 $ | 2007 $ |
|---|---|---|
| Other long-term liabilities include $1,100,000 (2007 - $1,222,025) related to the acquisition of Distribution Rights as described in note 4 (d) and a $175,000 (2007 - $259,000) amount related to a settlement in relation to a feature film | 1,275,000 | 1,472,025 |
| Less: Current portion | (1,275,000) | (480,000) |
| | – | 992,025 |

The aggregate amount of payments required during the year ending June 30, 2009 is $1,275,000.

## 16 Share capital and contributed surplus

### a) Authorized

100,000,000 Preferred variable voting shares, redeemable at the option of the Company at any time at a millionth of a cent per share, no entitlement to dividends, voting
10,000,000 Class A preferred shares, convertible to common shares at the option of the holder, redeemable at the option of the holder or the Company on or after June 16, 2010, at 1.5 times the issue price, voting
Unlimited common shares without nominal or par value

(expressed in Canadian dollars)

## 16 Share capital and contributed surplus (continued)

### b) Issued and outstanding

Changes in the Company's issued share capital during the years were as follows:

| | 2008 Number | 2008 Amount $ | 2007 Number | 2007 Amount $ |
|---|---|---|---|---|
| **Preferred variable voting shares** (note 16 (c)) | 100,000,000 | 100 | 100,000,000 | 100 |
| **Common shares** (note 16 (d)) | | | | |
| Opening balance | 32,801,452 | 40,778,665 | 32,576,452 | 40,499,600 |
| Issued for cash consideration | 9,815,000 | 15,939,560 | – | – |
| Share issuance costs, net of tax effect of $645,350 and $13,700, respectively | – | (1,380,974) | – | (38,185) |
| Issued as consideration for acquisition of Decode | – | – | 225,000 | 317,250 |
| Issued as consideration for acquisition of Bulldog Interactive | 99,333 | 149,993 | – | – |
| | 42,715,785 | 55,487,244 | 32,801,452 | 40,778,665 |
| **Common share purchase loans receivable** | | | | |
| Opening balance | – | (444,803) | – | (460,134) |
| Interest received on notes | – | 13,385 | – | 15,331 |
| | – | (431,418) | – | (444,803) |
| **Warrants** (note 16 (f)) | | | | |
| Opening balance | 435,125 | 217,280 | 1,213,859 | 1,131,888 |
| Issued for cash consideration | 4,922,750 | 1,732,808 | – | – |
| Warrant issuance costs, net of tax effect of $40,650 | – | (103,394) | – | – |
| Broker warrants issued | 738,413 | 440,494 | – | – |
| Expiration of warrants | (435,125) | (217,280) | (778,734) | (914,608) |
| | 5,661,163 | 2,069,908 | 435,125 | 217,280 |
| **Contributed surplus** (note 16 (g)) | | | | |
| Stock options | | | | |
| Opening balance | 1,921,547 | 1,495,819 | 1,021,547 | 210,879 |
| Options issued during the year | 790,000 | 158,843 | 1,175,000 | 79,461 |
| Compensation expense on existing options | – | 445,392 | – | 290,871 |
| Management bonuses | – | 300,000 | – | – |
| Options expired or cancelled | (275,000) | – | (275,000) | – |
| Warrants expired | – | 217,280 | – | 914,608 |
| | 2,436,547 | 2,617,334 | 1,921,547 | 1,495,819 |
| | | 59,743,168 | | 42,047,061 |

(expressed in Canadian dollars)

## 16 Share capital and contributed surplus (continued)

### c) Preferred variable voting shares

The Preferred variable voting shares were issued May 12, 2006 to an officer and director.

### d) Common shares

On December 18, 2006, the Company issued 225,000 common shares at $1.41 per share for the gross amount of $317,250. The 225,000 common shares were issued to two directors and a former shareholder of Decode as partial payment for a note payable owing to them in connection with the purchase of their interest in Decode.

On November 13 and 14, 2007, the Company issued a combined 9,815,000 units ("Unit or Units") from the treasury at a price of $1.80 per Unit for aggregate gross proceeds of $17,667,000 (the "Offering") plus an additional $5,368 for separately issued warrants. Each Unit consists of one common share in the capital of the Company and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share of the Company at a price of $2.10 per common share, expiring on November 13, 2010.

On May 26, 2008, the Company issued 99,333 common shares at $1.51 per share for a gross amount of $149,993. The 99,333 common shares were issued to former shareholders of Bulldog in connection with the purchase of Bulldog.

### e) Share purchase financing

During the fiscal year ended June 30, 2008, the Company issued no amounts for common share purchase financing (year ended June 30, 2007 – $nil).

The Company accounts for share purchase financing as a reduction of share capital and the benefit of the financing has been estimated using the Black Scholes option pricing model and the following assumptions: risk-free interest rate - 4.25%; expected life - two years; expected volatility - 50%; and expected dividend yield - 0%.

During the fiscal year ended June 30, 2008, no compensation expense was recognized (year-ended June 30, 2007 - $nil). Interest of $13,385 (year ended June 30, 2007 - $15,331) received on these loans is being recorded as capital contribution.

(expressed in Canadian dollars)

## 16 Share capital and contributed surplus (continued)

### f) Warrants

During the year ended June 30, 2008, 5,661,163 warrants were granted and 435,125 expired. In connection with the Offering, the Company issued 4,922,750 common share purchase warrants valued at $0.35 per warrant for cash consideration. The warrants entitle the shareholders to acquire 4,922,750 common shares for $2.10 and expire on November 13 and 14, 2010. Also, in connection with the Offering, the Company granted 738,413 common share warrants valued at $0.60 per warrant to the brokers of the Offering. The warrants entitle the holders to purchase 738,413 common shares for $1.80 and expire on May 13 and 14, 2009.

| | Number of warrants | Weighted average exercise price |
|---|---|---|
| **Outstanding at June 30, 2006** | 1,213,859 | 2.19 |
| Warrants expired | (778,734) | 2.10 |
| **Outstanding at June 30, 2007** | 435,125 | 2.35 |
| Issued for cash consideration | 4,922,750 | 2.10 |
| Broker warrants issued | 738,413 | 1.80 |
| Warrants expired | (435,125) | 2.35 |
| **Outstanding at June 30, 2008** | 5,661,163 | 2.06 |

The fair value of the warrants has been estimated by management using the Black Scholes option pricing model. The weighted average assumptions used in the pricing model to value the warrants are as follows:

| | 2008 | 2007 |
|---|---|---|
| Risk-free interest rate | 4.25% | 4.25% |
| Expected option life | 1.5 years | 1 year |
| Expected volatility | 65% | 50% |
| Expected dividend yield | nil | nil |

(expressed in Canadian dollars)

## 16 Share capital and contributed surplus (continued)

### g) Stock options

At June 30, 2008 and 2007, the Company had the following stock options outstanding:

| | Number of options | Weighted average exercise price |
|---|---|---|
| **Outstanding at June 30, 2006** | 1,021,547 | 2.14 |
| Granted to employees | 1,175,000 | 2.17 |
| Options expired | (275,000) | 1.85 |
| **Outstanding at June 30, 2007** | 1,921,547 | 2.20 |
| Granted to employees and directors | 510,000 | 1.62 |
| Granted to consultants | 280,000 | 1.52 |
| Options cancelled | (275,000) | 2.17 |
| **Outstanding at June 30, 2008** | 2,436,547 | 2.02 |
| **Exercisable at June 30, 2007** | 186,630 | 2.25 |
| **Exercisable at June 30, 2008** | 642,024 | 2.19 |

During the fiscal year ended June 30, 2007, 275,000 stock options issued at $1.85 per share expired and 900,000 were issued at $2.35 per share, vesting at various times over four years and expiring on October 3, 2011. On May 14, 2007, 275,000 stock options were issued at $1.58 per share, vesting at various times over four years and expiring on May 14, 2012.

During the fiscal year ended June 30, 2008, 510,000 stock options were issued to employees at $1.62 per share, vesting over four years and expiring on September 26, 2012. On May 14, 2008, the Company issued 100,000 stock options to consultants at $1.42 per share vesting at various times over a nine month period and expiring on May 14, 2013. On March 5, 2008, the Company issued 180,000 stock options to consultants at a price of $1.57 per share, vesting at various times over a nine month period and expiring on March 5, 2013. No stock options expired during the twelve month period ending June 30, 2008 and 275,000 stock options at $2.17 were cancelled.

As at June 30, 2008, 812,724 options to purchase common shares were issued by the Company above the maximum number of options issuable by the Company. No exercise of these 812,724 additional options shall occur until approval for their issuance and exercise is obtained from holders of common shares. As at June 30, 2008, 165,000 of the options issued, above the maximum number of options issuable, would have vested under all of the terms of the share option plan, however because they are conditional on shareholder approval they have not been included in the 642,024 options exercisable at June 30, 2008. The Company intends to seek approval of holders of common shares to raise the maximum number of options issuable under the employee share option plan.

(expressed in Canadian dollars)

## 16 Share capital and contributed surplus (continued)

### g) Stock options (continued)

The weighted average grant date value of stock options granted in 2008 has been estimated at $0.96 (2007 - $0.95) using the Black Scholes option pricing model. The following weighted average assumptions were used in the calculations:

| | 2008 | 2007 |
|---|---|---|
| Risk-free interest rate | 4.10% | 4.06% |
| Expected option life | 4 years | 4 years |
| Expected volatility | 61% | 59% |
| Expected dividend yield | nil | nil |

Changes in the assumptions can materially affect the fair value estimate and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the stock options.

During the year ended June 30, 2008, a total of $924,235 (2007 - $370,332) was recognized as compensation expense. Included in the compensation expense for June 30, 2008 was $300,000 awarded as bonuses to certain key executives of the Company to be paid in common shares of the Company based on achieving certain financial benchmarks by a wholly-owned subsidiary. The actual number of common shares to be issued will be determined based on the five day weighted average share price immediately prior to issuing.

### h) Put options

Pursuant to a financing by Media Fund, the Company granted to the new shareholders of Media Fund a right to have the Company purchase their common shares in exchange for common shares of the Company (the "put option") on a one-for-one basis. These put options are exercisable only if and when the Company obtains a public listing for its shares. The put options are automatically exercised on January 15, 2009, unless the holder rejects the put right. The Company has a buy-out right to acquire all of the Media Fund shares after obtaining a public listing unless more than 25 percent of the shareholders reject the put right.

The common shares of Media Fund are redeemable by January 15, 2009 since a listing of the Company has occurred. However, as these common shares of Media Fund are residual equity in Media Fund, these shares have been presented as non-controlling interest.

The put option was issued for no consideration. At June 30, 2008, 425,420 (2007 - 425,420) shares in Media Fund carried the put option described above.

(expressed in Canadian dollars)

## 17 Government financing and assistance

During the year ended June 30, 2008, investment in film and television programs was reduced by $2,861,595 (year ended June 30, 2007 - $4,745,072) related to production financing from government agencies. This financing is related to equity participation by government agencies and is repayable from distribution revenue of the specific productions for which the financing was made. In addition, during the year, investment in film also has been reduced by $8,383,944 (year ended June 30, 2007 - $7,853,362) related to non-repayable contributions from the Canadian Television Fund license fee program. Lastly, during the year, investment in film and television programs has been reduced by $21,032,742 (year ended June 30, 2007 - $9,319,676) in tax credits relating to production activities.

## 18 Income taxes

Significant components of the Company's future tax assets and liabilities as at June 30, 2008 and 2007 are as follows:

| | **2008** **$** | **2007** **$** |
|---|---|---|
| Property, plant and equipment | 213,000 | 437,000 |
| Share issue costs and deferred financing fees | 1,273,000 | 1,237,000 |
| Investment in film and television programs | (2,730,000) | (3,053,000) |
| Intangible assets | (3,455,000) | (927,000) |
| Non-capital losses and other | 1,994,000 | 433,000 |
| Future income taxes | (2,705,000) | (1,873,000) |

The reconciliation of income taxes computed at the statutory tax rates to income tax expense is as follows:

| | **2008** **$** | **2007** **$** |
|---|---|---|
| Income tax expense based on combined federal and provincial tax rates of 36.81% (2007 - 37.56%) | (364,000) | 673,000 |
| Income taxes increased (reduced) by | | |
| Stock-based compensation | 333,000 | 141,000 |
| Large corporation tax | 40,000 | 113,000 |
| Non-deductible expenses, rate changes and other | 17,000 | (37,000) |
| Foreign losses | 17,000 | 22,000 |
| Non-taxable portion of capital gains | (3,000) | (322,000) |
| Provision for income taxes | 40,000 | 590,000 |

(expressed in Canadian dollars)

## 19 Financial instruments

### a) Fair value of financial instruments

Management believes that the carrying amounts reported on the financial statements for amounts receivable, accounts payable and accrued liabilities, interim production financing, bank indebtedness, note payable and long-term debt all approximate their fair values due to their immediate or short-term maturities or variable interest rates.

### b) Credit risk

Amounts receivable from the Canadian federal government and other government agencies in connection with production financing represents 70% of total amounts receivable at June 30, 2008 (June 30, 2007 - 73%). Certain of these amounts are subject to audit by the government agency. Management believes that these amounts are fully collectible. The balance of trade accounts receivable are mainly with Canadian broadcasters and large distribution companies. Management believes that these amounts are fully collectible. An allowance against Federal and Provincial tax credits receivable has been booked based on the Company history of collection of these receivables.

### c) Interest rate risk

The Company is exposed to interest rate risk arising from fluctuations in interest rates as its interim production financing and certain long-term debt bear interest at floating rates.

### d) Currency risk

The Company's activities involve holding foreign currencies and incurring production costs and earning revenues denominated in foreign currencies. These activities result in exposure to fluctuations in foreign currency exchange rates. At the statement date, the Company revalued its financial instruments denominated in a foreign currency at the prevailing exchange rates.

## 20 Commitments and contingencies

The Company has entered into various operating leases for operating premises and equipment. The future minimum payments under these operating leases are as follows:

| | $ |
|---|---|
| Year ending June 30, 2009 | 1,069,026 |
| 2010 | 1,249,492 |
| 2011 | 944,341 |
| 2012 | 570,413 |
| 2013 | 488,683 |

(expressed in Canadian dollars)

## 21 Earnings (loss) per common share

Earnings (loss) per common share is calculated as follows:

| | 2008 $ | 2007 $ |
|---|---|---|
| Net income (loss) for the years | (1,029,070) | 1,200,755 |
| Weighted average number of common shares: | | |
| Basic | 39,038,719 | 32,698,508 |
| Fully diluted | 39,038,719 | 35,732,836 |
| Earnings (loss) per common share: | | |
| Basic | (0.03) | 0.04 |
| Fully diluted | (0.03) | 0.03 |

For the year ended June 30, 2008, the diluted weighted average number of common shares outstanding is the same as the basic weighted average number of common shares outstanding, as the Company had a net loss and the exercise of potentially dilutive instruments would be anti-dilutive.

At June 30, 2007, the weighted average number of potentially dilutive instruments, comprised of shares issuable in respect of convertible warrants, stock options and put options, was 3,034,328.

## 22 Net change in non-cash working capital balances related to operations

| | 2008 $ | 2007 $ |
|---|---|---|
| Decrease (increase) in amounts receivable | (11,747,548) | (2,198,716) |
| Decrease (increase) in prepaid expenses and deposits | (667,355) | 112,215 |
| Decrease (increase) in restricted cash | 17,646 | 327,532 |
| Increase (decrease) in accounts payable and accrued liabilities | 3,885,084 | (5,268,455) |
| Increase (decrease) in income taxes payable | (146,544) | (299,294) |
| Increase (decrease) in deferred revenue | 703,701 | 10,536,091 |
| | (7,955,016) | 3,209,373 |

| | 2008 | 2007 |
|---|---|---|
| During the year, the Company paid and received the following: | | |
| Interest paid | 2,775,956 | 2,021,936 |
| Interest received | 392,565 | 263,558 |
| Taxes paid | 1,090 | 51,156 |

(expressed in Canadian dollars)

## 23 Interest in joint ventures

The Company's interest in joint ventures is summarized below:

| | 2008 $ | 2007 $ |
|---|---|---|
| **Statement of operations** | | |
| Revenues | 747,857 | – |
| Direct production costs and amortization of film and television programs | (628,196) | – |
| General and administrative | (5,933) | – |
| Taxes | (2,215) | – |
| Income from joint ventures before income taxes | 111,513 | – |
| **Balance sheet** | | |
| Current assets | 3,966,862 | 3,869,979 |
| Current liabilities | (3,857,564) | (3,854,766) |
| | 109,298 | 15,213 |
| **Statement of cash flows** | | |
| Operating activities | 111,513 | – |
| Financing activities | (85,920) | (249,006) |
| Increase (decrease) in cash position | 25,593 | (249,006) |

## 24 Revenues and segmented information

The Company operates production entities and offices in Canada and the United Kingdom. In measuring performance, the Company does not distinguish or group its operations on a geographical or any other basis and, accordingly, has a single reportable segment for disclosure purposes and has the following sources of revenue:

| | 2008 $ | 2007 $ |
|---|---|---|
| Production revenue | 34,408,889 | 13,452,171 |
| Distribution revenue | 14,433,155 | 9,755,660 |
| Producer and service fee revenues | 1,714,515 | 1,100,575 |
| Other | 1,890,288 | 1,662,213 |
| | 52,446,847 | 25,970,619 |

(expressed in Canadian dollars)

## 25 Seasonality

Results of operations for any period are dependent on the number and timing of film and television programs delivered which cannot be predicted with certainty. Consequently, the Company's results from operations may fluctuate materially from period to period and the results of any one period are not necessarily indicative of results for future periods. Cash flows may also fluctuate and are not necessarily closely correlated with revenue recognition. The Company at times during the initial broadcast of the rights is reliant on the broadcaster financing and budget cycle and at times the license period gets delayed and commences at a later date than originally projected or scheduled.

The Company's film and television revenues are generally highest in the third and fourth fiscal quarters, driven by contracted deliveries with the primary broadcasters. Distribution revenues are contract and demand driven and can fluctuate significantly from period to period

## 26 Reconciliation of Canadian Generally Accepted Accounting Principles ("GAAP") and International Financial Reporting Standards ("IFRS")

These consolidated financial statements have been prepared in accordance with Canadian GAAP. In certain aspects, GAAP, as applied under IFRS differs from Canadian GAAP.

### a) Judgments made by management

IFRS requires disclosure of judgments that have been made by management in the preparation of the financial statements. In this regard, other than estimates which are disclosed under Canadian GAAP, management has made judgments about which development projects, with total costs of $1,757,410 at June 30, 2008 (2007 - $1,193,506) are likely to result in productions. Development projects which, during the reporting period, have not been assessed as likely to proceed have been written off.

### b) Leases

Under IFRS total costs charged to expenses under operating leases must be disclosed. The Company incurred rent expense of $732,911 for the year ended June 30, 2007 (2007 - $262,414).

### c) Financial instruments

Beginning on July 1, 2007, the Company adopted prospectively new financial instrument handbook sections (note 2 (a)). Under the new Canadian GAAP standards, assets held for trading are measured at fair market value, which is consistent with IFRS.

(expressed in Canadian dollars)

## 26 Reconciliation of Canadian Generally Accepted Accounting Principles ("GAAP") and International Financial Reporting Standards ("IFRS") (continued)

### c) Financial instruments (continued)

For the year ended June 30, 2007, under IFRS financial assets held for trading were measured at fair market value, whereas under Canadian GAAP these assets were recorded at the lower of cost or market value. Under IFRS any unrealized gains or losses related to the revaluation of financial assets held for trade are recorded in income for the year.

The Company had classified its short-term investments as held for trading. Under IFRS the following adjustments to the financials would be made:

| | **2007** **$** |
|---|---|
| Short-term investments under Canadian GAAP | 1,869,245 |
| Unrealized gain | 79,255 |
| Short-term investments under IFRS | 1,948,500 |
| | |
| Future income taxes under Canadian GAAP | 1,873,000 |
| Add: Taxation impact of the unrealized gain | 15,000 |
| Future income taxes under IFRS | 1,888,000 |
| | |
| Shareholders' equity under Canadian GAAP | 41,461,601 |
| Add: Unrealized gain | 79,255 |
| Less: Income tax effect | (15,000) |
| Shareholders' equity under IFRS | 41,525,856 |
| | |
| Net income for the year under Canadian GAAP | 1,200,755 |
| Add: Unrealized gain | 79,255 |
| Less: Income tax effect | (15,000) |
| Net income for the year under IFRS | 1,265,010 |
| | |
| Basic earnings per common share under IFRS | 0.04 |
| Fully diluted earnings per common share under IFRS | 0.04 |

(expressed in Canadian dollars)

## 27 Subsequent events

On July 21, 2008, the Company acquired imX Communications Inc. and its library of 20 feature films and 26 half hours of television drama, documentary and animation entertainment. The total consideration paid for the acquisition is $755,000, consisting of $655,000 in cash and 67,552 common shares of the Company.

On September 28, 2008, the Company entered into an Arrangement Agreement with Entertainment One Ltd. (Entertainment One). Under the agreement, Entertainment One proposes to acquire the Company through a reverse takeover. The proposal provides, among other closing transactions, that Entertainment One shareholders will exchange their common shares in Entertainment One for new common shares of the Company on a one-for-one basis. Current shareholders of the Company will then exchange their common shares for either 0.9409 new common shares or 0.7057 new common shares and $0.3975 in cash. After the proposed closing transactions, the Company will own Entertainment One and former shareholders of Entertainment One will own between 76% and 83% of the Company. Completion of the proposed transaction is subject to, among other things, final due diligence, shareholder approval of both the Company and Entertainment One and regulatory approval.