

THE MAGIC RAILROAD COMPANY LIMITED
DIRECTORS' REPORT AND FINANCIAL STATEMENTS
PERIOD ENDED 27 AUGUST 2002
Registered number: 3819082



THE MAGIC RAILROAD COMPANY LIMITED
DIRECTORS' REPORT AND FINANCIAL STATEMENTS
27 AUGUST 2002

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THE MAGIC RAILROAD COMPANY LIMITED

DIRECTORS' REPORT FOR THE PERIOD ENDED 27 AUGUST 2002

The directors submit their annual report and the audited financial statements of the company for the 14 month period ended 27 August 2002.

PRINCIPAL ACTIVITY

The principal activity of the company is that of ownership and development of intellectual property rights, of Thomas and the Magic Railroad feature film.

REVIEW OF THE BUSINESS

The company changed its accounting reporting date from 30 June 2002 to 27 August 2002.

The loss for the 14 month period was £9,728,000 (year ended 30 June 2001 – profit £2,464,000). The directors do not recommend the payment of a dividend (year ended 30 June 2001 – £nil).

On 27 August 2002, HIT Entertainment PLC took control of Gullane Entertainment PLC, the immediate and ultimate parent undertaking of the company, and acquired the whole of the issued and to be issued share capital of Gullane Entertainment PLC for approximately £141m. The consideration for the acquisition was paid in cash and ordinary shares of HIT Entertainment PLC.

FUTURE DEVELOPMENTS

Further exploitation of the company's intellectual property rights in additional territories is anticipated during 2002 / 2003.

DIRECTORS

The directors of the company during the period and to the date of this report were as follows:

W S Harris (resigned 3 September 2002)
T J Hilton (resigned 26 October 2001)
T W Ricketts (appointed 26 October 2001, resigned 3 September 2002)
N Birrell (appointed 3 September 2002)
C J Caminada (appointed 3 September 2002)
R I Lawes (appointed 3 September 2002)

DIRECTORS' INTERESTS

None of the directors had any interest in the share capital of the company during the period. Their interests in the shares of the immediate parent undertaking are disclosed in the financial statements of that company.

THE MAGIC RAILROAD COMPANY LIMITED

DIRECTORS' REPORT FOR THE PERIOD ENDED 27 AUGUST 2002 (continued)

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare accounts for each period which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking steps for the prevention and detection of fraud and other irregularities.

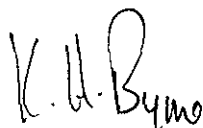
REGISTERED NUMBER

The registered number of the company is 3819082.

AUDITORS

Following the conversion of our auditors, PricewaterhouseCoopers, to a Limited Liability Partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned on 14 March 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditors.

By order of the Board



K H Byrne
Secretary

26 June 2003

Maple House
149 Tottenham Court Road
London
W1T 7NF

THE MAGIC RAILROAD COMPANY LIMITED

Independent auditors' report to the members of The Magic Railroad Company Limited

We have audited the financial statements which comprise the profit and loss account, the balance sheet and the related notes.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the directors' report.

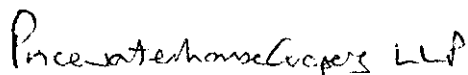
Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs at 27 August 2002 and of the loss for the period then ended and have been properly prepared in accordance with the Companies Act 1985.



PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
26 June 2003

THE MAGIC RAILROAD COMPANY LIMITED

PROFIT AND LOSS ACCOUNT
FOR THE PERIOD ENDED 27 AUGUST 2002

	Note	14 months ended <u>27 August 2002</u> £000	Year ended <u>30 June 2001</u> £000
TURNOVER	2	76	9,939
COST OF SALES		(11,134)	(5,951)
GROSS (LOSS) / PROFIT		(11,058)	3,988
ADMINISTRATIVE EXPENSES		-	(194)
(LOSS) / PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	3	(11,058)	3,794
TAX ON (LOSS) / PROFIT ON ORDINARY ACTIVITIES	6	1,330	(1,330)
RETAINED (LOSS) / PROFIT FOR THE FINANCIAL PERIOD/YEAR	13, 14	(9,728)	2,464
		<u>=====</u>	<u>=====</u>

There are no recognised gains or losses other than the loss for the period and therefore no separate statement of total recognised gains and losses has been presented.

There is no difference between the loss on ordinary activities and the loss for the period or year stated above and their historical cost equivalents.

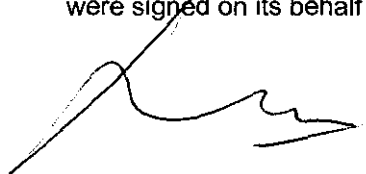
All amounts relate to continuing operations.

THE MAGIC RAILROAD COMPANY LIMITED

BALANCE SHEET AT 27 AUGUST 2002

	Note	<u>27 August 2002</u> £000	<u>30 June 2001</u> £000
CURRENT ASSETS			
Investment in programme portfolio	7	-	11,035
Debtors	8	588	710
Cash at bank and in hand		4	-
		<u>592</u>	<u>11,745</u>
CREDITORS – Amounts falling due within one year	9	(7,856)	(7,951)
NET CURRENT (LIABILITIES) / ASSETS		<u>(7,264)</u>	<u>3,794</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		(7,264)	3,794
PROVISIONS FOR LIABILITIES AND CHARGES	11	-	(1,330)
NET (LIABILITIES) / ASSETS		<u>(7,264)</u> =====	<u>2,464</u> =====
SHARE CAPITAL AND RESERVES			
Called up share capital	12	-	-
Profit and loss account	13	(7,264)	2,464
EQUITY SHAREHOLDERS' (DEFICIT)/FUNDS	14	<u>(7,264)</u> =====	<u>2,464</u> =====

The financial statements on pages 4 to 12 were approved by the board of directors on 26 June 2003 and were signed on its behalf by:



R I Lawes – Director

THE MAGIC RAILROAD COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS – 27 AUGUST 2002

1. PRINCIPAL ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention, and in accordance with applicable United Kingdom accounting standards.

The financial statements are prepared on a going concern basis. The company's ultimate parent undertaking, HIT Entertainment PLC, has undertaken to continue to provide financial support for the foreseeable future.

A summary of the significant accounting policies which have been applied is set out below.

Changes in Accounting Policies

The company adopted Financial Reporting Standard 18 ("Accounting Policies") and Financial Reporting Standard 19 ("Deferred Taxation") during the period.

During the period the company adopted a new accounting policy for the recognition of licence fees. This policy was applied to reflect compliance with best practice in the entertainment industry and adoption of accounting policies most appropriate for the business.

The adoption of these policies has had no impact on the comparative figures and hence no restatement was required.

The estimation technique used to amortise investment in programmes has been revised, reducing the maximum life of programmes to 10 years, and changing the basis on which costs are spread.

Turnover

Licence fees

Income recognised on the Thomas and the Magic Railroad feature film represents the invoiced value of licence fees including withholding tax but excluding value added tax. The company's policy is to recognise the income when all of the following criteria are met:

- (a) a licence agreement has been signed by both parties;
- (b) the programme has substantially met all necessary technical quality requirements;
- (c) delivery to the broadcaster has occurred;
- (d) the licence term has commenced;
- (e) the arrangement is fixed or determinable;
- (f) collection of the arrangement fee is reasonably assured.

Any licence fees received in advance, which do not meet all of the above criteria, are included in deferred income until the above criteria are met.

Previously, licence fee income in respect of television screening rights was recognised on the later of the first exploitation of the rights or when the licence fee was due.

THE MAGIC RAILROAD COMPANY LIMITED

NOTES TO THE ACCOUNTS – 27 AUGUST 2002 (continued)

1. PRINCIPAL ACCOUNTING POLICIES (continued)

Investment in Programmes

The investment in programmes including distribution advances is stated at the lower of cost, less accumulated amortisation, or net realisable value.

Costs comprise direct programme costs, which are capitalised up to the date of first release of the programme, and programme development costs. Costs for developing programmes are transferred to programme costs when a decision is made to proceed with the programme.

A charge is made to write down the cost of completed programmes over their useful lives. Completed programmes are expensed based on the ratio of the current period's net revenues to estimated total net revenues from all sources on an individual production basis.

An assessment is made at each balance sheet date by the directors to determine whether a provision is required to reduce the carrying value of the investment in programmes to net realisable value. Where programmes in development are not expected to proceed, the related costs are written off to the profit and loss account.

Any charge for writing down to net realisable value during the period is included in the profit and loss account as part of cost of sales.

Deferred Taxation

Full provision is made for taxation at effective rates on all timing differences. Deferred tax assets are recognised to the extent that they are regarded as recoverable. Previously, full provision was made on timing differences, except where the deferred tax liability was not expected to crystallise in the foreseeable future.

Foreign Currencies

Assets and liabilities denominated in foreign currencies are translated into sterling at rates prevailing at the period end or at the contracted forward rate where appropriate.

Transactions arising in foreign currency are translated at their spot rate.

Exchange differences on trading and other items are taken to the profit and loss account.

THE MAGIC RAILROAD COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS – 27 AUGUST 2002 (continued)

2. TURNOVER

Turnover is wholly derived from distribution operations. Turnover for the period may be analysed as follows:

	14 months ended <u>27 August 2002</u> £000	Year ended <u>30 June 2001</u> £000
United Kingdom	74	2,165
Europe	-	290
Australasia	-	140
Japan	-	1,206
North America	2	6,005
Other	-	133
	76	9,939
	====	====

3. (LOSS) / PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

The (loss) / profit on ordinary activities before taxation is stated after charging:

	14 months ended <u>27 August 2002</u> £000	Year ended <u>30 June 2001</u> £000
Write down of investment in programme portfolio (Note 7)	7,361	-
Amortisation of investment in programme portfolio	3,674	5,506
	====	====

Auditors' remuneration has been borne by the parent undertaking.

4. EMPLOYEE INFORMATION

Staff services are provided by the immediate parent undertaking, Gullane Entertainment Limited (formerly Gullane Entertainment PLC). The company does not employ any staff directly.

5. DIRECTORS' EMOLUMENTS

The services of all the directors are provided under an agreement with the immediate parent undertaking, Gullane Entertainment Limited (formerly Gullane Entertainment PLC). The company did not pay emoluments directly to any director. The emoluments have been apportioned to group undertakings in which the directors hold directorships and where activities of the directors are more than merely incidental to their other activities within the Gullane Entertainment Limited group. No directors' emoluments were apportioned to this company during the period or in the year ended 30 June 2001.

THE MAGIC RAILROAD COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS – 27 AUGUST 2002 (continued)

6. TAX ON (LOSS) / PROFIT ON ORDINARY ACTIVITIES

The tax (credit) / charge for the period/year is as follows:

	14 months ended <u>27 August 2002</u> £000	Year ended <u>30 June 2001</u> £000
Deferred tax		
- Timing differences, origination and reversal	(1,322)	1,330
- Adjustments in respect of prior periods	(8)	-
Total deferred tax	(1,330)	1,330
Tax on (loss) / profit on ordinary activities	(1,330) =====	1,330 =====

The current period tax charge/(credit) can be reconciled as follows:

(Loss) / profit on ordinary activities before taxation	(11,058)	3,794
Tax at UK standard rate of 30%	3,317	(1,138)
Capital allowances in excess of depreciation	(1,330)	1,330
Tax losses not recognised	(1,995)	(192)
Movement in short term timing differences	8	-
Current tax credit for the period/year	- =====	- =====

7. INVESTMENT IN PROGRAMME PORTFOLIO

	<u>27 August 2002</u> £000	<u>30 June 2001</u> £000
Completed programmes	- =====	11,035 =====

As described in note 1 above, the method of the amortisation for investment in programmes has changed during the period. The effect of the change is to increase the amortisation charge in the year by £2,578,000.

Following a review of the investment in programme portfolio the Directors have made a write down of £7,361,000.

THE MAGIC RAILROAD COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS – 27 AUGUST 2002 (continued)

8. DEBTORS

	<u>27 August 2002</u>	<u>30 June 2001</u>
	£000	£000
Amounts owed by group undertakings	588	710
	=====	=====

9. CREDITORS – AMOUNTS FALLING DUE WITHIN ONE YEAR

	<u>27 August 2002</u>	<u>30 June 2001</u>
	£000	£000
Trade creditors	-	2
Amount owed to group undertakings	7,683	7,597
Amount owed to associated undertakings of the Gullane		
Entertainment group	-	179
Other creditors	146	146
Accruals	27	27
	=====	=====
	7,856	7,951
	=====	=====

10. BANK LOANS AND OVERDRAFTS

The company has entered into a composite bank accounting agreement together with the other companies in the group. Consequently the company has guaranteed the bank indebtedness of the co-signatory group companies. The amount outstanding at 27 August 2002 was £76,624,000 (2001 - £17,629,000). The company has also granted the bank a fixed and floating charge over its assets to secure any loan or overdraft the group may have from time to time.

The composite bank accounting agreement was terminated in September 2002, following the repayment of all outstanding bank loans by the group.

11. PROVISIONS FOR LIABILITIES AND CHARGES

	Deferred Tax £000
Balance at 1 July 2001	1,330
Credit to profit and loss account	(1,330)
	=====
Balance at 27 August 2002	-
	=====

	<u>27 August 2002</u>	<u>30 June 2001</u>
The analysis of the deferred taxation balance is as follows:		
Accelerated capital allowances	-	1,330
	=====	=====

THE MAGIC RAILROAD COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS – 27 AUGUST 2002 (continued)

12. SHARE CAPITAL

Ordinary Shares of £1 each

	<u>27 August 20 02</u>		<u>30 June 2001</u>	
	No	£	No	£
Authorised	1,000	1,000	1,000	1,000
	=====	=====	=====	=====
Allotted, called up and fully paid	2	2	2	2
	=====	=====	=====	=====

13. RESERVES

	Profit and loss <u>Account</u> £000
Balance at 1 July 2001	2,464
Loss for the period	(9,728)

Balance at 27 August 2002	(7,264)
	=====

14. RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS

	<u>27 August 2002</u> £000	<u>30 June 2001</u> £000
Opening shareholders' funds	2,464	-
(Loss)/profit for the period	(9,728)	2,464
	-----	-----
Closing shareholders' (deficit)/funds	(7,264)	2,464
	=====	=====

15. CAPITAL COMMITMENTS

At 27 August 2002 the company had capital expenditure contracted for but not provided of £nil (2001 - £nil).

16. IMMEDIATE AND ULTIMATE PARENT UNDERTAKINGS

At the period end the company's immediate parent undertaking and ultimate controlling party was Gullane Entertainment Limited (formerly Gullane Entertainment PLC), which is registered in England and Wales. The company's financial statements are consolidated in the financial statements of Gullane Entertainment Limited for the period ended 27 August 2002.

Following its acquisition of Gullane Entertainment Limited, HIT Entertainment PLC is now the company's ultimate parent and controlling undertaking.

Copies of the financial statements for the above companies are available from Maple House, 149 Tottenham Court Road London, W1T 7NF.

THE MAGIC RAILROAD COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS – 27 AUGUST 2002 (continued)

17. CASH FLOW STATEMENT

The financial statements of Gullane Entertainment Limited for the period ended 27 August 2002 contain a consolidated cash flow statement. Consequently, the company has taken advantage of exemption 5(a) granted by Financial Reporting Standard 1 (Revised 1996) and has not published a cash flow statement.

18. RELATED PARTY TRANSACTIONS

The company has taken advantage of the exemption provided by paragraph 3(c) of Financial Reporting Standard 8 not to disclose transactions with entities that are part of the Gullane Entertainment Limited group. There were no other related party transactions in the period.

19. POST BALANCE SHEET EVENT

On 27 August 2002, the company's immediate and ultimate parent undertaking, Gullane Entertainment Limited, was acquired by HIT Entertainment PLC.

On 31 October 2002, the company acquired the entire share capital of 100 common shares of Magic Railroad Company Inc, which owns Magic Railroad Productions Limited, from Catalyst Entertainment (Productions) Inc for a consideration of \$100 CAD.