**DHX MEDIA LTD.**

# Q1 2007

**FORM 51-102F1**

**Management Discussion and Analysis**
**of Financial Condition and Results of Operations**
**For the Three Months Ended September 30, 2006 and September 30, 2005**
**(Unaudited)**

**DHX MEDIA LTD.**

Form 51 – 102F1 Quarterly Report
September 30, 2006

## MANAGEMENT DISCUSSION AND ANALYSIS

*The following Management Discussion & Analysis ("**MD&A**") prepared as of November 13, 2006, should be read in conjunction with the Company's unaudited interim consolidated financial statements and accompanying notes for the three months ended September 30, 2006 and 2005, as well as the Company's annual MD&A and audited consolidated financial statements and accompanying notes for the years ended June 30, 2006 and 2005. The unaudited interim consolidated financial statements and accompanying notes for the three months ended September 30, 2006 and 2005 have been prepared in accordance with Canadian Generally Accepted Accounting Principles for preparation of interim financial information and have been reviewed by* DHX.

*The Company's auditors, PricewaterhouseCoopers LLP, have not reviewed the unaudited interim consolidated financial statements and accompanying notes for the three months ended September 30, 2006 and 2005.*

*The unaudited comparative interim consolidated financial statements and accompanying notes for the three months ended September 30, 2005, are for periods prior to the acquisition of Decode Entertainment Inc. ("Decode") (see "Acquisitions" section of this MD&A for further details on the Decode acquisition).*

DHX Media Ltd. (the "**Company**" or "**DHX**") is a public company incorporated under the Canadian Business Corporations Act and its shares are listed on the TSX and AIM Exchanges as of May 19, 2006. Additional information relating to the Company can be found on SEDAR at www.sedar.com.

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles. Figures in this MD&A that are shown as ",000" (for example, "$100,000") are approximate and have been rounded to the nearest thousand.

This MD&A contains certain forward-looking statements, which reflect Management's expectations regarding the Company's growth, results of operations, performance and business prospects and opportunities.

Statements about the Company's future plans and intentions, results, levels of activity, performance, goals or achievements or other future events constitute forward-looking statements. Wherever possible, words such as "may," "will," "should," "could," "expect," "plan," "intend," "anticipate," "believe," "estimate," "predict," or "potential" or the negative or other variations of these words, or other similar words or phrases, have been used to identify these forward-looking statements. These statements reflect Management's current beliefs and are based on information currently available to Management.

Forward-looking statements involve significant risk, uncertainties and assumptions. Many factors could cause actual results, performance or achievements to differ materially from the results discussed or implied in the forward-looking statements. These factors should be considered carefully and readers should not place undue reliance on the forward-looking statements. Although the forward-looking statements contained in this MD&A are based upon what Management believes to be reasonable assumptions, the Company cannot assure readers that actual results will be consistent with these forward-looking statements. These forward-looking statements are made as of the date of this MD&A, and the Company assumes no obligation to update or revise them to reflect new events or circumstances. Many factors could cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements, including: general economic and market segment conditions, competitor activity, product capability and acceptance, international risk and currency exchange rates, and technology changes. An assessment of the risks that could cause actual results to materially differ from current expectations is contained in the "Risk Assessment" section of this MD&A. For a more detailed assessment of the risks that could cause actual results to materially differ from current expectations see the "Risk Assessment" section of the Company's Annual MD&A for the year ended June 30, 2006 found on SEDAR at www.sedar.com.

The foregoing is not an exhaustive list and other risks are detailed from time to time in other continuous disclosure filings of the Company. Should one or more of these risks or uncertainties materialize, or should assumptions underlying the forward-looking statements prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated or expected.

**Use of Non-GAAP Financial Measures**

In addition to the results reported in accordance with Canadian generally accepted accounting principles, determined with reference to the Handbook of the CICA ("GAAP"), the Company uses various non-GAAP financial measures, which are not recognized under Canadian GAAP, as supplemental indicators of our operating performance and financial position. These non-GAAP financial measures are provided to enhance the user's understanding of our historical and current financial performance and our prospects for the future. Management believes that these measures provide useful information in that they exclude amounts that are not indicative of our core operating results and ongoing operations and provide a more consistent basis for comparison between periods. The following discussion explains the Company's use of EBITDA and Gross Margin as measures of performance.

"**EBITDA**" means earnings (loss) before interest, taxes, depreciation and amortization. Amortization includes amortization of property, plant and equipment and intangible assets. EBITDA represents net income (loss) of the Company before amortization of property, plant and equipment and intangible assets, interest and amortization of deferred financing fees, interest income (expense), non-controlling interest, equity income (loss) and development expenses. EBITDA is not an earnings measure recognized by GAAP and does not have a standardized meaning prescribed by GAAP. Therefore, EBITDA may not be comparable to similar measures presented by other issuers. Management believes EBITDA to be a meaningful indicator of our performance that provides useful information to investors regarding our financial condition and results of operation.

"**Gross Margin**" means revenue less direct production costs and amortization of film and television programs. Gross Margin is not an earnings measure recognized by GAAP and does not have a standardized meaning prescribed by GAAP. Therefore, Gross Margin may not be comparable to similar measures presented by other issuers.

A reconciliation of historical results to EBITDA is presented at the end of this MD&A.

**Business of the Company**

DHX is a leading independent supplier of television and film productions. The Company is the result of the combination of The Halifax Film Company Limited ("Halifax Film") and Decode Entertainment Inc. ("Decode")

The Company produces, distributes and exploits the rights for television and film programming. DHX's primary focus is on children's and youth productions because of the international sales potential and longer-term and multiple revenue streams that this genre of programming provides. Children's programming travels across cultures more easily than other genres and can therefore be sold into numerous markets, typically has a longer lifespan than other genres and can be leveraged for merchandising and licensing revenues.

DHX's content library includes over 1,150 half-hours of programming and over 30 individual titles produced over the last nine years. The Company has eight children's series currently in first window broadcast on multiple major cable and broadcast networks in North America and internationally, including, *Lunar Jim, Franny's Feet, The Save-Ums* and *Naturally Sadie*. The Company's prime-time production slate also includes notable achievements in the comedy genre, including the award-winning Canadian prime-time comedy series *This Hour Has 22 Minutes,* which is produced for the CBC and is now in its 14th season. The Company operates from its offices and production facilities in Halifax and Toronto producing content for distribution in domestic and international markets which is marketed via its Toronto and London, England-based sales group.

**Revenue Model**

The Company historically earns revenues primarily from four categories: production and then distribution of its proprietary productions, producer and service fees from production services for third parties and other revenues which includes rental of studios and office facilities, investing income, music royalties and new media revenue. The Company is able to generate revenue from productions by licensing its initial broadcast rights and pre-licensing of territories for its programs. Production revenues include the initial broadcast license revenues and any pre-sales or distribution advances included in the initial financing of the production of a film and television program. Once a production is completed and delivered, the program is included in the Company's library of film and television programming. Further revenue from exploitation of the program is included in distribution revenue. The Company also generates revenue from production services for third parties. These service and corporate overhead fees are earned for producing of productions whose copyright is owned by third parties.

***Production Revenue***

The Company derives production revenues from the grant of initial broadcast rights for the initial showing of commissioned productions and pre-licensing of territories. These fees are typically partially earned upon commissioning of a production, during

production, once a completed production is delivered for broadcast and at some point in time after delivery as a holdback. (See "Critical Accounting Policies" section of this MD&A for details on revenue recognition.)

***Distribution Revenue***

The Company is able to retain the ownership rights to its proprietary production, which permits the Company to generate further revenues from the distribution of the Company's productions. In addition to generating revenues from the sale of initial broadcast rights, the Company is able to concurrently generate revenues from the sale of broadcast rights in other jurisdictions and on other platforms (such as DVD and video) for specified periods of time.

***Producer and Service Fee Revenue***

These service and corporate overhead fees are earned for producing productions whose copyright is owned by third parties.

***Other Revenue***

Other revenue includes rental of studios and office facilities, investing income, music royalties and new media revenue.

**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 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.

**Disclosure Controls and Procedures and Internal Controls over Financial Reporting ("ICFR")**

The Company's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining the Company's disclosure controls and procedures and establishing ICFR (as defined in Multilateral Instrument 52- 109, Certification of Disclosure in Issuers' Annual and Interim Filings).

The Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the date of this MD&A, have concluded that the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries required to be disclosed in the Company's reports filed or submitted under the Multilateral Instrument would have been known to them.

During Q1 2007, the Company completed an acquisition (Q4 2006 - the Company completed three acquisitions) (see "Acquisitions" section of this MD&A). Management is in the process of reviewing the design of ICFR for these new subsidiaries and to date is not aware of any material weaknesses. Through this review process management anticipates implementing some changes to enhance the ICFR for these subsidiaries to bring them in line with the overall policies of the Company.

**Critical Accounting Policies**

***Revenue Recognition***

*Production and Distribution Revenue*

The Company recognizes revenues from the licensing of film and television programs 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.

*Producer and Service Fee Revenue*

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.

***Variable Interest Entities***

The Company follows Accounting Guideline 15 – Consolidation of Variable Interest Entities ("AcG 15"). AcG 15 provides criteria for the identification of Variable Interest Entities (**"VIEs"**) and further criteria for determining what entity, if any should consolidate them. AcG 15 defines a VIE as an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the equity investors lack the characteristic of a controlling financial interest. VIEs are subject to consolidation by a company if that 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 VIEs' activities or is entitled to receive a majority of the VIEs' residual returns or both. (For a more detailed discussion of VIEs see "Change in Accounting Policy" section of this MD&A.)

***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. Investment in film and television programs also includes acquired film and television libraries. 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, the cost of overall deals, 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. Film and television programs in progress represent the accumulated costs of productions, which have not been completed by the Company. 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.

Revenue estimates are prepared on a title-by-title basis and are reviewed periodically based on current market conditions. For film, revenue estimates include net theatrical receipts, sale of videocassettes and DVDs, licensing of television broadcast rights and licensing of other ancillary film rights to third parties. For television programs, 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.

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.

The valuation of investment in film and television programs 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 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.

***Stock-based Compensation***

The Company follows the Canadian Institute of Chartered Accountants Handbook Section 3870 ("CICA 3870"), "Stock-based Compensation and Other Stock-based Payments". Under the amended standards of this Section, the fair value of all stock options granted to employees 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.

## SUMMARY CONSOLIDATED FINANCIAL INFORMATION

The summary consolidated financial information set out below for the three months ended September 30, 2006 and 2005 and as at September 30, 2006 and the year ended June 30, 2006 has been derived from the Company's unaudited interim consolidated financial statements and accompanying notes for the three moths ended September 30, 2006 and 2005 and from the audited consolidated financial statements and accompanying notes for the year ended June 30, 2006. Both can be found at www.sedar.com. The financial information for the three months ended September 30, 2006 in the table includes a full three month's activity of the Company's Halifax Film division and Decode division, however the comparative period for the three months ended September 30, 2005 only includes the activity of the Company's Halifax Film division and no amounts for the Decode division (See–"Acquisitions" section of this MD&A for further details on the Decode acquisition). All financial information herein prior to May 18, 2006 is for activity of periods prior to the acquisition of Decode. Each reader should read the following information in conjunction with those statements and the related notes.

| | **Three Months Ended September 30,** | |
|---|---|---|
| | **2006**<br>**$** | **2005**<br>**$** |
| **Consolidated Statements of Operations Data:** | | |
| Revenue | 3,199,786 | 1,479,379 |
| Direct production costs and amortization of film and television Programs | 2,120,522 | 1,319,911 |
| Gross margin | 1,079,264 | 159,468 |
| Selling, general and administrative | 1,601,898 | 414,323 |
| Operating income (loss) | (250,274) | (409,080) |
| Interest and other (expenses), net | (29,675) | (159,576) |
| Net loss | (201,949) | (568,656) |
| Basic and fully diluted (loss) per common share | (.01) | (.04) |
| Weighted average common shares outstanding | | |
| Basic | 22,889,770 | 14,037,270 |
| Fully Diluted | 25,550,596 | 14,312,270 |

| | **September 30, 2006**<br>**$** | **June 30, 2006**<br>**$** |
|---|---|---|
| **Consolidated Balance Sheet Data:** | | |
| Cash, restricted cash and short-term investments | 7,726,585 | 9,572,729 |
| Investment in film and television programs | 31,579,003 | 21,249,652 |
| Total assets | 83,623,085 | 77,798,440 |
| Total debts | 44,195,118 | 38,202,232 |
| Shareholder equity | 39,427,967 | 39,596,118 |

## SELECTED CONSOLIDATED QUARTERLY FINANCIAL INFORMATION

The following tables set out selected consolidated financial information for each of the last eight quarters with the last one being the most recent quarter ended September 30, 2006. In the opinion of management, this information has been prepared on the same basis as the audited consolidated financial statements for the years ended June 30, 2006 and 2005 as filed on www.sedar.com, and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly the unaudited quarterly results when read in conjunction with the audited consolidated financial statements and the notes to those statements. The financial information in the table below with the exception of information for Q1 Fiscal 2007 ended September 30, 2006 is for periods prior to the acquisition of Decode Entertainment Inc. (see "Acquisitions" section of this MD&A for further details on the Decode acquisition). The operating results for any quarter should not be relied upon as any indication of results for any future period.

| | **Fiscal 2007** | **Fiscal 2006** | | | | **Fiscal 2005** | | |
|---|---|---|---|---|---|---|---|---|
| | **Q1 Sept 30 $** | **Q4 June 30 $** | **Q3 Mar 31 $** | **Q2 Dec 31 $** | **Q1 Sept 30 $** | **Q4 June 30 $** | **Q3 March 31 $** | **Q2 Dec 31 $** |
| Revenue | 3,199,786 | 9,412,349 | 1,889,195 | 3,154,716 | 1,479,379 | 18,749,311 | 1,582,125 | 474,770 |
| Gross Margin | 1,079,264 | 1,831,139 | 277,318 | 738,955 | 159,468 | 486,592 | 303,904 | 129,822 |
| EBITDA | 20,318 | 550,841 | (77,697) | 112,606 | (206,047) | (234,807) | 146,958 | 13,475 |
| Net income (loss) | (201,949) | 416,008 | (359,743) | (402,499) | (568,656) | (350,947) | 145,137 | 16,602 |
| Basic and Diluted Earnings (Loss) Per Share | (0.01) | 0.02 | (0.03) | (0.03) | (0.04) | (0.01) | 0.01 | 0.00 |

### Results for the three months ended September 30, 2006 ("Q1 2007") compared to the three months ended September 30, 2005 ("Q1 2006")

#### *Revenues*

Revenues for Q1 2007 were $3.200 million, up from $1.479 million for Q1 2006 an increase of 116%. The increase is due to increases in the Company's major revenue categories. Management was pleased with the growth in revenue given that Q1 2007 was the first full quarter of integrating the Decode activities into the results of the Company. Management expects this integration to continue for the upcoming second to fourth quarters of Fiscal 2007 and to result in further synergies and revenue growth for the remainder of Fiscal 2007. The revenue growth for Q1 2007 is also encouraging given that Q1 is typically a slower quarter in the Canadian film and television industry as the majority of television deliveries occur in the winter and spring seasons, which for the Company is its third and fourth quarter. (See "Seasonality" section of this MD&A for further details).

Proprietary production revenues for Q1 2007 of $1.166 million were up 67% over the $0.699 million for Q1 2006. The increase for Q1 2007 is consistent with the Company's strategic goal to increase production revenue generated from home grown productions both in absolute dollars and as a percentage of the total production revenues earned. For Q1 2007 the Company delivered $1.166 million-13 half-hours of proprietary television programs ($0.380 million-4 half-hours of *Naturally Sadie* Season III, $0.655 million-8 half-hours of *POKO* Season III, $80,000-1 half hour of *Bo on the Go* Season I and $51,000 for producer fees earned by DHX Media UK) versus the delivery of $0.699 million-7 half-hours of *POKO* Season II for Q1 2006.

Net production service revenues for Q1 2007 brought forward to the Company's consolidated statement of operations accounted for using the equity method (see note 6 to the unaudited interim consolidated financial statements for the three months ended September 30, 2006 and 2005) were $0.322 million down 61% from Q1 2006 of $0.781 million. The breakdown

for net production service revenues was $0.307 million and $15,000 from the delivery of production services related to the feature films entitled *Outlander* and *Slevin* respectively (Q1 2006 -$0.771 million and $10,000 of production service revenues for delivery of services on *Slevin* and *Ambition* respectively).

For Q1 2007 gross production service revenues (see note 6 to the unaudited interim consolidated financial statements for the three months ended September 30, 2006 and 2005) were $4.778 million (Q1 2006 - $0.781 million). The breakdown for gross production service revenues were $4.763 million and $15,000 from the delivery of production services related to the feature films entitled *Outlander* and *Slevin* respectively (Q1 2006 -$0.771 million and $10,000 of production services on *Slevin* and *Ambition* respectively).

For Q1 2007 distribution, music royalty and new media revenues were up to $1.271 million (Q1 2006 - nil), $0.245 million (Q1 2006 - nil), and $0.196 million (Q1 2006 - nil) respectively. These revenue streams have increased from nil amounts in Q1 2006 as Q1 2007 includes these revenue steams for the Decode division whereas Q1 2006 includes no activities for Decode.

***Gross Margin***

Gross Margin for Q1 2007 was $1.079 million an overall 33.7% of revenue versus $0.160 million or 10.8% of revenue for Q1 2006, an increase of 212% or $0.920 million in absolute margin dollars. The Gross Margin for Q1 2007 was higher than Q1 2006 as there were significant increases in the following three revenue categories: distribution, music royalties and new media as a result of a full three months of activities for Decode. These revenue streams have much higher margins than the Company's historic production revenues when comparing Q1 2007 to Q1 2006. For Q1 2007 the margins for each revenue category in absolute dollars and as a percentage are as follows: production revenue margin $0.333 million or 28.5%, net production service revenue margin of $95,000 or 29.7%, distribution revenue margin of $0.405 million or 31.9%, music royalty revenue margin $0.128 million or 52.5% and new media revenue margin of $0.118 million or 60%. The largest contributor to the margin increase for Q1 2007 is distribution revenue in terms of absolute dollars contributing $0.405 million to the margin or 31.9% versus no amounts for Q1 2006. For Q1 2007, given that distribution, music royalties and new media margins combined represented over 70% of the total margin the overall Gross Margin for Q1 2007 at 33.7% was higher than management's projected margin and we would expect that in future periods' Gross Margin to be in the line with the 15 to 25% range previously reported.

***Income from rental and investing***

For Q1 2007 income from rental and other investing was $0.543 million. The breakdown was $86,000 (Q1 2006- nil), and $0.457 million (Q1 2006- $49,000) for rental of studios and other investing activities respectively.

***Operating Expenses***

Operating expenses for Q1 2007 were $1.872 million compared to $0.617 million for Q1 2006, an increase of 203%. The increase for Q1 2007 is mainly due to a 286% increase in SG&A to $1.602 million up from $0.414 million for Q1 2006. SG&A costs have increased as a result of the Company adding key personnel and expanding facilities as a result of increased activities and increased regulatory requirements from being public and a full three months of SG&A related to the Company's Decode division. For Q1 2007 included in Operating expenses is $0.271 million for amortization versus $2,000 for Q1 2006.

***EBITDA***

In Q1 2007 EBITDA was $20,000, as compared to a loss of $0.206 million for Q1 2006, an improvement of 110%. For Q1 2007 this was due to the increase in Gross Margin dollars of $0.920 million and was offset by the increase in net operating expenses and other expenses of $0.694 million for a total dollar change of $0.226 million.

***Amortization***

For Q1 2007 amortization of property, plant and equipment was $0.271 million (Q1 2006 - $2,000) due to the significant additions to property, plant and equipment and intangible assets for Q1 2007 over the Q1 2006 balances.

***Interest***

Interest expense, net of interest revenue, for Q1 2007 was $21,000 up from no amounts in Q1 2006. Net interest expense consists of $73,000 and $4,000 for interest expense on long-term debt and interest and bank charges respectively offset by interest revenue in Q1 2007 of $56,000. For Q1 2006 $0.267 million was for interest accreted on the Class A Preferred Shares and amortization and deferred financing.

***Equity Income (Loss) and Non-Controlling Interest***

For Q1 2007 there were no amounts for equity income (loss) (Q1 2006 –$0.108 million for equity income) and $9,000 expense for non-controlling interest (Q1 2006 - Nil).

***Income Taxes***

Income tax expense for Q1 2007 was a net recovery of income taxes of $78,000 made up from provisions of $20,000 (Q1 2006- Nil) for large corporation taxes and $9,000 (Q1 2006- recovery of $0.217 million) for current income taxes offset by a recovery of future income taxes of $0.107 million (Q1 2006- $0.217 million provision for future income taxes).

***Net Income (Loss)***

Net loss for Q1 2007 was $0.202 million, an improvement of 64% from a net loss of $0.569 million for Q1 2006. For Q1 2007 the overall decrease in the loss of $0.367 million was due to changes over Q1 2006 of the following amounts: a gross margin increase of $0.920 million offset by an increase in net operating expenses of $0.761 million and helped by a $0.130 million improvement in net interest expense and non-controlling interest and $78,000 recovery of income taxes

**Results for the three months ended June 30, 2006 ("Q4 2006") compared to the three months ended June 30, 2005 ("Q4 2005")**

***Revenues***

Revenues for Q4 2006 were $9.412 million, down from $18.749 for Q4 2005 a decrease of 50%. The decrease was due to the reduction in production service revenues by $16.645 million in absolute dollars as Q4 2006 actually had $145,000 reversal of prior production service revenues booked for the nine months ended March 31, 2006 down from $16.5 million for Q4 2005 ($9.7 million and $6.8 million in production service revenues for third parties respectively for *Slevin* and *Ambition*) as a conscious decision was made by management to focus on higher margin proprietary production that are anticipated in the future to generate distribution and exploitation revenue from the owning of the rights. This was further evidenced when comparing the proprietary production revenues for Q4 2006 of $8.489 million up 445% over the $2.101 million for Q4 2005. The increase for Q4 2006 was consistent with the Company's strategic goal to increase its proprietary television production and therefore increase the revenue generated from home grown productions both in absolute dollars and as a percentage of the total productions revenues earned. For Q4 2006 distribution and other revenues are up to $0.583 million and $0.485 million respectively over no amounts and $0.148 million respectively for Q4 2005.

For Q4 2006 the Company delivered 13 half-hours of proprietary television programs (6 half-hours of North South Season I, 2 half-hours of This Hour Has 22 Minutes Season XIII and 5 half-hours of POKO Season III) versus the delivery of 17 half-hours (10 half-hours of POKO Season II, 1 half-hour of Open Book Season III and 6 half-hours of Lunar Jim Season I). For Q4 2006 the Company delivered 2 (8 half-hours) proprietary feature film programs (4 half-hours for the feature film currently entitled *It's a Boy Girl Thing* and 4 half-hours for the feature film currently entitled *Intervention (*aka *Funny Farm*) versus no deliveries of proprietary feature film programs for Q4 2005.

***Gross Margin***

Gross Margin for Q4 2006 was $1.831 million an overall 19% of revenue versus $0.487 million or 3% of revenue for Q4 2005, an increase of 533%. The Gross Margin for Q4 2006 was higher than Q3 2005 because Q4 2006 had very little amounts earned from service producing fees versus $16.5 million for Q4 2006. The Gross Margin for Q4 2006 was in line with management's projected margins for proprietary productions of 15 to 25%. As each production is financed differently, these Gross Margins can vary greatly with the Company maintaining a larger share of the copyright on certain programs over others. This is due to certain projects requiring a larger percentage of pre-licensing in order to get the necessary production revenues to get the program produced. As more of the program territories are pre-licensed in advance it naturally reduces the number of territories available for distribution revenues. With lower distribution revenues comes a lower margined production.

***EBITDA***

In Q4 2006 EBITDA was $0.551 million, as compared to a loss of $0.235 million for Q4 2005, an improvement of 334%. For Q4 2006 this was due to the increase in Gross Margin dollars of $1.35 million and offset by the increase in SG&A dollars of $0.559 million for a total dollar change of $0.791 million.

***Net Income (Loss)***

Net income for Q4 2006 was $0.416 million up from a net loss of $0.351 million for Q4 2005, an increase of 219%. For Q4 2006 the overall increase of $0.767 million was due to changes over Q4 2005 of the following amounts: increases from a gross margin increase of $1.350 million, a development expense decrease of $43,000, a change in recovery of income taxes of $0.174 million and an interest revenue increase of $64,000 and reduced by an increase in SG&A of $0.559 million, and

increases of $120,000, $108,000, $72,000 and $5,000 for amortization, net interest expense, an equity loss and non-controlling interest.

**Results for the three months ended March 31, 2006 ("Q3 2006") compared to the three months ended March 31, 2005 ("Q3 2005")**

***Revenues***

Revenues for Q3 2006 were $1.889 million, up from $1.582 million Q3 2005 an increase of 19%. The increase is mainly due the delivery of 17 half-hours of higher revenue generating proprietary television programs (8 half-hours of *Lunar Jim* Season I and 9 half-hours of *This Hour Has 22 Minutes* Season XIII) versus the delivery of lower revenue generating shows totalling 28 half-hours (2 half-hours of *POKO* Season II, 25 half-hours of *Open Book* Season III and 1 half-hour pilot for *North South*). The increase for Q3 2006 was consistent with the Company's strategic goal to increase production budgets for its proprietary television production and therefore increase the revenue generated from home grown productions both in absolute dollars and as a percentage of the total productions revenues earned. For Q3 2006 the $1.889 million in production revenues was generated 100% from proprietary productions. The breakdown for the $1.889 million in proprietary television production was approximately $1.751 million and $210,000 for *This Hour Has 22 Minutes* Season XIII and *Lunar Jim* Season I, respectively, and a reversal of $72,000 for production service revenue for *Ambition*. In Q3 2005 revenues were split $1.493 million for proprietary television production and $89,000 from service producing Season XII of This Hour Has 22 Minutes. The breakdown for Q3 2005 proprietary television production revenue of $1.493 million was approximately $252,000, $207,000 and $1.034 million for *POKO* Season II, the pilot for *North South* and *Open Book* Season III respectively.

***Gross Margin***

Gross Margin for Q3 2006 was $277,000 an overall 15% of revenue versus $304,000 or 19% of revenue for Q3 2005, a decrease of 21%. The Gross Margin for Q3 2006 was lower than Q3 2005 because in Q3 2006 there were no amounts earned from service producing fees versus $89,000 for Q3 2005 earned from service producing Season XII of *This Hour Has 22 Minutes* the cost of which are fixed operating costs of the Company and are reflected as selling, general and administrative expenses ("SG&A") and therefore have no direct cost of goods sold associated with earning these service fees. When this is removed the margin for Q3 2005 is approximately 14% or consistent with Q3 2006. The Gross Margin for Q3 2006 was in line with management's projected margins for proprietary productions of 10 to 25%.

***EBITDA***

In Q3 2006 EBITDA was a loss of $78,000 as compared to earnings of $147,000 for Q3 2005, a decrease of 153%. For Q3 2006 this was due to the decrease in Gross Margin dollars of $30,000 and an increase in operating expense dollars of $195,000 for a total dollar change of $225,000.

***Net Loss***

Net loss for Q3 2006 was $360,000 down from net income of $145,000 for Q3 2005, an increase of 348%. For Q3 2006 the overall decrease of $505,000 was due to changes over Q3 2005 of the following amounts: a Gross Margin decrease of $31,000, an increase in SG&A of $195,000, and increases of $250,000, $15,000, $4,000 and $10,000 for net interest expense, an equity loss, non-controlling interest and income taxes, respectively.

**Results for the three months ended December 31, 2005 ("Q2 2006") compared to the three months ended December 31, 2004 ("Q2 2005")**

***Revenues***

Revenues for Q2 2006 were $3.155 million, up from $0.475 million for Q2 2005, an increase of 564%. The increase is mainly due the delivery of 19 half-hours of proprietary television (7 half-hours of *POKO* Season II, 5 half-hours of *Lunar Jim* Season I and 7 half-hours of *This Hour Has 22 Minutes* Season XIII) versus the delivery of only 6 half-hours of *Body of Knowledge* Season I in Q2 2005. The increase for Q2 2006 was consistent with the Company's strategic goal to increase home grown or proprietary television production as a percentage of the total productions revenues earned. Revenues for Q2 2006 consist of $2.375 million for proprietary television production (2005-$377,000), distribution revenues of $13,000 (2005-$13,000), production service revenues of $0.767 million (2005- $80,000). The breakdown for the $2.375 million in proprietary television production was $1.016 million and $1.359 million for *POKO* and *This Hour Has 22 Minutes*, respectively. The breakdown for the $0.767 million in production service revenue was $0.656 million and $111,000 for the motion pictures

entitled *Slevin* ("Slevin") and *Ambition* ("Ambition") respectively versus Q2 2005 the Company earned $80,000 from service producing Season XII of This Hour Has 22 Minutes.

***Gross Margin***

Gross Margin for Q2 2006 was $0.739 million an overall 23% of revenue was down slightly from 28% of revenue for Q2 2005. The Gross Margin for Q2 2006 was in line with projections of between 10 to 25% for proprietary productions. As each production is financed differently, these Gross Margins can vary greatly with the Company maintaining a larger share of the copyright on certain programs over others.

***EBITDA***

In Q2 2006 EBITDA was $0.113 million as compared to $13,000 for Q2 2005, an increase of 769%. For Q2 2006 this was due to the increase in Gross Margin to $0.739 million up from $0.129 million from Q2 2005 and offset mainly by SG&A of $0.578 million (2005-$0.116 million).

***Net Loss***

Net loss for Q2 2006 was $0.402 million, down from net income of $17,000 for Q2 2005, a decrease of 2465%. For Q2 2006 the overall decrease of $0.419 million was due to changes over Q2 2005 of the following amounts: a Gross Margin increase of $0.610 million offset by an increase in SG&A of $0.462, and increases of $240,000 for interest and amortization of deferred financing fees (2005-Nil), an equity loss of $0.319 million (2005-Nil), income tax provision of $21,000 and offset by a decrease in by interest revenue of $13,000 (2005-$5,000).

## Liquidity and Capital Resources

| | September 30, 2006 $ | June 30, 2006 $ |
|---|---|---|
| | (Amounts in Thousands, Except Balance Sheet Ratios) | |
| **Key Balance Sheet Amounts and Ratios:** | | |
| Cash, restricted cash[1] and short-term investments | 7,727 | 9,573 |
| Long-term assets | 25,276 | 25,910 |
| Working capital | 18,818 | 18,370 |
| Long-term liabilities | 4,667 | 4,684 |
| Working capital ratio[2] | 1.48 | 1.55 |
| **Cash Inflows and (Outflows) by Activity:** | | |
| Operating activities | (7,860) | (4,363) |
| Investing activities | (495) | (6,100) |
| Financing activities | 6,251 | 10,011 |
| Net cash inflows (outflows) | (2,104) | (452) |

(1) Restricted cash is the balance of cash on hand in Media Fund. The use of this cash is restricted to specified uses related to the production and development of film and television programs.
(2) Working capital ratio is current assets divided by current liabilities.

Based on the Company's current revenue expectations for Fiscal 2007, which are based on contracted and expected production and distribution revenue, the Company believes cash generated from operations will be sufficient to satisfy working capital needs for at least the next twelve months. Further to operations being self-sustaining to support contemplated strategic initiatives including potential acquisitions and the expansion of the Company's presence in international markets, the Company completed its IPO on May 19, 2006 where the Company issued 8,702,500 common shares for gross proceeds of $20.451 million (see "Initial Public Offering" section in this MD&A). As a result of our IPO, management believes that these proceeds, along with the remaining working capital surplus totalling $18.8 million, are sufficient to execute on its current business plan.

The Company also has an available revolving operating demand loan to a maximum of $0.5 million bearing interest at Royal Bank of Canada prime plus 0.5% per annum. The availability of the revolving demand loan is subject to the Company maintaining certain accounts receivable balances and financial ratios. The Company as at September 30, 2006 is in line with all ratios necessary to draw upon the revolving demand loan. The Company has made no borrowings on this facility to date. If the Company proceeds with one or any of the strategic acquisitions it is currently exploring there may be a capital requirement to go back to the public markets and raise additional financing to complete such acquisitions.

### *Changes in Cash*

Cash at September 30, 2006 was $4.008 million compared to $6.111 million as at June 30, 2006 a decrease of $2.104 million.

Cash flows from operating activities were a use of cash of $7.860 million for Q1 2007. Cash flows from operating activities resulted from a net loss of $0.202 million, which was reduced by non-cash items of amortization of film and television programs, property, plant and equipment, and intangible assets, stock based compensation, interest on promissory notes and non-controlling interest of $1.658 million, $0.112 million, $0.158 million, $60,000, $4,000, and $9,000 respectively and increased by $0.107 million for future income tax recovery, $11.987 million for investments in film and television programs and decreased by $2.435 million for net change in non-cash working capital balances related to operations.

Cash flows generated from financing activities were $6.251 million for Q1 2007. Cash flows from financing activities resulted primarily from cash generated from new borrowings of $6.218 million from interim financing and $0.180 million from long-term debt. This was offset by uses of cash of $30,000 and $0.117 million respectively from the adjustment to issuance costs in connection with the IPO and repayment of long-term debt.

Cash flows used in investing activities were $0.494 million for Q1 2007. Cash flows used in investing activities were $35,000, $0.201 million, $0.141 million and $0.117 million for business acquisitions, investment in short-term investments, acquisition of property, plant and equipment and cash advances to an investee.

### *Working Capital*

Working capital represents the Company's current assets less current liabilities ("Working Capital"). Increases of working capital of $0.448 million as at September 30, 2006 over June 30, 2006 were predominantly driven by increases in short-term investments and current portion of investment in film and television programs offset by increases in deferred revenue and interim production financing. The working capital ratio remained relatively consistent at 1.48:1 for September 30, 2006 as compared to 1.55:1 for June 30, 2006.

The increase for Q1 2007 was mainly as a result of the following net increases to Working Capital: the overall decrease in cash of $2.104 million as outlined above was offset by increases in short-term investments and prepaid expenses and deposits of $0.201 million and $0.169 million respectively and increases of $11.089 million for current portion of investment in film and television programs and a reduction of $3.030 million for accounts payable. These were offset by net increases in current liabilities as follows: income taxes payable of $0.108 million, deferred revenues of $2.661 million, interim production financing of $6.217 million, and the current portion of long-term debt of $53,000 and a decrease in amounts receivable of $2.898 million.

**Contractual obligations**

| *As of September 30, 2006*<br>**Payments Due by Period** | **Total** | **Fiscal 2007** | **Fiscal 2008-2010** | **Fiscal 2010-2011** | **After Fiscal 2011** |
|---|---|---|---|---|---|
| | **$** | **$** | **$** | **$** | **$** |
| *Purchase Obligations* | | | | | |
| Rights purchase for *This Hour Has 22 Minutes*[1] | 25,000 | 25,000 | — | — | — |
| Rights purchase for *POKO*[2] | 69,050 | 69,050 | — | — | — |
| Agreement to acquire rights to a television mini-series[3] | 1,126,505 | — | 1,126,505 | — | — |
| Note Payable[4] | 2,000,000 | 2,000,000 | — | — | — |
| *Long-term Debt payments principal and interest*[(5] | 5,310,034 | 412,864 | 827,560 | 655,754 | 3,413,856 |
| **Total Contractual Obligations** | 8,530,589 | 2,506,914 | 1,954,065 | 655,754 | 3,413,856 |

(1) Pursuant to an agreement whereby the Company acquired the right to develop, produce, distribute and otherwise exploit future seasons of the television series entitled "*This Hour Has 22 Minutes*", the Company is required to pay the vendor the following amounts, contingent upon producing future seasons of the series, as follows: $25,000 per half-hour episode for seasons thirteen. As at September 30, 2006 one half-hour at $25,000 per half-hour has been included in payments due less than one year.

(2) Pursuant to an agreement whereby the Company acquired the right to develop, produce, distribute and otherwise exploit future seasons of the television series entitled "*POKO*". The amount remaining as at June 30, 2006 was $69,050.

(3) The Company has entered into an agreement to acquire certain distribution rights to a television mini-series. The agreement requires the Company to pay $1,126,505 twelve months following satisfactory completion and delivery of the mini-series. At September 30, 2006, the mini-series had not yet been delivered. The Company is projecting the mini-series will be delivered during Fiscal 2007 and payment will be due in Fiscal 2008.

(4) As consideration for the acquisition of Decode, the Company committed to a $2,000,000 promissory note payable December 15, 2006 bearing interest at the Royal Bank of Canada prime rate.

(5) Long-term debt, to a maximum authorized amount of $3,575,000, bearing interest at Business Development Bank of Canada's floating base rate plus 1.5%, maturing in May 2021. Amounts repayable in monthly payments of principal of $19,900 plus interest and monthly principal instalments of $4,386, non-interest bearing.

**Outlook**

The Company believes that its recent IPO, completed on May 19, 2006 raising approximately net proceeds of $7.0 million in capital after the repayment of the $8.5 million in subordinate debt assumed on the acquisition of Decode and the resulting strengthening of the balance sheet, puts the Company in strong position going forward into the remainder of Fiscal 2007. This capital infusion was key to building on the Company's recent successes, with a view to taking advantage of the Company's strengths and opportunities and creating further value for shareholders. In particular, the Company believes that it will be able to utilize the proceeds of the offering to carry forward its contemplated strategic initiatives, including revenue growth in production and distribution, increasing profitability metrics, expanding the Company's presence in international markets, leveraging the Company's experience to focus on children, youth and family content and merchandising, and undertaking further potential acquisitions. This Company has taken an important first step in this direction as was exhibited by the 116% revenue growth for Q1 2007 and Gross Margin increasing to 33.7% over Q1 2006. Management was pleased with the growth in revenue considering that Q1 2007 was the first full quarter of integrating the Decode activities into the results of the Company. Management expects the integration of Decode to continue to result in further synergies and revenue growth for the remainder of Fiscal 2007.

**Capital Stock Financings During Q1 2007**

There were no capital stock financings during Q1 2007.

## Capital Stock Financings During Fiscal 2006

### *Initial Public Offering*

In connection with the IPO of the Company, completed on May 19, 2006, the Company issued 8,702,500 common shares for actual gross cash proceeds of $20.529 or an average price per share of $2.35 less $3.236 million share issuance costs, net of tax effect of $1.873 million. (See the Company's Final Prospectus filed on May 11, 2006 on www.sedar.com for further details).

### *Common share issuances*

During the remainder of Fiscal 2006 the company issued an additional 150,000 common shares to an officer and a director for net proceeds of $0.304 million or an average price per share of $2.03.

As part of the consideration for the acquisition of Decode (see "Acquisitions" section of this MD&A) 5,793,011 common shares were issued. As part of the purchase price allocation a value of $11.572 million was placed on the shares.

## Distribution Arrangement

The Company has an ongoing distribution arrangement with a European distributor of television productions. The distribution arrangement provides the Company the opportunity to underwrite production distribution advances in exchange for a share of the sales commissions and certain exclusive distribution rights to these productions.

Under the distribution arrangement, revenues are paid to the Company based on sales to foreign broadcasters. The Company can underwrite up to 10% of a production's budget before production commences in order to benefit from the exclusive rights to sell the foreign exploitation rights. A sale can be made to a foreign broadcaster before production commences, enabling the Company to offset its investment with pre-production down payments from broadcasters. Should no advance sale to foreign broadcasters be made prior to commencement of production, the Company's commitment of up to 10% can be drawn down for production funding to be recouped by any later sales made to foreign broadcasters. The distributor will be responsible for the sourcing of productions and the sale to broadcasters of the exclusive rights (see "Material Contracts – Distribution Arrangement" in the Company's Final Prospectus filed on May 11, 2006 on www.sedar.com for more details).

The estimated accounting and legal costs associated with this agreement are approximately $10,000. Since this arrangement is in its early days, the associated cost of termination would only include the write-off of these costs and at this time would not be considered material.

As of September 30, 2006 there was $25,000, nil, $25,000, and nil amounts recorded for revenues, expenses, receivables and payables respectively from this distribution arrangement. As at September 30, 2006 the Company has made two commitments under this distribution arrangement of $294,000 and $298,000 for the licensing of two properties. These amounts are shown in acquired participation rights included in investment in film and television programs. During Fiscal 2007, under this distribution arrangement, the Company expects to commit to additional amounts of $1.0 to 2.0 million. For the remainder of Fiscal 2007, under this distribution arrangement, the Company expects to commit to licensing of up to four additional films for a total investment in license fees of approximately $1.0 to 2.0 million. For the Fiscal 2007 based on the expected licensing of up to four films from this distribution arrangement, the Company expects to record the following approximate amounts for revenues, expenses, margin, assets and liabilities: $1.0 to $3.0 million, $0.5 million to $1.5 million, $0.5 to $1.5 million, $1.0 to $3.0 million and $0.5 million to $1.5 million respectively.

At this time there are no known events that would affect the availability or benefits under the distribution arrangement with the European distributor.

## Related Party Transactions

For Q1 2007 the Company earned no amounts (Fiscal 2006-$0.538 million) in producer and service fees from LJ 2003 Productions Limited, an investee production company, for the production of *Lunar Jim* Season I.

**Acquisitions**

During the three-month period ended September 30, 2006, the following business acquisition occurred:

(a) On July 1, 2006 (the "Effective Date"), the Company acquired all of the issued and outstanding shares of **Electropolis Studios Incorporated** for cash consideration of $31,852.

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of operations from the Effective Date.

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

| | $ |
|---|---|
| **Assets acquired** | |
| Amounts receivable | 45,041 |
| Prepaid expenses and deposits | 14,787 |
| Goodwill | 63,492 |
| | 123,320 |
| **Less: liabilities assumed** | |
| Accounts payable and accrued liabilities | 21,292 |
| Long-term debt | 70,176 |
| | 91,468 |
| | 31,852 |

During the year ended June 30, 2006, the following business acquisitions occurred:

(b) On May 19, 2006, the Company acquired all of the issued and outstanding shares of **Decode Entertainment Inc.** ("Decode"), a television production company, for the total consideration of $17,879,148 as follows:

- Cash of $3,700,000;
- $2,000,000 promissory note payable December 15, 2006, bearing interest at the Royal Bank of Canada prime rate;
- 5,793,011 common shares of the Company valued at $11,571,539;
- Transaction costs of $607,609; and
- An "Earnout amount" calculated as the 7.25 times the lesser of $1,300,000 and the amount by which "EBITDA" (as that term is defined in the agreement) exceeds $2,700,000 for the twelve-month period ended June 30, 2007. This consideration will be satisfied by the payment of readily available funds and/or by the issuance of additional common shares of the Company

On March 28, 2006, the Company entered into an agreement to acquire all of the issued and outstanding shares in the capital of Decode. Decode has been recognized in 2001 and 2003 as one of "Canada's 50 Best Managed Private Companies", an annual award bestowed on each of Canada's 50 best managed private companies. It has also received the Canada Export Award in 2002 from Canada's department of Foreign Affairs and International Trade.

Decode offers a highly complementary strategic fit due to its distribution experience and capabilities, its broadcaster relationships and the strength of its management. The key principals of Decode's management team, Neil Court, Steven

DeNure and Beth Stevenson, have been retained with employment contracts. Decode fits squarely into DHX's primary focus on children's and youth programming.

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of income from the Effective Date.

(c) On April 7, 2006 (the "Effective Date"), The Company acquired all of the issued and outstanding shares of **Boy Girl Productions Canada Limited** ("Boy Girl"), a film production company for cash consideration of $128,719.

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of income from the Effective Date.

(d) April 7, 2006 (the "Effective Date"), the Company acquired all of the issued and outstanding shares of **Funny Farm** Productions Limited ("Funny Farm"), a film production company for cash consideration of $90,073.

The acquisition has been accounted for using the purchase method and the results of operations are included in the consolidated statement of income from the Effective Date.

The acquisitions of Boy Girl and Funny Farm fit well into DHX's focus on rights retention. Whether through original creation or in this case through acquisition, the Company expects to generate distribution revenues through the exploitation of these rights.

## Change in Accounting Policy

***Variable Interest Entities***

Effective July 1, 2005, the Company adopted Accounting Guideline 15 ("AcG 15") – Consolidation of Variable Interest Entities ("VIEs"). AcG 15 provides criteria for the identification of VIEs and further criteria for determining what entity, if any should consolidate them. AcG 15 defines a VIE as an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the equity investors lack the characteristic of a controlling financial interest. VIEs are subject to consolidation by a company if that company is deemed the primary beneficiary of the VIE. The primary beneficiary is the party that is either exposed to a majority of the losses from the VIEs activities or is entitled to receive a majority of the VIEs residual returns or both.

Prior to the adoption of AcG 15, the Company consolidated all entities that it controlled through ownership of a majority of voting interests.

Effective July 1, 2005, the Company implemented AcG 15, retroactively without the restatement of prior periods, and as a result, the Company has consolidated entities in which it has control through ownership of a majority of the voting interests as well as all VIEs for which it is the primary beneficiary.

VIEs for which the Company is not the primary beneficiary have been accounted for using the equity method (see note 6 to the unaudited interim consolidated financial statements for the three-month period ended September 30, 2006).

**Financial Instruments**

***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, demand loan, note payable and long-term debt all approximate their fair values due to their immediate or short-term maturities or variable interest rates.

***Credit Risk***

Accounts receivable from the Canadian federal government and other government agencies in connection with production financing represents 71% of total accounts receivable at September 30, 2006 (June 30, 2006 – 66%). Certain of these amounts

are subject to audit by the government agency. Management believes that these amounts are fully collectable. The balance of trade accounts receivable are mainly with Canadian broadcasters and large distribution companies. Management believes that these amounts are fully collectible. No provision for losses has been booked in the financial statements.

***Interest Rate Risk***

The Company is exposed to interest rate risk arising from fluctuations in interest rates as its interim production financing and its long-term debt bear interest at floating rates. Management believes this exposure to be minimal. As an example, as at September 30, 2006, even a 1% rate increase would only result in an annualized increase of approximately $200,000 in interest expense.

## Risk Assessment

The following are the specific and general risks that could affect the Company that each reader should carefully consider. Additional risks and uncertainties not presently known to the Company or that the Company does not currently anticipate will be material, may impair the Company's business operations and its operating results and as a result could materially impact its business, results of operations, prospects and financial condition. These specific and general risks are as follows: risks related to the nature of the entertainment industry, risks related to television and film industries, risks related to doing business internationally, loss of Canadian status, competition, limited ability to exploit filmed and television content library, protecting and defending against intellectual property claims, fluctuating results of operations, raising additional capital, concentration risk, reliance on key personnel, market share price fluctuations, risks associated with acquisitions and joint ventures, potential for budget overruns and other production risks, management estimates in revenues and earnings, stoppage of incentive programs, financial risks resulting from the Company's capital requirements, government incentive program, change in regulatory environment, litigation, risk connected to the Nova Scotia Equity Tax Credit Act, technological change, labour relations and exchange rates. *For further details see "Risk Factors" contained in the Company's Annual MD&A for the year ended June 30, 2006 on www.sedar.com.*

## Reconciliation of Historical Results to EBITDA

EBITDA is not a recognized earnings measure under GAAP and does not have standardized meanings prescribed by GAAP. Therefore EBITDA may not be comparable to similar measures presented by other companies or issuers. Investors are cautioned that EBITDA should not be construed as alternatives to net income or loss determined in accordance with GAAP as an indicator of the Company's performance or to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows. The following table reconciles income (loss) before income taxes, EBITDA and Gross Margin, based on the historical unaudited financial statements of the Company for the there month periods ended September 30, 2006, June 30, 2006, March 31, 2006, December 31, 2005, September 30, 2005, June 30, 2005, March 31, 2005, and December 31, 2005 included elsewhere in this MD&A. For further description see "Use of Non-GAAP Financial Measures" elsewhere in this MD&A.

| | **Q1-07**<br>**$** | **Q4-06**<br>**$** | **Q3-06**<br>**$** | **Q2-06**<br>**$** |
|---|---|---|---|---|
| Income (Loss) before income taxes for the period.. | (279,949) | 310,401 | (349,743) | (380,892) |
| Interest and amortization of deferred financing fees.... | – | 141,709 | 256,986 | 239,626 |
| Interest and other income..... | 20,942 | (101,826) | (6,942) | (66,339) |
| Equity loss and non-controlling interest .............. | 8,733 | 76,846 | 19,462 | 318,494 |
| Amortization ....................... | 270,592 | 123,711 | 2,540 | 1,717 |
| Development expenses......... | – | – | – | – |
| **EBITDA** ............................. | **20,318** | **550,841** | **(77,697)** | **112,606** |
| Selling, general and administrative...................... | 1,601,898 | 1,280,298 | 355,015 | 577,542 |
| Rental and other investing income................................. | (542,952) | – | __ | 48,807 |
| **Gross Margin**..................... | **1,079,264** | **1,831,139** | **277,318** | **738,955** |

| | **Q1-06**<br>**$** | **Q4-05**<br>**$** | **Q3-05**<br>**$** | **Q2-05**<br>**$** |
|---|---|---|---|---|
| Income (Loss) before income taxes for the period.. | (568,656) | (281,947) | 145,137 | 16,602 |
| Interest and amortization of deferred financing fees.... | 267,190 | 33,826 | – | – |
| Interest and other income..... | – | (32,667) | – | (4,948) |
| Equity loss and non-controlling interest .............. | (107,614) | – | – | – |
| Amortization ....................... | 1,718 | 3,349 | 1,821 | 1,821 |
| Development expenses......... | 201,315 | 42,632 | – | – |
| **EBITDA** ............................. | **(206,047)** | **(234,807)** | **146,958** | **13,475** |
| Selling, general and administrative...................... | 414,322 | 721,399 | 156,946 | 116,347 |
| Rental and other investing income................................. | (48,807) | – | – | – |
| **Gross Margin**..................... | **159,468** | **486,592** | **303,904** | **129,822** |

**DHX MEDIA LTD.**

# Q1 2007

**Supplemental Information**
**For the Three Months Ended September 30, 2006**

**1. Summary of securities issued and options and warrants granted during the three-month period ended September 30, 2006 and the year ended June 30, 2006**

**a. Summary of securities issued**

| **Common Shares** | **Number of common shares** | **Value $** |
|---|---|---|
| **Balance at June 30, 2005** | **14,037,268** | **5,027,566** |
| Issued to Sir Graham Day, Director | 50,000 | 92,500 |
| Issued as consideration for Decode acquisition | 5,793,011 | 11,571,539 |
| Issued for cash in conjunction with IPO | 8,702,500 | 20,529,207 |
| Share issuance costs in conjunction with IPO, net of tax asset of $1,873,000 | - | (3,452,988) |
| Conversion of preferred shares in conjunction with IPO | 3,893,673 | 8,624,814 |
| Share issuance costs transferred from preferred shares | - | (2,104,038) |
| Issued to Dana Landry, CFO | 100,000 | 211,000 |
| **Balance at June 30, 2006** | **32,576,452** | **40,499,600** |
| Adjusted share issuance costs in connection with IPO | - | (30,044) |
| **Balance at September 30, 2006** | **32,576,452** | **40,469,556** |

| **Class A Preferred Shares** | **Number of preferred shares** | **Value $** |
|---|---|---|
| **Balance at June 30, 2005** | **3,893,673** | **1,603,992** |
| Share issue cost adjustment | - | (3,198) |
| Conversion to Common Shares in conjunction with IPO | (3,893,673) | (1,600,794) |
| **Balance at June 30, 2006 and September 30, 2006** | - | - |

b. **Summary of options and warrants**

| Options | Number of options | Weighted-average exercise price |
|---|---|---|
| **Balance at June 30, 2005** | **275,000** | **$1.85** |
| Granted to Sir Graham Day, Director | 100,000 | $2.25 |
| Granted to J. William Ritchie, Director | 100,000 | $2.25 |
| Granted to Joe Medjuck, Director | 100,000 | $2.25 |
| Granted to Donald Wright, Director | 100,000 | $2.25 |
| Granted to Dana Landry, CFO | 322,500 | $2.25 |
| Granted to Employees | 24,047 | $2.25 |
| **Balance at June 30, 2006 and September 30, 2006** | **1,021,547** | **$2.14** |

| Put Options | Number of put options | Weighted-average exercise price |
|---|---|---|
| **Balance at June 30, 2005** | **-** | **Nil** |
| Granted in connection with issuance of common shares of a subsidiary[1] | 425,420 | Nil |
| **Balance at June 30, 2006 and September 30, 2006** | **425,420** | **Nil** |

[1] Each convert on a one-to-one basis to common shares of the Company (see note 11 (i) of the consolidated financial statements for further details).

| Warrants | Number of warrants | Weighted-average exercise price |
|---|---|---|
| **Balance at June 30, 2005** (Balance forward pertains to warrants issued to transfer agent for June 16, 2005 private placement) | **389,367** | **$1.85** |
| Granted in connection with IPO | 824,492 | $2.35 |
| **Balance at June 30, 2006 and September 30, 2006** | **1,213,859** | **$2.19** |

**b. Summary of securities as at the end of the reporting period**

**a. Authorized share capital**

90,000,000 common shares without nominal or par value;
10,000,000 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;
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.

**b. Shares outstanding and recorded value**

32,576,452 common shares at a recorded value of $40,469,556;
100,000,000 preferred variable voting shares at a recorded value of $100.

**c. Description of options and warrants**

See Note 11 of the unaudited interim consolidated financial statements for the three-month period ended September 30, 2006.

**2. Directors and officers as at September 30, 2006**

**Directors**

| | |
|---|---|
| Sir Graham Day | Lead Director |
| Michael Donovan | Chairman, Board of Directors |
| J. William Ritchie | Director |
| Donald Wright | Director |
| Joe Medjuck | Director |
| Charles Bishop | Director |
| Steven DeNure | Director |
| Neil Court | Director |

**Officers**

| | |
|---|---|
| Michael Donovan | CEO |
| Dana Landry | CFO |
| Charles Bishop | Secretary and President of Halifax Film Ltd. |
| Steven DeNure | President of Decode Entertainment Inc. |
| Neil Court | President of Decode Enterprises |
| David Regan | Executive VP Corporate Development |
| Floyd Kane | VP Creative & Business Affairs |