

2005-2006 **16TH ANNUAL REPORT**

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**Board of Directors:**

Dr. Sudhish S Rambhotla	Chairman and Managing Director
Y. Suryanarayana	Executive Director
William Bill Buck	Director
Y. Kasipathy	Director
Kch. A.V.S.N. Murthy	Director
Dr. Chandra Bhushan	Director

Company Secretary:

Korepu Malleshham

Registered Office:

Plot No. 16, Road No. 5,
Jubilee Hills, Hyderabad – 500 033
Tel No. 040 – 23550268, 23544862/3/4

Auditors:

S N Murthy & Co.,
Chartered Accountants,
Chikkadpally,
Hyderabad – 500 020.

Registrars (Physical and Electronic)

Venture Capital and Corporate Investments Ltd.,
6-2-913914, 3rd Floor,
Progressive Towers, Khairatabad,
Hyderabad – 500 004.
Phone No. 040 – 23322262/4
Fax No. 040 - 23324803

NOTICE

Notice is hereby given that the 16th Annual General Meeting of the members of the company is scheduled to be held on 29th day of September 2006 at 11.00 AM at Famous Function Hall situated at 8-2-237/A/2, Beside Savera Function Palace, Yousufguda Corner, Hyderabad – 500 045 to transact the following business:

AS ORDINARY BUSINESS:

1. To receive, consider and adopt the Balance Sheet as at 31st March, 2006 and the Profit and Loss Account for the year ended 31st March, 2006 and the Reports of Board of Directors and Auditors thereon.
2. To appoint a Director in place of Mr. Y. Kasipathy who retires by rotation and being eligible offers himself for re-appointment.
3. To consider, and if thought fit, to pass, with or without modification(s) the following Resolution as an Ordinary Resolution:

“RESOLVED that M/s M.S.S. Prasad & Co., Chartered Accountants, Hyderabad be and are hereby appointed as Auditors of the Company in place of the retiring auditors M/s S.N. Murthy & Co., from the conclusion of this meeting until the conclusion of the next Annual General Meeting on a remuneration to be fixed by the Board of Directors of the Company in addition to actual out-of-pocket expenses incurred by them for the purpose of audit.”

By Order of the Board

Hyderabad
August 25, 2006

(Dr. Sudhish S Rambhotla)
Chairman and Managing Director

NOTES:

1. A member entitled to attend and vote at the Meeting is entitled to appoint one or more proxies to attend and vote instead of himself and the proxy need not to be a member. The instrument appointing a proxy should be deposited at the Registered Office of the Company not less than Forty-Eight Hours before the commencement of the Meeting.
2. Members seeking any information with regard to Annual Accounts are requested to write to the Company at least one week in advance, so as to enable the Company to keep information ready.



3. The Register of Members and Share Transfer Books of the Company will remain closed on 29th September, 2006.
4. Members are requested to notify changes in their address, if any, to Venture Capital & Corporate Investments Limited (Unit: Color Chips).

Hyderabad
August 25, 2006

By Order of the Board of Directors

(Dr. Sudhish S Rambhotla)
Chairman and Managing Director



DIRECTOR'S REPORT & MANAGEMENT DISCUSSION AND ANALYSIS REPORT:

To

The Members

Your Directors have pleasure in placing before you the 16th Annual Report of the company with Audited Financial statements for the year ended 31st March 2006.

OPERATIONS AND FUTURE OUT LOOK:

	(Rs In Lakhs)	
	2005-06	2004-05
Net Sales / Income from operations	1000.91	1093.68
Other Income	2.35	34.12
Total Expenditure	931	1054.42
Profit before Depreciation	171.87	171.90
Depreciation	99.56	98.54
Profit after depreciation	72.31	73.36
Profit of the PY brought forward	(105.79)	(179.15)
Provision for Deferred tax asset current year	0.96	Nil
Transitional Cum Deferred tax asset	34.32	Nil
Profit / Loss carried to Balance Sheet	(33.48)	(105.79)

During the year under review, your company has continued to execute projects for its European clients and has received appreciation from all quarters for the quality of its animation.

DIVIDEND:

Your directors after careful consideration of the accounts of the Company have not recommended any dividend to the equity shareholders of the Company.

SHARE CAPITAL:

Your company has issued 68,77,350 Equity Shares of Rs. 10/- each for cash at par on Rights basis to the Existing Equity Shareholders of the Company in the ration of one Equity Share for every two Equity Shares held [ie. 1:2] on Record Date i.e. July 25, 2005 aggregating to Rs. 687.735 Lakhs.

The issue was oversubscribed by 3.18 times and out of 68,77,350 Equity Shares issued 24,87,202 equity shares were allotted as fully paid shares and the remaining 43,90,148 Equity Shares were allotted as partly paid shares.

Out of 43,90,148 partly paid Equity Shares, 41,91,118 partly paid Equity Shares have been converted into fully paid Equity shares and the remaining 1,92,033 Equity Shares are still lying as partly paid shares as on 31.03.2006.

Your Company has issued 3,30,000 Equity Shares of Rs. 10/- each at a price of Rs. 12.22 to M/s. Color Chips Animation Park Limited, the existing promoter of the Company. The price of Rs. 12.22 was arrived as per regulation 13.1.1 of SEBI (DIP) Guidelines, 2000.

CORPORATE GOVERNANCE:

Your company has adopted the best corporate governance practices and has also taken steps to understand the interest of its stakeholders so that the needs of the stakeholders could be met.



A detailed Report along with a certificate of Compliance appears in the Annexure to the Director's Report.

DIRECTORS:

In accordance with the provisions of the Companies Act, 1956 and the Articles of association of the Company, Y. Kasipathy, Director will be retiring by rotation at the Annual General Meeting and being eligible, offers himself for reappointment.

AUDITORS AND AUDIT REPORT

M/s. S. N. Murthy & Co., Chartered Accountants, Hyderabad, the company's auditors retire at the conclusion of the ensuing annual general meeting. They have expressed their inability to continue as auditors of the company. Therefore the company is appointing M/s. M.S.S. Prasad & Co. as the auditors of the company.

DISCLOSURES

Disclosure in terms of Companies (Particulars of Employees) Rules, 1975 and Companies (Disclosure of particulars in the Report of the Board of Directors) Rules, 1988 in respect of conservation of energy, technology absorption, earnings and outgo of foreign exchange are attached and forms part of this report.

HUMAN RESOURCE

Your Company during the year has taken various initiatives with the assistance of renowned consultants to introduce and implement best HR practices that meet global standards.

CORPORATE SOCIAL RESPONSIBILITY:

Your company has always been a responsible corporate citizen and has made contributions towards community development and as part of this, your company has joined with the Government of Andhra Pradesh for the Jawahar Knowledge Initiative.

INTERNAL CONTROL SYSTEM:

Your Company has established internal controls which provides reasonable assurance with regard to maintaining proper financial system, preserving economy and efficiency of operations, safeguarding assets against unauthorized use or losses and facilitating reliability of financial and operational information. The Company's internal control systems are adequate and are routinely tested and certified by the statutory and internal auditors.

An Audit Committee of the Board of Directors regularly reviews the audit plans, significant audit findings, adequacy of internal controls as well as compliance with accounting standards. The Audit Committee met eight times during the year to review and monitor implementation of management actions for continuous improvement.

DIRECTORS RESPONSIBILITY STATEMENT:

As per Section 217(2AA) of the Companies Act, 1956, we directors of the Company, confirm the following:

1. That in the preparation of the accounts for the financial year ended 31st March 2006; the applicable accounting standards have been followed along with proper explanation relating to material departures;
2. That the Directors have selected such accounting policies and applied them consistently and made judgments and estimates that were reasonable and prudent so as to give a true and fair view of the state of the affairs of the Company at the end of financial year and of the profit and loss of the company year under review;
3. That the Directors have taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.
4. That the Directors have prepared the accounts for the financial year ended 31st March 2006 on a 'going concern' basis.

Animation - Opportunities and threats

Prospects in the Animation Industry

Animation is not just about cartoon; it is just one genre of animation. Animation has several applications like educational CDs, online education, video games, Internet, mobile phones, commercials and industry-specific applications in architecture, medical, law and insurance. Besides, newer applications for animation are already in progress. In a classical sense, animation is converting drawing skills to a moving format it could be either on paper (2D) or on the computer (3D). By 2008, the global animation market is expected to grow at the rate of 8%, while the Indian market is expected to have a 2.5% growth rate, according to a study carried out by the NASSCOM.

Segment wise analysis of the Industry

The high cost of production is one of the key reasons why studios are willing to outsource animation work to India. Overseas markets, already impressed by the country's proven success in the IT industry are increasingly looking at India to cut costs, as studios here offer services at lower rates due to availability of skilled yet cheaper manpower. India also has a strong advantage in getting outsourced work from the West because of the fast growing consumer class and lack of language barrier.

Industry Size

(Source: FICCI Report - 2006)

As per Nasscom estimates, the Indian entertainment industry contributes around 68 percent of the revenues of the Indian animation industry. This translates into revenues of approximately INR 8.8 million that the Indian animation industry earns from the Indian entertainment industry. Globally, the contribution of the entertainment industry towards animation is pegged at around 72 percent. Even if the existing share of 68 percent is maintained by the Indian Entertainment Industry in the growing animation market, the contribution by the entertainment segment has the potential to grow the Indian animation industry by an estimated 35 percent to reach up to INR 28.8 billion by 2009.

Business overview of the Company

Color Chips (India) Limited is into 2D and 3D Animation and syndication of comics & contents. In a short span, the company emerged as a leading player in animation industry in India. Color chips has produced various short animation films and worked with international animation production houses like BKN International, Germany, Benj Productions, France etc.

Risks and Concerns:

Computer animation Industry in India is in its Nascent Stage:

Animation is a new industry to the Indian Business Environment. Hence, the functioning of the Industry, its risks, the payoffs and the time taken to achieve the payoffs, are not very well understood. The company has been able to develop a strong track record of successful deliveries and has established a strong foundation for a robust growth in the years to come.

Manpower risks:

Over the years, one distinguishing factor about Color Chips has been the quality of the manpower and low attrition rate, which is much below the industry levels. Particularly, in the 2D animation business, the animators have seen Color Chips as a destination of choice due to training and high quality work opportunities, and a culture best suited for creative talents. This franchise is of utmost importance to this risk reduces progressively with the increase in trained manpower base but nevertheless is an inherent part of the business and needs to be managed actively at all times. Quality computer animation talent is in short supply and also takes time to develop and hence the other major challenges is to successfully increase the talented manpower base of the company.

Competition

The main Competitors for the Company includes all domestic animation companies like Heart Animation, Hyderabad; Data Quest, Hyderabad; Esco Toonz Limited, New Delhi; UTV Toons, Mumbai; Penta Media Graphics, Chennai; Crest Communications Ltd. etc. The company also faces stiff competition from Far East companies located in countries like China, Japan, Philippines, Taiwan etc. The other major challenge faced by the company being changing technologies, and upgrading the technologies is a task in itself. Our strength vis-à-vis our competitors are our trained staff, content library and creative team. ColorChips holds a strong creative team of professionals and suitable infrastructure to cater to requirements of print media, visual media & corporate communications. The above strengths give our company a wider market and more visibility.



Export Possibilities

The Company has already co-produced projects along with producers in Europe. With its ability to produce high quality animation shows the company expects to have good export possibilities of its products and services. Further as India has rich pool of historical, mythological and folklore which are till date not exposed in the international animation market the company expects that the content produced by it will have good export potential.

Cautionary Statement:

Statement in this Management Discussion and Analysis describing the Company's objective, projections, estimates and expectations may be 'forward looking statements' within the meaning of applicable laws and regulations. Certain observations made on the industry and other players also reflect an opinion by the management and the management accepts no liability on such opinions. Actual results might differ materially from those either expressed or implied.

DISCLOSURES AS PER THE LISTING AGREEMENT:

Cash Flow statement:

A Cash flow statement for the period ended 31-03-2006 is annexed forming a part of Annual Report in compliance with the requirement of clause 32 of the Listing Agreement with Stock Exchanges.

Stock Exchanges:

S No	Name of the Stock Exchange	Addresses
1	The Mumbai Stock Exchange	Phiroze JeeJeebhoy Towers Dalal Street, Mumbai -400 001
2	The National Stock Exchange of India Limited	Exchange Plaza, Plot No C/1 G Block Bandra - Kurla Complex , Bandra (E) Mumbai - 400 051
3	The Hyderabad stock Exchange Limited	6-3-275, Adjacent to Erramanjil Bus stop, Somajiguda, Hyderabad - 500 082.

FIXED DEPOSITS:

Your company has not accepted any deposits from the public or shareholders of the company pursuant to provisions of Section 58A of the Companies Act, 1956.

PARTICULARS OF EMPLOYEES:

The Provisions of Section 217 (2A) of the Companies Act, 1956 read with Companies (Particulars of Employees) Rules, 1975 is not applicable to the company, since no employee draws the remuneration in excess of the limits prescribed therein.

ACKNOWLEDGEMENT

Your Directors place on record their appreciation of the continued assistance and co-operation extended to your company by the Government of India, Government of Andhra Pradesh, the large family of shareholders and investors of your company, the dedicated employees and all others who are continuing to assist your company.

By Order of the Board

Hyderabad
August 25, 2006

(Dr. Sudhish S Rambhotla)
Chairman and Managing Director

ANNEXURE TO DIRECTORS REPORT

CONSERVATION OF ENERGY, TECHNOLOGY ABSORPTION AND FOREIGN EXCHANGE EARNINGS AND OUTGO OF THE COMPANIES (DISCLOSURE OF PARTICULARS IN THE REPORT OF BOARD OF DIRECTORS) RULES, 1988.

FORM A

FORM FOR DISCLOSURE OF PARTICULARS WITH RESPECT TO CONSERVATION ENERGY

The operations of your company are not energy intensive. Adequate measures have however, been taken on reduce energy consumption by using energy-efficient computer terminals and by the purchase of energy-efficient equipment incorporating the latest technology. Your Company constantly evaluates new technologies and invests in them, to make its infrastructure more energy-efficient. Energy efficient UPS systems have been purchased. Energy saving air conditioners is used only where required. These measures have enhanced energy efficiency. As energy cost forms a very small part of the total cost, the impact on cost is not material.

FORM B

FORM FOR DISCLOSURE OF PARTICULARS WITH RESPECT TO TECHNOLOGY ABSORPTION FOR THE YEAR 2005-2006.

A. RESEARCH AND DEVELOPMENT

1. Specific areas in which R & D carried out by the Company: Research and development is a continuous process and your company is devoting sufficient resources to continuously create and update its content in order to meet the changing education and entertainment needs of youngsters and elders.
2. Benefit derived as results of the above R & D: N.A
3. Future plans of Action: The Company intends to engage in research and development for improving quality as well as to reduce cost.
4. Expenditure in R & D: N.A

B. TECHNOLOGY ABSORPTION AND ADOPTION:

1. Efforts in brief towards technology absorption, adoption and innovation:
The company keeps it self abreast of latest developments in technology applicable to it and absorbs and adopts accordingly as may be permissible by its operations.
2. Benefit derived as results of the above R & D: N.A
3. Import of Technology: N.A

C. FOREIGN EXCHANGE EARNINGS AND OUT GO

Foreign exchange earnings: Rs. 44.90 lacs

Foreign Exchange Outgo: Rs. 75.93 lacs

CORPORATE GOVERNANCE REPORT FOR THE PERIOD APRIL 1, 2005 TO MARCH 31, 2006

ANNEXURE-D TO THE DIRECTOR'S REPORT

I. COMPANY'S PHILOSOPHY:

At Color Chips we believe in philosophy of SERVING SOCIETY THROUGH INDUSTRY, with the Color Chips culture being 'we live every moment of life in harmony with nature to create the value for ourselves, our stakeholders and the society'.

This philosophy backed by principles of concern, commitment, ethics, excellence and learning in all its acts and relationships with stakeholders, customers, associates and community at large which has always propelled the company towards higher origins.



Owing to the changing business environment in which the company today operates, your company has drawn up a vision "To be global leader in animation".

We are committed to continuously revoke customer delight through constant review, monitoring and delivering proactive valued added solutions. We are also committed strive for satisfaction of all stakeholders in a balanced manner through sustainable growth and profitability. We also aim to create an environment where work becomes enjoyable experience so as to align individual goals with organizational goals, share knowledge and information, be proactive and responsible, pursue excellence and be committed so as to transform the society around. Our aim is to create an environment, which enhances opportunities for all the good things, better health, education and overall quality of living that life has to offer.

At Color Chips, we believe that it is not latest technology or management practice (as important as they are) that makes an organization successful, as it ought to be. However, what makes it an enterprise worthy of emulation is that it shapes up the environment in which it grows. And to achieve this, we strive to be a learning organization where creativity, innovation, entrepreneurship and knowledge sharing are encouraged fostered actively.

We believe in the principles of trusteeship, fair play and transparency in all our dealings. We endeavor to have a work culture, which is performance driven and conducive to improving discipline, accountability, depth of character, team spirit and honesty in all our personal and professional relationships.

We also believe that mutual care and concern among the employees and the organization, shall be guiding principle.

1. The company views Corporate Governance under the following major parameters:

1. Transparency in relationship to appointments, meetings of directors on the Board of the company, responsibility and accountability of the Board of Directors.
2. Providing correct, accurate and relevant information to the shareholders regarding the functioning and performance of the company pertaining to financial and non-financial matters.
3. Internal and external controls and audits

2. Board of Directors:

The Board of Directors of the Company, headed by an Executive Chairman and Managing Director, consisted of the following Directors, as on March 31, 2006 categorized as indicated.

- (i) **Chairman and Managing Director:** Mr. Sudhish S Rambhotla
Executive Director: Mr. Y Suryanarayana

- (ii) **Non-Executive Directors – Independent:**

William Bill Buck
Dr. Chandra Bhushan
K Ch A V S N Murthy
Y.Kasipathy

3. During the financial year 2005-2006, Board met Thirteen times on the following dates:

- (1) i) 30.04.2005; ii) 07.05.2005; iii) 28.07.2006; iv) 25.08.2005; v) 19.10.2005 vi) 28.10.2005; vii) 19.11.2005; viii) 30.01.2006 ix) 31.01.2006; x) 01.03.2006; xi) 06.03.2006; xii) 09.03.2006; xiii) 17.03.2006
- (2) The details of the attendance of the Directors at Board Meeting and at the last Annual General Meeting with particulars of their other Directorship and Chairman / Membership of the Board Committees are given in the following table: