PEACE ARCH ENTERTAINMENT GROUP INC
Form 20-F
March 15, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

¨

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

þ

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended August 31, 2006

OR

¨

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

¨

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 1-15131

PEACE ARCH ENTERTAINMENT GROUP INC.

(Exact name of registrant as specified in the charter)

ONTARIO, CANADA

(Jurisdiction of Incorporation or Organization)

124 Merton Street, Suite 407, Toronto, Ontario, M4S 2Z2, Canada

(Address of principal executive offices)

Securities registered or to be registered pursuant to

Section 12(b) of the Act

Title of each class	Name of each exchange on which registered
Common Shares	American Stock Exchange, Inc.

Securities to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

Common Shares

The number of outstanding shares of each class of stock of PEACE ARCH ENTERTAINMENT GROUP INC. as of August 31, 2006 was: 31,308,665 Common Shares, without par value, 4,347,827 Series I Preference Shares, without par value and 2,661,929 Series II Preference Shares, without par value.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes___ No_X_

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes___ No_X_

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes _X_ No ___

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer _____

Accelerated Filer______

Non-accelerated filer ___X____

1

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17__ Item 18 __X__

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes___ No _X__

2

TABLE OF CONTENTS

	Page
PART I	
Item 1. Identity of Directors, Senior Management and Advisors	5
Item 2. Offer Statistics and Expected Timetable	5
Item 3. Key Information	5
Item 4. Information on the Company	13
Item 5. Operating and Financial Review and Prospects	23
Item 6. Directors, Senior Management and Employees	36
Item 7. Major Shareholders and Related Party Transactions	44
Item 8. Financial Information	46
Item 9. The Offer and Listing	47
Item 10. Additional Information	48
Item 11. Qualitative and Quantitative Disclosures about Market Risk	

55

Item 12. Description of Securities Other than Equity Securities

56

PART II

Item 13. Defaults, Dividends Arrearages and Delinquencies

57

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

57

Item 15. Controls and Procedures

57

Item 16. [Reserved]

58

Item 16A. Audit Committee Financial Expert

58

Item 16B. Code of Ethics

58

Item 16C. Principal Accountant Fees and Services

58

Item 16D. Exemptions from the Listing Standards for Audit Committees

59

Item 16E. Purchase of Equity Securities by the Issuer and Affiliated Purchasers

59

PART III

Item 17. Financial Statements

60

Item 18. Financial Statements

61

Item 19. Exhibits

62

The terms "Company", we , our and us refers to Peace Arch Entertainment Group Inc. (Peace Arch , PAE), an C
corporation, and includes, unless the context otherwise requires, all consolidated subsidiaries.

NOTE ON FORWARD-LOOKING STATEMENTS

Except for the statements of historical fact contained herein, some information presented in this annual report constitutes forward-looking statements. When used in this annual report, the works estimate, project, believe, anticipate, intend, expect, predict, may, should, the negative thereof or other variations thereon or co terminology are intended to identify forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, those factors discussed in the section entitled Risk Factors. Although the Company has attempted to identify important factors that could cause actual results to differ materially, there may be other factors that cause actual results not to be as anticipated, estimated or intended. There can be no assurance that such statements will prove to be accurate as actual results and future events could differ materially from those anticipated in such statements. Accordingly, prospective investors should not place undue reliance on forward-looking statements. The forward-looking statements in this annual report speak only as to the date hereof. The Company does not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Except as required by applicable law, including the securities laws of the United States, we do not intend to update any of the forward-looking statements to reflect events or circumstances occurring after the date hereof.

REVISION

The Company has revised its previously issued August 31, 2006 and 2005 US GAAP financial information furnished on form 6-K filed on November 30, 2006 to retrospectively reflect a change in accounting policy relating to share purchase warrants with an exercise price denominated in a currency other than the Company s functional currency. These are now reflected as a derivative liability. Please refer to note 32 of the financial statements in ITEM 18.

4

PART I

ITEM 1.

IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2.

OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3.

KEY INFORMATION

A.

SELECTED FINANCIAL DATA

The following table sets forth selected financial data regarding our consolidated operating results and financial position. The data has been derived from our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in Canada (Canadian GAAP). For reconciliation to accounting principles generally accepted in the United States (U.S. GAAP), see note 32 to the Consolidated Financial Statements as at August 31, 2006 and 2005 and for the years ended August 31, 2006, 2005 and 2004. The financial data as at August 31, 2003 and 2002 and for the years ended August 31, 2003 and 2002 have been derived from our audited financial statements not included in this Annual Report on Form 20-F (the Annual Report or Form F-20). The following selected financial data is qualified in its entirety by, and should be read in conjunction with, the consolidated financial statements and notes hereto included in Item 18 Financial Statements in this Annual Report. The selected financial data is expressed in Canadian dollars.

Selected Consolidated Financial and Operating Data

(in thousands, except per share data)

	Cdn$ 2006	**Cdn$ 2006**	**Cdn$ 2005**	**Cdn$ 2005**	**Cdn$ 2004**	**Cdn$ 2003**	**Cdn$ 2002**
Earnings Statement Data:							
Canadian GAAP							
Revenue		21,258		10,747	21,236	21,465	6,494
Net earnings (loss)		(4,120)		1,449[1]	(484)	2,859[2]	(7,021)
Net earnings (loss) per Common Share							
Basic		(0.19)		0.07	(0.03)	0.24	(1.81)
Diluted		(0.19)		0.07	(0.03)	0.19	(1.81)
Weighted average number of							
Common Shares		23,741		19,254	17,314	11,998	3,888
Diluted number of Common Shares		23,741		19,273	17,314	15,093	3,888
		Previously		**Previously**			
U.S. GAAP	**Revised** [3]	**Reported**	**Revised**[3]	**Reported**			
Net earnings (loss)	(3,957)[3]	(3,753)	2,299[1][3]	2,877(1)	(1,313)	(350)	(7,251)
Net earnings (loss) per Common Share							
Basic	(0.17)(3)	(0.16)	0.12(3)	0.15	(0.08)	(0.03)	(1.87)
Diluted	(0.17)(3)	(0.16)	0.12(3)	0.15	(0.08)	(0.03)	(1.87)
Weighted average number of							
Common Shares	23,741	23,741	19,254	19,254	17,314	11,998	3,888
Diluted number of Common Shares	23,741	23,741	19,273	19,273	17,314	11,998	3,888

	Cdn$	Cdn$	Cdn$	Cdn$	Cdn$	Cdn$	Cdn$
	2006	**2006**	**2005**	**2005**	**2004**	**2003**	**2002**
Balance Sheet Data:							
Canadian GAAP							
Total assets		83,542		51,168	57,468	36,905	10,763
Net assets		17,631		9,349	3,248	1,937	(5,267)
Capital stock		21,760		9,889[4]	35,925	35,878	31,870
		Previously		**Previously**			
U.S. GAAP	**Revised [3]**	**Reported**	**Revised[3]**	**Reported**			
Total assets	86,723	86,723	52,100	52,100	58,349	36,844	14,774
Net assets	15,301[3]	16,733	6,121[3]	7,480	(675)	(1,082)	(5,296)
Capital stock	50,942[3]	69,250	39,071[3]	39,596	35,925	35,878	31,870

(1)

Includes a gain on settlement of obligations of $2,560,000 (see Item 4.A. Reorganization and Settlement of Obligations).

(2)

Includes a gain on settlement of debt of $3,094,000 under Canadian GAAP.

(3)

Amounts revised for U.S. GAAP purposes, please refer to note 32 of the financial statements in Item 18.

(4)

On July 22, 2005, the shareholders authorized the reduction of the Company s stated capital for the Common Shares in the amount of $29,707,000 CDN which was applied to reduce the Company s accumulated deficit.

Currency and Exchange Rates

	United States Dollar per Canadian Dollars Fiscal Year Ended August 31				
	2006	**2005**	**2004**	**2003**	**2002**
End of period	0.9037	0.8411	0.7616	0.7217	0.6415
Average for the period	0.8714	0.8114	0.7511	0.6774	0.6354
High for the period	0.9099	0.8493	0.7879	0.7491	0.6619
Low for the period	0.8361	0.7652	0.7159	0.6258	0.6200

The following table sets forth the high and low exchange rates for one United States dollar expressed in terms of one Canadian dollar for each of the last six (6) months.

	January 2007	**December 2006**	**November 2006**	**October 2006**	**September 2006**	**August 2006**
High for the month	0.8457	0.8581	0.8715	0.8966	0.9047	0.9037

Low for the month	0.8584	0.8759	0.8868	0.8783	0.8871	0.8838

Exchange rates are based upon the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York. The noon rate of exchange on February 19, 2007 as reported by the United States Federal Reserve Bank of New York for the conversion of Canadian dollars into United States dollars was $0.8592 (US$1.00 = Cdn$1.1639). Unless otherwise indicated, in this Annual Report all references are to Canadian Dollars.

B.

CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C.

REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D.

RISK FACTORS

The Company s business is subject to a number of risks and uncertainties discussed below. 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.

Our consolidated financial statements have been prepared on a going concern basis.

The auditors report on our consolidated financial statements includes comments for U.S. readers on Canada-U.S. reporting differences and Note 1 to our consolidated financial statements outlines factors that cast substantial doubt on our ability to continue as a going concern.

The consolidated financial statements have been prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

The continuing operations of the Company are dependent upon its ability to continue to raise adequate financing and to generate profitable operations for the future.

Management is continuing to target sources of additional financing as well as other business and financial transactions to assume continuance of the Company s operations.

There can be no assurances that the Company will be successful in raising additional cash to finance operations or that the continued support of creditors and shareholders will be available. The consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.

We may be delisted from the American Stock Exchange (AMEX).

On February 10, 2004, we had received notice from AMEX indicating that we were in breach of AMEX s continued listing standards of maintaining a shareholders equity value greater than US$2,000,000 and sustaining losses in two of our three most recent fiscal years; and in breach of maintaining a shareholders equity value greater than US$4,000,000 and sustaining losses from continuing operations and/or net losses in three out of our four most recent fiscal years, all as set forth in Section 1003(a)(i) and Section 1003 (a)(ii), respectively, of the AMEX Company Guide.

Over the past three fiscal years we have increased our shareholders equity through a combination of an equity issuance of both common and preferred shares.

At August 31, 2006, the total of our shareholders equity was $21,760,000 (US$19,687,000), thereby complying with the AMEX listing standard of maintaining equity greater than US$4,000,000. There is no guarantee that we will be able to continue reporting profitability and that our shareholders equity will not decrease again below the AMEX threshold amount. If we incur losses and the losses are significant enough that our shareholders equity value declines

below the AMEX threshold we could, once again, be in breach of the AMEX listing requirements, which could result in our shares being delisted from the AMEX.

We have had losses, and we cannot assure future profitability.

We cannot assure you we will be able to operate profitably. In three of our last five years we have reported losses. We would have recognized losses in the last five fiscal years absent gains on settlement of obligations. As of August 31, 2006 we had an accumulated deficit of $8,683,000. If we continue to have losses in the future, we may not be able to generate positive cash flows sufficient to finance continuing activities. Our inability to meet those needs could have a material adverse effect on our business, results of operations and financial condition.

Our success depends on factors in the motion picture and television industry.

The business of producing and distributing film and television programming is highly competitive and involves a substantial degree of risk. Revenues derived from the production and distribution of film and television programming depend primarily upon acceptance by the public, which is difficult to predict. Each film and television program is an individual artistic work, and unpredictable audience reactions primarily determine commercial success. Generally, the popularity of our productions depends on many factors, including the critical acclaim they receive, the actors and other key talent, their genre and their specific subject matter. The commercial success of our productions also depends upon the quality and acceptance of productions that our competitors release into the marketplace at or near the same time, the availability of alternative forms of entertainment and leisure activities, general economic conditions and other tangible and intangible factors, many of which we do not control and all of which may change. We cannot predict the future effects of these factors with certainty, any of which factors could have a material adverse effect on our business, results of operations and financial condition. Some or all of our proprietary film and television programs may not be commercially successful, resulting in our failure to recoup its investment or realize its anticipated profits.

Our revenues and results of operations may fluctuate significantly.

Results of operations for any period depend on a number of factors such as on the number of film and television programs that are delivered, the price at which we are able to sell them and when the cost of the productions are within budget. Consequently, results may vary from period to period, and the results of any one period may not indicate results for future periods. In particular, results of operations in any period depend to a large extent upon our production and delivery schedule for television programs and motion pictures. As a result of the production cycle, our revenues are not recognized evenly throughout any given year. Cash flows may also fluctuate and may not directly correspond with revenue recognition.

Our business requires a substantial investment of capital.

Our ability to maintain and expand our development, production and distribution of proprietary programming and to cover our general and administrative expenses depends upon our ability to obtain financing through equity financing, debt financing (including credit facilities) or the sale or syndication of some or all of our interests in certain projects or other assets. If our access to existing credit facilities is not available, and if other funding does not become available to replace existing credit facilities should they not be available, there could be a material adverse effect on our business.

We are subject to risks associated with possible acquisitions, business combinations, or joint ventures.

From time to time we engage in discussions and activities with respect to possible acquisitions, business combinations, or joint ventures intended to complement or expand our business. We may not realize the anticipated benefit from any of the transactions we pursue. Regardless of whether we consummate any such transaction as well as the integration of the acquired business could require us to incur significant costs and cause diversion of management s time and resources. Events and circumstances subsequent to such transaction could also result in impairment of goodwill and other intangibles, development write-offs and other related expenses. Any of the foregoing could have a material adverse effect on our business, results of operations and financial condition.

We may be unable to comply in a timely manner with the requirements of the Sarbanes-Oxley Act relating to the assessment by us of the effectiveness of our internal controls over financial reporting, and our assessment may identify material weaknesses and may result in an attestation with an adverse opinion from our auditors, each of which could adversely affect our reputation and share price.

Section 404 of the Sarbanes-Oxley Act 2002 and related regulations presently requires that for the year ended December 15, 2008, we will be required to perform an evaluation of our internal controls over financial reporting and have our auditors attest to such evaluations on an annual basis. We have been and still are evaluating our internal control systems to allow our management to report on, and our auditors to attest to our internal control over financial reporting. As a result, we have incurred additional expenses in fiscal 2006 and a diversion of our management s time.

There can be no assurance that we will complete the necessary work to comply with all aspects of Section 404 and related regulations in a timely manner.

Weaknesses in our internal controls over financial reporting may cause us to be unable to prevent or detect material misstatements in a timely manner. Any failure to implement required new or improved controls, or difficulties encountered in their implementation, could cause us to fail to meet our reporting obligations. If the assessment of our internal control over financial reporting identifies material weaknesses that must be disclosed, we may receive an attestation with an adverse opinion from our auditors as to the adequacy of our internal control over financial reporting. Furthermore, potential acquisitions of businesses that are currently not in compliance with Section 404 requirements could lead to disclosures on currently unforeseen deficiencies in our internal control over financial reporting. This could adversely affect our ability to comply with business combinations accounting procedures in preparing our consolidated financial results. Each of these consequences could reduce the market s confidence in our financial statements and negatively affect the price of our shares.

While we believe that we will be able to meet the required deadlines, no assurance can be given that this will be the case. If we fail to complete this evaluation within the required time frame, or fail to remedy any identified material weakness or if our auditors render an adverse attestation, we may be subject to regulatory scrutiny and loss of public confidence in our internal controls. All of these factors may cause our stock price to decline.

The potential for budget overruns and other production risks are difficult to predict.

Actual production costs may exceed budget, perhaps significantly, due to factors within or beyond our control. These factors may delay or prevent completion of a production. If there are significant cost overruns, we may have to seek additional financing to complete the production. Financing on terms acceptable to us may not be available. We may be unable to recoup the additional costs, which could have a material adverse impact on operating results and

liquidity. Productions are bonded and, if necessary, calling upon the bonder to complete can mitigate any significant cost overrun or risk of completion.

We rely on a few key customers.

Our revenue is generated in part due to production activities in numerous countries. We have several primary customers who purchase distribution rights to the filmed product we sell. We also have several large customers through which we distribute our home entertainment product. In the year ended August 31, 2006, one customer represented approximately 25% of total revenues, a second customer represented approximately 9% of total revenues and a third customer represented approximately 5% of total revenues and two customers collectively represented approximately 8% of total revenues.

Sales of outstanding shares may hurt our stock price.

Our current shareholders hold a substantial number of shares. We filed a registration statement which was declared effective on November 2, 2006 on Form F-3 to register an aggregate of 36,061,540 shares of common shares on behalf

---

of certain shareholders of the Company. The sale of these shares could cause the trading price of our stock to substantially decline. In addition, such sales may create the perception by the public of difficulties or problems with our products and services or management. Sales of these shares could also make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem reasonable or appropriate.

The Preference Shares have priority over the Common Shares of the Company

The Company has 4,347,807 Series I and 2,661,929 Series II Preference Shares outstanding as of August 31, 2006 and the Company has the ability to issue additional Preference Shares. The Preference Shares shall be entitled to priority over the Common Shares and over any other shares of the Company ranking junior to the Preference Shares with respect to the payment of dividends and in the distribution of assets in the event of the liquidation, dissolution or winding-up of the Company, whether voluntary or involuntary, or any other distribution of the assets of the Company among its shareholders for the purpose of winding up its affairs.

Management s forecasts for future revenues supporting film book values may not be achieved.

Investments in film and television programming are amortized against revenues in the ratio that current revenues bear to management s estimate of ultimate revenues for each program pursuant to the Statement of Position (SOP-002) issued by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants. As a result of our policy we typically amortize a minimum of 80% of the costs over a three-year period. Management periodically reviews its estimates and adjusts the amortization of our programming accordingly. In the event that management should determine that the capitalized costs for a program exceed its fair value, capitalized costs would be written down in the current period, resulting in a corresponding decrease in earnings.

We could lose certain benefits by failing to meet certain government incentive programs

We currently finance a portion of our production budgets through Canadian and United States government agencies and incentive programs, including federal and provincial tax credits, as well as through similar international arrangements in the case of our international co-productions. These tax credits combined can represent approximately 20% of an individual production budget. We will continue to qualify for these tax credits if, among other things, Canadians beneficially own or control a majority of the voting rights of the Company. If Canadians fail to beneficially own or control a majority of our voting rights at any time, we could lose such tax incentives and the costs of our productions would increase substantially. Canadian law requires Canadian conventional, specialty, pay and pay-per-view television services to devote a certain amount of their programming schedules, including prime time, to Canadian productions. If we fail to qualify as a Canadian producer, it would be more difficult to obtain time slots in Canada for our programming, a "slot" being a broadcast time period for a program. We believe we will continue to qualify as a Canadian producer for this purpose as long as, among other things, Canadians beneficially own or control

a majority of our voting rights. These incentive programs, including federal and provincial tax credit programs, may be amended or eliminated in the future, which could result in a material increase in the effective cost of our productions. The loss or elimination of these tax and business incentives would have a material adverse effect on our results of operations and financial condition.

We are smaller and less diversified than many of our competitors.

Although we are an independent distributor and producer, we compete with major U.S. and international studios. Most of the major U.S. studios are part of large diversified corporate groups with a variety of other operations, including television networks and cable channels that can provide both means of distributing their products and stable sources of earnings that may allow them better to offset fluctuations in the financial performance of their film and television operations. In addition, the major studios have more resources with which to compete for ideas, storylines and scripts created by third parties as well as for actors, directors and other personnel required for production. The resources of the major studios may also give them an advantage in acquiring other businesses or assets, including film libraries, that we

10

might also be interested in acquiring. The foregoing could have a material adverse effect on our business, results of operations and financial condition.

Our revenues and results of operations are vulnerable to currency fluctuations.

The Company receives a portion of its revenues from U.S. and international sources in U.S. dollars while its operating costs and production costs of film and television programming is primarily denominated in Canadian dollars. Accordingly, results of operations can be affected by fluctuations in the U.S. dollar exchange rate. The results of these fluctuations may be material. To date, we have not entered into any material currency hedging instruments. In addition, the Company has not maintained significant amounts of U.S. dollar balances in order to reduce the risk of exchange rate fluctuations.

Our revenues and results of operations are subject to interest rate fluctuations.

The Company borrows funds from banks and other financial institutions to finance the production costs of its film and television programming that is generally incurred in advance of contracted receipts and revenues from these programs. These loans usually bear interest at rates that change as market interest rates fluctuate. A rise in interest rates would cause an increase in costs to produce film and television programs and an adverse effect on our results of operations and financial condition.

The loss of key personnel could adversely affect our business.

Our success depends to a significant degree upon the services of certain key personnel, particularly Gary Howsam, our Chief Executive Officer. Because we are a relatively small company, these members of management are involved in many aspects of the production process and virtually all significant decisions are made or significantly influenced by these individuals. The loss of the services of any one or more of our key personnel could have a material adverse effect on our business. Although we have obtained and intend to maintain "key man" life insurance coverage with respect to these personnel, there is no assurance that the proceeds would be sufficient to compensate fully for the loss of the services of any of these individuals if they were to die. The loss of services of any of these employees could have a material adverse effect on our business, results of operations or financial condition.

We could be adversely affected by strikes or other union job actions.

The film and television programming produced by us generally employ actors, writers and directors who are members of the Screen Actors Guild, Writers Guild of America and Directors Guild of America, respectively, pursuant to

industry-wide collective bargaining agreements. The collective bargaining agreement with the Writers Guild of America was successfully renegotiated and became effective as of November 1, 2004 for a term of three years. The collective bargaining agreements with the Screen Actors Guild and Directors Guild of America were each successfully renegotiated and became effective as of July 1, 2005 for a term of three years. Many productions also employ members of a number of other unions, including, without limitation, the International Alliance of Theatrical and Stage Employees, the Teamsters and the Alliance of Canadian Cinema, Television and Radio Artists. A strike by one or more of the unions that provide personnel essential to the production of motion pictures or television programs could delay or halt our ongoing production activities. Such a halt or delay, depending on the length of time, could cause a delay or interruption in our release of new motion pictures and television programs, which could have a material adverse effect on our business, results of operations or financial condition.

Piracy of motion pictures, including digital and internet piracy may reduce the gross receipts from the exploitation of our films.

Motion picture piracy is extensive in many parts of the world, including South America, Asia, the countries of the former Soviet Union and other former Eastern bloc countries. Additionally, as motion pictures begin to be digitally distributed using emerging technologies such as the Internet and online services, piracy could become more prevalent, including in the U.S., because digital formats are easier to copy. As a result, users can download and distribute

unauthorized copies of copyrighted motion pictures over the Internet. In addition, there could be increased use of devices capable of making unauthorized copies of motion pictures. As long as pirated content is available to download digitally, many consumers may choose to download such pirated motion pictures rather than pay for motion pictures. Piracy of our films may adversely impact the gross receipts received from the exploitation of these films, which could have a material adverse effect on our business, results of operations or financial condition.

We face additional risks from doing business internationally.

We distribute our film and television programming outside the United States and Canada through third party licensees and derive revenues from these sources. As a result, our business is subject to certain risks inherent in international business, many of which are beyond our control. In addition to the currency fluctuation risks described above, these additional risks include: changes in local regulatory requirements, including restrictions on content; changes in the laws and policies affecting trade, investment and taxes (including laws and policies relating to the repatriation of funds and to withholding taxes); differing degrees of protection for intellectual property; instability of foreign economies and governments; cultural barriers; and wars and acts of terrorism. Any of these factors could have a material adverse effect on our business, results of operations or financial condition.

Protecting and defending against intellectual property claims may have a material adverse effect on our business.

Our ability to compete depends, in part, upon successful protection of our intellectual property. We do not have the financial resources to protect our rights to the same extent as major studios. We attempt to protect proprietary and intellectual property rights to our productions through available copyright and trademark laws and licensing and distribution arrangements with reputable international companies in specific territories and media for limited durations. Despite these precautions, existing copyright and trademark laws afford only limited practical protection in certain countries. We also distribute our products in other countries in which there is no copyright and trademark protection. As a result, it may be possible for unauthorized third parties to copy and distribute our productions or certain portions or applications of our intended productions, which could have a material adverse effect on our business, results of operations or financial condition.

Litigation may also be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, or to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement or invalidity. Any such litigation could result in substantial costs and the diversion of resources and could have a material adverse effect on our business, results of operations or financial condition. We cannot assure you that infringement or invalidity claims will not materially adversely affect our business, results of operations or financial condition. Regardless of the validity or the success of the assertion of these claims, we could incur significant costs and diversion of resources in enforcing our intellectual property rights or in defending against such claims, which could have a material adverse effect on our business, results of operations or financial condition.

Because we are a Canadian corporation, it may be difficult to sue us or to enforce a judgment against us

We are a Canadian corporation with our principal place of business in Toronto, Ontario. Substantially all of our directors and executive officers and some of the experts named in this report are not residents of the U.S. and virtually all of the assets of these persons and substantially all of our assets are located outside the U.S. As a result, it may not be possible for you to serve summons and complaints within the U.S. upon these persons or upon us. Similarly, it may not be possible to enforce in U.S. courts, against such persons or against us, judgments of U.S. courts based upon civil liability provisions of the U.S. federal or state securities laws. In addition, it may be difficult in Canadian courts for you, in original suits or in suits for the enforcement of judgments of U.S. courts, to enforce civil liabilities based upon U.S. federal or state securities laws against us or our directors or executive officers, or our experts. We have appointed National Registered Agents, Inc. of Washington, D.C., to act as agent for service of process in any action in any U.S. federal or state court brought against us under the securities laws of the U.S.

ITEM 4.

INFORMATION ON THE COMPANY

A.

HISTORY AND DEVELOPMENT OF THE COMPANY

The Company is an integrated media company that finances, produces, acquires and distributes film and television programming for worldwide markets. The Company s three principal business segments are: Motion Picture, Television and Home Entertainment. Over the past few years, the Company has transformed itself into a streamlined, distribution driven company, while reducing the amount of capital and other resources devoted to production and other related activities.

Peace Arch was incorporated on October 22, 1986, as a British Columbia corporation under the name Vidatron Enterprises Ltd. On July 14, 1999, we changed our name to Peace Arch Entertainment Group Inc.

On February 11, 2004 under the *Company Act (British Columbia),* by special resolution, the following occurred:

•

Our Articles of Memorandum were amended such that the share capital was reorganized, eliminating the distinction between Class A Multiple Voting Shares without par value and Class B Subordinate Voting Shares without par value and designating such shares as Common Shares without par value each having one vote. Each class A Multiple Voting Share was exchanged for one new common share and one Class B Subordinate Voting Share was exchanged for one new common share. The reorganization was implemented to simplify the Company s share capital. Our common shares began trading on the TSX and AMEX on March 16, 2004 under the trading symbol PAE.

•

The Company deleted Article 29 Restrictions on the Issue and Transfer of Shares of its Articles of Memorandum resulting in the authorized share capital being 200,000,000 common shares with no par value as well as 25,000,000 preference shares with no par value.

•

The Company applied for and was accepted to continue under the *Business Corporations Act (Ontario),* OBCA . The Company became an Ontario corporation on September 1, 2004. Under the articles of continuance (the Articles) the Company s authorized share capital was changed to an unlimited amount of common shares with no par value and an unlimited amount of preference shares with no par value.

On August 24, 2005 under the *Business Corporations Act (Ontario)*, by special resolution, the following occurred:

- The Company altered its Articles by re-designating the Series I Non-Voting Preference Shares as Series I Preference Shares and Series II Non-voting Shares as Series II Preference Shares .

- The Company altered its Articles to change the Series I and Series II Preference Shares from non-voting to voting shares on the basis of one vote for each outstanding Series I Preference Share and one vote for each outstanding Series II Preference Share, and to re-designate such shares as series I Voting Preference Shares and Series II Voting Preference Shares.

- The Articles were amended to authorize the issuance of an unlimited number of common shares and an unlimited number of Preference Shares issuable in series.

- The Articles were amended to designate the Series I Voting Preference Shares and Series II Voting Preference Shares as each of such series of Preference Shares.

- The Articles were modified to delete the rights, privileges and conditions attaching to each class of shares as provided in the Articles of Continuance dated September 1, 2004.

- The directors were authorized to reduce the Company s stated capital account for the common shares by the amount of up to $29,706,623.

Our registered and principal office s address and phone telephone number are: 124 Merton Street, suite 407, Toronto, Ontario M4S 2Z2, (416) 486-0377. We also operate offices in Vancouver (Canada), Los Angeles (United States) and London (England).

The Company s agent for service in the United States is National Registered Agents Inc., 1090 Vermont Avenue, NW, suite 910, Washington, D.C. 20005.

Neither Peace Arch nor any of its subsidiaries have been subject to any bankruptcy, receivership or any similar proceedings.

There have been no indications of any public takeover offers by third parties in respect to our shares or by us in respect of other companies shares which have occurred during the last and current financial year.

Recent Developments

•

On January 23, 2006, the Company acquired 100% of the issues and outstanding shares of kaBOOM! Entertainment Inc. (kaBOOM), a home entertainment studio in Canada that distributes videocassettes, DVDs and ancillary merchandise to retailers and mass merchandisers in Canada, for a purchase price of approximately $7,983,000. The purchase price was paid by issuance of 1,033,058 common shares of the Company valued at $500,000, 50,000 options of the company valued at $17,000, and future cash consideration of $4,202,000 and direct costs of acquisition of $264,000. To finance the cash portion of the purchase price, the Company arranged a debt facility from a financial institution and for a portion of the cash and the balance was provided by letters of credit from the preference shareholders. kaBOOM! Entertainment Inc. was renamed to Peace Arch Home Entertainment Inc. on September 12, 2006.

•

On June 7, 2006, the Company completed a private placement of 7.5 million common shares for gross proceeds of $9,075,000 (net proceeds of $8,370,000). The proceeds were used to repay a term loan of $3,447,000, to settle letters of credit amounting to $4,202,000 in connection with the kaBOOM acquisition and to provide working capital. An additional 269,000 Common Share Purchase Warrants were issued to Westwind Partners Inc. as partial payment for acting as agent on the Canadian portion of the transaction.

•

On November 1, 2006, the Company entered into a binding letter agreement with CSC Global Technologies Inc. (CSC). Pursuant to the agreement, a new company will be created, where 51% of the common shares will be owned by the Company and 49% owned by CSC. The agreement will require the Company to provide financing toward the start up of the business venture. The amount of this obligation has not yet been determined.

•

On December 21, 2006, the Company acquired 100% of the issued and outstanding shares of Castle Hill Productions Inc. and Dream LLC, which holds the rights to a library of films for a purchase price of US$9,000,000. The purchase consideration is US$8,000,000 cash and US$1,000,000 in issuance of Company shares. The total amount of Common Shares issued was 1,120,419 and the fair value per Common Share was US$0.89, determined by the 10 day weighted average prior to closing.

The cash component of the transaction was financed by (i) a corporate facility with Canadian Imperial Bank of Commerce for US$2,700,000 secured by the acquisition s accounts receivables; (ii) two increased loan facilities with Imperial Capital Bank totalling US$4,600,000, secured by Peace Arch s accounts receivables; (iii) working capital of the Company in the amount of US$700,000. The acquisition will be accounted for under the purchase method and the results of operations will be included in the consolidated financial statements from the acquisition date in the Company s second quarter results of fiscal 2007.

Reorganization and Settlement of Obligations

Under the terms of a Debt Repayment Agreement with Fremantle Enterprises Ltd. (Fremantle), a former trade creditor who had previously agreed to exchange Fremantle s trade payable balance for a term loan issued a Conversion Right Certificate (the Fremantle conversion instrument). It was agreed that if any amount of the Fremantle debt, including unpaid interest, remained outstanding as of December 31, 2004, Fremantle would, for a period of 90 days, have the right to convert such unpaid amount to common shares in the capital of the Company at the lesser of either (a) $5.00 per share or (b) the average trading close price of the shares for the 30 days prior to December 31, 2004, provided that in no event would the conversion price be less than $3.00 per share. Pursuant to the terms of the Fremantle conversion instrument, 2,527,000 common shares, which represent the number of shares that could be issued for the principal amount of debt of $7,580,000, were reserved for issuance. During the year ending August 31, 2005, Fremantle converted its $8,793,000 note plus interest for 2,931,125 shares of the Company s common shares. During fiscal 2005, the Company recognized a gain on settlement of its obligation of $1,105,000 representing the difference between the carrying amount of the obligation and the fair value of the Company s common shares issued on the conversion date, and a gain on settlement of liability of $1,455,000 representing the extinguishment of the Company s distribution liability to Fremantle.

Pursuant to a Release and Reconstitution Agreement with Comerica Bank (Comerica), the terms of a loan guarantee of US$1,075,000 were restructured to restrict repayment of the loan to the ultimate sales proceeds of certain specific exploitation rights and, subject to priority interests, including repayment to Fremantle, to certain assets. The Company also issued a Conversion Right Certificate (the Comerica conversion instrument) to Comerica wherein it was agreed that if any amount of the loan remained outstanding as of December 31, 2005, Comerica would, for a period of 90 days, have the right to convert such unpaid amount to common shares in the capital of the Company at a deemed price of $5.00 per share. Pursuant to the terms of the Comerica conversion instrument, the Company reserved a sufficient number of shares that could be issued in settlement of the US$1,075,000 obligation. On March 30, 2006 Comerica converted its US$1,075,000 loan for 215,000 common shares in the Company. During fiscal 2006, the Company recognized a loss of $15,000 on the settlement of its obligation which represents the extinguishment of the Company s distribution liability to Comerica. Since the Company had issued a right to receive a variable amount of shares in settlement of their obligations, the Company reflected the amounts as a liability.

Pursuant to the reorganization Peace Arch Project Development Corp. (PAPDC) is owner of substantially all of the pre-existing assets, which consisted principally of accounts and loans receivable, film and television programming rights, and all shares and other securities (including intercompany loans) held by the Company in its subsidiaries existing on the date of the reorganization.

At the same time, PAPDC and its subsidiaries directly or indirectly were assigned substantially all of the pre-existing debts and liabilities of the Company, including the Company s indebtedness to Fremantle and Comerica. However, the Company continued to have a conditional obligation to satisfy any remaining indebtedness to Fremantle and Comerica by issuing a variable number of shares to Fremantle and Comerica under Conversion Rights Certificates (the conversion instruments) issued by the Company to each of them.

During the year ended August 31, 2004, the Company voluntarily issued 3,489,814 common shares to PAPDC in consideration for PAPDC agreeing to assume the obligation to issue the common shares of the Company to Fremantle and Comerica collectively known as the (Lenders) should the Lenders eventually opt to call upon those shares in settlement of the PAPDC obligations. The Company voluntarily issued common shares, in escrow, to PAPDC to settle the Lenders obligations. Following the issuance of shares in settlement of their obligations there remained 343,689

common shares held in escrow. On September 1, 2006, the Company returned 121,000 of these shares to treasury.

Subsequent to the reorganization, on August 1, 2003, the Company sold all of its shares in PAPDC. The Company determined that PAPDC was a Variable Interest Entity under the rules governing Accounting Guideline-15 (see discussion on Variable Interest Entities on page 31).

15

On May 26, 2005, the Company re-acquired 100% of PAPDC shares for a nominal amount, which had no effect on the carrying amount of any assets or liabilities.

Pursuant to the original arrangements with PAPDC, the Company was obligated to carry out management services for PAPDC. This obligation continued until June 25, 2004. During the year ended August 31, 2006, the Company recovered costs against the payable to Fremantle of $nil and $145,000 and $427,000 for the years ended August 31, 2005 and 2004, respectively.

B.

BUSINESS OVERVIEW

GENERAL

Peace Arch is an integrated media company that finances, produces, acquires and distributes high quality film and television programming for worldwide markets.

The Company earns revenues primarily from two sources: the distribution of newly acquired product and productions, and the distribution of its library. Once a production is completed and delivered, the progr