Management Discussion and Analysis

Overview

The global economic and investment climate remained challenging throughout the period. The outbreak of war in the Middle East went almost parallel with the outbreak of SARS during the second half of our fiscal year 2003. As a result, certain business activities were disrupted and new projects were pending until overseas travel resumed. Fortunately, the war was brief and SARS was under control by the end of June. By September, we had basically picked up momentum again. The signing of CEPA in June and the subsequent inclusion of the telecoms sector for liberalization in market access further boosts overall investment sentiment and promises genuine opportunities for the Group in mobile communications and wireless services.

Review of Operations

China market remained robust contributing HK$1,434 million to the Group's turnover, compared to HK$1,298 million in the last corresponding period. The strong performance of the China market was mainly attributable to the overall increase in wireless infrastructure expenditure in China's fast-growing telecoms industry. Had it not been for SARS which had the effect of deferring some orders to post fiscal year, Group performance would have registered even stronger growth.

European sales maintained steady growth with turnover increased by 25 percent to HK$305 million. Meanwhile, sales to other markets including the U.S. had also gained momentum.

The Group's focus on customized IT solutions continued, with new business concentrating on software enchanced wireless messaging, radio products and systems, as well as networking and Internet access products and solutions for niche market segments. In terms of strategic investment, the Group announced in November 2002 an investment in 4G1 Inc., which focuses on the development of next generation mobile communications systems. With the additional wireless dimension, the Group is positioned to include in its portfolio future-proof wireless communications which can meet the dual challenges of seamless global coverage and interface with continuously emerging new standards and protocols in IP-based networks, targeted at serving the needs of fixed line and wireless networks for data, voice, and video services.

In the areas of Internet and e-commerce, the Group had continued to build its customer base and expand its service offerings. Y28 Innovations, the Group's flagship portal and Internet data center, has added new content channels targeted at paid subscribers, and installed new shopping sites, selling a broad range of merchandise as souvenirs, ladies' cosmetics, healthcare products, accessories, and decorative items. Our Internet directories were also gaining a lot of traction and bringing in increased revenue. Meanwhile, Y28 News Channel became available as a mobile Internet service on PDAs, allowing information to be pulled from the web, and effectively turning the handheld device or next-generation phone into a portable information powerhouse without wireless connection.

During the year, the Group's software team continued to engage in the development of B2B exchanges for corporate customers. New focus was on rich media content such as MMS and SMS for mobile applications.

Kantone Holdings Limited (Kantone)

Overall performance of Kantone for the year under review was satisfactory. For the year ended 30 June 2003, Kantone recorded a turnover of HK$815 million, an increase of 13 percent over last year. Net profit was HK$110 million, representing an improvement of 74 percent compared with HK$63.3 million (before prior period adjustment of HK$65.9 million due to implementation of SSAP 34) last year. With the adoption of SSAP 34, Kantone's result for last year was a restated net loss of HK$2.6 million. *(For details refer to Financial Performance below)*

Kantone introduced its Access Integrator Messaging System (AIMS), which features DECT Messaging, TCP/IP, and Networking Messaging, and is also capable of working with a variety of internal and external devices. Market response has been encouraging. Meanwhile, a new management team has been formed at Kantone's European operations, which implemented cell-based manufacturing, targeted at increasing operation efficiency; and closely aligning production levels to customer needs, thus giving the ability to reduce inventory for the benefit of customers and the Group.

Kantone continued to be the preferred supplier of mission critical communications services for the emergency and rescue service sectors, accounting for 60 percent of the UK healthcare market, and 85 percent of UK fire services. The budgetary constraints for IT purchases in major institutions and public sectors actually helped Kantone's business, as cost-effective narrowband communications infrastructure building on existing communications systems are preferred, especially in Europe and America.

During the period under review, Kantone was awarded a contract to supply and install comprehensive narrowband communications systems for a chain of hospitals in the US. The status as the approved provider of onsite communications systems for the US market has opened the door to many exciting opportunities ahead, especially where many of the radio systems within the US Federal Government will soon require upgrading or replacement.

DIGITALHONGKONG.COM (Digital HK)
Digital HK has adjusted and repositioned itself to expand its revenue base. It now operates three complementary lines of business covering the provision of Internet and e-commerce enabling solutions; provision of IT consulting and technical services; and strategic investments in selected technologies and companies with a view to providing total solutions.

Given the slow take-off of e-commerce in Hong Kong against a very competitive market, Digital HK has adopted a conservative approach in rolling out its business objectives. Extreme diligence was exercised in managing its resources, resulting in the postponement or revision of development plans of some projects. Nevertheless, it had continued its efforts in pursuing business in relation to e-commerce solutions, and had been contracted to develop an e-commerce platform for deployment in the China market.

Its conservative efforts have paid off, as evidenced by ten consecutive quarters and two consecutive years of profit. For the year ended 30 June 2003, Digital HK recorded a net profit of HK$142,000 with a turnover of HK$9,642,000.

Financial Performance

During the year, the Group had continued its prudent investment in new product development and technologies to enhance its bundled offerings and services. Through better allocation of resources to existing operations and effective cost control, the Group was able to sustain profit growth amidst a general difficult economic climate and less than palatable global environment.

Turnover
The Group recorded an audited consolidated turnover for the year ended 30 June 2003 of HK$1,852 million, a 13 percent growth compared with HK$1,633 million for the previous year. The growth in turnover was attributable to an overall increase in sales, with China accounting for HK$1,434 million, a 10 percent growth compared to HK$1,298 million of last year. SARS had interrupted some of the business activities, deferred some shipments, and lengthened the outstanding period of accounts receivables. However, the overall strong demand for telecommunications equipment and services still outgrew the sales of last year.

Turnover from Europe increased 25 percent to reach HK$305 million. Sales to other markets also improved 25 percent to HK$113 million.

Profitability
Net profit for the year ended 30 June 2003 was HK$191 million, a 12 percent growth compared to HK$171 million (before prior year adjustment of HK$38 million due to implementation of SSAP 34), and a 44 percent growth compared with HK$133 million (restated with the adoption of SSAP 34) last year. Earnings per share was HK31.44 cents. Earnings before Interest, Taxation, Depreciation and Amortisation (EBITDA) was HK$670 million, up 19% compared with HK$563 million of last year.

The adoption during the year under review of certain new and revised SSAPs (Statements of Standard Accounting Practices) issued by the Hong Kong Society of Accountants has led to a number of changes in the Group's accounting policies. In particular, the adoption of SSAP 34 by the Group's subsidiary Kantone Holdings Limited in connection with the recognition of costs for the retirement benefit scheme of the latter has led to a prior period adjustment, taking into account of the effect of minority interests, of HK$38 million to the Group's net profit last year, which was restated to a net profit of HK$133 million, compared to HK$171 million prior to restatement. Similarly, EBITDA for last year was restated from HK$629 million to HK$563 million after costs of HK$66 million were fully recognised. The restatement is purely an accounting treatment. It is a non-cash item and has no effect on the financial health and performance of the Group.

The improved profitability was a result of effective cost control, improvement of gross and operating margins, as well as improved performance of European operations. Depreciation and amortisation of the Group's technology development, e-commerce and telecom investment projects remained steady at HK$402 million, and the impairment provision in relation to Internet-related investment and telecommunications projects were HK$92 million and HK$35 million respectively. The impairment charges were a result of the Group's re-arrangement of its interest in e-commerce and telecommunications projects.

Liquidity and Financial Resources
Throughout the year, the Group has maintained a net cash position. As at 30 June 2003, the Group had HK$573 million made up of deposits, bank balances, and cash. The gearing ratio at year-end was 0.17 (2002 (restated): 0.18), which calculation was based on the Group's total borrowings of HK$556 million (2002: HK$527 million) and shareholders' funds of HK$3,211 million (2002 (restated): HK$2,942 million).

Total borrowings comprise bank borrowings of HK$490 million (2002: HK$433 million); other borrowings, which represent block discounting loans of HK$22 million (2002: HK$30 million); obligations under finance leases of HK$1 million (2002: HK$2 million); and convertible bonds of

Management Discussion and Analysis

HK$43 million (2002: HK$62 million). The bank borrowings are mainly used as working capital for the Group. Finance costs for the year ended 30 June 2003 amounted to HK$27 million (2002: HK$31 million).

As at 30 June 2003, certain land and buildings of the Group with a net book value of HK$10 million (2002: HK$9 million) were pledged to a bank as security for banking facilities granted to the Group.

The Group does not engage in interest rate or foreign exchange speculative activities. To mitigate the foreign exchange risk of the Group arising from transactions during the normal course of business, management has endeavoured to match foreign currency income and expense. Management will continue to use appropriate hedging instrument for transactions with high exchange rate risk.

Post Balance-sheet Date Development

In September 2003, the Group issued the Tranche 2 Bonds in the aggregate principal amount of US$8 million (equivalent to approximately HK$62.4 million) pursuant to the Subscription Agreement entered into with Credit Suisse First Boston (Hong Kong) Limited in May 2002 for the issue of up to US$24 million 1.5 percent unlisted and unsecured convertible bonds due 2005. The new money further enhanced the Group's financial position and raised its cash position by HK$60.4 million.

Final Dividend and Scrip Dividend Scheme

Subject to the approval of shareholders at the forthcoming Annual General Meeting, the directors proposed a final dividend of HK2.6 cents per share for the year ended 30 June 2003 (2002: HK2.5 cents per share) to shareholders whose names appear on the register of members of the Company on 26 November 2003. Taking into account of the interim dividend of HK1.6 cents per share paid on 16 June 2003, total dividends for the year would amount to HK$27.6 million, an increase of 18 per cent over HK$23.4 million of last year.

The final dividend will be satisfied by allotment of new shares of the Company, credited as fully paid, by way of scrip dividend, with an alternative to the shareholders to elect to receive such dividend (or part thereof) in cash in lieu of such allotment (the "scrip dividend scheme").

The scrip dividend scheme is subject to the granting by the Listing Committee of The Stock Exchange of Hong Kong Limited of a listing of and permission to deal in the shares to be issued pursuant thereto. A circular setting out the details of the scrip dividend scheme together with the form of election will be sent to the shareholders of the Company as soon as practicable.

It is expected that certificates for shares to be issued under the scrip dividend scheme and dividend warrants will be despatched to those entitled thereto on or before 28 January 2004.

The Group's Restated Results following the adoption of SSAP34

	For the year ended 30 June		
	2003	**2002**	**2002**
	HK$'000	*HK$'000 (restated)*	*HK$'000 (before restatement)*
EBITDA	669,887	563,171	629,011
Net profit	191,247	133,040	170,570
Earnings per share			
– basic (in HK cents)	31.44	25.06	32.13