

Management Discussion and Analysis

OPERATIONS REVIEW

During fiscal 2005, demand for the Group's wireless systems and communications software solutions remained strong, in many ways reflecting the improved capital spending amid a steadily growing global economy.

China remains the Group's largest market, where sales maintained robust momentum in line with the country's thriving economy, contributing HK\$1,823 million to the Group's turnover, a rise of 5 percent compared with HK\$1,736 million in the last year. China has become the world's seventh biggest economy, having enjoyed eight consecutive quarters of annual growth of 9 percent or more. The continuing strong performance of the China market was attributable to overall increase in capital expenditure by our customers to improve the quality of their networks in order to meet increasing demands. In particular, China's plans to develop the Northeastern and Northwestern provinces and cities have a positive effect on the demand for the Group's products and services. The success of China's aerospace projects has also accelerated investments in the telecoms and related sectors. The Group's track record of innovative communications solutions and reliable systems deliveries has helped establish long-term and trusted relationships with our business partners. Comprehensive knowledge of the China telecoms and IT market is very much in our favour. With China's continued economic prosperity, the Group's products and services have grown from strength to strength.

The Group also reported stable business in Europe, where healthcare and fire services continued to be core sectors for the Group's wireless messaging solutions. During the year, several new installations were implemented which were accompanied by enhanced applications to deliver clinical efficiencies and improve emergency response times. Turnover attributable to the operations in Europe was HK\$409 million, compared with HK\$353 million in the last year. Sales to the US and South America was in line with expectations. Meanwhile, the Group had also seen expansion of its activities in the Middle East with the installation of onsite communications systems at a number of prestigious hotel and hospital sites throughout the region during the period.

During the year, the Group's Champion In-Car Telematics division was engaged in the brand building, marketing, promotion, and product development of a range of telematics solutions, including i-KEY, a technological breakthrough solution for drink driving prevention. As the global partner for i-KEY, the Group has embarked on a global marketing programme targeted at building a network of partners and licensees for the product launch. Initial market reception to the soft launch in Japan was encouraging. Within China, i-KEY was exhibited at several major hitech and automotive shows which drew a large audience and high profile publicity. In Europe, i-KEY was a Platinum Sponsor of the Annual Ignition Interlock Symposium recently held in France, which was attended by the major car manufacturers.

In March 2005, Champion Technology made the entry into the anti-radiation product market by announcing its initiative to test market and distribute in China anti-radiation products that counter electromagnetic pollution caused by mobile handsets. Various professional studies have indicated that radio frequency emissions may cause harm to the human body, with cancer, brain tumours, headaches and damage to DNA being named as the most common health risks.

The Group has carried out very extensive evaluation through its development team to gauge the effect on health of exposure to electromagnetic emissions. By early this year the Group was ready to introduce anti-radiation products that have been proved effective by studies and testings in counteracting electromagnetic waves generated by mobile phones. China is presently the world's largest mobile market with total users in excess of 370 million, and its fast-growing middle class are increasingly health-conscious. Initial response to the product was encouraging when it was introduced and sold on the Internet.

Kantone Holdings Limited ("Kantone")

Subsidiary Kantone's performance continued to improve. It recorded a turnover of HK\$1,127 million, an increase of 11 percent over the previous year. Net profit was HK\$268 million, representing an increment of 73 percent compared with HK\$155 million of the previous year.

Sales to China continued its momentum in line with the country's economic growth. With China's continued economic prosperity, Kantone's customised solutions and products have grown from strength to strength. A combination of factors such as natural economic growth, improved standards of living, and upcoming international events are growth drivers to sustain spending on telecoms and IT solutions.

In Europe, Kantone continued to expand on its dominant position within the healthcare and emergency services markets. The year under review saw the installation of new applications to deliver clinical efficiencies and improve emergency response times for the National Health Service (NHS) using wireless technology, and UK subsidiary Multitone was awarded key supplier status to the NHS as part of the latter's Purchase and Supply Agency (PASA) contracts. This has enabled Kantone to secure new businesses for key health authorities from its competitors, and its technologies are being adapted and introduced to key international markets.

In the US, Kantone has continued to benefit from the changes in the regulations with respect to new narrowband radio networks. The Federal Government has continued to upgrade the hospitals of the Veterans Administration throughout North America, of which Kantone has secured a market share of approximately 70 percent in terms of installation works. This places Kantone in a strong position to secure more business in the next phase of the band shift, which includes the Department of Defence.

Kantone has also seen expansion of its activities in the Middle East with the installation of onsite communications systems at a number of prestigious hotel and hospital sites throughout the region during the year.

DIGITALHONGKONG.COM ("Digital HK")

Subsidiary Digital HK reported full-year profit for the fourth consecutive year. It contributed HK\$1,240,000 to the Group's net profit, a growth of over four times compared with last year. Turnover for the year was HK\$8,724,000, compared with HK\$8,492,000 of last year. Digital HK has adapted admirably in the highly competitive marketplace and amidst the rapid technological changes in the IT industry. It continued to maintain momentum in its pursuit of business in relation to e-commerce solutions, and had benefited from a steadily growing customer base as there was increased awareness of its products and services.

In order to expand its revenue sources other than the provision of electronic payment services and IT consultancy, Digital HK had identified healthcare and related IT services as opportunity for future growth. It intends to participate more actively in the marketing and promotion of information medicine and online healthcare services through new investments and partnerships in order to achieve enhanced return. Digital HK had made a strategic investment in a bioinformatics project which focused on developing customised database design tools targeted at empowering the process of drug discovery. The project has reported steady progress, and is expected to contribute to the Digital HK's results in the coming years.

POST BALANCE SHEET EVENTS

Kantone's Acquisition of e-Lottery Business in China

On 23 August 2005, Kantone announced its move into the PRC electronic lottery market by acquiring a 60 percent interest in an investor (the "Investor") of a pioneer systems developer and service provider in paperless betting systems in China, Shenzhen Helper Science Development Co. Ltd. ("Shenzhen Helper"), which is engaged in providing technological support to PRC governmental lottery administration authorities in return for recurring revenue sharing of betting turnover. Shenzhen Helper has developed the telephone betting operating systems for the welfare lottery market in Shenzhen and Shanghai, where the bulk of the e-lottery activities in China takes place, and has entered into a new agreement with Anhui Province Welfare Lottery Centre for the design, development and maintenance of the paperless betting operating system for the entire Anhui province, as well as to assist in the development of e-lottery business in Anhui.

The acquisition consideration was HK\$52 million, with additional sum of HK\$18 million to be injected by Kantone to the Investor for its future development and expansion. In view of the rapid growth of China's lottery market, and the popularity of mobile phones and the Internet as communication medium, paperless lottery is expected to capture a significant share of the overall lottery growth, thereby having the potential to make contribution to Kantone's results in the forthcoming years.

Management Discussion and Analysis

Top-up Placing of Kantone Shares

On 23 September 2005, Kantone announced a top-up placing of 240 million Kantone shares at HK\$0.73 per share to institutional investors (the "Placing"). Upon completion of the Placing, Kantone will be able to raise net proceeds of about HK\$168 million, such amount to be applied to the investment in and future development of the e-lottery business including the above-mentioned acquisition, and general working capital of the Kantone group. In view of the current market conditions, the Placing represents an ideal opportunity for Kantone to raise additional funds for its future business developments, to enhance its capital base, and to increase its shareholders' base.

FINANCIAL REVIEW

During the year, the Group has achieved continued growth in turnover and net profit. Turnover increased to HK\$2,462 million, representing a rise of 9.4 percent as compared with HK\$2,250 million of the previous year. Net profit for the year was HK\$459 million, an increase of 55 percent as compared with HK\$297 million last year. Basic earnings per share for the year was HK37.94 cents (2004: HK32.13 cents), a rise of 18 percent.

The overall improved performance during the year reflected strong recurrent demand for the Group's customised solutions in wireless communications, where ongoing investments in our systems and networks have allowed us to significantly improve customer-service metrics while driving industry-leading productivity. The Group also realigned its operating activities targeted at achieving a higher return and a more stable income, while reducing the risks associated with an increased volume of business activity. In particular, the Group increased its use of outsourcing to third parties in terms of product distribution and development, which have helped to lower depreciation and amortisation expenses by HK\$116 million to HK\$199 million (2004: HK\$315 million). The Group's profit before minority interests was also helped by increased profit contribution of HK\$268 million from subsidiary Kantone (2004: HK\$155 million), and to a much lesser degree, profit contribution of HK\$1.24 million from another subsidiary Digital HK. The reduction of impairment losses recognised for investments from HK\$105 million to HK\$36 million also helped boost net profit.

Despite the general increase in interest rates during the year, finance costs for the year were lower at HK\$13 million (2004: HK\$18 million), as the Group benefited from the lower interest rate of convertible bonds.

LIQUIDITY AND FINANCIAL RESOURCES

The Group's financial position remained strong with a low gearing and a net cash position. During the year, the Company issued Additional Tranche 1 convertible bonds in the aggregate principal amount of US\$8 million (equivalent to approximately HK\$62.4 million) pursuant to the subscription agreement entered into between the Company and Credit Suisse First Boston (Hong Kong) Limited ("CSFB") on 22 May 2002 (and supplemented by an agreement dated 28 April 2005). Net proceeds raised amounted to HK\$60.3 million.

In April 2005, Champion's subsidiary, Kantone, issued a tranche of convertible bonds – Tranche 1 in the aggregate principal amount of US\$8 million (equivalent to approximately HK\$62.4 million) pursuant to a subscription agreement entered into by Kantone and CSFB on 1 April 2005 for the issue of up to US\$24 million 1 percent unlisted and unsecured convertible bonds due 2008. Net proceeds raised amounted to HK\$60.1 million.

As at 30 June 2005, the Group had HK\$738 million made up of deposits, bank balances and cash. Current assets were approximately HK\$1,637 million (2004: HK\$1,529 million) and current liabilities amounted to approximately HK\$329 million (2004: HK\$345 million). With net current assets of HK\$1,309 million, the Group had maintained a high level of financial liquidity. The gearing ratio at the end of the year, which calculation was based on the Group's total borrowings of HK\$193 million (2004: HK\$173 million) and shareholders' funds of HK\$4,705 million (2004: HK\$4,232 million), was 0.04 (2004: 0.04).

Total borrowings comprise bank borrowings of HK\$59 million (2004: HK\$105 million); other borrowings, which represent block discounting loans, of HK\$9 million (2004: HK\$17 million); obligations under finance lease of less than HK\$1 million (2004: less than HK\$1 million); and convertible bonds of HK\$125 million (2004: HK\$51 million). Finance costs for the year amounted to HK\$13 million (2004: HK\$18 million). The reduced level of borrowing was a result of the Group's adoption of equity financing during the year. The new funds as mentioned above helped the Group to reduce its reliance on borrowing to meet its working capital requirements.

Included in the bank borrowings of HK\$58,920,000 were bank loans and overdrafts of HK\$2,866,000 (2004: HK\$3,020,000) being secured by the Group's land and buildings with a net book value of HK\$10,277,000 (HK\$10,467,000). These borrowings comprise debts of HK\$1,148,000, HK\$672,000 and HK\$1,046,000 repayable within one year, the second year and in the third to fifth year respectively. The unsecured bank borrowings of HK\$56,054,000 were repayable on demand.

The other borrowings of HK\$9,202,000 are unsecured, with HK\$4,309,000 repayable within one year, HK\$2,594,000 repayable in the second year and the remaining in the third to fifth year.

As at 30 June 2005, the Group had outstanding convertible bonds of USD16 million, with USD 8 million due by the Company on 22 November 2005 and the remaining USD 8 million due by Kantone on 1 April 2008.

Except for the USD convertible bonds, all other borrowings were used by the subsidiaries of Group, bearing interest at floating rates, and were denominated in local currencies and the currency risk exposure associated with the Group's borrowings was insignificant.

CAPITAL COMMITMENTS

As at 30 June 2005, the Group's capital commitments contracted for but not provided in was HK\$69,000 (2004: Nil) and the Group's capital commitments authorised but not contracted for was HK\$388,000,000 (2004: HK\$319,897,000). These commitments were set aside for the acquisition of property, plant and equipment, and systems and networks.

EXPOSURE TO EXCHANGE RATE FLUCTUATIONS

The Group does not engage in interest rate or foreign exchange speculative activities. It is the Group's policy to manage foreign exchange risk through matching foreign exchange income with expense, and where exposure to foreign exchange is anticipated, appropriate hedging instrument will be used.

In the normal course of business, the Group has entered into a forward contract with creditworthy financial institution in order to limit its exposure to adverse fluctuations in foreign currency exchange rates. Gains and losses on these contracts serve as hedges in that they offset fluctuations that would otherwise impact the Group's financial results. Costs associated with entering into such contract are not material to the Group's financial results.

FINAL DIVIDEND AND SCRIP DIVIDEND SCHEME

Subject to the approval of shareholders at the forthcoming Annual General Meeting, the directors have proposed a final dividend of HK3.1 cents per share for the year ended 30 June 2005 (2004: HK2.7 cents per share) to shareholders whose names appear on the register of members of the Company on 25 November 2005. Taking into account the interim dividend of HK1.7 cents per share paid on 8 June 2005, total dividends for the year would amount to HK\$59.9 million, an increase of 8.3 percent over HK\$55.3 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 25 January 2006.

BONUS ISSUE OF WARRANTS

On 27 October 2005, the directors of the Company propose a bonus issue of new warrants to subscribe for shares of the Company equal to 20% of the number of shares of HK\$0.10 each of the Company ("Shares") in issue on 17 February 2006 ("New Warrants") to the shareholders of the Company on the register of members on 25 November 2005 in proportion as nearly as may be to their then shareholding in the Company (the "Bonus Issue").

As at the date of this report, the Company has outstanding (a) warrants which subscription period will expire on 16 February 2006; and (b) subscription rights granted to Credit Suisse First Boston (Hong Kong) Limited to subscribe for (i) 4,949,397 Shares at HK\$2.3635 per Share until 22 November 2005 ("CSFB Subscription Rights").

The New Warrants will be issued in registered form in units of HK\$1.15 of subscription rights entitling their holders to subscribe for shares of the Company at a price of HK\$1.15 per Share (subject to adjustments) at any time for a period of one year from the date of issue thereof (which is expected to be 27 February 2006) (after the expiry of the existing warrants of the Company on 16 February 2006 and the CSFB Subscription Rights on 22 November 2005)).

The Bonus Issue is conditional upon the approval of shareholders at a general meeting of the Company and the Listing Committee of The Stock Exchange of Hong Kong Limited granting listings of and permission to deal in the New Warrants and the Shares that fall to be issued on the exercise of the subscription rights thereunder.

A circular setting out the details of the Bonus Issue and incorporating a notice of a general meeting of the Company to approve the Bonus Issue will be sent to the shareholders of the Company as soon as practicable.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from 21 November 2005 to 25 November 2005, both days inclusive, during which period no transfer of shares will be effected. In order to qualify for the final dividend, the scrip dividend scheme and the Bonus Issue, all transfers of shares accompanied by the relevant share certificates and, in the case of warrant holders, all duly completed subscription forms accompanied by the relevant warrant certificates and the appropriate subscription moneys, must be lodged with the Company's Branch Share Registrars in Hong Kong, Secretaries Limited at Ground Floor, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong by no later than 4:00 p.m. on 18 November 2005.