

## MANAGEMENT DISCUSSION AND ANALYSIS

Amidst an improved operating environment and a more conducive investment climate, the Group had enjoyed steady progress in its major business activities during the period under review.

### Financial Results

The Group achieved a turnover of HK\$658 million for the six months ended 31 December 2005 (the “Period”), an increase of 24 percent as compared with HK\$530 million for the six months ended 31 December 2004 (the “Previous Period”). Profit attributable to equity holders for the Period was HK\$158 million, an increase of 24 percent as compared with HK\$127 million for the Previous Period. EBITDA (earnings before interest, taxation, depreciation and amortisation) rose by 29 percent to HK\$215 million. Before taking into account of HK\$25.9 million change in fair value of convertible bonds (see Note 3 for details) in line with the adoption of new accounting standards, profit before taxation was HK\$183 million, an increase of 43% over Previous Period. Earnings per share for the Period was HK6.27 cents, an increase of 14 percent as compared with HK5.51 cents for the Previous Period. The increase in turnover was mainly attributable to increased sales of existing and new products to the established customer base as well as the expanding clientele covering new markets.

Gross profit increased by 39 percent to HK\$303 million, and gross margin improved to 46 percent of turnover from 41 percent of the Previous Period. Such results were attributable to the Group’s continued investment in product development and systems advancement, thereby enhancing the value-added features of its products and solutions, and in turn helping drive industry-leading productivity. Total operating expenses have gone up largely in line with the increase in turnover and as a result of a general increase in staff costs. General and administrative expenses were HK\$42 million, up 38 percent (2004: HK\$30 million); depreciation and amortisation expenses were HK\$55 million, up 58 percent (2004: HK\$35 million); while distribution costs remained steady at HK\$26 million. Thanks to efficient outsourcing and cost control measures, Kantone’s operating margin at 28 percent of turnover (excluding HK\$25.9 million change in fair value of convertible bonds) was an improvement from 25 percent of the Previous Period.

Despite the general increase in interest rates during the Period, finance costs of HK\$2.6 million (2004: HK\$3.5 million) for the Period were lower by HK\$0.9 million, attributed to the lower interest rate of convertible bonds.

## Review of Operations

The Group continued to benefit from China's robust economy, where sales maintained its momentum in line with the country's economic growth. Telecom and related sectors were under increasing competitive pressure to invest in core network equipment to provide greater network capacity as well as to improve the quality of their networks, hence the demand for enhanced network monitoring, network security equipment and software continued. The success of China's aerospace projects as well as the forthcoming award of 3G telecom licenses are also drivers to the growth in investment in the telecoms and related sectors. For the six-month period, China sales accounted for HK\$408 million of the Group's turnover (2004: HK\$348 million).

In October 2005, Kantone completed its acquisition of a controlling stake in a pioneer systems developer and service provider in paperless betting systems in China, providing technological support to PRC governmental welfare lottery administrative authorities in return for recurring revenue sharing of betting turnover. Telephone betting systems in Shanghai and Shenzhen, including the launch of SMS assisted services, have proved popular, and the new e-lottery business is making a positive, albeit modest, contribution to Kantone's earnings. A third project to install the paperless betting operating system for the entire Anhui province is progressing smoothly, and is expected to be launched shortly. If paperless betting were to follow the trend of the high adoption rate of other technologies such as mobile phones and Internet usage, e-lottery will have a significant impact on China's overall lottery market.

In Europe, Kantone continued to expand on its dominant position within the healthcare and emergency services Command and Control Communications (CCC) market space. UK sales registered steady growth. The award of key supplier status by the National Health Service (NHS) as part of the latter's Purchase and Supply Agency (PASA) has won Kantone a number of new contracts in the personal security arena.

In the US, Kantone continued to benefit from the Federal Government's spectrum migration programme for public sector networks.

Meanwhile, Kantone continues to invest in research and development, and has a number of exciting products in the development pipeline. Some of these are designed to consolidate and improve existing markets. However, Kantone is also looking to utilise its skills and IPRs (intellectual property rights) in wireless technologies to expand into new business areas and markets within the rapidly expanding technology arena.