

# Endace Limited

## Press Announcement



FOR IMMEDIATE RELEASE

14 November 2006

### ENDACE LIMITED

#### INTERIM RESULTS FOR THE SIX MONTH PERIOD ENDED 30 SEPTEMBER 2006

Endace Limited ("Endace" or the "Group") (AIM: EDA), a world leader in high speed, high capacity IT network security and analysis products, is pleased to announce its unaudited interim results for the six months ended 30 September 2006 prepared under New Zealand equivalents to International Reporting Standards (NZ IFRS) for the first time.

#### Financial highlights

- Revenue up 44% on prior year to \$6.2m (H1, 2005: \$4.3m).
- Profit before tax and foreign exchange movements of \$591,000 (H1, 2005: loss of \$30,000).
- Pre-tax profit of \$882,000 (H1, 2005: \$193,000).
- Functional currency changed to US dollars from NZ dollars with effect from 1 April 2006.
- Cash position slightly higher over the six months at \$6.74m (March 2006: \$6.68m).

#### Operational highlights

- Secured a significant initial sale of Endace's OC768 network monitoring solution to one of the world's largest telecommunications companies, enabling the highest network speed now achievable with commercially available equipment.
- Signed a technology licensing agreement with Sprint Nextel Corp., a world leader in communications services, for two of their network traffic products.
- Commenced strategic alignment of company resources along two main product lines, network monitoring cards and Ninja platforms, to improve focus on new, higher yielding markets.

#### Commenting on the results, Endace's Chief Executive Officer, Selwyn Pellet said:

*"I am pleased to report a successful first half year trading result with strong revenue and profit growth over the same period last year. Our current backlog of orders gives us confidence for continued growth during our second half year."*

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#### About Endace

Endace is a world leader in high speed, high capacity IT network security and analysis software, firmware and hardware. Based in Manukau City, near Auckland, New Zealand, Endace also has offices in the UK and USA. Quoted on AIM, the stock code is LSE: EDA. For further information: <http://www.endace.com>.

## Interim Statement

### Introduction

Endace has made strong progress during the six months to 30 September 2006, both operationally and in terms of growth in revenues and profits.

The market for security systems for data networks operated by major corporations is growing and evolving rapidly. In order to meet and benefit from these changes in the market, Endace recently launched new high performance products and is placing an increasing emphasis on offering complete software and hardware solutions, known as 'security appliances'. To reflect this changing emphasis, Endace is altering its internal organisation in order to make the most of these new opportunities; further details are provided later in this statement.

### Results and finance

The results highlights are:

US\$000's	6 months to 30 September		
	2006	2005	Change
Revenue	6,245	4,346	+44%
Gross profit	4,569	3,234	+41%
Gross margin	73%	74%	
Profit before foreign exchange movements	591	(30)	n/a
Foreign exchange gain*	291	223	
Profit before tax	882	193	+357%

\* Realised and unrealised; see below for further details

For the first time the Group results (including comparatives) have been prepared in accordance with NZ IFRS. The results were previously reported under UK generally accepted accounting principles (UK GAAP), which was also the basis of the annual report issued in August this year. The net effect of the adoption of NZ IFRS was to increase profit before tax by \$60,000 for the six months ended 30 September 2006 with a similar impact on the prior comparative period. Further details of the differences between the NZ IFRS and UK GAAP results, as they apply to the Group, can be found in note 10 to this statement.

As announced recently, because Endace executes the bulk of its business in US dollars, it has changed its functional currency to US dollars with effect from 1 April 2006. Accordingly, these results have been prepared using US dollars as the functional currency of the Group. At the time of the IPO in June 2005, Endace adopted NZ dollars as its functional currency and US dollars as its presentational currency. In previous reporting periods, this gave rise to significant unrealised and realised foreign exchanges gains/losses which had little relevance to trading.

The results announced today include a realised foreign exchange gain of \$113,000. In the future, foreign exchange exposure will be limited mainly to establishment costs and salaries incurred in NZ dollars and revenues denominated in pounds and euros.

During the half year, revenue increased by 44% with growth being achieved across all sales regions with the US market showing the strongest growth. The top 10 customers represented 63% of total revenue, similar to the same period last year. Six of the top 10 customers this period were also present in the top 10 last year, reflecting a high amount of repeat business. Average selling prices are marginally down from \$5,181 at the end of March 2006 to \$4,987 due to changes in product mix.

Although overhead costs increased by 20% compared to the same period last year. In absolute terms, they have reduced from 80% to 67% as a percentage of revenue. As planned the Group has controlled overhead spending by keeping the monthly overhead costs consistent with the level incurred during the six months to 31 March 2006.

With increased sales volumes and control over costs, operating profit before foreign exchange differences represents a margin of 9.4% of revenue, compared to a loss for the six months to September 2005.

Despite strong growth and investment in future products, tight control of working capital during the half year has resulted in a small increase in cash to \$6.7m compared to the cash position at the beginning of the period.

## **Review of operations**

### ***Network monitoring cards***

New card products released over the past six months have maintained Endace's lead over the competition, providing more functionality, reliability and improved profit margins.

The Group continues to innovate in the development of its network monitoring card business. In August the Group announced the initial sales of its OC768 network monitoring solution to one of the world's largest telecommunications companies.

OC768, running at 40 gigabits per second (40 Gbps), is the highest network speed now achievable with commercially available equipment.

The wide range of connectivity options offered by the Endace card product line enables its customers and channel partners to deploy its solutions in a wide range of network connectivity scenarios. Management believes this positions the Group well as it starts to leverage its core technology and understanding into the current and planned Ninja family of integrated platform offerings.

### ***Platforms***

The Endace Ninjabox family has been developed for network engineers needing to deploy network security and analysis applications quickly and cost effectively. Endace's initial platform product, the Ninjabox ships with fully integrated Endace hardware, open source operating system, and web user interface. The platform is designed to accelerate the deployment of network monitoring and data capture applications and has been an important step in the Group's move towards offering more integrated appliance solutions.

Based on the market acceptance of this approach Endace has now made a significant commitment towards developing and delivering fully integrated appliance solutions. The first move towards this strategy was signalled by the recently announced licensing agreement with Sprint Nextel.

### ***Sprint licence agreement***

As previously announced, the Group entered into a technology licensing agreement with Sprint Nextel (NYSE: S), a world leader in communications services. The agreement provides Endace access to two of Sprint Nextel's innovative software applications that are designed to improve the capture, analysis, and classification of network traffic.

When combined with Endace's advanced hardware technology, these applications enable superior network security event detection and mitigation. This licensing arrangement demonstrates Endace's commitment to its appliance strategy, as the resulting products will represent fully integrated appliance solutions. Endace expects to commence delivery of products resulting from this technology licensing in early 2007.

## **Strategy for Growth**

### ***Market forces***

As anticipated, Endace's customers are starting to demand integrated solutions. As acceptance of the advanced network monitoring capabilities of Endace hardware technology increases, Endace is exploring with its customers how the customer can realise the value of fully integrated solutions which enable data to be analysed simultaneously in multiple locations and with an increasing level of automation.

Such solutions need to answer network space and power consumption restrictions, while also delivering ease of use and ongoing maintenance. These solutions can only be achieved through the integration of Endace hardware with firmware and application software integrated into an appliance solution. The need to deploy multiple security applications into distributed network environments has fuelled the growth of the UTM (unified threat management) appliance industry, and, as discussed previously, is a leading indicator of growth in the security appliance industry as a whole.

### ***Endace resource alignment***

Anticipating the market trend towards integrated hardware and software solutions, Endace has increased the resources devoted to developing appliance solutions. While network monitoring cards will continue to be the Group's foundation and ongoing technological differentiation, customer demand for integrated solutions now requires a realignment of our resources to address this important opportunity.

As a result, a decision has been made to split the research and development teams into appliance and card groups to allow a clear focus for this strategy. Marketing and product management has also been split to support these two divisions and manage the 'go to market' strategy.

Sales of fully integrated appliance solutions will significantly elevate repeat revenues, driven by annual software maintenance and application software licence revenue opportunities. The Group also believes that the delivery of appliances will open up access to additional Systems Integrator (SI) sales channels as well as enable us to partner with a wider set of Independent Software Vendors (ISVs).

## **Management**

During the past six months a number of key personnel have been added to the Group's senior management team, including Nicole Ho, Vice President of Asia Pacific Sales, Mike Riley, Vice President of Worldwide Marketing and Annie Rastello, Card Group Manager. All three join Endace with a wealth of global experience and will help to guide the business through the next stage of development.

## **Outlook**

Whilst the Group's business is traditionally weighted towards the second half of the year, the higher level of backlog orders gives the Board confidence that Endace will continue to perform in line with the their expectations.

**CONSOLIDATED INCOME STATEMENT  
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006**

		<b>6 Months Ended 30 Sept 2006 (unaudited) US\$'000</b>	<b>6 Months Ended 30 Sept 2005 (unaudited) US\$'000</b>	<b>12 Months Ended 31 March 2006 (audited) US\$'000</b>
	<b>Note</b>			
<b>Revenue</b>	3	6,245	4,346	10,989
Cost of sales		(1,676)	(1,112)	(2,750)
<b>Gross profit</b>		<u>4,569</u>	<u>3,234</u>	<u>8,239</u>
Other income		212	214	542
Selling and administrative expenses		(2,190)	(2,108)	(4,557)
Research and development expenses		(1,708)	(1,147)	(2,651)
Finance cost		(1)	-	(25)
<b>Profit before taxation</b>		<u>882</u>	<u>193</u>	<u>1,548</u>
Income tax expense	7	(278)	(79)	(302)
<b>Profit for the period</b>		<u>604</u>	<u>114</u>	<u>1,246</u>
<b>Earnings per share</b>		<b>US cents</b>	<b>US cents</b>	<b>US cents</b>
- basic	4	4.10	0.92	8.46
- diluted	4	3.96	0.89	8.23

The notes which follow are an integral part of these financial statements.

**CONSOLIDATED BALANCE SHEET  
AS AT 30 SEPTEMBER 2006**

	As at 30 Sept 2006 (unaudited) US\$'000	As at 30 Sept 2005 (unaudited) US\$'000	As at 31 March 2006 (audited) US\$'000
<b>Non-current assets</b>			
Property, plant and equipment	1,074	911	1,048
Goodwill	2,020	2,274	2,020
Other intangible assets	507	411	542
<b>Total non-current assets</b>	<u>3,601</u>	<u>3,596</u>	<u>3,610</u>
<b>Current assets</b>			
Inventories	1,680	463	1,590
Trade and other receivables	5,161	2,661	5,231
Cash and cash equivalents	6,741	9,200	6,678
<b>Total current assets</b>	<u>13,582</u>	<u>12,324</u>	<u>13,499</u>
<b>Total assets</b>	<u><u>17,183</u></u>	<u><u>15,920</u></u>	<u><u>17,109</u></u>
<b>Non-current liabilities</b>			
Long term provisions	-	-	42
<b>Total non-current liabilities</b>	<u>-</u>	<u>-</u>	<u>42</u>
<b>Current Liabilities</b>			
Trade and other payables	340	121	902
Current tax payable	237	(309)	64
Short term provisions	1,333	849	1,484
<b>Total current liabilities</b>	<u>1,910</u>	<u>661</u>	<u>2,450</u>
<b>Total liabilities</b>	<u>1,910</u>	<u>661</u>	<u>2492</u>
<b>Equity</b>			
Share capital	14,469	16,182	14,439
Other reserve - translation reserve	(147)	(2)	(147)
Retained earnings	951	(921)	325
<b>Total equity</b>	<u>15,273</u>	<u>15,259</u>	<u>14,617</u>
<b>Total equity and liabilities</b>	<u><u>17,183</u></u>	<u><u>15,920</u></u>	<u><u>17,109</u></u>

The notes which follow are an integral part of these financial statements.

**CONSOLIDATED CASH FLOW STATEMENT  
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006**

	<b>6 Months Ended 30 Sept 2006 (unaudited) US\$'000</b>	<b>6 Months Ended 30 Sept 2005 (unaudited) US\$'000</b>	<b>12 Months Ended 31 March 2006 (audited) US\$'000</b>
<b>Operating activities</b>			
Cash was provided from			
Receipts from customers	6,878	4,071	8,815
Interest received	157	164	420
Grants	51	-	122
	<u>7,086</u>	<u>4,235</u>	<u>9,357</u>
Cash was applied to			
Payments to suppliers	(4,397)	(2,730)	(6,022)
Payments to employees	(2,227)	(2,369)	(4,832)
Interest paid	(1)	-	(25)
Income tax paid	(113)	(214)	(644)
	<u>(6,738)</u>	<u>(5,313)</u>	<u>(11,523)</u>
<b>Net cash in/outflows from operating activities</b>	<u>348</u>	<u>(1,078)</u>	<u>(2,166)</u>
Cash was applied to			
Purchase of intellectual property	(37)	(176)	(294)
Purchase of tangible fixed assets	(268)	(562)	(1,079)
	<u>(305)</u>	<u>(738)</u>	<u>(1,373)</u>
<b>Net cash outflow from investing activities</b>	<u>(305)</u>	<u>(738)</u>	<u>(1,373)</u>
<b>Financing activities</b>			
Cash was provided from			
Issue of ordinary share capital on AIM listing	-	14,088	14,088
Net share repurchase and issue	11	-	-
Issue of convertible notes	-	1,291	1,048
	<u>11</u>	<u>15,379</u>	<u>15,136</u>
Cash was applied to			
IPO costs	-	(2,328)	(2,328)
Dividend	-	(1,757)	(1,757)
Payment of borrowings	-	(492)	(492)
Convertible Loans	(75)	-	-
	<u>(75)</u>	<u>(4,577)</u>	<u>(4,577)</u>
<b>Net cash in/outflows from financing activities</b>	<u>(64)</u>	<u>10,802</u>	<u>10,559</u>
<b>Net increase/(decrease) in cash held</b>	<u>(21)</u>	<u>8,986</u>	<u>7,020</u>
Cash a beginning of year	6,678	364	364
Exchange Differences	84	(150)	(706)
Cash at end of year	<u>6,741</u>	<u>9,200</u>	<u>6,678</u>
<b>Composition of cash</b>			
Cash and bank balances	<u>6,741</u>	<u>9,200</u>	<u>6,678</u>

The notes which follow are an integral part of these financial statements.

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY  
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006**

	Share Capital US\$'000	Foreign Currency translation reserve US\$'000	Retained earnings US\$'000	Total equity US\$'000
<b>Balance as at 1 April 2005</b>	<b>3,281</b>	<b>15</b>	<b>710</b>	<b>4,006</b>
Placing of shares at 162 pence per share	14,088	-	-	14,088
Admission and initial placing costs	(2,328)	-	-	(2,328)
Nethawk convertible note converted to shares	1,048	-	-	1,048
Capital raised on employee options	51	-	-	51
Exchange difference	42	(17)	(58)	(33)
Share option compensation expense	-	-	70	70
Dividend paid	-	-	(1,757)	(1,757)
Retained profit for the period	-	-	114	114
<b>Balance as at 30 September 2005</b>	<b>16,182</b>	<b>(2)</b>	<b>(921)</b>	<b>15,259</b>
Shares issued in partial consideration of nCap licence	42	-	-	42
Capital raised on employee options	2	-	-	2
Share option compensation expense	-	-	22	22
Share options forfeited	-	-	(2)	(2)
Share options exercised	-	-	53	53
Exchange difference	(1,787)	(145)	41	(1,891)
Retained profit for the period	-	-	1,132	1,132
<b>Balance as at 31 March 2006</b>	<b>14,439</b>	<b>(147)</b>	<b>325</b>	<b>14,617</b>
Admission and initial placing costs	19	-	-	19
Share option compensation expense	-	-	33	33
Share options exercised	11	-	(11)	-
Retained profit for the period	-	-	604	604
<b>Balance as at 30 September 2006</b>	<b>14,469</b>	<b>(147)</b>	<b>951</b>	<b>15,273</b>

The notes which follow are an integral part of these financial statements.

## NOTES TO THE INTERIM FINANCIAL STATEMENT

### 1 General information

Endace Limited ("Endace" or the "Group") operates in the network security and monitoring market sectors.

The Group has operations in the United States, the United Kingdom and New Zealand. The Group is a limited liability company incorporated and domiciled in New Zealand. The address of its registered office is Building 7, 17 Lambie Drive, Manukau City, New Zealand. The Group has its primary listing on the Alternative Investment Market (AIM) of the London Stock Exchange. These consolidated interim statements have been approved for issue by the Board of Directors on 13 November 2006.

### 2 Summary of significant accounting policies

These interim financial statements for the six months ended 30 September 2006 have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

#### (a) Basis of preparation

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

##### *Compliance with IFRS*

The separate and consolidated interim financial statements of Endace also comply with International Financial Reporting Standards (IFRS).

##### *Entities reporting*

The consolidated interim financial statements incorporate the assets and liabilities of all subsidiaries of the Group as at 30 September 2006 and the results of all subsidiaries of the Group for the six months then ended. Endace Limited and its subsidiaries together are referred to in these interim financial statements as the Group and are designated as profit oriented entities for financial reporting purposes.

##### *Statutory base*

Endace is a company registered under the Companies Act 1993 (New Zealand). The financial statements have been prepared in accordance with the requirements of the Financial Reporting Act 1993 (New Zealand) and the Companies Act 1993 (New Zealand).

##### *Application of NZ IFRS 1 First-time adoption of New Zealand equivalents to International Financial Reporting Standards*

These interim financial statements are the first Group financial statements to be prepared in accordance with NZ IFRS.

Financial statements of the Group for the year ended 31 March 2006 were prepared in accordance with UK GAAP. UK GAAP differs in certain respects from NZ IFRS. When preparing the financial statements, the Group has amended certain accounting, valuation and consolidation methods applied in the UK GAAP financial statements to comply with NZ IFRS. The comparative figures in respect of September 2005 and March 2006 were restated to reflect these adjustments.

The Group has applied NZ IFRS 1 in preparing these consolidated financial statements. The Group's date of transition is 1 April 2005 and the opening NZ IFRS balance sheet is prepared as at that date (see note 9). The reporting date of these interim financial statements is 30 September 2006 and Endace's NZ IFRS adoption date is 1 April 2006. The Group has restated the comparative figures as set out in these interim financial statements for compliance with NZ IFRS and a reconciliation to the original published financial statements is set out in note 9.

In accordance with NZ IFRS 1, the Group has applied the mandatory exceptions and the optional exemption relating to business combinations from full retrospective application of NZ IFRS. Business combinations that took place prior to the transition date of 1 April 2005 have not been restated.

##### *Interim financial statements*

These interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting.

##### *Historical cost convention*

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and liabilities (including derivative instruments) at fair value through the income statement.

*Critical accounting estimates*

The preparation of financial statements requires the use of certain critical accounting estimates. It also requires Endace to exercise its judgement in the process of applying the Group's accounting policies.

**(b) Principles of consolidation***(i) Subsidiaries*

Subsidiaries are all those entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Merger accounting was used by Endace Limited to acquire Endace Technology Limited. Endace Measurement Systems Limited has been accounted for using the purchase method of accounting.

Where the purchase method of accounting is used to account for the acquisition of subsidiaries by the Group, the cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement. Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of the impairment of the asset transferred.

**(c) Segment reporting**

A geographical segment is engaged in providing products or services within a particular economic environment and may be subject to risks and returns that are different from those of segments operating in other economic environments. A business segment is a Group of assets and operations engaged in providing products or services that may be subject to risks and returns that are different to those of other business segments. Endace has determined that its primary segments are geographical and as such it operates in one business segment..

**(d) Foreign currency translation***(i) Functional and presentation currency*

Items included in the financial statements of each of the Group's operations are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that operation ('functional currency').

Until 31 March 2006 the Group adopted the NZ dollars as its functional currency and US dollars as its presentation currency. Following a review of its functional currency, undertaken in accordance with NZ IAS 21 (Accounting for the effect of changes in foreign exchange rates) it was identified that US dollars has now become the currency that best reflects the economic substance of the underlying events and circumstances relevant to the Group.

Endace has changed its functional currency to US dollars effective from 1 April 2006. As this is not a change in accounting policy there is no restatement of the prior period balances and transactions. These interim financial statements are presented in US dollars.

*(ii) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges. Translation differences on non-monetary items are reported as part of the fair value gain or loss. Translation differences on non-monetary items are included in the fair value reserve in equity.

Exchange differences arising from the translation of any net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity.

**(e) Revenue recognition**

Revenue is recognised as follows:

*Product income*

The Group recognises revenue in respect of the sale of goods when significant risks and rewards of ownership are transferred to the buyer. This is when delivery occurs and the Group has no further obligations.

*Development income*

Revenue from product development is recognised on a percentage to completion basis over the period from commencement and development to customer acceptance. Under the percentage to completion method, provisions for estimated losses on uncompleted contracts are recognised in the period in which the likelihood of such losses is determined. The percentage to completion is measured by monitoring progress using records of actual costs incurred to date in the project compared with the total estimated project requirement, which approximates to the extent of performance.

*Support income*

The Group recognises revenue in respect of support services when the services are provided. Support is an option offered to customers on annual terms invoiced in advance. Revenue is recognised on a straight line basis over the period for which support is contractually agreed by the Group with the customer. The excess of support income invoiced over revenue recognised is recorded as deferred income.

*(ii) Interest Income*

Interest income is recognised on a time proportion basis using the effective interest method.

**(f) Government grants**

Revenue based government grants are recognised on a systematic basis in the income statement as other operating income over the periods necessary to match it with the costs that it is intended to compensate.

**(g) Research and development**

Expenditure incurred in research and product development and testing is charged to the income statement in the period in which it is incurred, unless the development expenditure meets the criteria for capitalisation.

Where the expenditure meets the criteria for capitalisation, development costs are capitalised and amortised over their useful economic lives.

**(h) Income tax**

The income tax expense for the period is the tax payable on the current period's taxable income, based on the income tax rate for each jurisdiction. This is then adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements, and changes in unutilised tax losses.

**(i) Deferred taxation**

Deferred tax assets and liabilities are recognised for temporary differences at the tax rates expected to apply when the assets are recovered or liabilities are settled, based on those tax rates which are enacted or substantively enacted for each jurisdiction. The relevant tax rates are applied to the cumulative amounts of deductible and taxable temporary differences to measure the deferred tax asset or liability. An exception is made for certain temporary differences arising from the initial recognition of an asset or a liability. No deferred tax asset or liability is recognised in relation to these temporary differences if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting profit or taxable profit or loss. Deferred tax assets are recognised for deductible temporary differences and unutilised tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses. Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in foreign operations where the Group is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

**(j) Leases**

Leases under which all the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Operating lease payments are recognised as an expense on a straight line basis over the lease term, even if the payments are not made on such a basis.

**(k) Impairment of assets**

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

**(l) Goods and services tax (GST)**

GST is the New Zealand equivalent of UK value added tax. The profit and loss account has been prepared so that all components are stated exclusive of GST. All items in the balance sheet are stated net of GST, with the exception of trade debtors and trade creditors which include GST invoiced.

**(m) Cash and cash equivalents**

Cash and bank balances includes cash on hand, deposits held at call with financial institutions, other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

**(n) Trade receivables**

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost less provision for impairment of receivables. The recoverability of trade receivables is reviewed on an ongoing basis. Debts which are known to be non-recoverable are written off. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables.

**(o) Inventories**

Inventories are stated at the lower of cost and net realisable value determined on a first in, first out basis.

**(p) Derivatives**

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured to their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either hedges of the fair value of recognised assets or liabilities or a firm commitment (fair value hedges) or hedges of exposures to variability in cash flows associated with recognised assets or liabilities or highly probable forecast transactions (cash flow hedges).

At the inception of the transaction, Endace documents the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions have been and will continue to be highly effective in offsetting changes in fair values or cash flows of hedged items.

*(i) Fair value hedge*

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognised in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

*(ii) Cash flow hedge*

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity in the hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are recycled in the income statement in the periods when the hedged item will affect profit or loss (for instance when the forecast sale that is hedged takes place). However, when the forecast transaction that is hedged results in the recognition of a non-financial asset (for example, stock) or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the measurement of the initial cost or carrying amount of the asset or liability.

When a hedging instrument expires or is sold or terminated, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

*(iii) Derivatives that do not qualify for hedge accounting*

Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement.

**(q) Convertible debt**

On issue of convertible debt, the fair value of the convertible option is recognised and presented as a liability since at inception the instrument will not convert into a fixed number of equity shares. The obligation to make future payments of principal and interest to note holders is carried as a liability until extinguished on conversion or maturity of the notes.

**(r) Property, plant and equipment**

Property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Cost may also include transfers from equity of any gains/losses on qualifying cash flow hedges of foreign currency purchases of property, plant and equipment. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred. Depreciation on other assets is calculated using the straight-line method to allocate their cost, net of their residual values, over their estimated useful lives, as follows:

	<u>Rate per annum</u>
Furniture and fittings	12%
Leasehold improvements	Shorter of 12.5% and the life of the lease
Office equipment	20%
Laboratory and test equipment	22%
Computer hardware	33%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing proceeds with the carrying amount.

**(s) Intangible assets***(i) Goodwill*

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired business at the date of acquisition. Goodwill on acquisitions of businesses is included in intangible assets. Goodwill acquired in business combinations is not amortised. Instead, goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired, and is carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold. Goodwill is allocated to cash generating units for the purpose of impairment testing.

*(ii) Acquired software*

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (three to seven years).

**(t) Employee benefits***(i) Salaries and annual leave*

Liabilities for salaries, including non-monetary benefits and annual leave expected to be settled within 12 months of the reporting date, are recognised in other payables in respect of employees' services up to the reporting date and are measured at the amounts expected to be paid when the liabilities are settled.

*(ii) Share-based payments*

The Group established an equity settled share based compensation plan on 23 December 2004. The fair value of the options granted is recognised as an expense in the profit and loss account and credited to the share option reserve over the vesting period. The total amount to be charged over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non market vesting conditions (for example, profitability and sales growth targets). Non market vesting conditions are included in assumptions about the number of options that are expected to become exercisable.

The proceeds received net of any directly attributable transaction costs are credited to share capital when the options are exercised.

**(u) Share capital**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds. Where any Group company purchases the company's equity share capital, the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the company's equity holders until the shares are cancelled, reissued or disposed of.

Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the company's equity holders.

**(v) Earnings per share***(i) Basic earnings per share*

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year.

*(ii) Diluted earnings per share*

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year plus the potential ordinary shares exercisable from issued options.

**3 Segment reporting**

The Group's revenue is attributable to the principal activities being sales, marketing and distribution of the products developed by the Group.

**Revenue**

Analysis of revenue based on territory of destination:

	<b>6 Months Ended 30 Sept 2006 (unaudited) US\$'000</b>	<b>6 Months Ended 30 Sept 2005 (unaudited) US\$'000</b>	<b>12 Months Ended 30 March 2006 (audited) US\$'000</b>
<b>Geographical analysis</b>			
North America	3,185	1,737	4,797
Europe, Middle East, Africa	2,123	2,001	4,761
Asia Pacific	937	608	1,431
<b>Total</b>	<b>6,245</b>	<b>4,346</b>	<b>10,989</b>

Revenue between segments is immaterial. All revenue originated from Asia Pacific.

**Profit before tax**

Analysis of operating profit based on territory of destination:

	<b>6 Months Ended 30 Sept 2006 (unaudited) US\$'000</b>	<b>6 Months Ended 30 Sept 2005 (unaudited) US\$'000</b>	<b>12 Months Ended 30 Sept 2006 (audited) US\$'000</b>
<b>Geographical analysis</b>			
North America	127	69	216
Europe, Middle East, Africa	85	80	235
Asia Pacific	514	(120)	702
<b>Operating profit</b>	<b>726</b>	<b>29</b>	<b>1,153</b>
Net interest income/(expense)	156	164	395
<b>Total</b>	<b>882</b>	<b>193</b>	<b>1,548</b>

#### 4 Earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year. On 4 May 2005 a 6:1 share split occurred, on 31 May 2005 all 546 class A shares were repurchased and subsequently cancelled, and on 9 June 2006 a 1:2 consolidation took place. The number of shares and dilutive securities for 2005 has been restated for the share split, cancellation and consolidation to show an equivalent basis to 2006.

	As at 30 September 2006 (unaudited)			As at 30 September 2005 (unaudited)			As at 31 March 2006 (audited)		
	Earnings US\$'000	Number of shares '000	Per share amount US cents	Earnings US\$'000	Number of shares '000	Per share amount US cents	Earnings US\$'000	Number of shares '000	Per share amount US cents
Profit attributable to shareholders	604			114			1,246		
<b>Basic EPS</b>									
Earnings attributable to ordinary shareholders	604	14,731	4.10	114	12,421	0.92	1,246	14,729	8.46
<b>Effect of dilutive securities</b>									
Options <sup>(1)</sup>	-	505	-	-	358	-	-	412	-
<b>Diluted EPS adjusted earnings</b>	604	15,236	3.96	114	12,779	0.89	1,246	15,141	8.23

(1) Includes the option entitlements held by non executive directors John Scott and Mark Rowan.

#### 5 Trade and other receivables

	As at 30 Sept 2006 (unaudited) US\$'000	As at 30 Sept 2005 (unaudited) US\$'000	As at 31 March 2006 (audited) US\$'000
<b>Trade and other receivables</b>			
Trade debtors	3,811	2,079	3,880
Less: provision for impairment of receivables	16	-	110
	3,795	2,079	3,770
Deferred tax	439	53	396
Other debtors	435	-	850
Amounts recoverable on long term contracts	-	303	-
Prepayments	292	226	90
Convertible advance	200	-	125
	5,161	2,661	5,231

The group has advanced \$200,000 to be used in establishing a distribution company in China. Interest is charged on the advance at 3% per annum, compounding monthly. The principal and interest will be secured by way of a first ranking debenture over the distribution company's assets.

The advance and interest are convertible into a 51% shareholding in the distribution company on the fulfilment of certain conditions agreed with the distribution company. If the company does not elect to convert the advance the distribution company will be required to repay the outstanding advance and interest. The convertible advance is held on the balance sheet at its fair value of \$200,000 (March 2006: \$125,000).

**6 Cash flow from operating activities**

	<b>6 Months Ended 30 Sept 2006 (unaudited) US\$'000</b>	<b>6 Months Ended 30 Sept 2005 (unaudited) US\$'000</b>	<b>12 Months Ended 31 March 2006 (audited) US\$'000</b>
<b>Continuing operations</b>			
Profit before tax	882	193	1,548
Net Interest (Income)/Expense	(156)	(164)	(395)
Depreciation & Amortisation	328	150	395
(Increase) in inventories	(90)	(293)	(1,420)
Decrease / (Increase) in debtors	70	1,731	(2,129)
(Decrease) / Increase in creditors	(395)	(2,472)	565
Foreign exchange (gain)/loss	(291)	(223)	(730)
<b>Total net cash inflow (outflow) from operating activities</b>	<b>348</b>	<b>(1,078)</b>	<b>(2,166)</b>

**7 Tax on profit on ordinary activities**

	<b>6 Months Ended 30-Sep 2006 (unaudited) US\$'000</b>	<b>6 Months Ended 30-Sep 2005 (unaudited) US\$'000</b>	<b>12 Months Ended 31-Mar 2006 (audited) US\$'000</b>
Profit before tax	882	193	1,548
Profit on ordinary activities multiplied by standard rate of corporation tax in New Zealand 33% (2005: 33%)	291	77	511
Effects of:			
Foreign tax differences	(45)	-	(59)
Adjustment to tax in respect of the prior year	-	-	(138)
Non assessable expenses/(income)	32	2	(12)
<b>Income tax expense</b>	<b>278</b>	<b>79</b>	<b>302</b>

## 8 Related party transactions

The Group had material transactions with the following related parties during the year:

Name of related party	Nature of relationship	Type of transactions	6 Months	6 Months	12
			Ended	Ended	Months
			30 Sept	30 Sept	31 March
			2006	2005	2006
			(unaudited)	(unaudited)	(audited)
			US\$'000	US\$'000	US\$'000
Prolificx New Zealand Ltd	Common director / shareholder	Purchase of inventory	1,039	1,095	3,044
Prolificx New Zealand Ltd	Common director / shareholder	Purchase of prototypes	83	7	122
Prolificx New Zealand Ltd	Common director / shareholder	Revenue	51	-	-
Nethawk Sway Communication Ltd (formerly Sellutions Management Group)	Shareholder	Revenue	159	118	429
	Common director / shareholder	Management services	3	35	35

At 30 September the Group was owed \$357,404 from Prolificx (September 2005: \$Nil, March 2006: \$Nil)

At 30 September the Group owed \$57,271 to Prolificx (September 2005: \$16,883, March 2006: \$525,084)

## 9 Contingent liabilities or contingent assets

The company and Group had no contingent liabilities or contingent assets as at 30 September 2006 (September 2005: nil, March 2006: Nil).

**10 Explanation of transition to New Zealand equivalents to IFRS**

Reconciliation of equity reported under previous UK GAAP to equity under NZ IFRS.

(a) At the date of transition to NZ IFRS:  
Consolidated Balance Sheet as at 1 April 2005

	<b>As published US\$'000</b>	<b>NZ IFRS 3 Business Combinations US\$'000</b>	<b>IAS38 Intangible Assets US\$'000</b>	<b>NZ IFRS restated US\$'000</b>
<b>Non-current assets</b>				
Property, plant and equipment	596	-	(18)	578
Goodwill	2,341	-	-	2,341
Other intangible assets	109	-	18	127
<b>Total non-current assets</b>	<b>3,046</b>	<b>-</b>	<b>-</b>	<b>3,046</b>
<b>Current assets</b>				
Inventories	170	-	-	170
Trade and other receivables	4,392	-	-	4,392
Cash and cash equivalents	364	-	-	364
<b>Total current assets</b>	<b>4,926</b>	<b>-</b>	<b>-</b>	<b>4,926</b>
<b>Total assets</b>	<b>7,972</b>	<b>-</b>	<b>-</b>	<b>7,972</b>
<b>Current Liabilities</b>				
Trade and other payables	858	-	-	858
Short term borrowings	1,812	-	-	1,812
Current tax payable	214	-	-	214
Short term provisions	1,001	-	-	1,001
<b>Total current liabilities</b>	<b>3,885</b>	<b>-</b>	<b>-</b>	<b>3,885</b>
<b>Non-current liabilities</b>				
Long term borrowings	81	-	-	81
<b>Total non-current liabilities</b>	<b>81</b>	<b>-</b>	<b>-</b>	<b>81</b>
<b>Total liabilities</b>	<b>3,966</b>	<b>-</b>	<b>-</b>	<b>3,966</b>
<b>Equity</b>				
Share capital	3,281	-	-	3,281
Other Reserve -translation reserve	15	-	-	15
Retained earnings	710	-	-	710
<b>Total equity</b>	<b>4,006</b>	<b>-</b>	<b>-</b>	<b>4,006</b>
<b>Total equity and liabilities</b>	<b>7,972</b>	<b>-</b>	<b>-</b>	<b>7,972</b>

**10 Explanation of transition to New Zealand equivalents to IFRS (continued)**

(b) At the date of the prior period interim accounts:  
Consolidated Balance Sheet as at 30 September 2005

	<b>As published US\$'000</b>	<b>NZ IFRS 3 Business Combinations US\$'000</b>	<b>IAS38 Intangible Assets US\$'000</b>	<b>NZ IFRS restated US\$'000</b>
<b>Non-current assets</b>				
Property, plant and equipment	1,182	-	(271)	911
Goodwill	2,214	60	-	2,274
Other intangible assets	140	-	271	411
<b>Total non-current assets</b>	<b>3,536</b>	<b>60</b>	<b>-</b>	<b>3,596</b>
<b>Current assets</b>				
Inventories	463	-	-	463
Trade and other receivables	2,661	-	-	2,661
Cash and cash equivalents	9,200	-	-	9,200
<b>Total current assets</b>	<b>12,324</b>	<b>-</b>	<b>-</b>	<b>12,324</b>
<b>Total assets</b>	<b>15,860</b>	<b>60</b>	<b>-</b>	<b>15,920</b>
<b>Current Liabilities</b>				
Trade and other payables	121	-	-	121
Current tax payable	(309)	-	-	(309)
Short term provisions	849	-	-	849
<b>Total current liabilities</b>	<b>661</b>	<b>-</b>	<b>-</b>	<b>661</b>
<b>Non-current liabilities</b>				
Long term provisions	-	-	-	-
<b>Total non-current liabilities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total liabilities</b>	<b>661</b>	<b>-</b>	<b>-</b>	<b>661</b>
<b>Equity</b>				
Share capital	16,182	-	-	16,182
Other Reserve -translation reserve	(2)	-	-	(2)
Retained earnings	(981)	60	-	(921)
<b>Total equity</b>	<b>15,199</b>	<b>60</b>	<b>-</b>	<b>15,259</b>
<b>Total equity and liabilities</b>	<b>15,860</b>	<b>60</b>	<b>-</b>	<b>15,920</b>

**10 Explanation of transition to New Zealand equivalents to IFRS (continued)**

(c) At the date of the last annual report:  
Consolidated Balance Sheet as at 31 March 2006

	As published US\$'000	NZ IFRS 3 Business Combinations US\$'000	IAS38 Intangible Assets US\$'000	Exchange Difference US\$'000	NZ IFRS restated US\$'000
<b>Non-current assets</b>					
Property, plant and equipment	1,278	-	(230)	-	1,048
Goodwill	1,920	119	-	(19)	2,020
Other intangible assets	312	-	230	-	542
<b>Total non-current assets</b>	<b>3,510</b>	<b>119</b>	<b>-</b>	<b>(19)</b>	<b>3,610</b>
<b>Current assets</b>					
Inventories	1,590	-	-	-	1,590
Trade and other receivables	5,231	-	-	-	5,231
Cash and cash equivalents	6,678	-	-	-	6,678
<b>Total current assets</b>	<b>13,499</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>13,499</b>
<b>Total assets</b>	<b>17,009</b>	<b>119</b>	<b>-</b>	<b>(19)</b>	<b>17,109</b>
<b>Current Liabilities</b>					
Trade and other payables	902	-	-	-	902
Current tax payable	64	-	-	-	64
Short term provisions	1,484	-	-	-	1,484
<b>Net current assets</b>	<b>2,450</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,450</b>
<b>Non-current liabilities</b>					
Long term provisions	42	-	-	-	42
<b>Total non-current liabilities</b>	<b>42</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>42</b>
<b>Total liabilities</b>	<b>2,492</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,492</b>
<b>Equity</b>					
Share capital	14,439	-	-	-	14,439
Other Reserve -translation reserve	(128)	-	-	(19)	(147)
Retained earnings	206	119	-	-	325
<b>Total equity</b>	<b>14,517</b>	<b>119</b>	<b>-</b>	<b>(19)</b>	<b>14,617</b>
<b>Total equity and liabilities</b>	<b>17,009</b>	<b>119</b>	<b>-</b>	<b>(19)</b>	<b>17,109</b>

**10 Explanation of transition to New Zealand equivalents to IFRS (continued)**

Reconciliation of profit reported under previous UK GAAP to profit under NZ IFRS.

(a) At the date of the prior period interim accounts:

Consolidated Income Statement for the six months ended 30 September 2005

	As at published US\$'000	NZ IFRS 3 Business Combinations US\$'000	IAS 18 Interest Income US\$'000	NZ IFRS restated US\$'000
<b>Revenue</b>	4,346	-	-	4,346
Cost of sales	(1,112)	-	-	(1,112)
<b>Gross profit</b>	3,234	-	-	3,234
Other income	50	-	164	214
Selling and administrative expenses	(2,108)	-	-	(2,108)
Research and development expenses	(1,207)	60	-	(1,147)
Finance Cost	164	-	(164)	-
<b>Profit before taxation</b>	133	60	-	193
Income tax expense	(79)	-	-	(79)
<b>Profit for the period</b>	54	60	-	114

(b) At the date of the last annual report:

Consolidated Income Statement for the year ended 31 March 2006

	As at published US\$'000	NZ IFRS 3 Business Combinations US\$'000	IAS 18 Interest Income US\$'000	NZ IFRS restated US\$'000
<b>Revenue</b>	10,989	-	-	10,989
Cost of sales	(2,750)	-	-	(2,750)
<b>Gross profit</b>	8,239	-	-	8,239
Other income	122	-	420	542
Selling and administrative expenses	(4,557)	-	-	(4,557)
Research and development expenses	(2,770)	119	-	(2,651)
Finance Cost	395	-	(420)	(25)
<b>Profit before taxation</b>	1,429	119	-	1,548
Income tax expense	(302)	-	-	(302)
<b>Profit for the period</b>	1,127	119	-	1,246

**IFRS 3 Business combinations**

IFRS 3 does not permit the annual amortisation of goodwill, but does require an annual impairment review of carrying values. Impairment reviews have been conducted on the carrying value of goodwill arising on business combinations at 1 April 2005, 30 September 2005 and 31 March 2006 with no impairments identified.

Goodwill amortisation charged in the income statement for the year six months ended 30 September 2005 of \$60,000 and for the year ended 31 March 2006 of \$119,000 is reversed under IFRS.

**IAS 38 Intangible assets**

Computer software costs previously capitalised as tangible fixed assets have been reclassified as intangible assets.

**IAS 18 Revenue**

Interest income previously netted against interest expense has been reclassified as other income.