



Advanced Card Systems Holdings Limited

龍傑智能卡控股有限公司*

(incorporated in the Cayman Islands with limited liability)

(Stock Code: 8210)



Interim Report 2006

CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET (“GEM”) OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE “STOCK EXCHANGE”)

GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

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This document, for which the directors of Advanced Card Systems Holdings Limited (the “Company”) collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM of the Stock Exchange for the purpose of giving information with regard to the Company. The directors, having made all reasonable enquires, confirm that, to the best of their knowledge and belief:- (i) the information contained in this document is accurate and complete in all material respects and not misleading; (ii) there are no other matters the omission of which would make any statement in this document misleading; and (iii) all opinions expressed in this document have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

As at the date of this document, the Board comprises 3 executive directors, namely Mr. Wong Yiu Chu, Denny, Mr. Tan Keng Boon and Ms. Tsui Kam Ling, Alice; and 3 independent non-executive directors, Dr. Yip Chak Lam, Peter, Mr. Yu Man Woon and Mr. Wong Yick Man, Francis.

HIGHLIGHTS

- Revenue of the Group for the six months ended 30 June 2006 increased by 21% to HK\$21.5 million from the first half year of 2005.
- Gross profit of the Group for the six months ended 30 June 2006 increased by 44% to HK\$10.5 million from the first half year of 2005.
- The profit of the Group amounted to HK\$1.2 million for the six months ended 30 June 2006 as compared to a loss of HK\$1.4 million for the first half year of 2005.

The Board of Directors (the “Board”) hereby announces the unaudited consolidated results of the Company and its subsidiaries (collectively, the “Group”) for the six months ended 30 June 2006 (the “Review Period”).

UNAUDITED CONSOLIDATED INCOME STATEMENT

For the three months and six months ended 30 June 2006

	Notes	Three months ended		Six months ended	
		30 June		30 June	
		2006	2005	2006	2005
		HK\$'000	HK\$'000	HK\$'000	HK\$'000
Revenue	2	10,653	9,918	21,516	17,781
Cost of sales		(4,858)	(6,191)	(11,000)	(10,460)
Gross profit		5,795	3,727	10,516	7,321
Other operating income		59	250	96	607
Other net loss		(49)	(16)	(114)	(28)
Staff costs		(2,840)	(2,465)	(5,923)	(4,970)
Depreciation		(233)	(199)	(459)	(397)
Amortisation of development costs		(288)	(310)	(546)	(665)
Other operating expenses		(1,218)	(1,671)	(2,293)	(3,147)
Operating profit/(loss)		1,226	(684)	1,277	(1,279)
Finance costs	4	(48)	(45)	(81)	(77)
Profit/(Loss) before income tax		1,178	(729)	1,196	(1,356)
Income tax	5	—	—	—	—
Profit/(Loss) for the period		1,178	(729)	1,196	(1,356)
Earnings/(Loss) per share					
— Basic	7	0.418 cents	(0.259) cents	0.424 cents	(0.481) cents
— Diluted		0.418 cents	N/A	N/A	N/A

CONSOLIDATED BALANCE SHEET

At 30 June 2006

	<i>Notes</i>	Unaudited 30 June 2006	Audited 31 December 2005
ASSETS AND LIABILITIES			
Non-current assets			
Plant and equipment	8	1,933	2,151
Development costs		9,000	8,148
Deferred tax assets		3,952	3,952
		<u>14,885</u>	<u>14,251</u>
Current assets			
Inventories		9,119	9,047
Trade and other receivables, deposits paid and prepayments	9	6,436	6,103
Pledged bank deposit		1,778	691
Cash and cash equivalents		7,080	6,390
		<u>24,413</u>	<u>22,231</u>
Current liabilities			
Bank borrowings		1,296	—
Trade and other payables, deposits received and accruals	10	6,454	6,130
		<u>7,750</u>	<u>6,130</u>
Net current assets		<u>16,663</u>	<u>16,101</u>
Total assets less current liabilities		<u><u>31,548</u></u>	<u><u>30,352</u></u>
EQUITY			
Share capital	11	28,180	28,180
Reserves	12	3,368	2,172
Total equity		<u><u>31,548</u></u>	<u><u>30,352</u></u>

CONDENSED CONSOLIDATED CASH FLOW STATEMENT
For the six months ended 30 June 2006

	Unaudited	
	Six months ended 30 June	
	2006	2005
Net cash generated from operating activities	1,984	131
Net cash used in investing activities	(1,422)	(1,950)
Net cash generated from/(used in) financing activities	128	(77)
	<hr/>	<hr/>
Net increase/(decrease) in cash and cash equivalents	690	(1,896)
Cash and cash equivalents at 1 January	6,390	13,103
	<hr/>	<hr/>
Cash and cash equivalents at 30 June	<u>7,080</u>	<u>11,207</u>

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 30 June 2006

	Share capital <i>HK\$'000</i>	Share premium <i>HK\$'000</i>	Merger reserve <i>HK\$'000</i>	Accumulated losses <i>HK\$'000</i>	Total equity <i>HK\$'000</i>
At 1 January 2005	28,180	24,333	4,496	(26,853)	30,156
Loss for the period	—	—	—	(1,356)	(1,356)
Total recognised income and expense for the period	<u>—</u>	<u>—</u>	<u>—</u>	<u>(1,356)</u>	<u>(1,356)</u>
At 30 June 2005	<u>28,180</u>	<u>24,333</u>	<u>4,496</u>	<u>(28,209)</u>	<u>28,800</u>
At 1 January 2006	28,180	24,333	4,496	(26,657)	30,352
Profit for the period	—	—	—	1,196	1,196
Total recognised income and expense for the period	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,196</u>	<u>1,196</u>
At 30 June 2006	<u>28,180</u>	<u>24,333</u>	<u>4,496</u>	<u>(25,461)</u>	<u>31,548</u>

NOTES ON THE CONDENSED INTERIM FINANCIAL STATEMENTS

1 BASIS OF PREPARATION

This condensed interim financial statements have been prepared in accordance with Hong Kong Accounting Standard (“HKAS”) 34 “Interim Financial Reporting” issued by the Hong Kong Institute of Certified Public Accountants, and the applicable disclosure provisions of the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited.

The preparation of the condensed interim financial statements in conformity with HKAS 34 requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses on a year to date basis. Actual results may differ from these estimates.

The accounting policies adopted in the 2005 annual financial statements have been consistently applied to these financial statements.

These financial statements are unaudited but have been reviewed by the audit committee of the Company. These financial statements were approved by the board of directors on 4 August 2006.

2 REVENUE

Revenue represents turnover which comprises total invoiced value of goods supplied and services rendered.

	Three months ended		Six months ended	
	30 June		30 June	
	2006	2005	2006	2005
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Sale of smart card products, software and hardware	10,429	9,865	20,840	17,725
Smart card related services	224	53	676	56
	<u>10,653</u>	<u>9,918</u>	<u>21,516</u>	<u>17,781</u>

3 SEGMENT INFORMATION

Primary reporting format – business segments

During the period, the Group was principally engaged in the development, sale and distribution of smart card products, software and hardware and the provision of smart card related services to customers.

Six months ended 30 June 2006

	Development, sale and distribution of smart card products, software and hardware	Provision of smart card related services	Total
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Revenue	20,840	676	21,516
Segment result and operating profit	601	676	1,277
Finance costs			(81)
Segment result and profit before income tax			1,196
Income tax			—
Profit for the period			1,196
Capital expenditure	1,515	—	1,515
Depreciation and amortisation	1,005	—	1,005

Six months ended 30 June 2005

	Development, sale and distribution of smart card products, software and hardware	Provision of smart card related services	Total
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Revenue	17,725	56	17,781
Segment result and operating (loss)/profit	(1,335)	56	(1,279)
Finance costs			(77)
Segment result and loss before income tax			(1,356)
Income tax			—
Loss for the period			(1,356)
Capital expenditure	2,074	—	2,074
Depreciation and amortisation	1,062	—	1,062

Over 90% of the segment assets and liabilities were attributable to the segment of “Development, sale and distribution of smart card products, software and hardware” and, accordingly, no segmental analysis of the Group’s assets and liabilities is presented.

Secondary reporting format – geographical segments

The Group’s operations are located in Hong Kong. In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of its customers who are principally located in the Americas, Asia Pacific, Europe, Middle East and Africa.

Sales revenue by geographical markets:

	Six months ended 30 June	
	2006	2005
	<i>HK\$'000</i>	<i>HK\$'000</i>
The Americas	3,515	1,741
Asia Pacific	7,246	7,627
Europe, Middle East and Africa	10,755	8,413
	<u>21,516</u>	<u>17,781</u>

Over 90% of the total assets and liabilities of the Group at the respective balance sheet dates were physically located in Hong Kong and substantially employed in Hong Kong. Accordingly, no geographical segmental analysis of the Group’s assets and liabilities and capital expenditure is presented.

4 **FINANCE COSTS**

	Three months ended		Six months ended	
	30 June		30 June	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Interests on bank borrowings wholly repayable within five years	13	—	13	—
Bank charges	35	45	68	77
	<u>48</u>	<u>45</u>	<u>81</u>	<u>77</u>

5 **INCOME TAX**

No provision for Hong Kong profits tax has been made in the financial statements as a subsidiary of the Group had losses brought forward from previous years to offset against its current period's assessable profits and the Company and other subsidiaries sustained losses for taxation purposes for the three months and six months ended 30 June 2006. No provision for Hong Kong profits tax has been made by the Group as it sustained a loss for taxation purposes for the three months and six months ended 30 June 2005.

6 **DIVIDENDS**

The Company had not declared or paid any dividends during the three months and six months ended 30 June 2006 (2005: Nil).

7 **EARNINGS/(LOSS) PER SHARE**

The calculation of basic earnings per share (2005: loss per share) for the three months and six months ended 30 June 2006 is based on the respective profit for the period of HK\$1,178,000 and HK\$1,196,000 (2005: loss of HK\$729,000 and HK\$1,356,000) and the weighted average of 281,800,255 and 281,800,255 (2005: 281,800,255 and 281,800,255) ordinary shares in issue during the period.

The calculation of diluted earnings per share for the three months ended 30 June 2006 is based on the profit for the period of HK\$1,178,000 and the weighted average of 281,838,000 ordinary shares in issue during the period, after adjusting for the effects of all dilutive potential ordinary shares during the period. Diluted earnings per share for the six months ended 30 June 2006 was not presented because the exercise prices of the outstanding options exceeded the average market price of ordinary shares during the period. Diluted loss per share for the three months and six months ended 30 June 2005 was not presented because the impact of the exercise of the share options were anti-dilutive.

8 PLANT AND EQUIPMENT

	Leasehold improvements <i>HK\$'000</i>	Furniture and fixtures <i>HK\$'000</i>	Computer and office equipment <i>HK\$'000</i>	Moulds <i>HK\$'000</i>	Total <i>HK\$'000</i>
At 1 January 2005					
Cost	378	242	2,386	1,017	4,023
Accumulated depreciation	(189)	(102)	(1,500)	(607)	(2,398)
Net book amount	<u>189</u>	<u>140</u>	<u>886</u>	<u>410</u>	<u>1,625</u>
Six months ended 30 June 2005					
Opening net book amount	189	140	886	410	1,625
Additions	23	48	258	45	374
Disposals	—	—	(20)	—	(20)
Depreciation	(103)	(29)	(176)	(89)	(397)
Closing net book amount	<u>109</u>	<u>159</u>	<u>948</u>	<u>366</u>	<u>1,582</u>
At 30 June 2005					
Cost	401	290	2,617	1,062	4,370
Accumulated depreciation	(292)	(131)	(1,669)	(696)	(2,788)
Net book amount	<u>109</u>	<u>159</u>	<u>948</u>	<u>366</u>	<u>1,582</u>
At 1 January 2006					
Cost	527	410	2,821	1,290	5,048
Accumulated depreciation	(76)	(165)	(1,841)	(815)	(2,897)
Net book amount	<u>451</u>	<u>245</u>	<u>980</u>	<u>475</u>	<u>2,151</u>
Six months ended 30 June 2006					
Opening net book amount	451	245	980	475	2,151
Additions	1	5	211	24	241
Depreciation	(112)	(45)	(206)	(96)	(459)
Closing net book amount	<u>340</u>	<u>205</u>	<u>985</u>	<u>403</u>	<u>1,933</u>
At 30 June 2006					
Cost	525	414	3,013	1,314	5,266
Accumulated depreciation	(185)	(209)	(2,028)	(911)	(3,333)
Net book amount	<u>340</u>	<u>205</u>	<u>985</u>	<u>403</u>	<u>1,933</u>

9 **TRADE AND OTHER RECEIVABLES, DEPOSITS PAID AND PREPAYMENTS**

	30 June 2006 HK\$'000	31 December 2005 HK\$'000
Trade receivables - net	5,437	5,042
Other receivables, deposits paid and prepayments	999	1,061
	<u>6,436</u>	<u>6,103</u>

Customers are generally granted credit terms of 30 to 60 days. The ageing analysis of the net trade receivables was as follows:

	30 June 2006 HK\$'000	31 December 2005 HK\$'000
0-30 days	2,974	4,577
31-60 days	662	143
61-90 days	1,162	37
Over 90 days	639	285
	<u>5,437</u>	<u>5,042</u>

10 **TRADE AND OTHER PAYABLES, DEPOSITS RECEIVED AND ACCRUALS**

	30 June 2006 HK\$'000	31 December 2005 HK\$'000
Trade payables	3,575	3,449
Other payables, deposits received and accruals	2,879	2,681
	<u>6,454</u>	<u>6,130</u>

The ageing analysis of the trade payables was as follows:

	30 June 2006 HK\$'000	31 December 2005 HK\$'000
0-30 days	3,236	2,856
31-60 days	190	393
61-90 days	63	114
Over 90 days	86	86
	<u>3,575</u>	<u>3,449</u>

11 SHARE CAPITAL

	Number of shares	Amount HK\$'000
Authorised:		
Ordinary shares of HK\$0.10 each		
At 31 December 2005 and 30 June 2006	<u>1,000,000,000</u>	<u>100,000</u>
Issued and fully paid:		
Ordinary shares of HK\$0.10 each		
At 31 December 2005 and 30 June 2006	<u>281,800,255</u>	<u>28,180</u>

12 RESERVES

The amount of the Group's reserves and the movements therein for the current and prior periods are presented in the consolidated statement of changes in equity on page 4 of the financial statements.

Merger reserve of the Group represents reserve of the subsidiary that have been capitalised as a result of a share-for-share exchange.

13 OPERATING LEASE COMMITMENTS

At 30 June 2006, the total future minimum lease payments under non-cancellable operating leases on land and buildings are payable as follows:

	30 June 2006 HK\$'000	31 December 2005 HK\$'000
Within one year	<u>916</u>	<u>1,025</u>
In the second to fifth years	<u>297</u>	<u>727</u>
	<u><u>1,213</u></u>	<u><u>1,752</u></u>

The Group leases a number of land and buildings under operating leases. The leases typically run for an initial period of one to three years, with an option to renew the lease and negotiate the terms at the expiry date or at dates as mutually agreed between the Group and respective landlords/lessors. None of the leases include contingent rentals.

14 MATERIAL RELATED PARTY TRANSACTIONS

The following transactions were carried out with related parties:

	Six months ended 30 June	
	2006	2005
	HK\$'000	HK\$'000
Consultancy fees payable (<i>note (i)</i>)	45	90
Salaries payable (<i>note (ii)</i>)	—	135
	<u> </u>	<u> </u>
Key management personnel remuneration		
— Salaries and other short-term employee benefits	2,053	2,553
— Retirement benefits costs	30	42
	<u> </u>	<u> </u>
	<u>2,083</u>	<u>2,595</u>

Notes:

- (i) A subsidiary has entered into an agreement with Mr. Tong Kam Hung for the provision of consultancy services. The terms of the consultancy fees are determined based on services provided with reference to market rates. Mr. Tong Kam Hung was interested in the agreement as a consultant and a shareholder of the Company.
- (ii) A subsidiary paid salaries to Ms. Tsui Kam Ling, Alice ("Ms. Tsui"), for her role as Vice President, Operations of the subsidiary during the period from 1 January to 22 March 2005. Ms. Tsui was then appointed as director of the Company on 23 March 2005. Ms. Tsui is a shareholder of the Company and the spouse of Mr. Wong Yiu Chu, Denny, a director of the Company.

The directors of the Company are of the opinion that the above transactions with related parties were conducted in accordance with the terms mutually agreed between the Group and the related parties.

MANAGEMENT DISCUSSION AND ANALYSIS

At the end of the second quarter of 2006 ended 30 June 2006, the three important products that the Group invested millions of Hong Kong dollars to develop had been launched. These products are: (1) ACR88, the portable PIN-pad smart card reader with display and with optional finger print scanner and optional contactless reader, (2) ACR100, a flash drive integrated with a PC linked reader, and (3) ACOS5 card, a PKI (Public Key Infrastructure) based high security smart card. Samples were provided to various interested customers. Initial responses were very encouraging and the Group is expecting to see sales in commercial scale in the third or the fourth quarter of 2006.

Financial Review

	Six months ended		Change
	30 June		
	2006	2005	
	HK\$'000	HK\$'000	HK\$'000
Revenue	21,516	17,781	+3,735
Cost of sales	(11,000)	(10,460)	+540
Gross profit	10,516	7,321	+3,195
Other operating income and Other net loss	(18)	579	-597
Operating expenses	(9,221)	(9,179)	+42
Operating profit/(loss)	1,277	(1,279)	+2,556
Finance costs	(81)	(77)	+4
Profit/(Loss) before income tax	1,196	(1,356)	+2,552

The total turnover of the Group increased by 21% to HK\$21.5 million in the first half year ended 30 June 2006. While the above mentioned three important products had just been launched and had not generated sales in commercial scale, the Group was able to bring increases in the sales of the existing products. In fact growths were recorded in various product lines as shown in the chart below.

	Six months ended		Change
	30 June		
	2006	2005	
	HK\$'000	HK\$'000	
Smart cards	3,141	2,818	+11%
PC linked readers	12,474	10,485	+19%
Other products	5,225	4,422	+18%
	20,840	17,725	
Smart card related services	676	56	+1,107%
	21,516	17,781	+21%

The biggest growth was recorded in the region of the Americas mainly because of the delivery of smart card readers to the USA government to read the smart cards issued by the US Naval Department and used as ID cards and electronic purses, and also because of the relatively big shipments of smart card reader chips to a customer in Brazil for producing readers for a banking project in the country. The change of the growth rate in one region or another in half a year does not indicate a general trend. The Group is making shipments to over eighty countries in the world and the relative sizes of the sales in the different regions are substantially proportional to the market sizes in the different regions of the products which the Group is supplying.

	Six months ended		Change
	30 June		
	2006	2005	
	<i>HK\$'000</i>	<i>HK\$'000</i>	
The Americas	3,515	1,741	+102%
Asia Pacific	7,246	7,627	-5%
Europe, Middle East and Africa	10,755	8,413	+28%
	<u>21,516</u>	<u>17,781</u>	+21%

The enhanced product mix within the existing several product lines provided the Group with an improved gross profit margin. For example, contactless readers (classified as "other products" here) are bringing higher profit margins even though their sales represented only about 6% of total revenue in the first half year of 2006. The overall gross profit margin increased to 49% in this first half year of 2006 compared with 41% in the corresponding period of 2005.

The operating expenses were increased by HK\$42,000 and with very small finance costs, the Group recorded a net profit before income tax of HK\$1,196,000 in the first half year. The net profit in the second quarter amounted to HK\$1,178,000 representing a big increase from the figure of HK\$18,000 in the first quarter.

Of the operating expenses of HK\$9,221,000 in the first half year of 2006, staff costs represented HK\$5,923,000 (versus HK\$4,970,000 in the first half year of 2005). The staff costs increased by HK\$953,000 largely owing to the increase of payroll as the total headcount increased to 67 persons at 30 June 2006 compared with 61 persons a year ago. The enlarged and strengthened team of engineering and sales and marketing people will be needed to promote, sell and offer technical support of, the three important products (ACR88, ACR100 and ACOS5 mentioned above) on top of the Group existing products. The increase of staff costs by HK\$953,000 was offset by the reduction in the other operating expenses which amounted to HK\$2,293,000, i.e. HK\$854,000 lower than the corresponding figure in the first half year of 2005 at HK\$3,147,000.

Dividend

The Board does not recommend the payment of an interim dividend in respect of the six months ended 30 June 2006. The declaration, payment, and amount of future dividends will be decided by the Board and will depend upon, among other things, the Group's results of operations, capital requirements, cash flows, general financial condition, and such other factors as the Board may deem relevant.

Business Review

Since its inception, the Group has always focused its efforts in developing new technologies and reliable products to address an ever changing market and technological landscape within the industry. The Group is now ranked and known throughout the international smart card reader manufacturing community as Asia's number one and the world's fourth largest supplier of smart card readers used with a personal computer. Although most of other international companies whom the Group is actively competing against have significantly higher financial resources, the Group managed to grow and is getting stronger day by day by exerting its best efforts to make efficient use of every dollar available to it in a productive and responsible manner.

Any proper allocation of resources requires great knowledge and insight of the market. When the Group received approximately HK\$17 million in net funds from its public listing in November of 2003, it began to invest a major portion of these funds into R&D (Research and Development) in order to produce innovative products previously unavailable in the market. In keeping with the general industry standard of taking approximately 24-36 months to affectively take a product design from the concept stage to a successful commercial release, the Group is now seeing the results of its past investments with the recent release of the ACR88 portable reader, the ACR100 flash drive smart card reader, and the ACOS5 smart card. Although the sales performance of these innovative products has yet to reach its full potential, the Group is excited about numerous upcoming opportunities in the industry as a result of the visionary investments made years ago.

In order to form a vision of the future, one may first look at its past. Two products that generated the Group the most sales from 1 January 2004 to 30 June 2006 (i.e. in the last two and half years after the listing in GEM) were ACR30, PC linked reader and ACR38, the more advanced PC linked reader. The bulk of the Investments in them were made before the listing of the Group in November 2003 but the sales came after:

	Investments from 1 January 2001 to 31 December 2003 <i>HK\$'000</i>	Investments from 1 January 2004 to 30 June 2006 <i>HK\$'000</i>	Total investments from 1 January 2001 to 30 June 2006 <i>HK\$'000</i>	Sales from 1 January 2004 to 30 June 2006 <i>HK\$'000</i>
ACR30	3,204	440	3,644	16,494
ACR38	1,048	879	1,927	27,610

On the other hand, the very promising products coming from the pine-line are ACR88, ACR100 and ACOS5 as mentioned previously. The Group invested substantially in these products after the listing and is expecting interesting sales revenue generated by them in the coming quarters and years.

As the Group is expanding its product range, it is placing more emphasis on its operations efficiency. The Group continues to develop internally its web-based programs, called WEQ (Web-based EnQuery) which is to manage mainly customer relationships and product development. At the same time, the Group is using outsourced programs to cope with its enterprise resources planning (ERP) challenges.

Prospects

When the Group continuously strives to excel in the industry, it is getting rewards in two forms. Firstly, when it develops a new product, it makes use of the technical knowledge accumulated in the past. Secondly, when a new product is launched, it has an existing base of customers to promote the product to. Thus the return on the investment in ACR38 was much higher than the return on investment in ACR30. When the Group built ACR38, it had already a lot of knowledge acquired from the development of the previous product ACR30. The reward expected from the three new products (ACR88, ACR100 and ACOS5) is expected to be still higher.

With the introduction of the new products, like ACR88, ACR100 and ACOS5 mentioned above, the Group is extending itself to broader market segments and new business opportunities. The average selling price of the portable device, ACR88, is over ten times the average selling price of PC linked reader. By integrating a smart card reader into a flash drive to form ACR100, the Group is adding much value to the popular flash drive. ACR100 not only holds data as a regular flash drive does but is also a device for secure logical access control or for payment. The PKI (Public Key Infrastructure) card, ACOS5, will enable the Group to offer a higher level of security for smart card applications and open up new opportunities for the Group in the identity card and payment areas.

While providing to the market smart card hardware, ACS has been preparing itself since two years ago to get into the smart card based solution business. Equipped now with the needed technologies and customer base, ACS is presented with an unprecedented opportunity to offer an automatic fare collection (AFC) system to the world market focusing initially on buses. A full plan to offer an AFC solution with state-of-the-art technology, with expandability and with recurrent income, has been prepared for this new business. The speed of the deployment of such a solution will depend on financial resources available. The top priority of the management of the Group is to capitalize the investments made after the Group was listed in Hong Kong Stock Exchange in November 2003. More financial resources available, the management will aim to grow the Group profitably at a higher speed by taking advantage of a better economy of scale.

Liquidity and Financial Resources

As at 30 June 2006, the Group's cash and cash equivalents amounted to HK\$7.1 million (30 June 2005: HK\$11.2 million) and pledged bank deposits amounted to HK\$1.8 million (30 June 2005: Nil). Out of the HK\$1.8 million pledged bank deposits, HK\$0.7 million was pledged in order to have a performance bond issued by a bank to a customer who gave the Group a prepayment for ordering the Group's products being developed. The balance of HK\$1.1 million was to secure a bank credit line. At 30 June 2006, the facilities were utilized to the extent of HK\$1.3 million (30 June 2005: Nil). Such bank borrowings were repayable within one year and were primarily denominated in Hong Kong dollars and United States dollars with floating interest rates.

The current ratio, being the ratio of current assets to current liabilities, was maintained at a level of 3.2 (30 June 2005: 3.3). Net asset value as at the end of the review period was HK\$31.5 million (30 June 2005: HK\$28.8 million). As at 30 June 2006, the gearing ratio, being the total interest bearing debts over the total equity, was at a low level of 4.1% (30 June 2005: zero).

Capital Structure

The Group relies on internal resources and bank borrowings as a source of funding. The Group keeps most of its cash in Hong Kong dollars and United States dollars in bank accounts as working capital for the Group.

Investments

During the first six months, the Group did not hold any significant investments.

Acquisitions and Disposals of Subsidiaries and Affiliated Companies

The Group did not have any material acquisitions or disposals of subsidiaries and affiliated companies during the six months ended 30 June 2006.

Exposure to Exchange Rate Fluctuations

The assets, liabilities and transactions of the Group are primarily denominated in Hong Kong dollars or United States dollars and the exchange rates between such currencies have been stable during the review period. There is no significant exposure to foreign exchange rate fluctuations. No hedging or other alternatives have been implemented during the period.

Pledge of Assets

As at 30 June 2006, the Group pledged a deposit of US\$88,000 to a bank for the bank to issue a performance bond to a customer. This customer paid the Group US\$88,000 as partial advanced payment when they placed the Group an order of 10,000 units of ACR100 (the flash drive integrated with a smart card reader) before the product was developed. In addition, the Group pledged a deposit of US\$140,000 to a bank for banking facilities. Save as disclosed herein, the Group did not pledge any of its assets.

Contingent Liabilities

As at 30 June 2006, the Company executed a corporate guarantee of HK\$2,000,000 (together with accrued interest thereon) to a bank in respect of banking facilities granted to a subsidiary. Save as disclosed herein, the Group did not have any significant contingent liabilities.

Employees and Remuneration Policies

As at 30 June 2006, the Group had 67 full-time employees as compared to headcount of 61 as at 30 June 2005. Staff costs charged to the consolidated income statement amounted to HK\$5.9 million (corresponding period in 2005: HK\$5.0 million). Remuneration policies and packages for the Group's employees are based on individual qualifications, performance, experience and conditions prevailing in the industry. In addition, various training sessions are offered to employees to enhance their product and market knowledge.

The Group has also adopted share option schemes under which the employees of the Group may be granted share options to subscribe for shares in the Company for the purposes of recognising their contributions to the Group.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

At 30 June 2006, the interests and short positions of the directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), which were notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO), or which were required, pursuant to Section 352 of the SFO, to be entered in the register referred to therein, or which were required to be notified to the Company and the Stock Exchange pursuant to the required standard of dealings by directors as referred to in Rule 5.46 of the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange (the "GEM Listing Rules") were as follows:

(i) Interests in issued shares

Name of director	Ordinary shares of HK\$0.10 each				Total number of shares held	Percentage of the Company's issued share capital as at 30 June 2006
	Personal interests (Note 1)	Family interests	Corporate interests	Other interests		
Mr. Wong Yiu Chu, Denny (Note 2)	80,768,000	38,034,522	—	—	118,802,522	42.16%
Ms. Tsui Kam Ling, Alice (Note 3)	38,034,522	80,768,000	—	—	118,802,522	42.16%
Mr. Tan Keng Boon	2,285,893	—	—	—	2,285,893	0.81%

Notes:

- The shares are registered under the names of the directors who are the beneficial owners.
- 80,768,000 shares are held by Mr. Wong Yiu Chu, Denny personally and 38,034,522 shares are held by his wife, Ms. Tsui Kam Ling, Alice personally. Mr. Wong Yiu Chu, Denny is taken to be interested in the shares held by Ms. Tsui Kam Ling, Alice under the SFO.
- 38,034,522 shares are held by Ms. Tsui Kam Ling, Alice personally and 80,768,000 shares are held by her husband, Mr. Wong Yiu Chu, Denny personally. Ms. Tsui Kam Ling, Alice is taken to be interested in the shares held by Mr. Wong Yiu Chu, Denny under the SFO.

(ii) Interests in underlying shares

The directors and chief executive of the Company have been granted options under the share option schemes, details of which are set out in the section "Share option schemes" below.

Save as disclosed above, to the best knowledge of the directors of the Company, as at 30 June 2006, none of the directors or their associates had any personal, family, corporate or other interest or short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which would have to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO), or which were required, pursuant to Section 352 of the SFO, to be entered in the register referred to therein, or which were required, pursuant to the required standard of dealings by directors as referred to in Rule 5.46 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange.

SHARE OPTION SCHEMES

(i) Pre-IPO Share Option Plan

At 30 June 2006, the consultants and employees of the Group had the following interests in options to subscribe for shares of the Company (market value per share at 30 June 2006 was HK\$0.095) with an exercise price of HK\$0.09 or HK\$0.24 per share under the Pre-IPO Share Option Plan (the "Plan") of the Company. The options are unlisted. Each option gives the holder the right to subscribe for one ordinary share of HK\$0.10 each of the Company.

Grantees	Date granted	Number of share options				Balance as at 30 June 2006	Period during which the options are exercisable	Exercise price per share	Percentage of the Company's issued share capital as at 30 June 2006
		Balance as at 1 January 2006	Granted during the period	Exercised during the period	Lapsed during the period				
Consultants & Employees	27 October 2003	1,521,745	–	–	–	1,521,745 (Note 1, 2)	10 May 2004 to 24 July 2010	HK\$0.09	0.54%
Employees	27 October 2003	862	–	–	–	862 (Note 2)	10 May 2004 to 27 December 2010	HK\$0.09	0.01%
	27 October 2003	1,100,949	–	–	–	1,100,949 (Note 3)	10 May 2004 to 20 January 2013	HK\$0.24	0.39%
		<u>2,623,556</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>2,623,556</u>			

Notes:

- 1 1,201,034 share options were granted to a consultant of the Group. All other options were granted to employees of the Group.
- 2 The options vested and were exercisable on 10 May 2004, which was 6 months after the listing date of the Company.
- 3 The options vested and were exercisable in three tranches as follows:
 - (a) one-third of the options vested and were exercisable on 10 May 2004;

- (b) a further one-third of the options vested and were exercisable on 31 December 2004; and
- (c) the remaining one-third of the options vested and were exercisable on 31 December 2005.

4 No option was granted, exercised, cancelled or lapsed during the period.

(ii) Share Option Scheme

Pursuant to the resolution of the shareholders of the Company dated 27 October 2003, the Company adopted a Share Option Scheme (the "Scheme"). As at the date of this report, no options had been granted under the Scheme.

DIRECTORS' RIGHTS TO ACQUIRE SHARES

Save as disclosed under the paragraphs headed "Directors' and chief executive's interests and short positions in shares, underlying shares and debentures" and "Share option schemes" above, at no time during the period were rights to acquire benefits by means of the acquisition of shares in or debentures of the Company granted to any directors or their respective spouse or children under 18 years of age, or were any such rights exercised by them, or was the Company, its holding company, or any of its subsidiaries and fellow subsidiaries a party to any arrangement to enable the directors to acquire such rights in any other body corporate.

SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSONS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

In addition to the interests disclosed under the section "Directors' and chief executive's interests and short positions in shares, underlying shares and debentures" above, the Company has been notified of the following interests in the Company's issued shares at 30 June 2006 which as recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO:

	Capacity	Total number of ordinary shares held	Percentage of the Company's issued share capital as at 30 June 2006
Proway Investment Limited (<i>Note 2</i>)	Beneficial Owner	31,740,305 shares (L)	11.26%
Morningside CyberVentures Holdings Limited (<i>Note 2</i>)	Other	31,740,305 shares (L)	11.26%
Biswick Holdings Limited (<i>Note 2</i>)	Other	31,740,305 shares (L)	11.26%
Verrall Enterprises Holdings Limited (<i>Note 2</i>)	Other	31,740,305 shares (L)	11.26%
Verrall Limited (<i>Note 2</i>)	Other	31,740,305 shares (L)	11.26%
Madam Chan Tan Ching Fen (<i>Note 2</i>)	Other	31,740,305 shares (L)	11.26%
Thomrose Holdings (BVI) Limited (<i>Note 3</i>)	Beneficial owner	16,815,162 shares (L)	5.97%
Mr. Wan Wah Tong, Thomas (<i>Note 3</i>)	Other	16,815,162 shares (L)	5.97%

Notes:

- 1 The letter "L" stands for the shareholders' long position (within the meaning stated in the form for notification specified pursuant to the SFO) in shares.
- 2 Proway Investment Limited is wholly owned by Morningside CyberVentures Holdings Limited. Morningside CyberVentures Holdings Limited is wholly owned by Biswick Holdings Limited in its capacity as trustee of a unit trust the units of which are owned by Verrall Enterprises Holdings Limited and Verrall Limited in their capacities as trustees of family trusts established by Madam Chan Tan Ching Fen. Madam Chan Tan Ching Fen is taken to be interested in the shares disclosed herein in her capacity as founder of the trust (as that term is defined in the SFO).
- 3 16,815,162 shares are held by Thomrose Holdings (BVI) Limited (a company which is wholly-owned by Mr. Thomas Wan). Mr. Thomas Wan is taken to be interested in the shares held by Thomrose Holdings (BVI) Limited under the SFO.

Save as disclosed above, as at 30 June 2006 and to the best knowledge of the directors, there was no person (other than the directors and chief executive of the Company) whose interests are set out in the paragraph "Directors' and chief executive's interests and short positions in shares, underlying shares and debentures" above, had an interest or short position in the shares or underlying shares of the Company as recorded in the register to be kept under Section 336 of the SFO.

DIRECTORS' INTERESTS IN COMPETING BUSINESS

Based on the information available to the Company and within the knowledge and belief of the directors of the Company, none of the directors or the management shareholders of the Company (as defined under the GEM Listing Rules) have any interests in a business which competes or may compete with the business of the Group during the period.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

During the period, neither the Company nor its subsidiaries purchased, sold or redeemed any of the Company's listed shares.

THE CODE ON CORPORATE GOVERNANCE PRACTICES

Upon the resignation of Mr. Mak Chi Him as the chief executive officer of the Company effective on 3 May 2006, Mr. Wong Yiu Chu, Denny was then appointed as the chief executive officer and he is also the chairman of the Company. The roles of chairman and chief executive officer were not separated. The Board considers that this structure will not impair the balance of power and authority between the Board and the Management of the Company. The Board also believes that his appointment being both the chairman and chief executive officer is beneficial to the business prospects of the Company. Save as disclosed above, the Company has met the code provisions set out in the Code on Corporate Governance Practices contained in Appendix 15 of the GEM Listing Rules throughout the six months ended 30 June 2006.

DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted the rules governing dealings by directors in listed securities of the Company ("dealings rules") on terms no less exacting than the required standard of dealings as referred to in Rules 5.48 to 5.67 of the GEM Listing Rules as the code of conduct regarding securities transactions by directors. Having made specific enquiry of all directors of the Company, all directors of the Company confirm that they complied with such dealings rules throughout the six months ended 30 June 2006.

AUDIT COMMITTEE

The Company has established an audit committee with written terms of reference in compliance with Rules 5.28 to 5.33 of the GEM Listing Rules. The audit committee comprises three independent non-executive directors namely, Mr. Yu Man Woon (being the chairman of the audit committee), Dr. Yip Chak Lam, Peter and Mr. Wong Yick Man, Francis and reports to the board of directors. The primary duties are to carry out the duties of reviewing and supervising the financial reporting process and internal control system of the Group. The audit committee has reviewed the Group's unaudited results for the six months ended 30 June 2006.

By order of the Board
WONG Yiu Chu, Denny
Chairman

Hong Kong, 4 August 2006