# 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)*


## Annual Report 2006

*For identification only

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*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.*

# CONTENTS

# CORPORATE INFORMATION

## DIRECTORS

*Executive Directors*
Mr. Wong Yiu Chu, Denny *(Chairman)*
Mr. Tan Keng Boon
Ms. Tsui Kam Ling, Alice

*Independent Non-executive Directors*
Dr. Yip Chak Lam, Peter
Mr. Yu Man Woon
Mr. Wong Yick Man, Francis

## AUTHORISED REPRESENTATIVES

Mr. Wong Yiu Chu, Denny
Mr. Tan Keng Boon

## COMPANY SECRETARY

Mr. Lee Yip Wah, Peter, *B.A., solicitor*

## QUALIFIED ACCOUNTANT

Ms. Wong Mei Ki, Maggie, *FCCA, CPA*

## COMPLIANCE OFFICER

Mr. Wong Yiu Chu, Denny

## AUDIT COMMITTEE

Mr. Yu Man Woon *(Chairman)*
Dr. Yip Chak Lam, Peter
Mr. Wong Yick Man, Francis

## REMUNERATION COMMITTEE

Dr. Yip Chak Lam, Peter *(Chairman)*
Mr. Wong Yiu Chu, Denny
Mr. Yu Man Woon

## AUDITORS

Grant Thornton
*Certified Public Accountants*
13th Floor, Gloucester Tower
The Landmark
15 Queen's Road Central
Hong Kong

## REGISTERED OFFICE

Ugland House
P.O. Box 309
George Town
Grand Cayman
Cayman Islands
British West Indies

## HEAD OFFICE & PRINCIPAL PLACE OF BUSINESS

Unit 1008, 10th Floor
Hongkong International Trade and Exhibition Centre
1 Trademart Drive
Kowloon Bay
Hong Kong

## PRINCIPAL BANKERS

DBS Bank (Hong Kong) Limited
Fubon Bank (Hong Kong) Limited

## PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fund Services (Cayman) Limited
Butterfield House, 68 Fort Street
P.O. Box 705, George Town
Grand Cayman
Cayman Islands
British West Indies

## HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited
46th Floor
Hopewell Centre
183 Queen's Road East
Hong Kong

## COMPANY'S WEBSITE ADDRESS

www.acs.com.hk

## STOCK CODE

8210

# CHAIRMAN'S STATEMENT

Advanced Card Systems Holdings Limited and its subsidiaries (the "Group") are pleased to present the Group's annual report for the year ended 31 December 2006.

The sales increased by 11% in the year ended 31 December 2006 to HK$43.2 million from HK$38.9 million in 2005. Net profit before income tax amounted to HK$3.8 million in 2006 compared with the loss of HK$2.1 million in 2005. In 2006, the net profit after income tax was HK$2.6 million after deducting the tax of HK$1.2 million while in 2005 the net profit after income tax was HK$0.2 million after adding the income tax credit of HK$2.3 million. The tax credit resulted from an accounting recognition of the benefit to the Group owing mainly to the tax losses carried forward. These accumulated losses can be used to offset the future taxable profits.

The Group has the mission to become a leading provider of smart card and smart card reader technologies in the world market. In the initial years of its business, the Group focused on building its competence in PC linked smart card readers. The Group succeeded in getting its readers accredited by internationally recognized certification bodies and won a big number of customers all over the world. In 2006, the Group continued to be ranked by Frost & Sullivan, the USA-based independent market research institute, to be Asia Pacific's top supplier and the world's fourth largest supplier of PC linked smart card readers. The Group expanded its product scope into other types of smart card readers and into smart cards. In 2006, the sales of PC linked readers accounted for 49% of the total sales. The balanced 51% resulted from the sales of a range of new products which the Group put the bulk of its research and development sources in during the past several years.

Three new products were launched in 2006 and in the same year the Group started the development of three new products. Owing to the constant introduction of innovative new products, the Group increased its gross profit margins; the gross profit margins in 2006, 2005 and 2004 were respectively 53%, 44% and 42%.

The Group's endeavour in product innovation was recognized in the industry. It received in July 2006, the D'ucoty's "Product Innovation Award in Telecommunications", a prestigious award established by the publisher of the magazine "CardsNow!Asia" and the organizer of the trade show "CardEX Asia" for the Group's innovative new product ACR100, a flash drive integrated with a PC linked smart card reader. The development of innovative products is part of an overall business development strategy to excel in the industry. The Group received in September 2006, Frost & Sullivan's "World Business Development Strategy Leadership" award as a recognition of the Group's success in spreading its PC linked readers to over 80 countries in the world for a big variety of applications.

In 2006, the Group continued to implement several key business strategies to enhance its competitiveness in the industry.

# CHAIRMAN'S STATEMENT

The Group considers the whole world to be the market for its main products. Needless to say, it has to face competition from the global suppliers. The Group has assembled a pool of talents with their respective skill sets and lots of experience to manage the business. As the business grows and the Group becomes cash flow positive, the strategy is to increase the ratio of junior people to senior people so that the total salary increase rate is less than the rate of head count increase. The Group places much emphasis on training its staff, especially the junior members so that they can take up more responsibilities.

A second strategy is to make more effective use of human resources by combining the strengths of Hong Kong, Shenzhen and Manila staff teams with (1) Shenzhen staff to do more hardware owing to proximity to Chinese factories; (2) Manila staff to do more software; and (3) Hong Kong staff to configure the Group's strategies, to build its brand image and to engage in IP (intellectual property) intensive technology development. Hong Kong being geographically close to Shenzhen and to Manila, the costs to exchange visits between Hong Kong and these two overseas offices are more affordable than if the cities are far apart.

A third strategy is to increase office automation. The Group continued to develop and enhance its WEQ (Web-based EnQuiry) IT system to handle information of its big customer base and to track its product development work from product idea formation to testing, debugging and supporting. At the same time, the Group uses externally licensed programs, such as ERP (enterprise resources planning) programs to increase its efficiency in its operations where data manipulations and quantitative analysis are required. The objective is to achieve a good IT system that allows its staff to get information any time, anywhere at high speed and to be able to dispatch required information to business partners and potential business partners effectively. With a powerful system, the Group will be better able to deploy staff members in Hong Kong, Manila and Shenzhen to work together efficiently and to serve the world's customers.

The world market of smart cards and related security products is growing rapidly as smart cards bring convenience to citizens and protect the physical (e.g. assets inside a building) and intangible assets (e.g. confidential information). The Group has proven to be able to develop innovative new products and introduce them to the market in a pipeline. It has the further advantage often to be able to secure sales of new products from customers who are buyers of its existing products such as PC linked readers, the Group's flag-ship products. The Group is exerting good efforts to train its staff especially junior members located in the three offices. They are now taking up more responsibilities and are enabling the Group to enhance its economy of scale and to become a respectable supplier in the smart card and security industry among the global players.

**WONG Yiu Chu, Denny**
*Chairman*

Hong Kong, 23 March 2007

The following discussion and analysis should be read along side with the Group's audited financial statements for the year ended 31 December 2006.

## FINANCIAL REVIEW

The total sales of the Group increased 11% to HK$43.2 million in the year ended 31 December 2006 from HK$38.9 million in the previous year. The sales of PC linked reader in quantity remained to be about the same in 2006 as in 2005 but the dollar amount dropped by 17% owing to decrease in the selling price. The product line of PC linked readers has been the cash cow and the profits generated from it have funded the development of new products. The growth in the sales of smart cards and other products, respectively at 41% and 68% reflected the successful introduction of new products, such as ACOS5 PKI cards.

| | For the year ended 31 December | | |
|---|---|---|---|
| | **2006** | 2005 | Change |
| | ***HK$'million*** | *HK$'million* | |
| Smart cards | **7.6** | 5.4 | +41% |
| PC linked readers | **21.1** | 25.3 | -17% |
| Other products | **12.4** | 7.4 | +68% |
| | **41.1** | 38.1 | |
| Smart card related services | **2.1** | 0.8 | +163% |
| | **43.2** | 38.9 | |

The Group managed to expand its sales in all the three regions, "Europe, Middle East and Africa", "Asia Pacific" and "The Americas". "The Americas" still remain to be the smallest region in term of the Group's sales figures. The Group had some successes in penetrating into the Latin American market such as the Brazilian and the Costa Rican markets. The biggest American market is in USA, mainly for smart card products used by the government departments. The Group is endeavouring to have its products customized to fit the requirements of the USA government.

FINANCIAL REVIEW *(continued)*

| | For the year ended 31 December | | |
|---|---|---|---|
| | **2006** | 2005 | Change |
| | ***HK$'million*** | *HK$'million* | |
| Europe, Middle East and Africa | **21.0** | 19.0 | +11% |
| Asia Pacific | **16.6** | 15.4 | +8% |
| The Americas | **5.6** | 4.5 | +24% |
| | **43.2** | 38.9 | |

Owing mainly to the introduction of innovative new products, the Group increased its gross profit margins to 53% in 2006 from 44% in 2005.

The total operating expenses and finance costs for 2006 amounted to HK$19.4 million compared with HK$20.2 million in 2005. Staff costs increased in 2006 by HK$1.2 million. Such an increase was compensated by the reduction in office rental expenses and legal and professional expenses. As a result, the total operating expenses and finance costs did not increase.

## DIVIDEND

The board of directors (the "Board") does not recommend the payment of a final dividend in respect of the year ended 31 December 2006. The declaration, payment and amount of future dividends will be at the discretion of the Board and will depend upon, among other things, the Group's results of operations, capital requirements, cash flows, general financial conditions and such other factors as the Board may deem relevant.

## BUSINESS REVIEW

In 2006, the Group took various measures to grow its business profitably, to manage its cash flow and to enhance its infrastructure in order to ensure its long-termed viability and prosperity in the smart card industry.



## BUSINESS REVIEW *(continued)*

### New products launched

Three main products were launched to the market in 2006. They are:

(1) ACR88, the portable PIN-pad smart card reader with display and with optional finger print scanner and optional contactless reader. There is a wide range of applications of this device, notably for national health card schemes and ID card schemes. The Hong Kong Immigration is the first customer of this product and they use the device to read the Hong Kong Identity Cards.

(2) the ACR100, a flash drive integrated with a PC linked reader. The device has the full functions of the popular flash drive and additionally provides security function and payment function by virtue of the SIM-sized smart card inserted in it. Before the product was launched, a mobile phone operator in Asia ordered ten thousand units for their pilot project to enable subscribers to use their special VoIP services.

(3) ACOS5 card, a PKI (Public Key Infrastructure) based smart card. Such cards are used in high security applications, e.g. for access to the Internet for home banking, on-line transactions, e-government services, etc.

Even though the sales of these products did not account for a significant percent of the total sales of the Group in 2006, these products were warmly accepted in the market and they created good potential of substantial sales in year 2007 and beyond.



## BUSINESS REVIEW *(continued)*

### Development of new products started in 2006

In 2006, the Group started to develop a few new products. They are:

(1) CryptoMate, a USB PKI token with an embedded smart card chip for extra convenience and security in access control to the Internet and PC networks. It combines the simplicity of a USB device with the capabilities of a cryptographic smart card and an integrated reader. It is ideal for applications such as enterprise banking, e-Commerce, Internet access, computer access control, etc.

(2) APG82, a dynamic password generator which generates one time password to provide a means of authentication in non face-to-face transactions, both online and offline.

(3) eH880, a multi-function smart reader using a 32-bit microprocessor. The eH880 is a secure and feature-rich smart card terminal and is used for various purposes with the initial target use in the German national health card project. This innovative device is capable of facilitating secure mutual authentications (e.g. between a doctor's and patient's card), displaying detailed multi-layered information from one or both cards based on embedded access rights, and facilitating various online and offline transactions through both private and public network infrastructures.

### Smart card and security projects in the world using the Group's products

In 2006, the Group secured business on a world-wide basis for a variety of projects with examples mentioned below:

*Developing specialized smart card reader for a global company*

In 2006, the Group succeeded in concluding an agreement with a global company to develop, manufacture and provide support, for a smart card reader accepting contactless smart card and finger print for physical access control, after the global company evaluated prototypes of the device the Group developed for them. This global company is among the world's leading providers of full access control systems. The Group is completing the product development while the customer is building the system software. Once the device is fully commercialized, substantial income can be expected.



## BUSINESS REVIEW *(continued)*

### Smart card and security projects in the world using the Group's products *(continued)*

*Belgium National ID cards using smart card readers, ACR38 from the Group*


The Group continued to supply its PC linked readers, ACR38, to ZETES SA, the prime contractor for the Belgian National Identity Cards using smart cards. The Group has supplied a substantial volume of readers to them in 2005 and 2006 and their requirement of readers has been extended to 2007.

*VoIP applications for a GSM mobile phone operator using the Group ACR100, flash drive integrated with a PC linked reader*

The Group delivered 10,000 units of ACR100 to a GSM mobile phone operator in a Southeast Asian country which provides the device to their subscribers for making long distance calls using specialized programs stored securely in the flash by virtue of the SIM-sized smart card inserted into ACR100. The subscribers will pay a fee on the use of services for making phone calls or using PC in public areas. If the operator is successful with their pilot runs using 10,000 units of ACR100, the Group can expect bigger volume of purchase from them.

*Customer loyalty program in Kenya*

In 2006, the Group received an order of 100,000 units of ACOS5 cards for multi-function loyalty programs for a supermarket store chain in Kenya. The project will be rolled out in East and Central Africa. The Group supplied 20,000 cards to them in the first quarter of 2007 and will continue to supply the cards in the rest of 2007. The project represents a new market penetration into this African country better known for its rich wildlife.

## BUSINESS REVIEW *(continued)*

### Smart card and security projects in the world using the Group's products *(continued)*

*Contactless smart card reader for Internet café in Korea*

The Group supplied over one thousand units of ACR120, contactless smart card reader and over ten thousand units of contactless cards to a system integrator in Korea for the management of payment in Internet café. The world consumption of contactless smart card readers in quantity is still small compared with that of contact smart card readers but it is rapidly increasing.

### Promotion

In 2006, the Group continued to participate in various smart card and security trade shows in the world as it had done in the previous years. These shows were:

— March: "CeBIT Hannover 2006" in Germany;

— April: "The 8th international Smart card Technology, Application Conference & Products Exhibition, 2006" in Shenzhen;

— April: "Hong Kong Electronics (Spring Edition)" in Hong Kong;

— May: "CardTech/SecureTech 2006" in the USA;

— May: "The 9th International fair of smart card, China (SCC) 2006" in Beijing;

— July: "CardEx Asia 2006" in Malaysia;

— November: "Cartes & IT Security" in France;

— November: "The 15th Annual Governmentware 2006" in Singapore; and

— December: "2006 China (Guangzhou) Card Expo And Summit of Card Industry" in Guangzhou.

The Group will continue to take part in trade shows in the world in order to secure new customers and meet existing customers spread out all over the world.

## BUSINESS REVIEW *(continued)*

### Industry awards

In July 2006, the Group won the D'ucoty's "Product Innovation Award in Telecommunications" as a recognition by the smart card industry of its development and launching of the innovative product ACR100 which integrates a flash drive with a PC linked reader. The awards were established by the publisher of the magazine "CardsNow!Asia" and the organizer of the trade show "CardEX Asia". The purpose of the awards is to recognize individuals and companies that demonstrated outstanding performance in the smart card industry throughout the Asia Pacific region. The Group received in September 2006, Frost & Sullivan's "World Business Development Strategy Leadership" award as a recognition of the Group's success in spreading its PC linked readers to over 80 countries in the world for a big variety of applications.

### Canadian subsidiary established

In 2006, the Group established a wholly owned subsidiary in Canada named "Advanced Card Systems (Canada) Limited". With the establishment of a subsidiary in Canada, it is expected that more sales can be made in Canada, an important market in "The Americas" region.

## PROSPECTS

Since the establishment of the business in 1995, the mission of the management of the Group has been to turn the Group into a respectable global player in the smart card industry. Financial resources have always been a major constraint in the Group's attempt to attain an economy of scale. The Group has not reached this scale yet but has moved big steps in the direction toward this goal through several measures.

Staff costs represent some two-thirds of the total operating expenses of the Group. Therefore the Group emphasizes on managing the human resources expenses by (1) increasing the ratio of junior staff to senior staff and providing them, especially the junior staff members good training and (2) to make the best use of the strengths of the staff teams in the three locations of Hong Kong, Manila and Shenzhen. To allow staff members in different locations to work simultaneously on the same project (e.g. developing, testing and producing a sophisticated product), efficient communication methods and a good IT system are required. The Group has made good progress in its attempt to increase its communication effectiveness and to build a powerful web-based IT system.

Through eleven years of hard work and determination to succeed by dedicated staff members since the establishment of the business in 1995, the Group has built a base of satisfied customers, core competence in smart card readers and has figured out a business strategy. It has proven to be able to secure business from high-profiled projects including nation-wide projects usually initiated by governments despite keen competitions from the strongest global players.

## PROSPECTS *(continued)*

The world market of the types of products in the Group's product portfolio is increasing as smart card systems provide convenience to citizens and protect the physical and intangible assets of people. Many applications of smart cards are getting popular in the world. Examples are (1) using contactless smart cards for the payment of fare (2) using smart cards to go through immigration check-point by verification of finger print stored in the smart cards (3) waving a contactless smart card to enter a building (4) using a contact smart card for accessing the Internet network for banking services, for micro-payments or for on-line commercial transactions and (5) using a smart card, a dynamic password generator or a finger print scanner to authenticate a person for accessing a web-server for confidential or valuable information, just to mention a few. The Group will definitely reap the benefits from the growth of the industry.

Within the constraint of limited financial resources to compete in the world market for smart card products, the Group's priority has to achieve profitability and to attain a positive cash flow. The Group managed to make a small net profit after income tax in 2006 and increased slightly its cash position at 31 December 2006 compared with the position a yeas ago.

Once the Group reaches its economy of scale, the growth of sales and profitability will accelerate.

## LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2006, the Group's cash at banks and on hand amounted to HK$7.9 million (2005: HK$7.1 million) which included the pledged bank deposits of HK$2.7 million (2005: HK$0.7 million). Out of the HK$2.7 million pledged bank deposits, HK$0.7 million was pledged for 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$2.0 million was to secure bank credit lines. At 31 December 2006, no credit line has been utilized (2005: Nil).

The current ratio, being the ratio of current assets to current liabilities, was kept at 5.2 (2005: 3.6). Net asset value as at the year end date was HK$32.9 million (2005: HK$30.4 million). As at 31 December 2006, the Group did not have any borrowings and, accordingly, the gearing ratio was zero (2005: zero).

## CAPITAL STRUCTURE

The Group relies on internal resources and the net proceeds from the Placing 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 year, the Group did not hold any significant investments.

## ACQUSITIONS AND DISPOSALS OF SUBSIDIARIES AND AFFILIATED COMPANIES

The Group did not have any material acquisitions or disposals of subsidiaries and affiliated companies during the year ended 31 December 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 year. There is no significant exposure to foreign exchange rate fluctuations. No hedging or other alternatives have been implemented during the year.

## PLEDGE OF ASSETS

As at 31 December 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 deposits of US$257,000 to two banks for banking facilities. Save as disclosed herein, the Group did not pledge any of its assets.

## CONTINGENT LIABILITIES

As at 31 December 2006, the Company executed corporate guarantee of HK$4 million (together with accrued interest thereon) to two banks 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 31 December 2006, the Group had 70 full time employees. Staff costs amounted to HK$12.1 million (2005: HK$10.9 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 SENIOR MANAGEMENT

## EXECUTIVE DIRECTORS

### Mr. WONG Yiu Chu, Denny

Mr. Denny Wong, aged 59, is the chairman and chief executive officer of the Company and the director of several subsidiaries of the Group. Mr. Wong founded Advanced Card Systems Limited ("ACS") in December 1995. In 1985, Mr. Wong founded his previous company, Advanced Electronics Limited, which distributed semiconductor components of Motorola Semiconductors (Hong Kong) Ltd., and provided design and application engineering services to manufacturers of consumer, industrial and telecommunication products. Later in 1997, Mr. Wong disposed of his entire shareholding interest in Advanced Electronics Limited to Future Electronics Holdings Inc., an electronic component distributor based in Canada and was appointed as its general manager for its distribution business in China during the period from July 1997 to April 2000. In June 2000, he became the chief executive officer of ACS. Mr. Wong obtained a bachelor of science degree in physics in 1972 and a masters degree in business administration in 1975 from The Chinese University of Hong Kong. He is the spouse of Ms. Tsui Kam Ling, Alice.

### Mr. TAN Keng Boon

Mr.Tan Keng Boon, aged 48, joined the Group in October 1999 as a full-time consultant of ACS and has been a full-time employee and the chief technical officer of ACS since May 2003 and an executive director since 25 October 2003. He is also a director of a subsidiary of the Group. Mr. Tan is responsible for the implementation of a technical sales and marketing programme for existing and prospective customers of ACS. He has been involved actively in defining the product development road map of ACS and leading the engineering team in the development of new products. Previously, Mr. Tan worked for Gemplus Technologies Asia Pte Ltd. and De La Rue Systems Asia Pte Ltd., both of which were subsidiaries of established companies in the smart card industry. This past working experience of Mr. Tan has allowed him to develop a network of contacts with system solution providers as well as smart card and terminal vendors which are potential customers of the Group. Mr. Tan obtained a bachelor of engineering degree from the National University of Singapore in 1983.

### Ms. TSUI Kam Ling, Alice

Ms. Tsui Kam Ling, Alice, aged 54, joined the Group in September 1998 as the Vice President, Operations of ACS and is mainly responsible for supervising the sourcing of raw materials, product production, product quality control and logistics of the delivery of finished products to customers. She is also the director of several subsidiaries of the Group. Prior to joining the Group, Ms. Tsui was a director of Advanced Electronics Limited which distributed semiconductor components until 1997 when it was acquired by Future Electronics Holdings Inc. She then worked as the administration manager of Future Advanced Electronics (Hong Kong) Limited from July 1997 to September 1998. Ms.Tsui had a teaching career from 1975 to 1983. Ms.Tsui graduated from The Chinese University of Hong Kong with a bachelor of arts degree in 1975. She is the spouse of Mr. Denny Wong.

# DIRECTORS AND SENIOR MANAGEMENT

## INDEPENDENT NON-EXECUTIVE DIRECTORS

### Dr. YIP Chak Lam, Peter

Dr. Peter Yip, aged 56, was appointed as an independent non-executive director on 25 October 2003. He was awarded a bachelor of science degree, a masters of philosophy degree and a doctor of philosophy degree, all in electronic engineering. He worked for Cable & Wireless in Hong Kong before he entered into teaching at Nanyang Technological Institute in Singapore in 1981. He joined and further pursued his academic career at City Polytechnic of Hong Kong (which later became City University of Hong Kong) from 1985 to 1994. During this period he started to engage in many telecommunications network and product design consultancy projects until he joined Hutchison in January 1995. In Hutchison, he was first put in charge of the engineering development and operations of its paging network, then stayed with the "Fixed Network" through the era of Hutchison Telecommunications (HK) Limited to Hutchison Global Crossing Limited ("HGC") until he retired in August 2002. He has been involved in all aspects in the building up and in the running of the "Fixed Network". He is widely acknowledged by peers as the main driving force of HGC. Dr. Yip is a Chartered Engineer and a fellow of the Institution of Electrical Engineers (IEE) of the United Kingdom. He has had one book and over 40 technical papers published. Dr. Yip is related to Mr. Wong Yick Man, Francis, Peter, an independent non-executive director of the Company, as common directors in Trident Telecom Ventures Limited.

### Mr. YU Man Woon

Mr. Yu Man Woon, aged 56, was appointed as an independent non-executive director on 30 September 2004. He is currently the assistant general manager of a local bank. Mr. Yu obtained a masters degree in business administration from the University of Minnesota and has over 25 years of experience in banking and finance with various international financial institutions. He is an independent non-executive director of Hantec Investment Holdings Limited which is listed on the Main Board of the Stock Exchange of Hong Kong Limited.

### Mr. WONG Yick Man, Francis

Mr. Wong Yick Man, Francis, aged 53, was appointed as an independent non-executive director on 1 June 2006. He is the Managing Director of Trident Telecom Ventures Limited. He has a strong background in accountancy, management consulting and financial operations prior to his move into the telecommunications industry in 1990. He was a founding director of the New World Telephone group and a key player in the deregulation process. He was the chief executive officer of a Hong Kong listed company and the founding partner of a major IDD wholesaler based in the United States. In 2000, he founded Trident Telecom Ventures Limited as Asia's first licensed Mobile Virtual Network Operator, offering innovative SIM based travel related mobile services. Mr. Wong is a graduate of Hong Kong University and a fellow member of the Association of Chartered Certified Accountants and a Certified Public Accountant of the Hong Kong Institute of Certified Public Accountants. Mr. Wong is related to Dr. Yip Chak Lam, Peter, an independent non-executive director of the Company, as common directors in Trident Telecom Ventures Limited.

## SENIOR MANAGEMENT

### Mr. Scott G. BOOTH

Mr. Scott Booth, aged 34, joined the Group in August 2005, as the Vice President of Business Development. Mr. Booth is responsible for the development and enhancement of existing and new business opportunities worldwide with a focus on North America and Western Europe. Mr. Booth joined the Group from SDLOGIC Technologies Inc., a North American based global smart card consultation and hardware design firm where he was the President and CEO of the company for over 4 years. Mr. Booth has been a FCC licensed amateur radio operator since 1991 and has served as a Board member for numerous non-profit organizations throughout North America. Mr Booth resigned from the Group with effect from 1 March 2007 for personal reasons.

### Ms. WONG Mei Ki, Maggie

Ms. Maggie Wong, aged 32, is the Finance Manager and qualified accountant of the Group. Prior to joining the Group in June 2003, she has worked for an international accounting firm in Hong Kong. Ms. Wong obtained her bachelor degree in business administration from The Chinese University of Hong Kong. She is a fellow member of the Association of Chartered Certified Accountants and a Certified Public Accountant of the Hong Kong Institute of Certified Public Accountants.

# CORPORATE GOVERNANCE REPORT

During the year, the Company has applied the principles of the Code on Corporate Governance Practices as set out in Appendix 15 of the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited (the "Code "). The Company has complied with the requirements of the Code except for the provision A.2 of the Code. A.2 of the Code provides that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. 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 does 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.

## 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 codes of conduct regarding securities transactions by directors and by relevant employees as defined in the Code. 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 year ended 31 December 2006.

## BOARD OF DIRECTORS

The Board comprises 3 executive directors, namely Mr. Wong Yiu Chu, Denny (being the chairman of the Board), 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. Details of each director are disclosed on pages 14 to 15 of this Annual Report.

During the year ended 31 December 2006, the Board at all times exceeded the minimum requirements of the GEM Listing Rules relating to the appointment of at least three independent non-executive directors, and complied with the requirement that these should include one such director with appropriate professional qualifications or accounting or related financial management expertise.

The Company has received an annual confirmation of independence pursuant to Rule 5.09 of the GEM Listing Rules from each of the independent non-executive director. The Company considers that all of its independent non-executive directors are independent.

The Board is responsible for establishing the strategic direction of the Group; setting objectives and business development plans; monitoring the performance of the senior management; and assuming responsibility for corporate governance. The management is responsible for implementing the strategies and plans established by the Board; and submitting reports on the Company's operations to the Board on a regular basis to ensure effective discharge of the Board's responsibilities.

# CORPORATE GOVERNANCE REPORT

## BOARD OF DIRECTORS *(continued)*

The Board has established schedule of matters specifically reserved to the Board for its decision and those reserved for the management. The Board reviews this schedule on a periodic basis to ensure that it remains appropriate to the needs of the Company.

The Company has held four meetings during the year ended 31 December 2006. Due notice and board papers were given to all directors prior to the meeting in accordance with the GEM Listing Rules and the Code. Details of individual attendance of directors are set out below:

| | Name of director | Attended/ Eligible to attend |
|---|---|---|
| Executive directors | Wong Yiu Chu, Denny *(Chairman)* | 4/4 |
| | Mak Chi Him (1) | 1/1 |
| | Tan Keng Boon | 4/4 |
| | Tsui Kam Ling, Alice | 4/4 |
| Independent non-executive directors | Yip Chak Lam, Peter | 4/4 |
| | Cheong Chung Chin (2) | 2/2 |
| | Yu Man Woon | 4/4 |
| | Wong Yick Man, Francis (3) | 2/2 |

*Notes:*

(1) Resigned on 2 May 2006

(2) Resigned on 31 May 2006

(3) Appointed on 1 June 2006

The Board has established procedure to enable directors, upon reasonable request, to seek independent professional advice in appropriate circumstances at the Company's expenses.

Ms. Tsui Kam Ling, Alice is the spouse of Mr. Wong Yiu Chu, Denny. Dr. Yip Chak Lam, Peter and Mr. Wong Yick Man, Francis are related as they are common directors in Trident Telecom Ventures Limited. Save as disclosed herein, there is no relationship (including financial, business, family or other material/relevant relationships) among members of the Board.

## CHAIRMAN AND CHIEF EXECUTIVE OFFICER

During the period from 1 January 2006 to 2 May 2006, Mr. Wong Yiu Chu, Denny was the chairman of the Company while Mr. Mak Chi Him was the chief executive officer of the Company. 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 does 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.

## NON-EXECUTIVE DIRECTORS

Dr. Yip Chak Lam, Peter, Mr. Cheong Chung Chin and Mr. Yu Man Woon were re-appointed by the board of directors on 25 October 2005 for a term commencing from 25 October 2005 to 31 May 2006. Mr. Cheong Chung Chin resigned as the independent non-executive director of the Company on 31 May 2006. Dr. Yip Chak Lam, Peter and Mr. Yu Man Woon were re-appointed by the board of directors for a term of two years commencing from 1 June 2006. Mr. Wong Yick Man, Francis was appointed by the board of directors as the independent non-executive director for a term of 2 years commencing from 1 June 2006.

## REMUNERATION OF DIRECTORS

The remuneration committee makes recommendations to the Board on the Company's policy and structure for all remuneration of directors and senior management and on the establishment of a formal and transparent procedure for developing the policy on such remuneration. The remuneration of directors is determined according to their expertise, knowledge and contributions to the Group with reference to the Group's profitability and the prevailing market conditions. Details of the remuneration payable to the directors during the year are set out in note 14 to the financial statement.

The remuneration committee comprises 3 members, namely Dr. Yip Chak Lam, Peter (being the chairman of the remuneration committee), Mr. Wong Yiu Chu, Denny and Mr. Yu Man Woon.

## REMUNERATION OF DIRECTORS *(continued)*

The remuneration committee has held three meetings during the year. Details of individual attendance of its members are set out below:

| | Name of director | Attended/ Eligible to attend |
|---|---|---|
| Independent non-executive directors | Yip Chak Lam, Peter *(Chairman)* | 3/3 |
| | Yu Man Woon | 3/3 |
| Executive director | Wong Yiu Chu, Denny | 3/3 |

Set out below is the summary of work performed by the remuneration committee during the year ended 31 December 2006:

1. to determine the specific remunerations packages of all executive directors and senior management;
2. to review and approve the compensation payable to executive directors in connection with their appointments; and
3. to make recommendations to the Board on the remuneration for the independent non-executive directors.

## NOMINATION OF DIRECTORS

The Board has not established a nomination committee. According to the Articles of Association of the Company, the Board has the power from time to time and at any time to appoint any person as a director either to fill a casual vacancy or as an addition to the Board. In assessing nomination of new directors, the Board has taken into consideration of nominee's qualification, ability and potential contribution to the Company. Mr. Mak Chi Him resigned as the executive director and chief executive officer of the Company for personal reasons with effect from 3 May 2006. Mr. Wong Yiu Chu, Denny was appointed as the chief executive officer of the Company with effect from 3 May 2006. Mr. Cheong Chung Chin resigned as the independent non-executive director of the Company for personal reasons with effect from 1 June 2006. Mr. Wong Yick Man, Francis was appointed as independent non-executive director of the Company on 1 June 2006.

## NOMINATION OF DIRECTORS *(continued)*

The Board has held two meetings to approve all the above-mentioned appointments and resignations. Details of individual attendance of directors are set out below:

| | Name of director | Attended/ Eligible to attend |
|---|---|---|
| Executive directors | Wong Yiu Chu, Denny *(Chairman)* | 2/2 |
| | Mak Chi Him [(1)] | 1/1 |
| | Tan Keng Boon | 2/2 |
| | Tsui Kam Ling, Alice | 2/2 |
| Independent non-executive directors | Yip Chak Lam, Peter | 2/2 |
| | Cheong Chung Chin [(2)] | 2/2 |
| | Yu Man Woon | 2/2 |

*Notes:*

(1) Resigned on 2 May 2006

(2) Resigned on 31 May 2006

## AUDITORS' REMUNERATION

For the year ended 31 December 2006, the fee payable to the auditors in respect of audit services amounted to HK$264,000.

## AUDIT COMMITTEE

The audit committee is primarily responsible for making recommendation to the Board on the appointment, reappointment and removal of the external auditor, and to approve the remuneration and terms of engagement of the external auditor, and any questions of resignation or dismissal of that auditor; to review the Company's financial controls, internal controls and risk management systems; and to review the financial statements of the Company.

The audit committee comprises 3 members, namely Mr. Yu Man Woon (being the chairman of the audit committee), Dr. Yip Chak Lam, Peter and Mr. Wong Yick Man, Francis.

## AUDIT COMMITTEE *(continued)*

The audit committee has held four meetings during the year. Details of individual attendance of its members are set out below:

| | Name of director | Attended/ Eligible to attend |
|---|---|---|
| Independent non-executive directors | Yu Man Woon *(Chairman)* | 4/4 |
| | Yip Chak Lam, Peter | 4/4 |
| | Cheong Chung Chin [(1)] | 2/2 |
| | Wong Yick Man, Francis [(2)] | 2/2 |

*Notes:*

(1) Resigned on 31 May 2006

(2) Appointed on 1 June 2006

Set out below is the summary of work performed by the audit committee during the year ended 31 December 2006:

(1) to approve the remuneration and terms of engagement of the external auditor;

(2) to monitor integrity of financial statements of the Company and the Company's annual report and accounts, interim report, and quarterly reports, and to review significant financial reporting judgments contained in them;

(3) to review the Company's financial controls, internal controls and risk management systems; and

(4) to discuss with the management the system of internal control and ensure that management has discharged its duty to have an effective internal control system.

## ACCOUNTABILITY AND AUDIT

The directors acknowledged that it is their responsibility for preparing the accounts. A statement by the auditors about their reporting responsibilities is set out on pages 37 to 38 of this Annual Report. There are no material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue as a going concern.

## INTERNAL CONTROL

The board is responsible for overseeing the system of internal control of the Group and for reviewing its effectiveness. To facilitate the effectiveness and efficiency of operations and to ensure compliance with relevant laws and regulations, the Group emphasizes on the importance of a sound internal control system which is also indispensable for mitigating the Group's risk exposures. The Group's system of internal control is designed to provide reasonable, but not absolute, assurance against material misstatement or loss and to manage and eliminate risks of failure in operational systems and fulfillment of the business objectives.

The management of the Group has appointed an external consultant to review the internal control system with focus on risk management of the Group during the year and has submitted the results of the review and its recommendations and opinions for consideration by the audit committee and the board. The audit committee and the board have discussed the relevant results of review, and are satisfied that, the present system of internal control is effective. The Group does not have the internal audit function and does not consider that there is a need to have one.

## COMMUNICATION WITH SHAREHOLDERS

The objective of shareholder communication is to provide our shareholders with detailed information about the Company so that they can exercise their rights as shareholders in an informed manner.

The Company uses a range of communication tools to ensure its shareholders are kept well informed of key business imperatives. These include annual general meeting, annual report, interim report, quarterly reports, various notices, announcements and circulars. Procedure for voting by poll has been included in circular of the Company and has been read out by the chairman at the general meeting.

At the 2006 annual general meeting, a separate resolution was proposed by the chairman in respect of each separate issue, including re-election of directors. The chairman of the Board, audit committee and remuneration committee attended the 2006 Annual General Meeting to answer questions of shareholders.

# REPORT OF THE DIRECTORS

The directors are pleased to submit their annual report together with the audited financial statements for the year ended 31 December 2006.

## PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The principal activities and other particulars of the subsidiaries are set out in note 16 to the financial statements.

The analysis of the principal activities and geographical locations of the operations of the Company and its subsidiaries during the year are set out in note 7 to the financial statements.

## MAJOR CUSTOMERS AND SUPPLIERS

The information in respect of the Group's sales and purchases attributable to the major customers and suppliers respectively during the financial year is as follows:

| | Percentage of the Group's total | |
|---|---|---|
| | Sales | Purchases |
| The largest customer | 16% | — |
| Five largest customers in aggregate | 32% | — |
| The largest supplier | — | 21% |
| Five largest suppliers in aggregate | — | 56% |

At no time during the year have the directors, their associates or any shareholder of the Company (which to the knowledge of the directors owns more than 5% of the Company's share capital) had any interest in these major customers and suppliers.

## FINANCIAL STATEMENTS

The profit of the Group for the year ended 31 December 2006 and the state of the Company's and the Group's affairs as at that date are set out in the financial statements on pages 39 to 82.

The directors do not recommend the payment of a dividend for the year ended 31 December 2006.

## RESERVES

Profit for the year of HK$2,564,000 (2005: HK$196,000) has been transferred to reserves. Details of the movements in the reserves of the Group and the Company during the year are set out in note 27 to the financial statements.

## PLANT AND EQUIPMENT

Details of the movements in plant and equipment of the Group are set out in note 15 to the financial statements.

## SHARE CAPITAL AND SHARE OPTIONS

Details of the movements in share capital and share options of the Company during the year are set out in notes 25 and 26 to the financial statements respectively.

## DIRECTORS

The directors who held the office during the year and up to the date of this report were:

*Executive Directors*
Mr. Wong Yiu Chu, Denny
Mr. Mak Chi Him (resigned on 2 May 2006)
Mr. Tan Keng Boon
Ms. Tsui Kam Ling, Alice

*Independent Non-executive Directors*
Dr. Yip Chak Lam, Peter
Mr. Cheong Chung Chin (resigned on 31 May 2006)
Mr. Yu Man Woon
Mr. Wong Yick Man, Francis (appointed on 1 June 2006)

In accordance with Articles 95 and 112 of the Company's Articles of Association, Mr. Wong Yiu Chu, Denny, Mr. Yu Man Woon and Mr. Wong Yick Man, Francis will retire at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

## DIRECTORS' SERVICE CONTRACTS

Mr. Wong Yiu Chu, Denny and Mr. Tan Keng Boon had entered into service agreements with the Company for an initial term of three years commencing on 27 October 2003 and shall continue thereafter unless and until terminated in accordance with the terms of the agreement. Mr. Mak Chi Him and Ms. Tsui Kam Ling, Alice had entered into service agreements with the Company for a term commencing from 23 March 2005 to 26 October 2006 and shall continue thereafter unless and until terminated in accordance with the terms of the agreement. Under the agreements, either party may terminate the agreement at any time by giving to the other not less than six months' prior written notice.

Mr. Mak Chi Him resigned as the executive director of the Company on 2 May 2006. The service agreements of the other executive directors were renewed for further two years from 27 October 2006 to 26 October 2008 and shall continue thereafter unless and until terminated in accordance with the terms of the agreements. Under the agreements, either party may terminate the agreement at any time by giving to the other not less than three months' prior written notice.

## DIRECTORS' SERVICE CONTRACTS *(continued)*

Dr. Yip Chak Lam, Peter, Mr. Cheong Chung Chin and Mr. Yu Man Woon were re-appointed by the board of directors on 25 October 2005 for a term commencing from 25 October 2005 to 31 May 2006. Mr. Cheong Chung Chin resigned as the independent non-executive director of the Company on 31 May 2006. Dr. Yip Chak Lam, Peter and Mr. Yu Man Woon were re-appointed by the board of directors for a term of two years commencing from 1 June 2006. Mr. Wong Yick Man, Francis was appointed by the board of directors as the independent non-executive director for a term of 2 years commencing from 1 June 2006.

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

At 31 December 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 GEM of the Stock Exchange (the "GEM Listing Rules") were as follows:

### (i) Interests in issued shares

| | Ordinary shares of HK$0.10 each | | | | | |
|---|---|---|---|---|---|---|
| Name of director | Personal interests *(Note 1)* | Family interests | Corporate interests | Other interests | Total number of shares held | Percentage of the Company's issued share capital as at 31 December 2006 |
| 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 | 1,789,893 | — | — | — | 1,789,893 | 0.64% |

## DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES *(continued)*

### (i) Interests in issued shares *(continued)*

*Notes:*

1. The shares are registered under the names of the directors who are the beneficial owners.

2. 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.

3. 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 31 December 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

Pursuant to the resolution of the shareholders of the Company dated 27 October 2003, the Company adopted a Pre-IPO Share Option Plan (the "Plan").

*(a) Purpose of the Plan*

The purpose of the Plan was to recognise the contribution of certain existing and past employees, directors of the Company and consultants of the Group to the growth of the Group and/or to the listing of the shares on GEM and for the purpose of cancellation of the terminated share option scheme.

## SHARE OPTION SCHEMES *(continued)*

### (i) Pre-IPO Share Option Plan *(continued)*

(b) *Participants of the Plan*

All options granted under the Plan were granted to those directors, employees and consultants which held options granted to them under the terminated share option scheme and which were outstanding immediately prior to the cancellation of such scheme as consideration for their agreement to cancel these outstanding options.

(c) *Total number of shares available for issue under the Plan*

The maximum number of shares in respect of which options may be granted under the Plan was 6,535,631 shares, which represents approximately 2.32% of the issued share capital as at 23 March 2007.

(d) *Period within which the shares must be taken up under an option*

Any option may be exercised in accordance with its terms at any time during a period notified by the Board to each grantee provided that the period within which the option must be exercised shall be not more than 10 years from the date of grant of the option.

(e) *Payment on acceptance of the option offer*

HK$1.00 was payable by the Participant to the Company on acceptance of the option offer as consideration for the grant from the Offer Date to such date as the Board determined and specified in the Offer Letter, both days inclusive.

(f) *Basis of determining the exercise price*

The exercise price per share is HK$0.09 or HK$0.24.

(g) *Remaining life of the Plan*

The Plan was valid and effective for a period commencing on 27 October 2003 and ending on the day immediately prior to the Listing Date i.e. 10 November 2003 (both dates inclusive), after which period no further options would be granted but in respect of all options which had been granted prior to the end of such period, the provisions of the Plan shall remain in full force and effect.

## SHARE OPTION SCHEMES *(continued)*

### (i) Pre-IPO Share Option Plan *(continued)*

At 31 December 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 29 December 2006 was HK$0.116) with an exercise price of HK$0.09 or HK$0.24 per share under 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.

| | | Number of share options | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Grantees | Date granted | Balance as at 1 January 2006 | Granted during the year | Exercised during the year | Lapsed during the year | Balance as at 31 December 2006 | Period during which the options are exercisable | Exercise price per share | Percentage of the Company's issued share capital as at 31 December 2006 |
| Consultants & Employees | 27 October 2003 | 1,521,745 | – | – | 160,138 *(Note 4)* | 1,361,607 *(Note 1, 2)* | 10 May 2004 to 24 July 2010 | HK$0.09 | 0.48% |
| 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 | – | – | 200,173 *(Note 4)* | 900,776 *(Note 3)* | 10 May 2004 to 20 January 2013 | HK$0.24 | 0.32% |
| | | 2,623,556 | – | – | 360,311 | 2,263,245 | | | |

*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 have vested and were exercisable on 10 May 2004;

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

(c) the remaining one-third of the options have vested and were exercisable on 31 December 2005.

4 The options lapsed upon the resignation of 2 participants from the Group.

5 No option was granted, exercised or cancelled during the year.

## SHARE OPTION SCHEMES *(continued)*

### (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.

*(a) Purpose of the Scheme*

The purpose of the Scheme is to provide the people and the parties working for the interest of the Group with an opportunity to obtain equity interest in the Company, thus linking their interest with the interest of the Group and thereby providing them with incentives to work better for the interest of the Group.

*(b) Participants of the Scheme*

Pursuant to the Scheme, the Company may grant options to any directors, employees, suppliers, advisors or consultants engaged by or worked for any member of the Group, who have in accordance with paragraph (a) above, contribute to the Group.

*(c) Total number of shares available for issue under the Scheme*

(1) At the time of adoption of the Scheme, the Company may seek approval of its shareholders in a general meeting to authorise the directors of the Company to grant options under the Scheme and any other share option schemes of the Company in issue entitling the Grantees to exercise up to an aggregate of 10% (the "Scheme Mandate Limit") of the total number of shares in issue immediately following completion of the Placing (excluding (i) any shares issued pursuant to the Scheme and any other share option schemes of the Company; and (ii) any pro rata entitlements to further shares issued in respect of those shares mentioned in (i)) unless the Company obtains a fresh approval from its shareholders pursuant to sub-paragraph (2) below. Options lapsed in accordance with the terms of the Scheme shall not be counted for the purpose of calculating the Scheme Mandate Limit.

## SHARE OPTION SCHEMES *(continued)*

### (ii) Share Option Scheme *(continued)*

*(c) Total number of shares available for issue under the Scheme (continued)*

(2) The Company may seek approval of its shareholders in general meeting to refresh the Scheme Mandate Limit such that the total number of shares in respect of which options may be granted by the directors of the Company under the Scheme and any other share option schemes of the Company in issue shall not exceed 10% (the "Refreshed Limit") of the issued share capital of the Company at the date of approval to refresh such limit (excluding (i) any shares issued pursuant to the Scheme and any other share option schemes of the Company; and (ii) any pro rata entitlements to further shares issued in respect of those shares mentioned in (i)). Options previously granted under the Scheme (including those outstanding, cancelled, lapsed in accordance with the Scheme or exercised options) shall not be counted for the purpose of calculating the Refreshed Limit.

(3) The Company may seek separate approval by its shareholders in general meeting for granting options beyond the Scheme Mandate Limit or, if applicable, the Refreshed Limit provided the options in excess of such limit are granted only to Participants specifically identified by the Company before such approval is sought.

Notwithstanding the above, the maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Scheme and any other share option schemes of the Company shall not exceed 30% of the total number of shares in issue from time to time. No options may be granted under any schemes of the Company if this will result in the aforesaid 30% limit being exceeded.

*(d) Maximum entitlement of each Participant*

The maximum number of shares issued and to be issued upon exercise of the options granted and to be granted pursuant to the Scheme and any other share option schemes of the Company to each Participant (including both exercised and outstanding options) in any 12-month period up to and including the date of grant of the options shall not exceed 1% of the total number of shares in issue. Any further grant of options which will result in such limit being exceeded shall be subject to the separate approval of the shareholders of the Company in general meeting, at which such Participant and his associates shall abstain from voting.

## SHARE OPTION SCHEMES *(continued)*

### (ii) Share Option Scheme *(continued)*

*(e) Time of exercise of option*

An option may be exercised in accordance with the terms of the Scheme at any time during a period of not more than 10 years to be notified by the Board to each Grantee, which period shall commence on the date on which an offer of the grant of an option is accepted or deemed to be accepted in accordance with the terms of the Scheme and expire on the last day of such period as determined by the Board.

*(f) Payment on acceptance of the option offer*

HK$1.00 is payable by the Participant to the Company on acceptance of the option offer as consideration for the grant from the Offer Date to a date being the fourteenth day after the Offer Date (or such other date as may be specified in the Offer Letter), both days inclusive.

*(g) Basis of determining the exercise price*

The subscription price in respect of each share issued pursuant to the exercise of options granted hereunder shall be a price determined by the Board and notified to a Participant and shall be no less than the highest of: (i) the closing price of the shares as stated in the daily quotations sheet issued by the Stock Exchange on the Offer Date; (ii) the average closing price of the shares as stated in the daily quotations sheets issued by the Stock Exchange for the five consecutive Trading Days immediately preceding the Offer Date (provided that the new issued price for the listing of the shares shall be used as the closing price for any Trading Day falling within the period before listing of the shares if the shares have been listed for less than 5 Trading Days before the Offer Date); and (iii) the nominal value of a share.

*(h) Remaining life of the Scheme*

The Scheme will remain valid for a period of 10 years commencing 27 October 2003, after which period no further options will be granted but in respect of all options which remain exercisable at the end of such period, the provisions of the Scheme shall remain in full force and effect.

## 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 year 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 31 December 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 31 December 2006 |
|---|---|---|---|
| Proway Investment Limited *(Note 2)* | Beneficial owner | 31,740,305 shares (L) | 11.26% |
| Morningside CyberVentures Holdings Limited *(Note 2)* | Other | 31,740,305 shares (L) | 11.26% |
| Biswick Holdings Limited *(Note 2)* | Other | 31,740,305 shares (L) | 11.26% |
| Verrall Enterprises Holdings Limited *(Note 2)* | Other | 31,740,305 shares (L) | 11.26% |
| Verrall Limited *(Note 2)* | Other | 31,740,305 shares (L) | 11.26% |
| Madam Chan Tan Ching Fen *(Note 2)* | Other | 31,740,305 shares (L) | 11.26% |
| Thomrose Holdings (BVI) Limited *(Note 3)* | Beneficial owner | 16,815,162 shares (L) | 5.97% |
| Mr. Wan Wah Tong, Thomas *(Note 3)* | Other | 16,815,162 shares (L) | 5.97% |

## SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSONS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES *(continued)*

*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 31 December 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 CONTRACTS

No contracts of significance in relation to the Group's business to which the Company, its subsidiaries, its fellow subsidiaries or its holding Company was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

## 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 year.

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

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

## BANK LOANS AND OTHER BORROWINGS

The Company and its subsidiaries obtained banking facilities during the year and no outstanding balances of bank loans and other borrowings as at the year end.

## FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group is set out on page 83 of the annual report.

## REMUNERATION POLICIES

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 remuneration of directors is determined according to their expertise, knowledge and contributions to the Group with reference to the Group 's profitability and the prevailing market conditions. The Group has also adopted share option schemes under which the directors and 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.

## RETIREMENT SCHEMES

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme ("MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for all of its employees in Hong Kong who are eligible to participate in the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independent administrated fund. Pursuant to the rules of the MPF Scheme, the Group and its employees are each required to make contributions to the scheme at 5% of their monthly relevant income, up to HK$1,000 per month. Pursuant to the relevant regulations of the People's Republic of China (the "PRC"), the subsidiary in the PRC has participated in a central pension scheme operated by the local municipal government (the "Scheme"), whereby the PRC subsidiary is required to contribute a certain percentage of the basic salaries of their employees to the Scheme to fund their retirement benefits. The Company's subsidiary operating in the Philippines participates in the mandatory Social Security System contribution scheme ("SSS Scheme") as prescribed by the Philippine law. Pursuant to the rules of the SSS Scheme, the Group and the employees are required to make monthly contributions to the scheme fixed at 9.4% of their relevant monthly income (6.07% for employer and 3.33% for employee), up to PHP910 per month for employer and PHP500 for employee. Contributions of the Group to the MPF Scheme, the Scheme and the SSS Scheme are charged to the income statement as incurred. During the year, the retirement scheme contributions borne by the Group amounted to HK$426,000 (2005: HK$422,000).

## PUBLIC FLOAT

Based on the information available to the Company and within the knowledge and belief of the directors of the Company, the Company has maintained the prescribed amount of public float during the year and up to the date of this report as required under the GEM Listing Rules.

## 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 met once with the external auditors to review the effectiveness of the internal control systems and the Group's audited results for the year ended 31 December 2006.

## AUDITORS

KPMG resigned as auditors of the Company with effect from 20 December 2005 and Grant Thornton were appointed to fill the casual vacancy in the office of auditors of the Company with effect from 23 December 2005. Save as disclosed herein, there was no other change in auditors of the Company in any of the preceding three years.

Grant Thornton retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of Grant Thornton as auditors of the Company is to be proposed at the forthcoming annual general meeting.

By order of the Board

WONG Yiu Chu, Denny
*Chairman*

Hong Kong, 23 March 2007

# INDEPENDENT AUDITORS' REPORT

Certified Public Accountants
Member of Grant Thornton International

Grant Thornton
均富會計師行

To the members of Advanced Card Systems Holdings Limited
龍傑智能卡控股有限公司
*(incorporated in the Cayman Islands with limited liability)*

We have audited the consolidated financial statements of Advanced Card Systems Holdings Limited (the "Company") set out on pages 39 to 82, which comprise the consolidated and company balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

## AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

# INDEPENDENT AUDITORS' REPORT

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Grant Thornton
*Certified Public Accountants*
13th Floor, Gloucester Tower
The Landmark
15 Queen's Road Central
Hong Kong

23 March 2007



# CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2006

| | *Notes* | **2006** | 2005 |
|---|---|---|---|
| | | ***HK$'000*** | *HK$'000* |
| **Revenue** | 5 | **43,165** | 38,853 |
| Cost of sales | | **(20,092)** | (21,808) |
| Gross profit | | **23,073** | 17,045 |
| Other revenue | 5 | **282** | 1,163 |
| Other net loss | 6 | **(196)** | (153) |
| Selling and distribution costs | | **(3,014)** | (4,080) |
| Administrative expenses | | **(16,185)** | (15,968) |
| **Operating profit/(loss)** | | **3,960** | (1,993) |
| Finance costs | 8.1 | **(206)** | (149) |
| **Profit/(Loss) before income tax** | 8 | **3,754** | (2,142) |
| Income tax (expense)/credit | 9 | **(1,190)** | 2,338 |
| **Profit for the year** | 10 | **2,564** | 196 |
| **Earnings per share** | 12 | | |
| Basic | | **HK0.91 cents** | HK0.07 cents |
| Diluted | | **HK0.91 cents** | N/A |

# CONSOLIDATED BALANCE SHEET

As at 31 December 2006

| | Notes | 2006 | 2005 |
|---|---|---|---|
| | | HK$'000 | HK$'000 |
| ASSETS AND LIABILITIES | | | |
| **Non-current assets** | | | |
| Plant and equipment | 15 | 1,932 | 2,151 |
| Development costs | 17 | 9,393 | 8,148 |
| Deferred tax assets | 18.1 | 2,762 | 3,952 |
| | | 14,087 | 14,251 |
| **Current assets** | | | |
| Inventories | 19 | 8,600 | 9,047 |
| Trade and other receivables, deposits paid and prepayments | 20 | 6,753 | 6,103 |
| Held-to-maturity financial asset | 21 | 17 | — |
| Pledged bank deposits | 22 | 2,691 | 691 |
| Cash and cash equivalents | 23 | 5,240 | 6,390 |
| | | 23,301 | 22,231 |
| **Current liabilities** | | | |
| Trade and other payables, deposits received and accruals | 24 | 4,472 | 6,130 |
| **Net current assets** | | 18,829 | 16,101 |
| **Net assets** | | 32,916 | 30,352 |
| EQUITY ATTRIBUTABLE TO COMPANY'S EQUITY HOLDERS | | | |
| Share capital | 25 | 28,180 | 28,180 |
| Reserves | 27.1 | 4,736 | 2,172 |
| **Total equity** | | 32,916 | 30,352 |

WONG Yiu Chu, Denny
*Director*

TSUI Kam Ling, Alice
*Director*

# BALANCE SHEET

As at 31 December 2006

| | Notes | 2006 HK$'000 | 2005 HK$'000 |
|---|---|---|---|
| ASSETS AND LIABILITIES | | | |
| **Non-current assets** | | | |
| Interests in and amounts due from subsidiaries | 16 | **46,742** | 44,707 |
| **Current assets** | | | |
| Other receivables, deposits paid and prepayments | 20 | **225** | 270 |
| Cash and cash equivalents | 23 | **477** | 3,473 |
| | | **702** | 3,743 |
| **Current liability** | | | |
| Accruals | 24 | **248** | 262 |
| **Net current assets** | | **454** | 3,481 |
| **Net assets** | | **47,196** | 48,188 |
| EQUITY | | | |
| Share capital | 25 | **28,180** | 28,180 |
| Reserves | 27.2 | **19,016** | 20,008 |
| **Total equity** | | **47,196** | 48,188 |

WONG Yiu Chu, Denny
*Director*

TSUI Kam Ling, Alice
*Director*

# CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2006

| | *Notes* | 2006 *HK$'000* | 2005 *HK$'000* |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit/(Loss) before income tax | | **3,754** | (2,142) |
| Adjustments for : | | | |
| Depreciation | 8.2 | **968** | 869 |
| Amortisation of development costs | 8.2 | **1,339** | 1,189 |
| Reversal of impairment loss on development costs | 8.2 | **(124)** | — |
| Impairment loss on development costs | 8.2 | **—** | 409 |
| Finance costs | 8.1 | **206** | 149 |
| Write-back of impairment of trade receivables | 8.2 | **(134)** | (164) |
| Reversal of write-down of inventories | 8.2 | **(540)** | — |
| Write-down of inventories to net realisable value | 8.2 | **—** | 355 |
| Impairment of trade receivables | 8.2 | **9** | 46 |
| Interest income | 5 | **(230)** | (231) |
| Loss on disposal of plant and equipment | 6 | **—** | 33 |
| Operating profit before working capital changes | | **5,248** | 513 |
| Decrease/(Increase) in inventories | | **987** | (2,061) |
| Increase in trade and other receivables, deposits paid and prepayments | | **(520)** | (595) |
| (Decrease)/Increase in trade and other payables, deposits received and accruals | | **(1,658)** | 985 |
| Net cash generated from/(used in) operating activities | | **4,057** | (1,158) |
| **Cash flows from investing activities** | | | |
| Purchase of plant and equipment | | **(749)** | (1,451) |
| Payment to acquire held-to-maturity financial asset | | **(17)** | — |
| Proceeds from disposal of plant and equipment | | **—** | 23 |
| Development costs capitalised | | **(2,460)** | (3,526) |
| Interest received | | **225** | 239 |
| Increase in pledged bank deposits | | **(2,000)** | (691) |
| **Net cash used in investing activities** | | **(5,001)** | (5,406) |
| **Cash flows from financing activities** | | | |
| Finance costs paid | | **(206)** | (149) |
| **Net cash used in financing activities** | | **(206)** | (149) |
| **Net decrease in cash and cash equivalents** | | **(1,150)** | (6,713) |
| **Cash and cash equivalents at 1 January** | | **6,390** | 13,103 |
| **Cash and cash equivalents at 31 December** | | **5,240** | 6,390 |

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2006

| | Share capital *HK$'000* | Share premium *HK$'000* | Merger reserve *HK$'000* | Accumulated losses *HK$'000* | Total *HK$'000* |
|---|---|---|---|---|---|
| At 1 January 2005 | 28,180 | 24,333 | 4,496 | (26,853) | 30,156 |
| Profit for the year | — | — | — | 196 | 196 |
| Total recognised income and expense for the year | — | — | — | 196 | 196 |
| At 31 December 2005 and 1 January 2006 | 28,180 | 24,333 | 4,496 | (26,657) | 30,352 |
| Profit for the year | — | — | — | 2,564 | 2,564 |
| Total recognised income and expense for the year | — | — | — | 2,564 | 2,564 |
| **At 31 December 2006** | 28,180 | 24,333* | 4,496* | (24,093)* | 32,916 |

* The aggregated amount of the above balances of HK$4,736,000 (2005: HK$2,172,000) represented the reserves in the consolidated balance sheet.

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2006

## 1. GENERAL INFORMATION

The Company was incorporated in the Cayman Islands on 13 April 2000 as an exempted company with limited liability under the Companies Law (Revised) of the Cayman Islands. The address of its registered office is Ugland House, P.O. Box 309, George Town, Grand Cayman, Cayman Islands, British West Indies and its principal place of business is located at Unit 1008, 10th Floor, Hongkong International Trade and Exhibition Centre, 1 Trademart Drive, Kowloon Bay, Hong Kong. The Company's shares are listed on The Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

The principal activities of the Company and its subsidiaries (the "Group") include the development, sale and distribution of smart card products, software and hardware and the provision of smart card related services to its customers.

The financial statements on pages 39 to 82 have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Interpretations issued by the Hong Kong Institute of Certified Public Accountants, the disclosure requirements of the Hong Kong Companies Ordinance and the Rules Governing the Listing of Securities on the GEM of the Stock Exchange ("GEM Listing Rules").

The financial statements for the year ended 31 December 2006 were approved by the board of directors on 23 March 2007.

## 2. ADOPTION OF NEW OR AMENDED HKFRSs

From 1 January 2006, the Group has adopted all the new and amended HKFRSs which are first effective on 1 January 2006 and relevant to the Group. The adoption of these new and amended HKFRSs did not result in significant changes to the Group's accounting policies. The specific transitional provisions contained in some of these new or amended HKFRSs have been considered.

### 2.1 New or amended HKFRSs that have been issued but are not yet effective

The Group has not early adopted the following HKFRSs that have been issued but are not yet effective. The directors of the Company anticipate that the adoption of such HKFRSs will not result in material financial impact on the Group's financial statements.

| | |
|---|---|
| Amendment to HKAS 1 | Presentation of Financial Statements - Capital Disclosures[1] |
| HKFRS 7 | Financial Instruments: Disclosures [1] |
| HKFRS 8 | Operating Segments [2] |
| HK(IFRIC) Interpretation 7 | Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies [3] |
| HK(IFRIC) Interpretation 8 | Scope of HKFRS 2 [4] |
| HK(IFRIC) Interpretation 9 | Reassessment of Embedded Derivatives [5] |
| HK(IFRIC) Interpretation 10 | Interim Financial Reporting and Impairment [6] |
| HK(IFRIC) Interpretation 11 | Group and Treasury Share Transactions [7] |
| HK(IFRIC) Interpretation 12 | Service Concession Arrangements [8] |

1 Effective for annual periods beginning on or after 1 January 2007

2 Effective for annual periods beginning on or after 1 January 2009

3 Effective for annual periods beginning on or after 1 March 2006

4 Effective for annual periods beginning on or after 1 May 2006

5 Effective for annual periods beginning on or after 1 June 2006

6 Effective for annual periods beginning on or after 1 November 2006

7 Effective for annual periods beginning on or after 1 March 2007

8 Effective for annual periods beginning on or after 1 January 2008

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### 3.1 Basis of preparation

The significant accounting policies that have been used in the preparation of these consolidated financial statements are summarised below. These policies have been consistently applied to all the years presented. The financial statements have been prepared on the historical cost convention. The measurement bases are fully described in the accounting policies below.

It should be noted that accounting estimates and assumptions are used in preparation of the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates.

### 3.2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31 December each year.

### 3.3 Subsidiaries

Subsidiaries are entities over which the Group has the power to control the financial and operating policies so as to obtain benefits from their activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are excluded from consolidation from the date that control ceases.

Intra-group transactions, balances and unrealised gains on transactions between group companies are eliminated in preparing the consolidated financial statements. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

In the Company's balance sheet, subsidiaries are carried at cost less impairment loss. The results of the subsidiaries are accounted for by the Company on the basis of dividends received and receivable at the balance sheet date.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### 3.4 Foreign currency translation

The consolidated financial statements are presented in Hong Kong dollars ("HK$"), which is also the functional currency of the Company.

In the individual financial statements of the consolidated entities, foreign currency transactions are translated into the functional currency of the individual entity using the exchange rates prevailing at the dates of the transactions. At balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the balance sheet date. Foreign exchange gains and losses resulting from the settlement of such transactions and from the balance sheet date retranslation of monetary assets and liabilities are recognised in the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

In the consolidated financial statements, all individual financial statements of foreign operations, originally presented in a currency different from the Group's presentation currency, have been converted into HK$. Assets and liabilities have been translated into HK$ at the closing rates at the balance sheet date. Income and expenses have been converted into the HK$ at the exchange rates ruling at the transaction dates, or at the average rates over the reporting period provided that the exchange rates do not fluctuate significantly. Any differences arising from this procedure have been dealt with in the currency translation reserve in equity.

### 3.5 Revenue recognition

Revenue comprises the fair value for the sale of goods, rendering of services, net of rebates and discounts. Provided it is probable that the economic benefits will flow to the Group and the revenue and costs if applicable, can be measured reliably, revenue is recognised as follows:

Sales of goods are recognised upon transfer of the significant risks and rewards of ownership to the customer. This is usually taken as the time when the goods are delivered and the customer has accepted the goods.

Smart card related services income are recognised in the accounting period in which the services are rendered, by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

Government grants are recognised at their fair value upon the completion of the relevant research and development project and have been approved by the Commissioner for Innovation and Technology of the Hong Kong Government.

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

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### 3.6 Research and development costs

Costs associated with research activities are expensed in the income statement as they occur. Costs that are directly attributable to the development phase of new customised products are recognised as intangible assets provided they meet the following recognition requirements:

(i) demonstration of technical feasibility of the prospective product for internal use or sale;

(ii) the intangible asset will generate probable economic benefits through internal use or sale;

(iii) sufficient technical, financial and other resources are available for completion; and

(iv) the intangible asset can be reliably measured.

Direct costs include employee costs incurred on product development along with an appropriate portion of relevant overheads. Development costs are recognised initially at cost. After initial recognition, development costs are carried at cost less accumulated amortisation and any accumulated impairment losses. Development costs capitalised are amortised to the income statement on a straight-line basis over their estimated useful lives of four years, commencing from the date on which the related products are put into commercial production. However, until completion of the development project, the assets are subject to impairment testing only as described below in note 3.8.

All other development costs which do not meet the above recognition criteria are expensed as incurred.

### 3.7 Plant and equipment

Plant and equipment are stated at acquisition cost less accumulated depreciation and accumulated impairment losses.

Depreciation is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows :

| | |
|---|---|
| Leasehold improvements | over the remaining term of the leases |
| Furniture and fixtures | 4 years |
| Computer and office equipment | 4 years |
| Moulds | 4 years |

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### 3.7 Plant and equipment *(continued)*

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

The gain or loss arising on retirement or disposal is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement.

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 costs, such as repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

### 3.8 Impairment of assets

The Group's intangible assets, plant and equipment and the Company's interests in subsidiaries are subject to impairment testing.

Intangible assets not yet available for use are tested for impairment at least annually, irrespective of whether there is any indication that they are impaired. All other assets are tested for impairment whenever there are indications that the asset's carrying amount may not be recoverable.

An impairment loss is recognised as an expense immediately for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value, reflecting market conditions less costs to sell, and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of time value of money and the risk specific to the asset.

For the purposes of assessing impairment, where an asset does not generate cash inflows largely independent from those from other assets, the recoverable amount is determined for the smallest group of assets that generate cash inflows independently (i.e. a cash-generating unit). As a result, some assets are tested individually for impairment and some are tested at cash-generating unit level.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### 3.8 Impairment of assets *(continued)*

Impairment loss is charged pro rata to the assets in the cash generating unit, except that the carrying value of an asset will not be reduced below its individual fair value less cost to sell, or value in use, if determinable.

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the asset's recoverable amount and only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

### 3.9 Leases

Operating lease payments are recognised as an expense on a straight-line basis. Affiliated costs, such as maintenance and insurance, are expensed as incurred.

### 3.10 Financial assets

The Group's accounting policies for financial assets other than interests in subsidiaries are set out below.

The Group's financial assets are classified into (i) held-to-maturity investments and (ii) loans and receivables.

Management determines the classification of its financial assets at initial recognition depending on the purpose for which the financial assets were acquired and where allowed and appropriate, re-evaluates this designation at every reporting date.

All financial assets are recognised when, and only when, the Group becomes a party to the contractual provisions of the instrument. Regular way purchases of financial assets are recognised on trade date. When financial assets are recognised initially, they are measured at fair value plus directly attributable transaction costs.

Derecognition of financial assets occurs when the rights to receive cash flows from the investments expire or are transferred and substantially all of the risks and rewards of ownership have been transferred. At each balance sheet date, financial assets are reviewed to assess whether there is objective evidence of impairment. If any such evidence exists, impairment loss is determined and recognised based on the classification of the financial asset.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### 3.10 Financial assets *(continued)*

*(i) Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group's management has the intention and ability to hold to maturity. Held-to-maturity investments are subsequently measured at amortised cost using the effective interest method, less any impairment losses. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest and transaction cost.

*(ii) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are subsequently measured at amortised cost using the effective interest method, less any impairment losses. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest and transaction cost.

Trade receivables are provided against when objective evidence is received that the Group will not be able to collect all amounts due to it in accordance with the original terms of the receivables. The amount of the write-down is determined as the difference between the asset's carrying amount and the present value of estimated future cash flows.

*Impairment of financial assets*

At each balance sheet date, financial assets other than at fair value through profit or loss are reviewed to determine whether there is any objective evidence of impairment. If any such evidence exists, the impairment loss is measured and recognised as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The amount of the loss is recognised in the income statement of the period in which the impairment occurs.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### 3.10 Financial assets *(continued)*

If, in subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed to the extent that it does not result in a carrying amount of the financial asset exceeding what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal is recognised in the income statement of the period in which the reversal occurs.

### 3.11 Inventories

Inventories comprise raw materials, supplies and purchased goods. Inventories are carried at the lower of cost and net realisable value. Cost is determined using the first-in, first-out method, which includes all expenses directly attributable to the manufacturing process as well as suitable portions of related production overheads, based on normal operating capacity. Financing costs are not taken into consideration. Net realisable value is the estimated selling price in the ordinary course of business less any applicable selling expenses.

### 3.12 Accounting for income taxes

Income tax comprises current tax and deferred tax.

Current income tax assets and/or liabilities comprise those obligations to, or claims from, tax authorities relating to the current or prior reporting period, that are unpaid at the balance sheet date. They are calculated according to the tax rates and tax laws applicable to the tax periods to which they relate, based on the taxable profit for the year. All changes to current tax assets or liabilities are recognised as a component of tax expense in the income statement.

Deferred tax is calculated using the liability method on temporary differences at the balance sheet date between the carrying amounts of assets and liabilities in the financial statements and their respective tax bases. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised for all deductible temporary differences, tax losses available to be carried forward as well as other unused tax credits, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, unused tax losses and unused tax credits can be utilised.

Deferred tax assets and liabilities are not recognised if the temporary difference arises from initial recognition (other than in a business combination) of assets and liabilities in a transaction that affects neither taxable nor accounting profit or loss.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### 3.12 Accounting for income taxes *(continued)*

Deferred tax liabilities are recognised for taxable temporary differences arising on interests in subsidiaries, except where the Group is able to control the reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax is calculated, without discounting, at tax rates that are expected to apply in the period the liability is settled or the asset realised, provided they are enacted or substantively enacted at the balance sheet date.

Changes in deferred tax assets or liabilities are recognised in the income statement, or in equity if they relate to items that are charged or credited directly to equity.

### 3.13 Cash and cash equivalents

Cash and cash equivalents include cash at banks and in hand as well as short term highly liquid investments.

### 3.14 Share capital

Ordinary shares are classified as equity. Share capital is determined using the nominal value of shares that have been issued.

### 3.15 Retirement benefit costs and short term employee benefits

*Defined contribution plan*

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for all of its employees in Hong Kong who are eligible to participate in the MPF Scheme. Contributions are made based on a percentage of the employees' basic salaries and are charged to the income statement as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independent administered fund. The Group's employer contributions vest fully with the employees when contributed into the MPF Scheme.

Pursuant to the relevant regulations of the Peoples' Republic of China (the "PRC"), the employees of the subsidiary in the PRC are required to participate in a central pension scheme operated by the local municipal government. This subsidiary is required to contribute a certain percentage of its payroll costs to the central pension scheme. The contributions are charged to the income statement as they become payable in accordance with the rules of the central pension scheme.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### 3.15 Retirement benefit costs and short term employee benefits *(continued)*

The Company's subsidiary operating in the Philippines participates in the mandatory Social Security System contribution scheme ("SSS Scheme") as prescribed by the Philippine law. Pursuant to the rules of the SSS Scheme, the Philippines' subsidiary and the employees of the subsidiary in the Philippines are required to make monthly contributions to the scheme fixed at 9.4% of their relevant monthly income (6.07% for employer and 3.33% for employee), up to PHP910 per month for employer and PHP500 for employee. There are no provisions under the SSS Scheme whereby forfeited contributions may be used to reduce future contributions.

*Short term employee benefits*

Employee entitlements to annual leave are recognised when they accrue to employees. Non-accumulating compensated absences are not recognised until the time of leave.

### 3.16 Share-based employee compensation

All share-based payment arrangements granted after 7 November 2002 and had not vested on 1 January 2005 are recognised in the consolidated financial statements. The Group operates equity-settled share-based compensation plans for remuneration of its employees.

All employee services received in exchange for the grant of any share-based compensation are measured at their fair values. These are indirectly determined by reference to the share options awarded. Their value is appraised at the grant date and excludes the impact of any non-market vesting conditions.

All share-based compensation is ultimately recognised as an expense in income statement with a corresponding increase in equity. If vesting periods or other vesting conditions apply, the expense is recognised over the vesting period, based on the best available estimate of the number of share options expected to vest. Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. Estimates are subsequently revised, and if there is any indication that the number of share options expected to vest differs from previous estimates. No adjustment to expense recognised in prior periods is made if fewer share options ultimately are exercised than originally vested.

At the time when the share options are exercised, the amount previously recognised in share option reserve will be transferred to share premium. When the share options are forfeited or are still not exercised at the expiry date, the amount previously recognised in share option reserve will continue to be held in share option reserve.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### 3.17 Financial liabilities

The Group's financial liabilities include trade and other payables and deposits received. They are included in balance sheet line items as "Trade and other payables, deposits received and accruals".

Financial liabilities are recognised when the Group becomes a party to the contractual provisions of the instrument. All interest related charges are recognised as an expense in finance costs in the income statement.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Payables and deposits received are recognised initially at their fair value and subsequently measured at amortised cost, using the effective interest method.

### 3.18 Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Timing or amount of the outflow may still be uncertain. Restructuring provisions are recognised only if a detailed formal plan for the restructuring has been developed and implemented, or management has at least announced the plan's main features to those affected by it. Provisions are not recognised for future operating losses.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the balance sheet date, including the risks and uncertainties associated with the present obligation. Any reimbursement expected to be received in the course of settlement of the present obligation is recognised as a separate asset, not exceeding the amount of the related provision. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. In addition, long term provisions are discounted to their present values, where time value of money is material.

All provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate.

### 3.19 Financial guarantees issued

A financial guarantee contract is a contract that requires the issuer (or guarantor) to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### 3.19 Financial guarantees issued *(continued)*

Where the Group issues a financial guarantee, the fair value of the guarantee is initially recognised as deferred income within trade and other payables. Where consideration is received or receivable for the issuance of the guarantee, the consideration is recognised in accordance with the Group's policies applicable to that category of asset. Where no such consideration is received or receivable, an immediate expense is recognised in the income statement on initial recognition of any deferred income.

The amount of the guarantee initially recognised as deferred income is amortised in the income statement over the term of the guarantee as income from financial guarantees issued. In addition, provisions are recognised if and when it becomes probable that the holder of the guarantee will call upon the Group under the guarantee and the amount of that claim on the Group is expected to exceed the current carrying amount i.e. the amount initially recognised less accumulated amortisation, where appropriate.

### 3.20 Segment reporting

In accordance with the Group's internal financial reporting, the Group has determined that business segments be presented as the primary reporting format and geographical as the secondary reporting format.

In respect of business segment reporting, unallocated costs represent corporate expenses. Segment assets consist primarily of intangible assets, plant and equipment, inventories, receivables and operating cash. Segment liabilities comprise operating liabilities.

Capital expenditure comprises additions to intangible assets and plant and equipment.

In respect of geographical segment reporting, revenue is based on the country in which the customer is located and total assets and capital expenditure are where the assets are located.

### 3.21 Related parties

Parties are considered to be related to the Group if:

(i) directly, or indirectly through one or more intermediaries, the party :

- — controls, is controlled by, or is under common control with, the Group;
- — has an interest in the Group that gives it significant influence over the Group;
- — has joint control over the Group;

(ii) the party is a jointly-controlled entity;

(iii) the party is an associate;

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

### 3.21 Related parties *(continued)*

(iv) the party is a member of the key management personnel of the Group or its parent;

(vi) the party is a close member of the family of any individual referred to (i) or (iv);

(vi) the party is an entity that is controlled, jointly-controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (iv) or (v); or

(vii) the party is a post-employment benefit plan for the benefit of employees of the Group, or of any entity that is a related party of the Group.

## 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

### 4.1 Research and development activities

Careful judgement by the Company's management is applied when deciding whether the recognition requirements for development costs have been met. This is necessary as the economic success of any product development is uncertain and may be subject to future technical problems at the time of recognition. Judgements are based on the best information available at each balance sheet date. In addition, all internal activities related to the research and development of products are continuously monitored by the Company's management.

### 4.2 Net realisable value of inventories

Net realisable value of inventories is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expenses. These estimates are based on the current market conditions and the historical experience of selling products of a similar nature. It could change significantly as a result of competitor actions in response to severe industry cycles. Management reassesses these estimations at the balance sheet date to ensure inventories are shown at the lower of cost and net realisable value.

## 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS *(continued)*

### 4.3 Impairment of receivables

The Group's management determines impairment of receivables on a regular basis. This estimate is based on the credit history of its customers and current market conditions. Management reassesses the impairment of receivables at the balance sheet date.

## 5. REVENUE AND OTHER REVENUE

Revenue, which is also the Group's turnover, represents total invoiced value of goods supplied and income from provision of services rendered. Revenue and other revenue recognised during the year are as follows:

| | 2006 | 2005 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| **Revenue** | | |
| Sale of smart card products, software and hardware | **41,123** | 38,125 |
| Smart card related services | **2,042** | 728 |
| | **43,165** | 38,853 |

| | 2006 | 2005 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| **Other revenue** | | |
| Forfeiture of deposits | — | 211 |
| Government grants received | — | 707 |
| Interest income | **230** | 231 |
| Sundry income | **52** | 14 |
| | **282** | 1,163 |

## 6. OTHER NET LOSS

| | 2006 | 2005 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Net foreign exchange loss | **196** | 120 |
| Loss on disposal of plant and equipment | — | 33 |
| | **196** | 153 |

## 7. SEGMENT INFORMATION

### Primary reporting format - business segments

During the year, 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 its customers.

### Year ended 31 December 2006

| | Development, sale and distribution of smart card products, software and hardware | Provision of smart card related services | Total |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| Revenue | 41,123 | 2,042 | 43,165 |
| Segment result and operating profit | 2,541 | 1,419 | 3,960 |
| Finance costs | | | (206) |
| Segment result and profit before income tax | | | 3,754 |
| Income tax expense | | | (1,190) |
| Profit for the year | | | 2,564 |
| Capital expenditure | 3,209 | — | 3,209 |
| Depreciation and amortisation | 2,307 | — | 2,307 |
| Reversal of impairment loss on development costs | (124) | — | (124) |
| Non-cash expenses other than depreciation and amortisation | 11 | — | 11 |

## 7. SEGMENT INFORMATION *(continued)*

### Primary reporting format - business segments *(continued)*

Year ended 31 December 2005

| | Development, sale and distribution of smart card products, software and hardware | Provision of smart card related services | Total |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| Revenue | 38,125 | 728 | 38,853 |
| Segment result and operating (loss)/profit | (2,472) | 479 | (1,993) |
| Finance costs | | | (149) |
| Segment result and loss before income tax | | | (2,142) |
| Income tax credit | | | 2,338 |
| Profit for the year | | | 196 |
| Capital expenditure | 4,977 | — | 4,977 |
| Depreciation and amortisation | 2,058 | — | 2,058 |
| Impairment loss on development costs | 409 | — | 409 |
| Non-cash expenses other than depreciation and amortisation | 488 | — | 488 |

Over 90% of the segment assets and liabilities are 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, liabilities and capital expenditure is presented.

## 7. SEGMENT INFORMATION *(continued)*

### Secondary reporting format - geographical segments

The Group's operations are located in Hong Kong. The following table provides an analysis of the Group's revenue by geographical market irrespective of the origin of the goods and services.

Sales revenue by geographical markets:

| | 2006 | 2005 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| The Americas | 5,545 | 4,433 |
| Asia Pacific | 16,644 | 15,424 |
| Europe, Middle East and Africa | 20,976 | 18,996 |
| | 43,165 | 38,853 |

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.

## 8. PROFIT/(LOSS) BEFORE INCOME TAX

| | 2006 | 2005 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Profit/(Loss) before income tax is arrived at after charging/(crediting) : | | |
| **8.1 Finance costs :** | | |
| Interests on bank borrowings wholly repayable within five years | 45 | — |
| Bank charges | 161 | 149 |
| | 206 | 149 |

## 8. PROFIT/(LOSS) BEFORE INCOME TAX *(continued)*

| | 2006 | 2005 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| **8.2 Other items :** | | |
| Amortisation of development costs | **1,339** | 1,189 |
| Auditors' remuneration | **264** | 267 |
| Cost of inventories recognised as expense | **19,765** | 20,601 |
| Depreciation | **968** | 869 |
| Impairment loss on development costs | **—** | 409 |
| Impairment of trade receivables | **9** | 46 |
| Reversal of impairment loss on development costs | **(124)** | — |
| Reversal of write-down of inventories (note 19) | **(540)** | — |
| Write-back of impairment of trade receivables | **(134)** | (164) |
| Write-down of inventories to net realisable value | **—** | 355 |
| Write-off of bad debts | **1** | 87 |
| Operating lease charges on land and buildings | **1,318** | 1,890 |
| Less : Amount included in research and development costs | **(112)** | (226) |
| | **1,206** | 1,664 |

### 8.3 Research and development costs :

Research and development costs amounting to HK$4,049,000 (2005: HK$4,821,000) for the year have been calculated to the extent that staff costs and direct overheads can be allocated by management on a reasonable basis to research and development activities. Included in the total costs of HK$4,049,000 (2005: HK$4,821,000) were amounts of HK$2,460,000 (2005: HK$3,526,000) capitalised during the year (note 17).

Other costs such as depreciation of plant and equipment and indirect overheads have not been included within research and development costs.

## 9. INCOME TAX (EXPENSE)/CREDIT

No provision for Hong Kong profits tax has been made in the financial statements as a subsidiary of the Group has losses brought forward from previous years to offset against its current year's assessable profits and the Company and other subsidiaries sustained losses for taxation purposes for the years ended 31 December 2005 and 2006.

No provision for overseas taxation has been made as no assessable profits arose from the operations in the PRC, Philippines and Canada during the year ended 31 December 2006 (2005: Nil).

## 9. INCOME TAX (EXPENSE)/CREDIT *(continued)*

| | 2006 | 2005 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| **Deferred tax** | | |
| Current year | 1,190 | (2,338) |
| Income tax expense/(credit) | 1,190 | (2,338) |

Reconciliation between income tax expense/(credit) and accounting profit/(loss) at applicable tax rates:

| | 2006 | 2005 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Profit/(Loss) before income tax | 3,754 | (2,142) |
| Tax on profit/(loss) before income tax, calculated at the rates applicable to profits in the tax jurisdiction concerned | 691 | (345) |
| Tax effect of non-deductible expenses | 481 | 306 |
| Tax effect of non-taxable revenue | (44) | (67) |
| Tax effect of unused tax losses not recognised | 215 | 505 |
| Tax effect of prior years' deferred tax recognised during the current year | (153) | (2,737) |
| Income tax expense/(credit) | 1,190 | (2,338) |

## 10. PROFIT FOR THE YEAR

Of the consolidated profit for the year of HK$2,564,000 (2005: HK$196,000), a loss of HK$992,000 (2005: HK$2,133,000) has been dealt with in the financial statements of the Company.

## 11. DIVIDENDS

The Company had not declared or paid any dividends during the year ended 31 December 2006 (2005: Nil).

## 12. EARNINGS PER SHARE

The calculations of the basic and diluted earnings per share is based on the following data :

| | 2006<br>*HK$'000* | 2005<br>*HK$'000* |
|---|---|---|
| Profit for the year for the purposes of calculating basic and diluted earnings per share | **2,564** | 196 |

| | 2006<br>*'000* | 2005<br>*'000* |
|---|---|---|
| Number of shares | | |
| Weighted average number of ordinary shares for the purposes of calculating basic earnings per share | **281,800** | 281,800 |
| Effect of dilutive potential ordinary shares relating to outstanding share options | **129** | |
| Weighted average number of ordinary shares for the purposes of calculating diluted earnings per share | **281,929** | |

Diluted earnings per share for the year ended 31 December 2005 was not presented because the exercise prices of the outstanding options exceeded the average market price of the Company's ordinary shares during the year and, accordingly, there was no dilutive effect on the basic earnings per share.

## 13. STAFF COSTS (INCLUDING DIRECTORS' EMOLUMENTS)

| | 2006<br>*HK$'000* | 2005<br>*HK$'000* |
|---|---|---|
| Salaries and benefits | **13,869** | 13,432 |
| Pension costs – defined contribution plans | **426** | 422 |
| Total staff costs | **14,295** | 13,854 |
| Less : Amounts capitalised in development costs | **(2,173)** | (3,002) |
| Staff costs (after amount capitalised) | **12,122** | 10,852 |

## 14. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS' EMOLUMENTS

### 14.1 Directors' emoluments – Executive directors and non-executive directors

| | Fees | Salaries, housing and other allowances and benefits in kind | Bonuses | Contributions to defined contribution plans | Total |
|---|---|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| **Year ended 31 December 2006** | | | | | |
| **Executive directors** | | | | | |
| Mr Wong Yiu Chu, Denny | — | 1,248 | — | 12 | 1,260 |
| Mr Mak Chi Him ** | — | 313 | — | 4 | 317 |
| Mr Tan Keng Boon | — | 691 | 20 | 12 | 723 |
| Ms Tsui Kam Ling, Alice | — | 600 | 20 | 12 | 632 |
| **Independent non-executive directors** | | | | | |
| Dr Yip Chak Lam, Peter | 120 | — | — | — | 120 |
| Mr Cheong Chung Chin** | 50 | — | — | — | 50 |
| Mr Yu Man Woon | 120 | — | — | — | 120 |
| Mr Wong Yick Man, Francis * | 70 | — | — | — | 70 |
| | 360 | 2,852 | 40 | 40 | 3,292 |

*  newly appointed during the year

**  resigned during the year

## 14. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS' EMOLUMENTS *(continued)*

### 14.1 Directors' emoluments – Executive directors and non-executive directors *(continued)*

| | Fees | Salaries, housing and other allowances and benefits in kind | Contributions to defined contribution plans | Total |
|---|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| Year ended 31 December 2005 | | | | |
| Executive directors | | | | |
| Mr Wong Yiu Chu, Denny | — | 1,248 | 12 | 1,260 |
| Mr Mak Chi Him* | — | 713 | 9 | 722 |
| Mr Tan Keng Boon | — | 691 | 12 | 703 |
| Ms Tsui Kam Ling, Alice* | — | 465 | 9 | 474 |
| Non-executive director | | | | |
| Mr Wan Wah Tong, Thomas ** | 147 | — | — | 147 |
| Independent non-executive directors | | | | |
| Dr Yip Chak Lam, Peter | 169 | — | — | 169 |
| Mr Cheong Chung Chin | 169 | — | — | 169 |
| Mr Yu Man Woon | 169 | — | — | 169 |
| | 654 | 3,117 | 42 | 3,813 |

* appointed in 2005

** resigned during the year

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

## 14. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS' EMOLUMENTS *(continued)*

### 14.2 Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year included three (2005: four) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining two (2005: As two members of staff were newly appointed as directors during the year ended 31 December 2005, the total emoluments payable to them, including their emoluments earned before they became directors, together with the emoluments payable to the remaining one) individuals during the year are as follows:

| | **2006** | 2005 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Basic salaries, housing and other allowances and benefits in kind | **1,168** | 1,888 |
| Bonuses | **20** | 42 |
| Contributions to defined contribution plans | **12** | 36 |
| | **1,200** | 1,966 |

The number of individuals' emoluments fell within the following bands:

| | **2006** | 2005 |
|---|---|---|
| Nil - HK$1,000,000 | **2** | 3 |

No emoluments were paid by the Group to the directors and the remaining two (2005: one) highest paid individuals as an inducement to join or upon joining the Group, or as compensation for loss of office (2005: Nil).

## 15. PLANT AND EQUIPMENT

| | Leasehold improvements | Furniture and fixtures | Computer and office equipment | Moulds | Total |
|---|---|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| 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 | 189 | 140 | 886 | 410 | 1,625 |
| Year ended 31 December 2005 | | | | | |
| Opening net book amount | 189 | 140 | 886 | 410 | 1,625 |
| Additions | 507 | 177 | 494 | 273 | 1,451 |
| Disposals | (30) | (5) | (21) | — | (56) |
| Depreciation | (215) | (67) | (379) | (208) | (869) |
| Closing net book amount | 451 | 245 | 980 | 475 | 2,151 |
| At 31 December 2005 | | | | | |
| Cost | 527 | 410 | 2,821 | 1,290 | 5,048 |
| Accumulated depreciation | (76) | (165) | (1,841) | (815) | (2,897) |
| Net book amount | 451 | 245 | 980 | 475 | 2,151 |
| **Year ended 31 December 2006** | | | | | |
| Opening net book amount | 451 | 245 | 980 | 475 | 2,151 |
| Additions | 2 | 32 | 538 | 177 | 749 |
| Depreciation | (225) | (91) | (445) | (207) | (968) |
| Closing net book amount | 228 | 186 | 1,073 | 445 | 1,932 |
| **At 31 December 2006** | | | | | |
| Cost | 525 | 441 | 3,334 | 1,460 | 5,760 |
| Accumulated depreciation | (297) | (255) | (2,261) | (1,015) | (3,828) |
| Net book amount | 228 | 186 | 1,073 | 445 | 1,932 |

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2006

## 16. INTERESTS IN AND AMOUNTS DUE FROM SUBSIDIARIES - COMAPNY

| | 2006 | 2005 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Unlisted shares, at cost | **14,004** | 14,004 |
| Amounts due from subsidiaries | **32,738** | 30,703 |
| | **46,742** | 44,707 |

The amounts due from subsidiaries are unsecured, interest free and are repayable on demand but will not be settled within twelve months of the balance sheet date.

During the year, the directors reviewed the carrying value of the amounts due from subsidiaries with reference to the business operated by the subsidiaries. In view of the current economic condition, no impairment loss (2005: Nil) has been identified and recognised in the Company's income statement.

Particulars of the subsidiaries at 31 December 2006 are as follows:

| Name | Place/country of incorporation and kind of legal entity | Particulars of issued capital/ registered capital | Percentage of issued capital/ registered capital held by the Company | Principal activities and place of operations |
|---|---|---|---|---|
| Advanced Card Systems Limited | Hong Kong, limited liability company | 18,000,000 ordinary shares of HK$1 each | 100% | Development, sale and distribution of smart card products, software and hardware and the provision of smart card related services in Hong Kong |

## 16. INTERESTS IN AND AMOUNTS DUE FROM SUBSIDIARIES - COMAPNY *(continued)*

| Name | Place/country of incorporation and kind of legal entity | Particulars of issued capital/ registered capital | Percentage of issued capital/ registered capital held by the Company | Principal activities and place of operations |
|---|---|---|---|---|
| Advanced Card Systems (Canada) Limited | Canada, limited liability company | 1 ordinary share of CAD1 each | 100% | Sale and distribution of smart card products, software and hardware and the provision of smart card related services in Canada |
| ACS Technologies Limited | Hong Kong, limited liability company | 1 ordinary share of HK$1 each | 100% | Development, sale and distribution of smart card products, software and hardware and the provision of smart card related services in Hong Kong and the Philippines |
| ACS Technologies (Shenzhen) Limited | The PRC, wholly foreign owned enterprise | HK$2.5 million | 100% | Development, sale and distribution of smart card products, software and hardware and the provision of smart card related services in the PRC |

## 17. DEVELOPMENT COSTS - GROUP

| | 2006 | 2005 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Carrying amount at 1 January | **8,148** | 6,220 |
| Capitalised during the year (note 8.3) | **2,460** | 3,526 |
| Amortisation charge | **(1,339)** | (1,189) |
| Reversal of impairment loss | **124** | — |
| Impairment loss | **—** | (409) |
| Carrying amount at 31 December | **9,393** | 8,148 |
| **At 31 December** | | |
| Gross carrying amount | **21,977** | 19,517 |
| Accumulated amortisation and impairment losses | **(12,584)** | (11,369) |
| Net carrying amount | **9,393** | 8,148 |

Amortisation charge is included in "Administrative expenses" in the consolidated income statement.

The directors have assessed the recoverable amount of the development costs, taking into consideration the expected market demand for the software and hardware products in the foreseeable future. Based on this assessment, a reversal of impairment loss was identified in respect of a product, and hence the carrying amount of the development costs was increased by HK$124,000 (2005: written down by HK$409,000).

## 18. DEFERRED TAX ASSETS - GROUP

### 18.1 Deferred tax assets and liabilities recognised

Deferred taxation is calculated in full on temporary differences under the liability method using a principal taxation rate of 17.5% (2005: 17.5%).

The components of deferred tax assets and liabilities recognised in the consolidated balance sheet and the movements during the year are as follows:

| | Accelerated tax depreciation *HK$'000* | Tax losses *HK$'000* | Total *HK$'000* |
|---|---|---|---|
| At 1 January 2005 | (109) | 1,723 | 1,614 |
| (Charged)/Credited to the income statement | (102) | 2,440 | 2,338 |
| At 31 December 2005 and 1 January 2006 | (211) | 4,163 | 3,952 |
| Credited/(Charged) to the income statement | 33 | (1,223) | (1,190) |
| At 31 December 2006 | (178) | 2,940 | 2,762 |

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same tax authority. The offset amounts are as follows:

| | **2006** ***HK$'000*** | 2005 *HK$'000* |
|---|---|---|
| Deferred tax assets | **2,940** | 4,163 |
| Deferred tax liabilities | **(178)** | (211) |
| Deferred tax assets recognised in the consolidated balance sheet | **2,762** | 3,952 |

Deferred tax assets are recognised for tax losses carried forward to the extent that realisation of the related tax benefit through the future taxable profits is probable. As at 31 December 2006, the Group recognised deferred tax assets arising from the future benefit of tax losses in the amount of HK$2,940,000 (2005: HK$4,163,000).

## 18. DEFERRED TAX ASSETS - GROUP *(continued)*

### 18.2 Deferred tax assets and liabilities unrecognised

Unrecognised deferred tax assets, representing the future benefit of tax losses to the extent that the directors do not consider it probable that sufficient taxable profits will be available in the foreseeable future, amounted to HK$215,000 (2005: HK$505,000). The tax losses do not expire under current tax legislation. There were no unrecognised deferred tax liabilities.

## 19. INVENTORIES - GROUP

| | 2006 | 2005 |
|---|---|---|
| | *HK$'000* | *HK$'000* |
| Raw materials | 6,132 | 6,839 |
| Work in progress | 125 | 63 |
| Finished goods | 2,343 | 2,145 |
| | 8,600 | 9,047 |

During the year ended 31 December 2006, the Group reversed HK$540,000 (note 8.2) being part of inventory write down made in previous years that was subsequently not required because the obsolete stock has been used or disposed. No such reversal was made during the year ended 31 December 2005. The amount reversed has been included in "Cost of sales" in the consolidated income statement.

## 20. TRADE AND OTHER RECEIVABLES, DEPOSITS PAID AND PREPAYMENTS

| | The Group | | The Company | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| Trade receivables | 6,440 | 6,239 | — | — |
| Less : Impairment of receivables | (1,072) | (1,197) | — | — |
| Trade receivables – net | 5,368 | 5,042 | — | — |
| Other receivables | 117 | 120 | 1 | 56 |
| Deposits paid | 529 | 467 | — | — |
| Prepayments | 739 | 474 | 224 | 214 |
| | 6,753 | 6,103 | 225 | 270 |

As at 31 December 2006, the amount of other receivables, deposits paid and prepayments of the Group expected to be recovered after more than one year is HK$109,000 (2005 : HK$383,000).

## 20. TRADE AND OTHER RECEIVABLES, DEPOSITS PAID AND PREPAYMENTS *(continued)*

Customers are generally granted credit terms of 30 to 60 days. As at 31 December 2006, the ageing analysis of net trade receivables was as follows:

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | ***HK$'000*** | *HK$'000* |
| 0 - 30 days | **2,993** | 4,577 |
| 31 - 60 days | **777** | 143 |
| 61 - 90 days | **36** | 37 |
| Over 90 days | **1,562** | 285 |
| | **5,368** | 5,042 |

The Group has recognised a loss of HK$9,000 (2005: HK$46,000) for the impairment of its trade receivables during the year ended 31 December 2006. The loss has been included in "Administrative expenses" in the consolidated income statement.

## 21. HELD-TO-MATURITY FINANCIAL ASSET - GROUP

| | **2006** | 2005 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Treasury bills | **17** | — |
| At amortised cost | **17** | — |
| Fair value of held-to-maturity financial asset | **17** | — |

Treasury bills in the series of PIBL1206A025 have a fixed yield of 4.75% and mature on 10 January 2007. No interest was received during the year.

## 22. PLEDGED BANK DEPOSITS - GROUP

As at 31 December 2006, the Group pledged deposits of HK$2,691,000 (2005: HK$691,000) to a bank for the bank to issue a performance bond to a customer and two banks to secure bank credit lines.

The interest rate of the deposits was ranged from 4.05% to 4.75% (2005: 2.3% to 2.75%). They have a maturity of one month.

## 23. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include the following components:

| | The Group | | The Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | ***HK$'000*** | *HK$'000* | ***HK$'000*** | *HK$'000* |
| Short-term bank deposits | **1,170** | 2,730 | **—** | 2,730 |
| Cash at banks and in hand | **4,070** | 3,660 | **477** | 743 |
| | **5,240** | 6,390 | **477** | 3,473 |

The interest rate of short-term bank deposits was ranged between 4.14% and 4.8% (2005: between 2.1% and 4.14%). They have a maturity of one month and are eligible for immediate cancellation without receiving any interest for the last deposit period.

Included in bank and cash balances of the Group is HK$74,000 (2005: HK$189,000) of bank balances denominated in Renminbi ("RMB") placed with the banks in the PRC. RMB is not a freely convertible currency.

## 24. TRADE AND OTHER PAYABLES, DEPOSITS RECEIVED AND ACCRUALS

| | The Group | | The Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | ***HK$'000*** | *HK$'000* | ***HK$'000*** | *HK$'000* |
| Trade payables | **1,871** | 3,449 | **—** | — |
| Deposits received | **922** | 1,413 | **—** | — |
| Accruals | **1,679** | 1,268 | **248** | 262 |
| | **4,472** | 6,130 | **248** | 262 |

All of the deposits received and accruals are expected to be settled within one year of the balance sheet date.

## 24. TRADE AND OTHER PAYABLES, DEPOSITS RECEIVED AND ACCRUALS *(continued)*

At 31 December 2006, the ageing analysis of trade payables was as follows:

| | The Group | |
|---|---|---|
| | **2006** | 2005 |
| | ***HK$'000*** | *HK$'000* |
| 0 – 30 days | **1,833** | 2,856 |
| 31 – 60 days | **38** | 393 |
| 61 – 90 days | **—** | 114 |
| Over 90 days | **—** | 86 |
| | **1,871** | 3,449 |

## 25. SHARE CAPITAL

| | **2006** | | 2005 | |
|---|---|---|---|---|
| | **Number of shares** | | Number of shares | |
| | ***'000*** | ***HK$'000*** | *'000* | *HK$'000* |
| Authorised : | | | | |
| Ordinary shares of HK$0.10 each | | | | |
| At 1 January and 31 December | **1,000,000** | **100,000** | 1,000,000 | 100,000 |
| Issued and fully paid: | | | | |
| Ordinary shares of HK$0.10 each | | | | |
| At 1 January and 31 December | **281,800** | **28,180** | 281,800 | 28,180 |

## 26. SHARE-BASED EMPLOYEE COMPENSATION

Pursuant to resolutions of the shareholders passed on 27 October 2003, the share option scheme dated 25 July 2000 was terminated and a new share option scheme was adopted. Options were granted under the new share option scheme to those employees and directors of the Group and consultants engaged by or who worked for the Group who held options granted to them under the Company's terminated share option scheme dated 25 July 2000. Accordingly, the Company cancelled the options to subscribe for an aggregate of 816,250 ordinary shares of US$0.10 each under the terminated share option scheme dated 25 July 2000 and issued options under the new share option scheme to subscribe for an aggregate of 6,535,631 shares of $0.10 each at an exercise price of $0.09 or $0.24 per share.

At 31 December 2006, the total number of shares available for issue under the share option scheme was 2,263,245 (2005: 2,623,556), representing approximately 0.8% (2005: 0.9%) of the issued share capital of the Company at that date.

Share options and exercise price are as follows for the reporting periods presented:

### Year ended 31 December 2006:

| Grantees | Date granted | Balance as at 1 January 2006 | Granted during the year | Exercised during the year | Lapsed during the year | Balance as at 31 December 2006 | Period during which the options are exercisable | Exercise price per share | Percentage of the Company's issued share capital as at 31 December 2006 |
|---|---|---|---|---|---|---|---|---|---|
| Consultants & employees | 27 October 2003 | 1,521,745 | — | — | (160,138) *(Note 3)* | 1,361,607 *(Note 1)* | 10 May 2004 to 24 July 2010 | HK$0.09 | 0.48% |
| Employees | 27 October 2003 | 862 | — | — | — | 862 *(Note 1)* | 10 May 2004 to 27 December 2010 | HK$0.09 | 0.01% |
| | 27 October 2003 | 1,100,949 | — | — | (200,173) *(Note 3)* | 900,776 *(Note 2)* | 10 May 2004 to 20 January 2013 | HK$0.24 | 0.32% |
| | | 2,623,556 | — | — | (360,311) | 2,263,245 | | | |

## 26. SHARE-BASED EMPLOYEE COMPENSATION *(continued)*

Year ended 31 December 2005:

| Grantees | Date granted | Balance as at 1 January 2005 | Granted during the year | Exercised during the year | Lapsed during the year | Balance as at 31 December 2005 | Period during which the options are exercisable | Exercise price per share | Percentage of the Company's issued share capital as at 31 December 2005 |
|---|---|---|---|---|---|---|---|---|---|
| Consultants & Employees | 27 October 2003 | 1,521,745 | – | – | – | 1,521,745 *(Note 1)* | 10 May 2004 to 24 July 2010 | HK$0.09 | 0.54% |
| Employees | 27 October 2003 | 862 | – | – | – | 862 *(Note 1)* | 10 May 2004 to 27 December 2010 | HK$0.09 | 0.01% |
| | 27 October 2003 | 1,291,114 | – | – | (190,165) *(Note 3)* | 1,100,949 *(Note 2)* | 10 May 2004 to 20 January 2013 | HK$0.24 | 0.39% |
| | | 2,813,721 | – | – | (190,165) | 2,623,556 | | | |

*Notes:*

(1) These options vested and were exercisable on 10 May 2004, which was 6 months after the listing date of the Company.

(2) The options vested and were exercisable in three tranches as follows:

(a) one-third of the options have vested and were exercisable on 10 May 2004;

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

(c) the remaining one-third of the options have vested and were exercisable on 31 December 2005.

(3) The options lapsed upon the resignation of 2 (2005: 4) participants from the Group.

## 27. RESERVES

### 27.1 Group

The amount of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on page 43 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.

### 27.2 The Company

| | Share premium | Accumulated losses | Total |
|---|---|---|---|
| | *HK$'000* | *HK$'000* | *HK$'000* |
| At 1 January 2005 | 24,333 | (2,192) | 22,141 |
| Loss for the year | — | (2,133) | (2,133) |
| At 31 December 2005 and 1 January 2006 | 24,333 | (4,325) | 20,008 |
| Loss for the year | — | (992) | (992) |
| At 31 December 2006 | 24,333 | (5,317) | 19,016 |

Included in the reserves of the Company available for the distribution is share premium arising from the issuance of Series A preference shares in June and October 2000.

Under the Companies Law (revised) of the Cayman Islands, the funds in the share premium account of the Company are distributable to the shareholders of the Company provided that immediately following the date on which a dividend is proposed to be distributed, the Company will be in a position to pay off its debts as they fall due in the ordinary course of business.

## 28. OPERATING LEASE COMMITMENTS

At 31 December 2006, the total future minimum lease payments under non-cancellable operating leases in respect of land and buildings are payable as follows:

| | The Group | | The Company | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | ***HK$'000*** | *HK$'000* | ***HK$'000*** | *HK$'000* |
| Within one year | **873** | 1,025 | **—** | — |
| In the second to fifth years | **83** | 727 | **—** | — |
| | **956** | 1,752 | **—** | — |

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 renegotiated 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.

## 29. MATERIAL RELATED PARTY TRANSACTIONS

The following transactions were carried out with related parties:

| | **2006** | 2005 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Consultancy fees payable *(note (i))* | **45** | 180 |
| Salaries payable *(note (ii))* | **—** | 135 |
| Key management personnel remuneration | | |
| - Salaries and other short-term employee benefits | **4,497** | 5,141 |
| - Retirement benefits costs | **54** | 84 |
| | **4,551** | 5,225 |

## 29. MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

*Notes:*

(i) A subsidiary has entered into 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 ("Alice"), for her role as Vice President, Operations of the subsidiary during the period from 1 January to 22 March 2005. Alice was then appointed as director of the Company on 23 March 2005. Alice is a shareholder of the Company and the spouse of Mr. Wong Yiu Chu, Denny, a director of the Company.

At 31 December 2006, the Company has given corporate guarantees to one of its wholly owned subsidiary to the extent of HK$4,000,000 (2005: HK$Nil) for certain banking facilities granted.

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.

## 30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group is exposed to a variety of financial risks which result from both its operating and investment activities. The Group does not have written risk management policies and guidelines. However, the board of directors meets periodically to analyse and formulate strategies to manage the Group's exposure to market risk, including changes in interest rates and currency exchange rates. Generally, the Group introduces conservative strategies on its risk management. The Group's exposure to market risk is kept to a minimum. The Group has not used any derivatives or other instruments for hedging purposes. The Group does not hold or issue derivative financial instruments for trading purposes.

### 30.1 Foreign currency risk

The Group mainly operated in Hong Kong and with most of the transactions settled in Hong Kong dollars and United States dollars and did not have significant exposure to risk resulting from changes in foreign currency exchange rates.

### 30.2 Credit risk

The Group has no significant concentrations of credit risk. The carrying amount of trade receivables represents the Group's maximum exposure to credit risk in relation to its financial assets. No other financial assets carry a significant exposure to credit risk. In addition, for sales to new customers, deposits are received to mitigate credit risk. The Group has adopted a no-business policy with customers lacking an appropriate credit history.

## 30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(continued)*

### 30.3 Interest rate risks

The Group's income and operating cash flows are substantially independent of changes in market interest rates and the Group has no significant interest-bearing assets or liabilities. The Group has not used any interest rate swaps to hedge its exposure to interest rate risk.

### 30.4 Fair values

The carrying amounts of the Group's financial assets including pledged bank deposits, cash and cash equivalents, trade and other receivables and financial liabilities including trade and other payables are not materially different from their fair values because of the immediate or short term maturity of these financial instruments.

# FINANCIAL SUMMARY

31 December

| | **2006** | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| | ***HK$'000*** | *HK$'000* | *HK$'000* | *HK$'000* | *HK$'000* |
| RESULTS | | | | | |
| Revenue | **43,165** | 38,853 | 24,369 | 38,646 | 27,794 |
| Cost of sales | **20,092** | 21,808 | 14,243 | 17,950 | 15,338 |
| Gross profit | **23,073** | 17,045 | 10,126 | 20,696 | 12,456 |
| Gross profit margin | **53%** | 44% | 42% | 54% | 45% |
| Profit/(Loss) for the year | **2,564** | 196 | (13,994) | 11,753 | 3,016 |
| Net profit margin | **6%** | 1% | — | 30% | 11% |
| ASSETS AND LIABILITIES | | | | | |
| Total assets | **37,388** | 36,482 | 35,301 | 52,099 | 17,177 |
| Total liabilities | **4,472** | 6,130 | 5,145 | 8,111 | 3,755 |
| Total equity | **32,916** | 30,352 | 30,156 | 43,988 | 13,422 |

# NOTICE OF ANNUAL GENERAL MEETING

**NOTICE IS HEREBY GIVEN** that the Annual General Meeting ("Meeting") of Advanced Card Systems Holdings Limited (the "Company") will be held at Unit 1008, 10th Floor, Hongkong International Trade and Exhibition Centre, 1 Trademart Drive, Kowloon Bay, Hong Kong on Friday, 4 May 2007 at 3:00 p.m. for the following purposes:

1. To receive and consider the audited consolidated financial statements and the reports of the directors and auditors for the year ended 31 December 2006.

2. To re-elect retiring directors and to authorise the board of directors to fix the remuneration of directors.

3. To re-appoint the auditors and to authorise the board of directors to fix their remuneration.

4. To consider and, if thought fit, pass the following resolution as an ordinary resolution of the Company:

   "THAT:

   (a) subject to paragraph (c) below, and pursuant to the Rules Governing the Listing of Securities on the Growth Enterprise Market (the "GEM Listing Rules") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), the exercise by the directors of the Company during the Relevant Period (as hereinafter defined) of all the powers of the Company to allot, issue and deal with any unissued shares in the capital of the Company and to make or grant offers, agreements and options (including but not limited to warrants, bonds and debentures convertible into shares of the Company) which might require the exercise of such powers be and is hereby generally and unconditionally approved;

   (b) the approval in paragraph (a) shall authorise the directors of the Company during the Relevant Period (as hereinafter defined) to make or grant offers, agreements and options (including but not limited to warrants, bonds and debentures convertible into shares of the Company) which might require the exercise of such power after the end of the Relevant Period (as hereinafter defined);

   (c) the aggregate nominal value of the share capital allotted or issued or conditionally or unconditionally agreed to be allotted or issued (whether pursuant to an option or otherwise) by the directors of the Company pursuant to the approval in paragraph (a) above, otherwise than pursuant to (i) a Rights Issue (as hereinafter defined); or (ii) an issue of shares upon the exercise of the subscription rights attaching to any warrants which may be issued by the Company from time to time; or (iii) an issue of shares upon the exercise of options which may be granted under any option scheme or similar arrangement for the time being adopted or to adopt for the grant or issue to officers, employees and/or directors of the Company and/or any of its subsidiaries of shares or rights to acquire shares; or (iv) any scrip dividend scheme or similar arrangement providing for the allotment and issue of shares in lieu of the whole or part of a dividend on shares in accordance with the articles of association of the Company; or (v) a specific authority granted by the shareholders of the Company in general meeting, shall not exceed 20 per cent. of the aggregate of the total nominal value of share capital of the Company in issue as at the date of passing of this Resolution, and the said approval shall be limited accordingly; and

(d) for the purpose of this Resolution:

"Relevant Period" means the period from the passing of this Resolution until whichever is the earliest of:

(i) the conclusion of the next annual general meeting of the Company;

(ii) the expiration of the period within which the next annual general meeting of the Company is required by the articles of association of the Company or any applicable laws to be held; or

(iii) the passing of an ordinary resolution by shareholders of the Company in general meeting revoking, varying or renewing the authority given to the directors of the Company by this Resolution; and

"Rights Issue" means an offer of shares or issue of options, warrants or other securities giving the right to subscribe for shares, open for a period fixed by the directors of the Company to holders of shares whose names appear on the register of members of the Company (and, where appropriate, to holders of other securities of the Company entitled to the offer) on a fixed record date in proportion to their then holdings of such shares (or, where appropriate, such other securities), subject in all cases to such exclusions or other arrangements as the directors of the Company may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of, or the requirements of any recognised regulatory body or any stock exchange in, any territory applicable to the Company."

5. To consider and, if thought fit, pass the following resolution as an ordinary resolution of the Company:

   "THAT:

   (a) subject to paragraph (b) below, the exercise by the directors of the Company during the Relevant Period (as hereinafter defined) of all powers of the Company to repurchase securities of the Company on the Growth Enterprise Market of the Stock Exchange or any other stock exchange of which the shares of the Company may be listed and recognised by the Securities and Futures Commission of Hong Kong and the Stock Exchange for such purpose, subject to and in accordance with all applicable laws and/or the requirements of the GEM Listing Rules (as defined in ordinary resolution no. 4 above) or of any other stock exchange as amended from time to time, be and is hereby generally and unconditionally approved;

   (b) the aggregate nominal value of shares of the Company repurchased by the Company pursuant to the approval in paragraph (a) above during the Relevant Period (as hereinafter defined) shall not exceed 10 per cent. of the aggregate of the total nominal value of share capital of the Company in issue as at the date of passing of this Resolution, and the authority granted pursuant to paragraph (a) above shall be limited accordingly; and

   (c) for the purposes of this Resolution, "Relevant Period" means the period from the passing of this Resolution until whichever is the earliest of:

      (i) the conclusion of the next annual general meeting of the Company; or

      (ii) the expiration of the period within which the next annual general meeting of the Company is required by the articles of association of the Company or any applicable laws to be held; or

      (iii) the passing of an ordinary resolution by shareholders of the Company in general meeting revoking, varying or renewing the authority given to the directors of the Company by this Resolution."

# NOTICE OF ANNUAL GENERAL MEETING

6. To consider and, if thought fit, pass the following resolution as an ordinary resolution of the Company:

   "**THAT** subject to the passing of the Resolutions nos. 4 and 5 set out in the notice convening this meeting, the general mandate granted to the directors of the Company and for the time being in force to exercise the powers of the Company to allot, issue and deal with any unissued shares pursuant to Resolution no. 4 set out in the notice convening this meeting be and is hereby extended by the addition to the aggregate nominal value of the share capital of the Company which may be allotted or agreed conditionally or unconditionally to be allotted by the directors of the Company pursuant to such general mandate of an amount representing the aggregate nominal value of the share capital of the Company repurchased by the Company under the authority granted pursuant to Resolution no. 5 set out in the notice convening this meeting, provided that such extended amount shall not exceed 10 per cent. of the aggregate of the total nominal value of share capital of the Company in issue as at the date of passing of the said Resolution."

By order of the Board of
Advanced Card Systems Holdings Limited
WONG Yiu Chu, Denny
*Chairman*

Hong Kong, 30 March 2007

*Principal place of business in Hong Kong:*
Unit 1008, 10th Floor
Hongkong International Trade and Exhibition Centre
1 Trademart Drive
Kowloon Bay
Hong Kong

*Registered Office:*
Ugland House
P.O. Box 309
George Town
Grand Cayman
Cayman Islands
British West Indies

# NOTICE OF ANNUAL GENERAL MEETING

*Notes:*

1. A shareholder entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, vote in his stead. A proxy need not be a shareholder of the Company.

2. In order to be valid, a form of proxy and the power of attorney or other authority (if any) under which it is signed or a notarially certified copy of that power or authority, must be deposited at the Company's branch share registrar in Hong Kong, Computershare Hong Kong Investor Services Limited, 46th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not less than 48 hours before the time appointed for the Meeting or any adjourned meeting.

3. Completion and return of the form of proxy will not preclude a shareholder of the Company from attending and voting in person at the Meeting if the shareholder of the Company so desires.

4. With regard to Resolution no. 2 in this notice, the board of directors of the Company proposes that the retiring directors of the Company, namely Mr. Wong Yiu Chu, Denny, Mr. Yu Man Woon and Mr. Wong Yick Man, Francis be re-elected as directors of the Company. Particulars of the said retiring directors are set out in Appendix II to the circular to the shareholders of the Company dated 30 March 2007.

5. An explanatory statement containing further details regarding ordinary resolution no. 5 as required by the GEM Listing Rules of the Stock Exchange is set out in Appendix I to the circular to the shareholders of the Company dated 30 March 2007.

*As at the date of this announcement, 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.*