



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)



Third Quarterly Report 2006

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

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

HIGHLIGHTS

- Revenue of the Group for the nine months ended 30 September 2006 increased by 25% to HK\$32.3 million from the first nine months of 2005.
- Gross profit of the Group for the nine months ended 30 September 2006 increased by 51% to HK\$16.7 million from the first three quarters of 2005.
- The profit of the Group amounted to HK\$2.7 million for the nine months ended 30 September 2006 as compared to a loss of HK\$2.3 million for the first three quarters of 2005.

UNAUDITED CONSOLIDATED RESULTS

The Board of Directors (the "Board") hereby announces the unaudited consolidated results of the Company and its subsidiaries (collectively, the "Group") for the three months and nine months ended 30 September 2006 together with the comparative unaudited figures for the corresponding periods in 2005, as follows:

	Notes	Three months ended 30 September		Nine months ended 30 September	
		2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
Revenue	2	10,776	8,045	32,292	25,826
Cost of sales		(4,598)	(4,291)	(15,598)	(14,751)
Gross profit		6,178	3,754	16,694	11,075
Other operating income		85	53	181	660
Other net loss		(49)	(37)	(163)	(65)
Staff costs		(2,776)	(2,772)	(8,699)	(7,742)
Depreciation		(249)	(226)	(708)	(623)
Amortisation of development costs		(376)	(271)	(922)	(936)
Other operating expenses		(1,186)	(1,434)	(3,479)	(4,581)
Operating profit/(loss)		1,627	(933)	2,904	(2,212)
Finance costs		(75)	(38)	(156)	(115)
Profit/(Loss) before income tax		1,552	(971)	2,748	(2,327)
Income tax	3	—	—	—	—
Profit/(Loss) for the period		1,552	(971)	2,748	(2,327)
Earnings/(Loss) per share	5				
- Basic		0.551 cents	(0.345) cents	0.975 cents	(0.826) cents
- Diluted		0.550 cents	N/A	0.975 cents	N/A

Notes:

1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards as issued by the Hong Kong Institute of Certified Public Accountants, and the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited.

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

These financial statements are unaudited but have been reviewed by the audit committee of the Company. These financial statements were approved by the board of directors on 3 November 2006.

2 REVENUE

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

	Three months ended		Nine months ended	
	30 September		30 September	
	2006	2005	2006	2005
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Sale of smart card products, software and hardware	9,745	7,458	30,585	25,183
Smart card related services	1,031	587	1,707	643
	<u>10,776</u>	<u>8,045</u>	<u>32,292</u>	<u>25,826</u>

3 INCOME TAX

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

4 DIVIDENDS

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

5 EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings per share (2005: loss per share) for the three months and nine months ended 30 September 2006 is based on the respective profit for the period of HK\$1,552,000 and HK\$2,748,000 (2005: loss of HK\$971,000 and HK\$2,327,000) and the weighted average of 281,800,255 and 281,800,255 (2005: 281,800,255 and 281,800,255) ordinary shares in issue during the period.

The calculation of diluted earnings per share for the three months and nine months ended 30 September 2006 is based on the respective profit for the period of HK\$1,552,000 and HK\$2,748,000 and the weighted average of 282,057,000 and 281,879,000 ordinary shares in issue during the period, after adjusting for the effects of all dilutive potential ordinary shares during the period. Diluted loss per share for the three months and nine months ended 30 September 2005 was not presented because the impact of the exercise of the share options were anti-dilutive.

6 RESERVES

	Share premium HK\$'000	Merger reserve HK\$'000	Accumulated losses HK\$'000	Total HK\$'000
At 1 January 2005	24,333	4,496	(26,853)	1,976
Loss for the period	—	—	(2,327)	(2,327)
At 30 September 2005	24,333	4,496	(29,180)	(351)
At 1 January 2006	24,333	4,496	(26,657)	2,172
Profit for the period	—	—	2,748	2,748
At 30 September 2006	24,333	4,496	(23,909)	4,920

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

MANAGEMENT DISCUSSION AND ANALYSIS

In the first nine months ended 30 September 2006, the Group recorded better bottom line owing to the increase in sales, increase in gross profit margin and no increase of operating expenses. The Group recorded a net profit before income tax of HK\$2.7 million in the first nine months of 2006 comparing with a net loss before income tax of HK\$2.3 million in the first nine months of 2005.

Financial Review

In the first nine months ended 30 September 2006, the Group increased its sales by 25% comparing with the sales in the corresponding period in 2005. The gross profit in dollar term increased by 51% owing to a higher gross profit margin of 52% compared with 43% in the corresponding period in 2005. With the operating expenses remaining to be the same, the Group reversed the situation of a net loss before income tax of HK\$2.3 million in the first nine months of 2005 to a net profit before income tax of HK\$2.7 million in the first nine months of 2006.

	Nine months ended		Change
	30 September		
	2006	2005	
	HK\$'000	HK\$'000	
Revenue	32,292	25,826	+25%
Cost of sales	(15,598)	(14,751)	+6%
Gross profit	16,694	11,075	+51%
Other operating income and Other net loss	18	595	-97%
Operating expenses	(13,808)	(13,882)	-1%
Operating profit/(loss)	2,904	(2,212)	
Finance costs	(156)	(115)	+36%
Profit/(Loss) before income tax	2,748	(2,327)	

The Group recorded an increase of the sales of the flag-ship product, PC linked readers by 15%. The biggest increase by percentage came from "Other products". The introduction of new products contributed to the increase in sales in this product category. As mentioned in the previous reports, the Group has just launched or is launching several new products. These new products began to make contributions to the sales growth. For example, the first commercial lot of ACR100 (a flash drive integrated with a PC linked reader) was delivered to a telephone operator in Asia and the shipment generated the sales of HK\$1.4 million. The increase in smart card related services was accounted for by the income as design fee of approximately HK\$1 million from a big US-based company (with annual sales of US\$30 billion) that appointed the Group to develop a specialized smart card reader at their specification.

**Nine months ended
30 September**

	2006 <i>HK\$'000</i>	2005 <i>HK\$'000</i>	Change
Smart cards	4,728	4,399	+7%
PC linked readers	17,194	14,972	+15%
Other products	8,663	5,812	+49%
	<u>30,585</u>	<u>25,183</u>	
Smart card related services	1,707	643	+165%
	<u><u>32,292</u></u>	<u><u>25,826</u></u>	

The sales grew in all the three regions with the biggest growth in the Americas while Europe, Middle East and Africa still represents the biggest region for the sales of the Group's products.

**Nine months ended
30 September**

	2006 <i>HK\$'000</i>	2005 <i>HK\$'000</i>	Change
The Americas	4,766	3,060	+56%
Asia Pacific	12,164	11,224	+8%
Europe, Middle East and Africa	15,362	11,542	+33%
	<u>32,292</u>	<u>25,826</u>	

Business Review

The Group has officially launched ACR100, a flash drive integrated with a PC linked reader and got some orders of commercial size. The PKI (Public Key Infrastructure) card named ACOS5 card was just launched and generated initial small orders for pilot runs. ACR88, the portable PIN-pad smart card reader, was given a soft launch as not all its features have been fully implemented in the product development process.

In the first nine months of 2006, the Group started the development of several new products. The main products are (1) ACR82, a dynamic password generator and (2) eH880, a PIN-pad reader using a 32-bit microprocessor platform (versus the 8-bit microprocessor platform used in ACR88). ACR82 is being developed based on the 3DSCAP specification defined by MasterCard and has the purpose to enhance the security of using the Internet. Simply put, after a user inserts his EMV smart card (i.e. that card developed based on Europay, Mastercard and Visa specification) into the device and inputs his PIN number, a certain new number will be generated and displayed. This number will become his new PIN to access the Internet. eH880 is developed based on the German health card specification but can be adapted to fit various smart card applications. The Group's ACR88 and eH880 complement each other to fulfill the requirements of a wide range of smart card applications and to meet customers' different acceptable levels of prices.

Owing to an expanded range of products, the Group needs to exert efforts to sell them. It has been actively training sales and marketing personnel especially the young staff members to take up more sales and marketing responsibilities. At the same time, the Group places much emphasis on the improving of the operations efficiency through the enhancement of the IT system.

Prospects

The Group places emphasis on developing state-of-the-art products and to keep itself abreast of the advancement of the technology in the smart card industry. On the other hand, it is the prime objective of the Group to keep a positive bottom line. Thus given the choice of either a high sale amount or a high gross profit margin, the Group will choose the latter. At the same time, owing to the controlling of expenses, a very small amount of funds is being spent in advertising and promotion. Fortunately, over the years, the Group has built a wide base of satisfied customers. A good portion of customers of the Group's existing products are also prospective customers of new products.

The Group believes that once its range of new products have been fully launched to the market, the sales will expand and the gross profits will increase. Then owing to reaching a better economy of scale (more effective use of manpower), the bottom line will increase. With more profits retained, a relatively higher percent of financial resources could be put into sales and marketing activities, especially in promotion, such as the participation of trade shows and industry forums.

Headquarters at the strategic geographical location of Hong Kong, the Group is deploying its teams in Shenzhen and in Manila on top of the team in Hong Kong effectively. These three places are not distant apart. The Group believes that its business model of deploying people from three locations with different skills and different cost structures will prove to be extremely successful in the not distant future.

Liquidity and Financial Resources

As at 30 September 2006, the Group's cash at bank and on hand amounted to HK\$8.2 million (30 September 2005: HK\$9.2 million) which included the pledged bank deposits of HK\$2.7 million (30 September 2005: Nil). Out of the HK\$2.7 million pledged bank deposits, HK\$0.7 million was pledged in order to have a performance bond issued by a bank to a customer who gave the Group a prepayment for ordering the Group's products being developed. The balance of HK\$2.0 million was to secure bank credit lines. At 30 September 2006, the facilities were utilized to the extent of HK\$0.9 million (30 September 2005: Nil). Such bank borrowings were repayable within one year and were primarily denominated in Hong Kong dollars and United States dollars with floating interest rates.

The current ratio, being the ratio of current assets to current liabilities, was maintained at a level of 4.0 (30 September 2005: 3.2). Net asset value as at the end of the review period was HK\$33.1 million (30 September 2005: HK\$27.8 million). As at 30 September 2006, the gearing ratio, being the total interest bearing debts over the total equity, was at 2.7% (30 September 2005: zero).

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

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

(i) Interests in issued shares

Ordinary shares of HK\$0.10 each

Name of director	Personal interests (Note 1)	Family interests	Corporate interests	Other interests	Percentage of the Company's issued share capital as at	
					Total number of shares held	30 September 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%

Notes:

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

(ii) Interests in underlying shares

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

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

SHARE OPTION SCHEMES

(i) Pre-IPO Share Option Plan

At 30 September 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 September 2006 was HK\$0.095) with an exercise price of HK\$0.09 or HK\$0.24 per share under the Pre-IPO Share Option Plan (the "Plan") of the Company. The options are unlisted. Each option gives the holder the right to subscribe for one ordinary share of HK\$0.10 each of the Company.

Grantees	Date granted	Number of share options				Balance as at 30 September 2006	Period during which the options are exercisable	Exercise price per share	Percentage of the Company's issued share capital as at 30 September 2006
		Balance as at 1 January 2006	Granted during the period	Exercised during the period	Lapsed during the period				
Consultants & Employees	27 October 2003	1,521,745	—	—	160,138	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%
		<u>2,623,556</u>	<u>—</u>	<u>—</u>	<u>360,311</u>	<u>2,263,245</u>			

Notes:

- 1 1,201,034 share options were granted to a consultant of the Group. All other options were granted to employees of the Group.
- 2 The options vested and were exercisable on 10 May 2004, which was 6 months after the listing date of the Company.
- 3 The options vested and were exercisable in three tranches as follows:
 - (a) one-third of the options vested and were exercisable on 10 May 2004;
 - (b) a further one-third of the options vested and were exercisable on 31 December 2004; and
 - (c) the remaining one-third of the options vested and were exercisable on 31 December 2005.
- 4 The options lapsed upon the resignation of 2 participants from the Group.
- 5 No option was granted, exercised or cancelled during the period.

(ii) Share Option Scheme

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

DIRECTORS' RIGHTS TO ACQUIRE SHARES

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

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

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

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

Notes:

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

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

DIRECTORS' INTERESTS IN COMPETING BUSINESS

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

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

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

DIRECTORS' SECURITIES TRANSACTIONS

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

AUDIT COMMITTEE

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

By order of the Board
WONG Yiu Chu, Denny
Chairman

Hong Kong, 3 November 2006