

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



FIRST QUARTERLY REPORT 2004



Q1

* For identification only

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

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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 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.

HIGHLIGHTS

- Turnover and gross profit for the quarter ended 31 March 2004 increased by 61% to approximately HK\$7.3 million and 36% to approximately HK\$3.4 million respectively from the first quarter of 2003.
- The Group recorded loss attributable to shareholders of approximately HK\$478,000 as a result of increased operating costs mainly due to the expansion of manpower to strengthen the Group.
- Financial position remains strong, with cash and cash equivalents of approximately HK\$19.9 million and no borrowings.

UNAUDITED CONSOLIDATED RESULTS

The Board of Directors herein announces the unaudited consolidated results of the Company and its subsidiary (the "Group" or "ACS") for the three months ended 31 March 2004 together with the comparative unaudited figures for the corresponding period in 2003, as follows:

	<i>Note</i>	Three months ended 31 March	
		2004	2003
		HK\$'000	HK\$'000
Turnover	2	7,323	4,551
Cost of sales		<u>(3,909)</u>	<u>(2,049)</u>
		3,414	2,502
Other revenue		26	8
Other net (loss) / income		(19)	8
Operating expenses			
Staff costs		(1,952)	(1,225)
Depreciation		(139)	(141)
Amortisation of development costs		(432)	(317)
Other operating expenses		<u>(1,341)</u>	<u>(710)</u>
(Loss) / profit from operations		(443)	125
Finance costs		<u>(35)</u>	<u>(22)</u>
(Loss) / profit from ordinary activities before taxation		(478)	103
Income tax	3	<u>—</u>	<u>—</u>
(Loss) / profit from ordinary activities after taxation and attributable to shareholders		<u>(478)</u>	<u>103</u>
(Loss) / earnings per share			
- Basic	4(a)	(0.171) cents	0.051 cents
- Diluted	4(b)	(0.170) cents	0.051 cents

Notes:

1 BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (which includes all applicable Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Society of Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. These financial statements also comply with the applicable disclosure provisions of the rules governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited.

The measurement basis used in the preparation of the financial statements is historical cost.

2 TURNOVER

The principal activities of the Group are the development, sale and distribution of smart card products, software and hardware and the provision of smart card related services to customers.

Turnover represents the invoiced value of sales to customers less discounts and returns during the period.

	Three months ended 31 March	
	2004	2003
	HK\$'000	HK\$'000
Sales of smart card products, software and hardware	6,049	4,176
Smart card related services	1,274	375
	<u>7,323</u>	<u>4,551</u>

3 INCOME TAX

No provision for Hong Kong Profits Tax has been made by the Company as it did not earn any assessable income during the three months ended 31 March 2004.

No provision for Hong Kong Profits Tax has been made by the subsidiary as the subsidiary sustained a taxable loss during the three months ended 31 March 2004.

4 BASIC AND DILUTED (LOSS) / EARNINGS PER SHARE

(a) *Basic (loss) / earnings per share*

The calculation of basic (loss) / earnings per share for the three months ended 31 March 2004 is based on the loss attributable to shareholders of HK\$478,000 (2003: profit attributable to shareholders of HK\$103,000) and the weighted average of 280,000,000 ordinary shares (2003: 202,000,000 ordinary shares) outstanding after the issuance of shares prior to the Listing as if those shares had been outstanding from 1 January 2003.

(b) *Diluted (loss) / earnings per share*

The calculation of diluted (loss) / earnings per share is based on loss attributable to shareholders for the period of HK\$478,000 (2003: profit attributable to shareholders of HK\$103,000) and the weighted average of 281,999,000 ordinary shares (2003: 202,000,000 ordinary shares) after adjusting for the effects of all dilutive potential ordinary shares as shown below:

	No. of shares	
	2004	2003
Weighted average number of ordinary shares used in calculating basic (loss) / earnings per share	280,000,000	202,000,000
Deemed issue of ordinary shares for no consideration	1,999,000	—
Weighted average number of ordinary shares used in calculating diluted (loss) / earnings per share	<u>281,999,000</u>	<u>202,000,000</u>

5 DIVIDENDS

The Company had not declared or paid any dividend during the three months ended 31 March 2004 (2003: HK\$Nil).

6 RESERVES

	Share premium	Merger reserves	Revenue reserves	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
At 1 January 2003	15,863	4,496	(24,612)	(4,253)
Profit for the period	—	—	103	103
At 31 March 2003	<u>15,863</u>	<u>4,496</u>	<u>(24,509)</u>	<u>(4,150)</u>
At 1 January 2004	24,351	4,496	(12,859)	15,988
Loss for the period	—	—	(478)	(478)
At 31 March 2003	<u>24,351</u>	<u>4,496</u>	<u>(13,337)</u>	<u>15,510</u>

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

The Group had a net reserves of HK\$15,510,000 at 31 March 2004 (2003: deficit of HK\$4,150,000) analysed as follows:

	Three months ended 31 March	
	2004	2003
	HK\$'000	HK\$'000
Company	23,404	15,718
Subsidiary	(12,390)	(24,364)
Merger reserves	4,496	4,496
Group	<u>15,510</u>	<u>(4,150)</u>

MANAGEMENT DISCUSSION AND ANALYSIS

The Group is pleased to report an increase of 61% in turnover in the first quarter of 2004 comparing the corresponding period of 2003. During the period, the Group increased its headcount by nearly one-third in its endeavour to strengthen the Group to prepare for its future growth by fueling its product development work and by actively participating in diverse marketing activities to boost sales.

FINANCIAL REVIEW

The Group achieved a 61% growth in turnover, reaching approximately HK\$7.3 million (2003: approximately HK\$4.6 million).

PC linked readers continued to be the Group's flagship product, generating approximately HK\$3.7 million revenue to the Group. With the successful strategy of product diversification and the introduction of new products, during the period under review the revenue portion contributed by the products other than PC linked readers in aggregate increased from 26% in the corresponding period last year to 33% this year.

The gross profit increased 36% to approximately HK\$3.4 million (2003: approximately HK\$2.5 million). However, mainly due to the increase in the costs of raw materials, the Group's gross profit margin decreased from 55% to 47%. Loss attributable to shareholders amounted to HK\$478,000 as a result of the 61% increase in operating costs arising mainly from the increase in human resources. Management strongly believes that the newly recruited engineering and marketing professionals can help the Group better grasp the opportunities ahead and accelerate the growth of ACS.

Looking at the geographical breakdown, Europe, Africa and the Middle East accounted for 62% (2003: 30%) of total turnover for the quarter ended 31 March 2004, Asia Pacific 32%, and the Americas 6%.

BUSINESS REVIEW

More and more governments around the world are turning to smart card based security solutions for information management and authentication of identity. This increasing popularity of the smart card, in fact, has generated immense business opportunities for ACS. In December 2003, the Group's smart card readers with pin-pad *ACR80* was selected for the national identity card project in Serbia & Montenegro, which will involve over 10 million smart cards. The first batch of order was delivered during the period under review. Closer to home, the continuous roll out of the Hong Kong smart card based electronic identity card generates steady demand for the Group's *ACR30* and *ACR30 Pro* PC linked readers.

In the first quarter, ACS planned its marketing activities in order to broaden its customer base. In March 2004, ACS participated in the CeBit show which is a well-known international show for information technology and telecommunication held in Germany.

During the period under review, the Group successfully secured a number of new customers, including the system solution provider for the National Identity Card project in Serbia & Montenegro, a government related organisation in Hong Kong and a system integrator in Germany for Point of Sales Terminal project.

PROSPECTS

As more and more industries and public sectors are adopting smart card technology to handle electronic commerce, security and access control issues, ACS is committed to equipping itself in grasping the enormous growth potentials of today's smart card applications. The Group is now negotiating with a number of lock and safe manufacturers to integrate its smart card reader and finger print authentication technology into traditional security systems, furthering its penetration into different industries.

Turning to product development, the prototyping of smart card terminal *AC-Mifare Terminal* is at its final stage of completion. Besides, an upgraded version of the smart card operating system *ACOS3* and a new version of the PC linked readers *ACR38T* are expected to be launched in the second quarter.

To further widen its customer base, the Group intends to continue to actively participate in trade shows in the United States, France, China, Hong Kong and Korea. Other sales and marketing activities will also include advertisements in technology related magazines.

Talented individuals are the backbone of a technology company, and ACS is no exception. Therefore, to be well prepared for future growth and in view of the increasing demand, the Group will continue to recruit additional staff members including well-experienced engineering and marketing professionals in the second quarter of 2004. These new recruits will bring with them valuable technical know-how and marketing expertise which management strongly believes will accelerate the development of ACS's business.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 March 2004, the Group's cash and cash equivalents amounted to approximately HK\$19.9 million (2003: approximately HK\$1.8 million). The current ratio, being the ratio of current assets to current liabilities, was maintained at a strong level of 7.1 (2003: 2.0). Net asset value as at the end of the review period was approximately HK\$43.5 million (2003: approximately HK\$13.5 million). As at 31 March 2004, the Group did not have any borrowing.

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

At 31 March 2004, 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 Rule 5.46 to 5.67 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*

Name of director	Personal interests (Note 1)	Family interests	Corporate interests	Other interests	Ordinary shares of HK\$0.10 each		Percentage of the Company's issued share Total capital as at 31 March 2004
					number of shares held		
Mr. Wong Yiu Chu, Denny (Note 2)	6,773,831	2,882,481	105,706,210	—	115,362,522	41.20%	
Mr. Pang Wang Kee, Lawrence (Note 3)	6,863,052	—	—	—	6,863,052	2.45%	
Mr. Tan Keng Boon	6,845,893	—	—	—	6,845,893	2.44%	
Mr. Wan Wah Tong, Thomas (Note 4)	2,402,068	—	17,615,162	—	20,017,230	7.15%	

Notes:

- The shares are registered under the names of the directors who are the beneficial owners.
- Of these shares, 105,706,210 shares are held by D&A Holdings Limited (a company which is owned as to 70% by Mr. Denny Wong and as to 30% by his wife, Mrs. Wong Tsui Kam Ling, Alice) and 2,882,481 shares are held by Mrs. Alice Wong personally. Mr. Denny Wong is taken to be interested in these shares under the SFO.
- The interest disclosed herein does not include the 1,601,378 shares subject to the options granted to him pursuant to the Pre-IPO Share Option Plan.
- Of these shares, 17,615,162 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 these shares 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.

SHARE OPTION SCHEMES

(i) *Pre-IPO Share Option Plan*

At 31 March 2004, the directors, consultants and employees of the Company had the following interests in options to subscribe for shares of the Company (market value per share at 31 March 2004 was HK\$0.26) 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.

Grantees	Date granted	Number of share options				Balance as at 31 March 2004	Period during which options exercisable	Exercise price per share	Percentage of the Company's issued share capital as at 31 March 2004
		Balance as at 1 January 2004	Granted during the period	Exercised during the period	Lapsed during the period				
1 director	27 October 2003	1,601,378	—	—	—	1,601,378 <i>(Note 1)</i>	10 November 2004 to 2 December 2011	HK\$0.24	0.57%
14 employees and 2 consultants	27 October 2003	2,802,413	—	—	—	2,802,413	10 May 2004 to 24 July 2010	HK\$0.09	1.00%
	27 October 2003	520,449	—	—	—	520,449	10 May 2004 to 27 December 2010	HK\$0.09	0.19%
	27 October 2003	1,411,218	—	—	—	1,411,218 <i>(Note 4)</i>	10 May 2004 to 20 January 2013	HK\$0.24	0.50%
	27 October 2003	200,173	—	—	200,173 <i>(Note 5)</i>	—	31 December 2004 to 20 January 2013	HK\$0.24	—
		<u>6,535,631</u>				<u>6,335,458</u>			

Notes:

- 1 The 1,601,378 share options were granted to a director, Mr. Pang Wang Kee, Lawrence. All other options were granted to employees and consultants of the Group.
- 2 The market value per share at the date of grant of the options was HK\$0.32 which was the issue price of the Company's placing shares on the listing on GEM.
- 3 None of the share options has been exercised during the period ended 31 March 2004.
- 4 The options will vest and be exercisable in three tranches as follows:
 - (a) one-third of the options will vest and be exercisable on 10 May 2004;
 - (b) a further one-third of the options will vest and be exercisable on 31 December 2004; and
 - (c) the remaining one-third of the options will vest and be exercisable on 31 December 2005.
- 5 The options lapsed upon the resignation of the participant from the Group.

(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 to the directors under the Scheme.

Save as disclosed above, to the best knowledge of the directors of the Company, as at 31 March 2004, 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 Rule 5.46 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange.

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 31 March 2004 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 March 2004
D & A Holdings Limited	Beneficial owner	105,706,210 shares (L)	37.75%
Mrs. Alice Wong (<i>Note 2</i>)	Personal	2,882,481 shares (L)	41.20%
	Family	112,480,041 shares (L)	
Proway Investment Limited (<i>Note 3</i>)	Beneficial Owner	31,740,305 shares (L)	11.34%
Morningside CyberVentures Holdings Limited (<i>Note 3</i>)	Other	31,740,305 shares (L)	11.34%
Verrall Limited (<i>Note 3</i>)	Other	31,740,305 shares (L)	11.34%
Madam Chan Tan Ching Fen (<i>Note 3</i>)	Other	31,740,305 shares (L)	11.34%
Thomrose Holdings (BVI) Limited	Beneficial owner	17,615,162 shares (L)	6.29%

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.
- 2 105,706,210 shares are held by D&A Holdings Limited, 2,882,481 shares are held by Mrs. Alice Wong personally and 6,773,831 shares are held by her husband, Mr. Denny Wong personally. Mrs. Alice Wong is taken to be interested in the shares held by Mr. Denny Wong and D&A Holdings Limited under the SFO.
- 3 Proway Investment Limited is wholly owned by Morningside CyberVentures Holdings Limited. Morningside CyberVentures Holdings Limited is wholly owned by Verrall Limited in its capacity as trustee of a family trust established by Madam Chan Tan Ching Fen. Madam Chan Tan Ching Fen will be 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).

Save as disclosed above, as at 31 March 2004 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

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.

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

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

SPONSOR'S INTERESTS

Neither the Company's sponsor, Anglo Chinese Corporate Finance, Limited (the "Sponsor"), nor its directors, employees or associates had any interests in any class of securities of the Company or any other company in the Group (including options or the right to subscribe for such securities) as at 31 March 2004 pursuant to Rule 6.35 of the GEM Listing Rules.

Pursuant to the sponsor agreement dated 30 October 2003 entered into between the Company and the Sponsor, the Sponsor receives a fee for acting as the Company's retained sponsor for the period from 10 November 2003 to 31 December 2005.

COMPLIANCE WITH THE BOARD PRACTICES AND PROCEDURES

The Company has complied with the Board Practices and Procedures requirements as set out in Rules 5.34 to 5.45 of the GEM Listing Rules throughout the period.

AUDIT COMMITTEE

The Company has established an audit committee with written terms of reference. The audit committee comprises two independent non-executive directors namely, Dr. Yip Chak Lam, Peter and Mr. Cheong Chung Chin and one executive director, Mr. Wong Yiu Chu, Denny 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 three months ended 31 March 2004.

By order of the Board
WONG Yiu Chu, Denny
Chairman

Hong Kong, 10 May 2004