

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



ANNUAL REPORT 2004



* For identification only

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As at the date of this document, the Board comprises 4 executive directors, namely Mr. Wong Yiu Chu, Denny, Mr. Tan Keng Boon, Mr. Mak Chi Him and Ms. Tsui Kam Ling, Alice; 1 non-executive director, Mr. Wan Wah Tong, Thomas; and 3 independent non-executive directors, Dr. Yip Chak Lam, Peter, Mr. Cheong Chung Chin and Mr. Yu Man Woon.

CONTENTS

Corporate Information	2
Chairman's Statement	3
Management Discussion and Analysis	4
Review of Business Objectives	12
Directors and Senior Management	14
Report of the Directors	18
Auditors' Report	31
Consolidated Profit and Loss Account	32
Consolidated Balance Sheet	33
Balance Sheet	34
Consolidated Statement of Changes in Equity	35
Consolidated Cash Flow Statement	36
Notes on the Financial Statements	38
Financial Summary	73
Notice of Annual General Meeting	74

CORPORATE INFORMATION

DIRECTORS

Executive Directors

Mr. Wong Yiu Chu, Denny (*Chairman*)
Mr. Tan Keng Boon
Mr. Mak Chi Him
Ms. Tsui Kam Ling, Alice

Non-executive Director

Mr. Wan Wah Tong, Thomas

Independent Non-executive Directors

Dr. Yip Chak Lam, Peter
Mr. Cheong Chung Chin
Mr. Yu Man Woon

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, *ACCA, CPA*

COMPLIANCE OFFICER

Mr. Wong Yiu Chu, Denny

AUDIT COMMITTEE

Mr. Yu Man Woon (*Chairman*)
Dr. Yip Chak Lam, Peter
Mr. Cheong Chung Chin

AUDITORS

KPMG
Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

COMPLIANCE ADVISOR

Anglo Chinese Corporate Finance, Limited
40th Floor, Two Exchange Square
8 Connaught Place
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 2910-2913, 29/F
The Center
99 Queen's Road Central
Hong Kong

PRINCIPAL BANKER

DBS Bank (Hong Kong) Limited
189-191 King's Road
North Point, Hong Kong

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Bank (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

In the year ended 31 December 2004, the main focus was to take several strategic moves in order to aim for the long-term viability of this high technology business in the smart card industry. Firstly, the Group continued to develop new smart card products in order to expand the product portfolio to avoid relying on the product line of PC linked readers which accounted for three-quarters of the total sales of the year ended 31 December 2003. Secondly, after getting listed in GEM in November 2003, the Group started to strengthen the man power of the Group by attracting and enrolling some talented people while at the same time enriching the training programs for the staff. Thirdly, the Group expanded its organization in Manila, The Philippines and opened an office in Shenzhen, China.

Owing to the long cycle to develop a product or to close a major business deal, a strategic move in this high technology business normally does not make a major impact until a year or two. On the other hand, owing to the limited resources available, the management has been very cautious in making its strategic decisions.

In the year 2004, the Group recorded a drop in turnover by approximately 37% to approximately HK\$24.4 million from the figure of approximately HK\$38.6 million in the previous year. The net loss before taxation for the Group in the year 2004 amounted to approximately HK\$14.0 million compared with the net profit before taxation for the Group of approximately HK\$10.1 million in the previous year. The cash balance was approximately HK\$13.1 million at 31 December 2004 compared with approximately HK\$21.5 million at 31 December 2003. There was no borrowing at the end of year.

The total staff cost increased to approximately HK\$8.9 million in the year 2004 from approximately HK\$5.8 million in the previous year as a result of the increased headcount. At 31 December 2004, the total headcount stood at approximately 60, compared with approximately 30 a year ago. An office was established in the year 2004 in Manila, The Philippines. An office was also officially established in Shenzhen, China in January 2005. Some engineering and sales and marketing tasks are assigned to these new offices operating at lower costs.

The Group has now a more balanced product mix, a stronger team of people and more cost effective organizations. Furthermore the overall smart card industry is still growing. The Group aims to see a growth in turnover in 2005 but is particularly keen in controlling its expenses in order to conserve resources required for future expansion.

I would like to close the statement with an expression of appreciation to all the staff members of the Group for their dedication and hard work and to all shareholders for their support.

WONG Yiu Chu, Denny

Chairman & CEO

Hong Kong, 23 March 2005

MANAGEMENT DISCUSSION AND ANALYSIS

The following discussions and analysis should be read along side with the Group's audited financial statements for the year ended 31 December 2004.

FINANCIAL REVIEW

The total turnover of the Group decreased by approximately 37% from approximately HK\$38.6 million in the year ended 31 December 2003 to approximately HK\$24.4 million in the year ended 31 December 2004. The turnover of PC linked readers which accounted for over three-quarters of the total sales in 2003 dropped by approximately 63%. The turnover of the other products increased by approximately 114%, not enough to offset the decrease in turnover of the PC linked readers.

	For the year ended		Percentage Change
	31 December		
	2004 HK\$'million	2003 HK\$'million	
Turnover of PC linked readers	10.7	29.2	-63%
Turnover of other products	12.2	5.7	+114%
	<u>22.9</u>	<u>34.9</u>	
Smart card related services	1.5	3.7	-60%
	<u>24.4</u>	<u>38.6</u>	-37%

The major applications of PC linked readers are for secure access to the PC and to the Internet. In the year ended 31 December 2003, the Group sold PC linked readers in the amount of approximately HK\$5.6 million to a telephone operator in Hong Kong for editing the content (telephone numbers and short messages) of the SIM cards in mobile phone. Sales of PC linked readers for such an application or to that scale did not recur in the year ended 31 December 2004. Also in the year 2004, most of the projects for which the Group provided PC linked readers were not so large as those secured in the year 2003. Thus the sales of PC linked readers dropped significantly.

About the turnover breakdown by region, the Group recorded a small increase in turnover of approximately 4% in the region of Europe, Africa and the Middle East while the biggest drop occurred in Asia Pacific (approximately 63%) and then the Americas (approximately 22%).

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL REVIEW *(continued)*

The Group's drop in sales in Asia Pacific is not considered as a result of the change of demand in the Asia Pacific region. It just happened that the Group was not able to secure orders of PC linked readers from this region in the year 2004 as it did in the previous year.

	For the year ended		
	31 December		
	2004	2003	Percentage
	HK\$'million	HK\$'million	Change
The Americas	2.5	3.2	-22%
Asia	8.3	22.3	-63%
Europe, Africa and the Middle East	13.6	13.1	+4%
	<u>24.4</u>	<u>38.6</u>	

Based on the experience in the year 2004, the Group realized that the sales of a product line could fluctuate as a result of the success or failure to secure business from the bigger projects. Thus it is advantageous for the Group to expand its range of products while still focusing on its smart card and reader business. Venturing into new product areas may mean taking risks in the investments as not all new products developed will generate sufficient profits in the future to recoup the investment in them. However, the innovation in products to a certain degree is considered vital to the long-term viability of a technology company.

The operating expenses and finance costs increased from approximately HK\$11.0 million in the year ended 31 December 2003 to approximately HK\$24.2 million in the year ended 31 December 2004. The net loss/profit before taxation changed from a profit figure of approximately HK\$10.1 million in the year 2003 to a loss figure of approximately HK\$14.0 million in the year 2004.

	For the year ended		
	31 December		
	2004	2003	Percentage
	HK\$'million	HK\$'million	Change
Turnover	<u>24.4</u>	<u>38.6</u>	-37%
Gross profit	10.1	20.7	-51%
Other revenue and other net loss	0.1	0.4	-75%
Operating expenses and finance costs	<u>(24.2)</u>	<u>(11.0)</u>	+120%
Net (loss)/profit before taxation	<u>(14.0)</u>	<u>10.1</u>	

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL REVIEW *(continued)*

Of the operating expenses and finance costs of approximately HK\$24.2 million, approximately HK\$8.9 million (2003: approximately HK\$5.8 million) represents the staff costs due to the increase in headcount to approximately 60 at 31 December 2004 from approximately 30 as at 31 December 2003. The Group made a provision of approximately HK\$5.0 million as the impairment loss on development costs. While the Group increased its sales of the other products in the year 2004 by approximately 114% from approximately HK\$5.7 million to approximately HK\$12.2 million as mentioned above, some new products developed or in the process of development were considered at the end of the year 2004 not to be able to turn out enough profits to cover the development costs in the future. Thus, the Group made such a provision to the development costs spent in these products.

DIVIDEND

The board of directors (the "Board") does not recommend the payment of a final dividend in respect of the year ended 31 December 2004. 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 condition and such other factors as the Board may deem relevant.

BUSINESS REVIEW

While some products developed are considered not successful, other products that were introduced into the market were proved to generate sales and profit to the Group. The smart cards and the smart card/finger print readers represent the growth areas. The sales of the smart cards increased from approximately HK\$1.0 million in the year 2003 to approximately HK\$3.5 million in 2004. The sales of the smart card/finger print readers increased from approximately HK\$0.5 million in the year ended 31 December 2003 to approximately HK\$3.4 million in the year ended 31 December 2004.

As more products are developed, more engineering resources will be required. While the Group continues to develop the core technologies in Hong Kong, it has been strengthening its engineering resources at places at lower costs, i.e. Manila and Shenzhen. At the same time, some sales and marketing work are assigned to these offices.

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW *(continued)*

The Group secured business from various projects in the world. Those projects that are worth mentioning include:

e-Cert programme in Hong Kong

As the Hong Kong citizens are getting their new smart card based identity cards, the Group continued to provide two models of its PC linked readers for the e-Cert programme which facilitates on-line services for the government, banks, other commercial firms and individuals. In addition to providing the readers, the Group offers answers to any technical questions associated with the use of the readers to all types of users. The Group is pleased to see its PC linked readers being deployed in its domestic market. The Group is supplying more of such readers in the year 2005.

Integrated smart card/finger print readers used in UAE

The Group provided over 1,300 pieces of AET63 (smart card/finger print readers) to a customer in UAE. They are providing IT and security solutions for Healthcard, e-government, e-purse, Passports, e-insurance and Banking to the UAE government. In particular, the UAE government requires some government departments and companies to keep a record of working immigrants. Every immigrant will be given an ID card and they need to register again with the government every three years. The customer launched its program to allow the immigrants to register online inside government departments or in the companies which the immigrants work for. The Group's product AET63 met exactly their requirements. The Group has continued its supply of such readers in 2005.

Smart cards, and integrated smart card/finger print readers used in Indonesia

One major bank in Indonesia bought from the Group through a solution house in Jakarta ACOS cards and the integrated smart card/finger print readers, AET63. The bank uses the cards to hold the personal particulars of customers and their finger print image and uses the AET63 to authenticate their broad base customers in this developing and populated country. The Group supplied approximately 200,000 units of ACOS cards and over 1,000 units of AET63 to them in the year 2004 and is continuing to supply such devices in the year 2005.

Smart card readers used for the Belgium government

In 2004, the Group continued to supply PC linked readers to a company in Belgium for use in Belgium National Identity Card project. The government provides the readers to the citizens free of charge. The reader is used together with their e-cert embedded in the national ID card for all their government online services. The Group supplied close to 20,000 units of PC linked readers ACR30/38 to them. The demand of such readers has continued in the year 2005.

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW *(continued)*

Supply of smart card readers with pin-pad for use in the Serbia identity card project

In the year 2004, the Group supplied over 4,000 smart card readers with pin-pad, *ACR80*, to a company in Serbia. The readers were used as desk-top devices in government departments for access to the identity documents of the country's citizens stored in the government's servers. The reader has two slots accepting two smart cards. When both an operator for a government department and a citizen have their smart cards inserted, the access to the identity documents of the citizen will be authorized.

Smart card trade shows

In the year 2004, the Group participated in various smart card and security trade shows in the world including "Card-tech and Secu-tech" in the United States, "CeBIT" in Germany and "Cartes" in France. These shows the Group attended in each of the last several years. In addition, the Group attended in the year 2004 three smart card trade shows in Asia, including "CardTech Korea" in Seoul, "Smart Card China" in Beijing, and "The 6th International Smart Card Technology, Application Conference and Products Exhibitions" in Shenzhen, China. Some potential customers were identified in these trade shows in Asia even though substantial sales to them have yet to be realized.

Product launch

In the year 2004, the Group launched five new products: one smart card operating system, two smart card readers and two integrated smart card/finger print readers. These new products were bought by various customers in the world with examples mentioned below.

The smart card product, *ACOS2* was used in the bank project in Indonesia as mentioned above.

One of the readers, *ACR38T*, was bought by a global card company based in France. The other reader, *ACR80*, was used in the national identity card project in Serbia as mentioned above.

The integrated smart card/finger print reader, *AET60*, was used for a bank in Malaysia. The other integrated smart card/finger print reader, *AET63*, was used for the bank in Indonesia as mentioned above. The major function of such a biometric and smart card reader device is to verify the identity of the card holders. The finger print image of the card holder is stored in the smart card. In the verification process, the card holder will place one of his fingers on the finger print scanner. The scanned finger print image will be compared with that image stored in the smart card. If the two images match, the card holder will be authenticated. The major difference between *AET60* and *AET63* is that when *AET60* is used, the finger print verification is done in the PC to which *AET60* is connected, but when *AET63* is used, the finger print verification is done in the *AET63* device itself for higher security.

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW *(continued)*

People and offices

The Group is pleased to see that three persons with successful management experience in the technology fields accepted the Group's invitations and joined the Group in the year 2004. Dr. Lui Ho Chung joined in the first quarter of 2004 as Vice President, Advanced Technology Development. His prime responsibility in the Group is to help the Group with its advancement of its new technologies. Mr. Damais Mak joined the Group in the second quarter of 2004 and currently he is Vice President, Product Development & Marketing of the Group. Mr. John Lee joined in the third quarter of 2004 to head the China office as its General Manager.

The Group continued to deploy its Manila office to develop Software Development Kits ("SDK") to help users understand the Group's products. Usually when a new product is launched, the corresponding SDK will be launched at the same time. In the year 2004, the Group launched the SDK for the following products: *ACR38T*, *AET60*, and *AET63*.

In the fourth quarter of the year 2004, the Group was actively preparing to establish the office in Shenzhen. The main purpose of the Shenzhen office is to do the sales and marketing work particularly for the Chinese market. Also some development work especially electronic hardware work will be done in this office.

The Group decided to delay the opening of the Europe office in order to conserve the limited resources.

Management Information System

The Group improved its management information system ("MIS") by upgrading its server and enhancing its business process software which was either bought outside or developed internally. The Group will continue to improve its MIS and to enhance its business process.

MANAGEMENT DISCUSSION AND ANALYSIS

PROSPECTS

The Group has now a more balanced product mix, a stronger team of people and more cost effective organizations. Furthermore the overall smart card industry is still growing. In particular, the contactless smart cards are increasingly being used in transportation and physical access control. The Group introduced its first contactless card reader, *ACR120*, to the market early in the year 2005 and has received positive responses from customers. Biometric devices particularly finger print scanning devices are in more popular use to authenticate users of banking services and government services, and to verify the identity of the holder of a passport or an identity card. The integrated smart card/finger print readers launched by the Group have found applications in banks and in governments and the Group is expecting wider deployment of such devices.

The Group has now spread its products to over eighty countries in the world. The management of the Group believes that customers are satisfied with the Group for various reasons. For example, a large majority of customers choose to buy from the Group once they are successful with their projects after the usual long cycle from qualifying one of the Group's products to the stage of making a purchase in a commercial scale. Messages of satisfaction on the Group's short delivery lead time and the fine quality of products are often heard from customers in trade shows. In fact when a new product from the Group is promoted to its existing customers, the customers tend to be receptive. As at 31 December 2004, orders on hand amounted to approximately HK\$4.5 million.

On account of the Group's reputation built over the years among its customers, the management believes that the Group has an advantage of good image over a majority of emerging and existing suppliers of similar products in different countries in the world.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2004, the Group's cash and cash equivalents amounted to approximately HK\$13.1 million (2003: approximately HK\$21.5 million). The Group continues to operate under a debt-free status with no outstanding net debt as at the year end date.

The current ratio, being the ratio of current assets to current liabilities, was maintained at a strong level of 5.0 (2003: 5.0). Net asset value as at the year end date was approximately HK\$30.2 million (2003: approximately HK\$44.0 million). As at 31 December 2004, the Group did not have any borrowings and, accordingly, the gearing ratio was zero (2003: 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.

MANAGEMENT DISCUSSION AND ANALYSIS

INVESTMENTS

During the year, the Group did not hold any significant investments.

ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES AND AFFILIATED COMPANIES

The Group did not have any material acquisitions or disposals of subsidiaries and affiliated companies during the year ended 31 December 2004.

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 2004, the Group did not pledge any of its assets.

CONTINGENT LIABILITIES

The Group did not have any significant contingent liabilities as at 31 December 2004.

EMPLOYEES AND REMUNERATION POLICIES

As at 31 December 2004, the Group had approximately 60 full time employees. Staff costs amounted to approximately HK\$8.9 million (2003: approximately HK\$5.8 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.

REVIEW OF BUSINESS OBJECTIVES

BUSINESS PROGRESS

The following is a comparison of the business objectives as set out in the prospectus dated 31 October 2003 and the actual business progress for the period from 1 July 2004 to 31 December 2004.

Business objectives as stated in the prospectus dated 31 October 2003

Actual business progress for the period from 1 July 2004 to 31 December 2004

Enhancing the PC linked readers and
developing new products

The Group finished the product development of *ACR38DT DualKey*, which is an extension of *ACR38T*. *ACR38DT* offers both solutions based on SIM-sized combi smart card (contactless and contact card) for logical and physical access control. It has full *ACR38T* functionalities with contactless value-added feature.

Strengthening and developing industry alliances

The Group teamed up with a renowned Australian company to develop a device for the application in physical access control.

Enhancing the design of customised products
with a view to developing more
generic products

With the technology acquired in developing the customized smart card readers with pin-pad *ACR50* and *ACR80* for Taiwan customers, the Group enhanced the products to develop its own generic product *ACR88*. *ACR88* is a versatile handheld portable smart card reader, having a built-in keypad, Liquid Crystal Display ("LCD") and buzzer features. It can also host additional features like fingerprint scanner, contactless card reader or non-volatile memory to enhance the security and give better support to customers' system.

Expansion of the Group's sales network

The Group participated in two trade shows in France and Korea. The Group is in the process of setting up an office in Shenzhen, China to serve the China market. This office would be opened in January 2005.

Enhancing research and development capability

An engineering team would also be set up in the Shenzhen office. The team would be engaged in testing smart card readers and developing smart card reader related hardware.

REVIEW OF BUSINESS OBJECTIVES

Business objectives as stated in the prospectus dated 31 October 2003

Exploring additional commercial applications

Building on new market opportunities

Catering to the needs of small and medium-sized customers

Actual business progress for the period from 1 July 2004 to 31 December 2004

The Group explored the opportunity with a solution house in China for the driving learning terminal project using *ACR88*. The application is to authenticate the identity of the learner.

The Group continued to strengthen its influence to the emerging markets. A solution house in the United Arab Emirates continued to buy *AET63* from the Group for an e-government project. The Group sold approximately 200,000 pieces *ACOS* cards and over 1,000 units of *AET63* in the year ended 31 December 2004 to one major bank in Indonesia through a solution house in Jakarta.

The Group finished the packaging of the software development kits ("SDK") for the contactless smart card reader *ACR120*.

USE OF PROCEEDS

The net proceeds from the placing of shares upon the listing of the Company which remains unutilized as at 31 December 2004 amounted to approximately HK\$11.3 million.

For the period from 1 July 2004 to 31 December 2004:

	Budgeted <i>HK\$ million</i>	Actual <i>HK\$ million</i>
Product development (<i>Note 1</i>)	3.8	1.5
Sales and marketing	0.8	0.8
Patent copyright and trademark registration	0.2	0.0
Management information system (<i>Note 2</i>)	0.5	0.1
Human resources (<i>Note 3</i>)	0.5	0.2
General working capital	0.4	0.4
	6.2	3.0

Notes:

- 1 The reduction in development costs is owing to the better utilization of the existing engineering resources than initially budgeted and the delay of the development of *China Tax Terminal* and *smart card balance reader in compliance with CEPS*.
- 2 Instead of acquiring a brand new Management Information System, the existing system was enhanced to accommodate the Group's business expansion at a lesser cost than the budgeted expenses as this enhanced system is considered to be adequate for a period of time.
- 3 The reduction in human resources is mainly due to more efficient deployment of human resources.

DIRECTORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS

Mr. WONG Yiu Chu, Denny

Mr. Denny Wong, aged 57, is the chairman and chief executive officer of the Company and the directors of several subsidiaries of the Group. Mr. Wong founded 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 March 1999, D&A Holdings Limited, in which Mr. Wong has a controlling interest and of which he is a director, was appointed as a director of ACS. 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 46, joined the Group in October 1999 as a full-time consultant of ACS and has become 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's responsibility has not changed as a result of changes in his position from a consultant to an employee 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 are 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.

Mr. MAK Chi Him, Damais

Mr. Damais Mak, aged 46, joined the Group in April 2004 and his present position is Vice President of Product Development & Marketing. Prior to joining the Group, Mr. Mak had fifteen-year working experience at Motorola Semiconductors Sector in Asia headquarters and held several business leadership positions. Before joining Motorola, Mr. Mak had worked in several companies performing various functions, in the electronics industry in Hong Kong. He did IC design at Elcap Electronics Limited, ASIC and PC system design at Everex Systems (Far East) Limited and Technical Marketing at Intel Semiconductors Limited. Mr. Mak obtained his bachelor's degree in electronic engineering from the University of Portsmouth in England and master's degree in business administration from The Chinese University of Hong Kong. Mr. Mak is a Chartered Engineer and Corporate Member of the Institution of Electrical Engineers, England.

DIRECTORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS *(continued)*

Ms. TSUI Kam Ling, Alice

Ms. Tsui Kam Ling, Alice, aged 52, 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 a director of a subsidiary of the Group. Prior to joining the Group, Ms. Tsui was a director of Advanced Electronics Limited until 1997 which distributed semiconductor components. She was later appointed as the administration manager of Future Advanced Electronics (Hong Kong) Limited from July 1997 to September 1998. Ms. Tsui took up 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.

NON-EXECUTIVE DIRECTOR

Mr. WAN Wah Tong, Thomas

Mr. Thomas Wan, aged 44, joined the Group as a non-executive director of its subsidiary in March 1999 and a director of the Company in April 2000. Mr. Wan is the chairman and chief executive officer of Hectrix Limited which is an information solution house that develops and sells security devices using smart card technology. Hectrix Limited is not in competition with the Group as it manufactures an entirely different line of smart card related finished products like authentication devices catering for wholesalers or end users. From 1998 to 2000, Mr. Wan served as a director and vice president of the NASDAQ-listed SRS Labs, Inc., a technology solution provider specialising in electronic appliances. During the same period, Mr. Wan was also a director and chief executive officer of Valence Technology Limited, a distributor of semiconductor products in Hong Kong.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Dr. YIP Chak Lam, Peter

Dr. Peter Yip, aged 54, was appointed as an independent non-executive director on 25 October 2003. He was awarded a bachelor of science degree, a master 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.

DIRECTORS AND SENIOR MANAGEMENT

INDEPENDENT NON-EXECUTIVE DIRECTORS *(continued)*

Mr. CHEONG Chung Chin

Mr. Cheong Chung Chin, aged 45, was appointed as an independent non-executive director on 25 October 2003. He has over nine years of experience in the smart card and electronics industry in Asia. Mr. Cheong joined Singapore Electronic and Engineering Pte Ltd., a solution house based in Singapore and a subsidiary of Singapore Technologies Pte Ltd., as a sales engineer in July 1985. Mr. Cheong was a marketing manager from 1994 to 1995 at Siemens Components Pte Ltd. which offered smart card based solutions. Mr. Cheong joined De La Rue Systems Asia Pacific Pte Limited as a general manager in 1997 and he was its President, Asia from January 1998 to October 1999. De La Rue Systems Asia Pacific Pte Limited is engaged in the printing of, among other things, bank notes, cheques, and confidential documents for governments and financial institutions and the provision of solutions for card systems. In October 1999, Mr. Cheong joined Oberthur Smart Cards (Asia) Pte Limited which acquired the card system division of De la Rue Systems Asia Pacific Pte Limited, a supplier of smart cards used in GSM mobile telephones. Mr. Cheong is now working for Oberthur Smart Cards (Asia) Pte Limited. Mr. Cheong was awarded a bachelor of science degree from the National University of Singapore in 1983.

Mr. YU Man Woon

Mr. Yu Man Woon, aged 54, was appointed as an independent non-executive director on 30 September 2004. He is currently the assistant general manager of a local bank. He obtained a Master 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.

SENIOR MANAGEMENT

Mr. LEE Chun Lam, John

Mr. John Lee, aged 57, joined the Group as Director and General Manager, China in August 2004. He is in charge to promote the Group's business in China. Before joining the Group, he worked in Pacific Enterprise (HK) Ltd. as the CEO and the President, giving consultancy services to the plastic card industry. Prior to Pacific Enterprise, he worked at DataCard Toppan Moore Ltd. as the Managing Director where he built up the 1st Visa/Master approved Security Card Factory in the South East Asia. Mr. Lee brings to the Group 26 years of senior management in Sales & Marketing as well as the related card technology. He has many years of overseas working experience in the Middle East, Japan, Taiwan and the USA. Mr. Lee studied Printing in Japan from 1969 to 1972.

For social service, Mr. Lee is the Honorary Chairman of Graphic Arts Association of Hong Kong, Committee member of CS & INSIG of Hong Kong Computer Society, Director of the Japan Society of Hong Kong and Life Member of Fu Hong Society for mentally handicapped.

DIRECTORS AND SENIOR MANAGEMENT

SENIOR MANAGEMENT *(continued)*

Dr. LUI Ho Chung

Dr. Lui, aged 53, joined the Group in January 2004. He is currently the Vice President, Advanced Technology Development. He focuses on developing RFID and fingerprint solutions for access control and logistic applications. Before joining the Group, he was the Associate Director of the E-Business Technology Institute at The University of Hong Kong, an applied R&D institution jointly set up by The University of Hong Kong and IBM. Prior to that, he worked for the Pacific Century Cyber Works in Hong Kong. Dr. Lui also spent 13 years in Singapore. He joined the Institute of Systems Science in Singapore as a Research Staff Member in 1987, and became the program director in 1996. After the Institute of Systems Science merged with the Information Technology Institute to become Kent Ridge Digital Labs ("KRDL"), he assumed the position as Director, Strategy group with a particular focus on technology transfer.

Dr. Lui received his B.Sc. degree in Electronics from The Chinese University of Hong Kong, and his M.Sc. and Ph.D. in Computer Science in The University of Illinois, Urbana-Champaign.

Ms. WONG Mei Ki, Maggie

Ms. Maggie Wong, aged 30, 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's degree in Business Administration from The Chinese University of Hong Kong. She is an associate member of the Association of Chartered Certified Accountants and a Certified Public Accountant of the Hong Kong Institute of Certified Public Accountants.

REPORT OF THE DIRECTORS

The directors submit herewith their annual report together with the audited financial statements for the year ended 31 December 2004.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The principal activities and other particulars of the subsidiaries are set out in notes 3 and 16 on 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 12 on 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	12%	—
Five largest customers in aggregate	37%	—
The largest supplier	—	31%
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 loss of the Group for the year ended 31 December 2004 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 32 and 72.

The directors do not recommend the payment of a dividend for the year ended 31 December 2004.

RESERVES

Loss attributable to shareholders of HK\$13,994,000 (2003: Profit of HK\$11,753,000) 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 24 on the financial statements.

FIXED ASSETS

Details of the movements in fixed assets of the Group are set out in note 14 on the financial statements.

REPORT OF THE DIRECTORS

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 22 and 23 on the financial statements respectively. Shares were issued during the year in respect of the share options being exercised by the employees.

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. Pang Wang Kee, Lawrence (resigned on 30 November 2004)

Mr. Tan Keng Boon

Mr. Mak Chi Him (appointed on 23 March 2005)

Ms. Tsui Kam Ling, Alice (appointed on 23 March 2005)

Non-executive Director

Mr. Wan Wah Tong, Thomas

Independent Non-executive Directors

Dr. Yip Chak Lam, Peter

Mr. Cheong Chung Chin

Mr. Yu Man Woon (appointed on 30 September 2004)

In accordance with Article 95 of the Company's Articles of Association, Mr. Yu Man Woon, Mr. Mak Chi Him and Ms. Tsui Kam Ling, Alice 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. Wan Wah Tong, Thomas, Dr. Yip Chak Lam, Peter, and Mr. Cheong Chung Chin were appointed by the board of directors on 25 October 2003 for a term of 2 years commencing on 25 October 2003. Mr. Yu Man Woon was appointed by the board of directors for a term commencing from 30 September 2004 to 24 October 2005.

REPORT OF THE DIRECTORS

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

At 31 December 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 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

Name of director	Ordinary shares of HK\$0.10 each				Total number of shares held	Percentage of the Company's issued share capital as at 31 December 2004
	Personal interests (Note 1)	Family interests	Corporate interests	Other interests		
Mr. Wong Yiu Chu, Denny (Note 2)	6,773,831	2,882,481	105,706,210	—	115,362,522	40.94%
Mr. Tan Keng Boon	6,845,893	—	—	—	6,845,893	2.43%
Mr. Wan Wah Tong, Thomas (Note 3)	2,402,068	—	17,615,162	—	20,017,230	7.10%

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, Ms. Tsui Kam Ling, Alice) and 2,882,481 shares are held by Ms. Tsui Kam Ling, Alice personally. Mr. Denny Wong is taken to be interested in these shares under the SFO.
- 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.

REPORT OF THE DIRECTORS

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

Save as disclosed above, to the best knowledge of the directors of the Company, as at 31 December 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 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.

(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 2005.

REPORT OF THE DIRECTORS

SHARE OPTION SCHEMES *(continued)*

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

(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 the 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.

REPORT OF THE DIRECTORS

SHARE OPTION SCHEMES *(continued)*

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

At 31 December 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 December 2004 was HK\$0.075) 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					Period during which the options are exercisable	Exercise price per share	Percentage of the Company's issued share capital as at 31 December 2004
		Balance as at 31 January 2004	Granted during the year	Exercised during the year	Lapsed during the year	Balance as at 31 December 2004			
1 director	27 October 2003	1,601,378 <i>(Note 1)</i>	—	—	1,601,378 <i>(Note 3)</i>	—	10 November 2004 to 2 December 2011	HK\$0.24	—
2 consultants	27 October 2003	1,361,172	—	—	—	1,361,172	10 May 2004 to 24 July 2010	HK\$0.09	0.48%
Employees	27 October 2003	1,441,241	—	1,280,668 <i>(Note 2)</i>	—	160,573	10 May 2004 to 24 July 2010	HK\$0.09	0.06%
	27 October 2003	520,449	—	519,587 <i>(Note 2)</i>	—	862	10 May 2004 to 27 December 2010	HK\$0.09	0.01%
	27 October 2003	1,411,218	—	—	120,104 <i>(Note 3)</i>	1,291,114 <i>(Note 4)</i>	10 May 2004 to 20 January 2013	HK\$0.24	0.46%
	27 October 2003	200,173	—	—	200,173 <i>(Note 3)</i>	—	31 December 2004 to 20 January 2013	HK\$0.24	—
		<u>6,535,631</u>	<u>—</u>	<u>1,800,255</u>	<u>1,921,655</u>	<u>2,813,721</u>			

REPORT OF THE DIRECTORS

SHARE OPTION SCHEMES *(continued)*

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

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 1,800,255 share options at an exercise price of HK\$0.09 each have been exercised by 3 employees during the year ended 31 December 2004. The closing price of the shares immediately before the date on which the options were exercised was HK\$0.243.
- 3 The options lapsed upon the resignation of 3 participants from the Group.
- 4 The options will vest and be exercisable in three tranches as follows:
 - (a) one-third of the options have vested and be exercisable on 10 May 2004;
 - (b) a further one-third of the options have vested 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 No option was granted or cancelled during the year.

(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 of any member of the Group, who have in accordance with paragraph (a) above, contribute to the Group.

REPORT OF THE DIRECTORS

SHARE OPTION SCHEMES *(continued)*

(ii) Share Option Scheme *(continued)*

(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.
- (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.

REPORT OF THE DIRECTORS

SHARE OPTION SCHEMES *(continued)*

(ii) Share Option Scheme *(continued)*

(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.

(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.

REPORT OF THE DIRECTORS

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 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 December 2004
D & A Holdings Limited	Beneficial owner	105,706,210 Shares (L)	37.51%
Ms. Tsui Kam Ling, Alice (Note 2)	Personal	2,882,481 Shares (L)	40.94%
	Family	112,480,041 Shares (L)	
Proway Investment Limited (Note 3)	Beneficial owner	31,740,305 Shares (L)	11.26%
Morningside CyberVentures Holdings Limited (Note 3)	Other	31,740,305 Shares (L)	11.26%
Verrall Limited (Note 3)	Other	31,740,305 Shares (L)	11.26%
Madam Chan Tan Ching Fen (Note 3)	Other	31,740,305 Shares (L)	11.26%
Thomrose Holdings (BVI) Limited	Beneficial owner	17,615,162 Shares (L)	6.25%

REPORT OF THE DIRECTORS

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.
- 2 105,706,210 shares are held by D&A Holdings Limited, 2,882,481 shares are held by Ms. Tsui Kam Ling, Alice personally and 6,773,831 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 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 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).

Save as disclosed above, as at 31 December 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 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

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 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 had no bank loans and other borrowings during the year.

REPORT OF THE DIRECTORS

FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group is set out on page 73 of the annual report.

RETIREMENT SCHEMES

With effect from 1 December 2000, the Group has participated in the Mandatory Provident Fund Scheme ("MPF Scheme") in Hong Kong. The MPF Scheme is registered with the Mandatory Provident Fund Scheme Authority under the Mandatory Provident Fund Schemes Ordinance. The assets of the MPF Scheme are held separately from those of the Group in funds under the control of an independent trustee. 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. The Company's subsidiary operating in Philippines participates in the mandatory Social Security System contribution scheme ("SSS Scheme") as prescribed by Philippine law. Pursuant to the rules of the SSS Scheme, the Group and the employees are required to make monthly contributions to the scheme pegged 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 and the SSS Scheme are charged to the profit and loss account as incurred. During the year, the retirement scheme contributions borne by the Group amounted to HK\$386,000 (2003: HK\$254,000).

COMPLIANCE ADVISOR'S INTERESTS

Neither the Company's Compliance Advisor, Anglo Chinese Corporate Finance, Limited (the "Compliance Advisor"), 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 December 2004 pursuant to Rule 6.35 of the GEM Listing Rules.

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

REPORT OF THE DIRECTORS

CORPORATE GOVERNANCE

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 (before the amendments effective on 1 January 2005) throughout the year.

The Company has adopted the rules governing dealings by directors in listed securities of the Company (“dealings rules”) pursuant to the required standard of dealings as referred to in Rules 5.48 to 5.67 of the GEM Listing Rules (“required standard of dealings”). 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 2004.

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.

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. Cheong Chung Chin 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 2004.

AUDITORS

KPMG retire and, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of KPMG 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 2005

AUDITORS' REPORT

Auditors' report to the shareholders of Advanced Card Systems Holdings Limited *(Incorporated in the Cayman Islands with limited liability)*

We have audited the financial statements on pages 32 to 72 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements 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.

BASIS OF OPINION

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2004 and of the Group's loss and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants
Hong Kong, 23 March 2005

CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2004
(Expressed in Hong Kong dollars)

	Note	2004 HK\$'000	2003 HK\$'000
Turnover	3	24,369	38,646
Cost of sales		<u>(14,243)</u>	<u>(17,950)</u>
		10,126	20,696
Other revenue	4(a)	145	504
Other net loss	4(b)	(39)	(68)
Operating expenses			
Staff costs		(8,910)	(5,827)
Depreciation		(711)	(600)
Amortisation of development costs		(2,157)	(1,498)
Impairment loss on development costs	15	(4,950)	—
Other operating expenses		<u>(7,371)</u>	<u>(2,965)</u>
(Loss)/profit from operations		(13,867)	10,242
Finance costs	5(a)	<u>(127)</u>	<u>(103)</u>
(Loss)/profit from ordinary activities before taxation	5	(13,994)	10,139
Income tax	6(a)	<u>—</u>	<u>1,614</u>
(Loss)/profit from ordinary activities after taxation and attributable to shareholders	9 & 24(a)	<u>(13,994)</u>	<u>11,753</u>
(Loss)/earnings per share			
— Basic	11(a)	<u>(4.98 cents)</u>	<u>5.51 cents</u>
— Diluted	11(b)	<u>(4.98 cents)</u>	<u>5.50 cents</u>

The notes on pages 38 to 72 form part of these financial statements.

CONSOLIDATED BALANCE SHEET

At 31 December 2004
(Expressed in Hong Kong dollars)

	Note	2004 HK\$'000	2003 HK\$'000
Non-current assets			
Fixed assets	14	1,625	832
Development costs	15	6,220	9,098
Deferred tax assets	21	1,614	1,614
		<u>9,459</u>	<u>11,544</u>
Current assets			
Inventories	17	7,341	5,738
Accounts receivable	18	4,292	12,071
Other receivables, deposits and prepayments	18	1,106	1,290
Cash and cash equivalents	19	13,103	21,456
		<u>25,842</u>	<u>40,555</u>
Current liabilities			
Accounts payable	20	3,079	5,665
Other payables, deposits and accruals	20	2,066	2,446
		<u>5,145</u>	<u>8,111</u>
Net current assets		<u>20,697</u>	<u>32,444</u>
NET ASSETS		<u>30,156</u>	<u>43,988</u>
CAPITAL AND RESERVES			
Share capital	22	28,180	28,000
Reserves	24(a)	1,976	15,988
		<u>30,156</u>	<u>43,988</u>

Approved and authorised for issue by the board of directors on 23 March 2005

WONG Yiu Chu, Denny
Director

TAN Keng Boon
Director

The notes on pages 38 to 72 form part of these financial statements.

BALANCE SHEET

At 31 December 2004
(Expressed in Hong Kong dollars)

	<i>Note</i>	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Non-current assets			
Investment in subsidiaries	16	<u>38,948</u>	<u>33,648</u>
Current assets			
Other receivables, deposits and prepayments	18	620	799
Cash and cash equivalents	19	<u>11,009</u>	<u>17,609</u>
Total current assets		<u>11,629</u>	<u>18,408</u>
Current liabilities			
Other payables, deposits and accruals	20	<u>256</u>	<u>281</u>
Net current assets		<u>11,373</u>	<u>18,127</u>
NET ASSETS		<u>50,321</u>	<u>51,775</u>
CAPITAL AND RESERVES			
Share capital	22	28,180	28,000
Reserves	24(b)	<u>22,141</u>	<u>23,775</u>
		<u>50,321</u>	<u>51,775</u>

Approved and authorised for issue by the board of directors on 23 March 2005

WONG Yiu Chu, Denny
Director

TAN Keng Boon
Director

The notes on pages 38 to 72 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2004
(Expressed in Hong Kong dollars)

	Note	2004 HK\$'000	2003 HK\$'000
Shareholders' equity at 1 January		43,988	13,422
(Loss)/profit for the year	24(a)	(13,994)	11,753
Movements in share capital:			
Shares issued upon conversion of share options prior to GEM listing	22(c) & 22(d)	—	971
Subscription for new shares of \$0.10 each	22(e)	—	16,586
Repurchase of shares of US\$0.10 each	22(e)	—	(16,556)
Redemption of Series A preference shares	22(f)	—	(2,090)
Shares issued upon conversion of preference shares and warrants and re-denomination of 10,000 ordinary shares of US\$0.10 each to \$0.10 each	22(f)	—	3,092
Capitalisation issue credited as fully paid	22(g)	—	522
Net issue and placing of shares	22(h)	—	7,800
Net share premium	24(a)	(18)	8,488
Shares issued upon conversion of share options	22(i)	180	—
Net increase in shareholders' equity arising from capital transactions with shareholders		<u>162</u>	<u>18,813</u>
Shareholders' equity at 31 December		<u><u>30,156</u></u>	<u><u>43,988</u></u>

The notes on pages 38 to 72 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2004
(Expressed in Hong Kong dollars)

	Note	2004 HK\$'000	2003 HK\$'000
Operating activities			
(Loss)/profit from ordinary activities before taxation		(13,994)	10,139
Adjustments for:			
– Depreciation		711	600
– Amortisation of development costs		2,157	1,498
– Impairment loss on development costs		4,950	—
– Finance costs		127	103
– Interest income		(95)	(2)
– Loss/(gain) from disposal of fixed assets		32	(2)
– Provision for doubtful debts		1,315	—
– Write-off of bad debts		285	—
– Foreign exchange loss		—	43
		<hr/>	<hr/>
Operating (loss)/profit before changes in working capital		(4,512)	12,379
Increase in inventories		(1,603)	(2,168)
Decrease/(increase) in accounts receivable		6,179	(8,773)
Decrease/(increase) in other receivables, deposits and prepayments		198	(934)
(Decrease)/increase in accounts payable		(2,586)	4,337
(Decrease)/increase in other payables, deposits and accruals		(380)	19
		<hr/>	<hr/>
Cash (used in)/generated from operations		(2,704)	4,860
Tax paid		—	—
		<hr/>	<hr/>
Net cash (used in)/generated from operating activities		(2,704)	4,860
		<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>
Investing activities			
Payments for the purchase of fixed assets		(1,536)	(560)
Proceeds from disposal of fixed assets		—	2
Development costs capitalised		(4,229)	(3,634)
Interest received		81	2
		<hr/>	<hr/>
Net cash used in investing activities		(5,684)	(4,190)
		<hr style="border-top: 1px dashed black;"/>	<hr style="border-top: 1px dashed black;"/>

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2004
(Expressed in Hong Kong dollars)

	Note	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Financing activities			
Other borrowing costs paid		(127)	(103)
Proceeds on issue of shares upon exercise of share options	22(c), 22(d) & 22(i)	162	1,148
Proceeds on issue of shares upon conversion of warrants	22(f)	—	500
Proceeds on issue of placing shares		—	24,960
Share issue expenses	24(a)	—	(7,838)
		<u> </u>	<u> </u>
Net cash generated from financing activities		<u> 35</u>	<u> 18,667</u>
Net (decrease)/increase in cash and cash equivalents		(8,353)	19,337
Cash and cash equivalents at 1 January		<u> 21,456</u>	<u> 2,119</u>
Cash and cash equivalents at 31 December	19	<u> 13,103</u>	<u> 21,456</u>

The notes on pages 38 to 72 form part of these financial statements.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

1 GROUP REORGANISATION AND BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

(a) The Company

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.

(b) Group Reorganisation and listing on the Growth Enterprise Market

The Company became the holding company of the Group (which comprised the Company and its subsidiary) on 28 April 2000 through a reorganisation ("the Reorganisation"). Pursuant to the Reorganisation, the Company issued and allotted a total of 17,999,998 shares of US\$0.10 each credited as fully paid to the then shareholders of its subsidiary in consideration for their sale to the Company of all the then issued shares of its subsidiary.

The Company obtained a listing on the Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited on 10 November 2003 ("the Listing").

(c) Basis of presentation and preparation of the financial statements

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

The Company and its subsidiary resulting from the Reorganisation have been regarded as a continuing group. Accordingly, the financial statements have been prepared on the basis of merger accounting in accordance with Statement of Standard Accounting Practice No. 2.127 "Accounting for group reconstructions" ("SSAP 27") issued by the Hong Kong Institute of Certified Public Accountants.

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

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 Institute of Certified Public 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 GEM of The Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Group is set out below.

(b) Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries made up to 31 December each year. All material intra-group transactions and balances are eliminated on consolidation.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(c) Subsidiaries and controlled enterprises

A subsidiary is an enterprise controlled by the Company. Subsidiaries are considered to be controlled if the Company has the power, directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from their activities.

An investment in a subsidiary is consolidated into the consolidated financial statements, unless a subsidiary is acquired and held exclusively with a view to subsequent disposal in the near future or operates under severe long-term restrictions which significantly impair its ability to transfer funds to the Group, in which case, it is stated in the consolidated balance sheet at fair value with changes in fair value recognised in the consolidated profit and loss account as they arise.

Intra-group balances and transactions, and any unrealised profits arising from intra-group transactions, are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

In the Company's balance sheet, an investment in a subsidiary is stated at cost less any impairment losses (see note 2(e)), unless it is acquired and held exclusively with a view to subsequent disposal in the near future or operates under severe long term restrictions which significantly impair its ability to transfer funds to the Company, in which case, it is stated at fair value with changes in fair value recognised in the profit and loss account as they arise.

(d) Fixed assets and depreciation

Fixed assets are stated at cost less accumulated depreciation and impairment losses (note 2(e)).

Depreciation is calculated to write off the cost of fixed assets on a straight-line basis over their anticipated useful lives as follows:

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

Subsequent expenditure relating to a fixed asset that has already been recognised is added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing assets, will flow to the Group. All other subsequent expenditure is recognised as an expense in the period in which it is incurred.

Gains or losses arising from the retirement or disposal of a fixed asset are determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and are recognised in the profit and loss account on the date of retirement or disposal.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(e) Impairment of assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

- fixed assets;
- development costs; and
- investment in subsidiaries.

If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised in the profit and loss account whenever the carrying amount of such an asset exceeds its recoverable amount.

(i) *Calculation of recoverable amount*

The recoverable amount of an asset is the greater of its net selling price 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 assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

(ii) *Reversals of impairment losses*

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the profit and loss account in the year in which the reversals are recognised.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(f) Inventories

Inventories are carried at the lower of cost and net realisable value.

Cost is calculated using the first-in-first-out method and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value is recognised as an expense in the profit and loss account in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, is recognised as a reduction in the amount of inventories recognised as an expense in the profit and loss account in the period in which the reversal occurs.

(g) Cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purpose of the consolidated cash flow statement.

(h) Income tax

- (i) Income tax for the year comprises current and deferred tax. Income tax is recognised in the profit and loss account except to the extent that it relates to items recognised directly to equity, in which case it is recognised in equity.
- (ii) Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(h) Income tax *(continued)*

- (iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax bases respectively. Deferred tax assets also arise from unused tax losses and unused tax credits.

All deferred tax liabilities and all deferred tax assets, to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

Current and deferred tax assets and liabilities are offset if, and only if, the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
 - the same taxable entity; or
 - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Company or Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(j) Recognition of income

Provided it is probable that the economic benefits will flow to the Group and the revenue and cost, if applicable, can be measured reliably, revenue is recognised in the profit and loss account as follows:

(i) Sales of goods

Revenue is recognised when goods are delivered at the customers' premises which is taken to be the point in time when the customer has accepted the goods and the related risks and rewards of ownership. Revenue is after deduction of any trade discounts.

(ii) Smart card related services fee income

Fees for the provision of smart card related services are recognised as revenue when the services are rendered.

(iii) Interest income

Interest income arising on bank deposits is accrued on a time apportioned basis by reference to the principal outstanding and the rate applicable.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(k) Research and development costs

Research and development costs comprise all costs that are directly attributable to research and development activities or that can be allocated on a reasonable basis to such activities.

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised as an expense in the period in which it is incurred.

Expenditure on development activities is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources and the intention to complete development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads which are directly attributable to development activities. Capitalised development costs are stated at cost less accumulated amortisation and impairment losses (see note 2(e)). Other development expenditure is recognised as an expense in the period in which it is incurred.

Amortisation is calculated to write off development costs on a straight-line basis over their estimated useful lives, commencing from the date when the products are put into commercial production.

(l) Translation of foreign currencies

The financial statements are prepared in Hong Kong dollars.

Foreign currency transactions are translated into Hong Kong dollars at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. Exchange gains and losses are dealt with in the profit and loss account.

The results of overseas branches are translated into Hong Kong dollars at the average exchange rates for the year, and balance sheet items are translated at the rates of exchange ruling at the balance sheet date. The resulting exchange differences are dealt with as a movement in the reserves.

(m) Operating leases

Where the Company or the Group has the use of assets under operating leases, payments made under the leases are charged to the profit and loss account in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in the profit and loss account as an integral part of the aggregate net lease payments made.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(n) Employee benefits

Salaries, annual bonuses, paid annual leave, leave passage and the cost to the Group of non-monetary benefits are accrued in the year in which the associated services are rendered by employees of the Group. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

Contributions to the Mandatory Provident Fund as required under the Hong Kong Mandatory Provident Fund Schemes Ordinance and the retirement benefits scheme operated by the local government in Philippines are charged to the profit and loss account when incurred.

When the Group grants to employees options to acquire shares in the Company at nominal consideration, no employee benefit cost or obligation is recognised at the date of grant. When such options are exercised, shareholders' equity is increased by the amount of the proceeds received.

(o) Borrowing costs

Borrowing costs are expensed in the profit and loss account in the year in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

(p) Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

2 SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(q) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group enterprises within a single segment.

Inter-segment pricing is based on similar terms as those available to other external parties.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets (both tangible and intangible) that are expected to be used for more than one year.

(r) Recently issued accounting standards

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ("new HKFRSs") which are effective for accounting periods beginning on or after 1 January 2005.

The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The Group has commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

3 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 year.

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Sale of smart card products, software and hardware	22,877	34,893
Smart card related services	1,492	3,753
	<u>24,369</u>	<u>38,646</u>

4 OTHER REVENUE AND OTHER NET LOSS

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
(a) Other revenue		
Interest income	95	2
Forfeiture of deposit	—	429
Sundry income	50	73
	<u>145</u>	<u>504</u>
(b) Other net loss		
Exchange loss	(7)	(70)
(Loss)/gain from disposal of fixed assets	(32)	2
	<u>(39)</u>	<u>(68)</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

5 (LOSS)/PROFIT FROM ORDINARY ACTIVITIES BEFORE TAXATION

(Loss)/profit from ordinary activities before taxation is arrived at after charging/(crediting):

	2004 HK\$'000	2003 HK\$'000
(a) Finance costs:		
Other borrowing costs:		
— bank charges	127	103
	<u>127</u>	<u>103</u>
(b) Other items:		
Cost of inventories	13,552	16,781
Reversal of write-down of inventories (<i>note 17</i>)	(27)	(59)
Provision for doubtful debts	1,315	—
Write-off of bad debts	285	72
Auditors' remuneration	354	312
	<u>13,552</u>	<u>16,781</u>
Salaries and benefits	11,987	7,890
Retirement scheme contributions	386	254
	<u>11,987</u>	<u>7,890</u>
Total staff costs	12,373	8,144
	<u>12,373</u>	<u>8,144</u>
Staff costs included in research and development costs	4,598	2,599
Less: Amounts capitalised in development costs	(3,463)	(2,317)
	<u>1,135</u>	<u>282</u>
Staff costs (after amounts capitalised)	8,910	5,827
	<u>8,910</u>	<u>5,827</u>
Consultancy fees	435	758
Less: Amount included in research and development costs	(311)	(611)
	<u>124</u>	<u>147</u>
Operating lease charges for properties	1,747	456
Less: Amount included in research and development costs	(271)	(90)
	<u>1,476</u>	<u>366</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

5 (LOSS)/PROFIT FROM ORDINARY ACTIVITIES BEFORE TAXATION *(continued)*

(Loss)/profit from ordinary activities before taxation is arrived at after charging/(crediting): *(continued)*

	2004 HK\$'000	2003 HK\$'000
(c) Research and development costs:		
Staff costs	4,598	2,599
Consultancy fees	311	611
Rental expenses	271	90
Direct overheads	324	656
	<u>5,504</u>	<u>3,956</u>
Less: Costs capitalised <i>(note 15)</i>	<u>(4,229)</u>	<u>(3,634)</u>
	<u><u>1,275</u></u>	<u><u>322</u></u>

Research and development costs amounting to \$5,504,000 (2003: \$3,956,000) 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 \$5,504,000 (2003: \$3,956,000) were amounts of \$4,229,000 (2003: \$3,634,000) capitalised during the year (note 15).

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

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

6 INCOME TAX

(a) Current tax

No provision for Hong Kong Profits Tax has been made by the Company as it sustained a loss for taxation purpose for the year ended 31 December 2004.

No provision for Hong Kong Profits Tax has been made by the subsidiaries as the subsidiaries sustained losses for taxation purposes for the year ended 31 December 2004.

	2004 HK\$'000	2003 HK\$'000
Deferred tax		
Origination and reversal of temporary differences	—	(109)
Benefit of previously unrecognised net deferred tax assets now recognised	—	1,723
	<u>—</u>	<u>1,723</u>
Income tax credit in the consolidated profit and loss account	—	1,614
	<u>—</u>	<u>1,614</u>

(b) Reconciliation between tax credit and accounting (loss)/profit at applicable tax rates

	2004 HK\$'000	2003 HK\$'000
(Loss)/profit from ordinary activities before taxation	<u>(13,994)</u>	<u>10,139</u>
Notional tax on (loss)/profit before tax, calculated at the rates applicable to profits in the countries concerned	(2,492)	1,774
Tax effect of non-deductible expenses	1,412	79
Tax effect of non-taxable revenue	(35)	(1)
Tax effect of tax losses utilised in the current year	—	(1,865)
Tax effect of tax losses now recognised	—	(1,723)
Tax effect of unused tax losses not recognised	1,115	—
Tax effect of deferred tax liabilities now recognised	—	122
	<u>—</u>	<u>1,614</u>
Actual tax credit	<u>—</u>	<u>(1,614)</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

7 DIRECTORS' REMUNERATION

Three of the seven directors of the Company were also directors or employees of the subsidiaries during the year. Details of the fees and emoluments paid and payable to these directors in their capacity as executive and non-executive directors of the Company and its subsidiaries for the year are as follows:

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Fees	586	100
Basic salaries, housing and other allowances and benefits in kind	2,379	2,304
Retirement scheme contributions	35	32
	<u>3,000</u>	<u>2,436</u>

An analysis of directors' emoluments by number of directors and emolument ranges is as follows:

	2004 <i>Number</i>	2003 <i>Number</i>
Not more than \$1,000,000	6	5
\$1,000,001 - \$1,500,000	1	1
	<u>7</u>	<u>6</u>

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Executive director – Mr. Wong Yiu Chu, Denny	1,260	1,260
Executive director – Mr. Pang Wang Kee, Lawrence*	451	492
Executive director – Mr. Tan Keng Boon	703	584
Non-executive director – Mr. Wan Wah Tong, Thomas	180	33
Independent non-executive director —Dr. Yip Chak Lam, Peter	180	33
Independent non-executive director —Mr. Cheong Chung Chin	180	34
Independent non-executive director —Mr. Yu Man Woon**	46	—
	<u>3,000</u>	<u>2,436</u>

* resigned during the year ended 31 December 2004

** newly appointed during the year

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

7 DIRECTORS' REMUNERATION *(continued)*

There were no emoluments paid during the year to former directors in connection with their retirement from employment with the Group. There were no amounts paid during the year to directors as an inducement to join or upon joining the Group and no director waived any emoluments during the year.

Details of the share options granted to directors of the Company are set out in note 23.

8 TOP FIVE EARNING INDIVIDUALS

Set out below is an analysis of the emoluments of two (2003: two) employees of the Group who, not being directors of the Company or its subsidiaries, were among the top five earning individuals (including directors and other employees of the Group) employed by the Group:

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Basic salaries, housing and other allowances and benefits in kind	1,230	900
Retirement scheme contributions	21	12
	<u>1,251</u>	<u>912</u>

An analysis of top five earning individuals' emoluments by number of employees and emolument ranges is as follows:

	2004 <i>Number</i>	2003 <i>Number</i>
Not more than \$1,000,000	<u>2</u>	<u>2</u>

No emoluments were paid or payable to top five earning individuals as an inducement to join the Group or as compensation for loss of office during the year.

9 (LOSS)/PROFIT ATTRIBUTABLE TO SHAREHOLDERS

The consolidated (loss)/profit attributable to shareholders includes a loss of \$1,616,000 (2003: loss of \$431,000) which has been dealt with in the financial statements of the Company.

10 DIVIDENDS

The Company had not declared or paid any dividends during the year ended 31 December 2004.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

11 BASIC AND DILUTED (LOSS)/EARNINGS PER SHARE

(a) Basic (loss)/earnings per share

The calculation of basic (loss)/earnings per share is based on the loss attributable to shareholders of \$13,994,000 (2003: profit of \$11,753,000) and the weighted average of 281,126,389 ordinary shares (2003: 213,112,329 ordinary shares) outstanding after the issuance of shares prior to the Listing as if those shares had been outstanding for each year presented.

(b) Diluted (loss)/earnings per share

The calculation of diluted (loss)/earnings per share is based on loss for the year of \$13,994,000 (2003: profit of \$11,753,000) and the weighted average of 281,126,389 ordinary shares (2003: 213,502,329 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	281,126,389	213,112,329
Deemed issue of ordinary shares for no consideration	—	390,000
	<hr/>	<hr/>
Weighted average number of ordinary shares used in calculating diluted (loss)/earnings per share	<u>281,126,389</u>	<u>213,502,329</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

12 SEGMENT INFORMATION

Segment information is presented in respect of the Group's business and geographical segments. Business segment information is chosen as the primary reporting format because this is more relevant to the Group in making operating and financial decisions.

(a) 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 customers.

Year ended 31 December 2004

	Development, sale and distribution of smart card products, software and hardware <i>HK\$'000</i>	Provision of smart card related services <i>HK\$'000</i>	Total <i>HK\$'000</i>
Turnover	22,877	1,492	24,369
Other revenue			
– unallocated	—	—	145
	<u>22,877</u>	<u>1,492</u>	<u>24,514</u>
Segment result and (loss)/profit from operations	(15,359)	1,492	(13,867)
Finance costs	(119)	(8)	(127)
(Loss)/profit from ordinary activities before taxation	(15,478)	1,484	(13,994)
Income tax	—	—	—
(Loss)/profit from ordinary activities after taxation	<u>(15,478)</u>	<u>1,484</u>	<u>(13,994)</u>
Depreciation and amortisation	<u>2,868</u>	<u>—</u>	<u>2,868</u>
Impairment loss on development costs	<u>4,950</u>	<u>—</u>	<u>4,950</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

12 SEGMENT INFORMATION *(continued)*

(a) Business segments *(continued)*

Year ended 31 December 2003

	Development, sale and distribution of smart card products, software and hardware <i>HK\$'000</i>	Provision of smart card related services <i>HK\$'000</i>	Total <i>HK\$'000</i>
Turnover	34,893	3,753	38,646
Other revenue – unallocated	—	—	504
	<u>34,893</u>	<u>3,753</u>	<u>39,150</u>
Segment result and profit from operations	6,489	3,753	10,242
Finance costs	(93)	(10)	(103)
Profit from ordinary activities before taxation	6,396	3,743	10,139
Income tax	1,023	591	1,614
Profit from ordinary activities after taxation	<u>7,419</u>	<u>4,334</u>	<u>11,753</u>
Depreciation and amortisation	<u>2,098</u>	<u>—</u>	<u>2,098</u>

All 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.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

12 SEGMENT INFORMATION *(continued)*

(b) Geographical segments

The Group's operations are located in Hong Kong. In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of its customers who are principally located in the Americas, Asia, Europe, Africa and the Middle East. Segment information relating to these geographical markets is presented below:

	Turnover	
	2004	2003
	HK\$'000	HK\$'000
The Americas	2,453	3,208
Asia	8,340	22,297
Europe, Africa and the Middle East	13,576	13,141
	<u>24,369</u>	<u>38,646</u>

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

13 RETIREMENT BENEFITS

The Group participates in the Mandatory Provident Fund ("MPF"), managed by an independent approved MPF trustee, which provides retirement benefits to all of the Group's employees in Hong Kong. All eligible staff and the employer make mandatory contributions which comply with the minimum requirements of the Mandatory Provident Fund Schemes Ordinance.

The employees of the Company's subsidiary operating in Philippines are members of a retirement benefits scheme operated by the local government in the Philippines. The subsidiary's branch office makes mandatory contributions to fund the employees' retirement benefits. The retirement contributions paid by the subsidiary's branch office are based on 6% of the employees' relevant monthly income, up to PHP910 per month, in accordance with the relevant regulations in the Philippines and are charged to the consolidated profit and loss account as incurred.

	2004	2003
	HK\$'000	HK\$'000
Retirement contributions payable to retirement schemes	<u>386</u>	<u>254</u>

At 31 December 2004, there were no forfeited contributions, which arose upon employees leaving the retirement scheme up to 31 December 2004 available to reduce the contributions payable by the Group in future periods.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

14 FIXED ASSETS

The Group

	Leasehold improvements <i>HK\$'000</i>	Computer and office equipment <i>HK\$'000</i>	Furniture and fixtures <i>HK\$'000</i>	Moulds <i>HK\$'000</i>	Total <i>HK\$'000</i>
<i>Cost:</i>					
At 1 January 2004	98	1,958	337	790	3,183
Additions	378	871	60	227	1,536
Disposals	(98)	(443)	(155)	—	(696)
	<u>378</u>	<u>2,386</u>	<u>242</u>	<u>1,017</u>	<u>4,023</u>
At 31 December 2004	<u>378</u>	<u>2,386</u>	<u>242</u>	<u>1,017</u>	<u>4,023</u>
<i>Accumulated depreciation:</i>					
At 1 January 2004	74	1,633	208	436	2,351
Charge for the year	191	303	46	171	711
Written back on disposal	(76)	(436)	(152)	—	(664)
	<u>189</u>	<u>1,500</u>	<u>102</u>	<u>607</u>	<u>2,398</u>
At 31 December 2004	<u>189</u>	<u>1,500</u>	<u>102</u>	<u>607</u>	<u>2,398</u>
<i>Net book value:</i>					
At 31 December 2004	<u>189</u>	<u>886</u>	<u>140</u>	<u>410</u>	<u>1,625</u>
At 31 December 2003	<u>24</u>	<u>325</u>	<u>129</u>	<u>354</u>	<u>832</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

15 DEVELOPMENT COSTS

	The Group	
	2004 HK\$'000	2003 HK\$'000
<i>Cost:</i>		
At 1 January	11,762	8,128
Additions through internal development during the year	4,229	3,634
At 31 December	<u>15,991</u>	<u>11,762</u>
<i>Accumulated amortisation:</i>		
At 1 January	2,664	1,166
Charge for the year	2,157	1,498
Impairment loss	4,950	—
At 31 December	<u>9,771</u>	<u>2,664</u>
<i>Net book value:</i>		
At 31 December	<u>6,220</u>	<u>9,098</u>

Development costs capitalised are being amortised to the consolidated profit and loss account 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. 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, an impairment loss was identified in respect of certain product lines, and the carrying amount of the development costs was written down by \$4,950,000 (2003: \$Nil).

16 INVESTMENT IN SUBSIDIARIES

	The Company	
	2004 HK\$'000	2003 HK\$'000
Unlisted shares, at cost	14,004	14,004
Amounts due from subsidiaries	24,944	19,644
	<u>38,948</u>	<u>33,648</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

16 INVESTMENT IN SUBSIDIARIES *(continued)*

Details of the subsidiaries are as follows:

Name of company	Place and date of incorporation and operation	Particulars of issued and paid up capital	Percentage of equity interest held by the Company	Principal activity
Advanced Card Systems Limited	Hong Kong (incorporated on 31 October 1995)	18,000,000 shares of \$1 each	100%	Development, sale and distribution of smart card products, software and hardware and the provision of smart card related services
ACS Technologies Limited	Hong Kong (incorporated on 30 April 2004)	1 share of \$1 each	100%	Development, sale and distribution of smart card products, software and hardware and the provision of smart card related services

No provision has been made for impairment loss in the value of the investment in subsidiaries as the directors did not consider that there was any impairment loss at 31 December 2004.

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

17 INVENTORIES

	The Group	
	2004 HK\$'000	2003 HK\$'000
Raw materials	5,798	4,674
Work in progress	121	12
Finished goods	1,422	1,052
	<u>7,341</u>	<u>5,738</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

17 INVENTORIES (continued)

Included in raw materials, work in progress and finished goods are inventories stated net of a specific provision of \$287,000 and \$314,000 at 31 December 2004 and 31 December 2003 respectively, made in order to state these inventories at the lower of their cost and estimated net realisable value.

The amount of reversal of a write-down of inventories to estimated net realisable value, recognised in the consolidated profit and loss account during the years ended 31 December 2004 and 2003 is \$27,000 and \$59,000, respectively. The reversal during the years ended 31 December 2004 and 2003 arose due to an increase in the estimated net realisable value of certain smart card products as a result of a change in consumer preferences.

18 ACCOUNTS RECEIVABLE, OTHER RECEIVABLES, DEPOSITS AND PREPAYMENTS

	The Group		The Company	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Accounts receivable	4,292	12,071	—	—
Other receivables	43	36	14	4
Utility and other deposits	631	701	468	508
Prepayments	432	553	138	287
	<u>1,106</u>	<u>1,290</u>	<u>620</u>	<u>799</u>
	<u>5,398</u>	<u>13,361</u>	<u>620</u>	<u>799</u>

The amount of other receivables, deposits and prepayments expected to be recovered after more than one year is \$527,000 at 31 December 2004 (2003: \$483,000).

Customers are generally granted credit terms of 30 to 60 days. An ageing analysis of accounts receivable (net of provisions for bad and doubtful debtors) is as follows:

	2004 HK\$'000	2003 HK\$'000
Current	2,644	7,308
Aged over 1 month but less than 2 months	371	1,293
Aged over 2 months but less than 3 months	72	1,377
Aged over 3 months	1,205	2,093
	<u>4,292</u>	<u>12,071</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

19 CASH AND CASH EQUIVALENTS

	The Group		The Company	
	2004	2003	2004	2003
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Deposits with banks	9,360	—	9,360	—
Cash at bank and in hand	3,743	21,456	1,649	17,609
	<u>13,103</u>	<u>21,456</u>	<u>11,009</u>	<u>17,609</u>

20 ACCOUNTS PAYABLE, OTHER PAYABLES, DEPOSITS AND ACCRUALS

	The Group		The Company	
	2004	2003	2004	2003
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Accounts payable	3,079	5,665	—	—
Other payables	—	1	—	—
Deposits received	896	1,268	—	—
Accruals	1,170	1,177	256	281
	<u>2,066</u>	<u>2,446</u>	<u>256</u>	<u>281</u>
	<u>5,145</u>	<u>8,111</u>	<u>256</u>	<u>281</u>

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

The following is an ageing analysis of accounts payable:

	The Group	
	2004	2003
	HK\$'000	HK\$'000
Current	2,741	3,903
Aged over 1 month but less than 2 months	44	1,381
Aged over 2 months but less than 3 months	—	152
Aged over 3 months	294	229
	<u>3,079</u>	<u>5,665</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

21 DEFERRED TAXATION

(i) Deferred tax assets and liabilities recognised

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

	Depreciation allowances in excess of the related depreciation <i>HK\$'000</i>	Future benefit of tax losses <i>HK\$'000</i>	Total <i>HK\$'000</i>
<i>Deferred tax arising from:</i>			
At 1 January 2003	—	—	—
(Charged)/credited to the profit and loss account	(109)	1,723	1,614
At 31 December 2003	<u>(109)</u>	<u>1,723</u>	<u>1,614</u>
At 1 January 2004	(109)	1,723	1,614
(Charged)/credited to the profit and loss account	—	—	—
At 31 December 2004	<u>(109)</u>	<u>1,723</u>	<u>1,614</u>
		2004	2003
		<i>HK\$'000</i>	<i>HK\$'000</i>
Deferred tax assets		1,723	1,723
Deferred tax liabilities		(109)	(109)
Deferred tax assets recognised in the balance sheet		<u>1,614</u>	<u>1,614</u>

At 31 December 2004, the Group recognised deferred tax assets arising from the future benefit of tax losses in the amount of \$1,723,000 (2003: \$1,723,000). The deferred tax assets are recognised to the extent that the directors consider that it is probable that the subsidiary of the Company will generate future taxable profits in the foreseeable future from the balance sheet date against which the deferred tax asset can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

21 DEFERRED TAXATION *(continued)*

(ii) 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 \$2,449,000 (2003: \$761,000). The tax losses do not expire under current tax legislation. There were no unrecognised deferred tax liabilities.

22 SHARE CAPITAL

The following is a summary of movements in the authorised and issued share capital of the Company.

	<i>Note</i>	Number of shares '000	Amount HK\$'000	Amount US\$'000
Authorised:				
(a) Ordinary shares				
At 1 January 2003				
shares of US\$0.10 each		43,283	—	4,328
Increase in authorised share capital	(a)	1,000,000	100,000	—
Decrease in authorised share capital	(b)	(43,283)	—	(4,328)
		<u>1,000,000</u>	<u>100,000</u>	<u>—</u>
At 31 December 2003 and 2004		<u>1,000,000</u>	<u>100,000</u>	<u>—</u>
(b) Series A preference shares				
At 1 January 2003				
shares of US\$0.10 each		6,717		672
Decrease in authorised share capital	(b)	(6,717)		(672)
		<u>—</u>		<u>—</u>
At 31 December 2003 and 2004		<u>—</u>		<u>—</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

22 SHARE CAPITAL (continued)

	Note	Number of shares '000	Amount HK\$'000	Amount US\$'000
Issued and fully paid:				
(a) Ordinary shares				
At 1 January 2003		20,029		2,003
Shares issued upon conversion of share options	(c)	157		16
Shares issued upon conversion of share options	(d)	1,088		109
Re-denomination of ordinary shares of the Company from US\$0.10 each to \$0.10 each by way of				
(i) Shares issued to existing shareholders	(e)	165,860	16,586	
(ii) Shares repurchased by the Company	(e)	(21,264)		(2,127)
Shares issued upon conversion of preference shares and warrants and re-denomination of 10,000 ordinary shares at US\$0.1 each to \$0.10 each				
(i) Subscription for ordinary shares of US\$0.10 each upon conversion of preference shares and warrants by a shareholder	(f)	3,954		395

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

22 SHARE CAPITAL (continued)

	Note	Number of shares '000	Amount HK\$'000	Amount US\$'000
Issued and fully paid: (continued)				
(a) Ordinary shares (continued)				
(ii) Subscription for ordinary shares of US\$0.10 each by the existing shareholder	(f)	30,920	3,092	
(iii) Repurchase of ordinary shares of US\$0.10 each	(f)	(3,964)		(396)
Capitalisation issue credited as fully paid	(g)	5,220	522	
New issue and placing of shares	(h)	78,000	7,800	
At 31 December 2003		280,000	28,000	—
Shares issued upon conversion of share options	(i)	1,800	180	—
At 31 December 2004		<u>281,800</u>	<u>28,180</u>	<u>—</u>
(b) Series A preference shares, shares of US\$0.10 each				
At 1 January 2003		2,687		269
Conversion of preference shares into ordinary shares	(f)	(2,687)		(269)
At 31 December 2003 and 2004		<u>—</u>		<u>—</u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

22 SHARE CAPITAL *(continued)*

Notes:

- (a) On 27 October 2003, the authorised ordinary share capital of the Company was increased by \$100,000,000 by the creation of an additional 1,000,000,000 ordinary shares of \$0.10 par value each ranking pari passu with the then existing shares in all respects.
- (b) Pursuant to a resolution of the shareholders passed on 27 October 2003, the authorised share capital was reduced by the cancellation of all of the authorised 6,717,000 Series A Preference Shares and 43,283,000 ordinary shares of US\$0.10 each.
- (c) On 25 July 2003, the Company issued 157,500 ordinary shares of US\$0.10 each as a result of the exercise by the holders of (1) share options issued on 25 July 2000 to subscribe for 150,000 shares of US\$0.10 each at US\$0.10 per share and (2) share options issued on 21 January 2003 to subscribe for 7,500 shares of US\$0.10 each at \$2.0 each.
- (d) On 23 October 2003, the Company issued a total of 1,087,500 ordinary shares which comprised (1) 950,000 ordinary shares of US\$0.10 each as a result of the exercise of share options issued on 25 July 2000 to subscribe for shares at US\$0.10 per share and (2) 137,500 ordinary shares of US\$0.10 each as a result of the exercise of options issued on 21 January 2003 to subscribe for shares at \$2.00 per share.
- (e) On 27 October 2003, 165,860,317 ordinary shares of \$0.10 each were issued for cash at par to the existing shareholders and 21,264,143 ordinary shares of US\$0.10 each then held by those existing shareholders were repurchased by the Company at a total consideration equivalent to the subscription price for 165,860,317 shares of \$0.10 each.
- (f) Pursuant to a resolution of the shareholders passed on 27 October 2003, the Company (1) issued 250,000 shares of US\$0.10 each to a shareholder at a subscription price of US\$0.2564 per share upon the exercise of the conversion right attached to the warrants issued by the Company; (2) redeemed 2,686,728 Series A preference shares of US\$0.10 each; and (3) issued 3,704,123 shares of US\$0.10 each to a shareholder.

The Company issued an aggregate of 30,920,160 ordinary shares at a total consideration of \$3,092,016 to repurchase and cancel all the 3,954,123 shares of US\$0.10 each pursuant to note (f) items (1) and (3) and 10,000 shares of US\$0.10 each.

- (g) Pursuant to a resolution of the shareholders passed on 27 October 2003, the directors were authorised to capitalise an amount of \$521,952 from the amount standing to the credit of the share premium account of the Company and to appropriate such amount as a capital issue of 5,219,523 ordinary shares at par to the persons whose names appeared on the register of members of the Company as at the close of business on 27 October 2003, pro-rata to its/their then existing shareholdings in the Company.
- (h) Pursuant to the listing of the shares of the Company on GEM on 10 November 2003, 78,000,000 ordinary shares of the Company were issued by way of a Placing for cash of \$0.32 per share. The excess of the issued price over the par value of the shares issued has been credited to the share premium account of the Company.
- (i) On 17 May 2004, the Company issued 1,800,255 ordinary shares of \$0.10 each as a result of the exercise by the holders of shares options issued on 27 October 2003 to subscribe for 1,800,255 shares of \$0.10 each at \$0.09 per share.
- (j) All shares both issued and unissued rank pari passu in all respects at 31 December 2004.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

23 SHARE OPTION SCHEME

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.

Grantees	Date granted	Balance as at 1 January 2004	Number of share options			Balance as at 31 December 2004	Period during which the options are exercisable	Exercise price per share	Percentage of the Company's issued share capital as at 31 December 2004
			Granted during the year	Exercised during the year	Lapsed during the year				
1 director	27 October 2003	1,601,378 (Note 1)	—	—	(1,601,378) (Note 1)	—	10 November 2004 to 2 December 2011	HK\$0.24	0.00%
2 consultants	27 October 2003	1,361,172	—	—	—	1,361,172	10 May 2004 to 24 July 2010	HK\$0.09	0.48%
Employees	27 October 2003	1,441,241	—	(1,280,668) (Note 2)	—	160,573	10 May 2004 to 24 July 2010	HK\$0.09	0.06%
	27 October 2003	520,449	—	(519,587) (Note 2)	—	862	10 May 2004 to 27 December 2010	HK\$0.09	0.01%
	27 October 2003	1,411,218	—	—	(120,104) (Note 4)	1,291,114 (Note 3)	10 May 2004 to 20 January 2013	HK\$0.24	0.46%
	27 October 2003	200,173	—	—	(200,173) (Note 4)	—	31 December 2004 to 20 January 2013	HK\$0.24	0.00%
		<u>6,535,631</u>	<u>—</u>	<u>(1,800,255)</u>	<u>(1,921,655)</u>	<u>2,813,721</u>			

Notes:

- (1) The 1,601,378 share options were granted to Mr. Pang Wang Kee, Lawrence. All 1,601,378 share options were lapsed upon the resignation of Mr. Pang Wang Kee, Lawrence on 30 November 2004.
- (2) 1,800,255 share options at an exercise price of HK\$0.09 each have been exercised by 3 employees during the year ended 31 December 2004. The closing price of the shares immediately before the date on which the options were exercised was HK\$0.243.
- (3) The options will vest and be exercisable in three tranches as follows:
 - (a) one-third of the options have vested and are exercisable on 10 May 2004;
 - (b) a further one-third of the options have vested and are exercisable on 31 December 2004; and
 - (c) the remaining one-third of the options will vest and be exercisable on 31 December 2005.
- (4) The options lapsed upon the resignation of 2 participants from the Group.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

24 RESERVES

(a) The Group

	Share premium <i>HK\$'000</i>	Merger reserves <i>HK\$'000</i>	Revenue reserves <i>HK\$'000</i>	Total <i>HK\$'000</i>
At 1 January 2003	15,863	4,496	(24,612)	(4,253)
Shares issued upon exercise of the share options prior to the Listing (<i>Note 22 (c) and (d)</i>)	177	—	—	177
Price adjustment upon conversion of preference shares	(794)	—	—	(794)
Shares issued upon exercise of warrants	305	—	—	305
Capitalisation issue	(522)	—	—	(522)
Shares issued upon placing	17,160	—	—	17,160
Share issue expenses	(7,838)	—	—	(7,838)
Profit for the year	—	—	11,753	11,753
At 31 December 2003 and 1 January 2004	24,351	4,496	(12,859)	15,988
Shares issued upon conversion of share options (<i>Note 22(ii)</i>)	(18)	—	—	(18)
Loss for the year	—	—	(13,994)	(13,994)
At 31 December 2004	24,333	4,496	(26,853)	1,976

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

24 RESERVES (continued)

(b) The Company

	Share premium <i>HK\$'000</i>	Revenue reserves <i>HK\$'000</i>	Total <i>HK\$'000</i>
At 1 January 2003	15,863	(145)	15,718
Shares issued upon exercise of the share options prior to the Listing (Note 22 (c) and (d))	177	—	177
Price adjustment upon conversion of preference shares	(794)	—	(794)
Shares issued upon exercise of warrants	305	—	305
Capitalisation issue	(522)	—	(522)
Shares issued upon placing	17,160	—	17,160
Share issue expenses	(7,838)	—	(7,838)
Loss for the year	—	(431)	(431)
	<hr/>	<hr/>	<hr/>
At 31 December 2003 and 1 January 2004	24,351	(576)	23,775
Share issued upon conversion of share options (Note 22(i))	(18)	—	(18)
Loss for the year	—	(1,616)	(1,616)
	<hr/>	<hr/>	<hr/>
At 31 December 2004	<u>24,333</u>	<u>(2,192)</u>	<u>22,141</u>

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

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.

As at 31 December 2004 and 2003, reserves of the Company available for distribution to shareholders amounted to \$22,141,000 and \$23,775,000 respectively.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

24 RESERVES (continued)

- (c) The Group had a net reserves of \$1,976,000 at 31 December 2004 (2003: \$15,988,000) analysed as follows:

	2004 HK\$'000	2003 HK\$'000
Company	22,141	23,775
Subsidiaries	(24,661)	(12,283)
Merger reserves	4,496	4,496
	<u>1,976</u>	<u>15,988</u>
Group	<u><u>1,976</u></u>	<u><u>15,988</u></u>

25 COMMITMENTS

(a) Capital commitments

Capital commitments outstanding at 31 December 2004 not provided for in the financial statements were as follows:

	The Group		The Company	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Contracted for	—	266	—	—
Authorised but not contracted for	—	—	—	—
	<u>—</u>	<u>266</u>	<u>—</u>	<u>—</u>
	<u><u>—</u></u>	<u><u>266</u></u>	<u><u>—</u></u>	<u><u>—</u></u>

(b) Operating lease commitments

At 31 December 2004, the total future minimum lease payments under non-cancellable operating leases for property rental are payable as follows:

	The Group		The Company	
	2004 HK\$'000	2003 HK\$'000	2004 HK\$'000	2003 HK\$'000
Within 1 year	1,372	1,124	1,156	1,070
After 1 year but within 5 years	153	1,156	—	1,156
	<u>1,525</u>	<u>2,280</u>	<u>1,156</u>	<u>2,226</u>
	<u><u>1,525</u></u>	<u><u>2,280</u></u>	<u><u>1,156</u></u>	<u><u>2,226</u></u>

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

25 COMMITMENTS *(continued)*

(b) Operating lease commitments *(continued)*

The Group and the Company lease a number of properties under operating leases. The leases typically run for an initial period of one to two years, with an option to renew the lease upon expiry when all terms are renegotiated. None of the leases includes contingent rentals.

26 MATERIAL RELATED PARTY TRANSACTIONS

The following represents a summary of material and significant related party transactions during the year between the Group and related parties identified by the directors:

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>
Consultancy fees payable <i>(note i)</i>	180	384
Rentals payable <i>(note ii)</i>	—	48
Salaries payable <i>(note iii)</i>	600	480
	<u> </u>	<u> </u>
Sales of smart card products <i>(note iv)</i>	16	327
	<u> </u>	<u> </u>

Notes:

- (i) A subsidiary has entered into agreements with Mr. Tong Kam Hung and Mr. Tan Keng Boon for the provision of consultancy services. The terms of the consultancy fees are determined based on services provided with reference to market rates. The agreement with Mr. Tan Keng Boon ceased in May 2003.

Mr. Tong Kam Hung and Mr. Tan Keng Boon were interested in the agreements as consultants and shareholders of the Company.

- (ii) On 1 January 2002, a subsidiary of the Company renewed a rental agreement with United Animal Exchange Limited ("UAEL"), whereby the subsidiary paid a monthly rental of \$24,000 to UAEL which approximated the market rate for a term of one year commencing from 1 January 2002 which was extended for a further two months for the period from 1 January 2003 to 28 February 2003 on the same terms.

Mr. Wong Yiu Chu, Denny was interested in the agreement as a director of the Company and a director and shareholder of UAEL.

- (iii) A subsidiary paid salaries to Ms. Tsui Kam Ling, Alice, for her role as Vice President, Operations of the subsidiary. Ms. Tsui Kam Ling, Alice is a shareholder of the ultimate holding company and the spouse of Mr. Wong Yiu Chu, Denny, a director of the Company.

NOTES ON THE FINANCIAL STATEMENTS

(Expressed in Hong Kong dollars)

26 MATERIAL RELATED PARTY TRANSACTIONS *(continued)*

Notes: (continued)

- (iv) A subsidiary provided smart card related service to Hectrix Limited in current year. Mr. Wan Wah Tong was interested in these transactions as a director and shareholder of Hectrix Limited and the Company.

A subsidiary sold smart card products to external customers during last year where T & C Technologies (Pte) Limited acted as a sales agent on behalf of the subsidiary. Mr. Tan Keng Boon was interested in these transactions as a major shareholder of T & C Technologies (Pte) Limited and a full time consultant of the subsidiary during the period from October 1999 to April 2003. Mr. Tan Keng Boon ceased to be a consultant of the subsidiary in May 2003 and was appointed as a chief technical officer of the Group in May 2003. Mr Tan Keng Boon ceased to be a shareholder of T & C Technologies (Pte) Limited in May 2003.

The terms of the above transactions are mutually agreed between the respective related parties and the subsidiary.

The directors of the Company are of the opinion that the above transactions with related parties were conducted on normal commercial terms and in the ordinary course of business.

27 POST-BALANCE SHEET EVENTS

A wholly-owned foreign enterprise, ACS Technologies (Shenzhen) Limited ("ACS Shenzhen") has been established in Shenzhen, PRC on 10 January 2005. The total investment in ACS Shenzhen amounted to \$1,000,000.

28 ULTIMATE HOLDING COMPANY

The directors consider the ultimate holding company at 31 December 2004 to be D & A Holdings Limited, which is incorporated in the British Virgin Islands.

FINANCIAL SUMMARY

31 December

	2004	2003	2002	2001	2000*
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
RESULTS					
Turnover	24,369	38,646	27,794	12,863	4,695
Cost of sales	14,243	17,950	15,338	7,517	2,718
Gross profit	10,126	20,696	12,456	5,346	1,977
Gross profit margin	42%	54%	45%	42%	42%
(Loss) / profit from ordinary activities after taxation	(13,994)	11,753	3,016	(4,189)	(6,617)
Net profit margin	—	30%	11%	—	—
ASSETS AND LIABILITIES					
Total assets	35,301	52,099	17,177	13,839	10,843
Total liabilities	5,145	8,111	3,755	8,766	2,181
Shareholders' equity	30,156	43,988	13,422	5,073	8,662

* For the period from 13 April 2000 (Date of incorporation) to 31 December 2000

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 2910-2913, 29/F, The Center, 99 Queen’s Road Central, Hong Kong on Thursday, 5 May 2005 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 2004.
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. As special business, 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

NOTICE OF ANNUAL GENERAL MEETING

(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. As special business, 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;

NOTICE OF ANNUAL GENERAL MEETING

- (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."
6. As special business, 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."

NOTICE OF ANNUAL GENERAL MEETING

7. As special business, to consider and, if thought fit, pass the following resolution as a special resolution of the Company:-

SPECIAL RESOLUTION

"THAT the existing articles of association of the Company be and are hereby amended in the following matter:-

- (a) Article 2

By deleting the definition of "subsidiary and holding company" and substituting therefor the following:

"subsidiary" and "holding company" shall have the meanings ascribed to them respectively in the Listing Rules;

- (b) Article 76

(i) By adding the words "unless a poll is taken as may from time to time be required under the Listing Rules or any other applicable laws, rules or regulations or" immediately before the word "unless" in the first sentence of Article 76;

(ii) By adding the words "a poll is so taken as required under the Listing Rules or any other applicable laws, rules or regulations or unless" immediately after the word "Unless" at the beginning of the second paragraph of Article 76;

- (c) Article 85(a)

By renumbering the existing Article 85(a) as Article 85(a)(i) and adding immediately thereafter the following new paragraph (ii):-

(ii) Where any member is, under any applicable laws or the Listing Rules from time to time, required to abstain from voting on any particular resolution or restricted to voting only for or only against any particular resolution, any votes cast by or on behalf of such member in contravention of such requirement or restriction shall not be counted.

NOTICE OF ANNUAL GENERAL MEETING

- (d) Article 103(c), (e) and (f)
- (i) By deleting the existing paragraph (c) of Article 103 in its entirety and substituting therefor the following new paragraph (c) and its marginal note:-
- (c) A Director shall not be entitled to vote on (nor shall be counted in the quorum in relation to) any resolution of the Board in respect of any contract or arrangement or any other proposal whatsoever in which he or any of his associates has any material interest, and if he shall do so his vote shall not be counted (nor is he to be counted in the quorum for the resolution), but this prohibition shall not apply to any of the following matters, namely:-
- Director
may not vote
where he has a
material
interest
- (i) the giving of any security or indemnity either:-
- Director
may vote
in respect
of certain
matters
- (aa) to the Director or his associate(s) in respect of money lent or obligations incurred or undertaken by him or any of them at the request of or for the benefit of the Company or any of its subsidiaries;
- (bb) to a third party in respect of a debt or obligation of the Company or any of its subsidiaries for which the Director or his associate(s) has/have himself/ themselves assumed responsibility in whole or in part and whether alone or jointly under a guarantee or indemnity or by the giving of security;
- (ii) any proposal concerning an offer of shares or debentures or other securities of or by the Company or any other company which the Company may promote or be interested in for subscription or purchase where the Director or his associate(s) is/are or is/are to be interested as a participant in the underwriting or sub-underwriting of the offer;
- (iii) any proposal concerning any other company in which the Director or his associate(s) is/are interested only, whether directly or indirectly, as an officer or executive or shareholder or in which the Director or his associate(s) is/are beneficially interested in the shares of that company, provided that, the Director, and any of his associates are not in aggregate beneficially interested in five per cent. or more of the issued shares of any class of such company (or of any third company through which his interest or that of his associates is derived) or of the voting rights;

NOTICE OF ANNUAL GENERAL MEETING

- (iv) any proposal or arrangement concerning the benefit of employees of the Company or any of its subsidiaries including:-
 - (aa) the adoption, modification or operation of any employees' share scheme or any share incentive scheme or share option scheme under which the Director or his associate(s) may benefit; or
 - (bb) the adoption, modification or operation of a pension fund or retirement, death or disability benefits scheme which relates both to Directors, his associates and employees of the Company or any of its subsidiaries and does not provide in respect of any Director, or his associate(s), as such any privilege or advantage not generally accorded to the class of persons to which such scheme or fund relates; and
 - (v) any contract or arrangement in which the Director or his associate(s) is/are interested in the same manner as other holders of shares or debentures or other securities of the Company by virtue only of his/their interest in shares or debentures or other securities of the Company.
- (ii) By deleting the existing paragraph (e) of Article 103 in its entirety and substituting therefor the following new paragraph (e) and its marginal note:-
- | | |
|--|--|
| <p>(e) If any question shall arise at any meeting of the Board as to the materiality of the interest of a Director or his associate(s) or the significance of a contract, arrangement or transaction or proposed contract, arrangement or transaction or as to the entitlement of any Director to vote or form part of a quorum and such question is not resolved by his voluntarily agreeing to abstain from voting or not to be counted in the quorum, such question shall be referred to the Chairman of the meeting (or, where question relates to the interest of the Chairman, to the other Directors at the meeting) and his ruling (or, as appropriate, the ruling of the other Directors) in relation to any other Director (or, as appropriate, the Chairman) shall be final and conclusive except in a case where the nature or extent of the interests of the Director and/or his associate(s) concerned (or, as appropriate, the Chairman) as known to such Director (or, as appropriate, the Chairman) has not been fairly disclosed to the Board.</p> | <p>Who to decide whether a Director may vote</p> |
|--|--|

NOTICE OF ANNUAL GENERAL MEETING

- (iii) By deleting the existing Article 103(f) in its entirety and substituting therefor the following new paragraph (f) and its marginal note:-

“For the purpose of paragraphs (c) and (e) of this Article, associate(s), in relation to any Director, shall have the meaning attributed to it in the Listing Rules”;

Definition of
“associate(s)”

- (e) Article 112

By deleting the existing Article 112 in its entirety and substituting therefor the following new Article and its marginal note:

112. Subject to the manner of retirement by rotation of Directors as from time to time prescribed under the Listing Rules, at each annual general meeting, one-third of the Directors for the time being, or, if their number is not three or a multiple of three, then the number nearest to, but not less than, one third, shall retire from office by rotation provided that every Director shall be subject to the retirement at least once every three years. The Directors to retire every year shall be those which have been longest in office since their last election but as between persons who became Directors on the same day those to retire shall (unless they otherwise agree between themselves) be determined by lot. A retiring Director shall retain office until the close of the meeting at which he retires, and shall be eligible for re-election thereat.
- Rotation and
retirement
of Directors

NOTICE OF ANNUAL GENERAL MEETING

(f) Article 116

By deleting the existing Article 116 in its entirety and substituting therefor the following new Article and its marginal note:

116. No person, other than a retiring Director, shall, unless recommended by the Board for election, be eligible for election to the office of Director at any general meeting, unless notice in writing of the intention to propose that person for election as a Director and notice in writing by that person of his willingness to be elected shall have been given to the Company provided that the minimum length of the period, during which such notices are given, shall be at least seven (7) days. The period for lodgment of such notices shall commence no earlier than the day after the despatch of the notice of the meeting appointed for such election and end no later than seven (7) days prior to the date of such meeting.”

Notice to be given when person proposed for election

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

Hong Kong, 31 March 2005

Principal place of business in Hong Kong:

Unit 2910-2913, 29/F.
The Center
99 Queen's Road Central
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 member 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 member 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 delivery of the form of proxy will not preclude a member of the Company from attending and voting in person at the Meeting if the member of the Company so desires.
4. An explanatory statement containing further details regarding ordinary resolution no.5 as required by the Rules Governing the Listing of Securities on the Growth Enterprise Limited of The Stock Exchange of Hong Kong Limited will be dispatched to the shareholders of the Company together with the 2004 annual report of the Company for the year ended 31 December 2004.

As at the date of this notice, the Board comprises 4 executive directors, namely Mr. Wong Yiu Chu, Denny, Mr. Tan Keng Boon, Mr. Mak Chi Him and Ms. Tsui Kam Ling, Alice; 1 non-executive director, Mr. Wan Wah Tong, Thomas; and 3 independent non-executive directors, Dr. Yip Chak Lam, Peter, Mr. Cheong Chung Chin and Mr. Yu Man Woon.