



Annual Report 2005



Advanced Card Systems Holdings Limited

龍傑智能卡控股有限公司*

(incorporated in the Cayman Islands with limited liability)

(Stock Code : 8210)

** 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. Mak Chi Him, Mr. Tan Keng Boon and Ms. Tsui Kam Ling, Alice; and 3 independent non-executive directors, Dr. Yip Chak Lam, Peter, Mr. Cheong Chung Chin and Mr. Yu Man Woon.

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CORPORATE INFORMATION

DIRECTORS

Executive Directors

Mr. Wong Yiu Chu, Denny (*Chairman*)

Mr. Mak Chi Him

Mr. Tan Keng Boon

Ms. Tsui Kam Ling, Alice

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

REMUNERATION COMMITTEE

Dr. Yip Chak Lam, Peter (*Chairman*)

Mr. Wong Yiu Chu, Denny

Mr. Yu Man Woon

AUDITORS

Grant Thornton

Certified Public Accountants

13th Floor, Gloucester Tower

The Landmark

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Central, Hong Kong

COMPLIANCE ADVISOR

Anglo Chinese Corporate Finance, Limited

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Central, Hong Kong

REGISTERED OFFICE

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Grand Cayman

Cayman Islands

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HEAD OFFICE & PRINCIPAL PLACE OF BUSINESS

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Hong Kong

PRINCIPAL BANKER

DBS Bank (Hong Kong) Limited

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North Point, Hong Kong

CORPORATE INFORMATION

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

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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
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Hong Kong

COMPANY'S WEBSITE ADDRESS

www.acs.com.hk

STOCK CODE

8210

CHAIRMAN'S STATEMENT

Advanced Card Systems Holdings Limited and its subsidiaries (the "Group") are pleased to announce that the Group recorded better financial performance in the year ended 31 December 2005 compared to the previous year. The sales increased by 59% to HK\$38.9 million from HK\$24.4 million. The gross profits increased to HK\$17.0 million from HK\$10.1 million and the gross profit margin increased to 44% from 42%. The Group recorded profit for the year of HK\$0.2 million in 2005, a notable and significant improvement over the previous year when the Group experienced loss for the year of HK\$14.0 million in 2004.

In the initial years after Advanced Card Systems Limited ("ACS"), the prime operating company of the Group, was established in 1995, the primary business of ACS was to develop PC linked smart card readers for the world market. This market was small at that time but ACS has gradually and consistently built its brand name and professional reputation to become one of the world's leading suppliers of reliable smart card readers. Over the years, ACS has earned the business of over a thousand customers and is now ranked by Frost and Sullivan as the world's number four and Asia's number one supplier of PC linked readers. The Group currently supplies its products directly to established customers in over 80 countries worldwide. These customers are primarily companies in the Information Technology sector of business.

In 2005, the Group continued to secure successfully business from very high-profiled government projects throughout the world that also attracted almost all the major competitive players in the Group's line of business. Some of the Group's ongoing Government projects include the National ID card project in Belgium, the smart card based electronic purse program for the USA Navy, e-Government projects in Italy, a National ID card program in Malaysia, an e-Certificate application for Hong Kong and Macau Smart ID cards, a taxation project for Egypt and a National ID card project in Serbia just to mention a few. No matter the use or the application, the Group's products have been constantly certified to be of world class.

With a customer base firmly established, the Group was empowered to allocate its limited financial resources more on research and development than on sales and marketing. This strategy was realized when the Group found that customers that purchased PC linked readers from the Group were potential customers of related products. Once the Group has accumulated more funds from retained earnings, it will boost its sales and marketing activities. In 2005, PC linked smart card readers still represented the main product line with their sales accounting for two-thirds of the total business of the Group. However, after the Group was listed as a public company in November of 2003, it began to develop several brand-new products. Since the development time of the Group's brand-new products ranged from half a year to over two years, year 2004 and to a lesser extent 2005 were considered the investment years after the listing.

At the end of 2005, the Group had three novel and important products which were ready to be launched in the first and second quarters of 2006. They are (1) the *ACR88*, the portable PIN-pad smart card reader with display and with optional finger print scanner and optional contactless reader, (2) the *ACR100*, a flash drive integrated with a PC linked reader, and (3) the *ACOS5* card, a PKI (Public Key Infrastructure) based high security smart card.

CHAIRMAN'S STATEMENT

These three products, which the Group invested a lot time and resources to develop, are expected to generate good revenue in 2006 and beyond.

After the listing in November 2003, the Group established two new offices, one in Shenzhen, which is near the border between Hong Kong and the mainland of China, also known as a gateway to China, and the other in Manila, The Philippines. The total number of employees at 31 December 2005 are 38 in Hong Kong, 13 in Shenzhen and 20 in Manila (30, 0, and 0 respectively at 31 December 2003). The combination of the ground breaking work being done at the Hong Kong headquarters and the invaluable support of the staff members from these two neighbouring cities with lower operating costs are now enabling the Group to serve the world market more efficiently and more cost-effectively.

The Group has been successful not only in achieving competitiveness in price on a global scale but has also earned a solid reputation as a company advanced in technology and innovative in its products, as evidenced by the Group winning the "D'ucoty Awards Product Innovation Award for Readers" in May 2005 as conferred by Frost & Sullivan and CardsNow!Asia.

The Group faced a painstaking period of struggling with limited financial resources to exploit the immense business opportunities open to the world's big players. The Group has proven that it has the strengths and power to win business from projects that the global top players are eagerly competing for. The Group has never had such a confidence in winning as it has today. This well earned confidence and strength will drive the Group's growth in sales and profitability in 2006 and beyond and will further build the Group as a respectable world supplier of smart card readers and related technology products.

The Group has not entered into the business of offering smart card based solutions even though such business is a natural extension of the Group's present business of solely offering products. In fact the Group's smart card knowledge and expertise, its competitive cost structure and its global customer base could enable the Group to offer such solutions. Funds available, the Group will select an area of smart card based solution with global demand and with great value to a big number of consumers, such as a payment system for transportation by buses.

I am very grateful to the shareholders for giving the management the time to prove that the Group could become a very respectable technology company. I would like to extend my thanks to all of our employees for their full dedication to their work.

WONG Yiu Chu, Denny

Chairman

Hong Kong, 23 March 2006

MANAGEMENT DISCUSSION AND ANALYSIS

The following discussion and analysis should be read along side with the Group's audited financial statements for the year ended 31 December 2005.

FINANCIAL REVIEW

The total turnover of the Group increased by 59% to HK\$38.9 million in the year ended 31 December 2005 from HK\$24.4 million in the previous year. The biggest growth was recorded in PC linked readers (+136%) in 2005 when several big customers in Europe and in Asia increased their purchase orders with the Group. Also the customer base was expanded. The smart card business saw a growth of 54% with a big portion of the growth coming from orders from a big bank in Indonesia which bought our smart cards and finger print sensor integrated with smart card readers, to authenticate bank customers in lieu of their signature. The sales of "Other products" dropped 15% when the Group focused in 2005 on developing the portable PIN-pad readers with display, called ACR88 which will be introduced in the second quarter of 2006.

	For the year ended		
	31 December		
	2005	2004	Change
	HK\$'million	HK\$'million	
Smart cards	5.4	3.5	+54%
PC linked readers	25.3	10.7	+136%
Other products	7.4	8.7	-15%
	<u>38.1</u>	<u>22.9</u>	
Smart card related services	0.8	1.5	-47%
	<u>38.9</u>	<u>24.4</u>	+59%

The turnover increased in all the three regions of EMEA (Europe, Middle East and Africa), Asia Pacific, and the Americas with the increase rate of 40%, 86%, and 80% respectively. The new office in China has identified a big number of potential customers but significant sales are to be expected only in 2006 and afterwards.

	For the year ended		
	31 December		
	2005	2004	Change
	HK\$'million	HK\$'million	
Europe, Middle East and Africa	19.0	13.6	+40%
Asia Pacific	15.4	8.3	+86%
The Americas	4.5	2.5	+80%
	<u>38.9</u>	<u>24.4</u>	

MANAGEMENT DISCUSSION AND ANALYSIS

The gross profit margin of the Group increased to 44% in the year ending 31 December 2005 from 42% in the previous year. This moderate increase does not indicate a trend but it is the Group's target to keep its gross profit margin to be above 40%.

	For the year ended		Change
	31 December		
	2005	2004	
	<i>HK\$'million</i>	<i>HK\$'million</i>	
Revenue	<u>38.9</u>	<u>24.4</u>	+59%
Gross profit	17.0	10.1	+68%
Other operating income and other net loss	1.0	0.1	+900%
Operating expenses and finance costs	<u>(20.1)</u>	<u>(24.2)</u>	-17%
Loss before income tax	(2.1)	(14.0)	
Income tax credit	<u>2.3</u>	<u>—</u>	
Profit/(Loss) for the year	<u>0.2</u>	<u>(14.0)</u>	

The total operating expenses and finance costs were reduced to HK\$20.1 million in 2005 from HK\$24.2 million in 2004. Of the HK\$24.2 million such costs incurred in 2004, HK\$5.0 million was for impairment loss on development costs. As the Group acquired more experience in determining what products to develop, such impairment cost was reduced in Year 2005 to HK\$0.4 million.

	For the year ended	
	31 December	
	2005	2004
	<i>HK\$'million</i>	<i>HK\$'million</i>
Operating expenses and finance costs breakdown		
Staff costs	10.8	8.9
Depreciation and amortisation	2.0	2.8
Impairment loss on development costs	0.4	5.0
Other operating expenses and finance costs	<u>6.9</u>	<u>7.5</u>
Operating expenses and finance costs	<u>20.1</u>	<u>24.2</u>

MANAGEMENT DISCUSSION AND ANALYSIS

DIVIDEND

The board of directors (the "Board") does not recommend the payment of a final dividend in respect of the year ended 31 December 2005. The declaration, payment, and amount of future dividends will be decided by the Board and will depend upon, among other things, the Group's results of operations, capital requirements, cash flows, general financial condition, and such other factors as the Board may deem relevant.

BUSINESS REVIEW

The Group continued to exert its best efforts to use its available financial resources to keep itself abreast of the technology of smart card readers and closely related products and to build its reputation as a supplier of reliable products to the world. In Year 2005, the Group made substantial achievements in different areas.

New Product development

After getting listed in November 2003, the Group applied its secured funds to develop a number of products. The time to develop a brand new product (from defining the product to commercialization of the product) ranges from half a year to two years. Quite a few products which the Group started to work on after the listing have not been launched yet. These products are expected to bring the Group respectable sales in 2006 and beyond.

At the end of 2005, the Group has three important products which are ready to be launched in the first quarter and second quarter of 2006. They are:

- (1) *ACR88*: the portable PIN-pad smart card reader with display and with optional finger print scanner and optional contactless reader. There is a wide range of applications of this device, notably for national health card schemes and ID card schemes. The Hong Kong Immigration is the first customer of this product and they use the device to read the Hong Kong Identity Cards.
- (2) *ACR100*: a flash drive integrated with a PC linked reader. The device has the full functions of the popular flash drive and additionally provides security function and payment function by virtue of the SIM-sized smart card inserted in it. Before the product was launched, a mobile phone operator in Asia ordered ten thousand units for their pilot project to enable subscribers to use their special VoIP services.
- (3) *ACOS5* card: a PKI (Public Key Infrastructure) smart card. Such cards are used in high security applications, e.g. for access to the Internet for home banking, on-line transactions, e-government services, etc.



MANAGEMENT DISCUSSION AND ANALYSIS

In January 2005, the Group started the development of a device using a 32-bit microprocessor which has PIN-pads and display and which accepts contactless card and finger prints. It uses Linux as its operating system. This is the first 32-bit device developed by the Group. This product can be considered as a smart card reader product but is a more powerful and technically more sophisticated device. This product is not yet launched.

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

While being busily engaged in new product development, the Group continued in 2005 to secure orders with its products, especially the PC linked readers.

The Group's products are used in various smart card and security projects in the world. A lot of the projects are government driven projects. This demonstrates the Group's capability to meet the usually demanding requirements of governments in suppliers' product quality, reliability, and services. The projects that generated business to the Group in 2005 included:

Belgian National ID cards using smart card readers, ACR38



been carried to year 2006.

The Group continued to supply its PC linked readers ACR38 to ZETES SA, the prime contractor for the Belgian National Identity Cards using smart cards. The government implements revolutionary applications benefited from the smart card technology, e.g. safe chatting on-line, reaching secured sites and obtaining secured files on line, taxation information on web, etc. By 31 December 2004, the Group had supplied close to 20,000 readers for the project. In 2005, the Group supplied more than 100,000 units of readers. The momentum has

Taxation project in Egypt using PIN-pad readers, ACR80



of both parties. The function keys are adapted for reading different portions of the information on the card. The project is one of the most complex applications in the field of e-government. The pilot stage of the project began in November 2005 and the project is expected to be implemented in the second quarter of Year 2006. The first implementation will involve 300,000 taxpayers, whereas the overall scope of the project is targeting 6 million taxpayers all over Egypt. The Group supplied hundreds of ACR80 for the pilot run and expects to get bigger orders once the project is in its full implementation.

The Egyptian Government is issuing new smart taxation cards for its taxpayers for higher security and efficiency in the administration of tax collections. The government needs a device to input, check and back-up transaction information to improve the security around their taxpayer records and financial data without compromising its staff's ability to access the data conveniently and efficiently. The LCD and PIN-pad on ACR80 are used for entering the PIN numbers of both the tax officers and the taxpayers thus ascertaining the authentication

MANAGEMENT DISCUSSION AND ANALYSIS

Hong Kong Government access control project using contactless readers, ACR120



One department of the Hong Kong Government is adopting ACS' contactless reader *ACR120* for its physical and logical access control applications. The government department has installed *ACR120* to their computer systems and building entries. The staff members need to authenticate themselves before they can enter the building or before they can access the confidential information. To gain access to physical premises, they simply flash their contactless ID badges on the *ACR120* contactless readers at the door. Similarly, staff members tap their cards on the reader attached to the PC for every logon to access the sensitive and confidential information therein.

VoIP application for a GSM operator using the Group's flash drive inbuilt with a reader, ACR100



A GSM operator in a Southeast Asian country ordered, for their pilot run, 10,000 units of *ACR100* to be provided to their subscribers for their VoIP applications. The VoIP application program is stored in a write-protected area of the flash drive and is accessible only by the insertion of the SIM-sized smart card. The public zone is a free area for reading and writing and is for storage just as an ordinary flash drive is. Mobile phone operators, especially those offering 3G services, are concerned that their business will be eroded because of the proliferations of VoIP use and WIFI hot spots. In the future, people will be able to use their portable PC or palm PC for VoIP applications not only at home but also in public areas with WIFI access. The operators want to find ways to encourage the subscribers to use their paid but better VoIP services. *ACR100* represents one of the tools for mobile phone operators or WIFI service providers to establish payment systems by which subscribers can pay fees conveniently.

Customer loyalty program in Japan using balance readers, ABR10RS



An international department store headquartered in Tokyo uses ACS' balance readers, *ABR10RS*, to read the smart cards for its loyalty program to attract more visiting customers as well as to stimulate their purchasing desire. The balance reader reads the transaction records, the balance, and the bonus points stored in the loyalty smart card and displays the information. In 2005, 10,000 units of balance readers were supplied to the department store which distributed them to their valued customers. More such balance readers will be supplied in 2006.

MANAGEMENT DISCUSSION AND ANALYSIS

Malaysian bank authentication system using finger print scanner and reader, AET63



A Malaysian Bank has implemented a PC-based Fingerprint Biometric Authorization System using ACS' AET63, a smart card and fingerprint reader. The project was rolled out across the country and involved about 800 units of AET63 to start with. An AET63 is connected to every teller machine. For large amount transactions (defined by the Bank) such as deposit or withdrawal exceeding a certain amount, authentication by fingerprint is required, replacing the less secure authorization by PIN (Personal Identification Number).

Some of the above projects have not brought substantial sales to the Group yet, as they are still in their initial phase of implementation. When they are implemented in full scale and when similar projects are spread out to the world, the sales of the products for such applications will take off.

Smart card trade shows

In Year 2005, the Group continued to participate in various smart card and security trade shows in the world as it had done in the previous years. These shows included "CeBIT" in March in Germany, "CardTech/SecureTech" in April in the USA, and "Cartes & IT Security" in November in France. The Group also participated in various trade shows in Asia, including "Int'l ICT Expo" in April in Hong Kong, "CardExAsia" in May in Malaysia, "The 8th International Fair of Smart Cards, China SCC" in May in Beijing, China, "China International Exhibition On Financial Banking Technology & Equipment" in September in Beijing, China, and "Smart Card Expo" in September in India. The Group will continue its practice of attending international trade shows. The Group's customers are spread all over the world and these shows present to the Group the opportunities to attract new customers and to meet its existing customers.

Product Innovation Award for Readers

In May 2005, the Group won the "D'ucoty Awards Product Innovation Award for Readers". The awards were established by Frost and Sullivan and CardsNow!Asia to select and recognize individuals and companies who had demonstrated outstanding performance within the smart card industry throughout the Asia Pacific region. Directly involved in the selection process, Ms. Jafizwaty Haju Ishahak, Frost & Sullivan's smart card and auto ID program leader responsible for the Asia Pacific region stated, "Looking at their history and product portfolio, ACS has a strong and stable foundation in the reader market. Also, ACS has always been at the forefront in terms of innovation; particularly in the PC-reader arena." Frost and Sullivan is a global business development consulting company and has a team of specialized smart card analysts within the Asia Pacific region. CardsNow!Asia is the Asia Pacific region's only bilingual (English and Chinese) trade magazine focusing on card technologies and applications.

MANAGEMENT DISCUSSION AND ANALYSIS

Offices and headcount

After the listing in November 2003, the Group started to implement the strategy to build a bigger team of people to serve the world while keeping the operating expenses in control. Thus two offices, one in Manila and one in Shenzhen, were established. As of 31 December 2005, the Group had 20 employees in Manila and 13 in Shenzhen compared to 38 in Hong Kong.

	31 December		
	2003	2004	2005
Hong Kong	30	38	38
Manila	—	14	20
Shenzhen	—	8	13
	<hr/>	<hr/>	<hr/>
Total	30	60	71
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

These offices are seen to be providing good support to Hong Kong both in engineering and in sales and marketing work, with China focusing on electronic hardware development and production support, and Manila focusing on software development and technical support. Hong Kong focuses on management, building customer relationships, formulating strategies and developing IP-intensive software. The combination of the headquarters work in Hong Kong and the support from staff members from the two neighbouring cities are empowering the Group to serve the world market more efficiently and cost-effectively.

PROSPECTS

According to the latest report by Frost and Sullivan published in 2006, ACS is the world's Number 4 and Asia's Number 1 supplier of smart card readers used with the PC. The market of PC linked reader is forecast by Frost and Sullivan to continue to grow. In fact more governments in the world will adopt the smart card technology for their national identity cards in order to increase the country's efficiency through the execution of on-line commercial and government activities. Taking the advantage of its reputation as a top Asian supplier of smart card readers and utilizing the respective skills of staff members in Hong Kong, Shenzhen and Manila in a most cost effective manner, the Group is becoming powerful as a world player in its industry.

MANAGEMENT DISCUSSION AND ANALYSIS

The Group was able not only to achieve competitiveness in price but was able to maintain its gross profit margin at over 40%. The management's expertise in sourcing components and managing contractor manufacturers play a vital role in maintaining a respectable gross profit margin.

The Group is using the funds obtained in listing and generated by the business of selling PC linked readers to develop brand new products such as *ACR88*, *ACR100* and *ACOS5* mentioned above. Once these products are launched, the Group will get into market segments which are much bigger than the market of its existing products mainly owing to the higher unit prices of these new products. These new innovative products will create many new applications to benefit a big number of consumers.

At the date of this report, *ACR88* has been demonstrated to the satisfaction of the government authority of Germany for a new nation-wide health card project involving over 80 million cards. The total demand of readers for the project is expected to be substantial. Also the Group is actively working with the world's leading IT system solution company to use the Group's readers *ACR38* to provide to banks in The United Kingdom ("UK") for their home banking projects. With various other projects brewing in UK, the Group is expecting to increase its business in the country in 2006 significantly. In the Group's domestic area, Asia Pacific, the Group maintains its strategy of promoting its image as a supplier of quality products at very competitive prices. The Group has an advantage over the non-Asian brands in serving this market and has an advantage over its Asian competitors by virtue of its brand name. In particular, the Group's China office with now trained sales people are expected to generate respectable revenue for the Group.

Two years after its listing in November 2003, the Group has substantially strengthened itself and is poised for a much faster growth in sales and in net profits in Year 2006 and in the years to come.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2005, the Group's cash and cash equivalents amounted to HK\$6.4 million (2004: HK\$13.1 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 at a level of 3.6 (2004: 5.0). Net asset value as at the year end date was HK\$30.4 million (2004: HK\$30.2 million). As at 31 December 2005, the Group did not have any borrowings and, accordingly, the gearing ratio was zero (2004: zero).

CAPITAL STRUCTURE

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

INVESTMENTS

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

MANAGEMENT DISCUSSION AND ANALYSIS

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 2005.

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 2005, the Group pledged a deposit of US\$88,000 to a bank for the bank to issue a performance bond to a customer. This customer paid the Group US\$88,000 as partial advanced payment when they placed the Group an order of 10,000 units of *ACR100* (the flash drive integrated with a smart card reader) before the product was developed. Save as disclosed herein, the Group did not pledge any of its assets.

CONTINGENT LIABILITIES

The Group did not have any significant contingent liabilities as at 31 December 2005.

EMPLOYEES AND REMUNERATION POLICIES

As at 31 December 2005, the Group had 71 full time employees. Staff costs amounted to HK\$10.8 million (2004: HK\$8.9 million). Remuneration policies and packages for the Group's employees are based on individual qualifications, performance, experience and conditions prevailing in the industry. In addition, various training sessions are offered to employees to enhance their product and market knowledge.

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

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 2005 to 31 December 2005.

Business objectives as stated in the prospectus dated 31 October 2003

Actual business progress for the period from 1 July 2005 to 31 December 2005

Enhancing the PC linked readers and developing new products

The product *ACR38T-IBS* was launched to the market. It has the functions of a full-sized PC linked reader but is small enough to fit into a key chain. It is also very simple to use and install. It is ideal for electronic commerce, home banking or e-purse facilities, secure computer access or any of a multitude of other applications.

Strengthening and developing industry alliances

The Group strengthened its relationship with an IT solution house in Belgium to promote its PC linked reader *ACR38* for the E-ID cards project for the Belgian government.

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

The Group has lined up with one of the leading mobile phone operator in the Philippines for developing its *ACR100*, a flash drive integrated with a smart card reader. This product is developed with customized features but is to be turned into a standard product.

Expansion of the Group's sales network

The Group participated in three trade shows in the second half of Year 2005: one trade show in Beijing, one in France and one in India.

Enhancing research and development capability

The Group continued to build a smart card and finger print reader based on a 32-bit microprocessor. The Group further enhanced its development capability in recruiting one experienced Engineering Manager to lead the engineering team in Manila.

REVIEW OF BUSINESS OBJECTIVES

Business objectives as stated in the prospectus dated 31 October 2003

Exploring additional commercial applications

Actual business progress for the period from 1 July 2005 to 31 December 2005

The Group has been identifying new commercial applications using the *ACR100* device. It has all the features of the popular flash drive for storing data. Since it accepts a plug-in smart card, it offers secure protection of the data and any software stored in the device. Also by virtue of the smart card, it can be used as a tool for payment system implementation, e.g. for WIFI providers to charge users for their service.

Building on new market opportunities

The Group expanded its influence to regions with emerging demands of smart card readers and related products. It strengthened its business relationship with customers in Egypt and Ivory Coast in Africa, and Brazil and Argentina in South America.

Catering to the needs of small and medium-sized customers

The providing of SDK (software development kits) reduces the needs of the Group and its distributors to educate customers in detail on how to use the Group's products. The Group took big efforts to enhance the features and qualities of its SDK in the second half of Year 2005.

USE OF PROCEEDS

The net proceeds from the placing of shares upon the listing of the Company which remains unutilized as at 31 December 2005 amounted to HK\$6.3 million.

For the period from 1 July 2005 to 31 December 2005:

	Budgeted <i>HK\$ million</i>	Actual <i>HK\$ million</i>
Product development (<i>Note 1</i>)	—	1.2
Sales and marketing	0.8	0.8
Patent copyright and trademark registration	0.2	0.1
General working capital	0.3	0.6
	<u>1.3</u>	<u>2.7</u>

Note:

- The increase in development costs is owing to longer development time than anticipated.

DIRECTORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS

Mr. WONG Yiu Chu, Denny

Mr. Denny Wong, aged 58, is the chairman and president of the Company and the director 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 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. MAK Chi Him, Damais

Mr. Damais Mak, aged 47, joined the Group in April 2004 and was initially appointed as Vice President of Product Development & Marketing. Exactly a year after, Mr. Mak is officially the new Chief Executive Officer of ACS. 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. Mr. Mak resigned from the Group with effect from 3 May 2006 for personal reasons.

DIRECTORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS *(continued)*

Mr. TAN Keng Boon

Mr. Tan Keng Boon, aged 47, joined the Group in October 1999 as a full-time consultant of ACS and has been a full-time employee and the chief technical officer of ACS since May 2003 and an executive director since 25 October 2003. He is also a director of a subsidiary of the Group. Mr. Tan is responsible for the implementation of a technical sales and marketing programme for existing and prospective customers of ACS. He has been involved actively in defining the product development road map of ACS and leading the engineering team in the development of new products. Previously, Mr. Tan worked for Gemplus Technologies Asia Pte Ltd. and De La Rue Systems Asia Pte Ltd., both of which were subsidiaries of established companies in the smart card industry. This past working experience of Mr. Tan has allowed him to develop a network of contacts with system solution providers as well as smart card and terminal vendors which are potential customers of the Group. Mr. Tan obtained a bachelor of engineering degree from the National University of Singapore in 1983.

Ms. TSUI Kam Ling, Alice

Ms. Tsui Kam Ling, Alice, aged 53, joined the Group in September 1998 as the Vice President, Operations of ACS and is mainly responsible for supervising the sourcing of raw materials, product production, product quality control and logistics of the delivery of finished products to customers. She is also the director of several subsidiaries of the Group. Prior to joining the Group, Ms. Tsui was a director of Advanced Electronics Limited which distributed semiconductor components until 1997 when it was acquired by Future Electronics Holdings Inc. She then worked as the administration manager of Future Advanced Electronics (Hong Kong) Limited from July 1997 to September 1998. Ms. Tsui had a teaching career from 1975 to 1983. Ms. Tsui graduated from The Chinese University of Hong Kong with a bachelor of arts degree in 1975. She is the spouse of Mr. Denny Wong.

DIRECTORS AND SENIOR MANAGEMENT

INDEPENDENT NON-EXECUTIVE DIRECTORS

Dr. YIP Chak Lam, Peter

Dr. Peter Yip, aged 55, 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.

Mr. CHEONG Chung Chin

Mr. Cheong Chung Chin, aged 46, was appointed as an independent non-executive director on 25 October 2003. He has over ten 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 55, was appointed as an independent non-executive director on 30 September 2004. He is currently the assistant general manager of a local bank. Mr. Yu obtained a 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.

DIRECTORS AND SENIOR MANAGEMENT

SENIOR MANAGEMENT

Mr. Scott G. BOOTH

Mr. Scott Booth, aged 33, joined the Group in August 2005, as the Vice President of Business Development. Mr. Booth is responsible for the development and enhancement of existing and new business opportunities worldwide with a focus on North America and Western Europe. Mr. Booth joins the Group from SDLOGIC Technologies Inc., a North American based global smart card consultation and hardware design firm where he was the President and CEO of the company for over 4 years. Mr. Booth brings to the Group over a decade of engineering and business management experience within the smart card, computer, and wireless industries, which facilitates his unique ability to understand every facet of a project from concept and design to product certification, distribution and marketing. Mr. Booth has been a FCC licensed amateur radio operator since 1991 and has served as a Board member for numerous non-profit organizations throughout North America. In 2004, Mr. Booth established the North American Smart Card Industry Consortium and enjoys traveling internationally to support the technology.

Dr. LUI Ho Chung

Dr. Lui, aged 54, joined the Group in January 2004. He is currently the Vice President, Advanced Technology Development of Advanced Card Systems Ltd. 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. Dr. Lui resigned from the Group in February 2006 for personal reasons.

Ms. WONG Mei Ki, Maggie

Ms. Maggie Wong, aged 31, 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.

CORPORATE GOVERNANCE REPORT

During the year, the Company has applied the principles of the Code on Corporate Governance Practices as set out in Appendix 15 of the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited (the "Code"). The Company has complied with the requirements of the Code except for the provision A.2 of the Code. A.2 of the Code provides that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. During the three months ended 31 March 2005, the roles of chairman and chief executive officer were not separated because the Company has yet to find an appropriate individual for the post of chief executive officer. Mr. Mak Chi Him was appointed as the chief executive officer on 1 April 2005.

DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted the rules governing dealings by directors in listed securities of the Company ("dealings rules") on terms no less exacting than the required standard of dealings as referred to in Rules 5.48 to 5.67 of the GEM Listing Rules as the codes of conduct regarding securities transactions by directors and by relevant employees as defined in the Code. Having made specific enquiry of all directors of the Company, all directors of the Company confirm that they complied with such dealings rules throughout the year ended 31 December 2005.

BOARD OF DIRECTORS

The Board comprises 4 executive directors, namely Mr. Wong Yiu Chu, Denny (being the chairman of the Board), Mr. Mak Chi Him, Mr. Tan Keng Boon and Ms. Tsui Kam Ling, Alice; and 3 independent non-executive directors, Dr. Yip Chak Lam, Peter, Mr. Cheong Chung Chin and Mr. Yu Man Woon. Details of each director are disclosed on pages 17 to 19 of this Annual Report.

During the year ended 31 December 2005, the Board at all times exceeded the minimum requirements of the GEM Listing Rules relating to the appointment of at least three independent non-executive directors, and complied with the requirement that these should include one such director with appropriate professional qualifications or accounting or related financial management expertise.

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

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

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

CORPORATE GOVERNANCE REPORT

BOARD OF DIRECTORS *(continued)*

The Company has held six meetings during the year ended 31 December 2005. Due notice and board papers were given to all directors prior to the meeting in accordance with the GEM Listing Rules and the Code. Details of individual attendance of directors are set out below:-

	Name of director	Attended/ Eligible to attend
Executive directors	Wong Yiu Chu, Denny (<i>Chairman</i>)	6/6
	Mak Chi Him ⁽¹⁾	6/6
	Tan Keng Boon	5/6
	Tsui Kam Ling, Alice ⁽¹⁾	6/6
Non-executive director	Wan Wah Tong, Thomas ⁽²⁾	2/4
Independent non-executive directors	Yip Chak Lam, Peter	6/6
	Cheong Chung Chin	4/6
	Yu Man Woon	6/6

Notes:

(1) Appointed on 23 March 2005

(2) Resigned on 24 October 2005

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

Ms. Tsui Kam Ling, Alice is the spouse of Mr. Wong Yiu Chu, Denny. Save as disclosed herein, there is no relationship (including financial, business, family or other material/relevant relationships) among members of the Board.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

The chairman of the Board is Mr. Wong Yiu Chu, Denny while the chief executive officer is Mr. Mak Chi Him. The chairman provides leadership for and overseeing the functioning of the Board; formulates overall strategies and policies of the Company; and overseeing the Group's operations. The chief executive officer manages the Group's business; implements major strategies; and makes day-to-day decision.

NON-EXECUTIVE DIRECTORS

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. Dr. Yip Chak Lam, Peter, Mr. Cheong Chung Chin and Mr. Yu Man Woon were re-appointed by the board of directors on 25 October 2005 for a term commencing from 25 October 2005 to 31 May 2006. Mr. Wan Wah Tong, Thomas resigned on 24 October 2005.

CORPORATE GOVERNANCE REPORT

REMUNERATION OF DIRECTORS

The remuneration committee makes recommendations to the Board on the Company's policy and structure for all remuneration of directors and senior management and on the establishment of a formal and transparent procedure for developing the policy on such remuneration. The remuneration of directors is determined according to their expertise, knowledge and contributions to the Group with reference to the Group's profitability and the prevailing market conditions. Details of the remuneration payable to the directors during the year are set out in note 15 on the financial statement.

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

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

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

Set out below is the summary of work performed by the remuneration committee during the year ended 31 December 2005:-

- (1) to determine the specific remunerations packages of all executive directors and senior management; and
- (2) to review and approve the compensation payable to executive directors in connection with their appointments.

NOMINATION OF DIRECTORS

The Board has not established a nomination committee. According to the Articles of Association of the Company, the Board has the power from time to time and at any time to appoint any person as a director either to fill a casual vacancy or as an addition to the Board. In assessing nomination of new directors, the Board has taken into consideration of nominee's qualification, ability and potential contribution to the Company. Mr. Mak Chi Him and Ms. Tsui Kam Ling, Alice were appointed as executive directors on 23 March 2005. Mr. Wong Yiu Chu, Denny ceased to act as the chief executive officer of the Company and Mr. Mak Chi Him was appointed as the chief executive officer with effect from 1 April 2005. Mr. Wan Wah Tong, Thomas resigned as the non-executive director on his own accord on 24 October 2005. Mr. Mak Chi Him resigned as the executive director and chief executive officer of the Company for personal reason with effect from 3 May 2006. Mr. Wong Yiu Chu, Denny is appointed as the chief executive officer of the Company with effect from 3 May 2006.

CORPORATE GOVERNANCE REPORT

NOMINATION OF DIRECTORS *(continued)*

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

	Name of director	Attended/ Eligible to attend
Executive directors	Wong Yiu Chu, Denny <i>(Chairman)</i>	3/3
	Mak Chi Him	3/3
	Tan Keng Boon	3/3
	Tsui Kam Ling, Alice	3/3
Non-executive director	Wan Wah Tong, Thomas	1/2
Independent non-executive directors	Yip Chak Lam, Peter	3/3
	Cheong Chung Chin	2/3
	Yu Man Woon	3/3

AUDITORS' REMUNERATION

For the year ended 31 December 2005, the fee payable to the auditors in respect of audit services amounted to HK\$267,000 while the fee payable to the auditors in respect of non-audit services relating to the taxation amounted to HK\$25,000.

AUDIT COMMITTEE

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

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

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

	Name of director	Attended/ Eligible to attend
Independent non-executive directors	Yu Man Woon <i>(Chairman)</i>	5/5
	Yip Chak Lam, Peter	5/5
	Cheong Chung Chin	4/5

CORPORATE GOVERNANCE REPORT

AUDIT COMMITTEE *(continued)*

Set out below is the summary of work performed by the audit committee during the year ended 31 December 2005:-

- (1) to make recommendation to the Board on the appointment and removal of the external auditor, and to approve the remuneration and terms of engagement of the external auditor, and any questions of resignation or dismissal of that auditor;
- (2) to monitor integrity of financial statements of the Company and the Company's annual report and accounts, interim report, and quarterly reports, and to review significant financial reporting judgments contained in them;
- (3) to review the Company's financial controls, internal controls and risk management systems; and
- (4) to discuss with the management the system of internal control and ensure that management has discharged its duty to have an effective internal control system.

ACCOUNTABILITY AND AUDIT

The directors acknowledged that it is their responsibility for preparing the accounts. A statement by the auditors about their reporting responsibilities is set out on page 39 of this Annual Report. There are no material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue as a going concern.

Pursuant to the provision C2.1 of the code, the Board should at least annually conduct a review of the effectiveness of the system of internal control of the Company and its subsidiaries and report to shareholders that they have done so in the Corporate Governance Report. Under the transitional arrangement, the said code provision C2.1 will be implemented for accounting periods commencing on or after 1 July 2005. The Company will conduct a review of its internal control system in Year 2006.

COMMUNICATION WITH SHAREHOLDERS

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

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

At the 2005 annual general meeting, a separate resolution was proposed by the chairman in respect of each separate issue, including re-election of directors. The chairman of the Board and audit committee attended the 2005 Annual General Meeting to answer questions of shareholders.

REPORT OF THE DIRECTORS

The directors submit herewith their annual report together with the audited financial statements for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The principal activities and other particulars of the subsidiaries are set out in note 17 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 8 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	13%	—
Five largest customers in aggregate	35%	—
The largest supplier	—	33%
Five largest suppliers in aggregate	—	58%

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

FINANCIAL STATEMENTS

The profit of the Group for the year ended 31 December 2005 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 40 to 81.

The directors do not recommend the payment of a dividend for the year ended 31 December 2005.

RESERVES

Profit for the year of HK\$196,000 (2004: Loss of HK\$13,994,000) has been transferred to reserves. Details of the movements in the reserves of the Group and the Company during the year are set out in note 27 on the financial statements.

REPORT OF THE DIRECTORS

PLANT AND EQUIPMENT

Details of the movements in plant and equipment of the Group are set out in note 16 on the financial statements.

SHARE CAPITAL AND SHARE OPTIONS

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

DIRECTORS

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

Executive Directors

Mr. Wong Yiu Chu, Denny

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

Mr. Tan Keng Boon

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

Non-executive Director

Mr. Wan Wah Tong, Thomas (resigned on 24 October 2005)

Independent Non-executive Directors

Dr. Yip Chak Lam, Peter

Mr. Cheong Chung Chin

Mr. Yu Man Woon

In accordance with Article 112 of the Company's Articles of Association, Mr. Tan Keng Boon, Dr. Yip Chak Lam, Peter and Mr. Cheong Chung Chin 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. Under the agreements, either party may terminate the agreement at any time by giving to the other not less than six months' prior written notice. Mr. Mak Chi Him 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 three months' prior written notice.

REPORT OF THE DIRECTORS

DIRECTORS' SERVICE CONTRACTS *(continued)*

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. Dr. Yip Chak Lam, Peter, Mr. Cheong Chung Chin and Mr. Yu Man Woon were re-appointed by the board of directors on 25 October 2005 for a term commencing from 25 October 2005 to 31 May 2006. Mr Wan Wah Tong, Thomas resigned on 24 October 2005.

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

At 31 December 2005, 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 2005
	Personal interests <i>(Note 1)</i>	Family interests	Corporate interests	Other interests		
Mr. Wong Yiu Chu, Denny <i>(Note 2)</i>	6,773,831	5,842,481	105,706,210	—	118,322,522	41.99%
Mr. Tan Keng Boon	2,285,893	—	—	—	2,285,893	0.81%
Ms. Tsui Kam Ling, Alice <i>(Note 3)</i>	5,842,481	112,480,041	—	—	118,322,522	41.99%

REPORT OF THE DIRECTORS

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

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

Notes:

- 1 The shares are registered under the names of the directors who are the beneficial owners.
- 2 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 5,842,481 shares are held by Ms. Tsui Kam Ling, Alice personally. Mr. Denny Wong is taken to be interested in these shares under the SFO.
- 3 Of these shares, 105,706,210 shares are held by D&A Holdings Limited 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 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.

Save as disclosed above, to the best knowledge of the directors of the Company, as at 31 December 2005, 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.

REPORT OF THE DIRECTORS

SHARE OPTION SCHEMES *(continued)*

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

(b) *Participants of the Plan*

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

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

The maximum number of shares in respect of which options may be granted under the Plan was 6,535,631 shares, which represents approximately 2.32% of the issued share capital as at 23 March 2006.

(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 2005, the consultants and employees of the Group had the following interests in options to subscribe for shares of the Company (market value per share at 30 December 2005 was HK\$0.093) with an exercise price of HK\$0.09 or HK\$0.24 per share under the Plan of the Company. The options are unlisted. Each option gives the holder the right to subscribe for one ordinary share of HK\$0.10 each of the Company.

Grantees	Date granted	Number of share options				Balance as at 31 December 2005	Period during which the options are exercisable	Exercise price per share	Percentage of the Company's issued share capital as at 31 December 2005
		Balance as at 1 January 2005	Granted during the year	Exercised during the year	Lapsed during the year				
Consultants & Employees	27 October 2003	1,521,745	—	—	—	1,521,745 (Note 1, 2)	10 May 2004 to 24 July 2010	HK\$0.09	0.54%
Employees	27 October 2003	862	—	—	—	862 (Note 2)	10 May 2004 to 27 December 2010	HK\$0.09	0.01%
	27 October 2003	1,291,114	—	—	190,165 (Note 4)	1,100,949 (Note 3)	10 May 2004 to 20 January 2013	HK\$0.24	0.39%
		<u>2,813,721</u>	<u>—</u>	<u>—</u>	<u>190,165</u>	<u>2,623,556</u>			

REPORT OF THE DIRECTORS

SHARE OPTION SCHEMES *(continued)*

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

Notes:

- 1 1,201,034 share options were granted to a consultant of the Group. All other options were granted to employees of the Group.
- 2 The options vested and were exercisable on 10 May 2004, which was 6 months after the listing date of the Company.
- 3 The options vested and were exercisable in three tranches as follows:
 - (a) one-third of the options vested and were exercisable on 10 May 2004;
 - (b) a further one-third of the options vested and were exercisable on 31 December 2004; and
 - (c) the remaining one-third of the options vested and were exercisable on 31 December 2005.
- 4 The options lapsed upon the resignation of 4 participants from the Group.
- 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.

REPORT OF THE DIRECTORS

SHARE OPTION SCHEMES *(continued)*

(ii) Share Option Scheme *(continued)*

(h) Remaining life of the Scheme

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

DIRECTORS' RIGHTS TO ACQUIRE SHARES

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

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

In addition to the interests disclosed under the section "Directors' and chief executive's interests and short positions in shares, underlying shares and debentures" above, the Company has been notified of the following interests in the Company's issued shares at 31 December 2005 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 2005
D & A Holdings Limited	Beneficial owner	105,706,210 Shares (L)	37.51%
Proway Investment Limited <i>(Note 2)</i>	Beneficial owner	31,740,305 Shares (L)	11.26%
Morningside CyberVentures Holdings Limited <i>(Note 2)</i>	Other	31,740,305 Shares (L)	11.26%
Biswick Holdings Limited <i>(Note 2)</i>	Other	31,740,305 Shares (L)	11.26%
Verrall Enterprises Holdings Limited <i>(Note 2)</i>	Other	31,740,305 Shares (L)	11.26%
Verrall Limited <i>(Note 2)</i>	Other	31,740,305 Shares (L)	11.26%
Madam Chan Tan Ching Fen <i>(Note 2)</i>	Other	31,740,305 Shares (L)	11.26%
Mr. Wan Wah Tong, Thomas <i>(Note 3)</i>	Other	17,615,162 Shares (L)	6.25%
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 Proway Investment Limited is wholly owned by Morningside CyberVentures Holdings Limited. Morningside CyberVentures Holdings Limited is wholly owned by Biswick Holdings Limited in its capacity as trustee of a unit trust the units of which are owned by Verrall Enterprises Holdings Limited and Verrall Limited in their capacities as trustees of family trusts established by Madam Chan Tan Ching Fen. Madam Chan Tan Ching Fen is taken to be interested in the shares disclosed herein in her capacity as founder of the trust (as that term is defined in the SFO).
- 3 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 the Shares held by Thomrose Holdings (BVI) Limited under the SFO.

Save as disclosed above, as at 31 December 2005 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

The Company's new business line is in direct competition with that of Mr. Wan Wah Tong, Thomas' private company in terms of product features and target customers. Mr. Wan Wah Tong, Thomas was a non-executive director of the Company who resigned on 24 October 2005.

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

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

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

REPORT OF THE DIRECTORS

BANK LOANS AND OTHER BORROWINGS

The Company and its subsidiaries had no bank loans and other borrowings during the year.

FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group is set out on page 82 of the annual report.

REMUNERATION POLICIES

Remuneration policies and packages for the Group's employees are based on individual qualifications, performance, experience and conditions prevailing in the industry. In addition, various training sessions are offered to employees to enhance their product and market knowledge. The remuneration of directors is determined according to their expertise, knowledge and contributions to the Group with reference to the Group's profitability and the prevailing market conditions. The Group has also adopted share option schemes under which the directors and employees of the Group may be granted share options to subscribe for shares in the Company for the purposes of recognising their contributions to the Group.

RETIREMENT SCHEMES

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. Pursuant to the relevant regulations of the Peoples' Republic of China (the "PRC"), the subsidiary operating in the PRC has participated in a local municipal government retirement benefits scheme (the "Scheme"), whereby the PRC subsidiary is required to contribute a certain percentage of the basic salaries of their employees to the Scheme to fund their retirement benefits. The local municipal government undertakes to assume the retirement benefits obligations of all existing and future retired employees of the PRC subsidiary. The only obligation of the Group with respect to the Scheme is to pay the ongoing required contributions under the Scheme mentioned above. The Company's subsidiary operating in the Philippines participates in the mandatory Social Security System contribution scheme ("SSS Scheme") as prescribed by the Philippine law. Pursuant to the rules of the SSS Scheme, the Group and the employees are required to make monthly contributions to the scheme fixed at 9.4% of their relevant monthly income (6.07% for employer and 3.33% for employee), up to PHP910 per month for employer and PHP500 for employee. Contributions of the Group to the MPF Scheme, the Scheme and the SSS Scheme are charged to the income statement as incurred. During the year, the retirement scheme contributions borne by the Group amounted to HK\$422,000 (2004: HK\$386,000).

REPORT OF THE DIRECTORS

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 2005 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.

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 2005.

AUDITORS

During the year, KPMG resigned as auditors of the Company and Grant Thornton were appointed to fill the casual vacancy in the office of auditors of the Company.

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

By order of the Board

WONG Yiu Chu, Denny

Chairman

Hong Kong, 23 March 2006

AUDITORS' REPORT

To the members of Advanced Card Systems Holdings Limited

(incorporated in the Cayman Islands with limited liability)

We have audited the financial statements on pages 40 to 81 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.

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 Hong Kong Standards on Auditing 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, 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 2005 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Grant Thornton

Certified Public Accountants

Hong Kong, 23 March 2006

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2005

	Notes	2005 HK\$'000	2004 HK\$'000
Revenue	6	38,853	24,369
Cost of sales		<u>(21,808)</u>	<u>(14,243)</u>
Gross profit		17,045	10,126
Other operating income	6	1,163	145
Other net loss	7	(153)	(39)
Staff costs	14	(10,852)	(8,910)
Depreciation		(869)	(711)
Amortisation of development costs		(1,189)	(2,157)
Impairment loss on development costs		(409)	(4,950)
Other operating expenses		<u>(6,729)</u>	<u>(7,371)</u>
Operating loss		(1,993)	(13,867)
Finance costs	9.1	<u>(149)</u>	<u>(127)</u>
Loss before income tax	9	(2,142)	(13,994)
Income tax credit	10	<u>2,338</u>	<u>—</u>
Profit/(Loss) for the year	11	<u>196</u>	<u>(13,994)</u>
Earnings/(Loss) per share	13		
— Basic		<u>HK0.07cent</u>	<u>HK(4.98cent)</u>
— Diluted		<u>N/A</u>	<u>N/A</u>

CONSOLIDATED BALANCE SHEET

As at 31 December 2005

	<i>Notes</i>	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
ASSETS AND LIABILITIES			
Non-current assets			
Plant and equipment	16	2,151	1,625
Development costs	18	8,148	6,220
Deferred tax assets	24	3,952	1,614
		<u>14,251</u>	<u>9,459</u>
Current assets			
Inventories	19	9,047	7,341
Trade and other receivables, deposits paid and prepayments	20	6,103	5,398
Pledged bank deposit	21	691	—
Cash and cash equivalents	22	6,390	13,103
		<u>22,231</u>	<u>25,842</u>
Current liabilities			
Trade and other payables, deposits received and accruals	23	6,130	5,145
Net current assets		<u>16,101</u>	<u>20,697</u>
Total assets less current liabilities		<u><u>30,352</u></u>	<u><u>30,156</u></u>
EQUITY			
Share capital	25	28,180	28,180
Reserves	27	2,172	1,976
Total equity		<u><u>30,352</u></u>	<u><u>30,156</u></u>

WONG Yiu Chu, Denny
Director

TAN Keng Boon
Director

BALANCE SHEET

As at 31 December 2005

	<i>Notes</i>	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
ASSETS AND LIABILITIES			
Non-current assets			
Interests in and amounts due from subsidiaries	17	<u>44,707</u>	<u>38,948</u>
Current assets			
Other receivables, deposits paid and prepayments	20	270	620
Cash and cash equivalents	22	<u>3,473</u>	<u>11,009</u>
		<u>3,743</u>	<u>11,629</u>
Current liability			
Accruals		<u>262</u>	<u>256</u>
Net current assets		<u>3,481</u>	<u>11,373</u>
Total assets less current liability		<u><u>48,188</u></u>	<u><u>50,321</u></u>
EQUITY			
Share capital	25	28,180	28,180
Reserves	27	<u>20,008</u>	<u>22,141</u>
Total equity		<u><u>48,188</u></u>	<u><u>50,321</u></u>

WONG Yiu Chu, Denny
Director

TAN Keng Boon
Director

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2005

	<i>Notes</i>	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Cash flows from operating activities			
Loss before income tax		(2,142)	(13,994)
Adjustments for :			
Depreciation		869	711
Amortisation of development costs		1,189	2,157
Impairment loss on development costs		409	4,950
Finance costs	9.1	149	127
Interest income	6	(231)	(95)
Loss on disposal of plant and equipment	7	33	32
		<hr/>	<hr/>
Operating profit/(loss) before working capital changes		276	(6,112)
Increase in inventories		(1,706)	(1,603)
(Increase)/Decrease in trade and other receivables, deposits paid and prepayments		(713)	7,977
Increase/(Decrease) in trade and other payables, deposits received and accruals		985	(2,966)
		<hr/>	<hr/>
Net cash used in operating activities		(1,158)	(2,704)
Cash flows from investing activities			
Purchase of plant and equipment		(1,451)	(1,536)
Proceeds from disposal of plant and equipment		23	—
Development costs capitalised		(3,526)	(4,229)
Interest received		239	81
		<hr/>	<hr/>
Net cash used in investing activities		(4,715)	(5,684)
Cash flows from financing activities			
Finance costs paid		(149)	(127)
Proceeds on issue of shares upon exercise of share options		—	162
Increase in pledged bank deposit		(691)	—
		<hr/>	<hr/>
Net cash (used in)/generated from financing activities		(840)	35
Net decrease in cash and cash equivalents		(6,713)	(8,353)
Cash and cash equivalents at 1 January		13,103	21,456
		<hr/>	<hr/>
Cash and cash equivalents at 31 December		<u>6,390</u>	<u>13,103</u>

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2005

	Share capital <i>HK\$'000</i>	Share premium <i>HK\$'000</i>	Merger reserve <i>HK\$'000</i>	Accumulated losses <i>HK\$'000</i>	Total equity <i>HK\$'000</i>
At 1 January 2004	28,000	24,351	4,496	(12,859)	43,988
Loss for the year	—	—	—	(13,994)	(13,994)
Total recognised income and expense for the year	—	—	—	(13,994)	(13,994)
Shares issued upon conversion of share options (<i>note 25</i>)	180	(18)	—	—	162
At 31 December 2004 and at 1 January 2005	28,180	24,333	4,496	(26,853)	30,156
Profit for the year	—	—	—	196	196
Total recognised income and expense for the year	—	—	—	196	196
At 31 December 2005	28,180	24,333	4,496	(26,657)	30,352

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

1. GENERAL INFORMATION

The Company was incorporated in the Cayman Islands on 13 April 2000 as an exempted company with limited liability under the Companies Law (Revised) of the Cayman Islands. The Company's shares are listed on The Growth Enterprise Market of The Stock Exchange of Hong Kong Limited ("GEM").

2. NATURE OF OPERATIONS

Principal activities of Advanced Card Systems Holdings Limited (the "Company") and its subsidiaries (the "Group") include the development, sale and distribution of smart card products, software and hardware and the provision of smart card related services to customers.

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS") as issued by the Hong Kong Institute of Certified Public Accountants, the disclosure requirements of the Hong Kong Companies Ordinance and the Rules Governing the Listing of Securities on the GEM ("GEM Listing Rules").

The financial statements for the year ended 31 December 2005 were approved by the board of directors on 23 March 2006.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

3. ADOPTION OF NEW OR REVISED HKFRS

From 1 January 2005, the Group has adopted the new or revised standards and interpretations of HKFRS which are effective for accounting periods beginning on or after 1 January 2005 for the preparation of these financial statements. The following HKFRS which are relevant to the Group's operations:

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKFRS 2	Share-based Payment

All the standards have been applied retrospectively except where specific transitional provisions require a different treatment.

3.1 Adoption of HKFRS 2

Prior to the adoption of HKFRS 2 on 1 January 2005, equity-settled share-based payment transactions were treated as changes in the entity's equity only upon execution. HKFRS 2 requires all goods and services received in the course of share-based payment transactions to be measured at fair value and recognised in the financial statements with a corresponding credit to equity, unless the transaction is settled in cash. When applied to employee share-based compensation, this leads to the recognition of share options which have been granted and are expected to vest as an expense in the income statement.

According to the transitional provisions of HKFRS 2, all equity-settled share-based payments granted after 7 November 2002 that had not vested at 1 January 2005 are required to be recognised retrospectively in the Group's financial statements.

The adoption of this HKFRS 2 had no significant impact on the Group's financial results for the years ended 31 December 2004 and 2005.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

3. ADOPTION OF NEW OR REVISED HKFRS *(continued)*

3.2 Other standards adopted *(continued)*

The adoption of the other HKFRS did not result in any significant changes to the Group's accounting policies. The specific transitional provisions contained in some of these standards were considered. The adoption of these other standards did not result in any changes to the amounts or disclosures in these financial statements and the 2004 financial statements.

3.3 New standards or interpretations that have been issued but are not yet effective

The Group has not early adopted the following standards or interpretations that have been issued but are not yet effective. The directors of the Company anticipate that the application of these standards and interpretations will have no material impact on the financial statements of the Group.

HKAS 1 (Amendment)	Capital Disclosures ¹
HKAS 19 (Amendment)	Employee Benefits - Actuarial Gains and Losses, Group Plans and Disclosures ²
HKAS 21 (Amendment)	The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation ²
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions ²
HKAS 39 (Amendment)	The Fair Value Option ²
HKAS 39 & HKFRS 4 (Amendment)	Financial Instrument's : Recognition and Measurement and Insurance Contracts - Financial Guarantee Contracts ²
HKFRS 6	Exploration for and Evaluation of Mineral Resources ²
HKFRS 7	Financial Instruments : Disclosures ¹
HK(IFRIC) - Int 4	Determining whether an Arrangement contains A Lease ²
HK(IFRIC) - Int 5	Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds ²
HK(IFRIC) - Int 6	Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment ³
HK(IFRIC) - Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies ⁴

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

² Effective for annual periods beginning on or after 1 January 2006

³ Effective for annual periods beginning on or after 1 December 2005

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

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

4. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

4.1 Basis of preparation

The principal accounting policies that have been used in the preparation of these consolidated financial statements are summarised below. The financial statements have been prepared on the historical cost basis except for certain financial assets and liabilities. The measurement bases are fully described in the accounting policies below.

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

4.2 Basis of consolidation

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

4.3 Subsidiaries

Subsidiaries are all entities over which the Company has the power to control the financial and operating policies. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

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

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

4. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES *(continued)*

4.4 Foreign currency translation

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

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

In the consolidated financial statements, all separate financial statements of subsidiaries, originally presented in a currency different from the Group's presentation currency, have been converted into Hong Kong dollars. Assets and liabilities have been translated into Hong Kong dollars at the closing rate at the balance sheet date. Income and expenses have been converted into the Group's presentation currency at the average rates over the reporting period. Any differences arising from this procedure have been charged/ (credited) to the currency translation reserve in equity.

4.5 Income and expense recognition

Revenue comprises the fair value of the sale of goods and services, net of rebates and discounts and after eliminating sales within the Group. Revenue is recognised as follows:

Sales of goods are recognised upon transfer of risk to the customer and collectibility of the related receivables is reasonably assured.

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

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

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

Operating expenses are recognised in the income statement upon utilisation of the service.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

4. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES *(continued)*

4.6 Research and development costs

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

- (i) demonstration of technical feasibility of the prospective product for internal use or sale
- (ii) the intangible asset will generate probable economic benefits through internal use or sale
- (iii) sufficient technical, financial and other resources are available for completion
- (iv) the intangible asset can be reliably measured

Direct costs include employee costs incurred on product development along with an appropriate portion of relevant overheads. Development costs are stated at cost less subsequent accumulated amortisation and any accumulated impairment loss. Development costs capitalised are amortised to the consolidated income statement using the straight-line basis over their estimated useful lives of four years, commencing from the date on which the related products are put into commercial production. However, until completion of the development project, the assets are subject to impairment testing only as described below in note 4.8.

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

4.7 Plant and equipment

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

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

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

4. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES *(continued)*

4.7 Plant and equipment *(continued)*

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

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

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

4.8 Impairment of assets

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

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). As a result, some assets are tested individually for impairment and some are tested at cash-generating unit level.

Individual assets or cash-generating units, that include intangible assets that are not yet available for use, are tested for impairment at least annually irrespective of whether there is any indications of impairment. All other individual assets or cash-generating units are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value, reflecting market conditions less costs to sell and value in use, based on an internal discounted cash flow evaluation. An impairment loss is reversed if there has been a change in the estimates used to determine the asset's recoverable amount and only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation if no impairment loss had been recognised.

4.9 Leases

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

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

4. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES *(continued)*

4.10 Financial assets

The Group's financial assets primarily comprise of trade and other receivables and deposits paid, which are recognised on their settlement date. Trade and other receivables and deposits paid are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arose when the Group provides money, goods or services directly to a debtor with no intention of trading the receivables. They are initially recognised at fair value and subsequently measured at amortised cost using the effective interest method.

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

4.11 Inventories

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

4.12 Accounting for income taxes

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

Deferred income taxes are calculated using the liability method on temporary differences. This involves the comparison of the carrying amounts of assets and liabilities in the consolidated financial statements with their respective tax bases. In addition, tax losses available to be carried forward as well as other income tax credits to the Group are assessed for recognition as deferred tax assets.

Deferred tax liabilities are provided for in full. Deferred tax assets are recognised to the extent that it is probable that they will be able to be offset against future taxable income. Deferred tax assets and liabilities are calculated, without discounting, at tax rates that are expected to apply to their respective period of realisation, provided they are enacted or substantively enacted at the balance sheet date.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

4. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES *(continued)*

4.12 Accounting for income taxes *(continued)*

Most changes in deferred tax assets or liabilities are recognised as a component of income tax expense in the income statement.

4.13 Cash and cash equivalents

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

4.14 Share Capital

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

Any transaction costs associated with the issuing of shares are deducted from equity (net of any related income tax benefits) to the extent they are incremental costs directly attributable to the equity transaction.

4.15 Pension obligations and short term employee benefits

The Group has participated in a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") for its employees in Hong Kong who are eligible to participate in the MPF Scheme, in accordance with the Mandatory Provident Fund Schemes Ordinance. Contributions are made based on a percentage of the employees' basic salaries and MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group.

Pursuant to the relevant regulations of the Peoples' Republic of China (the "PRC"), the subsidiary operating in the PRC has participated in a local municipal government retirement benefits scheme (the "Scheme"), whereby the PRC subsidiary is required to contribute a certain percentage of the basic salaries of their employees to the Scheme to fund their retirement benefits. The local municipal government undertakes to assume the retirement benefits obligations of all existing and future retired employees of the PRC subsidiary. The only obligation of the Group with respect to the Scheme is to pay the ongoing required contributions under the Scheme mentioned above. There are no provisions under the Scheme whereby forfeited contributions may be used to reduce future contributions.

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

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

4. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES *(continued)*

4.15 Pension obligations and short term employee benefits *(continued)*

Contributions of the Group to the MPF Scheme, the Scheme and the SSS Scheme are charged to the income statement as incurred.

Short-term employee benefits are recognised for the number of paid leave days (usually holiday entitlement) remaining at the balance sheet date. They are included in accruals at the undiscounted amount that the Group expects to pay as a result of the unused entitlement.

4.16 Share-based employee compensation

All share-based payment arrangements granted after 7 November 2002 are recognised in the consolidated financial statements. The Group operates equity-settled share-based compensation plans for remuneration of its employees.

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

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

Upon exercise of share options, the proceeds received net of any directly attributable transaction costs up to the nominal value of the share issued are reallocated to share capital with any excess being recorded as share premium.

4.17 Financial liabilities

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

The Group's financial liabilities primarily consist of trade and other payables, deposits received and accruals.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

4. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES *(continued)*

4.18 Provisions

Provisions are recognised when present obligations will probably lead to an outflow of economic resources from the Group which can be estimated reliably. Timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events. Restructuring provisions are recognised only if a detailed formal plan for the restructuring has been developed and implemented, or management has at least announced the plan's main features to those affected by it. Provisions are not recognised for future operating losses.

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

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

4.19 Segment reporting

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

Unallocated costs represent corporate expenses. Segment assets consist primarily of intangible assets, plant and equipment, inventories, receivables and operating cash. Segment liabilities comprise operating liabilities.

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

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

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

4. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES *(continued)*

4.20 Related parties

Parties are considered to be related to the Group if:

- (i) directly, or indirectly through one or more intermediaries, the party:
 - controls, is controlled by, or is under common control with, the Group;
 - has an interest in the Group that gives it significant influence over the Group;
 - has joint control over the Group;
- (ii) the party is a jointly-controlled entity;
- (iii) the party is an associate;
- (iv) the party is a member of the key management personnel of the Group or its parent;
- (v) the party is a close member of the family of any individual referred to (i) or (iv);
- (vi) the party is an entity that is controlled, jointly-controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (iv) or (v); or
- (vii) the party is a post-employment benefit plan for the benefit of employees of the Group, or of any entity that is a related party of the Group.

5. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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

Critical judgements in applying the Company's accounting policies

5.1 Research and development activities

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

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

5. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS *(continued)*

5.2 Impairment of receivables

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

6. REVENUE AND OTHER OPERATING INCOME

Revenue represents turnover which comprises total invoiced value of goods supplied and services rendered. Revenue and other operating income recognised during the year are as follows:

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Revenue/Turnover		
Sale of smart card products, software and hardware	38,125	22,877
Smart card related services	728	1,492
	<u>38,853</u>	<u>24,369</u>
Other operating income		
Interest income	231	95
Forfeiture of deposit	211	—
Government grants received	707	—
Sundry income	14	50
	<u>1,163</u>	<u>145</u>

7. OTHER NET LOSS

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Net foreign exchange loss	120	7
Loss on disposal of plant and equipment	33	32
	<u>153</u>	<u>39</u>

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

8. SEGMENT INFORMATION

Primary reporting format - business segments

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

Year ended 31 December 2005

	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>
Revenue	38,125	728	38,853
Segment result and operating (loss)/profit	(2,721)	728	(1,993)
Finance costs			(149)
Segment result and loss before income tax			(2,142)
Income tax credit			2,338
Profit for the year			196
Capital expenditure	4,977	—	4,977
Depreciation and amortisation	2,058	—	2,058
Impairment loss on development costs	409	—	409
Non-cash expenses other than depreciation and amortisation	488	—	488

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

8. SEGMENT INFORMATION *(continued)*

Primary reporting format - business segments *(continued)*

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>
Revenue	22,877	1,492	24,369
Segment result and operating (loss)/profit	(15,359)	1,492	(13,867)
Finance costs			(127)
Segment result and loss before income tax			(13,994)
Income tax credit			—
Loss for the year			(13,994)
Capital expenditure	5,765	—	5,765
Depreciation and amortisation	2,868	—	2,868
Impairment loss on development costs	4,950	—	4,950
Non-cash expenses other than depreciation and amortisation	1,600	—	1,600

Over 90% of the segment assets and liabilities are attributable to the segment of "Development, sale and distribution of smart card products, software and hardware" and, accordingly, no segmental analysis of the Group's assets, liabilities and capital expenditure is presented.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

8. SEGMENT INFORMATION *(continued)*

Secondary reporting format - geographical segments

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

Sales revenue by geographical markets:

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
The Americas	4,433	2,453
Asia Pacific	15,424	8,340
Europe, Middle East and Africa	18,996	13,576
	<u>38,853</u>	<u>24,369</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.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

9. LOSS BEFORE INCOME TAX

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Loss before income tax is arrived at after charging/(crediting):		
9.1 Finance costs:		
Bank charges	<u>149</u>	<u>127</u>
9.2 Other items:		
Cost of inventories recognised as expense	20,601	13,552
Reversal of write-down of inventories (<i>note 19</i>)	—	(27)
Write-down of inventories to net realisable value	355	—
Impairment of trade receivables	46	1,315
Write-back of impairment of trade receivables	(164)	—
Write-off of bad debts	87	285
Auditors' remuneration	267	354
Operating lease charges on land and buildings	1,890	1,747
Less: Amount included in research and development costs	<u>(226)</u>	<u>(271)</u>
	<u>1,664</u>	<u>1,476</u>

9.3 Research and development costs:

Research and development costs amounting to HK\$4,821,000 (2004: HK\$5,504,000) for the year have been calculated to the extent that staff costs and direct overheads can be allocated by management on a reasonable basis to research and development activities. Included in the total costs of HK\$4,821,000 (2004: HK\$5,504,000) were amounts of HK\$3,526,000 (2004: HK\$4,229,000) capitalised during the year (*note 18*).

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

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

10. INCOME TAX CREDIT

No provision for Hong Kong profits tax has been made in the financial statements as a subsidiary of the Group has losses brought forward from previous years to offset against its current year's assessable profits and the Company and other subsidiaries sustained losses for taxation purposes for the year ended 31 December 2005. No provision for Hong Kong profits tax has been made by the Group as it sustained a loss for taxation purpose for the year ended 31 December 2004.

No provision for overseas taxation has been made as no assessable profits arose from the operations in the PRC and Philippines during the year ended 31 December 2005 (2004: Nil).

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Deferred tax		
Current year	(2,338)	—
Income tax credit	(2,338)	—

Reconciliation between income tax credit and accounting loss at applicable tax rates:

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Loss before income tax	(2,142)	(13,994)
Tax on loss before income tax, calculated at the rates applicable to profits in the tax jurisdiction concerned	(345)	(2,492)
Tax effect of non-deductible expenses	306	1,412
Tax effect of non-taxable revenue	(67)	(35)
Tax effect of unused tax losses not recognised	505	1,115
Tax effect of prior years' deferred tax recognised during the current year	(2,737)	—
Income tax credit	(2,338)	—

11. PROFIT/(LOSS) FOR THE YEAR

Of the consolidated profit for the year of approximately HK\$196,000 (2004: loss of approximately HK\$13,994,000), a loss of approximately HK\$2,133,000 (2004: loss of approximately HK\$1,616,000) has been dealt with in the financial statements of the Company.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

12. DIVIDENDS

The Company had not declared or paid any dividends during the year ended 31 December 2005 (2004: Nil).

13. EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings per share (2004: loss per share) is based on the profit for the year of approximately HK\$196,000 (2004: loss of approximately HK\$13,994,000) and the weighted average of 281,800,255 (2004: 281,126,389) ordinary shares in issue during the year.

Diluted earnings per share for the year ended 31 December 2005 was not presented because the exercise prices of the outstanding options exceeded the average market price of ordinary shares during the year. Diluted loss per share for the year ended 31 December 2004 was not presented because the impact of the exercise of the share options were anti-dilutive.

14. EMPLOYEE BENEFIT EXPENSE (including directors' emoluments)

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Salaries and benefits	13,432	11,987
Pension costs – defined contribution plans	422	386
	<hr/>	<hr/>
Total staff costs	13,854	12,373
Less: Amounts capitalised in development costs	(3,002)	(3,463)
	<hr/>	<hr/>
Staff costs (after amount capitalised)	<u>10,852</u>	<u>8,910</u>

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

15. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS' EMOLUMENTS

15.1 Directors' emoluments - Executive directors and non-executive directors

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

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

15. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS' EMOLUMENTS

(continued)

15.1 Directors' emoluments - Executive directors and non-executive directors (continued)

	Fees <i>HK\$'000</i>	Salaries, housing and other allowances and benefits in kind <i>HK\$'000</i>	Contribution to defined contribution plans <i>HK\$'000</i>	Total <i>HK\$'000</i>
Year ended 31 December 2004				
Executive directors				
Mr Wong Yiu Chu, Denny	—	1,248	12	1,260
Mr Pang Wang Kee, Lawrence ***	—	440	11	451
Mr Tan Keng Boon	—	691	12	703
Non executive director				
Mr Wan Wah Tong, Thomas	180	—	—	180
Independent non executive directors				
Dr Yip Chak Lam, Peter	180	—	—	180
Mr Cheong Chung Chin	180	—	—	180
Mr Yu Man Woon*	46	—	—	46
	<u>586</u>	<u>2,379</u>	<u>35</u>	<u>3,000</u>

* newly appointed during the year

** resigned during the year ended 31 December 2005

*** resigned during the year ended 31 December 2004

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

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

15. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID INDIVIDUALS' EMOLUMENTS

(continued)

15.2 Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year included four (2004: three) directors whose emoluments are reflected in the analysis presented above. As two members of staff were newly appointed as directors during the year ended 31 December 2005, the total emoluments payable to them, including their emoluments earned before they became directors, together with the emoluments payable to the remaining one (2004: two) individual during the year are as follows:

	2005 HK\$'000	2004 HK\$'000
Basic salaries, housing and other allowances and benefits in kind	1,888	1,230
Bonuses	42	—
Contributions to defined contribution plans	36	21
	<u>1,966</u>	<u>1,251</u>

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

	2005	2004
Nil - HK\$1,000,000	<u>3</u>	<u>2</u>

No emoluments were paid by the Group to the directors and the remaining one (2004: two) highest paid individual as an inducement to join or upon joining the Group. No director waived any emoluments during the years ended 31 December 2004 and 2005.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

16. PLANT AND EQUIPMENT – GROUP

	Leasehold Improvements <i>HK\$'000</i>	Furniture and fixtures <i>HK\$'000</i>	Computer and office equipment <i>HK\$'000</i>	Moulds <i>HK\$'000</i>	Total <i>HK\$'000</i>
At 1 January 2004					
Cost	98	337	1,958	790	3,183
Accumulated depreciation	(74)	(208)	(1,633)	(436)	(2,351)
Net book amount	<u>24</u>	<u>129</u>	<u>325</u>	<u>354</u>	<u>832</u>
Year ended 31 December 2004					
Opening net book amount	24	129	325	354	832
Additions	378	60	871	227	1,536
Disposals	(22)	(3)	(7)	—	(32)
Depreciation	(191)	(46)	(303)	(171)	(711)
Closing net book amount	<u>189</u>	<u>140</u>	<u>886</u>	<u>410</u>	<u>1,625</u>
At 31 December 2004					
Cost	378	242	2,386	1,017	4,023
Accumulated depreciation	(189)	(102)	(1,500)	(607)	(2,398)
Net book amount	<u>189</u>	<u>140</u>	<u>886</u>	<u>410</u>	<u>1,625</u>
Year ended 31 December 2005					
Opening net book amount	189	140	886	410	1,625
Additions	507	177	494	273	1,451
Disposals	(30)	(5)	(21)	—	(56)
Depreciation	(215)	(67)	(379)	(208)	(869)
Closing net book amount	<u>451</u>	<u>245</u>	<u>980</u>	<u>475</u>	<u>2,151</u>
At 31 December 2005					
Cost	527	410	2,821	1,290	5,048
Accumulated depreciation	(76)	(165)	(1,841)	(815)	(2,897)
Net book amount	<u>451</u>	<u>245</u>	<u>980</u>	<u>475</u>	<u>2,151</u>

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

17. INTERESTS IN AND AMOUNTS DUE FROM SUBSIDIARIES - COMPANY

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Unlisted shares, at cost	14,004	14,004
Amounts due from subsidiaries	30,703	24,944
	<u>44,707</u>	<u>38,948</u>

No provision has been made for impairment loss in the value of the interests in subsidiaries as the directors did not consider that there was any impairment loss at 31 December 2005 (2004: Nil).

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

During the year, the directors reviewed the carrying value of the amounts due from subsidiaries with reference to the business operated by the subsidiaries. In view of the current economic condition, no impairment loss (2004: Nil) has been identified and recognised in the Company's income statement.

Particulars of the subsidiaries at 31 December 2005 are as follows:

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

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

17. INTERESTS IN AND AMOUNTS DUE FROM SUBSIDIARIES - COMPANY *(continued)*

Name	Place/ country of incorporation and kind of legal entity	Particulars of issued capital/ registered capital	Percentage of issued capital/ registered capital held by the Company	Principal activities and place of operations
ACS Technologies Limited	Hong Kong, limited liability company	1 ordinary share of HK\$1 each	100%	Development, sale and distribution of smart card products, software and hardware and the provision of smart card related services in Hong Kong and the Philippines
ACS Technologies (Shenzhen) Limited	The PRC, wholly foreign owned enterprise	HK\$1.5 million	100%	Development of smart card products, software and hardware and the provision of smart card related services in the PRC

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

18. DEVELOPMENT COSTS – GROUP

	HK\$'000
2004	
Carrying amount at 1 January 2004	9,098
Capitalised during the year	4,229
Amortisation charge	(2,157)
Impairment loss	(4,950)
	<u>6,220</u>
Carrying amount at 31 December 2004	<u><u>6,220</u></u>
At 31 December 2004	
Gross carrying amount	15,991
Accumulated amortisation and impairment losses	(9,771)
	<u>6,220</u>
Carrying amount	<u><u>6,220</u></u>
2005	
Carrying amount at 1 January 2005	6,220
Capitalised during the year	3,526
Amortisation charge	(1,189)
Impairment loss	(409)
	<u>8,148</u>
Carrying amount at 31 December 2005	<u><u>8,148</u></u>
At 31 December 2005	
Gross carrying amount	19,517
Accumulated amortisation and impairment losses	(11,369)
	<u>8,148</u>
Carrying amount	<u><u>8,148</u></u>

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 HK\$409,000 (2004: HK\$4,950,000).

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

19. INVENTORIES - GROUP

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Raw materials	6,839	5,798
Work in progress	63	121
Finished goods	2,145	1,422
	<u>9,047</u>	<u>7,341</u>

During the year ended 31 December 2004, the Group reversed HK\$27,000 being part of inventory write down made in 2003 that was subsequently not required because of an increase in the estimated net realisable value of certain smart card products as a result of a change in consumer preferences. No such reversal made during the year ended 31 December 2005.

20. TRADE AND OTHER RECEIVABLES, DEPOSITS PAID AND PREPAYMENTS

	The Group		The Company	
	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Trade receivables	6,239	5,607	—	—
Less: Impairment of receivables	(1,197)	(1,315)	—	—
Trade receivables — net	5,042	4,292	—	—
Other receivables	120	43	56	14
Deposits paid	467	631	—	468
Prepayments	474	432	214	138
	<u>6,103</u>	<u>5,398</u>	<u>270</u>	<u>620</u>

As at 31 December 2005, the amount of other receivables, deposits paid and prepayments expected to be recovered after more than one year was HK\$383,000 (2004: HK\$527,000).

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

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

Customers are generally granted credit terms of 30 to 60 days. At 31 December 2005, the ageing analysis of the net trade receivables was as follows:

	The Group	
	2005	2004
	HK\$'000	HK\$'000
0-30 days	4,577	2,644
31-60 days	143	371
61-90 days	37	72
Over 90 days	285	1,205
	<u>5,042</u>	<u>4,292</u>

The Group has recognised a loss of HK\$46,000 (2004: HK\$1,315,000) for the impairment of its trade receivables during the year ended 31 December 2005. The loss has been included in other operating expenses in the income statement.

21. PLEDGED BANK DEPOSIT – GROUP

As at 31 December 2005, the Group pledged a deposit of HK\$691,000 (2004: Nil) to a bank for the bank to issue a performance bond to a customer.

The interest rate of the deposit was ranged from 2.3% to 2.75% (2004: Nil). It has a maturity of one month.

22. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include the following components:

	The Group		The Company	
	2005	2004	2005	2004
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Short-term bank deposits	2,730	9,360	2,730	9,360
Cash at bank and in hand	3,660	3,743	743	1,649
	<u>6,390</u>	<u>13,103</u>	<u>3,473</u>	<u>11,009</u>

The interest rate of short-term bank deposits was ranged from 2.1% to 4.14% (2004: 0.85% to 2.1%). They have a maturity of one month and are eligible for immediate cancellation without receiving any interest for the last deposit period.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

22. CASH AND CASH EQUIVALENTS *(continued)*

Included in bank and cash balances of the Group is HK\$189,000 (2004: Nil) of bank balances denominated in Renminbi ("RMB") placed with banks in the PRC. RMB is not a freely convertible currency.

23. TRADE AND OTHER PAYABLES, DEPOSITS RECEIVED AND ACCRUALS - GROUP

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Trade payables	3,449	3,079
Deposits received	1,413	896
Accruals	1,268	1,170
	<u>6,130</u>	<u>5,145</u>

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

At 31 December 2005, the ageing analysis of the trade payables was as follows:

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
0-30 days	2,856	2,741
31-60 days	393	44
61-90 days	114	—
Over 90 days	86	294
	<u>3,449</u>	<u>3,079</u>

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

24. DEFERRED TAXATION – GROUP

24.1 Deferred tax assets and liabilities recognised

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

	Accelerated tax depreciation <i>HK\$'000</i>	Tax losses <i>HK\$'000</i>	Total <i>HK\$'000</i>
At 1 January 2004 and 31 December 2004	(109)	1,723	1,614
At 1 January 2005 (Charged)/Credited to the income statement	(102)	2,440	2,338
At 31 December 2005	(211)	4,163	3,952

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

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Deferred tax assets	4,163	1,723
Deferred tax liabilities	(211)	(109)
Deferred tax assets recognised in the consolidated balance sheet	3,952	1,614

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

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

For the year ended 31 December 2005

24. DEFERRED TAXATION – GROUP *(continued)*

24.2 Deferred tax assets and liabilities unrecognised

Unrecognised deferred tax assets, representing the future benefit of tax losses to the extent that the directors do not consider it probable that sufficient taxable profits will be available in the foreseeable future, amounted to HK\$505,000 (2004: HK\$2,449,000). The tax losses do not expire under current tax legislation. There were no unrecognised deferred tax liabilities.

25. SHARE CAPITAL

	2005		2004	
	Number of shares '000	HK\$'000	Number of shares '000	HK\$'000
Authorised:				
Ordinary shares of HK\$0.10 each				
At 1 January and 31 December	<u>1,000,000</u>	<u>100,000</u>	<u>1,000,000</u>	<u>100,000</u>
Issued and fully paid:				
Ordinary shares of HK\$0.10 each				
At 1 January	281,800	28,180	280,000	28,000
Shares issued upon conversion of share options (Note (a))	<u>—</u>	<u>—</u>	<u>1,800</u>	<u>180</u>
At 31 December	<u>281,800</u>	<u>28,180</u>	<u>281,800</u>	<u>28,180</u>

Note:

- (a) On 17 May 2004, the Company issued 1,800,255 ordinary shares of HK\$0.10 each as a result of the exercise by the holders of share options issued on 27 October 2003 to subscribe for 1,800,255 shares of HK\$0.10 each at HK\$0.09 per share.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

26. SHARE-BASED EMPLOYEE COMPENSATION

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

At 31 December 2005, the total number of shares available for issue under the share option scheme was 2,623,556 (2004: 2,813,721), representing approximately 0.9% (2004: 1.0%) of the issued share capital of the Company at that date.

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

Year ended 31 December 2004:

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				
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%
Consultants & Employees	27 October 2003	2,802,413	—	(1,280,668) (note 2)	—	1,521,745 (Note 3)	10 May 2004 to 24 July 2010	HK\$0.09	0.54%
Employees	27 October 2003	520,449	—	(519,587) (note 2)	—	862 (Note 3)	10 May 2004 to 27 December 2010	HK\$0.09	0.01%
	27 October 2003	1,411,218	—	—	(120,104) (Note 5)	1,291,114 (Note 4)	10 May 2004 to 20 January 2013	HK\$0.24	0.46%
	27 October 2003	200,173	—	—	(200,173) (Note 5)	—	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 ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

26. SHARE-BASED EMPLOYEE COMPENSATION (continued)

Year ended 31 December 2005:

Grantees	Date granted	Number of share options				Balance as at 31 December 2005	Period during which the options are exercisable	Exercise price per share	Percentage of the Company's issued share capital as at 31 December 2005
		Balance as at 1 January 2005	Granted during the year	Exercised during the year	Lapsed during the year				
Consultants & Employees	27 October 2003	1,521,745	—	—	—	1,521,745 (Note 3)	10 May 2004 to 24 July 2010	HK\$0.09	0.54%
Employees	27 October 2003	862	—	—	—	862 (Note 3)	10 May 2004 to 27 December 2010	HK\$0.09	0.01%
	27 October 2003	1,291,114	—	—	(190,165)	1,100,949 (Note 4)	10 May 2004 to 20 January 2013	HK\$0.24	0.39%
		<u>2,813,721</u>	<u>—</u>	<u>—</u>	<u>(190,165)</u>	<u>2,623,556</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) These options vested and were exercisable on 10 May 2004, which was 6 months after the listing date of the Company.
- (4) The options vested and were exercisable in three tranches as follows:
 - (a) one-third of the options have vested and were exercisable on 10 May 2004;
 - (b) a further one-third of the options have vested and were exercisable on 31 December 2004; and
 - (c) the remaining one-third of the options have vested and were exercisable on 31 December 2005.
- (5) The options lapsed upon the resignation of 4 (2004: 2) participants from the Group.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

27. RESERVES

27.1 Group

The amount of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on page 44 of the financial statements.

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

27.2 Company

	Share premium <i>HK\$'000</i>	Accumulated losses <i>HK\$'000</i>	Total <i>HK\$'000</i>
At 1 January 2004	24,351	(576)	23,775
Shares issued upon conversion of share options (<i>Note 25(a)</i>)	(18)	—	(18)
Loss for the year	—	(1,616)	(1,616)
	<hr/>	<hr/>	<hr/>
At 31 December 2004 and 1 January 2005	24,333	(2,192)	22,141
Loss for the year	—	(2,133)	(2,133)
	<hr/>	<hr/>	<hr/>
At 31 December 2005	<u>24,333</u>	<u>(4,325)</u>	<u>20,008</u>

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.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

28. OPERATING LEASE COMMITMENTS

At 31 December 2005, the total future minimum lease payments under non-cancellable operating leases on land and buildings are payable as follows:

	The Group		The Company	
	2005	2004	2005	2004
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Within one year	1,025	1,372	—	1,156
In the second to fifth years	727	153	—	—
	<u>1,752</u>	<u>1,525</u>	<u>—</u>	<u>1,156</u>

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

29. CAPITAL COMMITMENTS

The Group and the Company did not have any significant capital commitments as at 31 December 2004 and 2005.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

30. MATERIAL RELATED PARTY TRANSACTIONS

The following transactions were carried out with related parties:

	2005 <i>HK\$'000</i>	2004 <i>HK\$'000</i>
Consultancy fees payable (<i>note (i)</i>)	180	180
Salaries payable (<i>note (ii)</i>)	135	600
	<u> </u>	<u> </u>
Sales of smart card products (<i>note (iii)</i>)	—	16
	<u> </u>	<u> </u>
Key management personnel remuneration		
— Salaries and other short-term employee benefits	5,141	4,519
— Retirement benefits costs	84	72
	<u> </u>	<u> </u>
	<u>5,225</u>	<u>4,591</u>

Notes:

- (i) A subsidiary has entered into an agreement with Mr. Tong Kam Hung for the provision of consultancy services. The terms of the consultancy fees are determined based on services provided with reference to market rates. Mr. Tong Kam Hung was interested in the agreement as a consultant and a shareholder of the Company.
- (ii) A subsidiary paid salaries to Ms. Tsui Kam Ling, Alice ("Alice"), for her role as Vice President, Operations of the subsidiary during the year ended 31 December 2004 and the period from 1 January to 22 March 2005. Alice was then appointed as director of the Company on 23 March 2005. Alice is a shareholder of the ultimate holding company and the spouse of Mr. Wong Yiu Chu, Denny, a director of the Company.
- (iii) A subsidiary provided smart card related service to Hectrix Limited during the year ended 31 December 2004. Mr. Wan Wah Tong, Thomas, a non-executive director of the Company, was interested in these transactions as a director and a shareholder of Hectrix Limited and the Company.

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

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 December 2005

31. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group does not have written risk management policies and guidelines. The most significant financial risks to which the Group is exposed to are described below.

31.1 Foreign currency risk

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

31.2 Credit risk

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

31.3 Interest rate risks

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

31.4 Fair value

The carrying amounts of the Group's financial assets including pledged bank deposit, cash and cash equivalents, trade and other receivables; and financial liabilities including trade and other payables, approximate their fair values because of the immediate or short term maturity of these financial instruments.

32. ULTIMATE HOLDING COMPANY

The directors consider the ultimate holding company at 31 December 2005 to be D & A Holdings Limited, which is incorporated in the British Virgin Islands.

FINANCIAL SUMMARY

31 December

	2005	2004	2003	2002	2001
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
RESULTS					
Turnover	38,853	24,369	38,646	27,794	12,863
Cost of sales	21,808	14,243	17,950	15,338	7,517
Gross profit	17,045	10,126	20,696	12,456	5,346
Gross profit margin	44%	42%	54%	45%	42%
Profit/(Loss) for the year	196	(13,994)	11,753	3,016	(4,189)
Net profit margin	1%	—	30%	11%	—
ASSETS AND LIABILITIES					
Total assets	36,482	35,301	52,099	17,177	13,839
Total liabilities	6,130	5,145	8,111	3,755	8,766
Total equity	30,352	30,156	43,988	13,422	5,073

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that the Annual General Meeting of Advanced Card Systems Holdings Limited (the "Company") will be held at Unit 1008, 10th Floor, Hongkong International Trade and Exhibition Centre, Kowloon Bay, Hong Kong on Thursday, 4 May 2006 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 2005.
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 and, in this connection, to consider and, if thought fit, pass the following resolution as an ordinary resolution of the Company:

"**THAT** Grant Thornton, who have been appointed by the board of directors of the Company as auditors of the Company to fill the casual vacancy occasioned by the resignation of KPMG, be and are hereby re-appointed auditors of the Company to hold office until the conclusion of the next annual general meeting and that the board of directors of the Company be and is hereby authorised 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);

NOTICE OF ANNUAL GENERAL MEETING

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

(d) for the purpose of this Resolution:-

“Relevant Period” means the period from the passing of this Resolution until whichever is the earliest of:-

- (i) the conclusion of the next annual general meeting of the Company;
- (ii) the expiration of the period within which the next annual general meeting of the Company is required by the articles of association of the Company or any applicable laws to be held; or
- (iii) the passing of an ordinary resolution by shareholders of the Company in general meeting revoking, varying or renewing the authority given to the directors of the Company by this Resolution; and

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

NOTICE OF ANNUAL GENERAL MEETING

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;
- (b) the aggregate nominal value of shares of the Company repurchased by the Company pursuant to the approval in paragraph (a) above during the Relevant Period (as hereinafter defined) shall not exceed 10 per cent. of the aggregate of the total nominal value of share capital of the Company in issue as at the date of passing of this Resolution, and the authority granted pursuant to paragraph (a) above shall be limited accordingly; and
- (c) for the purposes of this Resolution, “Relevant Period” means the period from the passing of this Resolution until whichever is the earliest of:-
 - (i) the conclusion of the next annual general meeting of the Company; or
 - (ii) the expiration of the period within which the next annual general meeting of the Company is required by the articles of association of the Company or any applicable laws to be held; or
 - (iii) the passing of an ordinary resolution by shareholders of the Company in general meeting revoking, varying or renewing the authority given to the directors of the Company by this Resolution.”

NOTICE OF ANNUAL GENERAL MEETING

6. 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.”

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 95

By deleting the last sentence of article 95 and replacing thereof by the following new sentence:-

“Any Director so appointed by the Board shall hold office only until the next following general meeting of the Company (in the case of filling a casual vacancy) or until the next following annual general meeting of the Company (in case of an addition to the Board), and shall then be eligible for re-election at the meeting.”;

- (b) Article 102(vii)

By deleting the words “special resolution” in the first and second lines of Article 102(vii) and replacing them with the words “ordinary resolution”; and

NOTICE OF ANNUAL GENERAL MEETING

(c) Article 118(a)

By deleting the existing Article 118(a) in its entirety and substituting therefor the following new Article and its marginal note:

Power to remove Director by ordinary resolution	118(a). The Company may by ordinary resolution at any time remove any Director (including a Managing Director or other executive Director) before the expiration of his period of office notwithstanding anything in these Articles or in any agreement between the Company and such Director and may by ordinary resolution elect another person in his stead. Any person so elected shall hold office during such time only as the Director in whose place he is elected would have held the same if he had not been removed."
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By order of the Board of
Advanced Card Systems Holdings Limited
WONG Yiu Chu, Denny
Chairman

Hong Kong, 31 March 2006

Principal place of business in Hong Kong:

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

Registered Office:

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

NOTICE OF ANNUAL GENERAL MEETING

Notes:

1. A shareholder entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and, on a poll, vote in his stead. A proxy need not be a shareholder of the Company.
2. In order to be valid, a form of proxy and the power of attorney or other authority (if any) under which it is signed or a notarially certified copy of that power or authority, must be deposited at the Company's branch share registrar in Hong Kong, Computershare Hong Kong Investor Services Limited, 46th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not less than 48 hours before the time appointed for the meeting or any adjourned meeting.
3. Completion and delivery of the form of proxy will not preclude a shareholder of the Company from attending and voting in person at the meeting if the shareholder of the Company so desires.
4. 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 is set out in Appendix I to the circular to the shareholders of the Company dated 31 March 2006.

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