

NET 1 UEPS TECHNOLOGIES INC

Form S-1/A

June 20, 2005

As filed with the Securities and Exchange Commission on June 17, 2005

Registration No. 333-125273

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

AMENDMENT NO. 1 TO  
Form S-1  
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

**NET 1 UEPS TECHNOLOGIES, INC.**

*(Exact name of registrant as specified in its charter)*

**Florida**

*(State or other jurisdiction of  
incorporation or organization)*

**7389**

*(Primary Standard Industrial  
Classification Code Number)*

**65-0903895**

*(I.R.S. Employer  
Identification No.)*

**President Place, 4th Floor  
Cnr. Jan Smuts Avenue and Bolton Road  
Rosebank, Johannesburg, South Africa  
(2711) 343-2000**

*(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)*

**Net 1 UEPS Technologies, Inc.**

**President Place, 4th Floor  
Cnr. Jan Smuts Avenue and Bolton Road  
Rosebank, Johannesburg, South Africa  
(2711) 343-2000**

*(Name, address, including zip code and telephone number, including area code, of agent for service)*

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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after the effective date of this registration statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended (the Securities Act), check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective

registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.

**The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.**

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The information in this prospectus is not complete and may be changed. The selling shareholders and, if the over-allotment is exercised by the underwriters, we may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and the selling shareholders and, if the over-allotment is exercised by the underwriters, we are not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

**SUBJECT TO COMPLETION. DATED JUNE 17, 2005.**

**PROSPECTUS**

**Shares  
Common Stock**

This is a public offering of our shares of common stock. The selling shareholders are selling \_\_\_\_\_ shares of our common stock. We will not receive any of the proceeds from the sale of shares by the selling shareholders.

Our common stock is quoted on the OTC Bulletin Board under the symbol NOUT.OB. The last reported sale price of our common stock on June 16, 2005 was \$18.35 per share. We have applied to have our common stock included for quotation on the Nasdaq National Market under the symbol UEPS.

**Investing in our common stock involves risks. See Risk Factors beginning on page 11 to read about factors you should consider before buying shares of our common stock.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.**

	<b>Per Share</b>	<b>Total</b>
Public offering price	\$	\$
Underwriting discounts and commissions	\$	\$
Proceeds, before expenses, to selling shareholders	\$	\$

We have granted the underwriters an option to purchase up to an additional \_\_\_\_\_ shares of common stock to cover over-allotments at the public offering price less underwriting discounts and commissions.

The underwriters expect to deliver the shares to purchasers on \_\_\_\_\_, 2005.

**Morgan Stanley**

**JPMorgan**

**Robert W. Baird & Co.**

**Jefferies & Company, Inc.**

**Thomas Weisel Partners LLC**

The date of this prospectus is \_\_\_\_\_, 2005.

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You should rely only on the information contained in this prospectus. Neither we nor the selling shareholders have authorized anyone to provide you with different information. The selling shareholders are offering to sell, and seeking offers to buy, shares of common stock only in jurisdictions where offers and sales are permitted. The information in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our shares of common stock.

## PROSPECTUS SUMMARY

*You should read the following summary together with the entire prospectus, including the more detailed information in our audited consolidated financial statements and related notes as well as the unaudited interim financial information appearing elsewhere in this prospectus. You should consider carefully, among other matters, the matters we discuss in Risk Factors. All references in this prospectus to we, us, or our are references to Net 1 UEPS Technologies, Inc. and its consolidated subsidiaries, collectively, except as otherwise indicated or where the context indicates otherwise. All references in this prospectus to Net 1 are to Net 1 UEPS Technologies, Inc., all references to New Aplitec are to Net 1 Applied Technologies South Africa Limited and all references to Aplitec are to Net 1 Applied Technology Holdings Limited. All dollar amounts referred to in this prospectus are in U.S. dollars unless otherwise indicated. As of June 16, 2005, the exchange rate for South African Rand to U.S. dollars was ZAR 6.79 = US\$1.00.*

### **Our Company**

We provide our universal electronic payment system, or UEPS, as an alternative payment system for the unbanked and under-banked populations of developing economies. We believe that we are the first company worldwide to implement a system that can enable the estimated four billion people who generally have limited or no access to a bank account to enter affordably into electronic transactions with each other, government agencies, employers, merchants and other financial service providers. To accomplish this, we have developed and deployed the UEPS. This system uses secure smart cards that operate in real-time but offline, unlike traditional payment systems offered by major banking institutions that require immediate access through a communications network to a centralized computer. This offline capability means that users of our system can enter into transactions at any time with other card holders in even the most remote areas so long as a portable offline smart card reader is available. In addition to payments and purchases, our system can be used for banking, health care management, international money transfers, voting and identification.

Our technology is widely used in South Africa today. We have over 3.3 million clients in five provinces who receive social welfare grants using our smart cards. We have started to implement our UEPS for employers to pay wages and provide financial services to their employees. In addition, we are working closely with non-governmental organizations to deploy our new medical application into a number of hospitals and clinics. This application of our system is used to administer the treatment of HIV/ AIDS and other high-risk diseases, record patient progress and manage drug inventory.

Recently, Cell C (Proprietary) Limited, a mobile telephone service provider in South Africa, chose our solution as the transaction payment system for its planned roll-out of approximately 56,000 public cellular pay phones that will provide lower income consumers with telephone access at reduced rates. We believe the implementation of this project could provide us with up to 10,000 access points through which we will be able to market and sell our financial products. This deployment is part of a government initiative for the empowerment of small businesses in rural and semi-urban areas of South Africa.

Outside of South Africa, the Reserve Bank of Malawi has implemented our solution as a national payment system. To date, seven local financial institutions and BP p.l.c., a bulk fuel supplier, are using our system for transaction switching and settlement. We have deployed smaller, more limited versions of our system in Burundi, Ghana, Latvia, Mozambique, Rwanda, and Zimbabwe.

Unlike a traditional credit or debit card where the operation of the account occurs on a centralized computer, each of our smart cards effectively operates similar to an individual bank account in the case of financial services or an individual record management system in the case of medical services. All transactions that take place through our system occur between two smart cards at the point of service, or POS, with all of the relevant information necessary to perform and record a transaction held on the smart cards.

The transfer of money or other information can take place without any communication with a centralized computer since all validation, creation of audit records, encryption, decryption and authorization take place on, or are generated between, the smart cards themselves. Importantly, the cards are protected through the use of biometric fingerprint identification, which is designed to ensure the security of funds and card holder information. Transactions are generally settled by merchants and other commercial participants in the system by sending the transaction data to a mainframe computer on a batch basis. Settlement can be performed online or offline. The mainframe computer provides a central database of transactions, creating a complete audit trail that enables us to replace lost smart cards while preserving the notional account balance, and to identify fraud.

We generate our revenues by charging transaction fees to government agencies, employers, merchants and other financial service providers, by providing financial services such as loans and by selling hardware, software and related technology. In South African rand, our revenues and operating income increased by 32% and 39%, respectively, from fiscal 2003 to 2004, and by 29% and 34%, respectively, from fiscal 2002 to 2003. In South African rand, our revenues and operating income increased 31% and 62%, respectively, for the nine months ended March 31, 2005, as compared to the nine months ended March 31, 2004. We believe this growth reflects the accelerating adoption of our solution.

### **Market Opportunity**

According to the United States Census Bureau, the world's population currently exceeds 6.4 billion people. Yet of this total, it has been reported that over four billion people earn less than the purchasing parity equivalent of two dollars per day. In general, these people either have no bank account or very limited access to banking services. This situation arises when banking fees are too high relative to an individual's income, a bank account provides little meaningful benefit or there is insufficient infrastructure to provide banking services economically in the individual's geographical market. We refer to these people as the unbanked and the under-banked. These individuals generally receive wages, welfare benefits or loans in the form of cash and conduct commercial transactions, including buying food and clothing, in cash.

The use of cash, however, presents significant problems. In the case of recipients, they generally have no secure way of protecting that cash other than by converting it immediately into goods, carrying it with them or hiding it. In cases where an individual has access to a bank account, deposit, withdrawal and account fees meaningfully reduce the money available to meet basic needs. For government agencies and employers, using cash to pay welfare benefits or wages results in significant expense due to the logistics of obtaining that cash, moving it to distribution points and protecting it from theft.

The use of cash or lack of access to a bank account can dramatically increase the cost to, and in some cases completely prevent, individuals from engaging in basic financial transactions. These basic transactions include the routine payment of insurance premiums, the transfer of money to relatives and the use of credit. Without a bank account, it is also difficult for an individual to obtain a loan on attractive terms since that individual lacks a credit history and usually cannot present a reliable means of repayment to the lender.

For governments, assistance programs face significant challenges when dependent on the use of cash. In addition to the costs and difficulties of using cash, corruption becomes an even more challenging problem since there is no clear audit trail. In fact, the absence of an electronic system for the distribution of goods, including foodstuff or medicine, or welfare benefits presents a significant obstacle to ensuring the fair and reliable implementation of government policy or deployment of foreign aid.

Traditional payment systems offered today by the major banking institutions do not address the key requirements of the unbanked and the under-banked populations. In addition to the high cost of maintaining a bank account relative to a customer's income level, customers must generally have basic literacy, administrative and record-keeping abilities and a minimum income level. Additionally, banks operate through online transaction settlement systems, which are often unavailable or costly to implement in undeveloped areas. Finally, having a bank account does not eliminate the need for significant quantities of cash in many instances because customers must withdraw large sums at one time to avoid incremental transaction fees.

## Our Solution

We believe that we are the first company to enable the affordable delivery of financial products and services to the world's unbanked and under-banked people. Our approach takes full advantage of moving processing away from a centralized point to the computer chip embedded on a smart card. A smart card reader or other POS device is used to enable communication between smart cards in real-time during a transaction and indirectly with our mainframe computer at a later time. This architecture has significant implications in terms of the products and services that we can deliver compared to those offered by banking institutions or other card providers.

First, our system enables offline transactions, which is essential in serving the unbanked and under-banked. Second, it means that while offline, the smart card can engage in sophisticated transaction processing, using data encryption and biometric fingerprint protection to ensure security. In fact, our smart cards can calculate the interest owed to the card holder for having funds recorded onto our system without ever coming online. Third, with all of the software and transaction records on the smart card, the POS device itself requires far fewer components, circuitry and memory, substantially reducing costs. Fourth, each transaction is recorded on both participating smart cards, copied in subsequent transactions to additional smart cards, and ultimately reported to our mainframe computer. This creates a full audit trail that significantly reduces the potential for corruption, theft and fraud. Lastly, instead of having to build the overall system to handle peak loads, our system further reduces costs by smoothing the transaction flow over time.

We believe that our solution delivers benefits to each of the users of our system, including:

*Individuals.* There is no minimum income requirement for individuals to use our smart card, making our solution universally accessible. It is also inexpensive since the overall cost of the system is much less than widely available solutions, including cash, bank accounts and bank cards that require online access. Our solution additionally has the advantage of working everywhere, including remote areas where many unbanked and under-banked people live. Even more importantly, our solution is secure and smart cards are replaceable. This means that individuals do not have to fear that their money will be stolen or that they will be charged for fraudulent transactions. Since the smart card performs all of the required processing and contains all of the different service features, the smart card can be tailored to meet the needs of the individual. Card holders can also receive interest on their card balances, a benefit not available to them when transacting solely in cash. We believe our solution has the potential to enhance significantly the living standards of the unbanked and under-banked by reducing transaction costs and providing them with new and additional financial products and services.

*Merchants and Financial Service Providers.* Merchants derive several different benefits from our system. Our system decreases the amount of cash they must hold, improving security and reducing expenses. In addition, it provides a record of transactions that is useful for administrative purposes. For instance, by providing financial services through our POS devices, merchants benefit from new income streams at no additional incremental cost. For formal financial service providers, the use of smart cards provides opportunities to directly sell products and services to a market that was previously difficult to reach. For instance, insurance companies can offer their products with the premium deducted directly from the individual's smart card. In the case of lending, administrative costs are decreased along with the expense of holding cash. Again, the collection of payments can occur directly from the smart card, reducing credit risk and helping to establish credit history.

*Employers.* Our system enables employers to eliminate cash from the wage payment process. This reduces expenses by avoiding cash handling and management, the need to insure or transport that cash and the bank transaction fees associated with obtaining cash in the first place. The process of paying employees using cash is also time consuming, taking up to half a day per pay period in some instances. The use of our system eliminates this process and thereby increases productivity. In addition, because cash payments are distributed in packets to employees, disputes can arise as to the amount of cash in the packet. Our system also eliminates this problem since the amount reflected on the card holders' accounts are recorded on the back-end system and then distributed on the smart cards. Finally, employers frequently provide



additional services to their employees out of necessity, particularly loans. Our system enables other service providers to deliver these products.

*Government Agencies.* A fundamental policy goal for almost any government is to enhance the welfare of the poorest citizens in the country. Yet the use of cash is a poor method for delivering social welfare grants since it is difficult to track, and the recipients endure a range of expenses and dangers that reduce their options. By using our system, government agencies enjoy reduced costs in the delivery of benefits to recipients by eliminating the use of cash while increasing the options available to the recipient. This use of our system intrinsically increases the welfare that government agencies can provide from the same amount of taxes collected. Our system also has the potential to increase the amount of taxes collected by bringing informal businesses into the formal economy. The presence of a full audit trail also means that government agencies can combat corruption. Moreover, the use of smart cards for the delivery of additional services, including insurance products, means that regulatory bodies can expand their oversight of transactions for individuals who are frequently least able to protect themselves. In regard to medical benefits, our system provides comprehensive inventory management and has the potential to improve the treatment of patients significantly. For instance, we have deployed an artificial intelligence program on our smart cards used for the treatment of HIV/ AIDS in South Africa that can be used to adjust a patient's prescription based on data entered by a trained medical worker through the POS device.

### **Our Business Strengths**

We believe our business strengths include:

*Technology Leadership.* We believe we are the first company to develop, implement and operate an affordable, flexible and secure electronic payment system for the unbanked and under-banked that works offline. Of equal importance, our smart cards have a broad range of additional functionality through the use of wallets that can be turned on as needed or as services become available. We can deliver these services to the population at a fraction of the cost of traditional systems. Our ability to implement an HIV/ AIDS system on the same smart card as financial services demonstrates the flexibility of our approach. In addition, we have validated the security of our smart cards along with our overall system, forming the foundation for a trusted solution. Independent third parties have reviewed and published our security protocols and we have refined our system in a way to provide system integrity over the life of the smart cards. From our inception in 1989 to date, we have not suffered any security breaches or losses of transactions or funds on our system.

*Proven Solution.* Our system is proven and has been increasingly used. Today over 3.3 million clients in South Africa receive monthly welfare or pension payments through our system under contracts with five provinces. Historically, welfare and pension recipients would only download cash from smart cards, but these recipients increasingly choose to use their smart cards at merchant locations, which generates additional revenue for us. During the nine months ended March 31, 2005, the rate of client purchases using our smart cards rather than merely downloading the value for cash grew at a compounded monthly growth rate of 71% while the value of those transactions grew at a compounded monthly growth rate of 60%. As of March 31, 2005, we had 2,406 POS devices installed at 1,441 participating retail merchants. For the nine months ended March 31, 2005, the total value of transactions processed through our UEPS merchant network was approximately \$59.7 million. During the nine months following our implementation of these retail merchant POS devices in July 2004, the percentage of transactions which consisted of merchant purchases, as opposed to cash downloading only, increased from approximately 0% to approximately 23% of the total number of processed transactions.

*Versatile Application.* Once an individual begins using our smart card, we become a logical provider of a broad range of additional products and services. For instance, a card holder using our system for the administration of medical treatment can also use the same smart card for receiving welfare payments or wages as well as making purchases. Because use of each smart card is secured biometrically, the smart card can also be used for identification and voting. These additional uses mean that once we have enrolled

and delivered a smart card to an individual, our revenue potential increases significantly beyond the initial service for which that individual has signed up.

*Broad Appeal that Drives Opportunities.* Because our system provides economic benefits to all participants, we believe there are strong incentives for government agencies and employers to adopt our system in many developing countries. Our solution is also appealing because a single deployment enables the delivery of a broad array of new services to those who are potentially most in need of them, often at a lower cost than alternative distribution methods.

*Increasing Returns to Scale.* The initial establishment of our system in a province or country requires upfront expenditures for computers, distribution infrastructure and card holder registration. Once in place, though, the cost to us of supplying additional products to users is low. For instance, if a customer receives welfare payments on one of our smart cards and then chooses to purchase insurance through our system, there is almost no additional expense for us to deduct the insurance premium regularly. As a result, the operating margin for that customer increases significantly, offset only by any marketing or administrative costs associated with that product.

### **Our Strategy**

We intend to provide the leading system for the world's estimated four billion unbanked and under-banked people to engage in electronic transactions globally. To achieve this goal, we intend to pursue the following strategies:

*Disciplined Approach to New Markets.* We carefully evaluate new opportunities in order to deploy our business development resources effectively. We believe there are significant opportunities for our system in developing economies, such as Brazil, India, Mexico and Indonesia, where the unbanked and under-banked comprise a majority of the population. Where we believe it makes sense, we will use partnerships or make acquisitions to accelerate our entry into new markets.

*Unlock Target Markets with a Key Product.* The first step in establishing our system within a new province or country is to establish a broad base of smart card users around a single application. One of our preferred routes is to secure contracts to implement payment systems for government programs having large numbers of potential card holders. We believe another effective route will be the delivery of medical management applications, such as for HIV/AIDS. However, we are not dependent on government agencies to establish an initial base. Employers are widely examining our system to address their wage payment challenges and we are currently pursuing opportunities to deliver this solution.

*Expand Our Products Within the Markets We Serve.* With the establishment of a strong base of card holders and related infrastructure, we can then move to providing additional products and services. As part of broadening our card holders' options, we will also sell our smart card readers and POS devices to merchants to enable them to enter into transactions. Additionally, we will work to establish relationships with post offices, banks and other financial service providers with the goal of making our system ubiquitous in the markets we serve.

*Provide Products and Services Ourselves Where the Profit Potential is Compelling.* Our system can dramatically reduce transaction costs and improve data collection for a broad set of products and services. We intend to offer those products and services ourselves where the profit potential is significant. For instance, we engage in lending in South Africa. We are able to offer this service at a lower interest rate than competitors due to our ability to deduct interest and principal directly from a borrower's smart card and our knowledge of that individual's payment history.

*Establish Partnerships or Make Acquisitions When Appropriate.* As part of our disciplined approach to growing our presence globally, we will evaluate and enter into partnerships where we can draw on local knowledge and infrastructure to drive the rapid adoption of our system. We believe that this will enable us to focus on our core strength in technology as well as product development and delivery. In some instances, we will make acquisitions where we believe that our approach will enable us to gain customers and realize operational benefits rapidly from the deployment of our more efficient solution.

### **Corporate Information**

We were incorporated in Florida in May 1997. In June 2004, we acquired substantially all of the business and assets of Aplitec, a South African company listed on the JSE Securities Exchange South Africa, and the former shareholders of Aplitec obtained a majority voting interest in us. The Aplitec transaction is discussed in more detail under Corporate History.

Our principal executive offices are located at President Place, 4th Floor, Cnr. Jan Smuts Avenue and Bolton Road, Rosebank, Johannesburg, South Africa. Our phone number is (27-11) 343-2000. Our website address is [www.net1ueps.com](http://www.net1ueps.com). The information on our website, including any information accessible by a hyperlink or on another website accessible through our website, does not constitute part of this prospectus.

Our trademarks include NET1, FTS and UEPS. All other trademarks, trade names and service marks appearing in this prospectus are the property of their respective owners.

**Summary of the Offering**

Common stock offered by the selling shareholders	shares
Common stock outstanding prior to this offering, as of March 31, 2005	27,175,135 shares
Special convertible preferred stock outstanding prior to this offering, as of March 31, 2005	27,525,259 shares
Special convertible preferred stock converted into common stock and sold in this offering	shares
Common stock outstanding after this offering	shares
Special convertible preferred stock outstanding after this offering	shares
Use of proceeds	Certain of the selling shareholders may exercise options to purchase the shares of common stock that they are selling in this offering. We will not receive any proceeds from this offering other than proceeds we receive from the exercise of any of these options and from any shares sold pursuant to the exercise by the underwriters of the over-allotment option. We will use any proceeds we receive for working capital and general corporate purposes.
Purposes of this offering	To achieve a broader shareholder base, to increase visibility in the U.S. marketplace and to provide increased liquidity for our shareholders. The offering is also intended to provide our existing South African shareholders who desire to sell their shares with the opportunity to sell their shares in a broadly marketed underwriting.

Proposed Nasdaq National Market symbol UEPS

The number of shares of our common stock referred to above as outstanding after the offering and, unless otherwise indicated, the other information in the prospectus excludes:

27,525,259 shares of common stock issuable upon conversion of an equal number of outstanding shares of our special convertible preferred stock; and

2,906,980 shares of common stock issuable upon the exercise of options and other stock-based awards outstanding as of March 31, 2005, granted under our 2004 Stock Incentive Plan at a weighted average exercise price of \$1.50 per share.

Unless otherwise indicated, the information in this prospectus:

reflects a one-for-six reverse stock split of our common stock and special convertible preferred stock which became effective on June 13, 2005. The effect of this reverse stock split was to decrease the number of issued and outstanding shares by a factor of six and correspondingly increase the earnings per share by a factor of six; and

assumes no exercise of the underwriters' over-allotment option.

**The South African Invitation to Participate**

We have prepared and distributed in South Africa an invitation to participate, dated June 17, 2005, which invited holders of our linked units to offer for sale in this offering their shares of our common stock issuable upon conversion of the special convertible preferred stock these holders are entitled to receive upon giving of an exercise notice to the trustee of the South African trust. As described under Corporate History The Aplitec Transaction, the South African trustee holds for the benefit of the linked unit holders the New Aplitec B class loan accounts and B class preference shares which are part of the linked units. Our invitation to participate was sent only to holders of linked units who have mailing addresses in South Africa as reflected on the records of the South African trustee. We are not recommending that any holders of linked units participate in this offering, and we are not purchasing any of the shares of common stock offered in this offering.

The selling shareholders in this offering include holders of linked units who accept the invitation to participate and give the conversion notice to the trustee of the South African trust. Under the terms of the invitation to participate, each holder of linked units who elects to participate in this offering will deposit with the trustee of the South African trust, an irrevocable exercise form instructing the trustee of the South African trust to convert up to a specified number of special convertible preferred shares, effective only upon the closing of the offering.

The successful completion of these transactions by us, the selling shareholders and the trustee is a condition precedent to the underwriters' obligations to purchase any shares in the offering.

### Summary Consolidated Financial Data

The following table sets forth our summary consolidated balance sheet data as of March 31, 2005 and our consolidated statements of operations data for the years ended June 30, 2004, 2003 and 2002, and for the nine months ended March 31, 2005 and 2004. You should read the following summary consolidated financial data together with Selected Consolidated Financial Data, Management's Discussion and Analysis of Financial Condition and Results of Operations, the consolidated financial statements and notes thereto and other financial information included elsewhere in this prospectus. In connection with U.S. generally accepted accounting principles, we accounted for the Aplitec transaction as a reverse acquisition, which requires that the company whose shareholders retain a majority voting interest in a combined business be treated as the acquiror for accounting purposes. Therefore, for all periods after June 7, 2004, our consolidated financial statements and management's discussion and analysis reflect the operations of Net 1 and its consolidated subsidiaries and, for prior periods, reflect the operations of Aplitec and its consolidated subsidiaries, but not Net 1. The summary consolidated statements of operations data for the years ended June 30, 2004, 2003 and 2002, have been derived from our audited consolidated financial statements which are included elsewhere in this prospectus. Our audited consolidated financial statements are prepared in U.S. dollars and in accordance with accounting principles generally accepted in the United States. The summary consolidated balance sheet data as of March 31, 2005 and the summary consolidated statements of operations data for the nine months ended March 31, 2005 and 2004 are derived from unaudited interim financial information and have been prepared in accordance with accounting principles generally accepted in the United States. Results for interim periods are not necessarily indicative of the results expected for the entire year. You should also read the following summary of consolidated financial data in conjunction with the exchange rate information contained in Management's Discussion and Analysis of Financial Condition and Results of Operations - Currency Exchange Rate Information.

	Nine Months Ended March 31,		Year Ended June 30,		
	2005	2004	2004	2003	2002
(In thousands, except per share data)					
<b>Consolidated Statements of Operations Data:</b>					
Revenue	\$ 134,885	\$ 91,463	\$ 131,098	\$ 74,924	\$ 51,793
Cost of goods sold, IT processing, servicing and support	41,207	28,206	39,134	25,935	14,170
General and administrative charges	33,804	25,625	39,677	26,399	21,637
Depreciation and amortization	4,897	4,110	5,676	3,323	3,128
Reorganization costs		3,537	11,133		
Operating income	54,977	29,985	35,478	19,267	12,858
Interest, net	1,497	2,464	3,640	2,600	1,381
Income before taxes	56,474	32,449	39,118	21,867	14,239
Income tax expense	22,534	13,896	25,927	9,473	5,554
Income from continuing operations	34,420	18,553	13,278	11,942	8,518
Net income attributable to shareholders(1)	34,420	18,553	13,278	13,117	8,518
Income from continuing operations per share:					
Basic(2)	\$ 0.63	\$ 0.58	\$ 0.40	\$ 0.37	\$ 0.27
Diluted(2)	\$ 0.62	\$ 0.58	\$ 0.38	\$ 0.37	\$ 0.27
Cash dividend per share(3)	\$	\$	\$ 1.14	\$ 0.12	\$ 0.06

- (1) Net income attributable to shareholders for 2003 includes an extraordinary item of \$0.9 million and the results of a change in accounting policy of \$0.3 million as a result of the adoption and application of *Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets*.



- (2) The basic and diluted earnings per share have been restated as a result of the transaction described in notes 1, 10 and 11 to our consolidated financial statements and the one-for-six reverse stock split.
- (3) The cash dividend per share has been restated as a result of the transaction described in notes 1, 10 and 11 to our consolidated financial statements and the one-for-six reverse stock split. The cash dividend per share for 2004 was calculated based on 32,161,190 Aplitec shares and represents the dividend paid to shareholders of Aplitec as a result of the transaction.

**As of March 31, 2005**

**(In thousands)**

**Consolidated Balance Sheet Data:**

Cash and cash equivalents	\$	92,712
Total current assets		141,960
Total assets		175,318
Total current liabilities		32,650
Total debt		
Total shareholders equity		128,680

## RISK FACTORS

*Investing in our common stock involves a high degree of risk. You should consider carefully the following risk factors, as well as the other information in this prospectus, before deciding to invest in our shares of common stock. If any of the following risks actually occurs, our business, financial condition and results of operations would suffer. If this happens, the trading price of our common stock would likely decline and you might lose all or part of your investment in our common stock.*

### **Risks Relating to Our Business**

***The provincial governments of South Africa are our largest customers, and any non-renewal or termination of our government social welfare contracts would materially and adversely affect our business and revenues, results of operations and cash flows.***

A substantial portion of our current business involves the distribution of social welfare grants on behalf of five of the nine provincial governments of South Africa. For the foreseeable future, our revenues, results of operations and cash flows will depend on this concentrated group of customers. During the year ended June 30, 2004 and the nine months ended March 31, 2005, we derived approximately 82% and 77%, respectively, of our revenues from our government social welfare contracts. In general, these contracts provide for terms of three years and are extendable at the option of the provincial governments for an additional two year period. Our contracts with the governments of the Eastern Cape, KwaZulu-Natal and North West provinces will expire in 2005, unless renewed by consent of both parties. Our contracts with the governments of the Limpopo and Northern Cape provinces currently are scheduled to expire in November and December 2006, respectively. In addition, any of these contracts may be terminated at any time by the respective governments in the event of a material breach. The early termination, or our failure to obtain extensions, of any of these contracts would have a material adverse effect on our business and revenues, results of operations and cash flows. Moreover, because we incur a significant portion of the expenses associated with these contracts during the initial implementation phase, we have historically enjoyed higher profit margins on these contracts after the completion of the implementation period, which averages approximately 18 months. Therefore, the early termination of, or our failure to extend, any of these contracts would also adversely affect our margins. We cannot assure you that we will be successful in renewing any of these contracts upon expiration of the respective contract periods or that they will not otherwise be terminated.

In addition, there are legislative proposals and other initiatives underway in South Africa that could materially affect the way we do our business. The South African government passed legislation during 2004 for the creation of the South African Social Security Agency, or SASSA. The primary purpose of SASSA is to consolidate at the central government level the administration of social welfare grants, which is currently performed primarily at the provincial level. SASSA commenced operations on April 1, 2005. SASSA may appoint a single contractor to perform the distribution of social welfare grants on a national basis, following the expiration of the various contracts entered into by the individual provinces. If SASSA does not appoint us as a national social welfare grant contractor, then we may not be able to renew some or all of our social welfare distribution contracts when they expire, which could have a material adverse effect on our financial condition, cash flows and results of operations.

***We may not maintain our current level of profitability or rates of growth.***

We believe that our continued profitability and growth will depend in large part on our ability to do the following:  
continue to enroll new smart card users in South Africa;

hire and train personnel capable of marketing, installing and integrating our solution, supporting customers and managing operations;

continue to expand the range of applications that use our technology and to market these applications successfully;

successfully identify and enter other markets for our products; and

manage the costs of our business, including the costs associated with maintaining and developing our technology and expanding our operations internationally.

If we are not able to achieve any or all of the above, our profitability and/or growth rate will likely decline.

***Changes in current government regulations relating to social welfare grants could adversely affect our revenues and cash flows.***

We derive a substantial portion of our current business from the distribution of social welfare grants onto smart cards in South Africa and the transaction fees resulting from use of these smart cards. Because social welfare eligibility and grant amounts are regulated by the government, any changes to or reinterpretations of the government regulations relating to social welfare may result in the non-renewal or reduction of grants for certain individuals, or a determination that currently eligible social welfare grant recipients are no longer eligible. If any of these changes were to occur, the number of smart cards in use could decrease, the amount of money on any particular smart card could decrease or the amount of transactions effected on any particular smart card may decrease, all of which could result in a reduction of our revenues and cash flows.

***We may have difficulty managing our growth which could limit our ability to increase sales and cash flow.***

We have recently been experiencing significant growth, both in the scope of our operations and size of our organization. This growth is placing significant demands on our management, as well as on our operational resources. In order to achieve our business objectives, however, we anticipate that we will need this growth to continue. Continued growth would increase the challenges involved in:

implementing appropriate operational and financial systems;

expanding our sales and marketing infrastructure and capabilities;

providing adequate training and supervision to maintain high quality standards; and

preserving our culture and values.

Additionally, continued growth will place significant additional demands on our management and our financial and operational resources, and will require that we continue to develop and improve our operational, financial and other internal controls. If we cannot scale and manage our business appropriately, we will not experience our projected growth and our financial results may suffer.

***There are risks relating to operating in South Africa that could adversely affect our business, operating results, cash flows and financial condition.***

Our primary operations are located in South Africa and we currently generate substantially all of our revenues from our operations in South Africa. As a result, we are subject to any political, economic and regulatory uncertainties in South Africa.

*The changing political and social environment.* South Africa faces certain social, political and economic challenges, which may adversely affect our business, operating results, cash flows and financial condition. The country is experiencing high levels of unemployment and there are significant differences in the level of economic and social development among its people, with large parts of the population, particularly in the rural areas, having limited access to education, healthcare, housing and other basic services. Furthermore, South Africa faces challenges in building adequate infrastructure. These problems, together with a shortage of skilled labor, may in the future have an adverse impact on productivity.

*Inflation and interest rates.* The economy of South Africa is currently characterized by low inflation and interest rates. Currently, the inflation rate is approximately 3.6% per annum and the Reserve Bank's

base lending rate is approximately 7.0% per annum. However, the economy of South Africa in the past has been, and in the future may be characterized by high rates of inflation and high interest rates. High rates of inflation could increase our South African-based costs and decrease our operating margins. High interest rates could adversely affect our ability to obtain cost-effective debt financing in South Africa.

*Regulatory uncertainty regarding black economic empowerment.* The South African government, over the past five years, has been developing an economic indigenization program referred to as black economic empowerment, or BEE. BEE is regulated pursuant to an Act of the South African Parliament, namely the Broad-Based Black Economic Empowerment Act 53 of 2003, or the BBEE Act. The BBEE Act recognizes two distinct mechanisms for the achievement of BEE objectives: (1) codes of good practice issued under the Act and (2) sectoral transformation charters developed by specific industry sectors and which may be recognized by the Minister of Trade and Industry if they have been developed by the major stakeholders in the relevant industry and advance the objectives of the BBEE Act. Draft codes of good practice have recently been published for public comment, but none of them is, as yet, enforceable. The information and communication technology sector, or ICT sector, and the financial services sector have both developed sectoral transformation charters, but they have not yet been published in the Government Gazette and, consequently, they do not currently enjoy any formal status. The ICT sector has attempted to ensure as great a degree of comparability between its sectoral transformation charter and the draft codes of good practice, thereby assuring the probable publication of that charter in the Government Gazette by the Minister of Trade and Industry. By contrast, there are no indications that the financial services sector has made any attempt to achieve significant alignment between its transformation charter and the draft codes of good practice. Once the codes of good practice become law, all businesses in South Africa will be subject to those codes unless they form part of a sector in respect of which the Minister of Trade and Industry has published an industry charter in the Government Gazette as a code of good practice. The current uncertainty as to the final form of the regulatory regime poses a risk, but there are indications that the regime will be settled in the next 12 months. We are likely to be subject to the ICT sector's charter if this document is published in the Government Gazette as a code of good practice. This charter applies, among others, to companies that manufacture equipment for, or provide services relating to, the electronic capturing, transmission and display of data and information. Compliance with the charter is not enforced through civil or criminal sanction, but only through its effect on the ability to secure contracts in the public and private sectors. One of the components of BEE is that a certain percentage of ownership by black South Africans or historically disadvantaged South Africans of our South African business should be achieved over a period of time which is generally thought to be ten to 15 years. Although BEE is not expropriatory in nature, there may be a dilutive effect to current shareholders in the South African business and there may be a cost associated with increasing the level of black shareholders or historically disadvantaged South Africans, both of which factors may represent a risk. However, given that non-BEE compliance may place in jeopardy existing and future South African public and private sector contracts, the loss of which could cause a loss of revenue, the attendant risk associated with BEE non-compliance is material.

*Exchange control regulation.* South Africa's exchange control regulations restrict the export of capital from South Africa, the Republic of Namibia and the Kingdoms of Lesotho and Swaziland, known collectively as the Common Monetary Area. Transactions between South African residents, including companies, and non-residents of the Common Monetary Area are subject to exchange controls enforced by the South African Reserve Bank. In October 2004, the South African exchange control regulations were liberalized by the abolishment of exchange control limits on new investments outside of South Africa by South African companies. However, according to the circular giving notice of this liberalization, the South African Reserve Bank retains an oversight function, the exact nature of which is not entirely clear from the circular. According to the circular, South African companies investing outside of South Africa must now apply to the South African Reserve Bank only for monitoring purposes and for the approval of the South African Reserve Bank pursuant to existing foreign direct investment criteria, including demonstrated benefit to South Africa. The South African Reserve Bank reserves the right to stagger capital outflows relating to very large investments outside of South Africa by South African companies, so as to manage



any potential impact on the foreign exchange market. Also, these liberalization measures permit South African companies to retain, outside of South Africa, dividends received in relation to shares held by them in non-South African companies.

South African exchange controls are expected to continue for the foreseeable future. The South African government, however, has committed itself to gradually relaxing exchange controls, and significant relaxations have occurred in recent years. Nevertheless, under the current exchange control regulations, our management may be limited in its ability to consider strategic options and our shareholders may not be able to realize the premium over the current trading price of our shares.

Although Net 1 is a U.S. corporation and is not itself subject to these regulations, the ability of New Aplitec to raise and deploy capital outside the Common Monetary Area is restricted. As of March 31, 2005, approximately 87% of our cash and cash equivalents were held by New Aplitec and its subsidiaries. During the year ended June 30, 2004 and the nine months ended March 31, 2005, all of our revenues were generated by New Aplitec and its subsidiaries. In particular, New Aplitec will generally not be permitted to export capital from South Africa or to hold foreign currency without the approval of the South African Reserve Bank, unless such export of capital or foreign currency holding is permitted by the October 2004 liberalization measures. This restriction may affect New Aplitec's ability to pay dividends to Net 1. Moreover, although the requirement that the South African Reserve Bank approve investments by South African companies outside of South Africa has been relaxed, this requirement could restrict our future international expansion.

South African Reserve Bank approval is required for New Aplitec to receive loans from and repay loans to non-residents of the Common Monetary Area. In addition, New Aplitec may not use income earned in South Africa to repay or service foreign debts, without the South African Reserve Bank approval. Repayment of principal and interest on such loans will usually be approved at the time of the granting of such loans, where the payment is limited to the amount borrowed and a market related rate of interest. New Aplitec will also need South African Reserve Bank approval to raise capital involving a currency other than South African rand, which approval may be provided subject to conditions. Thus, unless we can obtain funding at the Net 1 level, these restrictions could prevent us from obtaining adequate funding on acceptable terms for acquisitions and other business opportunities outside South Africa.

*Trade unions and labor laws.* Most of South Africa's major industries are unionized, and the majority of employees belong to trade unions. In the past, trade unions have had a significant impact on the collective bargaining process as well as on social and political reform in South Africa in general. We currently have approximately 109 unionized employees which represents approximately 6% of our workforce. Although in recent years we have not experienced any labor disruptions, such labor disruptions may occur in the future. In addition, the cost of complying with labor laws may adversely affect our operations.

*Regional instability.* Historically, there has been regional, political, and economic instability in the countries surrounding South Africa. Such political or economic instability in neighboring countries could affect the social, political and economic conditions in South Africa, for example, as a result of immigration, and this could have a negative impact on our ability to manage our operations in the country.

*HIV/AIDS.* HIV/AIDS and tuberculosis, which is exacerbated in the presence of HIV/AIDS, are major healthcare challenges in South Africa and other sub-Saharan countries. HIV infection among women in antenatal clinics throughout South Africa has risen from 1% in 1990 to nearly 25% in 2000. According to the most recent research published by the Medical Research Council of South Africa, over five million South Africans were HIV positive in 2004, resulting in a total population prevalence rate of approximately 11%. Under South African law, we are generally prohibited from testing employees to determine their HIV status. Due to the high prevalence of HIV/AIDS in South Africa, we may incur costs relating to the loss of personnel and the related loss of productivity as well as the costs relating to recruiting and training of new personnel. We are not able to quantify these costs accurately and cannot

assure you that the costs we will incur in connection with this epidemic will not have a material adverse effect on us and our financial condition.

***There are risks relating to other countries in which we intend to operate that could adversely affect our future business, operating results, cash flows and financial condition.***

In the future, we intend to expand operations into countries and regions, including African countries outside South Africa, South America, Southeast Asia and Central Europe, that are subject to significantly differing political, economic and market conditions. Specific country and regional risks that may have a material impact on our business, operating results, cash flows and financial condition include:

political and economic instability;

loss due to civil strife, acts of war, guerrilla activities and insurrection;

competition from existing market participants that may have a longer history in or greater familiarity with the foreign markets we enter;

government interventions and protectionism;

potential adverse changes in laws and regulatory practices, including import and export license requirements, tariffs, legal structures and tax laws;

cancellation of contractual rights;

trade barriers;

difficulties in staffing and managing operations;

import and export restrictions;

adverse tax consequences;

the lack of well-developed legal systems which could make it difficult for us to enforce our intellectual property and contractual rights;

security and safety of employees;

restrictions on the right to convert or repatriate currency or export assets;

greater risk of uncollectible accounts and longer collection cycles;

currency fluctuations;

indigenization and empowerment programs;

logistical and communications challenges;

changes in labor conditions;

discrimination against U.S. companies; and

exposure to liability under U.S. securities laws, including the Foreign Corrupt Practices Act.

Many of these countries and regions are in various stages of developing institutions and legal and regulatory systems that are characteristic of democracies. However, institutions in these countries and regions may not yet be as firmly established as they are in democracies in the developed world. Many of these countries and regions are also in the process of transitioning to a market economy and, as a result, are experiencing changes in their economies and their government policies that can affect our investments in these countries and regions. Moreover, the procedural safeguards of the new legal and regulatory regimes in these countries and regions are still being developed and, therefore, existing laws and regulations may be applied inconsistently. In some circumstances, it may not be possible to obtain the legal remedies provided under those laws and regulations in a timely manner.



As the political, economic and legal environments remain subject to continuous development, investors in these countries and regions face uncertainty as to the security of their investments. Any unexpected changes in the political or economic conditions in these or neighboring countries or others in the region may have a material adverse effect on the international investments that we have made or may make in the future, which may in turn have a material adverse effect on our business, operating results, cash flows and financial condition.

***Volatility in the South African Rand to U.S. dollar exchange rate may adversely affect our reported operating results.***

The South African rand, or ZAR, is the primary operating currency for our business operations while our financial results are reported in U.S. dollars. Because our sales are primarily denominated in ZAR, a decline in the value of the ZAR against the U.S. dollar may have a significant adverse effect on our reported results of operations. During the two years ended June 30, 2002, the ZAR steadily depreciated against the U.S. dollar, moving at an average rate per U.S. dollar from ZAR 6.35 in 2000 to ZAR 7.61 in 2001 to ZAR 10.15 in 2002. However, since June 2002, the ZAR has appreciated against the U.S. dollar, mainly due to a general depreciation of the U.S. dollar and the strengthening of the South African economy and commodity and precious metals prices, reaching ZAR 6.79 on June 16, 2005. Over this period, the exchange rate has been volatile and we expect this volatility to continue in the foreseeable future.

Trends in sales and profits may experience significant fluctuations as the rate of exchange between the ZAR and the U.S. dollar fluctuates. We cannot assure you what effect, if any, changes in the exchange rate of the ZAR against the U.S. dollar will have on our results of operations and financial condition.

We do not currently engage in any currency hedging transactions intended to reduce the effect of fluctuations in foreign currency exchange rates on our results of operations, other than economic hedging relating to our inventory purchases which are settled in U.S. dollars or euros. We have used forward contracts in order to hedge our economic exposure to the ZAR/ U.S. dollar and ZAR/ euro exchange rate fluctuations from these foreign currency transactions. We cannot guarantee that we will enter into hedging transactions in the future or, if we do, that these transactions will successfully protect us against currency fluctuations.

***The loss of the services of Dr. Belamant or any of our other executive officers would adversely affect our business.***

Our future financial and operational performance depends, in large part, on the continued contributions of our Chief Executive Officer and Chairman, Dr. Serge Belamant, as well as Mr. Herman Kotze, our Chief Financial Officer, Ms. Brenda Stewart, our Senior Vice President-Marketing and Sales and Mr. Nitin Soma, our Senior Vice President-Information Technology. Many of our key responsibilities are performed by these four individuals, and the loss of the services of any of them could disrupt our development efforts or business relationships and our ability to continue to innovate and to meet customers' needs, which could have a material adverse effect on our business and financial performance. We do not have employment agreements with our executive officers, any of whom may terminate their employment at any time, nor do we maintain any key person life insurance policies.

***We face a highly competitive employment market and may not be successful in attracting and retaining a sufficient number of skilled employees, particularly in the technical and sales areas and senior management.***

Our future success depends on our ability to continue to develop new products that use our UEPS technology and to market these products to our target users. In order to succeed in our product development and marketing efforts, we need to identify, attract, motivate and retain sufficient numbers of qualified technical and sales personnel. An inability to hire and retain such technical personnel would adversely affect our ability to enhance our existing intellectual property, to introduce new generations of

technology and to keep abreast of current developments in technology. Demand for personnel with the range of capabilities and experience we require is high and there is no assurance that we will be successful in attracting and retaining these employees. The risk exists that our technical skills and sales base may be depleted over time because of natural attrition. Furthermore, social and economic factors in South Africa have led, and continue to lead, numerous qualified individuals to leave the country, thus depleting the availability of qualified personnel in South Africa. In addition, our multi-country strategy will also require us to hire and retain highly qualified managerial personnel in each of these markets. If we cannot recruit and retain people with the appropriate capabilities and experience and effectively integrate these people into our business, it could negatively affect our product development and marketing activities.

***We pre-fund the payment of social welfare grants on behalf of our South African government customers and any payment defaults by these customers would adversely affect our operations.***

We use our internal cash resources and facilities to fund the payment of social welfare grants under our contracts with the KwaZulu-Natal and Eastern Cape provincial governments. We recover these funds from the KwaZulu-Natal provincial government on a seven-day cyclical basis and from the Eastern Cape provincial government on a 14-day cyclical basis. Therefore, these pre-funding obligations expose us to the risk of default by the applicable provincial government. Although no provincial government has ever defaulted on a repayment of funds at the end of the payment cycle, we cannot guarantee that such a default will not occur in the future. Any such default could have a material adverse effect on us, our financial position and results of operations.

***Our ability to operate our wage payment and insurance products businesses may be limited by existing South African banking and financial services laws and regulations.***

The South African retail banking market is highly regulated, but the South African government has identified the need to service the unbanked market through the liberalization of the regulatory environment in order for retailers and non-banking service providers to innovate products and delivery channels for the unbanked market. However, under current law and regulations, a portion of our South African wage payment business activities in the unbanked market requires us to be registered as a bank in South Africa. We are not currently so registered and therefore are not entitled to perform these activities in South Africa and may face prosecution if we do. We are in the process of appointing expert advisers to assist us in making application for the appropriate banking license. While we believe that we will be able to obtain this license, there is a possibility that our application may not be successful or that a grant of the license may be delayed. In addition, the South African Financial Advisory and Intermediary Services Act, 2002, requires persons who give advice regarding the purchase of financial products or who act as intermediaries between financial product suppliers and consumers in South Africa to register as financial service providers. We have applied for a license under this Act in order to continue to provide advice and intermediary services in respect of the financial products on which we advise and the payment processing services we provide in South Africa on behalf of insurers and other financial product suppliers. While the license application is pending, we are entitled to continue this part of our business in South Africa. If we fail to obtain this license, we may be stopped from continuing this part of our business in South Africa.

***We may face competition from the incumbent retail banks in South Africa in the unbanked market segment.***

The incumbent South African retail banks recently announced a joint initiative to create a common banking product to offer to the significant portion of South Africa's population that does not have access to traditional banking services, or the unbanked. This bank account, generally referred to as the Mzansi account, was introduced in October 2004 and offers limited transactional capabilities at reduced charges, when compared to the accounts traditionally offered by these banks. We believe that currently there are approximately one million Mzansi account holders. The social welfare beneficiaries who are currently paid through our smart card system may elect to use these accounts to receive their grants. A decision by a

substantial number of these beneficiaries to elect to use these accounts rather than our smart card system may have a material adverse effect on our financial condition, cash flows and results of operations.

***We may face increased competition as our sales and product offerings increase.***

In addition to competition that we face from the use of cash, checks, credit and debit cards, existing payment systems and the providers of financial services, we have identified a number of other products currently being produced that use smart card technology in connection with a funds transfer system and the companies that promote them. These include EMV, a system that is being promoted by Visa International Service Association, MasterCard International and Europay International; Mondex International Limited, a subsidiary of MasterCard; and Proton World International N.V., a subsidiary of STMicroelectronics Belgium N.V. In South Africa, and specifically in the payment of social welfare grants, our competitors also include AllPay Consolidated Investment Holdings (Pty) Ltd., which is responsible for social welfare payments in the Free State, Gauteng and Western Cape provinces and a small portion of the Eastern Cape province, and Empilweni Payout Services, which is responsible for payments in the Mpumalanga province. We also may face competition from companies to which we have licensed our technology, including Visa and BGS Smart Card Systems AG. Moreover, as our product offerings increase and gain market acceptance, banks in South Africa and other jurisdictions in which we operate may seek governmental or other regulatory intervention if they view us as infringing on their funds transfer or other businesses.

***Patent competition may adversely affect our products or processes, and limited patent protection, a lack of proprietary protection and the potential to incur costly litigation could be harmful to our operations.***

Our products and technology have unique characteristics and structures and, as a result, are subject to patent protection, the extent of which varies from country to country. During the life of a patent, a product is only subject to competition by non-infringing products. However, aggressive patenting by our competitors and potential patent piracy may threaten protected products and processes and may result in an increased patent infringement risk, especially in emerging economies such as those where we currently operate. The expiration of a patent may also result in increased competition in the market for the previously patented products and processes. The patents for our funds transfer system, or FTS, will expire, at the latest, in Namibia in 2007; in South Africa, Botswana, Swaziland and Hong Kong in 2009; and in the United States in 2011. In addition, our European Union FTS patent has been challenged and revoked. Consequently, we do not have any patent protection in the member countries of the European Union. Additionally, we could have difficulty asserting the Hong Kong patent as it is not registered in our name and it could be difficult to record our ownership of that patent. Further, BGS, the local system operator in the Commonwealth of Independent States has stopped paying licensing fees to us on the grounds that the revocation of the European FTS patent relieves it from the obligation to pay such fees, although we believe that the licensing fees relate to BGS's use of our UEPS technology rather than the FTS patent. There is a risk that a similar refusal to pay our licensing fees can occur elsewhere. Moreover, although we have certain patent rights in the United States, these are not expected to have significant utility in our business given that our management does not expect the U.S. market to become a material part of our business in the future. Each of these factors could have a material adverse effect on our business, operating results, cash flows and financial condition. In addition, to date, we have relied not only on patent protections, but also on trade secret, trademark and copyright laws, as well as nondisclosure, licensing and other contractual arrangements to protect the proprietary aspects of our solutions. Other than the patents discussed above, we do not own any other patents that protect important aspects of our current solutions. We will, however, prepare patent applications where possible for technology related to our smart cards and UEPS system when we believe it is appropriate to do so. These applications and contractual arrangements and our reliance on these laws may not be successful.

Litigation to enforce our intellectual property rights or protect our trade secrets could result in substantial costs and may not be successful. Any loss of or inability to protect intellectual property in our technology could diminish our competitive advantage and also seriously harm our business, operating

results, cash flows and financial condition. In addition, the laws of certain foreign countries may not protect our intellectual property rights to the same extent as do the laws of South Africa, Namibia, Botswana, Swaziland, the United States and the European Union. Our means of protecting our intellectual property rights in South Africa, Namibia, Botswana, Swaziland, the United States and the European Union or any other country in which we operate, may not be adequate to fully protect our intellectual property rights. Similarly, if third parties claim that we infringe their intellectual property rights, we may be required to incur significant costs and devote substantial resources to the defense of such claims. We may be required to discontinue using and selling any infringing technology and services, to expend resources to develop non-infringing technology or to purchase licenses or pay royalties for other technology. In addition, if we are unsuccessful in defending any such third-party claims, we could suffer costly judgments and injunctions that could materially adversely affect our business, results of operations or financial condition.

***The copyrights in earlier versions of our UEPS software are jointly owned which may reduce our future revenues.***

While we own the exclusive copyrights in the current version of the UEPS software, these copyrights are subject to the preexisting copyrights in the earlier versions of our software that are owned jointly by us and Nedbank. As joint owners of the copyrights in these earlier versions of our software that existed prior to July 2000, there is a risk that Nedbank could license these works to others and otherwise commercially exploit these earlier works. If Nedbank licenses our works to others, our future revenues may be reduced.

***Our current license agreement with Visa imposes long-term restrictions on our ability to license rights in our technology and could inhibit our ability to realize additional revenue from these rights in our technology.***

In 1997, we entered into a technology license agreement with Visa. Under that agreement, Visa purchased a non-exclusive, perpetual, worldwide license to our technology rights, as defined in the agreement, relating to our UEPS technology and an exclusive, perpetual, worldwide license under our patents, as defined in the agreement, licensed to Visa that is exclusive to the financial services industry, as defined in the agreement. Our Visa agreement grants back to us the non-exclusive right under our Visa-licensed patents to make, use and sell our payment systems and other products in the financial services industry as discussed in the agreement. In our Visa agreement, Visa agrees not to grant a sublicense to any payment system to any entities in the financial services industry who are not members of Visa already if such entity already has a right to use such payment systems from us. The agreement permits Visa to sublicense our licensed technology rights to any of its members, any entity in the financial services industry or any entity outside of the financial services industry that provides products to Visa or its sublicensees. The agreement prohibits us from licensing our technology rights, not just our licensed patents, to any of Visa's competitors, including MasterCard, Europay, American Express Company, Discover Financial Services, Diners Club International Credit Card Co., Carte Blanche Card or JCB International Credit Card Co. or any of their parents, subsidiaries or affiliates. We may need Visa's consent, not to be unreasonably withheld, in order to transfer or assign our rights and obligations under the agreement. As this agreement does not contain a termination date and contains restrictions on our ability to license our technology rights in the financial services industry and to competitors of Visa, we may not be able to realize the full value of our technology rights.

***Our license agreement with Visa substantially impacts our ability to defend and enforce our patents licensed to Visa and could substantially inhibit our ability to protect the rights in our technology.***

Under our license agreement with Visa, we are restricted from suing Visa, its members and any third-party vendors or customers of Visa or its members for infringement of our technology rights licensed to Visa in connection with their manufacture, use or sale of any product or service offered by Visa. The license also grants Visa sole discretion with regard to enforcement of any of the licensed technology rights against third parties in the financial services industry. Under the agreement, Visa has the right to control

the prosecution and maintenance of the patents and related patent applications we have licensed to Visa in all jurisdictions, and we are obligated to cooperate and support any of Visa's actions in this regard. This arrangement could substantially impact our ability to defend these patents, and could make enforcement actions against our competitors more difficult.

***We depend upon third-party suppliers, making us vulnerable to supply shortages and price fluctuations, which could harm our business.***

We obtain our smart cards, POS devices and the other hardware we use in our business from a limited number of suppliers, and do not manufacture this equipment ourselves. We generally do not have long-term agreements with our manufacturers or component suppliers. If our suppliers become unwilling or unable to provide us with adequate supplies of parts or products when we need them, or if they increase their prices, we may not be able to find alternative sources in a timely manner and could be faced with a critical shortage. This could harm our ability to implement new systems and cause our revenues to decline. Even if we are able to secure alternative sources in a timely manner, our costs could increase. A supply interruption or an increase in demand beyond current suppliers' capabilities could harm our ability to distribute our equipment and thus, to acquire a new source of customers who use our UEPS technology. Any interruption in the supply of the hardware necessary to operate our technology, or our inability to obtain substitute equipment at acceptable prices in a timely manner, could impair our ability to meet the demand of our customers, which would have an adverse effect on our business.

***Escalating pricing pressures from our retail customers may adversely affect our business.***

We have recently begun to experience pressure from our retail merchant customers seeking to negotiate the fees we charge them. This pressure is likely to continue. This pricing pressure could cause us to reduce the level of the fees we charge to these customers, which could adversely impact our revenues and profit margins.

***Our strategy of partnering with companies outside South Africa may not be successful.***

In order for us to expand our operations into foreign markets, it may be necessary for us to establish partnering arrangements with companies outside South Africa. Some of these partnering arrangements may take the form of joint ventures in which we receive a minority interest. Minority ownership carries with it numerous risks, including dependence on partners to provide knowledge of local market conditions and to facilitate the acquisition of any necessary licenses and permits, as well as the inability to control the joint venture vehicle and to direct its policies and strategies. Such a lack of control could result in the loss of all or part of our investment in such entities. In addition, our foreign partners may have different business methods and customs which may be unfamiliar to us and with which we disagree. Our joint venture partners may not be able to implement our business model in new areas as efficiently and quickly as we have been able to do in South Africa. Furthermore, limitations imposed on New Aplitec by South African exchange control regulations, as well as limitations imposed on us by the Investment Company Act of 1940, may limit our ability to establish partnerships or entities in which we do not obtain a controlling interest. In addition, certain of our licensees, including BGS and Visa, have become our competitors and this could occur with our joint venture partners in the future.

We have lost license fees in the CIS as a result of a dispute with BGS, the local system operator, which claims that the revocation of the European FTS patent relieves it from the obligation to pay us licensee fees. We believe that the licensing fees due from BGS relate to its use of our UEPS technology rather than the FTS patent and, therefore, we are currently evaluating our options on this matter.

***System failures, including breaches in the security of our system, could harm our business.***

We may experience system failures from time to time, and any lengthy interruption in the availability of our back-end system computer, could harm our revenues and profits, and could subject us to the scrutiny of our government customers. Frequent or persistent interruptions in our services could cause

current or potential customers and users to believe that our systems are unreliable, leading them to avoid our technology altogether, and could permanently harm our reputation and brands. These interruptions would increase the burden on our engineering staff, which, in turn, could delay our introduction of new applications and services. Finally, because our customers may use our products for critical transactions, any system failures could result in damage to our customers' businesses. These customers could seek significant compensation from us for their losses. Even if unsuccessful, this type of claim could be time consuming and costly for us to address.

Although our systems have been designed to reduce downtime in the event of outages or catastrophic occurrences, they remain vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunication failures, terrorist attacks, computer viruses, computer denial-of-service attacks and similar events. Some of our systems are not fully redundant, and our disaster recovery planning may not be sufficient for all eventualities.

Protection against fraud is of key importance to the purchasers and end users of our solutions. We incorporate security features, including encryption software, biometric identification and secure hardware, into our solutions to protect against fraud in electronic transactions and to provide for the privacy and integrity of card holder data. Our solutions may be vulnerable to breaches in security due to defects in the security mechanisms, the operating system and applications or the hardware platform. Security vulnerabilities could jeopardize the security of information transmitted using our solutions. If the security of our solutions is compromised, our reputation and marketplace acceptance of our solutions will be adversely affected, which would cause our business to suffer, and we may become subject to damage claims. We have not yet experienced any security breaches affecting our business.

Despite any precautions we may take, the occurrence of a natural disaster or other unanticipated problems with our system could result in lengthy interruptions in our services. Our current business interruption insurance may not be sufficient to compensate us for losses that may result from interruptions in our service as a result of system failures.

***We may not be able to exploit technological advances quickly and successfully, which could impair our competitive position and operations.***

Most of our operations depend on the use of advanced technological methods, which must keep pace with rapid technological changes, new product introductions by competitors, evolving industry and government performance and security standards and changes in customer and end-user requirements. The use of the appropriate advanced technological procedures can affect, among other things, the competitiveness of our products, the safety of transactions performed using our products, the continuity of our operations and the capacity and efficiency of our production.

We believe that new technologies may emerge and that existing technologies may be further developed in the fields in which we operate. Unexpected rapid changes in employed technologies that affect our operations and product range could render the technologies we use obsolete or less competitive in the future. Difficulties in accessing new technologies may impede us from implementing them and competitive pressures may force us to implement these new technologies at a substantial cost. In addition, limited access to sources of new capital to acquire new technologies may adversely affect our results of operations and financial condition.

We cannot predict the effect of technological changes on our business or on our ability to provide competitive products. Our ability to meet the competition will depend on our timely and cost-effective implementation of new technological advances. It will also depend on our success in commercializing these advances in spite of competition we face by patents registered by our competitors. If we are unable to implement new technologies in a timely or cost-efficient basis or penetrate new markets in a timely manner in response to changing market conditions or customer requirements, we could experience a material adverse effect on our business, operating results, cash flows and financial condition.

***We may incur material losses in connection with our distribution of cash to recipients of social welfare grants.***

Many social welfare recipients use our services to access cash using their smart cards. We use armored vehicles to deliver large amounts of cash to rural areas across South Africa to enable these welfare recipients to receive this cash. In some cases, we also store the cash that will be delivered by the armored vehicles in depots overnight or over the weekend to facilitate delivery to these rural areas. We cannot insure against the risk of loss or theft of cash from our delivery vehicles as we have not identified any insurance underwriters willing to accept this risk. Therefore, we will bear the full cost of any loss or theft in connection with the delivery process, and such loss could materially and adversely affect our financial condition, cash flows and results of operations. During the year ended June 30, 2004 and the nine months ended March 31, 2005, we incurred losses in connection with our cash delivery system of \$4.2 and \$2.2 million, respectively.

***We may not recover outstanding amounts owed to our micro-finance businesses.***

We operate a traditional micro-finance business, with approximately 100 branches throughout South Africa. These branches extend short-term loans for periods ranging from 30 days to six months at loans bearing interest rates of 12% to 30% per month. Despite the fact that we attempt to reduce credit risk by employing credit profiling techniques, the rate of default on loans has been high due to the high credit risk of these borrowers and the difficulty of collecting outstanding repayments. We may therefore not recover some or all of the principal and interest amounts currently owed by our borrowers, which on March 31, 2005, totaled \$4.1 million, or ZAR 25.8 million. Our inability to recover some or all of these amounts may have a material adverse effect on our financial position and results of operations.

***We may undertake acquisitions that could increase our costs or liabilities or be disruptive to our business.***

One of our strategies is to pursue selective acquisitions. Although we do not currently have any commitments, contracts or understandings to acquire any specific businesses or other material operations, we have made a number of acquisitions in the past and will consider other acquisitions in the future. We may not be able to locate suitable acquisition candidates at prices that we consider appropriate or to finance acquisitions on terms that are satisfactory to us. If we do identify an appropriate acquisition candidate, we may not be able to successfully negotiate the terms of an acquisition, finance the acquisition or, if the acquisition occurs, integrate the acquired business into our existing business. Acquisitions of businesses or other material operations may require debt financing or additional equity financing, resulting in additional leverage or dilution of ownership. Integration of acquired business operations could disrupt our business by diverting management away from day-to-day operations. The difficulties of integration may be increased by the necessity of coordinating geographically dispersed organizations, integrating personnel with disparate business backgrounds and combining different corporate cultures. We also may not be able to maintain key employees or customers of an acquired business or realize cost efficiencies or synergies or other benefits that we anticipated when selecting our acquisition candidates. In addition, we may need to record write downs from future impairments of intangible assets, which could reduce our future reported earnings. At times, acquisition candidates may have liabilities or adverse operating issues that we fail to discover through due diligence prior to the acquisition.

***We may be subject to privacy laws in South Africa and other jurisdictions in which we operate.***

Our collection, storage and processing, and any disclosure of, customer and employee personal information must comply with South Africa's privacy laws, which are at various stages of legislative and judicial development. However, South African common law and the South African Constitution do recognize an individual's right to privacy, and there are some statutes and other regulations which have been enacted that apply to us and the way we operate our business. For example, one statute sets out a framework for the electronic collection, processing, storage and disclosure of personal information. Although compliance with this statute is voluntary, a South African court could determine that we would

be violating an individual's right to privacy if we do not operate in compliance with this framework. In addition, South African law requires that we must keep confidential the HIV status of the people that participate in our HIV/ AIDS program.

New privacy laws may be enacted in the future which could adversely affect the way we do business, and we could be required to devote substantial management time and resources to comply with these new laws. In addition, if we violate, or are judged to have violated, the privacy rights of people whose information we collect, store and process, we could become liable for damages, which could have a material adverse effect on our financial condition, cash flows or results of operations.

***Our international operations require us to comply with a number of U.S. and international regulations.***

We need to comply with a number of international regulations in countries outside of the United States. In addition, we must comply with the Foreign Corrupt Practices Act, or FCPA, which prohibits U.S. companies or their agents and employees from providing anything of value to a foreign official for the purposes of influencing any act or decision of these individuals in their official capacity to help obtain or retain business, direct business to any person or corporate entity or obtain any unfair advantage. Any failure by us to adopt appropriate compliance procedures and ensure that our employees and agents comply with the FCPA and applicable laws and regulations in foreign jurisdictions could result in substantial penalties and/or restrictions in our ability to conduct business in certain foreign jurisdictions.

***We may incur significant costs to ensure compliance with U.S. corporate governance and accounting requirements.***

We may incur significant costs associated with our public company reporting requirements, costs associated with newly applicable corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002 and other rules implemented by the Securities and Exchange Commission and the Nasdaq National Market. Moreover, many of these corporate governance requirements will not apply to us until our shares become listed for quotation on the Nasdaq National Market. We expect all of these newly applicable rules and regulations to increase our legal and financial compliance costs and to make some activities more time-consuming and costly. We also expect that these newly applicable rules and regulations may make it more difficult and more expensive for us to obtain director and officer liability insurance and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified individuals to serve on our board of directors or as executive officers. We are currently evaluating and monitoring developments with respect to these newly applicable rules, and we cannot predict or estimate the amount of additional costs we may incur or the timing of such costs.

***We may not be able to meet the accelerated filing and internal control reporting requirements imposed by the SEC.***

We will become an accelerated filer beginning June 30, 2005. As an accelerated filer, we will be required to file our Annual Report on Form 10-K by September 13, 2005. While we expect to meet the accelerated filer deadlines, there is a risk that we may not be able to comply with these accelerated filing requirements. If we fail to meet the accelerated filing requirements by the time we are required to file our Annual Report on Form 10-K, then the market price for our common stock may decline.

As directed by Section 404 of the Sarbanes-Oxley Act, the SEC adopted rules requiring each public company to include a report of management on the company's internal controls over financial reporting in its annual reports. In addition, the independent registered public accounting firm auditing a company's financial statements must also attest to and report on management's assessment of the effectiveness of the company's internal controls over financial reporting as well as the operating effectiveness of the company's internal controls. We were not subject to these requirements for the fiscal year ended June 30, 2004. We are in the process of evaluating our internal control systems in order to allow our management to report on, and our independent registered public accounting firm to attest to, our internal controls as a required



part of our Annual Report on Form 10-K beginning with our report for the fiscal year ending June 30, 2005.

While we have been expending significant resources in developing the necessary documentation and testing procedures required by Section 404 of the Sarbanes-Oxley Act, there is a risk that we may not be able to comply timely with all of the requirements imposed by this rule. At present, there is no precedent available with which to measure compliance adequacy. In the event we identify significant deficiencies or material weaknesses in our internal controls that we cannot remediate in a timely manner or we are unable to receive a positive attestation from our independent registered public accounting firm with respect to our internal controls, investors and others may lose confidence in the reliability of our financial statements and our stock price and ability to obtain equity or debt financing as needed could suffer.

In addition, in the event that our independent registered public accounting firm is unable to rely on our internal controls in connection with its audit of our financial statements, and in the further event that it is unable to devise alternative procedures in order to satisfy itself as to the material accuracy of our financial statements and related disclosures, it is possible that we would be unable to file our Annual Report on Form 10-K with the SEC, which could also adversely affect the market price of our common stock and our ability to secure additional financing as needed.

***We may be required to raise additional financing by issuing new securities with terms or rights superior to those of our shares of common stock, which could adversely affect the market price of our shares of common stock.***

We may require additional financing to fund future operations, including expansion in current and new markets, programming development and acquisition, capital costs and the costs of any necessary implementation of technological innovations or alternative technologies. Because of the early stage of development of our operations and exposure to market risks associated with economies in emerging markets, we may not be able to obtain financing on favorable terms or at all. If we raise additional funds by issuing equity securities, the percentage ownership of our current shareholders will be reduced, and the holders of the new equity securities may have rights superior to those of the holders of shares of common stock, which could adversely affect the market price and voting power of shares of common stock. If we raise additional funds by issuing debt securities, the holders of these debt securities would similarly have some rights senior to those of the holders of shares of common stock, and the terms of these debt securities could impose restrictions on operations and create a significant interest expense for us.

***We may have difficulty raising necessary capital to fund operations as a result of market price volatility for our shares of common stock.***

In recent years, the securities markets in the United States have experienced a high level of price and volume volatility, and the market price of securities of many companies have experienced wide fluctuations that have not necessarily been related to the operations, performances, underlying asset values or prospects of such companies. For these reasons, our shares of common stock can also be expected to be subject to volatility resulting from purely market forces over which we will have no control. If our business development plans are successful, additional financing may be required to continue to develop and exploit existing and new technologies and to expand into new markets. The exploitation of our technologies may, therefore, be dependent upon our ability to obtain financing through debt and equity or other means.

***Our quarterly operating results may fluctuate significantly as a result of factors outside of our control, which could cause the market price of our common stock to decline.***

We expect our revenues and operating results to vary from quarter to quarter. As a consequence, our operating results in any single quarter may fall below the expectations of securities analysts and investors, which could cause the price of our common stock to decline. Factors that may affect our operating results include:

demand for and acceptance of our new product offerings;

delays in the implementation and delivery of our products and services, which may impact the timing of our recognition of revenue;

variations in product mix and cost during any period;

development of new relationships and maintenance and enhancement of existing relationships with customers and strategic partners;

difficulties with component supplies, manufacturing or distribution;

deferral of customer contracts in anticipation of product or service enhancements;

timing of commencement, implementation or completion of major implementation projects;

the relative mix of net revenues from established markets, including South Africa, and unestablished markets;

fluctuations in currency exchange rates;

the fixed nature of many of our expenses; and

industry and economic conditions, including competitive pressures and inventory obsolescence.

In particular, differences in relative growth rates between our businesses in our established markets for certain products and unestablished markets may have a significant effect on our operating results, particularly our reported operating profit percentage, in any individual quarter, with unestablished market sales typically carrying lower margins in the initial phases of our operations in a new area or the introduction of a new product to an area in which we already operate. Certain transactions that occur infrequently, including the bulk supply of hardware to a customer, may also have a significant effect on our operating results. For example, during the nine months ended March 31, 2005, we supplied a customer with POS devices, pin-pads and smart cards for \$10.4 million. Sales of this nature are infrequent and cause fluctuations in revenue and operating income when they occur.

***The period between our initial contact with a potential customer and the sale of our products or services to that customer tends to be long and may be subject to delays which may have an impact on our revenues.***

The period between our initial contact with a potential customer and the purchase of our products and services is often long and subject to delays associated with the budgeting, approval and competitive evaluation processes that frequently accompany significant capital expenditures. A lengthy sales cycle may have an impact on the timing of our revenues, which may cause our quarterly operating results to fall below investor expectations. A customer's decision to purchase our products and services is often discretionary, involves a significant commitment of resources, and is influenced by customer budgetary cycles. To sell our products and services successfully we generally must educate our potential customers regarding the uses and benefits of our products and services, which can require the expenditure of significant time and resources; however, there can be no assurance that this significant expenditure of time and resources will result in actual sales of our products and services.

***We may become subject to a U.S. tax liability for failing to withhold on certain distributions on instruments issued in connection with the Aplitec transaction.***

There is no statutory, judicial or administrative authority that directly addresses the tax treatment of non-U.S. holders that elected to receive units in a trust representing beneficial interests in B class preference shares and B class loan accounts issued by New Aplitec pursuant to the reinvestment option in connection with our acquisition of Aplitec. We believe these interests should be treated for United States federal income tax purposes as, and we did treat them as, separate and distinct interests in New Aplitec. As such, we and our affiliates do not presently intend to withhold any amounts for U.S. federal taxes in respect of any distributions paid on such interests. There is a risk, however, that these interests, together with the special convertible preferred stock, may be treated as representing

a single direct equity interest in

us for U.S. federal income tax purposes. In such case, distributions received with respect to the B class preference shares and B class loan accounts could be subject to U.S. federal withholding tax, and we could be liable for failure to withhold such taxes in our capacity as withholding agent. In addition, our failure to collect and remit U.S. federal withholding tax may also subject us to penalties.

***Shipments of our electronic payment systems may be delayed by factors outside of our control, which can harm our reputation and our relationships with our customers.***

The shipment of payment systems requires us or our manufacturers, distributors or other agents to obtain customs or other government certifications and approvals and, on occasion, to submit to physical inspection of our systems in transit. Failure to satisfy these requirements, and the very process of trying to satisfy them, can lead to lengthy delays in the delivery of our solutions to our direct or indirect customers. Delays and unreliable delivery by us may harm our reputation in the industry and our relationships with our customers.

***Force majeure events, such as terrorist attacks, other acts of violence or war, political instability and health epidemics may adversely affect us.***

Terrorist attacks, war and international political instability, along with health epidemics, may disrupt our ability to generate revenues. These events may negatively affect our ability to maintain sales revenue and to develop new business relationships. Because a substantial and growing part of our revenues is derived from sales and services to customers outside of the United States and we have our electronic payment systems manufactured outside the United States, terrorist attacks, war and international political instability anywhere may decrease international demand for our products and inhibit customer development opportunities abroad, disrupt our supply chain and impair our ability to deliver our electronic payment systems, which could materially adversely affect our net revenues or results of operations. Any of these events may also disrupt global financial markets and precipitate a decline in the price of our common stock.

**Risks Relating to this Offering**

***The price for shares of our common stock quoted on the Over-the-Counter Bulletin Board may not be indicative of their fair value.***

The shares of our common stock are currently quoted on the Over-the-Counter Bulletin Board, or OTCBB. The trading volume for shares of our common stock historically has been limited. During the period from our completion of the Aplitec transaction on June 7, 2004 through June 16, 2005, the average daily trading volume of our shares of common stock has been approximately 38,433 shares. During this period, the market price of our shares of common stock has ranged from \$5.94 to \$61.50, after giving effect to the one-for-six reverse stock split. On June 16, 2005, the closing price per share of our common stock as quoted on the OTCBB was \$18.35. Although the trading volume of our common stock has increased since we completed the Aplitec acquisition, the prices at which our common stock has been quoted since that time may not be indicative of their fair value. If you purchase shares of our common stock, you may not be able to resell those shares at or above the public offering price.

In addition, an active public trading market may not develop after completion of this offering, or if developed, may not be sustained. The lack of a trading market may result in the loss of research coverage by securities analysts. Moreover, we cannot assure you that any securities analysts will initiate or maintain coverage of our company and our common stock.

***We expect that the price of our shares of common stock will fluctuate substantially.***

We expect that after this offering the market price for our shares of common stock will be affected by a number of factors, including:

the gain or loss of significant orders or customers;

announcements of our participation in a joint venture or partnership;

recruitment or departure of key personnel;

the announcement of new products or service enhancements by us or our competitors;

changes in government regulation that directly or indirectly affect our business;

quarterly variations in our results of operations;

changes in earnings estimates, investors' perceptions, recommendations by securities analysts or our failure to achieve analysts' earnings estimates;

developments in our industry;

events and news related to the regions where we and our subsidiaries conduct our business; and

general market conditions and other factors unrelated to our operating performance or the operating performance of our competitors.

These factors and price fluctuations may materially and adversely affect the market price of our shares of common stock.

***Future sales of our common stock could reduce our stock price.***

Upon the closing of this offering, approximately \_\_\_\_\_ shares of common stock and \_\_\_\_\_ shares of outstanding common stock issued in the future upon conversion of special convertible preferred stock issued in the Aplitec transaction are freely tradeable without restriction or further registration under the Securities Act. After this offering, holders of approximately \_\_\_\_\_ million shares of our common stock will have registration rights with respect to their shares. Sales by shareholders of substantial amounts of our shares, or the perception that these sales may occur in the future, could affect materially and adversely the market price of our common stock. The shares that the selling shareholders are offering for sale in this offering will be freely tradeable immediately following this offering. Our officers and directors, certain other shareholders and those selling shareholders who, prior to this offering, owned more than 10,000 linked units representing approximately 1,357 shares have agreed not to sell their shares (other than shares they are selling in this offering) for a period of 180 days after the date of this prospectus. As of March 31, 2005, there were options to purchase 1,453,490 shares of our common stock outstanding with a weighted average exercise price per share of \$3.00 and other stock-based awards with respect to 1,453,490 shares of common stock for no cash consideration. Except for shares held by our affiliates, the shares underlying these options will be freely tradeable upon exercise of the options and other stock-based awards after we have filed a Form S-8, which we intend to do prior to the closing of this offering or as soon as practicable after the closing of this offering. Currently, we do not have any further shares reserved for issuance of additional options or other stock-based awards under our 2004 Stock Incentive Plan. However, we intend to authorize additional shares under our 2004 Stock Incentive Plan or under a successor plan and seek shareholder approval of the increase after the closing of the offering. The market price of our common stock could drop significantly if the holders of shares sell them or are perceived by the market as intending to sell them.

***One of our shareholders will continue to hold a significant block of shares in our company after completion of this offering and, as a result, will continue to have significant influence over our company.***

Upon completion of this offering, three designees of South African Private Equity Fund III, L.P., or SAPEF, one of the entities that funded the Aplitec acquisition, will continue to serve on our current six-member board of directors and, pursuant to a shareholders agreement between us, SAPEF and Dr. Belamant, we anticipate that representatives of SAPEF will continue to serve on our board of directors in the future. See Certain Relationships and Related Party Transactions Shareholders Agreement. In addition, we expect SAPEF to beneficially own approximately \_\_\_\_\_% of the outstanding shares of our voting stock upon the closing of this offering. As a result of its right to board representation and substantial ownership interest, SAPEF may have the ability to exert significant influence on the

outcome of a shareholder vote by our shareholders in respect of matters such as a merger, sale or similar

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transaction involving us, the issuance of capital stock and the incurrence of substantial indebtedness, and SAPEF's interests could conflict with your interests. Additionally, SAPEF is in the business of making investments in companies and may from time to time acquire and hold interests in businesses that compete or could in the future compete, directly or indirectly, with us. SAPEF may also pursue acquisition opportunities that may be complementary to our business, and as a result, those acquisition opportunities may not be available to us.

***We have not paid dividends in the past and it is not our current policy to pay dividends, and any return on investment may be limited to the value of our stock.***

We have never paid cash dividends on our shares of common stock and we do not anticipate paying cash dividends on our shares of common stock in the foreseeable future. The payment of dividends on our shares of common stock will depend on our earnings and financial condition, our growth plans and strategies and other business and economic factors affecting us at such time as our board of directors may consider relevant.

In addition, New Aplitec's dividend policy must comply with the restrictions placed by the South African Reserve Bank on the declaration of dividends by New Aplitec as a condition of its approval of the Aplitec transaction. These restrictions will apply until such time as all of our special convertible preferred stock is converted into common stock. These restrictions provide that dividends may be declared by the New Aplitec board of directors only if:

declaration of the dividend is approved by a majority of the holders of New Aplitec B class preference shares,

all B loan accounts have been paid by New Aplitec and

the dividend does not exceed 50% of New Aplitec's annual earnings.

In addition, under South African law, New Aplitec will only be entitled to pay a dividend or other similar payment if it meets the solvency and liquidity tests set out in the South African Companies Act.

***You may have difficulties enforcing a U.S. judgment against us, our executive officers and directors and some of the experts named in this prospectus or asserting U.S. securities laws claims in South Africa.***

A significant portion of our assets and the assets of our directors and executive officers and some of the experts named in this prospectus are located outside the United States. In addition, most of the members of our board of directors, all of our executive officers and several of our experts named in this prospectus are residents of South Africa or other foreign countries. As a result, it may not be possible for you to effect service of process, within the United States or elsewhere outside South Africa, upon our non-U.S. directors, our officers or several of our experts. Moreover, any judgment obtained against us or any of these foreign persons in the United States, including one based on the civil liability provisions of the U.S. federal securities laws, may not be collectible in the United States and may not be enforced by a South African court. Further, if a foreign judgment is enforced by a South African court, it will be payable in South African currency. Also, under South Africa's Exchange Control laws, the approval of the South African Reserve Bank is required before a defendant resident in South Africa may pay money to a non-resident plaintiff in satisfaction of a foreign judgment enforced by a court in South Africa. The policy of South African courts is to award compensation only for loss or damage actually sustained by the person claiming the compensation. Punitive damages are generally not recognized by the South African legal system, on the grounds that such awards are contrary to South African public policy. Whether a judgment is contrary to public policy depends on the facts of each case. Exorbitant, unconscionable or excessive awards will generally be contrary to South African public policy. South African courts cannot consider the merits of a foreign judgment and cannot act as a court of appeal or review over the foreign court. South African courts will usually observe their own procedural laws, and where an action based on a contract governed by the laws of a foreign jurisdiction is brought before a South African court, the capacity of the parties to contract may under certain circumstances be determined in accordance with South African law.

A plaintiff who is not resident in South Africa may be required to provide security for costs where proceedings are initiated in South Africa. In addition, the Rules of the High Court of South Africa require that documents executed outside South Africa must be authenticated in a prescribed manner before they may be used in South Africa. Also, under the South African Protection of Business Act, 1978, foreign judgments concerning the ownership, use or sale of any matter or material connected with South African commerce (such as production, import and export) require consent from the South African Minister of Trade and Industry to be enforced. We have been advised by Cliffe Dekker, our South African counsel, that there are difficulties related to the enforceability against us and our directors and officers in South Africa of liabilities predicated solely upon the Federal securities laws of the United States. It also may be difficult for you to assert U.S. securities law claims in original actions instituted in South Africa. For more information regarding the enforceability of civil liabilities against us, our directors and our executive officers, please see [Enforceability of Civil Liabilities](#).



### **FORWARD LOOKING STATEMENTS**

Some of the statements under Summary, Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations, Business and elsewhere in this prospectus constitute forward-looking statements. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed, implied or inferred by these forward-looking statements. Such factors include, among other things, those listed under Risk Factors and elsewhere in this prospectus. In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, would, expects, plans, intends, anticipates, believe, predicts, potential or continue or the negative of such terms and other comparable terminology.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we do not know whether we can achieve positive future results, levels of activity, performance, or goals. Actual events or results may differ materially. We undertake no obligation to update any of the forward-looking statements after the date of this prospectus to conform those statements to reflect the occurrence of unanticipated events, except as required by applicable law.

You should read this prospectus and the documents that we reference in this prospectus and have filed as exhibits to the registration statement on Form S-1, of which this prospectus is a part, that we have filed with the Securities and Exchange Commission, completely and with the understanding that our actual future results, levels of activity, performance and achievements may be materially different from what we expect. We qualify all of our forward-looking statements by these cautionary statements.

### USE OF PROCEEDS

Certain of the selling shareholders may exercise options to purchase the shares of common stock that they are selling in this offering. We will not receive any proceeds from this offering other than proceeds we receive from the exercise of any of these options and from any shares sold pursuant to the exercise by the underwriters of the over-allotment option. We will use any proceeds we receive for working capital and general corporate purposes.

### PRICE RANGE OF COMMON STOCK

Our common stock is quoted on the OTCBB under the symbol NOUT.OB.

The following table sets forth, for the periods indicated, the high and low bid quotations for our common stock on the OTCBB. These quotations reflect prices between dealers and do not include retail mark-ups, mark-downs, and commissions and may not necessarily represent actual transactions. The trading volume for shares of our common stock historically has been limited. The price per share of our common stock quoted on the OTCBB may not be reflective of the fair value of those shares. You should not rely on the price per share quoted on the OTCBB as an indication of the fair value per share of our common stock.

Quarter Ended	High	Low
Sep. 30, 2002	\$ 7.20	\$ 5.40
Dec. 31, 2002	\$ 7.80	\$ 5.40
Mar. 31, 2003	\$ 7.80	\$ 5.40
June 30, 2003	\$ 12.72	\$ 6.36
Sep. 30, 2003	\$ 14.40	\$ 11.40
Dec. 31, 2003	\$ 40.80	\$ 13.32
Mar. 31, 2004	\$ 60.90	\$ 31.32
June 30, 2004	\$ 64.20	\$ 9.00
Sep. 30, 2004	\$ 14.10	\$ 6.66
Dec. 31, 2004	\$ 16.20	\$ 5.94
Mar. 31, 2005	\$ 21.30	\$ 10.56
June 30, 2005 (through June 16, 2005)	\$ 18.60	\$ 13.68

On June 16, 2005, the last reported sale price of our common stock was \$18.35 per share. As of March 31, 2005, there were approximately 56 shareholders of record of our common stock.

### DIVIDEND POLICY

Net 1 has not paid any dividends on our shares of common stock since our incorporation and we presently intend to retain future earnings to finance the expansion of business. We do not anticipate that we will pay dividends in the foreseeable future. Our future dividend policy will depend on our earnings, capital requirements, expansion plans, financial condition and other business and economic factors as our board of directors may consider relevant.

In addition, New Aplitec's dividend policy must comply with the restrictions placed by the South African Reserve Bank on the declaration of dividends by New Aplitec as a condition of its approval of the Aplitec transaction. These restrictions will apply until such time as all of our special convertible preferred stock is converted into common stock. These restrictions provide that dividends may be declared by the New Aplitec board of directors only if:

declaration of the dividend is approved by a majority of the holders of New Aplitec B class preference shares;

all B loan accounts have been paid by New Aplitec; and

the dividend does not exceed 50% of New Aplitec's annual earnings.

In addition, under South African law, New Aplitec will only be entitled to pay a dividend or other similar payment if it meets the solvency and liquidity tests set out in the South African Companies Act. Any dividends declared by New Aplitec will be distributed to the holders of A class and B class preference shareholders pro rata in accordance with their respective ownership interests in New Aplitec.

Aplitec's dividend policy in fiscal 2003 and 2002, the nine months ended March 31, 2004 and prior fiscal periods was to declare regular annual dividend payments of between 25% and 33% of earnings for such periods. Aplitec declared a dividend of ZAR 0.90 (US\$0.09) per share in fiscal 2003, which was paid in the first quarter of fiscal 2004, and ZAR 0.66 (US\$0.06) per share in fiscal 2002.

**CAPITALIZATION**

The following table sets forth our capitalization as of March 31, 2005. Our capitalization is presented on an actual basis and gives effect to the one-for-six reverse stock split of our common stock and special convertible preferred stock which became effective on June 13, 2005.

You should read this table in conjunction with our consolidated financial statements and related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this prospectus.

	<b>As of March 31, 2005</b>	
	<b>(In thousands)</b>	
<b>Shareholders' equity:</b>		
Common stock, \$0.001 par value; 83,333,333 shares authorized; 27,175,135 shares issued and outstanding	\$	27
Special convertible preferred stock, \$0.001 par value; 50,000,000 shares authorized; 27,525,259 shares issued and outstanding		28
B Class preferred stock, \$0.001 par value; 330,000,000 shares authorized; 209,809,130 shares issued and outstanding (net of shares held by us)		33
Additional paid-in-capital		71,959
Accumulated other comprehensive income		13,711
Retained earnings		42,922
 Total shareholders' equity	 \$	 128,680

**SELECTED CONSOLIDATED FINANCIAL DATA**

The following table sets forth our consolidated balance sheet data as of March 31, 2005 and 2004 and as of June 30, 2004, 2003, 2002, 2001 and 2000, and our consolidated statements of operations data for the nine months ended March 31, 2005 and 2004 and for the years ended June 30, 2004, 2003, 2002, 2001 and 2000. You should read the following selected consolidated financial data together with Management's Discussion and Analysis of Financial Condition and Results of Operations, the consolidated financial statements and notes thereto and other financial information included elsewhere in this prospectus. In connection with U.S. generally accepted accounting principles, we accounted for the Aplitec transaction as a reverse acquisition, which requires that the company whose shareholders retain a majority voting interest in a combined business be treated as the acquiror for accounting purposes. Therefore, for all periods after June 7, 2004, our consolidated financial statements and the discussion and analysis below reflect the operations of Net 1 and its consolidated subsidiaries and, for prior periods, reflect the operations of Aplitec and its consolidated subsidiaries, but not Net 1. The consolidated statements of operations data for the years ended June 30, 2004, 2003 and 2002, and the consolidated balance sheet data as of June 30, 2004 and 2003, have been derived from our audited consolidated financial statements which are included elsewhere in this prospectus. The consolidated statements of operations data for the years ended June 30, 2001 and 2000, and the consolidated balance sheet data as of June 30, 2002, 2001 and 2000, have been derived from Aplitec's unaudited consolidated financial statements which are not included in this prospectus. Our audited consolidated financial statements as of and for the years ended June 30, 2004, 2003 and 2002 and our unaudited consolidated financial statements as of and for the years ended June 30, 2001 and 2000, have been prepared in accordance with accounting principles generally accepted in the United States, or US GAAP. The selected consolidated balance sheet data as of March 31, 2005, and the summary consolidated statements of operations data for the nine months ended March 31, 2005 and 2004, are derived from unaudited and interim financial information included elsewhere in this prospectus. Results for interim periods are not necessarily indicative of the results expected for the entire year. You should also read the following selected consolidated financial data in conjunction with the exchange rate information in Management's Discussion and Analysis of Financial Condition and Results of Operations - Currency Exchange Rate Information.

	<b>Nine Months Ended</b>		<b>Year Ended June 30,</b>				
	<b>2005</b>	<b>2004</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
	<b>(In thousands, except per share data)</b>						
<b>Consolidated Statements of Operations Data:</b>							
Revenue	\$ 134,885	\$ 91,463	\$ 131,098	\$ 74,924	\$ 51,793	\$ 73,243	\$ 68,355
Cost of goods sold, IT processing, servicing and support	41,207	28,206	39,134	25,935	14,170	21,983	20,568
General and administrative charges(1)	33,804	25,625	39,677	26,399	21,637	36,779	33,754
Depreciation and amortization(1)	4,897	4,110	5,676	3,323	3,128		
Reorganization costs		3,537	11,133				
Operating income(2)	54,977	29,985	35,478	19,267	12,858	14,641	14,083
Interest, net	1,497	2,464	3,640	2,600	1,381	1,443	1,419
Income before taxes	56,474	32,449	39,118	21,867	14,239	16,084	15,503
Income tax expense	22,534	13,896	25,927	9,473	5,554	7,100	4,337
Income from continuing operations	34,420	18,553	13,278	11,942	8,518	8,069	7,557

Net income attributable to shareholders(3)	\$ 34,420	\$ 18,553	\$ 13,278	\$ 13,117	\$ 8,518	\$ 8,069	\$ 7,557
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	Nine Months Ended March 31,		Year Ended June 30,				
	2005	2004	2004	2003	2002	2001	2000
<b>(In thousands, except per share data)</b>							
<b>Income from continuing operations per share(4):</b>							
Basic	\$ 0.63	\$ 0.58	\$ 0.40	\$ 0.37	\$ 0.27	\$ 0.24	\$ 0.30
Diluted	\$ 0.62	\$ 0.58	\$ 0.38	\$ 0.37	\$ 0.27	\$ 0.24	\$ 0.24
Cash dividend per share(5)	\$	\$	\$ 1.14	\$ 0.12	\$ 0.06	\$	\$

- (1) Prior to 2002, we recorded depreciation as part of general and administrative charges. For the years ended June 30, 2001 and 2000, general and administrative charges included \$3.7 million and \$4.8 million, respectively, related to depreciation and amortization. After 2002, we began to present depreciation and amortization as a separate line item.
- (2) Includes \$160,000 and \$50,000 of other operating income for the years ended June 30, 2001 and 2000, respectively.
- (3) Net income attributable to shareholders for 2003 includes an extraordinary item of \$0.9 million and the results of a change in accounting policy of \$0.3 million as a result of the adoption and application of *Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets*.
- (4) The basic and diluted earnings per share have been restated as a result of transaction described in notes 1, 10 and 11 to our consolidated financial statements.
- (5) The cash dividend per share has been restated as a result of the transaction described in notes 1, 10 and 11 to our consolidated financial statements. The cash dividend per share for 2004 was calculated based on 32,161,190 Aplitec shares and represents the dividend paid to shareholders of Aplitec as a result of the transaction.

	Nine Months Ended March 31,		Year Ended June 30,				
	2005	2004	2004	2003	2002	2001	2000
<b>(In thousands)</b>							
<b>Additional Operating Data:</b>							
Cash flow from operating activities	\$ 15,576	\$ 35,357	\$ 41,895	\$ 17,644	\$ 11,753	\$ 19,005	\$ 12,677
Operating income margin	41%	33%	27%	26%	25%	20%	21%
Capital expenditures	2,982	2,392	2,802	6,712	1,919	3,640	3,460

**As of  
March 31,**

**As of June 30,**

**2005                      2004                      2003                      2002                      2001                      2000**

**(In thousands)**

**Consolidated Balance Sheet**

**Data:**

Cash and cash equivalents	\$ 92,712	\$ 80,282	\$ 54,313	\$ 32,150	\$ 27,033	\$ 10,172
Total current assets	141,960	117,412	78,705	45,480	43,163	33,628
Total assets	175,318	152,632	98,359	56,496	59,575	49,776
Total current liabilities	32,650	47,831	19,861	10,178	9,929	14,537
Total debt		252				751
Total shareholders equity	\$ 128,680	\$ 95,588	\$ 70,504	\$ 41,724	\$ 45,033	\$ 33,490



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with Selected Consolidated Financial Data and our consolidated financial statements and related notes included elsewhere in this prospectus. In addition to historical consolidated financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our financial condition and results of operations may change as a result of many factors, including those we discuss in Risk Factors and elsewhere in this prospectus. In connection with generally accepted accounting principles, we accounted for the Aplitec transaction as a reverse acquisition, which requires that the company whose shareholders retain a majority voting interest in a combined business be treated as the acquirer for accounting purposes. Therefore, for all periods after June 7, 2004, our consolidated financial statements and the discussion and analysis below reflect the operation of Net 1 and its consolidated subsidiaries and, for prior periods, reflect the operation of Aplitec and its consolidated subsidiaries, but not Net 1.

### Overview

We provide our universal electronic payment system technology as an alternative payment system to the unbanked and under-banked populations of developing economies. We believe that we are the first company worldwide to implement a system that can enable the estimated four billion people who generally have limited or no access to a bank account to effect affordably electronic transactions with one another, government agencies, employers, merchants and other financial services providers. To do this, we have developed and deployed the universal electronic payment system, or UEPS. This system uses secure smart cards that operate in real time but offline, unlike traditional payment systems offered by major banking institutions that require immediate access through a communications network to a centralized computer. This offline capability means that users of our system can enter into transactions at any time with other card holders in even the most remote areas so long as a portable offline card reader is available. In addition to payments and purchases, our system can be used for banking, health care management, international money transfers, voting and identification.

South Africa is the first major market where we achieved significant success and a high penetration rate in the areas we targeted. We believe that our operating experience in South Africa demonstrates the success of our business model in a developing economy. Currently, South Africa has a population of approximately 42 million people, of which an estimated 50% live below the poverty line. The South African unemployment rate is estimated at 30%. The success we have achieved in South Africa since commencing operations in December 1997 has primarily resulted from servicing the needs of the poorest section of the population—those who are dependent on government social welfare grants. We have designed and implemented a complete business model involving the payment, and subsequent spending, of these grants through our smart cards and UEPS technology, which provides us with the opportunity to earn multiple sources of revenue and provides our card holders with affordable functionality and lifestyle improvement. The South African government is also actively involved in a number of initiatives which may present us with opportunities to export our South African achievements, such as the New Partnership for Africa's Development and the India-Brazil-South Africa Dialogue Forum, which is currently considering the establishment of an economic trade bloc between these three countries.

On the African continent outside South Africa, we have implemented our systems at the request of a variety of customers in Ghana, Rwanda, Burundi, Malawi and Mozambique, which are some of the poorest countries in the world. In Malawi, our system has been implemented by the Reserve Bank of Malawi as a national payment system. We are not actively involved as either investors or operators in any of these systems, but we believe that our experience and success in South Africa, together with our understanding of trade in Africa, will permit us to take advantage of new opportunities both in and outside South Africa, which in some instances, may involve acquiring a minority ownership position in these owners and operators.

## **Description of Our Business and Operating Segments**

We analyze our business and operations in terms of four inter-related but independent operating segments: (1) Transaction-based activities, (2) Smart card accounts, (3) Financial services, and (4) Hardware, software and related technology sales. In addition, we have a corporate eliminations segment which consists of corporate and corporate office activities that are impracticable to ascribe directly to any of the other operating segments, as well as any inter-segment eliminations. Prior to the quarter ended March 31, 2005, we included the portion of the fee we earn from provincial governments that relates to the provision of a smart card account to each social welfare recipient in our Financial services operating segment. However, we have recently started analyzing separately the revenues generated from providing a smart card account, and therefore, we have expanded our operating segment analysis to include the fee we earn from provision of the smart card accounts in a separate segment. We have restated our operating segment information for prior periods in order to provide comparability between periods.

### ***Transaction-Based Activities***

The Transaction-based activities operating segment consists primarily of our contracts to distribute social welfare payments in South Africa through our subsidiary Cash Paymaster Services (Proprietary) Limited, or CPS, and its operating subsidiaries. CPS's operating subsidiaries utilize the UEPS technology to administer and distribute social welfare grants in five of South Africa's nine provinces. Revenues from Transaction-based activities include all fees that we earn from provincial governments and participating retail merchants from recurring UEPS transactions that we process through our back-end system, such as the payment of social welfare grants, debit orders, payment of wages, point of sale spending, distribution of medicine, money transfers and prepayment of utility bills. The expenses associated with Transaction-based activities are primarily variable expenses such as security and guarding expenses we incur to help ensure the security of the cash we transport and the safety of our employees who transport the cash, banking fees we incur when we withdraw and redeposit cash, insurance and fixed expenses such as salaries and property rental.

Historically, a substantial majority of the revenues we derive from Transaction-based activities has consisted of the service delivery component of the fee we charge to the provincial governments with whom we contract for the distribution of social welfare grants. As stated above, the portion of the fee that relates to the provision of the smart card account is included in another segment, Smart card accounts. However, as the implementation of our POS device infrastructure gathers momentum and the usage of POS devices accelerates, we expect that the transaction fees we receive from our participating merchant base will increase significantly.

South African social welfare grants consist of eight different grant types, including social security, child support and disability grants. During the quarter ended March 31, 2005, the Northern Cape provincial government extended its contract with us for distribution of social welfare grants in that province. Provincial government contracts are typically awarded for a period of three years, with an option by the provincial government to extend the contract for an additional two years.

The following table shows the current status of each of our provincial government contracts:

	<b>KwaZulu-Natal</b>	<b>Limpopo</b>	<b>North West</b>	<b>Northern Cape</b>	<b>Eastern Cape</b>
Original year of contract award	1992	1996	1995	1997	2002
Date acquired by Net 1	October 1998	October 1998	October 1998	October 1998	n/a
Date of first Net 1 contract	January 2000	December 2003	July 2000	January 2000	November 2003
UEPS smart card implementation date	January 2000	January 2004	October 2000	September 2001	November 2003
Merchant acquiring rollout date	December 2004	March 2005	n/a	July 2004	October 2004
Current contract expiration date (including extensions)	December 2005	November 2006	June 2005	December 2006	November 2005
Further possible extensions	1 year	2 years	Negotiable	Negotiable	2 years
Number of beneficiaries paid by CPS (as of March 31, 2005)	1,431,119	859,874	272,352	124,816	633,207

We believe that we currently have approximately 45% of the market share in South Africa, based on the number of beneficiaries, for the distribution of social welfare grants, including grants distributed by the South African Post Office and the formal banking sector.

A smart card-based biometric, or fingerprint, identification system is used to verify beneficiaries and effect payments of social welfare grants onto individual smart cards, with each card acting as an account for the beneficiary. The beneficiary then has the choice of either converting the electronic value to cash using automated cash dispensers or effecting electronic payments through the smart card for a range of services such as the purchase of goods, loan repayments and insurance premium payments. The system's biometric verification and audit capabilities help to reduce the risks of fraud and theft traditionally associated with the use and storage of cash.

Historically, due to the limited number of services available, almost all of the beneficiaries have downloaded the value of their grant payments onto their smart cards and then immediately accessed the full amount as cash. Our revenue has therefore been limited to fees we earn on the loading and redemption of value on the cards as well as the registration of beneficiaries rather than the provision of other services. We are, however, aggressively expanding the services available to beneficiaries to include debit orders, point of service spending and money transfers. We believe that by making these services available to beneficiaries, we have the potential to earn additional revenues in the future.

As of March 31, 2005, we have deployed our UEPS retail application into merchant stores throughout the Northern Cape, Eastern Cape, KwaZulu-Natal and Limpopo provinces of South Africa. The system allows all our card holders to load their social welfare grants or salaries onto their smart cards at any participating merchant. Once their smart cards have been loaded, card holders have the flexibility to either purchase goods or receive cash offline.

We believe that the support from South African merchants has been highly favorable and we have signed contracts with merchants in rural, semi-urban and urban areas, including large chain stores. Potential benefits to merchants from

participation in the system include increased sales from a growing smart card client base, reduced banking charges, reduced communications and reconciliation costs and a reduction of the risks associated with fraud and theft.

Participating merchants can also generate new income streams for themselves by selling a range of financial products that we offer.

***Smart Card Accounts***

Our Smart card accounts operating segment derives revenue from the provision of smart card accounts to our card holders, which currently primarily consist of social welfare grant beneficiaries. As described under Transaction-Based Activities above, we provide a smart card account to all social welfare beneficiaries to whom we distribute payments. A portion of the fee we earn for the delivery of the service is for the provision of the smart card account and is therefore included in the Smart card accounts operating segment. The fixed costs included in this operating segment are primarily computer equipment-related and personnel costs associated with the operation of the smart card accounts.

***Financial Services***

Our Financial services operating segment derives revenues from providing financial services to card holders through our smart card delivery channel. These financial services consist primarily of short-term loans and life insurance products. We provide the loans ourselves and generate revenue from the interest earned on these loans. We sell life insurance products on behalf of registered underwriters and earn revenue through the commissions we receive on the sale of policies. The fees we earn for the collection of insurance policy premiums through our debit order system is included in the Transaction-based activities operating segment. We plan to grow and develop this business by launching new products into the provinces in which we administer social welfare grants. The fixed expenses associated with the Financial services operating segment consist primarily of costs of administrative personnel and depreciation of computer equipment.

We also operate a traditional microlending business with approximately 100 branches located throughout South Africa. These branches extend short-term loans for periods ranging from 30 days up to six months, with the majority of loans being 30-day loans. The fixed costs associated with the provision of these accounts are primarily the leasing of office premises and salaries associated with the provision of microlending loans.

***Hardware, Software and Related Technology Sales***

We have developed a range of technological competencies to service our own internal needs and to provide links with our client enterprises. We derive revenues from the Hardware, software and related technology sales operating segment by providing to customers the hardware and software required to implement our system. Typical components for a system installation are:

hardware for the back-end switching and settlement system;

customization of the UEPS software to suit local conditions, including UEPS management system, automated teller machine, or ATM, integration and POS device integration;

customization of an applications suite to client's specific requirements, such as banking, retail or wage payments;

ongoing software and hardware support/maintenance; and

license fees.

One of our largest customers in this segment is Nedbank Limited, one of South Africa's largest banks by asset size. We have an arrangement with Nedbank relating to the outsourcing of its entire POS device management system, front-end switching Stratus computer platform, software development, smart cards and POS device maintenance. We also supply hardware to Nedbank in the form of POS devices and card readers.

## Description of Income Statement Line Items

### ***Cost of Goods Sold, IT Processing, Servicing and Support***

Cost of goods sold, IT processing, servicing and support includes all costs we incur to provide our systems. The most significant elements of these costs include (1) security and guarding expenses which we incur to help protect the security of the cash we transport and the safety of our employees who transport the cash, (2) banking expenses we incur when we withdraw and redeposit cash, (3) transportation expenses we incur, including fuel, maintenance and insurance for the automotive vehicles that travel throughout the provinces to distribute social welfare payments, (4) personnel expenses other than for our executive and administration employees, (5) rental and utilities for the facilities we operate and (6) inventory expenses, which consist primarily of spare parts to perform hardware repairs.

### ***General and Administrative***

General and administrative expenses consist primarily of (1) personnel expenses for our executive and administration employees, (2) costs associated with our head office facility, (3) professional fees, such as audit, legal, advisory and tax and (4) marketing and travel expenses.

### ***Depreciation and Amortization***

Depreciation and amortization consists of depreciation of property, plant and equipment and amortization of intangible assets.

### ***Reorganization Charges***

These expenses consist primarily of fees we incurred in connection with the Aplitec transaction, including financial advisory fees, legal and accounting fees, printing expenses and filing fees.

### ***Interest Income***

Interest income consists of interest we receive on our surplus cash in our bank accounts, net of the interest we pay on short-term borrowings. Interest income we earn from our business of providing short-term loans is included in revenue and is not included in interest income.

### ***Income Taxes***

We account for income taxes using the asset and liability method. This approach recognizes the amount of taxes payable or refundable for the current year, as well as deferred tax assets and liabilities for the future tax consequence of events we recognize in the financial statements and tax returns. Deferred income taxes are adjusted to reflect the effects of changes in tax laws or enacted tax rates. The tax rate in South Africa varies depending on whether income is distributed. The income tax rate is currently 30%, but upon distribution an additional tax of 12.5% is due based on the amount of dividends declared, net of dividends received during a dividend cycle. In February 2005, the Finance Minister of South Africa announced in his annual budget speech for the 2005/2006 tax year the decrease in statutory rate of taxation for South African-domiciled companies from 30% to 29% for all fiscal years ending on or after April 1, 2005. As at March 31, 2005, the change in the rate had not been promulgated by parliament in South Africa and thus is not the enacted rate as described in Statement of Financial Accounting Standard 109, *Accounting for Income Taxes*. It is difficult to predict the ratification date of the change in tax rate, however, after enactment the distributed tax rate would decrease from the current 37.78% to 36.89%. We have not completed our analysis to determine the effect of the change in tax rate on our tax expense.

### ***Earnings from Equity-Accounted Investment***

We use the equity method to account for investments in a company when we have a significant influence, but not control, over the operations of the investee company. Under the equity method, we initially record the investment at cost on our balance sheet. We reflect in our statements of operations our

proportionate share of the investee company's net income or loss and we adjust the carrying value of the investment to reflect this net income or loss. Currently, our sole equity-accounted investment is our 43% interest in Permit Group 2 (Proprietary) Limited, which in turn owns 95% of the common stock of New Era Life Insurance Company, a provider of various insurance products to the South African market.

### **Current Trends Affecting Our Business**

#### ***Government Decision Making***

We currently derive a significant portion of our revenues from our contracts with various South African provincial governments. The national South African government passed legislation in 2004 for creation of the South African Social Security Agency, or SASSA. The primary purpose of SASSA is to consolidate at the central government level the administration of social welfare grants. We believe that our successful record with our provincial government contracts will provide us with a good opportunity to benefit from the transition to national administration of social welfare grants because we may be able to obtain contracts to distribute grants in provinces with which we do not currently have a contractual relationship. However, there is a chance that this consolidation could lead to our losing our current contracts if the SASSA decides to appoint a single contractor to provide social welfare grant distribution and we were not chosen. During this transition period, our existing provincial government contracts will continue to be governed by their respective terms.

When a provincial government contract expires, whether at its originally scheduled expiration date or at the end of any applicable extension period, we must successfully re-tender in order to retain the contractual relationship. Usually, such a tender must be submitted as part of a competitive tender process. The fact that we previously held a particular contract does not necessarily mean that it will be awarded to us again. To date, we have successfully renewed every provincial government contract which we have been awarded. In addition, there have been occasions when a contract has not been formally renewed prior to its originally scheduled expiration date or expiration of the extension period, but in each of these cases, we and the provincial government have continued to operate under the terms of the expired contract until execution of a new contract.

#### ***Rate of Adoption by System Participants***

An important factor in the growth of our business is the rate at which system participants use our system to effect transactions with our smart cards, which in turn depends on our success in placing POS devices at the locations of retailers where our card holders can load and spend their social welfare grants or salaries and the rate at which smart card holders effect transactions through those POS devices. We believe that increased use of our system by participants will result in a significant improvement in the lifestyle of our card holders and at the same time will reduce our costs of delivering social welfare grants in cash to beneficiaries. Beginning in July 2004, we began the rollout of our merchant acquiring system and as of March 31, 2005, we had begun enrolling participating retailers in the Northern Cape, Eastern Cape, KwaZulu-Natal and Limpopo provinces. In each case, we conducted this rollout in consultation with the provincial governments and community participants to ensure a smooth and efficient implementation. We measure our success in achieving increased participant use of our system by tracking the number of new POS devices installed, the number of new participating retailer locations and the total value of transactions processed through these POS devices. During the first quarter of 2005, we enrolled 265 retail merchants and installed 340 POS devices at their locations. During the second quarter of 2005, we enrolled 435 retail merchants and installed 926 POS devices at their locations. In the third quarter of 2005, we enrolled 741 retail merchants and installed 1,140 POS devices at their locations.

The following chart shows the growth in the value of transactions processed through our installed base of POS devices since we began implementation of our merchant acquiring system in 2004:

**Migration to Merchant Infrastructure**

(Migration to Merchant Infrastructure Chart)

	<b>Total Spent</b>	<b>Total cash withdrawal</b>	<b>Total Spent and Withdrawn</b>
Jan-04	3	7	10
Mar-04	386	599	985
May-04	668	1351	2019
Jul-04	3135	9297	12432
Sep-04	4942	11260	16202
Nov-04	16770	46741	63511
Jan-05	22307	61231	83538
Mar-05	42266	149003	191269

***Implementation of New UEPS Systems***

The implementation of new UEPS systems, particularly in developing economies outside our current markets, is a vital component of our future growth. We are currently exploring a number of opportunities to implement UEPS systems and to participate as minority investors in these projects. The success of these endeavors are, however, subject to a number of factors over which we have little or no control, such as finding suitable partners with the appropriate financial, business and technical backing and continued governmental support for planned implementations. In some countries, finding suitable partners and obtaining the appropriate support from the government involved may take a number of years before we can commence implementation.

**Critical Accounting Policies**

Our annual financial statements have been prepared in accordance with US GAAP, which requires management to make estimates and assumptions about future events that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities. As future events and their effects cannot be determined with absolute certainty, the determination of estimates requires management's judgment based on a variety of assumptions and other determinants such as historical experience, current and expected market conditions and certain scientific evaluation techniques. Management believes that the following accounting policies are critical due to the degree of estimation required and the impact of these policies on the understanding of the results of our operations.

***Deferred Taxation***

We estimate our tax liability through the calculations done for the determination of our current tax liability when tax returns are filed, together with assessing temporary differences resulting from the different treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities which are disclosed on our balance sheet. Management then has to assess the likelihood that deferred tax assets will be recovered from future taxable income. To the extent that we believe recovery is



unlikely, we create a valuation reserve. The carrying value of our net deferred tax assets assumes that we will be able to generate sufficient future taxable income, based on estimates and assumptions. Management has considered future taxable income and ongoing feasible tax strategies in determining the need for the valuation allowance, but in the event that we were to determine that we would be able to realize deferred tax assets in the future, a valuation allowance may not be required which would reduce net income in the period that such determination is made.

***Accounts Receivable and Provision for Doubtful Debts***

We maintain a provision for doubtful debts in our microlending business resulting from the inability of certain of our clients to make the required payments. Our current policy is to provide for the full outstanding amount for all debts which are outstanding for 150 days and longer. As of March 31, 2005, the full amount of such debt outstanding totaled \$8.8 million (ZAR 55.7 million), which is a 2.6% increase, in rand terms, over the amount outstanding at March 31, 2004 (\$8.5 million or ZAR 54.3 million). We consider this policy to be appropriate taking into account factors such as historical bad debts, current economic trends and changes in our customer payment patterns. Additional provisions may be required should the ability of our clients to make payments when due deteriorate in the future. A significant amount of judgment is required to assess the ultimate recoverability of these receivables, including on-going evaluation of the creditworthiness of each client.

***Research and Development***

Our business activities and product offerings depend on our proprietary UEPS software. As a result, we have a large group of software engineers and developers who are constantly revising and improving the core UEPS software. We account for the development cost of software intended for sale to licensees in accordance with SFAS No. 86,

Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed. SFAS 86 requires product development costs to be charged to expenses as incurred until technological feasibility is attained. Technological feasibility is attained when our software has completed system testing and has been determined viable for its intended use. The time between the attainment of technological feasibility and completion of software development has been short with immaterial amounts of development costs incurred during this period. Accordingly, we did not capitalize any development costs in fiscal 2003 or fiscal 2002, particularly because the main part of our development is the enhancement and upgrading of existing products.

We account for the costs to develop software for our internal use in accordance with Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use (SOP 98-1), issued by the AICPA. SOP 98-1 requires these costs to be expensed as incurred, except to the extent that these costs are incurred during the application development stage. All other costs including those incurred in the project development and post-implementation stages are expensed as incurred.

A significant amount of judgment is required to separate research costs, new development costs and ongoing development costs based on the transition between these stages. A multitude of factors need to be considered by management, including an assessment of the state of readiness of the software and the existence of markets for the software. The possibility of capitalizing development costs in the future, within the criteria set by SFAS 86 or SOP 98-1, may have a material impact on our profitability in the period when the costs are capitalized, and in subsequent periods when the capitalized costs are amortized.

**Currency Exchange Rate Information**

Exchange rates at and for the nine months ended March 31, 2005 and 2004, and at and for the years ended June 30, 2004, 2003, 2002, 2001 and 2000, were as follows:

	Nine Months Ended March 31,		Year Ended June 30,				
	2005	2004	2004	2003	2002	2001	2000
<b>Actual exchange rates</b>							
ZAR: \$ average exchange rate	6.1546	6.9971	6.9001	9.0568	10.1477	7.6109	6.3487
Highest ZAR: \$ rate during period	6.7635	7.8030	7.8030	12.3300	13.8450	8.1900	9.1950
Lowest ZAR: \$ rate during period	5.5350	6.0576	6.0576	6.9900	7.9946	6.7300	5.9350
Rate at end of period	6.3099	6.3525	6.2750	7.4700	10.3700	8.0536	6.8250

**US\$: ZAR Exchange Rates****Translation Exchange Rates**

We are required to translate our results of operations from ZAR to U.S. dollars on a monthly basis. Thus, the average rates used to translate this data at and for the nine months ended March 31, 2005 and 2004, and at and for the years ended June 30, 2004, 2003, 2002, 2001 and 2000, may vary slightly from the averages shown in the table above. The translation rates we use in presenting our results of operations are the rates shown in the following table:

	Nine Months Ended March 31,		Year Ended June 30,				
	2005	2004	2004	2003	2002	2001	2000
Income and expense items: \$1 = ZAR	6.1433	6.9734	6.9183	9.0568	10.1477	7.6109	6.3487
Balance sheet items: \$1 = ZAR	6.3099	6.3525	6.2750	7.4700	10.3700	8.0536	6.8250

**Results of Operations**

The discussion of our consolidated overall results of operations is based on amounts in US GAAP as reflected in the unaudited condensed consolidated financial statements. However, our discussion of results of operations for individual business segments is based on amounts in South African GAAP, or SA GAAP, as reflected in note 6, Operating Segments, of the notes to the unaudited condensed consolidated financial statements because the internal financial reporting that is used by our chief operating

decision maker to evaluate segment performance is prepared on an SA GAAP basis. Please refer to note 6 to our unaudited condensed consolidated financial statements for information discussing certain differences between US GAAP and SA GAAP.

Additionally, our discussion analyzes our results of operations both in U.S. dollars, as presented in the consolidated financial statements, and supplementally in ZAR, because ZAR is the functional currency of the entities which contribute the majority of our profits and is the currency in which the majority of our transactions are initially incurred and measured. Due to the significant impact of currency fluctuations between the U.S. dollar and ZAR on our reported results and because we use the U.S. dollar as our reporting currency, we believe that the supplemental presentation of our results of operations in ZAR is useful to investors to understand the changes in the underlying trends of our business.

**Nine Months Ended March 31, 2005 Compared to Nine Months Ended March 31, 2004**

There are three factors which significantly impacted our results of operations during the periods presented: fluctuations in the exchange rate between the South African rand, or ZAR, which is our functional currency, and the U.S. dollar, which is our reporting currency;

commencement during the first quarter of the Nedbank project to deliver POS devices and the conclusion of the project during the third quarter; and

higher volumes in transaction-based activities and financial services.

In addition, our earnings per share of common stock and linked units for each period reflect the full impact of all new shares of common and special convertible preferred stock issued in connection with the Aplitec transaction. The calculation of earnings per share for the nine months ended March 31, 2005 is based on 54,700,394 shares outstanding which, as of March 31, 2005, comprised 27,175,135 shares of common stock and 27,525,259 shares of special convertible preferred stock, compared to 32,161,190 shares of common stock used for the calculation of earnings per share for the nine months ended March 31, 2004. We discuss under the non-GAAP measures heading below how our earnings per share for the nine months ended March 31, 2005 and 2004, would have been affected if all 54,700,394 shares had been outstanding on July 1, 2003.

**Consolidated Overall Results of Operations**

This discussion is based on the amounts which were prepared in accordance with US GAAP.

The following tables show the changes in the items comprising our statements of operations, both in U.S. dollars and in ZAR.

<b>In United States Dollars (US GAAP)</b>			
<b>Nine Months Ended March 31,</b>			
	<b>2005 \$ 000</b>	<b>2004 \$ 000</b>	<b>\$ % Change</b>
Revenue	134,885	91,463	47%
Cost of goods sold, IT processing, servicing and support	41,207	28,206	46%
General and administrative	33,804	25,625	32%
Depreciation and amortization	4,897	4,110	19%
Reorganization charges		3,537	(100)%
Operating income	54,977	29,985	83%
Interest income, net	1,497	2,464	(39)%
Income before income taxes	56,474	32,449	74%
Income tax expense	22,534	13,896	62%
Net income before earnings from equity accounted investment	33,940	18,553	83%
Earnings from equity accounted investment	480		
Net income	34,420	18,553	86%

<b>In South African Rand (US GAAP)</b>			
<b>Nine Months Ended March 31,</b>			
	<b>2005 ZAR 000</b>	<b>2004 ZAR 000</b>	<b>ZAR % Change</b>
Revenue	830,391	635,992	31%
Cost of goods sold, IT processing, servicing and support	254,899	194,876	31%
General and administrative	207,668	178,693	16%
Depreciation and amortization	30,084	28,661	5%
Reorganization charges		24,665	(100)%
Operating income	337,740	209,097	62%
Interest income, net	9,197	17,182	(46)%

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Income before income taxes	346,937	226,279	53%
Income tax expense	138,433	96,902	43%
Net income before earnings from equity accounted investment	208,504	129,377	61%
Earnings from equity accounted investment	2,949		
Net income	211,453	129,377	63%

Analyzed in ZAR, the increase in revenue and cost of goods sold, IT processing, servicing and support for the nine months ended March 31, 2005, was primarily due to the delivery of POS devices to Nedbank and the higher volumes in our transaction-based activities and financial services operating segments. The increase in depreciation and amortization for the nine months to March 31, 2005 was due, in part, to the inclusion of the Net 1 intangibles. The reorganization charges for the nine months ended March 31, 2004 relate to the Aplitec transaction.

The increase in operating income margin to 41% for the nine months ended March 31, 2005, from 33% for the nine months ended March 2004, was primarily due to improved efficiencies across all activities, performance of the Nedbank contract mentioned above and a significantly improved contribution from our contract to pay social welfare grants in the Eastern Cape province. We anticipate that as we continue to enroll participating retailers in our system, we will experience increased utilization of the installed base of our POS devices, which should result in further improvements in our operating income margins.

#### **Interest Received and Finance Costs**

Interest received consists of interest received on our surplus cash, while finance costs consist of interest paid on short-term borrowings. We have a unique cash flow cycle due to our obligations to pre-fund the payments of social welfare grants in the KwaZulu-Natal and Eastern Cape provinces. We provide the funds required for the grant payments on behalf of these provincial governments from our own cash resources and are reimbursed within two weeks by the KwaZulu-Natal and Eastern Cape governments, thus exposing us to these provinces' credit risk. These obligations result in a peak funding requirement, on a monthly basis, of approximately \$40 million (ZAR 250 million) for the KwaZulu-Natal contract and \$35 million (ZAR 220 million) for the Eastern Cape contract. The funding requirements are at peak levels for the first two weeks of every month during the year. The pre-funding requirement for the KwaZulu-Natal and Eastern Cape contracts has increased and resulted in higher finance costs. However, these increased expenses were partially offset by the decrease in the South African prime overdraft rate from an average of 12% per annum during the nine months ended March 31, 2004 to 11% per annum during the nine months ended March 31, 2005. Thus, finance costs increased from \$8.5 million (ZAR 59.3 million) for the nine months ended March 31, 2004 to \$10.1 million (ZAR 62.0 million) for the same period in 2005.

Interest on surplus cash for the nine months ended March 31, 2005 changed to \$11.5 million (ZAR 70.6 million) from \$10.8 million (ZAR 75.3 million) for the comparable period during the prior year. The decrease in ZAR was due to the lower prime overdraft rate during the 2005 period.

#### **Taxation**

Total tax expense for the nine months ended March 31, 2005 was \$22.5 million (ZAR 138.4 million) compared with \$13.9 million (ZAR 96.9 million) during the same period in the prior year. The increase was due to our increased profitability in all segments. In February 2005, the Finance Minister of South Africa announced in his annual budget speech for the 2005/2006 tax year the decrease in statutory rate of taxation for South African domiciled companies from 30% to 29% for all fiscal years ending on or after April 1, 2005. As of March 31, 2005, the change in the rate had not been promulgated by parliament in South Africa and has therefore not been reflected in the quarterly financial information presented. It is difficult to predict the ratification date of the change in tax rate, however, after enactment the distributed tax rate would decrease from the current 37.78% to 36.89%. We have not completed our analysis to determine the effect of the change in tax rate on our tax expense charge.

#### ***Results of Operations by Operating Segment***

The composition of revenue and the contributions of our operating segments to operating income are illustrated below. The discussion of our operating segments is based on amounts which were prepared in accordance with SA GAAP. Our management prepares financial statements for management purposes

under SA GAAP and our chief operating decision maker evaluates segment performance using SA GAAP measures.

**In United States Dollars (SA GAAP)**

**Nine Months Ended March 31,**

	<b>2005</b>	<b>% of</b>	<b>2004</b>	<b>% of</b>	<b>%</b>
	<b>\$ 000</b>	<b>Total</b>	<b>\$ 000</b>	<b>Total</b>	<b>Change</b>
<b>Operating Segment</b>					
Consolidated revenue:					
Transaction-based activities	77,538	57%	59,875	66%	30%
Smart card accounts	26,362	20%	15,762	17%	67%
Financial services	15,642	12%	12,384	14%	26%
Hardware, software and related technology sales	15,343	11%	3,312	3%	363%
<b>Total consolidated revenue</b>	<b>134,885</b>	<b>100%</b>	<b>91,333</b>	<b>100%</b>	<b>48%</b>
Consolidated operating income (loss):					
Transaction-based activities	31,629	55%	18,626	68%	70%
Smart card accounts	11,983	21%	7,165	26%	67%
Financial services	7,579	13%	5,150	19%	47%
Hardware, software and related technology sales	6,036	11%	(236)	(1)%	
Corporate/Eliminations	(174)	0%	(3,442)	(12)%	(95)%
<b>Total consolidated operating income</b>	<b>57,053</b>	<b>100%</b>	<b>27,263</b>	<b>100%</b>	<b>109%</b>

**In South African Rand (SA GAAP)**

**Nine Months Ended March 31,**

	<b>2005</b>	<b>% of</b>	<b>2004</b>	<b>% of</b>	<b>%</b>
	<b>ZAR</b>	<b>Total</b>	<b>ZAR</b>	<b>Total</b>	<b>Change</b>
	<b>000</b>		<b>000</b>		
<b>Operating Segment</b>					
Consolidated revenue:					
Transaction-based activities	477,346	57%	416,937	66%	14%
Smart card accounts	162,292	20%	109,755	17%	48%
Financial services	96,297	12%	86,238	14%	12%
Hardware, software and related technology sales	94,456	11%	23,062	3%	310%
<b>Total consolidated revenue</b>	<b>830,391</b>	<b>100%</b>	<b>635,992</b>	<b>100%</b>	<b>31%</b>

Consolidated operating income (loss):

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Transaction-based activities	194,605	55%	129,661	68%	50%
Smart card accounts	73,728	21%	49,878	26%	48%
Financial services	46,632	13%	35,847	19%	30%
Hardware, software and related technology sales	37,138	11%	(1,643)	(1)%	
Corporate/Eliminations	(1,071)	0%	(23,960)	(12)%	(96)%
<b>Total consolidated operating income</b>	<b>351,032</b>	<b>100%</b>	<b>189,783</b>	<b>100%</b>	<b>85%</b>

***Transaction-Based Activities***

In U.S. dollars, revenues increased by 30% for the nine months ended March 31, 2005, from the comparable period in 2004. Operating income increased by 70% for the nine months ended March 31, 2005, from the comparable period in 2004.



In ZAR, revenues increased by 14% for the nine months ended March 31, 2005, from the comparable period in 2004. Operating income increased by 50% for the nine months ended March 31, 2005, from the comparable period in 2004.

These increases in revenues and operating income were due primarily to the rollout of our merchant acquiring system which began in July 2004, implementation of transacting ability at participating retailers POS devices, full operation of the Eastern Cape provincial contract, higher volumes from our other provincial contracts and annual increases in the amounts we charge under our provincial contracts. We discuss these factors in more detail below.

*Rollout of our merchant acquiring system:* During July 2004, we began a major drive to install POS devices in rural areas where the majority of our card holders spend their social welfare grants. The number of POS devices installed, the number of new UEPS participating retail locations and the total value of transactions processed through these terminals is summarized in the table below:

Province	Three Months Ended			Total Year to Date
	Sept. 2004 (includes Northern Cape)	Dec. 2004 (includes Northern Cape and Eastern Cape)	Mar. 2005 (includes Northern Cape, Eastern Cape and KwaZulu-Natal)	(includes Northern Cape, Eastern Cape and KwaZulu-Natal)
POS devices installed	340	926	1,140	2,406
Number of new UEPS participating retail locations	265	435	741	1,441
Value of transactions processed through POS devices (in \$ 000)	3,563	10,596	45,529	59,688
Value of transactions processed through POS devices (in ZAR 000)	22,711	64,518	273,800	361,029

*Full operation of Eastern Cape contract:* During the first two quarters of fiscal 2004, the implementation of our social welfare grant payment system in the Eastern Cape Province was not fully operational. We processed 5,480,916 transactions during the nine months ended March 31, 2005, compared with 3,889,783 transactions during the nine months ended March 31, 2004.

*Higher volumes from our other provincial contracts:* We have experienced growth in most of the other provinces where we administer payments of social welfare grants. This growth has been mainly due to new qualifying criteria announced in 2003 by the South African government that increased the eligibility for child support grants, and a significant increase in the number of disability grants approved by the various provincial governments. In total, the volume of payments processed during the nine months ended March 31, 2005 increased 21% to 29,435,978 from the comparable period during 2004.

*Annual price increase adjustments:* Under our Service Level Agreements with provincial governments, we are entitled to annual price increases based upon factors such as average grant size, volumes and the South African Consumer Price Index, or CPI rates.



The higher volumes in existing contracts, as well as any price increases are detailed below:

**Nine Months Ended March 31,**

Province	Number of Payments		Average Price per Beneficiary Payment			
	2005	2004	2005 \$(1)	2004 \$(2)	2005 ZAR(1)	2004 ZAR(2)
KwaZulu-Natal	12,494,917	10,194,132	3.30	2.55	20.27	17.767
Limpopo	8,012,425	6,893,862	2.30	1.94	14.14	13.50
North West	2,366,301	2,332,115	2.92	2.31	17.93	16.10
Northern Cape	1,081,419	1,029,949	3.41	3.01	20.97	20.97
Eastern Cape	5,480,916	3,889,783	2.26	2.00	13.91	13.91
<b>Total</b>	<b>29,435,978</b>	<b>24,339,841</b>				

(1) The average price per payment excludes \$0.90 (ZAR 5.50) related to the provision of smart card accounts.

(2) The average price per payment excludes \$0.79 (ZAR 5.50) related to the provision of smart card accounts.

Operating income margin for the nine months ended March 31, 2005 increased to 41% from 31% for the nine months ended March 31, 2004. These profit margin improvements were mainly due to:

the increased volumes and the higher average price per payment as detailed in the table above;

the reduced losses on the Eastern Cape contract, where we incurred significant expenses during the first half of fiscal 2004 in connection with the process of optimizing the logistics of the Eastern Cape implementation, such as the number of vehicles, number of payment points and number of beneficiaries at each payment point;

the conversion of our operations in the Limpopo province during November 2003 to February 2004 to a full smart card-based payment system; and

the increase in the number of social grant beneficiaries paid through our POS device infrastructure at participating retailers, instead of payment using more costly automated cash dispensers.

***Smart Card Accounts***

In U.S. dollars, revenues and operating income each increased by 67% for the nine months ended March 31, 2005, from the comparable period in 2004.

In ZAR, revenues and operating income each increased by 48% for the nine months ended March 31, 2005, from the comparable period in 2004.

Operating income margin from providing smart card accounts was fairly constant at 45% for the each of the nine months ended March 31, 2005 and 2004.

Revenue from the provision of smart card based accounts grew in proportion to the higher number of beneficiaries serviced through our social welfare payment contracts. A total number of 3,321,368 smart card-based accounts were active as of March 31, 2005, compared to 2,949,976 active accounts as at March 31, 2004. The significant increase in the number of active accounts is primarily due to the conversion to a full smart card-based payment system of the beneficiaries we service in the Limpopo province. A total of 859,874 accounts were active in this province at March 31, 2005.

***Financial Services***

In U.S. dollars, revenues increased by 26% for the nine months ended March 31, 2005, from the comparable period in 2004. Operating income increased by 47% for the three months ended March 31, 2005, from the comparable period in 2004.

In ZAR, revenues increased by 12% for the nine months ended March 31, 2005, from the comparable period in 2004. Operating income increased by 30% for the nine months ended March 31, 2005, from the comparable period in 2004.

Revenues from UEPS-based lending improved as a result of growth in our loan portfolio as we expanded the areas where this service is offered. By contrast, the loan portfolio of the traditional micro-lending businesses remained static as a result of our strategic decision not to grow this business aggressively. The key indicators of these businesses are illustrated below:

	At March 31, 2005	At March 31, 2004	\$ % Change	At March 31, 2005 ZAR 000	At March 31, 2004 ZAR 000	ZAR % Change
Finance loans receivable:						
Traditional microlending gross	11,143	12,043	(7)%	70,313	76,502	(8)%
Provisions	(7,059)	(8,052)	(12)%	(44,541)	(51,148)	(13)%
Finance loans receivable:						
Traditional microlending net of provisions	4,084	3,991	2%	25,772	25,354	2%
Finance loans receivable:						
UEPS-based lending net and gross (i.e., no provisions)	4,746	4,550	4%	29,944	28,906	4%
	8,830	8,541		55,716	54,260	

Operating income margin for the financial services segment increased to 48% for the nine months ended March 31, 2005 from 42% for the nine months ended March 31, 2004, primarily due to the change in the composition of the lending portfolio from the lower margin and higher risk traditional microlending to the higher margin and lower risk UEPS-based lending. The provision of UEPS-based lending is volume driven and profitability improves as volumes increase, as most costs are fixed. During fiscal 2005, we have substantially reduced the staff cost associated with UEPS-based lending, as the fixed-term contracts of staff members who assisted in the establishment of this initiative expired. The change in the contribution to segment revenue and the change in the operating income margin of UEPS-based lending and traditional microlending for the nine months ended March 31, 2005 and 2004 are illustrated in the table below:

Nine Months Ended March 31,			
2005		2004	
% of Total Revenue	Profit Margin %	% of Total Revenue	Profit Margin %

UEPS-based lending	48%	76%	18%	66%
Traditional microlending	52%	22%	82%	26%
	100%		100%	

***Hardware, Software and Related Technology Sales***

In U.S. dollars, revenues increased by \$12.0 million for the nine months ended March 31, 2005, from the comparable period in 2004. Operating income increased by \$6.3 million for the nine months ended March 31, 2005, from the comparable period in 2004.

In ZAR, revenues increased by ZAR 71.4 million for the nine months ended March 31, 2005, from the comparable period in 2004. Operating income increased by ZAR 38.8 million for the nine months ended March 31, 2005, from the comparable period in 2004.

These increases were due primarily to revenues earned from commencement of our contract to supply Nedbank with 18,500 POS devices, 5,600 pin-pads and 66,000 merchant smart cards. Total revenues from

this contract were \$10.4 million for the nine months ended March 31, 2005 (approximately ZAR 63.6 million). As anticipated, we completed this project during the third quarter of fiscal 2005. Hardware sales of this nature are infrequent, and we do not anticipate revenue from similar large-scale hardware supply contracts to occur in the foreseeable future.

***Corporate/Eliminations***

In U.S. dollars, operating loss decreased by 95% for nine months ended March 31, 2005, from the comparable period in 2004.

In ZAR, operating loss decreased 96% for the nine months ended March 31, 2005, from the comparable period in 2004.

Changes in operating income resulted primarily from higher staff and audit costs. In addition, Net1's operating losses are not included in the comparative information. Operating income for the nine months ended March 31, 2005, include a gain of \$2 million (ZAR 12.8 million) relating to the closure of the insurance captive in the first quarter of 2005 and the earnings from the equity accounted investment. Operating income for the nine months ended March 31, 2004 includes the \$3.5 million (ZAR 24.7 million) reorganization charge related to the Aplitec transaction.

**Year Ended June 30, 2004 Compared to Year Ended June 30, 2003**

There were two factors that had a significant impact on our results of operations for the year ended June 30, 2004:

reorganization costs associated with the Aplitec transaction; and

fluctuations in the exchange rate between the ZAR and the U.S. dollar.

**Consolidated Overall Results of Operations**

This discussion is based on the amounts which were prepared in accordance with US GAAP.

The following tables show the changes in the items comprising our statements of operations, both in U.S. dollars and ZAR:

	<b>In United States Dollars (US GAAP)</b>		
	<b>Year Ended June 30,</b>		
	<b>2004</b>	<b>2003</b>	<b>\$ %</b>
	<b>\$ 000</b>	<b>\$ 000</b>	<b>Change</b>
Revenue	131,098	74,924	75%
Cost of goods sold, IT processing, servicing and support	39,134	25,935	51%
General and administrative	39,677	26,399	50%
Depreciation and amortization	5,676	3,323	71%
Reorganization charges	11,133		
Operating income	35,478	19,267	84%
Interest income, net	3,640	2,600	40%
Income before income taxes	39,118	21,867	79%
Income tax expense	25,927	9,473	174%
Net income before minority interest, earnings from equity accounted investment, extraordinary item and cumulative effect of an accounting charge	13,191	12,394	6%
Minority interest		452	(100)%
Earnings from equity accounted investment	87		
Extraordinary item		857	(100)%
Cumulative effect of an accounting change		318	(100)%
Net income	13,278	13,117	1%



	<b>In South African Rand (US GAAP)</b>		
	<b>Year Ended June 30,</b>		
	<b>2004 ZAR 000</b>	<b>2003 ZAR 000</b>	<b>ZAR % Change</b>
Revenue	898,768	678,568	32%
Cost of goods sold, IT processing, servicing and support	265,003	234,879	13%
General and administrative	274,497	239,090	15%
Depreciation and amortization	39,268	30,096	30%
Reorganization charges	77,021		
Operating income	242,979	174,503	39%
Interest income, net	25,183	23,548	7%
Income before income taxes	268,162	198,051	35%
Income tax expense	179,371	85,795	109%
Net income before minority interest, earnings from equity accounted investment, extraordinary item and cumulative effect of an accounting charge	88,791	112,256	(21)%
Minority interest		4,094	(100)%
Earnings from equity accounted investment	602		
Extraordinary item		7,762	(100)%
Cumulative effect of an accounting change		2,880	(100)%
Net income	89,393	118,804	(25)%

Analyzed in ZAR, the increase in revenue and cost of goods sold, IT processing, servicing and support for the year ended June 30, 2004, was primarily due the higher volumes in our transaction-based activities and financial services operating segments. The reorganization charges for the year ended June 30, 2004 relate to the Aplitec transaction.

The increase in operating income margin to 27% for the year ended June 30, 2004, from 26% for the year ended June 30, 2003, was primarily due to improved efficiencies across all activities.

#### **Interest Received and Finance Costs**

Interest received consists of interest received on our surplus cash, while finance costs consist of interest paid on short-term borrowings. We have a unique cash flow cycle due to our obligations to pre-fund the payments of social welfare grants in the KwaZulu-Natal and Eastern Cape provinces. We provide the funds required for the grant payments on behalf of these provincial governments from our own cash resources and are reimbursed within two weeks by the KwaZulu-Natal and Eastern Cape governments, thus exposing us to these provinces' credit risk. These obligations result in a peak funding requirement, on a monthly basis, of approximately \$36.1 million (ZAR 250 million) for the KwaZulu-Natal contract and \$26 million (ZAR 180 million) for the Eastern Cape contract. The funding requirements are at peak levels for the first two weeks of every month during the year. The significantly higher payment volumes in KwaZulu-Natal during the year ended June 30, 2004, as well as full operational implementation of the Eastern Cape provincial contract, increased our pre-funding requirements which resulted in an

increase in finance costs from \$5.5 million (ZAR 49.5 million) in 2003 to \$11.8 million (ZAR 81.5 million) in 2004.

Interest on surplus cash increased from \$8.1 million (ZAR 73.1 million) to \$15.4 million (ZAR 106.4 million), primarily due to the higher average cash on hand balances during the year ended June 30, 2004 compared with 2003. Cash on hand increased from \$54.3 million (ZAR 405.7 million) at June 30, 2003 to \$80.3 million (ZAR 503.7 million) at June 30, 2004.

**Taxation**

Total tax expense for the year ended June 30, 2004 increased from \$9.5 million (ZAR 85.8 million) in 2003 to \$26.0 million (ZAR 179.4 million), mainly due to our increased profitability and the large tax payments relating to the Aplitec transaction. These taxes relate primarily to capital gains tax. The majority of the reorganization charges are also not allowed as deductions for tax purposes, which further increased the amount of income taxes payable and the effective tax rate.

**Minority Interests**

No income was attributable to minority interests during the year ended June 30, 2004, as we acquired all of these minority interests during the year ended June 30, 2003.

**Results of Operations by Operating Segment**

The composition of revenue and the contributions of our operating segments to operating income are illustrated below. The discussion of our operating segments is based on amounts which were prepared in accordance with SA GAAP. Our management prepares financial statements for management purposes under SA GAAP and our chief operating decision maker evaluates segment performance using SA GAAP measures.

**In United States Dollars (SA GAAP)**

	<b>Year Ended June 30,</b>				
	<b>2004</b>	<b>% of</b>	<b>2003</b>	<b>% of</b>	<b>%</b>
	<b>\$ 000</b>	<b>Total</b>	<b>\$ 000</b>	<b>Total</b>	<b>Change</b>
<b>Operating Segment</b>					
Consolidated revenue:					
Transaction-based activities	83,275	64%	44,058	58%	89%
Smart card accounts	26,584	20%	13,750	18%	93%
Financial services	16,633	13%	13,407	18%	24%
Hardware, software and related technology sales	4,606	3%	5,135	6%	(10)%
<b>Total consolidated revenue</b>	<b>131,098</b>	<b>100%</b>	<b>76,350</b>	<b>100%</b>	<b>72%</b>
Consolidated operating income (loss):					
Transaction-based activities	24,913	63%	10,196	53%	144%
Smart card accounts	12,055	31%	5,500	28%	119%
Financial services	6,778	17%	4,705	24%	44%
Hardware, software and related technology sales	1,232	3%	680	4%	81%
Corporate/ Eliminations	(5,735)	(14)%	(1,663)	(9)%	245%
<b>Total consolidated operating income</b>	<b>39,243</b>	<b>100%</b>	<b>19,418</b>	<b>100%</b>	<b>102%</b>

## In South African Rand (SA GAAP)

Year Ended June 30,

	2004 ZAR 000	% of Total	2003 ZAR 000	% of Total	% Change
<b>Operating Segment</b>					
Consolidated revenue:					
Transaction-based activities	567,910	63%	399,016	58%	42%
Smart card accounts	183,917	20%	124,533	18%	48%
Financial services	115,077	13%	121,426	18%	(5)%
Hardware, software and related technology sales	31,864	4%	46,509	6%	(31)%
<b>Total consolidated revenue</b>	<b>898,768</b>	<b>100%</b>	<b>691,484</b>	<b>100%</b>	<b>30%</b>
Consolidated operating income (loss):					
Transaction-based activities	172,360	64%	92,343	53%	87%
Smart card accounts	83,599	31%	49,813	28%	68%
Financial services	46,696	17%	42,605	24%	10%
Hardware, software and related technology sales	8,525	3%	6,162	4%	38%
Corporate/Eliminations	(40,166)	(15)%	(15,055)	(9)%	167%
<b>Total consolidated operating income</b>	<b>271,014</b>	<b>100%</b>	<b>175,868</b>	<b>100%</b>	<b>54%</b>

**Transaction-Based Activities**

In U.S. dollars, revenues increased by 89% for the year ended June 30, 2004, from the comparable period in 2003. Operating income increased by 144% for the year ended June 30, 2004, from the comparable period in 2003.

In ZAR, revenues increased by 42% for the year ended June 30, 2004, from the comparable period in 2003. Operating income increased by 87% for the year ended June 30, 2004, from the comparable period in 2003.

These increases in revenues and operating income were due primarily to the full operation of the Eastern Cape provincial contract, significantly higher volumes from our other provincial contracts and annual increases in the amounts we charge under our provincial contracts. We discuss these factors in more detail below.

*Full operation of Eastern Cape contract:* The implementation of our social welfare grant payment system in the Eastern Cape province became fully operational in 2004, which dramatically increased the number of benefits processed during the year in that province to 5,482,237 transactions, compared with 1,050,833 in the prior year.

*Significantly higher volumes under existing provincial contracts:* We experienced significant growth in most of the other provinces where we administer payments of social welfare grants. This growth is mainly due to new qualifying criteria announced in 2003 by the South African government that increased the eligibility for child support grants. In total, the volume of payments processed during the year ended June 30, 2004 increased by 43% to 33,439,462 compared to the year ended June 30, 2003.

*Annual price increase adjustments:* Under our Service Level Agreements with provincial governments, we are entitled to annual price increases based upon factors such as average grant size, volumes and the South African Consumer Price Index, or CPI rates.



The higher volumes under existing provincial contracts during the year ended June 30, 2004, as well as any price increases, relative to 2003, are detailed below:

Province	Year Ended June 30,		Average Price per Beneficiary Payment			
	Number of Payments		2004		2003	
	2004	2003	(US\$)(1)	(US\$)(2)	(ZAR)(1)	(ZAR)(2)
KwaZulu-Natal	14,037,541	11,125,544	2.66	1.80	18.26	15.82
Limpopo	9,402,141	7,435,326	2.04	1.45	13.98	12.64
North West	3,127,808	2,940,723	2.35	1.82	16.09	15.99
Northern Cape	1,389,735	1,180,735	3.05	2.27	20.97	20.07
Eastern Cape	5,482,237	1,050,833	2.03	1.64	13.91	14.41
<b>Total</b>	<b>33,439,462</b>	<b>23,733,161</b>				

(1) The average price per payment excludes \$0.70 (ZAR 5.50) related to the provision of smart card accounts.

(2) The average price per payment excludes \$0.70 (ZAR 5.00) related to the provision of smart card accounts.

Operating income margin for the year ended June 30, 2004, improved to 30.3% from 20.6% for the year ended June 30, 2003. These margin improvements were mainly due to:

reduced losses on the Eastern Cape contract, on which we experienced significant losses during 2003 as a result of the substantial establishment costs and very low transaction volumes during the contract implementation period. The increased costs we incurred during the first half of 2004 in connection with the process of optimizing the logistics of the Eastern Cape implementation, such as number of vehicles, number of payment points and number of beneficiaries at each payment point, also resulted in reduced losses on the Eastern Cape contract during the second half of 2004; and

the conversion of our operations in the Limpopo province to a full smart card-based payment system.

As we depreciate capital expenditures in respect of the Limpopo and Eastern Cape provincial contracts and we improve logistical planning in the Eastern Cape, we expect our operating income margins from transaction-based activities to improve.

#### ***Smart Card Accounts***

In U.S. dollars, revenues increased by 93% for the year ended June 30, 2004, from the comparable period in 2003. Operating income increased by 119% for the year ended June 30, 2004, from the comparable period in 2003.

In ZAR, revenues increased by 48% for the year ended June 30, 2004, from the comparable period in 2003. Operating income increased by 68% for the year ended June 30, 2004, from the comparable period in 2003.

Operating income margin from providing smart card accounts increased by 5% for the year ended June 30, 2004, from the comparable period in 2003.

Revenue from the provision of smart card based accounts grew in proportion to the higher number of beneficiaries serviced through our social welfare payment contracts. A total number of 3,066,581 UEPS smart card-based accounts were active at June 30, 2004, compared to 1,852,624 active accounts as at June 30, 2003. The significant increase in the number of active accounts was primarily due to the conversion of the beneficiaries serviced in the Limpopo province to a full smart card-based payment system. A total of 840,320 accounts had been activated in this province at June 30, 2004.



**Financial Services**

In U.S. dollars, revenues increased by 24% for the year ended June 30, 2004, from the comparable period in 2003. Operating income increased by 44% for the year ended June 30, 2004, from the comparable period in 2003.

In ZAR, revenues decreased by 5% for the year ended June 30, 2004, from the comparable period in 2003. Operating income increased by 10% for the year ended June 30, 2004, from the comparable period in 2003.

Revenue from UEPS-based lending improved as a result of strong growth in our loan portfolio as we expanded the areas where we offer this service. In contrast, the loan portfolio of our traditional micro-lending businesses declined as a result of our strategic decision not to grow this business aggressively. The key indicators of these businesses are illustrated below:

	Year Ended June 30,					
	2004		2003		ZAR	
	\$ 000	\$ 000	\$ % Change	ZAR 000	ZAR 000	ZAR % Change
Finance loans receivable:						
Traditional microlending gross	12,609	10,963	15%	79,124	81,890	(3)%
Provisions	(8,352)	(6,529)	28%	(52,410)	(48,771)	8%
Finance loans receivable:						
Traditional microlending net of provisions	4,257	4,434	(4)%	26,714	33,119	(19)%
Finance loans receivable:						
UEPS-based lending net and gross (i.e., no provisions)	5,043	3,194	58%	31,647	23,861	33%
	9,300	7,628		58,361	56,980	

Operating income margin increased for the year ended June 30, 2004 to 41%, compared to 35% for the year ended June 30, 2003, primarily due to the change in the mix of the debtors book from the lower margin and higher risk traditional microlending to the higher margin and lower risk UEPS-based lending. The provision of UEPS-based lending is volume driven and profitability improves as volumes increase, as most costs are fixed. The change in the contribution of the various components to revenue and the change in the operating income margin from 2003 to 2004 are illustrated in the table below:

	Year Ended June 30,			
	2004		2003	
	% of Total Revenue	Operating Income Margin %	% of Total Revenue	Operating Income Margin %
UEPS-based lending	41%	66%	34%	58%
Traditional microlending	59%	27%	66%	31%
	100%		100%	



***Hardware, Software and Related Technology Sales***

In U.S. dollars, revenues decreased by 10% for the year ended June 30, 2004, from the comparable period in 2003. Operating income increased by 81% for the year ended June 30, 2004, from the comparable period in 2003.

In ZAR, revenues decreased by 31% for the year ended June 30, 2004, from the comparable period in 2003. Operating income increased by 38% for the year ended June 30, 2004, from the comparable period in 2003.

These activities have limited recurring revenues, such as royalty income, and are dependent on signing new contracts and/or the expansion of UEPS systems already implemented.

The revenue decrease was expected due to a significant change in the product mix, from low margin hardware sales to high margin software sales. As a result, operating income from these activities improved and the operating income margin increased to 27% for the year ended June 30, 2004 from 13% for 2003.

A significant local customer serviced through these activities is Nedbank Limited, one of South Africa's four largest banks, which outsources certain processing and development services to us. The Nedbank business remained fairly static during 2004. On July 27, 2004, we and Nedbank announced that we had been contracted to supply Nedbank with 18,500 POS devices, 5,600 pin-pads and 66,000 merchant smart cards. The revenue from this contract for the nine months ended March 31, 2005 was approximately \$10.7 million (ZAR 66.95 million).

***Corporate/Eliminations***

In U.S. dollars, operating loss increased by 245% for the year ended June 30, 2004, from the comparable period in 2003.

In ZAR, operating loss increased by 167% for the year ended June 30, 2004, from the comparable period in 2003.

The main component of the Corporate/ Eliminations segment for 2004 was costs relating to the Aplitec transaction. The total reorganization charge incurred during 2004 amounted to \$11.1 million (ZAR 77.0 million). The full amount of these costs was expensed during 2004.

**Year Ended June 30, 2003 Compared to Year Ended June 30, 2002**

The fluctuation in the exchange rate between the ZAR and the U.S. dollar was the only critical factor that had a significant impact on our results of operations during the year ended June 30, 2003.

**Consolidated Overall Results of Operations**

This discussion is based on the amounts which were prepared in accordance with US GAAP.

The following tables show the changes in the items comprising our statements of operations, both in U.S. dollars and in ZAR.

	<b>In United States Dollars (US GAAP)</b>		
	<b>Year Ended June 30,</b>		
	<b>2003 \$ 000</b>	<b>2002 \$ 000</b>	<b>\$ % Change</b>
Revenue	74,924	51,793	45%
Cost of goods sold, IT processing, servicing and support	25,935	14,170	83%
General and administration	26,399	21,637	22%
Depreciation and amortization	3,323	3,128	6%
Reorganization charges			
Operating income	19,267	12,858	50%
Interest income, net	2,600	1,381	88%
Income before income taxes	21,867	14,239	54%
Income tax expense	9,473	5,554	71%
Net income before minority interest, earnings from equity accounted investment, extraordinary item and cumulative effect of an accounting charge	12,394	8,685	43%
Minority interest	452	167	171%
Earnings from equity accounted investment			
Extraordinary item	857		
Cumulative effect of an accounting charge	318		
Net income	13,117	8,518	54%

	<b>In South African Rand (US GAAP)</b>		
	<b>Year Ended June 30,</b>		
	<b>2003</b>	<b>2002</b>	
	<b>ZAR</b>	<b>ZAR</b>	<b>ZAR</b>
	<b>000</b>	<b>000</b>	<b>% Change</b>
Revenue	678,568	525,174	29%
Cost of goods sold, IT processing, servicing and support	234,879	143,375	64%
General and administrative	239,090	219,566	9%
Depreciation and amortization	30,096	31,742	(5)%
Reorganization charges			
Operating income	174,503	130,491	34%
Interest income, net	23,548	14,014	68%
Income before income taxes	198,051	144,505	37%
Income tax expense	85,795	56,360	52%
Net income before minority interest, earnings from equity accounted investment, extraordinary item and cumulative effect of an accounting change	112,256	88,145	27%
Minority interest	4,094	1,695	142%
Earnings from equity accounted investment			
Extraordinary item	7,762		
Cumulative effect of an accounting change	2,880		
Net income	118,804	86,450	37%

Analyzed in ZAR, the increase in revenue and cost of goods sold, IT processing, servicing and support for the year ended June 30, 2003, was primarily due to the higher volumes in our transaction-based activities and financial services operating segments. The increase in depreciation and amortization for the year ended June 30, 2003 was due, in part, to the additional depreciation charge from the Eastern Cape provincial contract.

The increase in operating income margin to 26% for the year ended June 30, 2003, from 25% for the year ended June 30, 2002, was primarily due to improved efficiencies across all other activities.

#### **Interest Received and Finance Costs**

The significantly higher payment volumes in KwaZulu-Natal during the year ended June 30, 2003, as well as the implementation of the Eastern Cape provincial contract, increased our pre-funding requirements, which resulted in an increase in finance costs in 2003 from \$1.9 million (ZAR 19 million) in 2002 to \$5.5 million (ZAR 49.5 million).

Interest on our surplus cash increased from \$3.3 million (ZAR 33.1 million) for the year ended June 30, 2002 to \$8.1 million (ZAR 73.1 million) for the year ended June 30, 2003, primarily due to an increase of \$11.7 million (ZAR 106 million) in cash on hand, as well as significantly higher interest rates earned on deposits. We also maximized our interest income through the commencement in 2002 of a cash management system, which allows for the overnight set-off of all cash balances and overdrafts across all of our subsidiaries except for microlending subsidiaries. Any cash

balances related to unpaid social welfare grants received from provincial governments where we do not pre-fund such grants (*i.e.*, North West Province, Northern Cape Province and Limpopo) are excluded from our cash management system and overnight set-off, as the ownership of these accounts remains with the provincial governments.

**Taxation**

Total tax expense increased from \$5.6 million (ZAR 56.4 million) for the year ended June 30, 2002 to \$9.5 million (ZAR 85.8 million) for the year ended June 30, 2003, mainly due to our increased profitability.

The increase in the effective tax rate for 2003 was mainly due to non-deductible expenses of \$1.1 million (ZAR 10.2 million), including \$0.6 million (ZAR 5.3 million) resulting from the settlement of share options.

**Minority Interests**

Income attributable to minority interests increased from \$0.2 million (ZAR 1.7 million) for the year ended June 30, 2002 to \$0.5 million (ZAR 4.1 million) for the year ended June 30, 2003, due to the increased profitability of four subsidiaries that are involved in the social welfare payment business with outside shareholders. During 2003, we acquired the minority interests in three of these subsidiaries for a total consideration of \$1.4 million (ZAR 12.4 million), which should lead to a significant reduction in income attributable to minority interests in 2004.

**Results of Operations by Operating Segments**

The composition of revenue and the contributions of our operating segments to operating income are illustrated below. The discussion of our operating segments is based on amounts which were prepared in accordance with SA GAAP. Our management prepares financial statements for management purposes under SA GAAP and our chief operating decision maker evaluates segment performance using SA GAAP measures.

**In United States Dollars (SA GAAP)**

Operating Segment	Year Ended June 30,				
	2003 \$ 000	% of Total	2002 \$ 000	% of Total	% Change
<b>Consolidated revenue:</b>					
Transaction-based activities	44,058	58%	28,291	55%	56%
Smart card accounts	13,750	18%	8,318	16%	65%
Financial services	13,407	18%	10,465	20%	28%
Hardware, software and related technology sales	5,135	6%	4,719	9%	9%
<b>Total consolidated revenue</b>	<b>76,350</b>	<b>100%</b>	<b>51,793</b>	<b>100%</b>	<b>47%</b>
<b>Consolidated operating income (loss):</b>					
Transaction-based activities	10,196	53%	7,376	55%	38%
Smart card accounts	5,500	28%	2,772	21%	98%
Financial services	4,705	24%	900	7%	423%
Hardware, software and related technology sales	680	4%	1,611	12%	(58)%
Corporate/Eliminations	(1,663)	(9)%	642	5%	
<b>Total consolidated operating income</b>	<b>19,418</b>	<b>100%</b>	<b>13,301</b>	<b>100%</b>	<b>46%</b>

## In South African Rand (SA GAAP)

Year Ended June 30,

	2003 ZAR 000	% of Total	2002 ZAR 000	% of Total	% Change
<b>Operating Segment</b>					
Consolidated revenue:					
Transaction-based activities	399,016	58%	287,095	55%	39%
Smart card accounts	124,533	18%	84,404	16%	48%
Financial services	121,426	18%	106,196	20%	14%
Hardware, software and related technology sales	46,509	6%	47,890	9%	(3)%
<b>Total consolidated revenue</b>	<b>691,484</b>	<b>100%</b>	<b>525,585</b>	<b>100%</b>	<b>32%</b>
Consolidated operating income (loss):					
Transaction-based activities	92,343	53%	74,848	55%	23%
Smart card accounts	49,813	28%	28,135	21%	77%
Financial services	42,605	24%	9,131	7%	367%
Hardware, software and related technology sales	6,162	4%	16,354	12%	(62)%
Corporate/Eliminations	(15,055)	(9)%	6,532	5%	
<b>Total consolidated operating income</b>	<b>175,868</b>	<b>100%</b>	<b>135,000</b>	<b>100%</b>	<b>30%</b>

**Transaction-Based Activities**

In U.S. dollars, revenues increased by 56% for the year ended June 30, 2003, from the comparable period in 2002. Operating income increased by 38% for the year ended June 30, 2003, from the comparable period in 2002.

In ZAR, revenues increased by 39% for the year ended June 30, 2003, from the comparable period in 2002. Operating income increased by 23% for the year ended June 30, 2003, from the comparable period in 2002.

These increases in revenues and operating income were due primarily to the commencement of the Eastern Cape provincial contract, significantly higher volumes from our other provincial contracts and annual price adjustments in the amounts we charge under our provincial contracts. We discuss these factors in more detail below:

*New Eastern Cape contract:* In November 2002, we commenced the implementation of a social welfare grant payment system in the Eastern Cape province. At year-end, we had processed benefits for 469,918 beneficiaries. The Eastern Cape contract generated revenue of \$4.6 million (ZAR 47.1 million) in the last eight months in fiscal 2003.

*Significantly higher volumes under existing provincial contracts:* We experienced significant growth in most of the other provinces where we administer payments of social welfare grants. This growth is mainly due to new qualifying criteria announced by the South African government aimed at increasing the number of citizens eligible for social welfare grants.

*Annual price increase adjustments:* Under our Service Level Agreements with provincial governments, we are entitled to annual price increases based upon factors such as average grant size, volumes and the South African Consumer Price Index, or CPI rates.





The higher volumes under existing provincial contracts, as well as the 2003 price increases, are detailed below:

**Year Ended June 30,**

Province	Number of Payments		2003	2002	2003	2002
	2003	2002	(US\$)(1)	(US\$)(2)	(ZAR)(1)	(ZAR)(2)
KwaZulu-Natal	11,125,544	8,834,917	1.80	1.23	15.82	12.48
Limpopo	7,435,326	6,025,866	1.45	1.07	12.64	10.82
North West	2,940,723	2,992,402	1.82	1.52	15.99	15.43
Northern Cape	1,180,735	1,005,813	2.27	1.84	20.07	18.66
Eastern Cape	1,050,833		1.64		14.41	
<b>Total</b>	<b>23,733,161</b>	<b>18,858,998</b>				

(1) The average price per payment excludes \$0.70 (ZAR 5.00) related to the provision of smart card accounts.

(2) The average price per payment excludes \$0.70 (ZAR 4.50) related to the provision of smart card accounts.

Operating income margin decreased for the year ended June 30, 2003 to 23% from 26% for the year ended June 30, 2002.

We incurred significant costs in connection with the commencement of the Eastern Cape social welfare payment system. This is typical for businesses that have significant up-front implementation costs but cannot begin collecting revenue until implementation is complete. This business model exerts pressure on our operating income margin during the early stages of a new contract. Efficiency and profitability will increase over time as more customers are converted to our payment system. The conversion period in the Eastern Cape took approximately 14 months to complete.

The losses experienced in the Eastern Cape were marginally offset by the improved profitability of our social welfare payment contracts in other provinces. As these contracts are now well beyond their establishment phases, we continue to improve the efficiencies of these systems through strict cost control measures and improved logistical planning. We try to keep any increases in operational, selling, general and administrative expenses below the total annual price increase rates under these contracts. A further positive effect on our operating income margin was that our selling, general and administrative expenses remained predominantly fixed during the year ended June 30, 2003, while our revenue from these contracts benefited from the significant increase in volumes.

***Smart Card Accounts***

In U.S. dollars, revenues increased by 65% for the year ended June 30, 2003, from the comparable period in 2002. Operating income increased by 98% for the year ended June 30, 2003, from the comparable period in 2002.

In ZAR, revenues increased by 48% for the year ended June 30, 2003, from the comparable period in 2002. Operating income increased by 77% for the year ended June 30, 2003, from the comparable period in 2002.

Operating income margin from providing smart card accounts increased from 33% to 40% for the year ended June 30, 2003 as compared to the comparable period in 2002.

Revenue from the provision of UEPS smart card based accounts grew in proportion to the higher number of beneficiaries serviced through our social welfare payment contracts. A total number of 1,852,624 UEPS smart card-based accounts were active at June 30, 2003, compared to 1,154,088 active accounts as at June 30, 2002. The significant increase in the number of active accounts was primarily due

to the implementation of the smart card-based payment system in the Eastern Cape. A total of 469,910 accounts had been activated in this province at June 30, 2003.

**Financial Services**

In U.S. dollars, revenues increased by 28% for the year ended June 30, 2003, from the comparable period in 2002. Operating income increased by 423% for the year ended June 30, 2003, from the comparable period in 2002.

In ZAR, revenues increased by 14% for the year ended June 30, 2003, from the comparable period in 2002. Operating income increased by 367% for the year ended June 30, 2003, from the comparable period in 2002.

Revenue from UEPS-based lending improved as a result of strong growth in our loan portfolio as we expanded the areas where we offered this service. In contrast, the loan portfolio of our traditional micro-lending businesses remained fairly static as a result of our strategic decision not to grow this business aggressively. The key indicators of these businesses are illustrated below:

	Year Ended June 30,					
	2003	2002	\$ %	2003	2002	ZAR %
	\$ 000	\$ 000	Change	ZAR 000	ZAR 000	Change
Finance loans receivable:						
Traditional microlending gross	10,963	7,971	38%	81,890	82,664	(1)%
Provisions	(6,529)	(4,060)	61%	(48,771)	(42,102)	17%
Finance loans receivable:						
Traditional microlending net of provisions	4,434	3,911	13%	33,119	40,562	(18)%
Finance loans receivable:						
UEPS-based lending net and gross (i.e., no provisions)	3,194	1,945	64%	23,861	20,174	18%
	7,628	5,856		56,980	60,736	

Operating income margin increased for the year ended June 30, 2003 compared to 35%, compared to 9% for the year ended June 30, 2002, primarily due to the change in the mix of the debtors book from the lower margin and higher risk traditional microlending to the higher margin and lower risk UEPS-based lending. The provision of UEPS-based lending is volume driven and profitability improves as volumes increase, as most costs are fixed. The change in the contribution of the various components to revenue and the change in the operating income margin from fiscal 2002 to fiscal 2003 are illustrated in the table below:

	Year Ended June 30,			
	2003		2002	
	% of Total Revenue	Operating Income Margin %	% of Total Revenue	Operating Income Margin %
UEPS-based lending	34%	58%	21%	16%

Traditional microlending	66%	31%	79%	12%
	100%		100%	

The increases in revenues and operating income were due primarily to the full operation of UEPS-based lending during the year ended June 30, 2003 and significant improvements in traditional micro-lending activity. We discuss these factors in more detail below:

The UEPS-based lending initiative was profitable, on a monthly basis, for the entire 2003 year. During the first half of 2002, UEPS-based lending was in the start-up stage and therefore we

incurred significant costs in connection with these activities. Accordingly, the operating income on these activities improved significantly from the break-even result achieved during 2002.

Traditional microlending activity exhibited significant improvements in operating income margins following a management change in the second half of 2002. This new management focused heavily on cost controls and managing bad debt. We also established a dedicated collection department, which produced significant cost savings during 2003 as the amount of doubtful accounts written off and provisions for doubtful debts (calculated on the same basis as in previous years) was significantly reduced, while we made meaningful progress with the recovery of debts written off in prior years. The cost of running an internal collection department is also considerably less than our previous practice of outsourcing this function.

***Hardware, Software and Related Technology Sales***

In U.S. dollars, revenues increased by 9% for the year ended June 30, 2003, from the comparable period in 2002. Operating income decreased by 58% for the year ended June 30, 2003, from the comparable period in 2002.

In ZAR, revenues decreased by 3% for the year ended June 30, 2003, from the comparable period in 2002. Operating income decreased by 62% for the year ended June 30, 2003, from the comparable period in 2002.

These activities have limited recurring revenues and are dependent on signing new contracts and/or the expansion of UEPS systems already implemented.

The decrease in revenue was expected given the very successful UEPS implementation in Malawi in 2002. While we successfully implemented systems in Mozambique and Latvia in 2003, these were much smaller than the Malawi system. The implementation of the Malawi system resulted in some additional revenue in 2003 as we continue to provide smart cards and related equipment for that system.

Nedbank, a significant local customer, outsources certain processing and development services to us. The Nedbank business remained fairly static during 2003.

The decrease in the operating income margin was mainly due to a significant change in our product mix. The implementation of the national UEPS-based payment system in Malawi, which dominated the 2002 results, yielded significantly high margin revenue for that year. During 2003, we implemented systems in Latvia and Mozambique, but these were much smaller than the Malawi system. As a result, our low-margin products such as hardware sales and our outsourcing business with Nedbank, which remained fairly static during the year, had a significant impact on the margins reported for 2003.

**Use of Non-GAAP Measures**

Our results of operations for the periods presented were significantly affected by the issuance of shares of common stock and linked units in connection with the Aplitec transaction. In the table below, we have restated our as reported basic earnings per share of common stock and linked units, after giving effect to the one-for-six reverse stock split, using an aggregate of 54.7 million shares outstanding upon completion of the Aplitec transaction as if such issuance had occurred on July 1, 2003. The restated number of outstanding shares of common stock issued at June 30, 2004, was 54.7 million. The restated number of outstanding shares of common stock issued at March 31, 2004 and June 30, 2003, was 32.2 million. We

have presented the non-GAAP per share and linked unit data because our management believes that this information will assist investors in comparing our financial performance between the periods presented.

	Nine Months Ended March 31,	
	2005	2004
<b>Earnings per share (U.S. cents)</b>		
Basic earnings per common share and linked unit		
using shares in issue for period (as reported)	62.9	57.7
using shares issued as at March 31, 2005 (non-GAAP measure)	61.8	57.7
<b>Number of shares (thousands)</b>		
weighted average number of shares (as reported)	54,700	32,161
number of shares in issue as at March 31, 2005 (used in non-GAAP measure)	54,700	54,700

	Year Ended June 30,		
	2004	2003	2002
<b>Earnings per share (U.S. cents)</b>			
Basic earnings per common share and linked unit			
using shares in issue for period (as reported)	39.6	40.8	27.0
using shares issued as at March 31, 2005 (non-GAAP measure)	24.6	24.0	15.6
<b>Number of shares (thousands)</b>			
weighted average number of shares (as reported)	33,581	32,161	31,215
number of shares in issue as at March 31, 2005 (used in non-GAAP measure)	54,700	54,700	54,700

### *Quarterly Results of Operations*

The following table presents our unaudited quarterly results of operations for the eleven quarters in the period ended March 31, 2005. This unaudited information has been prepared in accordance with SA GAAP, which was the basis on which we prepared our financial statements for periods prior to June 7, 2004, when we completed the Aplitec transaction. We have reconciled this information to US GAAP information for periods after June 30, 2003, when we began reporting our results of operations in US GAAP. We have not reconciled this information to US GAAP information for prior periods because we believe that preparing such a reconciliation would involve an unreasonable effort and expense. The operating results for any quarter are not necessarily indicative of the results for any future quarters or for a full year.

### In United States Dollars Three Months Ended (SA GAAP)

June 30, 2003	Mar 31, 2003	Dec 31, 2002	Sept 30, 2002	Total YTD
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(In thousands except per share data)

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Revenue	21,861	20,169	16,204	18,116	76,350
Operating income (loss)	5,676	5,493	3,388	4,861	19,418
Net Income	4,468	3,463	2,656	3,345	13,932
Earnings per share (common stock and linked units)					
Basic earnings per share (US cents)	13.8	10.8	8.4	10.8	43.8
Diluted earnings per share (US cents)	13.8	10.8	8.4	10.8	43.8

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**In United States Dollars**  
**Three Months Ended (SA GAAP)**

	<b>June 30, 2004</b>	<b>Mar 31, 2004</b>	<b>Dec 31, 2003</b>	<b>Sept 30, 2003</b>	<b>Total YTD</b>
<b>(In thousands except per share data)</b>					
Revenue	39,765	36,144	29,338	25,851	131,098
Operating income (loss)	11,892	12,468	7,501	7,294	39,155
Net Income	(4,570)	8,208	5,503	4,866	14,007
Earnings per share (common stock and linked units)					
Basic earnings per share (US cents)	(12.0)	25.8	17.4	15.0	42.0
Diluted earnings per share (US cents)	(12.0)	25.8	17.4	15.0	40.2

**In United States Dollars**  
**Three Months Ended**  
**(SA GAAP)**

	<b>Mar 31, 2005</b>	<b>Dec 31, 2004</b>	<b>Sept 30, 2004</b>	<b>Total YTD</b>
<b>(In thousands except per share data)</b>				
Revenue	45,667	45,995	43,223	134,885
Operating income (loss)	20,544	18,343	18,166	57,053
Net income	13,951	13,616	12,991	40,558
Earnings per share (common stock and linked units)				
Basic earnings per share (US cents)	25.8	24.6	24.0	74.4
Diluted earnings per share (US cents)	25.2	24.6	23.4	72.6

We expect that the amount and timing of our sales expenses will vary from quarter to quarter depending on our level of actual and anticipated business activities.

Our sales and operating results are difficult to forecast and will fluctuate, and we believe that period-to-period comparisons of our operating results will not necessarily be meaningful. See [Risk Factors](#). Our quarterly operating results may fluctuate significantly as a result of factors outside of our control, which could cause the market price of our shares of common stock to decline.

#### **Liquidity and Capital Resources**

Our business has historically generated high levels of cash and we maintain large cash reserves (\$92.7 million at March 31, 2005). Cash on hand decreased from \$93.1 million at March 31, 2004 to \$92.7 million at March 31, 2005 as a result of a late payment by the Eastern Cape provincial government. All cash balances as at March 31, 2004 were ZAR denominated, whereas the cash balances as at March 31, 2005 were comprised of ZAR-denominated balances of ZAR 510 million (\$81 million), U.S. dollar-denominated balances of \$12 million and euro-denominated balances of 0.014 million (\$0.018 million).

Surplus cash held by our South African operations is invested in overnight call accounts in the South African money market, and surplus cash held by our non-South African companies is invested in the United States and European money markets.

We generally finance all operations, research and development, working capital, capital expenditure and acquisitions through our internally generated cash. Last year, however, we did raise cash from a group of South African private equity funds in connection with the Aplitec transaction. We have no long-term indebtedness. We maintain various overdraft facilities including a \$79.2 million (ZAR 500 million) revolving credit facility. From time to time, we borrow under these facilities on a short-term basis when our pre-funding requirements exceed the available cash on hand. We take the following factors into account when considering whether to borrow under our financing facilities:

cost of capital;

cost of financing;



opportunity cost of utilizing surplus cash; and

availability of tax efficient structures to moderate financing costs.

The significant increase in social welfare grant beneficiaries in the KwaZulu-Natal and Eastern Cape provinces may require external financing in the medium to long-term for the pre-funding of these grants payments. We believe that our cash reserves, and availability under our current overdraft facility and revolving credit facility will be sufficient to fund our activities and expansion plans for the foreseeable future.

***Cash Flows from Operating Activities***

Cash flows from operating activities for the nine months ended March 31, 2005 totaled \$15.6 million (ZAR 96 million) compared to \$35.4 million (ZAR 247.3 million) for the nine months ended March 31, 2004. The decrease was due primarily to the late payment mentioned above and to the taxes we paid on higher profits and as a result of the reorganization. In addition, cash received from customers and cash paid to suppliers and employees was higher in the nine months ended March 31, 2005 than during the comparable period during 2004 due to the sales to Nedbank and the increased levels of business activity in all of our operating segments.

Cash flows from operating activities for the year ended June 30, 2004 were \$41.8 million (ZAR 290.4 million) compared to \$17.6 million (ZAR 159.8 million) for the year ended June 30, 2003. This increase was primarily due to higher levels of revenue and operating profit and an increase in net interest earned, partially offset by an increase in working capital, as increased receivables and inventory partially offset increased payables, and by higher taxes and the payment of dividends during the year ended June 30, 2003. The slight increase in inventory was due to higher levels of spares stock at year end. The increase in receivables was due to a portion of the June 2004 Eastern Cape pre-funding owing to Net 1 by the Eastern Cape government, as well as higher pre-payments for smart cards bought for the Limpopo contract, which are paid for monthly, as part of the service fee, over the duration of the contract period. Payables increased mainly due to the bulk of the reorganization costs that were not paid at year end.

***Cash Flows from Investing Activities***

Cash used in investing activities for the nine months ended March 31, 2005, included capital expenditure of \$3 million (ZAR 18.4 million), of which \$0.4 million (ZAR 2.8 million) related to the purchase of an additional transaction processing computer at head-office and \$1.1 million (ZAR 5.7 million) related to the purchase of POS and pin-pad devices for use at retailers participating in our merchant acquiring project. Cash used in investing activities for the nine months ended March 31, 2004, included one-time costs we incurred to support the administration and distribution of welfare grants in the Eastern Cape province.

Cash used in investing activities for the years ended June 30, 2004 and 2003 was \$5.7 million (ZAR 39.7 million) and \$7.4 million (ZAR 67.0 million), respectively. This decrease was due to a \$8.3 million (ZAR 56.9 million) capital expenditure during the year ended June 30, 2003 related to start-up costs on the Eastern Cape contract.

Investing activities during the year ended June 30, 2004 consisted mainly of capital expenditures of \$2.8 million (ZAR 19.4 million), a loan of \$1.6 million (ZAR 11.4 million) to The Permit Group (Proprietary) Limited ( Permit ) to enable Permit to acquire 95% of the issued share capital of New Era Life Insurance Company Ltd., and the acquisition of contract rights in the Limpopo province amounting to \$1.3 million (ZAR 9.0 million).

***Cash Flows from Financing Activities***

The dividend declared by Aplitec for fiscal year end June 30, 2003 was paid in the three months ended September 30, 2003. Net cash raised from the issue of common stock and preferred stock of \$53.7 million (ZAR 336.8 million) during the year ended June 30, 2004, resulted from the issuance of

shares of common stock to the Brait Group in connection with the Aplitec transaction. The cash distribution and dividend paid to shareholders during the year ended June 30, 2004 consisted of \$72.7 million (ZAR 456.0 million) as a result of the Aplitec transaction and \$5.1 million (ZAR 35.5 million) paid to Aplitec shareholders as a dividend pursuant to Aplitec's dividend policy at the time. All cash raised from the issue of share capital during the year ended June 30, 2003, was due to the issuance of ordinary shares under the Aplitec employee share incentive scheme. The dividend paid during fiscal 2003 was effected pursuant to Aplitec's dividend policy at the time.

#### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

#### Capital Expenditures

Capital expenditures for the nine months ended March 31, 2005 and 2004 were as follows:

	Nine Months Ended March 31,			
	2005 \$ 000	2004 \$ 000	2005 ZAR 000	2004 ZAR 000
<b>Operating Segment</b>				
Transaction-based activities	2,313	2,077	14,352	14,519
Smart card accounts				
Financial services	669	111	4,118	775
Hardware, software and related technology sales		15		100
Corporate/ Eliminations		189		1,317
<b>Consolidated total</b>	<b>2,982</b>	<b>2,392</b>	<b>18,470</b>	<b>16,711</b>

	Year Ended June 30,					
	2004 \$ 000	2003 \$ 000	2002 \$ 000	2004 ZAR 000	2003 ZAR 000	2002 ZAR 000
<b>Operating Segment</b>						
Transaction-based activities	2,371	6,043	943	16,435	54,729	9,574
Smart card accounts						
Financial services	185	106	817	1,280	960	8,295
Hardware, software and related technology sales	34	15	5	234	135	54
Corporate/ Eliminations	218	548	153	1,512	4,967	1,549
<b>Consolidated total</b>	<b>2,808</b>	<b>6,712</b>	<b>1,918</b>	<b>19,461</b>	<b>60,791</b>	<b>19,472</b>

We operate in an environment where our contracts for the payment of social welfare grants require substantial capital investment to establish our operational infrastructure when a contract commences. Further capital investment is required when the number of beneficiaries increase to the point where the maximum capacity of the original infrastructure is exceeded.

As mentioned above, our capital expenditures for the nine months ended March 31, 2005 related mainly to the acquisition of a new transaction processing computer at our corporate headquarters and the acquisition of POS and pin-pad devices that we lease to participating retailers. Our capital expenditure for the nine months ended March 31, 2004 was mainly due to expansion in all provinces, as we experienced significant growth in the number of customers we had to service. Capital expenditures during the year ended June 30, 2004 were primarily due expansion in all provinces, as we experienced significant growth in the number of customers we had to service. Capital expenditures during the year ended June 30, 2004 were primarily due to start-up costs we incurred in connection with the implementation of our Eastern Cape provincial contract. Capital expenditures during the year ended June 30, 2002 related primarily to our expansion in the KwaZulu-Natal and Limpopo provinces, where we experienced significant growth in the number of customers we had to service.

Our other business activities require relatively little capital investment. The most notable exception was the capital expenditure incurred to establish the UEPS-based lending initiative within the financial services division during the year ended June 30, 2002.

All of our capital expenditures for the past three fiscal years were funded through internally generated funds. We had no outstanding capital commitments at March 31, 2005. We anticipate that capital spending for the fourth quarter of fiscal 2005 will relate primarily to the equipment required to service the increased number of beneficiaries in all provinces and the purchase of additional POS and pin-pad devices to be leased to participating retailers. We expect to fund these expenditures through internally generated funds.

#### **Contingent Liabilities, Commitments and Contractual Obligations**

We lease various premises under operating leases. Our minimum future commitments for lease premises as well as other commitments are as follows:

#### **Payments Due by Period, as of March 31, 2005 (in \$ 000s)**

	<b>Due Within 1 Year</b>	<b>Due Within 2 Years</b>	<b>Due Within 3 Years</b>	<b>Due Within 4 Years</b>	<b>Due Within 5 Years</b>	<b>More than 5 Years</b>	<b>Total</b>
Contractual obligations							
Long term debt obligations							
Long-term payables							
Capital lease obligations							
Operating lease obligations	1,642	1,026	809	486	48	4	4,015
Purchase obligations	98						98

Other than shown in the table above, we have no other purchase commitments, obligations or specific capital commitments for the next three years.

#### **Dividends**

Our future dividend policy will depend on our earnings, capital requirements, expansion plans, financial condition and other relevant factors. New Aplitec's future dividend policy also has to comply with the restrictions place by the South African Reserve Bank as a condition of its approval of the Aplitec transaction. These restrictions will apply until such time as all of our special convertible preferred stock has been converted into common stock. These restrictions provide that dividends may be declared by the New Aplitec board of directors only if (i) declaration of the dividend is approved by a majority of the holders of New Aplitec B class preference shares, (ii) all loan accounts have been paid by New Aplitec and (iii) the dividend does not exceed 50% of New Aplitec's annual earnings. In addition, under South African law, New Aplitec will only be entitled to pay a dividend if it meets the solvency and liquidity tests set out in the South African Companies Act. However, because the New Aplitec board will be appointed by Net 1, Net 1 will ultimately determine whether any dividends are declared by New Aplitec, subject to the above conditions. Any dividends declared by New Aplitec will be distributed to the holders of A class and B class preference shareholders pro rata in accordance with their respective ownership interests in New Aplitec.

Aplitec's dividend policy in the nine months ended March 31, 2004 and prior fiscal periods was to declare regular annual dividend payments of between 25% to 33% of earnings for such periods. There were no dividends declared in the nine month period ended March 31, 2005. Dividends declared for the year ended June 30, 2003 were paid in the first quarter of fiscal 2004.

#### **Acquisitions and Dispositions**

We made no acquisitions or dispositions during the nine months ended March 31, 2005 or 2004. During January 2003, Aplitec acquired the minority interests in CPS (KwaZulu-Natal), CPS (Northern Cape) and CPS (Northern). These acquisitions consolidated Aplitec's social welfare payment businesses under a single holding company, thus improving operating and tax efficiency. Profits (attributable to the minority interests acquired) were recognized and

consolidated from January 1, 2003. During January 2002,

Aplitec sold the assets and liabilities of its security guarding business for a total cash consideration of \$0.7 million (ZAR 4.913 million).

### **Equity-Accounted Investment**

On April 1, 2004, Aplitec purchased a 43% interest in Permit Group 2 (Proprietary) Limited ( Permit ). Our balance sheet includes Permit as an equity-accounted investment. Permit owns 95% of the common stock of New Era Life Insurance Company ( New Era ), a provider of various insurance products to the South African market. In connection with this acquisition, Aplitec loaned Permit approximately \$0.8 million at the then current South African prime interest rate (11% at March 31, 2005) with no fixed repayment terms. Permit used the proceeds of this loan to purchase 43% of a 95% interest in New Era.

For the nine months ended March 31, 2005, earnings from our equity accounted investment totaled \$0.5 million (ZAR 3 million). Future earnings from our equity accounted investment are expected to be comparable with the current quarter's earnings.

### **Employee Benefits**

We do not provide retirement benefits to any of our employees. We provide our employees with a choice of two health care service providers to which we make the monthly contribution. We do not provide any post-retirement health benefits.

### **Insurance**

We annually assess our risk exposure. At March 31, 2005, we believe that all risks were adequately covered by third party insurers, except where we considered the cost of insurance coverage to be excessive in relation to the probability and extent of loss or we were unable to find any insurance underwriters willing to accept the risks associated with certain aspects of our business. We have confronted the latter with respect to insurance for losses or theft of cash from our delivery vehicles.

The main categories of our insurance are: loss or damage to vehicles, electronic equipment and other assets; business interruption; motor vehicle third party claims; group personal accident; and employment practices liability.

### **Quantitative and Qualitative Disclosures About Market Risk**

We seek to reduce our exposure to currencies other than the South African rand through a policy of matching, to the extent possible, assets and liabilities denominated in those currencies. In addition, we use financial instruments in order to economically hedge our exposure to exchange rate and interest rate fluctuations arising from our operations. We are also exposed to credit risks.

#### ***Currency Exchange Risk***

We are subject to currency exchange risk because we purchase inventories that we are required to settle in other currencies, primarily the euro and U.S. dollar. We have used forward contracts in order to limit our exposure in these transactions to fluctuations in exchange rates between the South African rand, on the one hand, and the U.S. dollar and the euro, on the other hand. As of March 31, 2005, the outstanding foreign exchange contracts were as follows as of the dates indicated:

#### **As of March 31, 2005**

<b>Notional Amount</b>	<b>Strike Price</b>	<b>Maturity</b>
USD 98,000	ZAR 6.0542	September 30, 2005

**As of June 30, 2004**

<b>Notional Amount</b>	<b>Strike Price</b>	<b>Maturity</b>
EUR 16,250	ZAR 7.8475	July 12, 2004
EUR 202,000	ZAR 8.1822	August 2, 2004
EUR 16,250	ZAR 7.8878	August 10, 2004
EUR 16,250	ZAR 7.9299	September 10, 2004
EUR 16,250	ZAR 7.9749	October 12, 2004
EUR 263,200	ZAR 8.2129	October 29, 2004
EUR 4,243,000	ZAR 8.5225	January 7, 2005
USD 167,900	ZAR 6.2950	September 22, 2004

**As of June 30, 2003**

None

**As of June 30, 2002**

<b>Notional Amount</b>	<b>Strike Price</b>	<b>Maturity</b>
US\$16,250	ZAR 12.643	January 8, 2003

***Translation Risk***

Translation risk relates to the risk that our results of operations will vary significantly as the U.S. dollar is our reporting currency, but we earn most of our revenues and incur most of our expenses in ZAR. The U.S. dollar to ZAR exchange rate has fluctuated significantly over the past two years. As exchange rates are outside our control, there can be no assurance that future fluctuations will not adversely affect our results of operations and financial condition.

***Interest Rate Risk***

As a result of our normal borrowing and leasing activities, our operating results are exposed to fluctuations in interest rates, which we manage primarily through our regular financing activities. We generally maintain limited investment in cash equivalents and have occasionally invested in marketable securities. Typically, for every 1% increase in the South African Reserve Bank's repo rate, our interest expense on pre-funding social welfare grants in the KwaZulu-Natal and Eastern Cape provinces increases by \$15,594 per month, while interest earned per month on any surplus cash increases by \$13,672 per \$16.6 million (ZAR 100 million).

***Credit Risk***

Credit risk relates to the risk of loss that we would incur as a result of non-performance by counterparties. We maintain credit risk policies with regard to our counterparties to minimize overall credit risk. These policies include an evaluation of a potential counterparty's financial condition, credit rating, and other credit criteria and risk mitigation tools as our management deems appropriate.

With respect to credit risk on financial instruments, we maintain a policy of entering into such transactions only with South African and European financial institutions that have a credit rating of BBB or better, as determined by Standard & Poor's.

***Microlending Credit Risk***

We are exposed to credit risk in our microlending activities, which provides unsecured short-term loans to qualifying customers. We manage this risk by assigning each prospective customer a creditworthiness score, which takes into account a variety of factors such as employment status, salary earned, other debts and total expenditures on normal household and lifestyle expenses.





## BUSINESS

### Our Company

We provide our universal electronic payment system, or UEPS, as an alternative payment system for the unbanked and under-banked populations of developing economies. We believe that we are the first company worldwide to implement a system that can enable the estimated four billion people who generally have limited or no access to a bank account to enter affordably into electronic transactions with each other, government agencies, employers, merchants and other financial service providers. To accomplish this, we have developed and deployed the UEPS. This system uses secure smart cards that operate in real-time but offline, unlike traditional payment systems offered by major banking institutions that require immediate access through a communications network to a centralized computer. This offline capability means that users of our system can enter into transactions at any time with other card holders in even the most remote areas so long as a portable offline smart card reader is available. In addition to payments and purchases, our system can be used for banking, health care management, international money transfers, voting and identification.

Our technology is widely used in South Africa today. We have over 3.3 million clients in five provinces who receive social welfare grants using our smart cards. We have started to implement our UEPS for employers to pay wages and provide financial services to their employees. In addition, we are working closely with non-governmental organizations to deploy our new medical application into a number of hospitals and clinics. This application of our system is used to administer the treatment of HIV/AIDS and other high-risk diseases, record patient progress and manage drug inventory.

Recently, Cell C (Proprietary) Limited, a mobile telephone service provider in South Africa, chose our solution as the transaction payment system for its planned roll-out of approximately 56,000 public cellular pay phones that will provide lower income consumers with telephone access at reduced rates. We believe the implementation of this project could provide us with up to 10,000 access points through which we will be able to market and sell our financial products. This deployment is part of a government initiative for the empowerment of small businesses in rural and semi-urban areas of South Africa.

Outside of South Africa, the Reserve Bank of Malawi has implemented our solution as a national payment system. To date, seven local financial institutions and BP p.l.c., a bulk fuel supplier, are using our system for transaction switching and settlement. We have deployed smaller, more limited versions of our system in Burundi, Ghana, Latvia, Mozambique, Rwanda, and Zimbabwe.

Unlike a traditional credit or debit card where the operation of the account occurs on a centralized computer, each of our smart cards effectively operates similar to an individual bank account in the case of financial services or an individual record management system in the case of medical services. All transactions that take place through our system occur between two smart cards at the point of service, or POS, with all of the relevant information necessary to perform and record a transaction held on the smart cards.

The transfer of money or other information can take place without any communication with a centralized computer since all validation, creation of audit records, encryption, decryption and authorization take place on, or are generated between, the smart cards themselves. Importantly, the cards are protected through the use of biometric fingerprint identification, which is designed to ensure the security of funds and card holder information. Transactions are generally settled by merchants and other commercial participants in the system by sending the transaction data to a mainframe computer on a batch basis. Settlement can be performed online or offline. The mainframe computer provides a central database of transactions, creating a complete audit trail that enables us to replace lost smart cards while preserving the notional account balance, and to identify fraud.

We generate our revenues by charging transaction fees to government agencies, employers, merchants and other financial service providers, by providing financial services such as loans and by selling hardware, software and related technology. In South African rand, our revenues and operating income increased by

32% and 39%, respectively, from fiscal 2003 to 2004, and by 29% and 34%, respectively, from fiscal 2002 to 2003. In South African rand, our revenues and operating income increased 31% and 62%, respectively, for the nine months ended March 31, 2005, as compared to the nine months ended March 31, 2004. We believe this growth reflects the accelerating adoption of our solution.

### **Market Opportunity**

According to the United States Census Bureau, the world's population currently exceeds 6.4 billion people. Yet of this total, it has been reported that over four billion people earn less than the purchasing parity equivalent of two dollars per day. In general, these people either have no bank account or very limited access to banking services. This situation arises when banking fees are too high relative to an individual's income, a bank account provides little meaningful benefit or there is insufficient infrastructure to provide banking services economically in the individual's geographical market. We refer to these people as the unbanked and the under-banked. These individuals generally receive wages, welfare benefits or loans in the form of cash and conduct commercial transactions, including buying food and clothing, in cash.

The use of cash, however, presents significant problems. In the case of recipients, they generally have no secure way of protecting that cash other than by converting it immediately into goods, carrying it with them or hiding it. In cases where an individual has access to a bank account, deposit, withdrawal and account fees meaningfully reduce the money available to meet basic needs. For government agencies and employers, using cash to pay welfare benefits or wages results in significant expense due to the logistics of obtaining that cash, moving it to distribution points and protecting it from theft.

The use of cash or lack of access to a bank account can dramatically increase the cost to, and in some cases completely prevent, individuals from engaging in basic financial transactions. These basic transactions include the routine payment of insurance premiums, the transfer of money to relatives and the use of credit. Without a bank account, it is also difficult for an individual to obtain a loan on attractive terms since that individual lacks a credit history and usually cannot present a reliable means of repayment to the lender.

For governments, assistance programs face significant challenges when dependent on the use of cash. In addition to the costs and difficulties of using cash, corruption becomes an even more challenging problem since there is no clear audit trail. In fact, the absence of an electronic system for the distribution of goods, including foodstuff or medicine, or welfare benefits presents a significant obstacle to ensuring the fair and reliable implementation of government policy or deployment of foreign aid.

Traditional payment systems offered today by the major banking institutions do not address the key requirements of the unbanked and the under-banked populations. In addition to the high cost of maintaining a bank account relative to a customer's income level, customers must generally have basic literacy, administrative and record-keeping abilities and a minimum income level. Additionally, banks operate through online transaction settlement systems, which are often unavailable or costly to implement in undeveloped areas. Finally, having a bank account does not eliminate the need for significant quantities of cash in many instances because customers must withdraw large sums at one time to avoid incremental transaction fees.

### **Our Solution**

We believe that we are the first company to enable the affordable delivery of financial products and services to the world's unbanked and under-banked people. Our approach takes full advantage of moving processing away from a centralized point to the computer chip embedded on a smart card. A smart card reader, or POS device, is used to enable communication between smart cards in real-time during a transaction and indirectly with our mainframe computer at a later time. This architecture has significant implications in terms of the products and services that we can deliver compared to those offered by banking institutions or other card providers.

First, our system enables offline transactions, which is essential in serving the unbanked and under-banked. Second, it means that while offline, the smart card can engage in sophisticated transaction processing, using data encryption and biometric fingerprint protection to ensure security. In fact, our smart cards can calculate the interest owed to the card holder for having funds recorded onto our system without ever coming online. Third, with all of the software and transaction records on the smart card, the POS device itself requires far fewer components, circuitry and memory, substantially reducing costs. Fourth, each transaction is recorded on both participating smart cards, copied in subsequent transactions to additional smart cards, and ultimately reported to our mainframe computer. This creates a full audit trail that significantly reduces the potential for corruption, theft and fraud. Lastly, instead of having to build the overall system to handle peak loads, our system further reduces costs by smoothing the transaction flow over time.

We believe that our solution delivers benefits to each of the users of our system, including:

*Individuals.* There is no minimum income requirement for individuals to use our smart card, making our solution universally accessible. It is also inexpensive since the overall cost of the system is much less than widely available solutions, including cash, bank accounts and bank cards that require online access. Our solution additionally has the advantage of working everywhere, including remote areas where many unbanked and under-banked people live. Even more importantly, our solution is secure and smart cards are replaceable. This means that individuals do not have to fear that their money will be stolen or that they will be charged for fraudulent transactions. Since the smart card performs all of the required processing and contains all of the different service features, the smart card can be tailored to meet the needs of the individual. Card holders can also receive interest on their card balances, a benefit not available to them when transacting solely in cash. We believe our solution has the potential to enhance significantly the living standards of the unbanked and under-banked by reducing transaction costs and providing them with new and additional financial products and services.

*Merchants and Financial Service Providers.* Merchants derive several different benefits from our system. Our system decreases the amount of cash they must hold, improving security and reducing expenses. In addition, it provides a record of transactions that is useful for administrative purposes. For instance, by providing financial services through our POS devices, merchants benefit from new income streams at no additional incremental cost. For formal financial service providers, the use of smart cards provides opportunities to directly sell products and services to a market that was previously difficult to reach. For instance, insurance companies can offer their products with the premium deducted directly from the individual's smart card. In the case of lending, administrative costs are decreased along with the expense of holding cash. Again, the collection of payments can occur directly from the smart card, reducing credit risk and helping to establish credit history.

*Employers.* Our system enables employers to eliminate cash from the wage payment process. This reduces expenses by avoiding cash handling and management, the need to insure or transport that cash and the bank transaction fees associated with obtaining cash in the first place. The process of paying employees using cash is also time consuming, taking up to half a day per pay period in some instances. The use of our system eliminates this process and thereby increases productivity. In addition, because cash payments are distributed in packets to employees, disputes can arise as to the amount of cash in the packet. Our system also eliminates this problem since the amount reflected on the card holders' accounts are recorded on the back-end system and then distributed on the smart cards. Finally, employers frequently provide additional services to their employees out of necessity, particularly loans. Our system enables other service providers to deliver these products.

*Government Agencies.* A fundamental policy goal for almost any government is to enhance the welfare of the poorest citizens in the country. Yet the use of cash is a poor method for delivering social welfare grants since it is difficult to track, and the recipients endure a range of expenses and dangers that reduce their options. By using our system, government agencies enjoy reduced costs in the delivery of benefits to recipients by eliminating the use of cash while increasing the options available to the recipient. This use of our system intrinsically increases the welfare that government agencies can provide from the

same amount of taxes collected. Our system also has the potential to increase the amount of taxes collected by bringing informal businesses into the formal economy. The presence of a full audit trail also means that government agencies can combat corruption. Moreover, the use of smart cards for the delivery of additional services, including insurance products, means that regulatory bodies can expand their oversight of transactions for individuals who are frequently least able to protect themselves. In regard to medical benefits, our system provides comprehensive inventory management and has the potential to improve the treatment of patients significantly. For instance, we have deployed an artificial intelligence program on our smart cards used for the treatment of HIV/AIDS in South Africa that can be used to adjust a patient's prescription based on data entered by a trained medical worker through the POS device.

### **Our Business Strengths**

We believe our business strengths include:

*Technology Leadership.* We believe we are the first company to develop, implement and operate an affordable, flexible and secure electronic payment system for the unbanked and under-banked that works offline. Of equal importance, our smart cards have a broad range of additional functionality through the use of wallets that can be turned on as needed or as services become available. We can deliver these services to the unbanked population at a fraction of the cost of traditional systems. Our ability to implement an HIV/AIDS system on the same smart card as financial services demonstrates the flexibility of our approach. In addition, we have validated the security of our smart cards along with our overall system, forming the foundation for a trusted solution. Independent third parties have reviewed and published our security protocols and we have refined our system in a way to provide system integrity over the life of the smart cards. From our inception in 1989 to date, we have not suffered any security breaches or losses of transactions or funds on our system.

*Proven Solution.* Our system is proven and has been increasingly used. Today over 3.3 million clients in South Africa receive monthly welfare or pension payments through our system under contracts with five provinces. Historically, welfare and pension recipients would only download cash from smart cards, but these recipients increasingly choose to use their smart cards at merchant locations, which generates additional revenue for us. During the nine months ended March 31, 2005, the rate of client purchases using our smart cards rather than merely downloading the value for cash grew at a compounded monthly growth rate of 71% while the value of those transactions grew at a compounded monthly growth rate of 60%. As of March 31, 2005, we had 2,406 POS devices installed at 1,441 participating retail merchants. For the nine months ended March 31, 2005, the total value of transactions processed through our UEPS merchant network was approximately \$59.7 million. During the nine months following our implementation of these retail merchant POS devices in July 2004, the percentage of transactions which consisted of merchant purchases, as opposed to cash downloading only, increased from approximately 0% to approximately 23% of the total number of processed transactions.

*Versatile Application.* Once an individual begins using our smart card, we become a logical provider of a broad range of additional products and services. For instance, a card holder using our system for the administration of medical treatment can also use the same smart card for receiving welfare payments or wages as well as making purchases. Because use of each smart card is secured biometrically, the smart card can also be used for identification and voting. The additional uses mean that once we have enrolled and delivered a smart card to an individual, our revenue potential increases significantly beyond the initial service for which that individual has signed up.

*Broad Appeal that Drives Opportunities.* Because our system provides economic benefits to all participants, we believe there are strong incentives for government agencies and employers to adopt our system in many developing countries. Our solution is also appealing because a single deployment enables the delivery of a broad array of new services to those who are potentially most in need of them, often at a lower cost than alternative distribution methods.

*Increasing Returns to Scale.* The initial establishment of our system in a province or country requires upfront expenditures for computers, distribution infrastructure and card holder registration. Once in place,

though, the cost to us of supplying additional products to users is low. For instance, if a customer receives welfare payments on one of our smart cards and then chooses to purchase insurance through our system, there is almost no additional expense for us to deduct the insurance premium regularly. As a result, the operating margin for that customer increases significantly, offset only by any marketing or administrative costs associated with that product.

### **Our Strategy**

We intend to provide the leading system for the world's estimated four billion unbanked and under-banked people to engage in electronic transactions globally. To achieve this goal, we intend to pursue the following strategies:

*Disciplined Approach to New Markets.* We carefully evaluate new opportunities in order to deploy our business development resources effectively. We believe there are significant opportunities for our system in developing economies, such as Brazil, India, Mexico and Indonesia, where the unbanked and under-banked comprise a majority of the population. Where we believe it makes sense, we will use partnerships or make acquisitions to accelerate our entry into new markets.

*Unlock Target Markets with a Key Product.* The first step in establishing our system within a new province or country is to establish a broad base of smart card users around a single application. One of our preferred routes is to secure contracts to implement payment systems for government programs having large numbers of potential card holders. We believe another effective route will be the delivery of medical management applications, such as for HIV/AIDS. However, we are not dependent on government agencies to establish an initial base. Employers are widely examining our system to address their wage payment challenges and we are currently pursuing opportunities to deliver this solution.

*Expand Our Products Within the Markets We Serve.* With the establishment of a strong base of card holders and related infrastructure, we can then move to providing additional products and services. As part of broadening our card holders' options, we will also sell our smart card readers and POS devices to merchants to enable them to enter into transactions. Additionally, we will work to establish relationships with post offices, banks and other financial service providers with the goal of making our system ubiquitous in the markets we serve.

*Provide Products and Services Ourselves Where the Profit Potential is Compelling.* Our system can dramatically reduce transaction costs and improve data collection for a broad set of products and services. We intend to offer those products and services ourselves where the profit potential is significant. For instance, we engage in lending in South Africa. We are able to offer this service at a lower interest rate than competitors due to our ability to deduct interest and principal directly from a borrower's smart card and our knowledge of that individual's payment history.

*Establish Partnerships or Make Acquisitions When Appropriate.* As part of our disciplined approach to growing our presence globally, we will evaluate and enter into partnerships where we can draw on local knowledge and infrastructure to drive the rapid adoption of our system. We believe that this will enable us to focus on our core strength in technology as well as product development and delivery. In some instances, we will make acquisitions where we believe that our approach will enable us to gain customers and realize operational benefits rapidly from the deployment of our more efficient solution.

### **Our Technology**

We developed our technology to enable the affordable delivery of financial products and services to the world's unbanked and under-banked people. Our proprietary technology is designed to provide the secure delivery of these products and services in the most under-developed or rural environments, even in those that have little or no communications infrastructure.

### ***System Components***

Our platform consists of three fundamental components: (1) our FTS patent, (2) our UEPS and (3) our security protocol.

*FTS Patent.* The FTS patent describes a method by which funds can be transferred from one smart card to another in a secure and offline manner. The term *offline* refers to transactions that are effected without the need to contact or communicate with the issuer when the transactions occur, as the smart cards themselves perform the authorizations required. The FTS patent also describes how smart cards can be loaded or re-loaded with funds and how these can be redeemed for value in either banking or non-banking environments.

*UEPS.* Our UEPS is a suite of software programs that make use of the FTS methodology to deliver an integrated information, payment, switching and settlement environment that underpins our transaction processing system. Our software principally runs on three devices: the smart card, the POS device and the back-end system mainframe. When we sell a complete system to a customer or license our technology, we provide all of the software required to operate the UEPS, including the smart card functionality, the POS devices that allow our smart cards to transact with each other in an offline manner and our back-end system that primarily stores an audit trail of all transactions effected.

The primary strengths of the UEPS are its affordability, security and flexibility. The system is affordable because the computer chips on the smart cards contain all the software necessary to process UEPS transactions, thereby allowing the POS devices required to conduct these transactions to contain far fewer components and less circuitry than traditional POS devices. There is also a reduced need for processing power and on-board memory given that online communication is not necessary. This eliminates the need for an internal or external modem and its associated hardware, maintenance and call costs. As a result, the UEPS terminals are relatively inexpensive and do not require specialized technical expertise for installation. The UEPS also reduces or eliminates the need for national infrastructures, including electricity, telephone or data transmission. The UEPS is secure because the funds in each smart card are protected from illegal access through biometric fingerprint technology. In addition, every transaction is verified by the two smart cards involved in the transaction using state-of-the-art cryptographic systems in conjunction with protocols and techniques that we have developed. Finally, our UEPS is flexible because transactions are completed offline, eliminating virtually all restrictions where verified transactions can occur.

We released the first version of our UEPS in 1991. It included software to operate each smart card as well as the main payment system. Later versions of our UEPS provided all of the functions necessary to issue and manage a smart card and terminal base as well as those needed to effect settlement between all of the operators and participants. Our UEPS is fully traceable and auditable. It can also provide advanced capabilities including loss tolerance and smart card-based interest distribution. Finally, our UEPS is scalable and capable of working in small applications including a hospital setting as well as large settings such as country-wide implementations.

*Security Protocol.* Our security protocol was designed to prevent opportunistic fraud and enforce the correct transaction flow. The symmetric triple data encryption standard, or DES, is used extensively in association with a native random number generator that ensures that all transactions are performed by using a random session key pair. The DES encryption algorithm can be easily modified to use alternative symmetric or asymmetric encryption algorithms such as the Rivest, Shamir and Adleman or elliptic curves. Each message exchanged during a transaction names both transacting parties, includes unique information to guarantee freshness and depends explicitly on all the messages that occur before it.

***Our UEPS Platform***

The following diagram depicts how our UEPS platform is constructed.

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The UEPS we sell to clients is a platform with the potential to provide all of the products we develop which, when grouped together, form complete systems serving the specific needs of various business segments. Depending on the requirements of a particular customer, we assist the customer in the setup of its application which is tailored to provide only the products and services initially required, although the UEPS can later be updated to provide additional products. We outsource the manufacturing of the hardware components of our system, including smart cards, POS devices, ATMs, PCs and back-end mainframes. However, we have developed all of our application software modules so that they will run on different hardware platforms which allows us to be hardware-independent and to provide our customers with the latest and most economical hardware solutions.

*Scalability.* Our UEPS can be implemented in different environments, from small closed systems to national implementations. In closed-system environments, the UEPS front-end equipment is personal computer-based and can therefore be implemented at relatively low cost. In these instances, we provide the back-end system on a transaction fee basis, thus limiting the overall set up cost. This approach can also be used whenever larger implementations are required but where the customer prefers to focus on marketing and selling its products rather than initially concentrating on operating the back-end system. The cost to entry can thus be greatly reduced as the operations can first become profitable before expending large amounts of capital. On the other hand, large governmental institutions, financial institutions or medical insurers typically prefer to maintain control over the entire payment system and therefore invest in a full system implementation. The time to launch these projects tends to be longer due to the time that is required to train the end-user to operate the system.

Once a UEPS is installed on behalf of a customer, we believe that we are well-positioned to benefit from the scalability of the system as minimal changes are required to be made to the application base for the system to manage significantly greater numbers of users. We can therefore provide additional smart cards while leveraging the existing cost base in a market. In addition, we have a dedicated team of technicians and developers and an infrastructure capable of supporting a significant volume of customers and their transactions. As a result, we expect to benefit from economies of scale that pertain to increases in the number of products and services using the infrastructures we sell and/or implement.

### ***UEPS Smart Card Functionality***

We have combined these technologies to create a smart card application that incorporates and controls the functionality that is normally found on banking host systems. Our technology reverses the traditional approach where the card acts as an access mechanism to a host-managed account. Instead, the smart card controls the account itself while the host system is relegated to backing up and creating an audit trail for the smart card base.

As a result, our technology provides extensive and flexible functionality through a system that is practical, secure and auditable. The following list itemizes some of the unique and critical functions provided by our smart card technology.

*Identification, Authentication, Non-Repudiation and Affirmation of UEPS Transactions.* Traditional payment systems provide customers with paper receipts that reflect transaction details. Customers normally keep these receipts to reconcile their monthly account statements. During reconciliation, customers can detect fraudulent transactions and errors by matching account entries against their paper receipts, which may lead to disputes, financial losses and the repudiation of transactions. Fraud committed by people taking advantage of the inherent security weaknesses of traditional payment systems increases the cost of managing transactions effected through these systems. As a result, financial institutions and other system participants must invest significant resources to minimize the risk associated with fraud and errors.

A fundamental element of the UEPS is that all payment and money transfer transactions take place between two UEPS smart cards – the smart card to be debited and the smart card to be credited. During the transfer of value between the two smart cards, the transaction is written to a dedicated history file on each of the smart cards. These history files are subsequently used to ensure settlement either directly or through the activation of the UEPS multiple streams audit trail feature. Thus, smart card holders can



reconcile their monthly accounts directly from the smart card's transaction history file. Also, each smart card authorizes all debit transactions through the presentation and verification of one of the card holder's biometric fingerprint templates that are stored in the smart card, and each UEPS transaction is signed by both smart cards. Taken together, these features of the UEPS help prevent the fraudulent creation, duplication or alteration of a transaction, as well as any potential repudiation of a transaction. As a result, the UEPS helps to minimize the costs associated with account management and inquiry resolution and helps ensure that customers do not incur losses from undetected errors, fraud or transaction mismanagement.

*Continuous Debit.* People with limited economic means or unestablished credit histories may find it difficult to obtain access to public utility services such as telephone, fuel, water or electricity unless they purchase pre-paid units for these services. A pre-paid unit of service may be a liter of fuel, a kiloliter of water, ten minutes of electricity or a two minute local phone call, and may need to be used within a specified period of time before it expires. Pre-paying for services can deprive purchasers of flexibility to redeploy their funds to meet other financial needs.

The continuous debit feature of the UEPS eliminates the need for customers to buy pre-paid units by allowing them to use their smart cards to pay for these services as and when they need and use them. All a customer needs to do is to insert his smart card into the utility equipment and the smart card will debit itself whenever a unit of service is used. The continuous debit feature provides significant financial flexibility to customers and can be tailored to be used in any pay as you go environment, including Internet access.

Continuous debit transactions are typically a large number of small transactions that can quickly fill up the space on a smart card's transaction file. We eliminated this problem by designing the UEPS to minimize the file space that these transactions require by enabling subsequent transactions to replace and aggregate with earlier ones, thereby treating multiple transactions as one global transaction.

*Multiple and Restricted Wallets.* Unbanked people who keep their cash at home risk the loss of their funds from misplacement, theft or disasters such as floods or fires, which can have a devastating impact on their financial lives. Keeping funds at home does not generate any interest income and cannot help demonstrate financial responsibility or provide collateral security for the extension of credit. Finally, keeping funds in cash can make it more difficult for people to segregate their funds for specific purposes, whereas having one or more bank accounts can facilitate budgeting for various categories of expenses.

The multiple wallet feature allows card holders to use their smart cards to help manage their budgets. Up to 255 wallets can be configured and activated per card holder depending on the electrically erasable programmable read-only memory, or EEPROM, available on the particular smart card. Each of the wallets can be configured to meet the specific requirements of the card holder, and can be used for interest-generating savings, pre-paid utilities, medication management, credit, debit orders and for many other purposes. In addition, a wallet can be either protected or unprotected. Protected wallets require the biometric verification of the card holder to effect transactions. Unprotected wallets are normally used for low value transactions such as transportation for which speed of processing is critical.

Since the audit trail of all transactions performed by the active wallets is stored on the smart card's history file, card holders can provide third parties with a comprehensive record of their transaction histories, which can help evidence payments, such as insurance premiums and demonstrate a regular income stream from wages or other sources. This audit trail can provide unbanked people the opportunity to obtain affordable services from formal financial service providers which might otherwise deny or limit services to them.

Wallets can also be restricted. Restricted wallets allow transactions to be performed only at specific merchants. For example, if an employer desire to subsidize an employee's transportation costs, a wallet can be configured that permits the holder to spend the value loaded into that wallet only at specified transportation points. Restricted wallets can also be used by governments to prevent social welfare grant recipients from using payment for particular goods or services.

*Offline Loading.* The use of payment systems that depend on online authorizations is difficult to implement in developing economies and countries that do not have advanced or reliable telecommunication infrastructures. Online systems include magnetic stripe-based solutions that are widely used in first world economies and require that all transactions, including retail sales, the dispensing of cash, the loading of value to smart cards and the authorization of credit transactions, be performed only at self-service terminals, or SSTs, ATMs or POS devices that operate online. Thus, online systems cannot be used to provide financial or banking services to the millions of people, such as those in developing countries, that live in geographical areas that have little or no infrastructure. Most smart card systems therefore, such as EMV, also operate online. We believe that this reliance on online communication has limited the exploitation of smart card technology, has resulted in high system implementation and operational costs and has not addressed many of the needs of the world's unbanked population.

Our offline loading feature has been designed to solve these problems associated with reliance on limited infrastructures and allows value to be distributed through existing infrastructures such as the postal service, fixed line telephones, cellular phones, verbal communication and newspapers. Our solution is a unique ten-digit signature code that the UEPS back-end system generates to enable specific amounts to be loaded to specific smart cards. When a ten-digit signature code is presented at any offline POS device to the smart card for which it was created, the code will, after validation, allow the smart card to credit one or a number of its internal wallets in the appropriate amount.

The offline loading function can be used to transfer funds remotely for payments such as wages, pensions, welfare grants, refunds and third party transfers. When a number of ten-digit signature codes are created for a specific smart card, each ten-digit signature code can then only be applied to that smart card once. Ten-digit signature codes can be presented to a smart card in a different order from the one in which the codes were created but can be effected only by that particular smart card.

*Biometric Identification.* The magnetic stripe credit and debit card systems available today use a written signature or a PIN in an effort to verify the customer's identity and minimize the repudiation of transactions. However, PINs can be compromised, magnetic stripes can be cloned and if a card is stolen together with its PIN number, the card can be used to transact until it is reported stolen or its offline limits are reached. The PIN and card can also be used to gain access to back-end account information to defraud further the genuine card holder. Therefore, positive offline card holder verification is critical to ensure that a payment system does not effect fraudulent transactions. At the same time, the system must ensure that the genuine card holder's transactions are not rejected.

As an alternative form of customer identification, the UEPS supports biometrics in the form of fingerprint recognition. Biometric scanners are used to record a customer's fingerprint images. The fingerprint templates that result are stored in the holder's smart card and used for identification whenever the smart card is used.

Before a smart card is issued, the following fingerprint recordation process occurs:

All ten fingers are captured, with three fingerprint images captured per finger.

The three fingerprint images for each finger are consolidated and filtered to create the best image for that finger. This results in ten-high quality fingerprint images.

The ten fingerprint images are scored and the four highest scoring images are used to generate fingerprint templates. A fingerprint template is a unique geometric representation of one fingerprint.

The card holder is verified against these four templates using the highest fingerprint matching threshold to ensure the best recordation process. This process assists to eliminate the false rejection of genuine card holders due to initial bad fingerprint template recordation.

The four fingerprint templates are signed by an issuing UEPS smart card and stored on the card holder's smart card.

When a transaction is performed, the card holder's fingerprints are verified against those stored on the smart card. The verification process occurs in a secure session between the smart card and the fingerprint scanner. During the verification phase, a moderate matching threshold is used to compensate for the changes in the card holder's fingerprint conditions.

Our biometric identification feature is designed to protect our card holders against fraud, helps eliminate transaction repudiation and reduces the complexity associated with hot card management systems and hot line centers, as well as the cost of the systems that are utilized to deal with stolen and lost cards.

*Automatic Credit.* The distribution of social welfare benefits, unemployment insurance, food parcels or vouchers and medical supplies is personnel intensive. Furthermore, beneficiaries must present themselves regularly at designated distribution locations in order to receive their benefits. These requirements create a number of operational and logistical problems, which increase the direct or indirect costs for system owners, operators and members, including:

The costs of transporting beneficiaries and payment personnel to and from distribution points;

The time beneficiaries must spend waiting in line at distribution points rather than working or engaging in other activities;

The need to provide adequate staff, water, toilets, medical emergency services, shelters and security at distribution points;

The need to provide personnel to deal with beneficiary communications and inquiries; and

The need to create itineraries and schedules for payment delivery personnel, as well as to establish distribution centers and purchase vehicles to travel to distribution points.

Thus, governments incur significant costs in distributing social welfare payments at fixed or movable locations, and banking institutions must spend large sums to provide branches and ATMs where their customers can obtain cash. Many of these costs cannot be passed onto the client. We have developed the capacity in the UEPS to facilitate the distribution of cash at retail merchants in a manner that eliminates or reduces the need for social welfare beneficiaries and customers to travel to a specific ATM location, reduces merchants' costs of depositing excess cash and that enables banks to reduce their costs associated with providing, maintaining and servicing brick and mortar infrastructures.

We developed our automatic credit feature to allow our smart card holders to receive regular, fixed amount payments at POS devices that may not have the capability to perform online functions. The participants in an automatic credit transaction are the automatic credit initiator, the smart card holder and the merchant. The automatic credit initiator is the issuer which creates an automatic credit instruction for a particular wallet of a specific card holder. The smart card holder is the beneficiary of the automatic credit instruction which has been approved by the initiator. The merchant is any retailer which participates in the UEPS system and has a POS device for a card holder to activate automatic credit instructions.

Card holders go to designated points to register for an automatic credit instruction. While at the POS device, the credit initiator submits an application for an automatic credit instruction to the back-end system. The application can occur offline or online. Once the back-end system has validated the beneficiary's information, it creates an automatic credit instruction signature which is sent back to the POS device and is then recorded on the smart card. On the day that the card holder is due to receive a payment, the card holder inserts his smart card into any POS device. In the event that the automatic credit instruction is due and valid, the smart card of the card holder is automatically loaded.

*Interest on Card.* Unbanked people transact mainly with cash. One of the most fundamental disadvantages of cash is that it cannot generate interest income for the holder and that its value depreciates with inflation. The UEPS was designed, in essence, to be an alternative to a formal banking account that allows a smart card holder to earn interest on the value contained in his various wallets. The ability to earn interest provides an incentive for people to maintain

balances on their smart cards rather

than convert the full balances to cash or to unload them to a traditional banking account where they would not earn any interest.

There are numerous possible types of interest calculations, including simple, compound, continuous, minimum balance, average balance, daily and monthly interest. The UEPS uses the compound interest methodology, calculated daily on the previous day's closing balance. In order to calculate interest correctly, the client smart card requires a host date certificate, or HDC. This date originates from the back-end system, and is updated on the merchant smart card when it settles its transactions. The merchant smart card in turn passes the HDC to the card holder's smart card, which enables the client smart card to calculate the interest for any wallet that bears interest. The system is designed to ensure that the client smart card only calculates the interest using the latest HDC, and not any date given to it from an unsettled or inactive merchant smart card. Once interest is added to an interest-bearing wallet, a notification record is written to the card holder's smart card history file and forwarded to the merchant smart card for settlement. This record informs the back-end system of the interest amount credited.

*UEPS Morphing.* The UEPS is proprietary. It is designed for a specific market that requires specific features and as such is not compliant or compatible with other smart card systems. If it were compatible with other systems, the usefulness of the UEPS would be as limited as these other systems and could not provide a solution for the unbanked populations of the world. However, we have designed the UEPS in such a way so that it can inter-operate with other standard payment systems such as EMV, one of the more widely-used standards in the banking sector. In the future, smart card holders may wish to use their smart cards in environments that are currently enabled for other smart card-based payment systems. The UEPS morphing feature allows our smart cards to transact at EMV POS devices as if our smart cards were in fact EMV smart cards. Our card holders can thus transact at EMV POS devices but the functionality provided at these POS devices is limited to that offered by the EMV system. Our smart cards, when required, can morph into the standards supported by the POS devices thus minimizing the cost of deploying another POS infrastructure.

Our UEPS morphing feature is not merely a collection of multiple applications grouped together into a single smart card. This feature also enables inter-operability between these applications. The EMV standard is mainly an online application that requires offline card authentication, online host authorization and online card issuer authentication. The EMV payment application is invoked by the POS device using the application selection methodology. The UEPS smart card can recognize the type of environment in which it is used through the command structure passed to it from the ATM, SST, POS device or any other smart card reader conducting the transaction. Once the smart card has sensed the system in use, it immediately morphs this application and behaves as such for the duration of the transaction. The morphing feature is not limited to EMV, but can also be used with CEPS, Visa Horizon and Mondex, among other systems. It places the UEPS card holder in a unique position to possess a single smart card, and use it at any POS device, ATM or SST of his choice, without having to have different smart cards for every payment application.

*Automatic Debit.* Currently, payees experience various administrative problems and other challenges in collecting payments due to them through the formal banking system for insurance premiums, micro-loan payments and governmental statutory deductions for items such as unemployment insurance. In addition, collectors suffer payment losses as a result of insufficient funds, closed accounts, or charge back transactions, and may incur significant personnel costs for employees to attempt to collect from non-payers. Payees may find that their accounts are incorrectly debited, unauthorized debits are made or they pay high fees for debit orders which are not processed.

For unbanked people, their problems are often even greater since their only means of payment is cash. To pay a premium, they have to present themselves at the office of the financial service provider and pay their premium in cash. These offices are typically in urban areas and therefore unbanked people have to pay for transportation in order to make their monthly payments. Carrying substantial amounts of cash over long distances involves risks of theft and loss.

We created the automatic debit feature to allow a smart card to reduce the balance in any of its active wallets on a specific date and for a predetermined amount. This function can take place in an offline environment at any POS device. The automatic debit feature reduces the risks associated with collection of insurance premiums and other regularly scheduled payments by ensuring that any funds loaded to the smart card are first used to service the automatic debit before being transferred for the card holder's general use.

The participants in an automatic debit transaction are the automatic debit initiator, the merchant and the smart card holder. The automatic debit initiator is the issuer which will create an automatic debit instruction for a particular wallet of a specific smart card holder. The merchant is any retailer which is a participant in the system and has a POS device for a card holder to activate automatic debit instructions. The card holder is the person who must pay the premium or other payment.

Card holders register for automatic debit instruction at the offices of the automatic debit initiator. While at the POS device, they submit an application for an automatic debit instruction to the back-end system. This can occur offline or online. Once the back-end system has validated the beneficiary's information, it creates an automatic debit instruction signature which is sent back to the POS device and is then recorded on the smart card. On the day that the card holder is due to pay a premium or other payment, the card holder inserts his smart card into any POS device. In the event that the automatic debit instruction is due, the smart card of the card holder is automatically debited.

*Multiple Streams Audit Trails for Offline UEPS Transactions.* The UEPS, as an offline system, must ensure that all transactions effected offline are settled, at some point in time, by the back-end system. Settlement is critical to guarantee that no funds can be lost by card holders even when a POS device, its paper audit trail or its merchant smart card is lost, stolen or destroyed. Importantly, smart card transactions, including automatic credits, automatic debits, interest accruals, agent transfers, cash downloads and purchases, all have a financial effect on individual smart card balances and must therefore be settled in order to preserve system integrity. The UEPS multiple streams audit trail functionality is designed to ensure that the replacement smart card contains the correct amount of funds when a lost, stolen or defective card is replaced.

The UEPS provides the ability to activate multiple streams audit trails through POS device profile downloading. Multiple streams audit trails are distributed through the active smart card base and are completely transparent to all card holders. Multiple streams audit trails can only be implemented on smart cards which have an adequate amount of EEPROM memory as the size of the transaction file created on smart cards will at least double. The multiple streams audit trails functionality is especially useful in environments where either the POS device is offline or may be damaged or destroyed due to the harsh environmental conditions in which it operates or where there is a perceived risk that the POS device may be stolen.

When a client smart card is inserted into any POS device to perform one or more transactions, including a sale, load, unload, automatic credit, automatic debit or interest accrual transaction, the current transaction is written to both the client and the merchant smart cards. The previous transaction performed by the client smart card at another POS device is also written to the currently transacting merchant smart card transaction file as a piggy back record. The previous transaction or transaction group written to the merchant smart card from another client is also written to the client smart card of the currently transacting client.

This process ensures that each transaction or transaction group effected on a client smart card is distributed directly to a second merchant smart card and indirectly to a third merchant smart card. The third transfer occurs by writing the transaction or transaction group to another client smart card which in turn transfers the same to a different merchant smart card. The number of different audit trails streams can be selected through the POS device or merchant profiles.

Upon settlement of the merchant smart card, the transactions which were performed at other merchants will therefore also be settled. Each merchant smart card becomes the carrier for transactions

that have occurred at other merchants. All client smart cards become the multiple streams that facilitate the movement of transaction data among unrelated merchant smart cards. This process occurs in an offline environment.

In the event of the loss or destruction of any POS device or its associated merchant smart card or paper audit trail, all transactions that have been piggy backed can be recovered through the settlement of other merchant smart cards. The speed at which these transactions can be recovered will depend on how frequently the client smart cards that are used to piggy back transactions have transacted at other UEPS merchants. The multiple streams audit trails functionality provides complete and independent audit trails that help prevent fraud by single or colluding parties.

*Transparent and Automatic Recovery for Offline UEPS Transactions.* The UEPS, as an offline system, must ensure that all transactions effected offline complete successfully or that, in the event of a failure, the transaction in progress can be restarted without any loss being incurred by either the client or merchant concerned. Failure of the POS device or the premature removal of either of the smart cards involved during a transaction may lead to the client smart card being debited without the corresponding credit being reflected on the merchant smart card. Although the premature removal of either of the smart cards can be prevented by introducing motorized smart card readers, the cost involved is prohibitive and the solution does not address other possible failures due to POS device hardware problems or power failures, which are common in areas with unreliable power infrastructures.

The UEPS is designed to recover failed transactions through its transparent and automatic recovery feature. This feature is activated during the session key establishment phase that occurs whenever two smart cards transact. During the session key establishment phase, each smart card generates an eight-byte natural random number and triple-DES encrypts it with its generic UEPS key pair. These two encrypted blocks are then exchanged by the two smart cards, and once decrypted, used by each smart card to generate a random DES key pair. This new key pair is used to exchange further information between the smart cards until the transaction is completed.

During the next phase, each smart card passes to the other its smart card unique serial number and its current transaction counter. At this stage, the client smart card is now able to determine if the last transaction written to its transaction file was indeed also effected on the merchant smart card. If not, the client smart card simply unrolls its last transaction thus restoring the correct data image as it was prior to the transaction. This feature can also be used whenever a POS device is disabled for whatever reason. In this instance, the two smart cards can simply be inserted into any other working POS device and the two smart cards will automatically re-synchronize themselves. Further transaction processing can then resume normally. As a result of this feature, transactions such as transaction cancellation and reversals can be performed offline in a secure manner.

#### **Mechanics of Loading, Spending and Settlement**

The following describes how card holders can load value onto their smart cards and spend the value they receive. It also describes how merchants settle transactions with our back-end system.

*Loading.* All card holders that receive social welfare grants or whose employers participate in our system can load their smart cards at any POS device located in merchant stores. Card holders can load their smart cards in several different ways. If the card holder's electronic value was created through the ten-digit signature code, then the card holder has three options. He can effect an online auto load, in which case the POS device connects in real time to the back-end system, which then forwards any available ten-digit signature codes present in the account of the card holder. These codes will be loaded to the smart card automatically. If the communications network is erratic or unreliable, ten-digit signature codes can be downloaded to the POS device of a nearby participating merchant where and when the network is operational. The card holder can then perform an offline auto load whereby any ten-digit signature codes present in the POS device will be loaded to his smart card. If a network connection is not available, the card holder can key in his ten-digit signature code and amount to be loaded. In all scenarios the smart card will be credited only if the ten-digit signature code is decrypted successfully by the smart

card. If the card holder's smart card is initialized with one or a number of automatic credit instructions, the smart card will credit itself as we describe under Automatic Credit feature.

*Spending.* Once value has been loaded to a smart card, card holders may purchase goods or services, make cash withdrawals, initiate money transfers, request automatic loans, effect third party payments and invoke automatic credits and debit orders, all offline at any participating merchant store. To perform a transaction, the card holder inserts his smart card into the top smart card reader of the POS device and selects the appropriate function. Biometric fingerprint identification is required for most functions to protect card holders against the unintended or fraudulent usage of their funds. A printed receipt displays the details of the transaction performed and includes other system audit trail information.

*Settlement.* As spending on a UEPS smart card occurs offline, the settlement of the merchant transactions with the back-end system needs to take place within the two day window settlement period provided for in the contract, or as and when the merchant smart card becomes full. Settlement can be performed online or offline. Merchants who have access to a network infrastructure can use the settlement option on their POS devices to connect to the back-end system and settle their merchant smart cards online. During the settlement process, merchants choose whether to have the funds settled deposited to a traditional bank account or transferred to a client smart card.

Once the merchant selects the settlement option, the transactions are stripped off the merchant smart card, and the accumulated transaction values, less the transaction fees which the merchant is contractually required to pay to us, are paid to the merchant. Payment occurs either through the country's traditional banking clearing system, by check or is credited to the merchant's client smart card for immediate or future use. The last option is extremely beneficial for rural merchants who purchase their goods from larger wholesalers. Their funds are, upon settlement, immediately available. Therefore, they can purchase goods using their client smart card and/or withdraw cash at other participating merchants. Merchants who do not have access to a network infrastructure can insert their merchant smart card into any POS device that has online connectivity and perform the settlement process. Many merchants can share any POS device.

If a merchant does not have access to a communication network, the merchant can use our milking function with a milking smart card. This smart card has greater functionality than a regular smart card and therefore requires a large memory chip for storing multiple transactions, hot card files, a freshness certificate, and any other variables, including fees and/or interest rates that need to be updated on merchant smart cards which operate in deep rural areas. The milking smart card is inserted in the bottom smart card reader of a POS device and the merchant inserts the merchant smart cards to be milked into the top smart card reader. During this settlement process, the transactions are stripped from the transaction history file of the merchant smart card and at the same time, the new hot card file, freshness certificate, fee structure, interest rates and any other parameter that requires modification are updated. The milking smart card is then physically handed over to the central office in order to update the back-end system. At the time of settlement, all transactions are stripped from the merchant smart card, aggregated and paid into the nominated bank account of the merchant. Merchants can select their client smart card as their nominated account, in which case the amount to be paid is added to the merchant's client smart card.

We have designed and developed a dual functionality smart card called the Net1 Combi-Card for use in rural environments and for very small merchant stores or hawkers. Hawkers are typically small merchants that sell food or merchandise from a stand on the side of road or on a pavement. This smart card is initialized with both merchant and client functionality. While trading, the merchant section of the smart card is used for transaction storage which once settled will allow the merchant to use the same smart card to perform purchases or any other financial function.



**Our Products**

The following table summarizes each of our smart card to smart card, or S2S, products, including

the market introduction date;

the key features of the product;

the features of our UEPS technology which each product uses;

the types of fees we charge or currently plan to charge for the product; and

the target markets for the product:

<b>Product</b>	<b>Year of Market Introduction</b>	<b>Features</b>	<b>Types of Fees</b>	<b>Target Markets</b>
<b>S2S Pension and Welfare</b>	2000-2004	Ten-Digit Signature Codes Offline and Online Loading Automatic Credit Multiple Audit Trail Mutual Authentication Transparent and Automatic Recovery Biometric Identification	Loading Fee per Beneficiary Sales of Smartcards Registration and Enrollment	Government Social Welfare Grant Beneficiaries
<b>S2S Wage Payment</b>	2005	Ten-Digit Signature Codes Offline and Online Loading Multiple Wallets Restricted Wallets Multiple Audit Trails Mutual Authentication Transparent and Automatic Recovery Biometric Identification Interest Calculations	Wage Loading Fee per Employee per Month Equipment Sales per Payroll Clerk plus POS Terminals for the Payment of Wages in the Field or Factory Sales of Smartcards Mass Registration and Enrollment per Employee if Performed by us Monthly Smart Card Account Fee per Employee per	Employers Employees

Month

**S2S Medical Management, Patient Monitoring and Distribution**

2005	Multiple Wallets Restricted Wallets Multiple Audit Trails Mutual Authentication Transparent and Automatic Recovery Biometric Identification	Technology Processing Fee per Smart Card per Month (Volume Based) UEPS Software Fee (Volume Based) Database Capturing Module per Patient Patient License Fee per Hospital/ Clinic/ Health Care Facility Equipment Sales for Hospital/ Clinic and Health Care Facility Sales of Smartcards	Non-Governmental Organizations Government Paid Contractors Governments
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**S2S Retail and Wholesale**

2004	Ten-Digit Signature Codes Offline and Online Loading Automatic Credit Multiple Wallets Restricted Wallets Multiple Audit Trails Mutual Authentication Transparent and Automatic Recovery Biometric Identification Interest Calculations Settlement Offline and Online	Merchant Transaction Fee Cash Withdrawal Fee from UEPS Card Holders Excluding Social Grant Recipients Hardware Equipment Sales or Rentals Smart Card Sales Installation & Training Fee Reports and Banking Fees Monthly Card Account Fee per Retailer per Month	Retailers Wholesale Retailers UEPS Client Card Holders
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**S2S Insurance System**

2004	Multiple Audit Trails Mutual Authentication Transparent and Automatic Recovery Biometric Identification Settlement Offline	Insurance Merchant Transaction Fee Debit Order Collection Fee Hardware Equipment Sales or Rentals Smartcard Sales Installation and	Insurance Underwriter/ Broker (External Insurance Merchants)
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and Online

Training Fee  
Reports and  
Banking Fees

The following describes in more detail how our S2S products work and the benefits of each product.

### ***S2S Pension and Welfare***

S2S Pension and Welfare provides a secure and affordable transacting channel between social welfare grant beneficiaries, governmental agencies and formal businesses. Through this product, we distribute social welfare benefits to the unbanked and under-banked populations, and allow the recipients of these benefits to transact with formal businesses.

*How it works.* We enroll social welfare grant beneficiaries by issuing them a UEPS smart card that digitally stores their biometric fingerprint templates on the smart card, enabling them to access their social welfare grants securely at any time or place. The smart card, with its pre-printed and unique serial number, or USN, is issued to the beneficiary on site. Optical fingerprint sensor technology identifies and verifies beneficiaries. The fingerprint reader is programmed to create a random cryptographic session between itself and an inserted smart card, thereby limiting the possibility of fraudulent storage and replay of digital templates.

The smart card provides the holder with access to all of the UEPS functionality, which includes the ability to have the smart card funded with wage, pension or welfare payments, make retail purchases, enjoy the convenience of pre-paid facilities and qualify for a range of affordable financial services, including insurance and short-term loans. The smart card also offers the card holder the ability to make debit order payments to a variety of third parties, including utility companies, schools and retail merchants, with which the holder maintains an account. The card holder can also use the smart card as a savings account. Depending on a country's specific requirements, holders load their smart card using one of two methods—ten-digit signature code creation or automatic credit. We describe both of these methods under [Our Technology UEPS Smart Card Functionality Offline Loading and Automatic Credit](#).

When the ten-digit signature code method is used, the government agency submits to us a simple payroll file containing the beneficiary's identity number and the value of the grant. We then process this file and, using the identification number of each beneficiary, create a ten-digit signature code. The ten-digit signature code can only be loaded on to the smart card for which it was created. These ten-digit signature codes can be distributed to the memory of POS devices or other compatible devices, including fixed or mobile ATM dispensers or remote personal computers, by accessing a communication network such as satellite, X.25, TCP/IP or GPRS-GSM. Thereafter, the beneficiary can load the smart card offline. If a GPRS-GSM communication network is available, the beneficiary can load the smart card online.

The beneficiary simply inserts a smart card into the POS device and is prompted to present his fingerprint. If the fingerprint matches the one stored on the smart card, the smart card is loaded with the ten-digit signature code created for that particular smart card. The POS device then prints a receipt that outlines the amount of the grant paid to the beneficiary.

The automatic credit feature allows a smart card holder to receive regular, fixed-amount payments such as welfare grants or other benefits, food parcels, meal vouchers and/or medical supplies at POS devices that operate offline. Automatic credit instructions are recorded on the smart card at the time they are granted by the issuer. Each automatic credit instruction recorded embodies a number of parameters such as the amount and the wallet to be credited, the frequency at which the credit should occur and the commencement and expiration date of the instruction.

When the beneficiary inserts a smart card into a POS device or any other compatible device, the automatic credit feature will be automatically invoked. During this process, each automatic credit instruction previously recorded on the smart card will be reviewed. If all related parameters such as timing, commencement and expiration date are all correct the smart card is credited with the funds due. When this happens, the transaction is recorded immediately on the merchant smart card present in the POS device at the time that the beneficiary's smart card is credited. Since the electronic funds have been created offline, automatic credit transactions must be forwarded to the back-end system through a merchant settlement or through our multiple audit trail facility. We are able to claim the actual funds

loaded to beneficiaries smart cards from the government agency at the end of each business day because the back-end system is informed of all of the electronic values created.

*Benefits.* Our S2S Pension and Welfare system provides numerous benefits to government agencies and beneficiaries. The system offers provincial governments a reliable service at a reasonable price. For beneficiaries, our smart card offers convenience, security, affordability and flexibility. They can avoid long waiting lines at payment locations and do not have to get to payment locations on scheduled payment dates to receive cash. They do not lose money if they lose their smart cards, since a lost smart card is replaceable and the biometric fingerprint identification technology helps prevent fraud. Their personal security risks are reduced since they do not have to safeguard their cash. Beneficiaries have access to affordable financial services, can save and earn interest on their smart cards and can perform money transfers to friends and relatives living in other provinces. Finally, beneficiaries pay no transaction charges to load their smart cards, perform balance inquiries, make purchases or downloads or effect monthly debit orders. For us, the system allows us to reduce our operating costs by reducing the amount of cash we have to transport.

### ***S2S Wage Payment***

S2S Wage Payment allows an employer to pay employee wages electronically, either online or offline, by transferring the precise amount of the wage payment directly onto a smart card, thus eliminating the need for the employer to store and handle cash at the workplace. We originally designed this product for unbanked and under-banked workforces and their employers. However, employers of employees who often have bank accounts have expressed interest in this product as well, which we attribute to its affordability, convenience and security.

*How it works.* Employees of participating employers receive smart cards which we issue to them. We download a ten-digit signature code for each employee wage payment to a POS device, and the employer takes the POS device to the pay site on payday. The employee inserts his smart card into the POS device which then searches for any ten-digit signature codes created for that particular smart card. Once the POS device locates and decrypts the ten-digit signature code, it immediately loads the smart card with the wage payment. The POS device prints a receipt which acts as a pay stub by including the amount of the wage paid and any deductions made. The receipt also indicates the balance of the savings wallet, if available. The process takes up to six seconds from insertion of the smart card to completion of printing. Personal identification through finger print authentication is not necessary to perform a load as the ten-digit signature code is uniquely linked to the USN number of the employee's smart card.

*Benefits.* S2S Wage Payment provides numerous benefits to employers and to employees. For employers, the system helps to increase productivity in the work environment and reduce administration and labor costs associated with the management, transportation, delivery and general handling of cash. Electronic payment requires less time than manual distribution of cash pay packets, thereby reducing the amount of employee downtime. Employers in rural and semi-rural areas no longer need to incur the inconvenience and expense of transporting their employees to urban areas to enable them to receive their wages from ATMs nor to have to advance funds whenever these ATMs run out of cash. In addition, the system is configurable for each employer so that the database can be split up into departmental or company sub-databases, if required.

Further, employers of unbanked and under-banked employees are frequently put into a position of having to provide savings, loans, burial insurance and other financial services to their workers. With S2S wage payment, the employee can opt to have a portion of his wage loaded directly to a separate savings wallet on the smart card. Interest is calculated on the current daily balance and paid monthly to the card holder. The card holder can also qualify for an affordable loan, provided by us or another participating service provider, which is loaded onto his smart card. The smart card informs the back-end system of the monthly loan repayment which is applied against the wage after loading the amount due to the smart card. Finally, instead of the employer having to negotiate the most cost effective burial insurance for his employees, he can take advantage of the insurance we negotiate with selected insurance companies on

behalf of many employers. The issuance of the insurance policy is recorded in the chip of the smart card. For employees, S2S wage payment offers all of the benefits described above under S2S Pension and Welfare. Additional benefits include fees for cash withdrawal that are typically lower than bank charges for the same transaction.

### ***S2S Medical Management***

Our S2S Medical Management product applies the UEPS technology in a non-financial environment to facilitate the management, distribution and control of the anti-retroviral, or ARV, drugs used to combat HIV/ AIDS. The system is designed to operate in the deepest rural areas where no meaningful infrastructure exists. It is also designed to form a basis for the implementation of other drug distribution programs.

Governments and charitable organizations face many challenges in the distribution and control of ARV drugs. Patients who do not strictly adhere to the required drug regimen for the rest of their lives face the risk of drug resistance, which can lead to death. The toxicity of ARV drugs requires effective patient monitoring. Data needs to be collected to evaluate the effectiveness of drugs available for treatment.

*How it works.* We issue smart cards to participating hospitals, dispensaries and doctors and to their AIDS/ HIV patients. The smart cards use biometric fingerprint identification technology and act as portable electronic medical record books that allow patients to be serviced anywhere without relying on centralized systems and communications networks. The smart cards carry all patient-related information, including personal details, drug regimens, prescriptions, visitation history, doctor's details, dispensary information and other data. This data allows us to populate and update databases that track each patient's progress, each doctor's performance, each and every prescription dispensed and each dispensary's drug inventory levels. The system monitors patient activities, and is designed to ensure the integrity of data, reduce fraud, manage drug inventories and, control drug delivery, ensure patient anonymity and privacy, and distribute payment for goods and services. Each day, all registration information, changes to patient information, and information regarding drug dispensation is encrypted and communicated to our back-end system for batch processing. Once validated, this information is forwarded directly to a confidential server managed by the government and/or funding organizations.

*Benefits.* S2S Medical Management offers many benefits to government organizations, medical professionals and health care workers, and patients. For government organizations, the system helps save money by improving the efficiency of ARV drug distribution and by reducing the potential for fraud and falsification of data. For medical professionals and health care workers, the system facilitates the real time but offline registration of patients and the storage of crucial patient information, such as the patient's last visit date, changes in information such as height and weight and the most recent prescription. For patients, the portability of the electronic medical record allows them to be treated anywhere, without relying on centralized systems and communications networks. The system, which is provided free of charge to the patient, is designed to ensure patient privacy. Finally, our technology preserves the patient's information, even if the smart card is lost.

### ***S2S Retail and Wholesale***

Our S2S Retail and Wholesale product enables retailers, wholesalers and financial service providers to effect commercial transactions with one another and with unbanked and under-banked customers. Many merchants who service the unbanked and under-banked operate in underdeveloped areas where traditional financial institutions and their products are unavailable or limited due to the lack of communication infrastructures. In addition, these merchants do not meet the selection criteria imposed by financial service providers, including banks and credit card companies, either for financial reasons or because they cannot meet or adhere to the rules and regulations these formal institutions demand. The system permits participants, which include merchants, wholesalers and financial service providers to effect payments for goods and services, and to dispense cash from one smart card to another in a secure offline manner. The system is designed to eliminate unauthorized use by ensuring that all transactions are biometrically

approved by the card holders. The system guarantees integrity by providing an audit trail for each transaction that is stored on both the customer and merchant smart cards.

*How it works.* The participants in this system are merchants whom we enroll and consumers who are smart card holders. When we enroll a merchant, we issue a smart card to the merchant that contains its profile as well as the store's merchant reference number and install an appropriate POS device that takes into account the type of power and communications infrastructure available at the merchant's location. The POS device is either battery-operated or uses a municipal power supply. All our POS devices can use GSM/ GPRS, TCP/IP, X.25 or satellite networks to perform loading and settlement functions. The smart card is inserted in the bottom smart card reader of the POS device to perform on-line transactions with customers. We sign a contract with each merchant that is tailored to the needs of each merchant, reflecting the number of stores to be serviced and the specific hardware we agree to install. We provide each merchant with installation, system implementation and training. We also provide merchants with our marketing material for display at their locations so that their customers know that the merchant offers our services. The transactions stored on merchant smart cards cannot be overwritten until they have been settled by using our offline milking facility or connecting online to the back-end system.

*Benefits.* S2S Retail and Wholesale provides numerous benefits to merchants and to customers. A growing smart card base offers merchants a larger number of customers who can shop in their stores. The system also provides them with the opportunity to realize new income streams from the fees they collect by providing at their locations our broad range of financial services and products, including cash downloads, money transfers, loans and burial insurance. Finally, their security risks and expenses associated with handling cash can be significantly reduced, including banking charges and communications costs. The benefits of the system for customers are a combination of the ones we describe above under S2S Pension and Welfare and S2S Wage Payment.

### ***S2S Insurance***

Our S2S Insurance intermediary product enables unbanked and under-banked consumers to obtain affordable and reliable burial insurance policies. In South Africa, cultural reasons make burial insurance important to many people. Our system enables insurance companies to access this customer base. The insurance industry is subject to various laws and regulations which are designed to protect policyholders and our system ensures compliance with these laws and regulations by utilizing the key features of the UEPS technology.

*How it works.* In order to participate in the system, card holders and insurance brokers must be enrolled in our system. The broker enrollment procedure is similar to the procedure we use for merchants. The insurance broker's merchant smart card is created centrally and loaded with the broker's burial insurance product options. Individual brokers receive smart cards which digitally store their biometric fingerprint templates on the smart card. After completion of the enrollment process, we issue an insurance merchant smart card to the insurance broker. We provide the insurance broker with installation, implementation and training.

When an applicant applies for an insurance policy, the insurance broker explains relevant information, including the different policy options, waiting options and the 30-day cooling off period. The 30-day cooling off period allows the policy holder who has decided to buy a policy issued by another insurance company to change his mind and to keep the original policy instead. The system informs all parties involved, including the brokers for the previous insurer and the new insurer that the client is in a 30-day cooling off period. This makes the insurance broker of the previous insurer aware of the client's intention, and allows the insurance broker to contact the client in an effort to keep the client.

When a broker sells a policy to a client, the first check performed by the smart card is to ascertain if the client has already signed up for a similar product, which may be accomplished offline. If not, the client accepts the new policy by presenting his fingerprint for verification by the smart card. The broker also presents his fingerprint to prove that he sold the policy and thereby allow him to receive his sales commission. The system then writes the policy number and details, including the amount of the premium,

to the card holder's smart card. This reduces the risk of future disputes regarding the policy. When a insured individual dies, the beneficiary presents the identity document, the insured's smart card and death certificate, and the original policy document. This information is checked against the information stored on the smart card by simply inserting the deceased's smart card into a POS device and printing the data associated with burial policy information. If valid, the claim is paid out to the beneficiary immediately.

*Benefits.* Our S2S Insurance intermediary product offers numerous benefits to insurance brokers and policyholders. For brokers, the system provides improved access to its potential client base, minimizes the risks associated with fraud through biometric fingerprint identification, facilitates legal compliance and provides a secure channel for collection of premiums. In addition, brokerage commissions can be managed through the system. The benefits for policyholders are generally the same as for customers as described above under S2S Retail and Wholesale. In addition, because the system reduces premium collection risk to the insurance company, it provides consumers with access to more affordable insurance products of a higher quality than would otherwise be available.

### **Sources of Revenue**

We have structured our business and our business development efforts around four related but separate approaches to deploying our technology. In our most basic approach, we act as a supplier, selling our equipment, software, and related technology to a customer. As an example, in Malawi we sold a complete UEPS to the Central Bank, which owns and operates the resulting transaction settlement system. The revenue captured through this approach is reflected in our Hardware, software and related technology sales segment.

We have found that we have greater revenue opportunities, however, by acting as service provider instead of a supplier. In this approach we own and operate the UEPS ourselves, charging one-time and ongoing fees for the use of the system either on a fixed or ad valorem basis. This is the case in South Africa, where we distribute welfare grants on behalf of the provincial governments and employers on a fixed basis, but charge a fee on an ad valorem basis for goods purchased using our smart card. The revenue associated with this approach is captured in our Smart card accounts, Transaction-based sales and Financial services segments.

Because our smart cards are designed to enable the delivery of more advanced services and products, we are also willing to supply those services and products where the profit potential is compelling. For instance, we act as a lender today. This is an example of the third approach that we have taken. Here we can act as the principal in operating a business that can be better delivered through our UEPS. We can also act as an agent, for instance, in the provision of insurance policies. In both cases, the revenue and costs associated with this approach are captured in our Financial services segment.

Finally, we are willing to enter into business partnerships or joint ventures to introduce our solution to new markets. Here we take an equity position in the business while acting as a supplier of technology. In evaluating these types of opportunities, we intend to maintain a highly disciplined approach, carefully selecting partners, participating closely in the development of the business plan and remaining actively engaged in the management of the new business. In most instances, the joint venture or partnership will own the UEPS, including the back-end system. We plan to account for our equity investments using the equity method.

We believe that this flexible approach enables us to drive adoption of our solution while capturing the value created by the implementation of our technology.

### **Sales and Marketing**

Our marketing and sales strategy continues to evolve as we gain more and more market penetration. We currently focus our activities on the deployment of our POS device infrastructure in the rural areas of South Africa. These devices provide us and our card holders with service points at which they can transact and sign up for many financial services. The more of these points of service we deploy, the better our service delivery to our card holders. To achieve this, we are promoting the use of our POS devices in



many different applications which, once implemented, provide further access points at which we can market and sell our products. As a result, we are involved in the facilitation of telephone service and the pre-payment for water and electricity service.

We continue to develop our pension and welfare application as the customer base it generates allows us to gain critical mass as an issuer. Once we achieve critical mass, it should be far easier to acquire new merchants and other related organizations that wish to market and sell their products to and through our smart card base. We believe that success in one area of operations and market penetration will favorably affect others.

We have also commenced our activities in the distribution and management of medical products to HIV/ AIDS patients. This initiative assists us to acquire a new client and retail base such as hospitals, clinics and dispensaries. The smart cards we issue to these patients can operate the entire suite of UEPS products. Therefore, we believe that this new customer base will assist us in increasing our revenues.

We continue to engage institutions that can on the one hand benefit directly from our technology and on the other hand provide us with more clients and points of service to facilitate the use of our facilities and the cross selling of our products.

Our international strategy is changing rapidly. In the past, we did not drive markets directly as we were not ready structurally to take on contracts in many countries of the world. We now intend to target the unbanked market of developing economies aggressively through partnerships, joint ventures and the acquisition of synergistic but profitable businesses. This new strategy focuses on identifying, defining and activating an entry point in a specific country to commence operations. Once our system is implemented, we will then introduce our products and services to grow revenue and increase profit margins.

We intend to identify partners that are already operating businesses and infrastructures in various countries in order to benefit from their initiatives to introduce our operating platforms. We believe that our partners will benefit through the implementation of our technology and through the new income streams that our technology can activate.

We are currently revamping our business, sales, finance and information technology divisions in such a way as to facilitate our objectives.

### **Competition**

In addition to competition that we face from the use of cash, checks, credit and debit cards, existing payment systems and the providers of financial services, we have identified a number of other products currently being produced that use smart card technology in connection with a funds transfer system and the companies that promote them. These include EMV, a system that is being promoted by Visa International Service Association, MasterCard International and Europay International; Mondex International Limited, a subsidiary of MasterCard; and Proton World International N.V., a subsidiary of STMicroelectronics Belgium N.V. In South Africa, and specifically in the payment of social welfare grants, our competitors also include AllPay Consolidated Investment Holdings (Pty) Ltd., which is responsible for social welfare payments in the Free State, Gauteng and Western Cape provinces and a small portion of the Eastern Cape province, and Empilweni Payout Services, which is responsible for payments in the Mpumalanga province.

The incumbent South African retail banks recently announced a joint initiative to create a common banking product to offer to the significant portion of South Africa's population that does not have access to traditional banking services, or the unbanked. This bank account, generally referred to as the Mzansi account, was introduced in October 2004 and offers limited transactional capabilities at reduced charges, when compared to the accounts traditionally offered by these banks. We believe that currently there are approximately one million Mzansi account holders. The social welfare beneficiaries who are currently paid through our smart card system may elect to use these accounts to receive their grants.

We also may face competition from companies to which we have licensed rights to our technology, including Visa and BGS Smart Card Systems AG. Moreover, as our product offerings increase and gain market acceptance, banks in South Africa and other jurisdictions in which we operate may seek governmental or other regulatory intervention if they view us as infringing on their funds transfer businesses.



## **Research and Development**

Our business activities and product offerings depend on our proprietary UEPS software. As a result, we have a large group of software engineers and developers who are constantly revising and improving the core UEPS software and its functionality.

We believe that our smart card system is the most advanced system of its kind in the world today. However, we use a number of hardware platforms that are not proprietary to us and which are continuously being improved. These platforms include smart cards micro-controllers, POS devices, biometric readers and other back-end computer hardware. We continually work to take advantage of these improvements in our attempt to stay at the head of the competitive curve. A faster micro-controller on a smart card may allow us to process transactions faster and with more security. A larger memory smart card allows us to store more transactions and to load larger software applications. Larger memories also allow our smart cards to be used for more than one application at a time, thus eliminating the cost and the management of multiple smart card systems.

Our smart card system is designed to manage tokens of value such as cash, credit, savings, medical history, identification criteria, finger print templates and insurance policies. Security is therefore of prime importance as any breach would result in the loss of our system integrity. This would be followed by a loss of confidence and credibility that would jeopardise our growth and market penetration. We therefore continue to advance our security protocols and algorithms to combat the potential attacks that have currently been identified. These include crypto-analysis techniques as well as reverse engineering. Attacks such as the latest DPA or differential power analysis must also be circumvented.

We continue our research in new and more secure algorithms, such as the RSA or Rivest, Shamir and Adleman as well as new competitive asymmetric algorithms such as elliptic curves. We develop and implement these techniques ourselves and own the software that we create.

Lastly, we continue to study the needs of our target market and develop new UEPS features that satisfy these needs. As our UEPS system is implemented in more and more developing countries, we create greater connectivity between our systems to subsequently activate international transactions and cross-border money transfers.

## **Intellectual Property**

Our success depends in part on our ability to develop and maintain a competitive intellectual property advantage over potential competitors in the electronic financial services industry. We believe that we have developed the first payment system based on technology that is protected by our FTS patents. We rely on know-how, including trade secrets and other confidential information, continuing technological innovation and licensing opportunities to further develop our proprietary position. Our ability and the ability of our licensors to obtain intellectual property protection for the UEPS technology and related processes, including any improvements to and developments of them, to operate without infringing the intellectual property rights of others and to prevent others from infringing our intellectual property rights will be important factors to our success.