

NET 1 UEPS TECHNOLOGIES INC  
Form 10-Q  
February 07, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended December 31, 2007

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ To \_\_\_\_\_

Commission file number: **000-31203**

**NET 1 UEPS TECHNOLOGIES, INC.**

(Exact name of registrant as specified in its charter)

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

**98-0171860**  
(IRS Employer  
Identification No.)

**President Place, 4<sup>th</sup> Floor, Cnr. Jan Smuts Avenue and Bolton Road  
Rosebank, Johannesburg 2196, South Africa**

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: **27-11-343-2000**

**Not Applicable**

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer     Accelerated filer     Non-accelerated filer

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
YES [ ] NO [X ]

As of December 31, 2007 (the latest practicable date), 52,519,579 shares of the registrant's common stock, par value \$0.001 per share, and 5,208,755 shares of the registrant's special convertible preferred stock, par value \$0.001 per share, which are convertible into common stock on a one-for-one basis, were outstanding.

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## Part I. Financial Information

## Item 1. Financial Statements

NET 1 UEPS TECHNOLOGIES, INC.  
Condensed Consolidated Balance Sheets

|   | Unaudited<br>December<br>31,<br>2007 | (A)<br>June 30,<br>2007 |
|---|--------------------------------------|-------------------------|
|   | (In thousands, except share data)    |                         |
| <b>ASSETS</b>   |                                      |                         |
| <b>CURRENT ASSETS</b>   |                                      |                         |
| Cash and cash equivalents   | \$ 200,741                           | \$ 171,727              |
| Pre-funded social welfare grants receivable   | 42,761                               | 26,817                  |
| Accounts receivable, net of allowances of<br>December: \$386;<br>June: \$555          | 33,223                               | 30,503                  |
| Finance loans receivable, net of allowances of<br>December:<br>\$3,153; June: \$2,773 | 6,269                                | 5,755                   |
| Deferred expenditure on smart cards   | 259                                  | 507                     |
| Inventory   | 7,478                                | 5,645                   |
| Deferred income taxes   | 5,273                                | 7,028                   |
| Total current assets  | 296,004                              | 247,982                 |
| LONG-TERM RECEIVABLE  | 23                                   | 54                      |
| <b>PROPERTY, PLANT AND EQUIPMENT, NET OF<br/>ACCUMULATED<br/>DEPRECIATION OF</b>      |                                      |                         |
| December: \$27,051; June: \$24,406  | 7,538                                | 7,582                   |
| <b>EQUITY-ACCOUNTED INVESTMENTS</b>   | 2,982                                | 2,992                   |
| <b>GOODWILL</b>   | 88,456                               | 85,871                  |
| <b>INTANGIBLE ASSETS, NET OF ACCUMULATED<br/>AMORTIZATION OF</b>                      |                                      |                         |
| December: \$17,641; June: \$13,745  | 29,028                               | 31,609                  |
| <b>TOTAL ASSETS</b>   | 424,031                              | 376,090                 |
| <b>LIABILITIES</b>  |                                      |                         |
| <b>CURRENT LIABILITIES</b>  |                                      |                         |
| Bank overdraft  | 2                                    | 16                      |
| Accounts payable  | 5,340                                | 5,879                   |
| Other payables  | 37,129                               | 34,457                  |
| Income taxes payable  | 7,916                                | 14,346                  |
| Total current liabilities   | 50,387                               | 54,698                  |
| DEFERRED INCOME TAXES   | 40,631                               | 36,219                  |
| INTEREST BEARING LIABILITIES minority interest loans                                  | 4,150                                | 4,100                   |
| COMMITMENTS AND CONTINGENCIES   | -                                    | -                       |
| <b>TOTAL LIABILITIES</b>  | 95,168                               | 95,017                  |
| <b>SHAREHOLDERS EQUITY</b>  |                                      |                         |
| <b>COMMON STOCK</b>   |                                      |                         |
| Authorized: 83,333,333 with \$0.001 par value;  |                                      |                         |
| Issued shares - December: 52,819,400; June: 51,730,547                                | 52                                   | 52                      |
| <b>SPECIAL CONVERTIBLE PREFERRED STOCK</b>  |                                      |                         |
| Authorized: 50,000,000 with \$0.001 par value;  |                                      |                         |

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|  |            |            |
|--|------------|------------|
| Issued and outstanding shares - December: 5,208,755; June: | 5          | 5          |
| 5,656,110  |            |            |
| <b>B CLASS PREFERENCE SHARES</b>                           |            |            |
| Authorized: 330,000,000 with \$0.001 par value;            |            |            |
| Issued and outstanding shares (net of shares held by the   |            |            |
| Company) - December:                                       |            |            |
| 38,380,326; June: 41,676,625                               | 6          | 7          |
| <b>ADDITIONAL PAID-IN-CAPITAL</b>                          | 114,070    | 112,167    |
| <b>TREASURY SHARES, AT COST:</b> December: 299,821; June:  | (7,795)    | (7,795)    |
| 299,821  |            |            |
| <b>ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)</b>       | 4,222      | (3,915)    |
| <b>RETAINED EARNINGS</b>                                   | 218,303    | 180,552    |
| <b>TOTAL SHAREHOLDERS EQUITY</b>                           | 328,863    | 281,073    |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>           | \$ 424,031 | \$ 376,090 |
| (A) Derived from audited financial statements              |            |            |
| See Notes to Unaudited Condensed Consolidated Financial    |            |            |
| Statements   |            |            |

**NET 1 UEPS TECHNOLOGIES, INC.**  
**Unaudited Condensed Consolidated Statements of Operations**

|  | Three months ended<br>December 31,    |           | Six months ended<br>December 31,      |            |
|--|---------------------------------------|-----------|---------------------------------------|------------|
|  | 2007                                  | 2006      | 2007                                  | 2006       |
|  | (In thousands, except per share data) |           | (In thousands, except per share data) |            |
| REVENUE  | \$ 68,500                             | \$ 49,571 | \$ 128,759                            | \$ 102,497 |
| EXPENSE  |                                       |           |                                       |            |
| COST OF GOODS SOLD, IT<br>PROCESSING,  |                                       |           |                                       |            |
| SERVICING AND SUPPORT  | 20,175                                | 10,926    | 35,318                                | 24,245     |
| SELLING, GENERAL AND<br>ADMINISTRATION   | 17,266                                | 15,690    | 33,730                                | 29,175     |
| DEPRECIATION AND<br>AMORTIZATION   | 2,833                                 | 2,813     | 5,579                                 | 5,760      |
| OPERATING INCOME   | 28,226                                | 20,142    | 54,132                                | 43,317     |
| INTEREST INCOME, net   | 4,116                                 | 1,186     | 7,098                                 | 2,058      |
| INCOME BEFORE INCOME<br>TAXES  | 32,342                                | 21,328    | 61,230                                | 45,375     |
| INCOME TAX EXPENSE   | 11,788                                | 8,690     | 22,660                                | 17,530     |
| NET INCOME FROM<br>CONTINUING OPERATIONS<br>BEFORE MINORITY INTEREST<br>AND (LOSS) |                                       |           |                                       |            |
| EARNINGS FROM<br>EQUITY-ACCOUNTED<br>INVESTMENTS                                   | 20,554                                | 12,638    | 38,570                                | 27,845     |
| MINORITY INTEREST<br>(LOSS) EARNINGS FROM<br>EQUITY ACCOUNTED<br>INVESTMENTS       | -                                     | -         | (196)                                 | 205        |
| NET INCOME   | \$ 20,318                             | \$ 12,823 | \$ 38,246                             | \$ 27,895  |
| <b>Net income per share</b>  |                                       |           |                                       |            |
| Basic earnings, in cents<br>common stock and linked<br>units                       | 35.6                                  | 22.5      | 67.0                                  | 49.0       |
| Diluted earnings, in cents<br>common stock and<br>linked units                     | 35.2                                  | 22.3      | 66.4                                  | 48.5       |

See Notes to Unaudited Condensed Consolidated Financial Statements

**NET 1 UEPS TECHNOLOGIES, INC.**  
**Unaudited Condensed Consolidated Statements of Cash Flows**

|  | Three months ended<br>December 31, |                | Six months ended<br>December 31, |                 |
|--|------------------------------------|----------------|----------------------------------|-----------------|
|  | 2007                               | 2006           | 2007                             | 2006            |
|  | (In thousands)                     |                | (In thousands)                   |                 |
| <b>Cash flows from operating activities</b>  |                                    |                |                                  |                 |
| Net income   | \$ 20,318                          | \$ 12,823      | \$ 38,246                        | \$ 27,895       |
| Depreciation and amortization  | 2,833                              | 2,813          | 5,579                            | 5,760           |
| Loss (Earnings) from equity-accounted investments  | 236                                | (185)          | 520                              | (255)           |
| Fair value adjustment related to financial liabilities   | (169)                              | 153            | (242)                            | 153             |
| Fair value of FAS 133 derivative adjustments   | (17)                               | 75             | (10)                             | 77              |
| Interest payable   | 124                                | -              | 241                              | -               |
| Profit on disposal of property, plant and equipment  | (76)                               | (33)           | (86)                             | (67)            |
| Minority interest  | -                                  | -              | (196)                            | 205             |
| Stock-based compensation charge  | 911                                | 524            | 1,752                            | 496             |
| (Increase) Decrease in accounts receivable, pre-funded social welfare grants receivable and finance loans receivable | (23,786)                           | 6,477          | (18,248)                         | (2,552)         |
| Decrease in deferred expenditure on smart cards  | 166                                | 151            | 260                              | 194             |
| Decrease (Increase) in inventory   | 186                                | (174)          | (1,579)                          | (2,753)         |
| (Decrease) Increase in accounts payable and other payables   | (12,106)                           | (3,655)        | 313                              | (10,946)        |
| Decrease in taxes payable  | (7,128)                            | (512)          | (6,632)                          | (3,378)         |
| Increase (Decrease) in deferred taxes  | 2,939                              | (1,947)        | 4,756                            | 153             |
| <b>Net cash (used in) provided by operating activities</b>   | <b>(15,569)</b>                    | <b>16,510</b>  | <b>24,674</b>                    | <b>14,982</b>   |
| <b>Cash flows from investing activities</b>  |                                    |                |                                  |                 |
| Capital expenditures   | (1,205)                            | (860)          | (1,876)                          | (1,703)         |
| Proceeds from disposal of property, plant and equipment  | 77                                 | 28             | 118                              | 146             |
| Acquisition of Prism Holdings Limited, net of cash acquired  | -                                  | (224)          | -                                | (82,330)        |
| <b>Net cash used in investing activities</b>   | <b>(1,128)</b>                     | <b>(1,056)</b> | <b>(1,758)</b>                   | <b>(83,887)</b> |
| <b>Cash flows from financing activities</b>  |                                    |                |                                  |                 |

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|   |                 |                   |                   |                   |
|---|-----------------|-------------------|-------------------|-------------------|
| Proceeds from issue of share capital, net of share issue expenses | -               | -                 | 150               | 50                |
| Proceeds from bank overdrafts                                     | 1,453           | 43,410            | 1,462             | 61,583            |
| Repayment of bank overdraft                                       | (1,426)         | (45,216)          | (1,442)           | (62,272)          |
| Proceeds from interest bearing liabilities                        | -               | 3,513             | -                 | 3,513             |
| <b>Net cash provided by financing activities</b>                  | <b>27</b>       | <b>1,707</b>      | <b>170</b>        | <b>2,874</b>      |
| Effect of exchange rate changes on cash                           | 1,889           | 8,608             | 5,928             | 4,198             |
| <b>Net (decrease) increase in cash and cash equivalents</b>       | <b>(14,781)</b> | <b>25,769</b>     | <b>29,014</b>     | <b>(61,833)</b>   |
| <b>Cash and cash equivalents beginning of period</b>              | <b>215,522</b>  | <b>102,133</b>    | <b>171,727</b>    | <b>189,735</b>    |
| <b>Cash and cash equivalents end of period</b>                    | <b>200,741</b>  | <b>\$ 127,902</b> | <b>\$ 200,741</b> | <b>\$ 127,902</b> |

See Notes to Unaudited Condensed Consolidated Financial Statements

**NET 1 UEPS TECHNOLOGIES, INC.**  
**Notes to the Unaudited Condensed Consolidated Financial Statements**  
**for the three and six months ended December 31, 2007 and 2006**  
**(All amounts stated in thousands of United States Dollars, unless otherwise stated)**

**1. Basis of Presentation and Summary of Significant Accounting Policies**

*Unaudited Interim Financial Information*

The accompanying unaudited condensed consolidated financial statements include all majority-owned subsidiaries over which the Company exercises control and have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) and the rules and regulations of the Securities and Exchange Commission for quarterly reports on Form 10-Q and include all of the information and disclosures required for interim financial reporting. The results of operations for the three and six months ended December 31, 2007 and 2006 are not necessarily indicative of the results for the full year. The Company believes that the disclosures are adequate to make the information presented not misleading.

These financial statements should be read in conjunction with the financial statements, accounting policies and financial notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2007. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments), which are necessary for a fair representation of financial results for the interim periods presented.

References to the Company refer to Net1 and its consolidated subsidiaries, including Net1 Applied Technology Holdings Limited ( Aplitec ), unless the context otherwise requires. References to Net1 are references solely to Net 1 UEPS Technologies, Inc.

*Translation of foreign currencies*

The functional currency of the Company is the South African Rand ( ZAR ) and its reporting currency is the U.S. dollar. The current rate method is used to translate the financial statements of the Company to U.S. dollars. Under the current rate method, assets and liabilities are translated at the exchange rates in effect at the balance sheet date. Revenues and expenses are translated at average rates for the period. Translation gains and losses are reported in accumulated other comprehensive income in shareholders' equity.

Foreign exchange transactions are translated at the spot rate ruling at the date of the transaction. Monetary items are translated at the closing spot rate at the balance sheet date. Transactional gains and losses are recognized in income for the period.

*Recent accounting pronouncements adopted*

On July 1, 2007, the Company adopted Financial Accounting Standards Board ( FASB ) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* ( FIN 48 ), which clarifies the accounting for uncertainty in tax positions. The evaluation of a tax position under FIN 48 is a two-step process. The first step is recognition: Tax positions taken or expected to be taken in a tax return should be recognized only if those positions are more likely-than-not of being sustained upon examination, based on the technical merits of the position. In evaluating whether a tax position has met the more likely than not recognition threshold, it should be presumed that the position will be examined by the relevant taxing authority that would have full knowledge of all relevant information. The second step is measurement: Tax positions that meet the recognition criteria are measured at the largest amount of benefit that is greater than 50 percent likely of being recognized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods,

disclosure and transition. See note 13 - Income tax in interim periods for a discussion of the impact that the adoption of FIN 48 has had on the Company's financial position and results of operations.

The Company's policy is to include interest related to unrecognized tax benefits in interest income, net and penalties in selling, general and administration in the condensed consolidated statements of operations.

## **1. Basis of Presentation and Summary of Significant Accounting Policies (continued)**

*Recent accounting pronouncements not yet adopted as of December 31, 2007*

In September 2006, the FASB issued Statement of Financial Accounting Standard ( SFAS ) No. 157, *Fair Value Measurements* ( FAS 157 ). FAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. FAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier adoption is permitted. The Company has not yet assessed the impact of the adoption of FAS 157 on its overall results of operations, financial position or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115* ( FAS 159 ). FAS 159 permits an entity to choose to measure many financial instruments and certain other items at fair value. The unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. FAS 159 is effective for fiscal years beginning after November 15, 2007 and for interim periods within those fiscal years. The Company is currently assessing FAS 159 and has not yet determined the impact that the adoption of this standard will have on its financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141(revised 2007), *Business Combinations* ( FAS 141R ). FAS 141R replaces SFAS No. 141, *Business Combinations* ( FAS 141 ). FAS 141R retains the fundamental requirements in FAS 141 that the acquisition method of accounting (defined in FAS 141 as the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. FAS 141R requires the acquiring entity in a business combination to recognize the assets acquired and liabilities assumed at the acquisition date. FAS 141R also requires acquisition-related costs to be recognized separately from the business combination. FAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company is currently assessing FAS 141R and has not yet determined the impact that the adoption of this standard will have on its financial position or results of operations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* ( FAS 160 ). FAS 160 establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that does not result in deconsolidation. FAS 160 clarifies that all of those transactions are equity transactions if the parent retains its controlling financial interest in the subsidiary. FAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. However, FAS 160 shall be applied prospectively as of the beginning of the fiscal year in which it is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements shall be applied retrospectively for all periods presented. The Company is currently assessing FAS 160 and has not yet determined the impact that the adoption of this standard will have on its financial position or results of operations.

## **2. Pre-funded social welfare grants receivable**

The pre-funded social welfare grants receivable represents the amounts due from provincial governments, as the Company pre-funds social welfare grant payments on behalf of the government in these provinces and pre-funding provided to certain merchants participating in our merchant acquiring system. The pre-funded amounts are typically reimbursed to the Company within two weeks after the disbursement of the grants. The grant payment service normally commences during the week before the start of a calendar month at government pay points and merchant

locations. The January 2008 payment service commenced during the last few days of December 2007 and was offered at government pay points and at merchant locations.

**3. Deferred expenditure on smart cards**

The deferred expenditure on smart cards represents amounts paid for smart cards used in the administration and distribution of grants to beneficiaries. These expenditures are deferred and written off over the period of the contract with the provincial government.

**4. Inventory**

The Company's inventory comprised the following categories as of December 31, 2007 and June 30, 2007.

|                | <b>December<br/>31,<br/>2007</b> | <b>June 30,<br/>2007</b> |
|----------------|----------------------------------|--------------------------|
| Raw materials  | \$ 346                           | \$ 588                   |
| Finished goods | 7,132                            | 5,057                    |
|                | <b>\$ 7,478</b>                  | <b>\$ 5,645</b>          |

**5. Equity-accounted investments**

The percentage ownership and functional currency of the Company's equity-accounted investments is presented in the table below:

| <b>Equity-accounted investment</b>   | <b>%<br/>owned</b> | <b>Functional currency of the<br/>equity-accounted<br/>investment</b> |
|--|--------------------|---|
| SmartSwitch Namibia (Pty) Ltd ( SmartSwitch Namibia )                          | 50%                | Namibia Dollar  |
| SmartSwitch Botswana (Pty) Ltd ( SmartSwitch Botswana )                        | 50%                | Botswana Pula   |
| VTU De Colombia S.A. ( VTU Colombia )  | 50%                | Colombian Peso  |
| Vietnam Payment Technologies Joint Stock Company<br>( VinaPay <sup>(1)</sup> ) | 30%                | Vietnamese Dong   |

(1) acquired during the first quarter of fiscal 2008.

The functional currency of the Company's equity-accounted investments is not the U.S. dollar and thus the equity-accounted investments are restated at the period end U.S. dollar/foreign currency exchange rate with an entry against accumulated other comprehensive income.

Summarized below is the Company's interest in equity-accounted investments as of June 30, 2007 and December 31, 2007:

|   | <b>Equity</b>   | <b>Loans</b>    | <b>Loss</b>       | <b>Elimination</b> | <b>Total</b>    |
|---|-----------------|-----------------|-------------------|--------------------|-----------------|
| Balance as of June 30, 2007                           | 1,189           | 3,577           | (791)             | (983)              | 2,992           |
| Share capital acquired/ loans<br>extended             | 428             | -               | -                 | -                  | 428             |
| (Loss) Earnings from equity-<br>accounted investments | -               | -               | (822)             | 302                | (520)           |
| (Loss) Earnings from equity-<br>accounted investment  |                 |                 |                   |                    |                 |
| SmartSwitch Namibia <sup>(1)</sup>                    | -               | -               | (165)             | 153                | (12)            |
| (Loss) Earnings from equity-<br>accounted investment  |                 |                 |                   |                    |                 |
| SmartSwitch Botswana <sup>(1)</sup>                   | -               | -               | (272)             | 149                | (123)           |
| Loss from equity-accounted<br>investment VTU Colombia | -               | -               | (327)             | -                  | (327)           |
| Loss from equity-accounted<br>investment VinaPay      | -               | -               | (58)              | -                  | (58)            |
| Foreign currency adjustment <sup>(2)</sup>            | 26              | 114             | (24)              | (34)               | 82              |
| Balance as of December 31, 2007                       | <b>\$ 1,643</b> | <b>\$ 3,691</b> | <b>\$ (1,637)</b> | <b>(715)</b>       | <b>\$ 2,982</b> |

- (1) includes the (elimination of unrealized net income) recognition of realized net income as described below.
- (2) the foreign currency adjustment represents the effects of the combined net fluctuations between the functional currency of the equity-accounted investments and the U.S. dollar.

**5. Equity-accounted investments (continued)**

Summarized below is the Company's equity-accounted (loss) earnings for the three months ended December 31, 2007:

|   | Loss  | Elimination | Total |
|---|-------|-------------|-------|
| (Loss) Earnings from equity-accounted investments | (388) | 152         | (236) |
| SmartSwitch Namibia                               | (88)  | 82          | (6)   |
| SmartSwitch Botswana                              | (101) | 70          | (31)  |
| VTU Colombia                                      | (168) | -           | (168) |
| VinaPay   | (31)  | -           | (31)  |

The Company is required to eliminate its percentage of the net income generated from sales to its equity-accounted investments. The revenue generated and associated costs related to these sales are included in the line item captions above net income from continuing operations before minority interest and earnings (loss) from equity-accounted investments in the unaudited condensed consolidated statement of operations for the three and six months ended December 31, 2007 and 2006. The realized amount related to the elimination is included in the earnings (loss) from equity-accounted investments line in the consolidated statement of operations for the three and six months ended December 31, 2007 and 2006. The Company will recognize this net income from these sales during the period in which the hardware and software it has sold to its equity-accounted investments are utilized in its operations, or has been sold to third party customers, as the case may be.

**6. Goodwill and intangible assets****Goodwill**

Summarized below is the movement in carrying value of goodwill for the six months ended December 31, 2007.

|  | Carrying<br>value |
|--|-------------------|
| Balance as of July 1, 2007                 | \$ 85,871         |
| Foreign currency adjustment <sup>(1)</sup> | 2,585             |
| Balance as of December 31, 2007            | \$ 88,456         |

(1) the foreign currency adjustment represents the effects of the fluctuations between the South African rand and the U.S. dollar on the carrying value.

The carrying value of goodwill has been allocated to the Company's reportable segments as follows:

|   | As of<br>December<br>31, 2007 | As of<br>June 30,<br>2007 |
|---|-------------------------------|---------------------------|
| Transaction-based activities                    | \$ 40,661                     | \$ 39,391                 |
| Smart card accounts                             | -                             | -                         |
| Financial services                              | 5,177                         | 5,014                     |
| Hardware, software and related technology sales | 42,618                        | 41,466                    |
| Total   | \$ 88,456                     | \$ 85,871                 |

**6. Goodwill and intangible assets (continued)****Intangible assets**

Summarized below is the carrying value and accumulated amortization of the intangible assets as of December 31, 2007 and June 30, 2007:

|                                      | As of December 31, 2007 |                          |                    | As of June 30, 2007  |                          |                    |
|--------------------------------------|-------------------------|--------------------------|--------------------|----------------------|--------------------------|--------------------|
|                                      | Gross carrying value    | Accumulated amortization | Net carrying value | Gross carrying value | Accumulated amortization | Net carrying value |
| Finite-lived intangible assets:      |                         |                          |                    |                      |                          |                    |
| Customer relationships               | \$ 18,218               | (2,232)                  | \$ 15,986          | \$ 17,649            | \$(1,419)                | \$ 16,230          |
| Software and unpatented technology   | 11,589                  | (5,775)                  | 5,814              | 11,227               | (3,717)                  | 7,510              |
| FTS patent                           | 5,590                   | (4,194)                  | 1,396              | 5,415                | (3,792)                  | 1,623              |
| Exclusive licenses                   | 4,506                   | (2,321)                  | 2,185              | 4,506                | (1,997)                  | 2,509              |
|                                      | 4,204                   | (585)                    | 3,619              | 4,072                | (375)                    | 3,697              |
| Trademarks                           |                         |                          |                    |                      |                          |                    |
| Contract rights                      | 2,448                   | (2,448)                  | 0                  | 2,371                | (2,371)                  | -                  |
| Customer contracts                   | 114                     | (86)                     | 28                 | 114                  | (74)                     | 40                 |
| Total finite-lived intangible assets | \$ 46,669               | \$(17,641)               | \$ 29,028          | \$ 45,354            | \$(13,745)               | \$ 31,609          |

Aggregate amortization expense on the finite-lived intangible assets for the three and six months ended December 31, 2007 was approximately \$1.8 million and \$3.5 million, respectively (three and six months ended December 31, 2006 was approximately \$1.8 million and \$3.5 million, respectively). Future annual amortization expense is estimated at approximately \$7.0 million, however, this amount could differ from the actual amortization as a result of changes in useful lives and other relevant factors.

**7. Short-term facilities**

As of December 31, 2007, the Company had short-term facilities of approximately \$83.9 million, translated at exchange rates applicable as of December 31, 2007. The interest rates applicable to these short-term facilities range from the South African prime overdraft rate (14.5% per annum at December 31, 2007) to the South African prime overdraft rate less 225 basis points. As of December 31, 2007, the Company had utilized approximately \$0.02 million of its short-term facilities. The Company's management believes its current short-term facilities are adequate in order to meet its future obligations to distribute social welfare grants.

**8. Capital structure and creditor rights attached to the B Class Loans**

As described in Note 12 to the Company's audited consolidated financial statements included within the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2007, the Company's balance sheet reflects two classes of equity - common stock and linked units.

During the three and six months ended December 31, 2007, 203,336 and 447,355 shares of special convertible preferred stock were converted to common stock. The trigger events that gave rise to these conversions were requests by linked unit-holders to sell and/or convert 1,498,265 and 3,296,299 linked units during the three and six months ended December 31, 2007. The net result of these conversions was that 1,498,265 and 3,296,299 B class preference shares and B class loans were ceded to Net1 during the three and six months ended December 31, 2007, which converted 203,336 and 447,355 shares of special convertible preferred stock to 203,336 and 447,355 common stock in return for the ownership of 1,498,265 and 3,296,299 B class preferred shares and B class loans. As a result of the conversion, the number of outstanding shares of common stock has increased by 447,355 and the number of outstanding shares of special convertible preferred stock has decreased by 447,355. In addition, as a consequence of the conversion, Net1 now owns 198,596,861 B class preferred shares and B class loans. The reduction in the B class preference shares from \$0.007 million to \$0.006 million is due to the cession to Net1 of the B class preference shares as a result of the trigger events.

## 9. Earnings per share

The entire consolidated net income of the Company is attributable to the shareholders of the Company comprising both the holders of Net1 common stock and the holders of linked units. As described in Note 12 to the Company's audited consolidated financial statements included within the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2007, the linked units have the same rights and entitlements as those attached to common shares.

As the linked units owned by holders, other than the Company, are exchangeable for special convertible preferred stock at the ratio of 7.37:1, which is then converted to common stock at the ratio of 1:1, the basic earnings per share for the three and six months ended December 31, 2007, for the common stock and linked units are the same and is calculated by dividing the net income by the combined weighted average number (57.1 million) of common stock (51.5 million) and special convertible preferred stock (5.6 million) in issue. Diluted earnings per share have been calculated to give effect to the number of additional shares of common stock that would have been outstanding if the potential dilutive instruments had been issued in each period. The calculation of diluted earnings per share for the three months ended December 31, 2007, includes the dilutive effect of a portion of the restricted stock awards granted to employees in August 2007 as these restricted stock awards are considered contingently issuable shares for the purposes of the diluted earnings per share calculation and as of December 31, 2007, the vesting conditions in respect of a portion of the awards had been satisfied. The vesting conditions are discussed in note 11 Stock-based compensation.

The basic earnings per share for the three and six months ended December 31, 2006, for the common stock and linked units is the same and is calculated by dividing the net income by the combined number (56.9 million) of common stock (50.4 million) and special convertible preferred stock (6.5 million) in issue.

The following tables detail the weighted average number of outstanding shares used for the calculation of earnings per share for the three and six months ended December 31, 2007 and 2006.

|  | Three months ended<br>December 31, |             | Six months ended<br>December 31, |             |
|--|------------------------------------|-------------|----------------------------------|-------------|
|  | 2007<br>000                        | 2006<br>000 | 2007<br>000                      | 2006<br>000 |
| Weighted average number of<br>outstanding shares of    |                                    |             |                                  |             |
| common stock basic                                     | 51,481                             | 50,384      | 51,467                           | 50,375      |
| Weighted average effect of dilutive<br>securities:     |                                    |             |                                  |             |
| employee stock options                                 | 535                                | 481         | 422                              | 478         |
| Weighted average number of<br>outstanding shares of    |                                    |             |                                  |             |
| common stock diluted                                   | 52,016                             | 50,865      | 51,889                           | 50,853      |
|  |                                    |             |                                  |             |
|  | Three months ended<br>December 31, |             | Six months ended<br>December 31, |             |
|  | 2007<br>000                        | 2006<br>000 | 2007<br>000                      | 2006<br>000 |
| Weighted average number of<br>outstanding linked units |                                    |             |                                  |             |
| basic  | 5,656                              | 6,545       | 5,656                            | 6,545       |
| Weighted average effect of dilutive<br>securities:     |                                    |             |                                  |             |
| employee stock options                                 | 59                                 | 63          | 47                               | 62          |

|   |       |       |       |       |
|---|-------|-------|-------|-------|
| Weighted average number of<br>outstanding linked units<br>diluted | 5,715 | 6,608 | 5,703 | 6,607 |
|---|-------|-------|-------|-------|

|   | Three months ended<br>December 31, |             | Six months ended<br>December 31, |             |
|---|------------------------------------|-------------|----------------------------------|-------------|
|   | 2007<br>000                        | 2006<br>000 | 2007<br>000                      | 2006<br>000 |
| Total weighted average number of<br>outstanding shares<br>used to calculate earnings per<br>share basic | 57,137                             | 56,929      | 57,123                           | 56,920      |

|   |        |        |        |        |
|---|--------|--------|--------|--------|
| Total weighted average number of<br>outstanding shares<br>used to calculate earnings per<br>share diluted | 57,731 | 57,473 | 57,592 | 57,460 |
|---|--------|--------|--------|--------|

**10. Comprehensive income**

The Company's comprehensive income consists of net income and foreign currency translation gains and losses which, under GAAP, are excluded from net income. Total comprehensive income for the three and six months ended December 31, 2007 and 2006 was:

|  | Three months ended<br>December 31, |           | Six months ended<br>December 31, |           |
|--|------------------------------------|-----------|----------------------------------|-----------|
|  | 2007                               | 2006      | 2007                             | 2006      |
| Net income                               | \$ 20,318                          | \$ 12,823 | \$ 38,246                        | \$ 27,895 |
| Foreign currency translation adjustments | 2,275                              | 16,517    | 8,137                            | 5,977     |
|  | \$ 22,593                          | \$ 29,340 | \$ 46,383                        | \$ 33,872 |

**11. Stock-based compensation***Amended and Restated 2004 Stock Incentive Plan*

Other Stock-Based Awards granted under 2004 Stock Incentive Plan

In August 2007, the Remuneration Committee of the Board of Directors of the Company approved an award of 591,500 restricted shares of the Company's common stock to executive officers and other employees of the Company. These restricted shares are referred to as non-vested equity shares in terms of SFAS No. 123R, *Share-based Payment* ( FAS 123R ) and the Company has accounted for the restricted shares awarded in terms of the guidance provided in FAS 123R.

One-third of the award shares will vest on each of September 1, 2009, 2010 and 2011. Vesting of the award shares is conditioned upon each recipient's continuous service through the applicable vesting date and the Company achieving the financial performance target set for that vesting date. Specifically, the financial performance targets shall be set based on a 20% increase, compounded annually, in fundamental diluted earnings per share (expressed in South African rand) ( Fundamental EPS ) above the Fundamental EPS for the fiscal year ended June 30, 2007; provided, however, that in the case of Dr. Belamant and Mr. Kotze, the annual required increase shall be 25% rather than 20%. For this purpose, Fundamental EPS are calculated by adjusting GAAP diluted earnings per share (as reflected in the Company's audited consolidated financial statements) to exclude the effects related to the amortization of intangible assets, stock-based compensation charges, one-time, large, unusual expenses as determined in the discretion of the Remuneration Committee, and assuming a constant tax rate of 30%. If the Fundamental EPS for the specified fiscal year do not equal or exceed the Fundamental EPS target for such year, no award shares will become vested or nonforfeitable on the corresponding vesting date. Any award shares that do not become vested and nonforfeitable because the Fundamental EPS target is not met for the specified fiscal year remain outstanding and are available to become vested and nonforfeitable as of a subsequent vesting date if the Fundamental EPS target for a subsequent fiscal year is met; provided that the recipient's service continues through such subsequent vesting date. Any outstanding award shares that have not become vested and nonforfeitable as of September 1, 2011, will be forfeited by the recipient on September 1, 2011 and transferred to the Company for no consideration.

The grant date fair value of the 591,500 restricted shares was based on the closing price of the Company's stock quoted on the Nasdaq Global Select Market on the date of grant. The stock-based compensation charge for this award is recognized over the service period of four years. There are no tax consequences related to restricted shares granted to employees of Company subsidiaries incorporated in South Africa.

**11. Stock-based compensation****Activity under the 2004 Stock Incentive Plan, other stock options and options granted to employees of Prism**

Activity under the Plan, the options granted to the new employee in January 2006 and options granted to Prism employees for the three months ended December 31, 2007 and 2006, is summarized as follows:

|   |                    | Number of<br>shares | Weighted<br>average<br>exercise<br>price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(in years) | Aggregate<br>Intrinsic<br>Value<br>(\$ 000) |
|---|--------------------|---------------------|--|---|---|
| Balance outstanding                           | July 1, 2006       | 832,727             | \$ 9.66                                  | 8.36  | \$ 22,775                                   |
| Options granted to Prism employees            |                    | 904,674             | 22.51                                    | 10.00   | -   |
| Exercised                                     |                    | (16,666)            | -  | -   | 339   |
| Forfeitures                                   |                    | (200,000)           | -  | -   | -   |
| Balance outstanding                           | September 30, 2006 | 1,520,735           | \$ 7.54                                  | 8.67  | \$ 16,524                                   |
| Options granted under Plan on August 24, 2006 |                    | 569,120             | 22.51                                    | 10.00   | -   |
| Forfeitures                                   |                    | (124,082)           | -  | -   | -   |
| Balance outstanding                           | December 31, 2006  | 1,965,773           | \$ 16.40                                 | 8.70  | \$ 25,878                                   |
| Balance outstanding                           | July 1, 2007       | 1,374,543           | \$ 16.30                                 | 8.20  | \$ 10,840                                   |
| Exercised                                     |                    | (49,998)            | -  | -   | 1,172                                       |
| Balance outstanding                           | September 30, 2007 | 1,324,545           | \$ 16.80                                 | 8.00  | \$ 13,782                                   |
| Forfeitures                                   |                    | (96,623)            | -  | -   | -   |
| Balance outstanding                           | December 31, 2007  | 1,227,922           | \$ 16.31                                 | 7.70  | \$ 16,021                                   |

During the three and six months ended December 31, 2007, Prism employee resignations and terminations resulted in forfeitures of 96,623 options granted to employees of Prism (three and six months ended December 31, 2006: 124,082 options).

|             |         |    |      |     |    |       |
|-------------|---------|----|------|-----|----|-------|
| Exercisable | 195,142 | \$ | 14.2 | 7.5 | \$ | 2,962 |
|-------------|---------|----|------|-----|----|-------|

No stock options became exercisable during the three and six months ended December 31, 2007 and 2006.

No stock options were exercised during the three months ended December 31, 2007 and 2006. During the six months ended December 31, 2007 and 2006, respectively, the Company received approximately \$0.15 million and \$0.05 million from employees exercising stock options. The Company issues new shares to satisfy stock option exercises.

**Stock-based compensation charge and unrecognized compensation cost**

The Company has recorded a net stock compensation charge of \$0.9 million and \$0.5 million for the three months ended December 31, 2007 and 2006, respectively, which comprised:

| Total | Allocated<br>to<br>cost of<br>goods<br>sold, IT<br>processing, | Allocated to<br>selling, |
|-------|--|--------------------------|
|-------|--|--------------------------|

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|  | <b>charge<br/>(reversal)</b> | <b>servicing<br/>and<br/>support</b> | <b>general and<br/>administration</b> |
|--|------------------------------|--------------------------------------|---------------------------------------|
| <b>Three months ended December 31, 2006</b>                        |                              |                                      |                                       |
| Stock-based compensation charge                                    | \$ 524                       | \$ 156                               | \$ 368                                |
| <b>Total Three months ended December 31, 2006</b>                  | <b>\$ 524</b>                | <b>\$ 156</b>                        | <b>\$ 368</b>                         |
| <b>Three months ended December 31, 2007</b>                        |                              |                                      |                                       |
| Stock-based compensation charge                                    | \$ 1,197                     | \$ 100                               | \$ 1,097                              |
| Reversal of stock compensation charge related to options forfeited | (286)                        | (147)                                | (139)                                 |
| <b>Total Three months ended December 31, 2007</b>                  | <b>\$ 911</b>                | <b>\$ (47)</b>                       | <b>\$ 958</b>                         |

**11. Stock-based compensation (continued)****Stock-based compensation charge and unrecognized compensation cost (continued)**

The Company has recorded a net stock compensation charge of \$1.8 million and \$0.5 million for the six months ended December 31, 2007 and 2006, respectively, which comprised:

|  | Total<br>charge<br>(reversal) | Allocated<br>to<br>cost of<br>goods<br>sold, IT<br>processing,<br>servicing<br>and<br>support | Allocated to<br>selling,<br>general and<br>administration |
|--|-------------------------------|---|---|
| <b>Six months ended December 31, 2006</b>  |                               |   |   |
| Stock-based compensation charge  | \$ 712                        | \$ 218  | \$ 494  |
| Reversal of stock compensation charge related to options granted in January 2006 | (216)                         | -   | (216)   |
| <b>Total - six months ended December 31, 2006</b>                                | <b>\$ 496</b>                 | <b>\$ 218</b>   | <b>\$ 278</b>   |
| <b>Six months ended December 31, 2007</b>  |                               |   |   |
| Stock-based compensation charge  | \$ 2,038                      | \$ 200  | \$ 1,838  |
| Reversal of stock compensation charge related to options forfeited               | (286)                         | (147)   | (139)   |
| <b>Total six months ended December 31, 2007</b>                                  | <b>\$ 1,752</b>               | <b>\$ 53</b>  | <b>\$ 1,699</b>   |

The stock compensation charge and benefit have been allocated to cost of goods sold, IT processing, servicing and support and selling, general and administration based on the allocation of the cash compensation paid to the employees.

As of December 31, 2007, the total unrecognized compensation cost related to stock options was approximately \$3.7 million, which the Company expects to recognize over approximately four years. As of December 31, 2007, the total unrecognized compensation cost related to restricted stock awards was approximately \$12.1 million, which the Company expects to recognize over approximately three years. As of December 31, 2007, interest due from employees related to loans extended to fund stock option exercises was approximately \$0.03 million.

As of December 31, 2007, the Company has recorded a deferred tax asset of approximately \$0.3 million related to the stock-based compensation charge recognized related to employees of Net1 as it is able to deduct the grant date fair value for taxation purposes in the United States.

**12. Operating segments**

The Company discloses segment information in accordance with FAS 131, *Disclosures about Segments of an Enterprise and Related Information*, which requires companies to determine and review their segments as reflected in the management information systems reports that their managers use in making decisions and to report certain entity-wide disclosures about products and services, major customers, and the material countries in which the entity holds assets and reports revenues.

The Company currently has four reportable segments each of which operates mainly within South Africa: Transaction-based activities, Smart card accounts, Financial services and Hardware, software and related technology sales. The Company's reportable segments offer different products and services and require different resources and

marketing strategies and share the Company's assets.

The Transaction-based activities segment currently consists mainly of a state pension and welfare benefit distribution service provided to provincial governments in South Africa and transaction processing for retailers, utilities and banks. Fee income is earned based on the number of beneficiaries included in the government pay-file as well as from merchants and card holders using the Company's merchant retail application. In addition, utility providers and bankers are charged a fee for transaction processing services performed on their behalf at retailers. This segment has individually significant customers that each provides more than 10% of the total revenue of the Company. For each of the three and six months ended December 31, 2007, there were three such customers, providing 29%, 15% and 10%, and 32%, 16% and 10%, respectively, of total revenue (each of the three and six months ended December 31, 2006: three customers 35%, 17% and 10%, respectively, of total revenue).

The Smart card accounts segment derives revenue from the provision of smart card accounts, as a fixed monthly fee per card is charged for the maintenance of these accounts.

The Financial services segment derives revenue from the provision of short-term personal lending activities and life insurance products. Interest income is recognized in the income statement as it falls due, using the interest method by reference to the constant interest rate stated in each loan agreement. The final phase of the National Credit Act (No. 34 of 2005) ( NCA ) became effective in South Africa on June 1, 2007. The NCA has impacted the Company s traditional and UEPS-based lending activities in South Africa. In compliance with the provisions of the NCA, the Company is permitted to charge an initiation fee and a service fee on all traditional and UEPS-based lending activities as well as levy interest on a monthly basis. The Company s management decided, effective June 1, 2007, to cease charging interest on all new UEPS-based lending activities and now charges a service fee. The fees generated from new UEPS-based lending activities approximate the interest that was historically generated from these activities. The Company s management was required, effective June 1, 2007, to reduce the interest charged on all new traditional lending activities and also charges an initiation and service fee. The interest and fees generated from new traditional lending activities approximate the interest that was historically generated from these activities. The Company s management has included, and will continue to include in the foreseeable future, the initiation and service fees in the financial services segment.

The Hardware, software-related and technology sales segment markets, sells and implements the Universal Electronic Payment System ( UEPS ) as well as develops and provides Prism secure transaction technology, solutions and services. The segment undertakes smart card system implementation projects, delivering hardware, software and business solutions in the form of customized systems. Sales of hardware, SIM cards, cryptography services, and SIM card licenses are recorded within this segment. This segment also generates rental income from hardware provided to merchants enrolled in the Company s merchant retail application.

Corporate/Eliminations includes the Company s head office cost centers in addition to the elimination of inter-segment transactions.

**12. Operating segments (continued)**

The Company evaluates segment performance based on operating income. The following tables summarize segment information which is prepared in accordance with GAAP:

|  | Three months ended<br>December 31, |           | Six months ended<br>December 31, |           |
|--|------------------------------------|-----------|----------------------------------|-----------|
|  | 2007                               | 2006      | 2007                             | 2006      |
| Revenues to external customers                     |                                    |           |                                  |           |
| Transaction-based activities                       | \$ 39,991                          | \$ 29,973 | \$ 78,155                        | \$ 62,210 |
| Smart card accounts                                | 9,637                              | 8,487     | 18,773                           | 17,067    |
| Financial services                                 | 2,135                              | 2,793     | 4,318                            | 5,778     |
| Hardware, software and related<br>technology sales | 16,737                             | 8,318     | 27,513                           | 17,442    |
| Total  | 68,500                             | 49,571    | 128,759                          | 102,497   |
| Inter-company revenues                             |                                    |           |                                  |           |
| Transaction-based activities                       | 1,142                              | 1,006     | 2,221                            | 2,012     |
| Smart card accounts                                | -                                  | -         | -                                | -         |
| Financial services                                 | -                                  | -         | -                                | -         |
| Hardware, software and related<br>technology sales | (262)                              | 11,451    | (262)                            | 11,451    |
| Total  | 880                                | 12,457    | 1,959                            | 13,463    |
| Operating income                                   |                                    |           |                                  |           |
| Transaction-based activities                       | 21,381                             | 17,502    | 41,970                           | 35,930    |
| Smart card accounts                                | 4,380                              | 3,858     | 8,532                            | 7,758     |
| Financial services                                 | 458                                | 768       | 904                              | 1,828     |
| Hardware, software and related<br>technology sales | 2,265                              | 581       | 4,205                            | 1,630     |
| Corporate/Eliminations                             | (258)                              | (2,567)   | (1,479)                          | (3,829)   |
| Total  | 28,226                             | 20,142    | 54,132                           | 43,317    |
| Interest earned                                    |                                    |           |                                  |           |
| Transaction-based activities                       | -                                  | -         | -                                | -         |
| Smart card accounts                                | -                                  | -         | -                                | -         |
| Financial services                                 | -                                  | -         | -                                | -         |
| Hardware, software and related<br>technology sales | -                                  | -         | -                                | -         |
| Corporate/Eliminations                             | 6,978                              | 3,666     | 12,266                           | 6,871     |
| Total  | 6,978                              | 3,666     | 12,266                           | 6,871     |
| Interest expense                                   |                                    |           |                                  |           |
| Transaction-based activities                       | 2,838                              | 2,329     | 5,141                            | 4,659     |
| Smart card accounts                                | -                                  | -         | -                                | -         |
| Financial services                                 | -                                  | 1         | -                                | 1         |
| Hardware, software and related<br>technology sales | 16                                 | 3         | 19                               | 6         |
| Corporate/Eliminations                             | 8                                  | 147       | 8                                | 147       |
| Total  | 2,862                              | 2,480     | 5,168                            | 4,813     |
| Depreciation and amortization                      |                                    |           |                                  |           |
| Transaction-based activities                       | 1,233                              | 1,258     | 2,431                            | 2,618     |
| Smart card accounts                                | -                                  | -         | -                                | -         |
| Financial services                                 | 104                                | 100       | 208                              | 204       |

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|  |          |    |       |          |    |       |
|--|----------|----|-------|----------|----|-------|
| Hardware, software and related<br>technology sales | 1,156    |    | 1,112 | 2,269    |    | 2,257 |
| Corporate/Eliminations                             | 340      |    | 343   | 671      |    | 681   |
| Total  | \$ 2,833 | \$ | 2,813 | \$ 5,579 | \$ | 5,760 |

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**12. Operating segments (continued)**

|  | Three months ended<br>December 31, |          | Six months ended<br>December 31, |          |
|--|------------------------------------|----------|----------------------------------|----------|
|  | 2007                               | 2006     | 2007                             | 2006     |
| Income taxation expense                            |                                    |          |                                  |          |
| Transaction-based activities                       | \$ 5,478                           | \$ 4,394 | \$ 10,892                        | \$ 9,056 |
| Smart card accounts                                | 1,271                              | 1,119    | 2,475                            | 2,250    |
| Financial services                                 | 132                                | 222      | 261                              | 530      |
| Hardware, software and related<br>technology sales | 720                                | 150      | 1,321                            | 453      |
| Corporate/Eliminations                             | 4,187                              | 2,805    | 7,711                            | 5,241    |
| Total  | 11,788                             | 8,690    | 22,660                           | 17,530   |
| Net income after taxation                          |                                    |          |                                  |          |
| Transaction-based activities                       | 13,064                             | 10,779   | 26,131                           | 22,215   |
| Smart card accounts                                | 3,111                              | 2,738    | 6,060                            | 5,507    |
| Financial services                                 | 325                                | 545      | 640                              | 1,297    |
| Hardware, software and related<br>technology sales | 1,506                              | 426      | 2,843                            | 1,168    |
| Corporate/Eliminations                             | 2,312                              | (1,665)  | 2,572                            | (2,292)  |
| Total  | 20,318                             | 12,823   | 38,246                           | 27,895   |
| Segment assets                                     |                                    |          |                                  |          |
| Total  | 424,031                            | 335,926  | 424,031                          | 335,926  |
| Expenditures for long-lived assets                 |                                    |          |                                  |          |
| Transaction-based activities                       | 950                                | 808      | 1,460                            | 1,311    |
| Smart card accounts                                | -                                  | -        | -                                | -        |
| Financial services                                 | 234                                | 31       | 334                              | 101      |
| Hardware, software and related<br>technology sales | 21                                 | 21       | 82                               | 291      |
| Corporate/Eliminations                             | -                                  | -        | -                                | -        |
| Total  | \$ 1,205                           | \$ 860   | \$ 1,876                         | \$ 1,703 |

The segment information as reviewed by the chief operating decision maker does not include a measure of segment assets per segment as all of the significant assets are used in the operations of all, rather than any one, of the segments. The Company does not have dedicated assets assigned to a particular operating segment. Accordingly, it is not meaningful to attempt an arbitrary allocation and segment asset allocation is therefore not presented.

It is impractical to disclose revenues from external customers for each product and service or each group of similar products and services.

**13. Income tax in interim periods**

For the purposes of interim financial reporting, the Company determines the appropriate income tax provision in accordance with the guidance in APB Opinion 28, *Interim Reporting*, and FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods*. Accordingly, the tax charge is calculated by first applying the effective tax rate expected to be applicable for the full fiscal year to ordinary income. This amount is then adjusted for the tax effect of significant unusual or extraordinary items that are reported separately, and have an impact on the tax charge. The cumulative effect of any change in the enacted tax rate on the opening balance of deferred tax assets and liabilities is also included in the tax charge as a discrete event in the interim period in which the enactment date occurs.

For the three and six months ended December 31, 2007, the tax charge was calculated using the expected effective tax rate for the year (36.89%) . Our effective tax rate for the three and six months ended December 31, 2007 was 36.5% and 37.0%, respectively.

### 13. Income tax in interim periods (continued)

#### *Adoption of FIN 48*

The adoption of FIN 48 on July 1, 2007, has resulted in the recognition of gross unrecognized tax benefits for uncertain tax positions of \$0.2 million and a reduction in deferred tax assets of \$0.3 million. On adoption, the amount of unrecognized tax benefits that, if recognized, would impact the Company's effective tax rate was \$0.5 million, which was included as a reduction to the beginning balance of retained earnings on the balance sheet. As of July 1, 2007, the Company had accrued interest related to uncertain tax positions of approximately \$0.01 million on its balance sheet.

The Company increased its unrecognized tax benefits by \$0.1 million and reduced its deferred tax assets by approximately \$0.03 million during the three months ended December 31, 2007. As of December 31, 2007, the Company had accrued interest related to uncertain tax positions of approximately \$0.02 million on its balance sheet.

The Company does not expect the change related to unrecognized tax benefits will have a significant impact on the results of operations or financial position in the next 12 months.

The Company files income tax returns mainly in South Africa and in the U.S. federal jurisdiction. As of July 1, 2007, the Company is no longer subject to income tax examination by the South African Revenue Service for years before July 1, 2003. As of December 31, 2007, the Company is no longer subject to income tax examination by the South African Revenue Service for years before December 31, 2003. The Company is subject to income tax in other jurisdictions outside South Africa, none of which are individually material to its financial position, statement of cash flows, or results of operations.

#### **Change in fully distributed tax rate from 36.89% to 35.45%**

On January 8, 2008, the Revenue Laws Second Amendment Act (Act 36 of 2007) ( Revenue Laws Act ), was promulgated in South Africa. The Revenue Laws Act included the legislation to reduce the rate of Secondary Tax on Company's ( STC ) from 12.50% to 10.00%, effective October 1, 2007. Since the Revenue Laws Act was only promulgated in the third quarter of fiscal 2008 the fully distributed tax rate for the second quarter of fiscal 2008 remains at 36.89% . The fully distributed tax rate will be reduced to 35.45% from 36.89% during the third quarter of fiscal 2008. The reduction of the fully distributed tax rate during the third quarter of fiscal 2008 will result in the reversal of a portion of the deferred tax assets and liabilities recognized as of December 31, 2007. As a result of the fluctuations in the ZAR/ USD exchange rate the exact impact on the Company's condensed consolidated statement of operations and condensed consolidated balance sheet can not be quantified.

See Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Trends and Material Developments Affecting our Business Proposed abolishment of Secondary Taxation on Companies for further discussion and analysis of the change in the fully distributed tax rate on the Company's results.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and the notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q.

### **Forward-looking statements**

Some of the statements in this Quarterly Report on Form 10-Q 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 our Annual Report on Form 10-K for the year ended June 30, 2007. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "could," "we expect," "plans," "intends," "anticipates," "believes," "estimates," "predicts," "potential" or "continue" or the negative 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 Quarterly Report on Form 10-Q to conform those statements to reflect the occurrence of unanticipated events, except as required by applicable law.

You should read this Quarterly Report on Form 10-Q and the documents that we reference herein and the documents we have filed as exhibits hereto and which 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.

### **Trends and Material Developments Affecting our Business**

#### **South African Provincial Contracts**

The South African Social Security Agency, or SASSA, is in the process of conducting a national tender for the distribution of welfare grants in which bidders had the opportunity to bid for all of South Africa or on a province-by-province basis. On May 4, 2007, we filed proposals for each of South Africa's nine provinces, as well as a proposal for the entire country. SASSA provided an indicative time-frame for the evaluation of the tender proposals and the award of the contract to successful bidders, but all of the key dates have already been missed. As part of the evaluation process for the tender, all bidders were requested to demonstrate their proposed payment solution to SASSA. Our response to the request for proposal was demonstrated to the SASSA evaluation committee on October 25, 2007. In December 2007 we received a notice to bidders from SASSA requesting further details of our financial proposals in a standard format provided in the notice to bidders by no later than December 28, 2007. We provided our response to the notice to bidders to SASSA on December 28, 2007. On January 31, 2008 we received a further notice to bidders from SASSA advising bidders that, due to unforeseen circumstances, the tender evaluation process had not been completed and, as a result, SASSA was requesting tenderers to extend the validity period of their tender responses from February 9, 2008 to March 31, 2008. Our five existing contracts to provide welfare administration and distribution services expire on March 31, 2008. We believe that our existing contracts will be extended by at least six months due to these delays in the tender evaluation process and the minimum implementation timeframe specified in the tender specifications, although there can be no assurance that such extensions will in fact occur.

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 a national tender could lead to our losing one or more of our current contracts if SASSA decides to appoint a single (or other) contractor to provide social welfare grant distribution and we are not chosen. During this transition period our existing provincial government contracts will continue to be governed by their respective terms.

## International Expansion

### *Namibia*

We own 50% of SmartSwitch Namibia (Proprietary) Limited, or SmartSwitch Namibia, and the other 50% is owned by Namibia Post Limited, or NamPost, a government entity which provides post office and banking services across Namibia. SmartSwitch Namibia operates a national UEPS smart card-based switching and settlement system in Namibia and provided NamPost with a UEPS banking platform. The UEPS system will also be offered to employers, retailers, medical insurance companies and other government institutions.

As of December 31, 2007, SmartSwitch Namibia has activated 207,939 UEPS smart cards and has signed up 151 merchants to accept the UEPS smart cards. SmartSwitch Namibia utilizes the UEPS system to facilitate the sale of prepaid electricity and mobile airtime to UEPS smart card holders. This solution facilitates the sale of prepaid electricity and mobile airtime in rural and urban areas using the UEPS system to secure, authenticate and collect payments on behalf of the participating municipalities and the mobile airtime service providers.

The Payment Association of Namibia authorized SmartSwitch Namibia as a payment system service provider in Namibia in July 2007. SmartSwitch Namibia's projects with merchants, NamPost and Payzone are currently operational. In addition, SmartSwitch Namibia continues various UEPS-based pilot projects with employers which include the identification of employers interested in utilizing the UEPS-based system to pay employees. These employees will be able to use their UEPS smart cards at the 151 merchants accepting UEPS smart cards in Namibia.

### *Botswana*

We own 50% of Smartswitch Botswana (Proprietary) Limited, or Smartswitch Botswana, and the other 50% is owned by Capricorn Investment Holdings (Botswana) Proprietary Limited, or Capricorn, which owns 100% of Botswana-based Bank Gaborone Limited and the majority holding in a number of financial services companies operating in Botswana.

During the first quarter of fiscal 2008, SmartSwitch Botswana commenced pilot UEPS-based transactions with merchants, employers and card holders, and these transactions are underwritten by Bank Gaborone. The preliminary phases of the pilot were completed successfully during the second quarter of fiscal 2008 and SmartSwitch Botswana management is in the process of presenting the results to mining and construction employers for payment of wages to their employees. SmartSwitch Botswana currently uses the UEPS-based technology to perform the deduction of loan repayments from borrower's salaries on behalf of microlenders in Botswana.

### *Nigeria*

We consolidate SmartSwitch Nigeria Limited, or SmartSwitch Nigeria, for financial accounting purposes. This differs from the equity accounting treatment of our investments in SmartSwitch Namibia and SmartSwitch Botswana.

In August 2007, the Central Bank of Nigeria formally approved the SmartSwitch Nigeria banking license application to provide payment solutions and products in the Nigerian financial markets. As a result, SmartSwitch Nigeria can now officially commence its pilot for the UEPS service offering in Nigeria. We expected the pilot with Diamond Bank Limited, SmartSwitch Nigeria's 15% shareholder, to commence during the second quarter of fiscal 2008, however due to administrative delays the smart cards required for the pilot will only be delivered during the third quarter of fiscal 2008. We expect the pilot to commence during the third quarter of fiscal 2008.

### *Colombia*

We own 50% of VTU De Colombia SA, or VTU Colombia, and have fully installed and integrated the VTU system in Colombia. The VTU system in Colombia is now active with Colombia's third largest mobile operator. VTU Colombia has entered into an agreement with Colombia's largest mobile operator to utilize the VTU system. Customization for the largest mobile operator is expected to commence during the third quarter of fiscal 2008. In addition, agreements have been entered into with VTU Colombia's initial and primary distribution partner to deploy VTU enabled handsets through its national distribution and sales force.

VTU Colombia commenced VTU operations in August 2007. The following chart presents the growth in VTU Colombia revenue and the number of transactions during the five month period ended December 31, 2007:

*Vietnam*

In Vietnam, we own 30% of Vietnam Payment Technologies, or Vinapay, which was authorized and licensed to commence business activities at the end of May 2007. The VTU system became fully operational and the first commercial transactions were performed by customers in late December 2007. In addition, we continue preliminary discussions with two of Vietnam's other mobile operators and the country's largest internet gaming operator.

*Other Countries*

We have also implemented UEPS systems in Ghana, Rwanda, Burundi, Malawi and Mozambique, some of which are considered among the poorest countries in the world. In Malawi, our system has been implemented by the Reserve Bank of Malawi as a national payment system.

In addition, our relationship with MTN Group (Africa/Middle East's largest mobile operator group) regarding VTU continues to progress. Both MTN Ivory Coast and MTN Rwanda have purchased VTU systems, bringing the number of MTN operators using VTU for electronic pre-paid airtime top-up to six.

## **Ghanaian National Switch and Smart Card Payment System**

We continue software development and customization activities related to the Ghanaian National Switch and Smart Card Payment System. In addition, hardware required in terms of the tender specifications was delivered to Ghana in December 2007. During the first quarter of fiscal 2008 we commenced the process of integrating the Ghanaian participating banks with the National Switch and Smart Card Payment System.

It is expected that the Ghanaian National Switch and Smart Card Payment System will be officially launched during the fourth quarter of fiscal 2008. Progress has been made on the construction of the data room in Ghana and we expect to conclude the majority of the software development and hardware delivery phases of the contract in the third and fourth quarters of fiscal 2008.

During January 2008, the Central Bank of Ghana announced that is mandatory for all financial institutions, including banks, community banks and credit unions have to participate in the UEPS national switch. As a result, we anticipate that 169 different financial institutions will join the payment system. The Central Bank of Ghana has also ordered a further 1.5 million smart cards, 2,000 terminals, 810 registration workstations, 254 wage payment workstations and have asked us to upgrade all existing ATM s in Ghana to be UEPS compatible. We anticipate delivery of these additional requirements during the first two quarters of fiscal 2009.

### **Progress of wage payment implementation**

The implementation of our wage payment initiative in South Africa requires us to be registered as a bank in South Africa, or to have access to an existing deposit taking license. Our approach to obtaining our own license, or gain access to one was via one of the following channels:

- applying for a new banking license;
- purchasing an existing banking license; and
- entering into a joint venture arrangement with an existing banking institution to gain access to its banking license.

In January 2007, we signed a co-operation agreement with Grindrod Bank, a fully registered bank in South Africa, for the establishment of a retail banking division within Grindrod Bank that will focus on deploying our wage payment solution in South Africa. Under the agreement, Grindrod Bank is responsible for the human resources, administration, compliance, risk management and financial affairs of the division. Net1 is responsible for the supply and maintenance of all UEPS hardware and software required to implement and run its wage payment system, for which it will charge a monthly fee per smart card account at Net1 s cost price, and will receive ongoing fee payments based on the amount of business transacted by the division utilizing the UEPS technology. Net1 will assist Grindrod Bank with the implementation of the business plan and operational activities and both parties will each initially contribute \$0.7 million (ZAR 5 million) to assist with the set-up costs of the division. The division will report to an executive committee consisting of two Net1 and two Grindrod representatives.

The target markets for the wage payment system are the un-banked and under-banked wage earners in South Africa, estimated at five million people. These wage earners are typically paid in cash on a weekly, bi-weekly or monthly basis and have all the risks associated with cash payments, but none of the benefits associated with having a formal bank account. Net1 and Grindrod Bank plan to offer these wage earners a UEPS smart card that will allow the card holder to receive payment, transact and access other financial services in a secure, cost-effective way.

Net1 and Grindrod Bank commenced with the establishment of the division during the third quarter of fiscal 2007. During the establishment phase, all the relevant technological platforms will be installed, where required, or integrated between Net1 and Grindrod. Grindrod Bank, with Net1 s assistance, has also initiated the process that will enable it to become a member of the South African National Payment System and the various payment clearing houses in South

Africa. Grindrod Bank has been granted membership of the Payments Association of South Africa, or PASA, and we successfully completed the process of becoming a member of the EFT debit / credit clearing houses and we received permission from the South African Reserve Bank to join the national payment and settlement system. We remain on track to join the other various payment clearing houses, including debit / credit card issuing and acquiring.

In parallel, Net1 and Grindrod Bank have defined the products, pricing and marketing strategy for the wage payment system. During the fourth quarter of fiscal 2007, Net1 and Grindrod Bank commenced pilot operations of the wage payment system and approximately 2,100 people, mainly in the agricultural sector, are currently being paid through our wage payment system. During the second quarter, we engaged with several trade unions, payroll processors, financial services providers, large retailers and large employer groups who have the desire, and ability, to market and distribute our wage payment solution on a national basis.

## Proposed abolishment of Secondary Taxation on Companies

On February 21, 2007, the South African Minister of Finance announced in his National Budget speech that the National Government intends to phase out Secondary Taxation on Companies, or STC, and introduce a dividend tax at a shareholder level. Currently, South African companies are required to pay STC at a rate of 12.50% on dividends distributed, subject to certain exemptions. If a dividend tax is introduced South African companies will no longer be liable to pay STC, the shareholder will be liable to pay the dividend tax. Treaty relief would be available for foreign shareholders.

The reform is being implemented in two phases. The first phase entailed a reduction of the STC rate, effective October 1, 2007, to 10% and the second phase, expected in 2008, is a total conversion to a dividend tax. It is likely that South African companies will be required to withhold the dividend tax on all dividends paid. On January 8, 2008, the Revenue Laws Second Amendment Act (Act 36 of 2007), or the Revenue Laws Act, was promulgated. The Revenue Laws Act included the legislation to reduce the rate of STC from 12.50% to 10.00%, effective October 1, 2007. Since the Revenue Laws Act was only promulgated in the third quarter of fiscal 2008, the fully distributed tax rate for the second quarter of fiscal 2008 remains at 36.89%. The fully distributed tax rate will be reduced to 35.45% from 36.89% during the third quarter of fiscal 2008. The reduction of the fully distributed tax rate during the third quarter of fiscal 2008 will result in the reversal of deferred tax assets and liabilities recognized as of December 31, 2007. As a result of the fluctuations in the ZAR/ USD exchange rate the exact impact on our condensed consolidated statement of operations and condensed consolidated balance sheet can not be quantified, however, Table 1 illustrates the expected effect using the ZAR/ USD exchange rate as of December 31, 2007.

We can not reasonably determine whether the second phase will be enacted as proposed and we will comply with that new tax legislation once it has been enacted. If the announcements made by the South African Minister of Finance in his National Budget speech regarding the second phase are enacted we expect the proposed replacement of STC with a dividend tax to reduce our current fully distributed rate of 36.89% to 29%. Under GAAP we apply the fully distributed tax rate of 36.89% to our deferred taxation assets and liabilities. The change in the fully distributed tax rate is expected to reduce our deferred taxation assets and liabilities. We have not yet determined whether we would qualify for the treaty relief available to foreign shareholders.

Included in our earnings for the three and six months ended December 31, 2007, is deferred income tax expense of approximately \$2.1 million and \$4.5 million (ZAR 14.4 million and ZAR 31.1 million), respectively, related to the application of the fully distributed rate of 36.89% compared with the South African statutory rate of 29% to our Income before income taxes. The following table illustrates the effect on our December 31, 2007, income tax expense, earnings per share and net deferred tax liability as if the first and second phases described above had been enacted on July 1, 2007:

|  | <b>Three months ended December 31, 2007</b> |   |   |
|--|---|---|---|
|  | <b>Actual</b>                               | <b>Illustrative<br/>effect<br/>scenario<br/>1<sup>(1)</sup></b> | <b>Illustrative<br/>effect<br/>scenario<br/>2<sup>(2)</sup></b> |
| Fully distributed tax rate                           | 36.89%                                      | 35.45%  | 29.00%  |
| Income tax expense                                   | 11,788                                      | 11,363  | 9,663   |
| Earnings per share, in U.S. cents                    | 36  | 37  | 40  |
| Net deferred tax liability (asset) as at December 31 | 29,191                                      | 22,543  | (4,049)   |

  

|  | <b>Six months ended December 31, 2007</b> |                                |                                |
|--|---|--------------------------------|--------------------------------|
|  | <b>Actual</b>                             | <b>Illustrative<br/>effect</b> | <b>Illustrative<br/>effect</b> |

|  |        | <b>scenario<br/>1<sup>(1)</sup></b> | <b>scenario<br/>2<sup>(2)</sup></b> |
|--|--------|-------------------------------------|-------------------------------------|
| Fully distributed tax rate                                       | 36.89% | 35.45%                              | 29.00%                              |
| Income tax expense   | 22,660 | 21,764                              | 18,179                              |
| Net deferred tax liability reversal to net income <sup>(3)</sup> | -      | 5,607                               | 28,034                              |
| Earnings per share, in U.S. cents                                | 67     | 69                                  | 75                                  |
| Net deferred tax liability (asset) as at December 31             | 29,191 | 22,543                              | (4,049)                             |

(1) Scenario 1 illustrates the reduction in the fully distributed rate from 36.89% to 35.45% as a result of the enactment of the change in the fully distributed tax rate to 35.45% in January 2008 which we are required to apply from July 1, 2007 in our South African annual tax computation and reported results. As a result of the enactment in January 2008 the cumulative adjustment will be accounted for in the third quarter of fiscal 2008.

(2) Scenario 2 illustrates the abolishment of STC had this been enacted on July 1, 2007. Accordingly, the fully distributed rate decreases from 36.89% to 29%. All South African deferred tax assets and liabilities would then be measured at 29% which would result in a reversal of a portion of the net deferred tax liabilities recognized.

(3) The net deferred tax liability reversal to net income represents the portion of the net deferred tax liability rate adjustment as of June 30, 2007 translated at rates applicable as of June 30, 2007 assuming a) the fully distributed tax rate, prior to the abolishment of STC, was 35.45% (illustrative effect scenario 1) and b) the fully distributed tax rate is thereafter 29% (illustrative effect scenario 2).

As discussed above, we can not reasonably determine whether, or when, the phase two amendments will be enacted as proposed and what the ultimate effect on our reported earnings will be.

### **Critical Accounting Policies**

Our unaudited condensed consolidated 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.

Critical accounting policies are those that reflect significant judgments or uncertainties, and potentially may result in materially different results under different assumptions and conditions. Management has identified the following critical accounting policies that are described in more detail in our Annual Report on Form 10-K for the year ended June 30, 2007.

- Deferred taxation;
- Stock-based compensation;
- Intangible assets acquired through the acquisition of Prism;
- Accounts receivable and allowance for doubtful debts; and
- Research and development.

### **Recent accounting pronouncements adopted**

Refer to Note 1 of the unaudited condensed consolidated financial statements for a full description of recent accounting pronouncements, including the expected dates of adoption and effects on financial condition, results of operations and cash flows.

### **Recent accounting pronouncements not yet adopted as of December 31, 2007**

Refer to Note 1 of the unaudited condensed consolidated financial statements for a full description of recent accounting pronouncements not yet adopted as of December 31, 2007, including the expected dates of adoption and effects on financial condition, results of operations and cash flows.

**Currency Exchange Rate Information***Actual exchange rates*

The actual exchange rates for and at the end of the periods presented were as follows:

| <b>Table 2</b>                          | <b>Three months ended</b> |             | <b>Six months ended</b> |             | <b>Year ended</b> |
|---|---------------------------|-------------|-------------------------|-------------|-------------------|
|   | <b>December 31,</b>       |             | <b>December 31,</b>     |             | <b>June 30,</b>   |
|   | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> | <b>2007</b>       |
| ZAR : \$ average exchange rate          | 6.7909                    | 7.3435      | 6.9566                  | 7.2532      | 7.2188            |
| Highest ZAR : \$ rate during period     | 7.0843                    | 7.9748      | 7.5977                  | 7.9748      | 7.9748            |
| Lowest ZAR : \$ rate during period      | 6.4262                    | 6.8863      | 6.4262                  | 6.7193      | 6.7193            |
| Rate at end of period                   | 6.8547                    | 7.0551      | 6.8547                  | 7.0551      | 7.0760            |
| <b><u>ZAR: US \$ Exchange Rates</u></b> |                           |             |                         |             |                   |

*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 for the three and six months ended December 31, 2007 and 2006, 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:

| <b>Table 3</b>                       | <b>Three months ended</b> |             | <b>Six months ended</b> |             | <b>Year ended</b> |
|--------------------------------------|---------------------------|-------------|-------------------------|-------------|-------------------|
|                                      | <b>December 31,</b>       |             | <b>December 31,</b>     |             | <b>June 30,</b>   |
|                                      | <b>2007</b>               | <b>2006</b> | <b>2007</b>             | <b>2006</b> | <b>2007</b>       |
| Income and expense items: \$1 = ZAR. | 6.7765                    | 7.3190      | 6.9446                  | 7.2649      | 7.2100            |
| Balance sheet items: \$1 = ZAR       | 6.8547                    | 7.0551      | 6.8547                  | 7.0551      | 7.0760            |

## Results of operations

The discussion of our consolidated overall results of operations is based on amounts as reflected in Item 1 Financial Statements which are reported in U.S. dollars and are prepared in accordance with US GAAP. Our discussion analyzes our results of operations both in U.S. dollars and 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.

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, 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, are included in corporate/eliminations.

### Three Months Ended December 31, 2007 Compared to the Three Months Ended December 31, 2006

The following factors had a significant influence on our results of operations during the three months ended December 31, 2007 as compared with the same period in the prior year:

- significant strengthening of the South African rand, our functional currency, against the U.S. dollar, our reporting currency, which had a positive impact on our revenues and net income in U.S. dollars;
- increased revenues from price increases, effective from July 1, 2007 from the KwaZulu-Natal provincial government for welfare distribution and administration services;
- increased number of grants paid in the North West province;
- continuation of the contract to provide the Central Bank of Ghana with a National Switch and Smart Card Payment System utilizing our UEPS technology;
- increased revenues from continued adoption of our merchant acquiring system by cardholders; and
- stock-based compensation charges related to grants of restricted stock in August 2007 under the 2004 Amended and Restated Stock Incentive Plan.

### 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:

|  | In United States Dollars<br>(US GAAP) |                |                |
|--|---------------------------------------|----------------|----------------|
|  | Three months ended December 31,       |                |                |
|  | 2007<br>\$ 000                        | 2006<br>\$ 000 | \$ %<br>change |
| Revenue  | 68,500                                | 49,571         | 38%            |
| Cost of goods sold, IT processing, servicing and support | 20,175                                | 10,926         | 85%            |
| Selling, general and administration                      | 17,266                                | 15,690         | 10%            |
| Depreciation and amortization                            | 2,833                                 | 2,813          | 1%             |
| Operating income   | 28,226                                | 20,142         | 40%            |
| Interest income, net                                     | 4,116                                 | 1,186          | 247%           |

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|   |        |        |     |
|---|--------|--------|-----|
| Income before income taxes  | 32,342 | 21,328 | 52% |
| Income tax expense  | 11,788 | 8,690  | 36% |
| Income before minority interest and earnings from<br>equity-accounted investments | 20,554 | 12,638 | 63% |
| Minority interest   | -      | -      |     |
| (Loss) Earnings from equity-accounted investments                                 | (236)  | 185    |     |
| Net income  | 20,318 | 12,823 | 58% |
|   | 25     |        |     |

---

**In South African Rand  
(US GAAP)  
Three months ended December 31,**

**Table 5**

|  | <b>2007</b>    | <b>2006</b>    | <b>ZAR</b>          |
|--|----------------|----------------|---------------------|
|  | <b>ZAR 000</b> | <b>ZAR 000</b> | <b>%<br/>change</b> |
| Revenue  | 464,192        | 362,808        | 28%                 |
| Cost of goods sold, IT processing, servicing and support                       | 136,716        | 79,967         | 71%                 |
| Selling, general and administration  | 117,003        | 114,834        | 2%                  |
| Depreciation and amortization  | 19,198         | 20,588         | (7)%                |
| Operating income   | 191,275        | 147,419        | 30%                 |
| Interest income, net   | 27,892         | 8,680          | 221%                |
| Income before income taxes   | 219,167        | 156,099        | 40%                 |
| Income tax expense   | 79,882         | 63,602         | 26%                 |
| Income before minority interest and earnings from equity-accounted investments | 139,285        | 92,497         | 51%                 |
| Minority interest  | -              | -              |                     |
| (Loss) Earnings from equity-accounted investments                              | (1,599)        | 1,354          |                     |
| Net income   | 137,686        | 93,851         | 47%                 |

Analyzed in ZAR, the increase in revenue and cost of goods sold, IT processing, servicing and support for the three months ended December 31, 2007, was primarily due to the higher volumes in our transaction-based activities, a greater number of UEPS-based smart card holders and the sale of hardware and software development and customization to the Bank of Ghana.

Our operating income margin for each of the three months ended December 31, 2007 and 2006 was 41%, respectively.

Selling, general and administration expenses increased during the second quarter of fiscal 2008 from the comparable quarter in fiscal 2007 primarily due to the stock-based compensation charge related to the restricted stock grants awarded in the first quarter of fiscal 2008 and increases in goods and services purchased from third parties, including the effects of the increase in inflation in South Africa.

Our direct costs of maintaining a listing on Nasdaq as well as compliance with the Sarbanes-Oxley Act of 2002, or Sarbanes, particularly Section 404 of Sarbanes, includes independent directors fees, legal fees, fees paid to Nasdaq, our compliance officers salary, fees paid to consultants who assist with compliance with Sarbanes and fees paid to our independent accountants related to the audit and review process. This has resulted in expenditures of \$0.5 million (ZAR 3.1 million) and \$0.4 million (ZAR 2.6 million) during the three months ended December 31, 2007 and 2006, respectively.

Depreciation and amortization includes the amortization charge related to the acquisition of Prism of \$1.5 million (ZAR 10.0 million) and \$1.4 million (ZAR 10.0 million), respectively, for the three months ended December 31, 2007 and 2006. The deferred tax benefit included in our statement of operations related to the intangible amortization charge for each of the three months ended December 31, 2007 and 2006 was \$0.5 million (ZAR 3.6 million), respectively. Property, plant and equipment acquired to provide administration and distribution services to our customers is depreciated over the shorter of expected useful life and the contract period with the provincial government. We are currently in an extension phase with all our contracts and the majority of our property, plant and equipment related to the administration and distribution of social welfare grants has been written off. Accordingly, depreciation expense related to these activities has decreased during the three months ended December 31, 2007 compared with the three months ended December 31, 2006. This reduction in depreciation was partially offset by the

increase in depreciation of our participating merchant POS terminals.

Interest on surplus cash for the three months ended December 31, 2007 increased to \$7.0 million (ZAR 47.5 million) from \$3.7 million (ZAR 26.8 million) for the three months ended December 31, 2006. The increase in interest on surplus cash held in South Africa was due to a higher average daily ZAR cash balance during the three months ended December 31, 2007 compared with the three months ended December 31, 2006 and higher deposit rates resulting from the adjustment in the South African prime interest rate from an average of approximately 12.07% per annum for the three months ended December 31, 2006, to 14.08% per annum for the three months ended December 31, 2007.

During the three months ended December 31, 2007, our finance costs increased due to the increase in the average rates of interest on short-term facilities which was offset by an increase in available cash for our pre-funding obligation which resulted in less utilization of our short-term facilities. Finance costs increased to \$2.9 million (ZAR 19.7 million) for the three months ended December 31, 2007, from \$2.5 million (ZAR 18.1 million) for the three months ended December 31, 2006.

Total tax expense for the three months ended December 31, 2007 was \$11.8 million (ZAR 79.9 million) compared with \$8.7 million (ZAR 63.6 million) during the same period in the comparable quarter of the prior fiscal year. The increase was primarily due to our increased profitability in our transaction-based and hardware, software and related technology sales activities. Our effective tax rate for the three months ended December 31, 2007 was 36.7%, compared to 40.7% for the three months ended December 31, 2006. The change in our effective tax rate was primarily due to fewer non-deductible expenses during the three months ended December 31, 2007 compared to the three months ended December 31, 2006. The adoption of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB 109*, or FIN 48, has not had significant impact on our effective tax rate during the three months ended December 31, 2007.

Loss from equity-accounted investments for the three months ended December 31, 2007, of \$0.2 million (ZAR 1.6 million) does not include equity-accounted earnings attributable to Permit Group 2 (Pty) Ltd ( Permit ) because Permit was sold in the fourth quarter of fiscal year 2007. Earnings from equity-accounted investments for the three months ended December 31, 2006 of \$0.2 million (ZAR 1.7 million) does not include equity-accounted losses attributable to VTU Colombia and VinaPay because we had not invested in these entities as of December 31, 2006. During the three months ended December 31, 2007, we recognized income from license fees, software and hardware sales made to equity-accounted investees in prior periods of approximately \$0.2 million (ZAR 1.0 million). Eliminations of hardware sales and other services and income from license fees, software and hardware sales made in prior periods have been included in (loss) earnings from equity-accounted investments.

### Results of operations by operating segment

The composition of revenue and the contributions of our business activities to operating income are illustrated below.

**Table 6**

*In United States Dollars (US GAAP)*  
**Three months ended December 31,**

| <b>Operating Segment</b>                        | <b>2007<br/>\$ 000</b> | <b>% of<br/>total</b> | <b>2006<br/>\$ 000</b> | <b>% of<br/>total</b> | <b>%<br/>change</b> |
|---|------------------------|-----------------------|------------------------|-----------------------|---------------------|
| <b>Consolidated revenue:</b>                    |                        |                       |                        |                       |                     |
| Transaction-based activities                    | 39,991                 | 58%                   | 29,973                 | 60%                   | 33%                 |
| Smart card accounts                             | 9,637                  | 14%                   | 8,487                  | 17%                   | 14%                 |
| Financial services                              | 2,135                  | 3%                    | 2,793                  | 6%                    | (24)%               |
| Hardware, software and related technology sales | 16,737                 | 25%                   | 8,318                  | 17%                   | 101%                |
| <b>Total consolidated revenue</b>               | <b>68,500</b>          | <b>100%</b>           | <b>49,571</b>          | <b>100%</b>           | <b>38%</b>          |

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|   |               |             |               |             |            |
|---|---------------|-------------|---------------|-------------|------------|
| Consolidated operating income (loss):           |               |             |               |             |            |
| Transaction-based activities                    | 21,381        | 76%         | 17,502        | 87%         | 22%        |
| Smart card accounts                             | 4,380         | 16%         | 3,858         | 19%         | 14%        |
| Financial services                              | 458           | 2%          | 768           | 4%          | (40)%      |
| Hardware, software and related technology sales | 2,265         | 8%          | 581           | 3%          | 290%       |
| Corporate/eliminations                          | (258)         | (2)%        | (2,567)       | (13)%       | (90)%      |
| <b>Total consolidated operating income</b>      | <b>28,226</b> | <b>100%</b> | <b>20,142</b> | <b>100%</b> | <b>40%</b> |

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Table 7

*In South African Rand (US GAAP)*  
**Three months ended December 31,**

| <b>Operating Segment</b>                        | <b>2007<br/>ZAR<br/>000</b> | <b>% of<br/>total</b> | <b>2006<br/>ZAR<br/>000</b> | <b>% of<br/>total</b> | <b>%<br/>change</b> |
|---|-----------------------------|-----------------------|-----------------------------|-----------------------|---------------------|
| <b>Consolidated revenue:</b>                    |                             |                       |                             |                       |                     |
| Transaction-based activities                    | 271,000                     | 58%                   | 219,371                     | 60%                   | 24%                 |
| Smart card accounts                             | 65,305                      | 14%                   | 62,116                      | 17%                   | 5%                  |
| Financial services                              | 14,468                      | 3%                    | 20,442                      | 6%                    | (29)%               |
| Hardware, software and related technology sales | 113,419                     | 25%                   | 60,879                      | 17%                   | 86%                 |
| <b>Total consolidated revenue</b>               | <b>464,192</b>              | <b>100%</b>           | <b>362,808</b>              | <b>100%</b>           | <b>28%</b>          |
| <b>Consolidated operating income (loss):</b>    |                             |                       |                             |                       |                     |
| Transaction-based activities                    | 144,889                     | 76%                   | 128,097                     | 87%                   | 13%                 |
| Smart card accounts                             | 29,681                      | 16%                   | 28,237                      | 19%                   | 5%                  |
| Financial services                              | 3,104                       | 2%                    | 5,621                       | 4%                    | (45)%               |
| Hardware, software and related technology sales | 15,349                      | 8%                    | 4,252                       | 3%                    | 261%                |
| Corporate/eliminations                          | (1,748)                     | (2)%                  | (18,788)                    | (13)%                 | (91)%               |
| <b>Total consolidated operating income</b>      | <b>191,275</b>              | <b>100%</b>           | <b>147,419</b>              | <b>100%</b>           | <b>30%</b>          |
| <b>Transaction-based activities</b>             |                             |                       |                             |                       |                     |

In U.S. dollars, revenues increased by 33% for the three months ended December 31, 2007, from the three months ended December 31, 2006. Operating income increased by 22% for the three months ended December 31, 2007 from the three months ended December 31, 2006.

In ZAR, revenues increased by 24% for the three months ended December 31, 2007, from the three months ended December 31, 2006. Operating income increased by 13% for the three months ended December 31, 2007 from the three months ended December 31, 2006.

These increases in revenues and operating income were due primarily to the price increases in the KwaZulu-Natal, Eastern Cape, NorthWest and Limpopo provinces, higher volumes from all of our provincial contracts, continued adoption of our merchant acquiring system in the provinces where we distribute welfare grants and increased transacting ability at participating retailers POS devices in these provinces. We discuss these factors in more detail below.

Revenues for transaction-based activities include the transaction fees we earn through our merchant acquiring system and reflect the elimination of inter-company transactions.

Operating income margin for the three months ended December 31, 2007 decreased to 53% from 58% for the three months ended December 31, 2006. These profit margin decreases were mainly due to:

- inflationary increases in our cost components that were higher than the increases we negotiated with our customers;
- timing differences relating to our annual price increase negotiations, specifically in the Limpopo province where we received a back-dated price increase during the three months ended December 31, 2006; and

- lower revenues earned during the first half of fiscal 2008 compared with the first half of fiscal 2007 which resulted from the opening in December 2007 of the January 2008 payfile in all provinces except KwaZulu-Natal, whereas in December 2006, the January 2007 payfile was opened in all provinces.

These operating income margin decreases were partially offset by the increased revenues from price increases from the KwaZulu-Natal provincial government for welfare distribution and administration services and improved margins from EasyPay.

**Continued adoption of our merchant acquiring system:**

The key statistics and indicators of our merchant acquiring system during the three months ended December 31, 2007 and 2006, in each of the South African provinces where we distribute social welfare grants are summarized in the table below:

|  | <b>Three months ended<br/>December 31,</b> |                             |
|--|--|-----------------------------|
|  | <b>2007</b>                                | <b>2006</b>                 |
| Province included (1)  | NC, EC,<br>KZN, L<br>and NW                | NC, EC,<br>KZN, L<br>and NW |
| Total POS devices installed  | 4,304                                      | 4,145                       |
| Number of participating UEPS retail locations  | 2,532                                      | 2,443                       |
| Value of transactions processed through POS devices during the quarter<br>(2) (in \$ 000)                            | 258,852                                    | 185,190                     |
| Value of transactions processed through POS devices during the completed pay cycles for the quarter (3) (in \$ 000)  | 275,456                                    | 188,074                     |
| Value of transactions processed through POS devices during the quarter<br>(2) (in ZAR 000)                           | 1,757,836                                  | 1,355,399                   |
| Value of transactions processed through POS devices during the completed pay cycles for the quarter (3) (in ZAR 000) | 1,870,595                                  | 1,376,509                   |
| Number of grants paid through POS devices during the quarter (2)   | 3,439,226                                  | 2,788,529                   |
| Number of grants paid through POS devices during the completed pay cycles for the quarter (3)                        | 3,661,101                                  | 2,838,969                   |
| Average number of grants processed per terminal during the quarter<br>(2)  | 799  | 671                         |
| Average number of grants processed per terminal during the completed pay cycles for the quarter (3)                  | 851  | 683                         |

(1) NC = Northern Cape, EC = Eastern Cape, KZN = KwaZulu-Natal, L = Limpopo, NW = North West.

(2) Refers to events occurring during the quarter (i.e., based on three calendar months).

(3) Refers to events occurring during the completed pay cycle.

The increase in the number of POS devices installed and participating UEPS retail locations is mainly attributable to the growth of our merchant acquiring system in the North West as a result of the increased number of beneficiaries paid in that province.

The following chart presents the number of POS devices installed and the average spend per POS device, *per pay cycle and calendar month*, during the 22 month period ended December 31, 2007:

**POS installations and utilization per POS**

The following chart presents the growth in the value of loads at merchant locations processed through our installed base of POS devices, *per pay cycle and calendar month*, during the 22 month period ended December 31, 2007:

**Loads at merchant locations in South African Rand**

The following graph presents the number of social welfare grants loaded at merchant locations, *per pay cycle and calendar month*, for the 22 month period ended December 31, 2007:

**Number of social welfare grants loaded at merchant locations**

***Higher volumes from our provincial contracts:***

During the three months ended December 31, 2007, we experienced growth in all of the provinces where we administer payments of social welfare grants. This growth was mainly due to an increase in the number of child support grants and disability grants approved by the various provincial governments. In total, the volume of payments processed during the three months ended December 31, 2007 increased 5% to 11,896,755 from the three months ended December 31, 2006.

The higher volumes under existing provincial contracts during the three months ended December 31, 2007, as well as average revenue per grant paid, are detailed below:

| <b>Province</b>          | <b>Number of Grants Paid</b> |                   | <b>Average Revenue per Grant Paid</b> |                       |                        |                        |
|--------------------------|------------------------------|-------------------|---------------------------------------|-----------------------|------------------------|------------------------|
|                          | <b>2007</b>                  | <b>2006</b>       | <b>2007<br/>\$(1)</b>                 | <b>2006<br/>\$(2)</b> | <b>2007<br/>ZAR(1)</b> | <b>2006<br/>ZAR(2)</b> |
| <b>KwaZulu-Natal (A)</b> | 5,063,374                    | 5,022,500         | 3.26                                  | 2.75                  | 22.11                  | 20.18                  |
| <b>Limpopo (B)</b>       | 2,948,717                    | 2,905,861         | 2.56                                  | 2.18                  | 17.39                  | 15.98                  |
| <b>North West (C)</b>    | 1,230,354                    | 827,058           | 3.16                                  | 2.68                  | 21.43                  | 19.71                  |
| <b>Northern Cape (D)</b> | 498,877                      | 416,702           | 2.71                                  | 2.54                  | 18.37                  | 18.67                  |
| <b>Eastern Cape (E)</b>  | 2,155,433                    | 2,144,919         | 2.37                                  | 1.61                  | 16.11                  | 11.81                  |
| <b>Total</b>             | <b>11,896,755</b>            | <b>11,317,040</b> |                                       |                       |                        |                        |

(1) Average Revenue per Grant Paid excludes \$ 0.81 (ZAR 5.50) related to the provision of smart card accounts.

(2) Average Revenue per Grant Paid excludes \$ 0.75 (ZAR 5.50) related to the provision of smart card accounts.

(A) - in ZAR, the increase in the Average Revenue per Grant Paid in KwaZulu-Natal was due to price adjustment effective from July 2007.

(B) - in ZAR, the increase in the Average Revenue per Grant Paid in Limpopo was due to the negotiated annual price adjustment effective from January 2007.

(C) - in ZAR, the increase in the Average Revenue per Grant Paid in North West was due to the negotiated annual price adjustment approved by the provincial government in October 2006.

(D) - in ZAR, the decrease in the Average Revenue per Grant Paid in Northern Cape was primarily due to fewer registrations.

(E) - in ZAR, the increase in the Average Revenue per Grant Paid in Eastern Cape was due to negotiated price increases effective January 1, 2007.

#### ***EasyPay transaction fees:***

During the three months ended December 31, 2007 and 2006, EasyPay processed 135 million and 118 million transactions with an approximate value of \$4.4 billion (ZAR 30.3 billion) and \$3.7 billion, (ZAR 27.2 billion), respectively. The average fee per transaction during the three months ended December 31, 2007 and 2006 was \$0.03 (ZAR 0.21) . The number of transactions processed during the three months ended December 31, 2007 increased compared with the three months ended December 31, 2006, due to the strong economic climate experienced in South Africa during the second quarter of fiscal 2008 which has resulted in an increase in the number of transactions processed through retailers. We expect the number of transactions processed during the third quarter of fiscal 2008 to be lower than those during the second quarter of fiscal 2008 due to the festive season and summer holidays in South Africa during the second quarter. We do not expect a significant fluctuation, in ZAR, in the average fee per transaction during the third quarter of fiscal 2008.

Operating income margins generated by EasyPay during the three months ended December 31, 2007 and 2006, were 41.0% and 39.2%, respectively, which is lower than those generated by our pension and welfare business and

reduced the operating income margins within our transaction-based activities segment. Amortization of EasyPay intangible assets during the three months ended December 31, 2007 and 2006, of approximately \$0.5 million (ZAR 3.2 million) and \$0.4 million (ZAR 3.2 million), respectively, is included in the calculation of EasyPay operating margins. Operating income margin before amortization of EasyPay intangible assets during the three months ended December 31, 2007 and 2006 was 52.5% and 52.3%, respectively.

### **Smart card accounts**

In U.S. dollars, revenues increased by 14% for the three months ended December 31, 2007, from the three months ended December 31, 2006. Operating income increased by 14% for the three months ended December 31, 2007 from the three months ended December 31, 2006.

In ZAR, revenues increased by 5% for the three months ended December 31, 2007, from the three months ended December 31, 2006. Operating income increased by 5% for the three months ended December 31, 2007 from the three months ended December 31, 2006.

Operating income margin from providing smart card accounts was constant at 45% for each of the three months ended December 31, 2007 and 2006.

In ZAR, 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 3,976,684 smart card-based accounts were active at December 31, 2007, compared to 3,790,813 active accounts as at December 31, 2006. The increase in the number of active accounts resulted from an increase in the number of beneficiaries in all provinces qualifying for government grants and the transfer of beneficiaries in the North West province from the South African Post Office to our system.

### **Financial services**

In U.S. dollars, revenues decreased by 24% for the three months ended December 31, 2007, from the three months ended December 31, 2006. Operating income decreased by 40% for the three months ended December 31, 2007 from the three months ended December 31, 2006.

In ZAR, revenues decreased by 29% for the three months ended December 31, 2007, from the three months ended December 31, 2006. Operating income decreased by 45% for the three months ended December 31, 2007 from the three months ended December 31, 2006.

Revenues from UEPS-based lending decreased during the three months ended December 31, 2007 compared with the three months ended December 31, 2006 primarily due to the lower number of loans granted. In addition, on average, the return on these UEPS-based loans was lower during the three months ended December 31, 2007 compared with the three months ended December 31, 2006. We offer the UEPS-based loans to our beneficiaries with the primary purpose of assisting them to repay expensive loans with other loan providers and to escape the debt spiral that they are trapped in. Once our UEPS-based loans are repaid, we believe that the beneficiaries have an enhanced ability to remain debt-free, or take loans in amounts smaller than the original refinancing facility we offered to them. We believe that once cardholders escape the debt spiral they will have more disposable income to spend, including through our merchant acquiring base.

Revenues from our traditional microlending business decreased during the quarter due to increased competition, our strategic decision not to grow this business, and an overall lower return on traditional microlending loans as a result of compliance with the National Credit Act, or NCA. The NCA regulates fees and interest charged on micro-lending loans and imposes credit check obligations on lenders prior to granting of credit to individuals. The loan portfolio of the traditional microlending businesses has declined as a result of our strategic decision not to grow this business and compliance with the NCA.

Our current UEPS-based lending portfolio comprises loans made to elderly pensioners in some of the provinces where we distribute social welfare grants. We insure the UEPS-based lending book against default and thus no allowance is required. We consider UEPS-based lending less risky than traditional microfinance loans because the grants are distributed to these lenders by us and these loans are insured. We establish an allowance for doubtful

traditional microlending loans in respect of which we consider it likely that all or a portion of the principal amount of the loan or interest thereon will not be repaid by the borrower. We consider default likely after a specified period of non-payment, which is generally not more than 150 days. We assess this allowance based on a review by management of the aging of outstanding amounts, the payment history in relation to those specific accounts and the overall default history.

Some of the key indicators of these businesses are illustrated below:

| Table 10  | As at December 31, |         |        |          |          |        |
|---|--------------------|---------|--------|----------|----------|--------|
|   | 2007               | 2006    | \$ %   | 2007     | 2006     | ZAR %  |
|   | \$ 000             | \$ 000  | change | ZAR 000  | ZAR 000  | change |
| Traditional microlending:                                   |                    |         |        |          |          |        |
| Finance loans receivable gross                              | 5,336              | 7,399   | (28)%  | 36,575   | 52,206   | (30)%  |
| Allowance for doubtful finance loans receivable             | (3,153)            | (4,232) | (25)%  | (21,612) | (29,858) | (28)%  |
| Finance loans receivable net                                | 2,183              | 3,167   | (31)%  | 14,963   | 22,348   | (33)%  |
| UEPS-based lending:   |                    |         |        |          |          |        |
| Finance loans receivable net and gross (i.e., no allowance) | 4,086              | 4,429   | (8)%   | 28,012   | 31,244   | (10)%  |
| Total finance loans receivable, net                         | 6,269              | 7,596   |        | 42,975   | 53,592   |        |

Operating income margin for the financial services segment decreased to 21% for the three months ended December 31, 2007 from 27% for the three months ended December 31, 2006, primarily due to a lower return on our UEPS-based lending products and continued difficult operating conditions in our traditional micro-lending operations, as well as the effect of implementing the NCA.

### Hardware, software and related technology sales

In U.S. dollars, revenues increased by 101% for the three months ended December 31, 2007, from the three months ended December 31, 2006. Operating income increased by 290% for the three months ended December 31, 2007 from the three months ended December 31, 2006.

In ZAR, revenues increased by 86% for the three months ended December 31, 2007, from the three months ended December 31, 2006. Operating income increased by 261% for the three months ended December 31, 2007 from the three months ended December 31, 2006.

We continued software development and customization activities related to the Ghanaian national switch and smart card payment system contract during the second quarter of fiscal 2008. In addition, we commenced with the delivery of hardware to Ghana. Our revenues include approximately \$5.6 million (ZAR 37.9 million) from software development and customization activities and hardware related to this contract. Software development and customization are high margin activities for us and contributed to the increase in operating income during the three months ended December 31, 2007. During the third quarter of fiscal 2008 we expect to recognize revenues related to the Ghana contract for on-going software development and customization and delivery of hardware. We can not reasonably predict the revenue from these sales expected in the third quarter of fiscal 2008.

Our revenues for the three months ended December 31, 2007, includes approximately \$2.0 million (ZAR 13.8 million) from sales to Nedbank Limited, or Nedbank. The remainder of the order from Nedbank will be delivered during the three months ended March 31, 2008, and we expect to recognize revenue of approximately \$0.3 million (ZAR 2.0 million), translated at the USD/ ZAR exchange rate as of December 31, 2007.

Amortization of Prism intangible assets during the three months ended December 31, 2007 and 2006 was approximately \$1.0 million (ZAR 6.7 million) and \$0.9 million (ZAR 6.7 million), respectively, and reduced our operating income.

Hardware sales to Nedbank are infrequent, and we do not anticipate revenue from large-scale hardware supply contracts to occur in the foreseeable future. In addition, we expect sales of hardware, software and licenses related to our international expansion to occur on an ad hoc basis as and when new international ventures, such as SmartSwitch Namibia and SmartSwitch Botswana, are established, or contracts such as Ghana are concluded. Depending on the size of our equity interest in these ventures, we may have to eliminate the sale of any hardware, software and licenses to these entities.

#### **Corporate/eliminations**

In U.S. dollars, the operating loss decreased by \$2.3 million for the three months ended December 31, 2007, from the three months ended December 31, 2006.

In ZAR, the operating loss decreased by ZAR 17.0 million for the three months ended December 31, 2007, from the three months ended December 31, 2006.

Corporate/eliminations for the three months ended December 31, 2006 includes the non-recurring charges of approximately \$1.2 million (ZAR 8.6 million) related to an acquisition we ultimately decided not to pursue.

Our operating losses include expenditure related to compliance with Sarbanes, non-executive directors fees, employee and executives salaries and bonuses, stock-based compensation, legal and auditor fees, directors and officer s insurance premiums, telecommunications expenses, property related expenditures including utilities, rental, security and maintenance, and elimination entries.

### Six Months Ended December 31, 2007 Compared to the Six Months Ended December 31, 2006

The following factors had a significant influence on our results of operations during the six months ended December 31, 2007 as compared with the same period in the prior year:

- significant strengthening of the ZAR, our functional currency, against the U.S. dollar, our reporting currency, which had a positive impact on our revenues and net income in U.S. dollars;
- increased revenues from price increases, effective from July 1, 2007 from the KwaZulu-Natal provincial government for welfare distribution and administration services;
- increased number of grants paid in the North West province;
- commencement of the contract to provide the Central Bank of Ghana with a National Switch and Smart Card Payment System utilizing our UEPS technology;
- increased revenues from continued adoption of our merchant acquiring system by cardholders; and
- stock-based compensation charges related to grants of restricted stock in August 2007 under the 2004 Amended and Restated Stock Incentive Plan.

### 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:

| Table 11   | In United States Dollars<br>(US GAAP) |                |                |
|--|---------------------------------------|----------------|----------------|
|  | Six months ended December 31,         |                |                |
|  | 2007<br>\$ 000                        | 2006<br>\$ 000 | \$ %<br>change |
| Revenue  | 128,759                               | 102,497        | 26%            |
| Cost of goods sold, IT processing, servicing and support                       | 35,318                                | 24,245         | 46%            |
| Selling, general and administration  | 33,730                                | 29,175         | 16%            |
| Depreciation and amortization  | 5,579                                 | 5,760          | (3)%           |
| Operating income   | 54,132                                | 43,317         | 25%            |
| Interest income, net   | 7,098                                 | 2,058          | 245%           |
| Income before income taxes   | 61,230                                | 45,375         | 35%            |
| Income tax expense   | 22,660                                | 17,530         | 29%            |
| Income before minority interest and earnings from equity-accounted investments | 38,570                                | 27,845         | 39%            |
| Minority interest  | (196)                                 | 205            |                |

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|   |        |        |     |
|---|--------|--------|-----|
| (Loss) Earnings from equity-accounted investments | (520)  | 255    |     |
| Net income  | 38,246 | 27,895 | 37% |
|   | 35     |        |     |

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Table 12

| <b>In South African Rand<br/>(US GAAP)</b>                                     |                |                |                     |
|--|----------------|----------------|---------------------|
| <b>Six months ended December 31,</b>   |                |                |                     |
|  | <b>2007</b>    | <b>2006</b>    | <b>ZAR</b>          |
|  | <b>ZAR 000</b> | <b>ZAR 000</b> | <b>%<br/>change</b> |
| Revenue  | 894,180        | 744,630        | 20%                 |
| Cost of goods sold, IT processing, servicing and support                       | 245,270        | 176,137        | 39%                 |
| Selling, general and administration  | 234,241        | 211,953        | 11%                 |
| Depreciation and amortization  | 38,744         | 41,846         | (7)%                |
| Operating income   | 375,925        | 314,694        | 19%                 |
| Interest income, net   | 49,293         | 14,951         | 230%                |
| Income before income taxes   | 425,218        | 329,645        | 29%                 |
| Income tax expense   | 157,365        | 127,354        | 24%                 |
| Income before minority interest and earnings from equity-accounted investments | 267,853        | 202,291        | 32%                 |
| Minority interest  | (1,361)        | 1,489          |                     |
| (Loss) Earnings from equity-accounted investments                              | (3,611)        | 1,853          | (295)%              |
| Net income   | 265,603        | 202,655        | 31%                 |

Analyzed in ZAR, the increase in revenue and cost of goods sold, IT processing, servicing and support for the six months ended December 31, 2007, was primarily due to the higher volumes in our transaction-based activities, a greater number of UEPS-based smart card holders and the sale of hardware and software development and customization to the Bank of Ghana.

Our operating income margin for each of the six months ended December 31, 2007 and 2006 was 42%, respectively.

Selling, general and administration expenses increased during the first half of fiscal 2008 from the comparable period in fiscal 2007 primarily due to the stock-based compensation charge related to the restricted stock grants awarded in the first quarter of fiscal 2008 and increases in goods and services purchased from third parties, including the effects of the increase in inflation in South Africa.

Our direct costs of maintaining a listing on Nasdaq as well as compliance with Sarbanes includes independent directors fees, legal fees, fees paid to Nasdaq, our compliance officers salary, fees paid to consultants who assist with compliance with Sarbanes and fees paid to our independent accountants related to the audit and review process. This has resulted in expenditures of \$1.0 million (ZAR 7.2 million) and \$0.9 million (ZAR 6.2 million) during the six months ended December 31, 2007 and 2006, respectively.

Depreciation and amortization includes the amortization charge related to the acquisition of Prism of \$2.9 million (ZAR 19.9 million) and \$2.6 million (ZAR 19.1 million), respectively, for the six months ended December 31, 2007 and 2006. The deferred tax benefit included in our statement of operations related to the intangible amortization charge for the six months ended December 31, 2007 and 2006 was \$1.0 million (ZAR 7.2 million) and \$1.0 million (ZAR 7.0 million), respectively. Property, plant and equipment acquired to provide administration and distribution services to our customers is depreciated over the shorter of expected useful life and the contract period with the provincial government. We are currently in an extension phase with all our contracts and the majority of our property, plant and equipment related to the administration and distribution of social welfare grants has been written off. Accordingly, depreciation expense related to these activities has decreased during the six months ended December 31, 2007 compared with the six months ended December 31, 2006. This reduction in depreciation was partially offset by the increase in depreciation of our participating merchant POS terminals.



Interest on surplus cash for the six months ended December 31, 2007 increased to \$12.3 million (ZAR 85.6 million) from \$6.9 million (ZAR 49.9 million) for the six months ended December 31, 2006. The increase in interest on surplus cash held in South Africa was due to a higher average daily ZAR cash balance during the six months ended December 31, 2007 compared with the six months ended December 31, 2006 and the higher deposit rates resulting from the adjustment in the South African prime interest rate from an average of approximately 11.70% per annum for the six months ended December 31, 2006, to 13.66% per annum for the six months ended December 31, 2007.

During the six months ended December 31, 2007, our finance costs increased due to the increase in the average rates of interest on short-term facilities which was offset by an increase in available cash for our pre-funding obligation which resulted in less utilization of our short-term facilities. Finance costs increased to \$5.2 million (ZAR 36.2 million) for the six months ended December 31, 2007, from \$4.8 million (ZAR 34.9 million) for the six months ended December 31, 2006.

Total tax expense for the six months ended December 31, 2007 was \$22.7 million (ZAR 157.4 million) compared with \$17.5 million (ZAR 127.4 million) during the same period in the comparable quarter of the prior fiscal year. The increase was primarily due to our increased profitability in our transaction-based and hardware, software and related technology sales activities. Our effective tax rate for the six months ended December 31, 2007 was 37.2%, compared to 38.6% for the six months ended December 31, 2006. The change in our effective tax rate was primarily due to fewer non-deductible expenses during the six months ended December 31, 2007 compared to the six months ended December 31, 2006. The adoption of FIN 48, has not had significant impact on our effective tax rate during the six months ended December 31, 2007.

Loss from equity-accounted investments for the six months ended December 31, 2007, of \$0.5 million (ZAR 3.6 million) does not include equity-accounted earnings attributable to Permit Group 2 (Pty) Ltd ( Permit ) because Permit was sold in the fourth quarter of fiscal year 2007. Earnings from equity-accounted investments for the six months ended December 31, 2006 of \$0.3 million (ZAR 1.9 million) does not include equity-accounted losses attributable to VTU Colombia and VinaPay because we had not invested in these entities as of December 31, 2006. During the six months ended December 31, 2007, we recognized income from license fees, software and hardware sales made to equity-accounted investees in prior periods of approximately \$0.3 million (ZAR 2.1 million). Eliminations of hardware sales and other services and income from license fees, software and hardware sales made in prior periods have been included in (loss) earnings from equity-accounted investments.

### Results of operations by operating segment

The composition of revenue and the contributions of our business activities to operating income are illustrated below.

**Table 13**

*In United States Dollars (US GAAP)*  
Six months ended December 31,

| <b>Operating Segment</b>                        | <b>2007<br/>\$ 000</b> | <b>% of<br/>total</b> | <b>2006<br/>\$ 000</b> | <b>% of<br/>total</b> | <b>%<br/>change</b> |
|---|------------------------|-----------------------|------------------------|-----------------------|---------------------|
| <b>Consolidated revenue:</b>                    |                        |                       |                        |                       |                     |
| Transaction-based activities                    | 78,155                 | 61%                   | 62,210                 | 61%                   | 26%                 |
| Smart card accounts                             | 18,773                 | 15%                   | 17,067                 | 17%                   | 10%                 |
| Financial services                              | 4,318                  | 3%                    | 5,778                  | 6%                    | (25)%               |
| Hardware, software and related technology sales | 27,513                 | 21%                   | 17,442                 | 16%                   | 58%                 |
| <b>Total consolidated revenue</b>               | <b>128,759</b>         | <b>100%</b>           | <b>102,497</b>         | <b>100%</b>           | <b>26%</b>          |
| <b>Consolidated operating income (loss):</b>    |                        |                       |                        |                       |                     |

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|   |               |             |               |             |            |
|---|---------------|-------------|---------------|-------------|------------|
| Transaction-based activities                    | 41,970        | 78%         | 35,930        | 83%         | 17%        |
| Smart card accounts                             | 8,532         | 16%         | 7,758         | 18%         | 10%        |
| Financial services                              | 904           | 2%          | 1,828         | 4%          | (5)%1      |
| Hardware, software and related technology sales | 4,205         | 8%          | 1,630         | 4%          | 158%       |
| Corporate/eliminations                          | (1,479)       | (4)%        | (3,829)       | (9)%        | (61)%      |
| <b>Total consolidated operating income</b>      | <b>54,132</b> | <b>100%</b> | <b>43,317</b> | <b>100%</b> | <b>25%</b> |

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Table 14

*In South African Rand (US GAAP)*  
Six months ended December 31,

| Operating Segment                               | 2007<br>ZAR<br>000 | % of<br>total | 2006<br>ZAR<br>000 | % of<br>total | %<br>change |
|---|--------------------|---------------|--------------------|---------------|-------------|
| <b>Consolidated revenue:</b>                    |                    |               |                    |               |             |
| Transaction-based activities                    | 542,755            | 61%           | 451,949            | 61%           | 20%         |
| Smart card accounts                             | 130,371            | 15%           | 123,990            | 17%           | 5%          |
| Financial services                              | 29,987             | 3%            | 41,977             | 6%            | (29)%       |
| Hardware, software and related technology sales | 191,067            | 21%           | 126,714            | 16%           | 51%         |
| <b>Total consolidated revenue</b>               | <b>894,180</b>     | <b>100%</b>   | <b>744,630</b>     | <b>100%</b>   | <b>20%</b>  |
| <b>Consolidated operating income (loss):</b>    |                    |               |                    |               |             |
| Transaction-based activities                    | 291,465            | 78%           | 261,028            | 83%           | 12%         |
| Smart card accounts                             | 59,251             | 16%           | 56,361             | 18%           | 5%          |
| Financial services                              | 6,278              | 2%            | 13,280             | 4%            | (53)%       |
| Hardware, software and related technology sales | 29,202             | 8%            | 11,842             | 4%            | 147%        |
| Corporate/eliminations                          | (10,271)           | (4)%          | (27,817)           | (9)%          | (63)%       |
| <b>Total consolidated operating income</b>      | <b>375,925</b>     | <b>100%</b>   | <b>314,694</b>     | <b>100%</b>   | <b>19%</b>  |
| <b>Transaction-based activities</b>             |                    |               |                    |               |             |

In U.S. dollars, revenues increased by 26% for the six months ended December 31, 2007, from the six months ended December 31, 2006. Operating income increased by 17% for the six months ended December 31, 2007 from the six months ended December 31, 2006.

In ZAR, revenues increased by 20% for the six months ended December 31, 2007, from the six months ended December 31, 2006. Operating income increased by 12% for the six months ended December 31, 2007 from the six months ended December 31, 2006.

These increases in revenues and operating income were due primarily to the price increases in the KwaZulu-Natal, Eastern Cape, NorthWest and Limpopo provinces, higher volumes from all of our provincial contracts, continued adoption of our merchant acquiring system in the provinces where we distribute welfare grants and increased transacting ability at participating retailers POS devices in these provinces. We discuss these factors in more detail below.

Revenues for transaction-based activities include the transaction fees we earn through our merchant acquiring system and reflect the elimination of inter-company transactions.

Operating income margin for the six months ended December 31, 2007 decreased to 54% from 58% for the six months ended December 31, 2006. These profit margin decreases were mainly due to:

- inflationary increases in our cost components that were higher than the increases we negotiated with our customers;
- timing differences relating to our annual price increase negotiations, specifically in the Limpopo province where we received a back-dated price increase during the six months ended December 31, 2006;

- costs incurred during the six months ended December 31, 2007 for the registration of 120,000 new beneficiaries in the North West province; and
- lower revenues earned during the first half of fiscal 2008 compared with the first half of fiscal 2007 which resulted from the opening in December 2007 of the January 2008 payfile in all provinces except KwaZulu-Natal, whereas in December 2006, the January 2007 payfile was opened in all provinces.

These operating income margin decreases were partially offset by the increased revenues from price increases from the KwaZulu-Natal provincial government for welfare distribution and administration services and improved margins from EasyPay.

**Continued adoption of our merchant acquiring system:**

Refer to discussion under Three Months Ended December 31, 2007 Compared to the Three Months Ended December 31, 2006 Results of operations by operating segment Transaction-based activities Continued adoption of our merchant acquiring system.

**Higher volumes from our provincial contracts:**

During the six months ended December 31, 2007, we experienced growth in all of the provinces where we administer payments of social welfare grants. This growth was mainly due to an increase in the number of child support grants and disability grants approved by the various provincial governments. In total, the volume of payments processed during the six months ended December 31, 2007 increased 6% to 23,725,154 from the six months ended December 31, 2006.

The higher volumes under existing provincial contracts during the six months ended December 31, 2007, as well as average revenue per grant paid, are detailed below:

| <b>Province</b>              | <b>Number of Grants Paid</b> |                   | <b>Average Revenue per Grant Paid</b> |                       |                        |                        |
|------------------------------|------------------------------|-------------------|---------------------------------------|-----------------------|------------------------|------------------------|
|                              | <b>2007</b>                  | <b>2006</b>       | <b>2007<br/>\$(1)</b>                 | <b>2006<br/>\$(2)</b> | <b>2007<br/>ZAR(1)</b> | <b>2006<br/>ZAR(2)</b> |
| <b>KwaZulu-Natal<br/>(A)</b> | 10,103,529                   | 9,937,905         | 3.10                                  | 2.80                  | 21.57                  | 20.29                  |
| <b>Limpopo (B)</b>           | 5,883,827                    | 5,798,481         | 2.45                                  | 2.20                  | 17.08                  | 15.99                  |
| <b>North West<br/>(C)</b>    | 2,449,413                    | 1,648,013         | 3.06                                  | 2.60                  | 21.26                  | 18.85                  |
| <b>Northern Cape<br/>(D)</b> | 994,977                      | 829,945           | 2.69                                  | 2.58                  | 18.72                  | 18.73                  |
| <b>Eastern Cape<br/>(E)</b>  | 4,293,408                    | 4,272,911         | 2.24                                  | 1.63                  | 15.57                  | 11.83                  |
| <b>Total</b>                 | <b>23,725,154</b>            | <b>22,487,255</b> |                                       |                       |                        |                        |

(1) Average Revenue per Grant Paid excludes \$ 0.79 (ZAR 5.50) related to the provision of smart card accounts.

(2) Average Revenue per Grant Paid excludes \$ 0.76 (ZAR 5.50) related to the provision of smart card accounts.

(A) - in ZAR, the increase in the Average Revenue per Grant Paid in KwaZulu-Natal was due to price adjustment effective from July 2007.

(B) - in ZAR, the increase in the Average Revenue per Grant Paid in Limpopo was due to the negotiated annual price adjustment effective from January 2007.

(C) - in ZAR, the increase in the Average Revenue per Grant Paid in North West was due to the negotiated annual price adjustment approved by the provincial government in October 2006.

(D) the fluctuation in the Average Revenue per Grant Paid is insignificant.

(E) - in ZAR, the increase in the Average Revenue per Grant Paid in Eastern Cape was due to negotiated price increases effective January 1, 2007.

**EasyPay transaction fees:**

During the six months ended December 31, 2007 and 2006, EasyPay processed 254 million and 219 million transactions with an approximate value of \$8.1 billion (ZAR 56.4 billion) and \$6.9 billion, (ZAR 50.0 billion), respectively. The average fee per transaction during the six months ended December 31, 2007 and 2006 was \$0.03 (ZAR 0.21) . The number of transactions processed during the six months ended December 31, 2007 increased compared with the six months ended December 31, 2006, due to the strong economic climate experienced in South Africa during the first half of fiscal 2008 which has resulted in an increase in the number of transactions processed through retailers.

Operating income margins generated by EasyPay during the six months ended December 31, 2007 and 2006, were 40.3% and 32.7%, respectively, which is lower than those generated by our pension and welfare business and reduced the operating income margins within our transaction-based activities segment. Amortization of EasyPay intangible assets during the six months ended December 31, 2007 and 2006, of approximately \$0.9 million (ZAR 6.5 million) and \$0.8 million (ZAR 5.6 million), respectively, is included in the calculation of EasyPay operating margins. Operating income margin before amortization of EasyPay intangible assets during the six months ended December 31, 2007 and 2006 was 52.5% and 44.8%, respectively.

### **Smart card accounts**

In U.S. dollars, revenues increased by 10% for the six months ended December 31, 2007, from the six months ended December 31, 2006. Operating income increased by 10% for the six months ended December 31, 2007 from the six months ended December 31, 2006.

In ZAR, revenues increased by 5% for the six months ended December 31, 2007, from the six months ended December 31, 2006. Operating income increased by 5% for the six months ended December 31, 2007 from the six months ended December 31, 2006.

Operating income margin from providing smart card accounts was constant at 45% for each of the six months ended December 31, 2007 and 2006.

In ZAR, 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 3,976,684 smart card-based accounts were active at December 31, 2007, compared to 3,790,813 active accounts as at December 31, 2006. The increase in the number of active accounts resulted from an increase in the number of beneficiaries in all provinces qualifying for government grants and the transfer of beneficiaries in the North West province from the South African Post Office to our system.

### **Financial services**

In U.S. dollars, revenues decreased by 25% for the six months ended December 31, 2007, from the six months ended December 31, 2006. Operating income decreased by 51% for the six months ended December 31, 2007 from the six months ended December 31, 2006.

In ZAR, revenues decreased by 29% for the six months ended December 31, 2007, from the six months ended December 31, 2006. Operating income decreased by 53% for the six months ended December 31, 2007 from the six months ended December 31, 2006.

Revenues from UEPS-based lending decreased during the six months ended December 31, 2007 compared with the six months ended December 31, 2006 primarily due to the lower number of loans granted. In addition, on average, the return on these UEPS-based loans was lower during the six months ended December 31, 2007 compared with the six months ended December 31, 2006. We offer the UEPS-based loans to our beneficiaries with the primary purpose of assisting them to repay expensive loans with other loan providers and to escape the debt spiral that they are trapped in. Once our UEPS-based loans are repaid, we believe that the beneficiaries have an enhanced ability to remain debt-free, or take loans in amounts smaller than the original refinancing facility we offered to them. We believe that once cardholders escape the debt spiral they will have more disposable income to spend, including through our merchant acquiring base.

Revenues from our traditional microlending business decreased during the quarter due to increased competition, our strategic decision not to grow this business, and an overall lower return on traditional microlending loans as a result of compliance with the National Credit Act, or NCA. The NCA regulates fees and interest charged on micro-lending loans and imposes credit check obligations on lenders prior to granting of credit to individuals. The loan portfolio of the traditional microlending businesses has declined as a result of our strategic decision not to grow this business and compliance with the NCA.

Our current UEPS-based lending portfolio comprises loans made to elderly pensioners in some of the provinces where we distribute social welfare grants. We insure the UEPS-based lending book against default and thus no allowance is required. We consider UEPS-based lending less risky than traditional microfinance loans because the grants are distributed to these lenders by us and these loans are insured. We establish an allowance for doubtful

traditional microlending loans in respect of which we consider it likely that all or a portion of the principal amount of the loan or interest thereon will not be repaid by the borrower. We consider default likely after a specified period of non-payment, which is generally not more than 150 days. We assess this allowance based on a review by management of the aging of outstanding amounts, the payment history in relation to those specific accounts and the overall default history.

Some of the key indicators of these businesses are illustrated below:

| Table 16  | As at December 31, |         |             |          |          |              |
|---|--------------------|---------|-------------|----------|----------|--------------|
|   | 2007               | 2006    |             | 2007     | 2006     |              |
|   | \$ 000             | \$ 000  | \$ % change | ZAR 000  | ZAR 000  | ZAR % change |
| Traditional microlending:                                   |                    |         |             |          |          |              |
| Finance loans receivable gross                              | 5,336              | 7,399   | (28)%       | 36,575   | 52,206   | (30)%        |
| Allowance for doubtful finance loans receivable             | (3,153)            | (4,232) | (25)%       | (21,612) | (29,858) | (28)%        |
| Finance loans receivable net                                | 2,183              | 3,167   | (31)%       | 14,963   | 22,348   | (33)%        |
| UEPS-based lending:   |                    |         |             |          |          |              |
| Finance loans receivable net and gross (i.e., no allowance) | 4,086              | 4,429   | (8)%        | 28,012   | 31,244   | (10)%        |
| Total finance loans receivable, net                         | 6,269              | 7,596   |             | 42,975   | 53,592   |              |

Operating income margin for the financial services segment decreased to 21% for the six months ended December 31, 2007 from 32% for the six months ended December 31, 2006, primarily due to a lower return on our UEPS-based lending products and continued difficult operating conditions in our traditional micro-lending operations, as well as the effect of implementing the NCA.

#### Hardware, software and related technology sales

In U.S. dollars, revenues increased by 58% for the six months ended December 31, 2007, from the six months ended December 31, 2006. Operating income increased by 158% for the six months ended December 31, 2007 from the six months ended December 31, 2006.

In ZAR, revenues increased by 51% for the six months ended December 31, 2007, from the six months ended December 31, 2006. Operating income increased by 147% for the six months ended December 31, 2007 from the six months ended December 31, 2006.

We commenced software development and customization activities and delivered hardware to Ghana related to the Ghanaian national switch and smart card payment system contract during the six months ended December 31, 2007. Our revenues include approximately \$6.5 million (ZAR 44.6 million) from software development and customization activities and hardware related to this contract. Software development and customization are high margin activities for us and contributed to the increase in operating income during the six months ended December 31, 2007.

Our revenues for the six months ended December 31, 2007, includes approximately \$2.0 million (ZAR 13.8 million) from sales to Nedbank.

Amortization of Prism intangible assets during each of the six months ended December 31, 2007 and 2006 was approximately \$1.9 million (ZAR 13.4 million), respectively, and reduced our operating income.

Hardware sales to Nedbank are infrequent, and we do not anticipate revenue from large-scale hardware supply contracts to occur in the foreseeable future. In addition, we expect sales of hardware, software and licenses related to our international expansion to occur on an ad hoc basis as and when new international ventures, such as SmartSwitch Namibia and SmartSwitch Botswana, are established, or contracts such as Ghana are concluded. Depending on the size of our equity interest in these ventures, we may have to eliminate the sale of any hardware, software and licenses to these entities.

### **Corporate/eliminations**

In U.S. dollars, the operating loss decreased by \$2.4 million for the six months ended December 31, 2007, from the six months ended December 31, 2006.

In ZAR, the operating loss decreased by ZAR 17.5 million for the six months ended December 31, 2007, from the six months ended December 31, 2006.

Corporate/eliminations for the three months ended December 31, 2006 includes the non-recurring charges of approximately \$1.2 million (ZAR 8.6 million) related to an acquisition we ultimately decided not to pursue.

Our operating losses include expenditure related to compliance with Sarbanes, non-executive directors' fees, employee and executives salaries and bonuses, stock-based compensation, legal and auditor fees, directors and officer's insurance premiums, telecommunications expenses, property related expenditures including utilities, rental, security and maintenance, and elimination entries.

### **Liquidity and Capital Resources**

Our business has historically generated and continues to generate high levels of cash. At December 31, 2007, our cash balances were \$200.7 million, which comprised mainly ZAR-denominated balances of ZAR 1,087.7 million (\$158.7 million) and U.S. dollar-denominated balances of \$40.2 million. Our cash balances increased from June 30, 2007 levels mainly as a result of cash generated by operating activities.

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 U.S. and European money markets.

Historically, we have financed all operations, research and development, working capital, capital expenditures and acquisitions through our internally generated cash. We have aggregate credit facilities of \$83.9 million (ZAR 575.0 million). 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.

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 ourselves to these provinces' credit risk. These obligations result in a peak funding requirement, on a monthly basis, of approximately \$48.9 million (ZAR 340 million) for each of the KwaZulu-Natal and Eastern Cape contracts. The funding requirements are at peak levels for the first three weeks of every month during the year.

We currently believe that our cash and credit facilities are sufficient to fund our current operations for at least the next four quarters. However, if we are awarded additional provinces in the SASSA tender, we will likely need additional funding to pre-fund the payment of social welfare grants for these additional provinces. In anticipation of this need, we have sought and received a letter of intent from a major South African banking institution to increase the amount of our credit facilities. In addition, we may seek to access the global debt capital markets for this purpose. However, there can be no assurance that we will be able to increase our credit facilities or raise other debt capital on satisfactory terms, or at all.

**Cash flows from operating activities***Three months ended December 31, 2007*

Net cash outflows from operating activities for the three months ended December 31, 2007, was \$15.6 million (ZAR 105.6 million) compared to net cash inflows from operating activities of \$16.5 million (ZAR 120.9 million) for the three months ended December 31, 2006. The significant increase in net cash outflows is largely due to an amount outstanding from the KwaZulu-Natal provincial government as of December 31, 2007, which was paid in the first week of January 2008, an increase in the amounts paid to suppliers and an increase in provisional taxes paid due to our increased profitability.

During the three months ended December 31, 2007, we paid a \$12.3 million (ZAR 84.3 million) first provisional payment for our 2008 tax year. In addition, we paid a \$3.9 million (ZAR 26.5 million) third provisional payment for our 2007 tax year. See the table below for a summary of all taxes paid.

Taxes paid during the three months ended December 31, 2007 and 2006 were as follows:

|                            | <b>Three months ended December 31,</b> |               |                |               |
|----------------------------|--|---------------|----------------|---------------|
|                            | <b>2007</b>                            | <b>2006</b>   | <b>2007</b>    | <b>2006</b>   |
|                            | <b>\$</b>                              | <b>\$</b>     | <b>ZAR</b>     | <b>ZAR</b>    |
|                            | <b>000</b>                             | <b>000</b>    | <b>000</b>     | <b>000</b>    |
| First provisional payments | 12,274                                 | 9,230         | 84,333         | 65,320        |
| Third provisional payments | 3,861                                  | 2,334         | 26,526         | 16,516        |
| Taxation refunds received  | -                                      | (172)         | -              | (1,264)       |
| <b>Total tax paid</b>      | <b>16,135</b>                          | <b>11,392</b> | <b>110,859</b> | <b>80,572</b> |

*Six months ended December 31, 2007*

Net cash inflows from operating activities for the six months ended December 31, 2007, was \$24.7 million (ZAR 171.4 million) compared to net cash inflows from operating activities of \$14.9 million (ZAR 109.1 million) for the six months ended December 31, 2006. Cash inflows have increased due to the increase in activity, specifically in our transaction-based activities and hardware, software and related technology sales operating segments. These increases in cash inflows were offset by an amount outstanding from the KwaZulu-Natal provincial government as of December 31, 2007, which was paid in the first week of January 2008 and an increase in provisional taxes paid due to our increased profitability.

During the six months ended December 31, 2007, we paid a \$12.3 million (ZAR 84.3 million) first provisional payment for our 2008 tax year. In addition, we paid a \$3.9 million (ZAR 26.5 million) third provisional payment for our 2007 tax year. During the six months ended December 31, 2007, we paid an additional \$8.4 million (ZAR 60.5 million) second provisional payment related to our 2007 tax year. See the table below for a summary of all taxes paid.

Taxes paid during the six months ended December 31, 2007 and 2006 were as follows:

|                            | <b>Six months ended December 31,</b> |             |             |             |
|----------------------------|--------------------------------------|-------------|-------------|-------------|
|                            | <b>2007</b>                          | <b>2006</b> | <b>2007</b> | <b>2006</b> |
|                            | <b>\$</b>                            | <b>\$</b>   | <b>ZAR</b>  | <b>ZAR</b>  |
|                            | <b>000</b>                           | <b>000</b>  | <b>000</b>  | <b>000</b>  |
| First provisional payments | 12,274                               | 9,230       | 84,333      | 65,320      |
| Third provisional payments | 3,861                                | 2,334       | 26,526      | 16,516      |
|                            | 8,357                                | 9,027       | 60,465      | 66,837      |

|                                      |        |        |         |         |
|--------------------------------------|--------|--------|---------|---------|
| Taxation paid related to prior years |        |        |         |         |
| Taxation refunds received            | (10)   | (672)  | (66)    | (4,880) |
| <b>Total tax paid</b>                | 24,482 | 19,919 | 171,258 | 143,793 |

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***Cash flows from investing activities***

*Three months ended December 31, 2007*

Cash used in investing activities for the three months ended December 31, 2007 includes capital expenditure of \$1.2 million (ZAR 8.2 million), of which \$0.5 million (ZAR 3.5 million) relates to renovations of our transaction-based activities segment head office and data room, \$0.2 million (ZAR 1.5 million) relates to capital expenditure to maintain our EasyPay operations and \$0.2 million (ZAR 1.1 million) relates the acquisition of POS terminals for our merchant acquiring system.

Cash used in investing activities for the three months ended December 31, 2006 includes capital expenditure of \$0.9 million (ZAR 6.3 million), of which \$0.5 million (ZAR 3.5 million) relates to the purchase of equipment and furniture for SmartSwitch Nigeria's data room in Nigeria.

*Six months ended December 31, 2007*

Cash used in investing activities for the three months ended December 31, 2007 includes capital expenditure of \$1.9 million (ZAR 13.0 million), of which \$0.5 million (ZAR 3.5 million) relates to renovations of the transaction-based activities segment head office and data room, \$0.2 million (ZAR 1.5 million) relates to capital expenditure to maintain our EasyPay operations and \$0.4 million (ZAR 2.9 million) relates the acquisition of POS terminals for our merchant acquiring system.

Cash used in investing activities for the six months ended December 31, 2006 includes capital expenditure of \$1.7 million (ZAR 10.6 million), of which \$0.5 million (ZAR 3.5 million) relates to the purchase of equipment and furniture for SmartSwitch Nigeria's data room in Nigeria and \$0.8 million (ZAR 5.6 million) related to the purchase of equipment and other property plant and equipment by EasyPay in order to maintain operations. During the six months ended December 31, 2006, we paid \$82.1 million (ZAR 591.1 million), net of cash received, for the entire issued and outstanding ordinary capital of Prism.

***Cash flows from financing activities***

*Three months ended December 31, 2007*

There were no significant cash flows from financing activities during the three months ended December 31, 2007.

*Six months ended December 31, 2007*

During the six months ended December 31, 2007, we received \$0.15 million (ZAR 1.1 million) from employees exercising stock options.

During the six months ended December 31, 2006, we received \$0.05 million (ZAR 0.4 million) from an employee exercising stock options.

**Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements.

**Capital Expenditures**

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 increases to the point where the maximum capacity of the original infrastructure is exceeded.

We discuss our capital expenditures during the three and six months ended December 31, 2007, under **Liquidity and capital resources** cash flows from investing activities.

All of our capital expenditures for the past three fiscal years have been funded through internally generated funds. We had no outstanding capital commitments at December 31, 2007. We anticipate that capital spending for the third quarter of fiscal 2008 will relate primarily to on-going replacement of equipment used to administer and distribute social welfare grants and provide a switching service through EasyPay. 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:



### Item 3. 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 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 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 December 31, 2007 and 2006, our outstanding foreign exchange contracts were as follows:

#### As of December 31, 2007

| Notional amount | Strike price | Fair market value price | Maturity          |
|-----------------|--------------|-------------------------|-------------------|
| EUR 33,500      | ZAR 9.9030   | ZAR 10.1619             | February 11, 2008 |
| EUR 24,700      | ZAR 10.3232  | ZAR 10.2589             | March 31, 2008    |

#### As of December 31, 2006

| Notional amount | Strike price | Fair market value price | Maturity         |
|-----------------|--------------|-------------------------|------------------|
| EUR 487,500     | ZAR 9.5900   | ZAR 9.3110              | January 31, 2007 |
| EUR 140,000     | ZAR 9.3715   | ZAR 9.4400              | January 5, 2007  |
| USD 88,500      | ZAR 7.0203   | ZAR 7.1100              | January 26, 2007 |
| USD 65,000      | ZAR 7.4052   | ZAR 7.1200              | January 30, 2007 |
| USD 981,500     | ZAR 7.4290   | ZAR 7.2400              | June 29, 2007    |
| USD 266,000     | ZAR 7.1100   | ZAR 7.1800              | April 23, 2007   |
| USD 266,000     | ZAR 7.1320   | ZAR 7.2100              | May 21, 2007     |

#### 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 three 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 SARB's repurchase, or repo rate, our interest expense on pre-funding social welfare grants in the KwaZulu Natal and Eastern Cape provinces increases by \$21,401 per month, while interest earned per month on any surplus cash increases by \$11,991 per \$14.4 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.

**Micro-lending 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.

**Item 4. Controls and Procedures**

*Evaluation of disclosure controls and procedures*

Under the supervision and with the participation of our management, including our chief executive officer and our chief financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) under the Securities Exchange Act of 1934. Based on this evaluation, the chief executive officer and the chief financial officer concluded that our disclosure controls and procedures were effective as of December 31, 2007.

*Changes in Internal Control over Financial Reporting*

There have not been any changes in our internal control over financial reporting during the most recent fiscal quarter ended December 31, 2007, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## Part II. Other Information

### Item 1A. Risk Factors

See Item 1A RISK FACTORS in Part I of the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2007 for a discussion of the Company's risk factors. Except for the risk factor discussed below, for the quarter ended December 31, 2007, there have been no material changes to these risk factors.

The following risk factor is updated to include a new risk:

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

***Irregular electricity supply.*** Since December 2007, South Africa has experienced rolling blackouts due to an increasing demand for electricity. Although these blackouts have not affected our pension and welfare delivery performance because our UEPS-based technology can operate without the need for consistent networking or power infrastructure, they have adversely affected the productivity of certain portions of our South African workforce, including our head office and information technology personnel, and our manufacturing activities. In addition, even though we believe that we currently have adequate backup power facilities in the form of petrol and diesel generators to support our back-end processing activities, the strain on these generators caused by more frequent usage may shorten their lifespan. Although we have ordered additional generators for our head office, demand for backup generators is high and the lead time for delivery of new generators is currently approximately three months. We believe that the irregular supply of electricity may last for several years unless other short-term solutions are found.

Over the past several weeks there have been an increasing number of press reports predicting that the irregular electricity supply may adversely affect the South African economy. We could be adversely affected by such a downturn, and although we can not predict precisely how such a downturn would affect us, we currently believe that the most significant adverse impact would be a decreasing volume in our transactions-based activities and a significant weakening of the South African Rand, our functional currency, against the US Dollar, our reporting currency.

### Item 4. Submission of Matters to a Vote of Security Holders

Our Annual Meeting of Shareholders was held on November 30, 2007 to consider the following proposals:

Proposal 1. Election of directors; and

Proposal 2. Ratification of appointment of independent registered public accounting firm.

The following proposals were adopted by the votes indicated:

Proposal 1:

|                          | <b>For</b> | <b>Withheld</b> |
|--------------------------|------------|-----------------|
| Dr. Serge C.P. Belamant  | 46,247,387 | 267,916         |
| Herman G. Kotze          | 45,310,269 | 1,205,034       |
| Christopher S. Seabrooke | 40,092,015 | 6,423,288       |
| Anthony C. Ball          | 46,336,908 | 178,395         |
| Alasdair J. K. Pein      | 46,336,774 | 178,529         |
| Paul Edwards             | 46,352,629 | 162,674         |
| Florian P. Wendelstadt   | 46,334,857 | 180,446         |

Proposal 2:

|                                  | <b>For</b> | <b>Against</b> | <b>Abstained</b> |
|----------------------------------|------------|----------------|------------------|
| Deloitte & Touche (South Africa) | 46,404,639 | 8,289          | 102,375          |

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**Item 6. Exhibits**

The following exhibits are filed as part of this Form 10-Q

| <b>Exhibit Number</b> | <b>Description</b>  |
|-----------------------|---|
| <u>31.1</u>           | <u>Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>                          |
| <u>31.2</u>           | <u>Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>                          |
| <u>32</u>             | <u>Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of Sarbanes- Oxley Act of 2002</u> |

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on February 7, 2008.

NET 1 UEPS TECHNOLOGIES, INC.

By: /s/ Dr. Serge C.P. Belamant

Dr. Serge C.P. Belamant  
Chief Executive Officer, Chairman of the Board and Director

By: /s/ Herman Gideon Kotzé

Herman Gideon Kotzé  
Chief Financial Officer, Treasurer and Secretary, Director