

NET 1 UEPS TECHNOLOGIES INC  
Form 10-Q  
May 10, 2007

---

**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 March 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, 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-

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

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

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

---

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

As of March 31, 2007 (the latest practicable date), 50,877,323 shares of the registrant's common stock, par value \$0.001 per share, and 6,051,321 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.

---

**Form 10-Q****NET 1 UEPS TECHNOLOGIES, INC.****Table of Contents**

	<b>Page No.</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<b><u>Item 1. Financial Statements</u></b>	
<u>Condensed Consolidated Balance Sheets at March 31, 2007 (Unaudited) and June 30, 2006</u>	<u>2</u>
<u>Unaudited Condensed Consolidated Statements of Operations for the Three and Nine Months Ended March 31, 2007 and 2006</u>	<u>3</u>
<u>Unaudited Condensed Consolidated Statements of Cash Flows for the Three and Nine Months Ended March 31, 2007 and 2006</u>	<u>4</u>
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	<u>5</u>
<b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	<u>22</u>
<b><u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u></b>	<u>55</u>
<b><u>Item 4. Controls and Procedures</u></b>	<u>57</u>
<b><u>PART II. OTHER INFORMATION</u></b>	
<b><u>Item 1A. Risk Factors</u></b>	<u>58</u>
<b><u>Item 6. Exhibits</u></b>	<u>60</u>
<b><u>Signatures</u></b>	<u>61</u>

## Part I. Financial Information

## Item 1. Financial Statements

NET 1 UEPS TECHNOLOGIES, INC.  
Condensed Consolidated Balance Sheets

	Unaudited March 31, 2007	(A) June 30, 2006
	(In thousands, except share data)	
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 118,890	\$ 189,735
Pre-funded social welfare grants receivable	39,546	17,223
Accounts receivable, net of allowances of March: \$598; June: \$159	41,610	21,219
Finance loans receivable, net of allowances of March: \$4,359; June: \$3,448	6,210	6,713
Deferred expenditure on smart cards	516	656
Inventory	5,376	1,935
Deferred income taxes	8,177	3,237
Total current assets	220,325	240,718
LONG TERM RECEIVABLE	933	946
<b>PROPERTY, PLANT AND EQUIPMENT, NET OF ACCUMULATED</b>		
DEPRECIATION OF March: \$26,959; June: \$16,543	7,864	3,757
EQUITY ACCOUNTED INVESTMENTS	6,101	4,986
GOODWILL	83,647	13,923
<b>INTANGIBLE ASSETS, NET OF ACCUMULATED AMORTIZATION OF</b>		
March: \$11,753; June: \$6,549	32,469	5,649
<b>TOTAL ASSETS</b>	<b>351,339</b>	<b>269,979</b>
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Bank overdraft	149	20
Accounts payable	404	2,073
Other payables	40,577	28,575
Income taxes payable	16,058	12,455
Total current liabilities	57,188	43,123
DEFERRED INCOME TAXES	33,656	17,846
INTEREST BEARING LIABILITIES	3,830	-
<b>TOTAL LIABILITIES</b>	<b>94,674</b>	<b>60,969</b>
<b>SHAREHOLDERS' EQUITY</b>		
<b>COMMON STOCK</b>		
Authorized: 83,333,333 with \$0.001 par value;		
Issued and outstanding shares - March: 50,877,323; June: 49,596,879	51	50
<b>SPECIAL CONVERTIBLE PREFERRED STOCK</b>		
Authorized: 50,000,000 with \$0.001 par value;		
	6	7

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

Issued and outstanding shares - March: 6,051,321; June:  
7,315,099

**B CLASS PREFERENCE SHARES**

Authorized: 330,000,000 with \$0.001 par value;

Issued and outstanding shares (net of shares held by the  
Company) - March:

44,588,706; June: 53,900,752	7	9
<b>ADDITIONAL PAID-IN-CAPITAL</b>	106,530	105,792
<b>TREASURY SHARES ISSUED: March: 147,973; June: 147,973</b>	(3,958)	(3,958)
<b>ACCUMULATED OTHER COMPREHENSIVE INCOME</b>	(8,992)	(9,763)
<b>RETAINED EARNINGS</b>	163,021	116,873
<b>TOTAL SHAREHOLDERS EQUITY</b>	256,665	209,010
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	\$ 351,339	\$ 269,979

(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 March 31,		Nine months ended March 31,	
	2007	2006	2007	2006
	(In thousands, except per share data)		(In thousands, except per share data)	
REVENUE	\$ 61,275	\$ 54,584	\$ 163,772	\$ 147,900
EXPENSE				
COST OF GOODS SOLD, IT PROCESSING, SERVICING AND SUPPORT	13,940	14,469	38,185	39,196
GENERAL AND ADMINISTRATION DEPRECIATION AND AMORTIZATION COSTS RELATED TO PUBLIC OFFERING AND NASDAQ LISTING	15,515	13,620	44,690	36,232
OPERATING INCOME	29,068	25,042	72,385	66,612
INTEREST INCOME, net	735	1,535	2,793	3,781
INCOME BEFORE INCOME TAXES	29,803	26,577	75,178	70,393
INCOME TAX EXPENSE	11,397	10,074	28,927	27,062
NET INCOME FROM CONTINUING OPERATIONS BEFORE MINORITY INTEREST AND (LOSS)				
EARNINGS FROM EQUITY ACCOUNTED INVESTMENTS	18,406	16,503	46,251	43,331
MINORITY INTEREST (LOSS) EARNINGS FROM EQUITY ACCOUNTED INVESTMENTS	-	-	205	-
	(153)	73	102	356

NET INCOME	\$	18,253	\$	16,576	\$	46,148	\$	43,687
<b>Net income per share</b>								
Basic earnings, in cents common stock and linked units		32.1		29.2		81.1		77.4
Diluted earnings, in cents common stock and linked units		31.8		28.8		80.3		76.2

See Notes to Unaudited Condensed Consolidated Financial Statements



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

	Three months ended March 31,		Nine months ended March 31,	
	2007	2006	2007	2006
	(In thousands)		(In thousands)	
<b>Cash flows from operating activities</b>				
Net income	\$ 18,253	\$ 16,576	\$ 46,148	\$ 43,687
Adjustments to reconcile net income to net cash provide by operating activities:				
Depreciation and amortization	2,752	1,428	8,512	4,331
Earnings from equity accounted investments	153	(73)	(102)	(356)
Fair value adjustment related to financial liabilities	25	-	178	6
Fair value of FAS 133 derivative adjustments	(58)	(23)	19	30
Interest payable	110	-	110	-
(Profit) Loss on disposal of property, plant and equipment	(58)	2	(125)	11
Profit on disposal of business	-	(10)	-	(10)
Minority interest	-	-	205	-
Stock compensation charge	190	124	686	124
Increase in accounts receivable, pre-funded social welfare grants	(32,566)	(26,635)	(35,118)	(10,441)
receivable and finance loans receivable				
(Increase)				
Decrease in deferred expenditure on smart cards	(61)	283	133	1,943
Decrease	210	551	(2,543)	(719)
(Increase) in inventory				
	11,436	14,098	490	10,861

Increase in accounts payable and other payables				
Increase	5,649	98	2,271	(5,088)
(Decrease) in taxes payable				
(Decrease)	(1,898)	2,594	(1,745)	6,858
Increase in deferred taxes				
<b>Net cash provided by operating activities</b>	<b>4,137</b>	<b>9,013</b>	<b>19,119</b>	<b>51,237</b>
<b>Cash flows from investing activities</b>				
Capital expenditures	(943)	(315)	(2,646)	(1,203)
Proceeds from disposal of property, plant and equipment	116	16	262	100
Profit on disposal of business	-	10	-	10
Acquisition of Prism Holdings Limited, net of cash acquired	(9,713)	-	(92,043)	-
Acquisition of equity interest in and advance of loans to equity accounted investment	(310)	(761)	(310)	(2,612)
<b>Net cash used in investing activities</b>	<b>(10,850)</b>	<b>(1,050)</b>	<b>(94,737)</b>	<b>(3,705)</b>
<b>Cash flows from financing activities</b>				
Proceeds from issue of share capital, net of share issue expenses	-	-	50	32,219
Proceeds from bank overdrafts	148	-	61,731	-
Repayment of bank overdraft	-	-	(62,272)	-
Proceeds from interest bearing liabilities	-	-	3,513	-
<b>Net cash provided by financing activities</b>	<b>148</b>	<b>-</b>	<b>3,022</b>	<b>32,219</b>
Effect of exchange rate changes on cash	(2,447)	2,032	1,751	6,397

<b>Net (decrease) increase in cash and cash equivalents</b>	(9,012)		9,995		(70,845)		86,148
<b>Cash and cash equivalents beginning of period</b>	127,902		183,902		189,735		107,749
<b>Cash and cash equivalents end of period</b>	\$ 118,890	\$	193,897	\$	118,890	\$	193,897

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 nine months ended March 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*

On June 7, 2004, the Company completed a transaction, which is more fully described in the Company's Annual Report on Form 10-K for the year ended June 30, 2006, in which the former shareholders of Net1 Applied Technology Holdings Limited (Aplitec), acquired a majority voting interest in the Company. In accordance with U.S. generally accepted accounting principles (GAAP), the Company accounted for the Aplitec transaction as a reverse acquisition, which requires that the company whose shareholders retain a majority voting interest in a combined business be treated as the acquiror for accounting purposes. References to the Company refer to Net1 and its consolidated subsidiaries, including Aplitec, unless the context otherwise requires. References to Net1 are references solely to Net 1 UEPS Technologies, Inc.

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 the rules and regulations of the Securities and Exchange Commission for Quarterly Results on Form 10-Q and include all of the information and disclosures required by GAAP for interim financial reporting. The results of operations for the three and nine months ended March 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, 2006. 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.

*Translation of foreign currencies*

The functional currency of the Company is the South African rand, or 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*

In September 2006, the Emerging Issues Task Force (EITF) reached a consensus on EITF 06-3, *How Sales Taxes Collected from Customers and Remitted to Governmental Authorities should be presented in the Income Statement (That Is, Gross versus Net Presentation)* (EITF 06-3). The scope of EITF 06-3 includes any tax assessed by a governmental authority that is directly imposed on a revenue producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, and some excise taxes. EITF 06-3 concluded that the presentation of taxes within the scope of EITF 06-3 as either gross (included within revenues and costs) or net

(excluded from revenues) is an accounting policy decision that should be disclosed. In addition, for any such taxes that are reported on a gross basis, a company should disclose the amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented if those amounts are significant. The disclosure of those taxes can be done on an aggregate basis. The guidance in EITF 06-3 should be applied to financial reports for interim and annual reporting periods beginning after December 15, 2006. On adoption of EITF 06-3, the Company continued to present revenues net of taxes. The adoption of EITF 06-03 did not have a material impact on the Company's consolidated financial position, results of operations or cash flows or financial statement disclosure.

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

*Recent accounting pronouncements not yet adopted as of March 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* ( FAS 159 ). FAS 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company's choice to use fair value on its earnings. It also requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. FAS 159 does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in FAS 157. FAS 159 is effective as of the beginning of the Company's first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the Company makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of FAS 157. 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 June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB SFAS No. 109, *Accounting for Income Taxes*. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires recognition of tax benefits that satisfy a greater than 50% probability threshold. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for the Company beginning July 1, 2007. The Company is currently assessing the potential impact that the adoption of FIN 48 will have on its financial statements.

In November 2006, the EITF reached consensus on EITF No. 06-9, *Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee* (EITF 06-9). The EITF reached a consensus that a change in a subsidiary's or equity method investee's reporting period is a change in accounting principle. Therefore, the parent or investor should recognize the effects of the change through retrospective application to all prior periods presented pursuant to Statement 154, *Accounting Changes and Error Corrections*. The adoption of EITF 06-9 by the Company is not expected to have an impact on its overall results of operations, financial position or cash flows.

## 2. Acquisitions

### Prism

On July 3, 2006, the Company acquired the entire issued and outstanding share capital of Prism Holdings Limited ( Prism ) for ZAR1.16 per share (approximately \$0.16, at the USD:ZAR exchange rate as of July 3, 2006) for a total consideration of \$95.2 million which was paid in cash. On September 13, 2006, the Company reported the

pro-forma effects of the transaction on an amended Form 8-K with the SEC.

Prism is a company focused on the development and provision of secure transaction technology, solutions and services. Prism's core competencies around secure online transaction processing, cryptography and integrated circuit card (chip/smart card) technologies are principally applied to electronic commerce transactions in the telecommunications, banking, retail, petroleum and utilities market sectors. These technologies form the cornerstones of what Prism calls the "trusted transactions" environment and provide Prism with the building blocks for developing secure end-to-end payment solutions.

The Company acquired Prism because it fits in well within its strategy, particularly in South Africa. On July 3, 2006, Prism owned a 74.9% interest in EasyPay (Proprietary) Limited ("EasyPay"), the largest bank-independent financial switch, or transaction processor, in South Africa. Effective October 1, 2006, Prism acquired the remaining 25.1% interest in EasyPay. This transaction is discussed in more detail below.

**2. Acquisitions (continued)****Prism (continued)**

During fiscal 2006, EasyPay processed approximately 358 million transactions on behalf of retailers, bill issuers and financial institutions. The bulk of these transactions were acquired through a base of around 50,000 customer owned terminals, the majority of which are installed at all the retail locations of South Africa's two largest retailers, who have approximately 65% of the South African retail market share between them. Prism has also developed a core competency in mobile communications and licenses its intellectual property to manufacturers of Global System for Mobile Communication ( GSM ) Subscriber Identity Module ( SIM ) cards and mobile operators.

Prism has developed a number of innovative payment technologies for mobile phones including Virtual Top-up ( VTU ) that enables individuals to purchase any amount of mobile airtime and resell this airtime from their phones to other mobile phones without the need for additional authorization codes or physical vouchers. The addition of customers that engage Prism to provide switching services may extend the Company's merchant acquiring footprint in South Africa from the deep rural areas, where it is active today, to the urban environment. The Company intends to upgrade the 50,000 terminals that form part of Prism's network to accommodate its biometric-based UEPS technology, which will significantly enhance its wage payment program once it launches that service. The Company will also be able to capitalize on the convergence of technologies such as the mobile phone, UEPS and banking whereby it will be able to provide transacting and financial services to all segments of the population, regardless of their financial status or place of residence. In addition, the Company will continue with its strategy as a significant participant in the switching and settlement of formal credit and debit card transactions on behalf of formal banks and large retailers.

The following table sets forth the amount paid for Prism using exchange rates applicable as of July 3, 2006:

Acquisition of the entire issued and outstanding share capital of Prism for cash	\$ 95,178
Costs directly related to the acquisition	2,342
<b>Total purchase price</b>	<b>\$ 97,520</b>

The following table sets forth the final allocation of the purchase price using exchange rates applicable as of July 3, 2006:

Cash and cash equivalents	\$ 15,090
Accounts receivable, net	7,756
Inventory	1,497
Property, plant and equipment	4,211
Intangible assets (see Note 6)	27,900
Trade and other payables	(13,842)
Income taxes payable	(1,223)
Deferred tax assets	2,993
Deferred tax liabilities	(10,366)
Minority interests	(751)
Goodwill (see Note 6)	64,255
<b>Total purchase price</b>	<b>\$ 97,520</b>

The purchase price allocation was based on an independent appraisal and management estimates as of March 31, 2007 and may be adjusted up to one year following the closing of the transaction.

The results of Prism's operations, including 74.9% of EasyPay, are reflected in the Company's financial statements from July 3, 2006.

**EasyPay**



The remaining 25.1% interest in EasyPay was acquired by Prism effective October 1, 2006 for \$8.8 million, at the USD:ZAR exchange rate as of October 1, 2006. The Company's management believes the acquisition of the remaining 25.1% of EasyPay will enable the Company to pursue its strategy related to the Prism acquisition as it eliminates the consideration of minority interest.

**2. Acquisitions (continued)****EasyPay (continued)**

The following table sets forth the amount paid for EasyPay using exchange rates applicable as of October 1, 2006:

Acquisition of the remaining 25.1% of EasyPay from minority shareholder	\$	8,773
Costs directly related to the acquisition		22
Total purchase price	\$	8,795

FAS No. 141, *Business Combinations* ( FAS 141 ) requires the acquisition of some or all of the noncontrolling equity interests in a subsidiary, whether acquired by the parent, the subsidiary itself, or another affiliate, to be accounted for using the purchase method. Accordingly the fair value of assets and liabilities acquired were determined by management as of October 1, 2006. The following table sets forth the preliminary allocation of the purchase price using exchange rates applicable as of October 1, 2006:

Property, plant and equipment	\$	1,848
Trade and other receivables		1,202
Cash and cash equivalents		2,477
Trade and other payables		(3,864)
Amounts owing to group companies		(158)
Taxation		(324)
Intangible assets (see Note 6)		16,155
Deferred tax assets		132
Deferred tax liabilities		(4,685)
Total value of EasyPay		12,783
Fair value of remaining 25.1% of EasyPay acquired		3,209
Purchase price		8,795
Goodwill acquired (see Note 6)	\$	5,586

The purchase price allocation was based on management estimates as of December 31, 2006 and may be adjusted up to one year following the closing of the transaction.

The results of the remaining 25.1% of EasyPay's operations acquired effective October 1, 2006 are reflected in the Company's financial statements from October 1, 2006.

The purchase price of \$8.8 million, translated at exchange rates prevailing on October 1, 2006, was paid in January 2007.

**3. 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. 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. For the three and nine months ended March 31, 2007, the April payment service commenced during the last three days of March 2007 and was offered at government pay points and at merchant locations.

**4. 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.

## 5. Equity-accounted investments

During the three months ended March 31, 2007 the Company acquired a 50% interest in the issued and outstanding ordinary share capital and loans of VTU De Colombia S.A. ( VTU Colombia ). In addition, the Company has a 43.16% interest in the issued and outstanding ordinary share capital and loans of Permit Group 2 (Pty) Ltd ( Permit ) and a 50% interest in the issued and outstanding ordinary share capital and loans of SmartSwitch Namibia (Pty) Ltd ( SmartSwitch Namibia ) and SmartSwitch Botswana (Pty) Limited ( SmartSwitch Botswana ). The Company has sold hardware, software and/or licenses to SmartSwitch Namibia, SmartSwitch Botswana and VTU Colombia and defers recognition of 50% of the net income after tax related to these sales until SmartSwitch Namibia, SmartSwitch Botswana and VTU Colombia has used the purchased asset or has sold it to a third party. The deferral of the net income after tax is shown in the Elimination column in the table below.

The functional currency of the Company's equity-accounted investments is not the U.S. dollar and thus the investments are restated at the period end U.S. dollar/foreign currency exchange rate with an entry against accumulated other comprehensive income. The functional currency of Permit is the South African rand, the functional currency of SmartSwitch Namibia is the Namibian dollar, the functional currency of SmartSwitch Botswana is the Botswana pula and the functional currency of VTU Colombia is the Colombian peso.

Summarized below is the Company's interest in equity-accounted investments as of March 31, 2007 and June 30, 2006:

	Equity	Loans	Earnings (Loss)	Elimination	Total
Permit:					
Balance as of July 1, 2005	- \$	736 \$	444 \$	145 \$	1,325 \$
Earnings from equity-accounted investment	-	-	868	101	969
Foreign currency adjustment <sup>(1)</sup>	-	(59)	(145)	(23)	(227)
Balance as of June 30, 2006	-	677	1,167	223	2,067
Earnings from equity-accounted investment <sup>(6)</sup>	-	-	770	26	796
Foreign currency adjustment <sup>(1)</sup>	-	(40)	(125)	(15)	(180)
Balance as of September 30, 2006	-	637	1,812	234	2,683
Earnings from equity-accounted investment <sup>(6)</sup>	-	-	230	28	258
Foreign currency adjustment <sup>(1)</sup>	-	60	181	24	265
Balance as of December 31, 2006	-	697	2,223	286	3,206
2006					
Earnings from equity-accounted investment <sup>(5)(6)</sup>	-	-	199	30	229
Foreign currency adjustment <sup>(1)</sup>	-	(21)	(70)	(10)	(101)
Balance as of March 31, 2007	-	676	2,352	306	3,334
SmartSwitch Namibia:					
Share capital acquired/ loans extended	\$ 634	1,978	-	-	2,612
Loss from equity-accounted investment	-	-	(68)	(518)	(586)
Foreign currency adjustment <sup>(2)</sup>	(98)	(259)	9	61	(287)

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

Balance as of June 30, 2006	536	1,719	(59)	(457)	1,739
(Loss) Earnings from equity-accounted investment <sup>(6)</sup>	-	-	(219)	13	(206)
Foreign currency adjustment <sup>(2)</sup>	(27)	(101)	17	46	(65)
Balance as of September 30, 2006	509	1,618	(261)	(398)	1,468
(Loss) Earnings from equity-accounted investment <sup>(6)</sup>	-	-	(71)	33	(38)
Foreign currency adjustment <sup>(2)</sup>	52	154	(30)	(37)	139
Balance as of December 31, 2006	561	1,772	(362)	(402)	1,569
(Loss) Earnings from equity-accounted investment <sup>(5)(6)</sup>	-	-	(107)	33	(74)
Foreign currency adjustment <sup>(2)</sup>	(24)	(55)	16	12	(51)
Balance as of March 31, 2007	\$ 537	\$ 1,717	\$ (453)	\$ (357)	\$ 1,444

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

	Equity	Loans	Earnings (Loss)	Elimination	Total
<b>SmartSwitch Botswana:</b>					
Share capital acquired/ loans extended	\$ 710	\$ 708	-	-	\$ 1,418
(Loss) Earnings from equity-accounted investment	-	-	\$ (9)	\$ 9	-
Foreign currency adjustment <sup>(3)</sup>	(121)	(117)	-	-	(238)
Balance as of June 30, 2006	589	591	(9)	9	1,180
Loss from equity-accounted investment <sup>(6)(7)</sup>	-	-	(28)	(492)	(520)
Foreign currency adjustment <sup>(3)</sup>	(20)	(34)	(7)	32	(29)
Balance as of September 30, 2006	569	557	(44)	(451)	631
(Loss) Earnings from equity-accounted investment <sup>(6)</sup>	-	-	(79)	44	(35)
Foreign currency adjustment <sup>(3)</sup>	34	53	(5)	(41)	41
Balance as of December 31, 2006	603	610	(128)	(448)	637
Loan extended	-	310	-	-	310
(Loss) Earnings from equity-accounted investment <sup>(5)(6)</sup>	-	-	(175)	47	(128)
Foreign currency adjustment <sup>(3)</sup>	(24)	(19)	86	16	59
Balance as of March 31, 2007	579	901	(217)	(385)	878
<b>VTU Colombia</b>					
Share capital acquired/ loans extended	50	650	-	-	700
Loss from equity-accounted investment <sup>(5)(6)(7)</sup>	-	-	(38)	(219)	(257)
Foreign currency adjustment <sup>(4)</sup>	-	-	-	2	2
Balance as of March 31, 2007	50	650	(38)	(217)	445
Equity-accounted investments	\$ 1,166	\$ 3,944	\$ 1,644	\$ (653)	\$ 6,101

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

(2) the foreign currency adjustment represents the effects of the fluctuations between the Namibian dollar and the U.S. dollar, except for the foreign currency adjustment for loan balance which represents the effects of the fluctuations between the South African rand and the U.S. dollar.

(3) the foreign currency adjustment represents the effects of the fluctuations between the Botswana pula and the U.S. dollar, except for the foreign currency adjustment for loan balance which represents the effects of the fluctuations between the South African rand and the U.S. dollar.

(4) the foreign currency adjustment represents the effects of the fluctuations between the Colombia peso and the U.S. dollar.

(5) the sum of the earnings (loss) from equity accounted investment represents the amount presented on the earnings from equity accounted investments line in the unaudited condensed consolidated statement of operations for the three months ended March 2007.

(6) the sum of the earnings (loss) from equity accounted investment represents the amount presented on the earnings from equity accounted investments line in the unaudited condensed consolidated statement of operations for the nine months ended March 2007.

(7) includes the elimination of unrealized net income as described below.

As the Company owns 50% of SmartSwitch Namibia, SmartSwitch Botswana VTU Colombia, respectively, it is required to eliminate 50% of the net income generated from sales to SmartSwitch Namibia and SmartSwitch Botswana. During the three months ended March 31, 2007 the Company sold a license to VTU Colombia. During the three and nine months ended March 31, 2007, the Company sold hardware and software to SmartSwitch Botswana. During the three and six months ended March 31, 2006, the Company sold software to SmartSwitch Botswana. 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 nine months ended March 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 nine months ended March 31, 2007 and 2006. The Company will recognize this net income from these hardware and software sales during the period in which the hardware and software it has sold to SmartSwitch Namibia, SmartSwitch Botswana and VTU Colombia are utilized in its operations, or has been sold to third party customers, as the case may be.

## 6. Goodwill and intangible assets

On July 3, 2006, the Company acquired the entire issued and outstanding share capital of Prism for ZAR1.16 per share (approximately \$0.16, at the USD:ZAR exchange rate as of July 3, 2006) for a total consideration of \$95.2 million which was paid in cash. The goodwill associated with the acquisition of Prism and the remaining 25.1% of EasyPay represents the excess of cost over the fair value of acquired net assets. The goodwill is not deductible for taxation purposes. See note 2 for the allocation of the purchase price to the fair value of acquired net assets.

### Goodwill

The goodwill associated with the acquisition of Prism and the remaining 25.1% of EasyPay has been allocated to the Company's reportable segments, as follows:

	<b>Prism, July 3, 2006</b>	<b>EasyPay, October 1, 2006</b>
Transaction-based activities	\$ 30,200	\$ 5,586
Hardware, software and related technology sales	34,055	-
Total (see note 2)	\$ 64,255	\$ 5,586

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

	<b>Carrying value</b>
Balance as of July 1, 2006	\$ 13,923
Goodwill associated with the acquisition of Prism (see note 2)	64,255
Goodwill associated with the acquisition of EasyPay (see note 2)	5,586
Foreign currency adjustment <sup>(1)</sup>	(117)
Balance as of March 31, 2007	\$ 83,647

(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.

Summarized below is the movement in the carrying value of goodwill for the year ended June 30, 2006.

	<b>Carrying value</b>
Balance as of June 30, 2005	\$ 14,636
Foreign currency adjustment <sup>(1)</sup>	(713)
Balance as of June 30, 2006	\$ 13,923

(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.

As required by FAS 141 goodwill has been allocated to the Company's reportable segments as follows:

	<b>As of March 31, 2007</b>	<b>As of June 30, 2006</b>
Transaction-based activities	\$ 38,298	\$ 2,338
Smart card accounts	-	-



Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

Financial services	4,874	4,880
Hardware, software and related technology sales	40,475	6,705
Total	\$ 83,647	\$ 13,923

11

---

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

Summarized below are the fair value of the intangible assets acquired, translated at the exchange rate applicable as of July 3, 2006, and the weighted-average amortization period of these intangible assets:

	Fair value as of July 3, 2006	Weighted- Average Amortization period (in years)
Finite-lived intangible assets:		
Customer relationships	\$ 14,007	3 15
Software and unpatented technology	10,601	3
Trademarks	3,292	5 20
Total Prism finite-lived intangible assets acquired (see note 2)	\$ 27,900	

A deferred tax liability of \$10.3 million, at exchange rates applicable as of July 3, 2006, was recognized on the acquisition date related to the intangible assets acquired.

Summarized below are the fair value of the intangible assets related to the remaining 25.1% of EasyPay acquired, translated at the exchange rate applicable as of October 1, 2006, and the weighted-average amortization period of these intangible assets:

	Total fair value as of October 1, 2006	25.1% of fair value as of October 1, 2006	Weighted- Average Amortization period (in years)
Finite-lived intangible assets:			
Customer relationships	\$ 12,094	\$ 3,036	3 15
Software and unpatented technology	1,490	374	3
Trademarks	2,571	\$ 645	5 20
Total finite-lived intangible assets acquired (see note 2)	\$ 16,155		

A deferred tax liability of \$1.2 million, at exchange rates applicable as of October 1, 2006, was recognized on October 1, 2006 related to the intangible assets acquired.

Summarized below is the carrying value and accumulated amortization of the intangible assets as of March 31, 2007 and June 30, 2006:

	As of March 31, 2007			As of June 30, 2006		
	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
Finite-lived intangible assets:						
Customer relationships	\$ 17,158	\$ (1,018)	\$ 16,140	-	-	-
Software and unpatented technology	10,915	(2,701)	8,214	-	-	-
FTS patent	5,265	(3,555)	1,710	\$ 5,270	\$ (3,163)	\$ 2,107
Exclusive licenses	4,506	(1,835)	2,671	4,506	(1,349)	3,157
Trademarks	3,959	(271)	3,688	-	-	-

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

Contract rights	2,305	(2,305)	-	2,308	(1,987)	321
Customer contracts	114	(68)	46	114	(50)	64
Total finite-lived intangible assets	\$ 44,222	\$ (11,753)	\$ 32,469	\$ 12,198	\$ (6,549)	\$ 5,649

Aggregate amortization expense on the finite-lived intangible assets for the three and nine months ended March 31, 2007 was approximately \$1.7 million and \$5.2 million, respectively (three and nine months ended March 31, 2006 was approximately \$0.5 million and \$1.6 million, respectively). Future annual amortization expense is estimated at approximately \$6.7 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 a result of utilizing approximately \$95.2 million of its cash to acquire Prism on July 3, 2006, the Company was required, from time to time, to draw down on its short-term facilities in order to meet its obligations to distribute social welfare grants. As of March 31, 2007, the Company had short-term facilities of approximately \$92.6 million, translated at exchange rates applicable as of March 31, 2007. The interest rates applicable to these short-term facilities range from the South African prime overdraft rate (12.5% per annum at March 31, 2007) to the South African prime overdraft rate less 225 basis points. The Company's management believes its current short-term facilities are adequate in order to meet its future obligations to distribute social welfare grants.

On March 30, 2007, a duplicate payment of approximately \$18.8 million was erroneously deposited into the Company's bank account. The amount was remitted to the sender on April 5, 2007. This amount is not included in our cash and cash equivalents and other payables as of March 31, 2007, and has not been included in the Company's unaudited condensed consolidated statements of cash flows for the three and nine months ended March 31, 2007.

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

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

During the three and nine months ended March 31, 2007, 394,095 and 1,263,778 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 2,903,857 and 9,312,046 linked units during the three and nine months ended March 31, 2007. The net result of these conversions was that 2,903,857 and 9,312,046 B class preference shares and B class loans were ceded to Net1 during the three and nine months ended March 31, 2007, which converted 394,095 and 1,263,778 shares of special convertible preferred stock to 394,095 and 1,263,778 common stock in return for the ownership of 2,903,857 and 9,312,046 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 1,263,778 and the number of outstanding shares of special convertible preferred stock has decreased by 1,263,778. In addition, as a consequence of the conversion, Net1 now owns 192,388,481 B class preferred shares and B class loans. The reduction in the B class preference shares from \$0.009 million to \$0.007 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 10 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, 2006, 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 months ended March 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 (56.9 million) of common stock (50.8 million) and special convertible preferred stock (6.1 million) in issue. Diluted earnings per share has 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.

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

The basic earnings per share for the three months ended March 31, 2006, for the common stock and linked units are the same and is calculated by dividing the net income by the combined number (56.7 million) of common stock (48.0 million) and special convertible preferred stock (8.7 million) in issue. Included in the weighted average number of shares in issue to calculate earnings and diluted earnings per share were 1,538,794 shares of the Company's common stock issued in connection with the Company's August 2005 public offering.

The basic earnings per share for the nine months ended March 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 (56.9 million) of common stock (50.8 million) and special convertible preferred stock (6.1 million) in issue.

The basic earnings per share for the nine months ended March 31, 2006, for the common stock and linked units are the same and is calculated by dividing the net income by the combined weighted average number (56.4 million) of common stock (47.8 million) and special convertible preferred stock (8.6 million) in issue. Included in the weighted average number of shares in issue to calculate earnings and diluted earnings per share were 1,538,794 shares of the Company's common stock issued in connection with the Company's August 2005 public offering.

**9. Earnings per share (continued)**

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

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>March 31,</b>		<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>000</b>	<b>000</b>	<b>000</b>	<b>000</b>
Weighted average number of outstanding shares of				
common stock basic	50,878	48,010	50,872	47,781
Weighted average effect of dilutive securities:				
employee stock options	500	781	489	763
Weighted average number of outstanding shares of				
common stock diluted	51,378	48,791	51,361	48,544
	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>March 31,</b>		<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>000</b>	<b>000</b>	<b>000</b>	<b>000</b>
Weighted average number of outstanding linked units				
basic	6,051	8,661	6,051	8,661
Weighted average effect of dilutive securities:				
employee stock options	60	141	58	139
Weighted average number of outstanding linked units				
diluted	6,111	8,802	6,109	8,800
	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>March 31,</b>		<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>000</b>	<b>000</b>	<b>000</b>	<b>000</b>
Total weighted average number of outstanding shares				
used to calculate earnings per share basic	56,929	56,671	56,923	56,442
Total weighted average number of outstanding shares				
used to calculate earnings per share diluted	57,489	57,593	57,470	57,344

**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 nine months ended March 31, 2007 and 2006 was:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>March 31,</b>		<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net income	\$ 18,253	\$ 16,576	\$ 46,148	\$ 43,687
Foreign currency translation adjustments	(5,206)	1,958	771	9,053
	\$ 13,047	\$ 18,534	\$ 46,919	\$ 52,740

## 11. Share-based payments

### Stock options

#### Options granted under 2004 Stock Incentive Plan

In 2004, all stock options available for grant under the Company's 2004 Stock Incentive Plan (the "Plan") were granted to the Company's directors, officers, other employees and other eligible participants as non-qualified stock options. Of these options, 20% became exercisable on the date of grant, and 20% of the remaining options become exercisable on first, second, third and fourth anniversaries of the date of grant. The options expire ten years from date of grant. Under the rules governing the stock options, those stock options held by persons other than directors and executive officers are automatically exercised on the date they first become exercisable, with payment upon exercise provided by a loan from the Company to the option holder. Such loans are on a recourse basis and bear interest at market rates. Stock options held by directors and executive officers are not automatically exercised when they first become exercisable and no loan is extended for the payment for the exercise price upon exercise. All shares acquired upon exercise, whether held by directors, executive officers or others, may only be sold eleven months after they become exercisable, except as otherwise permitted by the Company's Remuneration Committee.

On December 1, 2006, the shareholders of the Company approved the amendment and restatement the Plan to increase, by 2,845,600 shares, the number of shares issuable under the Plan and to make other administrative revisions. On August 24, 2006, the Company granted 569,120 options at an exercise price of \$22.51 to employees of the Company, subject to the approval of the increase in the number of shares issuable under the Plan which was approved on December 1, 2006. These options become exercisable over a period of four and three quarter years commencing May 8, 2007. The period during which the options become exercisable are presented in the table below. The Company believes that it is reasonably likely that the employees will exercise the options as they become exercisable. Any unexercised options granted to the employee expire on August 24, 2016. The options were valued using the Cox Ross Rubinstein binomial model using the following assumptions:

Option exercisable	Market and Exercise Price (\$)	Expected life (in days)	Dividend yield	Risk free rate of return	Estimated expected volatility
On or after May 8, 2007 and prior to May 8, 2008	22.51	257	0%	4.8745%	25%
On or after May 8, 2008 and prior to May 8, 2009	22.51	622	0%	4.8053%	26%
On or after May 8, 2009 and prior to May 8, 2010	22.51	987	0%	4.7572%	30%
On or after May 8, 2010 and prior to May 8, 2011	22.51	1,352	0%	4.7664%	33%
On or after May 8, 2011	22.51	1,717	0%	4.7905%	35%

The estimated expected volatility was calculated based on the volatilities of similar listed companies within the payment processing industry. Using the Cox Ross Rubinstein binomial model, the fair value of these options on the grant date was approximately \$3.0 million. There are no tax consequences related to these options.

Awards that expire or are cancelled without delivery of shares generally become available for issuance under the Plan.

#### Other stock options

In January 2006, 200,000 non-qualified stock options were issued at an exercise price of \$30.71 per option to a new employee of the Company. The employee resigned on September 13, 2006 and because none of these options had become exercisable prior to the resignation date, the compensation charge of approximately \$0.2 million included in additional paid in capital and retained earnings has been reversed. In addition, the deferred tax asset and associated valuation allowance related to the 200,000 stock options has been reversed.





**11. Share-based payments (continued)***Stock options (continued)*

## Options granted to employees of Prism

In August 2006, 904,674 non-qualified stock options were issued at an exercise price of \$22.51 per option to employees of Prism. These options become exercisable over a period of four and three quarter years commencing May 8, 2007. The period during which the options become exercisable are presented in the table below. The Company believes that it is reasonably likely that the Prism employees will exercise the options one year after the option becomes exercisable. Any unexercised options granted to the employee expire on August 24, 2016. The options were valued using the Cox Ross Rubinstein binomial model using the following assumptions:

<b>Option exercisable</b>	<b>Market and Exercise Price (\$)</b>	<b>Expected life (in days)</b>	<b>Dividend yield</b>	<b>Risk free rate of return</b>	<b>Estimated expected volatility</b>
On or after May 8, 2007 and prior to May 8, 2008	22.51	730	0%	4.8745%	25%
On or after May 8, 2008 and prior to May 8, 2009	22.51	1,095	0%	4.8053%	26%
On or after May 8, 2009 and prior to May 8, 2010	22.51	1,460	0%	4.7572%	30%
On or after May 8, 2010 and prior to May 8, 2011	22.51	1,825	0%	4.7664%	33%
On or after May 8, 2011	22.51	2,190	0%	4.7905%	35%

The estimated expected volatility was calculated based on the volatilities of similar listed companies within the payment processing industry. Using the Cox Ross Rubinstein binomial model, the fair value of these options on the grant date was approximately \$5.7 million. Management has estimated forfeitures based on historic employee behavior under similar compensation plans. There are no tax consequences related to these options.

During the three and nine months ended March 31, 2007, Prism employee resignations and terminations resulted in forfeitures of 113,872 and 237,954 options, respectively.

The Company has recorded a net stock compensation charge of \$0.2 million and \$0.7 million for the three and nine months ended March 31, 2007, which comprised:

	<b>Total charge (benefit)</b>	<b>Allocated to cost of goods sold, IT processing, servicing and support</b>	<b>Allocated to general and administration</b>
<b>Three months ended March 31, 2007</b>			
Options granted to employees of Prism	\$ 37	\$ 19	\$ 18
Options granted to employees on August 24, 2006	153	-	153
<b>Total three months ended March 31, 2007</b>	<b>\$ 190</b>	<b>\$ 19</b>	<b>\$ 171</b>
<b>Nine months ended March 31, 2007</b>			
Options granted in January 2006	\$ 66	-	\$ 66
Options granted to employees of Prism	462	\$ 237	225
Options granted to employees on August 24, 2006	374	-	374
Reversal of stock compensation charge related to options			

granted in January 2006		(216)		-		(216)
Total - nine months ended March 31, 2007	\$	686	\$	237	\$	449

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

As of March 31, 2007, the total unrecognized compensation cost related to stock options was approximately \$7.8 million, which the Company expects to recognize over approximately 4.25 years. As of March 31, 2007, the interest due from employees related to loans extended to fund stock option exercises was approximately \$0.04 million.

**11. Share-based payments (continued)**

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

		Number of shares	Weighted average exercise price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Balance outstanding	July 1, 2005	1,088,762	\$ 3.00	9.00	-
Exercised		(66,664)	3.00	-	\$ 1,267
Balance outstanding	December 31, 2005	1,022,098	3.00	8.50	26,421
Granted to new employee		200,000	30.71	10.00	
Balance outstanding	March 31, 2006	1,222,098	\$ 7.54	8.50	\$ 25,859
					-
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
Forfeitures		(113,872)	-	-	-
Balance outstanding	March 31, 2007	1,851,901	16.0	8.4	\$ 16,575
Exercisable		24,999	\$ 3.00	7.50	\$ 549

During the three and nine months ended March 31, 2007 and 2006, the following activity occurred under the Company's 2004 Stock Incentive Plan:

	Three months ended March 31,		Nine months ended March 31,	
	2007	2006	2007	2006
Total intrinsic value of stock options exercised	\$ -	\$ -	\$ 339	\$ 1,267

No stock awards became exercisable during the three and nine months ended March 31, 2007 and 2006.

In September 2006, the Company received approximately \$0.05 million from an employee exercising stock options. The Company does not anticipate receiving any tax benefits from the exercise of options by employees.

The Company issues new shares to satisfy stock option exercises.

## 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 operations of Prism have been allocated to two of the existing reportable segments of the Company as the chief operating decision maker has currently been analyzing the business on this basis.

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 nine months ended March 31, 2007, there were three such customers, providing 29%, 21% and 16%, and 33%, 16% and 14%, respectively, of total revenue (each of the three and nine months ended March 31, 2006: three such customers, providing 44%, 24% and 14% and 37%, 19% and 11%, 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 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. Sales to SmartSwitch Nigeria Limited and the related taxation implications are not reflected in revenue to external customers, operating income, income taxation expense or net income after taxation presented in the tables below.

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 March 31,		Nine months ended March 31,	
	2007	2006	2007	2006
Revenues to external customers				
Transaction-based activities	\$ 40,962	\$ 31,767	\$ 103,172	\$ 86,840
Smart card accounts	8,655	9,570	25,722	26,866
Financial services	2,858	4,200	8,636	12,456
Hardware, software and related technology sales	8,800	9,047	26,242	21,738
Total	61,275	54,584	163,772	147,900
Inter-company revenues				
Transaction-based activities	1,030	1,130	3,042	3,151
Smart card accounts	-	-	-	-
Financial services	-	-	-	-
Hardware, software and related technology sales	62	-	11,513	-
Total	1,092	1,130	14,555	3,151
Operating income				
Transaction-based activities	24,869	16,428	60,799	44,077
Smart card accounts	3,934	4,351	11,692	12,212
Financial services	930	1,782	2,758	5,454
Hardware, software and related technology sales	991	5,449	2,621	13,390
Corporate/Eliminations	(1,656)	(2,968)	(5,485)	(8,521)
Total	29,068	25,042	72,385	66,612
Interest earned				
Transaction-based activities	-	-	-	-
Smart card accounts	-	-	-	-
Financial services	-	-	-	-
Hardware, software and related technology sales	-	-	-	-
Corporate/Eliminations	4,147	4,019	11,018	10,356
Total	4,147	4,019	11,018	10,356
Interest expense				

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

Transaction-based activities	3,383		2,476		8,042		6,414
Smart card accounts	-		-		-		-
Financial services	-		8		1		20
Hardware, software and related technology sales	4		-		10		141
	25		-		172		-
Corporate/Eliminations							
Total	3,412		2,484		8,225		6,575
Depreciation and amortization							
Transaction-based activities	1,206		982		3,824		3,106
Smart card accounts	-		-		-		-
Financial services	101		123		305		347
Hardware, software and related technology sales	1,145		-		3,402		-
	300		323		981		878
Corporate/Eliminations							
Total	\$ 2,752	\$	1,428	\$	8,512	\$	4,331

**12. Operating segments (continued)**

	Three months ended March 31,		Nine months ended March 31,	
	2007	2006	2007	2006
<b>Income taxation expense</b>				
Transaction-based activities	\$ 6,331	\$ 4,037	\$ 15,387	\$ 10,897
Smart card accounts	1,141	1,261	3,391	3,540
Financial services	270	515	800	1,576
Hardware, software and related technology sales	307	1,571	760	3,832
	3,348	2,690	8,589	7,217
Corporate/Eliminations				
Total	11,397	10,074	28,927	27,062
<b>Net income after taxation</b>				
Transaction-based activities	15,155	9,913	37,370	26,765
Smart card accounts	2,794	3,090	8,301	8,672
Financial services	660	1,260	1,957	3,860
Hardware, software and related technology sales	637	3,878	1,805	9,416
	(993)	(1,565)	(3,285)	(5,026)
Corporate/Eliminations				
Total	18,253	16,576	46,148	43,687
<b>Segment assets</b>				
Total	351,339	282,075	351,339	282,075
<b>Expenditures for long-lived assets</b>				
Transaction-based activities	804	242	2,115	910
Smart card accounts	-	-	-	-
Financial services	54	73	155	293
Hardware, software and related technology sales	85	-	376	-
	-	-	-	-
Corporate/Eliminations				
Total	\$ 943	\$ 315	\$ 2,646	\$ 1,203

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.

**13. Costs related to public offering and Nasdaq listing**



Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

The Company completed a public offering and Nasdaq listing in August 2005. The Company incurred the following costs in connection with this transaction during the three and nine months ended March 31, 2006.

	<b>Three months ended March 31, 2006</b>	<b>Nine months ended March 31, 2006</b>
Legal fees	\$ 25	1,007
Printing	-	243
Accounting fees	-	25
Regulatory and filing fees	-	165
Other	-	89
Total costs related to public offering and Nasdaq listing	\$ 25	1,529

The Other category includes costs to date related to venue hire, travel, bank charges and other miscellaneous expenses related to the public offering and Nasdaq listing. All costs related to the public offering are non-deductible for taxation purposes.

Underwriting discounts and commissions of \$2.4 million were incurred relating to underwriters exercising their over allotment option. The discounts and commissions have been charged directly to additional paid-in capital.

**14. 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 nine month ended March 31, 2007, the tax charge was calculated using the expected effective tax rate for the year (36.89%) and our effective tax rate for the three and nine months ended March 31, 2007 is 38.2% and 38.5%, respectively.

## **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. On June 7, 2004, we completed a transaction, which we more fully describe in our Annual Report on Form 10-K for the year ended June 30, 2005 in which the former shareholders of Net1 Applied Technology Holdings Limited, or Aplitec, acquired a majority voting interest in us. In accordance with U.S. generally accepted accounting principles, or GAAP, we accounted for the Aplitec transaction as a reverse acquisition, which requires that the company whose shareholders retain a majority voting interest in a combined business be treated as the acquiror for accounting purposes. References to we, our and us refer to Net1 and its consolidated subsidiaries including Aplitec, unless the context otherwise requires. When we refer to Net1, we are referring solely to Net 1 UEPS Technologies, Inc.

### **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, 2006. 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.

### **Overview**

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

South Africa is the first major market where we achieved significant success and a high penetration rate in the areas we targeted. We believe that our operating experience in South Africa demonstrates the success of our business model in a developing economy. According to estimates made by Statistics South Africa, or StatsSA, as of mid-2006, South Africa has a population of approximately 47.4 million people, of which an estimated 50% live below the poverty line. As of September 2006, StatsSA estimated that the South African unemployment rate is approximately 25.5% . The success we have achieved in South Africa since commencing operations in December 1997 has primarily resulted from servicing the needs of the poorest section of the population – those who are dependent on government social welfare grants. We have designed and implemented a complete business model involving the payment, and subsequent spending, of these grants through our smart cards and UEPS technology, which provides us with the opportunity to earn multiple sources of revenue and provides our card holders with affordable functionality and lifestyle improvement. The South African government is also actively involved in a number of initiatives which may present us with opportunities to export our South African achievements, such as the New Partnership for Africa's Development and the India-Brazil-South Africa Dialogue Forum, which is currently considering the establishment of an economic trade bloc between these three countries.

In July 2004, we began a major drive to install point of service, or POS, devices at merchants located in rural areas where the majority of our card holders spend their social welfare grants. The ability of our card holders to load their grants at these retailers and to spend these grants securely on goods and services, without the need to withdraw the full amount in cash, represents one of the basic underlying principles of the UEPS functionality. We believe that the installation of these POS devices has resulted in a significant improvement in the lifestyle of our card holders, while introducing a new revenue source for us in the form of merchant acquiring and other transaction fees. Use of the POS devices also lowers our costs by reducing the amount of cash we need to deliver to social welfare beneficiaries in cash at our mobile pay points. We discuss the progress of our merchant acquiring efforts since implementation of these efforts under **Progress of Our Merchant Acquiring System**.

In July 2006, we acquired Prism Holdings Limited, or Prism, which owns EasyPay (Proprietary) Limited, or EasyPay, the largest bank-independent financial switch, or transaction processor, in Southern Africa. The bulk of the 358 million transactions processed by EasyPay during the year ended June 30, 2006, on behalf of retailers, bill issuers and financial institutions were transacted through a base of around 50,000 customer owned terminals, the majority of which are installed at all the retail locations of South Africa's two largest retailers, who have approximately 65% of the South African retail market share between them. The addition of the Prism merchant acquiring network will extend our footprint in South Africa from the deep rural areas, where we are active today, to the urban environment. We intend to upgrade, where appropriate, the 50,000 terminals that form part of Prism's network to accommodate our biometric-based UEPS technology, which will significantly enhance our wage payment program once we launch that service.

We believe that the acquisition of Prism will also help us extend our ability to deliver solutions across the entire spectrum of transaction processing and assist us in expanding our international operations throughout Africa, Asia and Europe. The results of Prism's operations are reflected in our financial statements from July 3, 2006. We have also begun to explore strategic partnership and business opportunities across the Americas. For example, we are in the process of launching a Virtual Top-up, or VTU, solution in Colombia.

The implementation of new UEPS systems, particularly in developing economies outside our current markets, is a vital component of our future growth. We have implemented or are in the process of implementing our systems on the African continent outside South Africa. During fiscal 2006, we formed joint ventures with government entities and financial institutions to operate UEPS smart card-based switching systems in Namibia, Botswana and Nigeria. These joint ventures, which are described in more detail under **International Expansion**, are in various stages of development and operation.

### **Seasonality of Transaction-based Activities**

We experience seasonality in our transaction-based activities operating segment. Our beneficiaries are able to load their grants onto their cards as soon as the grant payment file is activated, which typically happens during the week preceding the commencement of a calendar month. We recognize the fee revenue related to the distribution of welfare grants when the beneficiaries load the grants to their cards. The general exception to this rule is the January payment cycle, when the activation of the payment file is done on a limited basis at merchant locations only. As a result, the revenue recognized in the second quarter of our fiscal year is generally lower than the other three quarters due to the limited number of grants distributed during the last week of December. The activation of the payment file for any month also depends on whether the first calendar day of a month is a weekday, or a Saturday, Sunday or public holiday.

### **South African Provincial Contracts**

We currently derive the majority of our revenues from our contracts with various South African provincial governments. The South African national government passed legislation in 2004 for the creation of the South African Social Security Agency, or SASSA. The primary purpose of SASSA is to consolidate at the central government level

the administration of social welfare grants. SASSA commenced operations on April 1, 2006.

On January 31, 2007 we received official notification from SASSA that our five existing contracts, which expired at the end of December 2006, have been extended until March 31, 2008. In February 2007 SASSA issued a request to submit proposals for the provision of payments services to social assistance grant recipients, or RFP. Pursuant to the RFP, potential bidders are invited to submit proposals for the provision of a payment service to social welfare grant recipients on province-by-province basis or for all of South Africa's nine provinces. According to the RFP, submissions of proposals were due by May 4, 2007, and the final evaluation process will be completed by July 13, 2007. Implementation of the new contract will commence on April 1, 2008. On May 4, 2007 we filed proposals for each of South Africa's nine provinces, as well as a proposal for the entire country.

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 the 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.

### Progress of Our Merchant Acquiring System

We have completed the installation of our POS terminals at the majority of those merchant locations we deem the most important to service the bulk of our cardholder base. The productivity of the existing terminal base continues to improve, as is evident from the increase in the number of transactions processed per POS terminal installed. We believe that the existing terminal base has reached or is close to saturation and do not expect significant growth in future. Our ongoing POS deployment plan is now focused on secondary locations and retailers, where we will install fewer terminals over a longer period of time. The acquisition of EasyPay provides us with potential access to an existing terminal base of approximately 50,000 customer owned terminals, the majority of which are situated in retailers in the urban and semi-urban areas of South Africa. These 50,000 terminals were acquired from Prism in prior periods and are owned by the retailers. In order for these terminals to become UEPS enabled, we will need to equip these terminals with biometric readers and install our UEPS software. We have already successfully demonstrated the integration of the biometric readers to the major retailers and we are currently negotiating the commercial terms and conditions of implementing the biometric solution.

The key statistics and indicators of our merchant acquiring system on a quarterly basis during the last 18 months in each of the South African provinces where we distribute social welfare grants are summarized in the table below:

**Table 1**

	<b>Three months ended</b>					
	<b>Dec. 31, 2005</b>	<b>Mar. 31, 2006</b>	<b>Jun. 30, 2006</b>	<b>Sept. 30, 2006</b>	<b>Dec. 31, 2006</b>	<b>Mar. 31, 2007</b>
Province included (1)	NC, EC, KZN, L and NW	NC, EC, KZN, L and NW	NC, EC, KZN, L and NW	NC, EC, KZN, L and NW	NC, EC, KZN, L and NW	NC, EC, KZN, L and NW
Total POS devices installed	3,929	3,905	4,038	4,169	4,145	4,179
Number of participating UEPS retail locations	2,366	2,352	2,381	2,468	2,443	2,511
Value of transactions processed through POS devices during the quarter (2) (in \$ 000)	118,396	187,841	189,649	202,299	185,190	237,993
Value of transactions processed through POS devices during the completed pay cycles for the quarter (3) (in \$ 000)	127,765	171,022	187,769	189,139	188,074	225,294
Value of transactions processed through POS devices during the quarter (2) (in ZAR 000)	781,251	1,158,546	1,225,168	1,449,071	1,355,399	1,726,532
Value of transactions processed through POS devices during the completed pay cycles for the quarter (3) (in ZAR 000)	840,695	1,055,203	1,213,026	1,354,805	1,376,509	1,634,410
Number of grants paid through POS devices						

during the quarter (2)	1,496,384	2,518,296	2,554,616	2,976,558	2,788,529	3,517,338
Number of grants paid through POS devices						
during the completed pay cycles for the quarter						
(3)	1,855,192	2,288,883	2,537,377	2,784,170	2,838,969	3,359,772
Average number of grants processed per terminal during the quarter (2)	379	643	643	725	671	845
Average number of grants processed per terminal during the completed pay cycles for the quarter (3)	470	584	639	678	683	807

(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. As discussed above under -Overview - Seasonality of Transaction-based Activities the grant payment file is typically activated during the week preceding the commencement of a calendar month.



The following chart presents the number of POS devices installed and the average spend per POS device, *per pay cycle*, during the 15 month period ended March 31, 2007:

The following chart presents the number of POS devices installed and the average spend per POS device, *per calendar month*, during the 15 month period ended March 31, 2007:



The following chart presents the growth in the value of loads at merchant locations and the transactions (expenditures) processed through our installed base of POS devices, *per pay cycle*, during the 15 month period ended March 31, 2007:

The following chart presents the growth in the value of loads at merchant locations and the transactions (expenditures), *per calendar month*, processed through our installed base of POS devices during the 15 month period ended March 31, 2007:



The following graph presents the number of social welfare grants loaded at merchant locations, *per pay cycle*, for the 15 month period ended March 31, 2007:

The following graph presents the number of social welfare grants loaded at merchant locations, *per calendar month*, for the 15 month period ended March 31, 2007:



## **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.

The system, the first of its kind in Namibia, is intended to improve the banking system in the country. NamPost, as the first customer of the switch, is expected to increase its market share in the financial services arena and position itself as the leading service provider for the un-banked and under-banked citizens of Namibia. NamPost has informed us that as of March 31, 2007, it had acquired 57,595 new clients as a direct result of the implementation of the UEPS technology.

As of March 31, 2007, SmartSwitch Namibia has activated 164,657 UEPS smart cards and has signed up 137 merchants to accept the UEPS smart cards. SmartSwitch Namibia has launched our UEPS-based prepaid electricity system with Payzone, a Namibian-based company that distributes electricity on behalf of the Windhoek Town Council. This solution will facilitate the sale of prepaid electricity in rural and urban areas using the UEPS system to secure, authenticate and collect payments on behalf of the participating municipalities.

Phase 1 of the project involves the transfer of all of NamPost's banking products to the smart card, offering affordability, security, simplicity and flexibility. Negotiations are currently underway with other financial institutions and companies that wish to participate as customers of SmartSwitch Namibia. Through SmartSwitch Namibia, NamPost is currently expanding its offering to include medical identification and life insurance sales and premium collection. Negotiations with the service providers are at an advanced stage. We expect the suite of smart card applications to include banking, retail, money transfers, third party bill payments, wages and social security grants.

During the third quarter of fiscal 2007 we completed the development of NamPost's investment products including Save as you Earn, Saving Certificates and Fixed Term Deposits which we expect will be used by local and foreign depositors.

As we own 50% of SmartSwitch Namibia, we are required under US GAAP to eliminate 50% of the net income generated from sales to SmartSwitch Namibia. In accordance with US GAAP, we will recognize this net income from these hardware and software sales during the period in which the hardware and software we have sold to SmartSwitch Namibia is utilized in its operations, or has been sold to third party customers, as the case may be.

SmartSwitch Namibia officially commenced operations during February 2006. During the year ended June 30, 2006, software and hardware were made available for collection to SmartSwitch Namibia and we have recognized net income related to these software and hardware sales during the first, second and third quarters of fiscal 2007.

### *Botswana*

During the third quarter of fiscal 2006, we formed SmartSwitch Botswana (Proprietary) Limited, or SmartSwitch Botswana, to launch and operate a national UEPS smart card-based switching and settlement system in Botswana. We own 50% of the company 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.

We believe that SmartSwitch Botswana will be the first system of its kind in Botswana and we expect that it will have a substantial impact on the financial industry in Botswana. Capricorn, as the first user of the UEPS technology in Botswana, has advised us that it believes that it can substantially increase its market share in the financial services industry and position its group as the front runner in serving the un-banked and under-banked citizens of Botswana. The initial smart card applications offered to Capricorn's customer base will include banking and a suite of financial services and products such as micro-finance, short- and long-term insurance, health care, third party deductions, third party payments, money transfers, wage payments and retail.

Together with Capricorn we have capitalized SmartSwitch Botswana with approximately \$2.4 million (BWP 15.4 million, at June 30, 2006, foreign exchange rates), in start-up capital and loans, which was contributed equally by both parties. The proceeds will be utilized by SmartSwitch Botswana for the acquisition of hardware and software from us and for general working capital purposes.



In February 2007 SmartSwitch Botswana entered into a Micro Lender Deductions Service Level Agreement with Lesaka Information Technology Services (Proprietary) Limited, or LITS. LITS has been contracted by the Government of Botswana in the capacity of a Central Loan Registry to facilitate the following functions:

- receiving loan approval requests from accredited micro financiers that are LITS-accredited micro financiers that provide loans to employees of the Government of Botswana, or Micro Financiers, and have procured the services of LITS and/ or SmartSwitch Botswana ;
- screening and vetting of loan applications in terms of established loan criteria and onward transmission of approvals or repudiations to the Micro Financiers;
- receiving monthly loan deduction requests from Micro Financiers;
- testing monthly deduction files to ensure compliance with the rules by the Micro Financiers;
- onward transmission of monthly deduction files to the Ministry of Finance and Development Planning, or MFDP;
- receiving payment of the monthly deductions from the MFDP; and
- reconciling the monthly deduction payment from MFDP for onward payment to the respective Micro Financiers.

SmartSwitch Botswana has been appointed by LITS as its technology service provider to provide the technology needed to perform these functions.

During the three months ended March 31, 2007, SmartSwitch Botswana concluded a successful pilot to perform the required functions. On March 19, 2007, the first monthly loan deductions request was received from a micro financier by SmartSwitch Botswana. The monthly deduction file was tested for compliance with the rules by SmartSwitch Botswana and was transmitted to the MFDP on March 20, 2007. The monthly deduction file was used to run deductions against the Government of Botswana's April pay file.

### *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. SmartSwitch Nigeria requires UEPS hardware and software to the value of approximately \$14 million from us. The revenue and profit arising from these transactions between us and SmartSwitch Nigeria have been eliminated upon consolidation and we have fully consolidated the start-up losses incurred during the three and nine months ended March 31, 2007 by SmartSwitch Nigeria. We estimate to incur total start-up losses of approximately \$2.0 million during the implementation period.

One of SmartSwitch Nigeria's initial objectives is to have an impact on the financial industry in Nigeria, where approximately 90% of the population of 140 million people is un-banked and transacts in cash. SmartSwitch Nigeria's other objectives will be to deploy the UEPS technology through several applications, including banking, health care, money transfers, pre-paid utilities and telephony and voting.

Diamond Bank, one of Nigeria's largest banking institutions, has ordered 50,000 smart cards from us for their initial deployment into the village community bank. SmartSwitch Nigeria, together with Diamond Bank, has applied for permission from the Central Bank of Nigeria to conduct a multi-lateral clearing and settlement system that will allow other financial institutions to participate in the switch.

SmartSwitch Nigeria and selected partners have tendered to provide the Nigerian government with a multi-purpose smart card. The multi-purpose card tender comprises:

- a national identity authentication/ verification system,
- a government financial payments for services system, and

- an affordable banking solution.

The Nigerian government is currently evaluating the tender submissions. Our consortium is one of the two remaining bidders and we expect the outcome of the tender to be finalized when the newly elected Nigerian government resumes with their duties.

During the three months ended March 31, 2007, we completed the SmartSwitch Nigeria computer room which houses the UEPS backend processing hardware and software in Nigeria. In addition, the switch has been commissioned and the required Nigerian staff have been appointed and trained.

We expect SmartSwitch Nigeria to become fully operative during the first quarter of fiscal 2008.

*Colombia and Vietnam*

We are at various stages of implementation of our VTU solution in Colombia and Vietnam. We have concluded shareholder and loans agreements with partners in Colombia and Vietnam to set up VTU services. In Colombia, we own 50% of VTU De Colombia SA, or VTU Colombia, and have fully installed and integrated the VTU system and have commenced a limited and low profile pilot with the Colombia's third largest mobile operator. In addition, agreements have been concluded with VTU Colombia's initial and primary distribution partner to deploy VTU enabled handsets through its national distribution and salesforce. We expect live transactions in the city of Bogota to commence towards the end of May 2007 once a significant initial batch of VTU Subscriber Identity Module, or SIM, cards have been delivered and the network operator has agreed to a full public announcement and launch date. VTU Colombia has also commenced preliminary discussions with the Colombia's largest mobile operator.

In Vietnam, we own 30% of Vietnam Payment Technologies, or Vinapay, and we expect Vinapay to be authorized and licensed to commence activities by the end of May 2007. We expect systems installation and integration to the first mobile operator to be concluded by mid-June 2007. In addition, we have commenced 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.

**Progress of wage payment implementation**

As discussed on our quarterly results conference call and in our quarterly filings on Form 10-Q and annual filings on Form 10-K, 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 late January 2007, we signed a co-operation agreement with Grindrod Bank Limited, or 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 will establish the division and will be responsible for the human resources, administration, compliance, risk management and financial affairs of the division. Net1 will be 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 5 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. In parallel, Net1 and Grindrod Bank have defined the products, pricing and marketing strategy for the wage payment system. We anticipate that the Grindrod Bank retail division will commence with the marketing of the wage payment solution during the fourth quarter of fiscal 2007.

## 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 12.5% 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 will be implemented in two phases, the first entailing a reduction of the STC rate, effective October 1, 2007, to 10% and the second, in 2008, a total conversion to a dividend tax. It is likely that South Africa companies will be required to withhold the dividend tax on all dividend paid.

We can not reasonably determine whether these proposals will be enacted as proposed and we will comply with the new tax legislation once it has been enacted. We expect the proposed replacement of STC with a dividend tax to reduce our current fully distributed rate of 36.89% to 29%. In addition, in terms of GAAP we apply the fully distributed rate of 36.89% to our deferred taxation assets and liabilities. The change in the fully distributed 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 nine months ended March 31, 2007 is deferred income tax expense of approximately \$2.3 million and \$6.2 million (ZAR 16.7 million and ZAR 44.1 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 tax. If the proposed amendments were enacted as of July 1, 2006, and a dividend tax at shareholder level were to be introduced, the following table illustrates the impact of the adjustments on our financial statements:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>March 31, 2007</b>		<b>March 31, 2007</b>	
	<b>Actual</b>	<b>Pro-forma</b>	<b>Actual</b>	<b>Pro-forma</b>
Income tax expense	11,397	9,078	28,927	22,741
Net deferred tax liability reversal to net income <sup>(1)</sup>	-	-	-	16,946
Earnings per share, in U.S. cents	32.1	36.2	81.1	92.0
Net deferred tax liability as at March 31	25,479	217	25,479	217

(1) the net deferred tax liability reversal to net income represents the net deferred tax liability rate adjustment as of June 30, 2006 translated at rates applicable as of June 30, 2006.

As discussed above, we can not reasonably determine whether, or when, these 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, 2006.

- Deferred taxation;
- 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 March 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 March 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 3</b>	<b>Three months ended</b>		<b>Nine months ended</b>		<b>Year ended June 30, 2006</b>
	<b>2007</b>	<b>March 31, 2006</b>	<b>2007</b>	<b>March 31, 2006</b>	
ZAR : \$ average exchange rate	7.2546	6.1688	7.2537	6.4178	6.4283
Highest ZAR : \$ rate during period	7.5375	6.3801	7.9748	6.9388	7.5323
Lowest ZAR : \$ rate during period	6.8715	5.9410	6.7193	5.9410	5.9256
Rate at end of period	7.2781	6.2557	7.2781	6.2557	7.2701

*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 nine months ended March 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:

**Table 4**

	<b>Three months ended</b>		<b>Nine months ended</b>		<b>Year ended</b>
	<b>2007</b>	<b>March 31,</b> <b>2006</b>	<b>2007</b>	<b>March 31,</b> <b>2006</b>	<b>June 30,</b> <b>2006</b>
Income and expense items: \$1 = ZAR.	7.2090	6.1709	7.2431	6.4025	6.4127
Balance sheet items: \$1 = ZAR	7.2781	6.2557	7.2781	6.2557	7.2701

32



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

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

- significant weakening of the South African rand, our functional currency, against the U.S. dollar, our reporting currency, which had a negative impact on our revenues and net income in U.S. dollars;
- receipt of a settlement payment from SASSA related to contract deviations and price increases;
- impact of the Prism acquisition, which has increased our reporting revenues and net income but has a negative impact on our operating margin;
- amortization of Prism and EasyPay-related intangible assets, which had a negative impact on our net income;
- continued decrease in margins in our traditional micro-lending operations; and
- increased revenues from continued adoption of our merchant acquiring system by cardholders.

### 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 (US GAAP)		
	Three months ended March 31,		
	2007 \$ 000	2006 \$ 000	\$% change
Revenue	61,275	54,584	12%
Cost of goods sold, IT processing, servicing and support .	13,940	14,469	(4)%
General and administration	15,515	13,620	14%
Depreciation and amortization	2,752	1,428	93%
Costs related to public offering and Nasdaq listing	-	25	
Operating income	29,068	25,042	16%
Interest income, net	735	1,535	(52)%
Income before income taxes	29,803	26,577	12%
Income tax expense	11,397	10,074	13%

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

Income before minority interest and earnings from equity-accounted investments	18,406	16,503	12%
Minority interest	-		
(Loss) Earnings from equity-accounted investments	(153)	73	
Net income	18,253	16,576	10%

33

**Table 6**

	<b>In South African Rand (US GAAP)</b>		
	<b>Three months ended March 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>ZAR</b>
	<b>ZAR 000</b>	<b>ZAR 000</b>	<b>%</b>
			<b>change</b>
Revenue	441,731	336,834	31%
Cost of goods sold, IT processing, servicing and support .	100,494	89,287	13%
General and administration	111,847	84,048	33%
Depreciation and amortization	19,839	8,812	125%
Costs related to public offering and Nasdaq listing	-	154	
Operating income	209,551	154,533	36%
Interest income, net	5,299	9,472	(44)%
Income before income taxes	214,850	164,005	31%
Income tax expense	82,161	62,166	32%
Income before minority interest and earnings from equity-accounted investments	132,689	101,839	30%
Minority interest	-	-	
(Loss) Earnings from equity-accounted investments	(1,103)	450	
Net income	131,586	102,289	29%

Analyzed in ZAR, the increase in revenue and cost of goods sold, IT processing, servicing and support for the three months ended March 31, 2007, was primarily due to the higher volumes in our transaction-based activities, a greater number of UEPS-based smart card holders, a settlement payment received from SASSA and the operations of Prism.

Our operating income margin for the three months ended March 31, 2007, increased to 47% compared with 46% for the three months ended March 31, 2006, primarily as a result of the continued adoption of our merchant acquiring system, increased volumes and pricing in our pension and welfare business and a settlement payment received from SASSA. The increase in our operating income margin during the quarter was reduced by the lower operating margins of the Prism business compared with our other operations and intangible amortization charges related to Prism intangible assets acquired.

General and administration expenses increased during the three months ended March 31, 2007 from the comparable quarter in 2006 primarily due to the inclusion of Prism's operations and increases in goods and services purchased from third parties, including the effects of the increase in inflation in South Africa.

Cost of goods sold, IT processing, servicing and support includes a stock-based compensation charge of \$0.02 million (ZAR 0.2 million) related to options granted to Prism employees. General and administration expenses includes a stock-based compensation charge of \$0.2 million (ZAR 1.5 million) related to options granted to employees. The stock-based compensation charges included in cost of goods sold, IT processing, servicing and support and general and administration are net of adjustments to the stock-based compensation charge related to adjustments as a result of forfeitures of \$0.1 million (ZAR 0.7 million) and \$0.1 million (ZAR 0.7 million), respectively.

Our total 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, resulted in expenditures of \$0.4 million (ZAR 2.6 million) and \$0.8 million (ZAR 5.1 million) during the three months ended March 31, 2007 and 2006.

The increase in depreciation and amortization during the three months ended March 31, 2007 compared to the three months ended March 31, 2006, was mainly due to the amortization of intangible assets acquired related to the

Prism acquisition as well as acquisition of the remaining 25.1% of EasyPay by Prism. The total amortization of these intangible assets during the three months ended March 31, 2007 was approximately \$1.4 million (ZAR 10.0 million). The deferred tax benefit included in our statement of operations related to the intangible amortization charge for the three months ended March 31, 2007 was \$0.5 million (ZAR 3.6 million). 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 March 31, 2007 compared with the three months ended March 31, 2006. This reduction in depreciation was partially offset by the increase in depreciation of our participating merchant POS terminals and Prism property, plant and equipment acquired.

Interest on surplus cash for the three months ended March 31, 2007 increased to \$4.1 million (ZAR 29.6 million) from \$4.0 million (ZAR 24.5 million) for the three months ended March 31, 2006. The increase in interest on surplus cash was due to the adjustment in the South African prime interest rate from an average of approximately 10.5% per annum for the three months ended March 31, 2006, to 12.50% per annum for the three months ended March 31, 2007 and the increase in the intended federal funds rate from an average of 4.43% per annum for the three months ended March 31, 2006 to 5.25% per annum for the three months ended March 31, 2007. The increase in the interest rates was partially offset by lower surplus cash balances as a result of the \$95.2 million paid in cash for the acquisition of Prism.

During the three months ended March 31, 2007, our finance costs increased due to an increase in our pre-funding obligation. Finance costs increased to \$3.4 million (ZAR 24.5 million) for the three months ended March 31, 2007, from \$2.5 million (ZAR 15.4 million) for the three months ended March 31, 2006.

Total tax expense for the three months ended March 31, 2007 was \$11.4 million (ZAR 82.2 million) compared with \$10.1 million (ZAR 62.2 million) during the same period in the comparable quarter of the prior fiscal year. The increase was due to our increased profitability in our transaction-based activities and the settlement payment received from SASSA.

Our effective tax rate for the three months ended March 31, 2007 was 38.2%, compared to 37.9% for the three months ended March 31, 2006. The change in our effective tax rate was primarily due to additional non-deductible expenses during the three months ended March 31, 2007 compared to the three months ended March 31, 2006.

For the three months ended March 31, 2007 and 2006, earnings from Permit totaled approximately \$0.2 million and \$0.05 million (ZAR 1.4 million and ZAR 0.3 million), respectively.

Included in (loss) earnings from equity accounted investments is a loss from equity accounted investment of approximately \$0.1 million (ZAR 0.7 million) and earnings from equity accounted investments of \$0.03 million (ZAR 0.2 million), before the realization of income from prior periods, related to SmartSwitch Namibia for the three months ended March 31, 2007 and 2006, respectively. During the three months ended March 31, 2007 we recognized income from license fees, software and hardware sales made to SmartSwitch Namibia in prior periods of approximately \$0.03 million (ZAR 0.2 million). This income has been included in earnings from equity accounted investments. During the three months ended March 31, 2006 we eliminated hardware sales and other services made to SmartSwitch Namibia of approximately \$0.01 million (ZAR 0.7 million).

(Loss) Earnings from equity-accounted investments includes a loss of \$0.1 million (ZAR 0.7 million) for the three months ended March 31, 2007 related to SmartSwitch Botswana. As of March 31, 2007, SmartSwitch Botswana had not commenced operations and therefore we have not recognized any equity-accounted earnings from SmartSwitch Botswana. We expect SmartSwitch Botswana to generate revenues during the three months ended June 30, 2007 but we do not expect SmartSwitch Botswana to generate net income during its first year of operations.

### Results of operations by operating segment

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

**Table 7**

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

<b>Operating Segment</b>	<b>2007</b>	<b>% of</b>	<b>2006</b>	<b>% of</b>	<b>%</b>
	<b>\$ 000</b>	<b>total</b>	<b>\$ 000</b>	<b>total</b>	<b>change</b>
Consolidated revenue:					
Transaction-based activities	40,962	67%	31,767	58%	29%

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

Smart card accounts	8,655	14%	9,570	18%	(10)%
Financial services	2,858	5%	4,200	8%	(32)%
Hardware, software and related technology sales	8,800	14%	9,047	16%	(3)%
<b>Total consolidated revenue</b>	<b>61,275</b>	<b>100%</b>	<b>54,584</b>	<b>100%</b>	<b>12%</b>
Consolidated operating income (loss):					
Transaction-based activities	24,869	86%	16,428	66%	51%
Smart card accounts	3,934	14%	4,351	17%	(10)%
Financial services	930	3%	1,782	7%	(48)%
Hardware, software and related technology sales	991	3%	5,449	22%	(82)%
Corporate/eliminations	(1,656)	(6)%	(2,968)	(12)%	(44)%
<b>Total consolidated operating income</b>	<b>29,068</b>	<b>100%</b>	<b>25,042</b>	<b>100%</b>	<b>16%</b>

35

**Table 8***In South African Rand (US GAAP)  
Three months ended March 31,*

<b>Operating Segment</b>	<b>2007 ZAR 000</b>	<b>% of total</b>	<b>2006 ZAR 000</b>	<b>% of total</b>	<b>% change</b>
<b>Consolidated revenue:</b>					
Transaction-based activities	295,295	67%	196,032	58%	51%
Smart card accounts	62,394	14%	59,056	18%	6%
Financial services	20,603	5%	25,918	8%	(21)%
Hardware, software and related technology sales	63,439	14%	55,828	16%	14%
<b>Total consolidated revenue</b>	<b>441,731</b>	<b>100%</b>	<b>336,834</b>	<b>100%</b>	<b>31%</b>
<b>Consolidated operating income (loss):</b>					
Transaction-based activities	179,281	86%	101,376	66%	77%
Smart card accounts	28,360	14%	26,850	17%	6%
Financial services	6,704	3%	10,997	7%	(39)%
Hardware, software and related technology sales	7,144	3%	33,625	22%	(79)%
Corporate/eliminations	(11,938)	(6)%	(18,315)	(12)%	(35)%
<b>Total consolidated operating income</b>	<b>209,551</b>	<b>100%</b>	<b>154,533</b>	<b>100%</b>	<b>36%</b>
<b>Transaction-based activities</b>					

In U.S. dollars, revenues increased by 29% for the three months ended March 31, 2007, from the three months ended March 31, 2006. Operating income increased by 51% for the three months ended March 31, 2007 from the three months ended March 31, 2006.

In ZAR, revenues increased by 51% for the three months ended March 31, 2007, from the three months ended March 31, 2006. Operating income increased by 77% for the three months ended March 31, 2007 from the three months ended March 31, 2006.

These increases in revenues and operating income were due primarily to the continued adoption of our merchant acquiring system in the provinces where we distribute welfare grants, increased transacting ability at participating retailers POS devices in these provinces, higher volumes from all of our provincial contracts, settlement payment received from SASSA and the inclusion of transaction fees generated by EasyPay. 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 March 31, 2007 increased to 61% from 52% for the three months ended March 31, 2006. These profit margin improvements were mainly due to:

- the increased volumes as detailed in the table below;
- the inflation adjustment to the price charged in the Limpopo, North West and Eastern Cape provinces;
- the increase in the number of social grant beneficiaries paid through our POS device infrastructure at participating retailers, instead of payment using more costly automated cash dispensers; and
- the settlement payment received.

*Continued adoption of our merchant acquiring system:*

Refer to discussion under Overview Progress of Our Merchant Acquiring System.

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

During the three months ended March 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 March 31, 2007 increased 6% to 11,410,296 from the three months ended March 31, 2006.



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

**Table 9**

Province	Number of Grants Paid		Three months ended March 31, Average Revenue per Grant Paid			
	2007	2006	2007	2006	2007	2006
			\$ (1)	\$ (2)	ZAR(1)	ZAR(2)
KwaZulu-Natal (A)	5,079,328	4,606,938	2.67	3.27	19.35	20.19
Limpopo (B)	2,925,621	2,832,121	2.23	2.50	16.19	15.42
North West (C)	833,683	801,524	2.92	2.79	21.19	17.23
Northern Cape (D)	417,990	401,712	2.57	3.05	18.62	18.84
Eastern Cape (E)	2,153,674	2,088,799	1.78	1.94	12.89	11.98
<b>Total</b>	<b>11,410,296</b>	<b>10,731,094</b>				

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

(2) Average Revenue per Grant Paid excludes \$ 0.89 (ZAR 5.50) related to the provision of smart card accounts.

**A** - in ZAR, the decrease in the Average Revenue per Grant Paid in KwaZulu-Natal was primarily due to a lower average grant paid per beneficiary as more child support grant recipients are registered on the system. Child Support grants are significantly less than other grant types. Our fee in this province is based on a percentage of the amount paid to beneficiaries.

**B** - in ZAR, the increase in the Average Revenue per Grant Paid in Limpopo was due to the annual inflation price adjustment effective from December 2005.

**C** - in ZAR, the increase in the Average Revenue per Grant Paid in North West was due to the annual inflation price adjustment approved by the provincial government in October 2006. The annual inflation price increase was effective from July 1, 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 inflation price increases effective January 1, 2007.

#### ***Settlement payment received from SASSA***

During the three months ended March 31, 2007, we received approximately \$6.9 million (ZAR 49.5 million) from SASSA as a result of the settlement of contract deviations that occurred during the implementation phases in the Eastern Cape province and for annual inflation price increases over the last three years which were not forthcoming. The price charged per beneficiary in the Eastern Cape province was increased as a result of the settlement reached and will be applied until the end of the current contract period, with a further inflation adjustment review scheduled for November 2007.

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

During the three months ended March 31, 2007, EasyPay processed 109 million transactions with an approximate value of \$3.4 billion, (ZAR 24.3 billion). The average fee per transaction during the three months ended March 31, 2007 was \$0.03 (ZAR 0.21). EasyPay transaction fees are not included in our results for the three months

ended March 31, 2006 as we acquired EasyPay on July 3, 2006. The number of transactions processed during the three months ended March 31, 2007 decreased compared with the three months ended December 31, 2006, due to the festive season and summer holidays in South Africa during the second quarter of fiscal 2007 where consumers perform more transactions using EasyPay. We expect the number of transactions processed during the fourth quarter of fiscal 2007 to be lower than those during the third quarter of fiscal 2007 as traditionally there are fewer transactions performed by consumers during this period. We do not expect a significant fluctuation, in ZAR, in the average fee per transaction during the fourth quarter of fiscal 2007.

Operating income margins generated by EasyPay during the three months ended March 31, 2007 were 28%, 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 March 31, 2007, of approximately \$0.4 million (ZAR 3.2 million) is included in the calculation of EasyPay operating margins.

**Allocation of revenues and operating income:**

The table below sets forth the allocation of revenues and operating income between transaction-based activities (excluding EasyPay) and EasyPay on a standalone basis:

<b>Table 10</b>	<b>Three months ended March 31, 2007</b>		
	<b>Revenue \$ 000</b>	<b>Operating Income \$ 000</b>	<b>Operating Income Margin</b>
Transaction-based activities (excluding EasyPay).	37,806	23,979	63%
EasyPay	3,156	890	28%
<b>Total</b>	<b>40,962</b>	<b>24,869</b>	<b>61%</b>

<b>Table 11</b>	<b>Three months ended March 31, 2007</b>		
	<b>Revenue ZAR 000</b>	<b>Operating Income ZAR 000</b>	<b>Operating Income Margin</b>
Transaction-based activities (excluding EasyPay).	272,543	172,865	63%
EasyPay	22,752	6,416	28%
<b>Total</b>	<b>295,295</b>	<b>179,281</b>	<b>61%</b>

**Smart card accounts**

In U.S. dollars, revenues decreased by 10% for the three months ended March 31, 2007, from the three months ended March 31, 2006. Operating income decreased by 10% for the three months ended March 31, 2007 from the three months ended March 31, 2006.

In ZAR, revenues increased by 6% for the three months ended March 31, 2007, from the three months ended March 31, 2006. Operating income increased by 6% for the three months ended March 31, 2007 from the three months ended March 31, 2006.

Operating income margin from providing smart card accounts was constant at 45% for each of the three months ended March 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 3,803,150 smart card-based accounts were active at March 31, 2007, compared to 3,601,076 active accounts as at March 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 due to the continued efforts of the South African government to provide social assistance to the very old and very young.

**Financial services**

In U.S. dollars, revenues decreased by 32% for the three months ended March 31, 2007, from the three months ended March 31, 2006. Operating income decreased by 48% for the three months ended March 31, 2007 from the three months ended March 31, 2006.

In ZAR, revenues decreased by 21% for the three months ended March 31, 2007, from the three months ended March 31, 2006. Operating income decreased by 39% for the three months ended March 31, 2007 from the three months ended March 31, 2006.

Revenues from UEPS-based lending decreased during the three months ended March 31, 2007 compared with the three months ended March 31, 2006 primarily due to the lower number of loans granted during the three months ended March 31, 2007 compared to the three months ended March 31, 2006. In addition, on average, the rate of interest charged on these UEPS-based loans was lower during the three months ended March 31, 2007 compared with the three months ended March 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. In addition, we continuously revise the interest rates charged on our UEPS-based loans, as part of our ongoing commitment to the South African government to provide affordable financial services to the unbanked population of that country. 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 lower interest rates charged on traditional microlending loans. The loan portfolio of the traditional microlending businesses has declined as a result of our strategic decision not to grow this business.

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 12	2007	2006	As at March 31,			
			\$ %	2007	2006	ZAR %
	\$ 000	\$ 000	change	ZAR 000	ZAR 000	change
Traditional microlending:						
Finance loans receivable	7,112	8,289	(14)%	51,765	51,853	0%
gross						
Allowance for doubtful						
finance loans						
receivable	(4,359)	(3,652)	19%	(31,727)	(22,846)	39%
Finance loans receivable	2,753	4,637	(41)%	20,038	29,007	(31)%
net						
UEPS-based lending:						
Finance loans receivable net						
and						
gross (i.e., no allowance)	3,457	3,855	(10)%	25,156	24,118	4%
Total finance loans						
receivable,						
net	6,210	8,492		45,194	53,125	

Operating income margin for the financial services segment decreased to 33% for the three months ended March 31, 2007 from 42% for the three months ended March 31, 2006, primarily due to lower interest rates offered on our UEPS-based lending products and continued difficult operating conditions in our traditional micro-lending operations.

**Hardware, software and related technology sales**

In U.S. dollars, revenues decreased by 3% for the three months ended March 31, 2007, from the three months ended March 31, 2006. Operating income decreased by 82% for the three months ended March 31, 2007 from the three months ended March 31, 2006.

In ZAR, revenues increased by 14% for the three months ended March 31, 2007, from the three months ended March 31, 2006. Operating income decreased by 79% for the three months ended March 31, 2007 from the three months ended March 31, 2006.

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

All activities related to Prism's products and services, other than EasyPay, have been included in our hardware, software and related technology sales segment.

Revenue and operating income for the three months ended March 31, 2007 comprises:

- sales of terminals to retailers and other customers;
- sales of Subscriber Identity Module, or SIM, cards to customers;
- rental of terminals to merchants participating in our merchant acquiring system; and
- repairs and maintenance services to customers.

The SIM card market is currently in a state of flux. Sales prices for SIM cards continue to decline due to price competition from manufacturers located in countries with lower production costs, global over-supply and global surplus manufacturing capacity. We expect this trend to continue into the foreseeable future. As a result we incurred a loss related to the sale of SIM cards during the three months ended March 31, 2006.

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

Included in our results for the three months ended March 31, 2006, were revenues of approximately \$4.4 million (approximately ZAR 27.4 million) earned from sales to Nedbank of POS devices and pin-pads and the sale of hardware to SmartSwitch Namibia of approximately \$1.2 million (ZAR 7.4 million) of which approximately \$0.01 million (ZAR 0.07 million), after taxation, of the SmartSwitch Namibia sale has been eliminated and included in the corporate/eliminations segment.

Hardware sales to Nedbank are infrequent, and we do not anticipate revenue from similar 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. 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.

**Allocation of revenues and operating income:**

The table below sets forth the allocation of revenues and operating income between hardware, software and related technology sales (excluding Prism) and Prism:

**Table 13**

	<b>Three months ended March 31, 2007</b>	
	<b>Revenue \$ 000</b>	<b>Operating Income (Loss) \$ 000</b>
Hardware, software and related technology sales (excluding Prism)	2,392	626
Prism	6,408	365
Prism before amortization of intangibles related to Prism acquisition	-	1,298
Amortization of intangibles related to Prism acquisition	-	(933)
<b>Total</b>	<b>8,800</b>	<b>991</b>

**Table 14**

**Three months ended  
March 31, 2006**

	<b>Revenue</b> <b>ZAR 000</b>	<b>Operating</b> <b>Income</b> <b>(Loss)</b> <b>ZAR 000</b>
Hardware, software and related technology sales (excluding Prism)	17,244	4,513
Prism	46,195	2,631
Prism before amortization of intangibles related to Prism acquisition	-	9,353
Amortization of intangibles related to Prism acquisition	-	(6,722)
<b>Total</b>	<b>63,439</b>	<b>7,144</b>

40



### **Corporate/eliminations**

In U.S. dollars, the operating loss decreased by \$1.3 million for the three months ended March 31, 2007, from the three months ended March 31, 2006.

In ZAR, the operating loss decreased by ZAR 6.4 million for the three months ended March 31, 2007, from the three months ended March 31, 2006.

The decrease in our operating losses for the three months ended March 31, 2007 compared with the three months ended March 31, 2006 was mainly due to reduction in legal fees and other regulatory fees and higher administration fees charged by our corporate head offices to operating segments. These reductions were partially offset by the inclusion of Prism's corporate head office charges, inflationary increases in goods and services purchased from third parties and stock compensation charges. Operating losses for the three months ended March 31, 2007, include all corporate activities of Prism until such time as its operational activities have been integrated with ours. The integration was complete as of March 31, 2007.

Our operating losses also include expenditure related to compliance with Sarbanes, non-executive directors' fees resulting from the election of independent directors to our board, employee and executives salaries and bonuses, legal and auditor fees, directors and officer's insurance premiums, telecommunications, property related expenditures including utilities, rental, security and maintenance and elimination entries.

### **Nine Months Ended March 31, 2007 Compared to the Nine Months Ended March 31, 2006**

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

- significant weakening of the South African rand, our functional currency, against the U.S. dollar, our reporting currency, which had a negative impact on our revenues and net income in U.S. dollars;
- receipt of a settlement payment from SASSA related to contract deviations and price increases;
- impact of the Prism acquisition, which has increased our reporting revenues and net income but has a negative impact on our operating margin;
- amortization of Prism-related intangible assets, which had a negative impact on our net income;
- revenues from hardware and software sales to SmartSwitch Botswana, which increased our revenue and net income;
- continued decrease in margins in our traditional micro-lending operations; and
- increased revenues from continued adoption of our merchant acquiring system by cardholders.

**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 15**

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

**Nine months ended March 31,**

	<b>2007</b>	<b>2006</b>	<b>\$ %</b>
	<b>\$ 000</b>	<b>\$ 000</b>	<b>change</b>
Revenue	163,772	147,900	11%
Cost of goods sold, IT processing, servicing and support	38,185	39,196	(3)%
General and administration	44,690	36,232	23%
Depreciation and amortization	8,512	4,331	97%
Costs related to public offering and Nasdaq listing	-	1,529	
Operating income	72,385	66,612	9%
Interest income, net	2,793	3,781	(26)%
Income before income taxes	75,178	70,393	7%
Income tax expense	28,927	27,062	7%
Income before minority interest and earnings from equity-accounted investments	46,251	43,331	7%
Minority interest	205		
Earnings from equity-accounted investments	102	356	(71)%
Net income	46,148	43,687	6%

**Table 16**

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

**Nine months ended March 31,**

	<b>2007</b>	<b>2006</b>	<b>ZAR %</b>
	<b>ZAR 000</b>	<b>ZAR 000</b>	<b>change</b>
Revenue	1,186,218	946,922	25%
Cost of goods sold, IT processing, servicing and support .	276,579	250,950	10%
General and administration	323,694	231,973	40%
Depreciation and amortization	61,653	27,729	122%
Costs related to public offering and Nasdaq listing	-	9,789	
Operating income	524,292	426,481	23%
Interest income, net	20,230	24,208	(16)%
Income before income taxes	544,522	450,689	21%
Income tax expense	209,521	173,263	21%
Income before minority interest and earnings from equity-accounted investments	335,001	277,426	21%
Minority interest	1,485	-	
Earnings from equity-accounted investments	739	2,279	(68)%
Net income	334,255	279,705	20%

Analyzed in ZAR, the increase in revenue and cost of goods sold, IT processing, servicing and support for the nine months ended March 31, 2007, was primarily due to the higher volumes in our transaction-based activities, a greater number of UEPS-based smart card holders, a settlement payment received from SASSA and the operations of Prism.

Our operating income margin for the nine months ended March 31, 2007, decreased to 44% compared with 45% for the nine months ended March 31, 2006. The inclusion of Prism operations during the nine months ended March 31, 2007, has reduced our overall operating margin as Prism operations generate a lower operating margin than our historical operations. In addition, our margin during the nine months ended March 31, 2007, was further reduced by intangible amortization charges related to Prism intangible assets acquired. This reduction was partially offset by the continued adoption of our merchant acquiring system, increased volumes and pricing in our pension and welfare business and a settlement payment received from SASSA.

General and administration expenses increased during the nine months ended March 31, 2007 from the comparable quarter in 2006 primarily due to the inclusion of Prism's operations and increases in goods and services purchased from third parties, including the effects of the increase in inflation in South Africa and expenses of \$1.2 million (ZAR 8.8 million) relating to a potential acquisition which we ultimately determined not to pursue.

Cost of goods sold, IT processing, servicing and support includes a stock-based compensation charge of \$0.2 million (ZAR 1.7 million) related to options granted to Prism employees. General and administration expenses includes a stock-based compensation charge of \$0.6 million (ZAR 4.4 million) related to options granted to employees. The stock-based compensation charges included in cost of goods sold, IT processing, servicing and support and general and administration are net of adjustments to the stock-based compensation charge related to adjustments as a result of forfeitures of \$0.1 million (ZAR 0.7 million) and \$0.1 million (ZAR 0.7 million), respectively. General and administration also includes the stock-based compensation charge of \$0.07 million (ZAR 0.5 million) related to options granted to an employee in January 2006. The employee resigned before any of the options vested and accordingly the stock-based compensation charge of \$0.2 million (ZAR 1.4 million) recorded from January to September 2006 has been reversed. The reversal has been included in general and administration.

Our total costs of maintaining a listing on Nasdaq as well as compliance with Sarbanes, particularly Section 404 of Sarbanes, resulted in expenditures of \$1.2 million (ZAR 8.9 million) and \$2.5 million (ZAR 16.1 million) during the nine months ended March 31, 2007 and 2006.

We completed our public offering and Nasdaq listing in August 2005. We incurred approximately \$1.5 million (ZAR 9.8 million) during the nine months ended March 31, 2006, related to legal fees, printing costs, registration and filing and accounting fees.

The increase in depreciation and amortization during the nine months ended March 31, 2007 compared to the nine months ended March 31, 2006, was mainly due to the amortization of intangible assets acquired related to the Prism acquisition and acquisition of the remaining 25.1% of EasyPay. The total amortization of these intangible assets during the nine months ended March 31, 2007 was approximately \$4.0 million (ZAR 29.0 million). The deferred tax benefit included in our statement of operations related to the intangible amortization charge for the nine months ended March 31, 2007 was \$1.5 million (ZAR 10.6 million). 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 of 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 nine months ended March 31, 2007 compared with the nine months ended March 31, 2006. This reduction in depreciation was partially offset by the increase in depreciation of our participating merchant POS terminals and Prism property, plant and equipment acquired.

Interest on surplus cash for the nine months ended March 31, 2007 increased to \$11.0 million (ZAR 79.8 million) from \$10.4 million (ZAR 66.6 million) for the nine months ended March 31, 2006. The increase in interest on surplus cash was due to the adjustment in the South African prime interest rate from an average of approximately 10.50% per annum for the nine months ended March 31, 2006, to 11.96% per annum for the nine months ended March 31, 2007 and the increase in the intended federal funds rate from an average of 3.93% per annum for the nine months ended March 31, 2006 to 5.25% per annum for the nine months ended March 31, 2007. The increase in the interest rates was partially offset by lower surplus cash balances as a result of the \$95.2 million paid in cash for the acquisition of Prism.

During the nine months ended March 31, 2007, our finance costs increased due to an increase in our pre-funding obligation. Finance costs increased to \$8.2 million (ZAR 59.5 million) for the nine months ended March 31, 2007, from \$6.6 million (ZAR 42.2 million) for the nine months ended March 31, 2006.

Total tax expense for the nine months ended March 31, 2007 was \$28.9 million (ZAR 209.5 million) compared with \$27.1 million (ZAR 173.3 million) during the same period in the comparable prior fiscal year. The increase was due to our increased profitability in our transaction-based activities and the settlement payment received.

Our effective tax rate for the nine months ended March 31, 2007 was 38.5%, compared to 38.4% for the nine months ended March 31, 2006. Our effective tax rate for the nine months ended March 31, 2007 was comparable with the prior year and was higher than the statutory tax rate due to non-deductible expenses incurred. The effect of the change in tax rate during the nine months ended March 31, 2006 is included in our tax expense and was approximately \$0.2 million (ZAR 1.0 million).

For the nine months ended March 31, 2007 and 2006, earnings from Permit totaled approximately \$1.3 million and \$0.9 million (ZAR 9.4 million and ZAR 5.6 million), respectively.

Included in earnings from equity accounted investments is a loss from equity accounted investment of approximately \$0.3 million (ZAR 2.3 million) and \$0.03 million (ZAR 0.2 million), before the realization of income from prior periods, related to SmartSwitch Namibia for the nine months ended March 31, 2007 and 2006, respectively. During the nine months ended March 31, 2007 we realized income from license fees, software and hardware sales made to SmartSwitch Namibia in prior periods of approximately \$0.08 million (ZAR 0.7 million). This income has been included in earnings from equity accounted investments. During the nine months ended March 31, 2006 we eliminated hardware sales and other services made to SmartSwitch Namibia of approximately \$0.6 million (ZAR 3.6 million).

Earnings from equity-accounted investments includes a loss of \$0.7 million (ZAR 5.0 million) for the nine months ended March 31, 2007 related to SmartSwitch Botswana. As of March 31, 2007, SmartSwitch Botswana had not commenced operations and therefore we have not recognized any equity-accounted earnings from SmartSwitch Botswana. We expect SmartSwitch Botswana to generate revenues during the three months ended June 30, 2007 but we do not expect SmartSwitch Botswana to generate net income during its first year of operations.

### Results of operations by operating segment

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

**Table 17**

*In United States Dollars (US GAAP)*

Operating Segment	Nine months ended March 31,				
	2007 \$ 000	% of total	2006 \$ 000	% of total	% change
Consolidated revenue:					
Transaction-based activities	103,172	63%	86,840	59%	19%
Smart card accounts	25,722	16%	26,866	18%	(4)%
Financial services	8,636	5%	12,456	8%	(31)%
Hardware, software and related technology sales	26,242	16%	21,738	15%	21%
<b>Total consolidated revenue</b>	<b>163,772</b>	<b>100%</b>	<b>147,900</b>	<b>100%</b>	<b>11%</b>
Consolidated operating income (loss):					
Transaction-based activities	60,799	84%	44,077	66%	38%
Smart card accounts	11,692	16%	12,212	18%	(4)%
Financial services	2,758	4%	5,454	8%	(49)%
Hardware, software and related technology sales	2,621	4%	13,390	20%	(80)%
Corporate/eliminations	(5,485)	(8)%	(8,521)	(12)%	(36)%
<b>Total consolidated operating income</b>	<b>72,385</b>	<b>100%</b>	<b>66,612</b>	<b>100%</b>	<b>9%</b>

**Table 18**

*In South African Rand (US GAAP)*

Operating Segment	Nine months ended March 31,				
	2007 ZAR 000	% of total	2006 ZAR 000	% of total	% change
Consolidated revenue:					
Transaction-based activities	747,286	63%	555,989	59%	34%
Smart card accounts	186,307	16%	172,008	18%	8%
Financial services	62,551	5%	79,749	8%	(22)%
Hardware, software and related technology sales	190,074	16%	139,176	15%	37%

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

<b>Total consolidated revenue</b>	1,186,218	100%	946,922	100%	25%
Consolidated operating income (loss):					
Transaction-based activities	440,374	84%	282,201	66%	56%
Smart card accounts	84,686	16%	78,187	18%	8%
Financial services	19,976	4%	34,919	8%	(43)%
Hardware, software and related technology sales	18,984	4%	85,729	20%	(78)%
Corporate/eliminations	(39,728)	(8)%	(54,555)	(12)%	(27)%
<b>Total consolidated operating income</b>	524,292	100%	426,481	100%	23%

44

**Transaction-based activities**

In U.S. dollars, revenues increased by 19% for the nine months ended March 31, 2007, from the nine months ended March 31, 2006. Operating income increased by 38% for the nine months ended March 31, 2007 from the nine months ended March 31, 2006.

In ZAR, revenues increased by 34% for the nine months ended March 31, 2007, from the nine months ended March 31, 2006. Operating income increased by 56% for the nine months ended March 31, 2007 from the nine months ended March 31, 2006.

These increases in revenues and operating income were due primarily to the continued adoption of our merchant acquiring system in the provinces where we distribute welfare grants, increased transacting ability at participating retailers POS devices in these provinces, higher volumes from all of our provincial contracts, the settlement payment received from SASSA and the inclusion of transaction fees generated by EasyPay. 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 nine months ended March 31, 2007 increased to 59% from 51% for the nine months ended March 31, 2006. These profit margin improvements were mainly due to:

- the increased volumes as detailed in the table below;
- the inflation adjustment to the price charged in the Limpopo, North West and Eastern Cape provinces;
- the increase in the number of social grant beneficiaries paid through our POS device infrastructure at participating retailers, instead of payment using more costly automated cash dispensers; and
- the settlement payment received.

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

Refer to discussion under [Overview](#) [Progress of Our Merchant Acquiring System](#).

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

During the nine months ended March 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 nine months ended March 31, 2007 increased 9% to 33,897,551 from the nine months ended March 31, 2006.

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

Province	Nine months ended March 31,					
	Number of Grants Paid		Average Revenue per Grant Paid			
	2007	2006	2007	2006	2007	2006
		\$ (1)	\$ (2)	ZAR(1)	ZAR(2)	
KwaZulu-Natal (A)	15,017,233	13,359,432	2.74	3.12	19.90	20.04
Limpopo (B)	8,724,102	8,279,826	2.23	2.40	16.16	15.38
North West (C)	2,481,696	2,365,496	2.78	2.65	20.17	17.01
Northern Cape (D)	1,247,935	1,188,037	2.57	2.95	18.67	18.92



Eastern Cape (E)	6,426,585	6,093,874	1.68	1.88	12.19	12.08
<b>Total</b>	<b>33,897,551</b>	<b>31,286,665</b>				

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

(2) Average Revenue per Grant Paid excludes \$ 0.86 (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 is primarily due to the increase in the per grant amount to beneficiaries announced in the 2006/2007 Budget Speech by the South African Minister of Finance. These per grant increases became effective on April 1, 2006. Our fee in this province is based on a percentage of the amount paid to beneficiaries.

**B** - in ZAR, the increase in the Average Revenue per Grant Paid in Limpopo is due to the annual inflation price adjustment effective from December 2005.

**C** - in ZAR, the increase in the Average Revenue per Grant Paid in North West is due to the annual inflation price adjustment approved by the provincial government in October 2006. The annual inflation price increase is effective from July 1, 2006 and resulted in higher Average Revenue per Grant Paid for the nine months ended March 31, 2007, compared with the nine months ended March 31, 2006.

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

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

### *Settlement payment received from SASSA*

Refer to discussion under Results of operations Three Months Ended March 31, 2007 Compared to the Three Months Ended March 31, 2006 Transaction-based activities Settlement payment received from SASSA.

### *EasyPay transaction fees:*

During the nine months ended March 31, 2007, EasyPay processed 327.3 million transactions with an approximate value of \$10.2 billion, (ZAR 74.3 billion). The average fee per transaction during the nine months ended March 31, 2007 was \$0.03 (ZAR 0.21) . EasyPay transaction fees are not included in our results for the nine months ended March 31, 2006 as we acquired EasyPay on July 3, 2006.

Operating income margins generated by EasyPay during the nine months ended March 31, 2007 were 31%, which was 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 nine months ended March 31, 2007 of approximately \$1.2 million (ZAR 8.9 million) is included in the calculation of EasyPay operating margins.

### **Allocation of revenues and operating income:**

The table below sets forth the allocation of revenues and operating income between transaction-based activities (excluding EasyPay) and EasyPay on a standalone basis:

<b>Table 20</b>	<b>Nine months ended March 31, 2007</b>		
	<b>Revenue \$ 000</b>	<b>Operating Income \$ 000</b>	<b>Operating Income Margin</b>
Transaction-based activities (excluding EasyPay).	93,526	57,761	62%
EasyPay	9,646	3,038	31%
<b>Total</b>	<b>103,172</b>	<b>60,799</b>	<b>59%</b>

<b>Table 21</b>	<b>Nine months ended March 31, 2007</b>		
	<b>Revenue ZAR 000</b>	<b>Operating Income ZAR 000</b>	<b>Operating Income Margin</b>

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

Transaction-based activities (excluding EasyPay).	677,419	418,369	62%
EasyPay	69,867	22,005	31%
<b>Total</b>	<b>747,286</b>	<b>440,374</b>	<b>59%</b>

46

---

### **Smart card accounts**

In U.S. dollars, revenues decreased by 4% for the nine months ended March 31, 2007, from the nine months ended March 31, 2006. Operating income decreased by 4% for the nine months ended March 31, 2007 from the nine months ended March 31, 2006.

In ZAR, revenues increased by 8% for the nine months ended March 31, 2007, from the nine months ended March 31, 2006. Operating income increased by 8% for the nine months ended March 31, 2007 from the nine months ended March 31, 2006.

Operating income margin from providing smart card accounts was fairly constant at 45% for each of the nine months ended March 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 3,803,150 smart card-based accounts were active at March 31, 2007, compared to 3,601,076 active accounts as at March 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 due to the continued efforts of the South African government to provide social assistance to the very old and very young.

### **Financial services**

In U.S. dollars, revenues decreased by 31% for the nine months ended March 31, 2007, from the nine months ended March 31, 2006. Operating income decreased by 49% for the nine months ended March 31, 2007 from the nine months ended March 31, 2006.

In ZAR, revenues decreased by 22% for the nine months ended March 31, 2007, from the nine months ended March 31, 2006. Operating income decreased by 43% for the nine months ended March 31, 2007 from the nine months ended March 31, 2006.

Revenues from UEPS-based lending decreased during the nine months ended March 31, 2007 compared with the nine months ended March 31, 2006 primarily due to the lower number of loans granted during the nine months ended March 31, 2007 compared to the nine months ended March 31, 2006. In addition, on average, the rate of interest charged on these UEPS-based loans was lower during the nine months ended March 31, 2007 compared with the nine months ended March 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. In addition, we continuously revise the interest rates charged on our UEPS-based loans, as part of our ongoing commitment to the South African government to provide affordable financial services to the unbanked population of that country. 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 nine months ended March 31, 2007, due to increased competition, our strategic decision not to grow this business and lower interest rates charged on traditional microlending loans. The loan portfolio of the traditional microlending businesses has declined as a result of our strategic decision not to grow this business.

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 22			As at March 31,			
	2007	2006	%	2007	2006	ZAR %
	000	000	change	ZAR	ZAR	change
				000	000	
Traditional microlending:						
Finance loans receivable	7,112	8,289	(14)%	51,765	51,853	0%
gross						
Allowance for doubtful						
finance loans						
receivable	(4,359)	(3,652)	19%	(31,727)	(22,846)	39%
Finance loans receivable	2,753	4,637	(41)%	20,038	29,007	(31)%
net						
UEPS-based lending:						
Finance loans receivable						
net						
and						
gross (i.e., no allowance)	3,457	3,855	(10)%	25,156	24,118	4%
Total finance loans						
receivable,						
net	6,210	8,492		45,194	53,125	

Operating income margin for the financial services segment decreased to 32% for the nine months ended March 31, 2007 from 44% for the nine months ended March 31, 2006, primarily due to lower interest rates offered on our UEPS-based lending products and continued difficult operating conditions in our traditional micro-lending operations.

### Hardware, software and related technology sales

In U.S. dollars, revenues increased by 21% for the nine months ended March 31, 2007, from the nine months ended March 31, 2006. Operating income decreased by 80% for the nine months ended March 31, 2007 from the nine months ended March 31, 2006.

In ZAR, revenues increased by 37% for the nine months ended March 31, 2007, from the nine months ended March 31, 2006. Operating income decreased by 78% for the nine months ended March 31, 2007 from the nine months ended March 31, 2006.

All activities related to Prism's products and services, other than EasyPay, have been included in our hardware, software and related technology sales segment.

Revenue and operating income for the nine months ended March 31, 2007 comprises of:

- sales of terminals to retailers and other customers;
- sales of SIM cards to customers;
- rental of terminals to merchants participating in our merchant acquiring system; and
- repairs and maintenance services to customers.

The SIM card market is currently in a state of flux. Sales prices for SIM cards continue to decline due to price competition from manufacturers located in countries with lower production costs, global over-supply and global surplus manufacturing capacity. We expect this trend to continue into the foreseeable future. As a result we incurred a loss related to the sale of SIM cards during the nine months ended March 31, 2006.

Revenues from sales of hardware to SmartSwitch Botswana during the nine months ended March 31, 2007, totaled approximately \$2.1 million (ZAR 15.3 million) of which approximately \$0.5 million (ZAR 3.9 million), after taxation, was eliminated and will be recognized in future periods. The elimination has been included in the Corporate/Eliminations. Our operating margin on these sales was significantly higher than other items, including Prism products and services, included within the hardware, software and related technology sales segment.

Revenues and operating income from sales to SmartSwitch Nigeria have been eliminated and are not reflected in the Hardware, software and related technology sales operating segment.

Amortization of Prism intangible assets during the nine months ended March 31, 2007 was approximately \$2.8 million (ZAR 20.2 million) and reduced our operating income.

Included in our results for the nine months ended March 31, 2006, was revenue earned from the orders to supply Nedbank with smart cards, smart card readers and terminals and the sale of hardware, software and licenses to SmartSwitch Namibia. Total revenues from the Nedbank orders during the nine months ended March 31, 2006, were approximately \$10.9 million (approximately ZAR 69.6 million). Revenues from sales of hardware, software and licenses to SmartSwitch Namibia during the nine months ended March 31, 2006, totaled approximately \$3.9 million (ZAR 25.0 million) of which approximately \$0.6 million (ZAR 3.6 million), after taxation, has been eliminated and included in the corporate/eliminations segment.

Hardware sales to Nedbank are infrequent, and we do not anticipate revenue from similar 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.

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.

#### Allocation of revenues and operating income:

The table below sets forth the allocation revenues and operating income between hardware, software and related technology sales (excluding Prism) and Prism:

**Table 23**

	<b>Nine months ended March 31, 2007</b>	
	<b>Revenue \$ 000</b>	<b>Operating Income (Loss) \$ 000</b>
Hardware, software and related technology sales (excluding Prism)	9,388	3,915
Prism	16,854	(1,294)
Prism before amortization of intangibles related to Prism acquisition	-	1,490
Amortization of intangibles related to Prism acquisition	-	(2,784)
<b>Total</b>	<b>26,242</b>	<b>2,621</b>

**Table 24**

	<b>Nine months ended March 31, 2006</b>	
	<b>Revenue ZAR 000</b>	<b>Operating Income (Loss) ZAR 000</b>
Hardware, software and related technology sales (excluding Prism)	67,998	28,357
Prism	122,076	(9,373)
Prism before amortization of intangibles related to Prism acquisition	-	10,794
Amortization of intangibles related to Prism acquisition	-	(20,167)
<b>Total</b>	<b>190,074</b>	<b>18,984</b>
<b>Corporate/eliminations</b>		

In U.S. dollars, operating loss decreased by \$3.0 million for the nine months ended March 31, 2007, from the nine months ended March 31, 2006.



In ZAR, operating loss decreased by ZAR 14.8 million for the nine months ended March 31, 2007, from the nine months ended March 31, 2006.

The decrease in our operating losses for the nine months ended March 31, 2007 compared with the nine months ended March 31, 2006 was mainly due to reduction in legal fees and other regulatory fees and higher administration fees charged by our corporate head offices to operating segments. These reductions were partially offset by the inclusion of Prism's corporate head office charges, inflationary increases in goods and services purchased from third parties and stock compensation charges. Operating losses for the nine months ended March 31, 2007, include all corporate activities of Prism until such time as its operational activities have been integrated with ours.

In addition, corporate/eliminations for the nine months ended March 31, 2006 includes the non-recurring charges related to our public offering and Nasdaq listing of \$1.5 million (ZAR 9.6 million) incurred primarily in the three months ended September 30, 2005.

Our operating losses also include expenditure related to compliance with Sarbanes, non-executive directors fees resulting from the election of independent directors to our board, employee and executives salaries and bonuses, legal and auditor fees, directors and officer s insurance premiums, telecommunications and property related expenditures including utilities, rental, security and maintenance.

### **Liquidity and Capital Resources**

Our business has historically generated and continues to generate high levels of cash. At March 31, 2007 our cash balances were \$118.9 million, which comprised mainly ZAR-denominated balances of ZAR 579.9 million (\$79.7 million) and U.S. dollar-denominated balances of \$35.0 million. Our cash balances declined from June 30, 2006 levels mainly as a result of the payment of the purchase price for Prism and the payment of provisional taxes, partially offset by the 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 \$92.6 million (ZAR 674 million). As a result of utilizing approximately \$96.2 million, representing approximately 50% of our June 30, 2006 cash balances to acquire Prism, during the three and nine months ended March 31, 2007, we borrowed under these facilities on a short-term basis when our pre-funding requirements exceeded the available cash on hand. We take the following factors into account when considering whether to borrow under our financing facilities:

- cost of capital;
- cost of financing;
- opportunity cost of utilizing surplus cash; and
- availability of tax efficient structures to moderate financing costs.

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 \$46.7 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. The increase in the number of social welfare grant beneficiaries in the KwaZulu-Natal and Eastern Cape provinces during the three months ended March 31, 2007 has increased our pre-funding requirements and we have utilized external short-term financing for the pre-funding of these grant payments.

The amount disbursed through merchants during March 2007 was reimbursed to us by the provincial governments during the first two weeks of April 2007. We settle our obligation to merchants within 48 hours of the distribution of the grant by the merchant to the social welfare beneficiaries, however, the provincial governments reimburse the amount due to us within two weeks after the distribution date. This practice results in a significant net cash outflow at the end of a month, and a quarter, however, the situation is typically reversed within a week.

We currently believe that our cash and credit facilities are sufficient to fund our operations for at least the next four quarters. However, the reduction in our available cash, due to payment of Prism's purchase price, may require us to seek additional sources of capital through an increase in availability under our credit facilities or issuance of debt securities. In addition, we have recently submitted tenders for the distribution and administration of social welfare grants in all nine provinces in South Africa in terms of which we may be required to pre-fund the payment of social welfare grants in all nine provinces which will require us to extend our credit facilities and/ or issue debt instruments. In this regard we have received letters of intent from banking institutions to extend such credit facilities and/ or raise debt instruments for us in the event that we are awarded the contracts.

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

Net cash inflows from operating activities for the three months ended March 31, 2007, was \$4.1 million (ZAR 29.6 million) compared to \$9.0 million (ZAR 55.5 million) for the three months ended March 31, 2006. The decrease in net cash inflows is largely due to the re-imbursement by the Eastern Cape provincial government of March 2007 pay cycle grants paid in early April 2007. In addition, the April 2007 pay cycle was opened at merchants in the last four days of March 2007 and merchants are traditionally reimbursed within 48 hours of distributing the grant to the beneficiary. The provincial governments typically repay us between seven and 14 days of distributing the grant.

During the three months ended March 31, 2007, SARS requested us to make an additional first provisional payment of \$3.0 million (ZAR 21.5 million) related to our 2007 tax year. See the table below for a summary of all taxes paid.

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

	<b>Three months ended March 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	2,998	5,901	21,515	36,121
Third provisional payments	237	n/a	1,696	n/a
Taxation paid related to prior years	n/a	602	n/a	3,695
Taxation refunds received	n/a	(269)	n/a	(1,645)
Secondary Taxation on Companies	70	n/a	502	n/a
<b>Total tax paid</b>	<b>3,305</b>	<b>6,234</b>	<b>23,713</b>	<b>38,171</b>

*Nine months ended March 31, 2007*

Net cash flows from operating activities for the nine months ended March 31, 2007, was \$19.1 million (ZAR 138.5 million) compared to net cash inflows of \$51.2 million (ZAR 327.7 million) for the nine months ended March 31, 2006. The decrease in net cash inflows is largely due to the re-imbursement by the Eastern Cape provincial government of March 2007 pay cycle grants paid in early April 2007. In addition, the April 2007 pay cycle was opened at merchants in the last four days of March 2007 and merchants are traditionally reimbursed within 48 hours of distributing the grant to the beneficiary. The provincial governments typically repay us between seven and 14 days of distributing the grant.

During the nine months ended March 31, 2007, we paid a \$12.2 million (ZAR 86.8 million) first provisional payment for our 2007 tax year. In addition, we paid a \$2.6 million (ZAR 18.2 million) third provisional payment for our 2006 tax year. During the nine months ended March 31, 2007, we paid an additional \$9.0 million (ZAR 66.8 million) second provisional payment related to our 2006 tax year. See the table below for a summary of all taxes paid.

Taxes paid during the nine months ended March 31, 2007 and 2006 were as follows:

	<b>Nine months ended March 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	12,228	11,963	86,835	74,905

Edgar Filing: NET 1 UEPS TECHNOLOGIES INC - Form 10-Q

Second provisional payments	-	8,656	-	56,124
Third provisional payments	2,571	2,861	18,212	18,361
Taxation paid related to prior years	9,027	602	66,837	3,695
Taxation refunds received	(672)	(269)	(4,880)	(1,645)
Secondary taxation on companies	70	496	502	3,332
<b>Total tax paid</b>	<b>23,224</b>	<b>24,309</b>	<b>167,506</b>	<b>154,772</b>

51

***Cash flows from investing activities***

*Three months ended March 31, 2007*

Cash used in investing activities for the three months ended March 31, 2007 includes capital expenditure of \$0.9 million (ZAR 6.8 million), of which \$0.4 million (ZAR 2.9 million) relates to the purchase of enrollment equipment and vehicles for the North West province. During the three months ended March 31, 2007, we lent an additional \$0.3 million (ZAR 2.2 million) to SmartSwitch Botswana.

Cash used in investing activities for the three months ended March 31, 2006 includes capital expenditure of \$0.3 million (ZAR 1.9 million). Capital expenditures during the three months ended March 31, 2006 were not significant. During the three months ended March 31, 2006, we lent an additional \$0.8 million (ZAR 4.8 million) to SmartSwitch Namibia.

During the three months ended March 31, 2007 we paid approximately \$9.7 million (ZAR 70 million) in cash as consideration for the remaining 25.1% of EasyPay.

In late January 2007, we entered into a co-operation agreement with Grindrod Bank 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 co-operation agreement, we are required to invest \$0.7 million (ZAR 5.0 million) to facilitate the establishment of this retail banking decision. We have opened a bank account with Grindrod and have transferred these funds and these funds will be drawn down as and when required by the retail banking division. As of March 31, 2007 the balance in the bank account is \$0.7 million (ZAR 5.0 million).

*Nine months ended March 31, 2007*

Cash used in investing activities for the nine months ended March 31, 2007 includes capital expenditure of \$2.6 million (ZAR 18.9 million), of which \$0.4 million (ZAR 2.9 million) relates to the purchase of enrollment equipment and vehicles for the North West province, \$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 three months ended March 31, 2007, we lent an additional \$0.3 million (ZAR 2.2 million) to SmartSwitch Botswana.

During the nine months ended March 31, 2007, we paid \$82.1 million (ZAR 591.1 million), net of cash received, for the entire issued and outstanding ordinary capital of Prism. In addition, during the nine months ended March 31, 2007 we paid approximately \$9.7 million (ZAR 70 million) in cash as consideration for the remaining 25.1% of EasyPay.

Cash used in investing activities for the nine months ended March 31, 2006 includes capital expenditure of \$1.2 million (ZAR 7.7 million), of which \$0.5 million (ZAR 3.5 million) related to the purchase of POS and pin-pad devices for use at retailers participating in our merchant acquiring project. In addition, during the first quarter of fiscal 2006 we invested \$0.6 million (ZAR 3.9 million) in equity and lent \$1.3 million (ZAR 7.8 million) to SmartSwitch Namibia, a UEPS based switching system established in Namibia. During the third quarter of fiscal 2006 we lent an additional \$0.8 million (ZAR 4.8 million) to SmartSwitch Namibia.

***Cash flows from financing activities***

*Three months ended March 31, 2007*

There were no significant cash flows from financing activities during the three months ended March 31, 2007 and 2006.

*Nine months ended March 31, 2007*

As discussed above we were required to utilize our credit facilities in order to meet our obligations to distribute social welfare grants to beneficiaries during the nine months ended March 31, 2007. As our reporting currency is the U.S. dollar and our functional currency is the ZAR the exchange rate fluctuations during the nine months ended March 31, 2007 resulted in reporting discrepancies between the proceeds from bank overdrafts and the repayment of bank overdrafts presented in our unaudited condensed consolidated statement of cash flow for the nine months ended March 31, 2007. The result of these exchange rate fluctuations are included in effect of exchange rate changes on cash presented in our unaudited condensed consolidated statement of cash flow for the nine months ended March 31, 2007.

During the nine months ended March 31, 2007, we received \$0.05 million (ZAR 0.36 million) from an employee exercising stock options. During the nine months ended March 31, 2007, the other shareholders of SmartSwitch Nigeria, in terms of the shareholders agreement, lent \$3.5 million (ZAR 25.6 million) to the switch.

In connection with our August 2005 initial public offering, we received approximately \$32.2 million (ZAR 209.3 million), net of underwriting discounts and commissions of approximately \$2.4 million (ZAR 15.6 million), from the underwriters exercising their option to acquire 1,538,794 shares of our common stock and employees exercising stock options and selling the underlying shares in the offering.

### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

### Capital Expenditures

Capital expenditures for the three months ended March 31, 2007 and 2006 were as follows:

Operating Segment	Three months ended March 31,			
	2007 \$ 000	2006 \$ 000	2007 ZAR 000	2006 ZAR 000
Transaction-based activities	804	242	5,797	1,493
Smart card accounts	-	-	-	-
Financial services	54	73	389	451
Hardware, software and related technology sales	85	-	613	-
Corporate / Eliminations	-	-	-	-
<b>Consolidated total</b>	<b>943</b>	<b>315</b>	<b>6,799</b>	<b>1,944</b>

Capital expenditures for the nine months ended March 31, 2007 and 2006 were as follows:

Operating Segment	Nine months ended March 31,			
	2007 \$ 000	2006 \$ 000	2007 ZAR 000	2006 ZAR 000
Transaction-based activities	2,115	910	15,334	5,826
Smart card accounts	-	-	0	-
Financial services	155	293	1,124	1,876
Hardware, software and related technology sales	376	-	2,726	-
Corporate / Eliminations	-	-	0	-
<b>Consolidated total</b>	<b>2,646</b>	<b>1,203</b>	<b>19,184</b>	<b>7,702</b>

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

As mentioned above, our capital expenditures for the three and nine months ended March 31, 2007 related mainly to the acquisition of:



- enrollment equipment and vehicles to service the North West province;
- equipment and furniture by SmartSwitch Nigeria to set up its data room; and
- equipment by EasyPay in order to maintain operations.

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 March 31, 2007. We anticipate that capital spending for the fourth quarter of fiscal 2007 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:

	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>More than 5 years</b>
Operating lease obligations	6,106	2,007	2,225	1,874	-
Purchase obligations	1,558	1,558	-	-	-
<b>Total</b>	<b>7,664</b>	<b>3,565</b>	<b>2,225</b>	<b>1,874</b>	<b>-</b>

54

### 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 March 31, 2007 and 2006, our outstanding foreign exchange contracts were as follows:

#### As of March 31, 2007

Notional amount	Strike price	Fair market value price	Maturity
USD 266,000	ZAR 7.1100	ZAR 7.3001	April 23, 2007
USD 266,000	ZAR 7.1320	ZAR 7.3220	May 21, 2007
EUR 1,026,400	ZAR 9.5298	ZAR 9.7869	June 15, 2007
EUR 34,071	ZAR 10.0732	ZAR 9.7869	June 15, 2007
USD 981,500	ZAR 7.4290	ZAR 7.3535	June 29, 2007

#### As of March 31, 2006

Notional amount	Strike price	Fair market value price	Maturity
EUR 1,838,394	ZAR 8.0529	ZAR 7.7215	November 30, 2006

#### Translation Risk

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

#### Interest Rate Risk

As a result of our normal borrowing and leasing activities, our operating results are exposed to fluctuations in interest rates, which we manage primarily through our regular financing activities. We generally maintain limited investment in cash equivalents and have occasionally invested in marketable securities. Typically, for every 1% increase in 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 \$19,073 per month, while interest earned per month on any surplus cash increases by \$11,348 per \$13.7 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 March 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 March 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

**INVESTING IN OUR COMMON STOCK INVOLVES A HIGH DEGREE OF RISK. YOU SHOULD CONSIDER CAREFULLY THE FOLLOWING RISK FACTORS, AS WELL AS THE OTHER INFORMATION IN THIS FORM 10-Q, BEFORE DECIDING TO INVEST IN OUR SHARES OF COMMON STOCK. IF ANY OF THE FOLLOWING RISKS ACTUALLY OCCURS, OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS WOULD SUFFER. IF THIS HAPPENS, THE TRADING PRICE OF OUR COMMON STOCK WOULD LIKELY DECLINE AND YOU MIGHT LOSE ALL OR PART OF YOUR INVESTMENT IN OUR COMMON STOCK. PLEASE REFER ALSO TO OUR ANNUAL REPORT ON FORM 10-K FOR FISCAL YEAR 2006 FOR ADDITIONAL INFORMATION CONCERNING THESE AND OTHER UNCERTAINTIES THAT COULD NEGATIVELY IMPACT THE COMPANY.**

*The South African Social Security Agency, or SASSA, has initiated the process of conducting a national tender for the award of contracts to distribute social welfare grants. If we were not to receive contracts to continue to distribute these grants in each of the provinces where we currently distribute them, or if we do win these contracts, but the terms are not as favorable to us as our current contracts, our financial condition, results of operations and cash flows would be materially and adversely affected.*

We currently derive a majority of our revenues from contracts to distribute social welfare grants on behalf of five of the nine provincial governments of South Africa. For the foreseeable future, our revenues, results of operations and cash flows will depend on this concentrated group of customers. During the nine months ended March 31, 2007 and during the years ended June 30, 2006, 2005 and 2004, we derived approximately 72%, 77%, 79% and 82%, respectively, of our revenues from payments made to us by these provinces under our government social welfare contracts.

SASSA commenced operations on April 1, 2006 and has issued a national tender for the distribution of welfare grants in which bidders will have the opportunity to bid for all of South Africa or on a province-by-province basis. In February 2007 SASSA issued a request to submit proposals for the provision of payments services to social assistance grant recipients, or RFP. Pursuant to the RFP, potential bidders are invited to submit proposals for the provision of a payment service to social welfare grant recipients in South Africa's nine provinces. According to the RFP, submissions of proposals are due by May 4, 2007, and the final evaluation process will be completed by July 13, 2007. Our extensions in all five provinces expire on March 31, 2008. Implementation of the new contract will commence on April 1, 2008. We will participate in the RFP process.

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 the 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.

There can be no assurance that the tender will result in our receiving contracts to continue to distribute social welfare grants in each of the five South African provinces where we currently distribute them. Even if we do receive new contracts, we cannot predict the terms that such contracts will contain. Any new contract we receive may contain pricing or other terms, such as provisions relating to early termination, that are not as favorable to us as the contracts under which we currently operate. The time and attention required by our management in connection with the tender process and the uncertainty surrounding the tender process may have a disruptive effect on our business. In addition,

although we believe that our existing contracts will be extended if the tender process is not completed on time, there can be no assurance whether such extensions will in fact occur, or if they do, what the length or terms of such extensions will be.

Moreover, because we incur a significant portion of the expenses associated with these contracts during the initial implementation phase, we have historically enjoyed higher profit margins on these contracts after the completion of the implementation period, which averages approximately 18 months. Therefore, to the extent that we are not successful in obtaining new provincial contracts, or if a new contract were to be terminated for any reason during the implementation period, our profit margins would also be adversely affected.



Finally, if we were to be awarded one or more contracts by SASSA, an unsuccessful tenderor could seek to challenge the award, which could result in the contract being set aside or could require us to expend time and resources in an attempt to defeat any such challenge. For example, the November 2002 award to us of the Limpopo provincial contract, which was executed in 2003, was challenged by a disqualified bidder for the contract. A South African court set aside the contract in 2005, although the court's ruling was suspended and the contract was reinstated as a result of an appeal of the ruling by the province. Nevertheless, the court challenge created uncertainty, consumed management time and attention and required us to incur substantial legal expenses.

**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 May 10, 2007.

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