

NET 1 UEPS TECHNOLOGIES INC  
Form 10-Q  
November 09, 2010

---

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

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2010

OR

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

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

Commission file number: **000-31203**

**NET 1 UEPS TECHNOLOGIES, INC.**

(Exact name of registrant as specified in its charter)

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

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

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

(Address of principal executive offices, including zip code)

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

**Not Applicable**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES [X] NO [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

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

any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES ☐ NO ☐

---

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

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

☒ Large accelerated filer

☐ Accelerated filer

☐ Non-accelerated filer

☐ Smaller reporting company

(do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ☐ NO ☒

As of October 31, 2010 (the latest practicable date), 45,392,353 shares of the registrant's common stock, par value \$0.001 per share, net of treasury shares, were outstanding.

---

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

|                                      | <b>Page<br/>No.</b>                                                                                                               |
|--------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|
| <b>PART I. FINANCIAL INFORMATION</b> |                                                                                                                                   |
| Item 1.                              | Financial Statements                                                                                                              |
|                                      | <u>Condensed Consolidated Balance Sheets at September 30, 2010 and June 30, 2010</u>                                              |
|                                      | <u>2</u>                                                                                                                          |
|                                      | <u>Unaudited Condensed Consolidated Statements of Operations for the Three Months Ended September 30, 2010 and 2009</u>           |
|                                      | <u>3</u>                                                                                                                          |
|                                      | <u>Unaudited Condensed Consolidated Statements of Changes in Equity for the Three Months Ended September 30, 2010</u>             |
|                                      | <u>4</u>                                                                                                                          |
|                                      | <u>Unaudited Condensed Consolidated Statements of Comprehensive Income for the Three Months Ended September 30, 2010 and 2009</u> |
|                                      | <u>5</u>                                                                                                                          |
|                                      | <u>Unaudited Condensed Consolidated Statements of Cash Flows for the Three Months Ended September 30, 2010 and 2009</u>           |
|                                      | <u>6</u>                                                                                                                          |
|                                      | <u>Notes to Unaudited Condensed Consolidated Financial Statements</u>                                                             |
|                                      | <u>7</u>                                                                                                                          |
| <u>Item 2.</u>                       | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                      |
|                                      | <u>20</u>                                                                                                                         |
| <u>Item 3.</u>                       | <u>Quantitative and Qualitative Disclosures About Market Risk</u>                                                                 |
|                                      | <u>34</u>                                                                                                                         |
| <u>Item 4.</u>                       | <u>Controls and Procedures</u>                                                                                                    |
|                                      | <u>35</u>                                                                                                                         |
| <b>PART II. OTHER INFORMATION</b>    |                                                                                                                                   |
| <u>Item 1A.</u>                      | <u>Risk Factors</u>                                                                                                               |
|                                      | <u>36</u>                                                                                                                         |
| <u>Item 6.</u>                       | <u>Exhibits</u>                                                                                                                   |
|                                      | <u>37</u>                                                                                                                         |
| <u>Signatures</u>                    | <u>37</u>                                                                                                                         |
| EXHIBIT 2.1                          |                                                                                                                                   |
| EXHIBIT 10.51                        |                                                                                                                                   |
| EXHIBIT 10.52                        |                                                                                                                                   |
| EXHIBIT 31.1                         |                                                                                                                                   |
| EXHIBIT 31.2                         |                                                                                                                                   |
| EXHIBIT 32                           |                                                                                                                                   |

**Part I. Financial Information****Item 1. Financial Statements****NET 1 UEPS TECHNOLOGIES, INC.  
Condensed Consolidated Balance Sheets**

|                                                                                                       | Unaudited<br>September<br>30,<br>2010<br>(In thousands, except share data) | (A)<br>June 30,<br>2010 |
|-------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------|-------------------------|
| ASSETS                                                                                                |                                                                            |                         |
| CURRENT ASSETS                                                                                        |                                                                            |                         |
| Cash and cash equivalents                                                                             | \$ 200,161                                                                 | \$ 153,742              |
| Pre-funded social welfare grants receivable (Note 2)                                                  | 4,597                                                                      | 6,660                   |
| Accounts receivable, net of allowances of September: \$885; June: \$807                               | 37,225                                                                     | 41,854                  |
| Finance loans receivable, net of allowances of September: \$-; June: \$-                              | 5,523                                                                      | 4,221                   |
| Deferred expenditure on smart cards                                                                   | 2                                                                          | -                       |
| Inventory (Note 3)                                                                                    | 6,144                                                                      | 3,622                   |
| Deferred income taxes                                                                                 | 18,546                                                                     | 16,330                  |
| Total current assets before settlement assets                                                         | 272,198                                                                    | 226,429                 |
| Settlement assets                                                                                     | 107,407                                                                    | 83,661                  |
| Total current assets                                                                                  | 379,605                                                                    | 310,090                 |
| OTHER LONG-TERM ASSETS, including available for sale securities (Note 4)                              | 8,130                                                                      | 7,423                   |
| PROPERTY, PLANT AND EQUIPMENT, NET OF ACCUMULATED DEPRECIATION OF September: \$39,683; June: \$35,271 | 7,637                                                                      | 7,286                   |
| EQUITY-ACCOUNTED INVESTMENTS (Note 4)                                                                 | 2,376                                                                      | 2,598                   |
| GOODWILL (Note 6)                                                                                     | 83,203                                                                     | 76,346                  |
| INTANGIBLE ASSETS, NET OF ACCUMULATED AMORTIZATION OF September: \$41,477; June: \$34,226 (Note 5)    | 71,646                                                                     | 68,347                  |
| TOTAL ASSETS                                                                                          | 552,597                                                                    | 472,090                 |
| LIABILITIES                                                                                           |                                                                            |                         |
| CURRENT LIABILITIES                                                                                   |                                                                            |                         |
| Accounts payable                                                                                      | 5,175                                                                      | 3,596                   |
| Other payables                                                                                        | 58,847                                                                     | 50,855                  |
| Income taxes payable                                                                                  | 9,330                                                                      | 3,476                   |
| Total current liabilities before settlement obligations                                               | 73,352                                                                     | 57,927                  |
| Settlement obligations                                                                                | 107,407                                                                    | 83,661                  |
| Total current liabilities                                                                             | 180,759                                                                    | 141,588                 |
| DEFERRED INCOME TAXES                                                                                 | 43,766                                                                     | 38,858                  |
| OTHER LONG-TERM LIABILITIES, including non-controlling interest loans                                 | 4,413                                                                      | 4,343                   |
| TOTAL LIABILITIES                                                                                     | 228,938                                                                    | 184,789                 |
| COMMITMENTS AND CONTINGENCIES                                                                         | -                                                                          | -                       |
| EQUITY                                                                                                |                                                                            |                         |
| NET1 EQUITY:                                                                                          |                                                                            |                         |

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

|                                                  |                              |                   |           |                |
|--------------------------------------------------|------------------------------|-------------------|-----------|----------------|
| COMMON STOCK (Note 7)                            |                              |                   |           |                |
| Authorized: 200,000,000 with \$0.001 par value;  |                              |                   |           |                |
| Issued and outstanding shares, net of treasury - |                              |                   |           |                |
| September:                                       | 45,392,353; June: 45,378,397 | 59                |           | 59             |
| PREFERRED STOCK                                  |                              |                   |           |                |
| Authorized shares: 50,000,000 with \$0.001 par   |                              |                   |           |                |
| value;                                           |                              |                   |           |                |
| Issued and outstanding shares, net of treasury:  |                              |                   |           |                |
| 2010: -; 2009: -                                 |                              | -                 |           | -              |
| ADDITIONAL PAID-IN-CAPITAL                       |                              | 134,841           |           | 133,543        |
| TREASURY SHARES, AT COST: September:             |                              |                   |           |                |
| 13,149,042; June: 13,149,042                     |                              | (173,671)         |           | (173,671)      |
| ACCUMULATED OTHER COMPREHENSIVE                  |                              |                   |           |                |
| LOSS                                             |                              | (38,906)          |           | (66,396)       |
| RETAINED EARNINGS                                |                              | 399,772           |           | 392,343        |
| TOTAL NET1 EQUITY                                |                              | 322,095           |           | 285,878        |
| NON-CONTROLLING INTEREST                         |                              | 1,564             |           | 1,423          |
| <b>TOTAL EQUITY</b>                              |                              | <b>323,659</b>    |           | <b>287,301</b> |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b> |                              | <b>\$ 552,597</b> | <b>\$</b> | <b>472,090</b> |
| (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**

|                                                                                      | <b>Three months ended</b>             |             |
|--------------------------------------------------------------------------------------|---------------------------------------|-------------|
|                                                                                      | <b>September 30,</b>                  |             |
|                                                                                      | <b>2010</b>                           | <b>2009</b> |
|                                                                                      | (In thousands, except per share data) |             |
| REVENUE                                                                              | \$ 64,283                             | \$ 65,514   |
| EXPENSE                                                                              |                                       |             |
| Cost of goods sold, IT processing, servicing and support                             | 18,067                                | 16,827      |
| Selling, general and administration                                                  | 30,326                                | 17,740      |
| Depreciation and amortization                                                        | 4,904                                 | 4,579       |
| OPERATING INCOME                                                                     | 10,986                                | 26,368      |
| INTEREST INCOME, net                                                                 | 2,836                                 | 2,371       |
| INCOME BEFORE INCOME TAXES                                                           | 13,822                                | 28,739      |
| INCOME TAX EXPENSE (Note 11)                                                         | 6,207                                 | 11,031      |
| NET INCOME FROM CONTINUING OPERATIONS BEFORE LOSS FROM EQUITY- ACCOUNTED INVESTMENTS | 7,615                                 | 17,708      |
| LOSS FROM EQUITY-ACCOUNTED INVESTMENTS (Note 4)                                      | (216)                                 | (111)       |
| NET INCOME                                                                           | 7,399                                 | 17,597      |
| ADD: NET LOSS ATTRIBUTABLE TO NON- CONTROLLING INTEREST                              | (30)                                  | (344)       |
| NET INCOME ATTRIBUTABLE TO NET1                                                      | \$ 7,429                              | \$ 17,941   |
| <b>Net income per share, in United States dollars (Note 8)</b>                       |                                       |             |
| Basic earnings attributable to Net1 shareholders                                     | \$ 0.16                               | \$ 0.37     |
| Diluted earnings attributable to Net1 shareholders                                   | \$ 0.16                               | \$ 0.37     |

See Notes to Unaudited Condensed Consolidated Financial Statements

**NET 1 UEPS TECHNOLOGIES, INC.**  
**Unaudited Condensed Consolidated Statement of Changes in Equity (in thousands)**

|                                                                         |                       | Net 1 UEPS Technologies, Inc. Shareholder |        |                    |                    |                                  |                      |                                                        | Total Net1<br>Equity |
|-------------------------------------------------------------------------|-----------------------|-------------------------------------------|--------|--------------------|--------------------|----------------------------------|----------------------|--------------------------------------------------------|----------------------|
|                                                                         |                       | Number of<br>Shares                       | Amount | Treasury<br>Shares | Treasury<br>Shares | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>other<br>comprehensive<br>(loss) income |                      |
| Balance                                                                 | July 1,<br>2010       | 58,527,439                                | \$ 59  | (13,149,042)       | \$ (173,671)       | \$ 133,543                       | \$ 392,343           | \$ (66,396)                                            | \$ 285,878           |
| Restricted<br>stock granted                                             |                       | 13,956                                    |        |                    |                    |                                  |                      |                                                        |                      |
| Loan portion<br>related to<br>options                                   |                       |                                           |        |                    |                    | 20                               |                      |                                                        |                      |
| Stock-based<br>compensation<br>charge                                   |                       |                                           |        |                    |                    | 1,438                            |                      |                                                        |                      |
| Utilization of<br>APIC pool<br>related to<br>vested<br>restricted stock |                       |                                           |        |                    |                    | (160)                            |                      |                                                        |                      |
| Comprehensive<br>income (loss),<br>net of taxes:                        |                       |                                           |        |                    |                    |                                  |                      |                                                        |                      |
| Net income                                                              |                       |                                           |        |                    |                    |                                  | 7,429                |                                                        | 7,429                |
| Other<br>comprehensive<br>income<br>(loss):                             |                       |                                           |        |                    |                    |                                  |                      |                                                        |                      |
| Movement<br>in foreign<br>currency<br>translation<br>reserve            |                       |                                           |        |                    |                    |                                  |                      | 27,490                                                 | 27,490               |
| Balance                                                                 | September 30,<br>2010 | 58,541,395                                | \$ 59  | (13,149,042)       | \$ (173,671)       | \$ 134,841                       | \$ 399,772           | \$ (38,906)                                            | \$ 322,095           |
| See Notes to Unaudited Condensed Consolidated Financial Statements      |                       |                                           |        |                    |                    |                                  |                      |                                                        |                      |



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

|                                                                 | <b>Three months ended<br/>September 30,</b> |             |
|-----------------------------------------------------------------|---------------------------------------------|-------------|
|                                                                 | <b>2010</b>                                 | <b>2009</b> |
|                                                                 | (In thousands)                              |             |
| Net income                                                      | \$ 7,429                                    | \$ 17,597   |
| Other comprehensive income, net of taxes:                       |                                             |             |
| Movement in foreign currency translation reserve                | 27,490                                      | 13,585      |
| Total other comprehensive income, net of taxes                  | 27,490                                      | 13,585      |
| Comprehensive income                                            | 34,919                                      | 31,182      |
| Add comprehensive loss attributable to non-controlling interest | (141)                                       | (246)       |
| Comprehensive income attributable to Net1                       | \$ 35,060                                   | \$ 31,428   |

See Notes to Unaudited Condensed Consolidated Financial Statements

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

|                                                                                                           | <b>Three months ended<br/>September 30,</b> |                   |
|-----------------------------------------------------------------------------------------------------------|---------------------------------------------|-------------------|
|                                                                                                           | <b>2010</b>                                 | <b>2009</b>       |
|                                                                                                           | (In thousands)                              |                   |
| <b>Cash flows from operating activities</b>                                                               |                                             |                   |
| Net income                                                                                                | \$ 7,399                                    | \$ 17,597         |
| Depreciation and amortization                                                                             | 4,904                                       | 4,579             |
| Loss from equity-accounted investments                                                                    | 216                                         | 111               |
| Fair value adjustments                                                                                    | (3,106)                                     | (142)             |
| Interest payable                                                                                          | 73                                          | 78                |
| Profit on disposal of property, plant and equipment                                                       | (5)                                         | (1)               |
| Stock-based compensation charge                                                                           | 1,438                                       | 1,422             |
| Decrease in accounts receivable, pre-funded social welfare grants receivable and finance loans receivable | 10,957                                      | 5,529             |
| Increase in deferred expenditure on smart cards                                                           | (2)                                         | (30)              |
| (Increase) Decrease in inventory                                                                          | (2,102)                                     | 1,015             |
| Increase in accounts payable and other payables                                                           | 6,025                                       | 25                |
| Increase in taxes payable                                                                                 | 5,134                                       | 6,211             |
| (Decrease) Increase in deferred taxes                                                                     | (773)                                       | 575               |
| <b>Net cash provided by operating activities</b>                                                          | <b>30,158</b>                               | <b>36,969</b>     |
| <b>Cash flows from investing activities</b>                                                               |                                             |                   |
| Capital expenditures                                                                                      | (768)                                       | (641)             |
| Proceeds from disposal of property, plant and equipment                                                   | 7                                           | 49                |
| Advance of loans to equity-accounted investment                                                           | (375)                                       | -                 |
| Repayment of loan by equity-accounted investment                                                          | 373                                         | -                 |
| Net change in settlement assets                                                                           | (15,544)                                    | -                 |
| <b>Net cash used in investing activities</b>                                                              | <b>(16,307)</b>                             | <b>(592)</b>      |
| <b>Cash flows from financing activities</b>                                                               |                                             |                   |
| Loan portion related to options                                                                           | 20                                          | 720               |
| Treasury stock acquired                                                                                   | -                                           | (126,304)         |
| Net change in settlement obligations                                                                      | 15,544                                      | -                 |
| Repayment of loans                                                                                        | -                                           | (137)             |
| <b>Net cash generated from (used in) financing activities</b>                                             | <b>15,564</b>                               | <b>(125,721)</b>  |
| Effect of exchange rate changes on cash                                                                   | 17,004                                      | 7,870             |
| <b>Net increase (decrease) in cash and cash equivalents</b>                                               | <b>46,419</b>                               | <b>(81,474)</b>   |
| <b>Cash and cash equivalents beginning of period</b>                                                      | <b>153,742</b>                              | <b>220,786</b>    |
| <b>Cash and cash equivalents end of period</b>                                                            | <b>\$ 200,161</b>                           | <b>\$ 139,312</b> |

See Notes to Unaudited Condensed Consolidated Financial Statements

**NET 1 UEPS TECHNOLOGIES, INC.**

**Notes to the Unaudited Condensed Consolidated Financial Statements**

**for the Three Months Ended September 30, 2010 and 2009**

**(All amounts stated in thousands of United States Dollars, unless otherwise stated)**

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

**Unaudited Interim Financial Information**

The accompanying unaudited condensed consolidated financial statements include all majority-owned subsidiaries over which the Company exercises control and have been prepared in accordance with US generally accepted accounting principles ( GAAP ) and the rules and regulations of the Securities and Exchange Commission for quarterly reports on Form 10-Q and include all of the information and disclosures required for interim financial reporting. The results of operations for the three months ended September 30, 2010 and 2009 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, 2010. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments), which are necessary for a fair representation of financial results for the interim periods presented.

References to the Company refer to Net1 and its consolidated subsidiaries, unless the context otherwise requires. References to Net1 are references solely to Net 1 UEPS Technologies, Inc.

**Translation of foreign currencies**

The primary functional currency of the Company is the South African Rand ( ZAR ) and its reporting currency is the US dollar. The Company also has consolidated entities which have the euro, Russian ruble or Indian rupee as their functional currency. The current rate method is used to translate the financial statements of the Company to US dollar. 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 total equity.

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

**Recent accounting pronouncements adopted**

On July 1, 2010, the Company adopted the new Financial Accounting Standards Board ( FASB ) guidance on the consolidation of variable interest entities. This guidance changed how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity's purpose and design and the reporting entity's ability to direct the activities of the other entity that most significantly impact the other entity's economic performance. The guidance also requires a reporting entity to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to such involvement. The adoption of this guidance did not have an impact on the Company's condensed consolidated financial statements.

On July 1, 2010, the Company adopted the new FASB guidance issued on the accounting for transfers of financial assets. This guidance requires more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a qualifying special-purpose entity, changes the requirements for de-recognizing financial assets, and requires additional disclosures. The adoption of this guidance did not have an impact on the Company's condensed consolidated financial statements.

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

**Recent accounting pronouncements adopted (continued)**

On July 1, 2010, the Company adopted the new FASB guidance on revenue recognition in multiple-deliverable revenue arrangements. The guidance amended the existing guidance on allocating consideration received between the elements in a multiple-deliverable arrangement and established a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence ( VSOE ) if available, third-party evidence if VSOE is not available, or estimated selling price if neither VSOE nor third-party evidence is available. The guidance replaced the term fair value in the revenue allocation with selling price to clarify that the allocation of revenue is based on entity specific assumptions rather than the assumptions of a market place participant. The guidance eliminates the residual method of allocation and requires that arrangement consideration be allocated using the relative selling price method. It also significantly expands the disclosures related to a vendor s multiple-deliverable revenue arrangements. The adoption of this guidance did not have an impact on the Company s condensed consolidated financial statements for the periods presented..

On July 1, 2010, the Company adopted the new FASB guidance which amended the scope of existing software revenue recognition accounting. Tangible products containing software components and non-software components that function together to deliver the product s essential functionality would be scoped out of the accounting guidance on software and accounted for based on other appropriate revenue recognition guidance. This guidance must be adopted in the same period that the company adopts the amended guidance for arrangements with multiple deliverables described in the preceding paragraph. The adoption of this guidance did not have an impact on the Company s condensed consolidated financial statements for the periods presented.

On July 1, 2010, the Company adopted new FASB guidance on the effect of denominating the exercise price of a share-based payment award in the currency of the market in which the underlying equity security trades. This guidance clarifies that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity s equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. The adoption of this guidance did not have an impact on the Company s condensed consolidated financial statements for the periods presented.

**Recent accounting pronouncements not yet adopted as of September 30, 2010**

In July 2010, the FASB issued amendments to the disclosure requirements about the credit quality of financing receivables and the allowance for credit losses. The purpose of the additional disclosures is to enable users of financial statements to better understand the nature of credit risk inherent in an entity s portfolio of financing receivables and how that risk is analyzed. For end of period balances, the new disclosures are required to be made in all interim and annual periods ending on or after December 15, 2010. For activity during a reporting period, the disclosures are required to be made in all interim and annual periods after January 1, 2011. These changes will not have an impact on the Company s condensed consolidated financial results as this guidance only relates to additional disclosures.

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

Pre-funded social welfare grants receivable represents amounts pre-funded by the Company to certain merchants participating in the merchant acquiring system. The October 2010 payment service commenced during the last four days of September 2010 and was offered at merchant locations only.

**3. Inventory**

The Company s inventory comprised the following categories as of September 30, 2010 and June 30, 2010.

|                | <b>September<br/>30,<br/>2010</b> | <b>June 30,<br/>2010</b> |
|----------------|-----------------------------------|--------------------------|
| Raw materials  | \$ 160                            | \$ 75                    |
| Finished goods | 5,984                             | 3,547                    |
|                | \$ 6,144                          | \$ 3,622                 |
|                |                                   | 8                        |

---

#### 4. Fair value of financial instruments and equity-accounted investments

##### Fair value of financial instruments

###### *Risk management*

The Company seeks to reduce its 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, the Company uses financial instruments in order to economically hedge its exposure to exchange rate and interest rate fluctuations arising from its operations. The Company is also exposed to equity price and liquidity risks as well as credit risks.

###### *Currency exchange risk*

The Company is subject to currency exchange risk because it purchases inventories that it is required to settle in other currencies, primarily the euro and US dollar. The Company uses foreign exchange forward contracts in order to limit its exposure in these transactions to fluctuations in exchange rates between the South African rand, on the one hand, and the US dollar and the euro, on the other hand. In addition, during the first quarter of fiscal 2011, the Company entered into foreign exchange forward contracts in order to hedge the fluctuations in the ZAR/ US dollar related to the anticipated flow of funds from South Africa to the United States to fund a portion of the KSNET, Inc. ( KSNET ) purchase price.

The Company's outstanding foreign exchange contracts are as follows:

As of September 30, 2010

| Notional amount | Strike price | Fair market value price | Maturity          |
|-----------------|--------------|-------------------------|-------------------|
| EUR 480,000     | ZAR 9.7960   | ZAR 9.5740              | November 10, 2010 |
| EUR 288,000     | ZAR 9.4669   | ZAR 9.5356              | October 15, 2010  |
| ZAR 460,000,000 | USD 0.1397   | USD 0.1432              | October 1, 2010   |
| ZAR 460,000,000 | USD 0.1401   | USD 0.1426              | October 1, 2010   |

As of September 30, 2009

None.

###### *Translation risk*

Translation risk relates to the risk that the Company's results of operations will vary significantly as the US dollar is its reporting currency, but it earns most of its revenues and incurs most of its expenses in ZAR. The US dollar to ZAR exchange rate has fluctuated significantly over the past two years. As exchange rates are outside the Company's control, there can be no assurance that future fluctuations will not adversely affect the Company's results of operations and financial condition.

###### *Interest rate risk*

As a result of its normal borrowing and leasing activities, the Company's operating results are exposed to fluctuations in interest rates, which it manages primarily through regular financing activities. The Company generally maintains limited investment in cash equivalents and has occasionally invested in marketable securities.

###### *Credit risk*

Credit risk relates to the risk of loss that the Company would incur as a result of non-performance by counterparties. The Company maintains credit risk policies with regard to its 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 the Company's management deems appropriate.

With respect to credit risk on financial instruments, the Company maintains 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 credit rating agencies such as Standard & Poor's, Moody's and Fitch Ratings.



**4. Fair value of financial instruments and equity-accounted investments (continued)**

**Fair value of financial instruments (continued)**

***Risk management (continued)***

***Equity price and liquidity risk***

Equity price risk relates to the risk of loss that the Company would incur as a result of the volatility in the exchange-traded price of equity securities that it holds and the risk that it may not be able to liquidate these securities. On March 1, 2009, the Company acquired approximately 22% of the issued share capital of Finbond Group Limited ( Finbond ), which are exchange-traded equity securities. The fair value of these securities as of September 30, 2010, represented approximately 1% of the Company's total assets, including these securities. The Company expects to hold these securities for an extended period of time and it is not concerned with short-term equity price volatility with respect to these securities provided that the underlying business, economic and management characteristics of the company remain sound. The market price of these securities may fluctuate for a variety of reasons, consequently, the amount the Company may obtain in a subsequent sale of these securities may significantly differ from the reported market value.

Liquidity risk relates to the risk of loss that the Company would incur as a result of the lack of liquidity on the exchange on which these securities are listed. The Company may not be able to sell some or all of these securities at one time, or over an extended period of time without influencing the exchange traded price, or at all.

**Financial instruments**

The following section describes the valuation methodologies the Company uses to measure financial assets and liabilities at fair value.

***Investments in common stock***

In general, and where applicable, the Company uses quoted prices in active markets for identical assets or liabilities to determine fair value. This pricing methodology would apply to Level 1 investments. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then the Company uses quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. These investments would be included in Level 2 investments. In circumstances in which inputs are generally unobservable, values typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques. Investments valued using such techniques are included in Level 3 investments.

The Company's Level 3 asset represents an investment of 84,632,525 shares of common stock of Finbond. The Company's ownership interest in Finbond as of September 30, 2010, is approximately 22%. The Company has no rights to participate in the financial, operating, or governance decisions made by Finbond. The Company also has no participation on Finbond's board of directors whether through contractual agreement or otherwise. Consequently, the Company has concluded that it does not have significant influence over Finbond and therefore equity accounting is not appropriate.

Finbond's shares are traded on the JSE Limited ( JSE ) and the Company has designated such shares as available for sale investments. The Company has concluded that the market for Finbond shares is not active and consequently has employed alternative valuation techniques in order to determine the fair value of such stock. Currently, the operations of Finbond include primarily mortgage brokering services, property investment and microlending. In

determining the fair value of Finbond, the Company has considered amongst other things Finbond's historical financial information (including its most recent public accounts), press releases issued by Finbond and its published net asset value. The Company believes that the best indicator of fair value of Finbond is its published net asset value and has used this value to determine the fair value.

***Derivative transactions - Foreign exchange contracts***

As part of the Company's risk management strategy, the Company enters into derivative transactions to mitigate exposures to foreign currencies using foreign exchange contracts. These foreign exchange contracts are over-the-counter customized derivative transactions. Substantially all of the Company's derivative exposures are with counterparties that have long-term credit ratings of BBB or better. The Company uses quoted prices in active markets for similar assets and liabilities to determine fair value. The Company has no derivatives that require fair value measurement under Level 1 or 3 of the fair value hierarchy.

**4. Fair value of financial instruments and equity-accounted investments (continued)****Financial instruments (continued)**

The following table presents the Company's assets and liabilities measured at fair value on a recurring basis as of September 30, 2010 according to the fair value hierarchy:

|                                                                                                 | <b>Quoted<br/>Price in<br/>Active<br/>Markets<br/>for<br/>Identical<br/>Assets<br/>(Level 1)</b> | <b>Significant<br/>Other<br/>Observable<br/>Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> | <b>Total</b> |
|-------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|----------------------------------------------------------------------|--------------------------------------------------------------|--------------|
| <b>Assets</b>                                                                                   |                                                                                                  |                                                                      |                                                              |              |
| Investment in common stock<br>(available for sale assets included in<br>OTHER LONG-TERM ASSETS) | -                                                                                                | -                                                                    | \$ 8,009                                                     | \$ 8,009     |
| Total assets at fair value                                                                      | -                                                                                                | -                                                                    | \$ 8,009                                                     | \$ 8,009     |
| <b>Liabilities</b>                                                                              |                                                                                                  |                                                                      |                                                              |              |
| Foreign exchange contracts                                                                      | -                                                                                                | \$ 2,746                                                             | -                                                            | \$ 2,746     |
| Total liabilities at fair value                                                                 | -                                                                                                | \$ 2,746                                                             | -                                                            | \$ 2,746     |

The following table presents the Company's assets measured at fair value on a recurring basis as of September 30, 2009 according to the fair value hierarchy:

|                                                                                                 | <b>Quoted<br/>Price in<br/>Active<br/>Markets<br/>for<br/>Identical<br/>Assets<br/>(Level 1)</b> | <b>Significant<br/>Other<br/>Observable<br/>Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> | <b>Total</b> |
|-------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|----------------------------------------------------------------------|--------------------------------------------------------------|--------------|
| <b>Assets</b>                                                                                   |                                                                                                  |                                                                      |                                                              |              |
| Investment in common stock (available for<br>sale assets included in<br>OTHER LONG-TERM ASSETS) | -                                                                                                | -                                                                    | \$ 7,401                                                     | \$ 7,401     |
| Total assets at fair value                                                                      | -                                                                                                | -                                                                    | \$ 7,401                                                     | \$ 7,401     |
| <b><i>Assets and liabilities measured at fair value on a nonrecurring basis</i></b>             |                                                                                                  |                                                                      |                                                              |              |

The Company measures its equity-accounted investments at fair value on a nonrecurring basis. The Company has no liabilities that are measured at fair value on a nonrecurring basis. These equity-accounted investments are recognized at fair value when they are deemed to be other-than-temporarily impaired.

The Company reviews the carrying values of its investments when events and circumstances warrant and considers all available evidence in evaluating when declines in fair value are other-than-temporary. The fair values of the Company's investments are determined using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections. An impairment charge is recorded when the cost of the investment exceeds its fair value and the excess is determined to be other-than-temporary. The Company has not

recorded any impairment charges during the reporting periods presented herein.

During the three months ended September 30, 2010, SmartSwitch Namibia commenced repaying outstanding loans, including outstanding interest. The repayments received have been allocated to the equity-accounted investments presented in our condensed consolidated balance sheet as of September 30, 2010, and reduce this balance. The cash inflow from principal repayments have been allocated to cash flows from investing activities and the cash inflow from the interest repayments have been included in cash flow from operating activities in our condensed consolidated statement of cash flows for the three months ended September 30, 2010.

**4. Fair value of financial instruments and equity-accounted investments (continued)****Financial instruments (continued)***Assets and liabilities measured at fair value on a nonrecurring basis (continued)*

In July 2010, the Company provided additional loan funding of \$375,000 for a specific growth initiative at VTU Colombia. As of September 30, 2010, the Company's share in VTU Colombia's accumulated losses continued to exceed its investment. VTU Colombia's other shareholders are providing short-term funding for continued operations and the Company has no obligation to provide any additional funding at this stage.

The Company has sold hardware, software and/or licenses to SmartSwitch Namibia and SmartSwitch Botswana and defers recognition of 50% of the net income after tax related to these sales until SmartSwitch Namibia and SmartSwitch Botswana 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 US dollar and thus the investments are restated at the period end US dollar/foreign currency exchange rate with an entry against accumulated other comprehensive loss. The functional currency of SmartSwitch Namibia is the Namibian dollar, the functional currency of SmartSwitch Botswana is the Botswana pula, the functional currency of VTU Colombia is the Colombian peso and the functional currency of Vinapay is the Vietnamese dong.

Summarized below is the Company's interest in equity-accounted investments as of June 30, 2010 and September 30, 2010:

|                                                   | <b>Equity</b> | <b>Loans</b> | <b>Earnings<br/>(Loss)</b> | <b>Elimination</b> | <b>Total</b> |
|---------------------------------------------------|---------------|--------------|----------------------------|--------------------|--------------|
| Balance as of June 30, 2010                       | \$ 3,549      | \$ 2,512     | \$ (3,905)                 | \$ 442             | \$ 2,598     |
| Loans provided                                    |               | 375          |                            |                    | 375          |
| Loan repaid                                       |               | (441)        |                            |                    | (441)        |
| (Loss) Earnings from equity-accounted investments | -             | -            | (302)                      | 86                 | (216)        |
| SmartSwitch Namibia <sup>(1)</sup>                | -             | -            | 20                         | 24                 | 44           |
| SmartSwitch Botswana <sup>(1)</sup>               | -             | -            | (54)                       | 62                 | 8            |
| VTU Colombia                                      | -             | -            | (245)                      | -                  | (245)        |
| VinaPay                                           | -             | -            | (23)                       | -                  | (23)         |
| Foreign currency adjustment <sup>(2)</sup>        | 225           | 179          | (298)                      | (46)               | 60           |
| Balance as of September 30, 2010                  | \$ 3,774      | \$ 2,625     | \$ (4,505)                 | \$ 482             | \$ 2,376     |

(1) includes the recognition of realized net income.

(2) the foreign currency adjustment represents the effects of the combined net currency fluctuations between the functional currency of the equity-accounted investments and the US dollar.

There were no significant sales to these investees that require elimination during the three months ended September 30, 2010 and 2009.

**5. Goodwill and intangible assets****Goodwill**

Summarized below is the movement in the carrying value of goodwill for the three months ended September 30, 2010.

**Carrying  
value**

|                                            |    |        |
|--------------------------------------------|----|--------|
| Balance as of June 30, 2010                | \$ | 76,346 |
| Foreign currency adjustment <sup>(1)</sup> |    | 6,857  |
| Balance as of September 30, 2010           | \$ | 83,203 |

(1) the foreign currency adjustment represents the effects of the fluctuations between the ZAR against the US dollar on the carrying value of goodwill.

**5. Goodwill and intangible assets (continued)****Goodwill (continued)**

Goodwill has been allocated to the Company's reportable segments as follows:

|                                                 | As of<br>September<br>30, 2010 | As of<br>June 30,<br>2010 |
|-------------------------------------------------|--------------------------------|---------------------------|
| Transaction-based activities                    | \$ 41,221                      | \$ 37,568                 |
| Smart card accounts                             | -                              | -                         |
| Financial services                              | -                              | -                         |
| Hardware, software and related technology sales | 41,982                         | 38,778                    |
| Total                                           | \$ 83,203                      | \$ 76,346                 |

**Intangible assets**

Summarized below is the carrying value and accumulated amortization of the intangible assets as of September 30, 2010 and June 30, 2010:

|                                               | As of September 30, 2010   |                             |                          | As of June 30, 2010        |                             |                          |
|-----------------------------------------------|----------------------------|-----------------------------|--------------------------|----------------------------|-----------------------------|--------------------------|
|                                               | Gross<br>carrying<br>value | Accumulated<br>amortization | Net<br>carrying<br>value | Gross<br>carrying<br>value | Accumulated<br>amortization | Net<br>carrying<br>value |
| Finite-lived<br>intangible<br>assets:         |                            |                             |                          |                            |                             |                          |
| Customer<br>relationships                     | \$ 85,998                  | \$ (27,673)                 | \$ 58,325                | \$ 77,452                  | \$ (22,519)                 | \$ 54,933                |
| Software<br>and unpatented<br>technology      | 12,121                     | (2,484)                     | 9,637                    | 11,047                     | (1,343)                     | 9,704                    |
| FTS patent                                    | 5,494                      | (5,354)                     | 140                      | 5,007                      | (4,880)                     | 127                      |
| Exclusive<br>licenses                         | 4,506                      | (4,103)                     | 403                      | 4,506                      | (3,941)                     | 565                      |
| Trademarks                                    | 4,132                      | (1,645)                     | 2,487                    | 3,766                      | (1,411)                     | 2,355                    |
| Customer<br>database                          | 872                        | (218)                       | 654                      | 795                        | (132)                       | 663                      |
| Total<br>finite-lived<br>intangible<br>assets | \$ 113,123                 | \$ (41,477)                 | \$ 71,646                | \$ 102,573                 | \$ (34,226)                 | \$ 68,347                |

Aggregate amortization expense on the finite-lived intangible assets for the three months ended September 30, 2010, was approximately \$3.9 million (three months ended September 30, 2009, was approximately \$3.6 million).

Future estimated annual amortization expense for the next five fiscal years, assuming exchange rates prevailing on September 30, 2010, is presented in the table below. Actual amortization expense in future periods could differ from this estimate as a result of acquisitions, changes in useful lives, exchange rate fluctuations and other relevant

factors.

|      |    |        |
|------|----|--------|
| 2011 | \$ | 15,819 |
| 2012 |    | 15,256 |
| 2013 |    | 13,637 |
| 2014 |    | 10,925 |
| 2015 | \$ | 10,925 |

#### **6. Short-term facilities**

As of September 30, 2010, the Company had a short-term facility in South African Rand of approximately \$35.8 million, translated at exchange rates applicable as of September 30, 2010, with Nedbank Limited ( "Nedbank" ). As of September 30, 2010, the overdraft rate on this facility was 8.35% . Certain of the Company's South African subsidiaries have provided a cross deed of suretyship whereby each of these companies has bound itself as surety and co-principal debtor with each other for the fulfillment of each other's obligations under the facility. These South African subsidiaries have agreed that any debit and credit bank account balances with Nedbank may be set off against each other. Certain South African subsidiaries have ceded trade receivables with an aggregate value of approximately \$19.3 million, translated at exchange rates applicable as of September 30, 2010, as security for the facility as well as the Company's investment in Cash Paymaster Services (Proprietary) Limited, a wholly owned South African subsidiary. As of September 30, 2010, the Company had utilized none of its South African short-term facility.



**6. Short-term facilities (continued)**

In addition, Net1 UTA had short-term facilities of approximately \$1.4 million, translated at exchange rates applicable as of September 30, 2010, with each of two of Austria's largest banks. These facilities are available to the Company. The interest rate applicable to these short-term facilities is negotiated when the facilities are utilized. As of September 30, 2010, the Company had utilized none of its Austrian short-term facilities.

Management believes that the Company's current short-term facilities are sufficient in order to meet its future obligations as they arise.

**7. Capital structure**

The Company's capital structure is described in Note 11 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, 2010.

**Common stock repurchases**

During the three months ended September 30, 2010, the Company did not repurchase any shares. On July 28, 2009, the Company repurchased an aggregate of 9,221,526 shares of its common stock from two shareholders, who originally acquired their shares in connection with the Aplitec transaction. The purchase price was \$13.50 (ZAR 105.98) per share and was paid from the Company's cash reserves in ZAR for an aggregate purchase price of \$124.5 million (ZAR 977.3 million).

**8. Earnings per share**

Basic earnings per share includes restricted stock awards that meet the definition of a participating security. Restricted stock awards are eligible to receive non-forfeitable dividend equivalents at the same rate as common stock. Basic earnings per share have been calculated using the two-class method and basic earnings per share for the three months ended September 30, 2010 and 2009, reflects only undistributed earnings.

Diluted earnings per share have been calculated to give effect to the number of additional shares of common stock that would have been outstanding if the potential dilutive instruments had been issued in each period. The calculation of diluted earnings per share for the three months ended September 30, 2010 and 2009, includes the dilutive effect of a portion of the restricted stock awards granted to employees in August 2007 as these restricted stock awards are considered contingently issuable shares for the purposes of the diluted earnings per share calculation and as of September 30, 2010 and 2009, the vesting conditions in respect of a portion of the awards had been satisfied.

The following table details the weighted average number of outstanding shares used for the calculation of earnings per share for the three months ended September 30, 2010 and 2009.

|                                                                         | <b>Three months ended<br/>September 30,</b> |                     |
|-------------------------------------------------------------------------|---------------------------------------------|---------------------|
|                                                                         | <b>2010<br/>000</b>                         | <b>2009<br/>000</b> |
| Weighted average number of outstanding shares of common stock - basic   | 45,384                                      | 48,815              |
| Weighted average effect of dilutive securities: employee stock options  | 32                                          | 103                 |
| Weighted average number of outstanding shares of common stock - diluted | 45,416                                      | 48,918              |



## 9. Stock-based compensation

### Stock option and restricted stock activity

#### *Options*

The following table summarizes stock option activity for the three months ended September 30, 2010, and 2009:

|             |                    | Number<br>of shares | Weighted<br>average<br>exercise<br>price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(in years) | Aggregate<br>Intrinsic<br>Value | Weighted<br>Average<br>Grant<br>Date Fair<br>Value |
|-------------|--------------------|---------------------|------------------------------------------|-----------------------------------------------------------------------|---------------------------------|----------------------------------------------------|
| Outstanding | July 1, 2010       | 1,813,656           | \$ 19.76                                 | 7.41                                                                  | \$ 585                          |                                                    |
| Outstanding | September 30, 2010 | 1,813,656           | \$ 19.76                                 | 7.16                                                                  | \$ 366                          |                                                    |
| Outstanding | July 1, 2009       | 1,896,994           | \$ 19.03                                 | 8.30                                                                  | \$ 1,576                        |                                                    |
| Exercised   |                    | (83,338)            | -                                        | -                                                                     | \$ 1,667                        |                                                    |
| Outstanding | September 30, 2009 | 1,813,656           | \$ 19.76                                 | 8.20                                                                  | \$ 5,135                        |                                                    |

No stock options became exercisable during the three months ended September 30, 2010 and 2009.

No stock options were exercised during the three months ended September 30, 2010. During the three months ended September 30, 2009, the Company received approximately \$0.3 million from stock options exercised and approximately \$0.4 million from repayment of stock option-related loans. The Company issues new shares to satisfy stock option exercises.

#### *Restricted stock*

The following table summarizes restricted stock activity for the three months ended September 30, 2010, and 2009:

|            |                    | Number of<br>Shares of<br>Restricted<br>Stock | Weighted<br>Average<br>Grant<br>Date Fair<br>Value |
|------------|--------------------|-----------------------------------------------|----------------------------------------------------|
| Non-vested | July 1, 2010       | 407,828                                       | -                                                  |
| Granted    | August 2010        | 13,956                                        | \$ 185                                             |
| Vested     | September 2010     | (201,704)                                     | -                                                  |
| Non-vested | September 30, 2010 | 220,080                                       | -                                                  |
| Non-vested | July 1, 2009       | 597,162                                       | -                                                  |
| Granted    | August 2009        | 10,098                                        | \$ 185                                             |
| Vested     | September 2009     | (198,338)                                     | -                                                  |

|            |                    |         |   |
|------------|--------------------|---------|---|
| Non-vested | September 30, 2009 | 408,922 | - |
|------------|--------------------|---------|---|

The fair value of restricted stock vested during the three months ended September 30, 2010 and 2009, was \$2.3 million and \$3.8 million, respectively.

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

The Company has recorded a stock compensation charge of \$1.4 million for each of the three months ended September 30, 2010 and 2009, respectively, which comprised:

|                                              |                                              | <b>Total<br/>charge</b> | <b>Allocated<br/>to<br/>cost of<br/>goods<br/>sold, IT<br/>processing,<br/>servicing<br/>and<br/>support</b> | <b>Allocated to<br/>selling,<br/>general and<br/>administration</b> |
|----------------------------------------------|----------------------------------------------|-------------------------|--------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------|
| <b>Three months ended September 30, 2010</b> |                                              |                         |                                                                                                              |                                                                     |
| Stock-based compensation charge              | \$                                           | 1,437                   | \$ 51                                                                                                        | \$ 1,386                                                            |
| <b>Total</b>                                 | <b>Three months ended September 30, 2010</b> | <b>\$ 1,437</b>         | <b>\$ 51</b>                                                                                                 | <b>\$ 1,386</b>                                                     |
| <b>Three months ended September 30, 2009</b> |                                              |                         |                                                                                                              |                                                                     |
| Stock-based compensation charge              | \$                                           | 1,422                   | \$ 51                                                                                                        | \$ 1,371                                                            |
| <b>Total</b>                                 | <b>Three months ended September 30, 2009</b> | <b>\$ 1,422</b>         | <b>\$ 51</b>                                                                                                 | <b>\$ 1,371</b>                                                     |

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

As of September 30, 2010, the total unrecognized compensation cost related to stock options was approximately \$4.0 million, which the Company expects to recognize over approximately three and a half years. As of September 30, 2010, the total unrecognized compensation cost related to restricted stock awards was approximately \$3.4 million, which the Company expects to recognize over approximately one year.

As of September 30, 2010, the Company has recorded a deferred tax asset of approximately \$0.8 million related to the stock-based compensation charge recognized related to employees of Net1 as it is able to deduct the grant date fair value for taxation purposes in the United States.

**10. Operating segments**

The Company discloses segment information as reflected in the management information systems reports that its chief operating decision makers use in making decisions and to report certain entity-wide disclosures about products and services, major customers, and the countries in which the entity holds material assets or reports material revenues.

The Company currently has four reportable segments: Transaction-based activities, Smart card accounts, Financial services and Hardware, software and related technology sales. Each segment, other than the Hardware, software and related technology sales segment, operates mainly within South Africa. The Company's reportable segments offer different products and services and require different resources and marketing strategies and share the Company's assets.

The Transaction-based activities segment currently consists mainly of a state pension and welfare benefit distribution service provided to the South African government, transaction processing for retailers, utilities, medical-related claim service customers and banks and transaction fees generated from UEPS-enabled smartcards used in Iraq. 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 banks 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 the three months ended September 30, 2010, there was one such customer providing 60% of total revenue (the three months ended September 30, 2009: there was one such customer providing 72% 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 provides short-term loans as a principal and life insurance products on an agency basis and generates initiation and services fees.

**10. Operating segments (continued)**

The Hardware, software and related technology sales segment markets, sells and implements the UEPS as well as develops and provides Prism secure transaction technology, solutions and services. From September 1, 2008, the segment includes the operations of Net1 UTA, which comprise mainly hardware sales and licenses of the DUET system. 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, SIM card licenses and other software 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.

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

|                                                 | <b>Three months ended<br/>September 30,</b> |             |
|-------------------------------------------------|---------------------------------------------|-------------|
|                                                 | <b>2010</b>                                 | <b>2009</b> |
| <b>Revenues to external customers</b>           |                                             |             |
| Transaction-based activities                    | \$ 44,892                                   | \$ 44,978   |
| Smart card accounts                             | 7,970                                       | 8,074       |
| Financial services                              | 1,248                                       | 792         |
| Hardware, software and related technology sales | 10,173                                      | 11,670      |
| Total                                           | 64,283                                      | 65,514      |
| <b>Inter-company revenues</b>                   |                                             |             |
| Transaction-based activities                    | 936                                         | 1,031       |
| Smart card accounts                             | -                                           | -           |
| Financial services                              | -                                           | -           |
| Hardware, software and related technology sales | 262                                         | 518         |
| Total                                           | 1,198                                       | 1,549       |
| <b>Operating income</b>                         |                                             |             |
| Transaction-based activities                    | 17,776                                      | 26,668      |
| Smart card accounts                             | 3,622                                       | 3,670       |
| Financial services                              | 929                                         | 531         |
| Hardware, software and related technology sales | (2,660)                                     | (1,713)     |
| Corporate/Eliminations                          | (8,681)                                     | (2,788)     |
| Total                                           | 10,986                                      | 26,368      |
| <b>Interest earned</b>                          |                                             |             |
| Transaction-based activities                    | -                                           | -           |
| Smart card accounts                             | -                                           | -           |
| Financial services                              | -                                           | -           |
| Hardware, software and related technology sales | -                                           | -           |
| Corporate/Eliminations                          | 3,084                                       | 2,647       |
| Total                                           | 3,084                                       | 2,647       |
| <b>Interest expense</b>                         |                                             |             |
| Transaction-based activities                    | 226                                         | 265         |
| Smart card accounts                             | -                                           | -           |

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

|                                                 |        |        |
|-------------------------------------------------|--------|--------|
| Financial services                              | -      | 1      |
| Hardware, software and related technology sales | 1      | 2      |
| Corporate/Eliminations                          | 21     | 8      |
| Total                                           | \$ 248 | \$ 276 |

17



**10. Operating segments (continued)**

|                                                 | <b>Three months ended<br/>September 30,</b> |             |
|-------------------------------------------------|---------------------------------------------|-------------|
|                                                 | <b>2010</b>                                 | <b>2009</b> |
| <b>Depreciation and amortization</b>            |                                             |             |
| Transaction-based activities                    | \$ 2,176                                    | \$ 1,481    |
| Smart card accounts                             | -                                           | -           |
| Financial services                              | 133                                         | 123         |
| Hardware, software and related technology sales | 2,421                                       | 2,686       |
| Corporate/Eliminations                          | 174                                         | 289         |
| Total                                           | 4,904                                       | 4,579       |
| <b>Income taxation expense</b>                  |                                             |             |
| Transaction-based activities                    | 4,960                                       | 7,512       |
| Smart card accounts                             | 1,014                                       | 1,027       |
| Financial services                              | 260                                         | 149         |
| Hardware, software and related technology sales | (596)                                       | 34          |
| Corporate/Eliminations                          | 569                                         | 2,309       |
| Total                                           | 6,207                                       | 11,031      |
| <b>Net income</b>                               |                                             |             |
| Transaction-based activities                    | 12,623                                      | 18,966      |
| Smart card accounts                             | 2,610                                       | 2,643       |
| Financial services                              | 669                                         | 381         |
| Hardware, software and related technology sales | (2,061)                                     | (1,733)     |
| Corporate/Eliminations                          | (6,412)                                     | (2,316)     |
| Total                                           | 7,429                                       | 17,941      |
| <b>Segment assets</b>                           |                                             |             |
| Total                                           | 552,597                                     | 424,306     |
| <b>Expenditures for long-lived assets</b>       |                                             |             |
| Transaction-based activities                    | 693                                         | 416         |
| Smart card accounts                             | -                                           | -           |
| Financial services                              | 59                                          | 60          |
| Hardware, software and related technology sales | 16                                          | 165         |
| Corporate/Eliminations                          | -                                           | -           |
| Total                                           | \$ 768                                      | \$ 641      |

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

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

**11. Income tax in interim periods**

For the purposes of interim financial reporting, the Company determines the appropriate income tax provision 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, for instance non-deductible transaction-related expenses, that are reported separately, and have an impact on the tax charge. The cumulative effect of any change in the enacted tax rate, if and when applicable, 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 months ended September 30, 2010, the tax charge was calculated using the expected effective tax rate for the year. The Company's effective tax rate for the three months ended September 30, 2010, was 44.9% as a result of non-deductible expenses, including transaction-related expenses relating to the acquisition of KSNET.

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

The Company increased its unrecognized tax benefits by \$0.1 million during the three months ended September 30, 2010. As of September 30, 2010, the Company had accrued interest related to uncertain tax positions of approximately \$0.1 million on its balance sheet.

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

The Company files income tax returns mainly in South Africa, Austria, the Russian Federation and in the US federal jurisdiction. As of September 30, 2010, the Company is no longer subject to income tax examination by the South African Revenue Service for years before September 30, 2007. The Company is subject to income tax in other jurisdictions outside South Africa, none of which are individually material to its financial position, statement of cash flows, or results of operations.

## 12. Subsequent events

On October 29, 2010, the Company acquired KSNET for KRW 270 billion (approximately \$240 million based on exchange rates on October 29, 2010). The acquisition of KSNET expands the Company's international footprint as well as diversifies the Company's revenue, earnings and product portfolio. The combination is expected to capitalize on multiple revenue synergies and provide an established base in Asia for further business development activities in the region.

The Company financed a portion of the KSNET acquisition price and related transaction expenses with the proceeds of a KRW 130.5 billion (approximately \$115.9 million based on October 29, 2010 exchange rates) five-year senior secured loan facility provided by a consortium of banks under a facilities agreement (the "Facilities Agreement"). The Facilities Agreement provides for three separate facilities: a Facility A loan to the Company's wholly owned subsidiary, Net1 Applied Technologies Korea ("Net1 Korea"), of up to KRW 130.5 billion (divided into Facility A1 (KRW 65.5 billion) and Facility A2 (KRW 65.0 billion)) and a Facility B loan to KSNET of up to KRW 65.0 billion. The Facility B loan, if drawn, must be used to repay the Facility A2 loan and may be borrowed only if Net1 Korea and KSNET complete a merger transaction with each other. Interest on the loans is payable quarterly and is based on the Korean CD rate in effect from time to time plus a margin of 4.10% for Facility A loans and 3.90% for the Facility B loan. The Facility A1 loan matures on the fifth anniversary of the initial drawdown with no required principal prepayments. Principal on the Facility A2 loan and Facility B loan is repayable in scheduled installments, beginning twelve months after initial drawdown and thereafter, semi-annually with final maturity scheduled for 54 months after initial drawdown. The loans are secured by substantially all of KSNET's assets, a pledge by Net1 Korea of its entire equity interest in KSNET and a pledge by the immediate parent of Net1 Korea (also one of the Company's subsidiaries) of its entire equity interest in Net1 Korea. The Facilities Agreement contains customary covenants that require Net1 Korea and its consolidated subsidiaries to maintain certain specified financial ratios (including a leverage ratio and a debt service coverage ratio) and restrict their ability to make certain distributions with respect to their capital stock, prepay other debt, encumber their assets, incur additional indebtedness, make capital expenditures above specified levels, engage in certain business combinations and engage in other corporate activities. The loans under the Facilities Agreement are without recourse to, and the covenants and other agreements contained therein do not apply to, the Company or any of our subsidiaries (other than Net1 Korea and its subsidiaries, including KSNET).

The Company incurred transaction-related expenditures of \$3.2 million during the three months ended September 30, 2010, related to this acquisition and expects to incur additional such expenses during the three months ending December 31, 2010. The Company is currently unable to quantify the amount of these additional expenditures.



## **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 unaudited condensed consolidated financial statements and the notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q.

### **Forward-looking statements**

Some of the statements in this Quarterly Report on Form 10-Q constitute forward-looking statements. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed, implied or inferred by these forward-looking statements. Such factors include, among other things, those listed under "Risk Factors" and elsewhere in our Annual Report on Form 10-K for the year ended June 30, 2010, and in Part II, Item 1A of this Quarterly Report on Form 10-Q. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "could," "would," "expects," "plans," "intends," "anticipates," "predicts," "potential" or "continue" or the negative of such terms and other comparable terminology.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we do not know whether we can achieve positive future results, levels of activity, performance, or goals. Actual events or results may differ materially. We undertake no obligation to update any of the forward-looking statements after the date of this 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.

### **Business Developments During Fiscal 2011**

#### ***South Africa***

##### ***New SASSA contract***

On August 24, 2010, we entered into a new service level agreement with SASSA which replaced our previous SASSA contract that expired on June 30, 2010. The new agreement is retroactively effective from July 1, 2010 and expires on March 31, 2011. Under the contract, we continue to provide our social welfare grants distribution service to SASSA in five of South Africa's nine provinces (KwaZulu-Natal, Limpopo, North West, Northern Cape and Eastern Cape). As was the case with our previous contract, the new contract contains a standard pricing formula for all provinces based on a transaction fee per beneficiary paid, regardless of the number or amount of grants paid per beneficiary, calculated on a guaranteed minimum number of beneficiaries per month. However, the new contract provides for a reduction in both the level of the transaction fee per beneficiary paid and the guaranteed minimum number of beneficiaries.

As we previously announced when we signed the new contract, we continue to derive a substantial percentage of our revenues from our SASSA contract, and thus we expect that its terms will materially reduce our revenues, operating income, net income and cash flow for fiscal 2011, unless we are able to offset reduced fees from SASSA by increasing our revenues from our other business activities, reducing expenses, or both.

*EasyPay Kiosk pilot project*

In September 2010, we launched our EasyPay Kiosk, or EP Kiosk, pilot project at select locations in the Gauteng province of South Africa. The EP Kiosk enables users to purchase prepaid electricity and airtime and perform any post paid bill payment service requirements using the interactive user-friendly touch screen kiosk interface. The user will also be able to transfer prepaid voucher value to other mobile phone users. Users can register their own prepaid voucher wallet on the EP Kiosk, with access to the wallet guaranteed via biometric identification of the user at time of registration. A five digit personal identification number, or PIN, is also required by the user so as to facilitate transactions done via their own mobile phones or via the website.

The EP Kiosk is a cash-acceptor and does not issue change, rather it issues a prepaid value voucher in lieu of change which can be used to purchase prepaid electricity and airtime or perform any post paid bill payment service requirements through an EP Kiosk or via the internet.

The pilot project will last until the end of the second quarter of fiscal 2011 at which time we will assess whether the EP Kiosk is a viable business medium.

### ***Outside South Africa***

#### ***Acquisition of KSNET, Inc., or KSNET, in the Republic of Korea***

On October 29, 2010, we acquired 98.73% of KSNET, a leading Republic of Korea payment processor, for KRW 270 billion (approximately \$240 million based on October 29, 2010 exchange rates). Most of KSNET's revenue is derived from the provision of payment processing services to approximately 200,000 merchants and to card issuers in Korea through its value-added network, or VAN. KSNET has a diverse product offering and we believe it is the only total payments solutions provider offering card VAN, payment gateway and banking VAN services in Korea, which differentiates KSNET from other Korean payment solution providers and allows it to cross-sell its products across its customer base.

The acquisition of KSNET expands our international footprint as well as diversifies our revenue, earnings and product portfolio. The combination is expected to capitalize on multiple revenue synergies and provide an established base in Asia for further business development activities in the region.

#### ***The African Continent and Iraq***

During the first quarter of fiscal 2011, we recorded revenue from transaction fees and the delivery of UEPS-enabled smartcards under our contract with the government of Iraq. We expect to generate ongoing revenues from transaction fees under our Iraqi contract and from smart card sales during the second quarter of fiscal 2011. We have entered the second phase of our initiative in Ghana and now generate recurring income in the form of hardware and software maintenance fees.

We continue to service our current customers on the African continent and in Iraq. Our UETS business unit continued its business development efforts in multiple new countries on the African continent during the quarter.

During the first quarter of fiscal 2011, SmartSwitch Namibia generated incremental transaction fees from prepaid airtime and electricity transactions and transactions conducted between Namibian merchants and UEPS-enabled smartcards. SmartSwitch Botswana generated transaction fees during the first quarter of fiscal 2011 from the payment of food voucher grants. We expect SmartSwitch Namibia and Botswana to continue generating transaction fees during the second quarter of fiscal 2011.

SmartSwitch Namibia is no longer dependent on shareholder funding and commenced repayment of its shareholder loans and interest during the first quarter of fiscal 2011. We expect SmartSwitch Botswana to commence the repayment of shareholder loan funding and interest during the second quarter of fiscal 2011.

#### ***Net 1 Universal Technologies (Austria) AG, or Net1 UTA***

Net1 UTA's operations are seasonal and the first quarter and third quarters are historically its weakest. Growth at Net1 UTA during the first quarter of fiscal 2011 continued to be adversely impacted by our transitioning of its business model from a hardware and software sale-oriented model to one which generates recurring transaction fees, as well as by challenging economic conditions in Eastern Europe. During the first quarter of fiscal 2011 we sold hardware and software licenses to a customer in Uzbekistan.

#### ***Net1 Virtual Card***

We launched our VCPay™, offering in the United States during the first quarter of fiscal 2011. Our mobile phone-based virtual payment card application is designed to eliminate fraud in Card-Not-Present ( CNP ) transactions. We have teamed up with MetroPCS Communications, Inc., or MetroPCS, The Bancorp Bank, a wholly-owned subsidiary of The Bancorp, Inc., FSV Payment Systems and MoneyGram International to offer a comprehensive card issuing, processing and distribution network to wireless subscribers in the United States.

MetroPCS will offer VCpay to its prepaid customers as an application that will be pre-loaded on new smartphones or can be downloaded on select existing devices. VCpay allows a subscriber to generate a unique, one-time use prepaid virtual card number to securely purchase goods and services or perform bill payments in any CNP environment. We believe that the VCpay application is the first mobile phone-based prepaid program with no requirement for the user to have a physical card or a bank account. Subscribers can load their prepaid virtual accounts with cash at any of MoneyGram's 40,000 U.S. agent locations, which are located in most communities including many grocery, pharmacy and convenience store chains.



## 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, 2010.

- Deferred taxation;
- Stock-based compensation;
- Intangible assets acquired through acquisitions;
- Accounts receivable and provision 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 adopted as of September 30, 2010, 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 September 30, 2010

Refer to Note 1 of the unaudited condensed consolidated financial statements for a full description of recent accounting pronouncements not yet adopted as of September 30, 2010, 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:

| Table 1                             | Three months ended |        | Year ended |
|-------------------------------------|--------------------|--------|------------|
|                                     | September 30,      |        | June 30,   |
|                                     | 2010               | 2009   | 2010       |
| ZAR : \$ average exchange rate      | 7.3577             | 7.8270 | 7.6117     |
| Highest ZAR : \$ rate during period | 7.7809             | 8.3187 | 8.3187     |
| Lowest ZAR : \$ rate during period  | 6.9190             | 7.2838 | 7.1731     |
| Rate at end of period               | 6.9750             | 7.4327 | 7.6529     |

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

We are required to translate our results of operations from ZAR to US dollars on a monthly basis. Thus, the average rates used to translate this data for the three months ended September 30, 2010 and 2009, vary slightly from the averages shown in the table above. The translation rates we use in presenting our results of operations are the rates shown in the following table:

| <b>Table 2</b>                      | <b>Three months ended</b> |                      | <b>Year ended</b> |
|-------------------------------------|---------------------------|----------------------|-------------------|
|                                     | <b>September 30,</b>      | <b>September 30,</b> | <b>June 30,</b>   |
|                                     | <b>2010</b>               | <b>2009</b>          | <b>2010</b>       |
| Income and expense items: \$1 = ZAR | 7.4053                    | 7.8153               | 7.6092            |
| Balance sheet items: \$1 = ZAR      | 6.9750                    | 7.4327               | 7.6529            |

**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 US dollars and are prepared in accordance with US GAAP. Our discussion analyzes our results of operations both in US 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 US dollar and ZAR on our reported results and because we use the US 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. The results of operation for the three months ended September 30, 2010, include the operations of MediKredit and FIHRST, which have been allocated to our transaction-based activities operating segment.

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.

**First quarter fiscal 2011 compared to the first quarter of fiscal 2010**

The following factors had an influence on our results of operations during the first quarter of fiscal 2011 as compared with the same period in the prior year:

- **SASSA price and volume reductions:** Our new contract with SASSA has reduced our revenue and operating income as a result of the previously announced price and volume reductions;
- **Favorable impact from the weakness of the US dollar:** The US dollar depreciated by 5% compared to the ZAR during the first quarter of fiscal 2011 compared to fiscal 2010 which has had a positive impact on our reported results;
- **Increased transaction volumes at EasyPay:** Our reported results were favorably impacted by increased transaction volumes at EasyPay resulting from growth in value-added services;
- **Increased revenue from MediKredit and FIRHST at lower operating margins than other transaction-based activity business:** Our MediKredit and FIRHST acquisitions positively impacted our revenue during the first quarter of fiscal 2011, however, because MediKredit generated a modest operating loss and FIRHST has operating margin that is lower than our other transaction-based activity businesses, they negatively impacted our operating margin. The inclusion of these businesses in our results has also contributed to the increase in selling, general and administration expense;
- **Increased user adoption in Iraq:** Our reported results were positively impacted by increased transaction revenues from the adoption of our UEPS technology in Iraq;
- **Lower revenues and margins from hardware, software and related technology sales segment:** Our hardware, software and related technology sales segment continues to be adversely impacted by lower revenues generated by card sales and software maintenance and development activities and fewer ad hoc sales to Iraq when compared to a year ago, partially offset by increased hardware sales by Net1 UTA;
- **Intangible asset amortization related to acquisitions:** Our reported results were adversely impacted by additional intangible asset amortization of approximately \$0.5 million related to the acquisitions of MediKredit and FIRHST during the third quarter of fiscal 2010; and
- **Non-recurring items included in selling, general and administration expense:** During the first quarter of fiscal 2011, we recognized, in selling, general and administration expense, an unrealized foreign exchange loss of \$2.6 million and incurred transaction-related expenses of \$3.4 million, primarily for the acquisition of KSNET.

**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 US dollars and in ZAR:

|                                                          | In United States Dollars<br>(US GAAP) |                |                |
|----------------------------------------------------------|---------------------------------------|----------------|----------------|
|                                                          | Three months ended September 30,      |                |                |
|                                                          | 2010<br>\$ 000                        | 2009<br>\$ 000 | \$ %<br>change |
| Revenue                                                  | 64,283                                | 65,514         | (2)%           |
| Cost of goods sold, IT processing, servicing and support | 18,067                                | 16,827         | 7%             |
| Selling, general and administration                      | 30,326                                | 17,740         | 71%            |
| Depreciation and amortization                            | 4,904                                 | 4,579          | 7%             |
| Operating income                                         | 10,986                                | 26,368         | (58)%          |
| Interest income, net                                     | 2,836                                 | 2,371          | 20%            |
| Income before income taxes                               | 13,822                                | 28,739         | (52)%          |

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

|                                                          |       |        |       |
|----------------------------------------------------------|-------|--------|-------|
| Income tax expense                                       | 6,207 | 11,031 | (44)% |
| Net income before loss from equity-accounted investments | 7,615 | 17,708 | (57)% |
| Loss from equity-accounted investments                   | (216) | (111)  | 95%   |
| Net income                                               | 7,399 | 17,597 | (58)% |
| Add: net loss attributable to non-controlling interest   | (30)  | (344)  | (91)% |
| Net income attributable to us                            | 7,429 | 17,941 | (59)% |

24

**Table 4**

**In South African Rand  
(US GAAP)  
Three months ended September 30,**

|  | <b>2010<br/>ZAR<br/>000</b> | <b>2009<br/>ZAR<br/>000</b> | <b>ZAR<br/>%<br/>change</b> |
|--|-----------------------------|-----------------------------|-----------------------------|
|--|-----------------------------|-----------------------------|-----------------------------|

|                                                          |         |         |       |
|----------------------------------------------------------|---------|---------|-------|
| Revenue                                                  | 476,035 | 512,011 | (7)%  |
| Cost of goods sold, IT processing, servicing and support | 133,791 | 131,508 | 2%    |
| Selling, general and administration                      | 224,573 | 138,644 | 62%   |
| Depreciation and amortization                            | 36,315  | 35,786  | 1%    |
| Operating income                                         | 81,356  | 206,073 | (61)% |
| Interest income, net                                     | 21,001  | 18,530  | 13%   |
| Income before income taxes                               | 102,357 | 224,603 | (54)% |
| Income tax expense                                       | 45,965  | 86,210  | (47)% |
| Net income before loss from equity-accounted investments | 56,392  | 138,393 | (59)% |
| Loss from equity-accounted investments                   | (1,600) | (867)   | 85%   |
| Net income                                               | 54,792  | 137,526 | (60)% |
| Add: net loss attributable to non-controlling interest   | (222)   | (2,688) | (92)% |
| Net income attributable to us                            | 55,014  | 140,214 | (61)% |

Analyzed in ZAR, the decrease in revenue for the first quarter of fiscal 2011, was primarily due to our new SASSA contract, discussed under Business developments during fiscal 2011 South Africa SASSA update and fewer sales of hardware, software and related technology, which was partially offset by higher revenues due to the inclusion of FIHRST and MediKredit, increased transaction volumes at EasyPay and higher utilization of our UEPS system in Iraq. Analyzed in ZAR, cost of goods sold, IT processing, servicing and support for the first quarter of fiscal 2011 was higher primarily due to the inclusion of FIHRST and MediKredit.

Analyzed in ZAR, selling, general and administration expenses increased during the first quarter of fiscal 2011 primarily due to increases in goods and services purchased from third parties and the inclusion of FIHRST's and MediKredit's operations. During the first quarter of fiscal 2011, selling, general and administration expense was also adversely impacted by an unrealized loss of \$2.6 million (ZAR 19.1 million) on a foreign exchange contract related to an intercompany dividend from South Africa to the United States to be used to partially fund the acquisition of KSNET and transaction-related costs of \$3.4 million (ZAR 24.9 million), primarily for the KSNET acquisition.

Our operating income margin for the first quarter of fiscal 2011 and 2010 was 17% and 40%, respectively. We discuss the components of the operating income margin under Results of operations by operating segment, however the significant decrease is attributable to the price and volumes reductions under our SASSA contract and certain foreign exchange and transaction-related costs.

Our direct costs of maintaining a listing on Nasdaq and obtaining a listing on the JSE, as well as compliance with the Sarbanes-Oxley Act of 2002, or Sarbanes, particularly Section 404 of Sarbanes, includes independent directors' fees, legal fees, fees paid to Nasdaq and the JSE, our compliance officer's salary, fees paid to consultants who assist with Sarbanes compliance, fees paid to our independent accountants related to the audit and review process. This has resulted in expenditures of \$0.6 million (ZAR 4.2 million) and \$0.7 million (ZAR 5.1 million) during the first quarter of fiscal 2011 and 2010, respectively.

In ZAR, depreciation and amortization increased during fiscal 2011 primarily as a result of intangible asset amortization related to the MediKredit and FIHRST acquisitions. The intangible asset amortization and deferred tax effects related to our various acquisitions are summarized in the tables below:

|                                                                 | Three months ended<br>September 30, |                |
|-----------------------------------------------------------------|-------------------------------------|----------------|
|                                                                 | 2010<br>\$ 000                      | 2009<br>\$ 000 |
| Amortization included in depreciation and amortization expense: | 3,664                               | 3,324          |
| Prism acquisition                                               | 436                                 | 413            |
| RMT acquisition (1)                                             | -                                   | 515            |
| MediKredit acquisition                                          | 506                                 | -              |
| FIHRST acquisition                                              | 559                                 | -              |
| Net1 UTA acquisition                                            | 2,163                               | 2,396          |
| Deferred tax included in income tax expense:                    | 1,056                               | 883            |
| Prism acquisition                                               | 146                                 | 138            |
| RMT acquisition (1)                                             | -                                   | 144            |
| MediKredit acquisition                                          | 175                                 | -              |
| FIHRST acquisition                                              | 193                                 | -              |
| Net1 UTA acquisition                                            | 542                                 | 601            |

(1) the RMT intangibles were fully amortized in fiscal 2010.

|                                                                 | Three months ended<br>September 30, |                 |
|-----------------------------------------------------------------|-------------------------------------|-----------------|
|                                                                 | 2010<br>ZAR 000                     | 2009<br>ZAR 000 |
| Amortization included in depreciation and amortization expense: | 27,132                              | 25,978          |
| Prism acquisition                                               | 3,229                               | 3,229           |
| RMT acquisition (1)                                             | -                                   | 4,024           |
| MediKredit acquisition                                          | 3,745                               | -               |
| FIHRST acquisition                                              | 4,140                               | -               |
| Net1 UTA acquisition                                            | 16,018                              | 18,725          |
| Deferred tax included in income tax expense:                    | 7,819                               | 6,905           |
| Prism acquisition                                               | 1,081                               | 1,081           |
| RMT acquisition (1)                                             | -                                   | 1,127           |
| MediKredit acquisition                                          | 1,294                               | -               |
| FIHRST acquisition                                              | 1,430                               | -               |
| Net1 UTA acquisition                                            | 4,014                               | 4,697           |

(1) the RMT intangibles were fully amortized in fiscal 2010.

Interest on surplus cash for the first quarter of fiscal 2011 increased to \$3.1 million (ZAR 22.8 million) from \$2.6 million (ZAR 20.3 million) for the first quarter of fiscal 2010. The increase in interest on surplus cash held in South Africa was due to a higher average daily ZAR cash balance during the first quarter of fiscal 2011 compared with the first quarter of fiscal 2010 offset by lower deposit rates resulting from the adjustment in the South African prime interest rate from an average of approximately 10.74% per annum for the first quarter of fiscal 2010 to 9.89% per annum for the first quarter of fiscal 2011.

Interest expense decreased during the first quarter of fiscal 2011 due to a decrease in the average rates of interest on our short-term facilities. Finance costs decreased to \$0.2 million (ZAR 1.8 million) for the first quarter of fiscal 2011 from \$0.3 million (ZAR 2.2 million) for the first quarter of fiscal 2010.

Total tax expense for the first quarter of fiscal 2011 was \$6.2 million (ZAR 46.0 million) compared with \$11.0 million (ZAR 86.2 million) during the same period in the prior fiscal year. Our total tax expense decreased primarily due to lower taxable income resulting from the SASSA price and volume reductions and a decrease in overall profitability. Our effective tax rate for the first quarter of fiscal 2011 was 44.9%, compared to 38.4% for the first quarter of fiscal 2010. The change in our effective tax rate was primarily due to an increase in non-deductible expenses, primarily related to the KSNET acquisition, during the first quarter of fiscal 2011 compared to the first quarter of fiscal 2010.

Net loss from equity-accounted investments for the first quarter of fiscal 2011 decreased from the prior year primarily due to an increase in transaction fees generated by SmartSwitch Namibia and SmartSwitch Botswana. VTU Colombia and VinaPay continue to incur losses.

### 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 September 30,

| Operating Segment                               | 2010<br>\$ 000 | % of<br>total | 2009<br>\$ 000 | % of<br>total | %<br>change  |
|-------------------------------------------------|----------------|---------------|----------------|---------------|--------------|
| Consolidated revenue:                           |                |               |                |               |              |
| Transaction-based activities                    | 44,892         | 70%           | 44,978         | 69%           | -%           |
| Smart card accounts                             | 7,970          | 12%           | 8,074          | 12%           | (1)%         |
| Financial services                              | 1,248          | 2%            | 792            | 1%            | 58%          |
| Hardware, software and related technology sales | 10,173         | 16%           | 11,670         | 18%           | (13)%        |
| <b>Total consolidated revenue</b>               | <b>64,283</b>  | <b>100%</b>   | <b>65,514</b>  | <b>100%</b>   | <b>(2)%</b>  |
| Consolidated operating income (loss):           |                |               |                |               |              |
| Transaction-based activities                    | 17,776         | 162%          | 26,668         | 101%          | (33)%        |
| Operating income before amortization            | 19,122         |               | 27,450         |               | (30)%        |
| Amortization of intangible assets               | (1,346)        |               | (782)          |               | 72%          |
| Smart card accounts                             | 3,622          | 33%           | 3,670          | 14%           | (1)%         |
| Financial services                              | 929            | 8%            | 531            | 2%            | 75%          |
| Hardware, software and related technology sales | (2,660)        | (24)%         | (1,713)        | (6)%          | 55%          |
| Operating (loss) income before amortization     | (343)          |               | 829            |               | (141)%       |
| Amortization of intangible assets               | (2,317)        |               | (2,542)        |               | (9)%         |
| Corporate/eliminations                          | (8,681)        | (79)%         | (2,788)        | (11)%         | 211%         |
| <b>Total consolidated operating income</b>      | <b>10,986</b>  | <b>100%</b>   | <b>26,368</b>  | <b>100%</b>   | <b>(58)%</b> |

**Table 8**

*In South African Rand (US GAAP)*  
Three months ended September 30,

| Operating Segment                               | 2010<br>ZAR<br>000 | % of<br>total | 2009<br>ZAR<br>000 | % of<br>total | %<br>change |
|-------------------------------------------------|--------------------|---------------|--------------------|---------------|-------------|
| Consolidated revenue:                           |                    |               |                    |               |             |
| Transaction-based activities                    | 332,439            | 70%           | 351,516            | 69%           | (5)%        |
| Smart card accounts                             | 59,020             | 12%           | 63,101             | 12%           | (6)%        |
| Financial services                              | 9,242              | 2%            | 6,190              | 1%            | 49%         |
| Hardware, software and related technology sales | 75,334             | 16%           | 91,204             | 18%           | (17)%       |
| <b>Total consolidated revenue</b>               | <b>476,035</b>     | <b>100%</b>   | <b>512,011</b>     | <b>100%</b>   | <b>(7)%</b> |
| Consolidated operating income (loss):           |                    |               |                    |               |             |
| Transaction-based activities                    | 131,637            | 162%          | 208,418            | 101%          | (37)%       |
| Operating income before amortization            | 141,609            |               | 214,529            |               | (34)%       |
| Amortization of intangible assets               | (9,972)            |               | (6,111)            |               | 63%         |
| Smart card accounts                             | 26,822             | 33%           | 28,682             | 14%           | (6)%        |
| Financial services                              | 6,880              | 8%            | 4,150              | 2%            | 66%         |
| Hardware, software and related technology sales | (19,698)           | (24)%         | (13,388)           | (6)%          | 47%         |
| Operating (loss) income before amortization     | (2,539)            |               | 6,479              |               | (139)%      |
| Amortization of intangible assets               | (17,159)           |               | (19,867)           |               | (14)%       |



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

|                                            |               |             |                |             |              |
|--------------------------------------------|---------------|-------------|----------------|-------------|--------------|
| Corporate/eliminations                     | (64,285)      | (79)%       | (21,789)       | (11)%       | 195%         |
| <b>Total consolidated operating income</b> | <b>81,356</b> | <b>100%</b> | <b>206,073</b> | <b>100%</b> | <b>(61)%</b> |
|                                            | 27            |             |                |             |              |

---

**Transaction-based activities**

In ZAR, the decreases in revenue were primarily due to the new SASSA nine month contract at lower economics, which was partially offset by increased transaction volumes at EasyPay, increased utilization of our UEPS system in Iraq and the inclusion of MediKredit and FIHRST.

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 of our transaction-based activities decreased to 40% from 59% a year ago. The decrease was primarily due to the lower revenues generated under our SASSA contract, additional intangible asset amortization related to the acquisition of MediKredit and FIHRST and lower margins in our recently-acquired transaction processing operations compared with legacy transaction-based activities, which was partially offset by increased transaction fees from the utilization of our UEPS system in Iraq.

***Pension and welfare operations:***

Our revenue and operating income related to our pension and welfare operations were impacted by our new contract discussed under Business developments during fiscal 2011 South Africa SASSA update. Our pension and welfare operations continue to generate the majority of our revenues and operating income in this operating segment and for us as a whole.

***South African transaction processors:***

The table below presents the total volume and value processed during the first quarter of fiscal 2011 and 2010 by our transaction processors:

**Table 9**

| <b>Transaction processor</b> | <b>Total volume ( 000s)</b> |             | <b>Total value \$ ( 000)</b> |             | <b>Total value ZAR ( 000)</b> |             |
|------------------------------|-----------------------------|-------------|------------------------------|-------------|-------------------------------|-------------|
|                              | <b>2010</b>                 | <b>2009</b> | <b>2010</b>                  | <b>2009</b> | <b>2010</b>                   | <b>2009</b> |
| EasyPay                      | 174,101                     | 152,881     | 5,039,411                    | 4,274,260   | 37,318,352                    | 33,404,547  |
| MediKredit                   | 2,543                       | -           | 113,670                      | -           | 841,758                       | -           |
| FIHRST                       | 5,492                       | -           | 2,018,993                    | -           | 14,951,248                    | -           |

Transaction processing related to our Iraqi contract continued to grow sequentially through fiscal 2010. This trend has continued into the first quarter of fiscal 2011.

Our results for the first quarter of fiscal 2011 includes the intangible asset amortization related to our MediKredit and FIHRST acquisitions but excludes RMT's intangible assets which were fully amortized in the third quarter of fiscal 2010. Our results for the first quarter of fiscal 2010 includes amortization related to the RMT intangible assets.

**Key statistics of our merchant acquiring system:**

The key statistics and indicators of our merchant acquiring system during the first quarter of fiscal 2011 and 2010, in each of

**Table 10**

|                                                                                                                      | <b>Three months ended<br/>September 30,</b> |                                      |
|----------------------------------------------------------------------------------------------------------------------|---------------------------------------------|--------------------------------------|
|                                                                                                                      | <b>2010</b>                                 | <b>2009</b>                          |
|                                                                                                                      | <b>NC, EC,<br/>KZN, L and<br/>NW</b>        | <b>NC, EC,<br/>KZN, L and<br/>NW</b> |
| Province included (1)                                                                                                |                                             |                                      |
| Total POS devices installed                                                                                          | 4,772                                       | 4,528                                |
| Number of participating UEPS retail locations                                                                        | 2,511                                       | 2,506                                |
| Value of transactions processed through POS devices during the quarter (2) (in \$ 000)                               | 399,637                                     | 380,782                              |
| Value of transactions processed through POS devices during the completed pay cycles for the quarter (3) (in \$ 000)  | 395,479                                     | 366,786                              |
| Value of transactions processed through POS devices during the quarter (2) (in ZAR 000)                              | 2,940,416                                   | 2,980,378                            |
| Value of transactions processed through POS devices during the completed pay cycles for the quarter (3) (in ZAR 000) | 2,909,818                                   | 2,870,837                            |
| Number of grants paid through POS devices during the quarter (2)                                                     | 4,819,458                                   | 4,846,515                            |
| Number of grants paid through POS devices during the completed pay cycles for the quarter (3)                        | 4,710,596                                   | 4,675,128                            |
| Average number of grants processed per terminal during the quarter (2) .                                             | 1,008                                       | 1,082                                |
| Average number of grants processed per terminal during the completed pay cycles for the quarter (3)                  | 985                                         | 1,044                                |

the South African provinces where we distribute social welfare grants are summarized in the table below:

- (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.

**Smart card accounts**

In ZAR, revenue from the provision of smart card-based accounts decreased in proportion to the lower number of beneficiaries serviced through our SASSA contract. A total number of 3,553,437 smart card-based accounts were active at September 30, 2010, compared to 3,794,827 active accounts as at September 30, 2009. The decrease in the number of active accounts resulted largely from the suspension and removal of invalid or fraudulent grants by SASSA.

Operating income margin from providing smart card accounts was constant at 45% for the first quarter of fiscal 2011 and 2010.

**Financial services**

Revenue from UEPS-based lending increased primarily due to an increase in the number of loans granted. In addition, on average, the return on these UEPS-based loans was higher. 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.

Operating income margin for the financial services segment increased to 74% for the first quarter of fiscal 2011 from 67% for the first quarter of fiscal 2010 primarily due to an increase in lending activity.

**Hardware, software and related technology sales**

The following table presents our revenue and operating income during the first quarter of fiscal 2011 and 2010:

| <b>Table 11</b>                                                          | <b>Three months ended</b> |               |
|--------------------------------------------------------------------------|---------------------------|---------------|
|                                                                          | <b>September 30,</b>      |               |
|                                                                          | <b>2010</b>               | <b>2009</b>   |
|                                                                          | <b>\$ 000</b>             | <b>\$ 000</b> |
| Revenue                                                                  | 10,173                    | 11,670        |
| Hardware, software and related technology sales excluding Net1 UTA       | 6,520                     | 10,622        |
| Net1 UTA                                                                 | 3,653                     | 1,048         |
| Operating (loss) income before amortization of intangible assets         | (343)                     | 829           |
| Operating loss                                                           | (2,660)                   | (1,713)       |
| Hardware, software and related technology sales excluding Net1 UTA       | (594)                     | 1,993         |
| Net1 UTA                                                                 | (2,066)                   | (3,706)       |
| Net1 UTA excluding amortization of acquisition related intangible assets | 97                        | (1,310)       |
| Amortization of acquisition related intangible assets                    | (2,163)                   | (2,396)       |

| <b>Table 12</b>                                                          | <b>Three months ended</b> |                |
|--------------------------------------------------------------------------|---------------------------|----------------|
|                                                                          | <b>September 30,</b>      |                |
|                                                                          | <b>2010</b>               | <b>2009</b>    |
|                                                                          | <b>ZAR 000</b>            | <b>ZAR 000</b> |
| Revenue                                                                  | 75,334                    | 91,204         |
| Hardware, software and related technology sales excluding Net1 UTA       | 48,282                    | 83,014         |
| Net1 UTA                                                                 | 27,052                    | 8,190          |
| Operating (loss) income before amortization of intangible assets         | (2,539)                   | 6,479          |
| Operating loss                                                           | (19,698)                  | (13,388)       |
| Hardware, software and related technology sales excluding Net1 UTA       | (4,398)                   | 15,575         |
| Net1 UTA                                                                 | (15,300)                  | (28,963)       |
| Net1 UTA excluding amortization of acquisition related intangible assets | 718                       | (10,238)       |
| Amortization of acquisition related intangible assets                    | (16,018)                  | (18,725)       |

The decrease in revenue was primarily due to lower revenues generated by card sales and software maintenance and development, as well as lower ad hoc hardware sales to Iraq in 2011 as compared with the prior year, which was offset marginally by increased hardware sales by Net1 UTA. In ZAR, the decrease in operating income was primarily due to lower sales activity

As we expand internationally, whether through traditional selling arrangements to provide products and services (such as in Ghana and Iraq) or through joint ventures (such as with SmartSwitch Namibia and SmartSwitch Botswana), we expect to receive revenues from sales of hardware and from software customization and licensing to establish the infrastructure of POS terminals and smart cards necessary to enable utilization of the UEPS and DUET technology in a particular country. To the extent that we enter into joint ventures and account for the investment as an equity investment, we are required to eliminate our portion of the sale of hardware, software and licenses to the investees. The sale of hardware, software and licenses under these arrangements occur on an ad hoc basis as new arrangements are established, which can materially affect our revenues and operating income in this segment from period to period.

**Corporate/eliminations**

The increase in our corporate expenses resulted from higher corporate head office-related expenditure, including the effects of inflation in South Africa, stock-based compensation charges, transaction related expenditures of \$3.4 million (ZAR 24.9 million) and a unrealized foreign exchange loss on a foreign exchange contract of \$2.6 million (ZAR 19.1 million) related to an intercompany dividend from South Africa to the United States to be used to partially fund the acquisition of KSNET.

Our corporate expenses also includes expenditure related to compliance with Sarbanes; non-executive directors fees; employee and executive salaries and bonuses; stock-based compensation; legal and audit fees; directors and officer s insurance premiums; telecommunications expenses; property-related expenditures including utilities, rental, security and maintenance; and elimination entries.

## Liquidity and Capital Resources

Our business has historically generated and continues to generate high levels of cash. At September 30, 2010, our cash balances were \$200.2 million, which comprised mainly ZAR-denominated balances of ZAR 1,239.6 million (\$177.7 million), US dollar-denominated balances of \$14.5 million and other currency deposits, primarily euro, of \$8.0 million. On October 29, 2010, we used approximately \$124 million of our cash to fund a portion of the KSNET purchase price.

We generally invest the surplus cash held by our South African operations in overnight call accounts that we maintain at South African banking institutions, and surplus cash held by our non-South African companies in the US and European money markets.

Historically, we have financed most of our operations, research and development, working capital, capital expenditures and acquisitions through our internally generated cash. 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 financed a portion of the KSNET acquisition price and related transaction expenses with the proceeds of a KRW 130.5 billion (approximately \$115.9 million based on October 29, 2010 exchange rates) five-year senior secured loan facility provided by a consortium of banks under a facilities agreement (the Facilities Agreement). The Facilities Agreement provides for three separate facilities: a Facility A loan to our wholly owned subsidiary, Net1 Applied Technologies Korea, or Net1 Korea, of up to KRW 130.5 billion (divided into Facility A1 (KRW 65.5 billion) and Facility A2 (KRW 65.0 billion)) and a Facility B loan to KSNET of up to KRW 65.0 billion. The Facility B loan, if drawn, must be used to repay the Facility A2 loan and may be borrowed only if Net1 Korea and KSNET complete a merger transaction with each other. Interest on the loans is payable quarterly and is based on the Korean CD rate in effect from time to time plus a margin of 4.10% for Facility A loans and 3.90% for the Facility B loan. The Facility A1 loan matures on the fifth anniversary of the initial drawdown with no required principal prepayments. Principal on the Facility A2 loan and Facility B loan is repayable in scheduled installments, beginning twelve months after initial drawdown and thereafter, semi-annually with final maturity scheduled for 54 months after initial drawdown. The loans are secured by substantially all of KSNET's assets, a pledge by Net1 Korea of its entire equity interest in KSNET and a pledge by the immediate parent of Net1 Korea (also one of our subsidiaries) of its entire equity interest in Net1 Korea. The Facilities Agreement contains customary covenants that require Net1 Korea and its consolidated subsidiaries to maintain certain specified financial ratios (including a leverage ratio and a debt service coverage ratio) and restrict their ability to make certain distributions with respect to their capital stock, prepay other debt, encumber their assets, incur additional indebtedness, make capital expenditures above specified levels, engage in certain business combinations and engage in other corporate activities. The loans under the Facilities Agreement are without recourse to, and the covenants and other agreements contained therein do not apply to, us or any of our subsidiaries (other than Net1 Korea and its subsidiaries, including KSNET).

We have a unique cash flow cycle due to the funding mechanism under our SASSA contract and our pre-funding of merchants. Under our SASSA contract, we receive the grant funds 48 hours prior to the provision of the service and any interest we earn on these amounts is for the benefit of SASSA. In addition, we pre-fund certain merchants who facilitate the distribution of grants through our merchant acquiring system. When grants are paid at merchant locations before the start of the payment service at pay points, we pre-fund these payments to the merchants distributing the grants on our behalf. We typically reimburse these merchants within 48 hours after they distribute the grants to the social welfare beneficiaries.

We currently believe that our cash and available credit facilities are sufficient to meet our business requirements for at least the next four quarters, including working capital requirements, capital expenditures and debt service obligations.

***Cash flows from operating activities***

*Three months ended September 30, 2010*

Net cash provided by operating activities for the first quarter of fiscal 2011 was \$30.2 million (ZAR 223.2 million) compared to \$37.0 million (ZAR 289.1 million) for the first quarter of fiscal 2010. Our net cash from operating activities decreased primarily due to the SASSA price and volume reductions which were effective July 1, 2010.



During the first quarter of fiscal 2011 we made additional second provisional tax payments of \$1.8 million (ZAR 12.7 million) related to our 2010 tax year in South Africa. During the first quarter of fiscal 2010 we made an additional second provisional tax payment of \$3.9 million (ZAR 29.6 million) related to our 2009 tax year in South Africa. See the table below for a summary of all taxes paid (refunded).

Taxes paid during the first quarter of fiscal 2011 and 2010 were as follows:

**Table 13**

|                                      | Three months ended<br>September 30, |                   |                    |                    |
|--------------------------------------|-------------------------------------|-------------------|--------------------|--------------------|
|                                      | 2010<br>\$<br>000                   | 2009<br>\$<br>000 | 2010<br>ZAR<br>000 | 2009<br>ZAR<br>000 |
| Taxation paid related to prior years | 1,774                               | 3,929             | 12,716             | 29,611             |
| Taxation refunds received            | (172)                               | (238)             | (1,302)            | (1,900)            |
| <b>Total tax paid</b>                | <b>1,602</b>                        | <b>3,691</b>      | <b>11,414</b>      | <b>27,711</b>      |

We expect to pay our first provisional payments in South Africa related to our 2011 tax year in the second quarter of fiscal 2011.

### ***Cash flows from investing activities***

#### *Three months ended September 30, 2010*

Cash used in investing activities for the first quarter of fiscal 2011 includes capital expenditure of \$0.8 million (ZAR 5.7 million), primarily for the acquisition of kiosks to service our EasyPay Kiosk pilot project, the replacement of computer and electronic hardware and the replacement of motor vehicles.

SmartSwitch Namibia commenced repayment of loans provided by its shareholders during the first quarter of fiscal 2010 and cash flows from investing activities for the first quarter of fiscal 2011 includes principal repayments of \$0.4 million. In July 2010, we provided additional loan funding to VTU Colombia of approximately \$0.4 million.

Cash used in investing activities for the first quarter of fiscal 2010 includes capital expenditure of \$0.6 million (ZAR 5.0 million), primarily for the acquisition of POS devices to service our merchant acquiring system, improvements to leasehold property and the acquisition of computer equipment.

### ***Cash flows from financing activities***

#### *Three months ended September 30, 2010*

There were no significant cash flows from financing activities during the first quarter of fiscal 2011.

During the first quarter of fiscal 2010 we repurchased, using our ZAR reserves, 9,221,526 shares of our common stock from Brait S.A. and its investment entities affiliates for \$13.50 (ZAR 105.98) per share, for an aggregate repurchase price of \$124.5 million (ZAR 977.3 million). In addition, we incurred costs of approximately \$0.5 million (ZAR 3.9 million) related to the repurchase of these shares. During the first quarter of fiscal 2010, we also paid \$1.3 million on account of shares we repurchased on June 30, 2009, under our share buy-back program. We also received \$0.7 (ZAR 5.5 million) from employees exercising stock options and repaying loans.

### **Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements.

## Capital Expenditures

We discuss our capital expenditures during the first quarter of fiscal 2011 under Liquidity and capital resources Cash flows from investing activities. All of our capital expenditures for the past three fiscal years have been funded through internally generated funds. We had outstanding capital commitments of \$0.1 million as of September 30, 2010. We anticipate that capital spending for the second quarter of fiscal 2011 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.

**Table 14** **Payments due by Period, as at September 30, 2010 (in \$ 000s)**

33

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We seek to reduce our exposure to currencies other than the South African rand, or ZAR, 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 equity price and liquidity risks as well as 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 US dollar. We have used forward contracts to limit our exposure in these transactions to fluctuations in exchange rates between the ZAR, on the one hand, and the US dollar and the euro, on the other hand. In addition, during the first quarter of fiscal 2011, we entered into foreign exchange contracts in order to hedge the fluctuations in the ZAR/ US dollar related to the anticipated flow of funds from South Africa to the United States to fund a portion of the KSNET purchase price. As of September 30, 2010 and 2009, our outstanding foreign exchange contracts were as follows:

**As of September 30, 2010**

| <b>Notional amount</b> | <b>Strike price</b> | <b>Fair market value price</b> | <b>Maturity</b>   |
|------------------------|---------------------|--------------------------------|-------------------|
| EUR 480,000            | ZAR 9.7960          | ZAR 9.5740                     | November 10, 2010 |
| EUR 288,000            | ZAR 9.4669          | ZAR 9.5356                     | October 15, 2010  |
| ZAR 460,000,000        | USD 0.1397          | USD 0.1432                     | October 1, 2010   |
| ZAR 460,000,000        | USD 0.1401          | USD 0.1426                     | October 1, 2010   |

**As of September 30, 2009**

None.

**Translation Risk**

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

**Interest Rate Risk**

As a result of our normal borrowing and leasing activities, our operating results are exposed to fluctuations in interest rates, which we manage primarily through our regular financing activities. We generally maintain limited investment in cash equivalents and have occasionally invested in marketable securities. The interest earned on our bank balances and short term cash investments is dependent on the prevailing interest rates in the jurisdictions where our cash reserves are invested.

**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 credit rating agencies such as Standard & Poor's, Moody's and Fitch Ratings.

### **Equity Price and Liquidity Risk**

Equity price risk relates to the risk of loss that we would incur as a result of the volatility in the exchange-traded price of equity securities that we hold and the risk that we may not be able to liquidate these securities. We have invested in approximately 22% of the issued share capital of Finbond Group Limited, which are exchange-traded equity securities. The fair value of these securities as of September 30, 2010, represented approximately 1% of our total assets, including these securities. We expect to hold these securities for an extended period of time and we are not concerned with short-term equity price volatility with respect to these securities provided that the underlying business, economic and management characteristics of the company remain sound.

The market price of these securities may fluctuate for a variety of reasons, consequently, the amount we may obtain in a subsequent sale of these securities may significantly differ from the reported market value.

Liquidity risk relates to the risk of loss that we would incur as a result of the lack of liquidity on the exchange on which these securities are listed. We may not be able to sell some or all of these securities at one time, or over an extended period of time without influencing the exchange traded price, or at all.

The following table summarizes our exchange traded equity securities with equity price risk as of September 30, 2010. The effects of a hypothetical 10% increase and a 10% decrease in market prices as of September 30, 2010 is also shown. The selected 10% hypothetical change does not reflect what could be considered the best or worst case scenarios. Indeed, results could be far worse due both to the nature of equity markets and the aforementioned liquidity risk.

**As of September 30, 2010**

**Table 15**

|                                   | <b>Fair<br/>value<br/>(\$ 000)</b> | <b>Hypothetical<br/>price change</b> | <b>Estimated fair<br/>value after<br/>hypothetical<br/>change in price<br/>(\$ 000)</b> | <b>Hypothetical<br/>Percentage<br/>Increase<br/>(Decrease) in<br/>Shareholders<br/>Equity</b> |
|-----------------------------------|------------------------------------|--------------------------------------|-----------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------|
| Exchange-traded equity securities | 8,009                              | 10%                                  | 8,810                                                                                   | 0.25%                                                                                         |
|                                   | 8,009                              | (10)%                                | 7,208                                                                                   | (0.25)%                                                                                       |

**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) promulgated under the Securities Exchange Act of 1934, as amended, as of September 30, 2010. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, the chief executive officer and the chief financial officer concluded that our disclosure controls and procedures were effective as of September 30, 2010.

***Changes in Internal Control over Financial Reporting***

There have not been any changes in our internal control over financial reporting during the fiscal quarter ended September 30, 2010, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## Part II. Other Information

### Item 1A. Risk Factors

See Item 1A RISK FACTORS in Part I of the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2010, for a discussion of our risk factors. In addition, we have identified the following risk factors related to our recent acquisition of KSNET:

***We will face challenges in integrating KSNET into our company and we will likely not include KSNET in our internal control certification and attestation for fiscal 2011.***

On October 29, 2010, we acquired KSNET, a large payment processor in the Republic of Korea for 270 million KRW, or approximately \$240 million (based on October 29, 2010 exchange rates). This acquisition was the largest acquisition we have effected to date. Integrating KSNET into our company will require significant attention from our senior management which may divert their attention from our day to day business. The difficulties of integration may be increased by geographical distance between South Africa and Korea, language and cultural differences and the necessity of retaining and integrating personnel, including KSNET's key employees. In addition, our management certification and auditor attestation regarding the effectiveness of our internal control over financial reporting as of June 30, 2011, will likely exclude the operations of KSNET. If we are unable to successfully integrate KSNET's operations into our internal control over financial reporting, our internal control over financial reporting may not be effective.

***We incurred secured debt on October 29, 2010, to fund the acquisition of KSNET which requires us to comply with restrictive and financial covenants. If we are unable to comply with these covenants, we could default on this debt, which would have a material adverse effect on our business and financial condition.***

We financed a portion of the KSNET acquisition price and related transaction expenses with the proceeds of a KRW 130.5 billion (approximately \$115.9 million based on October 29, 2010 exchange rates) five-year secured loan facility under the Facilities Agreement. The loans are secured by substantially all of KSNET's assets, a pledge by Net1 Korea of its entire equity interest in KSNET and a pledge by the immediate parent of Net1 Korea (also one of our subsidiaries) of its entire equity interest in Net1 Korea. The Facilities Agreement contains covenants that require Net1 Korea and its consolidated subsidiaries to maintain certain specified financial ratios (including a leverage ratio and a debt service coverage ratio) and restrict their ability to make certain distributions with respect to their capital stock, prepay other debt, encumber their assets, incur additional indebtedness, make capital expenditures above specified levels, engage in certain business combinations and engage in other corporate activities. Although these covenants only apply to our Korean subsidiaries, these security arrangements and covenants may reduce our operating flexibility or our ability to engage in other transactions that may be beneficial to us. If we are unable to comply with these covenants, we could be in default under the Facilities Agreement and the indebtedness thereunder could be accelerated. If this were to occur, we might not be able to obtain waivers of default or to refinance the debt with another lender and as a result, our business and financial condition would suffer.

***Our ability to operate KSNET successfully will depend on the continued services of KSNET's employees.***

We will rely on the continued services of the existing KSNET's management team. The services of these individuals will be important to the continued growth and success of the KSNET business and to our ability to integrate KSNET with the rest of our company. If we were to lose the services of these key employees, our ability to operate KSNET successfully would likely be materially and adversely impacted.

**Item 6. Exhibits**

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

| <b>Exhibit Number</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                                                                                    |
|-----------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1                   | Share Purchase Agreement, dated as of September 14, 2010, by and among the Company, Payment Services Asia LLC and H&Q NPS Van Investment, Ltd. (incorporated by reference to Exhibit 2.1 to our Form 8-K filed on September 16, 2010)                                                                                                                                                                                 |
| 10.51                 | Senior Facilities Agreement dated October 29, 2010, between Net 1 Applied Technologies Korea, as borrower, Hana Daetoo Securities Co., Ltd., as mandated lead arranger, Shinhan Bank and Woori Bank, as co-arrangers, the financial institutions listed therein as original lenders and Hana Bank, as agent and security agent (incorporated by reference to Exhibit 10.51 to our Form 8-K filed on November 3, 2010) |
| <u>10.52*</u>         | <u>Service Level Agreement, dated as of August 24, 2010, between the South African Social Security Agency and Cash Paymaster Services (Pty) Limited, a wholly-owned subsidiary of the Company</u>                                                                                                                                                                                                                     |
| <u>31.1</u>           | <u>Certification of Principal Executive Officer pursuant to Rule 13a-14(a) under the Exchange Act</u>                                                                                                                                                                                                                                                                                                                 |
| <u>31.2</u>           | <u>Certification of Principal Financial Officer pursuant to Rule 13a-14(a) under the Exchange Act</u>                                                                                                                                                                                                                                                                                                                 |
| <u>32</u>             | <u>Certification pursuant to 18 USC Section 1350</u>                                                                                                                                                                                                                                                                                                                                                                  |

\* Confidential treatment is being requested for certain portions of this Exhibit pursuant to Rule 24b-2 of the Exchange Act which portions have been omitted and filed separately with the Securities and Exchange Commission.

**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 November 9, 2010.

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