

Managing Growth

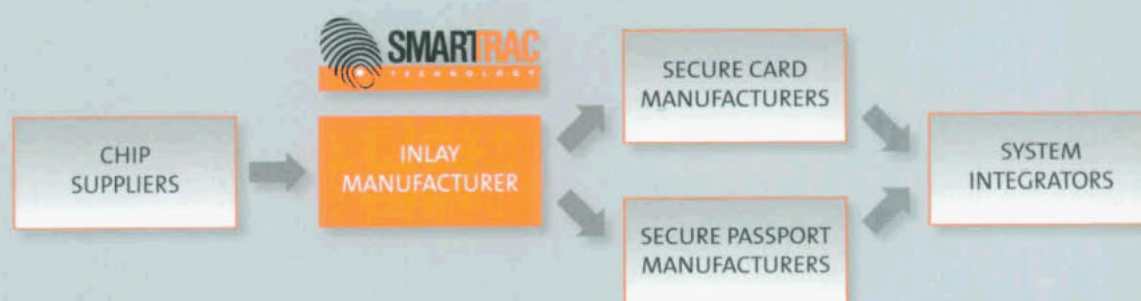
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Annual Report 2006

07-2007 02-07-2006

In thousands of euro	Consolidated 12 months ended December 2006	Combined and consolidated <sup>1)</sup> 12 months ended December 2005	Change	Change in %
<b>Consolidated income statement</b>				
Revenues	52,465	25,173	27,292	108.4
EBITDA <sup>2)</sup>	11,913	4,912	7,001	142.5
Net profit after tax	9,119	3,018	6,101	202.2
<b>Financial position and liquidity</b>				
Cash flow from operating activities	6,122	1,246	4,876	391.3
Working capital	11,983	5,239	6,744	128.7
Capital expenditure	11,254	4,621	6,633	143.5
Total assets	80,732	26,703	54,029	202.3
<b>Operating figures</b>				
Basic earnings per share <sup>2)</sup> euro	0.79	0.30	0.49	163.3
Cash flow per share <sup>2)</sup> euro	0.53	0.12	0.41	341.7
Equity ratio %	86.0	37.2	48.8	131.2
Headcount at month's end	1,756	1,104	652	59.1



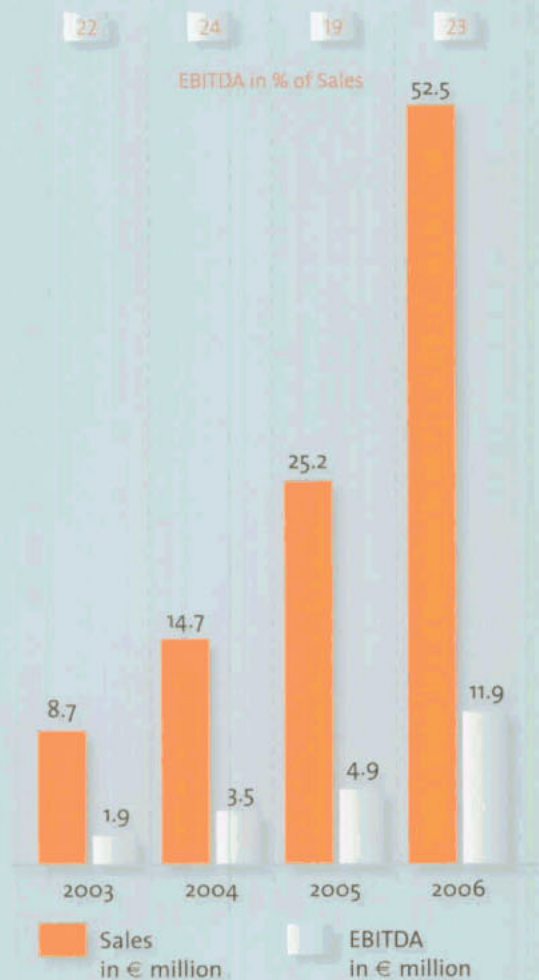
*Successful business model: leading supplier  
in the worldwide RFID value chain*

1) This information is presented for comparison only, as SMARTAC N.V. was not incorporated until early 2006.

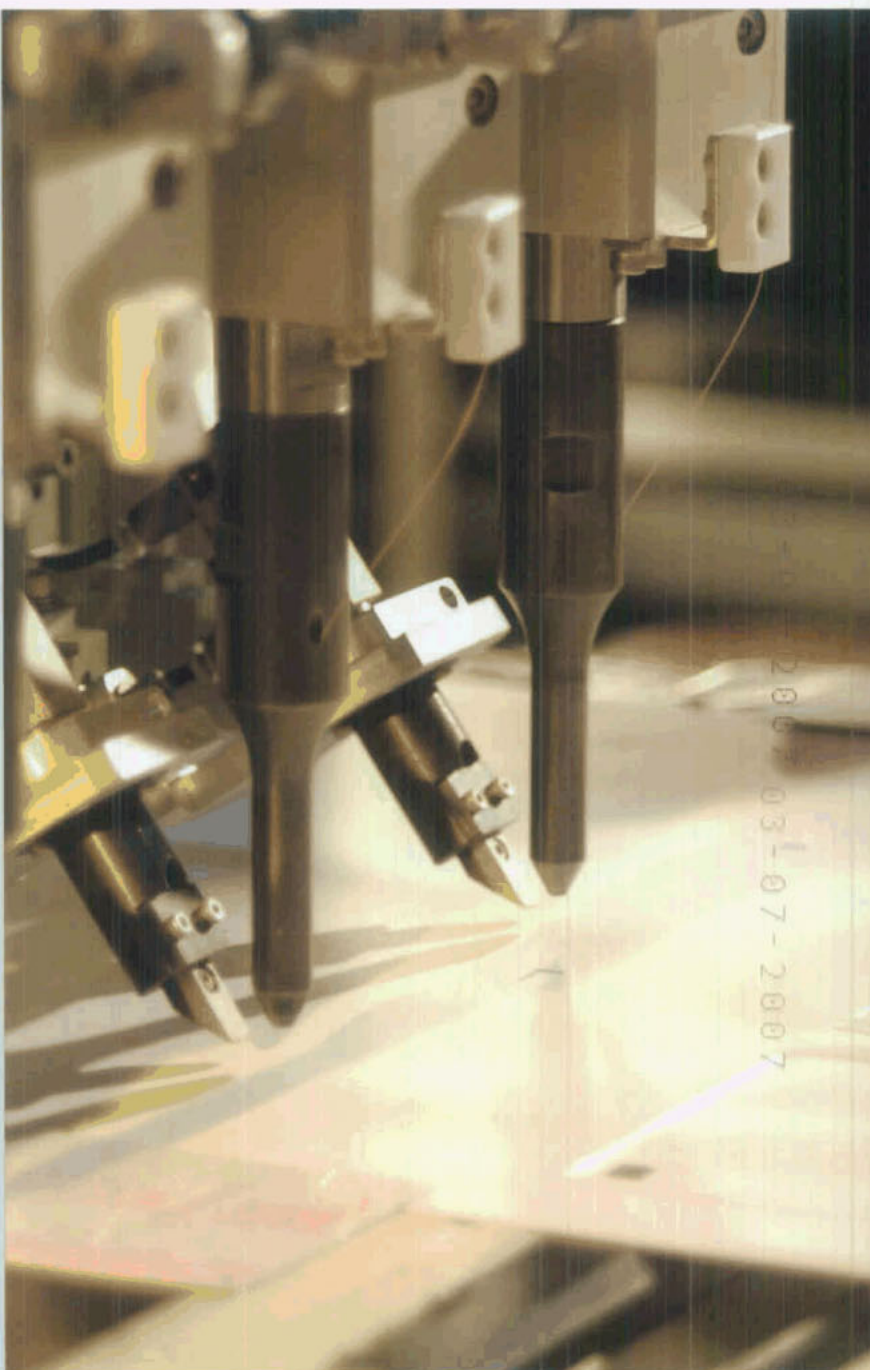
2) EBITDA is defined as operating profit for the period before depreciation, amortization, financial result, share of profits of associates and income tax result. The Group presents EBITDA because management believes it is a useful measure in evaluating the Group's operating performance. EBITDA is not a measure of operating performance or liquidity under IFRS. EBITDA as presented may not be comparable to measures with similar names as presented by other companies.



## Managing growth



*SMARTRAC at a glance:*  
superior financial track record

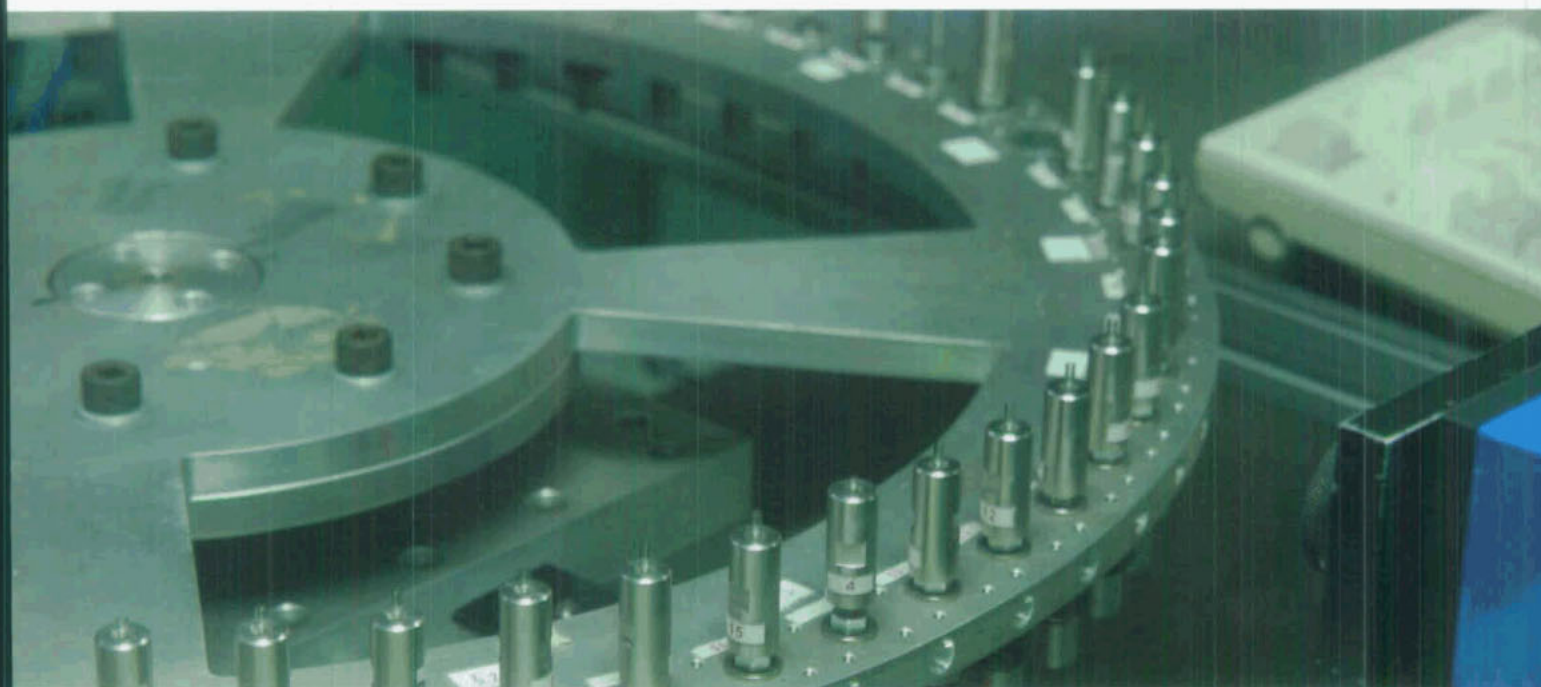


3) Basic earnings per share and cash flow per share for the 12 months ended 31 December 2005 are presented as Pro Forma earnings per share and Pro Forma Cash flow per share assuming the same amount of shares after the restructuring of SMARTRAC NV (10,000,000 shares).



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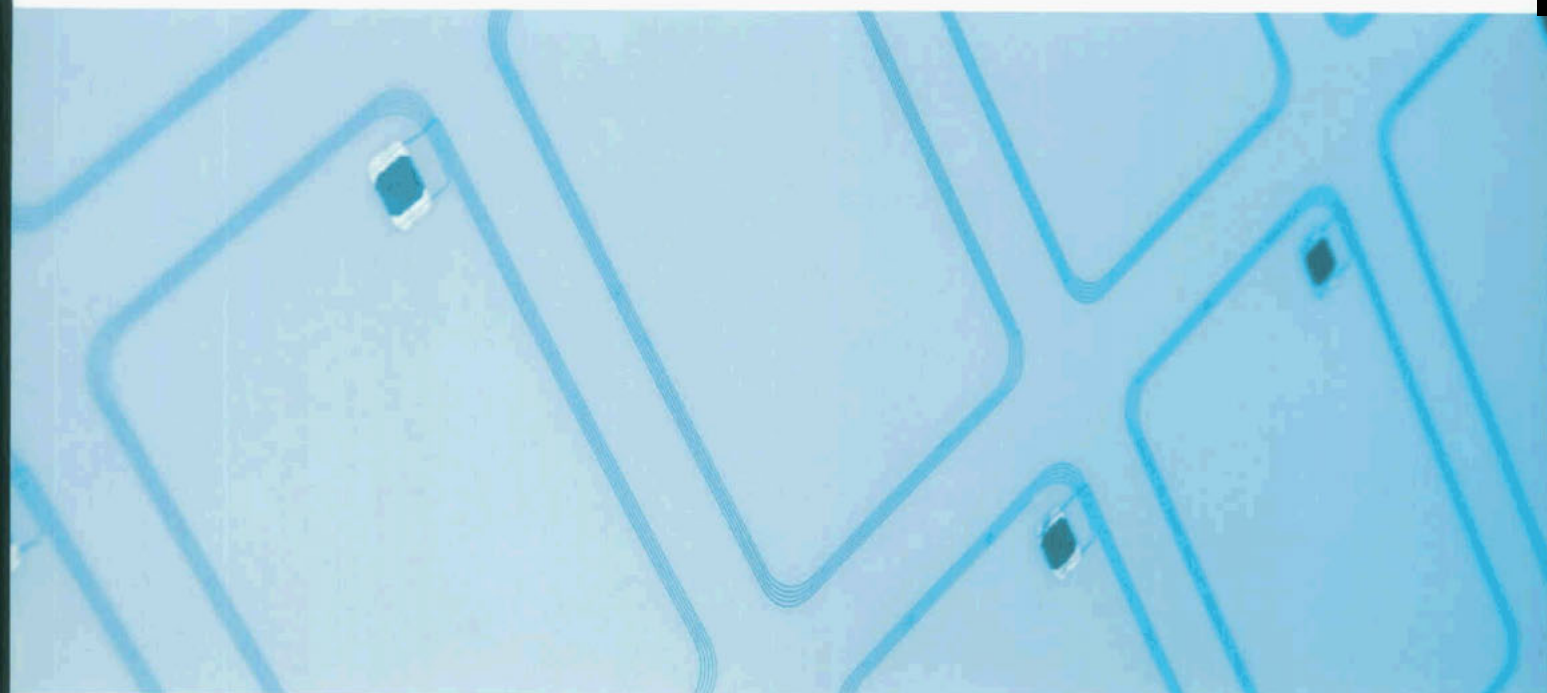
94 Declaration regarding decree article 10 takeover bids

97 Appropriation of the result

The information required by 2:391 of the Netherlands Civil Code is provided in the following sections on this annual report on page 16 to 41: letter of the CEO and the CFO, Business by segments, key factors affecting our business, disclosure about market risks, and corporate governance report.

SMARTRAC is the world's leading supplier of RFID (Radio Frequency Identification) components. We conduct our business in two segments – 'Standard' and 'High Security'.

*High quality RFID inlays from SMARTRAC fulfil highest customer requirements in terms of security and quality*



## Overview

SMARTRAC was founded in 2000. After a corporate restructuring and the IPO in July 2006, SMARTRAC N.V. has been a stock corporation under Dutch law, domiciled in Amsterdam and traded in the Prime Standard at the Frankfurt Stock Exchange (FSE).

SMARTRAC's main production and R&D facilities are located in the province of Ayutthaya near Bangkok (Thailand). As of December 31, 2006, SMARTRAC employed a total workforce of close to 1,800 people with the vast majority of them working in Thailand.

In the RFID value chain, SMARTRAC has positioned itself as a focused inlay manufacturer, located between main suppliers (e.g. chip manufacturers) and customers (card

manufacturers, system integrators and secure printing houses). Accordingly, SMARTRAC's business consists primarily of manufacturing and supplying inlays, as opposed to producing completed cards and readers or providing related system integration services. This business model has proven to be successful with excellent prospects and SMARTRAC will therefore continue to build upon the company's strong position in the worldwide RFID value chain.

The RFID inlays consist of a memory or microcontroller chip bonded to an antenna, which is embedded in a carrier material, such as PVC. SMARTRAC's inlays are integrated into the customers' finished products (such as cards or tags) to enable them to transmit data to a reader via radio waves.



BUSINESS SEGMENTS	STANDARD BUSINESS		HIGH SECURITY BUSINESS	
PRODUCT LINES	BIO AND LOGISTICS	TRANSPORT AND ACCESS	ePASSPORT	ePAYMENT
PRODUCTS	Low frequency products and tags	Inlays, white cards	Inlays for ePassports	Inlays for ePayment cards
APPLICATIONS	Product tracking, animal ID, laundry tags, casino chips	Transportation, Access Control	ePassports eID applications	Contactless Payment

For the Standard segment, SMARTRAC holds a leading position as manufacturer of RFID inlays for applications in public transport, access control and Bio/Logistics.

SMARTRAC also managed to build up a worldwide leading position in the High Security segment. This segment comprises RFID inlays for ePassports and contactless ePayment cards.

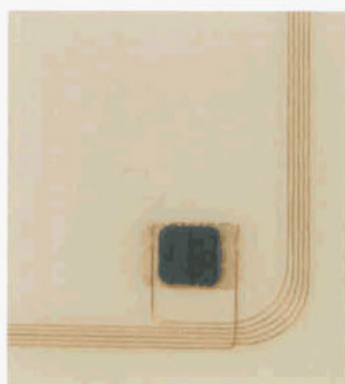
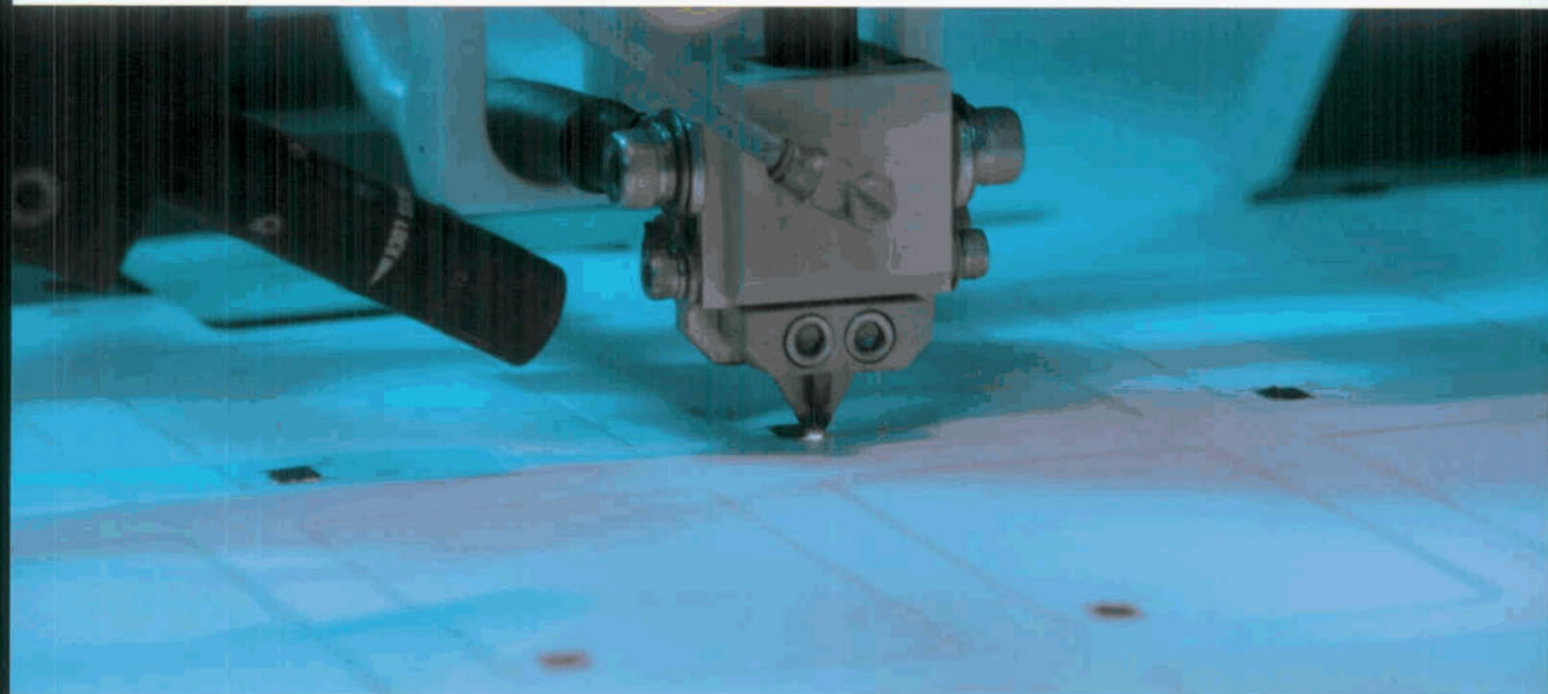
Compared to 2005, in financial year 2006 we saw the relative revenue contributions continuing to change in favour of the High Security segment due to the expansion of our activities in the ePassport market as well as secure contactless ePayment applications.

In the financial year of 2006, SMARTRAC continued along its growth path of the past years and more than doubled revenues compared to the previous year, with EBITDA actually growing significantly faster.

SMARTRAC generated overall revenues of € 52.5 million, a gross profit of € 18.5 million and an EBITDA of € 11.9 million in 2006, compared to revenues of € 25.2 million, a gross profit of € 7.8 million and EBITDA of € 4.9 million in 2005.

Revenues from the High Security segment amounted to € 27.1 million in 2006 (2005: € 5 million) accounting for 51.6 percent of the company's overall revenues in 2006 (2005: 19.8 percent). In 2006, our Standard segment contributed revenues of € 24.7 million, accounting for 47 percent of overall sales (2005: € 19.9 million, 79 percent).

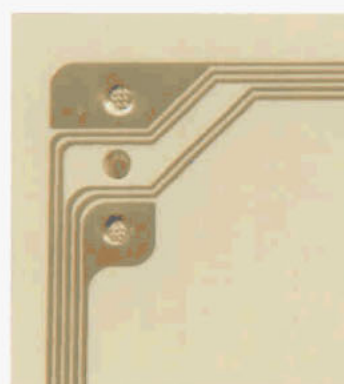
*Microchips are connected to an antenna with thermo compression bonding (TCB)*



**Wire-embedding technology:**  
An antenna is embedded into a carrier substrate by using ultrasonic energy.

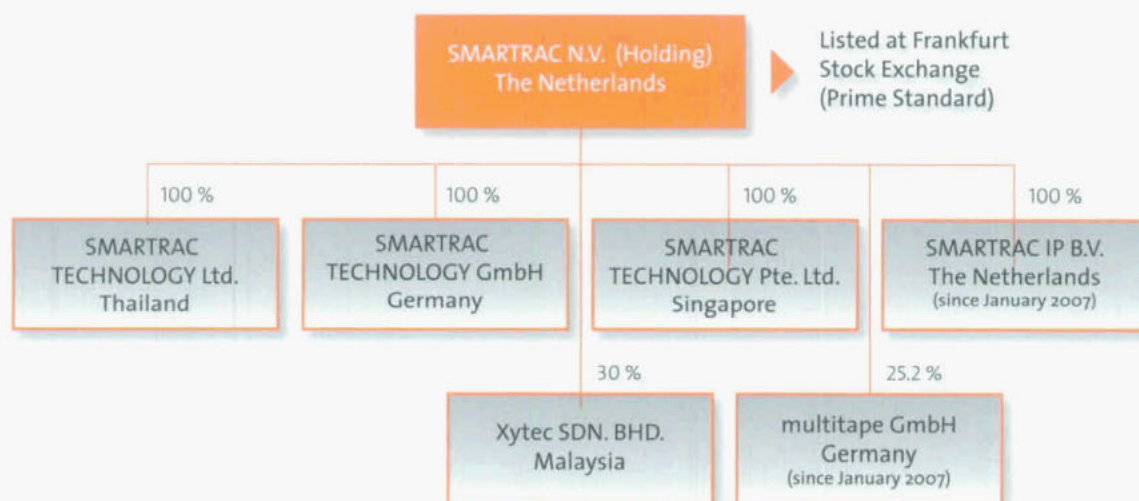


**Wire transfer technology:**  
Winded coils are placed on a substrate before lamination.



**Etching technology:**  
Antenna structures are etched out of a metallized carrier substrate.





*SMARTRAC's structure  
European company  
with a strong Asian  
presence*

SMARTRAC has a broad technology base. The company's core competence is the wire-embedding technology for the production of high-quality RFID inlays. SMARTRAC holds major patents taken out on the wire-embedding technology. To a certain extent SMARTRAC also applies wire transfer technology, which is also patented. The company also has access to the etching production processes of multitape GmbH, in which SMARTRAC has

held a 25.2 percent equity interest since January 2007. In addition, the company is permanently investing in research and development in order to maintain its leading competitive position.

Overall, SMARTRAC currently has over 100 customers located in more than 27 countries.

## Revenue by regions

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
<b>Revenues</b>		
Europe	35,654	14,484
Asia	5,954	5,616
North America	7,681	3,233
Others	3,176	1,840
<b>Total revenues</b>	<b>52,465</b>	<b>25,173</b>

## Share information

Initial public offering (IPO):	July 20, 2006
Shares outstanding:	13,500,000
ISIN (International Securities Identification Number):	NL0000186633
WKN (German Securities Identification Number):	AOJEHN
Stock abbreviation:	SM7

Listed in the Prime Standard at Frankfurt Stock Exchange (FSE):



## Shareholder structure

As of December 31, 2006, the family of Manfred Rietzler, CEO of SMARTRAC, together held 33.30 percent and Richard Bird, Vice Chairman of the Supervisory Board, held 34.17 percent of all shares. Other members of the management and their direct relatives together held 5 percent of all shares. At the end of the financial year 2006, the free float of the SMARTRAC share according to the definition of Deutsche Börse was 32.53 percent. As of February 2007 the free float had increased to 34.96 percent.

As of March 15, 2007, the free float increased to more than 75 percent thanks to a share transaction in which altogether approximately 40 percent of all SMARTRAC shares were placed mainly with institutional investors. In the course of this transaction, Richard Bird, founder of

SMARTRAC and Vice Chairman of the company's Supervisory Board, sold his interest in SMARTRAC. Another 550,000 shares came from the equity interest of TCL Netherlands B.V., controlled by Elisabeth Rietzler, the wife of Manfred Rietzler, CEO of SMARTRAC. Subsequent to this share transaction, the Rietzler family still controls a strategic majority equity interest of 25.2 percent of all shares. An additional 200,000 shares were sold by Wolfgang Schneider, Chief Sales Officer of SMARTRAC. Approximately 4 percent of SMARTRAC shares will continue to be held by the company's management.

## Use of proceeds from the IPO

The proceeds from the IPO have been used for repayment of existing debts, increase of capacity and investments in new products and technologies. SMARTRAC will continue





to invest the proceeds to facilitate the further sustainable growth of the company.

#### Dividend policy and dividend proposal

SMARTRAC currently has no plans to distribute a dividend.

#### Share price development

The fixed Share Price for the IPO in July 2006 was € 17. On December 31, 2006, the share price was € 21.29. Earnings per share for financial year 2006 are € 0.79. As of March 1, 2007, the share price went up to € 24.5. On March 19, 2007, the share price was € 23.

#### Information policy

In accordance with the regulatory framework for public listed companies, SMARTRAC's information policy is designed to inform the public in a comprehensive, timely and transparent a way as possible about the overall development of the company. Quarterly and annual financial figures as well as press releases and other information about strategies, prospects and products of SMARTRAC can also be found on the company's website at [www.smartrac-group.com](http://www.smartrac-group.com). To address the special information needs of financial investors and analysts, SMARTRAC organises roadshows and provides tailor-made offers of information, such as telephone conferences for analysts on the occasion of the quarterly financial disclosures or other significant occasions.

SMARTRAC share  
solid financial basis,  
value created

03-07-2007

## Statement of the SMARTRAC Supervisory Board

The SMARTRAC Supervisory Board hereby presents the Annual Report 2006 of SMARTRAC N.V. and would like to report on the activities of the Board in financial 2006 as well as pointing out the Board's assessment of the company's strategy and development during that period. The Chairman of the SMARTRAC Supervisory Board is Prof. Dr. Bernd Fahrholz, the Vice Chairman is Richard Bird and Wolfgang Huppenbauer is Member of the Supervisory Board.

Prof. Dr. Bernd Dieter Fahrholz and Wolfgang Huppenbauer fulfil the requirements of independent members of the Supervisory Board to the full extent. As founder of SMARTRAC and a major shareholder, the Vice Chairman

pervisory Board. On March 15, 2007, Richard Bird sold his interest of approximately 35 percent in SMARTRAC mainly to institutional investors. From this date on he does not hold any more interest in the company's share.

The general principles of good corporate citizenship according to the Dutch Corporate Governance Code are implemented at SMARTRAC. Deviations from the Code are justified by the specific requirements of SMARTRAC and are listed on page 37 of this report under the section "Corporate Governance".

The Supervisory Board held two meetings during financial year 2006, which were also attended by members of the



**Prof. Dr. Bernd Fahrholz (59)**

*Chairman of the Supervisory Board*

*Appointed with effect as of the date of the admission resolution by the FSE*

*Term of office ends in 2009*

*German Citizen, Home Domicile is Berlin, Germany*

- *Former CEO of Dresdner Bank AG*
- *Former Deputy Chairman of the Management Board of Allianz AG*
- *Supervisory Board Member of Fresenius Medical Care*

of the Supervisory Board Richard Bird maintains close relations to the management and operational business of the company. Nevertheless, he does not fulfil any official management functions that go beyond his mandate as a Vice Chairman of the SMARTRAC Supervisory Board. His business experience in the RFID industry has significantly supported the work of this Board, and he has thus completely fulfilled the role of a valuable member of the Su-

Board of Management of SMARTRAC N.V. In addition, the Supervisory Board also met without the management of the company being present and discussed the functioning and performance of the Management Board as a whole and of the individual members which is reflected by the change in the remuneration of the Management Board beginning in the year 2007.



The Supervisory Board also met in February 2007 without the management of the company being present to discuss its profile, composition and competence as well as its own functioning and that of its individual members. Not all members of the Board were present in all of the meetings in person. But in order to enable proper work of the Board, absent members participated via telephone.

By doing so, the operability of the Supervisory Board could be adequately guaranteed without any reservations. As the Supervisory Board consists of fewer than four members, the tasks of an audit committee, remuneration committee as well as selection and appointment committee were fulfilled by the full Supervisory Board in accordance with the principles of the Dutch Corporate Governance Code.

#### Audit Committee

The tasks of the audit committee were performed during regular meetings on the occasion of the quarterly reports of SMARTRAC.

#### Risk Management

The execution of internal and business risk management and the development of internal control systems were

discussed by the Supervisory Board and were monitored in its role of an audit committee. The assessments by the Management Board of the structure and operation of internal risk management and control systems were also on the agenda of the Supervisory Board. Systems and processes at SMARTRAC are not shaped to the full extent and are still being further developed and implemented. This is mainly due to the fact that SMARTRAC is a young publicly listed company with a highly dynamic growth path. But the SMARTRAC management gives top priority to managing company risks and is putting the right control systems into place, following a traceable strategy with clearly defined milestones in this respect as well. Overall, the risk management and control systems implemented at SMARTRAC to date fulfil the basic requirements.

#### Remuneration Committee

The remuneration of the management and the stock options plan were discussed during the regular meetings of the Supervisory Board. The remuneration policy of SMARTRAC consists of a base salary with variable performance compensation, closely linked to the individual achievement of objectives as well as the success of the company and including a Stock Option Plan. The overall remuneration policy is continuously adjusted to market developments with the set competitive comparison



**Richard Bird (66)**

*Vice Chairman of the Supervisory Board*

*Member since January 23, 2006*

*Term of office ends in 2010*

*Swiss Citizen, Home Domicile is Singapore*

*– Founder of SMARTRAC*

serving as an adjustment factor. With its remuneration policy SMARTRAC meets the goal of being an attractive company for skilled managers and employees to work for. The Supervisory Board regards the remuneration policy of SMARTRAC as adequate and therefore supports the company policy in this respect. A detailed remuneration report can be found at page 40 of this annual report.

#### Selection and Appointment Committee

As far as management appointments are concerned, the Supervisory Board maintained the role of a selection and appointment committee. Tasks and composition of the

#### Financial year and strategic approach

SMARTRAC N.V. reports on a very successful financial year with this first annual report since its corporate restructuring and the IPO in July 2006. The company achieved impressive growth figures for revenues and earnings in the reporting period. The Supervisory Board is altogether very pleased with the development of the company in the financial year 2006 and beyond.

The consolidated financial statements on pages 42 to 91 of this annual report have been audited by KPMG Accountants N.V. in Amsterdam, The Netherlands. Their report is included on pages 92 and 93.



#### **Wolfgang Huppenbauer (53)**

*Member of the Supervisory Board*

*Appointed with effect as of the date of the admission resolution by the FSE*

*Term of office ends in 2009*

*German Citizen, Home Domicile is Singapore*

- *President and CEO of DaimlerChrysler Thailand*
- *Former various management positions in Australia, Asia and Europe for DaimlerChrysler AG*

Supervisory Board as well as roles of the individual members were assessed on a regular basis and considered to be aligned with the specific conditions at SMARTRAC.

The Supervisory Board was involved in all of the company's considerations regarding the basic strategy, related risks of the business in a timely and reasonable manner. Comprehensive information was provided to the Supervisory Board on the implementation of risk management and control systems at SMARTRAC at all times, and transparency was facilitated to the Supervisory Board across all of the major transactions.

The Supervisory Board is very satisfied with the performance of the management of SMARTRAC as a whole, including the performance of each single management body as well as cooperation and coordination between the different management bodies.

From the point of view of the Supervisory Board, SMARTRAC acts upon a clearly defined strategy with the efficient allocation of financial and management resources in a quickly developing and highly dynamic RFID market environment. The corporate strategy was discussed by the Supervisory Board during its meetings in 2006.

The management of SMARTRAC followed a clear strategic approach in 2006 with a focus on three major fields, where future-oriented achievements for the company could be made. All decisions were clearly aligned with the overall goal of the company to deliver sustainable profitability.

- Corporate restructuring was nearly finalised and appropriate organisational and management structures are being implemented.
- The IPO was successfully accomplished, thus gaining the required financial resources for the further growth of the company. Since the IPO, the share price developed well and the company has already created significant value for its shareholders.
- Production capacity is an important factor in the worldwide competition and was enhanced in 2006.

Overall, the company created a solid basis for further growth and has also set the course for the further development. From the point of view of the Supervisory Board, SMARTRAC is well positioned in the worldwide RFID market and has the prerequisites to continue prospering as a major player in this marketplace.

We propose that the shareholders approve the Annual Report 2006 and the treatment of the results contained therein. The approval will serve to endorse the Management Board's conduct of the company's affairs and the supervision exercised by the members of the Supervisory Board.

Finally, the Supervisory Board wants to thank the management and all of the employees of SMARTRAC N.V. for their work and commitment, delivering a sustainable contribution to the success and prosperity of the company.

Amsterdam, March 19, 2007

Prof. Dr. Bernd Fahrholz  
Richard Bird  
Wolfgang Huppenbauer

The business address of the members of the SMARTRAC Supervisory Board is:  
Parnassusweg 103, 1077 DE Amsterdam, The Netherlands.



Dear shareholders,



*Dr. Christian Fischer,  
CFO (left) and  
Manfred Rietzler, CEO*

This first publicly available annual report marks an important milestone for SMARTRAC N.V., and we are proud to present to you the results of a successful financial year for our company.

With our superior and proprietary production technology base and the industry-wide biggest production capacity for high quality components in secure contactless data transmission, SMARTRAC today is a major player in the RFID industry. Our business primarily consists of manufacturing and supplying inlays, as opposed to producing completed cards and readers or providing related system integration services. Overall, this model as a focused inlay manufacturer, located between our suppliers and our customers has turned out to be very successful and will remain the basis of our current and future operations. Altogether, we processed more than 500 tons of plastics

into inlays and produced between 300.000 and 450.000 RFID inlays a day, with total shipments to customers adding up to close to 100 million units in 2006.

With our ongoing growth in revenues and profits we managed to build upon our leading position in key segments of the worldwide RFID market and to tie up with our profitable results from the previous years.

In 2006 our group-wide operations generated revenues of € 52.5 million, thus more than doubling the result of € 25.2 million in 2005. With regard to EBITDA, the growth rate is even more impressive. Compared to 2005, when we reported an EBITDA of € 4.9 million, last year's figure amounted to € 11.9 million, representing a plus of more than 140 percent.

The overall trend from the previous quarterly reporting periods consolidated for the financial year 2006, with the High Security segment comprising ePassports and ePayment being the main growth driver. In comparison to 2005, when RFID applications from this segment

ePassport projects in particular gained sustainable momentum throughout the past year. A significant number of governments have already introduced ePassports and more countries are about to opt for ePassport solutions. SMARTRAC is involved in most of the projects as the



accounted for € 5 million and 20 percent of overall revenues, the contribution in 2006 increased to an impressive € 27.1 million or 52 percent, representing a growth rate of 441 percent.

Nevertheless, standard RFID applications, historically our main source of revenues, remain an essential and strategically important part of SMARTRAC's business. In financial 2006, components from mass transit and access control and logistics together accounted for € 24.7 million, growing 24 percent compared to 2005 (€ 19.9 million).

The increasing revenue contribution of high security components at SMARTRAC reflects a major development in the highly dynamic worldwide marketplace, we are in.

main global supplier of RFID inlays. In 2006 SMARTRAC generated revenues of € 21.9 million with RFID inlays for ePassports, growing by 695 percent compared to 2005 (€ 2.8 million).

SMARTRAC maintained its leading position with high market share in the ePayment product line as well. Revenues amounted to € 5.2 million, growing significantly by 131 percent from € 2.3 million in 2005, despite the fact that growth rates did not reach the expected levels.

Our overall growth contributed significantly to the cash position of SMARTRAC.

Net cash provided by operating activities amounted to € 6.1 million in the past 12 months (compared to € 1.2

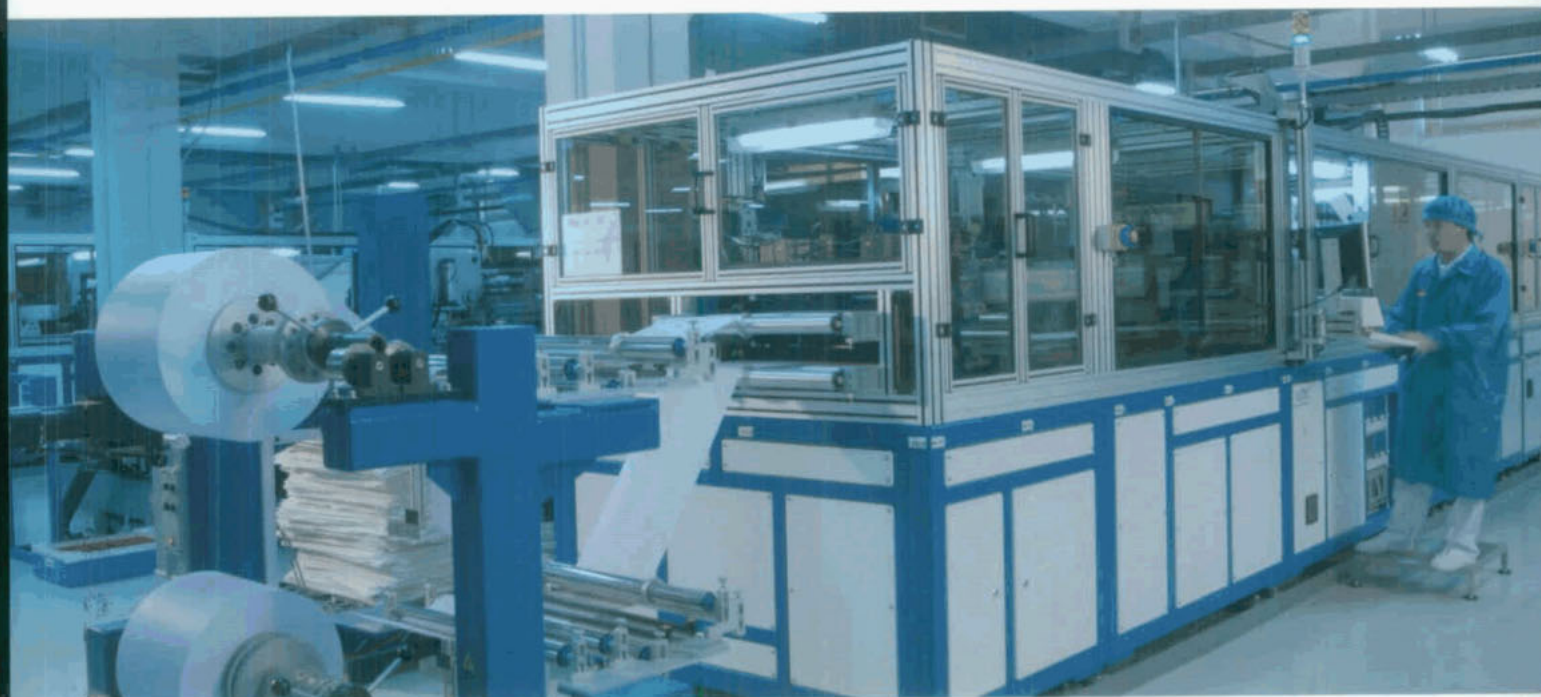
*SMARTRAC IPO in July 2006: well received by the financial community*

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million for the same period in the prior year), mainly due to the group earnings of € 9.1 million (prior year: € 3.0 million). Rising by € 6.1 million, the result for SMARTRAC also compares favourably with the prior year period. This effect was counter-balanced by a rise in working capital,

In the mid-term, SMARTRAC plans to invest around 3 percent of revenues in research and development of products and production technology. These activities are concentrated in Thailand, where a dedicated team of specialists is working on new technologies and products.



*Superior production  
technology: fully  
automated production  
of RFID inlays*

notably by the rise of trade receivables (€ 6.1 million) which reflects the strong increase in the level of sales volume compared to the prior year.

Mainly due to the further expansion of our production capacity, net cash used for investing activities accumulated to € 11.4 million in 2006 compared to € 4.5 million in 2005. Net cash provided by financing activities increased markedly by € 36.9 million after our successful initial public offering in July 2006. 3.5 million new shares were placed with institutional and private investors for a price of € 17 per share. The proceeds from the issue net of related cost (€ 48.5 million) were reduced to pay back substantially all loans amounting to € 14.7 million at that time. Furthermore, the proceeds proved to be a sustainable basis for the further expansion of our production capacities and product range. In the second half of the year 2006 we invested € 6.0 million in property, plant and equipment.

The increase in inventories and trade receivables in comparison to December 2005 reflects the ramp-up in production in conjunction with an ongoing rise in sales.

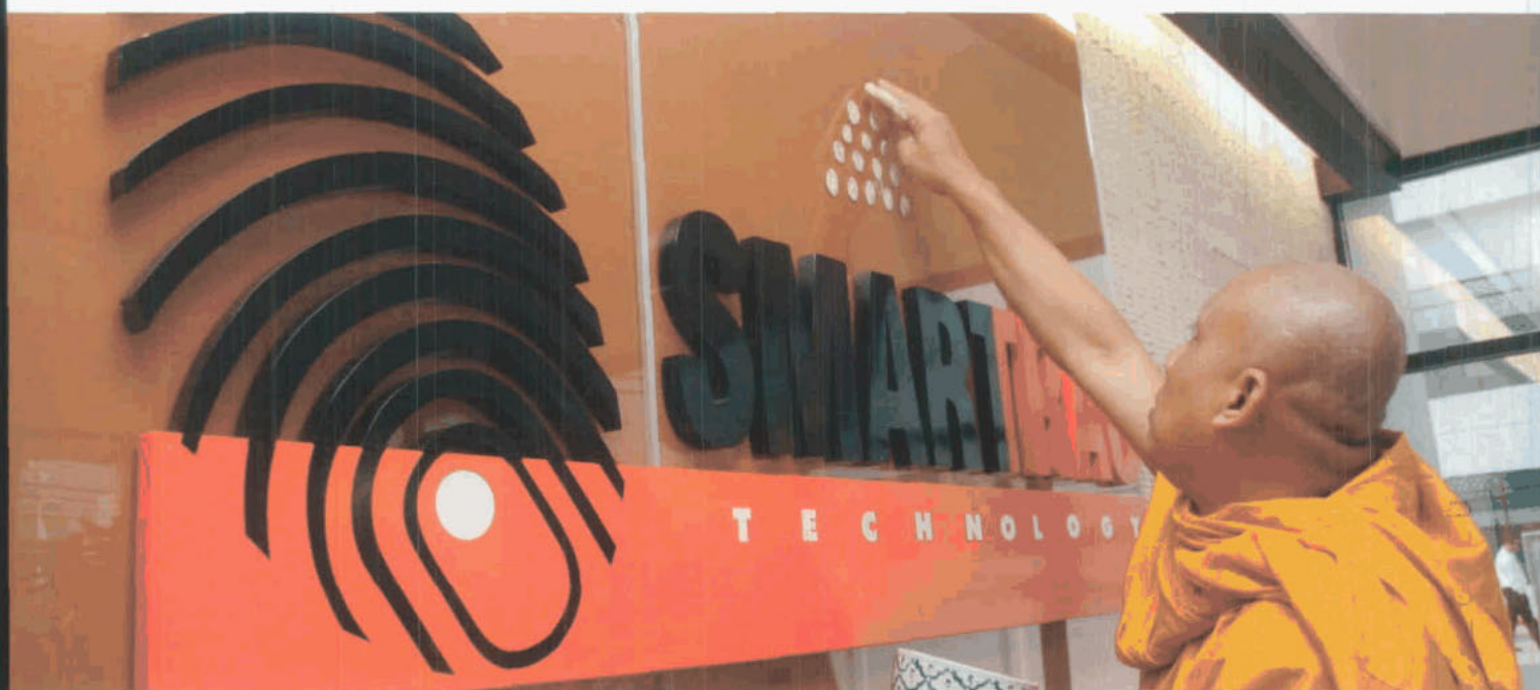
On the basis of the strategic decisions implemented in the reporting period to date, we are well prepared to assure our future prosperity. From the perspective of the Board of Management, the slogan "Managing growth" best describes what has been SMARTRAC's guiding principle and main challenge throughout the past financial year and beyond.

We nearly completed our corporate restructuring process with the incorporation of our Dutch holding company SMARTRAC N.V. and now have the right organisational structures and management in place. On this basis we will further adapt our organisation to the expanding company's needs. As in all strategic decisions, the contribution to the sustainable profitability of SMARTRAC will continue to be our leading principle.



SMARTRAC's successful IPO in July 2006 was definitely another important milestone, providing the company with a solid financial basis for further expansion. Overall, our company was well received by the financial community and there is rising interest in SMARTRAC shares.

Net cash and cash equivalents rose significantly by € 34.8 million in the year 2006. This can be traced back to the net proceeds received from the IPO in July 2006. Consequently, we reduced our financial liabilities by € 8.4 million thanks to the IPO proceeds.



We have already succeeded in creating significant value for our shareholders. And the assessments by respected financial institutes point out further growth perspectives for SMARTRAC's shares.

In a share transaction on March 15, 2007, approximately 40 percent of all SMARTRAC shares have been sold by original shareholders and placed mainly with institutional investors. As a result, the free float has increased to approximately 75 percent. It was our stated goal to significantly increase the free float of our share. Through this share transaction we have achieved this goal, and we have thus substantially increased the liquidity in the market, satisfying the requirements of institutional investors and strengthening their position. In our view, the great interest shown by institutional investors in SMARTRAC's shares is evidence that they look favourably upon our strategy and have confidence in our business model and the excellent prospects of our company.

Owing to the proceeds from the IPO in July 2006, share capital increased by € 1,750,000 to € 6,750,000. Additionally, the share premium account increased by € 48.5 million net of IPO costs and including related tax benefits. IPO costs and related tax advantages were directly offset against the share premium account in the course of the IPO.

Overall, in an upturning worldwide RFID market we chose exactly the right timing for the restructuring of SMARTRAC and the IPO as crucial prerequisites to build upon our leading position in this industry.

Another ongoing strategic direction in 2006 and beyond is the expansion of our production capacity. In the reporting period of 2006 we invested € 11.3 million in property, plant and equipment (2005: € 4.6 million). This investment includes our fourth plant in Thailand which was officially opened on February 2, 2007. This factory will concentrate on the production of standard components,

*Plant opening ceremony in Thailand in February 2007: Buddhist monk blesses factory and employees*

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thus releasing additional capacity at our other locations for the production of high-security RFID inlays.

We continue to have the biggest production capacity worldwide in the field of secure RFID components, and

In December 2006 SMARTRAC N.V. and the Swedish group Assa Abloy AB amicably clarified and settled all the issues that were previously open between the two companies in an agreement. The dispute primarily involved the use of certain patents related to the production of

In thousands of euro	Standard components		High Security components		Other operations		Consolidated	
	12 months ended Dec. 2006	12 months ended Dec. 2005	12 months ended Dec. 2006	12 months ended Dec. 2005	12 months ended Dec. 2006	12 months ended Dec. 2005	12 months ended Dec. 2006	12 months ended Dec. 2005
Segment revenue								
External sales	24,725	19,903	27,109	5,010	631	260	52,465	25,173
Segment result								
Gross profit	5,060	6,381	12,790	1,419	631	40	18,481	7,840
Operating expenses	(3,461)	(3,261)	(4,132)	(752)	(1,283)	(251)	(8,876)	(4,264)
Operating profit (loss)	1,599	3,120	8,658	667	(652)	(211)	9,605	3,576
Net financial expenses							(758)	(610)
Share of profit of associate					110	15	110	15
Income tax benefit							162	37
Profit for the period							9,119	3,018
Supplemental information								
Operating profit (loss)	1,599	3,120	8,658	667	(652)	(211)	9,605	3,576
Depreciation and amortization	1,212	991	1,096	277	–	68	2,308	1,336
Segment EBITDA*	2,811	4,111	9,754	944	(652)	(143)	11,913	4,912

our current production network allows us to react to market developments and customers' needs even more flexibly than before.

The expansion of our production capacities goes along with a broadening of our technology base. In January 2007, we acquired a 25.2 percent interest in the German company multitape GmbH, thus gaining access to its expertise in etching technology. For certain high volume RFID applications in the Standard segment we see this technology as complementary to our core competency in the wire-embedding technology.

What has also been put on the agenda as a strategic focus for 2006 and beyond is the protection of our intellectual property. In this matter, we have already taken crucial decisions with the first positive results for SMARTRAC.

radio frequency identification devices using the wire-embedding technology. Under this agreement Assa Abloy AB assigned its ownership rights in a number of patents to SMARTRAC N.V. In return, Assa Abloy AB received a worldwide, non-exclusive license for the ongoing use of the patents.

SMARTRAC acknowledges the importance of good corporate governance. As an ongoing effort, SMARTRAC is therefore further optimising the corporate governance structures and processes with a clear management focus on risk management and control systems. Although not all systems could be implemented to the full extent, we believe that we already meet all of the basic requirements and we will continue to improve in an ongoing management effort.



## Business outlook

We expect further growth in all segments. A flattening or even saturation in the market for secure RFID inlays cannot be foreseen from our current perspective.

to participate in this growth. Additionally, Bio/Logistics applications promise attractive future growth rates for SMARTRAC. We will continue to secure our position in the Standard segment also with significant investments in research, technology and product development.



With more and more countries starting ePassport projects, this product line will continue to gather momentum for SMARTRAC. This also holds true for the ePayment market, and we anticipate further organic growth for contactless payment applications as well. Like most new technologies, ePayment is equally subjected to challenges and we believe the slower-than-projected increase in volumes in this segment should be considered against this background. However, this market will develop further and quick turnaround times for unexpected high volumes will continue to be a major competitive advantage of SMARTRAC.

Furthermore, we see growth potential in the Standard segment. With our broad technology base, comprising superior production technologies, we are well prepared

“Managing growth” will definitely remain a core challenge at SMARTRAC. We will continue to build upon SMARTRAC’s strong position as the leading supplier for high quality RFID components in the worldwide RFID value chain. Our objectives for 2007 are clearly aligned with this goal to strengthen our competitive position and to deliver sustainable profitability in a fast-growing market environment. In this respect, the strategic decisions taken in 2006 also point out major strategic directions for the year of 2007 and beyond.

With our suppliers and customers we will continue our successful business relationship based on partnership, reliability, expertise, competitiveness and technological leadership.

*Glass-tube transponders: interesting prospects in the field of animal ID*

03-07-2007 03-07-2007





**Management Board**

*Behind (left to right):*

*Anthony Edward*

*Driessen, Ronald Brown*

*Front (left to right):*

*Manfred Rietzler,*

*Dr. Christian Fischer*

We will further expand production capacities and intend to start production of high security inlays in the United States. And we will develop additional markets with their own production plants. Nevertheless, Thailand will remain our main production location in 2007. Despite certain political developments, we still see the Thai authorities as reliable partners and Thailand as one of the best places in the world to conduct our business.

The protection of our intellectual property rights will also remain on the agenda. We see our patents mainly in the wire-embedding technology as a crucial asset of our company. We will therefore continue to take effective action against any patent infringements including additional patents resulting from new processes under development as well.

SMARTRAC N.V. will continue to be a strong player and make significant contribution to the future consolidation process in the RFID market place. We have all of the prerequisites and the right strategy in place. Our customers appreciate the high quality of our products as well as the innovative technological power of SMARTRAC and the financial market supports us. In addition, our workforce and management are highly identified with the goals of our company. In order to keep our leading position, we will therefore make sure that SMARTRAC remains an attractive company to work for.

Amsterdam, March 19, 2007

Manfred Rietzler  
CEO

Dr. Christian Fischer  
CFO

Company profile	Statement of the Supervisory Board	Letter of the CEO and the CFO	Business by segments	Key business factors	Risks	Corporate governance	Financial statements	Other information
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## Manfred Rietzler

Chief Executive Officer

Mr. Rietzler has a degree in electrical engineering from the Technical University of Munich and is an expert in RFID

technology, semiconductor packaging, SmartCard technology and transponder applications. He has specialized in

electrical engineering and automated production technologies. After graduating from University, Mr. Rietzler worked

as a scientific assistant in a research project on autonomous mobile robots at the University of Munich in 1987.

From 1987 to 1993, Mr. Rietzler was the head of electronic assembly of Maho AG, Pfronten (Germany). Mr. Rietzler

gained extensive management experience in the AmaTech group of which he was a co-founder. At AmaTech GmbH &

Co. KG, Mr. Rietzler served in various functions, including technical director and chief technical officer for development and production, from 1993 to 2000. From 2000 to

2001, Mr. Rietzler was a 20 percent shareholder in and held the function of a general manager of Louda Systems

GmbH, Gersthofen (Germany), a company specialized in the manufacturing of plastic card production equipment. Mr.

Rietzler joined SMARTRAC Technologies Limited (Thailand) as a major shareholder in 2001 and became chief executive

officer in 2003. Since January 2006, Mr. Rietzler has been a member of the Management Board of the Company.

## Dr. Christian Fischer

Chief Financial Officer

Dr. Christian Fischer has a degree in business administration and has a doctorate in financial economics from the

University of Hohenheim (Stuttgart). He started his career at Robert Bosch GmbH in 1996 where he was a project

manager in corporate planning and controlling. In 1999, Dr. Fischer joined Roland Berger Strategy Consultants Compe-

tence Center Restructuring and Corporate Finance where he became partner in 2003. In 2004, Dr. Fischer was appointed

chief financial officer and chief restructuring officer of Walter Bau-AG and became a member of the management

board (Mitglied des Vorstands). Dr. Fischer joined SMARTRAC as chief financial officer at the end of 2005 and became a

member of the Management Board upon the incorporation of the company in January 2006.

## Anthony Edward Driesen

Member of the Management Board

Mr. Driesen graduated from Leiden University law faculty in 1962 and became a partner of NautaDutilh N.V., an

international Dutch law firm, in 1970, to which, after his retirement in 2002, he still acts as advisor. Mr. Driesen has

been extensively involved in oil and gas related matters and is specialized in corporate law, M&A, joint ventures

and reorganizations. As of March 2006, in addition to his consultancy position with NautaDutilh N.V., Mr. Driesen

has become a member of the Management Board of the Company. Mr. Driesen currently also sits on the management boards of Sierra European Retail Real Estate Asset

Holdings B.V. (Netherlands) (since 2004) and Cairn Energy Netherlands Holding B.V. (Netherlands) (since 2001).

## Ronald Brown

Chief Operating Officer

Mr. Brown, Chief Operating Officer of SMARTRAC, manages production, quality management, engineering, purchasing,

and operations. He has over 35 years of experience in the high-tech electronics industry in the fields of manufactur-

ing, purchasing and operations and has held multiple senior management positions within these areas, among others,

senior positions at Seagate Technology in California and Singapore and USI Manufacturing in California. Mr. Brown

has acquired extensive experience in Asia. As Vice President Far East Materials for Seagate Technology, he managed all

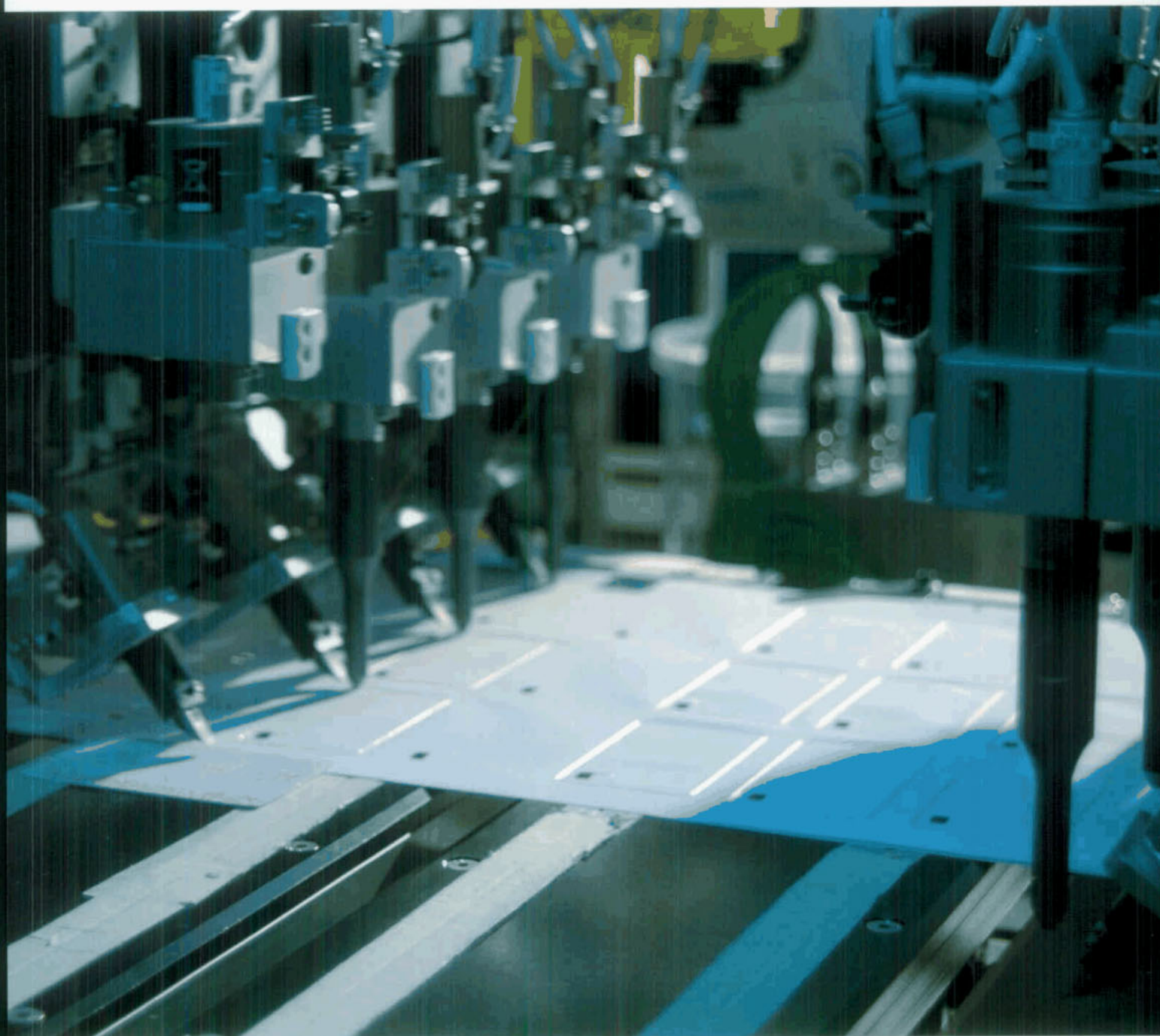
procurement, materials, manufacturing, scheduling and inventories for the manufacturing locations in Singapore,

Malaysia, Thailand and China as well as Japan, Korea, Hong Kong and Taiwan. Mr. Brown joined SMARTRAC in 2005 and

became a member of the Management Board in March 2006.



## Business by segments





## Standard segment

Secure RFID inlays produced in our Standard segment have historically been our primary source of revenue. In financial 2006 the ratio in revenues between standard and high security applications continued to change in favour of high security inlays. Nevertheless, standard RFID applications are and will continue to be an essential and strategically important part of SMARTRAC's business with significant growth perspectives.

Most of the inlays produced in our standard segment are part of our mass transit & access control product line. Although the inlays for contactless data transmission in the Standard segment contain a lower-end memory chip, basic security features such as password authentication and basic encryption are common.

Our Standard segment also encompasses our logistics product line, which besides card-related inlays also includes non-card related inlays and products used for logistical and verification applications (e.g. product tracking and tracing, animal ID implants, laundry tags and casino chips). Although volumes for our logistics products were still fairly low in 2006, they offered high growth potential and attractive margins and show a high growth potential for 2008 onwards.

The Standard segment generated revenues of € 24.7 million in 2006 and € 19.9 million in 2005. The successful implementation of large-scale projects around the world, which is encouraging more transit companies to adopt RFID technology, can be seen as main drivers for the substantial revenue growth in the Standard segment.

To name a few examples, SMARTRAC products are being used in the "Trans Santiago Public Transport Project" in Santiago, Chile, the "Oyster Card Public Transport Project" in London, Great Britain, the "Skytrain Public Transport Project" in Bangkok, Thailand, and the "Ski Amadee Ski Arena Access Control Project" in Salzburg, Austria.

We see additional significant growth potential in the field of Bio/Logistics and to a certain extent also for applications with so-called multi component cards. Compared to conventional cards, multi component cards include additional components such as a battery to apply energy for extra features like a display.

In addition, we are in permanent close contact with our customers to develop new tailor-made applications for their RFID requirements to support this growth. New applications in Bio/Logistics like glass-tube transponders offer interesting prospects in this segment.

On an ongoing basis we are also assessing additional technological options as well as strategic partnerships for the production of RFID components.

As an example, SMARTRAC broadened its technology base through the acquisition of 25.2 percent interest in multitape GmbH in January 2007, thus gaining access to etching technology, primarily as an option for applications in logistics and access control in addition to the wire-embedding technology, the core competency of SMARTRAC. The company now can further extend its product portfolio and is overall ideally placed for applications in the Standard segment with high volumes and great growth potential.

## Standard segment

In thousands of euro	2006	2005	Change in %
Revenues			
Mass Transport and Access Control	24,217	18,540	30.6
Logistics	508	1,363	(62.7)
Gross Profit	5,060	6,381	(20.7)
EBITDA	2,811	4,111	(31.6)

## Revenues

Revenue from our Standard segment increased from € 19.9 million in 2005 to € 24.7 million in 2006, representing a contribution to overall revenues of 47 percent. In financial year 2005, the Standard segment still accounted for 79 percent of overall revenues. The relative decrease for this percentage is mainly due to the faster growth of sales in our High Security segment.

In 2006, 98 percent of our Standard segment revenues were generated by mass transit & access control applications, with inlays for logistics generating 2 percent.

## Gross profit

During 2006, gross profit in our Standard segment was € 5.1 million (2005: € 6.4 million), representing a gross profit margin of 21 percent (2005: 32 percent). A substantial portion of our group-wide cost of sales is attributable to chip purchases. Whereas in the High Security segment only a small percentage of the chips embedded in our products is purchased, the percentage of chips bought in the Standard segment is significantly higher. In addition, the portion of chips sourced in the Standard segment in 2006 has increased compared to the previous year.

Overall, this leads to a lower gross profit margin in the Standard segment compared to the High Security segment.



## EBITDA

The Standard segment achieved EBITDA of € 2.8 million in 2006, compared to € 4.1 million for the year of 2005. The EBITDA margin decreased from 21 percent in 2005 to 11 percent in financial year 2006. The decrease had been anticipated and was partly caused by a seasonal sales decrease in the third quarter 2006 and a higher proportion of memory chips which bear less value added for the company as these are purchased (chip sourcing).

*Production of  
RFID components/  
SMARTRAC fulfills  
highest requirements  
regarding quality  
and security*

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## High Security segment

Our High Security segment includes two product lines – "ePayment" and "ePassport". Both of these product lines feature inlays containing microcontroller chips that

tactless banking, credit and debit cards. This product line generated € 2.3 million in revenues in financial year

2005 and € 5.2 million in revenues during the year 2006, representing a growth of 131 percent.

## High Security segment

In thousands of euro	2006	2005	Change in %
Revenues			
ePayment	5,205	2,255	130.8
ePassport	21,904	2,755	695.1
Gross Profit	12,790	1,419	801.4
EBITDA	9,754	944	933.3

include sophisticated encryption functions and permit advanced calculations to be made.

In 2006, SMARTRAC managed to build upon its leading position in this field due to superior production technologies as well as expanded production capacities. The company guarantees high security standards in production. SMARTRAC inlays fulfil the highest requirements in terms of security and quality.

### ePayment

SMARTRAC maintained its leading position with a high market share in ePayment. Our ePayment product line focuses on manufacturing high security inlays for con-

Since 2005, particularly in the United States, credit card organisations (e.g. VISA with "Visa Wave" and MasterCard with "PayPass") and financial institutions began introducing contactless payment systems with increasing volumes in test areas as forerunners of nationwide rollouts. In addition, the first ePayment projects already started in Europe in 2006.

Our PayPass inlays obtained a full Master Card CQM qualification. SMARTRAC's facility, processes and products have successfully completed Master Card's Card Quality Management Scheme (CQM) audit, and a corresponding CQM-label has been granted by VISA for SMARTRAC's inlays.

With these prerequisites, SMARTRAC is able to offer the full range of RFID inlay products for the secure payment industry and is the ideal manufacturing partner in this market.

## ePassports

In financial year 2006, we saw strong sustained growth in our ePassports product line, in which we manufacture special inlays designed for electronic passports. To a



Although we achieved strong growth in the ePayment product line over the past two years, growth rates overall did not reach the figures as anticipated in our internal estimates and outlined by industry experts as well as in independent studies.

Nevertheless, we still believe that ePayment is an emerging market segment and that an increasing number of card issuers will migrate from traditional magnetic stripe and contact-based chip cards to contactless cards. Compared to conventional credit cards these ePayment cards offer serious advantages for customers and banking companies as well as merchants. We thus still expect a high organic growth rate to happen with a certain delay compared to previous market projections. The United States and Asia will be the main markets with additional projects being implemented in Europe.

certain extent, this positive development could compensate for lower growth rates in the ePayment business and strengthen the overall position of the High Security segment within SMARTRAC's portfolio.

Revenues from our ePassports product line increased from € 2.8 million in financial year 2005 to € 21.9 million in 2006, representing a growth of 695 percent.

We believe that the ePassport product segment still has attractive prospects for future expansion of production volumes. In particular the security standards that have been defined by the US government can be seen as a main driving factor.

*Production conditions  
safeguard high quality  
product standards*

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Currently there are approximately 80 countries world-wide working towards implementing ePassports. SMARTRAC is involved in around 50 projects, already supplying some 20 projects with significant volumes.

In late 2007 and the beginning of 2008, the introduction of other RFID-enabled identification cards such as ID cards and drivers' licenses are expected to follow in certain high volume regional markets, e.g. Germany and Mexico.

*ePassport inlay:  
High Security  
segment main  
growth driver  
in 2006*

A major milestone for SMARTRAC's ePassport business was the purchase order the company obtained to supply several million ePassport inlays for the United States' ePassport project in 2006 and 2007. The purchase order placed by Infineon Technologies AG is the most significant order in the high-security RFID inlay industry to date. The US programme, for which SMARTRAC produces the inlays as supplier, is currently the world's largest ePassport project. Other orders such as the supply to the Austrian ePassport project also sustainably contribute to the growth in this business segment.

Regarding this background, we believe that the product line comprising passports, ID cards and drivers' licenses will remain on a growth path and continue to be a highly attractive business for our company in particular.

In addition certain applications for so called multi component cards could contribute to the further growth in the High Security segment as well in the future. Unlike conventional cards for contactless data transmission, comprising a chip and an antenna, we see potential in new applications with cards comprising additional components like displays, batteries, switches, or other attributes such as number generators. SMARTRAC is well prepared to become the leading supplier of inlays for these applications as well.

## Revenues

The high-security business has been the main growth driver in 2006, contributing considerably to the ongoing growth in sales and profits. Sales in our High Security segment were therefore far higher in financial year 2006 than in 2005. Due to the expansion of our activities in the ePassport market as well as secure contactless ePayment applications the relative revenue contributions in 2006 compared to 2005 continued to change significantly in favour of the High Security segment. Whereas the High Security segment accounted for 20 percent of total revenues in 2005 (€ 5 million), it accounted for 52 percent of total revenues in 2006 (€ 27.1 million).

In 2006, 19 percent of our High Security segment revenues were generated by ePayment inlays, with inlays for ePassports generating 81 percent. The ratio switched in favour of ePassports compared to 2005, when 45 percent revenues in the High Security segment came from ePayment and 55 percent from ePassports. The decline of the percentage of ePayment in relation to ePassport inlays is attributable to the overall conservative development of the ePayment market as well as the positive development in ePassports.

## Gross profit

During 2006, gross profit in our High Security segment was € 12.8 million (2005: € 1.4 million), representing a gross profit margin of 47 percent (2005: 28 percent). Due to the sensitiveness of the microchips, most of the chips in the High Security business segment are consigned. We currently only purchase a small percentage of the chips used in our high security products.

## EBITDA

In 2006, our High Security segment achieved EBITDA of € 9.8 million, compared to € 0.9 million for the year 2005, representing a major contribution to the profitable growth of the company. The EBITDA margin increased from 19 percent in 2005 to 36 percent in 2006.



## Key factors affecting our business

In this chapter we would like to reflect some of the major factors from the perspective of SMARTRAC that have had and will continue to have a material effect on our results of operations and financial conditions.

### Timing of project implementation by end-customers

We are experiencing significant growth in our business overall, and particularly in our High Security segment, as governments, retailers and banks continue implementing ePassport and ePayment systems. As these systems become more and more operational, governments and banks need to quickly supply their clients and citizens with a large number of ePassports and contactless cards.

Our customers, such as card manufacturers and secure printing houses and system integrators, provide us with forecasts of their expected order volumes based in part on estimates of when banks, governments and others will implement these new systems. In some cases, delays in the implementation of major projects have caused our customers to reduce forecast volumes. The risk of such delays is particularly high with regard to ePassports, where technical difficulties and political opposition to the introduction of electronic travel documents due to privacy and technical concerns have caused several countries to delay the implementation of ePassports. But as an increasing number of countries opt for ePassport solutions, we see the aforementioned concerns and obstacles decrease overall.

Customer acceptance and awareness as well as infrastructure are overall crucial prerequisites for the ePayment business. With regard to our ePayment products, retailer reluctance to make significant investments in

card readers may delay the acceptance of contactless credit and debit cards.

We have also already experienced delay in projects in our Standard segment where for example the implementation of some large infrastructure projects has been postponed.

Accordingly, our results of operations during any particular period have been and may continue to significantly be affected by the timing of project implementation by end-customers using devices incorporating our products.

### Growth in our ePayment and ePassport product line

Our High Security segment is growing faster than our Standard segment. We are able to realise superior margins on high security products compared to our standard product lines. Accordingly, our profitability could be affected by the timing of implementation by various countries.

### Capacity management

The availability of sufficient production capacity is one of our main competitive advantages, also enabling quick turnaround times for unexpected volumes. We seek to maintain up to 20 percent excess capacity to meet growing demand from our customers.

With our fourth production plant in Thailand, which opened in February 2007, we continued to increase our production capacity. The fourth factory will produce components in the Standard segment, thus releasing

additional capacity at other locations for the production of high-security RFID inlays according to our customers' high security standards and requirements.

Our ability to secure, order and receive additional manufacturing equipment in a timely manner and our ability to set up new production lines and facilities quickly and efficiently may have a significant impact on our customer relations and results of operations. Our results of operations may also be affected by ramp-up costs, such as staff training and a reduction in yield, output and utilisation during the process of expanding production. Accordingly, the opening of additional new production facilities may affect our results of operations.

#### Microchip purchases

The percentage of chips bought or consigned is a main aspect for the overall profit margins in our business. In financial year 2006 we purchased 85 percent of the microchips used in our Standard segment, and less than 8 percent of the microchips used in our High Security segment, on our own account (with the remainder consigned to us by our customers). The percentage of chips we purchase for our ePayment products currently is at a low level.

When we purchase the microchips used in our inlays, the costs of the chips represent a significant portion of the price we charge for each completed inlay. Accordingly, changes in the price of chips or in the percentage of inlays for which we purchase chips may have a significant impact on our revenues.

Our margins on the resale of microchips are significantly lower than on the design and manufacture of inlays.

Accordingly, although purchasing chips allows us to increase our absolute profits, an increase in the share of chips we buy on our own account or an increase in the price of such chips will dilute our margins. In addition, purchasing chips and maintaining an adequate chip inventory requires significant working capital, particularly with regard to the chips used in ePassports, which are more sophisticated than the chips used in our other product lines, and therefore more expensive on a per-unit basis.

#### Labour costs

During 2006, more than 80 percent of our labour costs were generated in Thailand, where we benefit from low labour costs. We intend to produce inlays in Germany and we are in the process to determine a production location for passport inlays in the United States to start production there in late 2007 or early 2008. Other projects are underway for the extension of our global production network.

In Germany, we face significantly higher labour costs than in Thailand. Moreover, production volumes of the products planned to be produced in Germany are significantly lower than the volumes of products we produce in Thailand. Accordingly, our overall margin in our ePassport business will be affected to the extent that we are unable to charge a higher average price for ePassports produced in Germany compared to those produced in Thailand.

In the United States, we expect significantly higher production volumes than in Germany, which we expect will mitigate the effects of higher labor costs compared to Thailand to a certain extent. If high production volumes cannot be achieved in the United States, our results of operations may be significantly affected.



### Effect of currency fluctuations

We publish our combined and consolidated financial information in euros. A significant portion of our revenues and costs, however, are generated in currencies other than the euro, particularly the US dollar for our revenues and the Thai baht for our costs. In addition, a small amount of our bank loans are denominated in Thai baht. Since we do not currently hedge against fluctuations in the exchange rates between these currencies and the euro, such fluctuations can have, and have had, a material impact on our reported results when we translate amounts denominated in dollars and baht into euros for reporting purposes.

In addition, to the extent that we incur costs in one currency and earn revenues in another, our profit margins may be affected by changes in the exchange rate between the currencies. Our revenues and gross profit can be highly sensitive to exchange rate fluctuations.

But we are currently developing a hedging strategy, and we will implement appropriate instruments and processes accordingly.

### Income taxes

We have not incurred any significant tax liabilities since our inception in 2000. In Thailand, we have enjoyed corporate income tax exemptions tied to a specific level of investment and specified production targets. These benefits may not be available in the future if the relevant tax rules change, the exemptions expire, we fail to meet the necessary requirements, or if we exceed the limits of the tax exemption, any of which could cause our effective tax rate to increase. Based on a rate of 30 percent, the normal corporate income tax rate in Thailand, our expected 2006 tax expense would have been € 2,759 thousand. In addition, our planned operations in Germany and in the United States will be subject to German and United States taxation, respectively, without a corresponding tax exemption and may increase our effective tax rate.

The temporary tax benefits we currently enjoy may not be available in the future due to changes in the relevant tax rules. In addition, our international expansion will subject us to taxation in other jurisdictions and could cause our effective tax rate to increase.

## Disclosure of market risks

We are exposed to a number of risks due to our business, international operations and competitive situation. The overall objective of our risk management is to evaluate and eliminate, to the extent deemed necessary, any financial risk in order to maintain our profitability and financial performance.

### Political risks

To a certain extent we are exposed to political risks due to the fact that our operations and productions as well as research and technology are predominantly based in Thailand. But despite ongoing political changes occurring in Thailand beginning in late 2006, there has not been any negative impact on the business operations of SMARTRAC in the country. The Thai Board of Investment Committee, Ministry of Industry, has already explicitly assured foreign investors of the continuity of their investment policy. We are therefore cooperating on a stable and sustainable basis with the Board of Investment Committee. All of the agreements between the Committee and SMARTRAC will be fulfilled without any constraints. SMARTRAC will therefore continue to benefit from the investor-friendly investment and tax environment in Thailand. This assessment has been confirmed e.g. by KPMG in Thailand which does not see any adverse effects on the operations of SMARTRAC.

### Risks related to rival RFID production technologies

Among the worldwide players in the competitive set of RFID production there are different production technologies for RFID inlays in operation. Nevertheless, SMARTRAC has a broad technology base compared to its main competitors. The company holds major patents taken out

on the wire-embedding technology and has exclusive rights of use in many areas. This technology has proven to be the most advanced for major high-quality RFID applications. Furthermore, SMARTRAC has access to etching technology via a 25.2 percent stake in multitape GmbH.

Additionally the company is permanently investing in research and technology to help it keep this leading position. SMARTRAC therefore sees itself well positioned compared to its worldwide competitors in terms of production technologies.

### Risks related to patent infringements by competitors

SMARTRAC holds major patents in the wire-embedding technology for the production of high-quality RFID inlays that have set standards across the industry. The company sees ongoing patent infringements by competitors as a threat to its business operations. SMARTRAC has therefore already taken legal actions against some competitors which have led to agreements, acknowledging the patent rights of SMARTRAC.

In December 2006, SMARTRAC reached a groundbreaking agreement with the Swedish company Assa Abloy AB regarding the use of certain patents related to the production of radio frequency identification devices using the wire-embedding technology. By this agreement Assa Abloy AB assigned its partial ownership rights in approximately 70 patents to SMARTRAC N.V. In return, Assa Abloy AB received a worldwide, non-exclusive license for the ongoing use of the patents.



In order to protect its leading position in the RFID industry, the company will continue to effectively protect its patent rights and will continue to take legal action in the case of any patent infringements.

#### Foreign currency risk

Our reporting currency is the euro. Due to our international customer base, we have to conduct transactions in several currencies, mainly the euro and the US dollar. As a result, SMARTRAC is exposed to exchange rate fluctuations. This risk is reduced, however, by the fact that our manufacturing costs are denominated in euro and Thai baht in an almost even ratio. Most of our materials are sourced in Europe and paid for in euro. The other components of our manufacturing costs are labor and supplies, which are mainly paid for in Thai baht. As the Thai baht is closely linked to the US dollar, our manufacturing costs are somewhat balanced between the euro and the US dollar. This partial "natural hedge" helps to reduce the risk of losses caused by exchange-rate fluctuations. Accumulated imbalances between euro and US dollar accounts are closely monitored. We are in the process of covering such imbalances by introducing hedging strategies and implementing appropriate instruments and processes.

#### Inflation risk

Inflation has not had a significant impact during the periods under review. However, we face the risk of increasing inflation with regard to one or more currencies in which we have significant receivables or savings.

#### Credit risk

Our credit risk reflects the fact that some of our customers might not be able to fulfill their contractual duties. We operate in a high technology industry that is relatively new and where the markets have yet to stabilize. Accordingly, certain of our customers may become

insolvent. To minimize this risk, we follow very strict guidelines for extending customer credit. Each individual customer is assigned credit limits, which are checked upon each new shipment. In addition, we require either a downpayment or a letter of credit before we accept orders from customers in critical regions.

#### Liquidity risk

Our liquidity risk management focuses on the management of our cash inflows and cash outflows. Due to the impact of chip purchases on our cash flow, we closely monitor our chip purchases to avoid significantly reducing our cash flow by purchasing too many chips. We will continue to carefully consider customer requests that we purchase more chips on our own account.

#### Price risk on chip prices

Chip prices generally tend to decrease over time. Changes in global demand can lead to temporary increases in demand, which might result in chip shortages and chip rationing. During periods of rationing, the lead times for chips and their prices increase.

#### Price risk on oil-based components

Most of our products are based on plastic materials such as PVC, PET or PC. These are oil-based products. Accordingly, prices for such materials may fluctuate with oil prices. Such prices are generally passed on to customers.

#### Interest rate risk

We are also exposed to interest rate risks. Given that our bank liabilities have been substantially reduced during financial year 2006, interest rate risk has been reduced accordingly.

## Corporate Governance report

SMARTRAC N.V. and its subsidiaries are committed to high standards of business integrity, ethical values and professionalism in all of their activities. As an essential part, the Management Board is committed to achieving high standards of Corporate Governance and the directors are accountable to the shareholders for doing so.

### Management structure

The company has a two-tier board structure consisting of a Management Board (Raad van Bestuur) and a Supervisory Board (Raad van Commissarissen).

### Management Board

The Management Board is responsible for the day-to-day management of the company's operations under the supervision of the Supervisory Board. The Management Board is required to keep the Supervisory Board informed, consult with the Supervisory Board on important matters and submit certain important decisions to the Supervisory Board for approval.

Members of the Management Board are appointed by the General Meeting of Shareholders, subject to the right of the Supervisory Board to make a binding nomination to appoint a Management Board member in accordance with the relevant provisions of the Dutch Civil Code.

### Supervisory Board

The Supervisory Board is responsible for supervising the conduct of and providing advice to the Management Board and supervising the company's business in general. In performing its duties, the Supervisory Board is required to act in the interest of the company's business as a whole. The members of the Supervisory Board are not authorized to represent the company in dealings with third parties.

### Board committees

As the Supervisory Board consists of fewer than four members, the tasks of an audit committee, remuneration committee as well as selection and appointment committee were fulfilled by the full Supervisory Board in accordance with the principles of the Dutch Corporate Governance Code.



## Dutch Corporate Governance Code

SMARTRAC N.V. is incorporated in the Netherlands as a Dutch company, and is listed at the Frankfurt Stock Exchange (FSE). It is subject to the Dutch Corporate Governance Code ("the Dutch Code") which sets out principles of good corporate governance and best practice provisions. The company has, to the extent possible, applied (or shall as it becomes appropriate to do so apply) the principles and applicable best practices of the Dutch Code, with the exception of the following best practice provisions:

II.1.3, II.1.6, II.2.1, II.2.2, II.2.4, II.2.6, II.2.13, III.1.1, III.3.1, III.3.6, III.4.3, III.7.1; III.7.3, IV.1.1.

II.1.3: The Group manages its various significant risks within the strategic, operational and financial areas. Although an effective system of internal control is in place, and these processes take cognisance of risks pertaining to the Group as a whole, no formalized risk monitoring process is in place. The management gives top priority to managing company risks and is putting the right control systems in place, following a traceable strategy with clearly defined milestones in this respect.

II.1.6: We do not yet have a whistle blower code at this point in time. At present the Management Board is discussing various alternatives of a policy which serves this purpose and will be applicable for all companies within the Group. We intend to introduce a whistle blower policy in accordance with the Dutch Code as soon as possible.

II.2.1: The vesting period of options granted to members of the Management Board is two years and not three years. The exercise of the options is not dependent on the fulfillment of pre-determined criteria, but solely on the lapse of the vesting period of two years. The company is of the opinion that, because other employees also have a vesting period of two years, management should not be treated differently. Also, the company believes that, in view of the very short history of the company, it is not required, nor possible to set pre-determined criteria for the exercise of options. This may change over time, and will be closely monitored.

II.2.2: The company has granted unconditional options to a member of the Management Board as a variable portion of the salary. The reason is that the salary should depend to a high extent on the performance of the company. It will depend on the performance of the Management Board whether the stock option price for the company's shares will be higher after the vesting period than the exercise price. The company is of the opinion, that additional specific performance criteria are not required. The vesting period of options granted to members of the Management Board is two years and not three years. The company is of the opinion that, because other employees have a vesting period of two years, management should not be treated differently.

II.2.4: The company's Stock Option Plan, provides for a period of ten trading days, instead of five, for the fixing of the exercise price of options, because we believe that due to the limited trading in our share ten days give a fairer exercise price than the average over five days.

II.2.6:	The Supervisory Board has not drawn up regulations concerning ownership of and transactions in securities other than securities issued by SMARTRAC N.V. by members of the Management Board because the Supervisory Board trusts that members of the Management Board do not trade other shares or securities in an illegal way.	II.2.13:	The company has not yet posted the remuneration report on the company's website since the Supervisory Board has decided to publish it on the website in conjunction with the publication of the Annual Report. The Supervisory Board places more value on the explanatory power of the remuneration report by including the actual amounts of the variable remunerations of the Management Board members for the respective period.	III.1.1:	The regulation for the Supervisory Board existed throughout 2006 and has due to other priorities within the group not yet been posted on the website of the company. We intend to do so in the course of 2007.	III.3.1:	The profile and the composition of the Supervisory Board were not defined by the Supervisory Board. In light of the limited members of the Supervisory Board we consider it unnecessary to establish a profile. However, the composition of the Supervisory Board has been outlined in the prospectus dated July 13, 2006.	III.3.6:	The regulation of the retirement scheme for the Supervisory Board has not yet been posted on the website of the company. In light of the limited number of the members of the Supervisory Board we consider it unnecessary to establish a retirement scheme.
III.4.3:	We believe that the regulation of implementing a company secretary is not applicable due to the current size of the company.	III.7.1:	The company deviates from this provision, in that it may grant options to a supervisory director. The company believes that this will not have a negative effect upon the performance of a director, and, on the other hand, will attract qualified members to the Supervisory Board. At present, no options have been granted to any of the members of the Supervisory Board.	III.7.3:	The regulation governing ownership of and transactions in securities other than securities issued by SMARTRAC N.V. by members of the Supervisory Board was not drawn up because the Supervisory Board trusts that members of the Supervisory Board do not trade in other shares or securities in an illegal way.	IV.1.1:	The company deviates from this provision, in that a binding nomination by the Supervisory Board can only be overruled by a majority of two thirds of the votes cast representing more than 50 percent of the issued share capital. We are of the opinion that the Supervisory Board should have significant influence over the appointment and the dismissal of managing directors, especially in the first years of the company's existence.		



## Remuneration report

The tasks of the Remuneration Committee have been fulfilled by the Supervisory Board in accordance with the principles of the Dutch Corporate Governance Code.

The Supervisory Board determines the remuneration and further conditions of employment for every member of the Management Board within the scope of the company's remuneration policy and subject to the provisions mentioned in section 135 Book 2 of the Dutch Civil Code.

The goals of the SMARTRAC remuneration policy for the members of the Management Board are to attract, retain and reward talented management by offering a compensation that is competitive, motivates members to meet the company's business objectives and aligns the interests of management with the interests of the shareholders. The overall remuneration policy is based on a remuneration scheme which takes into account specific tasks and the scope of individual responsibilities of each member of the Management Board. The overall remuneration of the members of the Management Board, assuming that challenging but achievable targets have been set and met, should be clearly above the market average of the remuneration practices of the comparison group.

### Compensation for Management Board members

#### Financial year 2006

New employment contracts were entered into between the company and Manfred Rietzler and Dr. Christian Fischer in February 2006.

Pursuant to his employment contract, Mr. Rietzler has received total annual compensation of € 144,000. In addition, housing and other expenses of Mr. Rietzler in Thailand amounting to € 37,000 were borne by the company.

Dr. Fischer receives a large percentage of his salary as a variable salary. The reason is that his salary should depend on the performance of the company. This is considered to be an incentive to work for the performance of the company. Mr. Rietzler who is a major shareholder in the company only receives a basic salary. Being a major shareholder is enough incentive for him to try to achieve a good performance of the company.

The compensation of Dr. Fischer pursuant to his employment contract consisted of an annual base compensation of € 240,000 and a variable compensation of 1 percent (2006: € 119,000) of EBITDA of the SMARTRAC Group in the respective year. His compensation also comprised an additional incentive-based portion granted in the form of an one-time IPO-bonus according to predetermined conditions. The bonus amounted to 1 percent (€ 595,000) of the gross proceeds to the company from the capital increase in connection with the successful initial public offering, dated July 20, 2006. This part of Dr. Fischer's remuneration acknowledges his crucial contribution to the successful IPO of the company. Dr. Fischer is eligible to participate in the company's current stock option program. In financial year 2006, Dr. Fischer received 5,000 options from this stock option program with a net realizable value of approximately € 33,000. The grant of the options does not depend on achievements of certain criteria. The Supervisory Board is of the opinion that the value of the options largely reflects the performance of the share of SMARTRAC for which the Management Board is accountable. Additional performance criteria are not necessary.

In addition, Mr. Rietzler and Dr. Fischer were provided with a company car.

The company has provided Mr. Rietzler and Dr. Fischer with general accident insurance coverage of a customary amount.

Under his employment agreement with a subsidiary of the company, Mr. Brown has received a total annual compensation of US\$ 200,000 and approximately € 4,000 as housing costs in the financial year 2006. Additionally, he was provided with a company car. Mr. Driessen has received annual compensation from the company of € 20,000.

All members of the Management Board do not receive redundancy payments. The terms of the employment agreements are equal to the terms of their appointment as directors.

### Financial years beginning 2007

In 2007 the salaries for Mr. Rietzler, Dr. Fischer and Mr. Brown have been increased. The main reason for the decision to increase the salaries is that given the growth of the company and its subsidiaries, the complexity of the structure and the tasks of the Management Board to procure further growth of the Company the salary increase better matches the remuneration policy determined by the shareholders meeting.

New employment contracts were entered into between the company and Mr. Rietzler, Dr. Fischer and Mr. Brown for the financial years beginning 2007:

Pursuant to his employment contract, Mr. Rietzler is entitled to receive total annual compensation of € 180,000. In addition, the housing and other expenses of Mr. Rietzler in Thailand will be borne by the company.

The compensation of Dr. Fischer under his employment contract consists of an annual base compensation of € 420,000 and a variable annual compensation of 1.50

percent, 1.75 percent and 2 percent of EBITDA of the SMARTRAC Group in the respective years 2007, 2008 and 2009 respectively. Dr. Fischer is eligible to participate in the company's stock option program. In the financial years 2007 and 2008 he will be granted 15,000 and 10,000 options. The grant of the options does not depend on achievements of certain criteria. The Supervisory Board is of the opinion that the value of the options largely depends on the performance of the share of SMARTRAC for which the Management Board is accountable.

Therefore, additional performance criteria are not required.

In addition, Mr. Rietzler and Dr. Fischer of the Management Board will be provided with a company car.

The company will provide both members of the Management Board with general accident insurance coverage of a customary amount. The regular term of the contract with Mr. Rietzler and Dr. Fischer ends December 31, 2009.

Under a new employment agreement with a subsidiary of the company, Mr. Brown as a member of the Management Board is entitled to receive total annual compensation of € 240,000 and a variable annual compensation of 0.75 percent of EBITDA of the SMARTRAC Group in the years 2007 and 2008. Mr. Brown's contractual term as member of the Management Board ends at the first General Meeting of Shareholders in 2008.

Mr. Driessen is entitled to receive annual compensation from the company in the amount of € 25,000. Mr. Driessen's contractual term as member of the Management Board ends at the first General Meeting of Shareholders in 2008.

All members of the Management Board are not entitled to receive redundancy payments. The term of the employment agreements are equal to the term of their appointment as directors.

For further details regarding the compensation to Supervisory Board members we refer to note 30 to the consolidated financial statements.



## Financial statements

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**Consolidated income statement**  
For the years ended 31 December

In thousands of euro	Note	Consolidated 2006	Combined and consolidated 2005
Revenues	4	52,465	25,173
Cost of sales	6	(33,984)	(17,333)
<b>Gross profit</b>		<b>18,481</b>	<b>7,840</b>
Administrative expenses	7	(8,711)	(4,255)
Other operating income and expenses	9	(165)	(9)
<b>Total operating expenses</b>		<b>(8,876)</b>	<b>(4,264)</b>
<b>Operating profit before financial income (expenses)</b>		<b>9,605</b>	<b>3,576</b>
Financial income		507	3
Financial expenses		(1,265)	(613)
<b>Net financial income (expenses)</b>	10	<b>(758)</b>	<b>(610)</b>
Share of profit of associates	5	110	15
<b>Profit before tax</b>		<b>8,957</b>	<b>2,981</b>
Income tax benefit	11	162	37
<b>Profit for the period attributable to the equity holders of the company</b>		<b>9,119</b>	<b>3,018</b>
Basic earnings per share (euro)	12	0.79	n/a
Pro forma earnings per share (euro)*	12	–	0.30
Diluted earnings per share (euro)	12	0.79	n/a

The accompanying notes (on page 48 to 83) are an integral part of the consolidated financial statements. It is imperative that users read note 1 to understand the basis of presentation of the consolidated financial statements.

\* *Pro forma earnings per share* are based on the number of shares of SMARTRAC N.V. outstanding upon incorporation of the Company.

## Consolidated balance sheet

As at 31 December

In thousands of euro	Note	Consolidated 2006	Combined and consolidated 2005
<b>Assets</b>			
Property, plant and equipment	13	19,286	11,734
Intangible assets	14	1,596	1,293
Investment in associates	5	158	48
Deferred tax assets	11	1,993	37
Other non-current assets		87	80
<b>Total non-current assets</b>		<b>23,120</b>	<b>13,192</b>
Inventories	15	7,190	3,824
Trade receivables	16	13,106	6,990
Other current assets	17	1,430	1,197
Cash and cash equivalents	18	35,886	1,500
<b>Total current assets</b>		<b>57,612</b>	<b>13,511</b>
<b>Total assets</b>		<b>80,732</b>	<b>26,703</b>
<b>Equity*</b>			
Share capital	1,19	6,750	5,000
Share premium	1,19	53,548	4,923
Translation reserve		24	–
Retained earnings		9,119	–
<b>Total equity</b>		<b>69,441</b>	<b>9,923</b>
<b>Liabilities</b>			
Secured loan	20	148	233
<b>Total non-current liabilities</b>		<b>148</b>	<b>233</b>
Bank overdraft	18	842	1,207
Current portion of secured loan	20	244	120
Interest-bearing loans and borrowings	20	314	8,448
Employee benefits	21	50	36
Trade and non-trade payables	22	8,377	4,936
Other current liabilities	23	1,316	1,800
<b>Total current liabilities</b>		<b>11,143</b>	<b>16,547</b>
<b>Total liabilities</b>		<b>11,291</b>	<b>16,780</b>
<b>Total equity and liabilities</b>		<b>80,732</b>	<b>26,703</b>

The accompanying notes (on page 48 to 83) are an integral part of the consolidated financial statements. It is imperative that users read note 1 to understand the basis of presentation of the consolidated financial statements.

\* Combined and consolidated equity as at 31 December 2005 is the pro forma equity of SMARTRAC N.V. at its incorporation date (23 January 2006).



**Consolidated statement of cash flows**  
For the years ended 31 December

In thousands of euro	Note	Consolidated 2006	Combined and consolidated 2005
<b>Cash flows from operating activities</b>			
Net profit		9,119	3,018
Reconciliation of net profit to net cash provided by (used in) operating activities:			
Depreciation and amortization		2,308	1,336
Interest expenses	10	448	271
Expenses for share based payments	26	77	—
(Reversal of) write down of inventories	9	(20)	90
(Gains) or losses on disposal of assets	9	517	(11)
Share of profit of associates	5	(110)	(15)
Deferred tax benefit	11	(162)	(37)
Decrease (increase) in operational assets/liabilities:			
Other non-current assets		(16)	(65)
Inventories		(3,346)	(1,901)
Other current assets		469	(221)
Trade receivables		(6,230)	(3,369)
Employee benefits		12	12
Trade and non-trade payables		3,542	1,636
Other current liabilities		(486)	502
<b>Net cash provided by operating activities</b>		<b>6,122</b>	<b>1,246</b>
<b>Cash flows from investing activities</b>			
Investment in associates		—	(33)
Proceeds from sale of equipment		251	122
Purchases of intangible assets	14	(408)	—
Purchases of property, plant and equipment	13	(10,532)	(4,465)
Deposits paid for property, plant and equipment	17	(722)	(156)
<b>Net cash used in investing activities</b>		<b>(11,411)</b>	<b>(4,532)</b>
<b>Cash flows from financing activities</b>			
Proceeds from issue of new share equity	1d	1,750	—
Proceeds from increase in share premium due to issue of new shares	1d	57,750	—
Payment of transaction costs	1d	(10,990)	—
Proceeds from interest-bearing loans and borrowings and secured loan		6,608	7,563
Repayments of interest-bearing loans and borrowings and secured loan		(14,662)	(4,264)
Interests paid		(526)	(234)
<b>Net cash provided by financing activities</b>		<b>39,930</b>	<b>3,065</b>
Net change in cash and cash equivalents and bank overdrafts		34,641	(221)
Cash and cash equivalents and bank overdrafts at 1 January		293	340
Effect of exchange rate fluctuations on cash and cash equivalents and bank overdrafts		110	174
<b>Cash and cash equivalents and bank overdrafts at 31 December</b>	<b>18</b>	<b>35,044</b>	<b>293</b>

The accompanying notes (on page 48 to 83) are an integral part of the consolidated financial statements. It is imperative that users read note 1 to understand the basis of presentation of the consolidated financial statements.

## Consolidated statement of changes in shareholders' equity For the year ended 31 December 2005 and 2006

Company profile	Statement of the Supervisory Board	Letter of the CEO and the CFO	Business by segments	Key business factors	Risks	Corporate Governance	Financial statements	Other information
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In thousands of euro	Issued and paid-up share capital	Share premium	Translation reserve	Retained earnings	Total
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Balance – beginning of year 2005	620	–	–	6,277	6,897
Foreign exchange translation	–	–	8	–	8
Profit for the year	–	–	–	3,018	3,018
Net equity before contribution*	620	–	8	9,295	9,923

Group restructuring†	(620)	–	(8)	(9,295)	(9,923)
Newly issued shares upon contribution in kind	5,000	4,923	–	–	9,923
Pro forma Balance – end of year 2005	5,000	4,923	–	–	9,923
Balance – beginning of year 2006	5,000	4,923	–	–	9,923

Par value of new shares – credited to share capital	1,750	–	–	–	1,750
Excess of gross proceeds over par value credited to share premium (note 1d)	–	57,750	–	–	57,750
IPO costs charged to share premium (note 1d)	–	(10,990)	–	–	(10,990)
Deferred tax effect of IPO costs credited to share premium (note 1f)	–	1,788	–	–	1,788
Share based payment (note 10)	–	77	–	–	77
Foreign exchange translation	–	–	24	–	24
Net profit for the year	–	–	–	9,119	9,119

Balance – end of year 2006	6,750	53,548	24	9,119	69,441
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The accompanying notes (on page 48 to 83) are an integral part of the consolidated financial statements. It is imperative that users read note 1 to understand the basis of presentation of the consolidated financial statements.

\* Combined and consolidated equity as at 31 December 2005 is the pro forma equity of SMARTRAC N.V. at its incorporation date (23 January 2006), as if SMARTRAC N.V. already existed as at 31 December 2005 and the contribution in kind of all group companies had already occurred as at 31 December 2005. This pro forma method of presentation only relates to the classification of equity elements, and does not affect the equity total.

\*\* Retained earnings include an amount of € 125,000 (2005: € 15,000) relating to the share of profits of the associate, which has not yet been distributed to SMARTRAC N.V.



## Notes to the consolidated financial statements for the year ended 31 December 2006

### 1. Reporting entity

#### a) General

SMARTRAC N.V. ("the Company") is a company domiciled in Parnassusweg 103, 1077 DE Amsterdam, The Netherlands. The Company was incorporated on 23 January 2006, to act as a the holding company for the SMARTRAC Group ("the Group"), comprising of the following entities:

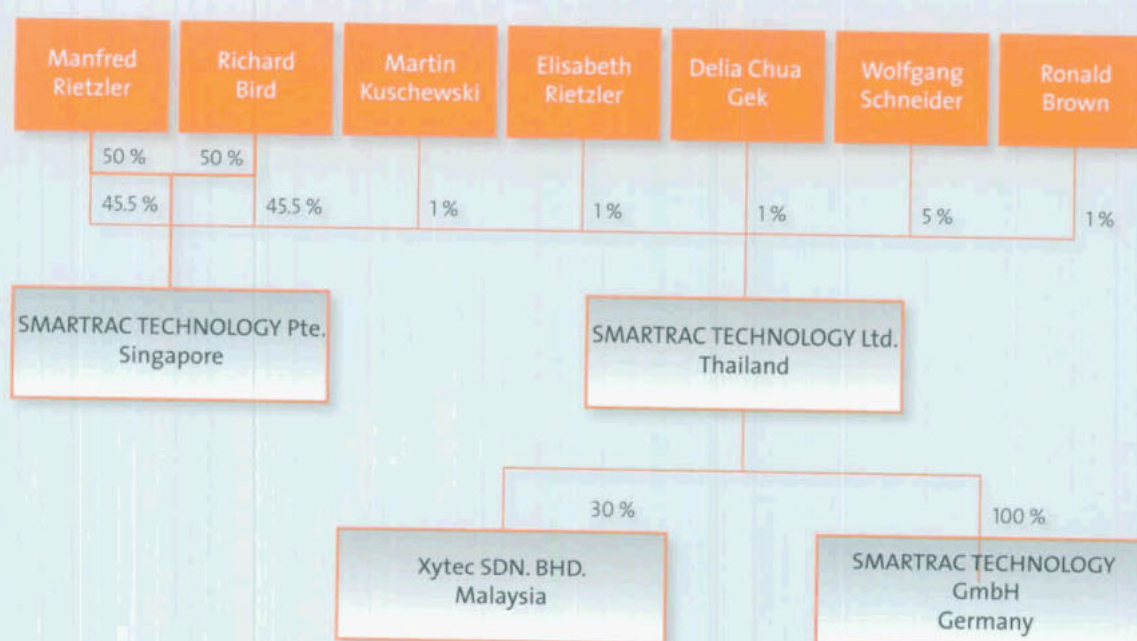
Company	Country of incorporation	Date of incorporation	Business type	Ownership and voting interest
<b>Subsidiaries</b>				
SMARTRAC TECHNOLOGY Ltd.	Thailand	1 January 2000	Manufacturing	100 %
SMARTRAC TECHNOLOGY GmbH	Germany	17 November 2003	Manufacturing	100 %
SMARTRAC TECHNOLOGY Pte. Ltd.	Singapore	7 October 2005	Trading	100 %
<b>Associate</b>				
Xytec Solutions Sdn. Bhd.	Malaysia	13 December 2004	Manufacturing	30 %

#### b) Activities

The Group is a leading supplier of inlays for passports and credit cards and also standard applications with an integrated contactless chip and an antenna.

### c) Group restructuring

Prior to the corporate restructuring, the shareholding structure of the SMARTRAC Group, under common control was as follows:



The legal and tax restructuring process to form the SMARTRAC Group started in November 2005 and was finalized in February 2006. As consideration for the above subsidiaries and associate, the Company issued 5,000,000 shares with a par value of € 1.00 each against the contribution in kind of the subsidiaries and associate by their shareholders with economic effect as at 31 December 2005.

At 31 December 2005, the value of the total net assets of the subsidiaries and the associate amounts to € 9,923,000. The difference between the total net assets of the Group as at 31 December 2005 and the par value of the 5,000,000 shares (€ 4,923,000) is presented as share premium.

On 7 February 2006, the shareholders resolved to amend the Company's Articles of Association by splitting and converting each existing € 1.00 share into two shares of € 0.50 each. Following this amendment the authorised share capital of the Company is € 25,000,000, comprising of 50,000,000 shares with a par value of € 0.50 each.

The combined and consolidated financial information for 2005 comprises the activities of the Thai and German companies consolidated and combined with the activities of the Singaporean company into one reporting entity. The Malaysian associate is accounted for under the equity method. This method of presentation reflects the economic substance of the combining companies as a single economic enterprise at 31 December 2005, although the legal parent-subsidiary relationships were not established until February 2006.



#### d) Initial public offering

In July 2006, SMARTRAC N.V. placed 3,500,000 new shares from a capital increase as part of its initial public offering ("IPO"). In light of the situation in the capital markets in July 2006, the existing shareholders have agreed not to sell any shares.

Around 99 percent of the shares were allocated to international institutional investors. Around one percent of the shares were allocated to retail investors. Retail allocations were made in compliance with the "Principles for the Allotment of Share Issues to Retail Investors" issued on 7 September 2000 by the Commission of Financial Market Experts at the German Federal Ministry of Finance. Trading in SMARTRAC N.V. shares started on 20 July 2006 under the trading symbol "SM7" and the ISIN "NL0000186633" in the official market ("Prime Standard") of the Frankfurt Stock Exchange. Settlement and delivery of the shares took place on Friday, 21 July 2006. The issue price was € 17 per share.

Gross proceeds amounted to € 59,500,000 which have been accounted for in the third quarter, together with IPO costs and their related tax effect as follows:

The company ultimately received net proceeds of approximately € 53,500,000. The difference between the net proceeds and the gross proceeds amounting to approximately € 6,000,000 were treated as IPO costs and were charged directly to equity. They mainly consist of success fees for the sole global coordinator and bookrunner amounting to € 3,500,000 and legal / consultancy / success fees amounting to approximately € 2,500,000. Additionally the company has incurred IPO costs amounting to € 4,990,000 which mainly consist of legal, consultancy and financial fees. These costs were also charged directly to equity.

IPO costs have been charged net of tax effects to the share premium. Please also refer to note 11. The net proceeds have been utilized to fund further growth and to repay most of the interest-bearing loans and borrowings. After the IPO, SMARTRAC has repaid loans totalling € 14,662,000.

#### e) Financial year

According to the Articles of Association of SMARTRAC N.V., the first financial reporting year ends at 31 December 2006. The combined and consolidated financial information 2005 is included for comparative purposes.

In thousands of euro	
Gross proceeds	59,500
Par value of new shares – credited to share capital	(1,750)
Excess of gross proceeds over par value credited to share premiums	57,750
Less - IPO costs charged to share premium	(10,990)
- Tax effect of IPO costs credited to share premium	1,788
Net movement in share premium arising from IPO	48,548

## 2. Basis of preparation

### a) Statement of compliance

The consolidated financial statements 2006 have been prepared in accordance with International Financial Reporting Standards (IFRSs) and interpretations of the International Accounting Standards Board (IASB) as adopted by the European Union (EU) and also comply with the financial reporting requirements included in Part 9 of Book 2 of the Netherlands Civil Code.

The financial statements have been prepared by the Management Board of the Company and authorised for issue on 19 March 2007 and will be submitted for adoption to the Annual General Meeting of Shareholders on 22 June 2007.

The company presents a condensed income statement, using the facility of Article 402 of Part 9, Book 2, of the Netherlands Civil Code.

### b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following:

- Cash equivalents are stated at fair value.
- A Stock Option Plan allows Group employees to acquire shares of the Company. The fair value of options granted is recognized as an employee expense with a corresponding increase in equity.

### c) Functional and presentation currency

These consolidated financial statements are presented in euro, which is the Company's functional currency. All financial information presented in euro has been rounded to the nearest thousand.

### d) Use of estimates and judgements

The preparation of the financial statements in conformity with IFRSs adopted by the EU requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRSs that have significant effect on the consolidated financial statements and estimates with a significant risk of material adjustment in the next year are discussed within their respected notes, if any.



### 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements.

#### a) Basis of consolidation

##### 1. Consolidated financial statements

The group restructuring explained in note 1 involved companies under common control. The consolidated financial statements are prepared using the historical cost method in a manner similar to the uniting of interests method as the restructuring involved companies under common control during the relevant periods. This method of presentation reflects the economic substance of the combining companies as a single economic enterprise, although the legal parent-subsidiary relationships were not established until February 2006. These consolidated financial statements are a combination or aggregation of all the financial statements of the companies in the Group as a single economic enterprise from either the first day of the first reporting period presented or the date they became commonly controlled.

##### 2. Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

##### 3. Associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an associate.

##### 4. Transactions eliminated on consolidation

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated when preparing the consolidated financial statements. Unrealised gains arising from transactions with associates are eliminated to the extent of the Group's interest in the entity. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

## b) Foreign currency

### 1. Foreign currency transactions

Items included in the financial statements of each of the Group's entities are measured or remeasured (when, such as in Thailand, local law requires the use of the local currency for the recording of transactions in an entity's accounting records) using the currency of the primary economic environment in which the entity operates (the functional currency). Remeasurement to the functional currency is performed by translating balances using approximate exchange rates at the dates of the relevant transactions; with all resulting differences recorded to foreign exchange gains (losses). The consolidated financial statements are presented in euro, which is the Company's presentation currency.

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

The exchange rates used to convert transactions and balances denominated in other currencies to the euro are as follows:

Currency	2006 Period end rate	2006 Period average rate	2005 Period end rate	2005 Period average rate
US dollar to euro	1.32	1.26	1.18	1.25
Thai baht to euro	47.46	47.68	48.64	50.01
Singapore dollar to euro	2.03	2.00	1.98	2.07

### 2. Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

## c) Property, plant and equipment

### 1. Recognition and measurement

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses (see accounting policy I). Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

### 2. Subsequent costs

The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.



### 3. Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. The estimated useful lives are as follows:

– Buildings	20 years
– Machinery	10 years
– Building improvements	5 years
– Tools and Equipment	5 years
– Furniture and Fixtures	5 years
– Office Equipment	5 years
– Motor Vehicles	5 years
– Toolings (vacuum plates)	2 years

The depreciation methods, residual values and useful lives are subject to annual reassessment. Toolings are included in tools and equipment.

### d) Intangible assets

#### 1. Patents and patent rights

Patents and patent rights are acquired by the Group and are stated at cost less accumulated amortisation (see accounting policy d (4.)) and impairment losses (see accounting policy i).

#### 2. Software

Software acquired by the Group is stated at cost less accumulated amortisation (see accounting policy d (4)) and impairment losses (see accounting policy i).

#### 3. Research and development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense as incurred.

Expenditure on development activities, should there be any and whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources to complete the development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Other development expenditure is recognised in the income statement as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses (see accounting policy i).

### 4. Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets from the date they are available for use. The estimated useful lives for patents and patent rights are 10 to 20 years and for software are 5 years. The useful lives are subject to annual reassessment.

### e) Trade and other receivables

Trade and other receivables are stated at amortized cost using the effective interest method less impairment losses (see accounting policy i).

### f) Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of inventories is based on the moving-average principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.

## g) Financial instruments

Pursuant to IAS 39, a financial instrument is any contract that gives rise to a financial asset at one entity and a financial liability or equity instrument at another entity.

If the trade date of a financial asset differs from the settlement date, the trade date is authoritative for initial recognition. Initial measurement of a financial instrument is at cost. Transaction costs are included. Subsequent measurement of financial instruments is either at fair value or amortized cost as set out in the applicable note.

With respect to measurement, IAS 39 distinguishes between the following categories of financial assets:

- Financial instruments recognized at fair value with effect on income,
- Held-to-maturity investments,
- Loans and receivables originated by the entity, and
- Available-for-sale investments.

By contrast, financial liabilities are divided into the two categories

- Financial instruments recognized at fair value with effect on income and financial instruments held for trading, and
- Other liabilities.

Measurement of financial instruments is either at fair value or amortized cost as set out in the applicable notes: Fair value corresponds to market price provided the financial instruments measured are traded on an active market. If there is no active market for a financial instrument, fair value is calculated using appropriate valuation methods such as recognized option price models or discounting future cash flows with the market interest rate.

Amortized cost corresponds to costs of purchase less redemption, impairment losses and the reversal of any difference between costs of purchase and the amount repayable upon maturity.

## h) Cash and cash equivalents

Cash comprises cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash equivalents are stated at fair value with movements through the income statement.

## i) Impairment

The carrying amounts of the Group's assets, other than inventories (see accounting policy f) and deferred tax assets (see accounting policy o), are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated (see accounting policy i (1)).

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.



#### 1. Calculation of recoverable amount

The recoverable amount of the Group's receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate. *Receivables with a short duration* are not discounted.

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset *that does not generate largely independent cash inflows*, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

#### 2. Reversals of impairment

An impairment loss in respect of a receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

#### j) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

#### k) Employee benefits

##### 1. Defined benefit plans

The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of any plan assets is deducted. The discount rate is the yield at the balance sheet date on Thai Government bonds that have maturity dates approximating to the terms of the Group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in the income statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in the income statement.

Actuarial gains and losses that arise in calculating the Group's obligation in respect of a plan are recognised in the income statement in accordance with IAS 19.93.

## 2. Share-based payment transactions

The grant date fair value of options granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the options. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest.

### l) Trade and other payables

Trade and other payables are stated at amortised cost.

### m) Revenue

Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due, associated costs or the possible return of goods also continuing management involvement with the goods.

### n) Expenses

#### 1. Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

#### 2. Net financing costs

Net financing costs comprise interest payable on borrowings calculated using the effective interest rate method. Interest income is recognised in the income statement as it accrues, using the effective interest method.

### o) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Temporary differences relating to (1.) the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, and (2.) differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future, are not recognised. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend.



#### p) Earnings per share

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise convertible notes and share options granted to employees.

#### q) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

#### r) New accounting policies

As from 1 January 2006, the Group applies IFRS 2 "Share-based Payment". The group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of the shares that will eventually vest.

#### s) New standards and interpretations

The following accounting standard which affects SMARTRAC's financial statements has been published by the IASB but which is not yet mandatory has not been early adopted:

IFRS 7 Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures require extensive disclosures about the significance of financial instruments for an entity's financial position and performance, and qualitative and quantitative disclosures on the nature and extent of risks. IFRS 7 and amended IAS 1, which become mandatory for the Group's 2007 financial statements, will require extensive additional disclosures with respect to Group's financial instruments and share capital.

The following mandatory accounting standards and interpretations which have been published by the IASB since the end of financial year 2005 had no material impact on the consolidated financial statements:

- IFRS 6 Exploration for and Evaluation of Mineral Resources
- Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Intra-group Transactions
- Amendments to IAS 39 Financial Instruments: Recognition and Measurement – The Fair Value Option
- Amendments to IAS 39 and IFRS 4 Financial Guarantee Contracts
- IFRIC 4 Determining whether an Arrangement contains a Lease
- IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
- IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
- IFRIC 9 Reassessment of Embedded Derivatives
- IFRIC 10 Interim Financial Reporting and Impairment



## 4. Segment reporting

Segment information is presented in respect of the Group's business and geographical segments. The primary format, business segments, is based on the Group's management and internal reporting structure.

Segment results include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Other operating expenses have been allocated to segments based on the volume of units produced by each segment. Assets and liabilities and capital expenditure are not allocated to segments because they are utilized in the production of both Standard and High Security components.

Where production/trade of a unit only affects one segment, the total depreciation of this unit was allocated to this segment. Where a unit produced for both segments, the depreciation was allocated according to the segment's portion of the shipment volume (pieces; depreciation within cost of sales) and according to the segment's portion of sales revenues (depreciation within administrative expenses).

### Business segments

The Group comprises the following main business segments:

- Standard components: the manufacture and sale of RFID inlays with embedded memory chips that have basic security features, such as password authentication and basic encryption, for use in applications such as access control, mass transportation and logistics.
- High Security components: the manufacture and sale of RFID inlays with embedded memory chips with high security features such as sophisticated data encryption, controlled data access and mutual authentication, for use in applications such as ePayment and ePassport.
- Other operations. The disposal of assets and other incomes that cannot be attributed to standard or high security components.

### Consolidated segment information for 2006 and 2005 by business segments:

In thousands of euro	Standard components		High Security components		Other operations		Consolidated	
	12 months ended Dec. 2006	12 months ended Dec. 2005	12 months ended Dec. 2006	12 months ended Dec. 2005	12 months ended Dec. 2006	12 months ended Dec. 2005	12 months ended Dec. 2006	12 months ended Dec. 2005
Segment revenue								
External sales	24,725	19,903	27,109	5,010	631	260	52,465	25,173
Segment result								
Gross profit	5,060	6,381	12,790	1,419	631	40	18,481	7,840
Operating expenses	(3,461)	(3,261)	(4,132)	(752)	(1,283)	(251)	(8,876)	(4,264)
Operating profit (loss)	1,599	3,120	8,658	667	(652)	(211)	9,605	3,576
Net financial expenses							(758)	(610)
Share of profit of associate					110	15	110	15
Income tax benefit							162	37
Profit for the period							9,119	3,018
Supplemental information								
Operating profit (loss)	1,599	3,120	8,658	667	(652)	(211)	9,605	3,576
Depreciation and amortization	1,212	991	1,096	277	–	68	2,308	1,336
Segment EBITDA*	2,811	4,111	9,754	944	(652)	(143)	11,913	4,912

\* EBITDA is defined as operating profit for the period before depreciation, amortization, financial result, share of profit of associates, and income tax result. EBITDA is not a measure of operating performance or liquidity under IFRS. EBITDA as presented may not be comparable to measures with similar names as presented by other companies.



The Group began producing and selling high security components in 2005.

Revenues by subsegment were as follows:

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
<b>Standard components</b>		
Mass transportation / access control	24,217	18,540
Logistics	508	1,363
<b>Subtotal</b>	<b>24,725</b>	<b>19,903</b>
<b>High security components</b>		
ePayment	5,205	2,255
ePassport	21,904	2,755
<b>Subtotal</b>	<b>27,109</b>	<b>5,010</b>
<b>Other operations</b>	<b>631</b>	<b>260</b>
<b>Total revenue</b>	<b>52,465</b>	<b>25,173</b>

### Geographical segments

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers. Segment assets are based on the geographical location of the assets. The Group's principal geographical areas are Europe, Asia and North America.

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
<b>Revenues</b>		
Europe	35,654	14,484
Asia	5,954	5,616
North America	7,681	3,233
Others	3,176	1,840
<b>Total revenues</b>	<b>52,465</b>	<b>25,173</b>
<b>Assets</b>		
Europe	36,964	579
Asia	43,768	26,124
<b>Total assets</b>	<b>80,732</b>	<b>26,703</b>

## 5. Investment in an associate

The Group has a 30% equity interest in Xytec Solutions Sdn. Bhd. (Xytec). The investment is accounted for under the equity method. Xytec is the only investment the Group has in associates.

Company	Country of incorporation	Ownership	
		Consolidated 2006	Combined and consolidated 2005
Xytec Solutions Sdn. Bhd.	Malaysia	30 %	30 %

Xytec shares are not listed on a stock exchange and hence the fair value of its shares cannot be determined. Financial information can be summarised as follows:

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Assets	2,299	1,178
Liabilities	1,743	965
Revenues	3,539	1,360
Profit	367	101
Profit attributable to the Group	110	15

All transfers of funds from Xytec to the Group, i.e. distribution of cash dividends, are subject to the approval of at least 51 % of all shareholders of the associate. The Group has not received any dividends from the associate.



## 6. Cost of Sales

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Raw materials and manufacturing supplies	24,903	12,736
Personnel expenses (note 8)	4,135	1,939
Depreciation and amortization (note 13 and 14)	1,910	1,168
Other manufacturing costs	3,036	1,490
<b>Total cost of sales</b>	<b>33,984</b>	<b>17,333</b>

## 7. Administrative Expenses

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Personnel expenses (note 8)	4,389	1,315
Rental expenses	381	94
Sales commission expenses	258	363
Professional fees	984	860
Depreciation and amortization (note 13 and 14)	398	168
Other administrative expenses	2,301	1,455
<b>Total administrative expenses</b>	<b>8,711</b>	<b>4,255</b>

## 8. Personnel expenses

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Wages and salaries	5,746	1,780
Compulsory social security contributions	129	40
Employee benefits	89	12
Subcontractor fees	2,414	1,355
Other	146	67
<b>Total</b>	<b>8,524</b>	<b>3,254</b>

Personnel expenses are classified in the income statement as follows:

In thousands of euro except headcount	Consolidated 2006	Combined and consolidated 2005
Cost of sales	4,135	1,939
Administrative expenses	4,389	1,315
<b>Total</b>	<b>8,524</b>	<b>3,254</b>
Number of staff employees	863	332
Number of subcontractors	893	772
<b>Total</b>	<b>1,756</b>	<b>1,104</b>

## 9. Other operating income (expenses)

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Scrap sales	–	70
Reversal of / (write down) of inventories	20	(90)
Gain / (loss) on disposal of fixed assets	(517)	11
Other	332	–
<b>Total</b>	<b>(165)</b>	<b>(9)</b>

A loss from disposal of fixed assets has been incurred due to a contractual arrangement with a customer in order to render technical equipment without remuneration. This loss amounts to € 513,000, equal to the book value of the equipment at the time of disposal.



## 10. Net financial income (expenses)

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Interest income	447	3
Foreign exchange gains	60	–
<b>Financial income</b>	<b>507</b>	<b>3</b>
Interest expenses	(448)	(271)
Bank charges	(76)	(57)
Foreign exchange losses	(741)	(285)
<b>Financial expenses</b>	<b>(1,265)</b>	<b>(613)</b>
<b>Net financial income (expenses)</b>	<b>(758)</b>	<b>(610)</b>

## 11. Corporate income tax

## Tax privileges

Almost the entire taxable income of the Group in 2006 and 2005 was generated in Thailand by SMARTRAC Technology Limited. The normal corporate income tax rate in Thailand is 30%. However, under the special promotional privileges granted by the Thailand Government (see note 27), SMARTRAC Technology Limited is entitled to the following corporate income tax facility relating to its production and sale of transponders in Thailand:

- Exemption from corporate income tax for seven years (until 2008) on taxable profits generated under the subsidiary's first Board of Investment licence
- Exemption from corporate income tax for seven years (until 2011), or a maximum of THB 183.5 million (approximately € 3.9 million), whichever occurs first, on taxable profits generated under the subsidiary's second Board of Investment licence
- Exemption from corporate income tax for seven years (until 2013) or a maximum of THB 1,975 million (approximately € 41.6 million) which occur first.

## Recognised in the income statement

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Current corporate tax expense	(6)	–
Deferred tax benefit	168	37
<b>Income tax benefit</b>	<b>162</b>	<b>37</b>

## Recognised directly in equity

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Deferred tax effect of IPO costs credited to share premium	1,788	—
<b>Total income tax recognised directly in equity</b>	<b>1,788</b>	<b>0</b>

The deferred tax asset as a result of IPO costs amounts to € 1,788,000 and was directly credited to the share premium. The effective tax charge of SMARTRAC N.V. is supposed to increase due to increasing taxable financial results of SMARTRAC N.V. in future periods. The deferred tax asset is capitalized to the extent the underlying tax loss carryforward can be utilized in the foreseeable future.

## Reconciliation of effective tax charge

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Profit before tax	8,957	2,981
Based on rate 30 %	2,687	906
Tax exempt income relating to promotional activities	(2,921)	(999)
Tax exempt income relating to equity accounted investment	(33)	(5)
Non-deductible permanent differences	19	31
Add back (deduct) as temporary differences	(2)	30
Impairment of carry forward tax losses	41	—
Carry forward tax losses	168	37
Tax rate differences	47	—
<b>Actual tax expense</b>	<b>6</b>	<b>0</b>

## Deferred tax assets

Movements in deferred tax assets are as follows:

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Balance 1 January	37	—
Recognised in income statement	168	37
Recognised directly in equity	1,788	—
<b>Balance 31 December</b>	<b>1,993</b>	<b>37</b>

At 31 December 2006, deferred tax assets have not been recognised in respect of deductible temporary differences amounting to € -2,000 (2005: € 30,000) because it is expected that these benefits (expenses) will be utilized during SMARTRAC Technology Limited's tax exemption periods.



## 12. Earnings per share and pro forma earnings per share

## Profit attributable to ordinary shareholders

The calculation of basic earnings per share at 31 December 2006 was based on the profit attributable to ordinary shareholders and amounts to € 9,119,000 (2005: € 3,018,000).

## Weighted average number of ordinary shares

The weighted average number of ordinary shares was affected by the 3,500,000 new shares issued in conjunction with the initial public offering in July 2006:

In thousands of shares	Consolidated 2006	Combined and consolidated 2005
Issued ordinary shares after Restructuring	5,000	10,000
Effect of Stock Split on 7 February 2006	5,000	—
Effect of 3.5 million shares issued in July 2006	1,556	—
Weighted average number of ordinary shares at 31 December	11,556	10,000

### Pro forma earnings per share 2005

In thousands of shares, except pro forma earnings per share	Combined and consolidated 2005
Pro forma number of ordinary shares at 31 December 2005	10,000
Profit attributable to ordinary shareholders	3,018
<b>Pro forma earnings per share (euro)</b>	<b>0.30</b>

Pro forma weighted average number of ordinary shares assumes both (1.) the combination of the subsidiaries in the Group (which legally occurred on 23 January 2006), and (2.) the splitting and converting of shares (which was resolved by the shareholders on 7 February 2006), as described in note 1, took place on, or before, 1 January 2005.

### Earnings per share

In thousands of euro and shares, except earnings per share	Consolidated 2006
Profit attributable to ordinary shareholders	9,119
Weighted average number of ordinary shares at 31 December	11,556
<b>Earnings per share (euro)</b>	<b>0.79</b>

### Weighted average number of ordinary shares for the purpose of diluted earnings per share

The weighted average number of ordinary shares for the purpose of diluted earnings per share include the dilutive potential shares of SMARTRAC stock option scheme (first tranche):

- Average market share price: The average market share price from 20 July 2006 until 31 December 2006 was € 17.51
- Effective tax rate: The effective tax rate is 0 %.
- Exercise Price: The exercise price of the stock options is € 17.00

In thousands of shares	Consolidated 2006
Weighted average of ordinary shares	11,556
Effect of potential dilutive shares:	
Share options	2
<b>Total</b>	<b>11,558</b>

### Diluted earnings per share

In thousands of euro and shares, except earnings per share	Consolidated 2006
Profit attributable to ordinary shareholders	9,119
Weighted average number of ordinary shares at 31 December	11,558
<b>Diluted earnings per share (euro)</b>	<b>0.79</b>



## 13. Property, plant and equipment

In thousands of euro	Land	Buildings and building improvements	Vehicles
<b>Cost</b>			
Balance at 1 January 2005	255	1,376	58
Acquisitions	193	1,267	–
Disposal	–	–	–
<b>Balance at 31 December 2005</b>	<b>448</b>	<b>2,643</b>	<b>58</b>
<b>Accumulated depreciation</b>			
Balance at 1 January 2005	–	253	18
Depreciation charge for the year	–	154	10
Disposal	–	–	–
<b>Balance at 31 December 2005</b>	<b>–</b>	<b>407</b>	<b>28</b>
<b>Carrying amounts</b>			
At 1 January 2005	255	1,123	40
<b>At 31 December 2005</b>	<b>448</b>	<b>2,236</b>	<b>30</b>
<b>Cost</b>			
Balance at 1 January 2006	448	2,643	58
Acquisitions	306	1,519	–
Disposal	–	–	(17)
<b>Balance at 31 December 2006</b>	<b>754</b>	<b>4,162</b>	<b>41</b>
<b>Accumulated depreciation</b>			
Balance at 1 January 2006	–	407	28
Depreciation charge for the year	–	462	11
Disposal	–	–	(5)
<b>Balance at 31 December 2006</b>	<b>–</b>	<b>869</b>	<b>34</b>
<b>Carrying amounts</b>			
At 1 January 2006	448	2,236	30
<b>At 31 December 2006</b>	<b>754</b>	<b>3,293</b>	<b>7</b>

Machinery	Tools and equipment	Furniture and fixtures	Office equipment	Construction in progress	Consolidated
8,179	692	128	151	24	10,863
2,329	421	136	220	(24)	4,542
(152)	(3)	–	–	–	(155)
<b>10,356</b>	<b>1,110</b>	<b>264</b>	<b>371</b>	<b>–</b>	<b>15,250</b>
1,592	277	49	73	–	2,262
888	163	31	52	–	1,298
(43)	(1)	–	–	–	(44)
<b>2,437</b>	<b>439</b>	<b>80</b>	<b>125</b>	<b>–</b>	<b>3,516</b>
6,587	415	79	78	24	8,601
<b>7,919</b>	<b>671</b>	<b>184</b>	<b>246</b>	<b>–</b>	<b>11,734</b>
10,356	1,110	264	371	–	15,250
4,748	811	348	171	2,630	10,533
(769)	(25)	–	–	–	(811)
<b>14,335</b>	<b>1,896</b>	<b>612</b>	<b>542</b>	<b>2,630</b>	<b>24,972</b>
2,437	439	80	125	–	3,516
1,269	270	101	92	–	2,205
(18)	(12)	–	–	–	(35)
<b>3,688</b>	<b>697</b>	<b>181</b>	<b>217</b>	<b>–</b>	<b>5,686</b>
7,919	671	184	246	–	11,734
<b>10,647</b>	<b>1,199</b>	<b>431</b>	<b>325</b>	<b>2,630</b>	<b>19,286</b>

Construction in progress mainly consists of buildings and building improvements under construction. No pledges or collaterals existed to 3rd parties, except a pledge of the Company's land (SMARTRAC Technology Ltd.) for the secured loan (note 20) in 2005 and 2006.



## 14. Intangible assets

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Patents and patent rights	1,592	1,281
Software	4	12
<b>Total intangible assets</b>	<b>1,596</b>	<b>1,293</b>

## Patents and patent rights

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
<b>Cost</b>		
Balance at 1 January	1,333	120
Acquisitions	408	—
Acquired through business combinations	—	1,213
Disposal (-)	(8)	—
<b>Balance at 31 December</b>	<b>1,733</b>	<b>1,333</b>
<b>Amortisation</b>		
Balance at 1 January	52	24
Amortization	94	28
Disposal (-)	(5)	—
<b>Balance at 31 December</b>	<b>141</b>	<b>52</b>
<b>Carrying amounts</b>		
At 1 January	1,281	96
<b>At 31 December</b>	<b>1,592</b>	<b>1,281</b>

The patents and patent rights relate to technical inventions and innovations used (or to be used) in production by the Group and/or licensed to other parties. They are held by SMARTRAC Technology Ltd., SMARTRAC Technology Pte Ltd. and SMARTRAC N.V.

## Software

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
<b>Cost</b>		
Balance at 1 January	40	40
Acquisitions	–	–
Balance at 31 December	40	40
<b>Amortisation</b>		
Balance at 1 January	28	20
Amortization	8	8
Balance at 31 December	36	28
<b>Carrying amounts</b>		
At 1 January	12	20
At 31 December	4	12

## 15. Inventories

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Raw materials and consumables	6,226	3,179
Work in progress	498	507
Finished goods	466	138
<b>Total inventories</b>	<b>7,190</b>	<b>3,824</b>



## 16. Trade receivables

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Trade receivables with related parties	541	161
Trade receivables	12,942	7,206
Impairments	(377)	(377)
<b>Total</b>	<b>13,106</b>	<b>6,990</b>

Trade receivables are shown net of impairments amounting to € 377,000 recognised in 2004; of which € 221,000 arises from a customer that has gone bankrupt; € 146,000 is from a related party, SMARTRAC Technology AG (a former sales agent of SMARTRAC Technology Ltd.) which has been outstanding since 2003 and is no longer considered recoverable; and the remaining is due from non-related parties.

## 17. Other current assets

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Advances for equipment purchases	722	114
Prepayments to vendor	30	156
Prepaid expenses	176	745
Other	502	182
<b>Total</b>	<b>1,430</b>	<b>1,197</b>

## 18. Cash and cash equivalents

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Cash	2,713	1,500
Cash equivalents	33,173	–
<b>Cash and cash equivalents</b>	<b>35,886</b>	<b>1,500</b>
Bank overdraft	(842)	(1,207)
<b>Cash and cash equivalents and bank overdrafts as stated in the cash flow statement</b>	<b>35,044</b>	<b>293</b>

At 31 December 2006, the Group had a total of unused credit facilities amounting to € 2,271,000 (2005: € 1,617,000).

At 31 December 2006 SMARTRAC held € 33,173,000 in debt instruments for trading purposes at fair value through profit and loss, with a duration of 3 months or less at the moment of acquisition.

## 19. Equity

### Share capital

Ordinary shares of SMARTRAC N.V. in thousands of shares	Consolidated 2006	Combined and consolidated 2005
On issue at 1 January	10,000	–
Issued for cash	3,500	–
Issued for contributed subsidiaries	–	10,000
<b>On issue at 31 December – fully paid</b>	<b>13,500</b>	<b>10,000</b>

### Authorised share capital

SMARTRAC N.V. was incorporated on 23 January 2006 with an authorised share capital of 25,000,000 shares of € 1.00 each and issued and paid up share capital of 5,000,000 shares of € 1.00 each. On 7 February 2006, the shareholders resolved to amend the Company's Articles of Association by splitting and converting each existing € 1.00 share into two shares of € 0.50 each. Following this amendment the authorised share capital of the Company is € 25,000,000, comprising of 50,000,000 shares with a par value of € 0.50 each. Regarding the 3,500,000 shares issued for cash please refer to note 1d.

### Share premium reserve

The increase in share premium in the financial year 2006 is mainly due to the excess amount received over par value of the 3,500,000 new shares issued for cash in 2006, please refer to note 1d. Regarding the increase of share premium reserve because of the Group's Stock Option Plan please refer to note 26.



## 20. Interest-bearing loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loan and bank borrowings. For more information about the Group's exposure to interest rate and foreign currency risk, see note 24.

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
<b>Non-current liability</b>		
Secured loan	148	233
	<b>148</b>	<b>233</b>
<b>Current liabilities</b>		
Current portion of secured loan	102	120
Trust receipt	142	—
	<b>244</b>	<b>120</b>
<b>Interest-bearing loans and borrowings</b>		
Short-term bank borrowings	314	—
Secured bank borrowings	—	7,656
Loan from related party	—	792
	<b>314</b>	<b>8,448</b>
	<b>706</b>	<b>8,801</b>

At 31 December 2006 all of the loans were denominated in Thai baht. At 31 December 2005 all of the loans are denominated in Thai baht except for secured bank borrowings totalling 1,129,000 and the loan from related party which were denominated in euro.

### Terms and debt repayment schedule

Secured four-year loan totalling of € 250,000 (31 December 2005: € 353,000) is with Siam Commercial Bank in Thailand. The loan is secured by land and buildings and it matures in 2009. Interest on the loan is calculated based on the bank's Minimum Loan Rate which is 6.25 % per annum as at 31 December 2006. Monthly repayments are € 10,000.

The trust receipt on a letter of credit amounting to € 142,000 (31 December 2005: € 0) is with Siam Commercial Bank in Thailand at a rate of 7.75 % and matures in 2007.

Short-term bank borrowings totalling of € 314,000 are with Siam Commercial Bank in Thailand at a rate of 7.75 % per annum as at 31 December 2006.

Secured bank borrowings totalling € 0 (2005: € 6,527,000) were with Deutsche Bank Thailand and were guaranteed by a related party.

Secured bank borrowings totalling € 1,129,000 at 31 December 2005 were with ABN Amro, Singapore Branch and were guaranteed by a related party. The interest rate for these borrowings was 2.5% to 2.8% per annum.

The loan from related party at 31 December 2005 of € 792,000 had no maturity date with an interest rate of 2.5 % per annum and was paid back in 2006.

## 21. Employee benefits

Under Thai law the Group is required to make severance payments to employees who reach retirement age while employed at SMARTRAC Technology Ltd. These lump sum payments are accounted for as unfunded post employment benefits in the balance sheet.

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Present value of unfunded obligations	51	37
Unrecognised actuarial gains and losses	(1)	(1)
<b>Total employee benefits</b>	<b>50</b>	<b>36</b>

### Expense recognised in the income statement

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Current service costs	13	11
Interest on obligation	1	1
	<b>14</b>	<b>12</b>

These expenses were classified under administrative expenses.

### Liability for defined benefit obligations

Principal actuarial assumptions at the balance sheet date (expressed as weighted averages):

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Discount rate at 31 December	5.00 %	5.00 %
Future salary increases	7.00 %	7.00 %
Price inflation	3.00 %	3.00 %

The Group has used the yield on 16-year Thai Government Bonds as the discount rate and nominal salary inflation in Thailand for determining the current fair value of employee benefits. If salary inflation were to increase, the Group's unrecognised actuarial gain would increase with the risk that the severance payments would be greater.



## 22. Trade and non-trade payables

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Trade payables due to related parties	4	17
Other trade payables	3,624	3,212
<b>Total trade payables</b>	<b>3,628</b>	<b>3,229</b>
Non-trade payables due to related parties	1,069	1,132
Other non-trade payables	3,680	575
<b>Total non-trade payables</b>	<b>4,749</b>	<b>1,707</b>
<b>Total trade and non-trade payables</b>	<b>8,377</b>	<b>4,936</b>

## 23. Other current liabilities

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Accrued expenses	962	888
Prepayments from customers	24	447
Other liabilities	330	465
<b>Total other current liabilities</b>	<b>1,316</b>	<b>1,800</b>

## 24. Financial instruments

Exposure to credit, interest rate and currency risks arises in the normal course of the Group's business. Derivative financial instruments are not used to hedge exposure to fluctuations in foreign exchange rates and interest rates.

### Credit risk

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. The Group does not require collateral in respect of financial assets.

Deposits are only made with counterparties that have good credit ratings. Given their high credit ratings, management does not expect any counterparty to fail to meet its obligations.

At 31 December 2005 and 2006 there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

### Interest rate risk

The Group's policy is to obtain short term borrowings with interest rates based on current market rates at that time.

The Group's exposure to interest rate risk due to repricing or maturity dates is disclosed in the respective notes for each class of financial asset and financial liability. The effective interest rates on financial assets and financial liabilities do not differ significantly from the nominal rates disclosed in these notes.

### Foreign currency risk

The Group is exposed to foreign currency risk on sales, purchases and borrowings that are denominated in a currency other than the euro. The currencies giving rise to this risk are primarily US dollars and Thai baht.

The majority of the Group's bank borrowings and loans at 31 December 2006 were in Thai baht (see note 20). The foreign currency risk from bank borrowings has decreased in the second half of the financial year 2006 since the majority of the bank borrowings and loans have been paid back.

### Sensitivity analysis

At 31 December 2006, it is estimated that a general increase of one percentage point in interest rates would increase the Group's profit for the year before tax by approximately € 68,000 (2005: decrease by € 54,000).

It is estimated that a general decrease of one percentage point in the value of the euro against other foreign currencies would have decreased the Group's operating profit before tax by approximately € 113,000 for the year ended 31 December 2006 (2005: € 69,000).

### Fair values

There were no financial instruments at balance sheet date which have fair values significantly different from carrying amounts.



**Estimation of fair values**

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments.

**Interest-bearing loans and bank borrowings**

Fair values approximate carrying amounts due to the relatively short-term maturity of the loans and borrowings.

**Trade and other receivables / payables**

For receivables / payables with a remaining life of less than one year, the notional amount is deemed to reflect the fair value.

**25. Operating leases****Leases as lessee**

Non-cancellable operating lease rentals are payable as follows:

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Less than one year	68	11
Between one and five years	80	55

SMARTRAC Technology Ltd. also leases vehicles under operating lease rentals which expire in 2009. For the year 2007 these operating lease expenses are below € 75,000.

During the year ended 31 December 2006, € 50,000 was recognised as an expense in the income statement in respect of operating leases (2005: € 17,000).

## 26. Stock option plan

On 8 February 2006, the Company's Management Board established a Stock Option Plan (the Stock Option Plan) for members of the Management and Supervisory Board, senior management and selected employees of the Group.

Stock options (the Stock Options) under the Stock Option Plan have rights to purchase shares in the Company. The exercise price of stock options granted within six weeks of the Company's IPO will be the IPO offer price. The exercise price of stock options granted thereafter were based on the weighted average price of the Company's shares during the ten business days immediately preceding the grant of the stock options.

The number of stock options granted under the Stock Option Plan may not exceed 5% of the Company's issued share capital immediately following the IPO. In addition, the number of stock options that can be granted to the Management Board and the Supervisory Board is limited to 1.0% and 0.5% respectively, of the Company's issued share capital immediately following the IPO. The remaining stock options can be granted to the employees of the Company or its affiliates.

On 17 August 2006, 68,250 stock options were granted (first tranche). Fair value is measured using the black scholes pricing model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations. Fair value of share options and the assumptions are:

- Expected term of the options: three years
- Vesting period: two years
- Exercise price: € 17.00 which is the price according to the option scheme for the first grant the offer price.
- Current price of underlying shares at the grant date: € 16.80
- Expected volatility: 55 % based on the historical volatility for similar companies over a period corresponding to the expected term of the options and the volatility of the share price of SMARTRAC in the period since it has been publicly traded (20 July to 17 August 2006)
- Expected annual employee turnover rate: 5 %
- Risk-free interest rate: 3.6 %
- Expected dividend payouts until expected date of exercise: none

The fair value of the stock options, based on the first tranche and the staggered vesting period, equals € 6.66 per stock option. Total expenses for the first tranche recorded in 2006 amount to € 77,000 (2005: € 0). They are reported under administrative expenses and as an increase in shareholders' equity (share premium) at the same time.



## 27. Promotional privileges

By virtue of the provisions of the Thai Government's Industrial Investment Promotion Act B.E. 2520, SMARTRAC Technology Ltd. has been granted promotional privileges relating to its manufacturing of transponders and electronic parts or components in Thailand. The promotional privileges include, among other things:

- Exemption from corporate income tax on net earnings from the promotional activities for up to seven years (see note 11)
- Exemption from corporate income tax on dividends received from companies using similar promotional privileges.

- Exemption from withholding tax deductions on distributions of net earnings of promoted activities paid to foreign shareholders during the tax exemption period.
- Permission to transfer foreign exchange in and out of Thailand.

SMARTRAC Technology Ltd. must also comply with specific conditions contained within the promotional certificates such as maintaining appropriate books and records, working capital and quality standards. Until 31 December 2006, the company complied with these conditions.

## 28. Capital commitments

As at 31 December 2006 existed no capital commitments with respect to land and buildings (31 December 2005: Approximately € 1,100,000 with the placement of a 10 % cash deposit)

As at 31 December 2006, the Group has outstanding purchase orders for machinery amounting to

€ 2,776,000 (31 December 2005: approximately € 1,900,000), thereof with Xytec (related party) € 2,542,000 (31 December 2005: approximately € 1,900,000). The group has made down payments on these purchase orders in 2006 amounting to € 722,000, thereof down payments to Xytec amounting to € 699,000.

## 29. Contingencies

### Legal claims

During the financial year 2006 and shortly after the financial year 2006 all legal claims, mainly related to patent issues which have been outlined in the notes of our combined and consolidated financial information 2005 as well as allegations raised in 2006 against the Group's CEO have been settled in favour of SMARTRAC N.V. and in favour of the Group's CEO. Consequently, no impairments or provisions have been accounted for as per 31 December 2006.

### Off balance sheet commitments

At 31 December 2005 and 2006, the Group has bank guarantees granted to utility suppliers and for litigation costs amounting approximately € 30,000 and 81,500, respectively.

### 30. Related parties

#### Identity of related parties

The Group has a related party relationship with its subsidiaries (see note 1), associate (see note 5), and with its directors and executive officers and entities controlled by its directors and executive officers.

#### Transactions with key management

As at 31 December 2006 directors of the Company and their immediate relatives control 33.9 % of the voting shares of the Company (31 December 2005: 93 %).

A loan from Mr. Richard Bird, as at 31 December 2005 amounted to € 792,000 and is included in „interest bearing borrowings“ (see note 20). This loan was repaid in 2006.

Total remuneration is included in „personnel expenses“ (see note 8), additionally a success fee with respect to the gross proceeds of the IPO amounting to € 595,500 was paid to the CFO of SMARTRAC N.V. in 2006 and directly charged to share premium as part of the IPO costs. This predetermined bonus was based on 1.00 percent of the gross proceeds to the Company from the capital increase in connection with the successful IPO, dated July 20, 2006 and acknowledged the contribution of Dr. Christian Fischer to the successful IPO of the company.

#### Remuneration

For detailed information regarding the composition of salaries of directors of the Management Board please refer to the section „Corporate governance report“ of the Annual Report.

#### Transactions with Supervisory Board

As remuneration as the Chairman of the Supervisory Board, an amount of € 21,000 for Prof. Dr. Bernd Fahrholz was accrued as at 31 December 2006.

Mr. Richard Bird in his function as member of the Supervisory Board of SMARTRAC N.V. indirectly controls 34.2 % of the voting shares as at 31 December 2006. On 15 March 2007, Mr. Bird sold his complete interest in SMARTRAC. Regarding his function as Vice President of the Supervisory Board, an amount of € 4,167 was accrued as at 31 December 2006.

Furthermore, Mr. Richard Bird received € 71,000 as a success fee for his efforts regarding the settlement of patent infringement negotiations led by him in the financial year 2006. He received interest payments amounting to € 18,000.

Regarding his function as a Member of the Supervisory Board, an amount of € 4,167 for Mr. Wolfgang Huppenbauer was accrued as at 31 December 2006.

All amounts except interest payments to Mr. Bird are presented on an accrual basis.

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
Directors	1,380	95
Executive officers	304	105
	1,684	200



### Transactions with associates

During the year ended 31 December 2006 (31 December 2005), the Group purchased goods from its associate worth € 3,442,000 (€ 1,360,000). Transactions with associates are priced on an arm's length basis. No dividends were received from associates.

### Related party transactions and balances

Related parties are summarised below.

Mr. Manfred Rietzler is both director and shareholder of SMARTRAC N.V. whereas Mr. Wolfgang Schneider and Mr. Martin Kuschewski are only shareholders of SMARTRAC N.V. Mr. Richard Bird was executive officer of SMARTRAC Technology Ltd. in 2005 and 2006, member of the Supervisory Board of SMARTRAC N.V., and is shareholder.

Name	Type of business	Relationship	Directors/shareholders
Safehaven Trading	Trading	Shareholder	Mr. Richard Bird
Emsquares AG	Development and sale of reading devices	Shareholder	Mr. Manfred Rietzler Mr. Martin Kuschewski
Safehaven Investments Ltd.	Investment and trading	Shareholder	Mr. Richard Bird
Intec Holding GmbH	Technical advice and trading	Shareholder	Mr. Manfred Rietzler
Xytec Solutions Sdn. Bhd.	Trading	30 % shareholder	SMARTRAC N.V. (30 %)

The Group had the following transactions with related parties:

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
<b>Sales</b>		
Emsquares AG	–	8
	–	8
<b>Purchases</b>		
Emsquares AG	–	19
Intec Holding GmbH	–	204
Xytec Solutions Sdn. Bhd.	3,442	1,360
	3,442	1,583

The balances of receivable and payables with related parties are shown below:

In thousands of euro	Consolidated 2006	Combined and consolidated 2005
<b>Trade receivables</b>		
Xytec Solutions Sdn. Bhd.	380	–
Emsquares AG	15	15
SMARTRAC Technology AG	146	146
	<b>541</b>	<b>161</b>
<b>Deposits paid</b>		
Emsquares AG	30	4
Xytec Solutions Sdn. Bhd.	703	13
	<b>733</b>	<b>17</b>
<b>Trade payables</b>		
Emsquares AG	4	4
Safehaven Trading	–	13
	<b>4</b>	<b>17</b>
<b>Non-trade payables</b>		
Safehaven Trading	317	467
Xytec Solutions Sdn. Bhd.	681	453
Intec Holding GmbH	–	12
Safehaven Investments Ltd.	–	200
Mr. Richard Bird	71	–
	<b>1,069</b>	<b>1,132</b>

The outstanding balances of the receivables with Emsquares AG (formerly SMARTRAC Technology AG) were fully provided for as at 31 December 2005 and 31 December 2006.

### 31. Subsequent events

On 25 January 2007, SMARTRAC N.V. has acquired 25.2 percent of the shares in multitape GmbH, which is domiciled in Salzkotten, Germany. The parties to the transaction have agreed not to divulge any details of the price paid. The two companies intend to cooper-

ate more intensively on the production of RFID (Radio Frequency Identification) components in the future. multitape GmbH has an expertise in etching which is a supplement to the Group's core competence, the wire-embedding technology.



## Company financial statements 2006 of SMARTRAC N.V.

## Company balance sheet as at 31 December 2006

In thousands of euro	Note	2006
<b>Assets</b>		
Intangible assets		210
Investment in subsidiary companies	5	19,214
Investment in associates	6	158
Deferred tax assets		1,831
<b>Total non-current assets</b>		<b>21,413</b>
Loans to subsidiary companies	7	16,350
Other current assets		733
Cash and cash equivalents		33,722
<b>Total current assets</b>		<b>50,805</b>
<b>Total assets</b>		<b>72,218</b>
<b>Equity and liabilities</b>		
Issued capital	9	6,750
Share premium	10	53,548
Retained earnings	10	–
Translation reserve	10	24
Profit for the year	10	9,119
<b>Capital and reserves</b>		<b>69,441</b>
Non-trade payables	11	2,493
Current liabilities to subsidiary companies	12	67
Other current liabilities		217
<b>Total liabilities</b>		<b>2,777</b>
<b>Total equity and liabilities</b>		<b>72,218</b>

## Company income statement for the year ended 31 December 2006

In thousands of euro	2006
Income from investment in subsidiary companies and associates	9,377
Other income (loss) after tax	(258)
Result attributable to shareholders	9,119



## Notes to the company financial statements of SMARTRAC N.V. for the year ended 2006

### 1. Reporting entity

The company financial statements of SMARTRAC N.V. ("the Company") are included in the consolidated statements of SMARTRAC. Where the financial statements reflect the same information as the consolidated financial statements, the note numbers refer to these notes.

### 2. Basis of preparation

The consolidated financial statements are prepared according to the standards laid down by the International Accounting Standards Board and adopted by the European Union (hereinafter referred to as EU-IFRS). In setting the principles for the recognition and measurement of assets and liabilities and determination of the result for its separate financial statements, SMARTRAC N.V. has made up use of the option provided in Article 362.8 of Part 9, Book 2 of the Netherlands Civil Code. This means that the principles for the recognition and measurement of assets and liabilities and determination of the result (hereinafter referred to as principles for recognition and

measurement) of the separate financial statements of SMARTRAC N.V. are the same as those applied for the consolidated EU-IFRS financial statements. Associates, over which significant influence is exercised are stated on the basis of the equity method. Reference is made to the accounting principles as described in note 2 and 3 of the consolidated financial statements.

The company presents a condensed income statement, using the facility of Article 402 of Part 9, Book 2, of the Netherlands Civil Code.

### 3. Group restructuring

For the understanding of the basis of presentation of the company financial statements it is imperative that users read note 1 of the consolidated financial statements.

### 4. Significant accounting policies

#### Investments in subsidiary companies

Investments in subsidiary companies are carried at net asset value. For the principles of valuation of assets and liabilities and for determination of results reference is made to the notes to the consolidated financial statements.

#### Investment in associates

The share in the result of associates consists of the share of SMARTRAC N.V. in the result of these associates. Results on transactions, where the transfer of assets and liabilities between SMARTRAC N.V. and its associates and mutually between associates themselves, are not incorporated insofar as they can be deemed to be unrealised.

## 5. Investments in subsidiary companies

Subsidiary	Country of incorporation	Carrying value 2006 in thousands of euro
SMARTRAC TECHNOLOGY Ltd.	Thailand	10,034
SMARTRAC TECHNOLOGY GmbH	Germany	(10)
SMARTRAC TECHNOLOGY Pte. Ltd.	Singapore	(101)
Carrying value of investment on 1 January 2006		9,923
Equity accounted earnings		9,267
Foreign exchange translation		24
Carrying value of investment at 31 December 2006		19,214

As per 31 December 2006, all investments represent 100 % of their issued capital.

## 6. Investments in associates

Subsidiary	Country of incorporation	Carrying value 2006 in thousands of euro
Xytec Solutions Sdn. Bhd.	Malaysia	48
Carrying value of investment on 1 January 2006		48
Equity accounted earnings		110
Carrying value of investment at 31 December 2006		158

## 7. Short-term loans to subsidiaries

Subsidiary	2006 in thousands of euro
SMARTRAC TECHNOLOGY Ltd.	12,599
SMARTRAC TECHNOLOGY GmbH	1,120
SMARTRAC TECHNOLOGY Pte. Ltd.	2,631
Total short-term loans to subsidiaries	16,350

Terms: all loans have a residual repayment term of less than 12 months and were granted at market interest rates.



## 8. Cash and cash equivalents

In thousands of euro	2006
Cash	549
Cash equivalents	33,173
<b>Total cash and cash equivalents</b>	<b>33,722</b>

At 31 December 2006 SMARTRAC held € 33,173,000 in debt instruments for trading purposes at fair value through profit and loss, with a duration of 3 months or less at the moment of acquisition.

## 9. Share capital

Authorised	2006
50,000,000 shares of € 0.50 each	25,000
<b>Issued</b>	
10,000,000 shares of € 0.50 each arising from the restructuring of the Group after stock split on 7 February 2006	5,000
3,500,000 shares of € 0.50 each arising from the capital increase 20 July 2006	1,750
<b>Balance at end of period</b>	<b>6,750</b>

For 2006, the impact of share-based payments is a net charge to income of € 77,000. At 31 December 2006, the accumulated amount is € 77,000. For further details regarding share-based payments please refer to note 26 of the consolidated financial statements and for further details regarding changes of share premium please refer to the following note 10 and additionally to note 1d of the consolidated financial statements.

## 10. Company statement of changes in capital and reserves

In thousands of euro	Issued capital	Share premium	Foreign currency translation reserve	Retained earnings	Total
At 31 December 2005					
Net equity before contribution*	620	–	8	9,295	9,923
Group restructuring*	(620)	–	(8)	(9,295)	(9,923)
Newly issued shares upon contribution in kind*	5,000	4,923	–	–	9,923
Pro forma balance – 31 December 2005	5,000	4,923	–	–	9,923
At 1 January 2006	5,000	4,923	–	–	9,923
Par value of new shares – credited to share capital	1,750	–	–	–	1,750
Excess of gross proceeds over par value – credited to share premium	–	57,750	–	–	57,750
IPO costs charged to share premium	–	(10,990)	–	–	(10,990)
Deferred tax effect of IPO costs – credited to share premium	–	1,788	–	–	1,788
Share based payment	–	77	–	–	77
Foreign exchange translation	–	–	24	–	24
Result for the year	–	–	–	9,119	9,119
At 31 December 2006	6,750	53,548	24	9,119	69,441

\* Equity as at 31 December 2005 is the pro forma equity of SMARTRAC N.V. at its incorporation date (23 January 2006), as if SMARTRAC N.V. already existed as at 31 December 2005 and the contribution in kind of all group companies had already occurred as at 31 December 2005. This pro forma method of presentation only relates to the classification of equity elements, and does not affect the equity total.

For further information, reference is made to note 1 of the consolidated financial statements.

## 11. Non-trade payables

In thousands of euro	2006
Creditors – professional fees	2,446
Wage tax	47
Total non-trade payables	2,493



## 12. Current liabilities to subsidiary companies

In thousands of euro	
SMARTRAC TECHNOLOGY Ltd.	29
SMARTRAC TECHNOLOGY GmbH	32
SMARTRAC TECHNOLOGY Pte. Ltd.	6
Total current liabilities to subsidiary companies	67

## 13. Compensation by key management

The remuneration of the directors during the year was as follows:

In thousands of euro	
Salary without Bonus	Bonuses
Total	
Executive director	240
Non executive director	20
Total	260

The figures have been compiled on an accrual basis.

Interests of directors in share options of the Company at year end are:

Number of Options (first tranche) with a net realizable value of € 33,000; 5,000 options.

## 14. Contingencies

### Legal claims

During financial year 2006 and shortly after financial year 2006 all legal claims, mainly related to patent issues which have been outlined in the notes of our Annual Report 2005 as well as allegations raised in 2006 against the Group's CEO have been settled in favour of SMARTRAC N.V. and in favour of the Group's CEO. Consequently, no impairments or provisions have been accounted for as per 31 December 2006.

In case of potential insolvency of SMARTRAC Technology PTE Ltd. and SMARTRAC Technology GmbH, SMARTRAC N.V. is, at written requirement of SMARTRAC Technology PTE Ltd. and SMARTRAC Technology GmbH, obliged to fulfil all obligations of these subsidiaries.

Amsterdam, March 19, 2007

### The Management Board

Manfred Rietzler  
Chief Executive Officer

Dr. Christian Fischer  
Chief Financial Officer

Ronald Brown  
Chief Operations Officer

Anthony Edward Driessen  
Member

### The Supervisory Board

Prof. Dr. Bernd Fahrholz  
Chairman

Richard Bird  
Vice Chairman

Wolfgang Huppenbauer  
Member



## Auditors' report

### Report on the financial statements

We have audited the 2006 financial statements of SMAR-TRAC N.V., Amsterdam as set out on pages 42 to 91. The financial statements consist of the consolidated financial statements and the company financial statements. The consolidated financial statements comprise the consolidated balance sheet as at 31 December 2006, the income statement, statements of changes in shareholders' equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes. The company financial statements comprise the company balance sheet as at 31 December 2006, the company income statement for the year then ended and the notes.

### Management's responsibility

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and with Part 9 of Book 2 of the Netherlands Civil Code, and for the preparation of the management board report in accordance with Part 9 of Book 2 of the Netherlands Civil Code. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Auditors' responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with Dutch law. This law requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion with respect to the consolidated financial statements

## Opinion with respect to the company financial statements

In our opinion, the consolidated financial statements give a true and fair view of the financial position of SMARTRAC N.V. as at 31 December 2006, and of its result and its cash flow for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union and with Part 9 of Book 2 of the Netherlands Civil Code.

In our opinion, the company financial statements give a true and fair view of the financial position of SMARTRAC N.V. as at 31 December 2006, and of its result for the year then ended in accordance with Part 9 of Book 2 of the Netherlands Civil Code.

Pursuant to the legal requirement under 2:393 sub 5 part e of the Netherlands Civil Code, we report, to the extent of our competence, that the management board report as set out on pages 16 to 41 is consistent with the financial statements as required by 2:391 sub 4 of the Netherlands Civil Code.

Amstelveen, March 19, 2007  
KPMG ACCOUNTANTS N.V.

J.M.A. Eskes RA



## Declaration regarding decree article 10 takeover bids

SMARTRAC N.V. ("the Company") complies with the Decree effecting article 10 of Directive 2005/25/EC of the European Parliament and the Council of 21 April 2004 on takeover bids ("the Decree") by providing the following information requested by the respective articles of the Decree:

**Article 1a:** As at 31 December 2006 the Company has issued 13,500,000 common shares with par value of € 0.50 each, which account for 100 percent of the issued share capital of the Company.

**Article 1b:** Not applicable

**Article 1c:** Participations in the company regarding which there is a notification requirement as provided for in articles 2 and 3 of the Act on the Disclosure of Major Holdings 1996:

**Article 1d-f:** Not applicable

**Article 1g:** Following agreements which are known to the Company whereby shareholders are a party and which may result in restrictions on the transfer of securities and/or voting rights are hereby given notice:

1. The Company has agreed, subject to certain exceptions, not to announce or effect an increase of the share capital, issue any securities convertible into shares of the UBS Investment Bank or any economically similar transaction without the prior written consent of the UBS Investment Bank, for six months after the Settlement Date of the Initial Public Offering of the Company (20 July 2006).
2. ICM Netherlands B.V. and the CEO of the Company, Mr. Manfred Rietzler, have agreed that they will not, for a period of 18 months from the Settlement Date

Name/institution	Number of shares	% of total shares	Number of voting rights	% of total voting rights
<b>Share capital interest and voting rights of major shareholders as at 31 December 2006</b>				
Avenue Capital Management LP	800,220	5.93	800,220	5.93
TCL Netherlands B.V. (Ms. Elisabeth Rietzler)	1,370,000	10.15	1,370,000	10.15
<b>Share capital interest and voting rights of members of the Supervisory Board as at 31 December 2006</b>				
RB Netherlands B.V. (Mr. Richard Bird)	4,612,500	34.17	4,612,500	34.17
<b>Share capital interest and voting rights of members of the Management Board as at 31 December 2006</b>				
ICM Netherlands B.V. (Mr. Manfred Rietzler)	3,125,500	23.15	3,125,500	23.15
Ronald Brown	100,000	0.74	100,000	0.74

of the Initial Public Offering of the Company (20 July 2006), and the CFO of the Company, Dr. Christian Fischer, (together with his daughters holding shares in the Company) has agreed that he will not, for a period of 12 months from the Settlement Date, and Ms. Tirza Trappe-Fischer have agreed that they will not, for a period of six months from the Settlement Date, in each case without the prior written consent of the UBS Investment Bank, directly or indirectly, offer, sell or announce the sale of any shares of the Company or propose any increase in the Company's share capital, vote in favour of such a proposed increase or otherwise support any capital increase proposed with respect to the Company.

3. Mr. Richard Bird (through RB Netherlands B.V.), Ms. Elisabeth Rietzler and Mr. Martin Kuschewski (both indirectly through TCL Netherlands B.V.), Mr. Wolfgang Schneider, and Mr. Ronald Brown have agreed that they will not, for a period of six months from the Settlement Date of the Initial Public Offering of the Company (20 July 2006), in each case without the prior written consent of the UBS Investment Bank, directly or indirectly, offer, sell or announce the sale of any shares of the Company or propose any increase in the Company's share capital, vote in favour of such a proposed increase or otherwise support any capital increase proposed with respect to the Company.

**Article 1h:** The General Meeting of Shareholders shall appoint the directors (as A director or B director) and may at any time suspend or dismiss directors. Resolutions to suspend or dismiss directors shall be capable of being passed if the proposal to that effect has been made by the Supervisory Board, with an absolute majority of the votes cast. If such proposal has not been made by the Supervisory Board, then these resolutions shall only be capable of being passed with a majority of at least two third of the votes validly cast representing more than half of the issued share capital.

The appointment of an A director or B director shall take place by way of a binding nomination naming at least two persons for each vacancy to be filled and prepared by the Supervisory Board within three months after the vacancy has arisen. If a binding nomination has not been prepared within the above period, the General Meeting shall be unrestricted in its choice. The General Meeting of Shareholders shall also be unrestricted in its choice if it renders the nomination non-binding by means of a resolution adopted by at least two-thirds of the valid votes cast, representing more than half of the issued capital.

The General Meeting shall appoint the Supervisory Board members and shall at all times be empowered to suspend or dismiss each and any Supervisory Board member. The Supervisory Board may make a non-binding nomination for each vacancy within three months of the vacancy arising. In the event of nomination for the appointment of a Supervisory Board member, the candidate's age, profession, the nominal amount of the shares held by him or her in the Company's capital and the positions which he or she holds or has held, to the extent relevant to the performance of the duties of a Supervisory Board member, shall be stated. The legal entities in which he or she already holds an office on a Supervisory Board shall also be indicated.



Where these legal entities include companies belonging to the same group, it shall be sufficient to designate that group. The reasons for any recommendation or proposal for appointment or re-appointment shall be stated. In the event of reappointment, the manner in which the candidate has performed his duties as a Supervisory Director shall be taken into account.

Resolutions to:

- a. amend the articles of association
- b. merge ("juridische fusie")
- c. split-off ("splitsing"), and
- d. wind up the Company,

shall be capable of being passed if the proposal to that effect has been made by the Management Board. If such proposal has not been made by the Management Board, then these resolutions shall only be capable of being passed with a majority of at least two thirds of the votes validly cast in a General Meeting, in which at least three quarters of the issued share capital is represented.

**Article 1i:** The Management Board is authorised until 9 March 2011 to issue shares, or to issue rights to take shares until the issued share capital amounts to € 13,000,000.

The Management Board is authorised until 8 August 2007 to repurchase and acquire up to 10 percent of the issued share capital of the Company at the time of any repurchase, for a consideration of at least 80 percent of the stock price of the shares of the Company at the date of such repurchase and for a maximum consideration of 120 percent of such stock price.

**Article 1j:** Not applicable

## Appropriation of the result in accordance with the articles of association

Pursuant to Article 24, section 1 of the articles of association, the profit shown in the adopted annual accounts, after deducting all tax owed by SMARTRAC N.V. (the Company), shall first be applied for the addition to the reserves of such an amount as the Management Board shall determine. The profit which then remains shall be at the unrestricted disposal of the General Meeting of Shareholders. The General Meeting of Shareholders can add the profits to the Company's reserves or distribute the profits in accordance with the dividend and reserves policy adopted by the General Meeting of Shareholders.

For the financial year 2006, the Management Board determines the profit shown in the attached annual accounts which is subject to the adoption of the General Meeting of Shareholders in June 2007 to be retained as retained earnings.





03-07-2007







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