



Setec

ANNUAL REPORT

2003



Setec Oy
Vantaa, Finland

- Government & Corporate business unit
- Telecom & Media business unit
- Banking & Retail business unit

Setec TAG AB
Stockholm, Sweden

AB Svenska Pass
Eskilstuna, Sweden

Setec Danmark A/S
Ballerup, Denmark

Setec Central Eastern Europe
Warsaw, Poland

Setec Card (Thailand) Ltd.
Bangkok, Thailand

Setec Asia, Singapore

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Setec's business

Setec secures the authentication of people and transactions in open data networks and face-to-face communication.

Setec develops, manufactures and supplies secure card solutions for public authorities, banks and telecom operators. The elements of Setec's card solutions are the cards themselves, such as official electronic and visual ID documents, payment cards and SIM cards, as well as related services, such as secure personalisation of cardholder details.

The primary purpose of Setec's card solutions is to ensure that the services of the card issuer as well as those of other service providers can be used securely. These include different public sector services through networks, payment card transactions and mobile phone services. Cards must also guarantee reliable identification of the cardholder.

Setec's card business is divided by customer group into three units: Government & Corporate, Banking & Retail and Telecom & Media. The Group's parent company is domiciled in Finland, but it also has service locations in Sweden, Denmark, Poland, Singapore and Thailand.

Growing share of services

Setec aims to forge long-lasting relationships with its customers by offering them a comprehensive package of services as part of a tailored card solution. In the future these services will account for a growing share of Setec's overall card solutions.

The Nordic countries are Setec's domestic market and also its most important single market area. The company aims to achieve market leadership of the Nordic region in all of its business areas. Setec also exploits its own business strengths in the pursuit of key customer relationships in other markets.

Setec's competitiveness is based on the industry's leading security expertise, a comprehensive service offering that meets the needs of key customers, and the ability to deliver that package on time and as promised.

Converging card markets

Setec's market can be divided by product segment into two main markets: the *smart card market* and the *ID market*. Business is currently brisk on the ID market. The smart card market is recovering from weak profitability and the future outlook is good. The smart card and ID markets will converge as smart card chips are incorporated more and more into passports and ID cards.

The banks' switchover to EMV cards is an important global change on the smart card market. In practice this means that all payment cards will become chip-based within ten years. The smart card technology on which EMV cards are based will also enable multi-application payment cards. The EMV standard will significantly raise the unit price of payment cards in the future.

The public authorities want to introduce more secure ID documents in response to the problems of terrorism, illegal immigration and security pressures arising from greatly increased travel. Setec manufactures high-security ID products based on the laser engraving of polycarbonate plastic. Demand for these products is currently growing strongly. Another significant change taking place in the Government & Corporate business area is the integration of new technologies into ID products. This change has been accelerated by factors such as the enactment of digital signature legislation in various countries and the need to incorporate biometrics into passports.

All of the new mobile phone network technologies (GPRS, CDMA2000, UMTS) continue to make use of conventional SIM cards. However, the larger capacities of these new networks enable the provision of more useful SIM-based value added services. This will increase SIM card turnover and boost demand for SIM cards with larger memory capacities. In the coming years SIM cards are expected to maintain their position as the biggest smart card segment in volume terms.

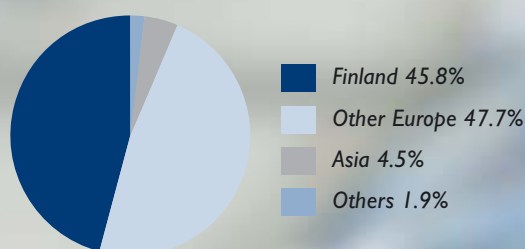
Key figures

EUR million	2003	2002
Net sales	45.9	50.7
Change from the previous year, %	-10	-27
Foreign sales	24.8	25.6
Operating profit (loss)	-4.5	-3,9
% of net sales	-10	-8
Profit (loss) before extraordinary items	-4.6	-4.0
% of net sales	-10	-8
Profit (loss) for the financial year	-4.4	-3,9
% of net sales	-10	-8
Earnings per share, EUR	-110	-98
Cash flow from business operations	0.5	-2.4
Depreciation	3.3	3.7
Capital expenditure on fixed assets excluding non-current investments	0.8	2.4
Return of investment, %	-26	-19
Equity ratio, %	46	61
Net gearing, %	20	10
Number of employees at 31 Dec.	349	418

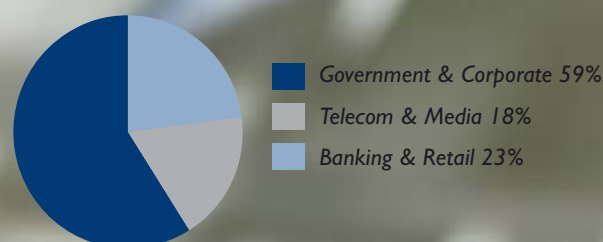
Setec Group's net sales by business units

EUR million	2003	2002
Government & Corporate		
Net sales	27.2	26.4
% of group net sales	59%	52%
Telecom & Media		
Net sales	8.4	12.1
% of group net sales	18%	24%
Banking & Retail		
Net sales	10.4	12.2
% of group net sales	23%	24%

Distribution of net sales by region 2003



Distribution of net sales by business unit 2003



*Setec's Board
of Directors appointed
Pekka Eloholma as the
President and CEO
of the company
with effect from
1 January 2004.*



Review by the President and CEO

New principal shareholder

In many respects 2003 was a milestone year in Setec's history. The year was marked, on the one hand, by production and financial difficulties and, on the other, by successes and new developments. A significant milestone in the company's 100-year history was reached in the autumn, when the Bank of Finland decided to relinquish its entire holding of Setec shares and sold its 40% stake in the company to funds managed by CapMan, a Finnish private equity investment company. The Bank of Finland's decision was based on the fact that in recent years the content of Setec's business has changed almost completely from traditional security printing to the manufacture of visual and electronic products for identification and transaction applications. In 2003 the company delivered 23 million 100 euro banknotes to the Bank of Finland, and banknote printing accounted for no more than 2% of the Group's total net sales. Passports accounted for 30% of net sales, visual ID products for 13% and smart cards for 34%.

Setec's new principal shareholder brings the company additional resources to develop its expertise and strengthen

its position in very competitive markets. In fact, at the end of 2003 Setec demonstrated its competitiveness as a supplier of products to public authorities by winning the international competitive tender for Denmark's biometric passport. The agreement made with the Danish authorities is an indication of the company's good standing and its strong technological know-how in the security products market.

Economically challenging year

The year 2003 was an economically challenging one for Setec. The Group's net sales fell to EUR 45.9 million (EUR 50.7m). The result was a loss of EUR 4.5 million (EUR -3.9m). The main reasons for the decline in net sales were subdued demand and low prices for SIM cards in the ITC sector and a year or two delay in the mass launch of EMV cards in the banking sector. Furthermore, the high level of the company's fixed costs especially in the first half of the year coupled with expenses due to the development of EMV technology and the biometric passport also weakened the

result. The first half of the year was a slack time for all of the company's business units. From the middle of the year onwards the markets started to pick up and all of the business units reported improved second-half net sales.

In the spring of 2003 Setec's production and economic difficulties led in April to the initiation of statutory employer-employee negotiations in order to adjust the operational structure and number of employees to the prevailing market and economic situation. As a result of the negotiations the Group's parent company made 28 employees redundant, laid off the entire staff for seven days, and decided not to extend any fixed-term employment contracts. Furthermore, the company reorganised its functions and operations in order to boost efficiency. As a result of these measures, Setec's fixed costs were considerably reduced, and the second-half result was much improved.

Strengthened position in the Baltic Rim markets

Setec strengthened its position on the Baltic Rim markets in all business areas during 2003. In the government sector Setec won two important passport tenders: Setec will deliver the Lithuanian passports in 2003–2004 and Denmark's new passports for the next five years. Setec's long-term development work on passports was rewarded when the company won the first ever international competitive tender for biometric passports. Denmark is the first country that has decided to order passports that comply with the International Civil Aviation Organisation's recommendations and are enabled for the future incorporation of biometric identifiers if necessary. The pilot version of the biometric passport developed by Setec was completed in 2003. Setec is the first passport manufacturer in the world capable of integrating into the highly secure polycarbonate data page a microchip on which biometric identifiers can be recorded.

In the Nordic countries the company forged even closer collaborative ties with TAG Systems International, especially in the banking sector. In the autumn this co-operation manifested itself in a concrete manner when Setec's Swedish subsidiary, Setec Card AB, acquired TAG Systems International's Swedish subsidiary, Card TAGnology AB. At the same time the name of Setec's Swedish subsidiary was changed to Setec TAG AB. The company's strength in the marketplace lies in the combination of Setec's smart card know-how with TAG Systems International's strong expertise

in service concepts. Setec TAG AB will focus in particular on ID products and serving customers in the banking sector.

Last year Setec was also able to strengthen its market in the Baltic states. The company delivered EMV and SIM cards to all of the Baltic states. Setec manufactured EMV cards for banks in Finland and seven other countries. Setec sold SIM cards to customers in the Nordic countries, in the Baltic states and also in China, where the company received orders for 1.5 million units in 2003.

Favourable outlook

The immediate goals for Setec are to achieve healthy growth in net sales and to put the business back on a profitable footing. Setec has all the means to achieve these goals because the passports, EMV cards, EID cards and SIM cards developed by the company are among the very best in the world. Also, the global markets for these products appear to be developing favourably at the moment.

However, growth and profitability will require the company to focus on its existing strengths more sharply than it has in the past. In addition to its extensive and technologically advanced product offering, the company's resources include a long tradition of security expertise, professionally competent personnel, a good market position and reputation and, above all, long-standing and confidential relationships with customers.

In future the company will focus more intently on deepening customer satisfaction. Setec aims to work together with customers on the design and development of products that will make a real contribution towards promoting their businesses. The principles of our business include being easily accessible and being ready to answer our customers' questions.

We also want to take good care of our employees' wellbeing and the development of their expertise. That will enable us to provide our customers and other partners with products and services of continuously improving quality.

I wish all of our customers, other partners and the employees of the company a successful year in 2004. I believe that we have years of favourable development in front of us.



Pekka Eloholma
President and CEO

& Government Corporate



Operating environment

During the review year demand for travel documents, especially passports, grew and public authorities around the world geared up for the introduction of biometric passports. These were the most important developments in the operating environment of the Government & Corporate business unit in 2003. The International Civil Aviation Organisation (ICAO) and the International Standards Organisation (ISO) continued to prepare specifications for the introduction of passports incorporating biometric identifiers. The final recommendations will probably be published in the first half of 2004.

In Finland two legislative changes occurred. From the beginning of 2003 Finnish paper-based ID documents ceased to be valid as official means of authenticating personal identity. Moreover, at the beginning of September an amendment to Finnish identity card legislation required all identity cards issued to adult persons to be chip-based smart cards.

Net sales

The net sales of the Government & Corporate business unit in 2003 were EUR 27.2 million (EUR 26.4m). Net sales were flat over the year but their composition changed markedly. Net sales from euro banknote deliveries declined significantly, the fall-off being offset almost entirely by growth in net sales from passport deliveries. Setec's banknote production accounted for about 5% of the unit's net sales in 2003.

Net sales from passports, electronic identity cards (EID) and visual identity cards grew in 2003. Passports and visual identity cards accounted for about 60% of net sales. Passport deliveries were up more than 50% on the previous year and

EUR million	2003	2002
Net sales	27.2	26.4
% of group net sales	59%	52%



Products and services

- Passports, biometric passports
- Electronic and visual identity cards
- Smart card applications and application programming interfaces (API)
- Euro banknotes and other security printing products
- Personalisation
- Consulting

Markets

- Nordic countries
- Baltic states
- Asia

Customers

- Public authorities
- Major companies



The general security features and durability of Setec's passport, responsive service, strong R&D resources and a successful track record as a supplier of demanding passport solutions, e.g. in Sweden, were all factors considered by the Danish authorities in selecting Setec as the supplier for their new passports at the end of 2003. The fact that Setec already had a demonstration version of a polycarbonate-based passport incorporating both high visual security and a biometric chip was also a decisive advantage. The Danish passport booklets are being manufactured by Setec in Finland and personalised by Setec Danmark AIS in Denmark.

they accounted for 32% of net sales. Deliveries of PKI-based smart cards developed for secure network transactions rose slightly.

About 39% of the unit's net sales came from Finland and 61% (59%) from abroad.

Customers and markets

Besides Finland, the Government & Corporate business unit's main markets are Sweden (25% of net sales), the other Nordic countries and the Baltic states. Non-European business accounts for about 5% of the unit's net sales.

The unit's biggest domestic customers in 2003 were the Ministry of the Interior, the Finnish Vehicle Administration (AKE), and the Social Insurance Institution of Finland (KELA). On the international market the biggest customers included the Swedish police authorities, the Norwegian juridical system, the Lithuanian Ministry of the Interior and the Singaporean immigration and employment authorities.

At the end of 2003 the Setec Group won an international competitive tender to supply the Danish passport, which will be the first in the world to be comply with the International Civil Aviation Organisation's new recommendations. Its data page will be enabled for incorporation of a microchip containing biometric identifiers. Deliveries of the new passport will begin at the end of 2004.

In 2003 the unit made an agreement with the Belgian Ministry of the Interior to supply, in partnership with the Belgian service provider Zetes, Belgium's EID cards in the years 2003–2007. Setec will supply the cards and Zetes will personalise and install the chips. Pilot shipments were made in 2003, and mass deliveries are expected to begin during

2004. The unit made two new agreements concerning the production of visas. Setec will supply Sweden's visas and residence permit cards over the period 2004–2006 as well as Estonia's new EU visas by May 2004. The unit also supplied the first security evaluated PKI-based smart cards for use by the Portuguese Bar Association.

Products

In 2003 Setec produced a pilot version of a passport in which a microchip can be incorporated into its polycarbonate data page. Biometric identifiers and other security features can be recorded on the chip.

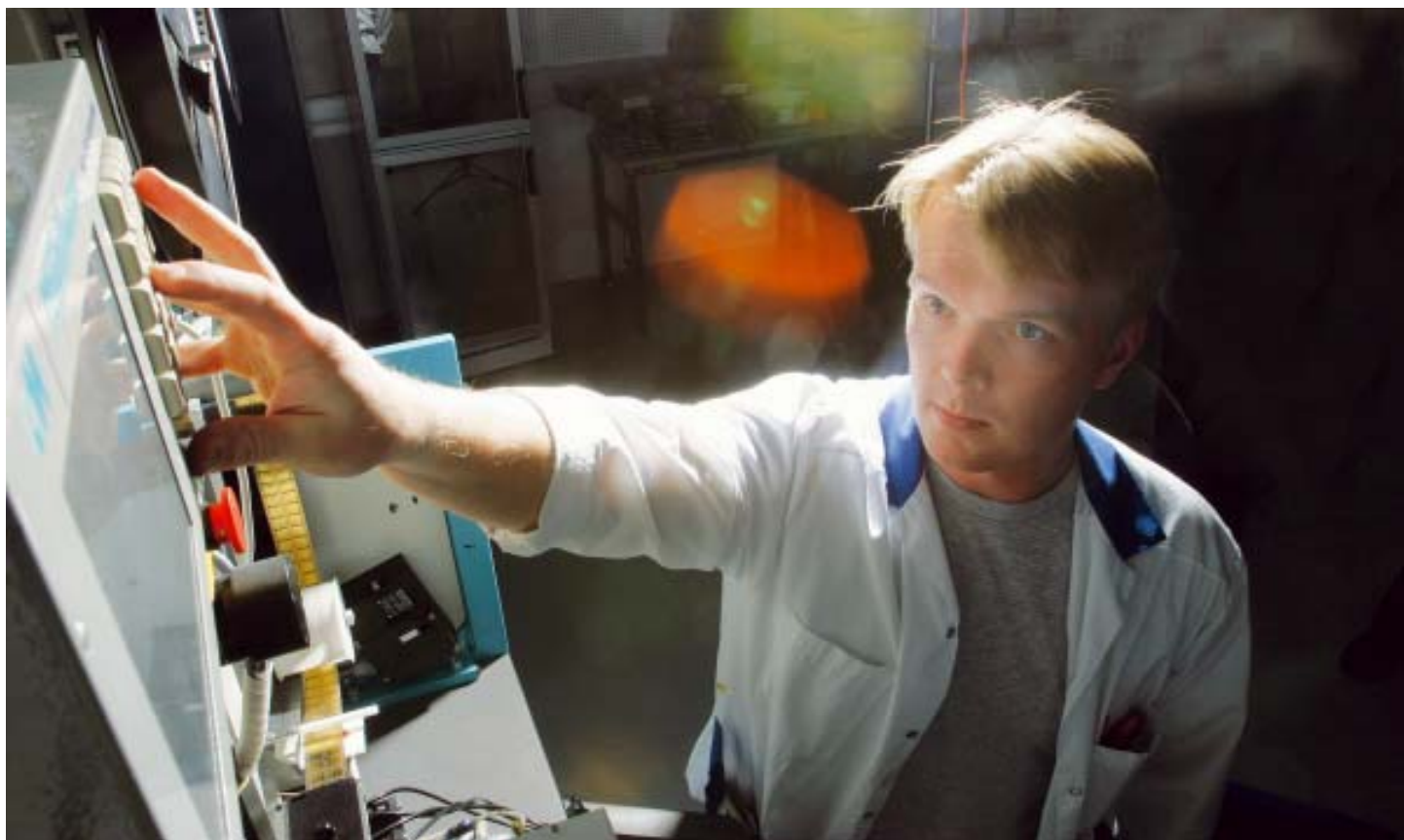
Setec also produced a new evaluated card operating system (SetCOS™ 4.4.1) for the 32K chip used in EID cards in connection with electronic identification, electronic transactions and digital signature.

The unit discontinued the production of physical access control cards for the corporate market.

Outlook

Strong demand relating especially to passports provides a favourable outlook for the Government & Corporate business area. A great many purchasing decisions concerning passports conforming to the ICAO's recommendations will be made during 2004 and 2005 in both Europe and Asia.

Deliveries of EID cards are also expected to increase, although the number of large-scale national EID project launches is expected to remain moderate. Deliveries of euro banknotes are quite unlikely in 2004 due to extremely fierce competition in this area.



Operating environment

In the first half of 2003 the Telecom & Media business unit's operating environment was subdued as customers' SIM card inventories were still high during that period. The SIM card market started to pick up in the second quarter and inventory levels were significantly lower by mid-summer. In the second half of the year, telecom operators stepped up the pace of 3G network testing and also initiated commercial rollouts. This resulted in increased demand for USIM cards.

The Finnish SIM card market picked up from July onwards, when it became possible for subscribers to transfer from one mobile phone operator to another without changing numbers. This stimulated demand for SIM cards as customers switching operators received new cards even though they kept the same phone number.

SIM card prices fell further during 2003, though the decline levelled off towards the end of the year. In 2003 the total number of SIM cards delivered to customers worldwide rose to 543 million, which was over 100 million more than in

EUR million	2003	2002
Net sales	8.4	12.1
% of group net sales	18%	24%



Products and services

- eSIM™ cards for 2G and 2.5G networks
- eSIM™ PKI solutions
- USIM cards for 3G networks
- Personalisation
- Consulting

Markets

- Nordic countries
- Baltic states
- Asia

Customers

- Telecom and service operators



Setec has been working in co-operation with Tele2 Latvia since 1997 and with all Tele2 operators in the Baltic states since 2003. The long-standing relationship is based on a successful product portfolio that fulfils customer needs and also on geographical proximity that enables close co-operation. Other essential elements of the partnership are the ability to respond quickly to changing customer needs and comprehensive and forward-looking product and technology consulting. At the beginning of 2003 Setec signed a frame agreement that covers all of the Tele2 Group companies.

2002. Global SIM card sales are expected to total 609 million in 2004 and 664 million in 2005.*

Net sales

The net sales of the Telecom & Media business unit in 2003 were EUR 8.4 million, which was significantly lower than in the previous year (EUR 12.1m). The first half of the year in particular was quiet because existing customers did not order new SIM cards due to the high level of their inventories. New customers have not yet begun to make orders and some prospective customer relationships failed to materialise. With the exception of the Chinese market, sales drives in the Asian markets were unsuccessful owing to very fierce price competition. From the latter half of the second quarter the unit's net sales picked up considerably, which showed up in the order book.

Foreign business accounted for 73% (58%) of the Telecom & Media business unit's net sales in 2003. The products generating the most net sales for the unit were the 16K, 32K and 32K PKI SIM cards.

Customers and markets

The unit's biggest customers in 2003 were Telenor (Norway), TeliaSonera Finland, Tele2 Baltia (Estonia, Latvia, Lithuania) and China Mobile, which received deliveries of SIM cards via Setec's Chinese partner. In January, Setec made a two-year frame agreement with Tele2 Group, as a consequence of which the unit gained all the Group's operators as new customers.

The unit's key market areas in 2003 were Finland, the Nordic countries, the Baltic states and China. Sales to Russia also started during 2003, with the first customers being won in the second half of the year.

New products

In 2003 the Telecom & Media unit introduced new versions of the 16K and 32K SIM cards as well as a 64 K SIM card which also supports 3G (USIM) and PKI functions. The first 3G customer pilots were launched before the end of the year. For mobile phone customers, new products and product versions mean greater effectiveness and security in the use of services, and also the opportunity to bring new and more versatile applications into use. The latest version of the SIM browser, WIB 1.2 was completed and its functionality certificated during the year.

Outlook

The Telecom & Media business unit's key customer relationships were strengthened in 2003, which will also have a positive impact on business in 2004. An active and sustained drive to win new customers has been made in the business unit's key markets of Finland, the Nordic countries and the Baltic states, and these new customers are expected to start making orders during 2004. Partner co-operation in the growing GSM markets of China and Russia also looks promising.

SIM card prices will continue to fall, but price competition appears to be abating. The unit's cost structure was made more competitive during 2003, setting the stage for a positive development in the business for 2004.

New 3G network rollouts, the centralisation of purchases by operators, Setec's renewed product range and the company's strong presence in and proximity to the unit's key market areas also indicate a favourable outlook for the Telecom & Media unit's business in 2004.

*) Source: Eurosmart Data and interviews on Smart Card Technology 10/2003. Frost & Sullivan 2002.

& Banking Retail

Operating environment

In the operating environment of the Banking & Retail business unit some banks began a phased transition to the use of EMV cards both in Finland and abroad during 2003. Nonetheless the majority of EMV card deliveries will not take place until 2005 and 2006. The main pressure for the migration to EMV cards comes from the continuing growth of card fraud. Chip cards also offer the banks an opportunity to differentiate themselves from their competitors, for instance, by providing their customers with more secure and versatile online banking services

In order to ensure their competitiveness and minimise the risks associated with card deliveries, large multinational banks prefer to select at least two suppliers for their EMV cards. Activation of the EMV market is also leading to fiercer price competition between the card vendors.

It is estimated that there were almost 100 million EMV cards on the market at the end of 2003. Furthermore, there were at least some payment terminals capable of handling EMV transactions in service already in 28 countries. In Setec's selected markets, the banks in the Baltic Rim region have been most active in bringing EMV cards into service.

Net sales

The net sales of the Banking & Retail business unit in 2003 were EUR 10.4 million (EUR 12.2m). The biggest single reason for the decline in net sales was still the slow progress of EMV projects, with the market's inadequate EMV readiness being a contributory factor. Many banks ordered fewer of the chip cards currently being used in the transitional phase, such as pure e-purse cards, because they are already anticipating the switch to EMV card distribution.



EUR million	2003	2002
Net sales	10.4	12.2
% of group net sales	23%	24%



Products and services

- EMV and multi-application cards
- Applications and software related to the cards
- Magnetic stripe cards
- Personalisation services
- Consulting

Markets

- Nordic countries
- Baltic states
- Poland
- Asia

Customers

- Banks
- Finnish retail and service sector customers

Setec has supplied various card products to Sampo Bank over the past twenty years. This long-standing partnership is based on fast and flexible customer service, advanced products, and card solutions tailored specifically to the needs of the bank. In 2003 Sampo Bank introduced new types of decorative motifs for the MasterCard and Visa payment cards that Setec manufactures for the bank. Altogether there are 12 new motifs, one of which is Marimekko's famous poppy flower design. In the manufacture of this lifestyle card Setec used the original Marimekko fabric as its model so that the colours would be reproduced as faithfully as possible when printed on the plastic. These lifestyle cards have achieved great popularity among Sampo's customers.



Chip-based payment cards accounted for a larger proportion of net sales than magnetic stripe cards, though the difference is still not great. Sales of chip cards were up 19% on the previous year, while net sales from magnetic stripe cards declined by 24%.

Business abroad accounted for 21% (24) of the unit's total net sales. Deliveries of EMV cards were made to customers in Finland and seven other countries: Denmark, Estonia, Latvia, Lithuania, Poland, Andorra and Malaysia. In the past Setec has made EMV card deliveries to Taiwan and South Korea, too. The Banking & Retail unit consulted with local personalisation companies and banks concerning their readiness for EMV personalisation.

Customers and markets

The Banking & Retail unit's business is focused on the markets of Finland, the Baltic states, Poland and the Nordic countries. In Asia the unit's strongest markets are Thailand and Malaysia, the latter taking deliveries of EMV cards in 2003.

On the Danish market the unit works together with Setec's associated company Setec Danmark A/S. The Swedish market is served in partnership with Setec's local subsidiary, which was renamed Setec TAG AB in 2003. In Norway the unit works in co-operation with TAG Systems AS.

EMV deliveries were made to all three Baltic states and a number of banks in Poland during 2003. In Poland Setec intensified its co-operation with PolCard, a local personalisation service provider. Setec acted as a consultant to PolCard in its EMV certification process. Chip-based payment cards were also delivered to the Middle East.

The unit's biggest customers in 2003 were Nordea,

OKOBANK Group, Sampo and Luottokunta in Finland and Hansabank Group in the Baltic states. Setec Danmark A/S's customers accounted for a significant proportion of the unit's net sales.

The unit agreed on EMV deliveries with Sampo, Samlink and Luottokunta in 2003. New customers included the Hansabanks in Estonia and Latvia, Svenska Handelsbanken, Nordea and ABN Amro in Poland.

Products

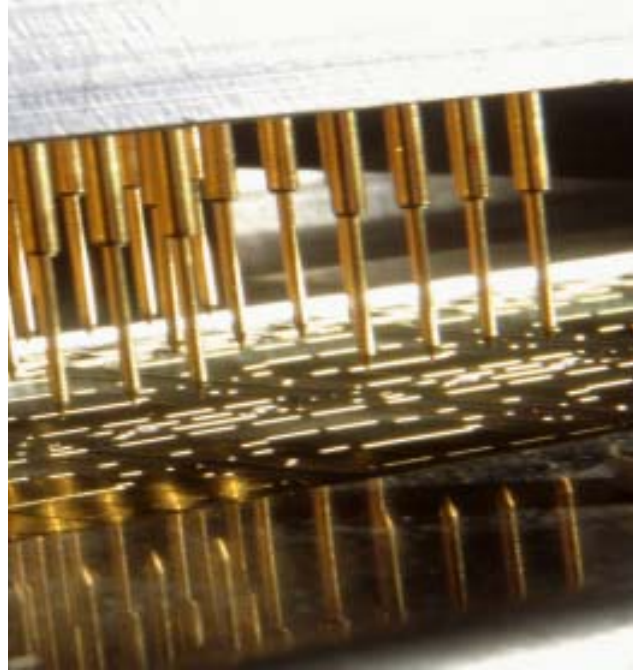
In 2003 the Banking & Retail unit's product development resources were focused on improving the readiness for EMV production. The MasterCard EMV certification process and the MasterCard EMV applet for the JAVA environment were completed during the year.

Outlook

The migration of the banks to EMV cards gathered pace. However, EMV preparations are still incomplete in many countries, and large-scale deliveries will not be made until 2005–2006.

The Banking & Retail unit's competitive advantages in the present climate of intensifying competition are its strong market position in the Baltic Rim region, good readiness for EMV production, excellent customer references, and successful relationships with partners. In the future, the focus of resource allocation will be on localisation, so that customer banks can be supported for the duration of the EMV project, e.g. by tailoring new products to customer requirements or by personalising cards for consumer use.

Research and product development



Setec's competitiveness in the manufacture and personalisation of highly secure smart card and ID products is based on specialisation, continuous product development and active co-operation with partners. Expertise in the field and knowledge of customer needs are an important part of Setec's product development, so product development representatives play an active role in customer projects.

Setec's product strategy is based on the needs of the company's customers and markets so that products developed by the company support the businesses of its clients as well as possible. Setec's card solutions comprise smart cards incorporating the SetCOS™ operating system, magnetic stripe cards, high-security ID cards and passports, personalisation systems for card and passport products, smart card interfaces, and consulting. For each card and passport version the product development unit constructs personalisation systems, some of which are also delivered to the Group's foreign production companies and partners.

Setec develops most of its products and solutions in-house at its product development units in Finland and Thailand. However, the company also collaborates in product development with a number of Finnish and foreign technology partners.

Pilot version of biometric passport completed

In 2003 Setec began product development work on a remotely readable chip-based passport suitable for biometric identification. During the year the product development unit completed the first pilot version of the passport, in which the processor chip is integrated into the passport's highly secure polycarbonate plastic data page. Thanks largely to this development work, Setec Group won an international competitive tender to supply the Danish passport, which will be manufactured in accordance with the International Civil Aviation Organisation's new recommendations, and will be enabled for future incorporation of a microchip containing biometric identifiers.

Another key product development project in 2003 was the development of the 64K Java card, Setec's SetCard+™, especially for the needs of banks and public authorities.

The product development projects of the Government & Corporate business unit included the SetCOS™ 32K card for PKI-based ID card solutions, which passed the ITSEC E3 High security evaluation. The card also complies with the provisions of the European Union's electronic signature directive. New versions of the SetWeb product and an EID applet for the Java™ card environment were completed during the year.

Most of the Banking & Retail business unit's product development needs were related to the creation and development of the company's own and its partners' EMV readiness. The MasterCard certification of Setec's EMV card and its related CAST security evaluation as well as the MasterCard applet for the Java™ card environment were completed during the year.

The most important product development projects of the Telecom & Media business unit were the PKI-based 64K USIM card for different types of network environments, such as the 3G UMTS network, and 16K and 32K SIM cards for the new scalable eSIM™ product family. The SIM card approved for the Chinese market was another significant achievement. The WIM applet for secure transactions on e.g. mobile networks was completed during the year.

The focus of Setec's research work was on cryptography, biometrics and materials technology. The company engages in applied research with the aim of exploiting the results directly in its own products.

In 2003 research and product development expenses represented 6.4% (5%) of the company's total net sales. At the end of 2003 there were 62 R&D employees in Finland and 11 in Thailand.

Demand will drive future R&D

Setec's research and product development in the near future will be driven by growing demand for biometric passports, EID cards and EMV cards, migration to Java-based SIM cards in mobile technology, 3G network rollouts and various European Union ID card projects. Common to all these projects are the high security and technology requirements of the products involved.

Human resources

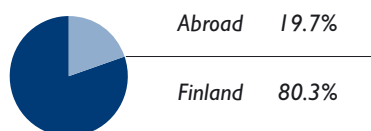


Changes in the personnel structure

The slower-than-expected development of the smart card market and the depressed state of some sectors that are important for Setec had a marked impact on the company's

Group personnel at 31 December	2003	2002
Setec Oy	285	373
Setec TAG AB	39	22
AB Svenska Pass	7	7
Setec Card (Thailand) Ltd.	18	16
Total	349	418

Group personnel abroad		
Subsidiaries	64	45
Setec Oy	5	8
Total	69	53



net sales and result. Indeed, in spring 2003 the parent company Setec Oy was forced for productional and financial reasons to initiate statutory employer-employee negotiations on personnel reductions. These negotiations led to 28 employees being made redundant. Furthermore, the whole workforce was laid off for seven days and all fixed-term contracts were terminated on the agreed dates. A major reorganisation of operations and functions inside the company was made in order to boost efficiency.

The reorientation of Setec's operations from traditional security printing to the smart card business over recent years continued to affect the personnel structure in 2003. Traditional security printing products now account for less than 10% of Setec's net sales, and banknote production generates a minimal proportion of the company's net sales compared with just a few years ago.

Internal training and retraining

As a result of the business's development, Setec's security printing employees were retrained during 2003 to take up posts in card production. Towards the end of the year retraining was also organised for those employees who were transferred to other assignments within the company after the statutory negotiations.

Internal product training events open to all Setec employees were organised during the spring. The aim of these events is to widen the personnel's understanding of the company's product offering and technological solutions beyond unit boundaries.

Functions outsourced

The practical manifestations of Setec's more intense focus on core businesses included the outsourcing of restaurant, cleaning, lobby, building maintenance and pay administration services. Outsourcing non-core functions to specialist external contractors will help to ensure the further development of these services in the future.





Report of the Board of Directors

Operating environment

The first half of 2003 was rather quiet in all of Setec's business areas, but the markets started to pick up in the second half. This manifested itself primarily in the form of increased demand for EMV and SIM cards, but interest in passports also grew towards the end of the year.

Increased demand for biometric passports in particular but also other travel documents was the most significant development in the operating environment of the Government & Corporate business unit. The public authorities in a number of countries are currently planning the introduction of biometric passports.

Sales of EMV cards rose especially in the second half of the year and the growth is expected to continue in 2004 as well. The introduction of EMV cards requires major infrastructure changes, and for that reason the migration to chip cards has been slower than expected. In Setec's selected markets, the banks in the Baltic states have been most active in the introduction of EMV cards.

The SIM card market also recovered in the second half of 2003. The first half of the year was slow owing to the large card stocks held by the telecom operators. The market picked up in the second half thanks to falling SIM card stock levels and 3G network rollouts. SIM card prices fell yet again in 2003.

Net sales and operating result

The Group's net sales in 2003 were EUR 45.9 million (EUR 50.7m), which was 9.5% down on the previous year. As much as 54.2% (50.4%) of the Group's net sales was generated abroad. The net sales of the parent company, Setec Oy, amounted to EUR 38.6 million (EUR 44.1m).

The Group's operating result was a loss of EUR 4.5 million (EUR -3.9m) and the result for the financial year was a loss of EUR 4.4 million (EUR -3.9m). Setec Oy's operating result was a loss of EUR 4.3 million (EUR -3.9m). Net sales were depressed especially by the slow first half of the year on the SIM and EMV markets. The operating result was weakened by high fixed costs in the first half, expenses arising from the development of the biometric passport and EMV technology, and lowered world market prices for SIM and EMV cards.

Provision was made in the annual accounts for product and leasing liability expenses in future years, and chip

inventories were written down mainly as a consequence of reduced chip prices. Non-recurring expenses booked in 2003 totalled EUR 2.25 million.

The Group's earnings per share were EUR -110 (EUR -98m), and the return on investment was -26% (-19%).

Financing and capital expenditure

Setec's financial position remains stable. The Group's interest-bearing liabilities totalled EUR 4.2 million (EUR 2.6m), of which the parent company Setec Oy's interest-bearing liabilities accounted for EUR 4.0 million (EUR 2.6m). The Group's equity ratio was 46% (61%) and net gearing was 20% (10%). The Group's distributable funds totalled EUR 1.0 million (EUR 5.5m). The Group had liquid assets and investments totalling EUR 2.1 million (EUR 1.2m) at the end of the financial year. Liquid assets and investments held by Setec Oy at the end of the year totalled EUR 0.3 million (EUR 0.2m). The total assets of the Group and Setec Oy were EUR 25.1 million (EUR 26.2m) and EUR 22.5 million (EUR 25.1m), respectively.

The Group's capital expenditure was EUR 0.8 million (EUR 2.4m), representing 2% of net sales (5%). Setec Oy's capital expenditure was EUR 0.8 million (EUR 2.2m), representing 2% of net sales. The most important capital expenditure items were systems necessary for the production of EMV cards as well as machines and graphical equipment.

Research and development

During the year the first pilot version of Setec's own biometric passport was completed. Integrated into the new passport's highly secure polycarbonate plastic data page is a microchip on which the passport holder's biometric identifiers can be recorded. Setec also continued to develop its own 64K Java™ card, Setec's SetCard+™, especially for the needs of banks and public authorities.

In addition to the biometric passport, the Government & Corporate business unit's product development projects also included the SetCOS™ 32K card for PKI-based ID card solutions, which was awarded the ITSEC E3 High certificate. The card also complies with the provisions of the European Union's electronic signature directive.

> > >

The Banking & Retail business unit's product development resources were targeted primarily at the creation and development of EMV readiness.

The most important product development projects of the Telecom & Media business unit were the PKI-based USIM card for different types of network environments, the 16K and 32K SIM cards for the new scalable eSIM™ product family, and the SIM card approved for the Chinese market.

In 2003 research and product development expenses represented 6.4% (5%) of the company's total net sales. At the end of 2003 there were 62 R&D employees in Finland and 11 in Thailand.

Personnel

The average number of employees in Setec Group in 2003 was 391 (462) and at the end of the year there were 349 (418) employees. Of these, 280 were located in Finland and 69 in other countries. As a consequence of statutory employer-employee negotiations conducted in the spring, Setec Oy made 28 employees redundant and decided not to extend any fixed-term employment contracts. The company also laid off the entire staff for seven days. The personnel reductions and lay-offs affected all the company's employees. Setec Oy also boosted the efficiency of its functions and operations by means of significant internal reorganisations.

Shares, shareholders and administration

Setec Oy's share capital is EUR 6.76 million. As the result of a bonus issue made during the year, the share capital rose by EUR 32,000 and the nominal value of each share is now exactly EUR 169. The company's ownership changed in October when the Bank of Finland sold its 40% stake in Setec Oy to funds managed by CapMan, a Finnish private equity investment company. At the same time Fennia Life Insurance Company Ltd sold its stake of just under one per cent in Setec Oy to CapMan's funds. The company's holdings of its own shares rose to just under 0.4% (0.2%) of the total shares in issue, and operative management's holdings fell correspondingly to 1.1% (1.3%).

The composition of the Board of Directors changed following the Bank of Finland's divestment of its holding. At the Extraordinary General Meeting held on 20 November 2003, Petri Niemi, Partner of CapMan Capital Management Oy, and Timo Tiihonen, Senior Advisor of CapMan Capital Management Oy were newly elected to serve as members of the Board of Directors.

The other members of the Board were Matti Packalén, B.Sc. (Econ.), M.Sc. (Eng.); Sakari Aaltonen, Senior Vice President,

Varma Mutual Pension Insurance Company; Mauri Jaakonaho, Senior Vice President, Finance and Administration, Metso Ventures; Juha Marjosola, President, Finnish Industrial Investment Ltd; and Anu Nokso-Koivisto, Director of the Finnish National Fund for Research and Development (Sitra).

Esa Ojanen, Head of Department at the Bank of Finland, who had served as a member of the Board of Directors up until the Extraordinary General Meeting, resigned from the Board. The Chairman of Setec Oy's Board of Directors was Matti Packalén and the Vice Chairman was Petri Niemi.

The company's auditors were KPMG Wideri Oy Ab with Nils Blummé and Kalervo Virtanen, Authorised Public Accountant, acting as auditors in charge. The deputy auditor was Heidi Vierros, Authorised Public Accountant, of KPMG Wideri Oy Ab.

In November 2003 Setec's Board of Directors appointed Pekka Eloholma to succeed Jyrki Lignell as the President and CEO of the company with effect from 1 January 2004.

Organisational changes

In the autumn of 2003 Setec's Swedish subsidiary, Setec Card AB, acquired TAG Systems International's Swedish subsidiary, Card TAGnology AB. In November the name of Setec's Swedish subsidiary was changed to Setec TAG AB. Setec Oy owns 56% of the company and Card TAGnology AB 44%. Erik Andersin, M.Sc. (Eng.), MBA continues as the Managing Director of the company.

Outlook

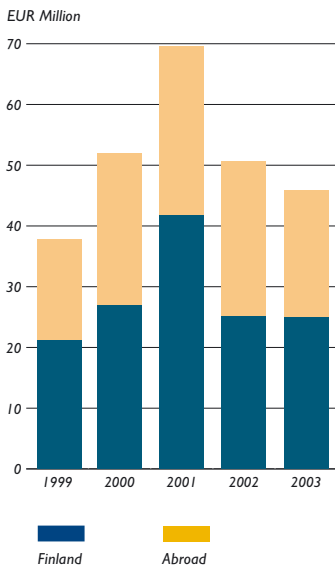
An essential feature of smart card and identity card markets is their continuing convergence, which means that more and more smart card chips will be used in passports and identity cards in the future.

This convergence holds much promise especially for the Government & Corporate business unit. In 2004 and 2005 many European and Asian countries will decide to procure chip-based biometric passports that comply with the recommendations of the International Civil Aviation Organisation.

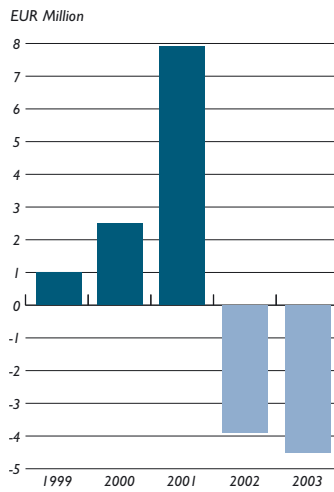
The timetable for the introduction of EMV cards will continue to be the biggest factor affecting the operating environment of the Banking & Retail business unit. The EMV project is gathering momentum all the time, but major deliveries will not take place until 2005–2006.

Intensifying price competition, especially on 2G SIM card market, is having an impact on the Telecom & Media unit's business. 3G networks will become more common in 2004, which is expected to give a boost to the unit's business.

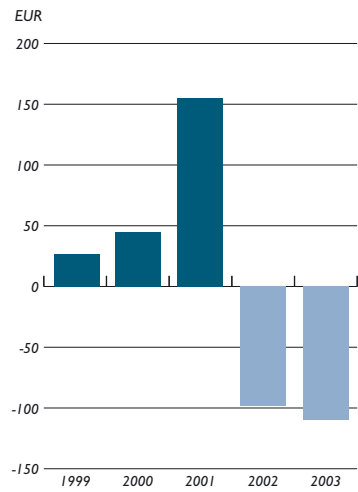
Net sales



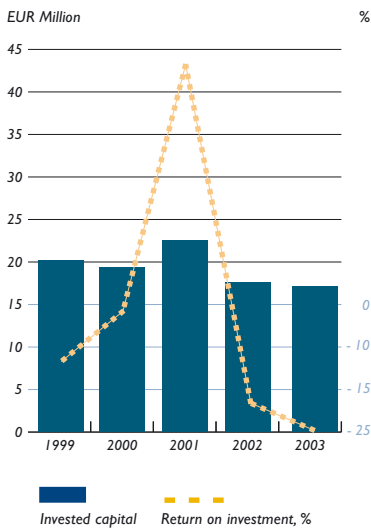
Operating profit



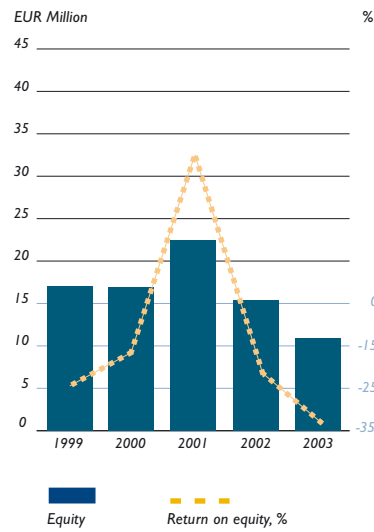
Earnings per share



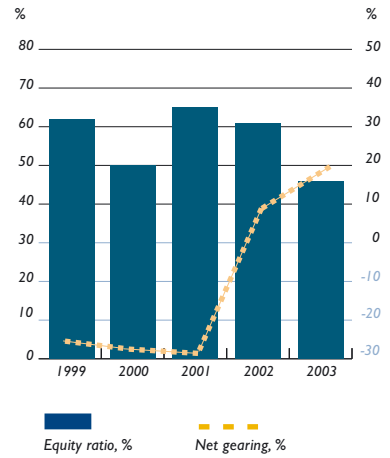
Return on investment



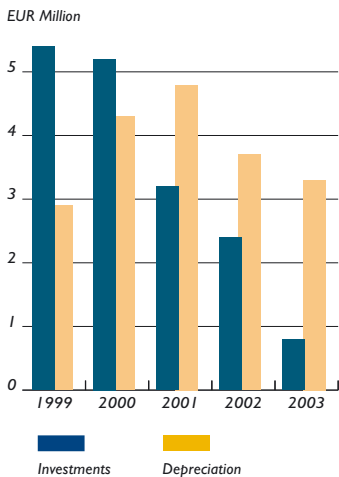
Return on equity



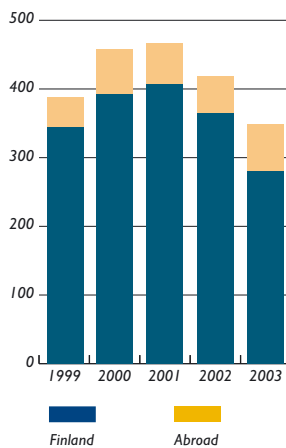
Equity ratio



Investments and depreciation



Personnel at 31 December



Income statements

1 000 €	Note	Group		Parent company	
		2003	2002	2003	2002
Net sales	1	45,889	50,725	38,583	44,067
Increase (+) or decrease (-) in stocks of finished products and work in progress		138	-868	138	-869
Production for own use		6	-	6	-
Share of profits of associated companies		38	143	-	-
Other operating income		627	531	450	583
Raw materials and services	2	-18,928	-19,058	-14,330	-15,211
Personnel expenses	3	-17,049	-19,093	-15,410	-17,599
Depreciation and value adjustments	4	-3,304	-3,708	-2,812	-3,290
Other operating costs and expenses	5	-11,944	-12,580	-10,880	-11,605
Operating profit (loss)		-4,527	-3,908	-4,255	-3,924
Financial income and expenses	6	-76	-56	-51	221
Profit (loss) before extraordinary items		-4,603	-3,964	-4,306	-3,703
Extraordinary items		-	-	-	-
Profit (loss) before appropriations and taxes		-4,603	-3,964	-4,306	-3,703
Appropriations	7	-	-	488	433
Profit (loss) before taxes		-4,603	-3,964	-3,818	-3,270
Income taxes	8	26	10	-	-106
Minority interest		177	22	-	-
Profit (loss) for the financial year		-4,400	-3,932	-3,818	-3,376

Balance sheets

1 000 €	Note	Group		Parent company	
		31.12.2003	31.12.2002	31.12.2003	31.12.2002
Assets					
Non-current assets					
Intangible assets	9	910	1,258	910	1,258
Goodwill on consolidation	10	223	186	-	-
Tangible assets	11	4,716	6,167	4,159	5,846
Holdings in associated companies	12	442	404	-	-
Non-current investment	13	51	51	1,401	1,358
Non-current assets, total		6,342	8,066	6,470	8,462
Current assets					
Stocks	14	7,638	8,524	6,647	8,030
Non-current receivables	15	-	-	1,370	898
Current receivables	16	9,020	8,532	7,755	7,528
Cash in hand and at banks		2,051	1,127	278	135
Current assets, total		18,709	18,183	16,050	16,591
		25,051	26,249	22,520	25,053
Shareholders' equity and liabilities					
Shareholders' equity					
Share capital	17	6,760	6,728	6,760	6,728
Reserve fund		2,624	2,656	2,624	2,656
Retained earnings		5,777	9,927	6,191	9,695
Profit (loss) for the financial year		-4,400	-3,932	-3,818	-3,376
Shareholders' equity, total		10,761	15,379	11,757	15,703
Minority interest		279	-125	-	-
Appropriations	18	-	-	-	488
Obligatory provisions	19	1,560	-	1,560	-
Liabilities					
Deferred tax liability	20	68	183	-	-
Non-current liabilities	21	1,615	182	1,499	-
Current liabilities	22	10,768	10,630	7,704	8,862
Liabilities, total		12,451	10,995	9,203	8,862
		25,051	26,249	22,520	25,053

Cash flow statements

EUR thousands	Group		Parent company	
	2003	2002	2003	2002
For business operations				
Operating profit (loss)	-4,527	-3,908	-4,255	-3,924
Adjustments to operating profit (loss)				
Depreciation	3,304	3,708	2,812	3,290
Change in obligatory provisions	1,560	-	1,560	-
Gain on sale of fixed assets	-17	-32	-17	-32
Share of profits of associated companies	-38	-143	-	-
Corporate profit on group premium on directed share issue	-229	-	-	-
Other adjustments	122	138	-	-
Cash flow before change in net working capital	175	-237	100	-666
Change in net working capital				
Increase (-) or decrease (+) in stocks	885	1,462	1,382	1,285
Increase (-) or decrease (+) in current receivables	-530	589	-181	890
Increase (+) or decrease (-) in non-interest-bearing liabilities	117	-1,768	-1,157	-2,225
Cash flow from operations before financial items and taxes	647	46	144	-716
Interest received	88	98	7	47
Interest paid	-155	-154	-81	-97
Other financial items	-	-	-14	-26
Taxes	-88	-2,438	-	-2,396
Cash flow from business operations, total	492	-2,448	56	-3,188
Capital expenditure				
Capital expenditure on tangible and intangible assets	-1,099	-2,360	-814	-2,169
Gain on disposal of tangible and intangible assets	54	119	54	119
Capital expenditure on other investments	-	-	-43	-
Loan repayments	-	-	-471	-
Dividends received from investments	-	255	-	255
Cash flow from investments, total	-1,045	-1,986	-1,274	-1,795
Cash flow before financing	-553	-4,434	-1,218	-4,983
Financing				
Acquisition of own shares	-129	-131	-129	-131
Sale of own shares	-	175	-	175
Drawings of long-term loans	1,598	-	1,499	-
Repayments of long-term loans	-	-62	-	-
Change in short-term financing	7	2,553	-9	2,553
Dividends paid	-	-3,191	-	-3,191
Financing, total	1,476	-656	1,361	-594
Change in liquid funds	923	-5,090	143	-5,577
Liquid funds, 1 January	1,127	6,217	135	5,712
Change	923	-5,090	143	-5,577
Liquid funds, 31 December	2,050	1,127	278	135

Accounting policy

Scope of the consolidated financial statements

The consolidated financial statements include the parent company, the subsidiary companies Setec TAG AB, Setec Sverige AB and Setec Card (Thailand) Ltd., in which the parent company holds over 50% of the conferred voting rights at the end of the financial year, and the joint venture AB Svenska Pass, of which Setec Oy owns 50%.

In addition, the accounts of the associated company Setec Danmark A/S have been consolidated by the equity method.

Principles of consolidation

The consolidated financial statements and the parent company's financial statements have been prepared in accordance with Finnish legislation and valid rules and regulations. The financial statements of foreign subsidiaries have been adjusted to correspond with Finnish accounting principles.

The consolidated financial statements have been prepared by applying the acquisition cost method. Mutual shareholdings have been eliminated using the acquisition cost method. Receivables, liabilities as well as intra-Group transactions and unrealised margins have been eliminated. Minority interests in the shareholders' equity and Group's profit have been separated and entered as a separate item. The items on the income statement, balance sheet and notes to the financial statements of the joint venture AB Svenska Pass have been consolidated in proportion to ownership. Joint decision-making authority in the company is based on a shareholders' agreement.

The accounts of Setec Oy's associated company Setec Danmark A/S have been consolidated using the equity method.

The income statements of foreign Group companies have been translated into euro using the average exchange rate for the financial year, and their balance sheets have been translated using the exchange rate quoted on the balance sheet date. In the elimination of mutual shareholdings, translation differences arising from changes in exchange rates are recorded in the shareholders' equity.

Valuation of intangible and tangible assets

Intangible and tangible assets are recorded on the balance sheet at acquisition cost less planned depreciation. Planned depreciation is calculated using the straight-line method over the economic lifetime of the assets in question. Depreciation is calculated from the first day of the month following the month of acquisition.

The depreciation periods are:

<i>Intangible rights</i>	<i>5 years</i>
<i>Goodwill</i>	<i>5–10 years</i>
<i>Other capitalised long-term expenses</i>	<i>5 years</i>
<i>Machinery and equipment</i>	<i>3–10 years</i>

Valuation of stocks

Stocks are valued according to the FIFO principle at acquisition cost or, if lower, their replacement cost or likely realisable value. The value of semi-finished and finished products includes, in addition to direct acquisition costs, the due proportion of manufacturing and depreciation charged in respect of production equipment.

Valuation of investments and liquid securities

Publicly quoted securities included in investment and liquid securities are valued at acquisition cost or, if lower, at the market value on the accounting date.

Net sales

Net sales are recorded as the invoicing values of products and services less indirect taxes connected with the sales, discounts, and exchange rate differences on the sales. Products and services are entered as income when payment is made.

Items denominated in foreign currencies

Transactions denominated in foreign currencies have been recorded at the exchange rate ruling on the transaction date. Receivables and liabilities denominated in foreign currencies have been valued using the exchange rate quoted by the Bank of Finland on the balance sheet date.

Research and development expenses

Research and development expenditure is entered as an expense in the year in which it is incurred, excluding non-recurring payments arising from the utilisation of intellectual property rights, which are written off over their estimated period of economic effect.

Pension commitments

Setec Oy has arranged pension cover for its personnel with a pension insurance institution. The insurance premiums have been recorded in the accounts in accordance with the principles of accrual accounting on the basis of a statement prepared by the pension insurance institution. A proportion of Setec Oy's personnel enjoy pension benefits superior to the statutory standard. This is based mainly on the situation prevailing prior to 1991, when Setec was part of the Bank of Finland's organisation. The supplementary pension cover in question has also been arranged with a pension insurance institution.

The pension cover of foreign companies has been arranged in accordance with local practice. The pension commitments of foreign companies have also been covered.

Extraordinary income and expenses

Major transactions that are not part of normal operations, for example the closure of business operations, are entered in the income statement as extraordinary items. The effects on the result of changes in accounting practice or procedures are also recorded as extraordinary items.

Expenditure commitments and losses

Expenditure commitments and losses that are considered to be certain or probable are included in the income statement items to which they, by their nature, belong. In the balance sheets the said expense provisions are entered as obligatory provisions in the case of extraordinary items and when there is uncertainty as to their amount or timing, and in other cases as accrued expenses and deferred income.

Taxes

Taxes on Group companies' profits for the financial year as well as adjustments to taxes of earlier financial years are recorded as income taxes in the income statements, as are deferred taxes.

Deferred tax liabilities and receivables have been calculated for all matching items between accounting and taxation using the confirmed tax rate of the succeeding years at year-end.

Deferred tax receivables have been recorded according to the amount of the estimated probable tax benefit.

Dividends

The Board of Directors' proposal on dividend distribution to the Annual General Meeting is not taken into account in the financial statements. Any possible dividend will be taken into account on the basis of the Annual General Meeting's decision.

Adjustments to the previous financial year's figures

Depreciation allowed under the Business Taxation Act and actually charged against taxation was about EUR 1 million less than the figure given in the financial statements. This has an effect on the result for the financial year, the deferred tax liability and the magnitude of the depreciation difference. The financial statements for the previous year have not been altered in these respects.

Notes to the financial statements

EUR million	Group			
1. Net sales by business unit	2003	2002		
Government & Corporate	27.2	26.4		
Telecom & Media	8.4	12.1		
Banking & Retail	10.4	12.2		
Total	45.9	50.7		
Foreign sales				
Nordic countries	15.7	14.7		
Rest of Europe	6.1	4.5		
Southeast Asia	2.1	3.9		
Others	0.9	2.5		
Foreign sales, total	24.8	25.6		
EUR thousand	Group		Parent company	
	2003	2002	2003	2002
2. Raw materials and services				
Materials and supplies				
Purchases during the financial year	13,389	15,414	10,459	12,900
Change in stocks	1,665	396	1,520	416
Materials and supplies, total	15,054	15,810	11,979	13,316
External services	3,874	3,248	2,351	1,895
Raw materials and services, total	18,928	19,058	14,330	15,211
3. Personnel expenses				
Wages and salaries	13,320	15,080	12,128	13,942
Pension expenses	2,371	2,561	2,295	2,510
Other personnel expenses	1,358	1,452	987	1,147
Total	17,049	19,093	15,410	17,599
Management fees and salaries				
Chief Executive Officer, Deputy Chief Executive Officer and members of the Board	556	581	453	520
Average number of personnel, Group and parent company during the financial year				
Salaried personnel	223	280	191	236
Workers	168	182	142	174
Total	391	462	333	410
Average number of personnel, Group and parent company during the financial year, total	349	418	285	373

	Group		Parent company	
	2003	2002	2003	2002
4. Depreciation and reductions in value				
Depreciation on intangible assets	573	711	475	613
Depreciation on tangible assets	2,731	2,997	2,337	2,677
Total	3,304	3,708	2,812	3,290
5. Other operating expenses				
Voluntary personnel expenses	348	877	295	748
Premises and security	3,363	3,116	2,885	2,854
Electricity and water	750	700	737	691
Supplies	640	964	598	905
Telephone and post	347	455	279	386
Travel and entertainment	952	1,536	856	1,413
Marketing and communications	199	634	188	631
Other external services	2,645	2,530	2,853	2,699
Other expenses	2,700	1,768	2,189	1,278
Total	11,944	12,580	10,880	11,605
6. Financial income and expenses				
Dividend income				
From participating interests	-	-	-	255
Dividend income, total	-	-	-	255
Interest income from long-term investments, total	-	-	-	255
Other interest and financial income				
From Group companies	-	-	49	38
From others	89	98	54	66
Other interest and financial income, total	89	98	103	104
Interest income from long-term investments and other interest and financial income, total	89	98	103	359
Interest and other financial expenses				
To others	164	154	153	138
Interest and other financial expenses, total	164	154	153	138
Financial income and expenses, total	-75	-56	-50	221
Exchange rate gains included in interest and financial income	-	-	50	19
Exchange rate losses included in interest and financial expenses	-	-	62	28
7. Appropriations				
Difference between depreciation according to plan and depreciation for taxation purposes	-	-	488	433
Total	-	-	488	433
In 2002 depreciation for tax purposes was approx. EUR 1 million less than that stated in the financial statements. This affects the net result, the tax liability and the magnitude of the depreciation difference. No changes have been made in the 2002 financial statements as a consequence of this.				
8. Income taxes				
Income taxes on business operations	90	33	-	-
Income taxes for previous years	-	106	-	106
Change in deferred tax liability	-116	-150	-	-
Total	-26	-11	-	106

	Group		Parent company	
	2003	2002	2003	2002

Notes to the balance sheets

Non-current assets

9. Intangible assets

Intangible rights

Acquisition cost 1 Jan.	2,279	2,012	2,260	1,993
Translation difference 1 Jan. – 31 Dec.	-	-	-	-
Increases 1 Jan. – 31 Dec.	125	267	125	267
Decreases 1 Jan. – 31 Dec.	-	-	-	-
Acquisition cost 31 Dec.	2,404	2,279	2,385	2,260
Accumulated depreciation 1 Jan.	-1,845	-1,632	-1,826	-1,613
Depreciation for the financial year	-209	-213	-209	-213
Accumulated depreciation 31 Dec.	-2,054	-1,845	-2,035	-1,826
Book value 31 Dec.	350	434	350	434

Other capitalised long-term expenses

Acquisition cost 1 Jan.	2,152	1,619	2,152	1,619
Increases 1 Jan. – 31 Dec.	2	533	2	533
Decreases 1 Jan. – 31 Dec.	-	-	-	-
Acquisition cost 31 Dec.	2,154	2,152	2,154	2,152
Accumulated depreciation 1 Jan.	-1,329	-928	-1,329	-928
Depreciation for the financial year	-266	-401	-266	-401
Accumulated depreciation 31 Dec.	-1,595	-1,329	-1,595	-1,329
Book value 31 Dec.	559	823	559	823

10. Goodwill

Acquisition cost 1 Jan.	1,021	1,017	-	-
Translation difference 1 Jan. – 31 Dec.	2	4	-	-
Increases 1 Jan. – 31 Dec.	297	-	-	-
Decreases 1 Jan. – 31 Dec.	-	-	-	-
Acquisition cost 31 Dec.	1,320	1,021	-	-
Accumulated depreciation 1 Jan.	-835	-738	-	-
Depreciation for the financial year	-262	-97	-	-
Accumulated depreciation 31 Dec.	-1,097	-835	-	-
Book value 31 Dec.	223	186	-	-

11. Tangible assets

Machinery and equipment

Acquisition cost 1 Jan.	39,115	37,768	36,724	35,528
Translation difference	8	-40	-	-
Increases 1 Jan. – 31 Dec.	1,114	1,560	686	1,369
Advance payments 1 Jan. – 31 Dec.	-	-	-	-
Decreases 1 Jan. – 31 Dec.	-178	-173	-37	-173
Acquisition cost 31 Dec.	40,059	39,115	37,373	36,724
Accumulated depreciation 1 Jan.	-32,948	-29,951	-30,878	-28,201
Depreciation for the financial year	-2,395	-2,997	-2,336	-2,677
Accumulated depreciation 31 Dec.	-35,343	-32,948	-33,214	-30,878
Book value 31 Dec.	4,716	6,167	4,159	5,846

Production machinery and equipment

Book value 31 Dec.	2,697	3,550	2,320	3,518
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	Group		Parent company	
	2003	2002	2003	2002
Holdings in participating interests and investments				
12. Shares in participating interests				
Acquisition cost 1 Jan.	404	516	506	506
Increases 1 Jan. – 31 Dec.	38	159	-	-
Decreases 1 Jan. – 31 Dec.	-	-271	-	-
Acquisition cost 31 Dec.	442	404	506	506
Book value 31 Dec.	442	404	506	506
13. Shares in Group companies				
Acquisition cost 1 Jan.	-	-	801	801
Increases 1 Jan. – 31 Dec.	-	-	43	-
Decreases 1 Jan. – 31 Dec.	-	-	-	-
Acquisition cost 31 Dec.	-	-	844	801
Book value 31 Dec.	-	-	844	801
Others				
Acquisition cost 1 Jan.	51	51	51	51
Increases 1 Jan. – 31 Dec.	-	-	-	-
Decreases 1 Jan. – 31 Dec.	-	-	-	-
Acquisition cost 31 Dec.	51	51	51	51
Book value 31 Dec.	51	51	51	51
Total book value of investments 31 Dec.	493	455	1,401	1,358

Goodwill according to the associated company's acquisition statement was fully depreciated at December 31, 2002.

Companies owned by the Group and parent company

Group companies	Setec Sverige AB	Setec TAG AB	Setec Card (Thailand) Ltd.
City of domicile	Tumba	Stockholm	Bangkok
Country of domicile	Sweden	Sweden	Thailand
Parent company holding, %	100	56.00	99.30
Group holding, %	100	56.00	99.30
Book value, parent company	EUR 775,328	SEK 12,471,270	EUR 68,303
Participating interests	AB Svenska Pass	Setec Danmark A/S	
City of domicile	Eskilstuna	Ballerup	
Country of domicile	Sweden	Denmark	
Parent company holding, %	50	47.50	
Group holding, %	50	47.50	
Profit for the financial year	SEK 3,646,797	DKK 592,543	
Book value, Group	0	EUR 442,083	
Book value, parent company	SEK 169,760	EUR 336,342	

14. Stocks

Materials and supplies	4,802	6,268	4,410	5,956
Work in progress	2,032	2,255	1,840	2,074
Finished products	804	-	398	-
Total	7,638	8,523	6,648	8,030

15. Long-term receivables from Group companies

Loan receivables	-	-	1,370	899
Long-term receivables, total	-	-	1,370	899

	Group		Parent company	
	2003	2002	2003	2002
16. Short-term receivables from Group companies				
Accounts receivable	-	-	428	43
Accrued income and deferred expenses	-	-	178	76
Receivables from participating interests				
Accounts receivable	1	190	1	190
Accrued income and deferred expenses	26	136	26	136
Receivables from other companies				
Accounts receivable	8,251	6,885	6,569	5,992
Other receivables	74	141	33	40
Accrued income and deferred expenses	668	1,180	520	1,051
Short-term receivables, total	9,020	8,532	7,755	7,528
Accrued income and deferred expenses				
Allocated statutory insurance premiums	173	630	173	630
Allocated interest and tax receivables	86	-	235	50
Other accrued income and deferred expenses	435	686	316	583
Accrued income and deferred expenses, total	694	1,316	724	1,263
Investments and securities				
Replacement value	105	57	105	57
Book value	51	51	51	51
Difference	54	6	54	6
17. Shareholders' equity				
Share capital 1 Jan.	6,728	6,728	6,728	6,728
Increases 1.1. – 31.12.	32	-	32	-
Share capital 31 Dec.	6,760	6,728	6,760	6,728
Reserve fund 1 Jan.	2,656	2,656	2,656	2,656
Decreases 1.1. – 31.12.	-32	-	-32	-
Reserve fund 31 Dec.	2,624	2,656	2,624	2,656
Retained earnings 1 Jan.	5,995	13,066	6,320	12,842
Dividends paid 1 Jan. – 31 Dec.	-	-3,191	-	-3,191
Translation difference	-89	8	-	-
Purchase of own shares	-129	-131	-129	-131
Sales of shares	-	175	-	175
Retained earnings 31 Dec.	5,777	9,927	6,191	9,695
Profit (loss) for the financial year	-4,400	-3,932	-3,818	-3,376
Shareholders' equity, total	10,761	15,379	11,757	15,703
The translation difference for 2003 relates mainly to corporate restructuring.				
Statement of distributable funds				
Retained earnings	5,777	9,927	6,191	9,695
Profit (loss) for the financial year	-4,400	-3,932	-3,818	-3,376
Portion of accumulated depreciation difference and voluntary provisions entered in shareholders' equity	-174	-453	-	-
Corporate profit on group premium on directed share issue	-229	-	-	-
Total	974	5,542	2,373	6,319

	Group		Parent company	
	2003	2002	2003	2002

Options

At the Annual General Meeting held on 29 May 1998 it was decided to issue share options, of which 600 are still outstanding. These entitle their holders to subscribe for 600 shares. If all the options are exercised the company's share capital will rise by EUR 0.1 million. The subscription period is 1 May 2001 to 30 May 2005. The exercising of these options is conditional on the attainment of an agreed operating margin before depreciation.

18. Appropriations

Appropriations in 2002 in the parent company (EUR 488,000) consist of the accumulated depreciation difference.

19. Obligatory provisions	1,560	-	1,560	-
Total	1,560	-	1,560	-

Obligatory provisions include estimated future expenses arising from certain product liabilities.

20. Deferred tax liabilities

Deferred tax liabilities consist of voluntary provisions, which in the consolidated financial statements are divided between shareholders' equity and deferred tax liability.

21. Non-current liabilities

Loans from financial institutions	1,615	16	1499	-
Other non-current liabilities	-	166	-	-
Non-current liabilities, total	1,615	182	1499	-

22. Current liabilities

Amounts owing to Group companies

Accrued expenses and deferred income	26	136	-	-
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Amounts owing to other companies

Loans from financial institutions	2,627	2,619	2,544	2,554
Advance payments received	857	1,170	593	870
Accounts payable	2,011	1,484	1,466	1,181
Other liabilities	1,005	1,202	557	728
Accrued expenses and deferred income	4,310	4,202	2,544	3,529
Current liabilities, total	10,836	10,813	7,704	8,862

Accrued expenses and deferred income

Charges relating to personnel expenses	2,031	2,281	2,031	2,281
Product liability	71	985	71	985
Immaterial rights payment	77	35	77	35
Other accrued expenses and deferred income	2,157	1,037	365	228
Total	4,336	4,338	2,544	3,529

Interest-bearing liabilities

Current liabilities	2,627	2,619	2,544	2,554
Non-current liabilities	1,615	16	1,499	-
Total	4,242	2,635	4,043	2,554

Other notes

	2003	2002
Pledges given, contingent liabilities and other commitments		
EUR thousand		
Bank guarantees		
Bank guarantees given on behalf of Setec Oy by financial institutions	455	462
Rental liabilities		
In 2004	2,325	2,315
Due later	8,976	11,105
Total	11,301	13,420

Rental liabilities concern rental agreements, which end in 4 and 8 years.

Leasing liabilities

In 2004	351	378
Due later	299	329
Total	650	707

Leasing liabilities consist mainly of ordinary company-car and copy machine leasing liabilities.

The premature termination of leasing agreements means that a certain percentage of the outstanding lease payments will be paid.

Derivative agreements

	2003		2002	
	Gross amount	Market value	Gross amount	Market value
Currency derivatives	406	36	-	-
Options				
Buy	-	-	1,250	16
Sell	-	-	1,250	-3

The Setec Group's foreign exchange risk is managed according to the foreign exchange policy approved by the Board of Directors. Setec's foreign exchange risk consists of transaction risk and valuation risk, namely the translation risk of capital denominated in foreign currency as well as subsidiary lending. The Group's internal netting, foreign exchange loans, foreign exchange forward contracts and foreign exchange options are used to hedge the foreign exchange position. Counterparty risk is avoided by entering into derivative contracts only with financially sound banks and credit institutions. Most transactions are denominated in euros and at least 50 percent of transaction positions are hedged. Valuation risks centre mainly on the Swedish crown, and 80 per cent of this position is hedged.

Proposal by the Board of Directors

The Board of Directors states that the distributable funds for the Group and the parent company are EUR 973,686.50 and EUR 2,373,046.48, respectively.

The Board of Directors proposes that no dividend will be paid and that the distributable funds will be transferred to the company's equity.

Vantaa, February 26, 2004

*Matti Packalén
Mauri Jaakonaho
Petri Niemi
Timo Tiihonen*

*Sakari Aaltonen
Juha Marjosola
Anu Nokso-Koivisto*

Auditors' report

To the shareholders of Setec Oy

We have audited the accounting records, the financial statements and the administration of Setec Oy for the financial year 1 January to 31 December 2003. The financial statements prepared by the Board of Directors and the Chief Executive Officer comprise the Board of Directors' report, consolidated and parent company income statements, balance sheets and notes to the financial statements. Based on our audit, we express an opinion on these financial statements and on the administration.

We have conducted the audit in accordance with generally accepted Finnish auditing standards. This requires that the accounting and the principles, substance and presentation of the financial statements are audited in sufficient scope to obtain reasonable assurance about whether the financial statements are free of material misstatement. The purpose of our audit of the administration is to assure ourselves that the members of the Board of Directors and the Chief Executive Office have legally complied with the provisions of the Companies Act.

In our opinion the financial statements have been prepared in accordance with the Accounting Act and other rules and regulations governing the preparation of financial statements. The financial statements give a true and fair view, as defined in the Accounting Act, of both the consolidated and parent company's result of operations as well as of the financial position.

The financial statements, including the consolidated financial statements, may be adopted and the members of the Board of Directors and the Chief Executive Officer of the parent company discharged from liability for the financial year audited by us. The appropriation of distributable funds proposed by the Board of Directors is in compliance with the Companies Act.

Helsinki, March 4, 2004

*KPMG Wideri Oy Ab
Nils Blummé
Authorised Public Accountant*

*KPMG Wideri Oy Ab
Heidi Vierros
Authorised Public Accountant*

Key indicators

	2003	2002	2001	2000	1999
Scope and profitability of operations, EUR million					
Net sales	45.9	50.7	69.8	51.8	37.7
Change from the previous year, %	-10	-27	35	37	-4
Depreciation	3.3	3.7	4.8	4.3	2.9
Operating profit (loss)	-4.5	-3.9	7.9	2.5	1.0
% of net sales	-10	-8	11	5	3
Profit (loss) before extraordinary items	-4.6	-4.0	8.6	2.4	1.4
% of net sale	-10	-8	12	5	4
Profit (loss) before taxes	-4.6	-4.0	8.7	0.8	1.4
% of net sales	-10	-8	12	1	4
Profit (loss) for the financial year	-4.4	-3.9	6.3	1.2	1.1
% of net sales	-10	-8	9	2	3
Return on equity, %	-35	-21	32	9	5
Return on investment, %	-26	-19	43	14	8
Research and development expenses	2.9	2.5	2.7	3.0	1.2
% of net sales	6	5	4	6	3
Number of employees					
At end of financial year	349	418	466	458	388
Average for the financial year	391	462	479	430	387
Financing and financial position, EUR million					
Cash flow from business operations	0.5	-2.4	8.9	4.7	2.1
Capital expenditure on fixed assets excluding non-current investments	0.8	2.4	3.2	5.2	5.4
% of net sales	2	5	5	10	14
Equity ratio, %	46	61	65	50	62
Net gearing, %	20	10	-27	2	4
Interest-bearing liabilities	4.2	2.6	0.2	2.9	3.2
Share-related indicators, EUR					
Earnings per share	-110	-98	155	45	27
Diluted earnings per share	-108	-97	152	45	26
Cash flow from business operations per share	12	-61	228	121	56
Equity per share	269	384	561	424	425
Dividend per share	0	0	80	17	25
Dividend-to-earnings ratio	0	0	52	37	95
Number of shares					
At end of financial year	40,000	40,000	40,000	40,000	40,000
Average for the financial year	40,000	40,000	40,000	40,000	40,000

Calculation principles of financial ratios

Return on equity, %	= 100 x	$\frac{\text{Profit before extraordinary items - taxes +/- tax effect of extraordinary items}}{(\text{Shareholders' equity} + \text{minority interests} + \text{untaxed reserves and accumulated depreciation difference less deferred tax liability})}$ (average for the financial year)
Return on investments, %	= 100 x	$\frac{\text{Profit before extraordinary items} + \text{interest and other financial expenses}}{\text{Balance sheet total} - \text{non interest-bearing liabilities}}$ (average for the financial year)
Equity ratio, %	= 100 x	$\frac{\text{Shareholders' equity} + \text{minority interests} + \text{untaxed reserves and accumulated depreciation difference less deferred tax liability}}{\text{Balance sheet total} - \text{advance payments received}}$
Net gearing, %	= 100 x	$\frac{\text{Interest-bearing liabilities} - \text{current and non-current investments} - \text{cash in hand}}{\text{Shareholders' equity} + \text{minority interests} + \text{untaxed reserves and accumulated depreciation difference less deferred tax liability}}$
Earnings per share	=	$\frac{\text{Profit before extraordinary items} +/- \text{minority interests} - \text{taxes} +/- \text{tax effect on extraordinary items}}{\text{Average number of shares}}$
Equity per share	=	$\frac{\text{Shareholders' equity}}{\text{Number of shares at the end of period}}$
Dividend per share	=	$\frac{\text{Proposed or paid dividend}}{\text{Number of shares at the end of period}}$
Dividend-to-earnings ratio, %	= 100 x	$\frac{\text{Dividend per share}}{\text{Earnings per share}}$

Shares and shareholders

The share capital of Setec Oy is EUR 6.76 million. Due to a share splitting the share capital has grown by EUR 32,000 and the nominal value of the company's share is now EUR 169. The company has one share series and each share carries one vote.

Shareholders at 31 December 2003

	Number of shares	% of shares and votes
<i>Funds managed by CapMan</i>	16,380	41.0
<i>Finnish National Fund for Research and Development Sitra</i>	9,277	23.2
<i>Finnish Industry Investment Ltd</i>	6,153	15.4
<i>Varma Mutual Pension Insurance Company</i>	3,970	9.9
<i>Sampo Life Insurance Company Limited</i>	3,620	9.1
<i>Executive management</i>	455	1.1
<i>Own shares controlled by the company</i>	145	0.4
<i>Total</i>	40,000	100.0*

The Board of Directors has no valid authorisations to decide on new share issues, grant share options or issue convertible bonds.

The Board of Directors has no valid authorisation to transfer the own shares controlled by the company. The Board of Directors has no valid authorisation to purchase the company's own shares.

**Due to rounding the percentage figures do not exactly total 100%*

The administration of Setec Oy

Ultimate responsibility for the administration and management of the Group resides with Setec Oy's official administrative bodies, which are the Annual General Meeting, the Board of Directors and the Chief Executive Officer. The administrative bodies have not been assigned any special responsibilities over and above those required by law.

The Annual General Meeting, which is usually convened once a year, is the company's supreme decision-making body. Each year, among other things, it approves the company's income statement and balance sheet and decides on the payment of a dividend. The Annual General Meeting elects the members of the Board of Directors, who then elect the Chairman of the Board and the Vice Chairman of the Board from among their number. According to the company's Articles of Association, the period of office for the members of the Board of Directors ends at the close of the next Annual General Meeting after their election. The company's Board of Directors consists of at least three and not more than seven members. In 2004 there are six members serving on the Board of Directors. The Chief Executive Officer of the company is not a member of the Board of Directors. The Board meets about ten times a year.

According to the Companies Act the task of the Board of Directors is to attend to the administration of the company and to organise its operations appropriately. The Board of Directors must also decide on such matters that are unusual and far-reaching in terms of the scope and quality of the company's operations. In order to fulfil these general obligations, the duties of the company's Board of Directors also include, in addition to the duties expressly prescribed in the Companies Act, approving the selection of the Chief Executive Officer's direct subordinates, confirming the company's strategy and budget as well as monitoring that it is adhered to, deciding on business arrangements, significant investments and loans, and confirming the senior management's salaries and other benefits as well as personnel policy.

The shareholders have made an agreement concerning their rights to appoint the members of the Board of Directors and the terms of the redemption clause in the Articles of Association.

The boards of directors of subsidiaries and associated companies are composed of members of Setec Oy's Board of Management as well as outsiders who can contribute added value to the operations of the companies.

Setec Oy's Chief Executive Officer has the task of managing and supervising the company's business operations in accordance with instructions and regulations issued by the Board of Directors. The Chief Executive Officer is appointed by the Board of Directors. The Chief Executive Officer is supported within the company by the Board of Management, its members being those executives responsible for Setec Oy's strategically critical functions. The Board of Management meets on average twice a month. The members of the Board of Management and their areas of responsibility are presented in the section Board of Directors, Board of Management and Auditors.

The salaries and fees paid to the Chief Executive Officer, the Executive Vice President and the members of the Board of Directors are presented in the notes to the financial statements. The members of the Board of Directors receive fees approved by the Annual General Meeting in respect of individual meetings. No separate compensation is paid to the members of the management in respect of board membership of subsidiaries or associated companies.

Board of Directors

31 December 2003



Matti Packalén
Chairman of the Board
b. 1947, B.Sc. (Econ.),
M.Sc. (Eng.),
D.Sc (B.A.) h.c.
Board member
since 2002



Juha Marjosola
Finnish Industry Investment Ltd,
Managing Director
b. 1952, M.Sc. (Econ.)
Board member
since 1998



Petri Niemi
Vice Chairman of the Board
CapMan Capital
Management, Partner
b. 1961, M.Sc. (Eng.)
Board member since 2003



Sakari Aaltonen
Varma Mutual Pension Insurance
Company, Senior Vice President,
IT and Administration
b. 1952, M.Sc.
Board member
since 1998



Timo Tiihonen
CapMan Capital Management,
Senior Advisor
b. 1948, M.Sc. (Eng.),
M.Sc. (Econ.)
Board member since 2003



Mauri Jaakonaho
Metso Corporation
Senior Vice President, Finance
Metso Ventures
b. 1946, M.Sc. (Econ.)
Board member since 1995



Anu Nokso-Koivisto
Finnish National Fund for Research
and Development Sitra, Director
b. 1957, M.Sc. (Eng.)
Board member
since 1998

Board of Management

18 March 2004

Pekka Eloholma
President and CEO
b. 1960, M.Sc. (Eng.)



Liisa Varjokallio
Senior Vice President
Human Resources
b. 1952, M.Soc.Sc., eMBA



Antti Metsäranta
Senior Vice President
Production
b. 1947



Jukka Virtamo
Senior Vice President
Finance and IT
b. 1959, M.Sc. (Econ.)



Tommi Nordberg
Senior Vice President
Sales & Marketing
b. 1963, M.Sc. (Eng.)



Tuovi Henttu
Senior Vice President
R&D
b. 1960, M.Sc.



Jorma Tuomimäki
Vice President
Staff representative
b. 1949

AUDITORS 2003

Nils Blummé
A.P.A.

Kalervo Virtanen
Professor, A.P.A.

Deputy Auditor
KPMG WIDERI OY AB
Authorised Public Accountants

Glossary

API

Application Programming Interface. Programming interface by which an additional function, for example a smart card based service, can be connected to an application or system.

Applet

Small software application by which new features and functionalities can be included in a smart card even after the card has been issued, e.g. EMV, PKI or electronic purse application.

Biometrics

Measurement of certain physical (fingerprint) or biological (voice) characteristics of an individual to create a unique identifier, which can be electronically stored and compared for positive identification purposes.

CAST

Compliance Assessment and Security Testing program.

A security evaluation program for smart card software and chip components established by MasterCard. All new MasterCard EMV card products have to be security evaluated as part of MasterCard EMV card type approval.

CDMA

Code Division Multiple Access. Digital cellular network technology used in mobile phone networks e.g. in North America and China.

EID

Electronic identity is stored on a smart card using PKI technology and containing a secret (private) key and the corresponding certificate issued often by the authority guaranteeing the identity of the holder. Such EID can be used in open networks, e.g. for positive identification and signing documents electronically.

Digital signature

Digital signature, produced for an electronic document, which guarantees the document's authenticity and integrity, which in turn makes the document legally binding.

EMV

The common specification by **Europay, Mastercard and Visa** for a payment application on a smart card.

GPRS

General Packet Radio Service. Technology developed for GSM networks by which data can be quickly transferred in packet form. A connection does not have to be opened for data transfer separately, because a GPRS phone can send and receive data continuously.

ID

Identity. See also EID.

Key management

Procedures and services to manage secret keys in a smart card based service. In PKI architecture it is important that the generation, use and storage of secret keys are reliable. When key management is arranged carefully, it is possible to use smart cards to manage multi-application solutions.

Laser engraving

Personal details including a portrait can be burned three dimensionally inside a plastic identity card or passport data page using a laser beam. No ink-like material is transferred using the technology, so the finished document cannot be forged later.

Personalisation

The incorporation of a card holder's personal details either visually on an identity document or electronically into the smart card's microcircuit, as required by the issuer.

PKI

Public Key Infrastructure. Architecture, procedures and policies for managing a public key cryptography environment. PKI is used to issue and manage public and private keys and certificates, which comprise the basis for secure communications and transactions. The public-private keypair is used for encryption and decryption of data. A certificate includes the user's public key and identity digitally signed by a trusted third party (certificate authority, CA). PKI enabled smart card can facilitate reliable identification, electronic (digital) signatures, data integrity and, if necessary, data confidentiality.

SIM

Subscriber Identity Module. A smart card used in the GSM system inside the mobile phone containing, among other things, the user's subscription information and confidential identity data.

Smart card

A plastic card, the size of a credit card or SIM card, which has an embedded microcircuit containing a microprocessor and memory. The card's operating system controls access to the memory and usage of the data. A smart card is a secure storage place for confidential information. The most common smart card is the SIM card used in mobile phones.

UMTS

Universal Mobile Telecommunications System. Third generation mobile phone system used in Europe. UMTS will offer up to 200 times faster data transmission speed than GSM enabling a wide range of voice, data and multimedia services.

USIM

Universal Subscriber Identity Module. SIM card used in third generation UMTS mobile networks. See also SIM.

WAP

Wireless Application Protocol. Data transfer protocol for mobile phones to access e.g. Internet services and e-mail.

WIB

Wireless Internet Browser. A SIM toolkit application, which provides a simple-to-use interface for wireless value-added-services such as information, entertainment, and secure mobile commerce.

WIM

WAP Identity Module. An identification module used in WAP services. It enables the authentication of both the user and the service provider, encryption of the communication and creation of a digital signature. WIM can be a part of SIM card functionality (so-called SWIM card) or a separate card.

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ASSOCIATED COMPANIES****Setec TAG AB**

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