

13. ACCOUNTANTS' REPORT



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13 MAY 2005

The Board of Directors
MLABS Systems Berhad
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Dear Sirs

Accountants' Report

This report has been prepared by Messrs KPMG, an approved company auditor, for inclusion in the Prospectus to be dated **27 MAY 2005** in connection with:

- i. the public issue of 26,150,850 new ordinary shares of RM0.10 each in MLABS Systems Berhad at an issue price of RM0.55 per ordinary shares payable in full upon application (hereinafter referred to as "MLABS " or "the Company") comprising:
 - a) 3,000,850 new ordinary shares of RM0.10 each to eligible Directors, employees and business associates of MLABS and its subsidiary ("MLABS Group" or "Group");
 - b) 21,150,000 new ordinary shares of RM0.10 each by private placement to identified placees; and
 - c) 2,000,000 new ordinary shares of RM0.10 each to Malaysian public.

and

- ii. the listing of and quotation for the entire issued and paid-up share capital of MLABS on the Malaysian Exchange of Securities Dealing & Automated Quotation Berhad ("MESDAQ") market of the Bursa Malaysia Securities Berhad ("Bursa Malaysia").

1 General information

1.1 Background

- 1.1.1 MLABS was incorporated in Malaysia on 21 May 2004 as a public limited company under the Companies Act, 1965. The principal activity of MLABS is that of investment holding.



KPMG. KPMG, a partnership established under Malaysian Law, is a member of KPMG International, a Swiss cooperative.

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1.2 Share Capital

At the date of incorporation, MLABS's authorised share capital was RM100,000 comprising of 1,000,000 ordinary shares of RM0.10 each and its issued and paid-up share capital was RM2.00 consisting of twenty (20) ordinary shares of RM0.10 each. The authorised share capital was increased to RM50,000,000 comprising 500,000,000 shares of RM0.10 each on 30 March 2005.

Pursuant to the listing scheme, including the listing of and quotation for the entire issued and paid-up share capital of MLABS on the MESDAQ market as set out below, the issued and fully paid-up share capital of MLABS will be increased to RM10,215,700 comprising 102,157,000 ordinary shares of RM0.10 each as shown below:

| Date of allotment | Number of ordinary shares at par value of RM0.10 each | Issue price per ordinary share RM | Purpose | Total issued and paid-up share capital RM |
|--------------------|---|--------------------------------------|--|--|
| Upon incorporation | 20 | 0.10 | Subscribers' shares | 2 |
| 31.3.2005 | 76,006,130 | 0.10 | Pursuant to the acquisition of MSB | 7,600,615 |
| To be allotted | 3,000,850 | 0.55 | Public issue for eligible Directors, employees and business associates | 7,900,700 |
| To be allotted | 21,150,000 | 0.55 | Placement for identified places | 10,015,700 |
| To be allotted | 2,000,000 | 0.55 | Public issue | 10,215,700 |

1.3 Listing scheme

In conjunction with and as part of the listing of and quotation for the entire enlarged issued and paid-up share capital of MLABS on the MESDAQ market, MLABS undertook the following restructuring and listing scheme. The restructuring scheme involved the following exercise:

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1.3.1 Acquisition of Multimedia Research Lab Sdn Bhd ("MSB")

Acquisition of the entire issued and paid-up share capital of the MSB, comprising 5,000,000 ordinary shares of RM1.00 each, for a total consideration of RM7,600,613 satisfied by the issuance of 76,006,130 new ordinary shares of MLABS of RM0.10 each at an issue price of RM0.10 per ordinary share credited as fully paid. The acquisition was completed on 31 March 2005.

The purchase consideration of RM7,600,613 was determined based on the audited shareholders' funds of MSB at 31 December 2003 of RM4,021,655, after adjusting for the increase in issued and paid-up share capital of 500,000 and 435,000 ordinary shares of RM1.00 each at issue price of approximately RM1.16 and RM6.90 per share respectively, totalling RM3,578,958 in April and May 2004.

1.4 Listing and quotation

1.4.1 In conjunction with the listing of and quotation for the entire enlarged issued and paid up share capital of MLABS on the MESDAQ market, MLABS will undertake a public issue of 26,150,850 new ordinary shares of RM0.10 each representing approximately 25.60% of the enlarged issued and paid-up capital of MLABS at an issue price of RM0.55 each payable in full on application, allocated as follows:

- a) 3,000,850 new ordinary shares of RM0.10 each available for application by eligible Directors, employees and business associates of the MLABS Group;
- b) 21,150,000 new ordinary shares of RM0.10 each available by way of placement to identified places; and
- c) 2,000,000 new ordinary shares of RM0.10 each available for application by the Malaysian public.

1.4.2 Flotation

Listing of and quotation for the entire issued and paid-up share capital of MLABS on the MESDAQ market of the Bursa Malaysia.

1.4.3 Employees' Share Option Scheme ("ESOS")

Establishment of an ESOS of up to 10,215,000 new ordinary shares of RM0.10 each in MLABS representing 10% of the issued and paid up share capital of MLABS for the benefit of eligible Directors and employees of the MLABS Group upon listing on the MESDAQ market.

13. ACCOUNTANTS' REPORT (Cont'd)**1.5 Information on the subsidiary**

The MLABS Group (or "Group") comprises MLABS and the following subsidiary, which is incorporated in Malaysia as private limited company under the Companies Act, 1965. The subsidiary and its principal activities are as follows:

| Subsidiary | Date of incorporation | Issued and paid-up capital RM | Effective equity interest % | Principal activity |
|------------|-----------------------|-------------------------------|-----------------------------|---|
| MSB | 28.7.1997 | 5,000,000 | 100 | Engaged in the business of research and development in multimedia videoconferencing systems as well as assembling and trading of multimedia videoconferencing systems and equipment |

1.6 Financial statements and auditors

The financial year end of all the companies is 31 December. KPMG were the auditors of MSB for the financial years ended 31 December 2002 to 2004, and MLABS since incorporation. The audited financial statements of MSB for the period/years ended 31 December 2000 to 2001 were audited by another firm of accountants.

As MLABS was incorporated on 21 May 2004, the first set of audited financial statements was made up to 31 December 2004.

The auditors' reports of MSB for the financial period/years under review were not subject to any qualification.

1.7 Dividends

1.7.1 MLABS has not paid or declared any dividends since its incorporation on 21 May 2004.

1.7.2 MSB has not paid or declared any dividends for the financial years/period under review.

2 Financial performance

We set out below the summarised proforma consolidated results of MLABS Group for the five (5) financial years/period ended 31 December 2000 to 2004 respectively after making such adjustments as we considered necessary on the assumption that the MLABS Group had been formed throughout the years/period under review. The following results are to be read in conjunction with the notes thereon.

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2.1 The MLABS Group – Proforma consolidated results

The following results are to be read in conjunction with the notes thereto:-

| | 15 months ended 31.12.00 RM'000 | Year ended 31.12.01 RM'000 | Year ended 31.12.02 RM'000 | Year ended 31.12.03 RM'000 | Year ended 31.12.04 RM'000 |
|---|--|----------------------------------|----------------------------------|----------------------------------|----------------------------------|
| Revenue | 537 | 1,041 | 917 | 2,556 | 5,042 |
| Profit/(Loss) before depreciation, amortisation and interest | (209) | 246 | 356 | 1,277 | 2,361 |
| Depreciation | (141) | (124) | (176) | (201) | (134) |
| Amortisation | - | (190) | (380) | (506) | (895) |
| Interest expense | (6) | (18) | (19) | (36) | (85) |
| Profit/(Loss) before taxation | (356) | (86) | (219) | 534 | 1,247 |
| Taxation | - | - | (1) | - | (9) |
| Profit/(Loss) after taxation | (356) | (86) | (220) | 534 | 1,238 |
| Number of ordinary shares of RM0.10 each assumed in issue ('000) | 102,157 | 102,157 | 102,157 | 102,157 | 102,157 |
| Earnings/(Loss) per share (sen) | | | | | |
| Gross | (0.35) | (0.08) | (0.21) | 0.52 | 1.22 |
| Net | (0.35) | (0.08) | (0.22) | 0.52 | 1.21 |
| Gross dividend rate (%) | - | - | - | - | - |

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2.1.1 Notes to the proforma consolidated results

(i) Basis of Accounting

The proforma consolidated results of the MLABS Group for the past five (5) years/period ended 31 December 2000 to 2004 have been prepared in compliance with applicable approved accounting standards in Malaysia.

(ii) Basis of consolidation

The proforma consolidated results of the MLABS Group are prepared for illustrative purposes only and are based on the audited financial statements of MSB and on the assumption that the Group had been in existence throughout the financial years/period under review.

(iii) Earnings per share (EPS)

The gross and net earnings per share are calculated based on the profit before and after taxation attributable to the shareholders of MLABS respectively. MLABS is assumed to have an issued and paid-up share capital of RM10,215,700 comprising 102,157,000 ordinary shares of RM0.10 each in issue throughout the years/period under review.

2.1.2 The MLABS Group - proforma consolidated balance sheets

Proforma consolidated balance sheets of the MLABS Group have been presented in respect of 31 December 2004 based on the latest audited statements of assets and liabilities as at 31 December 2004 as shown in Paragraph 3 of this Report.

No proforma balance sheets of MLABS were prepared for the years/period from 2000 to 2003 as MLABS was only incorporated on 21 May 2004.

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2.2 Multimedia Research Lab Sdn Bhd ("MSB")

Historical performance

The following financial information of MSB was extracted from the audited financial statements of MSB. The commentary for the relevant years/period under review has been obtained based on enquiries of management and representations made by the Directors.

2.2.1 Summary of results

| | 15 months ended 31.12.00 RM'000 | Year ended 31.12.01 RM'000 | Year ended 31.12.02 RM'000 | Year ended 31.12.03 RM'000 | Year ended 31.12.04 RM'000 |
|--|--|----------------------------------|----------------------------------|----------------------------------|----------------------------------|
| Revenue | 537 | 1,041 | 917 | 2,556 | 5,042 |
| Profit/(Loss) before depreciation, amortisation and interest | (209) | 246 | 356 | 1,277 | 2,368 |
| Depreciation | (141) | (124) | (176) | (201) | (134) |
| Amortisation | - | (190) | (380) | (506) | (895) |
| Interest expense | (6) | (18) | (19) | (36) | (85) |
| Profit/(Loss) before taxation | (356) | (86) | (219) | 534 | 1,254 |
| Taxation | - | - | (1) | - | (9) |
| Profit/(Loss) after taxation | (356) | (86) | (220) | 534 | 1,245 |
| Weighted average number of shares in issued during the year/period (*000) | 3,890 | 4,065 | 4,065 | 4,065 | 4,670 |
| Earnings/(Loss) per share (sen) | | | | | |
| Gross | (9.15) | (2.12) | (5.39) | 13.14 | 26.85 |
| Net | (9.15) | (2.12) | (5.41) | 13.14 | 26.66 |

Note:-

- i) There were no extraordinary or exception items in the years/period under review.

13. ACCOUNTANTS' REPORT (Cont'd)



2.2.1 Summary of results (Cont'd)

- ii) MSB was granted Multimedia Super Corridor ("MSC") status by the Multimedia Development Corporation Sdn. Bhd. ("MDC") on 25 January 1999.

By virtue of its MSC status, the Ministry of International Trade and Industry ("MITI") under the Promotion of Investments Act, 1986, granted MSB pioneer status for five (5) years. Accordingly, MSB's operating profit derived from eligible products and services is exempted from income tax.

The MSC status granted to MSB is subject to MSB's continuous compliance with the conditions as set out by MDC. MSB was granted the extension of its pioneer status for another five (5) years upon the expiry of its initial pioneer period on 24 January 2004.

2.2.2 Summarised balance sheets of MSB

| | 31.12.00 | 31.12.01 | 31.12.02 | 31.12.03 | 31.12.04 |
|--|----------|----------|----------|----------|----------|
| | RM'000 | RM'000 | RM'000 | RM'000 | RM'000 |
| Property, plant and equipment | 818 | 934 | 926 | 304 | 848 |
| Intellectual properties | 3,800 | 3,610 | 3,230 | 7,356 | 6,519 |
| Investment in a subsidiary | - | 10 | - | - | - |
| Investment in unquoted shares | - | - | - | - | 300 |
| Development expenditure | - | - | 285 | 228 | 171 |
| Current assets | 426 | 599 | 782 | 640 | 4,294 |
| Current liabilities | (961) | (1,050) | (1,454) | (4,506) | (3,286) |
| Net current assets/(liabilities) | (535) | (451) | (672) | (3,866) | 1,008 |
| | 4,083 | 4,103 | 3,769 | 4,022 | 8,846 |
| Financed by : | | | | | |
| Share capital | 4,065 | 4,065 | 4,065 | 4,065 | 5,000 |
| Retained profits/(Accumulated losses) | (271) | (358) | (577) | (43) | 3,846 |
| Shareholders' funds | 3,794 | 3,707 | 3,488 | 4,022 | 8,846 |
| Deferred income | - | 110 | - | - | - |
| Borrowings | 289 | 286 | 281 | - | - |
| | 4,083 | 4,103 | 3,769 | 4,022 | 8,846 |
| NTA/(NTL) per ordinary share of RM1.00 each (RM) | (0.002) | 0.024 | (0.007) | (0.876) | 0.431 |

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**3 Proforma consolidated statement of assets and liabilities**

The followings are the statements of assets and liabilities of MLABS as well as the proforma MLABS Group, which are prepared solely for illustration purposes and are based on the audited financial statements of MLABS and MSB as at 31 December 2004. The statement of assets and liabilities has been prepared to show the effects of the acquisition of MSB as stated in Paragraph 1.3.1 ("Proforma I"), the listing scheme of the MLABS Group as stated in Paragraphs 1.3 and 1.4.1 and 1.4.2 ("Proforma II") and the implementation of ESOS as stated in Paragraph 1.4.3 ("Proforma III") on the assumption that the respective transactions had been effected on 31 December 2004 and should be read in conjunction with the notes thereon.

Proforma I, II and III assumes that the acquisition is based on the merger method of accounting in accordance with MASB 21 whilst the acquisition method under Proforma I(A), II(A) and III(A) assumes that the acquisition is effected on 31 December 2004.

Both the Management and shareholders of the combining parties, that is MLABS and MSB consist solely of the same team or persons. The combining parties merged to form a Group in order to achieve economies of scale. The respective interests of the existing shareholders therefore do not change significantly. The merger method of accounting was adopted as it would reflect more appropriately the Group as a business combination which is the underlying nature of the combining parties. The substance of MLABS's restructuring is that there has been a continuity of the business insofar as the shareholders are concerned as set out under MASB 21.

Acquisition method will give rise to negative goodwill on acquisition which if recognised immediately, will be taken to the consolidated income statement whereas merger method will give rise to the merger deficit, which will be adjusted against any suitable reserve. Both methods will arrive at the same Net Tangible Assets value of 18.12sen per ordinary shares of RM0.10 each. However, this is on the assumption that under acquisition method, the fair values of the assets and liabilities acquired are equivalent to their carrying values at the date of acquisition.

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3 Proforma consolidated statement of assets and liabilities (Cont'd)

| | Note | * Company RM'000 | ← Merger method → | | | ← Acquisition method → | | |
|---|------|------------------------|-------------------------|--------------------------|---------------------------|----------------------------|-----------------------------|------------------------------|
| | | | Proforma I RM'000 | Proforma II RM'000 | Proforma III RM'000 | Proforma I(A) RM'000 | Proforma II(A) RM'000 | Proforma III(A) RM'000 |
| Property, plant and equipment | 3.2 | - | 848 | 848 | 848 | 848 | 848 | 848 |
| Intellectual properties | 3.3 | - | 6,519 | 6,519 | 6,519 | 6,519 | 6,519 | 6,519 |
| Investment in unquoted shares, at cost | | - | 300 | 300 | 300 | 300 | 300 | 300 |
| Development expenditure | 3.4 | - | 171 | 171 | 171 | 171 | 171 | 171 |
| Current assets | | | | | | | | |
| Trading inventories, at cost | | - | 61 | 61 | 61 | 61 | 61 | 61 |
| Trade and other receivables | 3.5 | - | 3,380 | 3,380 | 3,380 | 3,380 | 3,380 | 3,380 |
| Cash and cash equivalents | 3.6 | ** | 852 | 13,435 | 19,053 | 852 | 13,435 | 19,053 |
| | | - | 4,293 | 16,876 | 22,494 | 4,293 | 16,876 | 22,494 |
| Current liabilities | | | | | | | | |
| Trade and other payables | 3.7 | 7 | 3,285 | 3,285 | 3,285 | 3,285 | 3,285 | 3,285 |
| Taxation | | - | 8 | 8 | 8 | 8 | 8 | 8 |
| | | 7 | 3,293 | 3,293 | 3,293 | 3,293 | 3,293 | 3,293 |
| Net current (liabilities)/assets | | (7) | 1,000 | 13,583 | 19,201 | 1,000 | 13,583 | 19,201 |
| | | (7) | 8,838 | 21,421 | 27,039 | 8,838 | 21,421 | 27,039 |
| Financed by: | | | | | | | | |
| Share capital | 3.8 | *** | 7,600 | 10,215 | 11,237 | 7,600 | 10,215 | 11,237 |
| Share premium | 3.9 | - | 43 | 10,011 | 14,607 | - | 9,968 | 14,564 |
| (Loss carried forward)/Retained profit | 3.10 | (7) | 1,195 | 1,195 | 1,195 | 1,238 | 1,238 | 1,238 |
| Shareholders' funds | | (7) | 8,838 | 21,421 | 27,039 | 8,838 | 21,421 | 27,039 |
| Net tangible (liabilities)/assets per ordinary share of RM0.10 each (sen) | | (35,000) | 2.83 | 14.42 | 18.11 | 2.83 | 14.42 | 18.11 |

* At date of incorporation, i.e. 21 May 2004

** Cash of RM2.00 at date of incorporation

*** Issued and paid up capital of RM2.00

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3 Notes to the Proforma consolidated statement of assets and liabilities

3.1 Summary of significant accounting policies

The following accounting policies are adopted by the Proforma Group and are consistent with those adopted in previous years/period.

(a) Basis of Accounting

The financial statements of the Proforma Group and of the Company are prepared on the historical cost basis and in compliance with the provisions of the Companies Act, 1965 and applicable approved accounting standards in Malaysia.

(b) Basis of Consolidation

Subsidiaries are those enterprises controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that the date control effectively ceases. Subsidiaries are consolidated using the merger method of accounting.

The proforma group financial statements include the audited financial statements of the Company and its subsidiaries made up to 31 December 2004 on the assumption that the restructuring of MALBS Group as stated in Paragraph 1.3.1 had been effected as at 31 December 2004.

A subsidiary is excluded from consolidation when either control is intended to be temporary if the subsidiary is acquired and held exclusively with a view of its subsequent disposal in the near future and it has not previously been consolidated or it operates under severe long term restrictions, which significantly impair its ability to transfer funds to the Company. Subsidiaries excluded on these grounds are accounted for as investments.

Under the merger method of accounting, the results of the subsidiaries are presented as if the companies had been combined throughout the current and previous financial years. The difference between the nominal value of the share capital issued as purchase consideration and the nominal value of the share capital of the subsidiary acquired is taken to merger reserve (or adjusted against any suitable reserve in the case of debit differences).

Intragroup transactions and balances and the resulting unrealised profits are eliminated on consolidation. Unrealised losses resulting from intragroup transactions are also eliminated unless cost cannot be recovered.

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**(c) Property, plant and equipment**

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses, if any.

Property, plant and equipment retired from active use and held for disposal, if any, are stated at the carrying amount at the date when the asset is retired from active use, less impairment losses, if any.

Depreciation

Depreciation is calculated to write off the cost of each property, plant and equipment on a straight line basis over the term of their expected useful lives at the following principal annual rates :

| | |
|--|-----|
| Renovation | 25% |
| Motor vehicles | 20% |
| Furniture, fittings and office equipment | 10% |
| Computers and software | 20% |
| Books | 10% |

(d) Investments

Long term investment in subsidiary is stated at cost in the Company, less impairment loss where applicable.

(e) Intellectual Properties

This represents the purchase consideration for the ownership of multimedia conferencing system and its related intellectual property rights. Intellectual properties are stated at cost less accumulated amortisation and impairment losses. Amortisation is calculated to write off the cost of intellectual property rights over their expected useful lives of 10 years.

(f) Impairment

The carrying amount of assets, other than trading inventories and financial assets (financial assets in this context exclude investment in subsidiary) 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. An impairment loss is recognised whenever the carrying amount of an asset or the cash-generating unit to which it belongs exceeds its recoverable amount. Impairment losses are recognised in the income statement.

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(f) Impairment (Cont'd)

The recoverable amount is the greater of the asset's net selling price and its value in use. In assessing value in use, 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.

An impairment loss in respect of goodwill is not reversed unless the loss was caused by a specific external event of an exceptional nature that is not expected to recur and subsequent external events have occurred that reverse the effect of that event.

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. The reversal is recognised in the income statement.

(g) Trading Inventories

Trading inventories are stated at the lower of cost and net realisable value. Cost is determined on the first-in, first-out basis.

(h) Trade and Other Receivables

Trade and other receivables are stated at cost less allowance for doubtful debts.

(i) Liabilities

Borrowings and trade and other payables are stated at cost.

(j) Provisions

A provision is recognised when it is probable that an outflow of resources embodying economic benefits will be required to settle a present obligation (legal or constructive) as a result of a past event and a reliable estimate can be made of the amount.

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(k) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, balances and deposits with banks and highly liquid investments which have an insignificant risk of changes in value. For the purpose of the cash flow statement, cash and cash equivalents are presented net of bank overdrafts and pledged deposits, if any.

(l) Employee Benefits

ij) Short term employee benefits

Wages, salaries and bonuses are recognised as expenses in the year in which the associated services are rendered by employees of the Group. Short term accumulating compensated absences such as paid annual leave are recognised when services are rendered by employees that increase their entitlement to future compensated absences, and short term non-accumulating compensated absences such as sick leave are recognised when absences occur.

ii) Defined contribution plans

Obligations for contributions to defined contribution plans are recognised as an expense in the income statement as incurred.

(m) Research and Development Expenditure

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, 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 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.

Capitalised development expenditure is amortised and recognised as an expense on a systematic basis so as to reflect the pattern in which the related economic benefits are recognised over 5 years.

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(n) Income Recognition

i) Goods sold and services rendered

Revenue from sale of goods is measured at the fair value of the consideration receivable and is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer.

Revenue from services rendered is recognised in the income statement in proportion to the stage of completion of the transaction at the balance sheet date. Where the outcome of the transaction cannot be estimated reliably, revenue is recognised only to the extent of the expenses recognised that are recoverable.

ii) Interest income

Interest income is recognised in the income statement as it accrues, taking into account the effective yield on the asset.

iii) Dividend income

Dividend income is recognised when the right to receive payment is established.

(o) Financing Costs

All interest and other costs incurred in connection with borrowings are expensed as incurred.

(p) Income Tax

Tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement.

Current tax expense 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 liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Temporary differences are not recognised for goodwill not deductible for tax purposes and the initial recognition of assets or liabilities that at the time of the transaction affects neither accounting nor taxable profit. 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 substantially 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.

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**(q) Foreign Currency Transactions**

Transactions in foreign currencies are translated to Ringgit Malaysia at rates of exchange ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Ringgit Malaysia at the foreign exchange rates ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost are translated to Ringgit Malaysia at the foreign exchange rates ruling at the date of the transactions.

The principal closing rate used in the translation of foreign currency monetary assets and liabilities is 1 USD to RM3.80.

(r) Government Grant

Government grants are recognised initially at their fair value in the balance sheet as deferred income where there is reasonable assurance that the grant will be received and all conditions attached will be complied with. Grants that compensate the Group for expenses incurred are recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Grants that compensate the Group for the cost of an asset are recognised as income on a systematic basis over the useful life of the asset.

3.2 Property, plant and equipment

| Proforma Group | Cost RM'000 | Accumulated depreciation RM'000 | Net book value RM'000 |
|--|----------------|---------------------------------------|-----------------------------|
| Renovation | 56 | 34 | 22 |
| Furniture, fittings and office equipment | 131 | 68 | 63 |
| Computers and software | 1,258 | 497 | 761 |
| Books | 3 | 1 | 2 |
| | <u>1,448</u> | <u>600</u> | <u>848</u> |

The entire property, plant and equipment of the Group was charged to MSC Venture One Sdn. Bhd., details of which are as disclosed in Note 3.7.

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3.3 Intellectual properties

| | Proforma Group RM'000 |
|---------------------------------|--------------------------|
| At cost | 8,375 |
| Less : Accumulated amortisation | (1,856) |
| | <u>6,519</u> |

These represent the purchase consideration for the ownership of a multimedia conferencing system and its related intellectual property rights.

3.4 Development expenditure

| | Proforma Group RM'000 |
|---------------------------------|--------------------------|
| At cost | 285 |
| Less : Accumulated amortisation | (114) |
| | <u>171</u> |

3.5 Trade and other receivables

| | Proforma Group RM'000 |
|---|-----------------------------|
| Trade receivables | |
| - Related corporation | 130 |
| - Others | 2,088 |
| | <u>2,218</u> |
| Other receivables, deposits and prepayments | 1,162 |
| | <u>3,380</u> |

Included in other receivables is an amount of RM684,000 representing prepayment to set up a distribution network in Indonesia.

13. ACCOUNTANTS' REPORT (Cont'd)



3.6 Cash and cash equivalents

| | Proforma I and I(A) Group RM'000 | Proforma II and II(A) Group RM'000 | Proforma III and III(A) Group RM'000 |
|--|---|---|---|
| Cash and bank balances – audited as at 31 December 2004 | 92 | 92 | 92 |
| Fixed deposits with licensed banks – audited as at 31 December 2004 | 760 | 760 | 760 |
| Proceeds from public issue | - | 14,383 | 14,383 |
| Proceeds from ESOS issue | - | - | 5,618 |
| Less: Estimated share issue expenses | - | (1,800) | (1,800) |
| | <u>852</u> | <u>13,435</u> | <u>19,053</u> |

3.7 Trade and other payables

| | Proforma Group RM'000 |
|-------------------------------------|-----------------------------|
| Trade payables | 32 |
| Other payables and accrued expenses | 3,253 |
| | <u>3,285</u> |

Included in other payables and accrued expenses is an amount of RM2,400,000 due to MSC Venture One Sdn. Bhd. ("MV1") in accordance with the Novation Agreement and Settlement Agreement. The amount due to MV1 is repayable on 30 June 2005 and is secured over fixed and floating charges over all the present and future assets, undertaking, revenue rights and benefits both movable and immovable of a subsidiary. Late payment charges are payable at 6% per annum with effect from 1 July 2004.

13. ACCOUNTANTS' REPORT (Cont'd)



3.8 Share capital

| | Proforma I and I(A) Group RM'000 | Proforma II and II(A) Group RM'000 | Proforma III and III(A) Group RM'000 |
|---|---|---|---|
| Ordinary shares of RM0.10 each: Authorised | | | |
| At date of incorporation | <u>100</u> | <u>100</u> | <u>100</u> |
| Issued and fully paid | | | |
| At 31 December 2004 | * | * | * |
| Acquisition of MSB | 7,600 | 7,600 | 7,600 |
| Public Issue | - | 2,615 | 2,615 |
| ESOS | - | - | 1,022 |
| | <u>7,600</u> | <u>10,215</u> | <u>11,237</u> |

* denotes RM2

The authorised share capital was increased to RM50,000,000 comprising 500,000,000 shares of RM0.10 each on 30 March 2005.

3.9 Share premium

| | Proforma I Group RM'000 | Proforma II Group RM'000 | Proforma III Group RM'000 | Proforma I(A) Group RM'000 | Proforma II(A) Group RM'000 | Proforma III(A) Group RM'000 |
|---------------------------------------|----------------------------------|-----------------------------------|------------------------------------|-------------------------------------|--------------------------------------|---------------------------------------|
| Acquisition at date of acquisition | 2,644 | 2,644 | 2,644 | - | - | - |
| Less : Merger deficit | (2,601) | (2,601) | (2,601) | - | - | - |
| Public Issue | - | 11,768 | 11,768 | - | 11,768 | 11,768 |
| ESOS | - | - | 4,596 | - | - | 4,596 |
| Less: Share issue expenses | - | (1,800) | (1,800) | - | (1,800) | (1,800) |
| | <u>43</u> | <u>10,011</u> | <u>14,607</u> | <u>-</u> | <u>9,968</u> | <u>14,564</u> |

13. ACCOUNTANTS' REPORT (Cont'd)



3.10 (Loss carried forward)/Retained profit

| | Proforma I, II and III Group (Merger method) RM'000 | Proforma I(A), II(A) and III(A) Group (Acquisition method) RM'000 |
|---|--|---|
| Loss carried forward of MLABS at 31 December 2004 | (7) | (7) |
| Consolidated retained profit | 1,195 | (7) |
| Negative goodwill | - | 1,245 |
| | <u>1,195</u> | <u>1,238</u> |

3.11 Proforma consolidated cash flow statement

The proforma consolidated cash flow statement of the Proforma Group, prepared for illustrative purpose is based on the audited financial statements of MSB and on the assumption that the listing scheme of the MLABS Group as stated in Paragraphs 1.3, 1.4.1 and 1.4.2 had been effected on 31 December 2004.

| | Proforma I and I(A) Group RM'000 | Proforma II and II(A) Group RM'000 | Proforma III and III(A) Group RM'000 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Profit before tax | 1,254 | 1,254 | 1,254 |
| Adjustments for : | | | |
| Amortisation of intellectual properties | 837 | 837 | 837 |
| Depreciation | 134 | 134 | 134 |
| Interest expense | 85 | 85 | 85 |
| Property, plant and equipment written off | 15 | 15 | 15 |
| Interest income | (29) | (29) | (29) |
| Amortisation of development expenditure | 57 | 57 | 57 |
| Operating profit before working capital changes | <u>2,353</u> | <u>2,353</u> | <u>2,353</u> |
| Decrease/(Increase) in : | | | |
| Trading inventories | (13) | (13) | (13) |
| Trade and other receivables | (2,910) | (2,910) | (2,910) |
| Increase in trade and other payables | 2,550 | 2,550 | 2,550 |
| Net cash generated from operating activities | <u>1,980</u> | <u>1,980</u> | <u>1,980</u> |

13. ACCOUNTANTS' REPORT (Cont'd)



3.11 Proforma consolidated cash flow statement (Cont'd)

| | Proforma I and I(A) Group RM'000 | Proforma II and II(A) Group RM'000 | Proforma III and III(A) Group RM'000 |
|---|---|---|---|
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Investment in unquoted shares | (300) | (300) | (300) |
| Purchase of property, plant and equipment | (694) | (694) | (694) |
| Interest received | 29 | 29 | 29 |
| Net cash used in investing activities | (965) | (965) | (965) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Interest paid | (85) | (85) | (85) |
| Repayment of term loan | (200) | (200) | (200) |
| Issue of shares | - | 14,383 | 14,383 |
| Share issue expenses paid | - | (1,800) | (1,800) |
| Exercise of ESOS | - | - | 5,618 |
| Net cash (used in)/generated from financing activities | (285) | 12,298 | 17,916 |
| Net increase in cash and cash equivalents | 730 | 13,313 | 18,931 |
| Cash and cash equivalents at beginning of year | 122 | 122 | 122 |
| Cash and cash equivalents at end of year | 852 | 13,435 | 19,053 |

Notes to Proforma Consolidated Cash Flow Statement

(i) Cash and cash equivalents

Cash and cash equivalents included in the cash flow statements comprise the following balance sheet amounts:

| | Proforma I and I(A) Group RM'000 | Proforma II and II(A) Group RM'000 | Proforma III and III(A) Group RM'000 |
|--|---|---|---|
| Fixed deposits placed with licensed banks | 760 | 760 | 760 |
| Cash and bank balances | 92 | 12,675 | 18,293 |
| | 852 | 13,435 | 19,053 |

13. ACCOUNTANTS' REPORT (Cont'd)**3.11 Proforma consolidated cash flow statement (Cont'd)**

- ii) The net cash flow from financing activities would be increased by RM5,618,250 assuming full exercise of the ESOS option. The cash and cash equivalents of RM5,618,250 are included in the proforma consolidated cash flow statement after the full exercise of ESOS.

3.12 Proforma net tangible assets cover

Based on the statement of assets and liabilities of the Proforma Group as at 31 December 2004, the net tangible assets will be as follows:-

| | Proforma I and I(A) Group RM'000 | Proforma II and II(A) Group RM'000 | Proforma III and III(A) Group RM'000 |
|--|---|---|---|
| Net tangible assets as per statement of assets and liabilities of Proforma Group | <u>2,148</u> | <u>14,731</u> | <u>20,349</u> |
| Number of ordinary shares of RM0.10 each assumed in issue (‘000) | <u>76,006</u> | <u>102,157</u> | <u>112,372</u> |
| Net tangible assets per ordinary share of RM0.10 each (RM) | <u>0.03</u> | <u>0.14</u> | <u>0.18</u> |

3.13 Event subsequent to balance sheet date of 31 December 2004

Subsequent to balance sheet,

- a) MLABS's authorised share capital was increased to RM50,000,000 comprising 500,000,000 ordinary shares of RM0.10 each on 30 March 2005; and
- b) MLABS's issued and paid up share capital was increased from RM2 comprising 20 ordinary shares of RM0.10 each to RM7,600,613 comprising 76,006,130 ordinary shares of RM0.10 each on 31 March 2005 in consideration for the acquisition of MSB.

13. ACCOUNTANTS' REPORT (Cont'd)



3.14 Financial statements

No audited financial statements have been made up in respect of any period subsequent to 31 December 2004.

Yours faithfully

A handwritten signature in black ink, appearing to read 'KANG'.

KPMG
Firm Number: AF 0758
Chartered Accountants

A handwritten signature in black ink, appearing to read 'Lee Kean Teong'.

Lee Kean Teong
Partner
Approval Number: 1857/02/06 (J)

14. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT AND THE LETTER THEREON

(Prepared for inclusion in this Prospectus)

Infocredit 
Creating value...building trust

Infocredit D&B (Malaysia) Sdn Bhd (527570-M)
Level 9-3A, Menara Milenium, Jalan Damanlela,
Pusat Bandar Damansara, 50490 Kuala Lumpur, Malaysia.
Tel: (603) 2718 1000 Fax: (603) 2718 1001
Website: www.icdnb.com.my

14 APR 2005

Board of Directors
MLABS Systems Berhad
Suite 704 & 705
Tingkat 7
11, Lorong Kinta
10400 Pulau Pinang

RE: INDEPENDENT MARKET RESEARCH REPORT FOR MLABS SYSTEMS BERHAD

This Report has been prepared for inclusion in the Prospectus to be dated **27 MAY 2005** pursuant to the proposed listing of MLABS Systems Berhad ("MLABS") on the Mesdaq Market of the Bursa Malaysia Securities Berhad ("Bursa Securities").

This research is undertaken with the purpose of providing an overview of the Multimedia Conferencing and Videoconferencing Market in Malaysia. The research methodology for the research includes both primary research, involving in-depth trade interviews and telephone interviews of pertinent companies, as well as secondary research such as reviewing press articles, periodicals, trade/government literatures, in-house corporate databases, Internet research as well as online databases.

Infocredit D&B (Malaysia) Sdn Bhd ("Infocredit D&B") has prepared this Report in an independent and objective manner and has taken all reasonable consideration and care to ensure the accuracy and completeness of the Report. In addition, the Expert acknowledges that if there are significant changes affecting the content of the Infocredit D&B's Report after the issue of the Prospectus and before the issue of securities, then Infocredit D&B has an on-going obligation to either cause the Report to be updated for the changes and, where applicable, cause the Company to issue a Supplementary Prospectus, or withdraw our consent to the inclusion of the Report in the Prospectus.

An Executive Summary is highlighted in the following sections.

For and on behalf
INFOCREDIT D&B (MALAYSIA) SDN BHD



Tan Sze Chong
Managing Director

14. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT AND THE LETTER THEREON (Cont'd)

(Prepared for and extracted from Independent Market Research Report dated 21 June 2004, updated on 14 April 2005 for inclusion in this Prospectus)

(I) EQUIPMENT***Client Equipment***

- Client equipment can be divided into:
- Enterprise class group systems, including PC-centric systems, appliance-based systems and broadband videoconferencing systems that are based on Motion Picture Experts Group (MPEG) technology.
- Enterprise class personal/desktop systems, covering:
 - PC software systems. These use the PC's internal processor to encode and decode video and operate the conferencing application. Add-on hardware is not involved in audio/video processing.
 - PC hardware systems. These include both software and extra hardware, such as PC data cards and a video camera.
 - Videophones.
 - Consumer personal systems. These systems are generally inexpensive, operate on standard telephone lines, and provide minimal levels of quality picture and audio performance.

Infrastructure Equipment

The infrastructure equipment market can be divided in two main ways:

- By network, whether they run over ISDN, LAN, WAN, Internet, asynchronous digital subscriber line (ADSL) or virtual private network (VPN).
- By type of equipment, which includes:
 - Multipoint control unit (MCU). H.320 (ISDN) conferences are essentially a point-to-point connection and need to use an H.320 MCU — which is hardware-based — to link and manage all the ISDN lines in order to hold a conference with three or more participants. The H.320 MCU's basic function is to maintain the communications between all the participants in the conference. However, certain H.323 (IP) systems are also known to be backward compatible with H.320 standards.
 - Multipoint conference server (MCS). To allow three or more participants into a H.323 (LAN) or H.320 (ISDN) conference, a H.323 MCS is needed. Although these are also referred to as H.323 MCUs, they are not the same. The H.323 MCS's basic function is to maintain all the audio, video, data and control streams between all the participants in the conference and the majority of them are hardware-based.
 - Gateways. These provide translation and transcoding between different circuit-switched networks (ISDN and cellular) and packet-based networks (LAN), which enable the endpoints to communicate. The majority of gateways can support several conferences simultaneously and many work in conjunction with, and include, a basic gatekeeper functionality.
 - Gatekeepers. These are responsible for providing registration/admission/status (RAS) services in a conference. They provide address translation between LAN aliases and Internet protocol (IP) addresses; call control and routing services to endpoints; system management; and security policies. Gatekeepers provide the intelligence for delivering new IP services and applications and allow network administrators to configure, monitor and manage the activities of registered endpoints, set policies and control network resources, such as bandwidth usage.

14. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT AND THE LETTER THEREON (Cont'd)

(II) SERVICES***Installation Services***

An initial videoconferencing installation can include many components and associated costs, depending on an organisation's specific needs. Some of the common start-up costs include:

- The videoconferencing equipment, such as the codec and monitor — In addition, many organisations have dual monitor systems (two monitors in one room). For example, MCS allows one to have videoconferencing with one focusing on images and another on documents or other formats, etc.
- Cabling — In almost all cases, new cabling is required for meeting rooms. While this is usually for ISDN access, cabling can also include wiring for power or microphones.
- Lighting — Although this is not a very common expense, some customers find that their existing meeting rooms have poor lighting or lighting that will cause glare on the monitors.
- Furnishings — The most common furnishing is a cabinet for the system itself (to house the codec). However, while it is uncommon, some organisations also buy new tables and chairs or even undertake construction to modify existing rooms.
- WAN and LAN equipment.
- Document stands — This is a common item and many organisations have them in their videoconference-equipped conference rooms.
- Staff time — An important part of the initial costs associated with the installation of a videoconferencing system is the staff time required for managing the installation, planning network designs and overseeing the actual installation.

Other less common start-up costs include custom programming, administration software (such as for scheduling) and LAN equipment (for those organisations connecting the room system to a LAN). This report focuses on the value-added revenue earned by installers, which refers to the amount charged to the client less the bought-in costs of equipment and cabling.

Rental Revenue

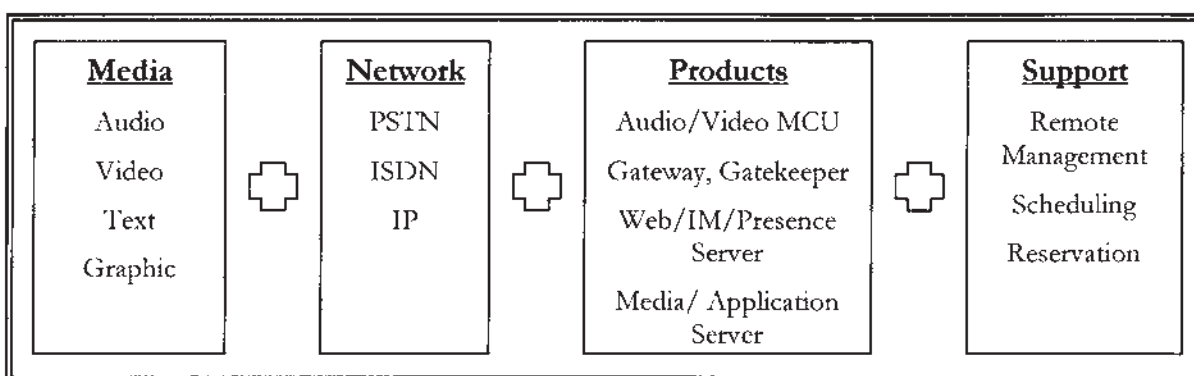
Some companies might rent videoconferencing equipment on a short-term basis in order to resolve a temporary problem, such as a need for a greater number of meetings than usual or to cope with a short-term increase in capacity. This might occur when more people are required to take part in a meeting or interactive presentation than usual, meaning that more endpoint equipment is needed.

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14. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT AND THE LETTER THEREON (Cont'd)

2.2 DEFINITION OF MULTIMEDIA VIDEOCONFERENCING

Multimedia videoconferencing is defined as "the experience produced by a suite of converging digital audio and visual technologies including videoconferencing, streaming media, static imagery and text. In addition to the flexible composition of rich media, its other virtue is derived from the convenience it offers multimedia-enabled participants due to the independence of physical proximity and temporal constraints. In other words, provided the necessary network components are there to support it, the rich media experience can be easily stored, searched, navigated and reproduced. This definition follows most closely to the evolution and convergence of the conferencing (audio, video, text, data) and streaming video industries, illustrated in the diagram below.



Videoconferencing is not a new high-tech business tool. In fact, it has been used since the early 1980s by a growing number of companies in a variety of industries. However, it has yet to reach the mass deployment stage. Part of the reason for this can be attributed to product price points and complex functionality. But another major barrier to wide-scale deployment of videoconferencing has been related to network readiness. Until recently, videoconferencing has been delivered almost exclusively over ISDN networks. Not only has this made device management difficult, it also goes against the current convergence trend that calls for aggregating voice, video, and data applications onto one common IP network infrastructure.

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14. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT AND THE LETTER THEREON (Cont'd)

3 MARKET SIZE FOR MULTIMEDIA VIDEOCONFERENCING INDUSTRY

3.1 TOTAL MARKET SIZE

The conferencing service provider industry can be separated into four distinct segments: audio conferencing, web data conferencing, multipoint videoconferencing services (video bridging) and IP video network services.

Wainhouse Research reported in mid-2003 that the total worldwide market for conferencing services would grow from USD3.0 billion in 2002 to USD5.5 billion in 2008. The top-level breakdown of this market forecast by conferencing segment can be seen in the table below.

Table 1.8: Global Multimedia Videoconferencing Industry, 2002 - 2008

| Market Size | 2002 USD mil | 2003 USD mil | 2004 USD mil | 2005 USD mil | 2006 USD mil | 2007 USD mil | 2008 USD mil | 5-yr Growth |
|------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|----------------|
| Audio Conferencing | 2,351 | 2,660 | 3,061 | 3,399 | 3,439 | 3,379 | 3,249 | 4.1% |
| Web-Based Data Conferencing | 314 | 472 | 627 | 768 | 896 | 936 | 949 | 15.0% |
| Multipoint Videoconferencing | 290 | 278 | 271 | 263 | 250 | 240 | 229 | -3.8% |
| IP Video Network Services | 13 | 59 | 144 | 533 | 855 | 1,069 | 1,099 | 79.5% |
| Total | 2,968 | 3,469 | 4,103 | 4,963 | 5,440 | 5,624 | 5,526 | 9.8% |

Source: Wainhouse Research

The worldwide revenue shown above can be further broken down by geographical region, with the North American market providing the largest portion of the revenue. However, the European and Asia Pacific markets have considerably higher growth rates. Also, while there is no specific market data for the Latin America region, the opportunity for conferencing service providers is promising.

Table 1.9: Global Multimedia Videoconferencing Industry, 2002 - 2008

| | 2002 (USD bil) | 2008 (USD bil) | Last 5 years |
|---------------|----------------|----------------|--------------|
| North America | 2.4 | 4.0 | 7.3% growth |
| Europe | 0.4 | 0.9 | 12.8% growth |
| Asia Pacific | 0.1 | 0.7 | 30.8% growth |

Source: Wainhouse Research

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14. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT AND THE LETTER THEREON (Cont'd)

3.1.1 MARKET SIZE AND SHARE OF MLABS

This report examines the multimedia videoconferencing industry with specific focus on the conferencing infrastructure market audio, video, and web conferencing servers and bridges, video gateways and gatekeepers and IM & presence servers. As there are no local players involved in the same industry, Infocredit ID&B used comparison and analysis based on various syndicated reports and sources from established technical experts including Wainhouse Research.

Based on the report by Wainhouse Research, the market size for Multimedia Videoconferencing in Asia Pacific is worth an estimated USD100 million in 2002 (Ref: Table 1.9) and is growing at a rate of 30.8% annually. Based on the same growth rate of 30.8%, the market size of Multimedia Videoconferencing in Asia Pacific could be worth an estimated USD130.8 million (RM497.0 million) in 2003. Despite its recent commercialisation of the MCS system, MLABS registered revenue of RM2.56 million in 2003 or 0.5% market share of the Asia-Pacific region.

4 INDUSTRY BACKGROUND

4.1 GOVERNMENT LEGISLATIONS & INCENTIVES

| Acts |
|--|
| Malaysian Communications and Multimedia Commission Act 1998 / Act 589 |
| Communications and Multimedia Act 1998 / Act 588 |
| Regulations |
| Communications and Multimedia (Licensing) Regulations 1999 / P.U. (A) 124 |
| Communications and Multimedia (Technical Standards) Regulations 2000 / P.U.(A) 124 |
| Communications and Multimedia (Spectrum) Regulations 2000 / P.U.(A) 128 |
| Communications and Multimedia (Licensing) Regulations 2000 / P.U.(A) 129 |
| Communications and Multimedia (Technical Standards) (Amendment) Regulations 2001 / P.U.(A) 89 |
| Communications and Multimedia (Technical Standards) (Amendment) Regulations 2001 / P.U.(A) 261 |
| Communications and Multimedia (Spectrum) (Amendment) Regulations 2001 / P.U.(A) 277 |
| Communications and Multimedia (Licensing) (Amendment) Regulations 2001 / P.U.(A) 298 |
| Communications And Multimedia (Compounding of Offences) Regulations 2001 / P.U.(A) 346 |
| Communications and Multimedia (Universal Services Provision) Regulations 2002 / P.U.(A) 419 |
| Communications and Multimedia (Universal Services Provision) (Amendment) Regulations 2003/ P.U.(A) 402 |
| Rules |
| Communications and Multimedia (Rates) Rules 2002 / P.U.(A) 79 |
| Exemption Orders |
| Communications and Multimedia (Licensing) (Exemption) Order 2000 / P.U.(A) 125 |

14. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT AND THE LETTER THEREON (Cont'd)

5 INDUSTRY CHALLENGES/RISK FACTORS

5.1 LACK OF ACCEPTANCE FROM SMES

There is clearly some resistance from the smaller organisations in Malaysia to implement videoconferencing systems as most companies are still using the old way of communication. However, more recently, videoconferencing solutions is no longer only the province of the larger enterprises attempting to connect their businesses across branches in different geographical locations. Smaller businesses are now able to justify the cost effectiveness of implementing videoconferencing solutions due to the lower installation cost.

5.2 CONSUMER DISADVANTAGES

In the consumer environment, videoconferencing still faces some key last-mile bandwidth issues that make it too costly and complex for most users today. Unlike most applications used by consumers, video requires a high-speed, two-way connection with relatively little or no packet loss. If an email is delayed for a few seconds before it is sent, no one notices, but if a video call has a one-second delay, the experience is ineffective.

Most broadband connections to the home provide ample 'down-speed' (downloading of information at high data transfer rates). However, home users do not typically have the need to send the data back at such high rates, so the carriers limit the 'up-speed'. However, the up-speed is just as critical for interactive, two-way communication like videoconferencing.

A bigger problem is packet loss as users are unaware of packet-loss during email sending or Internet browsing, because the system will automatically send the information again if there was a problem. However, when packets are lost during a video call, the video and audio transmission can degrade the transmission quality.

5.3 DOMINANT MARKET POSITION OF LARGE VENDORS

The videoconferencing market features a number of established players, who have developed Niche markets primarily in such areas as telemedicine and the provisioning of large scale "room" videoconferencing systems. For example, Polycoms position as market leader is a threat to smaller providers of videoconferencing services/equipment. Polycom is well known in the industry and many large organisations already own a Polycom system.

To compete, smaller vendors will need high investment in marketing and branding, which restricts competition as smaller firms lack the funds to successfully differentiate from the rest of the industry. Implementing a full-fledge marketing campaigns can be very costly.

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14. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT AND THE LETTER THEREON (Cont'd)

5.4 LEGACY VIDEOCONFERENCING SYSTEM

The majority of these company's sales are based on bundling ISDN, a form of "switched" (dialup telephone) telecommunications developed in the mid 1970s to standardise interoperability and to enable services such as "call-forwarding" to better support private telephone business (PBX) switches, and to provide better interoperability among back-haul telephone lines that were being converted to digital "frame relay", and ATM systems.

The ISDN market never fully materialised as individual telecom companies were never able to fully agree on implementing a common system. This was particularly a problem in the US, as the two leading vendors, Nortel and AT&T (now Lucent) championed proprietary versions of the system. In later years, firms such as S-robotics and dialup "Modem" devices were able to help many telephone companies standardise on a system called NI-IRRELEVANT INFO. But by that time the Internet protocol and broadband access technologies such as ADSL and Cable modem connectivity have made ISDN an obsolete strategy and this fact has seriously damaged many of the incumbent videoconferencing developers. Many of the original pioneers have since left the market.

Most of these players were also running on technology which are hardware-based. This is, in part, the legacy of their history. At the time many of the firms were founded, computers did not have the capacity to handle the demands of video compression and transmission. IP routing technology was still quite expensive. As a consequence many of these firms invested heavily in specialty hardware to convert video images or to route audio and video content. The conversion to IP connectivity has meant that many of these companies were left with significant capital investments in technology no one wanted. Many were severely cash strapped during the late 1990's during the Internet boom.

Many firms do not have a fully developed multipoint product. While some have multipoint voice, much like a conference voice telephone call, this multipoint functionality is often limited. Several firms are limited to eight simultaneous connections. Frequently these calls are nothing more than single point to point calls, bundled together, making multipoint connectivity hard to achieve without consuming enormous bandwidth and system resources.

The hardware focus of these legacy systems, the lack of multipoint functionality, and their dependence on ISDN connectivity, means that these systems are unable to fulfil many of the original promises of videoconferencing. They were hard to set up, and were unsuitable for many remote access applications.

5.5 TECHNICAL LIMITATIONS RESTRICTS MARKET POTENTIAL

These legacy systems which are hardware-based were too expensive and too difficult to set up to allow users casual video access. Therefore they never became part of the tools that remote workers used to stay connected to their offices. They never became a way to provide virtual connectivity to dozens or even hundreds of people simultaneously, limiting their application for remote students to participate in classroom discussions. They never were able to reach doctors offices in remote areas, therefore limiting their application as a source of video consultation.

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14. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT AND THE LETTER THEREON (Cont'd)

6 COMPETITOR ANALYSIS

6.1 COMPETITIVE ENVIRONMENT

The major companies in the videoconferencing industry can be categorised into the following:

- major equipment manufacturers
- major resellers and rental companies.

The equipment market is highly competitive, with production, marketing, engineering and other capabilities vital competitive weapons. Although barriers to entry can be high, advances in telecommunications standards, connectivity and video-processing technology, along with the increasing market acceptance of video communications, enables other established or new companies to develop or market new products that prove competitive with the established ones.

6.2 KEY INDUSTRY PLAYERS

- Polycom
- Tandberg
- RADVision
- VCON

6.3 SWOT ANALYSIS

6.3.1 STRENGTHS

Product

- Lower investment for customer
- Low operating cost – no call charges
- Easy to use and reliable – Windows look and feel
- Multipoint to multipoint- cost and bandwidth efficient

Market

- Good margin and not highly competitive
- Videoconferencing penetration still low due to expensive products from major vendors

Miscellaneous

- Low development cost through collaboration with USM in Malaysia
- Lower costs due to management and staff operating out of Malaysia
- Committed staff

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14. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT AND THE LETTER THEREON (Cont'd)

6.3.2 WEAKNESSES

- Until videoconferencing prices, installation and familiarity matches that of personal computers (PCs), many SMEs will remain sceptical about its use.
- Some businesses still perceive videoconferencing systems as being too complex and costly to install.
- Many SMEs are discouraged from purchasing videoconferencing systems, as companies insist on selling products based on their technical standards, which can make purchasing decisions overly complex.
- Major vendors already have established network of channels
- Lack of financial resources,
- Limited promotions of MCS

6.3.3 OPPORTUNITIES

- Enterprises of all sizes have been seeking to implement new and advanced communication tools that enable their employees, partners, suppliers and customers to collaborate more effectively within and across buildings, and over disparate geographies and time zones. Speed in decision-making is becoming even more critical in today's business environment.
- Generally, individuals prefer face-to-face encounters to less personal forms of communication, such as telephone and fax, as they can benefit from the non-verbal cues and body language that speeds communication and facilitates a deeper understanding. This is particularly true for more complex interactions, such as negotiations, sales, product development, project management and decision-making across geography/functions.
- The growth of international corporations and overseas trade are making internal communications increasingly important to companies. As such, videoconferencing is seen as a cost-effective and efficient way for companies to communicate internally.
- The growth of supply-chain management techniques and partnerships between suppliers, manufacturers and distributors is making face-to-face and rapid communication between companies increasingly important.
- Organisations have resorted to using a patchwork of discrete technologies to address the growing need for collaboration across distance and time, including video- and teleconferencing, fax, e-mail, Internet audio and video delivery, and data sharing applications. Many of these technologies have been widely adopted and collectively indicate the need for collaboration tools, such as networked video. However, these discrete technologies are not enough on their own for face-to-face meetings and presentations, as they do not provide an integrated communications solution that fosters team interaction and delivers critical, time-sensitive information quickly and reliably. By providing face-to-face collaboration in an integrated communications solution, videoconferencing can facilitate problem resolution and motivate action, trust and understanding. Users want to be able to create and publish video content from their desktops either spontaneously, as with e-mail or voicemail, or in a more formal manner for broader distribution through the Internet or corporate data network.

14. EXECUTIVE SUMMARY OF THE INDEPENDENT MARKET RESEARCH REPORT AND THE LETTER THEREON (Cont'd)

- Although limited video technologies are already in use in many enterprises, others require increasingly comprehensive, integrated and scalable video-enabled communication capabilities.
- Videoconferencing is rapidly increasing its value for money and cost effectiveness. As prices decrease and newer systems incorporate high-quality and functionality, the case for using videoconferencing is becoming stronger. This is opening the market to SMEs and new users.
- Availability of broadband in developed countries and growth in the rest of the world will increase videoconferencing usage to new level. MLABS well positioned to benefit from increase usage.
- With the pricing flexibility of MCS, videoconferencing becomes affordable to a new market segment for the small businesses and home users as well.

6.3.4 THREATS

- Profit margins are being rapidly squeezed, which risks converting hardware into a commodity business.
- As with the computer industry, the videoconferencing market remains vulnerable to adverse economic conditions.
- Delay in market penetration due to lack of resources will result in MLABS losing technological advantage

7 INDUSTRY OUTLOOK

- The web conferencing server market will benefit from a shift to internal hosting from web conference service providers as enterprise users seek more control, better integration into their IT environments, and a perceived increase in security. This trend is indicated by our user surveys.
- Unlike audio, the shift from ISDN to IP ports for videoconferencing MCUs is well underway with IP video ports outselling ISDN video ports on a ratio of about 6:1.
- While IP video network services are being marketed by upstarts like GlowPoint, Masergy, Internap, V-SPAN, IVCi, and others, their uptake has been slow. Thus the majority of the demand for IP video ports is coming from enterprise users.
- While demand for all forms of multimedia videoconferencing ports and seats is generally robust throughout the forecast period, the movement from PSTN to IP ports for audio / video bridges and the commoditisation of the web conferencing / IM feature set works to lower prices on a per-user basis resulting in limited revenue growth.
- Desktop videoconferencing may finally find its home as a feature that is added to IM and web conferencing rather than being a stand-alone application, which will fuel healthy growth in IP-based video infrastructure equipment (MCUs, gateways, gatekeepers).
- The need for stand-alone video gateways is quickly giving way in favour of mixed mode
- MCUs that can also handle the gateway function.
- Multimedia videoconferences will converge audio, web, and video conferences into one IP-based multimedia videoconferencing entity. IM and presence will be increasingly used to initiate conferences of all types from within a growing number of applications.

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