

SMARTReader

A quarterly newsletter from QI Systems Inc. February 2004 Volume 2 ,Issue1

A Message from QI Systems Inc.

During the past several months, the Board of Directors and new CEO Steve Garman, have been vigorously working to restructure and reposition QI Systems. The restructuring has progressed through three distinct phases.

During Phase One, which ran for approximately 90 days, the new management team developed a “Crisis Management Strategy” used to discover and address urgent issues that could, if not dealt with decisively, severely damage the company’s ability to sustain on-going operations. The first order of business involved taking immediate action on a claim filed by Revenue Canada against the company for non-payment of taxes. A large initial lump sum payment, the funds of which were provided by members of the Board of Directors, was made to Revenue Canada to forestall a pending closure judgment. A payment program was proposed by QI Systems to eliminate the remaining six figure balance and the company began paying down that debt which has now been retired.

Management proactively moved to settle several legal actions that had been initiated against the company by creditors and began paying employee wages that had been deferred for several months. To raise funds for immediate operational needs the company launched two small private placements, the proceeds of which were used for legal settlements and payment of outstanding debts. The company also settled approximately \$400,000US of accounts payable liability by launching a limited “Shares for Debt” offering. These placements were kept small in scope to limit shareholder dilution.

In Phase Two, which began in September of 2003, the management team initiated actions to improve internal operations and reestablish relationships with key vendors and clients. To this end, Aurora Davidson of Delphis Financial was hired to provide accounting expertise and oversight, train the company bookkeeper on industry standard policies and procedures, develop an invoice tracking system and prepare our annual financial filings. During this time QI Systems renewed partnership agreements with key customers like CALE’ Systems and USA Today, in addition to signing new alliances with corporate partners such as USOutsourcing and Edoc Systems Group.

During this phase QI Systems introduced a new corporate image and marketing direction. The company’s web center was revitalized and a crisp new logo was unveiled. To broaden the company’s sales opportunities, marketing efforts were redirected from a narrow OEM supplier focus to that of positioning QI Systems as a full service smart card system provider.

A revitalized sense of purpose within the company and increased attention to operational detail by the new management team resulted in an improved financial picture during this phase. Industry awareness of our restructuring efforts led to increased customer willingness to provide QI Systems with new business opportunities.

Beginning in January of this year the company moved to Phase Three during which QI Systems will concentrate on launching an aggressive marketing campaign to broaden our sales opportunities. Additional projects will be coming on line from established customers in the parking and vending industries while QI enters profitable industries, such as gaming, security / identification, information processing / storage, and medical / healthcare with new partners.

While the full effect of the restructuring has yet to be seen, as QI Systems ends the second quarter of fiscal 2004 sales are up, expenses are down, and the stock price has risen from \$0.06 on June 12, 2003 to nearly \$0.40 by February 19th.

QI offers software development kit.

For the first time in the company's history QI Systems has made available to selected business partners a new software development kit that will allow clients to write computer applications for our smart card readers. The development kit includes a technical manual, software and a testing tower that simulates various field applications for smart card use. The software development kit is designed to serve as a tool for customers that have some computer engineering expertise and want to write their own software programs.

QI Systems made the decision to sell the development kit for several reasons. It frees the company from working on relatively small, time consuming development projects where the client is still trying to identify their smart card needs. It allows QI to establish a technical link with customers with more sophisticated software design capability that might not otherwise work with QI unless they could utilize their internal resources. Finally, it helps expand the applications for QI card terminals as clients write software to exclusively interface with our products

Smartcard Applications for gaming.

One of the markets that presents QI Systems with significant potential in the coming years is the gaming industry. The stored value benefits found in smart card applications are well suited for the industry that is just beginning to embrace the technology.

Gaming in North America falls into two basic categories: Commercial gaming which is currently licensed in 11 US states (located principally in Las Vegas, NV and Atlantic City, NJ) and Indian Nation gaming which is active in 28 US states. Within the United States alone the gaming industry produced \$38.3 billion of revenue in 2001 and the market is aggressively growing. Between 1991 and 1998, gaming revenues in the United States more than tripled. Of total revenue, commercial gaming corporations accounted

for \$25.6 billion, with the remaining \$12.67 billion being produced by tribal gaming operations.

In particular, tribal gaming presents a major opportunity for smart card solutions because the industry is known to be experiencing security and accountability problems. There are 562 federally recognized Native American tribes of which over 200 are involved in the gaming industry. Native American gaming operations are found in 296 locations in the United States with forty tribes accounting for \$10 billion of the total revenue.

The gaming industry is a dynamic and fast paced environment. Each state has its own laws governing the industry and these laws are not static. For example, Oklahoma passed new legislation governing tribal gaming earlier today, February 26, 2004. For those who would like more reading the new legislation was referred to as Oklahoma Senate Bill 553 (SB553).

Watch the SMARTReader or the QI Systems web site (www.qisystems.ca) for more information about our plans for involvement in this market.

Parking

QI has been a leader in deploying smartcard payment solutions and hybrid card reader terminals in the parking industry for several years. A recent project in Wellesley, MA continues the company's innovative approach to parking systems. Wellesley needed a solution that would allow City residents to pay a preferred rate to park on-street. Working with Cale Systems, QI supplied a solution consisting of different series of smartcards for issuance to residents and to visitors. The QI hybrid reader payment terminals recognize the different card series and instruct the Cale meters to select the appropriate rate table for each card presented. The system allows the City to maximize its parking revenues while offering special rates to qualified residents.

Parking is an industry where the unique multi-card capabilities of the QI SmartKit family of payment terminals is becoming especially important. Many cities across North America are moving ahead aggressively to replace individual on street meters with multi space or pay-and-display technologies. Multiple card capability is becoming a standard item in the specifications for these new parking systems. Typically the cities require the ability to support several smart card schemes as well as mag stripe credit cards.

The QI SmartKit family of hybrid reader payment terminals is designed to satisfy these specifications and to meet the demanding environmental and operational requirements of the parking industry. Configured specifically to meet physical and electrical requirements of each target machine type, the QI products provide a total solution for parking equipment OEM's. QI hybrid terminals can support magnetic cards, existing series of smart cards and / or stored value cards supplied by QI. We expect significant new opportunities in this marketplace in coming months

Get Connected

QI recently announced that it is adding TCP-IP connectivity to the payment terminals installed in the water and waste water management system in Dawson Creek. QI payment terminals have supported various networking topologies from the first designs. Extending the connectivity to embrace TCP-IP will allow QI terminals to connect directly to internet ports and will thereby allow direct communication at essentially zero cost between the terminals and computers anywhere on the planet.

The world is changing. The opportunities for our products and the customer expectations of what can be achieved with our products are similarly changing. Adding internet connectivity to our products is only one example of what will and must be achieved. Connectivity, remote monitoring and remote reporting are becoming increasingly important features of UPOS devices of all types. Ironically the latest technologies to allow such connectivity do not involve physical connections. QI is acutely aware of these issues and is moving to ensure that our products meet the challenges and the opportunities. In subsequent issues of this letter we will delve into new issues including wireless networking, wireless internet connectivity and contactless card technologies and discuss how these technologies are creating new and expanded opportunities for QI.

Miscellaneous Stuff

Reminder About Warrants Expiration:

Anyone who participated in the Spring 2002 private placement of stock in QI Systems received share purchase warrants with a two year term. Those warrants will expire if not exercised by May 2004. Exercise price of the warrants is \$0.40US. We urge you to be aware of the market price of the company stock and to take advantage of your opportunity to acquire additional shares at this fixed price.

The warrants may be exercised by sending a completed and signed warrant exercise form together with a certified bank check (cheque for the Canadians) or money order to QI Systems, Inc., 101-3820 Jacombs Road, Richmond, British Columbia, Canada V6V 1Y6. For more information on exercising these warrants or other QI stock options or warrants, call QI Systems at 888-814-5899.

All at QI are working diligently toward making our company a successful one so please.....*”stay tuned”*