

Wafer Systems Limited

3rd Quarterly Report 2002

Wafer Systems Limited

Professional Services

Network Software

Network Infrastructure



WAFER SYSTEMS

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This report, for which the directors (the “Directors”) of Wafer Systems Limited (the “Company” or “Wafer Systems”) collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM for the purpose of giving information with regard to the Company. The Directors, having made all responsible enquiries, confirm that, to the best of their knowledge and belief: (i) the information contained in this report is accurate and complete in all material respects and not misleading; (ii) there are no other matters the omission of which would make any statement in this report misleading; and (iii) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

TO OUR SHAREHOLDERS

The board of Directors (the "Board") is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (together, the "Group") for the three and nine months ended 30 September 2002 together with the comparative unaudited figures for the corresponding periods in 2001.

FINANCIAL REVIEW

During the three months ended 30 September 2002 (the "Review Period"), the Group recorded a turnover of approximately HK\$40,004,000, maintaining a similar level as compared with the corresponding period of last year. The contribution from Professional Services increased by more than 6 times from approximately HK\$1,126,000 for the corresponding period last year to approximately HK\$8,105,000 this year and the Network Software business continued to make its contribution to the Group. The Group reported a turnover of approximately HK\$113,380,000 for the nine months ended 30 September 2002, representing an increase of approximately 25% over the same period last year. These results are in line with the Group's strategy to balance revenues generated from its three businesses.

Foreseeing the rapid market growth arising from China's accession into the World Trade Organization ("WTO"), the Group scaled-up its operations to strengthen its market presence in the PRC. The increases in scale and scope stimulated the growth of both its Professional Service and Network Software businesses. However, hindered by changes in regulations and policies brought about by the Chinese government in the telecommunications industry and the restructuring of the two dominant telecom players in mainland China, many investment projects were delayed during the Review Period, which in turn slowed down the growth of the Group's Network Infrastructure business.

As the growth in the Network Infrastructure business did not match the increase in operation costs resulting from the Group's scaled-up operations, the Group reported a loss attributable to shareholders of the Company of approximately HK\$1,861,000 and approximately HK\$6,552,000 for the three and nine months ended 30 September 2002, respectively. The Group believes that much of the uncertainty in the industry will gradually clear out and the restructuring processes of the major industry players will settle in due course. As a result, those projects currently on hold are expected to be released, with the financial performance of the Group picking up accordingly.

The Group had been closely monitoring the market development and adopted a flexible operational model in controlling costs and get ready to respond quickly to the changing market situation.

The Group maintained its prudent financial management policy and kept a healthy liquidity over the past nine months. As at 30 September 2002, the Group had cash and interest-bearing deposits of approximately HK\$32 million (31 December 2001: HK\$32 million) and banking facilities of approximately HK\$57 million (31 December 2001: HK\$34 million), of which approximately HK\$23 million (31 December 2001: HK\$26 million) were utilized.

Interim Dividend

The Board does not recommend the payment of an interim dividend for the nine months ended 30 September 2002 (2001 Nil).

Business Review

Despite the low visibility in the telecommunications market in mainland China, the Group is committed to gearing up and equipping itself by forming strategic alliances with leading industry players. During the Review Period, the Group formed a strategic alliance with IBM China/Hong Kong Limited ("IBM"), the world's largest Internet/electronic/IT business solutions provider, to jointly provide total e-business solutions to corporations. In addition, the Group also formed partnerships with EMC Corporation and a leading Quality of Service ("QoS") provider Sitara Networks Inc, to incorporate their advanced technology into Wafer System's networking solutions. These alliances will enhance the Group's competitive strengths, preparing it well for the industry's recovery.

Due to its sophisticated products and services, the Group has been able to secure new contracts despite the tough times. During the Review Period, the Group was commissioned by China Telecom in Jiangsu Province to expand and upgrade the functionality of its Data Communications Network ("DCN"). In building such a high capacity DCN, the Group utilized its existing network facilities and circuits, bringing about resource optimization.

Additionally, the Group has continued to secure a strong reputation with Multinational Corporations ("MNCs"), maintaining stable growth in this sector. In addition to the MNCs, demand for improved value-added professional services continues to rise among local domestic enterprises. The Group has already penetrated this domestic corporations market, with the provision of tailor-made critical services for customers.

With regard to the network software business, the Group launched its NextG IP Billing Software, providing telecommunications operators with more effective, accurate and flexible billing solutions. This sophisticated software has received a positive response from the market. The Group successfully secured contracts from two Canadian internet protocol ("IP") telephone service providers in the Review Period. This move further reinforces the outstanding results of the Group's NextG IP Billing Software, whilst at the same time extending its business scope to Canada.

Prospects

In order to be able to respond rapidly to the ever-changing market situation, the Group will continue to adopt a flexible operational model. The Group is committed to accelerating the growth of its Professional Service and Network Software in view of the promising results reported in these two sectors, turning them into the Group's future business growth drivers. Moreover, in order to be a first mover, the Group is currently developing its remote network management outsourcing service and expects to launch its round-the-clock network monitoring center when the market develops further.

Furthermore, the Group will continue to increase its research and development capabilities, continuing to develop new products. The Group is also placing strong emphasis on developing its Network Management Software, the Wafer Management Services Support Systems ("WMSS"). The trial version has been completed.

Looking ahead, Next Generation Network ("NGN") is emerging to become a new market trend. The market anticipates that NGN will be widely applied in all telecommunications and information services. This lucrative market has attracted many prominent telecommunications operators, accelerating their pace of development as they seek for suitable partners. As a pioneer in the IT infrastructure industry, the Group is looking for suitable partners in the area of network software and professional services, enhancing its core competencies in the provision of NGN related products and services.

The Group strongly believes that the PRC market provides tremendous business opportunities. With the experience accumulated from the provision of top quality network infrastructure and professional services as well as its solid relationships with corporate clients, the Group will continue its growth with a targeted vision for the future, a passion for service excellence, and a commitment to shareholder value.

FINANCIAL INFORMATION
 Unaudited Consolidated Results

	Notes	For the three months ended 30 September		For the nine months ended 30 September	
		2002 HK\$'000	2001 HK\$'000	2002 HK\$'000	2001 HK\$'000
Turnover	2	40,004	40,034	113,380	90,826
Management fees from (to) the Agents, net		-	(1,103)	-	(1,113)
Material and equipment		(30,467)	(30,049)	(85,653)	(68,324)
Employment costs		(4,474)	(3,720)	(13,868)	(8,946)
Depreciation of property, plant and equipment		(664)	(600)	(1,973)	(1,473)
Amortization of software development costs		(459)	(204)	(986)	(455)
Amortization of other non-current assets		(418)	-	(1,255)	-
Other operating expenses		(5,478)	(3,116)	(14,196)	(9,004)
(Loss)/Profit from operations		(1,956)	1,242	(4,551)	1,511
Other income		-	-	-	1,552
Interest income		541	125	700	610
Finance costs		(511)	(1,075)	(2,110)	(2,529)
(Loss)/Profit before taxation		(1,926)	292	(5,961)	1,144
Taxation	3	65	-	(591)	(191)
(Loss)/Profit attributable to shareholders		(1,861)	292	(6,552)	953
Dividends		-	-	-	-
(Loss)/Earnings per share					
- Basic (cents)	4	(0.66)	0.16	(2.89)	0.59
- Diluted (cents)	4	N/A	0.15	N/A	0.50

NOTES TO THE UNAUDITED CONSOLIDATED RESULTS

(1) **Basis of Presentation**

The Company was incorporated in the Cayman Islands as an exempted company with limited liability on 26 November 1998. The Company's shares were listed on GEM on 17 May 2002.

The unaudited consolidated results have been prepared in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the Hong Kong Society of Accountants.

In January 2002, the Group acquired approximately HK\$5,200,000 non-current assets and adopted the following accounting policy:

Other non-current assets

Other non-current assets are stated at cost less accumulated amortization and accumulation impairment losses. Amortization is provided on a straight-line method over its estimated useful life of three years.

Subject to the above, the principal accounting policies and basis of preparation adopted for the preparation of the unaudited consolidated results are consistent with those adopted by the Group in its annual financial statements for the year ended 31 December 2001.

The condensed financial statements are unaudited but have been reviewed by the audit committee of the Company (the "Audit Committee").

(2) **Turnover and revenue**

An analysis of the Group's turnover and revenue recognized for the three and the nine months ended 30 September 2002, respectively together with the comparative figures for the corresponding periods in 2001 are as follows:

	For the three months ended 30 September		For the nine months ended 30 September	
	2002 HK\$'000	2001 HK\$'000	2002 HK\$'000	2001 HK\$'000
Network infrastructure	31,682	38,908	99,033	86,832
Professional services	8,105	1,126	13,990	3,994
Network software	217	-	357	-
Total turnover	40,004	40,034	113,380	90,826
Other income	-	-	-	1,552
Interest income	541	125	700	610
Total revenue	40,545	40,159	114,080	92,988

(3) **Taxation**

Taxation charges consisted of:

	For the three months ended 30 September		For the nine months ended 30 September	
	2002 HK\$'000	2001 HK\$'000	2002 HK\$'000	2001 HK\$'000
Current taxation-				
Hong Kong profits tax	(245)	-	145	191
Mainland China enterprise income tax	180	-	446	-
	(65)	-	591	191

Hong Kong profits tax has been provided at the rate of 16% (2001: 16%) on the estimated assessable profits arising in Hong Kong during the periods under review.

Taxation arising in other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

(4) (Loss)/Earnings per share

The calculation of basic (loss)/earnings per share for the three months and the nine months ended 30 September 2002 is based on the unaudited (loss)/profit attributable to shareholders of approximately HK\$(1,861,000) and approximately HK\$(6,552,000) (three months and nine months ended 30 September 2001: approximately HK\$292,000 and approximately HK\$953,000, respectively) and on the weighted average number of approximately 282,268,000 shares and approximately 226,989,000 shares, respectively (2001: approximately 177,778,000 and approximately 160,803,000, respectively) in issue during the Review Period.

Diluted loss per share has not been presented for the three months and nine months ended 30 September 2002 since the effect is anti-dilutive.

The calculation of the diluted earnings per share for the three months and nine months ended 30 September 2001 is based on the net profit attributable to shareholders of approximately HK\$292,000 and approximately HK\$953,000, respectively, and on the weighted average number of approximately 190,533,000 shares.

(5) Reserves

	Share premium HK\$'000	Statutory reserves HK\$'000	Accumulated losses HK\$'000	Total HK\$'000
As at 1 January 2001	3,149	-	(7,479)	(4,330)
Premium on issue of ordinary shares	19,357	-	-	19,357
Share issuance expenses	(928)	-	-	(928)
Profit for the nine months ended 30 September 2001	-	-	953	953
	<u>21,578</u>	<u>-</u>	<u>(6,526)</u>	<u>15,052</u>
As at 30 September 2001				
As at 1 January 2002	20,059	1,087	(559)	20,587
Premium on new issue of shares to the public	30,251	-	-	30,251
Share issuance expenses	(11,642)	-	-	(11,642)
Premium on exercise of warrants	73	-	-	73
Premium on conversion of convertible note	17,084	-	-	17,084
Loss for the nine months ended 30 September 2002	-	-	(6,552)	(6,552)
	<u>55,825</u>	<u>1,087</u>	<u>(7,111)</u>	<u>49,801</u>
As at 30 September 2002				

Directors' and Chief Executive's Interests in Share Capital

As at 30 September 2002, the interests of the Directors and chief executive of the Company and their respective associates in the Company and their associated corporations as recorded in the register maintained under section 29 of the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance") of the Company or which required, pursuant to rules 5.40 to 5.59 of the GEM Listing Rules, to be notified to the Company and the Exchange were as follows:

Name of Director	Personal Interest	Family Interest	Corporate Interest	Other Interest	Total
Mr. CHAN Sek Keung, Ringo	-	-	56,400,000 shares (Note)	-	56,400,000 shares (Note)

Note: These shares, representing approximately 19.98% of the issued share capital of the Company, are held by Woodstock Management Limited, a company wholly-owned by Mr. CHAN Sek Keung, Ringo. Mr. CHAN Sek Keung, Ringo is deemed (by virtue of the SDI Ordinance) to be interested in these shares.

Save as disclosed above, as at 30 September 2002, none of the Directors, the chief executive of the Company or their respective associates had any personal, family, corporate or other interests in the shares in the Company or any of its associated corporation as defined in the SDI Ordinance or which, pursuant to rules 5.40 to 5.59 of the GEM Listing Rules, are required to be notified to the Company and the Exchange.

Directors' and Chief Executive's Rights to Acquire Shares

Pursuant to the Pre-IPO Share Option Scheme, as hereinafter defined, the Company has granted options to certain Directors to subscribe for shares in the Company. Details of the options granted to Directors are as follows:

Name of Director	Number of Options Granted	Number of Options Outstanding as at the date hereof	Subscription price per share	Exercise period
Mr. CHAN Sek Keung, Ringo (Executive Director)	3,000,000	3,000,000	HK\$0.55	17 November 2002 to 29 April 2012
Mr. PANG Hing Chung, Alfred (Independent Non-Executive Director)	750,000	750,000	HK\$0.55	17 November 2002 to 29 April 2012

Up to the date hereof, the Company has not made any grants to Directors under the Post-IPO Share Option Scheme.

Substantial Shareholders

So far as the Directors are aware, as at 30 September 2002, the register of substantial shareholders maintained by the Company under Section 16(1) of the SDI Ordinance showed that the Company has been notified the following interests, being 10% or more in the Company's issued share capital:

Name of Shareholder	Number of Shares	Shareholding
Woodstock Management Limited (note i)	56,400,000	19.98%
Mr. CHAN Sek Keung, Ringo (note i)	56,400,000	19.98%
The Applied Research Council (note iii)	48,460,000	17.17%
North 22 Nominees Limited (note iii)	36,900,000	13.07%
Mr. NG Lai Yick (note iii)	36,900,000	13.07%
QPL International Holdings Limited (note iv)	27,780,000	9.84%

Notes:

- i. Woodstock Management Limited is beneficially wholly owned by Mr. CHAN Sek Keung, Ringo, a Director of the Company.
- ii. In addition to this shareholding, The Applied Research Council also holds 5 convertible bonds issued by the Company with face value of \$20,048,100 in aggregate. If these convertible bonds were fully converted on their respective maturity dates, The Applied Research Council will hold an additional 38,063,603 shares in the Company.
- iii. North 22 Nominees Limited is beneficially wholly owned by Mr. NG Lai Yick.
- iv. In addition to this shareholding, QPL International Holdings Limited holds 7,676,745 warrants in the Company, which are exercisable within 6 months from 17 May 2003 at the price of HK\$0.01 per share.

Share Option Schemes

The Company adopted both a pre-IPO share option scheme (the "Pre-IPO Share Option Scheme") and a post-IPO share option scheme (the "Post-IPO Share Option Scheme") on 20 April 2002.

Pre-IPO Share Option Scheme

As at 30 September 2002, options comprising an aggregate of 10,898,000 shares to subscribe for shares in the Company at an exercise price of HK\$0.55 for each share were outstanding.

Details of the outstanding share options under the Pre-IPO Share Option Scheme during the Review Period are set out below:

Type of Participants	As at 30 April 2002 (Date of Grant)	Lapsed during the Review Period	As at 30 September 2002
Directors	3,750,000	–	3,750,000
Adviser	750,000	–	750,000
Employees	7,413,000	1,015,000 (Note)	6,398,000
Total	11,913,000	1,015,000	10,898,000

Note: These options, granted to 2 employees, lapsed 3 months after they ceased to be employees of the Group.

All the above outstanding options may be exercised in accordance with the terms of the Pre-IPO Share Option Scheme at any time during the period between 17 November 2002 and 29 April 2012, ten years from the date of grant of such options.

Post-IPO Share Option Scheme

As at 30 September 2002, options granted under the Post-IPO Share Option Scheme comprising an aggregate 5,257,000 shares to subscribe for shares in the Company at the exercise price of HK\$0.384 for each share were outstanding.

Details of the outstanding share options under the Post-IPO Share Option Scheme during the Review Period are as follows:

Type of Participants	As at 12 July 2002 (Date of Grant)	Cancelled during the Review Period	As at 30 September 2002
Employees	5,277,000	20,000 (Note)	5,257,000

Note: This option, granted to an employee, was cancelled after such employee ceased to be employee of the Group.

The above outstanding options may be exercised in accordance with the terms of the Post-IPO Share Option Scheme between 12 July 2003 and 11 July 2012, ten years from the date of grant of such options.

Save as disclosed above, no options granted pursuant to the Pre-IPO Share Option Scheme and Post-IPO Share Option Scheme had been exercised during the Review Period.

Competition and Conflict of Interests

Each of the Directors and the management shareholders of the Company and their respective associates (as defined in the GEM Listing Rules) has confirmed that none of them had any business or interest in companies that competes or may compete with the business of the Group or any other conflict of interests with the interests of the Group.

Sponsor's Interests

As confirmed by the Company's sponsor, CSC Asia Limited (the "Sponsor"), as at 30 September 2002, neither the Sponsor nor its directors, employees and associates (as referred in Note 3 to rule 6.35 of the GEM Listing Rules) had any interest in the securities of the Company or any member of the Group or any right to subscribe for or to nominate persons to subscribe for the securities of the Company, or any members of the Group.

Upon the listing of shares in the Company on GEM, the Sponsor will receive fees under a sponsor's agreement dated 10 May 2002 between the Company and the Sponsor in connection with services to be rendered by the Sponsor pursuant to rules 6.01 and 17.81 of the GEM Listing Rules.

Audit Committee

The Company established the Audit Committee on 29 October 2001 with written terms of reference in compliance with rules 5.23 to 5.25 of the GEM Listing Rules and with reference to guidance published by the Hong Kong Society of Accountants.

The Audit Committee consists of two independent non-executive Directors, namely, Mr. Tsoi Tai Wai, David and Mr. Pang Hing Chung, Alfred and the executive Director, Mr. Chan Sek Keung, Ringo. Mr. Tsoi is the Chairman of the Audit Committee. The Audit Committee has reviewed the draft of this report and has provided advice and comments thereon.

Board Practices and Procedures

The Company has complied with the board practices and procedures as set out in Rule 5.28 to 5.39 of the GEM Listing Rules during the Review Period.

Purchase, Redemption or Sale of Listed Securities of the Company

During the nine months ended 30 September 2002, neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's listed securities.

By Order of the Board
Wafer Systems Limited
CHAN Sek Keung, Ringo
Chairman and Chief Executive Officer

Hong Kong, 12 November 2002