



WAFER SYSTEMS

WAFER SYSTEMS LIMITED

(Incorporated in the Cayman Islands with limited liability)

FIRST QUARTERLY REPORT 2003

CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET (“GEM”) OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE “STOCK EXCHANGE”)

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This report, for which the directors of the Company (“Directors”) collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited 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 present the unaudited consolidated results of the Company and its subsidiaries (collectively the “Group”) for the three months ended 31 March 2003 (the “Review Period”) together with comparative unaudited figures for the corresponding period in 2002.

Subsequent to the restructuring and consolidation of the telecommunications industry in Mainland China, the situation is improving with projects previously on hold being released. This market recovery together with the synergies generated by the growing scale of the Group’s operations in Mainland China has resulted in an increase in both the Group’s turnover and profits.

During the Review Period, the Group had made a substantial effort to implement various cost control measures and had significantly reduced operating expenses. These had enabled the Group to achieve a net profit during the Review Period.

BUSINESS OVERVIEW AND REVIEW

Financial Review

As a result of the recovery in the telecommunications industry in Mainland China and the Group’s scaling up its operations in Mainland China, a 146% growth in turnover to approximately HK\$58.1 million was reported for the Review Period (2002: HK\$23.7 million).

However, as a result of the Group’s pursuit of more favourable commercial terms and in response to keen market competition, the gross profit margin decreased to approximately 25% during the Review Period (2002: 32%). In spite of this, the Group managed to achieved a net profit of approximately HK\$1 million during the Review Period, representing a significant turnaround from the loss of approximately HK\$3.7 million in the corresponding period in 2002.

Mainland China continued to be the Group’s major market during the Review Period, accounting for 89% (2002: 77%) of the total turnover with the remaining 11% (2002: 23%) generated from Hong Kong. Among the three core businesses, the Network Infrastructure business performed particularly well, with turnover increasing by 149% to approximately HK\$50.3 million (2002: HK\$20.2 million) and representing 87% (2002: 85%) of the Group’s total turnover. As a result of the successful penetration of the market for Multinational Corporations (“MNCs”) and leading domestic corporations, the turnover generated from the Professional Services business also increased significantly to approximately HK\$7.8 million (2002: HK\$3.5 million), representing growth of 126% as compared to the same period last year.

Interim Dividend

The Board does not recommend the payment of an interim dividend for the three months ended 31 March 2003. (2002: Nil)

Business Review

During the Review Period, the Network Infrastructure business has experienced significant growth. The emergence of the Next Generation Network (“NGN”) has generated tremendous business opportunities for the Group. In partnership with Cisco Systems Inc. (“Cisco”), the Group secured an additional contract of approximately HK\$14.59 million (US\$1.87 million) from a well-known telecommunications player in Sichuan Province to provide second phase NGN related infrastructure. This confirms the Group’s ongoing customer satisfaction and excellent service capabilities.

The Group continued to consolidate its leading reputation among MNCs. Its success in securing a contract of more than HK\$15 million from Motorola Inc. (“Motorola”) strongly demonstrates the Group’s niche position in the telecommunications market. Backed by its sophisticated expertise and experience, the Group will help Motorola to integrate its mobile telephone network with the Internet.

The Group also possesses strong competitive advantages in network optimization and security solutions. This has been confirmed by the new contracts obtained from a number of public and private institutions in Hong Kong, including the Hospital Authority, the Information Technology Services Department, the Vocational Training Council, Bank of China and Hutchison Global Communications. These contracts further consolidate the Group's leading position in providing network optimization and security related solutions in Hong Kong.

As a result of the Group's continuing efforts to develop its Professional Services business, the contribution from this sector increased satisfactorily during the Review Period. As more MNCs and local domestic enterprises demand value-added professional services and leveraging its solid foundations, past experience and impeccable reputation, the Board believes that this business sector will transform into a significant growth driver and income stream in the future.

Prospects

The outbreak of the Severe Acute Respiratory Syndrome ("SARS") brings both opportunities and challenges to the Group. Although some infrastructure projects may be delayed due to business disruptions, the Group believes that most of the projects that it is pursuing will not be cancelled but may be delayed. However, as many corporations have cancelled business trips during this critical period, the demand for video conferencing facilities has surged. Enquiries received by the Group for these products and services have doubled. In contrast to many other systems in the market, the Group's multipoint video conferencing system enables two or more people or groups to communicate "face-to-face" free from geographical constraints. In addition to voice and visual transmission, the Group's system also supports a wide array of other functions, including applications sharing, file transfer, video recording of meetings and whiteboard sharing. Taking advantage of this sophisticated system, the Group is committed to capture the increasing sales opportunities in this business sector.

In relation to its Professional Services business, the Group will continue its efforts to increase its penetration of both the MNCs and local domestic markets, providing critical services backed by its comprehensive monitoring centre.

The Group's self-developed NextG IP Billing Software continues to receive positive feedback from the market. During the Review Period, the Group successfully signed contracts with several telecommunication providers, located in Canada and Japan. This sophisticated software has helped the Group to expand its business scope internationally.

In addition, the Group has been invited by Cisco to join its Service Provider Solutions Ecosystem ("SPSE") program (the "Program"). The Program is offered to companies whose products and solutions exhibit market leadership with the use of Cisco's technology, while sharing in Cisco's commitment to customer services and satisfaction. The Group is the first Cisco partner in Hong Kong and Mainland China to receive this recognition under the solutions category "Voice/Packet Telephony Application". This demonstrates that the Group's capabilities in research and development for NGN software and solutions have been recognized by Cisco.

Leveraging off this strong partnership together with its sophisticated products and services, the Board believes that it is well positioned to take advantage of the significant business opportunities generated by the emergence of NGN as Mainland China enters the World Trade Organization. However, the Group is aware that the SARS outbreak may have a significant impact in Mainland China and may lead to additional challenges and opportunities for the Group. Although SARS has not currently had any significant negative impact on the Group, management will continue to monitor the situation closely and will respond appropriately to market conditions.

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

Hong Kong, 13 May 2003

FINANCIAL INFORMATION

Unaudited Consolidated Results

		For the three months ended 31 March	
		2003	2002
	Note	HK\$'000	HK\$'000
Turnover	2	58,113	23,660
Other operating income		39	78
Materials and equipment		(43,519)	(15,975)
Staff costs		(4,157)	(4,915)
Depreciation and amortization		(1,385)	(1,070)
Other operating expenses		(7,248)	(4,497)
Profit (loss) from operations		1,843	(2,719)
Finance costs		(828)	(874)
Profit (loss) before taxation		1,015	(3,593)
Taxation	3	-	(84)
Net profit (loss) attributable to shareholders		1,015	(3,677)
Earnings (loss) per share	4		
– Basic (<i>cents</i>)		0.36	(2.07)
– Diluted (<i>cents</i>)		N/A	N/A

Notes to the Unaudited Consolidated Results

(1) Basis of Presentation

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.

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 2002.

Certain comparative figures have been reclassified to conform with the current period's presentation.

The unaudited consolidated results have been reviewed by 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 months ended 31 March 2003 together with the comparative figures for the corresponding period in 2002 are as follows:

	For the three months ended 31 March	
	2003	2002
	HK\$'000	HK\$'000
Network infrastructure	50,318	20,204
Professional services	7,795	3,456
Network software	-	-
Total turnover	58,113	23,660
Other operating income		
– Interest income	39	78
Total revenue	58,152	23,738

(3) **Taxation**

Taxation charges consisted of:

	For the three months ended 31 March	
	2003	2002
	HK\$'000	HK\$'000
Current taxation		
Hong Kong profits tax	–	58
PRC income tax	–	26
	<u>0</u>	<u>84</u>

No provision for Hong Kong profits tax has been made during the period under review as the Group had no assessable profit arising in or derived from Hong Kong.

Mainland China income tax has not been provided during the Review Period as the Company's subsidiaries in Mainland China had no assessable profit or were within their respective tax exemption periods.

There was no significant unprovided deferred taxation for the three months ended 31 March 2003.

(4) **Earnings (loss) per share**

The calculation of basic earnings (loss) per share for the three months ended 31 March 2003 is based on the unaudited net profit attributable to shareholders of approximately HK\$1,015,000 (2002: net loss of approximately HK\$3,677,000) and on the weighted average number of approximately 282,268,000 shares (2002: approximately 177,778,000 shares) in issue during the period.

Diluted earnings (loss) per share has not been presented for the three months ended 31 March 2003 and its corresponding period in 2002 since there was no dilutive potential ordinary share in existence during the periods.

(5) **Reserves**

	Share premium HK\$'000	Statutory surplus reserves fund HK\$'000	Enterprise expansion fund HK\$'000	Staff welfare fund HK\$'000	Deficit HK\$'000	Total HK\$'000
As at 1 January 2002	20,059	543	272	272	(559)	20,587
Loss for the three months ended 31 March 2002	–	–	–	–	(3,677)	(3,677)
As at 31 March 2002	<u>20,059</u>	<u>543</u>	<u>272</u>	<u>272</u>	<u>(4,236)</u>	<u>16,910</u>
As at 1 January 2003	55,824	1,003	502	502	(7,328)	50,503
Profit for the three months ended 31 March 2003	–	–	–	–	1,015	1,015
As at 31 March 2003	<u>55,824</u>	<u>1,003</u>	<u>502</u>	<u>502</u>	<u>(6,313)</u>	<u>51,518</u>

Directors' and Chief Executive's Interests in Share Capital

As at 31 March 2003, the interests of the Directors, chief executive of the Company and their respective associates in the Company and its 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 Rules Governing the Listing of Securities on GEM ("GEM Listing Rules"), to be notified to the Company and the Stock Exchange were as follows:

Name of Director	Personal Interest	Family Interest	Corporate Interest	Other Interest	Total
Mr. CHAN Sek Keung, Ringo	564,000 shares	–	56,400,000 shares (Note)	–	56,964,000 shares

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 31 March 2003, 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 of 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 Stock Exchange.

Directors' and Chief Executive's Rights to Acquire Shares

Pursuant to the Company's pre-IPO and post-IPO share option schemes adopted on 20 April 2002, certain Directors have been granted options to subscribe for shares of the Company.

Name of Director	Date of Grant	Number of Options Granted	Number of Options Outstanding as at 31 March 2003	Exercise Price per share	Exercise Period
CHAN Sek Keung, Ringo (Executive Director)	30 April 2002	3,000,000	3,000,000	HK\$0.55	17 November 2002 to 29 April 2012
	20 February 2003	1,200,000	1,200,000	HK\$0.138	20 February 2004 to 19 February 2013
PANG Hing Chung, Alfred (Independent Non-Executive Director)	30 April 2002	750,000	750,000	HK\$0.55	17 November 2002 to 29 April 2012
	20 February 2003	750,000	750,000	HK\$0.138	20 February 2004 to 19 February 2013
TSOI Tai Wai, David (Independent Non-Executive Director)	20 February 2003	750,000	750,000	HK\$0.138	20 February 2004 to 19 February 2013
Alasdair Gordon NAGLE (Non-Executive Director)	20 February 2003	375,000	375,000	HK\$0.138	20 February 2004 to 19 February 2013
Clara HO (Non-Executive Director)	20 February 2003	375,000	375,000	HK\$0.138	20 February 2004 to 19 February 2013
KWAN Kit Tong (Non-Executive Director)	20 February 2003	375,000	375,000	HK\$0.138	20 February 2004 to 19 February 2013

None of the share options granted to the Directors have been exercised as at 31 March 2003.

Substantial Shareholders

So far as the Directors are aware, as at 31 March 2003, the register of substantial shareholders maintained by the Company under Section 16(1) of the SDI Ordinance showed that the Company has been notified of 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 ii)	56,964,000	20.18%
The Applied Research Council (note iii)	48,460,000	17.17%
North 22 Nominees Limited (note iv)	36,900,000	13.07%
Mr. NG Lai Yick (note iv)	36,900,000	13.07%
QPL International Holdings Limited (note v)	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. By virtue of the SDI Ordinance, Mr. CHAN Sek Keung, Ringo is deemed to be also interested in the 56,400,000 shares held by Woodstock Management Limited, in addition to the 564,000 shares held by himself personally.
- iii. In addition to this shareholding, the Applied Research Council also holds 5 Convertible Bonds issued by the Company with a face value of HK\$20,048,100 in aggregate. If these convertible bonds were fully converted on their respective maturity dates, the Applied Research Council would hold an additional 38,063,603 shares in the Company.
- iv. North 22 Nominees Limited is beneficially wholly owned by Mr. NG Lai Yick.
- v. In addition to this shareholding, QPL International Holdings Limited also 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 in a general meeting held on 20 April 2002 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").

(a) Pre-IPO Share Option Scheme

One single grant of options representing 11,913,000 shares in aggregate, was made to various participants on 30 April 2002 at an exercise price of HK\$0.55 under this Scheme.

As at 31 March 2003, options comprising an aggregate of 10,338,000 shares were outstanding, as detailed below:

Type of Participants	As at 31 December 2002	Cancelled during Review Period	As at 31 March 2003
Directors	3,750,000	0	3,750,000
Adviser	750,000	0	750,000
Employees	5,913,000	75,000 (Note)	5,838,000
Total	<u>10,413,000</u>	<u>75,000</u>	<u>10,338,000</u>

Note: These options, granted to 1 employee, were cancelled due to the employee having left the Group according to the rules of the Scheme.

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 the options.

(b) Post-IPO Share Option Schemes

- (i) The first grant of options representing 5,277,000 shares in aggregate, was made to various participants on 12 July 2002 at an exercise price of HK\$0.384 under this Scheme.

As at 31 March 2003, options comprising an aggregate of 4,827,000 shares were outstanding, as detailed below:

Type of Participants	As at 31 December 2002	Cancelled during Review Period	As at 31 March 2003
Employees	5,007,000	180,000 (Note)	4,827,000

Note: These options, granted to 7 employees, were cancelled due to the employees having left the Group according to the rules of the Scheme.

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 the options.

- (ii) The second grant of options representing 7,859,000 shares in aggregate, was made to various participants on 20 February 2003 at an exercise price of HK\$0.138 under this Scheme.

As at 31 March 2003, all options under this grant, comprising an aggregate of 7,859,000 shares, were outstanding, as detailed below:

Type of Participants	As at 20 February 2003 (Date of Grant)	Cancelled during Review Period	As at 31 March 2003
Directors	3,825,000	0	3,825,000
Adviser	300,000	0	300,000
Employees	3,734,000	0	3,734,000
Total	<u>7,859,000</u>	<u>0</u>	<u>7,859,000</u>

The above outstanding options may be exercised in accordance with the terms of the Post-IPO Share Option Scheme between 20 February 2004 and 19 February 2013, ten years from the date of grant of the options.

Save as above disclosed, no options granted pursuant to either the Pre-IPO Share Option Scheme or the Post-IPO Share Option Schemes 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 31 March 2003, 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.

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

Audit Committee

The Company established an 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 the guidelines 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 Review Period, 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, 13 May 2003