



WAFER SYSTEMS

**Wafer Systems Limited**

**威發系統有限公司\***

*(Incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 8198)**

**FIRST QUARTERLY REPORT  
FOR THE 3 MONTHS ENDED 31 MARCH 2004**

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

GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

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The principal means of information dissemination on GEM is publication on the Internet website operated by the Exchange. GEM-listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website at [www.hkgem.com](http://www.hkgem.com) in order to obtain up-to-date information on GEM-listed issuers.

*The Exchange takes no responsibility for the contents of this report, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this report.*

*As at the date of this report, the executive director of the Company is Mr. Chan Sek Keung, Ringo, the non-executive directors are Ms. Clara Ho, Mr. Alasdair Gordon Nagle and Mr. Kwan Kit Tong and the independent non-executive directors are Mr. Pang Hing Chung, Alfred and Mr. Tsoi Tai Wai, David.*

*This report, for which the directors (the “Directors”) of Wafer Systems Limited (the “Company”) collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on GEM (the “GEM Listing Rules”) 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.*

\* For identification purpose only

## **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 2004 (the “Review Period”) together with comparative unaudited figures for the corresponding period in 2003.

### **BUSINESS OVERVIEW AND REVIEW**

#### **Financial Review**

During the Review Period, the Group recorded a turnover of approximately HK\$40,493,000, approximately 30% lower than that recorded in the corresponding period last year. The decrease is mainly due to the fact that the first quarter in 2003 was an exceptional quarter, during which a HK\$15 million backlog order from Motorola was booked. The Group recorded a loss of approximately HK\$987,000 for the Review Period. (2003: profit of approximately HK\$1 million)

Mainland China continued to be the Group’s major revenue source, accounting for approximately 92.7% of the Group’s total turnover while the remaining portion of approximately 7.3% came from Hong Kong. During the Review Period, the Network Infrastructure business continued as the Group’s main revenue contributor, generating a turnover of approximately HK\$33,328,000 (2003: approximately HK\$50,318,000). This represented approximately 82.3% of the Group’s turnover in the Review Period (2003: approximately 86.6%). The Professional Services business remained steady with turnover maintained at approximately HK\$7,165,000 (2003: approximately HK\$7,795,000). The Professional Services and Network Software businesses are expected to contribute progressively larger share to both the Group’s turnover and profit in the future.

As at 31 March 2004, the Group had built up a very healthy backlog orders on hand of approximately HK\$37 million, as compared with last year’s approximately HK\$18 million.

#### **Interim Dividend**

The Board does not recommend the payment of an interim dividend for the three months ended 31 March 2004 (2003: Nil).

#### **Business Review**

##### *Network infrastructure*

Apart from offering high quality network infrastructure solution to telecommunications operators, the Group has also gained wider entry into the industrial sector. New customers include the China operations of automobile manufacturers such as DaimlerChrysler and Volkswagen, and the elevators and escalators manufacturer, KONE Corporation. This demonstrates that the Group has taken its first step to differentiate itself and penetrate into new market segments and pave the way for gaining a strong position in the industrial sector.

##### **Professional services**

Building upon its proven records in the Professional Services business, the Group continues to expand its customer base of multi-national corporations (“MNCs”) and large local corporations in Mainland China. New MNCs customers include Sybase Software (China) Co., Ltd. and EDS (China) Co., Ltd. and domestic enterprises such as Shanghai Posts & Telecommunications Equipment Co., Ltd. became customers of the Group during the Review Period.

Among other achievements, the Group is providing network optimization and security solutions to a host of local and international customers, including Schneider Electric (Hong Kong) Limited, QAD Asia Ltd., Bookham Technology plc., Hong Kong Interbank Clearing Ltd., and the Sogo department store outlets in both Mainland China and Hong Kong.

Professional Services is one of the Group’s core competencies. To this end, the Group will inject additional resources in developing this business, with an aim to further expand our clientele and consolidate our reputation in the field. Management believes that this business sector will continue to be the Group’s major growth driver, providing a steady and substantial stream of income in the future.

## Network Software

During the Review Period, the Group placed extra efforts in accelerating the pace of designing and developing software, such as the business support system (“BSS”), operation support system (“OSS”) and network security solutions, among others, to be launched in the coming years. The Group understands that advanced research and development capability is the cornerstone for the success of attracting top-tier clients. In this regard, the Group has strategically allied with Cisco Systems Inc. (“Cisco”) and has developed good working relations with their Asia Pacific research and development team, with a goal of introducing new products in the near future.

## Prospects

As a market pioneer, the Group has accumulated valuable and extensive experience in the Next Generation Network (“NGN”), with a particular emphasis on the telecommunications sector. As more and more telecommunications providers are attracted by the efficiency and effectiveness of NGN, they are now seeking reliable solution providers, a situation where the Group fits in perfectly.

The Group has been partnering with Cisco in developing NGN and its related businesses. As Cisco is a multinational company with customers across different countries, the Group’s partnership with them also enables the Group to reach customer in other regions of the world. The Group has secured contracts with customers in Taiwan and Singapore by offering them NGN consultancy service.

Turning to Network Software business, the Group will continue to enhance its software capabilities in order to maintain its leadership in the field. The Group will accelerate its pace of development for NGN software and solutions, so as to further consolidate its position as a NGN pioneer in the market.

With the rapid growth of the information technology and telecommunications industries, Management believes that the potentials for future business development are enormous. With its solid background and large pool of experienced staff, the Group will be able to take full advantage of the immense opportunities brought about by the emergence of NGNs and China deepens itself as a member of the World Trade Organization.

## FINANCIAL INFORMATION

### *Unaudited Consolidated Financial Results*

		For the three months ended	
		31 March	
	Note	2004 HK\$'000	2003 HK\$'000
Turnover	2	40,493	58,113
Other operating income		23	39
Changes in materials and equipment		(30,675)	(43,519)
Staff costs		(3,919)	(4,157)
Depreciation and amortization		(1,312)	(1,385)
Other operating expenses		(5,206)	(7,248)
(Loss)/profit from operations		(596)	1,843
Finance costs		(382)	(828)
(Loss)/profit before taxation		(978)	1,015
Taxation	3	–	–
(Loss)/profit before minority interests		(978)	1,015
Minority interests		(9)	–
Net (loss)/profit attributable to shareholders		<u>(987)</u>	<u>1,015</u>
(Loss)/earnings per share			
– Basic (cents)	4	<u>(0.34)</u>	<u>0.36</u>
– Diluted (cents)		<u>N/A</u>	<u>N/A</u>

## NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL 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 the Hong Kong Financial Reporting Standard 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 2003.

The unaudited consolidated results 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 Review Period together with the comparative figures for the corresponding period in 2003 are as follows:

	For the three months ended 31 March	
	2004	2003
	HK\$'000	HK\$'000
Network infrastructure	33,328	50,318
Professional services	7,165	7,795
Network software	—	—
	<hr/>	<hr/>
Total turnover	40,493	58,113
Other operating income		
– Interest income	23	39
	<hr/>	<hr/>
Total revenue	<u>40,516</u>	<u>58,152</u>

### (3) Taxation

No provision for Hong Kong profits tax has been made as the Group had no assessable profit for the Review Period and its corresponding period in 2003.

PRC income tax has not been provided for the Review Period and its corresponding period in 2003 as the Company's PRC subsidiaries had no assessable profit or were within their tax exemption period.

No deferred tax asset has been recognized in respect of the unutilized tax losses due to the unpredictability of future profit streams.

### (4) (Loss)/earnings per share

The calculation of basic (loss)/earnings per share for the Review Period is based on the unaudited net loss attributable to shareholders of approximately HK\$987,000 (2003: net profit of approximately HK\$1,015,000) and on the weighted average number of approximately 289,945,000 shares (2003: approximately 282,268,000) in issue during the Review Period.

Diluted (loss)/earnings per share has not been presented for the Review Period and its corresponding period in 2003 since the effect is anti-dilutive.

(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 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>
As at 1 January 2004	55,824	1,003	502	502	(6,471)	51,360
Loss for the three months ended 31 March 2004	–	–	–	–	(987)	(987)
As at 31 March 2004	<u>55,824</u>	<u>1,003</u>	<u>502</u>	<u>502</u>	<u>(7,458)</u>	<u>50,373</u>

**DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS OR SHORT POSITION IN SHARES AND UNDERLYING SHARES OF THE COMPANY**

As at 31 March 2004, the interests and short positions of the Directors, the chief executive of the Company and their respective associates in the shares, underlying shares and debentures of the Company and any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), as recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO or as otherwise notified to the Company and the Exchange pursuant to required standard of dealings by Directors as referred to in Rule 5.46 of the GEM Listing Rules, were as follows:

(a) Long positions in shares in the Company

Name of Director	Number of shares held						Approximate percentage of the Company's issued share capital	
	Personal interest	Capacity	Family interest	Corporate interest	Capacity	Other interest		
Mr. Chan Sek Keung, Ringo	3,336,000	Beneficial owner	–	56,400,000 (Note)	Interest of a controlled corporation	–	59,736,000	20.60%

Note: Such shares in the Company are held by Woodstock Management Limited ("Woodstock"), a company wholly owned by Mr. Chan Sek Keung, Ringo, who is deemed, by virtue of the SFO, to be interested in these shares.

(b) Long positions in underlying shares in the Company (Directors' rights to acquire shares)

Name of Director	Capacity	Date of grant	Number of unlisted pre-IPO share option outstanding as at 1 January 2004	Number of unlisted pre-IPO share option outstanding as at 31 March 2004	Number of unlisted post-IPO share option outstanding as at 1 January 2004	Number of unlisted post-IPO share option outstanding as at 31 March 2004	Aggregate interests	Exercise period of share options	Exercise price of share options (HK\$)	Approximate percentage of the Company's issued share capital
Mr. Chan Sui Keung, Ringo	Beneficial owner	30 April 2002	3,000,000	3,000,000	-	-	-	17 November 2002 to 29 April 2012 (Note 1)	0.55	-
		20 February 2003	-	-	1,200,000	1,200,000	4,200,000	20 February 2004 to 19 February 2013 (Note 2)	0.138	1.44%
Mr. Pang Hing Chung, Alfred	Beneficial owner	30 April 2002	750,000	750,000	-	-	-	17 November 2002 to 29 April 2012 (Note 1)	0.55	-
		20 February 2003	-	-	750,000	750,000	1,500,000	20 February 2004 to 19 February 2013 (Note 2)	0.138	0.52%
Mr. Tsoi Tai Wai, David	Beneficial owner	20 February 2003	-	-	750,000	750,000	750,000	20 February 2004 to 19 February 2013 (Note 2)	0.138	0.26%
Mr. Alasdair Gordon Nagle	Beneficial owner	20 February 2003	-	-	375,000	375,000	375,000	20 February 2004 to 19 February 2013 (Note 2)	0.138	0.15%
Ms. Clara Ho	Beneficial owner	20 February 2003	-	-	375,000	375,000	375,000	20 February 2004 to 19 February 2013 (Note 2)	0.138	0.15%
Mr. Kwan Kit Tong	Beneficial owner	20 February 2003	-	-	375,000	375,000	375,000	20 February 2004 to 19 February 2013 (Note 2)	0.138	0.15%

Notes:

- (1) Pre-IPO share options granted under the pre-IPO share option scheme adopted by the Company on 20 April 2002 are exercisable as to (i) a maximum of 25% of the total number of options granted six months after 17 May 2002 (the "Date of Listing"); (ii) a maximum additional 6.25% of the total number of options granted after the expiry of each 3-month period twelve months after the Date of Listing; and (iii) the remaining options on or after the third anniversary of the Date of Listing until the end of the option period or lapse of an option.
- (2) Post-IPO share options granted under the post-IPO share option scheme adopted by the Company on 20 April 2002 are exercisable starting from the first anniversary of the grant date at stepped annual increment of 25% of the total options granted, for a period not later than 10 years from the date of grant.
- (3) Each of the Directors' interests represent their respective long positions in the underlying shares in the Company by virtue of options granted to the Directors pursuant to the aforesaid pre-IPO and post-IPO share option schemes.

Other than as disclosed above, none of the Directors, the chief executive and their respective associates, had any interests or short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations as at 31 March 2004.

**SUBSTANTIAL SHAREHOLDERS AND OTHER SHAREHOLDERS WHOSE INTEREST ARE RECORDED UNDER SECTION 336 OF THE SFO**

As at 31 March 2004, the following persons or corporations, in addition to the Director stated under the section headed "Directors' and chief executive's interests or short position in shares and underlying shares of the Company" had interests in the shares and underlying shares in the Company as recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO.

(a) **Long positions in share in the Company**

Name of shareholder	Capacity	Type of interests	Number of shares	Approximate percentage of the Company's issued share capital
The Applied Research Council ("ARC") ( <i>Note 1</i> )	Beneficial owner	Corporate	48,460,000	16.71%
HSBC Private Equity Technology (Asia) Limited ( <i>Note 2</i> )	Investment manager	Corporate	48,460,000	16.71%
HSBC Private Equity (Asia) Limited ( <i>Note 2</i> )	Interest of a controlled corporation	Corporate	48,460,000	16.71%
North 22 Nominees Limited	Beneficial owner	Corporate	36,900,000	12.73%
Mr. Ng Lai Yick ( <i>Note 3</i> )	Beneficial owner Interest of a controlled corporation	Personal Corporate	3,134,744 36,900,000	1.08% 12.73%
QPL International Holdings Limited ("QPL") ( <i>Note 4</i> )	Beneficial owner	Corporate	35,456,745	12.23%
Mr. Li Tung Lok ( <i>Note 4</i> )	Interest of a controlled corporation	Corporate	35,456,745	12.23%
Madam Su Ching Wah ( <i>Note 4</i> )	Interest of spouse	Family	35,456,745	12.23%

*Notes :*

- (1) ARC is the beneficial owner of these shares. In addition to these shares, ARC also holds two convertible bonds issued by the Company with a face value of HK\$7,660,000 in aggregate. If these convertible bonds were fully converted on their respective maturity dates, ARC would hold an additional 14,543,383 shares in the Company.
- (2) HSBC Private Equity Technology (Asia) Limited is deemed, by virtue of the SFO, to be interested in these shares as it is the investment manager of ARC.  
  
HSBC Private Equity (Asia) Limited is deemed, by virtue of the SFO, to be interested in these shares as HSBC Private Equity Technology (Asia) Limited is its wholly-owned subsidiary.
- (3) Mr. Ng Lai Yick is deemed, by virtue of the SFO, to be interested in the 36,900,000 shares held by North 22 Nominees Limited as the company is wholly-owned by him.
- (4) Mr. Li Tung Lok is the controlling shareholder of QPL and is deemed, by virtue of the SFO, to be interested in the 35,456,745 shares held by QPL.  
  
Madam Su Ching Wah is the spouse of Mr. Li Tung Lok and is deemed, by virtue of the SFO, to be interested in the 35,456,745 shares held by QPL.

**(b) Long positions in underlying shares in the Company**

<b>Name of Shareholder</b>	<b>Capacity</b>	<b>Amount of convertible bonds of the Company issued</b>	<b>Number of underlying Shares</b>
ARC ( <i>Note 1</i> )	Beneficial owner	HK\$7,660,000	14,543,383
HSBC Private Equity Technology (Asia) Limited ( <i>Note 2</i> )	Investment manager	HK\$7,660,000	14,543,383
HSBC Private Equity (Asia) Limited ( <i>Note 2</i> )	Interest of a corporation controlled	HK\$7,660,000	14,543,383

*Notes:*

- (1) Pursuant to an agreement dated 26 April 2002 entered into among ARC, the Group and Woodstock, ARC would subscribe for five convertible bonds to be issued by the Company with respective face values of HK\$4,188,100, HK\$3,400,000, HK\$4,800,000, HK\$4,660,000 and HK\$3,000,000. As at 31 March 2004, the Company had redeemed three convertible bonds of face value of HK\$4,188,100, HK\$3,400,000 and HK\$4,800,000 respectively on their maturity date leading to ARC's underlying interests in Company's shares being decreased from 38,063,603 shares to 14,543,383 shares.
- (2) HSBC Private Equity Technology (Asia) Limited is deemed, by virtue of the SFO, to be interested in 14,543,383 underlying shares held by ARC as the Company is the investment manager of ARC.  
  
HSBC Private Equity (Asia) Limited is deemed, by virtue of the SFO, to be interested in 14,543,383 underlying shares held by ARC as HSBC Private Equity Technology (Asia) Limited is its wholly-owned subsidiary.

Other than as disclosed above, the Company has not been notified of any other relevant interests or short positions in the shares or underlying shares in the Company as at 31 March 2004.

**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").

Save as disclosed below, no options granted pursuant to either the Pre-IPO Share Option Scheme or the Post-IPO Share Option Schemes had lapsed or had been exercised during the Review Period.



(a) **Pre-IPO Share Option Scheme**

One single grant of 11,913,000 shares in aggregate was made to various participants on 30 April 2002 under this scheme. As at 31 March 2004, options comprising an aggregate of 9,868,000 shares were outstanding, as detailed below:

	Exercise price per share <i>HK\$</i>	Number of share options		
		Outstanding as at 1.1.2004	Cancelled during Review Period	Outstanding as at 31.3.2004
Type of Participants:				
Directors	0.55	3,750,000	–	3,750,000
Advisor	0.55	750,000	–	750,000
Employees	0.55	5,473,000	105,000 ( <i>Note</i> )	5,368,000
		<u>9,973,000</u>	<u>105,000</u>	<u>9,868,000</u>

*Note:* These options were cancelled according to the rules of this scheme due to the employees having left the Group.

The above outstanding options may be exercised, in accordance with the terms of the Pre-IPO Share Option Scheme, before 30 April 2012.

(b) **Post-IPO Share Option Schemes**

There have been a total of 4 Post-IPO Share Options grants. The number of share options granted were 5,277,000 shares on 12 July 2002, 7,859,000 shares on 20 February 2003, 385,000 shares on 10 October 2003 and 2,844,000 shares on 23 February 2004.

A summary of the Post-IPO Share Option Scheme movements during the Review Period and as at 31 March, 2004 is as follows:

Date of grant	Type of Participants	Exercisable Period	Exercise Price per share <i>HK\$</i>	Number of share options			
				Outstanding as at 1.1.2004	Granted during Review Period	Cancelled during Review Period <i>(Note)</i>	Outstanding as at 31.3.2004
12.7.2002	Employees	12.7.2003 to 11.7.2012	0.384	3,419,000	–	85,000	3,334,000
20.2.2003	Directors	20.2.2004 to 19.2.2013	0.138	3,825,000	–	–	3,825,000
	Advisors	20.2.2004 to 19.2.2013	0.138	300,000	–	–	300,000
	Employees	20.2.2004 to 19.2.2013	0.138	3,351,000	–	135,000	3,216,000
				<u>7,476,000</u>	<u>–</u>	<u>135,000</u>	<u>7,341,000</u>
10.10.2003	Employees	10.10.2004 to 9.10.2013	0.142	385,000	–	–	385,000
23.2.2004	Employees	23.2.2005 to 22.2.2014	0.165	–	2,844,000	–	2,844,000
				<u>11,280,000</u>	<u>2,844,000</u>	<u>220,000</u>	<u>13,904,000</u>

*Note:* These options were cancelled according to the rules of this scheme due to the employees having left the Group.

The above outstanding options may be exercised within the exercisable period in accordance with the terms of the Post-IPO Share Option Scheme.

## **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 2004, 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 the Audit Committee on 29 October 2001 with written terms of reference in compliance with Rules 5.28 to 5.30 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 Rules 5.34 to 5.45 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, 14 May 2004