



WAFER SYSTEMS

**Wafer Systems Limited**

**威發系統有限公司\***

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

(Stock Code: 8198)

**INTERIM REPORT  
FOR THE SIX MONTHS ENDED 30 JUNE 2005**

**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.

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the Main Board of the Exchange and no assurance is given that there will be a liquid market in the securities traded on GEM.

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, Mr. Tsoi Tai Wai, David and Mr. Yu Zhonghou.*

*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 reasonable 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 report the unaudited consolidated results of the Company and its subsidiaries (collectively, the "Group") for the six months ended 30 June 2005 (the "Review Period") together with the comparative unaudited figures for the corresponding period in 2004.

## BUSINESS OVERVIEW AND REVIEW

### Financial Highlights

	<b>Q2/2005</b> <i>HK\$'000</i>	Q2/2004 <i>HK\$'000</i>	Change	<b>1H/2005</b> <i>HK\$'000</i>	1H/2004 <i>HK\$'000</i>	Change
Turnover	<b>66,882</b>	55,917	+20%	<b>218,930</b>	96,410	+127%
Operating Profit	<b>571</b>	2,024	-72%	<b>2,211</b>	1,369	+62%
Profit attributable to shareholders of the Company	<b>84</b>	1,419	-94%	<b>862</b>	373	+131%
Basic EPS (HK Cents)	<b>0.03</b>	0.49	-94%	<b>0.30</b>	0.13	+131%
Orders on hand				<b>55,000</b>	92,700	-41%

### Financial Review

During the Review Period, the Group recorded a turnover of approximately HK\$218.9 million (2004: HK\$96.4 million), a sharp 127% increase from that recorded in the corresponding period in 2004. Profit attributable to shareholders of the Company for the Review Period increased by 131% to approximately HK\$862,000 (2004: HK\$373,000).

During the Review Period, mainland China continued to be the Group's major market. In particular, the Group was awarded a significant contract of approximately HK\$98 million for the supply of network infrastructure equipment to a major telecommunications service provider through Beijing Siemens Communications Network Co. Ltd. With this addition, mainland China accounted for 96.8% (2003: 92.1%) of the total turnover with the remaining 3.2% (2004: 7.9%) generated in Hong Kong. Turnover generated from Network Infrastructure business amounted to approximately HK\$195.1 million (2004: HK\$83.2 million). The turnover of Professional Services business amounted to approximately HK\$23.8 million (2004: HK\$12.1 million), while no Network Software business was achieved (2004: HK\$1.1 million).

### Interim Dividend

The Board does not recommend the payment of an interim dividend for the six months ended 30 June 2005 (2004: Nil).

## **Business Review**

During the first half of 2005, the Group maintained its business strategy of matching its professional expertise with the needs of its customers. The Group's policy of putting customer satisfaction first continued to win customer loyalty and support. During the Review Period, whilst continuing to serve the traditional market segment of multi-national corporations ("MNCs") where the Group remains strong, the Group also established more co-operation with major telecommunication service providers ("telcos") in mainland China as well as local industries and enterprises.

During the Review Period, the Group won a HK\$98 million network infrastructure contract which was the largest single contract in the Group's history. Although its margin was lower than typical margins, the project gave the Group exposure and experience in the execution of large scale projects and enhanced the relationship of the Group with the telcos sector.

Professional Services has always been an important part of the Group's business and provides a useful contribution to the Group's profitability. During the Review Period, the Group's professional services revenue amounted to approximately HK\$23.8 million, an increase of 96.7% over the corresponding period in 2004. In addition to large local enterprises, customers for the Group's professional services include IBM Global Services (China) Co. Ltd. and Motorola (China) Electronics Ltd. for the mainland China market and New World PCS Ltd. for Hong Kong. The Group has firmly established its reputation as a reliable partner for professional services.

During the Review Period, the Group continued with the research and development on network software. These sets of software include business support systems ("BSS"), operation support systems ("OSS") and network security solutions. In addition to continuing its co-operation with the Asia Pacific research and development team of Cisco Systems Inc., the marketing of the Group's proprietary software outside of China in collaboration with Cisco made good progress.

## **Prospects**

As the Group enters the third quarter of 2005, there is a healthy backlog of orders on hand. As at 30 June 2005, the total value of the backlog orders on hand was approximately HK\$55.0 million, compared with approximately HK\$35.5 million at 31 March 2005 and HK\$92.7 million as at 30 June 2004.

As the second half of the year is typically the busiest period for its business, the Group is cautiously optimistic about obtaining orders in addition to the delivery of the backlog orders.

The Group is also expecting continued success in attracting business from the MNCs, large local enterprise customers as well as from telecommunications service providers.

However, competition in the market continues to be keen resulting in tight profit margins. Strategically, the Group will continue to foster its existing excellent relationships with customers while placing more emphasis on the more niche market of professional services and software products.

## **MANAGEMENT DISCUSSION & ANALYSIS**

### **Liquidity, Financial Resources and Capital Structure**

During the Review Period, the Group continued its conservative policies in cash and financial management. Surplus funds were placed on interest-bearing deposits with banks. The Group generally financed its operations and serviced its debts from its internal resources and short-terms bank loans.

As at 30 June 2005, the Group recorded net current assets of approximately HK\$46.7 million as compared with approximately HK\$46.2 million as at 31 December 2004. However, the current ratio decreased to approximately 1.4 from 1.57 as at 31 December 2004. The decrease resulted mainly from the recognition of the HK\$98 million network infrastructure contract during the Review Period. Net current assets included bank balances and cash of approximately HK\$23.2 million (31 December 2004: HK\$40.6 million) and total short terms bank loans of approximately HK\$52.2 million (31 December 2004: HK\$48.0 million). During the Review Period, the Group redeemed the last convertible bond of HK\$3 million.

There was no non-current liabilities recorded as at 30 June 2005 and 31 December 2004.

As at 30 June 2005, all assets and liabilities of the Group were denominated in U.S. dollars, Hong Kong dollars and Renminbi.

### **Acquisitions, Disposals and Significant Investment**

The Group had not made any significant acquisitions, disposals or investments during the Review Period.

### **Segmental Information**

The segmental information of the Group is covered in the Financial Review and in note 2 to the Condensed Financial Information.

### **Employee Information**

As at 30 June 2005, the Group had 162 employees (2004: 130 employees) comprising 24 employees (2004: 22 employees) based in Hong Kong and 137 employees (2004: 108 employees) based in mainland China. The Group continues to provide remuneration packages to employees in accordance with market practices and past performance. In addition to basic remuneration, the Group also provides other benefits such as a mandatory provident fund, medical scheme, share options scheme and staff training program to employees.

## **Charges on Group Assets**

As at 30 June 2005, the Group did not have any significant charges on its assets.

## **Gearing Ratio**

As at 30 June 2005, the gearing ratio, i.e. total liabilities over total assets, increased to approximately 66.7% from approximately 58.7% as at 31 December 2004.

## **Foreign Exchange Exposure**

During the Review Period, the Group earned revenue and incurred costs and expenses mainly in U.S. dollars, Hong Kong dollars and Renminbi. As the exchange rates of such currencies have been stable, no hedging or other alternatives have been implemented.

## **Order Book & Prospects for New Business**

As at 30 June 2005, the Group had contracts on hand for sales amounting to approximately HK\$55.0 million (30 June 2004: HK\$92.7 million) which will be booked as revenue upon delivery and implementation.

## **Contingent Liabilities**

Except for those commitments and contingent liabilities set out in note 11 and note 12 to the Financial Information, the Group had no significant contingent liabilities as at 30 June 2005.

## **Future plans for Investments or Capital Assets and Sources of Funding**

The Group has no plans for any significant investments, acquisitions of capital assets or additional sources of funding.

## FINANCIAL INFORMATION

### Condensed Consolidated Income Statement (Unaudited)

	Note	For the three months ended 30 June		For the six months ended 30 June	
		2005 HK\$'000	2004 HK\$'000 (restated)	2005 HK\$'000	2004 HK\$'000 (restated)
Turnover	2	66,882	55,917	218,930	96,410
Other operating income		60	36	99	59
Charges for materials and equipment		(53,170)	(41,740)	(188,125)	(72,415)
Staff costs		(4,743)	(4,273)	(8,993)	(8,251)
Depreciation and amortization		(1,046)	(1,290)	(2,159)	(2,602)
Other operating expenses		(7,412)	(6,626)	(17,541)	(11,832)
Profit from operations	3	571	2,024	2,211	1,369
Finance costs		(552)	(585)	(1,355)	(967)
Profit before taxation		19	1,439	856	402
Taxation	4	65	(45)	–	(45)
<b>Profit for the period</b>		<b>84</b>	<b>1,394</b>	<b>856</b>	<b>357</b>
Attributable to:					
Shareholders of the Company		84	1,419	862	373
Minority interest		–	(25)	(6)	(16)
		<b>84</b>	<b>1,394</b>	<b>856</b>	<b>357</b>
Earnings per share					
– Basic (cents)	5	0.03	0.49	0.30	0.13
– Diluted (cents)	5	N/A	0.49	N/A	0.13

## Condensed Consolidated Balance Sheet

		(Unaudited) As at 30 June 2005	(Audited) As at 31 December 2004
	Note	<u>HK\$'000</u>	<u>HK\$'000</u> (restated)
Non-current assets			
Property, plant and equipment	6	4,080	3,779
Software product development costs		7,447	7,256
		<u>11,527</u>	<u>11,035</u>
Current assets			
Inventories		15,976	11,895
Trade and other receivables	7	124,226	75,072
Pledged bank deposits		–	9
Bank balances and cash		23,173	40,752
		<u>163,375</u>	<u>127,728</u>
Current liabilities			
Trade and other payables	8	63,917	29,635
Taxation		541	866
Convertible bonds maturing within one year		–	3,000
Short-term bank loans		14,019	18,411
Trust receipt and import loans – unsecured		32,636	29,568
Bank overdrafts – unsecured		5,554	–
		<u>116,667</u>	<u>81,480</u>
Net current assets		<u>46,708</u>	<u>46,248</u>
Total assets less current liabilities		<u>58,235</u>	<u>57,283</u>
Capital and Reserves			
Share Capital	9	2,900	2,900
Reserves		55,322	54,383
Equity attributable to shareholders of the Company		<u>58,222</u>	<u>57,283</u>
Minority Interest		13	–
		<u>58,235</u>	<u>57,283</u>

## Condensed Consolidated Statement of Changes in Equity (Unaudited)

	Share capital	Share premium	Statutory surplus reserve fund	Enterprise expansion fund	Staff welfare fund	Share options reserve	Attributable to shareholders of the Company	Minority Interest	Total	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	Deficit HK\$'000	HK\$'000	HK\$'000	
As at 1 January 2004 (as previously reported)	2,900	55,824	1,003	502	502	-	(6,471)	54,260	-	54,260
Effect of adoption of HKFRS 2	-	-	-	-	-	166	(166)	-	-	-
As at 1 January 2004, as restated	2,900	55,824	1,003	502	502	166	(6,637)	54,260	-	54,260
Issue of shares to minority shareholders of a subsidiary	-	-	-	-	-	-	-	-	35	35
Profit for the six months ended 30 June 2004	-	-	-	-	-	-	373	373	(16)	357
Share option benefits	-	-	-	-	-	141	-	141	-	141
As at 30 June 2004, as restated	<u>2,900</u>	<u>55,824</u>	<u>1,003</u>	<u>502</u>	<u>502</u>	<u>307</u>	<u>(6,264)</u>	<u>54,774</u>	<u>19</u>	<u>54,793</u>
As at 1 January 2005 (as previously reported)	2,900	55,824	1,003	502	502	-	(3,448)	57,283	-	57,283
Effect of adoption of HKFRS 2	-	-	-	-	-	453	(453)	-	-	-
As at 1 January 2005, as restated	2,900	55,824	1,003	502	502	453	(3,901)	57,283	-	57,283
Issue of shares to minority shareholders of a subsidiary	-	-	-	-	-	-	-	-	19	19
Profit for the six months ended 30 June 2005	-	-	-	-	-	-	862	862	(6)	856
Share option benefits	-	-	-	-	-	77	-	77	-	77
As at 30 June 2005	<u>2,900</u>	<u>55,824</u>	<u>1,003</u>	<u>502</u>	<u>502</u>	<u>530</u>	<u>(3,039)</u>	<u>58,222</u>	<u>13</u>	<u>58,235</u>



## Condensed Consolidated Cash Flow Statement (Unaudited)

	<b>Six months ended 30 June 2005</b>	Six months ended 30 June 2004
	<i>HK\$'000</i>	<i>HK\$'000</i>
Net cash used in operating activities	<b>(16,168)</b>	(9,694)
Net cash used in investing activities	<b>(2,641)</b>	(1,580)
Net cash used in financing activities	<b>(4,324)</b>	(7,171)
Net decrease in cash and cash equivalents	<b>(23,133)</b>	(18,445)
Cash and cash equivalents at the beginning of period	<b>40,752</b>	45,167
Cash and cash equivalents at the end of period	<b><u>17,619</u></b>	<u>26,722</u>
Analysis of the balances of cash and cash equivalents		
Bank balances and cash	<b>23,173</b>	27,834
Bank overdrafts	<b>(5,554)</b>	(1,112)
	<b><u>17,619</u></b>	<u>26,722</u>

## NOTES TO THE CONDENSED FINANCIAL STATEMENTS

### (1) Basis of presentation

The condensed financial statements have been prepared in accordance with Hong Kong Accounting Standard No. 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and the applicable disclosure requirements of the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited.

During the Review Period, the Group has adopted all of the new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ("new HKFRSs") issued by the HKICPA which are effective for accounting periods beginning on or after 1 January 2005. The impact of adoption of these new HKFRSs is set out below:

#### *Share-based Payments (HKFRS 2)*

HKFRS 2 requires the recognition of equity-settled share-based payments at fair value at the date of grant. The Group granted share options to certain directors, an advisor and employees. Prior to adoption of HKFRS 2, the Group did not recognise the financial effect of share options.

The adoption of HKFRS 2 has resulted in a change in accounting policy for share options. The fair value of share options is determined at the grant date and expensed on a straight-line basis over the vesting period. In accordance with the transitional provisions, HKFRS 2 has been applied retrospectively to all share options granted after 7 November 2002 that were unvested on or after 1 January 2005.

The effect of adoption of HKFRS 2 in the current and prior periods is summarized below:

	<b>For the six months ended 30 June</b>	
	<b>2005</b>	2004
	<b>HK\$'000</b>	HK\$'000
Increase in staff costs	(77)	(141)
Decrease in profit for the period	(77)	(141)
Decrease in basic earnings per share (cents)	(0.02)	(0.05)
Decrease in diluted earnings per share (cents)	N/A	(0.05)
	<b>As at</b>	
	<b>30 June</b>	31 December
	<b>2005</b>	2004
	<b>HK\$'000</b>	HK\$'000
Increase in deficit	(530)	(453)
Increase in share options reserve	530	453

Except for the above, the adoption of these new HKFRSs did not result in material changes to the Group's principal accounting policies and basis of preparation adopted in its annual financial statements for the year ended 31 December 2004.

The condensed financial statements are unaudited but have been reviewed by the Audit Committee.

## (2) Segment Information

### a. Business segment

An analysis of the Group's turnover and results by business segment is as follows:

	<b>(Unaudited)</b> <b>For the six months</b> <b>ended 30 June 2005</b>		<b>(Unaudited)</b> <b>For the six months</b> <b>ended 30 June 2004</b>	
	<b>Turnover</b> <i>HK\$'000</i>	<b>Results</b> <i>HK\$'000</i>	<b>Turnover</b> <i>HK\$'000</i>	<b>Results</b> <i>HK\$'000</i>
Network infrastructure	195,110	3,054	83,154	1,517
Professional services	23,820	666	12,111	469
Network software	–	(1,458)	1,145	(515)
	<u>218,930</u>	<u>2,262</u>	<u>96,410</u>	<u>1,471</u>
Other operating income		99		59
Central administrative expenses		(150)		(161)
Profit from operations		2,211		1,369
Finance costs		(1,355)		(967)
Profit before taxation		856		402
Taxation		–		(45)
Profit for the period		<u>856</u>		<u>357</u>

### b. Geographical segment

An analysis of the Group's turnover by geographical location is as follows:

	<b>(Unaudited)</b> <b>For the six months</b> <b>ended 30 June</b>	
	<b>2005</b> <i>HK\$'000</i>	<b>2004</b> <i>HK\$'000</i>
Hong Kong	6,987	7,659
PRC	211,943	88,751
	<u>218,930</u>	<u>96,410</u>

### (3) Profit from operations

Profit from operations has been arrived at after charging:

	For the three months ended 30 June		For the six months ended 30 June	
	2005 HK\$'000	2004 HK\$'000	2005 HK\$'000	2004 HK\$'000
Amortization of software product development costs	460	483	998	965
Depreciation of property, plant and equipment	586	807	1,161	1,637
Staff costs (including Directors' remuneration)	4,743	4,273	8,993	8,251
Loss on disposal of property, plant and equipment	–	10	–	10
and after crediting:				
Interest income	60	36	99	59

### (4) Taxation

The charges represented PRC income tax that were calculated at rates applicable to the respective PRC subsidiaries.

No provision for Hong Kong profits tax has been made as the Group had no assessable profit for the six months ended 30 June 2005 and its corresponding period in 2004.

Pursuant to the relevant laws and regulations in the PRC, the Company's PRC subsidiaries are entitled to exemption from PRC income tax for two or three years commencing from their first profit-making year of operation and thereafter, these PRC subsidiaries will be entitled to a 50% relief from PRC income tax for the following three years. During the Review Period, the Company has one PRC subsidiary within its tax exemption period and one PRC subsidiary within its 50% tax relief period.

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

### (5) Earnings per share

The calculation of basic earnings per share for the three months and the six months ended 30 June 2005 is based on the unaudited profit attributable to shareholders of the Company of approximately HK\$84,000 (2004: HK\$1,419,000) and approximately HK\$862,000 (2004: HK\$373,000) respectively and on the weighted average number of approximately 289,945,000 (2004: 289,945,000) shares in issue during the period.

Diluted earnings per share has not been presented for the three months and six months ended 30 June 2005 since the effect is anti-dilutive.

The calculation of the diluted earnings per share for the three months and the six months ended 30 June 2004 is based on the profit attributable to shareholders of the Company of approximately HK\$1,419,000 and approximately HK\$373,000 and on the weighted average number of approximately 290,029,000 shares and approximately 290,309,000 shares respectively.

## (6) Property, plant and equipment

Movements in property, plant and equipment were:

	<b>Computer equipment</b>	<b>Furniture, fixtures and office equipment</b>	<b>Motor vehicle</b>	<b>Tools</b>	<b>Total</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
<b>Cost</b>					
At 1 January 2005	9,210	1,825	438	5,462	16,935
Additions	231	64	450	739	1,484
Disposals	–	–	–	(54)	(54)
At 30 June 2005	<u>9,441</u>	<u>1,889</u>	<u>888</u>	<u>6,147</u>	<u>18,365</u>
<b>Accumulated depreciation</b>					
At 1 January 2005	7,499	1,545	355	3,757	13,156
Additions	470	109	40	545	1,164
Disposals	–	–	–	(35)	(35)
At 30 June 2005	<u>7,969</u>	<u>1,654</u>	<u>395</u>	<u>4,267</u>	<u>14,285</u>
<b>Net book value</b>					
At 30 June 2005	<u>1,472</u>	<u>235</u>	<u>493</u>	<u>1,880</u>	<u>4,080</u>
At 31 December 2004	<u>1,711</u>	<u>280</u>	<u>83</u>	<u>1,705</u>	<u>3,779</u>

## (7) Trade and other receivables

	<b>As at</b>	
	<b>30 June 2005</b>	<b>31 December 2004</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>
Trade receivables	<b>105,432</b>	61,312
Other receivables	<b>10,698</b>	4,124
Prepaid maintenance charges	<b>8,096</b>	9,636
	<u><b>124,226</b></u>	<u>75,072</u>

There was no change in the Group's credit policies since 31 December 2004.

The aged analysis of trade receivables is as follows:

	<b>As at</b>	
	<b>30 June 2005 HK\$'000</b>	31 December 2004 HK\$'000
<i>Age</i>		
0 to 90 days	53,794	38,007
91 to 180 days	32,791	16,597
181 to 365 days	15,814	4,349
over 365 days	7,812	5,460
	<u>110,211</u>	<u>64,413</u>
Less: allowance for bad and doubtful debts	(4,779)	(3,101)
	<u><u>105,432</u></u>	<u><u>61,312</u></u>

**(8) Trade and other payables**

	<b>As at</b>	
	<b>30 June 2005 HK\$'000</b>	31 December 2004 HK\$'000
Trade payables	51,005	18,548
Other payables	12,912	11,087
	<u>63,917</u>	<u>29,635</u>

The aged analysis of trade payables is as follows:

	<b>As at</b>	
	<b>30 June 2005 HK\$'000</b>	31 December 2004 HK\$'000
<i>Age</i>		
0 to 90 days	32,576	16,692
91 to 180 days	16,671	691
over 180 days	1,758	1,165
	<u>51,005</u>	<u>18,548</u>

**(9) Share capital**

	<b>Number of shares '000</b>	<b>Nominal value HK\$'000</b>
Authorized		
– ordinary shares of HK\$0.01 each	<u>500,000</u>	<u>5,000</u>
Issued and fully paid		
– at 1 January 2005 and 30 June 2005	<u>289,945</u>	<u>2,900</u>

**(10) Share-based payments**

The Group has two share option schemes for certain directors, an advisor and employees. They are the Pre-IPO Share Option Scheme and Pro-IPO Share Option Scheme and described below:

	<b>Pre-IPO Share Option Scheme</b>	<b>Post-IPO Share Option Scheme</b>
Exercise Price	HK\$0.55 per share, which was the same as the placing price per share at the time of IPO.	Average closing price of 5 trading days immediately prior to the date of grant.
Vesting Period	One-half to three years	One to four years
Contractual Life	10 years from date of grant	10 years from date of grant
Cancellation	After 3 months from the departure of grantees from the Group	After 3 months from the departure of grantees from the Group.

Details of the share option outstanding during the Review Period are as follows:

	<b>2005</b>		<b>2004</b>	
	<b>Number of share options '000</b>	<b>Weighted average exercise price HK\$</b>	<b>Number of share options '000</b>	<b>Weighted average exercise price HK\$</b>
Outstanding at 1 January	23,380	0.343	21,253	0.371
Granted during the period	–	–	2,844	0.165
Cancelled during the period	(2,499)	0.340	(530)	0.316
Exercised during the period	–	–	–	–
Outstanding at 30 June	<u>20,881</u>	0.343	<u>23,567</u>	0.347
Exercisable at 30 June	<u>13,943</u>	0.422	<u>8,181</u>	0.442

For the six months ended 30 June 2004, the Group granted approximately 2,844,000 options under the Post-IPO Share Option Scheme. The estimated fair value of each option is approximately HK\$0.091. This was calculated by applying the Black Scholes pricing model. The model inputs were the share price of HK\$0.165, exercise price of HK\$0.165, expected volatility of 63%, no expected dividends, expected life of 5 years, and a risk free rate of 2.65%.

No option was granted for the six months ended 30 June 2005.

**(11) Operating lease commitments**

As at 30 June 2005, the Group had operating lease commitments of approximately HK\$3,399,000 (31 December 2004: HK\$2,630,000), out of which approximately HK\$2,307,000 was payable within 1 year. (31 December 2004: HK\$2,067,000)

**(12) Contingent liabilities**

As at 30 June 2005, the Company has given corporate guarantees totaling approximately HK\$54,000,000 (31 December 2004: HK\$54,000,000) to banks to secure the credit facilities granted to its subsidiaries.



## DISCLOSURE OF TRADE RECEIVABLES ARISING FROM THE ORDINARY COURSE OF BUSINESS OF THE GROUP

The following continuing disclosure is made pursuant to Rule 17.22 of the GEM Listing Rules.

As at 30 June 2005, there were 289,944,745 shares in the Company in issue. Based on the average closing price of the Company's shares of HK\$0.1140 as stated in the Stock Exchange's daily quotation sheets for the trading days from 23 June 2005 to 29 June 2005 (both days inclusive), being the five business days immediately preceding 30 June 2005, the total market capitalisation of the Company was approximately HK\$33,053,701 (the "Total Market Capitalisation") as at 30 June 2005.

As at 31 December 2004, the consolidated total assets value of the Group was approximately HK\$138,763,000 (the "Total Assets Value").

As at 30 June 2005, the following trade receivables of the Group exceeded 8% of either the Total Market Capitalisation and/or the Total Assets Value:–

Customer Name	Amount due to the Group as at 30 June 2005 (HK\$'000)	Approximate percentage of Total Market Capitalisation	Approximate percentage of Total Assets Value
The China Unicom Group	6,991	21.2%	5.0%
Guangdong Telecom Appliance Corp.	6,655	20.1%	4.8%
Motorola (China) Electronics Ltd.	12,135	36.7%	8.7%
Shanxi Branch of China Telecom Group Corporation	3,691	11.2%	2.7%
Guangzhou Thinker Technology Co., Ltd. * 廣州創想科技股份有限公司	4,049	12.2%	2.9%
Beijing Siemens Communications Network Co. Ltd.	19,560	59.2%	14.1%
IBM Global Services (China) Company Ltd.	4,691	14.2%	3.4%
Joyou Data Technology Ltd., Co.	4,964	15.0%	3.6%
Aostar & Yin Hai Information Technologies Co., Ltd.	5,159	15.6%	3.7%

\* For identification purpose only

The aforesaid trade receivables of the Group all resulted from the sale of network equipment, the provision of services or the undertaking of system integration projects by the Group in its ordinary course of business. Payment terms with customers are mainly on credit together with deposits where applicable and under normal commercial terms. The receivables are all unsecured, interest-free and invoices are payable from 30 to 90 days of issuance. For some system integration projects with established customers, payment of the balance after deposits is phased into different stages of completion of the project concerned.

To the best of the knowledge, information and belief of the Directors having made all reasonable enquiries, all of the above customers and their respective ultimate beneficial owners are independent third parties not connected with any of the Directors, chief executive, management shareholders or substantial shareholders of the Company or any of its subsidiaries or any of their respective associates (all of the aforesaid terms as defined in the GEM Listing Rules).

#### **PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY**

During the Review Period, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

#### **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 30 June 2005, options comprising an aggregate of 8,823,000 shares were outstanding, as detailed below:

	<b>Exercise price per share</b> <i>HK\$</i>	<b>Number of share options</b>		
		<b>Outstanding as at 1.1.2005</b>	<b>Cancelled during Review Period</b>	<b>Outstanding as at 30.6.2005</b>
Type of Participants:				
Directors	0.55	3,750,000	–	3,750,000
Advisor	0.55	750,000	–	750,000
Employees	0.55	5,218,000	895,000 <i>(Note)</i>	4,323,000
		<u>9,718,000</u>	<u>895,000</u>	<u>8,823,000</u>

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

Pre-IPO share options 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.

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 5 Post-IPO share options grants. The numbers 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, 2,844,000 shares on 23 February 2004 and 828,000 shares on 11 October 2004. No option was granted during the Review Period.

A summary of the Post-IPO Share Option Scheme movements during the Review Period and as at 30 June 2005 is as follows:

Date of grant	Type of Participants	Exercisable Period	Exercise Price per share HK\$	Number of share options			
				Outstanding as at 1.1.2005	Granted during Review Period	Cancelled during Review Period (Note 1)	Outstanding as at 30.6.2005
12.7.2002	Employees	12.7.2003 to 11.7.2012	0.384	2,981,000	-	505,000	2,476,000
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	3,034,000	-	473,000	2,561,000
				<b>7,159,000</b>	<b>-</b>	<b>473,000</b>	<b>6,686,000</b>
10.10.2003	Employees	10.10.2004 to 9.10.2013	0.142	290,000	-	60,000	230,000
23.2.2004	Employees	23.2.2005 to 22.2.2014	0.165 (Note 2)	2,404,000	-	480,000	1,924,000
11.10.2004	Employees	11.10.2005 to 10.10.2014	0.124	828,000	-	86,000	742,000
				<b>13,662,000</b>	<b>-</b>	<b>1,604,000</b>	<b>12,058,000</b>

### Notes:

- (1) These options were cancelled according to the rules of this scheme due to the employees having left the Group.
- (2) The closing price of the share of the Company immediately before the date on which the options were granted was HK\$0.155.

Post-IPO share options 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.

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

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

As at 30 June 2005, the interests and short positions of the Directors, the chief executive of the Company and their respective associates (as defined in the GEM Listing Rules) in the shares, underlying shares and debentures of the Company and 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 the 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						Total interest in shares	Approximate percentage of the Company's issued share capital
	Personal interest	Capacity	Family interest	Corporate interest	Capacity	Other interest		
Mr. Chan Sek Keung, Ringo	5,816,000	Beneficial owner	-	56,400,000 (Note)	Interest of a controlled corporation	-	62,216,000	21.46%

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	Date of grant	Number	Number	Number of	Number	Aggregate	Approximate
		of unlisted pre-IPO share option outstanding as at 1.1.2005	of unlisted pre-IPO share option outstanding as at 30.6.2005	unlisted post-IPO share option outstanding as at 1.1.2005	of unlisted post-IPO share option outstanding as at 30.6.2005		
Mr. Chan Sek Keung, Ringo	30.4.2002 20.2.2003	3,000,000 –	3,000,000 –	– 1,200,000	– 1,200,000	4,200,000	1.45%
Mr. Pang Hing Chung, Alfred	30.4.2002 20.2.2003	750,000 –	750,000 –	– 750,000	– 750,000	1,500,000	0.52%
Mr. Tsoi Tai Wai, David	20.2.2003	–	–	750,000	750,000	750,000	0.26%
Mr. Alasdair Gordon Nagle	20.2.2003	–	–	375,000	375,000	375,000	0.13%
Ms. Clara Ho	20.2.2003	–	–	375,000	375,000	375,000	0.13%
Mr. Kwan Kit Tong	20.2.2003	–	–	375,000	375,000	375,000	0.13%

*Notes:*

- (1) Each of the above Directors is personally the beneficial owner of the share option granted to them.
- (2) Each of the Directors' interests represent his/her respective long positions in the underlying shares in the Company by virtue of options granted to the Directors pursuant to a pre-IPO share option scheme and a post-IPO share option scheme both adopted by the Company on 20 April 2002 (further details are set out under the section headed "Share Option Schemes").
- (3) Options granted on 30 April 2002 were exercisable during the period 17 November 2002 to 29 April 2012 at the exercise price of \$0.55 per share.
- (4) Options granted on 20 February 2003 were exercisable during the period 20 February 2004 to 19 February 2013 at the exercise price of \$0.138 per share.

Other than as disclosed above, none of the Directors, the chief executive of the Company and their respective associates (as defined in the GEM Listing Rules), had any interests or short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations as at 30 June 2005.

## **REQUIRED STANDARD OF SECURITIES DEALINGS BY DIRECTORS**

During the six months ended 30 June 2005, the Company had adopted a code of conduct for directors' securities transactions on terms no less exacting than the required standard of dealings set out in Rules 5.48 to 5.67 of the GEM Listing Rules.

Having made specific enquiry with all the Directors, the Directors of the Company confirmed that they had complied with the required standard of dealings and the code of conducts for directors' securities transactions during the six months ended 30 June 2005.

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

As at 30 June 2005, the following persons or corporations, in addition to the Directors, stated under the section headed "Directors' and chief executive's interests or short position in shares and underlying shares of the Company" were interested in shares or underlying shares representing 5% or more in the issued share capital of the Company as recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO.

## Long positions in shares 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") (Note 1)	Beneficial owner	Corporate	48,460,000	16.71%
HSBC Private Equity Technology (Asia) Limited (Note 2)	Investment manager	Corporate	48,460,000	16.71%
HSBC Private Equity (Asia) Limited (Note 2)	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 (Note 3)	Beneficial owner	Personal	3,134,744	1.08%
	Interest of a controlled corporation	Corporate	36,900,000	12.73%
QPL International Holdings Limited ("QPL") (Note 4)	Beneficial owner	Corporate	35,456,745	12.23%
Mr. Li Tung Lok (Note 4)	Interest of a controlled corporation	Corporate	35,456,745	12.23%
Madam Su Ching Wah (Note 4)	Interest of spouse	Family	35,456,745	12.23%



*Notes:*

- (1) ARC is the beneficial owner of these shares.
- (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.

Other than as disclosed above, the Company had not been notified of any other relevant interests or short positions in the shares or underlying shares in the Company as at 30 June 2005.

## **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 competed or might compete with the business of the Group or any other conflict of interests with the interests of the Group.

## **AUDIT COMMITTEE**

The Company established the Audit Committee on 29 October 2001 with written terms of reference in compliance with Rules 5.28 to 5.29 of the GEM Listing Rules and with reference to the guidelines published by the Hong Kong Institute of Certified Public Accountants.

The present Audit Committee consists of three independent non-executive Directors, namely, Mr. Tsoi Tai Wai, David, Mr. Pang Hing Chung, Alfred and Mr. Yu Zhonghou. Mr. Tsoi is the chairman of the Audit Committee. The relevant annual confirmation of independence have been received from Mr. Tsoi and Mr. Pang while the same will be due from Mr. YU in September 2005.

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 of the GEM Listing Rules during the Review Period.

## **CORPORATE GOVERNANCE**

At present, the roles of both the chairman and chief executive officer of the Company are carried out by the same individual, Mr. Chan Sek Keung Ringo, the sole executive director of the Company. Steps are being taken to change the board structure by appointing at least a second executive director with the aim of complying with paragraph A.2.1 in the Code on Corporate Governance Practices (“the Code”) as set out in Appendix 15 of the GEM Listing Rules in the future.

Under the present Articles of Association of the Company, the chairman of the Board and/or the managing director of the Company shall not, whilst holding such office, be subject to retirement by rotation. The Board has resolved that it would propose amendments to the Articles of Association, as special business, at the forthcoming Annual General Meeting with the aim of allowance compliance with paragraph A.4.2 of the Code in the future after the meeting.

Except as disclosed above, the Company was in compliance with the provisions of the Code during the Review Period.

By Order of the Board  
**WAFER SYSTEMS LIMITED**  
**CHAN Sek Keung, Ringo**  
*Chairman and Chief Executive Officer*

Hong Kong, 11 August 2005