WAFER SYSTEMS

Wafer Systems Limited

(Incorporated in the Cayman Islands with limited liability)

(Stock Code : 08198)

Annual Report

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 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. 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 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 the GEM of the Exchange (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.

CONTENTS

CORPORATE INFORMATION

BOARD OF DIRECTORS

Executive Director

Mr. Chan Sek Keung, Ringo
(Chairman & Chief Executive Officer)

Non-Executive Directors

Mr. Alasdair Gordon Nagle
Ms. Clara Ho
Mr. Kwan Kit Tong

Independent Non-Executive Directors

Mr. Pang Hing Chung, Alfred
Mr. Tsoi Tai Wai, David
Mr. Yu Zhonghou

AUDIT COMMITTEE

Mr. Tsoi Tai Wai, David *(Chairman)*
Mr. Pang Hing Chung, Alfred
Mr. Yu Zhonghou

REMUNERATION COMMITTEE

Mr. Tsoi Tai Wai, David *(Chairman)*
Mr. Pang Hing Chung, Alfred
Ms. Clara Ho

COMPLIANCE OFFICER

Mr. Chan Sek Keung, Ringo

COMPANY SECRETARY

Mr. Pang Kin Man, Edmond

QUALIFIED ACCOUNTANT

Mr. Yau Kin Wa

AUTHORIZED REPRESENTATIVES

Mr. Chan Sek Keung, Ringo
Mr. Pang Kin Man, Edmond

ADVISORS

Mr. Chen Sau Chung, John
Mr. Samuel Lin Jr.

REGISTERED OFFICE

4th Floor, Scotia Centre,
P.O. Box 2804
George Town
Grand Cayman
Cayman Islands

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS

Units 901-7, 9th Floor
MLC Millennia Plaza
663 King's Road
North Point
Hong Kong

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fund Services (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 705
George Town
Grand Cayman
Cayman Islands

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited
46th Floor
Hopewell Centre
183 Queen's Road East
Wanchai
Hong Kong

CORPORATE INFORMATION

PRINCIPAL BANKERS

Standard Chartered Bank (Hong Kong) Limited
4-4A Des Voeux Road Central
Hong Kong

China Construction Bank (Asia) Limited
41st Floor Tower 1, Lippo Centre
89 Queensway
Hong Kong

Dah Sing Bank Limited
36th Floor Dah Sing Financial Centre
108 Gloucester Road, Wanchai
Hong Kong

Bank of Communications
20 Pedder Street
Central
Hong Kong.

AUDITORS

Deloitte Touche Tohmatsu
Certified Public Accountants
26th Floor, Wing On Centre
111 Connaught Road Central
Hong Kong

LEGAL ADVISORS

Woo, Kwan, Lee & Lo
27th Floor
Jardine House
1 Connaught Place
Hong Kong

WEBSITE ADDRESS

www.wafersystems.com

STOCK CODE

8198

CHAIRMAN'S STATEMENT

TO OUR SHAREHOLDERS

For and on behalf of the board of Directors (the "Board"), I am pleased to present the annual report of Wafer Systems Limited (the "Company") and its subsidiaries (collectively, "Wafer Systems" or the "Group") for the year ended 31 December 2005 (the "Review Period").

During the Review Period, turnover increased by approximately 37% to approximately HK$368 million (2004: HK$270 million) while net profit decreased by approximately 47% to approximately HK$1.44 million (2004: HK$2.74 million).

FINANCIAL PERFORMANCE

	2005	**2004** Restated	**%Change**
Turnover *(HK$'000)*	368,250	269,688	+37%
EBITDA *(HK$'000)*	9,213	11,064	-17%
Profit attributable to equity holders of the parent *(HK$'000)*	1,443	2,701	-47%
Basic earnings per share *(HK cents)*	0.50	0.94	-47%
Net current assets *(HK$'000)*	48,757	46,248	+5%
Current ratio	1.52	1.57	-3%
Debt ratio (debts/assets)	61%	59%	+3%

During the Review Period, China remained the Group's substantial source of business. Network Infrastructure business accounted for the Group's main source of revenue, generating turnover of approximately HK$320 million, (2004: HK$241 million). Turnover from Professional Services business amounted to approximately HK$46 million (2004: HK$25 million) while turnover from Network Software was approximately HK$2.4 million (2004: approximately HK$4.0 million).

FINAL DIVIDEND

The Board of Directors does not recommend the payment of any dividend for the year ended 31 December 2005. (2004: Nil).

CHAIRMAN'S STATEMENT

BUSINESS REVIEW

Through participation in large scale projects, such as the CN2 project of China Telecom, the Group had gained more experience and knowledge into service providers operations. Such deeper knowledge is most important in the Group's future success when the markets goes into the 3G era and with new next generation network ("NGN") services as in voice over IP ("VOIP") and IPTV services. Even more important will be the groundwork now being laid in the sale of software which the Group has been developing and now near maturity.

Professional Services has shown a very satisfactory growth during the Review Period. Higher market share and penetration had been achieved, especially among the MNCs which your Group has a traditional strong hold as the result of high customer satisfaction.

Although competition has been keen, the Group remained much focused in our core business and has made heavy investments to improve our competitive strength in the areas of advanced technologies and professional services to cope with the challenge & opportunity in the coming NGN Era.

The ability to master advanced technologies is critical to the continued success of the Group. The business of network communication has evolved into the third phase. The first phase was for pure data transmission network. The second phase saw the pure data network evolving into a network of networks where an IP based backbone supporting multiple services and applications running over it. The third phase is the IP NGN where the network will be used as a platform enabling collaboration and inter-reaction of applications, converged real time communications, virtual storage and quadruple play services, etc. etc.

Wafer Systems has built up strong capability in advanced technologies and formed strong alliance with leading partners like Cisco Systems Inc. We are specialized partner of Cisco System in the areas of network security, IP telephony and wireless communication. For 2005 the Group was awarded the Global Partner of the Year in the Commercial Sector in recognition of its achievements.

The Group has developed a suite of IP NGN management software in the past few years. In 2005, we have consolidated, productized and packaged them into a portfolio of softwares addressing both the service provider market and the enterprise markets.

Service is a key differentiator of our Group's go to market strategy. We are serving hundreds of large multinational corporation and telecom operators. The choose Wafer Systems primarily because of our capability to provide good services.

CHAIRMAN'S STATEMENT

Over the year, Wafer Systems has already established our reputation as a reliable provider of traditional services like product installation, maintenance and project management. In 2005 we have invested heavily to equip us in the advanced services space to provide support across the entire network lifecycle. These included from planning to the implementation and ongoing network improvement. This will enhance our position in the services value chain, further securing our partnership with our customer and most important of all, ensure our customers' success.

PROSPECTS

The Group has successfully penetrated into the telecommunications service provider market and established stable revenue source. With the advent of the 3G communication, tipped to be launched in China in the near future, the Group will benefit.

On the other hand the strong technical capabilities of the Group's networking engineers has advanced the Group's ability to provide high value advanced Professional Services in consultancy, for the MNC market.

The overall market while competitive have become more rationalized and will improve gradually. Over the past two years, the Group phase invested to transform itself to a new business model focusing in advanced technologies and network life cycle services. This will position the Group in a more favorable competitive position.

With customer satisfaction in mind as our prime motivator, we will continue to provide the most suitable solution and professional services to clients who wish to reap the full benefits of the IP NGN era.

CONCLUSION

The Group has laid down a solid foundation going forward which is the direct result and the concerted efforts of our dedicated staff. In addition to the teamwork, for which I am most thankful, the Group's insistence in observing its vision and mission, and its emphasis on its corporate values were also vital in driving our achievements in the challenging market.

I take the opportunity to also thank our customers, suppliers, bankers, investors, business partners and advisors for their continued trust and support.

I would also like to thank my fellow directors for their wise counsel and support to me personally and contributions of time and efforts to the group during the year.

CHAN Sek Keung, Ringo
Chairman and Chief Executive Officer

Hong Kong, 28 March 2006

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTOR

Mr. Chan Sek Keung, Ringo, aged 46, is the founder, the Chairman and chief executive officer of the Company. Mr. Chan founded the Group in November 1998 and is responsible for the overall management, strategic planning and development of the Group. Mr. Chan has over 20 years of working experience in the data and networking communication industry. Mr. Chan holds a Bachelor's degree in Electrical Engineering from the University of Hong Kong, and is a Fellow Member of the Hong Kong Institute of Directors.

NON-EXECUTIVE DIRECTORS

Mr. Alasdair Gordon Nagle, aged 43, is a non-executive Director. Mr. Nagle joined the Group in March 1999. He is a director of both HSBC Private Equity (Asia) Limited and its wholly-owned subsidiary of HSBC Private Equity Technology (Asia) Limited, and is a nominee of The Applied Research Council ("ARC"), a substantial shareholder of the Company, on the Board. Mr. Nagle is a member of the Institute of Chartered Accountants in England & Wales and holds a Master of Arts degree in French and Business Studies from Edinburgh University.

Ms. Clara Ho, aged 34, is a non-executive Director. Ms. Ho joined the Group in May 2001. Ms. Ho is an Investment Director of HSBC Private Equity (Asia) Limited and is a nominee of The Applied Research Council ("ARC"), a substantial shareholder of the Company, on the Board. Ms. Ho holds a Bachelor's degree in Economics and Accounting from the University of Bristol and is a member of the Institute of Chartered Accountants in England & Wales.

Mr. Kwan Kit Tong, Kevin, aged 47, is a non-executive Director. Mr. Kwan joined the Group in May 2001. He is a Director and the Financial Controller of QPL International Holdings Limited ("QPL"), a substantial shareholder of the Company, and the nominee of QPL on the Board. He is also a director of ASAT Holdings Ltd., a public listed company in the United States. Mr. Kwan holds a Bachelor's degree in Commerce from the University of Southern Queensland and also a Fellow Member of the Chartered Association of Certified Accountants and the Hong Kong Institute of Certified Public Accountants.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Pang Hing Chung, Alfred, aged 44, is an independent non-executive Director. Mr. Pang was appointed as an independent non-executive Director of the Company in March 1999. Mr. Pang is a Managing Director and Vice Chairman of the Investment Banking Division of BOC International. Mr. Pang holds an MBA degree from the Stanford Graduate School of Business and also a Bachelor of Arts degree in Economics from Cornell University.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Mr. Tsoi Tai Wai, David, aged 58, is an independent non-executive Director. Mr. Tsoi was appointed as an independent non-executive Director of the Company since October 2001. A Certified Public Accountant by profession Mr. Tsoi currently practises as Director of Alliott, Tsoi CPA Limited.. Mr. Tsoi holds a Master's degree in Business Administration from the University of East Asia, Macau and also a Fellow Member of the Chartered Association of Certified Accountants, the Hong Kong Institute of Certified Public Accountants and an Associate Member of the Association of Certified General Accountants of Canada and Institute of Chartered Accountants of England & Wales. He is also a Fellow Member of the Hong Kong Institute of Directors.

Mr. YU Zhonghou, aged 54, is an independent non-executive Director. Mr. Yu was appointed an independent non-executive Director of the Company in September 2004. Mr. Yu is currently the chairman and general manager of Century Science and Technology Investments Co. Ltd. in Shenzhen, China. Mr. Yu holds a Master's degree in Commercial Economics from the Faculty of Finance and Trade of China Academy of Social Sciences and also a Bachelor's degree in Equipment Automation Science from Tianjin University.

SENIOR MANAGEMENT

Ms. Wang Fang, aged 37, is the vice president of the Group. Ms. Wang joined the Group in June 2001 and is responsible for the Group's overall operations, financial performance as well as sales and marketing activities in mainland China. Ms. Wang graduated from the Faculty of Telecommunications Engineering of the Nanjing Post and Telecom University in China and also holds an International MBA degree from Peking University.

Mr. Pang Kin Man, Edmond, aged 58, joined the Group in August 2001, is the company secretary. Mr. Pang has more than 30 years of working experience. Mr. Pang holds an associate membership of the Institute of Chartered Secretaries of UK and Hong Kong Institute of Chartered Secretaries. He is also a Fellow Member of the Hong Kong Institute of Directors and holder of its Professional Diploma in Corporate Governance issued jointly with the Hong Kong Productivity Council.

Mr. Yau Kin Wa, aged 37, is the qualified accountant and finance manager of the Group, Mr. Yau is a Fellow member of the Association of Chartered Certified Accountants and an Associate member of the Hong Kong Institute of Certified Public Accountants. Mr. Yau joined the Group in June 1999.

MANAGEMENT DISCUSSION AND ANALYSIS

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

During the Review Period, the Group kept 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 with its internal resources and short-term bank loans.

The Group remained healthy in the financial and liquidity position during the Review Period. As at 31 December 2005, the Group had net current assets of approximately HK$48.8 million, a 5% increase over last year end of HK$46.2 million. The current ratio dropped slightly from 1.57 to 1.52. Net current assets included bank balances and cash of approximately HK$17.1 million (2004: HK$40.8 million) and bank borrowings of approximately HK$48.3 million (2004: HK$48.0 million).

The Group had no long term liabilities (2004: Nil) as at year end.

As at 31 December 2005, all assets and liabilities of the Group were denominated in U.S. dollars, Hong Kong dollars and Renminbi.

ORDER BOOK AND PROSPECTS OF NEW BUSINESS

As at 31 December 2005, the Group had contracts on hand for sales amounting to approximately HK$28.9 million (2004: HK$36.6 million) which would be booked as revenue upon delivery and implementation.

SIGNIFICANT INVESTMENT HELD

The Group had not made any significant investment since floatation or during the Review Period.

SEGMENTAL INFORMATION

The segmental information of the Group is covered in the second paragraph of Financial Performance under the Chairman’s Statement and in note 7 to the financial statements.

CHARGES ON GROUP ASSETS

As at 31 December 2005, the Group had a pledged bank deposit of approximately HK$4.6 million for securing certain bank overdrafts facilities (2004: Nil).

Save as disclosed above, the Group did not have any significant charges on assets.

GEARING RATIO

As at 31 December 2005, the gearing ratio, i.e. total liabilities over total assets, slightly increased to approximately 0.61 from approximately 0.59 as at 31 December 2004.

MANAGEMENT DISCUSSION AND ANALYSIS

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 impact of foreign exchange exposure has been insignificant and positive, no hedging or other alternatives have been implemented.

ACQUISITIONS, DISPOSALS AND SIGNIFICANT INVESTMENT

The Group had not made any significant acquisition, disposal or investment during the Review Period

FUTURE PLANS FOR INVESTMENTS OR CAPITAL ASSETS AND SOURCES OF FUNDING

There are no plans for any significant investments in capital assets and sources of funding.

EMPLOYEE INFORMATION

As at 31 December 2005 the Group had 162 employees comprising 24 employees based in Hong Kong and 138 employees based in mainland China. Total employee expense, excluding for directors, was approximately HK$18.2 million (2004: HK$17.3 million) during the Review Period. The Group continues to provide remuneration package to employees according to market practices and past performance. In addition to basic remuneration, the Group also provides employees with other benefits such as a mandatory provident fund, medical insurance scheme, share option schemes and staff training program. There has been no major change on staff remuneration policies during the year.

CORPORATE GOVERNANCE REPORT

Corporate Governance Practices

The Company applies the principles of corporate governance and those in the Code on Corporate Governance Practices as contained in Appendix 15 of the GEM Listing Rules to provide a sound system of checks and balance in the leadership, executive management and business operations of the Company and its subsidiaries.

In practising corporate governance in line with, sometimes exceeding, the Code provisions, the Directors are conscientious as to the transparency of operations of the Company for the benefits of its shareholders and the investing public.

During the year under review, the Company met all the Code Provisions except for the two areas below.

Firstly, the Chairman and the Chief Executive Officer of the Company have been in the same individual, Mr. Ringo Chan.

The Board considers that, with the present board structure and scope of business of the Group, there is no immediate need to separate the roles into two individuals as Mr. Chan is perfectly capable of distinguishing the priority of these roles in which he has been acting.

The Board keeps the current structure under review and will propose changes as and when it becomes appropriate in the future.

Secondly, under the present Articles of Association of the Company, Mr. Ringo Chan, being Chairman and Chief Executive Officer of the Company, is not subject to retirement by rotation. This is not in compliance with the Code requirement that every director must retire by rotation once every 3 years.

A Special Resolution has been proposed for adoption at the forthcoming Annual General Meeting to amend the relevant Articles to facilitate future compliance of this requirement. Further, the service contract between the Company and Mr. Chan has been renewed for a term of 3 years from 1 January 2006 with terms and conditions appropriately adjusted to allow his future retirement by rotation.

Directors' securities transactions

The Company has adopted a code of conducts on terms no less exacting than required in GLR 5.48 and 5.68 on directors' transactions in the securities of the Company.

Specific enquiries have been made to all directors and they all confirmed their compliance with the Company's code of conducts during the year.

CORPORATE GOVERNANCE REPORT

Board of Directors

The Board has adopted practices and procedures as in the Code on Corporate Governance Practices (the "Code") during the year.

The Board consisted of the following directors who served throughout the year 2005:–

Executive director:–

Mr. Ringo Chan

Non-executive directors:–

Mr. Alasdair Nagle, Ms. Clara Ho and Mr. Kevin Kwan

Independent non-executive directors:–

Mr. David Tsoi, Mr. Alfred Pang and Mr. YU Zhonghou

During the year five board meetings were held with the following attendance by the respective directors:–

Director	Attendance
Mr. Ringo Chan	5/5
Mr. Alasdair Nagle	4/5
Ms. Clara Ho	4/5
Mr. Kevin Kwan	4/5
Mr. David Tsoi	5/5
Mr. Alfred Pang	4/5
Mr. Yu Zhonghou	2/5

The board operated along the guidelines of the Code. It met regularly to discuss and formulate the overall policy and business strategy of the Group. During the year, five meetings were held to set the annual budget, monitor performance, discuss annual and quarterly results and to discuss matters of importance and not delegated to management.

The division of decision making responsibilities between the Board and management are set out in writing. Matters of a direction, policy and control nature are reserved for the Board while day-to-day operational matters of the Group are delegated to management within these written guidelines.

Throughout the year, the Company complied with the requirements of the GEM Listing Rules in having three independent non-executive directors on the board and that one of whom is a practicing certified public accountant.

CORPORATE GOVERNANCE REPORT

During the year, all independent non-executive directors re-confirmed their respective independence and met the guidelines of rule 5.09 of the GEM Listing Rules.

Apart from the fact that Mr. Alasdair Nagle and Ms. Clara Ho were fellow colleagues at HSBC Private Equity (Asia) Limited and were nominated to the board by the Applied Research Council, a substantial shareholder of the Company, no other relationship existed amongst the individual directors.

Chairman and Chief Executive Officer

During the year, the Chairman and Chief Executive Officer of the Company were in the same individual, Mr. Ringo Chan, executive director.

As such, Mr. Chan carried both roles of the chairman and of the Chief Executive Officer of the Group.

Non-executive directors

All non-executive directors of the Company have been appointed for a term of two years.

Remuneration of directors

In determining the remuneration level and package to the directors, the Company took into account the prevailing practices and trends and to reflect on the time commitment, duties and responsibilities of the directors and their contributions to the Company and the Group. Long term inducements in the form of share options and performance bonuses were also employed.

The first Remuneration Committee of the Board was set up in February 2004 with written terms of reference.

Its functions are to advise the Board on matter of policy on the organization and human resources matters of the Group. It also recommends to the Board on remuneration and compensation levels of individual directors and determines those for members of senior management.

The Remuneration Committee consisted of three directors, viz. Mr. David Tsoi, Mr. Alfred Pang and Ms. Clara Ho, with Mr. David Tsoi as chairman.

During the year, the Remuneration Committee met three times with full attendance, viz.

Director	**Attendance**
Mr. David Tsoi	3/3
Ms. Clara Ho	3/3
Mr. Alfred Pang	3/3

CORPORATE GOVERNANCE REPORT

During the year, the Remuneration Committee reviewed the organization of the Group and its remuneration policy with reference to industry and market conditions.

In respect of the Directors, the Remuneration Committee had reviewed the service agreement terms with the Chief Executive Officer, and made recommendations to the Board on the remuneration terms of the respective appointment contracts on their renewal with all the directors.

The Remuneration Committee also determined the remuneration levels for members of senior management.

Nomination of directors

A nomination committee of the Board was not set up.

The Board will set up the appropriate nomination procedure and process and determine the policy for the nomination of directors when such need arises.

Auditors' remuneration

Deloitte Touche Tohmatsu was re-appointed the Group's external auditors at the Annual General Meeting of the Company held on 29 April 2005. On the recommendation of the Audit Committee, the Board has agreed with Deloitte Touche Tohmats fee of $470,000 for the audit of the Group's accounts for the year ended 31 December, 2005. For the sake of independence, the external auditors were not engaged in any non-audit services during the year.

Audit Committee

The Audit Committee of the Board was established in 2002, adopting the terms of reference as contained in "A Guide for Effective Audit Committee" published by the Hong Kong Institute of Certified Public Accountants.

Members of the Committee include the following independent non-executive directors:–

Mr. David Tsoi *(Chairman)*
Mr. Alfred Pang
Mr. Yu Zhonghou

CORPORATE GOVERNANCE REPORT

During the year, the Audit Committee met four times with attendance as follows:–

Director	**Attendance**
Mr. David Tsoi	4/4
Mr. Alfred Pang	4/4
Mr. YU Zhonghou	3/4

During the year the Audit Committee held meetings to discuss and review annual as well as quarterly results and in meeting with the external auditors. It also made the necessary review on the various aspects of the internal control systems of the Group.

An overall review on the effectiveness of the system of internal control of the Company and the subsidiaries has been planned and for completion before the end of 2006.

The Directors acknowledge that it was their responsibility for preparing the accounts of the Company and the Group to give a true and fair view of the state of affairs at the end of the financial year and of the profit or loss of the Company and the Group for the year.

CHAN Sek Keung, Ringo
Chairman and Chief Executive Officer
Hong Kong, 28 March 2006

DIRECTORS' REPORT

The directors present their annual report and the audited financial statements for the year ended 31st December, 2005.

PRINCIPAL ACTIVITIES

The Company acts as an investment holding company while its subsidiaries are principally engaged in the provision of network infrastructure solutions, including the sales of network equipment and software and the provision of related network infrastructure services, provision of network professional services, and sales of its proprietary network software.

The principal activities of the Company's principal subsidiaries are set out in note 28 to the financial statements.

RESULTS

The results of the Group for the year ended 31st December, 2005 are set out in the consolidated income statement on page 30 of this annual report.

The directors do not recommend the payment of a dividend.

SHARE CAPITAL

Details of share capital of the Company are set out in note 22 to the financial statements.

DISTRIBUTABLE RESERVES OF THE COMPANY

The Company's reserves available for distribution represent the share premium less accumulated losses which in aggregate amounted to HK$46.1 million (2004: HK$44.0 million) as at 31st December, 2005. Under the Companies Law (Revised) Chapter 22 of the Cayman Islands, the share premium of the Company is available for paying distributions or dividends to shareholders subject to the provisions of its Memorandum and Articles of Association and provided that immediately following the distribution or dividend the Company is able to pay its debts as they fall due in the ordinary course of business. In accordance with the Company's Articles of Association, dividends shall be distributed out of the retained profits or other reserves, including the share premium account, of the Company.

PROPERTY, PLANT AND EQUIPMENT

During the year, the Group spent approximately HK$1.8 million in the acquisition of property, plant and equipment which mainly comprised computer equipment and tools. Details of this and other movements in property, plant and equipment of the Group during the year are set out in note 14 to the financial statements.

DIRECTORS' REPORT

DIRECTORS AND SERVICE CONTRACTS

The directors of the Company during the year and up to the date of this report were as follows:

Executive director:
Chan Sek Keung, Ringo (Chairman and Chief Executive Officer)

Non-executive directors:
Alasdair Gordon Nagle
Clara Ho
Kwan Kit Tong, Kevin

Independent non-executive directors:
Pang Hing Chung, Alfred
Tsoi Tai Wai, David
Yu Zhonghou

The Company entered into a service contract with Mr. Chan Sek Keung, Ringo, executive director for an initial term of three years commencing on 1st January, 2002, which would continue thereafter until terminated by either party giving to the other not less than six months' prior written notice. In order to meet certain code provisions of the new Corporate Governance Practices, by mutual agreement of both parties, the appoint terms of the original service contract were modified to cover a term of three years from 1 January 2006 with the same remuneration level as in the original contract and the compensation for loss of office capped at 12 months' salary. Mr. Chan will be subject to retirement by rotation in accordance with Articles of Association of the Company, which have been proposed for amendments to cope with the Code.

Each of the non-executive directors and independent non-executive directors, except for Mr. Yu Zhonghou, has been appointed for a term of two years from 1st April, 2004, subject to retirement by rotation as required by the Articles of Association of the Company.

Mr. Yu Zhonghou, independent non-executive director, has been appointed for a term of two years from 23rd September, 2004, subject to retirement by rotation as required by the Articles of Association of the Company.

In accordance with Article 87 of the Company's Articles of association, Mr. Kwan Kit Tong, Kevin and Mr. Tsoi Tai Wai, David retire by rotation and, being eligible, offer themselves for re-election.

Other than as disclosed above, no director proposed for re-election of the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries which is not determinable by the Group within one year without payment of compensation other than statutory compensation.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS OR SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 31st December, 2005, the interests and short positions of the directors, chief executive and their respective associates in the shares, underlying shares and debenture or short position and share options of the Company and its associated corporations, as recorded in the register maintained by the Company pursuant to Section 352 of the Securities and Futures Ordinance (the "SFO"), or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to Rules 5.46 to 5.59 of the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange (the "GEM Listing Rules"), were as follows:

Long positions:

(a) Long position in ordinary shares of HK$0.01 each of the Company

Name of director	Capacity	Number of issued ordinary shares held	Approximate percentage of the issued share capital of the Company
Chan Sek Keung, Ringo	Beneficial owner	6,204,000	2.14%
	Held by controlled corporation*	56,400,000	19.45%
		62,604,000	21.59%

* These shares 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.

DIRECTORS' REPORT

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

Name of director	Capacity	Number of share options held	Number of underlying shares
Chan Sek Keung, Ringo	Beneficial owner	4,200,000	4,200,000
Alasdair Gordon Nagle	Beneficial owner	375,000	375,000
Clara Ho	Beneficial owner	375,000	375,000
Kwan Kit Tong, Kevin	Beneficial owner	375,000	375,000
Pang Hing Chung, Alfred	Beneficial owner	1,500,000	1,500,000
Tsoi Tai Wai, David	Beneficial owner	750,000	750,000
		7,575,000	7,575,000

Other than as disclosed above, none of the directors, 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 31st December, 2005.

DIRECTORS' REPORT

SUBSTANTIAL SHAREHOLDERS

As at 31st December, 2005, the following persons or corporations, in addition to the directors stated under the paragraph headed "Directors' and chief executive's interests or short positions in shares and underlying shares", has relevant interests in the issued share capital of the Company which were recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO.

Long position in ordinary shares of HK$0.01 each of 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 i)*	Beneficial owner	Corporate	48,460,000	16.71%
HSBC Private Equity Technology (Asia) Limited *(Note ii)*	Investment manager	Corporate	48,460,000	16.71%
HSBC Private Equity (Asia) Limited (Note ii)	Interest of a controlled corporation	Corporate	48,460,000	16.71%
North 22 Nominees Limited *(Note iii)*	Beneficial owner	Corporate	36,900,000	12.73%
Mr. Ng Lai Yick *(Note iii)*	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 iv)*	Beneficial owner	Corporate	35,456,745	12.23%
Mr. Li Tung Lok *(Note iv)*	Interest of a controlled corporation	Corporate	35,456,745	12.23%
Ms. Su Ching Wah *(Note iv)*	Interest of spouse	Family	35,456,745	12.23%

DIRECTORS' REPORT

Notes:

(i) ARC is the beneficial owner of these shares.

(ii) 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.

(iii) 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.

(iv) 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.

Ms. 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 has not been notified of any other relevant interests or short positions in the shares or underlying shares in the Company as at 31st December, 2005.

SHARE OPTION SCHEMES

The Company in a general meeting held on 20th April, 2002 adopted both a pre-Initial Public Offering ("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 Shares Option Scheme or the Post-IPO Share Option Schemes had been exercised during the year.

DIRECTORS' REPORT

(a) Pre-IPO Share Option Scheme

A summary of the pre-IPO share options granted on 30th April, 2002 which were exercisable from 17th November, 2002 to 29th April, 2012 is as follows:

Types of participants	Exercise price per share *HK$*	Number of share options: Outstanding as at 1.1.2005	Cancelled during the year	Outstanding as at 31.12.2005
Directors:				
Chan Sek Keung, Ringo	0.55	3,000,000	–	3,000,000
Pang Hing Chung, Alfred	0.55	750,000	–	750,000
		3,750,000	–	3,750,000
Adviser	0.55	750,000	–	750,000
Employees	0.55	5,218,000	(963,000)	4,255,000
		9,718,000	(963,000)	8,755,000

The $0.55 exercise price per share of the above share options granted under the Pre-IPO Share Option Scheme is the same as the initial public offering price of the Company's shares. No options granted under this scheme lapsed or were exercised since the date of grant and up to 31st December, 2005.

Options granted are exercisable as to (i) a maximum of 25% of the total number of options granted six months after 17th 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 granted on or after the third anniversary of the Date of Listing until the end of the option period or lapse of an option.

The total number of shares in respect of which options are issuable under this scheme was 8,755,000, representing approximately 3.02% of the issued share capital of the Company as at 31st December, 2005.

DIRECTORS' REPORT

(b) Post-IPO Share Option Scheme

A summary of the Post-IPO Share Options is as follows:

Type of participants	Date of grant	Exercisable period	Closing price* HK$	Exercise price per share# HK$	Number of share options: Outstanding as at 1.1.2005	Granted during the year	Cancelled during the year	Outstanding as at 31.12.2005
Directors:								
Chan Sek Keung, Ringo	20.2.2003	20.2.2004 to 19.2.2013	0.138	0.138	1,200,000	–	–	1,200,000
Alasdair Gordon Nagle	20.2.2003	20.2.2004 to 19.2.2013	0.138	0.138	375,000	–	–	375,000
Clara Ho	20.2.2003	20.2.2004 to 19.2.2013	0.138	0.138	375,000	–	–	375,000
Kwan Kit Tong, Kevin	20.2.2003	20.2.2004 to 19.2.2013	0.138	0.138	375,000	–	–	375,000
Pang Hing Chung, Alfred	20.2.2003	20.2.2004 to 19.2.2013	0.138	0.138	750,000	–	–	750,000
Tsoi Tai Wai, David	20.2.2003	20.2.2004 to 19.2.2013	0.138	0.138	750,000	–	–	750,000
					3,825,000	–	–	3,825,000
Adviser	20.2.2003	20.2.2004 to 19.2.2013	0.138	0.138	300,000	–	–	300,000
Employees	12.7.2002	12.7.2003 to 11.7.2012	0.385	0.384	2,981,000	–	(655,000)	2,326,000
	20.2.2003	20.2.2004 to 19.2.2013	0.138	0.138	3,034,000	–	(652,000)	2,382,000
	10.10.2003	10.10.2004 to 9.10.2013	0.142	0.142	290,000	–	(125,000)	165,000
	23.2.2004	23.2.2005 to 22.2.2014	0.160	0.165	2,404,000	–	(780,000)	1,624,000
	11.10.2004	11.10.2005 to 10.10.2014	0.124	0.124	828,000	–	(248,000)	580,000
					9,537,000	–	(2,460,000)	7,077,000
					13,662,000	–	(2,460,000)	11,202,000

* The closing price of the Company's shares immediately before the date of grant.

\# The exercise price represented the average of the closing prices of the Company's shares quoted on the Stock Exchange on the five trading days immediately preceding the date of grant of the options.

No options granted under this scheme lapsed or were exercised since the date of grant up to 31st December, 2005.

These grants under the Post-IPO Share Option Scheme are exercisable, starting from the first anniversary of the grant date at stepped annual increments of 25% of the total options granted, for a period not later than 10 years from the date of grant.

The total number of shares in respect of which options are issuable under this scheme shall not in aggregate exceed 10% of the number of issued shares.

No participant shall be granted an option which, if exercised in full, would result in such participant becoming entitled to subscribe for such number of shares, as when aggregated with the total number of shares already issued under all the options previously granted to him or her which have been exercised, and, issuable under all the outstanding options previously granted to him or her which are for the time being subsisting and unexercised, would exceed 1% of the total number of shares in issue in any 12 month period up to the date of grant of the option.

Because the Black-Scholes option pricing model requires the input of highly subjective assumptions, including the volatility of share price, changes in subjective input assumptions can materially affect the fair value estimate.

ARRANGEMENTS TO PURCHASE SHARES OF DEBENTURES

Other than the option holdings disclosed above, at no time during the year was the Company, its holding company, or any of its subsidiaries or fellow subsidiaries, a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

No contracts of significance to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

DIRECTORS' REPORT

COMPETING INTEREST

None of the directors or the management shareholders (as defined in the GEM Listing Rules) of the Company or their respective associates had any interest in a business which competes with or may compete with the business of the Group.

EMOLUMENT POLICY

The emolument policy regarding the employees of the Group is set up by the Management and is based on their merit, qualifications and competence.

The emoluments of the directors of the Company are decided by the Remuneration Committee, having regard to the Company's operating results, individual duties, responsibilities, experience, performance and comparable market statistics.

The Company has adopted a share option scheme as an incentive to directors and eligible employees, details of the scheme is set out in note 23 to the financial statements.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

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

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Articles of Association or the laws of Cayman Islands, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

INDEPENDENT NON-EXECUTIVE DIRECTORS

The Company has received, from each of the independent non-executive directors, an annual confirmation of his independence pursuant to Rule 5.09 of the GEM Listing Rules. The Company considers all of the independent non-executive directors are independent.

MAJOR CUSTOMERS AND SUPPLIERS

During the year, the aggregate sales attributable to the Group's five largest customers comprised approximately 44% of the Group's total sales while the sales attributable to the Group's largest customer was approximately 27% of the Group's total sales.

The aggregate purchases during the year attributable to the Group's five largest suppliers comprised approximately 83% of the Group's total purchases while the purchases attributable to the Group's largest supplier was approximately 74% of the Group's total purchases.

None of the directors, their associates or any shareholder, which to the knowledge of the directors owned more than 5% of the Company's issued share capital, had any interest in the share capital of any of the five largest customers or suppliers of the Group.

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

The following disclosure is made in pursuant to Rules 17.15 and 17.22 of the GEM Listing Rules.

As at 31st December, 2005, there were 289,944,745 shares of the Company in issue. Based on the average closing price of the Company's shares of HK$0.11 as stated in the Stock Exchange's daily quotation sheets for the trading days from 21st December, 2005 to 29th December, 2005 (both days inclusive), being the five business days immediately preceding 30th December, 2005, the total market capitalisation of the Company was approximately HK$31,893,922 (the "Total Market Capitalisation) as at 31st December, 2005.

As at 31st December, 2005, the following trade receivables of the Group exceeded 8% of the Total Market Capitalisation.

Customer name	**Amount due to the Group as at 31st December, 2005** *HK$'000*	**% of Total Market Capitalisation**
Beijing Siemens Communications Network Co. Ltd.	19,933	62.5%
Motorola (China) Electronics Ltd.	13,025	40.8%
The China Unicom Group	9,346	29.3%
China Netcom (Hong Kong) Operations Ltd.	8,758	27.5%
Shanghai Media Group* 上海文廣新聞傳媒集團	4,227	13.3%
IBM Global Services (China) Company Ltd.	3,801	11.9%
China Network Communications Corporation Limited	2,917	9.1%

* *For identification purpose only*

DIRECTORS' REPORT

These receivables, which resulted from sales of network equipment and provision of services by the Group in its ordinary course of business and on normal commercial terms, are unsecured, interest-free and payable under normal payment terms of the Group.

The above customers and their 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 (as defined in the GEM Listing Rules).

AUDITORS

The financial statements accompanying this Annual Report were audited by Messrs. Deloitte Touche Tohmatsu. A resolution will be submitted to the annual general meeting of the Company to be held on 28th April, 2006 for their re-appointment.

On behalf of the Board of Directors

CHAN SEK KEUNG, RINGO
Chairman and Chief Executive Officer
Hong Kong, 28th March, 2006

AUDITORS' REPORT

Deloitte.
德勤

德勤・關黃陳方會計師行
香港中環干諾道中111號
永安中心26樓

Deloitte Touche Tohmatsu
26/F, Wing On Centre
111 Connaught Road Central
Hong Kong

TO THE SHAREHOLDERS OF WAFER SYSTEMS LIMITED

(incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of Wafer Systems Limited (the "Company") and its subsidiaries (the "Group") on pages 30 to 69 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The directors are responsible for the preparation of consolidated financial statements which give a true and fair view. In preparing consolidated financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the consolidated financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the consolidated financial statements, and of whether the accounting policies are appropriate to the circumstances of the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the consolidated financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the consolidated financial statements give a true and fair view of the state of affairs of the Group as at 31st December, 2005 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Deloitte Touche Tohmatsu
Certified Public Accountants
Hong Kong
28th March, 2006

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31ST DECEMBER 2005

	NOTES	2005 HK$'000	2004 HK$'000 (restated)
Turnover	6	**368,250**	269,688
Other income		**1,615**	747
Charges in materials and equipment		**(310,684)**	(219,059)
Employee expense		**(17,822)**	(16,937)
Depreciation and amortisation		**(4,431)**	(5,297)
Other expenses		**(32,146)**	(23,375)
Finance costs	8	**(2,707)**	(2,593)
Profit before taxation	9	**2,075**	3,174
Taxation	12	**(632)**	(473)
Profit for the year		**1,443**	2,701
Profit (loss) attributable to:			
Equity holders of the parent		**1,443**	2,736
Minority interest		**–**	(35)
		1,443	2,701
Earnings per share – Basic	13	**0.50 cents**	0.94 cents

CONSOLIDATED BALANCE SHEET AT 31st December, 2005

	NOTES	2005 HK$'000	2004 HK$'000 (restated)
Non-current assets			
Property, plant and equipment	14	**3,142**	3,779
Software product development costs	15	**7,527**	7,256
		10,669	11,035
Current assets			
Inventories		**5,866**	11,895
Trade and other receivables	16	**114,338**	75,072
Pledged bank deposits	17	**4,571**	9
Bank balances and cash	18	**17,072**	40,752
		141,847	127,728
Current liabilities			
Trade and other payables	19	**43,989**	29,635
Taxation		**824**	866
Bank borrowings	20	**48,277**	47,979
Convertible bonds maturing within one year	21	**–**	3,000
		93,090	81,480
Net current assets		**48,757**	46,248
Net assets		**59,426**	57,283
Capital and reserves			
Share capital	22	**2,900**	2,900
Reserves		**56,526**	54,383
Equity attributable to equity holders of the parent		**59,426**	57,283
Minority interest		**–**	–
Total equity		**59,426**	57,283

The financial statements on pages 30 to 69 were approved and authorised for issue by the Board of Directors on 28 March, 2006 and are signed on its behalf by:

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

DIRECTOR

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY For the year ended 31st December, 2005

	Share capital	Share premium	Share-based payments reserve	Statutory surplus reserve fund	Enterprise expansion fund	Staff welfare fund	Translation reserve	Accumulated losses	Attributable to equity holders of the parent	Minority interest	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At 1st January, 2004											
– as previously reported	2,900	55,824	–	1,003	502	502	–	(6,471)	54,260	–	54,260
– effect of changes in accounting policies (note 2)	–	–	166	–	–	–	–	(166)	–	–	–
– as restated	2,900	55,824	166	1,003	502	502	–	(6,637)	54,260	–	54,260
Profit for the year, representing total recognised income and expense for the year	–	–	–	–	–	–	–	2,736	2,736	(35)	2,701
Capital contributions by a minority shareholder of a subsidiary	–	–	–	–	–	–	–	–	–	35	35
Recognition of equity settled share–based payments	–	–	287	–	–	–	–	–	287	–	287
At 1st January, 2005	2,900	55,824	453	1,003	502	502	–	(3,901)	57,283	–	57,283
Exchange differences on translation of foreign operations	–	–	–	–	–	–	566	–	566	–	566
Profit for the year	–	–	–	–	–	–	–	1,443	1,443	–	1,443
Total recognised income and expenses for the year	–	–	–	–	–	–	566	1,443	2,009	–	2,009
Recognition of equity settled share–based payments	–	–	134	–	–	–	–	–	134	–	134
At 31st December, 2005	2,900	55,824	587	1,003	502	502	566	(2,458)	59,426	–	59,426

As stipulated by the relevant laws and regulations for foreign investment enterprises in the Mainland China (the "PRC"), the PRC subsidiaries of the Company are required to maintain three statutory reserves, statutory surplus reserve fund, enterprise expansion fund and staff welfare fund which are non-distributable. Appropriations to such reserves are made out of profit after taxation based on statutory financial statements of the PRC subsidiaries and the amount and allocation basis are decided by its board of directors annually. The statutory surplus reserve fund can be used to make up prior year losses of the PRC subsidiaries, if any, and can be applied in conversion into capital by means of capitalisation issue. The enterprise expansion fund is used for expanding the capital base of the PRC subsidiaries by means of capitalisation issue. The staff welfare fund, which is to be used for the welfare of the staff and workers of the Company, is of a capital nature.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31st December, 2005

	2005 HK$'000	2004 HK$'000 (restated)
Operating activities		
Profit before taxation	2,075	3,174
Adjustments for:		
Interest income	(155)	(261)
Interest expense	2,707	2,217
Amortisation of discount on convertible bonds	–	376
Depreciation and amortisation	4,431	5,297
Loss on disposal of property, plant and equipment	–	9
Share-based payments expense	134	287
Impairment loss on trade and retention money receivables	3,685	2,435
Operating cash flows before movements in working capital	12,877	13,534
Decrease (increase) in inventories	6,029	(1,272)
Increase in trade and other receivables	(42,951)	(21,017)
Increase in trade and other payables	14,354	4,793
Cash used in operations	(9,691)	(3,962)
PRC income tax paid	(674)	(88)
Net cash used in operating activities	(10,365)	(4,050)
Investing activities		
Interest received	155	261
Purchase of property, plant and equipment	(1,764)	(2,570)
Proceeds from disposal of property, plant and equipment	66	80
Software product development costs paid	(2,347)	(2,450)
(Increase) decrease in pledged bank deposits	(4,562)	1,033
Net cash used in investing activities	(8,452)	(3,646)
Financing activities		
Interest paid	(2,707)	(2,217)
Proceeds from issue of shares to minority shareholders of a subsidiary	–	35
(Repayment of) borrowing raised from short-term bank loans	(4,125)	3,458
(Repayment of) increase in trust receipts and import loans	(1,235)	11,465
Redemption of convertible bonds	(3,000)	(9,460)
Net cash (used in) from financing activities	(11,067)	3,281
Net decrease in cash and cash equivalents	(29,884)	(4,415)
Cash and cash equivalents at 1st January	40,752	45,167
Effect of foreign exchange rate change	546	–
Cash and cash equivalents at 31st December	11,414	40,752
Analysis of the balances of cash and cash equivalents		
Bank balances and cash	17,072	40,752
Bank overdrafts	(5,658)	–
	11,414	40,752

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2005

1. GENERAL

The Company was incorporated in the Cayman Islands as an exempted company with limited liability. The shares of the Company are listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The address of the registered office and principal place of business of the Company are disclosed in the corporate information of the annual report.

The Company acts as an investment holding company while its subsidiaries (collectively referred to as the "Group") are principally engaged in the provision of network infrastructure solutions, including the sales of network equipment and software and the provision of related network infrastructure services, provision of network professional services, and sales of its proprietary network software.

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS

In the current year, the Group has applied, for the first time, a number of new Hong Kong Financial Reporting Standards (HKFRSs), Hong Kong Accounting Standards (HKASs) and Interpretations (hereinafter collectively referred to as "new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") that are effective for accounting periods beginning on or after 1st January, 2005. The application of the new HKFRSs has resulted in a change in the presentation of the consolidated income statement, consolidated balance sheet and consolidated statement of changes in equity. In particular, the presentation of minority interest has been changed. The changes in presentation have been applied retrospectively. The adoption of the new HKFRSs has resulted in changes to the Group's accounting policies in the following areas that have an effect on how the results for the current and prior accounting years are prepared and presented. The impact on basic and diluted earnings per share is discussed in note 13.

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS *(Continued)*

Share-based payments

In the current year, the Group has applied HKFRS 2 "Share-based payment" which requires an expense to be recognised when the Group buys goods or obtains services in exchange for shares or rights over shares ("equity-settled transactions"). The principal impact of HKFRS 2 on the Group is in relation to the expensing of the fair value of share options granted to directors, employees of the Group and other individuals providing similar services determined at the date of grant of the share options, and recognised over the vesting period. Prior to the application of HKFRS 2, the Group did not recognise the financial effect of these share options until they were exercised. The Group has applied HKFRS 2 to share options granted on or after 1st January, 2005. In relation to share options granted before 1st January, 2005, the Group elected not to apply HKFRS 2 with respect to share options granted on or before 7th November, 2002 and vested before 1st January, 2005. However, the Group is still required to apply HKFRS 2 retrospectively to share options that were granted after 7th November, 2002 and had not yet vested on 1st January, 2005.

The effect of the change in accounting policy is an increase of HK$166,000 in the accumulated loss at 1st January, 2004 and a decrease in the profit for the year ended 31st December, 2004 of HK$287,000 (included in employee expenses of HK$279,000 and other expenses of HK$8,000). The consolidated balance sheet at 31st December, 2004 has been restated to reflect the recognition of a share-based payments reserve of HK$453,000.

For the year ended 31st December, 2005, impact of share-based payment is a charge to income statement of HK$134,000 (include in employee expenses of HK$129,000 and other expenses of HK$5,000). At 31st December, 2005, the share-based payments reserve amounted to HK$587,000.

Financial instruments

In the current year, the Group has applied HKAS 32 Financial instruments: Disclosure and Presentation and HKAS 39 Financial instruments: Recognition and Measurement. HKAS 32 requires retrospective application. HKAS 39, which is effective for annual periods beginning on or after 1st January, 2005, generally does not permit the recognition, derecognition or measurement of financial assets and liabilities on a retrospective basis. The principal effects resulting from the implementation of HKAS 32 and HKAS 39 are summarised below:

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS *(Continued)*

Financial instruments *(Continued)*

Convertible bonds

The principal impact of HKAS 32 on the Group is in relation to convertible bonds issued by the Company that contain both liability and equity components. Previously, convertible bonds were classified as liabilities on the balance sheet. HKAS 32 requires an issuer of a compound financial instrument that contains both financial liability and equity components to separate the compound financial instrument into liability and equity components on initial recognition and to account for these components separately. At the date of issue, the liability component is the carrying amount of the financial liability determined by discounting the steam of future payment of interest and principal at the prevailing market rate. In subsequent periods, the liability component is carried at amortised cost using the effective interest method. The directors consider that the value of the equity component embedded in the convertible bonds is insignificant. Accordingly, no retrospective restatement is considerated.

HKAS 1 (Amendment)	Capital disclosures [1]
HKAS 19 (Amendment)	Actuarial gains and losses, group plans and disclosures [2]
HKAS 21 (Amendment)	Net investment in a foreign operation [2]
HKAS 39 (Amendment)	Cash flow hedge accounting of forecast intragroup transactions [2]
HKAS 39 (Amendment)	The fair value option [2]
HKAS 39 and HKFRS 4 (Amendments)	Financial guarantee contracts [2]
HKFRS 6	Exploration for and evaluation of mineral resources [2]
HKFRS 7	Financial instruments: Disclosures [1]
HK(IFRIC) - INT 4	Determining whether an arrangement contains a lease [2]
HK(IFRIC) - INT 5	Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds [2]
HK(IFRIC) - INT 6	Liabilities arising from participating in a specific market– waste electrical and electronic equipment [3]
HK(IFRIC) - Int 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies [4]

1 Effective for annual periods beginning on or after 1st January, 2007.
2 Effective for annual periods beginning on or after 1st January, 2006.
3 Effective for annual periods beginning on or after 1st December, 2005.
4 Effective for annual periods beginning on or after 1st March, 2006.

3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with HKFRSs issued by the HKICPA. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange and by the Hong Kong Companies Ordinance.

The consolidated financial statements have been prepared under the historical cost basis as explained in the accounting policies set out below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interest in the net assets of consolidated subsidiaries are presented separately from the Group's equity therein. Minority interest in the net assets consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and sales related taxes.

– Sales of network equipment and software are recognised when the network equipment and software are delivered and title has passed.

– Revenue from the provision of network infrastructure services and network professional services are recognised when the services are provided.

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Revenue recognition *(Continued)*

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any identified impairment loss at the balance sheet date.

The gain or loss arising from the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement.

Depreciation is provided to write off the cost of property, plant and equipment over their estimated useful lives, using the straight line method, at the rate of $33^1/_3$% per annum.

Impairment (other than intangible assets)

At each balance sheet date, the Group reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

Software product development costs

Research and development expenditures

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Software product development costs *(Continued)*

Research and development expenditures (Continued)

An internally-generated asset arising from software product development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly-defined project will be recovered through future commercial activity. The resultant asset is amortised on a straight line basis over its estimated useful life of three years. Amortisation of these costs commences when the software are ready for their intended use.

Where no internally-generated software product can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

Impairment

Intangible assets not yet available for use are tested for impairment annually by comparing their carrying amounts with their recoverable amounts, irrespective of whether there is any indication that they may be impaired. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years.

Intangible assets with finite useful lives are tested for impairment when there is an indication that an asset may be impaired (see the accounting policies in respect of impairment losses for tangible and intangible assets above).

Inventories

Inventories, which represent goods held for sale, are stated at the lower of cost and net realisable value. Cost, which comprises all costs of purchase and, where applicable, other costs that have been incurred in bringing the inventories to their present location and condition, is calculated using the weighted average method. Net realisable value represents the estimated selling price in the ordinary course of business less all estimated costs necessary to make the sale.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31st December, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Financial instruments

Financial assets and financial liabilities are recognised on the Company's balance sheet when the Company becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

Financial assets

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables including trade and other receivables, pledged bank deposits and bank balances are initially measured at fair value, and are subsequently measured at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in the income statement when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, cash at bank and demand deposits.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. The accounting policies adopted for specific financial liabilities and equity are set out below.

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Financial liabilities and equity *(Continued)*

Convertible bonds

Convertible bonds are regarded as compound instruments, consisting of a liability component and an equity component. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the convertible bonds and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the Group, is included in equity.

Issue costs (if any) are apportioned between the liability and equity components of the convertible bonds based on their relative carrying amounts at the date of issue. The portion relating to the equity component is charged directly against equity.

In subsequent periods, the liability component of the convertible bonds is carried at amortised cost using the effective interest method.

Financial liabilities other than financial liabilities at fair value through profit or loss ("other financial liabilities")

Other financial liabilities including trade and other payables and bank borrowings are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest method.

Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liabilities for current tax is calculated using tax rates that have been enacted or substantially enacted by the balance date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited to the income statement.

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in its functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in the income statement in the period in which they arise.

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Foreign currencies *(Continued)*

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Company (i.e. Hong Kong dollars ("HKD")), which is the same as the functional currency of the Company, at the rate of exchange prevailing at the balance sheet date, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the period, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognised as a separate component of equity (the translation reserve). Such exchange differences are recognised in the income statement in the period in which the foreign operation is disposed of.

Operating leases

Leases are classified as operating leases whenever, the terms of the lease do not transfer substantially all the risks and rewards of ownership to the lessees.

Rentals payable under operating leases are changed to the income statement on a straight line basis over the period of the respective leases.

Borrowing costs

All borrowing costs are recognised as and included in finance costs in the income statement in the period in which they are incurred.

Retirement benefit costs

Payments to the state-managed retirement benefit schemes or the Mandatory Provident Fund Scheme are charged as an expense as they fall due.

Equity-settled share-based payments

Share options granted to directors, employees of the Group and other individuals providing similar services.

The fair value of services received determined by reference to the fair value of share options granted at the grant date is expensed on a straight-line basis over the vesting period, with a corresponding increase in equity (share-based payments reserve).

At the time when the share options are exercised, the amount previously recognised in share option reserve will be transferred to share premium. When the share options are forfeited after vesting date or are still not exercised at the expiry date, the amount previously recognised in employee share-based compensation reserve will be transferred to accumulated losses.

NOTES TO THE FINANCIAL STATEMENTS For the year ended 31st December, 2005

4. KEY SOURCES OF ESTIMATION UNCERTAINTY

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Impairment of trade receivables

Note 3 describes that trade receivables are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest method. Appropriate allowances for estimated irrecoverable amounts are recognised in profit and loss when there is objective evidence that the receivables are not recoverable.

Management considered detailed procedures have been in place to monitor this risk as a significant proportion of the Company's majority of working capital is devoted to trade receivables. In determining whether impairment on trade receivable is occurred, the Company takes into consideration the ageing status and the likelihood of collection. An impairment loss on trade receivables is recognised when they are unlikely to be collected. The measurement of impairment loss requires the Company to estimate the future cash flows expected to be collected. In this regard, the directors of the Company are satisfied that this risk is minimal and adequate impairment has been made in the financial statements in light of the historical records of the Company and the current economic environment.

Recoverability of software product development costs

During the year, the management reconsidered the recoverability of its internally-generated intangible asset arising from the Group's software product development expenditure, which is included in its consolidated balance sheet at 31st December, 2005 at HK$7,527,000. The project continues to progress in a very satisfactory manner, and customer reaction has reconfirmed management's previous estimates of anticipated revenues from the project. However, keen competition has caused management to reconsider its assumptions regarding future market shares and anticipated margins on these products. Cash flow forecasts have been carried out and management is confident that the carrying amount of the asset will be recovered in full, even if returns are reduced. This situation will be closely monitored, and adjustments made in future periods, if future market activity indicates that such adjustments are appropriate.

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company's major financial instruments include pledged bank deposits, trade and other receivables, bank balances and cash, trade and other payables and bank borrowings. Details of these financial instruments are disclosed in respective notes. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

Currency risk

The Group collects some of its revenue and incurs some of expenditures in Renminbi ("RMB") are also denominated in RMB. On the other hand, the majority of purchase were denominated in U.S. dollar ("USD") which are linked up with HKD.

RMB is not a freely convertible currency. Future exchange rates of RMB could vary significantly from the current or historical exchange rates as a result of controls that could be imposed by the People's Republic of China (the "PRC") government. The exchange rates may also be affected by economic developments and political changes domestically and internationally, and supply and demand of RMB. The appreciation or devaluation of RMB against HKD and USD may have positive or negative impact on the results of operations of the Group.

Some of trade receivables and bank borrowings of the Group are denominated in RMB. The Group currently does not have a foreign currency hedging policy. However, the management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arises.

Credit risk

The Group's maximum exposure to credit risk in the event of the counterparties failure to perform their obligations as at 31st December, 2005 in relation to each class of recognised financial assets is the carrying amount of those assets as stated in the consolidated balance sheet. In order to minimise the credit risk, the management of the Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade debt at each balance sheet date to ensure that adequate impairment losses, if any, are made for irrecoverable amounts. In this regard, the directors of the Group consider that the Group's credit risk is significantly reduced.

NOTES TO THE FINANCIAL STATEMENTS For the year ended 31st December, 2005

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(Continued)*

Credit risk *(Continued)*

The credit risk on trade receivables is concentrated on a few of customers. However, the management consider the strong financial background and good creditability of these customers, and there is no significant credit risk.

Interest rate risk

The Group is exposed to interest rate risk through the impact of rate changes on interest bearing financial assets and liabilities. Interest bearing financial assets are mainly balances with banks which are all short term in nature. Interest bearing financial liabilities are mainly bank borrowings with fixed and floating interest rates. Therefore, any future variations in interest rate will not have a significant impact on the results of the Group.

6. Turnover

Turnover represents the aggregate of the net amounts received and receivable from third parties in connection with the provision of network infrastructure solutions, network professional services and network software. An analysis of the Groups' turnover for the year is as follows:

	2005	2004
	HK$'000	*HK$'000*
Network infrastructure	**319,903**	240,694
Network professional services	**45,927**	24,973
Network software	**2,420**	4,021
	368,250	269,688

7. BUSINESS AND GEOGRAPHICAL SEGMENTS

Business segments

For management purposes, the Group's operations are organised into three operating divisions namely network infrastructure, network professional services and network software. These divisions are the basis on which the Group reports its primary segment information.

Principal activities are as follows:

Network infrastructure	–	the sales of network equipment and software and the provision of related network infrastructure services
Network professional services	–	provision of network professional services
Network software	–	the sales of the Group's proprietary network software

Business segments for the year are as follows:

	Turnover		Results	
	2005	2004	**2005**	2004
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
				(restated)
Network infrastructure	**319,903**	240,694	**3,498**	5,255
Network professional services	**45,927**	24,973	**1,429**	1,659
Network software	**2,420**	4,021	**(1,421)**	(1,437)
	368,250	269,688	**3,506**	5,477
Unallocated corporate income			**1,615**	747
Unallocated corporate expenses			**(339)**	(457)
Finance costs			**(2,707)**	(2,593)
Profit before taxation			**2,075**	3,174
Taxation			**(632)**	(473)
Profit for the year			**1,443**	2,701

NOTES TO THE FINANCIAL STATEMENTS For the year ended 31st December, 2005

7. BUSINESS AND GEOGRAPHICAL SEGMENTS *(Continued)*

Business segments *(Continued)*

	2005	2004
	HK$'000	*HK$'000*
BALANCE SHEET		
Assets		
Segment assets		
– network infrastructure	106,823	68,803
– network professional services	5,013	5,055
– network software	9,483	10,710
Unallocated corporate assets	31,197	54,195
	152,516	138,763
Liabilities		
Segment liabilities		
– network infrastructure	43,989	29,635
Unallocated corporate liabilities	49,101	51,845
	93,090	81,480
OTHER INFORMATION		
Capital additions		
– network infrastructure	1,216	1,870
– network professional services	485	591
– network software	2,410	2,559
	4,111	5,020
Depreciation and amortisation		
– network infrastructure	1,672	2,514
– network professional services	683	794
– network software	2,076	1,989
	4,431	5,297
Impairment loss on trade and retention money receivables	3,685	2,435

7. BUSINESS AND GEOGRAPHICAL SEGMENTS *(Continued)*

Geographical segments

The Group's operations are located in the PRC and Hong Kong. The following table provides an analysis of the Group's geographical segment information:

	Turnover	
	2005	2004
	HK$'000	*HK$'000*
PRC	**351,880**	255,663
Hong Kong	**16,370**	14,025
	368,250	269,688

The following is an analysis of the carrying amount of segment assets and capital additions, analysed by the geographical area in which the assets are located:

	Carrying amount of segment assets		Capital additions	
	2005	2004	**2005**	2004
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*
PRC	**142,271**	128,293	**3,466**	3,250
Hong Kong	**10,245**	10,470	**645**	1,770
	152,516	138,763	**4,111**	5,020

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2005

8. FINANCE COSTS

	2005	2004
	HK$'000	*HK$'000*
Interest on bank borrowings wholly repayable within five years	**2,707**	2,217
Interest charged	**–**	376
	2,707	2,593

9. PROFIT BEFORE TAXATION

	2005	2004
	HK$'000	*HK$'000*
		(restated)
Profit before taxation has been arrived at after charging:		
Directors' emoluments *(note 10)*	**1,561**	1,557
Other staff's retirement benefits scheme contributions	**2,205**	1,317
Other staff costs	**15,971**	15,974
Share-based payments expense	**68**	177
Less: Staff costs capitalised in software product development costs	**(1,988)**	(2,096)
	17,817	16,929
Impairment loss on trade and retention money receivables	**3,685**	2,435
Amortisation of software product development costs (included in depreciation and amortisation)	**2,076**	1,989
Auditors' remuneration	**470**	440
Depreciation of property, plant and equipment	**2,355**	3,308
Loss on disposal of property, plant and equipment	**–**	9
Operating lease rentals in respect of land and buildings	**2,729**	2,630
and after crediting:		
Exchange gain	**674**	–
Interest income	**155**	261

10. DIRECTORS' EMOLUMENTS

The emoluments paid or payable to each of the seven (2004: seven) directors were as follows:

	Year ended 31st December, 2005							
	Chan Sek Keung, Ringo	Alasdair Gordon Nagle	Clara Ho	Kwan Kit Tong, Kevin	Pang Hing Chung, Alfred	Tsoi Tai Wai, David	Yu Zhonghou	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Fees	–	–	–	–	120	120	72	312
Other emoluments								
Salaries and other benefits	1,176	–	–	–	–	–	–	1,176
Contributions to retirement benefits schemes	12	–	–	–	–	–	–	12
Share-based payments expense	19	6	6	6	12	12	–	61
Total emoluments	1,207	6	6	6	132	132	72	1,561

NOTES TO THE FINANCIAL STATEMENTS For the year ended 31st December, 2005

10. DIRECTORS' EMOLUMENTS *(Continued)*

	Year ended 31st December, 2004							
	Chan Sek Keung, Ringo	Alasdair Gordon Nagle	Clara Ho	Kwan Kit Tong, Kevin	Pang Hing Chung, Alfred	Tsoi Tai Wai, David	Yu Zhonghou	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Fees	–	–	–	–	120	120	20	260
Other emoluments								
Salaries and other benefits	1,183	–	–	–	–	–	–	1,183
Contributions to retirement benefits schemes	12	–	–	–	–	–	–	12
Share-based payments expense	32	10	10	10	20	20	–	102
Total emoluments	1,227	10	10	10	140	140	20	1,557

During the year, no emoluments were paid by the Group to the five highest paid individuals (including directors and employees) as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors has waived any emoluments during the year.

11. FIVE HIGHEST PAID EMPLOYEES

The aggregate emoluments of the five highest paid individuals included one (2004: one) executive director of the Company, whose emoluments are included in note 10 above. The aggregate emoluments of the remaining four (2004: four) highest paid individuals are as follows:

	2005	2004
	HK$'000	*HK$'000*
		(restated)
Basic salaries and allowances	**2,036**	1,974
Retirement benefits scheme contributions	**44**	36
Share-based payments expense	**24**	37
	2,104	2,047

None of the four highest paid individuals received emoluments in excess of HK$1 million.

12. TAXATION

The charge represents PRC income tax which is calculated at rates applicable to respective PRC subsidiaries.

No provision for Hong Kong Profits Tax has been made in the financial statements as the Group had no assessable profit for the year.

Pursuant to the relevant laws and regulations in the PRC, the Company's PRC subsidiaries are entitled to the 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 year, two of the Company's PRC subsidiaries are within their 50% tax relief period, the rest is within its tax exemption period.

NOTES TO THE FINANCIAL STATEMENTS For the year ended 31st December, 2005

12. TAXATION *(Continued)*

The charge for the year is reconciled to profit before taxation per income statement as follows:

	2005	2004
	HK$'000	*HK$'000*
		(restated)
Profit before taxation	2,075	3,174
Tax at the applicable income tax rate of 17.5%	(363)	(555)
Tax effect of expenses not deductible for tax purposes	(44,592)	(27,261)
Tax effect of income not taxable for tax purposes	44,223	27,471
Tax effect of unrecognised tax losses	(50)	(203)
Utilisation of tax losses previously not recognised	227	49
Effect of tax concessionary rate granted to PRC subsidiaries	(33)	(38)
Others	(44)	64
Tax charge for the year	(632)	(473)

13. EARNINGS PER SHARE

The calculation of the basic and diluted earnings per share attributable to the equity holder of the parent is based on the following data:

	2005	2004
		(restated)
Earnings:		
Profit attributable to the equity holders of the parent purposes of basic and diluted earnings per share	HK$1,443,000	HK$2,736,000
Number of shares:		
Number of ordinary shares for the purposes of basic earnings per share	289,944,745	289,944,745

13. EARNINGS PER SHARE *(Continued)*

For the year ended 31st December, 2005 and 2004, there were no potential dilutive ordinary shares outstanding as the exercise price of the Company's outstanding share options is higher than the average market price for the Company for both years.

For the year ended 31st December,2004, the computation of diluted earnings per share does not assume the conversion of the Company's outstanding convertible bonds since their exercise would result in an increase in earnings per share for the year ended 31st December, 2004.

Impact on application of new HKFRSs

Changes in the Group's accounting policies during the year are described in detail in note 2. To the extent that those changes have had an impact on results reported for 2005 and 2004, they have had an impact on the amounts reported for earnings per share.

The following table summarises the impact on basic earnings per share as a result of:

	Impact on basic earnings per share		**Impact on diluted earnings per share**	
	2005	2004	**2005**	2004
	cents	cents	cents	cents
Reported figures before adjustments	**0.54**	1.04	**N/A**	1.04
Adjustments arising from changes in accounting policies	**(0.05)**	(0.10)	**N/A**	N/A
As reported/restated	**0.49**	0.94	**N/A**	N/A

No diluted earnings per share has been presented for 2004 because the exercise price of the Company's options, after taken into account of the effect share-based payment was higher than the average market price to the shares during 2004.

NOTES TO THE FINANCIAL STATEMENTS For the year ended 31st December, 2005

14. PROPERTY, PLANT AND EQUIPMENT

	Computer equipment	Furniture, fixtures and office equipment	Motor vehicles	Tools	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
COST					
At 1st January, 2004	7,891	1,779	438	4,602	14,710
Additions	1,360	145	–	1,065	2,570
Disposals	(40)	(99)	–	(206)	(345)
At 31st December, 2004	9,211	1,825	438	5,461	16,935
Additions	295	71	450	948	1,764
Exchange differences	90	19	6	62	177
Disposals	(24)	–	–	(239)	(263)
At 31st December, 2005	9,572	1,915	894	6,232	18,613
DEPRECIATION					
At 1st January, 2004	5,767	1,328	254	2,755	10,104
Provided for the year	1,773	310	101	1,124	3,308
Eliminated on disposals	(35)	(99)	–	(122)	(256)
At 31st December, 2004	7,505	1,539	355	3,757	13,156
Provided for the year	942	201	143	1,069	2,355
Exchange differences	82	15	6	54	157
Eliminated on disposals	(24)	–	–	(173)	(197)
At 31st December, 2005	8,505	1,755	504	4,707	15,471
CARRYING VALUES					
At 31st December, 2005	1,067	160	390	1,525	3,142
At 31st December, 2004	1,706	286	83	1,704	3,779

15. SOFTWARE PRODUCT DEVELOPMENT COSTS

	HK$'000
COST	
At 1st January, 2004	10,705
Additions	2,450
At 31st December, 2004	13,155
Additions	2,347
At 31st December, 2005	15,502
AMORTISATION	
At 1st January, 2004	3,910
Amortised for the year	1,989
At 31st December, 2004	5,899
Amortised for the year	2,076
At 31st December, 2005	7,975
CARRYING VALUE	
At 31st December, 2005	7,527
At 31st December, 2004	7,256

16. TRADE AND OTHER RECEIVABLES

	2005	2004
	HK$'000	*HK$'000*
Trade receivables	**84,061**	56,652
Retention money receivables	**20,724**	4,660
Other receivables	**3,285**	4,124
Prepaid maintenance charges	**6,268**	9,636
	114,338	75,072

NOTES TO THE FINANCIAL STATEMENTS For the year ended 31st December, 2005

16. TRADE AND OTHER RECEIVABLES *(Continued)*

Payment terms with customers are mainly on credit together with deposits. Invoices are normally payable from 30 to 90 days of issuance, except for certain well established customers. The following is an aged analysis of trade receivables at the balance sheet date:

	2005	2004
	HK$'000	*HK$'000*
Age		
0 to 30 days	**39,755**	18,254
31 to 60 days	**15,016**	9,044
61 to 90 days	**6,101**	10,709
91 to 180 days	**16,063**	16,597
181 to 365 days	**5,856**	4,349
Over 365 days	**4,256**	800
	87,047	59,753
Less: Accumulated impairment	**(2,986)**	(3,101)
	84,061	56,652

Retention money receivable represents the progress payments receivable on the contract works of network infrastructure, with aged over 180 days.

Prepaid maintenance charges which is expected to be recovered in more than twelve months after the balance sheet date is classified under current asset as it is expected to be realised in the Company's normal operating cycle.

The fair value of trade and others receivables approximate their carrying amounts.

17. PLEDGED BANK DEPOSITS

The deposits have been pledged to secure the banking facilities extended to the Group. Deposits amounting to HK$3,482,000 carry floating interest rate of LIBOR. The remaining deposits amounting to HK$1,089,000 carrying at prevailing market interest rate. The directors consider that the carrying amount of deposits approximate their fair value. The pledged bank deposits will be released upon the settlement of relevant bank borrowings.

18. BANK BALANCES AND CASH

Bank balances and cash comprise cash held by the Group and short-term bank deposits with an original maturity of three months or less at prevailing market interest rates. The directors consider that the carrying amount of these assets approximate their fair value.

19. TRADE AND OTHER PAYABLES

	2005	2004
	HK$'000	*HK$'000*
Trade payables	**31,859**	18,548
Other payables	**12,130**	11,087
	43,989	29,635

The following is an aged analysis of trade payables at the balance sheet date:

	2005	2004
	HK$'000	*HK$'000*
Age		
0 to 30 days	**17,831**	14,127
31 to 90 days	**10,792**	2,565
91 to 180 days	**1,046**	691
181 to 270 days	**344**	72
271 to 365 days	**60**	597
Over 365 days	**1,786**	496
	31,859	18,548

The fair value of trade and other payables approximate their carrying amounts.

NOTES TO THE FINANCIAL STATEMENTS For the year ended 31st December, 2005

20. BANK BORROWINGS

	2005	2004
	HK$'000	*HK$'000*
Bank overdrafts	**5,658**	–
Short-term bank loans	**14,286**	18,411
Trust receipts and import loans	**28,333**	29,568
	48,277	47,979
Secured	**2,819**	–
Unsecured	**45,458**	47,979
	48,277	47,979

Bank overdrafts are denominated in Hong Kong dollars. They arranged at prevailing market interest rates, repayable on demand and have been secured by pledged bank deposits.

Short-term bank loans are denominated in Renminbi. They are arranged at fixed interest rate of 6.138% per annum.

Trust receipts and import loans are denominated in United States dollars, and arranged at prevailing market rates ranged from 6.18% to 7.75%.

The directors consider that the carrying amounts of bank borrowings approximate their fair values.

21. CONVERTIBLE BONDS

	2005	2004
	HK$'000	*HK$'000*
Liability component at the beginning of the year	**3,000**	12,084
Repayment during the year	**(3,000)**	(9,460)
Interest charged	**–**	376
	–	3,000
The convertible bonds mature within one year	**–**	3,000

21. CONVERTIBLE BONDS *(Continued)*

The convertible bonds were issued by the Company in April 2002 to replace 50% of the convertible note issued by the Company's subsidiary which amounted to HK$17,437,500. The redemption monies of the convertible notes were used to subscribe for these convertible bonds which represent an aggregate face value of HK$20,048,100 with various maturity dates between 2003 and 2004 discounted at a rate of 7% per annum. The bondholder, the Applied Research Council, a substantial shareholder of the Company, has the right, at any time during the period from 18th May, 2003 up to and including the maturity date of the convertible bond, to convert into ordinary shares of the Company at a conversion price of HK$0.5267 per share, subject to adjustments. The Company has the right to redeem the convertible bonds prior to its maturity subject to the prior consent of the bondholder.

In compliance with the HKFRSs, the convertible bonds are presented as the liability component and equity component separately in the balance sheet. At the date of issue, the liability component is the camying amount of the financial liability by discounting the stream of future payments of interest and principal at the prevailiy market rate which is 7%. The equity component is an embedded option to convert the liability into equity. The director consider that the value of the equity component embedded in the convertible bonds is insignificant. Accordingly, no retrospective restatement is considered.

On 1st January 2005, the Company redeemed convertible bonds at face value of HK$3,000,000.

22. SHARE CAPITAL

	Number of shares	Amount
		HK$'000
Authorised:		
– at 1st January, 2004, 31st December, 2004 and 2005	500,000,000	5,000
Issued and fully paid:		
– at 1st January, 2004, 31st December, 2004 and 2005	289,944,745	2,900

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31st December, 2005

23. SHARE OPTIONS

(a) Pre-Initial Public Offering ("IPO") share option scheme

Pursuant to the pre-IPO share option scheme adopted by the Company on 20th April, 2002, the Company may grant options to any director, employee, adviser or business consultant of the Company or its subsidiaries, for the primary purpose of providing incentives to them, to subscribe for shares in the Company with the payment of HK$1 per offer. Options granted are exercisable for a period not later than 10 years from the date of grant of the relevant options.

Details of the movements in the number of share options during the year under the Company's pre-IPO share option scheme were as follows:

			Number of share options					
Type of participants	Date of grant	Exercisable period	Exercise price per share	Outstanding at 1.1.2004	Forteited during the year	Outstanding at 31.12.2004	Forteited during the year	Outstanding at 31.12.2005
			HK$					
Directors	20th April, 2002	17th November, 2002 to 29th April, 2012	0.55	3,750,000	–	3,750,000	–	3,750,000
Others	20th April, 2002	17th November, 2002 to 29th April, 2012	0.55	6,223,000	(255,000)	5,968,000	(963,000)	5,005,000
				9,973,000	(255,000)	9,718,000	(963,000)	8,755,000

(b) Post-IPO share option scheme

Pursuant to the post-IPO share option scheme adopted by the Company on 20th April, 2002, the Company may grant options to any director, employee, advisor or business consultant of the Company or its subsidiaries, for the primary purpose of providing incentives to them, to subscribe for shares in the Company with the payment of HK$1 per offer. The exercise price of the share option will be determined at the higher of the average of the closing prices of the Company's shares quoted on the Stock Exchange on the five trading days immediately preceding the date of grant of the options; the closing price of the shares on the Stock Exchange on the date of grant; and the nominal value of the shares.

23. SHARE OPTIONS *(Continued)*

(b) Post-IPO share option scheme *(Continued)*

These grants under the post-IPO share option scheme are exercisable for a period not later than 10 years from the date of grant, within which there is a total vesting period of four years, starting from the first anniversary of the grant date at stepped annual increments of 25% of the total options granted.

The total number of shares in respect of which options are issuable under this scheme shall not in aggregate exceed 10% of the number of issued shares.

Details of the movements in the number of share options during the year under the Company's post-IPO share option scheme were as follows:

			Year ended 31st December, 2005 Number of share options				
Type of participants	Date of grant	Exercisable period	Exercise price per share	Outstanding at 1.1.2005	Granted during the year	Forfeited during the year	Outstanding at 31.12.2005
			HK$				
Directors	20th February, 2003	20th February, 2004 to 19th February, 2013	0.138	3,825,000	–	–	3,825,000
Employees	12th July, 2002	12th July, 2003 to 11th July, 2012	0.384	2,981,000	–	(655,000)	2,326,000
	20th February, 2003	20th February, 2004 to 19th February, 2013	0.138	3,034,000	–	(652,000)	2,382,000
	10th October, 2003	10th October, 2004 to 9th October, 2013	0.142	290,000	–	(125,000)	165,000
	23rd February, 2004	23rd February, 2005 to 22nd February, 2014	0.165	2,404,000	–	(780,000)	1,624,000
	11th October, 2004	11th October, 2005 to 10th October, 2014	0.124	828,000	–	(248,000)	580,000
Adviser *(Note)*	20th February, 2003	20th February, 2004 to 19th February, 2013	0.138	300,000	–	–	300,000
				13,662,000	–	(2,460,000)	11,202,000
Number of options exercisable 31st December, 2005							5,631,500

NOTES TO THE FINANCIAL STATEMENTS For the year ended 31st December, 2005

23. SHARE OPTIONS *(Continued)*

(b) Post-IPO share option scheme *(Continued)*

			Year ended 31st December, 2004 Number of share options				
Type of participants	**Date of grant**	**Exercisable period**	**Exercise price per share**	**Outstanding at 1.1.2004**	**Granted during the year**	**Forfeited during the year**	**Outstanding at 31.12.2005**
		HK$					
Directors	20th February, 2003	20th February, 2004 to 19th February, 2013	0.138	3,825,000	–	–	3,825,000
Employees	12th July, 2002	12th July, 2003 to 11th July, 2012	0.384	3,419,000	–	(438,000)	2,981,000
	20th February, 2003	20th February, 2004 to 19th February, 2013	0.138	3,351,000	–	(317,000)	3,034,000
	10th October, 2003	10th October, 2004 to 9th October, 2013	0.142	385,000	–	(95,000)	290,000
	23rd February, 2004	23rd February, 2005 to 22nd February, 2014	0.165	–	2,844,000	(440,000)	2,404,000
	11th October, 2004	11th October, 2005 to 10th October, 2014	0.124	–	828,000	–	828,000
Adviser *(Note)*	20th February, 2003	20th February, 2004 to 19th February, 2013	0.138	300,000	–	–	300,000
				11,280,000	3,672,000	(1,290,000)	13,662,000
Number of options exercisable at 31st December, 2004							3,352,750

Note: This is an individual who rendered consultancy services in respect of the technology development to the Group without receiving any compensation. The Group granted share options to him for recognising his services similar to those rendered by other employees.

During the year ended 31st December, 2004, options were granted on 23rd February and 11th October. The estimated fair values of the options granted on those dates are HK$0.091 and HK$0.066 respectively.

23. SHARE OPTIONS *(Continued)*

(b) Post-IPO share option scheme *(Continued)*

These fair values were calculated using the Black-Scholes pricing model. The inputs into the model were as follows:

	Share option grant date	
	23.2.2004	11.10.2004
Closing share price immediately before date of grant	HK$0.155	HK$0.124
Exercise price	HK$0.165	HK$0.124
Expected volatility	62.76%	59.19%
Expected life	5 years	5 years
Risk-free rate	2.65%	2.98%
Expected dividend yield	N/A	N/A

Expected volatility was determined by using the historical volatility of the Company's share price over the previous 1 year. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non transferability, exercise restrictions and behavioral considerations.

The Group recognised the total expense of HK$134,000 for the year ended 31st December, 2005 (2004: HK$287,000) in relation to share options granted by the Company.

24. UNRECOGNISED DEFERRED TAXATION

At the balance sheet date, the Group has unutilised tax losses of HK$10,711,000 (2004: HK$11,773,000) available for offset against future profits. No deferred tax asset has been recognised in respect of the unutilised tax losses due to the unpredictability of future profit streams. These tax losses may be carried forward indefinitely.

NOTES TO THE FINANCIAL STATEMENTS For the year ended 31st December, 2005

25. OPERATING LEASE COMMITMENTS

At the balance sheet date, the Group was committed to make the following future minimum lease payments in respect of buildings leased under non-cancellable operating leases which fall due as follows:

	2005	2004
	HK$'000	*HK$'000*
Within one year	**3,161**	2,067
In the second to fifth year inclusive	**787**	563
	3,948	2,630

The lease payments represent the rental payable by the Group for certain buildings, the lease payments are fixed for an average of 1.5 years and no arrangements have been entered into for contingent rental payments.

26. RETIREMENT BENEFITS SCHEME

The Group operates a Mandatory Provident Fund Scheme (the "Scheme") for all qualifying employees in Hong Kong. The assets of the Scheme are held separately from those of the Group in funds under the control of trustee. The Group contributes 5% of relevant payroll costs, subject to a maximum of HK$1,000 for each employee each month, to the Scheme, which contribution is matched by employees.

The employees of the Company's PRC subsidiaries are members of the state-managed retirement benefits scheme operated by the PRC government. The Company's PRC subsidiaries are required to contribute a certain percentage of their payroll to the retirement benefits scheme to fund the benefits. The only obligation of the Group with respect to the retirement benefits scheme is to make the required contributions under the scheme.

27. RELATED PARTY TRANSACTIONS

Compensation of key management personnel

The remuneration of directors and other members of key management during the year was as follows:

	2005	2004
	HK$'000	*HK$'000*
Short-term benefits	**2,792**	3,067
Post-employment benefits	**43**	36
Share-based payments	**44**	75
	2,879	3,178

The emoluments of directors and key executives are determined by the remuneration committee and management respectively having regard to the performance of the individuals and market trends.

NOTES TO THE FINANCIAL STATEMENTS For the year ended 31st December, 2005

28. PRINCIPAL SUBSIDIARIES

Details of the Company's principal subsidiaries, all of which are wholly-owned by the Company, at 31st December, 2005 are as follows:

Name of subsidiary	Place of incorporation/ establishment/ operations	Nominal value of issued/ registered capital	Principal activities
Wafer Systems Holdings Limited*	Hong Kong	HK$10,000	Investment holding
北京威發新世紀信息技術有限公司 (Beijing Wafer New Century Information Technology Co., Ltd.)	PRC for a term of 15 years commencing 12th January, 2001#	US$1,500,000	Operation of businesses in network infrastructure, provision of network professional services and sales of proprietary network software
上海滬威網絡系統有限公司 (Wafer Network Systems (Shanghai) Co. Ltd.)	PRC for a term of 15 years commencing 28th July, 1999#	US$210,000	Operation of businesses in network infrastructure, provision of network professional services and sales of proprietary network software
Wafer Systems (China) Limited	Hong Kong	HK$10,000	Operation of businesses in network infrastructure, provision of network professional services and sales of proprietary network software

28. PRINCIPAL SUBSIDIARIES *(Continued)*

Name of subsidiary	Place of incorporation/ establishment/ operations	Nominal value of issued/ registered capital	Principal activities
Wafer Systems (Hong Kong) Limited	Hong Kong	HK$10,000	Operation of businesses in network infrastructure, provision of network professional services and sales of proprietary network software
威發(西安)軟件有限公司 (Wafer (Xi'an) Software Co., Ltd.)	PRC for a term of 15 years commencing 26th July, 2001#	US$100,950	Research and development

* Directly held by the Company.

These are wholly foreign owned enterprises established in the PRC.

The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affect the results or assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

On 1st January, 2005, the Company redeemed convertible bonds at face value of HK$3,000,000. Save as disclosed above, none of the subsidiaries had any debt securities outstanding at the end of the year, or at any time during the year.

FINANCIAL SUMMARY

	Year ended 31st December,				
	2001	**2002**	**2003**	**2004**	**2005**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
			(restated)	(restated)	
RESULTS					
Turnover	149,579	180,333	165,879	269,688	368,250
Profit (loss) before taxation	8,198	(6,400)	976	3,174	2,075
Taxation	(191)	551	(285)	(473)	(632)
Profit (loss) for the year	8,007	(5,849)	691	2,701	1,443
Profit (loss) attributable to:					
Equity holders of the parent	8,007	(5,849)	691	2,736	1,443
Minority interest	–	–	–	(35)	–
Profit (loss) for the year	8,007	(5,849)	691	2,701	1,443

	As at 31st December,				
	2001	**2002**	**2003**	**2004**	**2005**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
ASSETS AND LIABILITIES					
Total assets	103,280	165,763	124,723	138,763	152,516
Total liabilities	(80,915)	(112,437)	(70,463)	(81,480)	(93,090)
	22,365	53,326	54,260	57,283	59,426
Equity attributable to equity holders of the parent	22,365	53,326	54,260	57,283	59,426
Minority interest	–	–	–	–	–
	22,365	53,326	54,260	57,283	59,426

Amounts disclosed in the financial summary for prior years have been restated to reflect the changes in accounting policies in the current year as described in note 2 to the financial statements.

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN THAT the annual general meeting of Wafer Systems Limited (the "Company") will be held at Units 901-7, 9th Floor, MLC Millennia Plaza, 663 King's Road, North Point, Hong Kong on Friday, 28 April 2006 at 3:30 p.m. for the following purposes:

1. To receive and consider the audited consolidated financial statements and the reports of the directors and auditors for the year ended 31 December 2005;

2. To re-elect a director, Mr. Kwan Kit Tong, Kevin, retiring by rotation and to authorise the board of directors to fix his remuneration (if any); *(note 5)*

3. To re-elect a director, Mr. Tsoi Tai Wai, David, retiring by rotation and to authorise the board of directors to fix his remuneration (if any); *(note 6)*

4. To re-appoint the auditors and to authorize the board of directors to fix their remuneration; and

5. As special business, to consider and, if thought fit, pass the following resolutions as Ordinary Resolutions with or without amendments and/or Special Resolutions, respectively:

ORDINARY RESOLUTIONS

(1) "**THAT**:

(a) subject to paragraph (c) of this resolution, and pursuant to the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited, the exercise by the directors of the Company during the Relevant Period (as hereinafter defined) of all the powers of the Company to allot, issue and deal with additional shares in the capital of the Company and to make or grant, whether conditionally or unconditionally, offers, agreements and options (including warrants, bonds, debentures, notes and any securities which carry rights to subscribe for or are convertible into shares in the Company) which would or might require the exercise of such powers be and is hereby generally and unconditionally approved;

(b) the approval in paragraph (a) of this resolution shall authorize the directors of the Company during the Relevant Period to make or grant offers, agreements and options (including warrants, bonds, debentures, notes and any securities which carry rights to subscribe for or are convertible into the shares in the Company) which would or might require the exercise of such powers after the end of the Relevant Period;

NOTICE OF ANNUAL GENERAL MEETING

(c) the aggregate nominal amount of share capital allotted, issued or dealt with or agreed conditionally or unconditionally to be allotted, issued or dealt with (whether pursuant to options or otherwise) by the directors of the Company pursuant to the approval in paragraph (a) of this resolution, otherwise than pursuant to (i) a Rights Issue (as hereinafter defined); or (ii) the grant or exercise of any option under any share option scheme of the Company or any other option, scheme or similar arrangement for the time being adopted for the grant or issue to employee, director, advisor or business consultant of the Company and/or any of its subsidiaries of shares in the Company or rights to acquire shares in the Company; or (iii) any scrip dividend or similar arrangement providing for the allotment of shares in lieu of the whole or part of a dividend on shares in the Company in accordance with the Articles of Association of the Company in force from time to time; or (iv) any issue of shares in the Company upon the exercise of rights of subscription or conversion under the terms of any warrants or convertible bonds issued by the Company or any securities which carry rights to subscribe for or are convertible into shares in the Company, shall not exceed 20 per cent. of the aggregate nominal amount of the share capital of the Company in issue on the date of the passing this resolution and the authority pursuant to paragraph (a) of this resolution shall be limited accordingly; and

(d) for the purpose of this resolution,

"Relevant Period" means the period from the date of the passing this resolution until whichever is the earliest of:

(i) the conclusion of the next annual general meeting of the Company;

(ii) the expiration of the period within which the next annual general meeting of the Company is required by the Articles of Association of the Company or any applicable law of the Cayman Islands to be held; and

(iii) the passing of an ordinary resolution by the shareholders of the Company in general meeting revoking or varying the authority given to the directors of the Company by this resolution.

"Rights Issue" means an offer of shares in the Company, or offer or issue of warrants, options or other securities giving rights to subscribe for shares open for a period fixed by the directors of the Company to holders of shares in the Company on the register on a fixed record date in proportion to their then holdings of such shares (subject to such exclusions or other arrangements as the directors of the Company may deem necessary or expedient in relation to fractional entitlements, or having regard to any restrictions or obligations under the laws of, or the requirements of, or the expense or delay which may be involved in determining the existence or extent of any restrictions or obligations under the laws of, or the requirements of, any jurisdiction applicable to the Company, or any recognized regulatory body or any stock exchange in any territory applicable to the Company.)"

(2) "**THAT**:

(a) subject to paragraph (b) of this resolution, the exercise by the directors of the Company during the Relevant Period (as hereinafter defined) of all the powers of the Company to repurchase shares in the capital of the Company on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited or any other stock exchange on which the shares in the Company may be listed and recognized by the Securities and Futures Commission and The Stock Exchange of Hong Kong Limited for such purpose, subject to and in accordance with the rules and regulations of the Securities and Future Commission, The Stock Exchange of Hong Kong Limited, the Companies Law of the Cayman Islands and all other applicable laws in this regard, be and the same is hereby generally and unconditionally approved;

(b) the aggregate nominal amount of shares in the Company which the Company is authorised to repurchase pursuant to the approval in paragraph (a) of this resolution during the Relevant Period shall not exceed 10 per cent. of the aggregate nominal amount of the issued share capital of the Company as at the date of the passing of this resolution and the authority pursuant to paragraph (a) of this resolution shall be limited accordingly;

(c) for the purpose of this resolution,

"Relevant Period" means the period from the date of the passing of this resolution until whichever is the earliest of:

(i) the conclusion of the next annual general meeting of the Company;

NOTICE OF ANNUAL GENERAL MEETING

(ii) the expiration of the period within which the next annual general meeting of the Company is required by the Articles of Association of the Company or any other applicable law of the Cayman Islands to be held; and

(iii) the passing of an ordinary resolution by the shareholders of the Company in general meeting revoking or varying the authority given to the directors of the Company by this resolution. "

(3) " **THAT** conditional upon resolution nos. (1) and (2) set out in item 5. of the notice convening this meeting being passed, the general mandate granted to the directors of the Company to allot, issue and deal with additional shares in the Company pursuant to the said resolution no. (1) be and is hereby extended by the addition thereto of an amount representing the aggregate nominal amount of shares in the capital of the Company which are repurchased by the Company under the authority granted to the directors of the Company pursuant to the said resolution no. (2), provided that the amount of shares so repurchased by the Company shall not exceed 10 per cent. of the aggregate nominal amount of the issued share capital of the Company on the date of this resolution. "

SPECIAL RESOLUTION

(4) "**THAT**, the existing articles of association of the Company be and are hereby amended in the following manner:

(a) With respect to **Article 2(1)**, by deleting the existing definition of "Subsidiary and Holding Company" in its entirety and replacing therewith the following new definition of "Subsidiary and Holding Company":

"Subsidiary and Holding Company"	the meanings attributed to them in the rules of the Designated Stock Exchange or if there is none, in the Companies Ordinance of Hong Kong."

(b) With respect to **Article 3**, by inserting the following sentence at the end of sub-paragraph (2):

"The Company is hereby authorized to make payments in respect of a purchase of its shares out of capital or out of any other account or fund which can be authorized for these purposes in accordance with the Law."

NOTICE OF ANNUAL GENERAL MEETING

(c) With respect to **Article 66**,

(i) by inserting the words “voting by way of a poll is required by the rules of the Designated Stock Exchange or” after the words “a show of hands unless” in the third sentence;

(ii) by deleting the full-stop at the end of sub-paragraph (d), replacing therewith a semicolon and the word “or” and inserting the following new sub-paragraph (e):

“(e) if required by the rules of the Designated Stock Exchange, by any Director or Directors who, individually or collectively, hold proxies in respect of shares representing five per cent. (5%) or more of the total voting rights at such meeting.”

(d) With respect to **Article 68**, by deleting the second sentence in its entirety and substituting therefor the following:

“The Company shall only be required to disclose the voting figures on a poll if such disclosure is required by the rules of the Designated Stock Exchange.”

(e) With respect to **Article 86**,

(i) by deleting sub-paragraph (3) thereof in its entirety and substituting therefor the following:

“(3) The Directors shall have the power from time to time and at any time to appoint any person as a Director either to fill a casual vacancy on the Board or, as an addition to the existing Board but so that the number of Directors so appointed shall not exceed any maximum number determined from time to time by the Members in general meeting. Any Director so appointed by the Board shall hold office only until the next following general meeting of the Company (in the case of filling a casual vacancy) or until the next following annual general meeting of the Company (in the case of an addition to the Board), and shall then be eligible for re-election at that meeting.”

NOTICE OF ANNUAL GENERAL MEETING

(ii) by deleting the words "special resolution" in sub-paragraph (5) and replacing them with the words "ordinary resolution".

(f) With respect to **Article 87**,

(i) by deleting sub-paragraph (1) in its entirety and substituting therefor the following:

"(1) Notwithstanding any other provisions in the Articles, at each annual general meeting one-third of the Directors for the time being (or, if their number is not a multiple of three (3), the number nearest to but not less than one-third) shall retire from office by rotation, provided that every Director (including those appointed for a specific term) shall be subject to retirement by rotation at least once every three years."

(ii) by inserting the words "and shall continue to act as Director throughout the meeting at which he retires" at the end of the first sentence of sub-paragraph (2)."

(iii) by deleting the last sentence of "Any Director appointed pursuant to Article 86(2) or Article 86(3) shall not be taken into account in determining which particular Directors or the number of Directors who are to retire by rotation." from sub-paragraph (2) in its entirety."

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

Hong Kong, 28 March 2006

NOTICE OF ANNUAL GENERAL MEETING

Notes:–

1. A member of the Company entitled to attend and vote at the above meeting is entitled to appoint another person as his proxy to attend and vote instead of him. A member who is holder of two or more shares may appoint more than one proxy to attend and vote instead of him. A proxy need not be a member of the Company.

2. In order to be valid, a form of proxy together with the power of attorney or other authority (if any) under which it is signed, or a certified copy thereof, must be deposited at the Company's branch share registrar in Hong Kong, Computershare Hong Kong Investor Services Limited at 46th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong no later than 48 hours before the time appointed for the meeting (or any adjournment thereof).

3. With regard to ordinary resolution no. (2) set out in item 5 of this notice, an explanatory statement containing information regarding the repurchase by the Company of its own shares will be sent to shareholders of the Company together with the 2005 Annual Report of the Company.

4. Article 66 of the Company's articles of association sets out the procedures by which shareholders of the Company may demand a poll;

   A resolution put to the vote of a meeting shall be decided on a show of hands unless (before or on the declaration of the result of the show of hands or on the withdrawal of any other demand for a poll) a poll is demanded:

   (a) by the Chairman of such meeting; or

   (b) by at least three Members present in person or in the case of a Member being a corporation by its duly authorised representative or by proxy for the time being entitled to vote at the meeting; or

   (c) by a Member of Members present in person or in the case of a Member being a corporation by its duly authorised representative or by proxy and representing not less than one-tenth of the total voting rights of all Members having the right to vote at the meeting; or

   (d) by a Member or Members present in person or in the case of a Member being a corporation by its duly authorised representative or by proxy and holding shares in the Company conferring a right to vote at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all shares conferring that right.

   A demand by a person as proxy for a Member or in the case of a Member being a corporation by its duly authorised representative shall be deem to be the same as a demand by a Member.

NOTICE OF ANNUAL GENERAL MEETING

5. The biographical details on Mr. Kevin Kwan are as contained on page 8 of the Annual Report. Mr. Kwan's appointment as a non-executive director with the Company for the two years ending 31 March 2006 has been without any fee paid or payable to him. He has been re-appointed as a non-executive director of the Company for a term of two years commencing 1 April 2006 without any fee for the first year. However, the Company would consider paying him a fee for the second year after having regard to, among others, the operating results of the Group for the first year. His interests in the shares of the Company, within the meaning of Part XV of the Securities and Futures Ordinance, are the 375,000 share options in the Company granted to him on 20 February 2003 at the exercise price of HK$0.138 per share and expiring on 19 February 2013. For the past three years, apart from being a director of the Company and in addition to his appointment in January 2006 to the board of QPL International Holdings Ltd., the only other public listed company directorship Mr. Kwan held was, between 14 November 2003 and 4 March 2004 and again since 24 March 2006, in ASAT Holdings Ltd., United States of America.

6. The biographical details on Mr. Tsoi Tai Wai, David are as contained on page 9 of the Annual Report. Mr. Tsoi's appointment as an independent non-executive director with the Company for the two years ending 31 March 2004 carries an annual fee of HK$120,000. The said fee is determined by reference to his duties, responsibilities and experience. The appointment has been renewed at the same fee level for a further two (2) years term commencing from 1 April, 2006. Mr. Tsoi has served on both the Audit Committee and the Remuneration Committee of the Board ever since their inception and will remain a member of both committees in the new term. His interests in the shares of the Company, within the meaning of Part XV of the Securities and Futures Ordinance, are the 750,000 share options in the Company. The grant was made to him on 20 February 2003 at the exercise price of HK$0.138 per share and expiring on 19 February 2013. For the past three years, Mr. Tsoi has not held any directorship position in any other listed public company.

7. The translation into Chinese language of this notice (including without limitation the Special Resolution which contains the proposed new Articles) is for reference only. In case of any inconsistency, the English version shall prevail.