



WAFER SYSTEMS
Wafer Systems Limited
威發系統有限公司*

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 8198)

**FIRST QUARTERLY REPORT
FOR THE 3 MONTHS ENDED 31 MARCH 2006**

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

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

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

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

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

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

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

* For identification purpose only

TO OUR SHAREHOLDERS

The board of Directors (the “Board”) hereby reports the unaudited consolidated results of the Company and its subsidiaries (collectively, the “Group”) for the three months ended 31 March 2006 (the “Review Period”) together with comparative unaudited figures for the corresponding period in 2005.

BUSINESS REVIEW AND PROSPECTS

First quarter of the year is a traditional slow season for our business. During the Review Period, the Group recorded a turnover of approximately HK\$46.3 million (2005: approximately HK\$152.0 million)

The comparatively higher turnover during the same period in 2005 was mainly due to the Group’s participation in China Telecom’s large CN2 Project, which the Group will continue to take part in its Phase 2 and results will be reflected in due course during the year.

As the result of lower turnover, the Group recorded a loss of approximately HK\$3.9 million during the Review Period (2005: profit of HK\$778,000).

With the maturing of the projects and the Group’s participation in Phase 2 of the CN2 Project, the Group is optimistic that more satisfactory results will be achieved for the rest of the year.

Geographically, mainland China remained predominantly the biggest business generating area for the Group. During the Review Period, the Group continued to invest in building up its capability in NGN software and solutions and management software. Sales of such softwares during the Review Period have already shown an upward trend.

Looking ahead the Group will maintain its business philosophy to focus on customer satisfaction, higher technical and professional expertise in the area of NGN and strive to be a leading NGN solution and services provider.

INTERIM DIVIDEND

The Board does not recommend the payment of an interim dividend for the Review Period. (2005: Nil)

FINANCIAL INFORMATION
Unaudited Consolidated Financial Results

		For the three months ended 31 March	
		2006	2005
	<i>Note</i>	HK\$'000	<i>HK\$'000</i>
Turnover	2	46,358	152,048
Other income		483	39
Charges in materials and equipment		(38,555)	(134,955)
Employee expense		(4,962)	(4,250)
Depreciation and amortization		(1,210)	(1,113)
Other expenses		(5,255)	(10,129)
Finance costs		(749)	(803)
		<hr/>	<hr/>
(Loss) profit before taxation	3	(3,890)	837
Taxation	4	–	(65)
		<hr/>	<hr/>
(Loss) profit for the period		<u>(3,890)</u>	<u>772</u>
(Loss) profit attributable to:			
Equity holders of the parent		(3,890)	778
Minority interest		–	(6)
		<hr/>	<hr/>
		<u>(3,890)</u>	<u>772</u>
(Loss) earnings per share			
– Basic (cents)	5	<u>(1.34)</u>	<u>0.27</u>
– Diluted (cents)		<u>N/A</u>	<u>0.27</u>

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL RESULTS

(1) Basis of Presentation

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

The principal accounting policies and basis of preparation adopted for the preparation of the unaudited consolidated results are consistent with those adopted by the Group in its annual financial statements for the year ended 31 December 2005.

The unaudited consolidated results have been reviewed by the Audit Committee.

(2) Turnover

An analysis of the Group's turnover recognized for the three months ended 31 March 2006 together with the comparative figures for the corresponding period in 2005 are as follows.

	(Unaudited)	
	For the three months	
	ended 31 March	
	2006	2005
	HK\$'000	HK\$'000
Network infrastructure	39,454	137,523
Professional services	6,215	14,525
Network software	689	0
	<u>46,358</u>	<u>152,048</u>

(3) (Loss) profit before taxation

(Loss) Profit before taxation has been arrived at after charging:

	For the three months	
	ended 31 March	
	2006	2005
	HK\$'000	HK\$'000
Amortization of software product development costs	656	538
Depreciation of property, plant and equipment	554	575
Employee expense (including Directors' remuneration)	4,962	4,250
and after crediting:		
Exchange gain	464	–
Interest income	15	39

(4) Taxation

The charges represent PRC income tax which is calculated at rates applicable to respective PRC subsidiaries.

No provision for Hong Kong profits tax has been made as the Group had no assessable profit for the three months ended 31 March 2006 and its corresponding period in 2005.

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

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

(5) (Loss) earnings per share

The calculation of basic (loss)/earnings per share for the three months ended 31 March 2006 is based on the unaudited loss attributable to equity holders of the parent of approximately HK\$3,890,000 (2005: profit of approximately HK\$778,000) and on the weighted average number of approximately 289,945,000 ordinary shares (2005: approximately 289,945,000) in issue during the period.

Diluted loss per share has not been presented for the three months ended 31 March 2006 since the effect is anti-dilutive.

The calculation of the diluted earnings per share for the three months ended 31 March 2005 is based on the net profit attributable to equity holders of the parent of approximately HK\$778,000 and on the weighted average number of approximately 289,946,000 ordinary shares.

(6) Reserves

	Share-based Share premium	payments reserve	Statutory surplus reserves fund	Enterprise expansion fund	Staff welfare fund	Translation reserve	Accumulated losses	Total
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
As at 1 January 2005	55,824	453	1,003	502	502	0	(3,901)	54,383
Profit for the three months ended 31 March 2005	-	-	-	-	-	-	778	778
As at 31 March 2005	<u>55,824</u>	<u>453</u>	<u>1,003</u>	<u>502</u>	<u>502</u>	<u>0</u>	<u>(3,123)</u>	<u>55,161</u>
As at 1 January 2006	55,824	587	1,003	502	502	566	(2,458)	56,526
Recognition of equity settled share-based payments	-	24	-	-	-	-	-	24
Exchange difference on translation of foreign operations	-	-	-	-	-	338	-	338
Loss for the three months ended 31 March 2006	-	-	-	-	-	-	(3,890)	(3,890)
As at 31 March 2006	<u>55,824</u>	<u>611</u>	<u>1,003</u>	<u>502</u>	<u>502</u>	<u>904</u>	<u>(6,348)</u>	<u>52,998</u>

PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

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

SHARE OPTION SCHEMES

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

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

(a) Pre-IPO Share Option Scheme

One single grant of 11,913,000 shares in aggregate was made to various participants on 30 April 2002 under this scheme. As at 31 March 2006, options comprising an aggregate of 8,755,000 shares were outstanding, as detailed below:

	Exercise price per share <i>HK\$</i>	Number of share options		
		Outstanding as at 1.1.2006	Cancelled during Review Period	Outstanding as at 31.3.2006
Type of Participants:				
Directors	0.55	3,750,000	–	3,750,000
Advisor	0.55	750,000	–	750,000
Employees	0.55	4,255,000	–	4,255,000
		<u>8,755,000</u>	<u>–</u>	<u>8,755,000</u>

Pre-IPO share options are exercisable as to (i) a maximum of 25% of the total number of options granted six months after 17 May 2002 (the "Date of Listing"); (ii) a maximum additional 6.25% of the total number of options granted after the expiry of each 3-month period twelve months after the Date of Listing; and (iii) the remaining options on or after the third anniversary of the Date of Listing until the end of the option period or lapse of an option.

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

(b) Post-IPO Share Option Schemes

There have been a total of 5 Post-IPO share options grants. The numbers of share options granted were 5,277,000 shares on 12 July 2002, 7,859,000 shares on 20 February 2003, 385,000 shares on 10 October 2003, 2,844,000 shares on 23 February 2004 and 828,000 shares on 11 October 2004. No option was granted during the Review Period.

A summary of the Post-IPO Share Option Scheme movements during the Review Period and as at 31 March 2006 is as follows:

Date of grant	Type of Participants	Exercisable Period	Exercise Price per share HK\$	Outstanding as at 1.1.2006	Number of share options		Outstanding as at 31.3.2006
					Granted during Review Period	Cancelled during Review Period <i>(Note 1)</i>	
12.7.2002	Employees	12.7.2003 to 11.7.2012	0.384	2,326,000	-	148,000	2,178,000
20.2.2003	Directors	20.2.2004 to 19.2.2013	0.138	3,825,000	-	-	3,825,000
	Advisors	20.2.2004 to 19.2.2013	0.138	300,000	-	-	300,000
	Employees	20.2.2004 to 19.2.2013	0.138	2,382,000	-	50,000	2,332,000
				6,507,000	-	50,000	6,457,000
10.10.2003	Employees	10.10.2004 to 9.10.2013	0.142	165,000	-	-	165,000
23.2.2004	Employees	23.2.2005 to 22.2.2014	0.165 <i>(Note 2)</i>	1,624,000	-	-	1,624,000
11.10.2004	Employees	11.10.2005 to 10.10.2014	0.124	580,000	-	155,000	425,000
				11,202,000	-	353,000	10,849,000

Notes:

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

Post-IPO share options are exercisable starting from the first anniversary of the grant date at stepped annual increment of 25% of the total options granted, for a period not later than 10 years from the date of grant.

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

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

As at 31 March 2006, the interests and short positions of the Directors, the chief executive of the Company and their respective associates (as defined in the GEM Listing Rules) in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), as recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO or as otherwise notified to the Company and the Exchange pursuant to the required standard of dealings by Directors as referred to in Rule 5.46 of the GEM Listing Rules, were as follows:

(a) Long positions in shares in the Company

Name of Director	Number of shares held						Total interest in shares	Approximate percentage of the Company's issued share capital
	Personal interest	Capacity	Family interest	Corporate interest	Capacity	Other interest		
Mr. Chan Sek Keung, Ringo	7,084,000	Beneficial owner	-	56,400,000 (Note)	Interest of a controlled corporation	-	63,484,000	21.90%

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

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

Name of Director	Date of grant	Number of unlisted pre-IPO share option outstanding as at 1.1.2006	Number of unlisted pre-IPO share option outstanding as at 31.3.2006	Number of unlisted post-IPO share option outstanding as at 1.1.2006	Number of unlisted post-IPO share option outstanding as at 31.3.2006	Aggregate interests	Approximate percentage of the Company's issued share capital
Mr. Chan Sek Keung, Ringo	30.4.2002	3,000,000	3,000,000	-	-	4,200,000	1.45%
	20.2.2003	-	-	1,200,000	1,200,000		
Mr. Pang Hing Chung, Alfred	30.4.2002	750,000	750,000	-	-	1,500,000	0.52%
	20.2.2003	-	-	750,000	750,000		
Mr. Tsoi Tai Wai, David	20.2.2003	-	-	750,000	750,000	750,000	0.26%
Mr. Alasdair Gordon Nagle	20.2.2003	-	-	375,000	375,000	375,000	0.13%
Ms. Clara Ho	20.2.2003	-	-	375,000	375,000	375,000	0.13%
Mr. Kwan Kit Tong, Kevin	20.2.2003	-	-	375,000	375,000	375,000	0.13%

Notes:

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

Other than as disclosed above, none of the Directors, the chief executive of the Company and their respective associates (as defined in the GEM Listing Rules), had any interests or short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations as at 31 March 2006.

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

As at 31 March 2006, the following persons or corporations, in addition to the Directors, stated under the section headed "Directors' and chief executive's interests or short position in shares and underlying shares of the Company" were interested in shares or underlying shares representing 5% or more in the issued share capital of the Company as recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO.

Long positions in share in the Company

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

Notes:

- (1) ARC is the beneficial owner of these shares.
- (2) HSBC Private Equity Technology (Asia) Limited is deemed, by virtue of the SFO, to be interested in these shares as it is the investment manager of ARC.

HSBC Private Equity (Asia) Limited is deemed, by virtue of the SFO, to be interested in these shares as HSBC Private Equity Technology (Asia) Limited is its wholly-owned subsidiary.

- (3) Mr. Ng Lai Yick is deemed, by virtue of the SFO, to be interested in the 36,900,000 shares held by North 22 Nominees Limited as the company is wholly-owned by him.
- (4) Mr. Li Tung Lok is the controlling shareholder of QPL and is deemed, by virtue of the SFO, to be interested in the 35,456,745 shares held by QPL.

Madam Su Ching Wah is the spouse of Mr. Li Tung Lok and is deemed, by virtue of the SFO, to be interested in the 35,456,745 shares held by QPL.

Other than as disclosed above, the Company had not been notified of any other relevant interests or short positions in the shares or underlying shares in the Company as at 31 March 2006.

COMPETITION AND CONFLICT OF INTERESTS

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

AUDIT COMMITTEE

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

The present Audit Committee consists of three independent non-executive Directors, namely, Mr. Tsoi Tai Wai, David, Mr. Pang Hing Chung, Alfred and Mr. Yu Zhonghou. Mr. Tsoi is the chairman of the Audit Committee.

The Audit Committee has reviewed the draft of this report and has provided advice and comments thereon.

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

Hong Kong, 12 May 2006