



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

(Incorporated in the Cayman Islands with limited liability)
(Stock Code: 8198)

INTERIM REPORT
FOR THE SIX MONTHS ENDED 30 JUNE 2006

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

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

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

* For identification purpose only

TO OUR SHAREHOLDERS

The board of Directors (the "Board") is pleased to report the unaudited consolidated results of the Company and its subsidiaries (collectively, the "Group") for the six months ended 30 June 2006 (the "Review Period") together with the comparative unaudited figures for the corresponding period in 2005.

BUSINESS OVERVIEW AND REVIEW

Financial Highlights

	Q2/2006 HK\$'000	Q2/2005 HK\$'000	<i>Change</i>	1H/2006 HK\$'000	1H/2005 HK\$'000	<i>Change</i>
Turnover	94,590	66,882	+ 41%	140,948	218,930	- 36%
Operating Profit	5,964	571	+944%	2,823	2,211	+28%
Profit attributable to equity holders of the Company	4,902	84	+5,738%	1,012	862	+17%
Basic EPS (HK Cents)	1.69	0.03	+5,533%	0.35	0.30	+17%
Orders on hand				44,000	55,000	- 20%

Financial Review

During the Review Period, the Group recorded a turnover of approximately HK\$140.9 million (2005: HK\$218.9 million), a decrease of 36% from that recorded in the corresponding period in 2005. Profit attributable to equity holders of the Company for the Review Period increased by 17% to approximately HK\$1,012,000 (2005: HK\$862,000).

During the Review Period, mainland China continued to be the major market of the Group, accounting for 92.3% (2005: 96.8%) of the total turnover, with the remaining 7.7% (2005: 3.2%) generated in Hong Kong. Turnover generated from Network Infrastructure business amounted to approximately HK\$127.2 million (2005: HK\$195.1 million). The turnover of Professional Services business amounted to approximately HK\$12.5 million (2005: HK\$23.8 million). The turnover of Network Software business amounted to HK\$1.2 million (2005: Nil).

Interim Dividend

The Board does not recommend the payment of an interim dividend for the six months ended 30 June 2006 (2005: Nil).

BUSINESS REVIEW

Business during the first half of the year was relatively slow for the telecommunications sector. This was as a result of the restructuring of the telecommunications companies in addition to delays in the issue of the 3G licences.

During the Review Period, the customer base of the Group has grown to include more forward-looking local enterprises in China. Together with the multi-national corporations (“MNC”), telecommunications service providers (“SP”), local industries and government bodies; they form the backbone of the Group’s customer base and source of revenue. While working hard to match its professional expertise with the needs of the customers, the Group’s policy to put customer satisfaction first continued to win customer praise, support and loyalty.

Network Infrastructure business continued to account for the majority of the Group’s business in terms of both turnover and profits during the Review Period.

Professional Services has always been the business segment with higher margins for the Group. The Group’s co-operation with customers such as IBM Global Services (China) Co. Ltd., Motorola (China) Electronics Ltd. and New World PCS Ltd. has enabled it to make the best use of its technical expertise in serving the end-users. The Group has firmly established its reputation as a reliable partner for professional services.

In relation to proprietary softwares, the efforts in this direction have shown further signs of success. During the Review Period, the Group has expanded its software users base to include Philips, Xianjiang Uygur Autonomous Regions Taxation Bureau, Huadian Power International Corporation Limited, Aicent Beijing Communication Technology Limited, EDS and the three major local cable television operators.

PROSPECTS

As the Group enters the third quarter of 2006, there was a healthy backlog of orders on hand. As at 30 June 2006, the total value of backlog orders on hand amounted to approximately HK\$43.8 million.

As business is typically busier during the second half of the year, the Group is cautiously optimistic about securing more orders in addition to the delivery of the backlog orders.

The enlarged base of enterprise customers, telecommunications service providers and governmental bodies are making their final preparations for the last phase of the country’s opening up to the competition alongside with China’s WTO membership. All these will increase the investments activities of the market and the Group is expected to benefit.

Competition in the market will continue to be keen in the foreseeable future, thereby resulting in tight profit margins. The Group will, however, continue to strive for improvements in its profitability by strategic allocation of its resources.

MANAGEMENT DISCUSSION & ANALYSIS

Liquidity, Financial Resources and Capital Structure

The Group had total cash and bank deposits of HK\$55.1 million as at 30 June 2006 (2005: 21.6 million). The Group had no bank overdraft as at 30 June 2006 (2005: HK\$5.6 million). The Group, therefore, recorded a net cash balance of HK\$55.1 million as at 30 June 2006 as compared to HK\$16.0 million as at 31 December 2005.

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

As at 30 June 2006, the Group recorded net current assets of approximately HK\$50.6 million as compared with approximately HK\$48.8 million as at 31 December 2005. The current ratio, however, decreased to approximately 1.4 from 1.57 as at 31 December 2005.

There were no non-current liabilities recorded as at 30 June 2006 and 31 December 2005.

As at 30 June 2006, all assets and liabilities of the Group were denominated in U.S. dollars, Hong Kong dollars and Renminbi.

Acquisitions, Disposals and Significant Investment

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

Segmental Information

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

Employee Information

As at 30 June 2006, the Group had 161 employees (2005: 161 employees) comprising 19 employees (2005: 24 employees) based in Hong Kong and 142 employees (2005: 137 employees) based in mainland China. The Group continues to provide remuneration packages to employees in accordance with market practices and staff past performance. In addition to basic remuneration, the Group also provides other benefits such as a mandatory provident fund, medical scheme, share option scheme and staff training programs to employees.

Charges on Group Assets

As at 30 June 2006, the Group had a pledged bank deposit of approximately HK\$4.0 million for securing certain bank overdraft facilities (2005: HK\$4.6 million).

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

Gearing Ratio

As at 30 June 2006, the gearing ratio, i.e. total liabilities over total assets, increased to approximately 65.9% from approximately 61.0% as at 31 December 2005.

Foreign Exchange Exposure

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

Order Book & Prospects for New Business

As at 30 June 2006, the Group had contracts on hand for sales amounting to approximately HK\$43.8 million (2005: HK\$55.0 million) which will be booked as revenue upon delivery and implementation.

Contingent Liabilities

Except for those commitments and contingent liabilities set out in note 11 and note 12 to the Financial Information, the Group had no significant contingent liabilities as at 30 June 2006.

Future plans for Investments or Capital Assets and Sources of Funding

The Group does not have any plan for any significant investments, acquisitions of capital assets or additional sources of funding.

FINANCIAL INFORMATION

Condensed Consolidated Income Statement (Unaudited)

	Note	For the three months ended 30 June		For the six months ended 30 June	
		2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
Turnover	2	94,590	66,882	140,948	218,930
Other income		26	60	509	99
Charges in materials and equipment		(79,050)	(53,170)	(117,605)	(188,125)
Employee expense		(5,160)	(4,743)	(10,122)	(8,993)
Depreciation and amortization		(1,114)	(1,046)	(2,324)	(2,159)
Other expenses		(3,328)	(7,412)	(8,583)	(17,541)
Finance costs		(1,062)	(552)	(1,811)	(1,355)
Profit before taxation	3	4,902	19	1,012	856
Taxation	4	–	65	–	–
Profit for the period		4,902	84	1,012	856
Profit attributable to:					
Equity holders of the parent		4,902	84	1,012	862
Minority interest		–	–	–	(6)
		4,902	84	1,012	856
Earnings per share					
– Basic (cents)	5	1.69	0.03	0.35	0.30
– Diluted (cents)	5	N/A	N/A	N/A	N/A

Condensed Consolidated Balance Sheet

		(Unaudited) As at 30 June 2006	(Audited) As at 31 December 2005
	Note	<u>HK\$'000</u>	<u>HK\$'000</u>
Non-current assets			
Property, plant and equipment	6	2,569	3,142
Software product development costs		7,627	7,527
		<u>10,196</u>	<u>10,669</u>
Current assets			
Inventories		6,490	5,866
Trade and other receivables	7	106,525	114,338
Bank and cash balances		55,082	21,643
		<u>168,097</u>	<u>141,847</u>
Current liabilities			
Trade and other payables	8	93,657	43,989
Taxation		749	824
Bank borrowings		23,076	48,277
		<u>117,482</u>	<u>93,090</u>
Net current assets		<u>50,615</u>	<u>48,757</u>
Total assets less current liabilities		<u>60,811</u>	<u>59,426</u>
Capital and reserves			
Equity attributable to equity holders of the parent			
Share capital	9	2,900	2,900
Reserves		57,911	56,526
Total equity		<u>60,811</u>	<u>59,426</u>

Condensed Consolidated Statement of Changes in Equity (Unaudited)

	Share capital		Share-based payments	Statutory surplus reserve	Enterprise expansion fund	Staff welfare fund	Translation reserve	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	
As at 1 January 2005 (as previously reported)	2,900	55,824	-	1,003	502	502	-	(3,448)	57,283	-	57,283
Effect of adoption of HKFRS 2	-	-	453	-	-	-	-	(453)	-	-	-
As at 1 January 2005, as restated	2,900	55,824	453	1,003	502	502	-	(3,901)	57,283	-	57,283
Issue of shares to minority shareholders of a subsidiary	-	-	-	-	-	-	-	-	-	19	19
Profit for the six months ended 30 June 2005	-	-	-	-	-	-	-	862	862	(6)	856
Recognition of share-based payments	-	-	77	-	-	-	-	-	77	-	77
As at 30 June 2005	<u>2,900</u>	<u>55,824</u>	<u>530</u>	<u>1,003</u>	<u>502</u>	<u>502</u>	<u>-</u>	<u>(3,039)</u>	<u>58,222</u>	<u>13</u>	<u>58,235</u>
As at 1 January 2006 (as previously reported)	2,900	55,824	587	1,003	502	502	566	(2,458)	59,426	-	59,426
Exchange differences on translation of foreign operations	-	-	-	-	-	-	339	-	339	-	339
Profit for the six months ended 30 June 2006	-	-	-	-	-	-	-	1,010	1,010	-	1,010
Recognition of share-based payments	-	-	36	-	-	-	-	-	36	-	36
As at 30 June 2006	<u>2,900</u>	<u>55,824</u>	<u>623</u>	<u>1,003</u>	<u>502</u>	<u>502</u>	<u>905</u>	<u>(1,448)</u>	<u>60,811</u>	<u>-</u>	<u>60,811</u>

Condensed Consolidated Cash Flow Statement (Unaudited)

	Six months ended 30 June 2006	Six months ended 30 June 2005
	<u>HK\$'000</u>	<u>HK\$'000</u>
Net cash from (used in) operating activities	63,979	(16,168)
Net cash used in investing activities	(1,315)	(2,641)
Net cash used in financing activities	(25,201)	(4,324)
Net increase (decrease) in cash and cash equivalents	37,463	(23,133)
Cash and cash equivalents at the beginning of period	<u>17,619</u>	<u>40,752</u>
Cash and cash equivalents at the end of period	<u>55,082</u>	<u>17,619</u>
Analysis of the balances of cash and cash equivalents		
Bank and cash balances	55,082	23,173
Bank overdrafts	<u>–</u>	<u>(5,554)</u>
	<u>55,082</u>	<u>17,619</u>

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

(1) Basis of presentation

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

The accounting policies adopted in preparing the condensed consolidated financial report were in consistent with those applied for the annual financial report for the year ended 31 December 2005.

The condensed financial statements are unaudited but have been reviewed by the audit committee of the Company (the “Audit Committee”).

(2) Segment Information

(a) Business segment

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

	(Unaudited) For the six months ended 30 June, 2006		(Unaudited) For the six months ended 30 June, 2005	
	Turnover <i>HK\$'000</i>	Results <i>HK\$'000</i>	Turnover <i>HK\$'000</i>	Results <i>HK\$'000</i>
Network infrastructure	127,256	2,367	195,110	3,054
Professional services	12,478	967	23,820	666
Network software	1,214	(1,009)	–	(1,458)
	<u>140,948</u>	<u>2,325</u>	<u>218,930</u>	<u>2,262</u>
Unallocated corporate income		509		99
Unallocated corporate expenses		(11)		(150)
Finance costs		(1,811)		(1,355)
Profit before taxation		1,012		856
Taxation		–		–
Profit for the period		<u>1,012</u>		<u>856</u>

(b) Geographical segment

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

	(Unaudited) For the six months ended 30 June,	
	2006	2005
	<i>HK\$'000</i>	<i>HK\$'000</i>
Hong Kong	10,805	6,987
PRC	130,143	211,943
	<u>140,948</u>	<u>218,930</u>

(3) Profit before taxation

Profit before taxation has been arrived at after charging:

	For the three months ended 30 June		For the six months ended 30 June	
	2006	2005	2006	2005
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Amortization of software product development costs	656	460	1,312	998
Depreciation of property, plant and equipment	458	586	1,012	1,161
Staff costs (including directors' remuneration)	5,160	4,743	10,122	8,993
and after crediting:				
Interest income	15	60	40	99

(4) Taxation

No provision for Hong Kong and overseas profits tax has been made as the Group had either no assessable profit or had tax losses brought forward to set off the estimated assessable profit for the six months ended 30 June 2006 and the 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 their 50% tax relief period.

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

(5) Earnings per share

The calculation of basic earnings per share for the three months and the six months ended 30 June 2006 is based on the unaudited profit attributable to equity holders of the parent of approximately HK\$4,902,000 (2005: HK\$84,000) and approximately HK\$1,012,000 (2005: HK\$862,000) respectively and on the weighted average number of approximately 289,945,000 (2005: 289,945,000) shares in issue during the period.

Diluted earnings per share has not been presented for the three months and six months ended 30 June 2006 since the effect is anti-dilutive.

(6) Property, plant and equipment

Movements in property, plant and equipment were:

	Computer equipment	Furniture, fixtures and office equipment	Motor vehicle	Tools	Total
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Cost					
At 1 January 2006	9,572	1,915	894	6,232	18,613
Additions	92	–	253	102	447
Exchange differences	48	11	4	14	77
At 30 June 2006	<u>9,712</u>	<u>1,926</u>	<u>1,151</u>	<u>6,348</u>	<u>19,137</u>
Depreciation					
At 1 January 2006	8,505	1,755	504	4,707	15,471
Provided for the period	400	69	104	439	1,012
Exchange differences	44	9	3	29	85
At 30 June 2006	<u>8,949</u>	<u>1,833</u>	<u>611</u>	<u>5,175</u>	<u>16,568</u>
Carrying Value					
At 30 June 2006	<u>763</u>	<u>93</u>	<u>540</u>	<u>1,173</u>	<u>2,569</u>
At 31 December 2005	<u>1,067</u>	<u>160</u>	<u>390</u>	<u>1,525</u>	<u>3,142</u>

(7) Trade and other receivables

	As at	
	30 June 2006	31 December 2005
	<i>HK\$'000</i>	<i>HK\$'000</i>
Trade receivables	75,508	84,061
Retention money receivables	23,552	20,724
Other receivables	3,375	3,285
Prepaid maintenance charges	4,090	6,268
	<u>106,525</u>	<u>114,338</u>

There was no change in the Group's credit policies since 31 December 2005.

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

	As at	
	30 June 2006 HK\$'000	31 December 2005 HK\$'000
Age		
0 to 90 days	50,175	54,771
91 to 180 days	14,915	22,164
181 to 365 days	9,675	5,856
over 365 days	<u>2,659</u>	<u>4,256</u>
	77,424	87,047
Less: Accumulated impairment	<u>(1,916)</u>	<u>(2,986)</u>
	<u>75,508</u>	<u>84,061</u>

(8) Trade and other payables

	As at	
	30 June 2006 HK\$'000	31 December 2005 HK\$'000
Trade payables	62,070	31,859
Other payables	<u>31,587</u>	<u>12,130</u>
	<u>93,657</u>	<u>43,989</u>

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

	As at	
	30 June 2006 HK\$'000	31 December 2005 HK\$'000
Age		
0 to 90 days	58,087	28,623
91 to 180 days	2,517	1,046
over 180 days	<u>1,466</u>	<u>2,190</u>
	<u>62,070</u>	<u>31,859</u>

(9) Share capital

	Number of shares	Nominal value
	<i>'000</i>	<i>HK\$'000</i>
Authorised		
– ordinary shares of HK\$0.01 each	<u>500,000</u>	<u>5,000</u>
Issued and fully paid		
– at 1 January 2006 and 30 June 2006	<u>289,945</u>	<u>2,900</u>

(10) Share-based payments

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

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

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

	2006		2005	
	Number of share options	Weighted average exercise price	Number of share options	Weighted average exercise price
	<i>'000</i>	<i>HK\$</i>	<i>'000</i>	<i>HK\$</i>
Outstanding at 1 January,	19,957	0.349	23,380	0.343
Granted during the period	–	–	–	–
Cancelled during the period	(829)	0.301	(2,499)	0.340
Exercised during the period	–	–	–	–
Outstanding at 30 June	<u>19,128</u>	<u>0.351</u>	<u>20,881</u>	0.343
Exercisable at 30 June	<u>15,867</u>	<u>0.386</u>	<u>13,943</u>	0.422

No option was granted for the six months ended 30 June 2005 and 2006.

(11) Operating lease commitments

As at 30 June 2006, the Group had operating lease commitments of approximately HK\$3,470,000 (2005: HK\$3,948,000), out of which approximately HK\$2,827,000 was payable within 1 year. (2005: HK\$3,161,000)

(12) Contingent liabilities

As at 30 June 2006, the Company has provided corporate guarantees totalling approximately HK\$58,040,000 (2005: HK\$58,040,000) to banks to secure the credit facilities granted to its subsidiaries.

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 Scheme had lapsed or had been exercised during the Review Period.

(a) Pre-IPO Share Option Scheme

One single grant of 11,913,000 shares in aggregate was made to various participants on 30 April 2002 under this scheme. As at 30 June 2006, options comprising an aggregate of 8,575,000 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 30.6.2006
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	180,000 <i>(Note)</i>	4,075,000
		<u>8,755,000</u>	<u>180,000</u>	<u>8,575,000</u>

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

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

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

(b) Post-IPO Share Option Scheme

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

A summary of the Post-IPO Share Option Scheme movements during the Review Period and as at 30 June 2006 is as follows:

Date of grant	Type of Participants	Exercisable Period	Exercise Price per share <i>HK\$</i>	Number of share options			Outstanding as at 30.6.2006
				Outstanding as at 1.1.2006	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	–	243,000	2,083,000
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	–	105,000	2,277,000
				6,507,000	–	105,000	6,402,000
10.10.2003	Employees	10.10.2004 to 9.10.2013	0.142	165,000	–	30,000	135,000
23.2.2004	Employees	23.2.2005 to 22.2.2014	0.165 <i>(Note 2)</i>	1,624,000	–	116,000	1,508,000
11.10.2004	Employees	11.10.2005 to 10.10.2014	0.124	580,000	–	155,000	425,000
				11,202,000	–	649,000	10,553,000

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 date of grant at stepped annual increment of 25% of the total options granted, for a period not later than 10 years from the date of grant.

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

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

As at 30 June 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	7,208,000	Beneficial owner	-	56,400,000 (Note)	Interest through a controlled corporation	-	63,608,000	21.94%

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 have an interest 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	Number of	Number of	Number of	Aggregate interests	Approximate percentage of the Company's issued share capital
		unlisted pre-IPO share option outstanding as at 1.1.2006	unlisted pre-IPO share option outstanding as at 30.6.2006	unlisted post-IPO share option outstanding as at 1.1.2006	unlisted post-IPO share option outstanding as at 30.6.2006		
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 the personal beneficial owner of the share options granted to him or her.
- (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 from 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 from 20 February 2004 to 19 February 2013 at the exercise price of \$0.138 per share.

Other than as disclosed above, none of the Directors, the chief executive of the Company and their respective associates (as defined in the GEM Listing Rules), had any interests or short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations as at 30 June 2006.

REQUIRED STANDARD OF SECURITIES DEALINGS BY DIRECTORS

During the six months ended 30 June 2006, the Company had adopted a code of conduct for directors' securities transactions on terms no less exacting than the required standard of dealings set out in Rules 5.48 to 5.67 of the GEM Listing Rules.

Having made specific enquiry with all the Directors, the Directors confirmed that they had complied with the required standard of dealings and the code of conducts for directors' securities transactions during the six months ended 30 June 2006.

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

As at 30 June 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 shares in the Company

<u>Name of shareholder</u>	<u>Capacity</u>	<u>Type of Interests</u>	<u>Number of shares</u>	<u>Approximate Percentage of the Company's issued share capital</u>
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 through 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	Personal	3,134,744	1.08%
	Interest through a controlled corporation	Corporate	36,900,000	12.73%

Name of shareholder	Capacity	Type of Interests	Number of shares	Approximate Percentage of the Company's issued share capital
QPL International Holdings Limited (“QPL”) (Note 4)	Beneficial owner	Corporate	35,456,745	12.23%
Mr. Li Tung Lok (Note 4)	Interest through 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 have an interest in these shares as it is the investment manager of ARC.

HSBC Private Equity (Asia) Limited is deemed, by virtue of the SFO, to have an interest 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 have an interest 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 have an interest 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 have an interest in the 35,456,745 shares held by QPL.

Save as disclosed above, the Company had not been notified of any other relevant interests or short positions in the shares or underlying shares in the Company as at 30 June 2006.

AUDIT COMMITTEE

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

The present Audit Committee consists of three independent non-executive Directors, namely, Mr. Tsoi Tai Wai, David, Mr. Pang Hing Chung, Alfred and Mr. Yu Zhonghou. Mr. Tsoi is the chairman of the Audit Committee. The relevant annual confirmation of independence has been received from all these three Directors.

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

BOARD PRACTICES AND PROCEDURES

The Company has complied with the board practices and procedures as set out in Rule 5.34 of the GEM Listing Rules during the Review Period.

CORPORATE GOVERNANCE

At present, the roles of both the chairman and chief executive officer of the Company are carried out by the same individual, Mr. Chan Sek Keung Ringo, the sole executive director of the Company. This is not in line with paragraph A.2.1 in the Code on Corporate Governance Practices (the "Code") as set out in Appendix 15 to the GEM Listing Rules

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.

At the Annual General Meeting held on 28 April, 2006, special resolutions were passed to amend the Articles of Association of the Company to be in line with the Code requirements, inter alia, that all Directors are now subject to retirement by rotation.

The Board, initially through the Audit Committee, is in the process of reviewing the internal control system of the Group. The review is expected to be completed before year end with the Audit Committee submitting its report to the Board.

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

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

Hong Kong, 11 August 2006