



WAFER SYSTEMS

Wafer Systems Limited

威發系統有限公司*

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 8198)

**THIRD QUARTERLY REPORT
FOR THE NINE MONTHS ENDED 30 SEPTEMBER 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") is pleased to report the unaudited consolidated results of the Company and its subsidiaries (collectively, the "Group") for the three months and nine months ended 30 September 2006 (the "Review Period") together with the comparative unaudited figures for the corresponding period in 2005.

BUSINESS OVERVIEW AND REVIEW

Financial Highlights

	Q3/2006	Q3/2005		Q1-Q3/	Q1-Q3/	
	HK\$'000	HK\$'000	Change	2006	2005	Change
				HK\$'000	HK\$'000	
Turnover	78,550	73,685	7%	219,498	292,615	-25%
Operating profit	1,363	957	42%	4,186	3,168	32%
Profit attributable to equity holders of the Company	315	317	-1%	1,327	1,179	13%
Basic EPS (HK Cents)	0.11	0.11	–	0.46	0.41	12%
Orders on hand				47,951	31,070	

Financial Review

During the Review Period, the Group recorded a turnover of approximately HK\$219.5 million (2005: HK\$292.6 million), a decrease of 25% from that recorded in the corresponding period in 2005.

Profit attributable to shareholders of the Company for the Review Period increased by 13% to approximately HK\$1.3 million (2005: HK\$1.2 million).

Basic earnings per share during the Review Period were 0.46 HK cents, an increase of 12% as compared with 0.41 HK cents for the same period in 2005.

Interim Dividend

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

Business Review

During the Review Period turnover from the Network Infrastructure business decreased by approximately 25% to approximately HK\$192 million (2005: HK\$257 million), accounting for about 88% of the Group's total turnover. For Professional Services, turnover decreased by approximately 27% to approximately HK\$25 million (2005: HK\$35 million). Software sales during the Review Period saw a 460% increase to HK\$1.8 million (2005: HK\$0.3 million).

Prospects

The Group has started the final quarter of the year with a backlog of orders on hand of approximately HK\$48 million, as compared with approximately HK\$31 million at the same time last year.

The competition in the China market remains keen. The Group will continue to work hard on enterprise customers, both multinational and local, as well as making sure our established relations with telecommunications service providers continue to strengthen. The Group will also allocate more resources on businesses with higher margins for sales of professional services and software.

Barring unforeseen circumstances, the Group is cautiously optimistic about the completion of orders on hand as well as obtaining new orders for delivery during the balance of the year.

Financial Information

Unaudited Consolidated Financial Results

	Note	For the three months ended 30 September		For the nine months ended 30 September	
		2006	2005	2006	2005
		HK\$'000	HK\$'000	HK\$'000	HK\$'000
Turnover	2	78,550	73,685	219,498	292,615
Other income		138	17	647	116
Charges in materials and equipment		(64,999)	(59,426)	(182,604)	(247,551)
Employee expense		(4,637)	(5,000)	(14,759)	(13,993)
Depreciation and amortization		(1,127)	(1,125)	(3,451)	(3,284)
Other expenses		(6,562)	(7,194)	(15,145)	(24,735)
Finance costs		(798)	(640)	(2,609)	(1,995)
Profit before taxation		565	317	1,577	1,173
Taxation	4	(250)	–	(250)	–
Profit for the period		<u>315</u>	<u>317</u>	<u>1,327</u>	<u>1,173</u>
Profit attributable to:					
Equity holders of the parent		315	317	1,327	1,179
Minority interest		–	–	–	(6)
		<u>315</u>	<u>317</u>	<u>1,327</u>	<u>1,173</u>
Earnings per share					
– Basic (cents)	5	<u>0.11</u>	0.11	<u>0.46</u>	0.41
– Diluted (cents)	5	<u>N/A</u>	N/A	<u>N/A</u>	N/A

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL RESULTS

(1) Basis of presentation

The unaudited consolidated financial results have been prepared in accordance with Hong Kong Financial Reporting Standards 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 unaudited consolidated financial report were in consistent with those applied for the annual financial report for the year ended 31 December 2005.

The unaudited consolidated results have been reviewed by the audit committee of the Company (the "Audit Committee").

(2) Turnover

An analysis of the Group's turnover recognized for the three and nine months ended 30 September 2006 together with the comparative figures for the corresponding period in 2005 are as follows:

	For the three months ended 30 September		For the nine months ended 30 September	
	2006 <i>HK\$'000</i>	2005 <i>HK\$'000</i>	2006 <i>HK\$'000</i>	2005 <i>HK\$'000</i>
Network infrastructure	65,080	62,268	192,336	257,378
Professional services	12,837	11,087	25,315	34,907
Network software	633	330	1,847	330
Total	<u>78,550</u>	<u>73,685</u>	<u>219,498</u>	<u>292,615</u>

(3) Profit before taxation

Profit before taxation has been arrived at after charging:

	For the three months ended 30 September		For the nine months ended 30 September	
	2006 HK\$'000	2005 HK\$'000	2006 HK\$'000	2005 HK\$'000
Amortization of software product development costs	657	504	1,969	1,502
Depreciation of property, plant and equipment	470	621	1,482	1,782
Staff costs (including directors' remuneration)	4,637	5,000	14,759	13,993
and after crediting:				
Interest income	157	17	197	116

(4) Taxation

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

No provision for Hong Kong profits tax has been made for the Company and other Hong Kong subsidiaries either because the accumulated tax losses brought forward exceed the estimated assessable profits for the nine months ended 30 September 2006 and its corresponding period in 2005 or the entities sustained losses for taxation purposes.

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 50% tax relief period.

A deferred tax asset has not been recognized in the financial statement in respect of tax losses available to offset future profits as it is not certain that the tax losses will be utilized in the foreseeable future.

(5) Earnings per share

The calculation of basic earnings per share for the three months and the nine months ended 30 September 2006 is based on the unaudited profit attributable to equity holders of the parent of approximately HK\$315,000 (2005: HK\$317,000) and approximately HK\$1,327,000 (2005: HK\$1,179,000) 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 nine months ended 30 September 2006 and for the three months ended 30 September 2005 since the effect is anti-dilutive.

(6) Reserves

	Share capital	Share premium	Share-based reserve	Statutory reserve	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
As at 1 January 2005	2,900	55,824	–	1,003	502	502	–	(3,448)	57,283	–	57,283
(as previously reported)								(453)			
Effect of adoption of HKFRS 2	–	–	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
Exchange differences on translation of foreign operations	–	–	–	–	–	–	546	–	546	–	546
Profit for the nine months ended 30 September 2005	–	–	–	–	–	–	–	1,310	1,310	(6)	1,304
Recognition of share-based payments	–	–	115	–	–	–	–	–	115	–	115
As at 30 September 2005	2,900	55,824	568	1,003	502	502	546	(2,591)	59,254	13	59,267
As at 1 January 2006 (as previously reported)											
Exchange differences on translation of foreign operations	2,900	55,824	587	1,003	502	502	566	(2,458)	59,426	–	59,426
Profit for the nine months ended 30 September 2006	–	–	–	–	–	–	339	–	339	–	339
Recognition of share-based payments	–	–	44	–	–	–	–	1,327	1,327	–	1,327
As at 30 September 2006	2,900	55,824	631	1,003	502	502	905	(1,131)	61,136	–	61,136

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 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 September 2006, options comprising an aggregate of 8,310,000 shares were outstanding, as detailed below:

	Exercise price per share	Number of share options		
		Outstanding as at 1.1.2006	Lapsed during Review Period	Outstanding as at 30.9.2006
	HK\$			
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	445,000	3,810,000
			(Note)	
		<u>8,755,000</u>	<u>445,000</u>	<u>8,310,000</u>

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

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

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

(b) Post-IPO Share Option Schemes

There have been a total of 5 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 September 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 30.9.2006
				Outstanding as at 1.1.2006	Granted during Review Period	Lapsed during Review Period <i>(Note 1)</i>	
12.7.2002	Employees	12.7.2003 to 11.7.2012	0.384	2,326,000	–	301,000	2,025,000
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	–	421,000	1,961,000
				6,507,000	–	421,000	6,086,000
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	–	166,000	1,458,000
11.10.2004	Employees	11.10.2005 to 10.10.2014	0.124	580,000	–	155,000	425,000
				11,202,000	–	1,073,000	10,129,000

Notes:

- (1) These options were lapsed 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 September 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	7,676,000	Beneficial owner	-	56,400,000 (Note)	Interest through a controlled corporation	-	64,076,000	22.10%

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 30.9.2006	unlisted post-IPO share option outstanding as at 1.1.2006	unlisted post-IPO share option outstanding as at 30.9.2006		
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 September 2006.

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

As at 30 September 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

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

Notes:

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

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

Hong Kong, 14 November 2006