



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 2007

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 Board consists of one executive director, Mr. Chan Sek Keung, Ringo, one non-executive director, Mr. Kwan Kit Tong and three independent non-executive directors, namely Mr. Pang Hing Chung, Alfred, Mr. David Tsoi and Mr. Chan Tze Ngon.

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") of Wafer Systems Limited (the "Company") is pleased to report the un-audited consolidated results of the Company and its subsidiaries (the "Group") for the six months ended 30 June 2007 (the "Review Period") and the comparative un-audited figures for the correspondence period in 2006.

BUSINESS OVERVIEW AND REVIEW

Financial Highlights

| | Q2/2007 HK\$'000 | Q2/2006 HK\$'000 | <i>Change</i> | 1H/2007 HK\$'000 | 1H/2006 HK\$'000 | <i>Change</i> |
|--|-----------------------------------|---------------------|---------------|-----------------------------------|---------------------|---------------|
| Turnover | 144,615 | 94,590 | +52.9% | 195,167 | 140,948 | +38.5% |
| Operating Profit | 5,972 | 5,964 | +0.1% | 6,216 | 2,823 | +120.2% |
| Profit attributable to equity holders of the Company | 4,617 | 4,902 | -5.8% | 3,659 | 1,012 | +261.6% |
| Basic EPS (HK Cents) | 1.59 | 1.69 | -5.9% | 1.26 | 0.35 | +260.0% |

FINANCIAL REVIEW

During the Review Period, the Group recorded a turnover of approximately HK\$195.2 million (2006: HK\$140.9 million), an increase of 38.5% as compared to the corresponding period in 2006.

Profit of the period increased from HK\$1.0 million to HK\$3.7 million, representing an increase of 261.6% as compared to the corresponding period in 2006. Basic earnings per share were approximately HK1.26 cents (2006: HK0.35 cents).

During the Review Period, mainland China continued to be the major market of the Group, accounting for 95.2% (2006: 92.3%) of the total turnover, with the remaining 4.8% (2006: 7.7%) generated in Hong Kong. Turnover generated from Network Infrastructure business amounted to HK\$164.7 million (2006: HK\$127.3 million). The turnover of Professional Services business amounted to HK\$28.3 million (2006: HK\$12.5 million). The turnover of Network Software business amounted to HK\$2.2 million (2006: 1.2 million).

INTERIM DIVIDEND

The Board does not recommend the payment of an interim dividend for the six months ended 30 June 2007 (2006: Nil).

BUSINESS REVIEW

The development of information technology and internet industry in China has brought good potentials for network services and solutions providers. The Group's continued investment on the development of its capabilities in advanced technology of networking in the past years has enabled the Group to produce better turnover and profit during the first half of the year.

During the Review Period, the Group continued to expand its customer base which now covers a large number of multi-national corporations ("MNCs"), all major telephone companies, telecommunications service provider ("SP"), local industries and governmental bodies. The collaborations with globally renowned vendors in the telecommunications and networking sector continued to enable the Group to upgrade its capabilities in technology and applications.

Focusing on technologies in unified communications, network optimisation and network security, the Group continued to gain customer confidence and supplier appreciation. The diversified customer base has helped the Group in its grasp of user experience in the direction of technology migration. The Review Period has seen the Group's participation in the sizeable Chinanet Next Carrying Network ("CN2") project as well as awarded by vendor partners, such as Cisco China "The Best Partner Award in the Telco Sector" for their last financial year.

PROSPECTS

After experiencing the keen market competition and relatively slow business season in past years, the Group has entered into a more reasonable business climate. Leveraging on the advancement in technology of network infrastructure, enlarged customer and user bases and improvement of network services, the Group is cautiously optimistic towards business growth in the foreseeable future, though competition in the market will continue to be keen.

As the Group enters the third quarter of 2007, there was a healthy backlog of orders on hand. As at 30 June 2007, the total value of backlog on hand amounted to approximately HK\$50 million.

Wafer Systems will place high priority to further develop its advanced technologies including unified communications, network securities, network optimisation, proprietary networking software and other emerging technologies such as wi-max. Like always, the Group will endeavor to provide seamless solutions from the perspective of user-experience.

Looking forward, Wafer Systems will continue to strive for greater breakthrough in research and development, so as to enhance the Group's competitiveness, strengthen its position in the industry and enlarge its market share. The Group will continue to look for and grasp business development opportunities in mergers and acquisitions for the benefits and better returns to the Company and its shareholders.

APPRECIATION

On behalf of the Board, I would like to express sincere thanks to all of our management and staff for their commitments and contributions. I would also like to take this opportunity to thank our shareholders, investors and customers for their heartfelt encouragements and supports.

CHAN Sek Keung, Ringo
Chairman and Chief Executive Officer

Hong Kong, 13 August 2007

MANAGEMENT DISCUSSION & ANALYSIS

Liquidity, Financial Resources and Capital Structure

The Group had total cash and bank deposits of HK\$38.5 million as at 30 June 2007 (31 December 2006: 52.3 million). The Group had no bank overdraft as at 30 June 2007 (31 December 2006: Nil).

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, short-terms bank loans and other loans.

The Group remained healthy in the financial and liquidity position during the Review Period. As at 30 June 2007, the Group recorded net current assets of approximately HK\$63.3 million as compared with approximately HK\$61.0 million as at 31 December 2006. The current ratio slightly increased to approximately 1.54 from 1.47 as at 31 December 2006.

Non-current portion of other loan as at 30 June 2007 amounted to approximately HK\$3.6 million (31 December 2006: HK\$5.6 million).

As at 30 June 2007, 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 2007, the Group had 167 employees (2006: 161 employees) comprising 20 employees (2006: 19 employees) based in Hong Kong and 147 employees (2006: 142 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 2007, the Group had a pledged bank deposit of approximately HK\$5.0 million for securing certain bank overdraft facilities (31 December 2006: HK\$5.0 million).

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

Gearing Ratio

As at 30 June 2007, the gearing ratio, i.e. total liabilities over total assets, decreased to approximately 63.2% from approximately 67.5% as at 31 December 2006.

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.

Order Book & Prospects for New Business

As at 30 June 2007, the Group had contracts on hand for sales amounting to approximately HK\$50.0 million (2006: HK\$43.8 million) which would 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 2007.

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 | |
|------------------------------------|------|---------------------------------------|--------------|-------------------------------------|--------------|
| | | 2007 | 2006 | 2007 | 2006 |
| | | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Turnover | 2 | 144,615 | 94,590 | 195,167 | 140,948 |
| Other income | | 56 | 26 | 87 | 509 |
| Charges in materials and equipment | | (123,766) | (79,050) | (159,825) | (117,605) |
| Employee expense | | (5,835) | (5,160) | (11,401) | (10,122) |
| Depreciation and amortisation | | (1,192) | (1,114) | (2,269) | (2,324) |
| Other expenses | | (7,906) | (3,328) | (15,543) | (8,583) |
| Finance costs | | (1,355) | (1,062) | (2,557) | (1,811) |
| Profit before taxation | | 4,617 | 4,902 | 3,659 | 1,012 |
| Taxation | 4 | — | — | — | — |
| Profit for the period | | 4,617 | 4,902 | 3,659 | 1,012 |
| Profit attributable to: | | | | | |
| Equity holders of the Company | | 4,617 | 4,902 | 3,659 | 1,012 |
| Minority interest | | — | — | — | — |
| | | 4,617 | 4,902 | 3,659 | 1,012 |
| Earnings per share | | | | | |
| – Basic (cents) | 5 | 1.59 | 1.69 | 1.26 | 0.35 |
| – Diluted (cents) | 5 | 1.57 | N/A | 1.25 | N/A |

Condensed Consolidated Balance Sheet

| | | (Unaudited) As at 30 June 2007 | (Audited) As at 31 December 2006 |
|---------------------------------------|------|---|---|
| | Note | <u>HK\$'000</u> | <u>HK\$'000</u> |
| Non-current assets | | | |
| Property, plant and equipment | 6 | 2,262 | 2,032 |
| Software product development costs | | <u>8,044</u> | <u>7,753</u> |
| | | <u>10,306</u> | <u>9,785</u> |
| Current assets | | | |
| Inventories | | 12,552 | 5,602 |
| Trade and other receivables | 7 | 129,035 | 133,065 |
| Pledged bank deposits | | 5,013 | 5,013 |
| Cash and cash equivalents | | <u>33,534</u> | <u>47,276</u> |
| | | <u>180,134</u> | <u>190,956</u> |
| Current liabilities | | | |
| Trade and other payables | 8 | 52,235 | 54,721 |
| Tax Payable | | 1,126 | 1,548 |
| Bank borrowings | | 39,337 | 49,843 |
| Other loans | | <u>24,162</u> | <u>23,843</u> |
| | | <u>116,860</u> | <u>129,955</u> |
| Net current assets | | <u>63,274</u> | <u>61,001</u> |
| Total assets less current liabilities | | <u>73,580</u> | <u>70,786</u> |
| Non-current liabilities | | | |
| Other loans | | <u>3,575</u> | <u>5,573</u> |
| Net assets | | <u>70,005</u> | <u>65,213</u> |
| Capital and reserves | | | |
| Share capital | 9 | 2,916 | 2,900 |
| Reserves | | <u>67,089</u> | <u>62,313</u> |
| Total equity | | <u>70,005</u> | <u>65,213</u> |

Condensed Consolidated Statement of Changes in Equity (Unaudited)

| | Share capital | Share premium | Share- based payments reserve | Statutory surplus reserve fund | Enterprise expansion fund | Staff welfare fund | Exchange (accumulated reserve) | Retained earnings/ losses | Total |
|---|------------------|------------------|--|---|---------------------------------|--------------------------|-----------------------------------|---------------------------------|---------------|
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| As at 1 January 2006 (as previously reported) | 2,900 | 55,824 | 587 | 1,003 | 502 | 502 | 566 | (2,458) | 59,426 |
| Exchange differences on translation of foreign operations | - | - | - | - | - | - | 339 | - | 339 |
| Profit for the six months ended 30 June 2006 | - | - | - | - | - | - | - | 1,010 | 1,010 |
| Recognition of share-based payments | - | - | 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> |
| As at 1 January 2007 (as previously reported) | 2,900 | 55,824 | 643 | 1,505 | 502 | - | 1,196 | 2,643 | 65,213 |
| Exchange differences on translation of foreign operations | - | - | - | - | - | - | 834 | - | 834 |
| Profit for the six months ended 30 June 2007 | - | - | - | - | - | - | - | 3,659 | 3,659 |
| Recognition of share-based payments | - | - | 89 | - | - | - | - | - | 89 |
| Exercise of share options, net of expenses | 16 | 308 | (114) | - | - | - | - | - | 210 |
| As at 30 June 2007 | <u>2,916</u> | <u>56,132</u> | <u>618</u> | <u>1,505</u> | <u>502</u> | <u>-</u> | <u>2,030</u> | <u>6,302</u> | <u>70,005</u> |

CONDENSED CONSOLIDATED CASH FLOW STATEMENT (UNAUDITED)

| | Six months ended 30 June 2007 | Six months ended 30 June 2006 |
|---|--|--|
| | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Net cash from operating activities | 1,120 | 63,979 |
| Net cash used in investing activities | (2,886) | (1,315) |
| Net cash used in financing activities | (11,976) | (25,201) |
| Net (decrease)/increase in cash and cash equivalents | (13,742) | 37,463 |
| Cash and cash equivalents at the beginning of period | 47,276 | 17,619 |
| Cash and cash equivalents at the end of period | <u>33,534</u> | <u>55,082</u> |
| Analysis of the balances of cash and cash equivalents | | |
| Cash and cash equivalents | <u>33,534</u> | <u>55,082</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 2006.

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 2007 | | (Unaudited) For the six months ended 30 June 2006 | |
|---------------------------------|--|-----------------------------------|--|-----------------------------------|
| | Turnover HK\$'000 | Results HK\$'000 | Turnover HK\$'000 | Results HK\$'000 |
| Network infrastructure | 164,707 | 3,916 | 127,256 | 2,367 |
| Professional services | 28,258 | 1,760 | 12,478 | 967 |
| Network software | 2,202 | 469 | 1,214 | (1,009) |
| | <u>195,167</u> | <u>6,145</u> | <u>140,948</u> | <u>2,325</u> |
| Other operating income | | 87 | | 509 |
| Central administrative expenses | | (16) | | (11) |
| Profit from operations | | 6,216 | | 2,823 |
| Finance costs | | (2,557) | | (1,811) |
| Profit before taxation | | 3,659 | | 1,012 |
| Taxation | | – | | – |
| Profit for the period | | <u>3,659</u> | | <u>1,012</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 | |
|-----------|---|--------------------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 |
| Hong Kong | 9,386 | 10,805 |
| PRC | 185,781 | 130,143 |
| | <u>195,167</u> | <u>140,948</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 | |
|---|---------------------------------------|------------------|-------------------------------------|------------------|
| | 2007 HK\$'000 | 2006 HK\$'000 | 2007 HK\$'000 | 2006 HK\$'000 |
| Amortisation of software product development costs | 740 | 656 | 1,390 | 1,312 |
| Depreciation of property, plant and equipment | 452 | 458 | 879 | 1,012 |
| Staff costs (including directors' remuneration) | 5,835 | 5,160 | 11,401 | 10,122 |
| and after crediting: | | | | |
| Interest income | 56 | 15 | 87 | 40 |

(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 2007 and the corresponding period in 2006.

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 commencing from their first profit-making year of operation and thereafter entitled to a 50% relief from PRC income tax for the immediate following three years. During the Review Period, one of the Company's PRC subsidiaries is within its 50% tax relief period, one of the Company's PRC subsidiaries is subject to full PRC income tax at effective tax rate of 27% and one of the Company's PRC subsidiaries was still in its tax exemption period and its first profit-making year of operation had not started.

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 2007 is based on the unaudited profit attributable to equity holders of the Company of approximately HK\$4,617,000 (2006: HK\$4,902,000) and approximately HK\$3,659,000 (2006: HK\$1,012,000), respectively and on the weighted average number of approximately 290,376,000 (2006: 289,945,000) shares in issue during the period.

The calculation of diluted earnings per share for the three months and six months ended 30 June 2007 is based on the unaudited profit attributable to equity holders of the Company approximately HK\$4,617,000 and HK\$3,659,000, respectively and on the weighted average number of approximately 292,757,000 shares in issue during the period.

(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 2007 | 9,593 | 1,859 | 1,157 | 6,506 | 19,115 |
| Additions | 145 | 513 | – | 446 | 1,104 |
| Exchange differences | 153 | 34 | 18 | 125 | 330 |
| Disposals | (1) | (32) | – | (552) | (585) |
| At 30 June 2007 | <u>9,890</u> | <u>2,374</u> | <u>1,175</u> | <u>6,525</u> | <u>19,964</u> |
| Accumulated depreciation | | | | | |
| At 1 January 2007 | 8,967 | 1,722 | 731 | 5,663 | 17,083 |
| Charged for the period | 303 | 83 | 119 | 374 | 879 |
| Exchange differences | 140 | 30 | 12 | 107 | 289 |
| Written back on disposals | (1) | (32) | – | (516) | (549) |
| At 30 June 2007 | <u>9,409</u> | <u>1,803</u> | <u>862</u> | <u>5,628</u> | <u>17,702</u> |
| Net book value At 30 June 2007 | <u>481</u> | <u>571</u> | <u>313</u> | <u>897</u> | <u>2,262</u> |
| At 31 December 2006 | <u>626</u> | <u>137</u> | <u>426</u> | <u>843</u> | <u>2,032</u> |

(7) Trade and other receivables

| | As at | |
|-----------------------------|-------------------------|-----------------------------|
| | 30 June 2007 | 31 December 2006 |
| | <i>HK\$'000</i> | <i>HK\$'000</i> |
| Trade receivables | 107,322 | 113,079 |
| Retention money receivables | 10,700 | 10,696 |
| Other receivables | 10,501 | 7,458 |
| Prepaid maintenance charges | 512 | 1,832 |
| | <u>129,035</u> | <u>133,065</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 2007 HK\$'000 | 31 December 2006 HK\$'000 |
| Age | | |
| 0 to 90 days | 55,564 | 78,752 |
| 91 to 180 days | 18,329 | 17,285 |
| 181 to 365 days | 30,391 | 15,909 |
| over 365 days | <u>8,418</u> | <u>4,224</u> |
| | 112,702 | 116,170 |
| Less: Accumulated impairment | <u>(5,380)</u> | <u>(3,091)</u> |
| | <u>107,322</u> | <u>113,079</u> |

(8) Trade and other payables

| | As at | |
|----------------|--------------------------------------|---------------------------------|
| | 30 June 2007 HK\$'000 | 31 December 2006 HK\$'000 |
| Trade payables | 32,974 | 43,480 |
| Other payables | <u>19,261</u> | <u>11,241</u> |
| | <u>52,235</u> | <u>54,721</u> |

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

| | As at | |
|----------------|--------------------------------------|---------------------------------|
| | 30 June 2007 HK\$'000 | 31 December 2006 HK\$'000 |
| Age | | |
| 0 to 90 days | 30,114 | 38,633 |
| 91 to 180 days | 690 | 3,024 |
| over 180 days | <u>2,170</u> | <u>1,823</u> |
| | <u>32,974</u> | <u>43,480</u> |

(9) Share capital

| | <u>Number of shares</u> | <u>Nominal value</u> |
|--------------------------------------|-----------------------------|--------------------------|
| | <i>'000</i> | <i>HK\$'000</i> |
| Authorised | | |
| – Ordinary shares of HK\$0.01 each | | |
| – At 1 January 2007 and 30 June 2007 | <u>500,000</u> | <u>5,000</u> |
| Issued and fully paid | | |
| – At 1 January 2007 | 289,945 | 2,900 |
| – Exercise of share options | <u>1,570</u> | <u>16</u> |
| – At 30 June 2007 | <u>291,515</u> | <u>2,916</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 are 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 |
| Lapse | After 3 months from the departure of grantees from the Group | After 3 months from the departure of grantees from the Group |

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

| | 2007 | | 2006 | |
|-----------------------------|------------------------------------|--|------------------------------------|--|
| | <u>Number of share options</u> | <u>Weighted average exercise price</u> | <u>Number of share options</u> | <u>Weighted average exercise price</u> |
| | <i>'000</i> | <i>HK\$</i> | <i>'000</i> | <i>HK\$</i> |
| Outstanding at 1 January, | 18,329 | 0.354 | 19,957 | 0.349 |
| Granted during the period | 6,980 | 0.088 | – | – |
| Lapsed during the period | (37) | 0.245 | (829) | 0.301 |
| Exercised during the period | <u>(1,570)</u> | 0.138 | – | – |
| Outstanding at 30 June | <u>23,702</u> | 0.290 | <u>19,128</u> | 0.351 |
| Exercisable at 30 June | <u>16,186</u> | 0.382 | <u>15,867</u> | 0.386 |

Options granted during the six months ended 30 June 2007 were 6,980,000 shares (2006: Nil).

(11) Operating lease commitments

As at 30 June 2007, the Group had operating lease commitments of approximately HK\$6,328,000 (31 December 2006: HK\$3,355,000), out of which approximately HK\$2,498,000 was payable within 1 year (31 December 2006: HK\$2,366,000).

(12) Contingent liabilities

As at 30 June 2007, the Company has given corporate guarantees totaling approximately HK\$50,400,000 (31 December 2006: HK\$50,400,000) to banks to secure the credit facilities granted to its subsidiaries.

PURCHASE, SALE OR REDEMPTION 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, at the 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").

Share options exercised and lapsed for both schemes are detailed below:–

(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 2007, options comprising an aggregate of 8,300,000 shares were outstanding, as detailed below:

| | Number of share options | | | |
|------------------------|--------------------------|----------------------------|-----------------------------|-----------------------------|
| | Exercise price per share | Outstanding as at 1.1.2007 | Lapsed during Review Period | Outstanding as at 30.6.2007 |
| | HK\$ | | | |
| Types of participants: | | | | |
| Directors | 0.55 | 3,750,000 | – | 3,750,000 |
| Advisor | 0.55 | 750,000 | – | 750,000 |
| Employees | 0.55 | 3,810,000 | 10,000 (Note) | 3,800,000 |
| | | <u>8,310,000</u> | <u>10,000</u> | <u>8,300,000</u> |

Note: These options lapsed according to the rules of this scheme due to the employee 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 "Listing Date"); (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 Listing Date; and (iii) the remaining options granted on or after the third anniversary of the Listing Date 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 6 lots of Post-IPO share option grants. 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, 828,000 shares on 11 October 2004 and 6,980,000 shares on 12 January 2007.

A summary of the Post-IPO Share Option Scheme movements during the Review Period and as at 30 June 2007 is as follows:

| Date of grant | Type of participants | Exercisable period | Exercise price per share | Number of share options | | | | Outstanding as at 30.6.2007 |
|---------------|----------------------|--------------------------|--------------------------|----------------------------|------------------------------|--------------------------------|-----------------------------|-----------------------------|
| | | | | Outstanding as at 1.1.2007 | Granted during Review Period | Exercised during Review Period | Lapsed during Review Period | |
| | | | HK\$ | | | | (Note 1) | |
| 12.7.2002 | Employees | 12.7.2003 to 11.7.2012 | 0.384 | 2,025,000 | – | – | – | 2,025,000 |
| 20.2.2003 | Directors | 20.2.2004 to 19.2.2013 | 0.138 | 3,825,000 | – | 1,500,000 | – | 2,325,000 |
| | Advisors | 20.2.2004 to 19.2.2013 | 0.138 | 300,000 | – | – | – | 300,000 |
| | Employees | 20.2.2004 to 19.2.2013 | 0.138 | 1,961,000 | – | 36,000 | 10,000 | 1,915,000 |
| | | | | 6,086,000 | – | 1,536,000 | 10,000 | 4,540,000 |
| 10.10.2003 | Employees | 10.10.2004 to 9.10.2013 | 0.142 | 135,000 | – | – | 5,000 | 130,000 |
| 23.2.2004 | Employees | 23.2.2005 to 22.2.2014 | 0.165 | 1,458,000 | – | 20,000 | – | 1,438,000 |
| 11.10.2004 | Employees | 11.10.2005 to 10.10.2014 | 0.124 | 315,000 | – | 14,000 | 12,000 | 289,000 |
| 12.1.2007 | Directors | 12.1.2008 to 11.1.2017 | 0.088 | – | 750,000 | – | – | 750,000 |
| | Employees | 12.1.2008 to 11.1.2017 | 0.088 | – | 6,230,000 | – | – | 6,230,000 |
| | | | | – | 6,980,000 | – | – | 6,980,000 |
| | Total: | | | 10,019,000 | 6,980,000 | 1,570,000 | 27,000 | 15,402,000 |

Notes:

- (1) These options lapsed according to the rules of this scheme due to the employees having left the Group.
- (2) Out of these 1,500,000 exercised share options, 375,000 shares were granted to each of Mr. Alasdair Gordon Nagle and Ms. Clara Ho, directors appointed to the Board to represent the interests of The Applied Research Council (“ARC”). Both Mr. Nagle and Ms. Ho exercised the options on 3 April 2007 and shares were allotted to them accordingly. They subsequently resigned from directorship in the Company with effect from 13 April 2007 after ARC ceased to be a substantial shareholder of the Company after 12 April 2007.
- (3) Out of these 1,500,000 exercised share options, 750,000 shares were granted to Mr. David Tsoi. He exercised the options on 14 June 2007 and shares were allotted to him accordingly.

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 such exercise 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 2007, 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 | 23,160,000 | Beneficial owner | – | 56,400,000 (Note) | Interest through a controlled corporation | – | 79,560,000 | 27.29% |

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 1.1.2007 | unlisted pre-IPO share option outstanding as at 30.6.2007 | unlisted post-IPO share option outstanding as at 1.1.2007 | unlisted post-IPO share option outstanding as at 30.6.2007 | | |
| Mr. Chan Sek Keung, Ringo | 30.4.2002 20.2.2003 | 3,000,000 – | 3,000,000 – | – 1,200,000 | – 1,200,000 | 4,200,000 | 1.44% |
| Mr. Pang Hing Chung, Alfred | 30.4.2002 20.2.2003 | 750,000 – | 750,000 – | – 750,000 | – 750,000 | 1,500,000 | 0.51% |
| Mr. David Tsoi (Note 3) | 20.2.2003 12.1.2007 | – – | – – | 750,000 – | – 750,000 | 750,000 | 0.26% |
| Mr. Alasdair Gordon Nagle (Note 4) | 20.2.2003 | – | – | 375,000 | – | – | – |
| Ms. Clara Ho (Note 4) | 20.2.2003 | – | – | 375,000 | – | – | – |
| 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 or her respective long positions in the underlying shares in the Company by virtue of options granted to the directors pursuant to the 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) Mr. David Tsoi exercised his option rights on 14 June 2007 in respect of the 750,000 option granted to him on 20 February 2003.

- (4) Both Mr. Nagle and Ms. Ho exercised their respective option rights on 3 April 2007. They subsequently resigned from directorship in the Company with effect from 13 April 2007 after The Applied Research Council, whose interests Mr. Nagle and Ms. Ho were on the Board to represent, ceased to be a substantial shareholder of the Company after 12 April 2007.
- (5) 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.
- (6) 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.
- (7) Options granted on 12 January 2007 were exercisable during the period from 12 January 2008 to 11 January 2017 at the exercise price of \$0.088 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 2007.

REQUIRED STANDARD OF SECURITIES DEALINGS BY DIRECTORS

During the six months ended 30 June 2007, 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 2007.

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

As at 30 June 2007, 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> |
|--|---|--------------------------|-------------------------|---|
| North 22 Nominees Limited (<i>Note 1</i>) | Beneficial owner | Corporate | 36,900,000 | 12.66% |
| Mr. Ng Lai Yick (<i>Note 1</i>) | Beneficial owner | Personal | 3,134,744 | 1.08% |
| | Interest through a controlled corporation | Corporate | 36,900,000 | 12.66% |
| QPL International Holdings Limited ("QPL") (<i>Note 2</i>) | Beneficial owner | Corporate | 35,456,745 | 12.16% |
| Mr. Li Tung Lok (<i>Note 2</i>) | Interest through a controlled corporation | Corporate | 35,456,745 | 12.16% |
| Madam Su Ching Wah (<i>Note 2</i>) | Interest of spouse | Family | 35,456,745 | 12.16% |

Notes:

- (1) 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.
- (2) 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 2007.

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.

Mr. Yu Zhonghou resigned from the Board and the Audit Committee with effect from 1 February 2007 as in the announcement made by the Company on 30 January 2007. The vacancy was filled by the appointment of Mr. Chan Tze Ngon to the Board and the Audit Committee on 1 May 2007. The Audit Committee now consists of three independent non-executive directors, namely, Mr. David Tsoi, Chairman, Mr. Pang Hing Chung, Alfred and Mr. Chan Tze Ngon.

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 of 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.

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, 13 August 2007