

ACL SEMICONDUCTOR INC  
Form 10-Q  
August 14, 2007

**U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended June 30, 2007.

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from \_\_\_\_ to \_\_\_\_.

Commission File Number: 000-50140

**ACL Semiconductors Inc.**  
(Name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of incorporation)

**16-1642709**  
(I.R.S. Employer  
Identification No.)

**B24-B27,1/F., Block B  
Proficient Industrial Centre, 6 Wang Kwun Road  
Kowloon, Hong Kong**  
(Address of principal executive offices)

**011-852-2799-1996**  
(Registrant's telephone number)

Check whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Check whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate whether the registrant is a shell company. Yes  No

Registrant had 27,829,936 shares of common stock, par value \$0.001 per share, outstanding as of August 14, 2007.

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PART I - FINANCIAL INFORMATION

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## Cautionary Note Regarding Forward-Looking Statements

The Company has included in this quarterly report certain "Forward-Looking Statements" within the meaning of the Private Securities litigation Reform Act of 1995 concerning the Company's business, operations and financial condition. "Forward-Looking Statements" consist of all non-historical information and the analysis of historical information, including the references in this report to future revenue growth, future expense growth, future credit exposure, earning before interest, taxes, depreciation and amortization, future profitability, anticipated cash resources, anticipated capital expenditures, capital requirements, and the Company's plans for future periods. In addition, the words "could", "expects", "anticipates", "objective", "plan", "may affect", "may depend", "estimates", "projects" and similar words and phrases are also intended to identify such forward-looking statements.

Actual results could differ materially from those projected in the company's forward-looking statements due to numerous known and unknown risks and uncertainties, including, among other things, unanticipated technological difficulties, the volatile and competitive environment for computer and consumer electronic products, changes in domestic and foreign economic, market and regulatory conditions, the inherent uncertainty of financial estimates and projections, the uncertainties involved in certain legal proceedings, instabilities arising from terrorist actions and responses thereto, and other considerations described as "Risk Factors" in other filing by the Company with the Securities and Exchange Commission including its annual report on Form 10-K. Such factors may also cause substantial volatility in the market price of the Company's common stock. All such forward-looking statements are current only as of the date on which such statements were made. The Company does not undertake any obligations to publicly update any forward looking statement to reflect events or circumstances after the date on which any such statement is made or to reflect the occurrence of unanticipated events.

Any reference to "ACL", the "Company" or the "Registrant", "we", "our" or "us" means ACL Semiconductors Inc. and its subsidiaries.

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## ITEM 1. FINANCIAL STATEMENTS.

**ACL SEMICONDUCTORS INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

**ASSETS**

	As of June 30, 2007 (Unaudited)	As of December 31, 2006
<b>Current assets:</b>		
Cash and cash equivalents	\$ 842,288	\$ 1,447,486
Restricted cash	4,085,500	2,708,577
Accounts receivable, net of allowance for doubtful accounts of \$0 for 2007 and 2006	1,782,128	2,008,474
Accounts receivable, related parties	6,714,507	7,372,467
Inventories, net	6,178,996	3,253,255
Other current assets	191,031	40,937
<b>Total current assets</b>	<b>19,794,450</b>	<b>16,831,196</b>
<b>Investment in Securities (Pledged)</b>	<b>769,231</b>	<b>0</b>
<b>Property, equipment and improvements, net of accumulated depreciation and amortization</b>	<b>6,915,937</b>	<b>3,909,121</b>
<b>Other deposits</b>	<b>385,402</b>	<b>381,038</b>
	<b>\$ 27,865,020</b>	<b>\$ 21,121,355</b>

The accompanying notes are an integral part of these condensed consolidated financial statements

**ACL SEMICONDUCTORS INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)**

**LIABILITIES AND STOCKHOLDERS' EQUITY**

	As of June 30 2007 (Unaudited)	As of December 31, 2006
<b>Current liabilities:</b>		
Accounts payable	\$ 8,855,489	\$ 5,009,723
Accrued expenses	256,184	314,224
Lines of credit and notes payable	14,293,417	10,838,467
Current portion of long-term debt	124,794	107,739
Due to stockholders for converted pledged collateral	112,385	112,385
Amount due to stockholder/director	-	913,463
Income tax payable	95,592	74,839
Other current liabilities	106,702	302,430
<b>Total current liabilities</b>	<b>23,844,563</b>	<b>17,673,270</b>
Long-term debts, less current portion	2,658,283	1,900,997
	<b>26,502,846</b>	<b>19,574,267</b>
<b>Commitments and contingencies</b>	-	-
<b>Stockholders' equity:</b>		
Common stock - \$0.001 par value, 50,000,000 shares authorized, 27,829,936 shares outstanding at June 30, 2007 and December 31, 2006	27,830	27,830
Amount due from stockholder/director	(76,366)	-
Additional paid in capital	3,488,527	3,488,527
Accumulated deficit	(2,077,817)	(1,969,269)
<b>Total stockholders' equity</b>	<b>1,362,174</b>	<b>1,547,088</b>
	<b>\$ 27,865,020</b>	<b>\$ 21,121,355</b>

The accompanying notes are an integral part of these condensed consolidated financial statements

**ACL SEMICONDUCTORS INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(Unaudited)**

	Three Months Ended	
	June 30, 2007	June 30, 2006
<b>Net sales:</b>		
Related parties	\$ 7,595,771	\$ 5,577,040
Other	24,155,114	15,468,906
Less discounts to customers	(19,401)	(2,083)
	31,731,484	21,043,863
<b>Cost of sales</b>	31,221,150	20,327,980
<b>Gross profit</b>	510,334	715,883
<b>Operating expenses:</b>		
Selling	16,212	149,477
General and administrative	618,108	509,486
<b>Income from operations</b>	(123,986)	56,920
<b>Other income (expenses):</b>		
Interest expense	(242,930)	(140,323)
Unrealized profits	154,704	-
Miscellaneous	77,867	24,021
<b>Income before income taxes</b>	(134,345)	(59,382)
<b>Income taxes</b>	40,053	19,740
<b>Net income</b>	\$ (174,398)	\$ (79,122)
<b>Earnings per share - basic and diluted</b>	\$ (0.01)	\$ (0.00)
<b>Weighted average number of shares - basic and diluted</b>	27,829,936	27,829,936

The accompanying notes are an integral part of these condensed consolidated financial statements

**ACL SEMICONDUCTORS INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS**  
**(Unaudited)**

	Six months ended	
	June 30, 2007	June 30, 2006
<b>Cash flows provided by (used for) operating activities:</b>		
Net (loss) / income	\$ (108,548)	\$ 34,657
<b>Adjustments to reconcile net income to net cash provided by (used for) operating activities:</b>		
Depreciation and amortization	93,524	16,122
Change in inventory reserve	(89,744)	33,333
Fair value of options issued to employees	-	128,122
<b>Changes in assets and liabilities:</b>		
<b>(Increase) decrease in assets</b>		
Accounts receivable - other	226,345	25,862
Accounts receivable - related parties	657,960	(1,697,953)
Inventories	(2,835,997)	(1,056,676)
Refundable deposits		1,000,000
Other current assets	(150,093)	(159,904)
Deposits	(4,364)	105
<b>Increase (decrease) in liabilities</b>		
Accounts payable	3,845,766	(21,259)
Accrued expenses	(58,040)	(66,689)
Payable related to debt settlement	-	(76,088)
Income tax payable	20,753	22,732
Other current liabilities	(195,728)	(41,167)
Total adjustments	1,510,382	(1,893,460)
Net cash provided by (used for) operating activities	1,401,834	(1,858,803)
<b>Cash flows used for investing activities:</b>		
Repayments (to) from stockholders	(989,829)	15,934
Increase of restricted cash	(1,376,923)	(641,025)
Investment in Securities (Pledged)	(769,231)	-
Purchases of property, equipment and improvements	(3,100,340)	(6,225)
Net cash used for investing activities	(6,236,323)	(631,316)

The accompanying notes are an integral part of these condensed consolidated financial statements

**ACL SEMICONDUCTORS INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)**  
**INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS**  
**(Unaudited)**

	Six Months Ended	
	June 30, 2007	June 30, 2006
<b>Cash flows provided by financing activities:</b>		
Proceeds on lines of credit and notes payable	3,454,950	1,241,556
Principal loan (repayments) on long-term debt	774,341	-
Loan received from related parties	-	-
Net cash provided by financing activities	4,229,291	1,241,556
<b>Net decrease in cash and cash equivalents</b>	<b>(605,198)</b>	<b>(1,248,563)</b>
<b>Cash and cash equivalents, beginning of the period</b>	<b>1,447,486</b>	<b>2,537,799</b>
<b>Cash and cash equivalents, end of the period</b>	<b>\$ 842,288</b>	<b>\$ 1,289,236</b>
<b>Supplemental disclosure of cash flow information:</b>		
Interest paid	\$ 474,497	\$ 295,155
Income tax paid	\$ 29,640	\$ 20,089

The accompanying notes are an integral part of these condensed consolidated financial statements



**ACL SEMICONDUCTORS INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**1. Basis of Presentation and Nature of Business Operations Basis of Presentation**

**Basis of Presentation**

The condensed consolidated financial statements include the financial statements of ACL Semiconductors Inc. and its subsidiaries, Atlantic Components Ltd., a Hong Kong based company ("Atlantic") and Alpha Perform Technology Limited (collectively, "ACL" or the "Company"). The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete consolidated financial statements. These condensed consolidated financial statements and related notes should be read in conjunction with the Company's audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission (the "SEC"). In the opinion of management, these condensed consolidated financial statements reflect all adjustments which are of a normal recurring nature and which are necessary to present fairly the consolidated financial position of ACL as of June 30, 2007 and December 31, 2006, and the results of operations for the three-month and six-month periods ended June 30, 2007 and 2006 and the cash flows for the six month periods ended June 30, 2007 and 2006. The results of operations for the six months ended June 30, 2007 are not necessarily indicative of the results which may be expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated in preparation of the condensed consolidated financial statements.

**Nature of Business Operations**

ACL was incorporated under the State of Delaware on September 17, 2002 and acquired Atlantic through a reverse-acquisition that was effective September 30, 2003. The Company's principal activities are distribution of electronic components under the "Samsung" brandname which comprise DRAM and graphic RAM, FLASH, SRAM and MASK ROM for the Hong Kong and Southern China markets. Atlantic was incorporated in Hong Kong on May 30, 1991 with limited liability. On October 2, 2003, the Company set up a wholly-owned subsidiary, Alpha Perform Technology Limited ("Alpha"), a British Virgin Islands company, to provide services on behalf of the Company in jurisdictions outside of Hong Kong. Effective January 1, 2004, the Company ceased the operations of Alpha and all the related activities were consolidated with those of Atlantic.

**Revenue Recognition**

Product sales are recognized when products are shipped to customers, title passes and collection is reasonably assured. Provisions for discounts to customers, estimated returns and allowances and other price adjustments are deducted from the Company's gross sales in the same periods the related revenues are recorded.

**Currency Reporting**

Amounts reported in the accompanying condensed consolidated financial statements and disclosures are stated in U.S. Dollars, unless stated otherwise. The functional currency of the Company's subsidiaries is Hong Kong dollars ("HKD") as most of the Company's operations are conducted in HKD. Foreign currency transactions (outside Hong Kong) during the period are translated into HKD according to the prevailing exchange rate at the relevant transaction dates. Assets and liabilities denominated in foreign currencies at the balance sheet dates are translated into HKD at period-end exchange rates.

For the purpose of preparing these consolidated financial statements, the financial statements of ACL reported in HKD have been translated into U.S. Dollars at US\$1.00=HKD7.8, a fixed exchange rate maintained between the United States and China.

**2. Earnings Per Common Share**

In accordance with SFAS No. 128, "Earnings Per Share," the basic earnings (loss) per common share is computed by dividing net earnings (loss) available to common stockholders by the weighted average number of common shares outstanding. Diluted earnings (loss) per common share is computed similarly to basic earnings (loss) per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive.

**3. Related Party Transactions**

**Transactions with Mr. Yang**

As of June 30, 2007, the Company had an outstanding receivable from Mr. Yang, the President and Chairman of our Board of Directors, totaling \$76,366. As of December 31, 2006, the Company had an outstanding payable to Mr. Yang of \$913,463.

For the three months ended June 30, 2007 and 2006, the Company recorded and paid \$132,051 and \$50,000, respectively, to Mr. Yang as compensation. For the six months ended June 30, 2007 and 2006, the Company recorded and paid \$251,282 and \$100,000, respectively, to Mr. Yang as compensation.

During the three months ended June 30, 2007 and 2006, and the six months ended June 30, 2007 and 2006, the Company paid rent of \$7,906 \$23,077, \$17,521 and \$23,077, respectively, for Mr. Yang's personal residency as additional compensation.

**Transactions with Classic Electronics Ltd.**

As of June 30, 2007 and December 31, 2006, the Company had outstanding accounts receivable from Classic Electronics Ltd. ("Classic") totaling \$770,000 and \$6,709,495, respectively. The Company has not experienced any bad debt from this customer in the past. Pursuant to a written personal guarantee agreement, Mr. Yang has personally guaranteed up to \$10.0 million of the outstanding accounts receivable from Classic.

The Company leased one of its facilities and Mr. Yang's personal residency from Classic. Lease agreements for the two facilities expired and the properties were acquired from Classic by the Company on July 21, 2006. Prior to the expiration of the leases, monthly lease payments for these two leases totaled \$6,684. The Company paid rent expense of \$0, \$20,053, \$0 and \$40,106 to Classic for the three months ended June 30, 2007 and 2006 and the six months ended June 30, 2007 and 2006, respectively.

Mr. Ben Wong, a director of ACL, owns 99.9% of the equity of Classic. The remaining 0.1% of Classic is owned by a non-related party.

**Transactions with Solution Semiconductor (China) Ltd**

On August 31, 2006, the Company entered into a lease agreement with Solution Semiconductor (China) Ltd. ("Solution") pursuant to which the Company leases a warehouse unit of approximately 968 sq. ft. located at B10, 1/F., Block B, Proficient Industrial Centre, 6 Wang Kwun Road, Kowloon Bay, Kowloon, Hong Kong for a monthly lease payment of \$859 per month. The lease agreement for this facility expires on August 31, 2008. The Company paid rent expense of \$2,577, \$0, \$5,154 and \$0 to Solution for the three months ended June 30, 2007 and 2006 and the six months ended June 30, 2007 and 2006, respectively.

Two facilities located in Hong Kong owned by Solution were used by the Company as collateral for loans from Citic Ka Wah Bank Limited and Standard Chartered Bank (Hong Kong) Limited respectively.

Mr. Ben Wong, a director of the Company, owns 99% of the equity of Solution. The remaining 1% of Solution is owned by a non-related party.

**Transactions with Systematic Information Ltd.**

During the three months ended June 30, 2007 and 2006, and the six months ended June 30, 2007 and 2006, the Company received service fees of \$3,846, \$0 \$7,692 and \$0, respectively, from Systematic Information Ltd. (□Systematic□). There were no outstanding accounts receivable due from Systematic as of June 30, 2007 and December 31, 2006. The service fees were charged in consideration for the provision by the Company of back office support to Systematic.

On April 1, 2004, the Company entered into a lease agreement with Systematic pursuant to which the Company leased one residential property for Mr. Yang's personal use for a monthly lease payment of \$3,205. Upon expiration of the lease on June 15, 2007, ACL acquired this facility and personal residence from Systematic (see Note 9 for details). The Company paid rent expenses of \$8,013 \$9,615, \$19,230 and \$19,230 to Systematic for the three months ended June 30, 2007 and the six months ended June 30, 2007 and 2006, respectively.

Outstanding accounts payable \$40,004 and \$0 due to Systematic as of June 30, 2007 and December 31, 2006.

Mr. Alan Yang, the Company's Chief Executive Officer, majority shareholder and a director, is the sole beneficial owner of the equity interests of Systematic.

**Transactions with Global Mega Development Ltd.**

During the three months ended June 30, 2007 and 2006, and the six months ended June 30, 2007 and 2006, the Company received management fees of \$1,923, \$1,923 \$3,846 and \$3,846, respectively, from Global Mega Development Ltd. (□Global□). There were no outstanding accounts receivable due from Global as of June 30, 2007 and December 31, 2006. The management fee was charged in consideration for the provision by the Company of back office support to Global.

Mr. Alan Yang, the Company's Chief Executive Officer, majority shareholder and a director, is the sole beneficial owner of the equity interests of Global.

**Transactions with Intelligent Network Technology Ltd.**

During the three months ended June 30, 2007 and 2006, and the six months ended June 30, 2007 and 2006, the Company received management fees of \$0, \$1,923, \$0 and \$3,846, respectively, from Intelligent Network Technology Ltd. (□Intelligent□). There were no outstanding accounts receivable due from Intelligent as of June 30, 2007 and December 31, 2006. The management fees were charged in consideration for the provision by the Company of back office support to Intelligent.

Mr. Alan Yang, the Company's Chief Executive Officer, majority shareholder and a director, is a director and 80% shareholder of Intelligent. The remaining 20% of Intelligent is owned by a non-related party.

**Transactions with Systematic Semiconductor Ltd.**

During the three months ended June 30, 2007 and 2006, and the six months ended June 30, 2007 and 2006, the Company received management fees of \$3,846, \$3,846, \$7,692 and \$7,692, respectively, from Systematic Semiconductor Ltd. (□Systematic Semiconductor□). There were no outstanding accounts receivable due from Systematic Semiconductor as of June 30, 2007 and December 31, 2006. The management fees were charged in consideration for the provision by the Company of back office support to Systematic Semiconductor.

Mr. Alan Yang, the Company's Chief Executive Officer, majority shareholder and a director, is the sole beneficial owner of the equity interests of Systematic Semiconductor.

**Transactions with First World Logistics Ltd.**

During the three months ended June 30, 2007 and 2006, and the six months ended June 30, 2007 and 2006, the Company sold memory components \$0, \$2,925,988, \$0 and \$7,094,671, respectively, to First World Logistics Ltd. (□First□). Outstanding accounts receivable totaled \$0 as of June 30, 2007 and December 31, 2006. The Company has not experienced any bad debt from this customer in the past.

During the three months ended June 30, 2007 and 2006, and the six months ended June 30, 2007 and 2006, the Company purchased \$0, \$775,260, \$0 and \$825,900, respectively, of memory components from First. There were no outstanding accounts payable due to First as of June 30, 2007 and December 31, 2006.

Mr. Alan Yang, the Company's Chief Executive Officer, majority shareholder and a director, is the sole beneficial owner of the equity interests of First.

**Transactions with Aristo Technologies Ltd.**

During the three months ended June 30, 2007 and 2006, and the six months ended June 30, 2007 and 2006, the Company sold \$7,595,770, \$2,651,052, \$10,864,394 and \$2,651,052 respectively, of memory products to Aristo Technologies Ltd. (□Aristo□). Outstanding accounts receivable totaled \$4,984,511 and \$662,972 as of June 30, 2007 and December 31, 2006, respectively. The Company has not experienced any bad debt from this customer in the past.

During the three months ended June 30, 2007 and 2006, and the six months ended June 30, 2007 and 2006 the Company purchased \$477,400, \$288,552, \$1,039,116 and \$288,552, respectively, of memory products from Aristo. There are no outstanding accounts due to Aristo as of June 30, 2007 and December 31, 2006 respectively.

Mr. Yang, the Company's Chief Executive Officer, majority shareholder and a director, is the sole beneficial owner of the equity interests of Aristo.

**Transactions with City Royal Limited**

A residential property located in Hong Kong owned by City Royal Limited (□City□) was used by the Company as collateral for loans from DBS Bank (Hong Kong) Ltd.

Mr. Alan Yang, the Company's Chief Executive Officer, majority shareholder and a director, is a director and 50% shareholder of City. The remaining 50% of City is owned by the wife of Mr. Yang.

**4. Bank Facilities**

The Company has entered into a series of credit facilities and debt arrangements in connection with the above-referenced related party transactions with a group of banks in Hong Kong comprised of Dah Sing Bank Limited, DBS Bank (Hong Kong) Ltd. (formerly Overseas Trust Bank Limited), Standard Chartered Bank (Hong Kong) Limited, The Bank of East Asia Ltd., Citic Ka Wah Bank Limited and Hang Seng Bank Limited. The Company has pledged all of its assets as collateral to secure its current and future borrowings under these facilities including specifically: by:

- (i) a fixed cash deposit of \$769,231 (HK\$6,000,000) as collateral for loans from Dah Sing Bank Limited;
- (ii) a fixed cash deposit of \$641,025 (HK\$5,000,000), a security interest in two residential properties and facility located in Hong Kong owned by Atlantic, and a security interest in residential property located in Hong Kong owned by City Royal Limited, a related party, as collateral for loans from DBS Bank (Hong Kong) Ltd;

- (iii) a fixed cash deposit of \$1,298,321 (HK\$10,126,901), plus an unlimited personal guarantee by Mr. Yang , as collateral for loans from The Bank of East Asia, Limited;
- (iv) a fixed cash deposit of \$676,923 (HK\$5,280,000), a security interest in a facility located in Hong Kong purchased from Systematic Information, a related party; a security interest in a facility located in Hong Kong owned by Solution, a related party; plus an unlimited personal guarantee by Mr. Yang as collateral for loans from Standard Chartered Bank (Hong Kong) Limited;
- (v) a fixed cash deposit of \$700,000 (HK\$5,460,000), a security interest in a facility located in Hong Kong owned by Solution, a related party, plus a personal guarantee by Mr. Yang as collateral for loans from Citic Ka Wah Bank Limited; and
- (vi) a cash deposit/securities not less than \$769,231 (HK\$6,000,000) plus unlimited personal guarantee by Mr. Yang as collateral for loans from Hang Seng Bank Limited.

**5. Economic Dependence**

The Company's distribution operations are dependent on the availability of an adequate supply of electronic components under the "Samsung" brand name which have historically been principally supplied to the Company by Samsung Electronics H.K. Co., Ltd. ("Samsung HK"), a subsidiary of Samsung Electronics Co., Ltd., a Korean public company. Samsung HK supplied approximately 72% and 67% of materials to the Company for the six months ended June 30, 2007 and 2006, respectively. However, there is no written supply contract between the Company and Samsung HK and, accordingly, there is no assurance that Samsung HK will continue to supply sufficient electronic components to the Company on terms and prices acceptable to the Company or in volumes sufficient to meet the Company's current and anticipated demand, nor can assurance be given that the Company would be able to secure sufficient products from other third party supplier(s) on acceptable terms. In addition, the Company's operations and business viability are to a large extent dependent on the provision of management services and financial support by Mr. Yang.

For the three months ended June 30, 2007 and 2006, and the six months ended June 30, 2007 and 2006, the Company purchased \$23,777,908, \$14,258,149, \$47,585,487 and \$35,368,944, respectively, of components from Samsung HK. At June 30, 2007 and December 31, 2006, the Company's accounts payable, net of rebate receivable, due from Samsung totaled \$6,652,739 and \$2,545,866, respectively.

**6. Segment Reporting**

The Company's sales are generated from Hong Kong and the rest of China and substantially all of its assets are located in Hong Kong.

**7. Stock Option Plan**

Under the Company's 2006 Incentive Equity Stock Plan (the "Plan"), the Company may grant options to its employees for up to 5 million shares of common stock. The exercise price of each option should not be less than the market price of the Company's stock on the date of grant and an option's maximum term is ten years from the date of grant. Except in the case of options granted to Officers, Directors and Consultants or as otherwise provided in the relevant option agreement and approved by the Board, options granted under the Plan shall become exercisable at a rate of no less than 20% per year over five (5) years from the date the options are granted. The weighted average estimated fair value of stock options granted during 2006 was \$0.064 per share. On May 16, 2006, the Company granted a total of 2,000,000 options to three employees. The options were vested immediately and their fair value of \$128,122 was expensed during the three months ended June 30, 2006. The fair value of the options was estimated using the Black-Scholes valuation method, assuming a dividend yield of zero, a volatility factor of 115%, risk-free interest rates prevailing at the option grant dates which was approximately 3.75%, and expected option life was 0.6 year. A summary of the status of the Company's fixed stock option plan as of June 30, 2007, and changes during the years ending on those dates is presented below:

	Number of Shares	Weighted Average Exercise Price
Outstanding at December 31, 2006	2,000,000	\$ 0.22
Granted	-	-
Exercised	-	-
Cancelled	-	-
Outstanding at June 30, 2007	2,000,000	\$ 0.22
Options exercisable at December 31, 2006	-	\$ N/A
Options exercisable at June 30, 2007	-	\$ N/A

The following tables summarize information about fixed stock options outstanding and exercisable at June 30, 2007:

#### Stock Options Outstanding

<u>Range of Exercise Prices</u>	Number of Shares <u>Outstanding</u>	Weighted Average Remaining Contractual <u>Life in Years</u>	Weighted Average <u>Exercise Price</u>
\$0.22	2,000,000	9.0	\$0.22

#### Stock Options Exercisable

<u>Range of Exercise Prices</u>	Number of Shares <u>Exercisable</u>	Weighted Average <u>Exercise Price</u>
\$0.22	-	N/A

## 8. Recently Issued Accounting Pronouncements

In September 2006, the SEC released Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB 108 provides interpretive guidance on the SEC's views regarding the process of quantifying materiality of financial statement misstatements. SAB 108 is effective for fiscal years ending after November 15, 2006, with early application for the first interim period ending after November 15, 2006. The Company does not expect the adoption of SAB 108 will have a material impact on its financial position or results of operations.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is evaluating the impact of this new pronouncement to its financial position and results of operations or cash flows.

In September 2006, the FASB issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)." SFAS 158 requires companies to recognize the overfunded or underfunded status of a defined benefit post-retirement plan as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the

changes occur through comprehensive income, effective for fiscal years ending after December 15, 2006. SFAS 158 also requires companies to measure the funded status of the plan as of the date of its fiscal year-end, with

limited exceptions, effective for fiscal years ending after December 15, 2008. The Company does not expect the adoption of SFAS 158 will have a material impact on our financial position or results of operations, as the Company does not currently have any defined benefit pension or other post-retirement plans.

**9. PURCHASES OF REAL ESTATE PROPERTY FROM SYSTEMATIC**

On June 15, 2007, the Company purchased principally for investment purposes, an apartment that had been previously leased by the Company from Systematic as a residence of Mr. Alan Yang, for a purchase price of \$2,996,869 including certain closing costs of \$112,254. The purchase price for the property was based on the appraised value thereof made by an independent appraiser immediately prior to the closing of the sale. The Company believes the appraised value of this property represented the fair value of this property at the time of the transaction.

**10. Reclassification**

Certain reclassifications have been made to the 2006 consolidated financial statements to conform to the 2007 presentation.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Overview**

**Corporate Background**

The Company, through its wholly-owned subsidiary Atlantic is engaged primarily in the business of distribution of memory products under "Samsung" brandname which principally comprise DRAM and Graphic RAM, FLASH, SRAM and MASK ROM for the Hong Kong and Southern China markets. The Company's wholly-owned subsidiary, Alpha Perform Technology Limited ("Alpha"), which previously engaged in this business, ceased activities as of January 1, 2004, when its operations were consolidated with those of Atlantic.

As of June 30, 2007, ACL had more than 120 active customers in Hong Kong and Southern China.

ACL is in the mature stage of operations. As a result, the relationships between sales, cost of sales, and operating expenses reflected in the financial information included in this document to a large extent represent future expected financial relationships. Much of the cost of sales and operating expenses reflected in our financial statements are recurring in nature.

**Critical Accounting Policies**

The U.S. Securities and Exchange Commission ("SEC") recently issued Financial Reporting Release No. 60, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies" ("FRR 60"), suggesting companies provide additional disclosure and commentary on their most critical accounting policies. In FRR 60, the SEC defined the most critical accounting policies as the ones that are most important to the portrayal of a company's financial condition and operating results, and require management to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, ACL's most critical accounting policies include: inventory valuation, which affects cost of sales and gross margin; policies for revenue recognition, allowance for doubtful accounts, and stock-based



compensation. The methods, estimates and judgments ACL uses in applying these most critical accounting policies have a significant impact on the results ACL reports in its consolidated financial statements.

*Inventory Valuation.* Our policy is to value inventories at the lower of cost or market on a part-by-part basis. This policy requires us to make estimates regarding the market value of our inventories, including an assessment of excess or obsolete inventories. We determine excess and obsolete inventories based on an estimate of the future demand for our products within a specified time horizon, generally 12 months. The estimates we use for demand are also used for near-term capacity planning and inventory purchasing and are consistent with our revenue forecasts. If our demand forecast is greater than our actual demand we may be required to take additional excess inventory charges, which will decrease gross margin and net operating results in the future.

*Allowance for Doubtful Accounts.* ACL maintains an allowance for doubtful accounts for estimated losses resulting from the inability of ACL's customers to make required payments. ACL's allowance for doubtful accounts is based on ACL's assessment of the collectibility of specific customer accounts, the aging of accounts receivable, ACL's history of bad debts, and the general condition of the industry. If a major customer's credit worthiness deteriorates, or ACL's customers' actual defaults exceed ACL's historical experience, ACL's estimates could change and impact ACL's reported results.

### Contractual Obligations

The following table presents the Company's contractual obligations as of June 30, 2007 over the next five years and thereafter:

	Payments by Period				
	<u>Amount</u>	<u>Less Than 1 Year</u>	<u>1-3 Years</u>	<u>4-5 Years</u>	<u>After 5 Years</u>
Operating Leases	111,581	66,308	45,273	---	---
Line of credit and notes payable □ short-term	14,293,417	14,293,417	---	---	---
Short Term Loan	53,284	53,284	---	---	---
Long Term Loan	2,812,682	154,399	317,652	257,309	2,083,322
Total Contractual Obligations	\$ 17,270,964	\$ 14,567,408	\$ 362,925	\$ 257,309	\$ 2,083,322

### Accounting Principles; Anticipated Effect of Growth

Below is a brief description of basic accounting principles which the Company has adopted in determining its recognition of sales and expenses, as well as a brief description of the effects that the Company believes its anticipated growth will have on the Company's sales and expenses in the next 12 months.

#### Net sales

Sales from Samsung HK are recognized upon the transfer of legal title of the electronic components to the customers. The quantities of memory products the Company sells fluctuate with changes in demand from its customers. The prices set by Samsung HK that the Company must charge its customers are expected to fluctuate as a result of prevailing economic conditions and their impact on the market.

#### Cost of sales

Cost of sales consists of costs of goods purchased from Samsung HK, and purchases from other Samsung authorized distributors. Many factors affect the Company's gross margin, including, but not limited to, the



volume of production orders placed on behalf of its customers, the competitiveness of the memory products industry and the availability of cheaper Samsung memory products from overseas Samsung distributors due to regional demand and supply situations. Nevertheless, the Company's procurement operations are supported by Samsung HK, although there is no written long-term supply agreement in place between Atlantic and Samsung HK.

For the three months ended June 30, 2007, the Company realized net sales of US\$31.7 million, an increase of approximately 51% over net sales for the three month's ended June 30, 2006. The Company's gross profit for the three months ended June 30, 2007 was US\$510,334, representing 1.6% of net sales for such period.

The Company's net sales are derived approximately 50% from the sale of Flash memory products and approximately 50% from the sale of DRAM memory products. The Flash business includes the finished Flash card, a new Samsung product, the Flash component and the Flash wafer. The Flash business has undergone significant change as a result of the introduction in 4th quarter of 2006 of the finished Flash cards to the market. Many medium- and small-sized manufacturers of Flash cards, which purchase a significant percentage of Flash components, were negatively impacted by both a supply shortage of Flash components as well as the pricing of finished Flash cards from major suppliers such as Samsung, Toshiba and Transcend. As a result, some companies have changed from being manufacturers to become traders of Flash cards. Other companies, in an effort to further reduce costs, have been seeking to purchase Flash wafers from us to manufacture their own Flash components. Previously, we sold the finished products of Samsung such as Flash Card and Flash components. Since there has been an insufficient supply of those two products, we have included Flash wafers into our portfolio. As a result, we believe we have a more balanced product portfolio among Flash cards, Flash components and Flash wafers and have access to sufficient supply to meet the challenge of the continuing shortage of Flash components. The Company's net sales derived from sales of DRAM memory products during the three months ended June 30, 2007 decreased as a result of decreases in the market price for DDR2. While sales of DRAM chips during the three months ended June 30, 2007 hit a record high, net sales therefrom increased only slightly as a result of the decreased unit price. The price of Flash components has decreased steadily since the three month period ending December 31, 2006 through March 31, 2007. During this period, several Flash product manufacturers shifted their operations to manufacture DRAM rather than Flash products which, in turn, resulted in an over-supply of DRAM products on the market in the quarter ending June 30, 2007.

The three months ending June 30 are traditionally slower than other quarters. During this quarter, the Company increased its efforts to enlarge its market share and presence, especially in the mainland China market. During the three months ended June 30, 2007, the Company began marketing Samsung products to several 1st tier manufacturers in China, including Ramaxel, the largest subcontractor for Lenovo's module production, Konka Electronics, a television manufacturer; Coship, a manufacturer of set-top boxes and GPS systems, MTC Multimedia, a manufacturer of multimedia products and Netcom, a flash card manufacturer. While no written agreements have been entered, the Company hopes these new relationships will result in a significant increase in future orders for memory products.

#### *Operating expenses*

The Company's operating expenses for the three months ended June 30, 2007 and 2006 were comprised of sales and marketing and general and administrative expenses only.

Sales and marketing expenses consisted primarily of and external commissions paid to external sales personnel and costs associated with advertising and marketing activities.

General and administrative expenses include all corporate and administrative functions that serve to support the Company's current and future operations and provide an infrastructure to support future growth. Major items in this category include management and staff salaries, rent/leases, professional services, and travel and entertainment. The Company expects these expenses to increase as a result of increased legal and accounting fees anticipated in connection with the Company's compliance with ongoing reporting and accounting requirements of the Securities and Exchange Commission and as a result of anticipated expansion by the

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Company of its business operations. Sales and marketing expenses are expected to fluctuate as a percentage of sales due to the addition of sales personnel and various marketing activities planned throughout the year.

Interest expense, including finance charges, relates primarily to Atlantic's short-term and long-term bank borrowings, which the Company intends to reduce.

### *Results of Operations*

The following table sets forth unaudited statements of operations data for the three months ended June 30, 2007 and 2006 and should be read in conjunction with the "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's financial statements and the related notes appearing elsewhere in this document.

	Three Months Ended <u>June 30, 2007</u>	Three Months Ended <u>June 30, 2006</u>	Six Months Ended <u>June 30, 2007</u>	Six Months Ended <u>June 30, 2006</u>
	(Unaudited)			
Net Sales	100%	100%	100%	100%
Cost of sales	98.39%	96.60%	97.81%	96.39%
Gross Profit	1.61%	3.40%	2.19%	3.61%
Operating expenses:				
Selling	0.05%	0.71%	0.05%	0.79%
General and administrative	1.95%	2.42%	1.91%	2.10%
Total operating expenses	2.00%	3.13%	1.96%	2.89%
Income (loss) from operations	-0.39%	0.27%	0.23%	0.72%
Other expenses:				
Interest expenses	-0.77%	-0.67%	-0.74%	-0.64%
Miscellaneous	0.73%	0.11%	0.43%	-0.10%
Income (loss) before income taxes	-0.43%	-0.29%	-0.08%	0.18%
Income taxes expenses (benefits)	0.13%	0.09%	0.09%	0.11%
Net income (loss)	-0.56%	-0.38%	-0.17%	0.70%

### **Unaudited Three Months Ended June 30, 2007 Compared to the Three Months Ended June 30, 2006**

#### *Net sales*

Sales increased by \$10,687,621 or 50.8% from \$21,043,863 in the three months ended June 30, 2006 to \$31,731,484 in the three months ended June 30, 2007. The increase was mainly due to increased sales to OEM factories in Hong Kong and South China areas, resulting in a higher turnover when compared to the three months ended March 31, 2006.

#### *Cost of sales*

Cost of sales increased by \$10,893,170, or 53.6%, from \$20,327,980 for the three months ended June 30, 2006 to \$31,221,150 for the three months ended June 30, 2007. The increase in cost of sales was principally

attributable to the increase in net sales stated above. As a percentage of sales, cost of sales increased to 98.4% of

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sales in the three months ended June 30, 2007 from 96.6% of sales in the three months ended June 30, 2006, which is principally attributable to Samsung's reduction of its commission from 2.4% to 1.8%, a 25% decrease which has affected the company's profitability.

### *Gross profit*

Gross profit decreased by \$205,549 or 28.7%, from \$715,883 for the three months ended June 30, 2006 to \$510,334 for the three months ended June 30, 2007. The decrease in gross profits resulted primarily from the decrease in gross profit margin to 1.6% of sales in the three months ended June 30, 2007 compared to 3.4% of sales in the three months ended June 30, 2006, as a result of Samsung HK's reduction of the sales commission it pays its agents by 0.6%, with effect from the first quarter of 2007.

### *Operating expenses*

Sales and marketing expenses decreased by \$133,265 or 89.2%, from \$149,477 for the three months ended June 30, 2006 to \$16,212 for the three months ended June 30, 2007. This decrease was principally attributable to the decreased sales commission expenses incurred for the second quarter of 2007.

General and administrative expenses increased \$108,622 or 21.3% from \$509,486 in the three months ended June 30, 2006 to \$618,108 in the three months ended June 30, 2007. This increase was principally attributable to an increase in depreciation, director's remuneration and salary expenses.

Loss from operations for the Company was \$123,986 for the three months ended June 30, 2007 compared to income of \$56,920 for the three months ended June 30, 2006, representing a decrease of income by \$180,906 or 317.8%. This decrease was the result of the decrease in gross profit during the second quarter of 2007.

### *Other income (expenses)*

Interest expense increased by \$102,607 or 73.1%, from \$140,323 in the three months ended June 30, 2006, to \$242,930 in the three months ended June 30, 2007. This increase was mainly due to an increase in the Company's need to open and draw down on letters of credits to obtain goods from its suppliers. We expect our interest expense will increase significantly in 2007 because of an increase in bank lines of credit and loan facilities.

Unrealized profits increased by \$154,704 from \$0 in the three months ended June 30, 2006, to \$154,704 in the three months ended June 30, 2007. This increase was mainly attributable to the increase in the market value as of June 30, 2007 over the cost of purchase of certain securities pledged by the Company in favor of Hang Seng Bank Limited (see Note 4).

The Company's net loss increased by \$95,277 or 120.4% from \$79,121 for the three months ended June 30, 2006 to \$174,398 for the three months ended June 30, 2007, primarily due to the decrease in gross profit during the second quarter of 2007.

### *Income tax*

Income tax increased by \$20,313 or 102.9% from \$19,740 for the three months ended June 30, 2007 to \$40,053 for the three months ended June 30, 2007, primarily due to the underprovision for taxes for 2006 which was recorded in the second quarter of 2007.

## **Liquidity and capital resources**

The Company's principal sources of liquidity have historically been cash provided by operations, bank lines of credit and credit terms from suppliers. The Company's principal uses of cash have been for operations



and working capital. The Company anticipates these uses will continue to be its principal uses of cash in the future.

The Company may require additional financing in order to finance its growing business and implement its business plan. In order to meet anticipated demand for Samsung's memory products in the Southern China market, the Company has borrowed \$1.7 million in short-term borrowings from banks to finance the cash flow required to finance the purchase of Samsung memory products from Samsung HK one day in advance of the release of goods from Samsung HK's warehouse before receiving payments from customers upon physical delivery of such goods in Hong Kong which, in most instances, takes approximately two days from the date of such delivery. In certain limited instances, customers of Atlantic are permitted up to thirty (30) days to make payment for purchased memory products. As the anticipated cash generated by the Company's operations are insufficient to fund its growth requirements, it will need to obtain additional funds. There can be no assurance that the Company will be able to obtain the necessary additional capital on a timely basis or on acceptable terms, if at all. The Company's business growth and prospects would be materially and adversely affected. As a result of any such financing, if it is an equity financing, the holders of the Company's common stock may experience substantial dilution. In addition, as its results may be negatively impacted and thus delayed as a result of political and economic factors beyond the management's control, the Company's capital requirements may increase.

The following factors, among others, could cause actual results to differ from those expected caused by: pricing pressures in the industry; a downturn in the economy in general or in the memory products sector; an unexpected decrease in demand for Samsung's memory products; a decrease in its ability to attract new customers; an increase in competition in the memory products market; and the ability our customers to obtain financing. These factors or additional risks and uncertainties not known to ACL or that it currently deems immaterial may impair business operations and may cause ACL's actual results to differ materially from any forward-looking statement.

Although we believe our expectations of future growth are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are under no duty to update its expectation after the date of this report to conform them to actual results or to reflect changes in expectations.

In the six months ended June 30, 2007, net cash provided by operating activities was \$1,401,834 while in the six months ended June 30, 2006, ACL used net cash of \$1,858,803 in operating activities, an increase of \$3,260,637. This increase was primarily due to an increase of accounts payable as of June 30, 2007.

In the six months ended June 30, 2007, net cash used for investing activities was \$6,236,323, while in the six months ended June 30, 2006, ACL used \$631,316 for investing activities, an increase in cash used of \$5,605,007. This increase was primarily due to an increase in the cash and securities held by the bank group from which the Company borrows money, as collateral for such borrowings as well as the piece of real estate property owned by the Company (see Note 9).

In the six months ended June 30, 2007, net cash provided by financing activities was \$4,229,291 while in the six months ended June 30, 2006, net cash provided by financing activities was \$1,241,556 an increase of \$2,987,735. This increase was due to an increase in the Company's borrowings under bank lines of credit and long-term loans.

An essential element of the Company's growth in the future will be to obtain adequate additional working capital to meet anticipated market demand in the southern part of China.

### **ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

ACL is exposed to market risk for changes in interest rates as its bank borrowings accrue interest at floating rates of 0.25% to 0.5% over the Best Lending Rate (currently at the range of 8.0 to 8.25% per annum) prevailing in Hong Kong. For the six months ended June 30, 2007 and the six months ended June 30, 2006,



Atlantic did not generate any material interest income (expense). Accordingly, ACL believes that changes in interest rates will not have a material effect on its liquidity, financial condition or results of operations.

***Impact of Inflation***

ACL believes that its results of operations are not significantly impacted by moderate changes in inflation rates as it expects it will be able to pass these costs by component price increases to its customers.

**Seasonality**

ACL has not experienced any material seasonality in sales fluctuations over the past 2 years in the memory products markets.

**ITEM 4. CONTROLS AND PROCEDURES**

We maintain a set of disclosure controls and procedures designed to reasonably assure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission ("SEC") rules and forms. Disclosure controls are also designed to reasonably assure that information required to be disclosed is accumulated and communicated to our management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). The evaluation of our disclosure controls performed by our CEO and CFO included obtaining an understanding of the design and objective of the controls, the implementation of those controls and the results of the controls on this report on Form 10-Q. In the course of the evaluation of disclosure controls, we reviewed the controls that are in place to record, process, summarize and report, on a timely basis, matters that require disclosure in our reports filed under the Securities Exchange Act of 1934. We also considered the adequacy of the items disclosed in this report on Form 10-Q.

As of the date of the financial statements, an evaluation was carried out under the supervision and with the participation of our management, including the CEO and CFO, of the effectiveness of our disclosure controls and procedures. Based on that evaluation the CEO and the CFO concluded that as of June 30, 2007 our disclosure controls and procedures were effective at the reasonable assurance level in ensuring that all information required to be disclosed in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and that such information is accumulated and communicated to our management, including our CEO and CFO, in a manner that allows timely decisions regarding required disclosure.

We have also reviewed changes in our internal control over financial reporting during the most recent fiscal quarter, and our CEO and CFO have concluded that there have been no changes that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II**

ITEM 6. EXHIBITS AND REPORTS ON FORM 10-Q

(a) Exhibits:

- |      |   |
|------|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 32.1 | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification by Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

(b) Reports on Form 8-K.

No Reports on Form 8-K were filed during the three months ended June 30, 2007 except for:

1. Form 8-K/A filed January 23, 2007 relating to items 4.01 and 4.02 7.
2. Form 8-K/A filed Januar 24, 2007, relating to item 4.01 and 4.02.

**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ACL SEMICONDUCTORS INC.

Date: August 14, 2007

By: /s/Chung-Lun Yang  
Chung-Lun Yang  
Chief Executive Officer

Date: August 14, 2007

By: /s/ Kenneth Lap-Yin Chan  
Kenneth Lap-Yin Chan  
Chief Financial Officer