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ACL SEMICONDUCTOR INC  
Form 10-Q  
August 14, 2006

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, 2006.

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

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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)

(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 Exchange Act 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 non-accelerated filer.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the voting common equity held by non-affiliates of the registrant as of June 30, 2006 was approximately \$653,992 based upon the closing price of \$0.12 of the registrant's common stock on the OTC Bulletin Board, as of the last business day of the most recently completed second fiscal

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quarter (June 30, 2006). (For purposes of determining this amount, only directors, executive officers, and 10% or greater stockholders have been deemed affiliates).

Registrant had 27,829,936 shares of common stock, par value \$0.001 per share, outstanding as of August 10, 2006.

Transitional small business disclosure format (check one) Yes [ ] No [X]

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#### ITEM 1. FINANCIAL STATEMENTS.

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

##### ASSETS

As of June 30, 2006 (Unaudited)	As of December 31, 2005
-----	-----

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CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,289,236	\$ 2,537,799
Restricted cash	1,410,256	769,231
Accounts receivable, net of allowance for doubtful accounts of \$0 for 2006 and 2005	489,695	515,557
Accounts receivable, related parties	4,610,498	2,175,737
Inventories, net of reserve of \$174,359 for 2006 and \$141,026 for 2005	2,111,095	1,087,752
Refundable deposits	--	1,000,000
Other current assets	423,204	263,300
	-----	-----
Total current assets	10,333,984	8,349,376
PROPERTY, EQUIPMENT AND IMPROVEMENTS, net of accumulated depreciation and amortization	92,140	102,037
OTHER DEPOSITS	380,939	381,044
	-----	-----
	\$10,807,063	\$ 8,832,457
	=====	=====

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

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ACL SEMICONDUCTORS INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)

LIABILITIES AND STOCKHOLDERS' EQUITY

	As of June 30, 2006 (Unaudited)	As of December 31, 2005
	-----	-----
CURRENT LIABILITIES:		
Accounts payable	\$ 4,474,560	\$ 4,495,819
Accounts payable, related party	736,809	--
Accrued expenses	206,092	272,782
Lines of credit and notes payable	4,083,841	2,842,285
Payable related to debt settlement	--	76,088
Due to stockholders for converted pledged collateral	112,385	112,385
Income tax payable	240,185	217,453
Other current liabilities	13,852	55,019
	-----	-----
Total current liabilities	9,867,724	8,071,831
	-----	-----
Total liabilities	9,867,724	8,071,831

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COMMITMENTS AND CONTINGENCIES	--	--
STOCKHOLDERS' EQUITY:		
Common stock - \$0.001 par value, 50,000,000 shares authorized, 27,829,936 issued and outstanding	27,830	27,830
Additional paid in capital	3,488,527	3,360,405
Amount due from stockholder/director	(87,002)	(102,936)
Accumulated deficit	(2,490,016)	(2,524,673)
	-----	-----
Total stockholders' equity	939,339	760,626
	-----	-----
	\$ 10,807,063	\$ 8,832,457
	=====	=====

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

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ACL SEMICONDUCTORS INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	THREE MONTHS ENDED		
	JUNE 30, 2006	JUNE 30, 2005	
	-----	-----	-----
NET SALES:			
Related parties	\$ 5,577,040	\$ 7,882,140	
Other	15,468,906	18,674,004	3
Less discounts to customers	(2,083)	(55,530)	
	-----	-----	-----
	21,043,863	26,500,614	4
COST OF SALES	20,327,980	26,250,016	4
	-----	-----	-----
GROSS PROFIT	715,883	250,598	
OPERATING EXPENSES:			
Selling	149,477	100,177	
General and administrative	509,486	456,764	
	-----	-----	-----
INCOME (LOSS) FROM OPERATIONS	56,920	(306,343)	
OTHER INCOME (EXPENSES):			
Interest expense	(140,323)	(46,022)	
Miscellaneous	24,021	(1,815)	

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INCOME (LOSS) BEFORE INCOME TAXES	(59,382)	(354,180)	
INCOME TAXES	19,740	(56,815)	
NET INCOME (LOSS)	\$ (79,122)	\$ (297,365)	\$
EARNINGS (LOSS) PER SHARE - BASIC AND DILUTED	\$ (0.00)	\$ (0.01)	\$
WEIGHTED AVERAGE NUMBER OF SHARES - BASIC AND DILUTED	27,829,936	27,829,936	2

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

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

	Six Months Ended	
	June 30, 2006	June 30, 2005
CASH FLOWS PROVIDED BY (USED FOR) OPERATING ACTIVITIES:		
Net income (loss)	\$ 34,657	\$ (106,473)
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES:		
Depreciation and amortization	16,122	12,815
Bad debts	--	6,200
Change in inventory reserve	33,333	64,102
Fair value of options issued to employees	128,122	--
CHANGES IN ASSETS AND LIABILITIES:		
(INCREASE) DECREASE IN ASSETS		
Accounts receivable - other	25,862	(545,701)
Accounts receivable - related parties	(697,953)	1,477,740
Inventories	(1,056,676)	(603,310)
Other deposits	105	--
Other current assets	(159,904)	(20,404)
INCREASE (DECREASE) IN LIABILITIES		
Accounts payable	(21,259)	310,848
Accrued expenses	(66,689)	(169,509)
Payable related to debt settlement	(76,088)	--

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Income tax payable	22,732	(20,431)
Other current liabilities	(41,167)	7,627
	-----	-----
Total adjustments	(1,893,460)	519,977
	-----	-----
Net cash (used for) provided by operating activities	(1,858,803)	413,504
	-----	-----

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

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

	Six Months Ended	
	June 30, 2006	June 30, 2005
	-----	-----
CASH FLOWS PROVIDED BY (USED FOR) INVESTING ACTIVITIES:		
Repayments from stockholders	15,934	4,298
Increase of restricted cash	(641,025)	(1,025,641)
Loan repayments by related party	--	611,446
Repayments from related party	--	30,000
Purchases of property, equipment and improvements	(6,225)	(9,172)
	-----	-----
Net cash used for investing activities	(631,316)	(389,069)
	-----	-----
CASH FLOWS PROVIDED BY (USED FOR) FINANCING ACTIVITIES:		
Proceeds on lines of credit and notes payable	1,241,556	68,127
Principal payments on long-term debt	--	(104,295)
Loan received from related parties	--	414,195
Repayments to related party	--	(86,276)
	-----	-----
Net cash provided by financing activities	1,241,556	291,751
	-----	-----
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,248,563)	316,186
CASH AND CASH EQUIVALENTS, beginning of the period	2,537,799	512,548
	-----	-----
CASH AND CASH EQUIVALENTS, end of the period	\$ 1,289,236	\$ 828,734
	=====	=====

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

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Interest paid	\$ 295,155	\$ 43,210
	=====	=====
Income tax paid	\$ 20,089	\$ 29,930
	=====	=====
Increase of accounts receivable-related parties through return of acquisition deposits	\$ 1,000,000	\$ --
	=====	=====

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

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

1. BASIS OF PRESENTATION AND NATURE OF BUSINESS OPERATIONS

BASIS OF PRESENTATION

The condensed consolidated financial statements include the financial statements of ACL Semiconductors Inc. and its subsidiaries, Atlantic Components Ltd. 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 for the fiscal years ended December 31, 2005, 2004 and 2003 filed in the Form 10-K filed by the Company on April 17, 2006. 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, 2006 and December 31, 2005, and the results of operations for the three-month and six-month periods ended June 30, 2006 and 2005 and the cash flows for the six-month periods ended June 30, 2006 and 2005. The results of operations for the six months ended June 30, 2006 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.

On April 13, 2006, the Company entered into a Rescission Agreement with the seller of Classic Electronics Ltd. ("Classic") to rescind the original Stock Purchase Agreement entered on December 30, 2005. The seller agreed to fully refund the acquisition deposits of \$1.0 million during 2006.

The acquisition deposit of \$1 million was reclassified to increase the accounts receivable from Classic as the original deposit amount was recorded to offset the accounts receivable from Classic. Due to the termination of the acquisition, the original entry was reversed in the accompanying condensed balance sheets as of June 30, 2006.

NATURE OF BUSINESS OPERATIONS

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ACL Semiconductors Inc. ("Company" or "ACL") was incorporated under the State of Delaware on September 17, 2002. Through a reverse-acquisition of Atlantic Components Ltd., a Hong Kong based company, effective September 30, 2003, the Company's principal activity is the 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 Components Ltd., its wholly-owned subsidiary, 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 provided for in the same periods the related revenue is recorded which are deducted from the gross sales.

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### 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, which accounted for most of the Company's operations, is reported in Hong Kong dollars ("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 Hong Kong Special Administrative Region, China.

### 2. EARNINGS (LOSS) 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. For the six months ended June 30, 2006 and 2005, the Company had 2,000,000 and 2,121,641 shares, respectively, of common stock equivalents at the end of each reporting periods.

### 3. RELATED PARTY TRANSACTIONS

#### TRANSACTIONS WITH MR. YANG

As of June 30, 2006 and December 31, 2005, the Company had an outstanding receivable from Mr. Yang, the President and Chairman of our Board of Directors, totaling \$87,002 and \$102,936 representing advanced compensation paid. These balances bear no interest and are payable on demand.



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For the three months ended June 30, 2006 and 2005, the Company recorded and paid \$50,000 and \$50,000, respectively, to Mr. Yang, and for the six months ended June 30, 2006 and 2005, the Company recorded and paid \$100,000 and \$126,923, respectively, to Mr. Yang as compensation.

During the three months ended June 30, 2006 and 2005, and six months ended June 30, 2006 and 2005, the Company paid rent of \$23,077, \$23,077, \$46,153 and \$46,153, respectively, for Mr. Yang's personal residency as additional compensation.

### TRANSACTIONS WITH CLASSIC ELECTRONICS LTD.

During the three months ended June 30, 2006 and 2005, and six months ended June 30, 2006 and 2005, the Company sold \$0, \$5,528,522, \$0 and \$16,758,892, respectively, of memory products to Classic Electronics Ltd. ("Classic"). During the three months ended June 30, 2006 and 2005, and six months ended June 30, 2006 and 2005, the Company purchased Samsung memory products sourced from other authorized distributors of \$0, \$2,702,305, \$0 and \$3,765,066, respectively, from Classic to satisfy part of its product shortage from Samsung HK. The Company had outstanding accounts receivable from Classic totaling \$4,224,882 and \$2,175,737, respectively, as of June 30, 2006 and December 31, 2005. The Company has not experienced any bad debt from this customer in the past. Pursuant to a written personal guarantee agreement, Mr. Yang personally guarantees all the outstanding accounts receivable from Classic up to \$10 million.

The Company leased one of its facilities and Mr. Yang's personal residency from Classic. Lease agreements for the facility expire on November 30, 2006 while the lease agreement for Mr. Yang's personal residency expires on

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March 31, 2008. Monthly lease payments for these 2 leases total \$6,684. The Company incurred and paid rent expense of ACL of \$20,053, \$21,028, 40,106 and \$43,143 to Classic during the three months ended June 30, 2006 and 2005 and the six months ended June 30, 2006 and 2005, respectively.

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

### TRANSACTIONS WITH KADATCO COMPANY LTD.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company recognized revenues of \$0, \$2,330,574, \$0 and \$2,472,194 from the sale of memory products to Katatco Company Ltd. ("Katatco"). There were no outstanding accounts receivable due from Katatco as of June 30, 2006 and December 31, 2005. The Company has not experienced any bad debt from this customer in the past.

Mr. Yang is the sole beneficial owner of the equity interest of Katatco.

### TRANSACTIONS WITH RAMBO TECHNOLOGIES LTD.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company sold \$0, \$85, \$0 and \$165,225, respectively, to Rambo Technologies Ltd. ("Rambo"). There were no outstanding accounts receivable due from Rambo as of June 30, 2006 and December 31, 2005. The Company has not experienced any bad debt from this customer in the past.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company purchased \$0, \$451,804, \$0 and \$557,845,

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respectively, from Rambo. There were no outstanding accounts payable due to Rambo as of June 30, 2006 and December 31, 2005.

Mr. Ben Wong, a director of the Company, is a 60% shareholder of Rambo. The remaining 40% of Rambo is owned by a non-related party. Mr. Yang is a director of Rambo.

### TRANSACTIONS WITH ARISTO TECHNOLOGIES LTD.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company sold \$2,651,052, \$0, \$2,651,052 and \$0, respectively, to Aristo Technologies Ltd. ("Aristo"). Outstanding accounts receivable totaled \$474,109 and \$0 as of June 30, 2006 and December 31, 2005 respectively. The Company has not experienced any bad debt from this customer in the past.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company purchased \$288,552, \$0, \$288,552 and \$0, respectively, from Aristo. Outstanding accounts payable totaled \$88,493 and \$0 as of June 30, 2006 and December 31, 2005 respectively. Net accounts receivable totaled \$385,616 and \$0, as of June 30, 2006 and December 31, 2005.

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

### TRANSACTIONS WITH ATLANTIC NETCOM LTD.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company sold \$0, \$0, \$0 and \$1,652, respectively, to Atlantic Netcom Ltd. ("Atlantic Netcom"). Outstanding accounts receivable totaled \$0 as of June 30, 2006 and December 31, 2005, respectively. The Company has not experienced any bad debt from this customer in the past.

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Mr. Alan Yang, the Company's Chief Executive Officer, majority shareholder and a director, is a 60% shareholder and director of Atlantic Netcom. The remaining 40% of Atlantic Netcom is owned by a non-related party.

### TRANSACTIONS WITH SOLUTION SEMICONDUCTOR (CHINA) LTD

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company sold \$0, \$21,772 \$0 and \$55,112, respectively, to Solution Semiconductor (China) Ltd. ("Solution"). Outstanding accounts receivable totaled \$0 as of June 30, 2006 and December 31, 2005. The Company has not experienced any bad debt from this customer in the past.

During the three months ended June 30, 2006 and 2005 and the six months ended June 30, 2006 and 2005, the Company purchased \$0, \$21,758, \$0 and \$22,019, respectively, from Solution. There are no outstanding accounts payable due to Solution as of June 30, 2006 and December 31, 2005.

Mr. Ben Wong, a director of the Company, is a 99% shareholder 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, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company sold \$0, \$0, \$0 and \$61,910, respectively, to Systematic Information Ltd. ("Systematic"). There are no outstanding accounts receivable due from Systematic as of June 30, 2006 and December 31, 2005.

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The Company has not experienced any bad debt from this customer in the past.

On April 1, 2005, the Company entered into a lease agreement with Systematic pursuant to which the Company leases one residential property for Mr. Yang's personal use for a monthly lease payment of \$3,205. The lease agreement for this residency expires on March 31, 2008. The Company incurred and paid an aggregate rent expense of \$9,615 to Systematic during the three months ended June 30, 2006 and 2005.

Mr. Alan Yang, the Company's Chief Executive Officer, majority shareholder and a director, is a director and the shareholder of Systematic with a total of 100% interest.

### TRANSACTIONS WITH GLOBAL MEGA DEVELOPMENT LTD.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company sold \$0, \$1,167, \$0 and \$10,417 respectively, and received management fee \$1,923, \$0, 3,846 and \$0, respectively, from Global Mega Development Ltd. ("Global"). There are no outstanding accounts receivable due from Global as of June 30, 2006 and December 31, 2005.

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

### TRANSACTIONS WITH INTELLIGENT NETWORK TECHNOLOGY LTD.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, we received management fee \$1,923, \$0, \$3,846 and \$0, respectively, from Intelligent Network Technology Ltd. ("Intelligent"). There are no outstanding accounts receivable due from Intelligent as of June 30, 2006 and December 31, 2005.

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.

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### TRANSACTIONS WITH SYSTEMATIC SEMICONDUCTOR LTD.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, we received management fee of \$3,846, \$0, \$7,692 and \$0, respectively, from Systematic Semiconductor Ltd. ("Systematic Semiconductor"). There are no outstanding accounts receivable due from Systematic Semiconductor as of June 30, 2006 and December 31, 2005.

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

### TRANSACTIONS WITH TFT TECHNOLOGIES LTD.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, we sold \$0, \$0, \$0 and \$1,460, respectively, to TFT Technologies Ltd. ("TFT"). Outstanding accounts receivable totaled \$0 as of June 30, 2006 and December 31, 2005, respectively. We have not experienced any bad debt from this customer in the past.

Mr. Alan Yang the Company's Chief Executive Officer, majority shareholder and a

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director, is a director and 51% shareholder of TFT. The remaining 49% of TFT is owned by a non-related party.

### TRANSACTIONS WITH FIRST WORLD LOGISTICS LTD.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company sold \$2,925,988, \$0, \$7,094,671 and \$0, respectively, to First World Logistics Ltd. ("First World"). Outstanding accounts receivable totaled \$3,651 and \$0 as of June 30, 2006 and December 31, 2005. The Company has not experienced any bad debt from this customer in the past.

During the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company purchased \$775,260, \$0, \$825,900 and \$0, respectively, from First World. Outstanding accounts payable totaled \$740,460 and \$0 as of June 30, 2006 and December 31, 2005 respectively.

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

### 4. BANK FACILITIES

The Company has certain outstanding revolving lines of credit with Dah Sing Bank Limited and DBS Bank (Hong Kong) Ltd. (collectively, the "Banks"). With respect to the Company's debt and credit arrangements, the Company pledged its assets as collateral collectively to the Banks for all current and future borrowings from the Banks by the Company. Such borrowings are secured by:

1. a fixed cash deposit of \$769,231 (HK\$6,000,000) as collateral for loans from Dah Sing Bank Limited;
2. a fixed cash deposit of \$641,025 (HK\$5,000,000), a security interest on residential property located in Hong Kong owned by Systematic, a related party, and a security interest on residential property located in Hong Kong owned by City Royal Limited, a related party, as collateral for loans from DBS Bank (Hong Kong) Ltd;
3. a personal guarantee given by Mr. Yang for an unlimited amount together with a key man life insurance policy on Mr. Yang for \$500,000, in each case in favor of Dah Sing Bank Limited in respect of borrowings therefrom.

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### 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. The Company purchased approximately 67% and 70% of its materials from Samsung HK for the three months ended June 30, 2006 and 2005, respectively, and 76% and 77% for the six months ended June 30, 2006 and 2005. 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

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is to a large extent dependent on the provision of management services and financial support by Mr. Yang.

The Company is highly dependent on the product supplies from Samsung HK. If the relationship with Samsung HK is terminated, the Company may not be able to continue its business.

For the three months ended June 30, 2006 and 2005, and the six months ended June 30, 2006 and 2005, the Company purchased \$14,258,149, 18,937,732, \$35,368,944 and \$42,843,512, respectively. At June 30, 2006 and December 2005, accounts payable, net of rebates receivable due from Samsung HK, due to Samsung HK were \$2,460,092 and \$2,450,508, 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

The Company has a 2006 Incentive Equity Stock Plan, under which 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. Except in the case of Options granted to Officers, Directors and Consultants or as otherwise provided in the Option Agreement, Options 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 options to purchase an aggregate 2,000,000 shares of Common Stock of the Company to three employees as follows: (i) options to purchase 1,000,000 shares of Common Stock to Mr. Ben Wong, (ii) options to purchase 500,000 shares of Common Stock to Kenneth Chan, and (iii) options to purchase 500,000 shares of Common Stock to May Lau. These options were fully vested upon grant, have an exercise price of \$0.22 per share and are exercisable until May 16, 2016. The fair value of these options aggregating \$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, 2006, and changes during the years ending on those dates is presented below:

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	Number of Shares -----	Weighted Average Exercise Price -----
Outstanding at December 31, 2005	--	\$ --
Granted	2,000,000	0.22
Exercised	--	--
Cancelled	--	--
	-----	
Outstanding at June 30, 2006	2,000,000	\$ 0.22
Options exercisable at December 31, 2005	--	\$ N/A
Options exercisable at June 30, 2006	--	\$ N/A

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The following tables summarize information about fixed stock options outstanding and exercisable at June 30, 2006:

### Stock Options Outstanding

Range of Exercise Prices	Number of Shares Outstanding	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price
-----	-----	-----	-----
\$0.22	2,000,000	9.8	\$0.22

### Stock Options Exercisable

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

#### 8. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In February 2006, the FASB decided to move forward with the issuance of a final FSP FAS 123R-4 Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event. The guidance in this FSP FAS 123R-4 amends paragraphs 32 and A229 of FASB Statement No. 123R to incorporate the concept articulated in footnote 16 of FAS 123R. That is, a cash settlement feature that can be exercised only upon the occurrence of a contingent event that is outside the employee's control does not meet the condition in paragraphs 32 and A229 until it becomes probable that the event will occur. Originally under FAS 123R, a provision in a share-based payment plan that required an entity to settle outstanding options in cash upon the occurrence of any contingent event required classification and accounting for the share based payment as a liability. This caused an issue under certain awards that require or permit, at the holder's election, cash settlement of the option or similar instrument upon (a) a change in control or other liquidity event of the entity or (b) death or disability of the holder. With this new FSP, these types of cash settlement features will not require liability accounting so long as the feature can be exercised only upon the occurrence of a contingent event that is outside the employee's control (such as an initial public offering) until it becomes probable that event will occur. The guidance in this FSP shall be applied upon initial adoption of Statement 123(R). An entity that adopted Statement 123(R) prior to the issuance of the FSP shall apply the guidance in the FSP in the first reporting period beginning after February 2006. Early application of FSP FAS 123R-4 is permitted in periods for which financial statements have not yet been issued. The Company does not anticipate that this new FSP will have any material impact upon its financial condition or results of operations.

In February 2006, the FASB issued SFAS 155 "Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and In February 2006, the FASB issued SFAS 155 "Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140". This Statement amends FASB Statements No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of

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Statement 133 to Beneficial Interests in Securitized Financial Assets. This Statement:

- a. Permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation;
- b. Clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133;
- c. Establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation;
- d. Clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and
- e. Amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The fair value election provided for in paragraph 4 of this Statement may also be applied upon adoption of this Statement for hybrid financial instruments that had been bifurcated under paragraph 12 of Statement 133 prior to the adoption of this Statement. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including financial statements for any interim period for that fiscal year. Provisions of this Statement may be applied to instruments that an entity holds at the date of adoption on an instrument-by-instrument basis. The Company is currently evaluating the impact of SFAS 155.

In March 2006, the FASB issued SFAS No. 156 ("FAS 156"), "Accounting for Servicing of Financial Assets--An Amendment of FASB Statement No. 140." Among other requirements, FAS 156 requires a company to recognize a servicing asset or servicing liability when it undertakes an obligation to service a financial asset by entering into a servicing contract under certain situations. Under FAS 156 an election can also be made for subsequent fair value measurement of servicing assets and servicing liabilities by class, thus simplifying the accounting and provide for income statement recognition of potential offsetting changes in the fair value of servicing assets, servicing liabilities and related derivative instruments. The Statement will be effect beginning the first fiscal year that begins after September 15, 2006. The Company does not expect the adoption of FAS 156 will have a material impact on the financial position or results of operations.

In June 2006, the FASB issued FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes," the provides guidance on the accounting for uncertainty in income taxes recognized in financial statements. The interpretation will be adopted by us on January 1, 2007. We are currently evaluating the impact of adopting FIN 48; however, we do not expect the adoption of this provision to have a material effect on our financial position, results of operations or cash flows.

In July 2006, the FASB issued FASB Staff Position (FSP) No. FAS 13-2, "Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction," that provides guidance on how a change or a potential change in the timing of cash flows relating to income taxes generated by a leveraged lease transaction

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affects the accounting by a lessor for the lease. This staff position will be adopted by us on January 1, 2007. We are currently evaluating the impact of adopting this FSP; however, we do not expect the adoption of this provision to have a material effect on our financial position, results of operations or cash flows.

### 9. RECLASSIFICATION

Certain reclassifications have been made to the 2005 condensed consolidated financial statements to conform to the 2006 presentation.

### 10. SUBSEQUENT EVENT

On July 21, 2006, the Company purchased two properties from Classic which are currently leased from Classic. The purchase price is based on the latest appraised value of HK\$28,500,000 (US\$3,653,846). The purchase price will be used to offset the accounts receivable due from Classic.

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

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 QUARTERLY REPORT TO FUTURE REVENUE GROWTH, FUTURE EXPENSE GROWTH, FUTURE CREDIT EXPOSURE EARNINGS 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", "BELIEVES", "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 FILINGS BY THE COMPANY WITH THE SEC 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 OBLIGATION 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.

### OVERVIEW

#### CORPORATE BACKGROUND



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The Company, through its wholly-owned subsidiaries Atlantic Components Limited, a Hong Kong corporation ("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, cease activities as of January 1, 2004, when its operations were consolidated with those of Atlantic.

As of June 30, 2006, ACL had more than 150 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

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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, and allowance for doubtful accounts. The methods, estimates and judgments ACL use 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.

### RELATED PARTY TRANSACTIONS

The Company conducts business with several affiliated companies. All

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the related party transactions taking place during the reporting periods were conducted during the normal course of business. The prices of products sold to or purchased from these related entities are in the same price ranges as those offered to other non related customers or purchased from other vendors.

### CONTRACTUAL OBLIGATIONS

The following table presents the Company's contractual obligations as of June 30, 2006 over the next five years and thereafter:

	Payments by Period				
AMOUNT	LESS THAN 1 YEAR	1-3 YEARS	4-5 YEARS	AFTER YEARS	
Operating Leases	193,119	123,888	69,231	--	
Line of credit and notes payable - short-term	4,083,841	4,083,841	--	--	
Total Contractual Obligations	\$4,276,960	\$4,207,729	\$ 69,231	\$ --	\$

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### 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 decision and expenses in the next 12 months.

#### NET SALES

Sales 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 the changes in demand from its customers. The prices set by Samsung that the Company must charge its customers are expected to fluctuate as a result of prevailing economic conditions and their impact on the market. The Company's decision of its product combination is critical for the Company's overall performance.

Overall product demand in the semiconductor business declined during the second quarter of 2006. The Company believes such decline to have resulted in part from the "World Cup" taking place in the second quarter, which slowed down the overall consumer spending during the period. In reaction to the overall market slowdown, the Company changed its sales strategy focus on sales of dual in-line memory modules (DIMM) of both DDR and DDR 2, used in the PC market, in addition to FLASH memory. The Company believes that its balance of sales between DIMM and Flash sales resulted in an increase in the Company's overall gross profit by 180% compared to the same period of 2005. The Company also continues to keep its inventories at a relatively low level which reduces its average maintenance costs. The Company believes that an increase in variety of NAND Flash-based

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storage applications and multimedia handheld gadgets has boosted the NAND demand in the past months. The strengthening features of 3C (computer, consumer electronics & communications) products require larger memory density. The MP3 player market is estimated to have represented approximately 43% of the total FLASH consumption for 2006. However, while consumer electronics giants like Apple have been able to capture a large share of the MP3 market, 2nd and 3rd tier manufacturers of MP3 players in Hong Kong and South China have been struggling to compete and gain market share. The Company believes hundreds of factories have gone out of business or changed their production lines, as a result of weak market demand for FLASH toward the end of the second quarter. The price for the high-capacity 16Gb memory products peaked at US\$40.50 at the beginning of April 2006, however, its price dropped substantially during the second quarter of 2006 to approximately US\$31.40 at the end of June 2006.

The PC market on the other hand was quite stable during the most part of the second quarter in 2006. In regards with the Graphic Ram, there were some shortages on the 16x16 Graphic DDR targeting mainly for entry-level and mid-range VGA card, while 16x32 Graphic DDR has a more advanced application coverage from Notebook to high-end game console, which is mainly used in Sony and Microsoft products. The price for Graphic Ram tends to be more stable than that of PC DRAM. The Company expects to continue evaluate the market to ensure a healthy product portfolio.

Sales for PC memory modules (DIMM) are expected to be higher in the third quarter due to increased demand for computer products during the summer and back-to-school seasons. The demand for DDR 2 modules is expected to increase gradually as both AMD and Intel reduced the prices for their CPU at the end of July 2006 which the Company expects will boost the DDR 2 demand.

The Company expects demand for FLASH memory products, after a weak second quarter, to increase in anticipation of the holiday season, with Apple and Sony having the largest demand which may cause a shortage of the Flash memory in the market during the second half of the year. Sony is planning to launch the new version of PSP2 and PMP with 8Gb and 10Gb Flash memory. It is predicted that Apple and Sony will capture

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approximately 41% of the total NAND Flash sales. The market is expected to focus on the launch of the new products from Apple and Sony which will become a key factor determining the Flash prices in the coming months.

### 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.

### OPERATING EXPENSES

The Company's operating expenses for the three months and six months ended June 30, 2006 and 2005 comprised of selling and general and administrative expenses.

Selling expenses consisted primarily of and external commissions paid

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to external sales personnel and costs associated with advertising and marketing activities.

General and administrative expenses include cost for the 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, professional services, and travel and entertainment. The Company expects these expenses to increase as a result of the anticipated expansion by the 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, and amortization of discount on the convertible debenture.

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### RESULTS OF OPERATIONS

The following table sets forth unaudited statements of operations data for the three months and six months ended June 30, 2006 and 2005 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 June 30, 2006 -----	Three Months Ended June 30, 2005 -----	Six Months Ended June 30, 2006 -----	Six Months Ended June 30, 2005 -----
	(Unaudited)			
Net Sales	100%	100%	100%	100%
Cost of sales	96.60%	99.05%	96.39%	97.80%
Gross Profit	3.40%	0.95%	3.61%	2.20%
Operating expenses:				
Selling	0.71%	0.38%	0.79%	0.45%
General and administrative	2.42%	1.68%	2.10%	1.74%
Total operating expenses	3.13%	2.06%	2.89%	2.19%
Income (loss) from operations	0.27%	-1.11%	0.72%	0.01%
Other expenses:				
Interest expenses	-0.67%	-0.21%	-0.64%	-0.18%
Miscellaneous	0.11%	-0.01%	0.10%	-0.01%
Income (loss) before income taxes	-0.29%	-1.33%	0.18%	-0.18%
Income taxes expenses (benefits)	0.09%	-0.21%	0.11%	0.02%
Net income (loss)	-0.038%	-1.12%	0.07%	-0.20%

UNAUDITED THREE MONTHS ENDED JUNE 30, 2006 COMPARED TO THE THREE MONTHS ENDED JUNE 30, 2005

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### NET SALES

Sales decreased by \$5,456,751 or 20.6% from \$26,500,614 in the three months ended June 30, 2005 to \$21,043,863 in the three months ended June 30, 2006. The decrease was mainly due to drop in demand and shortage of supplies of Samsung products while there was the "World Cup" effect slowing down the whole consumer spending during the second quarter of 2006.

### COST OF SALES

Cost of sales decreased by \$5,922,036, or 22.6%, from \$26,250,016 for the three months ended June 30, 2005 to \$20,327,980 for the three months ended June 30, 2006. The decrease in cost of sales is comparable to the decrease of sales. As a percentage of sales, cost of sales decreased slightly to 96.60% of sales in the three months ended June 30, 2006 from 99.05% of sales in the three months ended June 30, 2005.

### GROSS PROFIT

Gross profit increased by \$465,285 or 185.7%, from \$250,598 for the three months ended June 30, 2005 to \$715,883 for the three months ended June 30, 2006. The Company's gross profit increased slightly to 3.4% of sales in the three months ended June 30, 2006 compared to 1% of sales in the three months ended June 30, 2005, as a result of shortage of supplies of Samsung products for the second quarter of 2006.

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### OPERATING EXPENSES

Selling expenses increased by \$49,300 or 49.2%, from \$100,177 for the three months ended June 30, 2005 to \$149,477 for the three months ended June 30, 2006. This increase was principally attributable to sales commission expenses incurred in the second quarter of 2006. As a percentage of sales, sales and marketing expenses increased to 0.71% of sales for the three months ended June 30, 2006 as compared to 0.38% of sales for the three months ended June 30, 2005.

General and administrative expenses increased \$52,722 or 11.5% from \$456,764 in the three months ended June 30, 2005 to \$509,486 in the three months ended June 30, 2006. Except for fair value of the options granted to certain employees in the amount of \$128,122, general and administrative expenses for such periods decreased by \$75,400 which was principally attributable to a decrease in certain expenses, such as insurance, entertainment and bad debts

### INCOME (LOSS) FROM OPERATIONS

Income from operations for the Company was \$56,920 for the three months ended June 30, 2006 compared to a loss of \$306,343 for the three months ended June 30, 2005, an increase of income by \$363,263 or 118.6%. This increase was the result of increase of gross profit and decrease of general and administrative expenses during the second quarter of 2006.

### OTHER INCOME (EXPENSES)

Interest expense increased by \$94,301, or 204.9%, from \$46,022 in the three months ended June 30, 2005, to \$140,323 in the three months ended June 30, 2006. This increase is mainly due to increase of the use of the short-term borrowings from the bank and increase in interest rate. We expect our interest expense continue to increase in 2006 because of increase of interest rate.

### INCOME TAX

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Income tax increased by \$76,555 or 134.7% from tax benefit \$56,815 for the three months ended June 30, 2005 to an income tax \$19,740 for the three months ended June 30, 2006, due to an increase of income before taxes increase for the three months ended June 30, 2006.

### NET LOSS

The Company's net loss decreased by \$218,243 or 73.4% from loss \$297,365 the three months ended June 30, 2005 to \$79,122 for the three months ended June 30, 2006 primarily due to increase of profit margin and decrease of general and administrative expenses.

UNAUDITED SIX MONTHS ENDED JUNE 30, 2006 COMPARED TO THE SIX MONTHS ENDED JUNE 30, 2005

### NET SALES

Net sales decreased by \$8,927,351 or 16.2% from \$55,146,867 in the six months ended June 30, 2005 to \$46,219,516 in the six months ended June 30, 2006. This decrease resulted primarily due to drop in demand and shortage of supplies of Samsung products while there was additionally the "World Cup" effect slowing down the consumer spending for the first half year of 2006.

### COST OF SALES

Cost of sales decreased by \$9,380,692 or 17.4% from \$53,933,388 in the six months ended June 30, 2005 to \$44,552,696 in the six months ended June 30, 2006. The cost of sales decreased in proportion to the decrease of net sales.

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### GROSS PROFIT

Gross profit increased by \$453,341 or 37.4% from \$1,213,479 in the six months ended June 30, 2005 to \$1,666,820 in the six months ended June 30, 2006. The gross profit % increased by 1.41% from 2.2% in the six months ended June 30, 2005 to 3.61% in the six months ended June 30, 2006. The increase in gross profit % was primarily attributable to the shortage of supplies of Samsung products for the first half year of 2006. We expect the gross profit be at this level in the coming months, but will improve if the Company can successfully diversify its businesses and products.

### OPERATING EXPENSES

Selling expenses increased by \$114,845 or 46.2% from \$248,832 in the six months ended June 30, 2005 to \$363,677 in the six months ended June 30, 2006. The increase was primarily attributable to the sales commission expenses incurred for the first half year of 2006.

General and administrative expenses increased by \$10,599 or 1.1% from \$957,974 in the six months ended June 30, 2005 to \$968,573 in the six months June 30, 2006. This increase was principally attributable to the fair value of options granted to certain employees during the six months ended June 30, 2006. ACL expects the general and administrative expenses in the second of half of 2006 be at the same approximate level of the first half in the year of 2006.

### INCOME (LOSS) FROM OPERATIONS

Income from operations increased by \$327,897 or 4,914% from \$6,673 in the six months ended June 30, 2005 to \$334,570 in the six months ended June 30,

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2006. The increase was mainly due to an increase in gross profit which as mentioned above increase by \$453,341.

### OTHER INCOME (EXPENSES)

Interest expenses increased by \$195,101 or 195% from \$100,054 in the six months ended June 30, 2005 to \$295,155 in the six months ended June 30, 2006. This increase is mainly due to increase of the use of the short-term borrowings from the bank and increase in interest rate. We expect our interest expense continue to increase in 2006 because of increased interest rates.

### INCOME TAX

Income tax increased by \$42,134 or 443.5% from \$9,500 in the six months ended June 30, 2005 to \$51,634 in the six months ended June 30, 2006 due to an increase of profit for the six months ended June 30, 2006.

### NET INCOME (LOSS)

Net income increase by \$141,130 or 132.6% from a loss of \$106,473 in the six months ended June 30, 2005 to a profit of \$34,657 in the six months ended June 30, 2006. It is mainly due to increase in gross profit together with reduction of general and administrative expenses.

### 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 continue be its principal uses of cash in the future.

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The Company may require additional financing in order to finance our growing business and implement its business plan. In order to meet anticipated demand for Samsung's memory products in the Southern China market over the next 12 months, the Company anticipates an additional need of working capital of at least \$2.0 million through short-term borrowings from the banks in order to finance the purchase of Samsung memory products from Samsung HK and credits given to its customers. As the anticipated cash generated by the Company's operations are insufficient to fund its growth, the Company needs to continue borrowing or raising additional working capital. There is 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 our operating 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 our ability to attract new customers; an increase in competition in the memory products market; and the ability of our customers to obtain financing. These factors or additional risks and uncertainties not known to ACL or that currently deems immaterial may impair business operations and may cause ACL's actual results to differ materially from any forward-looking statement.

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

In the six months ended June 30, 2006, net cash used for operating activities was \$1,858,803 while in the six months ended June 30, 2005, net cash provided by operating activities was \$413,504, an increase in net cash used for operating activities of \$2,272,307. This increase was primarily due to increase of inventories value and accounts receivable from related parties at June 30, 2006.

In the six months ended June 30, 2006, net cash used for investing activities was \$631,316 while in the six months ended June 30, 2005, ACL used \$389,069 in investing activities, an increase in cash used of \$242,247. Increase was primarily due to the increase of restricted cash deposited with the bank as part of the terms for its bank borrowings during the six months ended June 30, 2006.

In the six months ended June 30, 2006, net cash provided by financing activities was \$1,241,556 while in the six months ended June 30, 2005, net cash provided by financing activities was \$291,751, an increase of \$949,805. Increase was primarily due to increase of borrowings on the lines of credit and loan facilities.

An essential element of the Company's growth in the future will be to obtain adequate additional working capital to meet anticipated market demand from PC users (business and personal) in the southern part of China and to diversify its businesses and products in the near future.

### 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 0.5% to 1.0% 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, 2006 and the six months ended June 30, 2005, ACL did not generate any material interest income or incur significant interest expenses. Due to the increase in the line of credit and notes payables in 2006, ACL believes that changes in interest rates may have a material effect on its liquidity, financial condition or results of operations.

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### 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; however, it does anticipate an increase in sales of DIMM memory products as a result of a seasonal "back-to-school" increase in PC sales in the third quarter of 2006.

### ITEM 4. CONTROLS AND PROCEDURES

The Company has established disclosure controls and procedures to



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ensure that material information relating to the Company, including Atlantic, is made known to the officers who certify the Company's financial reports and to other members of senior management and the Board of Directors.

(a) Based on their evaluation as of a date within 90 days of the filing date of this Quarterly Report on Form 10-Q, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934 (the "Exchange Act")) are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

(b) There were no significant changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation. Although there were no significant deficiencies or material weaknesses, there were some areas where room for improvement was noted and management has committed to improving in these areas. The Company has adopted many of the formal and informal suggestions of our auditors, Stonefield Josephson, Inc., and are implementing weekly and monthly checks to assure that these disclosure controls and internal controls stay in place.

The regulations implementing Section 404 of the Sarbanes-Oxley Act of 2002 require an assessment of the effectiveness of the Company's internal controls over financial reporting beginning with our Annual Report on Form 10-K for the fiscal year ending on or after July 15, 2007. The Company's independent auditors will be required to confirm in writing whether management's assessment of the effectiveness of the internal controls over financial reporting is fairly stated in all material respects, and separately report on whether they believe management maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007.

As part of the assessment of our internal controls in connection with the process required by Section 404 of the Sarbanes-Oxley Act of 2002, management intends to continue to review, evaluate and strengthen our controls and processes. Management cannot state that material weaknesses in internal controls will not be determined. Management also cannot state that the process of evaluation and the auditor's attestation will be completed on time. If a material weakness is discovered, corrective action may be time consuming, costly and further divert the attention of management. The disclosure of a material weakness, even if quickly remedied, could reduce the market's confidence in the Company's financial statements and harm the Company's stock price, especially if a restatement of financial statements for past periods is required.

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### PART II

#### ITEM 6. 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

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906 of the Sarbanes-Oxley Act of 2002.

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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, 2006

By: /s/ Chung-Lun Yang

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Chung-Lun Yang  
Chief Executive Officer

Date: August 14, 2006

By: /s/ Kenneth Lap-Yin Chan

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Kenneth Lap-Yin Chan  
Chief Financial Officer (Principal  
Accounting Officer)

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