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ACL SEMICONDUCTOR INC  
Form 10-Q  
December 20, 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 September 30, 2006.

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 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 whether the registrant is a shell company. Yes  No

The aggregate market value of the voting common equity held by non-affiliates of  
the registrant as of September 30, 2006 was approximately \$708,491 based upon  
the closing price of \$0.13 of the registrant's common stock on the OTC Bulletin  
Board, as of the last business day of the most recently completed third fiscal  
quarter (September 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 November 14, 2006.

Transitional small business disclosure format (check one) Yes  No

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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ITEM 1. FINANCIAL STATEMENTS.

ACL SEMICONDUCTORS INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	As of September 30, 2006 (Unaudited)	As of December 31, 2005
	-----	-----
CURRENT ASSETS:		
Cash and cash equivalents	\$ 607,283	\$2,537,799
Restricted cash	2,692,308	769,231
Accounts receivable, net of allowance for doubtful accounts of \$0 for 2006 and 2005	1,153,597	515,557
Accounts receivable, related parties	5,876,057	2,175,737
Inventories, net of reserve of \$141,026 for 2006 and 2005	2,614,586	1,087,752
Refundable deposits	--	1,000,000
Other current assets	194,009	263,300
	-----	-----

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Total current assets	13,137,840	8,349,376
PROPERTY, EQUIPMENT AND IMPROVEMENTS, net of accumulated depreciation and amortization	3,861,793	102,037
OTHER DEPOSITS	375,730	381,044
	-----	-----
	\$17,375,363	\$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 September 30, 2006 (Unaudited)	As of December 31, 2005
	-----	-----
CURRENT LIABILITIES:		
Accounts payable	\$ 4,707,383	\$ 4,495,819
Accrued expenses	229,782	272,782
Lines of credit and notes payable	8,868,125	2,842,285
Current portion of long-term debt	87,971	--
Payable related to debt settlement	--	76,088
Due to stockholders for converted pledged collateral	112,385	112,385
Income tax payable	302,089	217,453
Other current liabilities	13,832	55,019
	-----	-----
Total current liabilities	14,321,567	8,071,831
Long-term debt, less current portion	1,898,256	--
	-----	-----
Total liabilities	16,219,823	8,071,831
	-----	-----
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

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Additional paid in capital	3,488,527	3,360,405
Amount due from stockholder/director	(84,060)	(102,936)
Accumulated deficit	(2,276,757)	(2,524,673)
	-----	-----
Total stockholders' equity	1,155,540	760,626
	-----	-----
	\$17,375,363	\$ 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 SEPTEMBER 30, 2006	SEPTEMBER 30, 2005	NINE MONTHS END SEPTEMBER 30, 2006	SEPTEMBER 30, 2005
	-----	-----	-----	-----
NET SALES:				
Related parties	\$ 6,457,711	\$ 5,060,580	16,203,434	24,111,000
Other	23,695,653	23,770,593	60,175,045	59,111,000
Less discounts to customers	(14,143)	(21,635)	(19,742)	(19,742)
	-----	-----	-----	-----
	30,139,221	28,809,538	76,358,737	83,111,000
COST OF SALES	28,936,358	28,004,464	73,489,054	81,111,000
	-----	-----	-----	-----
GROSS PROFIT	1,202,863	805,074	2,869,683	2,000,000
OPERATING EXPENSES:				
Selling	202,069	126,060	565,747	565,747
General and administrative	606,051	488,050	1,538,049	1,538,049
	-----	-----	-----	-----
INCOME FROM OPERATIONS	394,743	190,964	765,887	765,887
OTHER INCOME (EXPENSES):				
Interest expense	(191,943)	(53,021)	(487,098)	(487,098)
Miscellaneous	35,789	2,565	82,665	82,665
	-----	-----	-----	-----
INCOME BEFORE INCOME TAXES	238,589	140,508	361,454	361,454
INCOME TAXES	61,905	31,243	113,538	113,538
	-----	-----	-----	-----

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NET INCOME	\$ 176,684	\$ 109,265	\$ 247,916	\$
	=====	=====	=====	=====
EARNINGS PER SHARE - BASIC AND DILUTED	\$ 0.01	\$ 0.00	\$ 0.01	\$
	=====	=====	=====	=====
WEIGHTED AVERAGE NUMBER OF SHARES - BASIC AND DILUTED	27,829,936	27,829,936	27,829,936	27,
	=====	=====	=====	=====

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)

	Nine Months Ended	
	September 30, 2006	September 30, 2005
	-----	-----
CASH FLOWS PROVIDED BY (USED FOR) OPERATING ACTIVITIES:		
Net income	\$ 247,916	\$ 2,792
	-----	-----
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES:		
Depreciation and amortization	45,758	20,401
Bad debts	--	6,200
Change in inventory reserve	--	(29,487)
Fair value of options issued to employees	128,122	--
CHANGES IN ASSETS AND LIABILITIES:		
(INCREASE) DECREASE IN ASSETS		
Accounts receivable - other	(638,040)	(581,350)
Accounts receivable - related parties	(2,700,320)	1,947,972
Inventories	(1,526,834)	825,466
Other current assets	69,290	(8,760)
Other deposits	5,314	--
INCREASE (DECREASE) IN LIABILITIES		
Accounts payable	211,564	(1,199,038)
Accrued expenses	(43,000)	(288,032)
Payable related to debt settlement	(76,088)	66,088
Income tax payable	84,636	10,812
Other current liabilities	(41,187)	(7,027)
	-----	-----

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Total adjustments	(4,480,785)	763,245
	-----	-----
Net cash (used for) provided by operating activities	(4,232,869)	766,037
	-----	-----

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)

	Nine Months Ended	
	September 30, 2006	September 30, 2005
	-----	-----
CASH FLOWS PROVIDED BY (USED FOR) INVESTING ACTIVITIES:		
Repayments from stockholders	18,876	4,823
Increase of restricted cash	(1,923,076)	(769,231)
Loan repayments by related party	--	611,446
Repayments from related party	--	30,000
Purchases of property, equipment and improvements	(3,805,514)	(30,655)
	-----	-----
Net cash used for investing activities	(5,709,714)	(153,617)
	-----	-----
CASH FLOWS PROVIDED BY (USED FOR) FINANCING ACTIVITIES:		
Proceeds on lines of credit and notes payable	6,025,840	(1,060,311)
Principal advance (payments) on long-term debt	1,986,227	(194,729)
Loan received from related parties	--	414,195
Repayments to related party	--	(86,276)
	-----	-----
Net cash provided by financing activities	8,012,067	(927,121)
	-----	-----
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,930,516)	(314,701)
CASH AND CASH EQUIVALENTS, beginning of the period	2,537,799	512,548
	-----	-----
CASH AND CASH EQUIVALENTS, end of the period	\$ 607,283	\$ 197,847
	=====	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid		

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	\$ 487,097	\$ 53,021
	=====	=====
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 September 30, 2006 and December 31, 2005, and the results of operations for the three-month and nine-month periods ended September 30, 2006 and 2005 and the cash flows for the nine-month periods ended September 30, 2006 and 2005. The results of operations for the nine months ended September 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 September 30, 2006.

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### NATURE OF BUSINESS OPERATIONS

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, when 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 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 nine months ended September 30, 2006 and 2005, the Company had 2,000,000 and 441,000 shares, respectively, of common stock equivalents at the end of each reporting periods.

### 3. RELATED PARTY TRANSACTIONS

#### TRANSACTIONS WITH MR. YANG

As of September 30, 2006 and December 31, 2005, the Company had an outstanding



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receivable from Mr. Yang, the President and Chairman of our Board of Directors, totaling \$84,060 and \$102,936 representing advanced compensation paid. These balances bear no interest and are payable on demand.

For the three months ended September 30, 2006 and 2005, the Company recorded and paid \$50,000 and \$50,000, respectively, to Mr. Yang, and for the nine months ended September 30, 2006 and 2005, the Company recorded and paid \$150,000 and \$176,923, respectively, to Mr. Yang as compensation.

During the three months ended September 30, 2006 and 2005, and nine months ended September 30, 2006 and 2005, the Company paid rent of \$12,510, \$23,077, \$58,663 and \$46,153, respectively, for Mr. Yang's personal residency as additional compensation.

### TRANSACTIONS WITH CLASSIC ELECTRONICS LTD.

During the three months ended September 30, 2006 and 2005, and nine months ended September 30, 2006 and 2005, the Company sold \$0, \$1,951,509, \$0 and \$18,710,411, respectively, of memory products to Classic Electronics Ltd. ("Classic"). During the three months ended September 30, 2006 and 2005, and nine months ended September 30, 2006 and 2005, the Company purchased Samsung memory products sourced from other authorized distributors of \$0, \$1,289,368, \$0 and \$5,054,434, respectively, from Classic to satisfy part of its product shortage from Samsung HK. The Company had outstanding accounts receivable from Classic totaling \$4,645,993 and \$2,175,737, respectively, as of September 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.

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The Company leased one of its facilities and Mr. Yang's personal residence from Classic. At the end of the lease terms on July 21, 2006, ACL acquired this facility and personal residence from Classic (see Note 8 for details). Monthly lease payments for these 2 leases total \$6,684. The Company incurred and paid rent expense of ACL of \$4,312, \$20,053, 44,418 and \$63,197 to Classic during the three months ended September 30, 2006 and 2005 and the nine months ended September 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.

On February 21, 2006, a cross corporate guarantee was executed between Classic Electronics Limited and Atlantic Components Limited for banking facilities to be co-utilized with Standard Chartered Bank (Hong Kong) Limited. The maximum amount of facilities can be utilized by Atlantic was \$1.154 millions (HKD9 millions) and the facility lines was fully covered by collaterals provided by Classic Electronics Limited and companies other than Atlantic Components Limited. Subsequently, the cross guarantees have been released on December 7, 2006.

On July 6, 2006, a cross corporate guarantee was executed between Classic Electronics Limited and Atlantic Components Limited for banking facilities to be co-utilized with The Bank of East Asia Limited. The cross guarantee was temporarily created due to selling of properties from Classic Electronics Limited to Atlantic Components Limited. During the period of execution of the assignment of legal title, The Bank of East Asia Limited requested a cross guarantee for both companies. All facilities and outstanding loan balances were

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booked under and utilized by Atlantic Components Limited which will not absorb any losses from Classic Electronics Limited. Subsequently, the cross guarantees have been released in December 8, 2006.

### TRANSACTIONS WITH KADATCO COMPANY LTD.

During the three months ended September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, the Company recognized revenues of \$0, \$2,600,665, \$0 and \$5,072,859 from the sale of memory products to Kadatco Company Ltd. ("Kadatco"). There were no outstanding accounts receivable due from Kadatco as of September 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 Kadatco.

### TRANSACTIONS WITH RAMBO TECHNOLOGIES LTD.

During the three months ended September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, the Company sold \$0, \$0, \$0 and \$165,225, respectively, to Rambo Technologies Ltd. ("Rambo"). There were no outstanding accounts receivable due from Rambo as of September 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 September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, the Company purchased \$0, \$316,708, \$0 and \$874,553, respectively, from Rambo. There were no outstanding accounts payable due to Rambo as of September 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 September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, the Company sold \$5,831,407, \$508,406, \$8,482,459 and \$508,406, respectively, to Aristo Technologies Ltd. ("Aristo"). Outstanding accounts receivable totaled \$230,064 and \$0 as of September 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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During the three months ended September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, the Company purchased \$131,328, \$100,822, \$419,880 and \$100,822, respectively, from Aristo. Outstanding accounts payable totaled \$0 and \$0 as of September 30, 2006 and December 31, 2005 respectively. Net accounts receivable totaled \$230,064 and \$0, as of September 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 September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, the Company sold \$0, \$0, \$0 and \$1,652, respectively, to Atlantic Netcom Ltd. ("Atlantic Netcom"). Outstanding accounts

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receivable totaled \$0 as of September 30, 2006 and December 31, 2005, respectively. The Company has not experienced any bad debt from this customer in the past.

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 September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, the Company sold \$0, \$0 \$0 and \$55,122, respectively, to Solution Semiconductor (China) Ltd. ("Solution"). Outstanding accounts receivable totaled \$0 as of September 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 September 30, 2006 and 2005 and the nine months ended September 30, 2006 and 2005, the Company purchased \$0, 0, \$0 and \$22,019, respectively, from Solution. There are no outstanding accounts payable due to Solution as of September 30, 2006 and December 31, 2005.

On August 31, 2006, the Company entered into a lease agreement with Solution pursuant to which the Company leases one industrial property for office use for a monthly lease payment of \$859. The lease agreement for this property expires on August 31, 2008. The Company incurred and paid an aggregate rent expenses of \$859 and \$0 to Solution during the three months ended September 30, 2006 and 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 September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, the Company sold \$0, \$0, \$0 and \$61,910, respectively, and received service charges \$2,564, \$0, \$2,564 and \$0, respectively, from Systematic Information Ltd. ("Systematic"). There are no outstanding accounts receivable due from Systematic as of September 30, 2006 and December 31, 2005.

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 September 30, 2006 and 2005.

On August 31, 2006, the Company entered into a lease agreement with Systematic pursuant to which the Company leases one industrial property for office use for a monthly lease payment of \$641. The lease agreement

for this property expires on August 31, 2008. The Company incurred and paid an aggregate rent expenses of \$641 and \$0 to Systematic during the three months

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ended September 30, 2006 and 2005.

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

### TRANSACTIONS WITH GLOBAL MEGA DEVELOPMENT LTD.

During the three months ended September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, the Company sold \$0, \$8,657, \$0 and \$19,074 respectively, and received management fee \$1,923, \$641, 5,769 and 641, respectively, from Global Mega Development Ltd. ("Global"). There are no outstanding accounts receivable due from Global as of September 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 September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, we received management fee \$1,923, \$641, \$5,769 and 641, respectively, from Intelligent Network Technology Ltd. ("Intelligent"). There are no outstanding accounts receivable due from Intelligent as of September 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.

### TRANSACTIONS WITH SYSTEMATIC SEMICONDUCTOR LTD.

During the three months ended September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, we received management fee of \$3,846, \$0, \$11,538 and \$0, respectively, from Systematic Semiconductor Ltd. ("Systematic Semiconductor"). There are no outstanding accounts receivable due from Systematic Semiconductor as of September 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 September 30, 2006 and 2005, and the nine months ended September 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 September 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 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 September 30, 2006 and 2005, and the nine months ended September 30, 2006 and

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2005, the Company sold \$626,304, \$0, \$7,720,975 and \$0, respectively, to First World Logistics Ltd. ("First World"). Outstanding accounts receivable totaled \$0 as of September 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 September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, the Company purchased \$0, \$0, \$825,900 and \$0, respectively, from First World. Outstanding accounts payable totaled \$0 as of September 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, DBS Bank (Hong Kong) Ltd., The Bank of East Asia, Limited and Standard Chartered Bank (Hong Kong) Limited (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 and workshop located in Hong Kong owned by Atlantic Components Ltd ("Atlantic"), a wholly owned subsidiary of ACL, 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 fixed cash deposit of \$1,282,050 (HK\$10,000,000) plus personal guarantee by Mr. Yang and Mr. Ben Wong and corporate guarantee by Atlantic, as collateral for loans from The Bank of East Asia, Limited;
4. Corporate guarantee by Atlantic plus unlimited personal guarantee by Mr. Yang and Mr. Ben Wong, as collateral for maximum loan amount of \$1,153,846 (HK\$9,000,000) from Standard Chartered Bank (Hong Kong) Limited;
5. unlimited personal guarantee given by Mr. Yang 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.

#### 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 76% and 77% of its materials from Samsung HK for the three months ended September 30, 2006 and 2005, respectively, and 76% and 77% for the nine months ended September 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

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

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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 September 30, 2006 and 2005, and the nine months ended September 30, 2006 and 2005, the Company purchased \$22,832,844, 21,097,135, \$58,201,788 and \$63,940,646, respectively. At September 30, 2006 and December 2005, accounts payable, net of rebates receivable from Samsung HK, due to Samsung HK were \$3,719,366 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 a total of 2,000,000 options to three employees. The options were vested immediately and its 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 September 30, 2006, and changes during the years ending on those dates is presented below:

	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE
	-----	-----
Outstanding at December 31, 2005	--	\$ --
Granted	2,000,000	0.22
Exercised	--	--
Cancelled	--	--
	-----	
Outstanding at September 30, 2006	2,000,000	\$0.22

Options exercisable at

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December 31, 2005 -- \$ N/A

Options exercisable at  
September 30, 2006 -- \$ N/A

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

### STOCK OPTIONS OUTSTANDING

RANGE OF EXERCISE PRICES	WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	REMAINING CONTRACTUAL LIFE IN YEARS	WEIGHTED AVERAGE EXERCISE PRICE
-----	-----	-----	-----
\$0.22	2,000,000	9.6	\$0.22

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### STOCK OPTIONS EXERCISABLE

RANGE OF EXERCISE PRICES	NUMBER OF SHARES EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICE
-----	-----	-----
\$0.22	--	N/A

#### 8. PURCHASES OF REAL ESTATE PROPERTIES FROM CLASSIC

The Company purchased two real estate properties from Classic which were previously leased from Classic. The purchase prices were \$3,797,760 including purchase price including certain closing costs of \$143,914. The transactions were completed on July 21, 2006. The purchase prices for the properties were based on the appraised values estimated by an independent appraiser immediately prior to the closing of these transactions. The Company believed the appraised values of these properties represented the fair value of these properties at the time of the transactions. The outstanding accounts receivable due from Classic was reduced to offset the amounts due to Classic related to these purchases.

#### 9. RECLASSIFICATION

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

#### 10. 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

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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

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resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of 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



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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 take 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 Interpretation No. 48, "Accounting for Uncertainty in Income Taxes." This interpretation requires companies to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. FIN 48 provides guidance on de-recognition, classification, accounting in interim periods and disclosure requirements for tax contingencies. FIN 48 is effective for fiscal years beginning after December 15, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The Company is evaluating the impact of this new pronouncement to its financial position and 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 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.

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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

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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 on 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.

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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 subsidiary, 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, ceased activities as of January 1, 2004, when its operations were consolidated with those of Atlantic.

As of September 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 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.

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### RELATED PARTY TRANSACTIONS

The Company conducts business with several affiliated companies. All 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 September 30, 2006 over the next five years and thereafter:

	Payments by Period			
	AMOUNT	LESS THAN 1 YEAR	1-3 --- YEARS	4-5 --- YEARS
	-----	-----	-----	-----
Operating Leases	107,019	71,288	35,731	---
Line of credit and notes payable - short-term	8,868,125	8,868,125	---	---
Long Term Loans	1,986,227	87,971	191,262	206,424
Total Contractual Obligations	\$10,961,371	\$9,027,384	\$226,993	\$206,424

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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 regarding its product combination is critical for the Company's overall performance.

Overall product demand in the semiconductor business increased significantly during the 3rd quarter, due to the market expectation of release of Microsoft Vista and new wave of the personal PC upgrading, stocking activity for the components for the upcoming festival season. The company's 3rd quarter sales increased 4.6% year-on-year basis to US\$ 30.1 million, and the gross profit achieved a stunning 50% increase to \$1.2 million during the quarter ended

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September 30, 2006, an improvement from a gross profit % of 2.79% during the quarter ended September 30, 2005 to a gross profit % of 3.99% during the quarter ended September 30, 2006.

System memory demand for both DDR 1 and DDR 2 were increasing steadily during the quarter ended September 30, 2006 owing to the insufficient supply of stocks, the price kept ascending and the transaction volumes remained high, in particular the DDR 2 module and chip's output increased 20% - 30%. The prevailing personal PC models on the market are already equipped with a minimum of 512MB 533 MHz DDR2 module. One such example is the DELL entry level Dimension C 521 ad E521. In line with the setting of Intel and AMD CPU, DDR 2 modules were recognized as the industry standard. As for graphic RAM, DDR2 and DDR 3 were generally accepted as the industry standard from 256MB - 512MB per PC system, replacing the DDR1 256MB - 512 MB.

Flash component price moved upward surprisingly during the current quarter, especially from end July to August 2006. The Flash prices of both contract market and spot market showed a strong increase of up to 30% in the current quarter from the second quarter of 2006 which was the lowest point of the year. The improving Flash market sentiment predicted by major manufactures since end of the first quarter in 2006 finally took place in the third quarter, which were mainly caused by the good sales performance of Apple's iPod series. The iPod series, shifting its core technology from mini-HDD-based storage solution to Flash-based storage solution which, boosted the Samsung MLC (Multi-Level-Cell) Flash demand to it's all-year-high.

The MLC (Multi-Level-Cell) Flash technology was first developed by Toshiba and for quite a long time, Samsung concentrated its Flash technology on SLC (Single-Level-Cell), which is generally accepted as providing a more stable and faster performance in reading, writing and rewriting. The MLC had on the other hand a more cost-effective advantage, with a compromise of its performance in some products, especially for the MP3 players, where a more accurate interaction is required between the Flash component and the control chipset. This created challenges to many control chipset manufactures. However, as in iPod's case, Samsung not only provided a control chipset suitable for its large storage requirement and quick retrieval of information, but also integrated the MLC Flash into the solution. As the Samsung MLC flash output was drained with the production of iPod NANO 2nd generation, the prices for both the MLC and SLC increased substantially which moved the whole Flash market higher. Although the Flash shortage eased toward September of 2006, we largely benefited from it.

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The Company expects both the prices and the demands for DDR 1 and DDR 2 component and modules will remain stable through the rest of the year and will improve the Company's gross margin. We are optimistic on the FLASH memory products in the upcoming holiday season, however, the prices may suffer slightly after a surge of prices in the third quarter of this year. In addition, the whole market is awaiting Microsoft's end-of-year launch of Zune MP3 player.

### 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

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Atlantic and Samsung HK.

### OPERATING EXPENSES

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

Selling expenses consisted primarily of external commissions paid 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.

### RESULTS OF OPERATIONS

The following table sets forth unaudited statements of operations data for the three months and nine months ended September 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.

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	THREE MONTHS ENDED SEPTEMBER 30, ----- 2006 ----	THREE MONTHS ENDED SEPTEMBER 30, ----- 2005 ----	NINE MONTHS ENDED SEPTEMBER 30, ----- 2006 ----	NINE MONTHS ENDED SEPTEMBER 30, ----- 2005 ----
	(Unaudited)			
Net Sales	100%	100%	100%	100%
Cost of sales	96.01%	97.21%	96.24%	97.58%
Gross Profit	3.99%	2.79%	3.76%	2.40%
Operating expenses:				
Selling	0.67%	0.44%	0.74%	0.45%
General and administrative	2.01%	1.68%	2.01%	1.72%
Total operating expenses	2.68%	2.12%	2.75%	2.17%
Income (loss) from operations	1.31%	-0.67%	1.01%	0.23%
Other expenses:				

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Interest expenses	-0.64%	-0.18%	-0.64%	-0.18%
Miscellaneous	0.11%	-0.00%	0.10%	0.00%
Income (loss) before income taxes	0.78%	0.49%	0.47%	0.05%
Income taxes expenses (benefits)	0.21%	0.11%	0.15%	0.05%
Net income (loss)	0.57%	0.38%	0.32%	0.00%

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

### NET SALES

Sales increased by \$1,329,683 or 4.62% from \$28,809,538 in the three months ended September 30, 2005 to \$30,139,221 in the three months ended September 30, 2006. The increase was mainly due to the market expectation of release of new product and the new wave of PC upgrading, stocking activities for the components for the upcoming holiday season.

### COST OF SALES

Cost of sales increased by \$931,894, or 3.33%, from \$28,004,464 for the three months ended September 30, 2005 to \$28,936,358 for the three months ended September 30, 2006. The cost of sales increased in proportion to the increase of net sales.

### GROSS PROFIT

Gross profit increased by \$397,789 or 49.41%, from \$805,074 for the three months ended September 30, 2005 to \$1,202,863 for the three months ended September 30, 2006. The Company's gross profit increased slightly to 3.99% of sales in the three months ended September 30, 2006 compared to 2.79% of sales in the three months ended September 30, 2005, as a result of the demand and price of system memory and flash component products keeping upward for the third quarter of 2006.

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### OPERATING EXPENSES

Selling expenses increased by \$76,009 or 60.30%, from \$126,060 for the three months ended September 30, 2005 to \$202,069 for the three months ended September 30, 2006. This increase was principally attributable to sales commission expenses incurred in the third quarter of 2006. As a percentage of sales, sales and marketing expenses increased to 0.67% of sales for the three months ended September 30, 2006 as compared to 0.44% of sales for the three months ended September 30, 2005.

General and administrative expenses increased \$118,001 or 24.18% from \$488,050 in the three months ended September 30, 2005 to \$606,051 in the three months ended September 30, 2006. This increase was principally attributable to an increase in certain expenses, such as depreciation and staff salaries.

### INCOME FROM OPERATIONS

Income from operations for the Company was \$394,743 for the three months ended September 30, 2006 compared to \$190,964 for the three months ended

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September 30, 2005, an increase of income by \$203,779 or 106.71%. This increase was the result of increase of gross profit during the third quarter of 2006.

### OTHER INCOME (EXPENSES)

Interest expense increased by \$138,922, or 262.01%, from \$53,021 in the three months ended September 30, 2005, to \$191,943 in the three months ended September 30, 2006. This increase is mainly due to increase of the use of the short-term borrowings plus new mortgage loans from the bank and increase in interest rate during the period. We expect our interest expense to continue to increase in the fourth quarter of 2006 because of increase of interest rate.

### INCOME TAX

Income tax increased by \$30,662 or 98.14% from \$31,243 for the three months ended September 30, 2005 to \$61,905 for the three months ended September 30, 2006, due to an increase of income before taxes for the three months ended September 30, 2006.

### NET INCOME

The Company's net income increased by \$67,419 or 61.70% from \$109,265 the three months ended September 30, 2005 to \$176,684 for the three months ended September 30, 2006 primarily due to increase of net sales and profit margin.

UNAUDITED NINE MONTHS ENDED SEPTEMBER 30, 2006 COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2005

### NET SALES

Net sales decreased by \$7,597,669 or 9.05% from \$83,956,406 in the nine months ended September 30, 2005 to \$76,358,737 in the nine months ended September 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.

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### COST OF SALES

Cost of sales decreased by \$8,448,799 or 10.31% from \$81,937,853 in the nine months ended September 30, 2005 to \$73,489,054 in the nine months ended September 30, 2006. The cost of sales decreased in proportion to the decrease of net sales.

### GROSS PROFIT

Gross profit increased by \$851,130 or 42.17% from \$2,018,553 in the nine months ended September 30, 2005 to \$2,869,683 in the nine months ended September 30, 2006. The gross profit % increased by 1.35% from 2.40% in the nine months ended September 30, 2005 to 3.76% in the nine months ended September 30, 2006. The increase in gross profit % was primarily attributable to the shortage of supplies of Samsung products for the third quarter ended of 2006. We expect the gross profit to be at this level in the coming months, but it will improve if the Company can successfully diversify its businesses and products.

### OPERATING EXPENSES

Selling expenses increased by \$190,856 or 50.91% from \$374,891 in the nine months ended September 30, 2005 to \$565,747 in the nine months ended



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September 30, 2006. The increase was primarily attributable to the sales commission expenses incurred for the third quarter of 2006.

General and administrative expenses increased by \$92,024 or 6.36% from \$1,446,025 in the nine months ended September 30, 2005 to \$1,538,049 in the nine months September 30, 2006. This increase was principally attributable to the fair value of options granted to certain employees in 2006. ACL expects the general and administrative expenses in the remaining quarter of 2006 be at the same approximate level as the third quarter of 2006.

### INCOME FROM OPERATIONS

Income from operations increased by \$568,250 or 287.52% from \$197,637 in the nine months ended September 30, 2005 to \$765,887 in the nine months ended September 30, 2006. The increase was mainly due to an increase in gross profit which as mentioned above increased by \$851,130.

### OTHER INCOME (EXPENSES)

Interest expenses increased by \$334,023 or 218.21% from \$153,075 in the nine months ended September 30, 2005 to \$487,098 in the nine months ended September 30, 2006. This increase is mainly due to increase of the use of the short-term borrowings plus new mortgage loans from the bank and increase in interest rate. We expect our interest expense to continue to increase in 2006 because of increased interest rates.

### INCOME TAX

Income tax increased by \$72,796 or 178.68% from \$40,742 in the nine months ended September 30, 2005 to \$113,538 in the nine months ended September 30, 2006 due to an increase of profit for the nine months ended September 30, 2006.

### NET INCOME

Net income increased by \$245,124 or 8,779.51% from \$2,792 in the nine months ended September 30, 2005 to \$247,916 in the nine months ended September 30, 2006. It is mainly due to increase in gross profit.

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## 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 to 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 to 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

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timely basis or on acceptable terms, if at all. The Company's business growth and prospects would be materially and adversely affected. 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 the expected results: 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 deemed 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, 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 nine months ended September 30, 2006, net cash used for operating activities was \$4,232,869 while in the nine months ended September 30, 2005, net cash provided by operating activities was \$766,037, an increase in net cash used for operating activities of \$4,998,906. This increase was primarily due to increase of inventories value and accounts receivable from related parties at September 30, 2006.

In the nine months ended September 30, 2006, net cash used for investing activities was \$5,709,714 while in the nine months ended September 30, 2005, ACL used \$153,617 in investing activities, an increase in cash used to \$5,556,097. Increase was primarily due to the increase of purchases of fixed assets and restricted cash deposited with the bank as part of the terms for its bank borrowings during the nine months ended September 30, 2006.

In the nine months ended September 30, 2006, net cash provided by financing activities was \$8,012,067 while in the nine months ended September 30, 2005, net cash used for financing activities was \$927,121, an increase of \$8,939,188. Increase was primarily due to increase of advance on long-term debt and 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 0.25% 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 nine months ended September 30, 2006 and the nine months ended September 30,

2005, ACL did not generate any material interest income or incur significant

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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.

### 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 the fourth quarter of 2006.

### ITEM 4. CONTROLS AND PROCEDURES

The Company has established disclosure controls and procedures to 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 its former auditors, Stonefield Josephson, Inc., and is 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

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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 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.

We filed the following current reports on Form 8-K during the period from April 1, 2006 to August 5, 2006:  
Form 8-K filed April 13, 2006 relating to items 1.01 and 9.01

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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: December 20, 2006

By: /s/ Chung-Lun Yang

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Chung-Lun Yang  
Chief Executive Officer

Date: December 20, 2006

By: /s/ Kenneth Lap-Yin Chan

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

