

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the Quarterly Period Ended October 31, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: 0-26277

WPCS INTERNATIONAL INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

98-0204758

(IRS Employer Identification No.)

One East Uwchlan Avenue

Suite 301

Exton, Pennsylvania 19341

(Address of principal executive offices)

(610) 903-0400

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$0.0001 par value

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for 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

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

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

As of December 11, 2006, there were 5,514,521 shares of registrant's common stock outstanding.

WPCS INTERNATIONAL INCORPORATED AND SUBSIDIARIES

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WPCS INTERNATIONAL INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

| ASSETS | October 31, 2006 <u>(Unaudited)</u> | April 30, 2006 <u>(Note 1)</u> |
|--|---|--------------------------------------|
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 10,878,639 | \$ 12,279,646 |
| Accounts receivable, net of allowance of \$98,786 and \$104,786 at October 31, 2006 and April 30, 2006, respectively | 13,667,657 | 12,141,789 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 2,248,549 | 1,441,977 |
| Inventory | 1,557,735 | 1,204,540 |
| Prepaid expenses and other current assets | 683,732 | 286,625 |
| Deferred income taxes | 39,000 | 78,000 |
| Total current assets | <u>29,075,312</u> | <u>27,432,577</u> |
| PROPERTY AND EQUIPMENT, net | 2,035,386 | 1,352,216 |
| CUSTOMER LISTS, net | 1,535,638 | 864,388 |
| GOODWILL | 18,823,738 | 14,239,918 |
| DEBT ISSUANCE COSTS, net | 84,736 | 111,091 |
| DEFERRED INCOME TAXES | 80,000 | 51,000 |
| OTHER ASSETS | <u>248,130</u> | <u>71,128</u> |
| Total assets | <u>\$ 51,882,940</u> | <u>\$ 44,122,318</u> |

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

WPCS INTERNATIONAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (continued)

| LIABILITIES AND SHAREHOLDERS' EQUITY | October 31, 2006 (Unaudited) | April 30, 2006 (Note 1) |
|---|------------------------------------|-------------------------------|
| CURRENT LIABILITIES: | | |
| Current portion of capital lease obligation | \$ 14,224 | \$ - |
| Current portion of loans payable | 277,533 | 231,065 |
| Accounts payable and accrued expenses | 5,940,676 | 4,989,861 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 2,016,187 | 1,085,312 |
| Deferred revenue | 512,024 | 128,052 |
| Due to shareholders | 678,610 | 381,377 |
| Income taxes payable | 506,366 | 420,066 |
| Deferred income taxes | 17,000 | 21,000 |
| Total current liabilities | 9,962,620 | 7,256,733 |
| Borrowings under line of credit | 4,437,446 | 3,000,000 |
| Loans payable, net of current portion | 299,898 | 256,692 |
| Due to shareholders, net of current portion | 468,891 | 514,623 |
| Deferred income taxes | 488,000 | 531,000 |
| Total liabilities | 15,656,855 | 11,559,048 |
| COMMITMENTS AND CONTINGENCIES | | |
| SHAREHOLDERS' EQUITY: | | |
| Preferred stock - \$0.0001 par value, 5,000,000 shares authorized, none issued | - | - |
| Common stock - \$0.0001 par value, 75,000,000 shares authorized, 5,514,187 and 5,264,284 shares issued and outstanding at October 31, 2006 and April 30, 2006, respectively | 551 | 526 |
| Additional paid-in capital | 35,208,843 | 33,525,130 |
| Retained earnings (accumulated deficit) | 1,016,691 | (962,386) |
| Total shareholders' equity | 36,226,085 | 32,563,270 |
| Total liabilities and shareholders' equity | \$ 51,882,940 | \$ 44,122,318 |

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

WPCS INTERNATIONAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| | Three Months Ended October 31, | | Six Months Ended October 31, | |
|--|-----------------------------------|-------------------------|---------------------------------|-------------------------|
| | 2006 | 2005 (Notes 1 and 2) | 2006 | 2005 (Notes 1 and 2) |
| REVENUE | \$ 17,753,044 | \$ 14,250,243 | \$ 34,189,322 | \$ 26,421,882 |
| COSTS AND EXPENSES: | | | | |
| Cost of revenue | 12,360,962 | 10,339,132 | 24,052,430 | 19,469,223 |
| Selling, general and administrative expenses | 3,239,738 | 2,355,681 | 6,336,060 | 4,622,383 |
| Depreciation and amortization | 337,242 | 209,593 | 570,891 | 421,060 |
| Total costs and expenses | 15,937,942 | 12,904,406 | 30,959,381 | 24,512,666 |
| OPERATING INCOME | 1,815,102 | 1,345,837 | 3,229,941 | 1,909,216 |
| OTHER EXPENSE (INCOME): | | | | |
| Interest expense | 134,502 | 65,694 | 214,436 | 112,041 |
| Interest income | (74,214) | (13,687) | (174,752) | (24,016) |
| (Gain) loss on change in fair value of warrants | - | (2,382,912) | - | 1,727,682 |
| INCOME BEFORE INCOME TAX PROVISION | 1,754,814 | 3,676,742 | 3,190,257 | 93,509 |
| Income tax provision | 690,167 | 509,025 | 1,211,180 | 721,108 |
| NET INCOME (LOSS) | \$ 1,064,647 | \$ 3,167,717 | \$ 1,979,077 | (\$627,599) |
| Basic net income (loss) per common share | \$ 0.19 | \$ 0.82 | \$ 0.37 | (\$0.16) |
| Diluted net income (loss) per common share | \$ 0.18 | \$ 0.82 | \$ 0.34 | (\$0.16) |
| Basic weighted average number of common shares outstanding | 5,500,579 | 3,853,994 | 5,408,531 | 3,837,689 |
| Diluted weighted average number of common shares outstanding | 6,026,999 | 3,869,522 | 5,849,495 | 3,837,689 |

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

WPCS INTERNATIONAL INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED OCTOBER 31, 2006
(Unaudited)

| | Preferred Stock | | Common Stock | | Additional Paid-In Capital | Retained Earnings (Accumulated Deficit) | Total Shareholders' Equity |
|--|-----------------|--------|--------------|--------|----------------------------------|--|----------------------------------|
| | Shares | Amount | Shares | Amount | | | |
| BALANCE, MAY 1, 2006 | - | \$ - | 5,264,284 | \$ 526 | \$ 33,525,130 | (\$962,386) | \$ 32,563,270 |
| Net issuance of common stock, acquisition of Southeastern Communication Service, Inc. | - | - | 200,288 | 20 | 1,349,630 | - | 1,349,650 |
| Net proceeds from exercise of warrants | - | - | 30,281 | 3 | 197,872 | - | 197,875 |
| Fair value of stock options granted to employees | - | - | - | - | 21,302 | - | 21,302 |
| Net proceeds from exercise of stock options | - | - | 19,334 | 2 | 114,909 | - | 114,911 |
| Net income | - | - | - | - | - | \$ 1,979,077 | 1,979,077 |
| BALANCE, OCTOBER 31, 2006 | - | \$ - | 5,514,187 | \$ 551 | \$ 35,208,843 | \$ 1,016,691 | \$ 36,226,085 |

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

WPCS INTERNATIONAL INCORPORATED AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Six Months Ended October 31, | |
|--|---------------------------------|---------------------|
| | 2006 | 2005 |
| OPERATING ACTIVITIES : | | (Notes 1 and 2) |
| Net income (loss) | \$ 1,979,077 | \$ (627,599) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 570,891 | 421,060 |
| Fair value of stock options granted to employees | 21,302 | - |
| Change in fair value of warrant liability | - | 1,727,682 |
| Provision for doubtful accounts | (6,000) | 18,000 |
| Amortization of debt issuance costs | 26,354 | 21,581 |
| Gain on sale of fixed assets | (13,876) | - |
| Deferred income taxes | (37,000) | (52,000) |
| Changes in operating assets and liabilities, net of effects of acquisitions: | | |
| Accounts receivable | 1,416,610 | (2,435,329) |
| Costs and estimated earnings in excess of billings on uncompleted contracts | (384,956) | (1,057,973) |
| Inventory | 186,701 | 270,385 |
| Prepaid expenses and other current assets | (317,868) | (153,017) |
| Other assets | (119,964) | 18,786 |
| Accounts payable and accrued expenses | (758,607) | (222,781) |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 759,370 | 335,256 |
| Deferred revenue | 291,177 | 63,755 |
| Income taxes payable | 88,600 | 749,843 |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | <u>3,701,811</u> | <u>(922,351)</u> |
| INVESTING ACTIVITIES: | | |
| Acquisition of property and equipment | (419,709) | (137,767) |
| Acquisition transaction costs | - | (4,303) |
| Acquisition of NECS, net of cash received | (4,458,465) | - |
| Acquisition of SECS, net of cash received | (1,516,545) | - |
| NET CASH USED IN INVESTING ACTIVITIES | <u>(6,394,719)</u> | <u>(142,070)</u> |
| FINANCING ACTIVITIES: | | |
| Net proceeds from exercise of warrants | 197,875 | 300,000 |
| Net proceeds from exercise of stock options | 114,911 | - |
| Equity issuance costs | (50,363) | - |
| Debt issuance costs | - | (158,787) |
| Borrowings under lines of credit, net | 1,437,446 | 2,617,719 |
| Repayments of loans payable | (288,454) | (74,261) |
| Payments of amounts due to shareholders | (109,000) | (807,913) |
| Payments of capital lease obligations | (10,514) | (1,365) |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | <u>1,291,901</u> | <u>1,875,393</u> |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (1,401,007) | 810,972 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 12,279,646 | 989,252 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | <u>\$ 10,878,639</u> | <u>\$ 1,800,224</u> |

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for quarterly reports on Form 10-Q of Article 10 of Regulation S-X and do not include all of the information and note disclosures required by accounting principles generally accepted in the United States of America. Accordingly, the unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the fiscal year ended April 30, 2006 included in the Company's Annual Report on Form 10-KSB. The accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) which are, in the opinion of the management, considered necessary for a fair presentation of financial position, results of operations and cash flows for the interim periods. Operating results for the three and six month periods ended October 31, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending April 30, 2007. Certain reclassifications have been made to prior period financial statements to conform to the current presentation. The amounts for the April 30, 2006 balance sheet have been extracted from the audited consolidated financial statements included in Form 10-KSB for the year ended April 30, 2006.

The accompanying unaudited condensed consolidated financial statements include the accounts of WPCS International Incorporated ("WPCS") and its wholly owned subsidiaries, WPCS Incorporated, Invisinet Inc. ("Invisinet"), Walker Comm Inc. ("Walker"), Clayborn Contracting Group, Inc. ("Clayborn"), Heinz Corporation ("Heinz"), Quality Communications & Alarm Company ("Quality"), New England Communication Systems, Inc. ("NECS") from June 1, 2006 (date of acquisition) and Southeastern Communication Service, Inc. ("SECS") from July 19, 2006 (date of acquisition), collectively the "Company".

The Company provides design-build engineering services for specialty communication systems, which are dedicated wireless networks for specified applications, and for wireless infrastructure, which encompasses commercial cellular systems for wireless carriers. The Company provides a range of services including site design, spectrum analysis, engineering, trenching, electrical work, structured cabling, product integration, testing and project management.

Effective June 1, 2006, the Company acquired NECS, a Connecticut corporation, for approximately \$4,523,000 in cash. NECS was acquired pursuant to a Stock Purchase Agreement among WPCS, NECS, and the shareholders of NECS. Based on the preliminary allocation of the net assets acquired from NECS, the Company has recognized goodwill and other intangible assets of approximately \$3,537,000. Upon completion of the final purchase price allocation, there may be a decrease or increase in the amount assigned to goodwill and a corresponding increase or decrease in tangible or intangible assets.

Effective July 19, 2006, the Company acquired SECS of Sarasota, Florida for approximately \$2,061,000 in cash and 200,288 shares of the Company's common stock having a value of approximately \$1,400,000. SECS was acquired pursuant to a Stock Purchase Agreement among WPCS, SECS, and the shareholders of SECS. Based on the preliminary allocation of the net assets acquired from SECS, the Company has recognized goodwill and other intangible assets of approximately \$1,997,000. Upon completion of the final purchase price allocation, there may be a decrease or increase in the amount assigned to goodwill and a corresponding increase or decrease in tangible or intangible assets.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - EQUITY ISSUED WITH REGISTRATION RIGHTS

On November 16, 2004, the Company completed a private placement with certain investors for an aggregate of 2,083,887 shares of its common stock and 2,083,887 common stock purchase warrants for \$10,000,000. Under the terms of the sale, the investors were granted certain registration rights that provided for liquidated damages in the event the Company failed to timely perform under the registration rights agreements.

During the third quarter of fiscal 2006, the Company became aware that the SEC had recently announced its preferred interpretation of the accounting for common stock and warrants with registration rights under Emerging Issues Task Force ("EITF") 00-19, "Accounting for Derivative Financial Instruments Indexed To, and Potentially Settled in the Company's Own Stock," and EITF 05-04, "The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument Subject to EITF 00-19." Although the EITF was still reviewing the guidance in EITF 05-04, the SEC concluded that under EITF 00-19, the common stock and warrants subject to registration rights where significant liquidated damages could be required to be paid to the holder of the instrument in the event the issuer fails to maintain the effectiveness of a registration statement for a preset time period does not meet the tests required for shareholders' equity classification and, accordingly, must be reflected as temporary equity in the balance sheet until the conditions are eliminated. Additionally, the fair value of warrants should be recorded as a liability, with an offsetting reduction to shareholders' equity, adjusted to market value at the end of each period. In analyzing instruments under EITF 00-19, the SEC concluded that the likelihood or probability related to the failure to maintain an effective registration statement was not a factor at that time.

For the six months ended October 31, 2005, the warrant liability increased by \$1,727,682, due to the increase in the market value of the Company's common stock, resulting in the Company recording a non-cash loss on fair value of warrants during the six month period. The non-cash loss on warrants had no effect on the Company's cash flows or liquidity.

On April 11, 2006, the Company entered into a waiver agreement with the institutional investors related to this private placement. Under the waiver, the parties agreed to modify the registration rights agreement associated with the common stock and warrants issued in November 2004 affected by EITF 00-19, thereby eliminating the penalty provisions that could have resulted from not maintaining an effective registration statement related to these common shares and shares underlying the warrants, and eliminating any similar non-cash charges in subsequent fiscal years.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of significant accounting policies consistently applied in the preparation of the accompanying condensed consolidated financial statements follows (additional policies are set forth in the Company's Annual Report on Form 10-KSB):

Goodwill

In accordance with Statement of Financial Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," goodwill and indefinite-lived intangible assets are no longer amortized but are assessed for impairment on at least an annual basis. SFAS No. 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment.

SFAS No. 142 requires that goodwill be tested for impairment at least annually, utilizing a two-step methodology. The initial step requires the Company to determine the fair value of the business acquired (reporting unit) and compare it to the carrying value, including goodwill, of such business (reporting unit). If the fair value exceeds the carrying value, no impairment loss is recognized. However, if the carrying value of the reporting unit exceeds its fair value, the goodwill of the unit may be impaired. The amount, if any, of the impairment is then measured in the second step, based on the excess, if any, of the reporting unit's carrying value of goodwill over its implied value.

The Company determines the fair value of the reporting units for purposes of this test primarily by using a discounted cash flow valuation technique. Significant estimates used in the valuation include estimates of future cash flows, both future short-term and long-term growth rates, and estimated cost of capital for purposes of arriving at a discount factor. The Company performs its annual impairment test during the fourth quarter absent any interim impairment indicators.

WPCS INTERNATIONAL INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Changes in goodwill during the six months ended October 31, 2006:

| | | |
|--|----|-------------------|
| Beginning balance, May 1, 2006 | \$ | 14,239,918 |
| NECS acquisition -subject to appraisal adjustments | | 2,966,988 |
| SECS acquisition -subject to appraisal adjustments | | 1,616,832 |
| Ending balance, October 31, 2006 | \$ | <u>18,823,738</u> |

Revenue Recognition

The Company generates its revenue by providing engineering and deployment services for wireless infrastructure services and specialty communication systems. The Company provides a range of services including site design, spectrum analysis, engineering, trenching, electrical work, structured cabling, product integration, testing and project management.

The Company primarily records revenue and profit on a percentage-of-completion basis using the cost-to-cost method. Contracts in process are valued at cost plus accrued profits less earned revenues and progress payments on uncompleted contracts. Contracts are generally considered substantially complete when engineering is completed and/or site construction is completed.

The Company has numerous contracts that are in various stages of completion. Such contracts require estimates to determine the appropriate cost and revenue recognition. Cost estimates are reviewed monthly on a contract-by-contract basis, and are revised periodically throughout the life of the contract such that adjustments to profit resulting from revisions are made cumulative to the date of the revision. Significant management judgments and estimates, including the estimated cost to complete projects, which determines the project's percent complete, must be made and used in connection with the revenue recognized in the accounting period. Current estimates may be revised as additional information becomes available. If estimates of costs to complete long-term contracts indicate a loss, provision is made currently for the total loss anticipated.

The Company also recognizes certain revenue when equipment is delivered or the services have been provided to the customer. For maintenance contracts, revenue is recognized ratably over the service period.

Earnings (Loss) Per Share

Earnings (loss) per common share is computed pursuant to SFAS No. 128, "Earnings Per Share" ("EPS"). Basic income (loss) per common share is computed as net income (loss) divided by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common stock issuable through stock options and warrants. At October 31, 2006, the Company had 738,637 stock options and 1,884,347 warrants outstanding which are potentially dilutive securities. For the three months ended October 31, 2006, 135,834 options were not included in the computation of fully diluted earnings per share, because the stock option exercise price exceeded the market price of common stock and, therefore, the effects would be antidilutive. The assumed conversion of the remaining 602,803 stock options and 1,884,347 warrants resulted in a 526,420 share increase in weighted average shares for fully diluted earnings per share.

For the six months ended October 31, 2006, 135,834 options were not included in the computation of fully diluted earnings per share, because the stock option exercise price exceeded the market price of common stock and, therefore, the effects would be antidilutive. The assumed conversion of the remaining 602,803 stock options and 1,884,347 warrants resulted in a 440,964 share increase in weighted average shares for fully diluted earnings per share.

At October 31, 2005, the Company had 800,154 stock options and 2,509,671 warrants outstanding which were potentially dilutive securities. For the three months ended October 31, 2005, 568,651 stock options and 2,509,671 warrants were not included in the computation of fully diluted earnings per share, because the stock option and warrant exercise prices exceeded the market price of the common stock and, therefore, the effects would be antidilutive. The assumed conversion of the remaining 231,503 stock options resulted in a 15,528 share increase in weighted average shares for fully diluted earnings per share.

For the six months ended October 31, 2005, 800,154 stock options and 2,509,671 warrants were not included in the computation of fully diluted earnings per share, because the stock option and warrant exercise prices exceeded the market price of the common stock and, therefore, the effects would be antidilutive.

WPCS INTERNATIONAL INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Stock-Based Compensation

SFAS 123(R) (revised December 2004), *Share-Based Payment*, an amendment of SFAS 123, *Accounting for Stock-Based Compensation*, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As a result of the amendments to SFAS 123, the Company is required to expense the fair value of employee stock options effective May 1, 2006. The revised standard requires the Company to expense the fair value of employee stock options and other share-based payments over the service period.

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. The most significant estimates relate to the calculation of percentage-of-completion on uncompleted contracts, allowance for doubtful accounts, valuation of inventory, useful life of customer lists, deferred tax valuation allowance, the fair values of the assets and liabilities of purchased businesses and the factors related to determining if goodwill is impaired. Actual results will likely differ from those estimates.

Recently Issued Accounting Pronouncements

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FAS No. 109* ("FIN 48"), which clarifies the accounting for uncertainty in income taxes and is subject to significant and varied interpretations that have resulted in diverse and inconsistent accounting practices and measurements. Addressing such diversity, FIN 48 prescribes a consistent recognition threshold and measurement attribute, as well as clear criteria for subsequently recognizing, derecognizing and measuring changes in such tax positions for financial statement purposes. FIN 48 also requires expanded disclosure with respect to the uncertainty in income taxes. FIN 48 is effective for fiscal years beginning after December 15, 2006. We have not yet determined the impact of FIN 48 on the Company's condensed consolidated financial position, results of operations, cash flows or financial statement disclosures.

On September 15, 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("SFAS 157"), which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. We are currently evaluating the potential impact, if any, of the adoption of SFAS 157 on the Company's condensed consolidated financial position, results of operations and cash flows or financial statement disclosures.

NOTE 4 - ACQUISITIONS

In accordance with SFAS No. 141, "Business Combinations," acquisitions are accounted for under the purchase method of accounting. Under the purchase method of accounting, assets acquired and liabilities assumed are recorded at their estimated fair values. Goodwill is recorded to the extent the purchase price consideration, including certain acquisition and closing costs, exceeds the fair value of the net identifiable assets acquired at the date of the acquisition.

NECS

Effective June 1, 2006, the Company acquired all of the issued and outstanding common stock of NECS. The aggregate consideration paid by the Company to the NECS selling shareholders, net of acquisition transaction costs of \$65,150, was \$4,523,064, of which \$4,333,987 was paid at closing. Additional purchase price adjustments of \$189,077 were paid in October 2006 to settle working capital adjustments. In addition, for each \$2.00 of earnings before interest and taxes for the calendar year ending December 31, 2006, the NECS shareholders shall be paid aggregate additional consideration of \$1.00, up to a maximum of \$468,000. At the Company's option, any amount of consideration due to be paid may be paid in cash or shares of the Company's common stock (valued at the last sale price of the common stock on the date two days prior to the date the payment is due). In connection with the acquisition, NECS entered into employment agreements with two of the shareholders, each for a period of two years and a consulting agreement with one of the shareholders for a period of seven years.

The acquisition of NECS provides the Company with additional project engineering expertise for specialty communication systems, broadens the Company's customer base especially in the public safety and gaming markets, including the Massachusetts State Police, University of Connecticut and Foxwoods Resort Casino, and expands the Company's geographic presence in New England.

WPCS INTERNATIONAL INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Based on the preliminary information currently available, the acquisition resulted in goodwill and other intangible assets of approximately \$3,537,000. Upon completion of a formal purchase price allocation, there may be a decrease or increase in the amount assigned to goodwill and a corresponding increase or decrease in tangible or other intangible assets.

The preliminary purchase price allocation has been determined as follows:

| | |
|------------------------|---------------------|
| Assets purchased: | |
| Cash | \$ 129,749 |
| Accounts receivable | 990,860 |
| Inventory | 442,800 |
| Prepaid expenses | 33,237 |
| Fixed assets | 359,960 |
| Other assets | 3,455 |
| Customer list | 570,000 |
| Goodwill | 2,966,988 |
| | <u>5,497,049</u> |
| Liabilities assumed: | |
| Accounts payable | (747,379) |
| Accrued expenses | (31,162) |
| Deferred revenue | (94,803) |
| Notes payable | (24,738) |
| Accrued property taxes | (10,753) |
| | <u>(908,835)</u> |
| Purchase price | <u>\$ 4,588,214</u> |

SECS

Effective July 19, 2006, the Company acquired all of the issued and outstanding common stock of SECS. The aggregate consideration paid by the Company to the SECS selling shareholders, net of acquisition transaction costs of \$16,557, was \$3,460,514, of which \$1,620,000 was paid at closing, and the Company issued 200,288 shares of common stock valued at approximately \$1,400,000. Additional purchase price adjustments of \$440,514 were accrued at October 31, 2006, and paid in November 2006, to settle working capital adjustments. The Company filed a registration statement with the SEC on August 14, 2006 to register the shares of common stock issued to the former SECS shareholders, which was declared effective by the SEC on August 24, 2006. In connection with the acquisition, SECS entered into employment agreements and a consulting agreement with certain officers or former officers of SECS.

The acquisition of SECS provides the Company with additional project engineering expertise for wireless infrastructure services, broadens the Company's customer base of corporate, government and educational clients, including the National Oceanic and Atmospheric Administration (NOAA), Verizon, BellSouth, Comcast, Time Warner, University of Florida and Puerto Rico Telephone, and expands the Company's geographic presence in the Southeastern United States.

Based on the preliminary information currently available, the acquisition resulted in goodwill and other intangible assets of approximately \$1,997,000. Upon completion of a formal purchase price allocation, there may be a increase or decrease in the amount assigned to goodwill and a corresponding increase or decrease in tangible or other intangible assets.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The preliminary purchase price allocation has been determined as follows:

| | |
|-----------------------------|--------------|
| Assets purchased: | |
| Cash | \$ 200,012 |
| Accounts receivable | 1,945,618 |
| Inventory | 97,096 |
| Prepaid expenses | 54,186 |
| Costs in excess of billings | 421,616 |
| Fixed assets | 226,764 |
| Other assets | 400 |
| Backlog | 60,000 |
| Customer list | 320,000 |
| Goodwill | 1,616,832 |
| | 4,942,524 |
| Liabilities assumed: | |
| Accounts payable | (727,612) |
| Accrued expenses | (75,159) |
| Pension plan payable | (75,000) |
| Profit sharing | (40,056) |
| Notes payable | (378,129) |
| Billings in excess of cost | (169,498) |
| | (1,465,454) |
| Purchase price | \$ 3,477,070 |

Pro forma Information

The following unaudited pro forma financial information presents the combined results of operations of the Company, NECS and SECS for the three months and six months ended October 31, 2006 and 2005 as if the acquisitions had occurred at the beginning of the period, after giving effect to certain adjustments, including the issuance of the Company's common stock described above to finance the acquisition of SECS. The pro forma financial information does not necessarily reflect the results of operations that would have occurred had the Company, NECS and SECS been a single entity during this period.

| | Consolidated pro forma | | |
|-------------------------------------|---|--------------------------------------|--------------------------------------|
| | Three months ended October 31, 2005 | Six months ended October 31, 2006 | Six months ended October 31, 2005 |
| Revenues | \$ 18,429,364 | \$ 37,353,223 | \$ 34,300,059 |
| Net income (loss) | \$ 3,448,025 | \$ 2,034,171 | (\$440,176) |
| Basic net income (loss) per share | \$ 0.85 | \$ 0.37 | (\$0.11) |
| Diluted net income (loss) per share | \$ 0.85 | \$ 0.34 | (\$0.11) |

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NOTE 5 - COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS

Costs and estimated earnings on uncompleted contracts consist of the following at October 31, 2006:

| | |
|---|--------------------|
| Costs incurred on uncompleted contracts | \$ 30,727,843 |
| Estimated contract profit | 8,713,841 |
| | <u>39,441,684</u> |
| Less: billings to date | 39,209,322 |
| Net excess of costs | <u>\$ 232,362</u> |
| | |
| Costs and estimated earnings in excess of billings | \$ 2,248,549 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | <u>(2,016,187)</u> |
| Net excess of costs | <u>\$ 232,362</u> |

NOTE 6 - RELATED PARTY TRANSACTIONS

In connection with the acquisition of Walker, the Company assumed a ten-year lease with a trust, of which, a certain officer of the Company is the trustee, for a building and land located in Fairfield, California, which is occupied by its Walker subsidiary. For each of the six months ended October 31, 2006 and 2005, the rent paid for this lease was \$44,000.

In connection with the acquisition of Clayborn, an additional \$1,100,000 is due by September 30, 2007, payable in quarterly distributions to the Clayborn shareholders, by payment of 50% of the quarterly post tax profits, as defined, of Clayborn and the payment of the remainder on that date. Through October 31, 2006, payments of \$313,000 have been made to the former Clayborn shareholders and the total remaining due is \$787,000.

In connection with the acquisition of Heinz, a \$200,000 non-interest bearing promissory note was issued. Of the \$200,000, \$75,000 was paid in April 2005, \$75,000 was paid in April 2006 and \$50,000 is payable on April 30, 2007.

In connection with the acquisition of Quality, approximately \$758,000 of additional purchase price consideration was paid to the selling shareholders in June 2005 to settle working capital adjustments and income tax reimbursements related to the shareholders electing to make an Internal Revenue Service 338 (h) (10) election.

NOTE 7 - LINE OF CREDIT

On June 3, 2005, the Company entered into a credit agreement with a commercial bank. The credit agreement provides for a revolving line of credit in an amount not to exceed \$5,000,000, together with a letter of credit facility not to exceed \$500,000, (the "Credit Agreement"). The Company also entered into security agreements with the bank, pursuant to which each subsidiary granted a security interest to the bank in all of their assets.

Under the terms of the Credit Agreement, as amended, the Company was permitted to borrow up to \$5,000,000 under the revolving credit line, based upon eligible receivables as of October 31, 2006. As of October 31, 2006, the outstanding balance was \$4,437,446. Loans under the Credit Agreement bear interest at a rate equal to either the bank's reference rate plus one half (0.5%) percent, or LIBOR plus two and three-quarters (2.75%) percent, as the Company may request (8.187% as of October 31, 2006). The Company paid a facility fee to the bank of \$50,000 on the closing date. In addition to the loan, a \$500,000 letter of credit was also re-issued in favor of Walker's surety bonding company as collateral for performance and payment bonds. In November 2006, the letter of credit was released by the surety bonding company and cancelled by the bank.

The Credit Agreement contains customary covenants, including but not limited to (i) restrictions on the permitted ratio of total unsubordinated liabilities to tangible net worth plus subordinated indebtedness, (ii) the Company's total tangible net worth, (iii) working capital, (iv) minimum earnings before interest, taxes, depreciation and amortization, and the change in the warrant liability and (v) dividend restrictions. As of October 31, 2006, the Company was in compliance with the credit agreement covenants. The loan commitment expires on August 31, 2008. The Company may prepay the loan at any time.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 - STOCK-BASED COMPENSATION

In September 2006, the Company adopted the 2007 Incentive Stock Plan, under which officers, directors, key employees or consultants may be granted options. Under the 2007 Incentive Stock Plan, 400,000 shares of common stock were reserved for issuance upon the exercise of stock options, stock awards or restricted stock. At October 31, 2006, there were no stock options granted under this plan.

In September 2005, the Company adopted the 2006 Incentive Stock Plan, under which officers, directors, key employees or consultants may be granted options. Under the 2006 Incentive Stock Plan, 400,000 shares of common stock were reserved for issuance upon the exercise of stock options, stock awards or restricted stock. These shares were registered under Form S-8. Under the terms of the 2006 Incentive Stock Plan, stock options are granted at exercise prices equal to the fair market value of the common stock at the date of grant, and become exercisable and expire in accordance with the terms of the stock option agreement between the optionee and the Company at the date of grant. These options generally vest based on between 1 to 3 years of continuous service and have 5-year contractual terms. From plan inception through October 31, 2006, options to purchase 378,702 shares were granted at exercise prices ranging from \$6.14 to \$8.79. At October 31, 2006, there were 5,298 options available for grant under the 2006 Incentive Stock Plan.

In March 2003, the Company established a stock option plan pursuant to which options to acquire a maximum of 416,667 shares of the Company's common stock were reserved for grant (the "2002 Plan"). These shares were registered under Form S-8. Under the terms of the 2002 Plan, the options are exercisable at prices equal to the fair market value of the stock at the date of the grant and become exercisable in accordance with terms established at the time of the grant. These options generally vest based on between 1 to 3 years of continuous service and have 5-year contractual terms. At October 31, 2006, options to purchase 359,935 shares were outstanding at exercise prices ranging from \$4.80 to \$19.92. At October 31, 2006, there were 42,147 shares available for grant under the 2002 Plan.

Prior to May 1, 2006, the Company accounted for stock-based employee compensation under the recognition provisions of Accounting Principles Board Opinion No. 25 ("APB 25"), *Accounting for Stock Issued to Employees* and related interpretations.

Effective May 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123(R) (revised December 2004), *Share-Based Payment*, an amendment of SFAS 123, *Accounting for Stock-Based Compensation*, for stock-based employee compensation, using the modified prospective transition method. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107), to provide guidance regarding the adoption of SFAS 123(R), and then amended the compliance date for SFAS 123R to begin with the first fiscal year beginning on or after December 15, 2005. Under SFAS 123(R), the Company is required to recognize compensation cost for share-based compensation issued to employees, net of estimated forfeitures, under share-based compensation plans using a fair value method. Using the modified prospective transition method, compensation expense recognized for the six months ended October 31, 2006 includes (a) compensation cost for all share-based payments granted subsequent to May 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R) and (b) compensation cost for all share-based payments granted prior to, but not yet vested as of, May 1, 2006, based on the intrinsic value method. Results for prior periods have not been restated.

As a result of adopting SFAS 123(R) on May 1, 2006, the Company's income before income taxes and net income for the six months ended October 31, 2006 were each approximately \$21,000 lower than if it had continued to account for share-based compensation under APB 25. At October 31, 2006, the total compensation cost related to unvested stock options granted to employees under the Company's stock option plans but not yet recognized was approximately \$81,000 and is expected to be recognized over a weighted-average period of 1.6 years. For the six months ended October 31, 2006 and 2005, the weighted average fair value of stock options granted was \$3.86 and \$2.08, respectively.

The Company estimates the fair value of stock options granted using the Black-Scholes-Merton option-pricing model. Compensation cost is then recognized on a straight-line basis over the vesting or service period and is net of estimated forfeitures. The following assumptions were used to compute the fair value of stock options granted during the six months ended October 31, 2006:

| | |
|---------------------------|----------------|
| Risk-free interest rate | 4.73% to 4.96% |
| Expected volatility | 61.0% to 62.4% |
| Expected dividend yield | 0.0% |
| Expected life (in years) | 3.5 |

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The risk-free rate is based on the rate of U.S Treasury zero-coupon issues with a remaining term equal to the expected life of the option grants. Expected volatility is based on the historical volatility of the Company's common stock using the weekly closing price of the Company's common stock, pursuant to SAB 107. The expected dividend yield is zero based on the fact that the Company has never paid cash dividends and has no present intention to pay cash dividends. The expected term represents the period that the Company's stock-based awards are expected to be outstanding and was calculated using the simplified method pursuant to SAB 107.

Prior to May 1, 2006, the Company applied the intrinsic value method in accounting for its stock-based compensation plan. Had the Company measured compensation under the fair value-based method for stock options granted and amortized the cost over the related vesting period, the Company's net income and net income per share would have been as follows:

| | Three months ended October 31, 2005 | Six months ended October 31, 2005 |
|---|--|--|
| Net income (loss), as reported | \$ 3,167,717 | (\$627,599) |
| Deduct: total stock-based employee compensation expense determined under fair value based method for all awards, net of tax | (60,462) | (73,143) |
| Net income (loss), pro forma | <u>\$ 3,107,255</u> | <u>\$ (700,742)</u> |
| Basic net income (loss) per share | | |
| As reported | \$ 0.82 | \$ (0.16) |
| Pro forma | \$ 0.81 | \$ (0.18) |
| Diluted net income (loss) per share | | |
| As reported | \$ 0.82 | \$ (0.16) |
| Pro forma | \$ 0.80 | \$ (0.18) |

The following table summarizes stock option activity for the six months ended October 31, 2006, during which there were 19,334 options exercised under the Company's stock option plans:

| | 2002 Plan | | | | 2006 Plan | | | |
|-------------------------------|---------------------|---|--|---------------------------------|---------------------|---|--|---------------------------------|
| | Number of Shares | Weighted- average Exercise Price | Weighted- average Remaining Contractual Term | Aggregate Intrinsic Value | Number of Shares | Weighted- average Exercise Price | Weighted- average Remaining Contractual Term | Aggregate Intrinsic Value |
| Outstanding, May 1, 2006 | 402,932 | \$ 7.87 | | | 383,500 | \$ 6.16 | | |
| Granted | - | - | | | 11,252 | 8.01 | | |
| Exercised | (3,334) | 5.07 | | | (16,000) | 6.14 | | |
| Forfeited/Expired | (39,663) | 9.06 | | | (50) | 7.04 | | |
| Outstanding, October 31, 2006 | <u>359,935</u> | <u>\$ 7.77</u> | <u>2.7</u> | <u>\$ 1,031,803</u> | <u>378,702</u> | <u>\$ 6.21</u> | <u>4.2</u> | <u>\$ 1,491,267</u> |
| Vested and expected | | | | | | | | |
| to vest, October 31, 2006 | 357,294 | \$ 7.78 | 2.7 | \$ 1,023,421 | 376,543 | \$ 6.20 | 4.3 | \$ 1,485,962 |
| Exercisable, October 31, 2006 | 340,888 | \$ 7.82 | 2.6 | \$ 968,052 | 364,000 | \$ 6.15 | 4.3 | \$ 1,457,290 |

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9 - SEGMENT REPORTING

The Company's reportable segments are determined and reviewed by management based upon the nature of the services, the external customers and customer industries and the sales and distribution methods used to market the products. The Company has two reportable segments: wireless infrastructure services and specialty communication systems. Management evaluates performance based upon income (loss) before income taxes. Corporate includes corporate salaries and external professional fees, such as accounting, legal and investor relations costs. Corporate assets include cash, prepaid expenses and deferred tax assets. Segment results for the three and six months ended October 31, 2006 and 2005 are as follows:

| | For Three Months Ended October 31, 2006 | | | | For Three Months Ended October 31, 2005 | | | |
|-----------------------------------|---|-------------------------|-------------------------|---------------|---|-------------------------|-------------------------|---------------|
| | Corporate | Wireless Infrastructure | Specialty Communication | Total | Corporate | Wireless Infrastructure | Specialty Communication | Total |
| Revenue | \$ - | \$ 3,729,849 | \$ 14,023,195 | \$ 17,753,044 | \$ - | \$ 2,255,503 | \$ 11,994,740 | \$ 14,250,243 |
| Income (loss) before income taxes | (\$373,853) | \$ 217,397 | \$ 1,911,270 | \$ 1,754,814 | \$ 2,024,146 | \$ 233,336 | \$ 1,419,260 | \$ 3,676,742 |

| | As of/for Six Months Ended October 31, 2006 | | | | As of/for Six Months Ended October 31, 2005 | | | |
|-----------------------------------|---|-------------------------|-------------------------|---------------|---|-------------------------|-------------------------|---------------|
| | Corporate | Wireless Infrastructure | Specialty Communication | Total | Corporate | Wireless Infrastructure | Specialty Communication | Total |
| Revenue | \$ - | \$ 6,414,969 | \$ 27,774,353 | \$ 34,189,322 | \$ - | \$ 3,819,678 | \$ 22,602,204 | \$ 26,421,882 |
| Income (loss) before income taxes | (\$1,008,551) | \$ 543,125 | \$ 3,655,683 | \$ 3,190,257 | (\$2,607,851) | \$ 378,590 | \$ 2,322,770 | \$ 93,509 |
| Goodwill | \$ - | \$ 4,098,917 | \$ 14,724,821 | \$ 18,823,738 | \$ - | \$ 2,482,085 | \$ 11,626,198 | \$ 14,108,283 |
| Total assets | \$ 4,659,261 | \$ 10,782,827 | \$ 36,440,852 | \$ 51,882,940 | \$ 1,868,055 | \$ 5,362,382 | \$ 27,114,673 | \$ 34,345,110 |

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations includes a number of forward-looking statements that reflect Management's current views with respect to future events and financial performance. You can identify these statements by forward-looking words such as "may," "will," "expect," "anticipate," "believe," "estimate" and "continue," or similar words. Those statements include statements regarding the intent, belief or current expectations of us and members of its management team as well as the assumptions on which such statements are based. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risk and uncertainties, and that actual results may differ materially from those contemplated by such forward-looking statements.

Readers are urged to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the Securities and Exchange Commission. Important factors currently known to Management could cause actual results to differ materially from those in forward-looking statements. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes in the future operating results over time. We believe that its assumptions are based upon reasonable data derived from and known about our business and operations and the business and operations of the Company. No assurances are made that actual results of operations or the results of our future activities will not differ materially from its assumptions. Factors that could cause differences include, but are not limited to, expected market demand for the Company's services, fluctuations in pricing for materials, and competition.

Business Overview

We respond to the growing demand in wireless communications by providing engineering services for the design and deployment of wireless networks. We operate in two segments that we define as specialty communication systems and wireless infrastructure services.

We generate our revenue by providing a range of services including the design, deployment and maintenance of:

- two-way radio communication systems, which are used primarily for emergency dispatching;
- Wi-Fi networks, which are wireless local area networks that operate on a set of product compatibility standards;
- WiMAX networks, which are networks that can operate at higher speeds and over greater distances than Wi-Fi;
- mesh networks, which are redundant systems to route information between points;
- millimeter wave networks, which are high capacity networks for high speed wireless access;
- fixed wireless networks, which are used in point-to-point outdoor communications;
- Radio Frequency Identification, or RFID, networks, which allow customers to identify and track assets;
- free-space optics, which is a wireless communication technology that uses light to transmit voice, data and video; and
- commercial cellular systems, which are used primarily for mobile communications.

Specialty communication systems are wireless networks for a specified customer application. In this segment, we can utilize any facet of wireless technology or a combination of various wireless technologies to engineer a cost effective network for a customer's wireless communication requirement. Customers include corporations, government entities and educational institutions. For the six months ended October 31, 2006, specialty communication systems represented approximately 81% of our total revenue.

Wireless infrastructure services include the design, deployment and maintenance of commercial cellular systems. The primary customers in this category include major wireless service providers such as Sprint Nextel and Cingular. For the six months ended October 31, 2006, wireless infrastructure services represented approximately 19% of our total revenue.

Management currently considers the following events, trends and uncertainties to be important in understanding our results of operations and financial condition:

- For the six months ended October 31, 2006, the specialty communication systems segment represented approximately 81% of total revenue, and the wireless infrastructure services segment represented approximately 19% of total revenue, which remains consistent with our historical services revenue mix.

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

- As we continue to search for acquisitions, our primary goal is to identify companies which are performing well financially and are compatible with the services that we perform in the specialty communication systems segment. This trend could lead to a further shift in our revenue composition towards the specialty communication systems segment. We believe that the strength of our experience in the design and deployment of specialty communication systems gives us a competitive advantage.
- We also seek to achieve organic growth in our existing business by maximizing the value of our existing customer base, maintaining and expanding our focus in vertical markets and developing our relationships with technology providers.
- We believe that the emergence of new and improved technologies such as WiMAX will create additional opportunities for us to design and deploy solutions through the use of the latest technologies and assisting existing customers in enhancing the efficiency of their existing wireless networks using new technologies.
- We believe that the wireless carriers will continue to make expenditures to build and upgrade their networks, increase existing capacity, upgrade their networks with new technologies and maintain their existing infrastructure. In response to this trend, we will continue to provide network deployment services that address wireless carrier needs.
- In connection with the sale of our common stock and warrants to certain investors during the third quarter ended January 31, 2005, we granted certain registration rights that provided for liquidated damages in the event of failure to timely perform under the agreements. During the third quarter of fiscal 2006, we became aware that the SEC had recently announced its preferred interpretation of the accounting for common stock and warrants with registration rights under Emerging Issues Task Force (EITF) 00-19, "Accounting for Derivative Financial Instruments Indexed To, and Potentially Settled in the Company's Own Stock," and EITF 05-04, "The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument Subject to EITF 00-19." Although the EITF was still reviewing the guidance in EITF 05-04, the SEC concluded that under EITF 00-19, the common stock and warrants subject to registration rights where significant liquidated damages could be required to be paid to the holder of the instrument in the event the issuer fails to maintain the effectiveness of a registration statement for a preset time period does not meet the tests required for shareholders' equity classification and accordingly, must be reflected as temporary equity in the balance sheet until the conditions are eliminated. Additionally, the fair value of warrants should be recorded as a liability, with an offsetting reduction to shareholders' equity, adjusted to market value at the end of each period. In analyzing instruments under EITF 00-19, the SEC concluded that the likelihood or probability related to the failure to maintain an effective registration statement was not a factor at that time.

For the six months ended October 31, 2005, the warrant liability increased by \$1,727,682, due to the increase in the market value of our common stock, resulting in us recording a non-cash loss on fair value of warrants during the six month period. The non-cash loss on warrants had no effect on our cash flows or liquidity.

On April 11, 2006, we entered into a waiver agreement with the institutional investors related to this private placement. Under the waiver, the parties agreed to modify the registration rights agreement associated with the common stock and warrants issued in November 2004 affected by EITF 00-19, thereby eliminating the penalty provisions that could have resulted from not maintaining an effective registration statement related to these common shares and shares underlying the warrants, and eliminating any similar non-cash charges in subsequent fiscal years.

WPCS INTERNATIONAL INCORPORATED AND SUBSIDIARIES

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

Results of Operations for the Three Months Ended October 31, 2006 Compared to the Three Months Ended October 31, 2005

Consolidated results for the three months ended October 31, 2006 and 2005 were as follows. Certain reclassifications have been made to prior year financial statements to conform to the current presentation.

| | Three Months Ended October 31, | | | |
|--|-----------------------------------|--------|---------------|---------|
| | 2006 | | 2005 | |
| REVENUE | \$ 17,753,044 | 100.0% | \$ 14,250,243 | 100.0% |
| COSTS AND EXPENSES: | | | | |
| Cost of revenue | 12,360,962 | 69.6% | 10,339,132 | 72.6% |
| Selling, general and administrative expenses | 3,239,738 | 18.3% | 2,355,681 | 16.5% |
| Depreciation and amortization | 337,242 | 1.9% | 209,593 | 1.5% |
| Total costs and expenses | 15,937,942 | 89.8% | 12,904,406 | 90.6% |
| OPERATING INCOME | 1,815,102 | 10.2% | 1,345,837 | 9.4% |
| OTHER EXPENSE (INCOME): | | | | |
| Interest expense | 134,502 | 0.7% | 65,694 | 0.4% |
| Interest income | (74,214) | (0.4%) | (13,687) | (0.1%) |
| Gain on change in fair value of warrants | - | 0.0% | (2,382,912) | (16.7%) |
| INCOME BEFORE INCOME TAX PROVISION | 1,754,814 | 9.9% | 3,676,742 | 25.8% |
| Income tax provision | 690,167 | 3.9% | 509,025 | 3.6% |
| NET INCOME | \$ 1,064,647 | 6.0% | \$ 3,167,717 | 22.2% |

Revenue

Revenue for the three months ended October 31, 2006 was approximately \$17,753,000, as compared to approximately \$14,250,000 for the three months ended October 31, 2005. The increase in revenue for the period was primarily attributable to the acquisitions of NECS and SECS. For the three months ended October 31, 2006, we had one customer which comprised 19.5% of total revenue.

Total revenue from the specialty communication segment for the three months ended October 31, 2006 and 2005 was approximately \$14,023,000 or 79.0% and \$11,995,000 or 84.2% of total revenue, respectively. Wireless infrastructure segment revenue for the three months ended October 31, 2006 and 2005 was approximately \$3,730,000 or 21.0% and \$2,255,000 or 15.8% of total revenue, respectively.

Cost of Revenue

Cost of revenue consists of direct costs on contracts, materials, direct labor, third party subcontractor services, union benefits and other overhead costs. Our cost of revenue was approximately \$12,361,000 or 69.6% of revenue for the three months ended October 31, 2006, compared to approximately \$10,339,000 or 72.6% for the prior year. The dollar increase in our total cost of revenue was due to the corresponding increase in revenue during the three months ended October 31, 2006, primarily from the acquisitions of NECS and SECS. The decrease in cost of revenue as a percentage of revenue was due primarily to the revenue mix attributable to revenue from Walker, Clayborn, Heinz, Quality and the acquisitions of NECS and SECS.

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

The specialty communication segment cost of revenue and cost of revenue as a percentage of revenue for the three months ended October 31, 2006 and 2005 was approximately \$9,574,000 and 68.3% and \$8,599,000 and 71.7%, respectively. As discussed above, the dollar increase in our total cost of revenue was due to the corresponding increase in revenue during the three months ended October 31, 2006 primarily attributable to the acquisition of NECS. The decrease in cost of revenue as a percentage of revenue was due to the revenue mix attributable to revenue from Walker, Clayborn, Quality and the acquisition of NECS.

Wireless infrastructure segment cost of revenue and cost of revenue as a percentage of revenue for the three months ended October 31, 2006 and 2005 was approximately \$2,787,000 and 74.7% and \$1,740,000 and 77.1%, respectively. The dollar increase in our total cost of revenue was due to the corresponding increase in revenue during the three months ended October 31, 2006 primarily attributable to the acquisition of SECS. The increase in cost of revenue as a percentage of revenue was due to the revenue mix attributable to Heinz and Invisinet and the acquisition of SECS.

Selling, General and Administrative Expenses

For the three months ended October 31, 2006, total selling, general and administrative expenses were approximately \$3,240,000, or 18.3% of total revenue compared to \$2,356,000 or 16.5% of revenue for the same period in the prior year. Included in selling, general and administrative expenses for the three months ended October 31, 2006 were \$1,730,000 for salaries, commissions, and payroll taxes. The increase in salaries and payroll taxes compared to the prior year was due to the increase in headcount as a result of the acquisitions of NECS and SECS. Professional fees were \$85,000, which include accounting, legal and investor relation fees. Insurance costs were \$497,000 and rent for office facilities was \$145,000. Automobile and other travel expenses were \$257,000 and telecommunication expenses were \$90,000. Other selling, general and administrative expenses totaled \$436,000. For the three months ended October 31, 2006, total selling, general and administrative expenses for the specialty communication and wireless infrastructure segments were approximately \$2,336,000 and \$633,000, respectively.

For the three months ended October 31, 2005, selling, general and administrative expenses were approximately \$2,356,000 or 16.5% of revenue. Included in the selling, general and administrative expenses was \$1,359,000 for salaries, commissions and payroll taxes, \$88,000 in professional fees and insurance costs of \$377,000. Rent for our office facilities amounted to \$96,000. Automobile and other travel expenses were \$168,000 and telecommunication expenses were \$60,000. Other selling, general and administrative expenses totaled \$208,000. For the three months ended October 31, 2005, total selling, general and administrative expenses for the specialty communication and wireless infrastructure segments were approximately \$1,807,000 and \$255,000, respectively.

Depreciation and Amortization

For the three months ended October 31, 2006 and 2005, depreciation was approximately \$182,000 and \$135,000, respectively. The increase in depreciation was due to the purchase of property and equipment and the acquisition of fixed assets from acquiring NECS and SECS. The amortization of customer lists and backlog for the three months ended October 31, 2006 was approximately \$156,000 as compared to \$75,000 for the same period of the prior year. The increase in amortization was due to the acquisition of customer lists from NECS and SECS and backlog from SECS. All customer lists are amortized over a period of five to six years from the date of their acquisition. Backlog is amortized over a period of one year from the date of its acquisition.

Gain on Change in Fair Value of Warrants

Gain on change in fair value of warrants for the three months ended October 31, 2005 was approximately \$2,383,000. The increase in the gain was due principally to the decrease in the market value of our common stock. The gain represented the unrealized non-cash change in the fair value of certain warrants for the quarter, using the Black-Scholes option pricing model. The non-cash gain on fair value of warrants has no impact on our cash flows or liquidity.

Net Income

The net income was approximately \$1,065,000 for the three months ended October 31, 2006. Net income was net of federal and state income tax expense of approximately \$690,000. The variation in effective tax rates between periods was primarily due to the gain on fair value of warrants described above.

Net income was approximately \$3,168,000 for the three months ended October 31, 2005. Net income was net of federal and state income tax expense of approximately \$509,000.

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

Results of Operations for the Six Months Ended October 31, 2006 Compared to the Six Months Ended October 31, 2005

Consolidated results for the six months ended October 31, 2006 and 2005 were as follows. Certain reclassifications have been made to prior year financial statements to conform to the current presentation.

| | Six Months Ended October 31, | | | |
|--|---------------------------------|--------|---------------|--------|
| | 2006 | | 2005 | |
| REVENUE | \$ 34,189,322 | 100.0% | \$ 26,421,882 | 100.0% |
| COSTS AND EXPENSES: | | | | |
| Cost of revenue | 24,052,430 | 70.4% | 19,469,223 | 73.7% |
| Selling, general and administrative expenses | 6,336,060 | 18.5% | 4,622,383 | 17.5% |
| Depreciation and amortization | 570,891 | 1.7% | 421,060 | 1.6% |
| Total costs and expenses | 30,959,381 | 90.6% | 24,512,666 | 92.8% |
| OPERATING INCOME | 3,229,941 | 9.4% | 1,909,216 | 7.2% |
| OTHER EXPENSE (INCOME): | | | | |
| Interest expense | 214,436 | 0.6% | 112,041 | 0.4% |
| Interest income | (174,752) | (0.5%) | (24,016) | 0.0% |
| Loss on change in fair value of warrants | - | 0.0% | 1,727,682 | 6.5% |
| INCOME BEFORE INCOME TAX PROVISION | 3,190,257 | 9.3% | 93,509 | 0.3% |
| Income tax provision | 1,211,180 | 3.5% | 721,108 | 2.7% |
| NET INCOME (LOSS) | \$ 1,979,077 | 5.8% | (\$627,599) | (2.4%) |

Revenue

Revenue for the six months ended October 31, 2006 was approximately \$34,189,000, as compared to approximately \$26,422,000 for the six months ended October 31, 2005. The increase in revenue for the period was primarily attributable to the acquisitions of NECS and SECS. For the six months ended October 31, 2006, we had two separate customers which comprised 18.0% and 14.0% of total revenue.

Total revenue from the specialty communication segment for the six months ended October 31, 2006 and 2005 was approximately \$27,774,000 or 81.2% and \$22,602,000 or 85.5% of total revenue, respectively. Wireless infrastructure segment revenue for the six months ended October 31, 2006 and 2005 was approximately \$6,415,000 or 18.8% and \$3,820,000 or 14.5% of total revenue, respectively.

Cost of Revenue

Cost of revenue consists of direct costs on contracts, materials, direct labor, third party subcontractor services, union benefits and other overhead costs. Our cost of revenue was approximately \$24,052,000 or 70.4% of revenue for the six months ended October 31, 2006, compared to approximately \$19,469,000 or 73.7% for the prior year. The dollar increase in our total cost of revenue was due to the corresponding increase in revenue during the six months ended October 31, 2006, primarily from the acquisitions of NECS and SECS. The decrease in cost of revenue as a percentage of revenue was due primarily to the revenue mix attributable to revenue from Walker, Clayborn, Heinz, Quality and the acquisitions of NECS and SECS.

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

The specialty communication segment cost of revenue and cost of revenue as a percentage of revenue for the six months ended October 31, 2006 and 2005 was approximately \$19,265,000 and 69.4% and \$16,580,000 and 73.3%, respectively. As discussed above, the dollar increase in our total cost of revenue was due to the corresponding increase in revenue during the six months ended October 31, 2006 primarily attributable to the acquisition of NECS. The decrease in cost of revenue as a percentage of revenue was due to the revenue mix attributable to revenue from Walker, Clayborn, Quality and the acquisition of NECS.

Wireless infrastructure segment cost of revenue and cost of revenue as a percentage of revenue for the six months ended October 31, 2006 and 2005 was approximately \$4,787,000 and 74.6% and \$2,889,000 and 75.6%, respectively. The dollar increase in our total cost of revenue was due to the corresponding increase in revenue during the six months ended October 31, 2006 primarily attributable to the acquisition of SECS. The decrease in cost of revenue as a percentage of revenue was due to the revenue mix attributable to Heinz and the acquisition of SECS.

Selling, General and Administrative Expenses

For the six months ended October 31, 2006, total selling, general and administrative expenses were approximately \$6,336,000, or 18.5% of total revenue compared to \$4,622,000 or 17.5% of revenue for the same period in the prior year. Included in selling, general and administrative expenses for the six months ended October 31, 2006 were \$3,304,000 for salaries, commissions, and payroll taxes. The increase in salaries and payroll taxes compared to the prior year was due to the increase in headcount as a result of the acquisitions of NECS and SECS. Professional fees were \$423,000, which include accounting, legal and investor relation fees. Insurance costs were \$862,000 and rent for office facilities was \$271,000. Automobile and other travel expenses were \$480,000 and telecommunication expenses were \$150,000. Other selling, general and administrative expenses totaled \$846,000. For the six months ended October 31, 2006, total selling, general and administrative expenses for the specialty communication and wireless infrastructure segments were approximately \$4,481,000 and \$958,000, respectively.

For the six months ended October 31, 2005, selling, general and administrative expenses were approximately \$4,622,000 or 17.5% of revenue. Included in the selling, general and administrative expenses was \$2,520,000 for salaries, commissions and payroll taxes, \$326,000 in professional fees and insurance costs of \$688,000. Rent for our office facilities amounted to \$198,000. Automobile and other travel expenses were \$368,000 and telecommunication expenses were \$126,000. Other selling, general and administrative expenses totaled \$396,000. For the six months ended October 31, 2005, total selling, general and administrative expenses for the specialty communication and wireless infrastructure segments were approximately \$3,358,000 and \$500,000, respectively.

Depreciation and Amortization

For the six months ended October 31, 2006 and 2005, depreciation was approximately \$337,000 and \$272,000, respectively. The increase in depreciation was due to the purchase of property and equipment and the acquisition of fixed assets from acquiring NECS and SECS. The amortization of customer lists and backlog for the six months ended October 31, 2006 was approximately \$234,000 as compared to \$149,000 for the same period of the prior year. The increase in amortization was due to the acquisition of customer lists from NECS and SECS and backlog from SECS. All customer lists are amortized over a period of five to six years from the date of their acquisition. Backlog is amortized over a period of one year from the date of its acquisition.

Loss on Change in Fair Value of Warrants

Loss on change in fair value of warrants for the six months ended October 31, 2005 was approximately \$1,728,000. The increase in the loss was due principally to the increase in the market value of our common stock. The loss represents the unrealized non-cash change in the fair value of certain warrants for the quarter, using the Black-Scholes option pricing model. The non-cash loss on fair value of warrants has no impact on our cash flows or liquidity.

Net Income (Loss)

The net income was approximately \$1,979,000 for the six months ended October 31, 2006. Net income was net of federal and state income tax expense of approximately \$1,211,000. The variation in effective tax rates between periods was primarily due to the loss on fair value of warrants described above.

Net loss was approximately \$628,000 for the six months ended October 31, 2005. Net loss was net of federal and state income tax expense of approximately \$721,000.

ITEM 2- MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*Liquidity and Capital Resources*

At October 31, 2006, we had working capital of approximately \$19,113,000, which consisted of current assets of approximately \$29,075,000 and current liabilities of approximately \$9,962,000.

Operating activities provided approximately \$3,702,000 in cash for the six months ended October 31, 2006. The sources of cash from operating activities total approximately \$5,283,000, comprised of \$1,979,000 net income, \$562,000 in net non-cash charges, a \$1,417,000 decrease in accounts receivable, a \$759,000 increase in billings in excess of costs and estimated earnings on uncompleted contracts payable, a \$291,000 increase in deferred revenue, a \$187,000 decrease in inventory and a \$88,000 increase in income taxes payable. The uses of cash from operating activities total approximately \$1,581,000, comprised of, a \$385,000 increase in costs and estimated earnings in excess of billings on uncompleted contracts, a \$759,000 decrease in accounts payable and accrued expenses, and a \$437,000 increase in prepaid expenses and other assets.

Our investing activities utilized approximately \$6,395,000 in cash during the six months ended October 31, 2006, which consisted of \$420,000 paid for property and equipment, \$4,458,000 for the acquisition of NECS, net of cash acquired of approximately \$130,000 and \$1,517,000 for the acquisition of SECS, net of cash acquired of approximately \$200,000.

Our financing activities provided cash of approximately \$1,292,000 during the six months ended October 31, 2006. Financing activities include borrowings under lines of credit of approximately \$1,437,000, the net proceeds from the exercise of warrants of approximately \$198,000, proceeds from stock options of approximately \$115,000, offset by repayments of equipment loans and capital lease obligations of approximately \$299,000, \$109,000 to pay shareholder amounts previously accrued for acquisitions, and approximately \$50,000 of equity issuance costs related to shares of our common stock issued to the shareholders of SECS.

Our capital requirements depend on numerous factors, including the market for our services, the resources we devote to developing, marketing, selling and supporting our business, the timing and extent of establishing additional markets and other factors. On June 3, 2005, we entered into a credit agreement with a commercial bank. The credit agreement provides for a revolving line of credit in an amount not to exceed \$5,000,000, together with a letter of credit facility not to exceed \$500,000. We also entered into security agreements, pursuant to which each subsidiary granted a security interest to the bank in all of their assets.

Under the terms of our credit agreement, as amended, we were permitted to borrow up to \$5,000,000 under the revolving credit line, based upon eligible receivables as of October 31, 2006. As of October 31, 2006, the outstanding balance was \$4,437,446. The loan under the credit agreement bears interest at a rate equal to either the bank's reference rate plus one half (0.5%) percent, or LIBOR plus two and three-quarters (2.75%) percent, as we may request (8.187% as of October 31, 2006). We paid a facility fee to the bank of \$50,000 on the closing date. In addition to the loan, a \$500,000 letter of credit was re-issued in favor of Walker's surety bonding company as collateral for performance and payment bond requirements. In November 2006, the letter of credit was released by the surety bonding company and cancelled by the bank.

The credit agreement contains customary covenants, including but not limited to (i) restrictions on the permitted ratio of total unsubordinated liabilities to tangible net worth plus subordinated indebtedness, (ii) our total tangible net worth, (iii) working capital, (iv) minimum earnings before interest, taxes, depreciation and amortization, and the change in the warrant liability, and (v) dividend restrictions. As of October 31, 2006, we were in compliance with the credit agreement covenants. The loan commitment expires on August 31, 2008. We may prepay the loan at any time.

At October 31, 2006, we had cash and cash equivalents of approximately \$10,879,000, and working capital of approximately \$19,113,000. With the funds available from internally generated funds and the revolving credit line, we believe that we have sufficient capital to meet our needs through October 31, 2007. Our future operating results may be affected by a number of factors including our success in bidding on future contracts and our continued ability to manage controllable costs effectively. To the extent we grow by future acquisitions that involve consideration other than stock, our cash requirements may increase.

Effective June 1, 2006, we acquired NECS, a Connecticut corporation, for approximately \$4,523,000 in cash. NECS was acquired pursuant to a Stock Purchase Agreement among WPCS, NECS, and the shareholders of NECS. In addition, for each \$2.00 of earnings before interest and taxes for the calendar year ending December 31, 2006, the NECS shareholders shall be paid aggregate additional consideration of \$1.00, up to a maximum of \$468,000. At our option, any amount of consideration due to be paid may be paid in cash or shares of our common stock (valued at the last sale price of the common stock on the date two days prior to the date the payment is due). In connection with the acquisition, NECS entered into employment agreements with two of the shareholders, each for a period of two years and a consulting agreement with one of the shareholders for a period of seven years. Based on the preliminary allocation of the net assets acquired from NECS, we have recognized goodwill and other intangible assets of approximately \$3,537,000. Upon completion of a formal purchase price allocation there may be a decrease or increase in the amount assigned to goodwill and a corresponding increase or decrease in tangible or intangible assets.

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

The acquisition of NECS provides us with additional project engineering expertise for specialty communication systems, broadens our customer base especially in the public safety and gaming markets, including the Massachusetts State Police, University of Connecticut and Foxwoods Resort Casino, and expands our geographic presence in New England.

Effective July 19, 2006, we acquired SECS of Sarasota, Florida for approximately \$2,061,000 in cash and 200,288 shares of our common stock having a value of approximately \$1,400,000. SECS was acquired pursuant to a Stock Purchase Agreement among WPCS, SECS, and the shareholders of SECS. We filed a registration statement with the SEC to register the shares of common stock issued to the former SECS shareholders, and the registration statement was declared effective by the SEC on August 24, 2006. In connection with the acquisition, SECS entered into employment agreements and a consulting agreement with certain officers or former officers of SECS. Based on the preliminary allocation of the net assets acquired from SECS, we recognized goodwill and other intangible assets of approximately \$1,997,000. Upon completion of a formal purchase price allocation there may be a decrease or increase in the amount assigned to goodwill and a corresponding increase or decrease in tangible or intangible assets.

The acquisition of SECS provides us with additional project engineering expertise for wireless infrastructure services, broadens our customer base of corporate, government and educational clients, including the National Oceanic and Atmospheric Administration (NOAA), Verizon, BellSouth, Comcast, Time Warner, University of Florida and Puerto Rico Telephone, and expands our geographic presence in the Southeastern United States.

Backlog

As of October 31, 2006, we had a backlog of unfilled orders of approximately \$20.3 million compared to approximately \$19.2 million at October 31, 2005. We anticipate our backlog at October 31, 2006 to be recognized as revenue within eight months from that date. We define backlog as the value of work-in-hand to be provided for customers as of a specific date where the following conditions are met (with the exception of engineering change orders): (i) the price of the work to be done is fixed; (ii) the scope of the work to be done is fixed, both in definition and amount; and (iii) there is a written contract, purchase order, agreement or other documentary evidence which represents a firm commitment by the customer to pay us for the work to be performed. These backlog amounts are based on contract values and purchase orders and may not result in actual receipt of revenue in the originally anticipated period or at all. We have experienced variances in the realization of our backlog because of project delays or cancellations resulting from external market factors and economic factors beyond our control and we may experience such delays or cancellations in the future. Backlog does not include new firm commitments which may be awarded to us by our customers from time to time in future periods. These new project awards could be started and completed in this same future period. Accordingly, our backlog does not necessarily represent the total revenue that could be earned by us in future periods.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Critical Accounting Policies

Financial Reporting Release No. 60, published by the SEC, recommends that all companies include a discussion of critical accounting policies used in the preparation of their financial statements. While all these significant accounting policies impact our financial condition and results of operations, we view certain of these policies as critical. Policies determined to be critical are those policies that have the most significant impact on our consolidated financial statements and require management to use a greater degree of judgment and estimates. Actual results may differ from those estimates.

We believe that given current facts and circumstances, it is unlikely that applying any other reasonable judgments or estimate methodologies would cause a material effect on our consolidated results of operations, financial position or liquidity for the periods presented in this report.

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

The accounting policies identified as critical are as follows:

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenue and expenses during the reporting period. The most significant estimates relate to the estimation of percentage of completion on uncompleted contracts, valuation of inventory, allowance for doubtful accounts, estimated life of customer lists and estimates of the fair value of reporting units and discounted cash flows used in determining whether goodwill has been impaired. Actual results will likely differ from those estimates.

Accounts Receivable

Accounts receivable are due within contractual payment terms and are stated at amounts due from customers net of an allowance for doubtful accounts. Credit is extended based on evaluation of a customer's financial condition. Accounts outstanding longer than the contractual payment terms are considered past due. We determine the allowance by considering a number of factors, including the length of time trade accounts receivable are past due, our previous loss history, the customer's current ability to pay its obligation us, and the condition of the general economy and the industry as a whole. We write off accounts receivable when they become uncollectible, and payment subsequently received on such receivables are credited to the allowance for doubtful accounts.

Goodwill and other Long-lived Assets

We assess the impairment of long-lived assets whenever events or changes in circumstances indicate that their carrying value may not be recoverable from the estimated future cash flows expected to result from their use and eventual disposition. Our long-lived assets subject to this evaluation include property and equipment and amortizable intangible assets. We assess the impairment of goodwill annually as of April 30 and whenever events or changes in circumstances indicate that it is more likely than not that an impairment loss has been incurred. Intangible assets other than goodwill are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be fully recoverable. We are required to make judgments and assumptions in identifying those events or changes in circumstances that may trigger impairment. Some of the factors we consider include a significant decrease in the market value of an asset, significant changes in the extent or manner for which the asset is being used or in its physical condition, a significant change, delay or departure in our business strategy related to the asset, significant negative changes in the business climate, industry or economic condition, or current period operating losses, or negative cash flow combined with a history of similar losses or a forecast that indicates continuing losses associated with the use of an asset.

Our annual review for goodwill impairment for the fiscal years 2006 and 2005 found that no impairment existed. Our impairment review is based on comparing the fair value to the carrying value of the reporting units with goodwill. The fair value of a reporting unit is measured at the business unit level using a discounted cash flow approach that incorporates our estimates of future revenues and costs for those business units. Reporting units with goodwill include Invisinet and Heinz within our wireless infrastructure segment and Walker, Clayborn and Quality within our specialty communications segment. Our estimates are consistent with the plans and estimates that we are using to manage the underlying businesses. If we fail to deliver products and services for these business units, or market conditions for these businesses fail to improve, our revenue and cost forecasts may not be achieved and we may incur charges for goodwill impairment, which could be significant and could have a material adverse effect on our net equity and results of operations.

Deferred Income Taxes

We determine deferred tax liabilities and assets at the end of each period based on the future tax consequences that can be attributed to net operating loss and credit carryovers and differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, using the tax rate expected to be in effect when the taxes are actually paid or recovered. The recognition of deferred tax assets is reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized. The ultimate realization of deferred tax assets depends upon the generation of future taxable income during the periods in which those temporary differences become deductible.

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

We consider past performance, expected future taxable income and prudent and feasible tax planning strategies in assessing the amount of the valuation allowance. Our forecast of expected future taxable income is based over such future periods that we believe can be reasonably estimated. Changes in market conditions that differ materially from our current expectations and changes in future tax laws in the U.S. may cause us to change our judgments of future taxable income. These changes, if any, may require us to adjust our existing tax valuation allowance higher or lower than the amount we have recorded.

Revenue Recognition

We generate our revenue by providing project engineering and deployment services for wireless infrastructure services and specialty communication systems. We provide a range of engineering services including site design, spectrum analysis, engineering, trenching, electrical work, structured cabling, product integration, testing and project management.

We primarily record revenue and profit on a percentage-of-completion basis on the cost-to-cost method. Contracts in process are valued at cost plus accrued profits less earned revenues and progress payments on uncompleted contracts. Contracts are generally considered substantially complete when engineering is completed and/or site construction is completed. We include in operations pass-through revenue and costs on cost-plus contracts, which are customer-reimbursable materials, equipment and subcontractor costs, when the contract determines that we are responsible for the engineering specification, procurement and management of such cost components on behalf of the customer.

We have numerous contracts that are in various stages of completion. Such contracts require estimates to determine the appropriate cost and revenue recognition. Cost estimates are reviewed monthly on a contract-by-contract basis, and are revised periodically throughout the life of the contract such that adjustments to profit resulting from revisions are made cumulative to the date of the revision. Significant management judgments and estimates, including the estimated cost to complete projects, which determines the project's percent complete, must be made and used in connection with the revenue recognized in the accounting period. Current estimates may be revised as additional information becomes available. If estimates of costs to complete long-term contracts indicate a loss, provision is made currently for the total loss anticipated.

We also recognize certain revenue when equipment is delivered or the services have been provided to the customer. For maintenance contracts, revenue is recognized ratably over the service period.

Recently Issued Accounting Pronouncements

SFAS 123(R) (revised December 2004), *Share-Based Payment*, an amendment of SFAS 123, *Accounting for Stock-Based Compensation*, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As a result of the amendments to SFAS 123, we are required to expense the fair value of employee stock options effective May 1, 2006. The revised standard requires us to expense the fair value of employee stock options and other share-based payments over the service period.

No other recently issued accounting pronouncement issued or effective after the end of the fiscal year is expected to have a material impact on our consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FAS No. 109* ("FIN 48"), which clarifies the accounting for uncertainty in income taxes is subject to significant and varied interpretations that have resulted in diverse and inconsistent accounting practices and measurements. Addressing such diversity, FIN 48 prescribes a consistent recognition threshold and measurement attribute, as well as clear criteria for subsequently recognizing, derecognizing and measuring changes in such tax positions for financial statement purposes. FIN 48 also requires expanded disclosure with respect to the uncertainty in income taxes. FIN 48 is effective for fiscal years beginning after December 15, 2006. We have not yet determined the impact of FIN 48 on our condensed consolidated financial position, results of operations, cash flows or financial statement disclosures.

On September 15, 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("SFAS 157"), which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. We are currently evaluating the potential impact, if any, of the adoption of SFAS 157 on our condensed consolidated financial position, results of operations and cash flows or financial statement disclosures.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES
ABOUT MARKET RISK

Interest Rate Risk

Interest rate risk represents the potential loss from adverse changes in market interest rates. We are subject to interest rate risk with respect to amounts borrowed under our credit facility because such amounts bear interest at a variable rate. The interest rate is equal to the bank's reference rate plus one half (0.5%) percent, or LIBOR plus two and three-quarters (2.75%) percent, as we may request (8.187% as of October 31, 2006). At October 31, 2006, we had approximately \$4,437,000 million of indebtedness outstanding under our revolving credit facility. A 1.0% increase in interest rates on un-hedged variable rate borrowings of \$4.4 million at October 31, 2006 would result in additional interest expense of approximately \$22,000 for the six months ended October 31, 2006.

ITEM 4 - CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures.

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 as of October 31, 2006. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on our evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting.

We regularly review our system of internal control over financial reporting and make changes to our processes and systems to improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes.

There were no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are currently not a party to any material legal proceedings or claims.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors previously disclosed in Part I, "Risk Factors," of the Company's Annual Report on Form 10-KSB for the year ended April 30, 2006, other than to update certain financial information as of and for the three months ended October 31, 2006 regarding the following risk factors.

Amounts included in our backlog may not result in actual revenue or translate into profits.

As of October 31, 2006, we had a backlog of unfilled orders of approximately \$20.3 million. This backlog amount is based on contract values and purchase orders and may not result in actual receipt of revenue in the originally anticipated period or at all. In addition, contracts included in our backlog may not be profitable. We have experienced variances in the realization of our backlog because of project delays or cancellations resulting from external market factors and economic factors beyond our control and we may experience delays or cancellations in the future. If our backlog fails to materialize, we could experience a reduction in revenue, profitability and liquidity.

There may be an adverse effect on the market price of our shares as a result of shares being available for sale in the future.

As of October 31, 2006, holders of our outstanding options and warrants have the right to acquire 2,588,124 shares of common stock issuable upon the exercise of stock options and warrants, at exercise prices ranging from \$4.80 to \$19.92 per share, with a weighted average exercise price of \$6.98. The sale or availability for sale in the market of the shares underlying these options and warrants could depress our stock price. We have registered substantially all of the underlying shares described above for resale. Holders of registered underlying shares may resell the shares immediately upon issuance upon exercise of an option or warrant.

If our stockholders sell substantial amounts of our shares of common stock, including shares issued upon the exercise of outstanding options and warrants, the market price of our common stock may decline. These sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On September 25, 2006, we held our annual meeting of stockholders. During the annual meeting, three proposals were put to the stockholders for a vote. The stockholders approved all three proposals, including: 1) the election of five directors to the Board of Directors; 2) ratifying the selection of J.H. Cohn LLP as our independent registered public accounting firm for the fiscal year ending April 30, 2007; and 3) adopting the 2007 Stock Incentive Plan and authorizing 400,000 shares for issuance thereunder.

ITEM 5. OTHER INFORMATION

None.

PART II - OTHER INFORMATION

ITEM 6. EXHIBITS

31.1 - [Certification of Principal Executive Officer pursuant to Rule 13a-14 and Rule 15d-14\(a\), promulgated under the Securities and Exchange Act of 1934, as amended](#)

31.2 - [Certification of Principal Financial Officer pursuant to Rule 13a-14 and Rule 15d-14\(a\), promulgated under the Securities and Exchange Act of 1934, as amended](#)

32.1 - [Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 \(Chief Executive Officer\)](#)

32.2 - [Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 \(Chief Financial Officer\)](#)

WPCS INTERNATIONAL INCORPORATED AND SUBSIDIARIES

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WPCS INTERNATIONAL INCORPORATED

Date: December 14, 2006

By: */s/ JOSEPH HEATER*

Joseph Heater
Chief Financial Officer

I, Andrew Hidalgo, certify that:

1. I have reviewed this quarterly report on Form 10-Q of WPCS International Incorporated;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 14, 2006

By: /s/ ANDREW HIDALGO

Andrew Hidalgo
Chief Executive Officer

I, Joseph Heater, certify that:

1. I have reviewed this quarterly report on Form 10-Q of WPCS International Incorporated;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 14, 2006

By: /s/ JOSEPH HEATER

Joseph Heater
Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly report of WPCS International Incorporated (the "Company") on Form 10-Q for the period ended October 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Andrew Hidalgo, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities and Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: December 14, 2006

By: /s/ *ANDREW HIDALGO*

Andrew Hidalgo

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly report of WPCS International Incorporated (the "Company") on Form 10-Q for the period ended October 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Joseph Heater, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. section 906 of the Sarbanes-Oxley Act of 2002, that:

- (3) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities and Exchange Act of 1934; and
- (4) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: December 14, 2006

By: /s/ JOSEPH HEATER

Joseph Heater
Chief Financial Officer