

# **Walsin Technology Corporation**

**Financial Statements for the Six Months  
Ended June 30, 2005 and 2004 and  
Independent Auditors' Report**

## **INDEPENDENT AUDITORS' REPORT**

The Board of Directors and Stockholders  
Walsin Technology Corporation

We have audited the balance sheets of Walsin Technology Corporation (the "Company") as of June 30, 2005 and 2004, and the related statements of income, changes in stockholders' equity, and cash flows for the six months then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. However, we did not audit the financial statements as of and for the six months ended June 30, 2005 of companies in which the Company has long-term equity investments accounted for by the equity method, as shown in the accompanying financial statements. These investments amounted to NT\$901,336 thousand and NT\$939,013 thousand as of June 30, 2005 and 2004, respectively, and resulted in an investment loss of NT\$12,327 thousand and investment income of NT\$11,630 thousand for the six months ended June 30, 2005 and 2004, respectively. The financial statements of investees were audited by other auditors and, our opinion, insofar as it relates to the amounts included for these investments, is based solely on the reports of the other auditors.

We conducted our audits in accordance with the Rules Governing the Audit of Financial Statements by Certified Public Accountants and auditing standards generally accepted in the Republic of China. Those rules and standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of June 30, 2005 and 2004, and the results of its operations and its cash flows for the six months then ended in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the Republic of China.

As discussed in Note 3 to the financial statements, effective December 31, 2004, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 35, "Accounting for Asset Impairment." In addition, the Company adopted, effective January 1, 2005, SFAS No. 7, "Consolidated Financial Statements." Under SFAS No. 7, Pan Overseas Electronic Co., Ltd., a Company subsidiary, should be consolidated because the Company has significant control over this investee.

We have also audited the consolidated financial statements of the Company and its subsidiaries for the six months ended June 30, 2005 (not presented herewith) on which we have expressed a modified unqualified opinion thereon with emphasis of a matter paragraph.

August 5, 2005

Notice to Readers

*The accompanying financial statements are intended only to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in the Republic of China and not those of any other jurisdictions. The standards, procedures and practices to audit such financial statements are those generally accepted and applied in the Republic of China.*

*For the convenience of readers, the auditors' report and the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language auditors' report and financial statements shall prevail. Also, as stated in Note 2 to the financial statements, the additional footnote disclosures that are not required under generally accepted accounting principles were not translated into English.*

# WALSIN TECHNOLOGY CORPORATION

## BALANCE SHEETS

JUNE 30, 2005 AND 2004

(In Thousands of New Taiwan Dollars)

ASSETS	2005		2004		LIABILITIES AND STOCKHOLDERS' EQUITY	2005		2004	
	Amount	%	Amount	%		Amount	%	Amount	%
<b>CURRENT ASSETS</b>					<b>CURRENT LIABILITIES</b>				
Cash and cash equivalents (Notes 2 and 4)	\$ 619,067	4	\$ 316,798	2	Short-term bank borrowings (Note 12)	\$ 950,000	7	\$ 788,748	6
Short-term investments (Notes 2 and 5)	1,225,057	9	887,109	7	Short-term obligations (Note 13)	809,579	6	399,049	3
Notes receivable (Notes 2 and 6)	35,030	-	91,530	1	Notes payable	23,605	-	15,353	-
Notes receivable from related parties (Notes 2 and 6)	-	-	3,266	-	Accounts payable	740,427	5	654,816	5
Accounts receivable (Notes 2 and 6)	440,519	3	569,653	4	Accounts payable to affiliates (Note 22)	14,572	-	260,703	2
Accounts receivable from related parties (Notes 2, 6 and 22)	840,030	6	1,152,859	8	Other payables (Note 14)	645,481	5	1,128,480	8
Other financial assets, current (Note 7)	153,629	1	501,157	4	Other current liabilities	19,242	-	66,003	-
Inventories (Notes 2 and 8)	1,340,242	10	1,153,594	8	Total current liabilities	3,202,906	23	3,313,152	24
Deferred tax assets, current (Notes 2 and 21)	2,000	-	23,000	-					
Other current assets	77,039	1	146,952	1	<b>LONG-TERM LIABILITIES</b>				
Total current assets	4,732,613	34	4,845,918	35	Convertible notes payable (Notes 2 and 15)	1,024,423	7	1,195,635	9
<b>LONG-TERM EQUITY INVESTMENTS</b> (Notes 2 and 9)					<b>RESERVE FOR LAND VALUE INCREMENT TAX</b> (Note 11)	3,580	-	3,580	-
Long-term equity investments at equity method	4,812,170	34	4,552,340	33	<b>OTHER LIABILITIES</b>				
Long-term equity investments at cost method	333,264	3	343,794	3	Accrued pension cost	15,791	-	9,739	-
Total long-term equity investments	5,145,434	37	4,896,134	36	Deferred credit (Note 16)	104,968	1	103,732	1
<b>OTHER FINANCIAL ASSETS, NONCURRENT</b> (Note 2)	26,579	-	22,390	-	Total other liabilities	120,759	1	113,471	1
<b>PROPERTY, PLANT AND EQUIPMENT</b> (Notes 2 and 10)					Total liabilities	4,351,668	31	4,625,838	34
Cost					<b>STOCKHOLDERS' EQUITY</b>				
Buildings and improvements	854,941	6	825,559	6	Common stock (Note 17)	3,948,291	28	3,664,820	27
Machinery and equipment	4,477,620	32	4,057,103	30	Stock dividends to be distributed	87,612	1	-	-
Transportation equipment	20,507	-	19,261	-	Capital surplus				
Leasehold improvements	193,163	1	203,492	2	Additional paid-in capital	5,006,626	35	4,953,174	36
Other equipment	530,487	4	473,728	3	Property, plant and equipment revaluation increment	3,795	-	3,021	-
	6,076,718	43	5,579,143	41	Gain on disposal of property, plant and equipment	270,307	2	270,307	2
Less accumulated depreciation	(2,688,686)	(19)	(2,142,289)	(16)	Capital surplus from business combination	239,304	2	-	-
Construction in progress and prepayments	350,733	2	224,617	2	Retained earnings (Note 19)				
Property, plant and equipment, net	3,738,765	26	3,661,471	27	Legal reserve	79,344	1	37,642	-
<b>OTHER ASSETS</b> (Notes 2 and 11)	421,402	3	344,749	2	Special reserve	208,097	1	-	-
					Unappropriated earnings	124,417	1	270,082	2
					Unrealized loss on market value decline of long-term equity investments (Notes 2 and 9)	(993)	-	(41,714)	(1)
					Cumulative translation adjustments (Note 2)	(246,059)	(2)	(12,508)	-
					Treasury stock (Note 19)	(7,616)	-	-	-
					Total stockholders' equity	9,713,125	69	9,144,824	66
<b>TOTAL</b>	<b>\$ 14,064,793</b>	<b>100</b>	<b>\$ 13,770,662</b>	<b>100</b>	<b>TOTAL</b>	<b>\$ 14,064,793</b>	<b>100</b>	<b>\$ 13,770,662</b>	<b>100</b>

The accompanying notes are an integral part of the financial statements.

(With Deloitte & Touche audit report dated August 5, 2005)

# WALSIN TECHNOLOGY CORPORATION

## STATEMENTS OF INCOME

SIX MONTHS ENDED JUNE 30, 2005 AND 2004

(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2005		2004	
	Amount	%	Amount	%
NET SALES	\$2,853,957	100	\$3,050,745	100
COSTS OF SALES	<u>2,416,437</u>	<u>85</u>	<u>2,524,439</u>	<u>82</u>
GROSS PROFIT BEFORE INTERCOMPANY PROFIT	437,520	15	526,306	18
UNREALIZED INTERCOMPANY PROFIT	<u>(10,000)</u>	<u>-</u>	<u>(29,000)</u>	<u>(1)</u>
GROSS PROFIT	<u>427,520</u>	<u>15</u>	<u>497,306</u>	<u>17</u>
OPERATING EXPENSES				
Selling	111,989	4	111,213	4
General and administrative	86,399	3	84,292	3
Research and development	<u>80,240</u>	<u>3</u>	<u>74,354</u>	<u>2</u>
Total operating expenses	<u>278,628</u>	<u>10</u>	<u>269,859</u>	<u>9</u>
OPERATING INCOME	<u>148,892</u>	<u>5</u>	<u>227,447</u>	<u>8</u>
NONOPERATING INCOME AND GAINS				
Interest income	793	-	4,583	-
Investment income recognized under the equity method (Notes 2 and 9)	-	-	45,148	2
Dividend income	11,332	-	-	-
Gain on disposal of property, plant and equipment	3,363	-	3,711	-
Gain on disposal of investments	6,165	-	20,550	1
Gain on physical inventories	-	-	9,126	-
Foreign exchange, net	1,650	-	-	-
Gain on market price recovery of short-term investment	-	-	1,997	-
Other	<u>17,630</u>	<u>1</u>	<u>11,370</u>	<u>-</u>
Total nonoperating income and gains	<u>40,933</u>	<u>1</u>	<u>96,485</u>	<u>3</u>
NONOPERATING EXPENSES AND LOSSES				
Interest expense	12,810	-	10,548	-
Investment loss recognized under the equity method (Notes 2 and 9)	10,411	-	-	-
Loss on physical inventory	6,219	-	-	-
Foreign exchange loss, net	-	-	1,541	-
Provision for inventory devaluation and loss from inventory devaluation	13,389	1	20,072	1
Other	<u>16,948</u>	<u>1</u>	<u>17,596</u>	<u>1</u>
Total nonoperating expenses and losses	<u>59,777</u>	<u>2</u>	<u>49,757</u>	<u>2</u>
INCOME BEFORE INCOME TAX	130,048	4	274,175	9
PROVISION FOR INCOME TAX (Notes 2 and 21)	<u>(5,000)</u>	<u>-</u>	<u>(7,000)</u>	<u>-</u>
NET INCOME	<u>\$ 125,048</u>	<u>4</u>	<u>\$ 267,175</u>	<u>9</u>

(Continued)

# WALSIN TECHNOLOGY CORPORATION

## STATEMENTS OF INCOME

SIX MONTHS ENDED JUNE 30, 2005 AND 2004

(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

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	2005		2004	
	Before Income Tax	After Income Tax	Before Income Tax	After Income Tax
BASIC EARNINGS PER SHARE (Notes 2 and 17)	<u>\$ 0.32</u>	<u>\$ 0.31</u>	<u>\$ 0.74</u>	<u>\$ 0.72</u>
DILUTED EARNINGS PER SHARE (Notes 2 and 17)	<u>\$ 0.29</u>	<u>\$ 0.28</u>	<u>\$ 0.67</u>	<u>\$ 0.65</u>

Pro forma amounts, assuming common shares of the Company held by subsidiaries were not treated as treasury stock.

	Before Income Tax	After Income Tax
NET INCOME	<u>\$ 130,048</u>	<u>\$ 125,048</u>
BASIC EARNINGS PER SHARE	<u>\$ 0.32</u>	<u>\$ 0.31</u>
DILUTED EARNINGS PER SHARE	<u>\$ 0.29</u>	<u>\$ 0.28</u>

The accompanying notes are an integral part of the financial statements.

(With Deloitte & Touche audit report dated August 5, 2005)

(Concluded)

# WALSIN TECHNOLOGY CORPORATION

## STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY SIX MONTHS ENDED JUNE 30, 2005 AND 2004 (In Thousands of New Taiwan Dollars)

	Common Stock	Stock Dividends to Be Distributed	Capital Surplus			Capital Surplus from Business Combination	Retained Earnings			Unrealized Loss on Market Value Decline of Long-Term Equity Investments	Cumulative Translation Adjustments	Treasury Stock	Total
			Additional Paid-in Capital	Property, Plant and Equipment Revaluation Increment	Gain on Disposal of Property, Plant and Equipment		Legal Reserve	Special Reserve	Unappropriated Earnings				
BALANCE, JANUARY 1, 2005	\$3,921,034	\$ -	\$4,971,444	\$ 3,021	\$ 270,307	\$ 239,304	\$ 37,642	\$ -	\$ 419,926	\$ (27,300)	\$ (180,797)	\$ -	\$9,654,581
Appropriation and of prior year's earnings													
Transfer to legal reserve	-	-	-	-	-	-	41,702	-	(41,702)	-	-	-	-
Transfer to special reserve	-	-	-	-	-	-	-	208,097	(208,097)	-	-	-	-
Cash remuneration to directors and supervisors	-	-	-	-	-	-	-	-	(3,402)	-	-	-	(3,402)
Stock bonuses to employees	-	8,506	-	-	-	-	-	-	(8,506)	-	-	-	-
Stock dividends	-	79,106	-	-	-	-	-	-	(79,106)	-	-	-	-
Cash dividends	-	-	-	-	-	-	-	-	(79,106)	-	-	-	(79,106)
Convertible notes converted into common stock (Note 15)	27,257	-	35,182	-	-	-	-	-	-	-	-	-	62,439
Effect on change in percentage of ownership of equity-method investee	-	-	-	-	-	-	-	-	(638)	-	-	-	(638)
Increase in common shares held by subsidiaries (Note 19)	-	-	-	-	-	-	-	-	-	-	(7,616)	-	(7,616)
Net income in the six months ended June 30, 2005	-	-	-	-	-	-	-	-	125,048	-	-	-	125,048
Unrealized loss on market value decline of long-term equity investments (Note 9)	-	-	-	-	-	-	-	-	-	26,307	-	-	26,307
Adjustment of land revaluation increment tax by an equity method investees	-	-	-	774	-	-	-	-	-	-	-	-	774
Cumulative translation adjustments on long-term equity investments	-	-	-	-	-	-	-	-	-	-	(65,262)	-	(65,262)
<b>BALANCE, JUNE 30, 2005</b>	<b>\$3,948,291</b>	<b>\$ 87,612</b>	<b>\$5,006,626</b>	<b>\$ 3,795</b>	<b>\$ 270,307</b>	<b>\$ 239,304</b>	<b>\$ 79,344</b>	<b>\$ 208,097</b>	<b>\$ 124,417</b>	<b>\$ (993)</b>	<b>\$ (246,059)</b>	<b>\$ (7,616)</b>	<b>\$9,713,125</b>
BALANCE, JANUARY 1, 2004	\$3,535,589	\$ -	\$4,851,698	\$ 3,021	\$ 270,307	\$ -	\$ 20,530	\$ -	\$ 175,889	\$ -	\$ 30,927	\$ -	\$8,887,961
Appropriation and of prior year's earnings													
Transfer to legal reserve	-	-	-	-	-	-	17,112	-	(17,112)	-	-	-	-
Cash remuneration to directors and supervisors	-	-	-	-	-	-	-	-	(3,117)	-	-	-	(3,117)
Stock bonuses to employees	7,793	-	-	-	-	-	-	-	(7,793)	-	-	-	-
Stock dividends	72,480	-	-	-	-	-	-	-	(72,480)	-	-	-	-
Cash dividends	-	-	-	-	-	-	-	-	(72,480)	-	-	-	(72,480)
Convertible notes converted into common stock	48,958	-	101,476	-	-	-	-	-	-	-	-	-	150,434
Net income in the six months ended June 30, 2004	-	-	-	-	-	-	-	-	267,175	-	-	-	267,175
Unrealized loss on market value decline of long-term equity investments	-	-	-	-	-	-	-	-	-	(41,714)	-	-	(41,714)
Cumulative translation adjustments on long-term equity investments	-	-	-	-	-	-	-	-	-	-	(43,435)	-	(43,435)
<b>BALANCE, JUNE 30, 2004</b>	<b>\$3,664,820</b>	<b>\$ -</b>	<b>\$4,953,174</b>	<b>\$ 3,021</b>	<b>\$ 270,307</b>	<b>\$ -</b>	<b>\$ 37,642</b>	<b>\$ -</b>	<b>\$ 270,082</b>	<b>\$ (41,714)</b>	<b>\$ (12,508)</b>	<b>\$ -</b>	<b>\$9,144,824</b>

The accompanying notes are an integral part of the financial statements.

(With Deloitte & Touche audit report dated August 5, 2005)

# WALSIN TECHNOLOGY CORPORATION

## STATEMENTS OF CASH FLOWS SIX MONTHS ENDED JUNE 30, 2005 AND 2004 (In Thousands of New Taiwan Dollars)

	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 125,048	\$ 267,175
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	397,273	337,389
Unrealized intercompany profit	10,000	29,000
Reversal of provision for loss in marketable securities	-	(1,997)
Provision for inventory devaluation and loss from disposal of inventory	13,389	20,072
Net gain from disposal of long-term equity investments	-	(6,477)
Net loss (gain) on equity investments	10,411	(45,148)
Net gain from disposal of property, plant and equipment	(3,363)	(3,711)
Provision for losses on idle asset devaluation	-	6,600
Net changes in operating assets and liabilities		
Short-term investments for trading purposes	(146,463)	459,282
Notes receivable	(465)	(15,980)
Notes receivable from related parties	-	(3,266)
Accounts receivable	(663)	98,524
Accounts receivable from related parties	82,344	(247,936)
Other financial assets, current	193,188	30,665
Inventories	68,822	(205,742)
Other current assets	80,069	2,664
Net receivable (payable) on forward exchange contracts	(3,846)	230
Deferred tax assets, noncurrent	(10,500)	(4,000)
Other financial assets, noncurrent	308	(848)
Notes payable	(34,210)	(24,485)
Accounts payable	4,953	80,848
Accounts payable to related parties	(3,671)	144,618
Other payables	(251,725)	196,759
Exchange rate adjustment of convertible notes payable	(5,406)	-
Other current liabilities	(2,168)	(20,709)
Accrued pension cost	4,444	-
Net cash provided by operating activities	<u>527,769</u>	<u>1,093,527</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Increase in long-term equity investments	(30,000)	(672,841)
Proceeds from disposal of long-term equity investments	-	15,199
Proceeds from disposal of property, plant and equipment	213,823	154,350
Acquisition of property, plant and equipment	(387,864)	(767,033)
Decrease (increase) in refundable deposits	410	(239)
Increase in deferred charges	(290)	(12,371)
Net cash used in investing activities	<u>(203,921)</u>	<u>(1,282,935)</u>

(Continued)



# WALSIN TECHNOLOGY CORPORATION

## STATEMENTS OF CASH FLOWS SIX MONTHS ENDED JUNE 30, 2005 AND 2004 (In Thousands of New Taiwan Dollars)

	2005	2004
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Decrease in short-term bank borrowings	\$ (155,833)	\$ (359,689)
Increase (decrease) in short-term obligations	30,261	(539,466)
Decrease in long-term debt	<u>-</u>	<u>(249,916)</u>
Net cash used in financing activities	<u>(125,572)</u>	<u>(1,149,071)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	198,276	(1,338,479)
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<u>420,791</u>	<u>1,655,277</u>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<u>\$ 619,067</u>	<u>\$ 316,798</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid during the period		
Interest (net of amount capitalized)	<u>\$ 15,564</u>	<u>\$ 10,626</u>
Income tax	<u>\$ -</u>	<u>\$ 847</u>
<b>CASH PAID DURING THE PERIOD FOR ACQUISITION OF PROPERTY, PLANT AND EQUIPMENT</b>		
Property, plant and equipment acquired	\$ 206,525	\$ 790,916
Add payable for purchases of property, plant and equipment at beginning of period	407,116	179,678
Less payable for purchases of property, plant and equipment at end of period	<u>(225,777)</u>	<u>(203,561)</u>
Cash paid during the period for acquisition of property, plant and equipment	<u>\$ 387,864</u>	<u>\$ 767,033</u>
<b>SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES</b>		
Translation adjustments on long-term equity investments	<u>\$ (65,262)</u>	<u>\$ (43,435)</u>
Property, plant and equipment transfer to idle assets	<u>\$ 5,840</u>	<u>\$ 22,098</u>
Dividends payable	<u>\$ 79,106</u>	<u>\$ 72,480</u>
Remuneration payable to directors and supervisors	<u>\$ 3,402</u>	<u>\$ 3,117</u>

(Continued)

# WALSIN TECHNOLOGY CORPORATION

## STATEMENTS OF CASH FLOWS SIX MONTHS ENDED JUNE 30, 2005 AND 2004 (In Thousands of New Taiwan Dollars)

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	2005	2004
Convertible notes payable converted into common stock	<u>\$ 62,439</u>	<u>\$ 150,434</u>
Unrealized loss on market value decline of long-term equity investments	<u>\$ 26,307</u>	<u>\$ (41,714)</u>
Adjustment of land revaluation increment tax by on equity method investees	<u>\$ 774</u>	<u>\$ -</u>
Increase on common shares held by subsidiaries	<u>\$ (7,616)</u>	<u>\$ -</u>

The accompanying notes are an integral part of the financial statements.

(With Deloitte & Touche audit report dated August 5, 2005)

(Concluded)

# WALSIN TECHNOLOGY CORPORATION

## NOTES TO FINANCIAL STATEMENTS

SIX MONTHS ENDED JUNE 30, 2005 AND 2004

(In Thousands of New Taiwan Dollars, Unless Stated Otherwise)

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### 1. ORGANIZATION AND OPERATIONS

Walsin Technology Corporation (the “Company”) was incorporated in the Republic of China (ROC) on July 29, 1970 to design, develop and manufacture semiconductors. In 1992, the Company changed its major operations to the manufacture of electronic ceramics, including multilayer ceramic capacitors (MLCC) and positive temperature coefficient resistors (PTCR). In 1995, the Company established a branch in Kaohsiung to research, develop, produce and sell new products. The Company’s common stock began to be traded in Taiwan’s over-the-counter market on November 21, 1997. Later, the Company’s stock ceased to be OTC traded and became listed on the Taiwan Stock Exchange on September 17, 2001. As of June 30, 2005, the Company had 2,003 employees, and Walsin Lihwa Corporation had a 24.93% ownership interest in the Company.

To lower operating costs, promote competitiveness, and expand operating scale, the Company’s board of directors approved the Company’s merger with Eden Technology Corp. (“Eden”) on February 11, 2004. The merger took effect on August 1, 2004, with the Company as survivor entity; thus, the Company assumed all of Eden’s rights and obligations on that date. The merger was approved by the Fair Trade Commission, Taiwan Stock Exchange Corporation, Securities and Futures Bureau (SFB), and Ministry of Economic Affairs of the Republic of China.

In response to the call made by government for companies to merge as well as to reduce operating costs, increase global competitiveness and expand operating scale, the Company’s board of directors proposed in their meeting on April 6, 2005, the Company’s merger with Pan Overseas Electronic Corporation. The Company will be the survivor entity, and its name will not be changed. This proposal was approved by the stockholders in their meeting on June 23, 2005 and by the SFB on July 28, 2005. Under the merger agreement, the merger date is September 1, 2005.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation

The accompanying financial statements have been prepared in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the Republic of China (ROC). In preparing financial statements in conformity with these guidelines and principles, the Company is required to make certain estimates and assumptions that could affect the amounts of allowance for doubtful accounts, allowance for inventory devaluation, property depreciation, pension, and warranty. Actual results could differ from these estimates.

For the convenience of readers, the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail. However, the accompanying financial statements do not include English translation of the additional footnote disclosures that are not required under generally accepted accounting principles but are required by the Securities and Futures Bureau (SFB, formerly the “Securities and Futures Commission” before July 1, 2004) for their oversight purposes.

The Company’s significant accounting policies are summarized as follows:

### **Current/Noncurrent Assets and Liabilities**

Assets consisting of unrestricted cash and cash equivalents and other assets to be converted into cash, sold, or consumed in 12 months or in the normal operating cycle are classified as current. Liabilities to be liquidated in 12 months or in the normal operating cycle are classified as current. All other assets and liabilities are classified as noncurrent.

### **Mergers**

Mergers are accounted for under the Statement of Financial Accounting Standards No. 25, “Business Combination - Accounting Treatment under the Purchase Method.” When the market value of equity securities issued from merger cannot stand for the fair value of the acquired companies’ net assets, the fair value of the acquired net assets should be evaluated. The net amount after deducting the par value of equity securities issued from merger and related costs from the fair value of net assets is included in capital surplus.

### **Cash and Cash Equivalents**

Cash includes cash on hand and unrestricted bank deposits. Cash equivalents consist of time deposits and commercial paper, which can be readily converted into cash without significant penalty or have a value that will not be significantly affected by interest rate fluctuations.

### **Short-Term Investments**

Short-term investments are available-for-sale securities stated at the lower of aggregate cost or market. The cost of short-term investments sold is determined based on the weighted-average method.

Stock dividends received are not recognized as income, they are instead reflected as an increase in the number of shares held.

### **Allowance for Doubtful Accounts**

Allowance for doubtful accounts is provided on the basis of management’s evaluation of the collectibility of and past loss experience on receivables and pertinent factors.

### **Inventories**

Inventories are stated at the lower of cost or market, with cost being determined using the weighted average method. Market values of raw materials and supplies are determined at replacement costs and those of finished goods or work-in-process are determined at their net realizable values.

## **Long-Term Equity Investments**

Investments in corporations in which the Company's ownership interest is 20% or more are accounted for by the equity method. The difference between the underlying equity in an investee's net assets and the cost of the investment as of acquisition date is amortized on a straight-line basis over five years. An allowance is recognized to reflect an other than temporary decline in value, with the related provision for losses charged to current income.

If the Company owns directly and indirectly more than 50% equity interest or controllable investees, equity in earnings or losses of the investee is recognized based on financial statements of the investee for the same period reported on by the Company.

All other long-term equity investments are valued at cost, except for investments in listed companies, which stated at the lower of aggregate cost or market value. Unrealized loss on long-term equity investments is reflected as a separate component of stockholders' equity.

The Company treats intercompany stockholdings as treasury stock.

## **Property, Plant and Equipment**

Property, plant and equipment are stated at cost less accumulated depreciation. Expenditures that would increase the value or extend the useful lives of property, plant and equipment are capitalized.

Interest incurred during asset construction period is capitalized until the asset is substantially completed and ready for its intended use.

Depreciation is calculated using the straight-line method over the following estimated service lives prescribed by government authorities:

Buildings and improvements	3 to 40 years
Machinery and equipment	3 to 8 years
Transportation equipment	3 to 6 years
Other equipment	3 to 10 years
Leasehold improvements	Lower of six years or the contract term

Property, plant and equipment (including idle assets) that are not used in operations are classified as other assets at the lower of net realizable values or book values, and the lower amount is reported as nonoperating loss.

Upon sale or disposal of property, plant and equipment, the related cost and accumulated depreciation are removed from the accounts and any gain or loss is credited or charged to nonoperating income.

Impairment loss is recognized immediately when the recoverable value of property, plant and equipment significantly falls below carrying value. If the loss is reversed, the increase in carrying amount of the asset is recognized, but the increased carrying amount should not exceed the carrying amount that would have been determined had no impairment loss been recognized. A reversal of an impairment loss is immediately recognized as gain.

Under certain regulations, effective December 31, 2004, if revalued property, plant and equipment shows impairment loss, this loss should be recognized as a reduction of capital surplus - property, plant and equipment revaluation increment. A reversal of an impairment loss on a revalued asset is recognized as an addition to the revaluation increment. However, to the extent that an impairment loss on the same revalued asset was previously recognized as gain or loss, a reversal of that impairment loss is also recognized as gain or loss.

### **Deferred Charges**

Deferred charges, except the issue costs of convertible notes, which are amortized over their maturity periods, are amortized on a straight-line basis over three to five years.

### **Convertible Notes**

The convertible notes issued by the Company carry put rights. That is, each holder has the right, at the holder's option and on specified dates, to request the company to repurchase all or any portion of these notes. The interest payable at redemption, which is the amount of the agreed put price in excess of the face value of the notes, will be recognized as a liability under the interest method from the note issue date to the expiry date of the put rights.

When the holders exercise their conversion right, the unamortized issuing costs, accrued interest, accrued interest compensation and face value of convertible notes will be written off. The common stock exchange certificate (capital stock) should be valued at the carrying amount net of the amounts written off, and this net amount in excess of the par value of the common stock exchange certificate is recognized as capital surplus.

### **Employee Pension Fund**

The Company has a defined benefit pension plan covering all employees. The benefits to be paid under the plan are based primarily on an employee's years of service and average compensation for the six months before period prior to retirement. Under the ROC Labor Standards Law, this plan is funded by contributions at 3% of employee salaries and wages, and the pension fund is deposited in the Central Trust of China. The Company adopted Statement of Financial Accounting Standards No. 18, "Accounting for Pensions," issued by the Accounting Research and Development Foundation of the ROC, which requires the recognition of net periodic pension cost based on actuarial assumptions. As of June 30, 2005, the fund balance was \$142,469 thousand.

The "Labor Pension Act" (the "Act") provides for a new defined contribution plan, effective July 1, 2005. Employees subject to the Labor Standards Law before the enforcement of the Act and still work for the Company after the enforcement of this Act may choose to remain to be subject to the pension mechanism under the Labor Standards Law. If they choose to be subject to the pension mechanism under the Act, their service years accumulated before the enforcement of this Act will be retained. Under the Act, the rate of an employer's monthly contribution to the Labor Pension Fund should be at least 6% of the employee's monthly wages.

### **Treasury Stock**

The Company adopted Statement of Financial Accounting Standards No. 30 "Accounting for Treasury Stocks," which requires the Company to treat intercompany stockholdings as treasury stock.

## **Foreign-currency Transactions**

Foreign-currency transactions are recorded in New Taiwan dollars at exchange rates in effect on the transaction date. Gains or losses caused by applying prevailing exchange rates when foreign-currency receivables and payables are settled, are credited or charged to nonoperating income. Assets and liabilities denominated in foreign currencies are translated at the exchange rates prevailing on the balance sheet date, and any resulting gains or losses are credited or charged to non-operating income.

## **Cumulative Translation Adjustments**

Long-term equity investments accounted for by the cost method and denominated in foreign currencies are restated in New Taiwan dollars at the balance-sheet-date exchange rates. The related translation adjustments are reported as a separate component of stockholders' equity. Under the equity method, an investee's assets and liabilities denominated in foreign currencies are translated at the balance sheet date exchange rates. Stockholders' equity accounts should be translated at the historical rate, except for the beginning balance of the retained earnings, which is carried at the translated amount of the last period. Dividends are translated at the spot rate on the declaration date. Income statement accounts are translated at the current rate or weighted-average rate of the current period.

## **Income Tax**

The Company adopted Statement of Financial Accounting Standards No. 22, "Accounting for Income Taxes," which requires the asset and liability approach to financial accounting and tax reporting. Deferred income tax assets and liabilities are computed annually on the basis of the differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established for deferred tax assets that are not certain to be realized. Income tax expense or benefit is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

Under the Amended Income Tax Law of ROC, undistributed earnings of the Company generated since 1998 are subject to 10% additional income tax, which will be shown as income tax expense in the following year when the stockholders decide to retain these earnings.

## **Earnings Per Share**

Basic earnings per common share are calculated by dividing net earnings attributable to common stock by the weighted-average number of common shares outstanding.

On a diluted basis, both net earnings and shares outstanding are adjusted to assume the conversion of convertible notes from the date of issue, and the treasury stock method is used to calculate the potential dilutive common stocks of employee stock warrants. However, if the convertible notes and employee stock warrants have an anti-dilutive effect, they will be excluded from EPS calculation.

## **Derivative Financial Instruments**

Forward exchange contracts, which are used to hedge net foreign-currency asset or liability positions are recorded on the transaction dates. Assets and liabilities denominated in foreign currencies are translated at the exchange rates on the balance sheet date, and any resulting gains or losses are credited or charged to nonoperating income. Discounts or premiums (the differences between the forward rates and the spot rates on the date of purchase multiplied by the foreign-currency amounts) are amortized to income over the duration of the contracts.

If forward exchange contracts are used to hedge identifiable foreign-currency sales/purchase commitments and the contracts have settlement dates ahead of the actual sales/purchase date, any exchange gain should be deferred to the actual selling/purchase date. However, any exchange loss incurred should not be deferred. If the principal amounts of forward foreign currency exchange contracts exceed the recognizable foreign currency commitments, any excess is reflected directly to current income.

Receivable or payable on forward exchange contracts are included in the net receivable and payable in the balance sheet. The premiums to be received or paid on currency option contracts are deferred and recognized as revenue or expense or expiry of contracts.

## **Nonderivative Financial Instruments**

The recognition and valuation of nonderivative financial assets and liabilities are in accordance with the above accounting policies and generally accepted accounting principles.

## **Revenue Recognition**

Sales are recognized when titles to the products and the risks of the ownership are transferred to customers, primarily upon shipment.

## **Reclassifications**

Certain reclassifications have been made in the financial statements for the six months ended June 30, 2004 to be consistent with the presentation of the financial statements for the six months ended June 30, 2005.

### **3. ACCOUNTING CHANGES**

As disclosed in Note 2, the Company applied Statement of Financial Accounting Standards (SFAS) No. 35, "Accounting for Impairment of Assets," effective December 31, 2004. As a result, the Company's long-term equity investments decreased by \$22,842 thousand, and net income increased by \$4,283 thousand.

The Company also applied SFAS No. 7, "Consolidated Financial Statements," effective January 1, 2005, which stipulated new criteria for preparing consolidated financial statements. Thus, the Company treated Pan Overseas Electronic Co., Ltd. (POE) as a subsidiary, and the Company's shares held by POE were treated as treasury (see Note 19). As a result of this change, the Company's long-term investments decreased by \$7,616 thousand, and treasury stock increased by \$7,616 thousand also.



#### 4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of June 30, 2005 and 2004 were as follows:

	2005	2004
Cash on hand	\$ 575	\$ 545
Savings deposits	21,428	55,384
Demand deposits	10,839	6,966
Foreign-currency deposits	379,501	86,044
Certificates of deposit	21,724	67,238
Overseas bonds	-	100,621
Commercial paper and banker's acceptance	<u>185,000</u>	<u>-</u>
	<u>\$619,067</u>	<u>\$316,798</u>

Certificates of deposits amounting to \$19,420 thousand and \$16,420 thousand as of June 30, 2005 and 2004, respectively, had been pledged to secure materials purchase orders and to meet the requirements for the hiring of foreign labor. All of the above amounts were reported under other financial assets, noncurrent.

#### 5. SHORT-TERM INVESTMENTS

The carrying values and market values of short-term investments as of June 30, 2005 and 2004 are summarized as follows:

	<u>2005</u>		<u>2004</u>	
	Carrying Value	Market Value	Carrying Value	Market Value
Marketable securities traded on the Taiwan Stock Exchange	\$ 13,594	\$ 14,693	\$ 37,109	\$ 34,249
Convertible bonds	-	-	10,000	9,233
Open-end bond funds	1,111,463	1,121,623	840,000	848,243
Open-end stock funds	<u>100,000</u>	<u>102,573</u>	<u>-</u>	<u>-</u>
	1,225,057	1,238,889	887,109	891,725
Less allowance for decline in market value	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$1,225,057</u>	<u>\$1,238,889</u>	<u>\$ 887,109</u>	<u>\$ 891,725</u>

The market values of marketable securities and convertible bonds were determined at their average daily closing prices in June.

The market values of open-end bond funds and open-end stock funds were determined at their published fair value per unit at the end of June.

Marketable securities are valued at the lower of aggregate cost or market value. No investment valuation allowance had been provided as of June 30, 2005.

## 6. NOTES AND ACCOUNTS RECEIVABLE

Notes and accounts receivable as of June 30, 2005 and 2004 are summarized as follows:

	2005	2004
Third parties		
Notes receivable	\$ 35,030	\$ 91,530
Less allowance for doubtful accounts	<u>-</u>	<u>-</u>
	<u>35,030</u>	<u>91,530</u>
Accounts receivable	465,255	594,672
Less allowance for doubtful accounts	<u>(24,736)</u>	<u>(25,019)</u>
	<u>440,519</u>	<u>569,653</u>
	<u>\$ 475,549</u>	<u>\$ 661,183</u>
Related parties		
Notes receivable	\$ -	\$ 3,266
Less allowance for doubtful accounts	<u>-</u>	<u>-</u>
	<u>-</u>	<u>3,266</u>
Accounts receivable	840,030	1,152,859
Less allowance for doubtful accounts	<u>-</u>	<u>-</u>
	<u>840,030</u>	<u>1,152,859</u>
	<u>\$ 840,030</u>	<u>\$ 1,156,125</u>

## 7. OTHER FINANCIAL ASSETS, CURRENT

Other financial assets, current as of June 30, 2005 and 2004 are summarized as follows:

	2005	2004
Other receivable from related parties (Note 22)	\$ 151,855	\$ 478,315
Receivable from disposal of investment	-	15,199
Receivable on forward exchange contract, net (Note 25)	-	365
Other receivable	<u>1,774</u>	<u>7,278</u>
	<u>\$ 153,629</u>	<u>\$ 501,157</u>

## 8. INVENTORIES

Inventories as of June 30, 2005 and 2004 are summarized as follows:

	2005	2004
Raw materials	\$ 194,643	\$ 270,268
Supplies	15,344	22,038
Work-in-process	176,465	145,476
Semifinished goods	605,472	357,485
Finished goods	413,477	443,848
Raw materials in transit	<u>26,463</u>	<u>-</u>
	1,431,864	1,239,115
Less valuation allowance	<u>(91,622)</u>	<u>(85,521)</u>
	<u>\$ 1,340,242</u>	<u>\$ 1,153,594</u>

As of June 30, 2005 and 2004, inventory insurance amounted to \$1,509,500 thousand and \$1,416,500 thousand, respectively.

## 9. LONG-TERM EQUITY INVESTMENTS

Long-term equity investments as of June 30, 2005 and 2004 are summarized as follows:

	2005			2004	
	Original Investment Cost	Carrying Value	Ownership Percentage	Carrying Value	Ownership Percentage
Equity method					
Gallatown Developments Limited ("Gallatown")	\$4,256,903	\$3,568,479	100.00	\$3,065,624	100.00
Eagle Advanced Ceramics Corporation (EACC)	46,027	57,630	100.00	66,660	100.00
Philip Technology Corporation (PTC)	661	599	100.00	-	-
Eden Technology corporation (Samoa) (ETC)	15,213	11,168	100.00	-	-
POE International Co., Ltd. (POEI)	30,000	30,000	100.00	-	-
Pan Overseas Electronic Co., Ltd. (POE)	833,348	843,706	25.19	872,353	25.01
Hannstar Color Co., Ltd. (HC)	279,200	300,588	22.26	274,969	20.00
Eden Technology Corp. ("Eden")	-	-	-	233,953	30.44
Dolphin Co., Ltd. ("Dolphin")	<u>-</u>	<u>-</u>	<u>-</u>	<u>38,781</u>	<u>26.67</u>
	<u>5,461,352</u>	<u>4,812,170</u>		<u>4,552,340</u>	
Cost method					
Hannstar Electronics Corp.	20,190	7,532	4.04	30,000	5.77
Hann Spree Corp.	50,000	50,000	0.79	100,000	1.89
Parawin Venture Capital Corp.	15,000	15,000	1.50	15,000	1.50
Elcon International Co., Ltd.	<u>18,819</u>	<u>-</u>	<u>9.40</u>	<u>18,819</u>	<u>9.40</u>
	<u>104,009</u>	<u>72,532</u>		<u>163,819</u>	

	2005			2004	
	Original Investment Cost	Carrying Value	Ownership Percentage	Carrying Value	Ownership Percentage
At the lower of cost or market method					
Hannstar Board Corp.	260,732	260,732	4.69	221,689	5.52
Less allowance for devaluation	-	-		(41,714)	
	<u>260,732</u>	<u>260,732</u>		<u>179,975</u>	
	<u>\$5,826,093</u>	<u>\$5,145,434</u>		<u>\$4,896,134</u>	

Equity in gains (losses) in the six months ended June 30, 2005 and 2004, including the equity in earnings of EACC and POE in the six months ended June 30, 2005 and 2004 based on financial statements audited by other auditors, are summarized as follows:

	2005	2004
Gallatown	\$ 750	\$ 11,170
EACC	12,874	(4,290)
PTC	(5)	-
ETC	(7,368)	-
POE	(25,201)	15,920
HC	8,539	34,374
Eden	-	(11,545)
Dolphin	-	(1,712)
WSEM	-	1,231
	<u>\$ (10,411)</u>	<u>\$ 45,148</u>

Gallatown was formed in the Cayman Island as a 100% subsidiary of the Company. It is an investment holding company.

To offset its accumulated deficit, EACC decreased its capital stock by \$24,700 thousand on June 17, 2004.

Eden merged with the Company on August 1, 2004, with the Company as the survivor entity. The shares of Eden held by the Company were retired after the merger took effect. Another merger result was the Company's acquiring the shares of PTC and ETC.

POEI was incorporated in May 2005 as the Company's 100% subsidiary, which will sell electronic connectors and electronic wires. As of June 30, 2005, POEI had not started operations.

POE manufactures and sells of electronic connectors and electronic wires, and its stock is listed on the Taiwan Stock Exchange. POE bought and retired its treasury stock in August 2004, and the Company's ownership interests increased from 25.01% to 25.19%. POE is anticipated to merge with the Company and liquidated on September 1, 2005. The share swap ratio was set at 2 POE shares for 1 Company share. POE shares held by the Company will be canceled after the merger takes effect.

The Company bought 20,000,000 common shares of Hannstar Color Co., Ltd. for \$239,200 thousand from Walsin Lihwa Corporation and the Company's ownership interest was 20%, originally, and accounted by use of equity method of accounting. On December 14, 2004, Hannstar Color Co., Ltd. merged Dolphin Co., Ltd. with HC as the survivor company. The share swap ratio was set 1 Dolphin share for 0.7 Hannstar Color share. After the merger, the Company owned 22,800,000 common shares or 22.26% interests of ownership.

The carrying value and market value of long-term marketable equity securities as of June 30, 2005 and 2004 are summarized as follows:

	2005		2004	
	Carrying Value	Market Value	Carrying Value	Market Value
Hannstar Board	\$ 260,732	\$ 269,014	\$ 221,689	\$ 179,975
Less provision for losses on decline in value of marketable securities	-	-	(41,714)	-
	\$ 260,732	\$ 269,014	\$ 179,975	\$ 179,975

Market value of marketable equity securities are determined by averaging the daily market closing prices during the month of June. Marketable equity securities are valued at the lower of aggregate cost or market value. As of June 30, 2005, after considering the valuation allowance balance of \$26,307 thousand as of December 31, 2004, the amount of \$26,307 thousand was recovered.

## 10. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment as of June 30, 2005 and 2004 were as follows:

	2005			2004
	Cost	Accumulated Depreciation	Carrying Value	Carrying Value
Buildings and improvements	\$ 854,941	\$ 198,063	\$ 656,878	\$ 674,562
Machinery and equipment	4,477,620	1,988,597	2,489,023	2,490,458
Transportation equipment	20,507	14,682	5,825	7,492
Leasehold improvements	193,163	163,975	29,188	26,860
Other equipment	530,487	323,369	207,118	237,482
Construction in progress	350,733	-	350,733	224,617
	\$ 6,427,451	\$ 2,688,686	\$ 3,738,765	\$ 3,661,471

In the six months ended June 30, 2005 and 2004, interest expenses (before capitalized interest) were \$15,587 thousand and \$11,926 thousand, respectively; capitalized interest on asset construction amounted to \$2,777 thousand and \$1,378 thousand, respectively; and average interest rates were from 1.49% to 2.33% and from 0.89% to 2.39%, respectively.

As of June 30, 2005 and 2004, insurance for property, plant and equipment (excluding construction in progress) amounted to \$3,865,683 thousand and \$3,590,602 thousand, respectively.

See Note 22 for sales of property, plant and equipment to related parties.

## 11. OTHER ASSETS

Other assets as of June 30, 2005 and 2004 are summarized as follows:

	2005	2004
Idle assets		
Land	\$ 6,608	\$ 6,608
Buildings and improvements	6,526	738
Machinery equipment	235,460	214,627
Other equipment	<u>11,325</u>	<u>11,011</u>
	259,919	232,984
Less accumulated depreciation	(132,797)	(112,176)
Less allowance for devaluation	<u>(90,094)</u>	<u>(72,193)</u>
	37,028	48,615
Deferred charges (Note 2)	33,362	27,134
Deferred tax assets, noncurrent (Note 21)	<u>351,012</u>	<u>269,000</u>
	<u>\$421,402</u>	<u>\$344,749</u>

Idle assets included the road, revalued at \$6,608 thousand (cost of \$52 thousand and revaluation increment of \$6,556 thousand), which is a part of the Shin-Fon factory. A reserve of \$3,580 thousand had been provided for the land value increment tax for this revaluation increment.

## 12. SHORT-TERM BANK BORROWINGS

Short-term bank borrowings as of June 30, 2005 and 2004 were as follows:

	2005		2004	
	Interest Rate %	Amount	Interest Rate %	Amount
Credit loans	1.34-1.35	\$950,000	1.13-1.30	\$711,000
Foreign-currency borrowings	-	-	1.72-1.906	66,958
Letters of credit	-	-	1.73-2.8541	<u>10,790</u>
		<u>\$950,000</u>		<u>\$788,748</u>

## 13. SHORT-TERM OBLIGATIONS

Short-term obligations as of June 30, 2005 and 2004 were as follows:

	2005		2004	
	Interest Rate %	Amount	Interest Rate %	Amount
Commercial paper, unsecured	0.85~1.212	\$810,000	0.942~1.002	\$400,000
Less unamortized discount on commercial paper		<u>(421)</u>		<u>(951)</u>
		<u>\$809,579</u>		<u>\$399,049</u>

#### 14. OTHER PAYABLES

Other payables as of June 30, 2005 and 2004 were as follows:

	2005	2004
Accrued expenses	\$ 299,281	\$ 570,152
Payable for purchase of equipment	225,777	203,561
Dividends payable	79,112	72,480
Remuneration payable to director and supervisors	3,402	3,117
Others	<u>37,909</u>	<u>279,170</u>
	<u>\$ 645,481</u>	<u>\$ 1,128,480</u>

#### 15. CONVERTIBLE NOTES PAYABLE

Convertible notes payable as of June 30, 2005 and 2004 were as follows:

	2005	2004
Convertible notes	\$ 1,024,423	\$ 1,195,635
Add interest payable at redemption	<u>-</u>	<u>-</u>
	<u>\$ 1,024,423</u>	<u>\$ 1,195,635</u>

##### Convertible Notes - Second Issue

On December 30, 2003, the Company issued US\$40 million in convertible notes on the Luxemburg Stock Exchange. The notes, with face value of US\$10,000 and zero percent interest rate, will mature in five years.

##### Conversion Price

The initial price at which shares will be issued upon conversion is NT\$32.00 per share, which is subject to adjustments as prescribed in the covenants. The conversion price should be adjusted on the reset dates (December 31, 2004; December 31, 2005; December 31, 2006; and December 31, 2007) if the average closing price of the shares on the Taiwan Stock Exchange for 20 consecutive trading days before the reset date converted into U.S. dollars at the prevailing rate is less than the price in effect converted into U.S. dollars at the fixed exchange rate on the pricing date. However, any adjustment to the price must not result in the conversion price becoming lower than 80% of the initial price after antidilution adjustment.

The conversion price was set at NT\$24.99 per share. The conversion price is subject to adjustment based on changes of the Company's capital account or the market value becoming lower than the conversion price.

##### Conversion Period

The notes may be converted at any time on or after January 29, 2004 and before the notes are deposited on November 30, 2008 for conversion into shares.

## Redemption at the Option of the Company

The Company can redeem the notes at any time on or after December 31, 2004. The redemption terms are outlined as follows:

- (a) The notes may be redeemed when the closing price of the shares on each of 20 consecutive trading days is over 130% of the conversion price.
- (b) The notes may be redeemed when the outstanding notes are less than 10% of total issued notes.

The Company will, at the option of the noteholder, redeem all or part of the notes on December 30, 2006, December 30, 2007 and December 30, 2008 at par value.

As of June 30, 2005, the Company's noteholders had converted notes amounting to US\$7,600 thousand into 8,984,426 common shares, which resulted in an increase of \$154,928 thousand in additional paid-in capital.

Noteholders may request the Company to redeem the notes in cash at face value. They may also convert the notes into common stock at any time according to the conversion terms and related laws of the ROC.

## 16. DEFERRED CREDIT

Deferred credits as of June 30, 2005 and 2004 were as follows:

	2005	2004
Unrealized gain on sale of goods	\$ 76,123	\$ 81,280
Unrealized gain on sale of assets (Note 22)	26,010	22,452
Unrealized gain on sale of long-term equity investments	<u>2,835</u>	<u>-</u>
	<u>\$ 104,968</u>	<u>\$ 103,732</u>

## 17. CAPITAL STOCK

	June 30	
	2005	2004
Authorized capital		
Shares ('000)	<u>520,000</u>	<u>431,927</u>
Par value	<u>\$ 10</u>	<u>\$ 10</u>
Capital	<u>\$ 5,200,000</u>	<u>\$ 4,319,273</u>
Issued capital		
Shares ('000)	<u>394,829</u>	<u>366,482</u>
Par value	<u>\$ 10</u>	<u>\$ 10</u>
Capital	<u>\$ 3,948,291</u>	<u>\$ 3,664,820</u>



The Company's paid-in capital as of January 1, 2005 was \$3,921,034 thousand. In the six months ended June 30, 2005, convertible notes were converted into 2,725,728 common shares. Thus, as of June 30, 2005, the Company's paid-in capital had increased to \$3,948,291 thousand, divided into 394,829,106 common shares with NT\$10.00 par value.

The Company's board of directors proposed and the stockholders approved the distribution from the 2004 earnings of \$8,506 thousand as stock bonuses to employees and of \$79,106 thousand as stock dividends, for a total of \$87,612 thousand to be transferred to outstanding capital. The government approved this distribution on July 5, 2005. Thus the amount was regarded as stock dividends to be distributed on June 30. In the earnings per share calculation, the amount is included as common stock.

Earnings per share in the six months ended June 30, 2005 and 2004 were calculated as follows:

	<b>2005</b>				
	<u>Amount (Numerator)</u>			<u>Earnings Per Share</u>	
	<u>Before Tax</u>	<u>After Tax</u>	<u>Shares (Denominator)</u>	<u>Before Tax</u>	<u>After Tax</u>
Net income	<u>\$ 130,048</u>	<u>\$ 125,048</u>			
Basic earnings per share - for common stock	<u>\$ 130,048</u>	<u>\$ 125,048</u>	<u>402,711,967</u>	<u>\$ 0.32</u>	<u>\$ 0.31</u>
Potential common shares with dilutive effect					
Overseas convertible notes	\$ -	\$ -	<u>44,156,831</u>	\$ -	\$ -
Diluted earnings per share	<u>\$ 130,048</u>	<u>\$ 125,048</u>	<u>446,868,798</u>	<u>\$ 0.29</u>	<u>\$ 0.28</u>
	<b>2004</b>				
	<u>Amount (Numerator)</u>			<u>Earnings Per Share</u>	
	<u>Before Tax</u>	<u>After Tax</u>	<u>Shares (Denominator)</u>	<u>Before Tax</u>	<u>After Tax</u>
Net income	<u>\$ 274,175</u>	<u>\$ 267,175</u>			
Basic earnings per share - for common stock	<u>\$ 274,175</u>	<u>\$ 267,175</u>	<u>371,354,051</u>	<u>\$ 0.74</u>	<u>\$ 0.72</u>
Potential common shares with dilutive effect					
Employee stock warrants	\$ -	\$ -	<u>1,421,759</u>	\$ -	\$ -
Overseas convertible notes	-	-	<u>38,519,272</u>	-	-
Diluted earnings per share	<u>\$ 274,175</u>	<u>\$ 267,175</u>	<u>411,295,082</u>	<u>\$ 0.67</u>	<u>\$ 0.65</u>

Had the shares held by subsidiaries been treated as investments, not as treasury stock, the basic and diluted earnings would have been calculated as follows:

	<b>2005</b>				
	<u>Amount (Numerator)</u>		<u>Shares (Denominator)</u>	<u>Earnings Per Share</u>	
	<u>Before Tax</u>	<u>After Tax</u>		<u>Before Tax</u>	<u>After Tax</u>
Net income	<u>\$ 130,048</u>	<u>\$ 125,048</u>			
Basic earnings per share - common stock	<u>\$ 130,048</u>	<u>\$ 125,048</u>	<u>403,135,998</u>	<u>\$ 0.32</u>	<u>\$ 0.31</u>
Potential common shares with dilutive effect					
Overseas convertible notes	<u>\$ -</u>	<u>\$ -</u>	<u>44,156,831</u>	<u>\$ -</u>	<u>\$ -</u>
Diluted earnings per share	<u>\$ 130,048</u>	<u>\$ 125,048</u>	<u>447,292,829</u>	<u>\$ 0.29</u>	<u>\$ 0.28</u>

## 18. RETAINED EARNINGS

Based on the ROC Company Law and the Company's Articles of Incorporation, 10% of the Company's earnings, less tax and any deficit, should be appropriated as legal reserve until this reserve equals the paid-in capital and as special reserve as required by laws or domestic authorities. Unappropriated earnings could be retained for operating needs, if necessary. The remaining balance, if any, should be distributed in the following order:

- (a) Bonuses to employees - 5%, including subsidiaries' employees, if approved by the board of directors;
- (b) Remuneration to directors and supervisors - 2%; and
- (c) Any remainder, as dividends, bonuses to stockholders.

Information on earnings appropriation can be accessed online through the Market Observation Post System of the Taiwan Stock Exchange (<http://e-mops.tse.com.tw>).

The Company's board of directors had proposed and the stockholders had approved the distribution from the 2004 earnings of \$8,506 thousand as stock bonuses to employees (0.22% of the outstanding common shares as of December 31, 2004); \$79,106 thousand as stock dividend; \$79,106 thousand as cash dividend; and of \$3,402 thousand as remuneration to directors and supervisors.

In 2004, the earnings per share after income tax (before retroactive adjustment for stock dividend distribution in 2005) were NT\$1.11. Had the earning distribution to employees, directors, and supervisors been accounted for as expense, the pro forma earnings per share after income tax would have been NT\$1.08.

At their March 22, 2002 meeting, the Company's board of directors resolved to issue employee stock warrants in accordance with Article 28.3 of the Securities and Exchange Law, which limited the number of warrants for distribution to 10,000,000 units. Each warrant holder has the right to buy newly issued common share. The exercise price is the closing price of the Company's common shares at the warrant issuance date. The warrant holder can exercise the right up to 50% of the granted warrant units no earlier than two years from the grant date. After three years from the grant date, warrant holders are eligible to exercise all the warrants owned. As of June 7, 2002, the Company had issued 5,929,000 units of the employee stock warrants to the employees at the exercise price of NT\$34 per unit. As of May 2, 2003, the Company had issued another 4,071,000 units of the employee stock warrants to the employees at the exercise price of NT\$19.4 per unit.

The exercise price of these warrants had been retroactively restated at NT\$30.3 per share (from NT\$34 per share on the June 7, 2002 issuance) and NT\$17.4 per share (from NT\$19.4 on the May 2, 2003 issuance), respectively, for the distribution of stock dividends issued over the years.

## 19. TREASURY STOCK

The Company applied Statement of Financial Accounting Standards No. 7, "Consolidated Financial Statements," from January 1, 2005, which stipulated new criteria for preparing consolidated financial statements. Thus, in its financial statements for the six months ended June 30, 2005, the Company treated an investee, Pan Overseas Electronic Co., Ltd. (POE), as a subsidiary. POE held 1,683,330 shares of the Company's stock, with NT\$17.96 par value. On the basis of POE's holdings, the Company adjusted its equity interest in POE to 25.19%, and treasury stock amounting to \$7,616 thousand as of June 30, 2005 was recognized.

## 20. PERSONNEL, DEPRECIATION, DEPLETION AND AMORTIZATION EXPENSES

Personnel, depreciation, depletion and amortization expenses in the six months ended June 30, 2005 and 2004 are summarized as follows:

Function Expense Item	2005			2004		
	Operating Cost	Operating Expense	Total	Operating Cost	Operating Expense	Total
Personnel expense						
Salaries	\$257,202	\$113,121	\$370,323	\$289,762	\$103,098	\$392,860
Labor/health insurance	20,333	7,497	27,830	22,035	6,124	28,159
Pension cost	9,990	4,448	14,438	9,323	3,064	12,387
Others	49,792	6,244	56,036	53,513	5,102	58,615
Depreciation	352,550	28,215	380,765	309,794	23,573	333,367
Depletion	-	-	-	-	-	-
Amortization	1,532	5,697	7,229	575	3,447	4,022

## 21. INCOME TAX

Components of credits (provision) for income tax are summarized as follows:

Tax expenses from current operating gain	\$ 31,000
Investment tax credits	(30,000)
Deferred tax asset	<u>4,000</u>
Income tax provision, net	<u>\$ 5,000</u>

The tax effects of deductible temporary differences as well as investment tax credit that gave rise to deferred tax assets as of June 30, 2005 were as follows:

Deferred tax asset	
Investment tax credits	\$ 317,000
Net loss on equity investments	43,000
Unrealized loss from inventory devaluation	23,000
Unrealized loss from idle asset devaluation	22,500
Unrealized profit from intercompany transactions	19,000
Other	<u>19,512</u>
	444,012
Deferred tax liability	
Unrealized exchange gain	<u>(24,000)</u>
Total deferred tax asset	420,012
Less allowance	<u>(67,000)</u>
Deferred tax assets, net	353,012
Less noncurrent portion	<u>(352,012)</u>
Deferred tax assets, current	<u>\$ 2,000</u>

Current income tax expenses in the six months ended June 30, 2005 and income tax payable as of June 30, 2005 were as follows:

Income tax benefit at statutory rate of 25% (rounded off)	\$ 32,500
Decrease in tax resulting from	
Gain on disposal of investments	(1,500)
Investment loss recognized under the equity method	3,000
Dividend income	<u>(3,000)</u>
Income tax expenses from current operating gain	31,000
Provision (reversal of allowance) for deferred income tax assets (liabilities)	
Realized exchange gain	7,000
Unrealized exchange gain	(24,000)
Realized loss from idle asset devaluation	(17,500)
Unrealized profit from intercompany transactions	2,000
Other	<u>1,500</u>
Income tax payable as of June 30, 2005	<u>\$ -</u>

The prepaid income tax and withholding tax of \$623 thousand as of June 30, 2005 were a 2005 income tax prepayment.

Information on the imputation credit (IC) on the undistributed earnings as of June 30, 2005 is summarized as follows:

IC on undistributed 2005 earnings as of June 30	\$ 4,984
Undistributed earnings generated before 1998	<u>\$ -</u>
Undistributed earnings generated since 1998	<u>\$ 124,417</u>
Expected IC ratio on earnings to be distributed in 2005	1.23%
Actual IC ratio on stock dividends distributed in 2004	0.21%

The Company's investment tax credits and research and development expenditure tax credits as of June 30, 2005 for income tax purposes were as follows:

Expiry Year	Investment Tax Credit	Research and Development Tax Credit
2005	\$ 45,000	\$ 21,000
2006	38,000	16,000
2007	54,000	25,000
2008	88,000	-
2009	<u>9,000</u>	<u>21,000</u>
	<u>\$ 234,000</u>	<u>\$ 83,000</u>

The Company's income tax returns through 2002 had been approved by the tax authorities.

## 22. RELATED-PARTY TRANSACTIONS

The related parties were as follows:

Related Party	Relationship with the Company
Walsin Lihwa Corporation ("Walsin Lihwa")	Company's 24.93% stockholder as of June 30, 2005
Gallatown Developments Limited ("Gallatown")	100% subsidiary
Eagle Advanced Ceramics Corporation (EACC)	100% subsidiary
POE International Co., Ltd. (POEI)	100% subsidiary
Pan Overseas Electronic Co., Ltd. (POE)	An controllable investees
Eden Technology Corp. ("Eden")	Equity-method investee until its liquidation upon merger with the Company effective August 1, 2004
Walsin Electronics (S) Pte. Ltd. (WES)	100% subsidiary of Gallatown
Walsin Technology Corporation (HK) Limited (WTC [HK])	100% subsidiary of Gallatown
Walsin Technology Corporation U.S.A. (WTC [USA])	100% subsidiary of Gallatown
Walsin Passive Component Corp. (HK) (WPC)	100% subsidiary of Gallatown
Walsin Technology Corporation (Japan) Limited (WTC [J])	100% subsidiary of Gallatown

<b>Related Party</b>	<b>Relationship with the Company</b>
Walsin Technology Corporation (Malaysia) Sdn. Bhd. (WTC [M])	100% subsidiary of Gallatown
Dongguan Walsin Technology Electronics Company Limited (WTC [DG])	100% subsidiary of Gallatown
Suzhou Walsin Technology Electronics Company Limited (WTC [SH])	100% subsidiary of Gallatown
Eden Technology Corp. (HK) (“Eden [HK]”)	100% subsidiary of Gallatown
Nitsuko Electronics Corporation (NTK)	70% subsidiary of Gallatown
Walsin Info Electric Inc. (WIE)	Subsidiary of Walsin Lihwa Corporation
Hannstar Entertainment Corporation (HE)	Same chairman as the Company’s
Walton Advanced Engineering Inc. (“Walton Advanced”)	Same chairman as the Company’s
Hannstar Color Co., Ltd. (HC)	Same chairman as the Company’s
Hannstar Display Corporation (“Hannstar Display”)	Chairman is an immediate relative of the Company’s chairman
Hann Spree Corp. (“Hann”)	Chairman is an immediate relative of the Company’s chairman
Hannstar Electronics Corp. (“Hannstar”)	Chairman is an immediate relative of the Company’s chairman

Major transactions with related parties are summarized below:

### Sales

Sales to related parties in the six months ended June 30, 2005 and 2004 are summarized as follows:

	<b>Six Months Ended June 30</b>	
	<b>2005</b>	<b>2004</b>
WTC (HK)	\$ 735,994	\$ 794,666
WPC	306,997	305,355
POE	261,133	257,520
EACC	203,323	-
WTC (M)	29,629	18,638
WES	25,483	27,376
NTK	16,071	33,466
Eden	-	156,973
Other	2,208	2,731
	<u>\$ 1,580,838</u>	<u>\$ 1,596,725</u>

The Company’s management determined that the sales were at arm’s length.

## Purchases

Purchases from related parties in the six months ended June 30, 2005 and 2004 are summarized as follows:

	<u>Six Months Ended June 30</u>	
	<u>2005</u>	<u>2004</u>
WTC (HK)	\$ 382,233	\$ 96,934
POE	11,997	98,322
Eden	-	45,102
Other	<u>3,760</u>	<u>1,830</u>
	<u>\$ 397,990</u>	<u>\$ 242,188</u>

The Company's management determined that the purchases were at arm's length.

## Rental Expense

	<u>Six Months Ended June 30</u>	
	<u>2005</u>	<u>2004</u>
Walton Advanced	\$ 6,302	\$ 5,860
Walsin Lihwa	4,379	5,306
Hannstar Display	3,631	3,582
Others	<u>576</u>	<u>989</u>
	<u>\$ 14,888</u>	<u>\$ 15,737</u>

Rental expense was based on market rate and the Company determined that the terms of payment were at arm's length.

## Sales of Raw Materials and Supplies

	<u>Six Months Ended June 30</u>	
	<u>2005</u>	<u>2004</u>
WTC (HK)	\$ 158,642	\$ 211,656
POE	9,297	50,771
WPC	9,058	28,461
Eden	<u>-</u>	<u>34,455</u>
	<u>\$ 176,997</u>	<u>\$ 325,343</u>

Sale of raw materials and supplies includes price for sale of material and supplies. The net amount of sale and cost is listed under nonoperating income.

### Accounts Receivable

	June 30	
	2005	2004
WTC (HK)	\$ 429,811	\$ 494,283
WPC	226,036	343,567
POE	70,017	154,315
EACC	67,876	-
WTC (M)	16,476	10,497
WES	14,069	15,471
NTK	12,466	-
Eden	-	131,455
WTC (USA)	-	3,076
Others	3,279	195
	<u>\$ 840,030</u>	<u>\$ 1,152,859</u>

### Other Financial Assets, Current

	June 30	
	2005	2004
WTC (HK)	\$ 68,400	\$ 151,103
Gallatown	44,517	176,209
WPC	12,517	44,085
POE	4,303	46,705
Eden	-	55,236
Other	22,118	4,977
	<u>\$ 151,855</u>	<u>\$ 478,315</u>

Other receivable includes receivable from related parties for sale of equipment, materials, etc.

### Accounts Payable

	June 30	
	2005	2004
WTC (HK)	\$ 8,862	\$ 115,022
POE	5,602	64,783
Eden	-	80,147
Others	108	751
	<u>\$ 14,572</u>	<u>\$ 260,703</u>



## Property Transactions

Acquisition of property, plant and equipment to related parties in six months ended June 30, 2005 and 2004 are summarized as follows:

Related Party	Items	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
POE	Machinery and equipment	\$ 5,286	\$ 35,996
Gallatown	Machinery and equipment	4,046	-
WTC (HK)	Machinery and equipment	591	-
WIE	Construction in progress	2,000	-
Eden	Machinery and equipment	-	36,104

Purchase prices of machinery and equipment were based on carrying value quoted by the selling party.

Sales of property, plant and equipment to related parties in the six months ended June 30, 2005 and 2004 are summarized as follows:

Related Party	Items	2005		
		Book Value	Selling Price	Gain
Gallatown	Machinery and equipment and other equipment	\$ 117,543	\$ 118,067	\$ 524
WTC (HK)	Machinery and equipment and other equipment	28	29	1
EACC	Machinery and equipment	138	138	-
POE	Machinery and equipment	159	141	(18)

  

Related Party	Items	2004		
		Book Value	Selling Price	Gain
Gallatown	Machinery and equipment and other equipment	\$ 137,085	\$ 143,102	\$ 6,017
Eden	Machinery equipment	9,804	11,115	1,311

As of June 30, 2005, the unrealized profit of \$26,010 thousand from intercompany property transactions was included in other liabilities (see Note 16).

## Payment of Credit Guarantees

See Note 24-(2).

## 23. PLEDGED ASSETS

As of June 30, 2005 and 2004, the following assets had been pledged as collateral or security deposit for meeting requirements of customs authorities and for hiring foreign laborers.

Financial Statement Classification	Pledged Item	2005	2004
Other financial assets, noncurrent	Certificates of deposit	<u>\$19,420</u>	<u>\$16,420</u>

## 24. COMMITMENTS AND CONTINGENCIES

### Letters of Credit

As of June 30, 2005 and 2004, outstanding letters of credit of the Company were as follows:

	2005	2004
U.S. dollars	\$ 674,230	\$ 198,650
Japanese yen	321,088,050	221,998,853
Euro	-	69,353
Fr	-	178,500

### Loan Guarantees

As of June 30, 2005, the Company had guaranteed the following borrowings of its affiliates.

	Unit: thousand
Gallatown	US\$ 8,500
WTC (DG)	US\$ 30,000
WTC (HK)	US\$ 12,000

## 25. OTHERS

In compliance with Statement of Financial Accounting Standards No. 27, "Disclosure of Financial Instruments," the Company summarizes its derivative financial instruments as of June 30, 2005 and 2004 as follows:

### Contract (Nominal) Amount and Credit Risk

Financial Instruments	Type	2005		2004	
		Contract (Nominal) Amount	Credit Risk	Contract (Nominal) Amount	Credit Risk
Nontrading purposes					
Forward exchange contract	Purchase	JP¥	-	JP¥ 1,158,262,000	-
		US\$	-	US\$ 179,000	-
		CHF	-	CHF 161,000	-

The counter-parties to the forward contracts above are all commercial or investment banks or broker with high credit ratings; thus, credit risks are considered insignificant.

### **Market Price Risk**

The forward contract is used for hedging purposes. The gain or loss the interest rate or exchange rate fluctuation of the forward contract offsets the loss or gain on the hedged item. Thus, market risk is insignificant.

### **Liquidity Risk, Cash Flow Risk and Forecasted Cash Flow Risk**

Forecasted cash outflows from derivative contracts in effect as of June 30, 2005 are as follows:

Year	Payments
0-1 year	\$ -
1-2 year	-
2-3 year	-

The Company has the ability to meet its financial obligations under the derivative contracts; thus, liquidity risks virtually do not exist.

Forward rates for forward contracts are fixed; thus, cash flow risks are insignificant. In addition, the possibility that the Company's forward exchange contracts cannot be sold at a reasonable price in the market is remote; thus, liquidity risk is low.

### **Management Objective and Strategy of Derivative Financial Instruments**

Type	Purpose	Strategy
Forward exchange	To hedge exposure on foreign-currency transactions	Forward contracts have a strong negative correlation with the changes in fair value of underlying assets and liabilities; contracts are evaluated periodically for hedging effectiveness

### **Reporting of Derivative Instruments in the Financial Statements**

The receivables and payables on forward exchange contracts as of June 30, 2005 and 2004 are summarized below:

	2005	2004
Forward exchange receivable	\$ -	\$ 370,369
Less forward exchange payable	<u>-</u>	<u>(370,004)</u>
Receivable (payable) on forward exchange contracts, net	<u>\$ -</u>	<u>\$ 365</u>

A foreign exchange gain of \$3,306 thousand on forward contracts in the six months ended June 30, 2005 was included in nonoperating income.

## Fair Value of Financial Instruments

Fair value of nonderivative financial instruments as of June 30, 2005 is summarized as follows:

	Carrying Value	Fair Value
Assets		
Cash and cash equivalents	\$ 619,067	\$ 619,067
Short-term investments	1,225,057	1,238,889
Notes receivable	35,030	35,030
Accounts receivable	440,519	440,519
Accounts receivable from related parties	840,030	840,030
Other current assets derived from financial instruments	153,629	153,629
Long-term equity investments	5,145,434	4,928,706
Other assets derived from financial instruments	26,579	26,579
Liabilities		
Short-term bank borrowings	950,000	950,000
Short-term obligations	809,579	809,579
Notes payable	23,605	23,605
Accounts payable	740,427	740,427
Accounts payable to related parties	14,572	14,572
Other payable	645,481	645,481
Other current liabilities derived from financial instruments	19,242	19,242
Long-term liabilities	1,024,423	1,024,423

Approaches and assumptions used in assessing the fair values of financial instruments are summarized as follows:

- (a) Financial instruments classified as current assets or current liabilities are valued at carrying value because of their short maturities. This approach is applied to cash and cash equivalents, notes and accounts receivable, notes and accounts receivable from related parties, short-term bank borrowings, short-term obligations, notes and accounts payable, notes and accounts payable to related parties, and other financial instruments.
- (b) Marketable securities are valued at quoted market prices. For securities with no quoted market prices, financial or nonfinancial information may be used to compute fair values.