# High Tech Computer Corp. and Subsidiaries

## Consolidated Financial Statements for the Six Months Ended June 30, 2005 and Independent Accountants' Review Report

**INDEPENDENT ACCOUNTANTS' REVIEW REPORT**

The Board of Directors and Stockholders
High Tech Computer Corp.

We have reviewed the accompanying consolidated balance sheet of High Tech Computer Corp. and subsidiaries (the "Company") as of June 30, 2005, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the six months then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our reviews.

We conducted our reviews in accordance with the Statement of Auditing Standards No. 36, "Review of Financial statements," of the Republic of China. A review consists principally of applying analytical procedures to financial data and of making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such financial statements for them to be 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 stated in Note 2, the Company is subject to the requirement of the Securities and Futures Bureau to publish consolidated semiannual financial statements starting in 2005. These financial statements may cover only a single period for the first time when these financial statements are published.

Our reviews also comprehended the translation of the New Taiwan dollar amounts and, based on our reviews, such translation has been made in conformity with the basis stated in Note 2. Such U.S. dollar amounts are presented solely for the convenience of readers.

August 9, 2005

*Notice to Readers*

*The accompanying consolidated 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 review such financial statements are those generally accepted and applied in the Republic of China.*

*For the convenience of readers, the accountants' report and the accompanying consolidated 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 accountants' 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.*

## HIGH TECH COMPUTER CORP. AND SUBSIDIARIES

**CONSOLIDATED BALANCE SHEET**
**JUNE 30, 2005**
**(In Thousands)**
**(Reviewed, Not Audited)**

| ASSETS | NT$ | US$ (Note 2) |
|---|---|---|
| CURRENT ASSETS | | |
| Cash and cash equivalents (Notes 2 and 3) | $ 11,628,642 | $ 367,762 |
| Notes receivable, net (Notes 2 and 4) | 347,274 | 10,983 |
| Accounts receivable, net (Notes 2 and 4) | 7,726,383 | 244,351 |
| Accounts receivable from related parties (Notes 2 and 18) | 5,971 | 188 |
| Other current financial assets (Note 5) | 57,806 | 1,828 |
| Inventories (Notes 2 and 6) | 3,947,832 | 124,852 |
| Prepayments (Note 7) | 636,418 | 20,128 |
| Deferred income tax assets (Notes 2 and 15) | 165,460 | 5,233 |
| Total current assets | 24,515,786 | 775,325 |
| LONG-TERM EQUITY INVESTMENTS (Notes 2 and 8) | | |
| Securities available for sale | 2,139 | 68 |
| PROPERTY, PLANT AND EQUIPMENT, NET (Notes 2, 9 and 18) | | |
| Cost | | |
| Land | 576,001 | 18,216 |
| Buildings and structures | 951,716 | 30,099 |
| Machinery and equipment | 2,420,018 | 76,534 |
| Molding equipment | 201,567 | 6,375 |
| Computer equipment | 171,964 | 5,438 |
| Transportation equipment | 2,482 | 78 |
| Furniture and fixtures | 114,829 | 3,632 |
| Leasehold improvements | 56,311 | 1,781 |
| | 4,494,888 | 142,153 |
| Less accumulated depreciation | (2,008,618) | (63,524) |
| Prepayments for construction-in-progress and equipment-in-transit | 151,990 | 4,807 |
| Property, plant and equipment, net | 2,638,260 | 83,436 |
| OTHER ASSETS | | |
| Refundable deposits | 7,087 | 224 |
| Deferred charges (Note 2) | 175,650 | 5,555 |
| Deferred tax assets (Notes 2 and 15) | 158,054 | 4,999 |
| Other | 30,973 | 980 |
| Total other assets | 371,764 | 11,758 |
| TOTAL | $ 27,527,949 | $ 870,587 |

| LIABILITIES AND STOCKHOLDERS' EQUITY | NT$ | US$ (Note 2) |
|---|---|---|
| CURRENT LIABILITIES | | |
| Notes and accounts payable | $ 8,411,010 | $ 266,003 |
| Notes and accounts payable due to related parties (Note 18) | 117,389 | 3,712 |
| Income tax payable (Notes 2 and 15) | 210,291 | 6,651 |
| Accrued expenses (Note 10) | 667,659 | 21,115 |
| Payable for purchase of equipment | 22,097 | 699 |
| Other current liabilities (Notes 11 and 17) | 2,360,008 | 74,637 |
| Total current liabilities | 11,788,454 | 372,817 |
| LONG-TERM LIABILITIES, NET OF CURRENT PORTION | | |
| Bonds payable (Notes 2 and 12) | - | - |
| OTHER LIABILITIES | | |
| Guarantee deposits received | 495,160 | 15,660 |
| Total liabilities | 12,283,614 | 388,477 |
| STOCKHOLDERS' EQUITY (Note 13) | | |
| Capital stock | | |
| Common stock | 2,887,633 | 91,323 |
| Stock dividend for distribution | 682,527 | 21,585 |
| Capital surplus | | |
| Additional paid-in capital - common stock | 4,410,871 | 139,496 |
| Additional paid-in capital from merger | 25,972 | 821 |
| Retained earnings | | |
| Legal reserve | 813,326 | 25,722 |
| Special reserve | 19,133 | 605 |
| Accumulated earnings | 6,426,542 | 203,243 |
| Unrealized valuation loss on long-term investments | (1,024) | (32) |
| Cumulative translation adjustments (Note 2) | (20,645) | (653) |
| Total stockholders' equity | 15,244,335 | 482,110 |
| TOTAL | $ 27,527,949 | $ 870,587 |

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

(With Deloitte & Touche review report dated August 9, 2005)

## HIGH TECH COMPUTER CORP. AND SUBSIDIARIES

**CONSOLIDATED STATEMENT OF INCOME**
**SIX MONTHS ENDED JUNE 30, 2005**
**(In Thousands, Except Earnings Per Share)**
**(Reviewed, Not Audited)**

| | NT$ | US$ (Note 2) |
|---|---|---|
| REVENUES (Note 18) | | |
| Gross sales | $28,267,058 | $ 893,961 |
| Less sales returns and discounts | (104,159) | (3,294) |
| NET SALES | 28,162,899 | 890,667 |
| OTHER REVENUES | 464,985 | 14,705 |
| Total revenues | 28,627,884 | 905,372 |
| COST OF REVENUES (Note 18) | 22,047,945 | 697,278 |
| GROSS PROFIT | 6,579,939 | 208,094 |
| OPERATING EXPENSES (Note 18) | | |
| Administrative and selling expenses | 981,330 | 31,035 |
| Research and development expenses | 1,071,791 | 33,896 |
| Total operating expenses | 2,053,121 | 64,931 |
| OPERATING INCOME | 4,526,818 | 143,163 |
| NONOPERATING INCOME AND GAINS | | |
| Interest income | 55,203 | 1,746 |
| Gain on physical inventories | 3,231 | 102 |
| Rental revenue (Note 18) | 339 | 11 |
| Other | 30,997 | 980 |
| Total nonoperating income and gains | 89,770 | 2,839 |
| NONOPERATING EXPENSES AND LOSSES | | |
| Interest expense | 19,718 | 624 |
| Losses on disposal of property, plant and equipment | 504 | 16 |
| Foreign exchange loss | 224,165 | 7,089 |
| Provision for loss on decline in value of inventory | 193,710 | 6,126 |
| Other | 5,303 | 168 |
| Total nonoperating expenses and losses | 443,400 | 14,023 |
| INCOME BEFORE INCOME TAX | 4,173,188 | 131,979 |
| INCOME TAX EXPENSE (Notes 2 and 15) | (116,957) | (3,699) |
| NET INCOME | $ 4,056,231 | $ 128,280 |

(Continued)

## HIGH TECH COMPUTER CORP. AND SUBSIDIARIES

**CONSOLIDATED STATEMENT OF INCOME**
**SIX MONTHS ENDED JUNE 30, 2005**
**(In Thousands, Except Earnings Per Share)**
**(Reviewed, Not Audited)**

| | Before Income Tax | | After Income Tax | |
|---|---|---|---|---|
| | NT$ | US$ (Note 2) | NT$ | US$ (Note 2) |
| BASIC EARNINGS PER SHARE (Note 16) | $ 11.87 | $ 11.54 | $ 0.38 | $ 0.37 |
| DILUTED EARNINGS PER SHARE (Note 16) | $ 11.73 | $ 11.40 | $ 0.37 | $ 0.36 |

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

(With Deloitte & Touche review report dated August 9, 2005) (Concluded)

## HIGH TECH COMPUTER CORP. AND SUBSIDIARIES

**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY**
**SIX MONTHS ENDED JUNE 30, 2005**
**(In Thousands)**
**(Reviewed, Not Audited)**

| | Capital Stock | | | Capital Surplus | | Retained Earnings | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Common Stock | Capital Collected in Advance | Stock Dividend For Distribution | Additional Paid-in Capital - Common Stock | Additional Paid-in Capital from Merger | Legal Reserve | Special Reserve | Accumulated Earnings | Unrealized Valuation Loss on Long-Term Investments | Cumulative Translation Adjustments | Total |
| | NT$ | NT$ | NT$ | NT$ | NT$ | NT$ | NT$ | NT$ | NT$ | NT$ | NT$ |
| BALANCE, JANUARY 1, 2005 | $ 2,714,276 | $ 48,838 | $ - | $ 3,064,356 | $ 25,972 | $ 427,791 | $ 1,983 | $ 5,105,339 | $ (1,268) | $ (17,865) | $ 11,369,422 |
| Appropriation of 2004 net earnings | | | | | | | | | | | |
| Legal reserve | - | - | - | - | - | 385,535 | - | (385,535) | - | - | - |
| Special reserve | - | - | - | - | - | - | 17,150 | (17,150) | - | - | - |
| Stock dividend | - | - | 577,527 | - | - | - | - | (577,527) | - | - | - |
| Transfer of employee bonuses to capital stock | - | - | 105,000 | - | - | - | - | (105,000) | - | - | - |
| Employee bonuses | - | - | - | - | - | - | - | (206,000) | - | - | (206,000) |
| Cash dividend | - | - | - | - | - | - | - | (1,443,816) | - | - | (1,443,816) |
| Capital collected in advance transferred to common stocks | 48,838 | (48,838) | - | - | | - | - | - | - | - | - |
| Convertible bonds converted to common stocks | 124,519 | - | - | 1,346,515 | - | - | - | | - | - | 1,471,034 |
| Net income for the six months ended June 30, 2005 | - | - | - | - | - | - | - | 4,056,231 | - | - | 4,056,231 |
| Translation adjustments on long-term equity investments | - | - | - | - | - | - | - | - | - | (2,780) | (2,780) |
| Unrealized valuation loss on long-term investments | - | - | - | - | - | - | - | - | 244 | - | 244 |
| BALANCE, JUNE 30, 2005 | $ 2,887,633 | $ - | $ 682,527 | $ 4,410,871 | $ 25,972 | $ 813,326 | $ 19,133 | $ 6,426,542 | $ (1,024) | $ (20,645) | $ 15,244,335 |
| | US$ (Note 2) | US$ (Note 2) | US$ (Note 2) | US$ (Note 2) | US$ (Note 2) | US$ (Note 2) | US$ (Note 2) | US$ (Note 2) | US$ (Note 2) | US$ (Note 2) | US$ (Note 2) |
| BALANCE, JANUARY 1, 2005 | $ 85,840 | $ 1,545 | $ - | $ 96,912 | $ 821 | $ 13,529 | $ 63 | $ 161,459 | $ (40) | $ (565) | $ 359,564 |
| Appropriation of 2004 net earnings | | | | | | | | | | | |
| Legal reserve | - | - | - | - | - | 12,193 | - | (12,193) | - | - | - |
| Special reserve | - | - | - | - | - | - | 542 | (542) | - | - | - |
| Stock dividend | - | - | 18,264 | - | - | - | - | (18,264) | - | - | - |
| Transfer of employee bonuses to capital stock | - | - | 3,321 | - | - | - | - | (3,321) | - | - | - |
| Employee bonuses | - | - | - | - | - | - | - | (6,515) | - | - | (6,515) |
| Cash dividend | - | - | - | - | - | - | - | (45,661) | - | - | (45,661) |
| Capital collected in advance transferred to common stocks | 1,545 | (1,545) | - | - | | - | - | - | - | - | - |
| Convertible bonds converted to common stocks | 3,938 | - | - | 42,584 | - | - | - | - | - | - | 46,522 |
| Net income for the six months ended June 30, 2005 | - | - | - | - | - | - | - | 128,280 | - | - | 128,280 |
| Translation adjustments on long-term equity investments | - | - | - | - | - | - | - | - | - | (88) | (88) |
| Unrealized valuation loss on long-term investments | - | - | - | - | - | - | - | - | 8 | - | 8 |
| BALANCE, JUNE 30, 2005 | $ 91,323 | $ - | $ 21,585 | $ 139,496 | $ 821 | $ 25,722 | $ 605 | $ 203,243 | $ (32) | $ (653) | $ 482,110 |

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

(With Deloitte & Touche audit report dated August 9, 2005)

# HIGH TECH COMPUTER CORP. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF CASH FLOWS
**SIX MONTHS ENDED JUNE 30, 2005**
**(In Thousands)**
**(Reviewed, Not Audited)**

| | NT$ | US$ (Note 2) |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $ 4,056,231 | $ 128,280 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation | 296,249 | 9,369 |
| Amortization | 23,834 | 754 |
| Loss on disposal of property, plant and equipment | 504 | 16 |
| Provision for redemption of convertible bonds | 2,042 | 65 |
| Foreign-currency gains from conversion of convertible bonds | (8,179) | (259) |
| Amortization of bond issue costs | 17,675 | 559 |
| Deferred income tax assets | (98,747) | (3,123) |
| Accrued pension costs | (23,310) | (737) |
| Net changes in operating assets and liabilities | | |
| Notes receivable | (275,518) | (8,713) |
| Accounts receivable | 663,684 | 20,989 |
| Accounts receivable from related parties | (4,961) | (157) |
| Other current financial assets | 43,770 | 1,384 |
| Inventories | 321,441 | 10,166 |
| Prepayments | (379,180) | (11,992) |
| Notes and accounts payable | 483,699 | 15,298 |
| Notes and accounts payable due to related parties | 91,327 | 2,888 |
| Income tax payable | 115,790 | 3,663 |
| Accrued expenses | (213,625) | (6,756) |
| Other current liabilities | 291,668 | 9,224 |
| Net cash provided by operating activities | 5,404,394 | 170,918 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of property, plant and equipment | (395,370) | (12,504) |
| Proceeds from liquidation of long-term investments | 4,312 | 137 |
| Increase in refundable deposits | (417) | (13) |
| Increase in deferred charges | (1,091) | (35) |
| Increase in payable on forward exchange contracts | 10,123 | 320 |
| Increase in option contracts payable | 735 | 23 |
| Net cash used in investing activities | (381,708) | (12,072) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Increase in guarantee deposits received | 222,082 | 7,023 |
| Bonus to employees | (4,500) | (142) |
| Net cash provided by financing activities | 217,582 | 6,881 |
| EFFECT OF EXCHANGE RATE CHANGES | (2,168) | (69) |

(Continued)

# HIGH TECH COMPUTER CORP. AND SUBSIDIARIES

**CONSOLIDATED STATEMENT OF CASH FLOWS**
**SIX MONTHS ENDED JUNE 30, 2005**
**(In Thousands)**
**(Reviewed, Not Audited)**

| | NT$ | US$ (Note 2) |
|---|---|---|
| NET INCREASE IN CASH AND CASH EQUIVALENTS | $ 5,238,100 | $ 165,658 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 6,390,542 | 202,104 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $11,628,642 | $ 367,762 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | |
| Cash paid during the period | | |
| Income tax | $ 99,914 | $ 3,160 |
| NONCASH INVESTING AND FINANCING ACTIVITIES | | |
| Transfer of retained earnings and bonus to employees to stock dividend to be distributed | $ 682,527 | $ 21,585 |
| Transfer of convertible bonds to common stock and additional paid-in capital | $ 1,471,034 | $ 46,522 |
| PURCHASE OF PROPERTY, PLANT AND EQUIPMENT | | |
| Cost of property, plant and equipment purchased | $ 360,412 | $ 11,398 |
| Decrease in payable for purchase of equipment | 34,958 | 1,106 |
| Cash paid for purchase of property, plant and equipment | $ 395,370 | $ 12,504 |
| CASH DIVIDEND, BONUS TO EMPLOYEES AND DIRECTORS' REMUNERATION | | |
| Appropriation of cash dividend, bonus to employees and directors' remuneration | $ 1,649,816 | $ 52,176 |
| Increase in payable for cash dividend, bonus to employees and directors' remuneration | (1,645,316) | (52,034) |
| Cash paid | $ 4,500 | $ 142 |

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

(With Deloitte & Touche review report dated August 9, 2005) (Concluded)

## 1. ORGANIZATION AND OPERATIONS

High Tech Computer Corp. (the "Company") on May 15, 1997 under the Company Law of the Republic of China to design, manufacture and sell smart handheld devices. In 1998, the Company had an initial public offering and, in March 2002, the Company's stock was listed on the Taiwan Stock Exchange. On November 19, 2003, the Company started trading Global Depositary Receipts on the Luxembourg Stock Exchange.

To effect cooperation with other companies in the same trade, lower operating costs and expenses, and enhance competitiveness as well as research and development capabilities, the Board of Directors proposed the Company's merger with IA Style, Inc. on October 31, 2003, with the Company as the survivor entity. The effective merger date was March 1, 2004. The Company had 3,560 employees as of June 30, 2005.

The Company has one direct wholly owned subsidiary, H.T.C. (B.V.I.) Corp., which has four direct wholly owned subsidiaries: HTEK, HTC USA Inc., HTC Europe Co., Ltd., and High Tech Computer Corp. (Suzhou).

H.T.C. (B.V.I.) Corp. engages in global investing activities. The Company makes investments on behalf of H.T.C. (B.V.I.) Corp.

HTEK engages mainly in marketing activities and engineering support activities. The Company had four employees as of June 30, 2005.

HTC USA Inc. and HTC Europe Co., Ltd., which ngage mainly in repair and after-sales service, had 81 and 80 employees as of June 30, 2005, respectively.

High Tech Computer Corp. (Suzhou) manufactures and sells smart handheld devices. The Company had 19 employees as of June 30, 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 the 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:

**Consolidation**

The Company is subject to the requirement of the Securities and Futures Bureau to publish consolidated semiannual financial statements starting in 2005. These financial statements may cover only a single period for the first time when these financial statements are published.

The Company included the accounts of all its direct and indirect subsidiaries in the consolidated financial statements as of and for the six months ended June 30, 2005. All significant intercompany balances and transactions have been eliminated.

High Tech Computer Corp. and the foregoing subsidiaries are hereinafter referred to collectively as the "Group."

**Translation into U.S. Dollars**

The financial statements are stated in New Taiwan dollars. The translations of the 2005 New Taiwan dollar amounts into U.S. dollar amounts are included solely for the convenience of readers, using the noon buying rate of NT$31.62 to US$1.00 certified by the Bank of Taiwan for customs purposes on June 30, 2005. The convenience translations should not be construed as representations that the New Taiwan dollar amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other exchange rate.

**Current/Noncurrent Assets and Liabilities**

Current assets are unrestricted cash and cash equivalents and other assets to be realized in cash, sold, or consumed (prepaid items) during the normal operating cycle or one year, whichever is longer. Current liabilities are obligations to be paid or settled within one year or the normal operating cycle. All other assets or liabilities are classified as noncurrent.

**Cash Equivalents**

Cash equivalents are primarily bankers' acceptance, commercial paper and repurchased corporate bonds, which are highly liquid investments with a maturity of three months or less from the date of acquisition.

**Short-Term Investments**

Short-term investments include marketable equity securities and mutual funds, which are carried at the lower of aggregate cost or market. The net change in the investment valuation allowance used in the determination of net income is the result of changes in the difference between aggregate costs and market values of investments still held at period-end. The cost of investments sold is determined using the moving average method. Stock dividends received are not recognized as income; instead, they are 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 receivables, past loss experience, and pertinent factors.

**Inventories**

Inventories are stated at the lower of cost or market. Cost is determined using the moving average method. Market value is based on replacement costs of raw materials and work-in-process and on net realizable values of finished goods.

**Long-Term Equity Investments**

Investments in companies in which the Group's ownership interest is 20% or more, except where the Company cannot exercise significant influence over the investee, are accounted for by the equity method. The difference between investment acquisition cost and the Company's equity in an investee's net assets when an investment is acquired or when the equity method is first adopted, is amortized over five years. All other long-term investments are valued at cost, except for investments in listed companies, which are stated at the lower of cost or market value.

An impairment loss should be recognized whenever recoverable amount is below carrying amount. This loss is treated as an expense in the income statement.

For both equity-method and cost-method investments, the cost of an investment sold is determined using the weighted-average method.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost less accumulated depreciation. Interest incurred in connection with the purchase or construction of property, plant and equipment is capitalized. Major renewals and betterments are also capitalized, while maintenance and repairs are expensed in the period incurred.

On the balance sheet date, assets are evaluated for any impairment. If impairment is identified, the Company should evaluate the recoverable amount of the assets. An impairment loss should be recognized whenever recoverable amount is below carrying amount, and this loss should be charged to current income.

An impairment loss recognized in prior years can be reversed only if there is a change in the estimates used to determine recoverable amount since the last impairment loss was recognized. However, the loss reversal is only to the extent that the increased carrying amount of an asset would not exceed the asset carrying amount (net of depreciation) had no impairment loss been recognized in prior years. Under certain regulations, an impairment loss of a revalued asset should be treated as a revaluation increment decrease. A reversal of an impairment loss on a revalued asset is credited directly to equity under the heading revaluation increment. However, to the extent that an impairment loss on the same revalued asset was previously recognized as profit or loss, a reversal of that impairment loss is also recognized as profit or loss.

Depreciation is calculated on a straight-line basis over the estimated service lives of the assets plus one additional year for salvage value.

### Deferred Charges

Deferred charges are telephone installation charges, computer software costs and deferred license fees. Installation charges and computer software are amortized on a straight-line basis over 3 years, and deferred license fees are amortized over 10 years.

### Asset Impairment

An impairment loss should be recognized whenever recoverable amount is below carrying amount. The increased carrying amount due to reversal should not be more than what the depreciated historical cost would have been if the impairment had not been recognized. Otherwise, reversal of an impairment loss is recognized as income in the income statement. However, the reversal of impairment loss on goodwill is prohibited.

### Bonds Payable

Bonds are issued at face value and recorded as bonds payable. Each month's interest expense is booked at face value multiplied by the stated interest rate. For bonds sold under repurchase agreements, interest is calculated according to the repurchase value and recognized as interest expense by period. The direct and necessary expenses of issuing convertible bonds are recorded as issuance expenses and amortized over the period from issuance date to the maturity date. When a bondholder requests conversion of convertible bonds, unamortized issue costs, interest expense that is accreted to the date of conversion but need not be paid, recognized interest premium, and the par value of the bonds are written off. The common stock exchange certificate (capital stock) should be valued at the carrying amount net of the amounts written off, and the difference of this net amount from the par value of the common stock exchange certificate is recognized as additional paid-in capital.

### Employee Retirement Plan

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 18, "Accounting for Pensions," issued by the Accounting Research and Development Foundation of the Republic of China.

The Company has a pension plan covering all eligible employees in accordance with the Labor Standards Law of the ROC. On January 1, 2004, the rate of the Company's contributions to the plan increased from 2% to 8% of employees' salaries and wages. The funds are deposited in the Central Trust of China, a government-designated custodian of pension funds, and are managed by the Pension Fund Administration Committee.

The pension fund balances were NT$244,377 thousand (US$7,729 thousand) as of June 30, 2005.

Under SFAS No. 23, "Interim Financial Reporting and Disclosures," the interim financial statements need not be subject to SFAS No. 18, i.e., the Company does not have to remeasure the minimum pension liability and pension cost for the current interim period.

H.T.C. (B.V.I.) Corp. has no liability and pension cost.

High Tech Computer Corp. (Suzhou) has a defined contribution pension plan covering all eligible employees in accordance with the regulations of the local government. HTEK, HTC USA Inc. and HTC Europe Co., Ltd. have no pension plans.

**Stock-Based Employee Compensation Plans**

When the grant date of stock-based employee compensation plans is on or after January 1, 2004, the Company will apply the accounting guidelines for stock-based compensation issued by the Accounting Research and Development foundation of Republic of China. The fair value of option compensation is recorded initially as an asset. This asset is expensed ratably over the service period, which is generally the period over which the options vest.

**Revenue Recognition**

Revenues are recognized from sales of inventories upon shipment or when the earnings process is complete and sales are realizable. Allowances for sales returns are accounted for as a deduction from gross sales, and the related costs are deducted from cost of sales as they are incurred. Sales agreements set certain limits on returns.

Allowance for sales returns is generally based on historical rates of returns and pertinent factors.

**Income Tax**

The Group adopted Statement of Financial Accounting Standards No. 22, "Accounting for Income Taxes," which requires an asset and liability approach to financial accounting and reporting for income tax. Deferred income tax assets and liabilities are computed annually for 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 provided 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.

Adjustment of prior years' income tax is added to current income tax expense in the year the adjustment is made.

Under the Amended Income Tax Law of the ROC, the 25% regular corporate income tax and the 20% separate income tax on interest income from short-term investments remain, and a 10% additional income tax is levied on distributable earnings generated since 1998 that remain undistributed in the following year. Starting on January 1, 1998, every enterprise (except branch, partnership, and not-for-profit organization) is required to maintain an imputation credit account (ICA) to keep track of all its income taxes paid and income tax credits received, collectively called imputation credit (IC), and the allocation of IC to stockholders. Thus, these procedures are followed when earnings are distributed as cash or stock dividends:

(a) For resident individual stockholders (RIS), the RIS include the dividend income in their taxable income and claim an IC issued by the enterprise as deduction from their income tax payable.
(b) For nonresident individual or nonresident corporate stockholders (NRS), the NRS exclude the dividend income from their taxable income and do not claim an IC. Dividends paid to NRS are subject to 20% withholding tax, which can be offset by the 10% additional income tax paid on undistributed earnings.
(c) For resident corporate stockholders (RCS), the RCS exclude the dividend income from their taxable income and do not claim the IC as deduction from income tax payable. The IC received is added to the RCS's own ICA until the IC is allocated to RIS or NRS when the earnings are finally distributed to RIS or NRS.

**Foreign-Currency Transactions**

Foreign-currency transactions (except derivative transactions) are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Gains or losses caused by applying prevailing exchange rates when cash in foreign currency is converted into New Taiwan dollars or when foreign-currency receivables or payables are settled, are credited or charged against income in the conversion or settlement period. On the balance sheet date, balances of foreign-currency assets and liabilities are translated at the balance sheet date exchange rates, and any resulting gains or losses are credited or charged to current income.

**Derivative Financial Instruments**

Forward exchange contracts used to hedge net foreign-currency asset or liability positions are recorded at the contract date exchange rate. The premium or discount on the forward contract, which is the difference between the forward rate and the spot rate on the contract date multiplied by the foreign-currency amount, is amortized over the term of the contract. On the balance sheet dates, the gains or losses on the contracts, computed by multiplying the foreign-currency amounts of the contracts by the differences between the spot rates on the contract starting dates and the spot rates on the balance sheet dates (or the spot rate last used to measure a gain or loss on that contract for an earlier period), are recognized as income. Also, the receivables and payables on forward contracts open as of the balance sheet date are netted out, and the resulting amount is presented as an asset or liability.

Premiums received on short positions or paid on long positions of currency option contracts, which are used for nontrading and trading purposes, are included in other current liabilities or other current assets. Gain or loss from the exercise of the currency options are credited or charged to current income. Options not exercised as of the balance sheet dates are marked to market, and the resulting gains or losses are recognized either as assets or liabilities.

**Nonderivative Financial Instruments**

The recognition and valuation of nonderivative financial assets and liabilities and their related income or expenses are in accordance with the Company's accounting policies described herein and accounting principles generally accepted in the Republic of China.

**Merger**

The Company's acquisition of IA Style, Inc. effective March 1, 2004, with the Company as the survivor entity, was accounted for using the Statement of Financial Accounting Standards No. 25, "Business Combinations - Accounting Treatment under the Purchase Method," and measured at the fair value of the business acquired. The net assets of the acquired entity on the balance sheet were accounted for as an increase in additional paid-in capital from merger (credit) or a decrease retained earnings (debit).

## 3. CASH AND CASH EQUIVALENTS

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

| | NT$ | US$ (Note 2) |
|---|---|---|
| Cash on hand | $ 1,043 | $ 33 |
| Cash in banks | 16,051 | 508 |
| Time deposits | 3,481,760 | 110,112 |
| Cash equivalents | 8,129,788 | 257,109 |
| | $ 11,628,642 | $ 367,762 |

As of June 30, 2005, interest rates on time deposits ranged from 1.00% to 4.55%.

## 4. NOTES AND ACCOUNTS RECEIVABLE

Notes and accounts receivable as of June 30, 2005 were as follows:

| | NT$ | US$ (Note 2) |
|---|---|---|
| Notes receivable | $ 347,274 | $ 10,983 |
| Accounts receivable | 7,743,675 | 244,898 |
| Less allowance for doubtful accounts | (17,292) | (547) |
| | $ 8,073,657 | $ 255,334 |

## 5. OTHER CURRENT FINANCIAL ASSETS

Other current financial assets as of June 30, 2005 were as follows:

| | NT$ | US$ (Note 2) |
|---|---|---|
| Value-added tax refund receivables | $ 25,500 | $ 806 |
| Other receivables | 23,664 | 748 |
| Interest receivable | 3,874 | 123 |
| Others | 4,768 | 151 |
| | $ 57,806 | $ 1,828 |

## 6. INVENTORIES

Inventories as of June 30, 2005 were as follows:

| | NT$ | US$ (Note 2) |
|---|---|---|
| Finished goods | $ 590,526 | $ 18,675 |
| Work-in-process | 1,433,967 | 45,350 |
| Raw materials | 2,385,089 | 75,430 |
| | 4,409,582 | 139,455 |
| Less valuation allowance | (461,750) | (14,603) |
| | $ 3,947,832 | $ 124,852 |

Inventory insurance as of June 30, 2005 amounted to NT$5,387,457 thousand (US$170,381 thousand).

## 7. PREPAYMENTS

Prepayments as of June 30, 2005 were as follows:

| | NT$ | US$ (Note 2) |
|---|---|---|
| Prepayments for royalty (Note 20) | $459,721 | $14,539 |
| Prepayments for materials purchases | 4,571 | 145 |
| Others | 172,126 | 5,444 |
| | $636,418 | $20,128 |

## 8. LONG-TERM INVESTMENTS

Long-term investments as of June 30, 2005 were as follows:

| | Original Cost | | Carrying Value | | Ownership |
|---|---|---|---|---|---|
| | NT$ | US$ (Note 2) | NT$ | US$ (Note 2) | Percentage |
| LCM method | | | | | |
| VIA Technologies, Inc. | $ 1,971 | 62 | $ 1,971 | 62 | - |
| Cost method | | | | | |
| Answer Online, Inc. | 1,192 | 38 | 1,192 | 38 | 2 |
| Less valuation allowance | - | - | (1,024) | (32) | |
| | $ 3,163 | $ 100 | $ 2,139 | $ 68 | |

In December 1999, the Company invested NT$1,971 thousand in VIA Technologies, Inc. and accounted for this investment to short-term investment. In June 2001, the Company transferred this investment to long-term equity investment.

In December 2000, the Company acquired 20% equity interest in Auto Hi-Tech Computer Corp. for NT$4,000 thousand and accounted for this investment by the equity method. On October 6, 2004, Auto Hi-Tech Computer Corp. started liquidation procedures and completed these procedures by the end of January 2005.

In March 2004, the Company merged with IA Style, Inc. (Notes 1 and 2) and acquired 1.82% equity interest in Answer Online, Inc. as a result of the merger.

## 9. PROPERTY, PLANT AND EQUIPMENT

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

| | Cost | Accumulated Depreciation | Carrying Value | |
|---|---|---|---|---|
| | NT$ | NT$ | NT$ | US$ (Note 2) |
| Land | $ 576,001 | $ - | $ 576,001 | $ 18,216 |
| Buildings and structures | 951,716 | 242,119 | 709,597 | 22,441 |
| Machinery and equipment | 2,420,018 | 1,452,488 | 967,530 | 30,599 |
| Molding equipment | 201,567 | 201,567 | - | - |
| Computer equipment | 171,964 | 4,462 | 167,502 | 5,297 |
| Transportation equipment | 2,482 | 1,253 | 1,229 | 39 |
| Furniture and fixtures | 114,829 | 75,710 | 39,119 | 1,237 |
| Leasehold improvements | 56,311 | 31,019 | 25,292 | 800 |
| Prepayments on equipment-in-transit | 151,990 | - | 151,990 | 4,807 |
| | $4,646,878 | $2,008,618 | $2,638,260 | $ 83,436 |

In June, 2005, the Company acquired land and building from VIA Technologies, Inc. for NT$304,630 thousand and had paid NT$294,630 thousand as of June 30, 2005.

As of June 30, 2005, insurance for property, plant and equipment, excluding land, amounted to NT$2,129,544 thousand (US$67,348 thousand).

## 10. ACCRUED EXPENSES

Accrued expenses as of June 30, 2005 were as follows:

| | NT$ | US$ (Note 2) |
|---|---|---|
| Salaries and bonuses | $275,510 | $ 8,713 |
| Insurance | 67,351 | 2,130 |
| Professional fees | 22,820 | 722 |
| Research materials | 101,233 | 3,201 |
| Export expenses | 71,265 | 2,254 |
| Others | 129,480 | 4,095 |
| | $667,659 | $21,115 |

## 11. OTHER CURRENT LIABILITIES

Other current liabilities as of June 30, 2005 were as follows:

| | NT$ | US$ (Note 2) |
|---|---|---|
| Advance receipts | $ 19,397 | $ 614 |
| Reserve for warranty expenses | 615,590 | 19,468 |
| Receipts under custody | 31,016 | 981 |
| Payable on forward contracts, net (see Note 17) | 9,764 | 309 |
| Cash dividend payable | 1,443,816 | 45,661 |
| Employee bonus payable | 206,000 | 6,515 |
| Directors' remuneration | 21,842 | 691 |
| Other | 12,583 | 398 |
| | $2,360,008 | $ 74,637 |

## 12. BONDS PAYABLE

On January 29, 2003, the Company issued zero coupon convertible bonds s with an aggregate amount of US$66,000 thousand; bond maturity is in 2008. Unless previously redeemed, repurchased and canceled, or converted as herein provided, the bonds are redeemable on January 29, 2008 at their accreted principal amount in U.S. dollars. The issue price is 100% of the par value of US$1,000. The Company intended to use the net proceeds of the offering for the import of raw materials and input components to produce smart handheld devices.

Under the bond terms, a bondholder has the right to request the Company to redeem the bonds on April 29, 2004 at their accreted principal amount. Some bondholders requested the

Company to redeem bonds amounting to US$2,000 thousand, and other bondholders requested conversion of bonds amounting to US$64,000 thousand into 17,336 thousand shares. As a result, the Company had no outstanding bonds payable as of June 30, 2005.

**Bond Terms and Conditions**

Bondholders may exercise their conversion rights at any time within one month from the issuance date of February 28, 2003 or 20 days before the maturity date of January 9, 2008.

A bondholder has the right to request the Company to redeem the bonds on April 29, 2004 (holders' put date) at the accreted principal amount.

The accreted principal amount of a bond is the principal amount of the bond plus a premium representing a compounded yield of 0.5% per annum (accrued from the issue date and computed semiannually) on the redemption date.

On January 29, 2006, or three years from the issuance date, if the closing price of the shares for 30 consecutive trading days - with the last trading day within five trading days before the date when a redemption notice is given - is at least 130% of the conversion price, the Company has the option to redeem the bonds at their accreted principal amount.

If the balance of the unconverted bonds is less than US$3,300 thousand (5% of the issue amount), the Company has the option to redeem all the bonds at their accreted principal amount.

**Provisions for Conversion Rights**

A bondholder has the right to convert the bonds into Company shares.

*Conversion period*: Except during the period when ownership transfer is suspended, the bondholders may request to convert the bonds into shares after February 28, 2003 and before the close of business on January 9, 2008.

*The conversion process:* When the bondholders request to convert the bonds into shares, they should fill out the convertible bond certification form and related documents and deliver these documents to the conversion agent. The conversion is effective while the documents are being sent to the conversion agent and cannot be countermanded.

The number of shares issuable upon conversion of any bond is determined by dividing the principal amount of the bonds (translated into New Taiwan dollars at a fixed exchange rate of NT$34.658 to US$1.00) by the conversion price in effect on the conversion date.

The initial conversion price was NT$205.32 per share at the time of issuance. Upon the distribution of stock dividends and the issuance of additional common shares, the conversion price will be adjusted.

## 13. STOCKHOLDERS' EQUITY

**Capital Stock**

The Company's outstanding common stock as of January 1, 2005 amounted to NT$2,714,276 thousand, divided into 271,427 thousand common shares at NT$10.00 par value. In the fourth quarter of 2004, holders of US$18,030 thousand in bonds requested to convert the bonds into 4,884 thousand shares. The amounts were temporarily accounted for as "capital collected in advance." After finishing the registration of 4,884 thousand shares in capital collected in advance, these shares were transferred to common stocks. In the first and second quarters of 2005, holders of US$45,970 thousand in bonds requested to convert the bonds into 12,452 thousand shares. As a result, the amount of the Company's outstanding common stock as of June 30, 2005 increased to NT$2,887,633 thousand, divided into 288,763 thousand common shares at NT$10.00 par value. In June 2005, the stockholders approved the transfer of retained earnings amounting to NT$577,527 and employees bonuses amounting to NT$105,000 to capital stock. The amounts to be distributed were accounted for as "stock dividend for distribution" temporarily.

In their meeting on December 11, 2002, the Company's Board of Directors resolved to issue 7,000 thousand units of employee stock options in accordance with Article 28.3 of the Securities and Exchange Law. Each option represents the right to buy one newly issued common share of the Company. The exercise price is the closing price of the Company's common shares on the option issuance date or the share par value, whichever is higher. The option holders can exercise the right up to 35% of the granted option units no earlier than two years from the grant date. After three years from the grant date, the holders can exercise the right at up to 70% of the granted option units. After four years from the grant date, the option holders are eligible to exercise their rights on all the options owned. The exercise period is five years. As of June 30, 2005, the Company had issued 3,000 thousand units of the stock options to employees. After taking into account the effect of stock dividends and the issuance of additional common stocks, 5,735 thousand units of the employee stock options were outstanding as of June 30, 2005. The remaining employee stock options, amounting to 4,000 thousand units, expired on December 25, 2003.

**Global Depositary Receipts**

The Company issued 3,600 thousand units of Global Depositary Receipts (GDRs) representing 14,400 thousand common shares in November 2003. The Company's stockholders, including Via Technologies, Inc., also issued 3,219.6 thousand units of GDRs representing 12,878.4 thousand common shares of the Company. Thus, total offerings amounted to 6,819.6 thousand GDR units. Each GDR, which represents four common shares, was issued at NT$131.1 per share, resulting in an additional paid-in capital of NT$1,696,855 thousand, accounted for as "capital surplus." The related cash subscription was completed and registered on November 19, 2003.

The holders of these GDRs have the same rights and obligations as those of the Company's stockholders. However, in certain jurisdictions, the distribution of the offering and sales of the Company's GDRs and the shares represented may be restricted by law. Thus, the GDRs offered and the shares represented are not transferable, unless the transfer is in accordance with the restrictions described in the GDR offering circular and related laws applied in Taiwan. Through the depositary custodian in Taiwan, the holders are entitled to exercise these rights:

(a) Voting rights;
(b) Shares trading; and
(c) Receipt of dividends and participation in new cash subscriptions.

The GDR holders had the right to request the Company to redeem the GDRs and issue the common stock. After the issuance of stock dividends and additional common shares, the GDRs increased by 216.1 thousand units, representing 864.4 thousand common shares. As of June 30, 2005, GDR units numbering 6,657.4 thousand and representing 26,629.5 thousand common shares had been redeemed. The outstanding GDRs represented 1,513.3 thousand common shares, or 0.52% of the Company's issued shares.

**Capital Surplus**

The additional paid-in capital was NT$3,064,356 thousand as of January 1, 2005. Then, additional paid-in capital of NT$ 1,346,515 thousand was generated from the conversion of bonds payable into 12,452 thousand shares in the first and second quarters of 2005. As a result, the additional paid-in capital as of June 30, 2005 was NT$4,410,871 thousand. Under the Company Law, the Company may transfer the capital surplus to common stock if there is no accumulated deficit.

The additional paid-in capital from a merger (Note 1), which took effect on March 1, 2004, was NT$25,972 thousand.

**Appropriation of Retained Earnings and Dividend Policy**

Based on the Company Law of the ROC and the Company's Articles of Incorporation, 10% of the Company's annual net income less any deficit should first be appropriated as legal reserve until this reserve equals its paid-in capital. From the remainder, there should be appropriations of not more than 1% as remuneration to directors and supervisors and at least 5% as bonuses to employees.

The appropriation of retained earnings should be proposed by the board of directors and approved by the stockholders in their annual meeting.

As part of a high-technology and capital-intensive industry and as a growing enterprise, the Company considers its operating environment, industry developments, and long-term interests of stockholders as well as its programs to maintain operating efficiency and meet its capital expenditure budget and financial goals in determining the stock or cash dividends to be paid. The Company's dividend policy stipulates that only up to 95% of total dividends may be distributed as cash dividends.

Had the Company recognized the employees bonuses of NT$311,000 thousand as expenses in 2004, the pro forma earnings per share in 2004 would have decreased from NT$14.21 to NT$13.06.

## 14. PERSONNEL, DEPRECIATION AND AMORTIZATION EXPENSES

| Function / Expense Item | 2005 | | | | | |
|---|---|---|---|---|---|---|
| | NT$ | | | US$ (Note 2) | | |
| | Operating Costs | Operating Expenses | Total | Operating Costs | Operating Expenses | Total |
| Personnel expenses | $585,797 | $618,636 | $1,204,433 | $18,526 | $19,565 | $38,091 |
| Salary | 507,005 | 531,490 | 1,038,495 | 16,034 | 16,809 | 32,843 |
| Insurance | 28,948 | 34,943 | 63,891 | 915 | 1,105 | 2,020 |
| Pension cost | 22,982 | 24,643 | 47,625 | 727 | 779 | 1,506 |
| Other | 26,862 | 27,560 | 54,422 | 850 | 872 | 1,722 |
| Depreciation | 181,683 | 114,566 | 296,249 | 5,746 | 3,623 | 9,369 |
| Amortization | 393 | 23,441 | 23,834 | 13 | 741 | 754 |

## 15. INCOME TAX

The income tax returns through 2001 had been examined and cleared by the tax authorities.

Under the Statute for Upgrading Industries, the Company is exempt from paying corporate income tax on (a) sales of pocket PCs (wireless) and Smartphones for five consecutive years from April 26, 2001; (b) sales of pocket PCs (wireless) and Smartphones (wireless) for five consecutive years from January 1, 2002; and (c) sales of Win CE products for five consecutive years from January 1, 2003.

Provision for income tax for the six months ended June 30, 2005, deferred tax assets and income tax payable as of June 30, 2005 were as follows:

| | Income Tax Expense (Gain) | Income Tax Payable | Deferred Tax Asset |
|---|---|---|---|
| High Tech Computer Corp. | $117,358 | $210,291 | $321,036 |
| HTC USA Inc. | (401) | - | 2,478 |
| Income tax payable | $116,957 | $210,291 | $323,514 |

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

| | NT$ | US$ (Note 2) |
|---|---|---|
| Temporary differences | | |
| Unrealized depreciation | $ 1,507 | $ 48 |
| Provision for loss on decline in value of inventory | 114,560 | 3,623 |
| Unrealized royalties | 256,049 | 8,098 |
| Capitalize expense | 39,264 | 1,242 |
| Unrealized reserve for warranty expense | 153,898 | 4,867 |
| Other | 860 | 27 |
| Tax credit carryforwards | 633,588 | 20,038 |
| Total deferred tax assets | 1,199,726 | 37,943 |
| Less valuation allowance | (858,857) | (27,162) |
| Total deferred tax asset, net | 340,869 | 10,781 |
| Deferred tax liability | | |
| Unrealized pension cost | (7,185) | (227) |
| Unrealized foreign currency exchange gain, net | (10,170) | (322) |
| | 323,514 | 10,232 |
| Less current portion | (165,460) | (5,233) |
| Deferred tax assets, noncurrent | $ 158,054 | $ 4,999 |

Details of the tax credit carryforwards are as follows:

| Occurrence | Validity Period | NT$ | US$ (Note 2) |
|---|---|---|---|
| 2001 | 2001-2005 | $ 77,118 | $ 2,439 |
| 2002 | 2002-2006 | 56,405 | 1,784 |
| 2003 | 2003-2007 | 179,061 | 5,663 |
| 2004 | 2004-2008 | 214,346 | 6,779 |
| 2005 | 2005-2009 | 106,658 | 3,373 |
| | | $633,588 | $20,038 |

Based on the Income Tax Law of the ROC, the investment research and development tax credits can be carried forward for four years. The total credits used in each year cannot exceed half of the estimated income tax provision, except in the last year.

Valuation allowance is based on management's evaluation of the amount of tax credits that can be carried forward for four years, based on the Company's financial forecasts.

The income tax expenses for the six months ended June 30, 2005 were as follows:

| | NT$ | US$ (Note 2) |
|---|---|---|
| Current income tax expense | $215,492 | $ 6,815 |
| Increase in deferred income tax assets | (98,747) | (3,123) |
| Underestimation of prior year's income tax | 212 | 7 |
| Income tax expense | $116,957 | $ 3,699 |

The integrated income tax information is as follows:

| | June 30, 2005 | |
|---|---|---|
| | NT$ | US$ (Note 2) |
| Balance of imputation credit account | $ 93,811 | $ 2,967 |
| Unappropriated earnings from 1998 | 6,424,542 | 203,243 |
| Expected creditable ratio (including income tax payable) | 4.73% | 4.73% |

## 16. EARNINGS PER SHARE

Before-tax and after-tax earnings per share (EPS) are calculated by dividing net income by the weighted average number of common shares outstanding each year. The weighted-average number of shares used in EPS calculation was 351,438 thousand for the six months ended June 30, 2005.

The employee stock options had a dilutive effect on the 2005 EPS. The related information is as follows:

| | Six Months Ended June 30, 2005 | | | | |
|---|---|---|---|---|---|
| | Numerators | | Denominator | Earnings Per Share | |
| | Income before Income Tax NT$ | Income after Income Tax NT$ | Shares (Thousands) | Income before Income Tax NT$ | Income after Income Tax NT$ |
| Basic earnings per share | $4,173,188 | $4,056,231 | 351,438 | $11.87 | $11.54 |
| Employee stock options | - | - | 4,437 | | |
| Diluted earnings per share | $4,173,188 | $4,056,231 | 355,875 | $11.73 | $11.40 |

| | Six Months Ended June 30, 2005 | | | | |
|---|---|---|---|---|---|
| | Numerators | | Denominator | Earnings Per Share | |
| | Income before Income Tax US$ (Note 2) | Income after Income Tax US$ (Note 2) | Shares (Thousands) | Income before Income Tax US$ (Note 2) | Income after Income Tax US$ (Note 2) |
| Basic earnings per share | $ 131,979 | $ 128,280 | 351,438 | $ 0.38 | $ 0.37 |
| Employee stock options | - | - | 4,437 | | |
| Diluted earnings per share | $ 131,979 | $ 128,280 | 355,875 | $ 0.37 | $ 0.36 |

## 17. FINANCIAL INSTRUMENTS

Under the Approval Document (85) Tai-Tsai-Tseng (6) No. 00263 of the Securities and Futures Bureau of the ROC and Statement of Financial Accounting Standards No. 27, “Disclosure of Financial Instruments,” the Company discloses financial instrument information as follows:

### Amount of Contract and Credit Risk

***Forward Exchange Contracts***

| | June 30, 2005 | | |
|---|---|---|---|
| | Contract Amount | | Credit Risk |
| Forward exchange contracts | US$/NT$ | 65,000 | $ - |
| | EUR/US$ | 18,000 | - |
| | GBP/US$ | 2,000 | - |

The Company deals only with banks with good credit standing based on the banks’ reputation and takes into account its past experience with them. Moreover, the Company has a series of control procedures for derivative transactions. Thus, no significant credit risks are expected.

***Market Risk***

Forward exchange contracts are measured at market value on the balance sheet date. As of June 30, 2005, the Company recorded unrealized exchange losses of NT$9,764 thousand on these contracts.

***Liquidity Risk, Cash Flow Risk and the Amount, Timing and Uncertainty of Future Cash Requirements Risk***

The loss on forward exchange contracts will be from NT$2,296 thousand to NT$12,569 thousand, assuming exchange rates for the third quarter of 2005 are between NT$31.51 to NT$31.73:US$1.00 and NT$37.85 to NT$37.90:EUR1. Because the Company has sufficient working capital to settle these contracts, there are no future cash requirements for contract settlement. In addition, because the Company does not intend to sell currency options before their maturity dates, no liquidity risk is expected.

***Purpose and Category of Financial Instrument Held***

The Company used derivative contracts for nontrading purposes, i.e., to reduce any adverse effect of exchange rate fluctuations of accounts receivable / payable.

***Presentation of Derivative Instruments in the Financial Statements***

On the balance sheet date, the receivables and payables on forward exchange contracts will be netted out, and the net amount will be included in other current assets or other current liabilities. As of June 30, 2005, the net amount recorded as other current liabilities was NT$9,764 thousand. Derivative transactions resulted in losses of NT$7,987 thousand for the three months ended June 30, 2005.

**Fair Value of Financial Instruments**

***Derivative Financial Instruments***

| | June 30, 2005 | | | |
|---|---|---|---|---|
| | Carrying Amount | | Fair Value | |
| | NT$ | US$ (Note 2) | NT$ | US$ (Note 2) |
| Liabilities | | | | |
| Forward exchange contracts | $ 9,764 | $ 309 | $ 9,764 | $ 309 |

The fair values of derivative financial instruments are the estimated amounts that the Company would receive or pay if contracts are closed on the balance sheet date. The Company obtained quotes from banks to estimate fair values.

*Nonderivative Financial Instruments*

| | June 30, 2005 | | | |
|---|---|---|---|---|
| | Carrying Amount | | Fair Value | |
| | NT$ | US$ (Note 2) | NT$ | US$ (Note 2) |
| Assets | | | | |
| Cash and cash equivalents | $11,628,642 | $ 367,762 | $11,628,642 | $ 367,762 |
| Receivables | 8,079,628 | 255,522 | 8,079,628 | 255,522 |
| Other current financial assets | 57,806 | 1,828 | 57,806 | 1,828 |
| Long-term investments | 2,139 | 68 | 2,139 | 68 |
| Other financial assets | 7,087 | 224 | 7,017 | 222 |
| Liabilities | | | | |
| Payables | 8,528,399 | 269,715 | 8,528,399 | 269,715 |
| Income tax payable | 210,291 | 6,651 | 210,291 | 6,651 |
| Accrued expense | 667,659 | 21,115 | 667,659 | 21,115 |
| Payable for purchase of equipment | 22,097 | 699 | 22,097 | 699 |
| Other current financial liabilities | 2,330,748 | 73,711 | 2,330,748 | 73,711 |
| Other financial liabilities | 495,160 | 15,660 | 490,257 | 15,505 |

The following methods and assumptions are used to estimate the fair value of financial instruments:

For cash and cash equivalents, receivables, other current financial assets, payables, short-term borrowings and other current financial liabilities, the carrying amounts approximate fair values because of the short maturities of these instruments.

The fair values of long-term investment and short-term investments are based on their quoted market prices. If the securities do not have market prices, fair value is measured based on financial or other information.

The fair value of long-term debts is based on the discounted value of the future cash flows discounted at the average interest rate for time deposits with maturities similar to those of the long-term debts.

## 18. RELATED-PARTY TRANSACTIONS

The names and relationships of related parties are as follows:

| Related Party | Relationship with the Group |
|---|---|
| First International Computer Inc. (FIC) | Chairperson is an immediate relative of the Company’s chairperson |
| VIA Technologies, Inc. | Chairperson is the Company’s chairperson |
| Chander Electronics Corp. | Chairperson is the Company’s chairperson |
| Comserve Network Netherlands B.V. | Affiliate |
| Leo Systems, Inc. | Affiliate |

Major transactions with related parties are summarized below:

**Purchases of Inventories and Services**

| Related Party | Six Months Ended June 30, 2005 | | |
|---|---|---|---|
| | Amount | | % of Total Net Purchases |
| | NT$ | US$ (Note 2) | |
| Chander Electronics Corp. | $263,415 | $ 8,331 | 1 |

Terms of payment and purchasing prices for both related and third parties were similar.

**Sales and Services Provided**

| Related Party | Six Months Ended June 30, 2005 | | |
|---|---|---|---|
| | Amount | | % of Total Revenues |
| | NT$ | US$ (Note 2) | |
| Comserve Network Netherlands B.V. | $ 53,470 | $ 1,691 | - |
| Others | 1,525 | 48 | - |
| | $ 54,995 | 1,739 | - |

Selling prices and terms of payment for both related and third parties were similar.

**Notes and Accounts Receivable**

| Related Party | June 30, 2005 | | |
|---|---|---|---|
| | Amount | | % of Total Notes and Accounts Receivable |
| | NT$ | US$ (Note 2) | |
| Comserve Network Netherlands B.V. | $ 5,971 | $ 189 | - |

**Notes and Accounts Payable**

| Related Party | June 30, 2005 | | |
|---|---|---|---|
| | Amount | | % of Total Notes and Accounts Payable |
| | NT$ | US$ (Note 2) | |
| Chander Electronics Corp. | $117,389 | $ 3,712 | 1 |

**Outstanding Expense**

| Related Party | June 30, 2005 Amount NT$ | US$ (Note 2) | % of Outstanding Expense |
|---|---|---|---|
| First International Computer Inc. (FIC) | $ 7,350 | $ 232 | 4 |

**Service Warranty Expense**

| Related Party | Six Months Ended June 30, 2005 Amount NT$ | US$ (Note 2) | % of Warranty Expenses |
|---|---|---|---|
| Comserve Network Netherlands B.V. | $ 68,649 | $ 2,171 | 14 |

Service warranty expense resulted from authorizing the above related party to provide after-sales service.

**Leasing - Lessee**

***Operating Expense - Rental Expense***

| Related Party | Six Months Ended June 30, 2005 Amount NT$ | US$ (Note 2) | % of Total Rental Expense |
|---|---|---|---|
| VIA Technologies, Inc. | $ 8,304 | $ 263 | 55 |

The Company leased offices and parking space owned by VIA Technologies, Inc. at one-year renewable operating lease agreements, and the rental payment was determined at the rates prevailing in the surrounding area.

**Leasing - Lessor**

***Nonoperating Revenue - Rental Revenue***

| Related Party | Six Months Ended June 30, 2005 Amount NT$ | US$ (Note 2) | % of Rental Revenue |
|---|---|---|---|
| VIA Technologies, Inc. | $ 339 | $ 11 | 100 |

**Property Transaction**

In the second quarter of 2005, the Company acquired land and building from VIA Technologies, Inc. for NT$304,630 thousand and had paid NT$294,630 thousand as of June 30, 2005.

## 19. COMMITMENTS AND CONTINGENCIES

As of June 30, 2005, unused letters of credit amounted to US$65 thousand, JP¥690 thousand, and EUR€327 thousand.

## 20. SIGNIFICANT CONTRACTS AS OF JUNE 30, 2005

**Patent Agreement**

To enhance the quality of its products and manufacturing technologies, the Company had patent agreements as follows:

| Contractor | Contract Term | Description |
|---|---|---|
| Microsoft | December 1, 2004 - December 31, 2006 | Authorization to use embedded operating system; royalty payment based on agreement. |
| Texas Instruments France | January 14, 2000 - January 13, 2010 | Authorization to use GSM system software; royalty payment based on agreement. |
| Qualcomm Incorporated | December 20, 2000 to the following dates:<br>(a) If the Company materially breaches any covenant and fails to take remedial action within 30 days after Qualcomm's issuance of a written notice, the Company will be prohibited from using Qualcomm's property or patents.<br>(b) Any time when the Company is not using any of Qualcomm's intellectual property, the Company may terminate this agreement upon 60 days' prior written notice to Qualcomm. | Authorization to use CDMA technology to manufacture and sell units; royalty payment based on agreement. |
| Ericsson Mobile Platform AB | April 2003-March 2011 | Authorization to use EDGE reference design license and support agreement; royalty payment based on agreement. |
| Telefonaktiebolaget LM Ericsson | December 15, 2003 to the expiry dates of these patents, and no longer than December 14, 2008 | Authorization to use platform patent license agreement; royalty payment based on agreement. |

| Contractor | Contract Term | Description |
| --- | --- | --- |
| Nokia Corporation | January 1, 2003 to the expiry dates of these patents. | Authorization to use wireless technology, like GSM; royalty payment based on agreement. |
| InterDigital Technology Corporation. | December 31, 2003 to the expiry dates of these patents. | Authorization to use TDMA and CDMA technology; royalty payment based on agreement. |
| KONINKLIJKE PHILIPS ELECTRONICS N.V. | January 5, 2004 to the expiry dates of these patents | GSM/DCS 1800/1900 Patent License; royalty payment based on agreement. |
| Motorola, Inc. | December 23, 2003 to the latest of the following dates: (a) Expiry dates of patents (b) Any time when the Company is not using any of Motorola's intellectual property, | TDMA, NARROWBAND CDMA, WIDEBAND CDMA or TD/CDMA Standards patent license or technology; royalty payment based on agreement. |
| ALCATEL/TCL & Alcatel | July 1, 2004-June 30, 2009 | Authorization to use GSM, GPRS or EDGE patent license or technology; royalty payment based on agreement. |
| Siemens Aktiengesellschaft | July 1, 2004 to the expiry dates of these patents. | Authorization to use GSM, GPRS or EDGE patent license or technology; royalty payment based on agreement. |
| Lucent Technologies GRL LLC | July 1, 2004-June 30, 2009 | Authorization to use GSM, GPRS, EDGE, CDMA or WCDMA patent license or technology; royalty payment based on agreement. |