

**CHUNGHWA PICTURE TUBES, LTD.**  
**Financial Statements**  
**For The Years Ended**  
**December 31, 2004 And 2003**  
**With**  
**Report of Independent Auditors**

## **Report of Independent Auditors**

To the Board of Directors and Stockholders of  
Chunghwa Picture Tubes, Ltd.

We have audited the accompanying balance sheets of Chunghwa Picture Tubes, Ltd. (the "Company") as of December 31, 2003 and 2004, and the related statements of operations, changes in stockholders' equity and cash flows for the years ended December 31, 2003 and 2004. 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. We did not audit the financial statements of Toppan Chunghwa Electronic Co., Ltd., an equity investee accounted for under the equity method, as of and for the year ended December 31, 2003. Those statements were audited by other auditors, whose reports have been furnished to us, and our opinion, insofar as it related to the amounts included for such said investee, is based solely on the report of the other auditors. The investment balances amounted to NT\$802,197 thousand (0.70% of total assets) as of December 31, 2003, and related investment income recognized was NT\$172,744 thousand (14.80% of income before income tax) for the year then ended.

We conducted our audits in accordance with "Rules Governing Auditing and Certification of Financial Statements by Certified Public Accountants" and auditing standards generally accepted in the Republic of China. Those 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 report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Chunghwa Picture Tubes, Ltd. as of December 31, 2003 and 2004, and the results of its operations and its cash flows for the years ended December 31, 2003 and 2004, in conformity with the "Guidelines Governing the Preparation of Financial Report by Securities Issuers" and accounting principles generally accepted in the Republic of China.

Diwan, Ernst & Young  
Taipei, Taiwan  
Republic of China  
March 28, 2005

### Notice to Readers

The accompanying financial statements are intended only to present the financial position and 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.

CHUNGHWA PICTURE TUBES, LTD.  
BALANCE SHEETS  
DECEMBER 31, 2003 AND 2004  
(Expressed in Thousands of New Taiwan Dollars)

ASSETS	December 31,	
	2003	2004
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents(Notes 2 and 4)	\$16,578,676	\$24,107,563
Marketable securities (Notes 2 and 4)	817,613	1,115,499
Notes receivable, net (Notes 2 and 4)	130,019	49,335
Accounts receivable, net		
Trade (Notes 2 and 4)	4,193,396	8,842,167
Others	335,745	679,170
Due from affiliates, net		
Trade (Notes 2, 4 and 5)	6,111,616	3,464,071
Others (Note 5)	23,596	17,783
Inventories, net (Notes 2 and 4)	4,365,919	6,176,535
Prepayments	85,047	73,880
Deferred tax assets, net (Notes 2 and 4)	-	27,444
Pledged time deposits-current (Note 6)	82,600	2,005,742
Total Current Assets	<u>32,724,227</u>	<u>46,559,189</u>
<b>LONG-TERM INVESTMENTS: (Notes 2 and 4)</b>		
Equity method	27,033,561	28,500,784
Cost method	679,583	917,698
Total Long-term Investment	<u>27,713,144</u>	<u>29,418,482</u>
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
(Notes 2, 4, 5 and 6)		
Land	2,934,338	3,039,102
Buildings	10,094,539	10,650,390
Machinery and equipment	46,418,432	48,265,787
Transportation equipment	314,714	319,100
Furniture and fixtures	429,253	568,642
Miscellaneous equipment	10,761,841	11,470,737
Revaluation increment	57,192	57,192
Total	71,010,309	74,370,950
Less:Accumulated depreciation	(22,906,739)	(29,410,376)
Add: Prepayments on equipments and		
Construction in progress	3,632,303	51,547,628
Property, plant and equipment, net	<u>51,735,873</u>	<u>96,508,202</u>
<b>INTANGIBLE ASSETS:</b>		
Deferred pension cost(Notes 2 and 4)	236,221	202,475
<b>OTHER ASSETS:</b>		
Refundable deposits	42,561	35,669
Deferred charges (Notes 2 and 4)	1,566,086	2,565,326
Pledged time deposits-non-current (Note 6)	58,850	35,000
Others, net (Note 4)	294,954	306,861
Total Other Assets	<u>1,962,451</u>	<u>2,942,856</u>
<b>TOTAL ASSETS</b>	<u><u>\$114,371,916</u></u>	<u><u>\$175,631,204</u></u>

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

CHUNGHWA PICTURE TUBES, LTD.  
BALANCE SHEETS (CONTINUED)  
DECEMBER 31, 2003 AND 2004  
(Expressed in Thousands of New Taiwan Dollars)

LIABILITIES AND STOCKHOLDERS' EQUITY	December 31,	
	2003	2004
<b>CURRENT LIABILITIES:</b>		
Short-term bank loans (Note 4)	\$1,147,710	\$7,898,870
Accounts payable		
Trade	7,774,638	8,003,573
Others	2,943,290	10,176,522
Due to affiliates (Note 5)		
Trade	1,154,926	7,974,008
Others	301,648	1,631,821
Accrued expenses	2,311,039	2,192,875
Forward exchange contract payable, net (Notes 2 and 11)	-	26,891
Current portion of bonds payable (Notes 2 and 4)	4,424,387	7,092,242
Current portion of long-term bank loans (Notes 4, 5 and 6)	2,304,000	6,737,987
Other current liabilities	117,600	217,944
Total Current Liabilities	<u>22,479,238</u>	<u>51,952,733</u>
<b>LONG-TERM DEBT:</b>		
Bonds payable-net of current portion (Notes 2 and 4)	-	6,825,967
Long-term bank loans-net of current portion (Notes 4, 5 and 6)	21,704,192	18,717,716
Total Long-term Debt	<u>21,704,192</u>	<u>25,543,683</u>
<b>RESERVE FOR INCREMENT TAX ON LAND</b>		
REVALUATION (Notes 2 and 4)	<u>26,793</u>	<u>26,793</u>
<b>OTHER LIABILITIES:</b>		
Accrued pension liabilities (Notes 2 and 4)	1,538,766	1,511,990
Deferred tax liabilities, net (Notes 2 and 4)	627,210	543,767
Deferred gain on transactions with equity investee (Notes 2, 4 and 5)	1,347,841	1,276,165
Total Other Liabilities	<u>3,513,817</u>	<u>3,331,922</u>
Total Liabilities	<u>47,724,040</u>	<u>80,855,131</u>
<b>STOCKHOLDERS' EQUITY:</b>		
Capital		
Common stock (Note 4)	58,908,629	68,564,159
Capital reserve		
Additional paid-in capital (Note 4)	7,218,664	14,615,928
Premium on bonds payable (Notes 2 and 4)	2,324,653	3,927,694
Treasury stock (Notes 2 and 4)	744	744
Reserve for assets revaluation (Note 4)	59,304	59,304
Long-term investments (Note 4)	515,955	515,955
Retained earnings (Notes 2 and 4)		
Legal reserve	-	93,996
Special reserve	-	845,962
Unappropriated earnings	939,958	10,317,715
Other items in stockholders' equity		
Unrealized losses on long-term investments (Notes 2 and 4)	(3,197,632)	(2,398,311)
Foreign currency translation adjustments (Notes 2 and 4)	1,076,055	(566,572)
Excess of additional pension liability over unrecognized prior service cost (Notes 2 and 4)	(158,711)	(160,758)
Treasury stock (Notes 2 and 4)	<u>(1,039,743)</u>	<u>(1,039,743)</u>
Total Stockholders' Equity	<u>66,647,876</u>	<u>94,776,073</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<u>\$114,371,916</u>	<u>\$175,631,204</u>

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

CHUNGHWA PICTURE TUBES, LTD.  
STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2004  
(Expressed in Thousands of New Taiwan Dollars Except Per Share Information)

	Years Ended December 31,	
	2003	2004
OPERATING REVENUES:		
NET SALES (Notes 2, 4 and 5)	\$47,486,833	\$78,416,749
OPERATING COSTS:		
COST OF GOODS SOLD (Notes 4 and 5)	(41,390,510)	(67,691,660)
GROSS PROFIT INCLUDED UNREALIZED INTERCOMPANY PROFIT (Notes 2, 4 and 5)	6,096,323	10,725,089
REALIZED INTERCOMPANY GAIN, NET (Notes 2, 4 and 5)	288,376	148,683
UNREALIZED INTERCOMPANY GAIN, NET (Notes 2, 4 and 5)	(78,007)	(87,088)
NET GROSS PROFIT	6,306,692	10,786,684
OPERATING EXPENSES: (Notes 4 and 5)		
Selling and marketing	(434,454)	(790,293)
General and administrative	(882,800)	(1,326,807)
Research and development	(2,952,786)	(3,066,961)
Total	(4,270,040)	(5,184,061)
OPERATING INCOME	2,036,652	5,602,623
NON-OPERATING INCOME:		
Interest income	35,210	144,789
Investment income recognized by equity method, net (Notes 2 and 4)	813,658	5,332,415
Gain on disposal of property, plant and equipment, net (Notes 2 and 5)	48,546	5,996
Gain on disposal of marketable securities, net (Note 2)	21,100	62,327
Gain on foreign currency exchange, net (Note 2)	179,803	221,577
Reversal of provision for loss on decline in market value of inventory, net (Notes 2 and 4)	360,000	-
Others (Note 5)	192,171	227,683
Total	1,650,488	5,994,787
NON-OPERATING EXPENSES:		
Interest expenses (Notes 2 and 4)	(1,105,554)	(783,348)
Loss on decline in market value and obsolescence of inventory, net (Notes 2 and 4)	-	(181,000)
Loss on disposal of other assets (Notes 2 and 4)	(1,377,240)	(53,489)
Others	(37,272)	(10,128)
Total	(2,520,066)	(1,027,965)
INCOME BEFORE INCOME TAX	1,167,074	10,569,445
INCOME TAX EXPENSES (Notes 2 and 4)	(218,948)	(247,562)
NET INCOME	\$948,126	\$10,321,883
EARNINGS PER SHARE AVAILABLE TO COMMON STOCKHOLDERS (Notes 2 and 4)		
BASIC (in dollars)	\$0.18	\$1.58
DILUTED (in dollars)	\$0.16	\$1.39

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

CHUNGHWA PICTURE TUBES, LTD.  
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2004  
(Expressed in Thousands of New Taiwan Dollars)

	CAPITAL RESERVE					RETAINED EARNINGS				UNREALIZED LOSSES ON LONG- TERM INVESTMENTS	FOREIGN CURRENCY TRANSLATION ADJUSTMENTS	EXCESS OF ADDITIONAL PENSION LIABILITY OVER UNRECOGNIZED PRIOR SERVICE COST	TREASURY STOCK	TOTAL	
	COMMON	ADDITIONAL	PREMIUM	RESERVE FOR	TREASURY	LONG-TERM	LEGAL	SPECIAL	UNAPPROPRIATED(ACCUMULATED						
	STOCK	PAID-IN CAPITAL	ON BONDS PAYABLE	ASSETS REVALUATION	STOCK	INVESTMENTS	RESERVE	RESERVE	DEFICITS) EARNINGS						
Balance at January 1, 2003	\$51,062,011	\$4,331,090	\$1,833,671	\$59,304	\$-	\$545,988	\$942,597	\$1,981,158		\$(3,562,883)	\$(3,399,247)	\$1,473,166	\$(41,920)	\$(1,039,743)	\$54,185,192
Transfer of capital reserve, legal reserve and special reserve to offset accumulated deficits (Note 4)		(639,128)					(942,597)	(1,981,158)		3,562,883					-
Net income for 2003										948,126					948,126
Convertible bonds converted into common stock (Notes 2 and 4)	846,618		490,982												1,337,600
Capital increase by cash in premium (Note 4)	5,000,000	2,571,401													7,571,401
Issuance of GDSs representing common shares by cash in premium (Note 4)	2,000,000	955,301													2,955,301
Recovery gain on long-term investment (Note 4)											72,908				72,908
Recovery gain on long-term investment of investee company-net of related tax effect											128,707				128,707
Foreign currency translation adjustments-net of related tax effect(Note 2)												(397,111)			(397,111)
Deferred tax arising from revaluation of land accounted for under the equity method						(29,229)									(29,229)
Adjustment of unappropriated earnings arising from changes in ownership percentage in investees accounted for under the equity method (Note 2)						(804)				(8,168)					(8,972)
Excess of additional pension liabilities over unrecognized prior service cost (Note 2 and 4)													(116,791)		(116,791)
Transfer of treasury stock (Notes 2 and 4)					744									207,256	208,000
Acquisition of treasury stock (Notes 2 and 4)														(207,256)	(207,256)
Balance at December 31, 2003	58,908,629	7,218,664	2,324,653	59,304	744	515,955	-	-		939,958	(3,197,632)	1,076,055	(158,711)	(1,039,743)	66,647,876
Appropriations of 2003 earnings (Note 4)															
Legal reserve							93,996			(93,996)					-
Special reserve								845,962		(845,962)					-
Net income for 2004										10,321,883					10,321,883
Convertible bonds converted into common stock (Notes 2 and 4)	2,613,000		1,603,041												4,216,041
Capital increase by cash in premium (Note 4)	7,000,000	7,383,016													14,383,016
Recovery gain on long-term investment (Note 2)											238,115				238,115
Recovery gain on long-term investment of investee company-net of related tax effect											561,206				561,206
Foreign currency translation adjustments-net of related tax effect (Note 2)												(1,642,627)			(1,642,627)
Adjustment of unappropriated earnings arising from changes in ownership percentage in investees accounted for under the equity method (Note 2)										(4,168)					(4,168)
Excess of additional pension liabilities over unrecognized prior service cost (Notes 2 and 4)													4,335		4,335
Excess of additional pension liabilities over unrecognized prior service cost accounted for under the equity method (Notes 2 and 4)													(6,382)		(6,382)
Issuance of common stock - exercise of stock option	42,530	14,248													56,778
Balance at December 31, 2004	\$68,564,159	\$14,615,928	\$3,927,694	\$59,304	\$744	\$515,955	\$93,996	\$845,962		\$10,317,715	\$(2,398,311)	\$(566,572)	\$(160,758)	\$(1,039,743)	\$94,776,073

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

CHUNGHWA PICTURE TUBES, LTD.  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2004  
(Expressed in Thousands of New Taiwan Dollars)

	Years Ended December 31,	
	2003	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$948,126	\$10,321,883
Adjustments to reconcile net income to net cash provided by operating activities:		
Exchange rate effect (Note 2)	67,773	458,663
Depreciation (Notes 2 and 4)	7,837,615	9,207,712
Amortization (Notes 2 and 4)	867,204	724,056
Investment income recognized by equity method, net (Notes 2 and 4)	(813,658)	(5,332,415)
Cash dividend received from long-term investee accounted for under equity method (Notes 2 and 4)	2,365,370	2,414,773
Unrealized gain on foreign currency exchange of long-term debt	(320,438)	(736,253)
Transfer of property, plant and equipment to expense	193,270	201,386
Gain on disposal of property, plant and equipment, net (Notes 2 and 4)	(48,546)	(5,996)
Loss on disposal of other assets (Notes 2 and 4)	1,377,240	53,489
Loss (recovery) on decline in market value and obsolescence of inventory, net (Notes 2 and 4)	(360,000)	181,000
Forfeited interest on convertible bonds	36,881	1,863
Amortization of premium on bonds payable	-	(101,411)
Change in operating assets and liabilities:		
Decrease in notes receivable	252,489	80,684
Increase in accounts receivable-trade	(1,301,230)	(4,648,771)
(Increase) decrease in due from affiliates-trade	(2,351,002)	2,647,545
Increase in accounts receivable-others	(78,491)	(343,425)
Decrease in forward exchange contract receivable, net	4,566	-
(Increase) decrease in inventories	900,867	(1,991,616)
(Increase) decrease in prepayments	(20,394)	11,167
(Increase) decrease in deferred tax assets	311,674	(27,444)
Increase in accounts payable	3,306,414	228,935
Increase (decrease) in due to affiliates-trade	(2,206,316)	6,819,082
Increase in forward exchange contract payable, net	-	26,891
Increase in accrued expenses	1,060,503	(206,831)
Increase in accounts payable-others	1,441,107	7,233,232
Decrease in deferred gain on transaction with equity investee	(210,369)	(61,595)
Increase in accrued pension liabilities	323,924	248,997
Payments for pension	(155,182)	(149,026)
Increase in compensation interest payable	86,578	71,357
Increase (decrease) in deferred tax liabilities	(956,011)	275,005
Net cash provided by operating activities	<u>12,559,964</u>	<u>27,602,937</u>

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

CHUNGHWA PICTURE TUBES, LTD.  
STATEMENTS OF CASH FLOWS (CONTINUED)  
FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2004  
(Expressed in Thousands of New Taiwan Dollars and US Dollars)

	Years Ended December 31,	
	2003	2004
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
(Increase) decrease in pledged time deposits	11,550	(1,899,292)
(Increase) decrease in due from affiliates-others	(14,810)	5,813
(Increase) decrease in marketable securities, net	143,834	(297,886)
Decrease in other financial assets	139,120	-
Increase in deferred charges	(417,877)	(1,723,296)
Proceeds from disposal of property, plant and equipment	706,191	8,826
Proceeds from disposal other assets	57,801	70,373
Increase in long-term investments	(596,960)	-
Additions to property, plant and equipment	(21,428,037)	(54,330,106)
(Increase) decrease in refundable deposits	(29,405)	6,892
Net cash used in investing activities	<u>(21,428,593)</u>	<u>(58,158,676)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of bonds payable	-	14,885,985
Increase in short-term bank loans	878,938	6,751,160
Increase in due to affiliates-others	160,613	1,330,173
Redemption and discharge of bonds payable	(2,122,435)	(638,507)
Repayments of bonds payable	(2,500,000)	-
Increase in long-term bank loans	12,518,970	3,978,340
Repayments of long-term bank loans	(3,898,489)	(2,304,000)
Early redemption of long-term bank loans	(1,480,050)	-
Increase in other current liabilities	43,168	100,344
Capital increase by cash in premium	10,526,702	14,383,016
Transfer of treasury stock	208,000	-
Acquisition of treasury stock	(207,256)	-
Proceeds from exercise of stock options	-	56,778
Net cash provided by financing activities	<u>14,128,161</u>	<u>38,543,289</u>
<b>EXCHANGE RATE EFFECT</b>	<u>(67,773)</u>	<u>(458,663)</u>
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	5,191,759	7,528,887
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	11,386,917	16,578,676
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<u>\$16,578,676</u>	<u>\$24,107,563</u>
<b>SUPPLEMENT DISCLOSURES OF CASH FLOWS INFORMATION:</b>		
Interest expenses paid (excluding amount capitalized)	<u>\$1,113,064</u>	<u>\$752,200</u>
Income tax paid	<u>\$865,806</u>	<u>\$6,353</u>
<b>INVESTING AND FINANCING ACTIVITIES NOT AFFECTING CASH FLOWS:</b>		
Current portion of long-term debt	<u>\$6,728,387</u>	<u>\$13,830,229</u>
Property, plant and equipment transfer to other assets	<u>\$122,033</u>	<u>\$135,769</u>
Conversion of convertible bonds into common stock	<u>\$1,337,600</u>	<u>\$4,216,041</u>

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

CHUNGHWA PICTURE TUBES, LTD.  
NOTES TO FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2004  
(Expressed in Thousands of New Taiwan Dollars Except Par Value, Shares or Stated Otherwise)

**1. ORGANIZATION AND OPERATIONS**

Chunghwa Picture Tubes, Ltd. (the "Company") was incorporated under the Company Law of the Republic of China (the "ROC") on May 4, 1971. The main activities of the Company include the design, manufacture, sale, installation, maintenance service, import, export and agency service of cathode ray tubes ("CRT"), thin film transistor liquid crystal displays ("TFT-LCD"), plasma display panel ("PDP"), color filter ("CF") and related materials, parts and components.

As of December 31, 2003 and 2004, the Company employed 5,390 and 7,718 employees, respectively.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Generally Accepted Accounting Principles*

The financial statements have been prepared in accordance with "Guidelines Governing the Preparation of Financial Report of Securities Issuers" and accounting principles generally accepted in the Republic of China (collectively referred to as "ROC GAAP"). Certain amounts reported in previous years have been reclassified to conform to the 2004 presentation.

*Use of Estimates*

The preparation of the financial statements in conformity with ROC GAAP requires management to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and accompanying notes. Actual results could differ materially from those estimates.

*Foreign Currency Transactions and Translation*

The Company maintains its accounting records in New Taiwan dollars ("NT dollars" or "NT\$"), the national currency of the ROC. Transactions denominated in foreign currencies are recorded in NT dollars using the exchange rates in effect at the date of the transactions. Assets and liabilities denominated in foreign currencies are translated into NT dollars using the exchange rates in effect at the balance sheet date. Foreign exchange gains or losses are included in the statements of operations.

*Cash Equivalents*

The Company classified all highly liquid investments that are readily convertible to cash with insignificant interest rate risk and an original maturity period of three months or less when purchased as cash equivalents.

*Marketable securities*

Marketable securities are recorded at cost when acquired and are stated at the lower of aggregate cost or market value at the balance sheet date. The amount by which aggregate cost exceeds market value is reported as non-operating expenses in the statements of operations. Subsequent recoveries in market value are recognized as a gain to the extent that the market value does not exceed the original aggregate cost of the investment.

### Allowance for Doubtful Accounts

The allowance for doubtful accounts is provided based on the aging analysis and results of the Company's evaluation of collectibility of the outstanding notes and accounts receivable.

Account Receivable is derecognized while the risks and rewards of accounts receivable have been substantially transferred, including a loss of control over the accounts receivable.

### Inventories

Inventories are recorded at cost when acquired and are stated at the lower of aggregate cost or market value. Cost is determined using the weighted-average method. Market value of work-in-process and finished goods is determined on the basis of net realizable value. Market value of raw materials is determined on the basis of replacement cost.

### Long-term Investments

Investments in which the Company owns 20% or more of the voting shares of investees, or under 20% but is able to exercise significant influence over the investee's operational decisions, are accounted for under the equity method. When there is a difference between the investment cost and the share of net assets of equity investees upon acquisition and the difference is arising from depreciable assets or goodwill, then the difference is amortized over a period of 5 years. If the difference is arising from under-valuation of land, then the difference is charged to profit and loss account upon the revaluation or disposal of such land. Dividends received or receivable from equity investees are credited to investment cost.

The Company discontinues the equity method of accounting when the Company's share in the losses of an investee accumulates to the cost of investment unless the Company guarantees obligations of the investee, or is otherwise committed to providing further financial support for the investee.

When the Company subscribes to additional shares of an investee at a percentage different from its existing equity interest, the resulting difference between the carrying amount of the investment and the amount of the Company's proportionate share in the investee's net equity is recorded as an adjustment to capital reserve. If the capital reserve is not sufficient, then the excess will be charged to retained earnings.

If an equity investee records an addition in capital reserve, the Company will proportionately share the amount and increase its investments and capital reserve accordingly.

Investments in which the Company owns less than 20% of the voting shares of investees are stated at cost except for investments in listed companies, which are stated at the lower of aggregate cost or market value, with unrealized loss and subsequent recovery, net of related tax effect, recorded as a separate component of stockholders' equity. However, permanent diminution in the value of an investee is recognized in the statements of operations. Cash dividends received from an investee under the cost method are recorded as non-operating income.

Stock dividends received are not treated as income. Instead, the number of shares held is increased. When long-term investments are sold, the costs of investments sold are determined using the weighted-average method.

### Property, Plant and Equipment & Assets held for Disposal

Property, plant and equipment are stated at cost plus revaluation increment.

Major renewals and improvements are capitalized, while ordinary maintenances and repairs are expensed as incurred.

Gains or losses from sale or disposal of property, plant and equipment are recorded as non-operating income or expenses.

Fixed assets held for disposal are classified as other assets and stated at the lower of net realizable value or net carrying amount.

Depreciation is provided by using the straight-line method over the following estimated useful lives:

Buildings	5 – 60 years
Machinery and equipment	3 – 10 years
Transportation equipment	5 years
Furniture and fixtures	5 years
Miscellaneous equipment	5 – 10 years

Interest incurred on loans used to finance the construction of property, plant and equipment is capitalized and depreciated accordingly.

### Deferred charges

Deferred charges, including technology license fees, computer software, shadow mask, bond issuance costs, expense of syndication loan application and other charges, are recorded at cost and amortized using the straight-line method over the following useful lives:

- Technology license fees – 5 years or the term of the technology cooperation contract
- Computer software – 3 years
- Shadow mask – 3 years
- Bond issuance costs – the redemption period or over the period from issuance date to maturity date
- Expense of syndication loan application – the term of syndication loan
- Other charges – 3~5 years

### Convertible Bonds

The excess of the stated redemption price of the convertible bonds over its par value is recognized as interest expense and interest payable using the interest method during the redemption period. If the bondholders do not exercise the redemption option by the expiry date, the Company should amortize the interest premium, which has been recognized as a liability, over the period from the option expiration to the maturity date of the bonds as a decrease of interest expense.

When the bondholders exercise their conversion rights, the carrying amount of the bonds and related interest payable are transferred to common stock and capital reserve (book value approach). However, if the conversion is an induced conversion, the amount that the market value of the securities given exceeds the market value of the securities, which should be issued according to the original conversion terms, should be recognized as an expense.

Convertible bonds are classified as current liability or long-term liability according to redemption clauses.

#### Deferred gain on transaction with equity investee

Unrealized intercompany gains and losses are eliminated under the equity method. Profit from sales of depreciable assets between the investee and the Company is amortized and recognized based on the assets' economic service lives. Profit from other types of intercompany transactions is recognized when realized. Unrealized intercompany gains and losses arising from transactions between investees accounted for under the equity method are eliminated in proportion to the multiplication of the Group's ownership percentages; while those arising from transactions between majority-owned subsidiaries are eliminated in proportion to the Group's ownership percentage in the subsidiary that incurs a gain or loss.

#### Pension and employee retirement plans

The Company has a defined benefit pension plan for covering all regular employees. The net pension cost is computed based on an actuarial valuation in accordance with the provision of ROC. Statement of Financial Accounting Standards No. 18, which requires consideration of pension cost components such as employee service cost, interest cost, expected return on plan assets and amortization of net transition obligation. The unrecognized net transition obligation is amortized on the straight-line basis over the employees average remaining service period or 15 years.

#### Treasury Stock

When treasury stock is purchased, it is recorded at cost of acquisition. When treasury stock is obtained through donation, it is recorded at market value. If the loss exceeds the capital reserve, the excess is charged to retained earnings. Treasury stock is shown as a deduction to stockholders' equity.

#### Stock compensation

The Company accounted for employee stock options using the intrinsic value method of accounting in accordance with interpretations of ROC GAAP.

Under the intrinsic value method, deferred compensation for options granted to employees is equal to its intrinsic value determined as the difference between the exercise price of the option and the fair value of the underlying stock at the date of grant or amendment. The Company is required to disclose pro forma net income and earnings per share, if employee stock options that are amended or have options grant on or after January 1, 2004, assuming the fair value method had been used.

### Income tax

The Company adopted an inter-period and intra-period income tax allocation method to recognize income tax. Tax effects on taxable temporary differences are recognized as deferred tax liabilities. Tax effects on deductible temporary differences, operating loss carryforwards and investment tax credits are recognized as deferred tax assets. Valuation allowance is provided based on the expected realization of the deferred tax assets. A deferred tax asset or liability should, according to the classification of its related asset or liability, be classified as current or non-current. However, if a deferred tax asset or liability is not directly related to an asset or liability, then the classification is based on the expected realization date of such deferred income tax asset or liability. The income tax expense or benefit for unrealized losses or gains that are not included in net income for the period, but are reported directly in the stockholders' equity section, should be adjusted directly in stockholders' equity.

Tax credits arising from purchases of machinery, equipment and technology, research and development expenditures, and employee training are recognized in the year that such purchases, expenditures and training occur.

Unappropriated earnings generated after 1997 are subject to a 10% retained earning tax (10% tax) in compliance with the Income Tax Law of R.O.C. The 10% tax is recorded as income tax expense at the time stockholders resolve that the Company's earnings shall be retained.

### Derivative financial instruments

Foreign currency forward exchange contracts:

Foreign currency forward exchange contracts entered into to manage currency risks are recorded at the spot rate at the date of inception. The premium or discount of the forward exchange contract is amortized over the life of the contract. Gains or losses on these contracts resulting from actual settlement are charged or credited to statement of operations on the settlement date. At the balance sheet date, the receivables and payables of the foreign currency forward exchange contracts are offset and the resulting balances are recorded as either assets or liabilities. The difference between the spot rate at the date of inception and the spot rate at balance sheet date is reflected in the statement of operations.

Foreign currency option contracts:

Premiums and discounts on option contract are recorded at cost. The gains or losses arising from settlement of such options are recorded in the statement of operations on settlement date. The premiums paid or received for the call or put options are amortized using the straight-line method over the terms of contracts.

The carrying amount of outstanding call or put options at balance sheet date are accounted for at their fair value using the rate of exchange prevailing at the balance sheet date with differences included in the statement of operations.

Interest rate swap contracts:

No accounting entry is prepared for interest rate swap contracts at the contract date. Upon the settlement of the contract, the actual amount received or paid is credited to or charged against current year income.

Earnings per common share

The Company presents basic earnings per share if a simple capital structure exists; or both basic earnings per share and diluted earnings per share if a complex capital structure exists. Basic earnings per share is equal to the net income attributable to common stock divided by the weighted-average number of common shares. When calculating diluted earnings per share, the numerator includes or adds back potential common stock dividends, interest and other conversion revenues. The denominator includes all potentially dilutive common shares.

The weighted-average outstanding shares shall be retroactively adjusted for capital increases arising from transfer of retained earnings, capital reserves and bonuses to employees.

Revenue recognition

The Company recognizes revenue when the earnings process is complete, as evidenced by an agreement with the customer, transfer of title and acceptance, if applicable, as well as fixed pricing and probable collectibility. Allowance for sales discounts is accrued in the period the sales occur.

**3. ACCOUNTING CHANGES**

None.

**4. DETAILS OF SIGNIFICANT ACCOUNTS BALANCES**

(1) Cash and cash equivalents

	December 31,	
	2003	2004
Cash:		
Cash on hand	\$1,195	\$2,701
Cash in banks-checking and savings account	15,461,311	22,601,988
Cash in banks-time deposits	-	500,969
Cash equivalents:		
ROC Government bonds with repurchase agreements	500,049	1,001,905
Short-term commercial papers	616,121	-
Total	<u>\$16,578,676</u>	<u>\$24,107,563</u>

(2) Marketable securities

	December 31,			
	2003		2004	
	Cost	Market value	Cost	Market value
Open-end mutual funds	<u>\$817,613</u>	<u>\$865,918</u>	<u>\$1,115,499</u>	<u>\$1,128,104</u>

The market value of open-end mutual funds is determined by their net asset value per unit at balance sheet date.

(3) Receivable, net

	December 31,	
	2003	2004
Notes receivable	\$131,319	\$49,735
Less: Allowance for doubtful accounts	(1,300)	(400)
Net	\$130,019	\$49,335
Accounts receivable-trade	\$4,379,796	\$9,850,789
Less: Allowance for doubtful accounts	(186,400)	(351,000)
Allowance for sales discounts	-	(657,622)
Net	\$4,193,396	\$8,842,167
Due from affiliates-trade	\$6,114,216	\$3,510,071
Less: Allowance for doubtful accounts	(2,600)	(46,000)
Net	\$6,111,616	\$3,464,071

(4) Inventories, net

	December 31,	
	2003	2004
Raw materials and supplies	\$2,392,335	\$3,360,413
Work in process	1,314,957	1,561,279
Finished goods	768,627	1,545,843
Total	4,475,919	6,467,535
Less: Allowance for decline in market value and obsolescence	(110,000)	(291,000)
Net	\$4,365,919	\$6,176,535
Insurance coverage	\$4,443,152	\$4,170,000

(5) Long-term investments

Investee	December 31, 2003	Percentage of ownership or voting rights	December 31, 2004	Percentage of ownership or voting rights
<u>Equity method:</u>				
<u>Unlisted Company</u>				
Chunghwa P.T. (Bermuda) Ltd.	\$24,834,339	100.00	\$26,134,636	100.00
Chunghwa P.T.(Labuan)Ltd.	929,686	41.03	970,390	41.03
Shang Chin Investment Co., Ltd.	35,050	25.00	47,348	25.00
Forward Electronics Co., Ltd.	412,289	23.48	-	-
Grand Cathay Optronics Co., Ltd.	20,000	100.00	20,000	100.00
Toppan Chunghwa Electronics Co., Ltd. ("Toppan")	802,197	30.00	908,521	30.00
Subtotal	27,033,561		28,080,895	

Listed Company

Forward Electronics Co., Ltd.	-	-	419,889	23.16
Subtotal	<u>27,033,561</u>		<u>28,500,784</u>	

Lower of aggregate cost or market value:

Listed Company

Tatung Co., Ltd.	1,531,059	1.87	1,531,059	1.88
Less: Allowance for loss on decline in market value of long-term investments	<u>(851,476)</u>		<u>(613,361)</u>	
Net	<u>679,583</u>		<u>917,698</u>	
Total	<u>\$27,713,144</u>		<u>\$29,418,482</u>	

For the year ended December 31, 2003, the investment income recognized for Toppan, audited by other auditors, was \$172,744.

(6) Property, Plant and Equipment

- a. The Company, in accordance with related regulations of ROC, revalued its property, plant and equipment in 1978, 1979, and 1981. As a result, a total of \$88,005 was added to total assets and \$59,304 (net of reserve for incremental tax on land revaluation of \$28,701) was credited to capital reserve. As of December 31, 2003, the revalued assets amounted to \$57,192.
- b. The insurance coverage over property, plant and equipment as of December 31, 2003 and 2004 amounted to \$48,465,638 and \$86,807,751, respectively.
- c. Interest expense (before deducting capitalized amounts of \$138,916 and \$25,380 in 2003 and 2004, respectively) for the years ended December 31, 2003 and 2004 were \$1,244,470 and \$808,728, respectively. The interest rates of capitalized interest for the years ended December 31, 2003 and 2004, were ranged from 3.036% to 3.924% and 0.41% to 5.75%, respectively.

(7) Deferred charges

	December 31,	
	2003	2004
Technology license fees (TFT-LCD modes)	\$563,044	\$602,992
Technology license fees (PDP modes)	821,292	602,281
Expense of syndication loan application	40,841	185,916
Bond issuance cost	98,802	211,878
Shadow mask	-	912,424
Others	42,107	49,835
Total	<u>\$1,566,086</u>	<u>\$2,565,326</u>

(8) Other assets-others

	December 31,	
	2003	2004
Land		
Padeh, Taoyuan, Taiwan, ROC	\$247,992	\$247,992

Yangmei, Taoyuan, Taiwan, ROC	36,292	36,292
Lungtan, Taoyuan, Taiwan, ROC	-	22,577
Assets held for disposal	<u>10,670</u>	<u>-</u>
Total	<u>\$294,954</u>	<u>\$306,861</u>

- a. As of December 31, 2004, due to legal restriction of ROC, the Company had not been able to register as the legal owner of certain farmlands (3.400323 hectares) purchased by the Company. Accordingly, such lands were temporarily held in trust by third parties. However, in order to protect the Company's interest, the Company has kept control of the sellers' chop, land purchase agreement and the title deeds.
- b. Since late 2000, in order to implement the overall production plan, the Company has begun to relocate some of its production equipments to CPTF Optronics Co., Ltd. or sell them. Such equipment was reclassified to other assets held for disposal and stated at the lower of net realizable value or carrying amount.

(9) Short-term bank loans

Items	December 31,	
	2003	2004
Usance L/C loan	<u>\$1,147,710</u>	<u>\$7,898,870</u>
Interest rates	<u>0.43%-1.8879%</u>	<u>0.41%~5.75%</u>

(10) Bonds payable

Items	December 31,	
	2003	2004
Zero Coupon Convertible Bonds, issued in 2002 and due 2007	\$581,366	\$-
Add: Compensation interest payable	61,996	-
Subtotal	<u>643,362</u>	<u>-</u>
Convertible Bonds, issued in 2002 and due 2007 at 0.25%	3,636,766	1,198,483
Add: Compensation interest payable	144,259	88,089
Subtotal	<u>3,781,025</u>	<u>1,286,572</u>
Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2005	-	5,719,207
Add: Premium	-	86,463
Subtotal	<u>-</u>	<u>5,805,670</u>
Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2007	-	6,814,279
Add: Compensation interest payable	-	11,688
Subtotal	<u>-</u>	<u>6,825,967</u>

Less: Current portion of bonds payable	(4,424,387)	(7,092,242)
Bonds payable-net of current portion	\$-	\$6,825,967

The significant terms of the Convertible Bonds are as follows:

	Zero Coupon Convertible Bonds, issued in 2002 and due 2007	Convertible Bonds, issued in 2002 and due 2007 at 0.25%	Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2005	Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2007
· Amount	US\$80 million	US\$143.75 million	US\$230 million	US\$213.5 million
· Issue price	100%	100%	103%	100%
· Period	5 years (2002.2.1 to 2007.2.1)	5 years (2002.11.19 to 2007.11.19)	22 months (2004.1.13 to 2005.11.13)	30 months (2004.12.8 to 2007.6.8)
· Place of trading	Luxembourg Stock Exchange	Luxembourg Stock Exchange	Luxembourg Stock Exchange	Singapore Stock Exchange
· Coupon rate	-	0.25%	-	-
· Conversion period	Bondholders may convert the bonds to the Company's common shares during a period 30 days after the issuance and 30 days before the maturity. The number of common shares (or the number of the certificates) received by the bondholders is determined by dividing the principal amount over conversion price. No cash payment will be made for fractional shares. (The exchange rate is fixed at \$35.076 to US\$1)	Bondholders may convert the bonds to the Company's common shares during a period 30 days after the issuance and 30 days before the maturity. The number of common shares received by the bondholders is determined by dividing the principal amount over conversion price. No cash payment will be made for fractional shares. (The exchange rate is fixed at \$34.57 to US\$1)	Bondholders may convert the bonds to the Company's common shares during a period 30 days after the issuance and 30 days before the maturity. The number of common shares received by the bondholders is determined by dividing the principal amount over conversion price. No cash payment will be made for fractional shares. (The exchange rate is fixed at \$33.83 to US\$1)	Bondholders may convert the bonds to the Company's common shares during a period 30 days after the issuance and 30 days before the maturity. The number of common shares received by the bondholders is determined by dividing the principal amount over conversion price. No cash payment will be made for fractional shares. (The exchange rate is fixed at \$32.371 to US\$1)

· Conversion price and adjustment	The conversion price is \$45 per share and will be adjusted if number of the Company's common stock changes after the issuance of the bonds.	The conversion price is \$15.53 per share and will be adjusted if number of the Company's common stock changes after the issuance of the bonds. As of December 31, 2004 the conversion price was adjusted to \$13.44 per share.	The conversion price is \$16.46 per share and will be adjusted if number of the Company's common stock changes after the issuance of the bonds. As of December 31, 2004 the conversion price was adjusted to \$16.21 per share.	The conversion price is \$20.25 per share and will be adjusted if number of the Company's common stock changes after the issuance of the bonds.
	Zero Coupon Convertible Bonds, issued in 2002 and due 2007	Convertible Bonds, issued in 2002 and due 2007 at 0.25%	Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2005	Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2007
· Company's redemption rights	① After 2 years of the issuance of the bonds, the Company may redeem the bonds at 100% of the unpaid principal amount outstanding if the closing price of the Company's common stock on Taiwan Stock Exchange ("TSE") is equal to 130% or above of the conversion price in effect on each trading day for a period of 20 consecutive trading days, or the bonds not yet converted or bought back amounted to US\$5,000 thousand or below.	① After 2 years of the issuance of the bonds, the Company may redeem the bonds at 100% of the unpaid principal amount outstanding if the closing price of the Company's common stock on TSE is equal to 125% or above of the conversion price in effect on each trading day for a period of 20 consecutive trading days, or the bonds not yet converted or bought back amounted to US\$5,000 thousand or below.	① After six months of the issuance of the bonds, the Company may redeem the bonds at 100% of the unpaid principal amount outstanding if the closing price of the Company's common stock on TSE is equal to 120% or above of the conversion price in effect on each trading day for a period of 20 consecutive trading days, or the bonds not yet converted or bought back amounted to less than 10% of the aggregate principal amount originally issued.	① After 1 year of the issuance of the bonds, the Company may redeem the bonds at 100% of the unpaid principal amount outstanding if the closing price of the Company's common stock on TSE is equal to 125% or above of the conversion price in effect on each trading day for a period of 20 consecutive trading days, or the bonds not yet converted or bought back amounted to less than 10% of the aggregate principal amount originally issued.

	<p>② The Company may redeem the bonds at 100% of the unpaid principal amount outstanding if there is a change in legislation, resulting in an increase in tax liabilities of the Company.</p> <p>③ The bonds will mature on February 1, 2007 at 100% of their principal amount.</p>	<p>② The Company may redeem the bonds at 100% of the unpaid principal amount outstanding if there is a change in legislation, resulting in an increase in tax liabilities of the Company.</p> <p>③ The bonds will mature on November 19, 2007 at 117.59% of their principal amount.</p>	<p>② The Company may redeem the bonds at 100% of the unpaid principal amount outstanding if there is a change in legislation, resulting in an increase in tax liabilities of the Company.</p> <p>③ The bonds will mature on November 13, 2005 at 100% of their principal amount .</p>	<p>② The Company may redeem the bonds at 100% of the unpaid principal amount outstanding if there is a change in legislation, resulting in an increase in tax liabilities of the Company.</p> <p>③ The bonds will mature on June 8, 2007 at 105.36% of their principal amount.</p>
	<p>Zero Coupon Convertible Bonds, issued in 2002 and due 2007</p>	<p>Convertible Bonds, issued in 2002 and due 2007 at 0.25%</p>	<p>Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2005</p>	<p>Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2007</p>
• Bondholders' option rights	<p>① On the second and the third anniversary of the bonds, the bondholders have the right to require the Company to redeem the bonds at a price equal to 109% and 100% of the principal amount, respectively.</p> <p>② The bondholders may demand the Company to redeem the bonds if trading of the Company's shares is restricted on the TSE.</p>	<p>① On January 19, 2004 and the third anniversary of the bonds, the bondholders have the right to require the Company to redeem the bonds at a price equal to 103.84% and 110.19% of the principal amount, respectively.</p> <p>② The bondholders may demand the Company to redeem the bonds if trading of the Company's shares is restricted on the TSE.</p>	<p>① On the first anniversary of the bonds, the bondholders have the right to require the Company to redeem the bonds at a price equal to 100% of the principal amount.</p> <p>② The bondholders may demand the Company to redeem the bonds if trading of the Company's shares is restricted on the TSE.</p>	<p>None.</p> <p>① The bondholders may demand the Company to redeem the bonds if trading of the Company's shares is restricted on the TSE.</p>

· Converting status	All bonds have been repurchased as of December 31, 2004.	A total of US\$106,200 thousand of the bonds have been converted as of December 31, 2004, resulting in the issuance of 241,331,525 shares.	A total of US\$50,810 thousand of the bonds have been converted as of December 31, 2004, resulting in the issuance of 104,630,234 shares.	None.
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During the credit enhanced zero coupon convertible bonds repayment period, the Company is required to comply with the current ratio, debt to equity ratio, time interest tangible assets ratio and other financial ratios with certain restrictions as specified in the agreements.

(11) Long-term bank loans

	December 31,	
	2003	2004
Unsecured	\$-	\$300,000
Secured	24,008,192	25,155,703
Total	24,008,192	25,455,703
Less: current portion	(2,304,000)	(6,737,987)
Net	\$21,704,192	\$18,717,716
Interest rates	0.6131%-2.5423%	1.7918%-3.61625%

- Certain of the Company's loan agreements require the Company to maintain (1) a current ratio higher than 100%; (2) debt to equity ratio under 125% or 150%; (3) interest coverage over 1.15 or 1.2; and (4) tangible equity more than \$35 billion, \$40 billion or \$60 billion.
- The long-term bank loans are to be repaid in NT\$ or foreign currency quarterly, or semiannually, or upon maturity before February 2010.
- Some of the long-term bank loans were jointly guaranteed by the President of the Company. In addition, these loans are secured by the mortgage of the Company's land, building, machinery and equipment.

(12) Accrued pension liability and deferred pension cost

- Effective from October 1996, as required by the ROC Labor Standard Law, the Company makes monthly contributions to a pension fund at certain percentage of salaries paid. The pension fund is administered by the employee committee and deposited, in the committee's name, with Central Trust of China, a ROC government entity.
- The details of net periodic pension cost for the years ended December 31, 2003 and 2004 are as follows:

	2003	2004
Employee service cost	\$146,121	\$158,087
Interest cost	80,124	54,642
Expected return on plan assets	(12,370)	(8,088)
Amortization of net transition obligation	33,746	33,746
Amortization of prior service cost	66,634	-

Amortization of actuarial gain or loss	9,669	10,610
Total	\$323,924	\$248,997

c. The funded status as of December 31, 2003 and 2004:

	December 31,	
	2003	2004
Pension obligation		
Vested	\$101,480	\$216,800
Non-Vested	1,854,564	1,915,577
Accumulated benefit obligation	1,956,044	2,132,377
Additional benefits based on future salaries	229,619	526,017
Projected benefit obligation	2,185,663	2,658,394
Fair value of plan assets	(323,506)	(437,950)
Funded status	1,862,157	2,220,444
Unamortized net transition obligation	(236,221)	(202,475)
Unrealized loss on pension assets	(388,330)	(680,394)
Deferred pension cost	236,221	202,475
Excess of additional pension liability over unrecognized prior service cost	158,711	154,376
Accrued pension liability	1,632,538	1,694,426
Less: current portion	(93,772)	(182,436)
Long-term portion-net of current portion	\$1,538,766	\$1,511,990

d. The major actuarial assumptions are as follows:

	December 31,	
	2003	2004
Discount rate	4.00%	2.50%
Rate of increase in future compensation levels	1.00%	0.50%
Expected long-term rate of return on plan assets	4.00%	2.50%

For the years ended December 31, 2003 and 2004, vested benefits amounted to \$108,654 and \$232,052, respectively.

(13) Deferred gain on transaction with equity investee

a. As of December 31, 2003 and 2004, the balances of deferred gain on transaction with equity investees were as follows:

New Taiwan Dollars	Transaction item			Total
	Inventories	Fixed assets	Stock	
Balance at January 1, 2003	\$573,533	\$26,634	\$942,055	\$1,542,222
Increase in unrealized gain	78,007	21,786	-	99,793
Amortized and realized	(288,376)	(5,798)	-	(294,174)
Balance at December 31, 2003	363,164	42,622	942,055	1,347,841
Increase (decrease) in unrealized gain (loss)	87,088	(2,589)	-	84,499

Amortized and realized	(148,683)	(7,492)	-	(156,175)
Balance at December 31, 2004	<u>\$301,569</u>	<u>\$32,541</u>	<u>\$942,055</u>	<u>\$1,276,165</u>

- b. The unrealized gain of \$942,055 resulted from the stock transaction between the company and its subsidiaries. The gain was deemed unrealized as its subsidiaries have not disposed the stock.

(14) Capital

- a. The authorized and issued capital of the Company at January 1, 2003 was \$64,100,000 and \$51,062,011 (including 400 million shares reserved for future exercise of stock options), divided into 6,410,000,000 shares and 5,106,201,133 shares, respectively, each at a par value of \$10.
- b. On June 6, 2003, the Company's stockholders resolved to increase the authorized capital to \$85,000,000, divided into 8,500,000,000 shares (including 600 million shares reserved for future exercise of stock options), each at a par value of \$10. Stockholders also resolved to offset accumulated deficits by using additional paid-in capital of \$639,128, together with legal reserve of \$942,597 and special reserve of \$1,981,158.

On October 2, 2003, the Company completed a local offering of 500,000,000 shares, each at an offering price of \$15.3. Another 200,000,000 shares were issued for Global Depository Shares (GDSs) offering purposes. These 200,000,000 shares together with the 300,000,000 existing shares held by the Company's major stockholder, Tatung Co., Ltd., were utilized for 20,000 thousand units of GDSs (each unit representing 25 common shares) listed on the Luxembourg Stock Exchange.

- c. As of December 31, 2003, the Company issued 84,661,771 shares for the conversion of the Company's convertible bonds due 2007. Total outstanding shares increased to \$58,908,629 after the conversion.
- d. On December 15, 2003, the Board of Directors resolved to increase the capital by 700,000,000 shares by a local offering at a premium price of \$20.6 per share. The effective date of the issuance was May 6, 2004.
- e. On June 16, 2004, the Company's stockholders resolved to increase the authorized capital to \$99,700,000, divided into 9,970,000,000 shares (including 600 million shares reserved for further exercise of stock options), each at a par value of \$10. In addition, it was resolved that no earnings of 2003 could be distributed except for the appropriations of legal reserve and special reserve.
- f. On December 22, 2004, the Board of Directors resolved to increase the capital by issuing GDSs for up to 700,000 thousand shares. Such plan and was approved by the authorities on March 24, 2005.

- g. In 2004, the Company issued 156,669,754 shares and 104,630,234 shares for the conversion of the Company's convertible bonds due 2007 and 2005, respectively. Total outstanding shares increased to \$68,521,629 after the conversion.
- h. In 2004, total stock options exercised were 4,253,000 shares, each at \$13.35 of exercise price. Total issued common stock after exercise was \$68,564,159.

(15) Stock compensation

The Company has two stock option plans (2002 plan and 2004 plan). These stock options provide for the granting of options to qualified employees of the Company or any of its domestic or foreign subsidiaries for the purchase of the Company's common shares at the market price of the grant date. Stock options expire in five years from the date granted and vest over service periods that range from two to four years. The Company is authorized to grant options for up to 400,000 thousand shares and 233,982 thousand shares under the 2002 plan and 2004 plan, respectively.

- a. A summary of the Company's stock option activity and the related information for the years ended December 31, 2003 and 2004 were described as shown below:

	2003		2004			
	2002 plan		2002 plan		2004 plan	
	Options (in thousand shares)	Weighted-Average Exercise Price (in dollars)	Options (in thousand shares)	Weighted-Average Exercise Price (in dollars)	Options (in thousand shares)	Weighted-Average Exercise Price (in dollars)
Outstanding-beginning of year	97,596	\$13.35	218,041	\$12.45	-	\$-
Granted	165,710	11.90	-	-	186,170	16.11
Exercised	-	-	(4,253)	13.35	-	-
Forfeited	(45,265)	12.36	(15,721)	12.35	(7,125)	16.69
Outstanding-end of year	<u>218,041</u>	12.45	<u>198,067</u>	12.44	<u>179,045</u>	16.09

- b. Information with respect to the outstanding options of the Company's as of December 31, 2004 is as follows:

	Date of Approval	Range of Exercise Price (in dollars)	Outstanding options at balance sheet date			Options Exercise	
			Options (in thousand shares)	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price (in dollars)	Number of Exercisable Options (in thousands)	Weighted- Average Exercise Price (in dollars)
2002 plan	May 14, 2002	\$11.90-\$13.35	198,067	1.75	\$12.44	37,098	\$13.35
2004 plan	April 29, 2004	\$14.55-\$17.10	179,045	3.40	16.09	-	-

- c. Pro forma net income and earnings per share are disclosed below as if the Company had accounted for its employee stock options under the fair value method.

	2004
Net income as reported (in thousands)	\$10,321,883
Pro forma net income (in thousands)	\$10,107,849
Basic earnings per share as reported (in dollars)	\$1.58
Pro forma basic earnings per share (in dollars)	\$1.55
Diluted earnings per share as reported (in dollars)	\$1.39
Pro forma diluted earnings per share (in dollars)	\$1.36

The fair value of these options was calculated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions for the year ended December 31, 2004:

	2004
Dividend yield:	-
Risk-free interest rate:	1%
Expected volatility:	50.32% and 48.03%
Expected life:	5 years

Compensation cost recognized for the year ended December 31, 2004 was nil. Had the Company used the fair value method to account for its stock options, compensation cost would have been \$214,034.

(16) Capital Reserve

According to the ROC Company Law, additional paid-in capital and capital reserve can only be used for offsetting accumulated deficits or distribution of stock dividends. The Company cannot use additional paid-in capital or capital reserve to offset accumulated deficits unless the legal reserve is insufficient for offsetting such deficits.

(17) Legal Reserve

According to the Company Law in the ROC, the Company must retain at least 10% of its annual earnings as legal reserve until such reserve equals the amount of capital. Once the legal reserve equals one-half of the paid-in capital, 50% of the reserve may be transferred to common stock. The legal reserve can be used to offset deficit.

(18) Special reserve

In accordance with the ROC Securities Future Bureau (SFB) regulations, a special reserve must be provided for unrealized losses on long-term investments, excess of additional pension liability over unrecognized prior service cost, and foreign currency translation adjustment that are accounted for as deductions to stockholders' equity. Once the aforementioned deductions to stockholders' equity are reversed, the related reserve can be reversed to distributable earnings.

(19) Distributions of earnings

Pursuant to the Company's Articles of Incorporation, current year's earnings before tax, if any, shall be distributed in the following order:

- (a) payment of all taxes;

- (b) offset of prior years' operation losses;
- (c) set aside 10% of the remaining amount after deducting (a) and (b) as legal reserve;
- (d) set aside special reserve in accordance with regulation prescribed by the ROC's SFB or reverse special reserve previously provided; and
- (e) after deduction of items (a), (b), (c) and (d) from current year's earnings, the remaining is allocated as follows: 5%-10% as employees' bonus, and 90%-95% as distributable earnings.

The Company is engaged in high-tech industry and the cycle of high-tech industry is experiencing the stage of growth. In order to expand scale and improve its strength to compete with other major companies in the world, the Company adopts a policy of residual dividends. The Company shall base its budget on capital expenditures and the demands of the fund, taking into account the balance of retained earnings, to determine dividends or bonuses provided; however, cash dividends shall not be less than 100% of the sum of the on stock dividend and cash dividend.

The information relating to 2003 proposed earnings distribution (or makeup of accumulated deficits) and resolution of stockholders' meeting is accessible on the website of "Market observation post system" (mops. tse.com.tw) of TSE.

(20) Treasury stock

- a. The Company repurchased its own shares from open market. The purpose and ending balance of treasury stock were as follows:

Purpose	Number of Shares Repurchased			
	Beginning	Addition	Disposal	Ending
<u>2003</u>	In thousands of share			
Future issuance to employees as bonuses	53,412	16,000	16,000	53,412
<u>2004</u>				
Future issuance to employees as bonuses	53,412	-	-	53,412

- b. Pursuant to the resolution of the Board of Directors meeting of the Company in 2000 and 2002, the Company has repurchased its common stock totaling 104,463 thousand shares (\$2,197,987 in the amount), of which 51,051 thousand shares (\$1,158,244 in the amount) have been transferred to employees as of December 31, 2004.
- c. According to Stock Exchange Regulations in the ROC, the Company does not possess voting rights or rights to receive dividends for holding such treasury stock. The treasury stock should be transferred to employees within three years after the repurchase. If treasury stock is not transferred after the required three-year period, it will be treated as if not issued and the Company is required to report to the Government of ROC to change the capital status.

(21) Operating revenue

	2003	2004
TFT-LCD	\$42,119,647	\$73,662,527
PDP	2,408,504	2,109,972
STN-LCD	462,288	856,402
CPT and CDT	202,827	-
Others	2,293,567	1,787,848
Total	<u>\$47,486,833</u>	<u>\$78,416,749</u>

(22) Personnel, depreciation and amortization expenses

	2003			2004		
	Operating cost	Operating expenses	Total	Operating cost	Operating expenses	Total
Personnel expenses:						
Salaries	\$2,875,751	\$647,629	\$3,523,380	\$4,094,487	\$776,254	\$4,870,741
Staff labor/health insurance	169,511	38,691	208,202	229,258	38,336	267,594
Pension	267,955	55,969	323,924	205,113	43,884	248,997
Depreciation	7,662,607	175,008	7,837,615	9,019,410	188,302	9,207,712
Amortization	2,193	865,011	867,204	9,262	714,794	724,056

(23) Income tax

- a. The ROC income tax authorities have assessed the income tax returns of the Company through 2002 except for 2000 and 2001.
- b. There is no taxation charge on the profit of the Company and certain operating subsidiaries due to the following:
  - ① The Company is entitled to an income tax exemption for a period of five consecutive years for the income generated by sales of its TFT-LCD and 17 inches color display tubes (“CDT”).

The following are details of the Company’s effective tax exemption periods:

Tax exemption products	Tax exemption period
TFT-LCD and 17 inches color display tubes	2000~2004
TFT-LCD	2002~2006
TFT-LCD	2004~2008

- ② The Company obtained the approval letter for claiming tax exemption in respect of setting its headquarters in Taiwan.
- c. The provision for income tax expenses consists of the following:

2003	2004
------	------



Deferred tax assets-net-current	\$-	\$27,444
	December 31,	
	2003	2004
f. Deferred tax assets-non-current	\$7,793,336	\$6,061,818
Valuation allowance-non-current	(5,560,579)	(4,103,140)
Deferred tax assets-net-non-current	2,232,757	1,958,678
Deferred tax liabilities-non-current	(2,859,967)	(2,502,445)
Net deferred tax liabilities-non-current	\$(627,210)	\$(543,767)

g. Details of unused investment tax credits and tax operating loss carryforwards are as follows:

Regulation	Investment tax credit item	Investment tax credit	Unused investment tax credit	Expiration year
Statute for Upgrading Industries	Investment tax credit in production equipment	\$112,327	\$112,327	2008
		1,496,593	1,496,593	2007
		198,558	198,558	2006
		2,121,532	2,121,532	2005
		<u>\$3,929,010</u>	<u>\$3,929,010</u>	

Regulation	Investment tax credit item	Investment tax credit	Unused investment tax credit	Expiration year
Statute for Upgrading Industries	Investment tax credit in research and development expenditure,	\$365,867	\$365,867	2008
	employee training expenditure	531,237	531,237	2007
		508,712	508,712	2006
		317,989	317,989	2005
		<u>\$1,723,805</u>	<u>\$1,723,805</u>	

Income tax Law	Tax loss carryforward	\$167,112	\$167,112	2008
		94,509	94,509	2007
		1,315,238	1,315,238	2006
		<u>\$1,576,859</u>	<u>\$1,576,859</u>	

h. The integrated income tax information of the Company is as follows:

	December 31,	
	2003	2004
Imputation credit account (ICA)	<u>\$57,071</u>	<u>\$3,171</u>

The actual or expected creditable ratios for earnings distribution to ROC resident stockholders in 2003 and 2004 are 6.07% and 0.03%, respectively.

- i. Unappropriated earnings as of December 31, 2003 and 2004 are as follows:

	December 31,	
	2003	2004
Unappropriated earnings	\$939,958	\$10,317,715

(24) Earnings per common share

The following table sets forth the computation of the Company's basic and diluted earnings per common share:

	Amount	
	2003	2004
Numerator:		
Net income available to common stockholders	\$948,126	\$10,321,883
Net income available to common stockholders and diluted potential common shares	\$955,028	\$10,325,111
	Shares	
	2003	2004
Denominator:		
Denominator for basic income per share-weighted average share (in thousands)	5,241,023	6,513,734
Denominator for diluted income per share-weighted average share (in thousands)	5,765,123	7,430,671
	Amount	
	2003	2004
Basic earnings per common share (in dollars)	\$0.18	\$1.58
Diluted earnings per common share (in dollars)	\$0.16	\$1.39

(25) Technical cooperation agreement

TFT-LCD	The term of the contract	Content
Hitachi	January 2003   December 2010	<ol style="list-style-type: none"> <li>1. The Company is required to pay licensing fees for using the technologies by installment.</li> <li>2. The Company is required to pay royalty fees based on a certain percentage of net sales of the related products for continuing use of exclusive technology.</li> </ol>

Advanced Display Inc. (ADI)	April 1997   July 2006	<ol style="list-style-type: none"> <li>1. The Company is required to pay licensing fees for using the technologies by installment.</li> <li>2. The Company is required to pay royalty fees based on a certain percentage of net sales of the related products for continuing use of exclusive technology.</li> <li>3. ADI has the right to purchase not more than 15% of the total products from the Company at 90% of the average selling price. The Company bears the shipping costs of the products to locations designated by ADI.</li> </ol>
Sharp Corporation	January 2002   December 2006	<ol style="list-style-type: none"> <li>1. The Company is required to pay licensing fees for using the technologies by one time.</li> <li>2. The Company is required to pay royalty fees based on a certain percentage of net sales of the related products for continuing use of exclusive technology.</li> </ol>
Semiconductor Energy Laboratory Co., Ltd. (SEL)	January 2004   December 2008	<ol style="list-style-type: none"> <li>1. The Company is required to pay fees for using the technologies by installment.</li> <li>2. The Company is required to pay royalty fees based on a certain percentage of net sales of the related products for continuing use of exclusive technology.</li> </ol>
<u>PDP</u>		
Mitsubishi Electric Corporation	October 1999   September 2006	<ol style="list-style-type: none"> <li>1. The Company is required to pay licensing fees for using the technologies by installment.</li> <li>2. The Company is required to pay royalty fees based on a certain percentage of net sales of the related products for continuing use of exclusive technology.</li> </ol>

The Company, along with other companies in ROC of the same industry, has signed an Agreement for Joint Ownership of Patent Rights with Industrial Technology Research Institute (ITRI). According to the Agreement, ITRI agrees to share the ownership of TFT-LCD and related patents with the contracting parties for seven years. ITRI will become the sole owner of the TFT-LCD patent rights upon the expiry of the Agreement. The cost of the patents is amortized over the term of the Agreement.

The Company, Mitsubishi Electric Corporation and Advanced Display Inc. (a subsidiary of Mitsubishi

Electric Corporation) have signed an Agreement for Joint Ownership of TFT-LCD's Patent rights and technologies. The Company obtained the patents after paying fees for using the technologies. The Company, Mitsubishi Electric Corporation and Advanced Display Inc. (referred to as "joint owners") all agreed that no any joint owner can have the rights to grant a license under any patent rights to any third party without the prior written consent of the other joint owners.

## 5. RELATED PARTY TRANSACTIONS

### (1) Related parties and relationship:

Related parties	Relationship
Tatung Co., Ltd.	The Company's major stockholder and represented on the Company's board of directors
Forward Electronics Co., Ltd.	An investee accounted for under equity method
Toppan Chunghwa Electronics Co., Ltd.	An investee accounted for under equity method
Tatung Chungai Precious Metals Co., Ltd.	Subsidiary of Tatung Co., Ltd.
Tatung Atherton Co.	Subsidiary of Tatung Co., Ltd.
Taiwan Telecommunication Industry Co., Ltd.	Subsidiary of Tatung Co., Ltd.
Tatung-FDK Co., Ltd.	Subsidiary of Tatung Co., Ltd.
Tatung Fine Chemical Co., Ltd.	Subsidiary of Tatung Co., Ltd.
Shang Chih International Express Co., Ltd.	Subsidiary of Tatung Co., Ltd.
Related parties	Relationship
Tatung OTIS Elevator Co., Ltd.	Subsidiary of Tatung Co., Ltd.
Tatung-Fanuc Robotics Company	Subsidiary of Tatung Co., Ltd.
Tatung Co. of Japan, Inc.	Subsidiary of Tatung Co., Ltd.
Tatung (U.K.) Ltd.	Subsidiary of Tatung Co., Ltd.
Tatung (Thailand) Co., Ltd.	Subsidiary of Tatung Co., Ltd.
Tatung Co. of America, Inc.	Subsidiary of Tatung Co., Ltd.
Kuender Company Co., Ltd.	Subsidiary of Tatung Co., Ltd.
Tatung Okuma Co., Ltd.	Subsidiary of Tatung Co., Ltd.
Tatung Consumer Products (Taiwan) Co., Ltd	Subsidiary of Tatung Co., Ltd.
Tatung Electronics (Singapore) Pte Ltd.	Subsidiary of Tatung Co., Ltd.
Tatung System Technology Inc.	Subsidiary of Tatung Co., Ltd.
Tatung Telecom Corporation	An investee of Tatung Co., Ltd. accounted for under equity method
TIS Net Technology Inc.	Subsidiary of subsidiary of Tatung Co., Ltd.
Tatung Information Technology (Jiang Su) Co., Ltd.	Subsidiary of subsidiary of Tatung Co., Ltd.
Chunghwa P.T. (Bermuda) Ltd.	A subsidiary of the Company
Chunghwa P.T. (Labuan) Ltd.	A subsidiary of the Company's subsidiary
Chunghwa P.T. (Malaysia) Sdn. Bhd.	A subsidiary of the Company's subsidiary
Chunghwa P.T. (Kampar) Sdn. Bhd.	A subsidiary of the Company's subsidiary
Chunghwa P.T. (U.K.) Ltd.	A subsidiary of the Company's subsidiary

CPTF Optronics CO., Ltd.	A subsidiary of the Company's subsidiary
Chunghwa P.T. (Wujiang) Ltd.	A subsidiary of the Company's subsidiary
Dalemont Investment Ltd.	A subsidiary of the Company's subsidiary
Daliant Investment Ltd.	A subsidiary of the Company's subsidiary
Bangalor Investment Ltd.	A subsidiary of the Company's subsidiary
Bensaline Investment Ltd.	A subsidiary of the Company's subsidiary
Chunghwa P.T. Display Technology (Fujian ) Ltd.	A subsidiary of the Company's subsidiary
CPTF Visual Display (Fuzhou) Ltd.	A subsidiary of CPTF Optronics CO., Ltd.
Makolin Electronics (M) Sdn. Bhd.	The Company's affiliated company accounted for under equity method
Fujian Fujia Electronics Co., Ltd.	The Company's affiliated company accounted for under equity method
Jean Co., Ltd.	Chairman is one of the immediate family members of the Company's chairman (position held since October 1, 2003)
Jeffrey Investment Ltd.	Subsidiary of Jean Co., Ltd.
K-tronics, Inc.	Subsidiary of subsidiary of Jean Co., Ltd.
Jean (M) Sdn. Bhd., Malaysia	Subsidiary of Jean Co., Ltd.
Tatung University	The major stockholder of Tatung Co., Ltd.
Lin, Cheng-Hon	Chairman of Board of Directors and President of the Company.

(2) Significant Transactions with Related Parties:

a. Operating Revenue

Name of Related Parties	2003		2004	
	Amount	%	Amount	%
Tatung Co., Ltd.	\$540,965	1.14	\$203,762	0.26
Tatung (Thailand) Co., Ltd.	1,556,701	3.28	3,965	0.01
Chunghwa P.T. (Labuan) Ltd.	21,873,128	46.06	2,932,953	3.74
Chunghwa P.T. (Kampar) Sdn. Bhd.	325,605	0.69	362,109	0.46
Tatung Information Technology (Jiang Su) Co., Ltd.	-	-	8,668,768	11.05
Jean Co., Ltd.	1,121,689	2.36	114,940	0.15
Jeffrey Investment Ltd.	15,425	0.03	1,627,984	2.08
K-tronics, Inc.	219,633	0.46	6,045,243	7.71
Others	224,134	0.47	50,394	0.06
Total	<u>\$25,877,280</u>	<u>54.49</u>	<u>\$20,010,118</u>	<u>25.52</u>

There are no significant differences between prices to related parties and prices to ordinary customers.

The comparison of collection terms between related parties and ordinary customers is as follows:

2003

2004

<u>Region</u>	<u>Related parties</u>	<u>Ordinary customers</u>	<u>Related parties</u>	<u>Ordinary customers</u>
Overseas	Cash payment with 60 to 120 days	Cash payment with 30 to 60 days L/C with 30 to 45 days D/A with 75 days	O/A 90-120 days	Cash payment with 30 to 65 days L/C with 30 to 60 days At sight payment
ROC Domestic	Cash payment with 30 to 60 days	Cash payment with 30 to 60 days	O/A 90-120 days	Cash payment with 30 to 60 days At sight payment

b. Purchases

<u>Name of Related Parties</u>	<u>2003</u>		<u>2004</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Chunghwa P.T. (Labuan) Ltd.	\$3,021,435	10.98	\$21,629,451	39.78
Others	197,974	0.72	131,410	0.24
Total	<u>\$3,219,409</u>	<u>11.70</u>	<u>\$21,760,861</u>	<u>40.02</u>

There are no significant differences between purchase prices from related parties and from ordinary suppliers. The comparison of terms of payment between related parties and ordinary suppliers is summarized as follows:

<u>Region</u>	<u>2003</u>		<u>2004</u>	
	<u>Related parties</u>	<u>Ordinary suppliers</u>	<u>Related parties</u>	<u>Ordinary suppliers</u>
Overseas	T/T 30 to 180 days	L/C, T/T 30 to 180 days	T/T 30 to 180 days	L/C, T/T 30 to 180 days
ROC Domestic	60 to 90 days after QC	30 to 150 days after QC	30 to 60 days after QC	30 to 150 days after QC

c. Fixed asset addition

<u>Name of Related Parties</u>	<u>2003</u>		<u>2004</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Tatung Co., Ltd.	\$699,108	3.26	\$509,098	0.94
Tatung System Technology Inc.	60,778	0.28	75,053	0.14
Shang Chih International Express Co., Ltd.	27,260	0.13	29,334	0.05
Tatung OTIS Elevator Co., Ltd.	14,714	0.07	32,154	0.06
Others	3,301	0.02	25,142	0.04
Total	<u>\$805,161</u>	<u>3.76</u>	<u>\$670,781</u>	<u>1.23</u>

d. Expenditures

Name of Related Parties	2003		2004	
	Amount	%	Amount	%
Toppan Chunghwa Electronics Co., Ltd.	\$31,365	0.19	\$14,910	0.08
Chunghwa P.T. (Labuan) Ltd.	-	-	35,055	0.18
Tatung Co., Ltd.	21,269	0.13	51,340	0.26
Tatung Co. of Japan, Inc.	8,757	0.06	8,095	0.04
Tatung System Technology Inc.	18,218	0.11	12,129	0.06
Others	18,787	0.12	8,704	0.05
Total	\$98,396	0.61	\$130,233	0.67

(1) The above expenditure incurred in connection with the purchase of materials, products or services from related parties.

(2) The Company purchased certain raw material, components and equipment from Japan through Tatung Co. of Japan, Inc., which charges the Company commissions for such services. The total raw material and equipment purchased through Tatung Co. of Japan, Inc. amounted to \$3,445,316 and \$7,508,679 for the years ended on December 31, 2003 and 2004, respectively. The commission charged, included in the aforementioned purchase amount, amounted to \$8,757 and \$8,095 for the corresponding periods, respectively.

e. Fixed asset disposal

Name of Related Parties	Selling price	2003		2004		
		Carrying amount	Gain (Loss) on sale of fixed asset	Selling price	Carrying amount	Gain(Loss) on sale of fixed asset
Chunghwa P.T. (Labuan) Ltd.	\$713,853	\$699,309	\$14,544	\$4,167	\$6,779	\$(2,612)
Chunghwa P.T. (Malaysia) Sdn. Bhd.	9,352	9,352	-	913	913	-
Chunghwa P.T. (Kampar) Sdn. Bhd.	23,609	16,367	7,242	718	695	23
Tatung Co., Ltd.	350	3,723	(3,373)	790	790	-
Total	\$747,164	\$728,751	\$18,413	\$6,588	\$9,177	\$(2,589)

f. Non-operating income-Others

Name of Related Parties	2003		2004	
	Amount	%	Amount	%
Chunghwa P.T. (Malaysia) Sdn. Bhd.	\$1,372	0.71	\$2,479	1.09
Chunghwa P.T. (Labuan) Ltd.	3,995	2.08	2,883	1.27
Chunghwa P.T. (Kampar) Sdn. Bhd.	1,607	0.84	1,793	0.79
Tatung Co., Ltd.	1,883	0.98	2,768	1.21
Others	244	0.13	136	0.06
Total	\$9,101	4.74	\$10,059	4.42

g. Due from affiliates-Trade, net

Name of Related Parties	December 31,			
	2003		2004	
	Amount	%	Amount	%
Tatung Co., Ltd.	\$100,938	1.65	\$79,886	2.28
Chunghwa P.T. (Labuan) Ltd.	5,869,805	96.00	344,639	9.82
Tatung Information Technology (Jiang Su) Co., Ltd.	-	-	1,912,107	54.47
Jeffrey Investment Ltd.	-	-	1,032,211	29.41
K-tronics, Inc.	4,203	0.07	78,236	2.23
Others	139,270	2.28	62,992	1.79
Total	6,114,216	100.00	3,510,071	100.00
Less: Allowance for doubtful accounts	(2,600)		(46,000)	
Net	\$6,111,616		\$3,464,071	

h. Due from affiliates – Others

Name of Related Parties	December 31,			
	2003		2004	
	Amount	%	Amount	%
Chunghwa P.T. (Bermuda) Ltd.	\$17,100	72.47	\$8,393	47.20
Toppan Chunghwa Electronics Co., Ltd.	4,990	21.15	4,291	24.13
Chunghwa P.T. (Labuan) Ltd.	1,204	5.10	4,211	23.68
Others	302	1.28	888	4.99
Total	\$23,596	100.00	\$17,783	100.00

i. Due to affiliates – Trade

Name of Related Parties	December 31,			
	2003		2004	
	Amount	%	Amount	%
Tatung Co. of Japan, Inc.	\$1,075,219	93.10	\$4,161,731	52.19
Chunghwa P.T. (Labuan) Ltd.	398	0.03	3,749,282	47.02
Others	79,309	6.87	62,995	0.79
Total	\$1,154,926	100.00	\$7,974,008	100.00

j. Due to affiliates-Others

Name of Related Parties	December 31,			
	2003		2004	
	Amount	%	Amount	%
Tatung Co., Ltd.	\$70,109	23.24	\$253,248	15.52
Tatung Co. of Japan, Inc.	147,503	48.90	1,205,647	73.88
Chunghwa P.T. (Malaysia) Sdn. Bhd.	79,445	26.34	111,227	6.82
Others	4,591	1.52	61,699	3.78
Total	\$301,648	100.00	\$1,631,821	100.00

k. Other current liabilities

Name of Related Parties	December 31,			
	2003		2004	
	Amount	%	Amount	%
Chunghwa P.T. (Labuan) Ltd.	\$2,124	1.81	\$2,213	1.02
Tatung (Thailand) Ltd.	393	0.33	393	0.18
Tatung Co. of America, Inc.	266	0.23	300	0.14
Chunghwa P.T. (U.K.) Ltd.	249	0.21	249	0.11
Fujian Fujia Electronics Co., Ltd.	-	-	650	0.30
Jean Co., Ltd.	540	0.46	3,552	1.63
Others	251	0.21	419	0.19
Total	\$3,823	3.25	\$7,776	3.57

l. Deferred gain on transaction with equity investee

Name of Related Parties	December 31,			
	2003		2004	
	Amount	%	Amount	%
Chunghwa P.T. (Malaysia) Sdn. Bhd.	\$158,701	11.77	\$99,849	7.82
Chunghwa P.T. (Labuan) Ltd.	238,447	17.69	227,648	17.84
Chunghwa P.T. (Bermuda) Ltd. And Dalemont Investment Ltd. Etc.	942,055	69.90	942,055	73.82
Chunghwa P.T. (Kampar) Sdn. Bhd.	8,638	0.64	6,613	0.52
Total	\$1,347,841	100.00	\$1,276,165	100.00

m. Guarantees

The amount of guarantees that the Company provided for related parties as of December 31, 2003 and 2004 are as follows:

Name of Related Parties	Amount (in thousands)		
	December 31,		Purpose
	2003	2004	
Chunghwa P.T. (Bermuda) Ltd	USD70,000	USD82,000	Working Capital
Chunghwa P.T. (U.K.) Ltd.	GBP 8,000	-	Working Capital
	USD 5,000	-	Working Capital
CPTF Optronics CO., Ltd.	USD 13,000	USD16,900	Working Capital
Chunghwa P.T. (Labuan) Ltd.	USD 60,000	USD45,000	Working Capital
Toppan Chunghwa Electronics Co., Ltd.	NTD 330,000	NTD330,000	Working Capital
Chunghwa P.T. (Wujiang) Ltd.	-	USD10,000	Working Capital
Makolin Electronics(M) Sdn. Bhd.	RM6,839	-	Working Capital

- n. The Company leased portions of its plants to Toppan Chunghwa Electronics Co., Ltd. That generated rental revenue of \$14,541 and \$16,979 for the years ended December 31, 2003 and 2004, respectively. The related receivables (recorded in due from affiliates-others) were \$4,990 and \$4,291 as of December 31, 2003 and 2004, respectively. In addition, the Company charged Toppan Chunghwa Electronics

Co., Ltd. Management fees of \$47,590 and \$31,685 for the years ended December 31, 2003 and 2004, respectively, which were recorded as a deduction of expenditure.

- o. In order to integrate education-industry for research and development, the Company contributed a donation of about two hundreds of million to Tatung University.

## 6. ASSETS PLEDGED OR MORTGAGED

As of December 31, 2003 and 2004, the following assets were mortgaged to several banks, customs and government agencies as collateral for bank loans, credit facilities and other purposes:

Accounts	Creditors	Carrying amount	
		December 31,	
		2003	2004
Building	Chiao Tung Bank	\$-	\$2,012,125
Machinery and equipment	Chiao Tung Bank	18,931,353	15,991,060
Building	Bank of Taiwan	2,239,127	1,498,253
Machinery and equipment	Bank of Taiwan	14,892,635	9,256,676
Pledged time deposit	General office of the customs-Keelung, ROC	12,600	12,679
Pledged time deposit	General office of the customs-Taipei, ROC	125,000	171,255
Pledged time deposit	Hua Nan Commercial Bank	3,850	3,850
Pledged time deposit	Chiao Tung Bank	-	1,542,885
Pledged time deposit	Bank of Taiwan	-	310,073
		<u>\$36,204,565</u>	<u>\$30,798,856</u>

## 7. COMMITMENTS AND CONTINGENCIES

- A. The Company's unused letters of credit were approximately USD26,564 thousand, JPY8,827,239 thousand, CHF12,127 thousand and EUR4,948 thousand as of December 31, 2004.
- B. Besides the guarantees disclosed in Note 5 (2) m, the Company issued promissory notes, guarantee notes for bank loans and guarantee notes for account receivable factoring amounted to \$2,300,000, \$33,828,223 and \$5,000,000, respectively.
- C. The Company signed several construction contracts for the expansion of its factory space. As of December 31, 2004, these construction contracts have amounted to \$67,363,760 with \$40,946,739 remaining unpaid.

## 8. SIGNIFICANT DISASTER LOSS

NONE.

## 9. SIGNIFICANT SUBSEQUENT EVENTS

- (1) On January 18, 2005, the Board of Directors of the Company resolved the following:
- a. To invest in subsidiary (Hwa-Guan Optronics Ltd.) in Mainland China for the assembly and sale of TFT-LCD modules in the PRC .
  - b. To increase the investment in CPT Display Technology (Fujian) Ltd. And Chunghwa Picture Tubes (Wujiang) Ltd. In Mainland China.
  - c. To invest in Digital Display Manufacturing Co. for the assembly and sale of PDP modules in the PRC.
- (2) As of March 28, 2005, the detailed information of bondholders converting into common shares or the Company redeeming the convertible bonds from the holders was as follows:

Item	Common shares of conversion	Amount (in thousands)
Convertible Bonds, issued in 2002 and due 2007 at 0.25%	385,825	USD150

## 10. SEGMENT INFORMATION

### (1) Industrial information

The related information for 2003 and 2004 are as follows.

#### 2003

	<u>TFT-LCD</u>	<u>Other</u>	<u>Total</u>
Total revenues	\$42,142,089	\$5,344,744	\$47,486,833
Gross profit (loss)	\$7,315,626	\$(1,219,303)	\$6,096,323
Unrealized intercompany profit			210,369
R&D			(2,952,786)
SG&A			(1,317,254)
Interest income			35,210
Investment income recognized by equity method, net			813,658
Other income			801,620
Interest expenses			(1,105,554)
Other expenses			(1,414,512)
Income before income tax			<u>\$1,167,074</u>
Identifiable assets:			
Property, plant and equipment, net	\$39,869,002	\$8,875,341	\$48,744,343
Inventory, net	\$3,352,080	\$1,013,839	\$4,365,919
Depreciation expenses	\$6,659,116	\$1,178,499	\$7,837,615
Capital expenditure	\$20,304,755	\$1,123,282	\$21,428,037

#### 2004

	<u>TFT-LCD</u>	<u>Other</u>	<u>Total</u>
Total revenues	\$73,707,863	\$4,708,886	\$78,416,749
Gross profit (loss)	\$11,979,005	\$(1,253,916)	\$10,725,089
Unrealized intercompany loss			61,595
R&D			(3,066,961)
SG&A			(2,117,100)
Interest income			144,789
Investment income recognized by equity method, net			5,332,415
Other income			517,583
Interest expenses			(783,348)
Other expenses			(244,617)
Income before income tax			<u>\$10,569,445</u>
Identifiable assets:			
Property, plant and equipment, net	\$86,153,482	\$7,258,426	\$93,411,908
Inventory, net	\$5,704,005	\$472,530	\$6,176,535
Depreciation expenses	\$7,911,058	\$1,296,654	\$9,207,712
Capital expenditure	\$53,732,260	\$597,846	\$54,330,106

(2) Regional information

NONE.

(3) Export sales

Export sales by region for 2003 and 2004 are as follow:

	2003	2004
EUROPE	\$338,005	\$124,844
AMERICA	313,684	1,356,450
SOUTHEAST ASIA	37,886,865	71,235,856
OTHERS	114,040	612,278
Total	\$38,652,594	\$73,329,428

(4) Major customers (individual customer accounting for at least 10% of net operating revenue)

Customer Name	2003		2004	
	Sales	Percentage	Sales	Percentage
A Co., Ltd.	\$21,873,128	46.06%	\$2,932,953	3.74%
B Co., Ltd.	4,785,270	10.08%	11,037,632	14.08%
C Co., Ltd.	-	-	8,668,768	11.05%
D Co., Ltd.	1,215,976	2.56%	9,054,990	11.55%

11. Derivative

A. The relevant information of the derivative financial instruments is as follows:

- (1) Types of derivative financial instruments, purpose of holding the derivative financial instruments and the strategy for achieving the purpose:

The purpose for holding foreign currency forward exchange contracts and foreign currency option contracts is to hedge the exchange rate fluctuation risks (hedging against accounts payable denominated in Japanese Yen and British Pound or accounts receivable denominated in US dollars and British Pound). Interest rate swap (“IRS”) contracts are entered into to hedge interest rate fluctuation risk. The Company’s hedging strategy is to mitigate most of its market price risk. Derivative financial instruments selected for hedging purposes are highly negatively correlated with the fluctuation in the fair value of the hedged items. Derivatives are evaluated periodically.

(2) Details of contract amount or notional amount:

Financial instruments	December 31,	
	2003	2004
	Contract amount or notional amount (in thousands)	Contract amount or notional amount (in thousands)
a. Foreign currency forward exchange contract:		
Buy USD Sell JPY	-	USD 28,000
b. European style foreign currency options:		
<u>BUY</u>		
NTD Call / USD Put	-	USD 10,000
JPY Call / USD Put	USD346,000	USD 175,000
USD Call / JPY Put	-	USD 13,000
USD Call / GBP Put	GBP 8,000	-
<u>Sell</u>		
JPY Call / USD Put	-	USD 173,500
USD Call / JPY Put	USD1,013,550	USD 885,100
USD Call / GBP Put	-	GBP 8,000
USD Call / NTD Put	-	USD20,000
GBP Call / USD Put	GBP9,600	GBP 8,000
c. Interest rate swap transactions:		

Outstanding IRS contracts as of December 31, 2004 were as follows:

Maturity period	Notional Amounts	Payable on Fixed Interest Rate	Receivables on Floating Interest Rate	Fair Value
2009.4~2009.6	\$11,000,000	0.90%-1.65%	0.96%-1.077%	\$(44,112)

The Company did not engage in any IRS transactions in 2003.

(3) Transaction risk:

① Credit risk relating to derivative financial instruments:

Credit risk represents the risk of loss that would be recognized at reporting date if counterparties failed to perform. The Company entered into the above derivative contracts with major international foreign banks or reputable local banks. The likelihood of default by the counterparties is considered remote.

② Market price risk relating to derivative instruments:

Foreign currency forward exchange contracts and foreign currency option contracts:

Market price risk represents the accounting loss that would be recognized at the reporting date for the derivative financial instruments due to the changes in foreign exchange rates. As the Company's derivative financial instruments are for hedging purposes, the gains or losses due to changes in foreign exchange rates will be offset by the hedged items. As a result, market price risk is considered minimal.

Interest rate swap contracts:

The IRS contracts are used to hedge interest rate fluctuation on its liabilities with floating interest rates. Since the interest receivable and payable are settled at net amounts on the settlement date, the market risk is immaterial.

③ Liquidity risk, cash flow risk and the uncertainty of future cash needs:

Foreign currency forward exchange contracts and foreign currency option contracts:

Liquidity risk is the risk of being unable to settle the derivative contracts on schedule. The Company's working capital is sufficient for the cash demand upon the settlement of contracts. As such, there is no significant liquidity risk for the related cash flows. Furthermore, the exchange rates of the foreign currency forward exchange contract and foreign currency option contracts are fixed at the inception, so there is no significant cash flow risk.

Interest rate swap contracts:

There is no significant liquidity risk or cash flow risk involved in the interest rate swap contract as the Company has taken into consideration the future cost of capital before entering into such contract.

(4) Presentation of derivative instruments in the financial statements:

① Foreign currency forward exchange contracts:

Receivable and payable resulting from the forward exchange contracts that are not settled at reporting date are netted off. The net amount is recorded as other current assets or other current liabilities.

The details of foreign currency forward exchange contracts as of December 31, 2004 are as follows:

	<u>December 31, 2004</u>
Foreign currency forward exchange contracts-receivable	\$893,676
Foreign currency forward exchange contracts-payable	(917,162)
Unamortized premium	(3,405)
Foreign currency forward exchange contracts-payable, net	<u><u>\$(26,891)</u></u>

② Foreign currency option contracts:

The unrealized foreign currency loss for these contracts was \$81,182 in 2004.

③ Interest rate swap contracts:

Interest revenue and expense on these interest rate swap contracts for the year ended December 31, 2004 were \$1,104 and \$16,027, respectively.

Accounting policy : Please see Note 2.

B. Fair value of financial instruments:

Non-derivative	December 31, 2003	
	Carrying amount	Fair value
<u>Financial assets</u>		
Cash and cash equivalents	\$16,578,676	\$16,578,676
Marketable securities	817,613	865,918
Receivables, net	10,435,031	10,435,031
Long-term investments, net	27,713,144	27,713,144
Refundable deposits	42,561	42,561
Pledged time deposits	141,450	141,450
Deferred Charges	1,566,086	1,566,086
<u>Financial liabilities</u>		
Short-term bank loans	1,147,710	1,147,710
Payables	14,485,541	14,485,541
Other current liabilities	117,600	117,600
Bonds payable (including current portion)	4,424,387	4,661,988
Long-term bank loans (including current portion)	24,008,192	24,008,192
<u>Derivatives</u>		
Foreign currency options	-	251,329
December 31, 2004		
Non-derivative	Carrying amount	Fair value
<u>Financial assets</u>		
Cash and cash equivalents	\$24,107,563	\$24,107,563
Marketable securities	1,115,499	1,128,104
Receivables, net	12,355,573	12,355,573
Long-term investments, net	29,418,482	29,356,608
Refundable deposits	35,669	35,669
Pledged time deposits	2,040,742	2,040,742

Deferred Charges	2,565,326	2,565,326
	December 31, 2004	
	Non-derivative	
	Carrying amount	Fair value
<u>Financial liabilities</u>		
Short-term bank loans	\$7,898,870	\$7,898,870
Payables	29,978,799	29,978,799
Other current liabilities	217,944	217,944
Bonds payable (including current portion)	13,918,209	14,416,588
Long-term bank loans (including current portion)	25,455,703	25,455,703
<u>Derivatives</u>		
Foreign currency forward exchange contracts-payable, net	(26,891)	(26,891)
Foreign currency options contracts, net	(81,182)	(81,182)
Interest rate swap contracts	-	(44,112)

The methods and assumptions used to measure the fair value of financial instruments are as follows:

The carrying amounts of cash and cash equivalents, receivables, refundable deposits, pledged time deposits, deferred charges, short-term bank loans, payables and other current liabilities approximate fair values because of short maturity of these instruments.

Marketable securities and long-term investments are measured based on quoted market prices for these instruments. If market prices are unavailable, fair values are measured based on carrying amount in net assets or other information.

The fair values of long-term bank loans due within a year approximate carrying amount as the long-term bank loans bear interest at variable rates. The fair values of the non-current portion of bank loans are determined based on the sum of the carrying value of the bank loans and accrued interest payable. The fair values of bonds payable are determined based on market price provided by bank.

The fair value of derivative financial instruments represents the estimated net receivable or payable amount if those contracts are terminated at the balance sheet date.

## 12. Other

- (1) L.G. Philips LCD. Co., Ltd. (LGP) filed suit for patent infringement against the Company. The suit alleges that certain TFT-LCD products currently utilized by the Company infringe patents registered by LGP in Taiwan and U.S. As of the date of this report, due to the nature of the litigation, the

Company cannot predict the ultimate outcome of the lawsuit. The Company believes that the suit will not have a significant impact on the Company's operations.

- (2) In 2004, the Company entered into accounts receivable factoring agreements in the amount of USD 26,646 thousand, without recourse, with China Trust Commercial bank. Under the agreement, the Company bear the risk arising from business dispute in connection with the receivable factored. As of December 31, 2004, USD22,649 thousand has been paid to the Company and the remaining USD3,997 thousand has been reserved for future business dispute. Accordingly, the Company derecognized USD22,649 thousand and reclassified USD3,997 thousand to other receivable. The Company also issued a promissory note in the amount of \$5,000,000 to the banks the security of future business dispute. Related information with respect to the promissory note is as follows:

<u>Bank</u>	<u>Credit line</u>	<u>Prepaid proceeds</u>	<u>The range of interest rate of prepayment</u>
Chinatrust Commercial Bank	<u>\$5,000,000</u>	<u>\$722,902</u>	2M Libor+40bps