

**CHUNGHWA PICTURE TUBES, LTD.**  
**Financial Statements**  
**For The Six-Month Periods Ended**  
**June 30, 2005 and 2006**  
**With**  
**Report of Independent Auditors**

## Report of Independent Auditors

To the Board of Directors  
Chunghwa Picture Tubes, Ltd.

We have audited the accompanying balance sheets of Chunghwa Picture Tubes, Ltd. (the "Company") as of June 30, 2006 and 2005, and the related statements of operations, changes in stockholders' equity and cash flows for the six-month periods ended June 30, 2006 and 2005. 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.

Except as discussed in the following paragraph, 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 ("ROC"). 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 provide a reasonable basis for our opinion.

As described in the Note 4(6) to the financial statements, the financial statements of the Company's long-term investments accounted for under the equity method were not audited. These investments aggregately amounted to \$26,108,367 thousand (12.51% of total assets) and \$25,224,440 thousand (12.68% of total assets) as of June 30, 2006 and 2005, respectively. Related investment loss recognized amounted to \$2,455,013 thousand (38.10% of loss before income tax and cumulative effect of changes in accounting principles) and \$53,413 thousand (0.72% of loss before income tax) for the six-month periods ended June 30, 2006 and 2005, respectively.

In our opinion, except for the effect of such adjustment, if any, as might have been made had we been able to obtain audited financial statements of the equity-basis investees as of and for the six-month periods ended June 30, 2006 and 2005, 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 June 30, 2006 and 2005, and the results of its operations and its cash flows for the six-month periods ended June 30, 2006 and 2005, in conformity with the "Guidelines Governing the Preparation of Financial Report by Securities Issuers" and accounting principles generally accepted in the Republic of China.

As described in Note 3 to the financial statements, effective from January 1, 2005, the Company adopted the ROC Statement of Financial Accounting Standards No. 35, "Accounting for Asset Impairment" to account for the impairment of its assets.

As described in Note 3 to the financial statements, effective from January 1, 2006, the Company adopted the ROC Statement of Financial Accounting Standards No. 34, "Accounting for Financial Instruments" and No. 36, "Disclosure and Presentation of Financial Instruments" to account for its financial instruments.

We have also reviewed the consolidated financial statement of Chunghwa Picture Tubes, Ltd. as of and for the six-month periods then ended June 30, 2005 and 2006 and an unqualified review report with explanatory language were issued.

Ernst & Young  
Taipei, Taiwan  
Republic of China  
August 21, 2006

### 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  
JUNE 30, 2005 AND 2006  
(Expressed in Thousands of New Taiwan Dollars)

ASSETS	JUNE 30	
	2005	2006
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents (Notes 2, 4 and 11)	\$20,026,486	\$5,382,664
Financial assets at fair value through profit or loss (Notes 2, 4 and 11)	917,915	46,839
Derivative financial assets for hedging - current (Notes 2, 4 and 11)	-	3,185
Notes receivable, net (Notes 2, 4 and 10)	54,263	2,022
Accounts receivable, net (Notes 2, 4 and 11)		
Trade	10,872,583	15,049,166
Others	465,748	591,048
Due from affiliates, net (Notes 2, 4, 5 and 11)		
Trade	2,765,058	2,407,609
Others	2,008,407	915,961
Inventories, net (Notes 2 and 4)	6,515,125	13,191,136
Prepayments	179,830	153,421
Pledged time deposits-current (Notes 6 and 10)	1,054,327	356,149
Total current assets	<u>44,859,742</u>	<u>38,099,200</u>
<b>INVESTMENTS: (Notes 2, 4 and 10)</b>		
Investment in associated companies and subsidiaries	25,224,440	26,108,367
Available-for-sale financial assets	796,879	1,059,093
Derivative financial assets for hedging-non-current	-	19,906
Total investment	<u>26,021,319</u>	<u>27,187,366</u>
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
(Notes 2, 4, 5 and 6)		
Land	3,088,717	3,354,554
Buildings	10,650,390	23,464,912
Machinery and equipment	70,951,674	98,827,753
Transportation equipment	319,598	319,870
Furniture and fixtures	567,794	720,155
Miscellaneous equipment	12,069,768	25,738,967
Revaluation increment	57,192	57,192
Total	<u>97,705,133</u>	<u>152,483,403</u>
Less: Accumulated depreciation	(35,407,784)	(53,433,047)
Add: Prepayments on equipments and construction in progress	61,128,152	37,513,988
Property, plant and equipment, net	<u>123,425,501</u>	<u>136,564,344</u>
<b>INTANGIBLE ASSETS:</b>		
Deferred pension cost (Notes 2 and 4)	<u>202,475</u>	<u>168,729</u>
<b>OTHER ASSETS:</b>		
Refundable deposits	34,753	68,143
Deferred charges (Notes 2 and 4)	2,669,503	3,596,694
Prepayment for purchases-non-current (Note 4)	1,503,723	3,060,028
Others, net (Notes 2 and 4)	279,050	35,755
Total other assets	<u>4,487,029</u>	<u>6,760,620</u>
<b>TOTAL ASSETS</b>	<u><u>\$198,996,066</u></u>	<u><u>\$208,780,259</u></u>

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

CHUNGHWA PICTURE TUBES, LTD.  
BALANCE SHEETS (CONTINUED)  
JUNE 30, 2005 AND 2006  
(Expressed in Thousands of New Taiwan Dollars)

LIABILITIES AND STOCKHOLDERS' EQUITY	JUNE 30	
	2005	2006
<b>CURRENT LIABILITIES:</b>		
Short-term bank loans (Notes 4 and 11)	\$1,926,090	\$4,409,459
Financial liabilities at fair value through profit or loss (Notes 2, 4 and 11)	500,094	58,864
Accounts payable (Note 11)		
Trade	8,358,265	10,702,907
Others	5,782,309	7,054,378
Due to affiliates (Notes 5 and 11)		
Trade	7,206,041	11,116,161
Others	1,282,131	1,727,237
Cash dividend payable (Notes 4 and 11)	4,086,049	-
Accrued expenses (Note 11)	1,857,479	3,257,590
Current portion of bonds payable (Notes 2, 4 and 11)	6,537,372	7,213,014
Current portion of long-term bank loans (Notes 4, 5, 6 and 11)	6,322,660	11,492,438
Other current liabilities (Notes 5 and 11)	167,995	243,550
Total current liabilities	<u>44,026,485</u>	<u>57,275,598</u>
<b>LONG-TERM DEBT:</b>		
Derivative financial liabilities for hedging - non - current (Notes 2, 4 and 11)	-	305,438
Bonds payable, net of current portion (Notes 2, 4 and 11)	6,854,807	-
Long-term bank loans, net of current portion (Notes 4, 5, 6 and 11)	51,949,510	60,070,961
Total long-term debt	<u>58,804,317</u>	<u>60,376,399</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)	1,623,740	1,676,267
Deferred tax liabilities, net (Notes 2 and 4)	437,988	893,535
Deferred credits (Notes 2, 4 and 5)	1,154,819	1,125,794
Total other liabilities	<u>3,216,547</u>	<u>3,695,596</u>
Total Liabilities	<u>106,074,142</u>	<u>121,374,386</u>
<b>STOCKHOLDERS' EQUITY:</b>		
Capital		
Common stock (Note 4)	76,103,845	82,126,048
Stock dividends for distribution	6,549,453	-
Capital reserve (Notes 2 and 4)		
Additional paid-in capital	12,372,587	9,645,455
Premium on convertible bonds payable	4,054,878	4,028,677
Treasury stock	744	-
Long-term investments	10,482	10,482
Retained earnings (Notes 2 and 4)		
Legal reserve	1,125,768	-
Special reserve	3,125,641	-
Accumulated deficits	(6,544,515)	(7,248,490)
Other items in stockholders' equity : (Notes 2 and 4)		
Cumulative translation adjustment	(780,855)	273,034
Excess of additional pension liability over unrecognized prior service cost	(159,081)	(133,849)
Unrealized loss on available - for - sale financial assets	(2,540,117)	(1,696,358)
Unrealized loss on cash flow hedge	-	(241,963)
Unrealized incremental value from revaluation	642,837	642,837
Treasury stock (Notes 2 and 4)	<u>(1,039,743)</u>	<u>-</u>
Total Stockholders' Equity	<u>92,921,924</u>	<u>87,405,873</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<u>\$198,996,066</u>	<u>\$208,780,259</u>

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

CHUNGHWA PICTURE TUBES, LTD.  
STATEMENTS OF OPERATIONS  
FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2005 and 2006  
(Expressed in Thousands of New Taiwan Dollars Except Per Share Information)

	For the Six-Month Periods Ended June 30	
	2005	2006
OPERATING REVENUES:		
NET SALES (Notes 2, 4 and 5)	\$30,054,206	\$46,227,450
OPERATING COSTS:		
COST OF GOODS SOLD (Notes 4 and 5)	(34,253,297)	(44,854,735)
GROSS PROFIT (LOSS) INCLUDED UNREALIZED INTERCOMPANY PROFIT	(4,199,091)	1,372,715
REALIZED INTERCOMPANY PROFIT, NET (Notes 2, 4 and 5)	117,729	53,098
UNREALIZED INTERCOMPANY PROFIT, NET (Notes 2, 4 and 5)	-	(9,577)
NET GROSS PROFIT (LOSS)	(4,081,362)	1,416,236
OPERATING EXPENSES: (Notes 4 and 5)		
Selling and marketing	(402,350)	(589,076)
General and administrative	(586,310)	(796,211)
Research and development	(1,748,148)	(1,759,348)
Total	(2,736,808)	(3,144,635)
OPERATING LOSS	(6,818,170)	(1,728,399)
NON-OPERATING INCOME:		
Interest income	39,611	46,432
Gain on financial assets at fair value through profit or loss (Notes 2, 4 and 11)	46,415	-
Gain on financial liabilities at fair value through profit or loss (Notes 2, 4 and 11)	-	755,802
Gain on disposal of property, plant and equipment, net (Notes 2 and 5)	1,872	-
Gain on foreign currency exchange, net (Note 2)	143,318	-
Others (Note 5)	248,516	148,780
Total	479,732	951,014
NON-OPERATING EXPENSES:		
Interest expenses (Notes 2 and 4)	(584,430)	(2,203,422)
Investment loss recognized by using equity method, net (Notes 2 and 4)	(53,413)	(2,455,013)
Loss on disposal of property, plant and equipment, net (Note 2)	-	(1,397)
Loss on financial liabilities at fair value through profit or loss, net (Notes 2, 4 and 11)	(410,991)	-
Loss on financial assets at fair value through profit or loss, net (Notes 2, 4 and 11)	-	(3,766)
Loss on foreign currency exchange, net (Note 2)	-	(195,725)
Loss on decline in market value and obsolescence of inventory, net (Notes 2 and 4)	(7,000)	(806,000)
Others	(2,307)	(394)
Total	(1,058,141)	(5,665,717)
LOSS BEFORE INCOME TAX & CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	(7,396,579)	(6,443,102)
INCOME TAX EXPENSES (Notes 2 and 4)	-	-
CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES, NET OF TAX	-	(805,387)
NET LOSS	\$(7,396,579)	\$(7,248,489)
LOSS PER SHARE (Notes 2 and 4)		
BASIC (in dollars)		
BEFORE CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	\$(1.00)	\$(0.78)
CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	-	(0.10)
NET LOSS	\$(1.00)	\$(0.88)
DILUTED (in dollars)		
BEFORE CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	\$(1.00)	\$(0.78)
CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	-	(0.10)
NET LOSS	\$(1.00)	\$(0.88)

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

CHUNGHWA PICTURE TUBES, LTD.  
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2005 and 2006  
(Expressed in Thousands of New Taiwan Dollars)

	CAPITAL		CAPITAL RESERVE				RETAINED EARNINGS				OTHER ITEMS IN STOCKHOLDERS' EQUITY					TOTAL
	COMMON STOCK	STOCK DIVIDENDS FOR DISTRIBUTION	ADDITIONAL PAID-IN CAPITAL	CONVERTIBLE BONDS PAYABLE	TREASURY STOCK	LONG-TERM INVESTMENTS	LEGAL RESERVE	SPECIAL RESERVE	ACCUMULATED DEFICITS	CUMULATIVE TRANSLATION ADJUSTMENT	EXCESS OF LIABILITY OVER UNRECOGNIZED PRIOR SERVICE COST	UNREALIZED LOSSES AVAILABLE-FOR-SALE-FINANCIAL ASSETS	UNREALIZED LOSS ON CASH FLOW HEDGE	UNREALIZED INCREMENTAL VALUE FROM REVALUATION	TREASURY STOCK	
Balance at January 1, 2005	\$68,564,159	\$-	\$14,615,928	\$3,927,694	\$744	\$10,243	\$93,996	\$845,962	\$10,317,715	\$(566,572)	\$(160,758)	\$(2,398,311)	\$-	\$565,016	\$(1,039,743)	\$94,776,073
Distribution of earnings in 2004 (Note 4)																
Legal reserve							1,031,772		(1,031,772)							-
Special reserve								2,279,679	(2,279,679)							-
Cash dividend									(4,086,049)							(4,086,049)
Employees' dividend-cash									(280,246)							(280,246)
Stock dividend		1,362,016							(1,362,016)							-
Employees' dividend -stock		420,380							(420,380)							-
Transfer of capital reserves to common stock		4,767,057	(4,767,057)													-
Net loss for the six-month period ended June 30, 2005									(7,396,579)							(7,396,579)
Convertible bonds converted into common stock (Note 4)	338,266			127,184												465,450
Capital increase by cash in premium (Note 4)	7,000,000		2,483,215													9,483,215
Adjustments of undistributed earnings arising from changes in ownership percentage in investee accounted for under the equity method									(5,509)							(5,509)
Unrealized loss on available-for-sale financial assets (Note 2)												(120,819)				(120,819)
Proportional adjustments on unrealized loss on available-for-sale financial asset accounted for under the equity method												(20,987)				(20,987)
Cumulative translation adjustment, net of related tax effect (Note 2)										(214,283)						(214,283)
Proportional adjustments on incremental value from revaluation in investee accounted for under the equity method																-
Proportional adjustments on shares issued for conversion of convertible bonds in investee accounted for under the equity method															77,821	77,821
Proportional adjustments on excess of additional pension liabilities over unrecognized prior service cost in investee accounted for under the equity method																-
Issuance of common stock-exercise of stock option (Notes 2 and 4)	201,420		40,501			239						1,677				1,916
Balance at June 30, 2005	\$76,103,845	\$6,549,453	\$12,372,587	\$4,054,878	\$744	\$10,482	\$1,125,768	\$3,125,641	\$(6,544,515)	\$(780,855)	\$(159,081)	\$(2,540,117)	\$-	\$642,837	\$(1,039,743)	\$92,921,924
Balance at January 1, 2006	\$82,126,048	\$-	\$12,293,011	\$4,028,677	\$-	\$10,482	\$1,125,768	\$3,125,641	\$(6,898,965)	\$317,584	\$(133,849)	\$(2,711,230)	\$-	\$642,837	\$-	\$93,926,004
Effect of initial adoption of the SFAS No.34												27,560	(251,858)			(224,298)
Effect of initial adoption of the SFAS No.34 accounted for under the equity method												34,143	(34,124)			19
Offsetting accumulated deficits in 2005 (Note 4)																-
Transfer capital reserve and retained earning used for offsetting accumulated deficits			(2,647,556)				(1,125,768)	(3,125,641)	6,898,965							-
Net loss for the six-month period ended June 30, 2006									(7,248,489)							(7,248,489)
Cumulative translation adjustment, net of related tax effect (Notes 2 and 4)										(44,550)						(44,550)
Adjustments of undistributed earnings arising from changes in ownership percentage in investee accounted for under the equity method									(1)							(1)
Proportional adjustments on unrealized loss on available-for-sale financial accounted under the equity method (Note 4)												618,511				618,511
Unrealized loss on available - for - sale financial assets												334,658				334,658
Unrealized loss on cash flow hedge													40,098			40,098
Proportional adjustments on unrealized loss on cash flow hedge accounted for under the equity method (Note 4)													3,921			3,921
Balance at June 30, 2006	\$82,126,048	\$-	\$9,645,455	\$4,028,677	\$-	\$10,482	\$-	\$-	\$(7,248,490)	\$273,034	\$(133,849)	\$(1,696,358)	\$(241,963)	\$642,837	\$-	\$87,405,873

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

CHUNGHWA PICTURE TUBES, LTD.  
STATEMENTS OF CASH FLOWS  
FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2005 and 2006  
(Expressed in Thousands of New Taiwan Dollars)

	For the Six-Month Periods Ended June 30	
	2005	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$(7,396,579)	\$(7,248,489)
Adjustments to reconcile net loss to net cash used in operating activities:		
Exchange rate effect (Note 2)	(9,975)	(124,410)
Depreciation (Notes 2 and 4)	6,016,974	9,809,667
Amortization (Notes 2 and 4)	406,976	581,053
Investment loss recognized by using equity method, net (Notes 2 and 4)	53,413	2,455,013
Cash dividend received from investee accounted for under the equity method (Notes 2 and 4)	1,016,940	54,000
Unrealized (gain) loss on foreign currency exchange of long-term debt	28,397	(302,461)
Forfeited interest on convertible bonds	5	-
Transfer of property, plant and equipment to expense	97,060	120,269
(Gain) loss on disposal of property, plant and equipment, net (Notes 2 and 4)	(1,872)	1,397
Loss on decline in market value and obsolescence of inventory, net (Notes 2 and 4)	7,000	806,000
Amortization of premium on bonds payable	(49,403)	-
Amortization of discount on commercial paper payable - long - term bank loans	-	37,192
Change in operating assets and liabilities:		
(Increase) decrease in notes receivable	(4,928)	1,872
(Increase) decrease in accounts receivable-trade	(2,030,416)	868,748
(Increase) decrease in due from affiliates-trade	699,013	(435,945)
(Increase) decrease in accounts receivable-others	213,422	(174,691)
Increase in inventories	(345,590)	(4,179,807)
Increase in prepayments	(105,950)	(64,901)
Increase in prepayment for purchases-non-current	(1,503,723)	(777,517)
Decrease in deferred tax assests	27,444	-
Increase (decrease)in accounts payable	354,692	(1,867,920)
Decrease in due to affiliates-trade	(767,967)	(403,137)
Increase (decrease) in accrued expenses	(298,895)	533,579
Decrease in accounts payable-others	(4,394,213)	(1,652,018)
Decrease in deferred credits	(117,729)	(43,521)
Increase in accrued pension liabilities	168,103	135,195
Payments for pension	(92,854)	(170,151)
Increase in compensation interest payable	108,337	88,999
Increase in income tax payable	-	(55,959)
Decrease in deferred tax liabilities	(27,444)	-
Net cash used in operating activities	<u>(7,949,762)</u>	<u>(2,007,943)</u>

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

CHUNGHWA PICTURE TUBES, LTD.  
STATEMENTS OF CASH FLOWS (CONTINUED)  
FOR THE SIX-MONTH PERIODS ENDED JUNE 30, 2005 and 2006  
(Expressed in Thousands of New Taiwan Dollars)

	For the Six-Month Periods Ended June 30	
	2005	2006
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Decrease in pledged time deposits	986,415	36,201
Increase in due from affiliates-others	(24,009)	(138,192)
Increase in associated companies and subsidiaries	-	(300,000)
Decrease in financial assets at fair value through profit or loss	197,584	316,161
Increase (decrease) in financial liabilities at fair value through profit or loss	473,203	(207,504)
Increase in deferred charges	(511,153)	(817,723)
Proceeds from disposal of property, plant and equipment	11,932	343,907
Additions to property, plant and equipment	(33,017,199)	(7,680,762)
(Increase) decrease in refundable deposits	916	(46,511)
Net cash used in investing activities	<u>(31,882,311)</u>	<u>(8,494,423)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Increase (decrease) in short-term bank loans	(5,972,780)	1,281,021
Increase (decrease) in due to affiliates-others	(349,690)	1,092,261
Increase in long-term bank loans	36,774,246	4,700,000
Repayments of long-term bank loans	(4,105,696)	(5,131,373)
Increase (decrease) in other current liabilities	(49,949)	83,473
Capital increase by cash in premium	9,483,215	-
Employees' dividends-cash	(280,246)	-
Proceeds from exercise of stock options	241,921	-
Net cash provided by financing activities	<u>35,741,021</u>	<u>2,025,382</u>
EXCHANGE RATE EFFECT	9,975	124,410
DECREASE IN CASH AND CASH EQUIVALENTS	(4,081,077)	(8,352,574)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	24,107,563	13,735,238
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>\$20,026,486</u>	<u>\$5,382,664</u>
<b>SUPPLEMENT DISCLOSURES OF CASH FLOWS INFORMATION:</b>		
Interest expenses paid (excluding amount capitalized)	\$540,531	\$2,275,684
Income tax paid	<u>\$2,774</u>	<u>\$59,046</u>
<b>INVESTING AND FINANCING ACTIVITIES NOT AFFECTING CASH FLOWS:</b>		
Current portion of long-term debt (Note 4)	<u>\$12,860,032</u>	<u>\$18,705,452</u>
Other assets transfer to property, plant and equipment	<u>\$27,811</u>	<u>\$-</u>
Unpaid declared dividend	<u>\$4,086,049</u>	<u>\$-</u>
Unrealized loss or gain on derivative financial assets or liabilities for hedging	<u>\$-</u>	<u>\$211,760</u>

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

CHUNGHWA PICTURE TUBES, LTD.  
NOTES TO FINANCIAL STATEMENTS

As of and for the Six-Month Periods Ended June 30, 2005 and 2006

(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 thin film transistor liquid crystal displays ("TFT-LCD"), color filter ("CF") and related materials, parts and components.

As of June 30, 2005 and 2006, the Company had 8,517 and 8,601 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").

*Classification of Current and Noncurrent Assets and Liabilities*

Current assets are those expected to be converted to cash, sold or consumed within one year from the balance sheet date. Current liabilities are obligations expected to be due within one year from the balance sheet date. Assets and liabilities that are not classified as current are noncurrent assets and liabilities.

*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. Monetary assets and liabilities denominated in foreign currencies are translated into NT dollars using the exchange rates in effect at the balance sheet date. The resulting foreign exchange gains or losses from settlement of such transactions or translations of monetary assets and liabilities are recorded in statements of operations.

Effective from January 1, 2006, translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognized in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available-for-sale are included in the fair value reserve in equity. Non-monetary financial assets carried at cost shall be retranslated using a historical rate.

The assets and liabilities of the foreign subsidiaries are translated into NT dollars, with the local currency of each foreign subsidiary as its functional currency, at exchange rates in effect at the balance sheet date. Revenue and expense accounts are translated using a weighted average exchange rate for the relevant period. Equity accounts are translated using a historical exchange rate, dividend is using the rate at the date declaration. Difference in translation is recorded, net of tax effect, as a component of stockholders' equity.

#### 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.

#### Financial Assets and Liabilities

Effective from January 1, 2006, the Company adopted SFAS No.34 "Accounting for Financial Instruments" and No.36 "Disclosure and Presentation of Financial Instruments" to classify its financial assets in the following categories : financial assets and liabilities at fair value through profit or loss; available-for-sale financial assets and financial assets carried at cost. When financial assets are recognized initially, they are measured at fair value, plus transaction costs for all financial assets not carried at fair value through profit or loss.

##### (1) Financial assets or liabilities at fair value through profit or loss

This category has two sub-categories: financial assets held for trading and those designated at fair value through profit or loss at inception.

Financial assets or financial liabilities at fair value through profit or loss are subsequently measured at fair value and changes in fair value are recognized in profit and loss.

##### (2) Available-for-sale financial assets

Investments designated as available-for-sale are reported at fair value, with unrealized gains and losses, net of tax, recorded in other items in stockholders' equity until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the statement of operations.

The fair value is determined by reference to the close price at the balance sheet date for listed equity securities, or the net asset value per unit for open-end mutual funds.

##### (3) Financial assets carried at cost

Investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are carried at original cost, such as non-publicly traded stocks and mutual funds.

All regular way purchases and sales of financial assets are recognized on the trade date.

#### Derecognition of Financial Assets and Liabilities

##### Financial assets

A financial asset is derecognized in which the transfer or surrender control over those financial assets, and shall be accounted for as a sale.

If a transfer of financial assets in exchange for cash other consideration (other than beneficial interests in the transferred assets) does not meet the criteria for a sale, the Company accounted for the transfer as a borrowing with collateral.

##### Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged, cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in profit or loss.

Certain accounting policies which were adopted prior to December 31, 2005 of financial assets and liabilities are summarized, please see footnote 3.

#### 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 surrender 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.

#### Investments in Associated Companies and Subsidiaries

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. Effective from January 1, 2006, investment premiums, representing goodwill, are no longer being amortized; while investment discounts continue to be amortized over the remaining periods. An impairment loss shall be recognized if the carrying amount of long-term investment using equity

method may not be recoverable. Cash dividends received or receivable from equity investees are recorded as a reduction in investment.

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 against 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.

Stock dividends received are not treated as income. Instead, the number of share held in increased.

Certain accounting policies which were adopted prior to December 31, 2005 of long-term investments are summarized, please see footnote 3.

#### Property, Plant and Equipment

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.

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.

#### Impairment

##### Financial assets

##### Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in profit or loss, is transferred from equity to the statement of operations. Reversals in respect of equity instruments classified as available-for-sale are not recognized in profit. Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value

of the instrument can be objectively related to an event occurring after the impairment loss was recognized in profit or loss.

#### Financial assets carried at cost

If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

#### Non-financial assets

Pursuant to SFAS No. 35, the Company assesses indicators for impairment for all its assets within the scope of SFAS No. 35 at each balance sheet date. If impairment indicators exist, the Company shall then compare the carrying amount with the recoverable amount of the assets or the cash-generating unit ("CGU") and write down the carrying amount to the recoverable amount where applicable. Recoverable amount is defined as the higher of fair values less costs to sell and the values in use.

For previously recognized losses, the Company shall assess, at each balance sheet date, whether there is any indication that the impairment loss may no longer exist or may have decreased. If there is any such indication, the Company has to recalculate the recoverable amount of the asset. If the recoverable amount increases as a result of the increase in the estimated service potential of the assets, the Company shall reverse the impairment loss to the extent that the carrying amount after the reversal would not exceed the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the assets in prior periods.

Impairment loss /reversal is classified as non-operating losses/income.

#### Deferred Charges

Deferred charges, including technology license fees, computer software, shadow mask, bond issuance costs (the issue date of Bonds is prior to December 31, 2005), 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.
- Shadow mask and computer software – 2~5 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 years

#### Convertible Bonds

Prior to December 31, 2005, 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 is 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.

For convertible bonds issued after January 1, 2006, the components of compound financial instrument are separated by the Company on initial recognition. The liability component is measured first, and the difference between the proceeds of the bond issued and the fair value of the liability is accounted for as the equity component. The present value of the liability component is calculated using the market interest rate for similar debt without conversion options. The liability component is subsequently measured at amortized cost, and changes in fair value of the equity component are not recognized.

#### Pension and Employee Retirement Plans

For employees under defined benefit pension plan, the net pension cost is computed based on an actuarial valuation in accordance with the provision of SFAS 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.

For employees under defined contribution pension plan, the net pension cost is recorded based on the actual contribution made to the employees' individual pension account.

#### 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 proceeds from the disposal of treasury stock exceed or less than the carrying value of treasury stock, the excess is credited to capital reserve from treasury stock transaction and the loss is charged against capital reserve from treasury stock transaction of the same nature. If the loss exceeds the capital reserve, the excess is charged against retained earnings.

If treasury stock is retired, capital stock and additional paid-in capital are proportionately adjusted. If the carrying amount of treasury stock exceeds the total balance of par value and additional paid-in capital, the excess is debited to capital reserve from treasury stock. If the balance of capital reserve from treasury stock is not sufficient to absorb such deficiency, the remaining is recorded as a reduction of retained earnings. If the carrying amount of treasury stock is less than the total of par value and additional paid-in capital, the deficiency is credited to capital reserve from treasury stock.

Treasury stock is shown as a deduction to stockholders' equity.

#### Stock Compensation

In accordance with interpretations of ROC GAAP, the Company accounted for employee stock options using the intrinsic value method.

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.

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

According to the implemented Alternative Minimum Tax Act (AMT) which became effective from January 1, 2006, the Company will be subject to a 10% AMT if the income tax payable determined pursuant to the income tax law of R.O.C. is below the minimum amount prescribed under the AMT Act.

#### Earnings Per Common Share

The Company presents basic earnings per share and diluted earnings per share information. 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 and Allowance for Sales Discounts

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.

#### Accounting for Derivative Financial Instruments and Hedging Activities

The Company recognized derivative as either assets (when the fair value is positive) or liabilities (when the fair value is negative ) on the balance sheets and measures those instruments at fair value. Contracts that are effective at meeting the risk reduction and correlation criteria are recorded using hedge accounting.

The ineffective portion of derivatives financial assets and liabilities for hedging is also categorized as held for trading and the gain or loss is reported in earning immediately.

Hedges which meet the strict criteria for hedge accounting are accounted for as follows:

##### Fair value hedges

Fair value hedges are hedges of the Company's exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. For fair value hedges, the carrying amount of the hedged item is adjusted for gains and losses attributable to the risk being hedged, the derivative is remeasured at fair value and gains and losses from both are taken to profit or loss.

##### Cash flow hedges

Cash flow hedges are a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction and could affect profit or loss. The effective portion of the gain or loss on the hedging instrument is recognized directly in equity, while the ineffective portion is recognized in profit or loss immediately.

Amounts taken to equity are transferred to the statement of operations when the hedged transaction affects profit or loss, such as when hedged financial income or financial expense is recognized or when a forecast sale or purchase occurs. Where the hedged item is the cost of a non-financial asset or liability, the amounts taken to equity are transferred to the initial carrying amount of the non-financial asset or liability.

If the forecast transaction is no longer expected to occur, amounts previously recognized in equity are transferred to profit or loss. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, amounts previously recognized in equity remain in equity until the forecast transaction occurs. If the related transaction is not expected to occur, the amount is taken to profit or loss.

Instruments that do not meet the criteria for hedge accounting or contracts for which the Company has not elected hedge accounting are marked to fair value with unrealized gains or losses reported in earnings during the period of change.

Certain accounting policies which were adopted prior to December 31, 2005 of derivative financial instruments are summarized, please see footnote 3.

#### 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.

### **3. ACCOUNTING CHANGES**

- (1) Effective from January 1, 2005, the Company adopted SFAS No.35 “Accounting for Assets Impairment ” (SFAS No.35). The adoption of ROC SFAS No.35 did not have a material effect on the Company’s financial statements.
- (2) Effective from January 1, 2006, the Company adopted the No. 34 “Accounting for Financial Instruments” (SFAS No. 34) and No. 36 “Disclosure and Presentation for Financial Instruments” (SFAS No.36).

- a. Effect of adopting the SFAS No.34 and No.36:

The Company had properly categorized its financial assets and liabilities upon initial adoption of the SFAS No.34 and 36. The adjustments made to the carrying amounts of the financial instruments categorized as financial assets or financial liabilities at fair value through profit or loss were included in the cumulative effect of changes in accounting principles; on the other hand, the adjustments made to the carrying amounts of those categorized as available-for-sale financial assets and derivative financial instruments for cash flow hedge were recognized as adjustments to shareholders’ equity.



contracts payable, net		through profit or loss	
Unrealized losses on long-term investments	(2,540,117)	Unrealized losses on available-for-sale financial assets	(2,540,117)

For the six-month periods ended June 30, 2005

Before reclassification		After reclassification	
The account of income statement	Amount	The account of income statement	Amount
Loss on foreign currency exchange, net	\$(267,673)	Net loss on financial liabilities at fair value through profit or loss	\$(410,991)
Gain on foreign currency exchange	-	Gain on foreign currency exchange, net	143,318
Gain on disposal of marketable securities, net	46,415	Net gain on financial assets at fair value through profit or loss	46,415

(Note) Effective the fourth quarter ended December 31, 2004, in accordance with of interpretations of ROC GAAP, "The accounting treatment of foreign currency option contracts before the effectiveness of SFAS No.34", outstanding put options at balance sheet date shall be accounted for at their fair values and any differences between carrying amount and fair value were included in the income of operations.

Certain accounting policies prior to the adoption of the released SFAS No.34 and SFAS No.36 are summarized as follows:

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.

Long-term investment accounted for under the cost method

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, a permanent impairment in the value of an investee is recognized in the statements of operations. Cash dividends received from an investee accounted for under the cost method are recorded as non-operating income.

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 premiums or discounts of the forward exchange contract are amortized over the life of the contract. Gains or losses on these contracts resulting from actual settlement are charged against 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 differences between the spot rate at the date of inception and the spot rate at balance sheet date are 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.

Effective from the fourth quarter ended December 31, 2004, in accordance with interpretations of ROC GAAP, the carrying amount of outstanding call or put options at the balance sheet date is accounted for at their fair value using the rate of exchange prevailing at the balance sheet date and any differences between carrying amount and fair values were 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.

#### 4. DETAILS OF SIGNIFICANT ACCOUNTS BALANCES

##### (1) Cash and cash equivalents

	<u>June 30</u>	
	<u>2005</u>	<u>2006</u>
Cash:		
Cash on hand	\$3,731	\$1,594
Cash in banks-checking and savings account	18,464,341	5,381,070
Cash in banks-time deposits	774,615	-
Cash equivalents:		
Securities purchased under agreements to resell	783,799	-
Total	<u>\$20,026,486</u>	<u>\$5,382,664</u>

##### (2) Financial assets and liabilities at fair value through profit or loss-for trading purpose

	<u>June 30</u>	
	<u>2005</u>	<u>2006</u>
<u>Assets</u>		
Listed equity securities	\$215,890	\$-
Open-end mutual funds	702,025	41,673
Foreign currency forward exchange contracts	-	5,166
Total	<u>\$917,915</u>	<u>\$46,839</u>

##### Liabilities

Foreign currency option contacts	\$451,633	\$41,568
Foreign currency forward exchange contracts	48,461	17,296
Total	<u>\$500,094</u>	<u>\$58,864</u>

Detailed information of the derivative financial instruments above refers to Note 11.

(3) Derivative financial assets and liabilities for hedge

	June 30	
	2005	2006
<u>Assets</u>		
Foreign currency forward exchange contracts	\$-	\$23,091
Less : non-current portion	-	(19,906)
Foreign currency forward exchange contracts - current	<u>\$-</u>	<u>\$3,185</u>
<u>Liabilities</u>		
Interest rate swap contract – non - current	<u>\$-</u>	<u>\$305,438</u>

Detailed information of the derivative financial instruments above refers to Note 11.

(4) Receivable, net

	June 30	
	2005	2006
Notes receivable	\$54,763	\$2,040
Less: Allowance for doubtful accounts	(500)	(18)
Net	<u>\$54,263</u>	<u>\$2,022</u>
Accounts receivable-trade	\$11,251,115	\$15,522,098
Less: Allowance for doubtful accounts	(378,532)	(472,932)
Net	<u>\$10,872,583</u>	<u>\$15,049,166</u>
Due from affiliates-trade	\$2,791,058	\$2,452,609
Less: Allowance for doubtful accounts	(26,000)	(45,000)
Net	<u>\$2,765,058</u>	<u>\$2,407,609</u>

The Company entered into accounts receivable factoring agreements, without recourse, with China Trust Commercial Bank. Related information with respect to these agreements is as follows:

	June 30	
	2005	2006
Prepaid proceeds from factor	\$1,175,825	\$2,639,427
Due from factor (Note 1)	207,499	465,781
Amounts derecognized of accounts receivable	<u>\$1,383,324</u>	<u>\$3,105,208</u>
The range of interest rate of prepaid proceeds	<u>3.67%-3.88%</u>	<u>4.77%-6.16%</u>

Credit line	<u>\$5,000,000</u>	<u>\$5,400,000</u>
Promissory note (Note 2)	<u>\$5,000,000</u>	<u>\$1,240,000</u>

Note 1: The amount of due from factor was classified as “accounts receivable – others”.

Note 2: The promissory note was issued as the security of future commercial dispute.

(5) Inventories, net

	June 30	
	2005	2006
Raw materials and supplies	\$2,836,665	\$3,292,947
Work in process	2,044,216	2,636,898
Finished goods	1,847,551	8,245,291
Raw materials in transit	84,693	-
Total	<u>6,813,125</u>	<u>14,175,136</u>
Less: Allowance for decline in market value and obsolescence	<u>(298,000)</u>	<u>(984,000)</u>
Net	<u>\$6,515,125</u>	<u>\$13,191,136</u>
Insurance coverage	<u>\$5,768,000</u>	<u>\$8,257,355</u>

(6) Investment in associated companies and subsidiaries

	June 30			
	2005		2006	
Investee	Amount	Percentage of ownership or voting rights (%)	Amount	Percentage of ownership or voting rights (%)
<u>Unlisted Company</u>				
Chunghwa P.T. (Bermuda) Ltd.	\$23,154,988	100.00	\$23,795,652	100.00
Chunghwa P.T.(Labuan)Ltd.	678,606	41.03	531,977	41.03
Shang Chih Investment Co., Ltd.	40,684	25.00	53,682	25.00
Grand Cathay International Asset Management Co., Ltd (Formerly Known as Grand Cathay Optronics Co., Ltd.)	20,000	100.00	316,062	100.00
Toppan Chunghwa Electronics Co., Ltd.	<u>846,753</u>	30.00	<u>899,523</u>	30.00
Subtotal	24,741,031		25,596,896	
<u>Listed Company</u>				
Forward Electronics Co., Ltd.	<u>483,409</u>	22.78	<u>511,471</u>	22.49
Total	<u>25,224,440</u>		<u>26,108,367</u>	

- A. Grand Cathay International Asset Management Co., Ltd., has invested Sintronic Technology Inc., a company based in Taiwan which manufactured cold cathode fluorescent lamps (“CCFL”), in 2006 and obtained a 22% ownership.
- B. On November 14, 2005, the Board of Directors of the Company resolved to invest Xiamen Overseas Chinese Electronic Co., Ltd. via Chunghwa Picture Tubes (Wujiang) Ltd. (“CPTW”), a subsidiary of Chunghwa P.T. (Bermuda) Ltd. Hence, CPTW signed a share transfer agreement with the major shareholder of Xiamen Overseas Chinese Electronic Co., Ltd. on December 29, 2005. CPTW holds 32.64% shares, total amount of 311 million RMB. In August 2006, CPTW has received the approval letter from China Securities Regulatory Commission about the transfer agreement.
- C. The calculation of the carrying amounts of investments and the related investments income and loss accounted for under the equity method were based on unaudited financial statements for the six-month periods ended June 30, 2005 and 2006, respectively.

(7) Available-for-sale financial assets-non-current

Listed Company	June 30			
	2005		2006	
	Amount	Percentage of ownership or voting rights (%)	Amount	Percentage of ownership or voting rights (%)
Tatung Co., Ltd.	\$1,531,059	1.88	\$1,531,059	1.88
Allowance for unrealized loss on available-for-sale financial assets	(734,180)		(471,966)	
Total	<u>\$796,879</u>		<u>\$1,059,093</u>	

(8) 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 other items in stockholders’ equity. As of June 30, 2006, the revalued assets amounted to \$57,192.
- b. The insurance coverage over property, plant and equipment as of June 30, 2005 and 2006 amounted to \$141,312,681 and \$151,470,332, respectively.

- c. Interest expense (before deducting capitalized amounts of \$218,725 and \$0) for the six-month periods ended June 30, 2005 and 2006 was \$803,155 and \$2,203,422, respectively. The interest rates of capitalized interest for the six-month periods ended June 30, 2005 ranged from 0.41% to 6.10%.

(9) Deferred charges

	June 30	
	2005	2006
Technology license fees	\$986,350	\$1,133,803
Expense of syndication loan application	185,916	197,949
Bond issuance cost	157,503	39,504
Shadow mask	1,261,010	1,968,563
Others	78,724	256,875
Total	<u>\$2,669,503</u>	<u>\$3,596,694</u>

(10) Other assets-others

As of June 30, 2006, due to legal restriction of ROC, the Company had not been able to register as the legal owner of certain farmlands (0.347118 hectares; \$35,755 in the amount) 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 the title deeds.

(11) Short-term bank loans

Items	June 30	
	2005	2006
Unsecured loans	\$-	\$2,571,257
Usance L/C loan	1,926,090	1,838,202
Total	<u>\$1,926,090</u>	<u>\$4,409,459</u>
Interest rates	<u>0.41%~6.10%</u>	<u>0.45%~6.4485%</u>

(12) Bonds payable

	June 30	
	2005	2006
Convertible Bonds, issued in 2002 and due 2007 at 0.25%	\$1,158,061	\$-
Add: Compensation interest payable	105,635	-
Subtotal	<u>1,263,696</u>	<u>-</u>
Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2005	5,239,433	-
Add: Premium	34,243	-
Subtotal	<u>5,273,676</u>	<u>-</u>
Credit Enhanced Zero Coupon Convertible Bonds, issued in	6,755,354	6,930,210

2004 and due 2007		
Add: Compensation interest payable	99,453	282,804
Subtotal	6,854,807	7,213,014
Less: Current portion of bonds payable	(6,537,372)	(7,213,014)
Bonds payable, net of current portion	\$6,854,807	\$-

The significant terms of the Convertible Bonds are as follows:

	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\$143.75 million	US\$230 million	US\$213.5 million
· Issue price:	100%	103%	100%
· Duration:	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	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 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= 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= 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=US\$1)

· Conversion price and adjustment:	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.	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.	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. As of June 30, 2006, the conversion price was \$14.33 per share.
	<u>Convertible Bonds, issued in 2002 and due 2007 at 0.25%</u>	<u>Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2005</u>	<u>Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2007</u>
· 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 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.

	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.	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.	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.
	③ The bonds will mature on November 19, 2007 at 117.59% of their principal amount.	③ The bonds will mature on November 13, 2005 at 100% of their principal amount .	③ The bonds will mature on June 8, 2007 at 105.36% of their principal amount.
	<u>Convertible Bonds, issued in 2002 and due 2007 at 0.25%</u>	<u>Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2005</u>	<u>Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2007</u>
· Bondholders' option rights	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.	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.	None.
	② The bondholders may demand the Company to redeem the bonds if trading of the Company's shares is restricted on the TSE.	② The bondholders may demand the Company to redeem the bonds if trading of the Company's shares is restricted on the TSE.	① The bondholders may demand the Company to redeem the bonds if trading of the Company's shares is restricted on the TSE.
· Converting status	All bonds have been redemption on call options.	All bonds have been repayment on matured.	None.

During the credit enhanced zero coupon convertible bonds repayment period, the financial statements of the Company are required to maintain financial ratios such as current ratio, debt to equity ratio, time interest tangible assets ratio and other financial ratios with certain restrictions as prescribed in the agreements of bonds payable on annual consolidated basis and semi-annual consolidated basis.

As of December 31, 2005, the Company breached one or more of financial covenants. However, the Company had been obtained waivers for the six-month periods ended June 30, 2006.

(13) Long-term bank loans

	June 30	
	2005	2006
Unsecured syndicate loan	\$300,000	\$180,000
Secured loan	55,161,524	68,162,249
Secured-usance L/C loan	2,810,646	249,300
Subtotal	<u>58,272,170</u>	<u>68,591,549</u>
Commercial paper payable	-	3,000,000
Less: unamortized discount on commercial paper payable	-	(28,150)
Subtotal	<u>-</u>	<u>2,971,850</u>
Less: current portion	<u>(6,322,660)</u>	<u>(11,492,438)</u>
Net	<u>\$51,949,510</u>	<u>\$60,070,961</u>
Interest rates	<u>0.6488%~5.75%</u>	<u>0.45%~6.40%</u>

- a. Certain of the Company's syndicated loan agreements require the financial statements of 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 \$65 billion, respectively on annual consolidated basis and semi-annual unconsolidated basis.

As of December 31, 2005, the Company breach one or more of financial covenants which prescribed in the agreements of syndicate loan. The Bank of syndicate loan could prevent the Company from drawing down available funds under the Company's existing credit facilities. However, the Company believes that the Company will be able to obtain waivers after taking necessary action to remedy the violation.

- b. The long-term bank loans are to be repaid in NT\$ or foreign currency quarterly, or semiannually, or upon maturity before November 2012.
- c. The L/C facility and commercial paper payable is revolving within the credit limit of the syndicate loan. The Company classified the L/C loan and commercial paper payable as long-term bank loans because the term of the syndicate loan is over 12 months and the Company intends to refinance the syndicate loan.
- d. Certain 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 building and machinery and equipment (included prepayment on equipment).

(14) Accrued pension liability

- a. Effective from October 1996, as required by the ROC Labor Standard Law, the Company makes monthly contributions to a pension fund at pre-determined 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.
- b. The change in accrued pension liabilities of defined benefit pension plan for the six-month periods ended June 30, 2005 and 2006 are as follows:

	Six-month periods ended June 30	
	2005	2006
Balance, beginning of period	\$1,694,426	\$1,794,406
Net pension cost	168,103	46,286
Accrued payment	(92,854)	(80,028)
Balance, ending of period	1,769,675	1,760,664
Less: current portion	(145,935)	(84,397)
Long-term portion, net of current portion	<u>\$1,623,740</u>	<u>\$1,676,267</u>

- c. The major actuarial assumptions are as follows:

	June 30	
	2005	2006
Discount rate	3.00%	3.25%
Rate of increase in future compensation levels	1.00%	1.00%
Expected long-term rate of return on plan assets	3.00%	3.25%

Funding status and the reconciliation of certain pension accounts are not required to be disclosed in interim financial statements according to SFAS No. 23.

The Labor Pension Act of ROC (“the Act”), which adopts a defined contribution scheme, takes effect from July 1, 2005. In accordance with the Act, employees of the Company may elect to be subject to either the Act, and maintain their seniority before the enforcement of the Act, or the pension mechanism of the Labor Standards Law. For employees subject to the Act, the Company shall make monthly contributions to the employees’ individual pension accounts on a basis at 6% of the employees’ monthly wages.

(15) Deferred credits

- a. As of June 30, 2005 and 2006, the balances of deferred gain on transaction with equity investees were as follows:

	Transaction			Total
	Inventory	Fixed asset	Stock	
Balance at January 1, 2005	\$301,569	32,541	\$942,055	\$1,276,165

Increase in unrealized gain	-	-	-	-
Amortized and realized	(117,729)	(3,617)	-	(121,346)
Balance at June 30, 2005	<u>\$183,840</u>	<u>\$28,924</u>	<u>\$942,055</u>	<u>\$1,154,819</u>
Balance at January 1, 2006	\$204,383	\$25,308	\$942,055	\$1,171,746
Increase in unrealized gain	9,577	-	-	9,577
Amortized and realized	(53,098)	(2,431)	-	(55,529)
Balance at June 30, 2006	<u>\$160,862</u>	<u>\$22,877</u>	<u>\$942,055</u>	<u>\$1,125,794</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.

(16) Capital

- a. The authorized and issued capital of the Company at January 1, 2005 were \$99,700,000 and \$68,564,159 (including 600 million shares reserved for future exercise of stock options), divided into 9,970,000,000 shares and 6,856,415,892 shares, respectively, each at par value of \$10.
- b. On December 22, 2004, the Board of Directors resolved to increase the capital by issuing Global Depository Shares (GDSs) for up to 700,000,000 shares. On June 21, 2005, the Company completed the offering of 28,000,000 unit of GDSs (each unit representing 25 common shares) in Luxembourg stock Exchange.
- c. On May 18, 2005, the Company's stockholders resolved to increase the authorized capital to \$125,000,000 (including 700 million shares reserved for future exercise of stock options), divided into 12,500,000,000 shares, each at par value of \$10. The Board of Directors of Company also resolved to increase the capital by \$12,000,000 by a local right issue or GDSs. In addition, the stockholders of the Company also resolved to issue new shares by capitalizing retained earnings of \$1,362,016, employee's bonus of \$420,380 and additional paid-in capital of \$4,767,057.
- d. In August 2005, the Company decided to retire all treasury stock 53,412,000 shares, each at a par value of \$10. The Company adjusted decrease proportionately capital stock \$534,120 and paid-in capital \$106,151. The remaining deficiency was recorded as a reduction of capital reserve from treasury stock \$744 and retained earnings \$398,728. Total outstanding common stock after the retiring was \$81,579,492.
- e. For the year ended December 31, 2005, the Company issued 33,826,625 shares and 20,829,000 shares for the conversion of the Company's convertible bonds and stock options exercise, respectively. Total outstanding common stock after conversion and exercise was \$82,126,048.
- f. On June 14, 2006, the Company's stockholders resolved that special reserve \$3,125,641; legal

reserve \$1,125,768 and capital reserve \$2,647,556, totaling \$6,898,965 were used for offsetting accumulated deficits.

(17) 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 six-month periods ended June 30, 2005 and 2006 was shown below:

	Six-month periods ended June 30, 2005			
	2002 plan		2004 plan	
	Options (in thousand shares)	Weighted-Average Exercise Price (in dollars)	Options (in thousand shares)	Weighted-Average Exercise Price (in dollars)
Outstanding, beginning of period	198,067	\$12.44	179,045	\$16.09
Granted	-	-	46,430	12.30
Exercised	(20,142)	12.01	-	-
Forfeited	(3,879)	12.42	(8,705)	15.39
Outstanding, end of period	<u>174,046</u>	12.49	<u>216,770</u>	15.30

	Six-month periods ended June 30, 2006			
	2002 plan		2004 plan	
	Options (in thousand shares)	Weighted-Average Exercise Price (in dollars)	Options (in thousand shares)	Weighted-Average Exercise Price (in dollars)
Outstanding, beginning of period	167,513	\$11.03	209,570	\$13.47
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited	(5,814)	10.93	(11,088)	13.72
Outstanding, end of period	<u>161,699</u>	11.04	<u>198,482</u>	13.45

- b. Information with respect to the outstanding options of the Company's as of June 30, 2005 and 2006 was as follows:

Six-month periods ended June 30, 2005							
			Outstanding options at balance sheet date		Options Exercisable		
	Date of Approval	Range of Exercise Price (in dollars)	Options (in thousand shares)	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price (in dollars)	Number of Exercisable Options (in thousand shares)	Weighted-Average Exercise Price (in dollars)
2002 plan	May 14, 2002	\$11.90-\$13.35	174,046	1.24	\$12.49	87,023	\$12.49
2004 plan	April 29, 2004	\$12.30-\$17.10	216,770	3.05	15.30	-	-

Six-month periods ended June 30, 2006							
			Outstanding options at balance sheet date		Options Exercisable		
	Date of Approval	Range of Exercise Price (in dollars)	Options (in thousand shares)	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price (in dollars)	Number of Exercisable Options (in thousand shares)	Weighted-Average Exercise Price (in dollars)
2002 plan	May 14, 2002	\$10.50-\$11.80	161,699	0.24	\$11.04	121,274	\$11.04
2004 plan	April 29, 2004	\$10.80-\$15.00	198,482	2.05	13.45	46,888	15.00

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

	Six-month periods ended June 30	
	2005	2006
Net loss as reported (in thousands)	<u><u>\$(7,396,579)</u></u>	<u><u>\$(7,248,489)</u></u>
Pro forma net loss (in thousands)	<u><u>\$(7,617,310)</u></u>	<u><u>\$(7,504,270)</u></u>
Basic loss per share as reported (in dollars)	<u><u>\$(1.00)</u></u>	<u><u>\$(0.88)</u></u>
Pro forma basic loss per share (in dollars)	<u><u>\$(1.03)</u></u>	<u><u>\$(0.91)</u></u>
Diluted loss per share as reported (in dollars)	<u><u>\$(1.00)</u></u>	<u><u>\$(0.88)</u></u>
Pro forma diluted loss per share (in dollars)	<u><u>\$(1.03)</u></u>	<u><u>\$(0.91)</u></u>

Note: All shares have been adjusted retroactively

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 six-month periods ended June 30, 2005 and 2006, respectively:

	2005	2006
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Dividend yield:	1.00%	3.84%
Risk-free interest rate:	1.14%	1.00%
Expected volatility:	48.91%	37.68%
Expected life:	5 years	5 years

Compensation cost recognized for the six-month periods ended June 30, 2005 and 2006 was nil, respectively. Had the Company used the fair value method to account for its stock options, compensation cost for the six-month periods ended June 30, 2005 and 2006 would have been \$220,731 and \$255,781, respectively.

(18) Capital reserve

According to the 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.

(19) Legal Reserve

According to the Company Law, 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.

(20) Special reserve

In accordance with the ROC Securities and Futures Bureau (“SFB”) regulations, a special reserve must be provided for unrealized gain or loss on available-for-sale financial assets, excess of additional pension liability over unrecognized prior service cost, cumulative translation adjustment and unrealized gain or loss for cash flow hedge 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.

(21) 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 10% of the sum of the stock dividend and cash dividend.

The stockholders' meeting on June 14, 2006 resolved no distribution to shareholders and the appropriations of earnings of 2004 were approved in stockholders' meeting on May 18, 2005.

Appropriations of earnings and dividend per share were as follows:

	For fiscal year 2004		For fiscal year 2005	
	Appropriation of earnings	Dividend per share (in dollars)	Appropriation of earnings	Dividend per share (in dollars)
Legal reserve	\$1,031,772	\$-	\$-	\$-
Special reserve	2,279,679	-	-	-
Common stock-in cash	4,086,049	0.60	-	-
Common stock-in stock	1,362,016	0.20	-	-
Bonus paid to employees -in stock	420,380	-	-	-
Bonus paid to employees -in cash	280,246	-	-	-

On July 1, 2005, the Board of Directors resolved to change the above type and monetary amount of dividend distribution for 2004 due to adjust from issuance of GDSs, conversion of convertible bonds and exercising of stock option plans as follows:

	(Unit: per share in dollars)	
	Original	After change
Cash dividend	\$0.60	\$0.5407
Stock dividend	0.20	0.1802

The information relating to earnings distribution (or makeup of accumulated deficits) is accessible on the website of "Market observation post system" (<http://newmops.tse.com.tw>) of TSE.

(22) Treasury stock

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

Unit: thousand shares

Purpose	Number of Shares Repurchased			
	Beginning	Addition	Disposal	Ending

Six-month period ended June 30, 2005

Future issuance to employees as bonuses	53,412	-	-	53,412
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Six-month period ended June 30, 2006

Future issuance to employees as bonuses	-	-	-	-
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- 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.

The remaining of treasury stock 53,412,000 shares (\$1,039,743 in the amount ) were retired on August 31, 2005, resulting in a reduction of capital stock amounting to \$534,120.

(23) Operating revenue

	Six-month periods ended June 30	
	2005	2006
TFT-LCD (larger size)	\$28,581,918	\$43,583,373
TFT-LCD (smaller/medium size)	607,170	2,075,709
Others	865,118	568,368
Total	<u>\$30,054,206</u>	<u>\$46,227,450</u>

(24) Personnel, depreciation and amortization expenses

	Six-month periods ended June 30					
	2005			2006		
	Operating cost	Operating expenses	Total	Operating cost	Operating expenses	Total
Personnel expenses:						
Salaries	\$2,239,721	\$421,022	\$2,660,743	2,393,270	469,038	2,862,308
Staff labor/health insurance	138,432	24,907	163,339	156,122	27,266	183,388
Pension	139,493	28,610	168,103	110,106	25,089	135,195
Depreciation	5,842,912	174,062	6,016,974	9,646,759	162,908	9,809,667
Amortization	22,715	384,261	406,976	95211	485,842	581,053

(25) Income tax

- a. The ROC income tax authorities have assessed the income tax returns of the Company through 2003 except for 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.

Details of the Company's effective tax exemption periods are as follows:

Tax exemption products	Tax exemption period
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.

- b. The provision for income tax expenses consists of the following:

	Six-month periods ended June 30	
	2005	2006
Income tax-current	\$-	\$-
Income tax – deferred		
Net change in deferred income tax assets (liabilities):		
Investment tax credits	2,489,194	480,914
Operating loss carryforward	2,118,822	1,069,633
Temporary differences	(270,379)	151,491
Valuation allowances	(4,337,637)	(1,702,038)
Income tax expenses	\$-	\$-

- d. Significant components of the Company's deferred tax assets and liabilities at June 30, 2005 and 2006 were as follows:

Components	June 30	
	2005	2006
Deferred tax assets:		
Allowance for bad debts	\$67,645	\$84,545
Employees' welfare fund	74	
Unrealized loss on foreign currency exchange, net	-	5,198
Unrealized loss on financial assets and liabilities at fair value through profit or loss, net	-	201,592
Deferred pension expense	282,255	298,340
Unrealized loss on decline in market value and obsolescence of inventory	74,500	246,000
Unrealized intercompany losses	53,191	45,935
Unrealized loss on available-for-sale financial assets of overseas associated companies and subsidiaries	601,979	414,763
Unrealized loss on cash flow hedge	-	80,655
Investment tax credits	8,142,009	8,765,891

Operating loss carryforwards	3,695,681	4,619,688
Compensation interest payable	161,049	71,162
Cumulative translation adjustment	259,334	-
Others	6,781	4,843
	<u>\$13,344,498</u>	<u>\$14,838,612</u>

Deferred tax liabilities:

Overseas investment income accounted for under the equity method	\$(2,502,445)	\$(2,502,445)
Cumulative translation adjustment	-	(89,652)
Unrealized gain on foreign currency exchange, net	(96,580)	-
	<u>\$(2,599,025)</u>	<u>\$(2,592,097)</u>

June 30

	2005	2006
e. Deferred tax assets-current	\$2,581,740	\$1,244,605
Valuation allowance-current	(2,485,160)	\$(1,244,605)
Deferred tax assets-net-current	96,580	-
Deferred tax liabilities-current	(96,580)	-
Net deferred assets-current	<u>\$-</u>	<u>\$-</u>

June 30

	2005	2006
f. Deferred tax assets-non-current	\$10,762,758	\$13,594,007
Valuation allowance-non-current	(8,698,301)	(11,895,445)
Deferred tax assets-net-non-current	2,064,457	1,698,562
Deferred tax liabilities-non-current	(2,502,445)	(2,592,097)
Net deferred tax liabilities-non-current	<u>\$(437,988)</u>	<u>\$(893,535)</u>

- g. Details of unused investment tax credits and tax operating loss carryforwards as of June 30, 2006 were as follows:

Regulation	item	tax credit	Unused tax credit	Expiration year
Statute for Upgrading Industries	Investment tax credit in production equipment	\$191,119	\$191,119	2010
		4,351,764	4,351,764	2009
		136,267	136,267	2008
		1,496,593	1,496,593	2007
		198,558	198,558	2006

		<u>\$6,374,301</u>	<u>\$6,374,301</u>	
Statute for Upgrading	Investment tax credit in research	\$182,367	\$182,367	2010
Industries	and development expenditure,	549,242	549,242	2009
	employee training expenditure	620,032	620,032	2008
		531,237	531,237	2007
		508,712	508,712	2006
		<u>\$2,391,590</u>	<u>\$2,391,590</u>	
Income tax Law	Tax loss carryforward	\$1,046,209	\$1,046,209	2011
		2,021,261	2,021,261	2010
		142,471	142,471	2008
		94,509	94,509	2007
		1,315,238	1,315,238	2006
		<u>\$4,619,688</u>	<u>\$4,619,688</u>	

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

	June 30	
	2005	2006
Imputation credit account (ICA)	\$3,171	\$58,902
Accumulated deficits	\$(6,544,515)	\$(7,248,490)

(26) Loss per common share

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

	Amount	
	<u>Six-month periods ended June 30</u>	
	2005	2006
Numerator:		
Loss before cumulative effect changes in accounting principles	\$(7,396,579)	\$(6,443,102)
Cumulative effect of changes in accounting principles	-	(805,387)
Net loss available to common stockholders	<u>\$7,396,579</u>	<u>\$7,248,489</u>
	Shares	
	<u>Six-month periods ended June 30</u>	
	2005	2006
Denominator:		

Denominator for basic loss per share-weighted average share (in thousands)	<u>7,402,230</u>	<u>8,212,605</u>
	<u>Amount</u>	
	<u>Six-month periods ended June 30</u>	
	<u>2005</u>	<u>2006</u>
Loss before cumulative effect changes in accounting principles	\$(1.00)	\$(0.78)
Cumulative effect changes in accounting principles	-	(0.10)
Basic loss per common share (in dollars)	<u>\$(1.00)</u>	<u>\$(0.88)</u>

(Note: All shares have been adjusted retroactively)

The Company did not present diluted earning per common share for the six-month periods ended June 30, 2005 and 2006 because inclusion of such potential common shares-convertible bonds and stock options is antidilutive.

(27) Technical and purchase agreement

<u>Contracting party</u>	<u>The term of the contract</u>	<u>The content of repayment</u>
<u>Technology Agreement</u>		
<u>TFT-LCD</u>		
Hitachi	January 2003   December 2010	<ol style="list-style-type: none"> <li>1. The Company is required to pay licensing fees on installment basis for using the technologies.</li> <li>2. The Company is required to pay royalty fees based on a pre-determined percentage of net sales of the related products for continuing use of exclusive technology.</li> </ol>
	<u>The term of the contract</u>	<u>The content of repayment</u>
Advanced Display Inc. (ADI)	April 1997   July 2006	<ol style="list-style-type: none"> <li>1. The Company is required to pay licensing fees on installment basis for using the technologies.</li> <li>2. The Company is required to pay royalty fees based on a pre-determined percentage of net sales of the related products for continuing use of exclusive technology.</li> <li>3. ADI has the right to purchase no 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 	<ol style="list-style-type: none"> <li>1. The Company is required to pay licensing fees (one time payment) for using the technologies.</li> </ol>

	December 2006	2. The Company is required to pay royalty fees based on a pre-determined percentage of net sales of the related products for continuing use of exclusive technology.
Semiconductor Energy Laboratory Co., Ltd. (SEL)	January 2004   December 2008	1. The Company is required to pay licensing fees on installment basis for using the technologies. 2. The Company is required to pay royalty fees based on a pre-determined percentage of net sales of the related products for continuing use of exclusive technology.
Industrial Technology Research Institute (ITRI)	May 2002   May 2009	The Company is required to pay licensing fees on installment basis for using the technologies.
Mitsubishi Electric Corporation and Advanced Display Inc.	November 2002	The Company is required to pay licensing fees on installment basis for using the technologies.
Hewlett - Packard Development Company, L.P. (HP)	February 2004	The Company is required to pay licensing fees on installment basis for using the technologies.
Guardian Industries, Corp.	May 2006   April 2011	1. The Company is required to pay licensing fees on installment basis for using the technologies. 2. The Company is required to pay royalty fees based on a pre-determined percentage of net sales of the related products for continuing use of exclusive technology.

Purchase Agreement

Corning Display Technologies Taiwan Co., Ltd (“Corning Taiwan”)	April 2005   March 2011	1. Corning Taiwan will guarantee to supply materials of TFT-LCD to the Company for 6 generation fabrication. 2. The Company is required to make prepayments on installment basis to Corning Taiwan to deductible from subsequent purchase.
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**5. RELATED PARTY TRANSACTIONS**

(1) Name and relationship:

Name of related party	Relationship with the Company
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 the equity method
Toppan Chunghwa Electronics Co., Ltd.	An investee accounted for under the equity method
Grand Cathay International Asset Management	A subsidiary of the Company

Co., Ltd.	
Sintronic Technology Inc.	An investee of Grand Cathay International Asset Management Co., Ltd. accounted for under the 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 Fine Chemical Co., Ltd.	Subsidiary of Tatung Co., Ltd.
Shang Chih International Express 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.
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.
Toes Opto-Mechatronics Co.	Subsidiary of Tatung Co., Ltd.
Tatung OTIS Elevator Co., Ltd.	An investee of Tatung Co., Ltd. accounted for under the equity method
Elitegroup Computer Systems Co., Ltd.	An investee of Tatung Co., Ltd. accounted for under the equity method
Kuender Company Co., Ltd.	An investee of Tatung Co., Ltd. accounted for under the equity method
Tatung Okuma Co., Ltd.	An investee of Tatung Co., Ltd. accounted for under the equity method
Tatung Telecom Corporation	An investee of Tatung Co., Ltd. accounted for under the 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 Chunghwa P.T. (Malaysia) Sdn. Bhd.

(Continued)

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
Chunghwa P.T. Display Technology (Shen-Zhen)	A subsidiary of the Company's subsidiary

Ltd.	
CPT TPV optical Co., 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 the equity method
Fujian Fujia Electronics Co., Ltd.	The Company's affiliated company accounted for under the equity method
Jean Co., Ltd.	Chairman is one of the immediate family members of the Company's Chairman
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 party	Six-month periods ended June 30			
	2005		2006	
	Amount	%	Amount	%
Chunghwa P.T. (Labuan) Ltd.	\$1,001,702	3.33	\$1,044,803	2.26
Tatung Information Technology (Jiang Su) Co., Ltd.	1,293,928	4.31	836,583	1.81
Jeffrey Investment Ltd.	1,796,225	5.98	1,498,973	3.24
Tatung Co., Ltd.	190,693	0.63	500,604	1.08
Elitegroup Computer Systems Co., Ltd.	-	-	354,622	0.77
K-tronics, Inc.	496,872	1.65	433,092	0.94
Others	155,426	0.52	298,788	0.65
Total	<u>\$4,934,846</u>	<u>16.42</u>	<u>\$4,967,465</u>	<u>10.75</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:

Six-month periods ended June 30	
2005	2006

Region	Related party		Related party	
		Ordinary customer		Ordinary customer
Overseas	O/A 90-120 days	Cash payment with 30 to 65 days L/C with 30 to 60 days At sight payment	O/A 90-120 days	Cash payment with 30 to 90 days L/C with 30 to 65 days At sight payment
ROC Domestic	O/A 60-90 days	Cash payment with 30 to 60 days At sight payment	O/A 90-120 days	Cash payment with 30 to 60 days At sight payment

b. Purchases

Name of related party	Six-month periods ended June 30			
	2005		2006	
	Amount	%	Amount	%
Chunghwa P.T. (Labuan) Ltd.	\$9,784,986	38.98	\$15,545,339	43.81
Others	38,473	0.15	106,188	0.30
Total	\$9,823,459	39.13	\$15,651,527	44.11

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

Region	Six-month periods ended June 30			
	2005		2006	
	Related party	Ordinary supplier	Related party	Ordinary supplier
Overseas	T/T 30 to 180 days	L/C, T/T 30 to 180 days	T/T 30 to 360 days	L/C 30 to 180 days T/T 30 to 360 days
ROC Domestic	30 to 60 days after QC	30 to 150 days after QC	30 to 60 days after QC	30 to 180 days after QC

c. Fixed asset addition

Name of related party	Six-month periods ended June 30			
	2005		2006	
	Amount	%	Amount	%

Tatung Co., Ltd.	\$174,382	0.53	\$46,160	0.60
Tatung System Technology Inc.	76,904	0.23	19,061	0.25
Shang Chih International Express Co., Ltd.	175,270	0.53	231,579	3.01
Toppan Chunghwa Electronics Co., Ltd.	21,904	0.07	16,758	0.22
Others	39,595	0.12	13,732	0.18
Total	<u>\$488,055</u>	<u>1.48</u>	<u>\$327,290</u>	<u>4.26</u>

d. Expenditures

Name of related party	Six-month periods ended June 30			
	2004		2005	
	Amount	%	Amount	%
Chunghwa P.T. (Labuan) Ltd.	\$36,233	0.32	\$29,468	0.18
Tatung Co., Ltd.	17,647	0.15	8,709	0.05
Tatung Co. of Japan, Inc.	3,406	0.03	1,532	0.01
Tatung System Technology Inc.	3,543	0.03	3,319	0.02
Others	4,962	0.04	3,478	0.02
Total	<u>\$65,791</u>	<u>0.57</u>	<u>\$46,506</u>	<u>0.28</u>

- (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 equipments from Japan through Tatung Co. of Japan, Inc., which charges the Company commissions for such services. The total raw material and equipments purchased through Tatung Co. of Japan, Inc. amounted to \$3,177,405 and \$2,736,764 for the six-month periods ended on June 30, 2005 and 2006, respectively. The commission charged, included in the aforementioned purchase amount, amounted to \$3,406 and \$1,532 for the corresponding periods, respectively.

e. Fixed asset disposal

Name of related party	Six-month periods ended June 30					
	2005			2006		
	Selling price	Carrying amount	Loss on sale of fixed asset	Selling price	Carrying amount	Gain (Loss) on sale of fixed asset
Chunghwa P.T. (Labuan) Ltd.	\$11,932	\$13,477	\$(1,545)	\$1,097	\$813	\$284
Sintronic Technology Inc.	-	-	-	342,000	342,117	(117)
Total	\$11,932	\$13,477	\$(1,545)	\$343,097	\$342,930	\$167

f. Non-operating income-others

Six-month periods ended June 30	
2005	2006

Name of related party	Amount	%	Amount	%
Chunghwa P.T. (Labuan) Ltd.	\$2,314	0.93	\$1,097	0.74
Chunghwa P.T. (Malaysia) Sdn. Bhd.	796	0.32	943	0.63
Tatung Co., Ltd.	1,481	0.60	621	0.42
Others	717	0.29	81	0.05
Total	<u>\$5,308</u>	<u>2.14</u>	<u>\$2,742</u>	<u>1.84</u>

g. Due from affiliates-trade, net

Name of related party	June 30			
	2005		2006	
	Amount	%	Amount	%
Chunghwa P.T. (Labuan) Ltd.	\$171,785	6.16	\$64,161	2.62
Tatung Information Technology (Jiang Su) Co., Ltd.	1,320,734	47.32	675,941	27.56
Jeffrey Investment Ltd.	637,598	22.84	773,088	31.52
K-tronics, Inc.	507,762	18.19	287,918	11.74
Elitegroup Computer Systems Co., Ltd.	-	-	384,068	15.66
Tatung Co., Ltd.	61,512	2.20	192,520	7.85
Others	91,667	3.29	74,913	3.05
Total	<u>2,791,058</u>	<u>100.00</u>	<u>2,452,609</u>	<u>100.00</u>
Less: Allowance for doubtful accounts	<u>(26,000)</u>		<u>(45,000)</u>	
Net	<u>\$2,765,058</u>		<u>\$2,407,609</u>	

h. Due from affiliates - others

Name of related party	June 30			
	2005		2006	
	Amount	%	Amount	%
Chunghwa P.T. (Bermuda) Ltd.	\$1,953,152	97.25	\$743,655	81.19
Toppan Chunghwa Electronics Co., Ltd.	34,065	1.70	7,745	0.85
Forward Electronics Co., Ltd.	19,939	0.99	20,554	2.24
Sintronic Technology Inc.	-	-	143,640	15.68
Others	1,251	0.06	367	0.04
Total	<u>\$2,008,407</u>	<u>100.00</u>	<u>\$915,961</u>	<u>100.00</u>

i. Due to affiliates-trade

June 30	
2005	2006

Name of related party	Amount	%	Amount	%
Tatung Co. of Japan, Inc.	\$3,330,730	46.22	\$2,416,274	21.74
Chunghwa P.T. (Labuan) Ltd.	3,828,388	53.13	8,600,016	77.36
Others	46,923	0.65	99,871	0.90
Total	\$7,206,041	100.00	\$11,116,161	100.00

j. Due to affiliates-others

Name of related party	June 30			
	2005		2006	
	Amount	%	Amount	%
Tatung Co. of Japan, Inc.	\$1,121,563	87.48	\$1,508,469	87.33
Chunghwa P.T. (Malaysia) Sdn. Bhd.	67,813	5.29	-	-
Others	92,755	7.23	218,768	12.67
Total	\$1,282,131	100.00	\$1,727,237	100.00

k. Other current liabilities

Name of related party	June 30			
	2005		2006	
	Amount	%	Amount	%
Chunghwa P.T. (Labuan) Ltd.	\$2,245	1.34	\$-	-
Tatung Co. of America, Inc.	4,305	2.56	-	-
Chunghwa P.T. (Bermuda.) Ltd.	6,108	3.63	-	-
Tatung Co. of U.K. Inc.	-	-	175	0.07
Others	7,001	4.17	41	0.02
Total	\$19,659	11.70	\$216	0.09

l. Deferred credits

Name of related party	June 30			
	2005		2006	
	Amount	%	Amount	%
Chunghwa P.T. (Malaysia) Sdn. Bhd.	\$72,352	6.27	\$23,318	2.07
Chunghwa P.T. (Labuan) Ltd.	134,126	11.61	154,787	13.75
Chunghwa P.T. (Bermuda) Ltd. and Dalemont Investment Ltd. etc.	942,055	81.58	942,055	83.68
Chunghwa P.T. (Kampar) Sdn. Bhd.	6,286	0.54	5,632	0.50
Forward Electronics Co., Ltd.	-	-	2	-
Total	\$1,154,819	100.00	\$1,125,794	100.00

m. Guarantees

The amount of guarantees that the Company provided for related parties as of June 30, 2005 and

2006 was as follows:

Name of related party	Amount (in thousands)		Purpose
	June 30		
	2005	2006	
Chunghwa P.T. (Bermuda) Ltd	USD 82,000	USD 65,204	Working Capital
CPTF Optronics Co., Ltd.	USD 5,000	-	Working Capital
Chunghwa P.T. (Labuan) Ltd.	USD 45,000	-	Working Capital
Toppan Chunghwa Electronics Co., Ltd.	NTD 330,000	NTD 330,000	Working Capital
Chunghwa P.T. (Wujiang) Ltd.	USD 10,000	-	Working Capital

- n. The Company leased portions of its plants to Toppan Chunghwa Electronics Co., Ltd. Those generated rental revenue of \$9,428 and \$14,219 for the six-month periods ended June 30, 2005 and 2006, respectively. The related receivables (recorded in due from affiliates-others) were \$34,065 and \$7,745 as of June 30, 2005 and 2006, respectively. In addition, the Company charged Toppan Chunghwa Electronics Co., Ltd. management fees of \$22,986 and \$27,553 for the six-month periods ended June 30, 2005 and 2006, respectively, which were recorded as a deduction of expenditure.

## 6. ASSETS PLEDGED OR MORTGAGED

As of June 30, 2005 and 2006, the following assets were mortgaged to several banks, customs and government agencies as collateral for bank loans, credit facilities and other purposes:

Account	Creditor	Carrying amount	
		June 30	
		2005	2006
Building	Chiao Tung Bank	\$1,982,964	2,387,539
Building	Bank of Taiwan	1,474,738	1,427,707
Machinery and equipment	Chiao Tung Bank	13,719,474	9,938,342
Machinery, equipment and prepayments on equipment	Bank of Taiwan	50,497,545	56,520,640
Machinery, equipment and prepayments on equipment	Taiwan Cooperative Bank	-	8,810,766
Machinery and equipment & prepayments on equipment	China Trust Bank	6,334,345	17,012,517
Pledged time deposit	Chiao Tung Bank		200,000
Pledged time deposit	General office of the customs-Keelung, ROC	12,680	-
Pledged time deposit	General office of the customs-Taipei, ROC	134,255	121,875
Pledged time deposit	Hua Nan Commercial Bank	-	-
Pledged time deposit	Bank of Taiwan	907,392	34,274
		<u>\$75,063,393</u>	<u>96,453,660</u>

## 7. COMMITMENTS AND CONTINGENCIES

As of June 30, 2006, the following commitments and contingencies were not reflected in above financial statements:

- A. Unused letters of credit of the Company were approximately USD 24,604 thousand, JPY 2,993,162 thousand, CHF 790 thousand and EUR 72 thousand as of June 30, 2006.
- B. Besides the guarantees disclosed in Note 5 (2) m, the promissory notes, guarantee notes for bank loans and guarantee notes for account receivable factoring amounting to \$52,821,070, USD298,000 thousand and \$1,240,000, respectively.
- C. The Company signed several construction contracts for the expansion of its factory space. As of June 30, 2006, these construction contracts have amounted to \$ 118,302,509 with \$9,883,669 remaining unpaid.
- D. The Company leases land from the Central Taiwan Science Park. The operating lease agreement is renewable and will be expired on December 31, 2115. As of June 30, 2006, future lease payments were as follows.

<u>Period</u>	<u>Amount</u>
2006	\$3,551
2007	5,645
2008	5,645
2009	5,645
2010 and thereafter	90,320

8. **SIGNIFICANT DISASTER LOSS**

NONE.

9. **SIGNIFICANT SUBSEQUENT EVENTS**

In order to obtain funds for purchasing of TFT-LCD automatic production, the Company issued five years Zero Coupon Convertible Bonds of US\$250 million a on July 11, 2006. The significant terms of the Convertible Bonds are as follows:

- Amount: US\$250 million
- Issue price: 100%

- Duration: 5 years (2006.7.14 to 2011.7.14)
- Place of trading: Singapore Stock Exchange
- Coupon rate: Zero
- 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 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 \$32.345 = US\$1)
- Conversion price and adjustment: The conversion price is \$7.89 per share and will be adjusted if number of the Company's common stock changes after the issuance of the bonds.
- Company's redemption rights:
  - ① On and after January 14, 2008 of the Company may redeem the bonds at a gross yield of 2.75% on a semi-annual basis 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.
  - ② The Company may redeem the bonds at a gross yield of 2.75% on a semi-annual basis of the unpaid principal amount outstanding if there is a change in legislation, resulting in an increase in tax liabilities of the Company.
  - ③ The bonds will mature on July 14, 2011 at 114.63% of their principal amount.
- Bondholders' option rights:
  - ① On January 14, 2008, the bondholders have the right to require the Company to redeem the bonds at a price equal to 104.18% of the principal amount.
  - ② The bondholders may demand the Company to redeem the bonds if trading of the Company's shares is restricted on the TSE.

## 10. **SEGMENT INFORMATION**

The interim financial statements are not required to follow the principles outlined in the ROC Statements of Financial Accounting Standards No. 20 "Disclosures of Segment Financial Information."

## 11. **Derivative**

## (1) Fair value of financial instruments:

	June 30, 2005	
	Non-derivative	Carrying amount      Fair value
<u>Financial assets:</u>		
Cash and cash equivalents	20,026,486	20,026,486
Financial assets at fair value through profit or loss (listed equity securities and open-end mutual funds)	917,915	930,765
Receivables, net (included other receivable)	16,166,059	16,166,059
Available-for-sale financial assets-non-current	796,879	796,879
Pledged time deposits	1,054,327	1,054,327
<u>Financial liabilities:</u>		
Short-term bank loans	1,926,090	1,926,090
Payables (included other payable)	28,572,274	28,572,274
Other current liabilities	167,995	167,995
Bonds payable (including current portion)	13,392,179	13,553,446
Long-term bank loans (including current portion)	58,272,170	58,272,170
<u>Derivative</u>		
<u>Financial assets:</u>		
Financial assets at fair value through profit or loss:		
Foreign currency options contracts	-	-
<u>Financial liabilities:</u>		
Financial liabilities at fair value through profit or loss:		
Foreign currency options contracts	451,663	451,663
Foreign currency forward exchange contracts	48,461	48,461
Derivative financial liabilities for hedging – non-current:		
Interest rate swap contracts	-	5,577
<u>June 30, 2006</u>		
	Non-derivative	Carrying amount      Fair value
<u>Financial assets:</u>		
Cash and cash equivalents	5,382,664	5,382,664
Financial assets at fair value through profit or loss (listed equity securities and open-end mutual funds)	41,673	41,673
Receivables, net (included other receivable)	18,965,806	18,965,806
Available-for-sale financial assets-non-current	1,059,093	1,059,093
Pledged time deposits	356,149	356,149
<u>June 30, 2006</u>		

Non-derivative	Carrying amount	Fair value
<u>Financial liabilities:</u>		
Short-term bank loans	4,409,459	4,409,459
Payables (included other payable)	33,858,273	33,858,273
Other current liabilities	243,550	243,550
Bonds payable (including current portion)	7,213,014	6,941,042
Long-term bank loans (including current portion)	71,563,399	71,563,399
<hr/>		
Derivative		
<u>Financial assets:</u>		
Financial assets at fair value through profit or loss:		
Foreign currency options contracts	-	-
Foreign currency forward exchange contracts	5,166	5,166
Derivative financial assets for hedging:		
Foreign currency forward exchange contracts	23,091	23,091
 <u>Financial liabilities:</u>		
Financial liabilities at fair value through profit or loss:		
Foreign currency options contracts	41,568	41,568
Foreign currency forward exchange contracts	17,296	17,296
Derivative financial liabilities for hedging – non-current:		
Interest rate swap contracts	305,438	305,438

The methods and assumptions used by the Company to determine the above fair value of financial instruments are as follows:

- a. The carrying value of short-term financial instruments, such as cash and cash equivalents, receivables (included other receivable), pledged time deposits, short-term bank loans, payables (included other payable) and other current liabilities, approximate fair value because of short maturity of these instruments.
- b. The fair values of financial assets at fair value through profit or loss—listed equity securities, open-end mutual funds and available-for-sale financial assets were based on their quoted market price or the net asset value per unit.
- c. The fair values of long-term bank loans due within one 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 their market price.
- d. The fair values of derivative financial instruments were based on valuation techniques provided by the Bank.

- (2) The fair values of the Company's financial assets or liabilities determined by quoted price or valuation techniques are summarized as follows:

	June 30			
	2005		2006	
	Fair value determined by quoted price	Fair value determined by valuation technique	Fair value determined by quoted price	Fair value determined by valuation technique
<u>Non-derivative financial instruments</u>				
<u>Assets</u>				
Assets with fair value the same as the carrying value	-	37,246,872		24,704,619
Financial assets at fair value through profit or loss	930,765	-	41,673	-
Available-for-sale financial assets – non – current	796,879	-	1,059,093	-
<u>Liabilities</u>				
Liabilities with fair value the same as the carrying value	-	88,938,529	-	110,074,681
Bonds payable	13,553,446	-	6,941,042	-
<u>Derivative financial instruments</u>				
Financial assets (liabilities) at fair value through profit or loss:				
Foreign currency forward exchange contracts	-	(48,461)	-	(12,130)
Foreign currency option contracts	-	(451,633)	-	(41,568)
Derivative financial assets (liabilities) for hedging:				
Foreign currency forward exchange contracts	-	-	-	23,091
Interest rate swap contracts	-	(5,577)	-	(305,438)

As of and for the six-month period ended June 30, 2006, the derivative instruments for hedge failed to meet the criteria of hedge were classified as held for trading and the gain or loss reported in earnings immediately. please see footnote 2.

- (3) Financial risk factors and measurement of effectiveness of hedge relationship:

Except for derivative financial instruments, the Company held other kinds of financial instruments, such as short-term and long-term bank loans, bonds payable, and cash and cash equivalents for capital demand. The Company also held other financial assets and liabilities, such as account receivable and account payable generated from operating activities.

The Company's activities expose variety of financial risks as follows: cash flow risk on interest and exchange rate; credit risk; liquidity risk and market risk.

Cash flow risk exchange rate risk; interest and exchange rate

The derivative financial instruments are used to hedge floating interest rate and foreign exchange fluctuations of long-term bank loans. As of June 30, 2006, the expected cash flows of derivative financial instruments were as follows:

Financial Instruments	Period	(unit:thousands)	
		Cash out flow	Cash in flow
Foreign currency forward exchange contracts	January 2007 ~ July 2010	\$2,546,089	USD 85,750
Interest rate swap contracts	July 2006 ~ March 2010	\$1,557,135	\$877,496

Market risk

Open-end mutual funds and listed equity securities of the Company, managed by professional or reputable financial institutes (entered into investment management agreements with fund managers), were categorized as financial assets at fair value through profit or loss for trading purpose. As a result, market risk is considered minimal.

Credit risk

The credit risk consists principally of investment in listed equity securities, mutual funds and trade receivables. The credit risk is considered minimal by relatively better rated financial instruments and counterparties.

The majority of the Company's trade receivables is derived from sales to original design manufacturing. There are also policies of the Company to provide allowance for outstanding accounts and the Company regularly reviews them.

Exchange rate risk

The Company operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to New Taiwan Dollars. Gains or losses due to changes in foreign exchange rates will be offset by foreign monetary assets and liabilities accordingly.

Liquidity risk

Liquidity risk is the risk of being unable to settle the contracts on schedule. The Company's working capital is sufficient for the cash demand upon the settlement of contracts. Therefore, there is no significant liquidity risk.

The Company entered into foreign currency forward exchange contracts that hedge exposures to variability of foreign exchange rate in its borrowing activities in non-New Taiwan Dollar and entered into interest rate swap contracts that hedge exposures to the impact of interest rate changes primarily through its floating rate borrowing activities in New Taiwan dollars. All above derivative instruments are designated as cash flow hedge.

For above derivative instruments designated as a cash flow hedge, gain or loss from the effective portion of the derivative instruments is initially reported as a separate component of equity, net of tax. The ineffective portion of the gain or losses was reported in earnings immediately.

As of June 30, 2006, the designation of cash flow hedging instruments are as follows:

Item	Instruments for Hedging	Fair Value	Maturity Period
NTD long-term bank loans with floating rate	Interest rate swap contracts	(305,438)	2004~2010
Non-NTD long-term bank loans	Foreign currency forward exchange contracts	23,091	2006~2010
		<u>(282,347)</u>	

Gain or loss generated from cash flow hedging instruments was recognized as adjustments in equity accounts as follows:

Item	June 30, 2006
Adjustment in equity account (excluding cumulative effect of changes in accounting principles)	\$700,878
Loss transferred from equity account (accounted to interest expenses)	(754,342)
Non-derivative financial liabilities transferred from equity account (accounted to accrued expenses)	(754,342)

(4) Information of derivative financial instruments:

a. Foreign currency forward exchange contracts:

June 30, 2005

	contract amount or notional amount (in thousands)	Maturity period
Buy USD/ Sell NTD	<u>USD 75,000</u>	July 15, 2005~December 14, 2005

June 30, 2006

	contract amount or notional amount (in thousands)	Maturity period
Buy USD/ Sell NTD	<u>USD 85,750</u>	January 11, 2007~July 11, 2010

b. Foreign currency option contracts:

Financial instruments	June 30	
	2005	2006
	Contract amount or notional amount (in thousands)	Contract amount or notional amount (in thousands)
European style foreign currency options:		
<u>BUY</u>		
NTD Call / USD Put	USD100,000	-
JPY Call / USD Put	USD588,000	-
<u>Sell</u>		
USD Call / JPY Put	USD1,022,530	USD20,000
USD Call / NTD Put	USD100,000	-

c. Interest rate swap transactions:

Maturity period	Contract amount or notional amount (in thousands)	Payable on Fixed Interest Rate	Receivables on Floating Interest Rate
<u>June 30, 2005</u>			
2009.4~2010.3	<u>\$19,600,000</u>	0.77%-1.67%	1.166%-1.281%
<u>June 30, 2006</u>			
2009.4~2010.3	<u>\$19,600,000</u>	0.77%-4.489%	1.426%-1.568%

(5) Derivative financial instruments transaction of investees:

As of June 30, 2006, the information of derivative financial instruments transaction of investee –CPTF optronics Co., Ltd. was as follows:

a. Foreign currency forward exchange contracts:

	Contract amount or notional amount (in thousands)	Maturity period
Buy USD/ Sell RMB	<u>USD76,577</u>	2006.9~2007.5

b. Interest rate swap transactions:

Maturity period	Contract amount or notional amount (in thousands)	Payable on Fixed Interest Rate	Receivables on Floating Interest Rate
2008.2~2008.7	<u>USD30,000</u>	4.08%-4.28%	5.44%-5.6638%

c. Credit Linked Notes:

Item	Principal Amount	Expected annual return	Fair value
Credit Linked Notes	RMB30,000 thousand	2.4%	\$121,809

Chunghwa Pictures Display Technology ((Fujian) Ltd. (“FDT”) purchased its credit linked notes (CLN) from China Everbright bank. China Everbright bank launched the CLN which designed for a paycheck agreement to link Performance of Jiang Su Nanjing ffangzhow Expressway Co., Ltd. FDT will receive return at 2.4%.

12. Others

The Company currently involved in certain lawsuits of which mainly are with LG Philips LCD, Ltd. (LPL) in the United States (U.S.).

In August 2000, LPL filed suit in U.S. District Court, Central of California for a patent infringement against the Company, Tatung Company and Tatung Company of America (the “Tatung companies”) (“The First LPL Suit”). However, the Company believed that a certain technology claimed by LPL was developed and owned by Hewlett-Packard Development Company, LP (HP) and the Company acquired the technology from HP in 2004. The trail of The First LPL Suit is scheduled in October 2006.

In May 2005, LPL filed an additional patent infringement suit against the Company, Tatung Company and Tatung Company of America (the “Tatung Companies”) and View Sonic Corporation in the U.S. District Court, Delaware (“The Second LPL Suit”) alleging that the Company have infringed two of US patents of LPL (USP 6738121 and 50190029) relating to the design and manufacture of LCD devices. In May 2006, LPL withdrew lawsuit relating to USP 6738121; on the other hand, on July 2006, the jury entered a verdict finding the Company liable for patent infringement relating to USP 50190029 and however, the trial court has not entered judgment on the verdict.

The Company filed a patent infringement suit against LPL in the U.S. District Court, Central of California in January 10, 2005 (“The Third LPL Suit”). In April 2005, LPL filed an answer and counterclaims against the Company. Discovery is on-going and a jury trail is scheduled to commence May 1, 2007.

The Company believes that these suits will not have a material adverse effect on the Company’s result of operations or financial condition.