

**CHUNGHWA PICTURE TUBES, LTD.
AND SUBSIDIARIES
Consolidated Financial Statements
For The Years Ended
December 31, 2005 and 2006
With
Report of Independent Auditors**

The reader is advised that these consolidated financial statements have been prepared originally in Chinese. If there is any conflict between these consolidated financial statements and the Chinese version or any difference in the interpretation of the two versions, the Chinese language consolidated financial statements shall prevail.

Report of Independent Auditors

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

We have audited the accompanying consolidated balance sheets of Chunghwa Picture Tubes, Ltd. (the “Company”) and its subsidiaries as of December 31, 2005 and 2006, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Chunghwa Picture Tubes, Ltd. and its subsidiaries as of December 31, 2005 and 2006, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with the “Business Accounting Law”, “Guidelines Governing the Preparation of Financial Report by Securities Issuers” and accounting principles generally accepted in the ROC.

As described in Note 3 to the consolidated financial statements, effective from January 1, 2006, the Company and its subsidiaries adopted the ROC Statement of Financial Accounting Standards (“SFAS”) No. 34, “Accounting for Financial Instruments” and No. 36, “Disclosure and Presentation of Financial Instruments” to account for its financial instruments, and effective from January 1, 2005, the Company and its subsidiaries adopted the ROC SFAS No. 35, “Accounting for Asset Impairment” to account for the impairment of its assets.

Ernst & Young
Taipei, Taiwan
Republic of China
April 18, 2007

Notice to Readers

The accompanying consolidated financial statements are intended only to present the consolidated financial position and results of consolidated 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. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2005 AND 2006
(Expressed in Thousands of New Taiwan Dollars)

ASSETS	December 31	
	2005	2006
CURRENT ASSETS:		
Cash and cash equivalents (Notes 2, 4 and 11)	\$32,815,736	\$34,650,859
Financial assets at fair value through profit or loss - current (Notes 2, 4 and 11)	1,586,137	1,022,935
Derivative financial assets for hedging - current (Notes 2, 4 and 11)	-	11,627
Notes receivable, net (Notes 2, 4 and 11)	242,446	320,025
Accounts receivable, net (Notes 2, 4 and 11)		
Trade	20,991,044	17,622,774
Others	1,057,553	1,166,173
Due from affiliates, net (Notes 2, 4, 5 and 11)		
Trade	1,866,632	3,241,962
Others	6,025	167,097
Inventories, net (Notes 2 and 4)	14,368,790	18,603,646
Prepayments	122,759	712,663
Pledged time deposits - current (Notes 6 and 11)	748,850	701,386
Total current assets	<u>73,805,972</u>	<u>78,221,147</u>
INVESTMENTS: (Notes 2, 4 and 11)		
Investment in associated companies	1,546,284	3,379,172
Available - for -sale financial assets - non - current	2,514,870	3,746,515
Derivative financial assets for hedging - non - current	-	44,516
Financial assets carried at cost	239,772	198,217
Total investments	<u>4,300,926</u>	<u>7,368,420</u>
PROPERTY, PLANT AND EQUIPMENT: (Notes 2, 4, 5 and 6)		
Land	3,712,050	3,791,229
Buildings	29,495,118	36,358,850
Machinery and equipment	116,928,778	138,860,167
Transportation equipment	432,488	146,169
Furniture and fixtures	908,154	1,023,787
Miscellaneous equipment	33,258,427	37,905,748
Revaluation increment	596,565	593,117
Total	185,331,580	218,679,067
Accumulated depreciation	(63,931,005)	(84,156,662)
Prepayments on equipments and construction in progress	41,097,847	20,248,335
Property, plant and equipment, net	<u>162,498,422</u>	<u>154,770,740</u>
INTANGIBLE ASSETS:		
Deferred pension cost (Notes 2 and 4)	168,729	134,983
Land use right (Note 2)	239,869	244,711
Total Intangible Assets	<u>408,598</u>	<u>379,694</u>
OTHER ASSETS:		
Refundable deposits (Note 7)	32,142	97,893
Deferred charges (Notes 2 and 4)	3,388,955	3,368,133
Pledged time deposits-non-current (Note 6)	10,000	15,500
Prepayment for materials-non-current (Note 4)	2,282,511	3,126,532
Others, net (Notes 2 and 4)	35,755	35,755
Total other assets	<u>5,749,363</u>	<u>6,643,813</u>
TOTAL ASSETS	<u><u>\$246,763,281</u></u>	<u><u>\$247,383,814</u></u>

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

CHUNGHWA PICTURE TUBES, LTD. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (CONTINUED)
December 31, 2005 AND 2006
(Expressed in Thousands of New Taiwan Dollars)

LIABILITIES AND STOCKHOLDERS' EQUITY	December 31	
	2005	2006
CURRENT LIABILITIES:		
Short-term bank loans (Notes 4 and 11)	\$7,277,518	\$10,163,167
Financial liabilities at fair value through profit or loss - current (Notes 2, 4 and 11)	266,368	1,139
Derivative financial liabilities for hedging - current (Notes 2, 4 and 11)	-	35,699
Notes payable (Note 11)	288,835	189,111
Accounts payable (Note 11)		
Trade	29,030,519	34,525,113
Others	10,133,100	6,187,829
Due to affiliates (Notes 5 and 11)		
Trade	4,237,692	3,241,283
Others	598,584	1,530,252
Income tax payable (Notes 2, 4 and 11)	76,008	12,323
Accrued expenses (Note 11)	3,579,166	5,126,531
Current portion of bonds payable (Notes 2, 4 and 11)	-	7,346,900
Current portion of long-term bank loans (Notes 4, 5, 6 and 11)	10,173,088	19,048,634
Other current liabilities (Notes 5 and 11)	191,177	293,376
Total current liabilities	<u>65,852,055</u>	<u>87,701,357</u>
LONG-TERM DEBT:		
Financial liabilities at fair value through profit or loss - non - current (Notes 2, 4 and 11)	-	1,447,211
Derivative financial liabilities for hedging - non - current (Notes 2, 4 and 11)	-	89,499
Bonds payable, net of current portion (Notes 2, 4 and 11)	7,211,149	6,128,072
Long-term bank loans, net of current portion (Notes 4, 5, 6 and 11)	75,710,489	64,702,644
Long-term payable	95,078	350,718
Total long-term debt	<u>83,016,716</u>	<u>72,718,144</u>
RESERVE FOR INCREMENT TAX ON LAND REVALUATION (Notes 2 and 4)	26,793	26,793
OTHER LIABILITIES:		
Accrued pension liabilities (Notes 2 and 4)	1,681,231	2,171,510
Deferred tax liabilities, net (Notes 2 and 4)	800,322	1,295,196
Deferred credits (Notes 2, 4 and 5)	-	253
Total Other Liabilities	<u>2,481,553</u>	<u>3,466,959</u>
TOTAL LIABILITIES	<u>151,377,117</u>	<u>163,913,253</u>
STOCKHOLDERS' EQUITY:		
EQUITY ATTRIBUTABLE TO STOCKHOLDERS OF THE PARENT		
Capital: (Note 4)		
Common stock	82,126,048	82,126,048
Capital reserve: (Notes 2 and 4)		
Additional paid in capital	12,303,254	9,655,698
Premium on convertible bonds	4,028,677	4,028,677
Equity components of convertible bonds	-	572,717
Long-term investments	239	93,220
Retained earnings: (Note 4)		
Legal reserve	1,125,768	-
Special reserve	3,125,641	-
Accumulated deficits	(6,898,965)	(13,979,371)
Other items in stockholders' equity: (Notes 2, 3 and 4)		
Cumulative translation adjustment	317,584	950,036
Excess of additional pension liability over unrecognized prior service cost	(133,849)	(562,906)
Unrealized loss on available - for - sale financial assets	(2,711,230)	(1,337,363)
Unrealized loss on cash flow hedge	-	(49,145)
Unrealized incremental value from assets revaluation	642,837	642,837
TOTAL EQUITY ATTRIBUTABLE TO STOCKHOLDERS OF THE PARENT	<u>93,926,004</u>	<u>82,140,448</u>
MINORITY INTEREST	<u>1,460,160</u>	<u>1,330,113</u>
TOTAL STOCKHOLDER'S EQUITY	<u>95,386,164</u>	<u>83,470,561</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$246,763,281</u>	<u>\$247,383,814</u>

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

CHUNGHWA PICTURE TUBES, LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
For the years ended December 31, 2005 and 2006
(Expressed in Thousands of New Taiwan Dollars Except Per Share Information)

	2005	2006
OPERATING REVENUES: (Notes 2, 4 and 5)		
NET SALES	\$103,328,792	\$126,605,340
OPERATING COSTS: (Notes 4 and 5)		
COST OF GOODS SOLD	<u>(101,553,501)</u>	<u>(126,326,597)</u>
GROSS PROFIT INCLUDED UNREALIZED INTERCOMPANY PROFIT	1,775,291	278,743
UNREALIZED INTERCOMPANY PROFIT, NET (Notes 2, 4 and 5)	<u>-</u>	<u>(253)</u>
GROSS PROFIT	<u>1,775,291</u>	<u>278,490</u>
OPERATING EXPENSES: (Notes 4 and 5)		
Selling and marketing	(1,779,468)	(3,289,102)
General and administrative	(2,011,476)	(2,897,475)
Research and development	<u>(3,536,678)</u>	<u>(3,947,928)</u>
Total	<u>(7,327,622)</u>	<u>(10,134,505)</u>
OPERATING LOSS	<u>(5,552,331)</u>	<u>(9,856,015)</u>
NON-OPERATING INCOME:		
Interest income (Notes 4 and 11)	489,354	771,053
Investment income recognized by using equity method, net (Note 2)	91,608	-
Gain on disposal of property, plant and equipment (Note 2)	-	1,720
Gain on foreign currency exchange, net (Note 2)	66,242	525,123
Gain on financial assets at fair value through profit or loss, net (Notes 2, 3 and 11)	96,402	364,204
Gain on financial liabilities at fair value through profit or loss, net (Notes 2, 3 and 11)	-	586,883
Recovery on decline in market value and obsolescence of inventory, net (Notes 2 and 4)	111,194	-
Others (Note 5)	<u>207,787</u>	<u>465,481</u>
Total	<u>1,062,587</u>	<u>2,714,464</u>
NON-OPERATING EXPENSES:		
Interest expenses (Notes 2, 4 and 11)	(1,972,591)	(4,961,517)
Investment loss recognized by using equity method, net (Notes 2 and 4)	-	(6,731)
Loss on foreign currency exchange, net (Note 2)	(185,186)	-
Loss on decline in market value and obsolescence of inventory, net (Notes 2 and 4)	-	(190,493)
Impairment loss of available-for-sale financial assets (Notes 2 and 4)	(204,387)	(436,095)
Loss on disposal of property, plant and equipment (Note 2)	(10,836)	(219,001)
Others	<u>(183,653)</u>	<u>(112,808)</u>
Total	<u>(2,556,653)</u>	<u>(5,926,645)</u>
LOSS BEFORE INCOME TAX & CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	(7,046,397)	(13,068,196)
INCOME TAX EXPENSES (Notes 2 and 4)	<u>(201,401)</u>	<u>(51,388)</u>
LOSS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLES	(7,247,798)	(13,119,584)
CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES (Note 3)	<u>-</u>	<u>(806,822)</u>
NET LOSS	<u><u>\$(7,247,798)</u></u>	<u><u>\$(13,926,406)</u></u>
ATTRIBUTABLE TO:		
Stockholders of the parent	\$(7,352,301)	\$(13,966,810)
Minority interest	<u>104,503</u>	<u>40,404</u>
	<u><u>\$(7,247,798)</u></u>	<u><u>\$(13,926,406)</u></u>
LOSS PER SHARE		
STOCKHOLDERS OF THE PARENT (Notes 2 and 4)		
BASIC (in dollars)	<u><u>\$(0.94)</u></u>	<u><u>\$(1.70)</u></u>
DILUTED (in dollars)	<u><u>\$(0.94)</u></u>	<u><u>\$(1.70)</u></u>

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

CHUNGHWA PICTURE TUBES, LTD. AND SUBSIDIARIES
 STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
 For the years ended December 31, 2005 and 2006
 (Expressed in Thousands of New Taiwan Dollars)

	EQUITY ATTRIBUTABLE TO STOCKHOLDERS' OF THE PARENT																		
	CAPITAL		CAPITAL RESERVES				RETAINED EARNINGS				OTHER ITEMS IN STOCKHOLDERS' EQUITY								
	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	PREMIUM ON CONVERTIBLE BONDS	TREASURY STOCK	LONG-TERM INVESTMENTS	EQUITY COMPONENTS OF CONVERTIBLE BONDS	LEGAL RESERVE	SPECIAL RESERVE	UNDISTRIBUTED EARNINGS (ACCUMULATED DEFICITS)	CUMULATIVE TRANSLATION ADJUSTMENT	EXCESS OF ADDITIONAL PENSION LIABILITY OVER UNRECOGNIZED PRIOR SERVICE COST	UNREALIZED LOSS ON AVAILABLE - FOR - SALE FINANCIAL ASSET	UNREALIZED LOSS ON CASH FLOW HEDGE	UNREALIZED INCREMENTAL VALUE FROM REVALUATION	TREASURY STOCK	TOTAL	MINORITY INTEREST	TOTAL STOCKHOLDERS' EQUITY	
Balance at January 1, 2005	\$68,564,159	\$14,626,171	\$3,927,694	\$744	\$-	\$-	\$93,996	\$845,962	\$10,317,715	\$(566,572)	\$(160,758)	\$(2,398,311)	\$-	\$665,016	\$(1,039,743)	\$94,776,073	\$1,438,130	\$96,214,203	
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)		(4,086,049)	
Employees' dividend-cash									(280,246)							(280,246)		(280,246)	
Stock dividend	1,362,016								(1,362,016)										
Employees' dividend-stock	420,380								(420,380)										
Retired of treasury stock	(534,120)	(79,950)	(26,201)	(744)					(398,728)					1,039,743					
Transfer of capital reserves to common stock (Note 4)	4,767,057	(4,767,057)																	
Net loss for the year 2005									(7,352,301)							(7,352,301)	104,503	(7,247,798)	
Convertible bonds converted into common stock (Note 4)	338,266		127,184													465,450		465,450	
Capital increase by cash in premium (Note 4)	7,000,000	2,483,215														9,483,215		9,483,215	
Adjustments of changes in ownership percentage																			
in investee accounted for under the equity method (Note 2)									(5,509)							(5,509)		(5,509)	
Unrealized loss on available -for- sale financial assets (Notes 2 and 4)												(312,919)				(312,919)		(312,919)	
Cumulative translation adjustments, net of related tax effect (Notes 2 and 4)										884,156						884,156		884,156	
Proportional adjustments on reserve for assets revaluation in investee accounted for under the equity method (Notes 2 and 4)													77,821			77,821		77,821	
Proportional adjustments on capital reserve for conversion of convertible bonds in investee accounted for under the equity method (Note 2)					239											239		239	
Proportional adjustments on excess of additional pension liabilities over recognized prior service cost in investee accounted for under the equity method (Note 2)																(3,116)		(3,116)	
Excess of additional pension liabilities over unrecognized prior service cost (Notes 2 and 4)																30,025		30,025	
Issuance of common stock-exercise of stock option (Notes 2 and 4)	208,290	40,875														249,165		249,165	
Decrease in minority interest (Note 2)																	(82,473)	(82,473)	
Balance at December 31, 2005	82,126,048	12,303,254	4,028,677	-	239	-	1,125,768	3,125,641	(6,898,965)	317,584	(133,849)	(2,711,230)	-	642,837	-	93,926,004	1,460,160	95,386,164	
Effect of initial adoption of the SFAS No.34 (Note 3)												60,189	(285,982)			(225,793)	(4,300)	(230,093)	
Effect of initial adoption of the SFAS No.34 in investee accounted for under the equity method (Note 3)												1,514				1,514		1,514	
Make up accumulated deficits in 2005 (Note 4)																			
Transfer capital reserve and special reserve to make up accumulated deficits		(2,647,556)					(1,125,768)	(3,125,641)	6,898,965										
Net loss for the year 2006									(13,966,810)							(13,966,810)	40,404	(13,926,406)	
Adjustments of changes in ownership percentage																			
in investee accounted for under the equity method (Note 2)					92,981				(12,561)							80,420		80,420	
Cumulative translation adjustment (Notes 2 and 4)										632,452						632,452		632,452	
Proportional adjustments on unrealized loss on available - for - sale financial asset in investee accounted for under the equity method (Notes 2 and 4)												12,072				12,072		12,072	
Issued convertible bonds							572,717									572,717		572,717	
Proportional adjustments on excess of additional pension liabilities over recognized prior service cost in investee accounted for under the equity method (Note 2)																(1,011)		(1,011)	
Unrealized loss on available - for - sale financial assets (Notes 2 and 4)												1,300,092				1,300,092		1,300,092	
Unrealized loss on cash flow hedge (Notes 2 and 4)												236,837				236,837	2,786	239,623	
Excess of additional pension liabilities over unrecognized prior service cost (Notes 2 and 4)																(428,046)		(428,046)	
Decrease in minority interest (Note 2)																	(168,937)	(168,937)	
Balance at December 31, 2006	\$82,126,048	\$9,655,698	\$4,028,677	\$-	\$93,220	\$572,717	\$-	\$-	\$(13,979,371)	\$950,036	\$(562,906)	\$(1,337,363)	\$(49,145)	\$642,837	\$-	\$82,140,448	\$1,330,113	\$83,470,561	

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

CHUNGHWA PICTURE TUBES, LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, 2005 and 2006
(Expressed in Thousands of New Taiwan Dollars)

	2005	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss attributable to stockholders of the parent	\$(7,352,301)	\$(13,966,810)
Net income attributable to minority interest	104,503	40,404
Net loss	<u>(7,247,798)</u>	<u>(13,926,406)</u>
Adjustments to reconcile net loss to net cash provided by in operating activities:		
Exchange rate effect (Note 2)	(21,983)	(129,340)
Depreciation (Notes 2 and 4)	16,833,494	22,509,862
Amortization (Notes 2 and 4)	1,013,109	1,341,339
Investment loss (income) recognized by using equity method, net (Note 2)	(91,608)	6,731
Cash dividend received from investment accounted for under the equity method (Note 2)	94,939	74,554
Impairment loss of financial assets (Notes 2 and 4)	204,387	436,095
Loss on disposal of property, plant and equipment, net (Note 2)	10,836	217,281
Loss on decline in market value and obsolescence of inventory, net (Note 2)	-	190,493
Decrease (increase) in financial assets at fair value through profit or loss	(277,250)	563,202
Increase (decrease) in financial liabilities at fair value through profit or loss	158,295	(265,229)
Amortization of premium on bonds payable	(83,646)	-
Forfeited interest on convertible bonds	5	-
Amortization of discount on commercial paper payable	9,658	74,158
Change in operating assets and liabilities:		
Decrease in notes receivable	(175,750)	(77,579)
Decrease (increase) in accounts receivable-trade	(3,816,775)	3,368,270
(Increase) decrease in due from affiliates-trade	1,237,674	(1,375,330)
(Increase) decrease in accounts receivable-others	380,185	(108,620)
Increase in due from affiliates-others	(657)	(161,072)
Increase in inventories	(3,465,900)	(4,425,349)
Increase in prepayment for materials-non-current	(2,282,511)	(844,021)
Increase in prepayments	(14,674)	(589,904)
Decrease in deferred tax assets	47,650	-
Increase (decrease) in notes payable	288,835	(99,724)
Increase in accounts payable	7,634,841	5,494,594
Decrease in due to affiliates-trade	(1,520,609)	(996,409)
Decrease in accounts payable-others	(497,476)	(3,945,271)
Increase (decrease) in due to affiliates-others	(988,508)	931,668
Increase in accrued expenses	709,664	1,586,703
Decrease (Increase) in income tax payable	11,148	(63,685)
Increase in accrued pension liabilities	387,335	402,043
Payments for pension	(193,729)	(345,402)
Increase in compensation interest payable	222,104	288,306
Decrease in deferred tax liability	(33,150)	(332)
Increase in deferred credits	-	253
Increase (decrease) in other current liabilities	(83,853)	102,199
Net cash provided by operating activities	<u>8,448,282</u>	<u>10,234,078</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Decrease in pledged time deposits	1,667,507	41,964
Increase in investment accounted for under the equity method	-	(1,789,901)
Increase in deferred charges	(1,792,816)	(1,317,485)
Proceeds from disposal of property, plant and equipment	31,107	517,549
Additions to property, plant and equipment	(60,570,966)	(14,677,681)
Decrease (increase) in refundable deposits	30,655	(65,751)
Net cash used in investing activities	<u>(60,634,513)</u>	<u>(17,291,305)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase (decrease) in short-term bank loans	(5,502,817)	2,885,649
Issuance of convertible bonds	-	8,048,174
Repayments of bonds payable	(5,580,383)	-
Redemption of bonds payable	(1,358,165)	-
Increase in long-term bank loans	60,300,169	10,071,075
Repayments of long-term bank loans	(12,503,623)	(12,018,914)
Decrease (increase) in long-term payable	(32,406)	255,640
Decrease in minority interest	(82,473)	(168,937)
Proceeds from exercise of stock options	249,165	-
Capital increase by cash in premium	9,483,215	-
Cash dividends	(4,086,049)	-
Employees' bonus-cash	(280,246)	-
Net cash provided by financing activities	<u>40,606,387</u>	<u>9,072,687</u>
EXCHANGE RATE EFFECT	<u>1,539,362</u>	<u>(180,337)</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(10,040,482)</u>	<u>1,835,123</u>
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	42,856,218	32,815,736
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	<u>\$32,815,736</u>	<u>\$34,650,859</u>
SUPPLEMENT DISCLOSURES OF CASH FLOWS INFORMATION:		
Interest expenses paid, net of amount capitalized	<u>\$1,792,003</u>	<u>\$4,441,211</u>
Income tax expense paid	<u>\$185,603</u>	<u>\$148,693</u>
INVESTING AND FINANCING ACTIVITIES NOT AFFECTING CASH FLOWS:		
Current portion of long-term debt (Note 4)	<u>\$10,173,088</u>	<u>\$26,395,534</u>
Other assets transferred to property, plant and equipment	<u>\$271,106</u>	<u>\$-</u>
Conversion of convertible bond into common stock	<u>\$465,450</u>	<u>\$-</u>

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

CHUNGHWA PICTURE TUBES, LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of and for the years ended December 31, 2005 and 2006

(Expressed in Thousands of New Taiwan Dollars Except Par Value, Shares or Stated Otherwise)

1. Description of Business

Chunghwa Picture Tubes, Ltd. (the “Company” or “CPT”) was incorporated under the Company Law in the Republic of China (“ROC”) on May 4, 1971. The main activities of the Company and subsidiaries include the design, manufacture, sale, installation, maintenance service, import, export and agency service of cathode ray tubes (“CRT”), electron guns, deflection yokes, thin film transistor liquid crystal displays (“TFT-LCD”), color filter (“CF”) and related materials, parts and components.

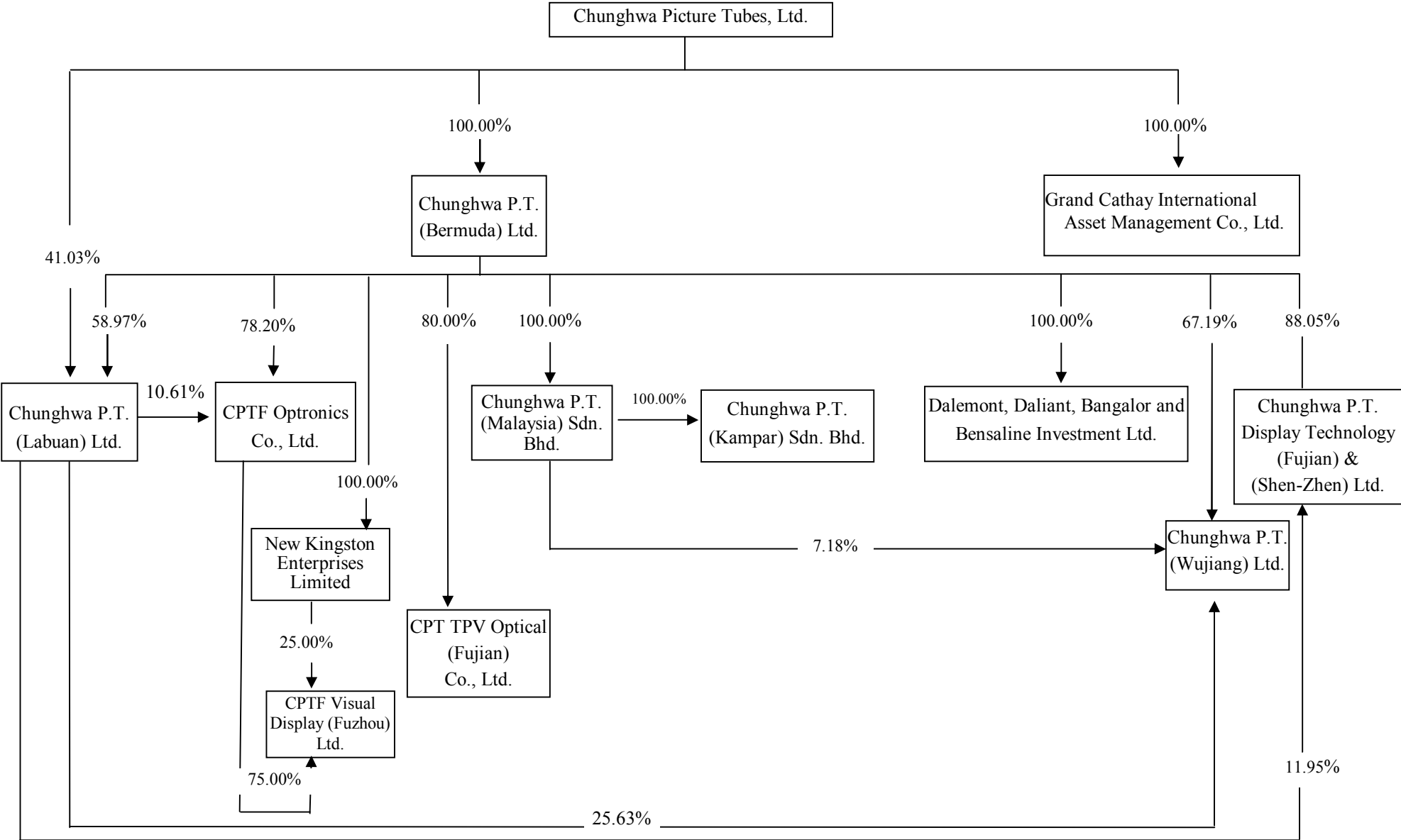
As of December 31, 2005 and 2006, the Company and subsidiaries had 22,945 and 22,592 employees, respectively.

The Company is required to include the accounts of following direct or indirect majority-owned subsidiaries in its consolidated financial statements:

Name of Investor	Name of Investee	Business Nature	Country of Incorporation	Percentage of ownership (%)	
				As of December 31 2005	2006
Chunghwa Picture Tubes, Ltd. (“CPT”)	Chunghwa Picture Tubes (Bermuda) Ltd. (“CPTB”)	Investment holding	British	100	100
CPT and CPTB	Chunghwa Picture Tubes (Labuan) Ltd. (“CPTL”)	Sales services and investment holding	Malaysia	100	100
CPTB	Chunghwa Picture Tubes (Malaysia) Sdn. Bhd. (“CPTM”)	Manufacture and sale of color cathode ray tubes (“CCRT”) and investment holding	Malaysia	100	100
	Dalemont Investment Ltd.	Investment holding	British Virgin Islands (“BVI”)	100	100
	Daliant Investment Ltd.	Investment holding	BVI	100	100
	Bangalor Investment Ltd.	Investment holding	BVI	100	100

Name of Investor	Name of Investee	Business Nature	Country of Incorporation	Percentage of ownership (%)	
				As of December 31	
				2005	2006
	Bensaline Investment Ltd.	Investment holding	BVI	100	100
CPTB	New Kingston Enterprise Limited (“NKEL”)	Investment holding	BVI	100	100
CPTB	CPT TPV Optical (Fujian) Co., Ltd.	Assembly final modules of TFT-LCD	The People’s Republic of China (“PRC”)	80	80
CPTB and CPTL	CPTF Optronics, Ltd. (“CPTFO”)	Manufacture and sales of CCRT and electron guns	PRC	88.81	88.81
	Chunghwa Pictures Display Technology (Fujian) Ltd. (“FDT”)	Assembly final module of TFT-LCD	PRC	100	100
	Chunghwa Picture Display Technology (Shen-Zhen) Ltd. (“SDT”)	Assembly final module of TFT-LLD; high definition TV and projectors	PRC	100	100
CPTB, CPTL and CPTM	Chunghwa Picture Tubes (Wujiang) Ltd. (“CPTW”)	Assembly final module of TFT-LCD	PRC	100	100
CPTFO and NKEL	CPTF Visual Display (Fuzhou) Ltd. (“FVD”)	Manufacture components of TFT-LCD	PRC	100	100
CPTM	Chunghwa Picture Tubes (Kampar) Sdn. Bhd. (“CPTK”)	Manufacture and sale of electron guns	Malaysia	100	100
CPT	Grand Cathay International Asset Management Co., Ltd. (Formerly Known as Grand Cathay Optronics Co., Ltd.)	Investment holding	ROC	100	100

The following diagram presents the relationship and ownership percentage among the Company and subsidiaries (wholly-owned or controlling company which owns less than 50% of the voting common stock) as of December 31, 2006:



2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Generally Accepted Accounting Principles

The consolidated financial statements have been prepared in accordance with “Business Accounting Law”, “Guidelines Governing the Preparation of Financial Report by Securities Issuers” and accounting principles generally accepted in the Republic of China (collectively referred to as “ROC GAAP”). Certain accounts reported in previous year have been reclassified to conform to the 2006 presentation.

Principles of Consolidation

The consolidated financial statements include the account of the Company and all majorities (directly and indirectly) owned subsidiaries and subsidiaries that the Company controls but owns less than 50% of the voting common stock. Significant intercompany balances and transactions among consolidated entities have been eliminated.

Minority interest in CPTF Optronics Co., Ltd. (11.19%) and CPT TPV Optical (Fujian) Co., Ltd (20%) is presented as a separate the stockholders’ equity.

Foreign Currency Transactions and Translation

The Company maintains its accounting records in New Taiwan dollars ("NT dollars" or "NT\$"). 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 consolidated 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.

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.

Cash Equivalents

The Company and subsidiaries 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 and subsidiaries adopted the ROC SFAS No.34, "Accounting for Financial Instruments" and No.36, "Disclosure and Presentation of Financial Instruments" to classify its financial assets: at fair value through profit or loss, available-for-sale and carried at cost; the financial liabilities: at fair value through profit or loss, derivative financial liabilities for hedging and carried at cost.

When financial assets or liabilities are recognized initially, they are measured at fair value, plus transaction costs for all financial assets or liabilities not carried at fair value through profit or loss.

(1) Financial assets 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 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 recognized in equity should be included in the consolidated statement of operations.

The fair value is determined by reference to the close price at the balance sheet date for listed equity securities, convertible bonds and close-end mutual funds 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.

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

(4) Financial liabilities

The Company and subsidiaries recognize all financial liabilities at amortized costs, except for financial liabilities at fair value through profit and loss and derivative financial liabilities for hedging. Such liabilities are measured at fair value.

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 consolidated 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 ROC SFAS No. 35, the Company assesses indicators for impairment for all its assets within the scope of ROC 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 are classified as non-operating losses/income.

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.

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.

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.

Investment in Associated Companies

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.

Unrealized intercompany gains and losses are eliminated under the equity method. Profit from sales of depreciable assets between the investee and the Company is amortized and recognized based on the assets' economic service lives. Profit from other types of intercompany transactions is recognized when realized.

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 shares held is increased.

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	3-15 years
Transportation equipment	5 -7 years
Furniture and fixtures	4-12 years
Miscellaneous equipment	4-12 years

When an impairment loss has been recognized, the depreciation for an impairment asset will be recalculated based on the adjusted value over the estimated useful lives.

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

Land Use Rights

Subsidiaries leased their land from the government of the People's Republic of China ("PRC"). The land use rights are amortized over the lease term of 50 years from the commencement of the business operation.

Deferred Charges

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

- Shadow mask – 2~5 years
- Bond issuance costs –the redemption period or over the period from issuance date to maturity date if the Bonds issued prior to December 31, 2005; Bond issuance costs will be treated as a reduction of the related debt liabilities if the Bonds issued after January 1, 2006.
- Expense of syndicated loan application – the term of syndicated loan.
- Technology license fees – 5 years or the term of the technology cooperation contract.

- Other charges – 3~10 years

Convertible Bonds

For convertible bonds issued 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.

For convertible bonds issued after January 1, 2006, the components of compound financial instrument with an embedded derivative that is not clearly and closely related to the host contract are bifurcated 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 (conversion option with a fixed exchange rate feature). The present value of the liability component is calculated using the market interest rate for similar debt without conversion options until the day before the conversion date. The liability component is subsequently measured at amortized cost, and changes in fair value of the equity component are not recognized while changes in fair value of the call and put option are reported to the consolidated statement of operations. When the bondholder exercises the conversion option before bond maturity, the adjusted carrying value of the debt components (bonds and embedded derivatives are included) is credited to a capital stock accounts. Bond issuance costs were allocated proportionately to the equity and liability components. Of this cost, equity components are presented under non-operating expenses and losses and liability components are amortized using the effective interest rate method to present under the interest expenses.

Pension

Funded defined benefit pension plans: Under these plans, the net pension cost is computed based on an actuarial valuation in accordance with the provision of ROC 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.

Funded defined contribution pension plans: Under these plans, the only obligation is to make periodical contributions to pension funds maintained with local governments. The net pension cost is recorded based on the actual contribution made to the employees' individual pension account.

Accounting for Derivative Financial Instruments and Hedging Activities

The Company and subsidiaries recognized derivative as either assets (when the fair value is positive) or liabilities

(when the fair value is negative) on the balance sheets and measured those instruments at fair value. Contracts that are effective at meeting the risk reduction and correlation criteria are recorded using hedge accounting.

The Company and subsidiaries formally documents at inception all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking various accounting hedges. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value of the hedged items. The Company and subsidiaries assesses on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

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 earnings 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 consolidated 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.

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 the carrying value of treasury stock, the excess is credited to capital reserve from treasury stock transaction. If the proceeds from disposal of treasury stock less than the carrying value of treasury stock, the difference should first be charged

against capital reserve from treasury stock transaction of the same nature, and the remainder, if any, 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 its 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.

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

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.

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 ROC is below the minimum amount prescribed under the AMT Act.

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.

Recognition of dividend

When cash dividends on equity securities are declared from pre-acquisition profits (for example, in the year of investment) , those dividends are credited to the securities account rather than to investment income except for cash dividends from financial assets at fair value through profit or loss. Receipts of cash dividends declared in the subsequent years are recognized as investment income on the date of ex-dividend or the date of shareholders' meeting. However, if the accumulated cash dividends distributed exceed to accumulated net incomes or losses for the time period starting from the investment to the prior year end, then the exceed parts shall be credited to the cost of the equity securities rather than to the investment income account.

Stock dividends are not recognized as investment income but instead as increase in the number of shares held.

Earnings Per 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 (expenses). 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.

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 and subsidiaries adopted the ROC 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 and subsidiaries adopted the ROC 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 ROC SFAS No.34 and No.36:

The Company and subsidiaries had properly categorized their financial assets and liabilities upon initial

adoption of the ROC 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 stockholders' equity.

The effect of adopting the ROC SFAS No.34 and No.36 is summarized as follows:

	Recognized as cumulative effect of change in accounting principles	Recognized as a separate component of Stockholders' equity
Financial assets at fair value through profit or loss	\$9,279	\$-
Unrealized losses on available-for-sale financial assets-non-current	-	60,189
Proportional adjustment on unrealized losses on available-for-sale financial assets accounted for under the equity method	-	1,514
Unrealized loss on derivative financial liabilities for cash flow hedge-non-current	-	(285,982)
Financial liabilities at fair value through profit or loss	(816,101)	-
	<u>\$ (806,822)</u>	<u>\$ (224,279)</u>

The adoption of the ROC SFAS No.34 and No.36 resulted in an increase in net loss before cumulative effect of changes in accounting principles of \$806,822 and basic loss per share of \$0.1 (in dollar) for the year ended December 31, 2006.

b. Reclassifications:

Certain accounts in the consolidated financial statements as of and for the year ended December 31, 2005 have been reclassified to conform to the classifications prescribed by the ROC SFAS No.34 and No.36. The reclassifications of the whole or a part of the account balances of certain accounts are summarized as follows:

As of December 31, 2005			
Before reclassification		After reclassification	
The account of balance sheet	Amount	The account of balance sheet	Amount
Marketable securities	\$1,585,042	Financial assets at fair value through profit or loss	\$1,585,042
Long-term investment accounted under the cost method	2,754,642	Available-for-sale financial assets-non-current	2,514,870
		Financial assets carried at cost-non-current	239,772
Forward exchange contracts payable,		Financial liabilities at fair value	

net	1,095	through profit or loss (Note)	1,095
Accrued expenses – foreign currency option contracts, net (Note)	(266,368)	Financial liabilities at fair value through profit or loss (Note)	(266,368)
Unrealized losses on long-term investments	(2,711,230)	Unrealized losses on available-for-sale financial assets	(2,711,230)

For the year ended December 31, 2005

Before reclassification		After reclassification	
The account of statement of operations	Amount	The account of statement of operations	Amount
Loss on foreign currency exchange, net	\$118,944	Net loss on financial liabilities at fair value through profit or loss	\$185,186
Gain on foreign currency exchange	-	Gain on foreign currency exchange, net	66,242
Gain on disposal of marketable securities, net	96,402	Net gain on financial assets at fair value through profit or loss	96,402

(Note) Effective from the fourth quarter of the year 2004, in accordance with interpretations of the ROC GAAP, the carrying amount of outstanding call or 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 consolidated statement of operations.

Certain accounting policies prior to the adoption of the ROC 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 consolidated 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.

The fair value is determined by reference to the average close price during the last month of period for listed equity securities, convertible bonds and close-end mutual funds, or the net asset value per unit at the balance sheet date for open-end mutual funds.

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 consolidated 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 consolidated 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 consolidated 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 consolidated 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.

Interest rate swap contracts:

No accounting entry is recorded 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

	December 31	
	2005	2006
Cash on hand	\$6,104	\$4,966
Cash in banks-checking and savings account	15,750,296	12,134,788
Cash in banks-time deposits	17,059,336	22,511,105
Total	<u>\$32,815,736</u>	<u>\$34,650,859</u>

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

	December 31	
	2005	2006
<u>Assets</u>		
Financial assets held for trading:		
Open-end mutual funds	\$1,585,042	\$582,427
Foreign currency forward exchange contracts	1,095	94,533
Financial assets designated at fair value through profit or loss:		
ROC convertible bonds	-	345,975
Total	<u>\$1,586,137</u>	<u>\$1,022,935</u>
<u>Liabilities</u>		
Foreign currency option contacts	\$266,368	\$-
Foreign currency forward exchange contracts	-	1,139

Debt components of convertible bonds-call and put option	-	1,447,211
Less : non-current liabilities	-	(1,447,211)
Total	<u>\$266,368</u>	<u>\$1,139</u>

Detailed information of the derivative financial instruments above refers to Note 4 (13) and Note 11.

(3) Derivative financial assets and liabilities for hedge

	December 31	
	2005	2006
<u>Assets</u>		
Foreign currency forward exchange contracts	\$-	\$56,143
Less : non-current portion	-	(44,516)
Foreign currency forward exchange contracts - current	<u>\$-</u>	<u>\$11,627</u>
<u>Liabilities</u>		
Foreign currency forward exchange contracts - current	<u>\$-</u>	<u>\$35,699</u>
Interest rate swap contract – non - current	<u>\$-</u>	<u>\$89,499</u>

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

(4) Receivable, net

	December 31	
	2005	2006
Notes receivable	\$242,446	\$320,261
Less: Allowance for doubtful accounts	-	(236)
Net	<u>\$242,446</u>	<u>\$320,025</u>
Accounts receivable-trade	\$21,548,765	\$18,072,338
Less: Allowance for doubtful accounts	(557,721)	(449,564)
Net	<u>\$20,991,044</u>	<u>\$17,622,774</u>
Due from affiliates-trade	\$1,885,169	\$3,274,962
Less: Allowance for doubtful accounts	(18,537)	(33,000)
Net	<u>\$1,866,632</u>	<u>\$3,241,962</u>

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

	December 31	
	2005	2006
Prepaid proceeds from factor	\$1,250,837	\$1,540,049
Due from factor (Note 1)	<u>220,736</u>	<u>271,774</u>

Amounts derecognized of accounts receivable	\$1,471,573	\$1,811,823
The range of interest rate of prepaid proceeds	3.67%~5.13%	4.77%~6.17%
Credit line	\$6,971,600	\$5,400,000
Promissory note (Note 2)	\$500,000	\$1,240,000

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

	December 31	
	2005	2006
Raw materials and supplies	\$6,741,965	\$6,189,360
Work in process	3,138,720	4,187,759
Finished goods	3,074,729	6,882,207
Raw materials in transit	1,605,949	1,727,386
Subtotal	14,561,363	18,986,712
Less: Allowance for decline in market value and obsolescence	(192,573)	(383,066)
Net	\$14,368,790	\$18,603,646
Insurance coverage	\$13,344,912	\$17,872,346

(6) Investment in associated companies

Name of Investee	December 31			
	2005		2006	
	Amount	Percentage of ownership (%)	Amount	Percentage of ownership (%)
<u>Unlisted Company</u>				
Shang Chin Investment Co., Ltd.	\$33,835	25.00	\$59,405	25.00
Makolin Electronics (M) Sdn. Bhd.	83,467	42.00	\$78,530	42.00
Toppan Chunghwa Electronics Co., Ltd.	922,516	30.00	962,480	22.49
Sintronic Technology Inc.	-	-	386,014	19.45
Subtotal	1,039,818		1,486,429	
<u>Listed Company</u>				
Forward Electronics Co., Ltd.	506,466	22.78	534,356	17.36
<u>Listed Company</u>				
Xiamen Overseas				
Chinese Electronic Co., Ltd.	-		1,170,287	27.00
Prepayments	-		188,100	-

Total	<u>\$1,546,284</u>	<u>\$3,379,172</u>
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- a. During 2006, Grand Cathay International Asset Management Co., Ltd. acquired 19.45% common shares of Sintronic Technology Inc., a company based in Taiwan which manufactured cold cathode fluorescent lamps.
- b. During 2006, Chunghwa Picture Tubes (Wujiang) Ltd. (“CPTW”), a subsidiary of Chunghwa P.T. (Bermuda) Ltd., acquired 27.00% shares of Xiamen Overseas Chinese Electronic Co., Ltd.

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

Name of Listed Companies	December 31			
	2005		2006	
	Amount	Percentage of ownership (%)	Amount	Percentage of ownership (%)
Tatung Co., Ltd.	\$5,238,780	5.25	\$5,238,780	5.06
Country Heights Holding Berhad	2,231,208	17.41	2,231,208	17.41
Cumulative translation adjustment	(389,148)		(424,084)	
Allowance for impairment loss on available-for-sale financial assets	(1,229,057)		(1,625,260)	
Allowance for unrealized loss on available-for-sale financial assets	<u>(3,336,913)</u>		<u>(1,674,129)</u>	
Total	<u>\$2,514,870</u>		<u>\$3,746,515</u>	

Chunghwa P.T. (Malaysia) recognized an impairment loss in value of the investment in Country Heights Holding Berhad amounted to \$204,387 and \$396,203 for the years ended December 31, 2005 and 2006, respectively.

(8) Financial assets carried at cost-non-current

	December 31			
	2005		2006	
	Amount	Percentage of ownership (%)	Amount	Percentage of ownership (%)
Mines Golf Resort Berhad (Formerly known as Country Heights Golf Resort Sdn. Bhd.)	\$185,425	10.00	\$185,425	10.00
Fujian JVC Electronics Co., Ltd.	70,014	10.00	70,014	10.00
Cumulative translation adjustment	(15,667)		(17,330)	
Allowance for impairment loss on financial assets carried at cost	-		<u>(39,892)</u>	
Total	<u>\$239,772</u>		<u>\$198,217</u>	

Chunghwa P.T. (Malaysia) recognized an impairment loss in value of the investment in Mines Golf Resort Berhad amounted to \$39,892 in 2006.

(9) 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 December 31, 2006, the revalued assets amounted to \$57,192.
- b. In accordance with related regulations in Malaysia, Chunghwa P.T. (Malaysia) revalued its land with a revaluation increase of USD27,380 thousand which was added to total assets and credited to other items in stockholders' equity.
- c. The insurance coverage over property, plant and equipment as of December 31, 2005 and 2006 amounted to \$190,274,108 and \$177,059,528, respectively.
- d. Interest expense (before deducting capitalized amounts of \$801,083 and \$86,831) for the years ended December 31, 2005 and 2006 was \$2,773,674 and \$5,048,348, respectively. The interest rates of capitalized interest for the years ended December 31, 2005 and 2006 ranged from 0.41% to 6.30% and 4.18%-6.46%, respectively.

(10) Deferred charges

	December 31	
	2005	2006
Shadow mask	\$1,824,855	2,066,545
Technology license fees	1,020,750	901,315
Bond issuance cost	61,051	17,956
Expense of syndicated loan application	204,980	170,072
Others	277,319	212,245
Total	<u>\$3,388,955</u>	<u>\$3,368,133</u>

(11) Other assets-other

As of December 31, 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 title deeds and land purchase agreement.

(12) Short-term bank loans

Items	December 31	
	2005	2006

Usance L/C loan	\$1,248,438	\$466,693
Unsecured loan	6,029,080	9,696,474
Total	<u>\$7,277,518</u>	<u>\$10,163,167</u>
Interest rates	<u>0.41%~6.10%</u>	<u>0.42%~6.48%</u>

(13) Bonds payable

	December 31	
	2005	2006
Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2007	\$7,015,610	\$6,970,775
Add: Compensation interest payable	195,539	376,125
Subtotal	<u>7,211,149</u>	<u>7,346,900</u>
Zero Coupon Convertible Bonds, issued in 2006 and due 2011-Debt components, net	-	6,128,072
Less: Current portion of bonds payable	-	(7,346,900)
Bonds payable, net of current portion	<u>\$7,211,149</u>	<u>\$6,128,072</u>

The significant terms of the Convertible Bonds are as follows:

	Credit Enhanced Zero Coupon Convertible Bonds, issued in 2004 and due 2007	Zero Coupon Convertible Bonds, issued in 2006 and due 2011
· Amount:	US\$213.5 million	US\$250 million
· Issue price:	100%	100%
· Duration:	30 months (2004.12.8 to 2007.6.8)	5 years (2006.7.14 to 2011.7.14)
· Place of trading:	Singapore Stock Exchange	Singapore Stock Exchange
· Coupon rate:	-	-

· 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 \$32.371=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 \$32.345=US\$1)
· Conversion price and adjustment:	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 December 31, 2006, the conversion price was \$14.33 per share.	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. As of December 31, 2006, the conversion price was \$6.83 per share.

Credit Enhanced Zero Coupon
Convertible Bonds, issued in 2004
and due 2007

Zero Coupon Convertible Bonds, issued
in 2006 and due 2011

· Company's redemption rights:	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.	① On and after January 14, 2008, 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.
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- 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 June 8, 2007 at 105.36% of their principal amount.
- 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
 - None.
 - The bondholders may demand the Company to redeem the bonds if trading of the Company's shares is restricted on the TSE.
 - Converting status
 - None.
 - None.
- 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.

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 ratio, tangible assets ratio and other financial ratios which certain restrictions as prescribed in the agreements of bonds payable on annual consolidated basis and semi-annual unconsolidated basis.

As of December 31, 2005, the Company breached one or more of financial covenants as specified with agreements of bonds payable. The committed bank of bonds payable could declare the Bonds immediately due and payable. However, the Company believes that they will be able to obtain waivers after taking necessary action to remedy the violation.

In accordance with the ROC SFAS No.36, "Disclosure and Presentation of Financial Instruments", the Company bifurcated its Zero Coupon Convertible Bonds, issued in 2006 and due 2011, as a liability and an equity component. The recognized amounts on December 31, 2006 are summarized as follows:

	<u>Amount</u>
Fair value of Zero Coupon Convertible Bonds, issued in 2006 and due 2011	\$8,048,174
Equity components	(572,717)
Debt components-call and put option	<u>(1,447,211)</u>

Debt components-non-derivative	6,028,246
Valuation adjustment	(8,870)
Interest expenses	108,696
Total	<u>\$6,128,072</u>

The Company applied to issue overseas zero coupon convertible bonds totaling USD250 million . As of the date of this report, the ROC Securities Future Bureau (“SFB”) approved the filing and the offering procedures are in process.

(14) Long-term bank loans

	December 31	
	2005	2006
Unsecured syndicate loan	\$13,950,670	\$15,772,871
Secured loan	67,108,666	64,813,046
Secured-usance L/C loan	1,889,584	239,046
Subtotal	<u>82,948,920</u>	<u>80,824,963</u>
Commercial paper payable	3,000,000	3,000,000
Less: Unamortized discount of commercial paper payable	<u>(65,343)</u>	<u>(73,685)</u>
Subtotal	<u>2,934,657</u>	<u>2,926,315</u>
Less: current portion	<u>(10,173,088)</u>	<u>(19,048,634)</u>
Net	<u>\$75,710,489</u>	<u>\$64,702,644</u>
Interest rates	<u>0.60%~6.30%</u>	<u>0.42%~7.10%</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, 2006, the Company breached one or more of financial covenants which prescribed in the agreements of syndicated loan. The Bank of syndicated 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 syndicated loan. The Company classified the L/C loan and commercial paper payable as long-term bank loans because the term of the syndicated 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 former President of the Company (the President resigned from his position effective from March 30, 2007). In addition, these loans are secured by the mortgage of the Company's building and machinery and equipment (included prepayment on equipment).
- e. As of December 31, 2006 and 2005, long-term bank loans (excluding long-term usance L/C secured bank loans and commercial paper payable) denominated in currencies are as follows:

(Unit: in thousands dollars)

<u>2006.12.31</u>	<u>Unsecured loan</u>	<u>Secured loan</u>
USD	\$290,549	\$457,214
RMB	231,000	-
NTD	120,000	49,885,000

<u>2005.12.31</u>	<u>Unsecured loan</u>	<u>Secured loan</u>
USD	\$405,860	\$525,857
RMB	92,000	-
NTD	240,000	49,829,000

(15) Pension

A. Pension expenses:

<u>Type of pension plan</u>	<u>2005</u>	<u>2006</u>
Defined benefit pension plan	\$299,258	\$219,489
Defined contribution pension plan	88,077	182,554
Total	<u>\$387,335</u>	<u>\$402,043</u>

B. Funded defined benefit pension plan:

- a. Effective from October 1996, as required by the ROC Labor Standard Law, the Company makes monthly contributions to a pension fund at a pre-determined percentage of salaries paid. The pension fund is administered by the employee committee and deposited, under the committee's name, with Central Trust of China.
- b. Details of net periodic pension cost of the defined benefit pension plan for the years ended December 31, 2005 and 2006 are as follows:

	<u>2005</u>	<u>2006</u>
Employee service cost	\$177,080	\$100,992
Interest cost	79,752	85,999
Expected return on plan assets	(13,139)	(14,772)
Amortization of net transition obligation	33,746	33,746
Amortization of actuarial gain or loss	21,819	13,524
Total	<u>\$299,258</u>	<u>\$219,489</u>

- c. The reconciliation statements of reporting funded status of the defined benefit pension plan as of December 31, 2005 and 2006 are as follow:

	December 31	
	2005	2006
Pension obligation		
Vested	\$187,890	\$115,348
Non-Vested	2,061,026	2,447,178
Accumulated benefit obligation	2,248,916	2,562,526
Additional benefits based on future salaries	263,601	298,865
Projected benefit obligation	2,512,517	2,861,391
Fair value of plan assets	(454,510)	(318,388)
Funded status	2,058,007	2,543,003
Unamortized net transition obligation	(168,729)	(134,983)
Unrealized loss on pension assets	(387,951)	(851,262)
Deferred pension cost	168,729	134,983
Excess of additional pension liability over unrecognized prior service cost	124,350	552,397
Accrued pension liability	1,794,406	2,244,138
Less: current portion	(113,175)	(72,628)
Long-term portion, net of current portion	<u>\$1,681,231</u>	<u>\$2,171,510</u>

- d. Major actuarial assumptions are as follows:

	December 31	
	2005	2006
Discount rate	3.00%	3.25%
Salary increment rate	1.00%	1.00%
Expected long-term rate of return on plan assets	3.00%	3.25%

C. Funded Defined contribution pension plans :

The Labor Pension Act of ROC (“the Act”) 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 of ROC. 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.

In addition, the Company’s subsidiaries have various defined contribution pension plans. Under these

plans, the only obligations of the subsidiaries have to make periodical contributions to pension account maintained with local governments.

(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 units 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 earning \$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.

(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 years ended December 31, 2005 and 2006 was shown below:

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 year	198,067	\$12.44	179,045	\$16.09
Granted	-	-	46,430	12.30
Exercised	(20,829)	11.96	-	-
Forfeited	(9,725)	11.59	(15,905)	14.53
Outstanding, end of year	<u>167,513</u>	11.03	<u>209,570</u>	13.47

	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 year	\$167,513	\$11.03	\$209,570	\$13.47
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited	(20,913)	10.94	(27,938)	13.49
Outstanding, end of year	<u>146,600</u>	11.05	<u>181,632</u>	13.46

- b. Information with respect to the outstanding options of the Company as December 31, 2005 and 2006 was as follows:

		December 31, 2005					
		Outstanding options at balance sheet date			Options Exercisable		
	Range of	Options	Weighted-Average	Weighted-	Number of	Weighted-	
Date of	Exercise Prices	(in	Remaining	Average	Exercisable	Average	
Approval	(in dollars)	thousand	Contractual Life	Exercise Price	Options (in	Exercise Price	
		shares)	(in years)	(in dollars)	thousands)	(in dollars)	
2002 plan	May 14, 2002	\$10.50-\$11.80	167,531	1.42	\$11.03	100,970	\$11.16
2004 plan	April 29, 2004	\$10.80-\$15.00	209,570	3.33	13.47	-	-

		December 31, 2006					
		Outstanding options at balance sheet date			Options Exercisable		
	Range of	Options	Weighted-Average	Weighted-	Number of	Weighted-	
Date of	Exercise Prices	(in	Remaining	Average	Exercisable	Average	
Approval	(in dollars)	thousand	Contractual Life	Exercise Price	Options (in	Exercise Price	
		shares)	(in years)	(in dollars)	thousands)	(in dollars)	

	Approval	(in dollars)	shares)	(in years)	(in dollars)	thousands)	(in dollars)
2002 plan	May 14, 2002	\$10.50-\$11.80	146,600	0.42	\$11.05	125,387	\$11.14
2004 plan	April 29, 2004	\$10.80-\$15.00	181,632	2.33	13.46	72,347	14.15

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 for the years ended December 31, 2005 and 2006:

	2005	2006
Net loss as reported attributable to the parent (in thousands)	<u><u>\$(7,352,301)</u></u>	<u><u>\$(13,966,810)</u></u>
Pro forma net loss (in thousands)	<u><u>\$(7,730,884)</u></u>	<u><u>\$(14,320,117)</u></u>
Basic loss per share as reported attributable to the parent (in dollars)	<u><u>\$(0.94)</u></u>	<u><u>\$(1.70)</u></u>
Pro forma basic loss per share (in dollars)	<u><u>\$(0.99)</u></u>	<u><u>\$(1.74)</u></u>
Diluted loss per share as reported attributable to the parent (in dollars)	<u><u>\$(0.94)</u></u>	<u><u>\$(1.70)</u></u>
Pro forma diluted loss per share (in dollars)	<u><u>\$(0.99)</u></u>	<u><u>\$(1.74)</u></u>

The fair value of these options was calculated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions for the year ended December 31, 2005 and 2006:

	Stock option plans	
	2002	2004
Dividend yield:	3.84%	3.84%
Risk-free interest rate:	1.00%	1.00%
Expected volatility:	37.68%	37.68%
Expected life:	3.875 years	3.875 years

d. No compensation was recognized because that the exercise price of the Company's stock options are equal to the market price at the grant date for the years ended December 31, 2005 and 2006, respectively. Had the Company used the fair value method to account for its stock options, compensation cost in 2005 and 2006 would have been \$378,583 and \$353,307, respectively.

(18) Capital reserve

According to the ROC Company Law, capital reserve can only be used for making up accumulated deficits if the legal reserve is insufficient for offsetting such deficits. Capital reserve derived from additional paid-in capital and donation from stockholders can also be used to increase common stock if the Company does not have accumulated deficits. The distribution of stock dividend can be made only once a year and cannot exceed 10% of issued capital.

(19) Legal reserve

According to the ROC 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 make up deficit.

(20) Special reserve

In accordance with the local 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) making up 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 local regulation 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. 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 making up accumulated deficits. Appropriations of earnings and dividend per share were as follows:

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

Bonus paid to employees -in cash	280,246	-
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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:

Purpose	Unit: thousand shares			
	Number of Shares Repurchased			
	Beginning	Addition	Disposal	Ending
<u>2005</u>				
Future issuance to employees as bonuses	53,412	-	53,412	-
<u>2006</u>				
Future issuance to employees as bonuses	-	-	-	-

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 totalling 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 thousand shares (\$1,039,743 in the amount) were all retired on August 31, 2005, resulting in a reduction of capital stock amounting to \$534,120.

(23) Operating revenue

	2005	2006
TFT-LCD	\$77,808,730	\$104,672,110
CRT	24,660,602	21,902,533
Others	859,460	30,697
Total	\$103,328,792	\$126,605,340

(24) Personnel, depreciation and amortization expenses

	2005			2006		
	Operating cost	Operating expenses	Total	Operating cost	Operating expenses	Total
Personnel expenses:						
Salaries	\$5,883,975	\$1,061,920	\$6,945,895	\$6,062,764	\$994,898	\$7,057,662
Staff labor/health insurance	300,092	53,084	353,176	340,889	58,875	399,764
Pension	333,209	54,126	387,335	414,326	57,620	471,946
Depreciation	16,400,575	432,919	16,833,494	22,049,281	460,581	22,509,862
Amortization	79,500	933,609	1,013,109	210,523	1,130,816	1,341,339

(25) Income tax

- a. The ROC income tax authorities have examined the income tax returns of the Company through 2004. The 2001 and 2004 income tax return have been assessed by the tax authorities for decreasing loss carryforwards, investment tax credit in research and development expenditure and income tax exemption in 2001 and 2004 and an additional tax payable for 2004 due to dispute in research and development expenditure are not eligible for using by the Company. However, the Company disagreed and filed a tax appeal.

The Company believed that it will not have an adverse material effect on the financial statement and did not accrue additional tax liability. In addition, deferred tax assets for loss carryforward and investment tax credit in research and development expenditure have been recorded a valuation of allowance in prior year; therefore, there is no significant impact on the current year income tax expense.

- b. There is no taxation charge on the profit of the Company and certain operating subsidiaries due to the followings:

- 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 products.

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

Tax –exempted products	Tax exemption period
TFT-LCD	2002~2006
TFT-LCD	2004~2008

- ② The Company obtained the approval letter for applying tax exemption in respect of setting its headquarters in Taiwan.

③ Chunghwa Picture Tubes (Malaysia) Sdn. Bhd. has been granted a tax holiday of five years starting July 1, 1996 under the Promotion of Investments Act, 1986 of Malaysia for the production of color cathode ray tubes (“CCRT”). The pioneer status expired on December 31, 2001. Subsequently, Chunghwa Picture Tubes (Malaysia) Sdn. Bhd. was granted an extension of pioneer status for the period from July 1, 2001 to December 31, 2006.

④ CPTF Optronics Co., Ltd., Chunghwa Picture Tubes (Wujiang) Ltd., CPT Display technology (Fujian) Ltd., CPTF Visual Display (Fuzhou) Ltd., CPT Display technology (Shen-Zhen) Ltd. and CPT TPV Optical (Fujian) Co., Ltd. are exempted from income tax in the first two profit making years, net of previous years’ losses, and allowed a 50% reduction in the next three years. In addition, CPTF Optronics Co., Ltd. is entitled to a reduced tax rate of 10% as its annual value of export goods has reached 70% of the total annual production value.

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

	<u>2005</u>	<u>2006</u>
Income tax-current	\$(136,880)	\$(83,093)
Income tax – deferred		
Net change in deferred income tax assets (liabilities):		
Investment tax credits	2,632,162	(530,313)
Operating loss carryforward	1,973,196	2,053,772
Temporary differences	(13,169)	3,680
Valuation allowances	(4,592,189)	(1,527,309)
Prior year adjustment	(50,148)	(131)
Others	(14,373)	32,006
Income tax expenses	<u><u>\$(201,401)</u></u>	<u><u>\$(51,388)</u></u>

d. Significant components of the Company’s deferred tax assets and liabilities at December 31, 2005 and 2006 were as follows:

Components	<u>December 31</u>	
	<u>2005</u>	<u>2006</u>
Deferred tax assets:		
Allowance for bad debts	\$92,337	\$67,988
Deferred pension expense	306,775	320,812
Unrealized loss on foreign currency exchange, net	254,261	54,931
Unrealized loss on decline in market value and obsolescence of inventory	44,500	92,000
Deferred credits	57,422	38,719
Unrealized loss on available-for-sale financial assets of overseas investee company	625,683	323,179
Investment tax credits	8,284,977	7,754,664

Operating loss carryforwards	3,550,055	5,603,827
Compensation interest payable	45,017	120,988
Unrealized loss on cash flow hedge	-	16,382
Unrealized interest expense for interest rate swap contracts	-	146,684
Deferred tax assets resulting from consolidated subsidiaries	4,838	7,631
Others	5,812	3,875
Valuation allowance	(11,438,013)	(12,965,322)
	<u>\$1,833,664</u>	<u>\$1,586,358</u>

Components	December 31	
	2005	2006
Deferred tax liabilities:		
Overseas investment income accounted for under the equity method	\$(2,502,445)	\$(2,502,445)
Cumulative translation adjustment	(103,859)	(313,492)
Unrealized gain or loss on the valuation of financial instruments	-	(36,193)
Deferred tax liabilities resulting from consolidated subsidiaries	(27,682)	(29,424)
	<u>\$(2,633,986)</u>	<u>\$(2,881,554)</u>

	December 31	
	2005	2006
e. Deferred tax assets-current	\$1,098,368	\$2,389,433
Valuation allowance-current	(1,098,368)	(2,353,240)
Deferred tax assets-net-current	-	36,193
Deferred tax liabilities-current	-	(36,193)
Net deferred tax assets-current	<u>\$-</u>	<u>\$-</u>

	December 31	
	2005	2006
f. Deferred tax assets-non-current	\$12,173,309	\$12,162,247
Valuation allowance-non-current	(10,339,645)	(10,612,082)
Deferred tax assets-net-non-current	1,833,664	1,550,165
Deferred tax liabilities-non-current	(2,633,986)	(2,845,361)
Net deferred tax liabilities-non-current	<u>\$(800,322)</u>	<u>\$(1,295,196)</u>

g. Details of unused investment tax credits and tax operating loss carryforwards as of December 31, 2006 were as follows:

Regulation of ROC	item	Tax credit	Unused tax credit	Expiration year
Statute for Upgrading	Investment tax credit in	\$309,972	\$309,972	2010

Industries	production equipment	4,351,764	4,351,764	2009
		136,267	136,267	2008
		1,496,593	1,496,593	2007
		<u>\$6,294,596</u>	<u>\$6,294,596</u>	
Statute for Upgrading	Investment tax credit in research	\$379,589	\$379,589	2010
Industries	and development expenditure, employee training expenditure	549,242	549,242	2009
		531,237	531,237	2007
		<u>\$1,460,068</u>	<u>\$1,460,068</u>	
Income tax Law	Tax loss carryforward	\$3,582,566	\$3,582,566	2011
		2,021,261	2,021,261	2010
		<u>\$5,603,827</u>	<u>\$5,603,827</u>	

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

	December 31	
	2005	2006
Imputation credit account (ICA)	<u>\$3,638</u>	<u>\$60,648</u>
Accumulated deficits	<u>\$(6,898,965)</u>	<u>\$(13,979,371)</u>

(26) Loss per share

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

	Amounts	
	Years ended December 31	
	2005	2006
Numerator:		
Loss before cumulative effect of changes in accounting principles	\$(7,352,301)	\$(13,161,423)
Cumulative effect of changes in accounting principles	-	(805,387)
Net loss available to common stockholders of the parent	<u>\$(7,352,301)</u>	<u>\$(13,966,810)</u>
Denominator:		
	Shares	
	2005	2006

Denominator for basic loss per share-weighted average share (in thousands)	<u>7,807,278</u>	<u>8,225,890</u>
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	Amounts	
	Years ended December 31	
	2005	2006
Loss before cumulative effect of changes in accounting principles	\$(0.94)	\$(1.60)
Cumulative effect of changes in accounting principles	-	(0.10)
Basic loss per share of the parent (in dollars)	<u>\$(0.94)</u>	<u>\$(1.70)</u>

The Company did not present diluted loss per share for the years ended December 31, 2005 and 2006 because inclusion of such potential common shares-convertible bonds and stock options is antidilutive.

(27) Technical and purchase agreement

Contracting party	The term of the contract	The content of repayment
<u>Technical agreement</u>		
<u>CRT</u>		
Hitachi	August 2002 March 2006	CPTF Optronics Co., Ltd. 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.
Hitachi	January 2001 March 2006	CPT Malaysia 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.
Contracting party	The term of the contract	The content of repayment
Hitachi Display Ltd.	January 2004 January 2009	CPT Malaysia 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.
<u>TFT-LCD</u>		
Hitachi	January 2003 December 2010	<ol style="list-style-type: none"> The Company is required to pay licensing fees on installment basis for using the technologies. 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.

Advanced Display Inc. (ADI)	April 1997 June 2006	<ol style="list-style-type: none"> 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. 3. ADI has the right to purchase no more than 15% of the total products from the Company at 90% of average selling price. The Company bears the shipping costs of the products to locations designated by ADI.
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Sharp Corporation	January 2002 June 2011	<ol style="list-style-type: none"> 1. The Company is required to pay licensing fees (one time payment) 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.
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Contracting party	The term of the contract	The content of repayment
Semiconductor Energy Laboratory Co., Ltd. (SEL)	January 2004 December 2008	<ol style="list-style-type: none"> 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	<ol style="list-style-type: none"> 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.
<u>Purchase agreement</u>		
Corning Display Technologies Taiwan Co., Ltd (“Corning Taiwan”)	April 2005 March 2011	<ol style="list-style-type: none"> 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.

5. RELATED PARTY TRANSACTIONS

(1) Name and relationship:

Name of related party	Relationship with the Company
Tatung Co., Ltd.	The Company's major stockholder
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
Sintronic Technology Inc.	An investee accounted for under the equity method
Makolin Electronics (M) Sdn. Bhd.	An investee accounted for under the equity method
Xiamen Overseas Chinese Electronic Co., Ltd.	An investee 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	Subsidiary of Tatung Co., Ltd.
Tatung Information Technology (Jiang Su) Co., Ltd.	Subsidiary of subsidiary of Tatung Co., Ltd.
TIS Net Technology Inc.	Subsidiary of subsidiary of Tatung Co., Ltd.
Elitegroup Computer Systems 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
Tatung OTIS Elevator 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 University	The major stockholder of Tatung Co., Ltd.
Suzhou Forward Electronics Technology Co., Ltd.	Subsidiary of subsidiary of Forward Electronics Co., Ltd.
Fuzhou Development Zone Yuen-Yeou Enterprise Co., Ltd.	Their Chairman is a supervisor of the CPTF Optronics Co., Ltd.
Champion Engineering Fuzhou Corp.	Their Chairman is a supervisor of the CPTF Optronics Co., Ltd.
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.
Mr. Lin, Chieng-Hon	Former Chairman and President of the Company (resignation of Chairman and President effective from March 30, 2007)

(2) Significant transactions with related parties:

a. Operating revenue

Name of Related party	2005		2006	
	Amount	%	Amount	%
Tatung Co., Ltd.	\$517,333	0.50	\$3,660,630	2.89
Tatung Information Technology (Jiang Su) Co., Ltd.	2,950,756	2.86	819,918	0.65
K-tronics, Inc.	2,317,617	2.24	500,512	0.39
Jeffrey Investment Ltd.	2,159,896	2.09	4,051,283	3.20
Xiamen Overseas Chinese Electronic Co., Ltd.	-	-	732,845	0.58
Tatung Co. of America, Inc.	42,787	0.04	124,154	0.10
Jean Co., Ltd.	22,835	0.02	249,298	0.20
Elitegroup Computer Systems Co., Ltd.	-	-	372,814	0.29
Others	7,040	0.01	54,438	0.05
Total	\$8,018,264	7.76	\$10,565,892	8.35

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:

Region	2005		2006	
	Related Parties	Ordinary customers	Related Parties	Ordinary customers
Overseas	O/A 90-120 days	O/A 30-65 days L/C 30-60 days At sight payment	O/A 90-120 days	O/A 30-90 days L/C 30-65 days At sight payment
ROC Domestic	O/A 60-120 days	O/A 30-60 days At sight payment	O/A 90-120 days	O/A 30-60 days At sight payment

b. Purchases

Name of Related Party	2005		2006	
	Amount	%	Amount	%
Makolin Electronics (M) Sdn. Bhd.	\$245,835	0.31	\$436,323	0.42
Forward Electronics Co., Ltd.	286,648	0.36	357,370	0.34
Tatung Co., Ltd.	1,035	-	344,142	0.33
Tatung Co. of America, Inc. and Tatung Electronics (Singapore) Pte Ltd.	54,644	0.07	54,584	0.05
Fuzhou Development Zone Yuen-Yeou Enterprise Co., Ltd.	522,360	0.67	373,070	0.36
Suzhou Forward Electronics Technology Co., Ltd.	946,756	1.21	3,311,689	3.16
Others	13,358	0.02	8,037	0.01

Total	\$2,070,636	2.64	\$4,885,215	4.67
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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	2005		2006	
	Related parties	Ordinary suppliers	Related parties	Ordinary suppliers
Overseas	T/T 30 -360 days	T/T 30 - 360 days L/C 30-180 days	T/T 30-360 days	L/C 30-180 days T/T 30-360 days
ROC Domestic	30 - 60 days after QC	30 - 180 days after QC	30 - 60 days after QC	30-180 days after QC

c. Fixed asset addition

Name of Related party	2005		2006	
	Amount	%	Amount	%
Tatung Co., Ltd.	\$297,531	0.49	\$116,811	0.80
Tatung System Technology Inc.	154,910	0.25	47,626	0.33
Toes Opto-Mechatronics Co., Ltd.	326,770	0.54	327,657	2.23
Toppan Chunghwa Electronics Co., Ltd.	37,855	0.06	29,638	0.20
Others	137,769	0.23	28,462	0.19
Total	\$954,835	1.57	\$550,194	3.75

d. Fixed asset disposal

Name of Related party	2005			2006		
	Selling price	Carrying	Loss on sale of	Selling price	Carrying	Loss on sale
		amount	fixed asset		amount	of fixed asset
Sintronic Technology Inc.	\$-	\$-	\$-	\$342,000	\$342,117	\$(117)

e. Expenditures

Name of Related party	2005		2006	
	Amount	%	Amount	%
Tatung Co. of Japan, Inc.	\$9,769	0.03	\$1,532	-
Tatung Co., Ltd.	31,930	0.10	17,397	0.04
Toppan Chunghwa Electronics Co., Ltd.	1,464	-	3,846	0.01
Tatung System Technology Inc.	8,437	0.03	14,273	0.03
Tatung OTIS Elevator Co., Ltd.	2,473	0.01	5,403	0.01
Tatung Telecom Corporation	4,183	0.01	4,189	0.01
Others	4,707	0.01	3,354	0.01
Total	\$62,963	0.19	\$49,994	0.11

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

(b) The Company and subsidiaries 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 \$6,905,729 and \$4,174,174 for the years ended December 31, 2005 and 2006, respectively. The commission charged, included in the aforementioned purchase amount, amounted to \$9,769 and \$1,532 for the corresponding periods, respectively.

f. Non-operating income-others

Name of Related party	2005		2006	
	Amount	%	Amount	%
Tatung Co., Ltd.	\$1,985	0.96	\$1,127	0.24
Others	322	0.15	-	-
Total	\$2,307	1.11	\$1,127	0.24

Name of related party	December 31			
	2005		2006	
	Amount	%	Amount	%
g. <u>Due from affiliates-trade</u>				
Tatung Co., Ltd.	\$144,544	7.67	\$1,949,046	59.51
Tatung Information Technology (Jiang Su) Co., Ltd.	963,395	51.10	15,249	0.47
K-tronics, Inc.	413,856	21.95	-	-
Jeffrey Investment Ltd.	355,563	18.86	967,486	29.54
Jean Co., Ltd.	-	-	109,249	3.34
Xiamen Overseas Chinese Electronic Co., Ltd.	-	-	120,311	3.67
Elitegroup Computer Systems Co., Ltd.	-	-	101,255	3.09
Others	7,811	0.42	12,366	0.38
Total	1,885,169	100.00	\$3,274,962	100.00

h. Due from affiliates-others

Toppan Chunghwa Electronics Co., Ltd.	\$5,863	97.31	\$9,327	5.58
Sintronic Technology Inc.	-	-	9,659	5.78
Sintronic Technology (Suzonu) Co., Ltd.	-	-	147,959	88.55
Others	162	2.69	152	0.09
Total	\$6,025	100.00	\$167,097	100.00

During 2006, Chunghwa Picture Tubes (Wujiang, Ltd.) funded Sintronic Technology (Suzhou) Co., Ltd. with the amount of RMB35, 000 thousand , the interest rate was 6.07% and the related interest revenue

was \$1,586 in 2006.

Name of related party	December 31			
	2005		2006	
	Amount	%	Amount	%
i. <u>Due to affiliates-trade</u>				
Tatung Co. of Japan, Inc.	\$3,044,339	71.84	\$1,578,416	48.70
Fuzhou Development Zone Yuen-Yeou Enterprise Co., Ltd.	287,885	6.79	101,765	3.14
Suzhou Forward Electronics Technology Forward Electronics Co., Ltd.	734,756	17.34	1,361,911	42.02
Forward Electronics Co., Ltd.	72,430	1.71	112,841	3.48
Others	98,282	2.32	86,350	2.66
Total	\$4,237,692	100.00	\$3,241,283	100.00
j. <u>Due to affiliates-others</u>				
Tatung Co., Ltd.	\$117,634	19.65	\$28,199	1.84
Tatung Co. of Japan, Inc.	323,029	53.97	1,437,032	93.91
Others	157,921	26.38	65,021	4.25
Total	\$598,584	100.00	\$1,530,252	100.00
k. <u>Other current liabilities</u>				
Tatung (U.K.) Ltd.	\$176	0.09	\$176	0.06
Tatung Co. of America, Inc.	-	-	867	0.29
Jean Co., Ltd.	2,740	1.44	-	-
K-tronics, Inc.	-	-	2,190	0.75
Total	\$2,916	1.53	\$3,233	1.10
l. <u>Deferred credit</u>				
Sintronic Technology Inc.	\$-	-	\$253	100.00

m. Guarantees

The amount of guarantees that the Company provided for related parties as of December 31, 2005 and 2006 was as follows:

Name of Related party	December 31		Purpose
	2005	2006	
Toppan Chunghwa Electronics Co., Ltd.	\$330,000	\$-	Working Capital

- n. The Company leased portions of its plants to Toppan Chunghwa Electronics Co., Ltd. That rental revenue of \$18,890 and \$29,528 for the years ended December 31, 2005 and 2006, respectively. The related receivables (recorded in due from affiliates-others) were \$5,863 and \$9,327 as of December 31, 2005 and 2006, respectively. In addition, the Company charged Toppan Chunghwa Electronics Co., Ltd. managements fees of \$46,367 and \$64,411 for the years ended December 31, 2005 and 2006, respectively,

which were recorded as a deduction of operation expense.

The Company leased portions of its plants to Sintronic Technology Inc. That rental revenue of \$9,985 for the years ended December 31, 2006. The related receivables (recorded in due from affiliates-others) were \$8,165 as of December 31, 2006. In addition, the Company charged Sintronic Technology Inc. management fees of \$7,281 for the year ended December 31, 2006, which were recorded as a deduction of operation expense.

6. ASSETS PLEDGED OR MORTGAGED

As of December 31, 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:

Accounts	Creditors	Carrying amount	
		December 31	
		2005	2006
Building	Mega International Bank	\$2,423,714	\$2,351,364
Machinery and equipment	Mega International Bank	11,564,800	8,311,619
Building	Bank of Taiwan	1,451,222	1,404,385
Machinery and equipment & prepayment on equipment	Bank of Taiwan	58,285,260	47,378,206
Machinery and equipment & prepayment on equipment	China Trust Bank	13,090,677	11,685,852
Machinery and equipment & prepayment on equipment	Taiwan Cooperative Bank	9,044,320	8,059,204
Pledged time deposit	Central Taiwan Science Park	-	6,000
Pledged time deposit	General office of the customs-Keelung, ROC	12,778	-
Pledged time deposit	General office of the custom-Taipei, ROC	144,875	138,437
Pledged time deposit	Mega International Bank	200,000	202,054
Pledged time deposit	Bank of Taiwan	34,697	35,995
Pledged time deposit	Trust Company	-	209,000
Pledged time deposit	China Construction Bank	41	-
Pledged time deposit	Bank of China	366,459	-
Pledged time deposit	Hengtai Securities Co., Ltd.	-	125,400
		<u>\$96,618,843</u>	<u>\$79,907,516</u>

7. COMMITMENTS AND CONTINGENCIES

General matters:

As of December 31, 2006, the following commitments and contingencies were not reflected in above consolidated financial statements:

- A. Unused letters of credit of the Company were approximately USD1,160 thousand, JPY2,693,337 thousand and CHF790 thousand.

B. The promissory notes, guarantee notes for bank loans and guarantee notes for account receivable factoring amounting to \$54,323,850, USD398,000 thousand and \$1,240,000, respectively.

C. The Company signed several construction contracts for the expansion of its factory space. As of December 31, 2006, these construction contracts amounted to \$118,687,985 with \$102,847,033 was paid.

CPT (Wujiang) signed several construction contracts for the expansion of its factory space. As of December 31, 2006, these construction contracts amounted to RMB590 with RMB167 thousand was paid .

CPT TPV Optical (Fujian) Co., Ltd. signed several construction contracts for the expansion of its factory space. As of December 31, 2006, these construction contracts amounted to RMB105,794 with RMB91,871 thousand was paid.

CPT Display Technology (Shen-Zhen) Ltd. signed several construction contracts for the expansion of its factory space. As of December 31, 2006, these construction contracts amounted to RMB327,800 with RMB195,729 thousand was paid.

CPT Display Technology (Fujian) Ltd. signed several construction contracts for the expansion of its factory space. As of December 31, 2006, these construction contracts amounted to RMB33,832 with RMB5,547 thousand was paid.

D. The Company leases land from the Central Taiwan Science Park. The term of lease agreement is from May 15, 2006 to December 31, 2025. Due to TFT-LCD market downturn, the aforementioned lease has been ceased temporarily in December 2006.

Legal process:

The Company currently is involved in a number of lawsuits as follows:

LG Philips LCD, Ltd. (LPL) and related matters:

In August 2002, LPL filed suit in U.S. District Court (“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”). In the suit, LPL alleges that the Company has infringed six of its U.S. patents relating to LCD and to manufacturing processes for TFT-LCD devices. However, the Company believed that a certain side-mount technology (the technology can be used to affix LCD modules into notebook computers) claimed by LPL to be covered by four out of six of the patents was developed and owned by Hewlett-Packard Development Company, L.P. (HP) and the Company acquired the technology from HP in 2004. In October 2006, the court ruled that LPL does not have standing to assert patents which relate to side-mounting technology and dismissed the counter-claim from LPL for alleged ownership for side-mount technology. However, the jury determined that two out of six the patents relate to semiconductor LCD manufacturing are willfully infringed a patent owned by LPL

in November 2006 and the trial court has not entered final judgement on the verdict.

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 5019002) 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 issued a verdict finding the Company was liable for patent infringement relating to USP 5019002 and however, the trial court has not entered judgement on the verdict.

The Company filed a patent infringement suit against LPL in the U.S. District Court, Central of California in January 2005 (“The Third LPL Suit”) and then, LPL filed an answer and counterclaims against the Company. In March 2007, the Company withdrew the case.

Anvik Corporation and related matters:

In February 2007, Anvik Corporation filed a patent infringement suit in the United States District Court of New York against the Company, Tatung Company and Tatung Company of America (the “Tatung Companies”). The lawsuit alleges that the Company and Tatung Companies for using the photo-masking equipment and the patented methods performed by such system in producing TFT-LCD panel without permission.

Honeywell International Inc and related matters:

In March 2007, the Company has been sued for patent infringed involved with the driver IC outsourced from other component suppliers by Honeywell International Inc. The Company has not yet received any official document related the complaint.

Antitrust:

The Company received notices together with other competitive companies under investigation by the Antitrust Division of the U.S. Department of Justice (“D.O.J.”), European Commission (“EC”), Canadian Bureau of Competition (“CBC”), and Japan Fair Trade Commission (“JFTC”) for involving in price-fixing behavior in the TFT-LCD industry.

Anti-dumping:

In January 2006, the European Union initiated an investigation in respect of claims of dumping of cathode ray color television picture tubes from China, Korea, Malaysia and Thailand. The final outcome of anti-dumping is no any adverse material effect on financial position and operating results against the Company’s overseas subsidiary-Chunghwa P.T. (Malaysia) Sdn. Bhd.

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

8. **SIGNIFICANT DISASTER LOSS**

NONE.

9. **SIGNIFICANT SUBSEQUENT EVENTS**

On March 30, 2007, the Board of Directors of the Company approved a resignation of Chairman and President,

Mr. Chieng-Hon Lin, from his position due to his personal reason. In addition, Mr. Wei-Shan Lin, Director of the Company, was elected to the position of Chairman and assigned Mr. Chuang-Yi Chiu to be Acting President of the Company.

10. SEGMENT INFORMATION

(1) Industrial information:

2005

	<u>CRT</u>	<u>TFT-LCD</u>	<u>Other</u>	<u>Total</u>
Total revenues	\$24,660,602	\$77,808,730	\$859,460	\$103,328,792
Gross profit (loss)	\$1,867,165	\$1,932,838	\$(2,024,712)	\$1,775,291
R&D				(3,536,678)
SG&A				(3,790,944)
Interest income				489,354
Investment income recognized by using equity method, net				91,608
Other income				481,625
Interest expense				(1,972,591)
Other expense				(584,062)
Loss before income tax				<u>\$(7,046,397)</u>
Identifiable assets:				
Property plant and equipment, net	\$15,864,849	\$137,953,224	\$4,371,734	\$158,189,807
Inventory, net	\$1,809,418	\$12,441,808	\$117,564	\$14,368,790
Depreciation expenses	\$2,437,454	\$12,468,182	\$1,927,858	\$16,833,494
Capital expenditure	\$314,780	\$59,992,700	\$263,486	\$60,570,966

2006

Total revenues	\$21,902,533	\$104,672,110	\$30,697	\$126,605,340
Gross profit (loss)	\$1,197,158	\$(577,808)	\$(340,607)	\$278,743
Unrealized intercompany profit				(253)
R&D				(3,947,928)
SG&A				(6,186,577)
Interest income				771,053
Investment loss recognized by using equity method, net				(6,731)
Other income				1,943,411
Interest expense				(4,961,517)
Other expense				(958,397)
Loss before income tax				<u>\$(13,068,196)</u>
Identifiable assets:				
Property plant and equipment, net	\$14,818,864	\$131,694,201	\$3,873,329	\$150,386,394
Inventory, net	\$2,110,035	\$16,479,581	\$14,030	\$18,603,646

Depreciation expenses	<u>\$2,126,040</u>	<u>\$19,858,784</u>	<u>\$525,038</u>	<u>\$22,509,862</u>
Capital expenditure	<u>\$113,875</u>	<u>\$14,422,505</u>	<u>\$141,301</u>	<u>\$14,677,681</u>

(2) Regional information:

	2005				2006			
	Taiwan	Oversea	Adjustment and eliminate	Total	Taiwan	Oversea	Adjustment and eliminate	Total
Revenue from customers other than consolidating subsidiaries	75,650,111	27,678,681	-	103,328,792	104,295,283	22,310,057	-	126,605,340
Revenue from consolidating subsidiaries	45,105,206	64,901,421	(110,006,627)	-	53,147,242	91,410,064	(144,557,306)	-
Total revenue	120,755,317	92,580,102	(110,006,627)	103,328,792	157,442,525	113,720,121	(144,557,306)	126,605,340
Net gross profit (loss) less R&D	(4,618,388)	2,781,474	75,527	(1,761,387)	(6,951,547)	3,029,625	252,484	(3,669,438)
Interest income				489,354				771,053
Investment income (loss) recognized by using equity method, net				91,608				(6,731)
Other income				481,625				1,943,411
SG&A				(3,790,944)				(6,186,577)
Interest expenses				(1,972,591)				(4,961,517)
Other expenses				(584,062)				(958,397)
Net loss before income tax				(7,046,397)				(13,068,196)
Identifiable assets (land and revaluation surplus excluded)	145,585,055	31,142,652	(4,169,110)	172,558,597	137,244,299	38,036,328	(6,290,587)	168,990,040
Fund and investment				4,300,926				7,368,420
Other assets (land and revaluation surplus included)				69,903,758				71,025,354
Total assets				246,763,281				247,383,814

(3) Export sales:

Region	2005	2006
EUROPE	\$1,796,972	\$5,837,681
AMERICA	1,343,713	3,698,927
SOUTHEAST ASIA	91,952,988	105,891,563
OTHERS	1,909,876	6,124,375
TOTAL	\$97,003,549	\$121,552,546

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

	2005		2006	
	Sales	Percentage	Sales	Percentage
A Co., Ltd.	15,033,494	14.55%	23,233,793	18.35%
B Co., Ltd.	6,647,955	6.43%	15,604,228	12.33%

11. **Financial Instruments**

(1) Fair value of financial instruments:

	Non-derivative	Carrying amount	December 31, 2005	
			Fair value	
			Fair value determined by quoted price	Fair value determined by valuation technique
Financial assets:				
Cash and cash equivalents		\$32,815,736	\$15,756,400	\$17,059,336
Financial assets at fair value through profit or loss		1,585,042	1,631,243	-
Receivables, net		24,163,700	-	24,163,700
Available-for-sale financial assets-non-current		2,514,870	2,514,870	-
Financial assets carried at cost-non-current		239,772	-	239,772
Pledged time deposits		758,850	-	758,850
Refundable deposits		32,142	-	32,142
Financial liabilities:				
Short-term bank loans		7,277,518	-	7,277,518
Account payables		44,288,730	-	44,288,730
Accrued expense		3,579,166	-	3,579,166
Income tax payable		76,008	-	76,008
Other current liabilities		191,177	-	191,177
Bonds payable (including current portion)		7,211,149	-	6,931,423
Long-term bank loans (including current portion)		85,883,577	-	85,883,577

		December 31, 2005	
		Fair value	
Derivative	Carrying amount	Fair value determined by quoted price	Fair value determined by valuation technique
<u>Financial assets:</u>			
Financial assets at fair value through profit or loss:			
Foreign currency forward exchange contracts	\$1,095	\$-	\$1,095
<u>Financial liabilities:</u>			
Financial liabilities at fair value through profit or loss:			
Foreign currency options contracts	266,368	-	1,081,034
Foreign currency forward exchange contracts	-	-	386,378
		December 31, 2006	
		Fair value	
Non-derivative	Carrying amount	Fair value determined by quoted price	Fair value determined by valuation technique
<u>Financial assets:</u>			
Cash and cash equivalents	\$34,650,859	\$12,139,754	\$22,511,105
Financial assets at fair value through profit or loss	582,427	588,606	-
Receivables, net	22,518,031	-	22,518,031
Available-for-sale financial assets-non-current	3,746,515	3,746,515	-
Financial assets carried at cost-non-current	198,217	-	198,217
Pledged time deposits	716,886	-	716,886
Refundable deposits	97,893	-	97,893
<u>Financial liabilities:</u>			
Short-term bank loans	10,163,167	-	10,163,167
Account payable	45,673,588	-	45,673,588
Accrued expense	5,126,531	-	5,126,531
Income tax payable	12,323	-	12,323
Other current liabilities	293,376	-	293,376
Bonds payable (including current portion)	13,474,972	-	13,297,374
Long-term bank loans (including current portion)	83,751,278	-	83,751,278

		December 31, 2006	
		Fair value	
Derivative	Carrying amount	Fair value determined by quoted price	Fair value determined by valuation technique
<u>Financial assets:</u>			
Financial assets at fair value through profit or loss:			
Foreign currency forward exchange contracts	\$94,532	\$-	\$94,532
ROC convertible bonds	345,975	345,975	-
Derivative financial assets for hedging:			
Foreign currency forward exchange contracts	56,143	-	56,143
<u>Financial liabilities:</u>			
Financial liabilities at fair value through profit or loss:			
Foreign currency forward exchange contracts	1,139	-	1,139
Debt components of convertible bonds-call and put option	1,447,211	-	1,447,211
Derivative financial liabilities for hedging:			
Foreign currency forward exchange contracts	35,699	-	35,699
Interest rate swap contracts	89,499	-	89,499

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

- a. The carrying value of short-term financial instruments, such as cash and cash equivalents, receivables short-term bank loans, payables, accrued expense, other current liabilities and income tax payable 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 are based on their quoted market price or the net asset value per unit.
- c. The fair values of pledged time deposits and refundable deposits are based on book values which approximate present value.
- d. The fair values of long-term bank loans and convertible bonds issued after January 1, 2006 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 are determined based on the sum of the carrying value and accrued interest payable. The fair values of convertible bonds issued prior to December 31, 2005 are determined

based on their market price which provided by financial institution.

- e. The fair values of derivative financial instruments were based on valuation techniques provided by the Bank.

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

Financial risk:

Besides derivative financial instruments, the Company and subsidiaries held certain of financial instruments for their working capital demand such as short-term and long-term bank loans, bonds payable, cash and cash equivalents, financial instruments at fair value through profit or loss, account receivable, account payable and available-for-sale financial assets.

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.

① Cash flow risk on 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 December 31, 2006, the expected cash flows of derivative financial instruments are as follows:

Financial Instruments	Period	Cash outflow	(unit:thousands
)
			Cash inflow
Foreign currency forward exchange contracts	2007.01-2010.07	\$3,877,238	USD125,827
Interest rate swap contracts	2007.01-2010.03	\$1,498,992	\$954,720

② Market risk

Market risk is a potential loss arising from adverse movements of market price, such interest rates, exchange rates and equity securities.

Investment in equity financial instruments owned by the Company and subsidiaries and issued Zero coupon Convertible Bonds of the Company are exposed to market price risk. In addition, 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.

The Company also 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.

③ Credit risk

Credit risk represents that the risk of potential loss that would be recognized at reporting date if counterparties fail to perform. The credit risk of the Company consists principally of investment in listed equity securities, mutual funds, convertible bonds 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 are 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.

④ Liquidity risk

Liquidity risk is the risk of being unable to settle the contracts on schedule. As of December 31, 2006, current liabilities of the Company was beyond current assets and liquidity risk is depend on whether the Company has enough funds from operation growth or not. However, the Company and subsidiaries controls their cash position by regularly monitoring and planning suitable fund-raising channel.

Measurement of effectiveness of hedge relationship:

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.

As of December 31, 2006, the designation of cash flow hedging instruments was as follows:

Item	Instruments for Hedging	Fair Value	Maturity Period
NTD long-term bank loans with floating rate	Interest rate swap contracts	\$(73,342)	2004-2010
Non-NTD long-term bank loans	Foreign currency forward exchange contracts	4,287	2006-2010
		\$(69,055)	

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

Item	December 31, 2006
Adjustment in equity account (excluding cumulative effect of changes in accounting principles)	\$286,298
Loss transferred from equity account (accounted to interest expenses)	(586,735)
Non-derivative financial liabilities transferred from equity account (accounted to accrued expenses)	(586,735)

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

(3) Information of derivative financial instruments:

a. Embedded derivatives of compound financial instrument:

Item	contract amount or notional amount (in thousands)	
	December 31, 2005	December 31, 2006
ROC Convertible Bonds	\$-	\$322,575

The convertible bonds contained a compound financial instrument and the Company elected to account for the whole instrument on a fair value basis.

b. Foreign currency forward exchange contracts:

	contract amount or notional amount (in thousands)	Fair Value (in thousands)	Maturity period
	<u>December 31, 2005</u>		
Buy USD/ Sell RMB	USD9,500	USD35	2005.12-2006.12
<u>December 31, 2006</u>			
Buy USD/ Sell NTD	USD85,750	\$93,935	2007.01.11-2010.07.11
Buy USD/ Sell JPY	USD7,000	(537)	2007.05.21
Buy USD/ Sell RMB	USD38,077	USD130	2006.09-2007.05

c. Foreign currency option contracts:

Financial instruments	December 31	
	2005	2006
	Contract amount or notional amount (in thousands)	Contract amount or notional amount (in thousands)
<u>Buy</u>		
NTD Call / USD Put	USD 10,000	-
JPY Call / USD Put	USD 46,000	-
<u>Sell</u>		
USD Call / JPY Put	USD 521,500	-
USD Call / NTD Put	USD 10,000	-

d. Interest rate swap transactions:

Maturity period	Contract amount or notional amount (in thousands)	Payable on Fixed Interest Rate	Receivables on Floating Interest Rate	Fair Value (in thousands)
	<u>December 31, 2005</u>			

2009.4~2010.3	<u>\$19,600,000</u>	0.77%-1.67%	1.166%-1.428%	<u>\$(335,811)</u>
<u>2008.3~2008.7</u>	<u>USD60,000</u>	4.308%-4.28%	4.5746%-4.7531%	<u>USD(1,539)</u>
<u>December 31, 2006</u>				
2009.4~2010.3	<u>\$19,600,000</u>	0.77%-4.489%	1.420%-1.652%	<u>\$89,499</u>
2008.2~2008.7	<u>USD30,000</u>	4.08%-4.28%	6.16%-6.26%	<u>USD495</u>