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U.S.\$300,000,000

Compal Electronics, Inc.

(incorporated as a company limited by shares in Taiwan, Republic of China)

Zero Coupon Convertible Notes due 2007

The Zero Coupon Convertible Notes due 2007 in the form of International Notes are being offered hereby by the Purchasers outside the United States to non-U.S. persons in reliance on Regulation S under the United States Securities Act of 1933. In addition to the offering outside the United States, Salomon Brothers International Limited ("SBIL" or "the Global Coordinator") and ABN AMRO Rothschild, through their U.S. selling agents, are concurrently offering Notes in the form of Rule 144A Notes in the United States only to institutions that are qualified institutional buyers as defined in Rule 144A under the United States Securities Act of 1933, as amended. The Notes are not being offered in the Republic of China.

The Notes will be direct, unsecured, unsubordinated and unconditional obligations of Compal Electronics, Inc. and will rank at least *pari passu* in right of payment with all other direct, unsecured, unsubordinated and unconditional debt of Compal Electronics, Inc., except as otherwise provided herein. The Notes will not bear interest except in the limited circumstances set forth herein. Holders of the Notes may convert the Notes into Common Shares of Compal Electronics, Inc. at any time (subject to certain restrictions) after November 9, 2002 and up to 30 days prior to maturity, or the fifth business day prior to any repurchase or earlier redemption of the Notes by Compal Electronics, Inc. Subject to compliance with certain conditions, converting holders may elect to receive Common Shares of Compal Electronics, Inc. or direct that the Common Shares issuable upon conversion be deposited with the Depository for issuance of Global Depositary Shares each representing five Common Shares. GDSs to be issued upon conversion of the Notes will be fungible with the existing GDSs, including those which are listed on the Luxembourg Stock Exchange. Application has been made to list the GDSs issuable on the conversion of the Notes on the Luxembourg Stock Exchange. The conversion rate is 957 Common Shares per U.S.\$1,000 principal amount of Notes, equivalent to 191 GDSs per U.S.\$1,000 principal amount of Notes, subject to adjustment in certain circumstances. This is equivalent to a conversion price of NT\$36.54 per Common Share, or U.S.\$5.22 per GDS, determined at the fixed exchange rate of NT\$34.97 = U.S.\$1.00. The Common Shares are listed on the Taiwan Stock Exchange and application will be made to list the Common Shares deliverable on conversion of the Notes on the Taiwan Stock Exchange. The closing sale price per Common Share on the Taiwan Stock Exchange on October 3, 2002 was NT\$30.20. Unless the Notes have been previously redeemed, repurchased and canceled or converted, holders of the Notes will also have the right to require Compal Electronics, Inc. to purchase for cash the Notes at a price equal to 100% of their outstanding principal amount plus the Redemption Premium on October 11, 2005. Holders of the Notes will also have the right to require Compal Electronics, Inc. to repurchase the Notes at a price equal to 100% of their outstanding principal amount plus the Redemption Premium in the event that the Common Shares cease to be listed on the Taiwan Stock Exchange or in the event of a change of control of Compal Electronics, Inc.

Unless the Notes have been previously redeemed, repurchased and cancelled or converted, Compal Electronics, Inc. will redeem the Notes at maturity at a price equal to 100% of their outstanding principal amount plus the Redemption Premium. The Notes may be redeemed in whole or in part by Compal Electronics, Inc. at any time on or after October 11, 2005, at a price equal to 100% of their outstanding principal amount plus the Redemption Premium if (i) the closing price of (a) the Common Shares (translated into U.S. Dollars at the prevailing exchange rate) and (b) the GDSs, divided by the number of Common Shares represented by each GDS, on each of 20 consecutive Trading Days, the last of which occurs not more than five days prior to the date on which notice of such redemption is given, is at least 130% of the conversion price (translated into U.S. Dollars at the fixed exchange rate of NT\$34.97 = U.S.\$1.00) and (ii) the applicable Redemption Date does not fall within a Closed Period. The Company may redeem all the Notes at any time if at least 95% in principal amount of the Notes originally outstanding has been redeemed, repurchased and cancelled or converted, provided that the applicable Redemption Date does not fall within a Closed Period. The Notes may also be redeemed in whole at any time at the option of Compal Electronics, Inc. at a price equal to 100% of their outstanding principal amount plus the Redemption Premium in the event of certain changes relating to Republic of China taxation.

The International Notes will be evidenced by an International Global Note deposited with and registered in the nominee name of a common depository for Euroclear and Clearstream, Luxembourg. Except as described herein, beneficial interests in the International Global Note will be shown on, and transfers thereof will be effected only through, records maintained by Euroclear, Clearstream, Luxembourg and their respective account holders. The Rule 144A Notes will be evidenced by a Rule 144A Global Note deposited with a custodian for The Depository Trust Company and registered in the name of a nominee of DTC. Except as described herein, beneficial interests in the Rule 144A Global Note will be shown on, and transfers thereof will be effected only through, records maintained by DTC or its nominee and the records of its direct and indirect participants.

Application has been made to have the Notes designated for trading in The PORTAL Market of The Nasdaq Stock Market, Inc. and to list the Notes on the Luxembourg Stock Exchange.

Investing in the Notes involves risks. See "Risk Factors" beginning on page 11.

	Per Note	Total
Price to investors	100.00%	U.S.\$300,000,000
Underwriting discount	1.75%	U.S.\$ 5,250,000
Proceeds to Compal Electronics, Inc. (before expenses)	98.25%	U.S.\$294,750,000

To the extent that the Purchasers sell more than U.S.\$300,000,000 in aggregate principal amount of the Notes, the Purchasers have the option, exercisable until November 9, 2002, to purchase up to an additional U.S.\$45,000,000 in aggregate principal amount of the Notes from Compal Electronics, Inc. at the offering price less the underwriting discount.

The Purchasers expect to deliver the International Notes through the facilities of Euroclear and Clearstream, Luxembourg and the Rule 144A Notes through the facilities of DTC against payment on October 9, 2002.

Global Coordinator and Sole Bookrunner

Salomon Smith Barney

Joint Lead Managers

Salomon Smith Barney

ABN AMRO Rothschild

Local Advisors

Grand Cathay Securities Corporation

KGI Securities, Co. Ltd.

Polaris Securities

October 9, 2002

This Offering Memorandum is being furnished by Compal Electronics, Inc. ("Compal Electronics", "Compal" or the "Company") in connection with an offering exempt from registration under the Securities Act of 1933 (the "Securities Act"), solely for the purpose of enabling a prospective investor to consider the purchase of the Zero Coupon Convertible Notes due 2007 (the "Notes") described in this Offering Memorandum. The information contained in this Offering Memorandum has been provided by the Company or extracted from other sources identified in this Offering Memorandum. No representation or warranty, express or implied, is made by the Purchasers named in this Offering Memorandum as to the accuracy or completeness of such information, and nothing contained in this Offering Memorandum is, or shall be relied upon as, a promise or representation by the Purchasers. Each offeree of the Notes, by accepting delivery of this Offering Memorandum, agrees to the foregoing.

The Notes and the common shares, par value NT\$10 per common share (the "Common Shares"), of the Company, issuable upon conversion of the Notes and the Global Depository Shares ("GDSs") representing such Common Shares have not been and will not be registered under the Securities Act, for offer or sale as part of their distribution and, subject to certain exceptions, may not be offered or sold in the United States or to U.S. persons. The Notes, the Common Shares issuable upon conversion of the Notes and the GDSs representing such Common Shares are not transferable except in accordance with the restrictions described herein. See "Description of the Notes", "Form of the Notes and Transfer Restrictions", "Description of the Global Depository Receipts", "Form of GDRs and Transfer Restrictions" and "Plan of Distribution".

The Notes and the Common Shares issuable upon conversion of the Notes and the GDSs representing such Common Shares have not been approved or disapproved by the United States Securities and Exchange Commission, any state securities commission in the United States or any other U.S. regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the offering of the Notes, the Common Shares issuable upon conversion of the Notes and the GDSs representing such Common Shares or the accuracy or adequacy of this document. Any representation to the contrary is a criminal offense in the United States.

No person has been authorized to give any information or to make any representations other than those contained in this Offering Memorandum, and, if given or made, such information or representations must not be relied upon as having been authorized. This Offering Memorandum does not constitute an offer to sell or the solicitation of an offer to buy any securities other than the securities to which it relates or an offer to sell or the solicitation of an offer to buy such securities by any person in any circumstances in which such offer or solicitation is unlawful. Neither the delivery of this Offering Memorandum nor any sale hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Company since the date hereof or that the information contained herein is correct as of any time subsequent to its date.

The distribution of this Offering Memorandum and the offering and sale of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Memorandum comes are required by the Company and the Purchasers to inform themselves about and to observe any such restrictions. The Offering Memorandum does not constitute an offer of, or an invitation to purchase, any of the Notes in any jurisdiction in which such offer or invitation would be unlawful. For a further description of certain restrictions on the offering and sale of the Notes, see "Plan of Distribution".

IN CONNECTION WITH THIS OFFERING, SALOMON BROTHERS INTERNATIONAL LIMITED MAY OVER-ALLOT OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE NOTES AND, SUBJECT TO APPLICABLE ROC LAWS, THE COMMON SHARES AND THE GDSs REPRESENTING THE COMMON SHARES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL FOR A LIMITED PERIOD OF TIME AFTER THE ISSUE DATE. HOWEVER, THERE MAY BE NO OBLIGATION ON SALOMON BROTHERS INTERNATIONAL LIMITED OR ITS AGENT TO DO THIS. SUCH STABILIZATION, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME, AND MUST BE BROUGHT TO AN END AFTER A LIMITED PERIOD. SEE "PLAN OF DISTRIBUTION".

NOTICE TO NEW HAMPSHIRE RESIDENTS ONLY

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENCED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER CHAPTER 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

NOTICE TO INVESTORS

Because of the following restrictions, purchasers are advised to consult legal counsel prior to making any offer, resale, pledge or other transfer of Rule 144A Notes, the Common Shares issuable upon conversion of such Rule 144A Notes or the GDSs representing such Common Shares.

Each owner of an interest in any Rule 144A Note, by its acceptance thereof, will be deemed to have acknowledged and represented and agreed as follows:

- 1 The Rule 144A Notes, the Common Shares issuable upon conversion of the Rule 144A Notes and the GDSs representing such Common Shares have not been and are not expected to be registered under the Securities Act or with any securities regulatory authority of any State of the United States and are subject to significant restrictions on transfer.
- 2 Such owner is a qualified institutional buyer ("QIB") within the meaning of Rule 144A under the Securities Act ("Rule 144A") and is purchasing the Rule 144A Notes for its own account, an account with respect to which it exercises sole investment discretion, or for an account which is a QIB, and such owner is aware that the transferor of such securities is relying on the exemption from registration under the Securities Act provided by Rule 144A for the transfer.
- 3 Such owner will not offer, sell, pledge or otherwise transfer any interest in the Rule 144A Notes, the Common Shares issuable upon conversion of the Rule 144A Notes and the GDSs representing such Common Shares except as permitted by the applicable legend set forth in paragraph 4 below.
- 4 The Rule 144A Notes will bear a legend to the following effect, unless the Company determines otherwise in compliance with applicable law, and that it will observe the restrictions contained therein:

THE RULE 144A NOTES ("RULE 144A NOTES") EVIDENCED HEREBY AND THE COMMON SHARES OF COMPAL ELECTRONICS, INC. ISSUABLE UPON CONVERSION OF THE RULE 144A NOTES AND THE GLOBAL DEPOSITARY SHARES ("GDSs") REPRESENTING SUCH COMMON SHARES HAVE NOT BEEN, AND ARE NOT EXPECTED TO BE, REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND SUCH SECURITIES MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT IS (A) A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) OR A PURCHASER THAT THE SELLER AND ANY PERSON ACTING ON THE SELLER'S BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER, IN EACH CASE PURCHASING FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER, AND (B) AWARE THAT THE OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (2) IN AN OFFSHORE TRANSACTION MEETING THE REQUIREMENTS OF REGULATION S UNDER THE SECURITIES ACT, (3) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OR (4) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE), IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND OTHER JURISDICTIONS. EACH HOLDER AND BENEFICIAL OWNER, BY ITS ACCEPTANCE OF THIS RULE 144A NOTE, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING RESTRICTIONS AND THAT NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 FOR REALES OF THIS NOTE, THE COMMON SHARES REPRESENTED THEREBY OR THE GDSs REPRESENTING SUCH COMMON SHARES.

- 5 The Rule 144A Notes offered in the Offering will initially be represented by the Rule 144A Global Note. Before any Rule 144A Notes evidenced by such Rule 144A Global Note may be sold or

otherwise transferred to a person who takes delivery in the form of International Notes evidenced by the International Global Note, the transferor and the transferee will be required to provide written certifications in the forms set forth in the Indenture.

- 6 Any resale or other transfer, or attempted resale or other transfer, of the Rule 144A Notes made other than in compliance with the above-stated restrictions shall not be recognized by the Company or by the Trustee.
- 7 The Company, the registrar, the Purchasers and their affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements. If it is acquiring any Notes for the account of one or more QIBs, it represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

Prospective purchasers are hereby notified that sellers of the Rule 144A Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.

AVAILABLE INFORMATION

The Company has agreed that, for so long as any Rule 144A Notes or the Common Shares issuable upon conversion of the Notes or GDSs representing such Common Shares are “restricted securities” within the meaning of Rule 144(a)(3) of the Securities Act, the Company will, during any period in which it is neither subject to Section 13 or 15(d) of the United States Securities Exchange Act of 1934 (the “Exchange Act”), nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder, provide to any holder or beneficial owner of such restricted securities or to any prospective purchaser of such restricted securities designated by such holder or beneficial owner, upon the request of such holder, the information required to be provided by Rule 144A(d)(4) under the Securities Act.

ENFORCEABILITY OF FOREIGN JUDGMENTS IN THE ROC

The Company is a company limited by shares incorporated under the ROC Company Law (as defined herein). All of the Company’s directors and executive officers, and its respective supervisors, are residents of the ROC (as defined herein) and a substantial portion of the assets of the Company and such persons are located in the ROC. As a result, it may not be possible for investors to effect service of process upon the Company or such persons outside the ROC, or to enforce against any of them judgments obtained in courts outside the ROC, including those predicated upon the civil liability provisions of the securities laws of the United States or any State or territory within the United States.

Any final judgment obtained against the Company in any court other than the courts of the ROC in respect of any legal suit or proceeding arising out of or relating to the Notes will be enforced by the courts of the ROC without further review of the merits only if the court of the ROC in which enforcement is sought is satisfied that (i) the court rendering the judgment has jurisdiction over the subject matter according to the laws of the ROC, (ii) the judgment is not contrary to the public order or good morals of the ROC, (iii) the judgment is a final judgment for which the period for appeal has expired or from which no appeal can be taken, (iv) if the judgment was rendered by default by the court rendering the judgment, the Company was served within the jurisdiction of such court or process was served on the Company with judicial assistance of the ROC and (v) judgments of the courts of the ROC are recognized and enforceable in the jurisdiction of the court rendering the judgment on a reciprocal basis.

A party seeking to enforce a foreign judgment in the ROC would, except under limited circumstances, be required to obtain foreign exchange approval from the Central Bank of China (the “CBC”) for the remittance out of the ROC of any amounts recovered in respect of such judgment denominated in a currency other than NT Dollars.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements under “Summary”, “Risk Factors”, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, “Business of the Company” and elsewhere in this Offering Memorandum constitute “forward-looking statements”. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: changes in political, social and economic conditions in the ROC and the PRC (as defined herein); changes in currency exchange rates; changes in market prices for the Company’s products; changes in the availability or prices of raw materials and components; changes in customer preferences; changes in competitive conditions; and changes in technology. Additional factors that could cause actual results, performance or achievements to differ materially include, but are not limited to, those discussed under “Risk Factors”. These forward-looking statements speak only as of the date of this Offering Memorandum. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any change in the Company’s expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

CERTAIN DEFINED TERMS, CONVENTIONS AND CURRENCY OF PRESENTATION

Except where the context otherwise requires, all references herein to “Compal”, “Compal Electronics”, the “Company”, “our company”, “ourselves”, “we”, “our” or “us” are references to Compal Electronics, Inc. and, where appropriate, Compal Electronics, Inc. and its subsidiaries. References to “you” or “your” are to potential investors in, and buyers of, the Notes. References to the “Offering” are to the offering set forth in this Offering Memorandum. All references herein to “Taiwan” or the “ROC” are to the island of Taiwan and other areas under the effective control of the Republic of China. All references herein to the “ROC Government” or the “ROC Company Law” are references to the government of the Republic of China and the Company Law of the Republic of China, respectively. All references herein to “ROC GAAP” and “U.S. GAAP” are to accounting principles generally accepted in the ROC and the United States, respectively. All references herein to “China” or the “PRC” are to the People’s Republic of China.

In this Offering Memorandum, (a) the Notes offered and sold outside the United States (the “International Notes”) and the Notes offered and sold in the United States to qualified institutional buyers (“QIBs”) as defined in Rule 144A (“Rule 144A”) under the Securities Act (the “Rule 144A Notes”) are collectively referred to as the “Notes”, (b) the International Deposit Agreement dated as of October 19, 2000, as amended as of May 21, 2001, among the Company, The Bank of New York, as depositary (the “Depositary”) and the owners and beneficial owners of global depositary receipts issued thereunder is referred to as the “International Deposit Agreement”, and the Rule 144A Deposit Agreement dated as of October 19, 2000, as amended as of May 21, 2001, among the Company, the Depositary and the owners and beneficial owners of global depositary receipts issued thereunder is referred to as the “Rule 144A Deposit Agreement”, which together with the International Deposit Agreement are referred to as the “Deposit Agreements”, (c) the global depositary shares issued under the International Deposit Agreement (the “International GDSs”) and the global depositary shares issued under the Rule 144A Deposit Agreement (the “Rule 144A GDSs”) are collectively referred to as the “Global Depositary Shares” or “GDSs”, (d) the global depositary receipts representing the International GDSs (the “International GDRs”) and the global depositary receipts representing the Rule 144A GDSs (the “Rule 144A GDRs”) are collectively referred to as the “Global Depositary Receipts” or the “GDRs” and (e) the common shares, par value NT\$10 per share, of the Company are referred to herein as the “Common Shares”.

The Company publishes its financial statements in New Taiwan Dollars, the lawful currency of the ROC. All references herein to “United States Dollars”, “U.S. Dollars” and “U.S.\$” are to United States dollars and references to “New Taiwan Dollars”, “NT Dollars” and “NT\$” are to New Taiwan Dollars. All translations from New Taiwan Dollars to United States Dollars have been made (unless otherwise indicated) on the basis of the noon buying rate in The City of New York for cable transfers in NT Dollars per U.S. Dollar as provided by the Federal Reserve Bank of New York (the “Noon Buying Rate”) on December 31, 2001 and March 29, 2002, as applicable, of NT\$35.00 = U.S.\$1.00. On October 3, 2002, the Noon Buying Rate between New Taiwan Dollars and United States Dollars was NT\$34.97 = U.S.\$1.00. See “Exchange Rates”. All amounts translated into United States Dollars as described above are provided solely for the convenience of the reader, and no representation is made that the NT\$ or U.S.\$ amounts referred to herein could have been or could be converted into U.S.\$ or NT\$, as the case may be, at any particular rate, the above rates or at all.

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SUMMARY

The following summary is qualified in its entirety by, and should be read in conjunction with, the more detailed information and financial statements appearing elsewhere herein. Except as otherwise indicated, all financial information set forth herein with respect to us is presented on a consolidated basis in New Taiwan Dollars in conformity with ROC GAAP.

Compal Electronics, Inc.

We are a leading manufacturer of notebook personal computer systems ("notebook PCs") and display monitors, including liquid crystal display ("LCD") monitors and cathode ray tube ("CRT") monitors. We also manufacture peripherals, accessories and spare parts primarily for notebook PCs. In early 2000, we began diversifying into mobile electronic devices such as personal digital assistants ("PDAs"), pocket personal computers ("pocket PCs") and wireless handsets using global system for mobile communication ("GSM") and code division multiple access ("CDMA") technologies.

We believe that we are one of the three largest producers of notebook PCs among Taiwanese companies. In 2001, Taiwanese notebook PC manufacturers supplied approximately 55% of the notebook PCs sold in the world, according to the Market Intelligence Center ("MIC"). Taiwanese manufacturers are projected to supply 59% of the world's production of notebook PCs for the year 2002 according to MIC. Worldwide shipment of notebook PCs is projected by International Data Corporation ("IDC") to grow from approximately 27.4 million units in 2001 to 29.5 million units in 2002.

Leading personal computer ("PC") vendors, as well as vendors of mobile devices, have increasingly outsourced their manufacturing in order to reduce costs, respond more quickly to customer needs and changes in product cycles and focus on building their brands. We have been a major beneficiary of this outsourcing trend. We mainly sell our products to our customers on an original design manufacturing ("ODM") or original equipment manufacturing ("OEM") basis. Our major customers include Dell, Toshiba, Hewlett-Packard (for both Hewlett-Packard and Compaq brands), Fujitsu, NEC-Mitsubishi, Acer and Hitachi.

We have expanded our product range to include mobile electronic devices such as wireless handsets and information appliance products ("IAs") to take advantage of the growing wireless market and to leverage our manufacturing and research and development ("R&D") capabilities. According to BIS Shrapnel Pty Ltd ("BIS"), the number of wireless users globally is projected to reach 1,273 million by 2003, with demand for mobile phones projected to reach 558 million units in 2003. We have a 58.7% interest in Compal Communications, Inc. ("Compal Communications"), a company that develops and manufactures GSM and General Packet Radio Service ("GPRS") handsets. In addition, Compal Electronics also produces GPRS handsets for sale to ODM/OEM customers. We commenced commercial manufacture and shipment of CDMA handsets during the fourth quarter of 2001. We develop and produce IAs, such as PDAs and pocket PCs, and began shipments to our customers in 2001.

We manufacture products in two plants in Taiwan and four plants in China. The two Taiwan production plants, both located in Pincheng, Taoyuan County, have the combined capacity to produce approximately 250,000 notebook PCs per month. In addition, our Taiwan plants have the capacity to produce 240,000 wireless handsets and 90,000 IAs per month in Pincheng. The plants in China, all located in Kunshan, Jiangsu Province, have the capacity to produce approximately 250,000 notebook PCs, 250,000 LCD monitors and 500,000 CRT monitors per month. The investment restrictions which prohibited Taiwanese manufacturers from producing notebook PCs in China were lifted by the ROC government in December 2001. We have subsequently shifted some of our notebook PC production capability to China, and we plan to continue to shift more of our notebook PC production to China. We are building a fifth production plant in Kunshan, China, where we expect to commence production of notebook PCs in the first quarter of 2003.

We, in association with Kinpo Electronics, Inc. ("Kinpo"), Uni-President Group and Teco Electric & Machinery Co., Ltd. ("Teco"), have established a joint venture company, Toppoly Optoelectronics Corp.

("Toppoly"), to engage in the development and production of low-temperature poly-silicon thin film transistor ("LTPS TFT") LCD panels. These panels are expected to be used primarily in wireless handsets and IAs. Toppoly began construction of a facility in Taiwan to manufacture LTPS TFT-LCD panels in February 2001, and we expect production to commence in the fourth quarter of 2002.

For the year ended December 31, 2001, we had total consolidated net sales of NT\$78.7 billion (U.S.\$2.2 billion), with net sales of notebook PCs, LCD monitors, CRT monitors, peripherals, accessories and spare parts, wireless handsets and IAs accounting for 66.1%, 14.3%, 13.6%, 5.8%, 0.05% and 0.1%, respectively, of total consolidated net sales. Our fiscal 2001 consolidated net sales represented a 4.2% increase over fiscal 2000 consolidated net sales of NT\$75.5 billion. For the six months ended June 30, 2002, we had total consolidated net sales of NT\$52.9 billion (U.S.\$1.6 billion), with net sales of notebook PCs, LCD monitors, CRT monitors, peripherals, accessories and spare parts, wireless handsets and IAs accounting for 64.3%, 18.7%, 8.0%, 5.6%, 1.8% and 1.6%, respectively, of total consolidated net sales. Total consolidated net sales for the six months ended June 30, 2002 represented a 58.7% increase over total consolidated net sales for the six months ended June 30, 2001 of NT\$33.3 billion (unaudited). These figures in each case do not include sales of Compal Communications, which we do not consolidate for accounting purposes in accordance with Taiwanese accounting rules.

Our Common Shares have been listed on the Taiwan Stock Exchange since 1992 and the GDSs have been listed on the Luxembourg Stock Exchange since 1999. As of August 23, 2002, we had a market capitalization of approximately NT\$88.7 billion (U.S.\$2.6 billion).

We are a Taiwan registered company. Our registered office is located at 7th Floor, 319 Pateh Road, Section 4, Taipei 105, Taiwan, ROC.

Strategy

Our primary objective is to enhance our position as one of the world's leading manufacturers of notebook PCs and LCD and CRT monitors while leveraging our strengths in our current businesses to diversify into mobile electronic devices, including wireless handsets and IAs. The key components of our strategy are as follows:

Be the ODM Manufacturing Partner of Choice in the Global Branded PC, Wireless Handset and Information Appliance Industries

Our strategy is to be the manufacturing partner of choice for leading global branded PC, wireless handset and IA companies. Changing dynamics in such markets are driving PC, wireless handset and IA companies to embrace a business model dependent upon ODM manufacturing companies' services and products. As an ODM manufacturer, we offer our customers an ability to design and produce high quality, high volume and low-cost customized notebook PCs, displays, wireless handsets and IAs with quick turn-around times. We are focused on continually improving our products and services in order to deliver even better design, manufacturing, production, fulfillment and after-sales services. We also continue to develop our production capacity which, when coupled with our management experience, gives us the ability to scale production more quickly to meet large demand.

Foster Product Innovation and Improve Product Quality through R&D

We work closely with our customers to design and develop high quality products that can be manufactured quickly and cost-effectively. We will continue to place strong emphasis on building a high quality R&D team to design products suitable for immediate sale by customers and to enable us to move quickly in creating new products based on customer specifications.

Expand Relationships with Existing Customers and Diversify Customer Base

One of our core aims is to build integrated relationships with our customers, from the design stage to after-sales service. We create a cross-department team for each key customer in order to develop an

in-depth understanding of the specifications, testing, quality, logistics and inventory management needs of such customer. We plan to continue to develop our working relationships with our customers to strengthen our ties to customers, increase their switching costs and create competitive barriers to entry. We intend to increase our marketing efforts in order to broaden our existing customer relationships and build new relationships with other leading PC, wireless handset and IA companies. We also plan to increase our customer diversification by focusing on the outsourcing trend in Japan.

Capitalize on Opportunities Created by the Growing Wireless and Information Appliance Market

In 2000, we entered the rapidly expanding global wireless market, and aim to leverage our technological and manufacturing expertise as well as our existing relationships with suppliers and customers to become a significant manufacturer of wireless handsets and IAs. We believe that, by utilizing our expertise in portable electronics products, we are well-positioned to diversify into wireless handsets and IAs, and to respond to future demand for products combining wireless communications and computing functions as personal communications and computing technologies converge.

Expand China Production and R&D Base for Greater Competitive Advantage

With more of our key customers establishing production and marketing facilities in China, we aim to shorten our supply chain by utilizing our production capabilities in China to manufacture products at lower unit costs and to ship our products directly to the customers' factories or outlets in China. Currently, we manufacture some of our notebook PCs and all of our CRT monitors and LCD monitors in our facilities in China. We plan to shift a higher proportion of our notebook PC manufacturing production capabilities to China. We believe that following China's entry into the World Trade Organization, more leading PC, wireless handset and IA companies will establish operations in China and seek partnerships with companies that can effectively supply and provide services in China. We opened a new R&D center in Kunshan in March 2001, which has over 130 engineers who are engaged in software and product development for entry-level products, and we plan to increase the number of engineers in Kunshan as necessary.

Build a Customer-Focused Global Logistics and Fulfillment Network

The leading PC, wireless handset and IA vendors have increasingly required ODM/OEM suppliers to provide global fulfillment and support networks so that such vendors can respond to market demand quickly and reduce their inventory risk. Our strategy is to offer such clients the ability to ship and service products in Asia, Europe and the United States on a timely and cost-effective basis.

Develop Toppoly into a Major Manufacturer of LTPS TFT-LCD Panels

We have a 30.1% interest in Toppoly, a joint venture company established to develop and manufacture LTPS TFT-LCD panels. Our goal is for Toppoly to become a major manufacturer of LTPS TFT-LCD panels to supply what we believe will be a growing market for such panels and be one of our suppliers of such panels for our wireless handsets and IAs. LTPS TFT-LCD panels are generally lighter, have better resolution, consume less power and produce clearer and brighter images than amorphous-silicon thin film transistor ("a-Si TFT") LCD panels currently in wide use. We believe that when Toppoly begins producing LTPS TFT-LCD panels in the fourth quarter of 2002, such panels will be in demand due to their superior quality and the rapidly growing market for mobile electronic devices. In addition to capitalizing on the potential market for LTPS TFT-LCD panels, Toppoly will enable us to source a portion of our requirements for such panels, even during supply shortages, for use in our mobile electronic devices. We believe that the high quality of LTPS TFT-LCD panels as well as our ability to secure supply of such panels will give our mobile electronic devices an advantage over competing products using a-Si TFT-LCD panels and provide us with an advantage in competing for customers.

Competitive Strengths

With our design and manufacturing capability and service infrastructure, we believe that we are well-positioned to capitalize on the growth in the PC, wireless handset and IA sectors, outsourcing by leading global branded PC, wireless handset and IA companies and the growth of the customers we target.

Proven Design and Manufacturing Track Record

We have assembled a high quality R&D team to work hand-in-hand with some of the world's largest PC, wireless handset and IA vendors. We have also developed cost-effective and quality controlled manufacturing processes and facilities. Our Design for Excellence ("DFx") project management program further streamlines our processes and reduces costs by, among other things, integrating our R&D development work with our manufacturing process. We have manufactured products for our major customers which have won numerous awards. For example, we received the "Worldwide Procurement Supplier Conference Playing to Win Quality Award" from Dell in March 2002.

High Quality Customer Base Driving Future Growth

Our customers include many of the leading global PC vendors: Dell, Toshiba, Hewlett-Packard, Acer and Fujitsu for notebook PCs; NEC-Mitsubishi, Hewlett-Packard (for Compaq brand), Acer, Hitachi and Toshiba for LCD monitors; and Hewlett-Packard (for Compaq brand), NEC-Mitsubishi, Acer and Hitachi for CRT monitors. We are continually taking steps to strengthen our close, strategic relationships with these customers as these customers represent an increasing share in the PC market due to ongoing consolidation of notebook PC sales among the leading vendors. We intend to increase our marketing efforts in order to broaden our existing customer relationships and build new relationships with other leading companies. We also intend to cross-sell our various products to our existing customer base. For instance, we successfully expanded our relationships with Dell and Toshiba, from supplying only notebook PCs to also supplying LCD monitors. We have also begun to build relationships with some of the leading wireless handset and IA vendors.

Depth of Customer Relationships Increases Switching Costs and Barriers to Entry

We provide our customers with leading design capabilities, a supply of key components, high quality and innovative products, scalable manufacturing facilities, a strategically placed logistics and fulfillment network and convenient after-sales services. In addition, we assign to each key customer a cross-functional team to ensure that these goods and services are designed, manufactured and delivered with high efficiency and consistency. We believe that the integration of our personnel and design and manufacturing system with those of our customers' has provided us with a sophisticated, in-depth understanding of our customers and their needs, creating competitive advantages by making it more costly for customers to switch to new manufacturing partners.

Value Added R&D Expertise

We believe that one of our significant competitive strengths is the quality of our R&D department, currently comprising over 1,000 engineers, including over 130 engineers located in our R&D center in China, with in-depth experience in the PC manufacturing sector. We believe the effectiveness of our R&D department, due in large part to its organization and the close interaction between it and our other departments, has enabled us to reduce the time we take to design and bring to market high quality and high performance products using advanced technology at a lower unit manufacturing cost. We continue to focus on building R&D capabilities for our new businesses and will continue to increase the size of our R&D department in China in order to support our growing manufacturing capabilities in China.

Competitive Cost Structure Due to Economies of Scale and Effective Cost Management

We enjoy significant benefits of economies of scale in our design and manufacturing process, customer service and sourcing of raw materials and components. Since many of our products use a substantial

number of the same materials and components, we have greater leverage in negotiations with key suppliers. Our increasing production capabilities in Kunshan, China will further enhance our ability to manufacture at relatively low cost and enjoy greater economies of scale. We are able to supply our key customers directly from our China plants, as these customers establish production and marketing facilities in China. In addition, our suppliers of key components have been expanding their production infrastructure in China, allowing us to manage our supplies and costs more effectively.

Scalability Supporting Further Expansion in the PC, Wireless Handset and IA Markets

We believe that consolidation in the PC, wireless handset and IA industries, coupled with the current trend towards increased outsourcing, will drive these vendors to identify and build closer relationships with partners, such as us, who have the ability to scale production rapidly to meet their growing needs. We believe that we are ranked among the top ten largest producers of notebook PCs worldwide for 2001 based upon our estimates of production volume and shipments.

The Offering

Issuer	Compal Electronics, Inc.
The Offering	The International Notes are being offered by the Purchasers outside the United States to non-U.S. persons in reliance on Regulation S under the Securities Act (“Regulation S”). The Rule 144A Notes are being offered concurrently in the United States by the Joint Global Coordinators, through their U.S. selling agents, only to institutions which are QIBs (as defined in Rule 144A) pursuant to Rule 144A.
Issue Price	100%
Closing Date	October 9, 2002.
Maturity Date	October 9, 2007.
Over-allotment Option	To the extent that the Purchasers sell more than U.S.\$300,000,000 in aggregate principal amount of the Notes, the Purchasers have the option exercisable within 30 days from the date hereof to purchase up to an additional U.S.\$45,000,000 aggregate principal amount of Notes. In the event that the Purchasers exercise the over-allotment option, the Company will promptly inform the Luxembourg Stock Exchange. See “Plan of Distribution”.
Interest	The Notes will not bear interest except in the limited circumstances set forth under “Description of the Notes — Default Interest”.
Conversion Rights	<p>Subject to certain conditions, each holder of the Notes (a “Holder”) will have the right during the Conversion Period (as defined herein) to convert its Notes (or any portion thereof being U.S.\$1,000 in principal amount or an integral multiple thereof) into Common Shares and, upon conversion may, subject to compliance with the terms and conditions of the Deposit Agreements or such other depository facility which may be established from time to time, including without limitation payment of the fees and expenses of the Depository, direct that the Common Shares be deposited with the Depository for issuance of GDSs, or with such other depository facility which may be established from time to time for issuance of depository receipts; <i>provided, however</i>, that the Conversion Right during any Closed Period (as defined herein) shall be suspended and the Conversion Period shall not include any such Closed Period. See “Risk Factors — Risks Relating to Ownership of the Notes, the GDSs and the Common Shares”, “Description of the Notes — Conversion” and “Description of the Global Depository Receipts — Deposit and Withdrawal”.</p> <p>GDSs will be issued under the Deposit Agreements. The Deposit Agreements will be made available for inspection at the offices of Banque Générale du Luxembourg S.A. currently located at 50, Avenue J.F. Kennedy, L-2951, Luxembourg.</p> <p>The Company shall as soon as practicable but in no event more than five Trading Days (as defined herein) from the Conversion</p>

	Date (as defined herein) issue Common Shares to the converting Holders or The Bank of New York, as depositary (or such other depositary as designated by the converting Holder), as the case may be.
Early Redemption Amount	The Early Redemption Amount will be equal to 100% of the outstanding principal amount of the Notes plus the Redemption Premium.
Redemption Premium	The Redemption Premium is determined so that the Redemption Premium represents for the holder a gross yield-to-maturity of 2.75% per annum, calculated on a semi-annual basis.
Repurchase at the Option of the Holder	Unless the Notes have been previously redeemed, repurchased and cancelled or converted, each Holder shall have the right, at such Holder's option, to require the Company to repurchase all (or any portion of the principal amount thereof which is U.S.\$1,000 or any integral multiple thereof) of such Holder's Notes, on October 11, 2005 at the Early Redemption Amount on the Holder's Put Date. See "Description of the Notes — Repurchase of the Notes".
Repurchase in the Event of Delisting . .	Unless the Notes have been previously redeemed, repurchased and cancelled or converted, in the event that the Common Shares cease to be listed or admitted to trading on the Taiwan Stock Exchange, each Holder shall have the right, at such Holder's option, to require the Company to repurchase all (or any portion of the principal amount thereof which is U.S. \$1,000 or any integral multiple thereof) of such Holder's Notes on the 20th Business Day after the Company gives to each Holder a notice regarding such delisting at the Early Redemption Amount on the Delisting Put Date. See "Description of the Notes — Repurchase of the Notes".
Repurchase at the Option of the Holder upon a Change of Control	Unless the Notes have been previously redeemed, repurchased and cancelled or converted, each Holder shall have the right, at such Holder's option, to require the Company to repurchase all (or any portion of the principal amount thereof which is U.S.\$1,000 or any integral multiple thereof) of such Holder's Notes at the Early Redemption Amount on the Change of Control Put Date upon the occurrence of a Change of Control, as defined herein. See "Description of the Notes — Repurchase of the Notes".
Redemption at the Option of the Company	The Notes may be redeemed at the option of the Company, in whole or in part, at any time on or after October 11, 2005 at the Early Redemption Amount on the Redemption Date; <i>provided</i> that the Closing Price (translated into U.S. Dollars at the prevailing rate) of (a) (i) the Common Shares and (ii) the GDSs, divided by the number of Common Shares represented by each GDS, on each of 20 consecutive Trading Days, the last of which occurs not more than five days prior to the date on which notice of such redemption is given, is at least 130% of the

	<p>Conversion Price (translated into U.S. Dollars at the Exchange Rate, as defined herein) and (b) the applicable Redemption Date does not fall within a Closed Period.</p> <p>Notwithstanding the foregoing, the Company may redeem all of the Notes at any time, on not less than 30 nor more than 60 days' notice, if at least 95% in principal amount of the Notes originally outstanding has been redeemed, repurchased and cancelled or converted, at the Early Redemption Amount on the Redemption Date; <i>provided</i> that the applicable Redemption Date does not fall within a Closed Period. See "Description of the Notes — Repurchase at the Option of the Company".</p>
Redemption for Taxation	
Reasons	<p>If, as a result of certain changes relating to the tax laws in the ROC or such other jurisdiction in which the Company is then incorporated and organized, the Company becomes obligated to pay Additional Amounts (as defined herein), the Notes may be redeemed at the option of the Company, in whole but not in part, at the Early Redemption Amount on the Redemption Date; <i>provided</i> that such right cannot be exercised earlier than 30 days prior to the first date on which the Company would be obligated to make an Additional Amounts payment with respect to all or substantially all of the outstanding Notes. See "Description of the Notes — Redemption for Taxation Reasons".</p>
Redemption at Maturity	<p>Unless the Notes have been previously redeemed, repurchased and cancelled or converted, the Company will redeem the Notes on the Maturity Date at a price equal to 114.63% of the outstanding principal amount thereof. See "Description of the Notes — Redemption at Maturity".</p>
Negative Pledge	<p>The Company will not, and will procure that none of its Principal Subsidiaries (as defined herein) will, create or permit to subsist any Lien (as defined herein) to secure for the benefit of the holders of any International Investment Securities (as defined herein) any sum owing in respect thereof or any guarantee or indemnity thereof without making effective provision to secure the Notes (a) equally and ratably with such International Investment Securities with a similar Lien or (b) with such other security as shall be approved by registered holders holding not less than 50% of the principal amount of the outstanding Notes. See "Description of the Notes — Certain Covenants — Negative Pledge".</p>
Further Issues	<p>The Company may from time to time without the consent of the holders of the Notes create and issue further securities having the same terms and conditions as the Notes in all respects so that such further issue shall be consolidated and form a single series with the respective Notes. See "Description of the Notes — Further Issues".</p>
Governing Law	<p>The Indenture and the Notes will be governed by, and construed in accordance with, the laws of the State of New York.</p>

Listing	Application has been made to have the Notes designated for trading in The PORTAL Market of The Nasdaq Stock Market, Inc. (the "PORTAL Market") and to list the Notes on the Luxembourg Stock Exchange. Application has been made to list the GDSs to be issued upon conversion of the Notes on the Luxembourg Stock Exchange. Application has been made to have the GDSs to be issued upon conversion of the Notes designated for trading on the PORTAL Market. Application will be made to list the Common Shares issuable on conversion of the Notes on the Taiwan Stock Exchange. The GDSs to be issued upon conversion of the Notes will be fungible with the existing GDSs including those which are listed on the Luxembourg Stock Exchange.
Trading Market for the Common Shares and the GDSs	The only trading market for the Common Shares is the Taiwan Stock Exchange. The Common Shares have been listed on the Taiwan Stock Exchange since 1992. Existing GDSs are listed on the Luxembourg Stock Exchange and traded on the International Order Book System of the London Stock Exchange.
Use of Proceeds	The net proceeds to us from the Offering, after payment of the underwriting discount and commissions and after deductions for offering expenses, are estimated to be approximately U.S.\$294,750,000 (or U.S.\$338,962,500 if the over-allotment option is exercised in full). We intend to use the net proceeds of the Offering for the purchase of raw materials from overseas suppliers and as working capital. See "Use Of Proceeds".
Delivery of the Notes	Delivery of the Notes, against payment in same-day funds, is expected on or about October 9, 2002, which is expected to be the third business day following the date of this Offering Memorandum, referred to as "T+3".
Ratings	The Notes have been rated BBB- by Standard and Poor's Ratings Group, a division of the McGraw-Hill Companies, Inc. Security ratings are not recommendations to buy, sell or hold the Notes. Ratings are subject to revision or withdrawal at any time by the ratings agencies.

Summary Consolidated Financial Data

The summary consolidated statement of income data for the years ended December 31, 1999, 2000 and 2001 and the six months ended June 30, 2002 and the summary consolidated balance sheet data as of December 31, 1999, 2000 and 2001 and June 30, 2002 set forth below are derived from the audited consolidated financial statements included in this Offering Memorandum and should be read in conjunction with, and are qualified in their entirety by reference to, such consolidated financial statements, including the notes thereto. The summary consolidated statement of income data for the six months ended June 30, 2001 and the summary consolidated balance sheet data as of June 30, 2001, are derived from the unaudited consolidated financial statements included in this Offering Memorandum and should be read in conjunction with, and are qualified in their entirety by reference to, such financial statements, including the notes thereto. The summary consolidated financial data as of and for the six months ended June 30, 2001 include all adjustments necessary to fairly state this information in the opinion of management. Results for the six months ended June 30, 2002, are not necessarily indicative of the results that may be expected for the full year. Our consolidated financial statements have been prepared and presented in accordance with ROC GAAP and reporting practices in the ROC. For a discussion of certain differences between ROC GAAP and U.S. GAAP, see "Summary of Certain Differences Between ROC GAAP and U.S. GAAP".

	Year ended and as of December 31,				Six months ended and as of June 30,		
	1999	2000	2001		2001	2002	
	(NT\$)	(NT\$)	(NT\$)	(U.S.\$)	(unaudited) (NT\$)	(NT\$)	(U.S.\$)
	(in millions, except per share amounts)						
Statement of Income Data:							
Net sales	47,293	75,469	78,658	2,247	33,294	52,853	1,580
Cost of sales	40,562	67,937	71,505	2,043	30,078	47,710	1,426
Gross profit ⁽¹⁾	6,761	7,515	7,130	204	3,248	5,133	153
Operating expenses	1,876	2,345	3,060	87	1,291	1,765	53
Operating income	4,885	5,170	4,070	116	1,957	3,368	101
Non-operating income	817	1,238	1,677	48	1,170	683	20
Non-operating expenses and losses	90	208	194	6	102	444	13
Income before income taxes and minority interest loss	5,611	6,200	5,553	159	3,025	3,607	108
Income tax expense	219	232	243	7	68	176	5
Minority interest in net loss of subsidiaries and preacquisition income	6	15	92	3	—	83	2
Net income	5,398	5,983	5,403	154	2,957	3,348	100
Net income per share	2.74	3.03	2.66	0.08	1.21	1.36	0.04
Balance Sheet Data:							
Current assets	19,941	24,474	35,989	1,028	31,564	43,158	1,290
Long-term equity investments	11,607	19,232	19,419	555	20,546	20,197	604
Total assets	37,353	50,269	61,891	1,768	58,189	71,008	2,122
Current liabilities	9,741	18,970	22,167	633	20,118	23,309	697
Non-current liabilities	141	192	391	11	417	687	21
Total liabilities	9,882	19,161	22,558	645	20,535	28,996	867
Total stockholders' equity	27,471	31,108	39,332	1,124	37,654	42,012	1,256

(1) Calculation of gross profit includes an adjustment for the change in unrealized intercompany profits, in the amounts of NT\$29.7 million, (NT\$16.3 million) and (NT\$22.7 million) for the years ended December 31, 1999, 2000 and 2001, respectively, and NT\$32.2 million and (NT\$10.0 million) for the six month periods ended June 30, 2001 and 2002, respectively. Profit and loss resulting from sales of products by us to subsidiaries and investee companies accounted for using the equity method are deferred as "unrealized profit from sales to subsidiaries" in the balance sheet, until such products are sold by the subsidiaries or investee companies.

RISK FACTORS

You should pay particular attention to the fact that we are governed in the ROC, and certain of our operations are governed in the PRC, by legal and regulatory environments which in some respects may be different from those which prevail in other countries. Before making an investment decision regarding the Notes being offered hereby, you should carefully consider all of the information contained in this Offering Memorandum, including the following information:

Risks relating to us and our business

We depend on key ODM and OEM customers

For each of the three years ended December 31, 1999, 2000 and 2001, our top five customers together accounted for approximately 82.2%, 86.0% and 80.3%, respectively, of our total consolidated net sales. For each of the three years ended December 31, 1999, 2000 and 2001, our largest customer accounted for approximately 47.3%, 25.5% and 30.0%, respectively, of our total consolidated net sales. For the six months ended June 30, 2002, our top five customers accounted for approximately 78.4%, and our largest customer accounted for approximately 25.9%, of total consolidated net sales.

As is customary in the industry, we are not a party to any long-term sale and purchase agreements with our ODM and OEM customers. The loss of one or more of these customers or reduction or delay in their orders could have a material adverse effect on our results of operations. For example, a reduction in orders from Dell, as a result of the phasing out of an older product line, had a significant impact on our results of operations for the six months ended June 30, 2001, and for the year ended December 31, 2001. In addition, because of the significance of such key customers to us, such customers may place demands on our resources or require special services, which have the effect of increasing our operating costs. These customers, including Dell, may also ask for reductions in the price of our products, which has the effect of decreasing our sales.

Our top five customers have included Hewlett-Packard and Compaq

For the year ended December 31, 2001, Hewlett-Packard and Compaq accounted for over 35% of our total consolidated net sales. For the six months ended June 30, 2002, Hewlett-Packard and Compaq accounted for approximately 17.9% of our consolidated net sales. Historically, we primarily sold notebook PCs to Hewlett-Packard and displays to Compaq. Hewlett-Packard announced the completion of its merger transaction with Compaq on May 3, 2002. Hewlett-Packard has announced that it will maintain a panel of four vendors, including Compal, in Taiwan. However, contracts will be awarded through competitive bidding. We cannot give any assurance that the merged company will continue to be one of our key customers in the future or that following the merger sales to the merged company will not be significantly less than the total of our sales to each of Hewlett-Packard and Compaq prior to the merger. In addition, competition for the business of the merged company among its vendors like us is expected to be intense, and could have an adverse effect on margins with respect to sales to the merged company.

The rate of growth in outsourcing may not continue

In recent years, we have benefited from the trend of notebook PC, display, wireless handset and IA vendors to increasingly outsource their manufacturing. There can be no assurance that this outsourcing trend will continue and that such vendors will not, in the future, reduce orders to outside manufacturers or decide to produce more of such products in-house. In the past, certain of our major customers have, from time to time, announced plans to expand production in their respective China plants. Recently, one of our major customers, Toshiba, announced plans to build one of the world's largest PC production facilities in China. It is yet uncertain whether this means Toshiba will decrease the outsourcing of its manufacturing and how this would affect purchase orders that we currently receive from Toshiba. However, if such customers, including without limitation Toshiba, and other leading vendors from which we receive purchase orders cease giving or reduce the amount of purchase orders to us due to a reversal or slowdown of such outsourcing trend, this would have an adverse effect on our results of operations and prospects.

We depend on access to key components, including LCD panels, the supply of which can be volatile

Our production depends on obtaining adequate supplies of components on a timely basis. We purchase our main components from a limited number of component manufacturers which can satisfy our quality standards and meet our volume requirements.

The key components for notebook PCs are LCD panels, CPUs, hard drives, optical disk drives and batteries. The key components for LCD monitors and CRT monitors are LCD panels and CRTs, respectively. The key components for wireless handsets are chip sets, passive components, batteries and LCD panels. The key components for IAs include CPUs, LCD panels, flash memory chips, passive components and batteries. From time to time, periodic shortages and over-supply of such components occur. A shortage in any of these components generally increases their prices, and may depress our margins to the extent that we are unable to pass these higher component prices on to our customers. These shortages, however, can quickly end and result in over-supply as suppliers ramp up production following capital expenditures to increase capacity. For example, there was a shortage of LCD panels from the end of 2001 to the second quarter of 2002, which resulted in higher costs of this key component. However, there quickly was an over-supply of LCD panels in the market. Such volatility in supply of LCD panels as well as other components may adversely affect our business if we cannot manage our supply of such components and react quickly to market changes. In addition, any shortage in a key component could limit the number of units we are able to produce. We believe that shortages and over-supply are cyclical, and there can be no assurance that shortages or over-supply of key components will not occur in the future or that any such shortages or over-supply will not have a material adverse effect on our results of operations.

We operate in a highly competitive environment

The markets for our major products are highly competitive, and we have experienced considerable pressure on our prices and margins. The PC and mobile devices industries have been characterized by periodic oversupply of products, price erosion, rapid technological change, short product life cycles and cyclical market patterns. Our ability to compete depends on factors both within and outside of our control, including product pricing, product functionality, performance and reliability, successful and timely product development, success or failure of our customers in marketing their brands and products, component and supply costs and general economic conditions. There can be no assurance that we will be able to compete successfully in the future as to any of these factors, and our failure to compete successfully in these or other areas could have a material adverse effect on our business, results of operations and financial condition.

Our main competitors in the production of notebook PCs include Arima, Inventec, Quanta and Wistron (Acer Group). Our main competitors for LCD monitors include Amtran Technology, AOC, BenQ, LG, Lite-On Technology and Samsung. Our main competitors in the production of CRT monitors include AOC, BenQ, LG, Lite-On Technology, Samsung and Tatung. Our main competitors in the production of wireless handsets include Arima, BenQ, GVC, Inventec, and Quanta. Some of our competitors have substantially greater financial, marketing, manufacturing, R&D and technological resources, greater brand-name recognition and larger customer bases than us. Recently, Lite-On Technology consolidated the businesses of four subsidiaries to emerge as the third largest IT company in Taiwan, outranking us for the first time in size. There can be no assurance that we will be able to compete successfully with such competitors.

Our gross margins are subject to downward pressure

The highly competitive environment and cyclical nature of the PC and mobile devices industries have subjected us to pressure on prices and margins. The principal factors which affect our gross margins include price competition among ODM/OEM manufacturers of notebook PCs, displays and other of our products, fluctuations of foreign exchange rates, reductions in average sale prices of our products during the life cycles of such products, fluctuations in the supply and demand for principal components and raw

materials for such products, our trend towards manufacturing and delivering more complete notebook PC systems and our ability to reduce unit manufacturing costs. We have in the past experienced periodic shortages of certain key components and raw materials as well as pressure from our customers to reduce unit prices of our products. In addition, we face downward pressure on the average selling prices of our products as such products may become commoditized as they move through their life cycles. Accordingly, our gross margins may continue to be subject to downward pressure as a result of the factors mentioned above, which could have a material adverse effect on our results of operations and prospects.

Our results of operations are subject to exchange rate fluctuations

In the year ended December 31, 2001, overseas sales, as to which payments are primarily in U.S. Dollars, accounted for approximately 99% of our consolidated net sales. In addition, approximately 85% of our purchases of raw materials were paid for in U.S. Dollars with 14% being paid for in NT Dollars and the balance being paid for in other currencies. We also have borrowings in NT Dollars and a significant portion of our operating expenses are paid in NT Dollars. Accordingly, fluctuations in exchange rates, in particular between the U.S. Dollar and the NT Dollar, affect our margins and may reduce our overall competitiveness. In addition, foreign exchange fluctuations could result in foreign exchange losses in respect of our assets and liabilities denominated in foreign currencies. While we recorded net foreign exchange gains in the years ended December 31, 2000 and 2001 of NT\$498.0 million and NT\$834.3 million (U.S.\$23.8 million), respectively, we had a net foreign exchange loss of NT\$39.9 million in the year ended December 31, 1999. We also recorded a foreign exchange loss of \$331.9 million for the six months ended June 30, 2002. The impact of future exchange rate fluctuations cannot be predicted. Although the impact of exchange rate fluctuations has in the past been partially mitigated by our natural hedging between our foreign currency receivables and payables, there can be no assurance that we will be able to offset the overall impact of any exchange rate fluctuations in the future.

Our new products and new investments may not be successful

Beginning in late 1999, we began to diversify our business operations through a series of strategic investments. In December 1999, in association with Kinpo and Uni-President Group, we established Toppoly to engage in the development and production of LTPS TFT-LCD panels. In May 2000, we acquired a majority equity interest in Compal Communications to engage in the development and manufacture of GSM and GPRS handsets. In July 2001, we merged with Palmax Technology Co., Ltd. ("Palmax"), to engage in the development and manufacture of PDAs and other IAs. In addition, in October 1999, we established VACOM Wireless, Inc. ("VACOM"), a subsidiary in Korea, to engage in the R&D of CDMA handsets. Although we believe that we have effectively managed our expansion with respect to existing and new businesses in recent years, we may not be able to continue to do so in the future. See "— We will need to manage our expansion".

The new product lines into which we have expanded are subject to rapid technology changes and intense competition. As a result, we will need to offer, on an ongoing basis, more advanced technologies in order to respond to competitive industry conditions and customer requirements. This may require that we make significant expenditures to acquire and develop technologies. In the wireless handset business, our success will depend on our ability to identify and acquire rapidly developing cellular technologies and our ability to recruit and retain experienced R&D engineers. With respect to the manufacture of IAs, we will need to continue to invest in R&D in order to design and manufacture more complex products such as PDAs and pocket PCs. With respect to the manufacture of LTPS TFT-LCD panels, Toppoly is developing the necessary production capabilities. We, however, cannot give any assurance that by the time Toppoly is able to produce such panels, the LTPS TFT-LCD technology will not have been replaced or superseded by a superior technology which may not be available to us or Toppoly, or that LTPS TFT-LCD technology will gain widespread acceptance.

Toppoly was formed as a joint venture, and we may in the future pursue other opportunities in joint ventures with third parties. Such investments may involve special risks associated with the possibility that the other shareholders or joint venture partners may, among other things, (i) have economic or business

interests or goals that are inconsistent with ours, (ii) take actions contrary to our instructions or requests or contrary to our policies or objectives, (iii) be unable or unwilling to fulfill their obligations under the relevant joint venture or shareholders' agreements or (iv) have financial difficulties.

We rely on key personnel

Our success depends on our ability to attract and retain highly qualified management, engineering and technical personnel. The process of hiring employees with the combination of skills and attributes required to implement our strategy can be extremely competitive and time-consuming. In particular, our expansion into the production of wireless handsets and IAs and our efforts through Toppoly to manufacture LTPS TFT-LCD panels have required us to employ additional employees with specific sets of skills. Such skilled workers, especially engineers with expertise in GSM and CDMA technologies, are in high demand, and there can be no assurance that we will be able to attract and retain the necessary personnel. The loss of the services of key personnel (including through unexpected death or disability), or the inability to attract additional qualified personnel, could have a material adverse effect on our business.

We rely on technology provided by third parties

The success of our investment in the manufacture of LTPS TFT-LCD panels, wireless handsets and IAs is dependent in part upon technology provided by third parties. For example, Qualcomm provides certain CDMA technology for our wireless handsets and Microsoft provides the operating system and technology for our PDAs. There can be no assurance that third parties will license or transfer additional advanced technologies to us or Toppoly in the future on terms satisfactory or acceptable to us or Toppoly, or at all. In the event that we or Toppoly are unable to license or obtain the transfer of advanced technologies from third parties, we or Toppoly, as the case may be, may be required to develop such technologies internally. There can be no assurance that we or Toppoly will be able to develop such technologies internally.

Our business depends on intellectual property and we may become involved in intellectual property litigation

Our success will depend in part on our ability to protect our proprietary rights and to operate without infringing on the proprietary rights of third parties. As of July 31, 2002, approximately 444 patents were issued to us. In addition, we had approximately 190 patent applications pending in different countries covering various aspects of our products, and we may apply for additional patents in the future. There can be no assurance that any of our current or future patent applications will result in issued patents, that the scope of the claims in any patents that are currently held by or will be issued to us will prevent competitors from introducing competing products or that any patents that are currently held by or will be issued to us would be enforceable if challenged. In addition, other parties may hold or receive patents that contain claims covering other technology included in our current or future products that could hinder or prevent the sale of our products or require us to obtain licenses for such technology, which might not be available on acceptable terms or at all.

The computer, telecommunications and technology industries frequently feature disputes over intellectual property. We may in the future be required to defend our intellectual property rights against infringement, duplication, discovery and misappropriation by third parties or to defend ourselves against third-party claims of infringement. Disputes may also arise in the future with respect to ownership of technology developed by employees who were previously employed by other companies or with respect to the terms and conditions of any licensing agreement we enter into. In addition, the contracts we enter into with our customers typically include provisions obligating us to indemnify and hold harmless such customers from all claims relating to products we sell to such customers.

We are currently involved in intellectual property disputes which could result in the incurrence of substantial costs and the diversion of our management's attention. In October 2000, Samsung Electronics Co., Ltd. initiated a patent infringement action in the United States District Court for the Northern

District of California against us and two of our subsidiaries and certain other notebook PC manufacturers in Taiwan. On February 13, 2001, Elonex I.P. Holdings, Ltd. filed several patent infringement actions in the United States District Court for the District of Delaware against us and a number of other major electronics and computer companies. On April 6, 2001, LG Electronics, Inc. filed a complaint for patent infringement against us and two of our subsidiaries in the United States District Court for the Northern District of California. On April 19, 2002, Thomson Multimedia Licensing, Inc. filed a complaint against our subsidiary, Compal Electronics (China) Co., Ltd. ("Compal China"), and us for the payment of royalty fees under a licensing agreement. See "Business — Litigation and Legal Issues". An adverse determination in these disputes and any other intellectual property dispute or litigation in the future could subject us to significant liabilities to third parties, require us to seek licenses from or pay royalties to third parties or require us to develop appropriate alternative technology. There can be no assurance that any such licenses would be available on acceptable terms or at all, or that we could develop alternate technology at an acceptable cost or at all. Any of these events could have a material adverse effect on our business, financial condition and results of operations.

We may face potential liability with respect to product defects

The contracts we enter into with our major customers typically include warranties that the products we deliver will be free from defects and perform in accordance with agreed-upon specifications. To the extent that products shipped by us to our customers do not, or are not deemed to, satisfy such warranties, we could be responsible for repairing or replacing any defective products, or, in certain circumstances, for the cost of effecting a recall of all products which might contain a similar defect, as well as for consequential damages.

On May 3, 2001, one of our major customers, Dell, announced that it would voluntarily recall approximately 284,000 batteries used in two of Dell's notebook computer series due to battery safety concerns. As we manufactured these notebook PCs for Dell, pursuant to our agreement with Dell, we could be liable for the costs of such recall as well as the costs associated with any damage that has occurred as a result of such product defect. We have reached an agreement under which our Japanese supplier of the recalled batteries will indemnify us for a substantial portion of any costs associated with the defective batteries. See "Business — Litigation and Legal Issues". However, there can be no assurance that we will be able to recover any losses incurred in respect of the defective batteries from the Japanese supplier, or would be able to recover any losses incurred as a result of product liability in the future from any third party, or that defects in the products sold by us, regardless of whether we are responsible for such defects, would not adversely affect our standing and reputation in the marketplace, result in monetary losses and have a material adverse effect on our business, financial condition and results of operations.

We may experience losses on inventories

Frequent new product introductions in the computer and mobile devices industries can result in a decline in average selling prices and the stated value of inventory. Our policy is to establish a full provision for any raw materials not utilized for a period of three months. With respect to other types of inventory, we established a provision for inventory loss based on the difference between the costs of inventory and the market price.

Since the introduction of our global logistics delivery network in June 1999, we have assumed part of the inventory risks of certain of our major customers such as Dell, NEC-Mitsubishi and Acer, as incomplete notebook PCs and displays are first shipped to hubs we established in the United States and Europe based on customers' rolling forecasts, for onward delivery to, and final configuration by, customers only after a firm order has been placed. This policy may have an adverse impact on our inventory management because it results in our bearing the inventory risk with respect to such products longer than if such incomplete notebook PCs and displays are shipped to our customers and held as part of their inventory before being configured.

We have purchased transportation insurance coverage for finished goods delivered to our hubs as part of our global logistics delivery network. While we believe that the coverage we maintain through insurance policies with independent third-party insurers should generally be adequate to cover the total amount of inventory we maintain at any time, a sudden increase in our inventory level or an underestimation set out in our submission to the relevant insurers could result in us being under-insured.

We are susceptible to general economic and industry conditions

Any general economic, business or industry conditions that cause customers or potential customers to reduce or delay their investments in computer systems could have a material adverse effect on our business, prospects and financial performance. In the year ended December 31, 2001, the worldwide economic slowdown, particularly in the computer industry, resulted in reduced consumer demand for our products compared to the year ended December 31, 2000. If worldwide economic conditions do not improve as rapidly as expected, our business, financial condition and results of operation could be negatively affected. The September 11, 2001 terrorist attacks on the United States created immediate significant economic and political uncertainty. The long-term effects on our business are uncertain, but could be material. Further terrorist acts or acts of war, whether in the United States or abroad, could cause disruption or damage to our business, our suppliers, distributors or customers, or could create political or economic instability, any of which may have a material adverse effect on our business, financial condition and results of operations.

Our operating results are seasonal

Our sales revenues are affected by seasonal variations in market conditions which contribute to the fluctuation of the average selling prices of notebook PCs, displays and wireless handsets. We generally experience seasonal lows in the demand for notebook PCs and displays during the first quarter of the year, reflecting generally decreased demand for PCs in the United States and Europe. On the other hand, we generally experience seasonal peaks during the latter part of the third quarter and the fourth quarter of the year, primarily as a result of increased demand for PCs in the United States and Europe from back-to-school and holiday season sales. We expect that our ongoing operations will continue to be materially affected by seasonality in our results of operations.

Our operations are subject to manufacturing risks

The manufacturing process for our products is continuously being updated in an effort to improve efficiency and to reduce product defects and unit manufacturing costs. In addition, we have been manufacturing wireless handsets and IAs for a relatively short period of time, and we recently commenced, and plan to significantly ramp up, notebook PC production in the PRC. There is a risk that, from time to time, there will be production difficulties that could cause delivery delays and reduced output. There can be no assurance that we will not experience manufacturing problems in achieving acceptable output, and/or product delivery delays in the future as a result of, among other things, capacity constraints, construction delays, difficulties in upgrading or expanding existing facilities, difficulties in changing our manufacturing line technologies or delays in delivery of equipment, any of which could result in a loss of future revenues.

We may have additional capital requirements in connection with our business strategy

In connection with our strategy of diversification into new products, we estimate that in 2002 we will spend approximately NT\$11.4 billion for the purchase of equipment, construction of new facilities and strategic investments. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources". However, in the event of adverse market conditions, we may not have sufficient internal sources of liquidity to effect our current operational plan and would need to secure additional financing from external sources. There can be no assurance that external sources of liquidity will be available to fund our ongoing operations or our product diversification program. The failure

to obtain financing would hinder our ability to make continued investments in our product diversification program, which could materially and adversely affect our business, prospects and results of operations.

We will need to manage our expansion

Our product diversification program and expansion will continue to put pressure on our managerial, technical, financial, production, operational and other resources. To manage future growth, we must add production and distribution capacity, enhance financing controls and hire additional engineering, particularly R&D and finance personnel. We will need to manage relationships with a greater number of customers, suppliers, equipment vendors and other third parties. In particular, to be successful in the wireless handset, IA and LTPS TFT-LCD panel markets, we will need to develop relationships with customers for such products and to secure profitable purchase orders. As we expand production of our new product lines, we may experience problems as a result of, among other things, capacity constraints, construction delays, increasing production at new facilities or upgrading or expanding existing facilities. We may also experience problems securing a stable supply of components or the necessary equipment to expand and maintain our production capabilities. There can be no assurance that we will be able to manage our expansion and growth effectively.

Risks Relating to Ownership of the Notes, the GDSs and the Common Shares

The market for the Notes, the GDSs and the Common Shares may not be liquid

Prior to the Offering, there has been no market for the Notes. Application has been made to list the Notes on the Luxembourg Stock Exchange and to have the Notes designated for trading in the PORTAL Market.

In addition, the Purchasers, or their affiliates, intend to purchase Notes for their own account and enter into transactions relating to the Notes, including asset swaps, repackagings and other transactions, which transactions may involve a substantial proportion of the Notes and may adversely affect the liquidity of any trading market in the Notes. Such transactions would be carried out as bilateral trades with selected counterparties and separately from any offering, sale or resale of the Notes to which this Offering Memorandum relates (notwithstanding that such selected counterparties may also be purchasers of the Notes). Furthermore, the Purchasers may make a market with respect to the Notes, but are not obligated to do so, and any market-making with respect to the Notes may be discontinued at any time without notice. Any of the foregoing transactions could adversely affect the liquidity in the Notes.

There has been no trading market for the Common Shares outside the ROC, and the only trading market for the Common Shares is the Taiwan Stock Exchange. Our GDSs are listed on the Luxembourg Stock Exchange and traded on the International Order Book System of the London Stock Exchange. Application has been made to list the GDSs which are issuable upon conversion of the Notes on the Luxembourg Stock Exchange. The GDSs which are issuable upon conversion of the Notes will be fungible with the existing GDSs which are listed on the Luxembourg Stock Exchange. Application has been made to have the GDSs which are issuable upon conversion of the Notes designated for trading in the PORTAL Market.

A holder of GDSs may withdraw and hold the Common Shares represented by such GDSs or request the Depositary to sell or cause to be sold on behalf of such holder the Common Shares represented by such GDSs; *provided* that the Custodian has received physical share certificates in respect of the Common Shares to be withdrawn or sold. There can be no assurance that the Depositary will be able to effect a sale of Common Shares in a timely manner or at a specified price, particularly during periods of illiquidity or volatility on the Taiwan Stock Exchange. Under current ROC law or as otherwise specified in the Deposit Agreements, except for additional GDSs which may be issuable in connection with (i) dividends on or free distributions of Common Shares, (ii) the exercise by owners of existing GDSs of their pre-emptive rights in connection with rights offerings, (iii) transfers between the depositary facility for the Rule 144A GDSs and the depositary facility for the International GDSs and (iv) the purchase directly by any person or through the Depositary of Common Shares on the Taiwan Stock Exchange for deposit into the

depository facility to replace previously issued GDSs which have been canceled when the underlying Common Shares were withdrawn and sold on the Taiwan Stock Exchange, no additional GDSs may be issued by the Depository without specific ROC regulatory approval. ROC regulatory approval has been received for GDSs to be issued upon deposit of Common Shares issuable upon conversion of the Notes.

Holders of the Notes will bear the risk of fluctuations in the price of the GDSs and the Common Shares

The market price of the Notes at any time will be affected by fluctuations in the price of the GDSs and the Common Shares. It is impossible to predict whether the price of the GDSs or the Common Shares will rise or fall. Trading prices of the GDSs and the Common Shares will be influenced by, among other things, our results of operations and political, economic, financial and other factors that can affect the capital markets on which the Common Shares are traded and the financial services market in Taiwan. Any decline in the price of the GDSs or the Common Shares would adversely affect the secondary market price of the Notes.

There are limitations on your ability to exercise conversion rights

You will not be able to exercise your conversion right during Closed Periods. Under current ROC law, regulations and policy, PRC persons are not permitted to convert the Notes or to register as our shareholders. See “Description of the Notes — Conversion”.

Holders of GDSs will have limited voting rights

Subject to the provisions described in the second succeeding paragraph below, which will apply to the election of our directors and supervisors, if a holder or holders together holding at least 51% of the GDSs outstanding at the relevant record date instruct the Depository to vote in the same manner in respect of one or more resolutions to be proposed at the meeting of our shareholders (other than the election of directors or supervisors), the Depository will notify the chairman of our Board of Directors, or such other person as he may designate (the “Voting Representative”), of such instructions and appoint the Voting Representative as the representative of the Depository and the holders to attend such meeting and vote all the Common Shares represented by GDSs in the manner so instructed by such holder in relation to such resolution or resolutions (the “Voting Instruction”).

If, for any reason, the Depository has not by the date specified by it received instructions from a holder or holders together holding at least 51% of all the GDSs outstanding at the relevant record date to vote in the same manner in respect of any resolution specified in the agenda for the meeting (other than the election of directors or supervisors), then such holders will be deemed to have instructed the Depository to authorize and appoint the Voting Representative as the representative of the Depository and the holders to attend such meeting and vote all the Common Shares represented by all GDSs as the Voting Representative deems appropriate with respect to such resolution or resolutions, which may not be in the interests of the holders of GDSs.

The Depository will notify the Voting Representative of the instructions for the election of directors and supervisors received from holders and appoint the Voting Representative as the representative of the Depository and the holders to attend such meeting, nominate, if necessary, the candidate or candidates named in such instructions, and vote the Common Shares represented by GDSs as to which the Depository has received instructions from holders for the election of directors and supervisors in the manner so instructed, subject to any restrictions imposed by ROC law and our Articles of Incorporation. Such holders who by the date specified by the Depository have not delivered instructions to the Depository will be deemed to have instructed the Depository to authorize and appoint the Voting Representative as the representative of the Depository and the holders to attend such meeting and vote all the Common Shares represented by GDSs as to which the Depository has not received instructions from the holders for the election of directors and supervisors as the Voting Representative deems appropriate with respect to such resolution or resolutions, which may not be in the best interests of the holders. Candidates standing for election as representatives of a shareholder may be replaced by such shareholder prior to the meeting

of the shareholders, and the votes cast by the holders for such candidates shall be counted as votes for their replacements.

Employee stock bonuses may have a diluting effect on the holdings and associated rights of the holders with respect to the Common Shares and the GDSs

Taiwanese companies generally pay employee stock bonuses (in the form of cash or stock) to their employees, and our Articles of Incorporation provide that (after certain deductions and provisions) employees should receive as bonuses an aggregate of not less than 5% of our distributed retained earnings. See “Business of the Company — Employees” and “Description of Common Shares — Dividends and Distributions”. In 2001, we issued approximately 30 million Common Shares, and in 2002 we issued approximately 27 million Common Shares as employee stock bonuses. The number of Common Shares issuable and the amount transferred from retained earnings for employee stock bonuses are calculated by reference to the par value of NT\$10 per Common Share, notwithstanding that the market value of the Common Shares as of the dates of declaration and distribution of the stock bonuses have been significantly higher than NT\$10 per Common Share. Employee bonuses in the form of new Common Shares to employees will effectively dilute the holdings and associated rights of holders with respect to the GDSs.

Holders of GDSs may not be able to participate in rights offerings

We may, from time to time, distribute rights to our shareholders, including rights to acquire securities. Under the Deposit Agreements, the Depositary will not offer rights to holders of GDSs unless both the rights and the securities to which such rights relate are either exempt from registration under the Securities Act, with respect to a distribution to all holders of GDSs, or are registered under the provisions of the Securities Act. However, under the Deposit Agreements, we are under no obligation to file a registration statement with respect to such rights or underlying securities or to endeavor to have such a registration statement declared effective. Accordingly, holders of GDSs may be unable to participate in our rights offerings and may experience dilution of their holdings as a result.

Holders of GDSs who withdraw Common Shares will be required to appoint a tax guarantor and a local agent in the ROC

Any holder of GDSs, who is a non-ROC person and elects to withdraw Common Shares represented by GDSs and register as our shareholder, will be required to appoint an agent (a “Tax Guarantor”) in the ROC for filing tax returns and making tax payments. Such Tax Guarantor will be required to meet the qualifications set by the Ministry of Finance of the ROC and will act as the guarantor of the withdrawing holder’s tax payment obligations. Evidence of the appointment of a Tax Guarantor and the approval of such appointment are required as conditions to such withdrawing holder’s repatriation of the profits derived from the sale of withdrawn Common Shares. There can be no assurance that a withdrawing holder will be able to appoint and obtain approval for a Tax Guarantor in a timely manner.

In addition, under current ROC law, such withdrawing holder is required to appoint a local agent in the ROC to, among other things, open a securities trading account with a local securities brokerage firm, remit funds and exercise a shareholder’s rights. In addition, such withdrawing holder must appoint a local bank to act as custodian for confirmation and settlement of trades, safekeeping of securities and cash proceeds and reporting and declaration of information. Under existing ROC laws and regulations, without such an account, holders of GDSs that withdraw and hold the Common Shares represented thereby would not be able to hold or otherwise transfer the Common Shares on the Taiwan Stock Exchange or otherwise.

Sales of a substantial number of Common Shares following the offering could have an adverse effect on the price of the Notes and the Common Shares

We, our President and Kinpo have agreed, subject to certain exceptions, not to offer, sell, contract to sell or otherwise dispose of, any of our securities that are similar to the Common Shares or the GDSs, including, but not limited to, any securities that are convertible into or exchangeable for, or that represent

the right to receive, Common Shares or any such substantially similar securities during a period of 90 days after the date of this Offering Memorandum without the prior written consent of the Joint Global Coordinators. However, the Joint Global Coordinators may waive or terminate these restrictions at any time. Sales of a substantial number of Common Shares by us, our President, Kinpo or our other principal shareholders or the perception that such sales may occur, could adversely affect the prevailing market price of the Common Shares, the GDSs and the Notes.

Risks Relating to the ROC

The value of an investment in the Notes, the GDSs and the Common Shares may be adversely affected by the volatility of the ROC securities market

The ROC securities market is smaller and more volatile than the securities markets in the United States and in certain European and other countries. The Taiwan Stock Exchange has experienced substantial fluctuations in the prices and volumes of sales of listed securities and there are currently limits on the range of daily price movements on the Taiwan Stock Exchange. From time to time, the ROC regulatory agencies have intervened in the Taiwan stock market during periods of extreme volatility. In the past decade, the Taiwan Stock Exchange Index (“TAIEX”) peaked at 10,393.59 in February 2000, and reached a low of 3,411.68 in September 2001. During 2001, the TAIEX peaked at 6,198.22 on February 16, 2001, and reached a low of 3,411.68 on September 26, 2001. On October 3, 2002, the TAIEX closed at 4,075.98, and the daily closing value of our Common Shares was NT\$30.20 per share. In addition, the Taiwan Stock Exchange has experienced problems such as market manipulation, insider trading and payment defaults. The recurrence of these or similar problems could adversely affect the market price and liquidity of the securities of ROC companies, including our Common Shares in both the domestic and the international markets. See “Appendix B — The Securities Market of the ROC”.

ROC exchange controls may adversely affect the ability of holders of GDSs to receive dividends or realize the proceeds from the sale of our Common Shares

Under existing ROC law and regulations relating to foreign exchange control, the Depositary must obtain foreign exchange approval from the CBC on a payment-by-payment basis for the conversion from NT Dollars into U.S. Dollars of the net proceeds realized from the sale of Common Shares received as stock dividends or from the sale of subscription rights for new Common Shares. Although such approvals have been routinely granted in the past, there can be no assurance that in the future any such approval will be obtained in a timely manner, or at all.

We are subject to ROC GAAP, which differs from U.S. GAAP

We are subject to financial reporting requirements in Taiwan that differ, in significant respects, from those applicable to companies in certain other countries, including the United States and the United Kingdom. In addition, our financial statements are prepared in accordance with ROC GAAP, which differs, in certain material respects, from U.S. GAAP. For example, under ROC GAAP, the distribution of employee stock bonuses is treated as an allocation from retained earnings, and we are not required to, and do not, charge the value of the employee stock bonuses to income. Under U.S. GAAP, however, we would be required to charge the market value of the employee stock bonuses to employee compensation expense in the period to which they relate; correspondingly, our net income and income per Common Share, if they had been calculated in accordance with U.S. GAAP, would be significantly reduced. See “— Employee stock bonuses may have a diluting effect on the holdings and associated rights of the holders with respect to the Common Shares and the GDSs” above. We have not quantified or identified the impact of the differences between ROC GAAP and U.S. GAAP. See “Summary of Certain Differences between ROC GAAP and U.S. GAAP”. You should consult your own professional advisers for an understanding of such differences and how they might affect the financial information contained herein.

An investment in the Notes, the GDSs or the Common Shares may be adversely affected by considerations relating to the ROC

We are incorporated in the ROC and a majority of our assets are located in Taiwan and a significant portion of our revenues are derived from our operations in Taiwan. The ROC has a unique international political status. Although the Chinese nation has existed for several thousand years, since 1949 Taiwan and the Chinese mainland have been separately governed. The ROC, which was founded in 1911, governs Taiwan while the PRC, which was founded in 1949, governs the Chinese mainland. The ROC asserts that the ROC and the PRC are equal political entities which should have "state-to-state" relations, while the PRC claims that it is the sole government in China and that Taiwan is part of China. Although relations between the ROC and the PRC have improved in a number of significant respects, the PRC has consistently refused to renounce the possibility that it may at some time use force to gain control over Taiwan.

Tensions in relations between the ROC and the PRC may adversely affect the value of the TAIEX. For example, renewed assertions by Taiwan in early August of its independence caused significant volatility on the TAIEX and our share price to decline approximately 6.4% on August 5, 2002. An increase in tensions in relations between the ROC and the PRC may also affect the market price and liquidity of the Notes, the Common Shares and the GDSs, the status of our property rights in our manufacturing facilities in the PRC, our production in our China factories, the availability of the PRC as an export market for our products and our ability to implement present and future plans for the development of production facilities in the PRC.

Taiwan is susceptible to earthquakes and typhoons that could disrupt the normal operation of our business and adversely affect earnings

Taiwan is susceptible to earthquakes and typhoons. In 1999 and 2000, Taiwan experienced severe earthquakes that caused significant property damage and loss of life, particularly in the central part of Taiwan. These earthquakes caused damage to production facilities and adversely affected the operations of many companies. The earthquakes also caused the breakdown of the electricity transmission system in Taiwan for a substantial period of time. Other parts of Taiwan have also experienced, from time to time, significant power outages and shortages in water supply that disrupted the businesses of many other companies in Taiwan. Any business disruption resulting from such events could cause significant delays in shipments of our products.

Risks Relating to the PRC

We are subject to the political and economic situation and legal developments in the PRC

We currently have a significant portion of our assets, including production facilities, in the PRC and expect to shift an increasing proportion of our manufacturing activities to the PRC and to make further investments in the PRC in the future. We also sell our products in the PRC. As a result, our business, financial condition, results of operations and future prospects are subject, to a significant degree, to the political and economic situation and legal developments in the PRC. There can be no assurance that our investments in the PRC and the sales of our products in the PRC will not be adversely affected if relations between the PRC and the ROC are further strained.

Prior to 1978, the PRC had adopted a central economic planning system. Since 1978, the PRC government has permitted foreign investment and implemented economic reforms, gradually changing from a planned economy towards a market-oriented economy. However, many of the reforms and economic policies adopted or to be adopted by the PRC government are unprecedented or experimental in nature and may have unforeseen results, which may have an adverse effect on enterprises with substantial business in the PRC, including our company.

In addition, there are currency exchange risks associated with doing business in the PRC. Although PRC governmental policies were introduced in 1996 to allow greater convertibility of the Renminbi, the

currency of the PRC, significant restrictions, including those relating to the repatriation of foreign currency denominated investments, still remain. No assurances can be made that the PRC regulatory authorities will not impose greater restrictions on the convertibility of the Renminbi.

We are subject to risks associated with the PRC legal system

Since 1979, many laws and regulations dealing with general economic matters or particular economic activities have been promulgated in the PRC. However, enforcement of existing laws and regulations may be uncertain and sporadic, and implementation and interpretation thereof may be inconsistent. The PRC legal system is based on statutory law. Under this system, prior court decisions may be cited as persuasive authority but do not have binding precedential effect. The outcome of any litigation in PRC courts may be uncertain. Further, it may be difficult to obtain swift and equitable enforcement, or to obtain enforcement of a judgment by a court of another jurisdiction. The introduction of new PRC laws and regulations and the interpretation of existing ones may be subject to policy changes. As the PRC legal system develops, changes in such legislation or interpretation thereof may have a material adverse effect on our business, financial condition, results of operations and future prospects, and could cause the price of the Common Shares and the GDSs to fall.

USE OF PROCEEDS

The net proceeds to us from the Offering, after payment of the underwriting discount and commissions and after deductions for offering expenses, are estimated to be approximately U.S.\$294,750,000 (or U.S. \$338,962,500 if the over-allotment option is exercised in full). We intend to use the net proceeds of the Offering for the purchase of raw materials from overseas suppliers, and as working capital.

MARKET PRICE INFORMATION

Our Common Shares have been listed on the Taiwan Stock Exchange since 1992. The table below sets forth, for the periods indicated, the high and low closing prices (actual and as adjusted for stock dividends) and the average daily volume of trading activity on the Taiwan Stock Exchange Index for our Common Shares and the highest and lowest of the daily closing values of the Taiwan Stock Exchange Index. For a recent closing price of our Common Shares, see the cover page of this Offering Memorandum.

	Adjusted closing price per Common Share ⁽¹⁾		Average daily trading volume (in thousands of shares)	Taiwan Stock Exchange Index	
	High (NT\$)	Low (NT\$)		High	Low
1997					
First Quarter	20.67	12.71	75,809.84	8,526.20	6,820.35
Second Quarter	29.69	19.53	99,000.00	9,030.28	7,952.12
Third Quarter	41.12	26.87	82,462.73	10,116.84	8,708.83
Fourth Quarter	28.6	18.84	79,922.14	8,695.02	7,089.56
1998					
First Quarter	38.09	23.59	79,573.96	9,277.09	7,375.14
Second Quarter	45.17	31.86	75,270.70	9,266.68	7,117.11
Third Quarter	47.45	36.82	58,192.85	8,047.67	6,251.38
Fourth Quarter	43.65	33.78	39,649.49	7,435.84	6,418.43
1999					
First Quarter	39.87	29.81	35,179.31	7,043.23	5,474.79
Second Quarter	65.11	33.42	72,709.78	8,608.91	7,018.68
Third Quarter	68.19	49.22	56,930.01	8,593.35	6,823.52
Fourth Quarter	56.91	47.69	25,336.57	8,448.84	7,362.69
2000					
First Quarter	64.87	52.05	44,557.69	10,202.20	8,536.50
Second Quarter	66.67	45.33	30,285.25	10,186.17	8,120.89
Third Quarter	52.00	30.04	16,513.93	8,585.52	6,185.14
Fourth Quarter	39.67	27.53	27,343.36	6,353.67	4,614.63
2001					
First Quarter	40.67	30.20	21,907.05	6,104.24	4,894.79
Second Quarter	41.33	30.42	22,766.72	5,608.50	4,768.55
Third Quarter	33.00	20.00	22,204.09	4,886.86	3,493.78
Fourth Quarter	37.92	18.33	36,094.13	5,551.24	3,446.26

	Adjusted closing price per Common Share ⁽¹⁾		Average daily trading volume (in thousands of shares)	Taiwan Stock Exchange Index	
	High (NT\$)	Low (NT\$)		High	Low
2002					
January	44.17	39.17	45,914.01	6,007.33	5,488.33
February	41.67	35.83	21,147.14	5,968.61	5,499.79
March	40.75	37.17	27,948.38	6,242.64	5,680.78
April	41.25	38.00	28,008.21	6,462.30	6,059.21
May	38.00	32.58	15,343.25	5,910.69	5,443.18
June	34.17	25.00	17,138.77	5,599.42	5,399.96
July	32.80	25.00	22,905.16	5,416.50	4,855.34
August	34.80	30.50	26,0204.6	4,968.85	4,572.35
September	32.50	29.10	17,642.45	4,668.01	4,185.95
October (up to October 3)	31.20	30.20	23,257.05	4,171.76	4,075.90

Source: Bloomberg

(1) Stock prices have been retroactively adjusted for issuance of new shares, including stock splits, stock dividends, employee stocks and rights issues, where applicable.

On October 3, 2002, the closing price of our Common Shares was NT\$30.2.

As of July 9, 2002, the date for which the latest information was available, there were approximately 175,554 holders of record of Common Shares.

The Taiwan Stock Exchange has experienced substantial fluctuations in the prices of listed securities and there are currently limits on the range of daily price movements. See “Risk Factors — Risks Relating to the ROC — The value of an investment in the GDSs may be adversely affected by the volatility of the ROC securities market” and “Appendix B — The Securities Market of the ROC — The Taiwan Stock Exchange” and “— Taiwan Stock Exchange Index”.

Our existing GDSs are listed on the Luxembourg Stock Exchange and traded on the International Order Book System of the London Stock Exchange. As of July 31, 2002, there were 25,464,760 GDSs outstanding, each representing five Common Shares.

The following table shows the high and low closing prices of the GDSs listed on the Luxembourg Stock Exchange from January 1, 2000:

	High ⁽¹⁾ (U.S.\$)	Low ⁽¹⁾ (U.S.\$)
2000		
First Quarter	10.88	8.30
Second Quarter	11.06	7.38
Third Quarter	8.49	5.24
Fourth Quarter	6.49	4.24
2001		
First Quarter	6.66	4.95
Second Quarter	6.71	4.50
Third Quarter	5.23	2.75
Fourth Quarter	5.58	2.79

	<u>High⁽¹⁾</u>	<u>Low⁽¹⁾</u>
	(U.S.\$)	(U.S.\$)
2002		
First Quarter	6.39	5.12
Second Quarter	5.87	3.71
Third Quarter	5.05	3.90

Source: Bloomberg

(1) Prices have not been retroactively adjusted for stock dividends paid by us. See “Dividends and Dividend Policy”.

On October 3, 2002, the closing price of the GDSs on the Luxembourg Stock Exchange was U.S.\$4.05.

DIVIDENDS AND DIVIDEND POLICY

We have paid either stock dividends or both cash and stock dividends in each year since 1991. The following table sets forth the aggregate number of outstanding Common Shares entitled to dividends, as well as the cash dividends per share and stock dividends per share paid during each of the years indicated in respect of Common Shares outstanding on the record date applicable to the payment of such dividends.

	Aggregate number of Common Shares(1)	Cash dividends per Common Share (NT\$)	Stock dividends per Common Share(2) (NT\$)	Total Common Shares issued as stock dividends
1997	380,623,600	—	3.0	114,187,068
1998	583,844,001	—	4.0	233,537,600
1999	849,510,060	1.0	3.5	297,328,521
2000	1,176,760,020	2.0	3.0	353,028,006
2001	1,556,834,837	0.5	2.5	389,208,708
2002	2,101,823,072	0.5	2.0	418,852,814

(1) Aggregate number of Common Shares outstanding on the record date applicable to the dividend payment.

(2) Holders of Common Shares receive as a stock dividend the number of Common Shares equal to the NT Dollar value per Common Share of the declared dividend, multiplied by the number of Common Shares owned, divided by the par value of NT\$10 per Common Share. Fractional Common Shares are not issued but are paid in cash.

Historically, we have paid dividends on our Common Shares with respect to the preceding year after approval by our shareholders at the annual general meeting of shareholders. In recent years, we have paid most of our dividends in the form of stock in order to reinvest our cash in operations. Our Articles of Incorporation provide that at least 10% of dividends each year for the three years beginning January 1, 2000 will be in cash. We expect that we will continue to pay a portion of our dividends in the form of stock. The form, frequency and amount of future dividends on the Common Shares will depend upon our earnings, cash flow, financial condition, reinvestment opportunities and other factors.

Except in limited circumstances, under the ROC Company Law, we are not permitted to distribute dividends or make other distributions to shareholders in respect of any year in which we did not record net income. The ROC Company Law also requires that 10% of annual net income (less prior years' losses and outstanding tax) be set aside as legal reserve until the accumulated legal reserve equals our paid-in capital. The remainder, plus the accumulated undistributed surplus profits carried over from the previous fiscal year, shall be the total allocable surplus profit, which, after deduction of additional reserves therefrom for business operations and special reserve specified in our Articles of Incorporation or decided by the shareholders' meeting, will be allocated in the proportions specified in our Articles of Incorporation. See "Description of Common Shares — Dividends and Distributions" and Note 13 of Notes to Consolidated Financial Statements as of and for the Years Ended December 31, 1999, 2000 and 2001.

Holders of GDSs will be entitled to receive dividends, subject to the terms of the applicable Deposit Agreement, to the same extent as the holders of the Common Shares. Cash dividends will be paid to the Depositary in NT Dollars and, after deduction of any applicable ROC taxes and except as otherwise described under "Description of the Global Depositary Receipts — Dividends, Other Distributions and Rights", will be converted by the Depositary into U.S. Dollars and paid to holders of GDSs. Stock dividends will be distributed to the Depositary and, after deduction of any applicable ROC taxes and except as otherwise described under "Description of the Global Depositary Receipts — Dividends, Other Distributions and Rights", will be distributed by the Depositary, in the form of additional GDSs, to holders of GDSs.

Holders of outstanding Common Shares on a dividend record date will be entitled to the full dividend declared without regard to any prior or subsequent transfer of such Common Shares. Holders of

outstanding GDSs on the relevant dividend record date will, after deduction of any applicable ROC taxes and subject to the terms of the applicable Deposit Agreement, be entitled to the full amount of any dividend declared at our next annual general meeting of the shareholders, which meeting is currently expected to be held in April or May 2003.

In the case of holders of the Notes being offered hereby who have converted their Notes into Common Shares which have been deposited with the Depositary against issuance of GDSs prior to the record date for dividends or any other distribution, any such dividend or distribution will be subject to the terms of the applicable Deposit Agreement.

For information relating to ROC withholding taxes payable on cash and stock dividends, see “Taxation — ROC Taxation — Dividends”. For information relating to ROC foreign exchange approvals required for the conversion by the Depositary of dividends on Common Shares from NT Dollars into U.S. Dollars for the payment thereof to holders of GDSs, see “Appendix A — Foreign Investment and Exchange Controls in the ROC — Depositary Receipts”.

EXCHANGE RATES

Fluctuations in the exchange rate between the NT Dollar and the U.S. Dollar will affect the U.S. Dollar equivalent of the NT Dollar price of our Common Shares on the Taiwan Stock Exchange and, as a result, are expected to affect the market price of the Notes. Fluctuations in the exchange rate between the NT Dollar and the U.S. Dollar have also had, and are expected to continue to have, a significant impact on our results of operations. See “Risk Factors — Our results of operations are subject to exchange rate fluctuations” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations”.

The following table sets forth the average, high, low and period-end noon buying rate between NT Dollars and U.S. Dollars (in NT Dollars per U.S. Dollar) for the periods indicated. No representation is made that the NT Dollar amounts actually represent such U.S. Dollar amounts or could have been, or could be, converted into U.S. Dollars at the rate indicated, or at any other rate, or at all.

	NT Dollars per U.S. Dollar Noon Buying Rate			
	Average	High	Low	Period-End
1997	29.06	33.25	27.34	32.80
1998	33.54	35.00	32.05	32.27
1999	32.38	33.40	31.39	31.39
2000	31.37	33.20	30.48	33.17
2001	33.82	35.12	32.23	35.00
2002 (through October 3)	34.94	35.99	32.87	34.99

Sources: Federal Reserve Bulletin, 1996, Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release H.10 (512), 1997-2002, Board of Governors of the Federal Reserve System.

CAPITALIZATION

The table below sets forth our consolidated short-term debt balance and total capitalization under ROC GAAP as of June 30, 2002 on an actual basis and on an adjusted basis and an as further adjusted basis.

The adjusted basis gives effect to the estimated net proceeds from the issuance of domestic corporate inverse floating rate bonds totalling NT\$4.0 billion in September 2002.

The further adjusted basis gives effect to the estimated net proceeds from the issuance of the Notes (assuming no exercise of the over-allotment option).

The following table should be read in conjunction with our Consolidated Financial Statements and the notes thereto included elsewhere herein. See "Management's Discussion and Analysis of Financial Condition and Results of Operations".

	As of June 30, 2002					
	Actual		As adjusted		As further adjusted	
	(NT\$)	(U.S.\$) (1)	(NT\$)	(U.S.\$) (1)	(NT\$)	(U.S.\$) (1)
	(in millions)					
Short-term notes and bills payable	250	7	250	7	250	7
Short-term loans	5	—	5	—	5	—
Convertible bonds payable	<u>1,322</u>	<u>40</u>	<u>1,322</u>	<u>40</u>	<u>1,322</u>	<u>40</u>
Total short-term debt	<u>1,577</u>	<u>47</u>	<u>1,577</u>	<u>47</u>	<u>1,577</u>	<u>47</u>
Domestic bonds	5,000	149	9,000	269	9,000	269
Notes being offered	—	—	—	—	10,038	300
Total long-term debt	<u>5,000</u>	<u>149</u>	<u>9,000</u>	<u>269</u>	<u>19,038</u>	<u>569</u>
Stockholders' equity:						
Common stock(2)	25,477	761	25,477	761	25,477	761
Capital surplus	4,113	123	4,113	123	4,113	123
Retained earnings	13,737	411	13,737	411	13,737	411
Foreign currency translation adjustments ..	<u>130</u>	<u>4</u>	<u>130</u>	<u>4</u>	<u>130</u>	<u>4</u>
Treasury stock	<u>(1,445)</u>	<u>(43)</u>	<u>(1,445)</u>	<u>(43)</u>	<u>(1,445)</u>	<u>(43)</u>
Total stockholders' equity	<u>42,012</u>	<u>1,256</u>	<u>42,012</u>	<u>1,256</u>	<u>42,012</u>	<u>1,256</u>
Total capitalization(3)	<u>48,589</u>	<u>1,452</u>	<u>52,589</u>	<u>1,572</u>	<u>62,627</u>	<u>1,872</u>

(1) Translated into United States Dollars solely for convenience of the reader using the Noon Buying Rate provided by the Federal Reserve Bank of New York on June 28, 2002 of NT\$33.46 to U.S.\$1.00.

(2) As of August 15, 2002, 3,480,000,000 Common Shares were authorized and 2,547,659,000 Common Shares were outstanding.

(3) Except as disclosed above, there has been no material change in our consolidated capitalization since June 30, 2002.

SELECTED CONSOLIDATED FINANCIAL INFORMATION

The selected consolidated statement of income data for the years ended December 31, 1999, 2000 and 2001 and for the six months ended June 30, 2002 and the selected consolidated balance sheet data as of December 31, 1999, 2000 and 2001 and June 30, 2002 set forth below are derived from the audited consolidated financial statements included in this Offering Memorandum and should be read in conjunction with, and are qualified in their entirety by reference to, such consolidated financial statements, including the notes thereto. The selected consolidated statement of income data for the six months ended June 30, 2001 and the selected consolidated balance sheet data as of June 30, 2001 are derived from the unaudited consolidated financial statements included in this Offering Memorandum and should be read in conjunction with, and are qualified in their entirety by reference to, such unaudited consolidated financial statements, including the notes thereto. The selected consolidated financial data as of and for the six months ended June 30, 2001 include all adjustments necessary to fairly state this information in the opinion of the management. Results for the six months ended June 30, 2002 are not necessarily indicative of the results that may be expected for the full year. Our consolidated financial statements have been prepared and presented in accordance with ROC GAAP and reporting practices in the ROC. For a discussion of certain differences between ROC GAAP and U.S. GAAP, see "Summary of Certain Differences Between ROC GAAP and U.S. GAAP".

	Year ended and as of December 31,				Six months ended and as of June 30,		
	1999	2000	2001		2001	2002	
	(NT\$)	(NT\$)	(NT\$)	(U.S.\$)	(unaudited) (NT\$)	(NT\$)	(U.S.\$)
	(in millions, except per share amounts)						
Statement of Income Data:							
Net sales	47,293	75,469	78,658	2,247	33,294	52,853	1,580
Cost of sales	40,562	67,937	71,505	2,043	30,078	47,710	1,426
Gross profit ⁽¹⁾	6,761	7,515	7,130	204	3,248	5,133	153
Operating expenses	1,876	2,345	3,060	87	1,291	1,765	53
Operating income	4,885	5,170	4,070	116	1,957	3,368	101
Non-operating income	817	1,238	1,677	48	1,170	683	20
Non-operating expenses and losses	90	208	194	6	102	444	13
Income before income taxes and minority interest loss	5,611	6,200	5,553	159	3,025	3,607	108
Income tax expense	219	232	243	7	68	176	5
Minority interest in net loss of subsidiaries and preacquisition income	6	15	92	3	—	83	2
Net income	5,398	5,983	5,403	154	2,957	3,348	100
Net income per share	2.74	3.03	2.66	0.08	1.21	1.36	0.04
Balance Sheet Data:							
Current assets	19,941	24,474	35,989	1,028	31,564	43,158	1,290
Long-term equity investments	11,607	19,232	19,419	555	20,546	20,197	604
Total assets	37,353	50,269	61,891	1,768	58,189	71,008	2,122
Current liabilities	9,741	18,970	22,167	633	20,118	23,309	697
Noncurrent liabilities	141	192	391	11	417	687	21
Total liabilities	9,882	19,161	22,558	645	20,535	28,996	867
Total stockholders' equity	27,471	31,108	39,332	1,124	37,654	42,012	1,256

(1) Calculation of gross profit includes an adjustment for the change in unrealized intercompany profits, in the amounts of NT\$29.7 million, (NT\$16.3 million) and (NT\$22.7 million) for the years ended December 31, 1999, 2000 and 2001, respectively, and NT\$32.2 million and (NT\$10.0 million) for the six month periods ended June 30, 2001 and 2002, respectively. Profit and losses resulting from sales of

products by us to our subsidiaries and investee companies accounted for using the equity method are deferred as “unrealized profit from sales to subsidiaries” in the balance sheet, until such products are sold by the subsidiaries or investee companies.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere in this Offering Memorandum. Except as otherwise indicated, all financial information set forth herein has been presented in New Taiwan Dollars in conformity with ROC GAAP. All financial information as at and for the years ended December 31, 1999, 2000 and 2001 and the six months ended June 30, 2002 set forth below has been audited and is given on a consolidated basis. All financial information as at and for the six months ended June 30, 2001 set forth below has not been audited and is given on a consolidated basis.

Overview

We are a leading manufacturer of notebook PCs and display products. Prior to 2000, we operated in four product areas: (i) notebook PCs, (ii) LCD monitors, (iii) CRT monitors and (iv) peripherals, accessories and spare parts. In 2000, we expanded our product lines to include GSM wireless handsets, CDMA wireless handsets and IAs. We mainly sell our products on an ODM or OEM basis, and our major customers include Dell, Toshiba, Hewlett-Packard, Fujitsu, NEC-Mitsubishi, Acer and Hitachi.

We sell approximately 99% of our products outside Taiwan. For the year ended December 31, 2001, our largest market was Asia (excluding Taiwan) comprising 40.1% of our consolidated net sales, followed by the United States comprising 31.5% and Europe comprising 26.5%. For the year ended December 31, 2001, sales to Asia and Europe increased by 19.0% and 25.0%, respectively, while sales to the United States decreased by 20.6%, in each case compared to the year ended December 31, 2000. For the six months ended June 30, 2002, Europe was our largest market comprising 35.0% of our consolidated net sales, followed by Asia (excluding Taiwan) comprising 32.3% and the United States comprising 28.3%.

We experienced significant growth in net sales during 2000 and for the first half 2002. Our consolidated net sales increased by 59.6% from NT\$47.3 billion in 1999 to NT\$75.5 billion in 2000. For the six months ended June 30, 2002, our consolidated net sales increased 58.7% to NT\$52.9 billion (U.S.\$1,580.0 million) from NT\$33.3 billion for the corresponding period in 2001. This growth was due to our success in obtaining new customers for notebook PCs, LCD monitors and CRT monitors, while at the same time expanding our relationship with our existing customers, which resulted in growth in sales to these customers. In addition, wireless handsets and IAs began to make contribution towards our consolidated net sales. However, for the year ended December 31, 2001, our consolidated net sales increased only 4.3% to NT\$78.7 billion (U.S.\$2.2 billion). We attributed this slower rate of growth to the global economic slowdown in 2001 and the phasing out of an older product line of one of our major notebook PC customers, Dell, during the first half of 2001.

We also experienced growth in net income during 2000 and during the first half 2002. Our consolidated net income increased by 11.1% from NT\$5.4 billion in 1999 to NT\$6.0 billion in 2000. For the six months ended June 30, 2002, our consolidated net income increased 13.3% to NT\$3.3 billion (U.S.\$100.1 million) from NT\$3.0 billion for the corresponding period in 2001. The growth in net income was primarily due to the growth in operating income as a result of the increase in sales. However, for the year ended December 31, 2001, our consolidated operating income decreased 21.3% to NT\$4.1 billion (U.S.\$116.3 million). As a result, consolidated net income decreased 9.7% for the year ended December 31, 2001 to NT\$5.4 billion (U.S.\$154.4 million).

Companies in the PC and mobile devices industries typically experience seasonal fluctuations in their results of operations, with sales of such companies generally higher in the third and fourth quarters of the year in conjunction with the back-to-school and holiday seasons, and generally lower in the first quarter. Sales are also generally higher in connection with successful launches of new products or new models, and lower as old product lines are phased out. We believe that our substantial annual increases in percentage terms in net sales helped to moderate the impact of such seasonality in the past. However, we believe that as the rate of growth in our net sales moderates, our results of operations will become increasingly subject to the impact of the seasonality of the PC and mobile devices industries, including the possibility that sales

in the first quarter of a given year will be lower than sales in the fourth quarter of the immediately preceding year.

Under ROC GAAP, a subsidiary in which we own more than 50% of the shares is not consolidated in our consolidated financial statements unless its total assets or total net sales exceeds 10% of our total assets or total net sales, respectively. Compal Communications is one of several of our subsidiaries which is not consolidated because it did not meet such test as at and for the year ended December 31, 2001.

Principal Income Statement Components

Net Sales. Our net sales are derived principally from sales of notebook PCs and, to a lesser extent, LCD monitors and CRT monitors to leading PC vendors in North America, Asia and Europe. We also derive net sales from the sales of peripherals, accessories and spare parts. We began to derive net sales from wireless handsets in 2000 and PDAs in 2001, although such sales accounted for a relatively small proportion of our total net sales during 2001 and the six months ended June 30, 2002. However, we expect sales of such products, particularly wireless handsets, to account for an increasing percentage of our net sales during 2002. We recognize net sales with the transfer of ownership of our product to our customer, which would typically be at the time we ship our product to our customer, or to the end user or distribution channel at the instruction of our customer. In 2001, our largest notebook PC customers were Hewlett-Packard, Toshiba and Dell; our largest LCD monitor customers were NEC-Mitsubishi, Compaq and Fujitsu; our largest CRT monitor customers were Compaq, NEC-Mitsubishi and Hitachi and our largest customers for peripherals, accessories and spare parts were Dell and Hewlett-Packard.

Costs of Sales. Our principal costs of sales are raw materials, supplies and components for the manufacture of notebook PCs, LCD monitors, CRT monitors, wireless handsets, IAs and peripherals, accessories and spare parts. The primary components for the manufacture of notebook PCs are LCD panels, which comprised approximately 25% of the consolidated cost of sales of notebook PCs in 2001. LCD panels are also the primary components for the manufacture of LCD monitors, comprising approximately 75% of the consolidated cost of sales of LCD monitors in 2001. There was a worldwide shortage of LCD panels from the end of 2001 to the second quarter of 2002, which has resulted in increased LCD panel prices and LCD panels constituting a significantly higher percentage of cost of sales in 2001 as compared to 2000. See “— Factors Affecting Financial Performance — Supply of LCD Panels” below. The primary components for the manufacture of CRT monitors are CRTs, which comprised approximately 55% to 60% (depending on monitor size) of the consolidated cost of sales of CRT monitors in 2001. The primary components for the manufacture of wireless handsets are chip sets, passive components, batteries and LCD panels.

Gross Margins. Our gross margins are impacted significantly by technological developments in the computer and mobile devices industries and the speed at which we and our principal customers are able to respond to such developments. Our gross margins are principally affected by the following factors:

- price competition among ODM/OEM manufacturers of notebook PCs, monitors and other products which we produce;
- fluctuations of exchange rates between the NT Dollar and the currencies in which payments to or by us are made;
- average sale prices of products, which tend to fall during the life cycle of products and as more advanced products are introduced;
- fluctuations in supply of and demand for (and the consequent fluctuations in market prices of) principal components for our products, the most significant of which is LCD panels, and our ability to pass increased component costs on to our customers (or to retain a portion of lower component costs);
- demand for higher-margin new products, such as wireless handsets;

- the trend toward manufacturing and delivering more complete and fully equipped notebook PC systems which reduces overall margins for notebook PCs as additional components are added at lower margins; and
- our ability to reduce unit manufacturing costs of our products by, among other things, increasing economies of scale through higher volume manufacturing and reducing variable and fixed costs, including shifting production to lower-cost labor markets such as the PRC.

Operating Expenses. Our operating expenses are categorized by selling expenses, administrative expenses and research and development expenses. Selling expenses generally include salaries of sales force personnel, export expenses, handling costs and after-sales service expenses. From 2000, selling expenses also included fees and commissions paid to one of our suppliers of CRTs, which is also a major CRT monitor customer, as discussed below. Administrative expenses include salaries of administrative personnel (related to finance, accounting, information technology, human resources and legal functions). Research and development expenses include salaries of research and development personnel, purchases of research and development equipment and testing and verification costs.

Factors Affecting Financial Performance

A number of general factors affected our financial performance during the three years ended December 31, 2001, and the six months ended June 30, 2002. The principal factors are discussed below.

Global Economic Conditions Affecting Demand. During the years ended December 31, 1999 and 2000, worldwide demand for notebook PCs increased significantly. According to IDC, worldwide notebook PC sales grew from U.S.\$47.5 billion in 1999 to U.S.\$56.5 billion in 2000. As a result, demand for notebook PCs from our major customers, all of whom are worldwide leaders in retail notebook PC sales, increased. Our sales revenues over the 1999 to 2000 period with respect to notebook PCs experienced a growth rate of 91.0%. However, according to IDC, worldwide notebook PC sales decreased to U.S.\$51.4 billion in 2001. In the year ended December 31, 2001, our consolidated net sales of notebook PCs increased at a slower rate of 1.6% as compared to the year ended December 31, 2000, in part as a result of the worldwide economic slowdown, particularly in the computer industry, which resulted in reduced consumer demand for our notebook PC products.

Shift to Selling Notebook PCs on Complete System Basis. Before 1999, we manufactured notebook PCs on a bare bone system basis, where we shipped incomplete notebook PCs to customers, and the customers inserted other components and accessories, such as CPUs, viewing screens and hard disks, before selling to the ultimate purchaser. Beginning in 1999, we have sold an increasing proportion of notebook PCs as complete systems, including on a built-to-order (“BTO”) or configured-to-order (“CTO”) basis, where we assemble notebook PCs according to the customer’s specifications, load requested software applications and ship the product directly to a distributor or the end-user. Although the average selling prices for complete systems are generally higher than for notebook PCs manufactured on a bare bone system basis, the gross margins with respect to additional components inserted and for assembly of a complete notebook PC are generally low, and, as a result, the overall gross margins on complete system notebook PCs are generally lower than for those built on a bare bone system basis. We anticipate that, as we generate an increasing percentage of our revenues from our complete systems sales, we will continue to experience pressure on our gross margins.

Supply of LCD Panels. There was a worldwide shortage of LCD panels during the end of 1998 and at the beginning of 1999, and there has been another shortage of LCD panels from the end of 2001 to the second quarter of 2002. The shortage quickly ended and then there was an over-supply of LCD panels. LCD panels are used as viewing screens and are a key component in the manufacture of notebook PCs and LCD monitors as well as wireless handsets and IAs. The worldwide shortage of LCD panels increased the prices for these components, pushing up average cost of sales for our notebook PCs, LCD monitors, wireless handsets and IAs. To the extent that we are unable to pass on all of the increased LCD panel costs to our customers, it adversely affects our gross margins. The LCD panel shortage may also result in higher average inventory levels, as inventories of other components cannot be utilized in the manufacturing

process until additional LCD panels are obtained. In addition, the volatility of LCD panel supply and our management of such supply may have an adverse effect on our business.

Depreciation of the NT Dollar. In the year ended December 31, 2001, overseas sales, as to which payments are primarily in U.S. Dollars, accounted for approximately 99% of our consolidated net sales. However, approximately 85% of components (including finished products) and raw materials were paid for in U.S. Dollars, with 14% being paid for in NT Dollars and the balance being paid for in other currencies. We also have borrowings, and a significant portion of our operating expenses are paid, in NT Dollars. Accordingly, fluctuations in exchange rates, in particular between the U.S. Dollar and the NT Dollar, affect our margins. In addition, foreign exchange fluctuations could result in foreign exchange losses in respect of our assets and liabilities denominated in foreign currencies. While we recorded net foreign exchange gains in the years ended December 31, 2000 and 2001 of NT\$498.0 million and NT\$834.3 million (U.S.\$23.8 million), respectively, we had a net foreign exchange loss of NT\$39.9 million in the year ended December 31, 1999. We posted a foreign exchange loss of NT\$331.9 million in the first half 2002 due to the rise of the NT Dollar against the U.S. Dollar.

Maturity of the CRT Monitor Market. With the increasing attractiveness and competitiveness of LCD monitors, which are substitutes for CRT monitors, worldwide demand for CRT monitors is not expected to grow significantly in the future and may decline. This has resulted in the CRT monitor market becoming a mature market with lower average selling prices for CRT monitors driving smaller players out of the market and causing the remaining players, including ourselves, to focus on reducing costs by shifting production to the PRC. During the 1999 to 2001 period, CRT monitors accounted for an increasingly smaller percentage of our net sales, and this trend is expected to continue.

Interim Consolidated Results of Operations

Under ROC GAAP, we publish quarterly unaudited non-consolidated financial statements, semi-annual audited non-consolidated financial statements, and annual audited consolidated and non-consolidated financial statements. We have prepared, solely for purposes of this Offering, semi-annual audited consolidated financial statements for the six months ended June 30, 2002. We are not required to, and do not prepare, quarterly or semi-annual financial statements on a consolidated basis.

Substantially all sales of our products, including sales of notebook PCs and monitors produced in our production facilities at Kunshan, are recognized through us in order to utilize our sales and marketing network and to allow customers to negotiate and deal directly with us. Customer orders are shipped from the place of manufacture directly to customers or to our hubs in Europe and the United States. With respect to monitors produced in Kunshan, Compal China, a wholly owned subsidiary of Just International Ltd. ("Just"), which in turn is a wholly owned consolidated subsidiary of ours, invoices us at the time the goods leave China at the cost of production plus a margin determined by us. Since March 2002, following our acquisitions of the relevant subsidiaries, production of notebook PCs has been shifted, in part, to the PRC facilities in Kunshan operated by Compal Electronics Technology (Kunshan) Co., Ltd. ("Compal Kunshan"), a wholly owned subsidiary of Compal International Holding Co., Ltd. ("Compal International"), which in turn is a wholly owned subsidiary of ours. Revenues recorded by Compal China (and beginning in 2002 Compal Kunshan) are consolidated with our net sales.

The following table sets forth certain consolidated statement of income data as a percentage of our total consolidated net sales for the six-month periods ended June 30, 2001 and 2002.

	Six months ended June 30,	
	2001 (unaudited) (%)	2002 (%)
Net sales	100.0	100.0
Cost of sales	(90.3)	(90.3)
Gross profit	9.8	9.7
Operating expenses		
Selling	(1.7)	(1.4)
Administrative	(1.0)	(0.8)
Research and development	(1.2)	(1.2)
Total operating expenses	(3.9)	(3.3)
Operating income	5.9	6.4
Non-operating income	3.5	1.3
Non-operating expenses and losses	(0.3)	(0.8)
Net income before income taxes and minority interest loss	9.1	6.8
Income tax expense	(0.2)	(0.3)
Net income	<u>8.9</u>	<u>6.3</u>

Six Months Ended June 30, 2002 Compared to Six Months Ended June 30, 2001 (Unaudited)

Net Sales. Consolidated net sales increased 58.7% to NT\$52.9 billion (U.S.\$1,580.0 million) in the six months ended June 30, 2002 ("First Half 2002") from NT\$33.3 billion in the six months ended June 30, 2001 ("First Half 2001"). This increase was primarily due to a 111.8% increase in sales of LCD monitors, to NT\$9,876 million in First Half 2002 from NT\$4,662 million in First Half 2001, principally as a result of increased sales to Compaq and NEC-Mitsubishi. LCD monitors are expected to account for an increasingly higher proportion of our display sales, in terms of both units and net sales. Notebook PC sales increased 53.8% to NT\$33,960 million in First Half 2002 from NT\$22,087 million in First Half 2001, principally because one of our major notebook PC customers, Dell, launched a new series of notebook PCs in the first quarter 2002. In addition, Dell phased out an older product line in the first quarter 2001, resulting in lower sales to Dell in that period. CRT monitor sales decreased 2.1% to NT\$4,217 million in First Half 2002 from NT\$4,307 million in First Half 2001, primarily as a result of the substantial increase in LCD monitor sales reflecting a greater customer preference for and acceptance of LCD monitors. Sales of peripherals, accessories and spare parts increased 32.7% to NT\$2,970 million in First Half 2002 from NT\$2,238 million in First Half 2001. Sale of wireless handsets by Compal Electronics increased to NT\$965 million in First Half 2002 from no sales in First Half 2001, principally due to the commencement of handset sales to new customers. Sales of IAs increased to NT\$865 million in First Half 2002 from no sales in First Half 2001, as the results of Palmax were not included with our own until our merger with Palmax was completed in July 2001.

Cost of Sales. Consolidated cost of sales increased 58.6% to NT\$47,710.0 million (U.S.\$1,425.9 million) in First Half 2002 from NT\$30,077.7 million in First Half 2001, generally in line with increased net sales. Our consolidated gross margin decreased from 9.8% in First Half 2001 to 9.7% in First Half 2002. The decline in gross margin was mainly attributable to a decline in the sales prices of our products due to a competitive environment brought on by decreased demand.

Gross Profit. As a result of the foregoing, our consolidated gross profit in First Half 2002 was NT\$5,132.6 million (U.S.\$153.4 million), an increase of 58.0% over consolidated gross profit of NT\$3,248.4 million in First Half 2001.

Operating Expenses. We incurred consolidated operating expenses of NT\$1,764.5 million (U.S.\$52.7 million) in First Half 2002 as compared to consolidated operating expenses of NT\$1,291.2 million in First Half 2001, an increase of 36.7%. This reflected a 52.8% increase in research and development expenses over the same period due to R&D activities related to new wireless handset and IAs, and a 29.4% increase in selling expenses due to an increase in service, freight and insurance expenses as certain of our customers required increased insurance in their sales contracts, and an increase of 28.5% in administrative expenses due to increased expenditure on enterprise resource planning and an increase in software and consulting fees. However, operating expenses decreased as a percentage of net sales, from 3.9% in First Half 2001 to 3.3% in First Half 2002, reflecting the large increase in net sales in First Half 2002.

Operating Income. As a result of the foregoing, we had consolidated operating income of NT\$3,368.1 million (U.S.\$100.7 million) in First Half 2002 as compared to NT\$1,957.3 million in First Half 2001, an increase of 72.1%.

Non-Operating Income. We had consolidated non-operating income of NT\$682.9 million (U.S.\$20.4 million) in First Half 2002 as compared to consolidated non-operating income of NT\$1,169.5 million in First Half 2001, a decrease of 41.6%. The decrease in consolidated non-operating income was primarily attributable to the fact that in First Half 2001, we had a foreign currency exchange gain of NT\$530.4 million. In First Half 2002, in contrast, we recorded a foreign currency exchange loss of NT\$331.9 million. Also, in First Half 2002, we received NT\$104.3 million in interest income, a 51.0% decrease compared to NT\$212.8 in First Half 2001, because of a decline in cash held and in interest rates. The decrease in non-operating income was mainly offset by a 29.0% increase in investment income due to the recognition of investment gains from Compal Communications Inc. and International Semiconductor under the equity method, and increased investment income from Toppoly, a 41.7% increase in rental income because of increased rental of factory space to Compal Communications Inc., and a 165% increase in other income, which consists of gains from sales of tooling and fixed assets, and compensation from the ROC Government relating to our adoption of certain government backed "B2B" initiatives.

Non-Operating Expenses and Losses. Consolidated non-operating expenses and losses increased 335.1% to NT\$443.7 million (U.S.\$13.3 million) in First Half 2002 from NT\$102.0 million in First Half 2001. The increase resulted primarily from a net foreign currency exchange loss in First Half 2002 of NT\$331.9 million compared to a net foreign currency exchange gain of NT\$530.4 million in First Half 2001, and an increase in provision for inventory obsolescence to NT\$58.9 million in First Half 2002 from NT\$8.2 million in First Half 2001 due to inventory increase.

Net Income Before Income Tax Expense. As a result of the foregoing, consolidated net income before income tax expense increased 19.3% to NT\$3,607.4 million (U.S.\$107.8 million) in First Half 2002 from NT\$3,024.8 million in First Half 2001.

Income Tax Expense. Consolidated income tax expense was NT\$176.3 million (U.S.\$5.3 million) (an effective rate of 4.9%) in First Half 2002 as compared to consolidated income tax expense of NT\$68.3 million (an effective rate of 2.3%) in First Half 2001, primarily due to an increase in deferred income tax expense for investment tax credits over the same period. For a discussion of certain tax credits applicable to us during First Half 2002, see Note 15 to the Consolidated Financial Statements as of and for the Six Months Ended June 30, 2001 and 2002, and "— Income Taxes" below.

Net Income. As a result of the factors discussed above, net income increased 13.3% to NT\$3,348.4 million (U.S.\$100.1 million) in First Half 2002 from NT\$2,956.5 million in First Half 2001.

Consolidated Results of Operations

The following table sets forth certain consolidated statement of income data as a percentage of our total consolidated net sales for each of the three years ended December 31, 1999, 2000 and 2001.

	<u>Years ended December 31,</u>		
	<u>1999</u>	<u>2000</u>	<u>2001</u>
	(%)	(%)	(%)
Net sales	100.0	100.0	100.0
Cost of sales	<u>(85.8)</u>	<u>(90.0)</u>	<u>(90.9)</u>
Gross profit	14.2	10.0	9.1
Operating expenses			
Selling	(1.4)	(1.1)	(1.7)
Administrative	(1.2)	(0.9)	(0.9)
Research and development	<u>(1.4)</u>	<u>(1.1)</u>	<u>(1.3)</u>
Total operating expenses	<u>(4.0)</u>	<u>(3.1)</u>	<u>(3.9)</u>
Operating income	10.3	6.9	5.2
Non-operating income	1.8	1.6	2.1
Non-operating expenses and losses	<u>(0.2)</u>	<u>(0.3)</u>	<u>(0.2)</u>
Income before income taxes and minority interest loss	11.9	8.2	7.1
Income tax expense	<u>(0.5)</u>	<u>(0.3)</u>	<u>(0.3)</u>
Net income	<u><u>11.4</u></u>	<u><u>7.9</u></u>	<u><u>6.9</u></u>

2001 Compared to 2000

Net Sales. Net sales increased 4.3% to NT\$78,658 million (U.S.\$2,247.4 million) in 2001 from NT\$75,469 million in 2000. Net sales in 2001 includes net sales of Palmax from July 4, 2001, the effective date of the merger of Palmax with and into us, although such inclusion of Palmax's net sales was not material to our net sales in 2001. The increase in net sales was primarily due to a 186.0% increase in sales of LCD monitors, to NT\$11,276 million in 2001 from NT\$3,942 million in 2000, principally as a result of increased orders from NEC-Mitsubishi and Compaq. Notebook PC sales increased only 1.6%, to NT\$52,020 million in 2001 from NT\$51,223 million in 2000, primarily as a result of increased orders from Hewlett-Packard and the commencement of shipments to Acer, which increase was offset in part by lower shipments to Dell (as Dell phased out an older product line in the first half of 2001) and Fujitsu. Sales of CRT monitors decreased 6.1% to NT\$10,707 million in 2001 from NT\$11,402 million in 2000, principally as a result of decreased orders from Compaq, offset in part by increased orders from NEC-Mitsubishi. The decrease in CRT monitor sales is consistent with the shift to LCD monitors and an increase in sales thereof. Sales of peripherals, accessories and spare parts decreased 48.5% to NT\$4,528 million in 2001 from NT\$8,792 million in 2000 as we sold fewer docking stations and port replicators to Dell. Sale of wireless handsets by Compal Electronics decreased to NT\$37.4 million in 2001 from NT\$110.4 million in 2000, principally due to the termination of sales as of December 31, 2000 to Compal Communications which began producing handsets for itself in space leased from us. Sales of IAs amounted to NT\$89.9 million in 2001 as we recorded sales of IAs as part of our consolidated results following the merger with Palmax.

Costs of Sales. Cost of sales increased 5.3% to NT\$71,505.1 million (U.S.\$2,043.0 million) in 2001 from NT\$67,937.1 million in 2000. The increase in cost of sales was generally in line with the increase in net sales but the percentage increase in cost of sales outpaced the percentage increase in net sales primarily as a result of the increase in prices of LCD panels, the main component for notebook PCs and LCD monitors, due to the worldwide shortage from the end of 2001, and the increase in prices of batteries for notebook PCs due to a worldwide shortage during 2001. As a result, our gross margin decreased to

9.1% in 2001 from 10.0% in 2000. The decline in gross margin was mainly attributable to pressure on the sales prices of our products due to a competitive environment brought on by decreased demand.

Gross Profit. As a result of the foregoing, our gross profit in 2001 was NT\$7,129.8 million (U.S.\$203.7 million), a decrease of 5.1% over gross profit of NT\$7,515.4 million in 2000.

Operating Expenses. We incurred operating expenses of NT\$3,060.0 million (U.S.\$87.0 million) in 2001 as compared to operating expenses of NT\$2,345.4 million in 2000, an increase of 30.5%. The increase in operating expenses was mainly due to a 57.6% increase in selling expenses and a 25.9% increase in research and development expenses in 2001 as compared to the prior year. Selling expenses increased primarily because of an increase in after-sales service expenses in response to customer requirements, as well as due to the payment of fees and commissions to one of our suppliers of CRTs. Because this supplier of CRTs is also one of our major CRT monitor customers, we account for the payment of these fees and commissions as selling expenses. Research and development expenses increased primarily because of an increase in headcount related to R&D projects for new products, in particular for wireless handsets and IAs. As a result, operating expenses as a percentage of net sales increased from 3.1% in 2000 to 3.9% in 2001.

Operating Income. As a result of the foregoing, we had operating income of NT\$4,069.8 million (U.S.\$116.3 million) in 2001 as compared to NT\$5,170.0 million in 2000, a decrease of 21.3%.

Non-Operating Income. We had non-operating income of NT\$1,677.1 million (U.S.\$47.9 million) in 2001 as compared to non-operating income of NT\$1,237.6 million in 2000, an increase of 35.5%. The increase in non-operating income was primarily attributable to a 67.5% increase in net foreign currency exchange gain to NT\$834.3 million in 2001 (U.S.\$23.8 million), as compared to a gain of NT\$498.0 million in 2000 due to the depreciation of the NT Dollar during 2001.

Non-Operating Expenses and Losses. Non-operating expenses and losses decreased 6.7% to NT\$193.7 million (U.S.\$5.5 million) in 2001 from NT\$207.6 million in 2000. The decrease resulted primarily from a decrease in provision for inventory obsolescence which more than offset increases in interest expense and other non-operating expenses.

Income Before Income Tax Expense. As a result of the foregoing, income before income tax expense decreased 10.4% to NT\$5,553.2 million (U.S.\$158.7 million) in 2001 from NT\$6,200.0 million in 2000.

Income Tax Expense. Income tax expense was NT\$242.7 million (U.S.\$6.9 million) (an effective rate of 4.4%) in 2001, a 4.6% increase as compared to income tax expense of NT\$232.0 million (an effective rate of 3.7%) in 2000. For a discussion of certain tax credits applicable to us during 2001, see Note 14 to the Consolidated Financial Statements as of and for the Years Ended December 31, 1999, 2000 and 2001.

Net Income. We had a NT\$77.1 million increase in minority interest in net loss of subsidiaries to NT\$92.3 million in 2001 as compared with NT\$15.2 million in 2000, due primarily to a greater loss suffered by our non wholly owned U.S. monitor subsidiary, Sceptre. As a result of this and the factors discussed above, net income decreased 9.7% to NT\$5,402.7 million (U.S.\$154.4 million) in 2001 from NT\$5,983.2 million in 2000.

2000 Compared to 1999

Net Sales. Net sales increased 59.6% to NT\$75,469 million in 2000 from NT\$47,294 million in 1999. This increase was primarily due to a 91.0% increase in notebook PC sales to NT\$51,223 million in 2000 from NT\$26,813 million in 1999, as a result of increased sales to Toshiba and, to a lesser extent, to Hewlett-Packard and other customers. Sales of LCD monitors increased 97.1% to NT\$3,942 million in 2000 from NT\$2,000 million in 1999, primarily due to increases in orders from Compaq, Dell and Toshiba. As a result of declines in LCD panel prices, worldwide sales of LCD monitors increased significantly in 2000. In addition, sales of CRT monitors increased 35.1% to NT\$11,402 million in 2000 from NT\$8,441 million in 1999, primarily due to increased sales to Compaq and the commencement of

sales to Hitachi. Sales of peripherals, accessories and spare parts declined 12.4% to NT\$8,792 million in 2000 from NT\$10,040 million in 1999, primarily due to a decrease in orders from Dell for docking stations and port replicators.

Costs of Sales. Total cost of sales increased 67.5% to NT\$67,937.1 million in 2000 from NT\$40,562.0 million in 1999. As a result, our gross margin decreased to 10.0% in 2000 from 14.2% in 1999. The decline in gross margin was mainly attributable to a decline in gross margin for sales of notebook PCs.

Higher priced "performance" notebook PCs, on which we traditionally earned relatively higher margins, have in recent years comprised an increasingly smaller portion of the worldwide notebook PC market with the increased sales of lower priced "value" notebook PCs. During 2000, our principal notebook PC customers introduced and sold increasing numbers of low-priced notebook PCs which had the effect of reducing those customers' profit margins. As a result, we were pressured to lower our own margins on low-priced notebook PCs. In addition, we sold a greater proportion of notebook PCs as complete systems in 2000 compared with 1999. Because of the narrow margins on the additional components required to assemble a complete notebook PC, the overall margins for such notebook PCs are lower than margins for bare bone notebook PCs shipped to a customer for final assembly.

Another factor which adversely affected our cost of sales related to the decrease in the price of LCD panels during the first half of 2000. In December 1999, in anticipation of possible Year 2000 problems, we stocked larger than usual amounts of inventory, particularly LCD panels. With the prices of LCD panels declining significantly in 2000, the larger than usual stock of LCD panels purchased at higher prices in December 1999 had a negative impact on the cost of sales of our notebook PCs and LCD monitors.

Our gross margin was also affected by the fluctuation in the exchange rate between the NT Dollar and the U.S. Dollar. In 2000, approximately 32% of our raw materials purchases were denominated in NT Dollars while approximately 99% of our net sales were denominated in other currencies, mainly the U.S. Dollar. The appreciation of the NT Dollar against the U.S. Dollar in the first quarter of 2000 adversely affected our gross margin, as our cost of sales increased and our net sales in terms of NT Dollars decreased. As the NT Dollar stabilized and depreciated against the U.S. Dollar during the remainder of the year, our gross margin increased, in particular in the second half of 2000.

Gross Profit. As a result of the foregoing, our gross profit in 2000 was NT\$7,515.4 million, an increase of 11.2% over gross profit of NT\$6,761.1 million in 1999.

Operating Expenses. We incurred operating expenses of NT\$2,345.4 million in 2000 as compared to operating expenses of NT\$1,876.2 million in 1999, an increase of 25.0%. The increase in operating expenses was mainly due to an increase in the number of employees required to support our increased sales, as well as an increase in average salaries. Operating expenses declined, however, as a percentage of net sales from 4.0% in 1999 to 3.1% in 2000, primarily due to economies of scale afforded by higher sales volumes.

Operating Income. As a result of the foregoing, we had operating income of NT\$5,170.0 million in 2000 as compared to NT\$4,884.9 million in 1999, an increase of 5.8%.

Non-Operating Income. We had non-operating income of NT\$1,237.6 million in 2000 as compared to non-operating income of NT\$816.6 million in 1999, an increase of 51.5%. The increase in non-operating income was attributable to our net foreign currency exchange gain and an increase in net investment income, offset by a decrease in interest income. We had net foreign exchange gain of NT\$498.0 million in 2000, compared to a net foreign exchange loss of NT\$39.9 million in 1999, as the depreciation of the NT Dollar in 2000 resulted in gains on our cash balance and accounts receivable denominated in U.S. Dollars. Our net investment income of NT\$291.4 million in 2000 consisted of a net loss of NT\$69.4 million on long-term investments accounted for under the equity method, a gain of NT\$249.3 million on disposal of investments, a loss of NT\$37 million on disposal of investments and NT\$148 million in cash dividends received. We also realized interest income of NT\$382.4 million in 2000, as compared to NT\$581.5 million in 1999, as a result of decreased cash balances.

Non-Operating Expenses and Losses. Non-operating expenses and losses increased to NT\$207.6 million in 2000 from NT\$90.5 million in 1999. The increase resulted primarily from an increase in interest expense from NT\$38.7 million in 1999 to NT\$138.6 million, as a result of increased short-term debt, in the form of bank loans and the issue of commercial paper, incurred primarily to fund our investments in Toppoly and a NT\$57.2 million provision for inventory obsolescence.

Income Before Income Tax Expense. As a result of the foregoing, income before income tax expense increased 10.5% to NT\$6,200.0 million in 2000 from NT\$5,611.0 million in 1999.

Income Tax Expense. Income tax expense was NT\$232.0 million (an effective rate of 3.7%) in 2000 as compared to income tax expense of NT\$219.2 million (an effective rate of 3.9%) in 1999. For a discussion of certain tax credits applicable to us during 2000, see Note 14 to the Consolidated Financial Statements as of and for the Years Ended December 31, 1999, 2000 and 2001.

Net Income. As a result of the factors discussed above, net income increased 10.8% to NT\$5,983.2 million in 2000 from NT\$5,398.0 million in 1999.

Working Capital Management

Careful management of working capital is an important part of our operations. Accounts receivable and inventories, principal components of our current assets, will continue to require significant amounts of working capital, particularly if net sales continue to increase. Accounts payable, the largest components of our current liabilities, serve as sources of working capital as we attempt to take advantage of extended payment terms from suppliers when making purchases.

The following table summarizes our accounts receivable, inventory, accounts payable and cash conversion cycle positions as at and for the dates and periods indicated.

	As at and for the year ended December 31,						As at and for the six months ended June 30,			
	1999		2000		2001		2001 (unaudited)		2002	
	NT\$	Average days	NT\$	Average days	NT\$	Average days	NT\$	Average days	NT\$	Average days
	(in millions, except for average days)									
Accounts receivable(1)	5,909	44	10,715	40	17,809	66	9,406	54	15,693	57
Inventory(2)	6,312	40	6,971	36	5,960	33	4,809	35	13,290	36
Accounts payable(3)	8,121	58	9,546	47	18,128	71	11,460	63	18,621	69
Cash conversion cycle(4)	—	26	—	29	—	28	—	27	—	24

- (1) The average number of days for accounts receivable for the years ended December 31, 1999, 2000 and 2001 is equal to 365 divided by (i) the net sales in such year divided by (ii) the average of the accounts receivable balance as of December 31 of that year and the accounts receivable balance as of December 31 of the immediately preceding year. The average number of days for accounts receivable for the six months ended June 30, 2001 and 2002 is equal to 180 divided by (i) the net sales in such six months divided by (ii) the average of the accounts receivable balance as of June 30 of that year and the accounts receivable balance as of December 31 of the immediately preceding year.
- (2) The average number of days for inventory for the years ended December 31, 1999, 2000 and 2001 is equal to 365 divided by (i) the cost of sales in such year divided by (ii) the average of the inventory balance as of December 31 of that year and the inventory balance as of December 31 of the immediately preceding year. The average number of days for inventory for the six months ended June 30, 2001 and 2002 is equal to 180 divided by (i) the cost of sales in such six months divided by (ii) the average of the inventory balance as of June 30 of that year and the inventory balance as of December 31 of the immediately preceding year.
- (3) The average number of days for accounts payable for the years ended December 31, 1999, 2000 and 2001 is equal to 365 divided by (i) the cost of sales in such year divided by the (ii) average of the accounts payable balance as of December 31 of that year and the accounts payable balance as of

December 31 of the immediately preceding year. The average number of days for accounts payable for the six months ended June 30, 2001 and 2002 is equal to 180 divided by (i) the cost of sales in such six months divided by the (ii) average of the accounts payable balance as of June 30 of that year and the accounts payable balance as of December 31 of the immediately preceding year.

- (4) The cash conversion cycle (the length of time between the purchase of inventory and the receipt of cash from accounts receivable) is equal to the sum of days saleable inventory and outstanding days receivable, minus outstanding days payable.

Notes and Accounts Receivable. Our billing terms for our major clients are generally 45 days on open account. The establishment of hubs in the United States and Europe in 1999 generally enabled certain of our notebook PC and display customers to receive their goods sooner, resulting in earlier settlements of invoices. As a result, we were able to reduce our consolidated outstanding days receivable from 44 days in 1999 to 40 days in 2000. However, consolidated outstanding days receivable increased to 66 days in 2001 because the changing competitive environment throughout the industry resulted in our customers requesting extended payment terms on the sale of our products to them.

In First Half 2002, our consolidated outstanding days receivable was 57, compared to 54 in First Half 2001.

Inventory. We believe that sound inventory management is a key factor to the successful operation and financial performance of our business. Our consolidated days saleable inventory was 40 days in 1999 and 36 days in 2000. We attribute this decrease in days saleable inventory to a build-up of inventory in 1999 brought on by concerns of the so-called "Y2K" problem. Days saleable inventory improved from our 2000 level to 33 days in 2001, because of improved monitoring and management of our inventory. In First Half 2002, our consolidated days saleable inventory was 36 days, compared to 35 days in First Half 2001 due to the establishment of new hubs.

Our policy is to establish a full provision for any raw materials not utilized for a period of three months. With respect to other types of inventory, such as work in progress and finished goods, we establish a provision for inventory loss based on the difference between the costs of inventory and the market price, if lower.

We have purchased transportation insurance coverage from independent third-party insurers for finished goods delivered as part of our global logistics delivery network, which generally insures against risk of damage up to 60 days from the date of shipment. In accordance with market practice, we are required to notify the insurers of the inventory amounts on a monthly basis, and the insurance coverage for the subsequent month is based on such inventory amount submitted by us in the previous month. While we believe that the coverage we maintain through insurance policies with independent third-party insurers should generally be adequate to cover the total amount of inventory maintained by us at any time, a sudden increase in our inventory level or an underestimation set out in our submission to the relevant insurers could result in our being under-insured.

Notes and Accounts Payable. Our consolidated outstanding days payable were 58 days in 1999 and 47 days in 2000, but increased significantly to 71 days in 2001. This increase in consolidated outstanding days payable resulted from our efforts to extend payment terms of our suppliers to mitigate the impact to us of our customers requesting extended payment terms on sales of our products. By increasing our domestic raw material purchases through suppliers who have established hubs in Taiwan, we have been able to offload part of our inventory risk to our suppliers while also extending the credit terms for settlement. Payment terms for overseas procurement are generally 60 days on an open account basis, while domestic procurements are generally on a 90-day credit basis.

In December 2000, we forecasted reduced demand from our customers in January 2001. In addition, as a result of the implementation of a new ERP system and the Chinese New Year holidays falling in January 2001, we anticipated curtailed manufacturing operations in January 2001. Accordingly, we reduced our purchases of materials in December 2000, resulting in reduced accounts payable as of December 31,

2000 and lower outstanding days payable for 2000. Our consolidated days payable were 63 days in First Half 2001 and 69 days in First Half 2002.

Cash Conversion Cycle. Our consolidated cash conversion cycle (being the sum of days saleable inventory and outstanding days receivable, minus outstanding days payable) was 26 days in 1999, 29 days in 2000, and 28 days in 2001. Our non-consolidated cash conversion cycle was 27 days in First Half 2001 and 24 days in First Half 2002.

Liquidity and Capital Resources

Over the 1999 to 2001 period, our primary sources of liquidity were net cash provided by operating activities, short-term borrowings and issuances of stock indexed zero coupon securities in October 2000 and of GDSs in May 2001.

Net cash provided by operating activities was NT\$5,894.6 million in 1999, NT\$2,411.8 million in 2000 and NT\$9,649.6 million (U.S.\$275.7 million) in 2001. The increase in net cash provided by operating activities in 2001 compared to 2000 was primarily attributable to an increase in notes and accounts payable to NT\$8,521.8 million in 2001 from NT\$1,424.7 million in 2000 and a decrease in inventories to NT\$1,234.0 million in 2001 from an increase in inventories to NT\$716.4 million in 2000, which offset an increase in notes and accounts receivables to NT\$7,122.3 million in 2001 from NT\$4,917.0 million in 2000. The decrease in net cash provided by operating activities in 2000 compared to 1999 was primarily attributable to increase in notes and accounts receivables to NT\$4,917.0 million in 2000 from NT\$553.7 million in 1999 and a decrease in notes and accounts payable to NT\$1,424.7 million in 2000 from NT\$3,232.9 million in 1999, which offset the decline in increase in inventories to NT\$716.4 million in 2000 from NT\$3,695.6 million in 1999.

We have lines of credit which provide for drawdowns as well as issuances of commercial paper from time to time. As at December 31, 2001, such lines totaled NT\$10,961.6 million, under which NT\$598.5 million had been drawn in the form of short-term loans, NT\$370.1 million aggregate principal amount of commercial paper had been issued and NT\$9,993.0 million was unused. Drawdowns and commercial paper issued under such lines as at December 31, 2001 bore interest at rates ranging from 1.85% to 7.07%.

In October 2000, we issued U.S.\$148.0 million aggregate principal amount of Stock Indexed Zero Coupon Securities due 2005 (the "SIZeS"). The SIZeS are convertible into our Common Shares which may be delivered in the form of Common Shares or GDSs. The terms of the SIZeS provide that the holders of the SIZeS have the right to require us to repurchase such SIZeS on each of October 19, 2001, 2002, 2003 and 2004 at a price equal to 100% of the aggregate principal amount thereof. As of December 31, 2001, approximately U.S.\$39.4 million aggregate principal amount of SIZeS was outstanding.

In May 2001, we raised approximately U.S.\$117 million through the issuance of 20 million GDSs representing 100 million Common Shares.

In addition to funding our working capital requirements, our principal uses of cash over the 1999 to 2001 period were capital expenditures, the repayment of debt (including the redemption of a portion of the SIZeS) and the payment of cash dividends.

For the years ended December 31, 1999, 2000 and 2001, we made long-term equity investments and capital expenditures of NT\$9,230.2 million, NT\$13,336.8 million and NT\$2,222.0 million (U.S.\$63.5 million), respectively. In 2001, we made long-term equity investments of NT\$1,716.5 million (U.S.\$49.0 million), consisting primarily of a NT\$489.4 million investment in International Semiconductor Technology, a NT\$170.0 million investment in Swenc Technology, a NT\$163.1 million investment in RF Integrated Corp. and a NT\$147.9 million investment in Emerging Display Technologies. We made capital expenditures for property, plant and equipment of NT\$505.5 million (U.S.\$14.4 million), primarily for a new production line in the PRC for LCD monitors. We used the proceeds of the issue of the SIZeS to repay short-term debt incurred to fund our equity investment in Toppoly. We used the proceeds of the

GDS issue to repay short-term bank loans incurred to fund our investments in Toppoly, with the balance used primarily to purchase input components and other raw materials. See “Business of the Company — Toppoly Optoelectronics Corp.”. In October 2001, we redeemed approximately U.S.\$105.5 million in aggregate principal amount of SIZeS in accordance with their terms. We paid cash dividends in 2001 in the amount of NT\$778.4 million (U.S.\$22.2 million), at a rate of NT\$0.5 per Common Share.

In First Half 2002, our primary source of liquidity was net cash provided by financing activities. Net cash provided by financing activities was NT\$4,959.6 million (U.S.\$148.2 million) in First Half 2002, consisting of increase in bonds payable and treasury stock transferred to employees. Cash provided by operating activities was not a source of liquidity in First Half 2002 because we significantly increased our inventories based on requests from our major customers, which resulted in the building of more hubs worldwide and the increase in finished products in such hubs. We also increased our inventories of LCD panels in order to be able to meet demand for LCD monitors in light of the worldwide shortage of LCD panels.

In addition to funding our working capital requirements, our principal uses of cash in First Half 2002 were for an investment of NT\$457.1 million in Compal International Holding to be used to invest in property, plant and equipment for our second factory in China to produce notebook PCs and an investment of NT\$189.8 million in HannStar Display. We also made an investment of NT\$168.0 million in Maxima Venture Co. Ltd., an investment of NT\$104.2 million in Lipo Holding Co. Ltd., an investment of NT\$1 billion in Mobile Network Co. Ltd. (“Taiwan 3G”) and invested approximately NT\$180 million for the purchase of equipment for our Taiwan facility.

We expect that our principal uses of cash for the remainder of 2002 will be for an additional capital contribution of approximately NT\$7 billion into Toppoly, the purchase of equipment for our notebook PC facility in the PRC of approximately NT\$1.1 billion, the purchase of equipment for our Taiwan facility of approximately NT\$650.0 million and the purchase of equipment for our display facility in the PRC of approximately NT\$350.0 million. We expect to finance these investments and expenditures with the proceeds of this Offering and cash flow from operations. In addition, in May 2002, we also raised NT\$5.0 billion in the domestic ROC market through the issuance of NT\$2.4 billion in aggregate principal amount of three-year unsecured bonds which bear interest at a rate of 3.05% and NT\$2.6 billion in aggregate principal amount of five-year unsecured bonds which bear interest at a rate of 3.45%. Also, in September 2002, we issued NT\$4.0 billion of unsecured domestic corporate inverse floating rate bonds of a maturity of not more than seven years.

In July 2002, we paid a cash dividend of NT\$0.50 per Common Share. See “Dividends and Dividend Policy”.

We expect to meet our working capital, long-term investment, capital expenditure, dividend payment and repayment requirements for the remainder of 2002 primarily from cash generated from operations and the proceeds of the Offering. We may also consider future offerings of equity and/or equity-linked securities, subject to financing needs and market conditions. As of December 31, 2001, we had consolidated cash, cash equivalents and short-term investments amounting to NT\$11,276.4 million (U.S.\$322.2 million), consolidated short-term loans, short-term notes and bills payable of NT\$968.6 million (U.S.\$27.7 million), consolidated unused credit lines of NT\$9,993.0 million (U.S.\$285.5 million) and consolidated stockholders’ equity of NT\$39,332.3 million (U.S.\$1,123.8 million). As of June 30, 2002, we had consolidated cash, cash equivalents and short-term investments amounting to NT\$12,346.4 million (U.S.\$369.0 million), consolidated short-term loans, short-term notes and bills payable of NT\$254.8 million (U.S.\$7.6 million), consolidated unused short-term credit lines of NT\$15,699.0 million (U.S.\$469.2 million) and consolidated total stockholders’ equity of NT\$42,012.1 million (U.S.\$1,255.6 million).

As of December 31, 2001, we were contractually committed in respect of NT\$710.8 million unused aggregate balance of trade letters of credit issued in connection with our purchase of materials and machinery in the ordinary course of business. We also were contractually committed in respect of NT\$47.0 million under a contract entered into by Compal China for the construction of a new factory and

the purchase of machinery and equipment. In addition, as of the same date, we had guaranteed certain obligations of two wholly owned subsidiaries in aggregate principal amount of U.S.\$3.0 million (U.S.\$8.0 million as of June 30, 2002 with respect to three wholly owned subsidiaries). We also have pension, product warranty and various royalty payment obligations. We do not have any material capital lease obligations, operating leases or unconditional purchase obligations, and are not committed to make payments in respect of any lines of credit or standby repurchase obligations.

From time to time, we review investment opportunities and will, if a suitable opportunity arises, make an investment. Future investments may be in the form of capital expenditures made directly or through subsidiaries, or acquisitions of, or investments in, other businesses or joint ventures with third parties.

Income Taxes

In recent years, we have paid income tax at an effective rate of approximately 5%, compared to the statutory rate of 25%, primarily due to tax exemptions under the ROC Statute for Upgrading Industries. Under such statute, we are exempted from taxation on income from sales of notebook PCs, certain monitors and certain wireless handsets manufactured using machinery and equipment purchased with proceeds from the issue of Common Shares for cash or out of retained earnings. This exemption lasts for five years commencing upon the completion of the investment plan for which the equipment was purchased. We estimate that this tax exemption reduced our income tax liability on a consolidated basis by NT\$948.6 million in 1999, NT\$1,065.0 million in 2000 and NT\$883.1 million in 2001 and by NT\$315.7 million in First Half 2002. Our purchases of machinery and equipment in 1999 for use in the production of notebook PCs, LCD monitors and wireless handsets are eligible for this exemption. The five-year exemption period with respect to such equipment purchases has not yet commenced. In lieu of this exemption, the statute provides the option for our stockholders who are corporate entities and have held their Common Shares for over three years to reduce their taxable income by up to 20% of the acquisition cost of such Common Shares and the tax credit applicable to our shareholders who are individuals is 10%. The stockholders may opt for this stockholder income tax deduction, instead of the five-year tax exemption for us, by a resolution of the meeting of stockholders. In addition, under the ROC Statute for Upgrading Industries, a company may earn investment tax credits ranging from 5% to 20% of equipment cost when it installs machinery to increase automation or for environmental protection purposes. These tax credits must be utilized within four succeeding years.

Our valuation allowance provided on deferred tax assets is calculated differently under ROC GAAP, compared to U.S. GAAP. This difference has a significant impact on us because we have a significant amount of potential deferred tax assets as a result of the various tax exemptions available to us under Republic of China governmental tax incentive programs. U.S. GAAP requires more stringent criteria by which such valuation allowance is determined. This recognition of net deferred tax assets under ROC GAAP resulted primarily from the projection of income before tax for the year ended December 31, 2002.

Inflation

We do not believe that inflation in Taiwan, where the majority of our operations is located, has had a material impact on our results of operations. Inflation in Taiwan was approximately 0.2%, 1.3% and 0% in 1999, 2000 and 2001, respectively. Inflation in Taiwan was 0.1% for the month of June 2002.

Exchange Rates

For each of the years ended December 31, 1999, 2000 and 2001, over 99% of our net sales were denominated in currencies other than the NT Dollar, principally U.S. Dollars. However, for the years ended December 31, 1999, 2000 and 2001, approximately 67%, 68% and 86%, respectively, of our purchases of raw materials were denominated in currencies other than the NT Dollar, principally the U.S. Dollar and, to a lesser extent, the PRC Renminbi and the Japanese Yen. In addition, we have significant foreign currency-denominated assets, principally U.S. Dollar-denominated notes and accounts receivable and cash balances, and foreign currency-denominated liabilities, principally U.S. Dollar and

Japanese Yen-denominated accounts payable. Accordingly, fluctuations in exchange rates, in particular between the U.S. Dollar and the NT Dollar, affect our gross and operating margins and result in foreign exchange losses or gains in respect of our assets and liabilities denominated in foreign currencies.

In 1999, we recorded a net foreign exchange loss of NT\$39.9 million due to appreciation of the NT Dollar. The depreciation of the NT Dollar in 2000 resulted in a net gain on foreign exchange of NT\$498.0 million. In 2001, the depreciation of the NT Dollar resulted in a net foreign currency exchange gain of NT\$834.3 million (U.S.\$23.8 million). In First Half 2002, we had a net foreign currency exchange loss of NT\$331.9 million (U.S.\$9.9 million).

To the extent we are exposed to exchange rate fluctuations beyond our natural hedge of U.S. Dollar sales and costs of sales, we attempt to mitigate the adverse effects of exchange rate fluctuations on our business primarily through the use of forward exchange contracts. For information relating to such contracts, see note 15 to the Consolidated Financial Statements as of and for the Years Ended December 31, 1999, 2000 and 2001. However, the impact of future exchange rate fluctuations between the U.S. Dollar and the NT Dollar on our results of operations cannot accurately be predicted.

New Accounting Pronouncements

Starting from 2002, we adopted ROC Statement of Financial Accounting Standards No. 30, "Accounting for Treasury Stock", pursuant to the Securities and Futures Committee regulations. Following this adoption, outstanding Common Shares held by our subsidiaries are regarded as treasury stock when calculating investment income recognized and in the presentation of our financial statements. No retroactive adjustments are required for prior periods. For information relating to the accounting for our treasury stock, see note 2(m) and note 4 to the Consolidated Financial Statements as of and for the six months ended June 30, 2001 and 2002.

BUSINESS OF THE COMPANY

Introduction

We are a leading manufacturer of notebook PCs and display monitors including LCD monitors and CRT monitors. We also manufacture peripherals, accessories and spare parts primarily for notebook PCs. In early 2000, we began diversifying into mobile electronic devices such as PDAs, pocket PCs and wireless handsets using GSM and CDMA technologies.

We believe that we are one of the three largest producers of notebook PCs among Taiwanese companies. In 2001, Taiwanese notebook PC manufacturers supplied approximately 55% of the notebook PCs sold in the world, according to MIC. Taiwanese manufacturers are projected to supply 59% of the world's production of notebook PCs for the year 2002 according to MIC. Worldwide shipment of notebook PCs is projected by IDC to grow from approximately 27.4 million units in 2000 to 29.5 million units in 2001.

Leading PC vendors, as well as vendors of mobile devices, have increasingly outsourced their manufacturing in order to reduce costs, respond more quickly to customer needs and changes in product cycles and focus on building their brands. We have been a major beneficiary of this outsourcing trend. We mainly sell our products to our customers on an ODM or OEM basis. Our major customers include Dell, Toshiba, Hewlett-Packard (for both Hewlett-Packard and Compaq brands), Fujitsu, NEC-Mitsubishi, Acer and Hitachi.

We have expanded our product range to include mobile electronic devices such as wireless handsets and IAs to take advantage of the growing wireless market and to leverage our manufacturing and R&D capabilities. According to BIS, the number of wireless users globally is projected to reach 1,273 million by 2003, with demand for mobile phones projected to reach 558 million units in 2003. We have a 58.7% interest in Compal Communications, a company that develops and manufactures GSM and GPRS handsets. In addition, Compal Electronics also produces GPRS handsets for sale to ODM/OEM customers. We commenced commercial manufacture and shipment of CDMA handsets during the fourth quarter of 2001. We develop and produce IAs, such as PDAs and pocket PCs, and began shipment to our customers in 2001.

We manufacture products in two plants in Taiwan and four plants in China. The two Taiwan production plants, both located in Pincheng, Taoyuan County, have the combined capacity to produce approximately 250,000 notebook PCs per month. In addition, our Taiwan plants currently have the capacity to produce 240,000 wireless handsets and 90,000 IAs per month in Pincheng. The plants in China, all located in Kunshan, Jiangsu Province, have the combined capacity to produce approximately 250,000 notebook PCs, 250,000 LCD monitors and 500,000 CRT monitors per month. The investment restrictions which prohibited Taiwanese manufacturers from producing notebook PCs in China were lifted by the ROC government in December, 2001. We have subsequently shifted some of our notebook PC production capability to China, and we plan to continue to shift more of our production to China. We are building a fifth production plant in Kunshan, China, where we expect to commence production of notebook PCs in the first quarter of 2003.

We, in association with Kinpo, Uni-President Group and Teco, have established a joint venture company, Toppoly, to engage in the development and production of LTPS TFT-LCD panels. These panels are expected to be used primarily in wireless handsets and IAs. Toppoly began construction of a facility in Taiwan to manufacture LTPS TFT-LCD panels in February 2001, and we expect production to commence in the fourth quarter of 2002. See “— Toppoly Optoelectronics Corp.”.

For the year ended December 31, 2001, we had total consolidated net sales of NT\$78.7 billion (U.S.\$2.2 billion), with net sales of notebook PCs, LCD monitors, CRT monitors, peripherals, accessories and spare parts, wireless handsets and IAs accounting for 66.1%, 14.3%, 13.6%, 5.8%, 0.05% and 0.1%, respectively, of total consolidated net sales. Our fiscal 2001 consolidated net sales represented a 4.3% increase over fiscal 2000 consolidated net sales of NT\$75.5 billion. For the six months ended June 30,

2002, we had total consolidated net sales of NT\$52.9 billion (U.S.\$1.6 billion), with net sales of notebook PCs, CRT monitors, LCD monitors, peripherals, accessories and spare parts, wireless handsets and IAs accounting for 64.3%, 18.7%, 8.0%, 5.6%, 1.8% and 1.6%, respectively, of total consolidated net sales. Total consolidated net sales for the six months ended June 30, 2002 represented a 58.7% increase over total consolidated net sales for the six months ended June 30, 2001 of NT\$33.3 billion (unaudited). These figures in each case do not include sales of Compal Communications, which we do not consolidate for accounting purposes in accordance with Taiwanese accounting rules.

Our Common Shares have been listed on the Taiwan Stock Exchange since 1992, and the GDSs have been listed on the Luxembourg Stock Exchange since 1999. As of August 23, 2002, we had a market capitalization of approximately NT\$88.7 billion (U.S.\$2.6 billion).

We are a Taiwan registered company. We were incorporated as a company limited by shares under ROC Company Law in June 1984. Our registered office is located at 7th Floor, 319 Pateh Road, Section 4, Taipei 105, Taiwan, ROC.

Industry Overview

Notebook PC Market

The worldwide market for notebook PCs has expanded rapidly in the past few years. According to IDC, 19.9 million notebook PCs were shipped in 1999, a 28.2% increase over 1998. According to IDC, notebook PC shipments increased by 30.5% to 26.0 million units in 2000 and 27.4 million notebook PCs were shipped in 2001, a 5% increase over 2000.

Companies based in Taiwan are currently the world's largest producers of notebook PCs, which typically include integrated hard drives and diskettes and weigh 5-8 pounds or less. Over the past few years, growth in notebook PC production by companies based in Taiwan has outpaced that for the rest of the world, and as a result companies based in Taiwan overtook companies based in Japan as the largest producers of notebook PCs in the world in 1999. According to MIC, the market share of companies based in Taiwan of global production of notebook PCs grew from 49% in 1999 to 52% in 2000. MIC estimates the market share of companies based in Taiwan of global production of notebook PCs to be 55% in 2001. We expect this trend to continue as global notebook PC vendors increasingly need to outsource their notebook production to compete in a global market characterized by falling notebook PC prices.

The notebook PC industry has undergone continuing consolidation of both vendors and manufacturers. In 1999, the ten largest notebook PC vendors accounted for 77.8% of total industry shipments, according to IDC. This number increased to 80.9% in 2001. The same consolidation is occurring on the manufacturing side. We believe that consolidation of manufacturers will continue in the year 2002 and beyond. Notebook PC vendors, including Japanese vendors which have historically conducted all manufacturing in-house, have relied increasingly on the limited number of ODM/OEM manufacturers that are able to provide quality products and supply chain management.

Display Market

According to IDC, unit sales of desktop PCs reached 104.6 million, and revenues were over U.S.\$141.1 billion in 2000, representing a 15.7% unit growth and a 12.3% revenue growth over 1999. In 2001, due to the slowdown in PC sales, unit sales of desktop PCs were 94.3 million, and revenues were U.S.\$112.7 billion, representing a 7.9% unit decrease and a 16.4% revenue decrease over 2000.

Companies based in Taiwan are the largest manufacturers of displays in the world. According to MIC, companies based in Taiwan shipped approximately 55.2 million PC monitors in 2001, representing a decline of 11.4% from 62.3 million units shipped in 2000 (which, in turn, had represented a growth of 11.4% from 55.9 million units shipped in 1999). Sales of PC monitors by Taiwanese manufacturers generated revenue of U.S.\$8.4 billion in 2001, U.S.\$10.2 billion in 2000 and U.S.\$9.4 billion in 1999.

LCD monitors represented about 15.0% of global PC monitor shipments and 37.2% of global PC monitor revenues in 2001, as compared to 85.0% and 62.8%, respectively, for CRT monitors according to IDC. The market for LCD monitors is expected to continue to increase, while the market for CRT monitors is expected to level off. LCD monitors with 15" screens were the most popular LCD models in 2001 in terms of units shipped. With respect to CRT monitors, 15" and 17" were the most commonly shipped sizes in 2001.

IDC estimates that for 2001, unit growth rates for PC monitors was 0.5% worldwide, and that revenues decreased by 7.0%. In addition, the year 2001 was marked by an increase of sales of flat CRT monitors, according to IDC. Several monitor vendors have already moved their entire lines over to flat CRTs, and IDC expects that trend to accelerate. We believe that by 2005, LCD monitors will be the dominant model of PC monitors in terms of global sales.

Wireless Market

The world wireless market is experiencing a period of rapid growth. According to BIS, worldwide mobile phone subscribers reached more than 890 million in 2001, and this base is expected to increase to approximately 1.9 billion subscribers in 2006.

Currently, most mobile phones are still in their second generation, which provides digital multiple access systems using either TDMA (Time Division Multiple Access) technology or CDMA technology. TDMA uses a slice of the spectrum commonly known as a "carrier" which is divided into channels or time slots per subscriber per call. The most popular access system based on TDMA technology is GSM. The GSM family of wireless communication platforms includes GPRS, which represents the first implementation of packet switching within GSM. GSM technology has been, and is expected to continue to be in the near future, the most widely used technology in wireless communications. According to BIS, there were approximately 201.8 million GSM subscribers in the Asia-Pacific region in 2001. BIS forecasts that by 2005 Asia-Pacific GSM subscribers will number over 208.8 million.

The CDMA system uses digital codes, rather than radio frequency channels, to differentiate subscribers. CDMA is commonly adopted in North America and in certain Asian countries, particularly Korea and Japan. BIS estimates the number of CDMA subscribers in the Asia-Pacific region at 43.8 million for 2001. One reason the adoption of CDMA has been slower than that of GSM is that CDMA handsets are manufactured by only a few vendors, making them relatively expensive. However, BIS expects demand for CDMA handsets in Asia to reach 139.8 million subscribers by 2005. The Korean and Japanese markets are expected to be the main drivers of this growth.

Major wireless handset vendors have reduced their own handset manufacturing and have outsourced an increasing amount of manufacturing to ODM/OEM manufacturers. In January 2001, Ericsson announced that it would abandon wireless handset production and outsource all of its handset manufacturing to Flextronics. Also in January 2001, Motorola announced the closing of its handset manufacturing facility in the United States.

Information Appliance Market

The rapidly growing market for IAs is composed primarily of Internet enabled PDAs, smart phones, Internet gaming devices and digital set-top boxes ("STBs"). According to IDC, the market for PDAs and smart phones is expected to grow from 4.1 million units in 2001 to 51.6 million units in 2005, representing a compounded annual growth rate of approximately 88%. Additionally, the market for Internet gaming devices and STBs is expected to grow from 59.6 million units in 2001 to 92.9 million units in 2005, representing a compounded annual growth rate of approximately 11.8%.

IAs are based on the idea that the PC is too complex, and that devices with discrete functionality are more efficient for certain applications. Because IAs are focused on functionality, they can perform specific functions, such as web surfing, streaming media and online gaming better than multi-purpose PCs. IAs are

generally more stable, easier to access and cheaper than PCs when they are developed for a specific application. IAs can also be more convenient than larger bulky PCs for certain applications.

Strategy

Our primary objective is to enhance our position as one of the world's leading manufacturers of notebook PCs and LCD and CRT monitors, while leveraging our strengths in our current businesses to diversify into mobile electronic devices including wireless handsets and IAs. The key components of our strategy are as follows:

Be the ODM Manufacturing Partner of Choice in the Global Branded PC, Wireless Handset and Information Appliance Industries

Our strategy is to be the manufacturing partner of choice for leading global branded PC, wireless handset and IA companies. Changing dynamics in such markets, including shortened product cycles and faster time-to-market requirements, are driving PC, wireless handset and IA companies to embrace a business model dependent upon ODM manufacturing companies' services and products. As an ODM manufacturer, we offer our customers an ability to design and produce high quality, high-volume and low-cost customized notebook PCs, displays, wireless handsets and IAs with quick turn-around times. We are focused on continually improving our products and services in order to deliver even better design, manufacturing, production, fulfillment and after-sales services. We continue to develop our production capacity which, when coupled with our management experience, gives us the ability to scale production more quickly to meet large demand. As a result, branded PC, wireless handset and IA customers would not have to allocate internal resources to establish and operate such capabilities; instead, those customers could focus more on their sales and marketing efforts.

Foster Product Innovation and Improve Product Quality through R&D

We work closely with our customers to design and develop high quality products that can be manufactured quickly and cost-effectively. While price competitiveness is always a consideration, we believe that the leading global notebook PC and desktop PC vendors, which comprise the majority of our customer base, are more focused on product reliability, quality and innovation, and rapid time-to-market capability. Our R&D team plays a key role in enabling us to design products suitable for immediate sale by customers and allows us to move quickly in creating new products based on customer specifications. Furthermore, the R&D team is primarily responsible for integrating design and manufacturing processes in order to produce reliable and high quality products. In addition, the R&D team has developed a system of component selection that employs frequent testing and uses various other means to ensure the quality of our products delivers. We will continue to place strong emphasis on building a top-quality R&D team. Currently, the R&D team consists of over 1,000 engineers, including over 130 engineers located in our R&D center in Kunshan. We plan to increase our R&D team as we grow our customer base, product lines and production capabilities in China.

Expand Relationships with Existing Customers and Diversify Customer Base

One of our core aims is to build integrated relationships with our customers, from the design stage to after-sales service. We create a cross-department team for each key customer in order to develop an in-depth understanding of the specifications, testing, quality, logistics and inventory management needs of such customer. The knowledge of and relationships with our customers allow us to strengthen our ties to customers, increasing switching costs and creating competitive barriers to entry. We plan to continue to develop and build upon these types of working relationships.

We intend to increase our marketing efforts in order to broaden our existing customer relationships and build new relationships with other leading companies. We also intend to cross-sell our various products to our existing customer base. For instance, we successfully expanded our relationships with Dell and Toshiba, from supplying only notebook PCs to also supplying LCD monitors.

We will continue to increase our customer diversification in terms of geographic distribution and more specifically focus on the outsourcing trend in Japan. In 1999, we recognized the emerging outsourcing trend in Japanese notebook PC vendors and secured a contract from Toshiba, becoming its first ODM supplier.

Capitalize on Opportunities Created by the Growing Wireless and Information Appliance Market

In 2000, we entered the rapidly expanding global wireless market. As personal communications and computing technologies converge, the growing trend is to combine various computing and wireless communications features and functions into a single product. We aim to leverage our technological and manufacturing expertise as well as our existing relationships with suppliers and customers in order to become a significant manufacturer of wireless handsets and IA.

We believe that, by utilizing our expertise in portable electronics products, we are well-positioned to diversify into wireless handsets and IAs, and to respond to future demands for products combining wireless communications and computing functions. In May 2000, we acquired a majority stake in Compal Communications, a company specializing in the ODM/OEM manufacture of GSM and GPRS handsets. Compal Electronics also manufactures GPRS handsets for our own separate OEM customers. In addition, we manufacture CDMA handsets under a license from Qualcomm. We have also established VACOM in Korea to focus on R&D for CDMA handsets. We believe that we were one of the first Taiwanese companies to manufacture both GSM/GPRS and CDMA handsets. In 1999, we expanded into IA manufacturing by acquiring a majority stake in Palmax, a Taiwan-based designer of IAs such as pocket PCs and PDA devices. We completed a full merger with Palmax in July 2001. Our IA strategy is to design and manufacture IAs for OEM customers. These investments also highlight part of our strategy, which has been to acquire stakes in existing companies through which we can accelerate time to market for the products of such companies.

Expand China Production and R&D Base for Greater Competitive Advantage

We are utilizing our notebook PC, LCD monitor and CRT monitor production capabilities in Kunshan, China to manufacture products at lower unit costs and service the global and Chinese markets more efficiently. With more of our key customers setting up production and marketing facilities in China, we can shorten our supply chain by shipping our products directly from the Kunshan plants to the customers' factories or outlets in China. Since the ROC government removed its investment restrictions related to the computer industry in December 2001, we have added notebook PC production capabilities in China. We currently produce all of our LCD monitors and CRT monitors in four manufacturing plants in China, and believe this existing presence in China will allow us to increase the production of our notebook PCs in China more quickly and at relatively low cost. We believe that since China has now entered into the World Trade Organization, more leading PC, wireless handset and IA companies will establish operations in China and seek partnerships with companies that can effectively supply and provide service in China.

In addition, in order to further support operations in China, we opened a R&D center in Kunshan in March 2001. The R&D center is currently staffed with over 130 engineers recruited from top Chinese universities, and are engaged in software and product development for entry-level products. We plan to increase the number of engineers in our R&D center in Kunshan as necessary. By moving these R&D functions to China, we are able to focus our R&D resources in Taiwan on product development for more sophisticated, higher value products.

Build a Customer-Focused Global Logistics and Fulfillment Network

The leading PC, wireless handset and IA vendors have increasingly required ODM/OEM suppliers to provide global fulfillment and support networks so that such vendors can respond to market demand quickly and reduce their inventory risk. Our strategy is to offer such clients the ability to ship and service products in Asia, Europe and the United States on a timely and cost-effective basis. For display customers,

we have built distribution hubs strategically located in Europe and the United States. We first ship our displays to these hubs, for rapid shipment within 24 to 48 hours to end-users upon final orders being placed. For notebook PC customers, we offer customers the ability to produce notebook PCs on a BTO/CTO basis and to deliver such products to customer-designated locations within five to seven days of receiving an order. In addition, we have developed a Customer Relationship Management (“CRM”) system through which we are able to communicate directly with our customers and customers can access electronically information on our R&D, testing and production progress.

Develop Toppoly into a Major Manufacturer of LTPS TFT-LCD Panels

We have a 30.1% interest in Toppoly, a joint venture company established to develop and manufacture LTPS TFT-LCD panels. Our goal is for Toppoly to become a major manufacturer of LTPS TFT-LCD panels, to be one of our suppliers for what we believe will be a growing market for such panels and to supply such panels for use in our wireless handsets and IAs. We expect Toppoly to begin producing LTPS TFT-LCD panels by the fourth quarter of 2002. Such panels are lighter, have better resolution, consume less power and produce clearer and brighter images compared to a-Si TFT-LCD panels currently in wide use. LTPS TFT-LCD panels employ recently developed technologies, and currently there are few manufacturers of such panels. We believe that when Toppoly begins producing LTPS TFT-LCD panels in the fourth quarter of 2002, such panels will be in demand due to their superior quality and the rapidly growing market for mobile electronic devices. In addition to capitalizing on the potential market for LTPS TFT-LCD panels, Toppoly will enable us to source a portion of our requirements for such panels, even during supply shortages, for use in our mobile electronic devices. We believe that the high quality of LTPS TFT-LCD panels as well as our ability to secure supply of such panels will give our wireless handsets and IAs an advantage over competing products using a-Si TFT-LCD panels and provide us an advantage in competing for customers. Our investment strategy for Toppoly also highlights our conservative approach to investing in new technologies, whereby we take minority positions to diversify risk.

Competitive Strengths

With our manufacturing and service infrastructure and ability to provide total solutions to leading global PC, wireless handset and IA customers, we believe that we are well-positioned to capitalize on the growth in such sectors, outsourcing by leading global branded PC, wireless handset and IA companies and the growth of the customers that we target. The following are our key competitive strengths:

Proven Design and Manufacturing Track Record

Many of our products manufactured for our major customers have won numerous awards, including the PC Magazine “The Best of 1999” award in December 1999, the PC Magazine Editors’ Choice awards in July 1999 and February 2000, the “Worldwide Procurement Supplier Conference Playing to Win Quality Award” from Dell in March 2002 and awards from Hewlett-Packard and Intel. We have assembled a high quality R&D team to work hand in hand with some of the world’s largest PC, wireless handset and IA vendors. We have also developed cost-effective and quality-controlled manufacturing processes and facilities. The DFX program we have developed is a project management program which encompasses a broad range of our operating functions, including R&D, design, manufacturing, packaging, quality assurance and testing. Among other things, the DFX program is designed to enhance our design capability by matching our R&D development work with a high quality manufacturing process. This initiative has further streamlined our manufacturing processes and reduced unit manufacturing costs.

High Quality Customer Base Driving Future Growth

Our customers include many of the leading global PC vendors: Dell, Toshiba, Hewlett-Packard, Acer and Fujitsu for notebook PCs; NEC-Mitsubishi, Hewlett-Packard (for Compaq brand), Acer, Hitachi and Toshiba for LCD monitors; and Hewlett-Packard (for Compaq brand), NEC-Mitsubishi and Hitachi for CRT monitors. We have established close, strategic relationships with these customers. As the computing

industry undergoes further consolidation of vendors and our customers increase their share of the growing computing market, we believe that we will be well-positioned to strengthen our relationships with such customers. We have also begun to build relationships with some of the leading wireless handset and IA vendors. In addition, our expansion into the Japanese customer base in 1999 has enabled us to take advantage of the growing outsourcing trend of Japanese companies.

Depth of Customer Relationships Increases Switching Costs and Barriers to Entry

We offer our customers a full range of products and services including leading design capabilities, a supply of key components, high quality and innovative products, scalable manufacturing facilities, a strategically placed logistics and fulfillment network and convenient after-sales services. In addition, we assign to each key customer a cross-function team to ensure that goods and services are designed, manufactured and delivered with efficiency and consistency. With the support of our high quality products and services, our customers can concentrate on sales and marketing without having to divert attention and resources to managing the design, production and fulfillment processes.

We believe that the integration of our design and manufacturing capabilities with those of our customers' has created competitive advantages. Our customer team, consisting of personnel from sales and marketing, logistics, R&D, manufacturing and quality assurances, becomes integrated with our customer's corporate management and develops an in-depth understanding of the customer's specifications, testing, quality, logistics, inventory and service needs, making it more costly for customers to switch to a new manufacturing partner. Our CRM system further enhances the link between our customers and our company.

Value Added R&D Expertise

We believe that one of our significant competitive strengths is the quality of our R&D department, currently comprising over 1,000 engineers, including over 130 engineers in China, with in-depth experience in the PC manufacturing sector. The department is divided into teams assigned to work either on different products or, in the case of notebook PCs, for specific key customers. Customer-specific R&D teams work closely with our personnel in sales, logistics, manufacturing and quality assurance in order to develop products to best serve the needs of the specific customer and to maintain our manufacturing readiness. We believe the effectiveness of the R&D department, due in large part to its organization and the close interaction between it and our other departments, has enabled us to reduce the time we take to design and bring to market high quality and high performance products using advanced technology at a lower unit manufacturing cost.

We continue to focus on building R&D capabilities for our new businesses and have research teams comprising over 70 engineers for GSM/GPRS products and over 90 engineers for IAs (which numbers of engineers in each case are included in the over 1,000 engineers discussed above).

Competitive Cost Structure Due to Economies of Scale and Effective Cost Management

With annual sales exceeding 2.3 million notebook PCs and 3.3 million displays in 2001, we enjoy significant benefits of economies of scale in our design and manufacturing process, customer service and sourcing of raw materials and components. Since many of our products use a substantial number of the same materials and components, we have greater leverage in negotiations with key suppliers. Our increasing production capabilities in Kunshan, China will further enhance our ability to ramp up our total production capacity at relatively low unit cost. With more of our key customers establishing production and marketing facilities in China, we can ship our products directly from our China plants to customers' factories or outlets in China. In addition, our suppliers of key components have been expanding their production infrastructure in China, thereby allowing us to manage our supplies and costs more effectively.

Scalability Supports Further Expansion in the PC, Wireless Handset and IA Markets

We believe that consolidation in the PC, wireless handset and IA industries, coupled with the current trend towards increased outsourcing, will drive these vendors to identify partners, such as us, who have the ability to scale production rapidly to meet their growing needs. We currently have total monthly capacity to produce 500,000 notebook PCs, 250,000 LCD monitors and 500,000 CRT monitors. Our Taiwanese facilities have the capacity to manufacture 240,000 wireless handsets and 90,000 IAs per month. We believe that we are ranked among the top ten largest producers of notebook PCs worldwide for 2001 based upon our estimates of production volume and shipments.

Compal Products

Our operations were historically organized into four major product lines — notebook PCs, LCD monitors, CRT monitors, and peripherals, accessories and spare parts. In 2000, we commenced the manufacture of wireless handsets and, in 2001, IAs.

Under ROC GAAP, a subsidiary in which we own more than 50% of the shares is not consolidated in our consolidated financial statements unless its total assets or total net sales exceeds 10% of our total assets or total net sales, respectively. Compal Communications is one of several of our subsidiaries which is not consolidated because it does not meet such test.

The following table sets out the breakdown of sales by product as a percentage of net sales for each of the periods indicated:

	Year ended December 31,			Six months ended June 30,	
	1999 (%)	2000 (%)	2001 (%)	2001 (unaudited) (%)	2002 (%)
Net Sales:					
Notebook PCs	56.6	67.9	66.1	66.3	64.3
LCD monitors	4.2	5.2	14.3	14.1	18.7
CRT monitors	17.8	15.1	13.6	12.9	8.0
Peripherals, accessories and spare parts	21.4	11.7	5.8	6.7	5.6
Wireless handsets(1)	—	0.1	0.1	—	1.8
IAs(2)	—	—	0.1	—	1.6
Total	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

(1) In 2000, Compal Electronics manufactured GSM handsets and sold them to Compal Communications. However, beginning January 1, 2001, Compal Communications began producing handsets itself in space leased from Compal Electronics rather than purchasing such handsets from Compal Electronics. Consequently, Compal Electronics did not have any non-consolidated net sales of wireless handsets in the period from January 1, 2001 to September 30, 2001. Compal Electronics began manufacturing and selling handsets for its own customers in October 2001. See “— Wireless Handsets — GSM Handsets”.

(2) We completed a full merger with Palmax in July 2001. In accordance with ROC GAAP, the results of Palmax were not consolidated with ours until 2001; therefore, IAs manufactured and sold by Palmax are not included in our consolidated or non-consolidated results for the years ended December 31, 1999 and 2000.

The following table sets out the unit sales of notebook PCs, LCD monitors, CRT monitors, wireless handsets and IAs for each of the periods indicated:

	Year ended December 31,			Six months ended June 30,	
	1999	2000	2001	2001	2002
Unit Sales:(1)					
Notebook PCs	1,012,899	1,798,457	2,316,856	877,490	2,014,027
LCD monitors	81,239	194,723	956,451	338,218	830,670
CRT monitors	1,820,914	2,385,549	2,344,326	838,877	1,107,686
Wireless handsets(2)	—	35,217	9,222	—	260,775
IAs(3)	—	—	10,071	—	94,764

- (1) Due to the nature and variety of products produced under “peripherals, accessories and spare parts,” the actual numbers of units produced under these products are not meaningful and therefore not provided.
- (2) In 2000, Compal Electronics manufactured GSM handsets and sold them to Compal Communications. However, beginning January 1, 2001, Compal Communications began producing handsets itself in space leased from Compal Electronics rather than purchasing such handsets from Compal Electronics. Consequently, Compal Electronics did not sell any wireless handsets for the period from January 1, 2001 to September 30, 2001. Compal Electronics began manufacturing and selling handsets for its own customers in October 2001. See “— Wireless Handsets — GSM Handsets”.
- (3) We completed a full merger with Palmax in July 2001. In accordance with ROC GAAP, the results of Palmax were not consolidated with ours until 2001; therefore, IAs manufactured and sold by Palmax are not included in our consolidated or non-consolidated results for the years ended December 31, 1999 and 2000.

The geographic breakdown of our consolidated net sales (according to shipment destinations) for the periods indicated below is as follows:

	Year ended December 31,			Six months ended June 30,	
	1999 (%)	2000 (%)	2001 (%)	2001 (%) (unaudited)	2002 (%)
North and South America	59.2	41.4	31.5	30.5	28.3
Europe	22.1	22.1	26.5	24.6	35.0
Asia (excluding Taiwan)	16.5	35.2	40.1	43.6	32.3
Taiwan	1.5	0.9	1.2	0.8	1.8
Others	0.7	0.4	0.7	0.5	2.6
Total	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Our consolidated net sales in Asia in the year ended December 31, 2000 and 2001 increased significantly due principally to the addition of Toshiba as a major customer, while net sales in North and South America decreased due to adverse economic conditions which affected consumer demand.

Notebook PCs

We sell a wide range of notebook PC models that vary as to all of the major configurations, such as processor brand and speed, hard drive, memory, type and size of display, and number and type of modules, among other things. Typically, we work closely with our ODM/OEM customers to develop models meeting these customers' specific needs and requests. Notebook PCs sold under individual customers' brands will often be different in terms of configuration and style, even for substantially similar models. The computer industry commonly recognizes four categories of notebook PCs: performance (high-end),

portable (light weight), value (low- to mid-end) and ultra portable (thin and light). We produce each of these types of notebook PCs.

Our ODM/OEM customers for notebook PCs consist mainly of major vendors in the global and regional notebook PC markets, including Dell, Toshiba, Hewlett-Packard, Acer and Fujitsu.

Before 1999, we manufactured all notebook PCs on a bare bone system basis, whereby various parts of the notebook PCs were assembled by us and the assembled products were then shipped to the customers for such customers to insert other components and accessories. Since 1999, we have been manufacturing and delivering increasing numbers of complete notebook PC systems, including notebook PCs on a BTO/CTO basis. Under a BTO/CTO arrangement, we assemble notebook PCs in our plants according to customers' specifications and load requested software applications on to the notebook PCs. We then arrange for delivery of the finished product to a distributor or the end user according to the customers' instructions, generally within five to seven days after receipt of a firm order. We anticipate that, generally, there will be a higher percentage of complete notebook PC system orders from our customers in the future as this method allows vendors to reduce in-house assembly and packaging costs and inventory levels. Manufacturing complete notebook PC systems on behalf of our customers also strengthens our relationship with our customers, as the customers become more dependent on our products and services.

Because a small number of vendors dominate the global notebook PC industry, there are a limited number of large customers for us and other ODM/OEM manufacturers. As a result, our sales of notebook PCs are concentrated in sales to a small number of key customers. We believe that our focus on a small number of major vendors enables us to work closely with such vendors in all aspects of design, production and distribution. In addition to working closely with current clients, we will continue to target aggressively the remaining top notebook PC vendors. In 1999, our focus on diversifying our customer base resulted in winning Toshiba as a new customer. By the end of 2000, Toshiba became, and continues to be, one of our top two notebook PC customers.

Displays

We manufacture LCD monitors and CRT monitors of different sizes. At present, our product range includes 14", 15" and 17" LCD monitors and 14", 15", 17", 19" and 21" CRT monitors. In the year ended December 31, 2001, we sold approximately 956,000 LCD monitors and approximately 2.3 million CRT monitors, and net sales of display products accounted for 28.0% of our total consolidated net sales. For the six months ended June 30, 2002, we sold approximately 831,000 LCD monitors and 1,108,000 CRT monitors, with net sales of display products accounting for 26.7% of our total consolidated net sales.

We sell our displays to customers primarily on an ODM or OEM basis. Our principal display customers have included NEC-Mitsubishi, Compaq and Fujitsu for LCD monitors and Compaq, NEC-Mitsubishi and Hitachi for CRT monitors. We also manufacture a relatively small volume of displays under our own brand names, "Sceptre" and "Komodo", primarily for the U.S. market. Sales of our Sceptre and Komodo products comprised only 1.5% of our total consolidated net sales of displays in the year ended December 31, 2001.

Our strategy with regard to display products is to continue to add major ODM/OEM customers by leveraging our customer base for notebook PCs and other products. In the first quarter of 2001, we secured NEC-Mitsubishi as a new customer for our CRT monitors and began shipping CRT monitors to NEC-Mitsubishi in April 2001. By the end of 2001, NEC-Mitsubishi had become one of our top two CRT monitor customers. We market to ODM/OEM customers by emphasizing our high quality, high volume manufacturing capabilities as demonstrated in the context of our notebook products. By adding new major ODM/OEM customers, we plan to increase production volumes, which leads to reduced unit manufacturing costs.

We follow market trends closely and expect to expand our production capacity and increase our sales of LCD monitors as demand for LCD monitors is expected to increase with the continued narrowing of

price differences between CRT monitors and LCD monitors. We also plan to change our CRT monitor product mix towards larger size monitors which generally have higher margins.

Peripherals, Accessories and Spare Parts

In addition to notebook PCs, LCD monitors and CRT monitors, we also manufacture peripherals and accessories for notebook PCs and sell spare parts for notebook PCs. Our major accessories products include docking stations, which are the bases for the insertion of cards, and port replicators, which are used to connect notebook PCs with monitors and peripherals.

We sell our docking stations and port replicators mainly to Dell and Hewlett-Packard for use with their branded notebook PCs. Docking stations and port replicators usually carry higher margins than other spare parts, and margins for peripherals, accessories and spare parts are generally higher than those for notebook PCs, LCD monitors and CRT monitors.

In the year ended December 31, 2001, the percentage of our consolidated net sales attributable to peripherals, accessories and spare parts decreased to 5.8% from 11.7% in the year ended December 31, 2000, mainly due to a decrease in orders for docking stations and port replicators from Dell. In the six months ended June 30, 2002, the percentage of our consolidated net sales attributable to peripherals, accessories and spare parts was 5.6%. As our customers increasingly purchase products from us on a complete system basis, we expect to ship more bundled products to customers such as Dell and Hewlett-Packard. As a result, sales of our separate docking stations and port replicators as a percentage of our net sales are expected to continue to decrease.

Wireless Handsets

We were one of the first companies in Taiwan to develop and manufacture both GSM and CDMA handsets. Compal Electronics manufactures and sells GPRS handsets, and we have a 58.7% interest in Compal Communications, which manufactures and sells GSM and GPRS handsets.

GSM Handsets

Although our GSM/GPRS handsets are developed and manufactured both by Compal Electronics (as part of the Personal Mobile Computing and Communications, or "PMCC", division) and Compal Communications, our equity method accounted affiliate, there is no overlap between the type of GSM/GPRS handsets produced nor in the customer bases. Compal Electronics focuses on the development and manufacture of GPRS handsets for customers that use Agere Systems (formerly a business unit of Lucent) solutions, while Compal Communications focuses on the development and manufacture of GSM and GPRS handsets for customers that use Texas Instruments solutions. However, since June 2000 Compal Electronics has controlled the Board of Directors of Compal Communications, and the President of Compal Electronics, Jui-Tsung Chen, is Chairman of the Board of Compal Communications. We expect that Compal Electronics and Compal Communications will continue to maintain product and customer differentiation.

Compal Communications. In May 2000, we invested NT\$1.3 billion to acquire a majority interest in Compal Communications, a company specializing in the ODM/OEM manufacture of GSM and GPRS handsets. This investment enabled us to enter into the GSM/GPRS handset manufacturing business. We believed at the time that there would be significant synergies in combining the GSM/GPRS products already developed by Compal Communications with our strength in manufacturing, sales and marketing, delivery and after-sales services and financial resources.

In 2000, Compal Electronics procured components and raw materials and manufactured GSM handsets for Compal Communications based on an arm's length arrangement between the two companies. Compal Communications then sold the handsets to cellular service providers and manufacturers. Compal Electronics began shipping GSM handsets in June 2000 to customers of Compal Communications in the PRC and other Asian markets. In the year ended December 31, 2000, Compal Electronics sold over

35,000 handsets to Compal Communications, and net sales of handsets by Compal Electronics accounted for 0.1% of our total consolidated net sales. Beginning January 1, 2001, Compal Communications began producing handsets in space leased from Compal Electronics in one of our Pincheng factories. Since that date, Compal Communications has conducted its own procurement of materials and components and its own manufacturing.

In April 2001, Compal Communications entered into a master ODM agreement with Motorola for the development and supply of wireless communications devices. Compal Communications is also focusing on OEM sales to electronics manufacturers in China. For the year ended December 31, 2001, Compal Communications sold approximately 620,000 GSM/GPRS handsets generating NT\$1.8 billion in revenues for Compal Communications, and for the six months ended June 30, 2002, Compal Communications sold approximately 615,000 GSM/GPRS handsets generating NT\$2.0 billion in revenues for Compal Communications.

Compal Communications has not been consolidated in our consolidated financial statements for the years 1999 to 2001 and for the six months ended June 30, 2002 since, under ROC GAAP, we are not required to include in our consolidated financial statement a subsidiary whose total assets or total revenues are less than 10% of our total assets or total revenues, respectively.

Compal Electronics. After entering the wireless handset business through our investment in Compal Communications and initially manufacturing wireless handsets for sale to Compal Communications' customers, we began to manufacture GPRS handsets for sale to our own separate ODM/OEM customers directly in October 2001.

Our wireless handsets strategy has been to focus initially on developing products and building up manufacturing capacity while selling GPRS handsets to cellular service providers and smaller, second-tier handset manufacturers. We then plan to gradually focus increasingly on first-tier handset manufacturers with the aim of becoming their ODM/OEM partner of choice.

Our current GPRS handset customers include Eastcom, Systex Corporate and other local Taiwanese companies, but we are targeting OEM sales to leading electronics manufacturers in China not being targeted or serviced by Compal Communications. For the year ended December 31, 2001, Compal Electronics sold approximately 4,200 GPRS handsets, and for the six months ended June 30, 2002, Compal Electronics sold approximately 139,000 GPRS handsets.

CDMA Handsets

Our CDMA handset business is also part of our PMCC division. In February 2000, we entered into a CDMA license agreement with Qualcomm to develop, make and sell products for CDMA wireless applications, including wireless handsets. Under the agreement, we also obtained CDMA technology from Qualcomm for the development of CDMA handsets. We believe that we are one of two Taiwanese cellular manufacturers to have entered into a CDMA license agreement with Qualcomm.

We commenced commercial manufacture and shipment of CDMA handsets during the fourth quarter of 2001. Through VACOM, a Korean subsidiary in which we hold an 83.2% equity interest, we are developing "smart phones" combining CDMA with either WAP or PDA functions. A CDMA-WAP handset has the ability to access the Internet, whereas a CDMA-PDA handset has a variety of PDA functions built into the handset.

Our goal is to position ourselves to take advantage of potential future demand for products using CDMA technology. To achieve this goal, we intend to engage in product development by acquiring relevant technologies and investing in R&D. Initially, we intend to target CDMA handset vendors in South America while awaiting the wider adoption of the CDMA standard in other markets, notably the PRC.

Our CDMA handset customers include Eastcom, Datang Telecom and other local customers in China and South America. For the year ended December 31, 2001, we sold approximately 5,000 CDMA handsets, and for the six months ended June 30, 2002, we sold approximately 122,000 CDMA handsets.

Information Appliances

We initially entered the IA business by acquiring a majority stake in Palmax in 1999. In July 2001, Palmax merged with and into us as part of our PMCC division. We are focused on the development and production of PDAs, pocket PCs and other wireless IAs (with both monochrome and color screens) which use Microsoft's Pocket PC operating system and Intel's processor chips. In addition, we plan to focus on the development of IAs that incorporate other product technologies of ours, such as LTPS TFT-LCD panels to be produced by Toppoly.

Although historically our products were sold primarily under the brand name of Palmax, we plan to take advantage of our existing customer base and know-how of ODM/OEM manufacturing to expand our sales on an ODM/OEM basis, until substantially all of our sales of IAs are on an ODM/OEM basis. Over 80% of our total net sales of IAs were on an ODM/OEM basis by the end of 2001.

We currently sell color pocket PCs to Legend on an ODM basis and recently began a project with a major U.S. PDA vendor to develop pocket PCs. We also manufacture PDAs and pocket PCs for Toshiba and Hitachi on an ODM basis, and are in discussions with other potential ODM/OEM customers regarding production of PDAs and pocket PCs. For the year ended December 31, 2001, we sold approximately 10,000 IAs, and for the six months ended June 30, 2002, we sold approximately 95,000 IAs.

Palmax has not been consolidated in our consolidated financial statements for the 1999 to 2000 period since, under ROC GAAP, we are not required to include in our consolidated financial statements a subsidiary whose total assets or total revenues are less than 10% of our total assets or total revenues, respectively. However, the business of Palmax has been fully included in our financial results from July 4, 2001, following its merger with and into us.

Toppoly Optoelectronics Corp.

We hold a 30.1% interest in Toppoly, a joint venture company established to develop and manufacture LTPS TFT-LCD panels. An LTPS TFT-LCD panel is different from a traditional a-Si TFT-LCD panel in that it integrates driver integrated-circuit chips into the "glass" of the panel. As a result, it is lighter, has better resolution, consumes less power and produces a clearer and brighter image. LTPS TFT-LCD panels that are 10.4" or larger are used as viewing screens in notebook PCs and LCD monitors. Smaller panels can be used in products such as IAs, digital cameras, wireless handsets, DVDs and car navigation screens. Toppoly is expected to commence the manufacture of 2" to 6" panels by the second half of 2002 and subsequently to expand to larger panels.

We, along with Kinpo and the Uni-President Group, established Toppoly as a joint venture company in December 1999. As of December 31, 2001, Toppoly had stockholders' equity of NT\$22.5 billion. All issued shares in Toppoly have been fully paid. We have invested NT\$7,130.5 million (U.S.\$213.1 million) for a 30.1% interest in Toppoly. There are no intercompany loans between Toppoly and us. The other major investors in Toppoly are the Uni-President Group, which has contributed NT\$7,429.8 million (U.S.\$220.0 million) for a 31.4% interest; Kinpo, which has contributed NT\$1,180.1 million (U.S.\$35.3 million) for a 5.0% interest; and Teco which, in Toppoly's second round equity capital raising, contributed NT\$3,686.4 million (U.S.\$110.2 million) for a 15.6% interest. We and our joint venture partners may make further capital contributions to Toppoly. Toppoly may also raise additional capital from new investors or enter into borrowing arrangements with lenders.

Individuals connected with us, including Shen-Hsiang Hsu, our Chairman, Jui-Tsung Chen, our President and Director, and I-Wei Wu, Toppoly's Executive Vice President and Director, have also invested in Toppoly. Of the 12 directors of Toppoly, Kinpo and we have appointed two directors, the Uni-President Group has appointed three directors, Teco has appointed two directors and the remaining two directors are independent. In addition, in the joint venture agreement establishing Toppoly, Kinpo, the Uni-President Group and we agreed that Toppoly's Chairman and Chief Executive Officer would be appointed by us. Jui-Tsung Chen, our President, is Toppoly's Chairman and Chief Executive Officer.

In November 1999, we entered into an agreement with the Electronics Research Service Organization of the Industry Technology Research Institute, Taiwan under which we acquired basic LTPS-related technologies. Our rights and obligations under this agreement were subsequently transferred to Toppoly. In addition, Toppoly entered into an agreement with a major Japanese manufacturer in March 2001 to acquire technologies for product development and volume production of LTPS TFT-LCD panels. The agreement was terminated in December 2001.

Manufacture of LTPS TFT-LCD panels involves the production of LTPS TFT glass substrates which are subsequently cut into individual panels. Production of LTPS TFT-LCD panels will take place in a newly built factory in the Hsinchu Science-Based Industrial Park in Taiwan. Toppoly began construction of the facility in February 2001. The facility will be equipped with advanced equipment and production is expected to begin in the fourth quarter of 2002. We expect the facility to have an initial production capacity of 10,000 mother glass substrates, which can be increased depending on demand.

We plan to source a portion of our requirements for LTPS TFT-LCD panels for use in our production of wireless handsets and IAs from Toppoly. Toppoly may also supply panels to Teco, a major manufacturer of electrical appliances in Taiwan, should Teco enter the IA manufacturing business. We expect that a portion of Toppoly's output will also be sold to third-party customers. We believe that our ability to offer wireless handsets and IAs with LTPS TFT-LCD technology sourced from Toppoly will be a competitive advantage in the future for obtaining manufacturing orders from top tier wireless handset and IA vendors.

Although Toppoly is currently in the early stages of establishing its business, our goal is for Toppoly to become a major manufacturer of LTPS TFT-LCD panels. We believe that LTPS TFT-LCD panels will be in demand in the future due to their superior quality and the growing market for wireless handset and IAs.

Sales and Marketing

We are organized into business units along product lines, with the Computer Business Unit for notebook PCs, the Display Business Unit for monitors and the PMCC division for wireless handsets and IAs. Each of these business units has sales and marketing teams focusing on the unit's products. Sales and marketing personnel are further divided into smaller groups dedicated to each of our major customers. Each dedicated customer group is headed by an account manager who is primarily responsible for our relationship with that specific customer.

We focus our sales and marketing activities on a small number of large, global customers, with whom we seek to build close relationships. The sales and marketing division endeavors both to maintain and to strengthen relationships with our current customers and to expand our business by attracting new clients and procuring larger, more diverse orders from existing clients. With respect to existing clients, the account manager responsible for a specific client will work closely both with the customer and with employees in our other divisions, such as R&D and manufacturing, in order to develop products tailored to meet that customer's specific needs. We believe that such contact between our staff and that of our clients further strengthens our relationships with our customers.

With respect to attracting new customers, we mainly target first-tier companies with whom we are not currently doing business. To aid in the process of securing purchase orders from new customers, we will, often in response to a request for quotation, set up a team dedicated to a specific potential client.

Due to the competitiveness of the markets for our products, long-term contracts are not typical. We do, however, enter into arrangements with customers whereby, for planning purposes, such customers supply us with non-binding rolling forecasts, which form the basis of purchase orders at a later point in time. The establishment of distribution hubs in the United States and Europe for displays enables customers to shorten time between firm orders and delivery.

We generally bill our customers on delivery of goods with a credit term of 30 to 90 days. Substantially all customer payments are made in U.S. Dollars.

We make available to each of our major customers our CRM system to maintain an on-going interactive channel of communication between the customer and our company. The CRM system is an internal information system interfaced with the data base of the customer, through which the customer can monitor each stage of the progress of products from design to shipping. This customer-engagement tool includes many protocols such as forecast, order, order confirmation, change of order, order change confirmation and shipment forecast. We believe our CRM system provides a convenient way for customers to interact with us and is an important element in achieving customer satisfaction.

Distribution and After-Sales Support

We ship most of our products either directly from our factories to our customers or, in the case of some of our notebook PCs and displays, through our hubs. In addition, notebook PC orders on a BTO/CTO basis are shipped to distributors or end-users, typically within five to seven days after a firm order is received. Other orders are delivered according to vendor specification.

Although we do not intend to establish manufacturing sites in regions where our major customers are located, our policy is to maintain after-sales service centers in strategic locations. We currently have two after-sales service centers in the United States, two in Kunshan, and one in Europe. In addition, our products are serviced through two third-party service centers in Japan. These after-sales service centers serve as our main point of contact with our notebook PC customers. The centers directly provide repair services to customers, thereby avoiding the expense and delay of shipping to Taiwan and eliminating the need for customers to establish their own service centers.

Raw Materials and Components

We focus on managing our raw materials and components to minimize costs and potential disruption to our business. We have implemented a supply chain management (“SCM”) system to allow closer communication between us and our suppliers. Similar to the CRM system, the SCM system is an information system used by us to monitor the supply of components and raw materials and manage our inventory and control costs. We do not enter into long-term supply contracts with our suppliers, but provide many of them with 12-week rolling forecasts. Payment terms generally require us to make payment between 60 to 90 days after invoicing.

Notebook PCs

We source all of the major components needed in the manufacture of notebook PCs from third-party suppliers or, in certain cases, from our customers. The major components include LCD panels, CPUs, hard drives, CD-ROM drives, batteries and DVD drives. The most significant component cost is that for LCD panels. Our principal suppliers of LCD panels (other than certain of our notebook PC customers themselves as discussed below) are Samsung, LG, NEC-Mitsubishi and Chunghwa Picture Tube, Ltd. (“CPT”). During the end of 1998 and at the beginning of 1999 and again from the end of 2001 to the second quarter of 2002, global shortages drove up the prices of LCD panels. However, the trend reversed subsequently and there was an oversupply of LCD panels. We believe such shortages and oversupply of LCD panels as well as other components occur from time to time.

As a major notebook PC manufacturer in Taiwan, we believe we are in a better position than many of our smaller competitors to obtain a reliable supply of necessary components as relationships we maintain with our suppliers, as well as the size of our purchases, help reduce the impact of any scarcities on our business. In addition, many of our customers source the LCD panels to be used in their notebook PCs themselves, thus reducing our risk of supply shortage and exposure to price fluctuations in LCD panels.

We typically contact our suppliers on a weekly basis and provide them with 12-week rolling forecasts. We generally accumulate one month’s worth of notebook PC raw materials and components in inventory, subject to adjustment for scarcity or oversupply.

Displays

The principal components for LCD monitors include LCD panels and, to a lesser extent, passive components such as chip capacitors and resistors. In addition to sourcing LCD panels from certain of our LCD monitor customers themselves as discussed below, we obtain our major components for LCD monitors from a number of domestic and international suppliers including CPT and Samsung (with respect to 14" LCD panels), and CPT, Hannstar Display and LG (with respect to 15" LCD panels). There was a shortage in the supply of LCD panels during the end of 1998 and the beginning of 1999 and again from the end of 2001 to the second quarter of 2002, which resulted in price increases in LCD monitor production cost. Subsequently, there was an oversupply of LCD panels. We believe we will be able to source a sufficient supply of LCD panels to meet our customers' orders for 2002.

In addition, some of our customers source the LCD panels to be used in their LCD monitors themselves, thereby reducing our risk of supply shortage and exposure to price fluctuations in LCD panels.

We source our components and raw materials for CRT monitors from leading domestic and overseas suppliers. The major components include CRTs and certain passive components, and the principal suppliers for CRTs include Samsung, CPT and Hitachi. We are not dependent upon any single supplier for any of our CRT monitor components and raw materials. We believe that there is currently a sufficient supply of components and raw materials for CRT monitors. In addition, we believe that the proximity of our CRT supplies in China reduces our transportation time and inventory costs.

Wireless Handsets

The key components for wireless handsets are chip sets, passive components, batteries and LCD panels. For our GSM/GPRS handsets, we source our flash memory chips from Intel, digital signal processors from Lucent and power amplifiers from Conexant Systems. We source our CDMA chip sets from Qualcomm and certain of our key passive components from companies in Japan. We expect that 50% of our raw materials for GSM/GPRS handsets will be sourced in Taiwan, and approximately 50% of our raw materials for CDMA handsets will be sourced from the United States and Japan. We expect to source some LTPS TFT-LCD panels from Toppoly starting in the fourth quarter of 2002.

Information Appliances

The key components for IAs include flash memory chips, CPUs, LCD panels (including touch panels), random access memory chips, passive components and batteries. We expect to source CPUs from Intel and LCD panels from Sharp and other Japanese suppliers. We expect that, starting in the fourth quarter of 2002, we will source LTPS TFT-LCD panels for our IAs from Toppoly. Recently there has been a shortage in the market with respect to touch panels. However, we do not expect this shortage to pose any significant disruption to our production of IAs.

Research and Development

We, including our subsidiaries, currently have an R&D staff consisting of over 1,000 engineers organized into teams based on products, including over 130 engineers in our R&D center in Kunshan. The focus of the department is to reduce the time-to-market of each product and to develop high quality products. The main activities of the R&D engineers are product initialization and manufacturing readiness.

Our relationships with our customers begin at the R&D and design stage. The engineers from the R&D department utilize the quality improvement loop ("QIL") system and an advanced design method to achieve the most satisfactory design. At each stage of product design and development, the engineers work closely with the sales and marketing personnel and customers and interact with them via the CRM system with respect to specifications, schedule, prices and manufacturing readiness. R&D personnel conduct phase reviews and a series of tests for each new product. The engineers participate in weekly telephone calls with customers and conduct regular customer visits. The objective is to design high quality products, measured by cost-effectiveness and ease of manufacturing.

Functional directors and knowledge managers supervise and coordinate the work of different R&D teams across the five function areas: sales and marketing, logistics, R&D, manufacturing and quality assurance. Two project managers are assigned to each project and are each responsible for development and manufacturing aspects of the project.

Notebook PCs

Our current R&D activities relating to notebook PCs are focused mainly on enhancing and improving our range of products. There are currently four core R&D teams, each dedicated to one of our key ODM/OEM notebook PC customers. The R&D team also maintains direct communications with other industry leaders such as Intel and Microsoft, and participates in various standard bodies such as USB (Universal Serial Bus), IEEE1394, 802.11a,b and Bluetooth wireless. Recent notebook PC R&D initiatives have included the development of one of the slimmest notebook PCs in the world which uses the Intel Desktop PIV processor and advanced thermal technology, the new generation notebook PC platform, examples of such products which we are developing include the Mobile Internet PC and the Tablet PC which feature wireless LAN, digitizer integrated LCD monitor and voice recognition technology. Other technologies such as high-speed board design and simulation, accurate impedance control method, power saving software application for Windows XP, whole system shock and vibration simulations and advanced materials for lighter, stronger and longer battery life notebooks are also part of the R&D program. We have an R&D staff of over 660 employees working on notebook PCs.

Knowledge management is another key area for Compal's R&D group. We focus on knowledge collection, sorting and sharing with the aim of improving the efficiency among different core R&D teams and achieving improved results.

Displays

We maintain an R&D staff of over 110 people that focuses on LCD and CRT monitors. As the CRT monitor is a relatively mature product, our R&D activities mainly focus on enhancing and improving our range of products to make them more competitive in the market. The R&D team collects market information from our customers and suppliers and develops new products based on the customers' requirements, desired specifications and features. Recent R&D activities include work on larger sized LCD monitors.

Wireless Handsets

By investing in Compal Communications, we gained access to GSM technology developed by Compal Communications, including technology for dual-band GSM handsets. Compal Communications has a team of 220 R&D personnel. We currently have our own GSM R&D team consisting of 73 engineers, and VACOM, the R&D center for our CDMA handsets, currently employs 59 engineers. Our wireless handset research efforts are focused on products such as the stinger smart phone and tri-band and quad-band GPRS, IMT-20003x and W-CDMA handsets. Other technologies which are also developed under our R&D program include the KJAVA Virtual Machine, BLEW and wireless handsets with built-in camera functions.

Information Appliances

Our R&D activities relating to IAs are focused on PDAs (including pocket PCs and pocket PCs with wireless handset functions), and embedded Mira system devices. Our R&D achievements include the development of one of the first pocket PCs with the Intel Xscale 400 MHZ processor, and one of the slimmest pocket PCs in the world. We are also developing a pocket PC with portable presentation and wireless LAN functions. This R&D effort leverages the R&D activities engaged in by Palmax prior to its merger with us. We currently have an R&D staff of 97 employees working on IAs.

Competition

Notebook PCs and Displays

The markets for notebook PCs, LCD monitors and CRT monitors are highly competitive. Competition mainly comes from other Taiwanese manufacturers, and we have experienced pressure on prices and margins. We compete with Arima, Inventec, Quanta and Wistron (Acer Group) with respect to notebook PCs; Amtran Technology, AOC, BenQ, LG, Lite-On Technology and Samsung with respect to LCD monitors; and LG and Samsung in Korea and AOC, BenQ, Lite-On Technology and Tatung in Taiwan with respect to CRT monitors.

As we focus primarily on ODM/OEM customers, we seek to offer superior design, products and service to our existing customers while also exploring opportunities to develop new relationships with other ODM/OEM customers. We believe that we will be able to maintain and improve our competitive position for a number of reasons. Our management team has been in the ODM and OEM business for a considerable period, and has acquired extensive experience and understanding of the development of each of our major products. Unlike some of our competitors, we consider centralized manufacturing (having our manufacturing plants in a restricted number of locations) a more effective way of managing production than establishing worldwide manufacturing capabilities. Resources (including capital and manpower) saved by central manufacturing are devoted to improving the quality of our products. However, to better serve our customers, we have established a number of after-sales hubs and service centers in the regions where our customers are located. We believe that centralized manufacturing, combined with regional hubs and service centers, enables us to maintain quality while providing enhanced service close to our customers.

In addition, we have been able to achieve greater economies of scale by moving some of our notebook PC production and all our LCD monitor and CRT monitor production to Kunshan, China, which management considers to be a favorable geographical location characterized by lower average labor costs (compared to Taiwan) and a lower employee turnover rate (compared to the southern part of China). We plan to move substantially all of our notebook PC manufacturing to China in order to further reduce unit manufacturing costs.

Wireless Handsets

We are one of the first companies in Taiwan to manufacture both GSM/GPRS and CDMA handsets. Our goal is to become an ODM/OEM manufacturing partner of major wireless handset vendors. In Taiwan, there are several manufacturers of handsets, including those which manufacture handsets on an ODM/OEM basis. Currently, the most significant ODM/OEM manufacturer of handsets in Taiwan is BenQ, which sells handsets on an ODM/OEM basis to Motorola. Other competitors in Taiwan include GVC, Quanta, Arima and Inventec. In addition, several other notebook PC and electronics manufacturers in Taiwan have begun to develop, or expressed interest in developing, wireless handset manufacturing capability. Outside of Taiwan, major manufacturers of wireless handsets on an outsourced basis include Flextronics and Solectron. We believe that these companies will be our primary competitors in the market for ODM/OEM manufacturing of handsets.

Competition in the wireless handset market is intense. Our handset businesses are dependent on the success and growth of the relevant technology standard, and the growth in outsourcing of manufacturing by major handset vendors. While we believe that our R&D efforts, such as the establishment of VACOM as an R&D center in Korea, and the access to advanced technology through our investment in Toppoly, will provide a competitive advantage over certain other entrants, there can be no assurance that other manufacturers in Taiwan or abroad may not be able to establish joint ventures or alliances which will give them access to advanced technology and customer orders. We plan to continue to focus our R&D on wireless technology as well as to leverage our customer base in other product lines to cultivate new clients for our wireless handsets.

Information Appliances

We believe that the global market for IAs has potential for significant growth. We plan to manufacture PDAs and pocket PCs primarily on an ODM/OEM basis. Currently, most major vendors of PDAs and pocket PCs do not source their products from ODM/OEM manufacturers. As a result, our primary source of competition is the manufacturing capacity of the vendors themselves, and the success of our IA manufacturing business will be dependent on the growth of outsourcing among IA vendors. In the ODM/OEM market, we will compete with IA manufacturers in and outside Taiwan, such as HTC Corporation, which has produced pocket PCs on an ODM/OEM basis for Compaq. In addition, should ODM/OEM manufacturing of IAs become more prevalent, we expect more electronics and computer manufacturers to expand into the business of manufacturing IAs.

Production Facilities

We currently have two production facilities operating in one site in Taiwan and four production facilities operating in two sites in China. Our Taiwan manufacturing facilities are located in Pincheng, Taoyuan County, Taiwan. The land and buildings are owned by us. Notebook PCs, wireless handsets, IAs and peripheral products are manufactured at these two plants. The two Taiwanese plants together have eight production lines with a monthly capacity to produce 250,000 notebook PCs, 240,000 wireless handsets and 90,000 IAs. Our capacity for wireless handsets and IAs is inter-changeable.

The four manufacturing plants in China are located in Kunshan, Jiangsu Province. The four existing plants in China currently manufacture notebook PCs, CRT monitors and LCD monitors. The plants have a combined monthly production capacity of 250,000 notebook PCs, 250,000 LCD monitors and 500,000 CRT monitors. We are constructing a fifth plant at one of our sites in Kunshan, China, and we expect to commence production of notebook PCs in that plant in the first quarter of 2003. We expect to increasingly shift production of notebook PCs from our Taiwan facilities to our China facilities.

Based on our assumptions about expected demand for our products through the end of 2002, we have plans to increase our monthly production capacity for our products to 600,000 notebook PCs, 250,000 LCD monitors, 500,000 CRT monitors, 480,000 wireless handsets and 200,000 IAs by adding shifts or adding lines.

A major earthquake occurred in Taiwan on September 21, 1999. Although production at the two Taiwan plants was disrupted for two days, no significant damage or injury was suffered during or as a result of the earthquake. The two plants resumed full-scale operation on September 23, 1999, relying on our own power generators. The consequent electricity restriction imposed in Taiwan had no significant effect on the plants, as our power generators generated sufficient electricity to sustain the operation throughout each affected production shift. We also had a small fire on one floor of one of our facilities in Taiwan in June 2001 which did not cause any significant damage or injury but did disrupt full-scale operation of, primarily, Compal Communications' wireless handset production line for two days.

Quality Control

We place special emphasis on quality control which we consider to be one of the keys to success in the computer industry. We employ quality control procedures at every critical manufacturing stage and carry out various tests on our sites. These tests include an engineering verification test, a development verification test and a production verification test. These tests enforce internal standards set by us for our products and are conducted by a team of staff dedicated to quality management. For customers having their own specifications, we will also carry out tests as prescribed by such customers. We also receive feedback reports from customers on a weekly basis. On-site checks are also carried out by us on our major suppliers' facilities.

Starting in 1998, our quality control procedures have included the use of an internal database system known as the QIL system by which we consult internal databases at every stage in the development of a new product. The QIL database contains market information and experience gained from the development

of past products. We believe that our QIL system helps to ensure quality as early as the design stage, and helps us to time- and cost-effectively design, engineer, develop and produce new products.

The notebook PCs that we developed and manufactured for our customers have received numerous awards, most notably the PC Magazine Editors' Choice awards, Mobile Insights MI99 award, Dell's "Worldwide Procurement Supplier Conference Playing to Win Quality Award" in March 2002 and awards from Hewlett-Packard and Intel. Existing manufacturing facilities in both Taiwan and China have received ISO9002 and ISO14001 certification. In addition, the existing Taiwan manufacturing facilities have received ISO9001 certification.

Trademarks, Patents and Licenses

As of July 31, 2002, we held 444 patents in respect of our products, in and outside of Taiwan. We believe that it is important to develop and patent our designs and special features in our products and may be able to license out some of the more important patents in the future. To date, the most significant patent we have developed is a design known as "Combo Module", which is a device combining the functions of a floppy diskette drive and a DVD drive. The design was patented in Taiwan and the United States in 1998. We intend to aggressively defend our patents and other intellectual property.

In May, 2002, our registration of the "Compal" trademark with the U.S. Patent and Trademark Office became effective.

We have entered into a license agreement with Qualcomm with respect to the sale and development of CDMA handsets using Qualcomm's CDMA technology. See "— Compal Products — Wireless Handsets — CDMA Handsets".

Environmental Protection

We are mainly engaged in the assembly of products which are generally not associated with environmental problems. We have not been subject to any material fines or actions involving non-compliance with environmental regulations of Taiwan or China and believe that we are in compliance in all material respects with relevant environmental protection regulations.

Litigation and Legal Issues

On October 13, 2000, Samsung Electronics Co., Ltd. initiated a patent infringement action in the United States District Court for the Northern District of California against us and certain other notebook PC manufacturers in Taiwan. The asserted patents purport to cover various aspects of notebook PC systems, including an easily-upgradable CPU board, a particular cache memory system, a counter for refreshing DRAMs using the system clock, a potential power-saving feature related to modems, certain PC facsimile devices, and use of special keys for certain applications. Samsung has indicated that it will likely seek the payment of damages or reasonable royalties if the action is successful. We submitted a preliminary response to the court in December 2000. Samsung has subsequently dropped the claims relating to three out of the six patents which we were originally alleged to have infringed. The defendants, including us, dispute the claims and are pursuing a defense of the action. If we are required to pay royalties or damages, there can be no assurance that such payments would not have a material adverse effect on our business, financial condition and results of operations.

On February 13, 2001, Elonex I.P. Holdings, Ltd. filed several patent infringement actions in the United States District Court for the District of Delaware against us and a number of other major electronics and computer companies. The claims relate to infringement of patents relating to power management in CRT monitors. We have reached a commercial resolution to this dispute which is pending the approval of the court and we do not believe the resolution will have a material adverse effect on our financial condition, results of operations or prospects.

On April 6, 2001, LG Electronics Inc. filed a complaint for patent infringement against us, two of our subsidiaries, Bizcom Electronics, Inc. and Sceptre Technologies, Inc., and a number of other companies in

the United States District Court for the Northern District of California. The complaint alleges infringement of five patents relating to various aspects of notebook PC systems and requests relief in the form of damages and injunctions enjoining future infringement. We are pursuing a defense of this suit. If we are required to pay royalties or damages or are enjoined, there can be no assurance that such payments or injunction would not have a material adverse effect on our business, financial condition and results of operations.

On May 3, 2001, one of our major customers, Dell, announced that it would voluntarily recall approximately 284,000 batteries used in Dell's Inspiron 5000 and Inspiron 5000e notebook computer series due to concerns that such batteries may overcharge, causing them to become very hot and possibly catch fire. As we manufactured these notebook PCs for Dell, pursuant to our agreement with Dell, we could be liable for the costs of such recall as well as the costs associated with any damage that has occurred as a result of such product defect. Pursuant to the terms of the supply agreement we entered into with the Japanese supplier of the recalled batteries, and subsequent correspondence between us, we have reached an agreement under which such Japanese supplier will indemnify us for a substantial portion of any costs associated with the defective batteries, including the recall and replacement of such batteries and any damages associated therewith. In addition, as the Inspiron 5000 and Inspiron 5000e models have been phased out by Dell and we have not produced them since February 2001, we currently have no such models in our inventory stock. However, there can be no assurance that such defects will not adversely affect our standing and reputation in the marketplace, which could have a material adverse effect on our business, financial condition and results of operations.

On April 19, 2002, Thomson Multimedia Licensing, Inc. initiated an action for breach of contract against us and our subsidiary, Compal China, in the United States District Court for the District of New Jersey. Thomson alleges that we have not paid royalty fees in accordance with the license agreement entered into in January 1998 pursuant to which Thomson granted us the right to produce color monitors. Thomson has indicated that it will terminate the licensing agreement, seek an injunction against us to produce color monitors and seek damages if the action is successful. If we are required to pay royalty fees or damages, there can be no assurance that such payments would not have a material adverse effect on our business, financial condition and results of operations.

Save as disclosed above, we are not and have not been involved in, and we are not aware of, any material litigation or other proceedings or legal issues the outcome of which might, individually or taken as a whole, affect our financial condition or results of operations.

Insurance

We have insurance policies covering risks of fire and damage to machinery, land and sea delivery and construction and installation damage which we consider adequate. Fire insurance includes coverage of risks from explosions, earthquakes and flooding. We have also purchased transportation insurance coverage for finished goods delivered as part of our global logistics delivery network. The damage and loss caused by the fire in our Taiwan facility was substantially covered by our fire insurance.

Employees

As of July 31, 2002, we had 4,252 employees. Our workforce is not unionized and to date we have not experienced any labor disputes. We believe that we maintain a good relationship with our employees. In addition, we have a mentoring system to assist our employees, which we believe contributes towards establishing good employer-employee relationships.

The salaries of our employees are reviewed on an annual basis. Salaries are adjusted based on industry standards, inflation and individual performance. We normally pay annual bonuses to our employees equivalent to an average of two months' salary. In addition, our Articles of Incorporation provide that our employees are entitled to employee bonuses out of the retained earnings which may be paid in cash or stock. See "Description of Common Shares". In 2001, we issued approximately 30 million Common Shares, and in 2002 our shareholders have approved the issue of approximately 27 million Common

Shares, to be delivered on August 28, 2002, as employee stock bonuses. Under ROC GAAP, employee stock bonuses are accounted for as a transfer from retained earnings to common shares in stockholders' equity. The amount allocated from retained earnings is calculated at par value of NT\$10 per Common Share, notwithstanding that the market value of the Common Shares on the date of declaration and distribution of employee stock bonuses have been significantly higher than NT\$10 per Common Share. We are not required to and do not charge the market value of the employee stock bonuses to employee compensation expense. ROC law requires that employees be given pre-emptive rights to subscribe to between 10% and 15% of any of our rights issues or share offerings. We do not have any share option schemes. See "Risk Factors — Risks Relating to Ownership of the GDSs — Employee stock bonuses may have a diluting effect on the holdings and associated rights of the holders with respect to the Common Shares and the GDSs".

We collect pension fund contributions for our domestic employees in accordance with the Labor Standards Laws of Taiwan and contribute 5% of the aggregate base monthly salaries of all domestic employees each month to Central Trust of China. All Taiwan companies listed on the Taiwan Stock Exchange are required to calculate their actuarial pension obligations. In common with other companies listed on the Taiwan Stock Exchange, we adopted Taiwan Statements of Financial Accounting Standard (SFAS) No. 18 "Accounting for Pensions" as of December 31, 1995.

In order to sustain our competitive advantage, our human resources team has developed the core competencies model based on our corporate strategy, and implemented an annual training program to develop various skills of our employees, including problem analysis, quality control, creative thinking, teamwork, customer relationship management and strategic thinking. The goal of such training is to align our employees' development with our corporate strategies.

In addition to complying with the ROC government's compulsory insurance policy of providing labor and national health insurance, we provide additional benefits to our employees, such as accident and medical insurance and, in some cases, accommodation.

Subsidiaries and Associated Companies

As of August 15, 2002, we held direct or indirect investments of 10% or more of the paid-in capital of the following principal subsidiaries and associated companies:

<u>Name and registered office of subsidiary/associated company</u>	<u>Main business</u>	<u>Our effective equity interest (%)</u>	<u>Jurisdiction of incorporation</u>
Allied Circuit Co., Ltd. 128 Kung Erh Rd., Wu Lin Village, Lung Tan, Taoyuan County, Taiwan, ROC	Printed circuit board manufacturing	19.72	Taiwan
Beijing Compower Xuntong Electronic Technology Co., Ltd. Beijing 3F, DSP Building 17 Zhongguancun Rd., Haidian Region Beijing 100080, China	Maintenance and wholesale of notebook PCs and other electronic products	50.00	PRC
Bizcom Electronics, Inc. 781 Ames Avenue, Miliptas, CA 95035, U.S.A.	Maintenance and wholesale of notebook PCs	100.00	U.S.A.
C&C Laboratory Co., Ltd. 7th Fl, 319 Pa-Teh Rd., Sec. 4, Taipei 105, Taiwan, ROC	EMI testing	33.45	Taiwan

<u>Name and registered office of subsidiary/associated company</u>	<u>Main business</u>	<u>Our effective equity interest (%)</u>	<u>Jurisdiction of incorporation</u>
Cal-Comp Electronics (Thailand) Public Co., Ltd. 191/54, 191/57 18th Fl., CTI Tower, Rachadapisek Rd., Klongtoey, Bangkok 10110, Thailand	Manufacture of calculators, facsimile machines, cordless phones, printers, CD-Roms and other types of electronic products	11.48	Thailand
Compal Communications Inc. 7th Fl, 319 Pa-Teh Rd., Sec. 4, Taipei 105, Taiwan, ROC	Design, manufacture and sale of GSM and GPRS handsets	58.67	Taiwan
Compal Electronics (China) Co., Ltd 988 Tung Feng East Rd., Economic & Technical Development Zone, Kunshan, Jiangsu, China	Manufacture and sale of CRT monitors	100.00	PRC
Compal Electronics Technology (Kunshan) Co. Ltd. The Third Street Kunshan Expat Processing Zone, Kunshan, Jiangsu, China	Manufacture and sale of notebook PCs and PDAs	100.00	PRC
Compal Europe B.V. Hoeksteen 149,2132 MX Hoofddorp, Netherlands	Maintenance and wholesale of notebook PCs and monitors	100.00	The Netherlands
Compal Europe (U.K.) Ltd. Unit A, Centrepoint, Marshall Stevens Way, Westinghouse Road, Trafford Park, Manchester, M17 1PP, UK	Maintenance of notebook PCs	100.00	U.K.
Compal Holding Ltd. Tropic Isle Building, P.O. Box 438, Road Town, Tortola, British Virgin Islands	Holding company	100.00	British Virgin Islands
Compal International Holding Co. Ltd. Tropic Isle Building, P.O. Box 438, Road Town, Tortola, British Virgin Islands	Holding company	100.00	British Virgin Islands
Compal International Ltd. Tropic Isle Building, P.O. Box 438, Road Town, Tortola, British Virgin Islands	Wholesale of monitors	100.00	British Virgin Islands
Compower International Ltd. Tropic Isle Building, P.O. Box 438, Road Town, Tortola, British Virgin Islands	Holding company	50.00	British Virgin Islands

<u>Name and registered office of subsidiary/associated company</u>	<u>Main business</u>	<u>Our effective equity interest (%)</u>	<u>Jurisdiction of incorporation</u>
Compower International Technology Co., Ltd. 11th Fl., 99 Nan-King E. Rd., Sec. 5, Taipei 105, Taiwan, ROC	Retail of office equipment, information software, import and export	10.00	Taiwan
eASPNet Inc. One Capital Place, P.O. Box 1787, Grand Cayman, Cayman Islands, British West Indies	Application service provider	11.76	Cayman Islands
Emerging Technology Venture Capital Corp. 13F-1, No. 128, Sec. 3, Ming Sheng E. Rd., Taipei, Taiwan, ROC	Venture capital	10.00	Taiwan
Everskil Technology Co., Ltd. No. 10 Chung Shan Rd., Industrial Park, Taipei Hsien Taiwan, ROC	Plastic injection, pressing	11.08	Taiwan
FR Venture Capital Inc. 13F, 563, Chung Hsiao E. Rd., Sec. 4, Taipei, Taiwan, ROC	Venture capital	15.63	Taiwan
Fushang International Capital Investment Management Co., Ltd. 11th-1 Floor, No. 22 Sec. 5, Nan-King E. Rd., Taipei 105, Taiwan, ROC	Venture capital	12.50	Taiwan
G-Advanced Semiconductor Tech. Corp. B2, No 8 Tung Hsing Rd., Taipei 105, Taiwan, ROC	GaAs IC foundry	15.38	Taiwan
Gallery Management Limited The Lake Building 1st Floor, Wickhams Cay 1, Road Town, Tortola, British Virgin Islands	Investment	41.12	British Virgin Islands
Gempal Technology Corp. 7th Fl, 319 Pa-Teh Rd., Sec. 4, Taipei 105, Taiwan, ROC	Wholesale of notebook PCs and monitors	99.99	Taiwan
Hua Cheng Venture Capital Corp 17th-1 Floor, 105 Tun Hwa S. Rd., Sec. 2, Taipei, Taiwan, ROC	Venture capital	10.00	Taiwan
International Semiconductor Technology Ltd. No. 5, South 6th Rd., K.E.P.Z. Kaohsiung, Taiwan, ROC	Smart card selling and testing	48.68	Taiwan

<u>Name and registered office of subsidiary/associated company</u>	<u>Main business</u>	<u>Our effective equity interest (%)</u>	<u>Jurisdiction of incorporation</u>
Just International (Singapore) Pte. Ltd. 138 Robinson Road #17-00 Hong Leong Centre Singapore 068906	Holding company	100.00	Singapore
Just International Ltd. Tropic Isle Building, P.O. Box 438, Road Town, Tortola, British Virgin Islands	Holding company	100.00	British Virgin Islands
Kadia Management Ltd. Tropic Isle Building, P.O. Box 439, Road Town, Tortola, British Virgin Islands	Holding company	100.00	British Virgin Islands
Kinpo Electronics, Inc. 10F, No 99, Nan-King E. Rd., Sec. 5, Taipei, Taiwan, ROC	Design and manufacture of consumer electronics, communications and PC peripherals products	10.32	Taiwan
Kunshan Botai Electronics Co. Ltd. 998 Tung Feng East Road, Economic & Technical Development Zone, Kunshan, Jiangsu, China	Manufacture and sale of notebook PCs	100.00	PRC
Landport Capital Investment Company 8F, No. 248 Nan-King E Rd., Sec. 3, Taipei 105, Taiwan, ROC	Venture capital	14.93	Taiwan
Lipo Holding Co., Ltd 4th Fl., Harbour Centre, P.O. Box 613, George Town, Grand Cayman, Cayman Islands British West Indies	Holding company	50.00	Cayman Islands
Liz Electronics (Kunshan) Co., Ltd. No. 989, Hanpu Road, Chengbei, Kunshan, Jiangsu, China	Manufacture and sale of chip resistors, ceramic capacitors and, chip diodes	30.00	PRC
Maxima Venture Co., Ltd. 1st Floor, No. 91, Song Ren Road, Taipei 110, Taiwan, ROC	Venture capital	31.99	Taiwan
Panpal Technology Corp. 7th Fl, 319 Pa-Teh Rd., Sec. 4, Taipei 105, Taiwan, ROC	Wholesale of notebook PCs and monitors	99.99	Taiwan

<u>Name and registered office of subsidiary/associated company</u>	<u>Main business</u>	<u>Our effective equity interest (%)</u>	<u>Jurisdiction of incorporation</u>
Prospect Fortune Group Ltd. Tropic Isle Building, P.O. Box 438, Road Town, Tortola, British Virgin Islands	Wholesale of notebook PCs, wireless handsets and PDAs	100.00	British Virgin Islands
RF Integrated Corp. 15375 Barranca Parkway, Suite B-109, Irvine, CA 92618, U.S.A.	GaAs RF IC design	16.25	U.S.A.
SaveCom InfoCom Inc. 7th Fl, 319 Pa-Teh Rd., Sec. 4, Taipei 105, Taiwan, ROC	Fixed line business	99.97	Taiwan
Sceptre Industries Inc. 16800 East Gale Ave., City of Industry, CA 91745 U.S.A.	Maintenance and wholesale of notebook PCs and monitors	60.00	U.S.A.
Softchina Venture Capital Corp. 13F-2, No. 50, Sec. 1, Chung Hsiao W. Rd., Taipei 100, Taiwan, ROC	Venture capital	15.00	Taiwan
Softchina (II) VC Corp. 13F-2, No. 50, Sec. 1, Chung Hsiao W. Rd., Taipei 100, Taiwan ROC	Venture capital	15.00	Taiwan
Solomon Solutions Services Suite 3149 3F No. 3 Pei-Ping West Road, Taipei, Taiwan, ROC	Solution provider for hospitals and medical service providers	10.77	Taiwan
Swenc Technology Co. Ltd. 6F, No. 26 Wen Hua Road, Hsin Chu Industrial Park, Hsinchu Hsien 303, Taiwan, ROC	Design, manufacture and sale of touch panels	48.27	Taiwan
Taiwan 3G Mobile Network Co., Ltd. 5th Fl., 36, Lan 358, Juikung Rd., Neihu, Taipei 114, Taiwan, ROC	Third generation mobile phone and value added services	12.50	Taiwan
Toppoly Optoelectronics Corp. 5F, No. 18, Creation Road I, Science-Based Industrial Park, Hsinchu, Taiwan, ROC	Manufacture and sale of LTPS TFT-LCD panels	30.11	Taiwan

<u>Name and registered office of subsidiary/associated company</u>	<u>Main business</u>	<u>Our effective equity interest (%)</u>	<u>Jurisdiction of incorporation</u>
Uniflex Technology Inc. 6F, 22, Lane 583, Nei Hu District Jui-Kuang Rd., Taipei, Taiwan, ROC	Flex printed circuit board manufacturing	14.66	Taiwan
Vacom Wireless Inc. 5-6fl, Yung Chang B/D, 250, Choul San-3 Dong, Kwang Meong City, Kyunggi-Do, Korea	Research and development on electric and communication apparatus	83.23	Korea

Description of Consolidated Subsidiaries

Panpal Technology Corp. was incorporated on August 20, 1997, with a paid-in capital of NT\$3,472.0 million. The registered office for Panpal is at 7th Fl, 319 Pateh Road, Section 4, Taipei 105, Taiwan, ROC. Its principal activities consist of investing in businesses relating to the PC industry. As of August 15, 2002, we owned a 99.99% stake in Panpal. As of and for the year ended December 31, 2001, Panpal had total assets, revenues and net profit of approximately NT\$3,426.0 million, NT\$0.0 and NT\$121.7 million, respectively (NT\$4,378.1 million, NT\$194.9 million and NT\$212.2 million, respectively, in 2000). The revenue for fiscal year 2001 was NT\$0.0 because from 2001 Panpal is purely a holding company with no operating revenue, whereas prior to 2001, Panpal was also a trading company. All the shares in Panpal have been fully paid up. Panpal paid cash dividends of NT\$3.5 million for the year ended December 31, 2001. There are no intracompany loans between Panpal and our company other than the loans outstanding owed by Gempal to Panpal described below under “— Related Party Transactions — Transactions with Other Related Parties”.

Just International Ltd. was incorporated on August 25, 1992, with a paid-in capital of U.S.\$27.8 million. The registered office for Just is at Tropic Isle Building, P.O. Box 438, Road Town, Tortola, British Virgin Islands. Its principal activities consist of acting as a holding company. As of August 15, 2002, we owned a 100.0% stake in Just. As of and for the year ended December 31, 2001, Just had total assets, revenues and net profit of approximately U.S.\$203.8 million, U.S.\$388.0 and U.S.\$5.8 million, respectively (U.S.\$153.7 million, U.S.\$387.5 million and U.S.\$13.6 million, respectively, in 2000). All the shares in Just have been fully paid up. Just did not pay any dividend for the year ended December 31, 2001. There are no intracompany loans between Just and our company.

Related Party Transactions

Relationship with Kinpo Electronics, Inc.

Kinpo is our largest shareholder and we are the largest shareholder of Kinpo. As of July 9, 2002, the most recent record date for which we have such shareholder information, Kinpo held 4.57% of our share capital and as of August 15, 2002, we held 10.32% of Kinpo's share capital. Kinpo designs and manufactures consumer electronic products, communications products and PC peripheral products. Mr. Sheng-Hsiung Hsu, Chairman of the Board of Kinpo, is also Chairman of our Board. In addition, there are four common directors and two common supervisors serving on both Boards. The original shareholders of Kinpo were Mr. Chao-Yin Hsu and certain members of his extended family. Transactions between Compal and Kinpo in recent years have not been material. Decisions made by the respective Boards of Directors of Kinpo and Compal are made independently of each other. However, there can be no assurance that Kinpo and Compal will not continue to pursue product expansion and diversification strategies which result in direct competition between the two companies.

We have invested NT\$1 billion for a 12.50% equity interest in Taiwan 3G. Taiwan 3G is one of the five 3G cellular license holders in Taiwan. Kinpo holds a 18.80% interest in Taiwan 3G, and Mr. Sheng-Hsiung Hsu is the Chairman of our company, Kinpo and Taiwan 3G.

Transactions with Other Related Parties

We sell our products to certain of our related parties, including Bizcom, a wholly owned subsidiary in the United States that is engaged in configuring our products and after-sales service, with respect to which we had net sales of NT\$959.7 million or 1.2% of our consolidated net sales for the year ended December 31, 2001, and Compower International Ltd., an equity method accounted affiliate, with respect to which we had net sales of NT\$141.0 million or 0.2% of our consolidated net sales for the year ended December 31, 2001. The sales price and terms to such related parties were similar to those for third-party customers. Total notes and accounts receivable from related parties as of December 31, 2001, was NT\$566.0 million, of which NT\$374.4 million was due from Bizcom.

We also purchase goods from related parties, including Compal Communications, an equity method accounted affiliate, from which we purchased NT\$178.7 million in goods or 0.3% of our total net purchases for the year ended December 31, 2001, and Acbel Polytech Inc., the chairman of which is our Chairman, from which we purchased NT\$173.0 million in goods, or 0.3% of our total net purchases for the year ended December 31, 2001. The sales price and terms to such related parties were similar to those for third-party suppliers. Total notes and accounts payable to related parties as of December 31, 2001, was NT\$157.2 million, of which NT\$108.0 was payable to Compal Communications.

In addition, Compal Electronics sold shares of Compal Communications amounting to NT\$123.4 million to Gempal, our wholly owned subsidiary, at book value, which was financed by a loan of NT\$120.5 million which Panpal extended to Gempal. Such loan matures on September 4, 2002, and bears interest at 2.75% per annum. Compal Electronics also sold shares of International Semiconductor Technology Ltd. at its original purchase price amounting to NT\$17.1 million to Gempal, which was financed by a loan of NT\$17.0 million extended to Gempal by Panpal. Such loan matures on October 17, 2002, and bears interest at 2.75% per annum. We also lease office space and plant space to Compal Communications. For the year ended December 31, 2001, the aggregate rent paid by Compal Communications to us was NT\$23.3 million.

We also had an aggregate of U.S.\$3.0 million in guarantees issued in favor of two related parties. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources" and note 16 of the Notes to the Consolidated Financial Statements for the Years Ended December 31, 1999, 2000 and 2001 and note 17 of the Notes to the Consolidated Financial Statements for the six-month period ended June 30, 2002.

MANAGEMENT

Our Board of Directors has ultimate responsibility for the management of our business and affairs. At present, there are eleven Directors and three Supervisors who are elected by our shareholders at our general shareholders' meeting. The term of office for Directors and the Supervisors is three years. Under our Articles of Incorporation, the Board of Directors is required to elect a Director to act as a Chairman. Our Chairman is the legal representative under the Company Law.

Our Articles of Incorporation require the election of three Supervisors. Under the Company Law, each Supervisor is responsible for overseeing the activities of the Board of Directors and has power to investigate our business and financial condition, examine our books, records and documents and request the Board of Directors to submit reports. A Supervisor may engage independent experts to carry out any such investigations or examinations at our cost. A Supervisor may also convene a meeting of shareholders when he deems it necessary.

We may, under the Company Law, by resolution adopted at a shareholders' meeting, allow any of our Directors to be a director of another company with the same or a similar scope as our business or to engage in any businesses within the scope of our business. However, a Director is precluded from voting in respect of any discussions regarding contracts or arrangements where he has, or will have, a direct or indirect personal interest or benefit.

The present Board of Directors was elected by our shareholders on March 30, 2000 for a term of three years expiring on March 29, 2003.

The particulars of each of our Directors, Supervisors and Senior Executives are set forth as follows:

Name	Position with Compal	Age	Years with Compal(1)
Hsu, Sheng-Hsiung	Chairman	59	18
Chen, Jui-Tsung	Director and President	53	27
Hsu, Wen Being	Director	53	18
Lin, Lina	Director (Representative of Kinpo Electronics, Inc.) (2)	54	3
Hsu, Sheng-Chieh	Director	55	11
Hou, Lee-Chun	Director	51	5
Lin, Kuang Nan	Director	58	14
Chang, Yung-Ching	Director and President of the Operation Business Unit	45	11
Chen, Jui-Hsuin	Director (Representative of China Development Industrial Bank) (2)	54	1
Shen, Wen-Chung	Director, Executive Vice President and President of the Computer Business Unit	49	11
Yang, Yu-Chin	Director	53	6
Ko, Charng-Chyi	Supervisor	67	18
Chou, Yen-Chia	Supervisor	53	5
Hsu, Chiung-Chi	Supervisor	38	8
Wang, Ping-Hsien	Executive Vice President and President of the Display Business Unit	53	25
Kung, Shao-Tsu	Senior Vice President, Computer Business Unit	42	11
Chang, Kao-An	Vice President, China Operations	43	11
Lin, Jui-ching	Vice President, Strategic Investment	49	17
Tso, Tseng-chin	Vice President, Human Resources & Administration	49	2

(1) Includes years worked with Kinpo.

(2) The number of years with Compal indicated is the number of years the relevant company has had a Representative on the Board.

Sheng-Hsiung Hsu, aged 59, is our Chairman. He received a bachelor's degree from National Taiwan Normal University. He has been with us for 18 years. He is also the Chairman of the Board of Directors of Kinpo, Panpal, Gempal, C&C Laboratory Co., Ltd., Compal Electronics (China) Ltd., Compower International Ltd. and Sceptre Industries Inc.

Jui-Tsung Chen, aged 53, is our President and a Director. He received a bachelor's degree from National Cheng Kung University (Electrical Engineering Department). He has been with us for 27 years and he is in charge of our operations. He is also the Chairman of the Board of Directors of International Semiconductor Technology Ltd., Toppoly Optoelectronics Corp. and Bizcom Electronics, Inc. Mr. Chen is also a Director of Kinpo, Panpal, Gempal, VACOM and C&C Laboratory Co., Ltd.

Wen Being Hsu, aged 53, is a Director. He graduated from National Tao-Yuan Senior Vocational Agricultural & Industrial School. He has been with us for 18 years.

Lina Lin, aged 54, is a Director as representative of Kinpo. She received a bachelor's degree from Chinese Culture University (Business Administration Department). She has been with us for 11 years.

Sheng-Chieh Hsu, aged 55, is a Director. He received a bachelor's degree from Tam Kang University (Architectural Department). He has been with us for 11 years. He is also a director of Kinpo.

Lee-Chun Hou, aged 51, is a Director. He is in charge of Manufacturing and Quality Control. He received a bachelor's degree from Chung Yuan Christian University (Industrial Engineering Department). He has been with us for 25 years.

Kuang Nan Lin, aged 58, is a Director. He received a bachelor's degree from Tam Kang University (Mathematics Department). He has been with us for 14 years.

Yung-Ching Chang, aged 45 is a Director and the President of the Operation Business Unit. He received a bachelor's degree from National Tsing Hua University (Industrial Engineering Department). He has been with us for 11 years.

Jui-Hsuin Chen, aged 54, is a Director as representative of China Development Industrial Bank. He is an Executive Vice President of China Development Industrial Bank. He received a bachelor's degree from Tung Hai University (Economics Department).

Wen-Chung Shen, aged 49, is an Executive Vice President and a Director. He is the President of the Computer Business Unit and in charge of R&D, Sales and Marketing and Global Logistics. He received a bachelor's degree from National Taiwan University (Electrical Engineering Department). He has been with us for 11 years. He is also a director of Panpal, Gempal, C&C Laboratory Co., Ltd., International Semiconductor Technology Ltd. and Toppoly Optoelectronics Corp.

Yu-Chin Yang, aged 53, is a Director. He received a bachelor's degree from Waseda University, Japan. He has been with us for six years. He is also a director of Kinpo.

Charng-Chyi Ko, aged 67, is a Supervisor. He received a bachelor's degree from National Taiwan University (Division of Business). He has been with us for 18 years. He is also a supervisor of Kinpo.

Yen-Chia Chou, aged 53, is a Supervisor. He received a bachelor's degree from National Taiwan University (Geology Department). He has been with us for five years. He also is a supervisor of Kinpo.

Chiung-Chi Hsu, aged 37, is a Supervisor. He received a Master's degree from San Francisco Golden Gate University. He has been with us for eight years.

Ping-Hsien Wang, aged 53, is a Senior Vice President and President of the Display Business Unit. He was educated in the Electronics Department of National Chiao Tung University. He has been with us for 25 years.

Shao-Tsu Kung, aged 42, is a Senior Vice President in the Computer Business Unit. He was educated in the Electrical Engineering Department of National Taiwan University. He has been with us for 11 years.

Kao-An Chang, aged 43, is a Vice President in charge of China Operations. He was educated in the Electronical Engineering Department of Chung Yuan Christian University. He has been with us for 11 years.

Jui-ching Lin, aged 49, is a Vice President in charge of strategic investment. He was educated in the Industrial Engineering Department of Chung Yuan Christian University. He has been with us for 17 years.

Tseng-chin Tso, aged 49, is in charge of Human Resources and Administration. He was educated in the Electrical Engineering Department of National Taiwan University. He has been with us for two years.

As of July 9, 2002 (and not including Common Shares distributed in August 2002 pursuant to an employee stock bonus), the Directors, Supervisors, Senior Executives and their families (spouses and children) held, directly or indirectly, approximately 9.22% of our issued Common Shares.

Subject to proposal by the Board of Directors and approval by shareholders, the Directors, Supervisors and Senior Executives are entitled to annual remuneration amounting to up to 2% of the net income allocated for distribution after offsetting accumulated net losses of prior years, any applicable income tax payments and a 10% appropriation to the legal reserve (until the accumulated legal reserve is equal to the amount of our paid-in share capital). The aggregate remuneration and benefits-in-kind granted to our Directors and Supervisors in their capacities as Directors and Supervisors for the year ended December 31, 2001, was approximately NT\$108.1 million (U.S.\$3.2 million).

There have been no loans or advances made by us or any of our subsidiaries to, or guarantees given by us or any of our subsidiaries in relation to loans or advances received by the Directors, and none of the Directors, Supervisors or Senior Executives have or have had interests in transactions which are or were unusual in their nature or conditions or significant in relation to our business or any of our subsidiaries and which were effected by us during the current financial year or the financial year immediately preceding the date of this document, or were effected by us during earlier financial years and remain, in any respect, outstanding or unperformed.

The business address of all our Directors, Supervisors and Senior Executives is 7th Floor, 319 Pateh Road, Section 4, Taipei 105, Taiwan, ROC.

PRINCIPAL SHAREHOLDERS

Kinpo is our largest shareholder. As of July 9, 2002, the date for which the latest information was available, Kinpo held approximately 116.3 million Common Shares, or 4.57% of our outstanding Common Shares.

The following table sets forth certain information, as of July 9, 2002, the date for which the latest information is available, with respect to the Common Shares owned by our top 10 shareholders.

<u>Name of Shareholder(1)</u>	<u>Number of Common Shares</u>	<u>Percentage of total outstanding Common Shares (%)</u>
1 Kinpo Electronics, Inc.	116,340,824	4.57
2 Directorate General of Postal Remittances and Savings Banks.....	106,579,644	4.18
3 Templeton Foreign Fund (a series of Templeton Funds, Inc.)	41,280,000	1.62
4 The National Financial Stabilization Fund.....	39,290,400	1.54
5 Management Board of Public Service Pension Fund	36,028,500	1.41
6 Jui-Tsung Chen(2)	35,413,557	1.39
7 Panpal Technology Corp.(3)	31,037,224	1.22
8 Li-Cu Hsu Tsai	30,270,487	1.19
9 The Labor Retirement Fund Supervisory Committee	29,484,750	1.16
10 Gempal Technology Corp.(3)	<u>21,006,876</u>	<u>0.82</u>
Total	<u>486,732,262</u>	<u>19.11</u>
Total Common Shares outstanding	2,547,659,000	

Notes:

- (1) The Bank of New York is the depository for the GDSs and holds approximately 149.9 million Common Shares, or 5.88% of our outstanding Common Shares, on behalf of our shareholders. See "Description of the Global Depository Receipts — Information Relating to the Depository".
- (2) Jui-Tsung Chen is our President. Figures do not include Common Shares expected to be distributed in July or August 2002, pursuant to an employee stock bonus.
- (3) Our 99.99%-owned subsidiary.

As of July 9, 2002, the date for which the latest information is available, the total number of Common Shares currently held by the Directors and Supervisors, Senior Executives, their spouses and minor children (including the Common Shares held by Kinpo and China Development Industrial Bank, each of which is represented by a director on our Board of Directors, but not including Common Shares distributed on August 28, 2002, pursuant to an employee stock bonus) was 234,977,175, or 9.22% of the outstanding Common Shares.

CHANGES IN ISSUED SHARE CAPITAL

According to our Articles of Incorporation, we have only one class of capital stock, Common Shares with a par value of NT\$10 per share. Currently, our Articles of Incorporation provide that our authorized share capital is NT\$34,800,000,000 divided into 3,480,000,000 Common Shares, which includes 300,000,000 Common Shares reserved for issuance upon exercise of employee stock options or warrants. All issued Common Shares are in registered form.

The following table shows, *inter alia*, the increases in our issued share capital since June 1984:

<u>Date of Issue</u>	<u>Type of Issue</u>	<u>Number of Common Shares Issued</u>	<u>Number of Common Shares outstanding after Issue</u>
June 1984	Incorporation	5,000,000	5,000,000
July 1986	Rights Issue	3,000,000	8,000,000
June 1987	Rights Issue	5,000,000	13,000,000
June 1988	Rights Issue	6,890,000	19,890,000
April 1990	Rights Issue	30,000,000	49,890,000
September 1991	From Retained Earnings	7,483,500	65,355,900
	From Capital Reserves	7,982,400	
September 1992	From Retained Earnings	1,960,677	76,466,403
	From Capital Reserves	9,149,826	
November 1993	From Capital Reserves	7,646,640	100,000,000
	Rights Issue	15,886,957	
October 1994	From Retained Earnings	10,000,000	150,200,000
	From Capital Reserves	10,000,000	
	Employees' bonuses	200,000	
	Rights Issue	30,000,000	
October 1995	From Retained Earnings	22,530,000	258,300,000
	From Capital Reserves	15,020,000	
	Employees' bonuses	550,000	
	Rights Issue	70,000,000	
May 1996	From Retained Earnings	7,749,000	297,600,000
	From Capital Reserves	30,996,000	
	Employees' bonuses	555,000	
December 1996	Rights Issue	70,000,000	367,600,000
April 1997	Conversion of convertible bonds	13,023,560	380,623,560
August 1997	From Retained Earnings	22,837,413.6	497,018,000
	From Capital Reserves	91,349,654.4	
	Employees' bonuses	2,207,372	
September 1997	Conversion of convertible bonds	24,174,233	521,192,233
December 1997	Rights Issue	60,000,000	581,192,233
March 1998	Conversion of convertible bonds	2,651,768	583,844,001
May 1998	From Retained Earnings	58,384,400	834,369,000
	From Capital Reserves	175,153,200	
	Employees' bonuses	16,987,399	
September 1998	Conversion of convertible bonds	10,272,722	844,641,722
February 1999	Rights Issue	2,200,000	846,841,722
March 1999	Conversion of convertible bonds	2,668,338	849,510,060

<u>Date of Issue</u>	<u>Type of Issue</u>	<u>Number of Common Shares Issued</u>	<u>Number of Common Shares outstanding after Issue</u>
May 1999	From Retained Earnings	297,328,521	1,171,190,000
	Employees' bonuses	24,351,419	
June 1999	Conversion of convertible bonds	1,085,200	1,172,275,200
September 1999	Conversion of convertible bonds	2,798,115	1,175,073,315
January 2000	Rights Issue	1,560,000	1,176,633,315
March 2000	Conversion of convertible bonds	126,705	1,176,760,020
May 2000	From Retained Earnings	82,373,201	1,556,770,000
	From Capital Reserves	270,654,805	
	Employees' bonuses	26,981,974	
December 2000	Conversion of convertible bonds	64,837	1,556,834,837
May 2001	Conversion of convertible bonds	2,468,352	1,559,303,189
May 2001	From Retained Earnings	233,525,225	1,978,418,352
	From Capital Reserves	155,683,483	
	Employees' bonuses	29,906,455	
	Issuance of GDS	100,000,000	2,078,418,352
June 2001	Rights Issue	23,396,492	2,101,814,844
March 2002	Conversion of convertible bonds	8,228	2,101,823,072
July 2002	From Retained Earnings	209,426,407	2,547,659,000
	From Capital Reserves	209,426,407	
	Employees' bonuses	26,983,114	

DESCRIPTION OF THE NOTES

The Notes shall be issued under an indenture dated as of October 9, 2002, (the "Indenture") between the Company and The Bank of New York, in its capacity as trustee (the "Trustee") for the holders of the Notes (the "Holders"). The following summary of certain provisions of the Notes and the Indenture does not purport to be complete and is subject to, and is qualified in its entirety by reference to, the provisions of the Notes and Indenture, including the definitions of certain terms therein. Copies of the Indenture will be available for inspection by any Holder on or after the Original Issue Date during normal business hours (as defined below) at the corporate trust office of the Trustee.

General

Except in the limited circumstances set forth under "Global Notes — Individual Definitive Certificates", Notes will only be issued in book-entry form. Accordingly, the following description of the Notes which makes reference to Notes in definitive form should be read in conjunction with the information set forth under "Global Notes".

The Notes will be issued on October 9, 2002, (the date on which the Notes are originally issued under the Indenture being referred to herein as the "Original Issue Date") as direct, unsecured, unsubordinated and unconditional obligations of the Company limited in aggregate principal amount to U.S.\$300,000,000 (or U.S.\$345,000,000 if the Purchasers' over-allotment option is exercised in full) and will be redeemed on October 9, 2007, (the "Maturity Date") unless earlier redeemed, repurchased and cancelled or converted pursuant to the terms thereof and of the Indenture.

The Notes will not bear interest except in the limited circumstances described below under "— Default Interest".

Each Note will be convertible, subject to compliance with certain conditions and procedures (see "— Conversion — Procedures; Conversion Notice; Taxes and Duties") at the Holder's election on any Business Day during the period (the "Conversion Period") commencing on November 9, 2002 (the 30th day following the Original Issue Date) and ending at the close of business in the location of the applicable Conversion Agent (i) on September 9, 2007, or (ii) on the fifth (5th) Business Day prior to the applicable Purchase Date of such Note or date fixed for redemption of such Note pursuant to a notice of redemption given by the Company in accordance with the provisions of the Indenture. The Conversion Period shall not include any Closed Period (as defined below). In the event that the Conversion Period is changed or modified, the Company will promptly (but in no event later than seven days after such change or modification) notify the Luxembourg Stock Exchange of such change or modification, and a publication will be made in an Authorized Newspaper as described under "— Notices".

The principal, premium and interest (if any) on the Notes will be payable in U.S. Dollars by the Company pursuant to the Notes, and the Notes may be presented for registration of transfer, exchange or conversion at the office or agency of the Company maintained for such purpose (the "Paying Agent", "Conversion Agent", or "Transfer Agent") located (i) in the Borough of Manhattan, The City of New York (which initially will be the corporate trust administration office of the Trustee, currently located at 101 Barclay Street, 21st Floor West, New York, New York 10286) or (ii) as long as the International Notes are listed on the Luxembourg Stock Exchange, and the rules of such exchange so require, in the Grand Duchy of Luxembourg (which initially will be the office of Banque Generale du Luxembourg S.A. currently located at 50, Avenue J.F. Kennedy, L-2951, Luxembourg).

The Company reserves the right, subject to the provisions of the Indenture, at any time to vary or terminate the appointment of any Paying Agent, Conversion Agent or Transfer Agent and to appoint further or other Paying Agents, Conversion Agents or Transfer Agents, *provided* that the Company will at all times maintain Paying Agents having offices in the Grand Duchy of Luxembourg (as long as the Notes are listed on the Luxembourg Stock Exchange and the rules of such exchange so require) and the Borough of Manhattan, The City of New York. Notice of any such termination or appointment and of any changes in the specified offices of the Paying Agents, Conversion Agents or Transfer Agents will be given

promptly by the Company to the Holders in accordance with the notice provisions of the Indenture as described below under “— Notices”.

No service charge will be payable for any registration of transfer or exchange of the Notes or for the conversion thereof, but the Company may require payment by a Holder of a sum sufficient to cover any transfer or stamp tax or other similar governmental charge payable in connection therewith and the Depository may require payment of its fees and expenses upon deposit of Common Shares for issuance of GDSs.

The Company and its Affiliates may at any time, subject to applicable law, purchase Notes in the open market, or otherwise, at any price. Any Notes owned by the Company or any of its Affiliates will be deemed not to be outstanding for certain purposes of the Indenture.

Book Entry; Delivery and Form

Except in the limited circumstances set forth under “Global Notes — Individual Definitive Certificates”, Notes will only be issued in book-entry form. International Notes sold in offshore transactions in reliance on Regulation S will be represented by a permanent global International Note or Notes in fully registered book-entry form without interest coupons (the “International Global Notes”) and will be registered in the name of a nominee of a common depository for Euroclear and Clearstream, Luxembourg which initially shall be The Bank of New York Depository (Nominees) Limited. Rule 144A Notes may be sold within the United States only to QIBs and will be represented by a permanent restricted global Rule 144A Note or Notes in fully registered book-entry form without interest coupons (the “Rule 144A Global Note” and, together with the International Global Note, the “Global Notes”) deposited with a custodian for The Depository Trust Company (“DTC” and, together with any successor, the “Depository”) and registered in the name of a nominee of DTC. The Notes will have minimum denominations of U.S.\$1,000 and any integral multiple of U.S.\$1,000 in excess thereof.

In the event individual definitive certificates are to be issued in respect of the Notes pursuant to the Indenture, the Company will give notice to the Holders. Such notice will be made by mail and by publication in an Authorized Newspaper (which so long as the Notes are listed on the Luxembourg Stock Exchange is expected to be the *Luxemburger Wort*), which notice shall specify, among other things, the procedures for receiving individual definitive certificates and for receiving payments and exercising Conversion Rights (as defined below) in respect of Notes in definitive form and, so long as the Notes are listed on the Luxembourg Stock Exchange, the name and address of the Paying Agent, Conversion Agent or Transfer Agent in Luxembourg.

The Notes are not issuable in bearer form.

Ranking

The Notes will (i) be direct, unsecured, unsubordinated and unconditional obligations of the Company, (ii) rank at least *pari passu* in right of payment with all other direct, unsecured, unsubordinated and unconditional Debt (as defined below) of the Company now or hereafter outstanding (except to the extent that such other Debt (x) ranks above such obligation solely by reason of Liens (as defined below) permitted under the Indenture or (y) is preferred by mandatory provisions of law) and (iii) be senior in right of payment to all Debt of the Company that is expressed to be subordinated in right of payment to the Notes.

The Notes will be effectively subordinated to all secured obligations of the Company with respect to claims against the assets securing such obligations (“Secured Debt”). As of May 31, 2002, on a pro forma basis after giving effect to the issuance of the Notes and the use of the proceeds therefrom, the Company had no Secured Debt outstanding.

Sinking Fund

The Notes will not be entitled to the benefit of a sinking fund.

Further Issues

The Company may, from time to time without the consent of the holders of any Notes, create and issue further securities under the Indenture having the same terms and conditions as the Notes in all respects so that such further issue shall be consolidated and form a single series with the outstanding Notes.

Transfer of Certificated Notes and Delivery of New Certificated Notes**(i) Transfer of Certificated Notes**

Certificated Notes may be transferred upon the surrender at the Corporate Trust Office (as defined in the Indenture) or at the office of any Transfer Agent of the Certificated Notes to be transferred, together with the form of transfer endorsed thereon (the "Form of Transfer") duly completed and executed and any other evidence that such Transfer Agent may reasonably require. In the case of a transfer of only part of a holding of Certificated Notes, a new Certificated Note shall be issued to the transferee in respect of the part transferred and a further new Certificated Note in respect of the balance of the holding not transferred shall be issued to the transferor. The Form of Transfer is available at the specified office of the Transfer Agent.

(ii) Delivery of New Certificated Notes

Each new Certificated Note shall be available for delivery upon receipt by the Transfer Agent at its specified office of the relevant Certificated Note and the Form of Transfer. Delivery of the new Certificated Notes shall be made at the specified office of such Transfer Agent to whom the relevant Certificated Note and the Form of Transfer shall have been surrendered or delivered or, at the option of the Holder making such delivery or surrender as aforesaid and as specified in the relevant Form of Transfer or otherwise in writing, be mailed by uninsured post at the risk of the Holder entitled to the new Certificated Note to such address as may be so specified, unless such Holder requests otherwise and pays in advance to the relevant Transfer Agent the costs of such other method of delivery and/or such insurance as it may specify.

(iii) Formalities Free from Charge

Transfers of the Certificated Notes will be effected without charge by or on behalf of the Company or any Transfer Agent, but only upon payment (or the giving of such indemnity as such Transfer Agent may require in respect) of any tax or other governmental charges which may be imposed in relation thereto.

(iv) Restricted Transfer Periods

No Noteholder may require the transfer of a Certificated Note to be registered during the period of 15 days ending on (and including) a Redemption Date.

Additional Amounts

All payments of the principal, premium and interest (if any) on the Notes and all deliveries of Common Shares made on conversion of the Notes are to be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or other governmental charges ("Taxes") imposed, levied, collected, withheld or assessed by or within the ROC (or any political subdivision or Taxing Authority (as defined below) thereof or therein), unless such withholding or deduction is required by law or by regulation or governmental policy having the force of law and cannot be reasonably avoided by the Company. In the event that any such withholding or deduction is so required, the Company will pay such additional amounts on the Notes (all such additional amounts being referred to herein as

“Additional Amounts”) as will result in receipt by the Holder of each Note of such amounts as would have been received by such Holder had no such withholding or deduction been required, except that no Additional Amounts shall be payable for or on account of:

(i) any Taxes that would not have been imposed but for:

(A) the existence of any present or former connection between the Holder of such Note and the ROC (or any other jurisdiction from which any payment on the Notes is made), other than merely holding such Note, including such Holder being or having been a national, domiciliary or resident of or treated as a resident thereof or being or having been present or engaged in a trade or business therein or having had a permanent establishment therein;

(B) the presentation of such Note (if presentation is required) more than 30 days after the later of the date on which the payment of the principal, premium and interest (if any) on such Note became due and payable pursuant to the terms thereof or the date that such payment was made or duly provided for, *except* to the extent that the Holder thereof would have been entitled to such Additional Amounts if it had presented such Note for payment on any date within such 30 day period; or

(C) the presentation of such Note for payment in the ROC (or any other jurisdiction from which any payment on the Notes is made), unless such Note could not have been presented for payment elsewhere;

(ii) any estate, inheritance, gift, sale, transfer, stamp, personal property or similar tax, assessment or other governmental charge;

(iii) any withholding or deduction imposed on a payment to an individual and required to be made pursuant to any European Union Directive on the taxation of savings implementing the conclusions of the ECOFIN Council meeting of November 26-27, 2000, or any law implementing or complying with, or introduced in order to conform to, such Directive;

(iv) the presentation for payment (if presentation is required) of such Note by or on behalf of a Holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another paying agent in a Member State of the European Union; or

(v) any combination of Taxes referred to in the preceding clauses (i) through (iv).

The Company will not pay Additional Amounts if the registered Holder of the Note is a fiduciary, partnership or other than the sole beneficial owner of any payment to the extent that a beneficiary or settlor with respect to a fiduciary, a member of a partnership or the beneficial owner of that payment would not have been entitled to the Additional Amounts if it had been the registered Holder of the Note.

Whenever there is mentioned, in any context, (i) the payment of principal, premium and interest (if any) on any Note or (ii) the delivery of Common Shares, GDSs or cash payments (if any) on conversion of any Note, such mention shall be deemed to include the payment of Additional Amounts to the extent that, in such context, Additional Amounts are, were or would be payable with respect thereto.

Redemption for Taxation Reasons

The Notes may be redeemed, in whole but not in part, at the option of the Company, at any time, on not less than 30 nor more than 60 days' notice to Holders (which notice shall be irrevocable) and upon reasonable notice to the Trustee, at the Early Redemption Amount on the Redemption Date (as defined below) if, as a result of any change in, or amendment to, the laws (including any regulations or rulings promulgated thereunder) of the ROC or such other jurisdiction in which the Company is then incorporated and organized (or any political subdivision or Taxing Authority thereof or therein), affecting taxation, or any change in official position regarding the application, interpretation or administration of such laws, regulations or rulings (including a holding, judgment or order by a court of competent jurisdiction), which change, amendment, application, interpretation or administration is proposed and

becomes effective on or after the Original Issue Date (or, in the case of any jurisdiction other than the ROC, the date on which the Company first becomes incorporated and organized in such other jurisdiction) with respect to any payment due or to become due on the Notes, the Company is required to pay Additional Amounts in connection therewith and such requirement to pay Additional Amounts cannot be avoided by the taking of reasonable measures by the Company, *provided that* such right cannot be exercised earlier than 30 days prior to the first date on which the Company would be obligated to make an Additional Amounts payment with respect to all or substantially all of the outstanding Notes. Prior to the giving of any such notice of redemption, the Company is required to deliver to the Trustee (i) an Officers' Certificate stating that such change or amendment has occurred, describing the facts related thereto and stating that such requirement cannot be avoided by the Company taking reasonable measures and (ii) an Opinion of Counsel or written advice of a qualified tax expert that the circumstances referred to in the preceding sentence exist as a result of such change, amendment, application, interpretation or administration. The notice of such redemption for tax reasons will be made by mail and by publication in an Authorized Newspaper (as defined in the Indenture, which so long as the Notes are listed on the Luxembourg Stock Exchange, will be the *Luxemburger Wort*) which notice shall specify, among other things, the Redemption Date (as defined below), the redemption price and the places of payment.

Redemption at the Option of the Company

At any time on or after October 11, 2005, the Notes will be redeemable at the option of the Company, in whole or in part, on not less than 30 nor more than 60 days' notice to the Holders (which notice shall be irrevocable) and upon reasonable notice to the Trustee, at the Early Redemption Amount on the Redemption Date; *provided, however*, that no such redemption may be made unless:

- (1) (a) the Closing Price (translated into U.S. Dollars at the Prevailing Rate, as defined below) of the Common Shares for a period of 20 consecutive Trading Days, the last of which occurs not more than five days prior to the date on which notice of such redemption is given, is at least 130% of the Conversion Price (translated into U.S. Dollars at the Exchange Rate, as defined below) and
(b) the Closing Price of the GDSs, divided by the number of Common Shares represented by each GDS on such date, for a period of 20 consecutive Trading Days, the last of which occurs not more than five days prior to the date on which notice of such redemption is given, is at least 130% of the Conversion Price (translated into U.S. Dollars at the Exchange Rate); and
- (2) the applicable Redemption Date does not fall within a Closed Period.

Notwithstanding the foregoing sentence, the Company may redeem all of the Notes at any time, on not less than 30 nor more than 60 days' notice, at the Early Redemption Amount on the Redemption Date if at least 95% in principal amount of the Notes originally outstanding has been redeemed, repurchased and cancelled or converted, *provided that* the applicable Redemption Date does not fall within a Closed Period.

Notice of any such redemption will be given by the Company to the Holders in accordance with the notice provisions of the Indenture as described below under "— Notices".

If there shall occur an event giving rise to a change in the Conversion Price during any 20 consecutive Trading Day period, appropriate adjustments for the relevant days shall be made for the purpose of calculating the Closing Price for such days. The "Prevailing Rate" for the translation of the Closing Price of the Common Shares shall be the mean of the buying and selling rates quoted by Bank of Taiwan for U.S. Dollars at 11:00 a.m. (Taipei time) on each relevant Trading Day.

Redemption at Maturity

Unless the Notes have been previously redeemed, repurchased and cancelled or converted, the Company will redeem the Notes on the Maturity Date at a price equal to 114.63% of the outstanding principal amount thereof. The Notes may be redeemed prior to the Maturity Date only as described above.

Redemption Procedures

Payment of the relevant redemption price for a Certificated Note is conditioned upon delivery of such Note (together with necessary endorsements) to the Trustee or the office of any Paying, Conversion and Transfer Agent. Payment of the relevant redemption price for any Note will be made on the Redemption Date or, if such Note is a Certificated Note and has not been so delivered on or prior to the Redemption Date, at the time of delivery of such Note. If the Trustee holds, in accordance with the terms of the Indenture, cash sufficient to pay the relevant redemption price of such Note on the Redemption Date, then, immediately after such Redemption Date, such Note will cease to be outstanding and interest (if any) on such Note will cease to accrue, whether or not such Note is delivered to a Paying, Conversion and Transfer Agent, and all other rights of the Holder shall terminate (other than the right to receive the relevant redemption price).

Not less than 30 nor more than 60 days prior to the Redemption Date, the Company will provide sufficient information to the Trustee (including, but not limited to, a certificate of an independent investment bank or other expert at the expense of the Company, certifying the amount of Early Redemption Amount and the Redemption Premium on the Redemption Date) in sufficient time for the arrangement of the notice to the Holder.

In the case of any redemption other than on the Maturity Date, the notice of redemption to each holder shall specify the CUSIP or ISIN number (as applicable), the Redemption Date, the Early Redemption Amount on the Redemption Date, the price at which such Notes will be redeemed, the Closing Price of the Common Shares on the most recent practicable Trading Day, the place or places of payment and that payment will be made upon presentation and surrender of the Notes to be redeemed. Such notice shall also specify the Conversion Price then in effect and the date on which the right to convert such Notes will expire.

Certain Definitions

Set forth below is a summary of certain of the defined terms used in the covenants and other provisions of the Indenture. Reference is made to the Indenture for the full definition of all such terms, as well as any other capitalized terms used herein for which no definition is provided.

“Affiliate” means, with respect to any Person (the “Specified Person”), (i) any Person other than the Specified Person directly or indirectly controlling, controlled by or under direct or indirect common control with, the Specified Person or (ii) any Person who is a Director or executive officer (A) of the Specified Person, (B) of any Subsidiary of such Specified Person or (C) of any Person described in clause (i) above. For purposes of this definition, the term “control” when used with respect to any Person means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of such Person, whether through the ownership of voting securities or by contract or otherwise.

“Authorized Newspaper” means (i) if any Certificated Notes are outstanding, a leading English language newspaper having general circulation in the United States (which is expected to be *The Wall Street Journal*) and in Europe (which is expected to be the *Financial Times*, London Edition) and (ii) so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of such exchange so require, a leading newspaper having general circulation in Luxembourg, which is expected to be the *Luxemburger Wort*.

“Business Day” means any day except a Saturday, Sunday or other day on which commercial banks in London, England and The City of New York (or, if applicable, in the city where the relevant Paying Agent, Conversion Agent and Transfer Agent is located) are authorized by law to close or are otherwise not open for business.

“Capital Stock” means, with respect to any Person, any and all shares, ownership interests, participation or other equivalents (however designated), including all common stock and all preferred stock, of such Person.

“Certificated Notes” means the Notes executed and delivered by the Company and authenticated by the Trustee, which may be delivered in exchange for the Rule 144A Global Notes or International Global Notes in the circumstances described in “Global Notes — Individual Definitive Certificates”.

“Closing Price” means for any Trading Day (a) with respect to the Common Shares, the closing sales price of the Common Shares on the Taiwan Stock Exchange on such day or, if no reported sales take place on such day, the average of the reported closing bid and offered prices, in either case as reported by the Taiwan Stock Exchange for such day as furnished by a leading independent securities firm in Taiwan selected from time to time by the Company and approved by the Trustee for this purpose, (b) with respect to the GDSs, the closing bid price of the GDSs on the SEAQ International System of the London Stock Exchange on such day and (c) with respect to Capital Stock of the Company (other than Common Shares), the closing bid price for such Capital Stock (other than Common Shares) on the Selected Exchange (as defined below).

“Common Shares” means shares of the common stock of the Company, par value NT\$10 per share.

“Conversion Price” means the initial Conversion Price set forth on the cover of this Offering Memorandum, subject to adjustment in the manner provided in “— Conversion — Adjustments”.

“Debt” means, with respect to any Person at any date, without duplication, (i) all obligations of such Person for borrowed money, (ii) all obligations of such Person evidenced by bonds, debentures, notes or other similar instruments, (iii) all obligations of such Person to pay the deferred purchase price of property or services, except trade accounts payable arising in the ordinary course of business, (iv) all obligations of such Person as lessee which are capitalized in accordance with the generally accepted accounting principles applicable to such Person, (v) all Debt secured by a Lien on any asset of such Person, whether or not such Debt is otherwise an obligation of such Person, (vi) all obligations of such Person to purchase securities or other property that arise out of or in connection with the sale of the same or substantially similar securities or property, (vii) all non-contingent obligations of such Person to reimburse any bank or other Person in respect of amounts paid under a letter of credit or similar instrument and (viii) all Debt of others guaranteed by such Person.

“Default” means any condition or event which, with the giving of notice or lapse of time or both, would become an Event of Default.

“Early Redemption Amount” means an amount equal to 100% of the principal amount of the Notes redeemed plus the Redemption Premium. “Redemption Premium” means, an amount that is determined so that such Redemption Premium represents for the Holder a gross yield-to-maturity of 2.75% per annum (which is identical to the gross yield-to-maturity in the case of redemption at maturity), calculated on an annual basis. The applicable Early Redemption Amount for each U.S.\$1,000 principal amount of Notes is calculated in accordance with the following formula, rounded (if necessary) to two decimal places with 0.005 being rounded upwards (*provided* that if the date fixed for redemption is the Annual Date (as set out below), such Early Redemption Amount shall be as set out in the table below in respect of such Annual Date):

$$\text{Early Redemption Amount} = \text{Previous Redemption Amount} \times (1 + r/2)^{d/p}$$

Previous Redemption Amount = the Early Redemption Amount for each U.S.\$1,000 principal amount on the Annual Date immediately preceding the date fixed for redemption as set out below (or if the Notes are to be redeemed prior to April 9, 2003, U.S.\$1,000)

<u>Annual Date</u>	<u>Early Redemption Amount</u>	<u>Annual Date</u>	<u>Early Redemption Amount</u>
April 9, 2003	U.S.\$1,013.75	October 9, 2003	U.S.\$1,027.69
April 9, 2004	1,041.82	October 9, 2004	1,056.14
April 9, 2005	1,070.67	October 9, 2005	1,085.39
April 9, 2006	1,100.31	October 9, 2006	1,115.44
April 9, 2007	1,130.78	October 9, 2007	1,146.33

$r = 2.75\%$ expressed as a fraction.

d = number of days from and including the immediately preceding Annual Date (or if the Notes are to be redeemed on or before April 9, 2003, from and including the Closing Date) to, but excluding, the date fixed for redemption, calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed.

$p = 180$

“Fair Market Value” means with respect to any asset, the price which could be negotiated in an arm’s length free market transaction, for cash, between a willing buyer and a willing seller, neither of which is under pressure or compulsion to complete the transaction.

“Holder”, “holder” and “Noteholder” in relation to a Note means the person in whose name a Note is registered in the register of the Notes.

“Lien” means, with respect to any property or asset, any mortgage, lien, pledge, charge, security interest or encumbrance of any kind in respect of such property or asset, including, without limitation, the right of a vendor, lessor or similar party under any conditional sales agreement, capital lease or other title retention agreement relating to such property or asset, and any other right of or arrangement with any creditor to have its claims satisfied out of any property or assets, or the proceeds therefrom prior to any general creditor of the owner thereof.

“Market Value” means (i) in the case of Common Shares, the average of the Closing Prices of the Common Shares for the most recent 30 Trading Days, (ii) in the case of Capital Stock (other than Common Shares) which is listed on the Selected Exchange, the average of the Closing Prices of such Capital Stock (other than Common Shares) for the most recent 30 Trading Days and (iii) in the case the market value cannot be determined pursuant to the procedures above, the market value determined by an opinion of an independent, internationally recognized investment banking firm selected by the Company.

“Person” means any individual, firm, corporation, partnership, association, joint venture, tribunal, limited liability company, trust, government or political subdivision or agency or instrumentality thereof, or any other entity or organization.

“Principal Subsidiary” means, with respect to any Person, any Subsidiary whose net sales constitute at least 10% of the consolidated net sales of such Person and its consolidated Subsidiaries or whose total assets constitute at least 10% of the consolidated total assets of such Person and its consolidated Subsidiaries, *provided, however*, with respect to the Company, that “Principal Subsidiary” shall be deemed to include (but not be limited to) Compal International Holding Co., Ltd., Just International Ltd. and Panpal Technology Corp. and their successors.

“Purchase Date” has the meaning specified under the caption “— Repurchase of the Notes — Repurchase Procedures”.

“Redemption Date” means, with respect to any Note, (i) the date fixed for redemption of such Note pursuant to a notice of redemption given by the Company in accordance with the provisions of the

Indenture or (ii) the Maturity Date of such Note if such Note has not been redeemed, repurchased and cancelled or converted in accordance with its terms prior to the Maturity Date.

“Subsidiary” means, with respect to any Person, any entity of which more than 50% of its Capital Stock is owned, directly or indirectly, by such Person; *provided, however*, with respect to the Company, that “Subsidiary” shall be deemed to include (but not be limited to) Compal International Holding Co., Ltd., Just International Ltd. and Panpal Technology Corp. and their successors.

“Taxing Authority” means any government or political subdivision, or any authority or agency thereof, having the legal power and authority to levy a mandatorily payable charge, assessment or tax.

“Trading Day” means (a) with respect to the Common Shares, a day when the Taiwan Stock Exchange is open for business; *provided, however*, if no transaction price or closing bid and offered prices are reported by the Taiwan Stock Exchange in respect of the Common Shares for one or more Trading Days, such day or days will be disregarded in any relevant calculation and will be deemed not to have existed when ascertaining any period of consecutive Trading Days, (b) with respect to the GDSs, a day when a bid price is reported by the SEAQ International System of the London Stock Exchange in respect of the GDSs, *provided, however*, if no bid price is reported by the SEAQ International System of the London Stock Exchange in respect of the GDSs for one or more Trading Days, such day or days will be disregarded in any relevant calculation and will be deemed not to have existed when ascertaining any period of consecutive Trading Days and (c) with respect to Capital Stock of the Company (other than Common Shares), a day on which any securities exchange or quotation system selected by the Company (the “Selected Exchange”) on which such Capital Stock (other than Common Shares) are quoted or traded is open for trading or quotation; *provided, however*, if no bid price is reported by the Selected Exchange in respect of such Capital Stock (other than Common Shares) for one or more Trading Days, such day or days will be disregarded in any relevant calculation and will be deemed not to have existed when ascertaining any period of consecutive Trading Days.

Repurchase of the Notes

Repurchase of Notes at the Option of the Holders

Each Holder shall have the right (the “Holders’ Put Right”), at such Holder’s option, to require the Company to repurchase all (or any portion of the principal amount thereof which is U.S.\$1,000 or any integral multiple thereof) of such Holder’s Notes, on October 11, 2005 (the “Holders’ Put Date”) at the Early Redemption Amount on the Holder’s Put Date (the “Holders’ Put Price”).

Repurchase of Notes in the Event of Delisting

In the event that the Common Shares cease to be listed or admitted to trading on the Taiwan Stock Exchange (a “Delisting”), the Company shall, within seven days of the Delisting, notify the Holders of such Delisting, and each Holder shall have the right (the “Delisting Put Right”), at such Holder’s option, to require the Company to repurchase all (or any portion of the principal amount thereof which is U.S.\$1,000 or any integral multiple thereof) of such Holder’s Notes on the 20th Business Day after the Company gives to each Holder such notice regarding the Delisting referred to under “— Repurchase Procedures” below (the “Delisting Put Date”) at the Early Redemption Amount on the Delisting Put Date (the “Delisting Put Price”).

Repurchase of Notes in the Event of Change of Control

If a Change of Control, as defined below, occurs with respect to the Company, each Holder shall have the right (the “Change of Control Put Right”), at such Holder’s option, to require the Company to repurchase all (or any portion of the principal amount thereof which is U.S.\$1,000 or any integral multiple thereof) of such Holder’s Notes on the date set by the Company for such repurchase (the “Change of Control Put Date”), which shall be not less than 30 nor more than 60 days following the date on which

the Company notifies the Trustee of the Change in Control, at the Early Redemption Amount on the Change of Control Put Date (the "Change of Control Put Price").

The definitions of certain terms used in this section are listed below:

"control" means the right to appoint and/or remove all or the majority of the members of the Company's Board of Directors or other governing body, whether obtained directly or indirectly, and whether obtained by ownership of share capital, the possession of voting rights, contract or otherwise.

a "Change of Control" occurs when:

(1) any person or persons (as defined below) acting together acquires control of the Company if such person or persons does not or do not have, and would not be deemed to have, control of the Company on the Original Issue Date;

(2) the Company consolidates with or merges into or sells or transfers all or substantially all of the Company's assets to any other person, unless the consolidation, merger, sale or transfer will not result in the other person or persons acquiring control over the Company or the successor entity; or

(3) one or more other persons acquires the legal or beneficial ownership of all or substantially all of the Company's capital stock.

However, a Change of Control will not be deemed to have occurred solely as a result of the issuance or transfer, with the Company's co-operation, of any preferred shares in the Company's capital.

a "person" includes any individual, company, corporation, firm, partnership, joint venture, undertaking, association, organization, trust, state or agency of a state, in each case whether or not being a separate legal entity. It does not include the Company's Board of Directors or any other governing board and does not include the Company's wholly owned direct or indirect subsidiaries.

Repurchase Procedures

Not less than 30 nor more than 60 days prior to the Holders' Put Date and promptly after becoming aware of, and in any event within seven days of, a Delisting or a Change of Control, the Company will provide sufficient information to the Trustee (including, but not limited to a certificate of an independent investment bank or other expert at the expense of the Company, certifying the amount of Early Redemption Amount and the Redemption Premium on the Redemption Date) in sufficient time in order for the Company to mail to each Holder and for so long as the Notes are listed on the Luxembourg Stock Exchange, and the rules of such exchange so require, to publish in English in an Authorized Newspaper, a notice regarding such Holders' Put Right, Delisting Put Right or Change of Control Put Right, as the case may be, which notice shall state, as appropriate:

(A) the Holders' Put Date, the Delisting Put Date or the Change of Control Put Date, as the case may be (each, a "Purchase Date");

(B) in the case of a Delisting, the date of such Delisting and, briefly, the events causing such Delisting;

(C) in the case of a Change of Control, the date of such Change of Control and, briefly, the events causing such Change of Control;

(D) the date by which the Holder Purchase Notice (as defined below) must be given;

(E) the Holders' Put Price, the Delisting Put Price or the Change of Control Put Price, as the case may be, and the method by which such amount will be paid;

(F) the names and addresses of all Paying Agents;

(G) briefly, the Conversion Right (as defined below) of the Holders of the Notes and the then current Conversion Price;

(H) the Closing Price of the Common Shares on the most recent practicable Trading Day for which such Closing Price can be provided;

(I) the procedures that Holders must follow and the requirements that Holders must satisfy in order to exercise their repurchase rights and Conversion Right; and

(J) that a Holder Purchase Notice, once validly given, may not be withdrawn.

To exercise its right to require the Company to purchase its Notes, the Holder must deliver a written irrevocable notice of the exercise of such right (a "Holder Purchase Notice") to any Paying Agent on any Business Day prior to the close of business at the location of such Paying Agent on such day and which day is not less than 20 Business Days prior to the Purchase Date.

Payment of the Holders' Put Price upon exercise of the Holders' Put Right, Delisting Put Price upon exercise of the Delisting Put Right or Change of Control Put Price upon exercise of the Change of Control Put Right for a Certificated Note for which a Holder Purchase Notice has been delivered is conditioned upon delivery of such Certificated Note (together with any necessary endorsements) to any Paying Agent on any Business Day on or after the delivery of such Holder Purchase Notice and will be made promptly following the later of the Purchase Date and the time of delivery of such Certificated Note. If the Paying Agent holds on the Purchase Date money sufficient to pay the Holders' Put Price, Delisting Put Price or the Change of Control Put Price, as the case may be, of Notes for which Holder Purchase Notices have been delivered in accordance with the provisions of the Indenture upon exercise of such right, then, whether or not such Note is delivered to the Paying Agent, on and after such Purchase Date, (i) such Note will cease to be outstanding, (ii) the interest (if any) on such Note will cease to accrue, (iii) such Note will be deemed paid and (iv) all other rights of the Holder shall terminate (other than the right to receive the Holders' Put Price, Delisting Put Price or the Change of Control Put Price, as the case may be).

Certain Covenants

Negative Pledge

So long as any Note remains outstanding, the Company will not, and will procure that none of its Principal Subsidiaries will, create or permit to subsist any Lien on any of its or, as the case may be, such Principal Subsidiary's, property, assets or revenues, present or future, to secure for the benefit of the holders of any International Investment Securities (i) payment of any sum owing in respect of any such International Investment Securities, (ii) any payment under any guarantee of any such International Investment Securities or (iii) any payment under any indemnity or other like obligation relating to any such International Investment Securities, unless contemporaneously therewith effective provision is made to secure the Notes (a) equally and ratably with such International Investment Securities with a similar Lien on the same property or assets securing such International Investment Securities for so long as such International Investment Securities are secured by such Lien or (b) with such other security as shall be approved by registered holders holding not less than 50% of the principal amount of the outstanding Notes.

As used herein, "International Investment Securities" means bonds, debentures, notes or other similar investment securities of the Company or any other person evidencing indebtedness with a maturity of not less than one year from the issue date thereof, or any guarantees thereof, which (i) either (A) are by their terms payable, or confer a right to receive payment, in any currency other than NT Dollars or (B) are denominated in NT Dollars and more than 50% of the aggregate principal amount thereof is initially distributed outside the ROC by or with the consent of the Company and (ii) are for the time being, or are intended to be, quoted, listed, ordinarily dealt in or traded, in each case primarily, on a stock exchange or over-the-counter or other securities market outside the ROC.

Consolidation, Amalgamation or Merger

The Company will not consolidate with, merge or amalgamate into or transfer its assets substantially as an entirety to any corporation or convey or transfer its properties and assets substantially as an entirety to any Person (the consummation of any such event, a "Merger"), unless:

(i) the corporation formed by such Merger or the Person that acquired such properties and assets shall expressly assume, by an indenture supplemental to the Indenture, all obligations of the Company under the Indenture and the performance of every covenant and agreement applicable to it contained therein;

(ii) immediately after giving effect to any such Merger, no Default or Event of Default shall have occurred or be continuing or would result therefrom;

(iii) the Company shall have delivered at least 20 Business Days prior to the Merger to the Trustee, among other things, an opinion of United States counsel of recognized standing to the effect that the holders of the Notes will not recognize income, gain or loss for United States federal income tax purposes as a result of such Merger and will be subject to United States federal income tax (if subject to United States federal income tax at all before or after such Merger) in the same amounts, in the same manner and at the same times as would have been the case if such Merger had not occurred; and

(iv) the corporation formed by such Merger, or the Person that acquired such properties and assets, shall expressly agree, among other things, to indemnify each holder of a Note against any tax, assessment or governmental charge payable by withholding or deduction thereafter imposed on such holder solely as a consequence of such Merger with respect to the payment of principal, premium and interest (if any) on the Notes.

In the event of any such Merger, the provisions described under "— Additional Amounts" and "— Redemption for Taxation Reasons" will be applicable to the corporation formed by such Merger or the Person acquiring such properties and assets as appropriate.

Conversion

Conversion Right

Each Holder will have the right (the "Conversion Right") during the Conversion Period to convert its Notes (or any portion thereof being U.S.\$1,000 in principal amount or an integral multiple thereof), at the option of such converting Holder, upon delivery of the Notes to the Trustee and upon delivery of an irrevocable notice (the "Conversion Notice") at the office of any Conversion Agent, on any Business Day prior to the close of business at the location of the Conversion Agent to which such Conversion Notice is delivered, into Common Shares and, upon conversion may, subject to compliance with the terms and conditions of the applicable Deposit Agreement or such other depository facility which may be established from time to time and in accordance with applicable law, including without limitation payment of the fees and expenses of the Depository, direct that the Common Shares issuable upon conversion be deposited with the Depository for issuance of GDSs, or with the depository under such other depository facility which may be established from time to time for issuance of depository receipts; *provided, however*, that the Conversion Right during any Closed Period shall be suspended and the Conversion Period shall not include any Closed Period. "Closed Period" means the periods of (i) 60 days prior to the date of the annual general shareholders' meeting, (ii) 30 days prior to an extraordinary shareholders' meeting, (iii) three Trading Days (under current regulations) prior to the day on which the Company notifies the Taiwan Stock Exchange of the record date for determination of shareholders entitled to receipt of dividends, subscriptions of shares due to capital increase or other benefits to such record date (which, under current regulations, amounts to a total of 15 Trading Days and five calendar days prior to such record date); or (iv) such other periods during which, under the laws of the ROC, the Company is required to close its stock transfer books and accordingly may not lawfully issue any share capital. The

Company shall procure that Holders are given not less than seven days' nor more than 60 days' prior notice of any Closed Period in accordance with the provisions of the Indenture.

The number of Common Shares to be issued upon conversion will be determined by the Company by dividing the aggregate principal amount of all the Notes to be converted by such Holder (translated into NT Dollars at the fixed rate of NT\$34.97 = U.S.\$1.00 (the "Exchange Rate")) by the Conversion Price in effect on the Conversion Date. Fractions of Common Shares will not be issued on conversion, and no cash adjustments will be made in respect of any such fraction. The number of GDSs to be issued upon conversion to converting Holders who elect to receive GDSs will be determined by dividing the aggregate principal amount of all the Notes to be converted by such Holder (translated into NT Dollars at the Exchange Rate) by the Conversion Price in effect on the Conversion Date, and dividing such quotient by the number of Common Shares represented by each GDS at the time of deposit of such Common Shares with the Depository. As of the date of this Offering Memorandum, each GDS represents five Common Shares. Converting Holders who direct that Common Shares be deposited for issuance of GDSs will be entitled, upon conversion, only to a number of Common Shares to be represented by an integral number of GDSs. Common Shares which would be represented by a fraction of one GDS will not be issuable, and such Holders will not receive any cash adjustments in respect of any such fraction. The Conversion Price shall at all times be subject to Anti-dilution Adjustment (as defined below).

A Holder who exercises the Conversion Right in respect of any Note in any year prior to the record date for dividends, benefits and other bonuses will receive such dividends, benefits and other bonuses distributed, if any, either in the form of cash or Common Shares, in respect of the Common Shares, declared at the annual shareholders' meeting in such year, from retained earnings and/or capital reserves, for the immediately preceding financial year and for all financial years thereafter.

Delivery of Common Shares or GDSs upon Conversion

In the event the converting Holder elects to receive Common Shares on exercise of its Conversion Right, the Company agrees to deliver as soon as practicable, but in no event more than five Trading Days from the Conversion Date (subject to subsequent changes to ROC laws and regulations), to a local agent appointed by such Holder, the number of Common Shares such Holder is entitled to receive upon Conversion.

In the event the converting Holder elects to receive GDSs on exercise of its Conversion Right, the Company agrees to deliver as soon as practicable, but in no event more than five Trading Days from the Conversion Date (subject to subsequent changes in ROC laws and regulations) to and deposit with the Custodian under the Deposit Agreements the number of Common Shares which such Holder is entitled to receive upon conversion. Such Common Shares will be registered in the name of the Depository or its nominee and deposited in accordance with the terms of the Deposit Agreements.

It is expected that any newly issued GDSs will be accepted into the book-entry settlement systems maintained by Euroclear and Clearstream, Luxembourg, and no person receiving GDSs shall receive or be entitled to receive physical delivery of the GDSs.

The Company agrees to take all such action and obtain all such approvals in the ROC, including (without limitation) the specific approval of the ROC SFC, necessary in order for such Common Shares to be deposited in the depository receipt facility and GDSs issued against such deposits. ROC regulatory approval has been received for GDSs to be issued upon deposit of Common Shares issuable upon conversion of the Notes.

Converting Holders who receive Rule 144A GDSs following exercise of their Conversion Right are also hereby notified that under the terms and conditions of the Rule 144A Deposit Agreement, the converting Holder will be required, prior to the issue of the Rule 144A GDSs, to pay applicable issuance

fees and to provide certain written acknowledgements, certifications and agreements to the Company and the Depositary to the effect that:

(a) the Rule 144A GDSs and the Common Shares of the Company represented thereby have not been and will not be registered under the Securities Act,

(b) it is a QIB acquiring such beneficial ownership for its own account or for the account of one or more QIBs, each of whom is able to and who does represent, acknowledge and agree to the same extent that would be required if it invested directly in Rule 144A GDSs, and

(c) it will comply with the restrictions set forth under “Form of GDRs and Transfer Restrictions” on transfers of the Rule 144A GDSs and the underlying Common Shares. See “Description of the Global Depositary Receipts — Deposit and Withdrawal”.

Converting Holders who receive International GDSs following exercise of their Conversion Right are also hereby notified that, under the terms and conditions of the International Deposit Agreement, the converting Holder will be required, prior to the issue of the International GDSs, to pay applicable issuance fees and to provide certain written acknowledgments, certifications and agreements to the Company and the Depositary (unless prior to such time a registration statement on Form F-6 under the Securities Act relating to the International GDSs has been filed and declared effective by the United States Securities and Exchange Commission) to the effect that:

(a) the International GDSs, and the Common Shares represented thereby, have not been and will not be registered under the Securities Act,

(b) it is not a U.S. person (within the meaning of Regulation S) and is located outside the United States (within the meaning of Regulation S) and has agreed to acquire and will acquire, the Common Shares to be deposited outside the United States,

(c) it is not an affiliate of the Company or a person acting on behalf of such an affiliate and it is not in the business of buying or selling securities, or, if it is in such business, it did not acquire the International Notes to be deposited from the Company or any affiliate thereof, and

(d) if it sells or otherwise transfers the International GDSs or the underlying Common Shares in accordance with Rule 144A, it will, prior to the settlement of such sale, cause such Common Shares to be withdrawn in accordance with the terms and conditions of the International Deposit Agreement and deposited under the Rule 144A Deposit Agreement for issuance of a Rule 144A GDR evidencing Rule 144A GDSs upon receipt of the proper certification on behalf of the purchaser and otherwise in accordance with the terms and conditions of the Rule 144A Deposit Agreement. See “Description of the Global Depositary Receipts — Deposit and Withdrawal”.

Upon delivery to and deposit with the Custodian of a sufficient number of Common Shares to which such Holder is entitled upon conversion, and receipt by the Depositary of the applicable written acknowledgments, certifications and agreements, and the payment of any fees and expenses, including issuance fees, the Depositary shall, pursuant to the terms of the Deposit Agreements, deliver the GDSs to or to the order of the converting Holder.

The Company’s delivery to or to the order of the Noteholder or the Depositary, as the case may be, of the number of Common Shares into which the Notes are convertible will be deemed to satisfy the Company’s obligation to pay the principal, premium and interest (if any) on such Notes.

Procedures; Conversion Notice; Taxes and Duties

In order to effect a conversion, each Holder must complete, execute and deliver at such Holder’s expense during the Conversion Period at the office of any Conversion Agent a Conversion Notice, in the form then obtainable from the office of any Conversion Agent, together, in the case of Certificated Notes, with the certificate representing the Notes to be converted, and any certificates and other documents as may be required under applicable law or the Deposit Agreements (if applicable) and any expenses or other

payments required to be paid by the Holder pursuant to the terms of the Indenture. Each Holder must complete, execute and deliver, at such Holder's expense, a Conversion Notice at the office of any Conversion Agent between 9:00 a.m. and 3:00 p.m. on any Business Day at the location of the Conversion Agent during the Conversion Period. A Conversion Notice or the Certificated Notes delivered outside the hours specified above or on a day which is not a Business Day at the office of the relevant Conversion Agent shall for all purposes be deemed to have been delivered to that Conversion Agent between 9 a.m. and 3 p.m. on the next Business Day. The Conversion Notice shall contain, *inter alia*, an option for such Holder to elect to receive either Common Shares or GDSs upon such conversion, and, in the event such Holder elects to receive Common Shares, an appointment of a local agent by such Converting Holder and the name and address of such local agent.

A Conversion Notice once so delivered may not be withdrawn without the consent in writing of the Company. Holders who deposit a Conversion Notice during a Closed Period will not be permitted to convert their Notes until the Trading Day following the last day of that Closed Period which (if all other conditions to conversion have been fulfilled) will be the Conversion Date for such Notes. Such Holders or the Depositary, as applicable, will not be registered as holders of Common Shares until the Conversion Date. The price at which such Notes will be converted will be the Conversion Price in effect on the Conversion Date.

As conditions precedent to conversion, the Holder must pay to the applicable Paying Agent all stamp, issue, registration and similar taxes and duties (if any) arising on conversion in the country in which the Note is deposited for conversion, or payable in any jurisdiction consequent upon the issue and delivery of Common Shares, GDSs or any other property or cash upon conversion to or to the order of a person other than the converting Holder. Except as aforesaid, the Company will pay the expenses arising in the ROC on the issue of Common Shares or GDSs on conversion of Notes and all charges of the Conversion Agent in connection therewith as provided in the Indenture. The Depositary may require the converting Holder to pay its fees and expenses upon deposit of Common Shares for issuances of GDSs. The date on which any Note and the Conversion Notice (in duplicate) relating thereto, together with any certificates and other documents as may be required under applicable law or the Deposit Agreements (if applicable), are deposited with the Conversion Agent and the payments, if any, required to be paid by the Holder are made is hereinafter referred to as the "Deposit Date". The "Conversion Date" applicable to a Note shall mean the day next following the Deposit Date, which day must be a Trading Day with respect to the Common Shares and must fall within the Conversion Period. The Holder must therefore satisfy all such conditions on or before the Business Day prior to the end of the Conversion Period.

In the event the converting Holder elects to receive Common Shares, with effect from the opening of business in the ROC on the Conversion Date, the Company will deem the person designated in the Conversion Notice as the person in whose name the Common Shares to be issued upon such conversion are to be registered as the holder of record of the number of Common Shares (disregarding any retroactive adjustment of the Conversion Price referred to below prior to the time such retroactive adjustment shall have become effective), and at such time the rights of such converting Holder as a Holder with respect to the Notes deposited for conversion shall cease. In the event the converting Holder elects to receive GDSs, with effect from the opening of business in the ROC on the Conversion Date, the Company will deem the Depositary as the person in whose name the Common Shares represented by such GDSs to be issued upon such conversion are to be registered as the holder of record of the number of Common Shares (disregarding any retroactive adjustment of the Conversion Price referred to below prior to the time such retroactive adjustment shall have become effective), and at such time the rights of such converting Holder as a Holder with respect to the Notes deposited for conversion shall cease.

On the Conversion Date, the Company will register the converting Holder (or its designee) or the Depositary (or its designee), as applicable, in the Company's register of shareholders as the owner of the number of Common Shares to be issued upon conversion of such Notes and, subject to any applicable limitations then imposed by ROC laws and regulations, according to the request made in the relevant Conversion Notice, procure that, as soon as practicable, and in any event within five Trading Days with respect to the Common Shares from the Conversion Date, there be delivered to the local agent appointed

by the converting Holder or the Custodian under the Deposit Agreements, as applicable, a certificate or certificates for the relevant Common Shares, registered in the name specified for that purpose in the relevant Conversion Notice, together with any other property or cash required to be delivered upon conversion and such assignments and other documents (if any) as may be required by law to effect the delivery thereof.

Adjustments

Antidilution. The Conversion Price will be subject to adjustment (“Antidilution Adjustment”) in the circumstances described below.

(i) If the Company shall issue Common Shares as a dividend in Common Shares or make a distribution of Common Shares which is treated as a capitalization issue for accounting purposes (including but not limited to capitalization of capital reserves), then the Conversion Price in effect when such dividend and/or distribution is declared (or, if the Company has fixed a prior record date for the determination of shareholders entitled to receive such dividend and/or distribution, on such record date) shall be adjusted in accordance with the following formula:

$$\text{NCP} = \text{OCP} \times [N / (N + n)]$$

where:

NCP = the Conversion Price after such adjustment.

OCP = the Conversion Price before such adjustment.

N = the number of Common Shares outstanding, at the time of issuance of such dividend and/or distribution (or at the close of business in Taipei on such record date as the case may be).

n = the number of Shares to be distributed to the shareholders as a dividend and/or distribution.

(ii) If the Company shall (a) subdivide its outstanding Common Shares, (b) combine its outstanding Common Shares into a smaller number of Common Shares, or (c) re-classify any of its Common Shares into other securities of the Company, then the Conversion Price shall be appropriately adjusted so that the holder of any Note, in respect of the Conversion Date which occurs after the coming into effect of the adjustment described in this paragraph (ii), shall be entitled to receive the number of Common Shares and/or other securities of the Company which it would have held or have been entitled to receive after the happening of any of the events described above had such Note been converted immediately prior to the happening of such event (or, if the Company has fixed a prior record date for the determination of shareholders entitled to receive any such securities issued upon any such subdivision, combination or reclassification, immediately prior to such record date), but without prejudice to the effect of any other adjustment to the Conversion Price made with effect from the date of the happening of such event (or such record date) or any time thereafter.

(iii) If the Company shall grant, issue or offer to the holders of Common Shares rights entitling them to subscribe for or purchase Common Shares, which expression shall include those Common Shares which are required to be offered to employees and persons other than shareholders in connection with such grant, issue or offer, at a consideration per Common Share receivable by the Company which is fixed:

(a) on or prior to the record date mentioned below and is less than the Market Value per Common Share on such record date; or

(b) after the record date mentioned below and is less than the Market Value per Common Share on the date the Company fixes the said consideration,

then the Conversion Price in effect (in the case of (a) above) on the record date for the determination of shareholders entitled to receive such rights or (in the case of (b) above) on the date the Company fixes the said consideration shall be adjusted in accordance with the following formula:

$$NCP = OCP \times [(N + v) / (N + n)]$$

where:

NCP and OCP have the meanings ascribed thereto in (i) above.

N = the number of Common Shares outstanding, at the close of business in the ROC (in the case of (a) above) on such record date or (in the case of (b) above) on the date the Company fixes the said consideration.

n = the number of Common Shares initially to be issued in connection with such rights issue at the said conversion.

v = the number of Common Shares which the aggregate consideration receivable by the Company would purchase at such Market Value specified in (a) or, as the case may be, (b) above.

Subject as provided below, such adjustment shall become effective immediately after the date the consideration for such Common Shares is received in full by the Company or (if later) immediately after the Company fixes the said consideration but retroactively to immediately after the record date mentioned above.

If, in connection with a grant, issue or offer to the holders of Common Shares of rights entitling them to subscribe for or purchase Common Shares, no Common Shares are subscribed and paid for by the persons entitled thereto, no further adjustment shall be made to the Conversion Price by reason of such offer and/or subscription.

(iv) If the Company shall grant, issue or offer to the holders of Common Shares warrants entitling them to subscribe for or purchase Common Shares at a consideration per Common Share receivable by the Company which is fixed:

(a) on or prior to the record date for the determination of shareholders entitled to receive such warrants and is less than the Market Value per Common Share at such record date; or

(b) after the record date mentioned above and is less than the Market Value per Common Share on the date the Company fixes the said consideration,

then the Conversion Price in effect (in a case within (a) above) on the record date for the determination of shareholders entitled to receive such warrants or (in a case within (b) above) on the date the Company fixes the said consideration shall be adjusted in accordance with the following formula:

$$NCP = OCP \times [(N + v) / (N + n)]$$

where:

NCP and OCP have the meanings ascribed thereto in (i) above.

N = the number of Common Shares outstanding at the close of business in the ROC (in the case of (a) above) on such record date or (in the case of (b) above) on the date the Company fixes the said consideration.

- n = the number of Common Shares initially to be issued upon exercise of such warrants at the said consideration where no applications by shareholders entitled to such warrants are required. Where applications by shareholders entitled to such warrants are required, n equals the number of such Common Shares that equals (A) the number of warrants which underwriters have agreed to underwrite as referred to below or, as the case may be, (B) the number of warrants for which applications are received from shareholders as referred to below save to the extent already adjusted for under (A).
- v = the number of Common Shares which the aggregate consideration receivable by the Company would purchase at such Market Value per Common Share specified in (a) or, as the case may be, (b) above.

Subject as provided below, such adjustment shall become effective (1) where no applications for such warrants are required from shareholders entitled to the same, upon their issue and (2) where applications by shareholders entitled to the same are required as aforesaid, immediately after the date the consideration for such warrants is received in full by the Company or (if later) immediately after the Company fixes the said consideration but retroactively to immediately after the record date mentioned above.

If, in connection with a grant, issue or offer to the holders of Common Shares warrants entitling them to subscribe for or purchase Common Shares, no warrants are subscribed and paid for by the persons entitled thereto, no further adjustment shall be made to the Conversion Price by reason of such offer and/or subscription.

(v) In case the Company or any Subsidiary of the Company shall distribute to all holders of Common Shares, any shares of Capital Stock of the Company other than Common Shares, evidences of indebtedness or other assets (other than cash distributions described below) of the Company, or rights or warrants to subscribe for or purchase any Capital Stock of the Company (other than Common Shares) at less than the Market Value of such indebtedness, assets or Capital Stock, determined as of the date on which the Board of Directors of the Company approves such distribution, then in each such case the Conversion Price shall be adjusted so that the same shall equal the price determined by multiplying the Conversion Price in effect immediately prior to the date of such distribution by a fraction of which:

(a) the numerator shall be the Market Value per Common Share, on the record date for determining holders of Common Shares entitled to such distribution, less the then Fair Market Value (as determined by the Board of Directors, whose determination shall, if made in good faith, be conclusive evidence of such Fair Market Value) of the portion of Capital Stock, evidences of indebtedness or other assets so distributed or of such subscription rights or warrants applicable to one Common Share; and

(b) the denominator shall be such Market Value per Common Share.

If the rights or warrants expire prior to exercise, the Conversion Price shall be readjusted to reflect the actual securities received upon exercise.

(vi) In case the Company shall, by dividend or otherwise, distribute to all holders of Common Shares cash (excluding any dividend that is not an Extraordinary Cash Dividend) then, in such case, the Conversion Price shall be adjusted (with such adjustment to be effective on the record date for

the determination of shareholders entitled to receive such distribution) in accordance with the following formula:

$$\text{NCP} = \text{OCP} \times [(M - C) / M]$$

where:

NCP and OCP have the meanings ascribed thereto in (i) above.

M = the Market Value per Common Share on such record date.

C = the amount of cash so distributed (and not excluded as provided for above) applicable to one Common Share.

If such dividend or distribution is not so paid or made, the Conversion Price shall again be adjusted to be the Conversion Price which would then be in effect if such dividend or distribution had not been approved.

For purposes of this subsection (vi), an Extraordinary Cash Dividend occurs if, at the effective date, the total amount of:

(a) any cash dividends paid or declared by the Company on the Common Shares, prior to deduction of any withholding tax plus any corporate tax attributable to that dividend; and

(b) all other cash dividends paid or declared on the Common Shares in the 365 consecutive day period prior to the effective date (other than any dividend or portion thereof previously deemed to be an Extraordinary Cash Dividend) (the "previous dividends"), except that where the date of announcement for dividends for two different fiscal years has occurred in such 365 day period, such dividends relating to the earlier fiscal year will be disregarded for the purpose of determining the previous dividend ((a) and (b) together being the "total current dividend").

equals or exceeds on a per Common Share basis 3.5% of the average closing price (as defined below) of the Common Shares during the relevant period (as defined below). For the avoidance of doubt, all amounts are on a per Common Share basis. Notwithstanding the foregoing, the Conversion Price shall be adjusted in accordance with the formula in this subparagraph (vi) with respect to the cash dividends declared at the annual shareholders' meeting on May 24, 2002.

The "average closing price" is the arithmetic average of the Closing Price per Common Share for each Trading Day during the relevant period.

The "relevant period" means the period beginning on the first Trading Day after the record date for the first cash dividend aggregated in the total current dividend, and ending on the Trading Day immediately preceding the record date for the cash dividend which caused the adjustment to the Conversion Price pursuant to this subsection (vi). However, if there were no cash dividends declared during the 365 consecutive day period prior to the record date for the cash dividend which caused the adjustment to the Conversion Price pursuant to the subsection (vi), the relevant period will be the entire period of 365 consecutive days.

(vii) In case a tender or exchange offer made by the Company or any Subsidiary of the Company for all or any portion of the Common Shares shall expire and such tender or exchange offer shall involve the payment by the Company or such Subsidiary of consideration per Common Share having a Fair Market Value (as determined by the Board of Directors of the Company or any Subsidiary of the Company, whose determination shall, if made in good faith, be conclusive evidence of such Fair Market Value) at the last time (the "Expiration Date") tenders or exchanges could have been made pursuant to such tender or exchange offer (as it shall have been amended) that exceeds

the Market Value per Common Share, as of the Expiration Date, the Conversion Price shall be adjusted in accordance with the following formula:

$$\text{NCP} = \text{OCP} \times [(N \times M)] / (a + [(N - n) \times M])$$

where:

NCP and OCP have the meanings ascribed thereto in subsection (i) above.

N = the number of Common Shares outstanding (including any tendered or exchanged Shares) on the Expiration Date.

M = Market Value per Common Share as of the Expiration Date.

a = the Fair Market Value of the aggregate consideration payable to the holders of Common Shares based on the acceptance (up to a maximum specified in the terms of the tender or exchange offer) of all Common Shares validly tendered or exchanged and not withdrawn as of the Expiration Date (the Common Shares deemed so accepted up to any such maximum, being referred to as the "Purchased Shares").

n = the number of Purchased Shares.

such reduction to become retroactively effective immediately prior to the opening of business on the day following the Expiration Date.

If the Company is obligated to purchase Common Shares pursuant to any such tender or exchange offer, but the Company is permanently prevented by applicable law from effecting any such purchase or all such purchases are rescinded, the Conversion Price shall again be adjusted to be the Conversion Price which would then be in effect if such tender or exchange offer had not been made.

(viii) In case the Company issues Common Shares (other than Common Shares based on any of the circumstances described in (i) and (ii)) or the Company or any Subsidiary of the Company shall issue any securities initially convertible into or exchangeable for Common Shares at a price per Common Share less than the Market Value per Common Share determined as of the date on which the Board of Directors of the Company or such Subsidiary, if applicable, approves such issuance, the Conversion Price shall be adjusted in accordance with the following formula:

$$\text{NCP} = \text{OCP} \times [(N + v) / (N + n)]$$

where:

NCP and OCP have the meanings ascribed thereto in subsection (i) above.

N = the number of Common Shares outstanding on the date of issuance of such Common Shares or initially convertible or exchangeable securities, immediately prior to such issuance.

n = the number of Common Shares issued or issuable upon conversion or exchange of such initially convertible or exchangeable securities.

v = the number of Common Shares which the aggregate consideration issue price of the total amount of Common Shares or initially convertible or exchangeable securities would purchase at Market Value.

If the conversion or exchange right of any such convertible or exchangeable securities expires prior to exercise, the Conversion Price shall be re-adjusted to reflect the actual securities converted or exchanged.

(ix) In any case in which the Indenture shall require that an adjustment be made immediately following a record date, the Company may elect to defer the effectiveness of such adjustment (but in no event until a date later than the effective date of the event giving rise to such adjustment), in which case the Company shall, with respect to any Note converted after such record date and before

such adjustment shall have become effective (i) defer issuing to the holder of such Note the number of Common Shares or GDSs issuable upon such conversion in excess of the number of Common Shares and GDSs, or issuable thereupon only on the basis of the Conversion Price prior to adjustment, and (ii) not later than 20 days after such adjustment shall have become effective, and issue to such holder the additional Common Shares and GDSs issuable on such conversion.

(x) In case of a Merger of the Company, each Note then Outstanding shall, without the consent of any Noteholders, become convertible only into the kind and amount of securities, cash and other property receivable upon such Merger by a holder of the number of Common Shares and GDSs, into which such Notes could have been converted immediately prior to such Merger. The corporation formed by such Merger or the Person that acquired such properties and assets shall enter into a supplemental indenture with the Trustee to provide for the continuation of the Conversion Rights to continue after such Merger and such supplemental indenture shall provide for adjustments to the Conversion Price which shall be as nearly equivalent as practicable to the adjustments provided in the Indenture, *provided* that where there has been a Change of Control pursuant to such Merger, a Holder may exercise its Change of Control Put Right as set forth in "Repurchase of Notes in the Event of Change of Control".

If any event or circumstance analogous to the events and circumstances described in (i) through (viii) occur, the Conversion Price shall be adjusted as set forth in the analogous subsection in the Indenture. For the avoidance of doubt, for purposes of the subsections (i) through (viii), "outstanding" Common Shares shall exclude treasury shares.

The Trustee shall not be obliged to monitor whether any event has occurred that may fall within (i) to (x) above and shall assume that none has occurred until it has actual knowledge by way of express notice in writing from the Company to the contrary.

U.S. Tax Effect of Conversion Price Adjustment. In the event of a taxable distribution to holders of Common Shares which results in an adjustment of the Conversion Price (or in which Holders otherwise participate) or in the event that the Conversion Price is decreased at the discretion of the Company, Holders may in certain circumstances be deemed to have received a distribution subject to United States federal income tax as a dividend. See "Taxation — United States Federal Income Taxation".

Provisions Applicable to All Conversions and Adjustments of Conversion Price

No adjustment of the Conversion Price will be required to be made until cumulative adjustments, required to be made in the circumstances set forth above, amount to 1.0% or more of the Conversion Price as last adjusted. However, any adjustment, required to be made in the circumstances set forth above, which is not made because of failure to meet the 1.0% threshold, will be carried forward. Except as otherwise described below, the Conversion Price may at any time be reduced by the Company.

The Company will not take any action which would reduce the Conversion Price per Common Share below the par value of the Common Shares (currently NT\$10 per share), unless, under applicable law then in effect, Notes could be converted at such reduced Conversion Price into legally issued, fully paid and non-assessable Common Shares.

All calculations relating to conversion, including adjustments of the Conversion Price, will be made to the nearest .001 of a share of securities or other property or nearest cent, as the case may be.

Whenever the Conversion Price is adjusted, the Company will promptly file with the Trustee an Officers' Certificate setting forth the Conversion Price after such adjustment and setting forth a brief statement of the facts requiring such adjustment. Promptly after receipt of such certificate, the Company will prepare a notice of such adjustment of the Conversion Price setting forth the event which triggered the adjustment in the Conversion Price, the adjusted Conversion Price and the date on which such adjustment became effective and shall give such notice of such adjustment of the Conversion Price to each Holder of a Note. For so long as the Notes are listed on the Luxembourg Stock Exchange, and the rules of such exchange so require, the Trustee will so inform the Luxembourg Stock Exchange, and the

Company will publish such notice in English in an Authorized Newspaper. The Trustee shall not be obliged to monitor whether any event has occurred that may require an adjustment of the Conversion Price and shall rely upon the delivery of the Officer's Certificate.

Events of Default; Notice and Waiver

The Indenture provides that, if an Event of Default specified therein shall have occurred and be continuing, either the Trustee at its discretion and if so requested in writing by Holders of not less than 25% in aggregate principal amount of the Notes then outstanding, or the Holders of not less than 25% in aggregate principal amount of the Notes then outstanding may declare the principal amount of the Notes then outstanding, plus the premium and interest (if any) payable thereon to the date of payment, to be immediately due and payable. The Trustee will be under no obligation to exercise any of its rights or powers under the Indenture or at the request or direction of any Holders to declare the outstanding principal amount to be immediately due and payable unless such Holders shall have offered to the Trustee indemnity satisfactory to the Trustee. In the case of certain events of bankruptcy or insolvency, the principal amount shall automatically become and be immediately due and payable. Under certain circumstances, the Holders of a majority in aggregate principal amount of the outstanding Notes may rescind any such acceleration with respect to the Notes and its consequences.

Under the Indenture, Events of Default include:

- (i) default in payment of the principal amount of any Note, as and when the same becomes due and payable, and continuance of such default for three Business Days;
- (ii) default in the payment of premium or interest (if any) or Additional Amounts upon any Note as and when the same becomes due and payable, and continuance of such default for five Business Days;
- (iii) failure by the Company to deliver the Common Shares as and when such Common Shares are required to be delivered following conversion of a Note;
- (iv) failure on the part of the Company duly to observe or perform any of the covenants or agreements provided in the Notes or the Indenture (other than those referred to in clauses (i), (ii) or (iii) above) which failure cannot be remedied or, if such failure can be remedied, is not remedied within 30 days after the date on which written notice thereof requiring the Company to remedy the same shall have been given to the Company by the Trustee at its discretion (subject to being indemnified or secured by the Holders to its satisfaction) or the Holders of at least 25% in aggregate principal amount of the Notes then outstanding;
- (v) there shall have been entered against the Company or any of its Subsidiaries a final judgment, decree or order by a court of competent jurisdiction for the payment of money in excess of U.S.\$10.0 million with respect to the Company or any of its Subsidiaries (or its equivalent in any other currency or currencies) and 60 days shall have passed since the entry of the order without it being bonded, satisfied, discharged or stayed; provided, that where two or more of the Company and/or its Subsidiaries are liable for the payment of the same relevant debt, whether liable jointly and severally, by way of guarantee, surety or otherwise, any such amount shall be counted once only;
- (vi) (A) the Company or any of its Subsidiaries shall fail to make any payment with respect to present or future Debt (other than the Notes) in an aggregate principal amount in excess of U.S.\$10.0 million with respect to the Company or any of its Subsidiaries (or its equivalent in any other currency or currencies) when and as the same shall become due and payable, if such failure shall continue for more than the period of grace, if any, originally applicable thereto or (B) the Company or any of its Principal Subsidiaries shall fail to perform or observe any covenant or agreement to be performed or observed by the Company or any of its Principal Subsidiaries contained in any agreement or instrument evidencing Debt (other than the Notes) in an aggregate principal amount in excess of U.S.\$10.0 million with respect to the Company or any of its Principal

Subsidiaries (or its equivalent in any other currency or currencies) and such failure results in the acceleration of the maturity of any amount owing thereunder;

(vii) a decree or order by a court having jurisdiction shall have been entered under any applicable bankruptcy, insolvency, reorganization or other similar law (A) adjudging the Company or any of its Principal Subsidiaries as bankrupt or insolvent, or approving as properly filed a petition seeking reorganization of the Company or any of its Principal Subsidiaries or (B) appointing a receiver or liquidator or trustee or assignee in bankruptcy or insolvency of the Company or any of its Principal Subsidiaries or of its property or (C) ordering the winding up or liquidation of the affairs of the Company or any of its Principal Subsidiaries and in any such case such decree or order shall have continued undischarged and unstayed for a period of 60 days; or

(viii) the Company or any of its Principal Subsidiaries shall voluntarily commence proceedings to be adjudicated a bankrupt or insolvent, or shall consent to the filing of a bankruptcy or insolvency proceeding against it, or shall file a petition or answer or consent seeking reorganization under any applicable bankruptcy, insolvency, reorganization or other similar law or shall consent to the filing of any such petition, or shall consent to the appointment of a receiver or liquidator or trustee or assignee in bankruptcy or insolvency of it or its property, or shall make an assignment for the benefit of creditors.

The Trustee shall, within 60 days after the occurrence of any default of which the Trustee shall be aware, mail to all Holders of the Notes notice of all defaults, unless such defaults shall have been cured or waived before the giving of such notice.

The Holders of a majority in aggregate principal amount of the outstanding Notes may direct the time, method and place of conducting any proceeding for any remedy available to the Trustee or exercising any trust or power conferred on the Trustee; *provided* that such direction shall not be in conflict with any applicable law or the Indenture and subject to certain other limitations. The Trustee may refuse to perform any duty, exercise any right or power, extend or risk its own funds or otherwise incur any financial liability, unless it receives security and/or indemnity satisfactory to it against any loss, liability or expense. No Holder of a Note will have the right to pursue any remedy with respect to the Indenture or the Notes, unless:

(i) such Holder shall have previously given the Trustee written notice of a continuing Event of Default;

(ii) the Holders of at least 25% in aggregate principal amount of the outstanding Notes shall have made a written request to the Trustee to pursue such remedy;

(iii) such Holder or Holders shall have offered to the Trustee security and/or indemnity against any loss, liability or expense satisfactory to it;

(iv) the Trustee shall have failed to comply with the request within 60 days after receipt of such notice, request and offer of security or indemnity; and

(v) the Holders of a majority in aggregate principal amount of the outstanding Notes shall not have given the Trustee a direction inconsistent with such request within 60 days after receipt of such request.

The right of any Holder (i) to receive payment of the principal, premium, interest (if any), Additional Amounts, the Holders' Put Price upon exercise of the Holders' Put Right, the Delisting Put Price upon exercise of the Delisting Put Right or the Change of Control Put Price upon exercise of the Change of Control Put Right, or to receive Common Shares or GDSs on or after any Redemption Date, Purchase Date or Conversion Date, as the case may be, (ii) to convert its Notes or (iii) to bring suit for the enforcement of any such right, shall not be impaired or adversely affected without such Holder's consent.

The Holders of a majority in aggregate principal amount of Notes at the time outstanding may waive any existing default and its consequences, except (i) any default in any payment on the Notes, (ii) any default with respect to the Conversion Rights of Holders of the Notes or (iii) any default with respect to certain covenants or provisions in the Indenture which may not be modified without the consent of the Holder of each Note as described in “— Meeting of Noteholders; Modification and Waiver” below. When a default is waived, it is deemed cured and shall cease to exist, but no such waiver shall extend to any subsequent or other default or impair any consequent right.

The Company will be required to furnish to the Trustee annually a statement concerning the performance and observance of its obligations under the Notes or the Indenture. In addition, the Company is required to file promptly with the Trustee written notice of the occurrence of any Default or Event of Default.

Default Interest

In case there shall be a default in the payment of all or any part of the principal or premium of any Note when the same shall have become due and payable, whether upon maturity or by declaration or otherwise, then upon demand of the Trustee, the Company will pay to the Trustee for the benefit of the holders of such Notes the whole amount that then shall have become due and payable on all such Notes at the time outstanding for principal and premium (including Additional Amounts), and, to the extent permitted by law, overdue interest on any overdue principal, premium and interest (if any) at the rate of 6.0% per annum.

Prescription

Claims in respect of payment of principal, premium and interest (if any) on the Note will be prescribed unless made within a period of ten years, in the case of principal and premium, and five years, in the case of interest (if any), as the case may be, from the relevant date of payment in respect thereof.

Meeting of Noteholders; Modification and Waiver

The Indenture contains provisions for convening meetings of the Holders to consider any matter affecting their interests, including the approval of certain amendments or modifications of the Notes or the provisions of the Indenture upon either the written consent of the Holders of a majority in principal amount of the outstanding Notes or the approval at a meeting of the Holders duly called by persons entitled to vote a majority in principal amount of the outstanding Notes. The quorum at any such meeting shall be two or more persons entitled to vote a majority in principal amount of the outstanding Notes.

Modifications and amendments of the Indenture or the Notes may be made by the Company and the Trustee with the written consent of the Holders of not less than a majority in aggregate principal amount of the outstanding Notes; *provided* that no such modification or amendment may, without the consent of each Holder of the Notes affected thereby:

- (i) change the Maturity Date of the principal of any Note;
- (ii) reduce the principal amount, or the rate of premium or interest (if any), on any Note or increase the Conversion Price (as adjusted in accordance with the provisions of the Indenture);
- (iii) change the place or currency of payment of principal, premium or interest (if any) on any Note or the method of calculating any such payment;
- (iv) impair the right to institute suit for the enforcement of any payment on or after the Maturity Date (or, in the case of a redemption, on or after the Redemption Date) of any Note;
- (v) alter the obligations of the Company under “— Certain Covenants — Negative Pledge”, “— Certain Covenants — Consolidation, Amalgamation or Merger” or “— Additional Amounts”;

(vi) modify, cancel or adversely affect the Conversion Right, Holders' Put Right, Delisting Put Right or the Change of Control Put Right;

(vii) modify the obligations of the Company to maintain an office or agency in the Borough of Manhattan, The City of New York, or, so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of such exchange so requires, in Luxembourg;

(viii) reduce the above-stated percentage of outstanding Notes the consent of whose Holders is necessary to modify or amend the Indenture;

(ix) reduce the percentage or aggregate principal amount of outstanding Notes the consent of whose Holders is necessary for waiver of compliance with certain provisions of the Indenture or for waiver of certain defaults;

(x) modify any of the percentage voting and quorum provisions described under “— Meeting of Noteholders; Modification and Waiver”; or

(xi) release the Company from any obligation under the Indenture other than in accordance with the provisions of the Indenture, or amend or modify any provision relating to such release.

Neither the Company nor any of its Subsidiaries will, directly or indirectly, pay or cause to be paid any consideration, whether by way of interest, fee or otherwise to any Holder of any Notes for or as an inducement to any consent, waiver or amendment of any of the terms or provisions of the Indenture or the Notes, unless such consideration is offered to be paid or agreed to be paid to all Holders of the Notes that consent, waive or agree to amend in the time frame set forth in the solicitation documents relating to such consent, waiver or amendment.

Without the consent of any Holder of Notes, the Company and the Trustee may amend the Indenture to:

(i) cure any ambiguity, defect or inconsistency, *provided* that such amendment does not materially adversely affect the rights of any Holder;

(ii) provide for the assumption by the surviving Person in a Merger effected in accordance with the provisions of the Indenture described under “— Certain Covenants — Consolidation, Amalgamation or Merger”;

(iii) make any change that does not materially adversely affect the rights of any Holder of Notes;

(iv) make any change necessary to comply with the Trust Indenture Act;

(v) add to the covenants or obligations of the Company under the Indenture or decrease the Conversion Price at the discretion of the Company or surrender any right, power or option conferred by the Indenture on the Company;

(vi) make arrangements satisfactory to the Trustee for Common Shares delivered on conversion of the Notes to be deposited into an alternative depositary receipt program or similar scheme; or

(vii) remove the option of the Holders to elect to receive GDSs in lieu of Common Shares, *provided*, that the Company has made arrangements set forth in (vi) above.

Notices

Whenever the Indenture provides for notice to be given to Holders, such notice will be validly given (except where otherwise expressly provided) if in writing and mailed, first-class postage prepaid, to each Holder entitled thereto, at such Holder's last address as it appears on the securities register maintained by the Trustee. In addition, notices shall be published in English in an Authorized Newspaper, which is expected to be, so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of such exchange so require, the *Luxemburger Wort*. Notice shall be deemed to have been given on the later of

- (i) the date of publication, or if published on different dates, on the date of the last such publication and
- (ii) the seventh day after the date such notice was mailed as aforesaid.

Concerning the Trustee

The Indenture provides that, prior to the occurrence of an Event of Default, the Trustee will not be liable except for the performance of such duties as are specifically set forth in such Indenture. If an Event of Default has occurred and is continuing, the Trustee will be obligated to use the same degree of care and skill as a prudent person would exercise under the circumstances in the conduct of such person's own affairs.

Governing Law

The Indenture and the Notes will be governed by, and construed in accordance with, the laws of the state of New York. The Company has submitted to the personal jurisdiction of any state or federal court located in the Borough of Manhattan, The City of New York, New York.

FORM OF THE NOTES AND TRANSFER RESTRICTIONS

Transfer Restrictions

Because of the following restrictions, purchasers are advised to consult legal counsel prior to making any offer, resale, pledge or other transfer of Rule 144A Notes, International Notes, the Common Shares issuable upon conversion of the Notes or the GDSs representing such Common Shares.

The Rule 144A Notes, the International Notes, the Common Shares issuable upon conversion of the Notes and the GDSs representing such Common Shares have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States or to U.S. Persons. The Notes are being offered and sold in the United States only to QIBs in reliance upon Rule 144A and are being offered and sold outside the United States to non-U.S. Persons in reliance upon Regulation S.

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of the Notes, the Common Shares issuable upon conversion of the Notes and the GDSs representing such Common Shares within the United States by any dealer (whether or not participating in the Offering) may violate the registration requirements of the Securities Act if such offer or sale is made other than in accordance with Rule 144A.

Except in certain limited circumstances, interests in the Notes may only be held through interests in the Global Notes. Such interests in the Global Notes will be shown on, and transfers thereof will be effected only through, records maintained by DTC (in the case of Rule 144A Notes) and Euroclear and Clearstream, Luxembourg (in the case of International Notes) and their respective direct and indirect participants.

According to Chapter VI, article 3, point A/II/2 of the Rules and Regulations of the Luxembourg Stock Exchange, the Notes shall be freely transferable and therefore no transaction made on the Luxembourg Stock Exchange shall be cancelled.

Transfer Restrictions on the Rule 144A Notes

Each owner of an interest in any Rule 144A Note, by its acceptance thereof, will be deemed to have acknowledged and represented and agreed as follows (terms used herein that are defined in Rule 144A or Regulation S are used as defined therein):

1. The Rule 144A Notes, the Common Shares issuable upon conversion of the Rule 144A Notes and the GDSs representing such Common Shares have not been and are not expected to be registered under the Securities Act or with any securities regulatory authority of any State of the United States and are subject to significant restrictions on transfer.
2. Such owner is a QIB within the meaning of Rule 144A under the Securities Act and is purchasing the Rule 144A Notes for its own account, an account with respect to which it exercises sole investment discretion, or for an account which is a QIB, and such owner is aware that the transferor of such securities is relying on the exemption from registration under the Securities Act provided by Rule 144A for the transfer.
3. Such owner will not offer, sell, pledge or otherwise transfer any interest in the Rule 144A Notes, the Common Shares issuable upon conversion of the Rule 144A Notes or the GDSs representing such Common Shares except as permitted by the applicable legend set forth in paragraph 4 below.

4. The Rule 144A Notes will bear a legend to the following effect, unless the Company determines otherwise in compliance with applicable law, and that it will observe the restrictions contained therein:

THE RULE 144A NOTES (“RULE 144A NOTES”) EVIDENCED HEREBY AND THE COMMON SHARES OF COMPAL ELECTRONICS, INC. ISSUABLE UPON CONVERSION OF THE RULE 144A NOTES AND THE GLOBAL DEPOSITARY SHARES (“GDSs”) REPRESENTING SUCH COMMON SHARES HAVE NOT BEEN, AND ARE NOT EXPECTED TO BE, REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), AND SUCH SECURITIES MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT IS (A) A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) OR A PURCHASER THAT THE SELLER AND ANY PERSON ACTING ON THE SELLER’S BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER, IN EACH CASE PURCHASING FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER, AND (B) AWARE THAT THE OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (2) IN AN OFFSHORE TRANSACTION MEETING THE REQUIREMENTS OF REGULATIONS UNDER THE SECURITIES ACT, (3) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OR (4) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE), IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND OTHER JURISDICTIONS. EACH HOLDER AND BENEFICIAL OWNER, BY ITS ACCEPTANCE OF THIS RULE 144A NOTE, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING RESTRICTIONS AND THAT NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 FOR REALES OF THIS NOTE, THE COMMON SHARES OR THE GDSs REPRESENTING SUCH COMMON SHARES.

5. The Rule 144A Notes offered in the Offering will initially be represented by the Rule 144A Global Note. Before any Rule 144A Notes evidenced by such Rule 144A Global Note may be sold or otherwise transferred to a person who takes delivery in the form of International Notes evidenced by the International Global Note, the transferor and the transferee will be required to provide written certifications in the forms set forth in the Indenture.

6. Any resale or other transfer, or attempted resale or other transfer, of the Rule 144A Notes made other than in compliance with the above-stated restrictions shall not be recognized by the Company or by the Trustee.

7. The Company, the registrar, the Purchasers and their affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements. If it is acquiring any Notes for the account of one or more QIBs, it represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

Prospective purchasers are hereby notified that sellers of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.

Transfer Restrictions on the International Notes

Each owner of an interest in any International Notes, by its acceptance thereof, will be deemed to have acknowledged and represented to and agreed with as follows (terms used herein that are defined in Rule 144A or Regulation S are used as defined therein):

1. The International Notes, the Common Shares issuable upon conversion of the International Notes and GDSs representing such Common Shares have not been and are not expected to be registered under the Securities Act or with any securities regulatory authority of any state of the United States and are subject to significant restrictions on transfer.
2. Each owner is a non-U.S. person purchasing the International Notes in an offshore transaction meeting the requirements of Rule 903 or 904 of Regulation S.
3. Such owner will not offer, sell, pledge or otherwise transfer any interest in the International Notes, Common Shares issuable upon conversion of the International Notes or the GDSs except as permitted by the applicable legend set forth in paragraph (4) below.
4. The International Notes will bear legends to the following effect, unless the Company determines otherwise in compliance with applicable law, and that it will observe the restrictions contained therein:

THE INTERNATIONAL NOTES (“INTERNATIONAL NOTES”) EVIDENCED HEREBY AND THE COMMON SHARES OF COMPAL ELECTRONICS, INC. ISSUABLE UPON CONVERSION OF THE INTERNATIONAL NOTES AND THE GLOBAL DEPOSITARY SHARES (“GDSs”) REPRESENTING SUCH COMMON SHARES HAVE NOT BEEN AND ARE NOT EXPECTED TO BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED IN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, ANY U.S. PERSON EXCEPT PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT AND ALL APPLICABLE LAWS. TERMS USED ABOVE HAVE MEANINGS GIVEN TO THEM IN REGULATIONS UNDER THE SECURITIES ACT.

5. The International Notes offered in the Offering will initially be represented by the International Global Note. Before any International Notes evidenced by such International Global Note may be sold or otherwise transferred to a person who takes delivery in the form of Rule 144A Notes evidenced by the Rule 144A Global Note, the transferor and the transferee will be required to provide written certifications in the forms set forth in the Indenture.
6. Any resale or other transfer, or attempted resale or other transfer of the International Notes made other than in compliance with the above-stated restrictions shall not be recognized by the Company or the Trustee.
7. The Issuer, the registrar, the Purchasers and their affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

GLOBAL NOTES

Global Notes

Upon the issue of the Rule 144A Global Note, DTC or its custodian will credit, in its internal system, the respective principal amount of the individual interests represented by such Rule 144A Global Note to the accounts of persons who have accounts with DTC. Such accounts initially will be designated by or on behalf of the Purchasers. Ownership of beneficial interests in the Rule 144A Global Note will be limited to persons who have accounts with DTC (“DTC Participants”) or persons who hold interests through DTC Participants. Ownership of beneficial interests in the Rule 144A Global Note will be shown on, and the transfer of that ownership will be effected only through, records maintained by DTC or its nominee (with respect to interests of DTC Participants) and the records of DTC Participants (with respect to interests of persons other than DTC Participants).

So long as DTC or its nominee is the registered owner or holder of the Rule 144A Global Note, DTC or such nominee, as the case may be, will be considered the sole owner or holder of the Rule 144A Notes represented by such Rule 144A Global Note for all purposes under the Indenture and the Notes. Unless DTC notifies the Company that it is unwilling or unable to continue as depository for the Rule 144A Global Note, or ceases to be a “clearing agency” registered under the United States Securities Exchange Act of 1934, as amended (the “Exchange Act”), or an Event of Default has occurred and is continuing with respect to the Notes, owners of interests in the Rule 144A Global Note will not be entitled to have any Rule 144A Notes registered in their names, will not receive or be entitled to receive physical delivery of Certificates in individual definitive form and will not be considered the owners or holders of the Rule 144A Global Note (or any Rule 144A Notes represented thereby) under the Indenture or the Notes. In addition, no beneficial owner of an interest in such Rule 144A Global Note will be able to transfer that interest except in accordance with DTC’s applicable procedures (in addition to those under the Indenture referred to herein and, if applicable, those of Euroclear and Clearstream, Luxembourg).

The International Global Note will be deposited with, and registered in the nominee name of, a common depository for Euroclear and Clearstream, Luxembourg (the “Common Depository”) and Euroclear and Clearstream, Luxembourg will credit their respective accountholders with the respective principal amounts of the individual interests represented by such International Global Note. Such accounts will be designated initially by or on behalf of the Purchasers. Ownership of beneficial interests in the International Global Note will be limited to persons who have accounts with Euroclear or Clearstream, Luxembourg or persons who hold interests through such accountholders. Ownership of beneficial interests in the International Global Note will be shown on, and the transfer of that ownership will be effected only through, the records maintained by Euroclear and Clearstream, Luxembourg (with respect to interests of their respective accountholders) and the records of such accountholders (with respect to interests of persons other than such accountholders).

Payments of the principal of the Global Notes will be made to DTC and the Common Depository or their respective nominees as the registered owners thereof. None of the Company, the Trustee, the Depository, the Paying Agents and any custodian, transfer agent or registrar will have any responsibility or liability for the accuracy of any of the records relating to, or payments made on account of, ownership interests in the Global Notes or for any notice permitted or required to be given to holders of Notes or any consent given or actions taken by such registered holders of Notes. The Company expects that upon receipt of any payment of principal in respect of a Global Note representing any Notes held by it or its nominee, DTC or the Common Depository, as the case may be, will immediately credit DTC Participants’ accounts, in the case of DTC, or Euroclear and Clearstream, Luxembourg, in the case of the Common Depository, with payments in amounts proportionate to their respective interests in the principal amount of such Global Notes as shown on their respective records.

Transfers between DTC Participants will be effected in DTC’s Same-Day Funds Settlement System. Transfers between accountholders in Euroclear and Clearstream, Luxembourg will be effected in accordance with their respective rules and operating procedures.

The laws of certain jurisdictions require that certain purchasers of securities take physical delivery of such securities in definitive form. Accordingly, the ability of beneficial owners to own, transfer or pledge beneficial interests in the Global Notes may be limited by such laws.

Conversion through participants in DTC will be effected in accordance with DTC's procedures. Conversion through participants in Euroclear and Clearstream, Luxembourg will be effected in the ordinary way in accordance with their respective rules and operating procedures.

Subject to compliance with the transfer restrictions applicable to the Notes described under "Form of the Notes and Transfer Restrictions", when beneficial interests in Global Notes are to be transferred from the account of a DTC Participant holding a beneficial interest in the Rule 144A Global Note to the account of a Euroclear or Clearstream, Luxembourg accountholder wishing to hold a beneficial interest in the International Global Note, the DTC Participant will deliver instructions for delivery to the relevant Euroclear or Clearstream, Luxembourg accountholder to DTC by 12:00 p.m. (noon), New York City time, on the settlement date. On the settlement date, the Trustee will (i) decrease the amount of Rule 144A Global Notes registered in the name of DTC or its nominee and evidenced by the Rule 144A Global Note and (ii) increase the amount of International Notes registered in the name of the Common Depository or its nominee and evidenced by the International Global Note. Book-entry interests will be delivered to Euroclear or Clearstream, Luxembourg, as the case may be, for credit to the relevant accountholder on the first Business Day following the settlement date.

Subject to compliance with the transfer restrictions applicable to the Notes described under "Form of the Notes and Transfer Restrictions", when beneficial interests in Global Notes are to be transferred from the account of a Euroclear or Clearstream, Luxembourg accountholder holding a beneficial interest in the International Global Note to the account of a DTC Participant wishing to hold a beneficial interest in the Rule 144A Global Note, the Euroclear or Clearstream, Luxembourg participant must send delivery instructions to Euroclear by 10:00 a.m. Brussels time for custody exchange instructions received by telex and by 3:00 p.m. Brussels time for custody exchange instructions received through SWIFT or Euclid and to Clearstream, Luxembourg by 7:45 p.m. Luxembourg time, one Business Day prior to the settlement date. Euroclear or Clearstream, Luxembourg, as the case may be, will in turn transmit appropriate instruction to the Trustee to arrange delivery to the DTC Participant on the settlement date. On the settlement date, the Trustee will (i) deliver such Rule 144A Notes by book-entry transfer to the relevant account of the DTC Participant and (ii) (a) decrease the amount of International Notes registered in the name of the Common Depository or its nominee and (b) increase the amount of Rule 144A Notes registered in the name of DTC or its nominee and evidenced by the Rule 144A Global Note.

Although DTC, Euroclear and Clearstream, Luxembourg have agreed to the foregoing procedures in order to facilitate transfers of interests in the International Global Note and in the Rule 144A Global Note among participants and accountholders of DTC, Clearstream, Luxembourg and Euroclear, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of the Company, the Trustee, the Depository, the Paying Agents, any custodian, any transfer agent, any registrar or any other agent of the Company will have any responsibility for the performance by DTC, Euroclear or Clearstream, Luxembourg or their respective participants, indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations.

DTC has advised the Company that it will take any action permitted to be taken by a holder of Notes (including the presentation of Notes for conversion as described below) only at the direction of one or more DTC Participants to whose account or accounts with DTC interests in the Rule 144A Global Note are credited and only in respect of such portion of the aggregate principal amount of Rule 144A Notes as to which such DTC Participant or DTC Participants has or have given such direction. The giving of notices and other communications by DTC to DTC Participants, by DTC Participants to persons who hold accounts with them and by such persons to holders of beneficial interests in the Global Notes will be governed by arrangements between them, subject to any statutory or regulatory requirements as may exist from time to time.

DTC has advised the Company as follows: DTC is a limited purpose trust company organized under the laws of the State of New York, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the Uniform Commercial Code and a "clearing agency" registered pursuant to the provision of Section 17A of the Exchange Act. DTC was created to hold securities for DTC Participants and facilitate the clearance and settlement of securities transactions between DTC Participants through electronic book-entry changes in accounts of DTC Participants, thereby eliminating the need for physical movement of certificates. DTC Participants include securities brokers and dealers, banks, trust companies and clearing corporations and may include certain other organizations. Indirect access to the DTC system is available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a DTC Participant, either directly or indirectly ("indirect participants").

Euroclear and Clearstream, Luxembourg each hold securities for participating organizations and facilitate the clearance and settlement of securities transactions between their respective participants through electronic book-entry changes in accounts of such participants. Euroclear and Clearstream, Luxembourg provide to their respective participants, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg participants are financial institutions throughout the world, including underwriters, securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. Indirect access to Euroclear and Clearstream, Luxembourg is also available to others, such as banks, brokers, dealers and trust companies which clear through or maintain a custodial relationship with a Euroclear or Clearstream, Luxembourg participant, either directly or indirectly.

Individual Definitive Certificates

If (i) DTC or any successor to DTC advises the Company in writing that it is at any time unwilling or unable to continue as a depository for the reasons described in "Global Notes" and a successor depository is not appointed by the Company within 90 days or (ii) either Euroclear or Clearstream, Luxembourg or a successor clearing system is closed for business for a continuous period of 14 days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so or (iii) an Event of Default has occurred and is continuing, the Company will issue individual Certificates in registered form in exchange for the Rule 144A Global Note and the International Global Note, as the case may be. Upon receipt of such notice from DTC, Euroclear, Clearstream, Luxembourg or the Trustee, as the case may be, the Company will use its best efforts to make arrangements for the exchange of interests in the relevant Global Note for individual definitive Certificates and cause the requested individual definitive Certificates to be executed and delivered to the Trustee in sufficient quantities and authenticated by the Trustee for delivery to Holders. Persons exchanging interests in a Global Note for individual definitive Certificates will be required to provide to the Trustee, through the relevant clearing system, (i) written instructions and other information required by the Company and the Trustee to complete, execute and deliver such individual definitive Certificates and (ii) in the case of an exchange of an interest in the Rule 144A Global Note, such certification as the Trustee shall require and, in all cases, individual definitive Certificates delivered in exchange for any Global Notes or beneficial interests therein will be registered in the names, and issued in any approved denominations, requested by the relevant clearing system.

In the case of individual definitive Certificates issued in exchange for the Rule 144A Global Note, such individual definitive Certificates will bear, and be subject to, such legends as the Company requires in order to assure compliance with any applicable law. The holder of a restricted individual definitive Certificate may transfer the Notes represented by such Certificate, subject to compliance with the provisions of such legend. Upon the transfer, exchange or replacement of Certificates bearing the legend, or upon specific request for removal of the legend on a Certificate, the Company will deliver only Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Company such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Company that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

DESCRIPTION OF COMMON SHARES

The following is a summary of certain provisions of our Articles of Incorporation, the ROC Company Law, the ROC Securities and Exchange Law and the regulations promulgated thereunder.

The ROC Company Law and the ROC Securities and Exchange Law provide that any change in the authorized share capital of a public company, such as the Company, requires the approval of its Board of Directors, an amendment to its Articles of Incorporation (which requires shareholder approval) and the approval of the SFC and the Ministry of Economic Affairs (“MOEA”). The rights attaching to the Common Shares are described below.

Dividends and Distributions

Except under limited circumstances as permitted under the Company Law, a company is not permitted to distribute dividends or to make any other distributions to shareholders at any time when that company has no Earnings (as defined below). In addition, before distributing a dividend or making any other distribution to shareholders, a company must recover any past losses, pay all outstanding taxes and set aside in a reserve, known as the “Legal Reserve”, 10% of its net profits after tax (“Earnings”) until such time as its Legal Reserve equals its paid-in-capital. Subject to compliance with these requirements, a company may pay dividends or make other distributions from its Earnings, reserves or other as permitted by the Company Law as set forth below.

Following approval by the shareholders in a general meeting, dividends are paid annually to shareholders from a company’s Earnings, in proportion to the number of shares held by them as listed on the register of shareholders as of the relevant record date (“Annual Dividends”). Annual Dividends may be distributed either in cash or in the form of common stock or a combination thereof, as determined by the shareholders at such meeting. All Common Shares, outstanding and fully paid as of the relevant record date for the distribution of dividends, are entitled to share equally in any dividend or other distribution so approved. The amount of any dividends is determined by the shareholders in a general meeting.

Our Articles of Incorporation provide that after recovering any past losses, paying all income taxes in accordance with the law and deducting 10% of the net profits as Legal Reserve, the remaining portion (plus the accumulated undistributed surplus profits carried over from the last fiscal year as permitted by the Company Law) shall be the total surplus profit available for distribution, which are allocated as follows:

1. 2% of such total surplus profit shall be distributed to directors and supervisors as remuneration.
2. 5% of such total surplus profit shall be distributed to employees as bonus.
3. The balance may be distributed as a shareholders’ dividend to all shareholders in proportion to their individual holdings proposed by the Board of Directors and approved by the shareholders’ meeting.

In addition to permitting dividends to be paid out of Earnings, the Company Law permits a company to make distributions to its shareholders in the form of additional shares of common stock from reserves (including the Legal Reserve and any special reserve or capital surplus reserve). In the case of a company’s Legal Reserve, however, the recapitalized portion payable out of such Legal Reserve is limited to 50% of the total accumulated Legal Reserve and such recapitalization can only be effected when the accumulated Legal Reserve amounts to 50% of the paid-in-capital of the company.

For information as to ROC taxes on dividends and distributions, see “Taxation — ROC Taxation”.

Pre-emptive Rights and Issues of Additional Shares

According to the Company Law, when a company issues new shares of capital stock for cash, 10% to 15% of the issue must be offered to its employees. According to the Securities and Exchange Law (in the

case of a listed company), at least 10% of the issue must also be offered to the public in order to fulfill the company's obligations as a public and listed company except when exempted by the SFC. This percentage can be increased by a resolution passed at a shareholders' meeting, thereby reducing the number of new shares subject to the pre-emptive rights of existing shareholders. Unless the percentage of the shares to be offered to the public is increased by such a resolution, existing shareholders of the company have a pre-emptive right to acquire the remaining 75% to 80% of the issue in proportion to their existing shareholdings. Such shares with respect to which no pre-emptive right has been exercised may be offered to other persons, subject to ROC law. Under the Company Law, the pre-emptive rights of shareholders are transferable, but the pre-emptive rights of employees may not be transferred. In practice, we will notify the shareholders or employees of the availability of such pre-emptive rights, and prescribe in the notice a period for paying the subscription price, and if the price is not paid or the pre-emptive right is waived, the shareholders or employees in question will not be able to obtain the new shares.

Authorized but unissued shares of any class may be issued at such times and, subject to the above mentioned provisions of the Company Law and the Securities and Exchange Law, upon such terms as the Board of Directors may determine.

Meeting of Shareholders

Our general meeting of shareholders is generally held in Taipei, Taiwan, within six months after the end of each fiscal year. Notice in writing of general meetings, stating the place, time and purpose thereof, must be dispatched to each shareholder at least 30 days prior to the date set for the meeting. Extraordinary meetings of shareholders may be convened by resolution of the Board of Directors whenever they consider it necessary, or under certain circumstances by shareholders or by a Supervisor. A notice in writing of such extraordinary meeting, stating the place, time and purpose thereof, must be dispatched to each shareholder at least 15 days prior to the date set for such meeting.

Voting Rights

A holder of Common Shares has one vote for each Common Share. Except as otherwise provided by law or by our Articles of Incorporation, a resolution can be adopted by the holders of a simple majority of the Common Shares represented at a shareholders' meeting at which a majority of the holders of the Common Shares is present.

The Company Law also provides that in order to approve certain major corporate actions, including any amendment of the Articles of Incorporation (which is required for, *inter alia*, any increase in authorized share capital), the dissolution or merger or spin-off of a company, the transfer of the whole or a substantial part of its business or its assets or the taking over of the whole of the business or assets of any other company which would have a significant impact on the acquiring company's operations, or the distribution of any stock dividend, a meeting of the shareholders must be convened with a quorum of holders of at least two-thirds of all issued and outstanding shares of common stock (or three-fourths in the case of dissolution or amalgamation of the company) at which the holders of at least a majority of the common stock represented at the meeting vote in favor thereof. Alternatively, in the case of a public company, such a resolution may be adopted by the holders of at least two-thirds of the shares of common stock represented at a meeting of shareholders at which holders of at least a majority of issued and outstanding shares of common stock are present.

A shareholder may be represented at a general or extraordinary meeting by proxy. A proxy must be delivered to us five days prior to the commencement of the meeting.

Register of Shareholders and Record Dates

We currently appoint Chinatrust Commercial Bank in Taipei, Taiwan as our share registrar to maintain the register of our shareholders and to enter transfers of the Common Shares in the register upon presentation of the certificates in respect of the Common Shares transferred. Under the Company Law, a transfer of Common Shares is effected by endorsement and delivery of the related share certificates. In

order, however, to assert shareholders' rights against us, the transferee must have his name and address registered on the register of shareholders. Our shareholders are required to file their respective specimen signatures or seals with us.

The Company Law permits us to set a record date and/or close the register of shareholders for a specified period in order for us to determine the shareholders or pledgees that are entitled to certain other rights pertaining to Common Shares by giving advance public notice. As provided in our Articles of Incorporation, our register of shareholders is closed for periods of 60 days, 30 days and five days immediately before each annual general meeting of shareholders, each extraordinary meeting of shareholders and each record date, respectively. The settlement of trading of the common stock is normally carried out on the book-entry system maintained by Taiwan Securities Central Depository Co., Ltd.

Acquisition of Common Shares by Us

We may not acquire our own Common Shares except in certain limited circumstances provided in ROC Company Law or ROC Securities and Exchange Law. Under Article 28-2 of the ROC Securities and Exchange Law, which took effect on July 19, 2000, we may, by a board resolution adopted by majority consent at a meeting with two-thirds of our directors present, purchase our Common Shares on the Taiwan Stock Exchange or by a tender offer, in accordance with the procedures prescribed by the SFC, for the following purposes: (1) to transfer Common Shares to our employees; (2) to convert bonds with warrants, preferred shares with warrants, convertible bonds, convertible preferred shares or certificates of warrants issued by us into our Common Shares; and (3) if necessary, to maintain our credit and our shareholders' equity; provided that the Common Shares purchased shall be cancelled thereafter.

We are not allowed to purchase more than 10% of our total issued and outstanding Common Shares. In addition, we may not spend more than the aggregate amount of the retained earnings, the premium from issuing shares and the realized portion of the capital reserve to purchase our Common Shares.

We may not pledge or hypothecate any purchased Common Shares. In addition, we may not exercise any shareholders' rights attaching to such Common Shares. In the event that we purchase our Common Shares on the Taiwan Stock Exchange, our affiliates, directors, supervisors, managers and their respective spouses and minor children and/or nominees are prohibited from selling any of our common shares during the period in which we purchase our Common Shares.

We have established a share buy-back program for transfer of our Common Shares to our employees. On September 22, 2001, the Board of Directors approved a purchase of a total of 103,920,000 Common Shares on the Taiwan Stock Exchange between September 24, 2001 and November 23, 2001, to be transferred to our employees. As of June 30, 2002, we held 7,559,000 Common Shares in treasury under that program, repurchased at the average price of NT\$25.64 per Common Share, and as of June 30, 2002 43,626,000 Common Shares have been transferred to employees.

The recent amendment to ROC Company Law prohibits our subsidiaries from acquiring our Common Shares if such subsidiaries are majority-owned, directly or indirectly, by us.

Annual Financial Statements

Ten days before the general meeting of shareholders, our annual financial statements must be made available at our principal office in Taipei for inspection by the shareholders. The Board of Directors is required to furnish the resolution for allocation of surplus profit or making up loss, including audited financial statements, to our shareholders.

Other Rights of Shareholders

Under ROC Company Law, dissenting shareholders are entitled to appraisal rights in the event of amalgamation and certain other major corporate actions. A dissenting shareholder may request the company to redeem all of the shares owned by such shareholder at a fair price to be determined by mutual

agreement or a court order if such agreement cannot be reached. Such shareholder may exercise such appraisal right by serving written notice on the company prior to the related shareholders' meeting or by raising and registering such objection at such shareholders' meeting. In addition to appraisal rights, any shareholder has the right to sue for the annulment of any resolution adopted at a shareholders' meeting where the procedures were defective. One or more shareholders who have held more than 3% of the issued and outstanding shares for over a year may require a supervisor to bring a derivative action against a director for such director's liability to the company as a result of such director's unlawful actions or failure to act. In addition, one or more shareholders who have held more than 3% issued and outstanding shares for over a year may require the Board of Directors to convene an extraordinary shareholders' meeting by sending a written request to the Board of Directors.

Liquidation Rights

In the event of our liquidation, the assets remaining after payment of all debts, liquidation expenses and taxes will be distributed *pro rata* to the shareholders in accordance with the ROC Company Law and our Articles of Incorporation.

DESCRIPTION OF THE GLOBAL DEPOSITARY RECEIPTS

The following, other than the paragraphs in italics, is a summary of certain material provisions of the Rule 144A Deposit Agreement dated October 19, 2000, as amended as of May 21, 2001, among us, the Depositary and the Owners and Beneficial Owners (as defined in the Rule 144A Deposit Agreement) from time to time of Rule 144A GDRs and the International Deposit Agreement dated October 19, 2000, as amended as of May 21, 2001, among us, the Depositary and the Owners and Beneficial Owners (as defined in the International Deposit Agreement) from time to time of International GDRs, pursuant to which the Rule 144A GDRs and International GDRs, respectively, are to be issued. This summary does not purport to be complete and is subject to and qualified in its entirety by reference to the Deposit Agreements, including the forms of Rule 144A GDRs and International GDRs. Terms used in this description and not otherwise defined shall have the meanings set forth in the Deposit Agreements. Copies of the Deposit Agreements are available for inspection at the Corporate Trust Office of the Depositary, currently located at 101 Barclay Street, New York, New York 10286, and at the principal Taipei office of the International Commercial Bank of China, the custodian and agent of the Depositary under each of the Deposit Agreements (the "Custodian"). The Depositary's principal executive office is located at One Wall Street, New York, New York 10286. Unless the context otherwise requires, references herein to GDRs shall apply equally to the Rule 144A GDRs and the International GDRs.

Global Depositary Receipts

Rule 144A GDSs evidenced by Rule 144A GDRs are issuable by the Depositary pursuant to the Rule 144A Deposit Agreement. International GDSs evidenced by International GDRs are issuable by the Depositary pursuant to the International Deposit Agreement. Each GDS will represent five Common Shares, or evidence of the right to receive five Common Shares, deposited with the Custodian and registered in the name of the Depositary or its nominee (together with any additional Common Shares at any time deposited or deemed deposited under the Deposit Agreements and any other securities, cash or other property received by the Depositary or the Custodian in respect of such Common Shares, the "Deposited Securities"). Only persons in whose name GDSs are registered on the books of the Depositary as owners of the GDSs will be treated by the Depositary and us as Owners.

The following description applies equally to the Rule 144A Deposit Agreement and the International Deposit Agreement, except as specifically indicated.

Deposit and Withdrawal

The Depositary has agreed, subject to the terms and conditions of the relevant Deposit Agreement, that upon delivery to the Custodian of Common Shares (or evidence of rights to receive Common Shares) to be represented by the GDSs and pursuant to appropriate instruments of transfer in a form satisfactory to the Custodian, the Depositary will upon payment of the fees, charges and taxes provided in the relevant Deposit Agreement, execute and deliver at its Corporate Trust Office to, or upon the written order of, the person or persons named in the notice of the Custodian delivered to the Depositary or requested by the person depositing such Common Shares with the Depositary, a GDR or GDRs, registered in the name or names of such person or persons, and evidencing any authorized number requested by such person or persons.

No deposit of Common Shares may be made into the Rule 144A GDS facility or the International GDS facility, and no GDSs may be issued against such deposits, without specific ROC regulatory approval, except in connection with (i) dividends on or free distributions of Common Shares, (ii) the exercise by Owners of existing GDSs of their pre-emptive rights in connection with rights offerings, (iii) transfers between the depositary facility for the Rule 144A GDSs and the depositary facility for the International GDSs and (iv) to the extent that previously issued GDSs have been canceled and the Common Shares represented thereby have been sold on the Taiwan Stock Exchange, reissuances of GDSs of up to an aggregate amount of outstanding GDSs not exceeding the total number of GDSs (subject to adjustment for the issuances described in clauses (i) and (ii) above) that were originally approved by the

ROC SFC. ROC regulatory approval has been received for GDSs to be issued upon deposit of Common Shares issuable upon conversion of the Notes.

Any deposit of Common Shares for Rule 144A GDSs must be accompanied by a written certification (“Depositor Certificate”) by or on behalf of the person who will be the beneficial owner of the Rule 144A GDSs to be issued upon deposit of such Deposited Securities, to the effect that (a) the Rule 144A GDSs and the Common Shares represented thereby have not been registered under the Securities Act, (b) it is a QIB acquiring such beneficial ownership for its own account or for the account of one or more QIBs and (c) it will comply with the restrictions set forth under “Form of GDRs and Transfer Restrictions” on transfers of the Rule 144A GDSs and the underlying Common Shares. No Common Shares will be accepted for deposit unless accompanied by evidence satisfactory to the Depository that all conditions to such deposit have been satisfied by the depositor under ROC laws and regulations. The Depository may also refuse to accept certain Common Shares for deposit under the Rule 144A Deposit Agreement if it believes that GDSs representing such Common Shares would not be eligible for resale pursuant to Rule 144A.

A registration statement on Form F-6 under the Securities Act relating to the International GDSs issued pursuant to the International Deposit Agreement may be filed with and declared effective (the “Effective Time”) by the U.S. Securities and Exchange Commission (“SEC” or the “Commission”). However, we have no present intention to cause any such registration statement to be filed with the SEC. There can be no assurance that a registration statement under the Securities Act relating to the International GDSs will be filed or, if filed, will be declared effective under the Securities Act by the SEC, nor can there be any assurance as to the timing of the filing of any such registration statement or the timing of the effectiveness thereof under the Securities Act.

Prior to the Effective Time, any depositor of Common Shares for International GDRs is required to (a) have made the representations and warranties required pursuant to the International Deposit Agreement and (b) acknowledge and agree that the International GDRs, the GDSs evidenced thereby and the Common Shares represented thereby have not been registered under the Securities Act and until the expiration of the 40-day period following the later of an offering of Shares by the Company or its affiliates or securities convertible, exercisable, or exchangeable into Shares, pursuant to which offering of securities we acquired the Shares being deposited, and the related closing (the “Distribution Compliance Period”) may not be offered, sold, pledged or otherwise transferred except (i) in accordance with Rule 144A under the Securities Act to a person that it and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or the account of a QIB or (ii) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S, in each case in accordance with any applicable securities laws of any State of the United States and *provided* that in connection with any transfer during the Distribution Compliance Period under (i) above, the transferor shall withdraw the Common Shares or the Deposited Securities in accordance with the terms and conditions of the International Deposit Agreement and instruct that such Common Shares be delivered to the Custodian under the Rule 144A Deposit Agreement for issuance, in accordance with the terms and conditions thereof, of Rule 144A GDSs to or for the account of such QIB.

Commencing three months after the closing date of an offering of new shares, an Owner may, to the extent that settlement for trading of Common Shares through the book-entry system maintained by the Taiwan Securities Central Depository Co. Ltd. is permitted, withdraw and hold the Common Shares represented by the GDSs or request the Depository to sell or cause to be sold on behalf of such Owner the Common Shares represented by such GDSs on the Taiwan Stock Exchange. However, Owners will not be able to withdraw Common Shares either for delivery or sale unless and until we have delivered to the Custodian physical share certificates for the Common Shares.

Upon surrender at the Corporate Trust Office of the Depository of a GDR for the purpose of withdrawal of the Deposited Securities underlying GDSs evidenced by such GDR, and upon payment of the fees, governmental charges and taxes provided in the relevant Deposit Agreement, and subject to the terms and conditions of such Deposit Agreement, our Articles of Incorporation and the Deposited

Securities, the Owner of such GDSs will be entitled (i) to request that such Deposited Securities be sold on such Owner's behalf, (ii) to delivery, to an account registered with us maintained by such Owner in the ROC, of the amount of Deposited Securities at the time represented by the GDSs, (iii) if applicable ROC law should change to prohibit one of the foregoing options, to whichever option shall remain or (iv) to such other dispositions of the Deposited Securities at the time represented by GDSs for such Owner's benefit as the Depositary and we may agree upon in compliance with ROC law.

In the case of any sale of Deposited Securities under (i) above, the following provisions shall apply:

The person requesting withdrawal of Deposited Securities shall deliver, or cause to be delivered, to the Depositary a written order requesting the Depositary to sell, or cause to be sold, such Deposited Securities. Upon the receipt of such an order and any other required instruments, the Depositary shall make a reasonable effort, in its sole discretion, to sell or cause to be sold such Deposited Securities in accordance with applicable law through a securities company in the ROC on the Taiwan Stock Exchange or in such manner as is or may be permitted under applicable ROC law. Any such sale of Deposited Securities shall be at the risk and expense of the Owner requesting such sale. There is no assurance that the Depositary will be able to effect any sale of the Deposited Securities in a timely manner or at a specified price, particularly during periods of illiquidity or volatility with respect to the Deposited Securities.

Upon receipt of any proceeds from such sale, the Depositary shall, subject to the provisions of the relevant Deposit Agreement and any restrictions imposed by ROC laws and regulations, convert or cause to be converted any such proceeds into U.S. Dollars and distribute any such proceeds to the Owners entitled thereto, after deduction or payment of any fees, expenses, taxes and governmental charges incurred in connection with such sale.

Under current ROC laws and regulations, a non-ROC withdrawing Owner is required to appoint a local agent in the ROC to, among other things, pay ROC taxes, open a securities trading account (with prior approval granted by the Taiwan Stock Exchange) with a local securities brokerage firm, remit funds and exercise a stockholder's right. In addition, such non-ROC withdrawing Owner must also appoint a bank in the ROC to act as custodian for confirmation and settlement of trades, safekeeping of securities and cash proceeds and reporting of information. Under existing ROC laws and regulations, without obtaining an approval from the Taiwan Stock Exchange and opening such securities trading account, a non-ROC withdrawing Owner would not be able to sell or otherwise transfer the Common Shares on the Taiwan Stock Exchange or otherwise.

In the case of any delivery of Deposited Securities under (ii) above, the following provisions shall apply:

Delivery of such Deposited Securities may be made by the delivery of (a) certificates in the name of such Owner or as ordered by him or certificates properly endorsed or accompanied by proper instruments of transfer to such Owner or as ordered by him and (b) any other securities, property and cash to which such Owner is then entitled in respect of such GDSs to such Owner or as ordered by him.

No Deposited Securities may be withdrawn upon surrender of a Rule 144A GDR in the manner described above unless, at or prior to the time of surrender, the Depositary shall have received a written certificate and agreement by or on behalf of the person surrendering such Rule 144A GDR or who after withdrawal will be the beneficial owner of the Deposited Securities withdrawn, acknowledging that such Common Shares have not been registered under the Securities Act, certifying that, (a) if it is the person surrendering the Rule 144A GDR, it is a QIB and is selling or transferring such Rule 144A GDR or the underlying Common Shares to another QIB or to a non-U.S. person (within the meaning of Regulation S) or (b) if it will be the beneficial owner upon withdrawal of the Common Shares underlying such Rule 144A GDR, it is either (i) a non-U.S. person (within the meaning of Regulation S) or (ii) a QIB (as defined in Rule 144A) and in the case of (ii), agrees (x) not to offer, sell, pledge or otherwise transfer such Common Shares except in a transaction that complies with the restrictions on transfer set forth under

“Form of GDRs and Transfer Restrictions” and (y) not to deposit or cause to be deposited such Common Shares into any unrestricted depositary receipt facility established or maintained by a depositary bank (including another facility maintained by the Depositary) relating to such Common Shares unless such Common Shares are no longer deemed to be restricted securities within the meaning of Rule 144(a)(3) under the Securities Act.

During the Distribution Compliance Period no Deposited Securities may be withdrawn upon surrender of an International GDR in the manner described above unless at or prior to the time of surrender, the Depositary shall have received a written certificate and agreement by or on behalf of the person surrendering such International GDR or who after withdrawal will be the beneficial owner of the Common Shares withdrawn, (a) acknowledging that such Common Shares have not been registered and will not be registered under the Securities Act and (b) certifying that, (i) if it is the person surrendering the International GDR, it is a non-U.S. person (within the meaning of Regulation S) and is selling or transferring such International GDR or the underlying Common Shares to another non-U.S. person or to a QIB in reliance on Rule 144A, in which latter case it shall cause, during the Distribution Compliance Period, the underlying Common Shares to be deposited under the Rule 144A Deposit Agreement for issuance of Rule 144A GDRs in accordance with the terms and conditions of the Rule 144A Deposit Agreement or (ii) if it will be the beneficial owner upon withdrawal of the Common Shares underlying such International GDR, it is either (x) a QIB and will cause, during the Distribution Compliance Period, the underlying Common Shares to be deposited under the Rule 144A Deposit Agreement for issuance of Rule 144A GDRs in accordance with the terms and conditions of the Rule 144A Deposit Agreement or (y) a non-U.S. person and in the case of (y), agrees, during the Distribution Compliance Period, not to offer, sell, pledge or otherwise transfer such Common Shares except in a transaction that complies with the restrictions on transfer set forth below under “Form of GDRs and Transfer Restrictions”.

Notwithstanding any of the foregoing, the Depositary may not accept requests for withdrawal or sale of Deposited Securities and no such withdrawal or sale shall be completed prior to three months after the closing date of an offering of new shares; *provided, however*, that the Depositary may accept requests for withdrawal of Deposited Securities from the Rule 144A facility or the international facility, as the case may be, during such period of time if such request for withdrawal is accompanied by instructions to be given to the Custodian for the immediate deposit under the International Deposit Agreement or the Rule 144A Deposit Agreement, as the case may be, of such withdrawn Deposited Securities and to the Depositary for the issuance of International GDRs or Rule 144A GDRs, as the case may be, all in accordance with the provisions of the International Deposit Agreement or the Rule 144A Deposit Agreement, as the case may be.

Neither the Depositary nor the Custodian under the International Deposit Agreement, nor any nominee or person on their behalf, shall accept Rule 144A GDRs issued pursuant to the Rule 144A Deposit Agreement or Common Shares withdrawn from the Rule 144A Deposit Agreement for the purpose of deposit under the International Deposit Agreement, or issue International GDRs against delivery thereof, as long as such Rule 144A GDRs or Common Shares are or may be deemed to be “restricted securities” within the meaning of Rule 144(a)(3) under the Securities Act.

Dividends, Other Distributions and Rights

Subject to any restrictions imposed by ROC law, regulations or applicable permits, the Depositary is required to convert or cause to be converted into U.S. Dollars, to the extent that in its judgment it can do so on a reasonable basis and can transfer the resulting U.S. Dollars to the United States, all cash dividends and other cash distributions denominated in a currency other than U.S. Dollars, including NT Dollars (“Foreign Currency”) that it receives in respect of the Deposited Securities, and to distribute the resulting U.S. Dollar amount (net of any expenses of conversion incurred by the Depositary and of the fees of the Depositary) to the Owners entitled thereto, in proportion to the number of GDSs representing such Deposited Securities held by them, respectively. Such distribution may be made upon an averaged or other practicable basis without regard to any distinctions among Owners on account of exchange restrictions or the date of delivery of any GDR or GDRs or otherwise. The amount distributed will be reduced by any

amount on account of taxes to be withheld by us or the Depositary. See “— Liability of Owner for Taxes”. If the Depositary determines that in its judgment any Foreign Currency received by it cannot be so converted and transferred, or if any approval or license of any government or agency thereof which is required for such conversion is denied or in the opinion of the Depositary is not obtainable, or if any such approval or license is not obtained within a reasonable period as determined by the Depositary, the Depositary may, subject to applicable laws and regulations, distribute the Foreign Currency (or an appropriate document evidencing the right to receive such foreign currency) received by it to, or in its discretion hold such Foreign Currency uninvested and without liability for interest thereon for the respective accounts of, the Owners entitled to receive the same. If any such conversion of Foreign Currency, in whole or in part, cannot be effected for distribution to some of the Owners entitled thereto, the Depositary may in its discretion make such conversion and distribution in U.S. Dollars to the extent permissible to the Owners entitled thereto, and may distribute the balance of the Foreign Currency received by it to, or hold such balance uninvested and without liability for interest thereon for the respective accounts of, the Owners entitled thereto. Notwithstanding the foregoing, Owners of International GDSs may elect to receive any such cash dividends or other cash distributions in a Foreign Currency under certain circumstances (a “Currency Election”) as set forth in the International Deposit Agreement.

If we declare a dividend in, or free distribution of, Common Shares, the Depositary may distribute to the Owners of outstanding GDRs entitled thereto, in proportion to the number of GDSs held by them, respectively, additional GDRs evidencing an aggregate number of GDSs representing the amount of Common Shares received as such dividend or free distribution, subject to the terms and conditions of the relevant Deposit Agreement with respect to the deposit of Common Shares and the issuance of GDSs, including the withholding of any tax or other governmental charge and the payment of fees of the Depositary. The Depositary may withhold any such distribution of GDRs if it has not received satisfactory assurances from us that such distribution does not require registration under the Securities Act or is exempt from registration under the provisions of such Act. In lieu of delivering GDRs evidencing fractional GDSs in the event of any such dividend or free distribution, the Depositary will sell the amount of Common Shares represented by the aggregate of such fractions and distribute the net proceeds in accordance with the relevant Deposit Agreement. If additional GDRs are not so distributed, each GDS shall thenceforth also represent the additional Common Shares distributed upon the Deposited Securities represented thereby. Each Beneficial Owner of Rule 144A GDSs (and prior to the Effective Time, each Beneficial Owner of International GDSs) or Common Shares so distributed shall be deemed to have acknowledged that the Common Shares have not been registered under the Securities Act and to have agreed to comply with the restrictions on transfer set forth under “Form of GDRs and Transfer Restrictions”.

If we offer or cause to be offered to the holders of any Deposited Securities any rights to subscribe for additional Common Shares or any rights of any other nature, the Depositary will have discretion as to the procedure to be followed in making such rights available to any Owners of GDSs or in disposing of such rights for the benefit of any Owners and making the net proceeds available in U.S. Dollars to such Owners or, if by the terms of such rights offering or for any other reason, the Depositary may not either make such rights available to any Owners or dispose of such rights and make the net proceeds available to such Owners, then the Depositary shall allow the rights to lapse; *provided, however*, if at the time of the offering of any rights the Depositary determines in its discretion that it is lawful and feasible to make such rights available to all Owners or to certain Owners but not to other Owners, the Depositary may distribute to any Owner to whom it determines the distribution to be lawful and feasible in proportion to the number of GDSs held by such Owner, warrants or other instruments therefor in such form as it deems appropriate. If the Depositary determines in its discretion that it is not lawful and feasible to make such rights available to certain Owners, it may sell the rights, warrants or other instruments in proportion to the number of GDSs held by the Owners to whom it has determined it may not lawfully or feasibly make such rights available, and allocate the net proceeds (net of the fees and expenses of the Depositary and all taxes and governmental charges payable in connection with such rights and subject to the terms and conditions of the relevant Deposit Agreement) of such sales for the account of such Owners otherwise entitled to such rights, warrants or other instruments, upon an averaged or other practical basis without

regard to any distinctions among such Owners because of exchange restrictions or the date of delivery of any GDR or GDRs, or otherwise.

In circumstances in which rights would not otherwise be distributed, if an Owner of GDSs requests the distribution of warrants or other instruments in order to exercise the rights allocable to the GDSs of such Owner, the Depositary will make such rights available to such Owner upon written notice from us to the Depositary that (a) we have elected in our sole discretion to permit such rights to be exercised and (b) such Owner has executed such documents as we have determined in our sole discretion are reasonably required under applicable law. Upon instruction pursuant to such warrants or other instruments to the Depositary from such Owner to exercise such rights, upon payment by such Owner to the Depositary for the account of such Owner of an amount equal to the purchase price of the Common Shares to be received in exercise of the rights, and upon payment of the fees of the Depositary as set forth in the relevant Deposit Agreement and in such warrants or other instruments, the Depositary will, on behalf of such Owner, exercise the rights and purchase the Shares, and we shall cause the Common Shares so purchased to be delivered to the Depositary on behalf of such Owner. As agent for such Owner, the Depositary will cause the Common Shares so purchased to be deposited, and will execute and deliver GDRs to such Owner, pursuant to the relevant Deposit Agreement.

The Depositary will not offer rights to Owners unless both the rights and the securities to which such rights relate are either exempt from registration under the Securities Act with respect to a distribution to all Owners or are registered thereunder. If an Owner of GDSs requests the distribution of warrants or other instruments, notwithstanding that there has been no such registration under the Securities Act, the Depositary shall not effect such distribution unless it has received an opinion from our recognized counsel in the United States, to be provided at our sole expense, upon which the Depositary may rely that such distribution to such Owner is exempt from such registration. Notwithstanding any terms of the relevant Deposit Agreement to the contrary, we shall have no obligation to prepare and file a registration statement for any purpose.

The Depositary shall not be responsible for any failure to determine that it may be lawful or feasible to make such rights available to owners in general or any Owner in particular.

Whenever the Depositary shall receive any distribution other than cash, Common Shares or rights in respect of the Deposited Securities, the Depositary will cause the securities or property received by it to be distributed to the Owners entitled thereto, after deduction or upon payment of any fees and expenses of the Depositary or any taxes or other governmental charges, in proportion to their holdings, respectively, in any manner that the Depositary may reasonably deem equitable and practicable for accomplishing such distributions; *provided, however*, that if in the opinion of the Depositary such distribution cannot be made proportionately among the Owners entitled thereto, or if for any other reason (including any requirement that we or the Depositary withhold an amount on account of taxes or other governmental charges or that such securities must be registered under the Securities Act in order to be distributed) the Depositary deems such distribution not to be feasible, the Depositary may adopt such method as it may deem equitable and practicable for the purpose of effecting such distribution, including but not limited to the sale (at public or private sale) of the securities or property thus received, or any part thereof, and the net proceeds (net fees and expenses as provided in the relevant Deposit Agreement) of any such sale will be distributed by the Depositary to the Owners entitled thereto as in the case of a distribution received in cash.

If the Depositary determines that any distribution of property (including Common Shares and rights to subscribe therefor) is subject to any tax or other governmental charge which the Depositary is obligated to withhold, the Depositary may dispose of all or a portion of such property in such amounts and in such manner as the Depositary deems necessary and practicable to pay such taxes or charges, by public or private sale, and the Depositary will distribute the net proceeds of any such sale after deduction of such taxes or charges to the Owners entitled thereto in proportion to the number of GDSs held by them, respectively.

Upon any change in nominal or par value, split-up, consolidation or any other reclassification of Deposited Securities, or upon any recapitalization, reorganization, merger or consolidation or sale of assets affecting us or to which we are a party, any securities that shall be received by the Depositary or Custodian in exchange for, in conversion of, or in respect of Deposited Securities will be treated as new Deposited Securities under the relevant Deposit Agreement, and the GDSs shall thenceforth represent, in addition to the existing Deposited Securities, the right to receive the new Deposited Securities so received in exchange or conversion, unless additional GDRs are delivered pursuant to the following sentence. In any such case, the Depositary may execute and deliver additional GDRs as in the case of distribution in Common Shares, or call for the surrender of outstanding GDRs to be exchanged for new GDRs specifically describing such new Deposited Securities.

Record Dates

Whenever any cash dividend or other cash distribution shall become payable or any distribution other than cash shall be made, or whenever rights shall be issued with respect to the Deposited Securities, or whenever for any reason the Depositary causes a change in the number of Common Shares that are represented by each GDS, or whenever the Depositary shall receive notice of any meeting of holders of Common Shares, or other Deposited Securities, or whenever the Depositary shall find it necessary or convenient, the Depositary will fix a record date which shall be the same date or as near as possible to the corresponding date we fixed, (a) for the determination of the Owners who shall be (i) entitled to receive such dividend, distribution or rights, or the net proceeds of the sale thereof, (ii) entitled to give instructions for the exercise of voting rights at any such meeting or (iii) obligated to pay any charges in connection with the servicing of the Common Shares or other Deposited Securities or (b) on or after which each GDS will represent the changed number of Common Shares, all subject to the provisions of the relevant Deposit Agreement.

Voting of Deposited Securities

Upon receipt of notice of any meeting of holders of Common Shares or other Deposited Securities, the Depositary shall, at our written request, as soon as practicable thereafter, fix a record date for determining the Owners entitled to receive information as to such meeting and shall deliver to the Owners of record: (a) the notice of such meeting sent by us, including, if an election of directors or supervisors is to be held at the meeting, a list of the candidates who have expressed their intention to run for an election of directors or supervisors, if such list is provided to the Depositary by us, (b) a statement that (i) if the Depositary receives instructions from Owners as of the close of business on a record date established by the Depositary of an aggregate of at least 51% of Rule 144A GDSs and International GDSs (a "Majority of Owners") instructing the Depositary to vote Common Shares in respect of any matter in the same manner (other than the election of directors or supervisors) to be voted upon at such meeting, then the Depositary will in respect of such matter appoint our Chairman or a person designated by our Chairman (the "Voting Representative") as the representative of the Depositary and the Owners to attend such meeting and to vote all the Common Shares represented by GDSs in accordance with such identical instructions, insofar as practical and permitted under applicable law and our Articles of Incorporation and (ii) if the Depositary does not receive such identical instructions from a Majority of Owners with respect to such matters, the Depositary will appoint the Voting Representative to attend the relevant meeting and to vote all the Common Shares represented by GDSs as the Voting Representative deems appropriate and (c) a statement as to the manner in which instruction in respect of such matter may be given by Owners.

If the Depositary receives instructions from a Majority of Owners instructing the Depositary to vote Common Shares in respect of any matter in the same manner (other than the election of directors or supervisors) to be voted upon at such meeting, then the Depositary will in respect of such matter appoint the Voting Representative as representative of the Depositary and the Owners to attend such meeting and to vote all the Common Shares represented by GDSs in accordance with such identical instructions, insofar as practicable and permitted under applicable law and our Articles of Incorporation. If the Depositary does not receive such identical instructions from a Majority of Owners with respect to such

matter, the Depositary will appoint the Voting Representative to attend such meeting and to vote all the Common Shares represented by GDSs as the Voting Representative deems appropriate; provided, however that the Depositary will not make any such appointment unless it has received an opinion of our ROC counsel addressed to the Depositary and in form and substance satisfactory to the Depositary, at our sole expense, to the effect that, under ROC law (i) the relevant Deposit Agreement is valid, binding and enforceable against us and the Owners and the Beneficial Owners and (ii) the Depositary will not be deemed to be authorized to exercise any discretion when voting in accordance with the relevant Deposit Agreement and will not be subject to any potential liability for losses arising from such voting.

In connection with the election of directors and supervisors, we will provide in the notice to stockholders an indication of the number of directors or supervisors to be elected and a list of the candidates proposed by us. Additional or different candidates may be nominated at the meeting of the stockholders other than those proposed in the list we provided. The Depositary will forward the instructions for election of directors and supervisors that it has received from the Owners to the Voting Representative and appoint the Voting Representative as the representative of the Depositary and the Owners to attend such meeting, nominate, if necessary, the candidate or candidates named in such instructions, and vote the Common Shares represented by GDSs for which it has received instructions for the election of directors and supervisors from Owners in the manner so instructed. If the Depositary does not receive any such instructions from any Owner as provided above by the date fixed by the Depositary as the last date to accept such instructions, then, subject to the preceding sentence, the Depositary will appoint the Voting Representative to attend the relevant meeting and vote all the Common Shares represented by GDSs as to which the Depositary has not received instructions (with respect to the election of directors and supervisors) as the Voting Representative deems appropriate; *provided, however* that the Depositary will not make any such appointment unless it has received an opinion of our ROC counsel addressed to the Depositary and in form and substance satisfactory to the Depositary, at our sole expense, to the effect that, under ROC law (i) the relevant Deposit Agreement is valid, binding and enforceable against us and the Owners and Beneficial Owners and (ii) the Depositary will not be deemed to be authorized to exercise any discretion when voting in accordance with the relevant Deposit Agreement and will not be subject to any potential liability for losses arising from such voting. In connection with the election of directors and supervisors, candidates standing for election as representatives of a stockholder may be replaced by such stockholder prior to the meeting of the stockholders, and the votes cast by the Owners for such candidates shall be counted as votes for their replacements.

The Depositary, in order to be qualified to act as representative of the Owners, shall take all appropriate actions required from time to time by applicable laws and regulations of the ROC, including acting as an Owner in its own capacity.

There can be no assurance that the Owners generally or any Owner in particular will receive the notice described in this paragraph sufficiently prior to the date established by the Depositary for the receipt of instructions to ensure that the Depositary will in fact receive such instructions on or before such date.

Reports and Other Communications

The Depositary will make available for inspection by Owners at its Corporate Trust Office any reports and communications, including any proxy soliciting material, received from us, which are both (a) received by the Depositary as the holder of the Deposited Securities and (b) made generally available to the holders of such Deposited Securities by us. The Depositary will also send to the Owners copies of such reports, when furnished by us pursuant to the relevant Deposit Agreement. Any such reports and communications, including any proxy soliciting material, furnished to the Depositary by us will be furnished in English when so required pursuant to any regulations of the Commission.

For so long as any of the GDSs are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act, at any time we are neither subject to Section 13 or 15(d) of the Exchange Act, nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder, we have agreed in the Deposit Agreements to supply to the Depositary such information in the English language, in sufficient quantities,

as is required to be delivered to any holder or beneficial owner of GDSs and a prospective purchaser designated by such holder (in each case, within the meaning of Rule 144A under the Securities Act) and the information delivery requirements of Rule 144A(d)(4) under the Securities Act, in order to permit compliance with Rule 144A thereunder in connection with resales of GDSs. Subject to receipt, the Depositary will deliver such information on our behalf in its capacity as an agent only, at our expense during any period in which we inform the Depositary that we are subject to the information delivery requirements of Rule 144A(d)(4), to any such holder, or beneficial owner or prospective purchaser at the request of such holder, beneficial owner or prospective purchaser.

Amendment and Termination of the Deposit Agreements

The GDRs and the Deposit Agreements may at any time be amended by agreement between the Depositary and our Company without the consent of the Owners or Beneficial Owners of GDRs; *provided, however*, that any amendment that imposes or increases any fees or charges (other than taxes, other governmental charges, delivery and other such expenses), or which otherwise prejudices any substantial existing right of Owners, will not take effect as to outstanding GDRs until the expiration of 30 days after notice of any amendment has been given to the Owners of outstanding GDRs. Every Owner of a GDS, at the time any amendment so becomes effective, will be deemed by continuing to hold such GDS to consent and agree to such amendment and to be bound by the relevant Deposit Agreement as amended thereby.

The Depositary shall at any time at our direction terminate the Deposit Agreements by mailing notice of such termination to the Owners or Beneficial Owners of the GDRs then outstanding at least 30 days prior to the date fixed in such notice for such termination. The Depositary may likewise terminate the Deposit Agreements by mailing notice of such termination to us and the Owners of all GDRs then outstanding if, at any time after 30 days have expired after the Depositary shall have delivered to us a written notice of its election to resign, a successor depositary shall not have been appointed and accepted its appointment, in accordance with the terms of the Deposit Agreements. If any GDRs remain outstanding after the date of termination of the Deposit Agreements, the Depositary thereafter will discontinue the registration of transfers of GDRs, will suspend the distribution of dividends to the Owners thereof and will not give any further notices or perform any further acts under the Deposit Agreements, except the collection of dividends and other distributions pertaining to the Deposited Securities, the sale of rights and other property and the delivery of underlying Deposited Securities, together with any dividends or other distributions received with respect thereto and the net proceeds of the sale of any rights or other property, in exchange for surrendered GDRs (after deducting the fees of the Depositary and other expenses set forth in the Deposit Agreements). At any time after the expiration of one year from the date of termination, the Depositary may sell the Deposited Securities then held thereunder and hold uninvested the net proceeds of such sale together with any other cash, unsegregated and without liability for interest, for the pro rata benefit of the Owners that have not theretofore surrendered their GDRs, such Owners thereupon becoming general creditors of the Depositary with respect to such net proceeds. After making such sale, the Depositary will be discharged from all obligations under the Deposit Agreements, except to account for net proceeds and other cash (after deducting the fees of the Depositary and other expenses set forth in the Deposit Agreements and any applicable taxes or other governmental charges). Upon termination of the relevant Deposit Agreement, we shall be discharged from all obligations under the relevant Deposit Agreement except for our obligations to the Depositary with respect to indemnities and payment of charges.

Charges of Depositary

The Depositary will charge any party depositing or withdrawing Common Shares or any party surrendering GDRs or to whom GDRs are issued (including, without limitation, issuance pursuant to a stock dividend or stock split declared by us or an exchange of stock regarding the GDRs or Deposited Securities or a distribution of GDRs pursuant to the relevant Deposit Agreement) where applicable: (1) taxes and other governmental charges; (2) such registration fees as may from time to time be in effect for the registration of transfers of Common Shares generally on our share register (or our appointed agent

for transfer and registration of Common Shares) and applicable to transfers of Common Shares to the name of the Depository or its nominee or the Custodian or its nominee on the making of deposits or withdrawals; (3) such cable, telex and facsimile transmission expenses as are expressly provided in the relevant Deposit Agreement to be at the expense of persons depositing Common Shares or Owners; (4) such expenses as are incurred by the Depository in the conversion of Foreign Currency pursuant to the relevant Deposit Agreement; (5) a fee not in excess of U.S.\$5.00 per 100 GDSs (or portion thereof) for the issuance or surrender, respectively, of GDRs pursuant to the Deposit Agreement; (6) a fee not in excess of U.S.\$0.02 per GDS (or portion thereof) for any cash distribution made pursuant to the relevant Deposit Agreement; (7) a fee for the distribution of securities or rights pursuant to the relevant Deposit Agreement, such fee being in an amount equal to the fee for the issuance of GDSs referred to above which would have been charged as a result of the deposit by the Owners of such securities (for purposes of this clause (7) treating all such securities as if they were Common Shares) but which securities are instead distributed by the Depository to the Owners; (8) a fee not in excess of U.S.\$1.50 per certificate for issuances or registrations of transfers of GDRs in definitive form made pursuant to the relevant Deposit Agreement; (9) any other charge payable by the Depository, any of the Depository's agents, including the Custodian, or the agents of the Depository's agents in connection with the servicing of Common Shares or other Deposited Securities (which charge shall be assessed against Owners of record as of the date or dates set by the Depository in accordance with the relevant Deposit Agreement and shall be collected at the sole discretion of the Depository by billing such Owners for such charge or by deducting such charge from one or more cash dividends or other cash distributions) and (10) a Currency Election fee of U.S.\$0.05 or less per International GDS for the acceptance by the Depository of a Currency Election.

Liability of Owner for Taxes

If any tax or other governmental charge shall become payable by the Custodian or the Depository with respect to any GDR, the GDSs evidenced thereby or any underlying Deposited Securities, such tax or other governmental charge will be payable by the Owner of such GDS to the Depository. The Depository may refuse to effect any transfer of such GDS or any withdrawal of Deposited Securities underlying such GDS until such payment is made and may withhold any dividends or other distributions or may sell for the account of the Owner or Beneficial Owners thereof any part or all of the Deposited Securities underlying such GDS and may apply such dividends, distributions or the proceeds of any such sale to pay any such tax or other governmental charge and the Owner of such GDS shall remain liable for any deficiency.

General

Neither the Depository nor we nor any of their/our respective directors, employees, agents or affiliates will be liable to any Owner or Beneficial Owner if by reason of any provision of any present or future law or regulation of the United States, ROC or any other country, or of any other governmental or regulatory authority or stock exchange or by reason of any provision, present or future, of our Articles of Incorporation, or by reason of any provision of any securities issued or distributed by us, or any offering or distribution thereof, or by reason of any act of God or war or other circumstances beyond our control, the Depository or us or any of their/our directors, employees, agents or affiliates shall be prevented, delayed or forbidden from, or be subject to any civil or criminal penalty on account of, doing or performing any act or thing which by the terms of the relevant Deposit Agreement or the Deposited Securities it is provided shall be done or performed; nor will the Depository or we incur any liability to any Owner or Beneficial Owner by reason of any non-performance or delay, caused as stated in the preceding clause, in the performance of any act or thing which by the terms of the Deposit Agreement it is provided shall or may be done or performed, or by reason of any exercise of, or failure to exercise, any discretion provided for under the relevant Deposit Agreement or our Articles of Incorporation.

The Depository and our Company assume no obligation nor will we be subject to any liability under the Deposit Agreements to the Owners or Beneficial Owners of GDSs, except that we agree to perform

our respective obligations specifically set forth under the relevant Deposit Agreement without negligence or bad faith.

The GDSs are transferable on the books of the Depositary, provided that the Depositary may close the transfer books at any time or from time to time when deemed expedient by it in connection with the performance of its duties or at our written request. As a condition precedent to the execution and delivery, registration of transfer, split-up, combination or surrender of any GDR or withdrawal of any Deposited Securities, the Depositary or the Custodian may require payment from the person presenting the GDR or the depositor of the Common Shares of a sum sufficient to reimburse it for any tax or other governmental charge and any stock transfer or registration fee with respect thereto (including any such tax or charge and fee with respect to Common Shares being deposited or withdrawn) and payment of any applicable fees payable by the Beneficial Owners. The Depositary may refuse to deliver GDRs, to register the transfer of any GDS or to make any distribution on, or related to, Common Shares until it has received such proof of citizenship or residence, exchange control approval or other information as it may deem necessary or proper as to the identity and genuineness of any signature and may also require compliance with any regulations the Depositary may establish consistent with the relevant Deposit Agreement. The delivery, transfer and surrender of GDRs generally may be suspended during any period when the transfer books of the Depositary, the Foreign Registrar or our company are closed or if any such action is deemed necessary or advisable by the Depositary or our company. At any time or from time to time at and subsequent to the Effective Time, the surrender of outstanding International GDRs, and the withdrawal of Deposited Securities may not be suspended subject only to (i) the temporary delays caused by closing the transfer books of the Depositary or our company or the deposit of Common Shares in connection with voting at a shareholders' meeting or the payment of dividends, (ii) the payment of any fees, taxes, and similar charges and (iii) compliance with any U.S. or foreign laws or governmental regulations relating to the GDSs or to the withdrawal of the Deposited Securities.

Subject to the terms and conditions of the Deposit Agreements unless requested in writing by us to cease doing so, the Depositary may execute and deliver GDRs prior to the receipt of Common Shares (a "Pre-Release") and deliver Common Shares upon the receipt and cancellation of GDRs which have been Pre-Released, whether or not such cancellation is prior to the termination of such Pre-Release or the Depositary knows that such GDR has been Pre-Released. The Depositary may receive GDRs in lieu of Common Shares in satisfaction of a Pre-Release. Each Pre-Release must be (i) preceded or accompanied by a written representation and agreement from the person to whom the GDRs or Common Shares are to be delivered (the "Pre-Releasee") that such person, or its customer, owns the Common Shares or GDRs to be remitted, as the case may be, assigns all beneficial right, title and interest in such Common Shares or GDRs, as the case may be, to the Depositary for the benefit of the Owners, and will not take any action with respect to such Common Shares or GDRs, as the case may be, that is inconsistent with the transfer of beneficial ownership (including, without the consent of the Depositary, disposing of such Common Shares or GDRs, as the case may be) other than in satisfaction of such pre-Release, (ii) at all times fully collateralized with cash, U.S. government securities or such other collateral, as the Depositary determines, in good faith, will provide substantially similar liquidity and security, (iii) terminable by the Depositary on not more than five business days' notice and (iv) subject to such further indemnities and credit regulations as the Depositary deems appropriate. The number of Common Shares not deposited but represented by GDSs outstanding at any time as a result of Pre-Releases will not normally exceed 30% of the Common Shares deposited under the Deposit Agreements; *provided, however*, that the Depositary reserves the right to disregard such limit from time to time as it deems reasonably appropriate, and may, with our prior written consent, change such limit for purposes of general application. The Depositary will also set U.S. Dollar limits with respect to Pre-Release transactions to be entered into under the Deposit Agreements with any particular Pre-Releasee on a case-by-case basis as the Depositary deems appropriate. For purposes of enabling the Depositary to fulfill its obligations to the Owners under the Deposit Agreements, the collateral referred to in clause (ii) above shall be held by the Depositary as security for the performance of the Pre-Releasee's obligations to the Depositary in connection with a Pre-Release transaction, including the Pre-Releasee's obligation to deliver Common Shares or GDRs upon termination of a Pre-Release transaction (and shall not, for the avoidance of doubt, constitute Deposited Securities).

Each deposit of Common Shares under the Rule 144A Deposit Agreement or, prior to the Effective Time, the International Deposit Agreement, in connection with a Pre-Release described above shall be subject to receipt by the Depositary of a duly executed and completed Depositor Certificate. The Depositary may retain for its own account any compensation received by it in connection with the foregoing.

The Depositary will keep books, at its transfer office in The City of New York, for the registration and transfer of GDSs, which at all reasonable times will be open for inspection by the Owners, provided that such inspection shall not be for the purpose of communicating with Owners in the interest of a business or object other than our business or a matter related to the Deposit Agreements or the GDSs.

The Depositary may, upon our written approval, appoint one or more co-transfer agents for the purpose of effecting transfers, combinations and split-ups of GDSs at designated transfer offices on behalf of the Depositary. In carrying out its functions, a co-transfer agent may require evidence of authority and compliance with applicable laws and other requirements by the Beneficial Owners or Owners or persons entitled thereto and will be entitled to protection and indemnity to the same extent as the Depositary.

Governing Law

The Deposit Agreements are governed by the laws of the State of New York.

FORM OF GDRs AND TRANSFER RESTRICTIONS

Because of the following restrictions, purchasers are advised to consult legal counsel prior to making any resale, pledge or other transfer of Rule 144A GDSs, International GDSs or Common Shares represented thereby.

The Rule 144A GDSs, the International GDSs and the Common Shares represented thereby have not been registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act.

Except in certain limited circumstances, interests in the GDSs may only be held through interests in the Master International GDR or the Master Rule 144A GDR (together, the "Master GDRs"). Such interest in the Master GDRs will be shown on, and transfers thereof will be effected only through, records maintained by DTC (in the case of the Master Rule 144A GDR) and Euroclear and Clearstream, Luxembourg (in the case of the Master International GDR) and their respective direct and indirect participants.

Rule 144A GDSs

Each owner of an interest in Rule 144A GDSs will be deemed to have represented, agreed and acknowledged that (terms used herein that are defined in Rule 144A or Regulation S are used as defined therein):

(1) It is (a) a qualified institutional buyer within the meaning of Rule 144A ("QIB"), (b) acquiring such Rule 144A GDSs for its own account or for the account of one or more QIBs, each of whom is able to and who does represent, acknowledge and agree to the same extent that would be required if it invested directly in the Rule 144A GDSs.

(2) It understands that such Rule 144A GDSs and the Common Shares represented thereby have not been and will not be registered under the Securities Act and may not be offered, sold, pledged or otherwise transferred except (a) to a person that it and any person acting on its behalf reasonably believe is a QIB within the meaning of Rule 144A in a transaction meeting the requirements of Rule 144A, (b) in accordance with Regulation S or (c) pursuant to an effective registration statement under the Securities Act or in accordance with Rule 144 (if available), in each case in accordance with any applicable securities laws of any State of the United States.

(3) It understands that the Rule 144A GDRs and the Master Rule 144A GDR, unless otherwise determined by the Company in accordance with applicable law, will bear a legend substantially to the following effect:

THIS RULE 144A GLOBAL DEPOSITARY RECEIPT ("GDR"), THE RULE 144A GLOBAL DEPOSITARY SHARES ("RULE 144A GDSs") EVIDENCED HEREBY, AND THE UNDERLYING SHARES OF COMPAL ELECTRONICS, INC. (THE "SHARES") REPRESENTED THEREBY, HAVE NOT BEEN, AND ARE NOT EXPECTED TO BE, REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND SUCH SECURITIES MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A UNDER THE SECURITIES ACT, TO A PERSON THAT IS (A) A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) OR A PURCHASER THAT THE SELLER AND ANY PERSON ACTING ON THE SELLER'S BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER, IN EACH CASE PURCHASING FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER AND (B) AWARE THAT THE OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (2) IN AN OFFSHORE TRANSACTION MEETING THE REQUIREMENTS OF REGULATION S UNDER THE SECURITIES ACT, (3) PURSUANT TO AN EFFECTIVE REGISTRATION

STATEMENT UNDER THE SECURITIES ACT OR (4) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE), IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES AND OTHER JURISDICTIONS. EACH OWNER AND BENEFICIAL OWNER, BY ITS ACCEPTANCE OF THIS RULE 144A GDR OR AN INTEREST IN THE RULE 144A GDSs EVIDENCED HEREBY, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING AND FOLLOWING RESTRICTIONS AND THAT NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 FOR REALES OF THIS NOTE OR THE SHARES REPRESENTED THEREBY.

NOTWITHSTANDING ANYTHING TO THE CONTRARY IN THE FOREGOING, THE SHARES REPRESENTED BY THE RULE 144A GDSs EVIDENCED HEREBY MAY NOT BE DEPOSITED INTO ANY UNRESTRICTED DEPOSITARY RECEIPT FACILITY IN RESPECT OF THE SHARES ESTABLISHED OR MAINTAINED BY A DEPOSITARY BANK (INCLUDING THE BANK OF NEW YORK), UNLESS AND UNTIL SUCH TIME AS SUCH SHARES ARE NO LONGER "RESTRICTED SECURITIES" WITHIN THE MEANING OF THE SECURITIES ACT.

UNLESS THIS CERTIFICATE IS PRESENTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITARY TRUST COMPANY, A NEW YORK CORPORATION ("DTC"), TO THE AGENT AUTHORIZED BY THE COMPANY FOR REGISTRATION OF TRANSFER, EXCHANGE, OR PAYMENT, AND ANY CERTIFICATE ISSUED IS REGISTERED IN THE NAME OF CEDE & CO. OR IN SUCH OTHER NAME AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF DTC (AND ANY PAYMENT IS MADE TO CEDE & CO. OR TO SUCH OTHER ENTITY AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF DTC), ANY TRANSFER, PLEDGE, OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL INASMUCH AS THE REGISTERED OWNER HEREOF, CEDE & CO., HAS AN INTEREST HEREIN.

(4) The Company, the Depositary, the Purchasers and their respective affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements. If it is acquiring any Rule 144A GDSs for the account of one or more QIBs, it represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

(5) It understands that the GDSs offered in reliance on Rule 144A will be represented by the Master Rule 144A GDR. Before any interest in the Master Rule 144A GDR may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Master International GDR, it will be required to provide a transfer agent with written certification (in the form provided in the Rule 144A Deposit Agreement) as to compliance with applicable securities laws.

International GDSs

Each owner of an interest in the International GDSs prior to the expiration of the 40-day period following the later of an offering of Shares by the Company or its affiliates or securities convertible, exercisable or exchangeable into Shares, pursuant to which offering of securities it acquired the Shares being deposited, and the related closing (the "Distribution Compliance Period"), will be deemed to have represented, agreed and acknowledged that:

(1) It understands that such International GDSs and the Common Shares represented thereby have not been and will not be registered under the Securities Act; it is acquiring such GDSs for its own account and that it is not a U.S. person (as defined in Regulation S) and is located outside the United States (within the meaning of Regulation S) and acquired, or have agreed to acquire and will have acquired, the Common Shares to be deposited outside the United States (within the meaning of

Regulation S); it is not an affiliate of the Company or a person acting on behalf of such affiliate; and it is not in the business of buying or selling securities, or, if it is in such business, it did not acquire the securities to be deposited from the Company or any affiliate thereof. It understands that, prior to the expiration of the Distribution Compliance Period (if applicable), it will not offer, sell, pledge or otherwise transfer such International GDSs and the Common Shares represented thereby except (a) to a person that it and any person acting on its behalf reasonably believe is a QIB within the meaning of Rule 144A in a transaction meeting the requirements of Rule 144A or (b) in accordance with Regulation S, in each case in accordance with any applicable securities laws of any State of the United States. If it sells or otherwise transfers the International GDS or the Common Shares represented thereby in accordance with Rule 144A prior to the expiration of the Distribution Compliance Period (if applicable), it will, prior to the settlement of such sale, cause such Common Shares to be withdrawn in accordance with the terms and conditions of the International Deposit Agreement and it will cause instructions to be given to the Depository to deliver such Shares to the custodian under the Rule 144A Deposit Agreement for deposit thereunder and issuance of a Rule 144A GDR evidencing a Rule 144A GDS upon receipt of the proper certification on behalf of the purchaser and otherwise in accordance with the terms and conditions of such Rule 144A Deposit Agreement.

(2) It understands that the International GDRs and the Master International GDR, unless otherwise determined by the Company in accordance with applicable law, will bear a legend substantially to the following effect prior to the termination of the Distribution Compliance Period (if applicable):

THIS INTERNATIONAL GLOBAL DEPOSITARY RECEIPT (“GDR”), THE INTERNATIONAL GLOBAL DEPOSITARY SHARES (“INTERNATIONAL GDSs”) EVIDENCED HEREBY AND THE UNDERLYING SHARES OF COMPAL ELECTRONICS, INC. (THE “COMPANY”) (THE “SHARES”) REPRESENTED THEREBY, HAVE NOT BEEN AND ARE NOT EXPECTED TO BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), AND PRIOR TO THE EXPIRATION OF THE 40-DAY PERIOD FOLLOWING THE LATER OF THE OFFERING OF SHARES BY THE COMPANY OR ITS AFFILIATES, OR SECURITIES CONVERTIBLE, EXERCISABLE, OR EXCHANGEABLE INTO SHARES, PURSUANT TO WHICH OFFERING OR SECURITIES THIS GDR IS DELIVERED, AND THE RELATED CLOSING (THE “DISTRIBUTION COMPLIANCE PERIOD”) SUCH SECURITIES MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT IS (A) A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) OR A PURCHASER THAT THE SELLER AND ANY PERSON ACTING ON THE SELLER’S BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER AND (B) AWARE THAT THE OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A OR (2) IN AN OFFSHORE TRANSACTION MEETING THE REQUIREMENTS OF REGULATION S UNDER THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND OTHER JURISDICTIONS AND FURTHER PROVIDED THAT, IN CONNECTION WITH ANY TRANSFER UNDER (1) ABOVE, THE TRANSFEROR SHALL, PRIOR TO THE SETTLEMENT OF SUCH SALE, WITHDRAW THE SHARES FROM DEPOSIT UNDER THE INTERNATIONAL DEPOSIT AGREEMENT AND CAUSE INSTRUCTIONS TO BE GIVEN TO THE CUSTODIAN FOR THE DEPOSITING OF SUCH SHARES UNDER THE RULE 144A DEPOSIT AGREEMENT AND TO THE DEPOSITARY FOR THE ISSUANCE OF RULE 144A GDRs TO OR FOR THE ACCOUNT OF SUCH QUALIFIED INSTITUTIONAL BUYER, ALL IN ACCORDANCE WITH THE PROVISIONS OF THE RULE 144A DEPOSIT AGREEMENT. EACH OWNER AND BENEFICIAL OWNER, BY ITS ACCEPTANCE OF THIS GDR OR AN INTEREST IN THE INTERNA-

TIONAL GDSs EVIDENCED HEREBY, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING AND FOLLOWING RESTRICTIONS.

UPON THE EXPIRATION OF THE DISTRIBUTION COMPLIANCE PERIOD, THE INTERNATIONAL GDSs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY SHALL NO LONGER BE SUBJECT TO THE RESTRICTIONS PROVIDED IN THIS LEGEND, PROVIDED THAT AT SUCH TIME AND THEREAFTER THE OFFER OR SALE OF THE INTERNATIONAL GDSs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY BY THE OWNER HEREOF IN THE UNITED STATES WOULD NOT BE RESTRICTED UNDER ANY APPLICABLE SECURITIES LAWS OF THE UNITED STATES OR OF THE STATES OR TERRITORIES OF THE UNITED STATES.

(3) The Company, the Depositary, the Purchasers and their respective affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

(4) It understands that the GDSs offered in reliance on Regulation S will be represented by the Master International GDR. Prior to the expiration of the Distribution Compliance Period (if applicable), before any interest in the Master International GDR may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Master Rule 144A GDR, it will be required to provide a transfer agent with a written certification (in the form provided in the International Deposit Agreement) as to compliance with applicable securities laws.

Other Provisions regarding Transfers of the GDRs

Interests in the Rule 144A GDSs may be transferred to a person whose interest in such GDSs is subsequently represented by the Master International GDR only upon receipt by the Depositary of written certification (in the form provided in the International Deposit Agreement) from the transferor to the effect that, among other things, such transfer is being made in accordance with Regulation S. Prior to the expiration of the Distribution Compliance Period (if applicable), interests in the International GDSs may be transferred to a person whose interest in such GDSs is subsequently represented by the Master Rule 144A GDR only upon receipt by the Depositary of written certifications from the transferor (in the form provided in the Rule 144A Deposit Agreement) to the effect that, among other things, such transfer is being made in accordance with Rule 144A. Any interest in GDSs represented by one of the Master GDRs that is transferred to a person whose interest in such GDSs is subsequently represented by the other Master GDR will, upon transfer, cease to be an interest in the GDSs represented by such first Master GDR and, accordingly, will therefore be subject to all transfer restrictions and other procedures applicable to interests in GDSs represented by such other Master GDR for so long as it remains such an interest.

Any resale or other transfer, or attempted resale or other transfer, made other than in compliance with the above-stated restrictions shall not be recognized by the Company or the Depositary in respect of the GDSs or the Common Shares represented thereby.

Settlement and Clearance

Ownership of Rule 144A GDSs evidenced by the Master Rule 144A GDR will be limited to DTC participants or persons who hold interests through DTC participants. Ownership of such interests will be shown on, and the transfer of that ownership will be effected only through, records maintained by DTC or its nominee (with respect to interests of DTC participants) and the records of DTC participants (with respect to interests of persons other than DTC participants).

So long as DTC, or its nominee, is the registered holder of the Master Rule 144A GDR, DTC or such nominee, as the case may be, will be considered the sole owner of the Rule 144A GDSs evidenced thereby for all purposes under the Rule 144A Deposit Agreement and the Rule 144A GDSs.

Transfers between DTC participants will be effected through DTC. The laws of some jurisdictions require that certain persons take physical delivery of securities in definitive form. Consequently, the ability

to transfer Rule 144A GDSs evidenced by the Master Rule 144A GDR to such persons may be limited. Because DTC can only act on behalf of DTC participants, who in turn act on behalf of indirect participants, the ability of a person owning Rule 144A GDSs evidenced by the Master Rule 144A GDR to pledge such interest to persons or entities that do not participate in the DTC system, or otherwise take action in respect of such interest, may be affected by the lack of physical individual definitive securities in respect of such interest.

DTC has advised the Company as follows: DTC is a limited purpose trust company organized under New York Banking Law, a "banking organization" within the meaning of New York Banking Law, a member of the U.S. Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the U.S. Securities Exchange Act of 1934. DTC holds securities for DTC participants and facilitates the settlement of securities transactions, such as transfers and pledges, between DTC participants through electronic book-entry changes in DTC participants' accounts, thereby eliminating the need for physical movement of certificates. Direct participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. Access to the DTC system is also available to others, such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with direct participants, either directly or indirectly.

Beneficial interests in the International GDSs will be represented by the Master International GDR registered in the name of a common depository for Euroclear and Clearstream, Luxembourg. The aggregate holdings of beneficial interests in the International GDSs in Euroclear and Clearstream, Luxembourg will be reflected in the book-entry accounts of each such institution. Ownership of International GDSs evidenced by the Master International GDR will be limited to Euroclear or Clearstream, Luxembourg accountholders or persons who hold interests through such accountholders. Ownership of such interests will be shown on, and the transfer of that ownership will be effected only through, records maintained by the common depository (with respect to the aggregate holdings of Euroclear and Clearstream, Luxembourg), the records of Euroclear and Clearstream, Luxembourg (with respect to the holdings of their respective accountholders) and the records of such Euroclear and Clearstream, Luxembourg accountholders (with respect to the interests of persons trading International GDSs through such accountholders).

Transfers of International GDSs held through Euroclear or Clearstream, Luxembourg will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream, Luxembourg.

Euroclear and Clearstream, Luxembourg each hold securities for participating organizations and facilitate the clearance and settlement of securities transactions between their respective participants through electronic book-entry changes in the accounts of such participants. Euroclear and Clearstream, Luxembourg provide to their respective participants, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg participants are financial institutions throughout the world, including underwriters, securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. Indirect access to Euroclear and Clearstream, Luxembourg is also available to others, such as banks, brokers, dealers and trust companies which clear through or maintain a custodial relationship with Euroclear or Clearstream, Luxembourg, either directly or indirectly.

TAXATION

ROC Taxation

In the opinion of Tsar & Tsai, the following discussion addresses the principal ROC tax consequences of the ownership and disposition of the Notes, GDSs or Common Shares to a non-resident individual or non-resident entity that holds such Notes, GDSs or Common Shares (a “Non-ROC Holder”). As used in the preceding sentence, a “non-resident individual” (a “Non-ROC Individual”) is a foreign national individual who is not physically present in the ROC for 183 days or more during any calendar year in which he or she owns GDSs and a “non-resident entity” (a “Non-ROC Entity”) is a corporation or a non-corporate body that is organized under the laws of a jurisdiction other than the ROC for profit-making purposes and does not have a fixed place of business or other permanent establishment in the ROC.

Under current ROC law, capital gains on securities transactions are exempt from ROC income tax. There can be no assurance that capital gains tax will not be imposed in the future or as to the manner in which any ROC capital gains tax in respect of the Notes and Common Shares represented by GDSs would be imposed or calculated. Historically, a portion of the Company’s net income has also been derived from gains on sales of securities, and the imposition of an ROC capital gains tax on the sale of securities could reduce the net gain realised upon any future sales of such securities.

Notes

Premium and Interest

Payments of premium or interest (if any) on a Note to a Non-ROC Holder are subject to ROC withholding tax, currently at a rate of 20% at the time of payment. The Company has agreed to pay Additional Amounts in respect of such withholding tax on the payments of interest. See “Description of the Notes — Additional Amounts”.

Sale

No securities transaction tax will be imposed on the sale of bonds.

Gains on sale of property in the ROC are generally subject to ROC income tax. Under current ROC law, however, capital gains from the sale of securities issued by ROC companies are exempt from income tax. This exemption applies to capital gains derived from sale of the Notes. The reintroduction of a capital gains tax requires the Legislative Yuan to engage in the full legislative process for the amendment of Income Tax Law.

Conversion

ROC law currently provides no specific provisions regarding the ROC income tax consequences of a conversion of the Notes into Common Shares or GDSs. Without further clarification from the ROC tax authorities, it is impossible to conclude definitively that gains on conversion of Notes into Common Shares or GDSs will not be deemed as taxable gains, additional interest income (subject to the 20% withholding tax) or otherwise subject to other ROC taxes.

There is no ROC stamp, issue or registration tax imposed on the issuance of Common Shares or GDSs upon conversion of the Notes.

GDSs

Dividends

Dividends (whether in cash or stock) declared by the Company out of retained earnings and distributed to a Non-ROC Holder in respect of Common Shares represented by GDSs are subject to ROC withholding tax, currently at a rate of 20% on the amount of the distribution (in the case of cash

dividends) or on the value of the distributed shares (in the case of stock dividends). The Depositary may dispose of a portion of the dividends to pay such tax.

Distributions of stock dividends out of capital reserves are not subject to ROC withholding tax.

Sale

Under current ROC law, transfers of GDSs are not subject to ROC securities transaction tax.

Gains on sale of GDSs are not subject to ROC income tax.

Common Shares

Dividends

Dividends (whether in cash or stock) declared by the Company out of retained earnings and distributed to a Non-ROC Holder in respect of Common Shares are subject to ROC withholding tax as described above under “— GDSs — Dividends”.

Sale

Securities transaction tax is payable and withheld by the seller at the rate of 0.3% of the transaction price upon a sale of Common Shares.

Under current ROC law, capital gains on transactions in shares issued by ROC companies are exempt from income tax. This exemption applies to capital gains derived from the sale of Common Shares.

Subscription Rights

Distributions of statutory subscription rights for the Common Shares in compliance with the Company Law are not subject to ROC tax. Proceeds derived from sales of statutory subscription rights evidenced by securities are currently exempted from income tax but are subject to securities transaction tax, currently at the rate of 0.3% of the gross amount received. Proceeds derived from sales of statutory subscription rights which are not evidenced by securities are subject to capital gains tax at the rate of (i) 25% of the gross amount received for Non-ROC Entity Holders and (ii) 35% of the gross amount received for Non-ROC Individual Holders. Subject to compliance with ROC law, the Company has the sole discretion to determine whether statutory subscription rights are evidenced by securities or not.

Inheritance Tax and Gift Tax

ROC inheritance tax is payable on any property within the ROC of a deceased Non-ROC Individual, and ROC gift tax is payable on any property within the ROC donated by any such person. Inheritance tax is payable at rates ranging from 2% of the first NT\$600,000 to 50% of amounts over NT\$100,000,000. Gift tax is payable at rates ranging from 4% of the first NT\$600,000 to 50% of amounts over NT\$45,000,000. Under ROC Inheritance and Gift Tax Law, shares issued by ROC companies are deemed located in the ROC irrespective of the location of the owner. It is unclear whether a holder of GDSs will be considered to own Common Shares for this purpose.

Tax Treaty

The United States does not have an income tax treaty with the ROC. At present, the ROC has entered into income tax treaties with Singapore, Australia, Indonesia, New Zealand, South Africa, Gambia, Swaziland, Malaysia, the Netherlands, Macedonia and Vietnam. It is unclear whether a Non-ROC Holder will be considered to own Common Shares for the purposes of these income tax treaties. Accordingly, Non-ROC Holders of GDSs who are entitled to the benefits of the relevant income tax treaty should consult their own tax advisors concerning their eligibility for benefits under the treaty with respect to GDSs.

Tax Reform

In order to increase Taiwan's competitiveness, an amendment to the ROC Income Tax Law (the "Amendment") was enacted on January 1, 1998, to integrate the corporate income tax and the shareholder income tax with respect to dividend income with the aim of eliminating the double taxation effect for resident shareholders of Taiwanese corporations.

According to the Amendment, a 10% retained earnings tax will be imposed on a company for its after-tax earnings generated after January 1, 1998, which are not distributed in the following year. The retained earnings tax so paid will further reduce the retained earnings available for future distribution. When the Company declares dividends out of those retained earnings, up to a maximum amount of 10% of the net dividend received will be credited against the 20% withholding tax imposed on the non-ROC Holders of its Common Shares.

Tax Guarantor

Holders of GDSs withdrawing Common Shares represented by such GDSs are required under current ROC law and regulations to appoint an agent in the ROC for filing tax returns and making payments. Such agent must meet certain qualifications set by the ROC Ministry of Finance and, upon appointment, becomes a guarantor of such withdrawing holder's ROC tax obligations. Evidence of the appointment of such agent and the approval for such appointment by the ROC tax authorities may be required as conditions to such withdrawing holder's repatriation of the profit derived from the sale of withdrawn Common Shares. There can be no assurance that such withdrawing holder of GDSs will be able to appoint and obtain approval for such agent in a timely manner.

Holders of Notes (being either individuals or legal entities) who are non-ROC persons, upon exercising their conversion right, will be required to appoint an agent in the ROC for filing tax returns and making tax payments if such Holders elect to receive Common Shares instead of GDRs. Such agent (a "Tax Guarantor") will be required to meet the qualifications set by the Ministry of Finance of the ROC (the "MOF") and to act as the guarantor of the converting Holder's tax payment obligations.

Under current ROC laws, repatriation of profits by Holders from sales of securities that take place within the ROC is subject to the submission of evidence of the appointment of a Tax Guarantor to, and approval thereof by, the tax authority or submission of tax clearance certificates to the tax authority so long as the capital gains from securities transactions are exempt from ROC income tax. Notwithstanding the above requirements for the appointment of a Tax Guarantor or submission of tax clearance certificates as provided in the ROC regulations, the CBC has not required submission of such evidence or tax clearance certificates as a condition to repatriation of sale proceeds of Common Shares from sales that take place within the ROC. However, there can be no assurance that the CBC will not require submission of such evidence or tax clearance certificates in the future.

United States Federal Income Taxation

The following is a summary of the material U.S. federal income tax consequences of the acquisition, ownership and disposition of Notes, GDSs or Common Shares by a U.S. Holder (as defined below). This summary deals only with initial purchasers of Notes and, after conversion, GDSs or Common Shares, that are U.S. Holders and that will hold the Notes, GDSs or Common Shares as capital assets. The discussion does not cover all aspects of U.S. federal income taxation that may be relevant to, or the actual tax effect that any of the matters described herein will have on, the acquisition, ownership or disposition of Notes, GDSs or Common Shares by particular investors, and does not address state, local, foreign or other tax laws. In particular, this summary does not address tax considerations applicable to investors that own (directly or indirectly) 10% or more of the voting stock of the Company nor does this summary discuss all of the tax considerations that may be relevant to certain types of investors subject to special treatment under the U.S. federal income tax laws (such as banks, insurance companies, investors liable for the alternative minimum tax, individual retirement accounts and other tax-deferred accounts, tax-exempt organizations, dealers in securities or currencies, investors that will hold the Notes, GDSs or Common

Shares as part of straddles, hedging transactions or conversion transactions for U.S. federal income tax purposes or investors whose functional currency is not the U.S. Dollar).

As used herein, the term "U.S. Holder" means a beneficial owner of Notes, GDSs or Common Shares that is (i) a citizen or resident of the United States for U.S. federal income tax purposes, (ii) a corporation, or other entity treated as a corporation, created or organized under the laws of the United States or any State thereof, (iii) an estate the income of which is subject to U.S. federal income tax without regard to its source or (iv) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust.

The summary assumes that the Company is not a passive foreign investment company (a "PFIC") for U.S. federal income tax purposes, which the Company believes to be the case. The Company's possible status as a PFIC must be determined annually and therefore may be subject to change. If the Company were to be a PFIC in any year, special, possibly materially adverse, consequences would result for U.S. Holders.

The summary is based on the tax laws of the United States, including the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations thereunder, published rulings and court decisions, all as currently in effect and all subject to change at any time, perhaps with retroactive effect.

THE SUMMARY OF U.S. FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS FOR GENERAL INFORMATION ONLY. ALL PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR OWN TAX ADVISERS AS TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING THE NOTES, GDSs OR COMMON SHARES, INCLUDING THE APPLICABILITY AND EFFECT OF STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW.

Notes

Original Issue Discount

General. Because of the premium payable at maturity or upon early redemption at the option of the holder or the Company (see "Description of the Notes"), the Notes will be considered to be issued with original issue discount ("OID"). A U.S. Holder must include a portion of the OID in gross income as interest in each taxable year or portion thereof in which the U.S. Holder holds the Notes even if the U.S. Holder has not received a cash payment in respect of the OID.

The amount of a Note's OID is the excess of the Note's stated redemption price at maturity over its issue price. Generally, the issue price of a Note will be the first price at which a substantial amount of Notes included in the issue of which the Note is a part is sold to persons other than bond houses, brokers or similar persons or organisations acting in the capacity of underwriters, placement agents or wholesalers.

U.S. Holders of Notes must include OID income calculated on a constant-yield method before the receipt of cash attributable to the income, and generally will have to include in income increasingly greater amounts of OID over the life of the Notes. The amount of OID includable in income by a U.S. Holder of a Note is the sum of the daily portions of the OID with respect to the Note for each day during the taxable year on which the U.S. Holder holds the Note ("accrued OID"). The daily portion is determined by allocating to each day in any "accrual period" a pro rata portion of the OID allocable to that accrual period. Accrual periods with respect to a Note may be of any length selected by the U.S. Holder and may vary in length over the term of the Note as long as no accrual period is longer than one year. The amount of OID allocable to an accrual period equals the product of the Note's adjusted issue price at the beginning of the accrual period and the Note's yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period). The "adjusted issue price" of a Note at the beginning of any accrual period is the issue price of the Note increased by the amount of accrued OID for each prior accrual period.

Acquisition Premium. A U.S. Holder that purchases a Note for an amount less than or equal to the Note's amount payable at maturity, but in excess of its adjusted issue price (this excess being "acquisition premium") and that does not make the election described below under "Election to Treat All interest as Original Issue Discount" is permitted to reduce daily portions of OID by a fraction, the numerator of which is the excess of the U.S. Holder's adjusted basis in the Note immediately after its purchase over the Note's adjusted issue price, and the denominator of which is the excess of the Note's amount payable at maturity over the Note's adjusted issue price. No OID will accrue on a Note purchased for more than its amount payable at maturity.

Market Discount. A Note generally will be treated as purchased at a market discount (a "Market Discount Note") if the Note's "revised issue price" exceeds the amount for which the U.S. Holder purchased the Note by at least 0.25 per cent. of the Note's revised issue price multiplied by the number of complete years from the date acquired by the U.S. Holder to the Note's maturity. If this excess is not sufficient to cause the Note to be a Market Discount Note, then the excess constitutes "*de minimis* market discount". For this purpose, the "revised issue price" of a Note generally equals its issue price, increased by the amount of any OID that has accrued on the Note.

Under current law, any gain recognized on the maturity or disposition of a Market Discount Note will be treated as ordinary income to the extent that the gain does not exceed the accrued market discount on the Note. Alternatively, a U.S. Holder of a Market Discount Note may elect to include market discount in income currently over the life of the Note. This election applies to all debt instruments with market discount acquired by the electing U.S. Holder on or after the first day of the first taxable year for which the election is made. This election may not be revoked without the consent of the Internal Revenue Service (the "IRS"). A U.S. Holder of a Market Discount Note that does not elect to include market discount in income currently generally will be required to defer deductions for interest on borrowings incurred to purchase or carry a Market Discount Note that is in excess of the OID on the Note includible in the U.S. Holder's income, to the extent that this excess interest expense does not exceed the portion of the market discount allocable to days on which the Market Discount Note was held by the U.S. Holder.

Under current law, market discount on a Market Discount Note will accrue on a straight-line basis unless the U.S. Holder elects to accrue the market discount on a constant-yield method. This election applies only to the Note with respect to which it is made and is irrevocable.

Election to Treat All Interest as Original Issue Discount. A U.S. Holder may elect to include in gross income all interest that accrues on a Note using the constant-yield method described above under "Original Issue Discount — General", with certain modifications. For purposes of this election, interest includes OID, market discount and *de minimis* market discount, as adjusted by any amortizable bond premium or acquisition premium. This election generally applies only to the Note with respect to which it is made and may not be revoked without the consent of the IRS. If the election to apply the constant yield method to all interest on a Note is made with respect to a Market Discount Note, the electing U.S. Holder will be treated as having made the election described above under "Market Discount" to include market discount in income currently over the life of all debt instruments held or thereafter acquired by the U.S. Holder. U.S. Holders should consult their tax advisors concerning the propriety and consequences of this election.

Purchase, Sale and Retirement of the Notes

A U.S. Holder's tax basis in a Note will generally be its U.S. Dollar cost increased by the amount of any OID or market discount included in the U.S. Holder's income with respect to the Note. A U.S. Holder will generally recognize gain or loss on the sale or retirement of a Note equal to the difference between the amount realized on the sale or retirement and the tax basis of the Note. Except to the extent described under "Market Discount" above and "Passive Foreign Investment Company Considerations" below, gain or loss recognized by a U.S. Holder on the sale or retirement of a Note will be capital gain or loss and will be long-term capital gain or loss if the Note was held by the U.S. Holder for more than one year. For a non-corporate U.S. Holder, the maximum capital gains rate is 20%.

Gain or loss realized by a U.S. Holder on the sale or retirement of a Note generally will be U.S. source. Prospective purchasers should consult their tax advisers as to the foreign tax credit implications of the sale or retirement of Notes.

See “Passive Foreign Investment Company Considerations” below for a discussion of more adverse rules that may apply to a sale or retirement of Notes if the Company is or becomes a PFIC for U.S. federal income tax purposes.

Conversion

Conversion of Notes. A U.S. Holder’s conversion of Notes into GDSs or Common Shares generally will not be a taxable event for U.S. federal income tax purposes. A U.S. Holder’s basis in GDSs or Common Shares received upon conversion will generally be the same as the U.S. Holder’s basis in the Notes converted.

Adjustment of Conversion Price. The conversion ratio of the Notes is subject to adjustment in certain circumstances. These adjustments may give rise to deemed dividend income to U.S. Holders. Furthermore, the failure to adjust the conversion ratio to reflect certain events can in some circumstances give rise to deemed dividend income to U.S. Holders. Prospective purchasers should consult their tax advisers concerning the consequences of these adjustments and events.

GDSs and Common Shares

U.S. Holders of GDSs

For U.S. federal income tax purposes, a U.S. Holder of GDSs will be treated as the owner of the corresponding number of Common Shares held by the Depository, and references herein to Common Shares refer also to GDSs representing the Common Shares.

Dividends

General. Distributions paid by the Company out of current or accumulated earnings and profits (as determined for U.S. federal income tax purposes), before reduction for any ROC withholding tax paid by the Company with respect thereto, will generally be taxable to a U.S. Holder as foreign source dividend income, and will not be eligible for the dividends received deduction allowed to corporations. Distributions in excess of current and accumulated earnings and profits will be treated as a non-taxable return of capital to the extent of the U.S. Holder’s basis in the Common Shares and thereafter as capital gain.

Foreign Currency Dividends. Dividends paid in NT Dollars will be included in income in a U.S. Dollar amount calculated by reference to the exchange rate in effect on the day the dividends are received by the Depository, regardless of whether the NT Dollars are converted into U.S. Dollars. If dividends received in NT Dollars are converted into U.S. Dollars on the day they are received by the Depository, the U.S. Holder generally will not be required to recognize foreign currency gain or loss in respect of the dividend income.

Effect of ROC Withholding Taxes. As discussed in “— ROC Taxation”, under current law payments of dividends by the Company to foreign investors are subject to a 20% ROC withholding tax. For U.S. federal income tax purposes, U.S. Holders will be treated as having received the amount of ROC taxes withheld by the Company, and as then having paid over the withheld taxes to the ROC taxing authorities. As a result of this rule, the amount of dividend income included in gross income for U.S. federal income tax purposes by a U.S. Holder with respect to a payment of dividends may be greater than the amount of cash actually received (or receivable) by the U.S. Holder from the Company with respect to the payment.

Subject to certain limitations, a U.S. Holder will generally be entitled to a credit against its U.S. federal income tax liability, or a deduction in computing its U.S. federal taxable income, for ROC income taxes withheld by the Company. For purposes of the foreign tax credit limitation, foreign source

income is classified into one of several “baskets”, and the credit for foreign taxes on income in any basket is limited to U.S. federal income tax allocable to that income. Dividends paid by the Company generally will constitute foreign source income in the “passive income” basket or, in the case of certain holders, the “financial services income” basket. In certain circumstances, a U.S. Holder may be unable to claim foreign tax credits (and may instead be allowed deductions) for foreign taxes imposed on a dividend if the U.S. Holder (i) has not held the GDSs for at least 16 days in the 30-day period beginning 15 days before the ex dividend date or (ii) holds the GDSs in arrangements in which the U.S. Holder’s expected profit, after non-U.S. taxes, is insubstantial. U.S. Holders that are accrual basis taxpayers must translate ROC taxes into U.S. Dollars at a rate equal to the average exchange rate for the taxable year in which the taxes accrue, while all U.S. Holders must translate taxable dividend income into U.S. Dollars at the spot rate on the date received. This difference in exchange rates may reduce the U.S. Dollar value of the credits for ROC taxes relative to the U.S. Holder’s U.S. federal income tax liability attributable to a dividend.

Prospective purchasers should consult their tax advisers concerning the foreign tax credit implications of the payment of ROC taxes.

Sale or other Disposition

Upon a sale or other disposition of GDSs (other than an exchange of GDSs for Common Shares) or Common Shares, a U.S. Holder generally will recognize capital gain or loss for U.S. federal income tax purposes equal to the difference, if any, between the amount realized on the sale or other disposition and the U.S. Holder’s adjusted tax basis in the GDSs or Common Shares. This capital gain or loss will be long-term capital gain or loss if the U.S. Holder’s holding period in the Common Shares or GDSs exceeds one year. For this purpose, the holding period of the GDSs or Common Shares includes the holding period of any Notes that were converted into the GDSs or Common Shares. Any gain or loss will generally be U.S. source, except that losses will be treated as foreign source to the extent the U.S. Holder received dividends that were includible in the financial services income basket during the 24-month period prior to the sale.

Passive Foreign Investment Company Considerations

A foreign corporation will be a PFIC in any taxable year in which, after taking into account the income and assets of the corporation and certain subsidiaries pursuant to the applicable “look-through rules,” either (i) at least 75% of its gross income is “passive income” or (ii) at least 50% of the average value of its assets is attributable to assets which produce passive income or are held for the production of passive income. The Company does not believe that it should be treated as a PFIC for U.S. federal income tax purposes, but the Company’s possible status as a PFIC must be determined annually and therefore may be subject to change. This determination will depend in part on whether the Company continues to earn substantial amounts of operating income, as well as on the market valuation of the Company assets and the Company’s spending schedule for its cash balances and the proceeds of the Offering. If the Company were to be treated as a PFIC, U.S. Holders of Common Shares would be required (i) to pay a special U.S. addition to tax on certain distributions and gains on sale and (ii) to pay tax on any gain from the sale of Common Shares at ordinary income (rather than capital gains) rates in addition to paying the special addition to tax on this gain. Prospective purchasers should consult their tax advisers regarding the potential application of the PFIC regime. Because of their conversion feature, the Notes are treated in the same manner as Common Shares under the PFIC rules, and therefore a U.S. Holder of Notes during any year in which the Company is a PFIC will be subject to similar rules. For PFIC purposes, the holding period of Common Shares acquired upon the conversion of Notes includes the holding period of the Notes.

Backup Withholding and Information Reporting

Payments of principal on, and the proceeds of sale or other disposition of Notes, as well as dividends and other proceeds with respect to GDSs, by a U.S. paying agent or other U.S. intermediary will be reported to the IRS and to the U.S. Holder as may be required under applicable regulations. Backup

withholding may apply to these payments if the U.S. Holder fails to provide an accurate taxpayer identification number or certification of exempt status or fails to report all interest and dividends required to be shown on its U.S. federal income tax returns. Certain U.S. Holders (including, among others, corporations) are not subject to backup withholding. U.S. Holders should consult their tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

PLAN OF DISTRIBUTION

The Company and the Purchasers named below (the "Purchasers") have entered into a Purchase Agreement dated October 4, 2002 with respect to the Notes. Subject to certain conditions set forth in the Purchase Agreement, each Purchaser has severally agreed to purchase the principal amount of Notes indicated in the following table. Salomon Brothers International Limited is acting as the Global Coordinator and Sole Bookrunner in this Offering and is the representative of the Purchasers.

<u>Purchasers</u>	<u>Principal Amount of Notes</u>
Salomon Brothers International Limited	U.S.\$240,000,000
ABN AMRO Rothschild	60,000,000
Total	U.S.\$300,000,000

The Purchasers are committed to take and pay for all of the Notes being offered, if any are taken, other than the Notes covered by the option described below unless and until this option is exercised. The purchase price for the Notes will be the initial offering price set forth on the cover page of this Offering Memorandum, less an underwriting discount. After the Notes are released for sale, the Purchasers may change the offering price and other selling terms.

If the Purchasers sell more Notes than the aggregate principal amount of Notes set forth in the table above, the Purchasers have an option to buy up to an additional U.S.\$45,000,000 principal amount of Notes, which may be either Rule 144A Notes or International Notes as the Purchasers may elect, from the Company to cover such sales. The Purchasers may exercise that option for 30 days from October 9, 2002. To the extent that the Purchasers exercise this option, the Purchasers will severally purchase Notes in approximately the same proportion as set forth in the table above.

The Notes, the Common Shares to be issued upon conversion of the Notes and the GDSs representing such Common Shares have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States or to U.S. persons. Each Purchaser has agreed that it will only offer or sell the Notes in the United States to qualified institutional buyers in reliance on Rule 144A under the Securities Act.

Each Purchaser has agreed that, except as permitted by the Purchase Agreement, it will offer or sell the International Notes, the Common Shares to be issued upon conversion of the Notes or the GDSs representing such Common Shares as part of its distribution at any time, only in accordance with Rule 903 of Regulation S (or Rule 144A). Accordingly, neither it, its affiliates nor any persons acting on its or their behalf have engaged or will engage in any directed selling efforts with respect to the International Notes, the Common Shares to be issued upon conversion of the Notes or the GDSs representing such Common Shares. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

The International Notes are being sold outside of the United States to non-U.S. persons in reliance on Regulation S. The Purchase Agreement provides that the Purchasers may, through their U.S. selling agents, arrange for the offer and resale of the Rule 144A Notes within the United States only to qualified institutional buyers in reliance on Rule 144A.

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of the Notes, the Common Shares issuable upon conversion of the Notes and the GDSs representing such Common Shares within the United States by a dealer that is not participating in the Offering may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A under the Securities Act or pursuant to another exemption from registration under the Securities Act.

Each Purchaser offering the International Notes has represented, warranted and agreed that (i) it has not offered or sold and, prior to the expiry of a period of six months from the closing date, will not offer or sell any International Notes to persons in the United Kingdom except to persons whose ordinary activities

involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 (as amended), (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act of 2000 (the "FSMA")) received by it in connection with the issue or sale of any International Note in circumstances in which section 21(1) of the FSMA does not apply to the Company, and (iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the International Notes in, from or otherwise involving the United Kingdom.

Each Purchaser offering the International Notes has represented, warranted and agreed that (i) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any International Notes other than to persons whose ordinary business is to buy or sell shares or debentures, whether as principal or agent, or in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 32) of Hong Kong and (ii) it has not issued or had in its possession for the purpose of issue, and will not issue or have in its possession for the purpose of issue, any invitation, advertisement or document relating to the International Notes in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to the International Notes intended to be disposed of to persons outside Hong Kong or only to persons whose business involves the acquisition, disposal or holding of securities, whether as principal or as agent.

This Offering Memorandum has not been and will not be registered as a prospectus with the Monetary Authority of Singapore under the Securities and Futures Act 2001 of Singapore (the "SFA") and the Notes are offered by the issuer pursuant to exemptions invoked under Section 274 and Section 275 of the SFA. Accordingly, each Purchaser has represented, warranted and agreed that this Offering Memorandum and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Notes may not be circulated or distributed, nor may the Notes be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor or other person specified in Section 274 of the SFA, (ii) to a sophisticated investor, and in accordance with the conditions, specified in Section 275 of the SFA or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

The International Notes have not been and will not be registered under the Securities and Exchange Law of Japan. Each Purchaser has represented, warranted and agreed that it has not offered or sold, and it will not offer or sell, directly or indirectly, any International Notes in Japan or to, or for the account or benefit of, any resident of Japan or to, or for the account or benefit of, any resident for reoffering or resale, directly or indirectly, in Japan or to, or for the account or benefit of, any resident of Japan except (i) pursuant to an exemption from the registration requirements of, or otherwise in compliance with, the Securities and Exchange Law of Japan and (ii) in compliance with the other relevant laws and regulations of Japan.

Each Purchaser has represented, warranted and agreed that in Italy, the Notes will not be offered, sold or delivered to any investors, other than to professional investors (*operatori qualificati*) as defined in Article 31, paragraph 2, of CONSOB Regulation n. 11522 of 1 July 1998, pursuant to Article 100, paragraph 1b and Article 30, paragraph 2 of the Italian Financial Act (Legislative Decree no. 58 of February 24, 1998), and in any case to any individual.

In France, neither this Offering Memorandum nor any other offering material relating to the Notes has been submitted to the clearance procedures of the *Commission des opérations de bourse*. Each Purchaser has represented, warranted and agreed that the Notes have not been offered or sold and will not be offered or sold, directly or indirectly, to the public in France and neither this Offering Memorandum nor any other offering material relating to the Notes has been distributed or caused to be distributed and will be distributed or caused to be distributed to the public in France, and such offers, sales and

distributions will be made in France only to qualified investors (*investisseurs qualifiés*) as defined in and in accordance with articles L.411-1 and L.411-2 of the French *Code monétaire et financier* and French Decree No. 98-880 dated 1 October 1998 relating to offers to qualified investors.

Each Purchaser has represented, warranted and agreed that the International Notes may not be offered, sold, transferred or delivered in or from the Netherlands, as part of their initial distribution or as part of any re-offering, and neither this Offering Memorandum nor any other document in respect of the offering may be distributed or circulated in the Netherlands, other than to individuals or legal entities which include, but are not limited to, banks, brokers, dealers, institutional investors and undertakings with a treasury department, who or which trade or invest in securities in the conduct of a business or profession.

The Purchasers have represented, warranted and agreed that they have not offered, sold or delivered and will not offer, sell or deliver, at any time, directly or indirectly, any International Notes, Common Shares or GDSs acquired by them as part of the Offering in the ROC or to, or for the account or benefit of, any resident of the ROC.

The Company (including its subsidiaries), Jui-Tsung Chen, its President (who holds an aggregate of 35,413,557 Common Shares as of July 9, 2002, or 1.39% of the outstanding Common Shares), and Kinpo (which holds an aggregate of 116,340,824 Common Shares as of July 9, 2002, or 4.57% of the outstanding Common Shares) have agreed with the Purchasers, during a period of 90 days after the date of this Offering Memorandum, not to offer, sell, contract to sell, pledge, grant any option to purchase, make any short sale or otherwise dispose, of any Notes, the Common Shares to be issued upon conversion of the Notes, the GDSs, or the GDRs, or any securities that are convertible into or exchangeable for, or that represent the right to receive, Common Shares to be issued upon conversion of the Notes, the GDSs, or the GDRs, subject to certain exceptions, without the prior written consent of the Joint Global Coordinators.

Buyers of the International Notes sold by the Purchasers may be required to pay stamp taxes and other charges in accordance with the laws and practice of the country of purchase in addition to the offering price of the Notes.

The Company has applied to have the Notes listed for trading on the Luxembourg Stock Exchange. The Company has also applied for the GDSs to be issued upon conversion of the Notes to be listed for trading on the Luxembourg Stock Exchange.

In connection with the Offering, the Purchasers may purchase and sell the Notes, the Common Shares or the GDSs in the open market. These transactions may include short sales, stabilizing transactions and purchases to cover positions created by short sales. Short sales involve the sale by the Purchasers of a greater number of Notes than they are required to purchase in the Offering. Stabilizing transactions consist of certain bids or purchases made for the purpose of preventing or retarding a decline in the market price of the Notes, the Common Shares, or the GDSs while the offering is in progress. SBIL will act as stabilization manager in connection with the Offering.

These activities by the Purchaser may stabilize, maintain or otherwise affect the market price of the Notes or Common Shares. As a result, the price of the Notes and the Common Shares may be higher than the price that might otherwise exist in the open market. If these activities are commenced, they may be discontinued by the Purchasers at any time. These transactions may be effected in the over-the-counter market or on the Taiwan Stock Exchange (subject to applicable ROC law) or the Luxembourg Stock Exchange or otherwise.

The Purchasers also may impose a penalty bid. This occurs when a particular Purchaser repays to the other Purchasers a portion of the underwriting discount received by it because the representatives have repurchased Notes sold by or for the account of such Purchaser in stabilizing or short covering transactions.

The Notes are expected to be eligible for trading in the PORTAL Market of The Nasdaq Stock Market, Inc.

The Company has agreed to indemnify the several Purchasers and certain other persons against certain liabilities, including liabilities under the Securities Act.

Grand Cathay Securities Corporation, KGI Securities Co. Ltd. and Polaris Securities have provided limited advisory services in Taiwan to the Company but are not Purchasers and have not provided any services in relation to the offer and sale of the Notes. They have received customary fees from the Company for such services.

LEGAL MATTERS

Certain legal matters with respect to the Notes and the Common Shares issuable upon conversion thereof will be passed upon for us by Tsar & Tsai, Taipei, Taiwan, ROC, and for the Purchasers with respect to the Notes by Linklaters, Hong Kong. Linklaters will rely upon Tsar & Tsai with respect to certain matters of ROC law. Tsar & Tsai will rely upon Linklaters with respect to certain matters of New York and U.S. federal law.

ACCOUNTANTS

The consolidated financial statements of Compal Electronics, Inc. as of December 31, 1999, 2000 and 2001 and for the years then ended and as of June 30, 2002 and for the six months then ended included in this Offering Memorandum have been audited by KPMG Certified Public Accountants, independent certified public accountants, whose reports appear elsewhere herein.

GENERAL INFORMATION

We are registered with the Ministry of Economic Affairs of the ROC under a uniform registration number of 21222725. Our registered office is located at 7th Floor, 319 Pateh Road, Section 4, Taipei 105, Taiwan, ROC.

We accept responsibility for the information contained herein. To the best of our knowledge and belief (having taken all reasonable care to ensure that such is the case), the information contained herein is in accordance with the facts and does not omit anything likely to affect the import of such information.

The Offering and the issue of the Notes were authorized and approved by our Board of Directors on, April 23, 2002 and by the ROC Securities and Futures Commission on, May 29, 2002, June 13, 2002 and August 28, 2002 (amendments approved).

Application has been made to list the Notes on the Luxembourg Stock Exchange. GDSs to be issued upon conversion of the Notes will be fungible with the existing GDSs, including those which are listed on the Luxembourg Stock Exchange. Application will be made to list the GDSs issued on the conversion of the Notes on the Luxembourg Stock Exchange. The legal notice relating to the issue of the Notes, our Articles of Incorporation, our Articles of Association and the By-laws of the Depositary will be registered prior to the listing with the Chief Registrar of the District Court in Luxembourg (*Greffier en Chef du Tribunal d'Arrondissement de et à Luxembourg*), where such documents will be available for inspection and where copies thereof can be obtained upon request. As long as the Notes are listed on the Luxembourg Stock Exchange, we will maintain a Paying Agent, Conversion Agent and Transfer Agent in Luxembourg.

We publish quarterly unaudited non-consolidated financial statements, semi-annual audited non-consolidated financial statements, and annual audited consolidated and non-consolidated financial statements. We have prepared, solely for purposes of this Offering, semi-annual audited consolidated financial statements for the six months ended June 30, 2002. We are not required to, and do not prepare, quarterly or semi-annual financial statements on a consolidated basis. For so long as any of the Notes are outstanding and listed on the Luxembourg Stock Exchange, copies (in English) of our most recent annual audited consolidated and non-consolidated accounts (beginning with the annual accounts as of and for the years ended 1999, 2000 and 2001), semi-annual audited non-consolidated accounts, quarterly unaudited non-consolidated financial statements, our Articles of Incorporation and the Deposit Agreements will be available at the offices of Banque Générale du Luxembourg S.A. at 50, Avenue J.F. Kennedy, L-2951, Luxembourg and the Depositary will publish all notices to holders of the GDSs in the *Luxemburger Wort*. We publish notices pursuant to requirements of ROC regulations in newspapers with general circulation in the ROC.

Application has been made to have the Rule 144A Notes designated for trading in The PORTAL Market of The Nasdaq Stock Market, Inc.

Except as disclosed herein, there has been no change in our financial position and that of our subsidiaries' since December 31, 2001, the date of the latest audited financial statements contained herein.

Save as disclosed in the section "Business of the Company — Litigation and Legal Issues", neither we nor any of our subsidiaries is involved in any litigation, arbitration or administrative proceedings relating to claims which are material in the context of the issue of the Notes and, so far as any of them is aware, no such litigation, arbitration or administrative proceedings are pending or threatened.

The Indenture, the Deposit Agreements and the Purchase Agreement are governed by the laws of the State of New York.

The Notes will be accepted for clearance through the facilities of The Depositary Trust Company, New York, New York. The CUSIP number for the Rule 144A Notes is 20440YAC5 and the ISIN for the Rule 144A Notes is US20440YAC57. The CUSIP for the International Notes is 20440Y9B9 and the ISIN for the International Notes is XS0149888744. The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg under Common Code number 014988874.

SUMMARY OF CERTAIN DIFFERENCES BETWEEN ROC GAAP AND U.S. GAAP

Our consolidated and non-consolidated financial statements are prepared and presented in accordance with ROC GAAP, which differs in certain material respects from U.S. GAAP. Certain principal differences between ROC GAAP applicable to us and U.S. GAAP are summarized below. Additionally, no attempt has been made to identify all disclosure, presentation or classification differences that would affect the manner in which events and transactions are presented in the consolidated financial statements or notes thereto. Further, no attempt has been made to identify future differences between ROC GAAP and U.S. GAAP as a result of prescribed changes in accounting standards. Regulatory bodies that promulgate ROC GAAP and U.S. GAAP have significant projects ongoing that could affect future comparisons such as this one.

<u>Subject</u>	<u>ROC GAAP</u>	<u>U.S. GAAP</u>
Consolidation Policy	The consolidated financial statements include the accounts of the company and all the subsidiaries in which more than 50% of the shares are owned by the company and in which total assets or sales exceeds 10% of the company's total assets or sales. If the total assets and sales of a subsidiary is less than 10% of the company's total assets and sales, then the subsidiary is accounted for under the equity method of accounting. For those subsidiaries in which more than 50% of the shares are owned by the company and in which total assets and sales do not exceed 10% of the corresponding accounts of the company, and the aggregate total assets and total sales of all these subsidiaries is less than 30% of the company's total assets and sales, respectively, the financial statements of these subsidiaries are not consolidated in the company's consolidated financial statements.	Under U.S. GAAP, all subsidiaries in which more than 50% of the shares are owned by the company are to be consolidated in the company's consolidated financial statements.
Derivative Financial Instrument Transactions	There are no definitive accounting standards, other than certain disclosure requirements, under ROC GAAP which address accounting for derivative financial instruments such as foreign currency options, futures, interest rate or foreign currency swaps. Because the rules are flexible, different companies may apply different accounting practices to derivatives.	Beginning January 1, 2001, all derivatives contracts are recognized at fair value. Under SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities," as amended, accounting for derivative instruments is in large part determined by the purpose for which the instrument was entered into. In general, derivative financial instruments which were entered into for speculative or trading purposes (or which do not meet the criteria for accounting for such items as hedges), rather than to hedge exposures to risks,

<u>Subject</u>	<u>ROC GAAP</u>	<u>U.S. GAAP</u>
Investment in Debt and Equity Securities	<p>Short-term investments are stated at the lower of cost or market value, investments in debt securities are stated at the lower of amortized cost or market value. Long-term investments in listed equity securities in respect of which the company does not exercise significant influence on operating and financial decisions of the investee are stated at the lower of cost or market value, and unrealized losses are deducted from shareholders' equity. Investments in non-listed equity securities in respect of which the company does not exercise significant influence on operating and financial decisions of the investee are stated at cost, subject to permanent impairment test.</p> <p>Share dividends received are recorded as an increase in voting</p>	<p>are accounted for at fair value with all gains and losses recognized currently in earnings. Derivative financial instruments which (i) are entered into in order to hedge certain exposures and (ii) meet defined criteria in order to be classified as hedges, are accounted for in a manner so as to offset the gains and losses applicable to the derivative financial instrument against the gains and losses on the transactions or commitments which are being hedged (i.e., either by recording the gains and losses on derivative financial instruments currently when they are used as hedges of existing (on-balance sheet) transactions or by deferring the gains and losses on derivative financial instruments in the equity section of the balance sheet when they are used as hedges of forecasted transactions). In addition, SFAS No. 133 also defines the concept of embedded derivatives which may now exist due to a broader definition of a derivative instrument. Embedded derivatives are accounted for in the same manner as any other derivatives.</p> <p>Investments in marketable equity securities are classified in one of three categories: trading, held-to-maturity or available-for-sale. Marketable equity securities classified as trading securities are reported at fair value with unrealized gains and losses included in earnings; debt securities classified as held-to-maturity securities are reported at amortized cost; and debt and marketable equity securities classified as available-for-sale securities are reported at fair value with unrealized gains and losses reported in a separate component of shareholders' equity. Share dividends received are recorded as investment income based on the fair value of the shares.</p>

<u>Subject</u>	<u>ROC GAAP</u>	<u>U.S. GAAP</u>
Bonuses to Employees, Directors and Supervisors	<p>shares and not as investment income.</p> <p>According to ROC regulations and our Articles of Incorporation, a portion of distributable earnings should be set aside as bonuses to employees, directors and supervisors. Bonuses to directors and supervisors are always paid in cash. However, bonuses to employees may be granted in cash or shares or both. All of these appropriations, including share bonuses which are valued at par value of NT\$10, are charged against retained earnings under ROC GAAP, after such appropriations are formally approved by the shareholders in the following year.</p>	<p>All bonuses and remuneration are charged to current income in the year incurred. Shares issued as part of these bonuses are recorded at fair market value. Since the amount and form of such bonuses are not finally determinable until the shareholders' meeting in the subsequent year, the total amount of the aforementioned bonuses is initially accrued based on management's estimate regarding the amount to be paid based on the company's Articles of Incorporation. Any difference between the initially accrued amount and the fair market value of the bonuses settled by the issuance of shares is recognized in the year of the shareholders' approval.</p>
Share Dividends	<p>Share dividends are recorded as a reduction to retained earnings for the par value of the shares issued, and a like amount is recorded to the capital stock account.</p>	<p>Share dividends are recorded as a reduction to retained earnings based on the fair value of the shares issued, and a like amount is recorded to the capital stock and capital surplus accounts.</p>
Gains on Disposition of Property, Plant and Equipment	<p>For all prior periods through December 31, 2001, gains on the dispositions of property, plant and equipment are first credited to non-operating income and then transferred, after deducting the applicable income tax, to capital surplus in the applicable fiscal year. After December 31, 2001, transfers to capital surplus are not allowed.</p>	<p>Any gains on the dispositions of property, plant and equipment are credited to income, with no transfer to capital surplus.</p>
Capital Surplus	<p>Under ROC GAAP, the following items are treated as capital surplus: (a) premium on issuance of shares; (b) gain, net of applicable income tax, on disposal of properties; (c) revaluation increment on properties, and (d) the value of the assets of a company acquired in a merger in excess of assumed liabilities and the consideration paid for shares of such company in connection with the acquisition.</p>	<p>Under U.S. GAAP, item (a) of the preceding column is the same as in ROC GAAP; item (b) of the preceding column is recorded as part of net income which is then included as a component of retained earnings; items (c) and (d) of the preceding column are not permitted.</p>

<u>Subject</u>	<u>ROC GAAP</u>	<u>U.S. GAAP</u>
Accounting for Pensions	<p>ROC Statement of Financial Accounting Standards (SFAS) No. 18 "Accounting for Pensions", is substantially similar to U.S. SFAS No. 87, except for the effect of the adoption of ROC SFAS No. 18 in relation to the amortization of unrecognized net transitional obligations, and which provides accounting regulations regarding an employer's accounting for employee retirement plans, including pensions of companies covered by the Labor Standards Law which require a contribution of a percentage of wages and salaries costs to an independent fund.</p> <p>ROC SFAS No. 18 is effective for financial statements in the year ended December 31, 1995. In the year of adoption, certain additional disclosures are required related to pension-related assets and liabilities as determined pursuant to an actuarial valuation; however, net periodic pension cost is not calculated pursuant to an actuarial valuation until the year ended December 31, 1996. Prior to 1996, pension expense under ROC GAAP was generally calculated as a fixed percentage of total annual salaries and wages.</p>	<p>Under U.S. GAAP, the annual pension provision is recognized as a charge to results of the operations over the employee's service period in accordance with SFAS No. 87. U.S. SFAS No. 87 focuses on the plan's benefit formula as the basis for determining the benefit earned, and therefore the cost incurred, for each year. The determination of the benefit earned is actuarially determined, and includes components for service cost, time value of money, return on plan assets and gains or losses from changes in previous assumptions. In certain cases, a minimum liability is recognized through a direct charge to shareholders' equity.</p>
Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed of	<p>ROC GAAP has no specific standards which address impairment of long-lived assets held and used by an entity. Normally, such assets would be carried at cost less accumulated depreciation.</p>	<p>Under U.S. GAAP, SFAS No. 121, as amended by SFAS No. 142, requires entities to perform separate calculations for assets to be held and used to determine whether recognition of an impairment loss is required, and if so, to measure the impairment. If the sum of the expected future cash flows, undiscounted and without interest charges, is less than an asset's carrying amount, an impairment loss is recognized; if the sum of the expected future cash flows is greater than an asset's carrying amount, an impairment loss can not be recognized. Measurement of an impairment loss is based on the fair value of the asset. U.S. SFAS No. 121, as amended by SFAS No. 142, also generally</p>

<u>Subject</u>	<u>ROC GAAP</u>	<u>U.S. GAAP</u>
Deferred Expenses	Under ROC GAAP, deferred expenses include organization costs, start-up costs, issuance costs of bonds, testing costs of reinstallation of machinery and equipment. Deferred expenses shall be amortized by systematic changes to income over the periods estimated to be benefited.	requires that long-lived assets and certain identifiable intangibles to be disposed of be reported at the lower of the carrying amount or fair value less cost to sell. Under U.S. GAAP, start-up costs are generally expensed as incurred.
Computer Software Developed or Obtained for Internal Use	Under ROC GAAP, there is no specific accounting guideline related to costs of computer software developed or obtained for internal use.	U.S. GAAP provides detailed guidance regarding the accounting treatment for internal-use software costs. AICPA Statement of Position 98-1 specifies the requirements for the capitalization of computer software costs obtained for internal use.
Amortization of Identifiable Intangible Assets with Finite Lives	Under ROC GAAP, technology transfer fees can be capitalized and amortized by systematic charges to income over the periods estimated to be benefited or over the terms of the agreements.	Under U.S. GAAP, the technology transfer fees are also amortized over their estimated life, but typically for a shorter period, i.e. 2-3 years.
Retained Earnings Tax	Companies in the ROC are subject to a 10% surtax on profits retained and earned after December 31, 1997. If the retained profits are distributed to the shareholders in the following fiscal year, the surtax can be avoided. Under ROC GAAP, surtax is recorded in the statement of income in the following fiscal year if the earnings are not distributed to the shareholders.	Under U.S. GAAP, income tax expense related to the 10% retained profit tax is recorded in the statement of income in the year that the profits were earned.
Income Tax	Prior to January 1, 1995, generally income tax expenses were provided based on current taxable income; deferred income tax was not recognized for timing differences. ROC Statements of Financial Accounting Standards No. 22 (ROC SFAS No. 22), "Accounting for Income Taxes", was issued in June 1994, and has been adopted as of January 1, 1995. ROC SFAS No. 22 is substantially similar to U.S. GAAP. However, under ROC	Under U.S. GAAP, current tax liabilities are recognized for estimated taxes payable for the current period. U.S. SFAS No. 109 requires that all material temporary differences between the carrying amounts of assets and liabilities and their respective tax bases be recognized as deferred tax liabilities or assets. A valuation allowance is provided on tax assets to the extent that it is not "more likely than not" that such deferred tax assets will be

<u>Subject</u>	<u>ROC GAAP</u>	<u>U.S. GAAP</u>
Depreciation Lives of Fixed Assets	<p>GAAP, the cumulative effect of adoption is included in the current year's provision for income tax rather than being separately presented as the cumulative effect of a change in accounting principle. Under ROC GAAP, the criteria for determining whether a valuation allowance is required are less stringent as compared to U.S. GAAP. Under U.S. GAAP, if a company has experienced cumulative losses in recent years, it is not generally able to consider projections of future operating profits for the purpose of determining the valuation allowance for deferred income tax assets.</p> <p>In practice, depreciation is generally provided using the guideline service lives as prescribed by ROC Internal Revenue Code plus one additional year as salvage value.</p> <p>ROC SFC regulations applicable to public companies require that when fixed assets have been fully depreciated over the prescribed service life and the underlying asset continues to be used, the remaining unamortized value (i.e. the salvage value portion) is depreciated over the asset's remaining economic life. The estimated life of a building under ROC GAAP can be depreciated over a period of 55 years.</p>	<p>realized. A change in tax rate or law requires an adjustment to such deferred assets and liabilities in the period of enactment, and is reported as a part of results of operations.</p> <p>Depreciation is provided on a straight-line basis over the asset's estimated useful life. No additional depreciation is provided on fully depreciated assets which continue to be used in the business.</p>
Long-term Debt Classification	<p>Under ROC GAAP, there are no specific criteria regarding the presentation of long-term debt where certain covenants were breached. Generally, such debt will be presented as non-current as long as there are indications that such breaches will not result in the debt being called by the creditor.</p>	<p>Under U.S. GAAP, breaches of loan covenants may require debt due after one year to be classified as a current liability.</p>
Compensated Absences	<p>ROC GAAP has no specific accounting practice regarding compensated absences.</p>	<p>Compensated absences must be accrued based on the liability for employees' rights to receive compensation for future absences when the benefits can be</p>

<u>Subject</u>	<u>ROC GAAP</u>	<u>U.S. GAAP</u>
Earnings Per Share	A company computes earnings per share based on the weighted average number of outstanding shares, retroactively adjusted for share dividends and new shares issuance issued through unappropriated earnings and capital surplus. No consideration is required to be given to convertible securities with less than a 3% dilutive effect.	<p>accumulated or vested over the service period.</p> <p>Under U.S. GAAP, when a simple capital structure exists, basic earnings per share is calculated based on the weighted average number of shares outstanding. When a complex capital structure exists, diluted earnings per share is calculated based on the weighted average number of shares outstanding plus the number of additional shares that would have been outstanding if dilutive potential shares had been issued, with appropriate adjustments to income or loss that would result from the assumed conversions of those potential shares. The materiality of the dilutive effect is not considered.</p> <p>Basic and diluted earnings per share calculations are not retroactively adjusted for new shares issued through unappropriated earnings and capital surplus.</p>
Comprehensive Income	There is no requirement to present comprehensive income.	<p>Comprehensive income and its components (revenues, expenses, gains and losses) must be presented in a full set of financial statements under U.S. GAAP. Comprehensive income includes all changes in shareholders' equity during a period, except changes resulting from investments by or distributions to owners, including certain items not included in the current results of operations.</p>
Acquisition of Businesses	Under ROC GAAP, if a company acquires an enterprise by issuing shares of its stock in exchange for 100% of the outstanding shares of the enterprise's stock, the fair value of the net assets acquired may be used to determine the fair value of the acquired enterprise. Under this method of accounting, the shares of stock issued by the acquirer are recorded at the fair value of the net assets acquired. No goodwill is recognised by the acquirer under this method. If a	Under U.S. GAAP, business combinations subsequent to July 1, 2001, are accounted for based on the "purchase" method. The difference between purchase consideration and historical net assets acquired is allocated based on the fair values of the net assets and other identifiable intangible assets acquired with any residual accounted for as goodwill. In such allocation of purchase consideration, purchased research and development costs would be expensed upon

<u>Subject</u>	<u>ROC GAAP</u>	<u>U.S. GAAP</u>
	<p>company acquires an enterprise using cash as the purchase consideration, the difference between the purchase consideration and the fair value of the net assets acquired is accounted for as a consolidation debit asset and amortised to income over five years.</p> <p>Also, ROC GAAP has no specific accounting practice related to the recognition of liabilities in connection with an acquisition of a business.</p>	<p>consummation of the acquisition. In an acquisition resulting in the exchange of shares of stock, the purchase consideration is measured based on the fair value of exchanged stock of either the acquirer or acquiree, whichever stock has a more readily determinable market value. The income of the acquirer includes the operations of the acquiree subsequent to the acquisition.</p> <p>U.S. GAAP requires goodwill to be recorded on the balance sheet as an intangible assets and not to be amortized but, rather, to be tested for impairment when events or circumstances indicate that goodwill of a reporting entity within a company might be impaired. A goodwill impairment loss would be charged to operations if the implied fair value of a reporting unit's goodwill is less than its carrying amount.</p> <p>U.S. GAAP has detailed guidance regarding the accounting treatment related to the recognition of liabilities in connection with a purchase business combination. EITF issue No. 95-3 specifies the accounting requirements related to the cost to exit an activity of an acquired company, including employee termination benefits and relocation costs.</p>
Functional Currency	The local currency of NT\$ is the functional currency of the company.	Management must make an assessment of the functional currency of a company and its subsidiaries. Such assessment is based on the primary economic environment in which the company and/or its subsidiaries operates.

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Compal Electronics, Inc.

We have audited the accompanying consolidated balance sheets of Compal Electronics, Inc. and subsidiaries as of December 31, 1999, 2000 and 2001, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the Republic of China. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material mis-statement. 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 financial position of Compal Electronics, Inc. and subsidiaries as of December 31, 1999, 2000 and 2001, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the Republic of China.

The accompanying consolidated financial statements as of and for the year ended December 31, 2001, have been translated into United States dollars solely for the convenience of the readers. We have audited the translation and, in our opinion, the consolidated financial statements expressed in New Taiwan Dollars have been translated into United States dollars on the basis set forth in note 2(p) of the notes to the consolidated financial statements.

KPMG Certified Public Accountants

Taipei, Taiwan
January 28, 2002

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

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 1999, 2000 and 2001

(expressed in thousands of New Taiwan or U.S. Dollars)

	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
ASSETS				
Current assets:				
Cash and cash equivalents (note 4)	7,141,903	5,860,046	11,229,063	320,830
Short-term investments (note 5)	—	19,260	47,315	1,352
Notes and accounts receivable (note 6)	5,729,900	10,074,957	17,242,949	492,656
Notes and accounts receivable — related parties (note 16)	178,710	640,015	566,015	16,172
Inventories (note 7)	6,312,458	6,971,328	5,959,919	170,283
Prepaid assets (notes 12 and 16)	88,321	54,916	113,399	3,240
Other current assets (notes 14, 15 and 16)	489,471	853,235	830,097	23,717
Total current assets	<u>19,940,763</u>	<u>24,473,757</u>	<u>35,988,757</u>	<u>1,028,250</u>
Long-term equity investments (notes 8, 15 and 16)	<u>11,606,784</u>	<u>19,232,397</u>	<u>19,419,293</u>	<u>554,837</u>
Property, plant and equipment (note 9):				
Land and land leasehold right	1,473,189	1,331,193	1,369,070	39,116
Buildings	1,401,260	2,426,312	2,630,980	75,171
Machinery and equipment	1,566,834	2,084,197	2,026,591	57,903
Molding equipment	556,896	859,919	922,700	26,363
Other equipment	588,272	724,457	1,067,293	30,494
	5,586,451	7,426,078	8,016,634	229,047
Less: accumulated depreciation	(1,069,347)	(1,681,107)	(2,546,674)	(72,762)
Construction in progress and prepayment for purchase of equipment	1,177,835	233,058	151,773	4,336
Net property, plant and equipment	<u>5,694,939</u>	<u>5,978,029</u>	<u>5,621,733</u>	<u>160,621</u>
Intangible assets	<u>—</u>	<u>—</u>	<u>97,946</u>	<u>2,798</u>
Other assets:				
Leased assets (notes 9 and 16)	—	241,686	405,128	11,575
Deferred expenses and other non-current assets	110,457	343,323	357,837	10,224
	110,457	585,009	762,965	21,799
Total assets	<u>37,352,943</u>	<u>50,269,192</u>	<u>61,890,694</u>	<u>1,768,305</u>

See accompanying notes to consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS — (Continued)
December 31, 1999, 2000 and 2001
(expressed in thousands of New Taiwan or U.S. Dollars)

	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Short-term loans (note 10)	464,928	1,101,058	598,505	17,100
Short-term notes and bills payable (note 10)	—	2,128,292	370,090	10,574
Notes and accounts payable	8,114,790	9,537,101	17,971,055	513,459
Notes and accounts payable — related parties (note 16)	6,456	8,834	157,166	4,490
Income tax payable	9,525	156,341	215,056	6,144
Accrued expenses	834,394	1,032,556	1,245,560	35,588
Other current liabilities (note 15)	311,164	125,855	229,640	6,561
Convertible bonds payable (note 11)	—	4,879,517	1,379,939	39,427
Total current liabilities	<u>9,741,257</u>	<u>18,969,554</u>	<u>22,167,011</u>	<u>633,343</u>
Non-current liabilities:				
Deferred income tax liabilities, net (note 14)	126,239	161,360	312,356	8,924
Unrealized profit from sales to subsidiaries	6,275	22,544	45,209	1,292
Accrued pension liability and others (notes 8 and 12)	7,998	7,645	33,808	966
Total liabilities	<u>140,512</u>	<u>191,549</u>	<u>391,373</u>	<u>11,182</u>
Total liabilities	<u>9,881,769</u>	<u>19,161,103</u>	<u>22,558,384</u>	<u>644,525</u>
Stockholders' equity (note 13):				
Common stock	11,750,733	15,568,348	21,018,148	600,518
Entitlement certificates of bond-to-stock conversion	1,267	—	—	—
Advance receipts for common stock	46,758	—	—	—
Total stockholders' equity	<u>11,798,758</u>	<u>15,568,348</u>	<u>21,018,148</u>	<u>600,518</u>
Capital surplus (note 13):				
Paid-in capital in excess of par value	6,921,885	4,326,946	6,159,707	175,991
Gain on disposal of property, plant and equipment	21,093	21,161	34,680	991
Surplus from long-term equity investments accounted for by the equity method	—	—	—	—
Total capital surplus	<u>6,942,978</u>	<u>4,348,107</u>	<u>6,194,387</u>	<u>176,982</u>
Retained earnings (note 13):				
Legal reserve	1,020,511	1,560,309	2,158,622	61,675
Special reserve	535,575	45,284	200,898	5,740
Unappropriated retained earnings	8,225,136	10,469,208	11,585,555	331,016
Total retained earnings	<u>9,781,222</u>	<u>12,074,801</u>	<u>13,945,075</u>	<u>398,431</u>
Foreign currency translation adjustment	47,997	175,669	236,760	6,765
Treasury stock (note 13)	(1,099,781)	(1,058,836)	(2,062,060)	(58,916)
Total stockholders' equity	<u>27,471,174</u>	<u>31,108,089</u>	<u>39,332,310</u>	<u>1,123,780</u>
Commitments and contingencies (notes 16 and 18)				
Total liabilities and stockholders' equity	<u>37,352,943</u>	<u>50,269,192</u>	<u>61,890,694</u>	<u>1,768,305</u>

See accompanying notes to consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31, 1999, 2000 and 2001

(expressed in thousands of New Taiwan or U.S. Dollars, except net income per share)

	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
Net sales (note 16)	47,293,452	75,468,781	78,657,593	2,247,360
Cost of sales (note 16)	<u>40,562,005</u>	<u>67,937,138</u>	<u>71,505,132</u>	<u>2,043,004</u>
	6,731,447	7,531,643	7,152,461	204,356
Change in unrealized intercompany profits	<u>29,669</u>	<u>(16,269)</u>	<u>(22,665)</u>	<u>(648)</u>
Gross profit	<u>6,761,116</u>	<u>7,515,374</u>	<u>7,129,796</u>	<u>203,708</u>
Operating expenses:				
Selling	666,056	850,190	1,340,150	38,290
Administrative	540,956	673,675	685,586	19,588
Research and development	669,161	821,499	1,034,290	29,551
	<u>1,876,173</u>	<u>2,345,364</u>	<u>3,060,026</u>	<u>87,429</u>
Operating income	<u>4,884,943</u>	<u>5,170,010</u>	<u>4,069,770</u>	<u>116,279</u>
Non-operating income:				
Interest income (notes 4 and 8)	581,507	382,436	421,606	12,046
Investment income, net (notes 8 and 13)	113,798	291,407	287,265	8,208
Foreign currency exchange gain, net	—	497,965	834,263	23,836
Rental income (note 16)	—	7,340	37,442	1,070
Other	<u>121,275</u>	<u>58,402</u>	<u>96,539</u>	<u>2,758</u>
	<u>816,580</u>	<u>1,237,550</u>	<u>1,677,115</u>	<u>47,918</u>
Non-operating expenses and losses:				
Interest expense	38,739	138,570	141,387	4,040
Foreign currency exchange loss, net	39,907	—	—	—
Provision for inventory obsolescence	—	57,246	19,778	565
Other	<u>11,845</u>	<u>11,737</u>	<u>32,556</u>	<u>930</u>
	<u>90,491</u>	<u>207,553</u>	<u>193,721</u>	<u>5,535</u>
Net income before income taxes and minority interest loss	5,611,032	6,200,007	5,553,164	158,662
Income tax expense (note 14)	(219,172)	(231,997)	(242,682)	(6,934)
Minority interest in net loss of subsidiaries	6,124	15,185	92,280	2,637
Net income	<u>5,397,984</u>	<u>5,983,195</u>	<u>5,402,762</u>	<u>154,365</u>
Net income per share (expressed in New Taiwan or U.S. Dollars)	<u>2.74</u>	<u>3.03</u>	<u>2.66</u>	<u>0.08</u>

See accompanying notes to consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years ended December 31, 1999, 2000 and 2001
(expressed in thousands of New Taiwan Dollars)

	Common stock NT\$	Advance receipts for common stock NT\$	Entitlement certificates of bond-to-stock conversion NT\$	Capital surplus NT\$	Retained earnings			Treasury stock NT\$	Foreign currency translation adjustment NT\$	Total stockholders' equity NT\$
					Legal reserve NT\$	Special reserve NT\$	Unappropriated NT\$			
Balance on January 1, 1999	8,446,417	5,620	2,356	6,613,281	533,465	269,295	7,744,205	(1,096,019)	22,584,295	
Appropriation of 1998 net income:										
Increase in special reserve	—	—	—	—	—	266,280	(266,280)	—	—	
Legal reserve	—	—	—	—	487,046	—	(487,046)	—	—	
Employees' bonuses	243,514	—	—	—	—	—	(243,523)	—	(9)	
Directors' remuneration	—	—	—	—	—	—	(97,409)	—	(97,409)	
Stock dividends	2,973,285	—	—	—	—	—	(2,973,285)	—	—	
Cash dividends	—	—	—	—	—	—	(849,510)	—	(849,510)	
Convertible bond transferred to common stock	65,517	—	(1,089)	175,697	—	—	—	—	240,125	
Issuance of common stock for cash	22,000	(5,620)	—	154,000	—	—	—	—	170,380	
Advance receipts for common stock	—	46,758	—	—	—	—	—	—	46,758	
Net income for 1999	—	—	—	—	—	—	5,397,984	—	5,397,984	
Foreign currency translation adjustment	—	—	—	—	—	—	—	(17,678)	(17,678)	
Increase in treasury stock	—	—	—	—	—	—	—	(3,762)	(3,762)	
Balance on December 31, 1999	11,750,733	46,758	1,267	6,942,978	1,020,511	535,575	8,225,136	(1,099,781)	27,471,174	
Appropriation of 1999 net income:										
Special reserve	—	—	—	—	—	(490,291)	490,291	—	—	
Legal reserve	—	—	—	—	539,798	—	(539,798)	—	—	
Employees' bonuses	269,820	—	—	—	—	—	(269,899)	—	(79)	
Directors' remuneration	—	—	—	—	—	—	(107,960)	—	(107,960)	
Stock dividends	823,732	—	—	—	—	—	(823,732)	—	—	
Cash dividends	—	—	—	—	—	—	(2,353,520)	—	(2,353,520)	
Gain on disposal of property, plant and equipment transferred to capital surplus	—	—	—	68	—	—	(68)	—	—	
Capital surplus transferred to common stock	2,706,548	—	—	(2,706,548)	—	—	—	—	—	
Convertible bonds transferred to common stock	1,915	—	(1,267)	2,409	—	—	—	—	3,057	
Issuance of common stock for cash	15,600	(46,758)	—	109,200	—	—	—	—	78,042	
Adjustment due to non-proportional investment in investee's increase in capital	—	—	—	—	—	—	(134,437)	—	(134,437)	
Net income for 2000	—	—	—	—	—	—	5,983,195	—	5,983,195	
Foreign currency translation adjustment	—	—	—	—	—	—	—	127,672	127,672	
Sale of treasury stock	—	—	—	—	—	—	—	40,945	40,945	
Balance on December 31, 2000	15,568,348	—	—	4,348,107	1,560,309	45,284	10,469,208	(1,058,836)	31,108,089	

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See accompanying notes to consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY — (Continued)
Years ended December 31, 1999, 2000 and 2001
(expressed in thousands of New Taiwan or U.S. Dollars)

	Common stock	Advance receipts for common stock	Entitlement certificates of bond-to-stock conversion	Capital surplus	Retained Earnings		Treasury stock	Foreign currency translation adjustment	Total stockholders' equity	
					Legal reserve	Special reserve			NT\$	U.S.\$
Balance on December 31, 2000	15,568,348	—	—	4,348,107	1,560,309	45,284	(1,058,836)	175,669	31,108,089	888,803
Appropriation of 2000 net income:										
Special reserve	—	—	—	—	—	155,614	—	—	—	—
Legal reserve	—	—	—	—	598,313	(598,313)	—	—	—	—
Employees' bonuses	299,065	—	—	—	—	(299,155)	—	—	(90)	(2)
Directors' remuneration	—	—	—	—	—	(119,663)	—	—	(119,663)	(3,419)
Stock dividends	2,335,252	—	—	—	—	(2,335,252)	—	—	—	—
Cash dividends	—	—	—	—	—	(778,418)	—	—	(778,418)	(22,241)
Capital surplus transferred to common stock	1,556,835	—	—	(1,556,835)	—	—	—	—	—	—
Issuance of common stock for cash	1,000,000	—	—	2,877,837	—	—	—	—	3,877,837	110,795
Convertible bonds converted into common stock	24,684	—	—	72,149	—	—	—	—	96,833	2,767
Issuance of common stock and capital surplus through merger of Palmax	233,964	—	—	439,610	—	—	—	—	673,574	19,245
Adjustment due to non-proportional investment in investee's increase in capital	—	—	—	13,519	—	—	—	—	13,519	386
Net income for 2001	—	—	—	—	—	—	—	—	5,402,762	154,365
Foreign currency translation adjustment	—	—	—	—	—	—	—	61,091	61,091	1,745
Increase in treasury stock	—	—	—	—	—	—	(1,003,224)	—	(1,003,224)	(28,664)
Balance on December 31, 2001	21,018,148	—	—	6,194,387	2,158,622	200,898	(2,062,060)	236,760	39,332,310	1,123,780

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See accompanying notes to consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 1999, 2000 and 2001

(expressed in thousands of New Taiwan or U.S. Dollars)

	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
Cash flows from operating activities:				
Net income	5,397,984	5,983,195	5,402,762	154,365
Adjustments to reconcile net income to net cash provided by operating activities:				
Minority interest in net loss of subsidiaries	(6,124)	(15,185)	(92,280)	(2,637)
Depreciation and amortization	499,222	782,802	1,252,817	35,795
Allowance for doubtful accounts, sales returns and discounts	18,286	110,663	81,973	2,342
Allowance for (recovery of) inventory obsolescence	(22,777)	57,572	20,213	578
Investment loss (income), net	118,333	69,390	(161,123)	(4,604)
Realized loss on long-term equity investments under the cost method	—	36,985	111,156	3,176
Gain on sale of long-term equity investments	(65,015)	(295,230)	(18,456)	(527)
Increase in notes and accounts receivable	(553,660)	(4,917,025)	(7,122,251)	(203,493)
Decrease (increase) in inventories	(3,695,565)	(716,442)	1,233,954	35,256
Decrease (increase) in prepaid and other current assets	887,385	(250,982)	(97,170)	(2,776)
Increase in notes and accounts payable	3,232,911	1,424,689	8,521,755	243,479
Increase (decrease) in income tax payable	(169,626)	146,816	58,715	1,677
Increase in accrued expenses and other current liabilities	139,221	12,853	301,367	8,610
Other	114,033	(18,265)	156,158	4,461
Cash provided by operating activities	5,894,608	2,411,836	9,649,590	275,702
Cash flows from investing activities:				
Additions to property, plant and equipment	(2,272,775)	(1,250,938)	(505,474)	(14,442)
Proceed from sale of property, plant and equipment and insurance compensation for property, plant and equipment	10,008	15,607	110,282	3,151
Acquisition of long-term equity investments	(6,957,430)	(12,085,901)	(1,716,519)	(49,043)
Sale of long-term equity investments	71,881	750,706	306,243	8,750
Repayment of long-term equity investments	—	3,800,000	205,394	5,868
Increase in other receivables — related parties	—	—	120,500	3,443
Cash received through merger of Palmax	—	—	858,621	24,532
Increase in deferred assets	(74,300)	(251,627)	(149,233)	(4,264)
Decrease in short-term investments	122,757	—	—	—
Other	(3,494)	(25,788)	(31)	(1)
Cash used in investing activities	(9,103,353)	(9,047,941)	(770,217)	(22,006)
Cash flows from financing activities:				
Increase (decrease) in short-term loans	(569,520)	2,764,422	(2,260,755)	(64,593)
Issuance of common stock for cash	217,138	78,042	3,877,837	110,795
Increase (decrease) in convertible bonds payable	—	4,882,650	(3,400,660)	(97,160)
Directors' remuneration and employee bonuses	(97,418)	(108,039)	(119,753)	(3,422)
Decrease (increase) in treasury stock	(3,762)	40,945	(886,894)	(25,340)
Cash dividends paid	(849,510)	(2,353,520)	(778,418)	(22,241)
Other	(2,068)	3,519	16,270	465
Cash provided by (used in) financing activities	(1,305,140)	5,308,019	(3,552,373)	(101,496)
Effect of exchange rate changes on cash and cash equivalents	(4,323)	46,229	42,017	1,200
Net increase (decrease) in cash and cash equivalents	(4,518,208)	(1,281,857)	5,369,017	153,400
Cash and cash equivalents at beginning of period	11,660,111	7,141,903	5,860,046	167,430
Cash and cash equivalents at end of period	7,141,903	5,860,046	11,229,063	320,830
Supplementary disclosures of cash flow information:				
Liabilities assumed	—	—	90,501	2,586
Issuance of common stock and capital surplus for net assets received	—	—	673,576	19,245
Long-term equity investment write-off	—	—	966,113	27,603
Less: non-cash assets received	—	—	(871,569)	(24,902)
Cash received	—	—	858,621	24,532
Supplementary disclosures of cash flow information:				
Cash paid during the period for:				
Interest	29,833	237,960	79,876	2,282
Income taxes	267,069	102,190	92,950	2,656
Investing and financing activities not affecting cash flows:				
Long-term equity investments reclassified to short-term investments	—	—	68,564	1,959
Convertible bonds payable and other items transferred to common stock and capital surplus	240,125	3,056	96,833	2,767

See accompanying notes to consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1999, 2000 and 2001
(expressed in thousands of New Taiwan or U.S. Dollars unless otherwise specified)

(1) Organization

Compal Electronics, Inc. (the "Company") was incorporated in the Republic of China ("ROC") as a company limited by shares in June 1984. The major business activities of the Company are the manufacture and sale of notebook personal computers ("notebook PCs"), monitors, wireless handsets and personnel digital assistants ("PDAs"). The Company merged with Palmax Technology Co., Ltd. ("Palmax") on July 4, 2001.

Consolidated subsidiaries that are directly owned by the Company included the following as of December 31, 2001:

Just International Ltd. ("Just") was incorporated in the British Virgin Islands on August 25, 1992. The main activity of Just is investing in equity securities. As of December 31, 2000, the Company owned 100% of Just's authorized common stock amounting to U.S.\$27,810. From 1996 to 2000, Just invested U.S.\$26,800 in Compal Electronics (China) Ltd. ("CPC"), which was incorporated in People's Republic of China and is engaged in the manufacture and sale of monitors. As of December 31, 2001, Just owned 100% of CPC's outstanding common stock. Just also invested in Sceptre Industries Inc. ("Sceptre"), which was incorporated in the United States of America and is mainly engaged in the sale of notebook PCs and monitors. As of December 31, 2001, Just owned 60% of Sceptre's outstanding common stock.

Compal Investment Corp. ("Compal Investment") was incorporated in August 1997 in the ROC. The main activity of Compal Investment is investing in businesses relating to the PC industry. Since December 1999, Compal Investment was renamed Panpal Technology Co. ("Panpal") in order to expand its business in selling electronic materials. As of December 31, 2001, the Company owned 100% of Panpal's outstanding common stock amounting to NT\$3,472,000.

(2) Summary of Significant Accounting Policies

(a) Accounting principles and consolidation policy

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the ROC. These financial statements are not intended to present the consolidated financial position of the Company and the related consolidated results of operations and cash flows based on accounting principles and practices generally accepted in countries and jurisdictions other than the ROC.

The consolidated financial statements include the accounts of the Company and all subsidiaries in which more than 50% of the shares are owned by the Company and in which total assets or sales exceeds 10% of the Company's total assets or sales. If the total assets or sales of a subsidiary is less than 10% of the Company's total assets or sales, then the subsidiary is accounted for under the equity method of accounting.

The consolidated financial statements in 1999, 2000 and 2001 included the consolidated accounts of Just and Panpal (the "Group"). All significant intercompany accounts and transactions have been eliminated. The common stock of the Company acquired by its subsidiaries is recorded as treasury stock, a deduction from stockholders' equity in the accompanying consolidated balance sheets.

Since the total assets and sales of Gempal Technology Co. ("Gempal"), Compal Communication Limited ("CCI"), Swenc Technology Co., Ltd. ("Swenc"), Compal Europe B.V. ("CEBV"), Bizcom Electronics, Inc. ("Bizcom"), SaveCom InfoCom Inc. ("SaveCom"), Compal Europe (UK) Ltd. ("CEUK"), Compal Holding Ltd. ("CPH"), Vacom Wireless, Inc. ("Vacom"), Pagine Corporation ("Pagine") (in process of liquidation) and Just International (Singapore) Pte Ltd. ("Just-Singapore") do

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

not exceed 10% of the corresponding accounts of the Company, and the aggregate total assets and total sales of all of these subsidiaries is less than 30% of the Company's total assets and sales, respectively, the financial statements of these subsidiaries have not been consolidated in the accompanying consolidated financial statements.

Sceptre's fiscal year ends on September 30, which was used for the purpose of recording accounting entries as at and for the year ended December 31, 2001. Sceptre is a subsidiary of Just. According to the Republic of China Statements of Financial Accounting Standards ("SFAS") No. 7 "Consolidated Financial Statements," if the subsidiary's fiscal year end differs from the Company's fiscal year end by three months, then the subsidiary's financial statements using its fiscal year end can be used for purposes of consolidation.

(b) Foreign currency transactions and translation

The functional currency of each company in the Group is its respective local currency. The Company's reporting currency is the New Taiwan Dollar. Foreign currency transactions are translated at the rates prevailing on the transaction dates. Foreign currency receivables and payables are translated into New Taiwan Dollars, or local currency, at the approximate market rate of exchange prevailing on the balance sheet date. The resulting unrealized gains or losses are included in current operations.

If a forward exchange contract is intended to hedge the risks of changes in foreign currency exchange rates, the related forward exchange contract receivables and payables are recorded in New Taiwan Dollars at the spot rate on the date of contract inception, and the balance on the balance sheet date is translated into New Taiwan Dollars at the prevailing spot rate. Gains or losses resulting from translation on the balance sheet date are recognized as non-operating income or losses. The discount or premium on a forward exchange contract is amortized over the life of the contract.

If a foreign currency options contract is intended to hedge the risks of changes in foreign currency exchange rates, the related assets or liabilities are not recorded on the date of contract inception, and exchange gains or losses resulting from settlement are recognized as non-operating income or losses. The related premiums received or paid are accounted for as advance receipts or prepaid expenses and amortized over the life of the contract. Gains or losses resulting from exercise are recognized as non-operating income or losses.

(c) Cash equivalents

Cash equivalents represent investments in bonds purchased under resale agreements and commercial paper with a maturity of three months or less from the date of investment.

(d) Short-term investments

Investments in publicly listed equity securities not intended to be held for the long term and mutual funds are classified as short-term investments in the accompanying balance sheets and stated at the lower of cost or market value. Market value of marketable equity securities is based on the average closing price of the last month of the accounting period. Market value of open-end mutual funds is based on the fair market value on the balance sheet date. Cost is determined using the weighted-average method.

(e) Allowance for doubtful accounts receivable

The allowance for doubtful accounts is based on an aging analysis and the likelihood of collection of the Company's accounts receivable balances.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****(f) Inventories**

Inventories are stated at the lower of cost or market value. Market value for raw materials and work in process is based on replacement cost. The market value of finished goods is based on net realizable value.

(g) Long-term equity investments

Investments in equity securities intended to be held for the long term are classified as long-term equity investments in the accompanying balance sheets. Long-term equity investments in publicly listed equity securities that represent less than 20% of the investee's common stock ownership are stated at the lower of cost or market value. Long-term equity investments in non-listed equity securities that represent less than 20% of the investee's common stock ownership are stated at cost. However, if there is evidence indicating that a decline in the value of an investment is not temporary, the investment is written down to reflect such decline. The resulting loss is recognized in the period incurred. Stock dividends are not recognized as income but as an increase in the number of the shares held.

Long-term equity investments are accounted for under the equity method when the Company owns between 20% and 50% of the investee's common stock or if the Company owns greater than 50% of a subsidiary's common stock, but the subsidiary's total assets and sales is less than 10% of the Company's total assets and sales. Refer to note 2(a). The difference between cost of investment and the amount of underlying equity in net assets of an investee is amortized using the straight-line method over 10 years. If an investee company accounted for under the equity method issues new shares and the Company does not purchase new shares proportionately, then the investment percentage, and therefore the equity in net assets for the investment, will be changed. Such difference shall be used to adjust capital surplus or retained earnings and long-term equity investments.

Unrealized intercompany profits or losses resulting from transactions between the Company and its subsidiaries and investees accounted under the equity method are deferred until realized, or are amortized based on the useful lives of the assets that give rise to such unrealized profits or losses.

The financial statements of foreign subsidiaries and investees accounted for under the equity method and reported in foreign currencies are translated into New Taiwan Dollars at the exchange rates prevailing on the balance sheet date, with the exception of stockholders' equity, which is translated at historical rates. Revenues, costs and expenses are translated using the weighted-average exchange rates during the applicable period. Adjustments, net of the related income taxes, from these translations are reflected in stockholders' equity as a foreign currency translation adjustment.

(h) Property, plant and equipment and leased assets

Property, plant and equipment are stated at cost. Interest in connection with the acquisition or construction of property, plant and equipment is capitalized. Excluding land and land use rights, depreciation of property, plant and equipment is provided for by using the straight-line method over the estimated useful lives of the assets. If the property, plant and equipment have reached their estimated useful lives but are still in use, the Company will estimate the remaining useful lives and residual values and depreciate the remaining costs using the same method. Gains on the disposal of property, plant and equipment are included in non-operating income and, for those gains that occurred before December 31, 2000, are transferred to capital surplus in the year of disposal, net of the related income taxes.

The expenditures for obtaining land leasehold rights, including charges for land leasehold rights and related expenses, are capitalized and amortized as rental expenses by using the interest method over the contract periods.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Property, plant and equipment leased to other parties under operating leases are classified as leased assets. Rental income received by the Company is recorded as non-operating income. The related depreciation is accounted for as a deducted item of rental income.

Leasehold improvements are amortized by using the straight-line method over the shorter of the estimated useful lives or the contract periods.

(i) Deferred assets

Charges for royalties are deferred and amortized over their respective contract periods. Costs of computer software are amortized by using the straight-line method over three years.

(j) Convertible bonds payable

Costs incurred for the issuance of redeemable convertible bonds are amortized during the period between the issuance date and the last redeemable date.

The entitlement certificate of bond-to-stock conversion is issued upon the bondholder's exercise of the option to convert the convertible bonds into the Company's common stock. The number of entitlement certificates for bond-to-stock conversion that is to be given, is calculated based on the volume of the convertible bond and the conversion price at the time of the conversion. The convertible bond payable over the par value of the common stock and deferred issuance costs are transferred to capital surplus upon conversion. In accordance with the conversion rules, the entitlement certification of bond-to-stock conversion is registered as common stock three times a year.

(k) Retirement plan

The Company has established employee noncontributory retirement plans covering all regular employees in the ROC. According to these plans, employees are eligible for retirement, or are required to retire, after meeting certain age or service requirements. The retirement benefits are lump-sum payments and are determined principally by the length of service of the employees. Payments of employee retirement benefits are based on the years of service and the average salary six months before the employee's retirement. Each employee will earn two months' salary for the first 15 years of service, and one month's salary for each service year after the sixteenth year. The maximum is 45 months of salary.

The Company has made monthly cash contributions of 5% of salaries and wages to its pension funds maintained with the Central Trust of China. Payment of employee retirement benefits will first be paid by the pension fund, and then by the Company if the level of funds is insufficient.

In accordance with ROC SFAS No. 18 "Accounting for Pensions", net periodic pension costs, including services costs, interest cost, expected return on plan assets, and amortization of net unrecognized transition assets and unrecognized service cost over the average remaining service period of the employees for 20 years, have been actuarially calculated for the Company in accordance with SFAS No. 18.

Sceptre has an established 401(k) plan. Under this plan, all employees over 21 years of age with over one year of employment are eligible to participate. Sceptre will match 100% of employee contributions up to a maximum of 3% of an employee's salary. An additional annual contribution can be made at the discretion of Sceptre's Board of Directors.

Payments of employee retirement benefits for the other consolidated subsidiaries are based on the local labor law of each subsidiary's registered jurisdiction. The Company has made a monthly cash contribution of 18% of salaries and wages to a pension fund and recognized this contribution as current expenses. The pension funds are maintained by local governments. Payment of employee retirement benefits will be paid from the pension funds.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)****(l) Income taxes**

Income taxes are calculated based on accounting income. The amounts for deferred income tax liabilities or assets are calculated by applying the provisions of enacted tax law to determine the amount of tax payable or refundable, currently or in future years. The tax effect of taxable temporary differences are recorded as deferred tax liabilities. The tax effects of deductible temporary differences, net operating losses and income tax credits will be recognized as deferred income tax assets. The realization of deferred income tax assets is evaluated and if it is considered more likely than not that the asset will not be realized, a valuation allowance is recognized accordingly.

Deferred income tax assets or liabilities are classified as current or non-current based on the classification of the asset or liability relating to the deferred item, or for certain transactions not directly related to an asset or liability, based on the timing of the expected reversal date.

The 10% surtax on undistributed earnings is recorded as current income tax expense after the resolution to appropriate retained earnings is approved in a stockholders' meeting.

The Company's income tax returns are calculated and filed based on the Company's and each subsidiary's registered local tax law.

(m) Treasury stock

Pursuant to ROC SFAS No. 30, "Accounting for Treasury Stock", the Company accounts for the cost of purchasing its outstanding stock as "treasury stock". A gain on the sale of treasury stock is credited to capital surplus-treasury stock. Losses are charged to capital surplus, but only to the extent of available net gains from previous sales or retirements of the same class of stock; otherwise, losses are charged to retained earnings. The cost of treasury stock is computed using the weighted-average method.

When treasury stock is retired, the weighted-average cost of the retired treasury stock is written off to offset the par value and the paid-in capital in excess of par value. If the weighted-average cost written off exceeds the sum of the par value and the paid-in capital in excess of par value, the difference is charged to capital surplus arising from the same class of stock or to retained earnings, and if vice versa, the difference is credited to capital surplus.

(n) Goodwill

Goodwill resulting from the Company's initial acquisition of 56% of Palmax shares and the use of Palmax's core technology is being amortized over 10 years.

(o) Net income per share

Net income per share of common stock is computed based on the weighted-average number of common shares outstanding during the period. The convertible bonds issued by the Company in 2000 are common stock equivalents. As such, assuming the convertible bonds are converted to common stock, simple net income per share will be disclosed if there is no dilution effect or the dilution effect is less than 3%. If the dilution effect is greater than 3%, both simple net income per share and fully diluted net income per share shall be disclosed. Net income per share for prior periods is retroactively adjusted to reflect the effect of stock issued by transferring capital surplus, retained earnings and employee bonuses.

(p) Convenience translation into U.S. Dollars

The consolidated financial statements are stated in New Taiwan Dollars. Translation of the 2001 New Taiwan Dollar amounts into U.S. Dollars amounts are included solely for the convenience of the readers, using the noon buying rate provided by the Federal Reserve Bank of New York on December 31, 2001, of NT\$35.00 to U.S.\$1. The convenience translations should not be construed as representations that the

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

New Taiwan dollar amounts have been, could have been, or could in the future be, converted into U.S. Dollars at this rate or any other rate of exchange.

(3) Merger with Palmax

The Company acquired the remaining 44% of the outstanding shares in Palmax on July 4, 2001, through the issuance of 23,396 thousand common shares bringing its ownership in Palmax to 100%. Under ROC GAAP, the merger was accounted for using the purchase method and accordingly, the prior period pro forma combined results of operation are provided.

The results of operations of Palmax have been combined into the income statement of the Company since July 4, 2001. The pro forma combined results of operations are summarized assuming that the merger had occurred on January 1, 2000, as follows:

	<u>2000</u>	<u>2001</u>
	NT\$	NT\$
Net sales	<u>75,688,954</u>	<u>78,717,139</u>
Gross profit	<u>7,488,040</u>	<u>7,107,497</u>
Operating income	<u>5,024,768</u>	<u>3,967,353</u>
Income before income taxes	6,136,045	5,510,628
Income tax expense	204,997	242,682
Minority interest in net loss of subsidiaries	<u>15,185</u>	<u>92,280</u>
Net income	<u>5,946,233</u>	<u>5,360,226</u>
Net income per share	<u>2.96</u>	<u>2.62</u>

(4) Cash and Cash Equivalents

	<u>December 31,</u>			
	<u>1999</u>	<u>2000</u>	<u>2001</u>	
	NT\$	NT\$	NT\$	U.S.\$
Cash on hand	12,404	1,190	3,324	95
Checking accounts and demand deposits	187,550	123,832	52,291	1,494
Time deposits	6,334,443	5,692,446	4,455,911	127,311
Bonds purchased under resale agreement and commercial paper	<u>607,506</u>	<u>42,578</u>	<u>6,717,537</u>	<u>191,930</u>
	<u>7,141,903</u>	<u>5,860,046</u>	<u>11,229,063</u>	<u>320,830</u>

The Company's interest income is primarily generated from cash and cash equivalents.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(5) Short-term Investments

	December 31,			
	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
Marketable equity securities (market value as of December 31, 2001, was NT\$27,315)	—	—	68,564	1,959
Open-end mutual funds (net asset values as of December 31, 2000 and 2001, was NT\$19,260 and NT\$23,491)	—	20,000	20,000	571
Less: allowance for losses on valuation of short-term investments	—	(740)	(41,249)	(1,178)
	<u>—</u>	<u>19,260</u>	<u>47,315</u>	<u>1,352</u>

(6) Notes and Accounts Receivable — Non-related parties

	December 31,			
	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
Notes receivable	79,813	31,022	78,640	2,247
Accounts receivable	5,847,296	10,324,194	17,585,065	502,431
Less: allowance for doubtful accounts	(19,539)	(36,750)	(120,287)	(3,437)
allowance for sales returns and discounts	(177,670)	(243,509)	(300,469)	(8,585)
	<u>5,729,900</u>	<u>10,074,957</u>	<u>17,242,949</u>	<u>492,656</u>

(7) Inventories

	December 31,			
	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
Finished goods	2,349,345	2,419,976	2,036,312	58,180
Work in process	757,239	726,806	682,928	19,512
Raw materials	3,164,660	3,804,919	3,475,460	99,299
Raw materials in transit	175,414	211,399	96,991	2,771
	6,446,658	7,163,100	6,291,691	179,762
Less: allowance for inventory obsolescence	(134,200)	(191,772)	(331,772)	(9,479)
	<u>6,312,458</u>	<u>6,971,328</u>	<u>5,959,919</u>	<u>170,283</u>
Insurance coverage amount for inventory	<u>3,387,561</u>	<u>7,763,563</u>	<u>5,967,027</u>	<u>170,486</u>

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(8) Long-term Equity Investments and Credit Balance of Long-term Equity Investment

	December 31,			
	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
Long-term equity investments:				
Under the equity method	3,343,853	12,388,946	12,115,793	346,165
Under the lower-of-cost-or-market value method	1,880,159	1,842,671	3,073,938	87,827
Under the cost method	<u>2,582,772</u>	<u>4,997,780</u>	<u>4,229,562</u>	<u>120,845</u>
	7,806,784	19,229,397	19,419,293	554,837
Prepayment for long-term equity investments	<u>3,800,000</u>	<u>3,000</u>	<u>—</u>	<u>—</u>
Total	<u><u>11,606,784</u></u>	<u><u>19,232,397</u></u>	<u><u>19,419,293</u></u>	<u><u>554,837</u></u>
Credit balance of long-term equity investments	<u><u>5,766</u></u>	<u><u>1,894</u></u>	<u><u>1,894</u></u>	<u><u>54</u></u>

- (a) As of December 31, 1999, 2000 and 2001, the market price of long-term equity investments using the lower-of-cost-or-market-value method amounted to NT\$4,726,845, NT\$1,676,533 and NT\$3,980,455, respectively.
- (b) Net investment income or loss on long-term equity investments under the equity method for the years ended December 31, 1999, 2000 and 2001, amounted to a NT\$118,333 loss, a NT\$69,390 loss and a NT\$161,123 gain, respectively. The calculation of these amounts was based on the investee's audited financial statements.
- (c) The Company increased its investment in SaveCom InfoCom Inc. by NT\$199,940 in December 1999. The percentage of ownership was 99.97%. SaveCom InfoCom Inc planned to be engaged in Type I telecommunications businesses, which includes local, long distance and international network business (integrated network business). As of April 12, 2000, the Company received back its investments for long-term equity investments in SaveCom InfoCom Inc. and related interest income amounted to NT\$3,820,100.
- (d) Net investment income for the year ended December 31, 2001, amounted to NT\$287,265, which primarily included investment income under the equity method amounting to NT\$161,123, cash dividends amounting to NT\$30,868 received from Cal-Comp Electronic (Thailand) Ltd., and cash dividends amounting to NT\$42,790 received from Kinpo Electronics, Inc.
- (e) On July 4, 2001, the Company merged with Palmax, which was one of the long-term equity investments accounted for under the equity method of the Company before this merger. The Company retired the shares of Palmax. See note 3.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

- (f) As of December 31, 1999, 2000 and 2001, the original costs of long-term equity investments under the equity method consisted of the following:

	December 31,			
	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
Toppoly Optoelectronics Corp.	83,064	7,215,568	7,215,568	206,159
CCI	—	1,479,793	1,456,397	41,611
IST	729,600	629,600	1,118,951	31,970
Gempal.....	899,940	899,940	899,940	25,713
Palmax	533,685	1,391,198	—	—
Other	1,371,365	1,232,182	1,326,863	37,910
	<u>3,617,654</u>	<u>12,848,281</u>	<u>12,017,719</u>	<u>343,363</u>

(9) Property, Plant and Equipment and Leased Assets

The Company does not provide property, plant and equipment as collateral for their loans. The Company's new office building in Neihu, Taiwan became operational in the second quarter of 2000. Accordingly, the related costs were transferred from construction in progress to buildings at the end of the second quarter of 2000. As of December 31, 1999, 2000 and 2001, insurance coverage for property, plant and equipment and leased assets amounted to NT\$3,450,378, NT\$6,064,869 and NT\$5,284,011, respectively.

In January 1996, the Company entered into an agreement with the government authority of Kunshan City, Jiangsu Province, People's Republic of China to acquire state-owned land use rights. The term of the state-owned land use rights extends from August 15, 1997, to April 9, 2046. According to the contract, total expenditures for obtaining state-owned land use rights amounted to U.S.\$4,637; related annual administrative expenses amounted to RMB77,280.

The Company entered into agreements to lease a portion of its office space and plants beginning in the third quarter of 2000. The contract period extends from one to three years. According to the contract, the rental is paid monthly. As of December 31, 2000 and 2001, the details of leased assets were as follows:

	December 31,		
	2000	2001	
	NT\$	NT\$	U.S.\$
Land	148,228	259,946	7,427
Buildings and other	<u>97,694</u>	<u>159,326</u>	<u>4,552</u>
	245,922	419,272	11,979
Less: accumulated depreciation	<u>(4,236)</u>	<u>(14,144)</u>	<u>(404)</u>
	<u>241,686</u>	<u>405,128</u>	<u>11,575</u>

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(10) Short-term Loans and Short-term Notes and Bills Payable

	December 31,			
	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
Credit loan.....	379,194	1,101,058	598,505	17,100
Usance letters of credit	85,734	—	—	—
	<u>464,928</u>	<u>1,101,058</u>	<u>598,505</u>	<u>17,100</u>
Notes and bills payable (net of discount \$21,708 and \$1,510, respectively, for 2000 and 2001)	—	2,128,292	370,090	10,574
Unused short-term credit line ...	<u>6,412,000</u>	<u>7,277,000</u>	<u>9,993,000</u>	<u>285,514</u>
Range of interest rates	<u>1.00% – 6.57%</u>	<u>4.73% – 7.54%</u>	<u>1.85% – 7.07%</u>	

As of December 31, 1999, 2000 and 2001, all short-term loans and short-term notes and bills payable were unsecured by any collateral.

(11) Convertible Bonds Payable

In 1996, the Company issued overseas unsecured bonds with a face value of U.S.\$95,000 (bearing a interest rate of 1.25%). In November 1999, the outstanding convertible bonds were fully redeemed at the option of the Company.

The Company issued overseas unsecured zero coupon bonds with a face value of U.S.\$148,000 on October 19, 2000. As of December 31, 2000 and 2001, the convertible bonds payable consisted of the following:

	December 31,		
	2000	2001	
	NT\$	NT\$	U.S.\$
Aggregate principal amount (U.S.\$148,000)	4,636,840	4,636,840	132,481
Accumulated converted amount (U.S.\$100 and U.S.\$3,100, respectively, in 2000 and 2001)	(3,133)	(102,051)	(2,916)
Accumulated redemption amount (U.S.\$105,544)	—	(3,306,694)	(94,477)
Foreign currency exchange loss	<u>245,810</u>	<u>151,844</u>	<u>4,339</u>
	<u>4,879,517</u>	<u>1,379,939</u>	<u>39,427</u>

The significant terms of the convertible bonds are as follows:

(a) Interest rate: 0%.

(b) Duration: five years (October 19, 2000 to October 19, 2005).

(c) Final redemption: unless previously redeemed at the option of the Company or the bondholders, or converted in accordance with the offering of the bonds, the bonds are to be redeemed at the principal amount on October 19, 2005.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

(d) Redemption at the option of the Company: the Company may redeem the bonds at a redemption price equal to 100% of the unpaid principal amount under the following circumstances:

1. On or after October 19, 2003: if (i) the closing price (translated into US Dollars at the prevailing rate) of the Company's common shares on the Taiwan Stock Exchange or (ii) the closing price of the Company's GDRs on the Luxembourg Stock Exchange for a period of 30 consecutive trading days before redemption has been at least 130% of the conversion price (translated into U.S. Dollars at the fixed rate, NT\$31.33) in effect on each such trading day.

2. In the event that at least 95% in principal amount of the bonds originally outstanding has been redeemed, repurchased, and canceled or converted.

3. In the event of certain changes in ROC taxation, which would require the Company to gross up for payments of principal, if any, at a rate exceeding 20%.

(e) Redemption at the option of bondholders: the bondholders have the right to require the Company to repurchase the bonds at a price equal to 100% of the unpaid principal amount under the following circumstances:

1. On October 19 of each of 2001, 2002, 2003 and 2004.

2. In the event that the Company's shares cease to be listed or admitted to trading on the Taiwan Stock Exchange.

3. In the event of change of control of the Company.

(f) Terms of conversion:

1. Bondholders may opt to have the bonds converted into common stock or GDRs of the Company from November 19, 2000 to September 19, 2005.

2. Conversion price: NT\$38.077 per share of common stock.

3. The conversion price is translated into New Taiwan Dollars at the fixed rate of NT\$31.33 = U.S.\$1.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(12) Pension

An actuarial valuation of the Company's pension plan was performed on December 31, 1999, 2000 and 2001. According to the actuarial reports, the reconciliation of funded status and accrued pension cost are as follows:

	December 31,			
	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
Benefit obligations:				
Vested benefit obligations	(1,598)	(9,368)	(57,318)	(1,638)
Non-vested benefit obligations	<u>(158,041)</u>	<u>(261,041)</u>	<u>(284,490)</u>	<u>(8,128)</u>
Accumulated benefit obligation	(159,639)	(270,409)	(341,808)	(9,766)
Effect of estimated future increase in salary . .	<u>(222,660)</u>	<u>(268,847)</u>	<u>(183,183)</u>	<u>(5,234)</u>
Projected benefit obligation	(382,299)	(539,256)	(524,991)	(15,000)
Fair value of plan assets	<u>317,643</u>	<u>374,505</u>	<u>452,193</u>	<u>12,920</u>
Funded status	(64,656)	(164,751)	(72,798)	(2,080)
Net unrecognized transition assets	(17,626)	(16,524)	(15,422)	(441)
Unrecognized net loss	94,991	72,289	68,158	1,947
Unrecognized prior service cost	<u>—</u>	<u>87,566</u>	<u>(8,976)</u>	<u>(256)</u>
Prepaid pension cost (Accrued pension liabilities)	<u>12,709</u>	<u>(21,420)</u>	<u>(29,038)</u>	<u>(830)</u>

The net pension costs in 1999, 2000 and 2001 consisted of the following:

	December 31,			
	1999	2000	2001	
	NT\$	NT\$	NT\$	U.S.\$
Service cost	50,224	66,981	56,767	1,622
Interest cost	21,993	29,345	22,555	645
Expected return on plan assets	(19,479)	(21,647)	(20,394)	(583)
Amortization of net unrecognized transition cost	<u>2,222</u>	<u>5,338</u>	<u>4,387</u>	<u>125</u>
Net pension cost, i.e. pension expenses	<u>54,960</u>	<u>80,017</u>	<u>63,315</u>	<u>1,809</u>

Actuarial assumptions are as follows:

	1999	2000	2001
Discount rate	7.0%	6.5%	5.0%
Future salary increase rate — year 2002 - 2004	6.0%	5.5%	1.5%
year 2005 and after	6.0%	5.5%	4.0%
Expected long-term rate of return on plan assets	7.0%	6.5%	5.0%

As of December 31, 1999, 2000 and 2001, the vested benefits were approximately NT\$62,366, NT\$78,558 and NT\$93,906, respectively. The actual payments of pension expenses for the years ended December 31, 1999, 2000 and 2001, amounted to NT\$8,901, NT\$6,121 and NT\$11,878, respectively.

The contributions of the Company for employee retirement benefits for the years ended December 31, 1999, 2000 and 2001, aggregated approximately NT\$157, NT\$17,346 and NT\$14,673, respectively.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The contributions from Sceptre for its 401(k) retirement plan for the years ended December 31, 1999, 2000 and 2001, aggregated approximately NT\$781, NT\$656 and NT\$674, respectively.

(13) Stockholders' Equity**(a) Capital increase**

Based on a resolution of the annual stockholders' meeting held on April 8, 1999, the Company increased its authorized common stock to 1.4 billion shares, and increased its capital through the issuance of stock dividends by transferring capital surplus, retained earnings and employee bonuses amounting to NT\$3,216,799.

Based on a resolution of the Board of Directors meeting held on September 2, 1999, the Company increased its common stock through the issuance of shares for NT\$15,600. The common stock was issued at NT\$80 per share.

A portion of the overseas convertible bonds were converted into 6.552 million shares of common stock in 1999.

Based on a resolution of the annual stockholders' meeting held on March 30, 2000, the Company increased its authorized common stock to 2 billion shares, declared a NT\$2 cash dividend per share, which amounted to NT\$2,353,520, and increased its common stock through the issuance of stock dividends by transferring capital surplus, retained earnings and employee bonuses amounting to NT\$3,800,100.

A portion of the overseas convertible bonds were converted into 192 thousand shares of common stock in 2000.

Based on a resolution of the annual stockholders' meeting held on April 3, 2001, the Company increased its authorized common stock to 2.8 billion shares, declared a NT\$0.5 cash dividend per share, which amounted to NT\$778,418, and increased its common stock through the issuance of stock dividends by transferring capital surplus, retained earnings, and employee stock bonuses amounting to NT\$4,191,152. The registration procedures related to this issuance have been completed.

Based on a resolution of the annual stockholders' meeting held on April 3, 2001, the Board of Directors of the Company was authorized to issue 100 million shares of common stock which were used for the offering of Global Depositary Shares ("GDSs"). The common stock was issued at NT\$40 per share on May 21, 2001. The registration procedures related to this issuance had been completed.

The above mentioned GDSs represent 20 million GDSs. Each GDS, having an offering price of U.S.\$6.07, represents five shares of common stock of the Company, and is listed on the Luxembourg Stock Exchange. Under current ROC law and the Deposit Agreements, during the three-month period following the closing of the offering, a holder of GDSs may not withdraw and hold common shares represented by such GDSs or have such common shares sold on its behalf on the Taiwan Stock Exchange. After such three-month period, a holder of GDSs may withdraw and hold the common shares represented by such GDSs or request the Depositary to sell or cause to be sold on behalf of such holder the common shares represented by such GDSs on the Taiwan Stock Exchange.

A portion of the overseas convertible bonds was converted into 2,468 thousand shares of common stock in 2001.

The Company merged with Palmax on July 4, 2001, and issued 23,396 thousand shares of its common stock to the stockholders of Palmax. The Company held a 56% interest in Palmax before this merger. After this merger, the total common stock issued amounted to NT\$21,018,148. The registration procedures related to this issuance have been completed. See Note 3.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

As of December 31, 1999, 2000 and 2001, the authorized common stock, at a par value of NT\$10 per share, amounted to NT\$14,000,000, NT\$20,000,000 and NT\$28,000,000, respectively.

(b) Treasury stock

As of December 31, 1999, 2000 and 2001, treasury stock of the Company held by subsidiaries amounted to NT\$1,099,781, NT\$1,058,836 and NT\$749,551, respectively.

As of December 31, 2001, the Company had purchased 51,185 thousand shares of treasury stock at a total cost of NT\$1,312,509 for the purpose of transferring to employees.

Pursuant to SFC regulations, the number of shares of treasury stock can not exceed 10% of the number of shares issued. The total purchase cost of treasury stock can not exceed the sum of retained earnings, paid-in capital in excess of par value, and realized capital surplus. The shares bought back with the intent of transferring to employees must be transferred within three years from the date of buyback. Otherwise, the shares shall be deemed as not issued by the Company, and cancelled. In addition, treasury stock can not be pledged for debts, and treasury stock does not carry any shareholder rights until it is disposed of or transferred to employees.

The Company records treasury stock held by subsidiaries as a deduction to stockholders' equity in the accompanying consolidated balance sheets. The Company recognized dividend income of approximately NT\$18 million, NT\$46 million and NT\$15 million related to treasury stock held by a subsidiary in the consolidated statement of income for the years ended December 31, 1999, 2000 and 2001, respectively. In 2000 and 2001, the Company recognized a gain on the sale of treasury stock of approximately NT\$58 million and NT\$154 million, respectively, in the consolidated statement of income.

(c) Capital surplus

Pursuant to the ROC Company Law, capital surplus can only be used to offset a deficit or to increase common stock. Cash dividends can not be declared out of capital surplus. According to the SFC regulations, capital increases by transferring paid-in capital in excess of par value should not exceed 10% of total common stock outstanding. In addition, capital increases by transferring paid-in capital in excess of par value can only commence in the following year.

(d) Special reserve

According to the Company's articles of incorporation, unrealized foreign currency exchange gains accounted for under SFAS No. 14, must be set aside as a special reserve before profit appropriation. The special reserve is transferred to retained earnings when the exchange gains or losses are realized.

(e) Legal reserve and Limitation on distribution of retained earnings

Based on the Company's articles of incorporation, 10% of annual net income after tax is to be set aside as legal reserve, 2% as remuneration to the directors and supervisors, and 5% as bonus to employees after offsetting prior years' deficits, if any. The remaining balance can be distributed as dividends to stockholders after special reserves are appropriated, if any. The dividends to stockholders can not be lower than 10% of annual net income after deducting the above items. If the annual net income per share is less than NT\$1, the Company may opt to retain net income. The remaining balance will be distributed as cash dividends, which will not be lower than 10% of total cash and stock dividends in the current year based on the capital demands for the Company's future operation and the cash inflow expectation of the Company's stockholders. If the retained earnings and working capital exceed the operational and cash dividend needs of the Company, the percentage of cash dividends may be increased in the future.

Based on Panpal's articles of incorporation, 10% of its annual net income is to be set aside as legal reserve after offsetting prior years' deficits, if any. No more than 2% of unappropriated earnings, after

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

deducting the legal reserve, can be distributed as remuneration to the directors and supervisors and no more than 2% (but not equal to zero) as bonuses to employees. The remaining balance can be distributed as dividends to stockholders based on the proposal provided at the Board of Directors' meeting and approved by the stockholders' meeting.

Based on Just's articles of incorporation, before recommending a dividend, the directors may set aside reserves based on a resolution by the directors' meeting. The remaining balance can be distributed as dividends to stockholders based on the resolution of the directors' meeting under the following two circumstances:

- (i) the Company will be able to satisfy its liabilities as they become due in the ordinary course of its business; and
- (ii) the realizable value of the assets of the Company will not be less than the sum of its total liabilities, other than deferred taxes, as shown in the books of account, and its capital.

Pursuant to ROC Company Law, the legal reserve must be used exclusively to offset losses, and can not be used for any other purpose, except that one-half of the legal reserve may be capitalized based on the resolution of the stockholders' meeting when it equals at least 50% of paid-in capital. According to SFC regulations, when there is a reduction of stockholders' equity during the year, an amount equal to the reduction before appropriation must be set aside as a special reserve.

(14) Income Taxes

(a) The purchase of machinery through proceeds from common stock issuances met the prescribed criteria under the "Statute for Upgrading Industries" in the following years:

<u>Year</u>	<u>Tax exemption products</u>	<u>Tax exemption chosen</u>	<u>Tax exemption period</u>
1995	Notebook PCs, multi-media PCs and 17-inch or above Liquid Crystal Display (LCD) monitors	Tax exemption on the Company's corporate income taxes for five years	September 1, 1996 – August 31, 2001
1996	Notebook PCs	Tax exemption on the Company's corporate income taxes for five years	January 31, 1998 – January 30, 2003
1997	Notebook PCs	Stockholders' income tax deduction	
1998	Notebook PCs	Tax exemption on the Company's corporate income tax for five years	October 31, 1999 – October 30, 2004
1999	Notebook PCs, Liquid Crystal Display (LCD) monitors, Cellphone	Tax exemption on the Company's corporate income tax for five years	December 1, 2000 – November 30, 2005

In 1999, 2000 and 2001, tax exemption on the Company's corporate income taxes amounted to NT\$948,646, NT\$1,065,019 and NT\$883,135, respectively.

(b) The operations of the Company are subject to income tax at a rate of 25%. A subsidiary of the Company is subject to income tax at a rate of 15%. According to the PRC Tax Law, CPC can, from the year in which it begins to make profits, be exempted from income tax in the first and second years and

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

allowed a 50% reduction in the third to fifth years. CPC has begun to make profits since 2001. The Company's operations outside Taiwan are subject to income tax rates applicable to the related foreign jurisdiction. The components of income tax expense of the Company for the years ended December 31, 1999, 2000 and 2001, consisted of the following:

	December 31, 1999			
	The Company	Panpal	Other subsidiaries	Total
	NT\$	NT\$	NT\$	NT\$
Current income tax expense (benefit)	90,491	26	(6,382)	84,135
10% surtax on unappropriated earnings	—	9,525	—	9,525
	<u>90,491</u>	<u>9,551</u>	<u>(6,382)</u>	<u>93,660</u>
Deferred income tax expense (benefit)				
Investment tax credits	(359)	—	—	(359)
Loss carryforwards	—	2,123	—	2,123
Investment income recognized under the equity method, net	73,014	—	—	73,014
Other deferred income tax expense	46,318	(2,127)	6,543	50,734
	<u>118,973</u>	<u>(4)</u>	<u>6,543</u>	<u>125,512</u>
Total income tax expense (benefit)	<u>209,464</u>	<u>9,547</u>	<u>161</u>	<u>219,172</u>
	December 31, 2000			
	The Company	Panpal	Other subsidiaries	Total
	NT\$	NT\$	NT\$	NT\$
Current income tax expense (benefit)	208,147	(8,449)	—	199,698
10% surtax on unappropriated earnings	141,320	11,789	—	153,109
Investment tax credits used in 10% surtax on unappropriated earnings	(70,660)	(5,894)	—	(76,554)
	<u>278,807</u>	<u>(2,554)</u>	<u>—</u>	<u>276,253</u>
Deferred income tax expense (benefit)				
Investment tax credits	(61,034)	(157,857)	—	(218,891)
Loss carryforwards	—	(5,692)	—	(5,692)
Investment income recognized under the equity method, net	93,190	—	—	93,190
Other deferred income tax expense	26,029	61,108	—	87,137
	<u>58,185</u>	<u>(102,441)</u>	<u>—</u>	<u>(44,256)</u>
Total income tax expense (benefit)	<u>336,992</u>	<u>(104,995)</u>	<u>—</u>	<u>231,997</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	December 31, 2001				
	<u>The Company</u>	<u>Panpal</u>	<u>Other</u>	<u>Total</u>	<u>Total</u>
	NT\$	NT\$	Subsidiaries NT\$	NT\$	U.S.\$
Current income tax expense	204,616	1,009	68	205,693	5,877
10% surtax on unappropriated earnings	177,365	19,414	—	196,779	5,622
Investment tax credits used in 10% surtax on unappropriated earnings	<u>(177,365)</u>	<u>(9,707)</u>	<u>—</u>	<u>(187,072)</u>	<u>(5,345)</u>
	<u>204,616</u>	<u>10,716</u>	<u>68</u>	<u>215,400</u>	<u>6,154</u>
Deferred income tax expense (benefit)					
Investment tax credits	(197,892)	10,777	—	(187,115)	(5,346)
Loss carryforwards	—	—	(157,082)	(157,082)	(4,488)
Change in valuation allowance	172,876	(7,846)	190,634	355,664	10,162
Unrealized foreign currency exchange gain, net	53,968	(1,535)	—	52,433	1,498
Investment income recognized under the equity method, net	39,347	—	—	39,347	1,124
Other deferred income tax expense	<u>(48,038)</u>	<u>5,625</u>	<u>(33,552)</u>	<u>(75,965)</u>	<u>(2,170)</u>
	<u>20,261</u>	<u>7,021</u>	<u>—</u>	<u>27,282</u>	<u>780</u>
Total income tax expense (benefit)	<u>224,877</u>	<u>17,737</u>	<u>68</u>	<u>242,682</u>	<u>6,934</u>

(c) Deferred income tax assets (liabilities) as of December 31, 1999, 2000 and 2001 are summarized as follows:

	December 31,			
	<u>1999</u>	<u>2000</u>	<u>2001</u>	
	NT\$	NT\$	NT\$	U.S.\$
Deferred income tax assets:				
Investment loss recognized under the equity method (overseas)	89,915	118,689	131,007	3,743
Unrealized foreign currency exchange loss	51,309	79,359	83,178	2,377
Sales returns and discounts	44,418	60,877	75,117	2,146
Accrued warranty cost	52,359	65,005	65,987	1,885
Inventory provisions	21,612	25,506	50,284	1,437
Investment tax credits	359	219,250	406,365	11,610
Loss carryforward	24,078	39,226	190,616	5,446
Other	<u>26,859</u>	<u>34,992</u>	<u>76,649</u>	<u>2,190</u>
	310,909	642,904	1,079,203	30,834
Valuation allowance	<u>(193,817)</u>	<u>(326,788)</u>	<u>(682,452)</u>	<u>(19,498)</u>
Net deferred income tax assets	117,092	316,116	396,751	11,336
Deferred income tax liabilities:				
Accrued pension liabilities	(5,968)	—	—	—

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	December 31,			
	1999 NT\$	2000 NT\$	2001 NT\$	U.S.\$
Investment income recognized under the equity method (overseas)	(134,613)	(256,577)	(308,242)	(8,807)
Unrealized foreign currency exchange gain . .	(11,456)	(50,228)	(106,480)	(3,042)
Other	—	—	(78,920)	(2,255)
Net deferred income tax assets (liabilities) . .	<u>(34,945)</u>	<u>9,311</u>	<u>(96,891)</u>	<u>(2,768)</u>
Net deferred income tax assets — current	91,294	170,671	215,465	6,156
Net deferred income tax liabilities — non-current	<u>(126,239)</u>	<u>(161,360)</u>	<u>(312,356)</u>	<u>(8,924)</u>
	<u>(34,945)</u>	<u>9,311</u>	<u>(96,891)</u>	<u>(2,768)</u>

(d) The ROC tax authorities have assessed the Company's income tax returns through 1998. The tax authorities assessed the Company additional income tax expenses for 1997 and 1998 in the amount of NT\$72,947 and NT\$50,684, respectively, which was mainly due to different interpretations related to tax-exempt income and income tax credits. The Company disagreed with the assessment and filed appeals related to these issues. The total amounts of the assessed additional income tax expenses were recognized in the accompanying statements of income. Any other assessed differences will be reflected as an adjustment after the tax appeal is resolved.

(e) Imputation credit account and creditable ratio

Beginning in 1998, the corporate income tax paid at the corporate level can be used to offset the resident stockholders' individual income tax. The amount of imputation credit which stockholders can claim depends on total corporate income tax paid at the corporate level. Beginning in 1998, corporations have been required to set up an Imputation Credit Account ("ICA") to keep track of the corporate income taxes paid and the imputation credit they have allocated for stockholders. In addition, the creditable ratio, which represents the imputation credit per dollar of accumulated retained earnings, shall be calculated for resident stockholders when corporations declare dividends. A calculation of the ICA balance and creditable ratio as of December 31, 1999, 2000 and 2001 are as follows:

	December 31,			
	1999 NT\$	2000 NT\$	2001 NT\$	U.S.\$
Unappropriated earnings retained prior to January 1, 1998	3,143,041	3,143,041	3,143,041	89,801
Unappropriated earnings retained after January 1, 1998	<u>5,617,670</u>	<u>7,371,451</u>	<u>8,638,863</u>	<u>246,825</u>
Total	<u>8,760,711</u>	<u>10,514,492</u>	<u>11,781,904</u>	<u>336,626</u>
ICA balance	<u>212,245</u>	<u>175,535</u>	<u>134,861</u>	<u>3,853</u>
Creditable ratio for earnings distribution	<u>5.09%(actual)</u>	<u>3.63%(actual)</u>	<u>2.63%(expected)</u>	

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(f) As of December 31, 2001, the unused investment tax credits of the Company, mainly resulting from investments in important and strategic technology enterprises, purchases of machinery for automation of production, research and development expenses, and personnel training expenditures, were as follows:

<u>Year</u>	<u>Aggregate tax credits</u>	<u>Unused tax credits</u>	<u>Year of expiry</u>
	NT\$	NT\$	
1999	224,838	152,282	2003
2000	338,440	247,792	2004
2001	<u>364,524</u>	<u>6,291</u>	2005
	<u>927,802</u>	<u>406,365</u>	

ROC income tax regulations stipulate that tax credits can be applied for only up to 50% of the income tax liability. Tax credits should be applied sequentially after first applying the current year's tax credit, and any unused balance can be carried forward for the following four years, subject to the same percentage limitation for each year except for the last year, in which it will expire.

(15) Related Information About Financial Instruments

(a) Derivative financial instruments

1. Foreign currency options and forward exchange contracts

December 31, 1999						
<u>Financial instruments</u>	<u>Nominal amount</u>	<u>Transaction period</u>	<u>Maturities</u>	<u>Strike rate</u>	<u>Fair value</u>	<u>Credit risk</u>
	U.S.\$				NT\$	
USD forward exchange contracts	54,000	December 13, 1999 – December 15, 1999	February 15, 2000 – March 17, 2000	30.509 – 31.532	(8,005)	—
December 31, 2000						
<u>Financial instruments</u>	<u>Nominal amount</u>	<u>Transaction period</u>	<u>Maturities</u>	<u>Strike rate</u>	<u>Fair value</u>	<u>Credit risk</u>
	U.S.\$				NT\$	
Option sold USD put/NTD call	15,000	December 18, 2000	January 19, 2001 – March 16, 2001	32.62 – 34.50	(666)	—
December 31, 2001						
<u>Financial instruments</u>	<u>Nominal amount</u>	<u>Transaction period</u>	<u>Maturities</u>	<u>Strike rate</u>	<u>Fair value</u>	<u>Credit risk</u>
	U.S.\$				NT\$	
USD forward exchange contracts	22,000	December 03, 2001 – December 13, 2001	January 15, 2002 – March 5, 2002	34.465 – 34.476	(11,672)	—

2. Credit risk

The amount of credit risk equals the aggregate amount of contracts with a positive fair value. The amount of the credit risk is a potential loss of the Company if the counterpart involved in that transaction defaults. Since the Company's derivatives financial instruments agreements are entered into with financial institutions with good credit ratings, management does not believe that there is significant credit risk from these transactions.

3. Market risk

The purpose of the foreign currency options and the forward exchange contracts are to hedge the exchange risk of the foreign currency assets. Therefore, the gains or losses resulting from changes in

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

exchange rates will be offset by those from the hedged item. Management believes that the related market risk is not significant.

4. Liquidity risk

The Company will incur cash inflows and outflows within the periods shown below. There are no financing risks due to expected sufficient U.S. Dollars received from accounts receivable. Management believes that the cash flow risk is not significant because contracted foreign currency exchange rates are fixed.

December 31, 1999			
<u>Financial instruments</u>	<u>Date</u>	<u>Cash outflow</u>	<u>Cash inflow</u>
		U.S.\$	NT\$
USD forward exchange contracts	February 2000 – March 2000	54,000	1,702,172
December 31, 2000			
<u>Financial instruments</u>	<u>Date</u>	<u>Cash outflow</u>	<u>Cash inflow</u>
		U.S.\$	NT\$
Option sold	January 2001 – March 2001	15,000	511,100
December 31, 2001			
<u>Financial instruments</u>	<u>Date</u>	<u>Cash outflow</u>	<u>Cash inflow</u>
		U.S.\$	NT\$
USD forward exchange contracts	January 2002 – March 2002	22,000	758,344

5. The categories and objectives of the derivatives, and strategies to accomplish the underlying objectives

The foreign currency options and the forward exchange contracts held by the Company are for the purpose of hedging the risks that may result from changes in currency rates of foreign currency assets and liabilities rather than for the purpose of trading. The hedging strategies of the Company are to hedge the market risk to the highest extent possible. The Company uses derivatives that are highly correlated to the changes in fair values of the hedged items as hedging instruments.

6. Presentation on financial statements

The receivables and payables derived from foreign currency forward contracts were offset against each other, and the net amount was accounted for as other current assets. As of December 31, 1999, the balance of net forward exchange contracts receivable was NT\$11,456. The exchange gains resulting from the forward transactions for the year ended December 31, 1999 were included in non-operating incomes in the accompanying statement of income.

As of December 31, 2000, the premiums received amounting to NT\$2,547 was accounted for as other current liabilities.

As of December 31, 2001, the balance of net forward exchange contracts payable was NT\$13,290. The exchange gain or loss resulting from the forward transactions for the year ended December 31, 2001, was included in non-operating income or loss in the accompanying statements of income.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

7. Fair value of derivative financial instruments

The book value and the estimated fair value of the options were as follows:

	<u>December 31, 1999</u>	
	<u>Book value</u>	<u>Estimated fair value</u>
	NT\$	NT\$
Net forward exchange contracts receivable.....	<u>11,456</u>	<u>(8,005)</u>
	<u>December 31, 2000</u>	
	<u>Book value</u>	<u>Estimated fair value</u>
	NT\$	NT\$
Foreign currency options — other current liabilities	<u>(2,547)</u>	<u>(666)</u>
	<u>December 31, 2001</u>	
	<u>Book value</u>	<u>Estimated fair value</u>
	NT\$	NT\$
Net forward foreign currency exchange contracts payable	<u>(13,290)</u>	<u>(11,672)</u>

The fair value of a derivative is the expected receivable or payable amount assuming that the contract is terminated on the balance sheet date. Generally, the unrealized gain or loss on open contracts is included in the fair value. The above fair value estimates were based on quotes from financial institutions.

(b) Non-derivative financial instruments

Except for long-term equity investments, the book value of non-derivative financial instruments was similar to fair market value as of December 31, 1999, 2000 and 2001.

As of December 31, 1999, 2000 and 2001, the book value of long-term equity investments were NT\$11,606,784, NT\$19,232,397 and NT\$19,419,293, respectively, of which NT\$1,880,159, NT\$1,842,671 and NT\$3,073,938 were invested in publicly listed equity securities, respectively. The remaining balance was invested in companies that are not publicly listed. The fair value of these publicly listed investments were NT\$4,726,845, NT\$1,676,533 and NT\$3,980,455 as of December 31, 1999, 2000 and 2001, respectively.

(16) Related Party Transactions

(a) Name of the related parties and relationship

<u>Related party</u>	<u>Relationship with the Company</u>
Bizcom	100% owned subsidiary
CEUK	100% owned subsidiary
CEBV	100% owned subsidiary
Gempal	100% owned subsidiary
Compower International Ltd. ("Compower")	Investee company accounted for under the equity method
Palmax	Investee company accounted for under the equity method
CCI	Investee company accounted for under the equity method
Acbel Polytech Inc. ("Acbel")	Acbel's chairman of the board is the same as the Company's chairman

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(b) Summary of significant transactions with related parties

1. Sales

	1999		2000		2001		
	Amount	% of net operating revenue	Amount	% of net operating revenue	Amount	% of net operating revenue	Amount
	NT\$		NT\$		NT\$		U.S.\$
CEBV	113,658	0.3	446	—	—	—	—
Bizcom	203,562	0.4	583,607	0.8	959,680	1.2	27,419
Compower	91,989	0.2	154,101	0.2	141,014	0.2	4,029
Other.....	56,173	0.1	58,911	0.1	51,180	0.1	1,463
	<u>465,382</u>	<u>1.0</u>	<u>797,065</u>	<u>1.1</u>	<u>1,151,874</u>	<u>1.5</u>	<u>32,911</u>

Sale prices to related parties were similar to those for third-party customers. The collection periods were approximately 45 to 120 days for CEBV, 75 to 120 days for Bizcom, and 90 to 120 days for Compower.

2. Purchases

	1999		2000		2001		
	Amount	% of net purchases	Amount	% of net purchases	Amount	% of net purchases	Amount
	NT\$		NT\$		NT\$		U.S.\$
CCI.....	—	—	—	—	178,732	0.3	5,107
Acbel	—	—	—	—	173,047	0.3	4,944
Other.....	89,393	0.2	69,815	0.1	25,552	—	730
	<u>89,393</u>	<u>0.2</u>	<u>69,815</u>	<u>0.1</u>	<u>377,331</u>	<u>0.6</u>	<u>10,781</u>

Purchase prices for finished goods from related parties were similar to those from third-party suppliers.

3. Processing fees income

Processing fees income received from CCI amounted to NT\$192,967 in 2000.

4. The Company sold shares of CCI at book value, amounting to NT\$123,396, to Gempal in 2001.

5. Financing

The Company's loan to related party in 2001 was as follows:

	Ending balance	Maximum balance	Contract period	Interest rate	Interest income
	NT\$	NT\$			
Gempal	<u>120,500</u>	<u>120,500</u>	December 28, 2001– September 4, 2002	2.75%	—

The above mentioned loan was unsecured by any collateral.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

6. Notes and accounts receivable (payable), prepayments to suppliers

The balances resulting from the above sales, purchases and other services transactions as of December 31, 1999, 2000 and 2001, were as follows:

	1999		2000		2001		Amount U.S.\$
	Amount NT\$	%	Amount NT\$	%	Amount NT\$	%	
Notes and accounts receivable:							
Bizcom	106,474	1.8	339,879	3.2	374,397	2.1	10,697
Compower	17,005	0.3	95,749	0.9	32,853	0.2	939
CEUK	—	—	46,644	0.4	69,035	0.4	1,972
CCI	—	—	215,515	2.0	—	—	—
Other	88,247	1.4	2,857	—	91,835	0.5	2,624
Less: allowance for doubtful accounts	(33,016)	(0.5)	(60,629)	(0.5)	(2,105)	—	(60)
	<u>178,710</u>	<u>3.0</u>	<u>640,015</u>	<u>6.0</u>	<u>566,015</u>	<u>3.2</u>	<u>16,172</u>
Prepayments to suppliers							
Palmax	<u>70,036</u>	<u>78.6</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Notes and accounts payable:							
CCI	—	—	368	—	108,041	0.6	3,087
Acbel	—	—	—	—	33,939	0.2	970
Other	<u>6,456</u>	<u>—</u>	<u>8,466</u>	<u>—</u>	<u>15,186</u>	<u>0.1</u>	<u>433</u>
	<u>6,456</u>	<u>—</u>	<u>8,834</u>	<u>—</u>	<u>157,166</u>	<u>0.9</u>	<u>4,490</u>

7. Rental income

The Company entered into an agreement with its subsidiary, CCI, to lease a portion of its office space and plants for one to two year. The related rental income in 2000 and 2001 amounted to NT\$6,265 and NT\$23,286, respectively.

8. Guarantees

	December, 31,		
	1999 U.S.\$	2000 U.S.\$	2001 U.S.\$
Loan guarantee:			
CEBV	2,500	—	—
Bizcom	—	2,000	2,000
Credit guarantee:			
CEUK	1,000	1,000	1,000

(17) Pledged Assets

There were no pledged assets as of December 31, 1999, 2000 and 2001.

(18) Commitments and Contingencies

(a) As of December 31, 2001, the unused balance of the Group's letters of credit for the purchase of materials and machinery was approximately NT\$710,780.

(b) Future payments related to Contracts signed by CPC for the construction of new factory and the purchase of machinery and equipment were approximately NT\$47,035.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(c) On October 13, 2000, Samsung Electronics Co., Ltd. (“Samsung”) brought a civil lawsuit in the State Court of California against the Company and various other companies related to patent rights infringement and sought damages. Management intends to vigorously defend this case and does not believe that the ultimate disposition of this matter will have a material adverse effect on the Company’s financial statements.

(d) On April 6, 2001, LG Electronics Co., Ltd. (“LG”) brought a civil lawsuit in the State Court of California against the Company, Bizcom and Sceptre related to patent rights infringement and sought damages. Management intends to vigorously defend this case and does not believe that the ultimate disposition of this matter will have a material adverse effect on the Company’s financial statements.

(e) See note 16 for guarantees made to related parties.

(19) Other

(a) As of December 31, 2001, the Company had the following significant royalty agreements:

<u>Royalty owners</u>	<u>Content</u>	<u>Period</u>
Phoenix Technologies, Ltd.	Produce, use, and sell quantitative Memory-Basic Input/Output Systems (BIOS)	Authorized certain quantity; contract shall be renewed after quantity fulfilled
SystemSoft Corporation	Basic input system, keyboard control software and PCMCIA driver program	April 1998 – March 2003
RCA Thomson Licensing Corporation	Produce, use, lease, sell and export the color monitor which have patents in the PRC, royalty is estimated by product volumes	January 1, 1998 – December 31, 2002
Qualcomm Incorporated	Acquire related technologies of manufacturing and researching CDMA mobile phone	None
Lucent Technologies Inc.	Use of specified GSM/GPRS technologies	July 2000 – June 2003
Microsoft Corporation	Use of Windows CE in Pocket PCs	Authorized certain quantity

(20) Segment Information

(a) Industrial information

The Group’s operations include two industry segments: electronics and telecommunications. The Group’s electronics segment manufactures and sells notebook PCs and computer monitors. The Group’s telecommunication’s segment manufactures and sells wireless handsets, Pocket PCs and PDAs. The telecommunications segment’s revenue, segment income and identifiable assets of the electronics segment were lower than 10% of the subject sums of all industries. Consequently, no industrial information is required to be disclosed.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(b) Geographic information

Geographic information has not been disclosed in the accompanying consolidated financial statements as sales and identifiable assets of the Company's foreign operation is less than 10% of the Company's consolidated sales and identifiable assets.

(c) Export sales

Export sales to geographic areas generating over 10% of the total revenue in the consolidated statements of income of 1999, 2000 and 2001 are summarized as follows:

<u>Destination area</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	
	<u>NT\$</u>	<u>NT\$</u>	<u>NT\$</u>	<u>U.S.\$</u>
United States	28,997,895	31,252,030	24,812,741	708,935
Europe	9,841,417	16,652,346	20,821,699	594,906
Asia (excluding Taiwan)	6,972,874	26,548,355	31,564,871	901,853
Other (individually less than 10% of total revenue)	<u>389,710</u>	<u>314,467</u>	<u>516,789</u>	<u>14,766</u>
	<u>46,201,896</u>	<u>74,767,198</u>	<u>77,716,100</u>	<u>2,220,460</u>

(d) Significant customers

Sales to individual customers generating over 10% of consolidated net sales for the years ended December 31, 1999, 2000 and 2001 are summarized as follows:

	<u>1999</u>		<u>2000</u>		<u>2001</u>		
	<u>Amount</u> <u>NT\$</u>	<u>% of total revenue</u>	<u>Amount</u> <u>NT\$</u>	<u>% of total revenue</u>	<u>Amount</u> <u>NT\$</u>	<u>% of total revenue</u>	<u>Amount</u> <u>U.S.\$</u>
A Company	22,343,895	47.3	19,293,114	25.5	8,690,888	11.0	248,311
B Company	993,051	2.1	17,942,304	23.8	17,344,959	22.1	495,570
C Company	8,708,370	18.4	13,601,690	18.0	23,610,849	30.0	674,596
D Company	<u>4,734,227</u>	<u>10.0</u>	<u>7,750,984</u>	<u>10.3</u>	<u>5,756,851</u>	<u>7.3</u>	<u>164,481</u>
	<u>36,779,543</u>	<u>77.8</u>	<u>58,588,092</u>	<u>77.6</u>	<u>55,403,547</u>	<u>70.4</u>	<u>1,582,958</u>

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Compal Electronics, Inc.:

We have audited the accompanying consolidated balance sheet of Compal Electronics, Inc. and subsidiaries as of June 30, 2002, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the six-month period then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

As stated in note 9 to the consolidated financial statements, the long-term equity investments accounted for under the equity method and amounting to NT\$11,880,267 as of June 30, 2002, and the related investment income of NT\$433,686 recognized for the six-month period ended June 30, 2002, were based on the investee companies' unaudited financial statements.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the investee companies financial statements discussed in the third paragraph been audited, the consolidated financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Compal Electronics, Inc. and subsidiaries as of June 30, 2002, and the results of their operations and their cash flows for the six-month period then ended, in conformity with accounting principles generally accepted in the Republic of China.

As stated in note 4 to the consolidated financial statements, starting from January 1, 2002, the Company's outstanding shares acquired by its subsidiaries have been treated as treasury stock.

The accompanying consolidated financial statements as of and for the six-month period ended June 30, 2002, have been translated into United States dollars solely for the convenience of the readers. We have audited the translation, and in our opinion, the consolidated financial statements expressed in New Taiwan Dollars have been translated into United States dollars on the basis set forth in note 2(p) of the notes to the consolidated financial statements.

The accompanying consolidated financial statements as of and for the six-month period ended June 30, 2001, were not audited by us, and accordingly, we do not express an opinion on them.

KPMG Certified Public Accountants

Taipei, Taiwan
July 19, 2002

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

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

June 30, 2001 (unaudited) and 2002

(expressed in thousands of New Taiwan or U.S. Dollars)

	2001 (unaudited)	2002	
	NT\$	NT\$	U.S.\$
ASSETS			
Current assets:			
Cash and cash equivalents (note 5)	15,339,330	12,319,865	368,197
Short-term investments (note 6)	88,564	26,544	793
Accounts receivable (note 7)	8,471,628	14,388,289	430,015
Accounts receivable — related parties (note 18)	934,387	1,304,446	38,985
Inventories (note 8)	4,809,245	13,289,978	397,190
Prepaid and other current assets (notes 16, 17 and 18)	<u>1,921,111</u>	<u>1,829,134</u>	<u>54,666</u>
Total current assets	<u>31,564,265</u>	<u>43,158,256</u>	<u>1,289,846</u>
Long-term equity investments (notes 9 and 18)	<u>20,546,380</u>	<u>20,197,450</u>	<u>603,630</u>
Property, plant and equipment (note 10):			
Land and land leasehold rights	1,225,443	1,430,754	42,760
Buildings	2,380,920	2,829,087	84,551
Machinery and equipment	1,953,093	2,850,021	85,177
Molding equipment	895,370	1,072,620	32,057
Other equipment	<u>768,098</u>	<u>1,168,144</u>	<u>34,912</u>
	7,222,924	9,350,626	279,457
Less: accumulated depreciation	(2,174,996)	(3,049,351)	(91,134)
Construction in progress and prepayment for purchase of equipment	<u>301,976</u>	<u>378,714</u>	<u>11,318</u>
Net property, plant and equipment	<u>5,349,904</u>	<u>6,679,989</u>	<u>199,641</u>
Intangible assets — goodwill	<u>—</u>	<u>91,648</u>	<u>2,739</u>
Other assets:			
Leased assets (notes 10 and 18)	404,510	455,465	13,612
Deferred expenses and other non-current assets	<u>323,467</u>	<u>425,395</u>	<u>12,714</u>
	727,977	880,860	26,326
Total assets	<u><u>58,188,526</u></u>	<u><u>71,008,203</u></u>	<u><u>2,122,182</u></u>

See accompanying notes to consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS — (Continued)
June 30, 2001 (unaudited) and 2002
(expressed in thousands of New Taiwan or U.S. Dollars)

	<u>2001</u> <u>(unaudited)</u> NT\$	<u>2002</u>	
		NT\$	U.S.\$
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Short-term loans (note 11)	571,839	5,040	151
Short-term notes and bills payable (note 11)	1,432,435	249,800	7,466
Accounts payable	11,245,905	18,555,081	554,545
Accounts payable — related parties (note 18)	213,890	65,886	1,969
Income tax payable	227,328	265,632	7,939
Accrued expenses and other current liabilities	1,436,248	1,798,488	53,750
Cash dividends payable (note 14)	14	1,047,146	31,296
Convertible bonds payable (note 12)	4,990,066	1,322,026	39,510
Total current liabilities	<u>20,117,725</u>	<u>23,309,099</u>	<u>696,626</u>
Bonds payable (note 12)	<u>—</u>	<u>5,000,000</u>	<u>149,432</u>
Noncurrent liabilities:			
Credit balance of long-term equity investments and other (notes 9 and 13)	101,441	205,192	6,132
Deferred income tax liabilities, net (note 16)	263,168	418,573	12,510
Unrealized profit from sales to subsidiaries	52,560	63,221	1,890
	<u>417,169</u>	<u>686,986</u>	<u>20,532</u>
Total liabilities	<u>20,534,894</u>	<u>28,996,085</u>	<u>866,590</u>
Stockholders' equity (note 14):			
Common stock	20,784,184	21,018,231	628,160
Stock dividends to be distributed	—	4,458,359	133,244
	<u>20,784,184</u>	<u>25,476,590</u>	<u>761,404</u>
Capital surplus (note 14):			
Paid-in capital in excess of par value	5,720,096	4,065,705	121,509
Other	46,896	47,463	1,418
	<u>5,766,992</u>	<u>4,113,168</u>	<u>122,927</u>
Retained earnings (note 14):			
Legal reserve	2,158,622	2,701,014	80,724
Special reserve	200,898	425,888	12,728
Unappropriated retained earnings	9,139,280	10,610,425	317,108
	<u>11,498,800</u>	<u>13,737,327</u>	<u>410,560</u>
Foreign currency translation adjustment	236,872	130,277	3,894
Treasury stock (note 14)	(633,216)	(1,445,244)	(43,193)
Total stockholders' equity	<u>37,653,632</u>	<u>42,012,118</u>	<u>1,255,592</u>
Commitments and contingencies (notes 18 and 20)			
Total liabilities and stockholders' equity	<u><u>58,188,526</u></u>	<u><u>71,008,203</u></u>	<u><u>2,122,182</u></u>

See accompanying notes to consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
Six-month periods ended June 30, 2001 (unaudited) and 2002
(expressed in thousands of New Taiwan or U.S. Dollars, except net income per share amounts)

	2001	2002				
	(unaudited)	NT\$	U.S.\$			
Net sales (note 18)	33,293,938	52,852,626	1,579,576			
Cost of sales (note 18)	<u>30,077,735</u>	<u>47,710,004</u>	<u>1,425,882</u>			
	3,216,203	5,142,622	153,694			
Change in unrealized intercompany profits	<u>32,211</u>	<u>(9,981)</u>	<u>(298)</u>			
Gross profit	<u>3,248,414</u>	<u>5,132,641</u>	<u>153,396</u>			
Operating expenses:						
Selling	556,082	719,425	21,501			
Administrative	321,739	413,502	12,358			
Research and development	<u>413,333</u>	<u>631,571</u>	<u>18,875</u>			
	<u>1,291,154</u>	<u>1,764,498</u>	<u>52,734</u>			
Operating income	<u>1,957,260</u>	<u>3,368,143</u>	<u>100,662</u>			
Non-operating income:						
Interest income (note 5 and 18)	212,812	104,265	3,116			
Investment income, net (note 9 and 14)	391,105	504,422	15,075			
Foreign currency exchange gain, net (note 17)	530,436	—	—			
Rental income (note 18)	15,405	21,828	652			
Other	<u>19,753</u>	<u>52,380</u>	<u>1,566</u>			
	<u>1,169,511</u>	<u>682,895</u>	<u>20,409</u>			
Non-operating expenses and losses:						
Interest expenses	88,540	49,924	1,492			
Foreign currency exchange loss, net (note 17)	—	331,918	9,920			
Provision for inventory obsolescence	8,206	58,873	1,760			
Other	<u>5,231</u>	<u>2,962</u>	<u>88</u>			
	<u>101,977</u>	<u>443,677</u>	<u>13,260</u>			
Net income before income tax expense	3,024,794	3,607,361	107,811			
Income tax expense (note 16)	(68,285)	(176,304)	(5,269)			
Preacquisition income	<u>—</u>	<u>(82,661)</u>	<u>(2,470)</u>			
Net income	<u>2,956,509</u>	<u>3,348,396</u>	<u>100,072</u>			
	Before	After	Before	After	Before	After
	income	income	income	income	income	income
	tax	tax	tax	tax	tax	tax
Basic net income per share (note 15)	<u>1.23</u>	<u>1.21</u>	<u>1.43</u>	<u>1.36</u>	<u>0.04</u>	<u>0.04</u>
Diluted net income per share	<u>1.17</u>	<u>1.15</u>	<u>1.41</u>	<u>1.34</u>	<u>0.04</u>	<u>0.04</u>

See accompanying notes to consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Six-month periods ended June 30, 2001 (unaudited) and 2002
(expressed in thousands of New Taiwan Dollars or U.S. Dollars)

	Common stock NT\$	Stock dividends to be distributed NT\$	Capital surplus NT\$	Retained earnings		Treasury stock NT\$	Foreign currency translation adjustment NT\$	Total Stockholders' equity	
				Legal reserve NT\$	Special reserve NT\$			Unappropriated NT\$	NT\$
Balance on January 1, 2001	15,568,348	—	4,348,107	1,560,309	45,284	10,469,208	175,669	31,108,089	—
Appropriation of 2001 net income:									
Special reserve	—	—	—	—	155,614	(155,614)	—	—	—
Legal reserve	—	—	—	598,313	—	(598,313)	—	—	—
Employee bonuses	299,065	—	—	—	(299,156)	(91)	—	(91)	—
Directors' remuneration	—	—	—	—	(119,663)	(119,663)	—	(119,663)	—
Stock dividends	2,335,252	—	—	—	(2,335,252)	—	—	—	—
Cash dividends	—	—	—	—	(778,418)	(778,418)	—	(778,418)	—
Gain on disposal of property, plant and equipment transferred to capital surplus	—	—	21	—	(21)	—	—	—	—
Capital surplus transferred to common stock	1,556,835	—	(1,556,835)	—	—	—	—	—	—
Convertible bonds transferred to common stock	24,684	—	72,149	—	—	—	—	96,833	—
Issuance of common stock for cash	1,000,000	—	2,877,837	—	—	—	—	3,877,837	—
Adjustment due to non-proportional investment in investee's increase in capital	—	—	25,713	—	—	—	—	25,713	—
Net income for the six-month period ended June 30, 2001	—	—	—	—	—	2,956,509	—	2,956,509	—
Foreign currency translation adjustment	—	—	—	—	—	—	61,203	61,203	—
Sale of treasury stock	—	—	—	—	—	425,620	—	425,620	—
Balance on June 30, 2001	20,784,184	—	5,766,992	2,158,622	200,898	9,139,280	236,872	37,653,632	—
	21,018,148	—	6,194,387	2,158,622	200,898	11,585,555	236,760	39,332,310	1,175,502
Balance on January 1, 2002	—	—	(21,161)	—	—	21,161	—	—	—
Capital surplus — gain on disposal of property plant and equipment prior to 2000 transferred to retained earnings	—	—	—	542,392	224,990	(224,990)	—	—	—
Appropriation of 2000 net income:									
Special reserve	—	—	—	—	(542,392)	(542,392)	—	—	—
Employee bonuses	—	269,831	—	—	(269,831)	—	—	—	—
Directors' remuneration	—	2,094,264	—	—	(108,055)	(108,055)	—	(108,055)	(3,229)
Stock dividends	—	2,094,264	—	—	(2,094,264)	—	—	—	—
Cash dividends	—	2,094,264	(2,094,264)	—	(1,047,132)	(1,047,132)	—	(1,047,132)	(31,295)
Capital surplus transferred to common stock	83	—	263	—	—	—	—	346	10
Convertible bonds converted into common stock	—	—	—	—	—	—	—	—	—
Adjustment due to non-proportional investment in investee's increase in capital	—	—	—	—	(58,023)	(58,023)	—	(58,023)	(1,734)
Net income for the six-month period ended June 30, 2002	—	—	—	—	—	3,348,396	—	3,348,396	100,071
Foreign currency translation adjustment	—	—	—	—	—	—	(106,483)	(106,483)	(3,182)
Treasury stock transferred to employees	—	—	33,943	—	—	—	—	1,118,678	34,448
Treasury stock held by subsidiary	—	—	—	—	—	(501,862)	—	(501,862)	(14,999)
Balance on June 30, 2002	21,018,231	4,458,359	4,113,168	2,701,014	425,888	10,610,425	130,277	42,012,118	1,255,592

See accompanying notes to consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Six-month periods ended June 30, 2001 (unaudited) and 2002
(expressed in thousands of New Taiwan or U.S. Dollars)

	2001	2002	
	(unaudited)	NT\$	U.S.\$
	NT\$	NT\$	U.S.\$
Cash flows from operating activities:			
Net income	2,956,509	3,348,396	100,072
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Preacquisition income	—	82,661	2,470
Depreciation and amortization	612,497	626,582	18,726
Allowance for doubtful accounts, sales returns and discounts	55,399	45,478	1,359
Allowance for inventory valuation and obsolescence loss	8,555	57,252	1,711
Equity in gain of affiliates, net	(171,806)	(433,686)	(12,961)
Investment loss, net	30,222	24,795	741
Decrease in notes and accounts receivable	1,780,739	2,160,276	64,563
Decrease (increase) in inventories	1,683,300	(6,390,487)	(190,989)
Increase in prepaid and other current assets	(745,197)	(1,048,537)	(31,337)
Increase (decrease) in notes and accounts payable	1,955,292	(1,199,533)	(35,850)
Increase in income tax payable	70,987	50,606	1,512
Increase in accrued expenses and other current liabilities	321,916	307,863	9,201
Change in net deferred income tax assets and liabilities	(120,735)	91,300	2,729
Unrealized exchange loss (gain) on convertible bonds	209,467	(57,563)	(1,720)
Other	20,277	12,986	388
Cash provided by (used in) operating activities	8,667,422	(2,321,611)	(69,385)
Cash flows from investing activities:			
Additions to property, plant and equipment	(168,401)	(828,698)	(24,766)
Acquisition of long-term equity investments	(1,196,666)	(1,674,037)	(50,031)
Sale of long-term equity investments	41,280	721,837	21,573
Repayment of long-term equity investments	—	62,380	1,864
Increase in deferred expenses	(82,271)	(65,588)	(1,960)
Increase in other receivable — related party	—	38,825	1,160
Other	17,313	28,381	848
Cash used in investing activities	(1,388,745)	(1,716,900)	(51,312)
Cash flows from financing activities:			
Decrease in short-term loans	(1,225,076)	(1,086,413)	(32,469)
Increase in bonds payable	—	5,000,000	149,432
Issuance of common stock for cash	3,877,837	—	—
Directors' remuneration and employees' bonus	(119,754)	(108,055)	(3,229)
Cash dividends paid	(778,418)	—	—
Treasury stock transferred to employees	—	1,152,621	34,447
Decrease in treasury stock	425,620	—	—
Other	6,654	1,401	42
Cash provided by financing activities	2,186,863	4,959,554	148,223
Effects of exchange rate change on cash	30,790	(2,810)	(83)
Net increase in cash and cash equivalents	9,496,330	918,233	27,443
Cash and cash equivalents at beginning of period	5,843,000	11,401,632	340,754
Cash and cash equivalents at end of period	15,339,330	12,319,865	368,197
Supplementary disclosures of cash flow information:			
Cash paid during the period for:			
Interest	54,127	15,509	464
Income taxes	88,285	32,060	958
Supplementary disclosures of investing and financing activities not affecting cash flows:			
Long-term equity investments reclassified to short-term investments	68,564	—	—
Convertible bonds payable and other items transferred to common stock and capital surplus	96,833	345	10
Cash dividends payable	14	1,047,146	31,295

See accompanying notes to consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2001 (unaudited) and 2002
(expressed in thousands of New Taiwan or U.S. Dollars, unless otherwise specified)

(1) Organization

Compal Electronics, Inc. (the "Company") was incorporated in the Republic of China ("ROC") as a company limited by shares in June 1984. The major business activities of the Company are the manufacture and sales of notebook personal computers ("Notebook PCs"), monitors, wireless handsets and personal digital assistants ("PDAs"). The Company merged with Palmax Technology Co., Ltd. ("Palmax") on July 4, 2001.

Consolidated subsidiaries that are directly owned by the Company comprised the following as of June 30, 2002:

Just International Ltd. ("Just") was incorporated in the British Virgin Islands on August 25, 1992. The main activity of Just is investing in equity securities. As of June 30, 2002, the Company owned 100% of Just's authorized common stock amounting to U.S.\$27,810. From 1996 to 2000, Just invested U.S.\$26,800 in Compal Electronics (China) Ltd. ("CPC"), which was incorporated in the People's Republic of China ("PRC") and is engaged in the manufacture and sale of monitors. As of June 30, 2002, Just owned 100% of CPC's outstanding common stock. Just also invested U.S.\$500 in Compal International Ltd. ("CPI") in April 1997. CPI was incorporated in the British Virgin Islands on April 15, 1997, and is engaged in the sales of monitors to the Company and sales of related electronic components to CPC. As of June 30, 2002, Just owned 100% of CPI's outstanding common shares.

Compal Investment Corp. ("Compal Investment") was incorporated in August 1997 in the ROC. The main activity of Compal Investment is investing in businesses relating to the PC industry. Since December 1999, Compal Investment was renamed Panpal Technology Co. ("Panpal") in order to expand its business in selling electronic materials. As of June 30, 2002, the Company owned 100% of Panpal's outstanding common stock amounting to NT\$3,472,000.

Great Islands Enterprises Co., Ltd. ("GI") was incorporated in the British Virgin Islands on January 12, 2000. The main activity of GI is investing in equity securities. In March 2002, the Company acquired 100% of GI and renamed it Compal International Holding Co., Ltd. ("CIH"). From 2000 to 2001, CIH invested U.S.\$12,000 in Compal Electronics Technology (Kunshan) Co., Ltd. ("CET"), which was incorporated in the PRC and is engaged in the manufacture and sale of Notebook PCs. As of June 30, 2002, CIH owned 100% of CET's outstanding common stock. CIH also established Prospect Fortune Group Ltd. ("PFG") in the British Virgin Islands on January 18, 2000. PFG is engaged in the sales of Notebook PCs and related electronic components. As of June 30, 2002, CIH owned 100% of PFG's outstanding common shares amounting to U.S.\$1.

(2) Summary of Significant Accounting Policies

(a) Accounting principles and consolidation policy

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the ROC. These financial statements are not intended to present the consolidated financial position of the Company and the related consolidated results of operations and cash flows based on accounting principles and practices generally accepted in countries and jurisdictions other than the ROC.

The consolidated financial statements include the accounts of the Company and all subsidiaries in which more than 50% of the shares are owned by the Company and in which total assets or sales exceed 10% of the Company's total assets or sales. If the total assets and sales of a subsidiary are less than 10% of

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

the Company's total assets and sales, then the subsidiary is accounted for under the equity method of accounting.

The consolidated financial statements in 2001 included the consolidated accounts of Just and Panpal. The consolidated financial statements in 2002 included the consolidated accounts of Just, Panpal, and CIH (called "the Group"). All significant inter-company accounts and transactions have been eliminated. The common stock of the Company acquired by its subsidiaries is recorded as treasury stock, a deduction from stockholders' equity in the accompanying consolidated balance sheets.

Since the total assets and sales of Compal Electronic International Ltd ("CII"), Gempal Technology Co. ("Gempal"), Compal Communication Limited ("CCI"), Swenc Technology Co., Ltd. ("Swenc"), Compal Europe B.V. ("CEBV"), Bizcom Electronics, Inc. ("Bizcom"), SaveCom InfoCom Inc. ("SaveCom") (in the process of liquidation), Compal Europe (UK) Ltd. ("CEUK"), Vacom Wireless, Inc. ("Vacom"), Pagine Corporation ("Pagine") (in the process of liquidation) and Just International (Singapore) Pte Ltd. ("Just-Singapore") do not exceed 10% of the corresponding accounts of the Company, and the aggregate total assets and total sales of all of these subsidiaries are less than 30% of the Company's total assets and sales, respectively, the financial statements of these subsidiaries have not been consolidated in the accompanying consolidated financial statements.

(b) Foreign currency transactions and translation

The functional currency of each Group company is its respective local currency. The Company's reporting currency is the New Taiwan Dollar. Foreign currency transactions are translated at the rates prevailing on the transaction dates. Foreign currency receivables and payables are translated into New Taiwan Dollars or local currency at the approximate market rate of exchange prevailing on the balance sheet date. The resulting unrealized gains or losses are included in current operations.

If a forward exchange contract is intended to hedge the risks of changes in foreign currency exchange rates, the related forward exchange contract receivables and payables are recorded in New Taiwan Dollars at the spot rate on the date of contract inception, and the balance on the balance sheet date is translated into New Taiwan Dollars at the prevailing spot rate. Gains or losses resulting from translation on the balance sheet date are recognized as non-operating income or losses. The discount or premium on a forward exchange contract is amortized over the life of the contract.

(c) Cash equivalents

Cash equivalents represent investments in bonds purchased under resale agreements or commercial paper with a maturity of three months or less from the date of investment.

(d) Short-term investments

Investments in publicly listed equity securities not intended to be held for the long term and mutual funds are classified as short-term investments in the accompanying balance sheets and stated at the lower of cost or market value. Market value of marketable equity securities is based on the average closing price of the last month of the accounting period. Market value of open-end mutual funds is based on the fair market value on the balance sheet date. Cost is determined by using the weighted-average method.

(e) Allowance for doubtful accounts

The allowance for doubtful accounts is based on an aging analysis and the likelihood of collection of the Company's accounts receivable balances.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(f) Inventories

Inventories are stated at the lower of cost or market value. Market value for raw materials and work in process is based on replacement cost. The market value of finished goods is based on net realizable value.

(g) Long-term equity investments

Investments in equity securities intended to be held for the long term are classified as long-term equity investments in the accompanying balance sheets. Long-term equity investments in publicly listed equity securities that represent less than 20% of the investee's common stock ownership are stated at the lower of cost or market value. Long-term equity investments in non-listed equity securities that represent less than 20% of the investee's common stock ownership are stated at cost. However, if there is evidence indicating that a decline in the value of an investment is not temporary, the investment is written down to reflect such decline. The resulting loss is recognized in the period incurred. Stock dividends are not recognized as income but as an increase in the number of the shares held.

Long-term equity investments are accounted for under the equity method when the Company owns between 20% and 50% of the investee's common stock or if the Company owns greater than 50% of a subsidiary's common stock but the subsidiary's total assets and sales are less than 10% of the Company's total assets and sales. Refer to note 2(a). The difference between cost of investment and the amount of underlying equity in net assets of an investee is amortized using the straight-line method over ten years. If an investee company accounted for under the equity method issues new shares and the Company does not purchase new shares proportionately, then the investment percentage, and therefore the equity in net assets for the investment, will be changed. Such difference shall be used to adjust capital surplus or retained earnings and long-term equity investments.

Unrealized inter-company profits or losses resulting from transactions between the Company and its subsidiaries and investees accounted for under the equity method are deferred until realized, or are amortized based on the useful lives of the assets that give rise to such unrealized profits or losses.

The financial statements of foreign subsidiaries and investees accounted for under the equity method and reported in foreign currencies are translated into New Taiwan Dollars at the exchange rates prevailing on the balance sheet date, with the exception of stockholders' equity, which is translated at historical rates. Revenues, costs and expenses are translated using the weighted-average exchange rates during the applicable period. Adjustments, net of the related income taxes, from these translations are reflected in stockholders' equity as a foreign currency translation adjustment.

(h) Property, plant and equipment, and leased assets

Property, plant and equipment are stated at cost. Interest in connection with the acquisition or construction of property, plant and equipment is capitalized. Excluding land and land leasehold rights, depreciation of property, plant and equipment is provided for by using the straight-line method over the estimated useful lives of the assets. If the property, plant and equipment have reached their estimated useful lives but are still in use, the Company will estimate the remaining useful lives and residual values and depreciate the remaining costs using the same method.

The expenditures for obtaining land leasehold rights, including charges for land leasehold rights and related expenses, are capitalized and amortized as rental expenses by using the interest method over the contract periods.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Property, plant and equipment leased to other parties under operating leases are classified as leased assets. Rental income received by the Company is recorded as non-operating income. The related depreciation is accounted for as a deducted item of rental income.

Leasehold improvements are amortized by using the straight-line method over the shorter of the estimated useful lives or the contract periods.

(i) Deferred expenses

Charges for royalties are deferred and amortized over the contract period. The cost of computer software for internal use is amortized by using the straight-line method over three years.

(j) Convertible bonds payable

Costs incurred for the issuance of redeemable convertible bonds are amortized during the period between the issuance date and the last redeemable date. When bondholders exercise their redemption rights, unamortized costs will be recognized as interest expense based on the percentage of redemption.

The number of common shares that are to be given is calculated based on the number of convertible bonds and the conversion price at the time of the conversion. The convertible bonds payable over the par value of the common stock and deferred issuance costs are transferred to capital surplus upon conversion. In accordance with the conversion rules, the new shares are registered as common stock three times a year.

(k) Retirement plan

The Company has established an employee noncontributory retirement plan covering all regular employees in the ROC. According to this plan, employees are eligible for retirement or are required to retire after meeting certain age or service requirements. The retirement benefits are lump-sum payments and are determined principally by the length of service of the employees. Payments of employee retirement benefits are based on the years of service and the average salary six months before the employee's retirement. Each employee will earn two months' salary for the first 15 years of service and one month's salary for each service year after the sixteenth year. The maximum is 45 months of salary.

The Company has made monthly cash contribution of 5% of salaries and wages to its pension fund maintained with the Central Trust of China. Payment of employee retirement benefits will be paid by the pension fund first, and then by the Company if the fund is insufficient.

In accordance with ROC SFAS No. 18 "Accounting for Pensions", net periodic pension costs, including services costs, interest cost, expected return on plan assets, and amortization of net unrecognized transition assets over the average remaining service period of the employees of 20 years, have been actuarially calculated for the Company in accordance with SFAS No. 18.

Payments of employee retirement benefits for the other consolidated subsidiaries are based on local labor law of each subsidiary's registered jurisdiction. The Company has made a monthly cash contribution of 18% of salaries and wages to a pension fund and recognized this contribution as current expenses. The pension funds are maintained by local governments. Payment of employee retirement benefits will be made from the pension funds.

(l) Income taxes

Income taxes are calculated based on accounting income. The amounts for deferred income tax liabilities and assets are calculated by applying the provisions of enacted tax law to determine the amount of tax payable or refundable, currently or in future years. The tax effects of taxable temporary differences

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

are recorded as deferred income tax liabilities. The tax effects of deductible temporary differences, net operating losses and income tax credits are recognized as deferred income tax assets. The realization of deferred income tax assets is evaluated, and if it is considered more likely than not that the asset will not be realized, a valuation allowance is recognized accordingly.

Deferred income tax assets or liabilities are classified as current or non-current based on the classification of the asset or liability that resulted in the deferred item or, for certain transactions not directly related to an asset or liability, based on the timing of the expected reversal date.

The 10% surtax on unappropriated earnings is recorded as current income tax expense after the resolution to appropriate retained earnings is approved in a stockholders' meeting.

The Company's income tax returns are calculated and filed based on the Company's and each subsidiary's registered local tax law.

(m) Treasury stock

Pursuant to ROC Statement of Financial Accounting Standards (SFAS) No. 30, "Accounting for Treasury Stock", the Company accounts for the cost of purchasing its outstanding stock as "treasury stock". A gain on the sale of treasury stock is credited to capital surplus — treasury stock. Losses are charged to capital surplus, but only to the extent of available net gains from previous sales or retirements of the same class of stock; otherwise, losses are charged to retained earnings. The cost of treasury stock is computed using the weighted-average method.

When treasury stock is retired, the weighted-average cost of the retired treasury stock is written off to offset the par value and the paid-in capital in excess of par value. If the weighted-average cost written off exceeds the sum of the par value and the paid-in capital in excess of par value, the difference is charged to capital surplus arising from the same class of stock or to retained earnings, and if vice versa, the difference is credited to capital surplus.

Starting from 2002, the Company adopted ROC SFAS No. 30 pursuant to Securities and Future Commission (SFC) regulations. The Company's outstanding shares held by its subsidiaries are regarded as treasury stock when calculating investment income recognized and presenting its financial statements. No retroactive adjustments are needed for the prior period.

(n) Goodwill

Goodwill resulting from the Company's initial acquisition of 56% of Palmax shares and the use of Palmax's core technology is being amortized over 10 years.

(o) Net income per share

Net income per share of common stock is computed based on the weighted-average number of common shares outstanding during the period. Net income per share for the prior period is retroactively adjusted to reflect the effects of stock issued by transferring capital surplus, retained earnings, and employee bonuses.

The convertible bonds issued by the Company in 2000 are potential common shares. Basic net income per share will be disclosed if there is no dilution effect. Otherwise, both basic and diluted net income per share shall be disclosed. For the purpose of calculating diluted net income per share, the potential common shares should be deemed to have been converted into common stock at the beginning of the period, and the effect on the net income attributable to additional common shares outstanding should be considered accordingly.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(p) Convenient translation into U.S. Dollars

The consolidated financial statements are stated in New Taiwan Dollars. Translation of the 2002 New Taiwan Dollar amounts into U.S. Dollars amounts is included solely for the convenience of the readers, using the noon buying rate provided by the Federal Reserve Bank of New York on June 28, 2002 of NT\$33.46 to U.S.\$1. The convenient translations should not be construed as representations that the New Taiwan Dollar amounts have been, could have been, or could in the future be, converted into U.S. Dollars at this rate or any other rate of exchange.

(3) Merger with Palmax

The Company acquired the remaining 44% of the outstanding shares in Palmax on July 4, 2001, through the issuance of 23,396 thousand common shares bringing its ownership in Palmax to 100%. Under ROC GAAP, the merger was accounted for using the purchase method and accordingly, the prior period pro forma combined results of operation are provided.

The results of operation of Palmax have been combined into the income statement of the Company since July 4, 2001. The pro forma combined results of operation are summarized assuming that the merger had occurred on January 1, 2001, as follows:

	<u>Six-month period ended June 30, 2001</u>
	NT\$
Net sales	<u>33,353,484</u>
Gross profit	<u>3,220,115</u>
Operating income	<u>1,854,843</u>
Income before income taxes	2,982,258
Income tax expense	<u>68,285</u>
Net income	<u>2,913,973</u>
Net income per share (in New Taiwan Dollars)	<u>1.18</u>

(4) New accounting pronouncements and the effect

Pursuant to SFC regulations, starting from 2002, the Company adopted SFAS No. 30, "Accounting for Treasury Stock". The Company's outstanding shares held by its subsidiaries are regarded as treasury stock. Cash dividends and disposal gains on sale of the Company's outstanding shares held by its subsidiaries cannot be recognized as investment income by the Company. According to this new accounting pronouncement, the amount of long-term equity investments was decreased by NT\$501,862, and accordingly the treasury stock increased by the same amount. The change had no significant effects to the consolidated financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(5) Cash and Cash Equivalents

	June 30		
	2001 (unaudited)	2002	
	NT\$	NT\$	U.S.\$
Cash on hand	2,285	2,681	80
Checking accounts and demand deposits	691,453	598,631	17,891
Time deposits	3,037,964	8,643,028	258,310
Bonds purchased under resale agreements and commercial paper ...	<u>11,607,628</u>	<u>3,075,525</u>	<u>91,916</u>
	<u>15,339,330</u>	<u>12,319,865</u>	<u>368,197</u>

The Company's interest income is primarily generated from cash and cash equivalents.

(6) Short-term Investments

	June 30		
	2001 (unaudited)	2002	
	NT\$	NT\$	U.S.\$
Marketable equity securities (market value as of June 30, 2001 and 2002, was NT\$132,699 and NT\$26,544, respectively)	68,564	68,564	2,049
Open-end mutual funds (net asset value as of June 30, 2001, was NT\$21,197)	20,000	—	—
Less: allowance for losses on valuation of short-term investments	—	(42,020)	(1,256)
	<u>88,564</u>	<u>26,544</u>	<u>793</u>

(7) Accounts Receivable — Nonrelated Parties

	June 30		
	2001 (unaudited)	2002	
	NT\$	NT\$	U.S.\$
Notes receivable	11,150	56,500	1,689
Accounts receivable	8,776,764	14,718,528	439,884
Less: allowance for doubtful accounts	(35,610)	(69,499)	(2,077)
allowance for sales returns and discounts	<u>(280,676)</u>	<u>(317,240)</u>	<u>(9,481)</u>
	<u>8,471,628</u>	<u>14,388,289</u>	<u>430,015</u>

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(8) Inventories

	June 30		
	2001 (unaudited)	2002	
	NT\$	NT\$	U.S.\$
Finished goods	1,496,750	4,621,270	138,113
Work in process	518,554	990,268	29,595
Raw materials	2,865,061	7,848,229	234,556
Raw materials in transit	<u>129,207</u>	<u>234,373</u>	<u>7,005</u>
	5,009,572	13,694,140	409,269
Less: allowance for inventory obsolescence	<u>(200,327)</u>	<u>(404,162)</u>	<u>(12,079)</u>
	<u>4,809,245</u>	<u>13,289,978</u>	<u>397,190</u>
Insurance coverage amount for inventory	<u>6,125,000</u>	<u>10,434,000</u>	<u>311,835</u>

(9) Long-term Equity Investments and Credit Balance of Long-term Equity Investments

	June 30		
	2001 (unaudited)	2002	
	NT\$	NT\$	U.S.\$
Long-term equity investments:			
Under the equity method	13,374,181	12,048,834	360,097
Under the lower-of-cost-or-market-value method	3,068,154	3,160,127	94,445
Under the cost method	<u>4,101,045</u>	<u>3,882,409</u>	<u>116,031</u>
	20,543,380	19,091,370	570,573
Prepayment of long-term equity investments	<u>3,000</u>	<u>1,106,080</u>	<u>33,057</u>
Total	<u>20,546,380</u>	<u>20,197,450</u>	<u>603,630</u>
Credit balance of long-term equity investments	<u>58,272</u>	<u>168,567</u>	<u>5,038</u>

- (a) As of June 30, 2001 and 2002, the market value of long-term equity investments accounted for under the lower-of-cost-or-market-value method amounted to NT\$2,573,065 and NT\$4,992,398, respectively.
- (b) Net investment income for the six-month period ended June 30, 2002 amounted to NT\$504,422, which mainly included net investment income on long-term equity investments accounted for under equity method amounting to NT\$433,686, cash dividends amounting to NT\$19,683 and NT\$76,618 received from Kinpo Electronics, Inc. and Cal-comp Electronic (Thailand) Ltd., respectively, gains on disposal of long-term equity investments in Hannstar Display Corp. and Toppoly Optoelectronics Corp. ("Toppoly") amounting to NT\$216,715 and NT\$114,786, respectively, and realized loss on long-term equity investments under the cost method of NT\$358,960.
- (c) Net investment income on long-term equity investments accounted for under the equity method for the six-month periods ended June 30, 2001 and 2002 amounted to NT\$171,806 and NT\$433,686, respectively. The calculation of these amounts were based on the investees' unaudited financial statements.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

- (d) On July 4, 2001, the Company merged with Palmax, which was one of the long-term equity investments accounted for under the equity method of the Company before this merger. The Company retired the shares of Palmax. See note 3.
- (e) As of June 30, 2001 and 2002, the original investment costs of long-term equity investments accounted for under the equity method were as follows:

	June 30		
	2001 (unaudited)	2002	
	NT\$	NT\$	U.S.\$
Toppoly	7,215,568	6,990,464	208,920
CCI	1,579,793	1,456,397	43,527
Palmax	1,391,198	—	—
International Semiconductor Technology Ltd. (IST)	1,109,391	1,102,147	32,939
Gempal.....	899,940	899,940	26,896
Other	1,374,393	1,631,939	48,773
	<u>13,570,283</u>	<u>12,080,887</u>	<u>361,055</u>

(10) Property, Plant and Equipment and Leased Assets

The Company does not provide property, plant and equipment as collateral for its loans. As of June 30, 2001 and 2002, insurance coverage for property, plant and equipment and operating lease assets amounted to NT\$4,839,000 and NT\$6,962,000, respectively.

In January 1996, the Company entered into an agreement with the government authority of Kunshan City, Jiangsu Province, People's Republic of China, to acquire state-owned land use rights. The term of the state-owned land use rights extends from April 10, 1996 to April 9, 2046. According to the contract, total expenditures for obtaining state-owned land use rights amounted to U.S.\$4,637, and related annual administrative expense amounted to RMB77,280.

In July 2000 and December 2000, the Company entered into an agreement with the government authority of Kunshan City, Jiangsu Province, People's Republic of China, to acquire state-owned land use rights. The term of the state-owned land use rights extend from October 5, 2000 to October 4, 2050, and March 8, 2001 to March 7, 2051, respectively. According to the contract, total expenditures for obtaining state-owned land use rights amounted to U.S.\$2,756, and related annual administrative expense amounted to RMB48,811.

The Company entered into agreements to lease a portion of its office space and plants. The contract periods extend from one to three years. According to the contracts, the rental is paid monthly. As of June 30, 2001 and 2002, the details of leased assets were as follows:

	June 30		
	2001 (unaudited)	2002	
	NT\$	NT\$	U.S.\$
Land	259,946	282,301	8,437
Buildings and other	156,419	191,557	5,725
	416,365	473,858	14,162
Less: accumulated depreciation	(11,855)	(18,393)	(550)
	<u>404,510</u>	<u>455,465</u>	<u>13,612</u>

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(b) The Company issued overseas unsecured zero coupon convertible bonds with a face value of U.S.\$148,000 on October 19, 2000. As of June 30, 2001 and 2002, the convertible bonds payable consisted of the following:

	June 30		
	2001		
	(unaudited)	2002	
	NT\$	NT\$	U.S.\$
Aggregate principal amount (U.S.\$148,000)	4,636,840	4,636,840	138,578
Accumulated Converted amount (U.S.\$3,100 for 2001 and U.S.\$3,110 for 2002)	(102,051)	(102,401)	(3,060)
Accumulated redemption amount (U.S.\$105,544)	—	(3,306,694)	(98,825)
Foreign currency exchange loss	455,277	94,281	2,817
	<u>4,990,066</u>	<u>1,322,026</u>	<u>39,510</u>

The significant terms of the convertible bonds are as follows:

1. Interest rate: 0%;
2. Duration: five years (October 19, 2000 to October 19, 2005);
3. Final redemption: unless previously redeemed at the option of the Company or the bondholders, or converted in accordance with the offering of the bonds, the bonds are to be redeemed at the principal amount on October 19, 2005;
4. Redemption at the option of the Company: the Company may redeem the bonds at a redemption price equal to 100% of the unpaid principal amount under the following circumstances:
 - (1) On or after October 19, 2003: if (i) the closing price (translated into U.S. Dollars at the prevailing rate) of the Company's common shares on the Taiwan Stock Exchange or (ii) the closing price of the Company's GDRs on the Luxembourg Stock Exchange for a period of 30 consecutive trading days before redemption has been at least 130% of the conversion price (translated into U.S. Dollars at the fixed rate of NT\$31.33) in effect on each such trading day;
 - (2) In the event that at least 95% of the principal amount of the bonds originally outstanding has been redeemed, repurchased, or converted; or
 - (3) In the event of certain changes in ROC taxation, i.e., if the withholding tax rate exceeds 20%, the Company has agreed to redeem the bonds.
5. Redemption at the option of bondholders: the bondholders have the right to require the Company to repurchase the bonds at a price equal to 100% of the unpaid principal amount under the following circumstances:
 - (1) On October 19 of 2001, 2002, 2003 and 2004;
 - (2) In the event that the Company's shares cease to be listed or admitted to trading on the Taiwan Stock Exchange;
 - (3) In the event of change of control of the Company.
6. Terms of conversion:
 - (1) Bondholders may opt to have the bonds converted into common stock or GDRs of the Company from November 19, 2000 to September 19, 2005;

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(2) Conversion price: NT\$38.077 per share of common stock; and

(3) The conversion price is translated into New Taiwan Dollars at the fixed rate of NT\$31.33 = U.S.\$1.

(13) Pension

	<u>Six-month periods ended June 30</u>		
	<u>2001</u>	<u>2002</u>	
	<u>(unaudited)</u>	<u>NT\$</u>	<u>U.S.\$</u>
Net pension cost	<u>48,912</u>	<u>37,415</u>	<u>1,118</u>
Pension fund deposits in the Central Trust of China	<u>410,400</u>	<u>483,034</u>	<u>14,436</u>
Accrued pension liability	<u>30,704</u>	<u>27,813</u>	<u>831</u>
Vested benefits	<u>82,936</u>	<u>114,386</u>	<u>3,419</u>

The contributions of the Company for employee retirement benefits for the six-month periods ended June 30, 2001 and 2002 aggregated approximately NT\$137 and NT\$416, respectively.

The rest of the consolidated subsidiaries did not incur any pension expense in 2001 and 2002.

(14) Stockholders' Equity

(a) Capital increase

Based on a resolution of the annual stockholders' meeting held on April 3, 2001, the Company increased its authorized common stock to 2.8 billion shares, declared a NT\$0.5 cash dividend per share, which amounted to NT\$778,418, and increased its common stock through the issuance of stock dividends by transferring capital surplus, retained earnings, and employee stock bonuses amounting to NT\$4,191,152.

Based on a resolution of the annual stockholders' meeting held on April 3, 2001, the Board of Directors of the Company was authorized to issue 100 million shares of common stock which were used for the offering of Global Depositary Shares ("GDSs"). The common stock was issued at NT\$40 per share on May 21, 2001. The abovementioned GDSs comprise 20 million units and are listed on the Luxembourg Stock Exchange.

The Company merged with Palmax on July 4, 2001 and issued 23,396 thousand shares of its common stock to the stockholders of Palmax. The Company held a 56% interest in Palmax before this merger. See note 3.

Based on a resolution of the annual stockholders' meeting held on May 24, 2002, the Company increased its authorized common stock to 3.48 billion shares, declared a NT\$0.5 cash dividend per share which amounted to NT\$1,047,132, and increased its common stock through the issuance of stock dividends by transferring capital surplus, retained earnings, and employee stock bonuses amounting to NT\$4,458,359. As of June 30, 2002, the registration procedure related to this issuance had not been completed.

A portion of the overseas convertible bonds was converted into 2,468 and 8 thousand shares of common stock in 2001 and 2002, respectively.

As of June 30, 2001 and 2002, the authorized common stock, at a par value of NT\$10 per share, was NT\$28,000,000 and NT\$34,800,000, respectively.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(b) Treasury stock

In 2001, the Company had purchased 51,185 thousand shares of treasury stock at a total cost of NT\$1,312,509 for the purpose of transferring to employees. As of June 30, 2002, 43,626 thousand shares of treasury stock had been transferred to employees. The remaining 7,559 thousand shares of treasury stock were at a cost of NT\$193,831.

Pursuant to SFC regulations, the number of shares of treasury stock cannot exceed 10% of the number of shares issued. The total purchase cost of treasury stock cannot exceed the sum of retained earnings, paid-in capital in excess of par value, and realized capital surplus. The shares bought back with the intent of transferring to employees must be transferred within three years from the date of buyback. Otherwise, the shares shall be deemed as not having been issued by the Company and cancelled. In addition, treasury stock cannot be pledged for debts, and treasury stock does not carry any shareholder rights until it is disposed of or transferred to employees.

The Company records treasury stock held by its consolidated subsidiary as a deduction to stockholders' equity in the accompanying consolidated balance sheets. As of June 30, 2001, and 2002, treasury stock of the Company acquired by its consolidated subsidiary amounted to NT\$633,216 and NT\$749,551. In the first half year of 2001, the Company recognized a gain on the sale of treasury stock of NT\$154,385 and recognized dividend income of NT\$14,920 related to treasury stock held by its consolidated subsidiary.

Refer to note 4, starting from 2002, the Company's outstanding shares held by its subsidiaries are regarded as treasury stock. As of June 30, 2002, treasury stock of the Company acquired by its subsidiary Gempal amounted to NT\$501,862. The subsidiaries of the Company did not sell the common stock of the Company for the first half year of 2002.

(c) Capital surplus

Pursuant to ROC Company Law, capital surplus can only be used to offset a deficit or to increase common stock. Cash dividends cannot be declared out of capital surplus. According to SFC regulations, capital increases by transferring paid-in capital in excess of par value should not exceed 10% of total common stock outstanding. In addition, capital increases by transferring paid-in capital in excess of par value can only commence in the following year.

(d) Special reserve

According to the Company's articles of incorporation, unrealized foreign currency exchange gains accounted for under SFAS No. 14 must be set aside as a special reserve before appropriation. The special reserve is transferred to retained earnings when the exchange gains or losses are realized.

According to SFC regulations, when there is a reduction item in stockholders' equity during the year, an amount equal to the reduction item before appropriation must be set aside as a special reserve.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)*****(e) Legal reserve and limitation on distribution of retained earnings***

Based on the Company's articles of incorporation, 10% of annual net income after tax is to be set aside as legal reserve, 2% as remuneration to the directors and supervisors, and 5% as bonus to employees after offsetting prior years' deficits, if any. The remaining balance can be distributed as dividends to stockholders after special reserves are appropriated, if any. The dividends to stockholders cannot be lower than 10% of annual net income after deducting the above items. If the annual net income per share is less than 1 New Taiwan Dollar, the Company may opt to retain net income.

Based on Panpal's articles of incorporation, 10% of its annual net income is to be set aside as legal reserve after offsetting prior years' deficits, if any. No more than 2% of unappropriated earnings, after deducting the legal reserve, can be distributed as remuneration to the directors and supervisors and no more than 2% (but not equal to zero) as bonuses to employees. The remaining balance can be distributed as dividends to stockholders based on the proposal provided at the board of directors' meeting and approved by the stockholders' meeting.

Based on Just's articles of incorporation, before recommending a dividend, the directors may set aside reserves based on a resolution by the directors' meeting. The remaining balance can be distributed as dividends to stockholders based on the resolution of the directors' meeting under the following two circumstances:

- (i) the Company will be able to satisfy its liabilities as they become due in the ordinary course of its business; and
- (ii) the realizable value of the assets of the Company will not be less than the sum of its total liabilities, other than deferred taxes, as shown in the books of account, and its capital.

Based on CIH's articles of incorporation, the directors may declare a dividend based on a resolution by the directors' meeting. No dividend shall be declared and paid except out of surplus and unless the directors determine that immediately after the payment of the dividend:

- (i) the Company will be able to satisfy its liabilities as they become due in the ordinary course of its business; and
- (ii) the realizable value of the assets of the Company will not be less than the sum of its total liabilities, other than deferred taxes, as shown in the books of account, and its capital.

Pursuant to ROC Company Law, the legal reserve must be used exclusively to offset losses and cannot be used for any other purpose, except that one-half of the legal reserve may be capitalized based on a resolution of the stockholders' meeting when it equals at least 50% of paid-in capital.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(15) Net Income Per Share

Net income per share for the six-month periods ended June 30, 2001 and 2002, are computed as follows (all net income per share amounts are expressed in dollars):

	2001 (unaudited)		Six-month period ended June 30, 2002			
	Before income tax	After income tax	Before income tax	After income tax	Before income tax	After income tax
	NT\$	NT\$	NT\$	NT\$	U.S.\$	U.S.\$
Basic net income per share:						
Net income after deducting preacquisition income	<u>3,024,794</u>	<u>2,956,509</u>	<u>3,524,700</u>	<u>3,348,396</u>	<u>105,341</u>	<u>100,072</u>
Weighted-average number of thousand shares outstanding, before retroactive adjustments	<u>2,001,567</u>	<u>2,001,567</u>	<u>2,014,536</u>	<u>2,014,536</u>	<u>2,014,536</u>	<u>2,014,536</u>
Net income per share before retroactive adjustments	<u>1.51</u>	<u>1.48</u>	<u>1.75</u>	<u>1.66</u>	<u>0.05</u>	<u>0.05</u>
Weighted-average number of thousand shares outstanding, after retroactive adjustments	<u>2,447,403</u>	<u>2,447,403</u>	<u>2,460,372</u>	<u>2,460,372</u>	<u>2,460,372</u>	<u>2,460,372</u>
Net income per share after retroactive adjustments	<u>1.23</u>	<u>1.21</u>	<u>1.43</u>	<u>1.36</u>	<u>0.04</u>	<u>0.04</u>
Diluted net income per share:						
Net income after deducting preacquisition income	3,024,794	2,956,509	3,524,700	3,348,396	105,341	100,072
Effects on dilutive potential common stock:						
Zero coupon convertible bonds payable	—	—	—	—	—	—
Net income per share before retroactive adjustment	<u>3,024,794</u>	<u>2,956,509</u>	<u>3,524,700</u>	<u>3,348,396</u>	<u>105,341</u>	<u>100,072</u>
Weighted-average number of thousand shares outstanding, before retroactive adjustments	2,001,567	2,001,567	2,014,536	2,014,536	2,014,536	2,014,536
Zero coupon convertible bonds payable	<u>121,076</u>	<u>121,076</u>	<u>32,377</u>	<u>32,377</u>	<u>32,377</u>	<u>32,377</u>
	<u>2,122,643</u>	<u>2,122,643</u>	<u>2,046,913</u>	<u>2,046,913</u>	<u>2,046,913</u>	<u>2,046,913</u>
	<u>1.42</u>	<u>1.39</u>	<u>1.72</u>	<u>1.64</u>	<u>0.05</u>	<u>0.05</u>

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	2001 (unaudited)		Six-month period ended June 30, 2002			
	Before income tax	After income tax	Before income tax	After income tax	Before income tax	After income tax
	NT\$	NT\$	NT\$	NT\$	U.S.\$	U.S.\$
Weighted-average number of thousand shares outstanding, after retroactive adjustments	<u>2,568,479</u>	<u>2,568,479</u>	<u>2,492,754</u>	<u>2,492,754</u>	<u>2,492,754</u>	<u>2,492,754</u>
Net income per share after retroactive adjustments	<u>1.17</u>	<u>1.15</u>	<u>1.41</u>	<u>1.34</u>	<u>0.04</u>	<u>0.04</u>

(16) Income Taxes

(a) The purchase of machinery through proceeds from common stock issuances met the prescribed criteria under the "Statute for Upgrading Industries" in the following years:

Year	Tax exemption products	Tax exemption chosen	Tax exemption period
1996	Notebook PCs	Tax exemption on the Company's corporate income taxes for five years	January 31, 1998~January 30, 2003
1997	Notebook PCs	Stockholders' income tax deduction	
1998	Notebook PCs	Tax exemption on the Company's corporate income taxes for five years	October 31, 1999~October 30, 2004
1999	Notebook PCs, Liquid Crystal Display ("LCD") monitors, cellphones	Tax exemption on the Company's corporate income taxes for five years	December 1, 2000~November 30, 2005
1999	PDAs (tax exemption transferred from Palmax)	Tax exemption on the Company's corporate income taxes for five years	Tax exemption is not applied until the Company completes its investment plan
2000	Notebook PCs, LCD monitors	Tax exemption on the Company's corporate income taxes for five years	Tax exemption is not applied until the Company completes its investment plan
2000	PDAs (tax exemption transferred from Palmax)	Tax exemption on the Company's corporate income taxes for five years	Tax exemption is not applied until the Company completes its investment plan
2001	Notebook PCs, LCD monitors, wireless handsets	Tax exemption on the Company's corporate income taxes for five years	Tax exemption is not applied until the Company completes its investment plan

Tax exemption on the Company's corporation income taxes for the six-month periods ended June 30, 2001 and 2002 amounted to NT\$560,285 and NT\$315,723, respectively.

(b) The operations of the Company and Panpal are subject to income tax at a rate of 25%. CPC and CET, two subsidiaries of the Company, are subject to income tax at a rate of 15%. According to PRC Tax Law, CPC and CET can, from the year in which they begin to make profits, be exempted from income tax in the first and second years and allowed a 50% reduction in the third to fifth years. CPC began to make profits in 2001. The Company's operations outside Taiwan are subject to income tax rates applicable

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

to the related foreign jurisdiction. The components of income tax expense of the Company for the six-month periods ended June 30, 2001 and 2002, consisted of the following:

	2001 (unaudited)				
	The Company NTS	Panpal NTS	Other subsidiaries NTS	Total NTS	
Current income tax expense	100,335	—	—	100,335	
10% surtax on unappropriated earnings	177,364	—	—	177,364	
Investment tax credits used in 10% surtax on unappropriated earnings	(88,682)	—	—	(88,682)	
	<u>189,017</u>	<u>—</u>	<u>—</u>	<u>189,017</u>	
Deferred income tax expense (benefit)					
Valuation allowance	14,251	10,000	—	24,251	
Investment income recognized under the equity method, net	6,365	—	—	6,365	
Investment tax credits	(151,381)	—	—	(151,381)	
Other deferred income tax expense	33	—	—	33	
	<u>(130,732)</u>	<u>10,000</u>	<u>—</u>	<u>(120,732)</u>	
Total income tax expense	<u>58,285</u>	<u>10,000</u>	<u>—</u>	<u>68,285</u>	
	2002				
	The Company NTS	Panpal NTS	Other subsidiaries NTS	Total NTS	Total U.S.\$
Current income tax expense	78,909	928	5,167	85,004	2,540
10% surtax on unappropriated earnings	91,972	—	—	91,972	2,749
Investment tax credits used in 10% surtax on unappropriated earnings	(91,972)	—	—	(91,972)	(2,749)
	<u>78,909</u>	<u>928</u>	<u>5,167</u>	<u>85,004</u>	<u>2,540</u>
Deferred income tax expense (benefit)					
Investment income recognized under the equity method, net	120,895	—	—	120,895	3,613
Investment tax credits	69,324	(9,415)	—	59,909	1,791
Change in valuation allowance	(3,563)	12,000	—	8,437	252
Unrealized foreign currency exchange loss, net	(73,444)	3,278	—	(70,166)	(2,097)
Other deferred income tax expense (benefit)	(23,713)	(4,062)	—	(27,775)	(830)
	<u>89,499</u>	<u>1,801</u>	<u>—</u>	<u>91,300</u>	<u>2,729</u>
Total income tax expense	<u>168,408</u>	<u>2,729</u>	<u>5,167</u>	<u>176,304</u>	<u>5,269</u>

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(c) Deferred income tax assets (liabilities) as of June 30, 2001 and 2002, were as follows:

	June 30		
	2001 (unaudited)	2002	
	NT\$	NT\$	U.S.\$
Deferred income tax assets:			
Investment tax credits	370,631	346,456	10,354
Unrealized foreign currency exchange loss	140,102	131,390	3,927
Investment loss recognized under the equity method	126,850	143,898	4,301
Sales returns and discounts	70,169	79,253	2,369
Accrued warranty cost	59,103	75,214	2,248
Inventory provisions	27,209	59,674	1,783
Other	<u>34,327</u>	<u>43,444</u>	<u>1,298</u>
	828,391	879,329	26,280
Valuation allowance	<u>(312,830)</u>	<u>(462,046)</u>	<u>(13,809)</u>
Net deferred income tax assets	515,561	417,283	12,471
Deferred income tax liabilities:			
Investment income recognized under the equity method	(271,103)	(442,028)	(13,211)
Unrealized foreign currency exchange gain	(114,415)	(84,526)	(2,526)
Foreign currency translation adjustment	<u>(76,575)</u>	<u>(43,426)</u>	<u>(1,298)</u>
Net deferred income tax assets (liabilities)	<u>53,468</u>	<u>(152,697)</u>	<u>(4,564)</u>
Net deferred income tax assets — current	316,636	265,876	7,946
Net deferred income tax liabilities — non-current	<u>(263,168)</u>	<u>(418,573)</u>	<u>(12,510)</u>
	<u>53,468</u>	<u>(152,697)</u>	<u>(4,564)</u>

(d) The ROC tax authorities have assessed the Company's income tax returns through 1998. The tax authorities assessed the Company's additional income tax expenses for 1997 and 1998 in the amount of NT\$72,947 and NT\$50,684, respectively, which was mainly due to different interpretations related to tax-exempt income and income tax credits. The Company disagreed with the assessment and filed appeals related to these issues. The total amounts of the assessed additional income tax expenses were recognized in the accompanying statements of income. Any other assessed differences will be reflected as an adjustment after the tax appeal is resolved.

(e) Imputation credit account and creditable ratio

Beginning in 1998, the corporate income tax paid at the corporate level can be used to offset the resident shareholders' individual income tax. The amount of imputation credit which shareholders can claim depends on total corporate income tax paid at the corporate level. Beginning in 1998, corporations have been required to set up an Imputation Credit Account (ICA) to keep track of the corporate income taxes paid and the imputation credit they have allocated for shareholders. In addition, the creditable ratio, which represents the imputation credit per dollar of accumulated retained earnings, shall be calculated for

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

resident shareholders when corporations declare dividends. Calculations of the ICA balance and creditable ratio as of June 30, 2001 and 2002, are as follows:

	June 30		
	2001 (unaudited)	2002	
	NT\$	NT\$	U.S.\$
Unappropriated earnings retained prior to January 1, 1998 . . .	3,143,041	3,143,041	93,934
Unappropriated earnings retained after January 1, 1998	6,197,137	7,893,272	235,902
Total	<u>9,340,178</u>	<u>11,036,313</u>	<u>329,836</u>
ICA balance	<u>109,820</u>	<u>153,474</u>	<u>4,587</u>
	2001	2002	
Creditable ratio for earnings distribution	<u>3.12% (Actual)</u>	<u>1.78% (Actual)</u>	

(f) As of June 30, 2002, the unused investment tax credits of the Company and Panpal, mainly resulting from purchases of machinery for automation of production, research and development expenses, personnel training expenditures, and investments in qualified industry specified by the official, were as follows:

<u>Year</u>	<u>Aggregated tax credit</u>	<u>Unused tax credits</u>	<u>Year of expiry</u>
	NT\$	NT\$	
1998	10,286	10,286	2002
1999	125,612	7,802	2003
2000	427,380	322,077	2004
2001	245,605	6,291	2005
2002	<u>339,395</u>	—	2006
	<u>1,148,278</u>	<u>346,456</u>	

ROC income tax regulations stipulate that tax credits resulting from purchases of machinery for automation of production, research and development expenses, and personnel training expenditures can be applied for only up to 50% of the income tax liability, as well as tax credits resulting from investments in qualified industry specified by the official. Tax credits should be applied sequentially after first applying the current year's tax credit, and any unused balance can be carried forward for the following four years, subject to the same percentage limitation for each year except for the last year, in which it will expire.

(17) Related Information About Financial Instruments

(a) Derivative financial instruments

1. Forward exchange contracts

<u>Financial Instruments</u>	June 30, 2002					
	<u>Nominal amount</u>	<u>Transaction period</u>	<u>Maturities</u>	<u>Strike rate</u>	<u>Fair value</u>	<u>Credit risk</u>
	U.S.\$				NT\$	
USD forward exchange contracts	238,000	April 26, 2002 to June 24, 2002	July 30, 2002 to December 19, 2002	33.496~ 34.772	161,865	—

The Company had settled all of the derivative financial instruments as of June 30, 2001.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

2. Credit risk

The amount of credit risk equals the aggregate amount of contracts with a positive fair value. The amount of the credit risk is a potential loss of the Company if the counterpart involved in that transaction defaults. Since the Company's derivative financial instrument agreements are entered into with financial institutions with good credit ratings, management does not believe that there is significant credit risk from these transactions.

3. Market risk

The purpose of the forward exchange contracts is to hedge the exchange risk of the foreign currency assets. Therefore, the gains or losses resulting from changes in exchange rates will be offset by those from the hedged item. Management believes that the related market risk is not significant.

4. Liquidity risk

The Company will incur cash inflows and outflows within the periods shown below. There are no financing risks due to expected sufficient U.S. Dollars received from accounts receivable. Management believes that the cash flow risk is not significant because contracted foreign currency exchange rates are fixed.

<u>Financial instruments</u>	<u>Date</u>	<u>Cash outflow</u>	<u>Cash inflow</u>
		U.S.\$	NT\$
USD forward exchange contracts	July 2002 to December 2002	238,000	8,166,134

5. The categories and objectives of the derivatives, and strategies to accomplish the underlying objectives

The forward exchange contracts held by the Company are for the purpose of hedging the risks that may result from changes in currency rates of foreign currency assets and liabilities rather than for the purpose of trading. The hedging strategies of the Company are to hedge the market risk to the highest extent possible. The Company uses derivatives that are highly correlated to the changes in fair values of the hedged items as hedging instruments.

6. Presentation on financial statements

The receivables and payables derived from foreign currency forward contracts were offset against each other, and the net amount was accounted for as other current assets. The exchange gains (losses) resulting from the forward transactions for the six-month periods ended June 30, 2001 and 2002, amounting to NT\$(21,600) and NT\$186,335, respectively, were included in non-operating income or expenses in the accompanying statement of income.

7. Fair value of derivative financial instruments

As of June 30, 2002, the book value and the estimated fair value of the forward exchange contacts were as follows:

	June 30, 2002			
	<u>Book value</u>		<u>Estimated fair value</u>	
	NT\$	U.S.\$	NT\$	U.S.\$
Net forward exchange contracts receivable	<u>185,578</u>	<u>5,546</u>	<u>161,865</u>	<u>4,838</u>

The fair value of a derivative is the expected receivable or payable amount assuming that the contract is terminated on the balance sheet date. Generally, the unrealized gain or loss on open contracts is included in the fair value. The above fair value estimates were based on quotes from financial institutions.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(b) Non-derivative financial instruments

1. Except for long-term equity investments, the book value of non-derivative financial instruments was similar to fair market value as of June 30, 2001 and 2002.

2. As of June 30, 2001 and 2002, the book values of long-term equity investments were NT\$20,546,380 and NT\$20,197,450, respectively, of which NT\$3,068,154 and NT\$3,160,127, respectively were invested in listed equity securities. The remaining balance was invested in companies that are not publicly listed. The fair values of these publicly listed investments were NT\$2,573,065 and NT\$4,992,398 as of June 30, 2001 and 2002, respectively.

(18) Related-party Transactions

(a) Name of the related parties and relationship

<u>Related Party</u>	<u>Relationship with the Company</u>
Bizcom	100%-owned subsidiary company
CEUK	100%-owned subsidiary company
CII	100%-owned subsidiary company
Gempal	100%-owned subsidiary company
Kunshan Botai Electronics Co., Ltd. (“Botai”)	100%-owned subsidiary company since March 2002
PFG	100%-owned subsidiary company since March 2002
Vacom	Investee company accounted for under the equity method
CCI	Investee company accounted for under the equity method
Sceptre Industries, Inc. (“Sceptre”)	Investee company accounted for under the equity method
Compower International Ltd. (“Compower”)	Investee company accounted for under the equity method
Acbel Polytech Inc. (“Acbel”)	The same chairman

(b) Summary of significant transactions with related parties

1. Sales

	<u>Six-month period ended June 30</u>				
	<u>2001</u>		<u>2002</u>		
	<u>(unaudited)</u>				
	<u>Amount</u>	<u>% of</u>	<u>Amount</u>	<u>% of</u>	<u>Amount</u>
	<u>NT\$</u>	<u>net sales</u>	<u>NT\$</u>	<u>net sales</u>	<u>U.S.\$</u>
Bizom	388,720	1.2	485,886	0.9	14,521
Sceptre	267,923	0.8	20,177	—	603
Compower	63,262	0.2	192,248	0.4	5,746
CII	—	—	464,127	0.9	13,871
Vacom	—	—	111,367	0.2	3,328
Other	<u>577</u>	<u>—</u>	<u>103,826</u>	<u>0.2</u>	<u>3,103</u>
	<u>720,482</u>	<u>2.2</u>	<u>1,377,631</u>	<u>2.6</u>	<u>41,172</u>

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Sale prices to related parties were similar to those for third-party customers. The collection periods were approximately 75 to 120 days for Bizcom, 30 to 88 days for Sceptre, 90 days for Compower, 30 days for CII, and 45 days for Vacom.

2. Purchases

	Six-month period ended June 30				
	2001 (unaudited)		2002		
	Amount NT\$	% of net purchases	Amount NT\$	% of net purchases	Amount U.S.\$
PFG	649,115	2.2	—	—	—
Acbel	38,609	0.1	73,636	0.2	2,201
CCI	—	—	288,011	0.6	8,608
Vacom	—	—	119,461	0.3	3,570
Other	6,858	—	20,794	—	621
	<u>694,582</u>	<u>2.3</u>	<u>501,902</u>	<u>1.1</u>	<u>15,000</u>

Purchase prices for finished goods from related parties were similar to those from third-party suppliers.

3. Sales of raw materials to subsidiaries

The Company sells raw materials to its subsidiaries and then purchases finished goods back after assembly. Pursuant to SFC regulations, this type of transaction should not be treated as sales in the accompanying consolidated statements of income. Therefore, the Company offsetted the recognized revenues and costs from those transactions, which amounted to NT\$588,509 and NT\$115,844 for the six-month periods ended June 30, 2001 and 2002, respectively.

Other receivables resulting from the above sales of raw materials to subsidiaries as of June 30, 2001 and 2002, were as follows:

	June 30		
	2001 (unaudited)	2002	
	NT\$	NT\$	U.S.\$
PFG	508,042	—	—
Vacom	—	63,529	1,899
Botai	—	29,852	892
	<u>508,042</u>	<u>93,381</u>	<u>2,791</u>

4. The Company sold shares of IST at a book value of NT\$17,064 to Gempal in 2002. As of June 30, 2002, the receivable had been collected.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

5. Accounts receivable (payable)

The balances resulting from the above sales and purchases as of June 30, 2001 and 2002, were as follows:

	June 30				
	2001 (unaudited)		2002		
	Amount NT\$	%	Amount NT\$	%	Amount U.S.\$
Accounts receivable:					
Sceptre	468,055	5.0	440,316	2.8	13,159
Bizcom	357,345	3.8	351,368	2.2	10,501
CCI	78,501	0.8	—	—	—
Compower	59,873	0.6	113,586	0.7	3,395
CII	—	—	391,173	2.5	11,691
CEUK	—	—	126,951	0.8	3,794
Other	38,737	0.4	34,716	0.3	1,038
	<u>1,002,511</u>	<u>10.6</u>	<u>1,458,110</u>	<u>9.3</u>	<u>43,578</u>
Less: allowance for doubtful accounts	<u>(68,124)</u>	<u>(0.7)</u>	<u>(153,664)</u>	<u>(1.0)</u>	<u>(4,593)</u>
	<u>934,387</u>	<u>9.9</u>	<u>1,304,446</u>	<u>8.3</u>	<u>38,985</u>
Accounts payable:					
PFG	210,697	1.9	—	—	—
Acbel	848	—	38,925	0.2	1,163
Vacom	—	—	21,705	0.1	649
Other	2,345	—	5,256	—	157
	<u>213,890</u>	<u>1.9</u>	<u>65,886</u>	<u>0.3</u>	<u>1,969</u>

6. Financing

The Group's loan to related parties was as follows:

	Six-month period ended June 30, 2002					
	Ending balance	Maximum balance	Interest rate	Period	Interest income	Interest receivable
	NT\$	NT\$			NT\$	NT\$
CEUK	<u>21,825</u>	<u>33,600</u>	2.34%	2002.3.27~2002.9.26	<u>79</u>	—
Gempal	<u>137,500</u>	<u>137,500</u>	2.75%	2001.12.28~2002.10.17	<u>1,754</u>	<u>311</u>

The Group did not retain any collateral from CEUK and Gempal.

7. Rental Income

The Company entered into an agreement with its subsidiary CCI to lease a portion of its office space and plants for one year. The related rental income after deducting the related depreciation expenses for the six-month periods ended June 30, 2001 and 2002, amounted to NT\$9,748 and NT\$14,699, respectively.

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

8. Guarantees

	June 30	
	2001 (unaudited)	2002
	U.S.\$	U.S.\$
Loan guarantee:		
Sceptre.....	7,000	7,000
Bizcom.....	2,000	2,000
CII.....	—	5,000
Credit guarantee		
CEUK.....	1,000	1,000

(19) Pledged Assets

There were no pledged assets as of June 30, 2001 and 2002.

(20) Commitments and Contingencies

(a) As of June 30, 2002, the unused balance of the Company's letters of credit for the purchase of materials was approximately NT\$682,614.

(b) On October 13, 2000, Samsung Electronics Co., Ltd. ("Samsung") brought a civil lawsuit in the State Court of California against the Company and various other companies related to patent rights infringement and sought damages. The Company believes it has meritorious defenses, including defenses of patent non-infringement and patent invalidity, and is vigorously defending itself against this case. Management engaged lawyers to deal with this case. The case was in the discovery stage as of June 30, 2002; the eventual outcome of this case is uncertain. However, even if the Company is required to pay royalties or damages, there would not be material adverse effects on the Company's business, financial condition or results of operations.

(c) On April 6, 2001, LG Electronics Co., Ltd. ("LG") brought a civil lawsuit in the State Court of California against the Company, Bizcom and Sceptre related to patent rights infringement and sought damages. Management engaged lawyers to deal with this case. The case was in the deposition stage as of June 30, 2002; the eventual outcome of this case is uncertain. However, even if the Company is required to pay royalties or damages, there would not be material adverse effects on the Company's business, financial condition or results of operations.

(d) On December 16, 2001, Thomsom Multimedia Licensing, Inc. ("RCA") filed a complaint in the State Court of New Jersey against the Company and CPC. RCA alleged that the Company sold monitors in the United State from approximately January 1, 1998 to the present without paying patent royalties and sought damages. Management engaged lawyers to deal with this case. The eventual outcome of this case is uncertain. However, even if the Company is required to pay royalties or damages, there would not be material adverse effects on the Company's business, financial condition or results of operations.

(e) See note 18 for guarantees made to related parties.

(21) Others

(a) In consideration of the payment for overseas raw materials purchase as well as the diversity and internationalization of fund raising, the board of directors of the Company decided to issue overseas unsecured convertible bonds with an upper limit of U.S.\$400,000 on April 23, 2002. The application was

COMPAL ELECTRONICS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

filed with SFC and approved on May 29, 2002. The Company will issue these bonds based on the market situation. As of the auditors' report date, the bonds had not been issued yet.

(b) As of June 30, 2002, the effective significant royalty agreements were as follows:

<u>Royalty Owners</u>	<u>Content</u>	<u>Period</u>
Phoenix Technologies, Ltd.	Produce, use, and sell quantitative Memory-Basic Input/Output Systems (BIOS)	Authorized a certain quantity; contract shall be renewed after quantity fulfilled
SystemSoft Corporation	Basic input system, keyboard control software and PCMCIA driver program	April 1998~March 2003
RCA Thomson Licensing Corporation	Produce, use, lease, sell and export color monitors which have patents in People's Republic of China; royalty is estimated by product volumes	January 1, 1998~December 31, 2002
Qualcomm Incorporated	Acquire related technologies for manufacturing and researching CDMA mobile phones	None
Qualcomm Incorporated	Royalty for producing, using, and selling CDMA mobile phones	Upon quantities sold
Lucent Technologies Inc.	Use specified GSM/GPRS technologies	July 2000~June 2003
Accelent Systems Inc.	Royalty for producing, using, and selling Pocket PCs	Upon quantities sold
Microsoft Corporation	Use of Windows CE in Pocket PCs	Authorized a certain quantity

(c) Reclassification

Certain accounts in the consolidated financial statements for the first half year of 2001 have been reclassified to conform with the 2002 presentation. Such reclassification does not have a significant impact on the accompanying consolidated financial statements.

APPENDIX A**FOREIGN INVESTMENT AND EXCHANGE CONTROLS IN THE ROC**

The information presented in this section has been extracted from publicly available documents which have not been prepared or independently verified by the Company, the Purchasers, the Depositary or any of their respective affiliates or advisors in connection with the Offering. References to the Securities and Futures Commission (the "ROC SFC") herein include both the ROC SFC and the ROC Securities and Exchange Commission, its predecessor.

General

Historically, foreign investments in the securities market of Taiwan were restricted. However, commencing in 1983, the Taiwan government has from time to time enacted legislation and adopted regulations to make foreign investment in the Taiwan securities market possible. Initially, only overseas investment trust funds of authorized securities investment trust enterprises established in Taiwan were permitted to invest in the Taiwan securities market. Since January 1, 1991, qualified foreign institutional investors have been allowed to make investments in the Taiwan listed securities market. Since March 1, 1996, overseas Chinese, foreign institutional and foreign individual investors (other than qualified foreign institutional investors), called "general foreign investors", have been permitted to make direct investments in the Taiwan listed securities market.

Qualified Foreign Institutional Investors

The Executive Yuan has approved guidelines for direct investment in securities listed on the Taiwan Stock Exchange or the OTC Securities Exchange in Taiwan by qualified foreign institutional investors. Qualified foreign institutional investors include:

- banks that hold securities assets of at least U.S.\$200 million, and have experience in the safekeeping or management of securities or assets and in international financial or trust business;
- insurance companies that hold securities assets of at least U.S.\$200 million;
- fund management institutions that manage securities assets of at least U.S.\$200 million;
- offshore fund management companies of which more than 50% of their capital is owned by a Taiwan securities investment trust enterprise, provided that the funds to be invested are not derived from sources in Taiwan or mainland China or owned by these offshore fund management companies;
- general securities firms that have a net worth of at least U.S.\$100 million and have experience in international securities investment;
- offshore subsidiary securities firms that are more than 50% owned by a Taiwan securities firm, or other securities firms that are wholly owned by these offshore subsidiary securities firms;
- offshore subsidiary securities firms that are wholly owned by a Taiwan securities firm, or other securities firms that are more than 51% owned by these offshore subsidiary securities firms;
- foreign government-owned investment institutions, provided that all of the funds to be invested are owned by the foreign government;
- pension funds;
- mutual funds, unit trusts or investment trusts that have assets of at least U.S.\$200 million;
- trust companies that hold securities assets in trust of at least U.S.\$200 million, and have experience in the safekeeping or management of securities or assets and in international financial or trust business; and

- any other professional institutional investors that hold securities or assets of at least U.S.\$200 million.

Each qualified foreign institutional investor wishing to invest directly in the Taiwan securities market is required to apply for an investment permit from the Securities and Futures Commission. If the investment amount exceeds U.S.\$50 million, an approval from the Central Bank of China is also required. The application to the Securities and Futures Commission and the Central Bank of China requires, among other things:

- the appointment of a local agent and custodian;
- proof of qualification; and
- a copy of the custodian contract.

Qualified foreign institutional investors who receive a permit may apply to invest up to U.S.\$3 billion and are required to remit the full amount into Taiwan within two years of receiving the investment permit. Capital remitted into Taiwan for investments in the Taiwan securities market may be repatriated at any time. The repatriated capital may be returned to Taiwan at any time within the approved two-year period without a Securities and Futures Commission approval, as long as its aggregate inward remittance after netting off its aggregate outward remittance does not exceed the investment amount approved by the ROC Securities and Futures Commission and Central Bank of China (if applicable). Capital gains and income on investments may also be repatriated at any time.

General Foreign Investors

General foreign investors may generally invest in Taiwan Stock Exchange-listed securities or securities traded on the OTC Securities Exchange up to a limit of U.S.\$50 million if they are institutional investors and U.S.\$5 million if they are individual investors, after obtaining the necessary approvals from the Taiwan Stock Exchange.

Foreign Ownership Limitations

Except for certain limits imposed by specific laws and regulations, there are generally no limits on the foreign ownership of the issued share capital in a Taiwan Stock Exchange-listed company or an OTC Securities Exchange-traded company.

Foreign Investment Approval

Other than:

- qualified foreign institutional investors;
- general foreign investors; and
- investors in overseas convertible bonds and depositary receipts,

foreign investors who wish to make direct investments in the shares of Taiwan companies may submit a "foreign investment approval" application to the Investment Commission of the Ministry of Economic Affairs of Taiwan or other governmental authority. Foreign investors who obtain this approval will be subject to the Law Governing Investments by Foreigners. The Investment Commission or other governmental authority reviews each foreign investment approval application and approves or disapproves the application after consultation with other governmental agencies. Any non-Taiwan person possessing a foreign investment approval may repatriate annual net profits, interests and cash dividends attributable to an approved investment. Stock dividends, investment capital and capital gains attributable to the investment may be repatriated with approval of the Investment Commission or other governmental authority.

In addition to the general restrictions against direct investment by non-Taiwan persons in Taiwan companies, non-Taiwan persons are currently prohibited from investing in prohibited industries in Taiwan which are listed under a Negative List, as amended. The prohibition on direct foreign investment in the prohibited industries in the Negative List is absolute and provides no specific exemption from its application. Under the Negative List, some industries are restricted so that non-Taiwan persons may directly invest only up to a specified level and with the specific approval of the relevant government authority.

Depository Receipts

In April 1992, the Securities and Futures Commission began allowing Taiwan companies listed on the Taiwan Stock Exchange to sponsor the issuance and sale of depository receipts evidencing depository shares. In December 1994, the Ministry of Finance began allowing companies whose shares are traded on the OTC Securities Exchange also to sponsor the issuance and sale of depository receipts evidencing depository shares. Approvals for these issuances are still required. Approvals are granted for a fixed number of depository receipts, if the underlying shares are newly issued shares, which may not be increased without a separate Securities and Futures Commission approval. Approvals are granted for a maximum number of depository receipts if the underlying shares are not newly issued shares.

No deposits of shares may be made in a depository receipt facility and no depository receipts may be issued against deposits without specific Securities and Futures Commission approval, unless they are:

- stock dividends;
- free distributions of shares;
- due to the exercise by depository receipt holders of their pre-emptive rights in the event of capital increases for cash; or
- due to the purchase by depository receipt holders, directly or through the depository, of shares on the Taiwan Stock Exchange or the OTC Securities Exchange for deposit in the depository receipt facility. In this event, the total number of depository receipts outstanding after an issuance cannot exceed the aggregate number of:
 - issued depository receipts previously approved by the Securities and Futures Commission; and
 - depository shares created from stock dividends, free distributions of shares and right offerings. These issuances of depository receipts may only be made to the extent that previously issued depository receipts have been cancelled and the shares have been sold on the Taiwan Stock Exchange or the Over-the-Counter Securities Exchange.

For depository shares that represent new shares, three months after the issuance of a depository receipt, a holder may request the depository to cause the underlying shares to be sold in Taiwan or to withdraw the shares and deliver the shares to the holder. For depository shares that represent previously existing shares, a holder may immediately after the issuance of depository receipts request the depository to cause the underlying shares to be sold in Taiwan or to withdraw the shares and deliver the shares to the holder.

A depository receipt holder wishing to withdraw shares represented by depository receipts in order to hold the shares is required to appoint a qualified local agent to, among other things, open a securities account with a local securities brokerage firm, remit funds and exercise shareholders' rights. In addition, the withdrawing holder is also required to appoint a custodian bank to hold the securities and cash proceeds in safekeeping, make confirmations, settle trades and report all relevant information. Without making this appointment and opening these accounts, the withdrawing holder would be unable to subsequently hold or sell the shares withdrawn from a depository receipt facility on the Taiwan Stock Exchange or otherwise. The withdrawing holder is also required to appoint a tax guarantor for filing tax returns and making tax payments.

A depositary may, without obtaining further approvals from the Central Bank of China or any other governmental authority or agency of Taiwan, convert New Taiwan Dollars from:

- the proceeds of the sale of shares represented by depositary receipts or received as stock dividends of the shares and deposited into the depositary receipt facility; or
- cash distributions received,

into other currencies, including U.S. Dollars. In addition, a depositary may convert into NT Dollars inward remittances of payments for purchases of underlying shares for deposit in the depositary facility against the creation of depositary shares. A depositary must obtain foreign exchange approval from the Central Bank of China on a payment-by-payment basis for conversion into foreign currencies from the proceeds from the sale of subscription rights for new shares. It is expected that the Central Bank of China will grant this approval as a routine matter. A depositary receipt holder may, after becoming a holder of shares, convert New Taiwan Dollars into other currencies from proceeds from the sale of any underlying shares withdrawn from the depositary receipt facility. Proceeds from the sale of the underlying shares withdrawn from the depositary receipt facility may be used for reinvestment in securities listed on the Taiwan Stock Exchange or traded on the Over-the-Counter Securities Exchange. These reinvestments will need to comply with the limitations and restrictions which apply to qualified foreign institutional investors or general foreign investors discussed above.

Overseas Corporate Notes

Since 1989, the Securities and Futures Commission has approved a series of overseas corporate bond issues by Taiwan companies listed on the Taiwan Stock Exchange and traded on the OTC Exchange. Under current ROC laws and regulations, these overseas corporate bonds (if their terms so provide) may be held or converted by non-Taiwan persons, other than mainland Chinese persons, into shares of Taiwan companies or, with Securities and Futures Commission approval, may be converted into depositary receipts issued under the sponsorship of the same Taiwanese company or the shares of other companies, in the case of exchangeable bonds. Public issuing companies may issue corporate debt in offerings outside Taiwan.

A non-Taiwanese converting bondholder, when exercising the conversion right to convert the bonds into shares of a Taiwan company, is required to appoint a qualified local agent to:

- open a securities trading account with a local brokerage firm;
- remit funds;
- exercise shareholders' rights; and
- perform other matters.

In addition, the converting holder is also required to appoint a custodian bank to hold the securities and cash proceeds in safekeeping, make confirmations and settle trades and report all relevant information. Without making this appointment and opening these accounts, the converting holder would be unable to subsequently hold or sell the shares converted from the bonds on the Taiwan Stock Exchange or otherwise. The converting holder is also required to appoint a tax guarantor for filing tax returns and making tax payments. Without obtaining further approvals from the Central Bank of China or any other governmental authority or agency of Taiwan, the issuing company may convert New Taiwan Dollars into other currencies for redemption of the bonds or the repayment of the principal or interest on the bonds. In addition, a converting bondholder may through its local agent convert net proceeds realized from the sale of shares or any stock dividends on the shares. In addition, a bondholder may also convert through its local agent any cash distributions relating to the shares and, after becoming a shareholder, onward remittances of subscription payments in connection with a rights offering.

In addition, any funds received by the converting bondholder may be used for reinvestment in Taiwan securities listed on the Taiwan Stock Exchange or traded on the OTC Exchange. These reinvestments will

need to comply with the limitations and restrictions which apply to qualified foreign institutional investors or general foreign investors discussed above.

Exchange Controls

Taiwan's Foreign Exchange Control Statute and regulations provide that all foreign exchange transactions must be executed by banks designated by the Ministry of Finance and by the Central Bank of China to handle foreign exchange transactions. Current regulations favor trade-related foreign exchange transactions. Consequently, foreign currency earned from exports of merchandise and services may now be retained and used freely by exporters. All foreign currency needed for the importation of merchandise and services may be purchased freely from the designated foreign exchange banks.

Aside from trade-related foreign exchange transactions, Taiwan companies and residents may, without foreign exchange approval, remit to and from Taiwan foreign currencies of up to U.S.\$50 million, or its equivalent, and U.S.\$5 million, or its equivalent, respectively, each calendar year. These limits apply to remittances involving a conversion between New Taiwan Dollars and U.S. Dollars or other foreign currencies. In addition, all private enterprises are required to register all medium and long-term foreign debt with the Central Bank of China.

In addition, a foreign person may, subject to certain requirements but without foreign exchange approval, remit to and from Taiwan foreign currencies of up to U.S.\$100,000 per remittance if the required documentation is provided to the Taiwan authorities. This limit applies only to remittances involving a conversion between New Taiwan Dollars and U.S. Dollars or other foreign currencies.

APPENDIX B**THE SECURITIES MARKET OF THE ROC**

The information presented in this section has been extracted from publicly available documents which have not been prepared or independently verified by the Company, the Purchasers, the Depositary or any of their respective affiliates or advisors in connection with the Offering.

The Taiwan Stock Exchange

In 1961, the Securities and Futures Commission established the Taiwan Stock Exchange to provide a marketplace for securities trading. The Taiwan Stock Exchange is a corporation owned by government-controlled and private banks and enterprises. The Taiwan Stock Exchange is independent of entities transacting business through it, each of which pays a user's fee. Generally, all transactions in listed securities by brokers, traders and integrated securities firms must be made through the Taiwan Stock Exchange.

The Taiwan Stock Exchange commenced operations in 1962. During the early 1980s, the Securities and Futures Commission actively encouraged new listings on the Taiwan Stock Exchange and the number of listed companies grew from 119 in 1983 to 595 as of December 31, 2001. As of March 31, 2002 the market capitalization of companies listed on the Taiwan Stock Exchange was approximately NT\$11,584.56 billion.

Historically, Taiwan companies have listed only shares and bonds on the Taiwan Stock Exchange. However, the Securities and Futures Commission has encouraged companies to list other types of securities. In 1988, the Securities and Futures Commission permitted the issuance of the Taiwan first convertible bonds. Since 1989, there have been offerings of domestic convertible bonds and convertible preferred shares. In addition, beneficiary units evidencing beneficiary interests in closed-end investment funds and bonds issued by the Asian Development Bank and other foreign banks are also listed on the Taiwan Stock Exchange or traded on the OTC Securities Exchange of Taiwan. The Securities and Futures Commission also has regulations which permit foreign issuers to list their equity securities directly on the Taiwan Stock Exchange or through the use of depositary receipts. To date, two foreign issuers have listed their equity securities on the Taiwan Stock Exchange through the use of depositary receipts in accordance with these regulations.

The Taiwan Stock Exchange requirements for listing are based on the following company attributes:

- the number and distribution of stockholders;
- length of time in business;
- amount of capital; and
- profitability.

However, special listing criteria apply to technology companies and key businesses engaging in national economic development.

The OTC Securities Exchange

To complement the Taiwan Stock Exchange, the OTC Securities Exchange was established in September 1982 on the initiative of the Securities and Futures Commission to encourage the trading of securities of companies who do not qualify for listing on the Taiwan Stock Exchange. As of March 31, 2002, 380 companies had listed equity securities on the OTC Securities Exchange and the total market capitalization of those companies was NT\$1,783.88 billion.

Taiwan Stock Exchange Index

The Taiwan Stock Exchange index is calculated on the basis of a wide selection of listed shares weighted according to the number of shares outstanding. This weighted average method is also used for the Standard and Poor's Index in the United States and the Nikkei Stock Average in Japan. The Taiwan Stock Exchange Index is compiled by dividing the market value by the base day's total market value for the index shares. The Taiwan Stock Exchange Index is the oldest and most widely quoted market index in Taiwan.

The weighting of stocks in the index is fixed as long as the number of shares outstanding remains constant. When the total number of shares outstanding changes, the weight of each stock is adjusted. Stock splits and stock dividends are adjusted automatically. Cash dividends are not included in the calculation.

The following table sets out for the periods indicated information relating to the Taiwan Stock Exchange Index.

<u>Period ended December 31,</u>	<u>Number of listed companies at the period end</u>	<u>Index high</u>	<u>Index low</u>	<u>Index at period end</u>
1990	199	12,495.34	2,560.47	4,503.16
1991	221	6,305.22	3,316.26	4,600.67
1992	256	5,391.63	3,327.67	3,377.06
1993	285	6,070.56	3,135.56	6,070.56
1994	313	7,183.75	5,194.63	7,124.66
1995	347	7,051.49	4,503.37	5,173.73
1996	382	6,982.81	4,690.22	6,933.94
1997	404	10,116.84	6,820.35	8,187.27
1998	437	9,277.09	6,251.38	6,418.43
1999	462	8,608.91	5,474.79	8,448.84
2000	531	10,202.20	4,614.63	4,739.09
2001	584	6,104.24	3,446.26	5,551.24

Sources: Status of Securities Listed on Taiwan Stock Exchange, Bloomberg.

As indicated above, the performance of the Taiwan Stock Exchange has in recent years been characterized by extreme price volatility.

Price Limits, Commissions, Transaction Tax and Other Matters

The Taiwan Stock Exchange has placed limits on block trading and on the range of daily price movements. Transactions that involve 500 trading lots (500,000 shares) or more must be registered and executed under Taiwan Stock Exchange guidelines. Fluctuations in the price of securities traded on the Taiwan Stock Exchange is restricted to 7% above and below the previous day's closing price in the case of equity securities, and 5% in the case of debt securities. The price limit for movements below the previous day's closing price has been modified from time to time by the Ministry of Finance based on market conditions.

Effective July 1, 2000, brokerage commission can be set at any rate not exceeding 0.1425% of the transaction price subject to reporting to the Taiwan Stock Exchange.

A securities transaction tax of 0.3% of the transaction price is payable by the seller of equity securities. The securities transaction taxes are withheld at the time of the transaction.

Sales of shares of listed companies on the Taiwan Stock Exchange are generally sold in "round lots" of 1,000 shares. Investors who desire to sell less than 1,000 shares of a listed company occasionally

experience delays in making these sales. Transactions that involve 500 trading lots (500,000 shares) or more must be registered and executed in accordance with Taiwan Stock Exchange guidelines.

Regulation and Supervision

The Securities and Futures Commission has extensive regulatory authority over public companies. Public companies are generally required to obtain approval from, or registration with, the Securities and Futures Commission for all securities offerings. The Securities and Futures Commission requires periodic reporting of financial and operating information by all public companies. In addition, the Securities and Futures Commission establishes standards for financial reporting and carries out licensing and supervision of participants in the Taiwan securities market.

The Securities and Futures Commission has responsibility for implementing the Securities and Exchange Law and for overall administration of governmental policies in the Taiwan securities market. It has extensive regulatory authority over the offering, issuing and trading of securities. In addition, the Securities and Exchange Law specifically empowers the Securities and Futures Commission to promulgate necessary rules. The Securities and Exchange Law prohibits market manipulation. For example, it permits an issuer to recover short-term trading profits made through purchases and sales within six months by directors, managerial personnel, supervisors and stockholders who (together with their spouses, minor children and nominees) hold 10% or more of the shares of the issuer, together with the spouses, minor children and nominees of these parties. The Securities and Exchange Law prohibits trading by "insiders" based on non-public information that materially affects share price movement. "Insiders" include:

- directors, supervisors, managers and shareholders who (together with their spouses, minor children and nominees) hold 10% or more of the issuing company's shares (together with the spouses, minor children and nominees of these parties);
- any person who has learned material, non-public information due to an occupational or controlling relationship with the issuing company; and
- any person who has learned material, non-public information from any of the above.

Sanctions include imprisonment. In addition, damages may be awarded to persons injured by the transaction.

The Securities and Exchange Law also imposes criminal liability on certified public accountants and lawyers who make false certifications in their examination and audit of an issuer's contracts, reports and other documents related to securities transactions. The Securities and Futures Commission regulations require that financial reports of listed companies be audited by accounting firms consisting of at least three certified public accountants and be signed by at least two certified public accountants.

In addition, the Securities and Exchange Law provides for civil liability for material misstatements or omission made by issuers, and regulation of tender offers.

The Securities and Futures Commission does not have criminal or civil enforcement powers under the Securities and Exchange Law. Criminal actions may be pursued only by government prosecutors. Civil actions may only be brought by plaintiffs who assert that they have suffered damages. The Securities and Futures Commission is empowered to curb abuses and violations of laws and regulations only through administrative measures including:

- issuance of warnings;
- temporary suspension of operation;
- imposition of administrative fines; and
- revocation of licenses.

In addition to providing a market for securities trading, the Taiwan Stock Exchange reviews applications by Taiwan issuers to list securities on the Taiwan Stock Exchange. If issuers of listed securities violate laws and regulations or encounter significant difficulties, the Taiwan Stock Exchange may, with the approval of the Securities and Futures Commission, delist securities of these issuers.

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Compal Electronics, Inc.

Zero Coupon Convertible Notes due 2007



October 4, 2002

Salomon Smith Barney

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