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ROMAN FINANCIAL PRESS LIMITED

21/F, Wheelock House, 20 Pedder Street, Central Hong Kong

Tel: (852) 2850 6933 Fax: (852) 2850 6050

Customer Services Hotline: (852) 2850 6000

<http://www.hkroman.com>



KING YUAN ELECTRONICS CO., LTD.

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



US\$90,000,000

Convertible Zero Yield Puttable Securities (ZYPSsm) due 2009

We are offering US\$90,000,000 Convertible Zero Yield Puttable Securities Due 2009, or the ZYPS. The ZYPS will be issued on January 16, 2004 and mature on January 16, 2009 at 100% of their principal amount. Lehman Brothers International (Europe) is entitled at any time, in whole or in part on one or more occasions, up to and including the date 30 days after the closing date of this offering, to require us to issue up to a further US\$10,000,000 aggregate principal amount of ZYPS. The ZYPS will bear interest only in the limited circumstances set forth herein.

The ZYPS are convertible at the holders' option at any time, except during certain closed periods, on or after February 16, 2004 and before the close of business on December 31, 2008 into our common shares, par value NT\$10 per share, which we refer to as our shares. The initial conversion price will be NT\$43.875 per share with a fixed exchange rate applicable on conversion of ZYPS of NT\$33.80 = US\$1.00, subject to adjustment in certain events. We may at our option pay cash in lieu of delivery of our shares.

On or after July 16, 2005, we may redeem the ZYPS, in whole or in part in integral multiples of US\$10,000, at 100% of their principal amount if our shares have achieved and maintained the price levels specified in this offering memorandum. At any time, we may redeem the ZYPS, in whole but not in part, at 100% of their principal amount if the aggregate principal amount of the ZYPS that remain outstanding is less than 5% of the aggregate principal amount of ZYPS originally issued, including ZYPS issued at the option of Lehman Brothers International (Europe). If specified changes relating to Republic of China taxation occur, we may redeem the ZYPS, in whole but not in part, at 100% of their principal amount. You may require us to redeem the ZYPS that you hold, in whole or in part in integral multiples of US\$10,000, at 100% of their principal amount on January 16, 2006, 2007 and 2008. You may require us to repurchase the ZYPS, in whole or in part in integral multiples of US\$10,000, at their principal amount upon the delisting of our shares or upon the disposition of all or substantially all of our assets.

Our shares are listed on the Taiwan Stock Exchange, or the TSE, and we will apply to designate the shares to be issued on conversion of the ZYPS for trading on the TSE. On January 9, 2004, the closing price of our shares on the TSE was NT\$37.50 per share. We have applied to list the ZYPS on the Luxembourg Stock Exchange. The Rule 144A ZYPS have been made eligible for trading on the PORTAL Market.

See "Risk Factors" on page 12 for a discussion of certain factors to be considered in connection with an investment in the ZYPS.

Issue Price: 100%

The ZYPS and our shares to be issued upon conversion of the ZYPS have not been and will not be registered under the U.S. Securities Act of 1933, as amended, or the U.S. Securities Act, and, subject to certain exceptions, may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons, except to qualified institutional buyers in reliance on the exemption from registration provided under Rule 144A under the U.S. Securities Act, or Rule 144A, and to certain persons in offshore transactions in reliance on Regulation S under the U.S. Securities Act, or Regulation S. See "Transfer Restrictions" and "Plan of Distribution."

ZYPS sold in reliance on Rule 144A, or Rule 144A ZYPS, will be represented by a Rule 144A global certificate and ZYPS sold in reliance on Regulation S, or Regulation S ZYPS, will be represented by a Regulation S global certificate. The Rule 144A global certificate will be deposited with a custodian for and registered in the name of a nominee of The Depository Trust Company, or DTC, for the account of its direct and indirect participants. The Regulation S global certificate will be deposited with and registered in the name of a common depository for Euroclear Bank S.A./N.V., as operator of the Euroclear System, which we refer to as Euroclear, and Clearstream Banking, *société anonyme*, which we refer to as Clearstream. Delivery of the ZYPS is expected on or about January 16, 2004.

LEHMAN BROTHERS

Sole Bookrunner

January 9, 2004

"ZYPSsm" is a service mark owned by Lehman Brothers, Inc.

You should rely only on the information contained in this offering memorandum. None of us or Lehman Brothers International (Europe) and the other managers named in “Plan of Distribution” below, collectively referred to herein as the managers, has authorized anyone to provide you with different information. Neither we, nor the managers, are making an offer of these securities in any state where such offer is not permitted. You should not assume that the information contained in this offering memorandum is accurate as of any date other than the date on the front cover of this offering memorandum. Our business, financial condition, results of operations and prospects may have changed since that date.

No United States federal, state or foreign securities commission or regulatory authority has recommended the ZYPS or reviewed, passed on, determined or confirmed the accuracy or adequacy of this offering memorandum. Any representation to the contrary may be a criminal offense.

We accept responsibility for the information contained in this offering memorandum. We, having made all reasonable enquiries, confirm that this offering memorandum contains all information with respect to us, our subsidiaries, the ZYPS and our shares that is material in the context of the issue and offering of the ZYPS, that the information contained in this offering memorandum is true and accurate in all material respects and is not misleading, that the opinions and intentions expressed are honestly held and have been reached after considering all relevant circumstances and are based on reasonable assumptions, that there are no other facts, the omission of which would, in the context of the issue and offering of the ZYPS, make this offering memorandum as a whole or any of such information or the expression of any such opinions or intentions misleading in any material respect and that all reasonable enquiries have been made by us to verify the accuracy of such information and that this offering memorandum does not contain an untrue statement of a material fact or omit to state a material fact required to be stated or necessary in order to make the statements, in the light of the circumstances under which they are made, not misleading.

The distribution of this offering memorandum and the offering and sale of the ZYPS in certain jurisdictions may be restricted by law. Persons into whose possession this offering memorandum comes are required by us and the managers to inform themselves about and to observe any such restrictions. For a description of certain further restrictions on offers and sales of the ZYPS and distribution of this offering memorandum, see “Transfer Restrictions” and “Plan of Distribution.” This offering memorandum does not constitute an offer of, or an invitation by or on behalf of us or the managers to subscribe for or purchase any of the ZYPS in any jurisdiction in which such offer or invitation would be unlawful. This offering memorandum may be used only for the purposes for which it has been published.

You are hereby notified that sellers of the ZYPS may be relying on the exemption from the provisions of Section 5 of the U.S. Securities Act provided by Rule 144A.

The ZYPS will not be offered or sold 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. The managers have complied and will comply with all provisions of the Financial Services and Markets Act 2000, or the FSMA, with respect to anything done by them in relation to the ZYPS in, from or otherwise involving the United Kingdom.

In connection with this offering, Lehman Brothers International (Europe) or any person acting for it may over-allot or effect transactions that stabilize or maintain the market price of the ZYPS or our shares at a level above that which might otherwise prevail for a limited period after the issue date. However, there is no obligation on Lehman Brothers International (Europe) or any of its agents to do so. Such stabilizing, if commenced, may be discontinued at any time and must be brought to an end after a limited period.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

All statements contained in this offering memorandum, statements made in press releases and oral statements that may be made by us or our officers, directors or employees acting on our behalf that are not statements of historical fact constitute “forward-looking statements.” You can identify some of these forward-looking statements by terms such as “expects,” “believes,” “plans,” “intends,” “estimates,” “anticipates,” “may,” “will,” “would” and “could” or similar words. However, you should note that these words are not the exclusive means of identifying forward-looking statements. All statements regarding our expected financial position, business strategy, plans and prospects are forward-looking statements. These forward-looking statements, including statements as to:

- our expected test machine utilization rates as we install newer test equipment;
- our capital expenditure plans;
- our future revenue and profitability;
- our expansion into the PRC;
- our ability to attract and retain significant new and existing customers;
- expected growth in consumer demand;
- expected terms or outcome of our turnkey relationship;
- other expected industry trends;
- anticipated dates for new or ongoing projects; and
- other matters discussed in this offering memorandum regarding matters that are not historical facts,

are only forecasts based on information currently available to us. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. These risks, uncertainties and other factors include, among others:

- changes in political, social and economic conditions and the regulatory environment in the ROC and the PRC;
- changes in currency exchange rates;
- our rate of growth and ability to meet the demands relating to our growth;
- changes in market prices for our services;
- changes in the availability and prices of raw materials and machinery and equipment we need to provide our services;
- changes in customer preferences;
- changes in competitive conditions and our ability to compete under these conditions; and
- other factors beyond our control.

Given the risks and uncertainties that may cause our actual future results, performance or achievements to be materially different than expected, expressed or implied by the forward-looking statements in this offering memorandum, we advise you not to place undue reliance on those statements. We are not representing or warranting to you that our actual future results, performance or achievements will be as discussed in those statements. Further, we disclaim any responsibility to update any of those forward-looking statements or publicly announce any revisions to those forward-looking statements to reflect future developments, events or circumstances.

FOR NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER RSA 421-B WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 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 TRANSACTION MEANS THAT THE SECRETARY OF STATE OF NEW HAMPSHIRE 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.

ENFORCEABILITY OF FOREIGN JUDGMENTS IN THE ROC

We are a company limited by shares and incorporated under the Company Law of the ROC. Most of our directors, executive officers and supervisors and certain of the experts named in this offering memorandum are residents of the ROC and substantially all of our assets and such persons are located in the ROC. As a result, it may be difficult for investors to enforce judgments obtained outside the ROC against us or such persons in the ROC, including those predicated upon the civil liability provisions of the federal securities laws of the United States. Any final judgment obtained against us 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 ZYPS or our shares will not be enforced by the courts of the ROC if any of the following applies to such final judgement:

- the court rendering the judgment did not have jurisdiction over the subject matter according to the laws of the ROC;
- the judgment or the procedures undertaken by the foreign court was contrary to the public order or good morals of the ROC;
- if we as the defeated party did not respond to the action, except where the summons or order necessary for the commencement of the action was legally served on us within the jurisdiction of such court within a reasonable period of time, or with the assistance of the judicial authorities of the ROC; and
- judgments made by the ROC courts are not reciprocally recognized by the court rendering the judgment.

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 for the remittance out of the ROC of any amounts recovered in respect of such judgment denominated in a currency other than N.T. dollars.

CERTAIN CONVENTIONS AND OTHER DATA

All references in this offering memorandum to “Taiwan” or the “ROC” are to the island of Taiwan and other areas under the effective control of the Republic of China, and all references to the “ROC government” are references to the government of the Republic of China. All references to “we,” “us” and “our” in this offering memorandum are references to King Yuan Electronics Co., Ltd., and, as the context may require, our subsidiaries. Any discrepancies in any table between totals and sums of the amounts listed are due to rounding.

We publish our financial statements in New Taiwan dollars, the lawful currency of the ROC. In this offering memorandum references to “United States dollars,” “U.S. dollars” and “US\$” are to United States dollars and references to “New Taiwan dollars,” “N.T. dollars” and “NT\$” are to New Taiwan dollars, the currency of the ROC. Unless otherwise noted, all translations from N.T. dollars to U.S. dollars were made at the noon buying rate in The City of New York for cable transfers in N.T. dollars per U.S. dollar as certified for customs purposes by the Federal Reserve Bank of New York, or the noon buying rate, as of September 30, 2003, which was NT\$33.78 = US\$1.00 as of that date. All amounts translated into U.S. dollars in this offering memorandum are provided solely for your convenience and no representation is made that the N.T. dollar or U.S. dollar amounts referred to in this offering memorandum could have been or could be converted into U.S. dollars or N.T. dollars, as the case may be, at any particular rate or at all. For further information relating to exchange rates, see “Exchange Rates.” On January 9, 2004, the noon buying rate was NT\$33.75 = US\$1.00.

AVAILABLE INFORMATION

If, at any time, we are neither subject to Section 13 or 15(d) of the U.S. Securities Exchange Act of 1934, as amended, or the U.S. Securities Exchange Act, nor exempt from reporting pursuant to Rule 12g3-2(b) under the U.S. Securities Exchange Act, we will furnish, upon request, to any person in whose name a ZYPS or our share is registered on the books maintained by our registrar, any holder of any ZYPS or share or any prospective purchaser designated by a holder, the information required to be delivered pursuant to Rule 144A(d)(4) under the U.S. Securities Act. Alternatively, a holder may obtain such information at the offices of the Luxembourg listing and transfer agent, The Bank of New York (Luxembourg) S.A., at its office located at Aerogolf Center, 1A Hoehenhof, L-1736 Senningerberg, Luxembourg, as such information will be provided free of charge to any person in Luxembourg who requests it.

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SUMMARY

This summary highlights information contained elsewhere in this offering memorandum. This summary may not contain all of the information that you should consider before deciding to invest in the ZYPS. We urge you to read this entire offering memorandum carefully, including the "Risk Factors" section on page 12 and our financial statements, including the notes to those statements, which have been prepared and presented on an unconsolidated basis in accordance with generally accepted accounting principles in the ROC, or ROC GAAP.

Overview

We are one of Taiwan's leading independent providers of semiconductor test and other backend semiconductor manufacturing services. We believe we are the only ROC company to provide the full range of integrated circuit test services. Our test services include wafer probing and final test for logic, mixed signal and memory devices. Other backend semiconductor manufacturing services provided by us include wafer grinding and dicing, chip-on-board packaging, tape and reel and drop shipment of finished semiconductor devices. We do not generally provide packaging services to our clients other than selected chip-on-board packaging, but act as a turnkey for some customers, working with packaging and other service providers to facilitate all backend semiconductor manufacturing services from wafer probing to drop shipment.

Our corporate headquarters, test and processing facilities are located in the Hsin-Chu semiconductor manufacturing corridor of Taiwan, where we owned 674 testing machines, and operated another 72 testers which were consigned or rented from third parties or held on a demonstration basis as of December 20, 2003. Taiwan is home to the world's largest independent wafer foundries and as such is home to some of the world's leading suppliers of outsourced semiconductor manufacturing services. Our close proximity to and relationships with Taiwan's leading wafer foundries allow us to benefit significantly from the trend towards outsourcing in the semiconductor industry and to quickly respond to our customers' needs. Our location in Taiwan also enables our customers to secure seamless services within Taiwan for all of their manufacturing needs, thereby minimizing the time required to deliver finished semiconductor devices to the market.

Our customers include major fabless integrated circuit design companies, integrated device manufacturers and semiconductor foundries. We provide services to customers producing a wide range of semiconductors. We believe some of the world's largest semiconductor manufacturers rely on both the quality of our test services and our ability to meet all of their testing needs. In 2003, we serviced customers including Advanced Micro Devices, Incorporated, Macronix International Corporation, MediaTek Incorporated, Silicon Storage Technology, Incorporated, United Microelectronics Corporation, Fujitsu Limited, Winbond Electronics Corporation, Powerchip Semiconductor Corporation, SanDisk Corporation and Toshiba Corporation. We service our customers with a direct sales force located in Taiwan, Japan and the United States. In addition to our sales team, we have technical personnel in Taiwan who provide our clients with on-site planning, calibration and coordination of our testing services.

We have shareholding relationships with a testing and packaging service provider and some of our key customers. Siliconware Precision Industries Co., Ltd., or SPIL, our largest shareholder, held 11.23%, of our outstanding shares and Silicon Storage Technology, Incorporated, one of our key customers, held 0.55% of our outstanding shares, each as of September 30, 2003. We have a turnkey relationship with SPIL, which operates in the field of semiconductor assembly. Pursuant to our turnkey relationship, we will utilize SPIL's assembly services as part of our managing the entire semiconductor backend manufacturing process for a customer. Under our relationship with SPIL, neither we nor SPIL receives commissions for referring business to each other, but collects fees for our respective services from each of our respective clients, which are passed directly on to the turnkey partner. In the past we entered into a contractual turnkey arrangement with Amkor Technology, Inc., which lapsed in accordance with its terms in September 2002.

Our legal and commercial name is King Yuan Electronics Co., Ltd. We were incorporated under the ROC Company Law as a company limited by shares on May 28, 1987 and our shares were listed on the Taiwan Stock Exchange in May 2001. Our principal executive offices are located at No. 1, Lane 99, Pu-Ding Road, Hsin-Chu 300, Taiwan, Republic of China, and our telephone number is 886-3-5751888. Our Internet website address is www.kyec.com.tw. Our website does not constitute a part of this offering memorandum.

Our Strategy

Continue to offer the broadest range of semiconductor testing services to our customers

Many of our customers require a wide range of test technologies for logic, mixed signal and memory devices. We believe we possess one of the most comprehensive sets of testing technology among our competitors, including the ability to test logic, mixed signal and memory semiconductors, CMOS image sensors, charge-coupled devices, LCD drivers, radio frequency chips and simple logic embedded memory devices and other SOC's. We are able to provide testing services for certain devices, such as CMOS image sensors, which certain of our competitors are not yet able to test. We provide memory test services for most types of memory devices in production, including up to one gigabit memory chips and logic and mixed signal testing for some of the fastest chipsets, currently up to 800 megahertz. We believe our ability to act as a single solution for most of our customers' testing needs makes us their preferred choice as a testing partner.

We intend to continually expand our portfolio of test technologies through internal development, joint development with customers and continued investment. We believe that leading technological capability is our most valuable asset, and that the ability to offer leading test technologies for the most complex integrated circuit devices is critical to attracting and retaining customers and maintaining high margins. We are currently developing test technologies which allow us to test newly developed sophisticated semiconductors such as chips with SOC technologies and advanced radio frequency chips which are utilized in telecommunication devices.

Maximize utilization rate of and continue to invest in leading edge technology and equipment

The high fixed cost and relatively short lifecycles of our equipment make maintaining high equipment utilization rates and hourly test charges key to the profitability of our operations. Our depreciation costs constituted 54.6% of our manufacturing cost for the nine months ended September 30, 2003, while variable costs accounted for just 20.0% in the same period. Our test revenues are based on hourly rates for the testing machines used to test our clients' products. In addition to market demand, test charges for a single machine may vary depending on the product tested, with more complex devices that require the most advanced test equipment and testing configurations generally commanding higher hourly test charges. By maintaining a steady flow of customer orders, carefully planning product testing cycles to maximize testing time per machine and continuing to obtain high-end test work from our clients, we expect to continue to increase our utilization rates and hourly test charges, and thus our operating margins.

We have made significant investments to construct, fit-out and equip large-scale facilities that deploy hundreds of sophisticated test units, to ensure that we have the necessary capability to design and perform our services. We will continue our investment, in a disciplined manner, in state-of-the-art equipment. We currently employ technologically advanced imported test machinery and equipment, and also cost-efficient test machinery designed and developed in-house. In addition to test equipment design and manufacture, our research and development team have developed processes for testing machines which reduce the time required to calibrate for new semiconductors, allow for quicker transition of semiconductors between machines and shorten the testing cycle time. This gives us the ability to test highly parallel, high speed, high pin-count and highly integrated devices, such as optical image-sensing integrated circuits, as well as the ability to achieve cost-efficient high volume testing of lower speed integrated circuits, all at speeds comparable to or faster than that of our competitors.

Provide customers with a full spectrum of backend semiconductor services directly and through our turnkey solutions

In addition to test services, our clients on occasion also require other backend semiconductor manufacturing services on a turnkey basis, which include packaging and assembly services, wafer grinding and dicing, chip-on-board packaging, tape and reel and drop shipment of the semiconductor devices. We believe that as semiconductor suppliers face shorter time-to-market demands and shorter product cycles, such backend services provided on a turnkey basis will become an increasingly important aspect of our customers' manufacturing and product distribution strategies. We are one of a small number of vendors capable of providing such backend services on a turnkey basis. Although we can provide most wafer grinding and dicing, tape and reel and drop shipment services to our customers, we lack the packaging capabilities, except for certain chip-on-board packaging solutions, that our customers require in their backend manufacturing process. We have therefore developed strong relationships with packaging service providers, in particular our shareholder SPIL, for the coordination of these turnkey services for our customers.

Leverage relationships with foundries to provide total solutions to customers

Our proximity to and demonstrated long-term relationship with Taiwan's leading foundries, including Taiwan Semiconductor Manufacturing Company Ltd. and United Microelectronics Corporation, provide our customers with unique advantages to conveniently access various manufacturing services and efficiently manage their supply chains. We conduct joint marketing with semiconductor foundries to capture the test and other backend semiconductor manufacturing requirements of their customers. These customers comprise principally integrated circuit design companies, integrated device manufacturers and systems original equipment manufacturers. We believe that by leveraging the relationships with these leading foundries, we are able to attract new customers as well as maintain our existing customers.

Focus on customer service and expand the customer base

We believe that our ability to anticipate and meet our customers' needs is critical to attracting and retaining leading semiconductor suppliers as customers. We strive to work closely with our customers on developing and fulfilling their current and future semiconductor test needs. We position ourselves as a high-tech service business and have a well established customer-oriented culture, and continuously enhance the quality, cost effectiveness, cycle times, and flexibility of our services. To provide a dedicated customer support infrastructure to our customers, we service our customers with a direct sales force located in Taiwan, Japan and the United States. In addition to our sales team, we have technical personnel in Taiwan who provide our clients with on-site planning, calibration and coordination of our testing services.

We intend to expand our customer base geographically by targeting customers located in the United States, Japan and Europe. We will expand our current sales and marketing team and the operations of our United States subsidiary, KYEC USA Corp. Currently, we schedule frequent visits by our sales team to Japan to visit existing customers and to secure new customers, which, for example, has resulted in our acquiring Fujitsu Limited as a customer. We have identified Europe as a potential market and intend to enhance our marketing efforts to European customers by scheduling regular visits by our sales and marketing team.

The Offering

Issuer	King Yuan Electronics Co., Ltd.
Offering.	US\$90,000,000 aggregate principal amount of Convertible Zero Yield Puttable Securities due 2009 to qualified institutional buyers in reliance on Rule 144A and to non-U.S. persons in offshore transactions in reliance on Regulation S.
Sole Bookrunner's Option	We have granted Lehman Brothers International (Europe) an option exercisable, in whole or in part, on one or more occasions up to and including the date 30 days after the closing date, to purchase up to an additional US\$10,000,000 principal amount of the ZYPS.
Offering Price.	100% of the principal amount of the ZYPS.
Closing Date	January 16, 2004.
Maturity Date	January 16, 2009.
Interest	The ZYPS will not bear interest except in the limited circumstances as described in "Description of the Convertible Zero Yield Puttable Securities — Default Interest."
Status of the ZYPS and Negative Pledge	The ZYPS will be our direct, unconditional, unsubordinated and, subject to the restriction on liens described in the next sentence, unsecured obligations and will at all times rank <i>pari passu</i> among themselves and with all of our other present and future direct, unconditional, unsubordinated and unsecured obligations. Neither we nor any of our subsidiaries will create security interests to secure the payment of, or guarantee or indemnity in respect of, any international investment securities (as defined herein) without granting equivalent security for the ZYPS. See "Description of the Convertible Zero Yield Puttable Securities — Status of the ZYPS and Negative Pledge."
Conversion Right	Except during certain closed periods described below, you may convert your ZYPS into our shares, at any time on or after February 16, 2004 and before the close of business on December 31, 2008 or, if such ZYPS are called for redemption prior to such date, then before the close of business on the date five days prior to the date fixed for redemption thereof (or, if such day is not a business day at the place where such ZYPS are deposited for conversion, on the immediately preceding business day at such place). The conversion price is initially NT\$43.875 per share. The conversion price may be adjusted as described in "Description of the Convertible Zero Yield Puttable Securities — Conversion — Adjustment to Conversion Price." Such price, as adjusted from time to time, is referred to as the conversion price. You will not be able to convert your ZYPS during certain closed periods, including: ● the 60 days immediately preceding each annual shareholders' meeting;

- the 30 days immediately preceding any special shareholders' meeting;
- the period beginning from three trading days prior to the day on which we notify the TSE of the record date for determination of shareholders' entitlement to dividends or other distributions or benefits with respect to our shares 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); and
- any period during which we are required by ROC law to suspend conversion or close our stock transfer books and accordingly may not lawfully issue any share capital.

See "Description of the Convertible Zero Yield Puttable Securities — Conversion — Conversion Terms."

Conversion Price Adjustment . .	The conversion price will be subject to adjustment for, among other things, subdivision or consolidation of our shares, bonus issues, rights issues and other dilutive events. See "Description of the Convertible Zero Yield Puttable Securities — Conversion — Adjustment to Conversion Price."
Conversion Price Reset	On October 16 of each year prior to maturity commencing in 2004, each of which is referred to as a reset date, if the average closing price of our shares on the TSE for the 20 consecutive trading days ending on such reset date, converted into U.S. dollars at the then prevailing rate, is less than the conversion price then in effect divided by 1.17 and converted into U.S. dollars at the fixed exchange rate of NT\$33.80 = US\$1.00, then the conversion price will be reset to such average closing price multiplied by 1.17; but any adjustment to the conversion price pursuant to the conversion price reset will be limited so that the adjusted conversion price will not be less than 80% of the initial conversion price (as adjusted from time to time for dilutive events, except for any conversion price reset, if applicable, prior to the relevant reset date). See "Description of the Convertible Zero Yield Puttable Securities — Conversion — Conversion Price Reset."
Special Conversion Price Reset .	We may at our option, during the 30 days preceding January 16, 2006, 2007, 2008 and 2009, each of such days referred to as a "special reset date," declare that the ZYPS will be convertible at 91% of the average closing prices of our shares on the TSE, whichever is the lowest, for any of the 10, 15 or 20 consecutive trading days during the 30 day period prior to the special reset date. Such reset will take effect within seven trading days beginning on the fifth trading day after the applicable special reset date, provided that no such adjustment may reduce the conversion price to less than 80% of the initial conversion price (as adjusted for dilutive events). See "Description of the Convertible Zero Yield Puttable Securities — Conversion — Special Conversion Price Reset."

Cash in Lieu of Delivery of

Shares	We may at our option make a cash settlement payment, which we refer to as a cash in lieu payment, in respect of all or any portion (being US\$10,000 in principal amount or any integral multiple thereof) of your ZYPS deposited for conversion pursuant to the exercise of a conversion right by delivering notice thereof to you not more than three trading days after the conversion date. Such cash settlement shall be an amount equal to the cash settlement market price (as defined herein) multiplied by the number of our shares which we elect not to deliver upon conversion and the resulting figure shall be rounded to the second decimal place with 0.005 being rounded upwards. If the cash in lieu payment is made for more than one ZYPS of the same holder of ZYPS, the cash settlement amount shall be calculated on the basis of the aggregate principal amount of ZYPS for which we make such cash in lieu payment. We shall pay such cash in lieu payment in U.S. dollars as promptly as practicable (but in no event later than three business days after the setting of the cash settlement market price, which shall also be a trading day). See “Description of the Convertible Zero Yield Puttable Securities — Conversion — Cash Payment in Lieu of Delivery of Our Shares.”
Redemption at Maturity	We will redeem the ZYPS at 100% of their principal amount on January 16, 2009.
Our Early Redemption Option. .	We may redeem the ZYPS, in whole or in part in integral multiples of US\$10,000, at any time on or after July 16, 2005 and prior to the maturity date at 100% of their principal amount if the average closing price of our shares (translated into U.S. dollars at the prevailing exchange rate) for each of the 30 consecutive trading days, the last of which occurs not more than five days prior to the date upon which notice of such redemption is given, is at least 125% of the conversion price per share (translated into U.S. dollars at the fixed exchange rate of NT\$33.80 = US\$1.00), as adjusted through, and in effect on, each such trading day. In addition, if at any time the aggregate principal amount of the ZYPS outstanding is less than 5% of the aggregate principal amount originally issued (including any ZYPS issued upon the exercise by the sole bookrunner of its option to purchase additional ZYPS), we have the option to redeem such outstanding ZYPS in whole but not in part at 100% of their principal amount.

Redemption for Taxation

Reasons

We may at any time (but not if notice of redemption has already been given to holders), at our option, redeem the ZYPS, in whole but not in part, at 100% of their principal amount if we determine that, as a result of any change in or amendment to the laws or regulations of the ROC or as further described under “Description of the Convertible Zero Yield Puttable Securities — Redemption, Repurchase and Cancellation — Redemption For Taxation Reasons,” we have been or will be required to pay additional amounts (as described under “Description of the Convertible Zero Yield Puttable Securities — Additional Amounts”) in excess of the additional amounts payable with respect to a deduction or withholding at a rate of 20% of the amount of any payments of interest (if any).

Redemption at the Option of the
Holders.

The holders may require us to redeem, in whole or in part in integral multiples of US\$10,000, the ZYPS on January 16, 2006, 2007 and 2008 at 100% of their principal amount.

Repurchase at the Option of the
Holders.

Additionally, the holders may require us to repurchase the ZYPS, in whole or in part in integral multiples of US\$10,000, at 100% of their principal amount if our shares are delisted or if we dispose of all or substantially all of our assets.

See “Description of the Convertible Zero Yield Puttable Securities — Redemption, Repurchase and Cancellation — Repurchase at the Option of Holders.”

Lockup Agreements. Subject to the exceptions discussed below, we and each of Siliconware Precision Industries Company Limited, C.K. Lee, D.F. Lin, Bright Shiao and China Development Industrial Bank have agreed that, for a 120-day period following the date of this offering memorandum, without the prior written consent of the sole bookrunner, we, it or he will not, directly or indirectly: (1) offer for sale, pledge, encumber, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend, or otherwise transfer or dispose of (or enter into any transaction or device which is designed to, or could be expected to, result in the disposition by any person at any time in the future of), directly or indirectly, any of our (A) ZYPS, (B) shares or securities convertible into or exercisable or exchangeable for our shares, (C) securities of the same class as the ZYPS or our shares or (D) other instruments representing interests in securities of the same class as the ZYPS or our shares; or (2) sell, grant or enter into any option, right, warrant, swap or other arrangement that are with respect to, or transfers to another, in whole or in part, any of the economic consequences of ownership of, the ZYPS or our shares whether any such transaction described in clause (1) or (2) above is to be settled by delivery of the ZYPS, our shares or such other securities, in cash or otherwise. In addition, we and each of Siliconware Precision Industries Company Limited, C.K. Lee, D.F. Lin, Bright Shiao and China Development Industrial Bank have agreed not to announce our, its or his intention or make any application or filing with any applicable regulatory authority for any of such transactions described in clause (1) or (2) above without the prior written consent of the sole bookrunner for a 120-day period.

The foregoing does not apply to 3,802,000 shares pledged under loan agreements, and in addition, in the case of us, (i) the issuance by us of our shares or options to purchase our shares pursuant to our employee share option plans in existence on the closing date of this offering, (ii) the issuance by us of our shares upon conversion of our convertible bonds in existence on the date of this offering memorandum and (iii) the distribution by us of ordinary share dividends or employee bonus shares.

Form of ZYPS The ZYPS will be issued in registered form and denominated in principal amounts of US\$10,000 and integral multiples of US\$10,000.

Rule 144A ZYPS will be represented by one Rule 144A global certificate. Regulation S ZYPS will be represented by one Regulation S global certificate. Except as described in this offering memorandum, interests in ZYPS evidenced by the Rule 144A global certificate will be deposited with a custodian for and registered in the name of a nominee of DTC, and interests in ZYPS evidenced by the Regulation S global certificate will be deposited with and registered in the nominee name of a common depositary for Euroclear and Clearstream. Except as described in this offering memorandum, definitive certificates with respect to ZYPS will not be issued in exchange for global certificates.

Taxation	All payments of principal and interest (if any) with respect to the ZYPS will be made after any deduction or withholding for or on account of any present or future taxes, duties, assessments or governmental charges of whatever nature imposed or levied by or on behalf of the government of the ROC or any authority thereof or therein having the power to tax. With respect to any such deduction or withholding from any such payment we will, at the time of such payment of principal and interest (if any) and subject to certain exceptions set forth in this offering memorandum, pay such additional amounts as will result in the receipt by the holders of the amounts which would have been received in the absence of any such withholding or deduction. See “Description of the Convertible Zero Yield Puttable Securities — Additional Amounts.”
Governing Law	The indenture and the ZYPS will be governed by, and construed in accordance with, the laws of the State of New York.
Listing	We have applied to list the ZYPS on the Luxembourg Stock Exchange, but we cannot assure you that the listing will be obtained. Any prospective purchaser is advised to check the listing status with the listing agent in Luxembourg. The Rule 144A ZYPS have been made eligible for trading on the PORTAL Market. Our shares are listed on the TSE and application will be made for the shares to be issued upon conversion of the ZYPS to be listed on the TSE.
Use of Proceeds	The net proceeds to be received by us from this offering will be approximately US\$88,200,000 million, or a total of approximately US\$98,000,000 million if the sole bookrunner’s option is exercised in full. We intend to use the net proceeds towards the procurement of machinery and equipment.
Trustee, ZYPS Registrar and Paying, Transfer and Conversion Agent	The Bank of New York.
Luxembourg Listing, Paying, Transfer and Conversion Agent	The Bank of New York (Luxembourg) S.A.
Risk Factors	For a discussion of certain risk factors that you should consider in connection with an investment in the ZYPS, see “Risk Factors.”

Summary Unconsolidated Financial and Operating Data

The following table presents our summary statement of income and balance sheet and operating data. The summary unconsolidated financial data as of and for the years ended December 31, 2000, 2001 and 2002 and as of and for the nine months ended September 30, 2002 and 2003 set forth below are qualified by reference to, and should be read in conjunction with, our audited and unaudited unconsolidated financial statements included in this offering memorandum. Our unconsolidated financial statements as of and for the years ended December 31, 2000, 2001 and 2002 have been prepared in accordance with ROC GAAP. Our unconsolidated financial statements as of and for the nine months ended September 30, 2002 and 2003 are unaudited.

Our financial statements have been prepared and presented on an unconsolidated basis and in accordance with ROC GAAP. ROC GAAP differs in certain material respects from generally accepted accounting principles in the United States, or U.S. GAAP. See “Summary of Material Differences Between ROC GAAP and U.S. GAAP.” You should also read “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which describes a number of factors that have affected our financial results.

	As of and for the Year Ended December 31,				As of and for the Nine Months Ended September 30,		
	2000	2001	2002		2002	2003	
	NT\$	NT\$	NT\$	US\$	NT\$	NT\$	US\$
	(in millions, except per share data)						
Income Statement data:							
Operating Revenues							
Sales revenue	4,225.5	3,970.9	5,403.5	160.0	3,863.1	4,798.3	142.0
Less: Sales discounts	(43.9)	(93.6)	(55.5)	(1.6)	(22.2)	(55.9)	(1.7)
Net operating revenues.	4,181.6	3,877.3	5,348.0	158.3	3,840.9	4,742.4	140.4
Cost of Goods Sold	(2,705.3)	(4,129.7)	(5,003.8)	(148.1)	(3,757.4)	(3,921.8)	(116.1)
Gross Profit (Loss).	1,476.3	(252.4)	344.2	10.2	83.5	820.7	24.3
Operating Expenses							
Selling expenses and administrative expenses	(255.1)	(378.6)	(450.5)	(13.3)	(330.2)	(356.7)	(10.6)
Research and development expenses	(50.7)	(58.2)	(74.5)	(2.2)	(54.6)	(58.1)	(1.7)
Total operating expenses	(305.8)	(436.8)	(524.9)	(15.5)	(384.9)	(414.8)	(12.3)
Operating Income (Loss)	1,170.5	(689.2)	(180.8)	(5.4)	(301.3)	405.9	12.0
Non-operating Income	43.1	153.1	91.4	2.7	65.0	126.3	3.7
Non-operating Expenses	(210.5)	(555.0)	(619.1)	(18.3)	(476.9)	(323.5)	(9.6)
Net Income (Loss) from Continuing Operations Before Income Tax . .							
	1,003.1	(1,091.1)	(708.5)	(21.0)	(713.2)	208.7	6.2
Income Tax Benefit	175.3	299.5	383.1	11.3	302.4	184.2	5.5
Income (Loss) from Continuing Operations							
	1,178.4	(791.7)	(325.4)	(9.6)	(410.8)	393.0	11.6
Extraordinary Gain	—	—	22.8	0.7	—	—	—
Net Income (Loss)	1,178.4	(791.7)	(302.6)	(9.0)	(410.8)	393.0	11.6
Per Share Data							
Net income (loss) from continuing operations	3.06	(1.81)	(0.74)	(0.02)	(0.93)	0.74	0.02
Basic net income (loss) per share .	3.06	(1.81)	(0.69)	(0.02)	(0.93)	0.74	0.02
Diluted net income (loss) per share	—	—	—	—	—	0.71	0.02
Balance Sheet data:							
Assets							
Current assets	3,050.6	916.2	2,802.9	83.0	3,125.4	3,419.2	101.2
Long-term investments.	4.9	5.1	310.5	9.2	43.1	420.2	12.4
Net property, plant and equipment. .	12,869.2	15,052.3	13,594.7	402.4	14,151.4	13,279.7	393.1
Other assets	291.0	2,042.1	2,077.6	61.5	1,926.3	1,747.1	51.7
Total assets	16,215.7	18,015.7	18,785.6	556.1	19,246.2	18,866.3	558.5

	As of December 31,				As of September 30, 2003		
	2000	2001	2002		2002	2003	
	NT\$	NT\$	NT\$	US\$	NT\$	NT\$	US\$
	(in millions, except per share data)						
Liabilities							
Current liabilities	3,601.0	4,671.2	3,151.2	93.3	3,316.6	3,337.9	98.8
Long-term liabilities	3,412.8	4,939.1	5,878.0	174.0	7,639.6	4,864.2	144.0
Other liabilities	19.2	24.4	192.1	5.7	25.0	137.1	4.1
Total liabilities	7,033.0	9,634.7	9,221.3	273.0	10,981.1	8,339.2	246.9
Shareholders' equity	9,182.7	8,381.0	9,564.4	283.1	8,265.1	10,527.0	311.6
Total liabilities and shareholders' equity	16,215.7	18,015.7	18,785.6	556.1	19,246.2	18,866.3	558.5

RISK FACTORS

You should pay particular attention to the fact that we are an ROC company and are subject to a legal and regulatory environment that in some respects may be different from that prevailing in other countries, in particular, the United States. You should consider carefully all the information included in this offering memorandum and, in particular, should evaluate the following risks before deciding to invest in the ZYPS and the shares issuable upon conversion of the ZYPS.

Risks Relating to Our Business and Our Industry

We experienced recent operating and net losses

We experienced net losses of NT\$791.7 million and NT\$302.6 million (US\$9.0 million) in 2001 and 2002, respectively, primarily because of the continuing sluggishness in the semiconductor industry in those years. Both the volume and the average unit prices of semiconductor sales for 2001 and 2002 were affected by this downturn, which resulted in reduced demand for our testing services and a reduction in our hourly charges for such services. These reduced revenues combined with our high fixed costs resulted in the net losses for 2001 and 2002. Although our financial performance has improved in 2003, there can be no assurance that we will regain the levels of profitability that we achieved in the past or that losses will not occur in the current period or future periods.

Our operating results are subject to significant fluctuations

Our historical revenues and net profit or loss have varied, at times significantly, from quarter to quarter. Our future revenues and net profit or loss may vary significantly due to a combination of factors. These factors include:

- our ability to quickly adjust to unanticipated declines or shortfalls in demand and market prices for our test services, due to our high percentage of fixed costs;
- timing of capital expenditures in anticipation of future orders;
- changes in prices of our test services;
- volume of orders relative to our test capacity;
- our ability to obtain adequate test equipment on a timely basis; and
- the impact of natural disasters.

Due to the factors listed above, it is possible that our future operating results or growth rates may be below the expectations of research analysts and investors.

If we are unable to maintain high capacity utilization rates, we may incur losses

The integrated circuit test business requires large capital expenditures for testing machinery and equipment. During the years 2000, 2001 and 2002 and the nine months ended September 30, 2003, we incurred NT\$9,605.3 million, NT\$5,676.3 million, NT\$1,872.3 million (US\$55.4 million) and NT\$2,394.1 million (US\$70.9 million) of capital expenditures, respectively. Our fixed costs are correspondingly high, reflecting the financing costs and depreciation charges associated with these fixed assets. Given the high fixed costs of our business, a high capacity utilization rate of our testers and other machinery allows us to maintain higher margins because it allows us to allocate fixed costs over a greater number of tested units. Increases or decreases in capacity utilization rates can have a significant effect on our business.

Accordingly, our ability to maintain or enhance our margins will continue to depend, in part, on our ability to maintain high capacity utilization rates. In order to maintain high capacity utilization rates, we must ensure that our test technology meets our customers' needs.

There is no guarantee that a high utilization rate is sustainable. In the past, our capacity utilization rates were negatively affected by an unexpected downturn in the semiconductor industry. As a result, we incurred substantial operating losses and net losses in 2001 and 2002. There can be no assurance that future declines in the semiconductor industry or other factors will not seriously harm capacity utilization or cause us to incur further losses.

We may not be able to meet all of our financial covenants

Under the terms of our domestic loan agreements, we are required to maintain certain minimum financial ratios. Certain of our loan agreements require that we maintain, among other financial ratios, a current ratio of at least 1.0, a total liabilities to net tangible assets ratio of less than 1.0, an interest coverage ratio of at least 3.0 and total net tangible assets of NT\$7.0 billion. The interest coverage ratio is measured as the total of pre-tax profit plus interest expense and depreciation and amortization expense, divided by interest expense. The current ratio requirement was breached based on our audited financial statements as of and for the year ended December 31, 2002. In addition, we have also breached other financial covenants in the past. We have cooperated with our lenders to resolve these breaches and supplemented, amended or had waived provisions of the relevant loan agreements to avoid default.

Under the terms of the credit facilities described above, the breach of one or more financial covenants could expose us to additional interest charges and potential acceleration of our obligations under the relevant agreement (which in turn could give rise to cross defaults under our other loan agreements). While we have obtained the necessary waivers for past breaches, we cannot assure you that future breaches would not occur or that waivers can be obtained with respect to any of these breaches if they in fact occur in the near-term. Any failure under, or breach of, these financial covenants in the future could have a material adverse effect on our financial condition by causing the acceleration of the relevant indebtedness as well as certain other outstanding indebtedness.

We have in the past delayed payments on our debt obligations and returned equipment due to liquidity problems

We agreed with our lender to delay payment of the NT\$76.5 million (US\$2.3 million) principal and interest installments which came due on December 20, 2001 and March 20, 2002 on our long-term syndicated loan arranged by China Development Industrial Bank. In addition, we agreed with our lender to delay payment of an NT\$17.1 million (US\$0.5 million) principal and interest installment which came due on January 25, 2002 on our long-term syndicated loan from Chiao Tung Bank. We subsequently made payment in full on these installments on April 19, 2002. During 2001 we agreed with one of our test equipment suppliers, Advantest Corporation, to return test equipment for which NT\$102.0 million (US\$3.0 million) in payments had already been made. This lack of liquidity resulted primarily from a deterioration of operating cash flow, a lack of sufficient lines of credit from our lenders to cover our income shortfalls and our investment in capital equipment in anticipation of order volumes that were not realized. We continue to plan our capital expenditures in such a way as to avoid liquidity difficulties such as those experienced in the past and maintained as of September 30, 2003 NT\$1,321 million (US\$39.1 million) and NT\$1,130 million (US\$33.5 million) of unused short-term and long-term loan facilities, respectively, from our lenders. However, there can be no assurance that a sudden downturn in the market for our services in the future will not again result in similar liquidity issues occurring. This in turn could result in the return of equipment used in our testing processes, the acceleration of our outstanding indebtedness or the reduction of our available lines of credit.

If capital resources required for future expansion plans are not available, we may be unable to successfully implement our business strategy

Our business growth strategy will require substantial capital expenditures to fund equipment and facilities expansion. The growing demand for semiconductor testing has and will continue to require significant capital expenditures on test technology and equipment. In making these planned capital expenditures, we may need to obtain additional capital resources or financing. It cannot be assured that additional capital resources or financing will be available when needed or available on terms satisfactory to us. If we are unable to obtain the necessary capital resources or financing, we will not be able to implement our business strategy or maintain our operations.

If we are unable to obtain equipment from our suppliers in a timely manner and at a reasonable cost, our business may be adversely affected

The semiconductor test business is capital intensive and requires significant investment in expensive equipment manufactured by a limited number of suppliers. The market for semiconductor test equipment is characterized by intense demand, limited supply and long delivery cycles. From time to time, increased demand for new equipment may cause lead times for delivery to our facilities to increase. In the past, increased demand for equipment has caused some equipment vendors to delay shipment of some or all of our equipment orders. If we are unable to obtain equipment in a timely manner, we may be unable to meet customer orders or implement expansion plans, which could reduce our revenues. See “Our Business — Equipment and Material.”

We do not have any significant backlog of orders because our customers do not place purchase orders far in advance, which makes us vulnerable to sudden changes in customer demand

Our customers generally do not place purchase orders far in advance and our relationships with major domestic customers do not require minimum purchases of our services. In addition, our customers’ purchase orders have varied significantly from period to period because demand for their products is often volatile. As a result, we do not typically operate with any significant backlog of orders. The lack of a significant backlog of orders makes it difficult for us to forecast our revenues and capacity utilization rates in future periods and causes our operating results to fluctuate from period to period. Moreover, our capital expenditure levels are based in part on our expectations of future revenue and we may be unable to adjust costs in a timely manner to compensate for revenue shortfalls. We expect that in the future our revenues in any quarter will continue to be substantially dependent upon purchase orders received in that quarter. We cannot assure you that any of our customers will continue to place orders with us in the future at the same levels as in prior periods. We also cannot assure you that our customers’ orders will be consistent with our expectations when we made or will make the necessary investments in raw materials, labor and equipment.

We depend on a limited number of customers for a substantial portion of our revenues and a loss of any one of these customers could result in the loss of a significant portion of our revenues

We are dependent on a limited number of customers for a substantial portion of our business. In 2000, 2001 and 2002 and the nine months ended September 30, 2003, 44.3%, 49.2%, 48.1% and 41.8% of our net operating revenues, respectively, were derived from the services provided to our top five customers. We expect that we will continue to depend on a relatively limited number of customers for a significant portion of our revenues because of the concentration of demand for our services. The ability to maintain close and satisfactory relationships with our customers is important to the future success of our business. None of our customers is presently obligated to purchase test services or to provide us with binding forecasts of purchases for any period. If any of our significant customers reduces, delays or cancels its orders, our revenues could be seriously diminished.

The addition of new significant customers could substantially impact our capital expenditure requirements

From time to time we seek to expand and diversify our customer base by approaching significant potential customers outside the ROC who have not traditionally used ROC testing service providers. We seek to enter into longer term agreements with these semiconductor manufacturers as compared to our domestic ROC customers in order to assure them of our ability to service their testing needs and to give us some indication of the testing equipment we require to meet these needs. While, if they are formed, we believe there are significant benefits to such relationships, the conclusion of such an agreement could lead to a reduction in our reliance on, and weakening of our relationships with, local Taiwanese semiconductor manufacturers and could require significant capital expenditures for the purchase of new testing equipment. If we are unable to procure funding for these capital expenditures we could lack capacity to provide the testing services for which we have contracted, which could require us to sub-contract the work to other testing houses or to fail to meet our contractual commitments, both of which could have a materially adverse impact on our revenues.

Some of our key customers are our related parties

Silicon Storage Technology, Incorporated held 0.55% of our shares as of September 30, 2003 and has the power to appoint one of our supervisors, and accounted for 9.3% of our operating revenues for the nine months ended September 30, 2003. In addition, the chairman of MediaTek Incorporated is the brother-in-law of our Chairman and MediaTek Incorporated accounted for 9.4% of our operating revenues in the nine months ended September 30, 2003. We believe that the terms on which we provide our services to Silicon Storage Technology, Incorporated and MediaTek Incorporated are generally equivalent to the terms provided to our other customers. We cannot assure you that these customers will not in the future obtain terms for our services more favorable than those provided to our other customers. This could in turn result in lower gross margins for our services and have a materially adverse effect on our results of operations.

The interests of our principal shareholders may not be the same as those of our other shareholders

SPIL owned approximately 11.23% of our issued share capital as of September 30, 2003. As a result, SPIL may influence our operations. Furthermore, SPIL operates in the same businesses as us, and conflicts may therefore arise between the interests of SPIL and the interests of our other shareholders. Any successful action by SPIL to limit or change our current or future scope of business could reduce our operating margins and our future results of operations.

If we are unable to manage our growth effectively, our profitability may be adversely affected

We have significantly expanded our testing operations in recent years and expect to continue to expand operations in future periods in terms of geography, customers and end-use products. See “Our Business — Equipment and Material” and “ Our Business — Facilities.” This expansion has placed, and will continue to place, pressure on our managerial, technical, financial, production, operational and other resources. To manage our growth, we must continue to implement and improve our operational, financial and quality assurance systems and to expand, train and manage our employees. Furthermore, we will need to manage relationships with a greater number of customers, suppliers, equipment vendors and other third parties. We may experience operating problems in the future as a result of, among other things:

- capacity constraints;
- construction delays;
- establishing operations at new facilities; or
- upgrading or expanding existing facilities.

While we believe we have effectively managed our expansion in recent years, we may not be able to continue to do so in the future. In particular, while we believe our current cash flow is sufficient to finance our currently scheduled capital expenditures, any future expansion may require additional external financing. Any failure to obtain sufficient funding may hamper the implementation of our expansion plans. Failure to implement our expansion plans in a timely manner could adversely affect our ability to maintain, expand and diversify our customer base. In addition, our implementation of our expansion plans may cause us to lose focus on our daily operations.

In connection with the implementation of our expansion plans, we expect to purchase a significant amount of additional testing equipment. If we purchase equipment beyond that needed to meet our future demand we may suffer from low utilization rates for our equipment, which may have an adverse effect on our operating margins. In addition, some of this equipment and related spare parts have been in short supply in recent years, are only available from a limited number of vendors or are manufactured in relatively limited quantities and may have lead times from order to delivery from three months to one year. The unavailability or failure of such equipment to operate in accordance with our specifications or requirements, or delays in the delivery of this equipment, could delay implementation of our expansion plans and thus restrict our revenues. See “Our Business — Equipment and Material.”

Our current operations or further investments in the PRC may expose us to political, regulatory, economic and foreign investment risks

Many of our customers and foreign competitors have expanded their operations to the PRC. In order to remain competitive and to position our company to gain market share, we have begun limited operations in the PRC, which may, depending on the ROC regulatory climate, be further expanded. We obtained foreign investment approval from the Investment Commission of the ROC Ministry of Economic Affairs to invest in a burn-in oven project in Suzhou, PRC. We had invested US\$7.9 million of paid-in capital in the venture as of September 30, 2003. This investment in the PRC and any future expansion of our PRC activities will cause our financial condition, results of operations and future prospects to be subject to the political and economic situation, regulatory control and general legal developments in the PRC and other foreign investment risks. Such operations could be adversely affected if relations between the PRC and the ROC subsequently became further strained. In addition, while we believe our current operations comply with ROC law governing investments in the PRC, these laws and their implementing regulations are often unclear and subject to interpretation by the relevant authorities. Any decision by the ROC Ministry of Economic Affairs or other regulator that our PRC operations violated these laws could result in substantial fines being levied against us, our being forced to discontinue our operations in the PRC or even the restriction of our operations in the ROC.

We may face significant competition from a number of competitors and from our customers’ in-house test capabilities

The independent semiconductor backend process service industry is very competitive. We face substantial competition from established test companies, including ASE Test Limited, ChipMOS Technologies Inc., United Test Center and SPIL. We also compete with the internal test capabilities of customers who have in-house test capability, including semiconductor foundries and integrated device manufacturers. Some of our competitors have greater financial and other resources than we do, including established relationships with many large semiconductor companies which are our current or potential customers. These relationships and lengthy qualification periods required by most of our potential customers may prevent us from securing new customers. See “Our Business — Sales and Marketing.”

In addition, we expect that there will be a significant increase in worldwide test capacity over the next few years. If growth in demand for this capacity fails to match the growth in supply, we expect more intense competition and pressure on the pricing of our services. Any significant increase in competition may erode our margins and reduce our earnings or increase our losses.

If the outsourcing trend for test and other backend semiconductor manufacturing services does not continue, we could lose a significant number of our current customers and we may be unable to implement our business plan

We depend on outsourcing of test and other backend semiconductor manufacturing services by semiconductor foundries, integrated device manufacturers and fabless integrated circuit design companies. In recent years, these companies have increasingly subcontracted parts of the semiconductor production process, including test, to independent companies to reduce costs and shorten production cycles. However, there can be no assurance that the outsourcing trend will continue. If our customers become dissatisfied with the services of independent semiconductor test companies, they may return to utilizing in-house test and other backend process capabilities. Moreover, if there is an economic downturn, these manufacturers may choose to use their in-house capacities before subcontracting to us. A reversal of, or slowdown in, the outsourcing trend could adversely affect our revenues and delay expansion plans.

The cyclical nature of the semiconductor industry makes us particularly vulnerable to economic downturns and changes in the semiconductor industry

The semiconductor industry is highly cyclical and economic downturns in the past have caused reduced demand for our services, rapid erosion of average selling prices, low capacity utilization and production overcapacity. Beginning in the second quarter of 2001, we experienced intense competition as a result of a general economic downturn and oversupply of test capacity in the local market. This caused average prices of many of our semiconductor test services to decrease significantly. These decreases in average prices and volume led to decreases in our gross margins which seriously affected our operating results. We expect that average prices for many of our existing services may decline in future economic downturns. If declines in average prices are not offset by reductions in the cost of providing these services, gross margins will decline and our operating results may be materially and adversely affected.

Our future results of operations could suffer from declining demand and average selling prices for our services as a result of a downturn in the electronics industry

We derive the vast majority of our operating revenues from customers who use our testing services to make semiconductors for communication applications, consumer electronics and personal computers. These testing and other backend semiconductor manufacturing services generated 98.5%, of our total operating revenues before testing and sales discounts in 2002. The personal computer, telecommunications and consumer electronics markets have experienced a sudden and substantial market downturn and inventory correction since late 2001. This downturn resulted in a reduced demand for our services, and hence lower revenues and incurrence of losses. Any significant decrease in the demand for integrated circuit products may further decrease the demand for our services. In addition, if the prices of integrated circuit products decline significantly, we will be pressured to further reduce the average selling prices of our testing services which may reduce our revenues and margins significantly.

As demonstrated by the downturn since late 2001 in demand for technology products, market conditions can change rapidly, without apparent warning or advance notice. In such instances, our customers will experience inventory buildup and/or difficulties in selling their products, and in turn, will reduce or cancel orders for testing and integrated circuit processing services from us. While these downturns are to be expected in the semiconductor business, their timing, severity and recovery cannot be predicted accurately or at all in advance. When they occur, our business and profitability are likely to suffer.

If demand for the services of Taiwan's wafer foundries decreases, a significant source of our sales would decrease, which would seriously harm our business

In recent years, a substantial portion of our net operating revenues were derived from the test of semiconductor wafers manufactured at Taiwan's wafer foundries. If the demand for foundry services offered by Taiwan's wafer foundries decreases for any reason, an important source of our sales would be lost and our operating results would be adversely affected.

We depend on key management and the loss of any key management personnel may disrupt our business

Our success depends upon the continued service of our key senior management. A majority of our senior management has served us for over three years and made substantial contributions to our growth. We do not have employment contracts with our senior executives that prevent them from leaving their posts. If we lose the services of key senior management it could be difficult to locate and integrate replacement personnel, which would adversely affect our client and supplier relationships, diminish our technical expertise and generally slow our operations.

Both we and our Chairman are defendants in securities law civil and criminal suits

One corporate and two individual shareholders have brought suit against us and our Chairman alleging that we tried to attract investors to purchase our shares before our initial public offering, which was conducted in May 2001, by means of misleading statements made by us and our management. The Chairman is named as a defendant in his capacity as our legal representative and in his personal capacity. The plaintiffs' allegations relate to our published projections and other statements made by us through our management. In addition to the civil proceedings, a criminal complaint has been filed with the office of the Hsin-Chu procuratorate, seeking prosecution of us and our Chairman for making fraudulent statements. The case is currently under investigation by the procuratorate after initially being rejected by the procuratorate but then directed for reinvestigation by the procuratorate's office for the Hsin-Chu higher court.

Although we are vigorously defending the civil suit, no assurance can be given as to the final disposition. Moreover, there can be no assurance that other plaintiffs similarly situated may not bring similar claims, or seek to certify a class of plaintiffs for a class action. A successful class action could have a material adverse effect on our financial position. We have from time to time received correspondence regarding potential actions or litigation. Other than as described above, none of this correspondence has led to any litigation or actions. Successful prosecution of a criminal suit against us or our Chairman could result in imprisonment of our officers, the resignation of our Chairman or fines being levied against us or our officers, and could result in reputational damage. In addition, the demands placed on the time and resources of senior management by the necessity to defend civil or criminal proceedings could have an adverse impact on our management's ability to oversee our operations.

Our failure to comply with environmental regulations or to defend against environmental claims could expose us to serious liabilities

Semiconductor wafer grinding and dicing processes require the use of chemicals and gases which are regulated by the government. For example, liquid waste is produced when silicon wafers are diced into chips using diamond saws and cooled with running water. Environmental claims or the failure to comply with any environmental regulations could result in damages or fines against us or suspension of production. We may be required by new regulations to acquire costly equipment or to incur other significant expenses. If we fail to control the use of hazardous substances, we could incur future liabilities, including cleanup costs.

Disruptions in the international trading environment may seriously decrease our international sales

A substantial portion of our revenues are derived from the provision of services to customers located outside of Taiwan. In 2002 and the nine months ended September 30, 2003, our overseas customers accounted for 26.2% and 33.6%, respectively, of our net operating revenues. We expect sales to customers outside of Taiwan to continue to represent a significant portion of our net operating revenues. Disruptions in the international trading environment, including adverse changes in foreign government regulations, political unrest and international economic downturns, could negatively affect the business of our customers and the demand for semiconductors and integrated circuits. This could in turn adversely affect our revenues.

Our business may be harmed by changes in general economic and business conditions resulting from events or factors beyond our control

The terrorist attacks in the United States on September 11, 2001 and in Indonesia on October 12, 2002 may have long-term effects on world economies and markets. The immediate impact of the September 11, 2001 attacks caused disruptions in the U.S. and global markets. The immediate impact of the October 12, 2002 and other recent attacks has been more muted. In early 2003, the United States and its allies carried out military operations against Iraq and continue to be involved in security and reconstruction operations there. Concerns about the war and possible acts of terrorism directed against the United States and its interests, as well as political tensions in other areas of the world, have affected, and will likely affect the global economy and consumer confidence.

Any economic downturn resulting from any of the events described above may reduce the demand for our services and negatively impact our results of operations. We cannot guarantee that our business will not be substantially affected by similar events in the future. The impact and future effects of these events are currently uncertain, and we are unable to predict the future impact they may have on our business and operations, the international markets in which we operate and the global economy in general.

Exchange Rate Fluctuations

A substantial portion of our revenues are denominated in N.T. dollars, while we purchase a substantial amount of machinery and equipment in U.S. dollars and finance these purchases with U.S. dollar-denominated debt. Accordingly, we are exposed to movements in the exchange rates between U.S. dollars on the one hand, and N.T. dollars on the other hand. We generally do not hedge against our exposure to exchange rate fluctuations. As a result, we recorded net exchange losses of NT\$25.2 million and NT\$51.9 million (US\$1.54 million) in 2000 and 2002, respectively, and net exchange gains of NT\$105.3 million and NT\$50.3 million (US\$1.49 million) in 2001 and the nine months ended September 30, 2003, respectively. The effect of future changes in currency exchange rates on our results of operations cannot be accurately predicted.

Risks Relating to Our Technologies

If we are unable to successfully test our customers' products within the acceptable range of precision, we will not be able to achieve satisfactory testing yields and our results of operations will suffer

Semiconductor test processes are complex and involve a number of precise steps. Defective tests can result from a number of factors, including:

- the level of contaminants in the testing environment;
- human error;
- equipment malfunction; and

- inadequate sample testing.

From time to time, we expect to experience lower than anticipated testing yields as a result of the above factors, particularly in connection with the expansion of our capacity or change in our processing methods. In addition, our test yields for new products will be lower than average as we develop the necessary expertise and experience to test those products. If we fail to meet customer testing requirements, our reputation may suffer and our customers may cancel their orders or return their products for rework.

The complexity of the integrated circuit testing and packaging process increases the costs and production risks of our business

Integrated circuit testing and packaging involves significant technological and process expertise. In order to improve capacity utilization and efficiencies in our testing operations, we maintain advanced and costly equipment and develop software conversion programs which enable us to test particular integrated circuits on multiple equipment platforms. If we fail to successfully develop software conversion programs or if we are unable to effectively reduce the lead time necessary to interface our customers' integrated circuits with our testing equipment, our operating efficiencies could suffer. In addition, our testing and packaging operations take place in clean rooms where air purity, temperature and humidity are controlled. If we are unable to effectively control our testing and packaging environment, some integrated circuits or wafers could be damaged. Although we believe our operating efficiency has generally improved in recent years, we have from time to time experienced, and may in the future experience, production interruptions due to technical problems in our testing and packaging processes. Any interruption in our operations could have a material adverse effect on our revenues and client relationships.

Our profitability depends on our ability to respond to rapid technological changes in the semiconductor industry

The semiconductor industry is characterized by rapid increases in the diversity and complexity of semiconductors. As a result, we expect that we will need to constantly offer more sophisticated test technologies and processes in order to respond to competitive industry conditions and customer requirements. If we fail to develop, or obtain access to, advanced test technologies or processes, we may become less competitive and less profitable.

We depend on our technical personnel and an inability to attract and retain them would jeopardize our operations

Our business depends on technology and, accordingly, our success depends on our ability to attract, retain and motivate large numbers of highly skilled employees, particularly engineering and technical personnel. Without sufficient numbers of skilled employees, our operations and our ability to work with clients to design test processes for next generation integrated circuits would be impaired. Competition for qualified engineering and technical employees in Taiwan is intense and replacement of qualified employees is difficult. We will require increased numbers of skilled employees at our proposed facilities in the PRC. If we are unable to attract, retain and motivate our engineering and technical personnel, our operations and expansion plans would be jeopardized and our operating efficiency would deteriorate.

Disputes over intellectual property rights could be costly and deprive us of the technology to stay competitive

We may suffer legal liabilities and damages if we infringe on the proprietary rights of others or incur costs resulting from legal claims and adverse proceedings against us. Despite this, we have no means of knowing what patent applications have been filed in the United States or elsewhere until they are granted. The semiconductor test and packaging industry is characterized by frequent litigation regarding patent and other intellectual property rights. If any third party were to make valid intellectual property infringement claims against us or our customers, we could be required to:

- discontinue using disputed process technologies which would prevent us from offering some of our test and packaging services;
- pay substantial monetary damages;
- seek to develop non-infringing technologies, which may not be feasible; or
- seek to acquire licenses to the infringed technology, which may not be available on commercially reasonable terms, if at all.

We could also be required to devote substantial resources to defend any claim alleging our infringement of patents or other intellectual property rights. If we fail to obtain necessary licenses or if litigation relating to patent infringement or other intellectual property matters occurs, it could seriously harm us.

In addition, we have acquired patents and trademarks to protect some of our proprietary technologies and products. We cannot assure you, however, that these measures will provide meaningful protection of our intellectual property. For example, our competitors may be able to develop similar or superior technologies or products, or we may not have sufficient financial and legal resources to protect and enforce our rights.

Political and Economic Risks Relating to the ROC

We face substantial political risks associated with doing business in Taiwan, particularly due to the tense relationship between Taiwan and the People's Republic of China, which could impact our business and the market price and liquidity of our shares and the ZYPS

Our principal executive offices and substantially all our assets are located in Taiwan and most of our revenues are derived from our operations in Taiwan. Accordingly, our business and results of operations and the market price of our shares and the ZYPS may be affected by changes in Taiwan governmental policies, taxation, inflation or interest rates and by social instability and diplomatic and social developments affecting Taiwan which are outside of our control. Taiwan, as part of the Republic of China, has a unique international political status. The People's Republic of China asserts sovereignty over mainland China and Taiwan and does not recognize the legitimacy of the Taiwan government. Although significant economic and cultural relations have been established during recent years between Taiwan and the People's Republic of China, the government in mainland China has indicated that it may use military force to gain control over Taiwan if Taiwan declares independence or indefinitely delays progress towards unification as well as if any foreign power interferes in Taiwan's affairs. The People's Republic of China has threatened to take hostile actions toward Taiwan if Taiwan does not officially endorse the People's Republic of China's one China policy. Relations between Taiwan and the People's Republic of China and other factors affecting the political or economic conditions of Taiwan could substantially impact our business and the market price and the liquidity of our shares and the ZYPS.

If economic conditions in Taiwan deteriorate, our current business and future growth would be materially and adversely affected

The semiconductor industry is significantly affected by global and local economic conditions. During recent years, the economic conditions in the world and in Asia have deteriorated to a degree. This economic downturn has reduced demand for the products that we test. Although economic conditions appear to be improving in certain respects, it is not certain that the global or Taiwanese economy will achieve full recovery or be immune from future economic downturns that could affect demand for semiconductor products and services.

In recent years, the currencies of many East Asian countries, including Taiwan, have experienced considerable volatility and depreciation. The Central Bank of China, the central bank of Taiwan, has from time to time intervened in the foreign exchange market to minimize the fluctuation of the U.S. dollar/N.T. dollar exchange rate and to prevent significant decline in the value of the New Taiwan dollar. In October 1997, the Central Bank of China halted its intervention and in January 1998, US\$1.00 exceeded NT\$34.00 for the first time since April 1987. New Taiwan dollars have depreciated against U.S. dollars by 19.0% from US\$1.00 = NT\$27.52 on January 2, 1997 to US\$1.00 = NT\$33.99 on December 31, 2003, based on the noon buying rates published by the Federal Reserve Bank of New York.

Portions of our current and long-term debt obligations are denominated in U.S. dollars whereas most of our revenues are denominated in N.T. dollars. Exchange rate fluctuations, therefore, could negatively impact our ability to service our debt obligations or otherwise adversely affect our financial condition or results of operations.

In addition, the banking sector in Taiwan has been seriously harmed by the general economic downturn in Asia and Taiwan which has caused a depressed property market and an increase in the number of companies filing for corporate reorganization and bankruptcy protection. As a result, financial institutions are more cautious in providing credit for businesses in Taiwan. We cannot assure you that we will continue to have access to credit at commercially reasonable rates of interest or at all.

Financial reporting and accounting standards in the ROC differ from other countries

We are subject to financial reporting requirements in the ROC 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 differ in certain material respects from U.S. GAAP. See “Summary of Material Differences Between ROC GAAP and U.S. GAAP.” Potential investors should consult their own professional advisers for an understanding of such differences and how they might affect the financial information contained herein.

For example, we paid in 2000 and 2001 employee bonuses of 15.0% of after-tax profits, less prior years’ losses and legal reserves, in the form of our shares and expect that, subject to shareholder approval, we will pay all or some of employee bonuses for the future periods in the form of our shares at a rate of 10.0% of after-tax profits. We granted an aggregate of 6,662,946 shares and 15,511,500 shares in 2000 and 2001 to our employees, respectively. In each case, the number of our shares distributed was obtained by dividing the total nominal N.T. dollar amount of the bonus by the par value of our shares rather than their market value, which has generally been higher than par value. Under ROC GAAP, the distribution of employee bonus shares is treated as an allocation from retained earnings when the distribution of employees bonuses is approved by the shareholders, and we are not required to, and do not, charge the value of the employee bonus shares to income. Under U.S. GAAP, bonuses to employees are charged as compensation expense against income in the period to which they relate. If the employee bonuses are paid in the form of our shares, the fair value of the shares issued is used to determine the amount of the expense. However, since the form of the payment of such bonuses are not finally determinable until a shareholders’ meeting in the subsequent year, the total amount of such bonuses is initially accrued based on management’s estimate of the number of shares to be issued, valued at the fair value of the shares. Any difference between the

initially accrued amount and the fair value of the shares upon the issuance of shares is recognized in the year when the shareholder approval is obtained. Correspondingly, our net income and income per share calculated in accordance with U.S. GAAP will be reduced. The resulting difference in the calculation of our net income under ROC GAAP and U.S. GAAP could be material.

The value of a ZYPS holders' investment may be adversely affected by the volatility of the ROC securities markets

The ROC securities markets are smaller and more volatile than the securities markets in the United States and in certain European and other countries. In 1961, the Securities and Futures Commission established the Taiwan Stock Exchange to provide a marketplace for securities trading. The TSE is a corporation owned by government-controlled and private banks and enterprises. The TSE 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 TSE. The TSE commenced operations in 1962. Since the early 1980s, the Securities and Futures Commission has actively encouraged new listings on the TSE and the number of listed companies grew from 119 in 1983 to 669 by the end of December 2003. As of December 31, 2003, the market capitalization of companies listed on the TSE was NT\$12,867.8 billion. Any impairment of the liquidity of TSE listed companies could adversely affect the market price of the Shares.

Our operation may be adversely affected by natural disasters in Taiwan

Our headquarters and some of our service facilities are in Hsin-Chu, Taiwan, which is vulnerable to natural disasters. Disruption of operations at our facilities for any reason, including work stoppages, power outages, fire, earthquakes or other natural disasters, would cause delays in performing our services, which could lead customers to obtain services from other sources. For example, we have in the past experienced major power outages on July 29 and September 21, 1999, each of which resulted in a brief suspension of operations. In September 1999, a major earthquake occurred, with its epicenter in central Taiwan. The earthquake caused interruptions to power supplies and significant damage to buildings across Taiwan. As a result of the earthquake, we were obliged to suspend our testing operation for two days. After the 1999 earthquake, there were a number of earthquakes in Taiwan in 2000 and 2001. However, the latest major earthquake experienced by Taiwan on 31st March, 2002 did not cause any disruption to our operations. Similar incidents may occur in the future, which could have a material adverse effect on our operating results.

Any recurrence of the recent outbreak of Severe Acute Respiratory Syndrome, or SARS, may adversely affect our business, financial condition and results of operations

Beginning March 2003, China, Hong Kong, Taiwan, Singapore, Vietnam, certain other Asian countries and North America experienced an outbreak of SARS, a highly contagious disease. In response to the severity of the SARS outbreak, the World Health Organization issued a travel advisory recommending that persons traveling to the affected areas consider postponing all but essential travel. In addition, most major airlines drastically reduced the number of flights to and from China, Hong Kong and Taiwan. The SARS outbreak adversely affected the trade and tourism industries as well as the economies and financial markets of these countries. Any economic downturn as a result of a recurrence of SARS may have an adverse effect on the demand for our customers' products and thus our revenues.

Risks Relating to the ZYPS and Our Shares

Your right to receive payments on the ZYPS is structurally subordinated

As of September 30, 2003, we had total debt of NT\$7,267.1 million (US\$215.1 million), of which NT\$2,725.1 million (US\$80.6 million) is unsecured and unsubordinated debt and NT\$4,542.0 million (US\$134.5 million) is secured by properties. The ZYPS are effectively subordinated to such secured debt. As of September 30, 2003, after giving pro forma effect to (1) this offering (excluding the exercise of the sole bookrunner's option) and (2) the conversion of US\$59.5 million of convertible bonds (equivalent to NT\$2,133.7 million including reserves for redemption) which took place between October 1, 2003 and November 30, 2003, we would have had total debt of NT\$8,173.6 million (US\$24.2 million).

The ZYPS will be effectively subordinated to any of our secured obligations with respect to assets that secure such obligations and the debt of any subsidiaries. The terms of the ZYPS do not prevent us or any subsidiary from incurring additional debt in the future and we are generally permitted to secure this indebtedness. In addition, we expect to incur significant capital expenditures in the future, a substantial portion of which may be financed through additional debt. If we incur further indebtedness, our ability to make payments on the ZYPS and, if required, to redeem the ZYPS may be adversely affected.

A liquid market for the ZYPS may not develop

Application has been made to have the ZYPS listed on the Luxembourg Stock Exchange. However, there can be no assurance that an active trading market or a trading market for the ZYPS will develop. Furthermore, the managers may make a market with respect to the ZYPS but are not obligated to do so, and any market-making with respect to the ZYPS may be discontinued at any time. The trading market for our shares is the TSE on which our shares were listed in May 2001. Our shares will not be listed on the Luxembourg Stock Exchange.

In connection with this offering, one or more investors may purchase, at the initial offering price, a substantial portion of the ZYPS offered by this Offering Memorandum. The amount of any such purchases, if any, will be determined at the time of pricing of the ZYPS and will be subject to total demand received and final allocations. As a result of any such purchases, the liquidity in the trading market for the ZYPS may be adversely affected.

The ZYPS are subject to restrictions on transfer

The ZYPS and our shares issuable upon conversion of the ZYPS have not been registered under the U.S. Securities Act or any state securities laws. Absent registration, the ZYPS and our shares issuable upon conversion of the ZYPS may be offered or sold only in transactions that are not subject to or that are exempt from the registration requirements of the U.S. Securities Act and applicable state securities laws. See "Transfer Restrictions" for a description of restrictions on transfer of the ZYPS and our shares issuable upon conversion of the ZYPS.

Our shareholders may have difficulty protecting their shareholder rights

Our corporate affairs are governed by our Articles of Association and by the laws governing corporations incorporated in Taiwan. The rights of our shareholders and the responsibilities of members of our Board of Directors under Taiwan law are different from those applicable to a corporation incorporated in the United States and, therefore, our shareholders may have more difficulty protecting their interests in connection with actions by the management, members of our Board of Directors or our controlling shareholders than they would as shareholders of a corporation incorporated in the United States.

A ZYPS holders' ability to exercise their conversion rights may be limited

The ZYPS are convertible into our shares at the option of the converting holders pursuant to the terms of the ZYPS. Purchasers of the ZYPS will not be able to exercise their conversion right during the Closed Periods, as defined in the “Description of the Convertible Zero Yield Puttable Securities.” Under current ROC law, regulations and policy, PRC persons are not permitted to hold or convert the ZYPS or to register as our shareholders.

You will be required to appoint a local agent or representative in Taiwan if you convert the ZYPS into shares

Under current ROC law, a non-ROC holder of ZYPS exercising its conversion rights is required to appoint a local agent or representative in the ROC to, among other things, open a securities trading account with a local securities brokerage firm, pay ROC taxes, remit funds, exercise shareholders' rights on behalf of, and as agent for, such converting holder, appoint a bank to act as custodian in respect of the securities and funds, report to the Central Bank of China in accordance with the current ROC law and appoint a local securities firm or financial institution to act as the agent to open an NT dollar bank account. See “Description of the Convertible Zero Yield Puttable Securities — Certain ROC Legal Requirements Relating to the ZYPS.”

Shares eligible for future sale by our current shareholders may adversely affect the market price of our shares

While we are not aware of any plans by any major shareholders to dispose of a significant amount of our shares, we cannot assure you that one or more of our shareholders will not dispose of our shares in the future. We also cannot predict the effect, if any, that future sales of our shares, or the availability of our shares for future sale, will have on the market price of our shares prevailing from time to time. Sales of substantial amounts of our shares in the public market, or the perception that such sales may occur, could adversely affect the prevailing market price of our shares.

USE OF PROCEEDS

The net proceeds to be received by us from this offering will be approximately US\$88,200,000 million, or a total of approximately US\$98,000,000 million if the sole bookrunner's option is exercised in full. We intend to use the net proceeds towards the procurement of machinery and equipment.

MARKET PRICE INFORMATION

Our shares have been listed on the TSE since May 9, 2001. The table below sets forth, for the periods indicated, the high and low closing prices and the average daily volume of trading activity on the TSE for our shares (adjusted for the effects of rights issues, employee bonus issues and stock dividends) and the highest and lowest of the daily closing values of the TSE Index. The closing price for our shares on the TSE on January 9, 2004 was NT\$37.50 per share.

	Closing Price per Common Share		Average Daily Trading Volume in Shares	TSE Index	
	High	Low	(in thousands)	High	Low
	NT\$	NT\$		(points)	
2001					
May (listed since May 9)	38.12	26.56	5,484	5,405.54	4,958.61
June	29.20	20.00	1,966	5,271.30	4,768.55
July	20.10	14.00	1,856	4,886.86	4,040.77
August	16.00	10.80	2,827	4,687.33	4,310.32
September	11.25	8.95	1,735	4,493.53	3,493.78
October	8.60	6.50	1,786	4,065.10	3,446.26
November	9.75	6.80	4,401	4,608.32	3,929.69
December	16.10	9.45	7,208	5,551.24	4,646.61
2002					
January	27.30	14.00	19,149	6,007.33	5,488.33
February	25.20	20.00	10,917	5,968.61	5,499.79
March	30.30	21.60	17,257	6,242.64	5,680.78
April	35.10	28.20	12,312	6,462.30	6,059.21
May	26.90	20.80	6,017	5,910.69	5,443.18
June	21.10	14.80	4,394	5,599.42	5,071.76
July	19.40	15.40	4,053	5,416.50	4,855.34
August	22.20	14.90	7,870	4,968.85	4,572.35
September	21.70	16.10	7,874	4,668.01	4,185.95
October	17.10	12.65	8,729	4,601.37	3,850.04
November	17.30	14.90	6,953	4,813.53	4,500.55
December	19.00	15.60	8,880	4,823.67	4,452.45
2003					
January	17.80	15.20	8,150	5,078.80	4,524.87
February	15.80	14.50	2,779	4,833.58	4,432.46
March	14.85	12.55	3,210	4,599.25	4,260.45
April	14.40	12.45	3,897	4,658.30	4,139.50
May	13.95	12.20	3,463	4,555.90	4,187.82
June	19.10	14.90	13,235	5,048.91	4,678.08
July	19.80	17.20	10,423	5,451.80	5,017.78
August	22.50	18.30	12,013	5,686.85	5,214.60
September	24.60	22.50	7,059	5,757.91	5,611.41
October	31.70	23.20	14,452	6,108.13	5,581.66
November	34.80	31.50	15,105	6,142.32	5,740.57
December	36.90	31.10	10,052	5,124.24	5,752.01
2004					
January (through January 9)	37.50	35.60	15,338	6,226.98	6,041.56

Source: Bloomberg

The TSE has experienced substantial fluctuations in the prices of listed securities and there are currently limits on the range of daily price movements. See “Appendix A: The Securities Markets of Taiwan — The Taiwan Stock Exchange” and “— The Taiwan Stock Exchange Index.”

EXCHANGE RATES

The following table sets forth the average of month-end rates, high, low and period-end Noon Buying Rate in the City of New York for cable transfers between N.T. dollars and U.S. dollars (in N.T. dollars per U.S. dollar) for the periods indicated. No representation is made that the N.T. 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, at any other rate or at all.

N.T. dollar/U.S. dollar Noon Buying Rate				
	Average of month-end rates	High	Low	Period End
1997	28.78	33.25	27.34	32.80
1998	33.55	35.00	32.05	32.27
1999	32.32	33.40	31.39	32.27
2000	31.26	33.25	30.35	33.17
2001	33.82	35.13	32.23	35.00
2002	34.53	35.16	32.85	34.70
2003	34.40	34.98	33.72	33.99
2004 ⁽¹⁾	33.75	33.98	33.95	33.75

Source: The Federal Reserve Bank of New York.

(1) Through January 9, 2004.

DIVIDENDS AND DIVIDEND POLICY

To date we have not paid any cash dividends on our outstanding shares. We have paid annual stock dividends on our outstanding shares from 1998 to 2001. Our policy as of September 30, 2003 is to distribute 89% of distributable earnings after the payment of income taxes, deduction of losses incurred in prior years and deduction of the legal reserve and any special reserve. As of September 30, 2003, employee bonuses and remunerations of directors and supervisors accounts for 10% and 1%, respectively, of the residual earnings approved by the shareholders. Our articles of incorporation as of September 30, 2003 provide at least 80% of any dividend will be in the form of our shares. All or part of the dividends to shareholders may be reserved at the relevant annual shareholders' meeting as retained earnings for distribution in later years.

In addition, if we do not have losses, we are also permitted to make distributions to our shareholders of additional shares by capitalizing reserves (including the legal reserve and capital surplus of premium from issuing stock and earnings from gifts received). However, amounts payable by capitalizing the legal reserve are limited to 50% of the total accumulated legal reserve and this capitalization can only be effected when the accumulated legal reserve exceeds 50% of our paid-in capital.

Except in limited circumstances, under 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. ROC Company Law also requires that 10% of annual net income (less tax due and prior years' losses) be set aside as a legal reserve until such time as the accumulated legal reserve equals our paid-in capital. See "Description of Share Capital."

In 2000, we distributed a share dividend of 37,312,500 shares, which was paid out of our retained earnings and capital surplus. In 2001, we distributed a share dividend of 86,864,398 shares, which was paid out of our retained earnings and capital surplus. We did not declare or distribute any dividends in 2002 due to the net loss we incurred in 2001. We did not declare or distribute any dividends in 2003 due to the net loss we incurred in 2002.

Holders of our outstanding shares on a dividend record date (including subsidiaries holding our shares) will be entitled to the full dividend declared without regard to any subsequent transfer of such shares.

CAPITALIZATION

The following table sets forth our unconsolidated short-term indebtedness and total capitalization as of September 30, 2003, prepared in accordance with ROC GAAP and as adjusted, as of September 30, 2003, which reflects the further conversion of US\$59.5 million of our convertible bonds (equivalent to NT\$2,133.7 million including reserves for redemption) by bondholders into 108,420,249 of our shares⁽¹⁾ which took place between October 1, 2003 and November 30, 2003 and giving effect to this offering, without giving effect to the exercise of the sole bookrunner's option. Except as disclosed above, there has been no material change in our short-term indebtedness or total capitalization since September 30, 2003. This table should be read in conjunction with our financial statements, including the notes to those statements, included elsewhere in this offering memorandum.

	As of September 30, 2003, actual		As of September 30, 2003, as adjusted for the offering and conversion of bonds ⁽²⁾	
	NT\$	US\$	NT\$	US\$
	(in millions)			
Short-term borrowings:				
Short-term bank loans	531.5	15.7	531.5	15.7
Current portion of long-term bank loans	1,630.9	48.3	1,630.9	48.3
Current portion of convertible bonds	<u>240.5</u>	<u>7.1</u>	<u>240.5</u>	<u>7.1</u>
Total short-term borrowings	2,402.9	71.1	2,402.9	71.1
Long-term indebtedness:				
Long-term bank loans	2,730.5	80.8	2,730.5	80.8
Convertible bonds	2,133.7	63.2	—	—
Convertible Zero Yield Puttable Securities being issued ⁽³⁾	<u>—</u>	<u>—</u>	<u>3,040.2</u>	<u>90</u>
Total long-term indebtedness	4,864.2	144.0	5,770.7	170.8
Total shareholders' equity:				
Shareholders' equity:				
Common shares par value NT\$10, 1,200,000,000 shares authorized, 579,303,400 shares issued . .	5,793.0	171.5	6,877.2	203.6
Capital surplus	4,127.0	122.2	4,127.0	122.2
Convertible bond conversion surplus	448.9	13.3	1,498.4	44.4
Retained profits	393.0	11.6	393.0	11.6
Treasury stock	(231.7)	(6.9)	(231.7)	(6.9)
Cumulative translation adjustments	<u>(3.2)</u>	<u>(0.1)</u>	<u>(3.2)</u>	<u>(0.1)</u>
Total shareholders' equity	<u>10,527.0</u>	<u>311.6</u>	<u>12,660.7</u>	<u>374.8</u>
Total capitalization ⁽⁴⁾	<u><u>15,391.2</u></u>	<u><u>455.6</u></u>	<u><u>18,431.4</u></u>	<u><u>545.6</u></u>

- (1) Which is the number of our shares obtained by multiplying our convertible bonds converted between October 1, 2003 and November 30, 2003 by a fixed exchange rate of NT\$34.979, divided by the conversion price at September 30, 2003 of NT\$19.18 per share.
- (2) Assumes an exchange rate of US\$1.00 = NT\$33.78.
- (3) Convertible after February 16, 2004 upon compliance with the procedures and requirements set forth in "Description of the Convertible Zero Yield Puttable Securities — Conversion."
- (4) Equal to long-term indebtedness plus total shareholders' equity.

SELECTED UNCONSOLIDATED FINANCIAL AND OPERATING DATA

The following table presents our selected statement of income and balance sheet and operating data. The selected unconsolidated financial data as of and for the years ended December 31, 2000, 2001 and 2002 and as of and for the nine months ended September 30, 2002 and 2003 set forth below are qualified by reference to, and should be read in conjunction with, our audited and unaudited unconsolidated financial statements included in this offering memorandum. Our unconsolidated financial statements as of and for the years ended December 31, 2000, 2001 and 2002 have been prepared in accordance with ROC GAAP. Our unconsolidated financial statements as of and for the nine months ended September 30, 2002 and 2003 are unaudited.

Our financial statements have been prepared and presented on an unconsolidated basis and in accordance with ROC GAAP. ROC GAAP differs in certain material respects from U.S. GAAP. See “Summary of Material Differences Between ROC GAAP and U.S. GAAP.” You should also read “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” which describes a number of factors that have affected our financial results.

	As of and for the Year Ended December 31,				As of and for the Nine Months Ended September 30,		
	2000	2001	2002		2002	2003	
	NT\$	NT\$	NT\$	US\$	NT\$	NT\$	US\$
(in millions, except per share data)							
Income Statement data:							
Operating Revenues							
Sales revenue	4,225.5	3,970.9	5,403.5	160.0	3,863.1	4,798.3	142.0
Less: Sales discounts	(43.9)	(93.6)	(55.5)	(1.6)	(22.2)	(55.9)	(1.7)
Net operating revenues	4,181.6	3,877.3	5,348.0	158.3	3,840.9	4,742.4	140.4
Cost of Goods Sold	<u>(2,705.3)</u>	<u>(4,129.7)</u>	<u>(5,003.8)</u>	<u>(148.1)</u>	<u>(3,757.4)</u>	<u>(3,921.8)</u>	<u>(116.1)</u>
Gross Profit (Loss)	<u>1,476.3</u>	<u>(252.4)</u>	<u>344.2</u>	<u>10.2</u>	<u>83.5</u>	<u>820.7</u>	<u>24.3</u>
Operating Expenses							
Selling expenses and administrative expenses	(255.1)	(378.6)	(450.5)	(13.3)	(330.2)	(356.7)	(10.6)
Research and development expenses	(50.7)	(58.2)	(74.5)	(2.2)	(54.6)	(58.1)	(1.7)
Total operating expenses	<u>(305.8)</u>	<u>(436.8)</u>	<u>(524.9)</u>	<u>(15.5)</u>	<u>(384.9)</u>	<u>(414.8)</u>	<u>(12.3)</u>
Operating Income (Loss)	<u>1,170.5</u>	<u>(689.2)</u>	<u>(180.8)</u>	<u>(5.4)</u>	<u>(301.3)</u>	<u>405.9</u>	<u>12.0</u>
Non-operating Income	43.1	153.1	91.4	2.7	65.0	126.3	3.7
Non-operating Expenses	<u>(210.5)</u>	<u>(555.0)</u>	<u>(619.1)</u>	<u>(18.3)</u>	<u>(476.9)</u>	<u>(323.5)</u>	<u>(9.6)</u>
Net Income (Loss) from Continuing Operations Before Income Tax	<u>1,003.1</u>	<u>(1,091.1)</u>	<u>(708.5)</u>	<u>(21.0)</u>	<u>(713.2)</u>	<u>208.7</u>	<u>6.2</u>
Income Tax Benefit	<u>175.3</u>	<u>299.5</u>	<u>383.1</u>	<u>11.3</u>	<u>302.4</u>	<u>184.2</u>	<u>5.5</u>
Income (Loss) from Continuing Operations	<u>1,178.4</u>	<u>(791.7)</u>	<u>(325.4)</u>	<u>(9.6)</u>	<u>(410.8)</u>	<u>393.0</u>	<u>11.6</u>
Extraordinary Gain	—	—	22.8	0.7	—	—	—
Net Income (Loss)	<u>1,178.4</u>	<u>(791.7)</u>	<u>(302.6)</u>	<u>(9.0)</u>	<u>(410.8)</u>	<u>393.0</u>	<u>11.6</u>
Per Share Data							
Net income (loss) from continuing operations	3.06	(1.81)	(0.74)	(0.02)	(0.93)	0.74	0.02
Basic net income (loss) per share	3.06	(1.81)	(0.69)	(0.02)	(0.93)	0.74	0.02
Diluted net income (loss) per share	—	—	—	—	—	0.71	0.02

	As of December 31,				As of September 30,		
	2000	2001	2002		2002	2003	
	NT\$	NT\$	NT\$	US\$	NT\$	NT\$	US\$
	(in millions, except per share data)						
Balance Sheet data:							
Assets							
Current assets	3,050.6	916.2	2,802.9	83.0	3,125.4	3,419.2	101.2
Long-term investments	4.9	5.1	310.5	9.2	43.1	420.2	12.4
Net property, plant and equipment	12,869.2	15,052.3	13,594.7	402.4	14,151.4	13,279.7	393.1
Other assets	291.0	2,042.1	2,077.6	61.5	1,926.3	1,747.1	51.7
Total assets	16,215.7	18,015.7	18,785.6	556.1	19,246.2	18,866.3	558.5
Liabilities							
Current liabilities	3,601.0	4,671.2	3,151.2	93.3	3,316.6	3,337.9	98.8
Long-term liabilities	3,412.8	4,939.1	5,878.0	174.0	7,639.6	4,864.2	144.0
Other liabilities	19.2	24.4	192.1	5.7	25.0	137.1	4.1
Total liabilities	7,033.0	9,634.7	9,221.3	273.0	10,981.1	8,339.2	246.9
Shareholders' equity	9,182.7	8,381.0	9,564.4	283.1	8,265.1	10,527.0	311.6
Total liabilities and shareholders' equity	16,215.7	18,015.7	18,785.6	556.1	19,246.2	18,866.3	558.5

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

The following discussion should be read in conjunction with "Selected Financial and Operating Data" and our unaudited financial statements as of and for the nine months ended September 30, 2002 and 2003 and our audited financial statements as of and for the years ended December 31, 2000, 2001 and 2002, including the notes to those financial statements, included elsewhere in this offering memorandum. Our financial statements have been prepared and presented on an unconsolidated basis in accordance with ROC GAAP, which differs in certain material respects from U.S. GAAP, as discussed under "Summary of Material Differences Between ROC GAAP and U.S. GAAP."

Overview

We are one of Taiwan's leading independent providers of semiconductor test and other backend semiconductor manufacturing services. We believe we are the only ROC company to provide the full range of integrated circuit test services, in addition to providing other backend integrated circuit processing services. Our test services include wafer probing and final test for logic, mixed signal and memory devices. Other backend semiconductor manufacturing services provided by us include wafer grinding and dicing, chip-on-board packaging, tape and reel and drop shipment of finished semiconductor devices. We do not generally provide packaging services to our clients other than selected chip-on-board packaging, but act as a turnkey for some customers, working with packaging and other source providers to facilitate all backend semiconductor manufacturing services from testing to drop shipment.

The high fixed cost and relatively short lifecycles of our equipment make maintaining high equipment utilization rates and hourly test charges key to our profitable operation. Our depreciation costs constituted 54.6% of our manufacturing cost for the nine months ended September 30, 2003, while variable costs accounted for 20.0% in the same period. Aside from the impact of demand and volume on prices, our test revenues are set in part based on hourly rates for the testing machines used to test our clients' products. Test charges for a single machine may vary depending on the product tested, with more complex devices that require the most advanced test equipment and testing configurations generally commanding higher hourly test charges. By maintaining a steady flow of customer orders, carefully planning product testing cycles to maximize testing time per machine and continuing to obtain high-end test work from our clients, we expect to continue to increase our utilization rates and hourly test charges, and thus our operating margins.

Other significant factors affecting our results of operations are as follows:

Cyclical and Seasonality of Operating Results

Our revenues are typically affected by cyclical and seasonal variations in market conditions that contribute to the fluctuation of the average selling prices of semiconductor products that require our testing and packaging services. Historically, prices have been cyclical in nature, with periods of price stability followed by periods of steep price declines, driven by changes in industry capacity at different stages of the cycle. In addition, testing services are usually provided immediately prior to the integration of individual semiconductors into computer systems, telecommunications equipment and other home and industrial electronics. Accordingly, the seasonal sales trends for semiconductor testing services closely mirror those for personal computer, telecommunications equipment and consumer electronics sales closely. We generally experience seasonal lows in the demand for semiconductor testing services during the second quarter and the beginning of the third quarter of the year, primarily as a result of decreased worldwide production and sales of personal computers, telecommunications equipment and consumer electronics during such periods, reflecting generally decreased worldwide demand for personal computers, telecommunications equipment and consumer electronics. On the other hand, we generally experience seasonal peaks during the later part of the third quarter and the fourth quarter of the year, primarily as a result of increased production and sales of personal computers and electronics during such period due to increased worldwide demand for personal computers from back-to-school and Christmas season sales. During market downturns, such as the one the

semiconductor industry experienced throughout 2001 and 2002, our revenues are also affected by inventory levels, as inventory build-up by personal computer manufacturers during global market downturns partially offsets the accelerating effect peak seasons have on demand for semiconductor testing and packaging services.

Substantial Capital Expenditures; High Proportion of Fixed Costs

The semiconductor test industry is characterized by substantial capital expenditures. In connection with the expansion of our testing capacity and the need to provide advanced test services, we incurred capital expenditures (excluding deferred charges) of NT\$1,546.4 million and NT\$2,394.1 million (US\$70.9 million) in the nine months ended September 30, 2002 and 2003, respectively, and of NT\$9,605.3 million, NT\$5,676.3 million and NT\$1,872.3 million (US\$55.4 million) in 2000, 2001 and 2002, respectively. The significant level of depreciation and financing costs resulting from our capital expenditures as a fixed cost represents a substantial portion of the overall cost of sales. Accordingly, our ability to maintain or enhance our operating margins will depend on our utilization rates for our equipment. We recorded depreciation expenses relating to costs of goods sold of NT\$2,031.7 million and NT\$2,172.4 million (US\$64.3 million) in the nine months ended September 30, 2002 and 2003, respectively, and of NT\$1,049.2 million, NT\$2,161.2 million and NT\$2,677.2 million (US\$79.3 million) in 2000, 2001 and 2002, respectively. This represented 54.1% and 55.4% of cost of goods sold in each of the nine months ended September 30, 2002 and 2003, respectively, and 38.8%, 52.3% and 53.5% in 2000, 2001 and 2002, respectively.

Operations at or near capacity have a significant positive effect on profitability, assuming constant or increasing prices, because a substantial percentage of our cost of sales is of a fixed nature. Our gross margin was 2.2% and 17.3% in the nine months ended September 30, 2002 and 2003, respectively, and 35.3%, (6.5)% and 6.4% in 2000, 2001 and 2002, respectively. Our results in 2002 improved as a result of slightly improved market conditions which saw an increase in average selling prices due partially to higher demand for testing services in 2002, compared to the results in 2001, which were negatively affected by the lower average selling prices caused by a slowdown in the global economy, overcapacity in the semiconductor industry and a worldwide semiconductor inventory adjustment. Our results in the nine months ended September 30, 2003 were improved by increasing average selling prices caused by improving market conditions and an increase in sales volume of our semiconductor testing and packaging services, compared to the same period in 2002.

Technology Migration

Since our inception, we have adopted testing methods and backend production services that respond to our clients' products characterized by greater miniaturization, higher lead counts and improved thermal and electrical performance. As a result, backend semiconductor manufacturing processes increasingly require sophisticated expertise and technological innovation. Moreover, the numerous test options required to support the proliferation of new semiconductor technologies make it extremely difficult for semiconductor companies to invest their time and resources in research and development in backend semiconductor manufacturing technology and capacity. Except during cyclical downturns in the semiconductor industry, the higher selling prices of services associated with such innovative semiconductor products more than offset the higher production costs associated with such services, which have contributed to the previous growth in our profit margins. Since prices for chips and wafers of a given level of technology typically decline over the technology's life cycle, we must continue to develop and successfully implement increasingly sophisticated technological capabilities in order to reduce our cost and maintain or improve our margins.

Rapid Technology Advances; Product Price Declines

As a result of product obsolescence due to rapid technological advances in the semiconductor industry, the price of a product tested by us tends to decline over its life cycle, reflecting increased competition, as more manufacturers are able to test similar products in volume. Fees for our testing services decline with the

sales prices of the products we test. The sales volume of a service tends to decrease from the middle to the late phases of the semiconductor life cycle for the foregoing reasons, but typically increases from the early to the middle phases of the semiconductor life cycle reflecting increased market acceptance of the semiconductor and the technology it incorporates, as well as increased demand. However, such pricing and sales trends are not linear and are subject to frequent fluctuations, particularly during the transition period from the early to middle phases and during the phase-out period of a product life cycle.

Results of Operations

The following table summarizes our results of operations as a percentage of net operating revenues for the periods shown:

	<u>As of and for the Year Ended December 31,</u>			<u>As of and for the Nine Months Ended September 30,</u>	
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2002</u>	<u>2003</u>
Net operating revenues.	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	<u>64.7</u>	<u>106.5</u>	<u>93.6</u>	<u>97.8</u>	<u>82.7</u>
Gross profit (loss)	35.3	(6.5)	6.4	2.2	17.3
Operating expenses					
Selling and general and administrative	6.1	9.7	8.4	8.6	7.5
Research and development	1.2	1.5	1.4	1.4	1.2
Total operating expenses	<u>7.3</u>	<u>11.2</u>	<u>9.8</u>	<u>10.0</u>	<u>8.7</u>
Income (loss) from continuing operations	28.0	(17.8)	(3.4)	(7.8)	8.6
Non-operating income	1.0	3.9	1.7	1.7	2.7
Non-operating expenses	<u>5.0</u>	<u>14.3</u>	<u>11.6</u>	<u>12.4</u>	<u>6.8</u>
Income (loss) from continuing operations before income tax	24.0	(28.1)	(13.2)	(18.6)	4.4
Income tax benefit.	<u>4.2</u>	<u>7.7</u>	<u>7.1</u>	<u>7.9</u>	<u>3.9</u>
Income (loss) from continuing operations	28.2	(20.4)	(6.1)	(10.7)	8.3
Extraordinary gain.	<u>—</u>	<u>—</u>	<u>0.4</u>	<u>—</u>	<u>—</u>
Net income (loss)	<u>28.2%</u>	<u>(20.4)%</u>	<u>(5.7)%</u>	<u>(10.7)%</u>	<u>8.3%</u>

Revenues by Principal Testing Category

The table below sets forth the breakdown of our total operating revenues before testing and sales discounts by each principal testing category:

	As of and for the Year Ended December 31,						As of and for the Nine Months Ended September 30,			
	2000		2001		2002		2002		2003	
	NT\$	%	NT\$	%	NT\$	%	NT\$	%	NT\$	%
	(in millions, except percentages)									
Wafer probing ⁽¹⁾	2,025.5	47.9%	1,770.0	44.6%	2,400.5	44.4%	1,678.4	43.5%	2,258.9	47.1%
Final test ⁽²⁾	1,965.0	46.5%	2,025.3	51.0%	2,921.6	54.1%	2,130.5	55.1%	2,437.8	50.8%
Other ⁽³⁾	235.0	5.6%	175.6	4.4%	81.4	1.5%	54.2	1.4%	101.6	2.1%
Total operating revenues before testing and sales discounts	4,225.5	100.0%	3,970.9	100.0%	5,403.5	100.0%	3,863.1	100.0%	4,798.3	100.0%

(1) Includes revenues from logic, mixed signal and memory wafer probing services and assembly services.

(2) Includes revenues from logic, mixed signal and memory final test services, burn-in test services and tape and reel services.

(3) Includes revenues from tester leasing, sale of self-assembled burn-in ovens and other revenue.

Aside from the impact of demand and volume on prices, our test revenues are set in part based on hourly rates for the testing machines used to test our clients' products. Test charges for a single machine may vary depending on the product tested, with more complex devices that require the most advanced test equipment and testing configurations generally commanding higher hourly test charges. Charges for our other backend services are set on a per-unit basis, and operating margins for these processes are fairly low, reflecting the lack of advanced technology or expertise being required for their completion. Another portion of our revenues includes lease income for on-site leasing to our competitors of our equipment, but exclude leasing income where our competitors remove our testing equipment from our premises, and also exclude payments received by us for turnkey services provided by third parties.

In accordance with ROC GAAP, we recognize revenues for our services once the service has been completed and the payment to be received for the services has been fixed.

The Nine Months Ended September 30, 2003 Compared to the Nine Months Ended September 30, 2002

Operating Revenues. Total operating revenues increased from NT\$3,863.1 million in the nine months ended September 30, 2002 to NT\$4,798.3 million (US\$142.0 million) in the nine months ended September 30, 2003, an increase of 24.2%, resulting from the general recovery in the semiconductor industry commencing in the second quarter of 2003. The volume of sales for the nine months ended September 30, 2003 increased due both to our expanded test capacity and demand from new and existing clients, while average revenues per semiconductor tested remained relatively stable. However, due to increasingly competitive market conditions, our customers requested greater concessions on pricing, which was the primary cause of a 151.9% increase in sales returns and allowances, from NT\$22.2 million in the nine months ended September 30, 2002 to NT\$55.9 million (US\$1.7 million) in the nine months ended September 30, 2003.

In the nine months ended September 30, 2003, the operating revenues generated from test and other backed semiconductor manufacturing services accounted for 97.9% of total sales, and operating revenues generated from other sources accounted for 2.1% of total sales. Our revenues generated from test and other backed semiconductor manufacturing services increased by 23.3% from NT\$3,808.9 million in the nine months ended September 30, 2002 to NT\$4,696.7 million (US\$139.0 million) in the nine months ended September 30, 2003, principally resulting from increases in orders from certain of our international customers as well as increased test revenues from new domestic and international customers. In the nine months ended September 30, 2003, we increased our service capacity by installing of a number of new

testers, which, combined with increased market demand, resulted in a 14.4% increase in final test revenues and a 34.6% increase in wafer probe revenues from NT\$2,130.5 million and NT\$1,678.4 million in the nine months ended September 30, 2002 to NT\$2,437.8 million (US\$72.2 million) and NT\$2,258.9 million (US\$66.9 million) in the nine months ended September 30, 2003.

Our revenues derived from other sources increased by 87.5% from NT\$54.2 million in the nine months ended September 30, 2002 to NT\$101.6 million (US\$3.0 million) in the nine months ended September 30, 2003.

Cost of Goods Sold. Our cost of goods sold consists mostly of depreciation, followed by direct labor costs, other factory overheads and materials for backend semiconductor manufacturing services. In the nine months ended September 30, 2003, our total cost of goods sold increased slightly by 4.4% to NT\$3,921.8 million (US\$116.1 million), driven principally by increases in depreciation costs associated with the new testers purchased and installed by us and increased labor costs to meet our growing demand.

We started recording depreciation for these new testers when they were put into service in 2002. Our depreciation costs increased accordingly from NT\$2,031.7 million in the nine months ended September 30, 2002 to NT\$2,172.4 million (US\$64.3 million) in the nine months ended September 30, 2003.

Gross margin increased to 17.3% in the nine months ended September 30, 2003 from 2.2% in the nine months ended September 30, 2002, primarily due to the increase in revenues accompanied by relatively stable depreciation costs and decreased labor costs realized through various operations streamlining projects.

Operating Expenses. Total operating expenses for the nine months ended September 30, 2003 were NT\$414.8 million (US\$12.3 million), compared to NT\$384.9 million for the nine months ended September 30, 2002, an increase of 7.8%.

Selling and general and administrative expenses

Selling and general administrative expenses increased by 8.0% in the nine months ended September 30, 2003 to NT\$356.7 million (US\$10.6 million). The increase was attributable to a rise in compensation expenses due to the expansion of our sales team, increases in maintenance charges, utilities charges, insurance expenses and depreciation and amortization.

Research and development expenses

Research and development expenses increased by 6.3% in the nine months ended September 30, 2003 to NT\$58.1 million (US\$1.7 million). The increase was attributable to increased compensation expenses due to the expansion of our research and development team and increases in utilities charges, insurance expenses and depreciation and amortization.

Operating income (loss). Operating income in the nine months ended September 30, 2003 was NT\$405.9 million (US\$12.0 million), compared to operating losses of NT\$301.3 million in the nine months ended September 30, 2002.

Non-operating income. Non-operating income increased by 94.4% to NT\$126.3 million (US\$3.7 million) in the nine months ended September 30, 2003, due primarily to net foreign exchange gains of NT\$50.3 million (US\$1.5 million) and an increase of 73.8% in rental income to NT\$43.3 million (US\$1.3 million) in the nine months ended September 30, 2003 from NT\$24.9 million in the nine months ended September 30, 2002.

Non-operating expenses. Non-operating expenses decreased by 32.2% to NT\$323.5 million (US\$9.6 million) in the nine months ended September 30, 2003 from NT\$476.9 million in the nine months ended September 30, 2002, principally due to decreases in interest expense, due to a decrease in the principal amount of outstanding working capital loans, a lack of net foreign exchange losses and decreased losses on disposal of property, plant, and equipment, which were offset in part by losses recognized on equity investments. Other losses remained steady at NT\$96.0 million (US\$2.8 million) for the nine months ended September 30, 2003. Other losses consists primarily of depreciation expenses for idle equipment which we define as equipment not in operation for any one calendar month, and assets leased to others.

Net income (loss). For the reasons stated above, pre-tax income for the nine months ended September 30, 2003 was NT\$208.7 million (US\$6.2 million), compared to a pre-tax loss of NT\$713.2 million for the nine months ended September 30, 2002. The income tax benefit for the nine months ended September 30, 2003 was NT\$184.2 million (US\$5.5 million), compared to NT\$302.4 million for the nine months ended September 30, 2002. Our income tax benefits are provided by the ROC tax authorities for our purchase of equipment for (i) factory automation, (ii) introduction of businesses to less developed areas of the ROC, (iii) research and development of test processes and (iv) training of personnel. The benefit is calculated by the tax authorities annually based on the depreciable value of the equipment involved and the extent it was used for the promotion of the purposes listed above.

As a result, net income in the nine months ended September 30, 2003 was NT\$393.0 million (US\$11.6 million), compared to a net loss of NT\$410.8 million for the nine months ended September 30, 2002.

See Notes 2 and 4(24) to our financial statements for information regarding income taxes.

Year Ended December 31, 2002 Compared to the Year Ended December 31, 2001

Operating Revenues. Total operating revenues increased from NT\$3,970.9 million in 2001 to NT\$5,403.5 million (US\$160.0 million) in 2002, an increase of 36.1%, resulting from a gradual recovery in the semiconductor industry throughout 2002, which was the primary cause of increased demand. In addition, increased demand allowed us to reduce concessions on pricing, which was the primary cause of a 40.7% decrease in sales returns and allowances, from NT\$93.6 million in 2001 to NT\$55.5 million (US\$1.6 million) in 2002.

In 2002, the operating revenues generated from test and other backend semiconductor manufacturing services accounted for 98.5% of total sales, and operating revenues generated from other sources accounted for 1.5% of total sales. Our revenues generated from test and other backend semiconductor manufacturing services increased by 40.2% from NT\$3,795.3 million in 2001 to NT\$5,322.1 million (US\$157.6 million) in 2002, principally resulting from an increase in all test services, in particular final test revenues which rose from NT\$2,025.3 million in 2001 to NT\$2,921.6 million (US\$86.5 million) in 2002.

The revenues we derived from other sources decreased by 53.6% from NT\$175.6 million in 2001 to NT\$81.4 million (US\$2.4 million) in 2002.

Cost of Goods Sold. In 2002, our total cost of goods sold increased by 21.2% to NT\$5,003.8 million (US\$148.1 million) from NT\$4,129.7 million in 2001, driven principally by a significant increase in depreciation and personnel costs associated with the new testers we purchased and installed for and the operation of, our Chung-Hwa Facility building in 2001.

As a result, our depreciation cost increased from NT\$2,161.2 million in 2001 to NT\$2,677.2 million (US\$79.3 million) in 2002.

Gross margin increased to 6.4% in 2002 from (6.5%) in 2001, primarily due to the increase in sales which outpaced increases in fixed costs, especially depreciation.

Operating Expenses. Total operating expenses for 2002 were NT\$524.9 million (US\$15.5 million), compared to NT\$436.8 million for 2001, an increase of 20.2%.

Selling and general and administrative expenses

Selling and general administrative expenses increased by 19.0% in 2002 to NT\$450.5 million (US\$13.3 million) from NT\$378.5 million in 2001. The increase was attributable to an increase in compensation expenses due to the expansion of our sales team, increases in maintenance charges, utilities charges, insurance expenses and depreciation and amortization.

Research and development expenses

Research and development expenses increased by 28% in 2002 to NT\$74.5 million (US\$2.2 million) from NT\$58.2 million in 2001. The increase was attributable to increases in compensation expenses due to the expansion of our research and development team and increases in maintenance charge, utilities charges, insurance expenses and depreciation and amortization.

Operating losses. As a result of the foregoing, operating loss in 2002 decreased substantially to NT\$180.8 million (US\$5.4 million), compared to an operating loss of NT\$689.2 million in 2001.

Non-operating income. Non-operating income decreased by 40.3% to NT\$91.4 million (US\$2.7 million) in 2002 from NT\$153.1 million in 2001, due to a lack of foreign exchange gains, partially offset by gains on disposal of property, plant and equipment and investments and increased rental income.

Non-operating expenses. Non-operating expenses increased by 11.6% to NT\$619.1 million (US\$18.3 million) in 2002 from NT\$555.0 million in 2001, principally due to the costs of issuing our convertible bonds and the corresponding increase in interest expense and net foreign exchange losses of NT\$51.9 million (US\$1.5 million), which was offset in part by a decrease in losses on disposals of property and investments.

Net loss. For the reasons set forth above, pre-tax loss for 2002 was NT\$708.5 million (US\$21.0 million), compared to a pre-tax loss of NT\$1,091.1 million for 2001. The income tax benefit for 2002 was NT\$383.1 million (US\$11.3 million), compared to NT\$299.5 million for 2001. As a result, net loss in 2002 was NT\$302.6 million (US\$9.0 million), compared to NT\$791.7 million for 2001.

See Notes 2 and 4(24) to the Financial Statements for information regarding income taxes.

Year Ended December 31, 2001 Compared to the Year Ended December 31, 2000

Operating Revenues. Total operating revenues declined from NT\$4,225.5 million in 2000 to NT\$3,970.9 million in 2001, a decrease of 6.0%, resulting from the general downturn in the semiconductor industry commencing in the second quarter of 2001. Both the volume and the hourly prices for test services for 2001 were affected. In addition, due to negative market conditions, our customers increasingly requested concessions on pricing, which was the primary cause of a 113.2% increase in sales returns and allowances, from NT\$43.9 million in 2000 to NT\$93.6 million in 2001.

In 2001, the operating revenues generated from test and other backend semiconductor manufacturing services accounted for 95.6% of total sales, and operating revenues generated from other sources accounted for 4.4% of total sales. Our revenues generated from test and other backend semiconductor manufacturing services decreased by 4.9% from NT\$3,990.5 million in 2000 to NT\$3,795.3 million in 2001, principally resulting from the decrease in test revenues from wafer probing and burn-in, which outpaced an increase in final test revenues. In 2001, we increased our service capacity by installing of a number of new testers to perform final tests in accordance with its expectation of increased demand resulting in a 3.1% increase in final test revenues from NT\$1,965.0 million in 2000 to NT\$2,025.3 million in 2001.

Our revenues derived from other sources decreased by 25.3% from NT\$235.0 million in 2000 to NT\$175.6 million in 2001.

Cost of Goods Sold. In 2001, our total cost of goods sold increased by 52.7% to NT\$4,129.7 million, driven principally by a significant increase in depreciation costs associated with the new testers purchased and installed by us and the completion of construction of our new Chung-Hwa Facility building in 2001.

We started recording depreciation on these new testers when they were put into service in 2001. Our depreciation cost increased from NT\$1,049.2 million in 2000 to NT\$2,161.2 million in 2001 as a result.

Gross margin decreased to (6.5)% in 2001 from 35.3% in 2000, primarily due to the decrease in sales accompanied by the significant increase in fixed costs, in particular depreciation costs.

Operating Expenses. Total operating expenses for 2001 were NT\$436.8 million, compared to NT\$305.8 million for 2000, an increase of 42.8%.

Selling and general and administrative expenses

Selling and general administrative expenses increased by 48.4% in 2001 to NT\$378.5 million. The increase was attributable to an increase in compensation expenses due to the expansion of our sales team, increases in maintenance charges, utilities charges, insurance expenses and depreciation and amortization mainly in connection with the completion of the Chung-Hwa Facility building, doubtful accounts relating to a particular customer and commissions paid to KYEC USA for sales and marketing in North America.

Research and development expenses

Research and development expenses increased by 14.8% in 2001 to NT\$58.2 million. The increase was attributable to an increase in compensation expenses due to the expansion of our research and development team and increases in maintenance charges, utilities charges, insurance expenses and depreciation and amortization as the portion of these expenses related to research and development activities increased due to the completion of newly constructed Chung-Hwa Facility building.

Operating losses. As a result of the foregoing, our operating loss in 2001 was NT\$689.2 million, compared to operating income of NT\$1,170.5 million in 2000, due to the sudden decline in demand for our services and our stable fixed costs.

Non-operating income. Non-operating income increased by 255.6% to NT\$153.1 million in 2001, due to net exchange gains of NT\$105.3 million primarily from the depreciation of Japanese yen, gain on the disposal of property, plant and equipment, losses consisting of the equipment related to a terminated sales contract, and gain on disposal of short-term investments, consisting of shares held in bond funds.

Non-operating expenses. Non-operating expenses increased by 163.7% to NT\$555.0 million in 2001, principally due to losses on disposal of property, plant, and equipment, interest expense and other losses. These losses relate to compensation of NT\$102.0 million payable in connection with the return of machinery and equipment to vendors, depreciation expense of NT\$36.6 million in relation to idle assets and depreciation expense of NT\$23.8 million in relation to leased assets.

Net income (loss). As a result of the foregoing, pre-tax loss for 2001 was NT\$1,091.1 million, compared to pre-tax income of NT\$1,003.1 million for 2000. Income tax benefit for 2001 was NT\$299.5 million, compared to NT\$175.3 million for 2000. As a result, the net loss in 2001 was NT\$791.7 million, compared to net income of NT\$1,178.4 million for 2000.

See Notes 2 and 4(24) to the Financial Statements for information regarding income taxes.

Quarterly Results

The following table sets forth unaudited unconsolidated financial information for the eight fiscal quarters ended September 30, 2003. We believe that all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly the selected quarterly information when read in conjunction with our unconsolidated financial statements and the related notes included elsewhere in this offering memorandum in relation to the years to ended December 31, 2001 and 2002. Our results of operations have varied and may continue to vary significantly from quarter to quarter and are not necessarily indicative of the results of any future period. Accordingly, we believe that period-to-period comparisons should not be relied upon as an indication of future performance.

	For the Three Months Ended							
	December 31, 2001	March 31, 2002	June 30, 2002	September 30, 2002	December 31, 2002	March 31, 2003	June 30, 2003	September 30, 2003
Net operating revenues, ...	867.9	926.8	1,418.7	1,495.4	1,507.1	1,422.9	1,522.3	1,797.2
Cost of goods sold	(1,094.8)	(1,140.9)	(1,322.8)	(1,293.7)	(1,246.4)	(1,304.6)	(1,267.9)	(1,349.3)
Gross profit (loss)	(226.9)	(214.1)	95.9	201.7	260.6	118.3	254.4	447.9
Operating expenses								
Selling, ...	—	(9.8)	(19.2)	(11.2)	(13.8)	(14.0)	(15.6)	(19.8)
General and administrative	(90.5)	(97.2)	(102.2)	(90.6)	(106.4)	(114.8)	(86.7)	(105.7)
Research and development	(16.4)	(15.0)	(19.1)	(20.5)	(19.9)	(18.0)	(24.6)	(15.5)
Total operating expenses	(106.8)	(122.0)	(140.5)	(122.3)	(140.1)	(146.8)	(126.9)	(141.0)
Income (loss) from								
continuing operations	(333.7)	(336.1)	(44.6)	79.4	120.6	(28.5)	127.5	306.9
Net non-operating income								
(expenses)	(154.5)	(175.6)	(10.7)	(225.5)	(115.9)	(73.0)	(76.7)	(47.5)
Income (loss) from								
continuing operations								
before income tax	(488.2)	(511.7)	(55.3)	(146.2)	4.7	(101.4)	50.8	259.4
Income tax benefit (expense)	85.1	216.2	11.9	74.3	80.7	107.8	32.2	44.2
Income (Loss) from								
continuing operations	(403.1)	(295.5)	(43.4)	(71.9)	85.4	6.3	83.0	303.6
Extraordinary gains	—	—	—	—	22.8	—	—	—
Net income (loss)	(403.1)	(295.5)	(43.4)	(71.9)	108.2	6.3	83.0	303.6

We believe our quarterly results of operations for the period stated above reflect both the rapid return of the semiconductor manufacturing industry in 2002 and the tendency for manufacturing volumes to be larger in the fourth quarter of each year in anticipation of the holiday season.

Recent Monthly Net Sales

We have recently announced our net sales for October and November 2003, being NT\$653.4 million and NT\$670.4 million, respectively. These monthly amounts have neither been audited nor been reviewed by Diwan, Ernst & Young, our independent auditors, and may not be indicative of our net sales for the full year of 2003.

Receivables

Receivables are the principal component of our current assets and require a significant amount of working capital to support, particularly as our sales continue to increase. Accordingly, control of receivables is a key aspect of our business operations.

The following tables summarize our receivables positions for the periods indicated below:

	As of December 31,				As of September 30,		
	2000	2001	2002		2002	2003	
	NT\$	NT\$	NT\$	US\$	NT\$	NT\$	US\$
	(in millions, except for turnover data)						
Receivables, net							
Notes receivable-trade	100.6	46.0	89.8	2.7	46.7	115.1	3.4
Accounts receivable-trade. . . .	1,281.4	593.2	1,122.6	33.2	1,149.0	1,259.8	37.3
Accounts receivable-related parties	73.4	82.8	255.0	7.5	286.0	267.4	7.9
Sub-total	1,455.4	722.0	1,467.4	43.4	1,481.7	1,642.3	48.6
Less: Allowance for doubtful accounts	(0.2)	(12.2)	(20.7)	(0.6)	(20.7)	(20.7)	(0.6)
Allowance for sales return	—	(13.0)	(29.1)	(0.8)	(14.9)	(7.6)	(0.2)
Receivables, net	<u>1,455.2</u>	<u>696.8</u>	<u>1,417.6</u>	<u>42.0</u>	<u>1,446.1</u>	<u>1,614.0</u>	<u>47.8</u>
Average receivables turnover (days)	89	102	73	—	78	89	—

Liquidity and Capital Resources

During the first nine months of 2003, we financed our operations primarily through proceeds from our convertible bonds issued in 2002, a private placement of our shares, long-term syndicated loans and cash flow from operations. During 2002, we financed our operations primarily through the proceeds from our issue of convertible bonds in the amount of US\$120.0 million, long-term syndicated loans, short-term working capital borrowings and cash flow from operations. During 2001, we financed our operations primarily through long-term syndicated loans, short-term working capital borrowings and also through cash flow from operations. In 2000, we financed our operations primarily through cash flow from operations and debt and equity financings. We issued 70,000,000 shares for an aggregate cash consideration of NT\$4,900.0 million.

Increases in sales and proceeds from our convertible bond issue in 2002 helped to alleviate the liquidity problems we encountered in 2001 due to the weak semiconductor market at that time. Strong sales during the first nine months of 2003 enabled us to maintain adequate sources of liquidity. Unused short-term loan facilities amounted to NT\$1,321.0 million (US\$39.1 million) at September 30, 2003.

Based on current levels of cash flow from operations, we are able to make required payments of interest and meet our other costs and expenses as they fall due. Under our loan agreements, we will be required to make total principal payments in 2003 in the amount of NT\$1,630.9 million in respect of long-term debt, and NT\$531.5 million in respect of short-term debt. We believe that, after giving effect to the issue and sale of the ZYPS, we will have sufficient liquidity to fund our operations through the end of 2003 and the first half of 2004. We expect that it will be necessary in the future to raise funds through the issue of equity securities, debt securities and bank loans to finance our operations and capital expenditures. There is no assurance that we will be able to raise such funds on terms that are acceptable to us, or at all.

Current ratio

As a consequence of the factors described above, our current ratio at September 30, 2003 rose to 102.4%. Under the terms of our long-term loans, we are required to maintain certain financial ratios, including a current ratio of not less than 100%, or will otherwise be required to make compensation

payments to our lending banks. See “— Liquidity and Capital Resources — Property, plant and equipment” below. Cash and cash equivalents at September 30, 2003 stood at NT\$1,124.9 million (US\$33.3 million), which is an adequate level for the operation of a business of our scale. Accounts receivable at September 30, 2003 increased by 9.6% to NT\$1,259.8 million (US\$37.3 million) compared to NT\$1,149.0 million at September 30, 2002. Accounts receivable at December 31, 2002 increased significantly by 89.2% to NT\$1,122.6 million (US\$33.2 million) compared to NT\$593.2 million at December 31, 2001. The accounts receivable balances were higher compared to the prior respective period-end mainly because of the increase in sales from 2001 to 2002. Related party receivables increased by 208.0% to NT\$255.0 million (US\$7.5 million) in 2002.

Total current liabilities increased from NT\$3,316.6 million at September 30, 2002 to NT\$3,337.9 million (US\$98.8 million) at September 30, 2003, an increase of 0.6%. The increase is principally attributable to an increase in the current portion of convertible bonds.

Property, plant and equipment

Based on our estimate of expected demand, we had capital expenditures of NT\$9,605.3 million, NT\$5,676.3 million and NT\$1,872.2 million (US\$55.4 million) in the years 2000, 2001 and 2002 respectively, and NT\$2,394.1 million (US\$70.9 million) in the nine months ended September 30, 2003. The following table shows the breakdown of our capital expenditures for these periods:

	For the Year Ended December 31,			For the Nine Months Ended September 30,	
	2000	2001	2002	2003	Sub-Total
			(NT\$ million)		
Land, building and facilities	1,661.9	1,207.4	20.2	41.6	2,931.1
Machinery and equipment	7,232.1	4,224.7	1,852.1	2,352.5	15,661.4
Others	711.3	244.2	—	—	955.5
Sub Total	<u>9,605.3</u>	<u>5,676.3</u>	<u>1,872.3</u>	<u>2,394.1</u>	<u>19,548.0</u>

From January 1, 1999 to September 30, 2003, these capital expenditures have been financed by proceeds of the issuance of shares for cash in the amount of NT\$6,350.0 million and long-term loans borrowed by the Company. The principal of the long-term loans borrowed by the Company from January 1, 1999 to September 30, 2003, after deducting repayment of certain loans during the period, amounted to NT\$4,361.4 million. As at September 30, 2003, we had NT\$4,361.4 million (US\$129.1 million) outstanding secured long-term loans from 23 financial institutions, of which NT\$1,630.9 million (US\$48.3 million) fell due between October 1, 2003 and December 31, 2003. The proceeds of this offering will be used to finance the acquisition of further machinery and equipment, in particular test equipment to service our current customers. We may in the future need to purchase further equipment, which in turn would require further financing, should we conclude an agreement with any significant new customers for the provision of testing services. The following table shows the detail of our long-term loans as of September 30, 2003:

Lead Bank	Original	Outstanding	Final Maturity	Annual Principal Repayment Amount					
	Principal	Principal		2003	2004	2005	2006	2007	2008
	Amount	Amount		NT\$	NT\$	NT\$	NT\$	NT\$	NT\$
	NT\$	NT\$		NT\$	NT\$	NT\$	NT\$	NT\$	NT\$
	(in millions)					(in millions)			
Chiao Tung Bank ⁽¹⁾	360.0	171.0	January 2006	68.4	68.4	68.4	17.1	—	—
Chiao Tung Bank ⁽²⁾	400.0	324.0	October 2007	76.0	76.0	76.0	76.0	77.0	—
Chiao Tung Bank ⁽³⁾	400.0	400.0	March 2008	—	—	123.0	123.0	123.0	30.9
China Development Industrial Bank and other 4 banks ⁽⁴⁾	995.0	306.2	September 2004	306.1	229.6	—	—	—	—
China Development Industrial Bank and other 16 banks ⁽⁵⁾	4,000.0	2,857.1	November 2005	1,142.9	1,142.9	1,142.8	—	—	—
Hsin-Chu International Commercial Bank ⁽⁶⁾ . . .	150.0	103.1	June 2006	37.5	37.5	37.5	18.8	—	—
ChinaTrust-Seventh Branch ⁽⁷⁾	1,330.0	200.0	October 2007	—	380.0	380.0	380.0	190.0	—
Total.	7,635.0	4,361.4		1,630.9	1,934.4	1,827.8	614.9	390.0	30.9

- (1) Principal repayable in 21 quarterly installments, starting from January 25, 2001. Except for the first installment of NT\$18 million, we are obligated to repay NT\$17 million in each quarter. Interest is payable monthly.
- (2) Principal repayable in 21 equal installments in each quarter, starting from October 5, 2002. Interest is payable monthly.
- (3) Principal repayable in thirteen quarterly installments starting from March 27, 2005. We are obligated to repay NT\$30.8 million in each quarter, except for a final quarterly installment of NT\$30.9 million. Interest is payable monthly.
- (4) Principal repayable in thirteen quarterly installments starting from September 2001. We will pay NT\$76.5 million in each installment for eight quarters and NT\$76.6 million in the subsequent installments.
- (5) Principal repayable in seven equal installments on a semi-annual basis, starting from November 20, 2002. Interest is payable monthly.
- (6) Principal repayable in 16 equal installments in each quarter, starting from June 26, 2002. Interest is payable monthly.
- (7) Syndicated loan of up to NT\$1,330.0 million currently drawn in the amount of NT\$200.0 million. Repayment in seven semi-annual installments begins on October 28, 2004. Interest is payable monthly.

We covenant with China Development Industrial Bank and other banks in the NT\$995.0 million syndicated loan due September 2004 that we will maintain current assets to current liability ratio at not less than 100% and debt to net tangible assets ratio at no greater than 100%. We also covenant with China Development Industrial Bank and other banks in the NT\$4,000.0 million syndicated loan due November 2005 that we will maintain current assets to current liability ratio at not less than 100%; debt to net tangible assets ratio at no greater than 100%, net tangible assets of at least NT\$7.0 billion, and that the multiple of our after-tax profits plus interest expense, depreciation and amortization expenses divided by interest expense will equal at least three. We are subject to a quarterly compensatory charge of 0.1% per year for non-compliance.

In addition, we covenant with ChinaTrust Commercial Bank and other banks in the NT\$1.33 billion syndicated loan agreement due October 2007 that we will maintain a current assets to current liability ratio of not less 100%, a debt to net tangible assets ratio at no greater than 100% and that the multiple of our after-tax profits plus interest expense, depreciation and amortization expenses divided by interest expense will equal at least three.

We also covenant with Chiao Tung Bank in agreements for the NT\$400 million loan due March 2008 that we will maintain a current assets to current liability ratio of not less than 100% and a debt to net tangible assets ratio at no greater than 125%. We are subject to a quarterly compensatory charge of 1.0% for non-compliance.

We issued US\$120.0 million zero coupon convertible bonds due 2005 in April 2002. Proceeds from the issue were used primarily for the repayment of our long-term debt obligations. US\$6.7 million of our convertible bonds were still outstanding as of November 30, 2003, the remainder having been converted or repurchased.

Net property, plant and equipment decreased by 6.2% on September 30, 2003 to NT\$13,279.7 million (US\$393.1 million), compared to NT\$14,151.4 million on September 30, 2002. This decrease was a result of a 47.5% increase in accumulated depreciation expenses to NT\$8,455.6 million (US\$250.3 million) as of September 30, 2003, from NT\$5,733.8 million (US\$169.7 million) as of September 30, 2002.

Other assets decreased to NT\$1,747.1 million (US\$51.7 million) as of September 30, 2003, compared to NT\$1,926.3 million on September 30, 2002.

Commitments and contingencies

At September 30, 2003, we entered into construction contracts for the expansion of factory facilities totaling NT\$49.9 million (US\$1.5 million), of which amount a total of NT\$46.9 million (US\$1.4 million) was un-accrued as of September 30, 2003. In addition, NT\$46.9 million will accrue upon our acceptance of the factory facilities.

Open letters of credit at September 30, 2003 totaled NT\$352.9 million (US\$10.4 million).

As of September 30, 2003, we were named as defendant in an action brought by Hwa Tsai Co., Ltd. and two other investors against us and our chairman, seeking payments of approximately NT\$47.0 million (US\$1.4 million) in damages for losses suffered as a result of alleged misleading statements we and our management allegedly made as part of our public offer of shares in 2001. A criminal complaint has been filed and is under investigation by the procuratorate for Hsin-Chu in relation to the same matter and for alleged violations of the Securities and Exchange Law and the Criminal Law. See “Our Business — Legal Proceedings.”

Quantitative and Qualitative Disclosures about Market Risk

The financial market risks to which we are exposed are principally risks relating to changes in exchange rates and interest rates.

Foreign Currency Risk

A substantial portion of our net sales are denominated in N.T. dollars, while we purchase a substantial amount of machinery and equipment in U.S. dollars and finance these purchases with U.S. dollar-denominated debt. Accordingly, we are exposed to movements in the exchange rates between U.S. dollars on the one hand, and N.T. dollars on the other hand. We recorded net exchange losses of NT\$25.2 million and NT\$51.9 million (US\$1.5 million) in 2000 and 2002, respectively, and net exchange gains of NT\$105.3 million and NT\$50.3 million (US\$1.5 million) in 2001 and the nine months ended September 30, 2003, respectively.

The effect of future changes in currency exchange rates on our results of operations cannot be accurately predicted. We continuously review our positions in relation to the various relevant currencies, and may enter into foreign currency forward contracts where available when we consider it appropriate to do so in order to hedge exposure. We, however, do not have any hedging contracts of any nature currently in effect.

To the extent possible, we attempt to match the currencies of our costs and expenses to the currencies of our revenues.

Interest Rate Risk

We have not entered into interest swaps or other hedging arrangements.

The following table shows long- and short-term bank loans outstanding at December 31, 2000, 2001, 2002 and at September 30, 2003:

Short-term loans:

	<u>Principal amount</u>	<u>Interest Rate⁽¹⁾</u>
	NT\$	
	(in millions)	
2000	1,776.5	0.99%–8.0867%
2001	1,502.6	0.78%–7.60%
2002	636.9	0.61%–3.37%
2003 ⁽²⁾	531.5	0.60%–2.04%

Long-term loans:

	<u>Principal amount</u>	<u>Interest Rate⁽³⁾</u>
	NT\$	
	(in millions)	
2000	3,330.0	6.655%–7.5%
2001	5,759.2	3.98%–6.9%
2002	4,698.9	3.03%–6.24%
2003 ⁽²⁾	4,361.4	2.53%–3.55%

(1) Floating interest rate.

(2) As of September 30, 2003.

(3) Floating interest rate except for the discount rate for long-term notes payable.

Income Tax

We are subject to income taxes in the ROC. The statutory income tax rate applicable to us in the ROC is 25.0%.

We benefit from tax incentives generally available to ROC companies, including tax credits as of September 30, 2003 ranging between 10% and 20% of the amount spent on qualifying machinery and equipment, at a rate of 35% for qualifying research and development, costs and employee training expenses. An additional tax credit may also be available to us, equal to 50% of the amount for the qualifying research and development costs or employee training expenses in the previous two years. If the tax credit cannot be fully utilized in the current year, the balance may be carried forward for up to four years. The available tax credit in each year is limited to 50% of the corporate tax payable in that year, except for the last of the four years for which there is no limit. Our income tax saving from such programs was NT\$133.3 million for 2000. In addition, we recorded NT\$1,066.7 million as tax losses in 2001 and NT\$619.0 million (US\$18.3 million) in 2002. The tax losses can be carried forward for a period of five years subsequent to the year the losses were recorded.

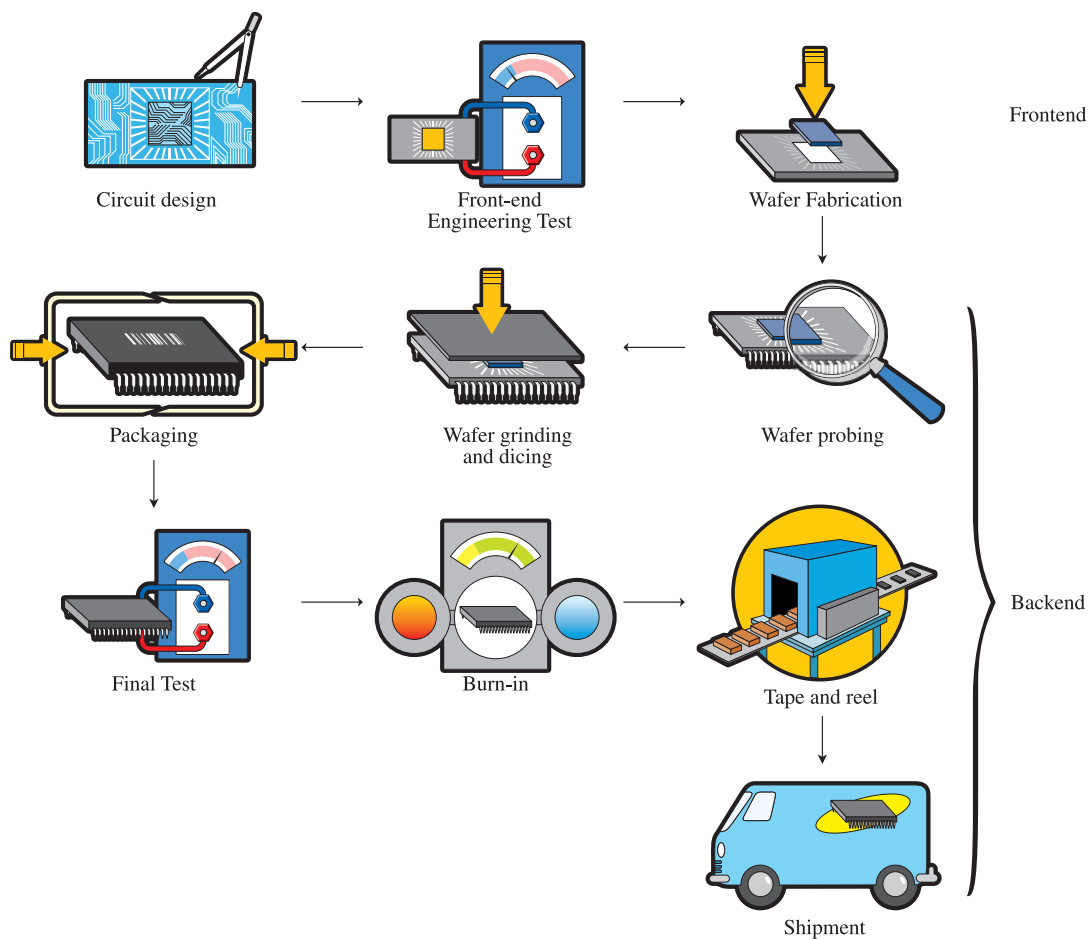
INDUSTRY

Industry Background

Semiconductors are critical components in a wide variety of machines, including computer systems, communications equipment and systems, automobiles, consumer products and industrial automation and control systems. As performance has increased and size and cost have decreased, the use of semiconductors in these applications has grown significantly. Gartner Dataquest estimates that worldwide semiconductor device market revenue will most likely grow from US\$156 billion in 2002 to US\$209 billion in 2004, a compound annual growth of 15.8% driven by continued strength in the cell phone handset market, the start of the corporate PC replacement cycle, and an improved macroeconomic environment.¹

The semiconductor manufacturing process

The semiconductor manufacturing process may be divided into the following stages from circuit design to shipment:



¹ "4Q03 Update: Global Semiconductor Forecast Scenarios", Richard Gordon, Gartner Dataquest, December 1, 2003.

Circuit Design	The design of a semiconductor is developed by laying out circuit components and interconnections.
Front-end engineering test	Throughout and following the design process, prototype semiconductors undergo front-end engineering test, which involves software development, electrical design validation, reliability and failure analysis.
Wafer fabrication	Wafer fabrication begins with the generation of a photomask through the definition of the circuit design pattern on a photographic negative, known as a mask, by an electron beam or laser beam writer. These circuit patterns are transferred to the wafers using various advanced processes.
Wafer probing*.	As part of the test process, each individual die on the wafer is electrically tested, or probed, for defects. Dies that fail this test are marked to be discarded.
Wafer grinding and dicing*.	Wafer grinding is a process that grinds the finished wafers to a designated thickness and dicing the wafers into dies, or chips.
Packaging*.	A semiconductor package is a plastic or ceramic container that protects and insulates the enclosed semiconductor so that it can be attached to a printed circuit board. Plastic packaging is the processing of bare semiconductors into finished semiconductors. Each sliced die is attached to a leadframe or a laminate (plastic or tape) substrate by epoxy resin. Each chip is then encapsulated with only the leads protruding from the finished casing or, in the “chip-on-board” process, is attached to a circuit board directly.
Final test*	Final test is conducted to ensure that the semiconductor device meets performance specifications. Final test involves the use of sophisticated test equipment and customized software programs to electrically test a number of attributes of packaged semiconductors, including functionality, speed, predicted endurance and power consumption. The final test of semiconductors is categorized by the functions of the semiconductors tested into logic/mixed signal final test, and memory final test. As compared with logic/mixed signal final test, memory final test typically requires simpler test software but longer test time per device tested.
Burn-in*	Burn-in refers to the process of subjecting finished semiconductors to extreme hot temperatures and high voltage over specified periods of time, depending on the circuitry and the intended use, to determine overall reliability under extreme conditions and to eliminate defective integrated circuits.
Tape and reel*.	Tape and reel is a process which involves the wrapping of finished semiconductors into continuous tape reels designed for use in customers’ automated surface mount technology lines.

* We are currently directly providing these services on a stand-alone or turnkey basis.

The semiconductor industry in Taiwan

The semiconductor industry in Taiwan developed later, and is less vertically integrated, than in other major semiconductor manufacturing countries such as the United States, Japan and Korea. Most of the semiconductor companies in Taiwan perform only one or two steps of the integrated circuit production process while in the United States, for example, many of the leading semiconductor companies are vertically integrated. Taiwan's semiconductor industry permits companies to focus on particular parts of the production process, develop economies of scale, maintain higher capacity utilization rates, and remain flexible in responding to customer needs. In addition, because companies engaged in each of the major stages of the production process are located in close proximity to each other, this structure is attractive to customers who wish to outsource parts of the semiconductor production process. Taiwan also has a high quality labor pool and, in particular, a large number of engineers suitable for sophisticated manufacturing industries.

As a result of these competitive advantages and the growth of the global semiconductor market, the semiconductor industry in Taiwan has experienced rapid growth in recent years and has made significant capital expenditures to expand capacity and technological capabilities. The government of Taiwan has also provided tax incentives, long-term loans at favorable rates and research and development support, both directly and indirectly through research institutes and universities. As a result of these investments and initiatives, the semiconductor industry in Taiwan is expected to continue to grow in the foreseeable future.

Increasing demand for outsourced semiconductor manufacturing services

Facing increasing design complexity, shorter time-to-market requirements, and shorter product life cycles, semiconductor companies are increasingly focusing their resources on their core competencies of product design, marketing and sales. This has led to a growing demand for outsourced semiconductor manufacturing services. Today, most major semiconductor companies, including those with their own manufacturing facilities, use independent packaging and test service providers for at least a portion of their manufacturing needs. According to Gartner Dataquest, independent test service revenues for the semiconductor industry in 2002 were approximately US\$1.6 billion. Gartner Dataquest projects that independent test revenues are expected to grow at a compound annual growth rate of 23.1% to US\$4.5 billion in 2007². We believe the principal factors contributing to this outsourcing trend are as set forth below.

Capital expenditures required for semiconductor test facilities have increased as processes become increasingly complex. As a result, equipment must be utilized at a higher capacity level in order to be cost effective. However, semiconductor companies have difficulty sustaining high levels of capacity utilization due to the need to continuously update test equipment to accommodate new products with ever-shorter life cycles. Independent providers of test services, on the other hand, can maintain high utilization levels over a longer period of time by providing a broad range of services to a variety of customers.

Furthermore, as the cost to build wafer fabrication facilities has dramatically increased, semiconductor companies with their own manufacturing facilities have been forced to concentrate their capital resources on core wafer manufacturing activities. As a result, semiconductor companies are increasingly using independent test providers who are able to focus on the provision of testing services.

Time-to-market pressures are increasing for semiconductor companies. In response, semiconductor companies are increasingly seeking to shorten their time-to-market for new products. Having the right backend process technology and capacity in place is a critical factor in reducing time-to-market. For this reason, semiconductor companies are increasingly utilizing the resources and capabilities of independent providers of test services in order to deliver their new products to market more quickly.

² "Semiconductor Assembly and Test Services (SATS) Forecast: 2002–2007", Jim Walker, Gartner Dataquest, March 31, 2003.

Sophisticated expertise and technological innovation are necessary. Semiconductor companies are facing ever-increasing demands for miniaturization, higher lead counts for more connections and improved thermal and electrical performance. The numerous test options required to support the proliferation of new semiconductor technologies make it extremely difficult for semiconductor companies to invest their time and resources in research and development of test technology and capacity. As such, semiconductor suppliers have increasingly relied on independent providers of test services which have, by specializing, developed substantial expertise in these technologies.

As a result of these factors, outsourcing of semiconductor manufacturing services continues to grow. Integrated device manufacturers with their own manufacturing capabilities continue to outsource an increasing amount of their manufacturing needs. Moreover, fabless integrated circuit design companies have proliferated in recent years. These companies outsource every step of the manufacturing process, including all backend semiconductor manufacturing processes, so that they can focus on their core competence of designing and marketing advanced semiconductor products.

OUR BUSINESS

Overview

We are one of Taiwan's leading independent providers of semiconductor test and other backend semiconductor manufacturing services. We believe we are the only ROC company to provide the full range of integrated circuit test services. Our test services include wafer probing and final test for logic, mixed signal and memory devices. Other backend semiconductor manufacturing services provided by us include wafer grinding and dicing, chip-on-board packaging, tape and reel and drop shipment of finished semiconductor devices. We do not generally provide packaging services to our clients other than selected chip-on-board packaging but act as a turnkey for some customers, working with packaging and other service providers to facilitate all backend semiconductor manufacturing services from wafer probing to drop shipment.

Our corporate headquarters, test and processing facilities are located in the Hsin-Chu semiconductor corridor of Taiwan, where we owned 674 testing machines, and operated another 72 testers which were consigned or rented from third parties or held on a demonstration basis as of December 20, 2003. Taiwan is home to the world's largest independent wafer foundries and as such is home to some of the world's leading suppliers of outsourced semiconductor manufacturing services. Our close proximity to and relationships with Taiwan's leading wafer foundries allow us to benefit significantly from the trend towards outsourcing in the semiconductor industry and to quickly respond to our customers' needs. Our location in Taiwan also enables our customers to secure seamless services within Taiwan for all of their manufacturing needs, thereby minimizing the time required to deliver finished semiconductor devices to the market.

Our customers include major fabless integrated circuit design companies, integrated device manufacturers and semiconductor foundries. We provide services to customers producing a wide range of semiconductors. We believe some of the world's largest semiconductor manufacturers rely on both the quality of our test services and our ability to meet all of their testing needs. In 2003, we serviced customers including Macronix International Corporation, MediaTek Incorporated, Silicon Storage Technology, Incorporated, United Microelectronics Corporation, Fujitsu Limited, Winbond Electronics Corporation, Powerchip Semiconductor Corporation, SanDisk Corporation and Toshiba Corporation. We service our customers with a direct sales force located in Taiwan, Japan and the United States. In addition to our sales team, we have technical personnel in Taiwan who provide our clients with on-site planning, calibration and coordination of our testing services.

We have shareholding relationships with a testing and packaging service provider and some of our key customers. SPIL, our largest shareholder, held 11.23%, of our outstanding shares and Silicon Storage Technology, Incorporated, one of our key customers, held 0.55% of our outstanding shares, each as of September 30, 2003. We have a turnkey relationship with SPIL, which operates in the field of semiconductor assembly. Pursuant to our turnkey relationship, we will utilize SPIL's assembly services as part of our managing the entire semiconductor backend manufacturing process for a customer. Under our relationship with SPIL, neither we nor SPIL receives commissions for referring business to each another, but collects fees for our respective services from each of our respective clients, which are passed directly on to the turnkey partner. In the past we entered into a contractual turnkey arrangement with Amkor Technology, Inc., which lapsed in accordance with its terms in September 2002.

Our legal and commercial name is King Yuan Electronics Co., Ltd. We were incorporated under the ROC Company Law as a company limited by shares on May 28, 1987 and our shares were listed on the Taiwan Stock Exchange in May 2001. Our principal executive offices are located at No. 1, Lane 99, Pu-Ding Road, Hsin-Chu 300, Taiwan, Republic of China, and our telephone number is 886-3-5751888. Our Internet website address is www.kyec.com.tw. Our website does not constitute a part of this offering memorandum.

Our Strategy

Continue to offer the broadest range of semiconductor testing services to our customers

Many of our customers require a wide range of test technologies for logic, mixed signal and memory devices. We believe we possess one of the most comprehensive sets of testing technology among our competitors, including the ability to test logic, mixed signal and memory semiconductors, CMOS image sensors, charge-coupled devices, LCD drivers, radio frequency chips and simple logic embedded memory devices and other SOCs. We are able to provide testing services for certain devices, such as CMOS image sensors, which certain of our competitors are not yet able to test. We provide memory test services for most types of memory devices in production, including up to one gigabit memory chips and logic and mixed signal testing for some of the fastest chipsets, currently up to 800 megahertz. We believe our ability to act as a single solution for most of our customers' testing needs makes us their preferred choice as a testing partner.

We intend to continually expand our portfolio of test technologies through internal development, joint development with customers and continued investment. We believe that leading technological capability is our most valuable asset, and that the ability to offer leading test technologies for the most complex integrated circuit devices is critical to attracting and retaining customers and maintaining high margins. We are currently developing test technologies which allow us to test newly developed sophisticated semiconductors such as chips with SOC technologies and advanced radio frequency chips which are utilized in telecommunication devices.

Maximize utilization rate of and continue to invest in leading edge technology and equipment

The high fixed cost and relatively short lifecycles of our equipment make maintaining high equipment utilization rates and hourly test charges key to the profitability of our operations. Our depreciation costs constituted 54.6% of our manufacturing cost for the nine months ended September 30, 2003, while variable costs accounted for 20.0% in the same period. Our test revenues are based on hourly rates for the testing machines used to test our clients' products. In addition to market demand, test charges for a single machine may vary depending on the product tested, with more complex devices that require the most advanced test equipment and testing configurations generally commanding higher hourly test charges. By maintaining a steady flow of customer orders, carefully planning product testing cycles to maximize testing time per machine and continuing to obtain high-end test work from our clients, we expect to continue to increase our utilization rates and hourly test charges, and thus our operating margins.

We have made significant investments to construct, fit-out and equip large-scale facilities that deploy hundreds of sophisticated test units, to ensure that we have the necessary capability to design and perform our services. We will continue our investment, in a disciplined manner, in state-of-the-art equipment. We currently employ technologically advanced imported test machinery and equipment, and also cost-efficient test machinery designed and developed in-house. In addition to test equipment design and manufacture, our research and development team have developed processes for testing machines which reduce the time required to calibrate for new semiconductors, allow for quicker transition of semiconductors between machines and shorten the testing cycle time. This gives us the ability to test highly parallel, high speed, high pin-count and highly integrated devices, such as optical image-sensing integrated circuits, as well as the ability to achieve cost-efficient high volume testing of lower speed integrated circuits, all at speeds comparable to or faster than that of our competitors.

Provide customers with a full spectrum of backend semiconductor services directly and through our turnkey solutions

In addition to test services, our clients on occasion also require other backend semiconductor manufacturing services on a turnkey basis, which include packaging and assembly services, wafer grinding and dicing, chip-on-board packaging, tape and reel and drop shipment of the semiconductor devices. We

believe that as semiconductor suppliers face shorter time-to-market demands and shorter product cycles, such backend services provided on a turnkey basis will become an increasingly important aspect of our customers' manufacturing and product distribution strategies. We are one of a small number of vendors capable of providing such backend services on a turnkey basis. Although we can provide most wafer grinding and dicing, tape and reel and drop shipment services to our customers, we lack the packaging capabilities, except for certain chip-on-board packaging solutions, that our customers require in their backend manufacturing process. We have therefore developed strong relationships with packaging service providers, in particular our shareholder SPIL, for the coordination of these turnkey services for our customers.

Leverage relationships with foundries to provide total solutions to customers

Our proximity to and demonstrated long-term relationship with Taiwan's leading foundries, including Taiwan Semiconductor Manufacturing Company Ltd. and United Microelectronics Corporation, provide our customers with unique advantages to conveniently access various manufacturing services and efficiently manage their supply chains. We conduct joint marketing with semiconductor foundries to capture the test and other backend semiconductor manufacturing requirements of their customers. These customers comprise principally integrated circuit design companies, integrated device manufacturers and systems original equipment manufacturers. We believe that by leveraging the relationships with these leading foundries, we are able to attract new customers as well as maintain our existing customers.

Focus on customer service and expand the customer base

We believe that our ability to anticipate and meet our customers' needs is critical to attracting and retaining leading semiconductor suppliers as customers. We strive to work closely with our customers on developing and fulfilling their current and future semiconductor test needs. We position ourselves as a high-tech service business and have a well established customer-oriented culture, and continuously enhance the quality, cost effectiveness, cycle times, and flexibility of services. To provide a dedicated customer support infrastructure to our customers, we service our customers with a direct sales force located in Taiwan, Japan and the United States. In addition to our sales team, we have technical personnel in Taiwan who provide our clients with on-site planning, calibration and coordination of our testing services.

We intend to expand our customer base geographically by targeting customers located in the United States, Japan and Europe. We will expand our current sales and marketing team and the operations of our United States subsidiary, KYEC USA Corp. Currently, we schedule frequent visits by our sales team to Japan to visit existing customers and to source new customers, which, for example, has resulted in our acquiring Fujitsu Limited as a customer. We have identified Europe as a potential market and intend to enhance our marketing efforts to European customers by scheduling regular visits by our sales and marketing team.

Our Services

The production of a semiconductor is a complex process that requires increasingly sophisticated engineering and manufacturing expertise. The production process can be broadly divided into three primary stages:

- wafer fabrication, including wafer probe;
- assembly of bare semiconductors, or die, into finished semiconductors (referred to as "assembly" or "packaging"); and
- final testing of assembled semiconductors.

Test Services

Semiconductor testing measures and ensures the performance, functionality and reliability of a packaged semiconductor device. Testing semiconductor devices requires significant technical expertise and knowledge of the specific applications and functions of the semiconductors tested. In addition to maintaining different types of advanced testing equipment which enable us to test a variety of semiconductor functions, we work closely with our customers to develop and convert programs to test particular semiconductor products on multiple equipment platforms effectively. Aside from the impact of demand and volume on prices, the charge for any specific test service is dependent on test time, the complexity of the test to be performed and the fixed cost of the test machine, usually measured in seconds, required to run a test which varies depending on the complexity of the semiconductor device and the customer's specification with the percentage of fault coverage.

Wafer Probing. We conduct wafer probing of a wide variety of logic and mixed signal integrated circuits, including complex, high-performance, as well as high volume integrated circuits, in addition to wafer probing of memory devices such as dynamic random access memory circuits.

Final Testing. We conduct final test of a wide variety of logic and mixed signal integrated circuits, including complex, high-performance, as well as lower performance integrated circuits. High-performance products include personal computer-related components including video chips, while major high volume products include integrated circuits used in consumer electronics devices.

We also provide final test services for a variety of memory products, such as state access memory circuits, dynamic random access memory circuits and single-bit read only erasable programmable memory integrated circuits. The test of memory products requires different equipment than that used in logic and mixed signal test and generally requires a longer test time.

Other backend semiconductor manufacturing services

Wafer grinding and dicing. As part of our backend semiconductor manufacturing services, we grind the wafers provided by customers to designated thicknesses and dice the wafer into dies, or chips. The wafer grinding and dicing process requires high-precision technologies and equipment to achieve precise tolerances.

Packaging. Packaging includes plastic packaging and chip-on-board packaging. Plastic packaging, or assembly, is the process of assembling bare semiconductors into finished semiconductors and serves to protect the die and facilitate electrical connections and heat dissipation. A chip-on-board refers to the process whereby a chip is not encapsulated in a mold but is attached to a circuit board directly. As our primary business consists of integrated circuit test services, we only conduct a limited volume of chip-on-board packaging to accommodate particular customer requirements.

Other Test Services. We also provide "burn-in" test services. Through "burn-in," a semiconductor is inserted into a socket and subjected to extremely hot temperatures over a period of time. "Burn-in" tests are typically conducted to determine overall reliability under extreme conditions.

In order to offer turnkey backend semiconductor manufacturing services, including packaging and assembly, we have formed a relationship with SPIL. Through flexible contracting and subcontracting arrangements, we provide our customers with packaging or assembly services. We jointly market turnkey backend semiconductor manufacturing services with SPIL to our customers under this relationship. See "— Turnkey Relationships" for details.

We believe that our ability to successfully execute our full range of services is an important factor in maintaining existing customers as well as attracting new customers.

The table below sets out our total operating revenues before testing and sales discounts by type of service for the periods indicated.

	As of and for the Year Ended December 31,						As of and for the Nine Months Ended September 30,			
	2000		2001		2002		2002		2003	
	NT\$	%	NT\$	%	NT\$	%	NT\$	%	NT\$	%
	(in millions, except percentages)									
Wafer probing ⁽¹⁾	2,025.5	47.9%	1,770.0	44.6%	2,400.5	44.4%	1,678.4	43.5%	2,258.9	47.1%
Final test ⁽²⁾	1,965.0	46.5%	2,025.3	51.0%	2,921.6	54.1%	2,130.5	55.1%	2,437.8	50.8%
Other ⁽³⁾	235.0	5.6%	175.6	4.4%	81.4	1.5%	54.2	1.4%	101.6	2.1%
Total operating revenues before testing and sales discounts	4,225.5	100.0%	3,970.9	100.0%	5,403.5	100.0%	3,863.1	100.0%	4,798.3	100.0%

(1) Includes revenues from logic, mixed signal and memory wafer probing services and assembly services.

(2) Includes revenues from logic, mixed signal and memory final test services, burn-in test services and tape and reel services.

(3) Includes revenues from tester leasing, sale of self-assembled burn-in ovens and other revenue.

Certain products we test are used in some product categories and not others, such as SOC products typically used in consumer electronics. By tracking the types of products in which our tested devices are used, we are able to some extent to predict market demand for our test services based on projected market demand for the products in which our tested products are used. We believe that our provision of test services for products used in different market segments helps in part to reduce the financial impact on us of a sudden downturn in any one product market.

We manage our business through three departments, which are the Business Center, the Manufacturing Center and the President's Office. The Business Center constitutes sales, marketing and customer service. The Manufacturing Center consists of six divisions, namely test development, logic and mixed signal probing test, logic and mixed signal final test, memory probing test, memory final test and assembly. The President's Office oversees all other aspects of our business, including research and development, quality control, information technology, finance, accounting and human resources.

Customers

Our customers include many of the largest integrated device manufacturers and semiconductor companies in the world. In 2000, 2001 and 2002, 44.3%, 49.2% and 48.1%, respectively, of our net operating revenues were derived from sales to our top five customers, and 65.5%, 67.4% and 65.1%, respectively, of our net operating revenues were derived from sales to our top ten customers. For the nine months ended September 30, 2002 and 2003, 52.2% and 41.8%, respectively, of our net operating revenues, on an unconsolidated basis, were derived from sales to our top five customers, and 67.0% and 61.9%, respectively, of our net operating revenues, on an unconsolidated basis, were derived from sales to our top ten customers. Listed below in alphabetical order are our top 10 customers for the nine months ended September 30, 2003:

Advanced Micro Devices, Inc.
 Chipbond Technology Corp.
 Elite Semiconductor Memory Technology Inc.
 Macronix International Co., Ltd.
 MediaTek Incorporated
 Novatek Microelectronics Corp., Ltd.
 Seiko Epson Corp.
 Silicon Storage Technology, Incorporated
 United Microelectronics Corporation
 Winbond Electronics Corporation

The table below sets forth our revenues categorized by customer type for the periods indicated.

	Year Ended December 31,	Nine months Ended September 30,	
	2002 ⁽¹⁾	2002	2003
Fabless	55.0%	56.4%	52.6%
IDM	36.0%	33.1%	40.3%
Foundry	4.4%	4.1%	7.1%
System.	4.6%	6.4%	0.0%
Total	100.0%	100.0%	100.0%

(1) We began tracking these data in 2002.

The following table sets forth our largest customers by product area for the nine months ended September 30, 2003:

Consumer Electronics	Computers	Communications
Macronix International Co., Ltd.	Silicon Storage Technology,	Advanced Micro Devices, Inc.
MediaTek Incorporated	Incorporated	Silicon 7, Inc.
Winbond Electronics Corporation	Novatek Microelectronics Corp.,	Fujitsu Limited
Elite Semiconductor Memory	Ltd.	
Technology Inc.	Powerchip Semiconductor	
Sunplus Technology Corp.	Corporation	

Industry-leading companies require early access to advanced testing and packaging because they manufacture products which have first to market technologies. Our close relationships with industry leading customers help us to further develop their technology and position us to benefit from the high unit volumes produced by these major semiconductor customers.

We believe we have benefited from our location in Taiwan where outsourced semiconductor manufacturing infrastructure is well established. Our long-term relationships with the world's largest independent wafer foundries are important to the continued growth of our business. The majority of the semiconductor devices we test have been manufactured in or for Taiwan's leading fabless design houses, integrated device manufacturers and wafer foundries. As these companies grow, we expect them to increase their demand for the services we provide. Moreover, we believe that we can leverage relationships with wafer foundries to jointly market seamless outsourced semiconductor manufacturing services from design to drop shipment and remain at the forefront in semiconductor technology. We also believe that our close proximity and close relationships to wafer foundries enables our customers to more efficiently manage their supply chains and find comprehensive solutions to their semiconductor needs.

Our customers generally do not place purchase orders far in advance. However, we engage customers in advance of the placement of purchase orders to gauge each customer's expected demand. Although we have long term sales relationships with a number of customers, our customers generally may cancel or reschedule orders without significant penalty. In the past, very few customers have cancelled firm orders for our test services. This is due in part to firm orders arriving only days before shipment of wafers to be tested by us.

Sales and Marketing

Our sales and marketing strategy is focused on providing high quality advanced semiconductor device test and other backend services, consistent on-time delivery, competitive pricing and the complete line of backend services through our relationships with other packaging providers. We believe that this strategy is best implemented by servicing a select number of customers whom we consider to have a high level of anticipated growth. We work on a cooperative basis with these customers so that we can best meet their needs.

We carry out reviews of all of our customers on at least a quarterly basis. We regularly collect data from different segments of the semiconductor industry and, when possible, we work closely with our customers to design and develop test solutions for their new products. These "co-development" or "sponsorship" projects can be critical when customers seek large scale early market entry with a new product.

Our sales and marketing efforts are primarily carried out by a team in Hsin-Chu near many of Taiwan's leading semiconductor companies. In addition, we have a subsidiary responsible for sales in the United States, KYEC USA Corp.

Set forth below is a geographic breakdown of our net operating revenues for the periods presented below:

	For the Year Ended December 31,			For the Nine Months Ended September 30,	
	2000	2001	2002	2002	2003
Taiwan	72.8%	72.1%	73.8%	72.0%	66.4%
United States	20.5%	23.4%	16.2%	17.0%	20.5%
Japan.	4.5%	3.4%	6.6%	8.5%	7.2%
Others ⁽¹⁾	2.2%	1.1%	3.4%	2.5%	5.9%
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

(1) Includes Hong Kong and Korea.

Sales generated outside Taiwan accounted for approximately 27.2%, 27.9% and 26.2% of net sales in 2000, 2001 and 2002, respectively and approximately 28.0% and 33.6% of net sales for the nine months ended September 30, 2002 and 2003, respectively, on an unconsolidated basis. We primarily target those U.S., Canadian and Japanese semiconductor companies that contract their wafer foundry services to major independent foundries in Taiwan.

We sign annual contracts with many of our significant customers. These contracts normally provide that the quantities of services furnished by us are updated by the customer every month, generally through three- to six-month non-binding rolling forecasts. We have such formal contracts with some of our overseas customers.

Turnkey Relationships

We maintain a turnkey relationship with SPIL whereby we agree to use each other's services for those of our clients wishing us to perform the full range of semiconductor backend process services on a turnkey basis. This relationship is not exclusive and may be terminated at any time. Through these relationships we have developed order flows from customers such as Ricoh and Toshiba. Under our relationship with SPIL, neither we nor SPIL receive commissions for referring business to one another, but collect fees for our respective services from each of our respective clients, which are passed directly on to the turnkey partner.

We believe that the joint promotional strategy will not only enlarge our customer base but also provide our existing customers more convenient one-shop services. We, by cooperating with SPIL and possibly with other companies, are able to quote the customers for turnkey backend semiconductor manufacturing services, including semiconductor testing and packaging. Under our prior contractual turnkey agreement with Amkor, we were required to discontinue all of our packaging operations within six months of executing the agreement. The agreement with Amkor has now expired in accordance with its terms, and we continue to operate limited packaging services. We have not to date received correspondence from Amkor on this matter, however there can be no assurance that Amkor will not take any action in the future.

Quality Control

We employ quality control procedures at every critical test stage, with the aim of identifying and solving problems at the earliest possible stage of the test process. Our quality control procedures include statistical process control, which involves sampling tests to control and monitor the test process. Tests include optical scanning and reliability tests, including temperature and humidity tests, pressure and stress tests and testing for resistance to solvents. If a problem is detected, failure analysis will be used to determine the cause. Visual inspection and optical scanning are performed on all assembled semiconductor devices to test for lead straightness and integrity. Final products are tested on a sample basis for open shorts in wire connections. To ensure that our quality control procedures are effectively applied, production line employees are provided with ongoing training.

Our operations are undertaken in clean rooms where air purity, temperature and humidity are controlled. To ensure stability and integrity of its operations, we maintain clean rooms at our facilities that meet U.S. Federal 209E class 100, 1,000, and 10,000 standards. Our comprehensive quality control programs have received numerous accredited International Standards Organization (ISO) certifications, including, ISO 9001/QS 9000, SAC 1, TL9000, ISO/TS 16949, ISO14001 and OHSAS 18001. We undergo periodic audits to maintain our ISO certification. ISO 9000 is an international standard on the requirements for production of quality products and services. It also sets forth quality management systems for product design, product development, installation and servicing. QS 9000 is a quality management system that addresses the specific production needs of automotive customers. Semiconductor Assembly Council or SAC certification is one of the most prestigious certifications in the semiconductor manufacturing industry. In addition, we have also achieved certification for ISO 14001 as well as OHSAS 18001. ISO 14001 is an international standard on environmental management systems to ensure environmental protection and

prevention of pollution in balance with socio-economic needs while OHSAS 18001 is the standard for implementation of an occupational health and safety management system. The ISO/TS 16949 certification is required for the processing of chips used in the automotive industry.

Although some semiconductor companies view the ISO certification as a basis for initiating contact with a potential subcontractor, they generally perform separate production and quality audits of the subcontractor themselves. In addition, test service customers generally require that our facilities undergo a stringent “qualification” process during which the customer evaluates our operations and production processes. The qualification process can take many weeks. Due to this lengthy qualification process, we believe semiconductor manufacturers are generally reluctant to switch semiconductor test companies once these companies have been qualified.

As part of our overall focus on quality service, we also closely monitor our product delivery performance against scheduled delivery times. We met or achieved shorter than scheduled delivery times substantially all of the time during the nine months ended September 30, 2003.

Research and Development

Our research and development department focuses on the reduction of our testing costs through process streamlining and the design of test programs and adjustment of our test equipment to facilitate testing of our clients’ evolving semiconductor products. We are developing test equipment peripherals such as leadboards and probe cards and software for parallel test of logic semiconductors, rapid automatic generation and cross-platform conversion of test programs to test logic/mixed signal semiconductors, automatic code generation for converting and writing test programs, testing new products using existing machines and providing customers remote access to monitor test results. We are also continuing the development of interface designs to provide for high-speed test by minimizing electrical noise. We provide memory test services for up to one gigabit memory chips and logic and mixed signal testing for up to 800 megahertz chipsets. Our strong research and development team allows us to test devices, such as CMOS image sensors, which certain of our competitors are not yet able to test. We also provide testing for SOCs used in consumer products. Our research and development division and sales personnel work closely with customers in designing and modifying test software and with equipment vendors to increase the efficiency and reliability of test equipment.

We also focus on improving the efficiency and technology of the test processes. We have successfully designed and manufactured burn-in ovens, including integrated circuit burn-in ovens and LCD aging systems both for our own use and for outside sale. The research and development division is currently designing cost-efficient logic testers, where we seek to increase market share.

Our research and development personnel include many employees with advanced degrees in electrical engineering or other related disciplines. In addition, we involve business operations and operations personnel in research and development activities. For 2000, 2001 and 2002, we spent NT\$50.7 million, NT\$58.2 million and NT\$74.5 million (US\$2.2 million), respectively, on research and development. For the nine months ended September 30, 2002 and 2003, we spent NT\$54.6 million and NT\$58.1 million (US\$1.7 million), on an unconsolidated basis, on research and development, respectively.

Equipment and Material

We make large capital investments in test equipment. We generally purchase equipment with broad functionality and flexibility for use in multiple test applications where possible, but are often required by the nature of our clients’ testing needs to purchase limited-use testing equipment. We purchase test equipment from a variety of major international manufacturers, including Advantest Corporation, Teradyne Inc., Agilent Technologies, Credence Systems Corporation and NPTest Inc. As of December 20, 2003, we

owned 674 testers, and operated another 72 testers through rental, consignment and demonstration arrangements. In addition, as of the same date, we owned and operated 115 burn-in ovens. We generate test revenues from the consigned testers on a processing fee basis.

We will place orders for additional test equipment in future periods to the extent market conditions and demand for our services make it desirable to do so, and make equipment purchasing decisions in close consultation with certain key customers. Nonetheless, given the heavy swings in market demand for our services and the long lead times required for equipment orders, it is often difficult to match our testing capacity to market demand. In addition, our conclusion of any significant agreements for the provision of testing services to a large, new customer would require us to purchase additional testing equipment to meet their needs and would result in our seeking further financing to make such purchases. Some of these equipment are only available from a limited number of vendors or are manufactured in relatively limited quantities and must be ordered three months to a year in advance. See “Risk Factors — Risks Relating to Our Business and Our Industry — If we are unable to obtain equipment from our suppliers in a timely manner and at a reasonable cost, our business may be adversely affected.”

We do not use raw materials for our testing services.

Our chip-on-board packaging operations require adequate supplies of materials and equipment on a timely basis. The principal raw materials used in packaging are leadframes, substrate, gold wire and molding compound. We purchase materials based on customer forecasts, and our customers are generally responsible for any unused materials in excess of the quantity that they indicated that they would need.

For other services, particularly tape and reel, we require limited materials such as plastic tapes and wrapping materials. We purchase materials from major suppliers, including Advantek Taiwan Inc., Morrison & Co. Ltd, Sing Way Corporation, Teradyne Inc. and Kinsus Interconnect Technology Corp.

Facilities

We own and operate two facilities in Taiwan. Our facilities are located in the Hsin-Chu semiconductor manufacturing corridor of Taiwan.

The following table sets out the location and primary use of our facilities as of September 30, 2003:

Facilities	Location	Commencement of Operation	Principal Usage	Floor Space	Number of Testers ⁽¹⁾ as of December 20, 2003
Headquarters	Hsin-Chu	July 2000	Administrative, logic wafer probing, tape and reel	16,407.6 m ²	171
Chung-Hwa Facility	Miao-Li	January 2000	Memory wafer probe and final test, logic final test, packaging, burn-in services, wafer grinding and dicing	95,484.3 m ²	575
Chu-Nan Facility ⁽²⁾	Miao-Li	January 1998	The lease by the Company to Poppoly Optoelectronics Corp. has been terminated on February 2002	6,232.5 m ²	—

(1) Includes 72 testers consigned or rented from third parties or held on a demonstration basis.

(2) Facility currently idle.

Headquarters

Our headquarters are located at No. 1, Lane 99, Pu-Ding Road, Hsin-Chu 300, Taiwan. We own the land and the building where our headquarters are located. We engage in sales and marketing, research and development, logic wafer probing, tape and reel and provide administrative services at our headquarters.

Chung-Hwa Facility

The Chung-Hwa Facility is located at 118, Chung-Hua Road, Chu-Nan, Miao-Li 350, Taiwan, and was bought by us in 1999 and commenced operations in January 2000. The Chung-Hwa Facility is our testing and operating center, including memory test, logic final test, chip-on-board packaging, burn-in and wafer grinding and dicing. The total floor space for the Chung-Hwa Facility is 95,484.3 square meters.

Due to current zoning restrictions, our Chairman, C.K. Lee, holds two lots of land adjacent to the Chung-Hwa Facility in trust for us, and is subject to an unconditional obligation to transfer the title of the land to us when the lots are rezoned.

The total building area of our facilities at our headquarters and the Chung-Hwa Facility is 111,892 square meters. We believe that our existing production and office facilities are adequate to meet current requirements, and that suitable additional or substitute space will be available as needed to accommodate any further physical expansion of production, corporate operations and for any additional sales offices.

In addition to the headquarters and Chung-Hwa Facility, we also own a Chu-Nan Facility which is located in Miao-Li, Taiwan. We once leased the entire Chu-Nan Facility to Poppoly Optoelectronics Corp. for a monthly rental of NT\$1,960,000. The lease terminated in February 2002 and the Chu-Nan Facility is currently idle.

We have not experienced any significant interruptions in production at any of our production facilities due to equipment failure or breakdown, raw material shortages, power interruptions, fire, labor disputes or other causes.

Competition

We operate in the highly competitive independent semiconductor test and backend manufacturing services market. We face competition from a number of vendors, including other independent semiconductor test and backend manufacturing service companies such as ASE Test Limited, ChipMOS Technologies Inc., United Test Center and SPIL. We also compete for the test business of foundries, integrated device manufacturers with in-house test capabilities and fabless integrated circuit design companies with their own in-house test capabilities. Some of these manufacturers have commenced, or may commence, in-house test operations in Taiwan and Asia.

Integrated device manufacturers that use the services provided by us continuously evaluate our performance against their own in-house test capabilities. These integrated device manufacturers may have access to more advanced technologies, and greater financial and other resources than we do. We believe, however, that we can offer greater efficiency and lower costs while maintaining equivalent or higher quality for the following reasons:

- We tend to have lower unit costs because of higher utilization rates as compared to the in-house test operations of integrated device manufacturers since integrated device manufacturers are less able to utilize individual testers for long periods of time due to the constant evolution of test technology.
- We offer a wider range of services in terms of complexity and technology as compared to the in-house test operations of integrated device manufacturers.

Information Network System

We implement information technology systems to coordinate our testing operations, realize performance improvements from our testing and other services, manage our business and take orders and share process information with our customers.

As maximizing capacity utilization is essential to our profitability, we manage the entry, preparation, test and shipment of all our clients' products down to the hour using proprietary software. This allows us to not only keep our test machines operating at higher utilization levels, but to also assess the value and appropriate timing of potential test jobs based on our hourly charges, the amount of work involved and the fixed cost and capacity of the test machines to be used.

Software developed by our research and development team is essential to the configuration of testing equipment for the testing of new semiconductors and the streamlining of the testing process. See "— Research and Development."

We also work with our clients through our extranet and email communications, providing them test and post-test data as well as taking orders and providing process updates.

We are one of the pioneers in the test industry for providing e-business solutions. We evaluate our customers' IT system and install necessary alliance manager hardware and software for our customers. Alliance manager (sourced from ExtricityTM) is the core software server that supports the design and execution of business processes, manages the integration of backend systems, and coordinates interactions between us and our customers. We believe that, by utilizing the alliance manager system, we can efficiently control the manufacturing process and provide our customers with efficient services.

Environmental Matters

Semiconductor test and tape and reel businesses involve no environmentally sensitive processes. Our facilities conducting such services are therefore free from environmental concerns and no anti-pollution devices are required to be installed in any of our test and tape and reel facilities. Our wafer grinding and dicing process is, however, environmentally sensitive. Liquid waste is produced at the stage where silicon wafers are diced into chips with the aid of diamond saws and cooled with running water. We have installed treatment equipment for liquid waste generated at all of our wafer grinding and dicing facilities. We believe that we have adopted adequate anti-pollution measures for the effective maintenance of environmental protection standards that are consistent with the semiconductor industry practice in Taiwan.

In addition, we believe that we are in substantial compliance with all material environmental regulations. We have not been subject to any material fines or legal action involving non-compliance with any relevant environmental regulations, nor are we aware of any threatened or pending action by any environmental regulatory authority in Taiwan.

Legal Proceedings

We are currently involved in the following legal proceedings:

In October 2001, Hwa Tsai Co., Ltd., or Hwa Tsai, an ROC incorporated company that is one of our shareholders, along with two of our individual shareholders, brought civil proceedings in the district court in Hsin-Chu against us and our Chairman, seeking damages for losses suffered as a result of alleged misleading statements made by us and our management. The Chairman is named as a defendant in his capacity as our legal representative and in his personal capacity. The plaintiffs, who purchased our shares, allege that the published projections made, and subsequent revisions of the projections, under which the original pre-tax profit projections were reduced by up to 97.0%, caused our share price to fall, and them to suffer damages. On June 18, 2002 the plaintiffs reduced the damages sought to NT\$47.0 million.

In addition, a criminal complaint relating to the same matters and alleging that we and the Chairman violated various provisions of the ROC Securities and Exchange Law and Criminal Law was filed with the procuratorate for Hsin-Chu. The procuratorate found insufficient grounds for suspicion that an offense had been committed and decided not to prosecute. After the complainant applied in writing for reconsideration of the ruling, the procuratorate for the Hsin-Chu higher court found the application to contain adequate grounds for investigation and ordered the procuratorate of the original court to pursue the case. The case remains under investigation.

We believe that the original projections and other statements, and the subsequent revisions of the projections, were based on assumptions that were reasonable at the times they were made. Moreover, we believe that the original projections and the related assumptions and statements, and the subsequent revisions, complied with applicable regulations for the preparation of financial projections.

We believe that we will be able to demonstrate that the projections, in light of the circumstances prevailing at the time of the publication, were not materially misleading, and that we and the Chairman have not committed any of the violations alleged. However, if our Chairman were convicted in either trial, he could be discharged from his chairmanship of our company. Further, according to the rules published by the ROC Securities and Futures Commission to the extent an ROC company has any chairman, general manager or other responsible person of such company that has been sentenced by an appropriate ROC court in a final judgment, or indicted by a procuratorate, for certain serious criminal offenses, the SFC may refuse to grant permission to any application submitted by such company for a public offering of debt or equity in Taiwan within three years thereafter. See “Risk Factors — Risks Relating to Our Business and Our Industry — Both we and our Chairman are defendants in securities law civil and criminal suits.”

We have from time to time received correspondence regarding potential actions or litigation. Other than as described above, none of this correspondence has lead to any litigation or actions.

Insurance

We maintain insurance policies with independent third parties in respect of buildings, goods in transit, equipment and certain inventories covering loss due to fire, explosion, earthquake, typhoon, flood and certain other risks. While we believe our insurance policies to be adequate and in line with industry norms in Taiwan, significant damage to any of our facilities could have a material adverse effect on us. Insurance coverage on property, plant and equipment amounted to approximately NT\$11,077.2 million (US\$327.9 million) as of September 30, 2003. In addition, we carry insurance policies for directors’ liabilities. We also carry business interruption insurance.

Employees

As of September 30, 2003, we had 2,723 employees. We conduct campus recruiting and utilize the Internet to attract workers. In addition, we give out employee bonuses as a reward for attracting new employees. We believe that we offer total compensation packages comparable to those of our competitors and as a result our employee turnover rate has been low. We source some employees from the Philippines, the majority of whom work in our testing and assembly division.

Our employees are not covered by any collective bargaining agreements. We consider our relationship with our employees to be good. In compliance with ROC law, we provide health benefits to our employees under the National Universal Health Plan and the Labor Health Plan. To date, we have not experienced any labor disputes.

We have a profit-sharing program for our full-time employees. Under our Articles of Association, 10% of our annual net income (after provision for tax due and losses incurred in prior years, deduction of the legal reserve and other necessary reserve) must be allocated as a special bonus to employees. We have implemented two share option plans, which were approved by our board of directors in 2002 and 2003, that have been offered to all full-time employees. Pursuant to these plans, options to purchase up to 60,000,000 newly issued and previously repurchased (including 16,857,000 treasury shares previously repurchased by

us) and reserved shares may be granted to our employees. Our president, chairman or board of directors, as the case may be, has the discretion to determine which of and when our employees will receive options under these plans. The exercise price for these options is the market price of our shares on the date of grant.

We maintain a pension plan for our employees in accordance with the ROC Labor Standards Law of 1984, or the ROC Labor Law. Pursuant to the ROC's Rules for the Allocation and Management of Employees' Retirement Fund, or the ROC Labor Rules, we have an obligation to contribute on a monthly basis an amount equal to 2% of an employee's total monthly wage payment to the retirement fund of our pension plan. The applicable rate of contribution under the ROC Labor Rules is determined by taking into account the seniority of employees, the wage structure, the employee turnover rate during the preceding five years, the number of employees who will retire over the succeeding five years and the amount of funds that were in our retirement account prior to the adoption of the ROC Labor Rules. The contribution rate used by us, determined in accordance with the ROC Labor Rules and approved by the relevant government authorities, was 3.95%, 3.95% and 2.75% in 2000, 2001 and 2002 respectively in each of the last three years. As of September 30, 2003, the retirement fund under our pension plan had approximately NT\$95.0 million (US\$2.8 million), including earned interest, deposited in the name of the Employees' Retirement Fund Committee with the Central Trust of China. Actual payment of pension or retirement benefits under the Labor Law and our retirement benefits plan is financed by such pension fund, and any insufficiency is funded by us and charged to income. We also provide our employees with benefits other than wages and bonuses such as food and transportation to work.

Subsidiaries and Affiliates

We maintain shareholdings in our subsidiaries and affiliates for long-term strategic and financial investment purposes. The following table sets forth certain information as of December 31, 2002 regarding our subsidiaries and affiliates in which we hold a significant equity interest:

Name and registered address	Book value of our investments as of December 31, 2002 (in millions)	Percentage of common shares owned by us as of December 31, 2002	Date of incorporation	Principal business
KYEC USA Corp. 415 Clyde Avenue, #106 Mountain View, CA 94094, U.S.A.	NT\$6.1	100%	July 6, 2000	Liaison and business agent for us in the United States
KYEC Investment International Co., Ltd. P.O. Box 957, Offshore Incorporations, Centre Road Town, Tortola, British Virgin Islands	NT\$99.0	100%	May 7, 2002	Investment holding company
KYEC Microelectronics Co., Ltd. P.O. Box 2804, Georgetown Grand Cayman, Cayman Islands	US\$2.8	100%	May 23, 2002	Investment holding company
King Long Technology (Suzhou) Limited Fengli Street, Suzhou Industrial Park, Suzhou City, Jiangsu Province, PRC	US\$2.8	100%	September 30, 2002	Manufacture of burn-in ovens and components for analog and mixed signal data processors

Subsidiary — KYEC USA Corp.

In July 2000, we established KYEC USA Corp. in order to facilitate communications with customers and to improve sales efforts in the United States. As of December 31, 2002, we held a 100.0% interest in KYEC USA Corp. It serves as a liaison and agency office in the United States and carries out sales and marketing operations.

In 2002, KYEC USA Corp.'s net revenue and net income were US\$0.2 million and US\$0.3 million, respectively. In addition, its total assets and shareholder's equity on December 31, 2002 were US\$0.2 million and US\$0.2 million, respectively.

Subsidiary — KYEC Investment International Co., Ltd.

In May 2002, we established KYEC Investment International Co., Ltd. as an investment holding company. As of December 31, 2002, we held a 100.0% interest in KYEC Investment International Co., Ltd. It is engaged in making investments in other companies in various industries, including our affiliates. It currently holds investments in our subsidiary, KYEC Microelectronics Co., Ltd. and, indirectly, in our subsidiary King Long Technology (Suzhou) Limited.

In 2002, KYEC Investment International Co., Ltd. had no net revenue and net loss of US\$0.1 million. In addition, its total assets and shareholder's equity on December 31, 2002 were US\$2.8 million and US\$2.8 million, respectively.

Subsidiary — KYEC Microelectronics Co., Ltd.

As of December 31, 2002, our wholly owned subsidiary KYEC Investment International Co. Ltd. held a 100.0% interest in KYEC Microelectronics Co., Ltd. KYEC Microelectronics Co., Ltd. is engaged in making investments in other companies in various industries. KYEC Microelectronics Co., Ltd. currently invests in our PRC subsidiary King Long Technology (Suzhou) Limited.

In 2002, KYEC Microelectronics Co. Ltd. had no net revenue and net loss of US\$0.1 million. In addition, its total assets and shareholder's equity on December 31, 2002 were US\$2.9 million and US\$2.8 million, respectively.

Subsidiary — King Long Technology (Suzhou) Limited

As of December 31, 2002, our subsidiary, KYEC Microelectronics Co., Ltd., which is wholly owned by our subsidiary KYEC Investment International Co., Limited, held a 100.0% interest in King Long Technology (Suzhou) Limited.

In 2002, King Long Technology (Suzhou) Limited had no net revenue and net loss of RMB0.4 million (US\$0.1 million). In addition, its total assets and shareholder's equity on December 31, 2002 were RMB30.5 million (US\$3.7 million) and RMB23.6 million (US\$2.9 million), respectively.

MANAGEMENT

ROC Company Law and our Articles of Association provide that our directors are to be elected by our shareholders for three-year terms in a general shareholders' meeting at which a quorum, consisting of a majority of all of our issued and outstanding shares, is present. The chairman is a director elected by and from our board. Our nine-member board of directors is responsible for the management of our business.

We currently have three supervisors. Each supervisor is elected by our shareholders for a three-year term at the general shareholders' meeting. The supervisors' duties and powers include, but are not limited to, investigation of our business and financial condition, inspection of our corporate records, verification of some statements by our board of directors at shareholders' meetings, calling of shareholders' meetings, representing us in negotiations with our directors and notification, when appropriate, to the board of directors to cease acting in contravention of any applicable law or regulation or in contravention of our articles of incorporation or beyond our scope of business. In accordance with the laws of the ROC relating to corporations, a supervisor cannot concurrently serve as a director, managerial officer or other staff member. ROC Company Law requires at least one supervisor be appointed at all times.

Directors and supervisors may serve any number of consecutive terms and may be removed from office at any time for a bona fide reason, including breach of duties, by a resolution adopted at a general shareholders' meeting. The terms of all our current directors and supervisors expire on May 7, 2005. We expect to elect new directors and supervisors on in May 2005.

The following table shows certain specified information with respect to each director and supervisor:

Name (represented shareholder) ⁽¹⁾	Position	Number of shares held directly as of September 30, 2003	Percentage of total shares issued as of September 30, 2003 ⁽²⁾
C.K. Lee	Director and Chairman	14,497,451	2.52%
D.F. Lin ⁽³⁾	Director	7,179,004	1.24%
Bright Shiao ⁽⁴⁾	Director	12,048,459	2.08%
W.P. Lin (Silicon Precision Industries Co., Ltd.)	Director	65,036,000	11.23%
China Development Industrial Bank.	Director	14,538,480	2.51%
H.T. Lin ⁽⁵⁾	Director	6,477,344	1.12%
Ben Lu	Director	4,167,331	0.71%
H.C. Shen	Director	0	0%
H.S. Huang	Director	0	0%
Ben Yang (H-Com Venture Capital Co., Ltd.) ⁽⁶⁾	Supervisor	1,940,281	0.33%
H.H. Liu (Silicon Storage Technology, Incorporated) ⁽⁷⁾	Supervisor	3,200,000	0.55%
Qi Jun Xie	Supervisor	3,129,008	0.54%
Total		<u>132,213,358</u>	<u>22.83%</u>

(1) In accordance with ROC law, each director or supervisor is elected either in his or her capacity as an individual or in his or her capacity as a representative of a corporate or government shareholder.

(2) Total shares issued includes the number of our shares outstanding and treasury shares. As of September 30, 2003, we held 16,857,000 treasury shares.

(3) Mr. D.F. Lin also serves as our President.

(4) Mr. Bright Shiao also serves as our Executive Vice President.

(5) Mr. H.T. Lin also serves as our Assistant Vice President.

(6) Mr. Ben Yang also serves as president of Pacific Venture Group Capital Co., Ltd.

- (7) Mr. H.H. Liu, a senior officer of Silicon Storage Technology, Incorporated, serves as the appointed supervisor for Silicon Storage Technology, Incorporated, which holds a seat on our board of supervisors.

The business address of our directors and supervisors is our registered office.

Executive Officers

The following table sets forth certain information relating to our executive officers:

Name	Position	Years with the Company	Age
D.F. Lin.	President	6	46
Bright Shiao . . .	Executive Vice President	12	43
H.M. Wang . . .	Vice President of the President's Office	1	44
C.M. Cheng . . .	Vice President of the Business Center	1	42
A.H. Liu	Vice President of the Manufacturing Center	4	45
P.K. Hung	Chief Financial Officer	2	43

D.F. Lin, aged 46, has served as one of our directors and as our President since February 1998. Before joining us, Mr. Lin served as the vice president of Macronix International Corporation and has a total of 20 years of experience in semiconductor manufacturing and testing. He holds a bachelor's degree in electrical engineering from Chung Yuan Christian University in the ROC.

Bright Shiao, aged 43, has served as one of our directors and as our Executive Vice President since November 1991. Before joining us, Mr. Shiao served as the President of Don-Sun Motor Co., Ltd. and has a total of 21 years of experience in business management. He holds a college degree in electronics from Southern Taiwan University of Technology in the ROC.

H.M. Wang, aged 44, has served as our Vice President of the President's Office since November 2002. Before joining us, Mr. Wang served as a plant manager for United Microelectronics Corporation. Mr. Wang holds a bachelor's degree in aeronautics and astronautics from Cheng Kung University.

C.M. Cheng, aged 42, has been our Vice President of the Business Center since March 2003. Before joining us, he served as a vice president of Walton Advanced Technology. Mr. Cheng holds a bachelor's degree in electrical engineering from National Sun Yat-Sen University in the ROC.

A.H. Liu, aged 45, joined us as the Vice President of the Manufacturing Center in March 2000. Before joining us, he served as a manager of Ford Motors (Taiwan) Co., Ltd. He holds a doctorate degree in mechanical engineering from North Carolina State University in the United States of America.

P.K. Hung, aged 43, joined us as the Chief Financial Officer in March 2002. Before joining us, he had been the Chief Financial Officer of UMC Japan for 4 years. He holds a bachelor's degree in public finance from National Cheng-chi University in ROC.

Compensation of Directors, Supervisors and Executive Officers

In 2002, our directors, supervisors and executive officers, in such capacities, received aggregate salary, bonus and other benefits from us of NT\$19.4 million. There are no outstanding loans granted by us to any of the directors, supervisors or executive officers and there are no outstanding guarantees provided by us for the benefit of any of the directors, supervisors or executive officers.

Interests of Management in Certain Transactions

Other than as described in this paragraph, none of our directors, supervisors and executive officers serves as a director, supervisor or executive officer of companies with which we do business. Silicon Storage Technology, Incorporated which accounted for 9.2% of our revenues in the nine months ended September 30, 2003, appoints one of our supervisors, who is also an officer of Silicon Storage Technology, Incorporated. SPIL, which owns 11.23% of our shares and to which we had payables of NT\$17.1 million (US\$0.5 million) as of September 30, 2003, and paid rental fees of NT\$2.0 million (US\$59,680) during the nine months ended September 30, 2003, appoints one of our directors, who is also an officer of SPIL. In addition, our Chairman's brother-in-law is the chairman of MediaTek Incorporated, which accounted for 9.4% our revenues in the nine months ended September 30, 2003. See "Principal Shareholders" and "Related Party Transactions." Our policy on transactions with related parties is that such transactions shall be conducted on a basis substantially as favorable to us as would be obtainable in a comparable arms' length transaction with a person other than a related party. Our directors, supervisors, executive officers and other members of our management and administrative staff do not have any interests, other than in the ordinary course of business, in our business transactions.

PRINCIPAL SHAREHOLDERS

The following table sets forth certain information as of September 30, 2003 with respect to our shares owned by each of our ten largest shareholders, according to our records, and by all directors, supervisors and executive officers as a group:

Name of shareholder	Number of shares	Percentage of total shares issued ⁽¹⁾
Siliconware Precision Industries Corporation Limited.	65,036,000	11.23%
Shanghai Huitong Trust Management Cayman Island Asia Pacific Technology Co., Ltd.	14,795,000	2.55%
China Development Industrial Bank.	14,538,480	2.51%
C.K. Lee	14,497,451	2.50%
Bright Shiao	12,048,459	2.08%
C.H. Zheng	10,967,112	1.89%
T.H. Lee	8,271,964	1.42%
Taiwan Industrial Bank	4,437,000	0.77%
D.F. Lin.	7,179,004	1.24%
KYEC Treasury Shares Account	16,857,000	2.91%
Total	<u>168,627,470</u>	<u>29.10%</u>

(1) Percentages calculated based on number of shares issued and outstanding plus treasury shares.

RELATED PARTY TRANSACTIONS

We have, from time to time, engaged in a variety of transactions with related parties. We have conducted our transactions with related parties as we would in comparable arms' length transactions with a person other than a related party, on a basis substantially as favorable to us as would be obtainable in such transactions.

In the nine months ended September 30, 2003 and the year 2002, we made sales and provided testing services to MediaTek Incorporated in the amount of NT\$445.4 million (US\$13.2 million) and NT\$650.4 million (US\$19.3 million), respectively, accounting for 9.4% and 12.2% of operating revenues, respectively, and to Silicon Storage Technology, Incorporated in the amount of NT\$438.4 million (US\$13.0 million), and NT\$441.4 million (US\$13.1 million), respectively, accounting for 9.3% and 8.3% of operating revenues, respectively. The chairman of MediaTek Incorporated is the brother-in-law of our Chairman, while Silicon Storage Technology, Incorporated, has a seat on our board of supervisors. The pricing and other terms of these transactions were comparable to similar arms' length transactions. As a result of the transactions with MediaTek Incorporated and Silicon Storage Technology, Incorporated we had receivables as of September 30, 2003 of NT\$121.6 million (US\$3.6 million) and NT\$139.5 million (US\$4.1 million), respectively.

SPIL, which has a seat on our board of directors and holds 11.23% of our outstanding shares as of September 30, 2003, rents certain equipment to us. During the nine months ended September 30, 2003, we paid rental fees to SPIL of NT\$2.0 million (US\$59,680), and as of September 30, 2003, we had payables to SPIL of NT\$17.1 million (US\$0.5 million) arising out of temporary receipts received for referring assembly orders to SPIL where we acted as a turnkey provider for our customers. The pricing and other terms of these transactions were comparable to similar arms' length transactions.

China Development Industrial Bank, which has a seat on our board of directors, is agent and a member of the syndicate for long-term syndicated loans in the amount of NT\$995.0 million and NT\$4,000.0 million granted to us. The outstanding balances on these loans as of September 30, 2003 were NT\$116.3 million and NT\$321.4 million, respectively. The interest rates on these loans vary between 2.5% and 3.4%, and the terms of the loans were comparable to similar loans negotiated at arm's length. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Quantitative and Qualitative Disclosures about Market Risk — Interest Rate Risk — Long-Term Loans."

We have also entered into other transactions with related parties. See note 5 to our annual financial statements and note 5 to our unaudited interim financial statements. We may enter into additional transactions with related parties in the future. We can give no assurance as to the terms of such transactions or that all of our transactions with related parties will benefit us.

CHANGES IN ISSUED SHARE CAPITAL

Changes in our issued share capital since our inception are set forth below:

Date of Issue	Type of Issue	Number of Shares Issued	Number of Shares Outstanding after Issue
May 1987.	Incorporation	7,000	7,000
February 1990	Rights Issue	2,500	9,500 ⁽¹⁾
July 1994.	Rights Issue	1,100,000	2,050,000
October 1995	Rights Issue	950,000	3,000,000
September 1996	Rights Issue	2,000,000	5,000,000
May 1997.	Rights Issue	4,000,000	9,000,000
September 1997	Rights Issue	8,000,000	17,000,000
February 1998	Rights Issue	18,000,000	35,000,000
August 1998.	Rights Issue and stock dividends	19,975,000	54,975,000
September 1998	Stock dividends	10,025,000	65,000,000
December 1998.	Rights Issue	5,000,000	70,000,000
July 1999.	Rights Issue and stock dividends	29,375,000	99,375,000
December 1999.	Rights Issue	25,000,000	124,375,000
July 2000.	Rights Issue and stock dividends	138,850,446	263,225,446
July 2001.	Rights Issue and stock dividends	173,446,768	436,672,214
February 2003	Private Placement	103,994,857	540,667,071
September 2003 ⁽²⁾	Conversion of Convertible Bonds	38,636,303	579,303,374

(1) In July 1994, the Company carried out a subdivision of the existing 9,500 shares of nominal value of NT\$1,000 each into 950,000 shares of nominal value of NT\$10 each.

(2) Shares issued up to September 30, 2003 upon conversion of our convertible bonds.

DESCRIPTION OF THE CONVERTIBLE ZERO YIELD PUTTABLE SECURITIES

The ZYPS will be issued under an indenture to be dated as of January, 2004, between us and The Bank of New York, as trustee which term also includes any co-trustee, agent or successor trustee duly appointed under the indenture. References to “we,” “us,” “our” and “King Yuan” in this section refer only to King Yuan Electronics Co., Ltd. and its successors under the indenture and do not include our subsidiaries.

The following description of the terms of the indenture and the ZYPS is a summary. This summary does not restate the indenture or the ZYPS in full and excludes certain definitions and complex legal terminology contained in the indenture. While we believe this summary contains all of the information about the indenture important to your decision to purchase the ZYPS, it does not include all of the provisions of the indenture that you may feel are important. It is the indenture, and not this summary, that will define your rights as a holder of ZYPS. Copies of the proposed form of indenture are available as set forth under “General Information.”

General

The ZYPS will be our direct, unconditional, unsubordinated and, subject to the restriction on liens described in “— Status of the ZYPS and Negative Pledge,” unsecured obligations, will at all times rank *pari passu* among themselves and with all of our other present and future direct, unconditional, unsubordinated and unsecured obligations, will be limited to US\$90,000,000 aggregate principal amount (plus any ZYPS issued pursuant to the option of the sole bookrunner to purchase additional ZYPS) and will mature on January 16, 2009. On September 22, 2003, our board of directors authorized the issuance of the ZYPS being offered hereby. The ZYPS will be denominated in principal amounts of US\$10,000 and integral multiples of US\$10,000.

The ZYPS will not bear interest except in the limited circumstances described in “— Default Interest.” Principal of and interest (if any) on the ZYPS will be payable in U.S. dollars, and the transfer of ZYPS will be registrable, at the corporate trust office of the trustee in The City of New York. In addition, payment of interest (if any) may, at our option, be made by check mailed to the address of the person entitled thereto as it appears in the security register.

As long as the ZYPS are listed on the Luxembourg Stock Exchange and the rules of such exchange so require, we will maintain a paying agent, transfer agent and conversion agent in Luxembourg, currently The Bank of New York (Luxembourg) S.A. in each aforementioned capacity. We will publish notice of any change in the listing agent, paying agent, transfer agent or conversion agent in Luxembourg as described below in “— Notices.” In the event that individual definitive ZYPS are issued (in the circumstances described below), payments, transfers and conversions with respect thereto may be executed at the office of The Bank of New York (Luxembourg) S.A. in Luxembourg. In the case of a transfer of only a part of an individual definitive ZYPS, a new individual definitive ZYPS in respect of the balance of the principal amount of the individual definitive ZYPS transferred will be delivered at the office of the Luxembourg transfer agent, and in the case of any lost, stolen, mutilated or destroyed individual definitive ZYPS, a holder thereof may obtain a new individual definitive ZYPS from the Luxembourg transfer agent. We expect that new certificated ZYPS issued in the circumstances set forth above will be available within seven business days at the office of the trustee or at the office of any paying agent.

Distributions of principal and interest (if any) on the individual definitive ZYPS will be made to holders in whose names the individual definitive ZYPS were registered at the close of business on the date 15 days prior to the relevant payment date. Distributions will be made by wire transfer or by check mailed to the address of such holder as it appears on the register of ZYPS maintained by the transfer agent. The final payment on any individual definitive ZYPS, however, will be made only upon presentation, and surrender of such individual definitive ZYPS at the office of the paying agent in Luxembourg on a payment date that is a business day in Luxembourg.

No service charge will be made for any registration of transfer or exchange of ZYPS, but we may require payment of a sum sufficient to cover any tax or governmental charge payable in connection with that registration.

Form and Denomination

The statements set forth in this section and in “— Global Certificates” include summaries of certain rules and operating procedures of DTC, Euroclear and Clearstream relating to transfers of interests in the global certificates.

The ZYPS will not be entitled to the benefits of any sinking fund.

The ZYPS will be issued only in fully registered form, in denominations of US\$10,000 and integral multiples of US\$10,000.

All ZYPS initially sold in the United States or to U.S. persons will be restricted ZYPS. The Rule 144A ZYPS will be issued in fully registered form to qualified institutional buyers pursuant to Rule 144A under the U.S. Securities Act, in the form of beneficial interests in one global certificate registered in the name of a nominee of DTC, and will be deposited with the trustee as custodian for DTC. We have initially appointed DTC as depositary with respect to the Rule 144A ZYPS.

The Rule 144A global certificate (and any ZYPS issued in exchange therefrom) will be subject to certain restrictions on transfer set forth therein and in the indenture and will bear the legends relating to such restrictions set forth under “Transfer Restrictions.”

ZYPS sold to non-U.S. persons in offshore transactions in reliance on Regulation S under the U.S. Securities Act will initially be represented by one Regulation S global certificate in fully registered form registered in the nominee name of and deposited with a common depositary for Euroclear and Clearstream.

Except in the limited circumstances described in the indenture, owners of interests in ZYPS represented by global certificates will not be entitled to receive definitive ZYPS in respect of their individual holding of ZYPS.

If ZYPS in definitive form are issued, the principal amount of the ZYPS in definitive form will be payable at the corporate trust office of the trustee in The City of New York, and, subject to applicable laws and regulations, in such other place or places as we may designate. In addition, as long as the ZYPS are listed on the Luxembourg Stock Exchange and the rules of such exchange so require, the principal amount of the ZYPS in definitive form will be payable at the corporate office of the paying agent in Luxembourg, currently located at Aerogolf Center, IA, Hoehenhof, L-1736, Senningerberg, Luxembourg. Payment of any principal of any ZYPS in definitive form will be made only upon presentment of such ZYPS. Payments of interest (if any) will be made, subject to applicable laws and regulations, by check mailed to the address of the person entitled thereto as shown in the register maintained by the trustee at the close of business on each record date and payments of principal may be made to addresses provided by the person entitled thereto at the time of presentment.

All moneys paid by us to a paying agent for the payment of the principal of or interest (if any) on any ZYPS that remains unclaimed at the end of two years after such principal or interest (if any) has become due and payable will be repaid to us (subject to prior notice of such as described in the indenture) and, afterwards, the holder of that ZYPS may look only to us for repayment. Claims in respect of payment of principal of and interest (if any) on the ZYPS will be prescribed unless made within a period of ten years, in the case of principal, and five years, in the case of interest (if any), from the date when the relevant principal or interest becomes due and payable.

Global Certificates

Upon the issue of the Rule 144A global certificate, DTC or its custodian will credit in its internal system the respective principal amount of the individual interests represented by the Rule 144A global certificate to the accounts of persons who have accounts with DTC. Such accounts initially will be designated by or on behalf of the managers. Ownership of beneficial interests in the Rule 144A global certificate will be limited to persons who have accounts with DTC, referred to as DTC participants, or persons who hold interests through DTC participants. Ownership of beneficial interests in the Rule 144A global certificate 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 certificate, DTC or such nominee, as the case may be, will be considered the sole owner or holder of the Rule 144A ZYPS represented by the Rule 144A global certificate for all purposes under the indenture and the ZYPS. Unless DTC or any successor to DTC notifies us that it is unwilling or unable to continue as depository for the Rule 144A global certificate, or ceases to be a “clearing agency” registered under the Exchange Act, and a successor depository is not appointed by us within 90 days, or any of the ZYPS has become immediately due and payable in accordance with the indenture, owners of interests in the Rule 144A global certificate will not be entitled to have any portions of the Rule 144A global certificate 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 certificate (or any Rule 144A ZYPS represented thereby) under the indenture or the ZYPS. In addition, no beneficial owner of an interest in the Rule 144A global certificate will be able to transfer that interest except in accordance with DTC’s applicable procedures (in addition to those under the indenture).

The Regulation S global certificate will be deposited with, and registered in the nominee name of, a common depository for Euroclear and Clearstream, and Euroclear and Clearstream will credit their respective accountholders with the respective principal amounts of the individual interests represented by the Regulation S global certificate. Such accounts will be designated initially by or on behalf of the managers. Ownership of beneficial interests in the Regulation S global certificate will be limited to persons who have accounts with Euroclear or Clearstream or persons who hold interests through such accountholders. Ownership of beneficial interests in the Regulation S global certificate will be shown on, and the transfer of that ownership will be effected only through, the records maintained by Euroclear and Clearstream (with respect to interests of their respective accountholders) and the records of such accountholders (with respect to interests of persons other such accountholders).

Payments of the principal of and interest (if any) on global certificates will be made to DTC and the common depository or their respective nominees as the registered owners thereof. Neither we nor the trustee 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 certificates or for any notice permitted or required to be given to holders of ZYPS or any consent given or actions taken by registered holders of ZYPS. We expect that DTC or the common depository, as the case may be, upon receipt of any payment of principal of and interest (if any) on global certificates representing any ZYPS held by it or its nominee, will immediately credit DTC participants’ accounts, in the case of DTC, or Euroclear and Clearstream, in the case of the common depository, with payments in amounts proportionate to their respective interests in the principal amount of such global certificates as shown on their respective records. We also expect that payments by DTC participants to owners of interests in such global certificates held through such DTC participants will be governed by standing instructions registered in the names of nominees for such customers. Such payments will be the responsibility of such DTC participants.

Transfers between DTC participants will be effected in DTC's Same-Day Funds Settlement System. Transfers between accountholders in Euroclear and Clearstream will be effected in accordance with their respective rules and operating procedures. The laws of some jurisdictions require that certain persons take physical delivery of securities in definitive form. Consequently, the ability to transfer interests in global certificates to such persons may be limited.

Conversion through participants in DTC will be effected in accordance with DTC's procedures. Conversion through participants in Euroclear and Clearstream 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 ZYPS described above, when beneficial interests in global certificates are to be transferred from the account of a DTC participant holding a beneficial interest in the Rule 144A global certificate to the account of a Euroclear or Clearstream accountholder wishing to hold a beneficial interest in the Regulation S global certificate, the DTC participant will deliver instructions for delivery to the relevant Euroclear or Clearstream accountholder to DTC by 12:00 p.m. (noon), The City of New York time, on the settlement date. On the settlement date, the trustee will (i) decrease the amount of Rule 144A ZYPS registered in the name of DTC or its nominee and evidenced by the Rule 144A global certificate and (ii) increase the amount of Regulation S ZYPS registered in the name of the common depositary or its nominee and evidenced by the Regulation S global certificate. Book-entry interests will be delivered to Euroclear or Clearstream, as the case may be, for credit to the relevant accountholder on the first business day following the settlement date. Prior to such transfer, the DTC participant will provide the trustee with the certifications required under the indenture.

Subject to compliance with the transfer restrictions applicable to the ZYPS described above, when beneficial interests in global certificates are to be transferred from the account of a Euroclear or Clearstream accountholder holding a beneficial interest in the Regulation S global certificate to the account of a DTC participant wishing to hold a beneficial interest in the Rule 144A global certificate, the Euroclear or Clearstream accountholder 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 by 7:45 p.m. Luxembourg time, one business day prior to the settlement date. Euroclear or Clearstream, 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 ZYPS by book-entry transfer to the relevant account of the DTC participant as specified in the transfer notice and (ii) (a) decrease the amount of Regulation S ZYPS registered in the name of the common depositary or its nominee and evidenced by the Regulation S global certificate and (b) increase the amount of Rule 144A ZYPS registered in the name of DTC or its nominee and evidenced by the Rule 144A global certificate. Prior to such transfer, the Euroclear or Clearstream, as the case may be, will provide the trustee with the certifications required under the indenture.

DTC has advised us that it will take any action permitted to be taken by a holder of ZYPS (including the presentation of ZYPS for exchange 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 certificate are credited and only in respect of such portion of the aggregate principal amount of the Rule 144A ZYPS as to which such DTC participant or DTC participants has or have given such direction. However, in the limited circumstances described below, DTC will exchange the Rule 144A global certificate for individual definitive certificates (in the case of ZYPS represented by the Rule 144A global certificate, bearing a restrictive legend), which will be distributed to its participants.

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 Rule 144A global certificate will be governed by arrangements between them, subject to any statutory or regulatory requirements as may exist from time to time.

DTC has advised us that it 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 provisions of Section 17A of the U.S. Securities 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.

Euroclear and Clearstream each holds 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 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 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 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 participant, either directly or indirectly.

Although DTC, Euroclear and Clearstream have agreed to the foregoing procedures in order to facilitate transfers of interests in the Regulation S global certificate and in the Rule 144A global certificate among participants and accountholders of DTC, Euroclear and Clearstream, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. Neither we nor the trustee, nor any agent of ours will have any responsibility for the performance by DTC, Euroclear or Clearstream or their respective participants, indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations.

Individual Definitive Certificates

We will issue individual definitive certificates in registered form in exchange for the Regulation S global certificates and the Rule 144A global certificates, as the case may be, if:

1. DTC or any successor to DTC advises us in writing that it is at any time unwilling or unable to continue as a depository for the reasons described in “— Global Certificates” and a successor depository is not appointed by us within 90 days; either Euroclear or Clearstream 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
2. the trustee advises us in writing that any of the ZYPS has become immediately due and payable as a result of an event of default under the indenture.

Upon receipt of such notice from DTC, Euroclear, Clearstream or the trustee, as the case may be, we will use our best efforts to make arrangements for the exchange of interests in the relevant global certificate for individual definitive certificates and cause the requested individual definitive certificates to be executed and delivered to the registrar in sufficient quantities and authenticated by the registrar for delivery to holders.

Persons exchanging interests in a global certificate for individual definitive certificates will be required to provide to the registrar, through the relevant clearing system:

1. written instructions and other information required by us and the registrar to complete, execute and deliver such individual definitive certificates; and
2. in the case of an exchange of an interest in a Rule 144A global certificate, such certification as the registrar shall require and, in all cases, individual definitive certificates delivered in exchange for any global certificates 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 certificate and in exchange for the Regulation S global certificate if issued during the distribution compliance period, such individual definitive certificates will bear, and be subject to, such legend as we require in order to assure compliance with any applicable law. The holder of a restricted individual definitive certificates may transfer the ZYPS 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, we will deliver only certificates that bear such legend, or will refuse to remove such legend, as the case may be unless (1) the request is made in respect of the Regulation S ZYPS after the distribution compliance period or (2) there is delivered to us such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by us that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the U.S. Securities Act.

Transfer of ZYPS; Issue of Definitive Certificates

Transfers Within Global Certificates

Subject to the procedures and limitations described above under “— Global Certificates,” transfers of beneficial interests within a global certificate may be made without delivery to us or the trustee of any written certifications or other documentation by the transferor or transferee.

Transfers Between Global Certificates

Prior to the expiration of 40 days after the later of the commencement of the offering and the completion of the distribution of the ZYPS, a beneficial interest in a Regulation S global certificate may be transferred to a person who takes delivery in the form of an interest in a Rule 144A global certificate only upon receipt by the trustee of a written certification from the transferee or the transferor, as the case may be (in the form provided in the indenture) to the effect that either:

1. such transferee is purchasing the ZYPS for its own account or for accounts as to which it exercises sole investment discretion and that it and, if applicable, each such account, is a qualified institutional buyer within the meaning of Rule 144A, in each case, in a transaction meeting the requirements of Rule 144A and in accordance with any applicable securities laws of any state of the United States or any other jurisdiction; or
2. the transferor did not purchase such ZYPS as part of the initial distribution thereof and the transfer is being effected pursuant to and in accordance with an applicable exemption from the registration requirements of the U.S. Securities Act and the transferor has delivered to the trustee such additional evidence that we or the trustee may require as to compliance with such available exemption.

Following the expiration of the 40-day restricted period specified above, the certifications contemplated above will no longer be required.

Beneficial interests in a Rule 144A global certificate may be transferred to a person who takes delivery in the form of an interest in a Regulation S global certificate, whether prior to or after the end of the 40-day restricted period specified above, only upon receipt by the trustee of a written certification from the transferor (in the forms provided in the indenture) to the effect that such transfer is being made in accordance with Rule 903 or Rule 904 of Regulation S (as applicable) under the U.S. Securities Act and that, if such transfer occurs prior to the end of the 40-day restricted period specified above, the interest transferred will be held immediately thereafter through Euroclear or Clearstream.

Any beneficial interest in any global certificate that is transferred to a person who takes delivery in the form of an interest in the other type of global certificate will, upon transfer, cease to be an interest in such global certificate and will become an interest in the other type of global certificate and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in such other type of global certificate for as long as it remains such an interest. Except in the circumstances described above and in “— Individual Definitive Certificates,” owners of beneficial interests in global certificates will not be entitled to receive physical delivery of certificated ZYPS.

Restrictions on transfers of the ZYPS and interests therein under the indenture are more fully described below in “Plan of Distribution” and “Transfer Restrictions.”

Issue of Definitive Certificates

Issues of definitive certificates in registered form upon transfer of ZYPS are subject to compliance by the transferor and transferee with the transfer restrictions and the procedures described above and in the indenture, and, in the case of the Rule 144A global certificate, compliance with the legend requirement specified in the indenture.

Each new definitive certificate to be issued on transfer of ZYPS will, within three business days of receipt by the registrar or the relevant transfer agent of the original definitive certificate and the form of transfer, be mailed at the risk of the holder entitled to the ZYPS to the address specified in the form of transfer. Where some but not all the ZYPS in respect of which a definitive certificate is issued are to be transferred, converted, repurchased or redeemed, a new definitive certificate in respect of the ZYPS not so transferred, converted, repurchased or redeemed will, within three business days of deposit or surrender of the original definitive certificate with or to the registrar or the relevant transfer agent, conversion agent or paying agent, be mailed at the risk of the holder of the ZYPS not so transferred, converted, repurchased or redeemed to the address of such holder appearing on the register of holders.

Conversion

General

Upon conversion of any ZYPS, the converting holder will receive our shares. All calculations relating to redemption and conversion, including adjustment of conversion price, will be made to the nearest NT\$0.01, with NT\$0.005 being rounded up to NT\$0.01; however, fractions of our shares will not be issued upon conversion and no cash adjustment will be made in respect of such fractions.

Conversion Terms

Each holder has the right under the terms of the ZYPS to convert any ZYPS into our shares.

Subject to and upon compliance with the provisions of the indenture, the conversion right attaching to any ZYPS may be exercised, at the option of the holder thereof and as and to the extent provided therein and in the indenture, at any time on or after February 16, 2004 and before the close of business (at the place where such ZYPS is deposited for conversion) on December 31, 2008, or, if such ZYPS shall have been called for redemption prior to January 16, 2009, then before the close of business (at the place aforesaid) on

the date five days prior to the date fixed for redemption thereof (or, if such day shall not be a business day at the place where such ZYPS is deposited for conversion, on the immediately preceding business day at such place); provided, however, that no ZYPS may be converted during the following closed periods:

1. the 60 days immediately preceding each annual shareholders' meeting;
2. the 30 days immediately preceding any special shareholders' meeting;
3. the period beginning from three trading days prior to the day on which we notify the TSE of the record date for determination of shareholders' entitlement to dividends, rights or other distributions or benefits with respect to our shares to such record date (which, under current regulations, amounts to a total to 15 trading days and five calendar days prior to such record date); and
4. any period during which we are required by ROC law to suspend conversion or close our stock transfer books and accordingly may not lawfully issue any share capital.

The term "business day" means any day except a Saturday, Sunday or another day on which commercial banking institutions are authorized or required to close in The City of New York or London (or, if applicable, in the city where the relevant agent is located, including, so long as the ZYPS are listed on the Luxembourg Stock Exchange, Luxembourg).

Additionally, if we default in making payment in full with respect to any ZYPS which have been called for redemption on the redemption date therefor, the conversion right attaching to such ZYPS will continue to be exercisable up to and including the close of business (at the place where the ZYPS are deposited for conversion) on the date upon which the full amount payable with respect to such ZYPS has been duly received by the trustee or the paying agent and notice of such receipt has been duly given to the holders.

Under current ROC law, regulations and policy, "PRC persons" are not permitted to convert the ZYPS or to register as our shareholders. Under current ROC law, "PRC person" means an individual holding a passport issued by the PRC, a resident of any area of China under the effective control or jurisdiction of the PRC (but not including a special administrative region of the PRC, such as Hong Kong and Macau), any agency or instrumentality of the PRC and any corporation, partnership or other entity organized under the laws of any such area or controlled or beneficially owned by any such person, resident, agency or instrumentality.

Under current ROC law, a holder of the ZYPS who converts and receives our shares is required to appoint a local agent in the ROC, with such qualifications as are set by the SFC, to open a securities trading account with a local securities brokerage firm, pay ROC taxes, remit funds, exercise shareholders' rights and perform such other matters as may be designated on behalf of and as agent for such holder. In addition, such holder must appoint a local bank to act as custodian for handling 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 such holder of the ZYPS would not be able to hold or to sell or otherwise transfer our shares into which the ZYPS may have been converted on the TSE or otherwise. See "Risk Factors — Risks Relating to the ZYPS and Our Shares — The ZYPS are subject to restrictions on transfer", "Transfer Restrictions" and "Appendix B: Foreign Investment and Exchange Controls in Taiwan."

The number of our shares to be issued upon conversion of any ZYPS will be determined by dividing the principal amount of the ZYPS (translated into N.T. dollars at the fixed rate of NT\$33.80 = US\$1.00) by the conversion price in effect on the conversion date. If more than one ZYPS shall be deposited for conversion at any one time by the same holder, the number of such shares to be issued upon conversion

thereof will be calculated on the basis of the aggregate principal amount of the ZYPS so deposited. Fractions of our shares will not be issued on conversion, and cash adjustments will not be made with respect thereto.

The conversion price at which our shares will be issued upon conversion will initially be NT\$43.875 per share, but will be subject to adjustment in the manner provided in “— Adjustments to Conversion Price” and “— Conversion Price Reset” below.

Exercise of Conversion Right

To convert any ZYPS, the holder thereof must complete, execute and deposit at such holder’s own expense between 9 a.m. and 3 p.m. on any business day at the specified office of any conversion agent at which the ZYPS is presented for conversion a notice of conversion in duplicate, duly completed and signed, in the then current form obtainable from the specified office of any conversion agent together with the ZYPS to be converted and any certificates and other documents as may be required under the laws of the ROC or the jurisdiction in which such conversion agent shall be located. A conversion notice deposited outside the specified hours above or on a day that is not a business day at the place of the specified office of the conversion agent shall for all purposes be deemed to have been deposited between 9 a.m. and 3 p.m. on the next business day. The conversion notice shall contain, *inter alia*:

1. an election to receive our shares;
2. an irrevocable instruction to deliver such shares to the converting holder of the ZYPS or, if such holder is a non-ROC person, to its local agent in the ROC (if the holder elects to receive our shares); and
3. if such notice is delivered prior to the expiration of 40 days after the later of the commencement of the offering and the completion of the distribution of the ZYPS, a representation that the converting holder, among other things, either is:
 - a non-U.S. person outside the United States (as such terms are defined in Regulation S) who purchased the ZYPS pursuant to Regulation S, or
 - a qualified institutional buyer within the meaning of Rule 144A.

Holders who deliver a conversion notice on the final trading day prior to a closed period as described above in “— Conversion Terms,” or who deliver a conversion notice during a closed period, will not be permitted to convert their ZYPS until the next trading day following the end of the closed period. Such holders will retain the rights of a holder with respect to the ZYPS until the date of conversion. The price at which such ZYPS will be converted will be the conversion price in effect on the date of conversion. A conversion notice once deposited may not be withdrawn without our consent in writing.

We will pay any and all taxes arising in the ROC that may be payable with respect to the issue or delivery of our shares on conversion of ZYPS. We will not, however, be required to pay any tax arising in the jurisdiction in which the ZYPS are deposited for conversion with respect to the issue or delivery of our shares on conversion of ZYPS nor to pay any tax which may be payable in respect of any transfer involved in the issue and delivery of our shares in a name other than that of the holder of the ZYPS or ZYPS to be converted, and no such issue or delivery shall be made unless and until the person requesting such issue has paid to us the amount of any such tax, or has established to our satisfaction that such tax has been paid. The date on which any ZYPS and the duly executed conversion notice (in duplicate) relating thereto are deposited with the trustee or any conversion agent and the payments, if any, required to be paid by the holder are made is hereinafter referred to as the “deposit date.” Conversion of a ZYPS will be effective the next trading day following the deposit date which occurs during a period which is not a closed period, such date hereinafter referred to as the “conversion date”.

On the conversion date we will deem the converting holder as the owner of the number of our shares to be issued pursuant to the terms of the ZYPS and the indenture upon conversion of such ZYPS and, subject to any applicable limitations then imposed by ROC laws and regulations, according to the request made in the relevant conversion notice, will procure that, as soon as practicable, and in any event within five trading days following the receipt of the conversion notice by us, there be delivered (or credited, in the case of a book-entry transfer) to the local agent appointed by the converting holder of ZYPS a certificate or certificates representing the relevant shares (or the relevant number of shares, in the case of a book-entry transfer), registered in the name of the converting holder, together with any other property or cash (including, without limitation, cash payable pursuant to the terms of the ZYPS and the indenture) 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.

If the conversion date in relation to any ZYPS shall be on or after a date with effect from which an adjustment to the share conversion price takes retroactive effect pursuant to the indenture and the relevant conversion date falls on a date when the relevant adjustment has not been reflected in the share conversion price, we have agreed to issue and deliver, within 20 days after the effective date of such adjustment of the conversion price, such number of shares as is equal to the number of additional shares that would have been required to be issued on conversion of such ZYPS if the relevant retroactive adjustment had been made as at the said conversion date over the number of such shares previously issued pursuant to such conversion, and, in such event and with respect to such number of shares, references in the immediately preceding paragraph to the conversion date shall be deemed to refer to the date upon which such retroactive adjustment becomes effective (disregarding the fact that it becomes effective retroactively). We have agreed that the provisions of the immediately preceding paragraph shall apply to such additional shares. Fractions of our shares will not be issued and no cash adjustment will be made in respect thereof.

Our shares issued upon conversion of the ZYPS will in all respects rank *pari passu* with our shares in issue on the relevant conversion date (except for any right provided to holders of record prior to such conversion date; with respect to preemptive rights in connection with rights issues and rights to dividends, except in the case where the record date for closure of our register of shareholders for a shareholders' meeting precedes such conversion date; and except for any other right excluded by mandatory provisions of applicable law).

We have reserved the right, subject to the provisions of the indenture (or any agency agreement), at any time to vary or terminate the appointment of any conversion agent and to appoint further or other conversion agents; *provided* that we will give notice of any such termination or appointment in accordance with the indenture, and, *provided further* that we will at all times maintain a conversion agent (which conversion agent may be the trustee) having specified offices in The City of New York, London and, as long as the ZYPS are listed on the Luxembourg Stock Exchange and the rules of such exchange so require, in Luxembourg.

Adjustment to Conversion Price

The conversion price will be subject to adjustment (in the manner set forth in the indenture) upon the occurrence of certain events set out in the indenture, including:

1. the declaration of a dividend in, or the making of a free distribution of, our shares (including any bonus issue of our shares);
2. subdivisions, consolidations or reclassifications of our shares;
3. the grant, issue or offer to our shareholders of options, rights or warrants to subscribe for or purchase our shares at less than the then current market price (as defined in the indenture) or to subscribe for or purchase any securities convertible into or exchangeable for our shares at less than the then current market price;

4. any capital distribution (as defined in the indenture) or the distribution to our shareholders of evidences of our indebtedness or of shares of our capital stock (other than our shares), assets (excluding regular periodic dividends in cash not constituting a capital distribution and distributions of cash mentioned in paragraph 5 below) or of options, rights or warrants to subscribe for or purchase shares or securities (other than those mentioned in paragraph 3 above);
5. the distributions to all holders of our shares by dividend or otherwise cash that is (i) a dividend or distribution in connection with the liquidation, dissolution or winding up of the Company or (ii) a cash dividend on our shares to the extent that the amount of all cash distributions per share in any calendar year exceeds 2.0% of the market value per share as determined as of the date on which the Board of Directors of the Company recommends such dividend (each, an “Extraordinary Cash Dividend”);
6. the issue of securities (other than the ZYPS or the entitlement certificates, inter alia, in any of the circumstances described in paragraph 3 above) convertible into or exchangeable for our shares, or the grant, issue or offer of options, rights or warrants to subscribe for or purchase our shares or securities convertible into or exchangeable for our shares (other than those options, rights and warrants mentioned in paragraphs 3 and 4 above), in any case at less than the then current market price;
7. the issue of our shares at less than the current market price other than our shares issued:
 - on conversion or exchange of any convertible or exchangeable securities (including the ZYPS, any convertible bonds and the entitlement certificates) issued by us;
 - on exercise of any options, rights or warrants granted, offered or issued by us;
 - in any of the circumstances described in paragraphs 1 to 3 above; or
 - to shareholders of any company into which we merge, in proportion to their shareholding in such company immediately prior to such merger, upon such merger);
8. the payment in respect of a tender or exchange offer by us or a subsidiary for any shares to the extent that the cash and value of any other consideration in such payment per share exceeds the current market price (as defined in the indenture) per share determined on the last date on which tenders or exchanges may be made under the tender or exchange offer; and
9. any other event or circumstance that would have an analogous effect on the conversion price.

No adjustment to the conversion price will be made unless such adjustment would require an increase or decrease of at least 1% of the then prevailing conversion price; *provided* that any adjustment not made as a result of the preceding sentence should be carried forward and combined with subsequent adjustments until such adjustments, on a cumulative basis, would require an increase or decrease of at least 1%, in which case such adjustment shall be made. We will provide notice of any adjustment to the holders of ZYPS in accordance with “— Notices” below. For so long as the ZYPS are listed on the Luxembourg Stock Exchange and the rules of such exchange so require, the Luxembourg Stock Exchange will be notified of such adjustment upon our publication of such notice in an authorized newspaper in Luxembourg. In addition, we will as soon as practicable notify the trustee and each of the relevant agents in writing of such adjustment.

The term “shares” includes, for purposes of this section, shares of any other class or classes of our share capital authorized after the date of the indenture which have no preference with respect to dividends or to amounts payable in the event of any voluntary or involuntary liquidation or winding-up of our company and, unless the context otherwise requires, entitlement certificates evidencing the right to receive shares.

Conversion Price Reset

If the average of the closing prices of our shares on the TSE for the period of 20 consecutive trading days (the “average closing price”) ending on October 16 of each year (commencing in 2004) prior to maturity (each, a “reset date”), translated into U.S. dollars at the prevailing exchange rate (referred to as the “prevailing rate”), is less than the conversion price per share on the relevant reset date divided by 1.17 and translated into U.S. dollars at the fixed exchange rate of NT\$33.80 = US\$1.00 (referred to as the “fixed exchange rate”), the conversion price shall be adjusted (each, a “conversion price reset”) in accordance with the following formula:

$$\text{adjusted conversion price} = \text{average closing price} \times 1.17 \times \frac{\text{fixed exchange rate}}{\text{prevailing rate}}$$

provided that: (i) any adjustment to the conversion price pursuant to the conversion price reset shall be limited so that the conversion price so adjusted shall not be less than 80% of the initial conversion price (as adjusted to reflect any antidilution adjustments which may have occurred prior to the relevant reset date, except for any conversion price reset, if applicable, prior to such relevant reset date); and (ii) for the avoidance of doubt, any adjustments to the conversion price made pursuant to this conversion price reset shall only be downward adjustments. Any conversion price reset shall become effective as of the reset date.

We will provide notice of any conversion price reset to the holders of ZYPS in accordance with “— Notices” below. For so long as the ZYPS are listed on the Luxembourg Stock Exchange and the rules of such exchange so require, the Luxembourg Stock Exchange will be notified of such adjustment upon our publication of such notice in an authorized newspaper in Luxembourg. In addition, we will as soon as practicable notify the trustee and each of the relevant agents in writing of such adjustment.

Special Conversion Price Reset

We may at our option, during the 30 days preceding January 16, 2006, 2007, 2008 and 2009, each of such days referred to as a “special reset date”, declare that the ZYPS will be convertible at the conversion price adjusted in accordance with the following formula, for a period of seven trading days beginning on the fifth trading day after the applicable special reset date:

$$\text{adjusted conversion price} = 91\% \times \text{average market price} \times \frac{\text{fixed exchange rate}}{\text{prevailing rate}}$$

where “average market price” means the average of the closing prices of our shares on the TSE, whichever is the lowest, for any of the periods of 10, 15 or 20 consecutive trading days within the 30 days preceding the relevant special reset date, *provided* that:

- (a) any adjustments to the conversion price described in the indenture shall apply, *mutatis mutandis*, to any special conversion price reset to ensure that appropriate adjustments shall be made to any closing price to reflect any adjustments made to the conversion price in accordance with such adjustments;

- (b) the conversion price shall not be reduced below the par value of our shares (at the closing date, NT\$10 per share) unless, under applicable law then in effect but subject to applicable regulatory approval, the ZYPS could be converted at such reduced conversion price into our legally issued, fully-paid and non-assessable shares;
- (c) any adjustment to the conversion price pursuant to a special conversion price reset shall be limited so that the conversion price so adjusted shall not be less than 80% of the initial conversion price (but adjusted to reflect any antidilution adjustments which may have occurred prior to the relevant special reset date); and
- (d) for the avoidance of doubt, (i) any adjustments to the conversion price made pursuant to the special conversion price reset shall only be downward adjustments, (ii) an adjustment may be made in respect of a special reset date notwithstanding that an adjustment may have been made in respect of a preceding special reset date and (iii) adjustment of the conversion price between January 1 and January 16, 2009 shall in no way extend the period during which the ZYPS may be converted.

Such adjusted conversion price shall be rounded upwards, if necessary, to the nearest NT\$0.01.

Consolidation or Merger

In the event of a consolidation or merger to which we are not the surviving entity or the sale, conveyance or transfer of all or substantially all of our assets, each ZYPS then outstanding will, subject to the terms thereof, become convertible only into the kind and amount of securities, cash and other property receivable upon the consolidation, merger, sale, conveyance or transfer by a holder of the number of our shares into which such ZYPS could have been exchanged immediately prior to such consolidation, merger, sale, conveyance or transfer.

Cash Payment in Lieu of Delivery of Our Shares

We may at our option make a cash settlement payment (the “cash in lieu payment”) in respect of all or any portion of the ZYPS of a holder of ZYPS deposited for conversion (being US\$10,000 in principal amount or any integral multiple thereof) pursuant to the exercise of a conversion right by delivering notice thereof to the tendering holder of ZYPS not more than three trading days after the conversion date. Such cash settlement shall be in an amount equal to the cash settlement market price (as defined below) multiplied by the number of our shares which we elect not to deliver upon conversion as described in “— Conversion Terms” and the resulting figure shall be rounded to the second decimal place with 0.005 being rounded upwards. If the cash in lieu payment is made for more than one ZYPS of the same holder of ZYPS, the cash settlement amount shall be calculated on the basis of the aggregate principal amount of ZYPS for which we make such cash in lieu payment. We shall pay such cash in lieu payment in U.S. dollars as promptly as practicable (but in no event later than three business days after the setting of the cash settlement market price, which shall also be a trading day).

“Cash settlement market price,” in relation to our shares, means the average of the market price (as defined in the indenture) converted into U.S. dollars at the prevailing rate (as defined in “— Conversion Price Reset”) on the same day for each of the five consecutive trading days commencing on the fourth trading day following the conversion date.

Redemption, Repurchase and Cancellation

Redemption at Maturity

Unless previously redeemed, converted or purchased and cancelled as herein provided, we will redeem the ZYPS at 100% of their principal amount on January 16, 2009. The ZYPS may be redeemed prior to that date only as provided below (but without prejudice to the rights of holders as set forth under “— Events of Default”).

Redemption at Our Option

Unless previously redeemed, converted or repurchased and cancelled as herein provided or called for repurchase as provided in “— Repurchase at the Option of Holders” below, on or at any time after July 16, 2005 and prior to maturity, subject to the limitations set forth in “— Redemption Notices; Priority of Notices” below, we may, having given not less than 30 or more than 60 days’ written notice to the holders (which written notice will be irrevocable), redeem the ZYPS in whole or in part at 100% of their principal amount, if the average closing price of our shares (translated into U.S. dollars at the prevailing exchange rate) for each of the 30 consecutive trading days, the last of which occurs not more than five days prior to the date upon which notice of such redemption is given, is at least 125% of the conversion price per share (translated into U.S. dollars at the fixed exchange rate of NT\$33.80 = US\$1.00), as adjusted through, and in effect on, each such trading day. If the closing price cannot be determined for one or more consecutive trading days, such day or days will be disregarded in the relevant calculation and will be deemed not to have existed when ascertaining such 30 trading day period. The “prevailing rate” for the translation of the closing prices shall be the arithmetic average of the middle rate for the purchase of U.S. dollars with N.T. dollars quoted by the Bank of Taiwan (or a replacement selected by us with the trustee’s consent) at the close of business on each day of the relevant 30 consecutive trading day period. If there shall occur an event giving rise to a change in the conversion price during any such 30 trading day period, appropriate adjustments for the relevant days shall be made for the purpose of calculating the closing price for such days.

The term “trading day” means a day on which the TSE is open for business. For the purposes of the foregoing, the term “closing price” for any trading day means the last reported transaction price or, if no transaction takes place on such day, the average of the closing bid and asked prices of our shares for such day as furnished by a leading independent securities firm licensed to trade on the TSE selected from time to time by us for that purpose.

Upon the expiry of any such notice, we will be bound to redeem the ZYPS to which such notice relates at the price aforesaid applicable at the date fixed for redemption together with interest accrued to the date of redemption.

In addition, unless previously redeemed, converted, purchased or repurchased and cancelled as herein provided or called for repurchased as provided in “— Repurchase at the Option of Holders” below, and subject to the limitations set forth in “—Redemption Notice; Priority of Notice” below, we may, having given not less than 30 nor more than 60 days’ written notice to the holders (which written notice shall be irrevocable), at any time redeem the ZYPS at their principal amount in whole but not in part if the aggregate amount of ZYPS outstanding is less than 5% of the aggregate principal amount of ZYPS originally issued (including any ZYPS issued upon the exercise by the managers of their option to increase the amount of this offering).

Redemption for Taxation Reasons

At any time (but not if notice of redemption as provided above has already been given to holders), subject to the limitations set forth in “— Redemption Notices; Priority of Notices” below, we may, having given not less than 30 nor more than 60 days’ written notice to the holders (which written notice shall be irrevocable), redeem the ZYPS in whole but not in part at 100% of their principal amount, if:

1. we provide the trustee with an opinion of legal counsel or our auditors immediately prior to the giving of such notice that we have or will become obliged to pay additional amounts as provided or referred to below under “— Additional Amounts” in excess of the additional amounts payable with respect to a deduction or withholding at a rate of 20% of the amount of any payment of interest (if any) as a result of any change in, or amendment to, the laws or regulations of the ROC or any political subdivision or any authority thereof or therein having power to tax, or any change in the general application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after January 16, 2004; and
2. such obligation cannot be avoided by taking reasonable measures available to us;

provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which we would be obliged to pay such additional amounts were a payment with respect to the ZYPS then due.

Redemption at the Option of Holders

The holder of any ZYPS, in accordance with the applicable provisions of the indenture, may require us to redeem such ZYPS (or any portion of the principal amount thereof which is US\$10,000 or any integral multiple thereof), on each of January 16, 2006, 2007 and 2008 at 100% of the principal amount thereof. To exercise such option, the holder must deposit the ZYPS with the trustee or any paying agent together with a duly completed redemption notice in the form obtainable from the trustee or any paying agent, not more than 60 nor less than 13 days prior to the applicable date. The ZYPS so deposited may be withdrawn (except as provided in the indenture) only with our written consent. We will notify holders not less than 30 nor more than 60 days’ prior to the date of the commencement of each such period of the holders’ right to deposit of ZYPS for redemption pursuant to this paragraph.

Repurchase at the Option of Holders

If a “repurchase event” occurs, we are required, within not more than 60 days nor less than 30 days following the occurrence of such event, to offer to repurchase all of the outstanding ZYPS at 100% of their principal amount.

In order to effect the repurchase, we will provide notice as described below in “Notices” promptly, but in no event later than 30 days after the occurrence of the repurchase event. The notice will govern the terms of our offer to repurchase the ZYPS and will describe the procedures that the holders must follow in order to accept the offer.

Any portion of the principal amount of the ZYPS that is equal to US\$10,000 or an integral multiple of US\$10,000 may be repurchased if properly tendered and not withdrawn by the holder. Our offer to repurchase the ZYPS will remain open until the close of business on the business day prior to the repurchase date.

If the holders exercise their right to require us to repurchase the ZYPS, and the repurchase constitutes a “tender offer” for purposes of Rule 14e-1 under the U.S. Securities Exchange Act, we will comply with the requirements of Rule 14e-1 as then in effect with respect to any repurchase.

A “repurchase event” means the occurrence of any of the following events:

1. we consolidate with, or merge with or into, another person or sell, assign, convey, transfer, lease or otherwise dispose of all or substantially all of our assets to any person (or any person consolidates with, or merges with or into, us), pursuant to a transaction in which our voting shares are converted into or exchanged for cash, securities or other property, except a transaction where our voting shares are converted into or exchanged for voting shares of the surviving or transferee corporation (other than voting shares that mature or are redeemable for cash or debt securities prior to the maturity date of the ZYPS); or
2. at any time our shares are not listed on the TSE (or its successor) or an exchange of comparable or greater standing.

“Beneficial owner” will be determined in accordance with Rules 13d-3 and 13d-5 under the U.S. Securities Exchange Act, except that the term will include, with respect to any securities, any person having the right to acquire those securities, whether immediately or after the passage of time, upon the happening of an event or otherwise.

Cancellation

All ZYPS surrendered for payment, redemption, repurchase, registration of transfer or exchange or conversion shall, if surrendered to any person other than the trustee, be delivered to the trustee and shall be promptly cancelled by it. We may at any time deliver to the trustee for cancellation any ZYPS which we may have acquired in any manner whatsoever, and all ZYPS so delivered shall be promptly cancelled by the trustee.

Redemption Notices; Priority of Notices

All notices of redemption to holders given by us or on our behalf will specify the date fixed for redemption, the redemption price and the conversion price as at the date of the relevant notice and the closing prices of our shares and the aggregate principal amount of the ZYPS outstanding as at the latest practicable date prior to the publication of the notice. We will provide notice of any such redemption as described below in “— Notices.”

No notice of redemption may be given by us or on our behalf if it specifies a due date for redemption falling during the period commencing 60 days and ending 30 days (both inclusive) prior to each of January 16, 2006, 2007 and 2008 (and if given shall not be effective). Any notice of redemption providing for redemption at our election given before such dates shall be without prejudice to the rights of holders to redeem at their election as provided above and shall not apply with respect to any ZYPS with respect to which the option to redeem at their election as provided above shall be or has been exercised.

We may not set a date for redemption for any reason during any closed period when holders are prohibited from converting their ZYPS or during the nine trading days after the date set for the determination of shareholders entitled to receive the annual dividend payment or, if during the annual shareholders’ meeting no annual dividends were declared, the nine trading days after the date of the annual shareholders’ meeting.

Redemption of Some Only of the ZYPS

In the case of a redemption of some only of the ZYPS, the ZYPS to be redeemed will be selected individually by lot by the paying agent, in such place as the trustee shall approve and in such manner as the trustee shall deem to be appropriate and fair not more than 70 days and not less than 40 days prior to the date fixed for redemption.

Additional Amounts

All payments of principal and interest (if any) made by us with respect to the ZYPS will be made after any deduction or withholding for or on account of any present or future taxes, duties, assessments or governmental charges of whatever nature imposed or levied by or on behalf of the government of the ROC or any authority thereof or therein having power to tax; *provided* that with respect to any such deduction or withholding from any such payment, we will, at the time of such payment of principal and interest (if any), pay such additional amounts as will result in the receipt by the holders of the amounts which would have been receivable in the absence of any such withholding or deduction, except that no such additional amounts shall be payable with respect to any ZYPS:

1. to a holder (or to a third party on behalf of a holder) who is subject to such taxes, duties, assessments or governmental charges with respect to such ZYPS by reason of such holder being connected with the ROC otherwise than by merely holding such ZYPS or by the mere receipt of principal or interest (if any) with respect to any ZYPS; or
2. if the ZYPS is surrendered more than 30 days after the relevant date except to the extent that the holder thereof would have been entitled to such additional amount on presenting the same for payment on the last day of such 30-day period. For this purpose, the “relevant date” in relation to any ZYPS means:
 - the due date for payment with respect thereto; or
 - (if the full amount payable on such due date has not been received in New York City by the trustee or any paying agent on or prior to such due date) the date on which notice is duly given to the holders that such amount has been so received.

All references elsewhere herein to the payment of principal and interest (if any) with respect to any ZYPS will be deemed to include the payment of any additional amounts which may be payable as provided above.

Status of the ZYPS and Negative Pledge

The ZYPS will constitute our direct, unconditional, unsubordinated and, subject to the following restriction on liens, unsecured obligations and will at all times rank *pari passu* among themselves and all of our other present and future direct, unconditional, unsubordinated and unsecured obligations. So long as any of the ZYPS remains outstanding (as defined in the indenture), we will not, and will procure that our subsidiaries will not, create or permit to be outstanding any encumbrance (any mortgage, charge, pledge or other security interest) upon the whole or part of our or their property, assets or revenues, present or future, to secure for the benefit of the holders of any international investment securities (1) payment of any sum due with respect to any such international investment securities, (2) any payment under any guarantee of any such international investment securities or (3) any payment under any indemnity or other like obligation relating to any such international investment securities, without in any such case at the same time granting to the registered holders of the ZYPS either the same security, as is granted to or is outstanding with respect to such international investment securities, guarantee, indemnity or other like obligation, or such other security as shall be approved by all of the holders of the ZYPS outstanding.

As used in the indenture, “international investment securities” means bonds, debentures, notes or other similar investment securities of our company or any other person evidencing indebtedness with a maturity of not less than one year, which (1) either (a) are by their terms payable, or confer a right to receive payment, in any currency other than N.T. dollars or (b) are denominated in N.T. dollars and more than 50% of the aggregate principal amount thereof is initially distributed outside the ROC by or with our

authorization and (2) are for the time being, or are intended to be, quoted, listed, ordinarily dealt in or traded, in each case primarily, on any stock exchange or over-the-counter or other securities market outside the ROC.

The ZYPS will be effectively subordinated to all of our secured obligations with respect to claims against the assets securing such obligations. As of September 30, 2003, we had such debt of approximately NT\$4,542.0 million (US\$134.5 million).

Merger and Consolidation

We have agreed in the indenture not to consolidate with or merge into any other person or convey, transfer or lease our properties and assets substantially as an entirety to any person, and not to permit any person to consolidate with or merge into us or convey, transfer or lease its properties and assets substantially as an entirety to us, unless among other requirements:

1. in case we consolidate with or merge into another person or convey, transfer or lease our properties and assets substantially as an entirety to any person, the person formed by such consolidation or into which we are merged or the person which acquires or leases our properties and assets substantially as an entirety is a corporation, partnership or trust, is organized and validly existing under the laws of the ROC and expressly assumes in a supplemental indenture all our obligations under the indenture;
2. immediately after giving effect to such transaction and treating any indebtedness which becomes an obligation of ours or a subsidiary as a result of such transaction as having been incurred by us or such subsidiary at the time of such transaction, no event of default, and no event which, after notice or lapse of time or both, would become an event of default, shall have happened and be continuing; and
3. if, as a result of any such consolidation or merger or such conveyance, transfer or lease, our properties or assets would become subject to a mortgage, pledge, lien, security interest or other encumbrance which would not be permitted under the indenture, we or such successor person, as the case may be, shall take such steps as shall be necessary effectively to secure the ZYPS equally and ratably with (or prior to) all indebtedness secured thereby.

Events of Default

Under the indenture, events of default include:

1. a default in the payment of the principal of or interest (if any) on any ZYPS after the date the same is due and payable;
2. a failure by us to deliver our shares as and when such shares are required to be delivered following conversion of a ZYPS which failure is not remedied within three trading days of the date delivery is due;
3. a default by us in the performance or observance of any other covenant, condition or provision contained in the indenture or in the ZYPS which default continues for a period of 30 days following the date on which a written notice requiring such default to be remedied is delivered to us by the trustee or by the holders of not less than 25% in principal amount of the ZYPS then outstanding, with a copy to the trustee;

4. there shall have been entered against us or any of our subsidiaries a final judgment, decree or order by a court of competent jurisdiction for the payment of money in excess of US\$20 million with respect to us or any of our subsidiaries (or its equivalent in any other currency or currencies), and 30 days shall have passed since the entry of the final judgment, decree or order without it being bonded, satisfied, discharged or stayed;
5. any other bonds, debentures, notes or other indebtedness for money borrowed having an aggregate principal amount of at least US\$20 million (or its equivalent in any other currency) (hereinafter collectively called “indebtedness”) of us or any of our subsidiaries (as defined in the indenture) shall become immediately due and payable in advance of its scheduled maturity following a default, or we or any of our subsidiaries default in the repayment of any such indebtedness at the maturity thereof (after giving effect to any applicable grace period therefor), or any guarantee of or indemnity with respect to any indebtedness of others given by us or any of our subsidiaries shall not be honored when due and called upon (after giving effect to any applicable grace period therefor);
6. any person entitled to the benefit thereof shall commence proceedings to enforce any security interest upon the whole or any part of the assets or revenues of us or any of our subsidiaries material to us and our subsidiaries taken as a whole unless we or such subsidiary is contesting such proceedings in good faith by appropriate proceedings;
7. a decree or order by a court having jurisdiction in the premises shall have been entered adjudging us or any of our subsidiaries bankrupt or insolvent, or approving a petition seeking reorganization of us or any of our subsidiaries under any applicable bankruptcy, insolvency or reorganization law, or for the appointment of a receiver or liquidator or trustee or assignee in bankruptcy or insolvency of us or any of our subsidiaries or of all or substantially all of the business or assets, or for the winding up or liquidation of the affairs, of us or any of our subsidiaries;
8. we or any of our subsidiaries shall institute proceedings to be adjudicated a voluntary bankrupt, or shall consent to the filing of a bankruptcy proceeding against it, or shall file a petition or answer or consent seeking reorganization or arrangement under any applicable bankruptcy, insolvency or reorganization 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 of all or substantially all its business or assets, or shall make an assignment for the benefit of its creditors, or shall admit in writing its inability to pay its debts generally as they become due, or corporate action shall be taken by us or any of our subsidiaries in furtherance of any of the aforesaid purposes; or
9. proceedings shall have been initiated against us or any of our subsidiaries under any applicable bankruptcy, insolvency or reorganization law and such proceedings shall not have been discharged or stayed within a period of 60 days.

For purposes of paragraphs 4 and 5 above, any amounts denominated in a currency other than U.S. dollars shall be translated into U.S. dollars at the spot rate for the sale of U.S. dollars against the purchase of the relevant currency quoted by any leading bank in the relevant market selected by the trustee on any day when the trustee requests such a quotation for such purposes.

Subject to the provisions of the indenture relating to the duties of the trustee in case an event of default shall occur and be continuing, the trustee will be under no obligation to exercise any of its rights or powers under the indenture at the request or direction of any of the holders, unless such holders shall have offered to the trustee indemnity and/or security to the satisfaction of the trustee. Subject to such provisions for the

indemnification of the trustee, the holders of a majority in aggregate principal amount of the outstanding ZYPS will have the right to 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.

If an event of default shall occur and be continuing, either the trustee or the holders of not less than 25% in principal amount of the outstanding ZYPS may declare the principal of all ZYPS to be due and payable immediately, by a notice to us in writing (and to the trustee if given by holders), and upon any such declaration such principal shall become immediately due and payable; *provided, however*, that after such declaration of acceleration has been made and before a judgment or decree based on acceleration, the holders of a majority in principal amount of outstanding ZYPS may, under certain circumstances, rescind and annul such declaration if all events of default, other than the non-payment of accelerated principal and interest on such amount, have been cured or waived as provided in the indenture. For information as to waiver of defaults, see “Modification and Waiver.” In the case of certain events of bankruptcy and insolvency, all principal will automatically become due and payable.

No holder of any ZYPS will have any right to institute any proceeding with respect to the indenture or for any remedy thereunder unless:

1. such holder shall have previously given to the trustee written notice of a continuing event of default;
2. the holders of not less than 25% in principal amount of the outstanding ZYPS shall have made written request, and offered indemnity and/or security to the trustee’s satisfaction, to the trustee to institute such proceeding as trustee;
3. the trustee shall not have received from the holders of a majority in principal amount of the outstanding ZYPS a direction inconsistent with such request; and
4. the trustee shall have failed to institute such proceeding within 60 days.

However, such limitations do not apply to a suit instituted by a holder of a ZYPS for enforcement of payment of the principal of or interest (if any) on such ZYPS on or after the respective due dates expressed in such ZYPS or of the right to convert such ZYPS in accordance with the indenture.

We will be required to furnish to the trustee annually a statement as to our performance and the performance of our subsidiaries of certain obligations under the indenture and to file promptly with the trustee written notice as to any default in such performance.

Default Interest

In case of any failure by us to pay all or any part of the principal of or any other amounts payable with respect to any ZYPS when such is due and payable, whether upon maturity, by declaration or otherwise, interest on such overdue principal or other amounts will accrue at the rate of 3.5% per annum.

Modification and Waiver

Certain modifications or amendments that will not affect the interest of holders may be made without the consent of any holder pursuant to the provisions of the indenture. Modifications and amendments of the indenture may be made by us and the trustee with the written consent of the holders of not less than two-thirds in principal amount of the outstanding ZYPS; *provided, however*, that no such modification or amendment may, without the consent of the holder of each outstanding ZYPS affected thereby:

1. change the stated maturity of the principal of any ZYPS;

2. reduce the principal amount of, or the rate of interest (if any) on, any ZYPS;
3. change the place or currency of payment of principal of, or interest (if any) on, any ZYPS;
4. impair the right to institute suit for the enforcement of any payment on or with respect to any ZYPS;
5. adversely affect the right to convert ZYPS;
6. reduce the above-stated percentage of outstanding ZYPS necessary to modify or amend the indenture; or
7. reduce the percentage of aggregate principal amount of outstanding ZYPS necessary for waiver of compliance with certain provisions of the indenture or for waiver of certain defaults.

The holders of a majority in aggregate principal amount of the outstanding ZYPS may waive any past default under the indenture, except a default in the payment of principal or interest (if any).

Replacement of ZYPS

In case any ZYPS shall become mutilated, destroyed, lost or stolen, it may be replaced at the office of the trustee or the transfer agent in Luxembourg upon payment of such costs as may be incurred in connection with such replacement and on such terms as to evidence and indemnity as we and the trustee or the transfer agent in Luxembourg, as applicable, may reasonably require.

Mutilated or defaced ZYPS must be surrendered before replacements will be issued.

Further Issues

In the case of any further issuance by us of securities that are fully fungible with the ZYPS, including in respect of the principal amount, interest rate, redemption dates and terms and conditions of redemption and conversion, we may, without the consent of the holders, and provided that the terms and conditions of such newly issued securities so allow, consolidate all such securities, for purposes of redemptions and conversions, so that redemptions and conversions would be made without any distinction in respect of the ZYPS and all securities subsequently issued. In the event of such consolidation, all holders would be members of a single class.

Notices

All notices to the holders of ZYPS required to be given by the indenture shall be deemed to have been duly given if (1) mailed to such holders at their respective addresses as shown on the register of holders maintained by the trustee and (2) published in an English language newspaper of general circulation in the United States, currently expected to be *The Wall Street Journal* (U.S. Eastern Edition), published in an English language newspaper of general circulation in Europe, currently expected to be the *Financial Times*, and, as long as the ZYPS are listed on the Luxembourg Stock Exchange and the rules of such stock exchange so require, published in a newspaper of general circulation in Luxembourg, currently expected to be the *Luxemburger Wort*. Any such notice shall be deemed to have been given on the first date on which both conditions shall have been met.

In case by reason of any other cause it shall be impracticable to publish any notice to holders of ZYPS as provided above, then such notification to such holders as shall be given with the approval of the trustee shall constitute sufficient notice to such holders for every purpose hereunder.

Governing Law, Jurisdiction and Waiver

The ZYPS and the indenture will be governed by and construed in accordance with the laws of the State of New York. In the indenture we have irrevocably submitted to the nonexclusive jurisdiction of the courts of The City of New York sitting in the Borough of Manhattan, The City of New York, or any federal court of the United States sitting in the Borough of Manhattan, The City of New York. We have irrevocably appointed CT Corporation System as our agent for service of process with respect to any legal action or proceeding arising out of or in relation to the indenture or the ZYPS.

Under current ROC law, ROC courts may refuse to recognize a foreign judgment where a default judgment was rendered by the foreign court and where the defendant was not personally served while within the jurisdiction of such foreign court. The ROC courts may further decide that any process served on our agent for service of process does not constitute a service of process in person. Therefore, to ensure the recognition of a foreign judgment by the ROC courts, it may be necessary to effect service of process through the judicial assistance of an ROC court. See “Enforceability of Foreign Judgments in the ROC.”

Holders should note that conversion of the ZYPS is subject not only to the provisions of the indenture but also to applicable ROC law.

Indemnification for Judgment Currency

Our obligations to any holder of ZYPS under the indenture or the ZYPS shall, notwithstanding any judgment in a currency, the judgment currency, other than U.S. dollars, be discharged only to the extent that on the day following receipt by such holder of any amount in the judgment currency, such holder may in accordance with normal banking procedures purchase U.S. dollars with the judgment currency. If the amount of U.S. dollars so purchased is less than the amount originally to be paid to such holder in U.S. dollars, we agree as a separate obligation and notwithstanding such judgment, to the extent permitted by applicable law, to pay the difference, and, if the amount of U.S. dollars so purchased exceeds the amount originally to be paid to such holder, such holder agrees to pay to or for our account such excess; *provided* that such holder shall not have any obligation to pay any such excess as long as an event of default has occurred and is continuing, in which case such excess may be applied by such holder to such obligations.

Certain ROC Legal Requirements Relating to the ZYPS

An Agent or Representative for Conversion

According to the amendment to the Regulations Governing Securities Investment by Overseas Chinese and Foreign Nationals, or the Regulations, approved by the Executive Yuan on September 30, 2003, prior to the exercise of the conversion right, the converting holders of ZYPS who are non-ROC persons (other than PRC persons who under current ROC law, regulations and policy, are not permitted to convert the ZYPS or to register as our shareholder) have to appoint agents or representatives to register with the TSE and obtain an investment identification for investing in securities in the ROC, unless such identification has been previously obtained. In the event the converting holder is a Foreign Institutional Investor outside the ROC and not a sub-account holder, the consent letter from the Central Bank of China, or the CBC, is also required. Holders of ZYPS upon conversion of their ZYPS will be required to appoint agents or representatives with such qualifications as are set forth in the Regulations, to open a securities trading account with a local brokerage firm, submit an application of conversion, exercise shareholders' rights, apply for foreign exchange remittance and pay taxes in the ROC, to appoint a bank which has been approved by the Ministry of Finance to engage in custodian services to handle matters regarding funds and securities custody, confirmation of trades and settlement, report on the status of the account, and to appoint a local securities firm or financial institution to act as the agent to open a New Taiwan dollar bank account. If prior to June 27, 2003, holders of ZYPS have opened a conversion account for overseas corporate convertible bonds, a redemption account for overseas deposit shares or a sales account for overseas stock, the holder of ZYPS shall provide all relevant documents to the TSE for transfer of the assets to the general investment

account of the holder of ZYPS. Under the existing law and regulations of the ROC, unless the foregoing procedures are complied with an investor in the ZYPS would not be able to receive, hold or sell or otherwise transfer our shares into which the ZYPS may be converted.

Under existing ROC law and regulations, repatriation of earnings by holders of ZYPS who are overseas Chinese or foreign nationals is subject to the submission of documents of evidence of appointment of the agent or representative for tax return filing and tax payment as approved by, or the tax clearance certificate issued by, the tax authorities; *provided* that during any period that securities income, i.e. capital gains tax, is not levied, under certain circumstances, repatriation may be made followed by the submission of the documents of evidence provided by the agent or representative appointed under applicable regulations. There can be no assurance that a holder of ZYPS would be able to appoint such an agent or representative and complete any related procedures in a timely manner.

Unless otherwise limited by the CBC, we may, without obtaining further approvals from the CBC or any other government authority of the ROC, convert N.T. dollars to other non-ROC currencies, including U.S. dollars, for making payments in respect of redemption of the ZYPS. A non-ROC converting holder of ZYPS may, through its agent or representative and without obtaining prior approval from the CBC, convert into foreign currency net proceeds realized from the sale of converted shares, or any share dividends relating to such shares, or any cash dividend or other cash distribution in respect of such shares in accordance with the current ROC foreign exchange law and regulations.

Disclosure Obligations

A holder of ZYPS requesting the conversion of its ZYPS may be required to provide certain information to us or the paying agent including the name and nationality of the person registered as the shareholder and the number of our shares such person has acquired in the past through conversion of ZYPS held by it, and supporting documents, before such conversion will be effected. Under applicable ROC laws, we are required to report such information to the SFC in the event that the person to be registered as a shareholder:

1. is a “related party” as defined in Statement of Financial Authority Standard No. 6 of the ROC; or
2. will hold immediately following such conversion, more than 10% of the total number of our shares issuable upon the conversion of the aggregate principal amount of all ZYPS at the time of issue.

Concerning the Trustee

We have appointed The Bank of New York as trustee under the indenture, which term also includes any co-trustee, agent or successor trustee duly appointed thereunder. The principal corporate trust office of the trustee is located at 101 Barclay Street, 21st Floor West, New York, New York 10286, U.S.A. The trustee is required to act on behalf of the holders of the ZYPS in accordance with the terms and conditions of the indenture.

We have agreed in the indenture to indemnify the trustee against any loss, liability or expense incurred without gross negligence or bad faith of the trustee in connection with the acceptance or administration of the trust created by the indenture.

Removal of the trustee may be initiated at any time by the holders of not less than a majority in aggregate principal amount of the outstanding ZYPS. We may remove the trustee if, at any time:

1. the trustee acquires a conflicting interest;

2. the trustee no longer meets the eligibility requirements specified in the indenture; or
3. the trustee becomes incapable of acting or is adjudged bankrupt or insolvent or a custodian or public officer takes charge of the trustee or of its property.

We will notify the Luxembourg Stock Exchange of any change of trustee and will notify the holders in accordance with the provisions of the indenture, which entail, among other things, publication in a newspaper of general circulation in Luxembourg, for as long as the ZYPS are listed on the Luxembourg Stock Exchange and its rules so require.

TRANSFER RESTRICTIONS

Neither the ZYPS nor our shares to be issued upon conversion of the ZYPS have been or will be 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, United States persons except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act.

The ZYPS and our shares are not being offered or sold in the United States except through the U.S. selling agents of certain of the purchasers only to qualified institutional buyers, as defined in Rule 144A, in reliance on the exemption from the registration requirements of the U.S. Securities Act provided by Rule 144A. ZYPS offered in reliance on Rule 144A will be represented by a Rule 144A global certificate.

The ZYPS sold outside the United States and the ROC will be offered by the purchasers to non-U.S. persons in offshore transactions in reliance on Regulation S under the Securities Act. ZYPS offered in reliance on Regulation S will be represented by a Regulation S global certificate.

Except in certain limited circumstances, interests in ZYPS may only be held through holding interests in ZYPS evidenced by one or more global certificates. Such interests will be shown on, and transfers thereof will be effected only through, records maintained by DTC and its direct and indirect participants, including Euroclear and Clearstream.

Any resale or other transfer, or attempted resale or other transfer, made other than in compliance with the restrictions described below will not be recognized by us or the trustee.

United States Offering Transfer Restrictions

Each purchaser of ZYPS within the United States, pursuant to Rule 144A, by accepting delivery of this offering memorandum and the ZYPS, will be deemed to have represented, agreed and acknowledged that:

1. it is:
 - a qualified institutional buyer, as defined in Rule 144A,
 - acquiring such ZYPS for its own account or for the account of a qualified institutional buyer, and
 - aware, and each beneficial owner of such ZYPS has been advised, that the sale of such ZYPS to it is being made in reliance on Rule 144A;
2. it understands that such ZYPS and our shares to be issued upon conversion of such ZYPS have not been and will not be registered under the U.S. Securities Act and may not be offered, sold, pledged or otherwise transferred except:
 - in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a qualified institutional buyer purchasing for its own account or for the account of a qualified institutional buyer,
 - in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S, or
 - pursuant to an exemption from registration under the U.S. 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;

3. it understands that the Rule 144A global certificate and any physical certificate evidencing the Rule 144A ZYPS constitute “restricted ZYPS” under the indenture and, unless otherwise determined by us, will bear a legend to the following effect:

THE CONVERTIBLE ZERO YIELD PUTTABLE SECURITIES (“ZYPS”) AND THE COMMON SHARES ISSUABLE UPON CONVERSION OF THE ZYPS HAVE NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (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. ACCORDINGLY, THE ZYPS ARE BEING OFFERED AND SOLD IN THE UNITED STATES ONLY TO QUALIFIED INSTITUTIONAL BUYERS IN RELIANCE ON RULE 144A UNDER THE SECURITIES ACT AND OUTSIDE THE UNITED STATES PURSUANT TO REGULATION S UNDER THE SECURITIES ACT. PROSPECTIVE PURCHASERS ARE HEREBY NOTIFIED THAT THE SELLER OF THE ZYPS MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A. THE ZYPS AND THE COMMON SHARES ISSUABLE UPON CONVERSION THEREOF ARE NOT TRANSFERABLE EXCEPT IN ACCORDANCE WITH THE RESTRICTIONS DESCRIBED HEREIN AND IN THE INDENTURE UNDER WHICH THE ZYPS ARE ISSUED;

4. it understands that to exercise its conversion rights it must make the representations, warranties and undertakings, including, among other things, that it is a qualified institutional buyer within the meaning of Rule 144A and with respect to certain restrictions on transfer that may apply to our shares received upon conversion, contained in the conversion notice described under “Description of the Convertible Zero Yield Puttable Securities — Conversion”;
5. it understands that the ZYPS offered in reliance on Rule 144A will be represented initially by a Rule 144A global certificate. Before any interest in a Rule 144A global certificate may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in a Regulation S global certificate, it will be required to deliver a written certificate (in the form provided in the indenture) as to compliance with, among other things, applicable securities laws;
6. if it is acquiring any ZYPS for the account of one or more qualified institutional buyers, it has sole investment discretion with respect to each such account and it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such account; and
7. we, the trustee, the initial purchasers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgments, representations and agreements.

International Offering Transfer Restrictions

Every person purchasing ZYPS outside the United States and the ROC pursuant to Regulations S, and each purchaser of such ZYPS in subsequent resales, by accepting delivery of this offering memorandum and the ZYPS will be deemed to have represented, agreed and acknowledged that:

1. it understands that such ZYPS and our shares to be issued upon conversion of the ZYPS have not been and will not be registered under the U.S. Securities Act and, prior to the expiration of 40 days after the later of the commencement of the offering and completion of the distribution of the ZYPS, may not be offered, sold, pledged or otherwise transferred except:
 - in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believes is a qualified institutional buyer purchasing for its own account or the account of a qualified institutional buyer or
 - in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S;
2. it is:
 - the beneficial owner of such ZYPS or our shares,
 - not a U.S. person and it is located outside the United States (in each case, as such terms are defined in Regulation S), and
 - not our affiliate or a person acting on behalf of such an affiliate;
3. it agrees (or if it is a broker-dealer, its customer has confirmed to it that such customer agrees) that prior to the end of the 40-day restricted period referred to above, it (or such customer) will not offer, sell, pledge or otherwise transfer such ZYPS except:
 - to a person whom it reasonably believes (or it and anyone acting on its behalf reasonably believes) is a qualified institutional buyer in a transaction meeting the requirements of Rule 144A, or
 - 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;
4. it understands that the Regulation S global certificate and any physical certificate evidencing the Regulation S ZYPS will constitute “restricted ZYPS” under the indenture prior to the end of the 40-day restricted period referred to above and, unless otherwise determined by us, will bear a legend to the following effect:

THE CONVERTIBLE ZERO YIELD PUTTABLE SECURITIES (“ZYPS”) AND THE COMMON SHARES ISSUABLE UPON CONVERSION OF THE ZYPS HAVE NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), AND, PRIOR TO THE EXPIRATION OF 40 DAYS AFTER THE LATER OF THE COMMENCEMENT OF THE OFFERING OF ZYPS AND THE COMPLETION OF THE DISTRIBUTION OF THE ZYPS (THE “RESTRICTED PERIOD”) 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. ACCORDINGLY, THE ZYPS ARE BEING OFFERED AND SOLD IN THE UNITED STATES ONLY TO

QUALIFIED INSTITUTIONAL BUYERS IN RELIANCE ON RULE 144A UNDER THE SECURITIES ACT AND OUTSIDE THE UNITED STATES PURSUANT TO REGULATION S UNDER THE SECURITIES ACT. PROSPECTIVE PURCHASERS ARE HEREBY NOTIFIED THAT THE SELLER OF THE ZYPS MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A. THE ZYPS AND THE COMMON SHARES ISSUABLE UPON CONVERSION THEREOF ARE NOT TRANSFERABLE EXCEPT IN ACCORDANCE WITH THE RESTRICTIONS DESCRIBED HEREIN AND IN THE INDENTURE UNDER WHICH THE ZYPS ARE ISSUED.

UPON THE EXPIRATION OF THE RESTRICTED PERIOD, THE ZYPS EVIDENCED HEREBY 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 ZYPS EVIDENCED HEREBY BY THE HOLDER 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;

5. it understands that the ZYPS offered in reliance on Regulation S will be represented initially by a Regulation S global certificate. Before any interest in a Regulation S global certificate may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in a Rule 144A global certificate, it and the transferee will be required to deliver written certificates (in the forms provided in the indenture) as to, among other things, the transferee's status as a qualified institutional buyer;
6. it understands that, prior to the end of the 40-day restricted period referred to above, to exercise its conversion rights it must make the representations, warranties and undertakings, including, among other things, that it is a non-U.S. person outside the United States (in each case, as such terms are defined in Regulation S) and with respect to certain restrictions on transfer that may apply to our shares received upon conversion, contained in the conversion notice described under "Description of the Convertible Zero Yield Puttable Securities — Conversion";
7. we, the trustee, the managers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

DESCRIPTION OF SHARE CAPITAL

Set forth below is certain information relating to our share capital, including brief summaries of certain provisions of our articles of incorporation, the ROC Securities and Exchange Law and the regulations promulgated thereunder and ROC Company Law, all as currently in effect.

General

We were incorporated on May 28, 1987 as a company limited by shares under ROC Company Law. As of September 30, 2003, our authorized share capital consists of 1,200,000,000 common shares of par value NT\$10 per share. We do not have any equity in the form of preference shares or otherwise outstanding as of the date of this offering memorandum. 579,303,374 common shares were issued as of September 30, 2003, including 16,857,000 treasury shares. We have implemented two share option plans, whereby we grant share options to our full-time employees that will permit them to purchase up to 50,000,000 newly issued and previously repurchased and reserved common shares. As of September 30, 2003, 190,000,000 shares of our authorized share capital are reserved for issuance pursuant to the potential conversion of convertible bonds or securities.

Dividends and Distributions

Except in limited circumstances under 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. ROC Company Law also requires that 10% of annual net income, after deduction of taxes due and prior year's losses, be set aside as a legal reserve until the accumulated legal reserve equals our paid-in capital. As of September 30, 2003, our articles of incorporation provide that 10% and 1% of our annual net income approved by the shareholders (after deduction of taxes due, prior years' losses and other necessary legal or special reserve) be paid to employees as bonuses and to the directors and supervisors as remuneration. The balance thereof can be paid to our shareholders as dividends upon a resolution of the annual shareholders' meeting. As of the same date, our articles of incorporation also provide that we will, subject to shareholders' approval, distribute 89% of distributable earnings after the payment of income taxes, deduction of losses incurred in prior years and deduction of the legal reserve and any special reserve. Employee bonuses and remunerations of directors and supervisors accounts for 10% and 1%, respectively, of the residual earnings approved by the shareholders. No more than 20% of such dividend distribution may be in the form of cash. See "Dividends and Dividend Policy" and note 4(22) to our financial statements.

At the annual general meeting of our shareholders, our board of directors submits to the shareholders for their approval our financial statements for the preceding fiscal year and any proposal for the distribution of the dividend or the making of any other distribution to shareholders from our net income (subject to compliance with the requirements mentioned above) for the preceding fiscal year. All common shares outstanding and fully paid as of the relevant record date are entitled to share equally in any dividend or other approved distribution to our shareholders. Payments of dividends are made through our paying agent in the ROC, Taiwan International Securities Corporation.

In addition to permitting dividends to be paid out of net income, ROC Company Law permits us to make distributions to our shareholders of additional common shares by capitalizing reserves (including the legal reserve, any special reserve and capital surplus). However, the capitalized portion payable out of our legal reserve is limited to 50% of the total accumulated legal reserve and such capitalization can only be effected when the accumulated legal reserve exceeds 50% of our paid-in capital. In addition, the capitalized portion payable out of our capital surplus is limited to the aggregate of the share premium received and the fair market value of any gifts or items of value we receive.

In 2000, we distributed a stock dividend of 37,312,500 common shares, which was paid out of our retained earnings and capital surplus. In 2001, we distributed a share dividend of 86,864,398 common shares. We did not declare or distribute any dividends in 2002 due to the net loss we incurred in 2001. We will not declare or distribute any dividend in 2003 due to the net loss we incurred in 2002.

Changes in Share Capital and Pre-emptive Rights

ROC Company Law provides that any change in the authorized share capital of a company limited by shares, such as King Yuan, requires an amendment to the articles of incorporation (which requires approval at a shareholders' meeting). In addition, any change in the issued share capital of a public company, such as ourselves, requires the approval of the SFC and, in our case, the approval of the Ministry of Economic Affairs. Authorized but unissued common shares may be issued at such times and, subject to the provisions of ROC Company Law and the ROC Securities and Exchange law mentioned below, upon such terms as our board of directors may determine.

Under ROC Company Law, when an ROC company issues new shares for cash, existing shareholders which are listed on the shareholders' register as of the record date have pre-emptive rights to subscribe for the new issue in proportion to their existing stockholdings, while a company's employees, whether or not they are shareholders of the company, have rights to subscribe for 10% to 15% of the new issue. Any new shares that remain unsubscribed at the expiration of the subscription period may be offered to the public or privately placed by ourselves.

In addition, in accordance with the ROC Securities and Exchange Law, a public company, such as ourselves, whose securities are listed on the Taiwan Stock Exchange, that intends to offer new shares for cash must offer to the public at least 10% of the shares to be sold. This percentage can be increased by a resolution passed at a shareholders' meeting, thereby diminishing the number of new shares subject to the pre-emptive rights of existing shareholders.

Meetings of Shareholders

General meetings of shareholders may be ordinary or extraordinary. We are required to hold one ordinary shareholders' meeting for each fiscal year within six months following the end of such fiscal year, usually held in Hsin-Chu City, Taiwan. Extraordinary meetings may be convened by the board of directors by resolution or upon the written request of any shareholder holding not less than 3% of the outstanding common shares for more than one year. Extraordinary meetings may also be convened by a supervisor when our board of directors does not or cannot convene a shareholders' meeting and when such meeting is necessary for the benefit of the company. Notice in writing of meetings of shareholders of a public company, such as our company, stating the place, time and purpose thereof, must be dispatched to each shareholder at least 30 days (in case of ordinary meetings) and 15 days (in case of extraordinary meetings) prior to the date set for such meeting.

We publish notices of shareholder meetings, as well as notices with respect to, e.g., dividends, rights issues and capital increases, on a newspaper with national circulation in the ROC or on <http://mops.tse.com.tw>, the website designated by the SFC for public disclosure purposes.

Voting Rights

Each common share is entitled to one vote. Except as otherwise provided by law or our articles of incorporation, a resolution can be adopted by the holders of a simple majority of the common total issued and outstanding shares represented at a shareholders' meeting. The quorum for a shareholder's meeting to discuss ordinary resolutions is a majority of the total issued and outstanding common shares, excluding the shares without voting rights. The election of directors and supervisors by our shareholders may be conducted by means of cumulative voting or other voting mechanisms adopted in our articles of incorporation. In all other matters, a shareholder must cast all his votes in the same manner when voting on

any of these matters. Under ROC Company Law, however, in order to approve certain major corporate actions, including any amendment to the articles of incorporation (which is required, *inter alia*, for any increase in authorized share capital), the dissolution or amalgamation of a company, the transfer of the whole or an important part of its business, the taking over of the whole of the business of any other company, removal of directors, 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 common shares, excluding the shares without voting rights, at which the holders of at least a majority of the common shares represented at the meeting vote in favor thereof. Alternatively, ROC Company Law provides that in the case of a public company, such as ourselves, such a resolution may be adopted by the holders of at least two-thirds of the common shares, excluding the shares without voting rights, represented at a meeting of shareholders at which holders of at least a majority of issued and outstanding common shares, excluding the shares without voting rights, are present.

A shareholder may be represented at an ordinary or extraordinary shareholders' meeting by proxy if a valid proxy form is delivered to us at least five days prior to the commencement of the ordinary or extraordinary shareholders' meeting. Voting rights attaching to our common shares exercised through a proxy are subject to the proxy regulations promulgated by the ROC SFC.

Any shareholder with a personal interest in a matter to be discussed at a shareholders' meeting, the outcome of which may impair the company's interests, is prohibited from voting or exercising voting rights on behalf of another shareholder on any such matter.

Register of Shareholders and Record Dates

Capital Security Corp. acts as our share registrar and maintains the register of our shareholders at its offices in Taipei, Taiwan, and enters transfers of common shares in such register upon presentation of, among other documents, certificates in respect of the common shares transferred.

Under ROC Company Law and our articles of incorporation, we may, by giving advance public notice, set a record date and/or close the register of our shareholders for a specified period (60 days, 30 days and five days, respectively, immediately before each ordinary meeting of shareholders, extraordinary meeting of shareholders and the relevant record date) in order for us to determine the shareholders that are entitled to certain rights pertaining to the common shares.

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. Subject to applicable law, 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.

Financial Statements

From at least ten days before the annual ordinary meeting of shareholders, our annual financial statements must be available at our principal office in Hsin-Chu for inspection by the shareholders. According to the regulations of the ROC SFC, we are required to publish our annual, semi-annual and quarterly unconsolidated financial statements in a national daily newspaper, which are also available in the office of the paying and conversion agent in Luxembourg and elsewhere.

Transfer of Common Shares

Under ROC Company Law as amended on November 14, 2001, a public company, such as ourselves, may issue one master share certificate, individual share certificates or no share certificate at all. The transfer of common shares evidenced by individual share certificates is effected by endorsement and delivery of the related share certificates but, in order to assert shareholders' rights against us, the transferee must have its name and address registered on our register of shareholders. Shareholders are required to file the respective specimen seals with us. The settlement of trading of common shares on the TSE is carried out on the book-entry system maintained by Taiwan Securities Central Depository Co. Ltd.

Acquisition of Common Shares by Us

Under the ROC Company Law, we may not acquire our own common shares except in certain limited circumstances. We must sell any common shares acquired by us at the current market price or cancel any common shares acquired by us within six months (or three years if the shares were acquired for sale to employees) after their acquisition. Under an amendment to the 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 TSE or by a tender offer, in accordance with the procedures prescribed by the SFC, for the following purposes: (1) to transfer 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 to be purchased shall be cancelled three years thereafter with regard to items (1) and (2) and six months thereafter with regard to item (3).

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 TSE, 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.

The recent amendment to ROC Company Law prohibits our subsidiaries from acquiring our shares if such subsidiaries are majority-owned, directly or indirectly, by us.

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 ROC Company Law.

Significant Shareholders and Transfer Restrictions

The ROC Securities and Exchange Law (1) requires each director, supervisor, manager or shareholder holding more than 10% of the shares of a public company to report the change in such person's holding to the company and (2) limits the number of shares that can be sold or transferred on the Taiwan Stock Exchange by such person per day.

Limitation on Shareholdings and Reporting Obligations

The ROC Securities and Exchange law requires each director, supervisor, manager or significant shareholder to report any change in that person's shareholding to us before each fifth day of each month and we shall report the same to the ROC SFC before the fifteenth day of each month. Such persons are also required to report immediately to us the pledge of their shares in us and we shall report the same to the ROC SFC within five days from the pledge date. A person or a person who along with other persons (as defined under the ROC SFC regulations) acquires more than 10% of our issued and outstanding Shares shall report to the ROC SFC, within ten days from the acquisition date, the acquisition purpose, funding sources and other information required by the ROC SFC.

TAXATION

ROC Taxation

The following is a summary under present law of the principal ROC tax consequences to a non-resident individual or a non-resident entity (which we refer to collectively as a non-ROC holder) of the ownership and disposition of ZYPS and our shares issuable upon conversion of the ZYPS. It applies only to a holder that is:

- an individual who is not an ROC citizen, who owns the ZYPS, our shares and who is not physically present in the ROC for 183 days or more during any calendar year; or
- a corporation or a non-corporate body that owns the ZYPS, our shares, is organized under the laws of a jurisdiction other than the ROC and has no fixed place of business or other permanent establishment or no business agent in the ROC.

Prospective purchasers of the ZYPS should consult their tax advisers concerning the ROC tax consequences of owning the ZYPS, our shares and the laws of any other relevant taxing jurisdiction to which they are subject.

ZYPS

Payments of interest, if any, on the ZYPS to a non-ROC holder constitute interest income and, therefore, are subject to ROC withholding tax, currently at the rate of 20%. We have agreed to pay additional amounts in respect of such withholding tax on the payments of interest (if any). See “Description of the Convertible Zero Yield Puttable Securities — Additional Amounts.” In addition, should withholding tax be payable, we will be responsible for withholding such taxes at the source.

Sale

No securities transaction tax will apply to transfers of the ZYPS.

Gains on sales 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 the sale of our ZYPS.

Conversion into Common Shares

ROC law currently provides no specific provisions regarding the ROC income tax consequences of a conversion of our ZYPS into our shares. Without further clarification from the ROC tax authorities, it is impossible to conclude definitively that gains on conversion of our ZYPS into our shares will not be deemed as taxable gains, additional interest income (subject to the 20% withholding tax) or otherwise subject to other ROC taxes. If ROC income or withholding tax is imposed on a conversion of ZYPS by you, we will pay such ROC income or withholding tax on your behalf.

There is no ROC stamp, issue or registration tax imposed on the issuance of our shares upon conversion of the ZYPS.

Common Shares

Dividends

Dividends (whether in cash or our shares) declared by us out of retained earnings and distributed to a non-ROC holder in respect of our shares are subject to ROC withholding tax, currently at the rate of 20%, on the amount of the distribution in the case of cash dividends or on the par value of our shares in the case of stock dividends. We are required to pay a 10% ROC retained earnings tax on our undistributed after-tax earnings, and upon the payment of this tax, we will apply a credit of up to 10% of the gross amount of any dividends declared out of those earnings to the amount of withholding tax we otherwise are required to withhold. This will effectively reduce the 20% ROC tax imposed on those distributions.

Dividends paid by us out of our capital surplus are not subject to ROC withholding tax.

Capital Gains

Under ROC law, capital gains derived from sales of common shares are exempt from income tax.

Subscription Rights

Distributions of statutory subscription rights to our shareholders for purchase of our shares in compliance with ROC law are not subject to any ROC tax. Proceeds derived from sales of statutory subscription rights evidenced by securities are exempted from income tax but are subject to securities transaction tax at the rate of 0.3% of the gross amount received. Proceeds derived from sales of statutory subscription rights that are not evidenced by securities are subject to a withholding tax at the rate of:

- 35% of the gains realized if the holder is a non-ROC natural person; or
- 25% of the gains realized if the holder is a non-ROC entity.

Subject to compliance with ROC law, we, at our sole discretion, can determine whether statutory subscription rights shall be evidenced by issuance of securities. The depositary, upon sale at the instruction of a non-ROC holder of statutory subscription rights evidenced by securities, will be subject to securities transaction tax at the rate of 0.3% of the gross amount received. Upon sale at the instruction of a non-ROC holder of statutory subscription rights not evidenced by securities, the depositary will be deemed as a non-ROC entity and will be subject to ROC withholding tax at the rate of 25% of the gains realized. Such taxes are payable by the non-ROC holder to the depositary under the terms of the deposit agreements.

Securities Transaction Tax

A securities transaction tax, at the rate of 0.3% of the gross amount received, is generally applicable to a sale of common shares in the ROC. The securities transaction tax and/or gift tax may be imposed in relation to the converting holder of ZYPS' designation of another person to be the holder of our shares upon conversion of the ZYPS. There is no ROC stamp, issue or registration tax imposed on the issuance of common shares upon conversion of the ZYPS.

Estate and Gift Tax

ROC estate tax is payable on any property within the ROC of a deceased individual, and ROC gift tax is payable on any taxable property within the ROC donated by any person. Estate tax is currently 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 estate and gift tax laws, common shares issued by ROC companies are deemed located in the ROC regardless of the location of the holder.

The ROC does not have a double taxation treaty with the United States, but does have double taxation treaties with Indonesia, Singapore, South Africa, Australia, Vietnam, New Zealand, Malaysia, Macedonia, Swaziland, Gambia, the United Kingdom and the Netherlands that may limit the rate of ROC withholding tax on dividends paid with respect to common shares in ROC companies.

United States Taxation

The following summary describes the material United States federal income tax consequences as of the date hereof of the ownership of ZYPSs purchased in connection with this offering and any shares issued upon conversion thereof. The discussion set forth below is applicable only to United States Holders (as defined below). Except where noted, this summary deals only with ZYPSs or our shares held as capital assets by initial purchasers of the ZYPSs at their original offering price, who do not have a fixed place of business or other permanent establishment or do not have a business agent in the ROC, who are not citizens of the ROC and who are not physically present in the ROC for 183 days or more within a calendar year, and does not deal with special situations, such as those of banks, dealers in securities or currencies, financial institutions, insurance companies, regulated investment companies, real estate investment trusts, tax-exempt entities, traders in securities that elect to use a mark-to-market method of accounting for their securities holdings, persons holding ZYPSs or our shares as part of a hedging, conversion, constructive sale or integrated transaction or a straddle, persons liable for the alternative minimum tax, persons who own more than 10% of the voting stock of our company or whose functional currency is not the United States dollar. Furthermore, the discussion below is based upon the provisions of the Internal Revenue Code of 1986, as amended (the “Code”) and United States Treasury regulations, rulings and judicial decisions thereunder as of the date hereof, and such authorities may be repealed, revoked or modified so as to result in United States federal income tax consequences different from those discussed below. Persons considering the purchase, ownership or disposition of ZYPSs or our shares should consult their own tax advisors concerning the United States federal income tax consequences in light of their particular situations as well as any consequences arising under the laws of any other taxing jurisdiction.

As used herein, the term “United States Holder” means a beneficial holder of ZYPS or our shares that is (i) a citizen or resident of the United States, (ii) a corporation or partnership created or organized in or under the laws of the United States or any political subdivision thereof, (iii) an estate the income of which is subject to United States federal income taxation regardless of its source, or (iv) a trust if (x) it is subject to the primary supervision of a court within the United States and one or more United States persons has authority to control all substantial decisions of the trust or (y) it has a valid election in effect under applicable United States Treasury regulations to be treated as a United States person.

If a partnership holds ZYPSs or our shares, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. If the United States Holder is a partner of a partnership holding the ZYPSs or our shares, such holder is urged to consult its tax advisors.

We intend to take the position that the ZYPSs constitute indebtedness for United States federal income tax purposes. The discussion below assumes that this treatment is correct, although no assurances can be given in this regard.

Payments of Interest

The ZYPSs are expected to be issued at 100% of the principal amount and, therefore, will not be treated as bearing original issue discount for United States federal income tax purposes. Any interest paid upon default (see “Description of the Convertible Zero Yield Puttable Securities — Default Interest”) will be taxable to a United States Holder as ordinary income in accordance with the United States Holder’s method of accounting for tax purposes.

If interest is paid on a ZYPS, you will be required to include in your income ROC taxes withheld from the interest payments and any additional amounts paid in respect of any such ROC tax that may be withheld from the interest payments or additional amounts you receive. You may be entitled to a credit or deduction for tax withheld, subject to applicable limitations in the Code. Interest income on the ZYPSs, including any ROC taxes withheld and additional amounts, generally will constitute foreign source income and generally should be considered “high withholding tax interest” for purposes of computing the foreign tax credit under United States federal income tax laws. Special rules apply to certain individuals whose foreign source income during the taxable year consists entirely of “qualified passive income” and whose creditable foreign taxes paid or accrued during the taxable year do not exceed US\$300 (US\$600 for joint filers). Guidance issued by the United States Internal Revenue Service (the “IRS”) may deny a foreign tax credit for foreign taxes imposed with respect to the ZYPSs where a United States Holder holds the ZYPSs in arrangements in which the United States Holder’s expected economic profit, after non-United States taxes, is insubstantial. The rules governing the foreign tax credit are complex. Investors are urged to consult their tax advisors regarding the availability of the foreign tax credit under their particular circumstances.

Adjustment of Conversion Price

Certain adjustments to the conversion price that increase the proportionate interest of United States Holders of ZYPSs in our shares may result in constructive distributions to the United States Holders of the ZYPSs, taxable as ordinary income to the extent of our current and accumulated earnings and profits (as determined for United States federal income tax purposes) for the year (or years) in which such adjustments are made. While these rules may apply to any adjustment to the conversion price, United States Holders should note that it is likely that the IRS would contend that United States Holders of ZYPSs received a taxable dividend distribution upon a conversion price reset, equal to the fair market value (determined on the reset date) of the additional shares a United States Holder would receive, upon exchange, due to the reset.

In addition, if full adjustment to the conversion price is not made upon the issuance of a stock dividend or upon the occurrence of another event, resulting in an increase in the proportionate interests of holders of our shares, such increase in the proportionate interests of holders of our shares will be treated as a distribution to such holders, which will be taxable as ordinary income to the extent of our current and accumulated earnings and profits (as determined for United States federal income tax purposes) for the year (or years) in which we failed to make such adjustments.

Conversion into Common Shares

In general, subject to the discussion in the succeeding paragraphs, no gain or loss will be recognized on a conversion of the ZYPSs into our shares, except to the extent of cash received, if any. If you receive solely cash for your ZYPSs, your gain or loss will be determined as described below under “Disposition of ZYPSs or Common Shares”. If you receive a combination of our shares and cash upon exercise of a ZYPS, the tax treatment is uncertain. You may be required to recognize gain, but not loss, equal to the excess of the fair market value of our shares and cash received over your adjusted tax basis in the ZYPS, but not in excess of the amount of cash received. Alternatively, the cash payment may be treated as proceeds from a sale of a ZYPS, as described below under “Disposition of ZYPSs or Common Shares.” In such case, your basis in the ZYPSs would be allocated pro rata between the common stock received (including any fractional share treated as received) and the ZYPS treated as sold for cash. You should consult your tax advisors regarding the proper treatment of the receipt of a combination of cash and common stock upon a conversion. In general, the adjusted tax basis of our shares received on conversion will equal the adjusted tax basis of the ZYPSs converted. The holding period of our shares received on conversion will include the period during which the ZYPSs were held.

As discussed above, under the caption “Taxation — ROC Taxation,” it is possible that the ROC may impose a withholding tax upon the conversion of the ZYPSs into our shares, which we will pay on your behalf. See “Description of the Convertible Zero Yield Puttable Securities — Conversion — Exercise of

Conversion Right.” Even though the conversion is not a taxable event for United States federal income tax purposes, a United States Holder would have taxable income on the conversion to the extent of ROC taxes paid by us on its behalf. However, because the conversion is generally not a taxable event for United States federal income tax purposes, United States Holders may not be able to use the credit attributable to ROC taxes imposed on a conversion unless it can be applied to other foreign source income in the appropriate limitation category.

Distributions on Common Shares

Distributions on our shares into which ZYPSs have been converted (other than certain pro rata distributions of our shares to all shareholders) will be taxable as dividends to the extent of our current and accumulated earnings and profits (as determined under United States federal income tax principles). Dividends will include any amounts withheld in respect of ROC taxes, determined based on the 20% ROC withholding tax reduced by any credit against such withholding taxes on account of the 10% retained earnings tax imposed on us. Such income will be includable in the gross income of a United States Holder as ordinary income on the day actually or constructively received by the United States Holder, in the case of our shares. Such dividends will not be eligible for the dividends-received deduction.

Under recently enacted legislation, dividends received before January 1, 2009 by United States holders that are individuals on shares of certain foreign corporations may be subject to United States federal income tax at lower rates than other types of ordinary income if certain conditions are met. We do not believe that dividends that we pay currently meet these conditions. Holders should consult their own tax advisors regarding the application of this legislation to their particular circumstances.

The amount of any dividend paid in N.T. dollars will equal the United States dollar value of the N.T. dollars received calculated by reference to the exchange rate in effect on the date the dividend is actually or constructively received by the United States Holder in the case of our shares regardless of whether the N.T. dollars are converted into United States dollars. If the N.T. dollars received are not converted into United States dollars on the day of receipt, a United States Holder will have a basis in the N.T. dollars equal to their United States dollar value on the date of receipt. Any gain or loss realized on a subsequent conversion or other disposition of the N.T. dollars will be treated as United States source ordinary income or loss.

Subject to certain significant conditions and limitations, the net amount of ROC tax withheld from dividends may be treated as foreign income tax eligible for credit against a United States Holder’s United States federal income tax liability. For purposes of the foreign tax credit, dividends paid on our shares will be treated as income from sources without the United States and will generally constitute “passive income” or, in the case of certain United States Holders, “financial services income.” Special rules apply to certain individuals whose foreign source income during the taxable year consists entirely of “qualified passive income” and whose creditable foreign taxes paid or accrued during the taxable year do not exceed US\$300 (US\$600 for joint filers). In certain circumstances, a United States Holder that (i) has held our shares for less than a specified minimum period during which it is not protected from the risk of loss, (ii) is obligated to make payments related to the dividends or (iii) holds our shares in arrangements in which the United States Holder’s expected economic profit, after non-United States taxes, is insubstantial will not be allowed a foreign tax credit for foreign taxes imposed on dividends paid on our shares. The rules governing the foreign tax credit are complex. Investors are urged to consult their tax advisors regarding the availability of the foreign tax credit under their particular circumstances.

To the extent that the amount of any distribution exceeds our current and accumulated earnings and profits for a taxable year, the distribution will first be treated as a tax-free return of capital, causing a reduction in the adjusted tax basis of our shares (thereby increasing the amount of gain, or decreasing the amount of loss, to be recognized by the investor on a subsequent disposition of our shares), and the balance in excess of adjusted tax basis will be taxed as capital gain.

It is possible that distributions of our shares that are received as part of a pro rata distribution to all of our shareholders may not be subject to United States federal income tax. In such event, the basis of the new shares so received will be determined by allocating the United States Holder's adjusted tax basis in the old shares between the old shares and the new shares received, based on their relative fair market values on the date of distribution. The United States Holder's holding period for the new shares will be the same as the holder's holding period for the old shares.

As discussed above under the caption “— ROC Taxation — Common Shares — Dividends”, the ROC imposes a 20% withholding tax on the par value of any shares distributed by us as a stock dividend to a United States Holder of our shares. However, the amount of ROC taxes withheld on a distribution is determined based on the 20% withholding tax reduced by a credit for any retained earnings tax paid by us. Subject to certain significant conditions and limitations set forth in the Code, actual ROC taxes withheld on such stock dividends may be treated as foreign taxes eligible for credit against a United States Holder's United States federal income tax liability. However, as discussed above, such stock dividends may not be subject to United States federal income tax (provided such stock dividends are pro rata). Consequently, a United States Holder may not be able to use the credit attributable to such ROC taxes unless it can be applied to other foreign source income in the appropriate limitation category.

Disposition of ZYPSs or Common Shares

Subject to the discussion under “— Conversion into Common Shares,” upon the sale, exchange or retirement of ZYPSs, or upon the sale, exchange or other disposition of our shares, a United States Holder generally will recognize capital gain or loss equal to the difference between the amount realized upon the sale, exchange or other disposition and the adjusted tax basis of the ZYPSs or our shares. A United States Holder's adjusted tax basis in a ZYPS will, in general, be the holder's cost therefore, while a United States holder's adjusted tax basis in a share will generally be the same as such holder's adjusted tax basis in the ZYPS immediately before the conversion. The capital gain or loss will be long-term capital gain or loss if at the time of sale, exchange or other disposition the ZYPSs or our shares have been held for more than one year. Capital gains of individuals derived with respect to capital assets held for more than one year are eligible for reduced rates of taxation depending upon the holding period of such capital assets. The deductibility of capital losses is subject to limitations. Any gain or loss recognized by a United States Holder will generally be treated as United States source gain or loss.

Holders should note that any ROC securities transaction tax generally will not be treated as a creditable foreign tax for United States federal income tax purposes, although United States Holders may be entitled to deduct such taxes, subject to applicable limitations under the Code.

Passive Foreign Investment Company Rules

We do not believe that we are, for United States federal tax purposes, a passive foreign investment company (a “PFIC”), and expect to continue our operations in such a manner that we will not be a PFIC. If, however, we are or become a PFIC, United States Holders could be subject to additional United States federal income taxes on gain recognized with respect to the ZYPSs or our shares and on certain distributions, plus an interest charge on certain taxes treated as having been deferred by the United States Holder under the PFIC rules. In addition, United States Holders who are individuals will not be eligible for reduced rates of taxation on dividends received from us prior to January 1, 2009, if we are a PFIC in the taxable year in which such dividends are paid or in the preceding taxable year.

Estate and Gift Taxation

The ROC imposes an estate tax on a decedent who owns ZYPSs or our shares, even if the decedent was not a citizen or resident of the ROC. See “Taxation — ROC Taxation — Estate and Gift Tax.” The amount of any estate tax paid to the ROC may be eligible for credit against the amount of United States federal estate tax imposed on the estate of a United States Holder. Prospective purchasers should consult their personal tax advisors to determine whether and to what extent they may be entitled to such credit.

Under present law, a comparable United States tax credit for foreign gift taxes (such as those imposed by the ROC) is not available.

Information Reporting and Backup Withholding

In general, information reporting requirements will apply to certain payments of principal and interest (if any) paid on ZYPSs, distributions on our shares and to the proceeds of the sale of ZYPSs or our shares made to United States Holders other than certain exempt recipients (such as corporations). A backup withholding tax may apply to such payments if the United States Holder fails to provide a correct taxpayer identification number or certification of foreign or other exempt status or fails to report in full dividend and interest income.

Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against such holder’s United States federal income tax liability provided the required information is furnished to the IRS.

PLAN OF DISTRIBUTION

Under the terms and subject to the conditions contained in a purchase agreement dated January 9, 2004 or the purchase agreement, the managers named below, for whom Lehman Brothers International (Europe) is acting as sole bookrunner, have severally but not jointly agreed to purchase from us the following respective principal amounts of the ZYPS:

Managers	Principal Amount
Lehman Brothers International (Europe)	US\$90,000,000
Total	<u>US\$90,000,000</u>

The purchase agreement provides that the obligations of the managers are subject to certain conditions precedent and that the managers will be obligated to purchase all the ZYPS if any are issued. The purchase agreement provides that, in the event of a default by a manager, in certain circumstances the purchase commitments of non-defaulting managers may be increased or the purchase agreement may be terminated.

We have granted the sole bookrunner an option exercisable in whole or in part on one or more occasions up to and including the date 30 days after the closing date of this offering, to purchase up to an aggregate of US\$10,000,000 principal amount of the ZYPS as the sole bookrunner elects, at the offering price set forth on the cover page of this offering memorandum. We will notify the Luxembourg Stock Exchange of any exercise of such option.

In connection with this offering, the sole bookrunner may over-allot or effect transactions which stabilize or maintain the market price of the ZYPS on the Luxembourg Stock Exchange, or our shares on the TSE (subject to applicable ROC law) at a level above that which might otherwise prevail for a limited period after issue date. However, there may be no obligation on the sole bookrunner or any of its agents to do so. Such stabilizing, if commenced, may be discontinued at any time and must be brought to an end after a limited period.

The purchase price for the ZYPS will be the initial offering price set forth on the cover page of this offering memorandum, or the offering price, less a combined management and underwriting commission and selling concession equal to 2.00% of the principal amount of the ZYPS purchased. The managers propose to offer the ZYPS at the offering price. After the ZYPS are released for sale, the offering price and other selling terms may from time to time be varied by the managers.

The managers or their affiliates may purchase the ZYPS for their own account and enter into transactions relating to the ZYPS, including asset swaps, repackaging and other transactions. Such transactions would be carried out as bilateral trades with selected counter-parties and separately from any existing sale or resale of the ZYPS, even if the selected counter-parties may also be purchasers of the ZYPS. These transactions may involve a substantial portion of the ZYPS.

Pursuant to the purchase agreement, we have agreed to indemnify the managers against certain liabilities, including civil liabilities under the U.S. Securities Act, or to contribute to payments which the managers may be required to make in respect thereof. The purchase agreement provides that the obligations of the managers are subject to certain conditions precedent, and entitles the managers to terminate it in certain circumstances prior to payments being made to us.

United States

The ZYPS and our shares issuable upon conversion of the ZYPS have not been and will not be registered under the Securities Act and may not be offered or sold in the United States or to, or for the account or benefit of, U.S. persons except, in either case, pursuant to an effective registration statement or in accordance with an applicable exemption from the registration requirements of the U.S. Securities Act.

Accordingly, the ZYPS are being offered and sold by the managers only (1) in the United States to qualified institutional buyers pursuant to Rule 144A under the U.S. Securities Act and (2) outside the United States in reliance upon Regulation S.

Each manager has agreed in the purchase agreement that it will not offer, sell or deliver any ZYPS (1) as part of its distribution at any time or (2) otherwise until 40 days after the later of the commencement of the offering and the completion of the distribution of the ZYPS, within the United States or to, or for the account or benefit of, U.S. persons except, in either case, in accordance with Regulation S or to persons who it reasonably believes to be qualified institutional buyers pursuant to Rule 144A, and that it will have sent to each dealer to which it sells the ZYPS and our shares issuable upon conversion of the ZYPS during the restricted period (unless such sale is made in accordance with Rule 144A) a confirmation or other notice setting forth the restriction on offers and sales of ZYPS within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the commencement of the offering, an offer or sale of the ZYPS within the United States by a dealer (whether or not participating in the offering) may violate the registration requirement of the U.S. Securities Act if such offer or sale is made otherwise than pursuant to Rule 144A. As used in this paragraph and the immediately preceding paragraph, the terms “United States” and “U.S. person” have the meanings given to them by Regulation S under the U.S. Securities Act.

United Kingdom

Each manager has represented and agreed that (1) it has not offered or sold and, prior to the expiry of the period of six months from the closing date, will not offer or sell any ZYPS 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); (2) it has complied and will comply with all applicable provisions of the Financial Services and Markets Act 2000, or FSMA, with respect to anything done by it in relation to the ZYPS in, from or otherwise involving, the United Kingdom; and (3) 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 FSMA) received by it in connection with the issue or sale of such ZYPS in circumstances in which section 21(1) of the FSMA does not apply to us.

ROC

Each manager has agreed that, as part of the distribution of the ZYPS, it has not offered or sold, and will not offer or sell, any ZYPS directly or indirectly in the ROC.

Japan

Each manager understands that the ZYPS have not been and will not be registered under the Securities and Exchange Law of Japan, and has severally represented that it has not offered or sold, and agrees not to offer or sell, directly or indirectly, any of the ZYPS in Japan or for the account of any resident of Japan except (1) pursuant to an exemption from the registration requirements of the Securities and Exchange Law of Japan and (2) otherwise in compliance with the applicable provisions of Japanese law.

Hong Kong

Each manager has severally represented and agreed that (1) it has not offered or sold and will not offer or sell the ZYPS in Hong Kong, by means of any document other than to persons whose ordinary business it 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 (2) it has not issued and will not issue any advertisement, invitation or document relating to the ZYPS, whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be assessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to ZYPS that are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” within the meaning of the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made thereunder.

Singapore

Each manager has severally represented and agreed that this offering memorandum has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this offering memorandum and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the ZYPS may not be circulated or distributed, nor may the ZYPS 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 Securities and Futures Act, Chapter 289 of Singapore, or 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.

France

Each manager has acknowledged and agreed that offers and sales of the ZYPS may only be made in France to a limited number of investors (*cercle restreint d'investisseurs*) acting for their own accounts and/or qualified investors (*investisseurs qualifiés*) acting for their own accounts, in each case in accordance with Article L.411-2 of the *Code Monétaire et Financier* and *Décret* no. 98-880 dated October 1, 1998. This offering memorandum has not been and will not be submitted to the *Commission des Opérations de Bourse*. Neither this offering memorandum nor any other offering material may be distributed to the public in France and the ZYPS may not be offered or sold, directly or indirectly, to the public in France.

Netherlands

Each manger has represented and agreed that it has not offered, transferred, delivered or sold and will not offer, transfer, deliver or sell any ZYPS, common Shares in or from the Netherlands as part of their initial distribution or as part of any re-offering, and that it may not distribute neither this offering memorandum nor any other document in respect of the offering in or from the Netherlands, other than to individuals or legal entities, who or which trade or invest in securities in the conduct of their profession or trade (which include banks, investment banks, securities firms, insurance companies, pension funds, other institutional investors and treasury departments and finance companies of large enterprises). In addition, transfer requirements may apply to ZYPS that qualify as savings certificates as defined in the Savings Certificates Act (“*Wet inzake spaarbewijzen*”).

Republic of Italy

Each manager has severally represented and agreed that the offering of the ZYPS has not been cleared by CONSOB (the Italian Securities Exchange Commission) pursuant to Italian securities legislation and, accordingly, no ZYPS may be offered, sold or delivered, either in the primary or the secondary market, nor may copies of the Offering Memorandum or of any other document relating to the ZYPS be distributed in the Republic of Italy, except:

1. to professional investors (“*operatori qualificati*”), as defined in Article 31, second paragraph, of CONSOB Regulation No. 11522 of July 1, 1998, as amended; or

2. in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of Legislative Decree No. 58 of February 24, 1998, or the “Financial Services Act”, and Article 33, first paragraph, of CONSOB Regulation No. 11971 of May 14, 1999, as amended.

Each manager has severally represented and agreed that any offer, sale or delivery of the ZYPS or distribution of copies of the Offering Memorandum or any other document relating to the ZYPS in the Republic of Italy under 1. or 2. above must be:

- (a) made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act and Legislative Decree No. 385 of September 1, 1993, or the “Banking Act”, as amended; and
- (b) in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy pursuant to which the issue or the offer of securities in the Republic of Italy may need to be preceded and followed by an appropriate notice to be filed with the Bank of Italy depending, *inter alia*, on the aggregate value of the securities issued or offered in the Republic of Italy and their characteristics; and
- (c) in accordance with any other applicable laws and regulations.

Lock-up Arrangements

Subject to the exceptions discussed below, we and each of Siliconware Precision Industrial Company Limited, C.K. Lee, D.F. Lin, Bright Shiao and China Development Industrial Bank have agreed that, for a 120-day period following the date of this offering memorandum, without the prior written consent of the sole bookrunner, we, it or he will not, and will not announce our, its or his intention or make any application or filing with any applicable regulatory authority to, directly or indirectly:

- (1) offer for sale, pledge, encumber, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend, or otherwise transfer or dispose of (or enter into any transaction or device which is designed to, or could be expected to, result in the disposition by any person at any time in the future of), directly or indirectly, any (A) ZYPS, (B) our shares or securities convertible into or exercisable or exchangeable for our shares, (C) securities of the same class as the ZYPS or our shares or (D) other instruments representing interests in securities of the same class as the ZYPS or our shares; or
- (2) sell, grant or enter into any option, right, warrant, swap or other arrangement that are with respect to, or transfers to another, in whole or in part, any of the economic consequences of ownership of, the ZYPS or our shares,

whether any such transaction described in clause (1) or (2) above is to be settled by delivery of the ZYPS, our shares or such other securities, in cash or otherwise. In addition, we and each of Siliconware Precision International Limited, C.K. Lee, D.F. Lin, Bright Shiao and China Development Industrial Bank have agreed not to announce our, its or his intention or make any application or filing with any applicable regulatory authority for any of such transactions described in clause (1) or (2) above without the prior written consent of the sole bookrunner for a 120-day period. The foregoing does not apply to 3,802,000 shares pledged under loan agreements, and in addition, in the case of us, (i) the issuance by us of our shares or options to purchase our shares pursuant to our employee share option plans in existence on the closing date of this offering, (ii) the issuance by us of our shares upon conversion of our convertible bonds in existence on the date of this offering memorandum and (iii) the distribution by us of ordinary share dividends or employee bonus shares.

SUMMARY OF MATERIAL DIFFERENCES BETWEEN ROC GAAP AND U.S. GAAP

Our financial statements are prepared and presented in accordance with ROC GAAP, which differs in certain material respects from U.S. GAAP. Certain material differences between ROC GAAP applicable to us and U.S. GAAP are summarized below. The summary should not be taken as inclusive of all ROC GAAP/U.S. GAAP differences. In making an investment decision, you must rely upon your own examination of our company, the terms of the offering and our financial information. You should consult your own professional advisors for an understanding of the differences between ROC GAAP and U.S. GAAP, and how these differences might affect the financial information contained herein. 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 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. Finally, no attempt has been made to identify all future differences between ROC GAAP and U.S. GAAP that may affect the Company's financial information as a result of transactions or events that may occur in the future.

Subject	ROC GAAP	U.S. GAAP
Presentation of non-consolidated financial statements	Under ROC GAAP requirements, non-consolidated financial statements of a company are presented as the primary financial statements and consolidated financial statements as supplemental financial statements.	Under U.S. GAAP, parent-company-only non-consolidated financial statements are not allowed to be presented as the primary financial statements for any period.
Consolidation	Under ROC GAAP, a company is required to include in its annual consolidated financial statements only those subsidiaries that are directly or indirectly more than 50% owned. For directly or indirectly owned subsidiaries (1) with total assets and operating revenues less than 10% of the company's non-consolidated total assets and operating revenues, or (2) which are in a negative equity position which is considered to be other than temporary and the company did not guarantee the obligations of the subsidiary or commit to provide additional financial support, the company has the option of whether or not to consolidate such subsidiaries. For purposes of applying the above test, the amounts are determined on the basis of each respective subsidiary's non-consolidated financial statements. Under ROC SFC requirements, beginning in 1995, if the combined operating revenues or total assets of all non-consolidated subsidiaries equal to or exceed 30% of a company's non-consolidated total assets or operating revenues, then each individual subsidiary with total assets or operating revenues greater than 3%, including 3%, of a company's respective non-consolidated amounts shall be consolidated. Such subsidiaries shall be included in the consolidated financial statements thereafter, unless the percentage of the combined total assets and operating revenues for all such subsidiaries decreases to less than 20%, including 20%, of a company's respective non-consolidated amount.	Under U.S. GAAP, consolidation is generally required when one of the companies in a group directly or indirectly has a controlling financial interest in the other companies. The usual condition for controlling financial interest is ownership of a majority of the voting interest and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company is a condition pointing towards consolidation. The consolidation of all majority-owned subsidiaries is required unless control does not rest with the majority owner or the investments are not subject to FASB Interpretation No. 46, "Consolidation of Variable Interest Entities".

Subject	ROC GAAP	U.S. GAAP
Investments in marketable debt and equity securities that represent less than 20% of an investee's ownership	Under ROC GAAP, short-term investments in debt securities and equity securities are stated at the lower of cost or market value with unrealized losses included in earnings. Long-term investments in debt securities and equity securities that have readily determinable fair value are stated at the lower of cost or market value with unrealized losses recorded as a deduction of shareholders' equity.	Under U.S. GAAP, investments in debt securities and equity securities that have readily determinable fair value are classified in one of three categories: trading, held-to-maturity or available-for-sale. Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value with unrealized gains and losses included in earnings; debt securities that a company has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost; and debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value with unrealized gains and losses reported in a separate component of shareholders' equity.
Employee bonus and remuneration to directors and supervisors	Under ROC GAAP, a portion of distributable earnings should be set aside as bonuses to employees, directors and supervisors in accordance with the provisions of a company's articles of incorporation. Remuneration to directors and supervisors can only be paid in cash. Bonuses to employees may be granted in cash or shares or both. If employee bonuses are paid in common shares of a company, the bonuses are valued at par value of the shares and charged against retained earnings in the year when such appropriations are formally approved by the shareholders.	Under U.S. GAAP, bonuses to employees and remuneration to directors and supervisors are charged as compensation expense against income in the period to which they relate. If the employee bonuses are paid in the form of common shares, the fair value of the shares issued is used to determine the amount of the expense. However, since the form of the payment of the such bonuses are not finally determinable until at the shareholders' meeting in the subsequent year, the total amount of such bonuses is initially accrued based on management's estimate of the number of shares to be issued, valued at fair value of the shares. Any difference between the initially accrued amount and the fair value of the shares upon the issuance of shares is recognized in the year when the shareholder approval is obtained.
Stock dividends	Stock dividends are recorded as a reduction to retained earnings for the par value of the stock issued, and a like amount is recorded to the capital stock account.	Stock dividends that are less than 20-25% of the common shares outstanding at the time of the dividend declaration are recorded as a reduction to retained earnings based on the fair value of the stock issued, with the par value recorded in the capital stock account and the excess of fair value over the par value being recorded in capital surplus account.
Gains on disposition of property, plant and equipment	Gains on the dispositions of property, plant and equipment generated before 2001 are first credited to non-operating income and then transferred, after deducting the applicable income tax, to capital surplus in the applicable fiscal year. Starting 2001, the transfer of gains from retained earnings to capital reserve is no longer allowed.	Under U.S. GAAP, the transfer of gains on the dispositions of property, plant and equipment from retained earnings is not allowed.

Subject	ROC GAAP	U.S. GAAP
Impairment of long-lived assets and long-lived assets to be disposed of	ROC GAAP has no specific standards that address impairment of long-lived assets held and used by an entity. Normally such assets are carried at cost less accumulated depreciation.	Under U.S. GAAP, if the sum of future cash flows, undiscounted and without interest charges, expected to result from the use of an asset and its eventual disposal is less than the asset's carrying value, an impairment loss is recognized. Measurement of an impairment loss is based on the difference between the fair value and the carrying value of the asset. Once an impairment is recognized, the reduced carrying amount of the asset is accounted for as its new cost. For a depreciable asset, the new cost is depreciated over the asset's remaining useful life. Restoration of previously recognized impairment losses is prohibited, except for impairment losses recorded on assets to be disposed of. However, if the fair value of an asset to be disposed of increases, resulting in a write-up, the increased carrying amount cannot exceed the carrying amount of the asset before the decision to dispose of the asset was made.
Derivative financial instrument transactions	ROC GAAP does not require that derivatives that do not qualify as hedges be recorded on the balance sheet at fair value. As such, significant assets or obligations, if represented by derivatives, will not be recognized for accounting purposes until the payments become due. Because there are no specific accounting requirements for derivative financial instruments, different companies may apply different accounting practices to derivatives.	Beginning January 1, 2001, all derivative contracts are recognized on the balance sheet at fair value (including those that do not qualify as a hedge), the measurement of which takes account of all contractually committed future cash flows under the contract regardless of when they will be paid. If hedge accounting criteria are met, the rules provide for deferral of gains and losses in equity for cash flow hedge and recognition of offsetting gain or loss on hedged item in the case of a fair value hedge (in both cases, to the extent effective).
Income tax	Under ROC GAAP, a valuation allowance determined is 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.	Under U.S. GAAP, a valuation allowance is provided on deferred tax assets to the extent that it is not "more likely than not" that such deferred tax assets will be realized.
10% tax on undistributed earnings	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 on 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 relating to the 10% retained profit tax is recorded on the statement of income in the year when the profits are earned and the related deferred tax effect is also accounted for.
Comprehensive income	There is no requirement to present comprehensive income under ROC GAAP.	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 stockholders' equity during a period, except changes resulting from investments by or distributions to owners.

Subject	ROC GAAP	U.S. GAAP
Stock options	ROC GAAP has no specific accounting practice regarding stock options or the disclosures of stock options.	Under U.S. GAAP, APB Opinion No. 25 “Accounting for Stock Issued to Employees” and SFAS No. 123 “Accounting for Stock-Based Compensation” have outlined detail principles on how to account for the accounting and reporting of stock-based compensation plans. In general, either the intrinsic value or fair value of stock options granted must be recognized as compensation expenses over the vesting period of the related stock options.
Compensated absences	ROC GAAP has no specific accounting practice regarding compensated absences.	Under U.S. GAAP, compensated absences must be accrued based on the liability for employees’ rights to receive compensation for future absences when the benefits can be accumulated or vested over the service period.
Translation of long-term foreign investments accounted for under cost method	Under ROC GAAP, long-term investments in foreign currencies are translated into New Taiwan dollars using the lower of the foreign currency exchange rate prevailing at the investment acquisition date or the exchange rate prevailing at balance sheet date.	Under U.S. GAAP, long-term investments in foreign currencies are translated into New Taiwan dollars using the foreign currency exchange rate in effect at the balance sheet date
Convertible debt securities with beneficial conversion feature	Under ROC GAAP, there are no specific regulations with respect to the accounting for the beneficial conversion feature embedded in convertible securities.	Under U.S. GAAP, the beneficial conversion feature should be recognized and measured by allocating a portion of the proceeds equal to the intrinsic value of that feature to additional paid-in capital.
Convertible debt securities denominated in a different currency than the equity into which it can convert trades	Under ROC GAAP, there are no specific regulations with respect to the accounting for a foreign currency exchange option embedded in convertible debt securities.	Under U.S. GAAP, convertible debt securities denominated in a different currency than the equity into which it can convert trades are considered to have embedded foreign currency exchange option that are not clearly and closely related to the host debt instrument. The embedded option must be bifurcated and accounted for separately under Statements of Financial Accounting Standards No. 133, “Accounting for Derivative Instruments and Hedging Activities”.
Secured borrowing by pledging of accounts receivable	Under ROC GAAP, loans borrowed from banks with accounts receivable pledged as collateral can be netted with the related accounts receivable.	Under U.S. GAAP, loans borrowed from banks with accounts receivable pledged as collateral cannot be netted with the related accounts receivable. The borrowing should be reflected in a liability account.
Equity method goodwill	Under ROC GAAP, goodwill resulting from the equity investment is included in the carrying value of the investment and amortized over five years.	Under U.S. GAAP, equity method goodwill is not amortized. The equity investment as a whole is reviewed for impairment, including the equity method goodwill.
Capitalization of borrowing cost	Under ROC GAAP, no interest capitalization is required on investments (equity, loans, and advances) accounted for by the equity method while the investee has activities in progress necessary to commence its planned principal operations provided that the investee’s activities include the use of funds to acquire qualifying assets for its operations.	Under U.S. GAAP, interest shall be capitalized for investments (equity, loans, and advances) accounted for by the equity method while the investee has activities in progress necessary to commence its planned principal operations provided that the investee’s activities include the use of funds to acquire qualifying assets for its operations.

Subject	ROC GAAP	U.S. GAAP
Earnings per share	Under ROC GAAP, earnings per share is retroactively adjusted for shares issued for employee bonus.	Under U.S. GAAP, shares issued employee bonus will affect the current period's earnings per share only.
Depreciation of idle assets and assets leased to others	Under ROC GAAP, it is required to that the depreciation of idle assets and assets leased to others be recorded under non-operating expenses.	Under U.S. GAAP, there is no requirement as to whether depreciation of idle assets and assets leased to others to be should be recorded as operating expense or non-operating expense.

We have not quantified the effects of the aforementioned differences between ROC GAAP and U.S. GAAP. Accordingly, there can be no assurance on the effects on balance sheet, net income and shareholders' equity reported in accordance with ROC GAAP if determined in accordance with U.S. GAAP.

LEGAL MATTERS

The validity of the ZYPS being offered pursuant to this offering memorandum will be passed upon for us by Chen & Lin Attorney-at-Law, Taipei, Taiwan. Certain legal matters in connection with the offering as to New York state and United States federal law will be passed upon for the managers by Simpson Thacher & Bartlett LLP.

INDEPENDENT AUDITORS

Our financial statements as of and for the years ended December 31, 2000, 2001 and 2002, and our financial statements as of and for each of the two six-month periods ended June 30, 2002 and 2003 included in this offering memorandum have been audited by Diwan, Ernst & Young, independent auditors, as stated in their report appearing in this offering memorandum.

GENERAL INFORMATION

1. The issuer of the ZYPS is King Yuan Electronics Co., Ltd., a company limited by shares and incorporated under the laws of the ROC on May 28, 1987. As of September 30, 2003, our authorized share capital was 1,200,000,000 common shares, NT\$10 par value, with an issued fully paid-up share capital of 579,303,374 common shares, including 16,857,000 treasury shares. We are not the subsidiary of any entity. Our registered and principal executive office is located at No. 1, Lane 99 Pu-Ding Road, Hsin-Chu 300, Taiwan, ROC, and our telephone number at the above address is (886-3) 575-1888. The uniform registration number assigned to us by the Ministry of Economic Affairs of the ROC is 22507241. According to our Articles of Association, our business scope is (i) designing, manufacturing, testing, outfitting, processing, packaging and trading integrated circuits; (ii) manufacturing, processing and trading burn-in ovens and parts thereof; (iii) exporting and importing integrated circuit and burn-in oven products; and (iv) quoting, bidding and selling the above products for foreign and domestic manufacturers.
2. The Regulation S ZYPS have been accepted for clearance through the facilities of Euroclear and Clearstream. The Rule 144A ZYPS have been accepted for clearance through the facilities of DTC. Relevant trading information is set forth below.

ZYPS	ISIN	Sedol	Common Code	CUSIP	Valoren	WKN
Regulation S ZYPS . . .	XS0183392348	7743784	018339234	—	TK1753652	AOABN3
Rule 144A ZYPS	US49566SAA96	—	—	49566S AA 9	—	AOABN4

The Rule 144A ZYPS have been made eligible for trading in PORTAL with the trading symbol “KYECCP08.”

3. Application has been made to list the ZYPS on the Luxembourg Stock Exchange. The legal notice relating to the issue of the ZYPS and our Articles of Association will be registered prior to the listing with the Trade and Companies Register in Luxembourg (*Registre de Commerce et des Sociétés*), where such documents are available for inspection and where copies thereof can be obtained upon request.
4. The issuance of the ZYPS was authorized by resolution of our board of directors dated September 22, 2003. We have obtained all necessary consents, approvals and authorizations as may be required in connection with the issue and performance of the ZYPS, except as disclosed in this offering memorandum.
5. Except as set forth in “Our Business — Legal Proceedings,” neither we nor our subsidiaries are involved in any material litigation or arbitration proceedings that may have, or have had during the twelve months preceding the date of this document, a material adverse effect on our financial position or any of our subsidiaries, nor, so far as we or our subsidiaries are aware, are there any such proceedings pending or threatened.
6. For so long as the ZYPS are listed on the Luxembourg Stock Exchange and the rules of such exchange so require, The Bank of New York (Luxembourg) S.A. will, in its capacity as transfer agent, serve as the intermediary among the Luxembourg Stock Exchange, any party having an interest in the issuance and listing of the ZYPS, including holders thereof, and us. For so long as the ZYPS are listed on the Luxembourg Stock Exchange, a copy of our Articles of Association will be available for inspection during usual business hours on any weekday (except public holidays) at the offices of The Bank of New York (Luxembourg) S.A., at its office located at Aerogolf Center, 1A Hoehenhof, L-1736 Senningerberg, Luxembourg, as the transfer agent in Luxembourg. As long as any of the ZYPS remains outstanding, copies of our annual report in English containing our audited financial statements and copies of our semi-annual and interim quarterly financial statements in English will be delivered to and be obtainable free of charge from the specified offices of The Bank of New York

(Luxembourg) S.A. Our last unaudited financial statements prepared were as of and for the nine months ended September 30, 2003. For as long as the ZYPS are listed on the Luxembourg Stock Exchange, we will publish all notices to holders in a newspaper with general circulation in Luxembourg, which is expected to be the Luxemburger Wort.

7. Except as disclosed in this offering memorandum, there has been no significant change in our financial position since June 30, 2003, the date of our last audited financial statements, and there has been no material adverse change in our financial condition, capitalization or prospects since June 30, 2003.
8. Our financial statements have been prepared and are presented on an unconsolidated basis and in accordance with generally accepted accounting principles in the ROC. We currently do not prepare any financial statements on a consolidated basis.
9. The EU Transparency Directive may be implemented in the United Kingdom in a manner which is unduly burdensome to us. In particular, we may be required to prepare our financial statements in accordance with International Financial Reporting Standards for accounting periods beginning on or after January 1, 2005. Pursuant to the terms of the indenture, in those circumstances, we may be entitled to seek an alternative listing of the ZYPS on a stock exchange outside the European Union.

GLOSSARY

Assembly/Rework. Terms denoting joining and replacement processes of microelectronic components. Assembly refers to the initial attachment of device and interconnections to the package. Rework refers to the removal of a device and interconnections, preparation of the joining site for a new device, and rejoining of the new device. Rework is necessary for either repair or engineering change.

Burn-In. A step in the semiconductor manufacturing process. The process of electrically stressing a device (usually at temperature and voltage) for a period of time long enough to cause failure of marginal devices.

Charge-Coupled Devices. A charge-coupled device (CCD) is an array of metal-oxide-semiconductor (MOS) silicon-based capacitors which can accumulate and store charge due to their capacitance.

Chip. The uncased and normally leadless form of an electronic component part, either passive or active, discrete or integrated. Also referred to as a die.

Chip-on-Board (or COB). Chip-on-board (COB) is a technology that relies on die attach and wire bond infrastructure to ensure highly reliable interconnection between the die and board, or substrate. COB provides the capability to perform direct chip-to-chip wiring that facilitates improved performance and strong functional integration in many modern high speed applications.

Circuit Design. A step in the semiconductor manufacturing process. The design of a semiconductor is developed by laying out circuit components and interconnections.

CMOS Image Sensors. Sensors that sense light in the same way as CCDs, but detect charge packets through charge-sensing amplifiers made from CMOS transistors built in the sensor array. CMOS image sensors draw significantly less power than CCDs, an advantage for mobile phones, PDAs and other handheld devices that rely on long battery time.

Die. Integrated circuit chip as cut (diced) from finished wafer. See *Chip*.

Dynamic Random Access Memory (or DRAM). A type of volatile memory product that is used to store data temporarily for faster access. It is the most common type of RAM and must be refreshed with electricity thousands of times per second or else it will fade away.

Drop Shipment. A method of merchandising that facilitates the sale of products without first buying and stocking an inventory of those products. Individual products are shipped directly to the customer of the party who purchases the products.

Fab. Short for wafer fabrication. See *Wafer Fabrication*.

Fabless Semiconductor Companies (or Fabless). Semiconductor companies that design, test and sell ICs, but subcontract wafer manufacturing by forming alliances with silicon wafer manufacturers.

Final Test. A step in the semiconductor manufacturing process. Final test is conducted to ensure that the semiconductor device meets performance specifications. Final test involves the use of sophisticated test equipment and customized software programs to electrically test a number of attributes of packaged semiconductors, including functionality, speed, predicted endurance and power consumption. The final test of semiconductors is categorized by the functions of the semiconductors tested into logic/mixed signal final test, and memory final test. As compared with logic/mixed signal final test, memory final test typically requires simpler test software but longer test time per device tested.

Flash. A type of non-volatile memory product that is used in electronic systems to store data and program instructions.

Front-end engineering test. A step in the semiconductor manufacturing process. Throughout and following the circuit design process, prototype semiconductors undergo front-end engineering test, which involves software development, electrical design validation, reliability and failure analysis.

Integrated Circuit (or IC). A microcircuit consisting of interconnected elements inseparably associated and formed in situ on a single substrate (usually silicon) to perform an electronic circuit function.

Integrated Device Manufacturers (or IDMs). A semiconductor device manufacturer that has its own manufacturing facilities.

Interconnection. The conductive path required to achieve connection from a circuit element to the rest of the circuit.

LCD Drivers. A display driver integrated circuit designed to control and drive LCDs. LCD drivers convert digital inputs into the multilevel signals needed to drive LCDs. LCD drivers can be used in a broad range of telecom display applications with low power consumption requirements, such as mobile phones and portable communication devices.

Leadframe. A metal frame, connected to the bonding pads of the die by leads, that provides electrical connection to other devices.

Logic Device. A device that contains digital integrated circuits that process, rather than store, information.

Mixed signal products. Products that can process both digital and analog data.

Packaging. A step in the semiconductor manufacturing process. A semiconductor package is a plastic or ceramic container that protects and insulates the enclosed semiconductor so that it can be attached to a printed circuit board. Plastic packaging is the processing of bare semiconductors into finished semiconductors. Each sliced die is attached to a leadframe or a laminate (plastic or tape) substrate by epoxy resin. Each chip is then encapsulated with only the leads protruding from the finished casing or, in the “chip-on-board” process, is attached to a circuit board directly.

Printed Circuit Board. A composite of organic and inorganic material with external and internal wiring allowing electronic components to be mechanically supported and electrically connected.

Radio frequency (or RF) chips. Analog communications chips used in a range of wireless and handheld devices. RF chips are more complicated to design than digital chips because they operate at higher frequencies. Although wireless communications and network systems are often termed “digital,” the RF chips that support them are analog.

Semiconductor Foundries (or Foundry). Manufacturing facilities where semiconductor chips are produced.

Substrate. The underlying material upon which a device, circuit, or epitaxial layer is fabricated, normally a silicon wafer.

Surface Mount Technology. A method of assembling hybrid circuits and printed circuit boards, where component parts are mounted onto, rather than into, the printed circuit boards.

System on a chip (or SOC). Technology that involves the packaging of all necessary electronic circuits and parts for a “system” (such as a cell phone or digital camera) on a single integrated circuit (IC), generally known as a microchip.

Tape and Reel. A step in the semiconductor manufacturing process. A process which involves the wrapping of finished semiconductors into continuous tape reels designed for use in customers’ automated surface mount technology lines.

Turnkey. An outsourcing method in which the contract manufacturer is responsible for providing and managing materials to the other parties customers. Used by complementary or even competing businesses to compensate for under utilization and over capacity situations or for the provision of complete customer solutions.

Wafer. Commonly, a slice of a semiconductor crystalline ingot whose active surface has been processed into arrays of discrete devices or ICs.

Wafer Fabrication. A step in the semiconductor manufacturing process. Wafer fabrication begins with the generation of a photomask through the definition of the circuit design pattern on a photographic negative, known as a mask, by an electron beam or laser beam writer. These circuit patterns are transferred to the wafers using various advanced processes.

Wafer Grinding and Dicing. A step in the semiconductor manufacturing process. Wafer grinding is a process that grinds the finished wafers to a designated thickness and dicing the wafers into dies, or chips.

Wafer Probing. A step in the semiconductor manufacturing process. As part of the test process, each individual die on the wafer is electrically tested, or probed, for defects. Dies that fail this test are marked to be discarded.

Wire Bonding. The method used to attach very fine wire to semiconductor components in order to provide electrical continuity between the semiconductor die and a terminal.

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REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders of
King Yuan Electronics Co., Ltd.

We have audited the accompanying balance sheets of King Yuan Electronics Co., Ltd. as of December 31, 2000, 2001 and 2002, and the related statements of income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of King Yuan Electronics Co., Ltd. as of December 31, 2000, 2001 and 2002, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles in the Republic of China.

Taipei, Taiwan
Republic of China
January 22, 2003

KING YUAN ELECTRONICS CO., LTD.
BALANCE SHEETS
(Expressed in thousands)

	Notes	As of December 31,			
		2000	2001	2002	
		NT\$	NT\$	NT\$	US\$
Current assets					
Cash and cash equivalents	2,4(1)	1,122,041	59,668	1,102,205	32,629
Short-term investments (Net) . . .	2,4(2)	8,541	3,350	—	—
Notes receivable (Net)	2,4(3)	100,580	46,041	89,783	2,658
Accounts receivable (Net)	2,4(3),6	1,281,248	567,974	1,072,731	31,756
Receivables from related parties .	4(3),5	73,376	82,807	255,066	7,551
Inventories (Net)	2,4(4)	76,529	56,831	41,249	1,221
Deferred tax assets — current (Net)	2,4(24)	241,806	14,678	148,483	4,396
Restricted deposits — current . .	6	—	4,903	12,500	370
Other current assets		146,442	79,933	80,833	2,393
Total current assets		<u>3,050,563</u>	<u>916,185</u>	<u>2,802,850</u>	<u>82,974</u>
Long-term investments	2,4(5)	<u>4,930</u>	<u>5,073</u>	<u>310,470</u>	<u>9,191</u>
Property, plant and equipment . .	2,4(6),6				
Land		924,066	869,222	869,222	25,732
Buildings and facilities		1,428,999	2,037,562	2,503,993	74,126
Machinery and equipment		7,388,822	12,667,241	13,462,751	398,542
Transportation equipment		15,314	15,687	19,040	564
Office furniture		119,107	232,172	241,030	7,135
Leased assets	2,4(14)	494,736	737,954	34,555	1,023
Leasehold improvements		58,863	431	65	2
Miscellaneous fixtures		<u>282,835</u>	<u>1,228,300</u>	<u>1,244,197</u>	<u>36,832</u>
Total cost		10,712,742	17,788,569	18,374,853	543,956
Less: Accumulated depreciation		(1,631,353)	(3,694,634)	(6,222,972)	(184,221)
Plus: Prepayments for equipment		3,087,189	573,012	1,429,959	42,332
Construction in progress .		<u>700,606</u>	<u>385,343</u>	<u>12,842</u>	<u>380</u>
Net property, plant and equipment		<u>12,869,184</u>	<u>15,052,290</u>	<u>13,594,682</u>	<u>402,447</u>
Other assets					
Leased assets to others (Net) . . .	4(7)	—	273,305	171,324	5,072
Idle assets (Net)	4(8)	—	245,347	637,049	18,859
Assets to be disposed (Net)	4(9)	—	650,826	—	—
Deposits out		10,459	4,605	31,274	926
Deferred assets	2	75,781	136,423	257,355	7,619
Deferred tax assets — noncurrent (Net)	2,4(24)	191,476	718,709	960,687	28,439
Restricted deposits — noncurrent	6	1,387	1,000	8,000	237
Other assets — land	4(10)	<u>11,935</u>	<u>11,935</u>	<u>11,935</u>	<u>353</u>
Total other assets		<u>291,038</u>	<u>2,042,150</u>	<u>2,077,624</u>	<u>61,505</u>
Total Assets		<u><u>16,215,715</u></u>	<u><u>18,015,698</u></u>	<u><u>18,785,626</u></u>	<u><u>556,117</u></u>

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

KING YUAN ELECTRONICS CO., LTD.
BALANCE SHEETS — (Continued)
(Expressed in thousands)

	Notes	As of December 31,			
		2000	2001	2002	
		NT\$	NT\$	NT\$	US\$
Current liabilities					
Short-term loans	4(11)	1,776,464	1,502,572	636,853	18,853
Short-term notes	4(12)	—	99,825	—	—
Current portion of long-term loans	4(13)	222,372	1,060,258	1,630,908	48,280
Current portion of lease obligations	2,4(14)	156,313	240,241	27,528	815
Installment accounts payable . . .	4(15)	—	—	10,881	322
Notes payable		341,621	315,218	199,722	5,913
Accounts payable		95,310	21,704	29,232	865
Payables to related parties	5	2,161	51,078	13,358	395
Payables to equipment suppliers .		591,999	984,577	282,517	8,364
Income taxes payable	2,4(24)	128,901	—	—	—
Accrued expenses and other current liabilities		<u>285,851</u>	<u>395,700</u>	<u>320,158</u>	<u>9,478</u>
Total current liabilities		<u>3,600,992</u>	<u>4,671,173</u>	<u>3,151,157</u>	<u>93,285</u>
Long-term Liabilities					
Convertible bonds	2,4(16)	—	—	2,810,046	83,186
Long-term loans, less current portion	4(13)	3,107,628	4,698,906	3,067,994	90,823
Lease obligations, less current portion	2,4(14)	<u>305,137</u>	<u>240,196</u>	<u>—</u>	<u>—</u>
Total long-term liabilities . . .		<u>3,412,765</u>	<u>4,939,102</u>	<u>5,878,040</u>	<u>174,009</u>
Other Liabilities					
Accrued pension liabilities	2,4(17)	19,228	20,476	24,077	713
Deposits in		<u>5</u>	<u>3,925</u>	<u>168,000</u>	<u>4,973</u>
Total other liabilities		<u>19,233</u>	<u>24,401</u>	<u>192,077</u>	<u>5,686</u>
Total Liabilities		<u>7,032,990</u>	<u>9,634,676</u>	<u>9,221,274</u>	<u>272,980</u>
Shareholders' Equity					
Capital					
Common stock	4(18)	2,632,254	4,366,722	4,528,767	134,067
Subscriptions received	4(18)	—	—	1,183,460	35,034
Capital reserve	4(20)	5,301,048	4,590,339	4,244,717	125,658
Retained earnings					
Legal reserve	4(21)	69,992	187,831	—	—
Unappropriated earnings (Accumulated deficits)		1,179,123	(764,467)	(302,635)	(8,959)
Cumulative translation adjustments	2,4(5)	308	597	1,061	31
Treasury stock	2,4(19)	<u>—</u>	<u>—</u>	<u>(91,018)</u>	<u>(2,694)</u>
Total Shareholders' Equity		<u>9,182,725</u>	<u>8,381,022</u>	<u>9,564,352</u>	<u>283,137</u>
Total Liabilities and Shareholders' Equity		<u>16,215,715</u>	<u>18,015,698</u>	<u>18,785,626</u>	<u>556,117</u>

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

KING YUAN ELECTRONICS CO., LTD.
STATEMENTS OF OPERATIONS
(Expressed in thousands, except per share data)

	Notes	Year ended December 31,			
		2000	2001	2002	
		NT\$	NT\$	NT\$	US\$
Operating Revenues					
Sales revenue		4,225,455	3,970,868	5,403,450	159,960
Less: Sales discounts		(43,881)	(93,570)	(55,453)	(1,642)
Net operating revenues	2,4(25),5	4,181,574	3,877,298	5,347,997	158,318
Cost of goods sold		<u>(2,705,271)</u>	<u>(4,129,702)</u>	<u>(5,003,827)</u>	<u>(148,130)</u>
Gross Profit (Loss)		<u>1,476,303</u>	<u>(252,404)</u>	<u>344,170</u>	<u>10,188</u>
Operating Expenses	5				
Selling expenses		(18,111)	(43,842)	(54,065)	(1,600)
Administrative expenses		(236,972)	(334,742)	(396,385)	(11,734)
Research and development expenses		<u>(50,685)</u>	<u>(58,204)</u>	<u>(74,476)</u>	<u>(2,205)</u>
Total operating expenses		<u>(305,768)</u>	<u>(436,788)</u>	<u>(524,926)</u>	<u>(15,539)</u>
Operating Income (Loss)		<u>1,170,535</u>	<u>(689,192)</u>	<u>(180,756)</u>	<u>(5,351)</u>
Non-operating Income					
Interest income		39,793	8,472	9,919	294
Gain on disposal of property, plant and equipment	2	64	533	14,345	425
Gain on disposal of investments	2	—	—	13,760	407
Foreign exchange gain	2	—	105,274	—	—
Rental income		—	25,850	41,015	1,214
Reversals of market value decline on short-term investments	2	—	6,110	—	—
Other income		<u>3,194</u>	<u>6,870</u>	<u>12,338</u>	<u>365</u>
Total non-operating income		<u>43,051</u>	<u>153,109</u>	<u>91,377</u>	<u>2,705</u>
Non-operating Expenses					
Interest expense	4(6)	(169,871)	(354,336)	(378,592)	(11,208)
Loss on decline in market value of short-term investments	2	(7,281)	—	—	—
Net loss from equity investments	2,4(5)	(351)	(146)	(478)	(14)
Loss on disposal of property, plant and equipment	2	(6,895)	(23,553)	(20,133)	(596)
Loss on disposal of investments		—	(4,214)	—	—
Foreign exchange loss	2	(25,171)	—	(51,887)	(1,536)
Inventory loss provision	2	—	(4,088)	(7,130)	(211)
Other losses	4(7),4(8)	<u>(898)</u>	<u>(168,686)</u>	<u>(160,920)</u>	<u>(4,763)</u>
Total non-operating expenses		<u>(210,467)</u>	<u>(555,023)</u>	<u>(619,140)</u>	<u>(18,328)</u>
Loss from Continuing Operations Before Income Taxes		1,003,119	(1,091,106)	(708,519)	(20,974)
Income Tax Benefit	2,4(24)	<u>175,316</u>	<u>299,455</u>	<u>383,110</u>	<u>11,341</u>
Income (loss) from Continuing Operations		1,178,435	(791,651)	(325,409)	(9,633)
Extraordinary Gain (net of tax NT\$7,591)		<u>—</u>	<u>—</u>	<u>22,774</u>	<u>674</u>
Net Income (Loss)		<u>1,178,435</u>	<u>(791,651)</u>	<u>(302,635)</u>	<u>(8,959)</u>
Basic Earnings Per Share	2,4(23)				
Net Income (Loss) from Continuing Operations		3.06	(1.81)	(0.74)	(0.02)
Extraordinary Gain		<u>—</u>	<u>—</u>	<u>0.05</u>	<u>—</u>
Net Income (Loss)		<u>3.06</u>	<u>(1.81)</u>	<u>(0.69)</u>	<u>(0.02)</u>

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

KING YUAN ELECTRONICS CO., LTD.
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Expressed in thousands)

	Retained Earnings				Unappropriated Earnings (Accumulated Deficits)	Cumulative Translation Adjustments	Treasury Stock	Total
	Common Stock	Subscriptions Received	Capital Reserve	Legal Reserve				
	NT\$	NT\$	NT\$	NT\$	NT\$	NT\$		NT\$
Balance as of January 1, 2000	1,243,750	—	1,349,750	21,120	493,804	—	—	3,108,424
Appropriation and distribution of 1999 earnings:								
Appropriation for legal reserve.	—	—	—	48,872	(48,872)	—	—	—
Stock dividends	373,125	—	—	—	(373,125)	—	—	—
Bonus to employee transferred to capital stock	66,629	—	—	—	(66,629)	—	—	—
Directors' and supervisors' remuneration.	—	—	—	—	(4,442)	—	—	(4,442)
Capital reserve transferred to common stock	248,750	—	(248,750)	—	—	—	—	—
Stock issuance for cash	700,000	—	4,200,000	—	—	—	—	4,900,000
Transfer of gain on disposal of property, plant and equipment to capital reserve	—	—	48	—	(48)	—	—	—
Cumulative translation adjustment	—	—	—	—	—	308	—	308
Net income for the year ended December 31, 2000.	—	—	—	—	1,178,435	—	—	1,178,435
Balance as of December 31, 2000 (in NT\$)	<u>2,632,254</u>	<u>—</u>	<u>5,301,048</u>	<u>69,992</u>	<u>1,179,123</u>	<u>308</u>	<u>—</u>	<u>9,182,725</u>
Appropriation and distribution of 2000 earnings:								
Appropriation for legal reserve.	—	—	—	117,839	(117,839)	—	—	—
Stock dividends	868,644	—	—	—	(868,644)	—	—	—
Bonus to employee transferred to capital stock	155,115	—	—	—	(155,115)	—	—	—
Directors' and supervisors' remuneration.	—	—	—	—	(10,341)	—	—	(10,341)
Capital reserve transferred to common stock	710,709	—	(710,709)	—	—	—	—	—
Cumulative translation adjustment	—	—	—	—	—	289	—	289
Net loss for the year ended December 31, 2001.	—	—	—	—	(791,651)	—	—	(791,651)
Balance as of December 31, 2001 (in NT\$)	<u>4,366,722</u>	<u>—</u>	<u>4,590,339</u>	<u>187,831</u>	<u>(764,467)</u>	<u>597</u>	<u>—</u>	<u>8,381,022</u>
Legal reserve used to cover accumulated deficit.	—	—	—	(187,831)	187,831	—	—	—
Capital reserve used to cover accumulated deficit.	—	—	(576,636)	—	576,636	—	—	—
Conversion of convertible bonds	162,045	—	231,014	—	—	—	—	393,059
Stock issuance for cash	—	1,183,460	—	—	—	—	—	1,183,460
Common stock repurchased	—	—	—	—	—	—	(91,018)	(91,018)
Cumulative translation adjustment	—	—	—	—	—	464	—	464
Net loss for the year ended December 31, 2002.	—	—	—	—	(302,635)	—	—	(302,635)
Balance as of December 31, 2002 (in NT\$)	<u>4,528,767</u>	<u>1,183,460</u>	<u>4,244,717</u>	<u>—</u>	<u>(302,635)</u>	<u>1,061</u>	<u>(91,018)</u>	<u>9,564,352</u>
Balance as of December 31, 2002 (in US\$)	<u>134,067</u>	<u>35,034</u>	<u>125,658</u>	<u>—</u>	<u>(8,959)</u>	<u>31</u>	<u>(2,694)</u>	<u>283,137</u>

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

KING YUAN ELECTRONICS CO., LTD.
STATEMENTS OF CASH FLOWS
(Expressed in thousands)

	Year ended December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Cash flows from operating activities:				
Net income (loss)	1,178,435	(791,651)	(302,635)	(8,959)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation	1,073,145	2,283,237	2,982,808	88,301
Amortization	20,236	65,621	95,463	2,826
Bad debt expense	—	12,002	8,500	252
Deferred income taxes	(308,535)	(300,105)	(375,783)	(11,124)
Net loss from equity investment	351	146	478	14
Physical inventory gain	(17)	(86)	—	—
Inventory loss provision	—	4,088	7,130	211
Net loss on disposal of property, plant and equipment	6,831	23,020	5,788	171
Loss on (Reversals of) decline in market value of short-term investments	7,281	(6,110)	—	—
(Increase) decrease in notes receivable	(30,280)	54,539	(43,742)	(1,295)
(Increase) decrease in accounts receivable	(909,952)	701,272	(513,257)	(15,194)
(Increase) decrease in receivables from related parties	79,317	(9,431)	(172,259)	(5,100)
(Increase) decrease in inventories	(48,115)	15,696	8,452	250
(Increase) decrease in other current assets	(126,046)	66,509	(900)	(27)
Increase (decrease) in notes payable	251,852	(26,403)	(115,496)	(3,419)
Increase (decrease) in accounts payable	62,167	(73,606)	7,528	223
Increase (decrease) in payables to related parties	2,161	(1,083)	12,280	364
Increase in accrued expenses and other current liabilities	128,846	107,348	36,891	1,092
Increase (decrease) in income taxes payable	74,839	(128,901)	—	—
Exchange rate adjustment for convertible bonds and long-term bonds investments	—	—	(18,272)	(541)
Increase in reserve for redemption of convertible bonds	—	—	83,908	2,484
Increase in accrued pension liabilities	12,692	1,248	3,601	107
Net cash provided by operating activities	<u>1,475,208</u>	<u>1,997,350</u>	<u>1,710,483</u>	<u>50,636</u>
Cash flows from investing activities:				
(Increase) decrease in restricted deposits	58,690	(4,516)	(14,597)	(432)
(Increase) decrease in short-term investments	(15,822)	11,301	3,350	99
Increase in long-term investments	(4,973)	—	(304,656)	(9,019)
Acquisition of property, plant and equipment	(9,521,640)	(5,283,694)	(1,972,907)	(58,405)
Proceeds from disposal of property, plant and equipment	5,777	17,431	100,964	2,989
Penalty on cancellation of equipment purchase	—	—	(102,092)	(3,022)
Increase in deferred assets	(82,560)	(126,263)	(216,395)	(6,406)
(Increase) decrease in deposits out	(4,513)	5,854	(26,669)	(789)
Acquisition of other assets	(11,935)	—	—	—
Net cash used in investing activities	<u>(9,576,976)</u>	<u>(5,379,887)</u>	<u>(2,533,002)</u>	<u>(74,985)</u>

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

KING YUAN ELECTRONICS CO., LTD.
STATEMENTS OF CASH FLOWS — (Continued)
(Expressed in thousands)

	Year ended December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Cash flows from financing activities:				
Increase (decrease) in short-term loans	1,556,264	(273,892)	(865,719)	(25,628)
Increase (decrease) in payables to related parties	—	50,000	(50,000)	(1,480)
Increase (decrease) in short-term notes	—	99,825	(99,825)	(2,955)
Increase (decrease) in long-term loans	1,966,630	2,429,164	(1,060,262)	(31,387)
Increase (decrease) in lease obligations	461,450	18,987	(452,909)	(13,408)
Increase in installment accounts payable	—	—	10,881	322
Increase in convertible bonds	—	—	4,191,600	124,085
Increase (decrease) in deposits in	—	(3,920)	164,075	4,857
Directors' and supervisors' remuneration	(4,442)	—	(10,341)	(306)
Repurchase of convertible bonds	—	—	(1,054,886)	(31,228)
Common stock repurchased	—	—	(91,018)	(2,694)
Stock issuance for cash	4,900,000	—	1,183,460	35,034
Net cash provided by financing activities	<u>8,879,902</u>	<u>2,320,164</u>	<u>1,865,056</u>	<u>55,212</u>
Net increase (decrease) in cash and cash equivalents	778,134	(1,062,373)	1,042,537	30,863
Cash and cash equivalents at the beginning of year	<u>343,907</u>	<u>1,122,041</u>	<u>59,668</u>	<u>1,766</u>
Cash and cash equivalents at the end of year	<u><u>1,122,041</u></u>	<u><u>59,668</u></u>	<u><u>1,102,205</u></u>	<u><u>32,629</u></u>
Supplemental disclosures of cash flows information:				
Interest paid during the year (excluding capitalized interest)	<u>155,047</u>	<u>362,606</u>	<u>304,557</u>	<u>9,016</u>
Income tax paid during the year	<u>58,421</u>	<u>130,723</u>	<u>264</u>	<u>8</u>
Investing activities partially paid by cash				
Acquisition of property, plant and equipment	9,605,297	5,676,272	1,872,275	55,426
(Increase) decrease in payables to equipment supplier	(83,657)	(392,578)	702,060	20,783
Purchase cancelled	—	—	(601,428)	(17,804)
Cash paid for purchase of property, plant and equipment	<u>9,521,640</u>	<u>5,283,694</u>	<u>1,972,907</u>	<u>58,405</u>
Financing activities not affecting cash flows				
Retained earnings transferred to stock dividends, bonus to employee and capital reserve transferred to common stock	<u>688,504</u>	<u>1,734,468</u>	<u>—</u>	<u>—</u>
Payable of directors' and supervisors' remuneration	<u>—</u>	<u>10,341</u>	<u>—</u>	<u>—</u>
Cumulative translation adjustments	<u>308</u>	<u>289</u>	<u>464</u>	<u>14</u>
Current portion of long-term loans and lease obligations	<u>378,685</u>	<u>1,300,499</u>	<u>1,658,436</u>	<u>49,095</u>
Conversion of convertible bonds into common stock	<u>—</u>	<u>—</u>	<u>393,059</u>	<u>11,636</u>

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

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS
(Amounts in thousands except otherwise stated)

1. HISTORY

KING YUAN ELECTRONICS CO., LTD. (the “Company”) was incorporated under the Company Law of the Republic of China in July 1987. The Company’s major business activities are testing and assembly service, and manufacture and selling IC Monitoring Burn-In machinery. The shares of the Company commenced trading on the Taiwan Stock Exchange in May 2001.

2. SUMMARY OF ACCOUNTING POLICIES

Cash Equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash, and so near their maturity that they present insignificant risk of changes in interest rates. Commercial paper, negotiable certificates of deposit, and bank acceptances with original maturities of three months or less at the investment date are considered to be cash equivalents.

Foreign Currency Transactions and Translation of Foreign Currency statements

The Company maintains its accounting records in New Taiwan dollars (“NT Dollars” or “NT\$”). Transactions denominated in foreign currencies are recorded in NT Dollars using the exchange rates in effect at the dates of transactions. Assets and liabilities denominated in foreign currencies are translated into NT Dollars using the exchange rates in effect at the balance sheet date. Foreign exchange gains or losses are included in other income or expenses.

Long-term foreign investments accounted for under the cost method are translated into NT Dollars using the prevailing exchange rates at acquisition date or balance sheet date, whichever is lower. Any difference is charged to the cumulative translation adjustments account.

For long-term foreign investments accounted for under the equity method, their financial statements are first translated into NT Dollars. The Company then recognizes the investment gain or loss and translation adjustment based on the translated financial statements. For the translation, the current rate at the balance sheet date is used for asset and liability accounts. The weighted average rate for the reporting period is used for the income statement accounts. Translation adjustments are included as a component of shareholders’ equity.

Short-term Investments

Short-term Investments are recorded at cost when acquired and are stated at the lower of aggregate cost or market value at the balance sheet date. The market value of listed equity securities or closed-ended funds is determined by the average closing price during the last month of the fiscal period. The market value for open-ended funds is determined by their equity value as reported at the balance sheet date. No revenue is recognized when stock dividends are received. Instead, the number of shares increases and the cost per share is recalculated. Disposal gain or loss of short-term investments is calculated based on the weighted average method.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is provided based on the collectibility and aging analysis of notes and accounts receivable and other receivables.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Inventories

Inventories are recorded at cost when acquired and stated at the lower of aggregate cost, based on weighted average method, or market value at the balance sheet date. The market value of raw materials and supplies is determined on the basis of replacement cost while work in process and finished goods on net realizable value. The allowance for loss on decline in market value and obsolescence is provided, when necessary.

Long-term Investments

- (1) Long-term investments in which the Company holds an interest less than 20% are stated at the lower of cost or market value, with unrealized losses recorded as a separate component of shareholders' equity. There is no recognition of unrealized gains.
- (2) Long-term investments in which the Company holds an interest of 20% or more are accounted for under the equity method. The difference between the cost of the investment and the underlying equity in the investee's net assets at the date of acquisition is amortized over five years. Adjustment to capital reserve is required when the holding percentage changes due to unproportional subscription to investee's new shares. If the capital reserve is insufficient, retained earnings is adjusted.
- (3) Unrealized inter-company gains and losses are eliminated under the equity method. Profit from sales of depreciable assets between the investee and the Company is amortized and recognized based on the assets' economic service lives. Profit from other types of inter-company transactions is recognized when realized.
- (4) If the Company's share of an investee company's losses equals to or exceeds the carrying amount of an investment accounted for under the equity method, the recognized investment losses shall be limited to the extent that makes the book value of a long-term investment equal to zero. However, if the Company intends to provide further financial support for the investee company, or the investee company's losses are temporary and there exists sufficient evidence showing imminent return to profitable operations, then the Company shall continue to recognize investment losses in proportion to the stock ownership percentage. Such credit long-term investment balance shall first offset the advance (if any) the Company made to the investee company, the remaining shall be recorded under other liabilities.
- (5) Consolidated financial statements are prepared if the Company owns at least 50% of the invested company's shares. However, the financial statements of any subsidiary in which the total assets and total revenue for the current year are less than 10% of that of the parent company may be excluded from the consolidated financial statements. If the sum of the total assets or sales of all unconsolidated subsidiaries equals to or exceeds 30% of the parent company's assets or sales, subsidiaries whose sales or assets are over or equal to 3% of the parent company's sales or assets should be consolidated.
- (6) Long-term bond investments are recorded at cost as acquired. Premiums or discounts are amortized over the bond life.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Property, Plant and Equipment

- (1) Property, plant and equipment are stated at cost. Depreciation is provided on the straight-line basis over the following useful lives:

Buildings and facilities	3 to 30 years
Machinery and equipment	3 to 10 years
Transportation equipment	5 years
Office furniture	3 to 10 years
Leased assets	4 to 5 years
Leasehold improvements	2 to 3 years
Miscellaneous fixtures	3 to 10 years

- (2) Improvements and replacements are capitalized and depreciated over their estimated useful lives while ordinary repairs and maintenance are expensed as incurred. Gain or loss on disposal of property, plant and equipment is recorded under non-operating income or expenses. When property, plant and equipment are disposed of, their original cost and accumulated depreciation are written off and related gain, net of income tax, is transferred to capital reserve in the current year. Gain on disposal of property, plant and equipment shall not be transferred to capital reserve starting in 2001 in accordance with an amendment to R.O.C. Regulation on Business Entity Accounting Handling. Equipment not held for operating purposes is transferred to the account of idle assets based on the lower of net realizable value or book value. Equipments for lease are transferred to the account of leased assets to others based on book value. Depreciation derived from idle assets and leased assets to others is recorded under non-operating expenses.

Lease agreement

Provided a lease agreement meets the capitalization criteria, the present value of the minimum lease payments net of executory costs is capitalized as an asset along with a corresponding liability.

Deferred Assets

Deferred assets are originally recorded at cost and amortized over their estimated useful lives, usually 1 to 5 years, using the straight-line method.

Revenue Recognition

Revenue is recognized according to R.O.C. Statement of Financial Accounting Standards No. 32, "Accounting for Revenue Recognition." Revenue can be recognized when all of the following are met:

- (i) It is realized or realizable.
- (ii) It is earned.
- (iii) The collectibility can be fairly assessed.

Sales allowances are accrued in the year that related sales occur.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Capital Expenditures vs. Revenue Expenses

If expenditures increase the future service potential of plant assets, the expenditures are capitalized, while the others are expensed as incurred.

Income Tax

Provision for income tax includes deferred tax resulting from temporary differences and investment tax credits. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements using enacted tax rates and laws that will be in effect when the difference is expected to reverse. A valuation allowance on deferred tax assets is provided to the extent that it is more likely than not that the tax benefits will not be realized.

Undistributed earnings generated after 1997 are subject to a 10% tax in compliance with R.O.C. income tax law. The 10% tax on undistributed earnings is recorded as an expense at the time shareholders resolve that its earnings shall be retained.

Income tax credits resulting from the acquisition of equipment, research and development expenditures, employee training and investment in equity stock shall be recognized in the year that such acquisition, expenditures, training and investment occur.

Convertible Bonds

- (1) The interest-premium of puttable convertible bonds, which is the difference between the specified put price and the par value, should be amortized using the interest method and be recognized as a liability over the period from the issuance date of the bonds to the expiry date of the put option. If the bondholder does not exercise the put option, the interest-premium, which has been recognized as a liability, should be amortized over the period from the expiry date to the maturity date using the interest method. However, if at the expiry date the market value of the common stock under conversion exceeds the put price, the interest-premium should be credited to additional paid-in capital.
- (2) The cost of issuing convertible bonds should be recorded as deferred assets and amortized using the straight-line method over the period from the issuance date of the convertible bonds to the expiry date of the put option.
- (3) When bondholders exercise their conversion rights, the book value of convertible bonds is credited to common stock at an amount equal to the par value of the common stock and the excess is credited to capital reserve; no gain or loss is recognized on bond conversion.

Pension Plan

The Company has a funded defined benefit pension plan covering all regular employees. The net pension cost is computed based on an actuarial valuation in accordance with the provision of R.O.C. Statement of Financial Accounting Standards No. 18, which requires consideration of pension cost components such as service cost, interest cost, expected return on plan assets and amortization of net obligation at transition. The unrecognized net obligation at transition is amortized on the straight-line basis over the employees average remaining service period provided, however, if the average remaining service period is shorter than 15 years, the unrecognized net obligation at transition may be amortized over 15 years. The pension fund is managed by an independent pension fund committee.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Earnings Per Share

In accordance with R.O.C. Statement of Financial Accounting Standards No. 24, “Earnings per Share,” the Company presents basic earnings per share if a simple capital structure exists; or both basic earnings per share and diluted earnings per share if a complex capital structure exists. Basic earnings per share is equal to the net income (loss) attributable to common stock divided by the weighted-average number of common shares. When calculating diluted earnings per share, the numerator should include or add back potential common stock dividends, interest and other conversion revenues (expenses). The denominator should include all dilutive potential common shares.

Derivative Financial Instruments

Forward currency exchange contract: A forward currency exchange contract obligates the Company to exchange predetermined amounts of specified foreign currencies at specified exchange rates for another currency on a specified date. The Company’s forward contracts are designated as hedges; discounts or premiums, being the difference between the spot exchange rate and the forward exchange rate at the inception of the contract, are accreted or amortized to the statement of operations over the contract lives using the straight-line method. Realized gains and losses from settlement or unrealized gains and losses resulting from changes in the spot exchange rate at the balance sheet date are recorded in the statement of operations as foreign exchange gains or losses in the period in which they relate. The related amounts due to or from counter-parties are included in other current assets or other current liabilities.

Treasury Stock

In accordance with the R.O.C. Statement of Financial Accounting Standards No. 30, “Accounting for Treasury Stock,” treasury stock is accounted for under the cost method. Under the cost method, the gross cost of shares reacquired is charged to treasury stock, which is presented as a contra equity account in the financial statements. Any excesses or deficiencies on treasury stock transactions are credited or charged to capital reserves.

Convenience Translation into US Dollars

The Company prepares its financial statements in NT Dollars, its reporting currency. The United States (“US”) dollar amounts disclosed in the financial statements as of and for the year ended December 31, 2002, are presented solely for the convenience of the reader and were translated at the rate of NT\$33.78 to US\$1.00 (on the basis of the noon buying rate in the City of New York for cable transfer in NT dollars per US dollar as certified for customer’s purpose by the Federal Reserve Bank of New York on September 30, 2003). Such translation amounts are unaudited and it should not be construed that the NT dollar amounts represent, or have been, or could be, converted into US dollars at that or any other rate.

3. REASONS AND EFFECT OF A CHANGE IN ACCOUNTING POLICY

Beginning 2001, gain on disposal of property, plant and equipment, net of income tax, are no longer transferred from retained earnings to capital reserve in accordance with the amended R.O.C. Regulation on Business Entity Accounting Handling. If this change in accounting policy had been adopted in 2000, capital reserve of the Company as of December 31, 2000 and 2001 would have decreased by NT\$48.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

4. CONTENTS OF SIGNIFICANT ACCOUNTS

(1) Cash and Cash Equivalents

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Cash on hand	366	366	340	10
Checking and savings accounts	990,675	59,302	604,183	17,886
Time deposits	131,000	—	168,150	4,978
Cash equivalents	—	—	329,532	9,755
Total	<u>1,122,041</u>	<u>59,668</u>	<u>1,102,205</u>	<u>32,629</u>

The Company has contracted to sell cash equivalents totaling NT\$329,532 (US\$9,755) back to three financing companies in January 2003 at an aggregate price of NT\$330,353 (US\$9,780).

(2) Short-term Investments

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Mutual funds and listed equity securities	15,822	4,521	—	—
Less: Allowance for market value decline	<u>(7,281)</u>	<u>(1,171)</u>	<u>—</u>	<u>—</u>
Net	<u>8,541</u>	<u>3,350</u>	<u>—</u>	<u>—</u>
Market value	<u>8,541</u>	<u>3,350</u>	<u>—</u>	<u>—</u>

Short-term investments were not pledged.

(3) Notes Receivable, Accounts Receivable and Receivables from Related Parties

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Notes receivable	100,580	46,041	89,783	2,658
Less: Allowance for doubtful accounts	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net	<u>100,580</u>	<u>46,041</u>	<u>89,783</u>	<u>2,658</u>

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Accounts receivable	1,281,446	585,463	1,122,595	33,232
Secured accounts receivable	—	38,511	—	—
Loan on security	—	(30,800)	—	—
Total	1,281,446	593,174	1,122,595	33,232
Less: Allowance for doubtful accounts	(198)	(12,200)	(20,700)	(613)
Allowance for sales discounts	—	(13,000)	(29,164)	(863)
Net	<u>1,281,248</u>	<u>567,974</u>	<u>1,072,731</u>	<u>31,756</u>

Please refer to Note 6 for accounts receivable pledged as collateral.

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Receivables from Related Parties				
Notes Receivable	3,918	1,253	1,544	46
Accounts receivable	69,458	81,554	253,522	7,505
Total	73,376	82,807	255,066	7,551
Less: Allowance for doubtful accounts	—	—	—	—
Net	<u>73,376</u>	<u>82,807</u>	<u>255,066</u>	<u>7,551</u>

(4) Inventories

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Raw materials and supplies	55,151	44,064	43,706	1,294
Work in process	22,160	8,383	7,414	219
Finished goods	—	9,254	934	28
Total	77,311	61,701	52,054	1,541
Less: Allowance for loss on decline in market value and obsolescence	(782)	(4,870)	(10,805)	(320)
Net	<u>76,529</u>	<u>56,831</u>	<u>41,249</u>	<u>1,221</u>

The insurance coverage over the above inventories and consigned-in items amounted to NT\$300,000, NT\$300,000 and NT\$286,000 (US\$8,467) as of December 31, 2000, 2001 and 2002, respectively.

Inventories were not pledged.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

(5) Long-term Investments

Investee Company	Ownership	As of December 31,			
		2000	2001	2002	
	%	NT\$	NT\$	NT\$	US\$
Long-term equity investments					
Equity method:					
KYEC USA Corp. . .	100	4,930	5,073	6,115	181
KYEC Investment International Co., Ltd.	100	—	—	98,980	2,930
Cost method:					
Parawin Venture Capital Corp.	2	—	—	20,000	592
APTOS (Taiwan) Corporation	8.48	—	—	168,000	4,974
Long-term bonds investments (stated at LCM)					
SINBON Electronics Co., Ltd.	—	—	—	17,375	514
Total		<u>4,930</u>	<u>5,073</u>	<u>310,470</u>	<u>9,191</u>

Investment losses recognized under the equity method amounted to NT\$351, NT\$146 and NT\$478 (US\$14) for the years ended December 31, 2000, 2001 and 2002, respectively.

Cumulative translation adjustments increased by NT\$308, NT\$289 and NT\$464 (US\$14) for the years ended December 31, 2000, 2001 and 2002, respectively.

The Company acquired long-term bond investments at par value. No publicly assessable value of the bonds was available as of December 31, 2002.

Consolidated financial statements for the long-term equity method investments are not required as the Company has met the ROC 10% exemption rule.

Long-term investments were not pledged.

(6) Property, Plant and Equipment

The Company's interest (including capitalized interest) amounted to NT\$169,871, NT\$421,676 and NT\$408,219 (US\$12,085) for the years ended December 31, 2000, 2001 and 2002, respectively. Total capitalized interest and the interest rates used were as follows:

	For the year ended December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Capitalized interest	<u>—</u>	<u>67,340</u>	<u>29,627</u>	<u>877</u>
Interest rate used.	<u>—</u>	<u>6.48%</u>	<u>6.48%</u>	<u>6.48%</u>

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

The insurance coverage over property, plant and equipment amounted to NT\$9,675,259, NT\$14,562,064 and NT\$9,193,174 (US\$272,148) as of December 31, 2000, 2001 and 2002, respectively.

Please refer to Note 6 for property, plant and equipment pledged as collateral.

(7) Leased Assets To Others

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Cost:				
Land	—	54,844	—	—
Buildings and facilities	—	138,662	—	—
Machinery and equipment	—	148,233	85,180	2,522
Leased assets	—	—	16,217	480
Leasehold improvements	—	76	—	—
Miscellaneous fixtures	—	2,875	—	—
Prepayments for equipment	—	—	104,522	3,094
Total	—	344,690	205,919	6,096
Less: Accumulated depreciation . . .	—	(71,385)	(34,595)	(1,024)
Net	—	273,305	171,324	5,072

The depreciation of leased assets to others, recorded in non-operating expenses, amounted to NIL, NT\$23,835 and NT\$18,860 (US\$558) for the years ended December 31, 2000, 2001 and 2002.

(8) Idle Assets

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Cost:				
Land	—	—	54,844	1,624
Buildings and facilities	—	164,055	288,259	8,533
Machinery and equipment	—	152,799	643,025	19,036
Miscellaneous fixtures	—	—	2,858	85
Total	—	316,854	988,986	29,278
Less: Accumulated depreciation . . .	—	(71,507)	(351,937)	(10,419)
Net	—	245,347	637,049	18,859

The depreciation of idle assets, included in non-operating expenses, amounted to NIL, NT\$36,597 and NT\$128,957 (US\$3,818) for the years ended December 31, 2000, 2001 and 2002.

(9) Assets To Be Disposed

The Company made several machinery purchases from Advantest Taiwan Inc. (“Advantest”) in the year 2001. However, on November 13, 2001, the Company entered into an agreement with Advantest to cancel all the purchases. Under the agreement, the Company is subject to a cancellation charge of NT\$102,092 (calculated based on 12% to 15% of original purchase prices) and is required to

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

transfer all machines back to Advantest. As of December 31, 2001, the Company reclassified the amount of the machines to the account of assets to be disposed and recognized a market value decline in the amount of NT\$2,698. Detail information is shown as follows:

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Cost:				
Machinery and equipment	—	298,219	—	—
Prepayments for equipment	—	367,777	—	—
Total	—	665,996	—	—
Less: Accumulated depreciation . . .	—	(12,472)	—	—
Book value	—	653,524	—	—
Less: Allowance for loss of machinery and equipment on decline in market value	—	(2,698)	—	—
Net	—	650,826	—	—

In 2002, the Company completed the machine transfer and paid the cancellation charge. The difference NT\$13,772 (US\$408), between the contracted machine transfer price and the book value at the time of transfer was recorded under non-operating income.

(10) Other Assets — Land

The Company purchased several pieces of agricultural land that was located in Miao Li County in 2000. However, due to a limitation in trading, the Company currently is not able to own the title of the land. Instead, the Company registered the land under the name of C.K. Lee, the chairman of the Company. The Company has entered into a trustee agreement with C.K. Lee to secure the Company's ownership over the land. The land was recorded under other assets. The book value of the land amounted to NT\$11,935 (US\$353) as of December 31, 2000, 2001 and 2002.

(11) Short-term Loans

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Letter of credit	1,776,464	173,598	636,853	18,853
Working capital loans	—	1,328,974	—	—
Total	1,776,464	1,502,572	636,853	18,853
Interest rates	0.99%— 8.0867%	0.78%— 7.60%	0.61%— 3.37%	0.61%— 3.37%

The Company's unused short-term lines of credit amounted to NT\$1,143,596, NT\$1,534,628 and NT\$967,397 (US\$28,638) as of December 31, 2000, 2001 and 2002, respectively.

Please refer to Note 6 for assets pledged for short-term loans.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

(12) Short-term Notes

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Secured short-term notes	—	100,000	—	—
Less: Unamortized discount	—	(175)	—	—
Net	—	99,825	—	—
Interest rates	—	4.48%	—	—

Please refer to Note 5(5) for assets pledged for short-term notes.

(13) Long-term Loans

Creditors	As of December 31,						
	Interest rate			Balance			
	2000	2001	2002	2000	2001	2002	
	%	%	%	NT\$	NT\$	NT\$	US\$
Medium-term loan from Chiao Tung Bank							
Repayable in 21 quarterly installments from January 2001 to January 2006 with interest due monthly	6.755	6.475	6.240	360,000	290,700	222,300	6,581
Medium-term loan from Chiao Tung Bank							
Repayable in 21 quarterly installments from October 2002 to October 2007 with interest due monthly	6.755	6.475	6.240	255,000	400,000	381,000	11,279
Medium-term loans from 5 banks							
Repayable in 13 quarterly installments from September 2001 to September 2004 (<i>Remark 1</i>) with interest due monthly	6.655	4.305	3.355	995,000	918,464	535,784	15,861
Medium-term loans from 17 banks							
Repayable in 7 semi-annual installments from November 2002 to November 2005 with interest due monthly	7.200	3.980	3.030	1,620,000	4,000,000	3,428,568	101,497
Medium-term loan from Hsinchu International Bank							
Repayable in 16 quarterly installments from September 2002 to June 2006 with interest due monthly	—	6.900	5.625	—	150,000	131,250	3,885
Medium-term loan from Industrial Bank of Taiwan							
Repayable in full at maturity with interest due monthly	7.500	—	—	100,000	—	—	—
Total long-term loans				3,330,000	5,759,164	4,698,902	139,103
Less: Current portion				(222,372)	(1,060,258)	(1,630,908)	(48,280)
Net				3,107,628	4,698,906	3,067,994	90,823

Remark 1: In accordance with an amendment to the original loan agreement, four installments totaling NT\$306,144 (US\$9,063) originally due on December 20, 2001, March 20, 2002, June 20, 2002 and September 20, 2002 have been extended to November 15, 2002. However, if the Company raises any funds from a public market, the Company shall repay no less than 50% of the funds within ten days from the completion of the funds raise.

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NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Please refer to Note 6 for assets pledged for long-term loans.

(14) Lease Obligations

The Company entered into two lease agreements for equipment with two suppliers. The lease terms are from May 1, 2000 to May 15, 2004 and from January 30, 2002 to January 30, 2003, respectively. Lease obligations are repayable in 36 monthly and 12 monthly installments, respectively, starting with the commencement of such leases. The agreement requires that the Company shall not remodel the equipment without permission from the lessor or sublease the equipment to third parties. The leases provide for a bargain purchase option amounting to NT\$0.001 and NT\$25,386, respectively, at the expiry date of such leases. Book value of the leased equipment amounted to NT\$494,736, NT\$737,954 and NT\$34,555 (US\$1,023) as of December 31, 2000, 2001 and 2002, respectively.

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Lease obligations	521,176	524,350	27,591	817
Less: Discount	(59,726)	(43,913)	(63)	(2)
Net	461,450	480,437	27,528	815
Less: Current portion	(156,313)	(240,241)	(27,528)	(815)
Long-term portion	<u>305,137</u>	<u>240,196</u>	<u>—</u>	<u>—</u>

Please refer to Note 6 for assets pledged for lease obligations.

(15) Installment accounts payable

The Company entered into an equipment purchase agreement with a supplier at the price of NT\$158,401(US\$4,689) in February 2002. The purchase price is payable in 12 monthly installments from the start of such purchase.

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Installment accounts payable.	—	—	10,990	325
Less: Discount	—	—	(109)	(3)
Net	<u>—</u>	<u>—</u>	<u>10,881</u>	<u>322</u>

Please refer to Note 6 for assets pledged for installment accounts payable.

(16) Convertible bonds

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Unsecured convertible bonds.	—	—	2,726,138	80,702
Add: Reserve for redemption	—	—	83,908	2,484
Total	—	—	2,810,046	83,186
Less: Current portion	—	—	—	—
Net	<u>—</u>	<u>—</u>	<u>2,810,046</u>	<u>83,186</u>

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NOTES TO FINANCIAL STATEMENTS — (Continued)
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On April 18, 2002, the Company issued 3-year unsecured convertible bonds. The major terms of the issue are as follows:

- a. Total amount was US\$120,000.
- b. Coupon interest rate: 0%; redeemable 110.87% of par value at maturity date.
- c. Type of debentures: Unsecured convertible bonds.
- d. Redemption at maturity/Redemption at the option of the Company

(a) *Redemption at maturity*

Unless previously redeemed, converted or purchased and canceled, the Company will redeem each bond at its redemption amount at the maturity date.

(b) *Redemption at the option of the Company*

On or at any time after April 18, 2003, the Company may, having given not less than 40 nor more than 60 days' notice to the bondholders, redeem all or part of the bonds at their principal amount if (i) the closing price of the Company's shares translated into U.S. dollars at the prevailing exchange rate for each of the 30 consecutive trading days is at least 150% of the conversion price then in effect, translated into U.S. dollars at the fixed exchange rate of NT\$34.979 = US\$1.00; (ii) the bonds outstanding are less than 10% of the issue amount.

- e. Redemption at the option of the holders:

The bonds are redeemable at 107.12% of par at the option of the bondholders, in whole or in part, beginning two years after the issue date.

- f. Conversion period/Conversion price and adjustment:

- (a) Subject to certain exceptions, conversion may be made at any time 30 days after the issue date and up to March 18, 2005.
- (b) The conversion price was NT\$24.50 per share at the issue date, translated into U.S. dollars at the fixed exchange rate of NT\$34.979 = US\$1.00.
- (c) Adjustments to conversion price:

The conversion price is subject to adjustment in the manner set forth in the Indenture upon the occurrence of certain events set out in the Indenture, including, among other things, the making of a free distribution or bonus issue of shares, subdivision of shares, merger, and issue of shares in cash.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
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(d) Conversion price reset:

Besides the adjustment stated in (c), the conversion price is subject to reset as discussed in the following:

(i) *Conversion price reset*

The conversion price shall be adjusted on April 18, 2003 (the “First Reset Date”) and April 18, 2004 (“the Second Reset Date”) (each a Reset Date), in the event that the average closing price of the share on the TSE translated into U.S. Dollars at the then prevailing rate for 30 consecutive trading days immediately prior to the Reset Date is less than the conversion price then in effect on the relevant Reset Date, in accordance with the following formula:

$$\text{Adjusted Conversion Price} = \frac{\text{Fixed Exchange Rate}}{\text{Prevailing Rate}} \times \text{Average Closing Price}$$

Any adjustment to the conversion price shall not be less than 80% of the initial conversion price prevailing on April 18, 2002 (as adjusted to reflect any adjustments required under f(c) above, which may have occurred prior to the Reset Date).

(ii) *Alternative conversion price reset*

The bondholders are entitled, within seven trading days after March 18, 2004 and March 18, 2005, to convert the bond at the alternative conversion price reset equal to 88% and 85%, respectively, of the then market price.

g. Places of trading:

Europe and Asia (except Taiwan); listed on the Luxembourg Stock Exchange.

As of December 31, 2002, totally US\$11,350 has been converted, which resulted in increases in common stock and capital reserve by NT\$162,045 (US\$4,797) and NT\$231,014 (US\$6,839), respectively. Please refer to Note 4(18).

As of December 31, 2002, bonds repurchased by the Company were US\$30,200.

(17) Pension Fund

The Company’s employee pension plan fund amounted to NT\$22,343, NT\$49,211 and NT\$76,264 (US\$2,258) as of December 31, 2000, 2001 and 2002, respectively. The pension cost recognized amounted to NT\$29,399 (Remark), NT\$26,409 and NT\$28,247 (US\$836) for the years ended December 31, 2000, 2001 and 2002, respectively.

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The components of net periodic pension cost were as follows:

	For the year ended December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Service cost	27,699	22,079	26,217	776
Interest cost	1,813	4,189	3,487	103
Expected return on plan assets .	(564)	(1,341)	(2,215)	(65)
Amortization	758	1,482	758	22
Net periodic pension cost	<u>29,706 (Remark)</u>	<u>26,409</u>	<u>28,247</u>	<u>836</u>

The funding status of pension plan is listed as follows:

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Vested benefit obligation	—	—	—	—
Non-vested benefit obligation	24,466	40,454	57,278	1,695
Accumulated benefit obligation	24,466	40,454	57,278	1,695
Effect on projected salary increase . .	45,349	37,027	49,987	1,480
Projected benefit obligation	69,815	77,481	107,265	3,175
Market-related value of plan assets . .	(22,343)	(49,211)	(76,264)	(2,257)
Funded status	47,472	28,270	31,001	918
Unrecognized transition obligation. . .	(9,096)	(8,338)	(7,580)	(224)
Unrecognized gain or loss	(14,945)	3,215	2,416	71
Accrued pension cost per actuarial report	23,431	23,147	25,837	765
Accrued expenses	(2,242)	(3,264)	(2,740)	(81)
Deposit in transit.	(2,195)	—	—	—
Over accrued	234	593	980	29
Accrued pension liability	<u>19,228</u>	<u>20,476</u>	<u>24,077</u>	<u>713</u>

Remark: Due to immaterial difference between the amount per actuarial report and the amount recorded on the books, the management did not make any adjustment.

The balances of the employees' vested benefit of the Company's pension plan amounted to NIL for each of the three years in the period ended December 31, 2002.

The actuarial assumptions were as follows:

	For the year ended December 31,		
	2000	2001	2002
Discount rate	6.00%	4.50%	4.00%
Rate of increase in future compensation levels	5.00%	3.00%	3.00%
Expected long-term rate on plan assets.	6.00%	4.50%	4.00%

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NOTES TO FINANCIAL STATEMENTS — (Continued)
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(18) Common Stock

As of January 1, 2000, the Company's authorized and issued common stock amounted to NT\$1,500,000 and NT\$1,243,750 divided into 150,000,000 shares and 124,375,000 shares, respectively, each at par of NT\$10.

Following the resolution of shareholders' meeting on April 10, 2000, the Company increased its authorized capital to NT\$5,600,000 divided into 560,000,000 shares, each share at par of NT\$10. The shareholders further resolved in the meeting to issue 6,662,946 shares in settlement of 1999 employee bonus and to declare a 30% stock dividend, which resulted in an issuance of 37,312,500 shares. The shareholders also resolved to transfer approximately NT\$248,750 from capital reserve to capital stock, which resulted in an issuance of 24,875,000 shares.

Following the resolution of the shareholders' meeting on April 10, 2000, the Board of Directors effected an issuance of 70,000,000 common shares at NT\$70 per share on June 12, 2000.

On March 12, 2001, the Company's shareholders resolved in the annual general meeting to increase its authorized capital to NT\$7,000,000, divided into 700,000,000 shares (including 140,000,000 shares reserved for conversion of convertible bonds), with par of NT\$10 each. The shareholders further resolved in the meeting to issue 15,511,500 shares in settlement of 2000 employee bonus and to declare a 33% stock dividend, which resulted in an issuance of 86,864,398 shares. The shareholders also resolved to transfer NT\$710,709 from capital reserve to capital stock, which resulted in an issuance of 71,070,870 shares.

Pursuant to the resolution of shareholders' meeting on May 7, 2002, the Company increased its authorized capital to NT\$8,700,000, divided into 870,000,000 shares, of which 210,000,000 shares and 100,000,000 shares are reserved for conversion and exercise of convertible bonds and stock options, respectively.

As of December 31, 2002, totaling NT\$162,045 (US\$4,797) of the Company's convertible bonds has been converted into common stock that resulted in the issuance of the Company's common stock of 16,204,533 shares.

On December 19, 2002, the Company's shareholders resolved in an extraordinary shareholders' meeting to increase its authorized capital to NT\$12,000,000 (US\$355,240), divided into 1,200,000,000 shares, with par of NT\$10 each. Shareholders also resolved to issue 108,000,000 shares and 200,000,000 shares, in the prices of NT\$14 and NT\$16 per share, respectively, through private placement and public offering, respectively. As of December 31, 2002, the Company raised NT\$1,183,460 (US\$35,034) (recorded under subscriptions received) through private placement. However, the public offering plan has yet to be implemented.

As of December 31, 2002, the Company's authorized and issued common stock amounting to NT\$12,000,000 (US\$355,240) and NT\$4,528,767 (US\$134,067) divided to 1,200,000,000 shares and 452,876,747 shares, respectively, each at par of NT\$10.

The Company has a stock option plan that provides for granting of 30,000 units of options to qualified employees for purchase of up to 30,000,000 common shares of the Company. Stock options expire in five years from the date granted. Option holders may exercise 50%, 75% and 100% of the options in the third year, fourth year and fifth year after the grant date. In July 2002, the board of directors resolved to amend the vesting period. After the amendment, except the holders who individually own not more than 30 units of the options may exercise all of their options in the third

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NOTES TO FINANCIAL STATEMENTS — (Continued)
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year after the grant date, holders may exercise 50% and 100% in the third year and in the fourth year after the grant date. The plan was authorized by the board of directors of the Company on June 13, 2002 and approved by Taiwan SFC on July 19, 2002. The Company granted 30,000 units of stock options on August 5, 2002. As of December 31, 2002, no options was exercised. Please refer to Note 10.2.(1) for more information.

(19) Treasury Stock

- a. On June 4, 2002, the Company's board of directors authorized the Company to repurchase its own common stock from the market for the purpose of transferring shares to employees. The Company repurchased 5,707 thousand shares for a total of NT\$91,018 (US\$2,694) during the year ended December 31, 2002.
- b. According to the Stock Exchange Regulations of Taiwan, total shares repurchased shall not exceed 10% of the Company's issued stock. Total repurchased amounts shall not exceed the sum of retained earnings and the realized capital reserve. The maximum amount and shares that the Company is allowed to repurchase, calculated based on the financial statements as of December 31, 2002, are NT\$3,942,082 (US\$116,699) and 45,288 thousand shares.
- c. In accordance with the Stock Exchange Regulations of Taiwan, treasury stock shall not be pledged, nor does it possess voting rights or receive dividends. Treasury stock shall be transferred to employees within three years from the date repurchased.

(20) Capital Reserve

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Additional paid-in capital	5,301,000	4,590,291	4,013,703	118,819
Conversion of convertible bonds	—	—	231,014	6,839
Gain on disposal of property, plant and equipment	48	48	—	—
	(Remark)	(Remark)	—	—
Total	<u>5,301,048</u>	<u>4,590,339</u>	<u>4,244,717</u>	<u>125,658</u>

According to the R.O.C. Company Law, capital reserve can only be used for making up deficiencies or distributions of stock dividends.

On May 7, 2002, the Company's shareholders resolved to make up its accumulated deficits by using capital reserve of NT\$576,636 (US\$17,070).

Remark: Please refer to Note 3.

(21) Legal Reserve

According to the R.O.C. Company Law, 10% of the Company's net income, after deducting previous years' losses, if any, is appropriated as legal reserve prior to any distribution until such reserve is equal to the Company's paid-in capital. When the legal reserve is equal to 50% of the paid-in stock, legal reserve may be distributed to the Company's shareholders through the issuance of additional common shares. However, such reserve, after distribution, shall not be smaller than 25% of paid-in capital.

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NOTES TO FINANCIAL STATEMENTS — (Continued)
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On May 7, 2002, the Company's shareholders resolved to make up its accumulated deficits by using legal reserve of NT\$187,831(US\$5,560).

(22) Income Distributions

The Company's articles of incorporation provide that the net income, after deducting the previous years' losses and the appropriation of legal and special reserves ("Distributable Earnings"), may be appropriated or distributed proportionally as follows:

- a. Dividend to shareholders at 84% of the Distributable Earnings;
- b. Employee bonuses at 15% of the Distributable Earnings;
- c. Remuneration for directors and supervisors' services at 1%.

Dividend to shareholders and employee bonuses will be distributed in the form of shares or cash, while remuneration for directors and supervisors' services can only be paid by cash.

(23) Basic Earnings Per Share

The capital structure of the Company is considered to be complex as there are convertible bonds and stock options outstanding. The Company has only presented basic earnings per share for the year ended December 31, 2000, 2001 and 2002 because those convertible bonds and stock options had an anti-dilutive effect if they had been fully converted or exercised. The calculation of the weighted average number of shares is as follows (in shares):

	For the year ended December 31,		
	2000	2001	2002
Common shares outstanding, beginning .	124,375,000	263,225,446	436,672,214
Stock dividend declared, employee bonus shares and capital reserve transferred to common shares in 2000 (totally 55.36%).	68,850,446	—	—
Stock issuance for cash on June 12, 2000	38,825,137	—	—
Stock dividend declared, employee bonus shares and capital reserve transferred to common shares in 2001 (totally 65.89%).	152,904,759	173,446,768	—
Bonds converted to common stocks . . .	—	—	8,275,019
Common stock repurchased	—	—	(2,817,929)
Weighted average numbers of shares . . .	<u>384,955,342</u>	<u>436,672,214</u>	<u>442,129,304</u>
	<u>Amount</u> <u>(numerator)</u>	<u>Shares</u> <u>(Denominator)</u>	<u>Earnings per</u> <u>share</u>
	<u>After tax</u>		<u>After tax</u>
	NT\$		NT\$
			(in dollars)
For the year ended December 31, 2000			
Basic Earnings Per Share			
Net Income	<u>1,178,435</u>	<u>384,955,342</u>	<u>3.06</u>

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	Amount (numerator) After tax	Shares (Denominator)	Earnings per share After tax NT\$ (in dollars)
	NT\$		
For the year ended December 31, 2001			
Basic Earnings Per Share			
Net Loss	<u>(791,651)</u>	<u>436,672,214</u>	<u>(1.81)</u>
For the year ended December 31, 2002			
Basic Earnings Per Share			
Net Loss Of Continued Operations	(325,409)	<u>442,129,304</u>	(0.74)
Extraordinary Gain	<u>22,774</u>		<u>0.05</u>
Net Loss (in NT\$)	<u>(302,635)</u>		<u>(0.69)</u>
Net Loss (in US\$)	<u>(8,959)</u>		<u>(0.02)</u>

(24) Income taxes

The Company's income tax assessment through 1999 has been finalized by the tax authorities.

As of December 31, 2002, unused tax credits available to reduce future tax payable were as follows:

Year incurred	Unused Balances		Expiration Years
	NT\$	US\$	
1999	124,840	3,695	2003
2000	737,891	21,844	2004
2001	145,043	4,294	2005
2002 (Estimated)	<u>902,260</u>	<u>26,710</u>	2006
Total	<u>1,910,034</u>	<u>56,543</u>	

As of December 31, 2002, net operating losses that can be carried forward for a period of five years were as follows:

Year incurred	Loss carryforward	Unused Balances	
	NT\$	NT\$	US\$
2001	1,066,720	1,066,720	31,579
2002 (Estimated)	<u>534,407</u>	<u>534,407</u>	<u>15,820</u>
Total	<u>1,601,127</u>	<u>1,601,127</u>	<u>47,399</u>

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NOTES TO FINANCIAL STATEMENTS — (Continued)
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The components of deferred tax assets and liabilities and income tax benefit are as follows:

(1)

	As of December 31,							
	2000		2001		2002			
	NT\$		NT\$		NT\$		US\$	
Total deferred tax liabilities	—		(18,255)		—		—	
Total deferred tax assets.	433,282		1,251,642		2,368,623		70,119	
Valuation allowance for deferred tax assets	—		(500,000)		(1,259,453)		(37,284)	
	<u>Amount</u>	<u>Tax Effect</u>	<u>Amount</u>	<u>Tax Effect</u>	<u>Amount</u>	<u>Tax Effect</u>	<u>Amount</u>	<u>Tax Effect</u>
Temporary differences that generated deferred tax assets or liabilities:								
Deductible temporary difference								
Employee welfare expense	10,200	2,550	7,120	1,780	4,200	1,050	124	31
Unrealized loss of short-term investments on decline in market value.	7,281	1,820	1,171	293	—	—	—	—
Unrealized pension expense	14,507	3,627	15,756	3,939	18,787	4,697	556	139
Unrealized foreign exchange loss.	36,082	9,020	—	—	78,522	19,631	2,325	581
Unrealized sales discounts	—	—	13,000	3,250	29,164	7,291	863	216
Unrealized inventory provision . .	782	196	4,870	1,218	10,805	2,701	320	80
Unrealized bad debt expense. . . .	—	—	4,980	1,245	7,839	1,960	232	58
Unrealized loss of machinery and equipment	—	—	2,698	674	—	—	—	—
Unrealized penalty on cancellation of equipment purchase	—	—	102,092	25,523	—	—	—	—
Unrealized reserve for redemption of convertible bonds	—	—	—	—	83,908	20,977	2,484	621
Taxable temporary difference								
Unrealized foreign exchange gains	—	—	73,018	18,255	—	—	—	—
Loss carryforwards	—	—	1,068,420	267,105	1,601,127	400,282	47,399	11,850
Income tax credits.	—	416,069	—	946,615	—	1,910,034	—	56,543

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		As of December 31,			
		2000	2001	2002	
		NT\$	NT\$	NT\$	US\$
(2)	Deferred tax assets — current . .	241,806	91,821	156,948	4,646
	Valuation allowance for deferred tax assets — current	—	(58,888)	(8,465)	(250)
	Net deferred tax assets — current	241,806	32,933	148,483	4,396
	Net deferred tax liabilities — current	—	(18,255)	—	—
	Net deferred tax assets and liabilities — current	<u>241,806</u>	<u>14,678</u>	<u>148,483</u>	<u>4,396</u>
		As of December 31,			
		2000	2001	2002	
		NT\$	NT\$	NT\$	US\$
(3)	Deferred tax assets — noncurrent	191,476	1,159,821	2,211,675	65,473
	Valuation allowance for deferred tax assets — noncurrent	—	(441,112)	(1,250,988)	(37,034)
	Net deferred tax assets — noncurrent	191,476	718,709	960,687	28,439
	Net deferred tax liabilities — noncurrent	—	—	—	—
	Net deferred tax assets and liabilities — noncurrent	<u>191,476</u>	<u>718,709</u>	<u>960,687</u>	<u>28,439</u>
		For the year ended December 31,			
		2000	2001	2002	
(4)	Income tax — current	132,638	—	—	—
	Net effect of deferred tax assets or liabilities:				
	Income tax credit	(293,278)	(530,546)	(963,419)	(28,520)
	Loss carryforwards	—	(267,105)	(133,177)	(3,942)
	Allowance for deferred tax assets	—	500,000	759,453	22,482
	Unrealized foreign exchange gains (loss)	(8,829)	27,275	(37,886)	(1,122)
	Other	(6,428)	(29,728)	(754)	(22)
	Income tax on extraordinary gain	—	—	(7,591)	(225)
	Other	<u>581</u>	<u>649</u>	<u>264</u>	<u>8</u>
	Income tax benefits	<u>(175,316)</u>	<u>(299,455)</u>	<u>(383,110)</u>	<u>(11,341)</u>

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Information relating to imputation of shareholders' income taxes:

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Available shareholders' tax credits	<u>3,802</u>	<u>3,077</u>	<u>3,382</u>	<u>100</u>
		<u>2000</u>	<u>2001</u>	<u>2002</u>
Actual ratio of shareholders' tax credits		<u>11.31%</u>	<u>—%</u>	<u>—%</u>

Information relating to undistributed retained earnings:

	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Prior to 1998	—	—	—	
After 1998 (inclusive)	<u>1,179,123</u>	<u>(764,467)</u>	<u>(302,635)</u>	<u>(8,959)</u>
Total	<u>1,179,123</u>	<u>(764,467)</u>	<u>(302,635)</u>	<u>(8,959)</u>

(25) Operating Revenues

	For the year ended December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Sales revenues	136,842	81,794	17,105	506
Rent revenues	98,161	92,393	63,535	1,881
Testing revenues	3,990,452	3,795,238	5,322,019	157,549
Other operating revenues	<u>—</u>	<u>1,443</u>	<u>791</u>	<u>24</u>
Total	4,225,455	3,970,868	5,403,450	159,960
Less: Testing and sales discounts. . .	<u>(43,881)</u>	<u>(93,570)</u>	<u>(55,453)</u>	<u>(1,642)</u>
Net operating revenues.	<u>4,181,574</u>	<u>3,877,298</u>	<u>5,347,997</u>	<u>158,318</u>

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5. RELATED PARTY TRANSACTIONS

(1) Name and Relationship of Related Parties:

Names of Related Parties	Relationship with the Company
C.K. Lee	The chairmen of the Company
D.F. Lin.	The president of the Company
Bright Shiao	The vice president of the Company
KYEC USA Corp. (“KYEC USA”)	Investee company
Mediatek Incorporation (“Mediatek”) . . .	The two companies’ chairmen are close relatives
Novatek Microelectronics Corp. (“Novatek”) (<i>Remark 1</i>)	The two companies’ chairmen are close relatives
Amic Technology Incorporation (“Amic”) (<i>Remark 1</i>)	The two companies’ chairmen are close relatives
Faraday Technology Corporation (“Faraday”) (<i>Remark 3</i>)	The two companies’ chairmen are close relatives
PixArt Imaging Inc. (“PixArt”)	The two companies’ chairmen are close relatives
KYEC Investment International Co., Ltd .	Investee company
KYEC Microelectronics Co., Ltd.	A subsidiary of KYEC Investment International Co., Ltd
Silicon Storage Technology (“SST”) (<i>Remark 4</i>)	The supervisor of the Company
China Development Industrial Bank.	The director of the Company
Yeong Chang Construction Corporation (“Yeong Chang”) (<i>Remark 2</i>)	The supervisor of the Company is the chairman of Yeong Chang

Remarks:

1. Novatek and Amic have been a non-related party since June 30, 2000.
2. Yeong Chang has been a non-related party since November 13, 2000.
3. Faraday has been a non-related party since May 3, 2002.
4. SST was non the supervisor of the Company until May 2002.

(2) Significant Related Party Transactions:

a. Sales:

Name of related parties	For the year ended December 31,					
	2000		2001		2002	
	NT\$	Percentage	NT\$	Percentage	NT\$	US\$ Percentage
Mediatek	415,963	9.94%	446,864	11.53%	650,410	19,254 12.16%
Novatek (<i>Remark 1</i>)	59,378	1.42%	—	—	—	—
Faraday	68,896	1.65%	46,703	1.20%	—	—
Amic (<i>Remark 1</i>)	24,162	0.58%	—	—	—	—
PixArt	17,812	0.43%	17,594	0.45%	19,480	577 0.37%
SST (<i>Remark 2</i>)	—	—	—	—	441,388	13,067 8.25%
Total	<u>586,211</u>	<u>14.02%</u>	<u>511,161</u>	<u>13.18%</u>	<u>1,111,278</u>	<u>32,898 20.78%</u>

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Price terms for the above sales were similar to those of regular customers. Payment terms were 45–60 days after invoice date, while those of regular customers were 60–90 days.

Remark:

1. The amount excludes the results of the third and fourth quarter of 2000.
2. The amounts include the results of the period from May to December 2002 only.

- b. Commissions paid to a related party were as follows:

Name of related parties	For the year ended December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
KYEC USA	2,161	5,583	6,890	204

- c. Yeong Chang leased certain of its facilities to the Company in 2000. The rental and renovation expenses of the leased facilities amount to NT\$7,400 and NT\$6,541, respectively, for the year ended December 31, 2000.

- (3) Payables to related parties — financing:

The Company's financing with China Development Industrial Bank (included in long-term loans) for the year ended December 31, 2002 was as follows:

Name of related parties	Highest Balance	Ending Balance	Interest expense	Interest Rate
	NT\$	NT\$	NT\$	%
For the year ended December 31, 2002				
The one billion loan from 5 banks. . .	349,016	203,596	6,498	3.35–4.31
The four billion loan from 17 banks . .	450,000	385,716	10,202	3.03–3.98
Total (in NT\$)		589,312	16,700	
Total (in US\$)		17,446	494	

Financing with other related parties:

For the year ended December 31, 2002

C.K. Lee	133,000	—	633	2.50
Bright Shiao	17,000	—	223	2.50
Total (in NT\$)		—	856	
Total (in US\$)		—	25	

Name of related parties	Highest Balance	Ending Balance	Interest expense	Interest Rate
	NT\$	NT\$	NT\$	%
For the year ended December 31, 2001				
C.K. Lee	33,000	33,000	—	—
Bright Shiao	17,000	17,000	—	—
Total		50,000	—	

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(4) Receivables and payables resulting from the above transactions were as follows:

a. Receivables from related parties:

Name of related parties	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
Mediatek	48,135	61,309	103,092	3,052
Faraday	9,613	18,739	—	—
PixArt	15,628	2,759	9,177	272
KYEC Microelectronics Co., Ltd. (Remark).	—	—	142	4
KYEC Investment International Co., Ltd. (Remark).	—	—	10	—
SST.	—	—	142,645	4,223
Total	<u>73,376</u>	<u>82,807</u>	<u>255,066</u>	<u>7,551</u>

Remark: Amounts relate to company establishment expenses.

b. Payables to related parties:

Name of related parties	As of December 31,			
	2000	2001	2002	
	NT\$	NT\$	NT\$	US\$
KYEC USA	2,161	1,078	2,323	68
China Development Industrial Bank	—	—	11,035	327
C.K. Lee	—	33,000	—	—
Bright Shiao.	—	17,000	—	—
Total	<u>2,161</u>	<u>51,078</u>	<u>13,358</u>	<u>395</u>

Remark: This amount includes interest payable to other banks. China Development Industrial Bank acts an agent for the receipt of interest of syndicate loans.

(5) Except for the short-term notes with Dah Chung Bills Financial Corporation and Fuji bank, which are guaranteed by C.K. Lee alone, the Company's loans are guaranteed, severally and jointly, by C.K. Lee and D.F. Lin. In addition, in 2001, C.K. Lee provided his personal investment totaling NT\$100,410 to the Company as the security of the Company's short-term notes.

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6. ASSETS PLEDGED AS COLLATERAL

Account	As of December 31,				Subject of collateral
	2000	2001	2002		
	NT\$	NT\$	NT\$	US\$	
Land	924,066	869,222	869,222	25,732	Long-term loans
Leased Assets — Land.	—	54,844	—	—	Short-term and long-term loans
Buildings and facilities	440,565	868,225	727,215	21,528	Long-term loans
Leased Assets — Buildings and facilities.	—	46,771	—	—	Short-term and long-term loans
Idle Assets — Buildings and facilities	—	159,130	186,841	5,531	Short-term and long-term loans
Idle Assets — Land.	—	—	54,844	1,623	Short-term and long-term loans
					Short-term loans, long-term loans,
Machinery and Equipment	2,493,644	6,340,763	4,206,123	124,515	and installment accounts payable
Leased assets	475,004	589,857	42,180	1,249	Financing lease
					Short-term loans and as guarantee
					security for foreign labors, HSIP
Restricted deposits.	1,387	5,903	20,500	607	and as financing lease
Accounts receivable.	—	38,511	—	—	Secured accounts receivable
Total	<u>4,334,666</u>	<u>8,973,226</u>	<u>6,106,925</u>	<u>180,785</u>	

7. COMMITMENTS AND CONTINGENT LIABILITIES

As of December 31, 2002, the Company had the following commitments and contingent liabilities:

- (1) The Company's unused letters of credit amounted to approximately NT\$60,845 (US\$1,801) as of December 31, 2002.
- (2) The Company has entered into several construction contracts. As of December 31, 2002, these contracts amounted to approximately NT\$304,950 (US\$9,028) with approximately NT\$61,934 (US\$1,833) remaining unpaid.
- (3) The promissory notes issued for bank loans amounted to NT\$9,689,342 (US\$286,837).
- (4) In accordance with the loan agreement the Company entered into with 17 banks including China Development Industrial Bank, the Company is required to maintain (1) a current ratio of no less than 100%; (2) debt ratio under 100%; (3) tangible equity of more than NT\$7 billion; and (4) interest coverage over 200% for the year 2001 and 2002 and over 300% for years since 2003. In case of breach of the above, the Company shall raise funds, by the end of September of the following year, by offering rights for cash or other financing instruments to the extent the terms can be complied. If the Company fails to raise sufficient funds within the permitted time period, the Company is subject to an additional compensation due quarterly at an annual rate of 0.1% of the unpaid loan. The Company recorded the additional compensation, included in non-operating expense, in the amount of NT\$3,992 and NT\$3,943 (US\$117) for the years ended December 31, 2001 and 2002, respectively.

In the terms of the syndicate loan with 5 banks including China Development Industrial Bank, the Company has to maintain a current ratio of no less than 100% and a debt ratio no more than 100% from 2001 to 2004. If noncompliance occurs, the Company shall take the same actions as stated in the preceding paragraph. The Company recorded the additional compensation, included in non-operating expense, in the amount of NT\$746 for the years ended December 31, 2002.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

- (5) The Company and its chairman have both been named as a defendant in a civil lawsuit filed by several parties including Hwa Tsai Co., Ltd. (“Hwa Tsai”, “the plaintiffs”). The plaintiffs claimed that the Company had violated Rule 20, Rule 21 and Rule 32 of the R.O.C. Securities Exchange Law, Rule 184 of the R.O.C. Civil Law, and Rule 23 of the R.O.C. Company Law and sought damage compensation of NT\$62,213 plus interest. The district court has requested the plaintiffs to recalculate the damage amount since the plaintiffs have sold out the underlying securities and, accordingly, the damage can be reasonably assessed. After recalculation, the plaintiffs reduced the damage claim to NT\$46,974 plus interest. The court has not yet made the final decision. The management anticipates no significant loss to incur due to this case.

Also, the Company and its chairman were involved in a criminal case for a claimed violation of Rule 339 of the R.O.C. Criminal Law, and Rule 171 and Rule 174 of the R.O.C. Securities Exchange Law. Although the Hsinchu District Court had decided that either the Company or its chairman should not be indicted, the plaintiffs (Hwa Tsai and several other parties) were not satisfied with this determination and filed an appeal with the Taiwan High Court for re-investigation. As of January 22, 2003, the final result of re-investigation has not yet been decided.

- (6) On May 8, 2002, an employee of the Company was hit by an aneurysm during work time and sent to hospital for emergency treatments. The employee died on May 20, 2002. The employee’s family considered her death an occupational accident and filed a lawsuit against the Company with Hsinchu district court, seeking reimbursement as required in Labor Standard Law plus an extra compensation of NT\$750 (US\$22). As of January 22, 2003, the case has not been finalized. The Company does not believe this case will have any significant impact on the Company’s financial conditions.

8. SIGNIFICANT DISASTER LOSSES

None.

9. SIGNIFICANT SUBSEQUENT EVENT

On January 8, 2003, the Company sold certain equipment to APTOS (Taiwan) corporation at the price of NT\$335,108 (US\$9,920) (tax is not included) that resulted in a disposal gain of NT\$1,010 (US\$30).

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

10. OTHER DISCLOSURES

1. Financial Instruments

Derivative Financial Instruments:

a. Contract Amount or Nominal Amount and Credit Risk:

Financial Instrument	As of December 31,							
	2000		2001		2002			
	Contract	Credit	Contract	Credit	Contract	Credit	Contract	Credit
	amount or		amount or		amount or		amount or	
	Nominal	Risk	Nominal	Risk	Nominal	Risk	Nominal	Risk
	amount		amount		amount		amount	
	NT\$	NT\$	NT\$	NT\$	NT\$	NT\$	US\$	US\$
Forward currency exchange								
contract-nontrading								
(note)	—	—	—	—	—	—	—	—

(Note): Forward currency exchange contracts were all closed as of December 31, 2000, 2001 and 2002.

Credit risk amount represents contracts with a positive fair value factoring in the offsetting effect of the master netting arrangement as of balance sheet date. If the credit risk amount is positive and the transaction party breaches the contract, the Company will incur a loss. The possibility of incurring a loss is remote since the Company's counter parties are reputable financial institutions.

b. Market Value Risk

Market value risk is insignificant due to the fact that the purpose of the forward exchange contracts is hedging and therefore any gain or loss from the fluctuation in interest or exchange rates will be offset by the gain or loss from the exchanges hedged.

c. Liquidity Risk, cash flow risk and the amount, duration and uncertainty related to future demand on cash flows

There is no significant liquidity risk regarding the derivative financial instrument that the Company has entered into since cash flows from operating activities will satisfy the cash demand in settling the derivative financial instrument contracts. Also, no significant additional cash flows are demanded since the settlement rate is fixed.

d. The Company's derivative financial instruments are entered into mainly for hedging purposes. The purpose of holding forward exchange contracts was to hedge exchange rate fluctuation risks resulting from assets, liabilities or commitments denominated in foreign currencies. The Company's hedging strategy is to mitigate its market price risk. Derivative financial instruments selected for hedging purposes are reviewed and anticorrelated with the fluctuation of the fair value of derivatives hedged. Derivatives are evaluated periodically.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

e. Derivative financial instruments

Forward exchange contracts receivable and payable are reported under current assets or liabilities on a net basis. The balances amounted to nil for both years.

Foreign exchange gains earned for the years ended December 31, 2000, 2001 and 2002 amounted to NT\$0, NT\$0, and NT\$3,810 (US\$113), respectively, which were included in non-operating income.

Fair value of financial instruments:

Non-derivative Instruments	As of December 31,							
	2000		2001		2002			
	Book Value	Fair Value	Book Value	Fair Value	Book Value	Fair Value	Book Value	Fair Value
	NT\$		NT\$		NT\$		US\$	
Assets								
Cash and cash equivalents . . .	1,122,041	1,122,041	59,668	59,668	1,102,205	1,102,205	32,629	32,629
Restricted deposits (Including current and non-current portion).	1,387	1,387	5,903	5,903	20,500	20,500	607	607
Short-term investments.	8,541	8,541	3,350	3,350	—	—	—	—
Receivables (Including receivables from related parties).	1,455,204	1,455,204	696,822	696,822	1,417,580	1,417,580	41,965	41,965
Long-term equity investments .	4,930	4,930	5,073	5,703	293,095	293,095	8,677	8,677
Long-term bonds investments .	—	—	—	—	17,375	(Remark)	514	(Remark)
Deposits out.	10,459	10,459	4,605	4,605	31,274	31,274	926	926
Liabilities								
Short-term loans	1,776,464	1,776,464	1,502,572	1,502,572	636,853	636,853	18,853	18,853
Short-term notes	—	—	99,825	99,825	—	—	—	—
Payables (Including payables to related parties and payables to equipment suppliers).	1,031,091	1,031,091	1,372,577	1,372,577	524,829	524,829	15,537	15,537
Accrued expenses	281,402	281,402	392,211	392,211	299,243	299,243	8,859	8,859
Long-term loans (Including current portion).	3,330,000	3,330,000	5,759,164	5,759,164	4,698,902	4,698,902	139,103	139,103
Lease obligations and installment accounts payable (Including current portion). .	461,450	470,504	480,437	488,183	38,409	38,409	1,137	1,137
Convertible bonds	—	—	—	—	2,810,046	(Remark)	83,186	(Remark)
Deposits in.	5	5	3,925	3,925	168,000	168,000	4,973	4,973

Remark: As of December 31, 2002, no publicly assessable value of Company's long-term bonds investment and convertible bonds was available.

Derivative Instruments	As of December 31,							
	2000		2001		2002			
	Book Value	Fair Value	Book Value	Fair Value	Book Value	Fair Value	Book Value	Fair Value
	NT\$		NT\$		NT\$		US\$	
Forward currency exchange contract	—	—	—	—	—	—	—	—

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Methods and assumptions used to measure fair values of financial instruments are as follow:

- a. The fair values of the Company's short-term financial instruments are based on the book value of those instruments at reporting date due to the short maturity of those instruments. The method applies to cash and cash equivalents, receivables, short-term loans, short-term notes, payables and accrued expenses.
- b. The fair values of the Company's deposits in, restricted deposits and deposits out are based on the book value of those instruments at reporting date as the amounts expected to be received or paid are close to the book values.
- c. The fair values of the Company's short-term investments and long-term investments are based on market prices at reporting date if market prices are available. The fair value of the Company's long-term investment is based on financial or any other information if market prices are not available.
- d. The fair value of the Company's long-term loans bearing variable interest rates, which includes the current portion of long-term loans, is estimated using the book value of the loans at the reporting date.
- e. The fair values of lease obligations and installment accounts payable are estimated using discounted cash flow analysis based on the Company's borrowing rates for similar types of borrowings.
- f. The fair value of derivative financial instruments (normally includes unrealized gains or losses from outstanding forward exchange contracts) is assumed to be the amount that the Company is entitled to receive or obligated to pay if the Company terminates the contracts.

2. Others

- (1) Employees' stock options (Expressed in NT dollars)

<u>Issue date</u>	<u>Total units</u>	<u>Total units outstanding</u>	<u>Exercisable Shares</u>	<u>Exercisable date</u>	<u>Exercise price</u>	<u>Executor method</u>	<u>Market value of common stock (During the period from August 5, 2002 to December 31, 2002)</u>	
							<u>Highest price</u>	<u>Lowest price</u>
August 5, 2002 . . .	30,000	30,000	30,000,000	August 5, 2004	\$14.90	Issue common stock	\$36.10	\$13.80

- (2) Certain accounts of the financial statements as of December 31, 2000 and 2001 have been reclassified to be in conformity with current year's presentation.

11. SEGMENT INFORMATION

1. Operations in different industries: The Company operates predominantly in one industry segment, which being the testing of integrated circuits.
2. Operations in different geographic areas: The Company has no overseas segment.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

3. Export sales: The export sales were NT\$1,138,893, NT\$1,081,872 and NT\$1,403,398 (US\$41,545) for the years ended December 31, 2000, 2001 and 2002, respectively, representing 27.24%, 27.90% and 26.24% of total sales of the corresponding years.

4. Major customers:

Revenues from customers representing over 10% of total net sales were as follows:

Customers	For the year ended December 31,							
	2000		2001		2002			
	Amount	%	Amount	%	Amount	%	Amount	%
	NT\$		NT\$		NT\$		US\$	
A	182,453	4.36	308,059	7.94	726,757	13.59	21,515	13.59
B	415,963	9.95	446,864	11.53	650,410	12.16	19,254	12.16
C	513,794	12.28	714,540	18.43	614,926	11.50	18,204	11.50
Total	<u>1,112,210</u>	<u>26.59</u>	<u>1,469,463</u>	<u>37.90</u>	<u>1,992,093</u>	<u>37.25</u>	<u>58,973</u>	<u>37.25</u>

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders of
King Yuan Electronics Co., Ltd.

We have audited the accompanying balance sheets of King Yuan Electronics Co., Ltd. as of June 30, 2002 and 2003, and the related statements of operations, changes in shareholders' equity, and cash flows for the six-month periods ended June 30, 2002 and 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, we conducted our audits in accordance with generally accepted auditing standards 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 described in Note 4(5), the financial statements of KYEC Investment International Co., Ltd., the investment which is reflected in the accompanying financial statements using the equity method of accounting, were not audited. The investment in KYEC Investment International Co., Ltd. reflects NT\$79,485 thousand (0.43% of the total assets) as of June 30, 2003, and its net loss represents loss of NT\$19,178 thousand (37.85% of the pre-tax loss) for the six-month period ended June 30, 2003.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary if the financial statements of KYEC Investment International Co., Ltd. had been audited, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of King Yuan Electronics Co., Ltd. as of June 30, 2002 and 2003, and the results of its operations and its cash flows for the six-month periods ended June 30, 2002 and 2003, in conformity with generally accepted accounting principles in the Republic of China.

Taipei, Taiwan
Republic of China
July 14, 2003
Except for Note 4(15)(C), as to
which the date is November 30, 2003

KING YUAN ELECTRONICS CO., LTD.
BALANCE SHEETS
(Amounts in thousands)

	Notes	As of June 30,		
		2002	2003	
		NT\$	NT\$	US\$
Current assets				
Cash and cash equivalents	2,4(1)	1,639,605	1,008,979	29,869
Short-term investments (Net)	2,4(2)	287,180	—	—
Notes receivable (Net)	2,4(3)	108,732	115,233	3,411
Accounts receivable (Net)	2,4(3)	811,925	1,040,201	30,793
Receivables from related parties	4(3),5	324,185	231,983	6,867
Other receivables		19,439	297,558	8,809
Inventories (Net)	2,4(4)	44,178	44,390	1,314
Deferred tax assets-current (Net)	2,4(23)	58,270	287,206	8,502
Restricted deposits-current	6	160,000	—	—
Other current assets		52,533	13,785	408
Total current assets		<u>3,506,047</u>	<u>3,039,335</u>	<u>89,973</u>
Long-term investments	2,4(5)	<u>4,619</u>	<u>290,028</u>	<u>8,586</u>
Property, plant and equipment	2,4(6),6			
Land		869,222	869,222	25,732
Buildings and facilities		2,475,717	2,521,672	74,650
Machinery and equipment		13,529,803	14,722,509	435,835
Transportation equipment		15,935	20,600	610
Office furniture		238,922	239,854	7,100
Leased assets	2,4(13)	51,203	—	—
Miscellaneous fixtures		<u>1,267,694</u>	<u>1,242,961</u>	<u>36,796</u>
Total cost		18,448,496	19,616,818	580,723
Less: Accumulated depreciation		(4,988,014)	(7,752,147)	(229,489)
Plus: Prepayments for equipment		203,707	1,342,578	39,745
Construction in progress		<u>2,579</u>	<u>574</u>	<u>17</u>
Net property, plant and equipment		<u>13,666,768</u>	<u>13,207,823</u>	<u>390,996</u>
Other assets				
Leased assets to others (Net)	4(7),6	38,631	172,310	5,101
Idle assets (Net)	4(8),6	613,716	397,614	11,771
Deposits out		31,271	4,874	144
Deferred assets	2	185,488	225,014	6,661
Deferred tax assets-noncurrent (Net)	2,4(23)	903,420	962,153	28,483
Restricted deposits-noncurrent	6	5,000	7,000	207
Other assets-land	4(9)	<u>11,935</u>	<u>11,935</u>	<u>353</u>
Total other assets		<u>1,789,461</u>	<u>1,780,900</u>	<u>52,720</u>
Total Assets		<u><u>18,966,895</u></u>	<u><u>18,318,086</u></u>	<u><u>542,275</u></u>

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

KING YUAN ELECTRONICS CO., LTD.
BALANCE SHEETS — (Continued)
(Amounts in thousands)

		As of June 30,		
	Notes	2002	2003	
		NT\$	NT\$	US\$
Current liabilities				
Short-term loans	4(10)	378,923	230,175	6,814
Short-term notes	4(11)	199,978	—	—
Current portion of convertible bonds	2,4(15),10	—	244,061	7,225
Current portion of long-term loans	4(12)	1,558,708	1,630,908	48,280
Current portion of lease obligations	2,4(13)	40,279	—	—
Installment accounts payable	4(14)	61,597	—	—
Notes payable		272,729	192,964	5,712
Accounts payable		29,642	33,576	994
Payables to related parties	5	15,528	36,237	1,073
Payables to equipment suppliers		69,228	271,300	8,031
Accrued expenses and other current liabilities . .		374,652	324,985	9,620
Total current liabilities		<u>3,001,264</u>	<u>2,964,206</u>	<u>87,749</u>
Long-term Liabilities				
Convertible bonds	2,4(15),10	3,798,031	2,613,639	77,372
Long-term loans, less current portion	4(12)	<u>3,883,448</u>	<u>2,852,540</u>	<u>84,445</u>
Total long-term liabilities		<u>7,681,479</u>	<u>5,466,179</u>	<u>161,817</u>
Other Liabilities				
Accrued pension liabilities	2,4(16)	23,517	27,481	814
Deposits in		<u>—</u>	<u>74,824</u>	<u>2,215</u>
Total other liabilities		<u>23,517</u>	<u>102,305</u>	<u>3,029</u>
Total Liabilities		<u>10,706,260</u>	<u>8,532,690</u>	<u>252,595</u>
Shareholders' Equity				
Capital				
Common stock	4(17)	4,478,797	5,568,716	164,852
Capital reserve	4(19)			
Paid-in capital in excess of par-common stock		4,013,703	4,127,047	122,174
Conversion of convertible bonds		158,974	231,014	6,839
Retained earnings				
Legal reserve	4(20)	—	—	—
Unappropriated earnings (accumulated deficits)	4(21)	(338,854)	89,364	2,645
Cumulative translation adjustments	2,4(5)	397	966	29
Treasury stock	2,4(18)	<u>(52,382)</u>	<u>(231,711)</u>	<u>(6,859)</u>
Total Shareholders' Equity		<u>8,260,635</u>	<u>9,785,396</u>	<u>289,680</u>
Total Liabilities and Shareholders' Equity		<u>18,966,895</u>	<u>18,318,086</u>	<u>542,275</u>

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

KING YUAN ELECTRONICS CO., LTD.
STATEMENTS OF OPERATIONS
(Amounts in thousands except per share data)

	Notes	For the six-month period ended June 30,		
		2002	2003	
		NT\$	NT\$	US\$
Operating Revenues				
Sales revenues		2,358,999	2,968,926	87,890
Less: Sales discounts		(13,555)	(23,707)	(702)
Net operating revenues	2,4(24),5	2,345,444	2,945,219	87,188
Cost of goods sold	4(25)	(2,463,640)	(2,572,495)	(76,154)
Gross Profit (Loss)		(118,196)	372,724	11,034
Operating Expenses	4(25),5			
Selling expenses		(29,003)	(29,637)	(877)
Administrative expenses		(199,422)	(201,583)	(5,968)
Research and development expenses		(34,096)	(42,530)	(1,259)
Total operating expenses		(262,521)	(273,750)	(8,104)
Operating Income (Loss)		(380,717)	98,974	2,930
Non-operating Income				
Interest income		5,431	3,374	100
Gain on disposal of property, plant and equipment	2	13,966	10,401	308
Gain on disposal of investments	2	598	7,600	225
Foreign exchange gain	2	68,750	9,520	282
Rental income		20,004	29,656	878
Other income		8,476	4,046	119
Total non-operating income		117,225	64,597	1,912
Non-operating Expenses				
Interest expense	4(6)	(212,670)	(124,584)	(3,688)
Net loss from equity investments	2,4(5)	(254)	(20,277)	(600)
Loss on disposal of property, plant and equipment	2	(19,620)	(4,501)	(133)
Inventory loss provision	2	(5,140)	—	—
Other losses	4(7),4(8)	(65,795)	(64,879)	(1,921)
Total non-operating expenses		(303,479)	(214,241)	(6,342)
Loss Before Income Taxes		(566,971)	(50,670)	(1,500)
Income Tax Benefit	2,4(23)	228,117	140,034	4,145
Net Income (Loss)		(338,854)	89,364	2,645
Basic Earnings Per Share				
(in New Taiwan Dollars)	2,4(22)			
Net Income (Loss) (in dollars)		(0.77)	0.17	0.005
Diluted Earnings Per Share				
(in New Taiwan Dollars)				
Net Income (in dollars)			0.17	0.005

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

KING YUAN ELECTRONICS CO., LTD.
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Amounts in thousands)

	Capital Reserve			Retained Earnings								
	Common Stock	Capital Collected In Advance	Paid-in Capital In Excess Of Par-Common Stock	Conversion Of Bonds		Capital Surplus From Gain On Disposal Of Property, Plant And Equipment		Legal Reserve	Unappropriated Earnings (Accumulated Deficits)	Cumulative Translation Adjustments	Treasury Stock	Total
				NT\$	NT\$	NT\$	NT\$					
Balance as of January 1, 2002.....	4,366,722	—	4,590,291	—	48	187,831	(764,467)	597	—	—	8,381,022	
Legal reserve used to cover accumulated deficit	—	—	—	—	—	(187,831)	187,831	—	—	—	—	
Capital reserve used to cover accumulated deficit	—	—	(576,588)	—	(48)	—	576,636	—	—	—	—	
Conversion of convertible bonds	112,075	—	—	158,974	—	—	—	—	—	—	271,049	
Common stock repurchased	—	—	—	—	—	—	—	—	—	(52,382)	(52,382)	
Cumulative translation adjustments	—	—	—	—	—	—	—	(200)	—	—	(200)	
Net loss for the six-month period ended June 30, 2002	—	—	—	—	—	—	(338,854)	—	—	—	(338,854)	
Balance as of June 30, 2002 (in NT\$) ..	4,478,797	—	4,013,703	158,974	—	—	(338,854)	397	(52,382)	—	8,260,635	
Balance as of January 1, 2003.....	4,528,767	1,183,460	4,013,703	231,014	—	—	(302,635)	1,061	(91,018)	—	9,564,352	
Stock issuance for cash	1,039,949	(1,183,460)	415,979	—	—	—	—	—	—	—	272,468	
Capital reserve used to cover accumulated deficit	—	—	(302,635)	—	—	—	302,635	—	—	—	—	
Common stock repurchased	—	—	—	—	—	—	—	—	(140,693)	—	(140,693)	
Cumulative translation adjustments	—	—	—	—	—	—	—	(95)	—	—	(95)	
Net income for the six-month period ended June 30, 2003	—	—	—	—	—	—	89,364	—	—	—	89,364	
Balance as of June 30, 2003 (in NT\$) ..	5,568,716	—	4,127,047	231,014	—	—	89,364	966	(231,711)	—	9,785,396	
Balance as of June 30, 2003 (in US\$) ..	164,852	—	122,174	6,839	—	—	2,645	29	(6,859)	—	289,680	

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

KING YUAN ELECTRONICS CO., LTD.
STATEMENTS OF CASH FLOWS
(Amounts in thousands)

	For the six-month period ended June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Cash flows from operating activities:			
Net income (loss)	(338,854)	89,364	2,645
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	1,503,843	1,571,720	46,528
Amortization	40,937	65,455	1,938
Bad debt expense	8,500	—	—
Deferred income taxes	(228,303)	(140,189)	(4,150)
Net loss from equity investments	254	20,277	600
Inventory loss provision	5,140	—	—
Net (gain) loss on disposal of property, plant and equipment	5,654	(5,900)	(175)
Increase in notes receivable	(62,691)	(25,450)	(753)
(Increase) decrease in accounts receivable	(252,451)	32,530	963
(Increase) decrease in receivables from related parties	(241,378)	23,083	683
(Increase) decrease in inventories	7,513	(3,141)	(93)
(Increase) decrease in other receivables	25,956	(18,869)	(559)
(Increase) decrease in other current assets	(17,995)	17,192	509
Decrease in notes payable	(42,489)	(6,758)	(200)
Increase in accounts payable	7,938	4,344	129
Increase in payables to related parties	14,450	22,879	678
Increase in accrued expenses and other current liabilities	81,044	4,827	142
Increase in reserve for redemption of convertible bonds	34,277	58,637	1,736
Exchange rate adjustment for convertible bonds and long-term bonds investments	(156,797)	(10,913)	(323)
Increase in accrued pension liabilities	3,041	3,404	101
Net cash provided by operating activities	<u>397,589</u>	<u>1,702,492</u>	<u>50,399</u>
Cash flows from investing activities:			
(Increase) decrease in restricted deposits	(159,097)	13,500	400
(Increase) decrease in short-term investments	(283,830)	—	—
Acquisition of property, plant and equipment	(594,680)	(1,494,629)	(44,246)
Proceeds from disposal of property, plant and equipment	72,487	316,656	9,374
Penalty on cancellation of equipment purchase	(102,092)	—	—
Increase in deferred assets	(90,002)	(35,703)	(1,057)
(Increase) decrease in deposits out	<u>(26,666)</u>	<u>26,400</u>	<u>781</u>
Net cash used in investing activities	<u>(1,183,880)</u>	<u>(1,173,776)</u>	<u>(34,748)</u>

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

KING YUAN ELECTRONICS CO., LTD.
STATEMENTS OF CASH FLOWS — (Continued)
(Amounts in thousands)

	For the six-month period ended June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Cash flows from financing activities:			
Decrease in short-term loans	(1,123,649)	(406,678)	(12,039)
Decrease in payables to related parties	(50,000)	—	—
Increase in short-term notes	100,153	—	—
Decrease in long-term loans	(317,008)	(215,454)	(6,378)
Decrease in lease obligations	(440,158)	(27,528)	(815)
Increase (decrease) in installment accounts payable	61,597	(10,881)	(322)
Increase in convertible bonds	4,191,600	—	—
Decrease in deposits in	(3,925)	(93,176)	(2,758)
Common stock repurchased	(52,382)	(140,693)	(4,165)
Stock issuance for cash	—	272,468	8,066
Net cash provided by (used in) financing activities	<u>2,366,228</u>	<u>(621,942)</u>	<u>(18,411)</u>
Net increase (decrease) in cash and cash equivalents	1,579,937	(93,226)	(2,760)
Cash and cash equivalents at the beginning of period	59,668	1,102,205	32,629
Cash and cash equivalents at the end of period	<u>1,639,605</u>	<u>1,008,979</u>	<u>29,869</u>
Supplemental disclosures of cash flows information:			
Interest paid during the period (excluding capitalized interest)	<u>187,190</u>	<u>70,231</u>	<u>2,079</u>
Income tax paid during the period	<u>186</u>	<u>155</u>	<u>5</u>
Investing activities partially paid by cash			
Acquisition of property, plant and equipment	280,759	1,483,412	43,914
Decrease in payables to equipment suppliers	915,349	11,217	332
Purchases cancelled	<u>(601,428)</u>	—	—
Cash paid for purchase of property, plant and equipment	<u>594,680</u>	<u>1,494,629</u>	<u>44,246</u>
Investing and Financing activities not affecting cash flows			
Cumulative translation adjustments	<u>(200)</u>	<u>(95)</u>	<u>(3)</u>
Current portion of long-term loans and lease obligations	<u>1,598,987</u>	<u>1,630,908</u>	<u>48,280</u>
Current portion of convertible bonds	<u>—</u>	<u>244,061</u>	<u>7,225</u>
Conversion of convertible bonds	<u>271,049</u>	<u>—</u>	<u>—</u>
Investing and Financing activities partially affecting cash flows			
Receivables from disposal of property, plant and equipment, and deferred assets	<u>—</u>	<u>228,833</u>	<u>6,774</u>

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

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS
(Amounts in thousands except otherwise stated)

1. HISTORY

KING YUAN ELECTRONICS CO., LTD. (the “Company”) was incorporated under the Company Law of the Republic of China in July 1987. The Company’s major business activities are testing and assembly service, and manufacture and selling IC Monitoring Burn-In machinery. The shares of the Company commenced trading on the Taiwan Stock Exchange in May 2001.

As of June 30, 2002 and 2003, the Company’s employees totaled 2,971 and 2,726, respectively.

2. SUMMARY OF ACCOUNTING POLICIES

Cash Equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash, and so near their maturity that they present insignificant risk of changes in interest rates. Commercial paper, negotiable certificates of deposit, and bank acceptances with original maturities of three months or less at the investment date are considered to be cash equivalents.

Foreign Currency Transactions and Translation of Foreign Currency Statements

The Company maintains its accounting records in New Taiwan dollars (“NT Dollars” or “NT\$”). Transactions denominated in foreign currencies are recorded in NT Dollars using the exchange rates in effect at the dates of transactions. Assets and liabilities denominated in foreign currencies are translated into NT Dollars using the exchange rates in effect at the balance sheet date. Foreign exchange gains or losses are included in other income or expenses.

Long-term foreign investments accounted for under the cost method are translated into NT Dollars using the prevailing exchange rates at acquisition date or balance sheet date, whichever is lower. Any difference is charged to the cumulative translation adjustments account.

For long-term foreign investments accounted for under the equity method, their financial statements are first translated into NT Dollars. The Company then recognizes the investment gain or loss and translation adjustment based on the translated financial statements. For the translation, the current rate at the balance sheet date is used for asset and liability accounts. The weighted average rate for the reporting period is used for the income statement accounts. Translation adjustments are included as a component of shareholders’ equity.

Short-term Investments

Short-term investments are recorded at cost when acquired and are stated at the lower of aggregate cost or market value at the balance sheet date. The market value of listed equity securities or closed-ended funds is determined by the average closing price during the last month of the fiscal period. The market value for open-ended funds is determined by their equity value as reported at the balance sheet date. No revenue is recognized when stock dividends are received. Instead, the number of shares increases and the cost per share is recalculated. Disposal gain or loss of short-term investments is calculated based on the weighted average method.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is provided based on the collectibility and aging analysis of notes and accounts receivable and other receivables.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Inventories

Inventories are recorded at cost when acquired and stated at the lower of aggregate cost, based on weighted average method, or market value at the balance sheet date. The market value of raw materials and supplies is determined on the basis of replacement cost while work in process and finished goods on net realizable value. The allowance for loss on decline in market value and obsolescence is provided, when necessary.

Long-term Investments

- (1) Long-term investments in which the Company holds an interest less than 20% are stated at the lower of cost or market value, with unrealized losses recorded as a separate component of shareholders' equity. There is no recognition of unrealized gains.
- (2) Long-term investments in which the Company holds an interest of 20% or more are accounted for under the equity method. The difference between the cost of the investment and the underlying equity in the investee's net assets at the date of acquisition is amortized over five years. Adjustment to capital reserve is required when the holding percentage changes due to unproportional subscription to investee's new shares. If the capital reserve is insufficient, retained earnings is adjusted.
- (3) Unrealized inter-company gains and losses are eliminated under the equity method. Profit from sales of depreciable assets between the investee and the Company is amortized and recognized based on the assets' economic service lives. Profit from other types of inter-company transactions is recognized when realized.
- (4) If the Company's share of an investee company's losses equals to or exceeds the carrying amount of an investment accounted for under the equity method, the recognized investment losses shall be limited to the extent that makes the book value of a long-term investment equal to zero. However, if the Company intends to provide further financial support for the investee company, or the investee company's losses are temporary and there exists sufficient evidence showing imminent return to profitable operations, then the Company shall continue to recognize investment losses in proportion to the stock ownership percentage. Such credit long-term investment balance shall first offset the advance (if any) the Company made to the investee company, the remaining shall be recorded under other liabilities.
- (5) According to R.O.C. Statement of Financial Accounting Standards No. 23, "Interim Financial Reporting Disclosures," the Company recognizes quarterly income and losses on investees in which the Company owns more than 20%.
- (6) Long-term bond investments are recorded at cost as acquired. Premiums or discounts are amortized over the bond life.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Property, Plant and Equipment

- (1) Property, plant and equipment are stated at cost. Depreciation is provided on the straight-line basis over the following useful lives:

Buildings and facilities	3 to 30 years
Machinery and equipment	3 to 10 years
Transportation equipment	5 years
Office furniture	3 to 10 years
Leased assets	4 to 5 years
Miscellaneous fixtures	2 to 10 years

- (2) Improvements and replacements are capitalized and depreciated over their estimated useful lives while ordinary repairs and maintenance are expensed as incurred. Gain or loss on disposal of property, plant and equipment is recorded under non-operating income or expenses. When property, plant and equipment are disposed of, their original cost and accumulated depreciation are written off and related gain, net of income tax, is transferred to capital reserve in the current year. Gain on disposal of property, plant and equipment shall not be transferred to capital reserve starting in 2001 in accordance with an amendment to R.O.C. Regulation on Business Entity Accounting Handling. Equipment not held for operating purposes is transferred to the account of idle assets based on the lower of net realizable value or book value. Equipments for lease are transferred to the account of leased assets to others based on book value. Depreciation derived from idle assets and leased assets to others is recorded under non-operating expenses.

Lease agreement

Provided a lease agreement meets the capitalization criteria, the present value of the minimum lease payments net of executory costs is capitalized as an asset along with a corresponding liability.

Deferred Assets

Deferred assets are originally recorded at cost and amortized over their estimated useful lives, usually 1 to 5 years, using the straight-line method.

Revenue Recognition

Revenue is recognized according to R.O.C. Statement of Financial Accounting Standards No. 32, "Accounting for Revenue Recognition." Revenue can be recognized when all of the following are met:

- (i) It is realized or realizable.
- (ii) It is earned.
- (iii) The collectibility can be fairly assessed.

Sales allowance are accrued in the year that related sales occur.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Capital Expenditures vs. Revenue Expenses

If expenditures increase the future service potential of plant assets, the expenditures are capitalized, while the others are expensed as incurred.

Income Tax

Provision for income tax includes deferred tax resulting from temporary differences and investment tax credits. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements using enacted tax rates and laws that will be in effect when the difference is expected to reverse. A valuation allowance on deferred tax assets is provided to the extent that it is more likely than not that the tax benefits will not be realized.

Undistributed earnings generated after 1997 are subject to a 10% tax in compliance with R.O.C. income tax law. The 10% tax on undistributed earnings is recorded as an expense at the time shareholders resolve that its earnings shall be retained.

Income tax credits resulting from the acquisition of equipment, research and development expenditures, employee training and investment in equity stock shall be recognized in the year that such acquisition, expenditures, training and investment occur.

Convertible Bonds

- (1) The interest-premium of puttable convertible bonds, which is the difference between the specified put price and the par value, should be amortized using the interest method and be recognized as a liability over the period from the issuance date of the bonds to the expiry date of the put option. If the bondholder does not exercise the put option, the interest-premium, which has been recognized as a liability, should be amortized over the period from the expiry date to the maturity date using the interest method. However, if at the expiry date the market value of the common stock under conversion exceeds the put price, the interest-premium should be credited to additional paid-in capital.
- (2) The cost of issuing convertible bonds should be recorded as deferred assets and amortized using the straight-line method over the period from the issuance date of the convertible bonds and the expiry date of the put option.
- (3) When bondholders exercise their conversion rights, the book value of convertible bonds is credited to common stock at an amount equal to the par value of the common stock and the excess is credited to capital reserve; no gain or loss is recognized on bond conversion.

Pension Plan

The Company has a funded defined benefit pension plan covering all regular employees. The net pension cost is computed based on an actuarial valuation in accordance with the provision of R.O.C. Statement of Financial Accounting Standards No. 18, which requires consideration of pension cost components such as service cost, interest cost, expected return on plan assets and amortization of net obligation at transition. The unrecognized net obligation at transition is amortized on the straight-line basis over the employees average remaining service period provided, however, if the average remaining service period is shorter than 15 years, the unrecognized net obligation at transition may be amortized over 15 years. The pension fund is managed by an independent pension fund committee.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Earnings Per Share

In accordance with R.O.C. Statement of Financial Accounting Standards No. 24, “Earnings per Share,” the Company presents basic earnings per share if a simple capital structure exists; or both basic earnings per share and diluted earnings per share if a complex capital structure exists. Basic earnings per share is equal to the net income (loss) attributable to common stock divided by the weighted-average number of common shares. When calculating diluted earnings per share, the numerator should include or add back potential common stock dividends, interest and other conversion revenues (expenses). The denominator should include all dilutive potential common shares.

Derivative Financial Instruments

Forward currency exchange contract: A forward currency exchange contract obligates the Company to exchange predetermined amounts of specified foreign currencies at specified exchange rates for another currency on a specified date. The Company’s forward contracts are designated as hedges; discounts or premiums, being the difference between the spot exchange rate and the forward exchange rate at the inception of the contract, are accreted or amortized to the statement of operations over the contract lives using the straight-line method. Realized gains and losses from settlement or unrealized gains and losses resulting from changes in the spot exchange rate at the balance sheet date are recorded in the statement of operations as foreign exchange gains or losses in the period in which they relate. The related amounts due to or from counter-parties are included in other current assets or other current liabilities.

Treasury Stock

In accordance with the R.O.C. Statement of Financial Accounting Standards No. 30, “Accounting for Treasury Stock,” treasury stock is accounted for under the cost method. Under the cost method, the gross cost of shares reacquired is charged to treasury stock, which is presented as a contra equity account in the financial statements. Any excesses or deficiencies on treasury stock transactions are credited or charged to capital reserves.

Convenience Translation into US Dollars

The Company prepares its financial statements in NT Dollars, its reporting currency. The United States (“US”) dollar amounts disclosed in the financial statements as of and for the six-month period ended June 30, 2003, are presented solely for the convenience of the reader and were translated at the rate of NT\$33.78 to US\$1.00 (on the basis of the noon buying rate in the City of New York for cable transfer in NT dollars per US dollar as certified for customer’s purpose by the Federal Reserve Bank of New York on September 30, 2003). Such translation amounts are unaudited and it should not be construed that the NT dollar amounts represent, or have been, or could be, converted into US dollars at that or any other rate.

3. REASONS AND EFFECT OF A CHANGE IN ACCOUNTING POLICY

None.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

4. CONTENTS OF SIGNIFICANT ACCOUNTS

(1) Cash and Cash Equivalents

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Cash on hand	396	340	10
Checking and savings accounts	277,754	367,012	10,865
Time deposits	913,106	—	—
Cash equivalents	448,349	641,627	18,994
Total	<u>1,639,605</u>	<u>1,008,979</u>	<u>29,869</u>

The Company has contracted to sell the cash equivalents totaling NT\$641,627 (US\$18,994) back to four financing companies in July 2003 at an aggregate price of NT\$644,456 (US\$19,078).

(2) Short-term Investments

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Mutual funds	287,180	—	—
Less: Allowance for market value decline.	—	—	—
Net	<u>287,180</u>	<u>—</u>	<u>—</u>
Market value	<u>287,768</u>	<u>—</u>	<u>—</u>

Short-term investments were not pledged.

(3) Notes Receivable, Accounts Receivable and Receivables from Related Parties

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Notes receivable	108,732	115,233	3,411
Less: Allowance for doubtful accounts.	—	—	—
Net	<u>108,732</u>	<u>115,233</u>	<u>3,411</u>

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Accounts receivable.	847,593	1,068,378	31,627
Less: Allowance for doubtful accounts.	(20,700)	(20,700)	(613)
Allowance for sales discounts	(14,968)	(7,477)	(221)
Net	<u>811,925</u>	<u>1,040,201</u>	<u>30,793</u>

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Receivables from related parties			
Notes receivable	2,191	—	—
Accounts receivable	321,994	231,983	6,867
Total	324,185	231,983	6,867
Less: Allowance for doubtful accounts	—	—	—
Net	<u>324,185</u>	<u>231,983</u>	<u>6,867</u>

(4) Inventories

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Raw materials and supplies	44,503	43,971	1,302
Work in process	8,741	10,290	304
Finished goods	934	934	28
Total	54,178	55,195	1,634
Less: Allowance for loss on decline in market value and obsolescence	(10,000)	(10,805)	(320)
Net	<u>44,178</u>	<u>44,390</u>	<u>1,314</u>

The insurance coverage over the above inventories and consigned-in items amounted to NT\$286,000 and NT\$200,000 (US\$5,921) as of June 30, 2002 and 2003, respectively.

Inventories were not pledged.

(5) Long-term Investments

Investee Company	Ownership	As of June 30,		
		2002	2003	
		NT\$	NT\$	US\$
Long-term equity investments				
Equity method:				
KYEC USA Corp.	100%	4,619	5,238	155
KYEC Investment International Co., Ltd. .	100%	—	79,485	2,353
Cost method:				
Parawin Venture Capital Corp..	2%	—	20,000	592
APTOS (Taiwan) Corporation	8.48%	—	168,000	4,974
Long-term bonds investments (stated at LCM)				
SINBON Electronics Co., Ltd..	—	—	17,305	512
Total		4,619	290,028	8,586

For the six-month periods ended June 30, 2002 and 2003, the Company recognized losses on the long-term investment of KYEC USA Corp. amounting to NT\$254 and NT\$1,099 (US\$32), respectively. The recognition, in accordance with R.O.C.'s financial reporting regulations, was based on the investee's unaudited financial statements.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

For the six-month period ended June 30, 2003, the Company recognized a loss on the long-term equity investment of KYEC Investment International Co., Ltd. amounting to NT\$19,178 (US\$568). The recognition was based on the investee's unaudited financial statements.

Cumulative translation adjustments decreased by NT\$200 and NT\$95 (US\$3) for the six-month periods ended June 30, 2002 and 2003, respectively.

The Company acquired long-term bond investments at par value. No publicly assessable value of the bonds was available as of June 30, 2003.

Long-term investments were not pledged.

(6) Property, Plant and Equipment

The Company's interest (including capitalized interest) amounted to NT\$217,129 and NT\$141,362 (US\$4,185) for the six-month periods ended June 30, 2002 and 2003, respectively. Total capitalized interest and the interest rates used were as follows:

Items	For the six-month period ended June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Capitalized interest	4,459	16,778	497
Interest rate used.	6.48%	3.48%	

The insurance coverage over property, plant and equipment amounted to NT\$9,026,893 and NT\$11,577,159 (US\$342,722) as of June 30, 2002 and 2003, respectively.

Please refer to Note 6 for property, plant and equipment pledged as collateral.

(7) Leased Assets To Others

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Cost:			
Machinery and equipment	45,798	208,112	6,161
Prepayments for equipment	—	25,156	745
Total	45,798	233,268	6,906
Less: Accumulated depreciation	(7,167)	(60,958)	(1,805)
Net	38,631	172,310	5,101

The depreciation of leased assets to others, recorded in non-operating expenses, amounted to NT\$3,746 and NT\$16,952 (US\$502) for the six month periods ended June 30, 2002 and 2003, respectively.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

(8) Idle Assets

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Cost:			
Land	54,844	54,844	1,623
Buildings and facilities	290,007	271,889	8,049
Machinery and equipment	550,760	285,812	8,461
Miscellaneous fixtures	2,950	9,283	275
Total	898,561	621,828	18,408
Less: Accumulated depreciation	(284,845)	(224,214)	(6,637)
Net	<u>613,716</u>	<u>397,614</u>	<u>11,771</u>

The depreciation of idle assets, included in non-operating expenses, amounted to NT\$57,060 and NT\$33,352 (US\$987) for the six-month periods ended June 30, 2002 and 2003, respectively.

(9) Other Assets — Land

The Company purchased several pieces of agricultural land located in Miao Li County in 2000. However, due to a limitation in trading, the Company currently is not able to claim the title of the land. Instead, the Company registered the land under the name of C.K. Lee, the chairman of the Company. The Company has entered into a trustee agreement with C.K. Lee to secure the Company's ownership over the land. The land was recorded under other assets. The book value of the land amounted to NT\$11,935 (US\$353) as of June 30, 2003.

(10) Short-term Loans

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Letter of credit	38,923	230,175	6,814
Working capital loans	340,000	—	—
Total	<u>378,923</u>	<u>230,175</u>	<u>6,814</u>
Interest rates	<u>1.50%~3.70%</u>	<u>0.6038%~2.04%</u>	

The Company's unused short-term lines of credit amounted to NT\$888,877 and NT\$1,442,875 (US\$42,714) as of June 30, 2002 and 2003, respectively.

Please refer to Note 6 for assets pledged for short-term loans.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

(11) Short-term Notes

	As of June 30,	
	2002	2003
	NT\$	NT\$ US\$
Secured short-term notes	200,000	— —
Less: Unamortized discount	(22)	— —
Net	<u>199,978</u>	<u>— —</u>
Interest rates.	<u>2.40%~3.00%</u>	<u>—</u>

Please refer to Note 6 for assets pledged for short-term notes.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

(12) Long-term Loans

Creditors	As of June 30,				
	Interest rates		Balance		
	2002	2003	2002	2003	
	%	%	NT\$	NT\$	US\$
Medium-term loan from Chiao Tung Bank					
Repayable in 21 quarterly installments from January 2001 to January 2006 with interest due monthly	6.420	4.000	222,300	188,100	5,568
Medium-term loan from Chiao Tung Bank					
Repayable in 21 quarterly installments from October 2002 to October 2007 with interest due monthly	6.420	4.000	381,000	343,000	10,154
Medium-term loan from Chiao Tung Bank					
Repayable in 13 quarterly installments from March 2005 to March 2008 with interest due monthly	—	3.735	—	400,000	11,841
Medium-term loans from 5 banks	3.830	3.040	688,856	382,712	11,330
Repayable in 13 quarterly installments from September 2001 to September 2004 (Remark 1) with interest due monthly					
Medium-term loans from 17 banks	3.505	2.715	4,000,000	2,857,136	84,581
Repayable in 7 semi-annual installments from November 2002 to November 2005 with interest due monthly.					
Medium-term loan from Hsinchu International Bank					
Repayable in 16 quarterly installments from September 2002 to June 2006 with interest due monthly	6.825	4.000	150,000	112,500	3,330
Medium-term loans from 7 banks	—	3.541	—	200,000	5,921
Repayable in 7 semi-annual installments from October 2004 to October 2007 with interest due monthly (Remark 2)					
Total long-term loans.			5,442,156	4,483,448	132,725
Less: Current portion.			(1,558,708)	(1,630,908)	(48,280)
Net			<u>3,883,448</u>	<u>2,852,540</u>	<u>84,445</u>

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Remark 1: In accordance with an amendment to the original loan agreement, four installments totaling NT\$306,144 (US\$9,063) originally due on December 20, 2001, March 20, 2002, June 20, 2002 and September 20, 2002 have been extended to November 15, 2002. However, if the Company raises any funds from a public market, the Company shall repay no less than 50% of the funds within ten days from the completion of the funds raise.

Remark 2: Total line of credit was NT\$1,330,000 (US\$39,372) which hasn't been fully utilized.

Please refer to Note 6 for assets pledged for long-term loans.

(13) Lease Obligations

The Company entered into a lease agreement for equipment with a lease company. The lease terms are from January 30, 2002 to January 30, 2003. The agreement requires that the Company shall not remodel the equipment without permission from the lessor or sublease the equipment to third parties. The lease provides for a bargain purchase option equal to NT \$ 25,386(US\$752), at the end of the lease terms. Book value of the leased equipment amounted to NT\$50,772 and NIL as of June 30, 2002 and 2003, respectively.

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Lease obligations	40,821	—	—
Less: Discount	(542)	—	—
Net	40,279	—	—
Less: Current portion	(40,279)	—	—
Lease obligations — long-term	—	—	—

Please refer to Note 6 for assets pledged for lease obligations.

(14) Installment accounts payable

The Company entered into an equipment purchase agreement with a supplier at the price of NT\$158,401(US\$4,689) in February 2002. The purchase price is payable in 12 monthly installments from the commencement of such purchase.

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Installment accounts payable.	63,739	—	—
Less: Discount	(2,142)	—	—
Net	61,597	—	—

Please refer to Note 6 for assets pledged for installment accounts payable.

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(15) Convertible bonds

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Unsecured convertible bonds.	3,763,754	2,715,154	80,377
Add: Reserve for redemption	34,277	142,546	4,220
Total	3,798,031	2,857,700	84,597
Less: Current portion.	—	(244,061)	(7,225)
Net	<u>3,798,031</u>	<u>2,613,639</u>	<u>77,372</u>

On April 18, 2002, the Company issued 3-year unsecured convertible bonds. The major terms of the issue are as follows:

- a. Total amount was US\$120,000.
- b. Coupon interest rate: 0%; redeemable 110.87% of par value at maturity date.
- c. Type of debentures: Unsecured convertible bonds.
- d. Redemption at maturity/Redemption at the option of the Company
 - (a) *Redemption at maturity*

Unless previously redeemed, converted or purchased and canceled, the Company will redeem each bond at its redemption amount at the maturity date.
 - (b) *Redemption at the option of the Company*

On or at any time after April 18, 2003, the Company may, having given not less than 40 nor more than 60 days' notice to the bondholders, redeem all or part of the bonds at their principal amount if (i) the closing price of the Company's shares translated into U.S. dollars at the prevailing exchange rate for each of the 30 consecutive trading days is at least 150% of the conversion price then in effect, translated into U.S. dollars at the fixed exchange rate of NT\$34.979 = US\$1.00; (ii) the bonds outstanding are less than 10% of the issue amount.
- e. Redemption at the option of the holders bond:

The bonds are redeemable at 107.12% of par at the option of the bondholders, in whole or in part, beginning two years after the issue date.
- f. Conversion period/Conversion price and adjustment
 - (a) Subject to certain exceptions, conversion may be made at any time after one month following the initial issuance of the bonds up to March 18, 2005.
 - (b) The conversion price was NT\$24.50 per share at the issue date, translated into U.S. dollars at the fixed exchange rate of NT\$34.979 = US\$1.00.

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(c) Adjustments to conversion price:

The conversion price will be subject to adjustment in the manner set forth in the Indenture upon the occurrence of certain events set out in the Indenture, including, among other things, the making of a free distribution or bonus issue of shares, subdivision of shares, merger, and issue of shares in cash.

On February 18, 2003, the Company adjusted the conversion price to NT\$23.97.

(d) Conversion price reset:

Besides the adjustment stated in (c), the conversion price is subject to reset in the manner set forth in the Terms and Conditions of the bonds is discussed in the following:

(i) *Conversion price reset*

The conversion price shall be adjusted on April 18, 2003 (the “First Reset Date”) and April 18, 2004 (“the Second Reset Date”) (each a Reset Date), in the event that the average closing price of the share on the TSE translated into U.S. Dollars at the then prevailing rate for 30 consecutive trading days immediately prior to the Reset Date is less than the conversion price then in effect on the relevant Reset Date, in accordance with the following formula:

$$\text{Adjusted Conversion Price} = \frac{\text{Fixed Exchange Rate}}{\text{Prevailing Rate}} \times \text{Average Closing Price}$$

Any adjustment to the conversion price shall not be less than 80% of the initial conversion price prevailing on April 18, 2002 (as adjusted to reflect any adjustments required under f (c) above, which may have occurred prior to the Reset Date).

(ii) *Alternative conversion price reset*

The bondholders are entitled, within seven trading days after March 18, 2004 and March 18, 2005, to convert the bond at the alternative conversion price reset equal to 88% and 85%, respectively, of the then market price.

On April 18, 2003, the Company reset the conversion price to NT\$19.18.

g. Places of trading: Europe and Asia (except Taiwan); listed on the Luxembourg Stock Exchange.

(A) As of June 30, 2003, totalling US\$11,350 was converted that resulted in increases in common stock and capital reserve by NT\$162,045 (US\$4,797) and NT\$231,014 (US\$6,839), respectively. Please refer to Note 4(17).

(B) As of June 30, 2003, bonds repurchased by the Company amounted to NT\$1,054,886 (US\$ 30,200).

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- (C) The Company has outstanding convertible bonds in the amount of US\$78,450 (equivalent to NT\$2,857,700, including reserve for redemption) at June 30, 2003, which can be redeemed at the bondholders' option starting from April 18, 2004. Since the debt will be due on demand within one year from April 18, 2003, the bonds are classified as current liabilities on the Company's balance sheet since April 28, 2003. However, during the period from July 1, 2003 to November 30, 2003, there have been US\$71,750 (equivalent to NT\$2,613,639, including reserve for redemption) bonds converted into the Company's common stock. The Company construed this conversion as the refinance of long-term debt in accordance with R.O.C SFAS No. 1 and, accordingly, the US\$71,750 (equivalent to NT\$2,613,639, including reserve for redemption) debt was reclassified to long-term liabilities. As a result, there is US\$6,700 (equivalent to NT\$244,061, including reserve for redemption) current portion of the convertible bonds reflected in the balance sheet as of June 30, 2003.

(16) Pension Fund

The Company's employee pension plan fund amounted to NT\$63,033 and NT\$88,853 (US\$2,630) as of June 30, 2002 and 2003, respectively. The pension cost recognized amounted to NT\$14,131 and NT\$15,693 (US\$465) for the six-month periods ended June 30, 2002 and 2003, respectively.

(17) Common Stock

As of January 1, 2002, the Company's authorized and issued common stock amounted to NT\$7,000,000 and NT\$4,366,722, divided into 700,000,000 shares and 436,672,214 shares, respectively, each at par of NT\$10.

Following the resolution of the shareholders' meeting on May 7, 2002, the Company increased its authorized capital to NT\$8,700,000, divided into 870,000,000 shares, of which 100,000,000 shares are reserved for exercise of stock options.

As of June 30, 2003, totaling NT\$162,045 (US\$4,797) of the Company's convertible bonds has been converted into common stock that resulted in the issuance of the Company's common stock of 16,204,533 shares.

On December 19, 2002, the Company's shareholders resolved in the extraordinary shareholders' meeting to increase its authorized capital to NT\$12,000,000, divided into 1,200,000,000 shares, with par of NT\$10 each. Shareholders also resolved to issue 108,000,000 shares and 200,000,000 shares, in the prices of NT\$14 and NT\$16 per share, through private placement and public offering, respectively. As of June 30, 2003, the Company has raised NT\$1,455,928 through private placement that resulted in the issuance of the Company's common stock of 103,994,857 shares. As of June 30, 2003, the public offering plan has not yet been implemented.

As of June 30, 2003, the Company's authorized and issued common stock amounting to NT\$12,000,000 (US\$355,240) and NT\$5,568,716 (US\$164,852), divided to 1,200,000,000 shares (including 100,000,000 shares reserved for the future exercises of stock options) and 556,871,604 shares, respectively, each at par of NT\$10.

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The Company has two stock option plans that provide for the granting of 60,000 units of options to qualified employees for purchase of up to 60,000,000 common shares of the Company. Stock options expire in five years from the date of granted except the holders who individually own not more than 30 units of the options may exercise all of their options in the third year after the grant date, holders may exercise 50% and 100% in the third year and in the fourth year after the grant date. The two stock option plans were authorized by the board of directors of the Company on June 13, 2002 and April 24, 2003 and approved by Taiwan's SFC on July 19, 2002, and May 26, 2003. The Company granted 30,000 units of options on August 5, 2002 and 20,000 units on May 29, 2003. As of June 30, 2003, no option was exercised. Please refer to Note 10.2. (1) for more detail information.

(18) Treasury Stock

- a. On June 4, 2002 and March 7, 2003, the Company's board of directors authorized the Company to repurchase its own common stock from the market for the purpose of transferring shares to employees. Based on the authorization, the Company repurchased 16,857 thousand shares for a total of NT\$231,711 (US\$6,859) as of June 30, 2003.
- b. According to the Stock Exchange Regulations of Taiwan, total shares repurchased shall not exceed 10% of the Company's issued stock. Total repurchased amounts shall not exceed the sum of retained earnings and the realized capital reserve. The maximum amount and shares that the Company is allowed to repurchase, calculated based on the financial statements as of June 30, 2003, are NT\$4,447,425 (US\$131,658) and 55,687 thousand shares.
- c. In accordance with the Stock Exchange Regulations of Taiwan, treasury stock shall not be pledged, nor does it possess voting rights or receive dividends. Treasury stock shall be transferred to employees within three years from the date repurchased.

(19) Capital Reserve

	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Additional paid-in capital	4,013,703	4,127,047	122,174
Conversion of convertible bonds	158,974	231,014	6,839
Total	<u>4,172,677</u>	<u>4,358,061</u>	<u>129,013</u>

According to the R.O.C. Company Law, capital reserve can only be used for making up deficits or distributions of stock dividends.

On May 7, 2002 and June 9, 2003, the Company's shareholders resolved to make up its accumulated deficits by using capital reserve of NT\$576,636 and NT\$302,635 (US\$8,959), respectively.

(20) Legal Reserve

According to the R.O.C. Company Law, 10% of the Company's net income, after deducting previous years' losses, if any, is appropriated as legal reserve prior to any distribution until such reserve is equal to the Company's paid-in capital. When the legal reserve is equal to 50% of the paid-

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in stock, legal reserve may be distributed to the Company's shareholders through the issuance of additional common shares. However, such reserve, after distribution, shall not be smaller than 25% of paid-in capital.

On May 7, 2002, the Company's shareholders resolved to make up its accumulated deficits by using legal reserve of NT\$187,831.

(21) Income Distributions

The Company's articles of incorporation provide that the net income, after deducting the previous years' losses and the appropriation of legal and special reserves ("Distributable Earnings"), may be appropriated or distributed proportionally as follows:

- a. Dividend to shareholders at 84% of the Distributable Earnings;
- b. Employee bonuses at 15% of the Distributable Earnings;
- c. Remuneration for directors and supervisors' services at 1%.

On June 9, 2003, the shareholders resolved to revise the above policy as follows:

- a. Dividend to shareholders at 89% of the Distributable Earnings;
- b. Employee bonuses at 10% of the Distributable Earnings;
- c. Remuneration for directors and supervisors' services at 1%.

Dividend to shareholders and employee bonuses will be distributed in the form of shares or cash, while remuneration for directors and supervisors' services can only be paid by cash.

(22) Earnings Per Share

The capital structure of the Company is considered to be complex as there are convertible bonds and stock options outstanding. The Company presents basic and diluted earnings per share for the six-month period ended June 30, 2003 as its stock options would have a dilutive effect if they had been fully exercised. However, the Company only presents basic earnings per share for the six-month period ended June 30, 2002 due to an anti-dilutive effect of convertible bonds.

	For the six-month period ended June 30,	
	2002	2003
Common shares outstanding, beginning	436,672,214	452,876,747
Common shares from private placement	—	75,841,553
Bonds converted to common stock.	1,961,250	—
Treasury stock	(181,718)	(9,506,011)
Weighted average numbers of shares	438,451,746	519,212,289
Potential common shares:		
The effect of dilutive stock options (assuming fully exercised)	—	1,005,346
Weighted average numbers of dilutive shares	438,451,746	520,217,635

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	Amount (numerator) After tax NT\$	Shares (Denominator)	Earnings per share After tax NT\$ (in dollars)
For the six-month period ended			
June 30, 2003			
Diluted Earnings Per Share			
Net income	89,364	519,212,289	<u>0.17</u>
Stock options	<u>—</u>	<u>1,005,346</u>	
Net income (in NT\$)	<u>89,364</u>	<u>520,217,635</u>	<u>0.17</u>
Net income (in US\$)	<u>2,645</u>		<u>0.005</u>
For the six-month period ended			
June 30, 2002			
Basic Earnings Per Share			
Net loss	<u>(338,854)</u>	<u>438,451,746</u>	<u>(0.77)</u>

(23) Income taxes

The Company's income tax assessment through 1999 has been finalized by the tax authorities.

As of June 30, 2003, unused tax credits available to reduce future tax payable were as follows:

Year incurred	Unused Balances		Expiration Years
	NT\$	US\$	
1999	124,109	3,674	2003
2000	315,963	9,354	2004
2001	560,452	16,591	2005
2002	940,256	27,835	2006
2003 (Estimated).	<u>30,248</u>	<u>895</u>	2007
Total	<u>1,971,028</u>	<u>58,349</u>	

As of June 30, 2003, net operating losses that can be carried forward for a period of five years were as follows:

Year incurred	Losses carry forwards	Unused Balances	
	NT\$	NT\$	US\$
2001	1,066,719	1,066,719	31,578
2002	619,029	619,029	18,325
2003 (Estimated).	<u>19,309</u>	<u>19,309</u>	<u>572</u>
Total	<u>1,705,057</u>	<u>1,705,057</u>	<u>50,475</u>

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The components of deferred tax assets and liabilities and income tax benefit are as follows:

(1)

		As of June 30,					
		2002		2003			
		NT\$		NT\$		US\$	
Total deferred tax liabilities		(12,615)		(6,505)		(193)	
Total deferred tax assets.		1,303,305		2,450,597		72,546	
Valuation allowance for deferred tax assets.		(329,000)		(1,194,733)		(35,368)	
		Amount	Tax Effect	Amount	Tax Effect	Amount	Tax Effect
Temporary differences that generated deferred tax assets or liabilities:							
Deductible temporary differences							
Employee welfare expense	5,660	1,415	3,150	788	93	23	
Unrealized foreign investment loss under equity method. . . .	—	—	21,251	5,313	629	157	
Unrealized pension expense . . .	18,797	4,699	21,403	5,352	634	159	
Unrealized sales discounts	14,968	3,742	7,477	1,869	221	55	
Unrealized inventory provision . .	10,000	2,500	10,805	2,701	320	80	
Unrealized bad debt expense. . .	11,063	2,766	6,582	1,645	195	49	
Unrealized reserve for redemption of convertible bonds	34,277	8,569	142,546	35,637	4,220	1,055	
Taxable temporary difference							
Unrealized foreign exchange gains	(50,460)	(12,615)	(26,015)	(6,505)	(770)	(193)	
Loss carryforwards	1,434,220	358,555	1,705,057	426,264	50,475	12,619	
Income tax credits.		921,059		1,971,028		58,349	
		As of June 30,					
		2002		2003			
		NT\$		NT\$		US\$	
(2) Deferred tax assets — current		76,328		446,813		13,227	
Valuation allowance for deferred tax assets — current.		(5,443)		(153,102)		(4,532)	
Net deferred tax assets — current		70,885		293,711		8,695	
Deferred tax liabilities — current		(12,615)		(6,505)		(193)	
Net deferred tax assets and liabilities — current		58,270		287,206		8,502	

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		As of June 30,		
		2002	2003	
		NT\$	NT\$	US\$
(3)	Deferred tax assets — noncurrent	1,226,977	2,003,784	59,319
	Valuation allowance for deferred tax assets — noncurrent	(323,557)	(1,041,631)	(30,836)
	Net deferred tax assets — noncurrent	903,420	962,153	28,483
	Deferred tax liabilities-noncurrent	—	—	—
	Net deferred tax assets and liabilities — noncurrent	<u>903,420</u>	<u>962,153</u>	<u>28,483</u>
		For the six-month period ended June 30,		
		2002	2003	
		NT\$	NT\$	US\$
(4)	Income tax — current	—	—	—
	Net effect of deferred tax assets or liabilities			
	Allowance for deferred tax assets	(171,000)	(64,720)	(1,916)
	Income tax credits	25,556	(60,944)	(1,804)
	Loss carryforwards	(91,450)	(25,982)	(769)
	Other	8,591	11,457	339
	Other	186	155	5
	Income tax benefit	<u>(228,117)</u>	<u>(140,034)</u>	<u>(4,145)</u>

Information relating to imputation of shareholders' income taxes:

		As of June 30,		
		2002	2003	
		NT\$	NT\$	US\$
	Available shareholders' tax credits	<u>3,291</u>	<u>3,567</u>	<u>106</u>
		2001	2002	
		—%	—%	
	Actual ratio of shareholders' tax credits	<u>—%</u>	<u>—%</u>	

Information relating to undistributed retained earnings:

		As of June 30,		
		2002	2003	
		NT\$	NT\$	US\$
	Prior to 1998	—	—	—
	After 1998 (inclusive)	(338,854)	89,364	2,645
	Total	<u>(338,854)</u>	<u>89,364</u>	<u>2,645</u>

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(24) Operating Revenues

	For the six-month period ended June 30,		
	2002	2003	
	NT\$	NT\$	US\$
Sales revenues	6,913	16,978	502
Rent revenues	25,419	45,705	1,353
Testing revenues	2,326,442	2,906,117	86,031
Other operating revenues	225	126	4
Total	2,358,999	2,968,926	87,890
Less: Testing and sales discounts	(13,555)	(23,707)	(702)
Net operating revenues	<u>2,345,444</u>	<u>2,945,219</u>	<u>87,188</u>

(25) Personnel, Depreciation and Amortization Expenses

	For the six-month period ended June 30,								
	2002			2003					
	Recorded under cost of goods sold	Recorded under operating expenses	Total	Recorded under cost of goods sold		Recorded under operating expenses		Total	
				NT\$	US\$	NT\$	US\$	NT\$	US\$
Personnel Expense:									
Salary expense	473,811	73,342	547,153	553,787	16,394	88,379	2,616	642,166	19,010
Insurance expense . .	39,678	5,772	45,450	47,943	1,419	6,804	201	54,747	1,620
Pension expense . . .	12,269	1,862	14,131	13,516	400	2,177	65	15,693	465
Other	28,944	3,158	32,102	30,153	893	3,260	97	33,413	990
Total	<u>554,702</u>	<u>84,134</u>	<u>638,836</u>	<u>645,399</u>	<u>19,106</u>	<u>100,620</u>	<u>2,979</u>	<u>746,019</u>	<u>22,085</u>
Depreciation (Remark1)	<u>1,360,029</u>	<u>83,008</u>	<u>1,443,037</u>	<u>1,440,003</u>	<u>42,629</u>	<u>81,413</u>	<u>2,410</u>	<u>1,521,416</u>	<u>45,039</u>
Amortization (Remark2)	<u>24,946</u>	<u>13,670</u>	<u>38,616</u>	<u>44,437</u>	<u>1,316</u>	<u>15,214</u>	<u>450</u>	<u>59,651</u>	<u>1,766</u>

Remark 1: The depreciation expenses of leased assets and idle assets, recorded in non-operating expenses, amounted to NT\$60,806 and NT\$50,304 (US\$1,489) for the six-month periods ended June 30, 2002 and 2003, respectively.

Remark 2: The amortization expenses of the issuance cost of convertible bonds, recorded in non-operating expenses, amounted to NT\$2,321 and NT\$5,804 (US\$172) for the six-month periods ended June 30, 2002 and 2003, respectively.

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5. RELATED PARTY TRANSACTIONS

(1) Name and Relationship of Related Parties:

Name of related parties	Relationship with the Company
C.K. Lee	The chairman of the Company
D.F. Lin.	The president of the Company
Bright Shiao.	The vice president of the Company
Mediatek Incorporation (“Mediatek”)	The two companies’ chairmen are close relatives
PixArt Imaging Inc. (“PixArt”).	The two companies’ chairmen are close relatives
KYEC USA Corp. (“KYEC USA”).	Investee company
KYEC Investment International Co., Ltd.	Investee company
KYEC Microelectronics Co., Ltd.	A subsidiary of KYEC Investment International Co., Ltd
Silicon Storage Technology (“SST”)	The supervisor of the Company
China Development Industrial Bank.	The director of the Company
Silicon Precision Industries Co., Ltd. (SPIL) (Remark).	The director of the Company

Remark: SPIL has become a related party since February 18, 2003 when its investment in the Company’s shares has exceeded 10%.

(2) Significant Related Party Transactions:

a. Sales:

Name of related parties	For the six-month period ended June 30,				
	2002		2003		
	Amount	Percentage	Amount	Percentage	
	NT\$	%	NT\$	US\$	%
Mediatek	359,326	15.32	276,652	8,190	9.39
PixArt	5,539	0.24	8,927	264	0.30
SST (Remark).	143,421	6.11	278,149	8,234	9.45
Total	<u>508,286</u>	<u>21.67</u>	<u>563,728</u>	<u>16,688</u>	<u>19.14</u>

Price terms for the above sales were similar to those of regular customers. Payment terms were 45~60 days after invoicing, while those of regular customers were 60~90 days.

Remark: SST was not the supervisor of the Company until May 7, 2002. The corresponding amounts disclosed above, as of June 30, 2002, include only the results of May to June, 2002.

b. Commissions paid to a related party were as follows:

Name of related party	For the six-month period ended June 30,		
	2002	2003	
	NT\$	NT\$	US\$
KYEC USA	<u>2,390</u>	<u>2,871</u>	<u>85</u>

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c. Payable to related parties — financing:

The Company's financing with China Development Industrial Bank (included in long-term loans) for the six-month periods ended June 30, 2002 and 2003 was as follows:

	<u>Highest Balance</u>	<u>Ending Balance</u>	<u>Interest expense</u>	<u>Interest Rate</u>
	NT\$	NT\$	NT\$	%
For the six-month period ended				
June 30, 2002				
The one billion loan from 5 banks	349,016	261,764	2,775	3.83
The four billion loan from 17 banks	450,000	<u>450,000</u>	<u>1,924</u>	3.51
		<u>711,764</u>	<u>4,699</u>	
For the six-month period ended				
June 30, 2003				
The one billion loan from 5 banks	203,596	145,428	2,997	3.04~3.35
The four billion loan from 17 banks	385,716	<u>321,432</u>	<u>5,364</u>	2.715~3.03
Total (in NT\$)		<u>466,860</u>	<u>8,361</u>	
Total (in US\$)		<u>13,821</u>	<u>248</u>	

Financing with other related parties:

For the six-month period ended				
June 30, 2002				
C.K. Lee.	133,000	—	633	2.50
Bright Shiao	17,000	<u>—</u>	<u>224</u>	2.50
Total.		<u>—</u>	<u>857</u>	

d. Property transaction:

On May 13, 2003, the Company acquired certain machines from Mediatek at the price of NT\$7,667 (US\$227).

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e. Receivables and payables resulting from the above transactions were as follows:

(a) Receivables from related parties:

Name of related parties	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
SST.	201,161	140,663	4,164
Mediatek	119,053	87,522	2,591
PixArt	3,971	3,588	106
KYEC Microelectronics Co., Ltd.	—	142	4
		(Remark)	(Remark)
KYEC Investment International Co., Ltd.	—	68	2
		(Remark)	(Remark)
Total	<u>324,185</u>	<u>231,983</u>	<u>6,867</u>

Remark: Amounts relate to company establishment expenses.

(b) Payables to related parties:

Name of related parties	As of June 30,		
	2002	2003	
	NT\$	NT\$	US\$
KYEC USA	955	1,264	37
Mediatek	—	7,615	226
China Development Industrial Bank. . . .	14,573	7,845	232
	(Remark 1)	(Remark 1)	(Remark 1)
SPIL	—	19,513	578
		(Remark 2)	(Remark 2)
Total	<u>15,528</u>	<u>36,237</u>	<u>1,073</u>

Remark 1: This amount includes interest payable to other banks. China Development Industrial Bank acts as an agent for the receipt of interest of syndicate loans.

Remark 2: Temporary receipts for referring IC assembly service to SPIL.

f. Except for the short-term loan with Hsinchu Commercial Bank and the syndicate loan with 7 banks including ChinaTrust Commercial Bank, which are guaranteed by C.K. Lee alone, the Company's loans are guaranteed, severally and jointly, by C.K. Lee and D.F. Lin.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

6. ASSETS PLEDGED AS COLLATERAL

Account	As of June 30,			Subject of collateral
	2002	2003		
	NT\$	NT\$	US\$	
Land	869,222	869,222	25,732	Long-term loans
Buildings and facilities	739,718	734,862	21,754	Long-term loans
Idle Assets — Land.	54,844	54,844	1,624	Short-term and long-term loans
Idle Assets — Buildings and facilities	190,129	163,405	4,837	Short-term and long-term loans
Machinery and equipment . .	4,376,769	5,557,264	164,514	Short-term loans, long-term loans, and installment accounts payable
Leased assets	46,866	—	—	Financing lease
Restricted deposits	165,000	7,000	207	Short-term loans and as guarantee security for HSIP and as financing lease
Total	6,442,548	7,386,597	218,668	

7. COMMITMENTS AND CONTINGENT LIABILITIES

As of June 30, 2003, the Company had the following commitments and contingent liabilities:

- (1) The Company's unused letters of credit amounted to approximately NT\$226,286 (US\$6,699) as of June 30, 2003.
- (2) The Company has entered into several construction contracts. As of June 30, 2003, these contracts amounted to approximately NT\$86,000 (US\$2,546) with unpaid amount of NT\$11,448 (US\$339).
- (3) The promissory notes issued for bank loans amounted to NT\$9,309,241 (US\$275,584).
- (4) In accordance with the loan agreement the Company entered into with 17 banks including China Development Industrial Bank, the Company is required to maintain (1) a current ratio of no less than 100%; (2) debt ratio under 100%; (3) tangible equity of more than NT\$7 billion; and (4) interest coverage over 200% for the year 2001 and 2002 and over 300% for years since 2003. In case of breach of the above, the Company shall raise funds, by the end of September of the following year, by offering rights for cash or other financing instruments to the extent the terms can be complied. If the Company fails to raise sufficient funds within the permitted time period, the Company is subject to an additional compensation due quarterly at an annual rate of 0.1% of the unpaid loan. The Company recorded the additional compensation, included in non-operating expense, in the amount of NT\$1,992 and NT\$291 (US\$9) for the six-month periods ended June 30, 2002 and 2003, respectively.

In the terms of the syndicate loan with 5 banks including China Development Industrial Bank, the Company has to maintain a current ratio of no less than 100% and a debt ratio no more than 100% from 2001 to 2004. If noncompliance occurs, the Company shall take the same actions as stated in the preceding paragraph. The Company recorded the additional compensation, included in non-operating expense, in the amount of NT\$46 (US\$1) for the six-month period ended June 30, 2003.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Under the syndicate loan agreement with ChinaTrust Commercial Bank and other banks, the Company is subject to the following financial covenants:

- (a) maintain a current ratio of no less than 100% for years from 2002 to 2007;
- (b) maintain a debt ratio of no more than 125% for the year 2002 and no more than 100% for years from 2003;
- (c) maintain an interest coverage of no less than 300%;
- (d) convert at least 50% of its convertible bonds into common stock by the end of March of 2004, or increase its shareholders equity by at least NT\$3 billion (compared with the balance as of April 30, 2002).

In case of failure to comply with the above, the banks may take certain actions.

According to the loan agreement with Chiao Tung Bank, the Company is subject to the following:

- (a) maintain a current ratio of no less than 100% from 2003 to 2007;
 - (b) maintain a debt ratio of no more than 125% from 2003 to 2007;
 - (c) raise funds of at least NT\$2 billion by issuing new shares by the end of year 2003;
 - (d) convert at least 50% of its convertible bonds into common stock by the end of year 2004. In the situation where the Company breaches any of the above, the Company will be subject to an additional compensation due monthly at an annual rate of 1% of the unpaid loan. In addition, the bank may also terminate the agreement and call the loan.
- (5) The Company and its chairman have both been named as a defendant in a civil lawsuit filed by several parties including Hwa Tsai Co., Ltd. (“Hwa Tsai”, “the plaintiffs”). The plaintiffs claimed the Company and its chairman had violated Rule 20, Rule 21 and Rule 32 of the R.O.C. Securities Exchange Law, Rule 184 of the R.O.C. Civil Law, and Rule 23 of the R.O.C. Company Law and sought damage reimbursement of NT\$62,213 plus interest. The district court has requested the plaintiffs to recalculate the damage amount since the plaintiffs have sold out the underlying securities and, accordingly, the damage could be reasonably assessed. After recalculation, the plaintiffs reduced the damage claim to NT\$46,974 plus interest. The court has not yet made the final decision. The management anticipates no significant loss to incur due to this case.

Also, the Company and its chairman were involved in a criminal case for a claimed violation of Rule 339 of the R.O.C. Criminal Law, and Rule 171 and Rule 174 of the R.O.C. Securities Exchange Law. Although the Hsinchu District Court had decided that either the Company or its chairman should not be indicted, the plaintiffs (Hwa Tsai and several other parties) were not satisfied with this determination and filed an appeal with the Taiwan High Court for re-investigation; therefore, the higher court considered that the application was well-grounded and ordered the prosecution of the original court to continue it. As of July 14, 2003, the final result of the district court prosecution has not yet been decided.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

8. SIGNIFICANT DISASTER LOSSES

None.

9. SIGNIFICANT SUBSEQUENT EVENT (UNAUDITED)

Permitted by the Ministry of the Economic Affairs in July 2003, the Company invested in King Long Technology (Suzhou) Limited in the amount of US\$5,000 in August 2003.

10. OTHER DISCLOSURES

1. Financial Instruments

Derivative Financial Instruments:

a. Contract Amount or Nominal Amount and Credit Risk:

Financial Instrument	As of June 30,					
	2002		2003			
	Contract amount or Nominal amount	Credit Risk	Contract amount or Nominal amount	Credit Risk	Contract amount or Nominal amount	Credit Risk
	NT\$	NT\$	NT\$	NT\$	US\$	US\$
Forward currency exchange contract-nontrading (Note)	—	—	—	—	—	—

(Note): Forward currency exchange contracts were all closed as of June 30, 2002 and 2003.

Credit risk amount represents contracts with a positive fair value factoring in the offsetting effect of the master netting arrangement as of balance sheet date. If the credit risk amount is positive and the transaction party breaches the contract, the Company will incur a loss. The possibility of incurring a loss is remote since the Company's counter parties are reputable financial institutions.

b. Market Value Risk

Market value risk is insignificant due to the fact that the purpose of the forward exchange contracts is hedging and therefore any gain or loss from the fluctuation in interest or exchange rates will be offset by the gain or loss from the exchanges hedged.

c. Liquidity Risk, cash flow risk and the amount, duration and uncertainty related to future demand on cash flows

There is no significant liquidity risk regarding the derivative financial instrument that the Company has entered into since cash flows from operating activities will satisfy the cash demand in settling the derivative financial instrument contracts. Also, no significant additional cash flows are demanded since the settlement rate is fixed.

d. The Company's derivative financial instruments are entered into mainly for hedging purposes. The purpose of holding forward exchange contracts was to hedge exchange rate fluctuation risks resulting from assets, liabilities or commitments denominated in foreign

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

currencies. The Company's hedging strategy is to mitigate its market price risk. Derivative financial instruments selected for hedging purposes are reviewed and anticorrelated with the fluctuation of the fair value of derivatives hedged. Derivatives are evaluated periodically.

e. Derivative financial instruments

Forward exchange contracts receivable and payable are reported under current assets or liabilities on a net basis. The balance amounted to nil for both years.

Foreign exchange gains earned for the six-month periods ended June 30, 2002 and 2003 amounted to NT\$3,810 and NT\$273 (US\$8), respectively, which were included in non-operating income.

Fair value of financial instruments:

Non-derivative Instruments	As of June 30,					
	2002		2003			
	Book Value	Fair Value	Book Value	Fair Value	Book Value	Fair Value
	NT\$		NT\$		US\$	
Assets						
Cash and cash equivalents . . .	1,639,605	1,639,605	1,008,979	1,008,979	29,869	29,869
Restricted deposits (Including current and non-current portion)	165,000	165,000	7,000	7,000	207	207
Short-term investments	287,180	287,768	—	—	—	—
Receivables (Including receivables from related parties)	1,244,842	1,244,842	1,387,417	1,387,417	41,071	41,071
Other receivables	19,439	19,439	297,588	297,588	8,809	8,809
Long-term equity investments .	4,619	4,619	272,723	272,723	8,074	8,074
Long-term bonds investments .	—	—	17,305	(Remark)	512	(Remark)
Deposits out	31,271	31,271	4,874	4,874	144	144
Liabilities						
Short-term loans	378,923	378,923	230,175	230,175	6,814	6,814
Short-term notes	199,978	199,978	—	—	—	—
Payables (Including payables to related parties and payables to equipment suppliers)	387,127	387,127	534,077	534,077	15,810	15,810
Accrued expenses	365,020	365,020	298,288	298,288	8,830	8,830
Long-term loans (Including current portion) . . .	5,442,156	5,442,156	4,483,448	4,483,448	132,725	132,725
Lease obligations and installment accounts payable (Including current portion) . .	101,876	101,793	—	—	—	—
Convertible bonds (Including current portion) . .	3,798,031	(Remark)	2,857,700	(Remark)	84,597	(Remark)
Deposits in	—	—	74,824	74,824	2,215	2,215

Remark: As of June 30, 2003, no publicly assessable value of Company's long-term bonds investments and convertible bonds was available.

Derivative Instruments						
Forward currency exchange contract	—	—	—	—	—	—

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS — (Continued)
(Amounts in thousands except otherwise stated)

Methods and assumptions used to measure fair values of financial instruments are as follow:

- a. The fair values of the Company's short-term financial instruments are based on the book value of those instruments at reporting date due to the short maturity of those instruments. The method applies to cash and cash equivalents, receivables, other receivables, short-term loans, short-term notes, payables and accrued expenses.
- b. The fair values of the Company's deposits in, restricted deposits and deposits out are based on the book value of those instruments at reporting date as the amounts expected to be received or paid are close to the book values.
- c. The fair values of the Company's short-term investments and long-term investments are based on market prices at reporting date if market prices are available. The fair value of the Company's long-term investment is based on financial or any other information if market prices are not available.
- d. The fair value of the Company's long-term loans bearing variable interest rates, which includes the current portion of long-term loans, is estimated using the book value of the loans at the reporting date.
- e. The fair values of lease obligations and installment accounts payable are estimated using discounted cash flow analysis based on the Company's borrowing rates for similar types of borrowings.
- f. The fair value of derivative financial instruments (normally includes unrealized gains or losses from outstanding forward exchange contracts) is assumed to be the amount that the Company is entitled to receive or obligated to pay if the Company terminates the contracts.

2. Others

- (1) Employees' stock options (Expressed in NT Dollars)

Issue Date	Total Units	Total Units Outstanding	Exercisable Shares	Exercisable Date	Exercise Price	Executor Method	Market price of Common Stock (During the period from January 1, 2003 to June 30, 2003)	
							Highest Price	Lowest Price
August 5, 2002 . . .	30,000	30,000	30,000,000	August 5, 2004	\$14.70 (Remark)	Issue common stock	\$19.30	\$12.15
May 29, 2003	20,000	20,000	20,000,000	May 29, 2005	\$13.05	Issue common stock	\$19.30	\$12.15

Remark: On February 18, 2003, the board of directors resolved to adjust the exercise price of stock options down to NT\$14.70 per share from NT\$14.90 per share due to change in the number of outstanding common shares as provided in the stock option plan.

- (2) Certain accounts of the financial statements as of June 30, 2002 have been reclassified to be in conformity with current period's presentation.

INDEPENDENT AUDITORS' REVIEW REPORT

The Board of Directors and Shareholders of
King Yuan Electronics Co., Ltd.

We have reviewed the balance sheets of King Yuan Electronics Co., Ltd. as of September 30, 2002 and 2003, and the related statements of operations, and cash flows for the nine-month periods ended September 30, 2002 and 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express a review opinion on these financial statements based on our review.

Except as discussed in the following paragraph, we conducted our review in accordance with R.O.C. Statement of Generally Accepted Auditing Standards No. 36, "The Review Standards of Financial Statements." A review consists principally of inquiries, comparison and analytical procedures. A review is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

As described in Note 4(6), the financial statements of KYEC Investment International Co., Ltd., the investment which is reflected in the accompanying financial statements using the equity method of accounting, were not reviewed. The investment in KYEC Investment International Co., Ltd. reflects NT\$228,080 thousand (1.21% of the total assets) as of September 30, 2003, and its net loss represents loss of NT\$37,692 thousand (18.06% of the pre-tax income) for the nine-month period ended September 30, 2003.

Based on our reviews, except for such modifications on the investment amounts that might have resulted had the financial statements of KYEC Investment International Co., Ltd. been reviewed, we are not aware of any modification on the financial statements referred to in the first paragraph necessary for them to be in conformity with accounting principles generally accepted in the Republic of China.

Taipei, Taiwan
Republic of China
October 19, 2003
Except for Note 4(16)(D), as to which
the date is November 30, 2003

KING YUAN ELECTRONICS CO., LTD.
BALANCE SHEETS (UNAUDITED)
(Amounts in thousands)

	Notes	As of September 30,		
		2002	2003	
		NT\$	NT\$	US\$
Current assets				
Cash and cash equivalents	2,4(1)	1,413,041	1,124,850	33,299
Short-term investments (Net)	2,4(2)	179	—	—
Notes receivable (Net)	2,4(3)	46,667	115,139	3,408
Accounts receivable (Net)	2,4(3)	1,113,469	1,231,503	36,457
Receivables from related parties	4(3),5	286,020	267,368	7,915
Other financial assets	4(4)	24,166	281,679	8,339
Inventories (Net)	2,4(5)	46,433	46,010	1,362
Deferred tax assets-current (Net)	2,4(24)	91,789	313,944	9,294
Restricted deposits-current	6	25,000	—	—
Other current assets		78,663	38,718	1,146
Total current assets		<u>3,125,427</u>	<u>3,419,211</u>	<u>101,220</u>
Long-term investments	2,4(6)	<u>43,091</u>	<u>420,224</u>	<u>12,440</u>
Property, plant and equipment	2,4(7),6			
Land		869,222	869,222	25,732
Buildings and facilities		2,491,848	2,552,400	75,560
Machinery and equipment		13,722,816	15,387,985	455,535
Transportation equipment		19,040	20,600	610
Office furniture		240,968	239,163	7,080
Leased assets	2,4(14)	51,203	—	—
Miscellaneous fixtures		<u>1,248,660</u>	<u>1,236,353</u>	<u>36,600</u>
Total cost		18,643,757	20,305,723	601,117
Less: Accumulated depreciation		(5,733,764)	(8,455,618)	(250,314)
Plus: Prepayments for equipment		1,239,056	1,385,013	41,001
Construction in progress		<u>2,327</u>	<u>44,627</u>	<u>1,321</u>
Net property, plant and equipment		<u>14,151,376</u>	<u>13,279,745</u>	<u>393,125</u>
Other assets				
Leased assets to others (Net)	4(8),6	154,253	153,938	4,557
Idle assets (Net)	4(9),6	554,851	347,681	10,293
Deposits out		31,271	5,458	162
Deferred assets	2	221,784	235,362	6,967
Deferred tax (Net)	2,4(24)	944,219	979,632	29,000
Restricted	6	8,000	13,067	387
Other assets-land	4(10)	<u>11,935</u>	<u>11,935</u>	<u>353</u>
Total other assets		<u>1,926,313</u>	<u>1,747,073</u>	<u>51,719</u>
Total Assets		<u><u>19,246,207</u></u>	<u><u>18,866,253</u></u>	<u><u>558,504</u></u>

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

KING YUAN ELECTRONICS CO., LTD.
BALANCE SHEETS (UNAUDITED) — (Continued)
(Amounts in thousands)

	Notes	As of September 30,		
		2002	2003	
		NT\$	NT\$	US\$
Current liabilities				
Short-term loans	4(11)	643,455	531,459	15,733
Short-term notes	4(12)	99,984	—	—
Current portion of convertible bonds	2,4(16),10	—	240,470	7,119
Current portion of long-term loans	4(13)	1,594,808	1,630,940	48,281
Current portion of lease obligations	2,4(14)	33,925	—	—
Installment accounts payable	4(15)	36,554	—	—
Notes payable		272,749	226,364	6,701
Accounts payable		24,683	41,718	1,235
Payables to related parties	5	14,845	26,151	774
Payables to equipment suppliers		296,416	309,099	9,150
Accrued expenses and other current liabilities . .		299,166	331,756	9,821
Total current liabilities		<u>3,316,585</u>	<u>3,337,957</u>	<u>98,814</u>
Long-term Liabilities				
Convertible bonds	2,4(16),10	3,878,126	2,133,721	63,165
Long-term loans, less current portion	4(13)	<u>3,761,437</u>	<u>2,730,497</u>	<u>80,832</u>
Total long-term liabilities		<u>7,639,563</u>	<u>4,864,218</u>	<u>143,997</u>
Other Liabilities				
Accrued pension liabilities	2,4(17)	24,972	28,880	855
Deposits in		—	108,170	3,202
Total other liabilities		<u>24,972</u>	<u>137,050</u>	<u>4,057</u>
Total Liabilities		<u>10,981,120</u>	<u>8,339,225</u>	<u>246,868</u>
Shareholders' Equity				
Capital				
Common stock	4(18)	4,525,912	5,793,034	171,493
Capital reserve	4(20)			
Paid-in capital in excess of par-common stock		4,013,703	4,127,047	122,174
Conversion of convertible bonds		226,724	448,887	13,289
Retained earnings				
Legal reserve	4(21)	—	—	—
Unappropriated earnings (accumulated deficits)	4(22)	(410,818)	392,958	11,633
Cumulative translation adjustments	2,4(6)	595	(3,187)	(94)
Treasury stock	2,4(19)	<u>(91,029)</u>	<u>(231,711)</u>	<u>(6,859)</u>
Total Shareholders' Equity		<u>8,265,087</u>	<u>10,527,028</u>	<u>311,636</u>
Total Liabilities and Shareholders' Equity		<u>19,246,207</u>	<u>18,866,253</u>	<u>558,504</u>

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

KING YUAN ELECTRONICS CO., LTD.
STATEMENTS OF OPERATIONS (UNAUDITED)
(Amounts in thousands except per share data)

	Notes	For the nine-month period ended September 30,		
		2002	2003	
		NT\$	NT\$	US\$
Operating Revenues				
Sales revenues		3,863,081	4,798,297	142,046
Less: Sales discounts		(22,171)	(55,857)	(1,654)
Net operating revenues	2,4(25),5	3,840,910	4,742,440	140,392
Cost of goods sold	4(26)	(3,757,376)	(3,921,782)	(116,098)
Gross Profit		83,534	820,658	24,294
Operating Expenses	4(26),5			
Selling expenses		(40,226)	(49,384)	(1,462)
Administrative expenses		(289,983)	(307,280)	(9,096)
Research and development expenses		(54,643)	(58,102)	(1,720)
Total operating expenses		(384,852)	(414,766)	(12,278)
Operating Income (Loss)		(301,318)	405,892	12,016
Non-operating Income				
Interest income		7,740	4,838	143
Net gain from equity investments	2,4(6)	550	—	—
Gain on disposal of property, plant and equipment and deferred assets	2	14,230	11,128	329
Gain on disposal of investments	2	7,582	11,758	348
Foreign exchange gain	2	—	50,303	1,489
Rental income		24,941	43,337	1,283
Other income		9,926	4,959	147
Total non-operating income		64,969	126,323	3,739
Non-operating Expenses				
Interest expense	4(7)	(297,853)	(181,018)	(5,359)
Net loss from equity investments	2,4(6)	—	(39,773)	(1,177)
Loss on disposal of property, plant and equipment	2	(19,911)	(6,651)	(197)
Foreign exchange loss	2	(65,197)	—	—
Inventory loss provision	2	(5,130)	—	—
Other losses	4(8),4(9)	(88,770)	(96,049)	(2,843)
Total non-operating expenses		(476,861)	(323,491)	(9,576)
Income (Loss) Before Income Taxes		(713,210)	208,724	6,179
Income Tax Benefit	2,4(24)	302,392	184,234	5,454
Net Income (Loss)		(410,818)	392,958	11,633
Basic Earnings Per Share				
(in New Taiwan Dollars)	2,4(23)			
Net Income (Loss)		\$(0.93)	\$0.74	\$0.02
Diluted Earnings Per Share				
(in New Taiwan Dollars)				
Net Income			\$0.71	\$0.02

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

KING YUAN ELECTRONICS CO., LTD.
STATEMENTS OF CASH FLOWS (UNAUDITED)
(Amounts in thousands)

	For the nine-month period ended September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Cash flows from operating activities:			
Net income (loss)	(410,818)	392,958	11,633
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	2,226,402	2,375,036	70,309
Amortization	65,108	101,140	2,994
Bad debt expense	8,500	—	—
Deferred income taxes	(302,621)	(184,406)	(5,459)
Net (gain) loss from equity investments	(550)	39,773	1,177
Inventory loss provision	5,130	—	—
Net (gain) loss on disposal of property, plant and equipment and deferred assets.	5,681	(4,477)	(132)
Gain on disposal of investments.	(7,582)	(11,758)	(348)
Increase in notes receivable.	(626)	(25,356)	(751)
Increase in accounts receivable	(553,995)	(158,772)	(4,700)
Increase in receivables from related parties	(203,213)	(12,302)	(364)
(Increase) decrease in inventories.	5,268	(4,761)	(141)
(Increase) decrease in other financial assets.	21,468	(41,735)	(1,236)
Increase in other current assets	(44,364)	(7,741)	(229)
Increase (decrease) in notes payable	(42,469)	26,642	789
Increase in accounts payable	2,979	12,486	370
Increase in payables to related parties.	13,767	12,793	379
Increase in accrued expenses and other current liabilities . .	1,633	11,598	343
Increase in reserve for redemption of convertible bonds . . .	74,907	82,862	2,453
Exchange rate adjustment for convertible bonds and long-term bonds investment	(3,317)	(73,220)	(2,168)
Increase in accrued pension liabilities.	4,496	4,803	142
Net cash provided by operating activities.	<u>865,784</u>	<u>2,535,563</u>	<u>75,061</u>
Cash flows from investing activities:			
(Increase) decrease in restricted deposits.	(27,097)	7,433	220
Decrease in short-term investments.	10,753	10,511	311
Increase in long-term investments	(36,620)	(171,150)	(5,066)
Acquisition of property, plant and equipment.	(1,633,163)	(2,367,532)	(70,087)
Proceeds from disposal of long-term investments	—	18,446	546
Proceeds from disposal of property, plant and equipment . .	74,207	421,922	12,490
Penalty on cancellation of equipment purchase.	(102,092)	—	—
Increase in deferred assets.	(150,469)	(49,041)	(1,452)
(Increase) decrease in deposits out	(26,666)	25,816	764
Net cash used in investing activities	<u>(1,891,147)</u>	<u>(2,103,595)</u>	<u>(62,274)</u>

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

KING YUAN ELECTRONICS CO., LTD.
STATEMENTS OF CASH FLOWS (UNAUDITED) — (Continued)
(Amounts in thousands)

	For the nine-month period ended September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Cash flows from financing activities:			
Decrease in short-term loans	(859,117)	(105,394)	(3,120)
Decrease in payables to related parties	(50,000)	—	—
Increase in short-term notes	159	—	—
Decrease in long-term loans	(402,919)	(337,465)	(9,990)
Decrease in lease obligations	(446,512)	(27,528)	(815)
Increase (decrease) in installment accounts payable	36,554	(10,881)	(322)
Increase in convertible bonds	4,191,600	—	—
Decrease in deposits in	—	(59,830)	(1,771)
Common stock repurchased	(91,029)	(140,693)	(4,165)
Stock issuance for cash	—	272,468	8,066
Net cash provided by (used in) financing activities	<u>2,378,736</u>	<u>(409,323)</u>	<u>(12,117)</u>
Net increase in cash and cash equivalents	1,353,373	22,645	670
Cash and cash equivalents at the beginning of period	<u>59,668</u>	<u>1,102,205</u>	<u>32,629</u>
Cash and cash equivalents at the end of period	<u>1,413,041</u>	<u>1,124,850</u>	<u>33,299</u>
Supplemental disclosures of cash flows information:			
Interest paid during the period (excluding capitalized interest)	<u>227,420</u>	<u>100,892</u>	<u>2,987</u>
Income tax paid during the period	<u>229</u>	<u>172</u>	<u>5</u>
Investing activities partially paid by cash			
Acquisition of property, plant and equipment	1,546,430	2,394,114	70,874
(Increase) decrease in payables to equipment suppliers	688,161	(26,582)	(787)
Purchases cancelled	<u>(601,428)</u>	<u>—</u>	<u>—</u>
Cash paid for purchase of property, plant and equipment	<u>1,633,163</u>	<u>2,367,532</u>	<u>70,087</u>
Investing and Financing activities not affecting cash flows			
Cumulative translation adjustments	<u>(2)</u>	<u>(4,248)</u>	<u>(126)</u>
Current portion of long-term loans and lease obligations	<u>1,628,733</u>	<u>1,630,940</u>	<u>48,281</u>
Current portion of convertible bonds	<u>—</u>	<u>240,470</u>	<u>7,119</u>
Conversion of convertible bonds	<u>385,914</u>	<u>442,191</u>	<u>13,090</u>
Investing and Financing activities partially affecting cash flows			
Receivables from disposal of property, plant and equipment, and deferred assets	<u>—</u>	<u>190,088</u>	<u>5,627</u>

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

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED)
(Amounts in thousands except otherwise stated)

1. HISTORY

KING YUAN ELECTRONICS CO., LTD. (the “Company”) was incorporated under the Company Law of the Republic of China in July 1987. The Company’s major business activities are testing and assembly service, and manufacture and selling IC Monitoring Burn-In machinery. The shares of the Company commenced trading on the Taiwan Stock Exchange in May 2001.

As of September 30, 2002 and 2003, the Company’s employees totaled 3,023 and 2,723, respectively.

2. SUMMARY OF ACCOUNTING POLICIES

Cash Equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash, and so near their maturity that they present insignificant risk of changes in interest rates. Commercial paper, negotiable certificates of deposit, and bank acceptances with original maturities of three months or less at the investment date are considered to be cash equivalents.

Foreign Currency Transactions and Translation of Foreign Currency Statements

The Company maintains its accounting records in New Taiwan dollars (“NT Dollars” or “NT\$”). Transactions denominated in foreign currencies are recorded in NT Dollars using the exchange rates in effect at the dates of transactions. Assets and liabilities denominated in foreign currencies are translated into NT Dollars using the exchange rates in effect at the balance sheet date. Foreign exchange gains or losses are included in other income or expense.

Long-term foreign investments accounted for under the cost method are translated into NT Dollars using the prevailing exchange rates at acquisition date or balance sheet date, whichever is lower. Any difference is charged to the cumulative translation adjustments account.

For long-term foreign investments accounted for under the equity method, their financial statements are first translated into NT Dollars. The Company then recognizes the investment gain or loss and translation adjustment based on the translated financial statements. For the translation, the current rate at the balance sheet date is used for asset and liability accounts. The weighted average rate for the reporting period is used for the income statement accounts. Translation adjustments are included as a component of shareholders’ equity.

Short-term Investments

Short-term Investments are recorded at cost when acquired and are stated at the lower of aggregate cost or market value at the balance sheet date. The market value of listed equity securities or closed-ended funds is determined by the average closing price during the last month of the fiscal period. The market value for open-ended funds is determined by their equity value as reported at the balance sheet date. No revenue is recognized when stock dividends are received. Instead, the number of shares increases and the cost per share is recalculated. Disposal gain or loss of short-term investments is calculated based on the weighted average method.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is provided based on the collectibility and aging analysis of notes and accounts receivable and other receivables.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

Inventories

Inventories are recorded at cost when acquired and stated at the lower of aggregate cost, based on weighted average method, or market value at the balance sheet date. The market value of raw materials and supplies is determined on the basis of replacement cost while work in process and finished goods on net realizable value. The allowance for loss on decline in market value and obsolescence is provided, when necessary.

Long-term Investments

- (1) Long-term investments in which the Company holds an interest less than 20% are stated at the lower of cost or market value, with unrealized losses recorded as a separate component of shareholders' equity. There is no recognition of unrealized gains.
- (2) Long-term investments in which the Company holds an interest of 20% or more are accounted for under the equity method. The difference between the cost of the investment and the underlying equity in the investee's net assets at the date of acquisition is amortized over five years. Adjustment to capital reserve is required when the holding percentage changes due to unproportional subscription to investee's new shares. If the capital reserve is insufficient, retained earnings is adjusted.
- (3) Unrealized inter-company gains and losses are eliminated under the equity method. Profit from sales of depreciable assets between the investee and the Company is amortized and recognized based on the assets' economic service lives. Profit from other types of inter-company transactions is recognized when realized.
- (4) If the Company's share of an investee company's losses equals to or exceeds the carrying amount of an investment accounted for under the equity method, the recognized investment losses shall be limited to the extent that makes the book value of a long-term investment equal to zero. However, if the Company intends to provide further financial support for the investee company, or the investee company's losses are temporary and there exists sufficient evidence showing imminent return to profitable operations, then the Company shall continue to recognize investment losses in proportion to the stock ownership percentage. Such credit long-term investment balance shall first offset the advance (if any) the Company made to the investee company, the remaining shall be recorded under other liabilities.
- (5) According to R.O.C. Statement of Financial Accounting Standards No. 23, "Interim Financial Reporting Disclosures," the Company recognizes quarterly income and loss on investees in which the Company owns more than 20%.
- (6) Long-term bond investments are recorded at cost as acquired. Premiums or discounts are amortized over the bond life.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

Property, Plant and Equipment

- (1) Property, plant and equipment are stated at cost. Depreciation is provided on the straight-line basis over the following useful lives:

Buildings and facilities	3 to 30 years
Machinery and equipment	3 to 10 years
Transportation equipment	5 years
Office furniture	3 to 10 years
Leased assets	4 to 5 years
Miscellaneous fixtures	2 to 10 years

- (2) Improvements and replacements are capitalized and depreciated over their estimated useful lives while ordinary repairs and maintenance are expensed as incurred. Gain or loss on disposal of property, plant and equipment is recorded under non-operating income or expenses. When property, plant and equipment are disposed of, their original cost and accumulated depreciation are written off and related gain, net of income tax, is transferred to capital reserve in the current year. Gain on disposal of property, plant and equipment shall not be transferred to capital reserve starting in 2001 in accordance with an amendment to R.O.C. Regulation on Business Entity Accounting Handling. Equipment not held for operating purposes is transferred to the account of idle assets based on the lower of net realizable value or book value. Equipments for lease are transferred to the account of leased assets to others based on book value. Depreciation derived from idle assets and leased assets to others is recorded under non-operating expenses.

Lease agreement

Provided a lease agreement meets the capitalization criteria, the present value of the minimum lease payments net of executory costs is capitalized as an asset along with a corresponding liability.

Deferred Assets

Deferred assets are originally recorded at cost and amortized over their estimated useful lives, usually 1 to 5 years, using the straight-line method.

Revenue Recognition

Revenue is recognized according to R.O.C. Statement of Financial Accounting Standards No. 32, "Accounting for Revenue Recognition." Revenue can be recognized when all of the following are met:

- (i) It is realized or realizable.
- (ii) It is earned.
- (iii) The collectibility can be fairly assessed. Sales allowance are accrued in the year that related sales occur.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

Capital Expenditures vs. Revenue Expenses

If expenditures increase the future service potential of plant assets, the expenditures are capitalized, while the others are expensed as incurred.

Income Tax

Provision for income tax includes deferred tax resulting from temporary differences and investment tax credits. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements using enacted tax rates and laws that will be in effect when the difference is expected to reverse. A valuation allowance on deferred tax assets is provided to the extent that it is more likely than not that the tax benefits will not be realized.

Undistributed earnings generated after 1997 are subject to a 10% tax in compliance with R.O.C. income tax law. The 10% tax on undistributed earnings is recorded as an expense at the time shareholders resolve that its earnings shall be retained.

Income tax credits resulting from the acquisition of equipment, research and development expenditures, employee training and investment in equity stock shall be recognized in the year that such acquisition, expenditures, training and investment occur.

Convertible Bonds

- (1) The interest-premium of puttable convertible bonds, which is the difference between the specified put price and the par value, should be amortized using the interest method and be recognized as a liability over the period from the issuance date of the bonds to the expiry date of the put option. If the bondholder does not exercise the put option, the interest-premium, which has been recognized as a liability, should be amortized over the period from the expiry date to the maturity date using the interest method. However, if at the expiry date the market value of the common stock under conversion exceeds the put price, the interest-premium should be credited to additional paid-in capital.
- (2) The cost of issuing convertible bonds should be recorded as deferred assets and amortized using the straight-line method over the period from the issuance date of the convertible bonds and the expiry date of the put option.
- (3) When bondholders exercise their conversion rights, the book value of convertible bonds is credited to common stock at an amount equal to the par value of the common stock and the excess is credited to capital reserve; no gain or loss is recognized on bond conversion.

Pension Plan

The Company has a funded defined benefit pension plan covering all regular employees. The net pension cost is computed based on an actuarial valuation in accordance with the provision of R.O.C. Statement of Financial Accounting Standards No. 18, which requires consideration of pension cost components such as service cost, interest cost, expected return on plan assets and amortization of net obligation at transition. The unrecognized net obligation at transition is amortized on the straight-line basis over the employees average remaining service period provided, however, if the average remaining service period is shorter than 15 years, the unrecognized net obligation at transition may be amortized over 15 years. The pension fund is managed by an independent pension fund committee.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

Earnings Per Share

In accordance with R.O.C. Statement of Financial Accounting Standards No. 24, “Earnings per Share,” the Company presents basic earnings per share if a simple capital structure exists; or both basic earnings per share and diluted earnings per share if a complex capital structure exists. Basic earnings per share is equal to the net income (loss) attributable to common stock divided by the weighted-average number of common shares. When calculating diluted earnings per share, the numerator should include or add back potential common stock dividends, interest and other conversion revenues (expenses). The denominator should include all dilutive potential common shares.

Derivative Financial Instruments

Forward currency exchange contract:

A Forward currency exchange contract obligates the Company to exchange predetermined amounts of specified foreign currencies at specified exchange rates for another currency on a specified date. The Company’s forward contracts are designated as hedges; discounts or premiums, being the difference between the spot exchange rate and the forward exchange rate at the inception of the contract, are accreted or amortized to the statement of operations over the contract lives using the straight-line method. Realized gains and losses from settlement or unrealized gains and losses resulting from changes in the spot exchange rate at the balance sheet date are recorded in the statement of operations as foreign exchange gains or losses in the period in which they relate. The related amounts due to or from counter-parties are included in other current assets or other current liabilities.

Treasury Stock

In accordance with the R.O.C. Statement of Financial Accounting Standards No. 30, “Accounting for Treasury Stock,” treasury stock is accounted for under the cost method. Under the cost method, the gross cost of shares reacquired is charged to treasury stock, which is presented as a contra equity account in the financial statements. Any excesses or deficiencies on treasury stock transactions are credited or charged to capital reserves.

Convenience Translation into US Dollars

The Company prepares its financial statements in NT Dollars, its reporting currency. The United States (“US”) dollar amounts disclosed in the financial statements as of and for the nine-month period ended September 30, 2003, are presented solely for the convenience of the reader and were translated at the rate of NT\$33.78 to US\$1.00 (on the basis of the noon buying rate in the City of New York for cable transfer in NT dollars per US dollar as certified for customer’s purpose by the Federal Reserve Bank of New York on September 30, 2003). Such translation amounts are unreviewed and it should not be construed that the NT dollar amounts represent, or have been, or could be, converted into US dollars at that or any other rate.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

3. REASONS AND EFFECT OF A CHANGE IN ACCOUNTING POLICY

None.

4. CONTENTS OF SIGNIFICANT ACCOUNTS

(1) Cash and Cash Equivalents

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Cash on hand	340	324	9
Checking and savings accounts	456,324	856,822	25,365
Time deposits	931,570	—	—
Cash equivalents	24,807	267,704	7,925
Total	<u>1,413,041</u>	<u>1,124,850</u>	<u>33,299</u>

The Company has contracted to sell cash equivalents totaling NT\$267,704 (US\$7,925) back to two financing companies in October 2003 at an aggregate price of US\$7,944.

(2) Short-term Investments

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Mutual funds and listed equity securities	179	—	—
Less: Allowance for market value decline.	—	—	—
Net	<u>179</u>	<u>—</u>	<u>—</u>
Market value	<u>181</u>	<u>—</u>	<u>—</u>

Short-term investments were not pledged.

(3) Notes Receivable, Accounts Receivable and Receivables from Related Parties

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Notes receivable	46,667	115,139	3,408
Less: Allowance for doubtful accounts.	—	—	—
Net	<u>46,667</u>	<u>115,139</u>	<u>3,408</u>

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Accounts receivable.	1,149,024	1,259,829	37,296
Less: Allowance for doubtful accounts	(20,700)	(20,700)	(613)
Allowance for sales discounts.	(14,855)	(7,626)	(226)
Net	<u>1,113,469</u>	<u>1,231,503</u>	<u>36,457</u>

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

	As of September 30,		
	2002		2003
	NT\$	NT\$	US\$
Receivables from Related Parties			
Notes Receivable	2,398	1,797	53
Accounts receivable	283,622	265,571	7,862
Total	286,020	267,368	7,915
Less: Allowance for doubtful accounts	—	—	—
Net	<u>286,020</u>	<u>267,368</u>	<u>7,915</u>

(4) Other Financial Assets

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Other receivables	21,750	279,589	8,277
Income tax refund receivable	1,596	1,849	55
Interest revenue receivable	820	241	7
Net	<u>24,166</u>	<u>281,679</u>	<u>8,339</u>

(5) Inventories

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Raw materials and supplies	44,691	45,487	1,346
Work in process	9,613	10,394	308
Finished goods	934	934	28
Total	55,238	56,815	1,682
Less: Allowance for loss on decline in market value and obsolescence	<u>(8,805)</u>	<u>(10,805)</u>	<u>(320)</u>
Net	<u>46,433</u>	<u>46,010</u>	<u>1,362</u>

The insurance coverage over the above inventories and consigned-in items amounted to NT\$286,000 and NT\$200,000 (US\$5,921) as of September 30, 2002 and 2003, respectively.

Inventories were not pledged.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

(6) Long-term Investments

Investee Company	Ownership	As of September 30,		
		2002	2003	
		NT\$	NT\$	US\$
Long-term equity investments				
Equity method:				
KYEC USA Corp.	100%	5,621	4,144	123
KYEC Investment International Co., Ltd.	100%	—	228,080	6,752
Total		<u>5,621</u>	<u>232,224</u>	<u>6,875</u>
Cost method:				
Parawin Venture Capital Corp..	2%	20,000	20,000	592
APTOS (Taiwan) Corporation	8.48%	—	168,000	4,973
Total		<u>20,000</u>	<u>188,000</u>	<u>5,565</u>
Long-term bond investments (stated at LCM)				
Convertible bonds-SINBON Electronics Co., Ltd.	—	17,470	—	—
Total		<u>43,091</u>	<u>420,224</u>	<u>12,440</u>

For the nine-month periods ended September 30, 2002 and 2003, the Company recognized gains (losses) on the long-term investment of KYEC USA Corp. amounting to NT\$550 and NT\$(2,081) (US\$(61)), respectively. The recognition, in accordance with R.O.C.'s financial reporting regulations, was based on the investee's unreviewed financial statements.

For the nine-month period ended September 30, 2003, the Company recognized a loss on the long-term equity investment of KYEC Investment International Co., Ltd. amounting to NT\$37,692 (US\$1,116). The recognition was based on the investee's unreviewed financial statements.

Cumulative translation adjustments decreased by NT\$2 and NT\$4,248 (US\$126) for the nine-month periods ended September 30, 2002 and 2003, respectively.

The Company was authorized by Ministry of Economic Affairs to indirectly invest in King Long Technology (Suzhou) Limited via KYEC Investment International Co., Ltd. and KYEC Microelectronics Co., Ltd. (a subsidiary of KYEC Investment International Co., Ltd.) to a maximum amount of US\$7,900. As of September 30, 2003, the investment funds of US\$7,900 were wired.

Long-term investments were not pledged.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

(7) Property, Plant and Equipment

The Company's interest (including capitalized interest) amounted to NT\$314,214 and NT\$203,890 (US\$6,036) for the nine-month periods ended September 30, 2002 and 2003, respectively. Total capitalized interest and the interest rates used were as follows:

Items	For the nine-month period ended September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Capitalized interest	<u>16,361</u>	<u>22,872</u>	<u>677</u>
Interest rate used	<u>6.48%</u>	<u>3.48%</u>	<u>3.48%</u>

The insurance coverage over property, plant and equipment amounted to NT\$9,193,174 and NT\$11,077,159 (US\$327,921) as of September 30, 2002 and 2003, respectively.

Please refer to Note 6 for property, plant and equipment pledged as collateral.

(8) Leased Assets To Others

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Machinery and equipment	161,999	195,419	5,785
Less: Accumulated depreciation	<u>(7,746)</u>	<u>(41,481)</u>	<u>(1,228)</u>
Net	<u>154,253</u>	<u>153,938</u>	<u>4,557</u>

The depreciation of leased assets to others, recorded in non-operating expenses, amounted to NT\$5,446 and NT\$21,553 (US\$638) for the nine-month periods ended September 30, 2002 and 2003.

(9) Idle Assets

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Cost:			
Land	54,844	54,844	1,624
Buildings and facilities	290,007	242,003	7,164
Machinery and equipment	465,601	333,155	9,862
Miscellaneous fixtures	<u>2,950</u>	<u>12,529</u>	<u>371</u>
Total	813,402	642,531	19,021
Less: Accumulated depreciation	<u>(258,551)</u>	<u>(294,850)</u>	<u>(8,728)</u>
Net	<u>554,851</u>	<u>347,681</u>	<u>10,293</u>

The depreciation of idle assets, included in non-operating expenses, amounted to NT\$73,829 and NT\$57,377 (US\$1,699) for the nine-month periods ended September 30, 2002 and 2003.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

(10) Other Assets — Land

The Company purchased several pieces of agricultural land that was located in Miao Li County in 2000. However, due to a limitation in trading, the Company currently is not able to own the title of the land. Instead, the Company registered the land under the name of C.K. Lee, the chairman of the Company. The Company has entered into a trustee agreement with C.K. Lee to secure the Company's ownership over the land. The land was recorded under other assets. The book value of the land amounted to NT\$11,935 (US\$353) as of September 30, 2002 and 2003.

(11) Short-term Loans

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Letter of credit	643,455	531,459	15,733
Interest rates.	0.6237%~4%	0.5992%~2.04%	0.5992%~2.04%

The Company's unused short-term lines of credit amounted to NT\$1,066,065 and NT\$1,321,041 (US\$39,107) as of September 30, 2002 and 2003, respectively.

Please refer to Note 6 for assets pledged for short-term loans.

(12) Short-term Notes

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Short-term notes	100,000	—	—
Less: Unamortized discount	(16)	—	—
Net	99,984	—	—
Interest rates.	2.25%	—	—

There was no asset pledged for short-term notes.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

(13) Long-term Loans

Creditors	As of September 30,				
	Interest rate		Balance		
	2002	2003	2002	2003	
	%	%	NT\$	NT\$	US\$
Medium-term loan from Chiao Tung Bank Repayable in 21 quarterly installments from January 2001 to January 2006 with interest due monthly	6.340	3.550	222,300	171,000	5,062
Medium-term loan from Chiao Tung Bank Repayable in 21 quarterly installments from October 2002 to October 2007 with interest due monthly	6.340	3.550	381,000	324,000	9,591
Medium-term loan from Chiao Tung Bank Repayable in 13 quarterly installments from March 2005 to March 2008 with interest due monthly	—	3.550	—	400,000	11,841
Medium-term loans from 5 banks Repayable in 13 quarterly installments from September 2001 to September 2004 (<i>Remark 1</i>) with interest due monthly .	3.580	2.855	612,320	306,176	9,064
Medium-term loans from 17 banks Repayable in 7 semi-annual installments from November 2002 to November 2005 with interest due monthly	3.255	2.530	4,000,000	2,857,136	84,581
Medium-term loan from Hsinchu International Bank Repayable in 16 quarterly installments from September 2002 to June 2006 with interest due monthly	5.725	3.400	140,625	103,125	3,053
Medium-term loans from 7 banks Repayable in 7 semi-annual installments from October 2004 to October 2007 with interest due monthly (<i>Remark 2</i>)	—	3.383	—	200,000	5,921
Total long-term loans.			5,356,245	4,361,437	129,113
Less: Current portion			(1,594,808)	(1,630,940)	(48,281)
Net			<u>3,761,437</u>	<u>2,730,497</u>	<u>80,832</u>

Remark 1: In accordance with an amendment to the original loan agreement, four installments totaling NT\$306,144 (US\$9,063) originally due on December 20, 2001, March 20, 2002, June 20, 2002 and September 20, 2002 have been extended to November 15, 2002. However, if the Company raises any funds from a public market, the Company shall repay no less than 50% of the funds within ten days from the completion of the funds raise.

Remark 2: Total line of credit was NT\$1,330,000 (US\$39,372) which hasn't been fully utilized.

Please refer to Note 6 for assets pledged for long-term loans.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

(14) Lease Obligations

The Company entered into a lease agreement for equipment with a lease company. The lease terms are from January 30, 2002 to January 30, 2003. The agreement requires that the Company shall not remodel the equipment without permission from the lessor or sublease the equipment to third parties. The lease provides for a bargain purchase option equal to NT\$25,386 (US\$752) at the end of the lease terms. Book value of the leased equipment amounted to NT\$50,772 and NIL as of September 30, 2002 and 2003, respectively.

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Lease obligations	34,206	—	—
Less: Discount	(281)	—	—
Net	33,925	—	—
Less: Current portion	(33,925)	—	—
Lease obligations — long-term	<u>—</u>	<u>—</u>	<u>—</u>

Please refer to Note 6 for assets pledged for lease obligations.

(15) Installment Accounts Payable

The Company entered into an equipment purchase agreement with a supplier at the price of NT\$158,401 in February 2002. The purchase price is payable in 12 monthly installments from the commencement of such purchase.

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Installment accounts payable.	37,364	—	—
Less: Discount	(810)	—	—
Net	<u>36,554</u>	<u>—</u>	<u>—</u>

Please refer to Note 6 for assets pledged for installment accounts payable.

(16) Convertible Bonds

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Unsecured convertible bonds.	3,803,219	2,232,563	66,091
Add: Reserve for redemption	74,907	141,628	4,193
Total	3,878,126	2,374,191	70,284
Less: Current portion	—	(240,470)	(7,119)
Net	<u>3,878,126</u>	<u>2,133,721</u>	<u>63,165</u>

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On April 18, 2002, the Company issued 3-year unsecured convertible bonds. The major terms of the issue are as follows:

- a. Total amount was US\$120,000.
- b. Coupon interest rate: 0%; redeemable 110.87% of par value at maturity date.
- c. Type of debentures: Unsecured convertible bonds.
- d. Redemption at maturity/Redemption at the option of the Company

(a) *Redemption at maturity*

Unless previously redeemed, converted or purchased and canceled, the Company will redeem each bond at its redemption amount at the maturity date.

(b) *Redemption at the option of the Company*

On or at any time after April 18, 2003, the Company may, having given not less than 40 nor more than 60 days' notice to the bondholders, redeem all or part of the bonds at their principal amount if (i) the closing price of the Company's shares translated into U.S. dollars at the prevailing exchange rate for each of the 30 consecutive trading days is at least 150% of the conversion price then in effect, translated into U.S. dollars at the fixed exchange rate of NT\$34.979 = US\$1.00; (ii) the bonds outstanding are less than 10% of the issue amount.

- e. Redemption at the option of the holders bond:

The bonds are redeemable at 107.12% of par at the option of the bondholders, in whole or in part, beginning two years after the issue date.

- f. Conversion period/Conversion price and adjustment

- (a) Subject to certain exceptions, conversion may be made at any time after one month following the initial issuance of the bonds up to March 18, 2005.
- (b) The conversion price was NT\$24.50 per share at the issue date, translated into U.S. dollars at the fixed exchange rate of NT\$34.979 = US\$1.00.
- (c) Adjustments to conversion price: The conversion price will be subject to adjustment in the manner set forth in the Indenture upon the occurrence of certain events set out in the Indenture, including, among other things, the making of a free distribution or bonus issue of shares, subdivision of shares, merger, and issue of shares in cash.

On February 18, 2003, the Company adjusted the conversion price to NT\$23.97.

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(d) Conversion price reset:

Besides the adjustment stated in (c), the conversion price is subject to reset in the manner set forth in the Terms and Conditions of the bonds as discussed in the following:

(i) Conversion price reset

The conversion price shall be adjusted on April 18, 2003 (the “First Reset Date”) and April 18, 2004 (“the Second Reset Date”) (each a Reset Date), in the event that the average closing price of the share on the TSE translated into U.S. Dollars at the then prevailing rate for 30 consecutive trading days immediately prior to the Reset Date is less than the conversion price then in effect on the relevant Reset Date, in accordance with the following formula:

$$\text{Adjusted Conversion Price} = \frac{\text{Fixed Exchange Rate}}{\text{Prevailing Rate}} \times \text{Average Closing Price}$$

Any adjustment to the conversion price shall not be less than 80% of the initial conversion price prevailing on April 18, 2002 (as adjusted to reflect any adjustments required under f(c) above, which may have occurred prior to the Reset Date).

(ii) Alternative conversion price reset

The bondholders are entitled, within seven trading days after March 18, 2004 and March 18, 2005, to convert the bond at the alternative conversion price reset equal to 88% and 85%, respectively, of the then market price.

On April 18, 2003, the Company reset the conversion price to NT\$19.18.

g. Places of trading: Europe and Asia (except Taiwan); listed on the Luxembourg Stock Exchange.

- (A) As of September 30, 2003, totally US\$23,650 has been converted that resulted in increases in common stock and capital reserve by NT\$386,363 (US\$11,438) and NT\$448,887 (US\$13,289), respectively. Please refer to Note 4(18).
- (B) As of September 30, 2003, bonds repurchased by the Company amounted to US\$30,200.
- (C) On September 22, 2003, the Company’s board of directors resolved to issue the second unsecured convertible bonds that highest limit amounting to US\$100,000. The issue plan is under process.
- (D) The Company has outstanding convertible bonds in the amount of US\$66,150 (equivalent to NT\$2,374,191, including reserve for redemption) at September 30, 2003, which can be redeemed at the bondholders’ option starting from April 18, 2004. Since the debt will be due on demand within one year from April 18, 2003, the bonds are classified as current liabilities on the Company’s balance sheet since April 28, 2003. However, during the period from October 1, 2003 to November 30, 2003, there have been US\$59,450 (equivalent to NT\$2,133,721, including reserve for redemption) bonds converted into the Company’s common stock. The Company

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construed this conversion as the refinance of long-term debt in accordance with R.O.C SFAS No. 1 and, accordingly, the US\$59,450 (equivalent to NT\$2,133,721, including reserve for redemption) debt was reclassified to long-term liabilities. As a result, there is US\$6,700 (equivalent to NT\$240,470, including reserve for redemption) current portion of the convertible bonds reflected in the balance sheet as of September 30, 2003.

(17) Pension Fund

The Company's employee pension plan fund amounted to NT\$67,560 and NT\$95,051 (US\$2,814) as of September 30, 2002 and 2003, respectively. The pension cost recognized amounted to NT\$22,084 and NT\$23,251 (US\$688) for the nine-month periods ended September 30, 2002 and 2003, respectively.

(18) Common Stock

As of January 1, 2002, the Company's authorized and issued common stock amounted to NT\$7,000,000 and NT\$4,366,722 divided into 700,000,000 shares and 436,672,214 shares, respectively, each at par of NT\$10.

Following the resolution of Shareholders' Meeting on May 7, 2002, the Company increased its authorized capital to NT\$8,700,000, divided into 870,000,000 shares, of which 100,000,000 shares are reserved for exercise stock options.

As of September 30, 2003, totaling US\$23,650 of the Company's convertible bonds has been converted to common stock that resulted in the issuance of the Company's common stock of 38,636,303 shares.

On December 19, 2002, the Company's shareholders resolved in the extraordinary shareholders' meeting to increase its authorized capital to NT\$12,000,000, divided into 1,200,000,000 shares, with par of NT\$10 each. Shareholders also authorized the Company to issue up to 108,000,000 shares and 200,000,000 shares, in the prices of NT\$14 and NT\$16 per share, through private placement and public offering, respectively. On May 29, 2003, based on this authorization, the Company's board of directors resolved to issue 100,000,000 new common shares for cash through public offering, at the prices of NT\$15 per share, each at par of NT\$10. However, on September 15, 2003, the company cancelled the public offering plan. As of September 30, 2003, the Company has raised NT\$1,455,928 through private placement that resulted in the issuance of the Company's common stock of 103,994,857 shares.

As of September 30, 2003, the Company's authorized and issued common stock amounting to NT\$12,000,000 (US\$355,240) and NT\$5,793,034 (US\$171,493) divided to 1,200,000,000 shares (including 100,000,000 shares reserved for the future exercises of stock options) and 579,303,374 shares, respectively, each at par of NT\$10.

The Company has two stock option plans that provide for the granting of 60,000 units of options to qualified employees for purchase of up to 60,000,000 common shares of the Company. Stock options expire in five years from the date of granted except the holders who individually own not more than 30 units of the options may exercise all of their options in the third year after the grant date, holders may exercise 50% and 100% in the third year and in the fourth year after the grant date. The two stock option plans were authorized by the board of directors of the Company on June 13, 2002 and April 24, 2003 and approved by Taiwan's SFC on July 19, 2002 and May 26, 2003. The Company

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granted 30,000 units of stock options on August 5, 2002 and 20,000 units on May 29, 2003. As of September 30, 2003, no option was exercised. Please refer to Note 10.2.(1) for more detail information.

(19) Treasury Stock

- a. On June 4, 2002 and March 7, 2003, the Company's board of directors authorized the Company to repurchase its own common stock from the market for the purpose of transferring shares to employees. The Company repurchased 16,857 thousand shares for a total of NT\$231,711 (US\$6,859) as of September 30, 2003.
- b. According to the Stock Exchange Regulations of Taiwan, total shares repurchased shall not exceed 10% of the Company's issued stock. Total repurchased amounts shall not exceed the sum of retained earnings and the realized capital reserve. The maximum amount and shares the Company allowed to repurchase, calculated based on the financial statements as of September 30, 2003, were NT\$4,968,892 (US\$147,096) and 57,930 thousand shares.
- c. In accordance with the Stock Exchange Regulations of Taiwan, treasury stock shall not be pledged, nor does it possess voting rights or receive dividends. Treasury stock shall be transferred to employees within three years from the date repurchased.

(20) Capital Reserve

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Additional paid-in capital	4,013,703	4,127,047	122,174
Conversion of convertible bonds	226,724	448,887	13,289
Total	<u>4,240,427</u>	<u>4,575,934</u>	<u>135,463</u>

According to the R.O.C. Company Law, capital reserve can only be used for making up deficiencies or distributions of stock dividends.

On May 7, 2002 and June 9, 2003, the Company's shareholders resolved to make up its accumulated deficits by using capital reserve of NT\$576,636 and NT\$302,635 (US\$8,959), respectively.

(21) Legal Reserve

According to the R.O.C. Company Law, 10% of the Company's net income, after deducting previous years' losses, if any, is appropriated as legal reserve prior to any distribution until such reserve is equal to the Company's paid-in capital. When the legal reserve is equal to 50% of the paid-in stock, legal reserve may be distributed to the Company's shareholders through the issuance of additional common shares. However, such reserve, after distribution, shall not be smaller than 25% of paid-in capital.

On May 7, 2002, the Company's shareholders resolved to make up its accumulated deficits by using legal reserve of NT\$187,831.

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(22) Income Distributions

The Company's articles of incorporation provide that the net income, after deducting the previous years' losses and the appropriation of legal and special reserves ("Distributable Earnings"), may be appropriated or distributed proportionally as follows:

- a. Dividend to shareholders at 84% of the Distributable Earnings;
- b. Employee bonuses at 15% of the Distributable Earnings;
- c. Remuneration for directors and supervisors' services at 1%.

On June 9, 2003, the shareholders resolved to revise the above policy as follows:

- a. Dividend to shareholders at 89% of the Distributable Earnings;
- b. Employee bonuses at 10% of the Distributable Earnings;
- c. Remuneration for directors and supervisors' services at 1%.

Dividend to shareholders and employee bonuses will be distributed in the form of shares or cash, while remuneration for directors and supervisors' services can only be paid by cash.

(23) Earnings Per Share

The capital structure of the Company is considered to be complex as there are convertible bonds and stock options outstanding. The Company presents basic and diluted earnings per share for the nine-month period ended September 30, 2003 as its stock options and convertible bonds would have an dilutive effect if they had been fully exercised. However, the Company only presents basic earnings per share for the nine-month period ended September 30, 2002 due to an anti-dilutive effect of stock options and convertible bonds.

	For the nine-month period ended September 30,	
	2002	2003
Common shares outstanding, beginning	436,672,214	452,876,747
Common shares from private placement	—	85,329,113
Bonds converted to common stock.	5,628,950	1,900,211
Treasury stock	(1,844,321)	(11,983,268)
Weighted average numbers of shares	440,456,843	528,122,803
Potential common shares:		
The effect of dilutive stock options (assuming fully exercised)	—	7,180,477
The effect of dilutive convertible bonds (assuming fully converted)	—	141,170,829
Weighted average numbers of dilutive shares	<u>440,456,843</u>	<u>676,474,109</u>

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	<u>Amount (numerator)</u> <u>After tax</u> NT\$	<u>Shares (Denominator)</u>	<u>Earnings per share</u> <u>After tax</u> NT\$ (in dollars)
For the nine-month period ended September 30, 2002			
Basic Earnings Per Share			
Net loss	<u>(410,818)</u>	<u>440,456,843</u>	<u>(0.93)</u>
For the nine-month period ended September 30, 2003			
Diluted Earnings Per Share			
Net income (in NT\$)	392,958	528,122,803	<u>0.74</u>
Convertible bonds	87,366	141,170,829	
Stock options	<u>—</u>	<u>7,180,477</u>	
Net income (in NT\$)	<u>480,324</u>	<u>676,474,109</u>	<u>0.71</u>
Net income (in US\$)	<u>14,219</u>		<u>0.02</u>

(24) Income taxes

The Company's income tax assessment through 1999 has been finalized by the tax authorities.

As of September 30, 2003, unused tax credits available to reduce future tax payable were as follows:

<u>Year incurred</u>	<u>Unused Balances</u>		<u>Expiration Years</u>
	NT\$	US\$	
1999	124,109	3,674	2003
2000	315,908	9,352	2004
2001	560,452	16,591	2005
2002	950,474	28,137	2006
2003 (Estimated)	<u>124,751</u>	<u>3,693</u>	2007
Total	<u>2,075,694</u>	<u>61,447</u>	

As of September 30, 2003, net operating losses that can be carried forward for a period of five years were as follows:

<u>Year incurred</u>	<u>Losses carryforwards</u>	<u>Unused Balances</u>	
	NT\$	NT\$	US\$
2001	1,066,719	1,066,719	31,579
2002	<u>619,029</u>	<u>619,029</u>	<u>18,325</u>
Total	<u>1,685,748</u>	<u>1,685,748</u>	<u>49,904</u>

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The components of deferred tax assets and liabilities and income tax benefit are as follows:

(1)

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Total deferred tax liabilities	—	(17,444)	(517)
Total deferred tax assets.	2,282,401	2,519,337	74,581
Valuation allowance for deferred tax assets	(1,246,393)	(1,208,317)	(35,770)

	Amount	Tax	Amount	Tax	Amount	Tax
	NT\$	Effect	NT\$	Effect	US\$	Effect
		NT\$		NT\$		US\$
Temporary differences that generated deferred tax assets or liabilities:						
Deductible temporary difference						
Employee welfare expense. . .	4,930	1,232	2,625	656	78	19
Unrealized foreign investment loss under equity method	—	—	40,747	10,187	1,206	302
Unrealized pension expense . .	20,252	5,063	22,668	5,667	671	168
Unrealized sales discounts . . .	14,855	3,714	7,626	1,906	226	57
Unrealized inventory provision	8,805	2,201	10,805	2,701	320	80
Unrealized bad debt expense. .	6,251	1,563	4,353	1,089	129	32
Unrealized reserve for redemption of convertible bonds	74,907	18,727	—	—	—	—
Unrealized foreign exchange losses	89,938	22,485	—	—	—	—
Taxable temporary difference						
Unrealized foreign exchange gains	—	—	(69,774)	(17,444)	(2,066)	(517)
Loss carryforwards	1,647,303	411,826	1,685,748	421,437	49,904	12,476
Income tax credits.		1,815,590		2,075,694		61,447

	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
(2) Deferred tax assets — current	97,232	446,238	13,211
Valuation allowance for deferred tax assets — current.	(5,443)	(114,850)	(3,400)
Net deferred tax assets — current	91,789	331,388	9,811
Deferred tax liabilities — current	—	(17,444)	(517)
Net deferred tax assets and liabilities — current	91,789	313,944	9,294

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		As of September 30,		
		2002	2003	
		NT\$	NT\$	US\$
(3)	Deferred tax assets — noncurrent	2,185,169	2,073,099	61,370
	Valuation allowance for deferred tax assets — noncurrent	(1,240,950)	(1,093,467)	(32,370)
	Net deferred tax assets — noncurrent . . .	944,219	979,632	29,000
	Deferred tax liabilities — noncurrent . . .	—	—	—
	Net deferred tax assets and liabilities — noncurrent	944,219	979,632	29,000
		For the nine-month period ended September 30,		
		2002	2003	
		NT\$	NT\$	US\$
(4)	Income tax — current	—	—	—
	Net effect of deferred tax assets or liabilities			
	Allowance for deferred tax assets	746,393	(51,136)	(1,514)
	Unrealized foreign exchange gains and loss	(40,740)	37,075	1,098
	Income tax credits	(868,975)	(165,660)	(4,904)
	Loss carryforwards	(144,721)	(21,155)	(627)
	Other	5,422	16,470	488
	Other	229	172	5
	Income tax benefit	(302,392)	(184,234)	(5,454)

Information relating to imputation of shareholders' income taxes:

		As of September 30,		
		2002	2003	
		NT\$	NT\$	US\$
	Available shareholders' tax credits	3,341	3,597	106
		2001	2002	
	Ratio of shareholders' tax credits	—%	—%	

Information relating to undistributed retained earnings:

		As of September 30,		
		2002	2003	
		NT\$	NT\$	US\$
	Prior to 1998	—	—	—
	After 1998 (inclusive)	(410,818)	392,958	11,633
	Total	(410,818)	392,958	11,633

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(25) Operating Revenues

	For the nine-month period ended September 30,		
	2002	2003	
	NT\$	NT\$	US\$
Sales revenues	13,416	23,177	686
Rent revenues	40,461	76,374	2,261
Testing revenues	3,808,851	4,696,712	139,038
Other operating revenues	353	2,034	61
Total	3,863,081	4,798,297	142,046
Less: Testing and sales discounts	(22,171)	(55,857)	(1,654)
Net operating revenues	<u>3,840,910</u>	<u>4,742,440</u>	<u>140,392</u>

(26) Personnel, Depreciation and Amortization Expenses

	For the nine-month period ended September 30,								
	2002			2003					
	Recorded under cost of goods sold	Recorded under operating expenses	Total	Recorded under cost of goods sold		Recorded under operating expenses		Total	
	NT\$	NT\$	NT\$	NT\$	US\$	NT\$	US\$	NT\$	US\$
Personnel Expense:									
Salary expense . .	729,069	111,018	840,087	830,122	24,574	133,914	3,964	964,036	28,538
Insurance expense	63,509	8,833	72,342	70,240	2,079	10,221	303	80,461	2,382
Pension expense .	19,185	2,900	22,085	19,985	592	3,266	97	23,251	689
Other.	44,643	4,816	49,459	44,646	1,322	4,963	147	49,609	1,469
Total	<u>856,406</u>	<u>127,567</u>	<u>983,973</u>	<u>964,993</u>	<u>28,567</u>	<u>152,364</u>	<u>4,511</u>	<u>1,117,357</u>	<u>33,078</u>
Depreciation									
(Remark 1)	<u>2,031,657</u>	<u>115,470</u>	<u>2,147,127</u>	<u>2,172,428</u>	<u>64,311</u>	<u>123,678</u>	<u>3,661</u>	<u>2,296,106</u>	<u>67,972</u>
Amortization									
(Remark 2)	<u>38,669</u>	<u>21,215</u>	<u>59,884</u>	<u>68,932</u>	<u>2,040</u>	<u>23,908</u>	<u>708</u>	<u>92,840</u>	<u>2,748</u>

Remark 1: The depreciation expenses of leased assets and idle assets, recorded in non-operating expenses, amounted to NT\$79,275 and NT\$78,930 (USD\$2,337) for the nine-month periods ended September 30, 2002 and 2003, respectively.

Remark 2: The amortization expenses of the issuance cost of convertible bonds, recorded in non-operating expenses, amounted to NT\$5,224 and NT\$8,300 (USD\$246) for the nine-month periods ended September 30, 2002 and 2003, respectively.

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5. RELATED PARTY TRANSACTIONS

(1) Name and Relationship of Related Parties

Name of related parties	Relationship with the Company
C.K. Lee	The chairman of the Company
D.F. Lin.	The president of the Company
Bright Shiao.	The vice president of the Company
Mediatek Incorporation (“Mediatek”) . .	The two companies’ chairmen are close relatives
PixArt Imaging Inc. (“PixArt”).	The two companies’ chairmen are close relatives
KYEC USA Corp. (“KYEC USA”). . . .	Investee company
KYEC Investment International Co., Ltd	Investee company
KYEC Microelectronics Co., Ltd.	A subsidiary of KYEC Investment International Co., Ltd
Silicon Storage Technology (“SST”) . . .	The supervisor of the Company
King Long Technology (Suzhou) Limited	Affiliates
China Development Industrial Bank. . . .	The director of the Company
Silicon Precision Industries Co., Ltd.	The director of the Company
(SPIL) (Remark)	

Remark: SPIL has become a related party since February 18, 2003 when its investment in the Company’s shares has exceeded 10%.

(2) Significant Related Party Transactions:

a. Sales:

Name of related parties	For the nine-month period ended September 30,				
	2002		2003		
	Amount NT\$	Percentage %	Amount NT\$	US\$	Percentage %
Mediatek	501,117	13.05	445,377	13,185	9.39
PixArt	10,826	0.28	14,658	434	0.31
SST (Remark).	294,209	7.66	438,442	12,979	9.25
Total	<u>806,152</u>	<u>20.99</u>	<u>898,477</u>	<u>26,598</u>	<u>18.95</u>

Price terms for the above sales were similar to those of regular customers. Payment terms were 45~60 days after invoice date, while those of regular customers were 60~90 days.

Remark: SST was not the supervisor of the Company until May 7, 2002. The corresponding amounts disclosed above, as of September 30, 2002, include only the results of May to September, 2002.

b. Commissions paid to a related party were as follows:

Name of related party	For the nine-month period ended September 30,		
	2002	2003	
	NT\$	NT\$	US\$
KYEC USA	<u>4,547</u>	<u>4,750</u>	<u>141</u>

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c. Rents paid to a related party were as follows:

Name of related party	For the nine-month period ended September 30,		
	2002	2003	
	NT\$	NT\$	US\$
SPIL (Remark)	—	2,016	60

(Remark): SPIL was not the related party of the Company until February 18, 2003. The corresponding amounts disclosed above, as of September 30, 2003, include only the results of February to September, 2003.

(3) Payable to related parties — financing:

The Company's financing with China Development Industrial Bank (included in long-term loans) for the nine-month periods ended September 30, 2002 and 2003 was as follows:

Name of related parties	Highest Balance	Ending Balance	Interest expense	Interest Rate
	NT\$	NT\$	NT\$	%
For the nine-month period ended September 30, 2002				
The one billion loan from 5 banks	349,016	232,680	4,385	3.58~3.83
The four billion loan from 17 banks	450,000	450,000	6,674	3.26~3.51
Total		<u>682,680</u>	<u>11,059</u>	
For the nine-month period ended September 30, 2003				
The one billion loan from 5 banks	203,596	116,344	4,083	2.855~3.35
The four billion loan from 17 banks	385,716	321,432	7,533	2.530~3.03
Total (in NT\$)		<u>437,776</u>	<u>11,616</u>	
Total (in US\$)		<u>12,960</u>	<u>344</u>	
Financing with other related parties:				
For the nine-month period ended September 30, 2002				
C.K. Lee	133,000	—	633	2.50
Bright Shiao	17,000	—	223	2.50
Total		<u>—</u>	<u>856</u>	

(4) Property transaction:

On May 13, 2003, the Company acquired certain machines from Mediatek at the price of NT\$7,667 (USD\$227).

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(5) Receivables and payables resulting from the above transactions were as follows:

a. Receivables from related parties:

Name of related parties	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
SST.	161,043	139,477	4,129
Mediatek	117,352	121,643	3,601
PixArt	5,644	6,017	178
King Long Technology (Suzhou) Limited. . .	1,981	—	—
	(Remark)		
KYEC Microelectronics Co., Ltd.	—	152	5
		(Remark)	
KYEC Investment International Co., Ltd . . .	—	79	2
		(Remark)	
Total	<u>286,020</u>	<u>267,368</u>	<u>7,915</u>

Remark: Amounts related to company establishment expenses.

b. Payables to related parties:

Name of related parties	As of September 30,		
	2002	2003	
	NT\$	NT\$	US\$
KYEC USA	1,534	1,880	56
China Development Industrial Bank.	13,311	7,143	211
	(Remark 1)	(Remark 1)	(Remark 1)
SPIL	—	17,128	507
		(Remark 2)	(Remark 2)
Total	<u>14,845</u>	<u>26,151</u>	<u>774</u>

Remark 1: This amount includes interest payable to other banks. China Development Industrial Bank acts an agent for the receipt of interest of syndicate loans.

Remark 2: Temporary receipts for referring IC assembly service to SPIL.

- (6) Except for the short-term loan with Hsinchu Commercial Bank, Ta Chong Bank, Esun Commercial Bank, United Credit Commercial Bank, and the syndicate loan with 7 banks including ChinaTrust Commercial Bank as of September 30, 2003, which are guaranteed by C.K. Lee alone, the Company's loans as of September 30, 2002 and 2003 are guaranteed, severally and jointly, by C.K. Lee and D.F. Lin.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

6. ASSETS PLEDGED AS COLLATERAL

Account	As of September 30,			Subject of collateral
	2002	2003		
	NT\$	NT\$	US\$	
Land	869,222	869,222	25,732	Long-term loans
Buildings and facilities	733,460	784,447	23,222	Long-term loans
Idle Assets — Land	54,844	54,844	1,624	Short-term and long-term loans
Idle Assets — Buildings and facilities	188,489	105,924	3,135	Short-term and long-term loans
Machinery and equipment . .	3,908,026	5,220,812	154,553	Short-term loans, long-term loans, and installment accounts payable
Leased assets	44,523	—	—	Financing lease
Restricted deposits	33,000	13,067	387	Financing lease and as guarantee security for HSIP
Total	5,831,564	7,048,316	208,653	

7. COMMITMENTS AND CONTINGENT LIABILITIES

As of September 30, 2003, the Company had the following commitments and contingent liabilities:

- (1) The Company's unused letters of credit amounted to approximately NT\$352,869 (US\$10,446) as of September 30, 2003.
- (2) The Company has entered into several construction contracts. As of September 30, 2003, these contracts amounted to approximately NT\$49,900 (US\$1,477) with approximately NT\$46,900 (US\$1,388) remaining unpaid.
- (3) The promissory notes issued for bank loans amounted to NT\$9,337,670 (US\$276,426).
- (4) In accordance with the loan agreement the Company entered into with 17 banks including China Development Industrial Bank, the Company is required to maintain (1) a current ratio of no less than 100%; (2) debt ratio under 100%; (3) tangible equity of more than NT\$7 billion; and (4) interest coverage over 200% for the year 2001 and 2002 and over 300% for years since 2003. In case of breach of the above, the Company shall raise funds, by the end of September of the following year, by offering rights for cash or other financing instruments to the extent the terms can be complied. If the Company fails to raise sufficient funds within the permitted time period, the Company is subject to an additional compensation due quarterly at an annual rate of 0.1% of the unpaid loan. The Company recorded the additional compensation, included in non-operating expense, in the amount of NT\$3,000 and NT\$291 (US\$9) for the nine-month period ended September 30, 2002 and 2003, respectively.

In the terms of the syndicate loan with 5 banks including China Development Industrial Bank, the Company has to maintain a current ratio of no less than 100% and a debt ratio no more than 100% from 2001 to 2004. If noncompliance occurs, the Company shall take the same actions as stated in the preceding paragraph. The Company recorded the additional compensation, included in non-operating expense, in the amount of NT\$594 and NT\$46 (US\$1) for the nine-month period ended September 30, 2002 and 2003, respectively.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

Under the syndicate loan agreement with ChinaTrust Commercial Bank and other banks, the Company is subject to the following financial covenants:

- (a) maintain a current ratio of no less than 100% for years from 2002 to 2007;
- (b) maintain a debt ratio of no more than 125% for the year 2002 and no more than 100% for years from 2003;
- (c) maintain an interest coverage of no less than 300%;
- (d) convert at least 50% of its convertible bonds into common stock by the end of March of 2004, or increase its shareholders equity by at least NT\$3 billion (compared with the balance as of April 30, 2002).

In case of failure to comply with the above, the banks may take certain actions.

According to the loan agreement with Chiao Tung Bank, the Company is subject to the following:

- (a) maintain a current ratio of no less than 100% from 2003 to 2007;
- (b) maintain a debt ratio of no more than 125% from 2003 to 2007;
- (c) raise funds of at least NT\$2 billion by issuing new shares by the end of year 2003;
- (d) convert at least 50% of its convertible bonds into common stock by the end of year 2004.

In the situation where the Company breaches any of the above, the Company will be subject to an additional compensation due monthly at an annual rate of 1% of the unpaid loan. In addition, the bank may also terminate the agreement and call the loan.

- (5) The Company and its chairman have both been named as a defendant in a civil lawsuit filed by several parties including Hwa Tsai Co., Ltd. (“Hwa Tsai”, “the plaintiffs”). The plaintiffs claimed the Company and its chairman had violated Rule 20, Rule 21 and Rule 32 of the R.O.C. Securities Exchange Law, Rule 184 of the R.O.C. Civil Law, and Rule 23 of the R.O.C. Company Law and sought damage reimbursement of NT\$62,213 plus interest. The district court has requested the plaintiffs to recalculate the damage amount since the plaintiffs have sold out the underlying securities and, accordingly, the damage could be reasonably assessed. After recalculation, the plaintiffs reduced the damage claim to NT\$46,974 plus interest. The court has not yet made the final decision. The management anticipates no significant loss to incur due to this case.

Also, the Company and its chairman were involved in a criminal case for a claimed violation of Rule 339 of the R.O.C. Criminal Law, and Rule 171 and Rule 174 of the R.O.C. Securities Exchange Law. Although the Hsinchu District Court had decided that either the Company or its chairman should not be indicted, the plaintiffs (Hwa Tsai and several other parties) were not satisfied with this determination and filed an appeal with the Taiwan High Court for re-investigation; therefore, the higher court considered that the application was well-grounded and ordered the prosecution of the original court to continue it. As of October 19, 2003, the final result of the district court prosecution has not yet been decided.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

8. SIGNIFICANT DISASTER LOSSES

None.

9. SIGNIFICANT SUBSEQUENT EVENT

On December 12, 2003, the Company transferred 11,000,000 shares of treasury stock to its employees at the price of NT\$13 per share.

10. OTHER DISCLOSURES

1. Financial Instruments

Derivative Financial Instruments:

a. Contract Amount or Nominal Amount and Credit Risk:

	As of September 30,					
	2002		2003			
	Contract amount or Nominal amount	Credit Risk	Contract amount or Nominal amount	Credit Risk	Contract amount or Nominal amount	Credit Risk
	NT\$	NT\$	NT\$	NT\$	US\$	US\$
Forward currency exchange contract-nontrading (note) . .	—	—	—	—	—	—

(Note): Forward currency exchange contracts were all closed as of September 30, 2002 and 2003.

Credit risk amount represents contracts with a positive fair value factoring in the offsetting effect of the master netting arrangement as of balance sheet date. If the credit risk amount is positive and the transaction party breaches the contract, the Company will incur a loss. The possibility of incurring a loss is remote since the Company's counter parties are reputable financial institutions.

b. Market Value Risk

Market value risk is insignificant due to the fact that the purpose of the forward exchange contracts is hedging and therefore any gain or loss from the fluctuation in interest or exchange rates will be offset by the gain or loss from the exchanges hedged.

c. Liquidity Risk, cash flow risk and the amount, duration and uncertainty related to future demand on cash flows

There is no significant liquidity risk regarding the derivative financial instrument that the Company has entered into since cash flows from operating activities will satisfy the cash demand in settling the derivative financial instrument contracts. Also, no significant additional cash flows are demanded since the settlement rate is fixed.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

- d. The Company's derivative financial instruments are entered into mainly for hedging purposes. The purpose of holding forward exchange contracts was to hedge exchange rate fluctuation risks resulting from assets, liabilities or commitments denominated in foreign currencies. The Company's hedging strategy is to mitigate its market price risk. Derivative financial instruments selected for hedging purposes are reviewed and anticorrelated with the fluctuation of the fair value of derivatives hedged. Derivatives are evaluated periodically.

- e. Derivative financial instruments

Forward exchange contracts receivable and payable are reported under current assets or liabilities on a net basis. The balance amounted to nil for both years.

Foreign exchange gains earned for the nine-month periods ended September 30, 2002 and 2003 amounted to NT\$3,810 and NT\$273 (US\$8), respectively, which were included in non-operating income.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

Fair value of financial instruments:

Non-derivative Instruments	As of September 30,					
	2002		2003			
	Book Value	Fair Value	Book Value	Fair Value	Book Value	Fair Value
	NT\$		NT\$		US\$	
Assets						
Cash and cash equivalents	1,413,041	1,413,041	1,124,850	1,124,850	33,299	33,299
Restricted deposits (Including current and non-current portion) . .	33,000	33,000	13,067	13,067	387	387
Short-term investments	179	181	—	—	—	—
Receivables (Including receivables from related parties)	1,446,156	1,446,156	1,614,010	1,614,010	47,780	47,780
Other Receivables	24,166	24,166	281,679	281,679	8,339	8,339
Long-term equity investments	25,261	25,261	420,224	420,224	12,440	12,440
Long-term bonds investments	17,470	(Remark)	—	—	—	—
Deposits out	31,271	31,271	5,458	5,458	162	162
Liabilities						
Short-term loans	643,455	643,455	531,459	531,459	15,733	15,733
Short-term notes	99,984	99,984	—	—	—	—
Payables (Including payables to related parties and payables to equipment suppliers)	608,693	608,693	603,332	603,332	17,861	17,861
Accrued expenses	292,980	292,980	321,199	321,199	9,509	9,509
Long-term loans (Including current portion)	5,356,245	5,356,245	4,361,437	4,361,437	129,113	129,113
Lease obligations and installment accounts payable (Including current portion)	70,479	70,086	—	—	—	—
Convertible bonds (Including current portion)	3,878,126	(Remark)	2,374,191	(Remark)	70,284	(Remark)
Deposit in	—	—	108,170	108,170	3,202	3,202

Remark: As of September 30, 2003, no publicly assessable value of Company's long-term bonds investments and convertible bonds was available.

Derivative Instruments						
Forward currency exchange contract	—	—	—	—	—	—

Methods and assumptions used to measure fair values of financial instruments are as follow:

- a. The fair values of the Company's short-term financial instruments are based on the book value of those instruments at reporting date due to the short maturity of those instruments. The method applies to cash and cash equivalents, receivables, other receivables, short-term loans, short-term notes, payables and accrued expenses.
- b. The fair values of the Company's deposits in, restricted deposits and deposits out are based on the book value of those instruments at reporting date due to the amount estimated of those instruments was similar with the book value.

KING YUAN ELECTRONICS CO., LTD.
NOTES TO FINANCIAL STATEMENTS (UNAUDITED) — (Continued)
(Amounts in thousands except otherwise stated)

- c. The fair values of the Company's short-term investments and long-term investments are based on market prices at reporting date if market prices are available. The fair value of the Company's long-term investment is based on financial or any other information if market prices are not available.
- d. The fair value of the Company's long-term loans bearing variable interest rates, which includes the current portion of long-term loans, is estimated using the book value of the loans at the reporting date.
- e. The fair values of lease obligations and installment accounts payable are estimated using discounted cash flow analysis based on the Company's borrowing rates for similar types of borrowings.
- f. The fair value of derivative financial instruments (normally includes unrealized gains or losses from outstanding forward exchange contracts) is assumed to be the amount that the Company is entitled to receive or obligated to pay if the Company terminated the contracts.

2. Others

- (1) Employees' stock options (Expressed in NT Dollars)

<u>Issue Date</u>	<u>Total Units</u>	<u>Total Units Outstanding</u>	<u>Exercisable Shares</u>	<u>Exercisable Date</u>	<u>Exercise Price</u>	<u>Executor Method</u>	<u>Market price of Common Stock (During the period from January 1, 2003 to September 30, 2003)</u>	
							<u>Highest Price</u>	<u>Lowest Price</u>
August 5, 2002 . .	30,000	30,000	30,000,000	August 5, 2004	\$14.70 (Remark)	Issue common stock	\$25.2	\$12.15
May 29, 2003 . . .	20,000	20,000	20,000,000	May 29, 2005	\$13.05	Issue common stock	\$25.2	\$12.15

Remark: On February 18, 2003, the board of directors resolved to adjust the exercise price of stock options from NT\$14.90 per share to NT\$14.70 per share, due to change in the number of outstanding common shares as provided in the stock option plan.

- (2) Certain accounts of the financial statements as of September 30, 2002 have been reclassified to be in conformity with current year's presentation.

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APPENDIX A: THE SECURITIES MARKETS OF TAIWAN

We have extracted from publicly available documents the information presented in this section, which has not been prepared or independently verified by the underwriters, the depositary or any of their respective affiliates or advisors in connection with this 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 entities 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. Subject to limited exceptions, all transactions in listed securities by brokers, traders and securities firms must be made through the Taiwan Stock Exchange.

The Taiwan Stock Exchange commenced operations in 1962. During the early 1980's, 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 638 as of December 31, 2002. As of December 31, 2002, the market capitalization of companies listed on the Taiwan Stock Exchange was approximately NT\$9,091 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 Taiwan's 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 Asian Development Bank and other foreign banks are also listed on the Taiwan Stock Exchange or traded on the ROC Over-The-Counter Market.

Currently only four non-Taiwan companies are listed on the Taiwan Stock Exchange through the use of depositary receipts. The Securities and Futures Commission's regulations, however, permit foreign issuers to list their equity securities directly on the Taiwan Stock Exchange or through the use of depositary receipts. The Taiwan Stock Exchange requirements for listing are based on:

- length of time the company has been established;
- amount of paid-in capital;
- profitability; and
- dispersion of shareholdings.

However, special listing criteria apply to technology companies and key businesses engaging in national economic development.

We, as a public company in Taiwan, are obligated to make reports to the Securities and Futures Commission and the Taiwan Stock Exchange, including without limitation:

- regular reports regarding monthly sales revenues; quarterly, semi-annual and annual financial information; public financial forecasts in the event of rights offering annual reports; minutes of shareholders' meetings; regular reports regarding solicitations of proxies; the execution of internal audits; and statements of internal controls;

- special reports regarding events which have had a significant impact on shareholders' rights or the price of our securities; resolutions of our board of directors related to a merger; prospectuses for approved issuances of securities; material changes that have been made regarding cash injections and corporate bond issuances; financial forecasts; approvals of changes of accounting principles;
- special reports regarding the issuance of securities; details of the issuance of overseas depositary receipts; revisions to procedures of acquiring or selling assets; and revisions to operating procedures for making third-party loans.

The ROC Over-The-Counter Market

To complement the Taiwan Stock Exchange, the ROC Over-The-Counter Market was established in September 1982 on the initiative of the Securities and Futures Commission to encourage trading of securities of companies who do not qualify for listing on the Taiwan Stock Exchange. As of December 31, 2002, 384 companies had equity securities listed on the ROC Over-The-Counter Market. As of December 31, 2002, the total market capitalization of companies with equity securities listed on the ROC Over-The-Counter Market was approximately NT\$862 billion. In addition, the Emerging Market of the Over-The-Counter Securities Exchange was established on January 1, 2002 on the initiative of the Securities and Futures Commission to encourage trading of the securities of companies which are public companies but not qualified for listing on the Taiwan Stock Exchange or the Over-The-Counter Market.

The 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 shows 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>Stock Trading Values</u>	<u>Index High</u>	<u>Index Low</u>	<u>Index at Period End</u>
		(in NT\$ billions)			
1990	199	19,031.3	12,495.34	2,560.47	4,530.16
1991	221	9,682.7	6,305.22	3,316.26	4,600.67
1992	256	5,917.1	5,391.63	3,327.67	3,377.06
1993	285	9,056.7	6,070.56	3,135.56	6,070.56
1994	313	18,812.1	7,183.75	5,194.63	7,124.66
1995	347	10,151.5	7,051.49	4,503.37	5,173.73
1996	382	12,907.6	6,982.81	4,690.22	6,933.94
1997	404	37,241.2	10,116.84	6,820.35	8,187.27
1998	437	29,619.0	9,277.09	6,251.38	6,418.43
1999	462	29,291.0	8,608.91	5,474.79	8,448.84
2000	531	30,526.6	10,202.20	4,614.63	4,739.09
2001	584	18,354.9	6,104.24	3,446.26	5,551.24
2002	638	21,874.0	6,462.30	3,850.04	4,432.45
2003	669	20,332.2	6,142.32	4,139.50	5,890.69

Sources: Status of Securities Listed on Taiwan Stock Exchange

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, that is 500,000 shares, or more must be registered and executed under Taiwan Stock Exchange block trade 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. However, these restrictions have been modified from time to time by the Ministry of Finance based on market conditions.

Effective from July 1, 2000, brokerage commission can be in any rates, as reported to the Taiwan Stock Exchange, not exceeding 0.1425% of the transaction price.

A securities transaction tax of 0.3% of the transaction value is payable by the seller of equity securities. These 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.

National Financial Stabilization Fund

In response to the declines and volatility in the securities markets in Taiwan, the ROC Government has formed the National Financial Stabilization Fund which has purchased and may from time to time purchase shares of Taiwan companies to support these markets. The details of the transactions of the National Financial Stabilization Fund have not been made public. In addition, the ROC Government's Labor Insurance Fund and other funds associated with the ROC Government have in the past purchased, and may from time to time purchase, shares of Taiwan companies on the Taiwan Stock Exchange or other markets.

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, as well as spouses, minor children and nominees of these parties, and shareholders together with their spouses, minor children and nominees holding 10% or more stocks of the issuer. 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, as well as spouses, minor children and nominees of these parties, and stockholders together with their spouses, minor children and nominees holding 10% or more of the issuing company;
- any person who has learned material, non-public information due to an occupational or controlling relationship with our 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 intentionally 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, among other things:

- civil liability for material misstatements or omissions made by issuers; and
- regulations 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 the 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.

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.

APPENDIX B: FOREIGN INVESTMENT AND EXCHANGE CONTROLS IN TAIWAN

Foreign Investment

Historically, foreign investment in the ROC securities markets has been restricted. Since 1983, the ROC government has periodically enacted legislation and adopted regulations to permit foreign investment in the ROC securities market. Currently, non-ROC persons may invest in ROC securities through the following vehicles.

Depository Receipts

In April 1992, the ROC SFC enacted regulations permitting ROC companies with securities listed on the TSE, with the prior approval of the ROC SFC, to sponsor the issue and sale to foreign investors of depository receipts. Depository receipts represent deposited shares of ROC companies. In December 1994, the Ministry of Finance allowed companies whose shares are traded on the GTSM or listed on the TSE, upon approval of the ROC SFC, to sponsor the issue and sale of depository receipts. On October 24, 2002, the ROC SFC began allowing public companies that are not listed on the TSE or the GTSM to sponsor the issuance and sale of depository receipts by way of private placements outside the ROC.

A holder of depository receipts may immediately after the initial issue date for the depository receipts, request the foreign depository issuing the depository receipts to cause the underlying securities to be sold in the ROC and to distribute the proceeds of the sale to the depository receipt holder or to withdraw from the depository receipt facility shares represented by depository receipts and transfer the shares to the depository receipt holder (other than citizens of the PRC and entities organized under the laws of the PRC).

Under existing laws and regulations relating to foreign exchange control, a depository may, without obtaining further approvals from the Central Bank of China or any other governmental authority or agency of the ROC, convert N.T. dollars into other currencies, including U.S. dollars, in respect of the following: proceeds of the sale of shares represented by depository receipts, proceeds of the sale of shares received as stock dividends and deposited into the depository receipt facility and any cash dividends or cash distributions received. In addition, a depository, also without any of these approvals, may convert inward remittances of payments into N.T. dollars for purchases of underlying shares for deposit into the depository receipt facility against the creation of additional depository receipts. Approval from the Central Bank of China is required on a payment-by-payment basis for conversion into N.T. dollars of subscription payments relating to rights offerings. A depository is also required to obtain foreign exchange approval from the Central Bank of China on a payment-by-payment basis for conversion from N.T. dollars into other currencies relating to the sale of subscription rights for new shares. Proceeds from the sale of any underlying shares by holders of depository receipts withdrawn from the depository receipt facility may be converted into other currencies without obtaining Central Bank of China approval, and may be used for reinvestment in the TSE or the GTSM, subject to limitations and restrictions applicable to foreign institutional investors or foreign individual investors.

Overseas Corporate Bonds

Since 1989, the ROC SFC has approved a series of overseas bond offerings by ROC companies listed on the TSE. The relevant regulations also permit companies whose shares are listed on the GTSM to issue and offer overseas corporate bonds. On October 24, 2002, the ROC SFC began allowing public companies that are not listed on the TSE or the GTSM to issue and offer overseas bonds by way of private placements outside the ROC. Under current ROC law, these overseas corporate bonds are convertible or exchangeable into shares of ROC companies. The regulations also permit public companies that are not listed on the TSE or the GTSM to issue non-convertible and non-exchangeable corporate bonds in offerings outside the ROC. Proceeds from sales of shares converted from overseas convertible bonds may be used for reinvestment in shares listed on the TSE or the GTSM, subject to the limitations and restrictions applicable to foreign institutional investors or foreign individual investors.

Under current ROC law, a non-ROC converting bondholder, when exercising its conversion right to convert bonds into shares, must appoint a local agent or representative with such qualifications specified by the ROC SFC to open a securities trading account with a local brokerage firm, pay ROC taxes, remit funds, exercise shareholders' rights, appoint a bank to act as custodian in respect of the securities and funds, report remittance to the CBC, appoint a local securities firm or financial institution to act as the agent to open NT dollar bank account and perform such other matters as may be designated by the converting bondholder on its behalf and as its agent.

A ROC company may, without obtaining further approvals from the Central Bank of China or any other government authority of the ROC, convert N.T. dollars to other non-ROC currencies, including U.S. dollars, for making payments in respect of redemption of bonds or repayment of principal of and interest on bonds. A non-ROC converting bondholder may, through its agent or representative and without obtaining prior approval from the Central Bank of China, convert into foreign currencies net proceeds realized from the sale of converted shares or any stock dividends relating to such shares, or any cash dividend or other cash distribution in respect of such shares in accordance with the current ROC foreign exchange laws or regulations.

Overseas Share Offerings

In June 1997, the ROC government promulgated regulations permitting ROC companies whose shares are listed on the TSE or traded on the GTSM to offer shares directly to non-ROC persons overseas without utilizing depositary receipt facilities. On October 24, 2002, the ROC SFC began allowing public companies that are not listed on the TSE or the GTSM to issue and offer shares directly to non-ROC persons through private placements outside the ROC.

Foreign Investors

On December 28, 1990, the Executive Yuan approved guidelines drafted by the ROC SFC which, since January 1, 1991, allow direct investment in ROC securities listed on the TSE or other ROC securities approved by the ROC SFC by certain eligible foreign institutional investors. According to the amended Regulations Governing Investment in Securities by Overseas Chinese and Foreign Nationals approved by the Executive Yuan on September 30, 2003, "Qualified Foreign Institutional Investors" ("QFII") designations have been abolished and the restrictions on QFIIs revised for foreign portfolio investors. According to the new rules, "Foreign Institutional Investor" ("FINI") means an entity which is incorporated under the laws of countries other than the ROC or the branch of a foreign entity which is established within the territory of the ROC, and "Foreign Individual Investor" ("FIDI") means overseas Chinese and foreign natural persons.

Each FINI who wishes to invest directly in the ROC securities market is required to register with the TSE, obtain an investment ID and apply to the CBC for approval if the FINI is a non-resident and has no sub-investment account in the ROC. Except for some restrictions imposed by specific laws and regulations, the individual and aggregate foreign ownership of the issued share capital in a TSE listed company or a GTSM quoted company is not restricted. ROC custodians for non-resident FINI are required to submit to the CBC and the TSE a report of trading activities and status of assets under custody and other matters every month. Capital remitted to the ROC under these guidelines may be remitted out of the ROC at any time after the date such capital is remitted to the ROC. Capital gains and income on investments may be remitted out of the ROC at any time.

Each FIDI who wishes to invest directly in the ROC securities market is also required to register with the TSE and obtain an investment ID. Any non-resident FIDI who invests in ROC securities is subject to the limitations on investment amount as jointly determined by the SFC and CBC.

Foreign institutional investors who receive a permit, or qualified foreign institutional investors, may currently invest up to US\$3 billion and may remit the full amount into the ROC within two years after receiving such investment permit. Except for certain specified industries, such as telecommunications, investments in ROC-listed companies by qualified foreign investors are not subject to individual or aggregate foreign ownership limits. Currently, we are not in any of the specified industries. Custodians for non-resident foreign institutional investors are also required to report the remittance amounts every day to the CBC and submit to the Central Bank of China and TSE a monthly report of trading activities and status of assets under custody and other matters. Capital remitted to the ROC under these guidelines may be remitted out of the ROC at any time after the date such capital is remitted to the ROC. Capital gains and income on investments may be remitted out of the ROC at any time.

Foreign Investment Approval

Foreign investors who wish to make direct investments in the shares of ROC companies are required to submit a foreign investment approval application to the Investment Commission of the ROC MOEA or other government authority. The Investment Commission or such other government authority reviews each foreign investment approval application and approves or disapproves each application after consultation with other governmental agencies (such as the Central Bank of China and the ROC SFC).

Under current law, any non-ROC person possessing a Foreign Investment Approval may remit capital for the approved investment and is entitled to repatriate annual net profits, interest and cash dividends attributable to such investment. Dividends attributable to such investment may be repatriated upon submitting certain required documents to the remitting bank, and investment capital and capital gains attributable to such investment may be repatriated after approvals of the Investment Commission or other authorities have been obtained.

In addition to the general restriction against direct investment by non-ROC persons in securities of ROC companies, non-ROC persons (except in certain limited cases) are currently prohibited from investing in certain industries in the ROC pursuant to a negative list, as amended by the Executive Yuan. The prohibition on foreign investment in the prohibited industries specified in the negative list is absolute in the absence of specific exemption from the application of the negative list. Pursuant to the negative list, certain other industries are restricted so that non-ROC persons (except in certain limited cases) may invest in such industries only up to a specified level and with the specific approval of the relevant competent authority which is responsible for enforcing the relevant legislation which the negative list is intended to implement.

Exchange Controls

The Foreign Exchange Control Statute and regulations provide that all foreign exchange transactions must be executed by banks designated to handle such business by the Ministry of Finance and by the Central Bank of China. Current regulations favor trade-related foreign exchange transactions and Foreign Investment Approval investments. Consequently, foreign currency earned from exports of merchandise and services may now be retained and used freely by exporters, and all foreign currency needed for the importation of merchandise and services may be purchased freely from the designated foreign exchange banks.

Trade aside, ROC companies and recognized foreign companies may, without foreign exchange approval, remit outside the ROC foreign currency of up to US\$50,000,000 (or its equivalent) and ROC residents and foreign persons with an alien resident card may remit to and from Taiwan foreign currency of up to US\$5,000,000 (or its equivalent) respectively in each calendar year. In addition, ROC companies and resident individuals may, without foreign exchange approval, remit into the ROC foreign currency of up to US\$50,000,000 (or its equivalent) and US\$5,000,000 (or its equivalent) respectively in each calendar year. The above limits apply to remittances involving a conversion of N.T. dollars to a foreign currency and vice versa. A requirement is also imposed on all enterprises to register medium- and long-term foreign debt with the Central Bank of China.

In addition, foreign persons, may, subject to certain requirements, but without foreign exchange approval of the Central Bank of China, remit outside and into the ROC foreign currencies of up to US\$100,000 (or its equivalent) for each remittance. The above limit applies to remittances involving a conversion of N.T. dollars to a foreign currency and vice versa.

ISSUER

King Yuan Electronics Co., Ltd.

No. 1, Lane 99 Pu-Ding Road
Hsin-Chu 300, Taiwan, ROC

**TRUSTEE, ZYPS REGISTRAR AND PAYING,
TRANSFER AND CONVERSION AGENT**

The Bank of New York
101 Barclay Street
21st Floor West
New York, NY 10286
United States of America

**PAYING, TRANSFER AND CONVERSION
AGENT IN LONDON**

The Bank of New York
48th Floor
One Canada Square
London E14 5AL
England

U.S. LEGAL ADVISER TO THE MANAGERS

Simpson Thacher & Bartlett LLP

7th Floor
Asia Pacific Finance Tower
3 Garden Road, Central
Hong Kong S.A.R.

ROC LEGAL ADVISER TO THE ISSUER

Chen & Lin Attorney-at-Law

Bank Tower, 6F
205 Tun Hwa North Road
Taipei, Taiwan, ROC

INDEPENDENT AUDITORS

Diwan, Ernst & Young

9th Floor
333 Keelung Road, Sec. 1
Taipei, Taiwan, ROC

LISTING, PAYING, TRANSFER AND CONVERSION AGENT IN LUXEMBOURG

The Bank of New York (Luxembourg) S.A.

Aerogolf Center
IA, Hoehenhof
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