

Phison Electronics Corp. and Subsidiaries

**Consolidated Financial Statements for the
Six Months Ended June 30, 2006 and 2005 and
Independent Accountants' Review Report**

INDEPENDENT ACCOUNTANTS' REVIEW REPORT

The Board of Directors and Shareholders
Phison Electronics Corp.

We have reviewed the accompanying consolidated balance sheets of Phison Electronics Corp. (the Corporation) and subsidiaries as of June 30, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity and cash flows for the six months then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to issue a report based on our reviews.

We conducted our review in accordance with Statement of Auditing Standards No. 36, "Standards for the Review of Financial Statements," of the Republic of China. A review consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the Republic of China, 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.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the Republic of China.

As disclosed in Note 3 to the financial statements, the Corporation adopted the newly issued Statement of Financial Accounting Standards (SFAS) No. 34, "Accounting for Financial Instruments," SFAS No. 36, "Disclosure and Presentation of Financial Instruments," and the revisions on the related SFASs in harmonizing with SFAS No. 34 and 36 on January 1, 2006.

July 28, 2006

Notice to Readers

The accompanying financial statements are intended only to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in the Republic of China and not those of any other jurisdictions. The standards, procedures and practices to audit such financial statements are those generally accepted and applied in the Republic of China.

For the convenience of readers, the auditors' report and the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language auditors' report and financial statements shall prevail.

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

BALANCE SHEETS

JUNE 30, 2006 AND 2005

(In Thousands of New Taiwan Dollars, Except Par Value)

(Reviewed, Not Audited)

ASSETS	2006		2005		LIABILITIES AND STOCKHOLDERS' EQUITY	2006		2005	
	Amount	%	Amount	%		Amount	%	Amount	%
CURRENT ASSETS					CURRENT LIABILITIES				
Cash and cash equivalents (Notes 2 and 4)	\$ 797,758	23	\$ 535,383	29	Short-term debts (Note 18)	\$ -	-	\$ 47,430	3
Financial assets at fair value through profit or loss - non current (Notes 2 and 5)	-	-	37,345	2	Notes and accounts payable				
Notes and accounts receivable					Third parties	951,356	27	376,925	20
Third parties (Notes 2 and 6)	1,141,603	32	542,723	29	Related parties (Note 17)	261,215	7	219,448	12
Related parties (Note 17)	130,677	4	113,979	6	Income tax payable (Notes 2 and 12)	20,459	1	8,486	1
Other financial assets	100,965	3	315	-	Accrued expenses (Note 17)	340,453	10	247,218	13
Inventories, net (Notes 2 and 7)	902,050	26	395,140	21	Other payables (Note 19)	45,000	1	45,000	2
Deferred income tax assets (Notes 2 and 12)	61,705	2	10,691	1	Other	12,506	-	14,988	1
Restricted assets (Note 18)	15,058	-	11,993	1					
Other (Note 17)	145,283	4	69,763	4	Total current liabilities	1,630,989	46	959,495	52
Total current assets	3,295,099	94	1,717,332	93	OTHER LIABILITIES				
LONG-TERM INVESTMENTS					Accrued pension cost (Notes 2 and 11)	-	-	733	-
Financial assets carried at cost - non current (Notes 2 and 8)	62,500	2	9,500	-	Guarantee deposits received	-	-	168	-
PROPERTIES (Notes 2 and 9)					Total other liabilities	-	-	901	-
Cost									
Testing equipment	27,957	1	19,174	1	Total liabilities	1,630,989	46	960,396	52
Office equipment	6,170	-	3,841	-	SHAREHOLDERS' EQUITY (Note 14)				
Leasehold improvements					Capital stock - \$10 par value				
Other equipment	4,499	-	3,283	-	Authorized - 80,000 thousand shares in 2006 and 60,000 thousand shares in 2005				
Total cost	51,076	2	33,706	2	Issued - 52,708 thousand shares in 2006 and 36,255 thousand shares in 2005	527,081	15	362,551	19
Less: Accumulated depreciation	22,971	1	12,423	1	Capital received in advance	1,190	-	420	-
Prepayment for equipment	5,469	-	-	-	Stock dividends to be issued	177,500	5	108,580	6
Net properties	33,574	1	21,283	1	Capital surplus - additional paid-in capital	501,962	15	51,962	3
INTANGIBLE ASSETS (Notes 2, 10,17 and 19)	38,579	1	47,089	3	Retained earnings				
OTHER ASSETS					Appropriated as legal reserve	128,122	4	69,113	4
Refundable deposits (Notes 18 and 19)	48,486	1	41,376	2	Unappropriated earnings	544,234	15	294,762	16
Deferred charges, net (Note 2)	30,760	1	11,204	1	Total retained earnings	672,356	19	363,875	20
Other (Notes 2, 11 and 12)	2,080	-	-	-	Total shareholders' equity	1,880,089	54	887,388	48
Total other assets	81,326	2	52,580	3	TOTAL	\$ 3,511,078	100	\$ 1,847,784	100
TOTAL	\$ 3,511,078	100	\$ 1,847,784	100					

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

(With Deloitte & Touche audit report dated July 28, 2006)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

SIX MONTHS ENDED JUNE 30, 2006 AND 2005

(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

(Reviewed, Not Audited)

	2006		2005	
	Amount	%	Amount	%
OPERATING REVENUE (Note 2 and 17)				
Gross sales	\$ 4,426,014	100	\$ 2,557,995	100
Sales returns and allowances	<u>53,845</u>	<u>1</u>	<u>6,673</u>	<u>-</u>
Net sales	4,372,169	99	2,551,322	100
Service revenue	<u>53,289</u>	<u>1</u>	<u>627</u>	<u>-</u>
Total revenue	4,425,458	100	2,551,949	100
OPERATING COSTS (Notes 13 and 17)	<u>3,789,249</u>	<u>85</u>	<u>2,213,996</u>	<u>87</u>
GROSS PROFIT	<u>636,209</u>	<u>15</u>	<u>337,953</u>	<u>13</u>
OPERATING EXPENSES (Notes 13 and 17)				
Marketing (Note 17)	59,948	1	35,418	1
General and administrative	24,852	1	19,435	1
Research and development	<u>131,427</u>	<u>3</u>	<u>65,861</u>	<u>2</u>
Total operating expenses	<u>216,227</u>	<u>5</u>	<u>120,714</u>	<u>4</u>
OPERATING INCOME	<u>419,982</u>	<u>10</u>	<u>217,239</u>	<u>9</u>
NONOPERATING INCOME AND GAINS				
Interest income	5,278	-	2,419	-
Gain on disposal of investments, net (Note 2)	3,398	-	1,760	-
Others	<u>4,807</u>	<u>-</u>	<u>55</u>	<u>-</u>
Total nonoperating income and gains	<u>13,483</u>	<u>-</u>	<u>4,234</u>	<u>-</u>
NONOPERATING EXPENSES AND LOSSES				
Losses on inventory decline value (Notes 2 and 7)	74,402	2	26	-
Foreign exchange loss, net (Note 2)	1,552	-	670	-
Others	<u>35</u>	<u>-</u>	<u>522</u>	<u>-</u>
Total nonoperating expenses and losses	<u>75,989</u>	<u>2</u>	<u>1,218</u>	<u>-</u>
INCOME BEFORE INCOME TAX	357,476	8	220,255	9
INCOME TAX EXPENSE (Notes 2 and 12)	<u>11,738</u>	<u>-</u>	<u>11,789</u>	<u>1</u>
CONSOLIDATED NET INCOME	<u>\$ 345,738</u>	<u>8</u>	<u>\$ 208,466</u>	<u>8</u>
ATTRIBUTED TO SHAREHOLDERS OF THE PARENT	<u>\$ 345,738</u>		<u>\$ 208,466</u>	

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PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

SIX MONTHS ENDED JUNE 30, 2006 AND 2005

(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

(Reviewed, Not Audited)

	2006		2005	
	Before Income Tax	After Income Tax	Before Income Tax	After Income Tax
EARNINGS PER SHARE (Note 14)				
Basic	<u>\$ 6.79</u>	<u>\$ 6.57</u>	<u>\$ 3.60</u>	<u>\$ 3.41</u>
Diluted	<u>\$ 6.77</u>	<u>\$ 6.55</u>	<u>\$ 3.48</u>	<u>\$ 3.29</u>

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

(With Deloitte & Touche review report dated July 28, 2006)

(Concluded)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

SIX MONTHS ENDED JUNE 30, 2006 AND 2005

(In Thousands of New Taiwan Dollars)

(Reviewed, Not Audited)

	Capital Stocks		Capital Received in Advance	Stock Dividends to Be Issued	Capital Surplus	Legal Reserve	Retained Earnings		Total Shareholders' Equity (Note 14)
	Shares (Thousands)	Amount			Paid-in Capital in Excess of Par Value		Unappropriated Earnings	Total	
BALANCE, JANUARY 1, 2006	52,212	\$ 522,121	\$ -	\$ -	\$ 501,962	\$ 69,113	\$ 676,382	\$ 745,495	\$ 1,769,578
Appropriation of 2005 year's earnings									
Legal reserve	-	-	-	-	-	59,009	(59,009)	-	-
Bonus to employees - stock	-	-	-	19,500	-	-	(19,500)	(19,500)	-
Bonus to employees - cash	-	-	-	-	-	-	(23,000)	(23,000)	(23,000)
Stock dividends - \$2.99088 per share	-	-	-	158,000	-	-	(158,000)	(158,000)	-
Cash dividends - \$3.97523 per share	-	-	-	-	-	-	(210,000)	(210,000)	(210,000)
Remuneration to directors and supervisors	-	-	-	-	-	-	(8,377)	(8,377)	(8,377)
Balance after appropriation	52,212	522,121	-	177,500	501,962	128,122	198,496	326,618	1,528,201
Issuance of stock due to exercise of stock options	496	4,960	-	-	-	-	-	-	4,960
Capital received in advance	-	-	1,190	-	-	-	-	-	1,190
Consolidated net income for the six months ended June 30, 2006	-	-	-	-	-	-	345,738	345,738	345,738
BALANCE, JUNE 30, 2006	<u>52,708</u>	<u>\$ 527,081</u>	<u>\$ 1,190</u>	<u>\$ 177,500</u>	<u>\$ 501,962</u>	<u>\$ 128,122</u>	<u>\$ 544,234</u>	<u>\$ 672,356</u>	<u>\$ 1,880,089</u>
BALANCE, JANUARY 1, 2005	36,232	\$ 362,321	\$ -	\$ -	\$ 51,962	\$ 34,280	\$ 379,692	\$ 413,972	\$ 828,255
Appropriation of 2004 year's earnings									
Legal reserve	-	-	-	-	-	34,833	(34,833)	-	-
Bonus to employees - stock	-	-	-	18,000	-	-	(18,000)	(18,000)	-
Bonus to employees - cash	-	-	-	-	-	-	(18,000)	(18,000)	(18,000)
Stock dividends - \$2.49380 per share	-	-	-	90,580	-	-	(90,580)	(90,580)	-
Cash dividends - \$3.49130 per share	-	-	-	-	-	-	(126,812)	(126,812)	(126,812)
Remuneration to directors and supervisors	-	-	-	-	-	-	(5,171)	(5,171)	(5,171)
Balance after appropriation	36,232	362,321	-	108,580	51,962	69,113	86,296	155,409	678,272
Issuance of stock due to exercise of stock options	23	230	-	-	-	-	-	-	230
Capital received in advance	-	-	420	-	-	-	-	-	420
Consolidated net income for the six months ended June 30, 2005	-	-	-	-	-	-	208,466	208,466	208,466
BALANCE, JUNE 30, 2005	<u>36,255</u>	<u>\$ 362,551</u>	<u>\$ 420</u>	<u>\$ 108,580</u>	<u>\$ 51,962</u>	<u>\$ 69,113</u>	<u>\$ 294,762</u>	<u>\$ 363,875</u>	<u>\$ 887,388</u>

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

(With Deloitte & Touche review report dated July 28, 2006)

PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

SIX MONTHS ENDED JUNE 30, 2006 AND 2005

(In Thousands of New Taiwan Dollars)

(Reviewed, Not Audited)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net income	\$ 345,738	\$ 208,466
Adjustments to reconcile net income to net cash provided by operating activities:		
Losses on inventory decline value	74,402	26
Deferred income tax	(9,564)	3,085
Amortization	12,449	11,223
Depreciation	5,983	4,025
Allowance for doubtful accounts	5,910	(7,889)
Gain on disposal of financial assets carried at cost	(2,139)	-
Gain on disposal of properties	(4)	-
Net changes in operating assets and liabilities		
Financial assets held for trading	-	60,154
Notes and accounts receivable	(172,322)	8,681
Other financial assets	(94,990)	1,186
Inventories	(338,669)	(164,860)
Other current assets	(32,516)	(6,070)
Notes and accounts payable	356,311	(86,937)
Income tax payable	905	3,344
Accrued expenses	(48,294)	46,351
Other current liabilities	(16,745)	8,868
Accrued pension cost	-	15
Net cash provided by operating activities	<u>86,455</u>	<u>89,668</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in financial assets carried at cost - non current	(42,500)	-
Increase in deferred charges	(15,412)	(6,637)
Acquisition of properties	(14,779)	(5,599)
Proceeds from disposal of financial assets carried at cost	6,789	-
Decrease (increase) in refundable deposits	(6,516)	39,995
Increase in intangible assets	(516)	(365)
Other	(1,372)	-
Decrease (increase) in restricted assets	(99)	5,104
Proceeds from disposal of properties	<u>24</u>	<u>-</u>
Net cash provided by investing activities	<u>(74,381)</u>	<u>32,498</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from exercise of stock options	4,960	230
Remuneration to directors and supervisors	(374)	(375)
Increase in short-term debts	-	47,430
Capital received in advance	<u>1,190</u>	<u>420</u>

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PHISON ELECTRONICS CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

SIX MONTHS ENDED JUNE 30, 2006 AND 2005

(In Thousands of New Taiwan Dollars)

(Reviewed, Not Audited)

	2006	2005
Net cash provided by financing activities	<u>5,776</u>	<u>47,705</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	17,850	169,871
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	<u>779,908</u>	<u>365,512</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 797,758</u>	<u>\$ 535,383</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	<u>\$ 33</u>	<u>\$ 516</u>
Income tax paid	<u>\$ 26,544</u>	<u>\$ 5,360</u>
INVESTING ACTIVITIES AFFECTING BOTH CASH AND NON-CASH ITEMS		
Acquisition of properties	\$ 10,193	\$ 5,323
Decrease in payables to contractors and equipment suppliers (included in accrued expenses)	<u>4,586</u>	<u>276</u>
Cash paid	<u>\$ 14,779</u>	<u>\$ 5,599</u>
Acquisition of intangible assets	\$ 516	\$ 47,795
Increase in payables to related parties	<u>-</u>	<u>(47,430)</u>
Cash paid	<u>\$ 516</u>	<u>\$ 365</u>

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

(With Deloitte & Touche review report dated July 28, 2006)

(Concluded)