

**Phison Electronics Corp.**

**Financial Statements for the Six Months Ended  
June 30, 2003 (With Comparative Financial  
Statements for the Six Months Ended June 30, 2002)  
Together with Independent Auditors' Report**

Readers are advised that the original version of these financial statements is in Chinese. This English translation is solely for the readers' convenience. If there is any conflict between these financial statements and the Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail.

English Translation of a Report Originally Issued in Chinese

Independent Auditors' Report

The Board of Directors and Shareholders  
Phison Electronics Corp.

We have audited the accompanying balance sheet of Phison Electronics Corp. as of June 30, 2003 and the related 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 express an opinion on these financial statements based on our audit. The Corporation's financial statements for the six months ended June 30, 2002 were unaudited and are presented herewith for comparative purposes only.

We conducted our audit in accordance with the Regulations for Audit of Financial Statements by Certified Public Accountants and auditing standards generally accepted in the Republic of China. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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 Phison Electronics Corp. as of June 30, 2003, and the results of its operations and its cash flows for the period then ended, in conformity with the Guidelines for Securities Issuers' Financial Reporting and accounting principles generally accepted in the Republic of China.

Deloitte & Touche

(T N Soong & Co and Deloitte & Touche (Taiwan)

Established Deloitte & Touche effective June 1, 2003)

Taipei, Taiwan

The Republic of China

August 19, 2003

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.

English Translation of Financial Statements Originally Issued in Chinese

PHISON ELECTRONICS CORP.

BALANCE SHEET

June 30, 2003

(With Comparative Financial Statements for June 30,2002)

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

<u>ASSETS</u>	<u>2003</u>		<u>2002</u> ( Unaudited )		<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>	<u>2003</u>		<u>2002</u> ( Unaudited )	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>		<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
<b>CURRENT ASSETS</b>					<b>CURRENT LIABILITIES</b>				
Cash and cash equivalents (Notes 2 and 3)	\$ 104,333	18	\$ 34,089	15	Notes payable	\$ 988	-	\$ 21,136	9
Short-term investments (Notes 2 and 4)	64,488	11	-	-	Accounts payable	199,364	34	61,681	28
Notes receivable	49,884	8	2,948	1	Income tax payable (Notes 2 and 8)	4,330	1	6,324	3
Accounts receivable	211,338	36	111,611	50	Accrued expenses and other current liabilities (Notes 2 and 7)	<u>28,067</u>	<u>5</u>	<u>8,970</u>	<u>4</u>
Allowance for sales returns and others (Notes 2)	( 826 )	-	( 261 )	-	Total Current Liabilities	<u>232,749</u>	<u>40</u>	<u>98,111</u>	<u>44</u>
Allowance for doubtful receivables (Notes 2)	( 708 )	-	( 869 )	( 1)	<b>SHAREHOLDERS' EQUITY (Note 10)</b>				
Other financial assets	1,359	-	1,487	1	Capital stock- \$10 par value				
Inventories - net (Notes 2 and 5)	73,474	12	53,326	24	Authorized - 30,000 thousand shares in 2003 and 12,000 thousand shares in 2002				
Deferred income tax assets (Notes 2 and 8)	2,418	1	132	-	Issued - 17,329 thousand shares in 2003 and 6,408 thousand shares in 2002	173,291	29	64,080	29
Pledged certificates of deposits (Note 13)	12,045	2	12,200	6	Capital received in advance	10,248	2	-	-
Prepaid expenses and other current assets	<u>12,567</u>	<u>2</u>	<u>2,884</u>	<u>1</u>	Capital surplus - paid-in capital	45,374	8	20,552	9
Total Current Assets	<u>530,372</u>	<u>90</u>	<u>217,547</u>	<u>97</u>	Retained earnings				
<b>PROPERTIES (Notes 2 and 6)</b>					Legal reserve	9,423	1	1,288	-
Cost					Unappropriated retained earnings	<u>117,427</u>	<u>20</u>	<u>39,947</u>	<u>18</u>
Testing equipment	3,315	1	1,380	1	Total retained earnings	<u>126,850</u>	<u>21</u>	<u>41,235</u>	<u>18</u>
Furniture and fixtures	1,968	-	764	-	Total Shareholders' Equity	<u>355,763</u>	<u>60</u>	<u>125,867</u>	<u>56</u>
Transportation equipment	200	-	200	-					
Leasehold improvements	750	-	-	-					
Other equipment	<u>7,419</u>	<u>1</u>	<u>1,445</u>	<u>1</u>					
Total cost	13,652	2	3,789	2					
Accumulated depreciation	<u>2,927</u>	<u>-</u>	<u>788</u>	<u>1</u>					
Net Properties	<u>10,725</u>	<u>2</u>	<u>3,001</u>	<u>1</u>					
<b>OTHER ASSETS</b>									
Refundable deposits (Note 14)	40,762	7	627	1					
Deferred charges - net (Note 2)	<u>6,653</u>	<u>1</u>	<u>2,803</u>	<u>1</u>					
Total Other Assets	<u>47,415</u>	<u>8</u>	<u>3,430</u>	<u>2</u>					
<b>TOTAL ASSETS</b>	<u>\$588,512</u>	<u>100</u>	<u>\$223,978</u>	<u>100</u>	<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u>\$588,512</u>	<u>100</u>	<u>\$223,978</u>	<u>100</u>

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

(With Deloitte & Touche auditors' report dated August 19, 2003)

English Translation of Financial Statements Originally Issued in Chinese

PHISON ELECTRONICS CORP.

STATEMENT OF INCOME

For the Six Months Ended June 30, 2003

(With Comparative Financial Statements for the Six Months Ended June 30, 2002)

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

	<u>2003</u>		<u>2002</u>		
	<u>Amount</u>	<u>%</u>	<u>( Unaudited )</u>	<u>Amount</u>	<u>%</u>
REVENUE					
Gross sales of products	\$ 797,617		\$ 341,726		
Sales returns and allowances (Note 2 and 12)	<u>2,019</u>		<u>1,407</u>		
Net sales	795,598		340,319		
Service revenue	<u>2,294</u>		<u>1,713</u>		
Total Revenue	797,892	100	342,032		100
COST OF SALES (Note 9)	<u>645,610</u>	<u>81</u>	<u>279,717</u>		<u>82</u>
GROSS PROFIT	<u>152,282</u>	<u>19</u>	<u>62,315</u>		<u>18</u>
OPERATING EXPENSES (Note 9)					
Selling	6,545	1	3,951		1
General and administrative	13,509	2	5,204		1
Research and development	<u>26,612</u>	<u>3</u>	<u>9,186</u>		<u>3</u>
Total Operating Expenses	<u>46,666</u>	<u>6</u>	<u>18,341</u>		<u>5</u>
OPERATING INCOME	<u>105,616</u>	<u>13</u>	<u>43,974</u>		<u>13</u>
NONOPERATING INCOME AND GAIN					
Gain identified during physical inventory	1,938	1	1,561		1
Commission	1,130	-	-		-
Gain on sales of short-term investments (Note 2)	617	-	414		-
Rental	171	-	-		-
Foreign exchange gain - net (Note 2)	143	-	-		-
Interest	118	-	286		-
Other income	<u>46</u>	<u>-</u>	<u>47</u>		<u>-</u>
Total Nonoperating Income and Gain	<u>4,163</u>	<u>1</u>	<u>2,308</u>		<u>1</u>
NONOPERATING EXPENSES AND LOSS					
Interest expense	13	-	27		-
Foreign exchange loss - net	-	-	1,972		1
Other expense	<u>1</u>	<u>-</u>	<u>-</u>		<u>-</u>
Total Nonoperating Expenses and Loss	<u>14</u>	<u>-</u>	<u>1,999</u>		<u>1</u>

(Forward)

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	<u>2003</u>		<u>2002</u>	
	<u>Amount</u>	<u>%</u>	<u>( Unaudited )</u>	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
INCOME BEFORE INCOME TAX	\$ 109,765	14	\$ 44,283	13
INCOME TAX EXPENSE (Notes 2 and 8)	<u>2,291</u>	<u>1</u>	<u>8,961</u>	<u>3</u>
NET INCOME	<u>\$107,474</u>	<u>13</u>	<u>\$ 35,322</u>	<u>10</u>
	Before	After	Before	After
	Income	Income	Income	Income
	<u>Tax</u>	<u>Tax</u>	<u>Tax</u>	<u>Tax</u>
EARNINGS PER SHARE (Note 11)				
Basic earnings per share	<u>\$ 6.33</u>	<u>\$ 6.20</u>	<u>\$ 4.56</u>	<u>\$ 3.64</u>
Diluted earnings per share	<u>\$ 6.28</u>	<u>\$ 6.15</u>		

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

(With Deloitte & Touche auditors' report dated August 19, 2003)

PHISON ELECTRONICS CORP.

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
For the Six Months Ended June 30, 2003  
(With Comparative Unaudited Financial Statements for the Six Months Ended June 30, 2002)  
(In Thousands of New Taiwan Dollars)

	CAPITAL STOCK		Capital Received In Advance ( Note 15 )	CAPITAL SURPLUS	RETAINED EARNINGS (Note 10)			TOTAL SHAREHOLDERS' EQUITY
	Shares (Thousands)	Amount		Additional Paid-in Capital	Legal Reserve	Unappropriated	Total	
BALANCE, JANUARY 1, 2003	7,908	\$ 79,080	\$ -	\$73,052	\$ 1,288	\$85,979	\$87,267	\$239,399
Appropriation of prior year's earnings								
Legal reserve	-	-	-	-	8,135	( 8,135 )	-	-
Bonus to employees - stock	1,355	13,550	-	-	-	( 13,550 )	( 13,550 )	-
Stock dividend - 67%	5,298	52,983	-	-	-	( 52,983 )	( 52,983 )	-
Remuneration to directors and supervisors	-	-	-	-	-	( 1,358 )	( 1,358 )	( 1,358 )
Capital transferred from capital surplus	2,768	27,678	-	( 27,678 )	-	-	-	-
Issuance of capital stock, May 16, 2003	-	-	10,248	-	-	-	-	10,248
Net income for the six months ended June 30,2003	-	-	-	-	-	107,474	107,474	107,474
BALANCE, JUNE 30, 2003	<u>17,329</u>	<u>\$173,291</u>	<u>\$10,248</u>	<u>\$45,374</u>	<u>\$9,423</u>	<u>\$117,427</u>	<u>\$126,850</u>	<u>\$355,763</u>
BALANCE, JANUARY 1, 2002	3,000	\$ 30,000	\$ -	\$ -	\$ -	\$12,885	\$12,885	\$ 42,885
Issuance of capital stock, March 1, 2002	2,000	20,000	-	-	-	-	-	20,000
Appropriation of prior year's earnings								
Legal reserve	-	-	-	-	1,288	( 1,288 )	-	-
Bonus to employees - stock	174	1,740	-	-	-	( 1,740 )	( 1,740 )	-
Stock dividend - 10%	500	5,000	-	-	-	( 5,000 )	( 5,000 )	-
Remuneration to directors and supervisors	-	-	-	-	-	( 232 )	( 232 )	( 232 )
Issuance of capital stock, April 30, 2002	734	7,340	-	20,552	-	-	-	27,892
Net income for the six months ended June 30,2002	-	-	-	-	-	35,322	35,322	35,322
BALANCE, JUNE 30, 2002	<u>6,408</u>	<u>\$ 64,080</u>	<u>\$ -</u>	<u>\$20,552</u>	<u>\$1,288</u>	<u>\$39,947</u>	<u>\$41,235</u>	<u>\$125,867</u>

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

(With Deloitte & Touche auditors' report dated August 19, 2003)

English Translation of Financial Statements Originally Issued in Chinese

PHISON ELECTRONICS CORP.

STATEMENT OF CASH FLOWS

For the Six Months Ended June 30, 2003

(With Comparative Financial Statements for the Six Months Ended June 30, 2002)

(In Thousands of New Taiwan Dollars)

	<u>2003</u>	<u>2002</u> ( Unaudited )
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 107,474	\$ 35,322
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	1,478	425
Amortization	1,057	63
Allowance for doubtful receivables	203	-
Gain on sales of short-term investments	( 617 )	( 414 )
Deferred income tax assets	( 134 )	2,603
Changes in operating assets and liabilities:		
Notes receivable	4,729	6,010
Accounts receivable	( 90,068 )	( 50,654 )
Other financial assets	1,099	( 412 )
Inventories	10,056	( 44,597 )
Prepaid expenses and other current assets	( 3,776 )	( 1,350 )
Notes payable	( 2,100 )	3,914
Accounts payable	20,907	23,662
Income tax payable	( 5,599 )	5,131
Accrued expenses and other current liabilities	( <u>1,958</u> )	<u>418</u>
Net Cash Provided by (Used in) Operating Activities	<u>42,751</u>	<u>( 19,879 )</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
(Increase) Decrease in short-term investments	( 53,871 )	14,420
Decrease in pledged certificates of deposits	7,981	-
Acquisition of properties	( 6,336 )	( 1,777 )
Decrease (increase) in refundable deposits	56	( 441 )
Increase in deferred charges	( <u>2,464</u> )	( <u>2,619</u> )
Net Cash (Used in) Provided by Investing Activities	<u>( 54,634 )</u>	<u>9,583</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Decrease in short-term loans	-	( 10,000 )
Proceeds from issuance of capital stock	-	47,892
Capital received in advance	<u>10,248</u>	-
Net Cash Provided by Financing Activities	<u>10,248</u>	<u>37,892</u>
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>( 1,635 )</b>	<b>27,596</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD (Forward)</b>	<b><u>105,968</u></b>	<b><u>6,493</u></b>

English Translation of Financial Statements Originally Issued in Chinese

	<u>2003</u>	<u>2002</u> ( Unaudited )
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 104,333</u>	<u>\$ 34,089</u>
SUPPLEMENTAL INFORMATION		
Interest paid	<u>\$ 13</u>	<u>\$ 27</u>
Income tax paid	<u>\$ 8,022</u>	<u>\$ 1,255</u>
Noncash investing activities:		
Net cash payments for acquisition of properties	\$ 5,586	\$ 1,777
Decrease in payables to contractors and equipment supplies	<u>750</u>	<u>-</u>
	<u>\$ 6,336</u>	<u>\$ 1,777</u>

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

(With Deloitte & Touche auditors' report dated August 19, 2003)



English Translation of Financial Statements Originally Issued in Chinese

PHISON ELECTRONICS CORP.

NOTES TO FINANCIAL STATEMENTS

( Financial Statements for the Six Months Ended June 30,2002 Are Unaudited)

(Amounts in Thousands of New Taiwan Dollars,

Unless Specified Otherwise)

1. GENERAL

The Corporation was incorporated on November 8, 2000 under the Company Law of the Republic of China. The Corporation was in the development stage until April 30, 2001 and started its operations and earning of significant revenue on May 1, 2001.

The Corporation mainly designs and sells flash memory controllers and peripheral system applications as well as designs the TI DSP (Texas Instruments' digital signal processor) system.

As of June 30, 2003 and 2002, the Corporation had 75 and 35 employees, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements are prepared in conformity with the Guidelines for Securities Issuers' Financial Reporting and accounting principles generally accepted in the Republic of China (ROC). Under these guidelines and principles, the Corporation should reasonably estimate the amounts of allowance for doubtful receivables; depreciation of property, plant and equipment; amortization of deferred charges and pension expenses. Actual results could differ from those estimates because of the uncertainty of circumstances.

The Corporation's significant accounting policies are summarized as follows:

Current and noncurrent assets and liabilities

Current assets are those expected to be converted to cash, sold or consumed within one year. Current liabilities are obligations due within one year. All other assets and liabilities are classified as current or noncurrent.

Cash and cash equivalents

Corporate bonds acquired under agreements that provide for repurchase for up to three months from date of purchase are classified as cash equivalents.

Short-term investments

Short-term investments are mainly in open-end funds, which are carried at the lower of cost or market value.

An allowance for losses is provided when the aggregate carrying value of the investments exceeds their total market value. Any recovery of the market value to the extent of the original carrying value is recognized as income.

Costs of ~~the~~ investments sold are determined using the weighted-average method. The market value of ~~the~~ open-end funds ~~beneficiary certificates~~ is their net asset value at the end of each period.

#### Allowance for doubtful receivables

Allowance for doubtful receivables is provided on the basis of a review of the aging and collectibility of receivables.

#### Inventories

Inventories consist of raw materials, work in process, semifinished goods and finished goods, which are stated at the lower of cost or market value. Inventories are carried at the lower of weighted-average cost or market value. The bases of market value are net realizable value for finished goods, semifinished goods and work in process and replacement cost for raw materials.

#### Properties

Properties are stated at cost less accumulated depreciation. Major additions, renewals and betterment are capitalized; maintenance and repairs are expensed currently.

Depreciation is calculated by the straight-line method over service lives initially estimated as follows: testing equipment - 3 years; furniture and fixtures - 3 years; transportation equipment - 5 years; leasehold improvements - 2 years; and other equipment - 2 to 5 years.

If an asset is still in use beyond its estimated service life, its residual value is written off over its newly estimated service life.

Upon sale or other disposal of properties, the related cost and accumulated depreciation are removed from the accounts, and any resulting gain or loss is credited or charged to income in the period of disposal.

#### Deferred charges

Deferred charges, consisting of costs in acquiring computer software and patents, are amortized using the straight-line method over 3 to 5 years.

#### Sales and sales returns and allowances

Sales are recognized when titles to products and risk of ownerships are transferred to customers, primarily upon shipment. Provisions for sales returns and others are estimated on the basis of past experience. These provisions are deducted from sales in the year the products are sold and estimated related costs are deducted from cost of sales.

Sales are determined at fair value, taking into account related sales discounts agreed to

by the Corporation and its customer. The fair value of sales receivables is equivalent to the nominal amount of cash received since the receivables are collectible within one year and sales transactions are frequent.

#### Pension costs

The Corporation has a retirement plan for all regular employees, which provides benefits based on length of service and average salaries and wages for the final six months of employment. Net periodic pension costs are recorded on the basis of actuarial calculations. Unrecognized net transition obligation is amortized over 26 years.

#### Income tax

The Corporation uses an inter-period tax allocation method for income tax. Deferred income tax assets and liabilities are recognized for the tax effects of temporary differences, unused tax credits, and operating loss carry forwards. Valuation allowances are provided to the extent, if any, that it is more likely than not that deferred income tax assets will not be realized. A deferred tax asset or liability is classified as current or noncurrent according to the classification of the related asset or liability for financial reporting. But if a deferred tax asset or liability cannot be related to an asset or liability in the financial statements, it is classified as current or noncurrent on the basis of the expected length of the realization period.

Tax credits for certain purchases of machinery, equipment and technology, research and development expenditures, personnel training, and investments are recognized currently.

Adjustments of prior years' tax liabilities are added to or deducted from the current year's tax provision.

Income tax (10%) on unappropriated earnings is expensed in the year the shareholders approve the retention of earnings.

#### Foreign-currency transactions

Foreign-currency transactions are recorded in New Taiwan dollars at spot rates. Gains or losses resulting from the application of different foreign exchange rates when cash in foreign currency is converted into New Taiwan dollars or when foreign-currency assets and liabilities are settled, are credited or charged to income in period-end of conversion or settlement. At period-end, the balances of foreign-currency assets and liabilities are restated at prevailing exchange rates, and the resulting differences are recorded as credits or charges to current income.

### 3. CASH AND CASH EQUIVALENTS

	<u>June 30</u>	
	<u>2003</u>	<u>2002</u>
Cash on hand	\$ 51	\$ 47
Checking and savings accounts	62,672	22,242
Corporate bonds acquired under repurchase agreements	34,610	-
Time deposits	<u>7,000</u>	<u>11,800</u>
	<u>\$104,333</u>	<u>\$ 34,089</u>

4. SHORT-TERM INVESTMENTS

	June 30	
	<u>2003</u>	<u>2002</u>
Open-end funds	\$ 64,488	\$ -
Market value ( based on net asset value on June 30, 2003 )	<u>\$ 64,533</u>	<u>\$ -</u>

5. INVENTORY

	June 30	
	<u>2003</u>	<u>2002</u>
Finished goods	\$ 2,933	\$ 6,930
Semifinished goods	17,971	8,678
Work in process	13,633	3,497
Raw materials	<u>39,353</u>	<u>34,454</u>
	73,890	53,559
Less: Allowance for decline in value of inventory	<u>416</u>	<u>233</u>
	<u>\$ 73,474</u>	<u>\$ 53,326</u>

6. PROPERTIES

Accumulated depreciation consisted of the following:

	June 30	
	<u>2003</u>	<u>2002</u>
Testing equipment	\$ 1,047	\$ 393
Furniture and fixtures	457	149
Transportation equipment	70	36
Leasehold improvements	188	-
Other equipment	<u>1,165</u>	<u>210</u>
	<u>\$ 2,927</u>	<u>\$ 788</u>

7. PENSION PLAN

The Corporation has a pension plan for all regular employees, which provides benefits based on length of service and average basic salaries or wages of the six months before retirement.

The Company contributes amounts equal to 3% of salaries to a pension fund monthly. The fund is administered by a pension fund monitoring committee and deposited in the committee's name in the Central Trust of China.

The changes in the fund and accrued pension cost are summarized as follows:

	Six Months Ended June 30	
	<u>2003</u>	<u>2002</u>
Pension fund		

Balance, beginning of the period	\$ 863	\$ 292
Contribution	446	242
Interest	<u>13</u>	<u>-</u>
Balance, end of the period	<u>\$ 1,322</u>	<u>\$ 534</u>

Accrued pension cost		
Balance, beginning of period	\$ 63	\$ -
Accruals	476	255
Contribution	<u>( 446 )</u>	<u>( 242 )</u>
Balance, end of period	<u>\$ 93</u>	<u>\$ 13</u>

## 8. INCOME TAX

- a. A reconciliation of income tax expense on income before income tax at the statutory rate and current income tax expense before tax credits is shown below:

	Six Months Ended June 30	
	<u>2003</u>	<u>2002</u>
Income tax expense based on income before income tax at statutory rate (25%)	\$ 27,441	\$ 11,071
Tax-exempt income	( 15,602)	-
Permanent difference	( 167)	( 100)
Temporary difference	<u>( 125)</u>	<u>255</u>
Current income tax expense before tax credits	<u>\$ 11,547</u>	<u>\$ 11,226</u>

- b. Income tax expense consisted of the following:

	Six Months Ended June 30	
	<u>2003</u>	<u>2002</u>
Current income tax expense before tax credits	\$ 11,547	\$ 11,226
Additional 10% tax on unappropriated earnings	1,169	137
Income tax credits	<u>( 6,358)</u>	<u>( 5,005)</u>
Income tax paid in current period	6,358	6,358
Net change in deferred income tax liabilities (assets )		
Investment tax credits	( 259)	3,024
Temporary differences	125	( 421)
Prior year adjustment	( 1,933)	-
Valuation allowance	<u>( 2,000)</u>	<u>-</u>
Income tax expense	<u>\$ 2,291</u>	<u>\$ 8,961</u>

- c. Deferred income tax assets consisted of the following:

	Six Months Ended June 30	
	<u>2003</u>	<u>2002</u>

Current:		
Temporary difference	\$ 318	(\$ 132)
Investment tax credits	<u>4,100</u>	<u>-</u>
	<u>\$ 4,418</u>	<u>(\$ 132)</u>

The effective tax rate used for deferred income tax assets calculation were 25%.

d. Integrated income tax information is as follows

	<u>June 30</u>	
	<u>2003</u>	<u>2002</u>
Imputation credit account (ICA)	<u>\$ 9,294</u>	<u>\$ 1,299</u>

The expected and actual creditable tax ratios for 2002 and 2001 were 10.81% and 0.01%, respectively.

e. As of June 30, 2003, investment tax credits consisted of the following:

<u>Regulation</u>	<u>Items</u>	<u>Total Creditable Amounts</u>	<u>Remaining Creditable Amounts</u>	<u>Expire Year</u>
Statute for Upgrading Industries	Purchase of machinery	\$ 37	\$ -	2005
	and equipment	<u>44</u>	<u>-</u>	2006
		<u>\$ 81</u>	<u>\$ -</u>	
	Research and development	\$ 697	\$ -	2004
	expenditures	2,312	-	2005
		1,540	-	2006
		<u>5,828</u>	<u>4,100</u>	2007
		<u>\$ 10,377</u>	<u>\$ 4,100</u>	

f. Income from the following expansion project based on the Corporation's investment plan is exempt from income tax:

Tax-Exemption Period

High-level IC design and pen drive production September 2002 to September 2007

Income tax returns through 2000 had been examined and cleared by the tax authorities.

## 9. PERSONNEL, DEPRECIATION AND AMORTIZATION EXPENSES

	<u>Six Months Ended June 30, 2003</u>	
	Classified as	
Classified as	Operating	
<u>Cost of Sales</u>	<u>Expense</u>	<u>Total</u>

Personnel			
Salary	\$ 4,311	\$ 21,268	\$ 25,579
Labor and health insurance	363	1,026	1,389
Pension	121	355	476
Other	242	2,038	2,280
Depreciation	393	1,085	1,478
Amortization	-	1,057	1,057
	<u>\$ 5,430</u>	<u>\$ 26,829</u>	<u>\$ 32,259</u>

Six Months Ended June 30, 2002

	Classified as Cost of Sales	Classified as Operating Expense	Total
Personnel			
Salary	\$ 1,681	\$ 10,964	\$ 12,645
Labor and health insurance	165	541	706
Pension	38	217	255
Other	98	364	462
Depreciation	63	362	425
Amortization	-	63	63
	<u>\$ 2,045</u>	<u>\$ 12,511</u>	<u>\$ 14,556</u>

## 10. SHAREHOLDERS' EQUITY

Capital surplus can only be used to offset a deficit under the ROC Company Law. However, the components of capital surplus generated from donations and the excess of the issue price over the par value of capital stock may be transferred to capital as stock dividends.

The Corporation's Articles of Incorporation provide that, under the board of directors' resolution, a certain percentage of annual net income (less tax, any deficit and 10% as legal reserve) plus accumulated unappropriated prior year's retained earnings, should be appropriated as follows:

- a. 2%, as remuneration to directors and supervisors;
- b. 10% to 20%, as bonus to employees; and
- c. The remainder, as dividends.

The dividend apportion is according to the net income of the year, and base the stability of dividends. Since it is expanding fast, the Corporation takes into account in its dividend policy the current and future investment conditions, capital disposal, domestic and international competitions, capital budgeting requirements, interests of the shareholders, balance between cash and stock dividends, and the Corporation's long-term financial plans. Based on these considerations, a proposal on dividend appropriation is prepared by the board of directors for shareholders' approval. Of total dividends, stock dividends are from 50% to 100% and cash dividends are from 0% to 50%.

These appropriations and the disposition of the remaining net income should be approved by the shareholders in the following year and given effect to in the financial statements of that year.

The appropriation for legal reserve should be made until the reserve equals the Corporation's authorized capital stock. The reserve can only be used to offset a deficit or when the balance of the reserve reaches 50% of the Corporation's paid-in capital, up to 50% thereof may be capitalized.

The appropriations of the earnings of 2002 and 2001 were approved in the shareholders' meeting on March 26, 2003 and April 9, 2002, respectively. The appropriations, including dividends per share, are as follows:

	<u>Appropriation of Earnings</u>		<u>Dividends Per Share (Dollars)</u>	
	<u>Of Fiscal Year 2002</u>	<u>Of Fiscal Year 2001</u>	<u>For Fiscal Year 2002</u>	<u>For Fiscal Year 2001</u>
Legal reserve	\$ 8,135	\$ 1,288	\$ -	\$ -
Bonus to employees - in stock	13,550	1,740	-	-
Common dividends	52,983	5,000	6.7	1.0
Remuneration to directors and supervisors - in cash	<u>1,358</u>	<u>232</u>	-	-
	<u>\$ 76,026</u>	<u>\$ 8,260</u>		

The above appropriation of the earnings of fiscal years 2002 and 2001 is consistent with the board of directors' proposals, which were approved by shareholders in their meetings on February 20, 2003 and March 5, 2002 respectively. Had the above employee bonus and remuneration to directors and supervisors been paid in cash and charged against the incomes of 2002 and 2001, the basic earnings per share for the years ended December 31, 2002 and 2001 would have decreased from NT\$13.98 to NT\$5.01 and from NT\$11.42 to NT\$4.43, respectively. The shares distributed as a bonus to employees represented 17.1% and 5.8% of the Company's total outstanding common shares as of December 31, 2002 and 2001, respectively.

Information on the appropriations of bonus to employees and remuneration to directors and supervisors can be viewed online through the Market Observation Post System on the Web site of the Taiwan Stock Exchange (<http://mops.tse.com.tw>).

The shareholders also approved the appropriation of \$13,350 thousand as stock bonuses to employees; \$52,983 thousand as common dividends; and \$27,678 thousand as a transfer from capital surplus to capital stock. For these three appropriations, new shares totaling \$94,211 thousand were issued. The total paid-in capital after this issuance will increase to \$173,291 thousand.

Under the integrated income tax system, ROC-resident shareholders are allowed a tax credit for the income tax paid by the Corporation on earnings generated. The Corporation maintains an imputation credit account (ICA) for this income tax. The tax credit allocated to each shareholder will be based on the ratio of the ICA balance to undistributed earnings. This ratio will be computed on the date of dividend distribution.

In their September 5, 2002 meeting, the board of directors approved the Corporation's



Employee Stock Option Plan (the "Plan"). The Plan provides qualified employees with 640 thousand units of option rights, with each unit representing 1 share of common stock. The option rights are valid for three years and exercisable after the second year of issuance. As of February 24, 2003 and September 6, 2002, there were 112 and 528 thousand shares granted, respectively, at approximately NT\$13.00 per share.

Information on the status of stock option rights under the Plan as of June 30, 2003 is as follows:

	Option Rights Available for Grant (Thousands)	Outstanding Option Rights	
		Number of Option Rights (Thousands)	Exercise Price (Dollars)
Balance, January 1, 2003	112	528	\$ 13
Options granted	( 112)	112	13
Balance, June 30, 2003	<u>-</u>	<u>640</u>	

#### 11. EARNINGS PER SHARE

The amounts used in computing earnings per share (EPS) were as follows:

	Amounts (Numerator)		Shares (Denominator) (Thousands)	EPS (Dollars)	
	Before Income Tax	After Income Tax		Before Income Tax	After Income Tax
<u>Six months ended June 30, 2003</u>					
Basic EPS					
Income of common shareholders	\$109,765	\$107,474	17,329	<u>\$ 6.33</u>	<u>\$ 6.20</u>
Employee stock option Dilutive effect of potential common shares	<u>-</u>	<u>-</u>	<u>152</u>		
Diluted EPS					
Income of common shareholders plus dilutive effect of potential common shares	<u>\$109,765</u>	<u>\$107,474</u>	<u>17,481</u>	<u>\$ 6.28</u>	<u>\$ 6.15</u>
<u>Six months ended June 30, 2002</u>					
Basic EPS					
Income of common shareholders	<u>\$44,283</u>	<u>\$35,322</u>	<u>9,716</u>	<u>\$ 4.56</u>	<u>\$ 3.64</u>

Based on the treasury stock method under the Statement of Financial Accounting Standards No. 24, "Earnings Per Share," the potential common shares from the Employee Stock Option Plan (See Note 10) were included in the denominator of the

diluted EPS computation because these shares were considered dilutive.

The average number of shares outstanding for EPS calculation had been adjusted retroactively for the issuance of stock dividends and stock bonuses. The retroactive adjustment caused the basic EPS before income tax and after income tax for the year ended June 30, 2001 to decrease from NT\$7.48 and NT\$5.97 to NT\$4.56 and NT\$3.64, respectively.

## 12. RELATED-PARTY TRANSACTIONS

- a. The Corporation had business transactions with the following related party:

<u>Related Party</u>	<u>Nature of Relationship</u>
M-Systems Flash Disk Pioneers	M-Systems Flash Disk Pioneers is the Parent company of the Board of Directors of the Corporation

- b. The significant transaction with the above related party is summarized as follows:

	<u>Six Months Ended June 30</u>			
	<u>2003</u>		<u>2002</u>	
<u>For the period</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Sales				
M-Systems Flash Disk Pioneers	<u>\$ -</u>	<u>-</u>	<u>\$ 25,668</u>	<u>8</u>
<u>At end of the period</u>				
Receivables	<u>\$ -</u>	<u>-</u>	<u>\$ 5,541</u>	<u>5</u>

The selling terms and price for related and third parties are similar.

## 13. PLEDGED ASSETS

The Corporation had pledged certificates of deposits as collateral for the issuance of letters of credit for purchasing materials.

	<u>June 30</u>	
	<u>2003</u>	<u>2002</u>
Pledged certificates of deposits	<u>\$ 12,045</u>	<u>\$ 12,200</u>

## 14. SIGNIFICANT COMMITMENTS AND CONTINGENCIES

The significant commitments and contingencies as of June 30, 2003 were as follows:

- a. The Corporation leases its office under operating lease agreements that will expire in December 2004. The current rent amounts to \$2,761 each year. As of June 30, 2003, the estimated future annual minimum rents under the lease agreements are as follows:

<u>Period</u>	<u>Amount</u>
2003 (from July to December)	\$ 1,308
2004	<u>2,509</u>
	<u>\$ 3,817</u>

- b. Unused letters of credit amounted to \$161,118 thousand.
- c. In March 2001, the Corporation entered into a product development agreement with the Industrial Technology Research Institute (the "Institute"). The Corporation should pay the Institute development expenses of \$1,000 in four installments. In addition, the Corporation should pay the Institute 1% of future net sales of products developed using the Institute's patent. As of September 30, 2002, the total development expenses had been paid off.
- d. In December 2002, the Corporation entered into a product development agreement with the Industrial Technology Research Institute (the "Institute"). The Corporation should pay the Institute development expenses of \$1,200 in three installments. As of July 31, 2003, the total development expenses had been paid off.
- e. On August 15, 2002, Feiya Technology Corp. ("Feiya", which was later renamed Silicon Motion, Inc.) filed a case with the Hsinchu District Court against the Corporation and the Corporation's president, Mr. Pua Khein Seng, and vice president, Mr. Aw Yong Chee Kong, who were former employees of Feiya. Feiya claimed damages of \$45,000 for alleged theft of trade secrets. According to the legal counsel of the Corporation, Feiya could not provide evidences for its charge. Therefore, no accruals had been provided because the Corporation believed the litigation would not have significant impact on its financial conditions and operations. Nevertheless, the Corporation placed \$40,000 with the Hsinchu District Court as guarantee deposit for this litigation.

#### 15. SIGNIFICANT SUBSEQUENT EVENTS

On July 1, 2003, the Corporation issued \$3,660 thousand in new common shares with a par value of NT\$10.00 and issuance price at NT\$28.00 per share. The total paid-in capital after this issuance will increase to \$176,951 thousand.

#### 16. ADDITIONAL DISCLOSURES

Following are the additional disclosures required by the Securities and Futures Commission for the Corporation and its investees:

- a. Marketable securities held: Table 1 (attached)
- b. Marketable securities acquired and disposed of at costs or prices of at least NT\$100 million or 20% of the paid-in capital: Table 2 (attached)
- c. Financial instrument transactions:
  - 1. The Company did not enter into any derivative transactions in the periods

ended June 30, 2003 and 2002.

2. Fair value of financial instruments:

	<u>June 30,2003</u>		<u>June 30,2002</u>	
	<u>Carrying</u>	<u>Fair</u>	<u>Carrying</u>	<u>Fair</u>
	<u>Value</u>	<u>Value</u>	<u>Value</u>	<u>Value</u>
<u>Assets</u>				
Cash and cash equivalents	\$ 104,333	\$ 104,333	\$ 34,089	\$ 34,089
Short-term investments	64,488	64,533	-	-
Notes receivable	49,884	49,884	2,948	2,948
Accounts receivable	211,338	211,338	111,611	111,611
Other financial asset	1,359	1,359	1,487	1,487
Pledged certificate of deposits	12,045	12,045	12,200	12,200
Refundable deposits	40,762	40,762	627	627
<u>Liabilities</u>				
Notes payable	988	988	21,136	21,136
Accounts payable	199,364	199,364	61,681	61,681

The following bases were used to estimate the fair values of financial instruments:

- 1) Short-term financial instruments - the carrying amounts reported in the balance sheet, which approximate their fair values;
- 2) Short-term investments - market values;
- 3) Refundable deposits and guarantee deposits - carrying values.

The fair values of nonfinancial instruments were not included in the fair values disclosed above. Thus, the sum of the fair values of the financial instruments listed above is not the fair value of the Corporation.

## PHISON ELECTRONICS CORP.

## MARKETABLE SECURITIES HELD

June 30, 2003

(Amounts in Thousands of New Taiwan Dollars, Unless Otherwise Specified)

Marketable Securities Type	Marketable Securities Name	Relationship with the Corporation	Financial Statement Account	June 30, 2003			Note	
				Shares/Units (Thousands)	Carrying Value	Percentage of Ownership		Market Value
Beneficiary certificate	Capital Cash Reserves Fund	-	Short-term investments	1,548	\$17,139	-	\$17,167	-
	Capital Safe Income Fund	-	Short-term investments	717	10,044	-	10,046	-
	Sheng Hua 1699 Bond Fund	-	Short-term investments	1,699	20,000	-	20,004	-
	Nam Short Term Fixed Income Fund	-	Short-term investments	39	17,305	-	17,316	-

Note: The Corporation held marketable securities that had not been guaranteed, pledged or mortgaged as collaterals ~~and~~ nor restricted by other commitments.

## PHISON ELECTRONICS CORP.

## MARKETABLE SECURITIES ACQUIRED AND DISPOSED OF AT COSTS OR PRICES OF AT LEAST NT\$100 MILLION OR 20% OF THE PAID-IN CAPITAL

For the Six Months Ended June 30, 2003

(Amounts in Thousands of New Taiwan Dollars, Unless Otherwise Specified)

Company Name	Marketable Securities Type and Name	Financial Statement Account	Counter-Party	Nature of Relationship	Beginning Balance		Acquisition		Disposal				Ending Balance	
					Shares (Thousands)	Amount	Shares/Units (Thousands)	Amount	Shares/Units (Thousands)	Amount	Carrying Value	Gain on Disposal	Shares/Units (Thousands)	Amount
Phison Electronics Corp.	<u>Beneficiary Certificate</u>													
	Capital Cash Reserves Fund	Short-term investments	-	-	-	\$ -	5,465	\$ 60,250	3,917	\$ 43,250	\$ 43,111	\$ 139	1,548	\$ 17,139
	Capital Safe Income Fund	Short-term investments	-	-	-	-	2,869	40,078	2,152	30,078	30,034	44	717	10,044
	Golden Fuhwa Bond Fund	Short-term investments	-	-	-	-	3,327	40,088	3,327	40,211	40,088	123	-	-
	Sheng Hua 1699 Bond Fund	Short-term investments	-	-	-	-	11,174	131,023	9,475	111,194	111,023	171	1,699	20,000
	Nam Short-term Fixed Income Fund	Short-term investments	-	-	-	-	102	45,062	63	27,776	27,757	19	39	17,305