Phison Electronics Corp.

Financial Statements for the Years Ended December 31, 2003 and 2002 Together with Independent Auditors' Report

Readers are advised that the original version of these financial statements is in Chinese. 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.

<u>English Translation of a Report Originally Issued in Chinese</u>

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
Phison Electronics Corp.

We have audited the accompanying balance sheets of Phison Electronics Corp. as of December 31, 2003 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 Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the Rules for Auditing and Certification 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 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 Phison Electronics Corp. as of December 31, 2003 and 2002 and the results of its operations and cash flows for the years then ended, in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the Republic of China.

February 27, 2004

<u>Notice to Readers</u>

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 SHEETS
DECEMBER 31, 2003 AND 2002
(In Thousands of New Taiwan Dollars, Except Par Value)

	2003		2002	
ASSETS	**Amount**	**%**	**Amount**	**%**
CURRENT ASSETS				
Cash and cash equivalents (Notes 2 and 3)	$ 97,361	8	$ 105,968	23
Short-term investments (Notes 2 and 4)	141,336	12	10,000	2
Notes receivable (Note 2)	64,023	5	54,613	12
Accounts receivable (Note 2)	517,486	44	121,270	26
Allowance for sales returns and others (Note 2)	(1,652)	-	(826)	-
Allowance for doubtful receivables (Note 2)	(17,558)	(2)	(505)	-
Other financial assets	20,806	2	2,458	1
Inventories—net (Notes 2 and 5)	242,383	21	83,530	18
Pledged bank deposits and certificates of deposits (Note 15)	18,070	2	22,026	5
Deferred income tax assets (Notes 2 and 10)	3,918	-	2,284	-
Prepaid expenses and other current assets	10,922	1	6,791	2
Total current assets	1,097,095	93	407,609	89
PROPERTIES (Notes 2 and 6)				
Cost				
Testing equipment	9,111	1	4,091	1
Transportation equipment	200	-	200	-
Furniture and fixtures	2,233	-	981	-
Leasehold improvements	750	-	750	-
Other equipment	5,393	-	2,044	1
Total cost	17,687	1	8,066	2
Less: Accumulated depreciation	5,765	-	1,449	1
Net properties	11,922	1	6,617	1
OTHER ASSETS				
Refundable deposits (Note 16)	40,788	4	40,818	9
Deferred income tax assets (Notes 2 and 10)	13,038	1	-	-
Deferred charges—net (Notes 2 and 7)	11,799	1	5,246	1
Total other assets	65,625	6	46,064	10
TOTAL ASSETS	$ 1,174,642	100	$ 460,290	100

	2003		2002	
LIABILITIES AND SHAREHOLDERS' EQUITY	**Amount**	**%**	**Amount**	**%**
CURRENT LIABILITIES				
Short-term loans (Note 8)	$ 30,609	3	$ -	-
Notes payable	91	-	3,088	1
Accounts payable	282,964	24	178,457	39
Payables to related parties (Note 14)	233,381	20	-	-
Income tax payable (Notes 2 and 10)	11,238	1	9,929	2
Other payables (Note 16)	45,000	4	-	-
Accrued expenses and other current liabilities	74,290	6	29,354	6
Total current liabilities	677,573	58	220,828	48
ACCRUED PENSION COST (Notes 2 and 9)	212	-	63	-
Total liabilities	677,785	58	220,891	48
SHAREHOLDERS' EQUITY (Note 12)				
Capital stock, $10 par value				
Authorized—30,000 thousand and 12,000 thousand shares as of December 31, 2003 and 2002, respectively				
Issued—17,695 thousand and 7,908 thousand shares as of December 31, 2003 and 2002, respectively	176,951	15	79,080	17
Capital surplus—paid-in capital	51,962	4	73,052	16
Retained earnings				
Legal reserve	9,423	1	1,288	-
Unappropriated retained earnings	258,521	22	85,979	19
Total retained earnings	267,944	23	87,267	19
Total shareholders' equity	496,857	42	239,399	52
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,174,642	100	$ 460,290	100

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

PHISON ELECTRONICS CORP.

STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002
(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2003		2002	
	Amount	%	Amount	%
REVENUE				
Gross sales	$ 2,476,411		$ 834,840	
Sale returns and allowances	8,820		6,575	
Net sales (Notes 2 and 14)	2,467,591		828,265	
Service revenue	2,658		6,737	
Total revenue	2,470,249	100	835,002	100
COST OF SALES (Notes 11 and 14)	2,000,426	81	686,058	82
GROSS PROFITS	469,823	19	148,944	18
OPERATING EXPENSES (Note 11)				
Selling	43,559	2	8,186	1
General and administrative	27,495	1	16,415	2
Research and development	103,630	4	31,255	4
Total operating expenses	174,684	7	55,856	7
OPERATING INCOME	295,139	12	93,088	11
NONOPERATING INCOME AND GAINS				
Commission	1,834	-	-	-
Interest	1,389	-	1,091	-
Gain on sales of short-term investments (Note 2)	1,155	-	669	-
Inventory gains identified during physical count	348	-	-	-
Subsidy income (Note 2)	-	-	571	-
Other income	1,152	-	913	-
Total nonoperating income	5,878	-	3,244	-
NONOPERATING EXPENSES AND LOSSES				
Losses on litigation (Note 16)	45,000	2	-	-
Losses on decline in value of inventory (Notes 2 and 5)	10,793	-	183	-
Foreign exchange loss—net (Note 2)	1,757	-	2,084	-
Interest expense	88	-	592	-
Inventory loss identified during physical count	-	-	1,636	-
Other expenses	2	-	2	-
Total nonoperating expenses and losses	57,640	2	4,497	-

(Continued)

	2003 Amount	2003 %	2002 Amount	2002 %
INCOME BEFORE INCOME TAX	$ 243,377	10	$ 91,835	11
INCOME TAX BENEFIT (EXPENSE) (Notes 2 and 10)	5,191	-	(10,481)	(1)
NET INCOME	$ 248,568	10	$ 81,354	10

	2003 Before Income Tax	2003 After Income Tax	2002 Before Income Tax	2002 After Income Tax
EARNINGS PER SHARE (Note 13)				
Basic earnings per share	$13.90	$14.19	$ 7.20	$ 6.38
Diluted earnings per share	$13.60	$13.89	$ 7.15	$ 6.34

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

English Translation of Financial Statements Originally Issued in Chinese

PHISON ELECTRONICS CORP.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002
(In Thousands of New Taiwan Dollars, Except Per Share Data)

	Capital Stock Issued		Capital Surplus	Retained Earnings (Note 12)			Total Shareholders' Equity
	Shares (thousands)	Amount	Paid-in Capital	Legal reserve	Unappropriated	Total	
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
Issuance of capital stock, December 27, 2002	1,500	15,000	52,500	-	-	-	67,500
Net income in 2002	-	-	-	-	81,354	81,354	81,354
BALANCE, DECEMBER 31, 2002	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, July 1, 2003	366	3,660	6,588	-	-	-	10,248
Net income in 2003	-	-	-	-	248,568	248,568	248,568
BALANCE, DECEMBER 31, 2003	17,695	$176,951	$ 51,962	$9,423	$258,521	$267,944	$496,857

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

PHISON ELECTRONICS CORP.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2002
(In Thousands of New Taiwan Dollars)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 248,568	$ 81,354
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,316	1,086
Amortization	3,737	509
Losses on litigation	45,000	-
Loss on decline in value of inventory	10,793	183
Deferred income tax assets	(14,672)	451
Accrued pension cost	149	63
Allowance for doubtful receivables	17,053	505
Allowance for sales returns and discounts	826	565
Changes in operating assets and liabilities:		
Notes receivable	(9,410)	(45,655)
Accounts receivable	(396,216)	(61,182)
Other financial assets	(18,348)	(1,383)
Inventories	(169,646)	(74,984)
Prepaid expenses and other current assets	(4,131)	(7,257)
Notes payable	(2,997)	(14,134)
Accounts payable	104,507	140,438
Payables to related parties	233,381	-
Income tax payable	1,309	8,736
Accrued expenses and other current liabilities	45,686	20,284
Net cash provided by operating activities	99,905	49,579
CASH FLOWS FROM INVESTING ACTIVITIES		
(Increase) decrease in short-term investments	(131,336)	4,006
(Increase) decrease in pledged bank deposits and certificates of deposits	3,956	(7,826)
Acquisition of properties	(10,371)	(5,304)
Decrease (increase) in refundable deposits	30	(40,632)
Increase in deferred charges	(10,290)	(5,508)
Net cash used in investing activities	(148,011)	(55,264)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in short-term loans	30,609	(10,000)
Proceeds from issuance of capital stock	10,248	115,392
Remuneration to directors and supervisors	(1,358)	(232)
Net cash provided by financing activities	39,499	105,160

(Continued)

	2003	2002
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	($ 8,607)	$ 99,475
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	105,968	6,493
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 97,361	$ 105,968
SUPPLEMENTAL INFORMATION		
Interest paid	$ 28	$ 592
Income tax paid	$ 8,044	$ 1,294
Noncash investing activities:		
Net cash payments for acquisition of properties	$ 9,621	$ 6,054
Decrease (increase) in payables to contractors and equipment suppliers (included in accrued expenses and other current liabilities)	750	(750)
	$ 10,371	$ 5,304

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

PHISON ELECTRONICS CORP.

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002
(Amounts in Thousands of New Taiwan Dollars, Unless Specified of Otherwise)

1. GENERAL

Phison Electronics Corp. (the "Corporation") was incorporated on November 8, 2000 under the Company Law of the Republic of China (ROC).

The Corporation's shares have been traded on the ROC over-the-counter securities exchange since January 2, 2004.

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 December 31, 2003 and 2002, the Corporation had 95 and 55 employees, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements are prepared in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers 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 sales returns and allowance; allowance for doubtful receivables, loss on decline in value of inventory, pension expenses; depreciation of properties, and amortization of deferred charges. 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 cash and cash equivalents and other assets 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 noncurrent.

Cash and Cash Equivalents

Corporate bonds acquired under agreements for repurchase within 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. Loss on decline in market value is recognized in the current year's income.

An allowance for losses is provided when the aggregate carrying value of the investments exceeds their total market value.

Costs of investments sold are determined using the weighted-average method. The market value of open-end funds 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 aggregated cost or market value. Inventories are carried at the weighted-average cost method. 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 two to five 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, since the earnings process is completed and sales is realized or realizable. For products shipped for further processing, sales are not recognized because there is no transfer of titles and risks. 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.

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.

Subsidy income

The Corporation receives a subsidy from the government for developing certain products. The Corporation recognizes the subsidy as income when it is realized, and records as deferred revenue if it is not realized.

Pension Costs

Effective December 31, 2002, the Corporation adopted Statement of Financial Accounting Standards No. 18, "Accounting for Pensions," which requires the (a) actuarial determination of assets and obligations as of December 31, 2002; (b) recognition of additional liability as both asset and liability; (c) disclosure of certain pension information; and (d) recognition of pension costs as actuarially determined starting 2003. The adoption had no significant impact on the Corporation's 2002 financial statements.

In 2002, the Corporation recognized pension expense for the amount contributed to a pension fund.

Pension benefits paid in excess of the fund are charged to expense.

Income Tax

The Corporation uses inter-period tax allocation method for income tax. Deferred income tax assets and liabilities are recognized for the tax effects of temporary differences and unused tax credits. 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 expense.

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 the year 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.

Reclassifications

Certain accounts for 2002 have been reclassified to conform to the 2003 financial statement presentation.

3. CASH AND CASH EQUIVALENTS

	2003	2002
Cash on hand	$ 53	$ 37
Checking and savings accounts	49,694	99,278
Time deposits	47,614	-
Corporate bonds acquired under repurchase agreements	-	6,653
	$ 97,361	$ 105,968

4. SHORT-TERM INVESTMENTS

	2003	2002
Open-end funds	$ 141,336	$ 10,000
Market value	$ 141,575	$ 10,000

5. INVENTORY

	2003	2002
Finished goods	$ 10,637	$ 5,675
Semifinished goods	42,394	27,801
Work in process	48,937	388
Raw materials	151,624	50,082
	253,592	83,946
Less: Allowance for decline in value of inventory	11,209	416
	$ 242,383	$ 83,530

6. PROPERTIES

Accumulated depreciation consisted of the following:

	2003	2002
Testing equipment	$ 2,370	$ 729
Transportation equipment	86	53
Furniture and fixtures	723	252
Leasehold improvements	375	-
Other equipment	2,211	415
	$ 5,765	$ 1,449

7. DEFERRED CHARGES－NET

	2003	2002
Computer software	$ 10,472	$ 4,500
Patents	1,327	746
	$ 11,799	$ 5,246

8. SHORT-TERM BORROWINGS

	2003
Unsecured loans: US$900 thousand, 2.38% annual interest, due in May 2004	$ 30,609

As of December 31, 2003, the Company had unused credit lines totaling about $141,178 thousand, which are available for short-term borrowings.

9. 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 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 plan assets and unfunded accrued pension cost for the years ended December 31, 2003 and 2002 are summarized as follows:

a. Components of pension cost

	2003
Service cost	$ 1,142
Interest cost	50
Projected return on plan assets	(41)
Amortization	29
Net pension cost	$ 1,180

b. Reconciliation of the fund status of the plan and accrued pension cost

	2003	2002
Benefit obligation		
Vested benefit obligation	$ -	$ -
Non-vested benefit obligation	1,664	758
Accumulated benefit obligation	1,664	758
Additional benefits based on future salaries	1,794	905
Projected benefit obligation	3,458	1,663
Fair value of plan assets	(1,925)	(876)
Funded status	1,533	787
Unrecognized net transitional obligation	(758)	(787)
Unrecognized net loss	(626)	-
Accrued pension liabilities	$ 149	$ -
Vested benefits	$ -	$ -

c. Actuarial assumptions

Discount rated used in determining present values	3.00%	3.00%
Future salary increase rate	3.00%	3.00%
Expected rate of return on plan assets	3.00%	3.00%

d. Summary of changes in the pension fund

Contributions	$ 1,031	$ 532
Payment of benefits	$ -	$ -

10. INCOME TAX

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

	2003	2002
Income tax expense based on income before income tax at statutory rate (25%)	$ 60,844	$ 22,959
Tax-exempt income	(56,785)	(3,470)
Permanent difference	10,685	(198)
Temporary difference	6,661	565
Current income tax expense before tax credits	$ 21,405	$ 19,856

b. Income tax benefit (expense) consisted of:

	2003	2002
Income tax expense before tax credits—current	($ 21,405)	($ 19,856)
Additional 10% tax on unappropriated earnings	(1,169)	(148)
Separate tax on short-term notes and bills	(127)	-
Income tax credits	11,287	10,002
Income tax paid—current	(11,414)	(10,002)
Net change in deferred income tax assets		
Investment tax credits	18,507	(451)
Temporary differences	3,918	-
Valuation allowance	(7,753)	-
Adjustments to prior year's income tax	1,933	(28)
Income tax benefit (expense)	$ 5,191	($ 10,481)

c. Deferred income tax assets consisted of the following:

	2003	2002
Current:		
Temporary differences	$ 3,918	$ 442
Investment tax credits	-	1,842
	$ 3,918	$ 2,284
Noncurrent:		
Temporary differences	$ 442	$ -
Investment tax credits	20,349	-
Valuation allowances	(7,753)	-
	$ 13,038	$ -

The effective tax rate used for deferred income tax asset calculation was 25%.

d. Integrated income tax information:

	2003	2002
Imputation credit account (ICA)	$ 9,294	$ 1,299

The estimated and actual creditable tax ratios for 2003 and 2002 were 3.60% and 1.51%, respectively.

The imputation credits allocated to the shareholders are based on the ICA balance as of the date of dividend distribution. Thus, the estimated creditable ratio for 2003 may be adjusted when the distribution of the imputation credits are made.

e. As of December 31, 2003, investment tax credits consisted of the following:

Regulation	Items	Total Creditable Amounts	Remaining Creditable Amounts	Expire Year
Statute for Upgrading Industries	Purchase of machinery and equipment	$ 37	$ -	2005
		44	-	2006
		66	-	2007
		$ 147	$ -	
	Research and development expenditures	$ 697	$ -	2004
		2,312	-	2005
		1,540	-	2006
		26,940	20,349	2007
		$ 31,489	$ 20,349	

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 2001 had been examined and cleared by the tax authorities.

11. PERSONNEL, DEPRECIATION AND AMORTIZATION EXPENSES

	2003		
	Classified as Cost of Sales	Classified as Operating Expense	Total
Personnel			
Salary	$ 14,394	$ 54,545	$ 68,939
Labor and health insurance	1,060	2,800	3,860
Pension	263	917	1,180
Other	1,608	3,699	5,307
Depreciation	1,114	3,202	4,316
Amortization	-	3,737	3,737
	$ 18,439	$ 68,900	$ 87,339

	2002		
	Classified as Cost of Sales	**Classified as Operating Expense**	**Total**
Personnel			
Salary	$ 6,790	$ 25,830	$ 32,620
Labor and health insurance	398	1,328	1,726
Pension	103	492	595
Other	249	810	1,059
Depreciation	423	663	1,086
Amortization	-	509	509
	$ 7,963	$ 29,632	$ 37,595

12. 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 issue price in excess of 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 any deficit and 10% as legal reserve) plus accumulated unappropriated 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 Corporation's dividend appropriation is based on its profitability. In addition, since the Corporation is expanding fast, the it considers the current and future investment environment, capital requirements, domestic and international competition, capital budget plans, shareholders' interests, balances between cash and stock dividends, and the Corporation's long-term financial plans in forming its dividend policy. The board of directors prepares the proposal on annual earning distribution for shareholders' approval. In the appropriation of total dividends, stock dividends should be 50% to 100% and cash dividends, 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.

Legal reserve should be appropriated until the reserve equals the Corporation's paid-in capital. 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 appropriation of the earnings of 2002 and 2001 was approved in the shareholders' meetings on March 26, 2003 and April 9, 2002, respectively. The appropriations, including dividends per share, are as follows:

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

The above appropriation of the earnings of fiscal years 2002 and 2001 is consistent with the board of directors' resolution in their meetings on February 24, 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$6.38 to NT$5.21 and from NT$2.29 to NT$2.02, respectively. The shares distributed as bonus to employees were 17.1% and 5.8% of the Corporation's total outstanding common shares as of December 31, 2002 and 2001, respectively.

As of February 27, 2004, the date of the accompanying auditors' report, the board of directors has not resolved the earnings appropriation for fiscal year 2003.

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

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.

On October 21, 2003 and May 16, 2002, the Securities and Futures Commission approved the Corporation's Employee Stock Option Plans (the "Plans"), which provided qualified employees with 1,200 thousand and 640 thousand units of option rights, respectively, with each unit representing one share of common stock. The option rights of both plans are valid for three years and exercisable at certain percentages after the second anniversary of issuance. Exercise price should not be lower than net book value per share, calculated on the basis of the Corporation's most recent audited financial statements.

Information on the status of stock option rights under the Plans as of December 31, 2003 is as follows:

	Option Rights Available for Grant (Thousands)	Outstanding Option Rights Number of Option Rights (Thousands)	Outstanding Option Rights Exercise Price (Dollars)
Balance, January 1, 2003	112	528	$ 10
Options increased	1,200	-	-
Options granted	(1,312)	1,312	10~30
Balance, December 31, 2003	-	1,840	

Under both Plans, the above number of outstanding option rights and exercise prices had been adjusted retroactively for the distribution of stock dividends.

13. EARNINGS PER SHARE

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

	Amounts (Numerator) Before Income Tax	Amounts (Numerator) After Income Tax	Shares (Denominator) (Thousands)	EPS (Dollars) Before Income Tax	EPS (Dollars) After Income Tax
For the year ended December 31, 2003					
Basic EPS					
Income of common shareholders	$243,377	$248,568	17,513	$13.90	$14.19
Effect of diluted securities					
Employee stock option	-	-	383		
Diluted EPS					
Income of common shareholders plus dilutive effect of potential common shares	$243,377	$248,568	17,896	$13.60	$13.89
For the year ended December 31, 2002					
Basic EPS					
Income of common shareholders	$ 91,835	$ 81,354	12,753	$ 7.20	$ 6.38
Effect of diluted securities					
Employee stock option	-	-	87		
Diluted EPS					
Income available to common shareholders plus diluted effect of potential common shares	$ 91,835	$ 81,354	12,840	$ 7.15	$ 6.34

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 12) 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 distribution of stock dividends and stock bonuses. The retroactive adjustment caused the basic EPS before income tax and after income tax for the year ended December 31, 2002 to decrease from NT$15.78 to NT$7.20 and from NT$13.98 to NT$6.38, respectively. This adjustment also resulted in the dilution of EPS before income tax and after income tax for the year ended December 31, 2002 from NT$15.55 to NT$7.15 and from NT$13.77 to NT$6.34, respectively.

14. RELATED-PARTY TRANSACTIONS

a. The Corporation's related parties are as follows:

Related Party	Relationship
M-Systems Flash Disk Pioneers	Parent company of a corporate member of the Corporation's Board of Directors
Toshiba Electronics Taiwan Corp.	Subsidiary of a corporate member of the Corporation's the Board of Directors

b. The significant transactions with the related parties are summarized as follows:

	2003		2002	
	Amount	%	Amount	%
For the year				
Sales				
M-Systems Flash Disk Pioneers	$ -	-	$ 25,668	3
Purchase				
Toshiba Electronics Taiwan Corp.	$ 884,892	43	$ 9,411	1
At end of year				
Payables				
Toshiba Electronics Taiwan Corp.	$ 233,381	45	$ -	-

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

15. PLEDGED ASSETS

The Corporation had pledged the following assets as collateral for the issuance of letters of credit for purchasing materials.

	2003	2002
Time deposits	$ 12,061	$ 20,026
Savings deposits	6,009	2,000
	$ 18,070	$ 22,026

16. SIGNIFICANT COMMITMENTS AND CONTINGENCIES

The significant commitments and contingencies as of December 31, 2003 were as follows:

a. The Corporation leases its office under renewable operating lease agreements that will expire in December 2004. The current rent amounts to $3,389 thousand each year. The agreements can be renewed upon their expiration.

b. Unused letters of credit amounted to $100,965 thousand.

c. 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 thousand in three installments. As of July 31, 2003, the total development expenses had been paid off.

d. 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 thousand for alleged theft of trade secrets. According to the legal counsel of the Corporation, Feiya could not provide evidences for its charge. Nevertheless, the Corporation placed $40,000 thousand with the Hsinchu District Court as guarantee deposit for this litigation. The Corporation believed the litigation would not have significant impact on its financial conditions and operations. Nevertheless, in 2003, following the conservatism principle, the Corporation recognized a probable loss on this litigation.

17. 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. Total purchase from or sale to related parties amounting to at least NT$100 million or 20% of the paid-in capital: Table 3 (attached).

d. Financial instrument transactions:

1) The Company did not enter into any derivative transactions for the year ended December 31, 2003.

2) Fair value of financial instruments:

	December 31,2003		December 31,2002	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Cash and cash equivalents	$ 97,361	$ 97,361	$ 105,968	$ 105,968
Short-term investments	141,336	141,575	10,000	10,000
Notes receivable	64,023	64,023	54,613	54,613
Accounts receivable – net	498,276	498,276	119,939	119,939
Other financial assets	20,806	20,806	2,458	2,458
Pledged bank deposits and certificate of deposits	18,070	18,070	22,026	22,026
Refundable deposits	40,788	40,788	40,818	40,818

(Continued)

	December 31,2003		December 31,2002	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Liabilities				
Short-term loans	$ 30,609	$ 30,609	$ -	$ -
Notes payable	91	91	3,088	3,088
Accounts payable	282,964	282,964	178,457	178,457
Payables to related parties	233,381	233,381	-	-

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

a) Short-term financial instruments—the carrying amounts reported in the balance sheet, which approximate their fair values;

b) Short-term investments—market values;

c) 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.

18. SEGMENT INFORMATION

a. Industry information: The Corporation mainly designs and sells flash memory controllers and peripheral system applications as well as designs TI DSP system, which all pertain to one segment.

b. Geographic information: As of December 31, 2003, the Corporation had no revenue-generating operating unit outside the Republic of China.

c. Overseas sales information:

Geographic Area	2003	2002
Europe	$ 241,827	$ 101,225
United States	489,054	92,438
Asia	162,043	71,151
Australia	33,166	-

d. Customers with sales at least 10% of the Corporation's total sales:

	2003		2002	
Customers	Amount	%	Amount	%
A	$ 237,773	10	$ 91,036	11
B	223,168	9	83,580	10
C	194,248	8	100,270	12

TABLE 1

PHISON ELECTRONICS CORP.

MARKETABLE SECURITIES HELD
DECEMBER 31, 2003
(Amounts in Thousands of New Taiwan Dollars)

Marketable Securities Type	Marketable Securities Name	Relationship with the Corporation	Financial Statement Account	December 31, 2003				Note
				Shares/Units (Thousands)	Carrying Value	Percentage of Ownership	Market Value	
Beneficiary certificate	President James Bond Fund	-	Short-term investments	2,451	$ 36,300	-	$ 36,310	
	Fubon Ju-I II Fund	-	Short-term investments	2,151	30,000	-	30,008	-
	Sheng Hua 1699 Bond Fund	-	Short-term investments	1,696	20,000	-	20,167	-
	Bond DAM Fund	-	Short-term investments	1,804	20,000	-	20,002	-
	NITC Bond Fund	-	Short-term investments	128	20,000	-	20,002	
	Asia Pacific Bond Fund	-	Short-term investments	1,232	15,036	-	15,086	-

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

TABLE 2

PHISON ELECTRONICS CORP.

MARKETABLE SECURITIES ACQUIRED AND DISPOSED OF AT COSTS O R PRICES OF AT LEAST NT$100 MILLION OR 20% OF THE PAID-IN CAPITAL
FOR THE YEAR ENDED DECEMBER 31, 2003
(Amounts in Thousands of New Taiwan Dollars)

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.	Beneficiary certificate													
	Capital Cash Reserves Fund	Short-term investments	-	-	-	$ -	8,563	$ 94,676	8,563	$ 94,933	$ 94,676	$ 257	-	$ -
	Sheng Hua 5599 Bond Fund	Short-term investments	-	-	-	-	5,876	71,134	4,644	56,257	56,098	159	1,232	15,036
	Golden Fuhwa Bond Fund	Short-term investments	-	-	-	-	3,998	42,500	3,998	42,553	42,500	53	-	-
	Fubon Ju-I II Fund	Short-term investments	-	-	-	-	5,901	81,904	3,750	51,970	51,904	66	2,151	30,000
	Sheng Hua 1699 Bond Fund	Short-term investments	-	-	-	-	14,152	166,223	12,456	146,454	146,223	231	1,696	20,000
	President James Bond Fund	Short-term investments	-	-	-	-	3,876	57,307	1,425	21,021	21,007	14	2,451	36,300
	Capital Safe Income Fund	Short-term investments	-	-	-	-	5,022	70,342	5,022	70,472	70,342	130	-	-
	Nam Short-term Fixed Income Fund	Short-term investments	-	-	-	-	180	79,680	180	79,833	79,680	153	-	-

TABLE 3

PHISON ELECTRONICS CORP.

TOTAL PURCHASE FROM OR SALE TO RELATED PARTIES AMOUNTING TO AT LEAST NT$100 MILLION OR 20% OF THE PAID-IN CAPITAL
FOR THE YEAR ENDED DECEMBER 31, 2003
(Amounts in Thousands New Taiwan Dollars)

Company Name	Related Party	Nature of Relationship	Transaction Details				Abnormal Transaction		Notes/Accounts Payable or Receivable		Note
			Purchase/ Sale	Amount	% to Total	Payment Terms	Unit Price	Payment Terms	Ending Balance	% to Total	
Phison Electronics Corp. (“Phison”)	Toshiba Electronics Taiwan Corp.	Subsidiary of a corporate member of the Corporation’s the Board of Directors	Purchase	$ 884,892	43	30 days after monthly closing	None	None	($ 233,381)	(45)	-