Phison Electronics Corp.

Financial Statements for the
Six Months Ended June 30, 2005 and 2004 and
Independent Auditors' Report

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 June 30, 2005 and 2004, 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 audits.

We conducted our audits in accordance with the Rules Governing the Audit of Financial Statements by Certified Public Accountants and auditing standards generally accepted in the Republic of China. Those rules and 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 June 30, 2005 and 2004, and the results of its operations and its cash flows for the six months 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.

July 22, 2005

<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.

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.

BALANCE SHEETS
JUNE 30, 2005 AND 2004
(In Thousands of New Taiwan Dollars, Except Par Value)

ASSETS	2005 Amount	2005 %	2004 Amount	2004 %
CURRENT ASSETS				
Cash and cash equivalents (Notes 2 and 3)	$ 535,383	29	$ 166,522	16
Short-term investments (Notes 2 and 4)	37,345	2	207,731	20
Notes receivable	18,788	1	17,959	2
Accounts receivable	543,730	29	351,572	34
Allowance for sales returns and discounts (Note 2)	(1,652)	-	(1,652)	-
Allowance for doubtful accounts (Note 2)	(18,143)	(1)	(21,188)	(2)
Receivables from related parties (Note 15)	113,979	6	10,110	1
Other financial assets	315	-	16,331	2
Inventories, net (Notes 2 and 5)	395,140	21	162,825	16
Deferred income tax assets (Notes 2 and 11)	10,691	1	2,077	-
Pledged bank deposits and certificates of deposits (Note 16)	11,993	1	18,589	2
Prepaid expenses and other current assets (Note 15)	69,763	4	15,718	1
Total current assets	1,717,332	93	946,594	92
LONG-TERM EQUITY INVESTMENTS - COST METHOD (Notes 2 and 6)	9,500	-	9,500	1
PROPERTIES (Notes 2 and 7)				
Cost				
Testing equipment	19,174	1	11,894	1
Transportation equipment	200	-	200	-
Furniture and fixtures	3,841	-	2,493	-
Leasehold improvements	7,408	1	750	-
Other equipment	3,083	-	6,314	1
Total cost	33,706	2	21,651	2
Less: Accumulated depreciation	12,423	1	8,689	1
Net properties	21,283	1	12,962	1
INTANGIBLE ASSETS (Notes 2, 8 and 15)	47,089	3	2,426	-
OTHER ASSETS				
Refundable deposits (Note 17)	41,376	2	40,791	4
Deferred charges, net (Note 2)	11,204	1	9,712	1
Deferred income tax assets (Notes 2 and 11)	-	-	5,991	1
Total other assets	52,580	3	56,494	6
TOTAL	$ 1,847,784	100	$ 1,027,976	100

LIABILITIES AND SHAREHOLDERS' EQUITY	2005 Amount	2005 %	2004 Amount	2004 %
CURRENT LIABILITIES				
Short-term loans (Notes 9 and 16)	$ 47,430	3	$ -	-
Notes payable	325	-	12,908	1
Accounts payable	376,600	20	187,983	18
Payables to related parties (Note 15)	273,316	15	79,080	8
Income tax payable (Notes 2 and 11)	8,486	1	13,919	1
Other payables (Note 17)	45,000	2	45,000	5
Cash dividends and bonus payable (Note 13)	144,812	8	17,695	2
Accrued expenses and other current liabilities (Note 15)	63,526	3	34,307	3
Total current liabilities	959,495	52	390,892	38
OTHER LIABILITIES				
Accrued pension cost (Notes 2 and 10)	733	-	644	-
Guarantee deposits	168	-	168	-
Total other liabilities	901	-	812	-
Total liabilities	960,396	52	391,704	38
SHAREHOLDERS' EQUITY (Note 13)				
Capital stock - $10 par value				
Authorized - 60,000 thousand shares and 30,000 thousand shares as of June 30, 2005 and 2004, respectively				
Issued - 36,255 thousand and 17,695 thousand shares as of June 30, 2005 and 2004, respectively	362,551	19	176,951	17
Capital received in advance	420	-	-	-
Stock dividends to be issued	108,580	6	180,560	18
Capital surplus - additional paid-in capital	51,962	3	51,962	5
Retained earnings				
Appropriated as legal reserve	69,113	4	34,280	3
Unappropriated earnings	294,762	16	192,519	19
Total retained earnings	363,875	20	226,799	22
Total shareholders' equity	887,388	48	636,272	62
TOTAL	$ 1,847,784	100	$ 1,027,976	100

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

PHISON ELECTRONICS CORP.

STATEMENTS OF INCOME
SIX MONTHS ENDED JUNE 30, 2005 AND 2004
(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2005		2004	
	Amount	**%**	**Amount**	**%**
REVENUE				
Gross sales	$ 2,557,995		$ 1,694,744	
Sales returns and allowances	(6,673)		(12,957)	
Net sales (Notes 2 and 15)	2,551,322		1,681,787	
Service revenue (Note 15)	627		5,705	
Total revenue	2,551,949	100	1,687,492	100
COST OF SALES (Notes 12 and 15)	2,213,996	87	1,461,025	87
GROSS PROFIT	337,953	13	226,467	13
OPERATING EXPENSES (Note 12)				
Marketing	35,418	1	14,869	1
General and administrative	19,435	1	14,200	1
Research and development (Note 15)	65,861	2	24,018	1
Total operating expenses	120,714	4	53,087	3
OPERATING INCOME	217,239	9	173,380	10
NONOPERATING INCOME AND GAINS				
Interest	2,419	-	540	-
Gain on sales of short-term investments (Note 2)	1,760	-	1,058	-
Foreign exchange gain, net (Note 2)	-	-	6,224	1
Others	55	-	608	-
Total nonoperating income and gains	4,234	-	8,430	1
NONOPERATING EXPENSES AND LOSSES				
Foreign exchange loss, net (Note 2)	670	-	-	-
Interest	522	-	43	-
Losses on inventory (Notes 2 and 5)	26	-	1,239	-
Total nonoperating expenses and losses	1,218	-	1,282	-
INCOME BEFORE INCOME TAX	220,255	9	180,528	11
INCOME TAX EXPENSE (Notes 2 and 11)	(11,789)	(1)	(19,372)	(1)
NET INCOME	$ 208,466	8	$ 161,156	10

(Continued)

	2005		2004	
	Before Income Tax	**After Income Tax**	**Before Income Tax**	**After Income Tax**
EARNINGS PER SHARE (Note 14)				
Basic	$ 6.08	$ 5.75	$ 5.05	$ 4.51
Diluted	$ 5.88	$ 5.56	$ 4.82	$ 4.30

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

PHISON ELECTRONICS CORP.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
SIX MONTHS ENDED JUNE 30, 2005 AND 2004
(In Thousands of New Taiwan Dollars)

	Capital Stocks		Capital	Stock Dividends	Capital Surplus	Retained Earnings			Total
	Shares (in Thousands)	Amount	Capital Received in Advance	Stock Dividends to be Issued	Additional Paid-in Capital	Legal Reserve	Unappropriated Earnings	Total	Total Shareholders' Equity
BALANCE, JANUARY 1, 2005	36,232	$ 362,321	$ -	$ -	$ 51,962	$ 34,280	$ 379,692	$ 413,972	$ 828,255
Appropriation of prior year's earnings									
Legal reserve	-	-	-	-	-	34,833	(34,833)	-	-
Employees' profit sharing - in stock	-	-	-	18,000	-	-	(18,000)	(18,000)	-
Employees' profit sharing - in cash	-	-	-	-	-	-	(18,000)	(18,000)	(18,000)
Stock dividends - 25%	-	-	-	90,580	-	-	(90,580)	(90,580)	-
Cash dividends - 35%	-	-	-	-	-	-	(126,812)	(126,812)	(126,812)
Remuneration to directors and supervisors	-	-	-	-	-	-	(5,171)	(5,171)	(5,171)
Employee stock options exercised	23	230	-	-	-	-	-	-	230
Capital received in advance	-	-	420	-	-	-	-	-	420
Net income in the six months ended June 30, 2005	-	-	-	-	-	-	208,466	208,466	208,466
BALANCE, JUNE 30, 2005	36,255	$ 362,551	$ 420	$ 108,580	$ 51,962	$ 69,113	$ 294,762	$ 363,875	$ 887,388
BALANCE, JANUARY 1, 2004	17,695	$ 176,951	$ -	$ -	$ 51,962	$ 9,423	$ 258,521	$ 267,944	$ 496,857
Appropriation of prior year's earnings									
Legal reserve	-	-	-	-	-	24,857	(24,857)	-	-
Employees' profit sharing - in stock	-	-	-	39,000	-	-	(39,000)	(39,000)	-
Stock dividends - 80%	-	-	-	141,560	-	-	(141,560)	(141,560)	-
Cash dividends - 10%	-	-	-	-	-	-	(17,695)	(17,695)	(17,695)
Remuneration to directors and supervisors	-	-	-	-	-	-	(4,046)	(4,046)	(4,046)
Net income in the six months ended June 30, 2004	-	-	-	-	-	-	161,156	161,156	161,156
BALANCE, JUNE 30, 2004	17,695	$ 176,951	$ -	$ 180,560	$ 51,962	$ 34,280	$ 192,519	$ 226,799	$ 636,272

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

PHISON ELECTRONICS CORP.

STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED JUNE 30, 2005 AND 2004
(In Thousands of New Taiwan Dollars)

	2005	**2004**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 208,466	$ 161,156
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,025	2,924
Amortization	11,223	3,271
Allowance for doubtful accounts	(7,889)	3,630
Loss on physical inventory	-	980
Deferred income tax assets	3,085	8,888
Accrued pension cost	15	432
Net changes in operating assets and liabilities		
Notes receivable	(3,743)	46,064
Accounts receivable	1,744	165,914
Receivables from related parties	10,680	(10,110)
Other financial assets	1,186	(16,175)
Inventories	(164,834)	78,578
Prepaid expenses and other current assets	(6,070)	15,854
Notes payable	(3,269)	12,817
Accounts payable	(138,652)	(94,981)
Payables to related parties	108,852	(154,301)
Income tax payable	3,344	2,681
Accrued expenses and other current liabilities	1,351	(45,229)
Net cash provided by operating activities	29,514	182,393
CASH FLOWS FROM INVESTING ACTIVITIES		
Decrease (increase) in short-term investments	60,154	(66,395)
Decrease (increase) in pledged bank deposits and certificates of deposits	5,104	(519)
Acquisition of long-term investments	-	(9,500)
Acquisition of properties	(5,599)	(2,764)
Increase in intangible assets	(365)	(1,425)
Decrease (increase) in refundable deposits	39,995	(3)
Increase in deferred charges	(6,637)	(2,185)
Net cash provided by (used in) investing activities	92,652	(82,791)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in short-term loans	47,430	(30,609)
Increase in guarantee deposits	-	168
Remuneration to directors and supervisors	(375)	-
Proceeds from exercise of stock options	230	-
Capital received in advance	420	-
Net cash provided by (used in) financing activities	47,705	(30,441)

(Continued)

	2005	2004
NET INCREASE IN CASH AND CASH EQUIVALENTS	$ 169,871	$ 69,161
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD	365,512	97,361
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	$ 535,383	$ 166,522
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	$ 516	$ 103
Income tax paid	$ 5,360	$ 7,803
CASH PAID FOR ACQUISITION OF PROPERTIES		
Increase properties	$ 5,323	$ 3,964
Decrease (increase) in payables to contractors and equipment suppliers (included in accrued expenses and other current liabilities)	276	(1,200)
	$ 5,599	$ 2,764
Increase in intangible assets	$ 47,795	$ -
Increase in payables to related parties	(47,430)	-
	$ 365	$ -

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

1. ORGANIZATION AND OPERATIONS

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 December 6, 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 June 30, 2005 and 2004, the Corporation had 154 and 108 employees, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements have been presented 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 make certain estimates and assumptions that could affect the allowance for sales returns and discounts; allowance for doubtful receivables, loss on inventory, pension expenses, depreciation of properties, and amortization of intangible assets and deferred charges. Actual results could differ from these estimates. because of the uncertainty of circumstances.

For the convenience of readers, 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 financial statements shall prevail.

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 to be converted to cash, sold or consumed within one year from the balance sheet date. Current liabilities are obligations due on demand within one year from the balance sheet date. All other assets and liabilities are classified as noncurrent.

Cash Equivalents

Corporate bonds under resell agreements and commercial paper acquired with maturities less than three months from the 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 aggregate cost or market value. An allowance for decline in value is provided and is charged to current income when the aggregate carrying amount of the investments exceeds the aggregate 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 reporting period.

Allowance for Doubtful Accounts

An allowance for doubtful accounts 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 weighted-average cost. Market value represents net realizable value for finished goods, semifinished goods and work in process and replacement cost for raw materials.

Long-term Investments

A long-term investment in which the Corporation owns less than 20% of the outstanding voting shares and has no significant influence on the investee is accounted for by the cost method.

Cash dividends received within a year of investment acquisition are recognized as reductions of the carrying amount of the long-term investments and are recognized as investment income in subsequent years. Stock dividends are recorded as an increase in the number of shares held and do not affect investment income or the carrying amount of the investment. If the carrying values of investments with no quoted market prices decline and this decline is other than temporary, the related impairment loss is charged to income.

The costs of investments sold are determined by the weighted-average method.

Properties

Properties are stated at cost less accumulated depreciation. Significant additions, renewals and betterments during the construction period are capitalized; maintenance and repairs are expensed in the period incurred.

If asset impairment is identified, the carrying amount of asset in excess of its recoverable amount is recognized as loss. If the recoverable amount increases, the reversal of the impairment loss will be recognized as a gain. However, the increased carrying amount of an asset due to a reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognized for the asset in prior years.

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

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

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

Intangible Assets

Intangible assets, consisting of costs to acquire royalty, patents and trademarks, are amortized using the straight-line method over three to six years. If the fair value of these assets fall below their carrying amount, an impairment loss is charged to current income. If asset impairment loss (excluding goodwill) is reversed, the increase in the carrying amount resulting from reversal is credited to current income. However, loss reversal should not be more than the carrying amount (net of depreciation) had the impairment not been recognized.

Deferred Charges

Deferred charges, consisting of costs to acquire computer software, are amortized using the straight-line method over two to five years. When an indication of significant impairment is identified, any excess of the carrying amount of an asset over its recoverable amount is recognized as a loss. If the recoverable amount increases in a future period, the amount previously recognized as impairment would be reversed and recognized as a gain. However, the adjusted amount may not exceed the carrying amount that would have been determined, net of amortization, as if no impairment loss had been recognized.

Pension Costs

The Corporation records net periodic pension costs on the basis of actuarial calculations.

Sales and Allowance for Sales Returns and Discounts

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 are 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 other allowances are estimated on the basis of historical 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 customers. The fair value of receivables is equivalent to the nominal amount of cash to be received since the receivables are collectible within one year and sales transactions are frequent.

Income Tax

The Corporation uses the 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 in accordance with 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 or settlement period.

Any tax credits for certain purchases of machinery, equipment and technology, research and development expenditures, personnel training, and investments in important technology-based enterprises are recognized using the flow-through method.

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

Income tax of 10% on unappropriated earnings generated since 1998 is expensed in the year of shareholder approval, which is the year after the year earnings are generated.

Derivative Financial Instruments

The Company enters into forward exchange contracts to manage exchange rate exposures on foreign-currency-denominated assets and liabilities. The contracts are recorded in New Taiwan dollars at the spot exchange rate on the contract starting date. The differences between the starting date rates and the contracted forward rates are amortized over the terms of the forward contracts using the straight-line method. Any resulting gain or loss upon settlement is credited or charged to income in the period of settlement. At the end of each period, the receivables or payables on forward contracts are restated at the prevailing exchange rates, with the resulting differences credited or charged to income. In addition, the receivables and payables on open forward contracts of the same counter-party are netted out, with the resulting amount presented as an asset or a liability.

Foreign-currency Transactions

Foreign-currency transactions are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Gains or losses (measured from the transaction date or the most recent intervening balance sheet date, whichever is later) from the application of prevailing exchange rates when cash in foreign currency is converted to New Taiwan dollars or when foreign-currency receivables and payables are settled, are credited or charged to current income. At the end of each period, assets and liabilities denominated in foreign currencies are revalued at the prevailing exchange rates, with the resulting gains or losses recognized as current income.

Reclassifications

Certain accounts in the financial statements as of and for the six months ended June 30, 2004 have been reclassified to be consistent with the financial statements as of and for the six months ended June 30, 2005.

3. CASH AND CASH EQUIVALENTS

	June 30	
	2005	**2004**
Cash on hand	$ 47	$ 66
Checking and savings accounts	372,989	146,126
Certificates of deposits	62,509	-
Commercial paper and corporate bonds acquired under resell agreements	99,838	20,330
	$ 535,383	$ 166,522

4. SHORT-TERM INVESTMENTS

	June 30	
	2005	2004
Open-end bond funds	$ 37,345	$ 207,731
Market value	$ 37,346	$ 207,898

5. INVENTORIES, NET

	June 30	
	2005	2004
Finished goods	$ 9,791	$ 17,992
Semifinished goods	47,961	15,396
Work in process	53,049	21,866
Raw materials	296,941	119,760
	407,742	175,014
Less: Allowance for losses	12,602	12,189
	$ 395,140	$ 162,825

6. LONG-TERM INVESTMENTS

	June 30			
	Carrying Amount	% of Ownership	Carrying Amount	% of Ownership
Cost method				
Trison Technology Corporation	$ 9,500	19	$ 9,500	19

In February 2004, the Corporation invested in Trison Technology Corporation, which manufactures SMT (surface mount technology).

7. PROPERTIES

Accumulated depreciation consisted of the following:

	June 30	
	2005	2004
Testing equipment	$ 7,049	$ 3,597
Transportation equipment	136	103
Furniture and fixtures	1,741	1,008
Leasehold improvements	1,611	563
Other equipment	1,886	3,418
	$ 12,423	$ 8,689

8. INTANGIBLE ASSETS

	June 30 2005	June 30 2004
Royalty	$ 42,888	$ 1,304
Technology license fees	2,592	-
Patents	1,577	1,111
Trademarks	32	11
	$ 47,089	$ 2,426

9. SHORT-TERM BORROWINGS

	June 30, 2005
Loans for materials acquisition: US$1,500 thousand, 4.366% annual interest, due in December 2005	$ 47,430

10. PENSION PLAN

The Corporation has a pension plan for all regular employees, which provides benefits based on the employee's length of service and average monthly basic salary or wage of the six months before retirement.

The Corporation contributes an amount equal to 3% of monthly salaries and wages to a pension fund. The fund is administered by a pension fund monitoring committee and deposited in the committee's name in the Central Trust of China. As of June 30, 2005 and 2004, the pension fund balance was $4,545 thousand and $2,539 thousand, respectively.

The changes in the fund and accrued pension cost in the six months ended June 30, 2005 and 2004 are summarized as follows:

	Six Months Ended June 30	
	2005	2004
Pension fund		
Balance, beginning of period	$ 3,511	$ 1,906
Contribution	1,003	614
Interest	31	19
Balance, end of period	$ 4,545	$ 2,539
Accrued pension cost		
Balance, beginning of period	$ 718	$ 212
Accruals	1,018	1,046
Contribution	(1,003)	(614)
Balance, end of period	$ 733	$ 644

The Labor Pension Act (the "Act"), which will take effect on July 1, 2005, provides for a new pension mechanism. The employees who were subject to the Labor Standards Law before the enforcement of this Act may choose to be subject to the pension mechanism under this Act or may continue to be subject to the pension mechanism under the Labor Standards Law. For those employees who were subject to the Labor Standards Law before July 1, 2005, still work for the same company after July 1, 2005 and choose to be subject to the pension mechanism under this Act, their service years as of July 1, 2005 be retained. Under the Act, the rate of an employer's monthly contribution to the Labor Pension Fund should be at least 6% of each employee's monthly salary or wage.

11. INCOME TAX

a. A reconciliation of income tax expense based on income before income tax at the statutory rate and current income tax expense before income tax credits was as follows:

	Six Months Ended June 30	
	2005	2004
Income tax expense based on income before income tax at statutory rate (25%)	$ 55,064	$ 45,132
Tax-exempt income	(35,220)	(24,710)
Permanent difference	(735)	(265)
Temporary difference	(9,230)	(293)
Current income tax expense before tax credits	$ 9,879	$ 19,864

b. Income tax expense consisted of the following:

	2005	2004
Current income tax expense before income tax credits	$ 9,879	$ 19,864
Additional tax at 10% on unappropriated earnings	7,881	8,034
Income tax credits	(8,880)	(13,949)
Income tax paid - current	8,880	13,949
Net change in deferred income tax assets		
Investment tax credits	(33,475)	9,105
Temporary differences	7,228	2,283
Valuation allowance	29,332	(2,500)
Prior year's adjustment	(176)	(3,465)
Income tax expense	$ 11,789	$ 19,372

c. Deferred income tax assets were as follows:

	June 30	
	2005	2004
Current:		
Temporary differences	$ 791	$ 2,077
Investment tax credits	9,900	-
	$ 10,691	$ 2,077
Noncurrent:		
Investment tax credits	$ 43,427	$ 11,244
Valuation allowance	(43,427)	(5,253)
	$ -	$ 5,991

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

d. Integrated income tax information is as follows:

	June 30 2005	June 30 2004
Imputation credit account (ICA)	$ 14,436	$ 16,096

The expected and actual creditable tax ratios for the distribution of the 2004 and 2003 earnings, respectively, were 3.80% and 6.23%, respectively.

The imputation credit allocated to the shareholders is based on its balance as of the date of dividend distribution. Thus, the expected creditable ratio may be adjusted when the actual distribution of the imputation credits is made.

e. As of June 30, 2005, investment tax credits were as follows:

Regulatory Basis of Tax Credits	Items	Total Creditable Amount	Remaining Creditable Amount	Expiry Year
Statute for Upgrading Industries	Purchase of machinery and equipment	$ 67	$ 67	2007
		64	64	2008
		$ 131	$ 131	
Statute for Upgrading Industries	Research and development expenditures	$ 20,349	$ 14,116	2007
		21,762	21,762	2008
		17,319	17,318	2009
		$ 59,430	$ 53,196	

f. The sales generated from the following expansion and construction of the Corporation's investment plan is exempt from income tax:

	Tax-exemption Period
First expansion and construction of the Corporation's factories	September 15, 2002 to September 14, 2007
Second expansion and construction of the Corporation's factories	August 1, 2004 to July 31, 2009

Income tax returns through 2001 had been examined and cleared by the tax authorities.

12. LABOR COST, DEPRECIATION AND AMORTIZATION

	Six Months Ended June 30, 2005		
	Classified as Cost of Sales	Classified as Operating Expense	Total
Labor cost			
Salary	$ 18,813	$ 41,082	$ 59,895
Pension	185	833	1,018
Meal	378	1,167	1,545
Welfare benefit	988	5,800	6,788
Labor and health insurance	634	2,604	3,238
	$ 20,998	$ 51,486	$ 72,484
Depreciation	$ 1,447	$ 2,578	$ 4,025
Amortization	$ -	$ 11,223	$ 11,223

	Six Months Ended June 30, 2004		
	Classified as Cost of Sales	Classified as Operating Expense	Total
Labor cost			
Salary	$ 6,526	$ 24,635	$ 31,161
Pension	197	849	1,046
Meal	313	809	1,122
Welfare benefit	857	2,324	3,181
Labor and health insurance	610	2,458	3,068
	$ 8,503	$ 31,075	$ 39,578
Depreciation	$ 1,265	$ 1,659	$ 2,924
Amortization	$ -	$ 3,271	$ 3,271

13. SHAREHOLDERS' EQUITY

Capital surplus (except that from equity-method investments) can only be used to offset a deficit under the Company Law. However, the capital surplus generated from donations and the excess of the issue price over the par value of capital stock may be appropriated as stock dividends, which are restricted to a certain percentage of the Corporation's paid-in capital.

The Corporation's Articles of Incorporation provide that, under the board of directors' resolution, annual net income (less any deficit and 10% as legal reserve) plus unappropriated 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, dividends will be appropriated considering the current and future investment environment, capital requirements, domestic and international competition, capital budget plans, shareholders' interests, balance 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 earnings distribution for the shareholders' approval.

Profits may be distributed as cash or stock dividend; however, the ratio for cash dividend should be at least 10% of total distribution, but the Corporation's operating results should be considered.

Any appropriations of net income are recorded in the financial statements in the year of shareholder approval.

Under the Integrated Income Tax System that became effective on January 1, 1998, the R.O.C. resident shareholders are allowed a tax credit for their proportionate share of the income tax paid by the Corporation on earnings generated since January 1, 1998.

Legal reserve should be appropriated until the reserve equals the Corporation's paid-in capital. The reserve can only be used to offset an accumulated deficit or the portion in excess of 50% of the Corporation's paid-in capital can be distributed as dividends and bonuses when the reserve balance has reached 50% of the Corporation's paid-in capital.

The appropriations of the 2004 and 2003 earnings were approved in the shareholders' meetings on June 16, 2005 and June 15, 2004, respectively. The appropriations and dividends per share are as follows:

	Appropriation of Earnings		**Dividends Per Share (NT$)**	
	For Fiscal Year 2004	**For Fiscal Year 2003**	**For Fiscal Year 2004**	**For Fiscal Year 2003**
Legal reserve	$ 34,833	$ 24,857	$ -	$ -
Employees' profit sharing - in stock	18,000	39,000	-	-
Employees' profit sharing - in cash	18,000	-	-	-
Common dividends				
Stock dividends	90,580	141,560	2.5	8.0
Cash dividends	126,812	17,695	3.5	1.0
Remuneration to directors and supervisors	5,171	4,046	-	-
	$ 293,396	$ 227,158		

The above appropriations were consistent with the resolutions passed at the board of directors' meetings on March 17, 2005 and March 22, 2004.

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 (http://emops.tse.com.tw) of the Taiwan Stock Exchange (TSE).

The appropriation of the 2004 earnings for 2004 was approved on June 28, 2005 by the Securities and Futures Bureau. Portions of this appropriation - $96,580 thousand in stock dividends and $18,000 thousand in stock bonus to employees - will be rendered as capital increase. The total capital will be 47,113 thousand common shares for a total of $471,131 thousand after the capital increase. The record date for this capital increase is August 1, 2005, which was approved by the Corporation's board of directors on July 7, 2005.

On October 21, 2003 and May 16, 2003, the Securities and Futures Commission (the name of the Securities and Futures Bureau before July 1, 2004) 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 common share. of common stock. The option rights on both plans are valid for three years from the date of issuance and exercisable at certain percentages after the second year of issuance.

Under the terms of the Plans, the options are granted at an exercise price equal to the closing price of the Company's common shares listed on the TSE on the grant date. Based on the Plans, the number of outstanding options and exercise prices have been adjusted to reflect the appropriation of dividends.

The outstanding stock options in the six months ended June 30, 2005 and 2004 were as follows:

	Six Months Ended June 30			
	2005		2004	
	Outstanding Option Rights (in Thousands)	Exercise Price (NT$)	Outstanding Option Rights (in Thousands)	Exercise Price (NT$)
Beginning balance	1,359	$10-15.41	1,840	$10-24
Options increased	-	-	-	-
Options granted	(23)	10	-	-
Options canceled	(37)	10	-	-
Ending balance	1,299		1,840	

As of June 30, 2005, outstanding and exercisable options were as follows:

Exercise Price (NT$)	Number of Outstanding Options (in Thousands)	Weighted-average Remaining Contractual Life (Years)	Weighted-average Exercise Price (NT$)	Weighted-Number of Exercisable Options (in Thousands)	Weighted-average Exercise Price (NT$)
10	99	0.59	10	99	10
11.62-15.41	1,200	1.37	12.57	-	-
	1,299				

14. EARNINGS PER SHARE

The numerators and denominators used in computing earnings per share (EPS) were as follows:

	Amounts (Numerator)		Number of Shares (Denominator) (in Thousands)	EPS (NT$)	
	Before Income Tax	After Income Tax		Before Income Tax	After Income Tax
Six months ended June 30, 2005					
Basic EPS					
Income available to common shareholders	$ 220,255	$ 208,466	36,247	$ 6.08	$ 5.75
Effect of dilutive potential common stock - stock options	-	-	1,241		
Diluted EPS					
Income available to common shareholders (including effect of dilutive potential common stock)	$ 220,255	$ 208,466	37,488	$ 5.88	$ 5.56

(Continued)

	Amounts (Numerator) Before Income Tax	After Income Tax	Number of Shares (Denominator) (in Thousands)	EPS (NT$) Before Income Tax	After Income Tax
Pro forma EPS					
Retroactive adjustment due to the recording of dividend appropriation after the financial statement date	$ 220,255	$ 208,466	47,105	$ 4.68	$ 4.43
Effect of dilutive potential common stock - stock options	-	-	1,613		
Pro forma EPS					
Retroactive adjustment due to the recording of dividend appropriation after the financial statement date	$ 220,255	$ 208,466	48,718	$ 4.52	$ 4.28
Six months ended June 30, 2004					
Basic EPS					
Income available to common shareholders	$ 180,528	$ 161,156	35,751	$ 5.05	$ 4.51
Effect of dilutive potential common stock - stock options	-	-	1,689		
Diluted EPS					
Income available to common shareholders (including effect of dilutive potential common stock)	$ 180,528	$ 161,156	37,440	$ 4.82	$ 4.30
Pro forma EPS					
Retroactive adjustment due to the recording of dividend appropriation after the financial statement date	$ 180,528	$ 161,156	46,466	$ 3.89	$ 3.47
Effect of dilutive potential common Stock - stock options	-	-	2,195		
Pro forma EPS					
Retroactive adjustment due to the recording of dividend appropriation after the financial statement date	$ 180,528	$ 161,156	48,661	$ 3.71	$ 3.31

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 as of June 30, 2004 to decrease from NT$9.11 to NT$4.51 and from NT$8.70 to NT$4.30, respectively.

15. RELATEDPARTY TRANSACTIONS

a. The Corporation’s related parties were as follows:

Related Party	Relationship with the Corporation
Toshiba Electronics Taiwan Corp.	Subsidiary of a corporate member of the Corporation’s board of directors
Toshiba Corporation, Japan	A member of the Corporation’s board of directors
Toshiba Digital Media Network Taiwan Corporation	Subsidiary of a corporate member of the Corporation’s board of directors

(Continued)

Related Party	Relationship with the Corporation
Taiwan Toshiba International Procurement Corp.	Subsidiary of a corporate member of the Corporation's board of directors
M-Systems B.V.	A member of the Corporation's board of directors
TwinSys Data Storage Limited Partnership	Subsidiary of a corporate member of the Corporation's board of directors
M-Systems Flash Disk Pioneers	Parent company of a corporate member of the Corporation's board of directors
M-Systems Asia Ltd.	Subsidiary of a corporate member of the Corporation's board of directors

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

	2005		2004	
	Amount	**%**	**Amount**	**%**
Six months ended June 30				
Net sales				
M-Systems Flash Disk Pioneers	$ 135,962	6	$ 8,971	1
TwinSys Data Storage Limited Partnership	80,143	2	-	-
M-Systems Asia Ltd.	33,845	1	5,942	-
Toshiba Electronics Taiwan Corp.	329	-	181	-
Toshiba Digital Media Network Taiwan Corporation	117	-	-	-
Taiwan Toshiba International Procurement Corp.	-	-	61	-
	$ 250,396	9	$ 15,155	1
Service revenue				
Toshiba Corporation, Japan	$ -	-	$ 2,809	49
Purchase				
Toshiba Electronics Taiwan Corp.	$1,048,564	47	$ 797,860	62
Toshiba Digital Media Network Taiwan Corporation	1,992	-	1,401	-
	$1,050,556	47	$ 799,261	62
Sales expenses (included in royalty, Note 17c)				
M-Systems Flash Disk Pioneers	$ 11,501	65	$ -	-
Research and development expenses				
Toshiba Digital Media Network Taiwan Corporation	$ 8	-	$ -	-
Toshiba Electronics Taiwan Corp.	-	-	133	-
	$ 8	-	$ 133	-

(Continued)

June 30	2005 Amount	%	2004 Amount	%
Accounts receivable				
M-Systems Flash Disk Pioneers	$ 106,991	94	$ 9,326	3
TwinSys Data Storage Limited Partnership	6,098	5	-	-
M-Systems Asia Ltd.	556	1	720	-
Toshiba Electronics Taiwan Corp.	294	-	-	-
Toshiba Digital Media Network Taiwan Corporation	40	-	-	-
Taiwan Toshiba International Procurement Corp.	-	-	64	-
	$ 113,979	100	$ 10,110	3
Prepayment to suppliers				
Toshiba Digital Media Network Taiwan Corporation	$ -	-	$ 12	-
Royalty (included in intangible assets)				
M-Systems Flash Disk Pioneers	$ 41,854	98	$ -	-
Toshiba Corporation, Japan	1,034	2	1,304	100
	$ 42,888	100	$ 1,304	100
Accounts payable				
Toshiba Electronics Taiwan Corp.	$ 219,448	80	$ 79,080	100
M-Systems Flash Disk Pioneers	53,868	20	-	-
	$ 273,316	100	$ 79,080	100
Advance sales receipts				
Toshiba Corporation, Japan	$ -	-	$ 700	99

The terms of sales to related parties were similar to those for third parties.

16. PLEDGED ASSETS

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

	June 30 2005	June 30 2004
Certificates of deposits	$ 9,990	$ 12,577
Savings deposits	2,003	6,012
	$ 11,993	$ 18,589

17. SIGNIFICANT COMMITMENTS AND CONTINGENCIES

The significant commitments and contingencies of the Corporation as of June 30, 2005 were as follows:

a. The Corporation rents its office under operating lease agreements expiring on various dates from December 2005 to December 2007.

   As of June 30, 2005, future remaining lease payments were as follows:

Period/Year	Amount
2005 (3rd to 4th quarters)	$ 3,077
2006	6,155
2007	6,155
	$ 15,387

b. Unused letters of credit as of June 30, 2005 amounted to $45,000 thousand.

c. 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. The claim was overruled by Hsinchu District Court because Feiya could not provide evidences for its charge. However, Feiya disagreed with this decision and filed an appeal with the Taiwan High Court on April 26, 2004. According to the Corporation's lawyer, as of June 30, 2005, the superior court was reviewing this case. The Corporation's lawyer believes this litigation would have no material effects on the Corporation's financial statements. However, following the principle of conservatism, the Corporation deposited $40,000 thousand as litigation guarantee and recognized a probable loss of $45,000 thousand on the guarantee deposit on this litigation (included in other payables).

d. In November 2003 the Corporation signed a license agreement on pen drive products with M-Systems. Under this agreement, the company should pay M-System royalties and commissions at a percentage of net sales over six years.

18. ADDITIONAL DISCLOSURES

Following are the additional disclosures required by the Securities and Futures Bureau 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. Receivable from related parties amounting to at least NT$100 million or 20% of the paid-in capital: Table 4 (attached)

e. Financial instrument transactions:

1) Derivative financial instruments

The Company entered into derivative financial instrument transactions in the six months ended June 30, 2005 to manage exposures related to exchange rate fluctuations.

As of June 30, 2005, there were no outstanding forward exchange contracts and payables. An exchange loss of $3,261 thousand in the six months ended June 30, 2005 was recognized.

2) Transaction risks

a) Credit risk. Credit risk represents the positive net settlement amount of derivative contracts with positive fair values on the balance sheet date. The positive net settlement amount represents the loss to be incurred by the Company if the counter-parties breach the contracts. The banks, which are the counter-parties to the foregoing derivative financial instruments, are reputable financial institutions. Thus, management believes its exposure due to the counter-parties' default is low.

b) Market price risk. All derivative financial instruments are intended as hedges for exchange rate and interest rate fluctuations. Gains or losses on these hedging instruments are likely to offset the gains or losses on the hedged items. Thus, market price risk is believed to be low.

c) Cash flow risk and the amount and future cash needs. The Corporation has sufficient operating capital to meet cash requirements for contract settlement. In addition, there will be a cash inflow corresponding to the cash outflow. Thus, the cash flow risk is low.

3) Fair value of financial instruments:

	June 30			
	2005		2004	
Nonderivative financial instruments	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Assets				
Cash and cash equivalents	$ 535,383	$ 535,383	$ 166,522	$ 166,522
Short-term investments	37,345	37,346	207,731	207,898
Notes receivable	18,788	18,788	17,959	17,959
Accounts receivable, net	523,935	523,935	328,732	328,732
Receivables from related parties	113,979	113,979	10,110	10,110
Other financial assets	315	315	16,331	16,331
Pledged bank deposits and certificates of deposits	11,993	11,993	18,589	18,589
Long-term investments	9,500	9,500	9,500	9,500
Refundable deposits	41,376	41,376	40,791	40,791
Liabilities				
Short-term loans	47,430	47,430	-	-
Notes payable	325	325	12,908	12,908
Accounts payable	376,600	376,600	187,983	187,983
Payables to related parties	273,316	273,316	79,080	79,080
Guarantee deposits	168	168	168	168

Fair values of financial instruments are determined as follows:

a) The carrying amounts of short-term financial instruments reported in the balance sheet approximate their fair values.

b) Fair value of short-term investments is based on quoted market prices.

c) Fair value of long-term investments, which have no quoted market prices, is based on the investees' net equity.

d) Fair value of refundable deposits and guarantee deposits is based on carrying values.

The fair values of some financial and nonfinancial instruments were not included in the fair values disclosed above. Thus, the sum of the fair values of the financial instruments listed above does not represent the fair value of the Corporation as a whole.

TABLE 1

PHISON ELECTRONICS CORP.

MARKETABLE SECURITIES HELD
JUNE 30, 2005
(In Thousands of New Taiwan Dollars, Unless Stated Otherwise)

Holding Company Name	Marketable Securities Type and Name	Relationship with the Holding Company	Financial Statement Account	June 30, 2005				Note
				Shares/Units (in Thousand)	Carrying Value	Percentage of Ownership	Market Value or Net Asset Value	
Phison Electronics Corp. (the "Corporation")	Beneficiary certificate							
	Fuhwa Advantage Bond Fund	-	Short-term investments	3,653	$ 37,345	-	$ 37,346	
	Common stock							
	Trison Technology Corporation	Cost-method investee	Long-term investments	950	9,500	19	9,500	

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 OR PRICES OF AT LEAST NT$100 MILLION OR 20% OF THE PAID-IN CAPITAL
SIX MONTHS ENDED JUNE 30, 2005
(In Thousands of New Taiwan Dollars, Unless Stated Otherwise)

Company Name	Marketable Securities Type and Name	Financial Statement Account	Counter-party	Nature of Relationship	Beginning Balance		Acquisition		Disposal				Ending Balance	
					Shares/Units (Thousand)	Amount	Shares/Units (Thousand)	Amount	Shares/Units (Thousand)	Amount	Carrying Value	Gain on Disposal	Shares/Units (Thousand)	Amount
Phison Electronics Corp. (the "Corporation")	Beneficiary certificate													
	Fuhwa Advantage Bond Fund	Short-term investments	-	-	1,590	$ 16,149	9,370	$ 95,571	7,307	$ 74,571	$ 74,375	$ 196	3,653	$ 37,345
	The Forever Fund	Short-term investments	-	-	-	-	12,032	170,072	12,032	170,361	170,072	289	-	-
	The IIT Wan Pao Fund	Short-term investments	-	-	-	-	6,749	100,000	6,749	100,280	100,000	280	-	-
	Ta Chong Bond Fund	Short-term investments	-	-	-	-	13,392	170,077	13,392	170,394	170,077	317	-	-

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
SIX MONTHS ENDED JUNE 30, 2005
(In Thousands of New Taiwan Dollars, Unless Stated Otherwise)

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. (the "Corporation")	Toshiba Electronics Taiwan Corp.	Subsidiary of a corporate member of the Corporation's board of directors	Purchase	$ 1,048,564	47	Net 30 days after monthly closing	None	None	$ (219,448)	(34)	-
	M-Systems Flash Disk Pioneers	Parent company of a corporate member of the Corporation's board of directors	Sale	135,962	5	Net 30 days after monthly closing	None	None	106,991	17	-

TABLE 4

PHISON ELECTRONICS CORP.

RECEIVABLES FROM RELATED PARTIES AMOUNTING TO AT LEAST NT$100 MILLION OR 20% OF THE PAID-IN CAPITAL
SIX MONTHS ENDED JUNE 30, 2005
(In Thousands of New Taiwan Dollars, Unless Stated Otherwise)

Company Name	Related Party	Nature of Relationship	Ending Balance	Turnover Rate	Overdue		Amounts Received in Subsequent Period	Allowance for Bad Debts
					Amount	Action Taken		
Phison Electronics Corp.	M-Systems Flash Disk Pioneers	Parent company of a corporate member of the Corporation's board of directors	$ 106,991	95 days	$ 14,716	Intensify collection of accounts receivable	$ 47,819	$ -