

**Phison Electronics Corp.**

**Financial Statements for the  
Six Months Ended June 30, 2006 and 2005 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. (the Corporation) as of June 30, 2006 and 2005, 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, 2006 and 2005, 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.

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

We have also audited the accompanying schedules of significant accounts, provided for supplementary analysis, by applying the same procedures described above. In our opinion, such schedules are consistent, in all material respects, with the financial statements referred to above.

We have also reviewed the consolidated balance sheets of the Corporation and its subsidiaries as of June 30, 2006 and 2005 and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the six months then ended. We have issued modified unqualified review reports on those consolidated financial statements.

July 28, 2006

Notice to Readers

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

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

# PHISON ELECTRONICS CORP.

## BALANCE SHEETS

JUNE 30, 2006 AND 2005

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

| ASSETS  | 2006         |     | 2005         |     | LIABILITIES AND SHAREHOLDERS' EQUITY   | 2006         |     | 2005         |     |
|---|--------------|-----|--------------|-----|--|--------------|-----|--------------|-----|
|   | Amount       | %   | Amount       | %   |  | Amount       | %   | Amount       | %   |
| <b>CURRENT ASSETS</b>   |              |     |              |     | <b>CURRENT LIABILITIES</b>   |              |     |              |     |
| Cash and cash equivalents (Notes 2 and 4)                             | \$ 777,690   | 22  | \$ 535,383   | 29  | Short-term debts (Notes 19)  | \$ -         | -   | \$ 47,430    | 3   |
| Financial assets at fair value through profit or loss (Notes 2 and 5) | -            | -   | 37,345       | 2   | Notes and accounts payable   |              |     |              |     |
| Notes and accounts receivable   |              |     |              |     | Third parties  | 951,356      | 27  | 376,925      | 20  |
| Third parties (Notes 2 and 6)   | 1,141,603    | 32  | 542,723      | 29  | Related parties (Note 18)  | 261,215      | 7   | 219,448      | 12  |
| Related parties (Note 18)   | 130,677      | 4   | 113,979      | 6   | Income tax payable (Notes 2 and 13)  | 20,459       | 1   | 8,486        | 1   |
| Other financial assets  | 100,965      | 3   | 315          | -   | Accrued expenses (Note 18)   | 340,453      | 10  | 247,218      | 13  |
| Inventories, net (Notes 2 and 7)                                      | 902,050      | 26  | 395,140      | 21  | Other payables (Note 20)   | 45,000       | 1   | 45,000       | 2   |
| Deferred income tax assets (Notes 2 and 13)                           | 61,705       | 2   | 10,691       | 1   | Other  | 12,506       | -   | 14,988       | 1   |
| Restricted assets (Note 19)   | 15,058       | -   | 11,993       | 1   |  |              |     |              |     |
| Other (Note 18)   | 145,282      | 4   | 69,763       | 4   | Total current liabilities  | 1,630,989    | 46  | 959,495      | 52  |
| Total current assets  | 3,275,030    | 93  | 1,717,332    | 93  | <b>OTHER LIABILITIES</b>   |              |     |              |     |
| <b>LONG-TERM INVESTMENTS</b>  |              |     |              |     | Accrued pension cost (Notes 2 and 12)  | -            | -   | 733          | -   |
| Financial assets carried at cost - non current (Note 2 and 8)         | 62,500       | 2   | 9,500        | -   | Guarantee deposits received  | -            | -   | 168          | -   |
| Investments accounted for using equity method (Note 2 and 9)          | 20,069       | 1   | -            | -   |  |              |     |              |     |
| Total long-term investments   | 82,569       | 3   | 9,500        | -   | Total other liabilities  | -            | -   | 901          | -   |
| <b>PROPERTIES (Notes 2 and 10)</b>                                    |              |     |              |     | Total liabilities  | 1,630,989    | 46  | 960,396      | 52  |
| Cost  |              |     |              |     | <b>SHAREHOLDERS' EQUITY (Note 15)</b>  |              |     |              |     |
| Testing equipment   | 27,957       | 1   | 19,174       | 1   | Capital stock - \$10 par value   |              |     |              |     |
| Office equipment  | 6,170        | -   | 3,841        | -   | Authorized - 80,000 thousand shares in 2006 and 60,000 thousand shares in 2005 |              |     |              |     |
| Leasehold improvements  | 12,450       | 1   | 7,408        | 1   | Issued - 52,708 thousand shares in 2006 and 36,255 thousand shares in 2005     | 527,081      | 15  | 362,551      | 19  |
| Other equipment   | 4,499        | -   | 3,283        | -   | Capital received in advance  | 1,190        | -   | 420          | -   |
| Total cost  | 51,076       | 2   | 33,706       | 2   | Stock dividends to be issued   | 177,500      | 5   | 108,580      | 6   |
| Less: Accumulated depreciation  | 22,971       | 1   | 12,423       | 1   | Capital surplus - additional paid-in capital                                   | 501,962      | 15  | 51,962       | 3   |
| Prepayment for equipment  | 5,469        | -   | -            | -   | Retained earnings  |              |     |              |     |
| Net properties  | 33,574       | 1   | 21,283       | 1   | Appropriated as legal reserve  | 128,122      | 4   | 69,113       | 4   |
| <b>INTANGIBLE ASSETS (Notes 2, 11, 18 and 20)</b>                     |              |     |              |     | Unappropriated earnings  | 544,234      | 15  | 294,762      | 16  |
| Refundable deposits (Note 19 and 20)                                  | 48,486       | 1   | 41,376       | 2   | Total retained earnings  | 672,356      | 19  | 363,875      | 20  |
| Deferred charges, net (Note 2)  | 30,760       | 1   | 11,204       | 1   |  |              |     |              |     |
| Other (Notes 2, 12 and 13)  | 2,080        | -   | -            | -   | Total shareholders' equity   | 1,880,089    | 54  | 887,388      | 48  |
| Total other assets  | 81,326       | 2   | 52,580       | 3   | <b>TOTAL</b>   | \$ 3,511,078 | 100 | \$ 1,847,784 | 100 |
| <b>TOTAL</b>  | \$ 3,511,078 | 100 | \$ 1,847,784 | 100 |  |              |     |              |     |

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

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

# PHISON ELECTRONICS CORP.

## STATEMENTS OF INCOME

SIX MONTHS ENDED JUNE 30, 2006 AND 2005

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

|   | 2006              |           | 2005              |           |
|---|-------------------|-----------|-------------------|-----------|
|   | Amount            | %         | Amount            | %         |
| OPERATING REVENUE (Note 2 and 18)                 |                   |           |                   |           |
| Gross sales                                       | \$ 4,426,014      | 100       | \$ 2,557,995      | 100       |
| Sales returns and allowances                      | <u>53,845</u>     | <u>1</u>  | <u>6,673</u>      | <u>-</u>  |
| Net sales   | 4,372,169         | 99        | 2,551,322         | 100       |
| Service revenue                                   | <u>53,289</u>     | <u>1</u>  | <u>627</u>        | <u>-</u>  |
| Total revenue                                     | 4,425,458         | 100       | 2,551,949         | 100       |
| OPERATING COST (Notes 14 and 18)                  | <u>3,789,249</u>  | <u>85</u> | <u>2,213,996</u>  | <u>87</u> |
| GROSS PROFIT                                      | <u>636,209</u>    | <u>15</u> | <u>337,953</u>    | <u>13</u> |
| OPERATING EXPENSES (Note 14 and 18)               |                   |           |                   |           |
| Marketing (Note 18)                               | 59,948            | 1         | 35,418            | 1         |
| General and administrative                        | 24,840            | 1         | 19,435            | 1         |
| Research and development                          | <u>131,427</u>    | <u>3</u>  | <u>65,861</u>     | <u>2</u>  |
| Total operating expenses                          | <u>216,215</u>    | <u>5</u>  | <u>120,714</u>    | <u>4</u>  |
| OPERATING INCOME                                  | <u>419,994</u>    | <u>10</u> | <u>217,239</u>    | <u>9</u>  |
| NONOPERATING INCOME AND GAINS                     |                   |           |                   |           |
| Interest income                                   | 5,167             | -         | 2,419             | -         |
| Gain on disposal of investments, net (Note 2)     | 3,398             | -         | 1,760             | -         |
| Equity in net income of investees (Note 2 and 9)  | 106               | -         | -                 | -         |
| Others  | <u>4,800</u>      | <u>-</u>  | <u>55</u>         | <u>-</u>  |
| Total nonoperating income and gains               | <u>13,471</u>     | <u>-</u>  | <u>4,234</u>      | <u>-</u>  |
| NONOPERATING EXPENSES AND LOSSES                  |                   |           |                   |           |
| Losses on inventory decline value (Notes 2 and 7) | 74,402            | 2         | 26                | -         |
| Foreign exchange loss, net (Note 2)               | 1,552             | -         | 670               | -         |
| Others  | <u>35</u>         | <u>-</u>  | <u>522</u>        | <u>-</u>  |
| Total nonoperating expenses and losses            | <u>75,989</u>     | <u>2</u>  | <u>1,218</u>      | <u>-</u>  |
| INCOME BEFORE INCOME TAX                          | 357,476           | 8         | 220,255           | 9         |
| INCOME TAX EXPENSE (Notes 2 and 13)               | <u>11,738</u>     | <u>-</u>  | <u>11,789</u>     | <u>1</u>  |
| NET INCOME  | <u>\$ 345,738</u> | <u>8</u>  | <u>\$ 208,466</u> | <u>8</u>  |

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|                              | 2006                             |                                 | 2005                             |                                 |
|------------------------------|----------------------------------|---------------------------------|----------------------------------|---------------------------------|
|                              | <b>Before<br/>Income<br/>Tax</b> | <b>After<br/>Income<br/>Tax</b> | <b>Before<br/>Income<br/>Tax</b> | <b>After<br/>Income<br/>Tax</b> |
| EARNINGS PER SHARE (Note 16) |                                  |                                 |                                  |                                 |
| Basic                        | <u>\$ 6.79</u>                   | <u>\$ 6.57</u>                  | <u>\$ 3.60</u>                   | <u>\$ 3.41</u>                  |
| Diluted                      | <u>\$ 6.77</u>                   | <u>\$ 6.55</u>                  | <u>\$ 3.48</u>                   | <u>\$ 3.29</u>                  |

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

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

(Concluded)

**PHISON ELECTRONICS CORP.**

**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
SIX MONTHS ENDED JUNE 30, 2006 AND 2005  
(In Thousands of New Taiwan Dollars, Except Per Share Data)**

|  | Capital Stocks        |                   | Capital Received<br>in Advance | Stock Dividends<br>to Be Issued | Capital Surplus                              | Legal Reserve     | Retained Earnings          |                   | Total<br>Shareholders'<br>Equity<br>(Note 15) |
|--|-----------------------|-------------------|--------------------------------|---------------------------------|--|-------------------|----------------------------|-------------------|---|
|  | Shares<br>(Thousands) | Amount            |                                |                                 | Paid-in Capital<br>in Excess of Par<br>Value |                   | Unappropriated<br>Earnings | Total             |   |
| BALANCE, JANUARY 1, 2006                           | 52,212                | \$ 522,121        | \$ -                           | \$ -                            | \$ 501,962                                   | \$ 69,113         | \$ 676,382                 | \$ 745,495        | \$ 1,769,578                                  |
| Appropriation of 2005 year's earnings              |                       |                   |                                |                                 |  |                   |                            |                   |   |
| Legal reserve                                      | -                     | -                 | -                              | -                               | -  | 59,009            | (59,009)                   | -                 | -   |
| Bonus to employees - stock                         | -                     | -                 | -                              | 19,500                          | -  | -                 | (19,500)                   | (19,500)          | -   |
| Bonus to employees - cash                          | -                     | -                 | -                              | -                               | -  | -                 | (23,000)                   | (23,000)          | (23,000)                                      |
| Stock dividends - \$2.99088 per share              | -                     | -                 | -                              | 158,000                         | -  | -                 | (158,000)                  | (158,000)         | -   |
| Cash dividends - \$3.97523 per share               | -                     | -                 | -                              | -                               | -  | -                 | (210,000)                  | (210,000)         | (210,000)                                     |
| Remuneration to directors and supervisors          | -                     | -                 | -                              | -                               | -  | -                 | (8,377)                    | (8,377)           | (8,377)                                       |
| Balance after appropriation                        | 52,212                | 522,121           | -                              | 177,500                         | 501,962                                      | 128,122           | 198,496                    | 326,618           | 1,528,201                                     |
| Issuance of stock due to exercise of stock options | 496                   | 4,960             | -                              | -                               | -  | -                 | -                          | -                 | 4,960   |
| Capital received in advance                        | -                     | -                 | 1,190                          | -                               | -  | -                 | -                          | -                 | 1,190   |
| Net income for the six months ended June 30, 2006  | -                     | -                 | -                              | -                               | -  | -                 | 345,738                    | 345,738           | 345,738                                       |
| <b>BALANCE, JUNE 30, 2006</b>                      | <b>52,708</b>         | <b>\$ 527,081</b> | <b>\$ 1,190</b>                | <b>\$ 177,500</b>               | <b>\$ 501,962</b>                            | <b>\$ 128,122</b> | <b>\$ 544,234</b>          | <b>\$ 672,356</b> | <b>\$ 1,880,089</b>                           |
| BALANCE, JANUARY 1, 2005                           | 36,232                | \$ 362,321        | \$ -                           | \$ -                            | \$ 51,962                                    | \$ 34,280         | \$ 379,692                 | \$ 413,972        | \$ 828,255                                    |
| Appropriation of 2004 year's earnings              |                       |                   |                                |                                 |  |                   |                            |                   |   |
| Legal reserve                                      | -                     | -                 | -                              | -                               | -  | 34,833            | (34,833)                   | -                 | -   |
| Bonus to employees - stock                         | -                     | -                 | -                              | 18,000                          | -  | -                 | (18,000)                   | (18,000)          | -   |
| Bonus to employees - cash                          | -                     | -                 | -                              | -                               | -  | -                 | (18,000)                   | (18,000)          | (18,000)                                      |
| Stock dividends - \$2.49380 per share              | -                     | -                 | -                              | 90,580                          | -  | -                 | (90,580)                   | (90,580)          | -   |
| Cash dividends - \$3.49130 per share               | -                     | -                 | -                              | -                               | -  | -                 | (126,812)                  | (126,812)         | (126,812)                                     |
| Remuneration to directors and supervisors          | -                     | -                 | -                              | -                               | -  | -                 | (5,171)                    | (5,171)           | (5,171)                                       |
| Balance after appropriation                        | 36,232                | 362,321           | -                              | 108,580                         | 51,962                                       | 69,113            | 86,296                     | 155,409           | 678,272                                       |
| Issuance of stock due to exercise of stock options | 23                    | 230               | -                              | -                               | -  | -                 | -                          | -                 | 230   |
| Capital received in advance                        | -                     | -                 | 420                            | -                               | -  | -                 | -                          | -                 | 420   |
| Net income for the six months ended June 30, 2005  | -                     | -                 | -                              | -                               | -  | -                 | 208,466                    | 208,466           | 208,466                                       |
| <b>BALANCE, JUNE 30, 2005</b>                      | <b>36,255</b>         | <b>\$ 362,551</b> | <b>\$ 420</b>                  | <b>\$ 108,580</b>               | <b>\$ 51,962</b>                             | <b>\$ 69,113</b>  | <b>\$ 294,762</b>          | <b>\$ 363,875</b> | <b>\$ 887,388</b>                             |

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

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

# PHISON ELECTRONICS CORP.

## STATEMENTS OF CASH FLOWS SIX MONTHS ENDED JUNE 30, 2006 AND 2005 (In Thousands of New Taiwan Dollars)

|   | 2006            | 2005          |
|---|-----------------|---------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |                 |               |
| Net income  | \$ 345,738      | \$ 208,466    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                 |               |
| Losses on inventory decline value   | 74,402          | 26            |
| Deferred income tax   | (9,564)         | 3,085         |
| Amortization  | 12,449          | 11,223        |
| Depreciation  | 5,983           | 4,025         |
| Allowance for doubtful accounts   | 5,910           | (7,889)       |
| Gain on disposal of financial assets carried at cost - non current                | (2,139)         | -             |
| Equity in net income of investees   | (106)           | -             |
| Gain on disposal of properties  | (4)             | -             |
| Net changes in operating assets and liabilities                                   |                 |               |
| Financial assets held for trading   | -               | 60,154        |
| Notes and accounts receivable   | (172,322)       | 8,681         |
| Other financial assets  | (94,990)        | 1,186         |
| Inventories   | (338,669)       | (164,860)     |
| Other current assets  | (32,517)        | (6,070)       |
| Notes and accounts payable  | 356,311         | (86,937)      |
| Income tax payable  | 905             | 3,344         |
| Accrued expenses  | (48,292)        | 46,351        |
| Other current liabilities   | (16,745)        | 8,868         |
| Accrued pension cost  | -               | 15            |
| Net cash provided by operating activities   | <u>86,350</u>   | <u>89,668</u> |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |                 |               |
| Increase in financial assets carried at cost - non current                        | (42,500)        | -             |
| Increase in deferred charges  | (15,412)        | (6,637)       |
| Acquisition of properties   | (14,779)        | (5,599)       |
| Proceeds from disposal of financial assets carried at cost - non current          | 6,789           | -             |
| Decrease (increase) in refundable deposits  | (6,516)         | 39,995        |
| Increase in intangible assets   | (516)           | (365)         |
| Other   | (1,372)         | -             |
| Decrease (increase) in restricted assets  | (99)            | 5,104         |
| Proceeds from disposal of properties  | <u>24</u>       | <u>-</u>      |
| Net cash provided by investing activities   | <u>(74,381)</u> | <u>32,498</u> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                       |                 |               |
| Proceeds from exercise of stock options   | 4,960           | 230           |
| Remuneration to directors and supervisors   | (374)           | (375)         |
| Increase in short-term debts  | -               | 47,430        |
| Capital received in advance   | <u>1,190</u>    | <u>420</u>    |

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# PHISON ELECTRONICS CORP.

## STATEMENTS OF CASH FLOWS SIX MONTHS ENDED JUNE 30, 2006 AND 2005 (In Thousands of New Taiwan Dollars)

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|   | 2006              | 2005              |
|---|-------------------|-------------------|
| Net cash provided by financing activities   | <u>5,776</u>      | <u>47,705</u>     |
| NET INCREASE IN CASH AND CASH EQUIVALENTS   | 17,745            | 169,871           |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD  | <u>759,945</u>    | <u>365,512</u>    |
| CASH AND CASH EQUIVALENTS, END OF PERIOD  | <u>\$ 777,690</u> | <u>\$ 535,383</u> |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION  |                   |                   |
| Interest paid   | <u>\$ 33</u>      | <u>\$ 516</u>     |
| Income tax paid   | <u>\$ 26,544</u>  | <u>\$ 5,360</u>   |
| INVESTING ACTIVITIES AFFECTING BOTH CASH AND<br>NON-CASH ITEMS                                |                   |                   |
| Acquisition of properties   | \$ 10,193         | \$ 5,323          |
| Decrease in payables to contractors and equipment suppliers (included<br>in accrued expenses) | <u>4,586</u>      | <u>276</u>        |
| Cash paid   | <u>\$ 14,779</u>  | <u>\$ 5,599</u>   |
| Acquisition of intangible assets  | \$ 516            | \$ 47,795         |
| Increase in payables to related parties   | <u>-</u>          | <u>(47,430)</u>   |
| Cash paid   | <u>\$ 516</u>     | <u>\$ 365</u>     |

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

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

(Concluded)