

**MEDIATEK INC.**

**FINANCIAL STATEMENTS**  
**WITH**  
**INDEPENDENT AUDITORS' REPORT**

**FOR THE YEARS ENDED**  
**DECEMBER 31, 2005 AND 2004**

English Translation of a Report Originally Issued in Chinese

**Independent Auditors' Report**

To the Board of Directors and Shareholders of  
MediaTek Inc.

We have audited the accompanying balance sheets of MediaTek Inc. as of December 31, 2005 and 2004, 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 Company'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 Auditing and Certification of Financial Statements by Certified Public Accountants" and generally accepted auditing standards in the Republic of China (R.O.C.). 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 MediaTek Inc. as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles in the R.O.C.

The Company has prepared consolidated financial statements as of December 31, 2005 and 2004 and for the years then ended. We also have expressed an unqualified audit opinion on those consolidated financial statements.

Diwan, Ernst & Young  
February 6, 2006  
Taipei, Taiwan  
Republic of China

Notice to Readers

The reader is advised that these financial statements have been prepared originally in Chinese. In the event of a conflict between these financial statements and the original Chinese version or difference in interpretation between the two versions, the Chinese language financial statements shall prevail.

The accompanying financial statements are intended only to present the financial position and results of operations and cash flows in accordance with accounting principles and practices generally accepted in the R.O.C. 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 R.O.C.

## English Translation of Financial Statements Originally Issued in Chinese

**MEDIATEK INC.**  
**BALANCE SHEETS**  
**As of December 31, 2005 and 2004**  
(Amounts in thousand New Taiwan dollars)

ASSETS	Notes	2005	2004	LIABILITIES AND SHAREHOLDERS' EQUITIES	Notes	2005	2004
<b>Current assets</b>				<b>Current liabilities</b>			
Cash and cash equivalents	2, 4(1)	\$ 31,405,861	\$ 22,770,147	Accounts payable		\$ 2,819,030	\$ 1,618,663
Short-term investments (net)	2, 4(2)	1,189,778	869,901	Payables to related parties	5	2,138,331	1,003,112
Accounts receivable (net)	2, 4(3)	3,987,387	3,479,147	Income tax payable	2, 4(17)	909,647	559,410
Receivables from related parties (net)	5	47,345	9,432	Accrued expenses	7	3,452,174	1,393,070
Other receivables	4(4),10(1)	311,262	270,334	Payables to equipment suppliers		316,185	140,660
Inventories (net)	2, 4(5)	3,235,893	3,251,668	Long-term debts-current portion	4(8)	-	10,643
Prepayments and other current assets		275,329	563,942	Other current liabilities		282,122	111,610
Deferred income tax assets-current (net)	2, 4(17)	159,691	155,953	Total current liabilities		9,917,489	4,837,168
Restricted deposits-current	6	24,000	81,770				
Total current assets		40,636,546	31,452,294				
<b>Long-term investments</b>	2, 4(6)			<b>Other liabilities</b>			
Long-term equity investments				Accrued pension liabilities	2, 4(9)	57,516	74,064
Accounted for under equity method		13,372,476	11,969,352	Total liabilities		9,975,005	4,911,232
Accounted for under cost method		1,015,000	15,000				
Long-term bond investments		-	67,576				
Total long-term investments		14,387,476	12,051,928				
<b>Property, plant and equipment</b>	2, 4(7),5			<b>Shareholders' equities</b>			
Buildings and facilities		742,135	739,276	Capital			
Machinery and equipment		116,374	60,388	Common stock	4(10)	8,640,506	7,693,359
Research and development equipment		716,238	607,151	Capital reserve			
Miscellaneous equipment		52,960	41,183	Additional paid-in capital	4(12)	69,689	69,689
Total cost		1,627,707	1,447,998	Treasury stock transaction	4(12)	145,472	84,975
Less : Accumulated depreciation		(514,296)	(384,618)	Donated assets	4(12)	1,260	1,260
Add : Construction in progress		2,711,279	943,865	Long-term investment transaction	4(12)	47,115	-
Prepayments for equipment		17,006	19,454	Total capital reserve		263,536	155,924
Property, plant and equipment (net)		3,841,696	2,026,699	Retained earnings			
<b>Intangible assets</b>	2			Legal reserve	4(11)	5,579,822	4,147,524
Software		287,753	213,108	Special reserve	4(13)	714,649	49,071
Patents and IPs	5	2,205,979	1,078,429	Undistributed earnings	4(13)	37,993,458	31,363,021
Prepayments for patents and technical rights	5	-	105,711	Other			
Total intangible assets		2,493,732	1,397,248	Cumulative translation adjustments	2	(391,751)	(714,649)
<b>Other assets</b>				Treasury stock-cost	2, 4(14)	(55,970)	(55,970)
Refundable deposits		72,707	8,385	Total shareholders' equities		52,744,250	42,638,280
Deferred income tax assets-noncurrent (net)	2.4(17)	1,287,098	612,958				
Total other assets		1,359,805	621,343				
<b>Total assets</b>		\$ 62,719,255	\$ 47,549,512	<b>Total liabilities and shareholders' equities</b>		\$ 62,719,255	\$ 47,549,512

The accompanying notes are an integral part to these financial statements.

**MEDIATEK INC.****STATEMENTS OF INCOME****For the years ended December 31, 2005 and 2004**

(Amounts in thousand New Taiwan dollars, except earnings per share)

	Notes	2005	2004
<b>Gross sales</b>	2, 4(15), 5	\$ 48,382,445	\$ 41,885,020
Less : Sales returns and discounts		(1,891,236)	(1,830,718)
Net sales		46,491,209	40,054,302
<b>Cost of goods sold</b>	4(16)	(21,107,425)	(20,438,854)
<b>Gross profits</b>		25,383,784	19,615,448
<b>Operating expenses</b>	2, 4(16),5,7,9		
Selling expenses		(734,129)	(434,436)
Administration expenses		(1,157,206)	(911,354)
Research and development expenses		(6,237,838)	(3,518,067)
Total operating expenses		(8,129,173)	(4,863,857)
<b>Operating income</b>		17,254,611	14,751,591
<b>Non-operating income</b>			
Interest income		411,532	191,866
Gain on equity investments	2,4(6)	78,114	-
Gain on disposal of short-term investments	2	23,515	18,983
Reversal of bad debts	2	-	21,804
Reversal of inventory loss provision	2,4(5)	239,671	-
Reversal of accrued license fee	7(2)	419,056	-
Others		9,717	11,978
Total non-operating income		1,181,605	244,631
<b>Non-operating expenses</b>			
Net loss from equity investments	2, 4(6)	-	(127,845)
Foreign exchange loss (net)	2, 10	(37,321)	(116,962)
Inventory loss provision	2, 4(5)	-	(409,050)
Others		(36)	(1,088)
Total non-operating expenses		(37,357)	(654,945)
<b>Income before income tax</b>		18,398,859	14,341,277
<b>Income tax expense</b>	2, 4(17)	(125,226)	(18,292)
<b>Net income</b>		\$ 18,273,633	\$ 14,322,985
<b>Earnings Per Share (in New Taiwan dollars)</b>	2, 4(18)		
Income before income tax		\$ 21.46	\$ 16.69
Net income		\$ 21.31	\$ 16.67
<b>Pro-forma data: (Assuming that the Company's shares owned by its subsidiary were not treated as treasury stock)</b>	2, 4(18)		
<b>Earnings Per Share (in New Taiwan dollars)</b>			
Income before income tax		\$ 21.36	\$ 16.62
Net income		\$ 21.22	\$ 16.59

The accompanying notes are an integral part to these financial statements.

## MEDIATEK INC.

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITIES

For the years ended December 31, 2005 and 2004

(Amounts in thousand New Taiwan dollars)

	Common stock	Capital reserve	Legal reserve	Special reserve	Undistributed earnings	Cumulative translation adjustments	Treasury stock	Total
Balance as of January 1, 2004	\$ 6,415,473	\$ 115,906	\$ 2,495,315	\$ -	\$ 27,113,421	\$ (49,071)	\$ (55,970)	\$ 36,035,074
Appropriation and distribution of 2003 earnings:								
Legal reserve	-	-	1,652,209	-	(1,652,209)	-	-	-
Special reserve	-	-	-	49,071	(49,071)	-	-	-
Directors' and supervisors' remuneration	-	-	-	-	(44,462)	-	-	(44,462)
Employees bonus	157,471	-	-	-	(816,711)	-	-	(659,240)
Shareholders' dividends	1,154,785	-	-	-	(6,607,937)	-	-	(5,453,152)
Purchase of treasury stock	-	-	-	-	-	-	(935,705)	(935,705)
Cancellation of treasury stock	(34,370)	(311)	-	-	(901,024)	-	935,705	-
Net income for the year ended December 31, 2004	-	-	-	-	14,322,985	-	-	14,322,985
The effects of subsidiaries' shareholding of the Company's stock recorded as treasury stock	-	43,777	-	-	-	-	-	43,777
The effects of change in long-term equity investment due to change in investment percentage	-	(3,448)	-	-	(1,971)	-	-	(5,419)
Cumulative translation adjustments	-	-	-	-	-	(665,578)	-	(665,578)
Balance as of December 31, 2004	7,693,359	155,924	4,147,524	49,071	31,363,021	(714,649)	(55,970)	42,638,280
Appropriation and distribution of 2004 earnings:								
Legal reserve	-	-	1,432,298	-	(1,432,298)	-	-	-
Special reserve	-	-	-	665,578	(665,578)	-	-	-
Directors' and supervisors' remuneration	-	-	-	-	(36,675)	-	-	(36,675)
Employees bonus	177,811	-	-	-	(1,045,951)	-	-	(868,140)
Shareholders' dividends	769,336	-	-	-	(8,462,694)	-	-	(7,693,358)
Net income for the year ended December 31, 2005	-	-	-	-	18,273,633	-	-	18,273,633
The effects of subsidiaries' shareholding of the Company's stock recorded as treasury stock	-	60,497	-	-	-	-	-	60,497
The effects of change in long-term equity investment due to change in investment percentage	-	47,115	-	-	-	-	-	47,115
Cumulative translation adjustments	-	-	-	-	-	322,898	-	322,898
Balance as of December 31, 2005	\$ 8,640,506	\$ 263,536	\$ 5,579,822	\$ 714,649	\$ 37,993,458	\$ (391,751)	\$ (55,970)	\$ 52,744,250

The accompanying notes are an integral part to these financial statements.

**MEDIATEK INC.**  
**STATEMENTS OF CASH FLOWS**  
**For the years ended December 31, 2005 and 2004**  
(Amounts in thousand New Taiwan dollars)

	2005	2004
<b>Cash flows from operating activities :</b>		
Net income	\$ 18,273,633	\$ 14,322,985
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	181,199	158,526
Amortization	765,259	343,764
Bad debt loss provision (reversal)	45,146	(21,804)
Inventory loss provision (reversal)	(239,671)	409,050
Cash dividends from investees	10,400	-
Net loss (gain) from equity investments	(78,114)	127,845
Gain on disposal of short-term investments	(23,515)	(18,983)
Gain on disposal of property, plant and equipment	-	(597)
Interest income on disposal of long-term bond investments	(5,763)	-
Decrease (increase) in accounts receivable	(550,309)	236,227
Decrease (increase) in receivable from related parties	(40,990)	3,370
Increase in other receivables	(40,928)	(29,806)
Decrease (increase) in inventories	255,446	(1,585,210)
Increase in net changes in deferred income tax assets	(677,878)	(506,178)
Decrease (increase) in prepayments and other current assets	288,613	(424,265)
Increase (decrease) in accounts payable	1,200,367	(634,518)
Increase (decrease) in payables to related parties	1,135,219	(925,068)
Increase in income taxes payable	350,237	246,583
Increase in accrued expenses	2,059,104	66,659
Increase in other current liabilities	170,512	62,481
Decrease (increase) in accrued pension liabilities	(16,548)	19,745
Net cash provided by operating activities	23,061,419	11,850,806
<b>Cash flows from investing activities :</b>		
Decrease in restricted deposits	57,770	1,617
Decrease (increase) in short-term investments	(296,362)	236,000
Increase in long-term investments	(2,002,900)	(1,347,230)
Disinvestment of long-term investment refundable	98,000	-
Proceeds from disposal of long-term bond investments	73,339	-
Proceeds from disposal of property, plant and equipment	-	1,238
Purchase of property, plant and equipment	(1,822,652)	(1,002,966)
Increase in intangible assets	(1,859,762)	(1,459,432)
Increase in refundable deposits	(64,322)	(2,895)
Net cash used in investing activities	(5,816,889)	(3,573,668)
<b>Cash flows from financing activities :</b>		
Decrease in long-term debts	(10,643)	(17,539)
Buying treasury stocks	-	(935,705)
Cash dividends	(7,693,358)	(5,453,152)
Directors' and supervisors' remuneration	(36,675)	(44,462)
Employee bonus	(868,140)	(659,240)
Net cash used in financing activities	(8,608,816)	(7,110,098)
Net increase in cash and cash equivalents	8,635,714	1,167,040
Cash and cash equivalents at the beginning of the year	22,770,147	21,603,107
Cash and cash equivalents at the end of the year	\$ 31,405,861	\$ 22,770,147
<b>Supplemental disclosures of cash flow information :</b>		
Income tax paid during the year	\$ 452,792	\$ 276,940
<b>Activities partially effected cash flows :</b>		
Purchase of property, plant and equipment	\$ 1,998,177	\$ 1,143,626
Less: increase in payables to equipment suppliers	(175,525)	(140,660)
Cash paid for the purchase of property, plant and equipment	\$ 1,822,652	\$ 1,002,966
<b>Non-cash activities :</b>		
Stock dividends and employee bonus capitalized	\$ 947,147	\$ 1,312,256
Long-term debts-current portion	\$ -	\$ 10,643
Cumulative translation adjustments	\$ 322,898	\$ (665,578)
Long-term equity investment adjustments	\$ 47,115	\$ (5,419)
Cancellation of treasury stock	\$ -	\$ (935,705)
Subsidiary hold the company's treasury stock as collect the company's cash dividends	\$ 60,497	\$ 43,777

The accompanying notes are an integral part to these financial statements.

**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS**

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

**1. Organization and Operation**

As officially approved, MediaTek Inc. (the "Company") was incorporated at Hsinchu Science-based Industrial Park on May 28, 1997. Since then, it has been specialized in the R&D, production, manufacture and marketing of Multimedia integrated circuits (ICs), computer peripherals oriented ICs, high-end consumer-oriented ICs and other ICs of extraordinary application. Meanwhile, it has rendered design, test runs, maintenance and repair and technological consultation services for software & hardware of the aforementioned products as well as import and export trade for the aforementioned products.

As of December 31, 2005 and 2004, the Company's employees totaled 1,171 and 895, respectively.

**2. Summary of Significant Accounting Policies**

The Company's financial statements are prepared in accordance with the R.O.C.'s "Guidelines Governing the Preparation of Financial Reports by Securities Issuer" and generally accepted accounting standards. Significant accounting policies are summarized as follows:

Cash Equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash, and so near their maturity that they present insignificant risk of changes in interest rates. Commercial papers, negotiable certificates of deposit, and bank acceptances with original maturities of three months or less are considered cash equivalents.

Foreign Currency Transactions

The Company maintains its accounting records in New Taiwan dollars ("NT Dollars" or "NT\$"), the national currency of the R.O.C. Transactions denominated in foreign currencies are recorded in NT Dollars using the exchange rates in effect at the dates of the transactions. Assets and liabilities denominated in foreign currencies are translated into NT Dollars using the exchange rates in effect at the balance sheet date. Foreign exchange gains or losses are included in other income or losses.

The assets and liabilities of the foreign subsidiaries are translated into NT Dollars, with the local currency of each foreign subsidiary as its functional currency, at current exchange rates in effect at the balance sheet date. Revenue and expense accounts are translated using a weighted average exchange rate for the relevant period. Translation gains and losses are included as a component of shareholders' equity. The accumulated exchange gains or losses resulting from the translation are recorded as cumulative translation adjustments under shareholders' equity.

**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

Short-term Investments

Short-term investments are recorded at cost when acquired and are stated at the lower of aggregate cost or market value at the balance sheet date. The market value of listed equity securities or closed-end funds is determined by the average closing price during the last month of the fiscal year. The market value for open-end funds is determined by their equity per unit at the balance sheet date. No revenue is recognized when stock dividends are received. Instead, the number of shares increases and the cost per share is recalculated. Interest income of credit-linked structured deposits matured within a year is accrued based on the contracted interest rate.

Allowance for Doubtful Accounts

The allowance for doubtful accounts are provided based on the collectibility and aging analysis of notes receivable, accounts receivable, receivables from related parties and by examining current trends in the credit quality of its customers as well as its internal credit policies.

Inventories

Inventories are carried at lower of cost or market value using the weighted average cost method. Replacement cost is used to determine the market value of raw materials. Net realizable value is used to determine the market value of work in process and finished goods. The lower of cost or market value is applied on aggregate basis to total inventory. Inventories that are not sold or moved for further manufactory within 60 days are deemed to be slow-moving items and certain allowance is set aside to reflect any possible loss from obsolescence.

Long-term Investments

Long-term equity investments

(1) Long-term investments accounted for under cost method

Long-term investments in which the Company holds less than 20% of the outstanding voting shares of the investee companies and is not able to exercise significant influence over the investee companies are stated at cost except for investments in listed companies which are stated at lower of cost or market value. The unrealized loss on long-term investments is recorded as a contra equity account. If it is evidenced that the stock price is unlikely to recover in the future, an other-than-temporary loss will be recognized in the current period, and the cost of a long-term investment shall be reduced to the market price, which will then become the new cost.



**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

(2) Long-term investments accounted for under equity method

Long-term investments in which the Company holds an interest of 20% or more and has the ability to exercise significant influence over the investee's operating and financial policies are accounted for under the equity method of accounting. The difference between the cost of the investment and the underlying equity in the investee's net assets at the date of acquisition is amortized over five years. Adjustment to capital reserve is required when holding percentage changes due to unproportional subscription to investee's new shares issued. If the capital reserve is insufficient, retained earnings are adjusted.

Unrealized intercompany gains and losses are eliminated under the equity method. Profit from sales of depreciable assets between the investee and the Company is amortized and recognized based on the assets' economic service lives. Profit from other types of intercompany transactions is recognized when realized.

When equity in loss of an investee exceeds carrying value accounted for by the equity method, the Company recognizes the investment loss by reducing the balance of the investment to zero. However, if the Company intends to provide further financial supports for the investee company, or the investee company's losses are temporary and there exists sufficient evidence showing imminent return to profitable operations, then the Company shall continue to recognize investment losses in proportion to the stock ownership percentage. Such credit long-term investment balance shall first offset the advance, if any, the Company made to the investee company. The remaining credit balance is recorded under other liabilities. For equity investees in which the Company possesses control, the Company recognizes its investee's total losses unless other investors are obligated to and have the ability to assume a portion of the loss. If an investee company subsequently reports net income, and investor company shall resume applying the equity method only after its shares of that net income equals the share of net losses not recognized during the period the equity method was suspended.

In accordance with the R.O.C. Statement of Financial Accounting Standards ("SFAS") No. 7, consolidated financial statements are prepared if the Company owns more than 50% of the equity investee's shares. However, the financial statements of any subsidiary in which the total assets and total revenues for the current year are less than 10% of those of the Company are not included in the consolidated financial statements. If the sum of the total assets or total revenues of all unconsolidated subsidiaries exceeds 30% of the Company's assets or revenues, each unconsolidated subsidiary with or over 3% of assets or revenues of the Company should be consolidated.

In accordance with the R.O.C. SFAS No. 7 amended since January 1, 2005, consolidated financial statements are required for the Company and its investees, whether the Company directly or indirectly owns more than 50% of the investee's shares or exercises control.

**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

Long-term Bond Investments

Long-term bond investments are recorded at cost when acquired and accounted for under cost method.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed on a straight-line basis over the following useful lives:

Buildings and facilities	3 to 50	years
Machinery and equipment	3 to 5	years
Research and development equipment	3 to 5	years
Miscellaneous equipment	2 to 5	years

Improvements and replacements are capitalized and depreciated over their estimated useful lives while ordinary repairs and maintenance are expensed as incurred.

When property, plant and equipment are disposed of, their original cost and accumulated depreciation are written off and related gains or losses are included in other income or losses.

Intangible Assets

Software (Design software), patents and IPs are stated at cost and amortized on a straight-line basis over the following useful lives:

Software (Design software)	3 years
Patents and IPs	3 years

Asset Impairment

On January 1, 2005, the Company adopted R.O.C. SFAS No.35, "Accounting for Assets impairment." The Company is required to perform (1) goodwill impairment tests annually on a reporting unit level; and (2) evaluate whether indicators of impairment exist for assets subject to guidelines set forth under the Statement. The Statement requires that such assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets might not be recoverable. Unrecoverable losses shall be recognized. Recognized losses on goodwill impairment shall not be reversed subsequently. For non-goodwill assets impaired in prior periods, a gain shall be recognized to the extent that such assets' carrying value do not exceed original value less associated depreciation or amortization.

**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

*Capital Expenditures vs. Revenue Expenditures*

If the expenditure increases the future service potential of the plant assets and the lump sum purchase price per transaction exceeds criteria, the expenditure is capitalized, while the others are expensed as incurred.

*Revenue Recognition*

Revenue is recognized in accordance with the R.O.C. SFAS No. 32, "Accounting for Revenue Recognition."

*Employee Retirement Benefits*

In accordance with the Labor Standards Law (the "Law") of the R.O.C., the Company makes a monthly contribution equal to 2% of the wages and salaries paid during the period to a pension fund maintained with the Central Trust of China. The fund is administered by the Employees' Retirement Fund Committee and is deposited in the committee's name. Therefore, the pension fund is not included in the financial statements of the Company.

The Labor Pension Act (the "Act"), which provides for a new defined contribution plan, took effect on July 1, 2005. Employees already covered by the Law can choose to remain to be subject to the pension mechanism under the Law or to be subject to the Act. Under the Act, the rate of an employer monthly contribution to the pension fund should be at least 6% of the employee's monthly wages.

The Company has a defined benefit pension plan covering substantially all of its employees and adopts the R.O.C. SFAS No. 18, "Accounting for Pensions." The minimum pension liability was recorded for the excess of accumulated pension obligations over the fair value of plan assets. Net transition obligations from the plan assets are amortized using the straight-line method over the employees' expected average remaining service period of 20 years. For employees under defined contribution pension plans, pension costs are recorded based on the actual contributions made to employees' individual pension accounts.

*Income Tax*

In accordance with the R.O.C. SFAS No.22,"Accounting for Income Taxes," income tax is accounted for under the inter-period and intra-period income tax allocation method. Provision for income tax includes deferred tax resulting from temporary differences and investment tax credits. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements using enacted tax rates and laws that will be in effect when the difference is expected to reverse. Valuation allowance on deferred tax assets is provided to the extent that it is more likely than not that the tax benefits will not be realized.

**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

Income tax credit is accounted for in accordance with the R.O.C. SFAS No. 12, "Accounting for Income Tax Credit." Income tax credits resulting from the acquisition of equipment, research and development expenditures and employee training shall be recognized using the flow-through method.

Income taxes (10%) on undistributed earnings are recorded as expenses in the year when the stockholders have resolved that the earnings shall be retained.

*Financial instruments-hedging purpose*

A forward foreign exchange contract obligates the Company to exchange predetermined amounts of specified foreign currencies at specified exchange rates for another currency on a specified date. For contracts that are designated as hedges, discounts or premiums, being the difference between the spot exchange rate and the forward exchange rate at the inception of the contract, are accreted or amortized to the income statement over the contract lives using the straight-line method. Realized gains and losses from settlement or unrealized gains and losses resulting from changes in the spot exchange rate at the balance sheet date is recorded in the income statement as foreign exchange gains or losses in the period in which they relate. The related amounts due to or from counter parties are included in other current assets or other current liabilities.

*Earnings Per Share*

In accordance with the R.O.C. SFAS No.24, "Earnings Per Share," the Company presents basic earnings per share. Earnings per common share are computed by dividing net income by the weighted-average number of common share outstanding during the year. Earnings per common share are adjusted retroactively by stock dividends resulting from retained earnings or capital surplus. Furthermore, if the base date of the capital increase for a stock dividend is before the issuance date of the financial statements, the earnings per common share shall be adjusted retroactively.

In accordance with the R.O.C. SFAS No. 30, "Accounting for Treasury Stock," the Pro-Forma earnings per share were computed as follows assuming that the Company's shares owned by its subsidiary were not treated as treasury stock.

**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

*Treasury Stock*

The Company's shares owned by its subsidiaries were accounting-treated as treasury stock according to R.O.C. SFAS No. 30, "Accounting for Treasury Stock." Cash dividends distributed to the Company's subsidiaries are deducted from investment income account and credited to capital reserves-treasury stock transaction.

In accordance with the R.O.C. SFAS No. 30, "Accounting for Treasury Stock," treasury stock transactions are accounted for under cost method. The gross cost of shares reacquired is recorded in a contra shareholders' equity account called treasury stock. At the date of subsequent resale, the treasury stock account is credited for the cost of the treasury stock. When treasury stock is sold for more than its acquisition cost, the difference is credited to capital reserve-treasury stock transaction. If treasury stock is sold for less than its acquisition cost, the difference is charged to the same capital reserve account to the extent the capital reserve account to reduce to zero. If the balance of the capital reserve is insufficient, any further reduction shall be charged to retained earnings instead.

When treasury stock is retired, the treasury stock account is credited and all capital account balances related to the treasury shares, including capital reserve-treasury stock transaction, are reduced on a proportionate basis. Any difference, if on credit side, is recorded in capital reserve -treasury stock transaction; if on debit side, retained earnings is charged.

**3. Reasons and Effects for Change in Accounting Principles**

Effective on January 1, 2005, the Company adopted accounting treatment for assets defined under the R.O.C. SFAS No.35, "Accounting for Assets Impairment." Restatements to prior period's financial statements caused by the Statement are not allowed. There are no significant impacts on the Company's total assets as of December 31, 2005, and net income and EPS for the year then ended.

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)****4. Contents of Significant Accounts****(1) Cash and Cash Equivalents**

<i>In thousand NTD</i>	As of December 31,	
	2005	2004
Savings and checking accounts	\$463,542	\$1,088,629
Time deposits	15,763,045	16,546,510
Cash equivalents- CP-Repo and bonds-Repo	15,179,274	5,135,008
Total	<u>\$31,405,861</u>	<u>\$22,770,147</u>

As of December 31, 2005, the Company has committed to sell the bonds-Repo back to the brokers during the three month period ended March 31, 2006.

Cash and cash equivalents were not pledged as of December 31, 2005.

**(2) Short-term Investments-Net**

<i>In thousand NTD</i>	As of December 31,			
	2005		2004	
	Cost	Market Value	Cost	Market Value
Mutual fund	\$990,000	\$1,000,590	\$370,085	\$370,255
Government bonds	199,778	199,821	499,816	499,816
Subtotal	1,189,778	1,200,411	869,901	870,071
Less: Allowance for market value decline	-	-	-	-
Net	<u>\$1,189,778</u>	<u>\$1,200,411</u>	<u>\$869,901</u>	<u>\$870,071</u>

Short-term investments were not pledged as of December 31, 2005.

**(3) Notes and Accounts Receivable-Net**

<i>In thousand NTD</i>	As of December 31,	
	2005	2004
Accounts receivable	\$4,227,885	\$3,677,576
Less: Allowance for doubtful accounts	(240,498)	(198,429)
Net	<u>\$3,987,387</u>	<u>\$3,479,147</u>

As of December 31, 2005 and 2004, accounts receivable from the most significant customer amounted to NT\$1,634,504 thousand and NT\$1,711,982 thousand, representing 38.20% and 46.43% of total accounts receivable, respectively. While, accounts receivable from the most 5 significant customers totaled to NT\$2,725,556 thousand and NT\$2,721,530 thousand, representing 63.71% and 73.81% of total accounts receivable, respectively.

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)****(4) Other Receivables**

<i>In thousand NTD</i>	As of December 31,	
	2005	2004
Forward exchange contracts receivable net	\$52,016	\$86,436
Interest receivable	77,385	24,373
VAT refundable	172,784	158,879
Others	9,077	646
Total	<u>\$311,262</u>	<u>\$270,334</u>

**(5) Inventories-Net**

<i>In thousand NTD</i>	As of December 31,	
	2005	2004
Raw materials	\$-	\$946
Work in process	2,175,224	1,877,726
Finished goods	1,189,629	1,732,020
Inventories in transit	31,095	127,327
Subtotal	3,395,948	3,738,019
Less: Allowance for inventory obsolescence	(160,055)	(486,351)
Net	<u>\$3,235,893</u>	<u>\$3,251,668</u>

- a. The insurance coverage for inventories amounted to NT\$150,000 thousand and NT\$300,000 thousand as of December 31, 2005 and 2004, respectively. The subcontractors provided insurance policies for the inventories at their hand for processing. Thus, the subcontractors will assume the responsibility of damage, if any.
- b. Inventories were not pledged as of December 31, 2005.

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)****(6) Long-term Investments**

a.

As of December 31, 2005

Investee Companies	Types	Shares/units	Amounts (NT\$'000)	Ownership (%)	Accounting Method
<u>Long-term equity investments</u>					
MediaTek Investment Corp.	Common share	285,000,000	\$2,505,474	100.00%	Equity
Hsu-Ta Investment Limited	Capital	-	3,519,633	100.00%	Equity
Hsu-Chia Investment Limited	Capital	-	3,272,227	100.00%	Equity
Hsu-Kang Investment Limited	Capital	-	3,272,085	100.00%	Equity
ALi Corporation	Common share	56,956,200	787,517	25.17%	Equity
Wiseali Technology Inc.	Common share	200,000	5,816	100.00%	Equity
Subtotal			13,362,752		
Add : Unrealized loss on disposal of long-term equity investments			9,724		
Total equity Method			13,372,476		
Yuantonix, Inc.	Common share	1,500,000	15,000	5.18%	Cost
Chinatrust Financial Holding Co. Ltd	Series B Preferred Stock	25,000,000	1,000,000	-	Cost
Total cost method			1,015,000		
Total			\$14,387,476		

As of December 31, 2004

Investee Companies	Types	Shares/units	Amounts ( NT\$'000)	Ownership (%)	Accounting Method
<u>Long-term equity investments</u>					
MediaTek Investment Corp.	Common share	185,000,000	\$1,554,475	100.00%	Equity
Hsu-Ta Investment Limited	Capital	-	3,316,653	100.00%	Equity
Hsu-Chia Investment Limited	Capital	-	3,083,444	100.00%	Equity
Hsu-Kang Investment Limited	Capital	-	3,083,407	100.00%	Equity
ALi Corporation	Common share	56,956,200	635,740	31.28%	Equity
Wiseali Technology Inc.	Common share	9,900,000	286,209	99.00%	Equity
Subtotal			11,959,628		
Add : Unrealized loss on disposal of long-term equity investments			9,724		
Total equity Method			11,969,352		
Yuantonix, Inc.	Common share	1,500,000	15,000	5.66%	Cost
<u>Long-term bonds Investments</u>					
ETI	Convertible bonds	236	67,576	-	Cost
Total			\$12,051,928		



**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

- b. For the years ended December 31, 2005 and 2004, the Company recognized investment gain and loss, on the long- term equity investment amounting to NT\$78,114 thousand and (NT\$127,845) thousand, respectively. The gain and loss were recognized based on the audited financial statements of the investee companies.
- c. On March 5, 2005, ALi Corporation offered 40,000 thousand common stocks in a private issuance. The Company did not present at the register of common shares, and because of the issuance for employees' stock options and the issuance of new shares from convertible bonds, the Company has declined in further investing in said offering which leads to a change in interest hold. As of December 31, 2005, the Company has recognized a capital reserve of \$55,204 thousand accordingly.
- d. The Company's holding interest on Hsu-Ta Investment Limited was decreased due to the subsidiary's employee stock options being exercised. Capital reserve was decreased by \$8,089 thousand accordingly.
- e. In December 2005, our investment in series B preferred stocks ("Preferred B") of Chinatrust Financial Holding Company is increased by NT\$1,000,000 thousand. Terms and conditions of the stock are as follows:
- (a) Duration : 7 years.
  - (b) Par value : \$10 per share.
  - (c) Issuing price : \$40 per share.
  - (d) Dividends:  
Dividend is fixed at 3.5% per year based on actual issuing price, and is paid in cash on an annual basis. In any given year a dividend is not distributed, either due to a loss status or constraints under regulation requirements, such dividend is postponed to following years.
  - (e) Redemption at maturity:  
Redemption price at maturity is set at 100% of actual issuing price, \$40 dollar per share.

Preferred stock issued under provision 1 of section 6 under the Articles of Incorporations is guaranteed the highest priority to the Company's property in the event of liquidation. Preferred B stockholders are next in line followed by common stockholders; Stockholders of Preferred B is not granted voting rights in Shareholder's Meeting unless such meeting is held among Preferred B stockholders only; Conversion of Preferred B to common shares of the company is disallowed; Cash or stock dividends distributed to common stockholders does not apply to Preferred B stockholders; In a capital raising event Preferred B stockholders enjoy a privileged right to participate, as is the case for stockholders of other classes of stocks issued.

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

f. A capital reduction by Wiseali Technology Inc. in October 2005 has caused an NT\$144,881 thousand loss to the Company while a refund of NT\$98,000 thousand is received.

g. Long-term investments were not pledged as of December 31, 2005.

**(7) Property, Plant and Equipment**

a. The insurance coverage for property, plant and equipment amounted to NT\$1,578,274 thousand and NT\$1,400,396 thousand as of December 31, 2005 and 2004, respectively.

b. No interest was capitalized for the years ended December 31, 2005 and 2004, respectively.

c. Property, Plant and Equipment were not pledged as of December 31, 2005.

**(8) Long-term Debts**

The authorities of HSIP financed the Company by providing free-interest loans for certain R&D projects:

Items	Original balance (NT\$'000)	As of December 31,		Repayment
		2005 (NT\$'000)	2004 (NT\$'000)	
Third project	24,000	\$-	\$10,643	The first repayment of NT\$2,715 thousand was made in August 2003. The remaining portion is repayable in eight quarterly installments, starting January 1, 2003, each of NT\$2,661 thousand.
Total long-term debts		-	10,643	
Less: Current portion		-	( 10,643 )	
Total		\$-	\$-	

**(9) Accrued Pension Liabilities**

a. The Company's pension fund amounted to NT\$39,985 thousand and NT\$31,436 thousand as of December 31, 2005 and 2004, respectively. The pension cost recognized amounted to NT\$14,678 thousand (including the pension cost amounting to NT\$24,057 thousand recognized under "Labor Pension Act") and NT\$29,824 thousand for the years ended December 31, 2005 and 2004, respectively.

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

## b. The components of net pension cost

<i>In thousand NTD</i>	For the year ended December 31,	
	2005	2004
Service cost	\$14,415	\$18,667
Interest cost	3,023	1,913
Expected return on plan assets	(1,227)	(748)
Amortization	(247)	(86)
Over (reversal) accrual	(25,343)	10,078
Net pension cost	<u>\$(9,379)</u>	<u>\$29,824</u>

## c. The funded status of the Company's pension plans under "Labor Standards Law"

<i>In thousand NTD</i>	As of December 31,	
	2005	2004
Benefit obligations		
Vested benefit obligation	\$-	\$-
Non-vested benefit obligation	(40,907)	(42,505)
Accumulated benefit obligation	(40,907)	(42,505)
Effect of projected future salary increase	(65,200)	(49,997)
Projected benefit obligation	(106,107)	(92,502)
Fair value of plan assets	39,958	31,436
Funded status of pension plan	(66,149)	(61,066)
Unrecognized net transitional obligation	1,059	1,148
Unrecognized loss	7,805	10,393
Over-accrual	(231)	(24,539)
Accrued pension liabilities	<u>\$(57,516)</u>	<u>\$(74,064)</u>

## d. The vested benefit was nil as of December 31, 2005 and 2004.

The underlying actuarial assumptions:

	For the year ended December 31,	
	2005	2004
Discount rate	3.5%	3.5%
Rate of increase in future compensation levels	4.0%	3.5%
Expected long-term rate of return on plan assets	3.5%	3.5%

**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

**(10) Common Stock**

As of January 1, 2004, the authorized and issued common shares of the Company amounted to NT\$8,960,000 thousand and NT\$6,415,473 thousand, divided into 896,000,000 shares and 641,547,256 shares, respectively, each share at par value of NT\$10.

The resolution of the shareholders' annual general meeting on June 9, 2004, the Company issued 131,225,575 new shares, each share at par value of NT\$10, for the capitalization of shareholders' bonus of NT\$1,154,785 thousand and employees' bonus of NT\$157,471 thousand. The capitalization date was on August 5, 2004 and the governmental approval has been successfully obtained.

Based on the approval from the Company's board of directors meeting held on May 7, 2004, the Company was allowed to purchase back its own common share. The Company bought 3,437,000 shares from market during the period from May 8 to July 7, 2004. On September 22, 2004, the Board further resolved to cancel the treasury stocks and the measurement date was on September 29, 2004. The cancellation of shares has been successfully updated to government.

Based on the resolution of shareholders' general meeting on June 13, 2005, the Company's Articles of Incorporation as revised provided that the authorized capital, NT\$400,000 thousand reserved for the grant of options to qualified employees was amended to NT\$200,000 thousand. The shareholders further resolved to issue 94,714,749 new shares at par value of NT\$10 for the capitalization of shareholders' bonus of NT\$769,336 thousand and employees' bonus of NT\$177,811 thousand. The capitalization date was set on August 16, 2005 and the governmental approval has been successfully obtained.

As of December 31, 2005, the authorized and issued common shares of the Company amounted to NT\$8,960,000 thousand and NT\$8,640,506 thousand, divided into 896,000,000 (including 20,000,000 shares reserved for exercise of employee stock options.) shares and 864,050,580 shares, respectively, each share at par value of NT\$10.

**(11) Legal Reserve**

According to the R.O.C. Company Law, 10% of the Company's net income, after deducting previous years' losses, if any, is appropriated as legal reserve prior to any distribution until such reserve is equal to the Company's paid-in capital. When the legal reserve is equal to or more than 50% of paid-in capital, 50% of such reserve may be distributed to the Company's shareholders through the issuance of additional common share.

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)****(12) Capital Reserve**

<i>In thousand NTD</i>	As of December 31,	
	2005	2004
Additional paid-in capital	\$69,689	\$69,689
Treasury stock transaction	145,472	84,975
Donated assets	1,260	1,260
Long-term investment transaction	47,115	-
Total	<u>\$263,536</u>	<u>\$155,924</u>

According to the R.O.C. Company Law, capital reserve can only be used for making up deficiencies or distributions of stock dividends. The Company shall not use capital reserve to make up its loss unless legal reserve is insufficient for making good such losses.

For the years ended December 31, 2005 and 2004, the cash dividends of NT\$60,497 thousand and NT\$43,777 thousand, respectively, distributed to the Company's subsidiary were credited to the Company's capital reserve account in accordance with the R.O.C. SFAS No. 30, "Accounting for Treasury Stock."

**(13) Earnings Distribution**

Net income for the year ended December 31, 2004 may be appropriated or distributed in the following sequences:

- (a) Income tax obligation;
- (b) Offsetting accumulated deficits, if any;
- (c) Legal reserve at 10% of net income;
- (d) Reserve or reverse for special reserve in compliance with the Company Law or the Securities and Exchange Law;
- (e) Remuneration for directors and supervisors to a maximum of 0.5% of the remaining of (a) through (d), while remuneration for directors and supervisors' services is limited to cash payments.
- (f) The remaining balance after all the above appropriations and distributions, combining with inappropriate earnings from prior years, shall be fully for shareholders' dividends and employee bonuses and may be retained or distributed proportionally. The portion of employee bonus may be within 10% to 15% of total earnings resolved to distribute for shareholders' dividends and employee bonuses. Employee bonuses may be distributed in form of shares or cash, or both. The qualification of employees entitled to the bonuses is at the discretion of board meeting. Employees serving the Company's subsidiaries are inclusive.

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

Shareholders and employee bonuses may be distributed in the form of shares or cash, or both, and cash dividend to be distributed might not be less than 10% of total dividends to be distributed while this guideline may be adjusted according to the Company's judgment on current performance. Remuneration for directors and supervisors is limited to cash payments.

The Company's articles of incorporation, revised on June 13, 2005, provided that the appropriation earnings for 2005 are consistent with the above appropriation of earning for 2004, while shareholders' dividends may be distributed in form of shares or cash, or both. According to the amended articles, cash dividend to be distributed might not be less than 10% of total dividends to be distributed to shareholders.

According to the regulations of Securities and Futures Bureau, Financial Supervisory Commission, Executive Yuan, R.O.C., the Company is required to appropriate a special reserve in the amount equal to the sum of debit elements under shareholders' equity, such as unrealized loss on long-term equity investment, negative cumulative translation adjustment, at each year-end. Such special reserve is prohibited from being distributed. However, if any of the debit elements is reversed, the special reserve in the amount equal to the reversal may be released for earnings distribution.

**(14) Treasury Stock**

Following the resolution of board meeting on May 7, 2004, the Company bought its own common shares back from open market. Treasury stock transactions were summarized as follows:

Treasury stock transactions for the year ended December 31, 2005: None

Treasury stock transactions for the year ended December 31, 2004:

Purpose	January 1, 2004		Increase		(Decrease)		December 31, 2004	
	Shares	Amounts ( NT\$'000)	Shares	Amounts ( NT\$'000)	Shares	Amounts ( NT\$'000)	Shares	Amounts ( NT\$'000)
Protecting shareholders' equity	-	\$-	3,437,000	\$935,705	(3,437,000)	(\$935,705)	-	\$-

a. According to the R.O.C. Securities and Exchange Law, total shares bought back shall not exceed 10% of the Company's issued stocks. Total bought-back amounts shall not exceed the sum of retained earnings and the realized capital reserve.

b. In compliance with the R.O.C. Securities and Exchange Law, treasury stock shall not be

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

pledged, nor does it possess voting rights or the rights to receive dividends. The Company shall cancel the treasury shares and file a change in registered paid-in capital to government within 6 months.

- c. The Company's shares owned by its subsidiaries are also accounted for as treasury stock. These shares were shown as follows:

Owner	January 1, 2005		Additions		December 31, 2005		
	Shares	Amount	Shares	Amount	Shares	Amount	Market Value
	(NT\$'000)		(NT\$'000)		(NT\$'000)		(NT\$'000)
MediaTek	6,049,700	\$55,970	604,970	\$-	6,654,670	\$55,970	\$2,395,082
Capital Corp.			(Note)				

  

Owner	January 1, 2004		Additions		December 31, 2004		
	Shares	Amount	Shares	Amount	Shares	Amount	Market Value
	(NT\$'000)		(NT\$'000)		(NT\$'000)		(NT\$'000)
MediaTek	5,122,656	\$55,970	924,044	\$-	6,049,700	\$55,970	\$1,280,177
Capital Corp.			(Note)				

(Note) Stock dividend received.

Cash dividends distributed to the Company's subsidiaries are deducted from investment income account and credited to capital reserves-treasury stock transaction. Please refer to note 4(12).

**(15) Sales Revenues-Net**

<i>In thousand NTD</i>	For the year ended December 31,	
	2005	2004
Revenues from sales of chipsets	\$48,006,117	\$40,982,258
Others	376,328	902,762
Subtotal	48,382,445	41,885,020
Less: Sales returns and sales discount	(1,891,236)	(1,830,718)
Net sales	\$46,491,209	\$40,054,302

Net sales from the Company's first 10 significant customers totaled to NT\$23,162,047 thousand and NT\$24,973,666 thousand, respectively, representing 49.82% and 62.35% of the Company's net sales, for the years ended December 31, 2005 and 2004, respectively.

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)****(16) Personnel, Deprecation and Amortization Expenses**

	For the year ended December 31,					
	2005			2004		
	Recorded under cost of goods sold	Recorded under operating expense	Total	Recorded under cost of goods sold	Recorded under operating expense	Total
<i>In thousand NTD</i>						
Personnel Expense						
Salary expense	\$54,127	\$1,565,899	\$1,620,026	\$45,472	\$1,031,909	\$1,077,381
Insurance expense	2,229	59,108	61,337	2,084	40,893	42,977
Pension expense	1,883	12,795	14,678	1,322	28,502	29,824
Other	297	20,652	20,949	297	14,792	15,089
Total	\$58,536	\$1,658,454	\$1,716,990	\$49,175	\$1,116,096	\$1,165,271
Depreciation	\$4,994	\$176,205	\$181,199	\$14,759	\$143,767	\$158,526
Amortization	\$300	\$764,959	\$765,259	\$150	\$343,614	\$343,764

**(17) Income Tax**

- a. Pursuant to the “Statute for the Establishment and Administration of Science-Based Industrial Park,” the Company was granted several periods of tax holidays with respect to income derived from approved investments. The tax holidays expired on December 31, 2004.
- b. Pursuant to the “Statute for Upgrading Industries,” the Company is entitled to an income tax exemption period for five consecutive years on the income generated from qualifying high technology activities. The Company has elected the tax exemption period to be from January 1, 2002 through December 31, 2006, January 1, 2003 through December 31, 2007, January 1, 2004 through December 31, 2008, and January 1, 2005 through December 31, 2009.
- c. The Company’s income tax returns for the years 1998 and 1999 have been assessed and approved by the tax authorities in 2002 and 2003, respectively. The Company should pay additional income tax of NT\$26,947 thousand and NT\$41,290 thousand for the years 1998 and 1999, respectively. The Company had made half of the requested tax payment and filed an administrative appeal to the Ministry of Finance (“MOF”). The administrative appeal was rejected in December 2004, and the Company filed an administrative appeal to the tax authorities in March 2005 again. The Company has recorded the additional tax as an expense.



**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

- d. The Company's income tax returns for the years 2000 and 2001 have been assessed and approved by the tax authorities in November 2004 and in March 2005, respectively. The Company should pay additional income tax of NT\$142,862 thousand and NT\$207,598 thousand, respectively. The Company has recorded the additional tax as an expense and also has filed a reinvestigation to the tax authorities in December 2004 and in May 2005, respectively.
- e. The Company's income tax returns for the year 2002 has been assessed and approved by the tax authorities in December 2005. The Company should pay additional income tax of NT\$899,276 thousand. However, because the different viewpoints of the calculation for tax income and of the related adopted regulation with Taxation Agency, the Company has filed for a revised result which has been assessed and approved to the tax authorities. The Company has recorded the additional tax of NT\$449,638 thousand as an expense.
- f. The Company's available investment tax credits as of December 31, 2005 were as follows:

Year incurred	Nature of Expenditures	Total credit amount (NT\$'000)	Unused amount (NT\$'000)	Year expired
2003	R&D	\$923,466	152,039	2007
	Human development	776	-	2007
2004	R&D	1,224,202	1,224,202	2008
	Human development	1,712	1,712	2008
2005	R&D	1,347,114	1,347,114	2009
(Estimate)	Human development	1,168	1,168	2009
		<u>\$3,498,438</u>	<u>\$2,726,235</u>	

g.

(a) Deferred income tax assets (liabilities) ( <i>In thousand NTD</i> )	As of December 31, 2005
Total deferred income tax liabilities	<u>\$ (91)</u>
Total deferred income tax assets	<u>\$2,734,030</u>
Valuation allowance for deferred income tax assets	<u>\$1,287,150</u>

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

(b) Temporary differences that generated deferred income tax assets (liabilities) ( <i>In thousand NTD</i> )		As of December 31, 2005	
		Amount	Tax effect
Deductible temporary difference-Recognition of unrealized accrued expenses		\$14,674	\$52
Deductible temporary difference-Recognition of unrealized allowance for inventory obsolescence		\$160,055	\$572
Deductible temporary difference-Unrealized allowance for doubtful accounts recognition		\$200,792	\$717
Deductible temporary difference-Unrealized technology license fee		\$1,806,750	\$6,454
Taxable temporary difference-Unrealized foreign exchange gain		\$(25,372)	\$(91)
Investment tax credits			\$2,726,235
(c) <i>In thousand NTD</i>		As of December 31, 2005	
Deferred income tax assets-current		\$159,834	
Valuation allowance for deferred income tax assets-current		(52)	
Net deferred income tax assets-current		159,782	
Deferred income tax liabilities-current		(91)	
Net deferred income tax assets and liabilities-current		\$159,691	
(d) <i>In thousand NTD</i>		As of December 31, 2005	
Deferred income tax assets-non-current		\$2,574,196	
Valuation allowance for deferred income tax assets-non-current		(1,287,098)	
Net deferred income tax assets-non-current		1,287,098	
Deferred income tax liabilities-non-current		-	
Net deferred income tax assets and liabilities-non-current		\$1,287,098	

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

(e) Income tax payable and income tax expense (benefit) are reconciled as follows:

<i>In thousand NTD</i>	For the year ended December 31, 2005
Income tax payable	\$69,181
10% tax on undistributed earnings	138,321
Investment tax credits	(103,751)
Deferred income tax effects	
Investment tax credits	(1,202,471)
Valuation allowance	518,605
Unrealized technology license fee	(5,144)
Others	11,132
Accruals for additional prior year income tax	657,236
Prior year income tax adjustment	40,143
Others	1,974
Income tax expense	<u>\$125,226</u>

(f) Integrated income tax information

As of December 31, 2005

Balance of the imputation credit account (ICA)

*(In thousand NTD)*\$696,965

Expected creditable ratio

2.03%(Note)

Note: The ratio was computed based on the amount of actual available shareholders' tax credits plus estimated income tax payable as of December 31, 2005.

(g) Information related to undistributed retained earnings

*(In thousand NTD)*As of December 31, 2005

Prior to 1998

\$-

After 1998 (inclusive)

37,993,458

Total

\$37,993,458

h.

(a) Deferred income tax assets (liabilities) *(In thousand NTD)*As of December 31, 2004

Total deferred income tax liabilities

\$(969)

Total deferred income tax assets

\$1,538,425

Valuation allowance for deferred income tax assets

\$768,545

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

- (b) Temporary differences that generated deferred income tax assets (liabilities) (*In thousand NTD*)

	As of December 31, 2004	
	Amount	Tax effect
Deductible temporary difference-Recognition of unrealized accrued expenses	\$433,730	\$5,354
Deductible temporary difference-Recognition of unrealized allowance for inventory obsolescence	\$486,351	\$6,003
Deductible temporary difference- Unrealized allowance for doubtful accounts recognition	\$161,559	\$1,994
Deductible temporary difference-Unrealized technology license fee	\$106,112	\$1,310
Taxable temporary difference-Unrealized foreign exchange gain	\$(78,485)	\$(969)
Investment tax credits		\$1,523,764

- (c) *In thousand NTD*

	As of December 31, 2004
Deferred income tax assets-current	\$163,586
Valuation allowance for deferred income tax assets-current	(6,664)
Net deferred income tax assets-current	156,922
Deferred income tax liabilities-current	(969)
Net deferred income tax assets and liabilities-current	\$155,953

- (d) *In thousand NTD*

	As of December 31, 2004
Deferred income tax assets-non-current	\$1,374,839
Valuation allowance for deferred income tax assets-non-current	(761,881)
Net deferred income tax assets-non-current	612,958
Deferred income tax liabilities-non-current	-
Net deferred income tax assets and liabilities-non-current	\$612,958

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

(e) Income tax payable and income tax expense (benefit) are reconciled as follows:

<i>In thousand NTD</i>	For the year ended December 31, 2004
Income tax payable	\$171,295
10% tax on undistributed earnings	617,864
Investment tax credits	(394,579)
Deferred income tax effects	
Investment tax credits	(769,503)
Valuation allowance	253,254
Unrealized technology license fee	12,988
Others	(2,917)
Accruals for additional prior year income tax	142,862
Prior year income tax adjustment	(14,671)
Others	1,699
Income tax expense	\$18,292

(f) Integrated income tax information

	As of December 31, 2004
Balance of the imputation credit account (ICA)	
<i>(In thousand NTD)</i>	\$547,753
Actual creditable ratio	3.06%

(g) Information related to undistributed retained earnings

<i>(In thousand NTD)</i>	As of December 31, 2004
Prior to 1998	\$-
After 1998 (inclusive)	31,363,021
Total	\$31,363,021

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)****(18) Basic Earnings Per Share**

The weighted average numbers of common shares outstanding were computed as follows: (in shares)

Contents	For the year ended December 31,	
	2005	2004
Common shares outstanding, beginning	769,335,831	641,547,256
Purchase and disposal of treasury stock (remark 1)	-	(2,018,628)
subtotal	769,335,831	639,528,628
Stock issuance for stockholder' bonus, August 5, 2004 (remark 2)	-	115,735,176
Stock issuance for employees' bonus, August 5, 2004 (remark 2)	-	15,782,096
Stock issuance for stockholder' bonus, August 16, 2005	76,933,583	76,933,583
Stock issuance for employees' bonus, August 16, 2005	17,781,166	17,781,166
Subtotal	864,050,580	865,760,649
Less: the Company's shares owned by its subsidiary	(6,654,670)	(6,654,670)
Weighted average shares outstanding, ending	<u>857,395,910</u>	<u>859,105,979</u>

Remark 1: Computed in a weighted-average basis.

Remark 2: Adjusted retroactively by stock dividends and computed in a weighted-average basis.

For the year ended	Amount (numerator)		Shares (Denominator)	Earning per share	
	Before tax	After tax		Before tax	After tax
<u>December 31, 2005:</u>					
Basic EPS					
Net income	<u>\$18,398,859</u>	<u>\$18,273,633</u>	<u>857,395,910</u>	<u>\$21.46</u>	<u>\$21.31</u>

For the year ended	Amount (numerator)		Shares (Denominator)	Earning per share	
	Before tax	After tax		Before tax	After tax
<u>December 31, 2004:</u>					
Basic EPS					
Net income	<u>\$14,341,277</u>	<u>\$14,322,985</u>	<u>859,105,979</u>	<u>\$16.69</u>	<u>\$16.67</u>

The Pro-Forma earnings per share were computed as follows assuming that the Company's shares owned by its subsidiary were not treated as treasury stock:

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

<u>For the year ended</u>	<u>Amount (numerator)</u>		<u>Shares</u> <u>(Denominator)</u>	<u>Earning per share</u>	
	<u>Before tax</u>	<u>After tax</u>		<u>Before tax</u>	<u>After tax</u>
<u>December 31, 2005:</u>					
Basic EPS					
Net income	\$18,398,859	\$18,273,633	857,395,910		
The effect of the Company's shares owned by its subsidiary were not treated as treasury stock	60,497	60,497	6,654,670		
Pro-Forma EPS	<u>\$18,459,356</u>	<u>\$18,334,130</u>	<u>864,050,580</u>	<u>\$21.36</u>	<u>\$21.22</u>

<u>For the year ended</u>	<u>Amount (numerator)</u>		<u>Shares</u> <u>(Denominator)</u>	<u>Earning per share</u>	
	<u>Before tax</u>	<u>After tax</u>		<u>Before tax</u>	<u>After tax</u>
<u>December 31, 2004:</u>					
Basic EPS					
Net income	\$14,341,277	\$14,322,985	859,105,979		
The effect of the Company's shares owned by its subsidiary were not treated as treasury stock	43,777	43,777	6,654,670		
Pro-Forma EPS	<u>\$14,385,054</u>	<u>\$14,366,762</u>	<u>865,760,649</u>	<u>\$16.62</u>	<u>\$16.59</u>

**5. Related Party Transactions****(1) Related Parties and Relations**

<u>Related parties</u>	<u>Relations</u>
United Microelectronics Corp. ("UMC")	The supervisor of the Company
King Yuan Electronics Co., Ltd. ("KING YUAN")	The chairman of the Company and KING YUAN are close relatives.
ALi Corporation ("ALi")	Affiliated Company
Wiseali Technology Inc. ("Wiseali")	Affiliated Company
UMC Japan ("UMCJ")	Affiliated company of UMC
MediaTek Limited ("MTL")	Affiliated company
CrystalMedia Technology, Inc. ("CrystalMedia")	Affiliated company
Wireless ICs, Inc. ("Wireless")	Affiliated company

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)****(2) Major Transactions with related parties****a. Purchases**

<i>In thousand NTD</i>	For the year ended December 31,			
	2005		2004	
	Amount	% of total purchase	Amount	% of total purchase
UMC	\$7,694,377	64.16	\$7,690,155	56.03
UMCJ	277,704	2.32	799,601	5.83
Total	<u>\$7,972,081</u>	<u>66.48</u>	<u>\$8,489,756</u>	<u>61.86</u>

Prices for purchase from related parties are not comparable because the manufacturing process and product specification are significantly different. Payment terms to UMC and UMCJ were end-of-month 45 to 60 days, which were similar those to other suppliers for the years ended December 31, 2005 and 2004, respectively.

**b. Sales**

<i>In thousand NTD</i>	For the year ended December 31,			
	2005		2004	
	Amount	% of net sales	Amount	% of net sales
MTL	\$110,085	0.24	\$47,461	0.12
ALi	24,917	0.05	-	-
Other	8,887	0.02	11,547	0.02
Total	<u>\$143,889</u>	<u>0.31</u>	<u>\$59,008</u>	<u>0.14</u>

Sales prices to the related parties were similar to those to third-party customers while trade credit terms were end-of-month 45 to 60 days. While, trade credit terms for third-party customers are the same or in advanced receipts for the years ended December 31, 2005 and 2004, respectively.

**c. IC testing, experimental services and manufacturing technology services**

<i>In thousand NTD</i>		For the year ended December 31,	
		2005	2004
KING YUAN	IC testing and experimental services	\$927,491	\$912,641
Other	Technology license expense	9,452	-
Total		<u>\$936,943</u>	<u>\$912,641</u>



**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

- d. The Company paid NT\$201,482 thousand commission expense to MTL for the year ended December 31, 2004.
- e. During August 2003, the Company has entered into technology transfer agreements with CrystalMedia and Wireless in amount of US\$4,250 thousand and US\$5,100 thousand, respectively. The Company has fully paid and recorded it under the caption of intangible assets as of December 31, 2004.
- f. The Company purchased certain patents and technical rights from ALi totally at the price of NT\$274,381 thousand. The Company has fully paid the price during the year ended December 31, 2004. The title of NT\$168,670 thousand of the underlying patents and technical rights have been transferred to the Company during the year ended December 31, 2004 and was recorded under the caption of patents and technical rights. The remaining NT\$105,771 thousand of the patents and technical rights has been transferred to the Company in January, 2005 and recorded under the caption of prepayments for patents and technical rights.
- g. The Company bought 100,000 and 8,751,000 shares of Wiseali's common stock from ALi totally at the price of NT\$2,900 thousand and NT\$253,779 thousand in June ,2005 and November ,2004, respectively.

## h. Property equipment and on behalf of certain operating expense :

<i>In thousand NTD</i>		For the year ended December 31,	
Related Party	Items	2005	2004
ALi	Payment on R&D equipment and computer software	\$1,011	\$3,592
Other	Payment on R&D equipment、 miscellaneous supplies and payment on behalf of others	-	18,423
Total		<u>\$1,011</u>	<u>\$22,015</u>

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

## (3) Receivables and payables resulting from the above transactions:

## a. Receivables from related parties

<i>In thousand NTD</i>	As of December 31,			
	2005		2004	
	Amount	%	Amount	%
MTL	\$45,946	1.14	\$855	0.03
ALi	4,200	0.10	-	-
Other	276	0.01	8,547	0.24
Subtotal	50,422	1.25	9,432	0.27
Less: Allowance for doubtful accounts	(3,077)	(0.08)	-	-
Net	<u>\$47,345</u>	<u>1.17</u>	<u>\$9,432</u>	<u>0.27</u>

## b. Payables to related parties

<i>In thousand NTD</i>	As of December 31,			
	2005		2004	
	Amount	%	Amount	%
UMC	\$1,931,843	38.97	\$790,985	30.17
KING YUAN	205,191	4.14	125,415	4.78
UMCJ	-	-	86,712	3.31
ALi	1,034	0.03	-	-
Other	263	-	-	-
Total	<u>\$2,138,331</u>	<u>43.14</u>	<u>\$1,003,112</u>	<u>38.26</u>

**6. Assets Pledged As Collateral**

## (1) As of December 31, 2005

<i>In thousand NTD</i>	Net book value	Secured financial institutions	Contents (Purpose)
Restricted deposits-current	<u>\$24,000(note)</u>	Farmers Bank of China	Long-term debt

Note : The company paid off this debt on October, 2005. The Company didn't finished handling and removing hypothecation yet up to December 31, 2005.

## (2) As of December 31, 2004

<i>In thousand NTD</i>	Net book value	Secured financial institutions	Contents (Purpose)
Restricted deposits-current	\$42,000	Farmers Bank of China	Long-term debt
Restricted deposits-current	39,770	Pixel	Contract executed deposits
Total	<u>\$81,770</u>		

**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

**7. Commitments and Contingencies**

**(1) Litigation**

**A. Litigation relating to Zoran/Oak**

(a) The Company's technology in CD-ROM drive control chipsets originally came from United Microelectronics Corporation ("UMC"). Around that time, UMC and OAK Technologies Inc. ("Oak") of the United States had been engaging in patent infringement disputes relating such products. In October 1997, Oak, based on the settlement agreement reached with UMC, filed a complaint with the Northern District of California alleging breach of contract and other causes of actions. Subsequently, the Company became one of the litigants of UMC's legal disputes with Oak. In April 1998, Oak accused the Company and UMC through the International Trade Commission (ITC) of violation of Section 337 of the Tariff Act of 1930. The final determination rendered by the ITC in May 2001 affirmed that the Company's products did not infringe Oak's patents. As Oak was merged into Zoran Corporation ("Zoran"), Zoran took over Oak's position in these cases. In 2003, base on ITC's final determination and subsequent developments, the Company assessed that the litigation would not possibly lead to a gross loss to the Company and, in turn, restored NT\$1,557,540,000 originally set aside as licensing fee payable from the accounts concerned. On March 11, 2005, the Company filed supplemental complaint against Oak, alleging intentional interference with economic advantage, malicious prosecution, abuse of process, unfair competition and breach of covenant not to sue, seeking damages from Oak tin the Northern District of California.

(b) On March 10, 2004, Zoran and Oak filed a complaint with the US ITC that the Company's CD-ROM drive and DVD player chipsets have infringed upon three United States patents of Zoran and Oak (Pat. No. 6466736, 6584527 and 6546440) in violation of Section 337 of the Tariff Act of 1930. The ITC Administrative Law Judge ("ALJ") issued its initial determination on May 15, 2005, stating that the Company's products did not infringe Zoran/Oak's two patents (Pat. No. 6466736 and 6546440), but also determined that some of the Company's older model chips infringed claim number 3 of one of Zoran/Oak's patents (Pat. No. 6584527). The ITC affirmed the ALJ's initial determination in its final determination on September 29, 2005. The Company strongly believes in the invalidity of Zoran's patent (Pat. No. 6584527) in addition to MediaTek's products' non-infringement of this patent. The Company does not believe that this final determination will have any major effect to the operation of the company. A refundable deposit of US\$1,943 thousand is currently required and paid to ITC, which is recorded under restricted deposits.

**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

- (c) On July 23, 2004, the Company filed separate complaints with ITC and Delaware Federal District Court of the United States, accusing Zoran and Oak of having infringed upon certain of the Company's patents in the United States relating to servo controller chips and player shockproof system (Pat. No. 6229773 and 5970031). The Company requested that ITC starts its investigation right away and further requested that ITC enjoin imports of all Zoran and Oak products which infringed upon the two MediaTek patents. The Company further requested that Delaware Federal District Court enjoin Zoran and Oak from importing products that infringed upon the two MediaTek patents of in addition to claiming treble damages for willful infringement. ITC already launched an investigation on August 26, 2004. Subsequently, the Company amended its complaint to add Sunext Technology Co., Ltd. as a respondent to this action and further alleged that Zoran, Oak and Sunext Technology Co., Ltd. have infringed upon another MediaTek US patent relating to CD-ROM firmware renewal technology (Pat. No. 6170043). The US ITC granted the Company's amended complaint on October 7, 2004 and the hearing is scheduled to be held late June 2005. The final determination is anticipated to come out no later than November 2005.
- (d) On February 2, 2005, the Company and its subsidiary filed a patent infringement suit in the Shenzhen Intermediate People's Court against Zoran and Zoran Corporation Shenzhen Representative Office, asserting that certain Zoran products infringe upon the Company's PRC Pat. No. 97120448.9. The Company requested the Court to immediately start its investigation into this matter and sought, among other things, monetary damages and cessation of sale, importation and exportation of Zoran's products that infringe upon the aforementioned Company patent in or from the People's Republic of China.

With respect to A, B, C and D, the Company and Zoran and its subsidiary-Oak have agreed to withdraw or dismiss any and all pending claims against each other in all cases.

**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

- B. On April 7, 2005, Sanyo Electric Co. (“Sanyo”) filed a complaint with the Central District of California, USA, alleging certain of the Company’s chips infringed two of its US patents (Pat. No. 5499252 and 5818801), seeking damages and injunctive relief against any and all infringing products. The Company filed a motion to add a counterclaim with one US patent (Pat. No. 6003151), seeking damages and injunctive relief against any and all of Sanyo’s infringing products. The Central District of California granted the Company’s motion on December 5, 2006. On August 31, 2005, the Company filed a complaint against Sanyo and Sanyo North America Corp. in the Eastern District of Texas, stating that Sanyo’s products such as DVD players, DVD recorders, and digital televisions separately infringed certain of the Company’s US patents (Pat. No. 5867819 and 6118486), seeking damages and future injunctive relief against any and all of Sanyo’s infringing products. In addition, the Company amended its complaint on October 3, 2006, adding that Sanyo’s DVD recorders, digital cameras and cellular phones also infringed another one of the Company’s US patents (Pat. No. 5751356). The Company will use its best efforts to handle this litigation.
- C. On August 3, 2005, Matsushita Electric Industrial Co., Ltd. (“MEI”) filed a complaint for patent infringement against the Company in the U.S. District Court for the Northern District of California. In the complaint, MEI alleges that the Company infringes U.S. Pat. No.5548249, 5970238 and 6728475. The Complaint seeks both damages and an injunction prohibiting the sale of the Company’s products that infringe upon the aforementioned MEI patents. The Company has asserted a counterclaim against MEI and Panasonic Corporation of North America (“Panasonic”) for patent infringement of U.S. Pat. No.5970031, also seeking both damages and an injunction prohibiting the sale of all MEI products that infringe upon the aforementioned Company patent. Further, on October 17, 2005, the Company filed a complaint for patent infringement against MEI and Panasonic in the Eastern District of Texas, asserting that the DVD recorders and digital TVs of MEI and Panasonic infringe upon the Company’s U.S. Pat. No.5802068 and 6118486 respectively. The Company is seeking monetary damages and an injunction. The Company is cautiously handling these litigations.

**(2) Commitments**

- A. The Company has entered into several contracts in total of NT\$3,717,269 thousand (sale tax excluded) for constructing its headquarter tower. As of December 31, 2005, the Company has paid out NT\$2,658,678 thousand. The other amount of NT\$1,058,591 thousand remained an irrevocable commitment.
- B. As of December 31, 2005, totaling US\$5,315 thousand of the Company’s other significant contracts remained unpaid.

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

- c. The Company has entered certain lease agreements for land with the Administrative Bureau of HSIP for its need of operation. Related rent incurred in the future would be as follows:

Lease Period	Amount
2006.01.01~2006.12.31	\$25,474
2007.01.01~2007.12.31	25,474
2008.01.01~2008.12.31	24,406
2009.01.01~2009.12.31	23,879
2010.01.01~2023.12.31	319,205
Total	\$418,438

**8. Significant Casualty Loss**

None

**9. Significant Subsequent Events**

The Company entered into a patent agreement with Zoran Corporation and its subsidiary-OAK in January 2006. Zoran Corporation granted the related patent usage of Optical Storage products to the Company and its subsidiaries. The Company also agreed to authorize the patent usage of its PC Optical Storage to Zoran Corporation. The Company estimated to pay Zoran US\$55,000 thousand (NT\$1,806,750 thousand) for royalties. As of December 31, 2005, the royalties were recorded under the R&D expense by the Company. Both came to an agreement that within 30 months, according to the Optical Storage Chips, as the sales quantity reaches to a certain amount, the Company must pay Zoran US\$1,000 thousand per month. Total amount will not exceed US\$30,000 thousand.

**10. Others****(1) Financial Instruments****a. Derivative Financial Instruments****(a) Contract Amount or Nominal Amount and Credit Risk**

. As of December 31, 2005,

Financial Instruments	Type	Maturity	Contract amount (US\$'000 )	Exercise rate	Credit risk
Forward exchange -Hedging	Sell USD	January 2006~ February 2006	\$100,000	32.986~33.505	-

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

. As of December 31, 2004,

Financial Instruments	Type	Maturity	Contract amount (US\$'000 )	Exercise rate	Credit risk
Forward exchange -Hedging	Sell USD	January 2005~ February 2005	\$130,000	31.885~33.413	-

Credit risk relates to the extent to which failures by counter parties to discharge their obligations could reduce the amount of future cash flows from financial assets on hand as of the balance sheet date. The Company minimizes exposure to credit risks by only dealing with reputable banks.

**(b) Price risk**

The Company considers that the price risk related to the hedge transactions is minimal as gains or losses from contracts for hedging purposes are likely to be offset by gains or losses from the underlying assets and liabilities denominated in foreign currencies.

**(c) Liquidity risks**

The exchange rate of the forward exchange contracts are fixed. The Company anticipates that they have enough USD assets, no significant additional cash requirement is anticipated, and therefore, cash flow risk is minimal.

**(d) Types of derivative financial instruments, purpose of holding the derivative financial instruments and the strategy for achieving the hedging purpose:**

The Company's derivative financial instruments are not held for trading purpose and held for decreasing cost of hedging. The purpose of holding forward exchange contracts is to hedge exchange rate fluctuation risk resulting from assets, liabilities or commitments denominated in foreign currency. The Company's hedging strategy is to avoid majority of market price risk. Derivative financial instruments selected for hedging are highly anti-co-related with the fluctuation of the fair value of derivatives hedged. Derivatives are evaluated periodically.

**(e) Presentation of derivative financial instruments**

Forward exchange contracts receivable and payable are reported under current assets or liability on a net basis. As of December 31, 2005 and 2004, details were as follows:

<i>In thousand NTD</i>	As of December 31,	
	2005	2004
Forward contract receivable	\$3,330,140	\$4,221,450
Forward contract payable	(3,285,000)	(4,149,210)
Discount	6,876	14,196
Forward exchange contracts receivable -net	<u>\$52,016</u>	<u>\$86,436</u>

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

The forward exchange contracts receivable-net is classified under the caption of other receivables.

Foreign exchange gain (loss) incurred from the derivatives for the years ended December 31, 2005 and 2004 amounted to (NT\$205,482) thousand and NT\$148,914 thousand, respectively.

b. Disclosures of risks for short-term investments in credit-linked notes and structured deposits

(a) Contract amount (*In thousand USD*)

Underlying investments	As of December 31,	
	2005	2004
NanYa Plastics Credit-linked deposit (owned by Core Tech Resources Inc.)	-	\$1,000
Mega Fin Hold (owned by Core Tech Resources Inc.)	-	\$2,450
Quanta Computer (owned by Core Tech Resources Inc.)	-	\$1,500
Delta Electronic Inc. Credit-linked deposit (owned by Gaintech Co. Limited)	-	\$5,000

(b) Credit risk

Default by the issuers of underlying securities may reduce the value of credit-linked deposits to zero. The Company minimizes the credit risk by selecting counter parties who are reputable and in good financial standing.

(c) Liquidity risk

The Company is unable to have the credit-linked investments redeemed or called before maturity, which being the liquidity risk. In minimizing such risk, the Company only invests in securities whose maturities are within a year.

(d) Market risk

There is no market risk for the underlying investment except for the fluctuations in the exchange rate of US Dollar to NT Dollar.

(e) Cash flow risk

No cash flow risk was involved as the entire amounts of credit-linked investments have been fully paid.



**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)**

## c. Fair value of financial instruments

<i>In thousand NTD</i>	As of December 31,			
	2005		2004	
	Carrying value	Fair value	Carrying value	Fair value
<b>Non-derivative</b>				
<b>Assets</b>				
Cash, cash equivalents and restricted deposits	\$31,429,861	\$31,429,861	\$22,851,917	\$22,851,917
Short-term investments	\$1,189,778	\$1,200,411	\$869,901	\$870,071
Receivables (including receivables from related parties)	\$4,034,732	\$4,034,732	\$3,488,579	\$3,488,579
Other receivables (excluding forward exchange contracts receivable -net)	\$259,246	\$259,246	\$183,898	\$183,898
Long-term investments				
- Those with market value	\$787,517	\$2,102,253	\$635,740	\$1,144,820
- Those without market value	\$13,599,959	\$-	\$11,348,612	\$-
Long-term bond investments				
- Those without market value	\$-	\$-	\$67,576	\$-
Refundable deposits	\$72,707	\$72,707	\$8,385	\$8,385
<b>Liabilities</b>				
Payables (including due to related parties)	\$4,957,361	\$4,957,361	\$2,621,775	\$2,621,775
Income taxes payable	\$909,647	\$909,647	\$559,410	\$559,410
Accrued expenses	\$3,452,174	\$3,452,174	\$1,393,070	\$1,393,070
Payables to equipment suppliers	\$316,185	\$316,185	\$140,660	\$140,660
Long-term debts (including current portion)	\$-	\$-	\$10,643	\$10,643
<b>Derivatives</b>				
Forward exchange contracts-hedging	\$52,016	\$49,010	\$86,436	\$74,485

The methods and assumptions used to estimate the fair value of derivative financial instruments are as follows:

**MEDIATEK INC.**

**NOTES TO FINANCIAL STATEMENTS – (continued)**

- (a) The fair value of the Company's short-term financial instruments is based on the carrying value of those instruments at reporting date due to the short maturity of those instruments. The method is applied to cash and cash equivalents, receivables, other receivables, payables, income taxes payable, accrued expenses and payables to equipment suppliers.
- (b) The fair value of the Company's short-term investments and long-term investments is based on market prices at the reporting date if market prices are available. The fair value of the Company's long-term investments is based on relevant financial or any other information if market prices are not available.
- (c) The fair value of the Company's refundable deposits and restricted deposits is based on the book value at the reporting date because the estimated future cash receipts were similar to the book value.
- (d) The fair value of long-term debts is estimated using the discounted cash flow method based on the Company's borrowing rates for similar types of borrowings.
- (e) The fair value of derivative financial instruments (normally including unrealized gains or losses from outstanding forward exchange contracts) is the amount that the Company is entitled to receive or obligated to pay, assuming the Company terminated contracts at reporting date.

**(2) Others**

- a. Based on the Board's approval at August 26, 2005, the Company set out its plan in acquiring Alpha Imaging Technology Corporation ("AIT") with a stock-for-stock transaction. Each of the Company's shares was entitled to 3.392 AIT shares according to the purchasing contract. At December 30, 2005, the contract is however cancelled due to the exchange rate unable to reflect true value of said transaction. The Board has approved on the cancellation.
- b. Certain accounts in the financial statements of the Company as of December 31, 2004 have been reclassified to conform to the presentation of the current period.

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS – (continued)****11. Segment Information****(1) Major Customers**

Sales to customers representing over 10% of the Company's net sales were as follows:

<i>In thousand NTD</i>	For the year ended December 31,			
	2005		2004	
	Amounts	%	Amounts	%
Customers				
A	\$7,440,702	16.00%	\$7,978,784	19.92%

**(2) Export Sales**

The Company's export sales totaled NT\$40,028,366 thousand and NT\$33,012,530 thousand for the years ended December 31, 2005 and 2004, respectively, representing 86.10% and 82.42% of the Company's net sales for corresponding years.

**(3) Geographic data**

The Company has no significant foreign operation.

**(4) Industry data**

The Company operates predominantly in one industry segment, which being the designing, manufacturing, and supply of integrated circuit chips and decoders.