

**MEDIATEK INC.**

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

**AS OF DECEMBER 31, 2006 AND 2005**  
**AND FOR THE YEARS THEN ENDED**

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, 2006 and 2005, 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, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with Business Accounting Law, the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and generally accepted accounting principles in the R.O.C.

As discussed in Note 3 to the financial statements, effective January 1, 2006, the Company adopted the R.O.C. Statement of Financial Accounting Standards No. 34 "Accounting for Financial Instruments" and the R.O.C. Statement of Financial Accounting Standards No. 36 "Disclosure and Presentation of Financial Instruments" to account for the related assets.

The Company has prepared consolidated financial statements as of December 31, 2006 and 2005 and for the years then ended. We have expressed a modified unqualified and an unqualified audit opinion on those consolidated financial statements, respectively.

Ernst & Young  
CERTIFIED PUBLIC ACCOUNTANTS  
January 29, 2007  
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, 2006 and 2005**

(Amounts in thousand New Taiwan Dollars)

<b>ASSETS</b>	Notes	2006	2005	<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>	Notes	2006	2005
<b>Current assets</b>				<b>Current liabilities</b>			
Cash and cash equivalents	2, 4(1)	\$ 36,655,169	\$ 31,405,861	Financial liability at fair value through profit or loss-current	2, 4(2)	\$ 14,586	\$ -
Financial assets at fair value through profit or loss-current	2, 4(2)	2,704,102	1,241,794	Accounts payable		4,079,674	2,819,030
Accounts receivable, net	2, 4(3)	3,856,794	3,987,387	Payables to related parties	5	201,052	2,138,331
Receivables from related parties, net	5	207	47,345	Income tax payable	2, 4(16)	2,341,449	909,647
Other receivables	4(4)	238,142	259,246	Accrued expenses		1,971,445	3,452,174
Inventories, net	2, 4(5)	3,494,063	3,235,893	Payables to contractors and equipment suppliers		160,161	316,185
Prepayments and other current assets		205,490	275,329	Other current liabilities		311,311	282,122
Deferred income tax assets-current	2, 4(16)	342,585	159,691	Total current liabilities		9,079,678	9,917,489
Restricted deposits-current	6	-	24,000				
Total current assets		47,496,552	40,636,546				
<b>Funds and investments</b>	2, 4(6), 5			<b>Other liabilities</b>			
Available-for-sale financial assets-noncurrent		628,110	-	Accrued pension liabilities	2, 4(8)	60,977	57,516
Financial assets carried at cost-noncurrent		3,000	15,000	Total liabilities		9,140,655	9,975,005
Bond portfolios with no active market-noncurrent		1,000,000	1,000,000				
Investments accounted for using equity method		19,519,896	13,372,476				
Total funds and investments		21,151,006	14,387,476				
<b>Property, plant and equipment</b>	2, 4(7), 5			<b>Shareholders' equity</b>			
Buildings and facilities		4,113,175	742,135	Capital			
Machinery and equipment		116,374	116,374	Common stock	4(9)	9,683,127	8,640,506
Research and development equipment		1,095,679	716,238	Capital reserve			
Miscellaneous equipment		107,391	52,960	Additional paid-in capital	4(11)	69,689	69,689
Total cost		5,432,619	1,627,707	Treasury stock transaction	4(11)	218,673	145,472
Less : Accumulated depreciation		(689,706)	(514,296)	Donated assets	4(11)	1,260	1,260
Add : Construction in progress		-	2,711,279	Long-term investment transaction	4(6), 4(11)	114,787	47,115
Prepayments for equipment		72,071	17,006	Total capital reserve		404,409	263,536
Property, plant and equipment, net		4,814,984	3,841,696	Retained earnings			
<b>Intangible assets</b>				Legal reserve	4(10)	7,407,185	5,579,822
Software	2	278,270	287,753	Special reserve	4(12)	714,649	714,649
Patents, IPs and others	2, 5	1,802,973	2,205,979	Undistributed earnings	4(12)	47,175,664	37,993,458
Total intangible assets		2,081,243	2,493,732	Other adjustments			
<b>Other assets</b>				Cumulative translation adjustments	2, 4(6)	(483,510)	(391,751)
Refundable deposits		13,888	72,707	Unrealized gain on financial instruments	2, 4(6)	2,679,976	-
Deferred income tax assets-noncurrent	2, 4(16)	1,108,512	1,287,098	Treasury stock	2, 4(13)	(55,970)	(55,970)
Total other assets		1,122,400	1,359,805	Total shareholders' equity		67,525,530	52,744,250
<b>Total assets</b>		<u>\$ 76,666,185</u>	<u>\$ 62,719,255</u>	<b>Total liabilities and shareholders' equity</b>		<u>\$ 76,666,185</u>	<u>\$ 62,719,255</u>

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

## MEDIATEK INC.

## STATEMENTS OF INCOME

For the years ended December 31, 2006 and 2005

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

Description	Notes	2006		2005	
<b>Gross sales</b>		\$	55,212,125	\$	48,382,445
Less : Sales returns and discounts			(2,270,520)		(1,891,236)
Net sales	2, 4(14), 5		52,941,605		46,491,209
<b>Cost of goods sold</b>	4(15), 5		(22,287,387)		(21,107,425)
<b>Gross profits</b>			30,654,218		25,383,784
<b>Operating expenses</b>	2, 4(15), 5				
Selling expenses			(967,116)		(734,129)
Administrative expenses			(1,462,771)		(1,157,206)
Research and development expenses			(4,408,762)		(6,237,838)
Total operating expenses			(6,838,649)		(8,129,173)
<b>Operating income</b>			23,815,569		17,254,611
<b>Non-operating income and gains</b>					
Interest income			637,726		411,532
Gain on equity investments, net	2, 4(6)		-		78,114
Gain on disposal of property, plant and equipment	2		35,476		-
Foreign exchange gain, net	2, 4(2)		56,851		-
Reversal of bad debts	2, 4(3)		56,139		-
Reversal of inventory loss provision	2, 4(5)		-		239,671
Reversal of accrued license fee			-		419,056
Valuation gain on financial instruments	2, 4(2)		71,553		23,515
Others			33,915		9,717
Total non-operating income and gains			891,660		1,181,605
<b>Non-operating expenses and losses</b>					
Loss on equity investments, net	2, 4(6)		(28,589)		-
Loss on disposal of property, plant and equipment	2, 5		(18,691)		-
Loss on disposal of investments	2, 4(6)		(2,202)		-
Foreign exchange loss, net	2, 4(2)		-		(37,321)
Inventory loss provision	2, 4(5)		(276,213)		-
Impairment loss	2, 4(6)		(12,000)		-
Others			(3,348)		(36)
Total non-operating expenses and losses			(341,043)		(37,357)
<b>Income from continuing operations before income taxes</b>			24,366,186		18,398,859
<b>Income tax expense</b>	2, 4(16)		(1,794,242)		(125,226)
<b>Income from continuing operations</b>			22,571,944		18,273,633
<b>Cumulative effect of changes in accounting principles (net of tax benefit of NT\$12 thousand)</b>	3		7,638		-
<b>Net income</b>		\$	22,579,582	\$	18,273,633
<b>Basic Earnings Per Share (in New Taiwan Dollars)</b>	2, 4(17)	Before tax	After tax	Before tax	After tax
Income from continuing operations		\$ 25.35	\$ 23.49	\$ 19.15	\$ 19.02
Cumulative effect of changes in accounting principles		0.01	0.01	-	-
Net income		\$ 25.36	\$ 23.50	\$ 19.15	\$ 19.02
<b>Pro-forma data: (Assuming that the Company's shares owned by its subsidiary were not treated as treasury stock)</b>	2, 4(17)	Before tax	After tax	Before tax	After tax
Basic Earnings Per Share (in New Taiwan Dollars)		\$ 25.24	\$ 23.38	\$ 19.06	\$ 18.93
Income from continuing operations		\$ 25.24	\$ 23.38	\$ 19.06	\$ 18.93
Cumulative effect of changes in accounting principles		0.01	0.01	-	-
Net income		\$ 25.25	\$ 23.39	\$ 19.06	\$ 18.93

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

## MEDIATEK INC.

## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the years ended December 31, 2006 and 2005

(Amounts in thousand New Taiwan Dollars)

Description	Common stock	Capital reserve	Legal reserve	Special reserve	Undistributed earnings	Cumulative translation adjustments	Unrealized gain on financial instruments	Treasury stock	Total
Balance as of January 1, 2005	\$ 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' bonuses	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
Adjustment arising from changes in percentage of ownership in investees	-	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
Appropriation and distribution of 2005 earnings:									
Legal reserve	-	-	1,827,363	-	(1,827,363)	-	-	-	-
Directors' and supervisors' remuneration	-	-	-	-	(49,339)	-	-	-	(49,339)
Employees' bonuses	178,570	-	-	-	(1,152,067)	-	-	-	(973,497)
Shareholders' dividends	864,051	-	-	-	(10,368,607)	-	-	-	(9,504,556)
Net income for the year ended December 31, 2006	-	-	-	-	22,579,582	-	-	-	22,579,582
Unrealized gain on financial instruments	-	-	-	-	-	-	2,679,976	-	2,679,976
The effects of subsidiaries' shareholding of the Company's stock recorded as treasury stock	-	73,201	-	-	-	-	-	-	73,201
Adjustment arising from changes in percentage of ownership in investees	-	67,672	-	-	-	-	-	-	67,672
Cumulative translation adjustments	-	-	-	-	-	(91,759)	-	-	(91,759)
Balance as of December 31, 2006	<u>\$ 9,683,127</u>	<u>\$ 404,409</u>	<u>\$ 7,407,185</u>	<u>\$ 714,649</u>	<u>\$ 47,175,664</u>	<u>\$ (483,510)</u>	<u>\$ 2,679,976</u>	<u>\$ (55,970)</u>	<u>\$ 67,525,530</u>

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

## MEDIATEK INC.

## STATEMENTS OF CASH FLOWS

For the years ended December 31, 2006 and 2005

(Amounts in thousand New Taiwan Dollars)

Description	2006	2005
<b>Cash flows from operating activities :</b>		
Net income	\$ 22,579,582	\$ 18,273,633
Adjustments to reconcile net income to net cash provided by operating activities:		
Cumulative effect of changes in accounting principles	(7,638)	-
Depreciation	353,930	181,199
Amortization	1,118,686	765,259
Bad debt loss provision (reversal)	(56,139)	45,146
Cash dividends from the equity investees	22,769	10,400
Inventory loss provision (reversal)	276,213	(239,671)
Net loss (gain) on equity investments	28,589	(78,114)
Loss on disposal of investments	2,202	-
Interest income from bond portfolios with no active market	-	(5,763)
Gain on disposal of property, plant and equipment	(16,785)	-
Impairment loss	12,000	-
Valuation gain on financial instruments	(71,553)	(23,515)
Decrease (increase) in accounts receivable	183,655	(550,309)
Decrease (increase) in receivables from related parties	50,215	(40,990)
Decrease (increase) in other receivables	21,104	(75,348)
Increase (decrease) in inventories	(534,383)	255,446
Decrease in prepayments and other current assets	69,839	288,613
Increase in deferred income tax assets	(4,308)	(677,878)
Increase in accounts payable	1,260,644	1,200,367
(Decrease) increase in payables to related parties	(1,937,279)	1,135,219
Increase in income taxes payable	1,431,802	350,237
(Decrease) increase in accrued expenses	(1,480,729)	2,059,104
Increase in other current liabilities	29,189	170,512
Increase (decrease) in accrued pension liabilities	3,461	(16,548)
Net cash provided by operating activities	23,335,066	23,026,999
<b>Cash flows from investing activities :</b>		
Decrease in restricted deposits	24,000	57,770
Purchase of property, plant and equipment	(1,986,867)	(1,822,652)
Proceeds from disposal of property, plant and equipment	520,410	-
Increase in financial assets at fair value through profit or loss-current	(1,368,531)	(261,942)
Increase in available-for-sale financial asset-noncurrent	(550,000)	-
Increase in bond portfolios with no active market-noncurrent	-	(1,000,000)
Proceeds from disposal of bond portfolios with no active market-noncurrent	-	73,339
Increase in investments accounted for using equity method	(3,550,000)	(1,002,900)
Disinvestment of investment accounted for using equity method	-	98,000
Increase in intangible assets	(706,197)	(1,859,762)
Decrease (increase) in refundable deposits	58,819	(64,322)
Net cash used in investing activities	(7,558,366)	(5,782,469)
<b>Cash flows from financing activities :</b>		
Decrease in long-term debts	-	(10,643)
Cash dividends	(9,504,556)	(7,693,358)
Directors' and supervisors' remuneration	(49,339)	(36,675)
Employees' bonuses	(973,497)	(868,140)
Net cash used in financing activities	(10,527,392)	(8,608,816)
Net increase in cash and cash equivalents	5,249,308	8,635,714
Cash and cash equivalents at the beginning of the year	31,405,861	22,770,147
Cash and cash equivalents at the end of the year	\$ 36,655,169	\$ 31,405,861
<b>Supplemental disclosures of cash flow information :</b>		
Income tax paid during the year	\$ 366,736	\$ 452,792
<b>Activities partially effected cash flows :</b>		
Purchase of property, plant and equipment	\$ 1,830,843	\$ 1,998,177
Add: decrease (increase) in payables to contractors and equipment suppliers	156,024	(175,525)
Cash paid for the purchase of property, plant and equipment	\$ 1,986,867	\$ 1,822,652
<b>Non-cash activities :</b>		
Stock dividends and employees' bonuses capitalized	\$ 1,042,621	\$ 947,147
Adjustment arising from changes in percentage of ownership in investees	\$ 67,672	\$ 47,115
Cumulative translation adjustments	\$ (91,759)	\$ 322,898
Change in unrealized gain on financial instruments	\$ 2,679,976	\$ -
Adjustment of cash dividends distributed to subsidiaries holding the Company's stock	\$ 73,201	\$ 60,497

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

**MEDIATEK INC.**

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

**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, 2006 and 2005, the Company's employees totaled 1,429 and 1,171, respectively.

**2. Summary of Significant Accounting Policies**

The Company's financial statements are prepared in accordance with the R.O.C.'s "Business Accounting Law", "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

- A. 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. At each balance sheet date, monetary assets and liabilities denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Exchange differences arising on the settlements of the monetary assets and liabilities, and on the retranslation of monetary assets and liabilities are included in earnings for the period. Exchange differences arising on the retranslation of non-monetary assets and liabilities carried at fair value are included in earnings for the period except for differences arising on the retranslation of non-monetary assets and liabilities in respect of which gains and losses are recognized directly in equity. For such non-monetary assets and liabilities, any exchange component of that gain or loss is also recognized directly in equity. Non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was determined. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction. Foreign exchange gains and losses are included in the statements of operations.

**MEDIATEK INC.**

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

- B. 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. Shareholders' equity accounts should be translated at the historical rate except for the beginning balance of the retained earnings, which is carried by the translated amount of the last period. Dividends are translated at the spot rate of the declared 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.

*Financial Assets and Financial Liabilities*

- A. Financial asset or liability is recognized when the Company becomes a party to the instrument contact. A regular way purchase or sale of financial assets are be recognized using either trade date accounting on equity instrument or settlement date accounting on debt security, beneficiary certificate and derivative instrument. Financial assets and financial liabilities are derecognized in accordance with R.O.C. SAFS No. 33, "Accounting for Derecognizing of Financial Assets and Financial Liabilities".
- B. When financial assets or financial liabilities are recognized initially, they are measured at fair value, plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial assets or financial liabilities.
- C. Financial assets or financial liabilities are classified as follows:
- a. Financial assets or financial liabilities at fair value through profit or loss  
There are two classes of the financial assets or financial liabilities at fair value through profit or loss, one is held for trading and the other is upon initial recognition it is designated as at fair value through profit or loss. Such assets or liabilities are subsequently measured at fair value and changes in fair value are recognized in profit or loss.
  - b. Bond portfolios with no active market  
It is a bond portfolio with fixed or determinable payments which is not quoted in an active market; or a preference shares which is not quoted in an active market that issuer has an obligation to redeem a preference share in specific price on a specific date, which shall be measured at amortized cost. If there is objective evidence which indicates that a financial asset is impaired, a loss is recognized. If, in a subsequent period, the amount of the impairment loss decreases and the decreases is clearly attributable to an event which occurred after the impairment loss was recognized, the previously recognized impairment loss is reversed to the extent of the decrease. The reversal may not result in a carrying amount that exceeds the amortized cost that would have been determined as if no impairment loss had been recognized.



**MEDIATEK INC.**

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

c. Financial assets carried at cost

It is not measured at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument. If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument, the amount of the impairment loss is recognized. Such impairment losses shall not be reversed.

d. Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as in any of the preceding categories, or are not classified as held-to-maturity investments or receivables.

When subsequently measured at fair value, the changes in fair value are excluded from earnings and reported as a separate component of shareholders' equity. The accumulated gains or losses are recognized in earnings when the financial asset is derecognized from the balance sheet.

If there is objective evidence which indicates that a financial asset is impaired, a loss is recognized. If, in a subsequent period, the amount of the impairment loss decreases, for equity securities, the previously recognized impairment loss is reversed to the extent of the decrease and recorded as an adjustment to shareholders' equity; for debt securities, the amount of the decrease is recognized in earnings, provided that the decrease is clearly attributable to an event which occurred after the impairment loss was recognized.

The fair value, as mentioned above, for publicly traded securities or close-ended funds are based on closing prices of the balance sheet date, while those of open-ended funds are determined based on net assets value of the balance sheet date. If a published price quotation in an active market does not exist for a financial instrument in its entirety, but active market exists for its component parts, fair value is determined on the basis of the relevant market price for the component part.

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

**MEDIATEK INC.**

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

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.

*Investment Accounted for Using Equity Method*

- A. Long-term investments in which the Company holds an interest of 20% or more or has the ability to exercise significant influence are accounted for under the equity method of accounting. The difference between the cost of the investment and the fair value of the identifiable assets at the date of acquisition is amortized over 5 years. Effective January 1, 2006, pursuant to the newly revised R.O.C. SFAS No. 25 “Business Combinations - Accounting Treatment under Purchased Method”, investment premiums, representing goodwill, are no longer amortized but are assessed for impairment at least on an annual basis while investment discounts continue to be amortized over the remaining period. In some cases, the fair value will exceed the investment cost. That excess generated after December 31, 2005 shall be allocated as a pro rata reduction of the amounts that otherwise would have been assigned to all of the acquired noncurrent assets. If any excess remains after reducing to zero the amounts that otherwise would have been assigned to those assets, that remaining excess shall be recognized as an extraordinary gain. Adjustment to capital reserve is required when the holding percentage changes due to unproportional subscription to investee’s new shares issued. If the capital reserve is insufficient, retained earnings are adjusted. An investor shall discontinue the use of the equity method from the date that it ceases to have significant influence over an investee and shall account for the investment in accordance with the R.O.C. SFAS No. 34 “Accounting for Financial Instruments” from that date. The carrying amount of the investment at the date that it ceases to be an associate shall be regarded as its cost on initial measurement as a financial asset.
- B. Unrealized gains and losses arising from intercompany transactions are deferred and recognized when realized.
- C. For equity investees in whom the Company does not possess control, the Company recognizes its investee’s losses only to the extent the Company’s long-term investment on that investee reaches zero. However, if the Company intends to provide further financial support 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 shall be 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.
- D. The accompanying consolidated financial statements include the accounts of all directly and indirectly majority owned subsidiaries of the Company, and the accounts of investees in which

**MEDIATEK INC.**

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

the Company's ownership percentage is less than 50% but the Company has a controlling interest.

Property, Plant and Equipment

- A. Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment. 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

- B. Improvements and replacements are capitalized and depreciated over their estimated useful lives while ordinary repairs and maintenance are expensed as incurred.
- C. When property, plant and equipment are disposed of, their original cost, accumulated depreciation and accumulated impairment are written off and related gains or losses are included in non-operating income or expenses.
- D. If property, plant and equipment are highly probable be sold within one year. Thereafter a non-current asset (or disposal group) classified as held for sale should be measured at the lower of its carrying amount and fair value less costs to sell. Such assets measured at fair value and changes in fair value are recognized in profit and loss.

Intangible Assets

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

Software (Design software)	3 Years
Patents, IPs and Others	3 to 5 Years

Asset Impairment

On January 1, 2005, the Company adopted the 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

**MEDIATEK INC.**

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

original value less associated depreciation or amortization.

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

- A. 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.
- B. 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.
- C. 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

- A. 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. A

**MEDIATEK INC.**

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

deferred tax asset or liability is classified as current or noncurrent in accordance with the classification of its related asset or liability. However, if a deferred tax asset or liability does not relate to an asset or liability in the financial statements, then it is classified as either current or noncurrent based on the expected length of time before it is realized or settled.

- B. 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.
- C. Income taxes (10%) on undistributed earnings are recorded as expenses in the year when the stockholders have resolved that the earnings shall be retained.
- D. Income Basic Tax Act took effect on January 1, 2006. The alternative minimum tax ("AMT") imposed under the Income Basic Tax Act is a supplemental tax levied at a rate of 10% which is payable if the income tax payable determined pursuant to the Income Tax Law is below the minimum amount prescribed under the Income Basic Tax Act. The tax effect of such amounts was taken into consideration in determining the realization of deferred income tax assets.

Earnings Per Share

- A. The Company’s EPS is computed and presented in accordance with the R.O.C. SFAS No. 24 “Earnings Per Share”. Basic earnings per 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.
- B. 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.

Treasury Stock

- A. The Company’s shares owned by its subsidiaries were accounting-treated as treasury stock according to the 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.
- B. Treasury stock transactions are accounted for under cost method. The acquisition cost of shares is recorded under the caption of treasury stock, a contra shareholders’ equity account.

**MEDIATEK INC.**

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

- C. 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.
- D. 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.

*Derivative Financial Instruments-Trading Purpose*

Derivative financial instruments that have been designated for hedging but not qualified for hedging effectiveness as SFAS No. 34 indicates are classified as financial assets/liabilities for trading; for example, forward contract is recognized and remeasured at fair value. When the fair value is positive, the derivative is recognized as a financial asset; when the fair value is negative, the derivative is recognized as a financial liability. The changes in fair value are recognized in profit and loss.

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

- A. On January 1, 2006, the Company adopted the newly released the newly released R.O.C. SFAS No. 34 “Accounting for Financial Instruments” and No. 36, “Disclosure and Presentation for Financial Instruments”. The effects of changes in adoption of the new principles are remarked as follows:

The Company had categorized its financial assets and liabilities in accordance with the new standards. The adjustments made to the carrying amounts of the financial instruments categorized as financial assets or financial liabilities at fair value through profit or loss were included in the cumulative effect of changes in accounting principles under the statement of income. While, the adjustments made to the carrying amounts of those categorized as available-for-sale financial assets were recorded in the account of financial instruments’ unrealized profit and loss under the shareholders’ equity account’s adjusted items.

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

The effects of adopting the newly released SFAS No. 34 and SFAS No. 36 were as follows:

	Amount (net of income tax)	
	Cumulative effect of changes in accounting principles	Cumulative effect of changes in accounting principles/Other adjustments in shareholders' equity which recognized by subsidiaries
Financial assets at fair value through profit or loss-current	\$7,638	\$-
Long-term investments/Gain on equity investments	-	418
Long-term investments/Unrealized gain on financial instrument	-	2,377
Total	<u>\$7,638</u>	<u>\$2,795</u>

Above changes in accounting policies resulted in an increase in income from continuing operations of NT\$418 thousand for the year ended December 31, 2006. The adoption of the newly released SFASs resulted in an increase in cumulative effect of changes in accounting principles of NT\$7,638 thousand that was included in net income for the year ended December 31, 2006, and an increase in basic earnings per share (after income tax) of NT\$0.01.

B. As to the different accounting policy regarding the financial instrument between the year of 2005 and 2006, are described as below:

a. 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.

b. Long-term investments

(a) 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.

**MEDIATEK INC.**

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

- (b) Investment in foreign entity which are stated at cost and required to translated its cost into presentation currency at the balance sheet date. At lower of the rate at transaction date or the rate at balance sheet date, the exchange losses resulting from the translation are recorded as the account of cumulative translation adjustments under shareholders' equity.

c. 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. In addition, the receivables and payables related to the contracts of the same counter party were netted with the resulting amount presented as either an asset or a liability. Any gain or loss from hedging an identifiable foreign currency commitment should be deferred to the actual transaction date and recorded as an adjustment to the transaction price. However, if the deferred exchange loss results in a loss in the sub subsequent accounting period, the exchange loss should not be deferred. If the forward contract is not for a greater number of foreign currency units than the foreign currency commitment, the gain or loss on that portion of the contract which exceeds the foreign currency commitment should not be deferred and should be accounted for as the current period gain or loss.

- C. Effective on January 1, 2006, the Company adopted the R.O.C. SFAS No. 5 "Long-term Investment Accounted for Using the Equity Method" and No. 25 "Business Combinations -Accounting Treatment under Purchase Method". The difference between the cost of the investment and the fair value of the identifiable assets at the date of acquisition, representing goodwill, is no longer amortized. Such adoption increased net income by NT\$56,328 thousand for the year ended December 31, 2006, and basic earnings per share increased by NT\$0.06. As of December 31, 2006, the Company's total assets was increased by NT\$56,328 thousand accordingly.
- D. 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 basic earnings per share 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,	
	2006	2005
Savings and checking accounts	\$629,696	\$463,542
Time deposits	30,959,187	15,763,045
Cash equivalents- bonds-Repo	5,066,286	15,179,274
Total	<u>\$36,655,169</u>	<u>\$31,405,861</u>

As of December 31, 2006, the Company has committed to sell the bonds-Repo back to the brokers during the one month period ended January 31, 2007.

Cash and cash equivalents were not pledged as of December 31, 2006.

**(2) Financial asset and liabilities at fair value through profit or loss**

<i>In thousand NTD</i>	As of December 31,	
	2006	2005
Held for trading financial assets		
Mutual fund	\$2,068,460	\$990,000
Government bonds	-	199,778
Corporate bonds	150,000	-
Forward exchange contracts	-	52,016
Subtotal	2,218,460	1,241,794
Adjustment for change in value of held for trading financial assets	84,698	-
Financial assets designated as at fair value through profit or loss		
Credit-linked deposit	400,000	-
Adjustment for change in value of financial assets designated as at fair value through profit or loss	944	-
Total	<u>\$2,704,102</u>	<u>\$1,241,794</u>

Credit-linked deposit is a compound financial instrument. Since it is impractical to measure the fair value of the embedded derivative separately either at acquisition or at a subsequent financial reporting date, the entire hybrid contract shall be designated as a financial instrument at fair value with change in value through profit or loss. For the year ended December 31, 2006, adjustment for change in value of the above-mentioned financial assets was NT\$944 thousand. Please refer to Note 10 to the financial statements for the disclosures of relative risks information for credit-linked deposit.

The Credit-linked deposits of the Company were detailed as follows:

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

<i>In thousand NTD</i>	As of December 31,	
	2006	2005
Underlying investments		
AmTRAN Credit-linked deposit	\$100,000	\$-
Powerchip Credit-linked deposit	100,000	-
Chi Mei Credit-linked deposit	200,000	-

b.		As of December 31,
	<i>In thousand NTD</i>	2006 2005
Held for trading financial liabilities-current		
Adjustment for change in value of trading		
financial liabilities -Forward exchange contracts	\$14,586	\$-

The Company entered into forward exchange contracts with banks in 2006 and 2005. The purpose of holding forward exchange contracts is to hedge exchange rate fluctuation risk resulting from assets and liabilities denominated in foreign currency. As of December 31, 2006 and 2005, outstanding forward exchange contracts were as follows:

## (a) As of December 31, 2006: (Note 1)

Held for trading financial assets:

Financial Instruments	Type	Maturity	Contract amount (US\$'000)
Forward exchange	Sell USD	January 2007	USD25,000

Held for trading financial liabilities:

Financial Instruments	Type	Maturity	Contract amount (US\$'000)
Forward exchange	Sell USD	January 2007~February 2007	USD75,000

## (b) As of December 31, 2005: (Note 2)

Financial Instruments	Type	Maturity	Contract amount (US\$'000)
Forward exchange	Sell USD	January 2006~February 2006	USD100,000

<i>In thousand NTD</i>	December 31, 2005
Forward contract receivable	\$3,330,140
Forward contract payable	(3,285,000)
Discount	6,876
Forward exchange contracts receivable-net	\$52,016

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

As of December 31, 2005, the amount of forward exchange contracts receivable-net from forward contracts above was classified under the caption of other receivables. After adopting the R.O.C SFAS No. 34, it has been reclassified to the account of financial asset at fair value through profit or loss-current.

Foreign exchange loss incurred from the derivatives for the years ended December 31, 2006 and 2005 amounted to NT\$59,075 thousand and NT\$205,482 thousand, respectively.

Note 1: The Company entered into forward exchange contracts for the year ended December 31, 2006 to manage exposures due to the fluctuations of foreign exchange rate. The forward exchange contracts entered into by the Company did not meet the criteria for hedge accounting prescribed by the R.O.C. SFAS No. 34 “Accounting for Financial Instruments”. Therefore, the Company hadn’t adopted hedge accounting. The forward exchange contracts have been classified to the account of financial asset/liabilities at fair value through profit or loss-current. Please refer to Note 10 for the disclosure of relative risks information to the financial report.

Note 2: The forward exchange contracts were in accordance with the R.O.C. SFAS No. 14 “Accounting for Foreign Currency Translation” during the 2005 financial year.

**(3) Accounts Receivable-Net**

<i>In thousand NTD</i>	As of December 31,	
	2006	2005
Accounts receivable	\$4,044,231	\$4,227,885
Less: Allowance for doubtful accounts	(187,437)	(240,498)
Net	<u>\$3,856,794</u>	<u>\$3,987,387</u>

**(4) Other Receivables**

<i>In thousand NTD</i>	As of December 31,	
	2006	2005
Interest receivable	\$86,000	\$77,385
VAT refundable	140,127	172,784
Others	12,015	9,077
Total	<u>\$238,142</u>	<u>\$259,246</u>

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

## (5) Inventories-Net

<i>In thousand NTD</i>	As of December 31,	
	2006	2005
Work in process	\$2,189,033	\$2,175,224
Finished goods	1,707,095	1,189,629
Inventories in transit	-	31,095
Subtotal	3,896,128	3,395,948
Less: Allowance for inventory obsolescence	(402,065)	(160,055)
Net	\$3,494,063	\$3,235,893

Inventories were not pledged.

## (6) Funds and Investments

a.	As of December 31, 2006			
Investee Companies	Types	Shares/units	Amounts (NT\$'000)	Ownership
<u>Available-for-sale financial assets-noncurrent</u>				
IIT Private Equity Real Estate Fund	Mutual fund	4,938,331	\$50,000	-
Cathay No. 2 Real Estate Investment Trust	Mutual fund	50,000,000	500,000	-
Subtotal			550,000	
Adjustment for change in value of available-for-sale financial asset			78,110	
Subtotal			628,110	
<u>Financial assets carried at cost-noncurrent</u>				
Yuantonix, Inc.	Common share	300,000	3,000	3.75%
<u>Bond portfolios with no active market-noncurrent</u>				
Chinatrust Financial Holding Co. Ltd	Series B Preferred Stock	25,000,000	1,000,000	-
<u>Accounted for using equity method</u>				
MediaTek Investment Corp.	Common share	640,000,000	7,926,510	100.00%
Hsu-Ta Investment Limited	Capital	-	3,680,424	100.00%
Hsu-Chia Investment Limited	Capital	-	3,421,298	100.00%
Hsu-Kang Investment Limited	Capital	-	3,421,574	100.00%
ALi Corporation	Common share	59,227,790	1,056,954	22.68%
Wiseali Technology Inc.	Common share	200,000	5,614	100.00%
Subtotal			19,512,374	
Add : Unrealized loss on disposal of long-term equity investments			7,522	
Subtotal			19,519,896	
Total			\$21,151,006	

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

As of December 31, 2005				
Investee Companies	Types	Shares/units	Amounts (NT\$'000)	Ownership
<u>Financial assets carried at cost-noncurrent</u>				
Yuantonix, Inc.	Common share	1,500,000	<u>\$15,000</u>	5.18%
<u>Bond portfolios with no active market-noncurrent</u>				
Chinatrust Financial Holding Co. Ltd	Series B			
	Preferred Stock	25,000,000	<u>1,000,000</u>	-
<u>Accounted for using equity method</u>				
MediaTek Investment Corp.	Common share	285,000,000	2,505,474	100.00%
Hsu-Ta Investment Limited	Capital	-	3,519,633	100.00%
Hsu-Chia Investment Limited	Capital	-	3,272,227	100.00%
Hsu-Kang Investment Limited	Capital	-	3,272,085	100.00%
ALi Corporation	Common share	56,956,200	787,517	25.17%
Wiseali Technology Inc.	Common share	200,000	<u>5,816</u>	100.00%
Subtotal			<u>13,362,752</u>	
Add : Unrealized loss on disposal of long-term equity investments			<u>9,724</u>	
Subtotal			<u>13,372,476</u>	
Total			<u><u>\$14,387,476</u></u>	

- b. For the years ended December 31, 2006 and 2005, the Company recognized investment loss and gain accounted for under the equity method amounting to (NT\$28,589) thousand and NT\$78,114 thousand, respectively, based on the audited financial statements of the investee companies.
- c. Since ALi Corporation, an investee accounted for under equity method, issued new shares for purposes of conversion of convertible bonds, exercise of employees' stock options and capitalization of employees' bonus, the Company's holding interest on ALi Corporation has been changed. As a result, the Company has recognized a capital reserve of NT\$75,020 thousand for the year ended December 31, 2006.
- d. 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 NT\$55,204 thousand accordingly.

**MEDIATEK INC.**

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

- e. The Company had increased its investment in MediaTek Investment Corp. in amount of NT\$3,550,000 thousand and NT\$1,000,000 thousand, for the years ended December 31, 2006 and 2005, respectively.
- f. A subsidiary of MediaTek Investment Corp. resolved a right offering in February 2006. MediaTek Investment Corp. forgave its preemptive right and subscribed none to the new issuance. MediaTek Investment Corp.'s interest in that subsidiary changed accordingly. As a result, the Company has recognized a reduction in capital reserve of NT\$7,348 thousand for the year ended December 31, 2006.
- g. The Company's holding interest on MediaTek Investment Corp. was decreased due to the subsidiary's employee stock options being exercised as of December 31, 2005. Capital reserve was decreased by \$8,089 thousand accordingly.
- h. In light that Yuanionix, Inc. cancelled its common shares to compensate accumulated deficits during May 2006, the Company assessed its investment in Yuanionix, Inc. has been impaired, therefore, recognized impairment loss in amount of NT\$12,000 thousand.
- i. The Company recognized an unrealized gain of NT\$2,601,866 thousand in shareholders' equity for the changes in available-for-sale financial assets held by its investee companies accounted for under the equity method for the year ended December 31, 2006.
- j. The Company has recognized a realized loss on disposal of long-term equity investments for the year ended December 31, 2006 in amount of NT\$2,202 thousand.
- k. 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.
- l. 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.

**MEDIATEK INC.**

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

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.

The above-mentioned preferred stock held by the Company is a financial instrument with nature of bonds in substance and shall be classified as bond portfolios with no active market.

m. Due to the fact that the Company no longer had controlling interest in ALi Corporation starting the fourth quarter of 2006, ALi Corporation is excluded in the Company's consolidated financial statements as of December 31, 2006 and for the year then ended. All subsidiaries, including ALi Corporation, were included in the consolidated financial statements as of December 31, 2005 and for the year then ended.

n. Funds and investments were not pledged as of December 31, 2006.

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

a. No interest was capitalized for the years ended December 31, 2006 and 2005, respectively.

b. Property, plant and equipment were not pledged as of December 31, 2006.

**(8) Accrued Pension Liabilities**

a. The Company's pension fund contributed to a fiduciary account in China Trust Bank amounted to NT\$40,978 thousand and NT\$39,958 thousand as of December 31, 2006 and 2005, respectively. The total pension expenses, including net pension cost under the old Standard Labor Law and the pension expenses under the new Labor Pension Act, amounted to NT\$62,848 thousand and NT\$14,678 thousand for the years ended December 31, 2006 and 2005, respectively. The pension expenses under the Labor Pension Act amounted to NT\$59,119 thousand and NT\$24,057 thousand, respectively.

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

## b. The components of net pension cost under the Labor Standards Law

<i>In thousand NTD</i>	For the year ended December 31,	
	2006	2005
Service cost	\$1,235	\$14,415
Interest cost	3,714	3,023
Expected return on plan assets	(1,399)	(1,227)
Amortization	88	(247)
Over (reversal) accrual	91	(25,343)
Net pension cost	<u>\$3,729</u>	<u>\$(9,379)</u>

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

<i>In thousand NTD</i>	As of December 31,	
	2006	2005
Benefit obligations		
Vested benefit obligation	\$-	\$-
Non-vested benefit obligation	(54,118)	(40,907)
Accumulated benefit obligation	(54,118)	(40,907)
Effect of projected future salary increase	(84,503)	(65,200)
Projected benefit obligation	(138,621)	(106,107)
Fair value of plan assets	40,978	39,958
Funded status of pension plan	(97,643)	(66,149)
Unrecognized net transitional obligation	971	1,059
Unrecognized loss	35,934	7,805
Over-accrual	(239)	(231)
Accrued pension liabilities	<u>\$(60,977)</u>	<u>\$(57,516)</u>

## d. The vested benefit was nil as of December 31, 2006 and 2005.

## e. The underlying actuarial assumptions:

	For the year ended December 31,	
	2006	2005
Discount rate	2.75%	3.5%
Rate of increase in future compensation levels	4.0%	4.0%
Expected long-term rate of return on plan assets	2.75%	3.5%

## (9) Common Stock

As of January 1, 2005, the authorized and issued common shares of the Company amounted to NT\$8,960,000 thousand and NT\$7,693,359 thousand, divided into 896,000,000 shares and 769,335,831 shares, respectively, each share at par value of NT\$10.



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

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' dividends 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.

Based on the resolution of shareholders' general meeting on June 21, 2006, the Company increased its authorized capital to NT\$12,000,000 thousand, divided into 1,200,000,000 shares, each shares at par value of NT\$10. Among the authorized capital, NT\$200,000 thousand was reserved for the grant of options to qualified employees. The shareholders further resolved to issue 104,262,103 new shares at per value of NT\$10 for the capitalization of shareholders' dividends of NT\$864,051 thousand and employees' bonus of NT\$178,570 thousand. The capitalization date was set on August 8, 2006 and the government approval has been successfully obtained.

As of December 31, 2006, the authorized and issued common shares of the Company amounted to NT\$12,000,000 thousand and NT\$9,683,127 thousand, divided into 1,200,000,000 (including 20,000,000 shares reserved for exercise of employee stock options) shares and 968,312,683 shares, respectively, each share at par value of NT\$10.

**(10) 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.

**(11) Capital Reserve**

<i>In thousand NTD</i>	As of December 31,	
	2006	2005
Additional paid-in capital	\$69,689	\$69,689
Treasury stock transaction	218,673	145,472
Donated assets	1,260	1,260
Long-term investment transaction	114,787	47,115
Total	<u>\$404,409</u>	<u>\$263,536</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

**MEDIATEK INC.**

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

make up its loss unless legal reserve is insufficient for making good such losses.

The Company had paid cash dividend in amount of NT\$73,201 thousand and NT\$60,497 thousand to certain subsidiaries who owned the Company's common shares for the years ended December 31, 2006 and 2005, respectively. Since the Company's shares held by its subsidiaries are treated as treasury stocks, the cash dividend paid to the Company's subsidiaries are recorded as an adjustment to capital reserve - treasury stock transactions accordingly.

**(12) Earnings Distribution**

Net income for the year ended December 31, 2005 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 employees' bonuses and may be retained or distributed proportionally. The portion of employees' bonuses may be within 10% to 15% of total earnings resolved to distribute for shareholders' dividends and employees' bonuses. Employees' 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.

Shareholders' dividends and employees' bonuses may be distributed in the form of shares or cash, or both, and cash dividends to be distributed might not be less than 10% of total dividends to be distributed.

The Company's Articles of Incorporation, revised on June 21, 2006, provided that the appropriation earning for 2006 are consistent with the above appropriation of earning for 2005. According to the amended articles, the portion of employee bonus may not be less than 1% of total earnings resolved to distribute for shareholders' dividends and employees' bonuses.

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

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

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.

**(13) Treasury Stock**

The Company's shares owned by its subsidiaries are accounted for as treasury stock. Movement of the Company's treasury stock was as follows:

Owner	January 1, 2006		Additions		December 31, 2006		
	Shares	Amount (NT\$'000)	Shares	Amount (NT\$'000)	Shares	Amount (NT\$'000)	Market Value (NT\$'000)
MediaTek			665,467				
Capital Corp.	6,654,670	\$55,970	(Note)	\$-	7,320,137	\$55,970	\$2,466,886

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

(Note) Stock dividends 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(11).

**(14) Sales Revenues-Net**

<i>In thousand NTD</i>	For the year ended December 31,	
	2006	2005
Revenues from sales of chipsets	\$54,729,722	\$48,006,117
Others	482,403	376,328
Subtotal	55,212,125	48,382,445
Less: Sales returns and sales discounts	(2,270,520)	(1,891,236)
Net sales	\$52,941,605	\$46,491,209

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS—(continued)****(15) Personnel, Deprecation and Amortization Expenses**

	For the year ended December 31,					
	2006			2005		
	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	\$64,742	\$2,040,257	\$2,104,999	\$54,127	\$1,565,899	\$1,620,026
Insurance expense	2,616	70,750	73,366	2,229	59,108	61,337
Pension expense	2,037	60,811	62,848	1,883	12,795	14,678
Other	484	25,631	26,115	297	20,652	20,949
Total	<u>\$69,879</u>	<u>\$2,197,449</u>	<u>\$2,267,328</u>	<u>\$58,536</u>	<u>\$1,658,454</u>	<u>\$1,716,990</u>
Depreciation	<u>\$5,654</u>	<u>\$348,276</u>	<u>\$353,930</u>	<u>\$4,994</u>	<u>\$176,205</u>	<u>\$181,199</u>
Amortization	<u>\$833</u>	<u>\$1,117,853</u>	<u>\$1,118,686</u>	<u>\$300</u>	<u>\$764,959</u>	<u>\$765,259</u>

**(16) Income Tax**

- a. 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.
- b. The Company’s income tax returns for the years from 1998 to 2001 have been assessed and approved by the tax authorities and NT\$418,697 thousand of additional income tax payable was imposed. Though the Company has vigorously filed several administrative appeals to tax authority and the Courts, the Company has fully accrued the additional tax liability. For 1999’s appeal, the final ruling in favor for the Company has been determined by court during July 2006 and the tax authority has to re-assess the tax return accordingly. Besides, the tax authority has assessed the Company’s income tax returns for the Year 2002 and imposed an additional income tax of NT\$899,276 thousand. The discrepancy between the Company’s tax return filing and the result of tax authority’s assessment was mainly because of the different viewpoints on the calculating exempted income from tax holiday. The Company has vigorously filed a revision on the tax assessment and sufficiently accrued the probable tax payable.

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

c. The Company's available investment tax credits as of December 31, 2006 were as follows:

Year incurred	Nature of Expenditures	Total credit amount (NT\$'000)	Unused amount (NT\$'000)	Year expired
2004	R&D	\$1,224,202	905,204	2008
2005	R&D	1,095,201	1,095,201	2009
	Human development	1,168	1,168	2009
2006	R&D	1,321,874	1,321,874	2010
(Estimate)	Human development	1,327	1,327	2010
		<u>\$3,643,772</u>	<u>\$3,324,774</u>	

d.

(a) Deferred income tax assets (liabilities) (*In thousand NTD*) As of December 31, 2006

Total deferred income tax liabilities	<u>\$(1,047)</u>
Total deferred income tax assets	<u>\$3,340,644</u>
Valuation allowance for deferred income tax assets	<u>\$1,888,500</u>

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

	As of December 31, 2006	
	Amount	Tax effect
Deductible temporary difference-Recognition of unrealized allowance for inventory obsolescence	<u>\$402,065</u>	<u>\$3,875</u>
Deductible temporary difference-Unrealized allowance for doubtful accounts recognition	<u>\$146,975</u>	<u>\$1,416</u>
Deductible temporary difference-Unrealized technology license fee	<u>\$1,084,050</u>	<u>\$10,447</u>
Taxable temporary difference-Unrealized foreign exchange gain	<u>\$(108,616)</u>	<u>\$(1,047)</u>
Deductible temporary difference-Unrealized loss on valuation of financial assets	<u>\$13,689</u>	<u>\$132</u>
Investment tax credits		<u>\$3,324,774</u>

(c) *In thousand NTD* As of December 31, 2006

Deferred income tax assets-current	<u>\$343,632</u>
Valuation allowance for deferred income tax assets-current	<u>-</u>
Net deferred income tax assets-current	<u>343,632</u>
Deferred income tax liabilities-current	<u>(1,047)</u>
Net deferred income tax assets and liabilities-current	<u>\$342,585</u>

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

(d)	<i>In thousand NTD</i>	<u>As of December 31, 2006</u>
	Deferred income tax assets-noncurrent	\$2,997,012
	Valuation allowance for deferred income tax assets-noncurrent	(1,888,500)
	Net deferred income tax assets-noncurrent	1,108,512
	Deferred income tax liabilities-noncurrent	-
	Net deferred income tax assets and liabilities-noncurrent	<u>\$1,108,512</u>

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

	<i>In thousand NTD</i>	<u>For the year ended December 31, 2006</u>
Income tax payable		\$228,949
10% tax on undistributed earnings		487,626
Investment tax credits		(358,287)
Deferred income tax effects		
Investment tax credits		(598,539)
Valuation allowance		601,350
Unrealized technology license fee		(3,993)
Others		(3,126)
Accruals for additional prior year income tax		1,331,000
Prior year income tax adjustment		112,331
Others		(3,081)
Income tax expense		<u>\$1,794,230</u>
Tax benefit from cumulative effect of changes in accounting principles		12
Income tax expense from continuing operations		<u>\$1,794,242</u>

(f) Integrated income tax information	<u>As of December 31, 2006</u>
<i>(In thousand NTD)</i>	
Balance of the imputation credit account (ICA)	\$712,562
Expected creditable ratio	2.19%(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, 2006.

(g) Information related to undistributed retained earnings	<u>As of December 31, 2006</u>
<i>(In thousand NTD)</i>	
Prior to 1998	\$-
After 1998 (inclusive)	47,175,664
Total	<u>\$47,175,664</u>

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

e.

## (a) Deferred income tax assets (liabilities)

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

Total deferred income tax liabilities

\$(91)

Total deferred income tax assets

\$2,734,030

Valuation allowance for deferred income tax assets

\$1,287,150(b) Temporary differences generated from deferred income tax assets (liabilities) *(In thousand NTD)*As of December 31, 2005AmountTax 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) *In thousand NTD*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) *In thousand NTD*As of December 31, 2005

Deferred income tax assets-noncurrent

\$2,574,196

Valuation allowance for deferred income tax assets-noncurrent

(1,287,098)

Net deferred income tax assets-noncurrent

1,287,098

Deferred income tax liabilities-noncurrent

-

Net deferred income tax assets and liabilities-noncurrent

\$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>	<u>For the year ended December 31, 2005</u>
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 from continuing operations	<u><u>\$125,226</u></u>

(f) Integrated income tax information

<i>(In thousand NTD)</i>	<u>As of December 31, 2005</u>
Balance of the imputation credit account (ICA)	<u><u>\$696,965</u></u>
Actual creditable ratio	<u><u>2.16%</u></u>

(g) Information related to undistributed retained earnings

<i>(In thousand NTD)</i>	<u>As of December 31, 2005</u>
Prior to 1998	\$-
After 1998 (inclusive)	<u>37,993,458</u>
Total	<u><u>\$37,993,458</u></u>

**(17) Basic Earnings Per Share**

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

<u>Contents</u>	<u>For the year ended December 31,</u>	
	<u>2006</u>	<u>2005</u>
Common shares outstanding, beginning	864,050,580	769,335,831
Stock issuance for stockholder' bonus, August 16, 2005	-	76,933,583
Stock issuance for employees' bonus, August 16, 2005	-	17,781,166
Stock issuance for stockholder' bonus, August 8, 2006	86,405,058	86,405,058
Stock issuance for employees' bonus, August 8, 2006	<u>17,857,045</u>	<u>17,857,045</u>
Subtotal	968,312,683	968,312,683
Less: the Company's shares owned by its subsidiary	<u>(7,320,137)</u>	<u>(7,320,137)</u>
Weighted average shares outstanding, ending	<u><u>960,992,546</u></u>	<u><u>960,992,546</u></u>



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

	<u>Amount(numerator)</u>			<u>Earning per share</u>	
	<u>Before tax</u>	<u>After tax</u>	<u>Shares (Denominator)</u>	<u>Before tax</u>	<u>After tax</u>
<u>For the year ended December 31, 2006:</u>					
Basic EPS					
Income before cumulative effect of changes in accounting principles	\$24,366,186	\$22,571,944	<u>960,992,546</u>	\$25.35	\$23.49
Cumulative effect of changes in accounting principles	<u>7,626</u>	<u>7,638</u>		<u>0.01</u>	<u>0.01</u>
Net income	\$24,373,812	\$22,579,582		\$25.36	\$23.50

For the year ended December 31, 2005:

## Basic EPS

Income before cumulative effect of changes in accounting principles	\$18,398,859	\$18,273,633	<u>960,992,546</u>	\$19.15	\$19.02
Cumulative effect of changes in accounting principles	<u>-</u>	<u>-</u>		<u>-</u>	<u>-</u>
Net income	<u>\$18,398,859</u>	<u>\$18,273,633</u>		<u>\$19.15</u>	<u>\$19.02</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:

	<u>Amount(numerator)</u>			<u>Earning per share</u>	
	<u>Before tax</u>	<u>After tax</u>	<u>Shares (Denominator)</u>	<u>Before tax</u>	<u>After tax</u>
<u>For the year ended December 31, 2006:</u>					
Pro-Forma EPS					
Income before cumulative effect of changes in accounting principles	\$24,366,186	\$22,571,944	960,992,546		
The effect of the Company’s shares owned by its subsidiary were not treated as treasury stock	<u>73,201</u>	<u>73,201</u>	<u>7,320,137</u>		
Subtotal	24,439,387	22,645,145	<u>968,312,683</u>	\$25.24	\$23.38
Cumulative effect of changes in accounting principles	<u>7,626</u>	<u>7,638</u>		<u>0.01</u>	<u>0.01</u>
Net income	\$24,447,013	\$22,652,783		\$25.25	\$23.39

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

	<u>Amount(numerator)</u>			<u>Earning per share</u>	
	<u>Before tax</u>	<u>After tax</u>	<u>Shares (Denominator)</u>	<u>Before tax</u>	<u>After tax</u>
<u>For the year ended December 31, 2005:</u>					
Pro-Forma EPS					
Income before cumulative effect of changes in accounting principles	\$18,398,859	\$18,273,633	960,992,546		
The effect of the Company's shares owned by its subsidiary were not treated as treasury stock	<u>60,497</u>	<u>60,497</u>	<u>7,320,137</u>		
Subtotal	18,459,356	18,334,130	<u>968,312,683</u>	\$19.06	\$18.93
Cumulative effect of changes in accounting principles	<u>-</u>	<u>-</u>		<u>-</u>	<u>-</u>
Net income	\$18,459,356	\$18,334,130		\$19.06	\$18.93

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

Related parties	Relations
United Microelectronics Corp. ("UMC")	The supervisor of the Company(Note)
King Yuan Electronics Co., Ltd. ("KING YUAN")	The chairman of the Company and KING YUAN are close relatives
PixArt Imaging Inc. ("PII")	A subsidiary served as the Board
ALi Corporation ("ALi")	Equity investee
Alpha Imaging Technology Corp. ("Alpha")	Indirect equity investee
UMC Japan ("UMCJ")	Affiliated company of UMC(Note)
MediaTek Limited ("MTL")	Affiliated company

Note: Due to UMC quitted as board supervisor of the Company on April 18, 2006, and UMC and its affiliated company were not be related parties of the Company as of December 31, 2006, the following relative information be disclosed for three months ended March 31, 2006.

**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,			
	2006		2005	
	Amount (Note)	% of total purchase	Amount	% of total purchase
UMC	\$2,546,083	19.87	\$7,694,377	64.16
UMCJ	-	-	277,704	2.32
Total	\$2,546,083	19.87	\$7,972,081	66.48

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, 2006 and 2005, respectively.

**b. Sales**

<i>In thousand NTD</i>	For the year ended December 31,			
	2006		2005	
	Amount	% of net sales	Amount	% of net sales
MTL	\$149,699	0.28	\$110,085	0.24
ALi	12,883	0.02	24,917	0.05
Alpha	46,486	0.09	8,887	0.02
Total	\$209,068	0.39	\$143,889	0.31

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, 2006 and 2005, respectively.

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

<i>In thousand NTD</i>		For the year ended December 31,	
		2006	2005
KING YUAN	IC testing and experimental services	\$1,159,672	\$927,491
Alpha	Technology license expense	-	9,452
Total		\$1,159,672	\$936,943

d. 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

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

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\$105,711 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.

- e. The Company bought 100,000 shares of Wiseali's common stock from ALi totally at the price of NT\$2,900 thousand in June, 2005.
- f. The Board of Directors resolved to sell part of its building and miscellaneous equipment to PII in August 2006 and the Company entered into a facility sales agreement with PII in amount of NT\$82,220 thousand. The title of facility has been perfectly passed to PII in November 2006 and the Company incurred a loss on disposal of assets amounting to NT\$18,691 thousand accordingly. The selling price has been fully collected as of the end of Year 2006.

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

## a. Receivables from related parties

<i>In thousand NTD</i>	As of December 31,			
	2006		2005	
	Amount	%	Amount	%
MTL	\$-	-	\$45,946	1.14
ALi	43	-	4,200	0.10
Alpha	164	-	276	0.01
Subtotal	207	-	50,422	1.25
Less: Allowance for doubtful accounts	-	-	(3,077)	(0.08)
Net	<u>\$207</u>	<u>-</u>	<u>\$47,345</u>	<u>1.17</u>

## b. Payables to related parties

<i>In thousand NTD</i>	As of December 31,			
	2006		2005	
	Amount	%	Amount	%
UMC	\$-	-	\$1,931,843	38.97
KING YUAN	196,472	4.59	205,191	4.14
ALi	-	-	1,034	0.03
Other	4,580	0.11	263	-
Total	<u>\$201,052</u>	<u>4.70</u>	<u>\$2,138,331</u>	<u>43.14</u>

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS--(continued)****6. Assets Pledged As Collateral**

(1) As of December 31, 2006: None

(2) As of December 31, 2005:

<i>In thousand NTD</i>	<u>Net book value</u>	<u>Secured financial institutions</u>	<u>Contents (Purpose)</u>
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.

**7. Commitments and Contingencies**

(1) Litigation

- a. 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). On November 28, 2005, Sanyo filed motion to transfer this action to Central District of California where a second and unrelated action is pending. Furthermore, Sanyo attempted to add two counterclaims for patent infringement that included two unrelated patents (Sanyo's U.S. Patent No. 6594213 and 6487616). On February 1, 2006, the Texas Court denied Sanyo's motion to transfer. The judge in the Eastern District of Texas severed Sanyo's counterclaims from the Texas case and transferred U.S. Patent No. 6594213 and 6487616 to the Central District of California where they were re-filed as the current action. On April 25, 2006, Sanyo and the Company filed a joint stipulation that the action in the Central District, including Sanyo's allegations that the Company's Chips infringed U.S. Patents No. 6594213 and 6487616, be dismissed with prejudice. On April 28, 2006, the Court signed an order dismissing the Central District Case, and all claims pending therein, with prejudice. The Company will use its best efforts to handle this litigation.

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

- b. 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. On February 2, 2006, Matsushita and Panasonic filed their answer to the complaint. Included in the answer are counterclaims for patent infringement of Matsushita's U.S. Patent No. 5347232 and 6828865. The Company is cautiously handling these litigations.

**(2) Commitments**

- a. As of December 31, 2006, totaling US\$2,056 thousand of the Company's other significant contracts remained unpaid.
- b. The Company entered into a patent license agreement with Zoran Corporation and its subsidiary-OAK in January 2006. Zoran Corporation and OAK granted to the Company and its subsidiaries the right of utilizing related patent on Optical Storage products. Both parties came to an agreement that, starting January 2006, the Company shall pay Zoran a monthly royalty charge of US\$1,000 thousand for a period of 30 months if the sale of units of the licensed products reaches certain level. Total royalties charge shall not exceed the ceiling of US\$30,000 thousand.
- 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
2007.01.01~2007.12.31	\$25,474
2008.01.01~2008.12.31	24,406
2009.01.01~2009.12.31	23,879
2010.01.01~2010.12.31	23,879
2011.01.01~2023.12.31	295,326
Total	\$392,964

**MEDIATEK INC.****NOTES TO FINANCIAL STATEMENTS—(continued)****8. Significant Casualty Loss**

None

**9. Significant Subsequent Events**

None

**10. Others**

## (1) Financial Instruments

## a. Fair value of financial instruments

	As of December 31,			
	2006		2005	
	Carrying value	Fair value	Carrying value	Fair value
<u>Non-derivative</u>				
Assets				
Cash and cash equivalents	\$36,655,169	\$36,655,169	\$31,405,861	\$31,405,861
Held for Trading financial assets-current (excluding derivatives)	\$2,302,261	\$2,302,261	\$1,189,778	\$1,200,411
Financial assets designated as at fair value through profit or loss	\$400,944	\$400,944	\$-	\$-
Receivables (including receivables from related parties)	\$3,857,001	\$3,857,001	\$4,034,732	\$4,034,732
Other receivables	\$238,142	\$238,142	\$259,246	\$259,246
Available-for-sale financial assets	\$628,110	\$628,110	\$-	\$-
Financial assets carried at cost	\$3,000	\$-	\$15,000	\$-
Bond portfolios with no active market	\$1,000,000	\$-	\$1,000,000	\$-
Investment accounted for using equity method				
-Those with market value	\$1,056,954	\$3,512,208	\$787,517	\$2,102,253
-Those without market value	\$18,462,942	\$-	\$12,584,959	\$-
Refundable deposits	\$13,888	\$13,888	\$72,707	\$72,707
Restricted deposits	\$-	\$-	\$24,000	\$24,000
Liabilities				
Payables (including due to related parties)	\$4,280,726	\$4,280,726	\$4,957,361	\$4,957,361
Income taxes payables	\$2,341,449	\$2,341,449	\$909,647	\$909,647
Accrued expenses	\$1,971,445	\$1,971,445	\$3,452,174	\$3,452,174
Payables to contractors and equipment suppliers	\$160,161	\$160,161	\$316,185	\$316,185

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

	As of December 31,			
	2006		2005	
	Carrying value	Fair value	Carrying value	Fair value
<u>Derivatives</u>				
Assets				
Held for trading financial assets-current				
Forward exchange contracts	\$897	\$897	\$52,016	\$49,010
Held for trading financial liabilities-current				
Forward exchange contracts	\$14,586	\$14,586	\$-	\$-

(a) The following methods and assumptions were used by the Company in estimating the fair value of financial instruments:

(i) The fair values of the Company's short-term financial instruments were based on the book value of those instruments at the reporting date due to their short maturities. This method was applied to cash and cash equivalents, accounts receivable, other receivables, payables, income taxes payables, accrued expenses and payables to contractors and equipment suppliers.

(ii) The fair values of the Company's refundable deposits and restricted deposits were based on the book value because the Company predicts the future cash inflow is similar with the book value.

(iii) The fair values of held for trading financial assets and available-for-sale financial assets were based on their quoted market price at the reporting date.

(iv) Financial assets carried at cost: Holdings in the following stocks that have no material influence, or derivatives linked to and settled in those stocks:

- I. Stocks not listed on the Taiwan Stock Exchange or the GreTai.
- II. Emerging stocks.

(v) The fair values of the Company's investments accounted for under equity method were based on quoted market prices, if available, at the reporting date. If market prices were impractical and not available, the Company did not provide the information of fair values.

(vi) The fair values of derivative financial instruments-forward exchange contracts and financial assets designated as at fair value through profit or loss - credit link deposits, were based on the quoted market price provided by counter-party banks.

(b) Losses recognized for the changes in fair value of financial assets estimated using valuation techniques were NT\$12,745 thousand for the year ended December 31, 2006.



**MEDIATEK INC.**

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

- (c) As of December 31, 2006 and 2005, financial assets exposed to fair value interest rate risk were NT\$34,641,577 thousand and NT\$26,417,495 thousand, respectively, and financial assets exposed to cash flow interest rate risk were NT\$3,564,536 thousand and NT\$6,212,144 thousand, respectively.
- (d) Interest income recognized from financial assets and financial liabilities that are not at fair value through profit or loss amounted to NT\$597,295 thousand and NT\$380,070 thousand as of December 31, 2006 and 2005, respectively. The Company recognized an unrealized gain of NT\$78,110 thousand and NT\$0 in shareholder's equity for the changes in fair value of available-for-sale financial assets for the years ended December 31, 2006 and 2005, respectively, and the amount that was removed from equity and recognized in profit or loss was nil for the years ended December 31, 2006 and 2005. The Company also recognized an unrealized gain of NT\$2,601,866 thousand in shareholders' equity for the changes in available-for-sale financial assets held by its investee companies accounted for under equity method for the year ended December 31, 2006. Please refer to Note 4.(6) I to the financial statements for details.
- (e) The impairment loss on financial assets amounted to NT\$12,000 thousand and NT\$0 for the years ended December 31, 2006 and 2005, respectively.

b.

(a) Risk management policy and hedge strategy for financial instruments

The Company held certain non-derivative financial instruments, including: cash and cash equivalents, held for trading financial assets-mutual fund, government bonds and corporate bonds. The Company held the financial instruments to meet operating cash needs. The Company held other financial instruments such as receivables, other receivables, payables, financial assets designated as at fair value through profit or loss, available-for-sale financial assets, financial assets measured at cost, bond portfolios with no active market and long-term investments accounted for using equity method.

The Company entered into forward exchange contracts. Forward contracts were used to hedge foreign-currency-denominated assets and liabilities. Derivatives that do not meet the criteria for hedge accounting of the newly released SFAS No. 34 are initially recognized at financial assets/liabilities at fair value through profit or loss-current.

(b) Information of financial risks

Major risks of financial instruments were market risk, credit risk, liquidity risk and cash flow interest rate risk. The management policy was summarized as follows:

**MEDIATEK INC.**

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

**Market risk**

Market risk includes currency risk; it comes from the purchases or sales activities which are not denominated in functional currency. The Company reviews its foreign-currency-denominated assets and liabilities, and decides to enter into forward exchange contracts for hedging exchange rate fluctuation risk to meet operating needs. Because the purpose of holding forward exchange contracts is to hedge exchange rate fluctuation risk, the contracts are expected to offset changes in rates of a hedged item, and the market risk is not material. Credit-linked deposits are affected by interest rate. When interest rate increases, the market value may decrease even below the initial investment cost; in the contrary, the market value may increase. The fair value of mutual fund, government bonds and corporate bonds will be fluctuated by other market factors as well as interest rates.

**Credit risk**

Credit risk represents the potential loss that would be incurred by the Company if the counter-party or third-party breached the contracts. It affects significant concentrations of credit risk, components, the price of contract and other receivables of financial instruments. The accrual amount of credit risk were NT\$187,437 thousand and NT\$243,575 thousand as of December 31, 2006 and 2005, respectively. Financial instruments with positive fair values at the balance sheet date are evaluated for credit risk, which incurs when counter-party or third-party to a financial instrument fails to discharge an obligation and the Company is caused to suffer a financial loss.

Since the counter-party or third-party to the foregoing forward exchange contracts are of reputable financial institution, management believes that the Company's exposure to default by those parties is low. Credit risk of credit-linked deposits would be incurred if the issuing banks breached the contracts or the debt issuer could not pay off the debts and the value of credit-linked deposits may drop to zero. Therefore, the Company minimized the credit risk by selecting counter-party who is reputable and in good financial standing.

**Liquidity risk**

The Company has sufficient operating capital to meet cash needs upon settlement of derivatives financial instruments. Therefore, the liquid risk is low.

Except for financial assets measured at cost, investment in bonds with no active market and long-term investment accounted for under equity method that may have significant liquidity risks resulted from lack of an active market, the equity securities, bonds and funds held by the Company are traded in active markets and can be sold promptly at the prices close to its fair values. Since the exchange rates of forward exchange contracts are fixed at the time the contracts are entered into and the Company does hold and anticipates holding sufficient financial asset position in USD, no significant additional cash requirement is anticipated and the liquid risk is low.

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

The liquidity risk for credit-linked investment incurs since the Company has no right to have the instrument redeemed or called prior to its maturity. The Company minimized such risk by prudential evaluation over the underlying before investment.

Cash flow interest rate risk

The Company main financial instruments exposed to cash flow interest rate risk is the investment in time deposits with variable interest rate. There is no significant impact due to fluctuation in interest rate since the duration of time deposits is short. The cash flow risk from fluctuation in interest rate is minimized.

## (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, 2005 have been reclassified to conform to the presentation of the current period.

**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,			
	2006		2005	
	Amounts	%	Amounts	%
Customers				
A	\$5,661,441	10.69	\$7,440,702	16.00
B	6,262,884	11.83	2,366,420	5.09
C	7,037,408	13.29	1,282,282	2.76
	<u>\$18,961,733</u>	<u>35.81</u>	<u>\$11,089,404</u>	<u>23.85</u>

## (2) Export Sales

The Company's export sales totaled NT\$48,353,628 thousand and NT\$40,028,366 thousand for the years ended December 31, 2005 and 2006, respectively, representing 91.23% and 86.10% of the Company's net sales for corresponding years.

**MEDIATEK INC.**

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

(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.