

INVENTEC CORPORATION
FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002
AND
INDEPENDENT AUDITORS' REPORT

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Inventec Corporation

Financial Statements

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Independent Auditors' Report

The Board of Directors
Inventec Corporation:

We have audited the accompanying balance sheets of Inventec Corporation as of December 31, 2003 and 2002, and the related statements of income, changes in stockholders' 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 did not audit the financial statements of certain investee companies accounted for under the equity method, which statements reflect total assets constituting 0.58 percent and 0.57 percent of total assets and total investment income constituting 1.4 percent and 1.0 percent of income before income tax in 2003 and 2002, respectively. Those statements were audited by other auditors whose reports has been furnished to us, and our opinion, insofar as it relates to the amounts included for the investee companies, is based solely on the reports of the other auditors.

We conducted our audits in accordance with "Rules Governing Auditing and Certification of Financial Statements by Certified Public Accountants" and auditing standards generally accepted in the Republic of China. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statement presentation. We believe that our audits and reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Inventec Corporation as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the Republic of China.

For reference purposes, Inventec Corporation has prepared consolidated financial statements for the years ended December 31, 2003 and 2002, on which we have expressed an unqualified opinion with explanatory paragraphs.

Taipei, Taiwan, ROC
February 13, 2004

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

INVENTEC CORPORATION
BALANCE SHEETS
DECEMBER 31, 2003 AND 2002
(New Taiwan Dollars in Thousands, Except for Share Data)

| | December 31, 2003 | | December 31, 2002 | |
|--|--------------------------|------------|--------------------------|------------|
| | Amount | % | Amount | % |
| ASSETS | | | | |
| Current Assets: | | | | |
| Cash and cash equivalents (Notes 2 and 3) | \$ 8,993,432 | 17 | 7,725,918 | 18 |
| Notes receivable (Note 2) | | | | |
| - Other customers | 2 | - | 38,406 | - |
| - Related parties | 776 | - | 1,193 | - |
| Accounts receivable - less allowance for doubtful accounts (Notes 2 and 4) | | | | |
| - Other customers | 10,372,435 | 20 | 4,328,161 | 10 |
| - Related parties | 5,917,967 | 12 | 9,922,147 | 24 |
| Other financial assets - current | 10,480,396 | 20 | 2,800,285 | 7 |
| Inventories, net of allowance for market value decline and obsolescence (Notes 2 and 5) | 1,644,794 | 3 | 2,534,086 | 6 |
| Prepayments and other current assets | 65,638 | - | 72,011 | - |
| Deferred tax assets - current (Notes 2 and 10) | 600,104 | 1 | 267,299 | 1 |
| | <u>38,075,544</u> | <u>73</u> | <u>27,689,506</u> | <u>66</u> |
| Long-term equity investments (Notes 2 and 6) | | | | |
| Accounted for under the equity method | 10,055,473 | 19 | 10,111,599 | 24 |
| Accounted for under the cost method | 1,561,000 | 3 | 1,574,802 | 4 |
| Prepayments for long-term investments | 369,873 | 1 | - | - |
| | <u>11,986,346</u> | <u>23</u> | <u>11,686,401</u> | <u>28</u> |
| Other financial assets - non-current | | | | |
| | <u>56,602</u> | <u>-</u> | <u>70,379</u> | <u>-</u> |
| Property, Plant, and Equipment (Notes 2 and 7) | | | | |
| Land | 788,144 | 2 | 788,870 | 2 |
| Buildings | 427,252 | 1 | 427,252 | 1 |
| Machinery | 543,367 | 1 | 960,222 | 2 |
| Transportation equipment | 24,458 | - | 24,458 | - |
| Furniture and office facilities | 906,786 | 2 | 849,137 | 2 |
| Other equipment | 197,758 | - | 391,468 | 1 |
| Less: Accumulated depreciation | (1,308,369) | (3) | (1,609,736) | (4) |
| Construction in progress | 15,260 | - | - | - |
| Prepayment on equipment | 737 | - | 460 | - |
| | <u>1,595,393</u> | <u>3</u> | <u>1,832,131</u> | <u>4</u> |
| Intangible Assets(Notes 2 and 9) | | | | |
| Deferred Pension Cost | 117,546 | - | - | - |
| Other Assets: | | | | |
| Deferred debits - intercompany loss (Note 2) | 194,663 | 1 | 194,663 | - |
| Other (Notes 2 and 8) | 157,473 | - | 706,822 | 2 |
| | <u>352,136</u> | <u>1</u> | <u>901,485</u> | <u>2</u> |
| TOTAL ASSETS | \$ 52,183,567 | 100 | 42,179,902 | 100 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | |
| Current Liabilities: | | | | |
| Notes payable | \$ 506,379 | 1 | 1,112,547 | 3 |
| Accounts payable: | | | | |
| - Other vendors | 10,623,265 | 20 | 8,809,181 | 21 |
| - Related parties | 9,559,127 | 18 | 4,679,387 | 11 |
| Accrued expenses | 761,611 | 1 | 511,293 | 1 |
| Advance collection | 118,133 | - | 27,695 | - |
| Other current liabilities | 502,897 | 1 | 231,074 | 1 |
| Estimated warranty reserve (Note 2) | 753,182 | 2 | 505,554 | 1 |
| | <u>22,824,594</u> | <u>43</u> | <u>15,876,731</u> | <u>38</u> |
| Other Liabilities: | | | | |
| Accrued pension liabilities (Notes 2 and 9) | 325,053 | 1 | 159,735 | - |
| Deferred tax liabilities - noncurrent (Notes 2 and 10) | 401,580 | 1 | 385,776 | 1 |
| Deferred credits - intercompany profits (Note 2) | 121,320 | - | 213,323 | 1 |
| Other | 684 | - | 1,003 | - |
| | <u>848,637</u> | <u>2</u> | <u>759,837</u> | <u>2</u> |
| Total Liabilities | <u>23,673,231</u> | <u>45</u> | <u>16,636,568</u> | <u>40</u> |
| Stockholders' Equity | | | | |
| Capital Stock, par value \$10 per share; authorized 2,500,000,000 shares, 2,026,000,000 shares issued and outstanding as of December 31, 2003; authorized 2,000,000,000 shares, 1,835,000,000 shares issued and outstanding as of December 31, 2002.(Note 2, 11, and 13) | 20,260,000 | 39 | 18,350,000 | 44 |
| Capital Surplus (Note 2) | | | | |
| Additional paid-in capital | 447,723 | 1 | 447,723 | 1 |
| Capital surplus of long-term investments | 121,064 | - | 121,064 | - |
| Other | 177 | - | 177 | - |
| Retained Earnings: | | | | |
| Legal reserve (Note 2) | 2,910,055 | 6 | 2,575,062 | 6 |
| Undistributed earnings (Notes 2 and 10) | 4,685,416 | 9 | 3,828,661 | 9 |
| Cumulative translation adjustments (Note 2) | 85,901 | - | 220,647 | - |
| Total Stockholders' Equity | <u>28,510,336</u> | <u>55</u> | <u>25,543,334</u> | <u>60</u> |
| Commitments and Contingencies | | | | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 52,183,567 | 100 | 42,179,902 | 100 |

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

INVENTEC CORPORATION
STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2003 AND 2002
(New Taiwan Dollars in Thousands, Except for Share Data)

| | 2003 | | 2002 | |
|---|---------------------|------------------|---------------------|------------------|
| | Amount | % | Amount | % |
| Operating Revenue: | | | | |
| Net sales | \$ 81,569,045 | 100 | 68,289,869 | 100 |
| Technical service revenue | 9,032 | - | 10,009 | - |
| Processing revenue | - | - | 38 | - |
| Net operating revenue | 81,578,077 | 100 | 68,299,916 | 100 |
| Operating Cost: | (75,852,905) | (93) | (62,561,276) | (92) |
| | 5,725,172 | 7 | 5,738,640 | 8 |
| Realized intercompany profits | 99,201 | - | 102,369 | - |
| Unrealized intercompany profits | (3,075) | - | (99,201) | - |
| Gross margin | 5,821,298 | 7 | 5,741,808 | 8 |
| Operating Expenses: | | | | |
| Selling expenses | (2,374,144) | (3) | (1,826,110) | (3) |
| Administrative expenses | (1,107,398) | (2) | (1,071,839) | (2) |
| Research and development expenses | (1,340,614) | (1) | (953,315) | (1) |
| | (4,822,156) | (6) | (3,851,264) | (6) |
| Income from Operations | 999,142 | 1 | 1,890,544 | 2 |
| Non-Operating Revenues: | | | | |
| Interest revenue | 86,109 | - | 201,857 | - |
| Investment income accounted for under the equity method | 1,816,175 | 2 | 741,185 | 1 |
| Dividend income | 600 | - | 6,000 | - |
| Gain on disposition of property | 32,293 | - | 25,409 | - |
| Gain on disposition of investments | 802,114 | 1 | - | - |
| Gain on recovery of inventory market decline | 34,998 | - | 122,217 | - |
| Other revenue | 523,837 | 1 | 986,032 | 1 |
| | 3,296,126 | 4 | 2,082,700 | 2 |
| Non-Operating Expenses: | | | | |
| Interest expense | (471) | - | (550) | - |
| Loss on disposal of properties | (53,577) | - | (34) | - |
| Foreign currency exchange loss | (25,709) | - | (146,071) | - |
| Other losses | (55,323) | - | (426) | - |
| | (135,080) | - | (147,081) | - |
| Income before income tax | 4,160,188 | 5 | 3,826,163 | 4 |
| Income tax benefit (expense) | 88,012 | - | (476,232) | (1) |
| Net Income | \$ 4,248,200 | 5 | 3,349,931 | 3 |
| | Before Tax | After Tax | Before Tax | After Tax |
| Earnings per share (Notes 2 and 13) | | | | |
| Basic | \$ 2.05 | 2.10 | 2.09 | 1.83 |
| Earnings per share after retroactive adjustment: | | | | |
| Basic | \$ - | - | 1.89 | 1.65 |

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

INVENTEC CORPORATION
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2003 AND 2002
(New Taiwan Dollars in Thousands)

| | Capital Stock | Capital Surplus | Retained Earnings | | Cumulative Translation Adjustment | Total |
|---|----------------------|--------------------|-------------------|---------------------------|---|-------------------|
| | | | Legal Reserve | Undistributed Earnings | | |
| Beginning balance, January 1, 2002 | \$ 16,607,000 | 806,677 | 2,193,313 | 4,227,410 | 196,571 | 24,030,971 |
| 2001 earnings distribution and appropriation: | | | | | | |
| Legal reserve | - | - | 381,749 | (381,749) | - | - |
| Compensation to directors and supervisors | - | - | - | (103,072) | - | (103,072) |
| Employee bonus | - | - | - | (158,202) | - | (158,202) |
| Employee bonus in stock dividends | 82,300 | - | - | (82,300) | - | - |
| Stock dividends | 1,411,595 | - | - | (1,411,595) | - | - |
| Cash dividends distributed | - | - | - | (1,660,700) | - | (1,660,700) |
| Capitalization of capital surplus | 249,105 | (249,105) | - | - | - | - |
| Net income for 2002 | - | - | - | 3,349,931 | - | 3,349,931 |
| Reversal of after-tax gain on disposition of properties | - | (49,941) | - | 49,941 | - | - |
| Adjustment arising from change in ownership percentage in an investee | - | 61,333 | - | (1,003) | - | 60,330 |
| Translation adjustment to long-term investments (net of income tax of \$8,025) | - | - | - | - | 24,076 | 24,076 |
| Ending balance, December 31, 2002 | \$ 18,350,000 | 568,964 | 2,575,062 | 3,828,661 | 220,647 | 25,543,334 |
| Beginning balance, January 1, 2003 | \$ 18,350,000 | 568,964 | 2,575,062 | 3,828,661 | 220,647 | 25,543,334 |
| 2002 earnings distribution and appropriation: | | | | | | |
| Legal reserve | - | - | 334,993 | (334,993) | - | - |
| Compensation to directors and supervisors | - | - | - | (90,448) | - | (90,448) |
| Employee bonus | - | - | - | (136,046) | - | (136,046) |
| Employee bonus in stock dividends | 75,000 | - | - | (75,000) | - | - |
| Stock dividends | 1,835,000 | - | - | (1,835,000) | - | - |
| Cash dividends distributed | - | - | - | (917,500) | - | (917,500) |
| Net income for 2003 | - | - | - | 4,248,200 | - | 4,248,200 |
| Adjustment arising from change in ownership percentage in an investee | - | - | - | (2,458) | - | (2,458) |
| Translation adjustment to long-term investments (net of income tax of \$44,915) | - | - | - | - | (134,746) | (134,746) |
| Ending balance, December 31, 2003 | \$ 20,260,000 | 568,964 | 2,910,055 | 4,685,416 | 85,901 | 28,510,336 |

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

INVENTEC CORPORATION
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2003 AND 2002
(New Taiwan Dollars in Thousands)
INVENTEC CORPORATION

| | 2003 | 2002 |
|---|---------------------|--------------------|
| Cash flows from operating activities: | | |
| Net income | \$ 4,248,200 | 3,349,931 |
| Adjustment to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 270,470 | 305,376 |
| Amortization | 290,063 | 478,384 |
| Loss (gain) on disposal and scrapping of properties | 21,925 | (34,803) |
| Gain on disposal of deferred assets | (4,737) | (539) |
| Gain on disposition of long-term investments, net | (802,114) | - |
| Gain on recovery of inventory market decline | (34,998) | (122,217) |
| Foreign currency exchange loss (gain), net | (6,077) | 31,152 |
| Provision for doubtful accounts | 4,118 | 28,811 |
| Gain on investments recognized under the equity method in excess of cash dividends received | (1,147,678) | (703,766) |
| Provision (reversal) for warranty reserve | 247,628 | (79,887) |
| Change in assets and liabilities: | | |
| Notes and accounts receivable | (2,005,391) | (2,390,270) |
| Other financial assets - current | (7,680,111) | (2,684,591) |
| Inventories | 924,290 | (219,285) |
| Prepayments and other current assets | 6,373 | (31,000) |
| Deferred tax assets and liabilities, net | (272,086) | 127,517 |
| Notes and accounts payable | 6,087,656 | 6,477,847 |
| Income tax payable | - | (260,752) |
| Accrued expenses | 250,318 | (179,597) |
| Advance collection | 90,438 | (38,393) |
| Deferred credits - intercompany profits | (92,003) | 7,301 |
| Other current liabilities | 108,795 | (28,930) |
| Accrued pension liabilities | 47,772 | (235,340) |
| Net cash provided by operating activities | 552,851 | 3,796,949 |
| Cash flows used in investing activities: | | |
| Increase in long-term investments | (1,761,784) | (3,848,476) |
| Purchase of property and equipment | (61,214) | (188,676) |
| Proceeds from disposal of long-term investments | 3,229,512 | - |
| Proceeds from disposal of property and equipment | 724,999 | 62,994 |
| Proceeds from disposal of deferred assets | 21,754 | 906 |
| Increase in deferred charges | (321,302) | (482,847) |
| Other financial assets - non-current | 13,777 | 3,065 |
| Decrease in other assets | 7,157 | 14,657 |
| Net cash provided by (used in) investing activities | 1,852,899 | (4,438,377) |
| Cash flows from financing activities: | | |
| Compensation to directors and supervisor and employee bonus | (226,494) | (261,274) |
| Cash dividends paid | (917,500) | (1,660,700) |
| Increase in other liabilities | (319) | (8,555) |
| Net cash used in financing activities | (1,144,313) | (1,930,529) |
| Effect of changes in foreign exchange rate | 6,077 | (31,152) |
| Net increase (decrease) in cash and cash equivalents | 1,267,514 | (2,603,109) |
| Cash and cash equivalents, beginning of the year | 7,725,918 | 10,329,027 |
| Cash and cash equivalents, end of the year | \$ 8,993,432 | 7,725,918 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the year for interest | \$ 471 | 3,182 |
| Cash paid during the year for income taxes | \$ 184,074 | 607,121 |
| Acquisition of properties with cash and other payables: | | |
| Increase in property and equipment | \$ 224,242 | 190,490 |
| Add: Other payables - beginning of the year | 5,044 | 3,230 |
| Less: Other payables - end of the year | (168,072) | (5,044) |
| Cash paid | \$ 61,214 | 188,676 |

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

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS
Years Ended December 31, 2003 and 2002
(New Taiwan Dollars in Thousands, Unless Otherwise Stated)

1. Overview

The Company engages primarily in developing, manufacturing, processing and trading of computers, word processors and related products. Significant historical events are the following:

- 1975- The Company was founded with a registered capital of \$1,000 to produce calculators and telephone sets.
- 1989- The Company started to manufacture laptops and word processors.
The Company invested in Inventec Besta Co., Ltd.
The Company commenced to manufacture a series of electronic dictionaries as well as language CDs.
- 1990- The Company built overseas manufacturing plants to manufacture telephone and facsimile machines through investing in Inventec Electronics (M) SDN. BHD.
- 1991- The Company invested in Inventec Electronics (Shanghai) Co., Ltd. through its investment in Inventec Corporation (Hong Kong) Co., Ltd. to expand software business.
- 1993- Mass production of PDA's commenced.
- 1994- The Company invested in Inventec Electronics (Nanking) Co., Ltd., Inventec Electronics (Tianjin) Co., Ltd., Inventec Electronics (Beijing) Co., Ltd. and Inventec Electronics (Xi'an) Co., Ltd. to engage in software business.
- 1995- Mass production of multi-function, multimedia Pentium-computers commenced and a site at Wu-Ku Industrial Park for plant expansion was purchased.
- 1996- Operation of the factory in Wu-Ku commenced.
A site at Lin-Ko Industrial Park was acquired by the Company for factory expansion and construction was launched.
The Company's stock was listed in Taiwan Stock Exchange in November.
- 1997- Operation of the factories in Lin-Ko Industrial Zone commenced.
Subsidiaries of the Company in Scotland, Singapore and the United States were registered and engaged in assembling and after-sales services.
- 1998- The Company established Inventec Holding (North America) Co., Ltd. for after-sale services of its U.S. subsidiaries.
- The Company purchased Ta-Shi plant in Tao-Yuan. Production of servers and desktops commenced.

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

1999- The Company sold its personal learning system department and related trademark, patents, and copyrights to the investee company Inventec Besta Co., Ltd.

- The Company sold its investment in Inventec Electronic (Xi'an) Co., Ltd. to its investee company Inventec Besta Co., Ltd.
- The Company purchased a second factory at Wu-Ku Industrial Park for business in information appliance (IA).
- The Company established Inventec Multimedia and Telecom Corp. for multimedia products and communication related businesses.
- The Company established Inventec Micro-Electronics Corp. to manufacture telecommunication equipment.
- The Company established Inventec Online Corp. for software development.

2000- The PDA division was transferred to Inventec Appliances Corp. and asset valuation was used as the basis of the Company's investment.

- The Company established Inventec Communication and Technology Co. for investing activities.
- The Company sold its investment in Inventec Electronics (M) SDN. BHD. to the investee company Inventec Communication and Technology Co. to integrate operation and business.
- Investee companies Inventec Multimedia and Telecom Corp. and Inventec Communication and Technology Co. merged to reinforce administrative efficiency, integrate resources, and reduce costs. Inventec Multimedia and Telecom Corp. is the continuing company after the merger.
- The Company invested in Inventec Corporation (Cayman) Co., Ltd. for further investment in Inventec Corporation (Shanghai) Co., Ltd., of which parts assembling is the major line of its business.

2001- The Company invested in Inventec Tomorrow Studio Corporation for editorial tasks of book and electronic publication and sales.

2002- Inventec Online Corp. and Inventec Appliances Corp. merged to integrate resources. Inventec Appliances Corp. is the surviving company after the merger.

2003- The Company sold its investment in Inventec Appliance (Shanghai) Co., Ltd. to investee Appliances Corp.

- The Company invested in Inventec Corporation (Cayman) Co., Ltd. which invested in Inventec (Pudong) Corp. Inventec (Pudong) Corp. engages in parts assembling.

As of December 31, 2003, the average number of employees was 2,087.

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

2. Summary of Significant Accounting Policies

The Company's financial statements were prepared in accordance with generally accepted accounting principles of the Republic of China. Summary of significant accounting policies and their measurement basis are as follows:

a. Cash Equivalents

Cash equivalents are Treasury bills, commercial paper, or banker's acceptances with maturities within three months. Commercial paper and banker's acceptance are stated at cost and valued by the specific identification method. At year-end, interest receivables are accrued on unsold investments.

b. Notes and Accounts Receivable and Allowance for Doubtful Accounts

Allowance for doubtful accounts is based on the age and results of the Company's evaluation of the collectibility of outstanding receivable balances. Allowance for receivables outstanding beyond 1 year and of customers with financial difficulties is fully provided, net of likely collectible amount.

c. Inventories and Allowance for Inventory Market Decline and Obsolescence

Inventories are stated at cost on a perpetual inventory basis by the weighted-average method and valued at the lower of cost or market at year-end. Allowance for inventory market decline is provided for when the market value of inventories is lower than cost, and valuation is based on the total amount of inventories. Allowance for inventory obsolescence is provided for obsolete or slow-moving (over 6 months) items, net of estimated useful or salvage values.

d. Long-Term Equity Investments

Long-term equity investments where the Company cannot exercise significant influence are stated at cost. If an investee company is a listed company, an allowance for market decline is provided when market price is lower than cost, with unrealized market decline charged to stockholders' equity. For non-listed companies, should evidence suggest investment value impairment may be other than temporary and the possibility of recovery remote, loss is recognized immediately, and the restated book value is the new cost.

Long-term equity investments where the Company can exercise significant influence are accounted for under the equity method. Premium or discount on investments is amortized equally over 5 years. Exchange differences from translation of foreign-denominated financial statements at year-end are reflected as translation adjustments under stockholders' equity. If the fiscal year of the investee company is different from that of the Company, equity earnings of an investee company are recognized according to equivalent ownership at year-end closing. If the current audited financial statements are unavailable on a timely basis, gain or loss on investments are recognized in the following year based upon the current equivalent ownership of the investee company at year-end.

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

Unrealized intercompany transactions are eliminated and recorded as deferred debits. Regardless of downstream or upstream transactions, unrealized inter-company gains and losses are eliminated in proportion to shareholding ratio, except for in downstream transactions, where gain or loss must be fully eliminated when controlling interests exist. Unrealized gains and losses resulting from transactions between investee companies are eliminated in proportion to shareholding ratio if controlling interests exist. Otherwise the unrealized gains or losses are eliminated according to the product of shareholding ratio. Gains and losses resulted from transactions of depreciable assets are recognized ratably over their economic lives, while those from other assets are recognized immediately.

Cost and gains or losses on disposition of long-term equity investments are determined by the weighted-average method. Capital surplus from disposition of such investments is reduced by the percentage sold, with gains and losses included in current earnings.

Long-term equity investments where the Company has controlling interest are accounted for under the equity method and consolidated financial statements are required according to rules set forth in the Statement of Financial Accounting Standards (“SFAS”) and by the Securities and Futures Commission (“SFC”) under the Ministry of Finance (“MOF”).

e. Property, Plant, Equipment and Depreciation

Property, plant, and equipment are stated at cost. Major additions, improvements, and replacements are capitalized. Depreciation is applied by the straight-line method based on estimated economic lives. Assets still in use after full depreciation may continue to be depreciated by their estimated economic lives. Economic lives of major property and equipment are the following:

| | |
|---------------------------------------|----------------|
| Buildings | 10 to 46 years |
| Machinery | 2 to 13 years |
| Transportation equipment | 4 to 6 years |
| Furniture and office facilities | 3 to 18 years |
| Power equipment | 2 to 16 years |
| Renovation and leasehold improvements | 2 to 15 years |
| Miscellaneous equipment | 2 to 16 years |

Gain and loss on disposal of properties are included in current earnings. Non-operating properties are listed as other assets. Properties with no operating value are reclassified as other assets and carried at the lower of book or net realizable value, and their costs and accumulated depreciation shall offset each other, with difference reported as current loss.

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

f. Deferred Expenses

Telephone line charges and cost of power distributors are amortized equally over 5 years. Molds and tools are amortized equally over 12 months. Software costs are amortized at the ratio of its current total production over total current and estimated future production. If production ceases for over six months, then the software will be fully reflected as other losses.

g. Pension Plan

The Company has a pension plan covering all regular employees, and pension payment is commensurate with years of service. The Company contributes annually to the pension fund and deposits in a government designated account. The pension fund is not reflected in the Company's financial statements. Effective 1995, the Company adopted SFAS No.18 and secured actuarial report on pension liabilities with December 31 as the measurement date. Provisions for pension expense commenced on January 1, 1996, and unrecognized net transitional obligations are amortized equally over 15 years.

h. Foreign Currency Translation

Assets and liabilities of overseas subsidiaries are translated at the spot rate of the balance sheets date; stockholders' equity is translated by historical rate except for the beginning balance of retained earnings, where the spot rate at the beginning of the year is used. Income statement accounts are translated at the weighted-average rate of the year, with difference reflected as translation adjustments to stockholders' equity.

Foreign-denominated non-forward transactions are recorded at rates as transactions occur. Foreign exchange gain and loss on settlement of foreign-denominated assets and liabilities and those of year-end adjustment to foreign-denominated assets and liabilities by the spot rates then are included in current earnings.

i. Capital Surplus

According to the Company Law, capital surplus is used exclusively to offset cumulative losses and increase capital. If the Company revalues properties and uses capital surplus to offset cumulative losses, it must first be restored by future earnings before dividends or other distributions can be made.

j. Legal Reserve

Legal reserve is used exclusively to offset cumulative losses or to increase capital. Capitalization of legal reserve is permitted only when it reaches 50% of the paid-in capital, and only 50% of it can be capitalized. It may not be used for any other purpose.

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

k. Earnings Distribution and Dividend Policy

The Company's Articles of Incorporation prescribe that after-tax earnings shall first offset cumulative losses, and 10% of the rest be set aside as legal reserve. Special reserve may be appropriated for operations or to meet regulations. 7% and 3% of the remainder will be distributed as employee bonuses and compensation for directors and supervisors, respectively. The remaining balance is distributed according to the proposal presented to the annual stockholders' meeting by the Board of Directors.

In consideration of the Company's future funding needs and long-term budget planning, and in order to meet shareholders' demand of cash flow, annual cash dividends paid cannot be fewer than 10% of total current dividends.

l. Commitments and Contingencies

If loss from a commitment or contingency is deemed highly likely and the amount can be reasonably estimated, then such loss is immediately recognized. Otherwise, only the nature of such loss is disclosed in notes to the financial statements.

m. Revenue Recognition

Revenue is recognized when title to the product and risk and benefits of ownership are transferred to the customer; otherwise recognition is deferred until conditions are met.

n. Warranty Reserve

An allowance is provided for products with warranty based on estimated warranty service cost, and the related liability is classified as current or non-current, depending on its nature.

o. Classification of Capital and Operating Expenditures

Expenditures that benefit the Company in future years are capitalized, while immaterial expenditures or those with no future benefits are treated as current expense or loss.

p. Income Tax

The Company adopted the SFAS No. 22, "Accounting for Income Taxes" to make inter- and intra-period income tax allocation. Tax effects of deductible temporary differences, unused investment tax credits, and operating loss carryforwards are treated as deferred tax assets, whereas those of taxable temporary differences are accounted for as deferred tax liabilities. A valuation allowance is provided for deferred tax assets by assessing whether it is more likely than not such assets will realize. Adjustments to prior years' earnings are reported under stockholders' equity rather than included in current earnings. Income tax expense or benefits resulting from unearned gain or loss or changes in capital surplus are reported under respective accounts in net. Adjustments to prior years' income taxes are reflected as current income taxes.

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

The 10% surtax on undistributed earnings is reported as current expense on the date of the annual stockholder's meeting declaring distribution of earnings.

q. Earnings per Share ("EPS")

EPS is based on the effect of all common shares issued and outstanding and is calculated by dividing net income by the weighted-average shares outstanding during the year. In the event of capital increase through capitalization of retained earnings or capital surplus, EPS is retroactively adjusted to reflect the capital increase for all years presented in the financial statements, regardless of the outstanding period in which the incremental shares are issued.

3. Cash and Cash Equivalents

| | <u>December 31, 2003</u> | <u>December 31, 2002</u> |
|---|---------------------------------|---------------------------------|
| Cash on hand | \$ 504 | 509 |
| Checking accounts | 12,653 | 13,849 |
| Demand deposits | 17,540 | 12,724 |
| Time deposits | 1,713,110 | 441,100 |
| Foreign currency time deposits | 4,297,402 | 7,062,580 |
| Foreign currency deposits | 90,845 | 57,156 |
| Cash equivalents (short-term bills and bonds) | 2,861,378 | 138,000 |
| Total | <u>\$ 8,993,432</u> | <u>7,725,918</u> |

4. Accounts Receivable

| | <u>December 31, 2003</u> | <u>December 31, 2002</u> |
|---------------------------------------|---------------------------------|---------------------------------|
| Accounts receivable - other customers | \$ 10,378,545 | 4,330,729 |
| Less: Allowance for doubtful accounts | (6,110) | (2,568) |
| Net | 10,372,435 | 4,328,161 |
| Accounts receivable - related parties | 5,917,967 | 9,922,147 |
| Total | <u>\$ 16,290,402</u> | <u>14,250,308</u> |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

5. Inventories

| | <u>December 31, 2003</u> | <u>December 31, 2002</u> |
|--|--------------------------|--------------------------|
| Raw materials | \$ 1,081,886 | 1,640,375 |
| Work in process | 373,408 | 508,152 |
| Finished goods | 627,126 | 833,277 |
| Supplies-in-transit | - | 24,942 |
| | <u>2,082,420</u> | <u>3,006,746</u> |
| Less: Allowance for market decline and obsolescence | (437,662) | (472,660) |
| Net | <u>\$ 1,644,758</u> | <u>2,534,086</u> |
| Insurance coverage | <u>\$ 3,508,580</u> | <u>4,908,230</u> |

6. Long-Term Equity Investments

| <u>Name of Investee Company</u> | <u>December 31, 2003</u> | | | <u>December 31, 2002</u> | | |
|---|--------------------------|----------------------|----------------------------|--------------------------|-------------------|----------------------------|
| | <u>Equity Holding</u> | <u>Book Value</u> | <u>Original Investment</u> | <u>Equity Holding</u> | <u>Book Value</u> | <u>Original Investment</u> |
| <u>Carried under the equity method</u> | | | | | | |
| Inventec Besta Co., Ltd. | 38.69% | \$ 1,185,758 | 765,058 | 38.69% | 1,193,248 | 765,058 |
| Inventec Corporation (Hong Kong) Co., Ltd. | 100.00% | 359,030 | 8,705 | 100.00% | 1,743,106 | 781,090 |
| Inventec Corporation (Scotland) Co., Ltd. | 100.00% | 298,207 | 39,518 | 100.00% | 233,934 | 39,518 |
| Inventec Corporation (Singapore) Co., Ltd. | 100.00% | 6,688 | 6,888 | 100.00% | 6,829 | 6,888 |
| Inventec Holding (North America) Co., Ltd. | 100.00% | 412,120 | 159,003 | 100.00% | 384,704 | 159,003 |
| Inventec Multimedia and Telecom Corp. | 59.60% | 1,367,135 | 967,400 | 59.71% | 1,266,019 | 967,400 |
| Inventec Micro-Electronics Corp. | 70.48% | 399,324 | 401,625 | 70.48% | 432,381 | 401,625 |
| Inventec Appliances Corp. | 50.13% | 2,970,536 | 2,489,325 | 95.03% | 4,226,211 | 3,544,475 |
| Inventec Corporation (Cayman) Co., Ltd. | 100.00% | 2,870,797 | 2,720,758 | 100.00% | 416,463 | 556,463 |
| Inventec Tomorrow Studio Corp. | 60.00% | 185,878 | 298,800 | 60.00% | 208,704 | 298,800 |
| Subtotal | | <u>10,055,473</u> | | | <u>10,111,599</u> | |
| <u>Carried under the cost method</u> | | | | | | |
| <u>Common Stock</u> | | | | | | |
| WK Technology Fund IV | 1.52% | 40,000 | | 1.52% | 40,000 | <u>Fair Value</u> |
| SINA.COM | - | - | | 0.78% | 13,802 | <u>72,547</u> |
| Eastern Broadband | 0.15% | 100,000 | | 0.15% | 100,000 | |
| Storage Bank Inc. | 10.09% | 26,400 | | 10.09% | 26,400 | |
| <u>Preferred Stock</u> | | | | | | |
| E28 Limited | | 1,394,600 | | | 1,394,600 | |
| Subtotal | | <u>1,561,000</u> | | | <u>1,574,802</u> | |
| <u>Prepaymentwts for long-term investment</u> | | | | | | |
| Inventec (Czech) S.R.O. | | 69,873 | | | - | |
| Inventec Eriterprise System Corporation | | 200,000 | | | - | |
| Global Strategic Investment Fund | | 100,000 | | | - | |
| Subtotal | | <u>369,873</u> | | | <u>-</u> | |
| Total | | <u>\$ 11,986,346</u> | | | <u>11,686,401</u> | |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

In 2003 and 2002, investment income (loss) where the Company has controlling interest or can exercise significant influence were the following:

| <u>Name of investee company</u> | <u>2003</u> | <u>2002</u> |
|--|---------------------|----------------|
| Inventec Besta Co., Ltd. | \$ 8,089 | 13,507 |
| Inventec Corporation (Hong Kong) Co., Ltd. | (11,679) | 255,818 |
| Inventec Corporation (Scotland) Co., Ltd. | 58,505 | 39,656 |
| Inventec Corporation (Singapore) Co., Ltd. | (216) | (1,038) |
| Inventec Holding (North America) Co., Ltd. | 42,348 | 65,845 |
| Inventec Multimedia and Telecom Corp. | 126,654 | 32,614 |
| Inventec Micro-Electronics Corp. | (15,568) | 15,034 |
| Inventec Online Corp. (dissolved after merger) | - | (9,010) |
| Inventec Appliances Corp. | 1,299,250 | 515,660 |
| Inventec Corporation (Cayman) Co., Ltd. | 331,618 | (138,111) |
| Inventec Tomorrow Studio Corp. | (22,826) | (48,790) |
| Total | <u>\$ 1,816,175</u> | <u>741,185</u> |

Registered capital of the wholly-owned subsidiary Inventec Corporation (Hong Kong.) Co., Ltd. was HK\$2,500 (US\$322), representing 2,500,000 shares. On January 2, 2003, the Company sold all shares of Inventec Appliances (Shanghai) Co., Ltd. originally held by Inventec Corporation (Hong Kong) Co., Ltd. to Inventec Appliance (Cayman) Holding Corp., an investee company of Inventec Appliances Corp. for US\$31,918, resulting in loss of US\$1,518. Recognition of the loss is deferred until the shares of Inventec Appliances (Shanghai) Co., Ltd. are sold to a non-related party. As of December 31, 2003, the Company received returned capital of US\$24,865 (Reflected as advance receipts for capital in Inventec Corporation (Hong Kong) Co., Ltd's accounts. Cash capitalization procedures have not been processed).

Effective March 1, 2001, wholly-owned subsidiary Inventec Corporation (Singapore) Co., Ltd. temporarily ceased operations. Its registered capital was SG\$350 (US\$250), representing 350,000 shares with par value of SG\$1. The Company is entitled to 349,625 shares, and 375 shares are registered under individuals. Shareholding ratio was 100%.

The wholly-owned subsidiary Inventec Corporation (Cayman) Co., Ltd. was founded in November 2000 with a registered capital of US\$6,500, which was approved by Investment Commission's Letter Ruling No. (89)(2)89037593. In 2003 and 2002, the Company increased its investment by US\$63,000 and US\$10,000, respectively, and the investments were approved by Investment Commission's Letter Ruling No. (92)(2)092029469, (92)(2)091049980, (91)(2)091023283 and (90)(2)90025133. As of December 31, 2003, registered capital for investments in Mainland China was US\$79,500.

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

The Company's investee, Inventec Appliances Corp. increased capital with cash in June 2002. Pursuant to the Company law, 10% of new shares were withheld for employee subscription. Consequently, shareholding ratio declined from 99.99% to 95.59%. In November 2002, Inventec Online Corp. merged with Inventec Appliances Corp. with Inventec Appliances Corp. as the surviving company. After the merger, The Company's ownership in Inventec Appliances Corp. decreased to 95.03%. On May 30, 2003, the Company's shareholders meeting resolved to sale 105,515,000 shares of Inventec Appliance Corp. in order to meet the ownership diversification requirement for Inventec Appliances Corp's application for listed stocks. Gain on disposal of investment was \$540,824. Consequently, shareholding ratio declined to 50.13%.

In September 2003, the Company established Inventec (Czent) S.R.O, with a registered capital of US\$2,000. As of December 31, 2003, the Company remitted EUR1,806 and registration has not been completed.

As of December 31, 2003, the Company established Inventec Enterprise System Corporation, with a registered capital of \$200,000. Shareholding ratio was 100%. As of December 31, 2003, registration has not been completed.

In September 2003, the Company sold shares of SINA.COM to non-related parties for a disposal gain of \$261,290.

In October 2002, the Company purchased 40,000,000 shares of convertible preferred stock of E28 Limited for US\$40,000. The preferred shares pay a dividend of 4% per annum and the dividend is neither cumulative nor participating.

The fiscal year of Inventec Corporation (Singapore) Co., Ltd. ends on March 31 and those of Inventec Holding (North America) Co., Ltd. and Inventec Corporation (Scotland) Co., Ltd. end on September 30.

In 2003 and 2002, cash dividends from investee companies were the following:

| <u>Name of investee company</u> | <u>2003</u> | <u>2002</u> |
|--|-------------------|---------------|
| Inventec Corporation (Hong Kong) Co., Ltd. | \$ 524,385 | - |
| Inventec Appliances Corp. | 117,802 | - |
| Inventec Besta Co., Ltd. | 12,270 | 16,359 |
| Inventec Micro-Electronics Corp. | 14,040 | 21,060 |
| WK Technology Fund IV | 600 | 6,000 |
| Total | <u>\$ 669,097</u> | <u>43,419</u> |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

The Company has controlling interests in Inventec Appliances Corp., Inventec Holding (North America) Co., Ltd., Inventec Corp. (Scotland) Co., Ltd., Inventec Multimedia & Telecom Corp., Inventec Corp. (Hong Kong) Co., Ltd., and Inventec Corporation (Cayman Is.) Co., Ltd. and therefore the above investees were included in consolidated financial statements. Since total assets or total operating revenues of Inventec Corp. (Singapore) Co., Ltd., Inventec Micro-Electronics Corp., and Inventec Tomorrow Studio Corp., do not exceed 10% of the Company's respective accounts, and the combined total assets or operating revenues of these investee companies do not exceed 30% of the Company's respective accounts, the above investees were not included in the consolidated financial statements.

7. Property, Plant, and Equipment

| <u>December 31, 2003</u> | <u>Cost</u> | <u>Accumulated Depreciation</u> | <u>Net</u> |
|---------------------------------|----------------------------|-------------------------------------|-------------------------|
| Land | \$ 788,144 | - | 788,144 |
| Buildings | 427,252 | 115,747 | 311,505 |
| Machinery | 543,367 | 391,235 | 152,132 |
| Transportation equipment | 24,458 | 23,480 | 978 |
| Furniture and office facilities | 906,786 | 623,703 | 283,083 |
| Electrical equipment | 72,954 | 55,424 | 17,530 |
| Renovation | 82,816 | 68,442 | 14,374 |
| Miscellaneous equipment | 41,988 | 30,338 | 11,650 |
| Construction in progress | 15,260 | - | 15,260 |
| Prepayment for equipment | 737 | - | 737 |
| Total | <u>\$ 2,903,762</u> | <u>1,308,369</u> | <u>1,595,393</u> |
| | | | |
| <u>December 31, 2002</u> | | | |
| Land | \$ 788,870 | - | 788,870 |
| Buildings | 427,252 | 100,403 | 326,849 |
| Machinery | 960,222 | 658,096 | 302,126 |
| Transportation equipment | 24,458 | 21,924 | 2,534 |
| Furniture and office facilities | 849,137 | 582,535 | 266,602 |
| Electrical equipment | 255,851 | 140,606 | 115,245 |
| Renovation | 88,348 | 71,806 | 16,542 |
| Miscellaneous equipment | 47,269 | 34,366 | 12,903 |
| Prepayment for equipment | 460 | - | 460 |
| Total | <u>\$ 3,441,867</u> | <u>1,609,736</u> | <u>1,832,131</u> |

As of December 31, 2003 and 2002, fire and auto accident insurance coverage of the above property, plant, and equipment amounted to \$4,228,755 and \$3,943,151, respectively.

In 2003 and 2002, interest capitalized was \$0.

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

8. Other Assets

| | <u>December 31, 2003</u> | <u>December 31, 2002</u> |
|--|--------------------------|--------------------------|
| Deferred expenses | \$ 64,851 | 50,629 |
| Temporary payments | 8,733 | 8,893 |
| Rental assets, net of accumulated depreciation | 3,418 | 3,495 |
| Idle assets, net of accumulated depreciation | 63,581 | 619,918 |
| Prepayment for molds and tools | 16,890 | 23,887 |
| Overdue accounts in collection | 25,076 | 24,500 |
| Less: Allowance for doubtful accounts | (25,076) | (24,500) |
| Total | <u>\$ 157,473</u> | <u>706,822</u> |

On May 18, 1998, the Company provided idle land located at Nanjing East Road and demolished construction built thereupon. The construction of the new building and renovations was completed in late September 2002. The building is reflected under idle assets since the building is unused.

In November 2002, due to a change in operation policy, operating activities at the plant and factories located in Lin-Kou Industrial Park were decreased. Related land and buildings were transferred from property, plant, and equipment to idle assets. As of December 31, 2003, land, buildings, and facilities related to the factory were sold to non-related parties for \$610,000, resulting in a disposal loss of \$42,500.

As of December 31, 2003 and 2002, insurance coverage of the above idle and rental assets amounted to \$55,000 and \$201,000, respectively.

9. Pension Plan

The Company has a pension plan covering all employees, and payment is commensurate with years of service. 2 units are granted for each of the first 15 years of service, and 1 unit for each of the years thereafter, up to a maximum of 45 units. Any fraction of a year shorter than 6 months is counted as half a year and any fraction of a year longer than 6 months is counted as 1 year of service. Effective February 1987, the Company contributed to the pension fund deposited with Central Trust of China. As of December 31, 2003 and 2002, pension fund was \$404,894 and \$378,484, respectively.

Actuarial assumptions used for pension cost calculation in 2003 and 2002 were the following:

| | <u>2003</u> | <u>2002</u> |
|--|-------------|-------------|
| Discount rate | 4.00% | 4.00% |
| Growth rate of compensations in the future | 3.00% | 3.00% |
| Estimated long-term rate of return on investment | 4.00% | 4.00% |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

As of December 31, 2003 and 2002, reconciliation between funded status and accrued pension liabilities per books was the following:

| | <u>December 31,</u> <u>2002</u> | <u>December 31,</u> <u>2002</u> <u>(Before payment)</u> | <u>December 31,</u> <u>2002</u> <u>(Effect)</u> | <u>December 31,</u> <u>2002</u> <u>(After payment)</u> |
|--|------------------------------------|---|---|--|
| Benefit obligations: | | | | |
| Vested benefit obligation | \$ (36,567) | (14,426) | - | (14,426) |
| Non-vested benefit obligation | (693,380) | (745,201) | 253,564 | (491,637) |
| Accumulated benefit obligation | (729,947) | (759,627) | 253,564 | (506,063) |
| Effect of increase in future salary | (134,328) | (391,682) | 163,702 | (227,981) |
| Estimated benefit obligation | (864,275) | (1,151,309) | 417,266 | (734,044) |
| Fair value of pension fund assets | 404,894 | 378,483 | - | 378,484 |
| Funded status | (459,381) | (772,826) | 417,266 | (355,560) |
| Unrecognized net transitional benefit obligation | (64,914) | (126,644) | 45,899 | (80,745) |
| Unamortized prior years' service cost | 61,006 | - | - | - |
| Unrecognized gain on pension fund assets | 255,782 | 433,785 | (157,215) | 276,570 |
| Retroactive recognition of accrued pension liabilities | (117,546) | - | - | - |
| Accrued pension liabilities | <u>\$ (325,053)</u> | <u>(465,685)</u> | <u>305,950</u> | <u>(159,735)</u> |

In 2002, there were significant changes in the Company's personnel. A portion of the employees accepted retirement. Gain on payment amounted to \$309,950, reflected under salary expense as a deduction to pension fund.

As of December 31, 2003 and 2002, vested benefit was \$37,810 and \$14,920, respectively.

In 2003 and 2002, components of net pension costs were the following:

| | <u>2003</u> | <u>2002</u> |
|--|------------------|------------------|
| Service cost | \$ 63,228 | 75,445 |
| Interest cost | 29,362 | 57,487 |
| Actual return on pension fund assets | \$ (5,492) | (10,480) |
| Gain on pension fund assets | (9,647) | (12,347) |
| Estimated return on pension fund assets | (15,139) | (22,827) |
| Amortization of unrecognized net transitional obligation | (15,831) | (15,831) |
| Amortization of gain on pension fund | 18,744 | 19,154 |
| Gain on payment | - | (305,950) |
| Net pension costs | <u>\$ 80,364</u> | <u>(192,522)</u> |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

10. Income Tax

1. Deferred income tax assets and liabilities:

| | <u>December 31, 2003</u> | <u>December 31, 2002</u> |
|---|--------------------------|--------------------------|
| a. Total deferred tax assets | \$ 651,295 | 306,609 |
| b. Total deferred tax liabilities | (452,771) | (425,086) |
| | | |
| | Income Tax | Income Tax |
| c. Temporary differences: | Amount | Effects |
| | Amount | Effects |
| - Recognition of unrealized foreign exchange loss: deductible | \$ 41,376 | 10,344 |
| - Recognition of inventory obsolescence : deductible | 437,662 | 109,416 |
| - Recognition of warranty expenses: deductible | 753,181 | 188,295 |
| - Recognition of loss on overseas investments: taxable | (593,383) | (148,346) |
| - Recognition of gain on investments: taxable | (945,467) | (236,367) |
| - Recognition of unrealized intercompany profits: taxable | (157,698) | (39,424) |
| - Cumulative translation adjustment to long-term investments: taxable | (114,535) | (28,634) |
| - Recognition of pension expense: deductible | 204,764 | 51,191 |
| - Unused balance of investment tax credits | - | 292,049 |
| | | |
| | <u>December 31, 2003</u> | <u>December 31, 2002</u> |
| 2. Deferred tax assets - current | \$ 600,104 | 267,299 |
| Deferred tax liabilities - current | - | - |
| Net | <u>\$ 600,104</u> | <u>267,299</u> |
| | | |
| 3. Deferred tax assets - non-current | \$ 51,191 | 39,310 |
| Deferred liabilities - non-current | (452,771) | (425,086) |
| Net | <u>\$ (401,580)</u> | <u>(385,776)</u> |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

4. Income taxation calculation for 2003 and 2002 were the following:

| | <u>2003</u> | <u>2002</u> |
|---|---------------------------|-----------------------|
| Income tax calculated per statutory tax rate | \$ 1,040,037 | 956,531 |
| Permanent differences | (607,403) | (134,956) |
| Temporary differences | (49,793) | (137,101) |
| Tax-exempt income | (118,491) | (61,795) |
| Investment tax credits | <u>(132,175)</u> | <u>(263,030)</u> |
| Current income tax payable | 132,175 | 359,649 |
| Income tax separately levied | 1,843 | 3,804 |
| Prior years' income tax adjustments | 20,226 | (24,322) |
| Unused balance of investment tax credits | (292,049) | - |
| Income tax effect of temporary differences: | | |
| Provision and reversal of inventory obsolescence, net | 8,749 | 106,871 |
| Provision and reversal of loss on overseas investments, net | 107,888 | (15,274) |
| Provision and reversal of warranty reserve, net | (61,906) | 19,971 |
| Recognition of loss on investments | (25,952) | 55,543 |
| Recognition of unrealized intercompany gains, net | 20,494 | 4,792 |
| Recognition of unrealized foreign currency exchange loss (gain), net | 12,401 | (93,365) |
| Recognition of pension expense | <u>(11,881)</u> | <u>58,563</u> |
| Income tax expense (benefit) | <u><u>\$ (88,012)</u></u> | <u><u>476,232</u></u> |

5. The Company's tax returns through 1998 have been assessed by the Tax Authority. Additional tax assessed for 1997 and 1998 was \$31,743 and \$51,737, respectively. The Company has petitioned for administrative relief.

6. Stockholders' Imputation Tax Credit Account and Tax Rate:

| | <u>December 31, 2003</u> | <u>December 31, 2002</u> |
|---|--------------------------|--------------------------|
| Stockholder's imputation tax credit account | <u>\$ 355,108</u> | <u>490,605</u> |

In 2003 and 2002, after filing the corporate income tax returns, the estimated and the actual imputation tax credit rate for earnings distributed to R.O.C. residents would approximately be 7.58% and 11.33%, respectively.

| <u>Undistributed earnings:</u> | <u>December 31, 2003</u> | <u>December 31, 2002</u> |
|--------------------------------------|--------------------------|--------------------------|
| Accumulated prior to 1997 and before | \$ 477,632 | 477,632 |
| Accumulated after 1998 | 4,207,784 | 3,351,029 |
| Total | <u>\$ 4,685,416</u> | <u>3,828,661</u> |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

7. According to Article 6, Section 3 of the Statute of Upgrading Industries, unused investment tax credits which may be applied to offset income tax in the future are the following:

| <u>Year of occurrence</u> | <u>Investment tax credits</u> | <u>Year of expiration</u> |
|---------------------------|-------------------------------|---------------------------|
| 2003 | \$ 292,049 | 2007 |

11. Capital Increase

On May 30, 2003, pursuant to resolutions of the annual stockholders' meeting, the Company capitalized earnings of \$1,835,000, and employee bonuses of \$75,000, for a total of \$1,910,000. Total capital after the increase was \$20,260,000 with July 21, 2003 as the record date. The Company completed relevant registration change.

On May 30, 2002, pursuant to resolutions of the annual stockholders' meeting, the Company capitalized earnings of \$1,411,595, capital surplus of \$249,105 and employee bonuses of \$82,300, for a total of \$1,743,000. Total capital after the increase was \$18,350,000 with July 16, 2002 as the record date. The Company completed relevant registration change.

12. Earnings Distribution

The Articles of Incorporation of the Company mandate that after-tax earnings should first offset cumulative losses, then 10% of the remainder be set aside as legal reserve. Special reserve may be appropriated for operations or to meet regulations 7% and 3% of the remainder are appropriated as employee bonus and remuneration to directors and supervisors, respectively. The rest will be distributed per the proposal presented to annual stockholders' meeting for resolutions.

Information regarding the Company's 2002 earnings distribution for remuneration of directors and supervisors and employee bonuses resolved on May 30, 2003 and May 30, 2002 is as follows:

| | <u>2002</u> | <u>2001</u> |
|--|-------------------|----------------|
| Common stock dividends per share (dollars) | | |
| Cash | \$ 0.50 | 1.00 |
| Stock at par | 1.00 | 0.85 |
| Total | \$ 1.50 | 1.85 |
| | | |
| Employee bonus - stock at par | \$ 75,000 | 82,300 |
| Employee bonus - cash | 136,046 | 158,202 |
| Compensation to directors and supervisors | 90,448 | 103,072 |
| Total | \$ 301,494 | 343,574 |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

The above earnings distribution is the same as the Board of Directors meeting resolutions. If the above employee bonus and remuneration to directors and supervisors were distributed as cash and included in current expenses, then basic earnings per share (after tax) would decrease from \$1.83 and \$2.27 to \$1.66 and \$2.07, respectively, for 2002 and 2001. The total number of employee bonus issued was 0.41% and 0.5%, respectively, of the total number of shares outstanding as of December 31, 2002 and 2001.

The proposal for the appropriation of employee bonus and remuneration to directors and supervisors for 2003 has yet to be presented in the shareholders' meeting. Information regarding employee bonus and remuneration to directors and supervisors distributed shall be posted on the market observation post system after the related meetings are held.

13. Earnings Per Share

EPS is calculated by dividing net income by the weighted-average shares outstanding during the period. As of December 31, 2003 and 2002, weighted-average number of common shares outstanding were 2,026,000,000 and 1,835,000,000, respectively. As of December 31, 2002, the number of outstanding shares retroactively adjusted due to stock dividends was 2,026,000,000.

I. Financial Instruments

(1) **Financial Derivatives: None.**

(2) **Fair Value of Financial Instruments**

| | December 31, 2003 | |
|--------------------------------|--------------------------|-------------------|
| Financial Assets | Book Value | Fair Value |
| Book value equal to fair value | \$ 35,821,610 | 35,821,610 |
| Long-term investments | 11,986,346 | 11,746,182 |
| Total | \$ 47,807,956 | 47,567,792 |
| | | |
| Financial Liabilities | | |
| Book value equal to fair value | \$ 22,278,380 | 22,278,380 |
| | | |
| | December 31, 2002 | |
| Financial Assets | Book Value | Fair Value |
| Book value equal to fair value | \$ 24,886,489 | 24,886,489 |
| Long-term investments | 11,686,401 | 11,814,319 |
| Total | \$ 36,572,890 | 36,700,808 |
| | | |
| Financial Liabilities | | |
| Book value equal to fair value | \$ 15,504,220 | 15,504,220 |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

Method and assumptions used by the Company to evaluate the fair value of financial instruments are the following:

- (a) The fair value of short-term financial instruments is determined by their face value on the balance sheet. Since such instruments will mature with short notice, the face value is a reasonable basis in establishing the fair value. The method is applicable to cash and cash equivalents, notes and accounts receivable, other current assets, short-term borrowings, notes and accounts payable, and other current liabilities.
- (b) The book value of long-term investments is accounted for under the cost or the equity method based on audited or self-prepared financial statements of investee companies. Since there are no market quotes or reference reports for non-listed companies, fair value of these investments are determined by their net equity worth or cost.
- (c) With respect to financial instruments such as refundable deposits that are indispensable guarantee for the ongoing operations of the Company, it is impossible to estimate the time necessary to accomplish exchange of assets. Consequently, the fair market value of such financial instruments cannot be established. The book value is used as the fair market value.

(3) Financial Instruments with Off-Balance-Sheet Credit Risk:

As of December 31, 2003 and 2002, guarantees provided by the Company to related parties for their bank loans were US\$110,000, GBP500 and US\$111,500, GBP500, respectively.

As of December 31, 2003 and 2002, promissory notes issued for bank loans were \$6,058,292 and \$5,913,292, respectively.

(4) Information on Concentration of Credit Risk:

Concentrations of credit risk exist when changes in economic, industry or geographic factors similarly affect groups of counter-parties whose aggregate credit exposure is material in relation to the Company's total credit exposure. As of December 31, 2003 and 2002, the Company's contracts with credit risk concentration were the following:

| <u>Accounts Receivable- By Region</u> | <u>December 31, 2003</u> | <u>December 31, 2002</u> |
|---------------------------------------|--------------------------|--------------------------|
| Domestic | \$ 1,095,219 | 889,065 |
| Asia | 6,745,795 | 3,443,679 |
| Europe | 4,774,147 | 4,975,455 |
| Americas | 3,626,460 | 4,902,188 |
| Australia | 48,781 | 39,921 |
| Total | <u>\$ 16,290,402</u> | <u>14,250,308</u> |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

15. Related Party Transactions

A. Name of Related Party and their Relationship with the Company:

| Name of Related Party | Relationship with the Company |
|--|--|
| Inventec Besta Co., Ltd. | An investee company accounted for under the equity method |
| Inventec Corporation (Scotland) Co., Ltd. | A subsidiary |
| Inventec Multimedia and Technology Corp. | " |
| Inventec Micro-Electronic Corp. | " |
| Inventec Appliances Corp. | " |
| Inventec Corporation (Hong Kong) Co., Ltd. | " |
| Inventec Holding (North America) Co., Ltd. | " |
| Inventec Corporation (Cayman) Co., Ltd. | " |
| Inventec Tomorrow Studio Corp. | " |
| Inventec Electronics (Beijing) Co., Ltd. | A subsidiary of Inventec Corporation (Hong Kong) Co., Ltd. |
| Inventec Electronics (Nanking) Co., Ltd. | " |
| Inventec Electronics (Tianjin) Co., Ltd. | " |
| Inventec Appliances (Shanghai) Co., Ltd. | A third-level subsidiary of Inventec Appliances Corp. |
| Inventec Corp. (Shanghai) Co., Ltd. | A subsidiary of Inventec Corporation (Cayman) Co., Ltd. |
| Inventec (Pudong) Corp. | " |
| Inventec Electronics (M) SDN. BHD. | A subsidiary of Inventec Multimedia and Telecom Corp. |

B. Significant Transactions with Related Parties:

1) Sales

| Name of Related Party | 2003 | | 2002 | |
|--|---------------------|----------------|-------------------|----------------|
| | Amount | % of Net Sales | Amount | % of Net Sales |
| Inventec Electronics (M) SDN. BHD. | \$ 315,828 | - | 665,132 | 1% |
| Inventec Corporation(Scotland) Co., Ltd. | 13,731,829 | 17% | 18,212,535 | 27% |
| Invertec Holding (North America) Co., Ltd. | 12,894,114 | 16% | 14,794,853 | 22% |
| Inventec Corporation (Hong Kong) Co., Ltd. | 847,078 | 1% | 9,083,180 | 13% |
| Others | 1,817 | - | 4,055 | - |
| Total | \$27,790,666 | 34% | 42,759,755 | 63% |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

Prices of sale of motherboards to Inventec Electronics (M) SDN. BHD. are based on cost with collection terms varying between one to three months.

The Company sold work-in-process to the assembling department of Inventec Corporation (Scotland) Co., Ltd. and upon completion of assembling, finished products were sold to non-related parties. Prices of work-in-process are negotiated. Since Inventec Corporation (Scotland) Co. is an overseas after-sales service and assembling center, no basis of price reference exists. Collection period is within two months.

The Company sold work-in-process to Inventec Holding (North America) Co., Ltd. Prices of work-in-process are negotiated. Since Inventec Holding (North America) Co., Ltd. is an overseas after-sales service and assembling center, no basis of price reference exists. Collection period is within three months.

Prices of finished goods sold to Inventec Corporation (Hong Kong) Co., Ltd. are the same as those with other clients. Collection period is within two months.

As of December 31, 2003 and 2002, unrealized gross profit of sales to related parties was \$3,075 and \$99,201, respectively.

2) Warranty Services and Product Maintenance

In 2003 and 2002, payment to related parties for service and maintenance expenses, after netting product warranty reserve, was the following:

| <u>Name of Related Party</u> | <u>2003</u> | <u>2002</u> |
|--|-------------------|----------------|
| Inventec Holding (North America) Co., Ltd. | \$ 279,532 | 266,665 |
| Inventec Corporation (Scotland) Co., Ltd. | 156,947 | 139,939 |
| Total | <u>\$ 436,479</u> | <u>406,604</u> |

3) Purchases

In 2003 and 2002, purchases of materials and goods were the following:

| <u>Name of Related Party</u> | <u>2003</u> | | <u>2002</u> | |
|--|----------------------|---------------------------|-------------------|---------------------------|
| | <u>Amount</u> | <u>% of Net Purchases</u> | <u>Amount</u> | <u>% of Net Purchases</u> |
| Inventec Corporation (Hong Kong) Co., Ltd. | \$ 47,091,624 | 63% | 12,020,654 | 34% |
| Inventec Electronics (M) SDN. BHD. | 1,014,063 | 1% | 2,039,941 | 6% |
| Inventec Holding (North America) Co., Ltd. | 151,424 | - | - | - |
| Inventec Corporation (Scotland) Co., Ltd. | 457,635 | 1% | - | - |
| Others | 7,953 | - | 8,320 | - |
| Total | <u>\$ 48,722,699</u> | <u>65%</u> | <u>14,068,915</u> | <u>40%</u> |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

The Company purchased motherboards from Inventec Electronics (M) SDN. BHD. at an agreed-upon price. The payment term is approximately one to three months.

The Company purchased finished goods and work in process from Inventec Corporation (Hong Kong) Co., Ltd. at an agreed-upon price. The payment term is approximately two to three months.

The Company purchased supplies used for warranty service from Inventec Holding (North America) Co., Ltd. at an agreed-upon price. The payment term is within two months.

The Company purchased supplies used for warranty service from Inventec Corporation (Scotland) Co., Ltd. at an agreed-upon price. The payment term is within two months.

In 2002, unrealized gross profit of purchases from related parties, reflected as a deduction of long-term investments, was \$5,910.

4) Technical Service

The Company entered into an agreement with Inventec Besta Co., Ltd., which would pay royalty to the Company for use of patents and copyrights in the manufacturing of information and electronic-related products. Royalty is determined by sales volume. In 2003 and 2002, royalty collected from Inventec Besta Co., Ltd. was \$2,410 and \$5,061, respectively.

The Company entered into an agreement with Inventec Tomorrow Studio Corp. in which the Company collects royalty through production, distribution, and sale of Dr Eye 2002. Royalty is based on sales volume. In 2003 and 2002, royalty collected from Inventec Tomorrow Studio Corp. for the right to sale computer software amounted to \$5,864 and \$4,948, respectively.

5) Purchase of Software

In 2003 and 2002, purchase of software for product development from Inventec Corporation (Hong Kong) Co., Ltd., reflected as deferred expense, was \$172,788 and \$375,799, respectively. Prices were negotiated with payment terms of two to three months.

6) Others

(1) In 1999, the Company sold properties, deferred assets, assets stated under expense, and trademarks to Inventec Besta Co., Ltd., resulting in a gain on property disposition of \$51,712 and other revenue of \$40,453. As of December 31, 2003 and 2002, unrealized gain on sale of properties to Inventec Besta Co., Ltd. was \$17,517 and \$17,708, respectively, with unrealized other revenue of \$4,270 and \$5,040, respectively.

(2) In 2000, the Company invested in Inventec Appliances Corp. with properties, deferred assets, and assets stated under expense resulting in a gain on asset disposition of \$103,713 and other revenue of \$31,693. The Company sold properties and deferred assets, resulting in a gain on property disposition of \$1,156 and other revenue of \$6,427. As of December 31, 2003 and 2002, unrealized gain on sale of properties was \$59,323 and \$68,340, respectively, and unrealized other revenue was \$19 and \$33, respectively.

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

- (3) In 2003, the Company sold properties, deferred assets, and assets stated under expense to Inventec Corporation (Hong Kong) Co., Ltd. resulting in a gain on property disposition of \$44,946 and other revenue of \$2,562. As of December 31, 2003 and 2002, unrealized gain on sale of properties \$35,366 and \$20,738, respectively, and unrealized other revenue was \$1,750 and \$2,263, respectively.
- (4) In 2002, the Company subsidized Inventec Besta Co., Ltd. for \$9,442, reflected as other expense.
- (5) In 2003 and 2002, general and administrative expenses collected from Inventec Appliances Corp., Inventec Micro-Electronic Corp., Inventec Multimedia and Telecom Corp. and Inventec Tomorrow Studio Corp. were \$59,894 and \$49,775, respectively, reflected as other revenue.
- (6) As of December 31, 2003, promissory notes issued to Inventec Appliances Corp. for the Company's participation in the Ministry of Economic Affairs "Mobile Terminal Application Platform" plan amounted to \$50,292.

7) Accounts Receivable (Payable)

| | December 31, 2003 | | December 31, 2002 | |
|--|--------------------------|------------|--------------------------|------------|
| | Balance | % | Balance | % |
| Total notes receivable | \$ 776 | 99% | 1,193 | 3% |
| Accounts Receivable: | | | | |
| Inventec Holding (North America) Co., Ltd. | \$ 2,542,604 | 16% | 2,012,237 | 14% |
| Inventec Corporation (Scotland) Co., Ltd. | 3,278,312 | 20% | 4,602,774 | 33% |
| Inventec Electronics (M) SDN. BHD. | 63,223 | - | 197,753 | 1% |
| Inventec Corporation (Hong Kong) Co., Ltd. | 33,414 | - | 3,109,109 | 22% |
| Other | 414 | - | 274 | - |
| Total | \$ 5,917,967 | 36% | 9,922,147 | 70% |
| Total other receivables | \$ 31,563 | - | 52,867 | 38% |
| Other Current Assets: | | | | |
| Inventec Corporation (Hong Kong) Co., Ltd. | \$ 10,122,328 | 97% | 2,557,754 | 91% |
| Other | 606 | - | 1,282 | - |
| Total | \$ 10,122,934 | 97% | 2,559,036 | 91% |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

| | <u>December 31, 2003</u> | | <u>December 31, 2002</u> | |
|--|--------------------------|------------|--------------------------|------------|
| | <u>Balance</u> | <u>%</u> | <u>Balance</u> | <u>%</u> |
| Total notes payable | <u>\$ 169</u> | <u>-</u> | <u>2,864</u> | <u>-</u> |
| <u>Accounts Payable:</u> | | | | |
| Inventec Corporation (Hong Kong) Co., Ltd. | \$ 9,447,844 | 47% | 4,542,200 | 34% |
| Inventec Electronics (M) SDN. BHD. | 107,228 | 1% | 137,006 | 1% |
| Other | 4,055 | - | 181 | - |
| Total | <u>\$ 9,559,127</u> | <u>48%</u> | <u>4,679,387</u> | <u>35%</u> |
| <u>Other Current Liabilities:</u> | | | | |
| Inventec Corporation (Hong Kong) Co., Ltd. | <u>\$ 72,511</u> | <u>-</u> | <u>177,763</u> | <u>81%</u> |

8) Guarantee and Endorsements

| <u>Name of Related Party Guaranteed</u> | <u>December 31,</u> | | <u>December 31,</u> | | <u>Name of Bank</u> |
|--|---------------------|---------|---------------------|---------|------------------------|
| | <u>2003</u> | | <u>2002</u> | | |
| Inventec Corporation (Hong Kong) Co., Ltd. | US\$ | 15,000 | US\$ | 15,000 | Citibank, N.A. |
| Inventec Corporation (Cayman) Co., Ltd. | | 30,000 | | 30,000 | " |
| Inventec Appliances (Shanghai) Co., Ltd. | | - | | 14,500 | Bank of America |
| Inventec Electronics (Nanking) Co., Ltd. | | 1,500 | | 1,500 | " |
| Inventec Electronics (Tianjin) Co., Ltd. | | 2,500 | | 2,500 | " |
| Inventec Electronics (Beijing) Co., Ltd. | | 1,000 | | 1,000 | " |
| Inventec Corp. (Shanghai) Co., Ltd. | | 25,000 | | 25,000 | " |
| Inventec Corporation (Scotland) Co., Ltd. | GBP | 500 | GBP | 500 | Government of Scotland |
| " | US\$ | 28,000 | US\$ | 20,000 | Citibank, N.A. |
| Inventec Holding (North America) Co., Ltd. | US\$ | 2,000 | US\$ | 2,000 | Bank of America |
| Inventec (Pudong) Corp. | US\$ | 5,000 | | | " |
| Total | US\$ | 110,000 | US\$ | 111,500 | |
| | GBP | 500 | GBP | 500 | |

16. Pledged Assets

| <u>Asset</u> | <u>December 31, 2003</u> | <u>December 31, 2002</u> | <u>Purpose of pledge</u> |
|---------------------|--------------------------|--------------------------|--|
| Refundable deposits | <u>\$ 56,602</u> | <u>70,379</u> | Guarantees for foreign labor, customs duties, and property deposits. |

INVENTEC CORPORATION
NOTES TO FINANCIAL STATEMENTS (CONT'D)

17. Significant Commitments And Contingencies (Excluding Related Party Transactions)

- (1) As of December 31, 2003 and 2002, unused standby letters of credit were JPY4,480 and US\$1,721, respectively.
- (2) As of December 31, 2003 and 2002, promissory notes issued for bank loans totaled \$6,058,292 and \$5,913,292, respectively.

18. Other

- (1) Personnel, depreciation, and amortization expense incurred categorized as operating cost or expense are as follows:

| Categorized as Nature | 2003 | | | 2002 | | |
|---------------------------------------|-------------------|----------------------|-----------|-------------------|----------------------|-----------|
| | Operating Cost | Operating expense | Total | Operating Cost | Operating expense | Total |
| Personnel expense | | | | | | |
| Salary expense | \$ 565,752 | 1,157,721 | 1,723,473 | 1,142,753 | 1,300,295 | 2,443,048 |
| Health and labor insurance expense | 37,037 | 60,054 | 97,091 | 65,413 | 53,104 | 118,517 |
| Pension expense | 22,081 | 57,775 | 79,856 | 52,100 | 57,927 | 110,027 |
| Other expense | 441,086 | 82,549 | 523,635 | 284,529 | 111,352 | 395,881 |
| Depreciation expense | 94,563 | 129,607 | 224,170 | 170,283 | 127,460 | 297,743 |
| Amortization expense | 240,395 | 48,337 | 288,732 | 452,496 | 22,961 | 475,457 |

- (2) In October 13, 2000, Samsung Electronics Co., Ltd. ("Samsung") named the Company and 10 other parties as defendants for patents infringement in United States District Court for the District of Texas. The plaintiff claimed that the defendants violated six of its U.S. patents. Five of the six claims have been dropped by Samsung. Patent No. 5333273 is currently under trial. The Company has appointed a counsel for the litigation. In November 2002, the Magistrate Judge ruled that unless the Company and Samsung object within a stated period of time, the trial will be tried by a federal judge. After the judge's decision, the trial proceedings will continue. Litigation procedures will commence within a year after trial proceedings are underway.