

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES
Consolidated Financial Statements
December 31, 2002 and 2001
(With Independent Auditors' Report Thereon)

Independent Auditors' Report

The Board of Directors
Holtek Semiconductor Inc.

We have audited the consolidated balance sheets of Holtek Semiconductor Inc. and subsidiaries as of December 31, 2002 and 2001, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of certain subsidiaries included in the consolidated financial statements, which statements reflect total assets of \$250,297 thousand, constituting 8% of total consolidated assets as of December 31, 2002, and total revenue of \$1,131,471 thousand, constituting 34% of total consolidated revenue, for the year ended December 31, 2002. Those statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to these amounts, is based solely on the reports of the other auditors.

We conducted our audits in accordance with 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 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, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Holtek Semiconductor Inc. and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the Republic of China.

Hsinchu, Taiwan (the Republic of China)
January 10, 2003

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

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2002 and 2001
(In thousands of New Taiwan dollars)

	<u>2002</u>	<u>2001</u>		<u>2002</u>	<u>2001</u>
Assets			Liabilities and Stockholders' Equity		
Current assets:			Current liabilities:		
Cash and cash equivalents (note 3)	\$ 244,122	215,491	Short-term loans	\$ 17,836	-
Short-term investments (note 4)	823,851	841,113	Notes payable	224,857	224,161
Notes receivable	74,680	173,202	Accounts payable	213,221	214,045
Accounts receivable, net of allowance for doubtful accounts of \$12,000 and \$13,000 as of December 31, 2002 and 2001, respectively	468,931	322,247	Payables to related parties (note 15)	191,833	122,978
Receivables from related parties (note 15)	1,411	2,499	Current portion of long-term debt (note 8)	9,200	9,200
Inventories (note 5)	734,759	578,526	Accrued expenses and other current liabilities	<u>85,445</u>	<u>129,018</u>
Prepaid expenses and other current assets (note 13)	<u>88,714</u>	<u>83,682</u>	Total current liabilities	<u>742,392</u>	<u>699,402</u>
Total current assets	<u>2,436,468</u>	<u>2,216,760</u>	Long-term debt, excluding current installments (note 8)	<u>2,844</u>	<u>62,044</u>
Long-term equity investments (note 6)	92,025	10,330	Other noncurrent liabilities:		
Property, plant and equipment (notes 5, 15 and 16):			Pension accrual (note 9)	27,407	15,697
Buildings	190,260	186,785	Deposits in (note 10)	<u>45,807</u>	<u>59,022</u>
Machinery and equipment	203,557	196,381	Total other noncurrent liabilities	<u>73,214</u>	<u>74,719</u>
Furniture and fixtures	52,969	44,682	Total liabilities	818,450	836,165
Other equipment	<u>15,650</u>	<u>15,550</u>	Stockholders' equity (note 11):		
	462,436	443,398	Common stock	1,751,187	1,533,800
Less: accumulated depreciation	(174,921)	(122,576)	Capital surplus	152	152
Advances for purchases of machinery and equipment	<u>2,331</u>	-	Legal reserve	117,466	86,393
Net property, plant and equipment	289,846	320,822	Unappropriated earnings	350,792	310,953
Other noncurrent assets:			Foreign currency translation adjustment	<u>(18,150)</u>	<u>(13,681)</u>
Deferred expenses (note 7)	30,590	62,708	Total stockholders' equity	2,201,447	1,917,617
Deferred income tax assets (note 13)	151,242	107,759	Commitments and contingent liabilities (notes 8 and 17)		
Other (note 16)	<u>19,726</u>	<u>35,403</u>			
Total other noncurrent assets	<u>201,558</u>	<u>205,870</u>			
Total assets	<u>\$ 3,019,897</u>	<u>2,753,782</u>	Total liabilities and stockholders' equity	<u>\$ 3,019,897</u>	<u>2,753,782</u>

See accompanying notes to consolidated financial statements.

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Consolidated Statements of Income

Years ended December 31, 2002 and 2001

(In thousands of New Taiwan dollars, except earnings per common share)

	<u>2002</u>	<u>2001</u>
Sales (note 15)	\$ 3,373,533	3,330,287
Less: sales returns and allowances	<u>(22,527)</u>	<u>(36,216)</u>
Net sales	3,351,006	3,294,071
Cost of goods sold (note 15)	<u>2,374,925</u>	<u>2,451,623</u>
Gross profit	<u>976,081</u>	<u>842,448</u>
Operating expenses:		
Selling	152,035	144,202
Administrative	217,420	183,906
Research and development	<u>358,813</u>	<u>413,348</u>
	<u>728,268</u>	<u>741,456</u>
Operating income	<u>247,813</u>	<u>100,992</u>
Non-operating income:		
Interest income	3,188	17,111
Investment income	45,460	65,712
Foreign currency exchange gain, net	2,014	27,217
Other (note 17)	<u>28,697</u>	<u>40,612</u>
	<u>79,359</u>	<u>150,652</u>
Non-operating expenses:		
Interest expense	2,079	5,005
Other	<u>2,002</u>	<u>5,699</u>
	<u>4,081</u>	<u>10,704</u>
Income before income taxes	323,091	240,940
Income tax benefit (note 13)	<u>27,646</u>	<u>69,795</u>
Net income	<u>\$ 350,737</u>	<u>310,735</u>
	<u>Pre- After-</u>	<u>Pre- After-</u>
	<u>tax tax</u>	<u>tax tax</u>
Basic earnings per common share (Note 12)	<u>\$ 1.83 2.00</u>	<u>1.39 1.78</u>

See accompanying notes to consolidated financial statements.

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2002 and 2001

(In thousands of New Taiwan dollars)

	<u>Common stock</u>	<u>Capital surplus</u>	<u>Legal reserve</u>	<u>Unappro- priated earnings</u>	<u>Foreign currency translation adjustment</u>	<u>Total stockhold- ers' equity</u>
Balance as of January 1, 2001	\$ 1,220,000	152	25,267	611,831	12,993	1,870,243
Appropriation of earnings:						
Legal reserve	-	-	61,126	(61,126)	-	-
Stock dividends	231,800	-	-	(231,800)	-	-
Employees' bonuses	82,000	-	-	(82,572)	-	(572)
Cash dividends	-	-	-	(219,600)	-	(219,600)
Directors' and supervisors' remuneration	-	-	-	(16,515)	-	(16,515)
Net income for 2001	-	-	-	310,735	-	310,735
Foreign currency translation adjustment	-	-	-	-	(26,674)	(26,674)
Balance as of December 31, 2001	1,533,800	152	86,393	310,953	(13,681)	1,917,617
Appropriation of earnings:						
Legal reserve	-	-	31,073	(31,073)	-	-
Stock dividends	176,387	-	-	(176,387)	-	-
Employees' bonuses	41,000	-	-	(41,974)	-	(974)
Cash dividends	-	-	-	(53,069)	-	(53,069)
Directors' and supervisors' remuneration	-	-	-	(8,395)	-	(8,395)
Net income for 2002	-	-	-	350,737	-	350,737
Foreign currency translation adjustment	-	-	-	-	(4,469)	(4,469)
Balance as of December 31, 2002	\$ <u>1,751,187</u>	<u>152</u>	<u>117,466</u>	<u>350,792</u>	<u>(18,150)</u>	<u>2,201,447</u>

See accompanying notes to consolidated financial statements.

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2002 and 2001
(In thousands of New Taiwan dollars)

	<u>2002</u>	<u>2001</u>
Cash flows from operating activities:		
Net income	\$ 350,737	310,735
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	100,121	103,663
Loss from disposal of property, plant and equipment	667	127
Reversal of provision for inventory obsolescence and devaluation and allowance for doubtful accounts	(16,000)	(35,000)
Gain on investment income under equity method and from disposal of long-term equity investment	(15,791)	(9,703)
Increase in net deferred income tax assets	(29,555)	(85,357)
Increase in pension accrual	11,710	7,399
Decrease (increase) in accounts receivable	(67,124)	160,046
Decrease (increase) in inventories	(141,188)	49,267
Decrease (increase) in prepaid expenses and other current assets	(34,502)	38,072
Increase (decrease) in accounts payable	88,965	(426,841)
Decrease in accrued expenses and other current liabilities	<u>(24,664)</u>	<u>(196,578)</u>
Net cash provided by (used in) operating activities	<u>223,376</u>	<u>(84,170)</u>
Cash flows from investing activities:		
Additions to property, plant and equipment	(26,052)	(204,922)
Increase in deferred expenses	(11,306)	(11,710)
Decrease in short-term investments	17,262	12,886
Increase in long-term equity investments	(91,824)	(21,419)
Decrease (increase) in restricted bank deposits	17,900	(22,262)
Proceeds from disposal of long-term equity investment	22,347	33,120
Decrease in refundable deposits and other	<u>421</u>	<u>762</u>
Net cash used in investing activities	<u>(71,252)</u>	<u>(213,545)</u>
Cash flows from financing activities:		
Increase in long-term debt	17,723	-
Repayment of long-term debt	(59,200)	(19,817)
Increase (decrease) in deposits in	(12,571)	3,536
Payments of cash dividends, directors' remuneration and employees' bonuses	<u>(62,438)</u>	<u>(236,687)</u>
Net cash used in financing activities	<u>(116,486)</u>	<u>(252,968)</u>
Effect of exchange rate change on cash and cash equivalents	<u>(7,007)</u>	<u>(28,855)</u>
Net increase (decrease) in cash and cash equivalents	28,631	(579,538)
Cash and cash equivalents at beginning of year	<u>215,491</u>	<u>795,029</u>
Cash and cash equivalents at end of year	<u>\$ 244,122</u>	<u>215,491</u>
Supplemental disclosures of cash flow information:		
Cash payments for interest	<u>\$ 3,210</u>	<u>5,192</u>
Cash payments for income taxes	<u>\$ 18,708</u>	<u>71,678</u>
Supplemental disclosures of non-cash financing activities:		
Current installments of long-term debt	<u>\$ 9,200</u>	<u>9,200</u>

See accompanying notes to consolidated financial statements.

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2002 and 2001

(Amounts expressed in thousands of New Taiwan dollars, except for per share information and unless otherwise noted)

(1) Organization and Principal Activities

Holtek Semiconductor Inc. (the Company) was incorporated on October 1, 1998, as a company limited by shares under the laws of the Republic of China (ROC) and the ROC Statute for the Establishment and Administration of the Science-Based Industrial Park. The Company began operations on December 11, 1998. The Company established a Hong Kong branch in April 2000. The Company is engaged in the research, development, manufacture and sales of integrated circuits.

The shares of the Company have been traded on the Taiwan over-the-counter market since November 4, 2002.

The subsidiaries in which the Company directly or indirectly owns greater than 50 percent of the subsidiaries' voting shares are summarized below according to their primary business activities:

(a) Investing and holding companies:

<u>Company's name</u>	<u>Location</u>	<u>Incorporation date</u>	<u>Percentage directly or indirectly owned by the Company</u>	
			<u>2002</u>	<u>2001</u>
Holtek Semiconductor Holding (BVI) Ltd. (Holtek BVI)	British Virgin Islands	1999.12	100%	100%
Sigmos Holdings Ltd. (Sigmos)	British Virgin Islands	2000.12	100%	100%
Kingtek Semiconductor Holding (BVI) Ltd. (Kingtek BVI)	British Virgin Islands	2002.01	100%	-

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HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(b) Sales of integrated circuits and related technical service:

<u>Company's name</u>	<u>Location</u>	<u>Incorporation date</u>	<u>Percentage directly or indirectly owned by the Company</u>	
			<u>December 31,</u>	
			<u>2002</u>	<u>2001</u>
Holtek Semiconductor (HK) Ltd. (Holtek (HK))	Hong Kong	1999.12	100%	100%
Holtek Semiconductor (Shanghai) Inc. (Holtek (Shanghai))	China	2001.03	100%	100%
Holmate Semiconductor Inc. (Holmate)	United States of America	2001.05	100%	100%
Kingtek Semiconductor (Suzhou) Inc. (Kingtek (Suzhou))	China	2002.04	100%	-

(2) Summary of Significant Accounting Policies

(a) Accounting principles and consolidation policy

The consolidated financial statements include the accounts of the Company and subsidiaries in which the Company directly or indirectly owns greater than 50 percent of the subsidiaries' voting shares and is able to exercise control over the subsidiaries' operations and financial activities.

The subsidiaries included in the accompanying consolidated financial statements as of and for the year ended December 31, 2002, are Holtek BVI, Holtek (HK), Holtek (Shanghai), Sigmos, Holmate, Kingtek BVI and Kingtek (Suzhou). The subsidiaries included in the accompanying 2001 consolidated financial statements are Holtek BVI, Holtek (HK), Holtek (Shanghai), Sigmos and Holmate.

All significant inter-company balances and transactions are eliminated in consolidation.

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HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES**Notes to Consolidated Financial Statements****(b) Foreign currency transactions and translation**

Except for Holtek BVI, Kingtek BVI and Sigmos, the Company's foreign subsidiaries use their respective local currencies as their functional currencies and reporting currencies. Holtek BVI, Kingtek BVI and Sigmos use New Taiwan dollars as their functional currency and reporting currency. Foreign currency transactions are recorded at the exchange rate prevailing at the transaction date. At the balance sheet date, monetary assets and liabilities denominated in foreign currency are translated using the exchange rate on that date. The resulting exchange gains or losses from settlement of such transactions or translation of monetary assets and liabilities are reflected in the accompanying consolidated statements of income.

The financial statements of foreign subsidiaries are translated into New Taiwan dollars at the exchange rates prevailing on the balance sheet date, with the exception of stockholders' equity, which is translated at historical rates, and revenues, costs and expenses, which are translated at the weighted-average exchange rates during the reporting period. Translation differences resulting from the translation of such financial statements into New Taiwan dollars are recorded as a foreign currency translation adjustment, a separate component of stockholders' equity.

(c) Cash equivalents

The Company considers all highly liquid financial instruments, such as commercial paper purchased with a maturity of three months or less, to be cash equivalents.

(d) Short-term investments

Short-term investments are stated at the lower of cost or market value. Market value is determined using the net asset value of non-listed securities on the last day of the period.

(e) Inventories

Inventories are stated at the lower of cost or market value. Cost is determined using the weighted-average method. Market value is based on estimated net realizable value for merchandise, finished goods and work in process, and on replacement cost for materials and supplies.

(f) Long-term equity investments

Long-term equity investments in which the Company directly or indirectly owns less than 20% of the investee's voting shares and is not able to exercise significant influence over the investee's operations and financial policies are accounted for by the cost method. Investments are accounted for by the equity method where the Company owns more than 20% of the investee's outstanding shares of common stock.

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HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES**Notes to Consolidated Financial Statements****(g) Property, plant and equipment**

Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment is provided for by using the straight-line method over the estimated useful lives of the assets. Cost associated with significant additions, replacements and improvements to property, plant and equipment are capitalized.

As of December 31, 2002 and 2001, insurance coverage for property, plant and equipment amounted to \$286,440 and \$405,622, respectively.

(h) Deferred expenses

The costs of computer software, proprietary know-how and electronic power systems are recorded as deferred expenses and are amortized over periods ranging from two to five years, on a straight-line basis.

(i) Retirement plan

The Company established an employee non-contributory retirement plan (the Plan) covering all local regular employees in 1998. In accordance with the Plan, the Company's employees are eligible for retirement or are required to retire after meeting certain age or service requirements. Payments of retirement benefits are based on the years of service and the average salary for the six-month period before the employee's retirement. Each employee earns two months of salary for the first fifteen years of service, and one month of salary for each year of service thereafter. The maximum retirement benefit is 45 months of salary. The Company contributes 2 percent of wages and salaries to a pension fund maintained with the Central Trust of China on a monthly basis. Retirement benefits are paid to eligible participants on a lump-sum basis upon retirement.

The Company adopted ROC Statement of Financial Accounting Standards (SFAS) No. 18, "Accounting for Pensions". SFAS No. 18 requires the Company to perform an actuarial calculation on its pension obligation as of each fiscal year-end. Based on the actuarial calculation, the Company recognizes a minimum pension liability and net periodic pension costs.

For employees hired by the Company's Hong Kong branch, Holtek (HK), Holtek (Shanghai) and Kingtek (Suzhou), pension costs are recognized based on the actual contribution.

(j) Sales revenue

Sales revenue is recognized when title to products and the risks and rewards of ownership are transferred to the customer, primarily upon shipment.

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HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(k) Income taxes

Income taxes are accounted for under the asset and liability method. Deferred income taxes are determined based on differences between the financial statements and tax basis of assets and liabilities using the enacted tax rates in effect during the years in which the differences are expected to reverse. The income tax effects resulting from taxable temporary differences are recognized as deferred income tax liabilities. The income tax effects resulting from deductible temporary differences, tax credits and net operating loss carryforwards are recognized as deferred income tax assets. The realization of the deferred income tax assets is evaluated, and if it is considered more likely than not that the deferred income tax assets will not be realized, a valuation allowance is recognized accordingly.

Classification of the deferred income tax assets or liabilities as current or non-current is based on the classification of the related assets or liabilities. If the deferred income tax asset or liability is not directly related to a specific asset or liability, the classification is based on the asset's or liability's expected realization date.

According to the ROC Income Tax Law, the Company's unappropriated earnings are subject to an additional 10 percent corporate income surtax. The surtax is charged to income tax expense after the appropriation of earnings is resolved by the stockholders in the following year.

(l) Earnings per common share

Earnings per common share are computed based on the weighted-average number of common shares outstanding during the period. The effect on earnings per common share from the increase in stock through the issuance of stock dividends from unappropriated earnings, capital surplus and employee bonuses is computed retroactively.

(3) Cash and Cash Equivalents

Cash and cash equivalents as of December 31, 2002 and 2001, consisted of the following:

	<u>December 31,</u>	
	<u>2002</u>	<u>2001</u>
Petty cash	\$ 519	190
Checking account	1,997	1,293
Demand deposits	103,231	106,149
Time deposits	<u>138,375</u>	<u>107,859</u>
	\$ <u>244,122</u>	<u>215,491</u>

(4) Short-term Investments

Short-term investments consisted of open-end mutual funds as of December 31, 2002 and 2001. The market value of these investments amounted to \$828,252 and \$844,296 as of December 31, 2002 and 2001, respectively.

(Continued)

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(5) Inventories

Inventories as of December 31, 2002 and 2001, consisted of the following:

	December 31,	
	2002	2001
Finished goods	\$ 288,634	288,499
Work in process	491,584	380,275
Raw materials	54,463	25,289
Merchandise	3,962	3,206
Supplies	1,116	1,257
	839,759	698,526
Provision for inventory obsolescence and devaluation	(105,000)	(120,000)
	\$ 734,759	578,526

As of December 31, 2002 and 2001, insurance coverage for inventories amounted to \$534,216 and \$615,510, respectively.

(6) Long-term Equity Investments

Long-term equity investments as of December 31, 2002 and 2001, are summarized below:

Investee	Acquisition cost	Percentage of ownership (%)	December 31,	
			2002	2001
Equity method:				
MCU Holdings Ltd.	US\$150,000	100%	\$ 5,275	-
Cost method:				
Unitech Capital Inc.	US\$2,500,000	5%	86,750	-
Tomato LSI Inc.	US\$300,000	6.96%	-	10,330
			\$ 92,025	10,330

Total assets and revenue of MCU Holdings Ltd., the Company's subsidiary did not exceed 10% of the Company's total assets and revenue in 2002 and 2001, respectively. Therefore, MCU Holdings Ltd. was not included in the Company's consolidated financial statements.

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HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(7) Deferred Expenses

Deferred expenses as of December 31, 2002 and 2001, consisted of the following:

	December 31,	
	2002	2001
Computer software	\$ 15,644	37,542
Proprietary know-how	11,000	23,000
Other	3,946	2,166
	\$ 30,590	62,708

(8) Long-term Debt

Long-term debt as of December 31, 2002 and 2001, consisted of the following:

	December 31,	
	2002	2001
Long-term commercial paper	\$ -	50,000
Long-term payable	12,044	21,244
	12,044	71,244
Less: current portion of long-term debt	(9,200)	(9,200)
	\$ 2,844	62,044

In October 2001, the Company entered into a long-term revolving note facilities agreement amounting to \$100,000 with Da An Commercial Bank effective until October 11, 2004. A commitment fee of 0.2% per annum is required if the unused credit facilities exceed 50% of the granted credit line. As of December 31, 2002 and 2001, the Company issued commercial paper according to the agreement amounting to \$0 and \$50,000, respectively, and the interest rate was 1.82~2.26% and 2.023%~2.42%, respectively.

As of December 31, 2002 and 2001, the Company received loans amounting to \$12,044 and \$21,244, respectively, from the Industrial Development Bureau (IDB) of the Ministry of Economic Affairs (MOEA) to develop new product (refer to note 17(c)).

As of December 31, 2002 and 2001, unused credit facilities amounted to approximately \$584,000 and \$480,000, respectively.

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HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(9) Retirement Plan

The following table sets forth the benefit obligation and accrued pension balance relating to the Company's retirement plan as of December 31, 2002 and 2001:

	<u>December 31,</u>	
	<u>2002</u>	<u>2001</u>
Vested benefit obligation	\$ -	-
Non-vested benefit obligation	(30,047)	(18,838)
Accumulated benefit obligation	(30,047)	(18,838)
Projected compensation increase	(28,749)	(24,748)
Projected benefit obligation	(58,796)	(43,586)
Fair value of plan assets	17,567	13,328
Funded status	(41,229)	(30,258)
Unrecognized pension loss	10,896	11,489
Unrecognized net assets at transition	2,926	3,072
Accrued pension	<u>\$ (27,407)</u>	<u>(15,697)</u>

The components of net periodic pension cost for the years ended December 31, 2002, and 2001, were as follows:

	<u>2002</u>	<u>2001</u>
Service cost	\$ 13,670	10,371
Interest cost	1,961	1,441
Actual return on plan assets	(550)	(382)
Amortization	348	(84)
Net pension cost	<u>\$ 15,429</u>	<u>11,346</u>

Significant assumptions used in the above calculation for 2002 and 2001 are summarized as follows:

	<u>December 31,</u>	
	<u>2002</u>	<u>2001</u>
Discount rate	3.75%	4.50%
Rate of increase in future compensation levels	3.75%	4.50%
Expected long-term rate of return on plan assets	3.75%	4.50%

There were no vested benefit obligations as of December 31, 2002.

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HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

The pension costs of the Company's Hong Kong branch, Holtek (HK), Holtek (Shanghai) and Kingtek (Suzhou), which were recognized based on actual contribution for the years ended December 31, 2002 and 2001, were as follows:

	2002	2001
Hong Kong branch	\$ 2,189	407
Holtek (HK)	1,237	2,156
Holtek (Shanghai)	2,172	877
Kingtek (Suzhou)	74	-

(10) Deposits In

As of the December 31, 2002 and 2001, deposits held by Holtek (HK) from its distribution agents to secure their purchase credit lines amounted to \$45,807 and \$59,022, respectively. In 2002 and 2001, Holtek (HK) paid interest on such deposits at a rate of 2% and 5%, respectively.

(11) Stockholders' Equity

(a) Common stock

Pursuant to a stockholders' resolution on March 2, 2001, the Company increased its outstanding common stock by 31.38 million shares at par value of ten New Taiwan dollars per share through the capitalization of unappropriated earnings and employees' bonuses of \$231,800 and \$82,000, respectively. The increase in common stock was registered with and approved by the governmental authorities on April 29, 2001. As of December 31, 2001, the Company's authorized and issued common stock amounted to \$1,800,000 and \$1,533,800, respectively.

Pursuant to a stockholders' resolution on April 17, 2002, the Company increased its outstanding common stock by 21.7387 million shares at par value of ten New Taiwan dollars per share through the capitalization of unappropriated earnings and employees' bonuses of \$176,387 and \$41,000, respectively. The increase in common stock was registered with and approved by the governmental authorities on June 16, 2002. As of December 31, 2002, the Company's authorized and issued common stock amounted to \$1,800,000 and \$1,751,187, respectively.

(b) Capital surplus

Pursuant to the ROC Company Law, capital surplus can only be used to offset an accumulated deficit or to increase common stock. Capital surplus can not be used to declare cash dividends.

(Continued)

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(c) Legal reserve and appropriation of earnings

According to the Company's articles of incorporation, 10% of the Company's net income, after offsetting any accumulated deficit, shall be set aside as a legal reserve. The remainder, if any, may be appropriated according to the proposal of the Board of Directors and the resolution of the stockholders' meeting. The percentage of such appropriation should be as follows:

- 82% as dividends to stockholders;
- 15% as bonuses to employees; and
- 3% as remuneration to directors and supervisors.

Regarding the above-mentioned dividends to stockholders, the cash dividends to stockholders should not less than 10% of total cash and stock dividends. But the amount of earnings distribution and the ratio of cash dividends could be adjusted according to the resolution of the stockholders' meeting based on the estimation of the current year's operation results and cash flow expectation.

Informations about directors' and supervisors' remuneration and employees' bonuses distributed from unappropriated earnings of 2001 is as follows:

Employees' bonuses - paid in common stock (par value)	\$ 41,000
Employees' bonuses - paid in cash	974
Directors' and supervisors' remuneration	<u>8,395</u>
	<u><u>\$ 50,369</u></u>

The Company distributed 4,100 thousand shares as employees' bonuses, which represented 2.67% of outstanding shares of the Company as of December 31, 2001. Assuming the above-mentioned employees' bonuses and directors' and supervisors' remuneration were recognized as periodic expenses, earnings per share (after-tax) of 2001 would be \$1.78.

The actual distribution of employees' bonuses and directors' and supervisors' remuneration for 2002 is subject to a resolution of the Company's directors and approval at the Company's stockholders' meeting.

According to ROC SFC regulations, the Company should retain a special reserve equal to any deductions made to stockholders' equity for items such as foreign currency translation adjustments before distributing annual earnings. If the aforementioned deduction from stockholders' equity is reversed, the same amount could be removed from special reserve and transferred to unappropriated earnings.

(Continued)

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(12) Earnings per Share

	<u>2001</u>		<u>2000</u>	
	<u>Income before</u>		<u>Income before</u>	
	<u>income tax</u>	<u>Net income</u>	<u>income tax</u>	<u>Net income</u>
Basic earnings per share:				
Income applicable to common stockholders	\$ <u>323,091</u>	<u>350,737</u>	<u>240,940</u>	<u>310,735</u>
Weighted-average common shares outstanding (thousand shares)	\$ <u>175,119</u>	<u>175,119</u>	<u>153,380</u>	<u>153,380</u>
Basic earnings per share	\$ <u>1.84</u>	<u>2.00</u>	<u>1.57</u>	<u>2.03</u>

(13) Income Taxes

The Company meets the requirements of a "Scientific Industry" as prescribed by the Statute for the Establishment and Administration of a Science-Based Industrial Park (the "Statute"). The income tax rate for scientific industry income and non-scientific industry income was 20% and 25%, respectively. Due to amendment of the Statute, starting from January 20, 2001, the income tax rate is 25%. The Company's subsidiaries are subject to the current tax rate of the countries in which they operate.

In accordance with the ROC Statute for Upgrading Industries, the Company or its stockholders are entitled to either a corporate income tax exemption period of five years or to a tax credit equal to 20% of their investment in the Company. Pursuant to a stockholders' resolution, the Company's stockholders have resolved to receive the tax credit on their investment of \$1 billion in the Company.

The tax exemptions related to the expanded operations accompanying the capital increases are as follows:

	Duration of tax exemption
Capital increase (2000)	2002.01.01~2005.12.31
Capital increase (2001)	2002.01.01~2006.12.31

The components of income tax benefit for the years ended December 31, 2002 and 2001, are summarized as follows:

	<u>2002</u>	<u>2001</u>
Current	\$ 1,909	15,562
Deferred	<u>(29,555)</u>	<u>(85,357)</u>
Income tax benefit	\$ <u>(27,646)</u>	<u>(69,795)</u>

(Continued)

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

The reconciliation of the expected income tax expense at the statutory tax rate and the actual income tax benefit for the years ended December 31, 2002 and 2001, was as follows:

	<u>2002</u>	<u>2001</u>
Income tax expense computed at the statutory tax rate	\$ 80,036	60,745
Tax effect of exempted capital gain on securities transaction	(7,405)	(15,200)
Tax exemption	(416)	-
Investment tax credits	(60,000)	(124,723)
Changes in valuation allowance of deferred income tax assets	(29,000)	29,000
Effect of tax rate change	-	(8,914)
Additional 10% income surtax on unappropriated earnings	4,761	-
Other	<u>(15,622)</u>	<u>(10,703)</u>
Actual income tax benefit	<u>\$ (27,646)</u>	<u>(69,795)</u>

The components of deferred income tax assets (liabilities) as of December 31, 2002 and 2001, were as follows:

	<u>December 31,</u>			
	<u>2001</u>		<u>2000</u>	
	<u>Amount</u>	<u>Tax effect</u>	<u>Amount</u>	<u>Tax effect</u>
Current:				
Allowance for doubtful accounts	\$ 9,708	2,427	10,228	2,557
Provision for inventory obsolescence and devaluation	105,000	26,250	120,000	30,000
Unrealized foreign exchange gain	(40,261)	(10,065)	-	-
Loss carryforward of foreign branch and subsidiaries	-	-	23,037	3,684
Investment tax credits	37,000	37,000	33,000	33,000
Other	2,000	<u>500</u>	4,408	<u>799</u>
		<u>\$ 56,112</u>		<u>70,040</u>

(Continued)

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

	December 31,			
	2001		2000	
	<u>Amount</u>	<u>Tax effect</u>	<u>Amount</u>	<u>Tax effect</u>
Non-current:				
Investment loss accounted for by the equity method	\$ 15,939	3,985	11,650	2,912
Pension accrual	25,408	6,352	13,698	3,425
Loss carryforward of foreign branch	11,569	1,851	-	-
Investment tax credits	139,054	139,054	129,922	129,922
Other	-	-	2,000	500
		151,242		136,759
Less: valuation allowance		-		(29,000)
		<u>\$ 151,242</u>		<u>107,759</u>
Total deferred income tax assets		<u>\$ 217,419</u>		<u>206,799</u>
Total deferred income tax liabilities		<u>\$ 10,065</u>		<u>-</u>
Total valuation allowance of deferred income tax assets		<u>\$ -</u>		<u>29,000</u>

According to the ROC Statute for Upgrading Industries, the total amount of investment tax credits those can be utilized per year is limited to 50 percent of the year's current income tax expense. However, the foregoing limit does not apply to the last year of the investment tax credits' expiration period. As of December 31, 2002, the estimated unused investment tax credits and related expiration dates were as follows:

<u>Unused investment tax credits</u>	<u>Expiration date</u>
\$ 29,873	December 31, 2003
50,199	December 31, 2004
46,982	December 31, 2005
49,000	December 31, 2006
<u>\$ 176,054</u>	

The Company's income tax returns after 1998 have not been assessed by the tax authorities.

Beginning in 1998, an integrated income tax system was implemented in the ROC. Under the new tax system, the income tax paid at the corporate level can be used to offset the ROC resident stockholders' individual income tax. The Company is required to establish an Imputation Credit Account (ICA) to maintain a record of the corporate income taxes paid and imputation credit that can be allocated to each stockholder. The credit available to each ROC resident stockholder is calculated by multiplying the dividend by the creditable ratio. The creditable ratio is calculated as the balance of the ICA divided by earnings retained since January 1, 1998.

(Continued)

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Information relating to the Company's ICA as of December 31, 2002 and 2001, is summarized as follows:

	December 31,	
	2002	2001
Unappropriated retained earnings:		
Earned after December 31, 1997	\$ <u>350,792</u>	<u>310,953</u>
Imputation credit account balance	\$ <u>309</u>	<u>32</u>
	2002	2001
Expected creditable ratio for earnings distribution to resident stockholders	<u>0.09%</u> (expected)	<u>6.41%</u> (actual)

(14) Financial Instruments

(a) Derivative financial instruments

The Company entered into several forward foreign currency exchange contracts and foreign currency exchange option contracts to hedge exposures on foreign currency accounts receivable and payable. The counter-parties of the derivative contracts are reputable domestic financial institutions. Therefore, the Company's management believes that the risk of default by the counter-parties is remote. The Company and subsidiaries did not hold any derivative financial contracts as of December 31, 2002 and 2001.

(b) Non-derivative financial instruments

The Company and subsidiaries' non-derivative financial assets include cash and cash equivalents, short-term investments, notes and accounts receivable, receivables from related parties, and long-term equity investments. The Company and subsidiaries' non-derivative financial liabilities consist of notes and accounts payable, payables to related parties, and long-term debt.

The following methods and assumptions are used to estimate the fair value for each class of non-derivative financial instruments:

1. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate their fair value due to the short-term nature of these items.
2. The fair value of short-term investments is based on publicly quoted market prices. Refer to note 4 for information on market value of short-term investments.
3. It is not practicable to determine the fair value of long-term equity investments since these investments are not publicly traded. Please refer to note 6 for information on book value of long-term equity investments.

(Continued)

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

4. The book value of the loans from the IDB of the MOEA amounted to \$12,044 as of December 31, 2002. Their fair value based on the present value of the expected future cash flows was \$11,462 as of December 31, 2002. The discount rate was based on the prime rate of Bank of Taiwan. Except for the above-mentioned loans from the IDB, the Company's long-term debt bears floating interest rates; therefore, the principal amounts of long-term debt approximate their fair value.

(15) Transactions with Related Parties

(a) Names and relationships

<u>Name of related party</u>	<u>Relationship</u>
United Microelectronics Corp. (i UMCi)	The Company's major shareholder
Applied Component Technology Corp. (i ACTCi)	Investee accounted for under the equity method by UMC
Faraday Electronics Manufacture Corp. (i FEMCi)	Investee accounted for under the equity method by UMC
Novatek Microelectronics Corp. (i NMCi)	Investee accounted for under the equity method by UMC
Sunny Tone Limited (i Sunnyi)	Subsidiary indirectly owned by the Company

- (b) Significant transactions and balances with related parties as of and for the years ended December 31, 2002 and 2001, are summarized below:

Sales

	<u>2002</u>		<u>2001</u>	
	<u>Amount</u>	<u>Percentage of net sales</u>	<u>Amount</u>	<u>Percentage of net sales</u>
ACTC	\$ <u>22,333</u>	<u>1</u>	<u>23,424</u>	<u>1</u>

There were no significant differences in credit terms between related parties and third-party customers.

Purchases

	<u>2002</u>		<u>2001</u>	
	<u>Amount</u>	<u>Percentage of total purchases</u>	<u>Amount</u>	<u>Percentage of total purchases</u>
UMC	\$ <u>828,383</u>	<u>32</u>	<u>546,614</u>	<u>23</u>

(Continued)

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

There were no significant differences in purchasing terms between related parties and third-party suppliers.

Accounts receivable/payable

- Accounts receivable

	December 31,			
	2002		2001	
	Amount	Percentage of total accounts receivable	Amount	Percentage of total accounts receivable
ACTC	\$ <u>1,411</u>	<u>-</u>	<u>2,499</u>	<u>1</u>

- Accounts payable

	December 31,			
	2002		2001	
	Amount	Percentage of total accounts payable	Amount	Percentage of total accounts payable
UMC	\$ <u>191,076</u>	<u>30</u>	<u>121,124</u>	<u>22</u>

Purchase of property and equipment

The Company purchased a building located in the Hsin Chu Science-Based Industrial Park and related improvements amounting to \$165,000 from UMC in March 2001. There were no outstanding balances as of December 31, 2001, relating to the purchase.

Operating leases

The Company leased its office, dormitory and parking lots from UMC in 2001. In 2001, total rental expense amounted to \$3,318, and the related payable balance as of December 31, 2001 was \$0.

Other

The service fee for IC design which the Company outsourced to FEMC in 2002 and 2001 amounted to \$819 and \$4,386, respectively. The related payable balance as of December 31, 2002 and 2001, amounted to \$0 and \$1,622, respectively.

(Continued)

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

UMC paid certain expenses on behalf of the Company amounting to \$3,612 and \$4,801 in 2002 and 2001, respectively. The related payable balance as of December 31, 2002 and 2001, amounted to \$757 and \$232, respectively.

The service fee for IC design which the Company outsourced to Sunny in 2002 amounted to \$837. The related payable balance as of December 31, 2002, was \$0.

(16) Pledged Assets

Assets pledged as collateral as of December 31, 2002 and 2001, are summarized as follows:

<u>Assets</u>	<u>Pledged for</u>	<u>Carrying amount as of December 31,</u>	
		<u>2002</u>	<u>2001</u>
Time deposits	Long-term payable	\$ 12,100	30,000
Buildings and structures	Long-term debt	-	120,000
		<u>\$ 12,100</u>	<u>150,000</u>

(17) Commitments and Contingent Liabilities

(a) The Company entered into certain lease agreements for its office and parking lots. As of December 31, 2002, the minimum future rental payments under existing rental agreements were as follows:

<u>Year ending</u>	<u>Amount</u>
2003	\$ 11,529
2004	1,493
	<u>\$ 13,022</u>

(b) The Company leases land for the site of its building from the Industrial Park Administration Bureau. The lease term for the current agreement is effective for 20 years, starting from March 15, 2001. In accordance with the lease agreement, rental payment is subject to adjustment as the government reappraises the land value. The current rental is \$3,102 per year.

(Continued)

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

- (c) Under a research and development agreement with the IDB of the MOEA, the Company was entitled to receive both a grant and a loan amounting to \$29,210 during the period from August 1, 1998, to April 30, 2000. The agreement was completed on April 30, 2000. The Company can not apply for the patent to produce project products outside Taiwan until the loan and compensation required under the agreement are fully paid to the Development Funds of the Executive Yuan, or until the Company obtains approval from the IDB. In accordance with the agreement, the Company has issued promissory notes amounting to \$29,210 to Chiao Tung Bank and will repay the loan in twelve quarterly installments beginning from May 2001. Beginning from the date that sales of the project's products commence, the Company must make quarterly payments to a governmental institution in an amount equal to 2% of sales for three consecutive years. The aggregate amount shall not exceed 40% of the above loan. There were no sales of the project's products as of December 31, 2002.

(18) Segment Information

(a) Industry information

The Company and subsidiaries operate predominantly in one industry segment, integrated circuits.

(b) Geographic information

	2 0 0 2					
	Mainland					
	T a i w a n	H o n g K o n g	C h i n a	O t h e r s	E l i m i n a t i o n s	C o n s o l i d a t e d
Area revenue:						
Customers	\$ 1,631,833	1,633,313	25,183	60,677	-	3,351,006
Inter-company	<u>1,554,720</u>	<u>1,147,464</u>	<u>-</u>	<u>-</u>	<u>(2,702,184)</u>	<u>-</u>
	<u>\$ 3,186,553</u>	<u>2,780,777</u>	<u>25,183</u>	<u>60,677</u>	<u>(2,702,184)</u>	<u>3,351,006</u>
Net income	<u>\$ 385,939</u>	<u>(6,219)</u>	<u>(5,357)</u>	<u>2,815</u>	<u>(26,441)</u>	<u>350,737</u>
Area identifiable assets	<u>\$ 2,940,037</u>	<u>797,575</u>	<u>95,163</u>	<u>190,832</u>	<u>(1,003,710)</u>	<u>3,019,897</u>
	2 0 0 1					
	Mainland					
	T a i w a n	H o n g K o n g	C h i n a	O t h e r s	E l i m i n a t i o n s	C o n s o l i d a t e d
Area revenue:						
Customers	\$ 1,791,844	1,488,399	10,997	2,831	-	3,294,071
Inter-company	<u>1,267,876</u>	<u>1,220,119</u>	<u>-</u>	<u>-</u>	<u>(2,487,995)</u>	<u>-</u>
	<u>\$ 3,059,720</u>	<u>2,708,518</u>	<u>10,997</u>	<u>2,831</u>	<u>(2,487,995)</u>	<u>3,294,071</u>
Net income	<u>\$ 274,029</u>	<u>(21,554)</u>	<u>(6,538)</u>	<u>489</u>	<u>64,309</u>	<u>310,735</u>
Area identifiable assets	<u>\$ 2,671,748</u>	<u>602,203</u>	<u>62,212</u>	<u>99,522</u>	<u>(681,903)</u>	<u>2,753,782</u>

(Continued)

HOLTEK SEMICONDUCTOR INC. AND SUBSIDIARIES**Notes to Consolidated Financial Statements**

(c) Significant customers

Sales to major customers for the years ended December 31, 2002 and 2001, are summarized as follows:

	<u>2002</u>		<u>2001</u>	
	<u>Amount</u>	<u>% of total sales</u>	<u>Amount</u>	<u>% of total sales</u>
Customer A	\$ <u>402,859</u>	<u>12</u>	<u>507,623</u>	<u>15</u>