

Chapter 6. Review and Analysis of Financial Conditions, Operating Results and Risk Management

Balance Sheet Analysis

Standalone balance sheet analysis

Explanation of significant changes – i.e., at least a 10% change amounting to more than NT\$10 million – in the past two years' assets, liabilities and shareholders' equity:

1. The Company had a capital reduction and acquired a 51% stake in Fubon Multimedia Technology (momo), leading to a decrease in current assets.
2. Investments increased due to the acquisition of a 51% stake in momo.
3. Other assets declined because of lower deferred income tax assets.
4. Current liabilities rose while long-term liabilities declined as a result of reclassification of a portion of long-term corporate bonds due within one year.
5. Paid-in capital dropped because of a capital reduction in 2011.

2010- 2011 Standalone Balance Sheet

Unit: NT\$'000, %

	2010	2011	YoY change	
			Amount	%
Current assets	23,819,685	10,307,087	(13,512,598)	(56.73)
Investments	11,359,143	26,670,657	15,311,514	134.79
Fixed assets	35,014,385	31,677,951	(3,336,434)	(9.53)
Intangible assets	12,818,208	12,356,964	(461,244)	(3.60)
Other assets	4,144,036	3,715,045	(428,991)	(10.35)
Total assets	87,155,457	84,727,704	(2,427,753)	(2.79)
Current liabilities	25,621,285	29,904,013	4,282,728	16.72
Long-term liabilities	8,800,000	4,000,000	(4,800,000)	(54.55)
Other liabilities	1,864,617	1,875,680	11,063	0.59
Total liabilities	36,285,902	35,779,693	(506,209)	(1.40)
Paid-in capital	38,009,254	34,208,328	(3,800,926)	(10.00)
Capital surplus	12,432,489	12,432,446	(43)	-
Retained earnings	32,243,481	33,272,277	1,028,796	3.19
Other equity	(31,815,669)	(30,965,040)	850,629	2.67
Total shareholders' equity	50,869,555	48,948,011	(1,921,544)	(3.78)

Consolidated balance sheet analysis

Explanation of significant changes – i.e., at least a 10% change amounting to more than NT\$10 million – in the past two years' assets, liabilities and shareholders' equity:

1. Current assets increased due to the consolidation of momo.
2. Investments decreased due to the recognition of an impairment loss from investments in Taiwan High Speed Rail.
3. Intangible assets rose due to the increase in goodwill from the acquisition of momo.
4. Current liabilities rose due to an increase in short-term borrowings, the consolidation of momo and a portion of long-term corporate bonds to be due within one year.
5. Long-term borrowings decreased owing to reclassification of a portion of long-term corporate bonds due within one year and repayment of syndicated loans.
6. Other liabilities increased due to the consolidation of momo.
7. Paid-in capital dropped because of a capital reduction in 2011.

8. Minority interest increased due to the acquisition of a 51% stake in momo.

2010 - 2011 Consolidated Balance Sheet

Unit: NT\$'000, %

	2010	2011	YoY change	
			Amount	%
Current assets	15,242,392	18,132,547	2,890,155	18.96
Investments	3,196,711	2,161,551	(1,035,160)	(32.38)
Fixed assets	43,613,993	41,305,336	(2,308,657)	(5.29)
Intangible assets	20,347,050	27,251,800	6,904,750	33.93
Other assets	3,084,054	2,943,134	(140,920)	(4.57)
Total assets	85,484,200	91,794,368	6,310,168	7.38
Current liabilities	23,231,653	36,354,411	13,122,758	56.49
Long-term liabilities	10,300,000	4,000,000	(6,300,000)	(61.17)
Other liabilities	1,053,129	1,376,072	322,943	30.67
Total liabilities	34,584,782	41,730,483	7,145,701	20.66
Paid-in capital	38,009,254	34,208,328	(3,800,926)	(10.00)
Capital surplus	12,432,489	12,432,446	(43)	-
Retained earnings	32,243,481	33,272,277	1,028,796	3.19
Other equity	(31,815,669)	(30,965,040)	850,629	2.67
Minority interest	29,863	1,115,874	1,086,011	3,636.64
Total shareholders' equity	50,899,418	50,063,885	(835,533)	(1.64)

Impact of changes on financial results: No significant impact

Preventive measures: Not applicable

Income Statement Analysis

Standalone income statement analysis

1. Increase in operating costs and the drop in operating income: Cost of handsets sold increased in 2011 due to an increase in smartphone sales volume.
2. Decrease in non-operating expense: Losses from asset write-offs shrank in 2011 compared with a year earlier.

2010 – 2011 Standalone Income Statement

Unit: NT\$'000, %

	2010	2011	YoY change	
			Amount	%
Revenue	58,547,285	61,919,273	3,371,988	5.76
Operating costs	32,808,712	37,793,874	4,985,162	15.19
Gross profit	25,738,573	24,125,399	(1,613,174)	(6.27)
Operating expense	12,038,007	12,955,675	917,668	7.62
Operating income	13,700,566	11,169,724	(2,530,842)	(18.47)
Non-operating income	4,465,716	4,506,462	40,746	0.91
Non-operating expense	1,768,138	833,190	(934,948)	(52.88)
Income before tax	16,398,144	14,842,996	(1,555,148)	(9.48)
Net income	13,822,186	13,468,763	(353,423)	(2.56)

Consolidated income statement analysis

1. Revenue, operating cost and operating expense rose due to the consolidation of momo and increased sales of smartphones.
2. Despite fewer losses from asset write-offs in 2011, non-operating expense grew from a year earlier due to impairment losses from Taiwan High Speed Rail (THSR).

2010 – 2011 Consolidated Income Statement

Unit: NT\$'000, %

	2010	2011	YoY change	
			Amount	%
Revenue	70,146,004	81,369,183	11,223,179	16.00
Operating costs	38,162,363	48,655,458	10,493,095	27.50
Gross profit	31,983,641	32,713,725	730,084	2.28
Operating expense	13,675,930	15,123,920	1,447,990	10.59
Operating income	18,307,711	17,589,805	(717,906)	(3.92)
Non-operating income	739,516	672,876	(66,640)	(9.01)
Non-operating expense	1,945,905	2,134,112	188,207	9.67
Income before tax	17,101,322	16,128,569	(972,753)	(5.69)
Net income	13,817,778	13,626,180	(191,598)	(1.39)

Consolidated financial ratio analysis

		2010	2011	
Financial structure (%)	Liability to asset ratio	40.46	45.46	
	Long-term capital to fixed asset ratio	140.32	130.89	
Solvency (%)	Current ratio	65.61	49.88	
	Quick ratio	57.83	41.77	
	Interest coverage ratio (x)	54.53	67.97	
Operations	Accounts receivable turnover (x)	9.25	10.35	
	Average collection days	39.46	35.27	
	Inventory turnover (x)	10.31	11.39	
	Accounts payable turnover (x)	11.68	9.73	
	Average days sales	35.40	32.05	
	Fixed asset turnover (x)	1.61	1.97	
	Total asset turnover (x)	0.82	0.89	
Profitability (%)	Return on assets	16.44	15.60	
	Return on equity	26.84	26.99	
	% of paid-in capital	Operating income	48.17	51.42
		Pre-tax income	44.99	47.15
	Net profit margin	19.70	16.75	
EPS (NT\$)	4.62	4.70		
Cash flow (%)	Cash flow ratio	111.89	69.48	
	Cash flow adequacy ratio	140.61	154.40	
	Cash reinvestment rate	12.87	14.30	

Leverage	Operating leverage	1.91	1.97
	Financial leverage	1.02	1.01
<p>Explanation for items in 2011 with major changes (>20%) from the previous year:</p> <p>(1) Significant increases in sales and in procurement of smartphones resulted in an increase in advanced receipts from customers and accounts payable to vendors, which, coupled with higher short-term borrowings, led to a rise in the ratio of liabilities to assets.</p> <p>(2) The decrease in shareholders' equity and long-term debts and the increase in current liabilities were due to capital reduction and the reclassification of corporate bonds due within one year to corporate bonds-current portion in 2011. As a result, the long-term capital to fixed-asset ratio, current ratio, quick ratio and cash flow ratio all decreased.</p> <p>(3) As syndicated loans were due and paid in March 2011, interest expense dropped and interest coverage ratio rose.</p>			

Revenue outlook, key assumptions, potential impact on the Company's business and corresponding proposal:

In 2012, the Company will continue to leverage mobile internet products to expand its wireless market share. As global demand for smart devices expands, telecom operators are expected to aggressively devise new strategies and increase investments in value-added services to tap into this market's full growth potential. The Company will focus on developing the latest top-of-the-line mobile value-added services to satisfy customers' demand, such as mobile shopping, video/audio services and the myBook store (an e-book platform), raising the revenue from mobile value-added services and increasing average revenue per user (ARPU). To meet these targets, the Company will utilize full potential of its competitive edge in handset procurement to raise its marketing and cost-efficiency.

Cash Flow Analysis

Standalone cash flow analysis

1. Cash flow from investment activities: Cash outflow decreased in 2011 due to a decline in financing to related parties, despite rising investment in subsidiaries.
2. Cash flow from financing activities: Cash outflow was higher in 2011 due to repayment of bank loans and capital reduction.

2010 – 2011 Standalone Cash Flow Statement

Unit: NT\$'000, %

	2010	2011	YoY change	
			Amount	%
Cash inflow (outflow) from operating activities	23,318,054	22,171,276	(1,146,778)	(4.92)
Cash inflow (outflow) from investment activities	(11,109,826)	(7,899,540)	(3,210,286)	(28.90)
Cash inflow (outflow) from financing activities	(9,384,389)	(17,275,099)	7,890,710	84.08
Net cash	2,823,839	(3,003,363)	(5,827,202)	(206.36)

Consolidated cash flow analysis

The changes in cash flow from operating activities and financing activities and acquisition of cash and cash equivalents for subsidiaries all resulted from the consolidation of momo.

2010 – 2011 Consolidated Cash Flow Statement

Unit: NT\$'000, %

	2010	2011	YoY change	
			Amount	%
Cash inflow (outflow) from operating activities	25,993,712	25,260,280	(733,432)	(2.82)
Cash inflow (outflow) from investment activities	(6,319,636)	(15,435,642)	9,116,006	144.25
Cash inflow (outflow) from financing activities	(16,630,430)	(11,501,769)	(5,128,661)	(30.84)
Effect of exchange rate changes	(14,014)	35,963	49,977	(356.62)
Cash and cash equivalents arising from merger	20,662	2,285,830	2,265,168	10,962.97
Net cash	3,050,294	644,662	(2,405,632)	(78.87)

Plans to improve negative liquidity: Not applicable

Standalone projected cash flow for 2012

1. Projected cash inflow from operating activities: Expected to remain stable
2. Projected cash outflow from investment activities: For capital expenditures and to raise subsidiaries' capital
3. Projected cash outflow from financing activities: For cash dividend distribution and repayment of corporate bonds

2012 Standalone Cash Flow Analysis

Unit: NT\$'000

Cash balance, beginning of the year (1)	Forecast net cash inflow from operations (2)	Forecast cash outflow from investment and financing activities (3)	Cash balance, end of the year (1) + (2) - (3)	Source of funding for negative cash balance	
				Cash inflow from investment activities	Cash inflow from financing activities
877,518	20,198,791	17,554,266	3,522,043	-	-

Source of funding for negative cash flow in 2012: Not applicable

Analysis of Major Capex and its Impact on Finance and Operations

Given stable operations and cash flows, the Company was able to maintain the Company's financials stable in 2011.

Investment Policies, Reasons for Profit/Loss, Plans for Improvement, and Future Investment Plan

Unit: NT\$'000

Item	Explanation	Carrying value as of end of 2011	Investment policy	Source of income/ loss	Improvement plans	Future investment plans
Taiwan Cellular Co., Ltd.		17,195,352	Investment in fixed network and other telecom-related business	Investment income from Taiwan Fixed Network Co., Ltd. and TCC Investment Co., Ltd.	-	-
Wealth Media Technology Co., Ltd. (WMT)		8,862,169	Investment in CATV and retail-related businesses	Investment income from Fubon Multimedia Technology Co., Ltd. and Tai Fu Media Technology Co., Ltd.	-	The Company's BOD approved a rights issue of up to NT\$6.5bn for WMT in July 2009.
Taipei New Horizons Co., Ltd.		562,812	Investment in a property development project located at the old Songshan tobacco factory site for use as headquarters	Investment loss incurred as the project is still at the preparatory stage	-	The Company's BOD approved future rights issue in accordance with construction progress and funding demands in January 2009.
Bridge Mobile Pte Ltd.		50,324	Cooperation with other operators in Asia to enhance the Company's competitiveness	- (Note)	- (Note)	-
Yes Mobile Holdings Company (Yes Mobile)		-	TWM's investment in Yes Mobile resulted from merging Mobitai, and TWM already booked permanent price decline losses for Yes Mobile in 2004.	- (Note)	- (Note)	-

Note: Investment was booked as "Financial assets carried at cost." The Company has no significant influence over it.

Risk Management

Impact of inflation, as well as interest and exchange rate fluctuations, and preventive measures:

1. Impact of interest rate fluctuations

As the Company had no floating interest rate borrowing in 2011, interest rate fluctuations had a minimal impact on its earnings.

2. Impact of exchange rate fluctuations

The Company's main service area is Taiwan. Except for its international roaming business, all operating revenues are denominated in NT dollars. However, some of the Company's capital expenditures are denominated in euros and US dollars. To minimize the impact from foreign exchange rate fluctuations, the Company hedges risk through foreign exchange spot market transactions. Overall, exchange rate fluctuations had a minimal impact on the Company.

3. Impact of inflation

Inflation had a minimal impact on the Company's operating performance in 2011 and up to the publication date.

Investment policy and reasons for gains & losses for high-risk/high-leverage financial products, derivatives, loans to others and guarantees of debts:

1. The Company was not involved in any high-risk, high-leverage financial investment.
2. The Company passed the "Rules and Procedures on Lending and Making Endorsements/Guarantees" to supervise its financing and endorsement activities. As the counterparties in its loans and guarantees are all its subsidiaries, there is minimal operating risk.
3. Derivatives transaction: None.

Research and development plans

Project name	Objective	Status	Completion date
3G CRM platform	Develop customized modules for customer relations management based on existing 3G network traffic analysis platform.	Working on system implementation	Sept. 2012
Customer telecommunication transmission quality analysis	Analyze telecommunication transmission quality to identify customers experiencing poor network quality in order to address and resolve any problems to the network.	Structure design completed	Sept. 2012
E-commerce analysis and campaign promotions	Analyze TWM's new e-commerce business to gain an in-depth understanding of customers' browsing and buying behavior. CRM system will be expanded to support e-commerce campaign promotions.	Working on system planning	Dec. 2012
Fixed-line billing system consolidation	To consolidate the operations flow of the fixed-line business and simplify related services, TWM needs to retire the i1 billing system and port existing i1 data to TFNBS billing system.	Working on data porting and billing testing.	Dec. 2012
myCloud	Provide cloud storage services. Subscribers can upload or synchronize documents, phone books and digital content from their multiple devices to cloud storage.	Working on service plan	Jun. 2012
Cloud IDC and cloud services	To construct a new generation green internet data center (IDC) for various cloud services through cooperation with upstream and downstream companies in the industry chain.	Working on system development	Mar. 2013
Near Field	TWM is talking to other major Taiwanese	Conducting joint-venture	Dec. 2012

Project name	Objective	Status	Completion date
Communication (NFC)	operators about building a common trusted service managers (TSM) platform to enable NFC services.	discussions	

Regulatory changes

1. Revision of digital convergence regulation

(1) Status

The "digital convergence development program" approved by the Executive Yuan is divided into two stages. The first stage involves promoting cross-media convergence services and solving urgent problems relating to other laws or regulations that might hinder its implementation as well as cross-industry barriers. The second stage focuses on creating a new environment to facilitate digital convergence, overcome the obstacles left from the first stage and establish a managing structure with layers of networks, platforms and content. The NCC started to amend the Telecommunications Act in 2011 to promote telecommunications and broadcasting convergence and fair/effective competition in the telecom industry. There are five key points in amending the law: 1) encouraging telecom operators to provide convergent services and setting related regulations, 2) strengthening regulations on internet content; 3) promoting effective competition of fixed-line business; 4) classifying interconnection charges as a main item under Type 1 telecom operators' tariffs; and 5) enhancing management over information and communications security.

(2) Countermeasures

The Company is closely monitoring the progress of the amendments and continues to communicate with and forward suggestions and recommendations concerning related policy and regulations to the NCC.

2. Second round of mobile tariff cuts from April 1, 2010

(1) Status

On January 6, 2010, the NCC announced that mobile retail tariffs should be cut per annum for three consecutive years from April 1, 2010 to March 31, 2013. The adjustment coefficient (X value) of 5% was applied to text messages and off-net mobile outgoing calls. Under the formula: tariff reduction = $\Delta\text{CPI} - X$, given that the CPI contracted by 0.87% in 2010, tariffs were cut by 5.87% in the first year, followed by a 4.04% cut in 2011 and will be cut by 3.58% in 2012. For bucket rate plans, i.e. a fixed monthly fee with free talk minutes, the Company has also given users additional free minutes equivalent to the 4.04% tariff cut, retroactive to April 1, 2011.

(2) Countermeasures

As developed countries no longer regulate mobile retail tariffs, the Company continues to communicate with the NCC on this issue to reduce its impact on revenues. Separately, more than 190,000 customers benefited from the additional free minutes.

3. Renewal of GSM licenses

(1) Status

On November 12, 2010, the Executive Yuan passed a measure governing the expiration of GSM (2G) licenses, which extended their validity to June 2017. The NCC revised Regulations Governing Mobile Telecommunications Businesses on September 19, 2011 and announced the details and documents required for applying for renewal of 2G licenses on December 5, 2011.

(2) Countermeasures

In compliance with the NCC regulation, the Company renewed its GSM licenses and continues to provide subscribers with advanced mobile communications and digital convergence services to enhance customer satisfaction.

4. Revision of the National Communications Commission Organization Act

(1) Status

Amendments to the National Communications Commission (NCC) Organization Act were passed on Dec. 14, 2011 with the following revisions: 1) the NCC Chairperson and Vice Chairperson shall be nominated by the Premier of the Executive Yuan, 2) The Premier has the authority to dismiss the NCC Commissioners, and 3) Civil servants can be nominated as NCC Commissioners. With these revisions, the NCC shall coordinate more with the Executive Yuan in carrying out its policies.

(2) Countermeasures

The national communications policy should be more consistent. The Company lauds these revisions and continues to monitor subsequent developments.

5. Reducing IP peering and other wholesale charges

(1) Status

In March 2011, the NCC approved Chunghwa Telecom's new wholesale pricing scheme, lowering IP peering fees by 32%, asynchronous transfer mode (ATM)-based circuit fees by 10%, Giga Ethernet circuit fees by 20%, and data leased circuit fees by 5%, all compared with a year ago, thereby reducing the Company's operating costs.

(2) Countermeasures

The Company is pushing for further reductions in IP peering costs and other leased line wholesale prices as it develops its broadband business.

6. NCC approved expansion of CATV service areas

(1) Status

To promote competition, CATV digitization and consumer rights, the NCC approved a proposal on April 27, 2011, to expand the CATV service areas based on city/county and to open licenses to new entrants, while the details are still under deliberation at the time of publication.

(2) Countermeasures

The Company continues to communicate with and forward suggestions and recommendations concerning related policy and regulations to the NCC.

Technology changes and development

1. Wireless Broadband Access (WBA)

(1) Status

WBA is a communications technology based on orthogonal frequency division multiplexing (OFDM). WiMAX is one of the examples of OFDM technologies and is capable of providing speeds of up to 10 Mbps on 3G's 5MHz equivalent frequency bandwidth. All six local WiMAX operators have launched regional services one after another since 2Q09. To date, WiMAX has had minimal impact on 3G voice and data revenue because of its limited network coverage. However, with WiMAX operators pursuing mergers since 2011, they may be able to reduce their network installation and operating costs, potentially increasing their threat to 3G operators.

(2) Countermeasures

3.5G technology for high-speed packet access plus (HSPA+) is mature and has been commercialized. The speed of the connection throughput for HSDPA already surpasses that of WBA technology and is a more commercially competitive technology.

TWM has aggressively deployed 3.5G technology since late 2007, and has offered 14.4Mbps wireless broadband services in urban areas since 2009. In 2010, TWM added more 7.2Mbps and 14.4Mbps base stations. In 2011, TWM started to introduce HSPA+ high-speed mobile internet services in five major metropolitan areas. For 2012, TWM will continue to expand its HSPA+ coverage. The Company will also continue its evaluation of LTE – a technology that surpasses WiMAX and is already deployed in many countries – and plans to make trial runs in 2012.

2. Rising popularity of internet protocol

(1) Status

The popularity of internet protocol (IP) has revolutionized the telecommunications business and network infrastructure, giving rise to increased IP-based communications traffic. IP-based telecom is able to simplify network infrastructure, translating into big savings on operating costs. This trend accelerated the use of IPv4 addresses, which is near exhaustion worldwide, and made IPv6 migration an urgent need in the future. On the other hand, not only has the increasing availability of cheap or free VoIP services had a great impact on traditional fixed-line operators' long distance and international voice call revenue, free mobile IP messaging services even caused a decline in SMS traffic during the New Year holiday.

(2) Countermeasures

The necessity of building an IP core network infrastructure based on next generation network (NGN) is an urgent task. TWM has been building the latest IP-based optical core network and started to deploy IP core access and transmission technologies. It is also conducting laboratory tests of various IPv6 IOT (interoperability testing), VoIP and IP messaging application services to lead industry development.

The Company is developing and testing new IPv6 technology and new IP application services and conducting research on the latest optical packet carrier ethernet technologies to introduce more services that provide households with the most advanced and innovative broadband services. The Company will also continue to monitor free VoIP and IP messaging traffic trends and reference global operators' actions in dealing with their impact to formulate its own strategy.

3. Digital convergence and cloud services

(1) Status

Because of the digitalization trend, the transmission and exchange of related digital content and services among different carriers, systems and platforms have brought about changes in wired and wireless communications and broadcasting industries. This has not only promoted competition and integration of the two industries, but also facilitated an industry consolidation. The digitalization of terrestrial TV, which will go into force on July 1, 2012, is expected to accelerate the development of digital convergence services. As such, cloud computing technology and service – the base of digital convergence – have progressed from merely a concept to a profitable business, and should be the future trend.

(2) Countermeasures

After merging Taiwan Fixed Network (TFN) and Taiwan Telecommunication Network Services (TTN) in 2007, the Company enhanced its status as a leader in the digital convergence era. TWM had integrated the group's resources to facilitate research and development in digital convergence and launched fixed-mobile convergence (FMC) services for corporate accounts. It is also aggressively planning new digital convergence services that will integrate cable TV, digital TV, cable broadband, and interactive entertainment services. At the end of 2010, the Company launched its four-screen-and-a-cloud digital convergence service, integrating handset, PC, tablet and TV. Not only was TWM the first to introduce such services in Taiwan, it was also an industry pioneer in Asia. In 2011, TWM invested in the construction of an internet data center (IDC) for cloud services to provide infrastructure as a service (IAAS), enabling TWM to launch additional intelligent cloud services in four key areas – mobile life, digital content, intelligent life and intelligent enterprise in the future.

4. Popularity of mobile smart devices and femto/WiFi technologies

(1) Status

The popularity of the iPhone, Android phone and other mobile smart devices has dramatically boosted the growth of 3G data usage. This has forced global mobile operators to expand their 3G access network's backhaul bandwidth and

network capacity, which in turn has increased the pressure on their operating costs. Many mobile operators have started building WiFi networks and femtocells to offload 3G data traffic.

(2) Countermeasures

In 2011, the Company not only continued expanding the backhaul bandwidth and network capacity of its HSPA network, but also purchased some WiFi and femto network equipment. The Company has started providing WiFi service to selected customers and is waiting for NCC's approval to provide femto service. Should this solution turn out well, the Company will deploy more WiFi and femto networks in 2012.

Impact of changes in brand image on the Company's risk management policies:

None. TWM has long built up a sound image among investors and customers for its continuing efforts to enhance corporate governance, network communication quality and customer service, as well as to fulfill its corporate social responsibility. These efforts won numerous recognitions and awards in 2011 (please refer to Chapter 1) and should aid the Company in preventing, controlling and managing latent risks that it may face and help it maintain its good corporate image.

Expected benefits and risks from mergers in recent years until publication date

The Company, acquired a 51% stake in Fubon Multimedia Technology Co., Ltd. (also known as momo) through Wealth Media Technology Co., Ltd., a 100% owned subsidiary of TWM, in July 2011.

1. Expected benefits:

To benefit from the synergy of combining traditional and virtual channels and enhance M-commerce business.

2. Potential risks:

Affected by the macro-economy, the subsidiary's operating performance fell behind expectations in 2011.

3. Countermeasures:

Periodic review and supervision of subsidiaries' operating performance.

Expected benefits and risks related to plant facility expansions: Not applicable

Risks from supplier and buyer concentrations in recent years until publication date

The Company's main supplier is Chunghwa Telecom (CHT) for network interconnections and leased lines. These costs accounted for 11% of total operating costs in 2011. The Company has been increasing usage of leased lines supplied by Taiwan Fixed Network, the Company's 100% owned subsidiary, to diversify supplier risk.

On the revenue side, CHT is the Company's largest source of interconnection revenue. But since the Company has a very diverse subscriber base for its mobile services, there is no buyer concentration risk.

Significant changes in shareholdings of directors and major shareholders: None.

Changes in management controls: Not applicable

Significant lawsuits and non-litigious matters

1. The Company: None

2. The Company's directors, general manager, any person with actual responsibility with the Company, any major shareholder holding greater than 10 percent of the Company's shares: None

3. The Company's subsidiaries

(1) Globalview Cable TV Co., Ltd., Phoenix Cable TV Co., Ltd., Union Cable TV Co., Ltd., and Yeong Jia Leh Cable TV Co., Ltd. (collectively referred to as “four SOs”)

The NCC fined the four system operators (SO) NT\$100,000 each and ordered them to divest indirect holdings by the Taipei City Government within one year after the ruling.

Parties Involved: The four SOs are the defaulting parties.

Grounds for Lawsuit:

The NCC ruled that the four SOs had violated Paragraph 4, Article 19 of the Cable, Radio and Television Act, which states that the government, political parties, as well as foundations established with their endowments, and those commissioned thereof, shall not directly or indirectly invest in cable, radio and/or television system operators. The four SOs disagreed with the NCC’s administrative disposition fining them NT\$100,000 each and ordering them to divest indirect holdings by the Taipei City Government within one year after receiving the ruling (the “First Disposition”), and filed individual administrative appeals in 2010. The Executive Yuan revoked the First Disposition, but in June and July 2010, the NCC issued a new administrative disposition to each of the four SOs (hereinafter referred to as the “Second Disposition”) with the same administrative penalty and conditions mentioned in the First Disposition. The four SOs disagreed with the Second Disposition and filed individual administrative appeals in July 2010. The Executive Yuan revoked the Second Disposition. Thereafter the NCC held a hearing for the said dispute on July 28, 2011, and issued a new administrative disposition to each of the four SOs (“Third Disposition”) with the same administrative penalty and conditions mentioned in the First and Second dispositions to the four SOs in January 2012. The four SOs disagreed with the Third Disposition, and will seek other legal process in accordance with the law.

(2) Win TV Broadcasting Co., Ltd.

The NCC fined Win TV broadcasting Co., Ltd. NT\$200,000 as an administrative penalty and instructed it to dispose of indirect holdings by the Taipei City Government within one year after the ruling.

Parties Involved: Win TV is the defaulting party.

Grounds for Lawsuit:

The NCC ruled that Win TV had violated Paragraph 3, Article 9 of the Satellite Broadcasting Act, which stipulates that political parties, the government and foundations established with their endowments, and those commissioned thereof, shall not invest directly or indirectly in satellite broadcasting businesses. Win TV was fined NT\$200,000 as an administrative penalty and ordered to divest indirect holdings by the Taipei City Government within one year after receiving the administrative disposition (the “First Disposition”). Win TV disagreed with the First Disposition and filed an administrative appeal. The Executive Yuan revoked the First Disposition. The NCC issued a second administrative disposition (“Second Disposition”) in September 2010 with the same penalty and conditions as in the First Disposition. Win TV disagreed with the Second Disposition and filed an appeal. The Executive Yuan revoked the Second Disposition.

Other major risks

Customer fraud management policy

1. Verification before activation

(1) ID confirmation: An application shall be denied if the applicant’s ID matches one on the blacklist. Approval may be given if the ID has been removed from the blacklist (e.g. after clearing unpaid bills).

(2) Customer profile confirmation: After passing the aforementioned process, if the applicant’s customer profile falls into the high-risk group, conditional approval may be granted (e.g. requiring advanced payment of bills).

2. Monitoring after activation

- (1) Verification calls: After activation, relatively “high-risk” applicants will receive a follow-up call from the Company to guard against fraud/fake accounts. In incidents where fraud is suspected (e.g. fake accounts), the Company will suspend phone service during the investigation period to protect customers’ interests.
- (2) Credit classification: The system grades and authorizes credit based on customers’ usage and payment history. When a customer’s usage exceeds his credit and a verifying call confirms that usage is unusual and abnormal, the Company will temporarily suspend phone service during the investigation period to protect customers’ interests.
- (3) Wireless data service notification: There is a notification mechanism to alarm customers when they are using mobile internet service domestically or overseas. Through the new feature of NTR (Network Traffic Re-direction), introduced in the middle of 2011, users who signed up for discounted international data roaming packages will be registered on the preferred network automatically. For those who haven’t signed up for this service, they will still be alerted and notified by text messages sent from the Company when they are using international data roaming.

Other significant items: None