

Chung Hung Steel Corporation

**Financial Statements for the
Years Ended December 31, 2009 and 2008 and
Independent Auditors' Report**

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
Chung Hung Steel Corporation

We have audited the accompanying balance sheets of Chung Hung Steel Corporation (the "Corporation") as of December 31, 2009 and 2008, 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 Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Corporation as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, requirements of the Business Accounting Law and Guidelines Governing Business Accounting relevant to financial accounting standards, and accounting principles generally accepted in the ROC.

As stated in Note 3 to the accompanying financial statements, starting January 1, 2009, the Corporation adopted the newly revised Statement of Financial Accounting Standards No. 10 - "Inventories".

January 26, 2010

Notice to Readers

The accompanying financial statements are intended only to present the financial position, results of operations and cash flows in accordance with 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.

For the convenience of readers, the auditors' report and the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language auditors' report and financial statements shall prevail. Also, as stated in Note 2 to the financial statements, the additional footnote disclosures that are not required under generally accepted accounting principles were not translated into English.

CHUNG HUNG STEEL CORPORATION

BALANCE SHEETS

DECEMBER 31, 2009 AND 2008

(In Thousands of New Taiwan Dollars, Except Par Value)

| ASSETS | 2009 | | 2008 | | LIABILITIES AND STOCKHOLDERS' EQUITY | 2009 | | 2008 | |
|---|----------------------|------------|----------------------|------------|--|---------------|-----|---------------|------|
| | Amount | % | Amount | % | | Amount | % | Amount | % |
| CURRENT ASSETS | | | | | CURRENT LIABILITIES | | | | |
| Cash | \$ 17,026 | - | \$ 160,930 | 1 | Short-term loans (Notes 13 and 25) | \$ 7,324,558 | 22 | \$ 14,443,509 | 39 |
| Financial assets at fair value through profit or loss (Notes 2, 4 and 23) | 25,580 | - | 80,668 | - | Commercial paper payable (Note 14) | 849,800 | 3 | 1,249,166 | 3 |
| Notes receivable | 276,916 | 1 | 442,874 | 1 | Financial liability at fair value through profit or loss (Notes 2, 4 and 23) | 903 | - | 73 | - |
| Accounts receivable (Notes 2 and 5) | 326,831 | 1 | 147,808 | 1 | Notes payable | - | - | 110,709 | - |
| Accounts receivable from related parties (Note 24) | 50,152 | - | 38,058 | - | Accounts payable | 695,636 | 2 | 70,076 | - |
| Income tax refund receivable | 458,243 | 1 | 458,118 | 1 | Accounts payable to related parties (Note 24) | 159,086 | 1 | 77,131 | - |
| Other receivables | 46,466 | - | 300,904 | 1 | Accrued expenses (Notes 16 and 24) | 308,049 | 1 | 171,263 | 1 |
| Inventories (Notes 2, 3 and 6) | 5,585,622 | 17 | 11,785,716 | 32 | Payable on purchase contract loss (Notes 2 and 26) | - | - | 2,239,770 | 6 |
| Office supplies (Notes 2 and 3) | 870,319 | 3 | 1,089,491 | 3 | Other payables (Notes 10 and 17) | 289,768 | 1 | 557,907 | 2 |
| Overpaid value-added tax | 582,322 | 2 | 499,140 | 1 | Current portion of long-term loans (Notes 15 and 25) | 1,057,143 | 3 | 5,857,143 | 16 |
| Restricted assets (Note 25) | 300,000 | 1 | 300,000 | 1 | Others (Note 24) | 727,537 | 2 | 38,878 | - |
| Others (Note 24) | 79,924 | - | 727,217 | 2 | | | | | |
| Total current assets | 8,619,401 | 26 | 16,030,924 | 44 | Total current liabilities | 11,412,480 | 35 | 24,815,625 | 67 |
| INVESTMENTS (Notes 2, 7, 8, 9 and 10) | | | | | LONG-TERM LOANS, NET OF CURRENT PORTION (Notes 15 and 25) | | | | |
| Available-for-sale financial assets | 1,561,916 | 5 | 1,048,266 | 3 | | 5,558,678 | 17 | 3,412,421 | 10 |
| Financial assets carried at cost | 290,635 | 1 | 291,850 | 1 | OTHER LIABILITIES | | | | |
| Investments accounted for by the equity method | 5,348,042 | 16 | 1,157,210 | 3 | Accrued pension cost (Note 18) | 287,694 | 1 | 421,207 | 1 |
| Other financial assets | 2,948 | - | 2,774,968 | 7 | Guarantee deposits received | 1 | - | 1 | - |
| Total investments | 7,203,541 | 22 | 5,272,294 | 14 | Deferred credits (Notes 2, 10 and 24) | 1,213,448 | 3 | - | - |
| | | | | | Total other liabilities | 1,501,143 | 4 | 421,208 | 1 |
| PROPERTIES (Notes 2, 11, 24, 25 and 26) | | | | | Total liabilities | 18,472,301 | 56 | 28,649,254 | 78 |
| Land | 2,188,469 | 7 | 2,183,230 | 6 | COMMON STOCK - NT\$10.00 par value, authorized 2,043,160 thousand shares; issued and outstanding - 1,684,571 thousand shares and 1,284,571 thousand shares as of December 31, 2009 and 2008, respectively (note 19) | 16,845,706 | 52 | 12,845,706 | 35 |
| Buildings and improvements | 2,499,148 | 8 | 2,670,943 | 7 | CAPITAL SURPLUS (Note 19) | 345,084 | 1 | 344,341 | 1 |
| Machinery and equipment | 14,168,487 | 43 | 14,012,488 | 38 | ACCUMULATED DEFICIT (Note 19) | | | | |
| Miscellaneous equipment | 2,988,387 | 9 | 2,700,799 | 7 | Legal reserve | - | - | 307,816 | 1 |
| Total costs | 21,844,491 | 67 | 21,567,460 | 58 | Accumulated deficit | (3,042,394) | (9) | (3,760,483) | (11) |
| Less: Accumulated depreciation | 10,452,380 | 32 | 9,783,535 | 26 | Total accumulated deficit | (3,042,394) | (9) | (3,452,667) | (10) |
| | 11,392,111 | 35 | 11,783,925 | 32 | OTHER EQUITY (Note 19) | | | | |
| Construction in progress | 332,589 | 1 | 195,863 | 1 | Unrealized gain (loss) on financial instruments | 92,963 | - | (1,452,425) | (4) |
| Prepayments for equipment | 987,448 | 3 | 549,858 | 1 | Total stockholders' equity | 14,241,359 | 44 | 8,284,955 | 22 |
| Net properties | 12,712,148 | 39 | 12,529,646 | 34 | TOTAL | \$ 32,713,660 | 100 | \$ 36,934,209 | 100 |
| OTHER ASSETS (Notes 2, 3 and 12) | | | | | | | | | |
| Rental assets | 48,553 | - | 49,097 | - | | | | | |
| Nonoperating assets, net | 3,774,429 | 12 | 2,629,563 | 7 | | | | | |
| Deferred charges | 299,189 | 1 | 366,286 | 1 | | | | | |
| Others | 56,399 | - | 56,399 | - | | | | | |
| Total other assets | 4,178,570 | 13 | 3,101,345 | 8 | | | | | |
| TOTAL | \$ 32,713,660 | 100 | \$ 36,934,209 | 100 | | | | | |

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

(With Deloitte & Touche audit report dated January 26, 2010)

CHUNG HUNG STEEL CORPORATION

STATEMENTS OF INCOME

YEARS ENDED DECEMBER 31, 2009 AND 2008

(In Thousands of New Taiwan Dollars, Except Basic Earnings [Loss] Per Share)

| | 2009 | | 2008 | |
|--|--------------------|------------|--------------------|------------|
| | Amount | % | Amount | % |
| SALES (Notes 2, 24 and 27) | \$ 37,405,817 | 101 | \$ 49,532,016 | 102 |
| LESS: SALES RETURNS AND ALLOWANCES | <u>541,892</u> | <u>1</u> | <u>871,327</u> | <u>2</u> |
| NET SALES | 36,863,925 | 100 | 48,660,689 | 100 |
| SERVICE REVENUE | <u>49,679</u> | <u>-</u> | <u>504,725</u> | <u>1</u> |
| TOTAL OPERATING REVENUE | 36,913,604 | 100 | 49,165,414 | 101 |
| OPERATING COSTS (Notes 2, 6, 21 and 24) | <u>37,019,198</u> | <u>101</u> | <u>51,980,731</u> | <u>107</u> |
| GROSS LOSS | <u>(105,594)</u> | <u>(1)</u> | <u>(2,815,317)</u> | <u>(6)</u> |
| OPERATING EXPENSES (Note 21) | | | | |
| Selling expenses | 939,578 | 2 | 731,203 | 2 |
| General and administrative expenses | <u>248,046</u> | <u>1</u> | <u>233,850</u> | <u>-</u> |
| Total operating expenses | <u>1,187,624</u> | <u>3</u> | <u>965,053</u> | <u>2</u> |
| OPERATING LOSS | <u>(1,293,218)</u> | <u>(4)</u> | <u>(3,780,370)</u> | <u>(8)</u> |
| NONOPERATING INCOME AND GAINS | | | | |
| Interest income (Note 23) | 2,686 | - | 6,244 | - |
| Valuation gain on financial assets (Note 4) | 1,247 | - | 79,573 | - |
| Investment income recognized under the equity method, net (Note 9) | 160,094 | 1 | 30,503 | - |
| Dividend income | 59,893 | - | 171,357 | 1 |
| Gain on disposal of properties | 11,443 | - | - | - |
| Gain on sale of investments (Note 8) | - | - | 7,413 | - |
| Reversal of impairment loss, net (Notes 8 and 12) | 1,143,651 | 3 | - | - |
| Others (Notes 6, 21 and 24) | <u>760,415</u> | <u>2</u> | <u>50,635</u> | <u>-</u> |
| Total nonoperating income and gains | <u>2,139,429</u> | <u>6</u> | <u>345,725</u> | <u>1</u> |
| NONOPERATING EXPENSES AND LOSSES | | | | |
| Interest expense (Notes 11 and 23) | 287,610 | 1 | 326,879 | 1 |
| Valuation loss on financial liabilities (Note 4) | 3,294 | - | 19,472 | - |
| Others (Note 21) | <u>13,966</u> | <u>-</u> | <u>10,495</u> | <u>-</u> |
| Total nonoperating expenses and losses | <u>304,870</u> | <u>1</u> | <u>356,846</u> | <u>1</u> |
| INCOME (LOSS) BEFORE INCOME TAX | 541,341 | 1 | (3,791,491) | (8) |

(Continued)

CHUNG HUNG STEEL CORPORATION

STATEMENTS OF INCOME

YEARS ENDED DECEMBER 31, 2009 AND 2008

(In Thousands of New Taiwan Dollars, Except Basic Earnings [Loss] Per Share)

| | 2009 | | 2008 | |
|--|-------------------------|------------------------|-------------------------|------------------------|
| | Amount | % | Amount | % |
| INCOME TAX BENEFIT (Notes 2 and 20) | \$ (1,732) | - | \$ (23,942) | - |
| NET INCOME (LOSS) | \$ 543,073 | 1 | \$ (3,767,549) | (8) |
| | 2009 | | 2008 | |
| | Before Income Tax | After Income Tax | Before Income Tax | After Income Tax |
| BASIC EARNINGS (LOSS) PER SHARE (New Taiwan dollars; Note 22) | \$ 0.34 | \$ 0.34 | \$ (2.95) | \$ (2.93) |

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

(With Deloitte & Touche audit report dated January 26, 2010)

(Concluded)

CHUNG HUNG STEEL CORPORATION

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY YEARS ENDED DECEMBER 31, 2009 AND 2008 (In Thousands of New Taiwan Dollars)

| | Issued and Outstanding Common Stock | Capital Surplus | Retained Earnings (Accumulated deficit) | | | Other Equity | | Total Stockholders' Equity |
|---|---|-------------------|---|--------------------------------------|-----------------------|--|---|-------------------------------|
| | | | Legal Reserve | Unappropriated Earnings (Deficit) | Net | Unrealized Gain (Loss) on Financial Instruments | Net Loss not Recognized as Pension Cost | |
| | | | | | | | | |
| BALANCE, JANUARY 1, 2008 | \$ 12,845,706 | \$ - | \$ 39,324 | \$ 2,694,377 | \$ 2,733,701 | \$ 1,002,699 | \$ (1) | \$ 16,582,105 |
| Appropriation of the 2007 earnings (Note 19) | | | | | | | | |
| Legal reserve | - | - | 268,492 | (268,492) | - | - | - | - |
| Cash dividends - 17.7% | - | - | - | (2,273,690) | (2,273,690) | - | - | (2,273,690) |
| Bonuses to employees | - | - | - | (120,941) | (120,941) | - | - | (120,941) |
| Remuneration to directors and supervisors | - | - | - | (24,188) | (24,188) | - | - | (24,188) |
| Change in unrealized loss on available-for-sale financial assets (Note 19) | - | - | - | - | - | (868,245) | - | (868,245) |
| Adjustment from changes in equity recognized under the equity method (Note 19) | - | 344,341 | - | - | - | (1,586,879) | - | (1,242,538) |
| Change in net loss not recognized as pension cost (Note 2) | - | - | - | - | - | - | 1 | 1 |
| Net loss in 2008 | - | - | - | (3,767,549) | (3,767,549) | - | - | (3,767,549) |
| BALANCE, DECEMBER 31, 2008 | 12,845,706 | 344,341 | 307,816 | (3,760,483) | (3,452,667) | (1,452,425) | - | 8,284,955 |
| Compensation cost recognized for employee stock options (Note 19) | - | 67,200 | - | - | - | - | - | 67,200 |
| Issuance of common stock for cash (Note 19) | 4,000,000 | (67,200) | - | (132,800) | (132,800) | - | - | 3,800,000 |
| Offset of deficit (Note 19) | - | - | (307,816) | 307,816 | - | - | - | - |
| Compensation cost recognized by the Corporation on its treasury stock (Note 19) | - | 743 | - | - | - | - | - | 743 |
| Change in unrealized gain on available-for-sale financial assets (Note 19) | - | - | - | - | - | 513,650 | - | 513,650 |
| Adjustment from changes in equity recognized under the equity method (Note 19) | - | - | - | - | - | 1,031,738 | - | 1,031,738 |
| Net income in 2009 | - | - | - | 543,073 | 543,073 | - | - | 543,073 |
| BALANCE, DECEMBER 31, 2009 | <u>\$ 16,845,706</u> | <u>\$ 345,084</u> | <u>\$ -</u> | <u>\$ (3,042,394)</u> | <u>\$ (3,042,394)</u> | <u>\$ 92,963</u> | <u>\$ -</u> | <u>\$ 14,241,359</u> |

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

(With Deloitte & Touche audit report dated January 26, 2010)

CHUNG HUNG STEEL CORPORATION

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2009 AND 2008 (In Thousands of New Taiwan Dollars)

| | 2009 | 2008 |
|---|------------------|--------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income (loss) | \$ 543,073 | \$ (3,767,549) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities | | |
| Depreciation | 1,071,921 | 983,428 |
| Amortization | 33,144 | 31,567 |
| Reversal of allowance for doubtful accounts | (19,200) | (17,079) |
| Provision for loss on inventories | - | 7,131,879 |
| Reversal of impairment loss on properties and equity-method investments, net | (1,143,651) | - |
| Cash dividends received from equity-method investments | - | 1,924 |
| Gain on sale of investments | - | (7,413) |
| Investment income recognized under the equity method, net | (160,094) | (30,503) |
| Valuation loss (gain) on financial instruments | 2,047 | (60,101) |
| Loss (gain) on disposal of properties | (11,443) | 34 |
| Amortization on disposal of nonperforming loans | (43,586) | - |
| Purchase contract loss | 1,036,875 | 2,239,770 |
| Compensation cost recognized for employee stock options | 67,200 | - |
| Compensation cost recognized on the Corporation's treasury stock | 743 | - |
| Net changes in operating assets and liabilities | | |
| Financial assets at fair value through profit or loss | 53,871 | (3,867) |
| Notes receivable | 165,958 | (180,844) |
| Accounts receivable (including those from related parties) | (171,917) | 843,018 |
| Income tax refund receivable | (125) | (144,369) |
| Others receivables | 254,438 | (298,202) |
| Inventories | 6,200,094 | (11,970,116) |
| Office supplies | 219,172 | (446,093) |
| Overpaid value-added tax | (83,182) | (499,140) |
| Other current assets | 647,293 | (120,978) |
| Notes payable | (110,709) | 110,709 |
| Accounts payable (including those to related parties) | 707,515 | (2,030,755) |
| Income tax payable | - | (802,195) |
| Accrued expenses | 136,786 | (272,981) |
| Payable on purchase contract loss | (3,276,645) | (199,662) |
| Other payables | (159,531) | 201,497 |
| Other current liabilities | 688,659 | (88,706) |
| Provision for pension cost | (133,513) | (22,728) |
| Net cash provided by (used in) operating activities | <u>6,515,193</u> | <u>(9,419,455)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds of the disposal of other financial assets-noncurrent | 4,028,152 | - |
| Increase in other financial assets-noncurrent | (22,380) | (529,738) |
| Proceeds of the disposal of financial assets carried at cost | - | 7,413 |
| Increase in long-term stock investments under the equity method | (2,999,000) | (2,152) |

(Continued)

CHUNG HUNG STEEL CORPORATION

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2009 AND 2008 (In Thousands of New Taiwan Dollars)

| | 2009 | 2008 |
|--|---------------------|--------------------|
| Acquisition of properties | \$ (1,357,655) | \$ (925,424) |
| Proceeds of the disposal of assets | 28,991 | - |
| Decrease (increase) in refundable deposits | 902 | (223) |
| Decrease (increase) in deferred charges | <u>37,353</u> | <u>(106,494)</u> |
| Net cash used in investing activities | <u>(283,637)</u> | <u>(1,556,618)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Increase (decrease) in short-term loans | (7,118,951) | 10,052,649 |
| Increase (decrease) in commercial paper payable | (399,366) | 749,388 |
| Increase in guarantee deposits received | - | 1 |
| Repayments of long-term loans | (5,407,143) | (2,287,143) |
| Proceeds from long-term loans | 2,750,000 | 5,000,000 |
| Issuance of common stock for cash | 3,800,000 | - |
| Cash dividends | - | (2,273,690) |
| Bonuses to employees | - | (120,941) |
| Remuneration to directors and supervisors | <u>-</u> | <u>(24,188)</u> |
| Net cash provided by (used in) financing activities | <u>(6,375,460)</u> | <u>11,096,076</u> |
| NET INCREASE (DECREASE) IN CASH | (143,904) | 120,003 |
| CASH, BEGINNING OF YEAR | <u>160,930</u> | <u>40,927</u> |
| CASH, END OF YEAR | <u>\$ 17,026</u> | <u>\$ 160,930</u> |
| SUPPLEMENTAL CASH FLOW INFORMATION | | |
| Interest paid (excluding capitalized interest) | \$ 304,939 | \$ 315,156 |
| Income tax paid | - | 778,253 |
| INVESTING ACTIVITIES AFFECTING BOTH CASH AND NON-CASH ITEMS | | |
| Acquisition of properties | \$ 1,271,427 | \$ 999,353 |
| Decrease (increase) in payable on properties purchased | <u>86,228</u> | <u>(73,929)</u> |
| Cash paid | <u>\$ 1,357,655</u> | <u>\$ 925,424</u> |
| Increase in other financial assets - noncurrent | - | \$ 552,118 |
| Decrease (increase) in other payables | <u>22,380</u> | <u>(22,380)</u> |
| | <u>\$ 22,380</u> | <u>\$ 529,738</u> |
| NON-CASH INVESTING AND FINANCING ACTIVITIES | | |
| Current portion of long-term loans | \$ 1,057,143 | \$ 5,857,143 |
| Properties reclassified into nonoperating assets | - | 1,057,633 |

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

(With Deloitte & Touche audit report dated January 26, 2010)

(Concluded)

CHUNG HUNG STEEL CORPORATION

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2009 AND 2008

(In Thousands of New Taiwan Dollars, Unless Stated Otherwise)

1. ORGANIZATION

Chung Hung Steel Corporation (the "Corporation") was incorporated in September 1983 and started operations in September 1985. It mainly manufactures and sells steel products, such as cold and hot rolled coils and steel pipes. China Steel Corporation, the Corporation's parent and major stockholder (41%), controls the Corporation's management and operations.

The Corporation's shares have been listed on the Taiwan Stock Exchange since February 1992.

As of December 31, 2009 and 2008, the Corporation had 913 and 912 employees, respectively.

The Corporation had an operating deficit caused by the recession in the steel market in 2008. However, as of December 31, 2009, the Corporation's debit ratio had decrease to 56% because of the recovery of the price of steel in the market in 2009.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The financial statements of the Corporation are prepared in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, Business Accounting Law, Guidelines Governing Business Accounting and accounting principles generally accepted in the Republic of China. According to these guidelines, laws and principles, the Corporation is required to make certain assumptions and estimates, which affect the amounts of recorded assets, liabilities, revenues and expenses, including provisions for doubtful accounts and inventory losses, purchase contract loss, allowance for sales discounts, depreciation of property, impairment loss on assets, pension cost, income tax, bonuses to employees, directors and supervisors, etc. Actual results could differ from these estimates.

For the convenience of readers, the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail. However, the accompanying financial statements do not include the English translation of the additional footnote disclosures that are not required under generally accepted accounting principles but are required by the Securities and Futures Bureau (SFB, formerly "Securities and Futures Commission" before July 1, 2004) for their oversight purposes.

The Corporation's significant accounting policies are summarized as follows.

Current and Noncurrent Assets and Liabilities

Current assets include cash and those assets held primarily for trading purposes or to be realized, sold or consumed within one year from the balance sheet date. All other assets such as properties are classified as noncurrent. Current liabilities are obligations incurred for trading purposes or to be settled within one year from the balance sheet date. All other liabilities are classified as noncurrent.

Financial Instruments at Fair Value Through Profit or Loss

Financial instruments at fair value through profit or loss include financial assets or financial liabilities held for trading. The Corporation recognizes a financial asset or a financial liability on its balance sheet when the Corporation becomes a party to the contractual provisions of the financial instrument. A financial asset is derecognized when the Corporation has lost control of its contractual rights over the financial asset. A financial liability is derecognized when the obligation specified in the relevant contract is discharged, cancelled or expired. These financial instruments are initially recognized at fair value, and related transaction costs are expensed currently. When these instruments are remeasured at fair value, the changes in fair value are recognized under current income. A regular purchase or sale of financial assets is recorded using trade date accounting.

Derivatives that do not meet the criteria for hedge accounting are treated as financial assets or liabilities held for trading. When the fair value of the derivative is a positive number, the financial instrument is recorded as a financial asset; when the fair value is a negative number, the financial instrument is recorded as a financial liability.

Available-for-sale Financial Assets

Available-for-sale financial assets are initially recognized at fair value plus transaction costs that are directly attributable to the acquisition. When subsequently measured at fair value, the changes in fair value are excluded from earnings and reported as a separate component of stockholders' equity. The accumulated gains or losses are recognized under earnings when the financial asset is derecognized from the balance sheet. A regular purchase or sale of financial assets is recorded using trade date accounting.

The recognition and derecognition bases of available-for-sale financial assets are similar to those of financial instruments at fair value through profit or loss.

Cash dividends received on investment in equity securities are recognized as income in the period received. Stock dividends received are recognized only as an increase in the number of shares of stock held on the ex-dividend date. Costs of investments sold are determined by the weighted-average method.

If there is objective evidence that a financial asset is impaired, an impairment loss is recognized. If the impairment loss decreases, for equity securities, the previously recognized impairment loss is reversed to the extent of the decrease and recorded as an adjustment to stockholders' equity; for debt securities, the amount of the decrease is recognized under earnings if the decrease is clearly attributable to an event that occurred after impairment loss recognition.

The fair value of financial assets and financial liabilities at the balance sheet date are determined at the closing prices of publicly traded stocks.

Revenue Recognition, Sales Returns and Allowances and Allowance for Doubtful Accounts

Revenue is recognized when the titles to products and evident risks of ownership are transferred to customers, primarily upon shipment. Domestic sales are recognized when products are delivered to and accepted by the customers, and export sales are recognized when products are loaded onto shipping vessels in accordance with the sales terms.

Sales are measured at fair value, which is a price (net of trade discounts and sales discounts) agreed by the Corporation and customers. However, if the related receivables are due within one year, the differences between their fair values and receivable amounts are immaterial and sales transactions are frequent, the fair values of related receivables are not calculated using the discounted imputed interest rate.

Sales returns are recorded as reductions of sales in the year of actual return, and the related cost of sales is reversed to inventory. Sales allowances are monetary discounts applied when sales volume reaches a certain level and are recorded as sales allowances payable.

An allowance for doubtful accounts is provided on the basis of a review of the collectibility of receivables. This review includes an aging analysis of receivables and economic situation. However, aging analysis of receivables had exceeded certain period and was reclassified into overdue receivables.

Factoring of Accounts Receivable

The following three conditions must be met to recognize factoring of accounts receivable:

- a. The accounts receivable have been legally isolated from the Corporation.
- b. The transferees have obtained the right to pledge or exchange the accounts receivable, which are either the transferred accounts receivable or beneficial interest in the transferred assets.
- c. The transferor does not maintain effective control, through an agreement to repurchase or redeem the transferred accounts receivable before their maturity, over the transferred accounts receivable.

If the three conditions are met, the difference between the proceeds and the face value of the accounts receivable is recognized as a loss and recorded as nonoperating expenses.

Inventories

Inventories consist of raw materials, supplies, finished goods, work-in-process and scraps. Before January 1, 2009, inventories were stated at the lower of cost or market value. Any write-down on an item was made on total-inventory basis. Market value meant replacement cost for raw materials and supplies and net realizable value for finished goods, work in process and scraps. As stated in Note 3, effective January 1, 2009, inventories are stated at the lower of cost or net realizable value. Inventory write-downs are made by item, except where it may be appropriate to group similar or related items. Net realizable value is the estimated selling price of inventories less all estimated costs of completion and costs necessary to make the sale. Inventories are recorded at weighted-average cost on the balance sheet date.

Financial Assets Carried at Cost

Investments with no quoted market prices, such as non-publicly traded stocks and mutual funds, and with fair values that cannot be reliably measured are carried at original cost. If there is objective evidence of financial asset impairment, impairment loss is recognized. No recording of a subsequent recovery of fair value is allowed.

Investments Accounted for by the Equity Method

The equity method is applied to investments in companies in which the Corporation owns 20% or more of investees' common stock or exercises significant influence over their operating and financial policy decisions.

These investments are initially stated at cost, and their carrying amounts are subsequently adjusted for the Corporation's proportionate share in the net income or net loss and cumulative translation adjustment. Cash dividends received are accounted for as a reduction of the carrying value of the investments. When the investee recognizes net loss not recognized as pension cost and unrealized valuation gains or losses on financial instruments, the Corporation also records its equity in the investee's unrealized gains or losses as an adjustment to stockholders' equity.

Other Financial Assets - Noncurrent (Nonperforming Loans)

Other financial assets - noncurrent are mainly nonperforming loans (NPLs), which are recorded at cost at the time of acquisition. The costs of acquired NPLs include the purchase price and necessary handling charges on acquisition. All expenditures related to bid participation - government fees, outsourcing costs, appraisal fees, etc. - are expensed when incurred. For any default on loans, costs related to the application to a court for a provisional seizure of assets or provisional disposition - fees for adjudication request, foreclosure ruling, and appraisal field review, etc. - are recorded as expenses.

The cost recovery method is used to recognize revenues from the recovery or disposal of acquired NPLs. After the cost of an acquired loan is recovered, revenue is recognized for the amounts recovered in excess of the acquisition cost of the loan. The acquired NPLs are de-recognized from the balance sheet on the disposal of the collaterals for the acquired loans or on the recovery of assets upon loan settlement. If there is NPL impairment, an impairment loss should be recognized.

Properties

Lands are stated at cost, and other properties are stated at cost less accumulated depreciation. Major additions, renewals and betterments are capitalized, while maintenance and repairs are expensed currently. Interest incurred during the construction and acquisition period is also capitalized as cost of the property.

Depreciation is calculated using the straight-line method over service lives estimated as follows: buildings and improvements, 10 to 60 years; machinery and equipment, 3 to 18 years; and miscellaneous equipment, 3 to 18 years. The residual values of properties that have reached the end of their original service lives but are still in use are further depreciated over their estimated remaining service lives.

Upon retirement or disposal of properties, the related cost and accumulated depreciation are removed from the accounts. Any gain or loss on disposal of the asset is included in nonoperating gains or losses in the year of disposal.

Nonoperating Assets

Nonoperating assets are stated at the lower of carrying value or net fair value.

Rental Assets

Rental assets are stated at the lower of carrying value (cost less accumulated depreciation) or recoverable value. Depreciation is calculated by the straight-line method over estimated service lives of 55 years.

Impairment of Asset

If the recoverable amount of an asset (mainly properties, investments accounted for by the equity method and other assets) is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount.

If an impairment loss subsequently reverses, the carrying amount of the asset is increased accordingly, but the increased carrying amount may not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years.

For long term equity investments on which the Corporation has significant influence but has no control, the carrying amount of each investment is compared with its own recoverable amount for the purpose of impairment testing.

Deferred Charges

Deferred charges pertain to standby and service equipments. Standby equipments are amortized over their estimated lives. The costs of service equipments are transferred to expense as these equipments are used.

Stock-based Compensation

Employee stock options granted on or after January 1, 2008 are accounted for under Statement of Financial Accounting Standards No. 39 - "Share-based Payment." Under the statement, the value of the stock options granted, which is equal to the best available estimate of the number of stock options expected to vest multiplied by the grant-date fair value, is expensed on a straight-line basis over the vesting period, with a corresponding adjustment to capital surplus - employee stock options. The estimate is revised if subsequent information indicates that the number of stock options expected to vest differs from previous estimates.

Purchase Contract Losses

Purchase contract losses pertain to irrevocable raw materials purchase contracts. If the estimated costs of finished goods are in excess of their expected net realizable values, payable on purchase contract losses are recognized as operating losses.

Deferred Credits

Deferred credit is unrealized gain on the disposal of nonperforming loans (Note 10). This gain is recognized throughout the amortization period of the collaterals for these loans.

Pension

Pension costs under the defined contribution plan are recognized on the basis of the Corporation's required monthly contributions to the employees' individual pension accounts.

Pension costs under the defined benefit plan are recognized on the basis of actuarial calculations. The balance of total provision less the funded amounts is recorded in the accrued pension cost account. Payment of retirement benefits is made initially from the pension fund or is charged against accrued pension costs, and any shortage will be charged to expense when paid.

Income Tax

The Corporation applies the inter-year income tax allocation method. Tax effects of deductible temporary differences and unused loss carryforwards are recognized as deferred income tax assets. Valuation allowance is provided for deferred tax assets that are not certain to be realized. Tax effects of taxable temporary differences are recognized as deferred tax liabilities. A deferred tax asset or liability is classified as current or noncurrent in accordance with the classification of its related asset or liability. However, if a deferred income tax asset or liability does not relate to an asset or liability in the financial statements, then it is classified as either current or noncurrent based on the expected length of time before it is realized or settled.

Tax credits for purchases of machinery, equipment and technology, research and development expenditures, and personnel training expenditures are recognized using the flow-through method.

Adjustments of prior years' tax liabilities are added to or deducted from the current year's tax provision.

According to the Income Tax Law, an additional tax at 10% of unappropriated earnings is provided for as income tax in the year the stockholders approve to retain the earnings.

Foreign Currency Transactions

Non-derivative foreign-currency transactions are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Exchange differences arising from settlement of foreign-currency assets and liabilities are recognized in profit or loss.

Reclassifications

Certain accounts in the financial statements as of and for the year ended December 31, 2008 have been reclassified to conform to the presentation of the financial statements as of and for the year ended December 31, 2009.

The reclassifications were as follows:

| | Before | After |
|------------------|----------------------|----------------------|
| Balance Sheet | | |
| Current | | |
| Inventory | \$ 13,219,132 | \$ 11,785,716 |
| Office supplies | - | 1,089,491 |
| Noncurrent | | |
| Deferred Charges | <u>22,361</u> | <u>366,286</u> |
| | <u>\$ 13,241,493</u> | <u>\$ 13,241,493</u> |

3. EFFECTS OF CHANGES IN ACCOUNTING PRINCIPLES

Accounting for Inventories

On January 1, 2009, the Corporation adopted the newly revised Statement of Financial Standards No. 10 - "Inventories". The main revisions are (1) inventories are stated at the lower of cost or net realizable value, and inventories are written down to net realizable value by item, except when the grouping of similar or related items is appropriate; (2) unallocated overheads are recognized as expenses in the period in which they are incurred; and (3) abnormal costs, write-downs of inventories and any reversal of write-downs are recorded as cost of goods sold for the period. This accounting change had no significant influence on the financial statements as of and for the year ended December 31, 2009.

Accounting for Bonuses to Employees, Directors and Supervisors

In March 2007, the Accounting Research and Development Foundation issued Interpretation 2007-052, which requires companies to recognize as compensation expenses bonuses paid to employees, directors and supervisors beginning January 1, 2008. These bonuses were previously recorded as appropriations from earnings. This accounting change had no significant influence on the financial statements as of and for the year ended December 31, 2008.

4. FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

The Corporation entered into derivative contracts during the years ended December 31, 2009 and 2008 to manage exposures due to exchange rate and interest rate fluctuations. The financial risk management objective of the Corporation is to minimize risks due to changes in fair value or cash flows. Derivatives that do not meet the criteria for hedge accounting are treated as financial assets or liabilities held for trading.

As of December 31, 2009 and 2008, forward exchange contracts recognized in financial assets designated as at FVTPL amounted to NT\$25,580 thousand and NT\$80,668 thousand, respectively, forward exchange contracts recognized in financial liabilities designated as at FVTPL amounted to NT\$903 thousand and NT\$73 thousand, respectively. Outstanding forward exchange contracts as of December 31, 2009 and 2008 were as follows:

| | Currency | Maturity Date | Amount (In Thousands) |
|--------------------------|-----------------|-----------------------|------------------------------|
| <u>December 31, 2009</u> | | | |
| Buy | NT/USD | 2010.01.13-2010.03.31 | NT\$277,974/US\$8,705 |
| Buy | NT/EUR | 2010.06.30 | NT\$41,464/EUR989 |
| Buy | NT/YEN | 2010.12.30 | NT\$150,245/YEN493,416 |
| <u>December 31, 2008</u> | | | |
| Buy | NT/USD | 2009.03.31-2010.03.31 | NT\$658,444/US\$21,000 |
| Buy | NT/EUR | 2009.01.28-2010.06.30 | NT\$45,461/EUR1,074 |
| Buy | NT/YEN | 2010.12.30 | NT\$338,048/YEN1,110,000 |

Net gains on financial assets designated as at FVTPL for the years ended December 31, 2009 and 2008 were NT\$1,247 thousand and NT\$79,573 thousand, respectively; net losses on financial liabilities designated as at FVTPL for the years ended December 31, 2009 and 2008 were NT\$3,294 thousand and NT\$19,472 thousand, respectively.

5. ACCOUNTS RECEIVABLE

| | <u>December 31</u> | |
|--|--------------------|-------------------|
| | 2009 | 2008 |
| Accounts receivable | \$ 344,617 | \$ 167,008 |
| Less: Allowance for doubtful accounts (Note 2) | <u>17,786</u> | <u>19,200</u> |
| | <u>\$ 326,831</u> | <u>\$ 147,808</u> |

Movements of allowances for doubtful accounts were as follows:

| | <u>Years Ended December 31</u> | | | | | |
|----------------------------|--------------------------------|--|------------------|--------------------------------|--|------------------|
| | <u>2009</u> | | | <u>2008</u> | | |
| | Accounts Receivable | Other Noncurrent Financial Assets (Note 10) | Total | Accounts Receivable | Other Noncurrent Financial Assets (Note 10) | Total |
| Balance, beginning of year | \$ 19,200 | \$ 17,786 | \$ 36,986 | \$ 17,079 | \$ 36,986 | \$ 54,065 |
| Reversal of provision | (19,200) | - | (19,200) | (17,079) | - | (17,079) |
| Reclassification | <u>17,786</u> | <u>(17,786)</u> | <u>-</u> | <u>19,200</u> | <u>(19,200)</u> | <u>-</u> |
| Balance, end of year | <u>\$ 17,786</u> | <u>\$ -</u> | <u>\$ 17,786</u> | <u>\$ 19,200</u> | <u>\$ 17,786</u> | <u>\$ 36,986</u> |

The Corporation entered into a factoring accounts receivable contract (without recourse) with Mega International Commercial Bank. Under the contract, the Corporation is authorized to sell accounts receivable to Mega upon the delivery of products to customers and is required to complete related formalities on the next banking day. Under this contract, the Corporation does not bear the risk of the uncollectibility of the accounts receivable. The receivables sold and the related credit lines, which may be used on a revolving basis, were as follows:

| Counter-parties | Advances Received at Year-begin | Receivables Sold | Amounts Collected | Advances Received at Year-end | Interest Rates on Advances Received (%) | Credit Line |
|--|---------------------------------------|---------------------|----------------------|-------------------------------------|---|-------------|
| Year ended <u>December 31, 2009</u> | | | | | | |
| Mega Bank | <u>\$ 1,100,937</u> | <u>\$ 3,194,656</u> | <u>\$ 3,262,853</u> | <u>\$ 1,032,740</u> | 1.24 | \$3 billion |
| Year ended <u>December 31, 2008</u> | | | | | | |
| Mega Bank | <u>\$ 1,757,340</u> | <u>\$ 4,827,042</u> | <u>\$ 5,483,445</u> | <u>\$ 1,100,937</u> | 2.78 | \$3 billion |

6. INVENTORIES

| | December 31 | |
|---------------------------------------|---------------------|----------------------|
| | 2009 | 2008 |
| Finished goods | \$ 1,267,500 | \$ 2,762,601 |
| Work-in-process | 705,982 | 790,359 |
| Raw materials | 2,717,783 | 8,028,997 |
| Supplies | 50,488 | 125,980 |
| Scraps | 19,559 | 77,779 |
| Raw materials and supplies in transit | <u>824,310</u> | <u>-</u> |
| | <u>\$ 5,585,622</u> | <u>\$ 11,785,716</u> |

The costs of inventories recognized as operating costs were NT\$37,012,983 thousand in 2009 and NT\$51,683,341 thousand in 2008. The items recorded as operating costs were as follows:

| | December 31 | |
|---|--------------|--------------|
| | 2009 | 2008 |
| Provision for loss on inventories | \$ - | \$ 7,131,879 |
| Provision for purchase contract loss | 1,036,875 | 2,239,770 |
| Reduction of purchase contract loss payable | (3,276,645) | (199,662) |
| Income from supplies and scraps | (772,548) | (1,221,027) |

As described in Note 24, the Corporation signed a contract with Chian Steel Corporation (CSC) for CSC to transfer to the Corporation the certain slab purchasing rights from EAUS. In March 2008, CSC repaired blast furnaces and reduced the number of slabs to which the Corporation has purchasing rights; thus, the Corporation had an operating loss. For this loss, the Corporation obtained NT\$650,000 thousand (included in nonoperating income and gain) as insurance compensation from Chung Kuo Insurance Company and nine other insurance companies in December 2009.

7. AVAILABLE-FOR-SALE FINANCIAL ASSETS - NONCURRENT

| | <u>December 31</u> | |
|-------------------------------------|---------------------|---------------------|
| | <u>2009</u> | <u>2008</u> |
| Domestic quoted stocks | | |
| China Steel Corporation | \$ 1,030,586 | \$ 1,030,586 |
| Adjustments for appraisal (Note 19) | <u>531,330</u> | <u>17,680</u> |
| | <u>\$ 1,561,916</u> | <u>\$ 1,048,266</u> |

8. FINANCIAL ASSETS CARRIED AT COST - NONCURRENT

| | <u>December 31</u> | |
|--|--------------------|-------------------|
| | <u>2009</u> | <u>2008</u> |
| Emerging market stocks | | |
| Yieh United Steel Corp. | \$ 257,600 | \$ 257,600 |
| Domestic unquoted common stocks | | |
| Risalink Venture Capital Corp. | 30,000 | 30,000 |
| Pacific Harbour Stevedoring Corp. | 2,750 | 2,750 |
| Cheng Shin House Management Consulting Corp. | <u>285</u> | <u>1,500</u> |
| | <u>\$ 290,635</u> | <u>\$ 291,850</u> |

In February 2008, the Corporation sold all its shares in Far Glory Life for NT\$7,413 thousand, and the gain on this sale was NT\$7,413 thousand, included in nonoperating gains. In 2009, the Corporation recognized an impairment loss of NT\$1,215 thousand on its investment in Cheng Shin House Management Consulting Corp, and later included this amount in the reversal of impairment loss. The Corporation had investments in Sol Hwang Enterprise, Chateau Bridgetop Inc., Taiwan Vespa and Sol Hwang Enterprise. The carrying amounts of these investments were reduced to zero because of impairment losses on these investments.

Stocks with no quoted prices and their fair values could not be measured reliably were classified as financial assets carried at cost.

9. INVESTMENTS ACCOUNTED FOR BY THE EQUITY METHOD

| | <u>December 31</u> | | | |
|-------------------------------------|---------------------|------------------------|---------------------|------------------------|
| | <u>2009</u> | | <u>2008</u> | |
| | Amount | % of Owner- ship | Amount | % of Owner- ship |
| Hung Li Steel Corp. (HLC) | \$ 3,045,442 | 100 | \$ 204 | 100 |
| Trans Glory Investment Corp. (TGIC) | 2,242,209 | 41 | 1,108,550 | 41 |
| Hong Kao Investment Corp. (HKIC) | 37,274 | 100 | 25,423 | 100 |
| Taiwan Steel Corp.(TSC) | <u>23,117</u> | 100 | <u>23,033</u> | 100 |
| | <u>\$ 5,348,042</u> | | <u>\$ 1,157,210</u> | |

Significant movements were as follows:

TGIC was incorporated in May 2005. The Corporation made a payment of NT\$1,152 thousand to acquire 104 thousand shares from related party in March 2008. The investment in TGIC amounted to NT\$2,001,152 thousand as of December 31, 2009.

HLC was incorporated in July 2008. The Corporation invested NT\$1,000 thousand in HLC in July 2008 and NT\$2,999,000 thousand in July 2009. As of December 31, 2009, the Corporation had invested NT\$3,000,000 thousand in HLC, representing 100% ownership.

The recognition of the following investment income (loss) from investments accounted for by the equity method was based on the investees' audited financial statements of the same reporting periods as those of the Corporation:

| | <u>Years Ended December 31</u> | |
|------|--------------------------------|------------------|
| | <u>2009</u> | <u>2008</u> |
| TGIC | \$ 111,527 | \$ 28,825 |
| HLC | 46,238 | (796) |
| HKIC | 2,245 | 2,921 |
| TSC | <u>84</u> | <u>(447)</u> |
| | <u>\$ 160,094</u> | <u>\$ 30,503</u> |

The Corporation's consolidated financial statements included the subsidiaries (HLC, HKIC and TSC).

10. OTHER FINANCIAL ASSETS - NONCURRENT

| | <u>December 31</u> | |
|---|--------------------|---------------------|
| | <u>2009</u> | <u>2008</u> |
| Nonperforming loans (Note 2) | <u>\$ -</u> | <u>\$ 2,771,118</u> |
| Long-term accounts receivable | - | 17,786 |
| Less: Allowance for doubtful accounts (Notes 2 and 5) | <u>-</u> | <u>17,786</u> |
| | <u>-</u> | <u>-</u> |
| Refundable deposits | <u>2,948</u> | <u>3,850</u> |
| | <u>\$ 2,948</u> | <u>\$ 2,774,968</u> |

To expand the value chain of the Corporation's product, the Board of Directors approved the acquisition of the obligatory rights on from the collateralized syndicated bank loans of NT\$6.887 billion of Jenn An Steel Co., Ltd (JAS), and the processing of this acquisition was delegated to Far Eastern Asset Management Co., Ltd. The Corporation used NT\$2.219 billion to acquire these rights. JAS's syndicated bank loan of NT\$6.887 billion consisted of (a) NT\$6.287 billion (89.32% of JAS's total syndicated loan of NT\$7.039 billion), which were collateralized with land, buildings and equipment for cold-rolled and zinc-galvanized coils, etc. and (b) NT\$0.6 billion collateralized with stock shares of An Feng Steel Co., Ltd. The Corporation completed the rights acquisition and payment on November 2007.

In order to integrate JAS's debts, the Corporation paid NT\$0.5 billion of the NT\$1.09 billion in creditor's right of Yung Chi Paint on JAS, and this transaction was completed in January 2008. In addition, in November 2008, the Corporation signed a legal mortgage contract with Knight Commander Holding (KCH). Under this contract, the Corporation should pay KCH NT\$52,380 thousand for KCH's placing under legal mortgage NT\$52,109 thousand in JAS's debts and should also pay related interests.

The collaterals for JAS's syndicated loan and its obligations to Yung Chi Paint and KCH include land, factory buildings, cold-rolled equipment, miscellaneous equipment, etc. On July 22, 2009, Taiwan Kaohsiung District Court (TKDC) auctioned off JAS's collaterals, and HLC bid NT\$4,591,194 thousand for them. On November 13, 2009, TKDC allocated the proceeds of the auction of JAS's collaterals, with the Corporation getting the largest allocation. In addition, the Corporation earned NT\$77,710 thousand on JAS's fire insurance and recognized this amount as a reduction of nonperforming loans.

As of November 13, 2009, the carrying value of the nonperforming loans was NT\$2,693,408 thousand, and the Corporation obtained NT\$3,976,096 thousand on the disposal of these loans in December 2009. But the Corporation needed to pay a 2% business tax of NT\$25,654 thousand. As a result of this tax, the gain on disposal of nonperforming loans decreased to NT\$1,257,034 thousand. In addition, because some of the collaterals were gotten by HLC, a subsidiary of the Corporation, the gain was reclassified to deferred credits and was recognized on the basis of its realization period (which is HLC's property depreciation period).

11. PROPERTIES

Accumulated depreciation consisted of:

| | December 31 | |
|----------------------------|----------------------|---------------------|
| | 2009 | 2008 |
| Buildings and improvements | \$ 826,241 | \$ 871,209 |
| Machinery and equipment | 7,871,959 | 7,472,070 |
| Miscellaneous equipment | <u>1,754,180</u> | <u>1,440,256</u> |
| | <u>\$ 10,452,380</u> | <u>\$ 9,783,535</u> |

Interest expenses capitalized were as follows:

| | Years Ended December 31 | |
|---|--------------------------------|-------------------|
| | 2009 | 2008 |
| Total interest expenses | \$ 301,033 | \$ 353,948 |
| Interest capitalized | <u>(13,423)</u> | <u>(27,069)</u> |
| Interest expenses reflected in the income statement | <u>\$ 287,610</u> | <u>\$ 326,879</u> |
| Capitalized interest rate | 0.94%-2.16% | 2.55%-2.90% |

12. OTHER ASSETS

a. Rental assets

| | December 31 | |
|--------------------------------|--------------------|------------------|
| | 2009 | 2008 |
| Land - Taipei office | \$ 64,026 | \$ 64,026 |
| Buildings and improvements | <u>30,289</u> | <u>30,289</u> |
| | 94,315 | 94,315 |
| Less: Accumulated depreciation | 7,262 | 6,718 |
| Accumulated impairment loss | <u>38,500</u> | <u>38,500</u> |
| | <u>\$ 48,553</u> | <u>\$ 49,097</u> |

The Corporation leased the Taipei office to a third party under a renewable operating lease contract. Until June 2009, the rental income was NT\$304 thousand monthly, which was lowered to NT\$285 thousand monthly in July 2009.

b. Nonoperating assets, net

| | December 31 | |
|--|---------------------|---------------------|
| | 2009 | 2008 |
| Land | | |
| Kaohsiung Long Dong Section | \$ 2,640,958 | \$ - |
| Kaohsiung Long Hua Section | 226,557 | 2,867,515 |
| Tainan Kuo An Section | 2,782,496 | 2,782,496 |
| Shin Bin Industrial District | <u>122,502</u> | <u>122,502</u> |
| | <u>5,772,513</u> | <u>5,772,513</u> |
| Less: | | |
| Accumulated impairment loss - Kaohsiung Long Dong Section | 143,627 | - |
| Accumulated impairment loss - Kaohsiung Long Hua Section | 102,844 | 1,391,337 |
| Accumulated impairment loss - Tainan Kuo An Section | 1,724,863 | 1,724,863 |
| Accumulated impairment loss - Shin Bin Industrial District | <u>26,750</u> | <u>26,750</u> |
| | <u>1,998,084</u> | <u>3,142,950</u> |
| | <u>\$ 3,774,429</u> | <u>\$ 2,629,563</u> |

In February 2009, parts of Kaohsiung Long Hua Section were reclassified from industrial land to commercial land and renamed the Kaohsiung Long Dong section after urban land rezoning. The Corporation became the owner of the reclassified land and reclassified the cost of NT\$2,640,958 thousand and accumulated impairment loss of NT\$1,281,410 thousand from Long Hua Section to Long Dong section. The related land appraisal report showed that the Corporation had recognized a gain on the impairment loss reversal amounting to NT\$1,144,866 thousand (NT\$7,083 thousand for Long Hua section and NT\$1,137,783 thousand for Long Dong Section). The gain was included in nonoperating income and gains.

c. Others

The Corporation bought farmlands for warehousing at the Jia Xing Section and Bai Mi Section of the Gangshan Town in Kaohsiung County in July 2007, October 2005, and April 2005, respectively. As of December 31, 2009 and 2008, the farmlands both amounted to NT\$56,399 thousand, included in others of other assets. However, because certain regulations prohibit the Corporation from registering the title of this farmland in the Corporation's name, the registration was made in the name of individual. The individual consented to fully cooperate with the Corporation in changing the land title in the future and pledged the land to the Corporation as collateral.

13. SHORT-TERM LOANS

| | December 31 | |
|---|---------------------|----------------------|
| | 2009 | 2008 |
| Revolving loans - interest of 0.78%-1.00% in 2009 and 1.4%-2.81% in 2008 | \$ 5,690,000 | \$ 6,961,250 |
| Letter of credit loans - interest of 0.788%-1.00% in 2009 and 2.11%-2.65% in 2008 | 1,382,275 | 7,005,257 |
| Bank overdraft - interest of 0.37% in 2009 and 0.686%-2.46% in 2008 | <u>252,283</u> | <u>477,002</u> |
| | <u>\$ 7,324,558</u> | <u>\$ 14,443,509</u> |

14. COMMERCIAL PAPER PAYABLE

| | <u>December 31</u> | |
|---|--------------------|---------------------|
| | <u>2009</u> | <u>2008</u> |
| Commercial paper - interest of 0.212%-0.362% in 2009 and 1.762%-2.250% in 2008 | \$ 850,000 | \$ 1,250,000 |
| Unamortized discounts | <u>(200)</u> | <u>(834)</u> |
| | <u>\$ 849,800</u> | <u>\$ 1,249,166</u> |

15. LONG-TERM LOANS

| | <u>December 31</u> | |
|--|---------------------|---------------------|
| | <u>2009</u> | <u>2008</u> |
| Syndicated bank loans | | |
| Mega International Commercial Bank, etc. | | |
| Type A | \$ 3,428,571 | \$ 4,285,714 |
| Type B | 3,000,000 | 5,000,000 |
| Bank loans | | |
| China Development Industrial Bank, Repayable until June 2010, interest of 0.8975% in 2009 | <u>200,000</u> | <u>-</u> |
| | 6,628,571 | 9,285,714 |
| Less: Current portion | 1,057,143 | 5,857,143 |
| Syndicated loan fee | <u>12,750</u> | <u>16,150</u> |
| | <u>\$ 5,558,678</u> | <u>\$ 3,412,421</u> |

In September 2006, the Corporation entered into a syndicated credit facility agreement with Mega International Commercial Bank and 20 other banks as follows :

- a. The credit line is \$14 billion, which consists of Type A of \$6 billion, Type B of \$5 billion and Type C of \$3 billion.
- b. Type A is a secured loan (non-revolving credit). The used balance is repayable in 14 installments from April 2007 to October 2013. As of December 31, 2009 and 2008, the interest rates were 1.0719% and 2.8362%, respectively.
- c. Type B is an unsecured loan (revolving credit). The selection of a 30-, 60-, 90- or 180- day's loan period must be made before every loan use, but the period must not exceed 180 days. On making an application for loan use, the principal should be paid in full on the due date. However, by giving the lending bank a five days' notice ahead of loan maturity, the loan may be partly or fully rolled over even if full repayment is not yet completed. As of December 31, 2009 and 2008, the interest rates were 1.1258%-1.1279% and 2.5127% to 2.8393%, respectively.
- d. Type C is commercial papers (revolving credit), and the financing period is available for 30, 60, 90 or 180 days. Every issuance may cover up to two periods, but an issuance date cannot exceed type C's creditable period, and the amount of every issued commercial paper must be over NT\$200,000 thousand and a multiple of NT\$10,000 thousand. The payment of the principal and interest should be made in full on commercial paper maturity.
- e. Under the agreement, China Steel Corporation and its related parties should collectively hold at least 30% of the Corporation's issued shares and have over half of the seats in the board of directors and control the Corporation's operation. Starting 2007, the Corporation's net tangible assets should not be less than half of the capital, and the ratio of financial liabilities to net tangible assets should not exceed

350%.

The amounts referring to the above restrictions should be based on audited financial statements. If the Corporation breaches the agreement, the Corporation should take remedial measures within six months from the next day of the financial statements' declaration date or adjust the interest rate and the rate of the guarantee fee in accordance with the agreement.

- f. As of December 31, 2009, the Corporation was in compliance with the syndicated credit facility agreement.

16. ACCRUED EXPENSES

| | <u>December 31</u> | |
|-------------------|--------------------|-------------------|
| | <u>2009</u> | <u>2008</u> |
| Salary and bonus | \$ 87,115 | \$ 4,472 |
| Utilities | 59,930 | 33,449 |
| Export fee | 44,319 | 40,517 |
| Delivery pay | 39,245 | 16,855 |
| Processing charge | 22,901 | 13,307 |
| Welfare benefits | 16,031 | 3,543 |
| Interest | 3,854 | 21,183 |
| Others | <u>34,654</u> | <u>37,937</u> |
| | <u>\$ 308,049</u> | <u>\$ 171,263</u> |

17. OTHER PAYABLES

| | <u>December 31</u> | |
|----------------------|--------------------|-------------------|
| | <u>2009</u> | <u>2008</u> |
| Sales discount | \$ 220,652 | \$ 418,455 |
| Properties purchased | 29,572 | 115,800 |
| Nonperforming loans | - | 22,380 |
| Others | <u>39,544</u> | <u>1,272</u> |
| | <u>\$ 289,768</u> | <u>\$ 557,907</u> |

18. PENSION PLAN

The pension plan under the Labor Pension Act (LPA) is a defined contribution plan. Based on the LPA, the rate of the Corporation's monthly contributions to employees' individual pension accounts is at 6% of monthly salaries and wages. Related pension costs were NT\$4,822 thousand for 2009 and NT\$5,037 thousand for 2008.

The Corporation has a retirement plan in accordance with the Labor Standards Law. Retirement benefits are based on employee's length of service and his/her average salaries and wages of the last six months before retirement.

The Corporation contributes amounts equal to 12.9% of total monthly salaries and wages to a pension fund administered by the pension fund monitoring committee. The pension fund is deposited in the Bank of Taiwan in the committee's name.

Other information on the defined benefit plan is as follows:

a. Components of net pension cost

| | Years Ended December 31 | |
|---------------------------------|--------------------------------|------------------|
| | 2009 | 2008 |
| Service cost | \$ 32,869 | \$ 33,872 |
| Interest cost | 19,555 | 26,449 |
| Projected return on plan assets | (8,122) | (5,445) |
| Amortization | <u>11,435</u> | <u>11,435</u> |
| Net pension cost | <u>\$ 55,737</u> | <u>\$ 66,311</u> |

b. Reconciliation of the fund status of the plan and accrued pension cost

| | December 31 | |
|--|--------------------|-------------------|
| | 2009 | 2008 |
| Benefit obligations | | |
| Vested | \$ 449,329 | \$ 409,225 |
| Non-vested | <u>192,316</u> | <u>192,418</u> |
| Accumulated | 641,645 | 601,643 |
| Additional benefits based on future salaries | <u>163,763</u> | <u>180,565</u> |
| Projected benefit obligations | 805,408 | 782,208 |
| Fair value of plan assets | <u>(471,158)</u> | <u>(292,407)</u> |
| Funded status | 334,250 | 489,801 |
| Unrecognized prior service cost | (57,830) | (63,087) |
| Unrecognized net transition obligation | (24,709) | (30,887) |
| Unrecognized net actuarial gain | <u>35,983</u> | <u>25,380</u> |
| Accrued pension cost | <u>\$ 287,694</u> | <u>\$ 421,207</u> |
| Vested benefits | <u>\$ 656,321</u> | <u>\$ 534,941</u> |

c. Actuarial assumptions

| | Years Ended December 31 | |
|---|--------------------------------|-------------|
| | 2009 | 2008 |
| Discount rate used in determining present value | 2.00% | 2.50% |
| Future salary increase rate | 1.75% | 2.00% |
| Expected rate of return on plan assets | 2.00% | 2.50% |

d. Contributions to the fund during the year

| | |
|------------|-----------|
| \$ 186,579 | \$ 88,369 |
|------------|-----------|

e. Payments from the fund during the year

| | |
|------------------|-----------------|
| <u>\$ 10,167</u> | <u>\$ 6,427</u> |
|------------------|-----------------|

19. STOCKHOLDERS' EQUITY

a. Common stock

On March 31, 2009, the Corporation issued 400,000 thousand common shares for cash at an NT\$9.5 par value. As of December 31, 2009, the Corporation's issued and outstanding shares amounted to NT\$16,845,706 thousand.

In June 2009, the Corporation revised the number of its authorized shares to 3,000,000 shares upon obtaining the approval in the stockholders' meeting. However, because the Company Law prohibits the Corporation from revising the number of authorized shares before the full issuance of the original authorized shares, the number of authorized shares remained unchanged.

b. Employee Stock Option Plans

In February 2009, the board of directors approved the issuance of common stock. Under the Company Law, the Corporation should reserve 10% of the stock for employee stock options. In addition, under Statement of Financial Accounting Standards NO. 39 -"Share-based Payment," the stock options are recognized at fair value and transferred to salary expenses on granted date.

Other information on employee stock options is as follows:

| | Number of Options (In Thousands) | Weighted -average Exercise Price (NT\$) |
|---|---|--|
| Balance, beginning of year | \$ - | \$ - |
| Granted | 40,000 | 9.5 |
| Exercised | (20,870) | - |
| Disclaimed | <u>(19,130)</u> | - |
| Balance, end of year | <u><u>-</u></u> | |
| Options exercisable, end of year | <u><u>-</u></u> | |
| Weighted-average fair value of options granted (NT\$) | <u><u>1.68</u></u> | |

Options granted during the year ended December 31, 2008 were priced using the Black-Scholes model and the inputs to the model were as follows:

| | |
|-------------------------------|---------|
| Grant-date share price (NT\$) | 11.2 |
| Exercise price (NT\$) | 9.5 |
| Expected volatility | 45.5% |
| Expected life (years) | 1 month |
| Expected dividend yield | - |
| Risk-free interest rate | 1.01% |

In 2009, the Corporation recognized NT\$67,200 thousand as compensation cost and equal capital surplus—employee stock options was recognized. The Corporation transferred exercised employee stock options amounting to (a) NT\$35,062 thousand from capital surplus—employee stock options to capital surplus—additional paid in capital and (b) NT\$32,138 thousand from capital surplus—employee stock options to capital surplus—abandonment of stock option. The NT\$200,000 thousand difference between the share issue price of NT\$9.5 and par value of NT\$10.00 was deducted from the capital surplus of NT\$67,200 thousand and from NT\$132,800 thousand of retained earnings.

c. Capital surplus

| | Years Ended December 31 | |
|----------------------------|--------------------------------|-------------------|
| | 2009 | 2008 |
| Long-term investments | \$ 344,341 | \$ 344,341 |
| Additional paid in capital | <u>743</u> | <u>-</u> |
| | <u>\$ 345,084</u> | <u>\$ 344,341</u> |

In October, 2008, TGIC exchanged its common stock and preferred stock of Dragon Steel Corporation for CSC's common stock. The Corporation recognized the disposal gain as long-term investment at its percentage of ownership of TGIC.

CSC plans to transfer its treasury stocks to its employees and subsidiaries. Options for 97,612 shares were granted to employees of the Corporation. The Corporation recognized a salary expense of NT\$743 thousand for 2009. When all treasury stock options were exercised, the Corporation reclassified capital surplus-employee stock options to capital surplus-additional paid-in capital.

The capital surplus from long-term investments may not be used for any purpose.

d. Appropriation of Retained Earnings and Dividend Policy

The Corporation's Articles of Incorporation provide that from annual net income less any prior years' deficit, 10% should be set aside as legal reserve as well as a certain percentage as special reserve based on relevant laws or regulations or as requested by the authorities in charge. The remaining earnings should be appropriated in accordance with the resolution passed at a stockholders' meeting if the dividend per share is not lower than NT\$0.02. The appropriation should include (a) at least 0.3% as bonus to employees and (b) 1% as remuneration to directors and supervisors.

The Corporation is in a mature steel industry. Thus, dividends will be appropriated in cash or in stock at an appropriate ratio, with cash dividends to be at least 50% of total dividends.

The Corporation had an accumulated deficit in 2009 and 2008; thus, the Corporation did not estimate any bonuses to employees and remunerations to directors and supervisors.

Based on a directive issued by the Securities and Futures Bureau, an amount equal to the net debit balance of certain stockholders' equity accounts (including unrealized gain or loss on financial instruments and net loss not recognized as pension cost) shall be transferred from unappropriated earnings to a special reserve. Any special reserve appropriated may be reversed to the extent of the decrease in the net debit balance.

Under the Company Law, legal reserve should be appropriated from retained earnings until its balance equals the Corporation's paid-in capital. Legal reserve may be used to offset a deficit. When the reserve exceeds 50% of the Corporation's paid-in capital, (a) the excess may be distributed as dividends and bonuses if the Corporation has no unappropriated earnings or (b) the excess portion that is over 25% of the Corporation's paid-in capital may be transferred to capital if the Corporation has no deficit.

The offset of deficit for 2008 and the appropriation of the 2007 earnings were proposed by the board of directors and approved in the stockholders' meetings in June of 2009 and 2008, respectively. The appropriations (offset of deficit) and dividends per share were as follows:

| | Appropriation of Earnings (Offset of Deficit) | | Dividends Per Share (NT\$) | |
|---|--|---------------------|-------------------------------|---------|
| | 2008 | 2007 | 2008 | 2007 |
| Legal reserve | \$ - | \$ 268,492 | | |
| Offset of deficit by legal reserve | (307,816) | - | | |
| Cash dividends | - | 2,273,690 | \$ - | \$ 1.77 |
| Bonus to employees - cash | - | 120,941 | | |
| Remuneration to directors and supervisors - cash | - | 24,188 | | |
| | <u>\$ (307,816)</u> | <u>\$ 2,687,311</u> | | |

Information on deficit offset and earnings appropriation may be accessed online through the Market Observation Post System on the Web site of the Taiwan Stock Exchange Corporation.

e. Unrealized Gain or Loss on Financial Instruments

For the years ended December 31, 2009 and 2008, movements of unrealized gain (loss) on financial instruments were as follows:

| | Available-for- sale Financial Assets | Equity-method Investments | Total |
|-------------------------------------|--|------------------------------|-----------------------|
| <u>Year ended December 31, 2009</u> | | | |
| Balance, beginning of year | \$ 17,680 | \$ (1,470,105) | \$ (1,452,425) |
| Recognized in stockholders' equity | <u>513,650</u> | <u>1,031,738</u> | <u>1,545,388</u> |
| Balance, end of year | <u>\$ 531,330</u> | <u>\$ (438,367)</u> | <u>\$ 92,963</u> |
| <u>Year ended December 31, 2008</u> | | | |
| Balance, beginning of year | \$ 885,925 | \$ 116,774 | \$ 1,002,699 |
| Recognized in stockholders' equity | <u>(868,245)</u> | <u>(1,586,879)</u> | <u>(2,455,124)</u> |
| Balance, end of year | <u>\$ 17,680</u> | <u>\$ (1,470,105)</u> | <u>\$ (1,452,425)</u> |

20. INCOME TAX

- a. A reconciliation of income tax expense (benefit) based on income before income tax at the 25% statutory rate and income tax expense (benefit) was as follows:

| | Years Ended December 31 | |
|---|-------------------------|--------------|
| | 2009 | 2008 |
| Tax on pretax income at statutory rate (25%) | \$ 135,335 | \$ (947,873) |
| Tax effect of adjusting items: | | |
| Permanent differences | | |
| Investment income under the equity method | (40,024) | (7,626) |
| Dividend income | (14,973) | (42,839) |
| Reversal of impairment loss | (285,913) | - |
| Deferred interest expenses for nonoperating assets - land | 13,881 | 11,131 |
| Others | 4,967 | (1,840) |
| | | (Continued) |

| | Years Ended December 31 | |
|--|--------------------------------|--------------------|
| | 2009 | 2008 |
| Temporary differences | | |
| Unrealized (realized) loss on purchase contract | \$ (559,943) | \$ 510,027 |
| Unrealized (realized) discounts on sales | (49,451) | 50,463 |
| Unrealized (realized) gain on financial instruments | 13,980 | (15,992) |
| Unrealized (realized) loss on inventories | (409,351) | 399,414 |
| Gain on disposal of nonperforming loans | 303,362 | - |
| Pension difference | (33,378) | (5,682) |
| Others | 3,370 | (3,385) |
| Gain on loss carryforwards | <u>918,138</u> | <u>54,202</u> |
| | - | - |
| Current income tax expense | | |
| Deferred income tax expense | | |
| Temporary differences | 732,116 | (945,040) |
| Loss carryforwards | (918,138) | (54,202) |
| Effect of tax law changes on deferred income tax | 281,270 | - |
| Adjustment in valuation allowance due to changes in tax laws | (281,270) | - |
| Other adjustment in valuation allowance | <u>186,022</u> | <u>999,242</u> |
| | - | - |
| Adjustments for prior years' tax | <u>(1,732)</u> | <u>(23,942)</u> |
| Income tax benefit | <u>\$ (1,732)</u> | <u>\$ (23,942)</u> |

(Concluded)

In January 2009, the Legislative Yuan passed the amendment of Article 39 of the Income Tax Law, which extends the operating losses carryforward period from 5 to 10 years.

In May 2009, the Legislative Yuan passed the amendment of Article 5 of the Income Tax Law, which reduces a profit-seeking enterprise's income tax rate from 25% to 20%, effective 2010. The Corporation recalculated its deferred tax assets and liabilities in accordance with this amendment and recorded the resulting difference as a deferred income tax benefit or expense.

- b. Deferred income tax assets (liabilities) were as follows:

| | December 31 | |
|---|--------------------|------------------|
| | 2009 | 2008 |
| Current | | |
| Deferred income tax assets | | |
| Sales discount payable | \$ 44,130 | \$ 104,614 |
| Purchase contract loss | - | 559,943 |
| Allowance for inventory loss | - | 409,351 |
| Others | <u>8,312</u> | <u>(13,085)</u> |
| | 52,442 | 1,060,823 |
| Less: Valuation allowance | <u>47,507</u> | <u>1,060,823</u> |
| | 4,935 | - |
| Deferred income tax liabilities | | |
| Unrealized valuation gains on financial instruments | <u>(4,935)</u> | <u>-</u> |
| | - | - |

(Continued)

| | December 31 | |
|---|--------------------|----------------|
| | 2009 | 2008 |
| Noncurrent | | |
| Deferred income tax assets | | |
| Unfunded pension cost | \$ 57,539 | \$ 105,302 |
| Loss carryforwards | 777,343 | 54,202 |
| Gain on disposal of nonperforming loans | <u>242,690</u> | <u>-</u> |
| | 1,077,572 | 159,504 |
| Less: Valuation allowance | <u>1,077,572</u> | <u>159,504</u> |
| | <u>-</u> | <u>-</u> |
| Total deferred income tax assets | <u>\$ -</u> | <u>\$ -</u> |

Valuation allowance is fully provided for deferred tax assets because the steel industry constantly changes.

Loss carryforwards as of December 31, 2009 comprised of:

| <u>Unused Amount</u> | <u>Expiry Year</u> |
|----------------------|--------------------|
| \$ 214,164 | 2018 |
| 3,672,551 | 2019 |

c. The tax returns through 2007 had been examined by the tax authorities.

d. Information on integrated income tax is as follows:

For distribution of earnings generated after January 1, 1998, the ratio for the imputation credits allocated to stockholders of the Corporation is based on the balance of the ICA as of the date of dividend distribution. The expected creditable ratio for the 2007 earnings may be adjusted, depending on the ICA balance on the date of dividend distribution. As of December 31, 2009 and 2008, the balances of the imputation credits which can be allocated to the stockholders amounted to NT\$1,081,921 thousand and NT\$1,028,808 thousand, respectively.

The creditable ratio for the distribution of the 2007 earnings was 33.38%.

21. PERSONNEL, DEPRECIATION AND AMORTIZATION

| | Years Ended December 31 | | | | | | | |
|---------------------------------|-------------------------|--------------------|-------------|-------------------|-------------------|--------------------|-------------|-------------------|
| | 2009 | | | | 2008 | | | |
| | Operating Costs | Operating Expenses | Others | Total | Operating Costs | Operating Expenses | Others | Total |
| Personnel | | | | | | | | |
| Salary (including annual bonus) | \$ 535,032 | \$ 120,602 | \$ - | \$ 655,634 | \$ 518,311 | \$ 116,122 | \$ - | \$ 634,433 |
| Insurance | 39,765 | 7,325 | - | 47,090 | 38,976 | 6,779 | - | 45,755 |
| Pension cost | 50,693 | 9,866 | - | 60,559 | 60,214 | 11,134 | - | 71,348 |
| Welfare benefits | 123,087 | 19,399 | - | 142,486 | 190,148 | 29,855 | - | 220,003 |
| Other | <u>2,348</u> | <u>3,383</u> | <u>-</u> | <u>5,731</u> | <u>2,249</u> | <u>9,137</u> | <u>-</u> | <u>11,386</u> |
| | <u>\$ 750,925</u> | <u>\$ 160,575</u> | <u>\$ -</u> | <u>\$ 911,500</u> | <u>\$ 809,898</u> | <u>\$ 173,027</u> | <u>\$ -</u> | <u>\$ 982,925</u> |
| Depreciation | \$ 1,063,941 | \$ 7,436 | \$ 544 | \$ 1,071,921 | \$ 975,292 | \$ 7,592 | \$ 544 | \$ 983,428 |
| Amortization | 22,077 | 7,667 | 3,400 | 33,144 | 26,682 | 1,485 | 3,400 | 31,567 |

Depreciation of properties and rental assets were included in depreciation above.

22. BASIC EARNINGS PER SHARE

The Corporation has a simple capital structure; thus, basic earnings per share (EPS) are presented. The numerators and denominators used in the computation of basic EPS were as follows:

- a. Numerator, net income (loss)

| | Years Ended December 31 | | | |
|-------------------|-------------------------|-------------------|-----------------------|-----------------------|
| | 2009 | | 2008 | |
| | Before Tax | After Tax | Before Tax | After Tax |
| Net income (loss) | \$ <u>541,341</u> | \$ <u>543,073</u> | \$ <u>(3,791,491)</u> | \$ <u>(3,767,549)</u> |

- b. Denominator - shares (thousands)

| | Years Ended December 31 | |
|---|-------------------------|------------------|
| | 2009 | 2008 |
| Weighted average of outstanding common shares | 1,284,571 | 1,284,571 |
| Add: Issuance of common stock for cash | <u>302,466</u> | <u>-</u> |
| | <u>1,587,037</u> | <u>1,284,571</u> |

23. FINANCIAL INSTRUMENTS

- a. As of December 31, 2009 and 2008, the fair values of financial instruments were as follows:

| | December 31 | | | |
|--|----------------|--------------|----------------|--------------|
| | 2009 | | 2008 | |
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| <u>Nonderivative financial instruments</u> | | | | |
| Assets | | | | |
| Available-for-sale financial assets - noncurrent | \$ 1,561,916 | \$ 1,561,916 | \$ 1,048,266 | \$ 1,048,266 |
| Financial assets carried at cost - noncurrent | 290,635 | | 291,850 | |
| Nonperforming loans (included in other financial assets - noncurrent) | - | - | 2,771,118 | 2,771,118 |
| Refundable deposits (included in other financial assets) - noncurrent) | 2,948 | 2,948 | 3,850 | 3,850 |
| Liabilities | | | | |
| Long-term loans (including current portion) | 6,628,571 | 6,628,571 | 9,285,714 | 9,285,714 |
| Guarantee deposits received | 1 | 1 | 1 | 1 |
| <u>Derivative financial instruments</u> | | | | |
| Forward contracts | | | | |
| Financial assets at fair value through profit and loss - current | 25,580 | 25,580 | 80,668 | 80,668 |
| Financial liabilities at fair value through profit and loss - current | 903 | 903 | 73 | 73 |

- b. The assumptions and methods used to estimate the fair values of financial instruments are as follows:

- 1) The carrying values of cash, notes and accounts receivable, accounts receivable from related parties, other receivables, restricted assets - current, short-term loans, commercial paper payable, notes and accounts payable, accounts payable to related parties, accrued expenses, payable on purchase contract loss and other payables, approximate fair value because of the short maturities of these

instruments.

- 2) The fair values of available-for-sale financial assets are determined at their market value.

If derivative financial instruments have no market values, the fair values are determined using valuation methods incorporating assumptions consistent with those used in the market. The fair values of forward contracts are calculated at exchange rates quoted by financial institutions on the maturity dates.

- 3) Financial assets carried at cost are investments in unquoted shares, which have no quoted prices in an active market and entail an unreasonably high cost to obtain verifiable fair value. Therefore, no fair value is presented.
- 4) Nonperforming loans was included in other financial assets-noncurrent, and due to its high uncertainty in recovery period and amount, no fair value is presented.
- 5) The fair values of refundable deposits and guarantee deposits are their carrying values.
- 6) Fair values of long-term loans are determined at the present values of future cash flows discounted by the interest rates of similar long-term debts available for the Corporation.
- c. Fair values of financial assets and liabilities based on quoted market prices or valuation techniques were as follows:

| | <u>Quoted Market Prices</u> | | <u>Valuation Techniques</u> | |
|--|-----------------------------|--------------|-----------------------------|-------------|
| | <u>December 31</u> | | <u>December 31</u> | |
| | <u>2009</u> | <u>2008</u> | <u>2009</u> | <u>2008</u> |
| Assets | | | | |
| Available-for-sale financial assets - noncurrent | \$ 1,561,916 | \$ 1,048,266 | \$ - | \$ - |
| Financial assets at FVTPL - current | - | - | 25,580 | 80,668 |
| Liabilities | | | | |
| Financial liabilities at FVTPL - current | - | - | 903 | 73 |

- d. Valuation gains and loss arising from changes in fair value of financial instruments determined using valuation techniques were loss NT\$2,047 thousand for 2009 and gains NT\$60,101 thousand for 2008.
- e. As of December 31, 2009 and 2008, financial assets exposed to cash flow interest rate risk amounted to NT\$315,758 thousand and NT\$336,510 thousand, respectively; and financial liabilities exposed to cash flow interest rate risk amounted to NT\$13,953,129 thousand and NT\$23,729,223 thousand, respectively.
- f. As of December 31, 2009 and 2008, the interest income (expense) associated with financial assets (liabilities) other than those at fair value through profit or loss was as follows:

| | <u>Years Ended December 31</u> | |
|---|--------------------------------|-------------|
| | <u>2009</u> | <u>2008</u> |
| Total interest income | \$ 2,686 | \$ 6,244 |
| Total interest expense (including capitalized interest) | 301,033 | 353,948 |

- g. Financial risk information

- 1) Market risk

This includes fair value risk on interest and exchange rate changes and on market prices. The Corporation's investment in the shares of China Steel Corporation (CSC) involves market risk, i.e., if CSC's share price increases or decreases by NT\$1.00, fair value will increase or decrease by

NT\$47,331 thousand.

2) Credit risk

Credit risk represents the potential loss that would be incurred by the Corporation if the counter-parties or third-parties breach the contracts. Factors affecting credit risk are credit risk concentration, instrument components, contract amounts and other receivables.

As of December 31, 2009, the Corporation's credit risks amounted to NT\$573,550 thousand (including notes and accounts receivable, receivables from related parties, other receivables and refundable deposits), and the maximum credit risk on the instruments and the carrying value of these instruments are the same. The credit risk on the Corporation's cash and bank deposits (including pledged time deposits) were considered insignificant. The maximum credit risk (excluding the fair value of collaterals) is as follows:

| | <u>2009</u> | |
|---|-------------------|----------------------------|
| | Book Value | Maximum Credit Risk |
| Off-balance-sheet commitments and guarantee | | |
| HLC | \$ - | \$ 3,100,000 |

3) Liquidity risk

The Corporation had profit and got net cash provided by operating activities in 2009. Although the Corporation's current liabilities was in excess of current assets as the December 31, 2009, the Corporation's operating funds were deemed sufficient to meet cash flow demand. Thus, liquidity risk was not considered significant.

In addition, available-for-sale financial assets can be readily sold at prices approximating fair values.

There are liquidity risks, however, for financial assets carried at cost because they have no market values.

4) Cash flow risk on interest rate changes

The Corporation's short-term and long-term loans are floating-rate loans. When the market interest rate increases by 1%, the Corporation's cash outflow will increase by about NT\$139,531 thousand a year.

24. RELATED-PARTY TRANSACTIONS

a. Related parties

| <u>Related Party</u> | <u>Relationship with the Corporation</u> |
|--|--|
| China Steel Corporation (CSC) | Major stockholder (41%) |
| Long-Yuan-Fa Investment Corporation | Supervisor |
| Horng-Yih Investment Corporation | Director |
| Goang Yaw Investment Corporation | Director |
| Pacific Harbour Stevedoring Corp. (PHSC) | Serves as the direction and supervision |
| Cheng Shin House Management Consulting Corp. | Serves as the director |

(Continued)

| Related Party | Relationship with the Corporation |
|---|--|
| Taiwan Steel Corporation | Subsidiary with no significant transaction |
| Hong Kao Investment Corporation | Subsidiary with no significant transaction |
| Hung Li Steel Corporation (HLC) | Subsidiary |
| Trans Glory Investment Corporation (TGIC) | Equity method investee |
| China Steel Global Trading Corporation (CSGC) | Affiliate |
| Infor-Champ Systems Corporation (ICSC) | Affiliate |
| China Ecotdk Corporation (CEC) | Affiliate |
| China Steel Machinery Corporation (CSMC) | Affiliate |
| China Hi-ment Corporation (CHC) | Affiliate |
| Steel Castle Technology Corporation (SCT) | Affiliate |
| China Steel Security Corporation (CSS) | Affiliate |
| Shin-Mau Investment Corporation (SMIC) | Affiliate |
| China Steel Structure Corporation (CSSC) | Affiliate |
| United Steel Engineering and Construction Corporation (USECC) | Affiliate |
| Universal Exchange Inc. | Affiliate |
| Union Steel Development Corporation | Affiliate |
| Hi-mag Magnetic Corporation | Affiliate |
| China Steel Management Consulting Corporation | Affiliate |
| CSC Steel SDN. BHD. (CSSB) | Affiliate |
| CSGT (Singapore) Pte. Ltd | Affiliate |
| Kao Hsing Chang Iron & Steel Corp. (KHC) | Director of affiliate |
| Chun Yuan Steel industry Co., Ltd. | Director of affiliate |
| Mayer steel Pipe Corporation | Director of affiliate |
| Chang Yee steel Co., Ltd. | Director of affiliate |
| Asia Cement Corporation | Director of affiliate |

(Concluded)

b. Significant related-party transactions were as follows:

| | Years Ended December 31 | | | |
|---------------------------|--------------------------------|-------------------|---------------------|-------------------|
| | 2009 | | 2008 | |
| | Amount | % to Total | Amount | % to Total |
| 1) Sale of steel products | | | | |
| KHC | \$ 3,816,535 | 10 | \$ 3,113,635 | 7 |
| CSSB | 506,558 | 1 | 586,910 | 1 |
| Others | <u>195,968</u> | <u>1</u> | <u>23,031</u> | <u>-</u> |
| | <u>\$ 4,519,061</u> | <u>12</u> | <u>\$ 3,723,576</u> | <u>8</u> |

The selling prices of steel products were similar to those for third parties. However, CSSB had to pay by telegraphic transfers (T/T) in seven days from product shipment, and this payment arrangement was dissimilar with those for third parties, from whom payments were collected in advance.

| | Years Ended December 31 | | | |
|--------------------|--------------------------------|-------------------|-------------------|-------------------|
| | 2009 | | 2008 | |
| | Amount | % to Total | Amount | % to Total |
| 2) Service revenue | | | | |
| CSC | \$ 43,911 | 88 | \$ 504,725 | 100 |
| Others | <u>132</u> | <u>1</u> | <u>-</u> | <u>-</u> |
| | <u>\$ 44,043</u> | <u>89</u> | <u>\$ 504,725</u> | <u>100</u> |

The Corporation entered into an agreement with CSC for the Corporation to do certain processing work on CSC's steel products. The calculation of processing charges to CSC was based on the formula stated in the agreement. The Corporation bills CSC within one month after approval of delivery.

3) Purchase of materials

| | | | | |
|--------|---------------------|----------|---------------------|----------|
| CSC | \$ 2,290,239 | 9 | \$ 2,317,642 | 5 |
| Others | <u>3,273</u> | <u>-</u> | <u>6,120</u> | <u>-</u> |
| | <u>\$ 2,293,512</u> | <u>9</u> | <u>\$ 2,323,762</u> | <u>5</u> |

Payment terms for purchases of materials were similar to normal purchases from third parties.

4) Deferred Credits

As stated in Note 10, the gain on disposal of nonperforming loans should be deferred. Related information is as follows:

| | |
|-----------------------------------|---------------------|
| Unrealized gain in 2009 (Note 10) | \$ 1,257,034 |
| Realized gain in 2009 | <u>(43,586)</u> |
| Balance, end of year | <u>\$ 1,213,448</u> |

The realized gain on nonperforming loans was included in others of nonoperating income and gains.

5) Authorization fees

In May 2003, CSC, Sumitomo Metal Industries, Ltd. (SMI) and Sumitomo Corporation (SC) entered into a joint venture agreement and established a holding company named East Asia United Steel Corporation (EAUS) in July 2003. CSC will have a stable supply of good quality slab through this joint venture. CSC then signed a contract with the Corporation, transferring to the Corporation the right to buy slab from EAUS. The Corporation should pay authorization fees of US\$6.00 per ton to CSC. These fees (included in the purchase of materials) were \$286,742 thousand in 2009 and \$212,337 thousand in 2008. As of December 31, 2009 and 2008, authorization fees payable (included in payables to related parties) were \$72,932 thousand and \$30,952 thousand, respectively. The calculation of slab purchase prices was based on the formula stated in the agreement.

6) Acquisition of shares

The Corporation acquired 104 thousand shares of TGIC from SMIC for NT\$1,152 thousand, the purchase price referred to TGIC's proportionate share in the investee's equity.

7) Lending and returning of steel slabs

To maintain steel slabs for production, the Corporation entered into a contract with CSC, under which the Corporation can borrow slabs from CSC when the Corporation needs more production materials and then return the slabs to CSC when the Corporation has a surplus of materials. The borrowing and returning of steel slabs in 2009 and 2008 are summarized as follows:

| | Years Ended December 31 | | | |
|------------------------------|-------------------------|---------------------|---------------|-------------------|
| | 2009 | | 2008 | |
| | Tons | Amount | Tons | Amount |
| Balance, beginning of year | 24,712 | \$ 642,332 | (1,276) | \$ (27,296) |
| Lending for the year | 144,789 | 2,083,603 | 160,686 | 3,227,694 |
| Returns for the year | (211,904) | (3,355,019) | (136,026) | (2,605,382) |
| Allowance for inventory loss | <u>1,390</u> | <u>37,195</u> | <u>1,328</u> | <u>47,316</u> |
| Balance, end of year | <u>(41,013)</u> | <u>\$ (591,889)</u> | <u>24,712</u> | <u>\$ 642,332</u> |

As of December 31, 2009 and 2008, the amount of the slabs to be returned or lent by CSC was included in other current liabilities and other current assets, respectively.

8) Processing charge

The Corporation authorized HLC to do some processing amounting to NT\$107,361 thousand in 2009. As of December 31, 2009, the processing payable was NT\$12,295 thousand, included in accrued expenses.

9) Construction- in-progress and other expenditures

Other expenditures paid to related parties, which pertained to construction or maintenance, were as follows:

| | Years Ended December 31 | | | |
|--------|-------------------------|--------------------------|--------------------|--------------------------|
| | 2009 | | 2008 | |
| | Other Expenditures | Construction-in-progress | Other Expenditures | Construction-in-progress |
| PHSC | \$ 171,194 | \$ - | \$ 184,937 | \$ - |
| CSGC | 121,658 | - | 103,829 | - |
| CSC | 20,451 | 5,000 | 20,917 | - |
| CSMC | 15,336 | 48 | 61,212 | 40,547 |
| CEC | 12,560 | 10,769 | 2,498 | 22,399 |
| CSS | 7,738 | 4,596 | 9,677 | - |
| ICSC | 6,170 | 15,474 | 4,943 | 24,664 |
| SCT | 1,225 | - | 2,097 | 17,025 |
| USECC | - | 14,900 | - | - |
| Others | <u>6,066</u> | <u>7,642</u> | <u>9,235</u> | <u>-</u> |
| | <u>\$ 362,398</u> | <u>\$ 58,429</u> | <u>\$ 399,345</u> | <u>\$ 104,635</u> |

10) Income from supplies and scrap

| | December 31 | | | |
|--------|--------------------|-------------------|------------------|-------------------|
| | 2009 | | 2008 | |
| | Amount | % to Total | Amount | % to Total |
| CHC | \$ 242,341 | 31 | \$ 60,319 | 5 |
| Others | <u>3,420</u> | <u>1</u> | <u>10,444</u> | <u>1</u> |
| | <u>\$ 245,761</u> | <u>32</u> | <u>\$ 70,763</u> | <u>6</u> |

11) Sales of office supplies

In 2009, the Corporation sold HLC office supplies at their carrying value of NT\$282,735 thousand. As of December 31, 2009, all the receivable above had been collected.

12) Guarantee

As of December 31, 2009, the Corporation had provided HLC with guarantees amounting to NT\$3,100,000 thousand.

c. Balances at year-end

| | December 31 | | | |
|------------------------|--------------------|-------------------|------------------|-------------------|
| | 2009 | | 2008 | |
| | Amount | % to Total | Amount | % to Total |
| 1) Accounts receivable | | | | |
| CHC | \$ 25,469 | 7 | \$ 3,916 | 2 |
| CSC | 13,274 | 4 | 26,290 | 14 |
| KHC | 2,148 | - | 7,794 | 4 |
| Others | <u>9,261</u> | <u>2</u> | <u>58</u> | <u>-</u> |
| | <u>\$ 50,152</u> | <u>13</u> | <u>\$ 38,058</u> | <u>20</u> |
| 2) Accounts payable | | | | |
| CSC | \$ 113,848 | 13 | \$ 38,264 | 26 |
| CSGC | 19,299 | 2 | 10,049 | 7 |
| ACC | 18,283 | 2 | 13,560 | 9 |
| KHC | 2,073 | - | 6,426 | 4 |
| Others | <u>5,583</u> | <u>1</u> | <u>8,832</u> | <u>6</u> |
| | <u>\$ 159,086</u> | <u>18</u> | <u>\$ 77,131</u> | <u>52</u> |

d. Compensation of directors, supervisors and management personnel

| | Years Ended December 31 | |
|----------------------|--------------------------------|------------------|
| | 2009 | 2008 |
| Salaries | \$ 14,976 | \$ 19,806 |
| Special compensation | 438 | 432 |
| Incentives | <u>4,706</u> | <u>2,686</u> |
| | <u>\$ 20,120</u> | <u>\$ 22,924</u> |

25. PLEDGED ASSETS

Assets pledged or mortgaged as collateral for bank loans and performance guarantees were as follows:

| | December 31 | |
|---|---------------------|----------------------|
| | 2009 | 2008 |
| Properties, net | \$ 9,126,383 | \$ 9,765,941 |
| Restricted assets - Pledged time deposits | <u>300,000</u> | <u>300,000</u> |
| | <u>\$ 9,426,383</u> | <u>\$ 10,065,941</u> |

26. SIGNIFICANT COMMITMENTS AND CONTINGENCIES AS OF DECEMBER 31, 2009

- a. Unused letters of credit for purchases of raw materials and machinery and equipment amounted to about NT\$4,139,900 thousand.
- b. The Corporation had signed agreements to buy equipment for NT\$2,579,300 thousand, of which NT\$1,501,280 thousand had been paid (included in properties, construction-in-progress and prepayments for equipment).
- c. The Corporation had signed contracts with foreign suppliers to buy slabs to ensure sufficiency of production materials. Unpaid purchase amounts for 475,000 tons of slabs as of December 31, 2008 were NT\$6.6 billion. Some of the contracts' purchase price plus processing costs will be higher than its net realizable value, the variance in losses of purchase contract payable were as follows:

| | Years Ended December 31 | |
|---------------------------------|--------------------------------|---------------------|
| | 2009 | 2008 |
| Balance, beginning of year | \$ 2,239,770 | \$ 199,662 |
| Provision for the year (Note 6) | <u>(2,239,770)</u> | <u>2,040,108</u> |
| Balance, end of year | <u>\$ -</u> | <u>\$ 2,239,770</u> |

- d. Authorization fee please refer to Note 24.
- e. The Corporation's endorsements of credit line of related party amount to NT\$3,100,000 thousand (Note 24).

27. SEGMENT INFORMATION

The Corporation operates in a single industry: Steel manufacturing. Under Statement of Financial Accounting Standards No. 20 - "Segment Reporting," the Corporation discloses its export sales and significant customers, as follows:

a. Export sales

| Area | Years Ended December 31 | | | |
|---------|-------------------------|------------|----------------------|------------|
| | 2009 | | 2008 | |
| | Amount | % to Total | Amount | % to Total |
| Asia | \$ 14,291,692 | 39 | \$ 10,898,931 | 22 |
| America | 304,674 | 1 | 1,326,711 | 3 |
| Others | <u>262,726</u> | <u>-</u> | <u>1,005,594</u> | <u>2</u> |
| | <u>\$ 14,859,092</u> | <u>40</u> | <u>\$ 13,231,236</u> | <u>27</u> |

b. Major customers

| | Years Ended December 31 | | | |
|-----------|-------------------------|------------|----------------------|------------|
| | 2009 | | 2008 | |
| | Amount | % to Total | Amount | % to Total |
| Company A | \$ 3,816,535 | 10 | \$ 3,113,635 | 6 |
| Company B | 3,792,134 | 10 | 4,755,666 | 10 |
| Company C | <u>1,846,175</u> | <u>5</u> | <u>4,783,561</u> | <u>10</u> |
| | <u>\$ 9,454,844</u> | <u>25</u> | <u>\$ 12,652,862</u> | <u>26</u> |