# ALPHA NETWORKS INC. AND SUBSIDIARIES

**Consolidated Financial Statements**

**December 31, 2010 and 2009**
**(With Independent Auditors’ Report Thereon)**

## Independent Auditors' Report

The Board of Directors
Alpha Networks Inc.:

We have audited the consolidated balance sheets of Alpha Networks Inc. and subsidiaries (the "Company") as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the Regulations Governing Auditing and Certification of Financial Statements by Certified Public Accounts and auditing standards generally accepted in the Republic of China. Those regulations 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Alpha Networks Inc. and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended, in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the Republic of China.

Hsinchu, Taiwan (Republic of China)
February 18, 2011

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

The auditors' report and the accompanying financial statements are the English translation of the Chinese version prepared and used in the Republic of China. If there is any conflict between, or any difference in the interpretation of, the English and Chinese language auditors' report and financial statements, the Chinese version shall prevail.

## ALPHA NETWORKS INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

## December 31, 2010 and 2009
## (Expressed in thousands of New Taiwan dollars)

| Assets | 2010 | 2009 |
|---|---|---|
| **Current assets:** | | |
| Cash and cash equivalents (note 4) | $ 2,831,660 | 4,808,984 |
| Financial assets at fair value through profit or loss－current (note 6) | 32,209 | 30,705 |
| Notes and accounts receivable, net (note 7) | 2,988,757 | 1,849,069 |
| Receivables from related parties (note 17) | 2,926,427 | 2,784,147 |
| Other financial assets－current (note 18) | 155,155 | 12,768 |
| Inventories (note 8) | 4,078,451 | 2,411,445 |
| Other current assets (note 14) | 224,247 | 148,460 |
| | 13,236,906 | 12,045,578 |
| **Funds and investments:** | | |
| Other financial assets－noncurrent (note 18) | 43,213 | 29,453 |
| Available-for-sale financial assets－noncurrent (note 5) | 295,631 | 332,093 |
| Financial assets carried at cost－noncurrent (note 5) | 9,996 | 9,996 |
| | 348,840 | 371,542 |
| **Property, plant and equipment** (note 17): | | |
| Land | 102,603 | - |
| Buildings and improvements | 1,924,014 | 1,920,803 |
| Machinery and equipment | 1,521,510 | 1,466,509 |
| Transportation, office and other equipment | 282,514 | 277,161 |
| | 3,830,641 | 3,664,473 |
| Less: accumulated depreciation | 1,735,474 | 1,535,432 |
| Prepayment for equipment and construction in progress | 725,414 | 14,840 |
| | 2,820,581 | 2,143,881 |
| **Intangible assets:** | | |
| Trademarks | 116 | - |
| Goodwill | 140,913 | 140,913 |
| Core technologies (note 9) | 8,635 | 20,148 |
| Land use right (note 9) | 106,540 | 147,320 |
| | 256,204 | 308,381 |
| **Other assets** (note 7)**:** | | |
| Deferred expenses and others | 105,335 | 90,532 |
| **Total assets** | $ 16,767,866 | 14,959,914 |

| Liabilities and Stockholders' Equity | 2010 | 2009 |
|---|---|---|
| **Current liabilities:** | | |
| Short-term borrowings (note 10) | $ 905,675 | 145,824 |
| Accounts payable | 4,793,827 | 4,161,996 |
| Payables to related parties (note 17) | 25,383 | 22,234 |
| Income tax payable | 117,743 | 169,365 |
| Accrued expenses | 563,590 | 619,445 |
| Payroll and bonus payable | 550,469 | 450,718 |
| Financial liabilities at fair value through profit or loss－current (note 6) | 12,539 | 13,473 |
| Other financial liabilities－current | 116,498 | - |
| Bonds payable－current (note 11) | 137,600 | - |
| Other current liabilities | 321,342 | 137,601 |
| | 7,544,666 | 5,720,656 |
| **Bonds payable (note 11)** | - | 378,883 |
| **Other liabilities:** | | |
| Accrued pension liabilities (note 12) | 129,344 | 111,048 |
| Deferred income tax liabilities – noncurrent (note 14) | 10,722 | 29,535 |
| Miscellaneous liabilities – other | 354 | 333 |
| | 140,420 | 140,916 |
| **Total liabilities** | 7,685,086 | 6,240,455 |
| **Stockholders' equity (note 13):** | | |
| Equity attributable to Alpha Networks Inc. | | |
| Common stock | 4,711,143 | 4,642,035 |
| Advance receipts for common stock | 48,180 | 12,540 |
| | 4,759,323 | 4,654,575 |
| Capital surplus | 1,796,734 | 1,625,768 |
| Retained earnings: | | |
| Legal reserve | 599,696 | 516,800 |
| Special reserve | - | 42,504 |
| Unappropriated earnings | 2,152,891 | 1,859,557 |
| | 2,752,587 | 2,418,861 |
| **Other:** | | |
| Cumulative foreign currency translation adjustment | 34,371 | 143,560 |
| Unrealized gain or loss on available-for-sale financial assets | (136,875) | (100,413) |
| Treasury stock | (126,009) | (28,962) |
| | (228,513) | 14,185 |
| **Total equity attributable to Alpha Networks Inc.** | 9,080,131 | 8,713,389 |
| Minority interest | 2,649 | 6,070 |
| **Total stockholders' equity** | 9,082,780 | 8,719,459 |
| **Commitments and contingencies (note 19)** | | |
| **Total liabilities and stockholders' equity** | $ 16,767,866 | 14,959,914 |

See accompanying notes to consolidated financial statements.

## ALPHA NETWORKS INC. AND SUBSIDIARIES

### Consolidated Statements of Income

### Years ended December 31, 2010 and 2009
### (Expressed in thousands of New Taiwan dollars, except for net income per common share)

| | | 2010 | 2009 |
|---|---|---|---|
| **Sales** (note 17) | $ | 26,004,892 | 17,462,187 |
| **Less: sales returns and allowances** | | 153,496 | 140,492 |
| | | 25,851,396 | 17,321,695 |
| **Cost of goods sold** (notes 8 and 17) | | 21,853,866 | 13,961,932 |
| **Gross profit** | | 3,997,530 | 3,359,763 |
| **Operating expenses** (note 17)**:** | | | |
| Selling | | 522,623 | 531,976 |
| General and administrative | | 680,318 | 509,960 |
| Research and development | | 1,597,189 | 1,499,417 |
| | | 2,800,130 | 2,541,353 |
| **Operating income** | | 1,197,400 | 818,410 |
| **Non-operating income and gains:** | | | |
| Interest income | | 17,831 | 24,411 |
| Gain on reversal of impairment loss on financial assets (note 5) | | 31,875 | - |
| Dividend revenue | | 9,854 | 4,381 |
| Foreign currency exchange gain, net | | - | 59,028 |
| Gain on valuation of financial liabilities | | 127,242 | 127,462 |
| Other income, net | | 111,064 | 27,153 |
| | | 297,866 | 242,435 |
| **Non-operating expenses and loss:** | | | |
| Interest expense (note 11) | | 31,599 | 32,399 |
| Impairment loss on financial assets (note 5) | | - | 34,690 |
| Foreign currency exchange loss, net | | 392,044 | - |
| | | 423,643 | 67,089 |
| **Income before income taxes** | | 1,071,623 | 993,756 |
| **Income tax expense** (note 14) | | 138,577 | 166,673 |
| **Net income** | **$** | **933,046** | **827,083** |
| **Attributable to:** | | | |
| Equity holders of the parent company | $ | 936,446 | 828,961 |
| Minority interest | | (3,400) | (1,878) |
| | **$** | **933,046** | **827,083** |

| | | 2010 Before taxes | 2010 After taxes | 2009 Before taxes | 2009 After taxes |
|---|---|---|---|---|---|
| **Earnings per share (in New Taiwan dollars)** (note 15) | | | | | |
| Basic earnings per share | **$** | **2.30** | **2.01** | **2.17** | **1.80** |
| Diluted earnings per share | **$** | **2.23** | **1.94** | **2.08** | **1.73** |

See accompanying notes to consolidated financial statements.

# ALPHA NETWORKS INC. AND SUBSIDIARIES

## Consolidated Statements of Changes in Stockholders' Equity

## Years ended December 31, 2010 and 2009
## (Expressed in thousands of New Taiwan dollars)

| | | | | Retained Earnings | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Common stock | Advance receipts for common stock | Capital surplus | Legal reserve | Special reserve | Unappro-priated earnings | Cumulative foreign currency translation adjustment | Unrealized gain or loss on available-for-sale financial assets | Treasury stock | Minority interest | Total |
| **Balance at January 1, 2009** | $ 4,487,737 | 610 | 1,539,841 | 411,544 | - | 1,625,411 | 191,618 | (234,122) | (28,962) | 6,768 | 8,000,445 |
| Appropriation of earnings (note 1): | | | | | | | | | | | |
| Legal reserve | - | - | - | 105,256 | - | (105,256) | - | - | - | - | - |
| Special reserve | - | - | - | - | 42,504 | (42,504) | - | - | - | - | - |
| Stock dividends | 89,411 | - | - | - | - | (89,411) | - | - | - | - | - |
| Cash dividends | - | - | - | - | - | (357,644) | - | - | - | - | (357,644) |
| Issuance of stock for conversion of bonds | 491 | - | 756 | - | - | - | - | - | - | - | 1,247 |
| Bonuses to employees－stock | 57,066 | - | 85,030 | - | - | - | - | - | - | - | 142,096 |
| Foreign currency translation adjustments | - | - | - | - | - | - | (48,058) | - | - | - | (48,058) |
| Issuance of stock for employee stock options exercised | 7,330 | 11,930 | - | - | - | - | - | - | - | - | 19,260 |
| Unrealized gains or losses on available-for-sale financial assets | - | - | - | - | - | - | - | 133,709 | - | - | 133,709 |
| Adjustments to capital surplus for changes in investee’s equity | - | - | 141 | - | - | - | - | - | - | 48 | 189 |
| Increase in minority interest | - | - | - | - | - | - | - | - | - | 1,132 | 1,132 |
| Net income for 2009 | - | - | - | - | - | 828,961 | - | - | - | (1,878) | 827,083 |
| **Balance at December 31, 2009** | 4,642,035 | 12,540 | 1,625,768 | 516,800 | 42,504 | 1,859,557 | 143,560 | (100,413) | (28,962) | 6,070 | 8,719,459 |
| Appropriation of earnings (note 2): | | | | | | | | | | | |
| Legal reserve | - | - | - | 82,896 | - | (82,896) | - | - | - | - | - |
| Special reserve | - | - | - | - | (42,504) | 42,504 | - | - | - | - | - |
| Cash dividends | - | - | - | - | - | (602,720) | - | - | - | - | (602,720) |
| Issuance of stock for conversion of bonds | 55,456 | 42,829 | 150,896 | - | - | | - | - | - | - | 249,181 |
| Foreign currency translation adjustments | - | - | - | - | - | - | (109,189) | - | - | - | (109,189) |
| Issuance of stock for employee stock options exercised | 13,652 | (7,189) | 1,629 | - | - | - | - | - | - | - | 8,092 |
| Purchase of treasury stock | - | - | - | - | - | - | - | - | (126,009) | - | (126,009) |
| Treasury stocks transferred to employees | - | - | 18,553 | - | - | - | - | - | 28,962 | - | 47,515 |
| Unrealized gains or losses on available-for-sale financial assets | - | - | - | - | - | - | - | (36,462) | - | - | (36,462) |
| Adjustments to capital surplus for changes in investee’s equity | - | - | (112) | - | - | - | - | - | - | (21) | (133) |
| Net income for 2010 | - | - | - | - | - | 936,446 | - | - | - | (3,400) | 933,046 |
| **Balance at December 31, 2010** | $ 4,711,143 | 48,180 | 1,796,734 | 599,696 | - | 2,152,891 | 34,371 | (136,875) | (126,009) | 2,649 | 9,082,780 |

Note 1: Remuneration to directors and supervisors and employees’ bonuses in the amount of $14,209 and $142,096, respectively, had been charged against earnings of 2008.

Note 2: Remuneration to directors and supervisors and employees’ bonuses in the amount of $7,886 and $118,329, respectively, had been charged against earnings of 2009.

See accompanying notes to consolidated financial statements.

# ALPHA NETWORKS INC. AND SUBSIDIARIES
## Consolidated Statements of Cash Flows
## Years ended December 31, 2010 and 2009
## (Expressed in thousands of New Taiwan dollars)

| | | 2010 | 2009 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Net income | $ | 933,046 | 827,083 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization | | 436,257 | 462,668 |
| Provision (reversal of provision) for allowance for doubtful accounts | | (42,104) | 6,613 |
| Effect of valuation of financial assets and liabilities at fair value through profit or loss | | (19,670) | (17,232) |
| Provision (reversal of provision) for inventory obsolescence and devaluation loss | | (41,440) | 93,502 |
| Loss on disposal of property, plant and equipment | | 819 | 1,707 |
| Compensation cost arising from treasury stocks transferred to employees | | 18,641 | - |
| Amortization of discount on bonds payable | | 7,898 | 10,137 |
| Increase in inventories | | (1,623,349) | (523,694) |
| Decrease (increase) in deferred income tax assets | | (28,199) | 515 |
| Decrease in financial assets at fair value through profit or loss | | 30,705 | 27,504 |
| Decrease in financial liabilities at fair value through profit or loss | | (13,473) | (1,111) |
| Loss on (gain on reversal of) impairment of bond investment without market price | | (31,875) | 34,690 |
| Expenses with no effect on cash flow | | - | 1,180 |
| Decrease (increase) in notes and accounts receivable (including related parties) | | (1,239,825) | 336,004 |
| Decrease (increase) in other operations-related current assets | | (71,308) | 10,087 |
| Increase in accounts payable (including related parties) | | 634,980 | 1,063,398 |
| Increase (decrease) in other operations-related current liabilities | | 176,015 | (151,556) |
| Increase in accrued pension | | 18,296 | 11,910 |
| **Cash provided by (used in) operating activities** | | (854,586) | 2,193,405 |
| **Cash flows from investing activities:** | | | |
| Return of (increase in) bond investment without market price | | 31,875 | (34,690) |
| Acquisition of property and equipment | | (1,127,746) | (220,937) |
| Proceeds from disposal of property and equipment | | 285 | 5,160 |
| Increase in deposits and other assets | | (3,614) | (6,360) |
| Increase in intangible assets and deferred expenses | | (57,922) | (193,670) |
| Decrease (increase) in restricted cash in bank | | (10,146) | 8,840 |
| Increase in guarantee deposit received | | 53 | 277 |
| **Cash used in investing activities** | | (1,167,215) | (441,380) |
| **Cash flows from financing activities:** | | | |
| Increase in short-term borrowings | | 759,851 | 11,732 |
| Payments of cash dividends | | (602,720) | (357,644) |
| Proceeds from issuance of stock for employee stock options exercised | | 8,092 | 19,260 |
| Repurchase of treasury stock | | (126,009) | - |
| Treasury stock transferred to employees | | 28,874 | - |
| **Cash provided by (used in) financing activities** | | 68,088 | (326,652) |
| **Effect of exchange rate changes on cash** | | (23,611) | (27,955) |
| **Net increase (decrease) in cash and cash equivalents** | | (1,977,324) | 1,397,418 |
| **Cash and cash equivalents at beginning of year** | | 4,808,984 | 3,411,566 |
| **Cash and cash equivalents at end of year** | $ | 2,831,660 | 4,808,984 |
| **Supplemental disclosures of cash flow information:** | | | |
| Cash payments of interest | $ | 23,929 | 26,689 |
| Cash payments of income taxes | $ | 217,479 | 314,793 |
| **Supplementary disclosure of non-cash investing and financing activities:** | | | |
| Convertible bonds converted into common stock and capital surplus | $ | 249,181 | 1,247 |
| Bonds payable – current | $ | 137,600 | - |
| Capitalization of employee bonuses | $ | - | 142,096 |

See accompanying notes to consolidated financial statements.

## ALPHA NETWORKS INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

## December 31, 2010 and 2009
## (Amounts expressed in New Taiwan dollars)

### 1. Organization and Principal Activities

Alpha Networks Inc. ("Alpha") was established by a spin-off whereby on August 16, 2003, D-Link Corporation ("D-Link") separated its original design manufacturing and original equipment manufacturing ("ODM/OEM") operations from its D-Link brand business and transferred related operating assets and liabilities to Alpha. Alpha was incorporated on September 4, 2003, as a company limited by shares under the laws of the Republic of China ("ROC") and the ROC Statute for the Establishment and Administration of the Science-Based Industrial Park. The shares of Alpha have been traded on the Taiwan Stock Exchange ("TSE") since December 20, 2004. Based on the resolution of Alpha's board of directors on April 17, 2006, Alpha merged with Cellvision System Inc. (Cellvision) on October 1, 2006. Cellvision was eliminated in the procedure.

Alpha's main activities include the research, development, design, production and sale of broadband products, computer network systems, wireless local area networks ("LANs"), and relevant spare parts.

Cellvision's main activities included the research, development, design, production and sale of network print servers, file servers, internet cameras and servers, etc.

As of December 31, 2010, Alpha and subsidiaries had 6,126 employees.

### 2. Summary of Significant Accounting Policies

(1) The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the Republic of China (ROC). The major accounting policies and measurement basis adopted in preparing the accompanying consolidated financial statements are summarized as follows:

(a) The consolidated subsidiaries of Alpha are summarized below.

| Investor | Investee | Percentage of ownership at December 31, 2010 | Percentage of ownership at December 31, 2009 | Business nature |
|---|---|---|---|---|
| Alpha | Alpha Holdings Inc. (Alpha Holdings) | 100 | 100 | Investment holding |
| Alpha | Alpha Solutions Co., Ltd. (Alpha Solutions) | 100 | 100 | Sale of network equipment and technical services |

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

| Investor | Investee | Percentage of ownership at December 31, 2010 | Percentage of ownership at December 31, 2009 | Business nature |
|---|---|---|---|---|
| Alpha | Alpha Networks Inc. (Alpha USA) | 100 | 100 | Manufacture and sale of network equipment and procurement service |
| Alpha | Darson Trading Limited (Darson) | 100 | 100 | Shipping and transportation service; in October 2010, the Company ceased operation of the business |
| Alpha | Net Mag Technology Corp. (Net Mag) | 100 | 100 | Testing and maintaining electrical equipment |
| Alpha | Aescu Technology Inc. (Aescu) | 84.65 | 84.65 | Sale of equipment for medical treatment |
| Alpha | Alpha Networks (Hong Kong) Limited (Alpha HK) | 100 | 100 | Investment holding |
| Alpha | Alpha Technical Services Inc. (ATS) | 100 | 100 | Post-sale service |
| Alpha | Alpha Networks NL B.V. (Alpha NL) | 100 | - | Sale of network equipment |
| Alpha Holdings | D-Link Asia Investment Pte. Ltd. (D-Link Asia) | 100 | 100 | Investment for manufacturing business |
| Alpha Holdings | Alpha Networks (Chengdu) Co., Ltd. (Alpha Chengdu) | 100 | 100 | Research, development, production and sale of network products |

(Continued)

| Investor | Investee | Percentage of ownership at December 31, 2010 | Percentage of ownership at December 31, 2009 | Business nature |
|---|---|---|---|---|
| Alpha Holdings | Alpha Investment Pte. Ltd. (Alpha Investment) | 100 | 100 | Investment holding |
| Alpha Investment | Mirac Networks (Dongguan) Co., Ltd. (Mirac) | 100 | 100 | Production and sale of network products |
| D-Link Asia | DongguanYouxun Electronics Co., Ltd. (Dongguan Youxun) | 100 | 100 | Production and sale of interface cards |
| Alpha HK | Alpha Networks (Changshu) Co., Ltd. (Alpha Changshu) | 100 | 100 | Research, development, production and sale of network products |

(b) The details of changes in subsidiaries included in the consolidated financial statements:

Alpha indirectly invested in Alpha Changshu in the first quarter of 2009. In addition, the board of directors approved the modification of investment structure in March 2009. As a result, Alpha directly invested in Alpha USA, instead of through Des Voeux. These subsidiaries are included in the consolidated financial statements of the Company starting from 2009.

In 2010, Alpha incorporated Alpha NL, which is included in the consolidated financial statements of the Company starting from 2010.

(2) Basis of consolidation

The consolidated financial statements include the accounts of Alpha and its subsidiaries, in which Alpha directly or indirectly owns over 50% of the voting shares and is able to exercise control over the subsidiaries' operations and financial policies. Alpha and its consolidated subsidiaries are referred to individually or collectively as “the Company”. All significant inter-company transactions and balances are eliminated in consolidation.

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## ALPHA NETWORKS INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

(3) Use of estimates

The preparation of the consolidated financial statements requires management to make reasonable estimates and assumptions that affect the reported amount of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the reporting periods. Actual results may differ from management's estimates.

(4) Foreign currency transactions and translation

Entities included in the consolidated financial statements record transactions in their respective functional currencies. Non-derivative foreign currency transactions are recorded at the exchange rates prevailing on the transaction date. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated using the exchange rates on that date. The resulting exchange gains or losses from settlement of such transactions or translation of foreign-currency-denominated monetary assets or liabilities are reflected as non-operating gains or losses in the accompanying consolidated statements of income.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into New Taiwan dollars at the rates prevailing at the balance sheet date. If the non-monetary assets or liabilities are measured at fair value through profit or loss, the resulting unrealized exchange gains or losses from such transactions are recorded in current profit or loss. If the non-monetary assets or liabilities are measured at fair value through stockholders' equity, then the resulting unrealized exchange gains or losses from such transactions are recorded as a separate component of stockholders' equity.

In translating foreign currency financial statements into New Taiwan dollars, balance sheet date rates are used for asset and liability accounts; historical rates are used for equity accounts, except that the prior-year translated balance is carried forward for the beginning retained earnings, and weighted-average rates are used for profit and loss accounts. Translation differences are included in the cumulative translation adjustment account under stockholders' equity.

(5) Principles of classifying assets and liabilities as current and noncurrent

Cash or cash equivalents that are not restricted in use, assets held for the purpose of trading, and assets that will be held for a short time period and are expected to be converted to cash within 12 months from the balance sheet date are recorded as current assets; all other assets are recorded as noncurrent assets.

Liabilities that are incurred for the purpose of trading or are expected to be liquidated within 12 months after the balance sheet date are recorded as current liabilities; all other liabilities are recorded as noncurrent liabilities.

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(6) Asset impairment

The Company assesses at each balance sheet date whether there is any indication that an asset (individual asset or cash-generating unit) other than goodwill may have been impaired. If any such indication exists, the Company estimates the recoverable amount of the asset. The Company recognizes impairment loss for an asset whose carrying value is higher than the recoverable amount. The Company reverses an impairment loss recognized in prior periods for assets other than goodwill if there is any indication that the impairment loss recognized no longer exists or has decreased. The carrying value after the reversal should not exceed the recoverable amount or the depreciated or amortized balance of the assets assuming no impairment loss was recognized in prior periods.

The Company assesses the cash-generating unit to which goodwill is allocated on an annual basis and recognizes an impairment loss on the excess of carrying value over the recoverable amount.

(7) Cash equivalents

The Company considers all highly liquid investments, such as investments in bonds with repurchase agreements, with a maturity of three months or less to be cash equivalents.

(8) Financial instruments

The Company adopted transaction (or settlement) date accounting for financial instrument transactions. Upon initial recognition, financial instruments are evaluated at fair value. Except for financial instruments held for trading purposes, acquisition cost or issuance cost is added to the originally recognized amount.

After initial recognition, the Company classifies the financial instruments according to their purpose of holding or issuance as follows:

1. Financial assets (liabilities) at fair value through profit or loss

   Financial assets (liabilities) at fair value through profit or loss are held with the intention of buying and selling them within a short period of time. Except for those that the Company holds for hedging purposes and are considered to be effective hedging instruments, financial derivatives are classified into this account.

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2. Available-for-sale financial assets

If there is objective evidence that a financial asset is impaired, a loss is recognized. If, in a subsequent period, events or changes in circumstances indicate that the amount of impairment loss has decreased, the previously recognized impairment loss on equity securities is reversed to the extent of the decrease and recorded as an adjustment to stockholders' equity, while for debt securities, the reversal is allowed through profit or loss provided that the decrease is clearly related to an event which occurs after the impairment loss is recognized.

3. Financial assets carried at cost

Equity investments which could not be measured at fair value with reasonable certainty are carried at their initial cost. However, if there is objective evidence of impairment, a loss is recognized. Restoration of a previously recognized impairment loss is prohibited.

4. Bond investment without market price

Bond investment without market price is measured at amortized cost using the effective interest method. If there is objective evidence which indicates that a financial asset is impaired, a loss is recognized. If, in a subsequent period, the amount of the impairment loss decreases and the decrease is clearly attributable to an event which occurred after the impairment loss was recognized, the previously recognized impairment loss is reversed to the extent of the decrease. The reversal may not result in a carrying amount of the financial asset that exceeds the amortized cost that would have been determined if no impairment loss had been recognized.

(9) Allowance for doubtful receivables

The allowance for doubtful accounts is determined based on the ageing of receivables, credit evaluation results, past experience, and the Company's internal credit policies.

(10) Inventories

Inventories are measured at the lower of cost or net realizable value (except for the inventory costs of Aescu, which are measured by the weighted-average method), including necessary costs to be saleable and freight fees. The cost of inventories is based on the standard cost method. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses at the end of the period. The difference between standard cost and actual cost is recognized as cost of goods sold.

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(11) Property, plant and equipment

Property, plant and equipment are stated at cost. Costs associated with significant additions, improvements, and replacements to property, plant and equipment are capitalized. Repairs and maintenance are charged to expenses as incurred.

Depreciation of property, plant and equipment of the Company is provided for by using the straight-line method over the estimated useful lives of the respective assets. At the end of each fiscal year, the Company evaluates the remaining useful lives, depreciation method, and residual value of fixed assets. Any change in the remaining useful lives, depreciation method, and residual value is treated as a change of accounting estimate.

The useful lives of property, plant and equipment are as follows:

(a) Buildings and improvements: 5~50 years.
(b) Machinery and equipment: 3~10 years.
(c) Transportation: 3~10 years.
(d) Office equipment and others: 3~8 years.

Gains or losses on the disposal of property, plant and equipment are accounted for as non-operating income or losses in the consolidated statement of income.

(12) Intangible assets

Expenditure on research is recognized as an expense when it is incurred, except for the recognition of goodwill or intangible assets in a business combination. An intangible asset arising from technology development is recognized if, and only if, the Company can demonstrate all of the following:

(a) The technical feasibility of completing the intangible asset so that it will be available for use or sale.
(b) Its intention to complete the intangible asset and use or sell it.
(c) Its ability to use or sell the intangible asset.
(d) How the intangible asset will generate probable future economic benefits.
(e) The availability of adequate technical, financial, and other resources to complete the development and to use or sell the intangible asset.
(f) Its ability to measure reliably the expenditure attributable to the intangible asset during its development.

(Continued)

Goodwill represents the excess of the cost of the acquisition over the interest in the fair value of the identifiable assets, liabilities, and contingent liabilities acquired. Goodwill is measured at cost less accumulated impairment losses. Core technologies are amortized over periods ranging from three to five years, on a straight-line basis. The costs of land use rights are amortized using the straight-line method over the lease terms, ranging from 50 to 60 years.

The residual value, useful life, and amortization method for an intangible asset with a finite useful life are reviewed at least at each fiscal year-end. Any changes shall be accounted for as changes in accounting estimates.

(13) Deferred expenses

The purchase costs of software are recorded as deferred expenses and are amortized over periods ranging from three to five years, on a straight-line basis.

(14) Convertible bonds

Convertible bonds issued by the Company involving financial liabilities and conversion options where the bondholder could elect to convert the bond into the Company's common stock are treated as compound financial instruments. The issuance costs are allocated pro-rata to the liability and equity elements of the convertible bonds based on their original recognized amount. The fair value of the liability element in convertible bonds is determined by reference to the fair value of a similar liability which has no relation with the equity element. The amount of the equity element is calculated by reducing the fair value of the liability element from the total value of the convertible bonds. The interest expense of convertible bonds is calculated by the effective interest rate method and recorded in the consolidated statements of income over the duration of the bonds.

The Company recognized the conversion option with price reset as an equity element. In accordance with ARDF Interpretation No. (97) 331, increases in the fair value of issued common stock due to conversion price reset are accounted for as non-operating losses in the consolidated statement of income.

(15) Retirement plan

Alpha established a non-contributory defined benefit employee retirement plan (the "Plan") covering all regular employees. Alpha Holdings, D-Link Asia, Alpha Investment, Alpha HK and Alpha NL have not set up any retirement plans due to having no employees. Aescu, Darson, Dongguan Youxun, Alpha Chengdu, Mirac, Alpha Solutions, Alpha Changshu, Alpha USA and ATS have set up their respective retirement plans based on local government regulations. Net Mag has not set up a retirement plan due being in the development stage.

In accordance with the Plan, all of Alpha’s employees in the Republic of China are eligible for retirement or are required to retire after meeting certain age or service requirements. Payments of retirement benefits are based on the years of service and the average salary for the six-month period before the employee’s retirement. Each employee earns two months of salary for the first fifteen years of service, and one month of salary for each year of service thereafter. The maximum retirement benefit is 45 months of salary. The Plan is funded by contributions made by Alpha. Beginning July 1, 2005, pursuant to the ROC Labor Pension Act (hereinafter referred to as the “New Act”), employees who elected to participate in the new system or joined the Company after July 1, 2005, are covered by a defined contribution plan under the New Act. For these employees, the Company is required to make a monthly contribution at a rate no less than 6% of the employee’s monthly wages to the employee’s individual pension fund account at the ROC Bureau of Labor Insurance.

The defined benefit plan under the ROC Labor Standards Law (the “old system”) is accounted for in accordance with Republic of China Statement of Financial Accounting Standards (“ROC SFAS”) No. 18 “Accounting for Pensions”, which requires an actuarial calculation of pension obligation at year-end. Based on the actuarial calculation, Alpha recognizes a minimum pension liability and net periodic pension costs covering the service lives of the retirement plan participants, including current service cost, net obligation at transition, and pension gains or losses amortized on a straight-line basis. In accordance with the requirement of the ROC Labor Standards Law, Alpha has contributed monthly at the rate of 2% of salaries and wages to a pension fund.

Under the New Act, Alpha and Aescu contribute 6% of employees’ monthly wages to the Bureau of Labor Insurance. The contribution for a period is recognized as pension cost for that period.

Alpha Holdings, Alpha Investments, Alpha HK, D-Link Asia, Alpha NL and Net Mag did not establish pension plans, and therefore, no pension expense was recognized.

Darson, Dongguan Youxun, Alpha Chengdu, Mirac, Alpha Changshu, Alpha USA, ATS and Alpha Solutions have defined contribution retirement plans. For the defined contribution plans, the companies are required to make a monthly contribution at a certain rate based on an employee’s monthly salary or wages to the employee’s individual pension fund account at a trust fund separate from the companies. Cash contributions are charged to current operations as pension cost. Except for the contribution above, there is no pension obligation.

(Continued)

(16) Share-based payment

The Company has share-based payment agreements. The equity instruments under the agreements were granted after January 1, 2008. The accounting treatments of shared-based payment transactions are according to Republic of China Statement of Financial Accounting Standards ("ROC SFAS") No. 39 Share-based Payment. However, the pro forma net income and earnings per share, and the nature and the scope of the share-based payment must be disclosed.

The Company used the intrinsic value method to recognize compensation cost for its employee stock options issued between January 1, 2004, and December 31, 2007, which is the difference between the market price of the stock and the exercise price of the employee stock option on the measurement date, in accordance with ARDF Interpretation Nos.(92) 070~072. Compensation cost should be charged to expense over the employee vesting period and increase stockholders' equity accordingly.

The private consolidated subsidiaries apply the intrinsic value method to share-based payment agreements which were established after January 1, 2008; namely, they recognize compensation cost, which is the difference between the value of the net stockholders' equity of the most recent financial statements and the exercise price of the employee stock option on the measurement date. Under the intrinsic value method, the compensation cost should be charged to expense over the employee vesting period and increase stockholders' equity accordingly, and any gains or losses on changes in intrinsic value on the follow-up balance sheet dates and share-based payment agreement completion date should be recognized.

The accounting treatment of the Company for the capital increase by cash reserved for employee stock subscription since January 1, 2008, was in accordance with ARDF Interpretation No. (96) 267. The compensation cost based on the option-pricing model on the grant date is accrued and is being amortized over the requisite service period. The subsidiaries should recognize embedded value as compensation cost if the subsidiaries' shares have not been publicly listed and fair value could not be reliably estimated on the grant date. The grant date was either the ex-dividend date or the date of approval by the board of directors if approval from the board of directors is required. However, the private subsidiaries accounted for employee stock options using the intrinsic value method, and the deferred compensation for options is equal to the difference between the exercise price of the option and the value of the net stockholders' equity at the measurement date.

(Continued)

(17) Treasury stock

The Company repurchases its outstanding stock and recognizes it as treasury stock at cost. If the disposal price is more than the book value of treasury stock, the difference will be presented under capital surplus – treasury stock transactions. The difference will be offset with capital surplus resulting from transactions of the same sort of treasury stock if the book value is more than the disposal price. The difference will be charged to retained earnings if capital surplus is insufficient.

Upon retirement of treasury stock, the "capital stock" and "capital surplus – additional paid-in capital" are debited on a pro rata basis. If the book value exceeds the sum of the par value of capital stock and the premium on stock issuance, the difference is charged against capital surplus arising from the same class of treasury stock transactions, and the remainder, if any, is charged against retained earnings. If the book value is less than the sum of the par value of capital stock and the premium on stock issuance, the difference is credited to capital surplus arising from the same class of treasury stock transactions.

When treasury stock is transferred to employees as bonus, compensation cost is measured by the use of option pricing models if the date of grant was after January 1, 2008, and is amortized over the requisite service period. The grant date is the date when the transfer of treasury stock, number of shares, and price are determined. If approval for the number of shares and price is required, the grant date is the date of approval.

(18) Revenue recognition

Sales revenue is recognized when title to the products and the risks and rewards of ownership are transferred to the customers, which occurs principally at the time of shipment. Outsourcing revenue is recognized when the conversion work has been completed and processed products are delivered.

(19) Employee bonuses and remuneration to directors and supervisors

Effective January 1, 2008, in accordance with Interpretation No. (96) 052 issued by the ARDF, the Company estimates employee bonuses and remuneration to directors and supervisors and charges them to current operations, classified under cost of goods sold and operating expense, as appropriate. The difference, if any, between the amount approved by stockholders in the subsequent year and the amount estimated in the current-year financial statements is accounted for as a change in accounting estimate, and charged to profit or loss in the subsequent year.

(20) Income taxes

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

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

The Company's purchase of machinery and technology for the automation of production and expenditures for research and development and for training entitle the Company to tax credits that are recognized by using the flow-through method.

According to the ROC Income Tax Act, undistributed earnings of Alpha and its subsidiaries in the ROC are subject to an additional 10 percent corporate income surtax. The surtax is charged to income tax expense after the appropriation of earnings is approved by the stockholders in the following year.

The income tax return of each consolidated entity is filed separately and could not be consolidated with Alpha's filing. The Company's income tax expense in the consolidated financial statements includes the accounts of Alpha and its subsidiaries.

(21) Earnings per share ("EPS")

In computing EPS, net income (loss) is divided by the weighted-average number of common shares. The Company's convertible bonds, employee stock options, and employee stock bonuses to be issued after January 1, 2009, are potential common stock. In computing diluted EPS, net income (loss) and the weighted-average number of common shares outstanding during the year are adjusted for the effects of dilutive potential common stock, assuming dilutive share equivalents had been issued. The weighted-average outstanding shares are retroactively adjusted for the effects of stock dividends transferred from retained earnings and capital surplus to common stock, and employee stock bonuses issued prior to January 1, 2008. Effective January 1, 2008, EPS are not retroactively adjusted for employee stock bonuses.

(Continued)

**3. Reasons for and Effect of Changes in Accounting Principle**

The identification of related party was pursuant to ARDF Interpretation No. (99) 371. The interpretation has no effect on the net income and EPS.

The Company adopted, effective January 1, 2009, Republic of China Statement of Financial Accounting Standards ("ROC SFAS") No. 10 "Inventories," as amended, resulting in a decrease in net income and basic earnings per common share of NT$14,236 thousand and NT$0.03, respectively, for the year ended December 31, 2009.

**4. Cash and Cash Equivalents**

| | December 31, 2010 | December 31, 2009 |
|---|---|---|
| | (in thousands) | |
| Cash on hand | $ 4,250 | 8,566 |
| Checking and savings accounts | 1,804,102 | 920,690 |
| Time deposits | 386,610 | 3,442,457 |
| Cash equivalents – bonds with repurchase agreements | 636,698 | 437,271 |
| | **$ 2,831,660** | **4,808,984** |

**5. Financial Assets**

| | December 31, 2010 | December 31, 2009 |
|---|---|---|
| | (in thousands) | |
| Bond investment without market price – current: | | |
| Bonds – iStor Networks Inc. | $ - | 34,690 |
| Less: accumulated impairment – bond investments without market price | - | (34,690) |
| | **$ -** | **-** |
| Available-for-sale financial assets – noncurrent: | | |
| Publicly traded stock – D-Link Corp. | **$ 295,631** | **332,093** |
| Financial assets carried at cost – noncurrent: | | |
| TGC, Inc. | $ - | - |
| QuieTek Corp. | 9,996 | 9,996 |
| | **$ 9,996** | **9,996** |

(Continued)

The bonds of iStor held by the Company are not traded publicly, and therefore, the value of the bonds is measured based on an amortization schedule. Alpha recognized impairment loss of $34,690 thousand on the valuation of the bonds in the year ended December 31, 2009. As of December 31, 2010, the Company had received from iStor Networks Inc. $31,875 thousand, accounted for as gain on reversal of impairment loss on financial assets.

For the purpose of expanding the marketing of networking products in Mainland China, Alpha invested $16,985 thousand in TGC, Inc. in September 2004. As of December 31, 2010, the Company had obtained 1.83% of the voting shares.

For the purpose of new product testing and certification, Alpha invested $9,996 thousand in QuieTek Corp. in April 2007. As of December 31, 2010, the Company had obtained 1.8% of the voting shares.

The stock of the Company's investees TGC, Inc. and QuieTek Corp. is not traded publicly, and therefore, the cost method is used to measure its value. In addition, TGC Inc. had net losses for the past years including the current year, and as a result, the Company recognized $16,985 thousand of impairment loss.

## 6. Derivative Financial Instruments

As of December 31, 2010 and 2009, the Company used derivative financial instruments to hedge existing assets and liabilities denominated in foreign currency, as summarized below:

(i) Derivative financial assets

The Company and Standard Chartered Bank subscribed a structured derivative product (USD/CNY Target Digital Pivot) with a 9-month contract starting from September 28, 2010, and monthly foreign exchange settlement. As stipulated in the contract, on each expiry date, if the USD/CNY Expiry Reference Rate is above 6.80, the Company will settle at the exchange rate of 6.80 to buy CNY equivalent to USD6,000 thousand; if the USD/CNY Expiry Reference Rate is between 6.80 and 6.60, the Company will settle at the Expiry Reference Rate plus 0.048 to buy CNY equivalent to USD3,000 thousand; however, if the USD/CNY Expiry Reference Rate is below 6.6, the Company will not have any gains or losses. All transactions with respect to the contract will be settled with respect to the difference in USD exchange rates. In addition, the contract will be automatically terminated if the Company accumulates settlement gains on 6 occasions. For the year ended December 31, 2010, the Company recognized settlement gain of NT$2,539 thousand on the aforementioned derivative transactions. Accordingly, unrealized valuation gain amounting to NT$686 thousand was accounted for as financial assets at fair value through profit or loss – current, as summarized below:

(Continued)

## ALPHA NETWORKS INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

**December 31, 2010**

| Contract | Notional amount (in thousands) | Currency | Maturity | Carrying amount (in thousands) |
|---|---|---|---|---|
| Put option (sell USD) | USD 145,000 | USD/NTD | 2011.01~2011.03 | $ (21,825) |
| Put option (buy USD) | USD 145,000 | USD/NTD | 2011.01~2011.03 | 53,348 |
| Structured derivative | USD 6,000 | USD/CNY | 2010.09~2011.06 | 686 |
| | | | | $ 32,209 |

**December 31, 2009**

| Contract | Notional amount (in thousands) | Currency | Maturity | Carrying amount (in thousands) |
|---|---|---|---|---|
| Call option (sell USD) | USD 125,000 | USD/NTD | 2010.01~2010.03 | $ (3,812) |
| Put option (sell USD) | USD 125,000 | USD/NTD | 2010.01~2010.03 | (44,587) |
| Put option (buy USD) | USD 125,000 | USD/NTD | 2010.01~2010.03 | 77,116 |
| Forward foreign currency exchange | USD 3,000 | USD/CNY | 2010.01 | 219 |
| Cross currency swap contract | USD 5,000 | USD/NTD | 2010.01 | 1,769 |
| | | | | $ 30,705 |

(ii) Derivative financial liabilities

**December 31, 2010**

| Contract | Notional amount (in thousands) | Currency | Maturity | Carrying amount (in thousands) |
|---|---|---|---|---|
| Call option (sell USD) | USD 145,000 | USD/NTD | 2011.01~2011.03 | $ 10,706 |
| Put option (sell USD) | USD 2,000 | USD/JPY | 2011.01 | 429 |
| Cross currency swap contract | USD 5,000 | USD/NTD | 2011.01 | 1,404 |
| | | | | $ 12,539 |

(Continued)

The Company and Standard Chartered Bank subscribed a structured derivative product (USD/CNY Target Digital Pivot) with an 18-month contract starting from October 14, 2009, and monthly foreign exchange settlement. As stipulated in the contract, on each expiry date, if the USD/CNY Expiry Reference Rate is above 6.88, the Company will settle at the exchange rate of 6.88 to buy CNY equivalent to USD10,000 thousand; if the USD/CNY Expiry Reference Rate is between 6.88 and 6.70, the Company will settle at the Expiry Reference Rate plus 0.06 to buy CNY equivalent to USD5,000 thousand; however, if the USD/CNY Expiry Reference Rate is below 6.70, the Company will not have any gains or losses. All transactions with respect to the contract will be settled with respect to the difference in USD exchange rates. In addition, the contract will be automatically terminated if the Company accumulates settlement gains on 10 occasions. For the years ended December 31, 2010 and 2009, the Company recognized settlement gain of NT$10,579 thousand and NT$2,815 thousand, respectively, on the aforementioned derivative transactions. Accordingly, unrealized valuation loss amounting to NT$0 thousand and NT$13,473 thousand, respectively, was accounted for as financial liabilities at fair value through profit or loss – current.

## 7. Notes and Accounts Receivable, Net

| | December 31, | |
|---|---|---|
| | **2010** | **2009** |
| | (in thousands) | |
| Notes receivable | $ 31,042 | 2,823 |
| Accounts receivable | 2,988,608 | 1,917,249 |
| Less: allowance for doubtful receivables | (30,893) | (71,003) |
| | **$ 2,988,757** | **1,849,069** |

As of December 31, 2010 and 2009, the overdue accounts receivable were $397,729 thousand and $373,032 thousand, respectively, and were reclassified into overdue receivables under other assets; the overdue receivables were fully reserved.

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

## 8. Inventories

| | December 31, 2010 | December 31, 2009 |
|---|---|---|
| | (in thousands) | |
| Finished goods | $ 963,629 | 497,358 |
| Less: provision for devaluation | (55,385) | (72,309) |
| | 908,244 | 425,049 |
| Work in process | 699,002 | 561,130 |
| Less: provision for devaluation | (42,253) | (41,800) |
| | 656,749 | 519,330 |
| Raw materials | 2,689,467 | 1,668,044 |
| Less: provision for devaluation | (176,009) | (200,978) |
| | 2,513,458 | 1,467,066 |
| | **4,078,451** | **2,411,445** |

In the year ended December 31, 2010, the total amount of the write-off of provision for devaluation, due to sale of inventory, and the write-down of inventory costs to net realizable value was $41,440 thousand, decreasing the cost of goods sold. In the year ended December 31, 2010, gain on physical inventory and scrap loss charged to cost of goods sold were $7,427 thousand and $155 thousand, respectively. In the year ended December 31, 2009, the Company recognized cost of goods sold of $92,351 thousand from the write-down of inventory costs to net sales value. Due to the sales of inventory, the net sales value was not below inventory costs, and the Company reversed cost of goods sold of $131,177 thousand. In the year ended December 31, 2009, loss on physical inventory and scrap loss decreasing cost of goods sold were $1,365 thousand and $1,151 thousand, respectively.

## 9. Intangible Assets

Intangible assets as of December 31, 2010 and 2009, consisted of the following:

| | 2010 Core technologies | 2010 Land use right |
|---|---|---|
| | (in thousands) | |
| Original cost | | |
| Balance at January 1, 2010 | $ 107,063 | 152,027 |
| Write off | (49,500) | (30,624) |
| Effect of exchange rate changes | - | (8,035) |
| Balance at December 31, 2010 | 57,563 | 113,368 |

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

| | | 2010 | |
|---|---|---|---|
| | | **Core technologies** | **Land use right** |
| | | (in thousands) | |
| Accumulated amortization | | | |
| Balance at January 1, 2010 | | 86,915 | 4,707 |
| Amortization | | 11,513 | 2,545 |
| Write off | | (49,500) | - |
| Effect of exchange rate changes | | - | (424) |
| Balance at December 31, 2010 | | 48,928 | 6,828 |
| Book value at December 31, 2010 | $ | 8,635 | 106,540 |

| | | 2009 | |
|---|---|---|---|
| | | **Core technologies** | **Land use right** |
| | | (in thousands) | |
| Original cost | | | |
| Balance at January 1, 2009 | $ | 107,063 | 14,080 |
| Acquisition | | - | 141,605 |
| Effect of exchange rate changes | | - | (3,658) |
| Balance at December 31, 2009 | | 107,063 | 152,027 |
| Accumulated amortization | | | |
| Balance at January 1, 2009 | | 75,403 | 2,718 |
| Amortization | | 11,512 | 2,092 |
| Effect of exchange rate changes | | - | (103) |
| Balance at December 31, 2009 | | 86,915 | 4,707 |
| Book value at December 31, 2009 | $ | 20,148 | 147,320 |

## 10. Short-term Borrowings

Short-term borrowings consisted of the following as of December 31, 2010 and 2009:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | **Amount** | **Interest rate %** | **Amount** | **Interest rate %** |
| | (in thousands) | | | |
| Unsecured borrowings | $ 905,675 | 1.28%~5.61% | 145,824 | 4.86%~5.59% |
| Unused available balance | $ 2,346,126 | | 1,959,761 | |

(Continued)

## 11. Bonds Payable

The significant terms of the unsecured domestic convertible bonds payable issued on January 5, 2006, are summarized as follows:

| | |
|---|---|
| Par value | NT$1,200,000 thousand, par value NT$100 thousand |
| Issue date | January 5, 2006 |
| Maturity date | January 4, 2011 |
| Coupon rate | 0% |
| Conversion method | Bondholders may convert bonds into Alpha's common shares at any time between February 5, 2006, and December 25, 2010 |
| Conversion price and price adjustment | The basis date for setting the conversion price of the bonds is December 22, 2005. The conversion price is calculated as 105.87% of the basis price, which is the lowest price among the three arithmetic averages of the Company's closing prices for one, three, and five business days before the basis date.<br>The selected closing price for determining the conversion price should be converted into the ex-dividend price when the ex-dividend date occurs before the basis date.<br>The conversion price should be adjusted in accordance with the above formula when the ex-dividend date occurs between the date of determining the conversion price and the date of actual issuance.<br>Using the above approach, the conversion price of the issuance was NT$37 per share based on the basis price of NT$34.95 per share.<br>In addition to the adjustment of the conversion price based on the anti-dilution effect of the above approach, the reset basis dates of the conversion price were the date six months after the issuance of bonds and the basis date for distributing interest of each year between the years 2007 and 2010. If there is no distribution of interest in a year, the basis date will be the date of distribution of stock. And the basis date will be July 31 of a year without any distribution of stock. The conversion price is adjusted by the lowest price of the average closing price of common shares for one, three, and five business days before the basis date times the premium rate of the original issuance. The maximum adjustment downward is 80% of the issued conversion price, with no adjustment upward allowed, and is based on the change in the number of common shares of the Company, if any.<br>The resetting of the conversion price does not apply on or before the reset basis date. |

(Continued)

## ALPHA NETWORKS INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

| | |
|---|---|
| | As of December 31, 2010, the conversion price was NT$25.66. |
| Redemption at the option of Alpha | On or at any time after January 5, 2007, and before November 25, 2010, Alpha may, having given not less than 30 days' notice to the bondholders, redeem all of the bonds at their principal amount. However, no such redemption may be made unless (i) the closing price of common stock on the TSE for the period of 30 consecutive trading days is more than 50% of the current conversion price or (ii) at least 90% of the aggregate principal amount of bonds issued has already been converted, redeemed, or purchased and cancelled. |
| Redemption at the option of bondholders | Alpha will at, the option of any bondholder, redeem all or part of the bonds held by the bondholder on January 5, 2008, at their principal amount. To exercise such option, the holder must deposit the certificate issued in respect of such bond with the agent together with a duly completed redemption notice not less than 40 days prior to the relevant date. |

Based on Republic of China Statement of Financial Accounting Standards ("ROC SFAS") No. 36, Alpha separated the conversion option from the liability element when the convertible bonds were issued and recorded them as equity and liability, respectively. Details are summarized as follows:

| **Item** | (in thousands) |
|---|---|
| Total amount of convertible bonds | $ 1,200,000 |
| Fair value of non-equity embedded derivatives | (32,640) |
| Issue cost | (5,639) |
| Fair value of convertible bonds | (1,048,081) |
| Equity element – conversion options | **$ 113,640** |

The above straight bond has an effective interest rate of 2.6%.

As of December 31, 2010 and 2009, the fair values of the above non-equity embedded derivatives estimated based on an evaluation method amounted to $0.

As of December 31, 2009, unsecured convertible bonds amounting to $778,400 thousand had been converted into 25,702 thousand shares of Alpha's common stock. This bond conversion increased capital surplus by $453,319 thousand.

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

The unsecured convertible bonds mentioned above amounting to $252,200 thousand were converted into 9,828 thousand shares of common stock in 2010. As of December 31, 2010, unsecured convertible bonds issued in 2006 amounting to $1,030,600 thousand had been converted into 35,530 thousand shares of Alpha's common stock. Of those shares, 4,283 thousand shares were still in the subscription process, recorded under advance receipts for common stock amounting to $42,829 thousand. The bond conversion increased capital surplus by $604,215 thousand.

The details of convertible bonds as of December 31, 2010 and 2009, are summarized below:

| | 2010 | 2009 |
|---|---|---|
| | (in thousands) | |
| Convertible bonds payable | $ 1,200,000 | 1,200,000 |
| Less: Unamortized discount | - | (10,917) |
| Converted into common stock | (1,030,600) | (778,400) |
| Total repurchased amount | (31,800) | (31,800) |
| Current portion | (137,600) | - |
| | $ - | 378,883 |
| Interest expense | $ 7,898 | 10,137 |

The first domestic unsecured convertible bonds of Alpha matured on January 4, 2011, and were redeemed in full.

## 12. Retirement Plans

The following table sets forth the benefit obligation and accrued pension balance for the defined benefit plan as of December 31, 2010 and 2009:

| | 2010 | 2009 |
|---|---|---|
| | (in thousands) | |
| Benefit obligation: | | |
| Vested benefit obligation | $ (14,083) | (1,993) |
| Nonvested benefit obligation | (312,568) | (258,104) |
| Accumulated benefit obligation | (326,651) | (260,097) |
| Projected future salary increase | (356,834) | (298,931) |
| Projected benefit obligation | (683,485) | (559,028) |
| Fair value of plan assets | 261,016 | 262,217 |
| Funded status | (422,469) | (296,811) |
| Unrecognized net loss | 293,125 | 185,763 |
| Accrued pension cost | $ (129,344) | (111,048) |

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

The components of net periodic pension cost for 2010 and 2009 are summarized as follows:

| | | 2010 | 2009 |
|---|---|---|---|
| | | (in thousands) | |
| The defined benefit plan: | | | |
| Service cost | $ | 7,225 | 8,192 |
| Interest expenses | | 12,578 | 13,097 |
| Actual returns on pension fund | | (4,310) | (1,811) |
| Amortization | | 4,296 | 20 |
| Net pension cost | $ | **19,789** | **19,498** |
| The defined contribution plan: | $ | **111,894** | **98,617** |

Actuarial assumptions at December 31, 2010 and 2009, are summarized as follows:

| | 2010 | 2009 |
|---|---|---|
| Discount rate | 1.75% | 2.25% |
| Rate of increase in future compensation levels | 4.00% | 4.00% |
| Expected long-term rate of return on plan assets | 1.75% | 2.25% |

As of December 31, 2010 and 2009, the vested benefits of employees meeting retirement requirement amounted to $18,067 thousand and $2,475 thousand, respectively.

The subsidiaries Aescu, Darson, Mirac, Alpha Chengdu, Dongguan Youxun, Alpha Changshu, Alpha USA and ATS comply with the pension regulations of each local government and recognize pension costs under defined contribution retirement plans.

## 13. Stockholders' Equity

(1) Common stock

Pursuant to a stockholders' resolution on June 19, 2009, Alpha increased its common stock by $231,507 thousand in order to distribute shareholder dividends and employee bonuses of $89,411 thousand and $142,096 thousand, respectively. The basis date for the dividends was August 12, 2009. Alpha issued 5,707 thousand shares of new common stock at $24.90 for employee bonuses of $142,096 thousand, based on the stock price on the day before the shareholders' meeting and considering the ex-rights and ex-dividend effect.

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

(2) Employee stock options

As of December 31, 2010, employee stock options issued were as follows:

| Classification | Authorization date | Grant date | Vesting period | Issued units in thousands | Exercise price per share (NT$) | Fair value on measurement date | Adjusted exercise price per share (NT$) |
|---|---|---|---|---|---|---|---|
| First issuance of employee stock options in 2007 | Sept. 4, 2007 | Oct. 5, 2007 | Service periods between two and four years | 15,000 | 38.50 | 38.50 | 30.90 |
| Second issuance of employee stock options in 2007 | Oct. 30, 2007 | Nov. 9, 2007 | Service periods between two and four years | 7,500 | 32.30 | 32.30 | 24.80 |
| Second issuance of employee stock options in 2007 | Oct. 30, 2007 | Dec. 6, 2007 | Service periods between two and four years | 7500 | 30.75 | 30.75 | 23.70 |

In 2010 and 2009, 332 thousand shares and 1,926 thousand shares, respectively, of Alpha's employee stock options were exercised, and $8,092 thousand and $19,260 thousand had been received as of December 31, 2010 and 2009, respectively. Of those shares, 221 thousand shares and 1,254 thousand shares, respectively, were still in the subscription process, recorded under advance receipts for common stock amounting to $5,351 thousand and $12,540 thousand, respectively.

Alpha applied the intrinsic value method in accounting for stock options granted to employees from the year 2004 to the year 2007 under the stock option plan. Under the intrinsic value method, no compensation cost was recognized since the exercise price of Alpha's employee stock options was equal to the market price of the underlying stock on the date of the grant.

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

If the compensation cost of employee stock options were accounted for by using the fair-value method and the Black-Scholes model were used to estimate the fair value of employee stock options granted, the fair value of each unit of employee stock options would be $0.6~10.3 Weighted-average assumptions are summarized as follows:

| | |
|---|---|
| Expected dividend yield | 15% |
| Expected volatility | 37.16%~45.24% |
| Risk-free interest rate | 1.98%~2% |
| Expected life | 5~6 years |

Information related to Alpha's employee stock option plan for the years ended December 31, 2010 and 2009, is as follows:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| **Employee stock options** | **Options (thousands)** | **Weighted-average exercise price (NT$)** | **Options (thousands)** | **Weighted-average exercise price (NT$)** |
| Outstanding at beginning of year | 30,000 | 28.90 | 34,245 | 26.48 |
| Exercised | (332) | 24.35 | (1,926) | 10.00 |
| Forfeited | - | - | (2,319) | 10.00 |
| Outstanding at end of year | 29,668 | 27.61 | 30,000 | 28.90 |
| Exercisable at end of year | 8,668 | | 9,000 | |
| Weighted-average fair value of options granted during the year (NT$) | $ 0.6~10.3 | | 0.6~10.3 | |

The weighted-average grant-date fair value per share of common stock was $27.09 and $27.25 for 2010 and 2009, respectively. As of December 31, 2010 and 2009, the weighted-average remaining contractual life of outstanding options was 1.83 and 2.83 years, respectively.

(Continued)

Based on the resolution of the board meeting in May 2009, Aescu issued 475 units of employee stock options, and each unit entitles the holder to subscribe for 1,000 shares of common stock of Alpha. The option rights are valid for 5 years. As of December 31, 2010, a summary of the employee stock option certificates was as the follows:

| Classification | Issue date | Units (thousands) | Option duration | Restricted period | Exercise price per share (NT$) | Adjusted exercise price per share (NT$) |
|---|---|---|---|---|---|---|
| First issuance of employee stock options in 2009 | 2009.5.15 | 475 | 2009.5.15~ 2014.5.14 | 2009.5.15~ 2011.5.14 | 10.0 | 10.0 |

Aescu recognized compensation cost of the employee stock options, based on embedded value. The exercise price of the employee stock options was higher than net value per share based on the financial statements closest to the measurement date. Therefore, the recorded compensation cost based on embedded value was $0 for the years ended December 31, 2010 and 2009.

Information related to Aescu's employee stock option plan for the years ended December 31, 2010 and 2009, is as follows:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| Employee stock options | Options (thousands) | Weighted-average exercise price (NT$) | Options (thousands) | Weighted-average exercise price (NT$) |
| Outstanding at beginning of year | 475 | 10.0 | - | - |
| Granted | - | | 475 | 10.0 |
| Exercised | - | - | - | - |
| Forfeited | (95) | - | - | - |
| Outstanding at end of year | 380 | 10.0 | 475 | 10.0 |
| Exercisable at end of year | - | | - | |

In the years ended December 31, 2010 and 2009, no employee stock option was exercised. As of December 31, 2010 and 2009, the weighted-average remaining contractual life of outstanding options was 3.37 and 4.37 years, respectively.

(Continued)

If ROC SFAS No. 39 is adopted for the employee stock option plan and the compensation cost is recognized, the pro forma net income and earnings per share in the Company's financial statements would be as follows:

| | | | 2010 | 2009 |
|---|---|---|---|---|
| | | | (in thousands, except for per share data) | |
| Net income- attributable to equity holders of the parent company | | $ | 936,446 | 828,961 |
| | Pro forma net income | | 891,506 | 756,632 |
| Basic earnings per share | Earnings per share (NT$) | | 2.01 | 1.80 |
| | Pro forma earnings per share (NT$) | | 1.91 | 1.65 |
| Diluted earnings per share | Earnings per share (NT$) | | 1.94 | 1.73 |
| | Pro forma earnings per share (NT$) | | 1.84 | 1.58 |

As of December 31, 2010 and 2009, the authorized common stock amounted to $6,600,000 thousand (including $500,000 thousand authorized for the issuance of the employee stock options), and the issued common stock amounted to $4,711,143 thousand and $4,642,035 thousand, respectively.

(3) Capital surplus

Capital surplus consisted of the following as of December 31, 2010 and 2009:

| | | 2010 | 2009 |
|---|---|---|---|
| | | (in thousands) | |
| Issuance of new shares – premium | $ | 1,043,437 | 1,041,808 |
| Conversion options of convertible bonds (note 11) | | 14,964 | 42,391 |
| Treasury stock | | 22,011 | 3,458 |
| Adjustment to capital surplus for changes in investee's equity | | 29 | 141 |
| Conversion premium of convertible bonds | | 604,215 | 453,319 |
| Stock options | | 112,078 | 84,651 |
| | **$** | **1,796,734** | **1,625,768** |

Pursuant to the ROC Company Act, realized capital surplus can be used to increase share capital after offsetting accumulated deficit. Realized capital surplus includes proceeds received in excess of the par value of common stock issued and any amounts donated to the Company.

Alpha recorded the additional paid-in capital – stock option in proportion to the convertible bonds converted into common stock.

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

(4) Legal reserve

According to the ROC Company Act, 10 percent of the annual earnings shall be allocated as legal reserve until accumulated legal reserve equals the issued common stock. Legal reserve can only be used to offset accumulated deficits and increase common stock.

(5) Distribution of earnings and dividend policy

Pursuant to the Company's articles of incorporation amended on June 19, 2009, current year's earnings before tax, if any, shall be distributed in the following order:

(a) payment of all taxes;
(b) offset prior years' operating losses;
(c) set aside 10% of the remaining amount after deducting (a) and (b) as legal reserve;
(d) set aside special reserve in accordance with the Securities and Exchange Act prescribed by the ROC SFB or reverse special reserve previously provided; and
(e) after deducting items (a), (b), (c) and (d) from current year's earnings, the remainder is allocated as follows: 1% as directors' and supervisors' remuneration, 10~22.5% as employee bonuses, and the remainder as distributable earnings as proposed by a resolution of the stockholders' meeting.

Alpha's dividend policy is based on the industry environment, business growth characteristics, long-term financial plan, retention of talent, and long-term operation of the business. Alpha considers the capital budget to determine the distribution of stock dividends accompanied by cash dividends, which should be no less than 10% of total dividends.

Employee bonuses and remuneration to directors and supervisors in 2010 and 2009 were computed at 15% and 1%, respectively, based on the Company's net income for the year ended December 31, 2010 and 2009, after setting aside 10% as legal reserve. Information about Alpha recognized employee bonuses and remuneration to directors and supervisors of 2010 and 2009 is as follows:

| | 2010 | 2009 |
|---|---|---|
| | (in thousands) | |
| Employee – bonuses – cash | $ 111,045 | 118,329 |
| Directors' and supervisors' remuneration | 7,403 | 7,886 |
| | **$ 118,448** | **126,215** |

(Continued)

## ALPHA NETWORKS INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

The number of common shares to be issued as employee bonuses was computed based on the closing price of Alpha's common stock on the day before the stockholders' meeting, taking into consideration the effects of the dividend announcement and rights offering. If the stockholders' meeting subsequently approves an actual distribution different from the accrual, the difference will be accounted for as a change in accounting estimate and recorded under the net income of next year.

On June 18, 2010, and June 19, 2009, the meeting of stockholders of Alpha approved the plan for distribution of retained earnings proposed by the board of directors. Information about Alpha's directors' and supervisors' remuneration and employee bonuses which were distributed from unappropriated earnings of 2009 and 2008 is as follows:

| | | 2009 | 2008 |
|---|---|---|---|
| | | (in thousands, except for per share date) | |
| Dividend per common share | | | |
| Cash | $ | 1.28 | 0.80 |
| Stock (at par value) | | - | 0.20 |
| | $ | 1.28 | 1.00 |
| Directors' and supervisors' remuneration | $ | 7,886 | 14,209 |
| Employee bonuses – cash | | 118,329 | - |
| Employee bonuses – stock | | - | 142,096 |
| | $ | 126,215 | 156,305 |

The above earnings distribution, which was charged to expense, had no difference from the resolution of Alpha's board of directors in the year ended 2009 and 2008.

The actual distribution of employee bonuses and directors' and supervisors' remuneration for 2010 is subject to the proposal of the board of directors and a resolution of the stockholders' meeting. Relevant information would be available on the Market Observation Post System of the Taiwan Stock Exchange after the above-mentioned meetings.

(6) Treasury stock

Alpha repurchased common stock from the open market in accordance with related regulations of the stock exchange. Details of the treasury stock transactions in 2010 and 2009 are as follows:

| Purpose | | As of January 1, 2010 | Increase | Decrease | As of December 31, 2010 |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| For transfer to employees | $ | 1,883 | 5,248 | 1,883 | 5,248 |

(Continued)

## ALPHA NETWORKS INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

| Purpose | As of January 1, 2009 | Increase | Decrease | As of December 31, 2009 |
|---|---|---|---|---|
| | | (in thousands) | | |
| For transfer to employees | $ 1,883 | - | - | 1,883 |

Alpha transferred 1,883 thousand shares of treasury stocks to employee in the year 2010. If the compensation cost were calculated using the Black-Scholes option pricing model in accordance with ROC SFAS No. 39, the fair value of the options would amount to $18,641 thousand. The assumptions are summarized as follows.

| | 2010 |
|---|---|
| Cash dividend rate | - |
| Expected volatility | 22.52% |
| Risk-free interest rate | 0.4469% |
| Expected life (in years) | 0.0438 years |
| Transfer price | 15.38 |
| Underlying stock current price | 25.3 |

According to the Securities and Exchange Act of the R.O.C., the total shares of treasury stock shall not exceed 10% of Alpha's issued stock, and the total purchase amount shall not exceed the sum of the retained earnings, additional paid-in capital－premium, and realized additional paid-in capital. In compliance with the Securities and Exchange Act of the R.O.C., treasury stock should not be pledged, nor is it entitled to voting rights or dividends.

### 14. Income Taxes

(1) The components of the Company's tax exemption are summarized below:

| Earnings Distribution | Law/Statute | Tax exemption period |
|---|---|---|
| Distribution of 2005 earnings | Statute for Emerging, Important, and Strategic Industries | August 20, 2008～August 19, 2013 |
| Distribution of 2008 earnings | Statute for Emerging, Important, and Strategic Industries | Pending designation |

(Continued)

The income tax return of each consolidated entity is filed separately and could not be consolidated with Alpha's filing. Alpha and its subsidiaries are subject to the current tax rate of the countries in which they operate except for Mirac and Alpha Chengdu, which is subject to the Income Tax Law of Enterprises with Foreign Investment in the People's Republic of China, under which it is exempt from income tax in the first and second years and allowed a fifty percent reduction in the third and fifth year. Years 2010 and 2009 were the second year and third year respectively. Alpha Holding and Alpha Investment are tax exempt entities

The tax returns of Alpha, Net Mag and Aescu were prepared under current enacted income tax law, and an alternative minimum tax ("AMT") was calculated in accordance with the Income Basic Tax Act ("IBTA"). On May 27, 2009, the Republic of China government promulgated an amendment of the Income Tax Act and the statutory income tax rate was changed from 25% to 20%. On June 15, 2010, pursuant to the Income Tax Act, as revised, the statutory income tax rate applicable to the Company was changed from 20% to 17% starting from 2010. According to the amendment, the income tax rate of Alpha, Net Mag and Aescu will be reduced from 20% to 17%, effective in 2010. The statutory income tax rate applicable to Alpha's subsidiaries located in the PRC ranges between 15% and 25%.

For the years ended December 31, 2010 and 2009, income tax expense was as follows:

| | | 2010 | 2009 |
|---|---|---|---|
| | | (in thousands) | |
| Current | $ | 148,191 | 120,383 |
| Deferred | | (28,199) | 515 |
| Additional 10% income surtax on undistributed earnings | | 18,585 | 45,775 |
| | **$** | **138,577** | **166,673** |

(2) The reconciliation of the expected income tax expense at the statutory tax rate and the actual income tax expense for the years ended December 31, 2010 and 2009, was as follows:

| | | 2010 | 2009 |
|---|---|---|---|
| | | (in thousands) | |
| Income tax expense computed at the statutory tax rate | $ | 182,176 | 248,439 |
| Difference generated by the application of different tax rate for subsidiaries | | (16,319) | (25,554) |
| Tax effect of permanent difference | | 33,878 | 45,226 |
| Investment tax credits | | (5,241) | (256,223) |
| Income tax exemption | | (10,714) | - |
| Additional 10% income surtax on undistributed earnings | | 18,585 | 45,775 |
| Valuation allowance for deferred tax assets | | (166,470) | 95,398 |
| Prior year's adjustment | | 57,789 | (57,974) |
| Effect of change in tax rate | | 44,893 | 71,586 |
| Income tax expense | **$** | **138,577** | **166,673** |

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

(3) The components of deferred income tax assets (liabilities) as of December 31, 2010 and 2009, are summarized as follows:

| | 2010 | 2009 |
|---|---|---|
| | (in thousands) | |
| Deferred tax assets – current: | | |
| Investment tax credits | $ 102,251 | - |
| Unrealized bad debt losses | 63,287 | 84,984 |
| Unrealized decline in value of inventories | 46,520 | 61,717 |
| Unrealized exchange loss | 14,577 | 3,979 |
| Product warranty | 28,958 | 2,850 |
| Others | 23,081 | 40,904 |
| | 278,674 | 194,434 |
| Less: valuation allowance | (166,139) | (112,267) |
| | **$ 112,535** | **82,167** |
| Deferred tax assets – noncurrent: | | |
| Investment tax credits | $ 86,887 | 340,265 |
| Accrued pension cost | 21,989 | 22,210 |
| Investment loss on long-term equity investments in foreign entities | 146,355 | 138,570 |
| Goodwill | (19,491) | (17,535) |
| Foreign currency translation adjustment | (10,857) | (39,084) |
| Loss carryforward of Alpha's subsidiaries | 27,378 | 14,338 |
| Others | 17,427 | 12,453 |
| | 269,688 | 471,217 |
| Less: valuation allowance | (280,410) | (500,752) |
| | **$ (10,722)** | **(29,535)** |
| Total deferred tax assets | **$ 578,710** | **722,270** |
| Total deferred tax liabilities | **$ 30,348** | **56,619** |
| Total valuation allowance | **$ 446,549** | **613,019** |

(4) According to the Industrial Innovation Act, Alpha's investment credits from research and development expenditures can be deducted from the current income tax expenses, subject to the threshold of 30% of current income tax expenses. Based on Industrial Innovation Act, the deduction of investment credits for the current-year income tax payable amounted to $5,241 thousand. Alpha's investment credits from the purchase of machinery, research and development expenditure, and training expenditure under the ROC Statute for Upgrading Industries that can be utilized each year are limited to 50 percent of the current year's tax expense. However, the foregoing limit does not apply to the last year of the utilization period.

(Continued)

As of December 31, 2010, Alpha's unused investment tax credits from research and development expenditure and the related expiration year were as follows:

| Unused investment tax credit (in thousands) | Expiration year |
|---|---|
| $ 51,962 | 2011 |
| 52,120 | 2012 |
| 85,056 | 2013 |
| $ 189,138 | |

(5) According to the ROC Income Tax Act amended in January 2009, the previous 10 years' losses of ROC subsidiaries as assessed by the tax authorities can offset the current year's taxable profit for income tax purposes. As of December 31, 2010, the unused loss carryforwards and related expiration year of the Company were as follows:

| Year of loss | Tax effect (in thousands) | Expiration year |
|---|---|---|
| 2009 | $ 9,568 | 2019 |
| 2010 | 22,154 | 2020 |
| | $ 31,722 | |

In accordance with the tax law of each area, losses of foreign subsidiaries as assessed by the tax authorities can be carried forward to offset the future years' taxable profits. As of December 31, 2010, the tax effects of the unused loss carryforwards were $21,985 thousand.

Based on the examination of Alpha's 2008 tax return, the tax authority rejected the tax credit from the merger with Cellvision, and Alpha had to accrue $5,078 thousand of tax payable. Alpha filed a petition for review of the assessment. As of December 31, 2010, the tax authority and Alpha had reached an agreement that the tax payable was $3,298 thousand, and Alpha had paid the full amount.

As of the December 31, 2010, Alpha's income tax returns had been examined by the tax authorities through 2007.

(6) Information relating to the ICA of Alpha as of December 31, 2010 and 2009, is summarized as follows:

| | 2010 | 2009 |
|---|---|---|
| | (in thousands) | |
| Unappropriated earnings: | | |
| Earned after January 1, 1998 | $ 2,152,891 | 1,859,557 |
| ICA balance | $ 269,956 | 372,859 |
| Creditable ratio for earnings distribution to resident stockholders | 12.54% (Estimated) | 22.13% (Actual) |

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

## 15. Earnings per Share

The calculations of basic earnings per share and diluted earnings per share attributable to the stockholders of Alpha in years 2010 and 2009 were as below.

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Before taxes | After taxes | Before taxes | After taxes |
| | (in thousands, except for per share data) | | | |
| **Basic earnings per share:** | | | | |
| Net income－equity holders of the parent company | $ 1,075,023 | 936,446 | 995,634 | 828,961 |
| Weighted-average common shares outstanding (thousand shares) | 466,399 | 466,399 | 459,504 | 459,504 |
| Basic earnings per share (NT$) | $ 2.30 | 2.01 | 2.17 | 1.80 |
| **Diluted earnings per share:** | | | | |
| Net income－equity holders of the parent company | $ 1,075,023 | 936,446 | 995,634 | 828,961 |
| Potential dilution effects of common shares －convertible bonds | 7,898 | 6,555 | 10,137 | 7,603 |
| Net income when calculating diluted EPS | $ 1,082,921 | 943,001 | 1,005,771 | 836,564 |
| Weighted-average common shares outstanding (thousand shares) | 466,399 | 466,399 | 459,504 | 459,504 |
| Potential dilution effects of common shares | 18,998 | 18,998 | 24,462 | 24,462 |
| Diluted weighted-average common shares outstanding (thousand shares) | 485,397 | 485,397 | 483,966 | 483,966 |
| Diluted earnings per share (NT$) | $ 2.23 | 1.94 | 2.08 | 1.73 |

## 16. Financial Instruments

(1) Derivative financial instruments

The Company’s transactions involving derivative financial instruments in 2010 and 2009 are disclosed in note 6. Valuation of financial assets and liabilities through profit or loss amounted to $19,670 thousand and $17,232 thousand for the years ended December 31, 2010 and 2009, respectively.

(Continued)

(2) Non-derivative financial instruments

(i) The Company's non-derivative financial assets or liabilities with short maturities include notes and accounts receivable (including related parties), other financial assets — current/noncurrent, and accounts payable (including related parties), whose fair value was estimated based on book value at the balance sheet date. The carrying amounts approximate their fair value due to the short-term nature of these items.

(ii) Except for the financial assets and liabilities identified in item (i) above, the carrying amounts and estimated fair value of financial instruments as of December 31, 2010 and 2009, were as follows:

| | | December 31, | | | |
|---|---|---|---|---|---|
| | | 2010 | | 2009 | |
| | | **Book value** | **Fair value** | **Book value** | **Fair value** |
| | | (in thousands) | | | |
| Financial assets: | | | | | |
| Bond investment without market price – current | $ | - | - | - | (2)(iii) below |
| Available-for-sale financial assets – noncurrent | | 295,631 | 295,631 | 332,093 | 332,093 |
| Financial assets carried at cost – noncurrent | | 9,996 | (2)(iii) below | 9,996 | (2)(iii) below |
| Financial liabilities: | | | | | |
| Bonds payable (including current portion) | | 137,600 | 137,600 | 378,883 | 378,883 |

(iii) The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

(a) The fair value of bonds payable, available-for-sale financial assets, and financial assets (liabilities) at fair value through profit or loss is the active market quoted price if it is available. If the active market quoted price is unavailable, the Company will determine the fair value based on an evaluation method, and the estimates and assumptions incorporated in such evaluation are consistent with those used by market participants in their pricing of financial instruments.

(b) Bond investment without market price – current: No quoted price existed in an active market, and they are classified as financial assets carried at cost. The bond investment has incurred impairment loss based on valuation. Please refer to note 5 for the book values and other information.

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

(c) It is not practicable to determine the fair values of financial assets carried at cost when these investments are not publicly traded. Refer to note 5 for the details.

(3) Details of quoted market prices and estimated fair values of financial instruments are as follows:

| | December 31, 2010 | | 2009 | |
|---|---|---|---|---|
| | Quoted market price | Estimated fair value | Quoted market price | Estimated fair value |
| | (in thousands) | | | |
| Financial assets: | | | | |
| Cash and cash equivalents | $ 2,831,660 | - | 4,808,984 | - |
| Notes and accounts receivable (including related parties) | - | 5,915,184 | - | 4,633,216 |
| Financial assets at fair value through profit or loss – current | - | 32,209 | - | 30,705 |
| Other financial assets – current | - | 155,155 | - | 12,768 |
| Other financial assets – noncurrent | 25,841 | 17,372 | 15,695 | 13,758 |
| Available-for-sale financial assets – noncurrent | 295,631 | - | 332,093 | - |
| Financial liabilities: | | | | |
| Short-term borrowings | - | 905,675 | - | 145,824 |
| Accounts payable (including related parties) | - | 4,819,210 | - | 4,184,230 |
| Financial liabilities at fair value through profit or loss – current | - | 12,539 | - | 13,473 |
| Other financial liabilities – current | - | 116,498 | - | - |
| Bonds payable (including current portion) | - | 137,600 | - | 378,883 |

(4) Financial risk information

(i) Market price risk

As the Company's derivative financial instruments are for hedging purposes, the gains or losses due to changes in the interest rates or foreign exchange rates will be naturally offset by the hedged items. As a result, market price risk is considered low. Publicly traded stocks held by the Company are classified as available-for-sale financial assets. Since these assets are measured by the fair value, the Company and subsidiaries will be exposed to the risks of equity market price change.

(Continued)

(ii) Credit risk

The Company's potential credit risk is derived primarily from cash and cash equivalents, and accounts receivable. The Company maintains its cash in various creditworthy financial institutions. Credit risk exposure to each financial institution is controlled by the Company. As a result, the Company believes that there is no concentration of credit risk of cash.

The main customers of the Company are in the networking and related industries. It is a normal practice for the Company to provide customers a credit limit according to their credit evaluations. Therefore, the credit risk of the Company is mainly influenced by the networking industry.

As of December 31, 2010 and 2009, 67% and 77%, respectively, of the Company's accounts receivable consisted of five customers.

Although there is a potential concentration of credit risk, the Company routinely assesses the collectibility of the accounts receivable and makes a corresponding allowance for doubtful accounts.

(iii) Liquidity risk

There is no liquidity risk of being unable to raise capital to settle contractual obligations since the Company has sufficient capital and working capital to settle the contractual obligations.

Liquidity risk is the risk of being unable to settle derivative contracts on schedule. The purpose of these instruments held by the Company was to manage and hedge the floating interest rates and foreign currency exchange rates. There is no significant liquidity risk for the related cash flows. The Company has liquidity risk when investing in financial assets carried at cost that are not publicly traded.

(iv) Cash flow risk of fluctuating interest rate

The Company mainly invests in financial instruments with fixed interest rates. Therefore, the fluctuation of market interest rate has no significant influence on the Company's cash flows.

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

## 17. Related-party Transactions

(1) The name and relationship of the related parties with which Alpha and its subsidiaries had significant transactions are shown below:

| Name | Relationship |
|---|---|
| D-Link Corporation (D-Link) | Equity method investor of Alpha |
| D-Link System Inc. (D-Link Systems) | 97.76%-owned subsidiary of D-Link |
| D-Link Europe Ltd. (D-Link Europe) | Subsidiary of D-Link |
| D-Link International Pte Ltd. (D-Link International) | Subsidiary of D-Link |
| D-Link (Shanghai) Co., Ltd. (DLSH) | Subsidiary of D-Link |
| Directors, supervisors, president, and vice president | The Company’s key management team |

(2) Significant transactions with related parties as of and for the years ended December 31, 2010 and 2009, are summarized as follows:

(a) Sales

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Amount (in thousands) | Percentage of net sales | Amount (in thousands) | Percentage of net sales |
| D-Link International | $ 10,897,142 | 42 | 7,762,031 | 45 |
| DLSH | 975,588 | 4 | 687,493 | 4 |
| D-Link | 416,966 | 2 | 358,286 | 2 |
| D-Link Systems | 43,177 | - | 23,140 | - |
| | **$ 12,332,873** | **48** | **8,830,950** | **51** |

(Continued)

As of December 31, 2010 and 2009, receivables resulting from the above transactions were as follows:

| | December 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Amount (in thousands) | Percentage of total receivables | Amount (in thousands) | Percentage of total receivables |
| D-Link International | $ 2,550,282 | 43 | 2,363,347 | 51 |
| DLSH | 202,193 | 3 | 221,458 | 5 |
| D-Link | 158,172 | 3 | 206,430 | 4 |
| D-Link Systems | 15,780 | - | 11,206 | - |
| Less: allowance for doubtful receivables | - | - | (19,946) | - |
| | $ 2,926,427 | 49 | 2,782,495 | 60 |

The selling prices for sales to related parties were determined by the products' fair market value, area, volume, etc.

The collection terms for sales to unrelated customers were 30 to 75 days, and to related parties were 45 to 120 days during 2010 and 2009. However, collection terms for related parties might be further extended when necessary.

(b) Purchases

In 2010 and 2009, the Company did not purchase from related parties; however, the account payables to related parties resulting from purchases that occurred before 2009 were as follows.

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Amount (in thousands) | Percentage of net purchases | Amount (in thousands) | Percentage of net purchases |
| DLSH | $ 1 | - | - | - |

(c) Service fees and others

The Company paid fees to related parties for warranty services, royalties, and other services. The total fees for the years ended December 31, 2010 and 2009, and the related unpaid balance as of December 31, 2010 and 2009, are summarized as follows:

| | | 2010 | | 2009 | |
|---|---|---|---|---|---|
| | | Current expense | Accrued expense | Current expense | Accrued expense |
| | | (in thousands) | | | |
| D-Link International | $ | 41,738 | 13,460 | 26,929 | 9,914 |
| D-Link | | 11,351 | 10,230 | 12,087 | 10,702 |
| D-Link Europe | | 3,676 | 287 | 3,716 | - |
| Others | | 39 | - | 612 | 210 |
| | $ | 56,804 | 23,977 | 43,344 | 20,826 |

(d) Property, plant and equipment

Acquisition of property, plant and equipment and core technologies for the years ended December 31, 2010 and 2009, and the related unpaid balance as of December 31, 2010 and 2009, are summarized as follows:

| | | 2010 | | 2009 | |
|---|---|---|---|---|---|
| | | Expenditure | Account payable | Expenditure | Account payable |
| | | (in thousands) | | | |
| D-Link | $ | 167 | - | - | - |

(e) Others

As of December 31, 2010 and 2009, net receivable from (payable to) related parties resulting from certain payments made by the Company and subsidiaries on behalf of related parties or made by related parties on behalf of the Company and subsidiaries were as follows:

| | | 2010 | 2009 |
|---|---|---|---|
| | | (in thousands) | |
| D-Link International | $ | - | 1,652 |

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

(f) Alpha entered into a plant lease agreement with D-Link for the Taipei Neihu office. The rental expense was $5,338 thousand in each of the years 2010 and 2009. As of December 31, 2010 and 2009, payables resulting from the above transactions amounted to $1,405 thousand and $1,408 thousand, respectively, which were recorded in payable to related parties.

(3) Compensation of the principal management team

| | 2010 | 2009 |
|---|---|---|
| | (in thousands) | |
| Salaries and cash awards | $ 40,316 | 43,933 |
| Business expense | 13,200 | 4,533 |
| Transportation allowances and business expense | 26 | 34 |
| Employee bonuses | 23,152 | 33,665 |

The aforementioned amounts contained the accruals for remuneration of directors and supervisors and for employee bonuses; refer to the section "stockholders' equity" for further details.

## 18. Pledged Assets

Assets pledged as collateral as of December 31, 2010 and 2009, are summarized as follows:

| Pledged assets | Pledged to secure | December 31, 2010 | December 31, 2009 |
|---|---|---|---|
| | | (in thousands) | |
| Time deposit (recorded in other financial assets – noncurrent) | Import guarantee for Customs | $ 7,000 | 7,000 |
| Time deposit (recorded in other financial assets – noncurrent) | Guarantee for no-unpaid tax certificate | 10,000 | 5,000 |
| Bank deposit (recorded in other financial assets – current) | Guarantee for derivative financial instruments | - | 2,403 |
| Bank deposit (recorded in other financial assets – noncurrent) | Guarantee for labor | 8,841 | 1,292 |
| | | **$ 25,841** | **15,695** |

(Continued)

## 19. Commitments and Contingencies

(1) Operating leases

| Lessee | Object | Lessor | Period for lease | Rental expense in 2010 | Payment method |
|---|---|---|---|---|---|
| Alpha | Land | Hsinchu Science Park | Nov 3, 2003~ Dec 31, 2022 | $8,069 thousand | Monthly |

According to the lease agreement, rent payment is subject to an adjustment as the government adjusts the land value.

Based on the signed leases for offices and employee dormitories, the estimated minimum rental expenditures are as follows:

| | Amount (in thousands) |
|---|---|
| 2011.01.01~2011.12.31 | $ 23,218 |
| 2012.01.01~2012.12.31 | 21,697 |
| 2013.01.01~2013.12.31 | 13,654 |
| | $ 58,569 |

(2) Alpha entered into royalty agreements with Fine Point, Wind River, and others. Pursuant to the terms of each signed agreement, Alpha is obligated to pay royalties when Alpha's products utilize technologies specified in the royalty agreements. Total royalty expenses incurred in 2010 and 2009 were $23,301 thousand and $32,880 thousand, respectively.

(3) As of December 31, 2010 and 2009, Alpha had outstanding letters of credit amounting to $8,778 thousand and $11,564 thousand, respectively.

(4) As of December 31, 2010 and 2009, the significant outstanding commitments for property, plant and equipment construction amounted to $338,288 thousand and $10,415 thousand, respectively.

(5) Former employees of Alpha USA brought lawsuits claiming that their employment was inappropriately terminated and claiming unpaid wages. Alpha USA hired lawyers to resolve the disputes. As of the audit report date, Alpha USA estimates that the lawsuits will not significantly impact Alpha USA's operations.

(Continued)

**20. Other Information**

(1) Information on personnel expenses, depreciation, and amortization, by function, for the years ended December 31, 2010 and 2009, is summarized as follows:

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| **Account** | **Cost of goods sold** | **Operating expense** | **Total** | **Cost of goods sold** | **Operating expense** | **Total** |
| | | | (in thousands) | | | |
| Personnel expenses: | | | | | | |
| Salaries | 901,128 | 1,395,458 | 2,296,586 | 619,635 | 1,259,018 | 1,878,653 |
| Labor and health insurance | 33,388 | 88,752 | 122,140 | 28,239 | 81,994 | 110,233 |
| Pension | 23,159 | 108,524 | 131,683 | 25,111 | 93,004 | 118,115 |
| Others | 23,154 | 70,899 | 94,053 | 20,950 | 79,337 | 100,287 |
| Depreciation | 139,068 | 210,326 | 349,394 | 152,142 | 228,877 | 381,019 |
| Amortization | 653 | 86,210 | 86,863 | 404 | 81,245 | 81,649 |

(2) As of December 31, 2010 and 2009, the significant financial assets and liabilities in foreign currency were as follows:

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | **Foreign currency** | **Exchange rate** | **NTD** | **Foreign currency** | **Exchange rate** | **NTD** |
| | (in thousands, except for exchange rate data) | | | | | |
| Financial assets: | | | | | | |
| Monetary items: | | | | | | |
| USD | 245,613 | 29.26 | 7,186,636 | 199,312 | 32.03 | 6,383,963 |
| JPY | 384,370 | 0.36 | 138,373 | 278,488 | 0.35 | 97,471 |
| CNY | 236,032 | 4.41 | 1,040,901 | 191,569 | 4.70 | 900,374 |
| Non-monetary items: | | | | | | |
| USD | 296,000 | 29.26 | (2)(i) below | 383,000 | 32.03 | (2)(i) below |
| Financial liabilities: | | | | | | |
| Monetary items: | | | | | | |
| USD | 91,903 | 29.26 | 2,689,082 | 73,419 | 32.03 | 2,351,611 |
| JPY | 305,747 | 4.41 | 1,348,344 | 126,258 | 4.70 | 593,413 |
| Non-monetary items: | | | | | | |
| USD | 152,000 | 29.26 | (2)(i) below | 10,000 | 32.03 | (2)(i) below |

(i): The Company’s transactions involving derivative financial instruments in 2010 and 2009 are disclosed in note 6.

(Continued)

## ALPHA NETWORKS INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

(3) Reclassification

In order to conform with the presentation of the consolidated financial statements for the year ended December 31, 2010, several amounts in the consolidated financial statements for the year ended December 31, 2009, have been reclassified. The reclassification has no significant effect on the consolidated financial statements for the year ended December 31, 2009.

**21. Segment Financial Information**

(1) Industry information

The Company principally operates in one industry segment: the research, development, manufacturing and sale of network communication products.

(2) Geographic information

| | 2010 | | | | | |
|---|---|---|---|---|---|---|
| | **Taiwan** | **Asia** | **Americas** | **Europe** (in thousands) | **Adjustments and eliminations** | **Consolidated** |
| Area revenue: | | | | | | |
| Third-party customers | $ 19,591,334 | 1,885,340 | 4,363,951 | 10,771 | - | 25,851,396 |
| Inter-company | 4,572,028 | 1,109,369 | - | - | (5,681,397) | - |
| | **$ 24,163,362** | **2,994,709** | **4,363,951** | **10,771** | **(5,681,397)** | **25,851,396** |
| Operating income (loss) | **$ 995,562** | **(350,367)** | **(40,241)** | **473** | **466,196** | **1,071,623** |
| Area identifiable assets | **$ 15,264,659** | **5,636,636** | **1,188,298** | **40,305** | **(5,362,032)** | **16,767,866** |

| | 2009 | | | | |
|---|---|---|---|---|---|
| | **Taiwan** | **Asia** | **Americas** (in thousands) | **Adjustments and eliminations** | **Consolidated** |
| Area revenue: | | | | | |
| Third-party customers | $ 14,703,942 | 1,299,942 | 1,317,811 | - | 17,321,695 |
| Inter-company | 1,358,494 | 867,642 | 867 | (2,227,003) | - |
| | **$ 16,062,436** | **2,167,584** | **1,318,678** | **(2,227,003)** | **17,321,695** |
| Operating income (loss) | **$ 960,174** | **(724,894)** | **(32,388)** | **790,864** | **993,756** |
| Area identifiable assets | **$ 14,131,423** | **4,714,487** | **716,376** | **(4,602,372)** | **14,959,914** |

(Continued)

**ALPHA NETWORKS INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

(3) Export sales

The export sales of the consolidated entities located in the ROC for the years ended December 31, 2010 and 2009, are summarized as follows:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | **Amount** (in thousands) | **Percentage of net sales** | **Amount** (in thousands) | **Percentage of net sales** |
| Asia | $ 6,654,734 | 26 | 3,688,393 | 35 |
| Americas | 6,657,358 | 26 | 5,661,881 | 23 |
| Europe | 11,202,040 | 43 | 5,740,812 | 36 |
| Others | 856,706 | 3 | 748,600 | 5 |
| | **$ 25,370,838** | **98** | **15,839,686** | **99** |

(4) Major customers

Individual customers that represented greater than 10% of consolidated revenue in 2010 and 2009 were as follows:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | **Amount** (in thousands) | **Percentage of net sales** | **Amount** (in thousands) | **Percentage of net sales** |
| D-Link International | **$ 10,897,142** | **42** | **7,762,031** | **45** |