ALPHA NETWORKS INC. AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2012 and 2011
(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, 2012 and 2011, 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, 2012 and 2011, 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)
March 4, 2013

The accompanying financial statements are intended only to present the financial position, results of operations, and cash flows in accordance with accounting principles and practices generally accepted in the Republic of China and not those of any other jurisdictions. The standards, procedures and practices to audit (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 was 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, 2012 and 2011
(Expressed in thousands of New Taiwan dollars)

Assets		**2012**	**2011**
Current assets:			
Cash and cash equivalents (note 4)	$	2,370,758	3,266,754
Financial assets at fair value through profit or loss – current (note 6)		12,929	10,901
Notes and accounts receivable, net (note 7)		3,561,852	3,945,596
Receivables from related parties (note 18)		2,303,383	3,373,778
Other financial assets – current (note 19)		5,141	162,040
Inventories (note 8)		3,625,215	4,787,314
Other current assets (note 16)		591,940	388,539
		12,471,218	15,934,922
Funds and investments:			
Prepayments for long-term investments in stocks (note 9)		78,305	-
Other financial assets – noncurrent (note 19)		33,786	36,984
Available-for-sale financial assets – noncurrent (note 5)		180,828	201,522
Financial assets carried at cost – noncurrent (note 5)		9,996	9,996
		302,915	248,502
Property, plant and equipment (note 18):			
Cost:			
Land		99,805	102,377
Buildings and improvements		3,080,998	3,057,152
Machinery and equipment		2,273,344	1,896,115
Transportation, office and other equipment		310,708	399,198
		5,764,855	5,454,842
Less: accumulated depreciation		2,197,147	2,026,243
Prepayment for equipment and construction in progress		33,488	58,523
		3,601,196	3,487,122
Intangible assets (note 10)**:**			
Trademarks		-	127
Goodwill		134,883	140,913
Land use right		107,895	114,020
		242,778	255,060
Other assets (note 7)**:**			
Deferred expenses		111,381	109,101
Total assets	$	**16,729,488**	**20,034,707**

Liabilities and Stockholders' Equity		**2012**	**2011**
Current liabilities:			
Short-term borrowings (note 11)	$	775,806	1,299,455
Accounts payable		3,978,703	6,202,891
Payables to related parties (note 18)		20,039	24,221
Income tax payable		124,446	128,402
Accrued expenses		483,011	619,007
Payroll and bonus payable		327,692	614,249
Financial liabilities at fair value through profit or loss – current (note 6)		1,922	12,844
Other current liabilities		461,775	444,001
		6,173,394	9,345,070
Long-term liabilities			
Long-term loans payable (note 12)		293,007	-
Financial liabilities at fair value through profit or loss – noncurrent (notes 6 and 13)		964	3,385
Bonds payable (note 13)		177,081	844,453
		471,052	847,838
Other liabilities:			
Accrued pension liabilities (note 14)		186,231	153,724
Deferred income tax liabilities – noncurrent (note 16)		34,496	44,759
Miscellaneous liabilities – other		382	648
		221,109	199,131
Total liabilities		6,865,555	10,392,039
Stockholders' equity (notes 13 and 15)**:**			
Equity attributable to Alpha Networks Inc.			
Common stock		5,136,764	4,756,784
Advance receipts for common stock		1,546	28,883
		5,138,310	4,785,667
Capital surplus		2,237,319	1,929,425
Retained earnings:			
Legal reserve		788,389	693,341
Special reserve		65,322	102,505
Unappropriated earnings		2,159,282	2,197,107
		3,012,993	2,992,953
Other:			
Cumulative foreign currency translation adjustment		95,478	165,662
Unrealized gain or loss on available-for-sale financial assets		(251,678)	(230,984)
Treasury stock		(368,489)	-
		(524,689)	(65,322)
Total equity attributable to Alpha Networks Inc.		9,863,933	9,642,723
Minority interest		-	(55)
Total stockholders' equity		9,863,933	9,642,668
Commitments and contingencies (notes 12 and 20)			
Total liabilities and stockholders' equity	$	**16,729,488**	**20,034,707**

See accompanying notes to consolidated financial statements.

ALPHA NETWORKS INC. AND SUBSIDIARIES

Consolidated Statements of Income

Years ended December 31, 2012 and 2011
(Expressed in thousands of New Taiwan dollars, except for net income per common share)

		2012	2011
Sales (note 18)	$	25,093,268	25,677,524
Less: sales returns and allowances		186,124	209,280
		24,907,144	25,468,244
Cost of goods sold (notes 8 and 18)		21,040,596	21,701,333
Gross profit		3,866,548	3,766,911
Operating expenses (note 18)**:**			
Selling		598,602	562,544
General and administrative		808,819	787,169
Research and development		1,437,149	1,476,096
		2,844,570	2,825,809
Operating income		1,021,978	941,102
Non-operating income and gains:			
Interest income		24,941	23,943
Dividend revenue		10,840	13,053
Foreign currency exchange gain, net		-	290,957
Gain on valuation of financial assets		160,443	-
Other income, net		20,022	37,548
		216,246	365,501
Non-operating expenses and loss:			
Interest expense (note 13)		65,836	54,320
Foreign currency exchange loss, net		235,357	-
Impairment loss on goodwill (note 10)		6,030	-
Loss on valuation of financial assets		-	71,008
		307,223	125,328
Income before income taxes		931,001	1,181,275
Income tax expense (note 16)		214,821	233,497
Net income	**$**	**716,180**	**947,778**
Attributable to:			
Equity holders of the parent company	$	716,125	950,482
Minority interest		55	(2,704)
	$	**716,180**	**947,778**

		2012 Before taxes	2012 After taxes	2011 Before taxes	2011 After taxes
Earnings per share (in New Taiwan dollars) (note 15)					
Basic earnings per share	**$**	**1.83**	**1.41**	**2.50**	**2.01**
Diluted earnings per share	**$**	**1.76**	**1.36**	**2.40**	**1.93**

See accompanying notes to consolidated financial statements.

ALPHA NETWORKS INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2012 and 2011

(Expressed in thousands of New Taiwan dollars)

	Common stock	Advance receipts for common stock	Capital surplus	Retained Earnings: Legal reserve	Retained Earnings: Special reserve	Retained Earnings: Unappropriated 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, 2011	$ 4,711,143	48,180	1,796,734	599,696	-	2,152,891	34,371	(136,875)	(126,009)	2,649	9,082,780
Appropriation of earnings (note 1):											
Legal reserve	-	-	-	93,645	-	(93,645)	-	-	-	-	-
Special reserve	-	-	-	-	102,505	(102,505)	-	-	-	-	-
Cash dividends	-	-	-	-	-	(710,116)	-	-	-	-	(710,116)
Stock-option component of convertible bonds issued	-	-	100,900	-	-	-	-	-	-	-	100,900
Issuance of stock for conversion of bonds	42,829	(13,946)	24,755	-	-	-	-	-	-	-	53,638
Foreign currency translation adjustments	-	-	-	-	-	-	131,291	-	-	-	131,291
Issuance of stock for employee stock options exercised	2,812	(5,351)	3,961	-	-	-	-	-	-	-	1,422
Unrealized gains or losses on available-for-sale financial assets	-	-	-	-	-	-	-	(94,109)	-	-	(94,109)
Treasury stocks transferred to employees	-	-	3,075	-	-	-	-	-	126,009	-	129,084
Net income for 2011	-	-	-	-	-	950,482	-	-	-	(2,704)	947,778
Balance at December 31, 2011	4,756,784	28,883	1,929,425	693,341	102,505	2,197,107	165,662	(230,984)	-	(55)	9,642,668
Appropriation of earnings (note 2):											
Legal reserve	-	-	-	95,048	-	(95,048)	-	-	-	-	-
Special reserve	-	-	-	-	(37,183)	37,183	-	-	-	-	-
Cash dividends	-	-	-	-	-	(690,725)	-	-	-	-	(690,725)
Issuance of stock for conversion of bonds	390,385	(27,337)	311,153	-	-	-	-	-	-	-	674,201
Foreign currency translation adjustments	-	-	-	-	-	-	(70,184)	-	-	-	(70,184)
Issuance of stock for employee stock options exercised	22,805	-	28,740	-	-	-	-	-	-	-	51,545
Purchase of treasury stock	-	-	-	-	-	-	-	-	(439,058)	-	(439,058)
Canceled treasury stock	(33,210)	-	(31,999)	-	-	(5,360)	-	-	70,569	-	-
Unrealized gains or losses on available-for-sale financial assets	-	-	-	-	-	-	-	(20,694)	-	-	(20,694)
Net income for 2012	-	-	-	-	-	716,125	-	-	-	55	716,180
Balance at December 31, 2012	**$ 5,136,764**	**1,546**	**2,237,319**	**788,389**	**65,322**	**2,159,282**	**95,478**	**(251,678)**	**(368,489)**	**-**	**9,863,933**

Note 1: Remuneration to directors and supervisors and employees' bonuses in the amount of $7,403 and $111,045, respectively, had been charged against earnings of 2010.

Note 2: Remuneration to directors and supervisors and employees' bonuses in the amount of $8,926 and $151,747, respectively, had been charged against earnings of 2011.

See accompanying notes to consolidated financial statements.

ALPHA NETWORKS INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2012 and 2011
(Expressed in thousands of New Taiwan dollars)

	2012	2011
Cash flows from operating activities:		
Net income	$ 716,180	947,778
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	532,359	446,696
Provision for (reversal of) allowance for doubtful accounts	2,101	(21,985)
Effect of valuation of financial assets and liabilities at fair value through profit or loss	(10,043)	(757)
Provision for inventory obsolescence and devaluation loss	215,538	132,990
Compensation cost arising from treasury stock transferred to employees	-	3,457
Amortization of discount on bonds payable	6,559	5,076
Impairment loss on goodwill	6,030	-
Others	6,917	4,832
Net change in operating assets and liabilities:		
Notes and accounts receivable (including related parties)	1,452,038	(1,382,205)
Inventories	934,796	(855,688)
Financial assets at fair value through profit or loss	10,901	32,209
Deferred income tax assets	23,321	51,178
Other operations-related current assets	(217,266)	(180,153)
Accounts payable (including related parties)	(2,224,188)	1,409,064
Financial liabilities at fair value through profit or loss	(15,959)	(12,539)
Other operations-related current liabilities	(408,362)	181,483
Accrued pension liabilities	32,507	24,380
Cash provided by operating activities	1,063,429	785,816
Cash flows from investing activities:		
Increase in equity-method investments	(78,305)	-
Proceeds from disposal of property and equipment	10,076	-
Acquisition of property and equipment	(648,647)	(774,329)
Decrease in refundable deposits	3,198	2,388
Increase in intangible assets and deferred expenses	(97,342)	(82,697)
Decrease (increase) in restricted cash in bank	151,555	(147,714)
Cash used in investing activities	(659,465)	(1,002,352)
Cash flows from financing activities:		
Increase (decrease) in short-term borrowings	(523,649)	393,780
Increase in long-term loans	293,007	-
Repayment of bonds payable	-	(137,600)
Payments of cash dividends	(690,725)	(710,116)
Increase (decrease) in guarantee deposit received	(266)	318
Increase in bonds payable	-	1,000,0000
Cash received from exercise of employee stock options	51,545	1,422
Purchase of treasury stock	(439,058)	-
Treasury stock transferred to employees	-	125,627
Cash provided by (used in) financing activities	(1,309,146)	673,431
Effect of exchange rate changes on cash	9,186	(21,801)
Net increase (decrease) in cash and cash equivalents	(895,996)	435,094
Cash and cash equivalents at beginning of year	3,266,754	2,831,660
Cash and cash equivalents at end of year	**$ 2,370,758**	**3,266,754**
Supplemental disclosures of cash flow information:		
Cash payments of interest	**$ 58,435**	**45,194**
Cash payments of income taxes	**$ 195,456**	**176,770**
Supplementary disclosure of non-cash investing and financing activities:		
Convertible bonds converted into common stock and capital surplus	**$ 674,201**	**53,638**
Acquisition of property, plant and equipment:		
Increase in property, plant and equipment	$ 644,092	844,199
Change in payables on equipment	4,555	(69,870)
	$ 648,647	**774,329**

See accompanying notes to consolidated financial statements.

(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, 2012 and 2011, Alpha and subsidiaries had 6,392 and 6,412 employees, respectively.

2. Summary of Significant Accounting Policies

(1) The accompanying consolidated financial statements were prepared in accordance with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and 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.

		Percentage of ownership at December 31,		Business
Investor	**Investee**	**2012**	**2011**	**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, 2012	2011	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 operations; now liquidating.
Alpha	Net Mag Technology Corp. (Net Mag)	100	100	Testing and maintaining electrical equipment
Alpha	Aescu Technology Inc. (Aescu)	91.36	91.36	Sale of medical equipment, etc. On August 8, 2012, shareholders' meeting approved liquidation.
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	100	Sale of network equipment
Alpha	Universal Networks Trading Limited (Universal)	100	100	Sale of electrical products
Alpha	Global Networks Trading Limited (Global)	100	100	Sale of electrical products

(Continued)

ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Investor	Investee	Percentage of ownership at December 31, 2012	2011	Business nature
Alpha	Alpha Technical Services Japan Inc. (ATSJ)	100	100	Post-sale service
Alpha Holdings	D-Link Asia Investment Pte. Ltd. (D-Link Asia)	100	100	Investment in manufacturing business
Alpha Holdings	Alpha Networks (Chengdu) Co., Ltd. (Alpha Chengdu)	100	100	Research, development, production and sale of network products
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	Alpha Networks (Dongguan) Co., Ltd. (Alpha Dongguan) (note)	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
Alpha HK	Maintrend Technical Services (Changshu) Co., Ltd. (Maintrend)	100	100	Post-sale service

Note: Formerly known as Dongguan Youxun Electronics Co., Ltd.; in 2012, changed its name to Alpha Networks (Dongguan) Co., Ltd.

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

In 2011, Alpha incorporated Universal, Global, ATSJ and Maintrend, and they were included in the consolidated financial statements of the Company since the inception.

ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(2) Basis of consolidation

The consolidated financial statements include the accounts of Alpha and its subsidiaries in which Alpha directly or indirectly owned over 50% of the voting shares and was 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.

(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.

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(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.

(6) Asset impairment

The Company assesses at each balance sheet date whether there was 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 was higher than the recoverable amount. The Company reverses an impairment loss recognized in prior periods for assets other than goodwill if there was 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 was 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

1. Financial assets at fair value through profit or loss

   Financial assets measured 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. At initial recognition, financial instruments are evaluated at fair value. Acquisition cost or issuance cost is recognized in profit or loss. Changes in fair values are charged to current operations.

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ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

2. Available-for-sale financial assets

These are measured at fair value, and any changes, excluding impairment loss and unrealized foreign currency exchange gain or loss, are reported as a separate component of stockholders' equity before gain or loss on financial instruments is realized. Realized gain or loss on financial instruments is charged to current operations. If there is any objective evidence of impairment, an impairment loss is recognized in profit or loss. If, in a subsequent period, events or changes in circumstances indicate that the amount of impairment loss has decreased, the previously recognized impairment loss for equity securities is reversed to the extent of the decrease and recorded as an adjustment to equity. The Company uses transaction-date accounting for financial instrument transactions.

3. Financial assets carried at cost

Financial instruments whose fair values cannot be measured with reasonable certainty are measured at their initial cost. However, if there is any objective evidence of impairment, a loss should be recognized thereon. Such impairment loss could not be reversed.

4. Accounts receivable and other receivables

Accounts receivable are the creditors' rights from selling goods or rendering services. Other receivables are created from non-operating income.

Concerning financial assets, the Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. Assets that are individually assessed for impairment and for which an impairment loss was or continues to be recognized are not included in a collective assessment of impairment.

Impairment loss is recognized and measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account. The impairment loss is recognized in profit or loss. The present value of estimated future cash flows includes the recoverable amount of collateral and insurance.

If, in a subsequent period, the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment was reversed. The amount of the reversal shall be recognized in profit or loss.

(Continued)

(9) Inventories

The cost of inventories shall comprise all costs of purchase, costs of conversion, and other costs incurred in bringing the inventories to their present location and condition. The allocation of fixed production overheads to the finished goods and work in progress is based on the normal capacity of the production facilities. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities. Inventories are measured at the lower of cost or net realizable value on an individual item basis. The cost of inventories is based on the weighted-average-cost principle. 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.

(10) Equity-method investments

The equity method is adopted when the aggregate shareholding of the Company and its affiliated companies in the investee exceeds 20% of common shares, or is less than 20% of the investee's common stock ownership, but the Company and its affiliated companies have significant influence on the investee. The cost of such an investment shall be analyzed, and the cost of investment in excess of the fair value of identifiable net assets acquired, representing goodwill, shall not be amortized. If the fair value of identifiable net assets acquired exceeds the cost of investment, the excess shall be proportionately allocated as reductions of fair values of noncurrent assets. If the book values of those non-current assets are reduced to zero, the remaining excess should be recorded as extraordinary gains.

(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 in 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 statements of income.

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(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.

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) Financial liabilities at fair value through profit or loss

Financial liabilities measured 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.

(Continued)

ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(15) 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 deducting 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.

(16) 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 Alpha NL, Universal and Global have not set up any retirement plans due to having no employees. Aescu, Darson, Alpha Dongguan, Alpha Chengdu, Mirac, Alpha Solutions, Alpha Changshu, Maintrend, Alpha USA, ATS and ATSJ have set up their respective retirement plans based on local government regulations. Net Mag has not set up a retirement plan.

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 under the New Act 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 old system, Alpha has contributed monthly at the rate of 2% of salaries and wages to a pension fund.

(Continued)

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, Universal, Global and Net Mag did not establish pension plans, and therefore, no pension expense was recognized.

Darson, Alpha Dongguan, Alpha Chengdu, Mirac, Alpha Changshu, Maintrend, Alpha USA, ATS, Alpha Solutions and ATSJ 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.

(17) 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 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 was 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 non-public 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.

(Continued)

The accounting treatment of the Company for the cash capital increase reserved for employee stock subscription since January 1, 2008, is 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 amortized over the requisite service period. The grant date is 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 non-public consolidated subsidiaries account for employee stock options using the intrinsic value method, and the compensation cost 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.

(18) 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 is 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.

(19) 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.

(Continued)

(20) 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.

(21) 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 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.

(Continued)

(22) Earnings per share ("EPS")

In computing EPS, net income (loss) is divided by the weighted-average number of common shares. Alpha's convertible bonds, employee stock options, and employee bonuses which are distributable in the form of shares of stock but have not yet been resolved by the meeting of stockholders are potential common stock. If the potential common shares are not dilutive, only the basic earnings per common shares are disclosed; otherwise, disclosure of diluted earnings per common share is added. 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 from retained earnings and capital surplus.

(23) Operating segment information

Operating segments are components of the Company which engage in operations that generate profit and expenses (including intercompany transactions within the consolidated corporation). The segment's operating results were reviewed regularly by the Company's chief operating decision maker to make decisions pertaining to the allocation of resources to the segment and to assess its performance for which discrete financial information is available.

3. Reasons for and Effect of Changes in Accounting Principle

(1) Effective January 1, 2011, the Company adopted the newly released ROC SFAS No. 41 "Operating Segments". This Standard regulates the disclosure of operating segment information to enable users of financial statements to evaluate the nature and financial effects of an entity's business activities and the economic environments in which it operates. This Standard requires identification and disclosure of operating segments on the basis of how the Company's chief operating decision maker regularly reviews the information in order to allocate resources and assess performance. ROC SFAS No. 41 supersedes ROC SFAS No. 20 "Segment Reporting." The adoption of the newly released SFAS did not have any influence on the consolidated financial statements for the year ended December 31, 2011.

(2) Effective January 1, 2011, the Company adopted the newly revised ROC SFAS No. 34 "Financial Instruments: Recognition and Measurement". The recognition, measurement, and impairment evaluation of receivables are subject to the newly revised SFAS. The adoption of the newly released SFAS did not have any influence on net income and basic earnings per share for the year ended December 31, 2011.

(Continued)

ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

4. Cash and Cash Equivalents

		December 31, 2012	December 31, 2011
		(in thousands)	
Cash on hand	$	7,802	6,942
Checking and savings accounts		985,816	1,261,275
Time deposits		1,092,063	1,308,955
Cash equivalents – bonds with repurchase agreements		285,077	689,582
	$	**2,370,758**	**3,266,754**

5. Financial Assets

		December 31, 2012	December 31, 2011
		(in thousands)	
Available-for-sale financial assets – noncurrent:			
Publicly traded stock – D-Link Corp.	**$**	**180,828**	**201,522**
Financial assets carried at cost – noncurrent:			
TGC, Inc.	$	-	-
QuieTek Corp.		9,996	9,996
	$	**9,996**	**9,996**

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, 2012, 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, 2012, the Company had obtained 1.62% of the voting shares.

The stock of the Company’s investees TGC, Inc. and QuieTek Corp. was not traded publicly, and therefore, the cost method was 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.

(Continued)

ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

6. Derivative Financial Instruments

Financial assets and liabilities at fair value through profit or loss are summarized below:

	December 31, 2012	December 31, 2011
	(in thousands)	
Assets – current		
Currency option	$ 967	9,298
Cross currency swap contract	11,323	1,588
Forward exchange contract	639	-
Structured derivative	-	15
	$ 12,929	10,901
Liabilities – current		
Currency option	-	4,743
Cross currency swap contract	1,922	8,101
	1,922	12,844
Liabilities – noncurrent		
Call and put option – convertible bonds payable (note)	964	3,385
	$ 2,886	16,229

Note: Please refer the abovementioned derivative financial derivatives to Note 13.

As of December 31, 2012 and 2011, the foreign currency derivative financial instruments were as follows:

December 31, 2012

Financial instrument	Notional amount (in thousands)		Currency	Maturity
Put option (buy USD)	USD	5,000	USD/NTD	January 2013
Call option (sell USD)	USD	5,000	USD/NTD	January 2013
Put option (sell USD)	USD	5,000	USD/NTD	January 2013
Cross currency swap contract	USD	151,000	USD/NTD	January 2013~April 2013
Forward exchange contract	USD	12,000	USD/CNY	March 2013~September 2013

(Continued)

December 31, 2011

Financial instrument	Notional amount (in thousands)		Currency	Maturity
Put option (buy USD)	USD	75,000	USD/NTD	January 2012~March 2012
Call option (sell USD)	USD	75,000	USD/NTD	January 2012~March 2012
Put option (sell USD)	USD	75,000	USD/NTD	January 2012~March 2012
Put option (sell USD)	USD	2,000	USD/JPY	March 2012
Cross currency swap contract	USD	83,000	USD/NTD	January 2012~April 2012
Structured derivative	USD	2,000	USD/CNY	March 2011~March 2012
Structured derivative	USD	1,000	USD/CNY	January 2012~November 2012

For the years ended December 31, 2012 and 2011, the Company recognized an unrealized valuation gain amounting to NT$10,043 thousand and NT$757 thousand, respectively, on the aforementioned derivative transactions.

7. Notes and Accounts Receivable, Net

	December 31, 2012	December 31, 2011
	(in thousands)	
Notes receivable	$ 29,920	116,024
Accounts receivable	3,544,203	3,839,211
Less: allowance for doubtful receivables	(12,271)	(9,639)
	$ 3,561,852	3,945,596

As of December 31, 2012 and 2011, the overdue accounts receivable were $396,467 thousand and $396,998 thousand, respectively, and were reclassified into overdue receivables under other assets; the overdue receivables were fully reserved.

ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

8. Inventories

	December 31, 2012 (in thousands)	December 31, 2011 (in thousands)
Finished goods	$ 945,281	1,100,192
Less: provision for devaluation	(79,744)	(57,028)
	865,537	1,043,164
Work in process	552,766	770,379
Less: provision for devaluation	(65,199)	(64,655)
	487,567	705,724
Raw materials	2,563,180	3,276,402
Less: provision for devaluation	(291,069)	(237,976)
	2,272,111	3,038,426
	$ 3,625,215	**4,787,314**

In the year ended December 31, 2012, the Company recognized cost of goods sold of $88,117 thousand from the write-down of inventory costs to net realizable value. In the year ended December 31, 2012, loss on physical inventory and scrap charged to cost of goods sold was $528 thousand and $127,421 thousand, respectively. In the year ended December 31, 2011, the Company recognized cost of goods sold of $72,154 thousand from the write-down of inventory costs to net realizable value. In the year ended December 31, 2011, gain on physical inventory credited to cost of goods sold was $2,945 thousand and scrap loss charged against cost of goods sold was $60,836 thousand.

9. Prepayments for Long-term Investments in Stocks

	December 31, 2012 (in thousands)
Prepayments:	
Delta Mobile Software, Inc. (DMS)	**$ 78,305**

For the investing program, Alpha invested $78,305 thousand in Delta Mobile Software, Inc. (including common stock and convertible preferred stock without voting rights). As of December 31, 2012, the investing procedures were in process.

(Continued)

ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

10. Intangible Assets

The movement of intangible assets for the years ended as of December 31, 2012 and 2011, was as follows:

		2012			
		Trademarks	**Goodwill**	**Core technologies**	**Land use right**
			(in thousands)		
Original cost					
Balance at January 1, 2012	$	127	140,913	57,563	123,352
Write-off		-	-	(57,563)	-
Impairment		-	(6,030)	-	-
Effect of exchange rate changes		-	-	-	(3,539)
Balance at December 31, 2012		127	134,883	-	119,813
Accumulated amortization					
Balance at January 1, 2012	$	-	-	57,563	9,332
Amortization		127	-	-	2,866
Write-off		-	-	(57,563)	-
Effect of exchange rate changes		-	-	-	(280)
Balance at December 31, 2012		127	-	-	11,918
Book value at December 31, 2012	**$**	**-**	**134,883**	**-**	**107,895**

		2011			
		Trademarks	**Goodwill**	**Core technologies**	**Land use right**
			(in thousands)		
Original cost					
Balance at January 1, 2011	$	116	140,913	57,563	113,368
Acquisition		11	-	-	-
Effect of exchange rate changes		-	-	-	9,984
Balance at December 31, 2011		127	140,913	57,563	123,352
Accumulated amortization					
Balance at January 1, 2011	$	-	-	48,928	6,828
Amortization		-	-	8,635	1,801
Effect of exchange rate changes		-	-	-	703
Balance at December 31, 2011		-	-	57,563	9,332
Book value at December 31, 2011	**$**	**127**	**140,913**	**-**	**114,020**

Aescu held an extraordinary shareholders' meeting on August 8, 2012, to resolve a dissolution and liquidation solution. As of December 31, 2012 the Company had recognized impairment loss of $12,833 thousand. Pursuant to ROC SFAS No. 35 "Impairment of Assets", impairment loss shall first be use to reduce goodwill, and then any remaining impairment loss shall be allocated to the carrying amounts of assets. The Company consequently reduced goodwill by $6,030 thousand.

(Continued)

ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

11. Short-term Borrowings

Short-term borrowings consisted of the following as of December 31, 2012 and 2011:

	December 31, 2012	December 31, 2011
	(in thousands)	
Unsecured borrowings	$ 775,806	1,147,900
Guaranteed borrowings (note)	-	151,555
	$ 775,806	1,299,455
Range of interest rates	1.49%~ 7.2%	1.004%~ 7.2%
Unused available balance	$ 2,433,769	2,743,236

Note: Refer to note 19 for assets pledged as collateral to secure short-term borrowings.

12. Long-term Loans Payable

As of December 31, 2012, the details were as follows:

Financial institution	Purpose	Redemption	December 31, 2012
Fubon Bank	Long-term working capital operating	From January 19, 2012, to January 18, 2015. Repayable on contractual maturity date.	$ 293,007
Unused credit facility			$ -
Interest rates			1.97%

On January 19, 2012, Alpha Changshu entered into an agreement for credit facilities of US$10,000 thousand with Fubon Bank. These credit facilities contained covenants that required Alpha, as co-guarantor, on its annual and semiannual consolidated financial statements, to maintain certain financial ratios such as current ratio, debt ratio, and interest coverage ratio as specified in the loan agreement. If the Company does not maintain the financial ratios as specified in the loan agreement, the default will be deemed a breach, and the facilities will be reconsidered by Fubon Bank.

Alpha was in compliance with the aforementioned financial covenants as of December 31, 2012.

(Continued)

ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

13. Bonds Payable

The first and second domestic unsecured convertible bonds of Alpha were issued on January 5, 2006, and October 14, 2011, respectively. The first domestic unsecured convertible bonds of Alpha matured on January 4, 2012, and were redeemed in full. The details of convertible bonds as of December 31, 2012 and 2011, are summarized below:

	2012	2011
	(in thousands)	
Convertible bonds payable	$ 1,000,000	1,000,000
Less: Unamortized discount	(15,719)	(102,124)
Converted into common stock	(807,200)	(53,423)
	$ 177,081	**844,453**

	For the years ended December 31, 2012	2011
Interest expense	**$ 6,559**	**5,076**

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

Issue total amount	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 was December 22, 2005. The conversion price was calculated as 105.87% of the basis price, which was the lowest price among the three arithmetic averages of Alpha's closing prices for one, three, and five business days before the basis date. 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. 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.

(Continued)

ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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.

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 was 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 was 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 was 80% of the issued conversion price, with no adjustment upward allowed, and was based on the change in the number of common shares of the Company, if any.

The resetting of the conversion price does not apply on or before the reset basis date.

As of January 4, 2010, before maturity, 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 was 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.

(Continued)

ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Based on 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 January 4, 2011, before maturity, the first unsecured convertible bonds amounting to $1,030,600 thousand had been converted into 35,530 thousand shares of Alpha's common stock. The bond conversion increased capital surplus by $604,215 thousand.

(2) The significant terms of the second unsecured domestic convertible bonds payable issued on October 14, 2011, are summarized as follows:

Issue total amount	NT$1,000,000 thousand, with a par value of NT$100 thousand. Issued in accordance with 100.5% of the par value.
Issue date	October 14, 2011
Maturity date	October 13, 2016
Coupon rate	0%
Conversion method	Bondholders may convert bonds into Alpha's common shares at any time between November 15, 2011, and October 3, 2016.
Conversion price and price adjustment	The basis date for setting the conversion price of the bonds was October 5, 2011. The conversion price was calculated as 120% of the basis price, which was the lowest price among the three arithmetic averages of Alpha's closing prices for one, three, and five business days before the basis date. 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. 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.

(Continued)

	Using the above approach, the conversion price of the issuance was NT$20.6 per share.
	If any securities with common stock conversion rights or warrants for common stock are issued by the Company after the convertible bond is issued, the Company should adjust the bond price based on the formula in the conversion policy, and the Company should also adjust the conversion price if the number of its common shares changes after the issuance of the bonds.
	As of December 31, 2011, the conversion price was NT$19.4.
Redemption at the option of Alpha	On or at any time after November 14, 2011, and before September 3, 2016, 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 the common stock on the TSE for the period of 30 consecutive trading days is more than 30% 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 October 14, 2014, 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 30 days prior to the relevant date.

Based on 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	$ 1,005,000
Fair value of non-equity embedded derivatives	(6,300)
Issue cost	(5,000)
Fair value of convertible bonds	(892,800)
Equity element – conversion options	**$ 100,900**

The above straight bond has an effective interest rate of 2.27%.

As of December 31, 2012, the fair values of the above non-equity embedded derivatives estimated based on an evaluation method amounted to $964 thousand.

(Continued)

The unsecured convertible bonds mentioned above amounting to $747,700 thousand were converted into 36,305 thousand shares of common stock in 2012. As of December 31, 2012, the second unsecured convertible bonds amounting to $807,200 thousand had been converted into 39,193 thousand shares of Alpha's common stock. Of those shares, 155 thousand shares were still in the subscription process, and they were recorded under advance receipts for common stock amounting to $1,546 thousand. The bond conversion increased the capital surplus by $335,908 thousand.

The unsecured convertible bonds mentioned above amounting to $59,500 thousand were converted into 2,888 thousand shares of common stock in 2011. As of December 31, 2011, the unsecured convertible bonds issued in 2011 amounting to $59,500 thousand had been converted into 2,888 thousand shares of Alpha's common stock. Of those shares, 2,888 thousand shares were still in the subscription process, and they were recorded under advance receipts for common stock amounting to $28,883 thousand. The bond conversion increased the capital surplus by $24,755 thousand.

14. Retirement Plans

The following table sets forth the benefit obligation and accrued pension liabilities for the defined benefit plan as of December 31, 2012 and 2011:

	2012	2011
	(in thousands)	
Benefit obligation:		
Vested benefit obligation	$ (28,083)	(13,578)
Nonvested benefit obligation	(354,285)	(299,721)
Accumulated benefit obligation	(382,368)	(313,299)
Projected future salary increase	(311,739)	(321,262)
Projected benefit obligation	(694,107)	(634,561)
Fair value of plan assets	209,241	250,501
Funded status	(484,866)	(384,060)
Unrecognized net loss	298,635	230,336
Accrued pension liabilities	**$ (186,231)**	**(153,724)**

The components of net periodic pension cost for 2012 and 2011 are summarized as follows:

	2012	2011
	(in thousands)	
The defined benefit plan:		
Service cost	$ 6,390	7,795
Interest expenses	12,691	11,961
Actual returns on pension fund	(2,264)	(3,078)
Amortization	5,403	9,201
Loss on curtailment	11,786	-
Net pension cost	**$ 34,006**	**25,879**
The defined contribution plan:	**$ 145,300**	**123,516**

(Continued)

Actuarial assumptions at December 31, 2012 and 2011, are summarized as follows:

	2012	2011
Discount rate	1.75%	2.00%
Rate of increase in future compensation levels	4.00%	4.00%
Expected long-term rate of return on plan assets	1.75%	2.00%

As of December 31, 2012 and 2011, the vested benefits of employees meeting the retirement requirement amounted to $34,997 thousand and $17,665 thousand, respectively.

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

15. Stockholders' Equity

(1) Employee stock options

As of December 31, 2012, 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	28.10
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	21.80
Second issuance of employee stock options in 2007	Oct. 30, 2007	Dec. 6, 2007	Service periods between two and four years	7,500	30.75	30.75	20.90

(Continued)

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In 2012 and 2011, 2,281 thousand shares and 60 thousand shares, respectively, of Alpha's employee stock options were exercised, and $51,545 thousand and $1,422 thousand had been received as of December 31, 2012 and 2011, respectively The legal procedures were completed.

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.

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, 2012 and 2011, is as follows:

	2012		**2011**	
Employee stock options	**Options (thousands)**	**Weighted-average exercise price (NT$)**	**Options (thousands)**	**Weighted-average exercise price (NT$)**
Outstanding at beginning of year	29,608	26.10	29,668	27.61
Exercised	(2,281)	22.60	(60)	23.70
Forfeited	(27,327)	25.06	-	-
Outstanding at end of year	-		29,608	26.10
Exercisable at end of year	-		29,608	
Weighted-average fair value of options granted during the year (NT$)	$ 0.6~10.3		0.6~10.3	

The weighted-average exercised-date fair value per share of common stock was $25.76 and $25.62 for 2012 and 2011, respectively. As of December 31, 2012 and 2011, the weighted-average remaining contractual life of outstanding options was 0 and 0.83 years, respectively.

(Continued)

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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 Aescu. The option rights were valid for 5 years. On August 8, 2012, special shareholders' meeting of Aescu approved liquidation of the company. As of December 31, 2012, the option rights were invalid.

Aescu recognized compensation cost of the employee stock options, based on intrinsic 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 intrinsic value was $0 for the years ended December 31, 2012 and 2011.

Information related to Aescu's employee stock option plan for the years ended December 31, 2012 and 2011, is as follows:

	2012		**2011**	
Employee stock options	**Options (thousands)**	**Weighted-average exercise price (NT$)**	**Options (thousands)**	**Weighted-average exercise price (NT$)**
Outstanding at beginning of year	355	10.0	380	10.0
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited	(355)	10.0	(25)	10.0
Outstanding at end of year	-	-	**355**	10.0
Exercisable at end of year	-		**107**	

In the years ended December 31, 2012 and 2011, no employee stock option of Aescu was exercised. As of December 31, 2011, the weighted-average remaining contractual life of outstanding options of Aescu was 2.37 years.

(Continued)

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

Attributable to equity holders of the parent company:

		2011 (in thousands, except for per share data)
Net income	Net income	$ 950,482
	Pro forma net income	930,245
Basic earnings per share	Earnings per share (NT$)	2.01
	Pro forma earnings per share (NT$)	1.96
Diluted earnings per share	Earnings per share (NT$)	1.93
	Pro forma earnings per share (NT$)	1.88

As of December 31, 2012 and 2011, 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 $5,136,764 thousand and $4,756,784 thousand, respectively.

(3) Capital surplus

Capital surplus consisted of the following as of December 31, 2012 and 2011:

	2012	2011
	(in thousands)	
Issuance of new shares – premium	$ 1,069,225	1,047,398
Conversion options of convertible bonds (note 13)	19,453	94,896
Treasury stock	-	25,086
Adjustment to capital surplus for changes in investee's equity	29	29
Conversion premium of convertible bonds	940,123	628,970
Stock options (note)	193,525	118,082
Convertible bonds – others	14,964	14,964
	$ 2,237,319	1,929,425

Pursuant to the ROC Company Act amended in January 2012, capital surplus should be used to offset a deficit first, and realized capital surplus can be converted into capital and distributed as stock dividends or distributed as cash dividends. The aforementioned realized capital surplus was generated from the excess of the issuance price over the par value of the capital stock and donations received.

(Continued)

According to current ROC securities regulations, the total capital surplus capitalized per annum may not exceed 10 percent of the paid-in capital.

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

(4) Legal reserve

Pursuant to the ROC Company Act amended in January 2012, 10% of the Company's annual net income is to be set aside as legal reserve until such retention equals the amount of the issued common stock. When a company incurs no loss, it may pursuant to a resolution to be adopted by a shareholders' meeting, distribute the amount of the legal reserve that exceeds 25% of issued common stock either by capitalizing its legal reserve and distributing the new shares as dividend shares to its original shareholders in proportion to the number of shares held by each of them or by distributing a cash dividend.

(5) Distribution of earnings and dividend policy

Pursuant to Alpha's articles of incorporation amended on June 15, 2012, 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 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' remuneration, 10~22.5% as employee bonuses granted to Alpha's employees, and the remainder as distributable earnings as proposed by a resolution of the stockholders' meeting. Alpha may issue stock to employees of the affiliates for profit sharing.

Pursuant to regulations promulgated by the Financial Supervisory Commission, a special reserve equal to the total amount of contra accounts that were accounted for as deductions from the stockholders' equity shall be set aside from current earnings, and not distributed. Alpha shall not distribute the special reserve equivalent to the net debit balance of shareholders' equity from the prior fiscal years made from the prior unappropriated earnings. This special reserve shall be made available for appropriation when these contra accounts to stockholders' equity are reversed in subsequent periods.

(Continued)

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 for 2012 and 2011 were computed at 17%, and remuneration to directors and supervisors was computed at 1%, based on the Company's net income for the years ended December 31, 2012 and 2011, after setting aside 10% as legal reserve and setting aside or reversing any previous special reserve. Information about Alpha's employee bonuses and remuneration to directors and supervisors for 2012 and 2011 is as follows:

		2012	2011
		(in thousands)	
Employee bonuses	$	94,118	151,747
Directors' and supervisors' remuneration		5,536	8,926
	$	**99,654**	**160,673**

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 the next year.

On June 15, 2012, and June 10, 2011, 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 2011 and 2010 is as follows:

		2011	2010
		(in thousands, except for per share date)	
Dividend per common share			
Cash	**$**	**1.34**	**1.50**
Directors' and supervisors' remuneration	$	8,926	7,403
Employee bonuses – cash		151,747	111,045
	$	**160,673**	**118,448**

The above earnings distribution, which was charged to expense, had no difference from the resolution of Alpha's board of directors in the years 2011 and 2010.

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The accrual distribution of employee bonuses and directors' and supervisors' remuneration of $99,654 thousand for 2012 is subject to the proposal of the board of directors' meeting 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 Taiwan Stock Exchange Corporation (TWSE) in accordance with the "Regulation Governing Share Repurchase by Exchange-Listed and OTC-Listed Companies". Details of the treasury stock transactions in 2012 and 2011 are as follows:

Purpose	**As of January 1, 2012**	**Increase**	**Decrease (Note)**	**As of December 31, 2012**
		(in thousands)		
To maintain the Company's credit and shareholders' equity	-	23,321	3,321	20,000

Purpose	**As of January 1, 2011**	**Increase**	**Decrease**	**As of December 31, 2011**
		(in thousands)		
For transfer to employees	5,248	-	5,248	-

Note: On October 22, 2012, the meeting of the board of directors approved the purchase of common stock amounting 3,321 thousand shares and changed the purpose of repurchased common stock from "transferring to employees" to "maintaining the Company's credit and shareholders' equity". Common stock amounting to 3,321 thousand shares was approved to be retired.

Alpha transferred 5,248 thousand shares of treasury stock to employees in the year 2011. 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 $3,457 thousand.

(Continued)

The assumptions are summarized as follows:

	2011
Cash dividend rate	-
Expected volatility	26.33%~37.85%
Risk-free interest rate	0.4469%~0.9783%
Expected life (in years)	0.0575 years~ 0.1521years
Transfer price	24.01
Underlying stock current price	21.3~24.8

According to the Securities and Exchange Act of the ROC, 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 ROC, treasury stock should not be pledged, nor is it entitled to voting rights or dividends.

16. Income Taxes

(1) The components of the Alpha'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	November 30, 2012~ November 29, 2017
Distribution of 2007 earnings	New investments in manufacturing and related technical services exempt from corporate income taxes for five consecutive years effective from July 1, 2008, to December 31, 2009	January 1, 2011~ December 31, 2015

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 are subject to the Income Tax Law of Enterprises with Foreign Investment in the People's Republic of China, under which they are exempt from income tax in the first and second years and allowed a fifty percent reduction from the third to fifth year (Mirac was allowed a reduction from 2009 to 2011, and Alpha Chengdu was exempted from 2008 to 2009 and allowed a reduction from 2010 and 2012). Alpha Holding, Alpha Investment, Universal and Global are tax-exempt entities.

(Continued)

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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"). For Alpha, Net Mag and Aescu, the statutory income tax rate is 17%. The statutory income tax rate applicable to Alpha's subsidiaries located in the PRC ranges between 12.5% and 25%, in the USA ranges between 5% and 35%, and in Japan ranges between 35% and 40%.

For the years ended December 31, 2012 and 2011, income tax expense was as follows:

		2012	2011
		(in thousands)	
Current	$	171,311	179,301
Deferred		23,321	51,178
Additional 10% income surtax on undistributed earnings		20,189	3,018
	$	214,821	233,497

(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, 2012 and 2011, was as follows:

		2012	2011
		(in thousands)	
Income tax expense computed at the statutory tax rate	$	158,270	200,817
Difference generated by the application of different tax rate for subsidiaries		22,425	10,103
Loss (gain) on investments of subsidiaries		24,224	(35,943)
Tax effect of permanent difference		(1,805)	63,884
(Increase in) expiration of investment tax credits		(22,557)	667
Income tax exemption		-	(7,057)
Additional 10% income surtax on undistributed earnings		20,189	3,018
Valuation allowance for deferred tax assets		32,854	(24,673)
Prior year's adjustment and others		(18,779)	22,681
Income tax expense	$	214,821	233,497

(Continued)

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(3) The components of deferred income tax assets (liabilities) as of December 31, 2012 and 2011, are summarized as follows:

	2012	2011
	(in thousands)	
Deferred tax assets – current:		
Investment tax credits	$ -	72,537
Unrealized bad debt losses	57,900	56,070
Unrealized decline in value of inventories	52,783	34,132
Unrealized exchange loss (gain)	6,117	(4,610)
Product warranty	44,325	32,189
Others	1,322	576
	162,447	190,894
Less: valuation allowance	(113,153)	(122,391)
	$ 49,294	68,503
Deferred tax assets – noncurrent:		
Investment tax credits	$ 2,311	14,502
Accrued pension liabilities	31,659	26,133
Investment loss on equity investments in foreign entities	171,334	193,449
Investment gain on equity investments in foreign entities	(17,281)	(15,153)
Goodwill	(22,930)	(22,930)
Foreign currency translation adjustment	(23,373)	(37,748)
Loss carryforward of Alpha's subsidiaries	131,051	75,458
Others	34,310	21,015
	307,081	254,726
Less: valuation allowance	(341,577)	(299,485)
	$ (34,496)	(44,759)
Total deferred tax assets	$ 533,112	526,061
Total deferred tax liabilities	$ 63,584	80,441
Total valuation allowance	$ 454,730	421,876

(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 income tax payable. Based on the Industrial Innovation Act, the investment credits for the current-year income tax payable amounted to $22,557 thousand and $0 thousand in 2012 and 2011, respectively. Alpha's investment credits under the ROC Statute for Upgrading Industries that can be utilized each year were limited to 50 percent of the current year's tax payable. However, the foregoing limit does not apply to the last year of the utilization period.

(Continued)

As of December 31, 2012, Alpha's unused investment tax credits from research and development expenditure had expired. As of December 31, 2012, Alpha's subsidiaries' unused investment tax credits from research and development expenditure and the related expiration year were as follows:

Unused investment tax credits (in thousands)	Expiration year
$ 2,311	2013

(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, 2012, the unused loss carryforwards and related expiration year of the Company and its ROC subsidiaries were as follows:

Year of loss	Tax effect (in thousands)	Expiration year
2009	$ 9,568	2019
2010	21,834	2020
2011	25,005	2021
2012	14,988	2022
	$ 71,395	

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 future years' taxable profits. As of December 31, 2012, the tax effects of the unused loss carryforwards were $118,914 thousand.

As of the December 31, 2012, Alpha's income tax returns had been examined by the tax authorities through 2010.

(6) Information relating to the imputation credit account (ICA) of Alpha as of December 31, 2012 and 2011, is summarized as follows:

	2012	2011
	(in thousands)	
Unappropriated earnings:		
Earned after January 1, 1998	$ 2,159,282	2,197,107
ICA balance	$ 260,651	231,454
Creditable ratio for earnings distribution to resident stockholders	16.02% (Estimated)	14.81% (Actual)

(Continued)

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15. Earnings per Share

The calculations of basic earnings per share and diluted earnings per share attributable to the stockholders of Alpha in years 2012 and 2011 were as below.

		2012		2011	
		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	$	930,946	716,125	1,183,979	950,482
Weighted-average common shares outstanding (thousand shares)		509,241	509,241	473,530	473,530
Basic earnings per share (NT$)	$	1.83	1.41	2.50	2.01
Diluted earnings per share:					
Net income－equity holders of the parent company	$	930,946	716,125	1,183,979	950,482
Potential dilution effects of common shares －Decrease in interest expense of convertible bonds		6,559	5,444	5,076	4,213
Net income when calculating diluted EPS	$	937,505	721,569	1,189,055	954,695
Weighted-average common shares outstanding (thousand shares)		509,241	509,241	473,530	473,530
Potential dilution effects of common shares		22,053	22,053	21,993	21,993
Diluted weighted-average common shares outstanding (thousand shares)		531,294	531,294	495,523	495,523
Diluted earnings per share (NT$)	$	1.76	1.36	2.40	1.93

16. Financial Instruments

(1) Derivative financial instruments

The Company’s transactions involving derivative financial instruments in 2012 and 2011 are disclosed in note 6.

(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, short-term borrowings, 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.

(Continued)

(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, 2012 and 2011, were as follows:

	December 31,			
	2012		2011	
	Book value	Fair value	Book value	Fair value
	(in thousands)			
Financial assets:				
Available-for-sale financial assets – noncurrent	$ 180,828	180,828	201,522	201,522
Financial assets carried at cost – noncurrent	9,996	(2)(iii) below	9,996	(2)(iii) below
Financial liabilities:				
Long-term borrowings	293,007	293,007	-	-
Bonds payable (including current portion)	177,081	202,344	844,453	995,049

(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 was the active market quoted price if it was available. If the active market quoted price was unavailable, the Company will determine the fair value based on an evaluation method, and the estimates and assumptions incorporated in such evaluation were consistent with those used by market participants in their pricing of financial instruments.

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

(c) The fair value of long-term borrowings bearing a floating rate approximates the carrying value.

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

	December 31,			
	2012		2011	
	Quoted market price	Estimated fair value	Quoted market price	Estimated fair value
	(in thousands)			
Financial assets:				
Cash and cash equivalents	$ 2,370,758	-	3,266,754	-
Notes and accounts receivable (including related parties)	-	5,865,235	-	7,319,374
Financial assets at fair value through profit or loss – current	-	12,929	-	10,901
Other financial assets – current	-	5,141	151,555	10,485
Other financial assets – noncurrent	22,000	11,786	22,000	14,984
Available-for-sale financial assets – noncurrent	180,828	-	201,522	-
Financial liabilities:				
Short-term borrowings	-	775,806	-	1,299,455
Accounts payable (including related parties)	-	3,978,703	-	6,202,891
Other payables – related parties	-	20,039		24,221
Financial liabilities at fair value through profit or loss – current	-	1,922	-	12,844
Financial liabilities at fair value through profit or loss– noncurrent	-	964	-	3,385
Long-term borrowings	-	293,007	-	-
Bonds payable (including current portion)	-	202,344	-	995,049

(4) Financial risk information

(i) Market price risk

As the Company's derivative financial instruments were 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 was considered low. Publicly traded stocks held by the Company were classified as available-for-sale financial assets. Since these assets were measured by the fair value, the Company will be exposed to the risks of equity market price change.

(ii) Credit risk

The Company's potential credit risk was 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 was controlled by the Company. As a result, the Company believes that there was no concentration of credit risk of cash and cash equivalents.

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

As of December 31, 2012 and 2011, 57% and 60%, respectively, of the Company's accounts receivable consisted of seven customers.

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

(iii) Liquidity risk

There was 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 was 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 foreign currency exchange rates. There was 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 related to the fluctuation of interest rates

Some of the Company's short-term and long-term loans bear floating interest rates. The changes in the effective rate along with the fluctuation of the market interest rate influence the Company's future cash flow. As of December 31, 2012 and 2011, if the market interest rate increased by 1%, the Company's future yearly cash outflow would increase by approximately $2,672 thousand and $3,249 thousand, respectively.

(Continued)

18. 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 Systems Inc. (D-Link Systems)	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, 2012 and 2011, are summarized as follows:

(a) Sales

	2012		2011	
	Amount (in thousands)	**Percentage of net sales**	**Amount** (in thousands)	**Percentage of net sales**
D-Link International	$ 8,042,277	32	8,779,199	34
DLSH	1,034,076	4	1,009,431	4
D-Link	844,281	4	868,540	3
D-Link Systems	230,392	1	188,668	1
	$ 10,151,026	**41**	**10,845,838**	**42**

As of December 31, 2012 and 2011, receivables resulting from the above transactions were as follows:

	December 31, 2012		December 31, 2011	
	Amount (in thousands)	**Percentage of total receivables**	**Amount** (in thousands)	**Percentage of total receivables**
D-Link International	$ 1,849,426	32	2,483,400	34
DLSH	193,857	3	487,232	7
D-Link	188,000	3	310,112	4
D-Link Systems	72,100	1	93,034	1
	$ 2,303,383	**39**	**3,373,778**	**46**

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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 90 days, during 2012 and 2011. However, collection terms for related parties might be extended when necessary.

(b) Purchases

In 2012 and 2011, the Company did not purchase from related parties; however, the account payables to related parties resulting from purchases that occurred before 2011 were as follows.

	2012		2011	
	Amount (in thousands)	**Percentage of net purchases**	**Amount** (in thousands)	**Percentage of net purchases**
DLSH	$ 1	-	1	-

(c) Service fees and others

The Company paid fees to related parties for warranty services and other services. The total fees for the years ended December 31, 2012 and 2011, and the related unpaid balance as of December 31, 2012 and 2011, are summarized as follows:

	2012		2011	
	Current expense	**Accrued expense**	**Current expense**	**Accrued expense**
	(in thousands)			
D-Link International	$ 28,770	9,485	33,241	12,637
D-Link	9,965	9,284	11,193	10,051
D-Link Europe	4,819	989	2,679	-
D-Link Systems	-	-	504	-
	$ 43,554	19,758	47,617	22,688

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(d) Property, plant and equipment

i. Acquisition of property, plant and equipment for the years ended December 31, 2012 and 2011, and the related unpaid balance as of December 31, 2012 and 2011, are summarized as follows:

	2012		2011	
	Expenditure	Account payable	Expenditure	Account payable
	(in thousands)			
D-Link	$ 2,646	-	-	-

ii. Sales of equipment for the years ended December 31, 2012 and 2011, and the related balance not received as of December 31, 2012 and 2011, are summarized as follows:

	2012		2011	
	Amount	Account Receivable	Amount	Account Receivable
	(in thousands)			
D-Link	$ 5	-	-	-

(e) Others

Alpha entered into a plant lease agreement with D-Link for the Taipei Neihu office. The rental expense was $914 thousand and $5,551 thousand in the years 2012 and 2011, respectively. As of December 31, 2012 and 2011, payables resulting from the above transactions amounted to $280 thousand and $1,532 thousand, respectively, which were recorded in payable to related parties.

(3) Compensation of the principal management team

	2012	2011
	(in thousands)	
Salaries	$ 42,170	47,681
Compensation	11,382	10,769
Service charges	101	-
Employee bonuses	21,592	14,550

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.

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19. Pledged Assets

Assets pledged as collateral as of December 31, 2012 and 2011, are summarized as follows:

Pledged assets	Pledged to secure	2012 (in thousands)	2011
Time deposit (recorded in other financial assets – noncurrent)	Import guarantee for Customs	$ 22,000	22,000
Time deposit (recorded in other financial assets – current)	Short-term borrowings	-	151,555
		$ 22,000	173,555

20. Commitments and Contingencies

Aside from the matters discussed in note 12, the commitments and contingences were as follows:

(1) Operating leases

Lessee	Object	Lessor	Period for lease	Rental expense in 2012	Payment method
Alpha	Land	Hsinchu Science Park	Nov. 3, 2003~ Dec. 31, 2022	$8,069 thousand	Monthly

According to the lease agreement, rent payment was 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 were as follows:

	Amount (in thousands)
2013.01.01~2013.12.31	$ 24,138
2014.01.01~2014.12.31	14,632
2015.01.01~2015.12.31	10,446
	$ 49,216

(2) Alpha entered into royalty agreements with Fine Point and Wind River. Pursuant to the terms of each signed agreement, Alpha was obligated to pay royalties when Alpha’s products utilized technologies specified in the royalty agreements. The royalty expense was $11,704 thousand and $13,811 thousand in the years 2012 and 2011, respectively.

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(3) As of December 31, 2012 and 2011, the significant outstanding commitments for construction and purchase of property, plant and equipment amounted to $1,805 thousand and $77,964 thousand, respectively.

(4) 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. Alpha USA estimates that the lawsuits will not significantly impact Alpha USA's operations.

21. Casualty Loss: None.

22. Subsequent Events: None.

23. Other Information

(1) Information on personnel expenses, depreciation, and amortization, by function, for the years ended December 31, 2012 and 2011, is summarized as follows:

	2012			2011		
Account	**Cost of goods sold**	**Operating expense**	**Total**	**Cost of goods sold**	**Operating expense**	**Total**
			(in thousands)			
Personnel expenses:						
Salaries	1,133,533	1,362,299	2,495,832	1,036,445	1,409,723	2,446,168
Labor and health insurance	43,677	95,409	139,086	46,842	87,995	134,837
Pension	68,195	111,111	179,306	25,701	123,694	149,395
Others	26,261	79,682	105,943	25,866	80,806	106,672
Depreciation	216,375	218,226	434,601	155,610	200,671	356,281
Amortization	2,105	95,653	97,758	2,543	87,872	90,415

(2) As of December 31, 2012 and 2011, the significant financial assets and liabilities in foreign currency were as follows:

	2012			2011		
	Foreign currency	**Exchange rate**	**NTD**	**Foreign currency**	**Exchange rate**	**NTD**
		(in thousands, except for exchange rate data)				
Financial assets:						
Monetary items:						
USD	205,296	29.03	5,959,743	256,342	30.26	7,756,909
JPY	18,471	0.3366	6,217	321,778	0.3907	125,719
Non-monetary items:						
USD	143,000	29.03	(note)	78,000	30.26	(note)

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ALPHA NETWORKS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

	2012 Foreign currency	2012 Exchange rate	2012 NTD	2011 Foreign currency	2011 Exchange rate	2011 NTD
	(in thousands, except for exchange rate data)					
Prepayments for long-term investments in stocks items:						
USD	2,700	29.002	78,305	-	-	-
Financial liabilities:						
Monetary items:						
USD	78,597	29.03	2,281,671	86,118	30.26	2,605,931
Non-monetary items:						
USD	35,000	29.03	(note)	235,000	30.26	(note)

Note: The Company's transactions involving derivative financial instruments in 2012 and 2011 are disclosed in note 6.

24. Segment Financial Information

(1) General information

The Company operates predominantly in one industry segment, which includes the research, development, design, production and sale of network products.

The segment financial information can be found in the consolidated financial statements. For sales to third parties and segment profit and loss, please refer to the consolidated statements of income. For segment assets, please see the consolidated balance sheets.

(2) Entity-wide disclosures

(i) Production information

Revenue from non-consolidated entities' customers:

	2012	2011
	(in thousands)	
LAN/MAN	$ 12,182,578	12,181,401
Wireless	6,778,936	7,078,836
Digital Home	3,452,945	3,738,168
Broadband	2,086,640	2,188,968
Others	406,045	280,871
	$ 24,907,144	**25,468,244**

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ALPHA NETWORKS INC. AND SUBSIDIARIES

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(ii) Geographic information

The revenue from external customers is categorized by the area of the collection of the account receivables, and the noncurrent assets are categorized by the area the assets are located.

Revenue from external customers:

Area		**2012**	**2011**
		(in thousands)	
China	$	7,555,790	3,050,047
United States		6,189,331	6,142,949
Singapore		3,476,397	1,060,650
Netherlands		990,491	3,124,447
England		892,988	2,537,778
Japan		641,131	1,007,640
Other countries		5,161,016	8,544,733
	$	**24,907,144**	**25,468,244**

Noncurrent assets:

Area		**2012**	**2011**
		(in thousands)	
China	$	2,753,291	2,578,931
Taiwan		1,050,239	1,110,069
United States		147,046	161,762
Japan		4,779	521
	$	**3,955,355**	**3,851,283**

(iii) Major customer information

Sales to individual customers representing greater than 10% of consolidated revenue in 2012 and 2011 were as follows:

		2012	**2011**
		(in thousands)	
D-Link International	**$**	**8,042,277**	**8,779,199**