

HUA NAN FINANCIAL HOLDINGS CO., LTD.

# 2005 ANNUAL REPORT



# Shareholders Information

## **Hua Nan Financial Holdings Co., Ltd.**

Address: No. 38, Sec. 1, Chungching South Rd.  
Taipei

Telephone: 886-2-2371 3111

Website: <http://www.hnfhc.com.tw>

## **Subsidiaries Headquarter**

### **Hua Nan Commercial Bank, Ltd.**

Address: No. 38, Sec. 1, Chungching South Rd.  
Taipei

Telephone: 886-2-2371 3111

Website: <http://www.hncb.com.tw>

### **Hua Nan Securities Co., Ltd.**

Address: 5F, No. 54, Sec. 4, Minsheng East Rd.  
Taipei

Telephone: 886-2-2545 6888

Website: <http://www.entrust.com.tw>

### **Hua Nan Bills Finance Corp.**

Address: 10F, No.188, Sec. 5, Nanjing East Rd.  
Taipei

Telephone: 886-2-2747 2345

Website: <http://www.huananbills.com.tw>

### **South China Insurance Co. Ltd.**

Address: 5F, No.560, Sec. 4, Chung Hsiao East  
Rd. Taipei

Telephone: 886-2-2758 8418

Website: <http://www.south-china.com.tw>

### **Hua Nan Securities Investment Trust Co., Ltd.**

Address: 3-1F, No. 54, Sec. 4, Minsheng East  
Rd. Taipei

Telephone: 886-2-2719 6688

Website: <http://www.hnitc.com.tw>

## **Hua Nan Venture Capital Co., Ltd.**

Address: 3F, No.143, Sec. 2, Minsheng East Rd.  
Taipei

Telephone: 886-2-2500 0622

## **Hua Nan Management & Consulting Co., Ltd.**

Address: 3F, No.143, Sec. 2, Minsheng East Rd.  
Taipei

Telephone: 886-2-2500 0622

## **Hua Nan Asset Management Company Ltd.**

Address: Room 405, 4F, No.18, Sec. 1, Chang-  
An East Rd. Taipei

Telephone: 886-2-2511 2900

## **Equities Administration Center**

Address: 4F, No. 54, Sec. 4, Minsheng East Rd.  
Taipei

Telephone: 886-2-2718 6425

## **CPA Firm**

### **Deloitte & Touche**

Address: 12F, No.156, Sec. 3, Minsheng East  
Rd. Taipei

Telephone: 886-2-2545 9988

Website: <http://www.deloitte.com.tw>

## **Credit Rating Agency**

### **Taiwan Ratings Corp.**

Address: 49F, No.7, Sec. 5, Shinyi Rd. Taipei

Telephone: 886-2-8722 5800

Website: <http://www.taiwanratings.com/tw>

## **Investment Relations**

Telephone: 886-2-2371 3111

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## Hua Nan Financial Holdings Company

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## 2005 ANNUAL REPORT

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### Statement of Internal Control

# Letter to Shareholders



Continued rises in international crude oil and raw materials prices in the first half of 2005 caused a global economic slowdown. In order to ward off the threat of inflation, major economies staged a number of interest rate hikes. The factors combined to have negative impacts on Taiwan's exports, which in turn caused economic momentum on Taiwan to wane. As a result, Taiwan's economic growth rate in the first half of 2005 was only 2.73%. Starting in the second half of the year, however, an upturn in the United States and China as well as increased international demand for IT and electronics products, helped to spark Taiwan's external trade. The economy as a whole rebounded, enabling economic growth rate for the year to reach 4.09%.

In the first half of 2005, cause of the weakening of economic environment has slowed down the growth of bank loans. The average annual growth rate in the M2 money supply slipped from 6.20% in January to a low of 5.57% in April. For the first half of the year as a whole, the M2 money supply grew by an annualized 6.03%. In the second half of the year, bank lending and investment staged rebounds before slowing again. Annual growth in the M2 in July and August hit 6.51% and 6.52%, respectively, but the level slipped to 6.14% by November. For the year as a whole, the M2 rose 6.22%. Meanwhile,

market interest rates began to move higher in light of continued interest rate hikes by central banks at home and abroad. The weighted average interbank overnight rate rose from 1.202% at the beginning of the year to 1.406% in December, equivalent to a 0.204% rise for the year.

Hua Nan Financial Holdings Company (HNFHC) and its subsidiaries faced considerable challenges during the year amid this complex and uncertain operating environment. Thanks to the efforts and contributions of the board, supervisors, staff and shareholders, stable growth was maintained in all major areas of business. In 2001, Hua Nan Commercial Bank and Entrust Securities (then known as Hua Nan Securities) engaged in a stock swap, paving the way for the establishment of HNFHC. Since then, Hua Nan Bills Finance, South China Insurance and Hua Nan Investment Trust have been included under the FHC umbrella. Most recently, Hua Nan Venture Capital, Hua Nan Management & Consulting and Hua Nan Asset Management Company have been established under the HNFHC framework. HNFHC's eight subsidiaries enable the Company's operations to reach into a wide range of areas. With banking as its core, HNFHC also has a presence in securities, insurance and asset management. The Company maintains a comprehensive product line, satisfying the one-stop shopping needs of its customers.

## Group Operation Result

At the end of 2005, Hua Nan Group's consolidated assets stood at NT\$1.67 trillion, a rise of NT\$397.1 billion or 31.17% from previous year. HNFHC and its subsidiaries continue to seek to expand their asset size, but without jeopardizing asset quality. In May 2002, Hua Nan Commercial Bank (HNCB), in response to the government's financial reform policies, wrote off a large amount of

distressed loans, cleaning up its asset structure. Its overdue loan ratio dropped from 8.27% at the time of HNFHC's establishment to 2.12% at the end of 2005. The capital injection into Hua Nan Securities (HNS) via a cash subscription enables the brokerage to raise its capital adequacy from 202% at HNFHC's establishment to 355.58% at the end of 2005. Also the NPL ratio of another subsidiary, Hua Nan Bills Finance (HNBF), had drop sharply.

HNFHC's profitability has benefited from non-operating income in the form of recovery of distressed loans that had been written off. In addition, the establishment of more cross-sales counters throughout the island has boosted the bottom line. At the end of 2005, HNFHC boasted 308 cross-selling counters domestically or 8% increased from last year, which rank number 1 of cross-selling counters among 14 financial holding companies.

### Credit Ratings

HNFHC has been appointed Taiwan Ratings, Moody's Ratings and Fitch Ratings to access the credit rating for each company within Hua Nan Financial Group.

#### Taiwan Ratings

- ▣ Hua Nan FHC:twA+/twA-2/Stable
- ▣ Hua Nan Commercial Bank:twAA-/twA-1/Stable
- ▣ Hua Nan Securities:twA/twA-2/Stable
- ▣ South China Insurance:twAA-/Stable

#### Moody's Ratings

- ▣ Hua Nan Commercial Bank:A3/P-1/Stable

#### Fitch Ratings

- ▣ Hua Nan Bills Finance:A-(twn)/F2(twn)/Stable

### Revenue, Expenditures and Profitability

HNFHC's operating revenues in 2005 were NT\$9.44 billion, while operating expenses were NT\$188 million, operating income stood at NT\$9.25 billion. After deducting non-operating expenses and losses of NT\$140 million, income before tax was NT\$9.12 billion. After adding tax benefit of NT\$412 million, net income stood at NT\$9.53 billion, translating to after-tax earnings per share of NT\$1.60. RoA was 10.57%, RoE was 11.20% and the profits achieved 89% of the 2005 budgeted amount.

On a consolidated basis, 2005's operating revenues stood at NT\$68.03 billion, operating expenses at NT\$57.04 billion and operating income at NT\$10.992 billion. Non-operating income was NT\$195 million. Income before tax was NT\$11.19 billion, tax expenses were NT\$1.66 billion and after-tax profit was NT\$9.53 billion. Consolidated RoA was 0.58% and consolidated RoE was 11.20%.

Major Research and Development for HNFHC and Subsidiaries in 2005

- Drafting medium- and long-term development strategies for the Group to serve as a basis for subsidiaries.
- Continuing to undertake organization reform, with the present focus being on organizational restructuring at Hua Nan Commercial Bank. This effort will be gradually expanded to the whole Group members.
- HNFHC is introducing the Basel II capital framework into its operations. It is engaging in research related to the new Basel capital accord in order to comply with the framework. HNFHC expects the implementation of the new Basel capital accord to effectively strengthen and realize a Company-wide risk management mechanism.

# Letter to Shareholders



- Development of a FHC Integrated Common Platform: By linking information systems and introducing standardization, information on each subsidiary's clientele, products, employees and corporate resources is integrated into a platform that enables each unit to share and exchange data. This achieves the goal of cross-selling and joint distribution networks, helping to reduce costs and bolstering efficiency. The platform also provides customers with integrated services, raising customer satisfaction and loyalty.
- Strengthening Corporate Data Warehousing System: The enormous amount of business-related information of HNFHC's subsidiaries is being compiled into a Company-wide integrated data warehousing system. This unified, comprehensive and accurate information supports analytical customer relationship management (CRM), operational CRM (including SFA and call centers), and risk management systems. It provides mid- and high-ranking managers with a flexible tool to analyze and utilize customer data, which leads to customer-driven sales and management. It is also an important resource in setting business strategies.
- Creation of PA (performance analyzer), FTP (funds transfer pricing) and ALM (asset and liability management) systems in tandem with HNFHC, helping to set reasonable costs and raise competitiveness as well as boosting income. These systems will also monitor investment risk at a glance and strengthen risk management.
- Introducing "Home Banking" operations.
- Continuing to develop and introduce structured products employing NT dollar denominated time deposits and NT dollar interest rate swaps. These provide customers with more options in personal finance and boost returns for investors as the result of trading profits.
- Development of a VIP Wealth Management System: This system generates customer names, delegation/management by account officers, sales assistance, operational analysis, investment analysis and financial planning in an effort to raise Hua Nan commercial Bank's (HNCB) status as a wealth management bank and a provider of VIP services.
- Establishment of a credit card loyalty management system (LMS): HNCB is completing its LMS and EDC delivery and testing. The LMS system included in the chip card facilitates implementation of loyalty point or promotion activities for customers.
- Establishing Centralized Operations Centers: HNCB has set up and continues to establish centralized operations centers and check clearing centers throughout Taiwan.
- Completion of a Bank Branch Terminal System (NT dollar denominated business) (e-TABS): HNCB has introduced a new NT dollar denominated business terminal trading and graphic interface, helping to raise the service quality provided by tellers and offering comprehensive customer service.
- Continuing of Interest Rate Options Business: HNCB assists customers in hedging against interest rate risk and provides customers with a wide range of selections in foreign exchange products.
- HNCB continues to engage in new types of business, such as interest rate swaps, interest rate options and asset swaps to underpin its development and increase sources of income.

- Development of Investment Bank Business: Hua Nan Securities (HNS) is aggressively developing its corporate restructuring, mergers and acquisitions, and financial consulting operations, as well as its broking and underwriting business. HNS is moving in the direction of becoming an investment bank.
- Serving as Market Maker in Futures, Taiwan Stock Index and Individual Stock Options, and ETF: HNS continues to expand its function as a market maker, helping to bolster trading activity of futures-related products on Taiwan.
- Introduction of New Property Insurance Products: South China Insurance (SCI) brings in the new products which include financial institution credit insurance, motor physical damage insurance extra compensation clauses, motor physical damage insurance covering rental cars and reimbursement for rental car fees clauses, and personal & family liability insurance with personal accident riders.

## 2006 Goals

In the future, HNFHC will continue to strive to be Taiwan's leading financial group and work towards becoming a regional financial institution. Going forward, HNFHC's major initiatives will be as follows:

- (1) Carrying out Group organizational reform
- (2) Introducing customer relationship management systems
- (3) Bolstering Group risk management ability
- (4) Strengthening Group information utilization
- (5) Expanding market share in the Group's various operations

The key pillar of organizational reform will be with regards to Hua Nan Commercial Bank. After organizational restructuring, HNCB will be a customer-driven financial institution, which will help raise competitiveness and increase profitability. The introduction of customer

relationship management systems will aid in promoting related operations. Product design and sales procedures will more accurately reflect market and customer needs, which will ultimately raise the FHC's overall revenues. HNFHC has hired ABN AMRO Bank to share its experience in the area of risk management. This will assist us in strengthening the risk management culture and abilities, and pave the way to establishing the risk management mechanisms and implementing the Basel framework. We are aggressively integrating the information systems and data warehouses of each subsidiary to raise efficiency in the utilization of information throughout the Group. With regards to expanding market share, the Group will strengthen its competitive advantages and continue to broaden its corporate banking operations to increase profitability. Hua Nan will also be involved in consumer banking, and develop new financial products and train wealth management specialists to provide the foundation to increase its wealth management business. We intend to develop underwriting and venture capital business with an eye toward expanding the scale of its investment banking operations.

We thank shareholders for their support over the past years. In the days ahead, we will continue to provide customers with outstanding banking services, pursue business with the best interests of shareholders, create an outstanding working environment for its employees, and exhibit its social responsibility by paying back society. HNFHC has established a corporate image that symbolizes quality, enabling it to win the support of customers, shareholders, employees and society in general.

Chairman   
MING-CHENG LIN

President   
JENG-YIH LEE



# State of Company

## Company Introduction

When it comes to branch network and e-commerce services, Hua Nan Financial Holdings Company (HNFHC) is ranked number one among all 14 financial holding companies in Taiwan. The group was formed on December 19, 2001, when Hua Nan Commercial Bank (HNCB) and Hua Nan Securities (HNS) undertook a share swap. On the same day, HNFHC was formally listed on the Taiwan Stock Exchange, making it the first licensed financial holding company in Taiwan.

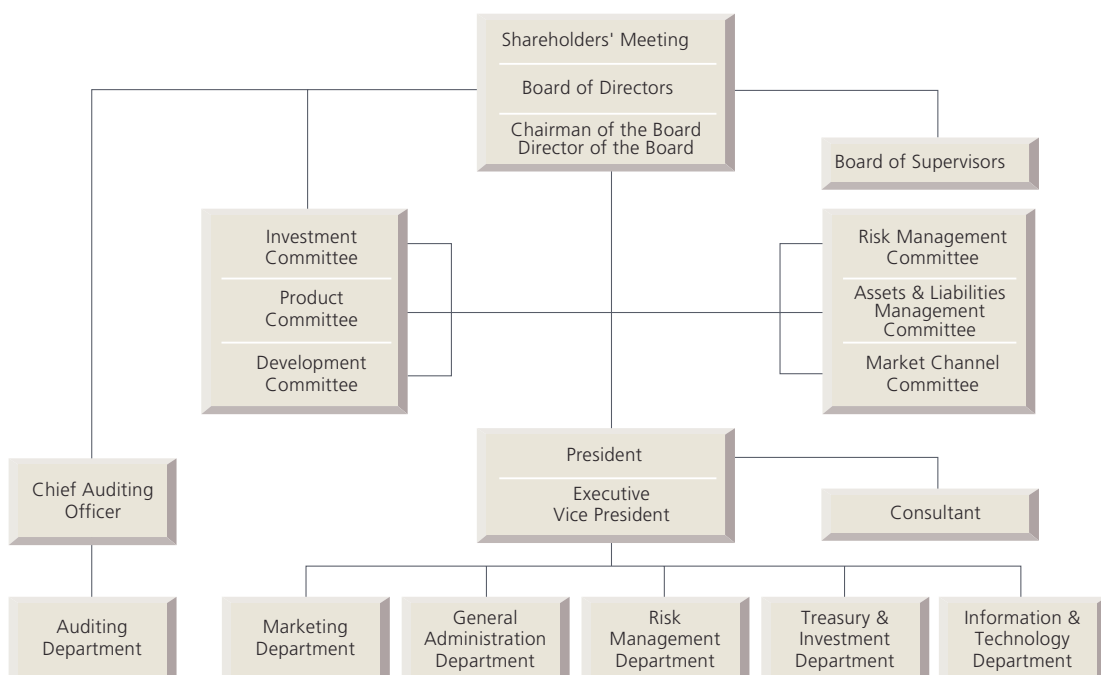
HNCB, the largest subsidiary of HNFHC, was established in 1919. Since then, it has grown itself in tandem with the economic development of Taiwan. As a household brand and with its strength in corporate banking, HNCB forms a solid foundation of HNFHC. Over the years, HNCB has accumulated nearly 5 million clients and 182 domestic branches. HNCB wrote off bad loans to the tune of NT\$52.6 billion in 2002 to improve its asset quality and pave the

way for long-term development that prompted other financial institutions to follow our moves. In the following years, HNFHC has led its peers in ushering a new era of financial services by merging four sub-branches of the industry—commercial banking, investment banking, insurance and asset management.

As of end of 2005, HNFHC has 8 subsidiaries, including HNCB, HNS, Hua Nan Bills Finance, South China Insurance, Hua Nan Investment Trust, Hua Nan Venture Capital, Hua Nan Management Consulting Company and Hua Nan Asset Management Company. (As organization chart is as attached below). The common goal of these companies is to provide comprehensive, superb services while maximizing shareholders value. As of the end of 2005, HNFHC boasts an asset of NT\$1,671 billion, an equity capital of NT\$59.7 billion, 10,014 employees, and 265 domestic and 7 global outlets and offices.

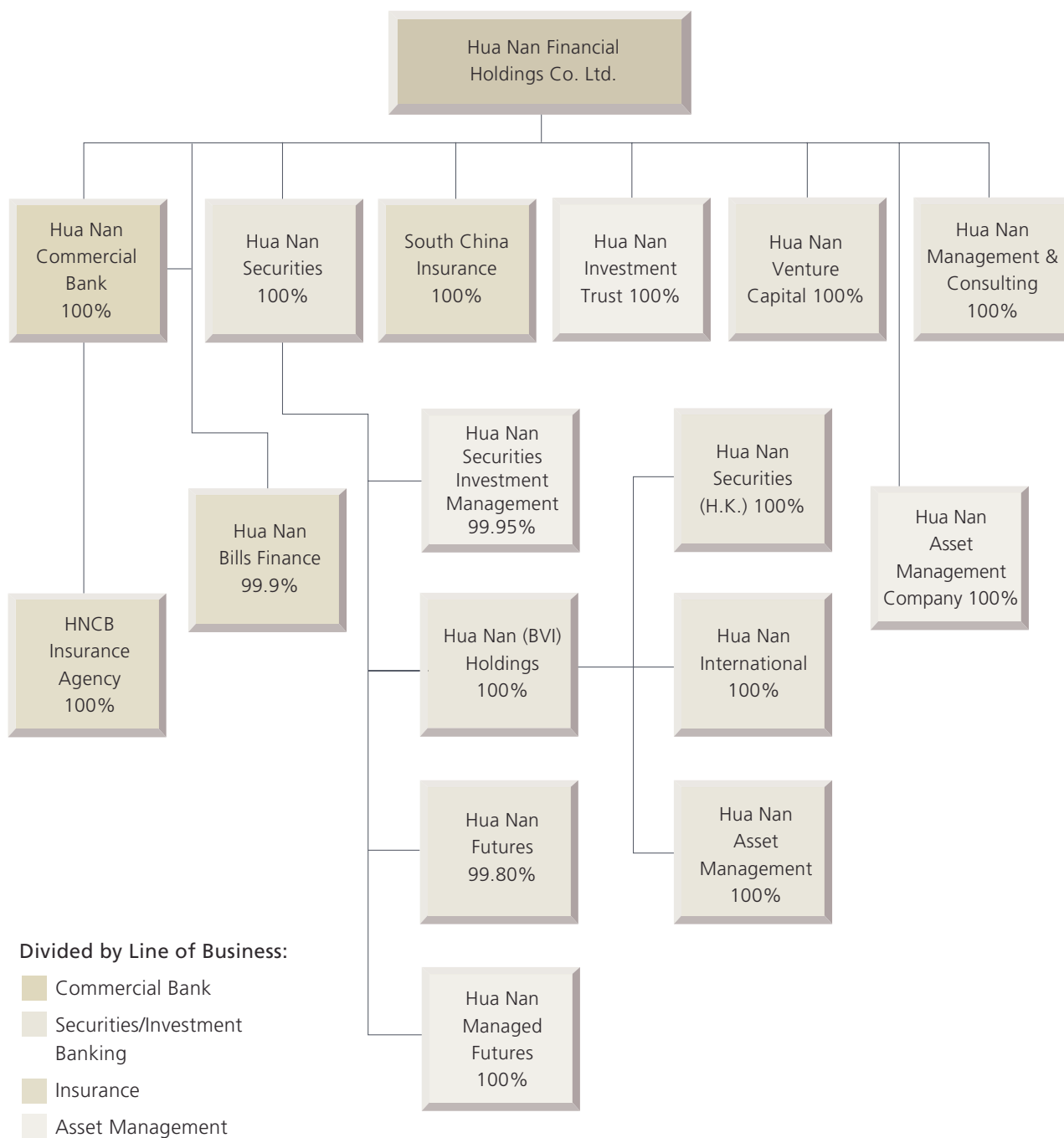
## Company Organization

### Organizational Structure and Major Departments





## Group Orgnaizational



Note: HNFHC maintains a 57.49% stake in Hua Nan Bills Finance Co. while subsidiary HNCB holds a 42.41%

# State of Company

## Leadership

April 24, 2006

### BOARD OF DIRECTORS

Ming-Cheng Lin  
Delegate of Memorial Scholarship Foundation  
to Mr. Lin Hsiung-Chen  
Chairman, Hua Nan Financial Holdings Co., Ltd

Jeng-Yih Lee  
Delegate of Ministry of Finance  
Managing Director & President, Hua Nan  
Financial Holdings Co., Ltd.

Rong-Chu Liu  
Delegate of Ministry of Finance  
Counselor, Ministry of Finance

Chan-Sheng Chen  
Delegate of Ministry of Finance  
President, Central Deposit Insurance Corp.

Shiu-Hsiung Chen  
Delegate of Bank of Taiwan  
President, Maxwell Electric Co., Ltd.

Chuan-Chuan Hsieh  
Delegate of Bank of Taiwan  
S.V.P & General Manager, Loan & Discounts  
Dept., Bank of Taiwan

Ya-Hwei Yang  
Delegate of Bank of Taiwan  
Research Fellow, Chung-Hua Institution for  
Economic Research

Yun Lin  
Delegate of Bank of Taiwan  
Professor, Dept. of Finance, National Taiwan  
University

Chih-Yang Lin  
Delegate of Yung-Da Real Estate &  
Construction Co., Ltd.  
General Manager, Ta-Yung Hsing Yeh Co., Ltd.

Hsien-Hsien Hsu  
Delegate of Shin Kong Life Foundation  
Assistant to the Chairman of Shin-Kong  
Wu Ho-Su Memorial Hospital

Hsu-Hsueh Chang  
Delegate of Fu Chuan Enterprises Co., Ltd.  
Supervisor, Fu Chuan Enterprises Co. Ltd.

Tommy Lin  
Delegate of Evergreen Asset Management Co.,  
Ltd.  
Special Assistant to the Chairman, Yong Da  
Construction Co., Ltd.

An-Lan Chen Hsu  
Delegate of Han Ting Enterprise Co., Ltd.  
Director, Hua Nan Securities Co., Ltd.

Po-Wei Hsu  
Delegate of Han Ting Enterprise Co., Ltd.  
Chairman, Hua Nan Securities Co., Ltd.

### BOARD OF SUPERVISORS

Sou-Shan Wu  
Delegate of Bank of Taiwan  
Dean & Professor, College of Management,  
Chang Gung University

Wen-Yuh Tsai  
Delegate of Ministry of Finance  
Chairman of Sin-Jang CPAS office

Li-Yen Yang  
Delegate of Bank of Taiwan  
S.V.P & General Manager, International  
Banking Dept., Bank of Taiwan

James Hui-Jan Yen  
Delegate of Yong Ding Construction Co., Ltd.  
Chairman, Asia Jewelry Co., Ltd.

Chia-Ying Shen  
Delegate of China Man-made Fiber Corp.  
Supervisor, Hua Nan Financial Holdings Co.,  
Ltd.

## TOP MANAGEMENTS

Jeng-Yih Lee  
President

Mao-Hsien Liu  
Executive Vice President and G.M. of  
General Administration Dept.

James H. J. Liu  
Executive Vice President and G.M. of  
Risk Management Dept.

Jeffrey C. F. Lee  
Chief Auditing Officer  
Auditing Dept.

Ching-Yuh Wu  
G.M. of Investment Dept.

Chen-Fang Chang  
G.M. of Marketing Dept.

Casey Lo  
G.M. of Information Technology

## Outstanding Shares and Dividends

### 1.Source of Share Capital

Date	Issue Price	Authorized Share Capital		Paid-in Share capital		Notes
		No. of Shares	Amount(NT\$)	No. of Shares	Amount (NT\$)	Source of Share Capital
DEC.2001	\$10	10,000,000,000	100,000,000,000	4,146,799,357	41,467,993,570	NT\$41,467,993,570 transferred to shares
AUG.2002	\$10	10,000,000,000	100,000,000,000	4,478,543,305	44,785,433,050	Capital surplus NT\$3,317,439,480 transferred to common stock
AUG.2003	\$10	10,000,000,000	100,000,000,000	4,728,503,594	47,285,035,940	NT\$1,696,952,890(South China)and NT\$802,650,000(Hua Nan Investment Trust) transferred to shares
AUG.2004	\$10	10,000,000,000	100,000,000,000	5,579,634,240	55,796,342,400	Profit and capital surplus NT\$8,511,306,460 transferred to common stock
AUG.2005	\$10	10,000,000,000	100,000,000,000	5,970,208,636	59,702,086,360	Profit NT\$3,905,743,960 transferred to common stock

Type of Stock	Authorized Share Capital			Note
	Shares Outstanding	Un-issued Stock	Total	
Common Stock	5,970,208,636 shares	4,029,791,364 Shares	10,000,000,000 shares	Listed Stock

### 2.Shareholder Structure

April 11, 2006

Shareholder Structure Amount of shares	Government Agencies	Financial Institutions	Other Institutions	Individuals	Foreign Institutions and Foreigners	Total
No. of People	10	34	434	183,508	200	184,186
Share Held	122,932,406	2,328,873,676	1,158,243,610	2,082,908,961	277,249,983	5,970,208,636
% of Share Held	2.06	39.01	19.40	34.89	4.64	100.00

# State of Company

## Major Shareholder

Name of Major Shareholders	% of Shares
Bank of Taiwan	29.36%
Shin Kong Life Insurance Co., Ltd	4.83%
Ta-Yung Hsing Yeh Co., Ltd	3.90%
First Bank	2.53%
Yuan Ding Investment Co., Ltd.	2.26%
Ministry of Finance	1.99%
Memorial Scholarship Foundation to Mr. Lin Hsiung Chen	1.69%
Chung Hwa Post Co. Ltd.	1.09%
Entrust Investment Corporation	1.02%
Worker Pension Fund	0.96%

## Major Institutional Investors

Name of Institutional Shareholders
Ministry of Finance
Bank of Taiwan
Memorial Scholarship Foundation to Mr. Lin Hsiung Chen
First Bank
Yong Da Construction Co., Ltd
Shin Kong Life Foundation
Fu Chuan Enterprises Co., Ltd.
Evergreen Asset management Co., Ltd,
Han Ting Enterprise Co., Ltd.
Yuan Ding Investment Co., Ltd.
China Man-Made Fiber Corp.

## Stock Price, Net Value Profits & Dividends per Share in 2004 and 2005

Item		Year	Fiscal 2005	Fiscal 2004	Up to April 24, 2006
Market Price per Share	Highest		27.40	33.80	24.40
	Lowest		19.85	21.50	20.90
	Average		23.62	27.46	22.59
Net Value per Share (Note 1)	Pre-dividend		15.00	14.45	15.60
	Ex-dividend		Note 3	13.73	Note 3
Earning per Share	Avg. Weighted No. of Shares (in 1000)		5,970,209	5,579,634	5,970,209
	Earning Per Share		1.60	1.93	0.50
Dividend per Share	Cash dividend		0.70	0.20	Note 3
	Stock dividend		0.70	1.60	Note 3
Return on Investment	P/E Ratio		14.76	14.23	11.30
	Dividend Yield		33.74	137.30	Note 3
	Cash Dividend Yield		2.96%	0.73%	Note 3

Note:

1. Based on the number of outstanding shares at the end of the year and the dividend payout for the following year approved at the shareholders' meeting.
2. Earning per share will be shown as pre-adjusted here.
3. Profits for 2005 have yet to be verified by the 2006 shareholders' meeting.

## Dividend Policies and State of Execution

1. The dividend policy is carried out according to Article 35 of HNFHC's charter:

In order to continue to expand the scale of HNFHC and increase profitability, as well as to abide by related regulations, HNFHC has adopted a residual dividend policy.

If HNFHC has profit after year and closing, tax must be paid first and any losses from previous year covered. It then sets aside a regulated surplus reserve and when necessary a special surplus reserve for operations needs. The remainder is distributed based on resolution at the shareholders' meeting as follows:

A. No more than 1% can be used for remuneration of board members and supervisors.

B. The sum of employee bonuses can amount to between 0.02% and 0.16%, with the exact amount to be determined by shareholders, who decide whether to allocate all of the funds or just a portion to be carried out through the issuance of new shares. Employee eligible for share bonuses must be employees affiliated with HNFHC. Any changes to regulation must be made by the board.

C. Shareholder dividends are calculated by also mobilizing undistributed profit from the previous year, and a decision on the distribution of profits is made at the shareholders' meeting. Shareholder dividends are decided based on HNFHC's operational plans and are divided into cash and stock dividends. Cash dividends shall be no less than 10% of the total dividend to be distributed. When the cash dividend is less than NT\$0.1 based on this formula, the cash dividend will not be distributed unless decided otherwise at a shareholders' meeting.

2. Dividend Distribution Proposed for the 2006 Shareholders' Meeting:

Shareholders will review a proposal to distribute cash dividend NT\$8,358,292,090, translating to NT\$1.4 per share.

# State of Company

## State of Company Bonds

### Issuance of Corporate Bonds

Type of Corporate Bond		2002 No. 1 Domestic Subordinate Bond
Issue Date		November 8~22, 2002
Face Value		NT\$1,000,000
Issue and Trading Place		Taiwan
Issue Price		100% of Face Value
Total Amount		NT\$6,000,000,000
Interest Rate		Type A Coupon:3.0%, Type B Coupon:2.9778%
Term		5 Years for both types
Guarantor		None
Commissioned Agency		The Trust Dept. of the International Commercial Bank of China
Underwriter		None
Certification Lawyer		Kuo Fang-Kwei Legal Firm: Kuo Fang-Kwei
Certification Accounting		Deloitte & Touche Chih-Rung Lee & Jih-Yen Chang
Method of Repayment		1.Method to Calculate and Pay Interest: interest paid on type A bonds once a year from issuance based on face value. Interest compounded every six months for type B bonds and paid out \$once a year based on the issue date. Interest paid on every NT\$1 million of bonds and based on rounding up or down according to the 0.5 decimal rule.  2.Methods of Payment of Principal: principal repaid in full amount on the fifth anniversary of issuance.
Amount Outstanding		NT\$6,000,000,000
Redemption or Early Repayment		None
Restrictive Articles		None
Name of Ratings Agency, Date of Rating and Rating of Corporate Bond		Credit Rating Agency: Taiwan Ratings Rating Date: September 10, 2002 Company Rating: twA
Conversion (Swap) Rights	Converted (Swapped) Shares, Overseas Depositary Receipts, or Other Securities	None
	Issuance and Conversion (Swap) methods	None
Name of Custodian Institution for Conversion		None

## State of Operation.

### 1. Operation

#### (1) Business Scope

- Banking
- Bills Finance
- Credit Cards
- Trust
- Insurance
- Securities
- Futures
- Venture Capital
- Overseas Financial Institutions (regulatory approval)
- Other Financial-Related Operations as specified by authorities

#### (2) Business Plan for 2006

- (a) Expanding Group economies scale
- (b) Raising Group operational synergy
- (c) Expanding Group cross-selling and marketing operations
- (d) Continuing to strengthen Group risk management ability
- (e) To raise the Group's wealth management business.
- (f) To expand the scale of HNFHC's investment banking business.
- (g) Engaging in the area of asset management and finance
- (h) To expand market shares
- (i) To raise the weighting of the Group's non-interest-based income.
- (j) To introduce advanced international banking techniques and concepts.

#### (3) Short- and Long-term business Development Projects

HNFHC will utilize cross-selling strategies, employing the networks and facilities of each subsidiary to expand business. In the short term, subsidiary networks and employees will be instrumental in referring customers. In addition, facilities will be shared in order to carry out sales of products from each unit. This will effectively increase HNFHC'S service network and reduce sales and marketing costs. In addition, an analytical customer relationship management system will analyze customer attributes and possible needs for various financial products, be to provide the appropriate products and raising cross-selling synergy.

In the medium- and long term, the establishment of an operational customer relationship management system will strengthen HNFHC's sales network, simplify sales procedures and raise cross-sales. In addition, HNFHC will engage in strategic alliances with foreign financial institutions to gain expertise in fiscal engineering and techniques to develop structured financial products, enabling it to move toward its ultimate goal of being an international integrated financial group.

HNFHC focuses its investment on core operations. It makes investments in subsidiaries with an eye towards sustainable operations for the Group and in an effort to create a comprehensive financial services platform. Investment is aimed at paving the way for the HNFHC to become Taiwan's leading financial holding company and a regional financial institution.



# State of Company

HNFHC's investment strategies focus on ensuring stable development in the four major financial spheres, namely banking, insurance, securities and asset management. As such, in the near term the HNFHC's investment will continue to focus primarily on internal growth. It will continue to establish subsidiaries on its own and engage in joint investment with others based on business development needs. It will also participate in cash subscription projects held by its subsidiaries. Over the longer term, it sees the need to engage in mergers and acquisitions, and it will especially target top notch large-sized domestic banks or other large-sale financial holdings companies focusing on banking as potential merger and acquisition targets. This will help to rapidly strengthen HNFHC's competitiveness in its core banking operations.

## 2. Cross-selling and Marketing Efficiencies

### (1) cross-selling and Marketing

HNFHC has a comprehensive financial blueprint, with subsidiaries in the fields of banking, securities, insurance, investment trust, asset management and venture capital. In order to maximize the Group's network advantage, HNFHC has established 308 cross-selling counters. In addition, based on the resources of each subsidiary and the developmental aims of Hua Nan Group as a whole, HNFHC has drafted cross-selling targets for all of its subsidiaries. By sharing resources and the Group's channels, each unit will introduce customers to other subsidiaries, gradually achieving synergy with regards to cross-selling. This will enable business generated by cross-selling to rise year by year, and act as an important source for new business for each subsidiary. For instance, South

China Insurance's market position with regards to

total premium income rose to 11th from 12th in 2003 due to referrals provided by other subsidiaries. Its market ranking for fire insurance rose to 10th from 12th in that year. In the future, HNFHC will utilize an analytical customer relationship management system, strengthen database analysis and applications, and analyze customer attributes to identify customers that will bolster the business development of its subsidiaries.

### (2) Utilizing subsidiary Resources to Reduce Costs

#### A. Maximizing Utilization of Office Space:

(a) Hua Nan Securities (HNS) and South China Insurance (SCI) have rented office space in Hua Nan Commercial Bank (HNCB) branches to set up branches and liaison offices of their own.

(b) HNS has set up 92 securities counters throughout HNCB branches and 2 securities counters at Hua Nan Bills Finance (HNBF) branches in Taipei and Kaohsiung, for a total of 94 service points. SCI has established 180 insurance counters throughout HNCB's branch network, as well as 2 counters at HNBF for a total of 182 service points. This strategy not only increases the number of service points for the securities and insurance subsidiaries, but also reduces the operational guarantees required of HNS in setting up individual branch offices.

#### B. Cost Savings in Developing Clientele:

These cross-selling counters refer customers to other subsidiaries,

reducing costs associated with developing new sources of clients.

**C. Cost Savings by Avoiding Redundant Systems:**

HNFHC's analytical customer relationship management system is expected to go online in June 2006. In the future, this system will provide centralized analytical systems and tools, and will be available for use by sales units of each subsidiary. This will avoid redundant investment in the establishment of similar systems by each subsidiary.

### 3. Corporate Responsibility and Ethical Behavior

HNFHC and its subsidiaries work in tandem with government financial and banking policies and provide corporations and the public with a comprehensive range of financial services, helping to promote economic development and social prosperity. HNFHC embodies the operational concepts of sincerity, trust and innovation. It works to create a healthy and stable financial institution that is capable of sustainable operations. It is constantly working to improve its performance, to protect the interests of customers and to create the greatest value for shareholders.

### 4. Information Hardware

HNFHC's information systems have been designed to support the entire Group's operational strategies and integrate the information resources of each subsidiary in support of joint sales and marketing efforts. Some systems have been completed, some are still in the development stage, while others will be developed in the future.

**(1) System Already Completed**

A. Creation of HNFHC website and webpage, and management of content.

B. Establishment of the foundation for HNFHC corporate network system.

C. Creation of HNFHC electronic document system. Set up under the corporate network system, this system enables the transmission and receipt of internal documents and management of such.

D. Creation of HNFHC conflict of interest system.

E. Creation of a risk management system: HNFHC has established a comprehensive risk management system in an effort to create a systematic risk management mechanism that monitors fluctuations in asset value and that serves in strengthening information used in setting policies related to asset management performance. This system includes:

(a) Asset and Liability Management System: This pinpoints the Group's interest rate and liquidity risk, and assesses the level of exposure, providing an important reference tool for managers in medium- and long-term planning.

(b) Funds Transfer Pricing System: This improves inter-branch dealings within Hua Nan Commercial Bank and serves as a basis for product pricing, reflecting up-to-the-minute market fluctuations. This system helps business units in setting their operational direction and creates the foundation for a fair performance and evaluation system.

# State of Company

## (c) Risk Adjustment Performance

Evaluation System: HNFHC has set up tools for risk and post-cost sharing products or customer profit analysis. The level of risk can be adjusted via direct and indirect cost allocation.

## (2) Systems in Development

- A. HNFHC Integrated Common Platform:  
By linking information systems and introducing standardization, information on each subsidiary's clientele, products, employees and corporate resources is integrated into a platform that enables each unit to share and exchange data. This achieves the goal of cross-sales and joint distribution networks, helping to reduce costs and bolster efficiency. The platform also provides customers with integrated services, raising customer satisfaction and loyalty.
- B. HNFHC Corporate Data Warehousing System: The enormous amount of business-related information of HNFHC's subsidiaries is compiled into a Company-wide integrated data warehousing system. This unified, comprehensive and accurate information supports analytical customer relationship management (CRM), operational CRM (including SFA and call centers), and risk management systems. It provides mid- and high-ranking managers with a flexible tool to analyze and utilize customer information, which leads to customer-driven sales and management. It is also an important resource in setting operational strategies.

## (3) Future Development Projects

- A. Operational CRM system will be created to boost operational synergy and promote cross-marketing and sales.
- B. A customer service center system will be designed to reinforce the customer service of HNFHC.

## (4) Emergency Preparations and Safety Measures

- A. HNFHC and its subsidiaries have emergency systems in place. All important information programs have been backed up in order to ensure operational normalcy and safety of all information.
- B. Firewalls have been set up at the entrance to all portals of subsidiaries. In addition, a hacker detection system has been put in place. These help to create walls between the internet and HNFHC's websites and strengthen network management among subsidiaries.
- C. An automated real-time update system helps to guard against viruses from entering websites and systems.
- D. Various detection systems have been installed to prevent Internet crimes and attacks on the website. This helps to guarantee the safety of Internet transactions.

## 5. Group Critical Indicators

	2005	2004	2003	2002
<b>(1) RoA</b>				
HNHFC	10.57%	13.25%	14.18%	-34.12%
HNCB	0.61%	0.68%	0.66%	-2.12%
HNS	1.93%	4.34%	3.99%	2.82%
HNBF	0.01%	0.02%	0.04%	-46.92%
SCI	2.77%	3.35%	2.54%	1.56%
HNIT	-0.99%	28.58%	19.79%	23.59%
HNVC	-0.49%	-87.00%	-	-
HNMC	18.22%	22.97%	-	-
HNAMC	-0.49%	-	-	-
<b>(2) RoE</b>				
HNHFC	11.20%	14.21%	15.34%	-35.54%
HNCB	13.75%	16.11%	16.62%	-42.04%
HNS	4.26%	10.51%	12.31%	9.91%
HNBF	0.11%	0.15%	0.10%	-99.36%
SCI	9.40%	11.04%	8.21%	4.83%
HNIT	-4.63%	32.60%	22.48%	26.30%
HNVC	-0.49%	-0.87%	-	-
HNMC	22.68%	28.13%	-	-
HNAMC	-0.49%	-	-	-
<b>(3) CAR</b>				
HNHFC	109.25%	111.75%	113.74%	101.79%
HNCB	12.13%	11.91%	11.22%	9.07%
HNS	355.58%	411.24%	367.62%	239.95%
HNBF	10.97%	13.16%	26.80%	23.21%
SCI	812.97%	744.77%	726.84%	-
<b>(4) NPL Ration</b>				
HNCB	2.12%	2.27%	3.33%	4.16%
<b>(5) Coverage Ratio</b>				
HNCB	47.14%	41.51%	35.28%	27.08%

# Capital Utilization

## 1. Capital use of previous cash subscriptions and corporate bond issuances:

- (1) Cash subscriptions: None
- (2) Corporate bond issuances:

HNHFC issued NT\$6 billion of five year unsecured subordinated corporate bonds in November 2002. The funds were used for investment in subsidiaries. As of December 31, 2005, the funds have been total invested in subsidiary companies as follows:

Date	Target	Amount (in NT\$1,000)	Share Gain (in 1,000 shares)
2002.12.26	Hua Nan Bills Finance Corp.	2,300,000	230,000,000
2003.04.25	Hua Nan Securities Co. Ltd.	1,500,000	150,000,000
2004.01.05	Hua Nan Venture Capital Co. Ltd.	1,000,000	100,000,000
2004.01.05	Hua Nan Management & Consulting Co., Ltd.	6,000	600,000
2004.07.31	Hua Nan Securities Co. Ltd.	1,000,000	100,000,000
2005.04.26	Hua Nan Asset Management Co. Ltd. (Note)	194,000	19,400,000

Note: This investment total amount is NT\$1 billion, the gap of the investment amount was paid by HNFHC's own capital.

## 2. Cash subscriptions and corporate bond issuances that have yet to be completed:

- (1) Cash subscriptions: None
- (2) Corporate bond issuances: None

## 3. Analysis of impact of capital utilization plans over the past three years:

Returns on short-term capital usage are limited by legal restrictions placed on financial holding companies. The returns from long-term capital utilization are exhibited in the net profit growth and in terms on improving asset quality. Fund usage has boosted operational ability and competitiveness in line with expectations.

## Capital Utilization Implementation

### Expected Returns from Capital Utilization in 2006:

#### 1. Returns associated with short-term capital utilization

Safety, liquidity and returns are the three foremost concerns in making judgments regarding the short-term use of capital. Of these, safety is the most important. In addition, the term of investment (maturity date) must also conform to the company's timetable with regards to capital needs. According to Clause 1 of Article 39 of the Financial Holding Company Law, FHC short-term capital utilization is restricted to investment in fixed-return financial products and the returns on short-term capital usage are limited:

- (1) Deposits or trust funds.
- (2) Purchase of government bonds of financial bonds.
- (3) Purchase of treasury bills or bank negotiable certificates of deposit.
- (4) Purchase of bank guarantees, acceptances or commercial paper with credit ratings above those specified by regulators.
- (5) Purchase of financial products other than the four above and which have been approved by regulators.

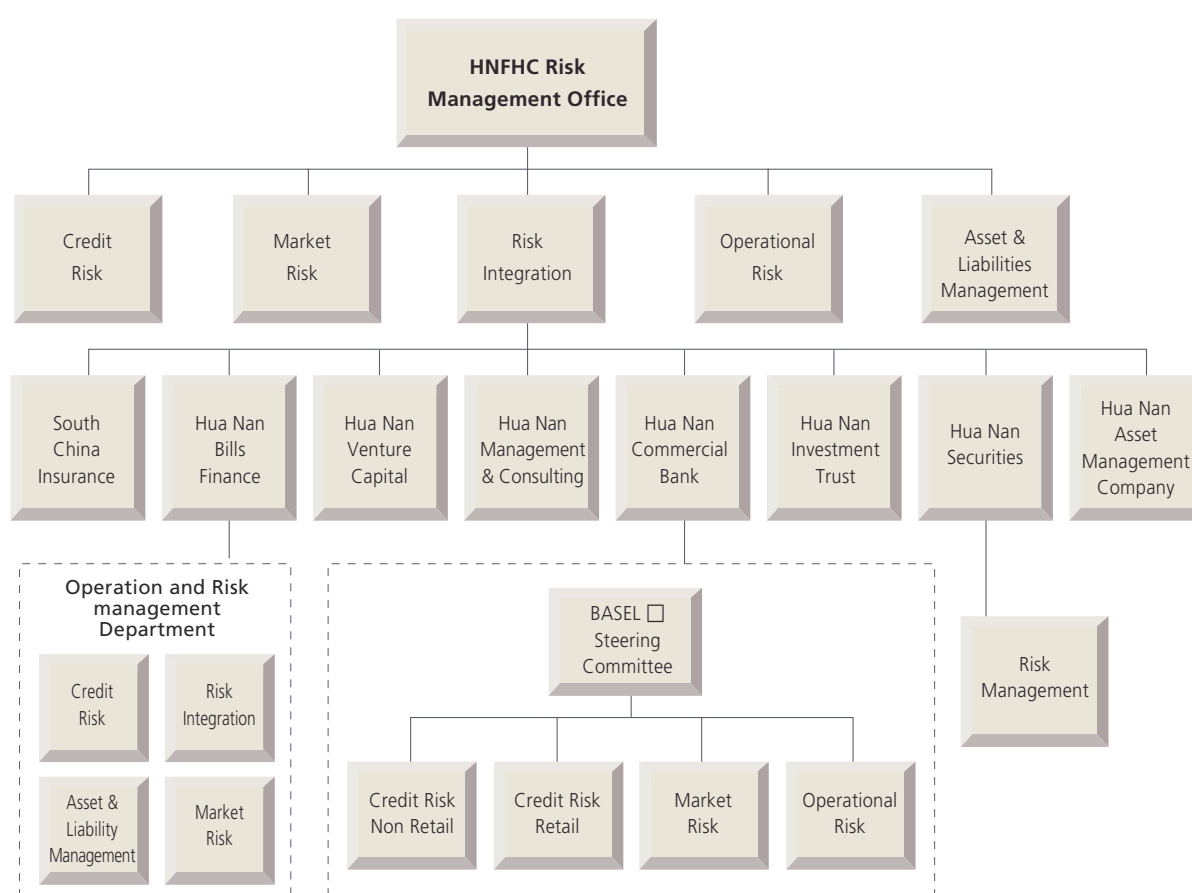
#### 2. Return associated with long-term capital utilization

HNHFC is a financial holding company that invests in core operations. Article 7 of the Company's investment strategies states, "The Company's investment is to reflect the strategic planning by the Company for the Group's operational development, to achieve the goals of assisting the Group in becoming Taiwan's leading financial holding company and a regional financial institution, and to produce stable investment returns over the long term." The primary source of long-term capital utilization returns is derived from returns from investment in its subsidiaries. Impacted by a weak performance by Taiwan's securities and bond markets, HNFHC's net profits in fiscal 2005 fell 11.56% from the previous year to NT\$9.527 billion. However, its ranking among financial holding company counterparts in the area of after-tax earnings per share rose in 2005 compared with 2004. If Taiwan's economic and banking environment improve in 2006, HNFHC can be expected to exhibit stable growth in long-term capital utilization returns.

# Risk Management

Risk management issues are analyzed below based on consolidated financial reports and the state of operations in the past year and up to the publishing of this annual report.

## Hua Nan Financial Holding Group Risk Management Framework





## HNFHC Risk Management Goals and Policies

HNFHC has established an asset and liability management committee and a risk management committee. The former is responsible for calculating HNFHC's capital adequacy ratio, asset and liability management, budgets, settlements, and compiling and auditing financial statements. The latter is responsible for creating and implementing a risk management system, risk assessment, establishment of financial firewalls and monitoring capital adequacy ratio.

HNFHC has set up the risk management department, while subsidiaries set up their own independent risk management units based on their operational and practical needs.

The goal of risk management is to enable to recognize, measure, monitor and control risk in all operations of HNFHC and subsidiaries. Risk and rewards will be rationalized to the degree that operations will only be allowed to bear a certain degree of risk and that the Group's equity capital exceeds that of risk capital.

## HNFHC Measures to Quantify and Manage All Types of Risk

### 1. Strategies and Procedures

HNFHC's risk management is carried out by the independent risk management department as well as risk management unit in each subsidiary. In addition to implementing risk policies, controlling risk approaches and generating risk reports, the risk management department enhances and integrates the risk management mechanisms of all subsidiaries. The three key areas of work include quantifying risk, centralizing risk management and risk-reward rationalization. The ultimate goal of HNFHC's

risk management is to allocate risk capital / economic capital to maximize the value of shareholders.

### 2. Risk Management System Organization and Platform

In order to achieve risk information transparency and in the spirit of risk-return tradeoff, HNFHC has created a risk adjusted performance measurement system, which is used to appropriately allocate resources, including the following sub-systems funds transfer pricing, performance analyzer and risk management system.

#### (1) Funds Transfer Pricing (FTP)

Funds transfer pricing is used to improve the current internal transfer mechanism of Hua Nan Commercial bank, benchmarking the transfer rate against a market-derived yield curve. It can provide a basis for product pricing, centralize interest rate risk management process and enhance the fairness and objectivity of profitability measurement.

#### (2) Performance Analyzer (PA)

This system tabulates risk adjusted performance returns and is applied in Hua Nan Bank's performance evaluation and budget planning. Risk adjusted performance returns consider the extra returns for shareholders after undertaking the risk. The new system will provide comprehensive risk capital and cost allocation functions, calculating risk adjusted performance returns. This will be used in pricing products, performance evaluation and budget planning. Only by having an awareness of risk costs can managers determine the hidden risks in budget goals.

# Risk Management

## (3) Asset and Liability Management (ALM)

The Performance Analyzer system must be carried out in tandem with comprehensive asset and liability management in order to pursue the greatest profits amid risk. The goal of bank asset and liability management is to accurately quantify current interest rate risk and liquidity risk for management as a point of reference in their medium- and long-term planning. By weighing risk, cost and returns, Hua Nan Commercial Bank's assets and liabilities can be allocated for the highest level of profit. In addition to boosting shareholders' equity in the short term, the Bank's credit ratings and corporate image will benefit over the long run.

## 3. Measures Planned to Conform to Basel II Accord

### (1) Credit Risk

A number of measures are being instituted to assist Hua Nan Bank in credit risk management prior to lending, such as credit scorecards, a credit assessment system, default loss database, risk quantifier assessment, and an inserted pricing mechanism. Meanwhile, risk adjustment performance is used to help subsidiaries manage asset quality, strengthening risk management procedures. In the future, a Group-wide risk management platform and risk adjustment performance system will be introduced to help subsidiaries create risk management systems. The Group-wide risk adjustment performance measurement system will also help to manage asset portfolio and concentration risk.

### (2) Market Risk

In light of operational growth among subsidiaries, HNFHC is currently evaluating the establishment of a Group-wide integrated market risk management platform to monitor trading positions and risk adjusted return on capital (RAROC).

### (3) Operational Risk

HNFHC is planning and designing an integrated operational risk management framework for the entire group. This includes operations risk management (ORM) strategies, policies, organizational structure and relevant tools such as risk self assessment, corporate loss database, key operational risk control, key risk indicator and operational risk assessment process to fulfill a completed ORM cycle for identifying, assessing and measuring, controlling, monitoring and reporting operational risks.

## 4. Risk Reports and Risk Quantifying Systems

The risk management divisions of HNFHC and subsidiaries provide real-time, daily and periodic risk management reports to supervisors. Reports are also regularly provided to the board of directors. These reports enable the board and management to understand whether risk is within specified limits and help decision-makers map out operational policies.

HNFHC's risk quantifying system focuses on following areas:

## A. Risk Quantifying

The development and application of an internal credit rating model is the first step in strengthening credit risk management. HNFHC engage external consultants to assist modeling credit scoring, and focus on the improvement of credit risk organization and its process. Also, HNFHC assist Hua Nan Commercial Bank in introducing a capital requirement system that conforms to Basel II, which will strengthen internal risk management.

## B. Centralizing Risk Management

Advanced risk quantifying techniques must be established in a reasonable management framework to be effective. Advanced risk quantifying relies on large amounts of information processing and analysis. A reasonable management framework is determined by the expertise and understanding of managers with regards to risk. Centralized management helps HNFHC to achieve these goals. Another aim of centralization is to allocate risk to units that are capable of managing risk. After detailed quantifying is carried out by risk managers, the managers then actively manage this risk within set risk parameters. This is proactive management, not passive management. Proactive management includes re-allocating risk to maximize rewards.

## C. Risk-to-Return Rationalization

Exposure to default in each area of operations will be transferred into risk capital and charged to the unit bearing the risk. This will instill a risk cost concept directly into operational costs, will impact business decisions and will gradually improve the return on assets and return on equity ratios of each subsidiary. The company is planning to institute a shareholder value added management framework in all subsidiaries to create shareholder value.

## D. Strategies and Procedures Regarding Hedging and Risk Mitigation Policies, and Survey Circumvention and Mitigation Tools

All operations carried out by HNFHC and its subsidiaries are to conform to the Company's risk management policies and guidelines. Risk factors and management are considered in all operations. In addition, risk, trading and authority limits are set according to the nature of each business. These limits are screened on a regular basis and assessments are also carried out on all risk positions. HNFHC has also established risk indicators and a warning mechanism, aiming to use quantitative methods to calculate VaR and other risk-related indicators.

# Hua Nan Commercial Bank (HNCB)



Unit: in NT\$1,000

	2005	2004
Revenue	53,813,396	47,893,818
Net Income	9,402,773	9,962,622
Capital	37,091,000	37,091,000
Assets	1,584,445,252	1,508,528,762
Equity	71,735,171	65,040,291

## Brief History

Hua Nan Commercial Bank (HNCB), the largest subsidiary of Hua Nan Financial Holdings Company (HNFHC), was found in 1919. Since then, it has grown itself in tandem with the economic development of Taiwan. In 1998, a large number of government-owned shares were released (reduced from 58.76% to 31.35%, about 19% reduction from its original holdings), HNCB has therefore become a private sector. On December 19, 2001, it joined HNFHC through a share swap. Over the years, HNCB has accumulated nearly 5 million clients and 182 domestic outlets. As a household brand and with its strength in corporate banking, HNCB forms a solid foundation of HNFHC.

## Overview of Banking Industry In Taiwan

Continued rises in international oil and raw materials prices in the first half of 2005 caused a global economic slowdown. In order to ward off the threat of inflation, major economies staged a number of interest rate hikes. The factors combined to have a negative impact on Taiwan's exports, which in turn caused economic momentum on Taiwan to wane. Taiwan's economic growth for the year was 4.09%.

In the first half of 2005, a slowdown in Taiwan's economy caused a slide in bank lending growth. Last year, annual growth in Taiwan's M1A and M1B money supplies gradually declined to around 7%. Meanwhile, annual growth in the M2 money supply stood at around 6%. These levels were within the Central Bank of China's money supply target range of 3.5-7.5%, indicating loose liquidity.

## Operating Performance in 2005

Operating income in 2005 was NT\$53.81 billion, while net profit was NT\$9.40 billion. After tax earning per share stood at NT\$2.54. HNCB's RoA was 0.61% and RoE was 13.75%. It achieved 97% of its profit target for the year.

The individual business performance of HNCB in 2005 was shown in following:

1. Deposit: the average total deposit stood at NT\$1,174.11 billion, an increase of 6.69% from 2004.
2. Lending: the average outstanding loan stood at NT\$868.37 billion, a rise of 3.84% from 2004.
3. Personal Finance: the average outstanding balance of the personal financing stood at NT\$278.8 billion, a growth of 11.70% from 2004.
4. Foreign Exchange and International Banking: Foreign exchange business in 2004 amounted to US\$180.97 billion, a rise of US\$22.92 billion, or 14.50% from 2004.
5. Investment in Local and Overseas Securities by Designated Trusts:
  - (1) Foreign Currency Trust Funds: Investment in foreign funds, structured notes and government bonds in 2005 stood at US\$471 million, a rise of US\$258 million, or 121% growth from 2004.
  - (2) NT Dollar Trust Funds: Investment in domestic funds and structured products in 2005 stood at NT\$98.88 billion, an increase of 5.7% from 2004.

# Hua Nan Commercial Bank (HNCB)

## Business Plan for 2006

### (a) Deposits:

To strengthen management of deposit operations so as to reduce capital costs and create the largest possible return on capital.

### (b) Loans:

Seeking to lead domestic and foreign consortium loans.

### (c) Foreign Exchange:

To continue to strengthen the function of Shenzhen and Vietnam representative offices in preparation to elevate them to branches.

### (d) Trust:

To continue to expand the range of top quality investment targets on Taiwan and overseas, such as funds, structured bonds, foreign sovereign bonds and institutional bonds, and other securities with investment value to serve as targets for non-discretionary trusts.

### (e) Management of Lending and Liabilities:

To amend "Guidelines on Lending Guarantee Operations" with regulations regarding collateral for minors in order to guarantee Hua Nan Bank's rights.

### (f) Financial Investment:

To strengthen Hua Nan Bank's fiscal structure and raise its capital adequacy ratio, and to issue subordinated debentures at an appropriate time.

### (g) Management Project:

To establish a new FTP system, together with asset and liability management system, and to set reasonable costs in an effort to raise competitiveness and increase income. In addition, to regularly review risk associated with all investments and strengthen its risk control mechanism.

# Hua Nan Securities Co., Ltd. (HNS)



Unit: in NT\$1,000

	2005	2004
Revenue	2,796,869	3,894,629
Net Income	426,686	999,046
Capital	8,111,743	8,111,743
Assets	21,454,490	22,871,826
Equity	9,899,117	10,155,022



# Hua Nan Securities Co., Ltd. (HNS)

## Brief History

Entrust Securities (before joined into HNFHC) was established in August 1988 with NT\$200 million capital and focused solely on brokerage operations. Due to changes in the environment and the long-term development needs, Entrust had raised capitalization to \$1 billion and became an integrated securities company in 1990.

In order to strengthen competitiveness, Entrust's shareholders on November 14, 1991 approved a proposal to stage a share conversion with Hua Nan Commercial Bank in preparation to establish HNFHC. The conversion date was December 19, 1991 and 1.2821 Entrust shares were converted into 1 HNFHC share. Also, it renamed into Hua Nan Securities.

## Overview of Securities Industry in Taiwan

In March 2005, mainland China passed the Anti-secession Law directed at Taiwan. In August to October, rising oil prices and the threat of avian flu caused stock market trading volume to shrink. While share prices remained in a fairly narrow range, local investors generally remained sidelined due to a lack of confidence. In the fourth quarter, foreign institutions remitted in funds and purchased a large amount of shares, causing the stock market to move steadily higher. Shares continued to move higher in early 2006 before the market retreated on Taiwan's abolishment of the National Unification Council and the credit/cash card debt crisis.

## Operating Performance in 2005

Operating Income for 2005 was NT\$2.80 billion, with net profit amounting to NT\$427 million, equivalent to after tax earning per share of NT\$0.53. HNS's RoA was 1.93% and

RoE was 4.26%. It achieved 29% of its profit target for the year.

The individual business performance of HNS in 2005 was shown in following:

1. Broking: The average market share of HNS was 2.51% in 2005. Broking handling fee income stood at NT\$1.81 billion, a decrease of 27.43%.
2. Dealing: Dealing operations (including financial products and futures dealing) in 2005 contributed NT\$677 million of income, a decrease of 35.29%.
3. Underwriting: HNS worked with 19 lead or co-lead underwriting contracts, 34 underwriting projects and be the custodian for 83 companies in 2005. Underwriting income for the year stood at NT\$157 million, a decline of 7.19% from last year.

## Business Plan for 2006

Hua Nan Securities pursues balanced development in broking, underwriting, dealing and new financial products. The Company is also developing wealth management operations and other new areas of business. Hua Nan ranks among Taiwan's Top 10 domestic brokerages in terms of profits and capital size. It maintains a policy of acquiring specific branches of brokerages, and is also strengthening its e-trading platform. In addition, the Company is raising productivity, initiating new operations, issuing a range of financial products and aggressively developing institutional customers. Meanwhile, Hua Nan is dedicated to strengthening risk controls, raising service quality and providing training for its employees. It is also bolstering its cooperation with other HNFHC subsidiaries in the pursuit of reducing costs and achieving cross-sales synergy.

# Hua Nan Bills Finance Corp. (HNBF)



Unit: in NT\$1,000

	2005	2004
Revenue	1,291,315	759,810
Net Income	4,459	6,195
Capital	4,001,000	4,001,000
Assets	56,653,963	51,876,317
Equity	4,017,172	4,012,713

# Hua Nan Bills Finance Corp. (HNBF)

## Brief History

Central Bills Finance Corp. (before joined into HNFHC) was established in September 1996 with registered capital of NT\$2.528 billion. The major business lines are short-term bills and bond trading. On December 26, 2002, HNFHC invested in Central Bills Finance Corp. for NT\$2.3 billion to maintain a share holding of 57.49% while its subsidiary HNCB holding a 42.41% of shares. Central Bills Finance Corp became a subsidiary of HNFHC and changed the company name into Hua Nan Bills Finance Corp.

## Overview of Bills Finance Industry in Taiwan

Taiwan's Central Bank of China raised its rediscount rate by 0.125 percentage point in the third quarter, leading to a slight tightening in market liquidity. However, since the CBC still maintains around NT\$3 trillion of CDs that have yet to mature and foreign investors increased their stakes in Asian markets, overall liquidity in 2005 remained flush. Compared with a 0.5 percentage point rise in the rediscount rate since the end of 2004, the weighted average interbank overnight rate in 2005 rose just 0.277 percentage point to 1.482%. The rate on 30-day CP in the secondary market during the year rose 0.23 percentage point to 1.44%, which was also lower than the scale of the rise in the CBC's rediscount rate.

The yields on 10-year bonds consolidated at low levels in the first half of the year. Government bond yields here remained low due to flush liquidity and demand by trading houses in spite of the continued rise in interest rates by the US Federal Reserve and the gradual hike in rates by the CBC. At one point, the 10-year bond yield hit an historical low of 1.69%. At the end of December, the yield on the benchmark 10-year bond stood at 1.77%, which was a fall of 0.63 percentage point compared with the 2.40% yield at the end of 2004.

## Operating Performance in 2005

Operating revenue in 2005 was NT\$1,291 million. Pre-tax profit of pre-provisioning stood at NT\$476 million, while after-tax profit of post-provisioning was NT\$4 million. After tax earning

per share was NT\$0.01. HNBF's RoA was 0.01% and RoE was 0.11%. It achieved 393% of its profit target for the year.

The individual business performance of HNBF in 2005 was shown in following:

1. Guarantee: The issuance of guarantee amount of commercial paper in 2005 was NT\$100.91 billion, an increase of 25.37% from last year.
2. Bond Trading in the Secondary Market: bond trading in 2005 amounted to NT\$6.32 trillion, a rise of 348.77% from 2004's.

## Business Plan for 2006

- (a) To strengthen the relationship with existing customers and develop new customers.
- (b) To strengthen asset and liability management in order to raise operational performance.
- (c) To expand joint-sales activities with FHC subsidiaries in order to provide comprehensive financial services.
- (d) To develop new financial products in an effort to broaden operational development and increase opportunities for profit.
- (e) To provide education and training for employees to enhance long-term development of Hua Nan Bills Finance and raise service quality.
- (f) To strengthen internal auditing and internal controls, rationalize operational procedures and enhance information systems in order to raise operational performance.
- (g) To implement a policy to hold only customer with better credit and maximize profits while shouldering the lowest amount of risk possible.
- (h) To participate in corporate syndicated loans in order to boost awareness of Hua Nan Bills Finance and broaden sources of customers and bills, helping to raise profits.
- (i) To understand changes in the marketplace and develop new areas of business founded on CP, bolstering Company income.
- (j) To continue to write off bad loans, dispose of collateral and sell distressed assets in order to rapidly lower its NPL ratio and strengthen financial structure.

# South China Insurance Co. Ltd. (SCI)



Unit: in NT\$1,000

	2005	2004
Revenue	9,716,061	9,162,940
Net Income	217,328	250,381
Capital	2,001,386	2,001,386
Assets	8,080,731	7,604,386
Equity	2,313,390	2,312,044

# South China Insurance Co. Ltd. (SCI)

## Brief History

South China Insurance Co. Ltd. was established on May 1, 1963 with initial capital of NT\$30 million. Nowadays, South China Insurance cover the business scope in fire & allied named perils insurance, residential earthquake insurance, cargo insurance, marine hull insurance, fishing vessel insurance, fishing vessel third party liability insurance, inland transportation insurance, aviation insurance, motor physical damage insurance, motor third party liability insurance, motor theft insurance, compulsory motor insurance, compulsory motorcycle insurance, construction/erection all risk insurance, credit/guarantee insurance, liability insurance, Other property insurance, personal accident insurance, and Reinsurance. Furthermore, 7 branches and 28 representative offices are spread over Taiwan.

In face of the current financial industry trend, South China Insurance Co Ltd. joined HNFHC as its affiliate in accordance with stock transformation on March 19, 2003.

## Overview of Non-Life Insurance Industry in Taiwan

Economic growth in 2005 stood at 4.09%, according to the Directorate General of Budget, Accounting and Statistics. The forecasting agency predicts growth in 2006 to accelerate to 4.25%. The premium income of 2005 raised 3.36% to NT\$119.37 billion in Taiwan domestic non-life insurance market, and the premiums for personal accident insurance grew by NT\$1.3 billion, equivalent to 18.54% growth. This area of insurance will clearly be the star of the future.

## Operating Performance in 2005

Operating income in 2005 was NT\$9.72 billion and after-tax profit was \$217 million, translating to net earning per share of NT\$1.09. SCI's RoA was 2.77% and RoE was 9.40%. It achieved 72% of its profit target for the year.

The individual business performance of SCI in 2005 was shown in following:

### 1. Total premium income in 2005 amounted to NT\$5.15 billion, a rise of 8.57% from last year. This breaks down as follows:

- A. Fire insurance premiums were NT\$1,068 million, up 18.05%.
- B. Marine insurance premiums were NT\$337 million, up 6.86%.
- C. Motor insurance premiums were NT\$2,814 million, up 13.78%.
- D. Casualty insurance premiums were NT\$932 million, down 11.36%.

### 2. Reinsurance income in 2005 stood at NT\$300 million, a decline of 1.94% from 2004.

## Business Plan for 2006

- (a) To integrate IT systems, establish and plan customer relationship management mechanisms, and integrate network-based operations platforms, helping to raise customer service quality.

- (b) To establish a corporate portal website to boost efficiency in employee communication; to establish a B2B system to support sales and marketing efforts through the Company's network; and to implement information safety measures to protect the interests of customers.
- (c) To add depth to development of the FHC's property insurance operations and to plan and replicate successful sales models.
- (d) To continue to introduce packages of insurance products that include personal insurance products and new products that can be sold through various sales networks and that provide one-stop shopping convenience, which will help reduce costs in seeking new customers.
- (e) To expand the sales and market network and to re-allocate operation outlets for creating a comprehensive sales and service network. Also, to bolster the customer service center facilities and to combine the e-cover network for raising customer satisfaction levels.
- (f) Implementing an agent reward system that is based on performance and contribution, helping to raise productivity.
- (g) To strengthen employee training and introduce a study passport system. Also, to implement a system that links promotion of an employee to his or her success in obtaining professional licenses.
- (h) To implement a loss prevention mechanism and instill the concept of avoiding losses. To provide customers with suggestions on how to prevent against losses and use a VaR model to reduce the chances of risks, ultimately strengthen operational performance.
- (i) To strengthen premium collection mechanisms by increasing the number of payment methods, such as credit card payment via the Internet and bar code payment via direct payment transfer to the Company through the postal savings system, bank deposits and convenience stores. This will raise the premium collection ratio.
- (j) To gradually establish regional administrative management centers that will delineate organizational responsibilities and raise efficiency and quality in handling customer needs. The Company will also train experts in reviewing and approving insurance applications, as well as claim settlement specialists. South China will also provide better logistical support in its business operation systems to raise customer satisfaction and increase profits.

# Hua Nan Investment Trust Corp. (HNIT)



Unit: in NT\$1,000

	2005	2004
Revenue	250,474	372,737
Net Income	(20,767)	156,766
Capital	300,000	300,000
Assets	3,611,507	587,554
Equity	383,761	514,264



## Brief History

Entrust Investment Trust Corp. was established in 1992. As Taiwan's financial holding companies enter a new age, the keys to success will be understanding the latest developments in financial markets and strengthening competitiveness, therefore, Entrust Investment Trust Corp. joined to be a subsidiary of HNFHC at August 15, 2003 and re-named 華南投資信託公司 Hua Nan Investment Trust Corp. □

## Overview of Investment Trust Industry in Taiwan

Taiwan had 45 securities investment trust companies as of the end of 2005, and a total of 502 securities investment trust funds in issuance. The size of these funds stood at NT\$1.96 trillion. Over the past year, bond-style funds faced systemic risk. As a result, the aggregate size of these funds fell NT\$520 billion in 2004 from the NT\$2.48 trillion level at the end of 2004. However, with the initiation of private equity funds, growth in these funds was quite impressive. The size of these funds has reached NT\$43.7 billion.

In light of the regulatory liberalization of private equity funds and agency sales for offshore funds, the investment trust sector on Taiwan is rapidly internationalizing its operations. While there is now more opportunity to expand business, the market at the same time will become even more competitive. Amid internationalization, a large amount of traditional mutual fund products will become available on Taiwan. In addition, new types of financial products, such as hedge funds, will also be a potential area of business. More and more new products and avenues for investment will be seen. As a result, the ability to design and market these products will be the key factor for investment trust companies to survive and remain competitive.

## Operating Performance in 2005

Operating income in 2005 was NT\$250 million and after-tax loss was \$21 million, translating to net earning per share of NT\$-0.69. HNIT's RoA was -0.99% and RoE was -4.63%.

The individual business performance of HNIT in 2005 was shown in following:

1. Equity Fund: The size of equity-style funds at the end of 2005 was NT\$1,975 million, a drop of 58.01% from 2004.
2. Fixed Income Funds: The size of fixed income-style funds at the end of 2005 was NT\$28.33 billion, a decline of 54.59% from last year.
3. Discretionary Trading: Funds entrusted for discretionary trading at the end of 2005 stood at NT\$1,262 million, less 17.75% from 2004.

## Business Plan for 2006

- (a) To engage in overseas fund product business and seek to serve as an agent and sales institution for offshore funds. This will broaden this Company's product line and offer a wider range of investment options for investors.
- (b) To aggressively issue all types of private equity funds and to bolster product R&D.
- (c) To develop new types of discretionary trading business, including fixed income and overseas financial product discretionary trading. This will reduce the impact of fluctuations in domestic stock prices on discretionary assets under trust.
- (d) To focus on combining innovation and core sales abilities, balancing company assets and the structure of its customers, and expanding market share of assets under management.
- (e) To strengthen investment research quality, raise asset management performance and ensure long-term sources of profits for the Company.
- (f) To strengthen risk controls, rationalize operational procedures, reinforce information systems and raise service efficiency.

# Hua Nan Venture Capital Co., Ltd. (HNVC)

## Hua Nan Management & Consulting Co., Ltd. (HNMC)



### HNVC

Unit: in NT\$1,000

	2005	2004
Revenue	5,907	11,561
Net Income	(4,810)	(8,854)
Capital	1,000,000	1,000,000
Assets	984,204	986,679
Equity	984,113	986,589

### HNMC

Unit: in NT\$1,000

	2005	2004
Revenue	19,264	18,851
Net Income	3,109	3,914
Capital	10,000	10,000
Assets	17,084	17,041
Equity	13,500	13,914

## Brief History

Hua Nan Venture Capital (HNVC) was established on January 28, 2004. The company was established as a way to diversify Hua Nan Financial Holdings services and resources. HNVC primarily invests in early stage high tech and biotech companies in the Asia Pacific region, primarily in Taiwan, and in the United States.

Hua Nan Management & Consulting (HNMC) was established on February 5, 2004 in partnership with ChengXin Venture Capital Group. The company manages its venture capital fund which focuses on investments into early stage high tech and biotech companies in the Asia Pacific region, primarily in Taiwan, and in the United States. HNMC also advises its investment portfolio companies on business model analysis, financial management, and strategic planning.

## Overview of Venture Capital Market in Taiwan

A total of 19 new venture capital funds were established in 2004, with a total of NT\$12.79 billion of capital available. This was a slight decline from the previous year when 23 such funds, encompassing NT\$20.42 billion of capital, were set up. In 2004, venture capital funds invested a total of NT\$15.27 billion in 1,063 projects, which was also a slight decline from a total of NT\$16.54 billion in 1,159 projects in the previous year. In 2004, 59.3% of all investment by the funds was funneled into the opto-electronics, semiconductor and electronics industries. The biotechnology and digital content industries attracted a total of 7.9% of all venture capital investment that year. The majority of funds, 51.7%, was invested in the expansion stage, followed by 22.1% in the mature stage of operations. In 2004, 80.2% of venture capital funds were invested on Taiwan, while 9.96% were funneled to the Silicon Valley area. In 2004, Taiwan's venture capital sector registered a loss per share of NT\$0.09, which was the lowest since 1997.

## Operating Performance in 2005

### Hua Nan Venture Capital Co., Ltd. (HNVC)

Operating income in 2005 was NT\$12 million and after-tax loss was \$5 million, translating

to net earning per share of NT\$-0.05. HNVC's RoA was -0.49% and RoE was -0.49%.

For the year 2005, HNVC invested 8 projects and totaling NT\$180 million.

### Hua Nan Management & Consulting Co., Ltd. (HNMC)

Operating income in 2005 was NT\$19 million and after-tax profit was \$3 million, translating to net earning per share of NT\$3.11. HNS's RoA was 18.22% and RoE was 22.68%. It achieved 142% of its profit target for the year.

HNMC had provided assessment on 111 potential investment projects, forwarding 12 to the board of directors of HNVC for consideration. 8 of those were approved, with an investment amount totaling NT\$180 million.

## Business Plan for 2006

Hua Nan Venture Capital anticipates making 10 investments in 2006 totaling about NT\$350 million. At the end of the year, it will have aggregate investments of about NT\$700 million. The first three years of Hua Nan Venture Capital have been designated as "active" investment year in which the core investment portfolio is built upon with investments targeting companies in the expansion stage. Also these companies in the portfolio generally do not have plans to list on the stock market. Therefore, Hua Nan Venture Capital is not expected to post any investment gains in 2006, and as investments are funneled to investment targets, the interest earnings accumulated from the funds on hand will also decline. As a result, HNVC can be expecting losses of about NT\$ 12.91 million.

The income of Hua Nan Management & Consulting is largely derived from fund management and profit-sharing bonuses. Since Hua Nan Venture Capital is still in the process of setting up its portfolio, income in 2006 will be in the form of management income, amounting to about NT\$19.05 million. Operating expenses are to be about NT\$17.49 million. After-tax profit for 2006 is expected to be about NT\$1.32 million.

# Hua Nan Asset Management Company (HNAMC)



Unit: in NT\$1,000

	2005	2004
Revenue	0	-
Net Income	(4,908)	-
Capital	1,000,000	-
Assets	996,743	-
Equity	995,092	-

## Overview of Asset Management Industry in Taiwan

The number of large-sized tranche sales of distressed assets fell in 2005. For the year as a whole, the number of NPLs traded was only NT\$231.3 billion, and the number is expected to decline again in 2006. Data tabulated by the FSC's Banking Bureau on domestic bank asset quality show that the domestic financial institution NPL ratio fell from 11.30% in December 2001 to 2.24% in December 2005. The total NPL ratio is within the government's policy target of 5%. As a result, Taiwan's NPL market is gradually maturing and a reduction in the size of distressed assets bought and sold is inevitable.

## Operating Performance in 2005

HNAMC was established at May, 10, 2005 and acquired the NPL about NT\$7.4 billions from Hua Nan Bills Finance at the same year.

Operating income in 2005 was NT\$7 million and after-tax loss was \$5 million, translating to net earning per share of NT\$-0.05. HNAMC's RoA was -0.49% and RoE was -0.49%.

## Business Plan for 2006

Hua Nan Asset Management was established on May 10, 2005. Initially, it plans to acquire NPLs not only from HNFHC's bank and bills finance subsidiaries but other institutions. In late November 2005, it purchased NT\$7.4 billion of distressed assets sold by Hua Nan Bills Finance. It is also negotiating with Hua Nan Commercial Bank on a cooperative plan to dispose of the Bank's distressed assets on its behalf. Hua Nan Asset Management has drafted the following business plans for 2006:

### 1. Acquisition of Financial Institution Distressed Assets:

To continue to purchase distressed assets from financial institutions. The company

anticipates that by the second quarter it will complete initial evaluation work related to new tranches of distressed loans that will become available. It will bid for a package of NPLs to be sold by Land Bank of Taiwan.

To seek local and foreign cooperative partners to jointly engage in evaluation and investment.

### 2. Handling Distressed Loans or Assets on Behalf of Financial Institutions or Other Asset Management Companies:

A.To recover distressed loans on behalf of Hua Nan Commercial Bank.

B.To continue to develop and provide asset management services for multinational companies with investments in Taiwan.

C.To evaluate the size of, competitive situation of and regulations governing Taiwan's market for outsourcing of debt collection in order to raise the Company's competitiveness.

### 3. Providing Merger and Acquisition Information and Consulting Services in Evaluating and Selecting Direct Investment Targets and the Development of Specific Targets:

A.To carefully select and carry out feasibility studies on the possibility of direct investment in some of the distressed assets it has acquired.

B.To provide negotiation, planning and execution services for particular investors interested in acquiring specific assets.

C.To seek multinational cooperative partners in carrying out direct investment in specific assets or to provide assets acquisition services.

# Financial Statements

2005 ANNUAL REPORT





# INDEPENDENT AUDITORS' REPORT

## **The Board of Directors and the Stockholders**

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The Board of Directors and the Stockholders  
Hua Nan Financial Holdings Co., Ltd.

We have audited the accompanying balance sheets of Hua Nan Financial Holdings Co., Ltd. (the "Company") as of December 31, 2005 and 2004, and the related statements of income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these statements based on our audits.

We conducted our audits in accordance with the Rules Governing the Audit of Financial Statements by Certified Public Accountants, Rules Governing the Auditing and Certification of Financial Statements of Financial Institutions by Certified Public Accountants and auditing standards generally accepted in the Republic of China. Those rules, 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 financial statements referred to above present fairly, in all material respects, the financial position of Hua Nan Financial Holdings Co., Ltd. as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended, in conformity with the Criteria Governing the Preparation of Financial Reports by Financial Holding Companies and accounting principles generally accepted in the Republic of China.

We have also audited the consolidated financial statements of Hua Nan Financial Holdings Co., Ltd. and subsidiaries as of and for the years ended December 31, 2005 and 2004, on which we have issued an unqualified opinion.

January 24, 2006

### Notice to Readers

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

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

# Financial Statements

## HUA NAN FINANCIAL HOLDINGS CO., LTD.

### STATEMENTS OF INCOME

YEARS ENDED DECEMBER 31, 2005 AND 2004

(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2005		2004	
	Amount	%	Amount	%
INCOME FROM LONG-TERM EQUITY INVESTMENTS, NET (Notes 2 and 6)	\$ 9,442,051	100	\$ 10,844,394	100
OPERATING EXPENSES				
General and administrative (Notes 2, 13 and 15)	186,892	2	181,948	2
Others	676	-	1,027	-
Total operating expenses	187,568	2	182,975	2
OPERATING INCOME	9,254,483	98	10,661,419	98
NONOPERATING INCOME				
Interest (Note 15)	38,887	1	19,256	-
Others	1,754	-	1,256	-
Total nonoperating income	40,641	1	20,512	-
NONOPERATING EXPENSES				
Interest	180,000	2	180,065	1
Others	430	-	95	-
Total nonoperating expenses	180,430	2	180,160	1
INCOME BEFORE INCOME TAX	9,114,694	97	10,501,771	97
INCOME TAX (Notes 2 and 12)	412,165	4	270,120	2
NET INCOME	\$ 9,526,859	101	\$ 10,771,891	99
	Pre-Tax	After Tax	Pre-Tax	After Tax
BASIC EARNINGS PER SHARE (Note 14)	\$ 1.53	\$ 1.60	\$ 1.76	\$ 1.80

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



## HUA NAN FINANCIAL HOLDINGS CO., LTD.

### BALANCE SHEETS

DECEMBER 31, 2005 AND 2004

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

ASSETS	2005		2004	
	Amount	%	Amount	%
CURRENT ASSETS				
Cash and cash equivalents (Notes 4 and 15)	\$ 6,057,564	6	\$ 4,601,436	5
Receivables	359,822	1	100,897	-
Receivables from related parties (Notes 5, 12 and 15)	300,919	-	422,536	1
Prepayments and other current assets	6,577	-	5,100	-
Total current assets	6,724,882	7	5,129,969	6
LONG-TERM EQUITY INVESTMENTS (Notes 2 and 6)				
Equity method	88,628,041	93	81,323,291	94
Cost method	354,000	-	354,000	-
Total long-term equity investments	88,982,041	93	81,677,291	94
PROPERTIES, NET (Notes 2 and 7)	9,699	-	11,560	-
OTHER ASSETS (Notes 2 and 12)	50,451	-	151,252	-
TOTAL	\$ 95,767,073	100	\$ 86,970,072	100
LIABILITIES AND STOCKHOLDERS' EQUITY	2005		2004	
	Amount	%	Amount	%
CURRENT LIABILITIES				
Payables	\$ 64,937	-	\$ 69,071	-
Payables to related parties (Notes 2, 12 and 15)	117,759	-	273,901	-
Total current liabilities	182,696	-	342,972	-
LONG-TERM LIABILITIES				
Bonds payable (Notes 2 and 8)	6,000,000	6	6,000,000	7
Other long-term liabilities (Note 11)	17,719	-	12,314	-
Total long-term liabilities	6,017,719	6	6,012,314	7
OTHER LIABILITIES	280	-	345	-
Total liabilities	6,200,695	6	6,355,631	7
STOCKHOLDERS' EQUITY (Notes 2, 9 and 10)				
Capital stock - \$10 par value, authorized 10,000,000,000 shares, issued 5,970,208,636 shares and 5,579,634,240 shares as of December 31, 2005 and 2004, respectively	59,702,086	62	55,796,342	64
Capital surplus				
Additional paid-in capital	12,352,244	13	12,352,244	14
Revaluation increments on properties	4,184	-	4,184	-
Donation	2,936	-	2,936	-
Treasury stock reissuance	52,360	-	52,360	-
Others	3,400,187	4	2,077	-
Retained earnings				
Legal reserve	2,147,366	2	1,070,177	2
Special reserve	111,017	-	9,494	-
Unappropriated earnings	11,861,021	13	11,435,643	13
Cumulative translation adjustments	( 67,023)	-	( 111,016)	-
Total stockholders' equity	89,566,378	94	80,614,441	93
TOTAL	\$ 95,767,073	100	\$ 86,970,072	100

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

# Financial Statements

## HUA NAN FINANCIAL HOLDINGS CO., LTD.

### STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

YEARS ENDED DECEMBER 31, 2005 AND 2004

(In Thousands of New Taiwan Dollars)

	Capital Stock		Capital Surplus
	Shares (Thousands)	Amount	
BALANCE, JANUARY 1, 2004	4,728,504	\$ 47,285,036	\$ 13,359,502
Appropriation of 2003 earnings			
Legal reserve	-	-	-
Special reserve	-	-	-
Remuneration to directors and supervisors	-	-	-
Employees bonus	-	-	-
Cash dividends	-	-	-
Stock dividends	756,560	7,565,605	-
Capital surplus appropriated as stock dividends	94,570	945,701	( 945,701)
Translation adjustments on long-term equity investments	-	-	-
Treasury stock transaction - subsidiary's sale of Company's stock	-	-	-
Net income in 2004	-	-	-
BALANCE, DECEMBER 31, 2004	5,579,634	55,796,342	12,413,801
Appropriation of 2004 earnings			
Legal reserve	-	-	-
Special reserve	-	-	-
Remuneration to directors and supervisors	-	-	-
Employees bonus	-	-	-
Cash dividends	-	-	-
Stock dividends	390,575	3,905,744	-
Translation adjustments on long-term equity investments	-	-	3,398,110
Net income in 2005	-	-	-
BALANCE, DECEMBER 31, 2005	5,970,209	\$ 59,702,086	\$ 15,811,911

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

	Retained Earnings				Cumulative Translation Adjustments	Treasury Stock	Total Stockholders' Equity
	Legal Reserve	Special Reserve	Unappropriated Earnings	Total			
	\$ 60,022	\$ -	\$ 10,292,792	\$10,352,814	\$ ( 9,494)	\$ ( 22)	\$ 70,987,836
	1,010,155	-	( 1,010,155)	-	-	-	-
	-	9,494	( 9,494)	-	-	-	-
	-	-	( 90,819)	( 90,819)	-	-	( 90,819)
	-	-	( 7,266)	( 7,266)	-	-	( 7,266)
	-	-	( 945,701)	( 945,701)	-	-	( 945,701)
	-	-	( 7,565,605)	( 7,565,605)	-	-	-
	-	-	-	-	-	-	-
	-	-	-	-	( 101,522)	-	( 101,522)
	-	-	-	-	-	22	22
	-	-	10,771,891	10,771,891	-	-	10,771,891
	1,070,177	9,494	11,435,643	12,515,314	( 111,016)	-	80,614,441
	1,077,189	-	( 1,077,189)	-	-	-	-
	-	101,523	( 101,523)	-	-	-	-
	-	-	( 95,932)	( 95,932)	-	-	( 95,932)
	-	-	( 15,349)	( 15,349)	-	-	( 15,349)
	-	-	( 3,905,744)	( 3,905,744)	-	-	( 3,905,744)
	-	-	( 3,905,744)	( 3,905,744)	-	-	-
	-	-	-	-	43,993	-	3,442,103
	-	-	9,526,859	9,526,859	-	-	9,526,859
	<u>\$ 2,147,366</u>	<u>\$ 111,017</u>	<u>\$ 11,861,021</u>	<u>\$ 14,119,404</u>	<u>\$ ( 67,023)</u>	<u>\$ -</u>	<u>\$ 89,566,378</u>

# Financial Statements

## HUA NAN FINANCIAL HOLDINGS CO., LTD.

### STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2005 AND 2004

(In Thousands of New Taiwan Dollars)

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 9,526,859	\$ 10,771,891
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	5,978	5,925
Loss from disposal of properties	-	97
Income from long-term equity investments under the equity method	( 9,442,051)	( 10,844,394)
Cash dividends and remuneration to directors and supervisors received from long-term equity investments under the equity method	6,579,404	3,932,099
Net changes in operating assets and liabilities		
Receivables	( 258,925)	310,282
Receivables from related parties	121,617	( 194,374)
Prepayments and other current assets	( 1,597)	2,916
Deferred income tax	89,248	( 107,656)
Payables	( 4,134)	21,022
Payables to related parties	( 156,142)	( 239,042)
Accrued pension cost	5,405	1,410
Others	8,673	-
Net cash provided by operating activities	6,474,335	3,660,176
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in long-term investments	( 1,000,000)	( 2,300,000)
Acquisition of properties	( 1,117)	( 3,523)
Proceeds from disposal of properties	-	3,320
Net cash used in investing activities	( 1,001,117)	( 2,300,203)
CASH FLOWS FROM FINANCING ACTIVITIES		
Other liabilities	( 65)	-
Remuneration to directors and supervisors	( 95,932)	( 90,819)
Employees bonuses	( 15,349)	( 7,266)
Cash dividends paid	( 3,905,744)	( 945,701)
Net cash used in financing activities	( 4,017,090)	( 1,043,786)
NET INCREASE IN CASH	1,456,128	316,187
CASH, BEGINNING OF YEAR	4,601,436	4,285,249
CASH, END OF YEAR	\$ 6,057,564	\$ 4,601,436
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	\$ 180,000	\$ 180,000
Income tax paid	\$ 3,861	\$ 1,943
NONCASH INVESTING ACTIVITIES		
Effect on changes in subsidiaries' capital surplus (Note 6)	\$ 3,398,110	\$ -

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

## HUA NAN FINANCIAL HOLDINGS CO., LTD. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF INCOME

YEARS ENDED DECEMBER 31, 2005 AND 2004

(In Thousands of New Taiwan Dollars, Except Earnings per Share)

	2005		2004	
	Amount	%	Amount	%
OPERATING REVENUES AND GAINS				
Interest	\$ 38,047,007	56	\$ 33,223,841	54
Gross written premium	5,414,320	8	5,000,057	8
Recovered reinsurance claims	1,524,694	2	1,174,384	2
Recovered unearned premium reserve	2,036,909	3	2,027,380	3
Recovered special reserve	44,803	-	104,274	-
Recovered claims reserve	29,447	-	26,750	-
Service fees	6,881,821	10	6,890,211	11
Income from securities, net	5,823,291	9	4,013,927	7
Income from long-term stock investments under the equity method, net	762	-	304,824	1
Foreign exchange gain, net	914,616	1	676,776	1
Others	7,312,982	11	8,271,702	13
Total operating revenues and gains	68,030,652	100	61,714,126	100
OPERATING COSTS AND EXPENSES				
Interest	19,996,031	29	15,501,058	25
Reinsurance premium expenses	2,489,725	4	2,598,544	4
Insurance claims paid	2,882,412	4	2,452,721	4
Unearned premium reserve	2,111,087	3	2,036,909	3
Special reserve	297,742	-	329,384	1
Claims reserve	34,501	-	29,447	-
Service charges	1,738,097	3	1,563,449	3
Provision for reserves, bad debts and losses from decline in market value of securities purchased and investments	9,392,780	14	6,765,106	11
Operational, general and administrative expenses	16,630,685	25	15,887,590	26
Others	1,465,224	2	942,752	1
Total operating cost and expenses	57,038,284	84	48,106,960	78
OPERATING INCOME	10,992,368	16	13,607,166	22
NONOPERATING REVENUES AND INCOMES	568,826	1	734,223	1
NONOPERATING EXPENSES AND LOSSES	374,132	1	322,680	1
INCOME BEFORE INCOME TAX	11,187,062	16	14,018,709	22
INCOME TAX EXPENSE	1,658,962	2	3,246,784	5
CONSOLIDATED INCOME	\$ 9,528,100	14	\$ 10,771,925	17
Income before minority interest	\$ 9,526,859	14	\$ 10,771,891	17
Minority interest income	1,241	-	34	-
	\$ 9,528,100	14	\$ 10,771,925	17
	Pre-Tax	After Tax	Pre-Tax	After Tax
BASIC EARNINGS PER SHARE	\$ 1.87	\$ 1.60	\$ 2.35	\$ 1.80

# Financial Statements

## HUA NAN FINANCIAL HOLDINGS CO., LTD. AND SUBSIDIARIES

### CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2005 AND 2004

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

ASSETS	2005		2004	
	Amount	%	Amount	%
CASH AND CASH EQUIVALENTS	\$ 44,359,983	3	\$ 30,236,716	2
DUE FROM THE CENTRAL BANK AND OTHER BANKS	145,254,012	9	127,364,364	8
SECURITIES PURCHASED, NET	373,313,759	22	396,538,808	25
RECEIVABLES, NET	38,729,262	2	37,204,559	2
CUSTOMERS' MARGIN DEPOSITS	1,182,644	-	1,936,879	-
PREPAYMENTS	4,120,106	-	3,093,922	-
BILLS PURCHASED, DISCOUNTS AND LOANS, NET	942,599,507	56	885,797,852	56
LONG-TERM INVESTMENTS				
Stock under the equity method	80,806	-	2,520,279	-
Stock under the cost method	6,363,205	-	8,057,738	-
Bonds	58,877,554	4	41,001,966	3
Real-estate	124,560	-	115,913	-
Others	2,864,437	-	2,247,085	-
Total long-term investments	68,310,562	4	53,942,981	3
PROPERTIES				
Cost				
Land (including revaluation increments)	13,687,176	1	13,719,624	1
Buildings (including revaluation increments)	12,446,201	1	12,111,167	1
Office equipment	5,417,562	-	5,230,887	-
Transportation equipment	982,562	-	960,488	-
Other equipment	2,500,337	-	2,284,472	-
Leasehold improvements	512,259	-	492,286	-
Cost and revaluation increments	35,546,097	2	34,798,924	2
Less accumulated depreciation	10,261,471	-	9,540,030	-
	25,284,626	2	25,258,894	2
Prepayments and construction in progress	91,786	-	231,034	-
Net properties	25,376,412	2	25,489,928	2
INTANGIBLE ASSETS	61,034	-	148,030	-
OTHER ASSETS				
Refundable deposits	1,838,260	-	2,282,894	-
Others	20,539,419	1	20,259,034	1
Deferred income tax assets, net	5,363,845	1	6,364,587	1
Total other assets	27,741,524	2	28,906,515	2
TOTAL	\$ 1,671,048,805	100	\$ 1,590,660,554	100

LIABILITIES AND STOCKHOLDERS' EQUITY	2005		2004	
	Amount	%	Amount	%
LIABILITIES				
Short-term borrowings	\$ 6,024,661	-	\$ 6,909,015	1
Bonds sold under agreements to repurchase	61,895,686	4	60,475,667	4
Stock warrants issued, net	-	-	184,149	-
Due to the Central Bank and other banks	91,150,499	6	98,137,349	6
Payables	54,915,887	3	45,733,541	3
Futures traders' equity	1,031,930	-	1,919,467	-
Advance collections	600,170	-	617,860	-
Deposits and remittances	1,282,562,748	77	1,211,095,387	76
Bank debentures payable	63,033,000	4	60,670,000	4
Bonds payable	6,000,000	-	6,000,000	-
Other liabilities	14,256,991	1	18,298,459	1
Total liabilities	1,581,471,572	95	1,510,040,894	95
STOCKHOLDERS' EQUITY				
Total stockholders' equity before minority interest				
Capital stock - \$10 par value				
Authorized: 10,000,000,000 shares				
Issued: 5,970,208,636 shares and 5,579,634,240 shares in 2005 and 2004, respectively	59,702,086	3	55,796,342	3
Capital surplus				
Additional paid-in capital	12,352,244	1	12,352,244	1
Reserve for property revaluation increments	4,184	-	4,184	-
Donation	2,936	-	2,936	-
Treasury stock reissuance	52,360	-	52,360	-
Others	3,400,187			
Retained earnings		-	2,077	-
Legal reserve	2,147,366	-	1,070,177	-
Special reserve	111,017	-	9,494	-
Unappropriated earnings	11,861,021	1	11,435,643	1
Cumulative translation adjustments	( 67,023)	-	( 111,016)	-
Total stockholders' equity before minority interest	89,566,378	5	80,614,441	5
Minority interest	10,855	-	5,219	-
Total stockholders' equity	89,577,233	5	80,619,660	5
COMMITMENTS AND CONTINGENT LIABILITIES				
TOTAL	\$ 1,671,048,805	100	\$ 1,590,660,554	100

# Financial Statements

## HUA NAN FINANCIAL HOLDINGS CO., LTD. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

YEARS ENDED DECEMBER 31, 2005 AND 2004

(In Thousands of New Taiwan Dollars)

	Capital Stock		Capital Surplus
	Shares (Thousands)	Amount	
BALANCE, JANUARY 1, 2004	4,728,504	\$ 47,285,036	\$ 13,359,502
Appropriation of 2003 earnings			
Legal reserve	-	-	-
Special reserve	-	-	-
Remuneration to directors and supervisors	-	-	-
Employees bonus	-	-	-
Cash dividends	-	-	-
Stock dividends	756,560	7,565,605	-
Capital surplus appropriated as stock dividends	94,570	945,701	( 945,701)
Translation adjustments on long-term equity investments	-	-	-
Treasury stock transaction - subsidiary's sale of Company' s stock	-	-	-
Net income in 2004	-	-	-
BALANCE, DECEMBER 31, 2004	5,579,634	55,796,342	12,413,801
Effect on subsidiaries' initial consolidation	-	-	-
Appropriation of 2004 earnings			
Legal reserve	-	-	-
Special reserve	-	-	-
Remuneration to directors and supervisors	-	-	-
Employees bonus	-	-	-
Cash dividends	-	-	-
Stock dividends	390,575	3,905,744	-
Capital surplus appropriated as stock dividends	-	-	-
Translation adjustments on long-term equity investments	-	-	3,398,110
Net income in 2005	-	-	-
BALANCE, DECEMBER 31, 2005	5,970,209	\$ 59,702,086	\$ 15,811,911



# H E A R T

HONESTY / EFFICIENCY / ACTIVENESS / RESPONSIBILITY / TEAMWORK

	Retained Earnings				Cumulative Translation Adjustments	Treasury Stock	Minority Interest	Total Stockholders' Equity
	Legal Reserve	Special Reserve	Unappropriated Earnings (Loss)	Total				
	\$ 60,022	\$ -	\$ 10,292,792	\$10,352,814	\$( 9,494)	\$( 22)	5,185	\$ 70,993,021
	1,010,155	-	( 1,010,155)	-	-	-	-	-
	-	9,494	( 9,494)	-	-	-	-	-
	-	-	( 90,819)	( 90,819)	-	-	-	( 90,819)
	-	-	( 7,266)	( 7,266)	-	-	-	( 7,266)
	-	-	( 945,701)	( 945,701)	-	-	-	( 945,701)
	-	-	( 7,565,605)	( 7,565,605)	-	-	-	-
	-	-	-	-	-	-	-	-
	-	-	-	-	( 101,522)	-	-	( 101,522)
	-	-	-	-	-	22	-	22
	-	-	10,771,891	10,771,891	-	-	34	10,771,925
	1,070,177	9,494	11,435,643	12,515,314	( 111,016)	-	5,219	80,619,660
	-	-	-	-	-	-	5,805	5,805
	1,077,189	-	( 1,077,189)	-	-	-	-	-
	-	101,523	( 101,523)	-	-	-	-	-
	-	-	( 95,932)	( 95,932)	-	-	( 45)	( 95,977)
	-	-	( 15,349)	( 15,349)	-	-	( 280)	( 15,629)
	-	-	( 3,905,744)	( 3,905,744)	-	-	( 1,085)	( 3,906,829)
	-	-	( 3,905,744)	( 3,905,744)	-	-	-	-
	-	-	-	-	-	-	-	-
	-	-	-	-	43,993	-	-	3,442,103
	-	-	9,526,859	9,526,859	-	-	1,241	9,528,100
	<u>\$ 2,147,366</u>	<u>\$ 111,017</u>	<u>\$ 11,861,021</u>	<u>\$ 14,119,404</u>	<u>\$( 67,023)</u>	<u>\$ -</u>	<u>\$ 10,855</u>	<u>\$ 89,577,233</u>

# Financial Statements

## HUA NAN FINANCIAL HOLDINGS CO., LTD. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2005 AND 2004

(In Thousands of New Taiwan Dollars)

	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Consolidated income	\$ 9,528,100	\$ 10,771,925
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,221,902	1,161,064
Amortization of premium on long-term bond investments	943,078	334,313
Gain from long-term stock investments under the equity method	( 762)	( 304,824)
Realized loss from sale of long-term investments, net	( 113,609)	8,130
Realized loss from capital decrease of investee	310,745	-
(Gain)on disposal of properties, net	( 176,698)	( 326,493)
Cash dividends and remuneration to directors and supervisors from long-term stock investments under the equity method	-	169,253
Provision for reserves, bad debts and losses from decline in market value of securities purchased and investments	9,790,377	7,660,864
Net changes in operating assets and liabilities		
Accrued pension cost	114,169	169,782
Deferred income tax	1,016,158	2,946,544
Receivables and prepayments	( 3,793,833)	( 5,804,840 )
Securities purchased	26,115,567	( 67,328,622)
Payables and advance collections	9,217,580	7,115,823
Liabilities for stock warrants issued	( 184,149)	( 11,544)
Bonds sold under agreements to repurchase	1,080,524	37,950,166
Others	( 260,418)	49,856
Net cash provided by used in operating activities	54,808,731	( 5,438,603 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
(Increase) Decrease in due from the Central Bank and other banks	( 17,889,648)	14,045,111
Increase in bills purchased, discounts and loans	( 64,784,024)	( 34,082,518)
Increase in long-term stock investments	( 19,796,530)	( 43,382,401)
Proceeds from sale of long-term equity investments	812,220	1,057,663
Acquisition of properties and intangible assets	(985,604)	( 1,411,009 )
Increase in other assets	( 1,132,298 )	( 689,486)
Proceeds from sale of properties	4,072	467,670
Decrease (Increase) in restricted asset	1,179,236	( 3,364,581)
Net cash used in investing activities	( 102,592,576)	( 67,359,551)

(Continued )

## HUA NAN FINANCIAL HOLDINGS CO., LTD. AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2005 AND 2004

(In Thousands of New Taiwan Dollars)

	2005	2004
CASH FLOWS FROM FINANCING ACTIVITIES		
Decrease in short-term borrowings	\$( 884,354)	\$( 1,002,773)
Decrease increase in due to the Central Bank and other banks	( 6,986,850 )	( 21,708,655)
Increase in deposits and remittances	72,065,835	83,061,389
Increase in bank debentures payable	2,363,000	10,000,000
Decrease in funds borrowed from the Central Bank and other banks	-	-
Payment of cash dividends	( 3,907,440)	( 945,700)
Remuneration and bonuses paid to directors, supervisors and employees	( 690,966)	( 604,640)
(Decrease)Increase in other liabilities	( 1,479,007)	357,072
Net cash provided by financing activities	60,480,218	69,156,693
EFFECT ON SUBSIDIARIES*¶ INITIAL CONSOLIDATION	1,426,894	-
INCREASE(DECREASE) IN CASH AND CASH EQUIVALENTS	14,123,267	( 3,641,461)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	30,236,716	33,878,177
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 44,359,983	\$ 30,236,716
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	\$ 19,616,510	\$ 15,259,441
Income tax paid	\$ 1,234,648	\$ 1,022,534

# Statement of Internal Control

## Statement of Internal Controls for Hua Nan Financial Holdings Co., Ltd.

We represent Hua Nan Financial Holdings Co., Ltd in declaring that HNFHC has established an internal controls system and implemented risk management according to the Rules Governing the Establishment of Internal Controls and Auditing Systems for Financial Holding Companies. An independent auditing agency audits the state of implementation and regularly reports to the board of directors and supervisors. After careful screening, it is determined that all units have effectively implemented internal controls and have abided by laws. The content of this statement constitutes important information in HNFHC's annual report and prospectus, and is public information. Any inaccuracies, concealed information or other legal infractions are subject to judicial action under Articles 20, 32, 171 and 174 of the Securities Exchange Law.

To

Financial Supervisory Commission

Chairman:



President:



Chief Auditor:



Director of Internal Control:



April 24, 2006



## HUA NAN FINANCIAL HOLDINGS CO., LTD.

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