NEIMAN MARCUS GROUP INC
Form 424B3
February 11, 2008

PROSPECTUS SUPPLEMENT **Filed Pursuant to Rule 424(b)(3)**
(To Prospectus dated October 25, 2007) **Registration No. 333-136297**

The Neiman Marcus Group, Inc.

7.125% Senior Debentures due 2028

This prospectus supplement updates and supplements The Neiman Marcus Group, Inc. s Prospectus dated October 25, 2007.

You should carefully consider the risk factors beginning on page 5 of the Prospectus before investing.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

This prospectus will be used by Credit Suisse Securities (USA) LLC in connection with offers and sales in market-making transactions at certain negotiated prices related to prevailing market prices. Credit Suisse Securities (USA) LLC has advised us that it is currently making a market in the securities; however, it is not obligated to do so and may stop at any time. Credit Suisse Securities (USA) LLC may act as principal or agent in any such transaction. We will not receive the proceeds of the sale of the securities but will bear the expenses of registration. See Plan of Distribution in the Prospectus.

Credit Suisse

February 11, 2008

INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

We have incorporated by reference into this prospectus certain information that our Parent files with the SEC. This means that we can disclose important business, financial and other information in the prospectus by referring you to the documents containing this information. All information incorporated by reference is deemed to be part of this prospectus, unless and until that information is updated and superseded by the information contained in this prospectus or any information filed with the SEC and incorporated later.

We incorporate by reference:

- our Parent s Annual Report on Form 10-K for the fiscal year ended July 28, 2007, as filed with the SEC on September 26, 2007;

- our Parent s Quarterly Report on Form 10-Q for the period ended October 27, 2007; and

- our Parent s Current Report on Form 8-K dated February 7, 2008.

We will provide without charge to each person, including any beneficial owner, to whom a copy of this prospectus is delivered, upon the written or oral request of such person, a copy of our Parent s Annual Report on Form 10-K, our Parent s Quarterly Report on Form 10-Q and our Parent s Current Report on Form 8-K. Requests should be directed to:

Nelson A. Bangs, Esq.

The Neiman Marcus Group, Inc.

One Marcus Square, 1618 Main Street

Dallas, Texas 75201

Telephone: (214) 741 6911

The documents listed above which have been incorporated into this prospectus are also available through our website at http://www.neimanmarcusgroup.com. The information found on our website is not incorporated into or part of this prospectus.

s New Roman" SIZE="2"> 11

Order backlog

10

Goodwill

138

Negative Goodwill

(2)

Other assets

42 55

Total assets acquired

2,041 1,494

Amounts payable to banks and long-term debt due within one year

(31)

Trade notes and accounts payable

(510) (482)

Other current liabilities

(224) (82)

Long-term debt

(181) (8)

Other liabilities

(29) (2)

Total liabilities assumed

(975) (574)

Net assets acquired

$1,066 $920

Goodwill of NT$130 million and NT$8 million were assigned to the other segment and the ILD segment, respectively. The negative goodwill was recorded in other income (expenses), net.

The allocation of the purchase price is based on preliminary data performed by a third-party valuation firm and may be subject revision. The subsequent revisions, if any, are not expected to be material.

10. PROPERTY, PLANT AND EQUIPMENT, NET

	December 31	
	2006	**2007**
	NT$	**NT$**
Cost		
Land	$ 42,483	$ 43,140
Buildings and improvements	59,259	62,939
Telecommunications equipment	629,451	639,094
Miscellaneous equipment	26,666	22,804
	757,859	767,977
Accumulated depreciation		
Buildings and improvements	14,268	15,303
Telecommunications equipment	468,325	486,252
Miscellaneous equipment	21,329	17,706
	503,922	519,261
Construction in progress	23,462	16,451
Advances related to acquisition of equipment	27	16
Property, plant and equipment, net	$ 277,426	$ 265,183

Table of Contents

Interest expense was capitalized for the years ended December 31, 2005, 2006 and 2007 was nil, nil and NT$1 million, respectively. The capitalized interest rate was 2.850-3.215% for the year ended December 31, 2007.

11. ACCRUED EXPENSES

	December 31	
	2006	2007
	NT$	NT$
Accrued compensation	$ 12,995	$ 11,070
Accrued franchise fees	2,413	2,159
Other accrued expenses	4,529	3,356
	$ 19,937	$ 16,585

12. OTHER CURRENT LIABILITIES

	December 31	
	2006	2007
	NT$	NT$
Amounts collected from subscribers on behalf of other telecommunications companies and carriers	$ 3,364	$ 2,834
Payable to equipment suppliers	1,661	1,826
Payables to construction suppliers	1,073	1,066
Other	3,246	3,938
	$ 9,344	$ 9,664

13. SHORT-TERM LOANS

	December 31	
	2006	2007
	NT$	NT$
Bank loans annual rate 2.955% and 2.850% for 2006 and 2007, respectively	$ 126	$ 36

14. LONG-TERM LOANS (INCLUDING CURRENT PORTION OF LONG-TERM LOANS)

	December 31	
	2006	2007
	NT$	NT$
Loan from the Fixed-Line Fund	$ 300	$
Bank loans annual rate 3.050% and 2.794% for 2006 and 2007, respectively	23	20
	323	20

Less: Current portion of long-term loans	323	20
	$	$

The loan from the Fixed-Line Fund was obtained pursuant to a long-term loan agreement with the Fixed-Line Fund managed by the Ministry of Interior that allows the Company to obtain unsecured interest-free credit up to the original amount contributed to the fund. The outstanding principal is carried at its undiscounted amount and is payable in three annual installments (NT$200 million, NT$200 million and NT$300 million) starting on March 12, 2005 until March 12, 2007. The Company remaining balance was repaid in March 2007.

Table of Contents

SENAO obtained an unsecured loans from Industrial Bank of Taiwan. Interest and principal are payable semiannually and the loan is due by May 4, 2008.

CHIEF obtained a secured loan from Chinatrust Commercial Bank. Interest and principal were payable monthly and the secured loan was due on November 18, 2007.

15. STOCKHOLDERS EQUITY

Under Chunghwa s Articles of Incorporation, Chunghwa s authorized capital is $120,000,000,020. Chunghwa s Articles of Incorporation and the Republic of China Telecommunications Act provide that the MOTC has the right to purchase two redeemable preferred shares at NT$10 (par value) in the event its ownership of Chunghwa falls below 50% of the outstanding common shares. On March 28, 2006, the board of directors approved the issuance of the 2 preferred shares, and the MOTC purchased the 2 preferred shares at par value on April 4, 2006.

The MOTC, as the holder of those preferred shares is entitled to the same rights as holders of common shares and certain additional rights as specified in Chunghwa s Articles of Incorporation as follows:

a. The holder of the preferred shares, or its nominated representative, will act as a director and/or supervisor during the entire period in which the preferred shares are outstanding.

b. The holder of preferred shares has the same pre-emptive rights as holders of common shares when Chunghwa raises capital by issuing new shares.

c. The holder of the preferred shares will have the right to veto on any change in the name of Chunghwa or the nature of its business and any transfer of a substantial portion of Chunghwa s business or property.

d. The holder of the preferred shares may not transfer the ownership. Chunghwa must redeem all outstanding preferred shares within three years from the date of their issuance.

As the preferred shares are mandatory redeemable in 2009, the shares are classified as other long-term liabilities. The redemption value of preferred shares is NT$20.

For the purpose of privatizing Chunghwa, the MOTC sold 1,109,750 thousand common shares of Chunghwa in an international offering of securities in the form of ADS amounting to 110,975 thousand units (one ADS represents ten common shares) on the New York Stock Exchange on July 17, 2003. Subsequently, the MOTC sold 1,350,682 thousand common shares in the form of ADS amounting to 135,068 thousand units on August 10, 2005. Afterwards, the MOTC and Taiwan Mobile Co., Ltd. sold 505,389 thousand and 58,959 thousand common shares of Chunghwa, respectively, to third parties in the form of ADS amounting to 56,435 thousand units in total on October 4, 2006. As of December 31, 2006, the MOTC and Taiwan Mobile Co., Ltd. have sold 3,024,780 thousand common shares in the form of ADS amounting to 302,478 thousand units.

The ADS holders generally have the same rights and obligations as other common stockholders, subject to the provision of relevant laws. The exercise of such rights and obligations shall comply with the related regulations and deposit agreement, which stipulate, among other things, that ADS holders can, through deposit agents, exercise their voting rights, sell their ADSs, and receive dividends declared and subscribe to the issuance of new shares.

As of December 31, 2006 and 2007, the outstanding ADSs were 307,399 thousand units and 281,030 thousand units (including stock dividends), which equaled approximately 3,073,988 thousand and 2,810,302 thousand common shares and represented 31.8% and 29.07% of Chunghwa s total outstanding common shares, respectively.

Under the ROC Company Law, additional paid-in capital may only be utilized to offset deficits For those companies having no deficits, additional paid-in capital arising from capital surplus can be used to increase

Table of Contents

capital stock and distribute to stockholders in proportion to their ownership at the ex-dividend date. Also, such amounts can only be declared as a stock dividend by Chunghwa at an amount calculated in accordance with the provisions of existing regulations.

In addition, before distributing a dividend or making any other distribution to stockholders, Chunghwa must pay all outstanding taxes, recover any past losses and set aside a legal reserve equal to 10% of its net income, and depending on its business needs or requirements, may also set aside a special reserve. In accordance with the Articles of Incorporation, no less than 50% of the earnings comprising remaining balance of net income, if any, plus cumulative undistributed earnings, shall be distributed in the following:

a. From 2% to 5% of distributable earnings shall be distributed to employees as employee bonus.

b. No more than 0.2% of distributable earnings shall be distributed to board of directors and supervisors as remuneration in the following years after privatization.

c. Cash dividends to be distributed shall not be less than 50% of the total amount of dividends to be distributed.

During the year of privatization, the distributable earnings are limited to the earnings generated after privatization. The remaining distributable earnings can be distributed to the stockholders based on the resolution of stockholders meeting.

If cash dividends to be distributed is less than NT$0.10 per share, such cash dividend shall be distributed in the form of common shares.

Under the ROC Company Law, the appropriation for legal reserve shall be made until the accumulated reserve equals the aggregate par value of the outstanding capital stock of Chunghwa. This reserve can only be used to offset a deficit, or when reaching 50% of the aggregate par value of the outstanding capital stock of Chunghwa, up to 50% of the reserve may, at the option of Chunghwa, be declared as a stock dividend and transferred to capital.

The appropriations and distributions of the 2005 and 2006 earnings of Chunghwa have been approved and resolved by the stockholders on May 30, 2006 and June 15, 2007, respectively, as follows:

	2005 NT$	2006 NT$
Legal reserve	$ 4,765	$ 3,998
Special reserve		(1)
Cash dividends NT$4.3 and NT$3.58 per share for 2005 and 2006, respectively	40,660	34,611
Stock dividends NT$0.2 per share for 2005	1,891	
Employee bonus cash	230	1,257
Employee bonus stock (at par value)	230	
Remuneration to board of directors and supervisors	15	36
	$ 47,791	$ 39,901

The distribution of stock dividends in 2006 from earnings recorded in 2005 was less than 25% of the numbers of shares previously outstanding and was accounted for as a transfer between retained earnings, capital stock and additional paid-in capital of NT$11,347 million, NT$1,891 million and NT$ 9,456 million, respectively, at the fair value of the shares on the date of the dividend declaration.

The amount of compensation expense related to employee stock bonus is determined based on the market value of the Company s common stock at the grant date. For the year ended December 31, 2006, the compensation expense related to employee stock bonus was NT$1,151 million in addition to NT$230 million which had been recognized in prior year.

F-24

Table of Contents

The stockholders, at the stockholders meeting held on June 15, 2007, also resolved to reduce the amount of capital in the Company by a cash distribution to its stockholders in order to improve the financial condition of the Company and better utilize its excess funds. The capital reduction plan was effected by a transfer of capital surplus in the amount of NT$9,668 million to common capital stock. Subsequently, common capital stock was reduced by NT$9,668 million and a liability for the actual amount of cash to be distributed to stockholders of NT$9,588 million was recorded. The difference between the reduction in common capital stock and the distribution amount represents treasury stock of NT$110 million held by the Company and concurrently cancelled. Such cash payment to stockholders was made on January 9, 2008.

16. TREASURY STOCK (COMMON STOCK IN THOUSANDS OF SHARES)

	Year Ended December 31	
	2006 Shares	**2007 Shares**
Balance, beginning of year		
Increase	192,000	121,075
Decrease	192,000	11,007
Balance, end of year		110,068

In order to effect the capital reduction plan discussed in Note 15, above, Chunghwa repurchased 121,075 million outstanding shares for NT$7,217 million from August 29, 2007 to October 25, 2007. On December 29, 2007, Chunghwa cancelled 11,007 thousand shares of treasury stock by reducing common stock by NT$110 million. In 2006, Chunghwa repurchased 192,000 million shares from February 10, 2006 to April 7, 2006 for NT$11,392 million. On June 30, 2006, Chunghwa cancelled the treasury stock by reducing common stock by NT$1,920 million, capital surplus by NT$4,269 million and retained earnings by NT$5,203 million.

17. SHARE-BASED COMPENSATION

The MOTC provided employees of Chunghwa with two stock purchase plans: The market discount plan and the par value plan.

Market discount plan under the market discount plan, the MOTC sold shares of stock at discounted prices to employees at various times from October 2000 to September 2005. The employees purchased the common shares at discounts of 10% and 20% and 50% from the quoted market price in consideration for their commitment to hold the common shares for two, three and four years (the holding periods), respectively. The common shares are held by an escrow agent on behalf of the employees/stockholders. There are no circumstances under which the MOTC or Chunghwa would be required to repurchase these common shares. Also, the employees are not required to remain employed with Chunghwa during the duration of the holding periods. Chunghwa recognized NT$12,542 million as compensation expense for the discounted shares purchased by employees for the year ended December 31, 2005. There were no market discount plan offerings during the years ended December 31, 2006 and 2007.

Par value plan under the par value plan, the MOTC sold shares of stock to employees at par value (NT$10). The difference between the market price of the stock on the offering dates and the par value was recognized as compensation expense. The total shares sold to employees by the MOTC for the year ended December 31, 2006 and 2007 were 10,411,955 shares and zero shares, respectively. The MOTC received total proceeds of NT$104 million and nil for the years ended December 31, 2006 and 2007, respectively, from these sales.

Chunghwa recognized NT$228 million, NT$503 million and nil as compensation expense for the discounted shares purchased by employees under the par value plan for the years ended December 31, 2005, 2006 and 2007, respectively.

Table of Contents

SENAO has several employee stock option plans (SENAO Plans) which has graded vesting schedule for which 50% of option granted will vest two years after the grant date and another two tranches of 25% will vest three and four years after the grant date respectively. The SENAO Plans have exercise price adjustment formula upon the issuance of new common shares, capitalization of retained earnings and/or capital reserves, stock split, except (i) in the case of issuance of new shares in connection with mergers and in the case of cancellation of outstanding shares in connection with capital reduction, and (ii) except if the exercise price after adjustment exceeds the exercise price before adjustment.

Information about SENAO s stock option activity and related information is as follows:

Stock Options Under the 2003 to 2007 Plan	Number of Options Shares (in Thousands)	Weighted Average Exercise Price (NT$)	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (NT$ in Million)
Outstanding at January 1, 2007	16,488	$ 14.66	3.114	$ 200
Options granted	6,181	44.20		
Options exercised	(3,419)	13.31		110
Options forfeited	(658)	15.30		
Outstanding at December 31, 2007	18,592	24.70	2.997	288
Exercisable at December 31, 2007	1,053	15.29	1.100	26

The weighted-average grant-date fair value of stock options granted during the year ended December 31, 2007 was NT$15.60.

As of December 31, 2007, information about SENAO s outstanding and exercisable options were as follows:

Range of Exercise Price (NT$)	Options Outstanding			Options Exercisable	
	Number of Options (Thousand)	Weighted-Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (NT$)	Number of Options (Thousand)	Weighted Average Exercise Price (NT$)
$10.5-$15.7	10,945	2.45	$ 14.69	310	$ 10.50
$17.1-$20.8	1,466	1.62	17.23	743	17.29
$44.2	6,181	4.29	44.20		
	18,592	3.00	24.70	1,053	15.29

During the year ended December 31, 2007, the Company recognized approximately NT$14 million of stock-based compensation expense which is included in the Company s results of operations. As of December 31, 2007, total unrecognized compensation expense related to stock options granted is NT$70 million. The unrecognized compensation expense as of December 31, 2007 is expected to be recognized over the next 4.29 years.

The aggregate intrinsic value in the table above represents the total intrinsic value (the difference between the Company s closing stock price on the last trading day of fiscal year 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2007. Intrinsic value will change in future periods based on the fair market value of the Company s stock and the number of shares outstanding.

Table of Contents

The 2007 compensation expense was determined by calculating the fair value of each option grant using the Black-Scholes option-pricing mode. SENAO used the following weighted-average assumptions in calculating the fair value of the options granted:

	December 31, 2007
Expected dividend yield	
Expected volatility	39.63%-53.07%
Risk free interest rate	1.75%-2.00%
Expected life	4.375 years

Risk-free interest rate is based on the rate of the Taiwan government bonds in effect at the time of grant. Expected volatilities are based on historical volatilities of stock prices of the similar company in the same industry and SENAO. Expected life represents the periods that SENAO s share-based awards are expected to be outstanding and was determined based on historical experience regarding similar awards, giving consideration to the contractual term of the share-based awards. The dividend yield is zero as share-based awards agreeing on that the price will be adjusted when SENAO pays dividends.

18. PENSION PLAN

At the time of its incorporation on July 1, 1996, Chunghwa continued the existing two noncontributory defined benefit pension plans covering all its employees, as previously adopted by the DGT. The first plan (hereinafter referred to as Plan A) covered civil service eligible employees (i.e., employees who meet the necessary qualifications set by the ROC Government) and the second plan (hereinafter referred to as Plan B) covered all other employees of Chunghwa (hereinafter referred to as non-civil service eligible employees). The adoption of two pension plans was necessary as different pension laws apply to civil service eligible and non-civil service eligible employees.

Plan A provided benefits equal to the sum of: (a) the lump-sum payment equivalent to one benefit unit per year for the first twenty service years rendered and one-half benefit unit per service year rendered thereafter, with one benefit unit equivalent to a portion of the salary of the employee at the time of retirement (referred to hereinafter as pensionable salary), and (b) annuity payments payable monthly equivalent to a certain percentage of the benefit unit. Plan B provided benefits equal to the lesser of: (a) forty-five benefit units, or (b) two benefit units per service year rendered for the first fifteen years, and one-half benefit unit per service year exceeding fifteen years rendered before August 1, 1984 and one benefit unit per service year for services rendered after August 1, 1984, with one benefit unit equivalent to the monthly average base salary (consisting of regular salary items plus overtime salary). Plan A was funded based on amounts included in budgets approved by the Legislative Yuan and supplementary budgets approved by the Executive Yuan while Plan B was funded by Chunghwa at an amount equivalent to 2% to 15% of the monthly salary.

Chunghwa adopted SFAS No. 87 on July 1, 1996 (adoption date), the date of its incorporation. The unrecognized net transition obligation recorded to stockholders equity on July 1, 1996 was NT$6,571 million which represents the difference in the net pension cost for the period from the issuance of SFAS No. 87 and the date of adoption. The remaining unrecognized net transition obligation of NT$16,790 million is amortized over the estimated remaining service period of the employees as determined on July 1, 1996, which is a period of twenty-five years for civil service eligible employees and seventeen years for non-civil service eligible employees.

As required by the ROC Government for state-owned enterprises instructed to undergo privatization plans effective on the privatization date, except for those employees who reached the mandatory retirement age (the age of 65 for Plan A participants and age 60 for Plan B participants) by that day, employees received pension benefit payments calculated in accordance with the Guidelines on Payments of Severance Benefits to Employees of State-Owned Enterprises (Guidelines).

Table of Contents

Under the Guidelines, on the privatization date, settlement benefit payments were distributed to both Plan A and Plan B participants as follows: (a) employees who voluntarily left Chunghwa on the privatization date (hereinafter referred to as separated employees) received a service clearance payment which is calculated similar to the benefit formula under the original Plan B as mentioned above plus an additional six-month salary and one-month advance notice pay (hereinafter referred to as the additional separation payments); and (b) employees who opted to remain with the privatized company after the privatization date (hereinafter referred to as privatized company employees) would receive an amount equivalent to those received by the separated employees without the additional separation payments. Privatized company employees who are involuntarily terminated by Chunghwa within five years from the date of privatization (hereinafter referred to as redundant employees) will receive redundancy benefits equivalent to the pension amount as computed based on one benefit unit for every year of service after privatization plus the additional separation payments (hereinafter referred to as redundancy benefit payments). The six-month portion of the additional separation payments was paid by the MOTC. The accrued pension amount after privatization and the one-month advance notice pay were paid by Chunghwa.

The unrecognized prior service costs, which amounted to NT$30,018 million, related to the increased benefits provided under the Guidelines described in the preceding paragraph were amortized through June 30, 2001. The unrecognized prior service costs excluded any costs expected to be incurred for the additional separation payments or redundancy benefit payments. The additional separation payments under the Guidelines were accounted for as special termination benefits and were recognized in the period when the employee accepted the offer while the redundancy benefit payments will be recognized in the period management approves a plan of termination.

In order to increase operational efficiency, Chunghwa approved a Special Retirement Incentive Program (Program A). Program A allowed eligible employees who voluntarily left Chunghwa on February 1, 2005 to receive benefit payments based on the respective original plan (meaning Plan A or Plan B) plus the additional separation payments. The present value of such amount over and above the lump sum amount was NT$821 million and was accounted for as special termination benefits in the statement of income for the year ended December 31, 2005. A portion of the Program A benefits amounting to NT$243 million were recognized in 2004 when employees formally accepted the terms of Program A.

In order to provide employees with additional consideration, Chunghwa approved another Special Retirement Incentive Program (Program B) in May 2005. Program B allowed eligible employees who voluntarily left Chunghwa on August 11, 2005, the day before privatization, to also receive benefit payments based on the respective original plan (meaning Plan A or Plan B) plus the additional separation payments. The present value of such amount over and above the lump sum amount was NT$1,325 million and was accounted for as special termination benefits in the statement of income for the year ended December 31, 2005.

Chunghwa also approved another Special Retirement Incentive Program (Program C) in December 2005. Program C allowed eligible employees who voluntarily applied to leave Chunghwa from March 1 to March 31, 2006 to also receive benefit payments based on the respective original plan plus the additional separation payments. The approval procedure took up to 15 days after applications were submitted therefore, if employees applied for the voluntary retirement on March 31, 2006, they were eligible to retire from Chunghwa on or before April 14, 2006. The present value of such amount over and above the lump sum amount that would have been paid to the eligible employees was accounted for as special termination benefits. Accordingly, such benefits were recognized as a liability and charged to income when employees formally accepted the terms of Program C. Chunghwa recognized expense of NT$2,302 million for Program C during 2006. The New Plan B vested benefit obligations for the majority of the employees electing Program C were settled; the remaining employees have accumulated benefits under New Plan B but were not eligible to receive the benefits and the election of Program C terminated their employment earlier than expected, thereby reducing their expected years of future service.

Table of Contents

Afterwards, Chunghwa approved another Special Retirement Incentive Program (Program D) in March 2007. Program D allowed eligible employees who voluntarily applied to leave Chunghwa from April 1 to April 30, 2007 to also receive benefit payments based on the respective original plan plus the additional separation payments. They were eligible to retire from Chunghwa on May 1, 2007. The present value of such amount over and above the lump sum amount that would have been paid to the eligible employees was accounted for as special termination benefits. Accordingly, such benefits were recognized as a liability and charged to income when employees formally accepted the terms of Program D. Chunghwa recognized expense of NT$1,874 million for Program D during 2007. The New Plan B vested benefit obligations for the majority of the employees electing Program D were settled; the remaining employees have accumulated benefits under New Plan B but were not eligible to receive the benefits and the election of Program D terminated their employment earlier than expected, thereby reducing their expected years of future service.

Under applicable ROC regulations, upon the privatization, the obligation related to annuity payments due after the date of privatization for civil serve eligible employees who retire prior to that date would be born by the MOTC. Chunghwa completed its privatization plan on August 12, 2005. On the date of privatization, the MOTC settled all employees past service costs. The portion of the pension obligations that was settled by the MOTC, represented by the difference between the accrued pension liabilities and the deferred pension cost and related deferred income tax assets and was accounted for as contributed capital and recorded in stockholders equity as of August 12, 2005. The non-cash financing activities and related amounts of the pension obligation settlement as of the date of privatization are disclosed on the face of the statement of cash flows.

Upon privatization, the MOTC settled all accrued pension obligations for Plan A and Plan B including service clearance payment, lump sum payment under civil plan, additional separation payments, and other related obligations upon the completion of the privatization in accordance with the Statute Governing Privatization of Stated-Owned Enterprises. After paying all pension obligations for privatization, the plan assets would be transferred to the Fund for Privatization of Government-owned Enterprises (the Privatization Fund) under the Executive Yuan. According to the instructions of MOTC, Chunghwa had been requested to administer the distributions to employees for pension obligations including service clearance payment, lump sum payment under civil service plan, additional separation payments, and other related obligations upon the completion of the privatization on the MOTC s behalf acting as the MOTC s agent merely in an administrative capacity with no rights or duties received or owed for a six-month transition period. In August 2006, Chunghwa transferred the remaining funds to be disbursed to employees to the Privatization Fund.

Upon privatization and settlement of the related obligations, Plan A and Plan B ceased to exist. A new plan (New Plan B), having similar terms and benefits as Plan B, was established and offered to employees. Employees choosing to enter into New Plan B were not credited with any prior service nor did they receive any accumulated benefits from prior service and benefits begin to accrue to them under this plan commencing from the privatization date. The components of net periodic benefit costs before privatization are for both Plan A and Plan B. The effect of privatization relates to both Plan A and Plan B. The amounts of plan assets remaining after privatization and the components of net periodic benefit costs after privatization relate to New Plan B.

Chunghwa s subsidiaries SENAO and CHIEF have their own pension plans, which are similar to New Plan B of Chunghwa.

Table of Contents

Before Privatization

The components of net periodic benefit costs are as follows:

	Period Ended August 12, 2005 NT$
Service cost	$ 1,253
Interest cost	1,232
Expected return on plan assets	(798)
Amortization of unrecognized net transition obligation	575
Amortization of unrecognized net loss	996
Net periodic benefit pension cost	$ 3,258

The changes in benefits obligation and plan assets and the reconciliation of funded status are as follows:

	Period Ended August 12, 2005 NT$
Change in benefits obligation:	
Projected benefits obligation, beginning of year	$ (134,911)
Services cost	(1,253)
Interest cost	(1,232)
Actuarial gain (loss)	2,294
Benefits paid	2,126
Projected benefits obligation, end of period	$ (132,976)

	Period Ended August 12, 2005 NT$
Change in plan assets:	
Fair value of plan assets, beginning of year	$ 85,870
Actual return on plan assets	441
Employer contributions	2,956
Benefits paid	(2,126)
Fair value of plan assets, end of period	$ 87,141
Reconciliation of funded status:	
Funded status	$ (45,835)
Unrecognized net transition obligation	8,237
Unrecognized actuarial loss	26,267
Net amount recognized	$ (11,331)

Table of Contents

The target asset allocations are established through an investment policy established by the Chunghwa Telecom s Employee Pension Fund Committee and agreed to by the Ministry of Finance (MOF). As increased liquidity of the fund is necessary due to the privatization of Chunghwa, the current policy for plan assets is to place funds in time deposit accounts of the financial and postal institutions, non-designated trust funds in an investing company or financial institution and government bonds. In addition, the pension fund may invest in beneficial certificates of equity securities.

Effect of Privatization

	Before Privatization NT$	Effect of Privatization NT$	After Privatization NT$
Projected benefits obligation	$ (132,976)	$ 132,976	$
Plan assets at fair value	87,141	(86,061)	1,080
Funded status	(45,835)	46,915	1,080
Unrecognized net transition obligation	8,237	(8,237)	
Unrecognized net loss	26,267	(26,267)	
Net amount recognized	$ (11,331)	$ 12,411	$ 1,080

The plan assets and net period benefit costs after privatization represent those assets and costs of New Plan B.

After Privatization

The components of net periodic benefit costs of New Plan B for the period from August 13, 2005 through December 31, 2005, and of New Plan B and the pension plan of subsidiaries as of December 31, 2006 and 2007 are as follows:

	Period From August 13 to December 31, 2005 NT$	Year Ended December 31 2006 NT$	Year Ended December 31 2007 NT$
Service cost	$ 1,192	$ 3,073	$ 2,809
Interest cost		59	110
Expected return on plan assets	(14)	(66)	(80)
Amortization of unrecognized net loss		45	6
Curtailment/settlement loss to be recognized		161	191
Net periodic benefit pension cost	$ 1,178	$ 3,272	$ 3,036

Table of Contents

The changes in benefits obligation and plan assets and the reconciliation of funded status for New Plan B and the pension plans of subsidiaries are as follows:

	Period From August 13 to December 31, 2005 NT$	Year Ended December 31 2006 NT$	2007 NT$
Change in benefits obligation:			
Projected benefits obligation, beginning of year	$	$ (1,683)	$ (4,534)
Services cost	(1,192)	(3,073)	(2,810)
Interest cost		(59)	(111)
Curtailment/settlement effect		270	462
Actuarial (loss) gain	(501)	19	310
Benefits paid	10	6	20
Impact on acquisition of subsidiary		(14)	(99)
Projected benefits obligation, end of year	$ (1,683)	$ (4,534)	$ (6,762)
Change in plan assets:			
Fair value of plan assets, beginning of year	$ 1,080	$ 1,637	$ 2,922
Actual return on plan assets	(18)	66	82
Actuarial (loss) gain			(3)
Employer contributions	585	1,544	372
Benefits paid settlement		(326)	(606)
Benefits paid	(10)	(6)	
Impact on acquisition of subsidiary		7	98
Fair value of plan assets, end of year	$ 1,637	$ 2,922	$ 2,865
Reconciliation of funded status			
Funded status	$ (46)	$ (1,612)	$ (3,897)
Unrecognized actuarial loss	504		
Net amount recognized prepaid current asset (accrued pension liability)	$ 458	$ (1,612)	$ (3,897)

	Year Ended December 31 2006 NT$	2007 NT$
Amounts recognized in accumulated other comprehensive income		
Net actuarial loss (gain), pretax	$ 334	$ (380)
Deferred tax asset (liability)	(108)	123
Net impact in accumulated other comprehensive loss	$ 226	$ (257)

Chunghwa, SENAO and CHIEF have defined benefit plans under the Labor Standards Law that provide benefits based on an employee s length of service and average monthly salary for the six-month period prior to retirement. Chunghwa, SENAO and CHIEF contribute in the amounts equal to 2% to 15% of salaries paid each month to their respective pension funds (the Funds), which are administered by the Labor Pension Fund

Supervisory Committee established by the ROC government (the Committee) and deposited in the name of the Committee in the Bank of Taiwan (originally the Central Trust of China, which was merged into the Bank of Taiwan on July 1, 2007). Under the Labor Standards Law, the ROC government is responsible for the administration of the Funds and determination of the investment strategies and policies. As of December 31, 2006 and 2007, the asset allocation was primarily in cash, equity securities and debt securities. Furthermore, under the Labor Standards Law, the rate of return on assets shall not be less than the

Table of Contents

average interest rate on a two-year time deposit published by the local banks. The ROC government is responsible for any shortfall in the event that the rate of return is less than the required rate of return.

As of December 31, 2006 and 2007, the accumulated benefit obligation was NT$5,755 million and NT$3,844 million, respectively.

The amounts recognized in the accompanying balance sheets at December 31, 2006 and 2007 are as follows:

	Year Ended December 31	
	2006 NT$	2007 NT$
Amounts recognized		
Prepaid pension (included in other assets)	$	$ 6
Accrued pension liability	(1,612)	(3,903)
Net amount recognized	$ (1,612)	$ (3,897)

Actuarial assumptions:

	Year Ended December 31		
	2005	2006	2007
Discount rate used in determining present value	2.25%	2.00%	2.50%
Rate of compensation increase all employees	2.00%	1.50-3.00%	1.50-3.50%
Rate of return on plan assets all employees	3.00%	2.75-3.00%	2.75%

The Labor Pension Act of ROC (Act) was effective beginning July 1, 2005 and this pension mechanism was considered as a defined contribution plan. The employees who were subject to the Labor Standards Law prior to the enactment of the Act may choose to be subject to the pension mechanism under the Act or continue to remain subject to the pension mechanism under the Labor Standards Law. For those employees who were subject to the Labor Standards Law prior to July 1, 2005 and still work for the same company after July 1, 2005 and choose to be subject to the pension mechanism under the Act, their seniority as of July 1, 2005 shall be maintained. The rate of contribution by an employer to the Labor Pension Fund per month shall not be less than 6% of each employee s monthly salary or wage. The Company has contributed 6% of each employee s monthly salary per month beginning July 1, 2005. For the year ended December 31, 2006 and 2007, total contributions were NT$67 million and NT$112 million, respectively.

19. INCOME TAXES

The components of income taxes are as follows:

	Year Ended December 31		
	2005 NT$	2006 NT$	2007 NT$
Current	$ 3,044	$ 13,875	$ 14,270
Deferred	9,689	1,406	273
	$ 12,733	$ 15,281	$ 14,543

F-33

Table of Contents

A reconciliation between income tax expense computed by applying the statutory income tax rate of 25% to income before income tax and income tax expense shown in the statements of operations and comprehensive income is as follows:

	Year Ended December 31		
	2005 NT$	2006 NT$	2007 NT$
Income tax expense computed at statutory tax rate	$ 11,508	$ 14,335	$ 15,999
Permanent differences	3,158	149	(63)
Investment tax credits	(1,987)	(3,093)	(2,404)
10% undistributed earning tax	979	3,942	4,324
Prior year adjustment	(5)	(871)	(3,865)
Other	(920)	819	552
Income tax expense	$ 12,733	$ 15,281	$ 14,543

The balance of income tax payable as of December 31, 2006 and 2007 was shown net of prepaid income tax.

Permanent differences consist primarily of tax-exempt income from the sale of available-for-sale securities and employees stock compensation expense.

Deferred income taxes arise due to temporary differences in the book and tax bases of certain assets and liabilities. Significant components of deferred income tax assets are shown in the following table:

	December 31	
	2006 NT$	2007 NT$
Current:		
Deferred income	$ 1,227	$ 1,166
Other, net	84	299
	1,311	1,465
Non-current:		
Deferred income	2,837	1,733
Accrued pension costs	390	1,089
Effect on application of SFAS No. 158	108	
Other	192	185
	3,527	3,007
Less valuation allowance	110	83
	$ 4,728	$ 4,389

Upon the completion of the privatization, a significant portion of the deferred income tax assets related to accrued pension costs was reversed due to the settlement of the related pension obligations.

The above deferred income tax assets were computed based on a tax rate of 25%. In addition, the basis of 10% undistributed earnings tax was amended from tax-basis undistributed earnings to book-basis undistributed earnings in May 2006 and June 2007, respectively. As such, the tax rate applied to temporary difference has been changed.

20. TRANSACTIONS WITH RELATED PARTIES

The Company was a state-owned enterprise, the ROC Government is one of the Company s customers. The Company provides fixed-line services, wireless services, Internet and data and other services to the various departments and agencies of the ROC Government and other state-owned enterprises in the normal course

Table of Contents

of business and at arm s-length prices. The information on service revenues from government bodies and related organizations have not been provided because details of the type of users were not maintained by the Company. The Company believes that all costs of doing business are reflected in the financial statements and that no additional expenditures would be incurred as a result of the privatization being completed.

a. The Company engages in business transactions with the following related parties:

Company	Relationship
Senao International Co., Ltd. (SENAO)	Equity-accounted investee before the Company has control over SENAO on April 12, 2007
Chunghwa Investment Co., Ltd. (CHI)	Equity-accounted investee
Taiwan International Standard Electronics Ltd. (TISE)	Equity-accounted investee
Spring House Entertainment Inc.(SHE)	Equity-accounted investee
ELTA Technology Co., Ltd. (ELTA)	Equity-accounted investee
Skysoft Co., Ltd. (SKYSOFT)	Equity-accounted investee
Chunghwa Precision Test Technical Co., Ltd (CHPT)	Subsidiary of CHI
Chunghwa Investment Holding Company (CIHC)	Subsidiary of CHI
Chunghwa System Integration Co., Ltd. (CHSI)	Subsidiary of CHI prior to acquisition
Chunghwa Telecom Global, Inc. (CHTG)	Subsidiary of CHI prior to acquisition
Donghwa Telecom Co., Ltd. (DHT)	Subsidiary of CHI prior to acquisition
Tai Zhong He	Former chairman of CHIEF, a current member of the board of directors of CHIEF
Senao Networks, Inc. (SNI)	Subsidiary of SENAO before May 23, 2007
SENAO Technology Education Foundation (STEF)	A nonprofit organization of which the funds donated by SENAO exceeds one third of its total funds
Paul Lin	Vice chairman and general manager of SENAO
Senao International Miami Inc. (SIM)	Chairman of SIM is the vice chairman and general manager of SENAO
Senora Trading Company (STC)	Chairman of STC and SENAO s vice chairman and general manager are immediate family

Table of Contents

b. Significant transactions with the above related parties are summarized as follows:

	December 31	
	2006 NT$	2007 NT$
1) Receivables		
Trade notes and accounts receivable		
SNI	$	$ 2
CHTG	44	
Others		3
	$ 44	$ 5
2) Payables		
Trade notes payable, accounts payable, and accrued expenses		
TISE	$ 294	$ 141
CHSI	193	
CHTG	37	
Others		9
	$ 524	$ 150
Payable to construction supplier (included in other current liabilities)		
TISE	$ 345	$ 191
CHSI	13	
	$ 358	$ 191
Amounts collected in trust for others (included in other current liabilities)		
Others	$	$ 2
3) Other payables (included in other current liabilities)		
Tai, Zhong He	$ 20	$
4) Revenues		
STC	$	$ 135
CHTG	95	89
SENAO		32
Others	14	115
	$ 109	$ 371
5) Cost of revenues		
SENAO	$	$ 1,175
CHSI	306	441
TISE	374	388
ELTA		98
CHTG	101	64
STC		36
Others		37

	$ 781	$ 2,239
6) Acquisition of equipment		
TISE	$ 920	$ 948
CHSI	283	578
Others	1	44
	$ 1,204	$ 1,570
7) Payments for acquisitions of investments		
CHI	$	$ 909
CIHC		11
	$	$ 920

Table of Contents

The Company acquired all of the shares of CHSI and CHTG from CHI in December 2007, for a total purchase price of NT$909 million cash. The Company also acquired all of the shares of DHT from CIHC, for a total purchase price of NT$11 million cash.

The foregoing terms were conducted as arm s length transactions except for other payable to Tai, Zhong He. In 2005, CHIEF agreed to provide compensation to Tai, Zhong He for providing assets that were pledged as collateral in connection with a financing arrangement during the period from 2002 to 2005. The total compensation payable to Tai, Zhong He for this pledge was NT$20 million. The amount was based on the number of days that the pledged assets were used by CHIEF as collateral and was calculated at an interest rate below 5%. CHIEF had paid NT$20 million to Tai, Zhong He in September 2007.

The above transactions between the Company and SENAO occurred prior to the Company obtaining control over SENAO on April 12, 2007. The above transactions between the Company and CHSI, CHTG and DHT occurred prior to the Company obtaining control over CHSI, CHTG and DHT on December 20, 2007. After such dates, such transactions were eliminated upon consolidation.

SENAO rents a building from Paul Lin for retail sales and service centers. The rent is paid monthly.

21. COMMITMENTS AND CONTINGENCIES

As of December 31, 2007, the Company has commitments under non-cancelable contracts with various parties as follows: (a) acquisitions of land and buildings of NT$1,203 million, and (b) acquisitions of telecommunications equipment of NT$12,423 million.

The Company also has non-cancelable operating leases covering certain buildings, computers, computer peripheral equipment and operating system software under contracts that expire in various years. Minimum rental commitments under those leases are as follows:

	December 31, 2007 NT$
Within the following year	$ 1,413
During the second year	1,130
During the third year	654
During the fourth year	373
During the fifth year and thereafter	220
	$ 3,790

As of December 31, 2007, the Company had unused letters of credit of NT$1,624 million.

As a part of the government s effort to upgrade the existing telecommunication infrastructures, the Company and other public utility companies were required by the ROC government to contribute a total of NT$4,500 million to funds called the Fixed-Line Fund and the Piping Fund (collectively referred to as the funds). Under the Fixed-Line Fund, the Company contributed NT$1,000 million to the fund, administered by the ROC Ministry of Interior Affair, on June 30, 1995. Under the Piping Fund, the Company contributed NT$1,000 million to the fund, administered by the Taipei City Government, on August 15, 1996. Both contributions were accounted for by the Company as other assets other on the Company s balance sheets.

Through the use of the Funds, the governmental agencies will construct new underground fixed-lines and conduits and perform on-going maintenance operations. Currently, a portion of the fixed-lines and conduits are constructed and ready to be used. If the contributions to the funds were not sufficient to finance the construction of the new underground fixed lines and conduits, the contributors to the Funds and the governmental agencies will determine if and when to raise additional funds and the amounts of such contributions from each party.

Table of Contents

In August 2007, ROC government decided to dissolve the Fixed-Line Fund and would refund money to the contributors within one year; therefore, the Company reclassified the Fixed-Line Fund from other assets- other to other current assets. The Company received the full amount of its original contribution of NT$1,000 million on January 11, 2008.

For Piping Fund, the Company understands that if the project is considered no longer be necessary by the ROC government, the Company will receive back its proportionate share of the net equity of the fund upon dissolution of the fund. No expiration or dissolution date is specified in the related documents.

22. SUBSEQUENT EVENTS

On January 17, 2008, the Company acquired an additional 26% shares of Spring House Entertainment Inc. (SHE) amounting to 3,980 thousand common shares for a total purchase price of NT$40 million cash. Due to this acquisition, the Company increased its ownership of SHE from 30% to 56% and obtained control of SHE; therefore, the Company consolidates the accounts of SHE and its subsidiaries from that date.

In January 2008, the Company acquired 33.4% shares of KingWay Technology Co., Ltd. (KWT) amounting to 1,002 thousand common shares for a total purchase price of NT$70 million cash. KWT engages mainly in publishing books, data processing and software services.

In February 2008, the Company established Light Era Development Co., Ltd. (LED) as a wholly-owned subsidiary by paying NT$3,000 million cash. LED engages mainly in housing, office building development, rent and sale services.

In January 2008, the Company invested 16.67% shares of Industrial Bank of Taiwan II Venture Capital Co., Ltd. (IBT II) by paying NT$200 million cash. IBT II is an in investment company.

In January 2008, the Company invested NT$30 million cash in Taiwan Goal Co., Ltd. (TG). TG was established to perform import and export activities for machine wholesale, arms and ammunition products. On March 17, 2008, the shareholders of TG resolved to dissolve TG at a special meeting. The Company will receive back its original investment on proportionate share of the net equity of TG after TG completes its liquidation procedure.

23. LITIGATION

A portion of the land used by the Company during the period July 1, 1996 to December 31, 2004 was co-owned by the Company and Taiwan Post Co., Ltd. (the former Chunghwa Post Co., Ltd., Directorate General of Postal Service). In accordance with the claims process in Taiwan, on July 12, 2005, the Taiwan Taipei District Court sent a claim notice to the Company to reimburse Taiwan Post Co., Ltd. in the amount of $768 million for land usage compensation due to the portion of land usage area in excess of the Company s ownership, along with interest calculated at 5% interest rate from June 30, 2005 to the payment date. However, the Company believes that the computation used to derive the land usage compensation amount is inaccurate because most of the compensation amount has expired as result of the expiration clause. Therefore, the Company has filed an appeal at the Taiwan Taipei District court. As of March 18, 2008, the case is still in the procedure of the first instance at the Taiwan Taipei District Court. While the Company cannot make any assurance regarding the eventual resolution of the litigation, the Company does not believe the final outcome will have a material adverse effect on its results of operations or financial condition. As of December 31, 2007, no provision was provided for the litigation.

The Company is involved in various legal proceedings of a nature considered normal to its business. It is the Company s policy to accrue for amounts related to these legal matters when it is probable that a liability has been incurred and the amount is reasonably estimable.

The Company believes that the various asserted claims and litigation in which it is involved will not materially affect its financial position, future operating results or cash flows, although no assurance can be given with respect to the ultimate outcome of any such claim or litigation.

Table of Contents

24. INFORMATION ON FINANCIAL INSTRUMENTS

a. Derivative financial instruments

The Company entered into forward exchange contracts and index future contracts and currency options to reduce its exposure to foreign currency risk and variability in operating results due to fluctuations in exchange rates and in stock prices for the years ended December 31, 2006 and 2007. Net losses arising from derivative financial instruments for the year ended December 31, 2006 and 2007 were NT$52 million (including realized settlement losses of NT$32 million and valuation losses of NT$20 million) and NT$856 million (including realized settlement losses of NT$271 million and valuation losses of NT$585 million), respectively.

Outstanding forward exchange contracts on December 31, 2006 and 2007 were as follows:

	Currency	Maturity Period	Contract Amount (in Million)	
December 31, 2006				
Sell	JPY/USD	2007.01	JPY	490
	EUR/USD	2007.01	EUR	7
	GBP/USD	2007.01	GBP	2
December 31, 2007				
Sell	EUR/USD	2008.02	EUR	19
	JPY/USD	2008.02	JPY	590
	GBP/USD	2008.02	GBP	2
	USD/NTD	2008.01-03	USD	450
	EUR/NTD	2008.02-03	EUR	80
	NTD/USD	2008.01	NTD	324
Buy	NTD/USD	2008.01	NTD	65

Outstanding index future contracts on December 31, 2006 and 2007 were as follows:

	Maturity Date	Units	Contract Amount (in Million)	
December 31, 2006				
Index future contracts				
AMSTERDAM IDX FUT	2007.01	8	EUR	1
CAC40 10 EURO FUT	2007.01	45	EUR	2
DAX INDEX FUTURE	2007.03	11	EUR	2
IBEX 35 INDEX FUTR	2007.01	7	EUR	1
MINI S&P/MIB FUT	2007.03	23	EUR	1
FTSE 100 IDX FUT	2007.03	33	GBP	2
TOPIX INDEX FUTURE	2007.03	32	JPY	513
S&P 500 FUTURE	2007.03	23	USD	8
S&P 500 EMINI FUTURE	2007.03	13	USD	1
December 31, 2007				
Index future contracts				
AMSTERDAM IDX FUT	2008.01	14	EUR	1
CAC40 10 EURO FUT	2008.01	17	EUR	1
DAX INDEX FUTURE	2008.03	1	EUR	
IBEX 35 INDEX FUTR	2008.01	7	EUR	1
MINI S&P/MIB FUT	2008.03	35	EUR	1

FTSE 100 IDX FUT	2008.03	35	GBP	2
TOPIX INDEX FUTURE	2008.03	20	JPY	314
S&P 500 FUTURE	2008.03	16	USD	6
S&P 500 EMINI FUTURE	2008.03	23	USD	2

Table of Contents

In September 2007, the Company entered into a 10-year, foreign currency derivative contract with Goldman Sachs Group Inc. (Goldman) in order to hedge foreign currency fluctuations caused by capital expenditures payments and international call settlement fees which are primary denominated in US dollars. In accordance with the terms of the contract, the Company deposited US$3 million with Goldman (included in other current assets). Under the terms of the contract, if the NT dollar/US dollar exchange rate is less than NT$31.50 per US$ at any two consecutive bi-weekly valuation dates during the valuation period starting from October 4, 2007 to September 5, 2017, the Company is required to make a cash payment to Goldman. The settlement amount is determined by the difference between the applicable exchange rates and the base amount of US$4 million. Conversely, if the NT dollar/US dollar exchange rate is above NT$31.50 per US dollar using the same valuation methodology, Goldman would have a settlement obligation to the Company determined using a base amount of U$2 million. Further, if the exchange rate is at or above NT$32.70 per US dollar starting from December 12, 2007 at any time, the contract will be terminated at that time. The unrealized valuation loss arising from this contract for the year ended December 31, 2007 was NT$580 million (included in realized and unrealized loss on derivative financial instruments).

b. Non-derivative financial instruments are as follows:

	December 31, 2006		December 31, 2007	
	Carrying Amount NT$	Fair Value NT$	Carrying Amount NT$	Fair Value NT$
Assets				
Cash and cash equivalents	$ 70,673	$ 70,673	$ 76,233	$ 76,233
Short-term investments	6,951	6,951	18,809	18,809
Long-term Investments for which it is:				
Not practicable	1,945	1,945	2,074	2,074
Refundable deposits (included in other assets other)	3,545	3,545	2,410	2,410
Liabilities				
Short-term loans	126	126	36	36
Customers deposits	6,654	5,641	6,386	5,407
Long-term loans (including current portion of long-term loans)	323	323	20	20

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

a. Cash and cash equivalents and short-term investments the carrying amounts approximate fair values because of the short maturity of those instruments.

b. Long-term investments there are no quoted market prices, a reasonable estimate of fair value could not be made without incurring excessive costs. Additional information pertinent to the value of an unquoted investment is provided above.

c. Refundable deposits the carrying amounts approximate fair values as the carrying amounts are the amount receivable on demand at the reporting date.

d. Customers deposits the fair value is the discounted value based on projected cash flows. The projected cash flows were discounted using the average expected customer service periods.

e. Short-term loans and long-term loans (including current portion) the fair value is based on the current rates offered to the Company for debt of the same remaining maturities.

Table of Contents

25. SEGMENT REPORTING

Operating segments are defined as components of an enterprise regarding which separate financial information is available for regular evaluation by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance.

The Company organizes its operating segments based on the various types of telecommunications services and products provided to customers. The operating segments are segregated as below:

Local operations the provision of local telephone services;

DLD operations the provision of domestic long distance call services;

ILD operations the provision of international long distance call services;

Cellular service operations the provision of cellular and related services;

Internet and data operation the provision of Internet access, lease line, and related services;

Cellular phone operations the provision of cellular phones and accessories sales;

All other operations the services other than the above five categories, such as paging operations and carrying out project research and providing training.

The operating segments are managed separately because each operating segment represents a strategic business unit that serves different markets.

The Company evaluates performance based on several factors using information prepared on the ROC government regulations basis. The information below is provided on this basis with a summary of US GAAP adjustments to reconcile to the amounts presented in the statement of operations. The Company does not allocate interest and other income, interest expense or taxes to operating segments, nor does the Company s chief operating decision maker evaluate operating segments on these criteria. Except as discussed above, the accounting policies for segment reporting are the same as for the company as a whole. The Company s primary measure of segment profit is based on income or loss from operations.

F-41

Table of Contents

a. Business segments:

As of and for the year ended December 31, 2005

	Fixed-line						
	Local NT$	DLD NT$	ILD NT$	Cellular Service NT$	Internet and Data NT$	All Other NT$	Total NT$
Revenues for reportable segments	$ 57,873	$ 13,268	$ 14,482	$ 73,938	$ 56,951	$ 3,317	$ 219,829
Elimination of intersegment amount	(17,360)	(2,400)		(1,167)	(14,806)	(17)	(35,750)
US GAAP adjustments	228	83	99	238	(1)	(30)	617
Total revenues from external customers	$ 40,741	$ 10,951	$ 14,581	$ 73,009	$ 42,144	$ 3,270	$ 184,696
Operating costs and expenses, excluding depreciation and amortization	$ 35,625	$ 4,786	$ 10,549	$ 35,565	$ 27,227	$ 3,173	$ 116,925
Elimination of intersegment amount	(4,027)	(3,359)	(3,183)	(13,838)	(10,848)	(495)	(35,750)
US GAAP adjustments	4,365	82	262	1,025	5,981	541	12,256
	$ 35,963	$ 1,509	$ 7,628	$ 22,752	$ 22,360	$ 3,219	93,431
Unallocated corporate amount							4,941
Total operating costs and expenses, excluding depreciation and amortization							$ 98,372
Depreciation and amortization	$ 19,256	$ 728	$ 662	$ 7,474	$ 12,495	$ 800	$ 41,415
US GAAP adjustments	(233)	(8)	(10)	(65)	(105)	27	(394)
	$ 19,023	$ 720	$ 652	$ 7,409	$ 12,390	$ 827	41,021
Unallocated corporate amount							142
Total depreciation and amortization							$ 41,163
Income from operations	$ 2,992	$ 7,754	$ 3,271	$ 30,899	$ 17,229	$ (656)	$ 61,489
Elimination of intersegment amount	(13,333)	959	3,183	12,671	(3,958)	478	
US GAAP adjustments	(3,904)	9	(153)	(722)	(5,877)	(598)	(11,245)
	$ (14,245)	$ 8,722	$ 6,301	$ 42,848	$ 7,394	$ (776)	50,244
Unallocated corporate amount							(5,083)
Total income from operations							$ 45,161
Segment income before income tax	$ 3,215	$ 8,003	$ 3,417	$ 31,368	$ 17,653	$ (1,149)	$ 62,507
Elimination of intersegment amount	(13,333)	959	3,183	12,671	(3,958)	478	
US GAAP adjustments	(3,762)	(152)	(301)	(1,010)	(6,089)	(228)	(11,542)
	$ (13,880)	$ 8,810	$ 6,299	$ 43,029	$ 7,606	$ (899)	50,965
Unallocated corporate amount							(4,933)
Total segment income before income tax							$ 46,032

Segment assets	$ 192,398	$ 6,342	$ 11,779	$ 62,004	$ 98,573	$ 17,639	$ 388,735
US GAAP adjustments	(40,455)	(1,510)	(1,573)	(4,591)	(13,827)	(4,619)	(66,575)
	$ 151,943	$ 4,832	$ 10,206	$ 57,413	$ 84,746	$ 13,020	322,160
Unallocated corporate amount							73,008
Total segment assets							$ 395,168
Expenditures for segment assets	$ 4,518	$ 403	$ 229	$ 4,449	$ 12,707	$ 608	$ 22,914
Unallocated corporate amount							16
Total expenditures for segment assets							$ 22,930

F-42

Table of Contents

As of and for the year ended December 31, 2006

	Fixed-line Local NT$	Fixed-line DLD NT$	ILD NT$	Cellular Service NT$	Internet and Data NT$	All Other NT$	Total NT$
Revenues for reportable segments	$ 56,378	$ 12,353	$ 13,978	$ 76,179	$ 60,888	$ 4,225	$ 224,001
Elimination of intersegment amount	(18,790)	(2,529)	(1)	(3,202)	(14,562)	(166)	(39,250)
US GAAP adjustments	1,411	64	68	46	2		1,591
Total revenues from external customers	$ 38,999	$ 9,888	$ 14,045	$ 73,023	$ 46,328	$ 4,059	$ 186,342
Operating costs and expenses, excluding depreciation and amortization	$ 36,586	$ 4,828	$ 10,566	$ 38,065	$ 27,680	$ 3,905	$ 121,630
Elimination of intersegment amount	(4,650)	(3,437)	(3,625)	(14,695)	(12,062)	(778)	(39,247)
US GAAP adjustments	2,780	(151)	49	(288)	224	53	2,667
	$ 34,716	$ 1,240	$ 6,990	$ 23,082	$ 15,842	$ 3,180	85,050
Unallocated corporate amount							4,345
Total operating costs and expenses, excluding depreciation and amortization							$ 89,395
Depreciation and amortization	$ 18,178	$ 663	$ 551	$ 8,289	$ 12,499	$ 729	$ 40,909
US GAAP adjustments	(215)	(7)	(9)	(69)	(110)	29	(381)
	$ 17,963	$ 656	$ 542	$ 8,220	$ 12,389	$ 758	40,528
Unallocated corporate amount							122
Total depreciation and amortization							$ 40,650
Income from operations	$ 1,613	$ 6,862	$ 2,861	$ 29,804	$ 20,731	$ (409)	$ 61,462
Elimination of intersegment amount	(14,140)	908	3,624	11,493	(2,500)	612	(3)
US GAAP adjustments	(1,154)	222	28	403	(112)	(82)	(695)
	$ (13,681)	$ 7,992	$ 6,513	$ 41,700	$ 18,119	$ 121	60,764
Unallocated corporate amount							(4,467)
Total income from operations							$ 56,297
Segment income before income tax	$ 736	$ 7,113	$ 2,797	$ 30,190	$ 20,872	$ (679)	$ 61,029
Elimination of intersegment amount	(14,140)	908	3,624	11,493	(2,500)	612	(3)
US GAAP adjustments	130	52	11	(74)	(341)	(59)	(281)
	$ (13,274)	$ 8,073	$ 6,432	$ 41,609	$ 18,031	$ (126)	60,745
Unallocated corporate amount							(3,405)
Total segment income before income tax and minority interest							$ 57,340

Segment assets	$ 180,710	$ 5,104	$ 9,898	$ 60,026	$ 91,816	$ 23,684	$ 371,238
US GAAP adjustments	(38,999)	(1,338)	(1,670)	(4,454)	(13,820)	(5,376)	(65,657)
	$ 141,711	$ 3,766	$ 8,228	$ 55,572	$ 77,996	$ 18,308	305,581
Unallocated corporate amount							93,200
Total segment assets							$ 398,781
Expenditures for segment assets	$ 5,066	$	$ 350	$ 9,406	$ 12,482	$ 360	$ 27,664
Unallocated corporate amount							17
Total expenditures for segment assets							$ 27,681

Table of Contents

As of and for the year ended December 31, 2007

	Local NT$	Fixed-line DLD NT$	ILD NT$	Cellular Service NT$	Internet and Data NT$	Cellular Phone NT$	All Other NT$	Total NT$
Revenues for reportable segments	$ 50,886	$ 11,378	$ 14,260	$ 79,372	$ 63,922	$ 11,358	$ 6,986	$ 238,162
Elimination of intersegment amount	(14,915)	(2,283)	(5)	(5,728)	(14,691)		(2,921)	(40,543)
US GAAP adjustments	2,987	140	128	105	1		(69)	3,292
	$ 38,958	$ 9,235	$ 14,383	$ 73,749	$ 49,232	$ 11,358	$ 3,996	200,911
Unallocated corporate amount								
Total revenues from external customers								$ 200,911
Operating costs and expenses, excluding depreciation and amortization	$ 33,643	$ 4,661	$ 11,288	$ 33,274	$ 30,687	$ 13,009	$ 5,960	$ 132,522
Elimination of intersegment amount	(4,520)	(3,167)	(3,428)	(14,880)	(14,061)		(395)	(40,451)
US GAAP adjustments	2,093	(62)	(11)	(105)	179		173	2,267
	$ 31,216	$ 1,432	$ 7,849	$ 18,289	$ 16,805	$ 13,009	$ 5,738	94,338
Unallocated corporate amount								4,398
Total operating costs and expenses, excluding depreciation and amortization								$ 98,736
Depreciation and amortization	$ 16,570	$ 605	$ 412	$ 8,732	$ 12,778	$ 33	$ 526	$ 39,656
US GAAP adjustments	(183)	(6)	(7)	(81)	(120)		(4)	(401)
	$ 16,387	$ 599	$ 405	$ 8,651	$ 12,658	$ 33	$ 522	39,255
Unallocated corporate amount								106
Total depreciation and amortization								$ 39,361
Income from operations	$ 673	$ 6,112	$ 2,560	$ 37,366	$ 20,457	$ (1,684)	$ 500	$ 65,984
Elimination of intersegment amount	(10,395)	884	3,423	9,152	(630)		(2,526)	(92)
US GAAP adjustments	1,077	208	146	291	(58)		(238)	1,426
	$ (8,645)	$ 7,204	$ 6,129	$ 46,809	$ 19,769	$ (1,684)	$ (2,264)	67,318
Unallocated corporate amount								(4,504)
Total income from operations								$ 62,814
Segment income before income tax	$ (618)	$ 6,232	$ 2,624	$ 37,563	$ 20,485	$ (1,597)	$ 265	$ 64,954
Elimination of intersegment amount	(10,395)	884	3,423	9,152	(630)		(2,526)	(92)
US GAAP adjustments	2,478	137	107	94	(112)		(127)	2,577
	$ (8,535)	$ 7,253	$ 6,154	$ 46,809	$ 19,743	$ (1,597)	$ (2,389)	67,439

Unallocated corporate amount								(3,106)
Total segment income before income tax								$ 64,333
Segment assets	$ 159,576	$ 4,778	$ 8,182	$ 56,119	$ 85,636	$ 4,741	$ 40,775	$ 359,807
US GAAP adjustments	(37,235)	(1,422)	(1,652)	(4,494)	(13,881)		(5,804)	(64,488)
	$ 122,341	$ 3,356	$ 6,530	$ 51,625	$ 71,755	$ 4,741	$ 34,971	295,319
Unallocated corporate amount								110,915
Total segment assets								$ 406,234
Expenditures for segment assets	$ 4,795	$	$ 323	$ 5,340	$ 14,073	$ 39	$ 426	$ 24,996
Unallocated corporate amount								72
Total expenditures for segment assets								$ 25,068

Table of Contents

Upon consolidating the accounts of SENAO and its subsidiaries, the chief operating decision maker allocates resources and assesses the performance of aforementioned entities as cellular phone operation and has been presented such as a separate reportable segment.

As significance of paging operations has been decreased below quantitative thresholds required by SFAS No. 131 in 2006 and thereafter, the Company did not disclose paging operations separately, and the disclosures for 2005 was changed accordingly to conform with the segment disclosure for 2006.

b. Geographic information

The users of the Company s services are mainly from Taiwan, ROC. The revenues it derived outside Taiwan are mainly inter-connection fees from other telecommunication carriers. The geographic information for revenues is as follows:

	Year Ended December 31		
	2005	**2006**	**2007**
	NT$	**NT$**	**NT$**
Taiwan, ROC	$ 180,793	$ 182,687	$ 195,981
Overseas	3,903	3,655	4,930
	$ 184,696	$ 186,342	$ 200,911

c. Gross sales to major customers

The Company has no single customer account representing 10% or more of its total revenues for all periods presented.

The Company has long-lived assets in Thailand, U.S., Vietnam, Hong Kong and China and except for NT$0.06 million and NT$37 million at December 31, 2006 and December 31, 2007, respectively, in the aforementioned areas, the other long-lived assets are located in Taiwan, ROC.