

Pacific Hospital Supply Co., Ltd.

**Financial Statements for the
Years Ended December 31, 2006 and 2005 and
Independent Auditors' Report**

INDEPENDENT AUDITORS' REPORT

The Board of Directors and the Shareholders
Pacific Hospital Supply Co., Ltd.

We have audited the accompanying balance sheets of Pacific Hospital Supply Co., Ltd. as of December 31, 2006 and 2005, and the related statements of income, changes in shareholders' 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 financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pacific Hospital Supply Co., Ltd. as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, requirements of the Business Accounting Law and Guidelines Governing Business Accounting relevant to financial accounting standards, and accounting principles generally accepted in the Republic of China.

We have also audited the consolidated financial statements of Pacific Hospital Supply Co., Ltd. and subsidiaries as of and for the years ended December 31, 2006 and 2005 on which we have issued an unqualified opinion in our report dated January 26, 2007.

January 26, 2007

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.

PACIFIC HOSPITAL SUPPLY CO., LTD.

BALANCE SHEETS

DECEMBER 31, 2006 AND 2005

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

ASSETS	2006		2005		LIABILITIES AND SHAREHOLDERS' EQUITY	2006		2005	
	Amount	%	Amount	%		Amount	%	Amount	%
CURRENT ASSETS					CURRENT LIABILITIES				
Cash and cash equivalent (Notes 2, 4 and 20)	\$ 222,229	27	\$ 172,863	24	Short-term bank loans (Notes 10 and 20)	\$ 20,000	2	\$ 20,000	3
Notes receivable, net of allowance for doubtful accounts of \$1 thousand in 2006 and 2005 (Notes 2 and 19)	26,461	3	20,859	3	Notes payable	70,920	9	55,670	8
Accounts receivable, net of allowance for doubtful accounts of \$865 thousand in 2006 and \$554 thousand in 2005 (Notes 2 and 19)	96,350	12	99,450	14	Accounts payable	32,760	4	29,492	4
Other receivables, net of allowance for doubtful accounts of \$634 thousand in 2006 and \$909 thousand in 2005 (Note 2)	4,250	1	11,838	2	Income tax payable (Notes 2 and 16)	13,057	1	-	-
Inventories, net (Notes 2 and 6)	139,574	17	107,683	15	Accrued expenses	46,614	6	32,318	5
Constructions in progress, net (Notes 2 and 7)	15,442	2	10,597	2	Other payables	-	-	2,376	-
Deferred income tax assets - current (Notes 2 and 16)	7,326	1	9,672	1	Advances - sales revenue	16,663	2	12,127	2
Restricted assets - current (Notes 4, 5 and 20)	6,900	1	22,940	3	Advances - construction, net (Notes 2 and 7)	6,142	1	6,692	1
Prepayments and other current assets	3,771	-	8,270	1	Current portion of long-term bank loans (Notes 12 and 20)	930	-	908	-
					Other current liabilities	5,331	1	3,216	-
Total current assets	522,303	64	464,172	65	Total current liabilities	212,417	26	162,799	23
LONG-TERM STOCK INVESTMENTS ACCOUNTED FOR USING - EQUITY METHOD (Notes 2 and 8)	8,233	1	8,547	1	LONG-TERM LIABILITIES				
PROPERTIES (Notes 2, 9, 20 and 21)					Bonds payable (Notes 2 and 11)	-	-	46,597	7
Cost					Long-term bank loans, net of current portion (Notes 12 and 20)	925	-	1,853	-
Land	11,638	1	-	-	Total long-term liabilities	925	-	48,450	7
Building	105,946	13	-	-	OTHER LIABILITIES				
Machinery equipment	152,750	19	137,048	19	Accrued pension liability (Notes 2 and 13)	13,241	2	11,517	1
Transportation equipment	9,314	1	10,839	2	Guarantee deposits received	30	-	30	-
Leasehold improvements	16,128	2	14,582	2	Total other liabilities	13,271	2	11,547	1
Miscellaneous equipment	61,320	8	51,100	7	Total liabilities	226,613	28	222,796	31
	357,096	44	213,569	30	SHAREHOLDERS' EQUITY				
Less: Accumulated depreciation	141,595	17	109,696	15	Capital stock: \$10 par value; authorized - 60,000 thousand shares; issued - 41,443 thousand shares in 2006 and 39,375 thousand shares in 2005	414,430	51	393,745	55
	215,501	27	103,873	15	Capital surplus from stock issued in excess of par value	64,826	8	49,894	7
Constructions in progress	49,209	6	91,715	13	Retained earnings				
Prepayment for equipment	3,031	-	3,090	-	Legal reserve	23,133	3	20,206	3
Net properties	267,741	33	198,678	28	Unappropriated earnings	86,760	10	31,170	4
DEFERRED PENSION COST (Notes 2 and 13)	5,286	1	3,147	-	Total retained earnings	109,893	13	51,376	7
OTHER ASSETS					Total shareholders' equity	589,149	72	495,015	69
Refundable deposits (Note 19)	6,667	1	5,471	1	TOTAL	\$ 815,762	100	\$ 717,811	100
Deferred charges (Note 2)	868	-	1,101	-					
Overdue receivables, net of allowance for doubtful accounts of \$10,848 thousand in 2006 and \$10,743 thousand in 2005 (Note 2)	2,675	-	390	-					
Deferred income tax assets - noncurrent (Notes 2 and 16)	1,989	-	2,093	-					
Restricted assets - noncurrent (Notes 20 and 21)	-	-	34,212	5					
Total other assets	12,199	1	43,267	6					
TOTAL	\$ 815,762	100	\$ 717,811	100					

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

PACIFIC HOSPITAL SUPPLY CO., LTD.

STATEMENTS OF INCOME

YEARS ENDED DECEMBER 31, 2006 AND 2005

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

	2006		2005	
	Amount	%	Amount	%
REVENUE (Notes 2 and 19)				
Sales	\$ 621,303	84	\$ 466,133	88
Less: Sales returns and allowances	<u>(3,354)</u>	<u>-</u>	<u>(7,635)</u>	<u>(2)</u>
Net sales	617,949	84	458,498	86
Construction	112,009	15	64,596	12
Services	<u>8,968</u>	<u>1</u>	<u>7,742</u>	<u>2</u>
Total net revenue	<u>738,926</u>	<u>100</u>	<u>530,836</u>	<u>100</u>
COSTS (Notes 2 and 17)				
Sales	449,610	61	346,482	65
Construction	82,406	11	47,880	9
Services	<u>5,495</u>	<u>1</u>	<u>5,308</u>	<u>1</u>
Total costs	<u>537,511</u>	<u>73</u>	<u>399,670</u>	<u>75</u>
GROSS PROFIT	<u>201,415</u>	<u>27</u>	<u>131,166</u>	<u>25</u>
OPERATING EXPENSES (Notes 17 and 19)				
Marketing	42,788	6	35,896	7
General and administrative	56,112	8	50,354	9
Research and development	<u>11,653</u>	<u>1</u>	<u>8,103</u>	<u>2</u>
Total operating expenses	<u>110,553</u>	<u>15</u>	<u>94,353</u>	<u>18</u>
OPERATING INCOME	<u>90,862</u>	<u>12</u>	<u>36,813</u>	<u>7</u>
NONOPERATING INCOME AND GAINS				
Interest income	1,660	-	1,560	-
Gain on disposal of properties and idle assets	9,981	1	2,192	1
Gain on disposal of investments	955	-	1,668	-
Gain on physical inventory	15	-	8	-
Foreign exchange gain, net	3,774	1	-	-
Revenue from sales of scraps	720	-	791	-
Others	<u>5,269</u>	<u>1</u>	<u>6,258</u>	<u>1</u>
Total nonoperating income and gains	<u>22,374</u>	<u>3</u>	<u>12,477</u>	<u>2</u>
NONOPERATING EXPENSES AND LOSSES				
Interest expense	1,659	-	1,676	-
Investment loss recognized by the equity method (Note 8)	314	-	2,826	1
Loss on disposal of properties and restricted assets	6,107	1	905	-

(Continued)

PACIFIC HOSPITAL SUPPLY CO., LTD.

STATEMENTS OF INCOME

YEARS ENDED DECEMBER 31, 2006 AND 2005

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

	2006		2005	
	Amount	%	Amount	%
Loss on physical inventory	\$ 32	-	\$ 1	-
Foreign exchange loss, net	-	-	331	-
Loss on market price decline and obsolete inventories	355	-	3,917	1
Others	<u>2,933</u>	<u>-</u>	<u>2,350</u>	<u>-</u>
Total nonoperating expenses and losses	<u>11,400</u>	<u>1</u>	<u>12,006</u>	<u>2</u>
INCOME BEFORE INCOME TAX	101,836	14	37,284	7
INCOME TAX EXPENSES (Notes 2 and 16)	<u>23,119</u>	<u>3</u>	<u>8,014</u>	<u>1</u>
NET INCOME	<u>\$ 78,717</u>	<u>11</u>	<u>\$ 29,270</u>	<u>6</u>
	2006		2005	
	Before Income Tax	After Income Tax	Before Income Tax	After Income Tax
EARNINGS PER SHARE (Note 18)				
Basic	<u>\$ 2.63</u>	<u>\$ 2.03</u>	<u>\$ 0.99</u>	<u>\$ 0.77</u>
Diluted	<u>\$ 2.43</u>	<u>\$ 1.88</u>	<u>\$ 0.89</u>	<u>\$ 0.71</u>

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

(Concluded)

PACIFIC HOSPITAL SUPPLY CO., LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars)

	Capital Stock Issued		Certificates of Bond-to-stock Conversion (Notes 2 and 11)		Capital Surplus - Issue of Stock in Excess of Par Value (Note 14)	Retained Earnings (Notes 2, 14 and 15)			Treasury Stock (Note 15)	Total Shareholders' Equity
	Shares (Thousands)	Amount	Shares (Thousands)	Amount		Legal Reserve	Unappropriated Earnings	Total		
BALANCE, JANUARY 1, 2005	30,132	\$ 301,315	64	\$ 641	\$ 15,918	\$ 13,786	\$ 65,291	\$ 79,077	\$ -	\$ 396,951
Appropriation of 2004 earnings										
Legal reserve	-	-	-	-	-	6,420	(6,420)	-	-	-
Cash dividends - \$1.3 per share	-	-	-	-	-	-	(48,671)	(48,671)	-	(48,671)
Remuneration to directors and supervisors	-	-	-	-	-	-	(1,300)	(1,300)	-	(1,300)
Stock bonus to employees	-	-	-	-	-	-	(7,000)	(7,000)	-	(7,000)
Capital surplus transferred to common stock	749	7,488	-	-	(7,488)	-	-	-	-	-
Issuance of stock upon exercise of stock options	1,187	11,865	-	-	59	-	-	-	-	11,924
Convertible bonds converted to capital stock	7,307	73,077	(64)	(641)	41,405	-	-	-	-	113,841
Net income in 2005	-	-	-	-	-	-	29,270	29,270	-	29,270
BALANCE, DECEMBER 31, 2005	39,375	393,745	-	-	49,894	20,206	31,170	51,376	-	495,015
Appropriation of 2005 earnings										
Legal reserve	-	-	-	-	-	2,927	(2,927)	-	-	-
Cash dividends - \$0.419 per share	-	-	-	-	-	-	(15,762)	(15,762)	-	(15,762)
Remuneration to directors and supervisors	-	-	-	-	-	-	(400)	(400)	-	(400)
Stock bonus to employees	-	-	-	-	-	-	(2,350)	(2,350)	-	(2,350)
Issuance of stock upon exercise of stock options	866	8,662	-	-	47	-	-	-	-	8,709
Convertible bonds converted to capital stock	3,002	30,023	-	-	17,164	-	-	-	-	47,187
Net income in 2006	-	-	-	-	-	-	78,717	78,717	-	78,717
Treasury stock buy back	-	-	-	-	-	-	-	-	(21,967)	(21,967)
Treasury stock write off	(1,800)	(18,000)	-	-	(2,279)	-	(1,688)	(1,688)	21,967	-
BALANCE, DECEMBER 31, 2006	41,443	\$ 414,430	-	\$ -	\$ 64,826	\$ 23,133	\$ 86,760	\$ 109,893	\$ -	\$ 589,149

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

PACIFIC HOSPITAL SUPPLY CO., LTD.

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2006 AND 2005 (In Thousands of New Taiwan Dollars)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 78,717	\$ 29,270
Depreciation and amortization	29,777	24,693
Bad debts	3,510	259
Loss on market price decline and obsolete inventories	355	3,917
Gain on disposal of short-term investments	(955)	(1,668)
Investment loss recognized by the equity method	314	2,826
Gain on disposal of properties, idle assets and restricted assets, net	(3,874)	(1,287)
Accrued interest compensation	590	990
Deferred income taxes	2,450	2,102
Accrued pension liabilities	(415)	(797)
Net changes in operating assets and liabilities		
Notes receivable	(5,602)	(7,389)
Accounts receivable	2,789	(12,264)
Other receivables	7,863	(7,611)
Inventories	(32,246)	(2,502)
Construction in progress, net	(4,845)	5,568
Prepayments and other current assets	4,499	(6,411)
Overdue receivables	(5,759)	(715)
Notes payable	15,250	4,134
Accounts payable	3,268	2,810
Income tax payable	13,057	(14,434)
Accrued expenses	14,296	(4,063)
Other payables	(2,376)	(18,000)
Advances for sales revenue	4,536	1,793
Advances for construction, net	(550)	6,543
Other current liabilities	<u>2,115</u>	<u>(24)</u>
Net cash provided by operating activities	<u>126,764</u>	<u>7,740</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of available-for-sale financial assets	-	(156,000)
Proceeds from disposal of available-for-sale financial assets	16,912	273,670
Decrease in restricted assets - current	83	85
Acquisition of properties	(73,867)	(108,823)
Proceeds from disposal of properties, idle assets	13,851	8,070
Decrease in refundable deposits	(1,196)	189
Increase in deferred charges	(505)	(862)
Increase in restricted assets - noncurrent	<u>-</u>	<u>(234)</u>
Net cash provided by (used in) investing activities	<u>(44,722)</u>	<u>16,095</u>

(Continued)

PACIFIC HOSPITAL SUPPLY CO., LTD.

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2006 AND 2005 (In Thousands of New Taiwan Dollars)

	2006	2005
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayments of long-term bank loans	\$ (906)	\$ (743)
Decrease in guarantee deposits received	-	(5)
Issuance of stock due to exercise of stock options	8,709	11,924
Cash dividends	(15,762)	(48,671)
Cost of treasury stock buy back	(21,967)	-
Remuneration to directors and supervisors	<u>(2,750)</u>	<u>(8,300)</u>
Net cash used in financing activities	<u>(32,676)</u>	<u>(45,795)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	49,366	(21,960)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>172,863</u>	<u>194,823</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 222,229</u>	<u>\$ 172,863</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid (excluded capitalized interest)	\$ 1,675	\$ 671
Income tax paid	7,612	20,346
NONCASH INVESTING AND FINANCING ACTIVITIES		
Current portion of long-term bank loans	928	908
Convertible bonds converted to capital stock and capital surplus	47,187	113,841
Restricted assets transferred to fixed assets	34,212	-

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

(Concluded)

PACIFIC HOSPITAL SUPPLY CO., LTD.

NOTES TO FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2006 AND 2005 (In Thousands of New Taiwan Dollars, Unless Stated Otherwise)

1. ORGANIZATION AND OPERATIONS

Pacific Hospital Supply Co., Ltd. (the "Company") manufactures, processes and sells medical disposable products and equipment and does medical engineering work on centralized gas piping systems.

The Company's common shares were listed on the exchange of the GreTai Securities Market (GTSM) in February 2004.

As of December 31, 2006 and 2005, the Company had 482 and 380 employees, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements have been prepared in conformity with the Guidelines Governing the preparation of Financial Reports by Securities Issuers, Business Accounting Law and Guidelines and accounting principles generally accepted in the Republic of China (ROC). In preparing financial statements in conformity with these guidelines and principles, the Company is required to make certain estimates and assumptions that could affect the amounts of allowance for doubtful accounts, allowance for inventory devaluation, property depreciation, pension and accrued litigation loss. Actual results could differ from these estimates.

For the convenience of readers, the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail.

The Company's significant accounting policies are summarized as follows:

Current and Noncurrent Assets and Liabilities

Unrestricted cash and cash equivalents and other assets to be converted to cash, sold or consumed within one year from the balance sheet date are classified as current. Liabilities to be settled within one year from the balance sheet date are classified as current. All other assets and liabilities are classified as noncurrent.

Cash Equivalents

Cash equivalents are callable bonds that mature in three months from the investment date and have a face value at or near fair market value.

Available-for-sale Financial Assets

Available-for-sale financial assets are initially recognized at fair value plus transaction costs that are directly attributable to the acquisition. Changes in fair value from subsequent remeasurement are reported as a separate component of shareholders' equity. The corresponding accumulated gains or losses are recognized in earnings when the financial asset is derecognized from the balance sheet.

Revenue Recognition, Accounts Receivable and Allowance for Doubtful Accounts

Sales are recognized when titles to products and evident risks of ownerships are transferred to customers, primarily upon shipment, since the earnings process is almost completed and revenues are realized or realizable. Sales returns and allowances are subtracted from gross sales, and the related costs of goods are eliminated. Sales are not recognized on the shipment of raw materials to subcontractors for further processing since the shipment does not involve a transfer of ownership titles and risks.

Sales are determined at fair value, taking into account related sales discounts agreed to by the Company and customer. Since receivables from sales are collectible within one year and sales transactions are frequent, the fair value of receivables is equivalent to the nominal amount of cash received.

On the accounting for construction revenue, please refer to the section "Construction Contracts" on the preceding page.

Service revenues are recognized when services are rendered.

Allowance for doubtful accounts is provided on the basis of a review of the collectibility of accounts receivable. The Company evaluate doubtful accounts based on the outstanding account analysis, credit ratings, and economic environment analysis, and periodically evaluate the collectibility of each account.

Inventories

Inventories, including raw materials, finished products and goods in process, are stated at the lower of weighted-average cost or market value. An allowance for losses is recognized for obsolete and slow-moving items. Market value refers to replacement cost of raw materials and to net realizable value of finished goods and work in process.

Construction Contracts

Revenues of construction contracts are recognized using the completed-contract method since the construction periods are less than one year. Provisions for estimated losses on uncompleted contracts are recognized in the period in which these losses are determined. Any reduction of the estimated losses will be recognized as income in the periods these reductions are determined.

Upon the completion of a project, the advances for construction and construction in progress are recognized as construction revenue and cost, respectively. On balance sheet dates, if the balance of the construction in progress for each project exceeds the related advances, the excess is classified under current assets; conversely, the excess is classified under current liabilities.

Long-term Stock Investments Accounted for Using Equity Method

A long-term stock investment in which the Company owns at least 20% of the outstanding voting shares or exercises significant influence on the investee is accounted for by the equity method.

On the balance sheet date, the Company evaluates investments for any impairment. An impairment loss is recognized and charged to current income if the investment carrying amount as of the balance sheet date exceeds the expected recoverable amount. Investments in which the Company has significant influence over investees are tested for impairment separately at their carrying amounts.

Equity-method investments are stated at cost plus (or less) the proportionate share in the investees' net earnings (or net losses). The share in net earnings or losses of the investees is recognized as investment income or loss, and cash dividends received are recognized as a reduction of the carrying value of the investments. Stock dividends received are accounted for only as increases in the number of shares held and are not recognized as investment income. Cost or carrying value per share is recomputed on the basis of total shares after stock dividends are received. Provisions for estimated losses are recognized in the period in which these losses are determined.

Properties and Idle Assets

Properties and idle assets are stated at cost less accumulated depreciation. Major additions, renewals and betterments are capitalized, while maintenance and repairs are expensed currently.

Provisions for estimated losses on properties and idle assets are recognized in the period in which these losses are determined. Any reduction of the estimated losses will be recognized as income in the periods these reductions are determined, with maximum income set at original book value minus depreciation.

Depreciation is calculated using the straight-line method over service lives estimated as follows: buildings, 5 to 50 years; machinery and equipment, 3 to 10 years; transportation equipment, 5 years; leasehold improvements, 2 to 5 years; and miscellaneous equipment, 2 to 8 years. Properties that have reached their residual value but are still being used by the Company are depreciated over their newly estimated service lives.

Upon sale or other disposal of properties, the related cost and accumulated depreciation are removed from the accounts, and any gain or loss is credited or charged to income.

Deferred Charges

Software installation costs are amortized using the straight-line method over three years.

Provisions for estimated losses on deferred charges are recognized in the period in which these losses are determined. Any reduction of the estimated losses will be recognized as income in the periods these reductions are determined, with maximum income set at original book value minus amortization.

Convertible Bonds

Effective January 1, 2006, pursuant to the bond issued prior to December 31, 2005, the total issuing price is recorded as financial liability. The stated redemption price in excess of the face value of the bond is recognized as interest expense over a period starting from the issuance date to the last day of the redemption period, using the effective interest rate method.

The stated redemption price in excess of the face value of the bond is recognized as interest expense over a period starting from the issue date to the last day of the redemption period, using the effective interest rate method. The book value approach is used to account for bond conversion by bondholders. Under this method, the unamortized issue costs, recognized interest-premium, unpaid accrued interests and par value of the convertible bonds are written off. The common stock exchange certificate (capital stock) should be valued at the carrying amount net of the amounts written off, and the difference of this net amount from the par value of the common stock exchange certificate (capital stock) is recognized as capital surplus.

Pension Costs

The Company has two types of pension plans: Defined contribution and defined benefit.

Under the defined contribution plan, pension costs are recognized on the basis of actuarial reports; under the defined benefit plan, the Company's contributions to employees' individual pension accounts are charged to current expense.

The prior service cost caused by the amendment of a defined benefit plan is amortized over the average period from the amendment date until the benefits are vested. When benefits become vested, prior service costs are immediately charged to current expense.

If the defined benefit plan is curtailed or settled, the resulting gains or losses are recognized as part of the net pension cost for the period.

Treasury Stock

The Company reacquired its issued shares in accordance with government regulations and recorded this reacquisition as treasury stock at cost, which is presented as a deduction to stockholders' equity.

Income Tax

The Company uses the inter-period tax allocation method. Deferred income taxes are recognized for tax effects of temporary differences, loss carryforwards and unused tax credits. Valuation allowance is provided for deferred tax assets that are not certain to be realized. A deferred tax liability or asset should be classified as current or noncurrent according to the classification of the related asset or liability for financial reporting. But if a deferred tax liability or asset cannot be related to a liability or asset in the financial statements, it should be classified as current or noncurrent on the basis of the expected length of the settlement or recovery period of the temporary difference.

Tax credits for certain purchases of machinery, equipment and technology, research and development expenditures, and personnel training are recognized as reduction of the current year's income tax expense.

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

Income taxes (10%) on unappropriated earnings generated since 1998 are recorded as income tax expense in the year when the shareholders resolve to retain the earnings.

Foreign-currency Transactions

Foreign-currency transactions are recorded in New Taiwan dollars at the rate of exchange in effect when the transaction occurs. Gains or losses from the settlement of foreign-currency transactions or conversion of cash in foreign currency into New Taiwan dollars at prevailing rates are recognized as current income. At period-end, foreign-currency assets and liabilities are revalued at the prevailing exchange rates, with the resulting gain or loss recognized as current income. If an equity-method investee's functional currency is a foreign currency, gain or loss resulting from translation of the amounts in the foreign-currency financial statements into New Taiwan dollars is recognized as translation adjustment under shareholders' equity.

3. ACCOUNTING CHANGES

The Company adopted the newly released SFAS No. 34 "Accounting for Financial Instruments" and SFAS No. 36 "Disclosure and Presentation for Financial Instruments" and the related revisions of previously released SFASs.

Upon the adoption of SFAS No. 34, certain accounts in the financial statements for the year ended December 31, 2005 should be reclassified and presented to conform to the financial statements for the year ended December 31, 2006. The financial statements need not be restated.

Significant accounting policies prior to adoption of newly released and amended SFAS are summarized as follows:

Short-term investments that were publicly-traded, easily converted to cash, and not acquired for the purpose of controlling the investees or establishing close business relationship with the investees were carried at the lower of cost or market value at the balance sheet date, with any temporary decline in value charged to current income. The market value of publicly-traded stocks was determined using the average-closing prices for the last month of the period.

Certain accounts in the financial statements as of and for the year ended December 31, 2005 have been reclassified to conform to the classifications prescribe by the newly released and revised SFASs. The reclassifications of certain accounts are summarized as follows:

	2005	
	Before Reclassification	After Reclassification
<u>Balance sheet</u>		
Short-term investments (restricted assets - current)	\$ 15,957	\$ -
Available-for-sale financial assets - current (restricted assets - current)	-	15,957

4. CASH AND CASH EQUIVALENTS

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Cash on hand	\$ 1,164	\$ 922
Cash in banks	190,253	109,809
Time deposits - interest of 1.3%-2.2% in 2006 and 1.05%-2.35% in 2005	37,712	37,479
Cash equivalents		
Callable bonds - interest of 1.55%-4.20%	<u>-</u>	<u>31,636</u>
	229,129	179,846
Less: Restricted assets - current (Note 20)	<u>6,900</u>	<u>6,983</u>
	<u>\$ 222,229</u>	<u>\$ 172,863</u>

As of December 31, 2006 and 2005, cash in overseas banks was as follows:

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
China - Hong Kong (US\$1 thousand and HK\$4 thousand in 2006 and US\$1 thousand and HK\$4 thousand in 2005)	<u>\$ 49</u>	<u>\$ 51</u>

5. AVAILABLE-FOR-SALE FINANCIAL ASSETS - CURRENT

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Government bonds - interest of 3.698%	\$ -	\$ 15,957
Less: Restricted assets - current (Note 20)	<u>-</u>	<u>15,957</u>
	<u>\$ -</u>	<u>\$ -</u>

6. INVENTORIES

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Finished goods	\$ 47,790	\$ 39,245
Work in process	12,404	9,867
Raw materials	<u>97,778</u>	<u>76,614</u>
	157,972	125,726
Less: Allowance for decline in value	<u>18,398</u>	<u>18,043</u>
	<u>\$ 139,574</u>	<u>\$ 107,683</u>

7. CONSTRUCTIONS IN PROGRESS AND ADVANCES ON CONSTRUCTION

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Constructions in progress	\$ 31,501	\$ 11,870
Less: Advances on construction	<u>16,059</u>	<u>1,273</u>
Constructions in progress, net	<u>\$ 15,442</u>	<u>\$ 10,597</u>
Advances on construction	\$ 9,774	\$ 17,813
Less: Constructions in progress	<u>3,632</u>	<u>11,121</u>
Advances on construction, net	<u>\$ 6,142</u>	<u>\$ 6,692</u>

As of December 31, 2006, outstanding construction projects amounting to about \$59,201 thousand were expected to be completed by the end of August 2007.

8. LONG-TERM STOCK INVESTMENTS ACCOUNTED FOR USING EQUITY METHOD

	<u>December 31</u>			
	<u>2006</u>		<u>2005</u>	
	Carrying Value	% of Ownership	Carrying Value	% of Ownership
Equity method				
Pacific Medical Engineering & Consultant Co., Ltd.	\$ 8,078	99.996	\$ 8,340	99.996
Pacific Hospital Supply Co., Ltd.	<u>155</u>	100.000	<u>207</u>	100.000
	<u>\$ 8,233</u>		<u>\$ 8,547</u>	

The calculation of the carrying value of the investments accounted for by the equity method and the related investment losses was based on the investees' audited financial statements as of and for the years ended December 31, 2006 and 2005.

Investment losses on stocks were \$314 thousand in 2006 and \$2,826 thousand in 2005.

9. PROPERTIES

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Costs	\$ 357,096	\$ 213,569
Accumulated depreciation		
Building	11,486	-
Machinery equipment	79,364	69,917
Transportation equipment	3,800	4,111
Leasehold improvements	8,093	5,504
Miscellaneous equipment	<u>38,852</u>	<u>30,164</u>
	<u>141,595</u>	<u>109,696</u>
	215,501	103,873

(Continued)

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Constructions in progress	\$ 49,209	\$ 91,715
Prepayments for equipment	<u>3,031</u>	<u>3,090</u>
Properties, net	<u>\$ 267,741</u>	<u>\$ 198,678</u> (Concluded)

10. SHORT-TERM BANK LOANS

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Unsecured loans: Interest of 1.980%-2.427% in 2006 and 2.000%-2.626% in 2005	<u>\$ 20,000</u>	<u>\$ 20,000</u>

11. BONDS PAYABLE

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Domestic unsecured convertible bonds		
Bonds payable	\$ -	\$ 45,500
Accrued interest compensation	<u>-</u>	<u>1,097</u>
	<u>\$ -</u>	<u>\$ 46,597</u>

Convertible Bonds

On September 1, 2004, the Company issued its first unsecured convertible bonds amounting to \$180,000 thousand with par value of \$100 thousand. These bonds were listed on Taiwan's over-the-counter securities exchange. The bonds have zero nominal interest rate and a five-year maturity. Bondholders have the right to convert the bonds into common stock between the 30th day after issuance and the 10th day before maturity at the current conversion price. Bondholders also have the right to require the Company to redeem the convertible bonds at interest rates of 2.41%, 4.56% and 7.39% in the second, third and fourth years of issuance, respectively. Between the 30th day after issuance and the 40th day before maturity, the Company has the right to redeem all the residual outstanding bonds when the closing price of the Company's listed common stock exceeds 50% of the conversion price over 30 consecutive days, or when over 90% of the total bonds issued have been redeemed or converted, the Company is required to redeem all remaining outstanding shares. On maturity date, the Company should redeem all outstanding shares at face value. As of December 31, 2006, bondholders applied for the conversion of all outstanding bonds into shares (1,314 shares in 2004, 7,307 shares in 2005 and 3,002 shares in 2006, with total conversion of 11,623 shares).

12. LONG-TERM BANK LOANS

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Secured loans - repayable in installments starting January 2002, annual interest of 4.05% in 2006 and 3.77% in 2005	\$ 1,855	\$ 2,761
Less: Current portion	<u>930</u>	<u>908</u>
	<u>\$ 925</u>	<u>\$ 1,853</u>

13. PENSION PLAN

The Labor Pension Act (the "Act") became effective on July 1, 2005 and the pension mechanism under the Act is deemed a defined contribution plan. The employees who were subject to the Labor Standards law prior to July 1, 2005 were allowed to choose to be subject to the pension mechanism under the Act or continue to be 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 have chosen to be subject to the pension mechanism under the Act, their seniority as of July 1, 2005 shall be maintained. Employees who joined the Company after July 1, 2005 can only be subject to the pension mechanism under the Act.

The pension mechanism under the Act is deemed a defined contribution plan. Pursuant to the Act, the Company has made monthly contributions to employees' pension accounts per month at 6% of each employee's monthly salary starting from July 1, 2005. Under the Act, total pension costs were \$7,620 for the year ended December 31, 2006.

Under the Labor Standards Law, the Company has a retirement plan which is regarded as defined benefit plan. According to the retirement plan, employees can get pension benefit based on length of service before retirement. The Company appropriates 4% of an employee's monthly salary into a fund, and beginning January and July 2004 the percentage changed to 6% and 3%, respectively, of Labor Retirement Fund Supervising Committee who in turn deposit the fund into a designated account at the Central Trust of China.

Other information on the defined benefit plan is as follows:

a. Net pension cost

	<u>2006</u>	<u>2005</u>
Service cost	\$ 1,708	\$ 2,921
Interest cost	1,486	1,260
Projected return on plan assets	(559)	(440)
Amortization of net transitional obligation	596	596
Amortization of pension cost	<u>33</u>	<u>-</u>
Net pension cost	<u>\$ 3,264</u>	<u>\$ 4,337</u>

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

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Benefit obligation		
Vested benefit obligation	\$ -	\$ -
Non-vested benefit obligation	38,380	32,426
Accumulated benefit obligation	38,380	32,426
Additional benefits based on future salaries	11,008	10,034
Projected benefit obligation	49,388	42,460
Fair value of plan assets	<u>(25,138)</u>	<u>(20,909)</u>
Funded status	24,250	21,551
Unrecognized net transitional obligation	(7,750)	(8,346)
Unrecognized net loss	(8,545)	(4,835)
Additional liability	<u>5,286</u>	<u>3,147</u>
Accrued pension cost	<u>\$ 13,241</u>	<u>\$ 11,517</u>
Vested benefit	<u>\$ -</u>	<u>\$ -</u>

c. Actuarial assumptions

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Discount rate used in determining present values	3.50%	3.50%
Future salary increase rate	2.00%	2.00%
Expected rate of return on plan assets	2.50%	2.50%

14. SHAREHOLDERS' EQUITY

In August of 2003 and 2002, the Company granted qualified employees 153 thousand units and 192 thousand units, respectively, of option rights, with each unit representing 10 common shares. The option rights on both plans are valid for five years and exercisable at 50% on the second year of issuance, 80% on the third year of issuance, and 100% on the fourth year and thereafter of issuance.

Outstanding stock options in 2006 and 2005 were as follows:

	<u>2003 Option Plan</u>		<u>2002 Option Plan</u>	
	Number of Outstanding Stock Option Rights (in Thousands)	Weighted- average Exercise Price (NT\$)	Number of Outstanding Stock Option Rights (in Thousands)	Weighted- average Exercise Price (NT\$)
<u>2006</u>				
Beginning outstanding balance	84	\$ 10.1	46	\$ 10.0
Options exercised	(47)	10.1	(39)	10.0
Options canceled	<u>(4)</u>	10.1	<u>(1)</u>	10.0
Ending outstanding balance	<u>33</u>		<u>6</u>	

(Continued)

	<u>2003 Option Plan</u>		<u>2002 Option Plan</u>	
	Number of Outstanding Stock Option Rights (in Thousands)	Weighted-average Exercise Price (NT\$)	Number of Outstanding Stock Option Rights (in Thousands)	Weighted-average Exercise Price (NT\$)
<u>2005</u>				
Beginning outstanding balance	153	\$ 10.3	108	\$ 10.0
Options exercised	(59)	10.1	(59)	10.0
Options canceled	<u>(10)</u>	10.1	<u>(3)</u>	10.0
Ending outstanding balance	<u>84</u>		<u>46</u>	

(Concluded)

The number of outstanding option rights and exercise prices have been adjusted retroactively to reflect the appropriation of dividends based on the plans.

As of December 31, 2006, outstanding and exercisable option rights were as follows:

	Exercise Price (NT\$)	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
		Number of Outstanding Options (in Thousands)	Weighted-averaged Remaining Contractual Life (Years)	Weighted-average Exercise Price (NT\$)	Number of Exercisable Options (in Thousands)	Weighted-average Exercise Price (NT\$)
2003 option plan	\$10.1	\$ 33	1.67	\$10.1	8	\$10.1
2002 option plan	10.0	<u>6</u>	0.67	10.0	6	10.0
		<u>39</u>				

Capital Surplus

Under the ROC Company Law, capital surplus may only be used to offset deficit. However, capital surplus from the issue of stock in excess of par value may be transferred to capital stock as stock dividends. Capital surplus can be transferred to capital stock at a certain ratio each year.

Earnings Appropriation and Dividend Policy

The Company's Articles of Incorporation provide that 10% of annual net income less any deficit should be appropriated as legal reserve. From the remainder, the board of directors should propose the appropriation of up to 5% as remuneration to directors and supervisors and 1% to 15% as bonus to employees.

The Company has a balanced dividend policy. Dividends are appropriately distributed in the form of common shares or cash. The policy takes into account both the Company's operational needs and shareholders' interests. However, cash earning distribution cannot be less than 20% of overall distribution value.

Under the Company Law, legal reserve must be appropriated each year until the reserve equals the Company's paid-in capital. This reserve may be used to offset deficit. Also, when the reserve reaches 50% of paid-in capital, up to 50% of the reserve may be transferred to capital.

The appropriation of the remaining earnings should be resolved by the shareholders in, and given effect to in the financial statements of, the year following the year of earnings generation.

When the Company appropriates the earnings generated after January 1, 1998, resident noncorporate shareholders are allowed a tax credit based on the ratio of creditable tax to unappropriated earnings on the date of appropriation.

The appropriation of the earnings of 2005 and 2004 were approved in the shareholders' meetings in June 2006 and June 2005, respectively. The appropriations and dividends per share are as follows:

	<u>Appropriation of Earnings</u>		<u>Dividends Per Share (NT\$)</u>	
	<u>For Fiscal Year 2005</u>	<u>For Fiscal Year 2004</u>	<u>For Fiscal Year 2005</u>	<u>For Fiscal Year 2004</u>
Legal reserve	\$ 2,927	\$ 6,420		
Common dividends - in cash	15,762	48,671	\$0.419	\$1.3
Remuneration to directors and supervisors - in cash	400	1,300		
Bonus paid to employees - in cash	<u>2,350</u>	<u>7,000</u>		
	<u>\$ 21,439</u>	<u>\$ 63,391</u>		

Had the above employee bonus and remuneration to directors and supervisors been paid in cash and charged against the 2005 and 2004 income, the basic earnings per share would have decreased from NT\$0.77 to NT\$2.21 in 2005 and from NT\$0.70 to NT\$1.92 in 2004.

The appropriation of the 2006 earnings was approved by the board of directors as follows:

- a. Legal reserve: \$7,872 thousand;
- b. Employee bonus of \$9,500 thousand and remuneration to directors and supervisors of \$1,050 thousand, both in cash;
- c. Cash dividend of \$62,363 thousand.

15. TREASURY STOCK

Reasons for Common Stock Buyback	Beginning Balance	Current Year Increase	Current Year Cancellation	Year End Balance
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2006

To preserve company credibility and shareholder's interest	-	1,800	1,800	-
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Treasury stocks held by the Company cannot be mortgaged, does not distribute dividend, nor possess voting rights according to law.

The board of the Company have consented in April 28, 2006 to cancel all treasury stocks as of April 28, 2006. The capital decrease were approved by the Executive Yuan Financial Supervisory Commission.

16. INCOME TAX

The ROC government enacted the Alternative Minimum Tax Act (AMT Act), which became effective on January 1, 2006. The alternative minimum tax (AMT) imposed under the AMT Act is a supplemental tax levied at a rate of 10% which is payable if the income tax payable determined pursuant to the Income Tax Law is below the minimum amount prescribed under the AMT Act. The taxable income for calculating the AMT includes most of the income that is exempted from income tax under various laws and statutes. The Company has considered the impact of the AMT Act in the determination of its tax liabilities.

- a. A reconciliation of income tax expense based on "income before income tax" at statutory rate and income tax currently payable was as follows:

	2006	2005
Income tax expense based on income before income tax at statutory rate of 25%:	\$ 25,449	\$ 9,311
Add (deduct) tax effects of		
Permanent differences		
Tax exempt income	(4,892)	(462)
Others	180	850
Temporary differences	(434)	(3,606)
Tax on unappropriated earnings (10%)	783	1,142
Less investment tax credits	<u>(5,952)</u>	<u>(1,736)</u>
Tax payable	<u>\$ 15,134</u>	<u>\$ 5,499</u>

- b. Income tax expense consisted of:

	2006	2005
Current income tax	\$ 15,134	\$ 5,499
Prior years' adjustments	5,535	413
Deferred income tax expense	<u>2,450</u>	<u>2,102</u>
	<u>\$ 23,119</u>	<u>\$ 8,014</u>

- c. Changes in income tax payable:

	2006	2005
Balance, beginning of year	\$ -	\$ 14,434
Current income tax	15,134	5,499
Payment in current year	(7,612)	(20,346)
Prior year adjustments	<u>5,535</u>	<u>413</u>
Balance, end of year	<u>\$ 13,057</u>	<u>\$ -</u>

d. Deferred income tax assets were as follows:

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Current		
Allowance for decline in value of inventories	\$ 4,600	\$ 4,511
Allowance for doubtful accounts	2,726	2,704
Unused investment credit	-	1,863
Unrealized loss due to fire	<u>-</u>	<u>594</u>
Deferred income tax assets	<u>\$ 7,326</u>	<u>\$ 9,672</u>
Noncurrent		
Deferred pension cost	<u>\$ 1,989</u>	<u>\$ 2,093</u>

e. The Company's sales generated through expansion projects are exempt from income tax from January 1, 2006 to December 31, 2010.

f. The information on the integrated income tax system is as follows:

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Year-end balance of the imputation credit account	<u>\$ 9,888</u>	<u>\$ 7,871</u>

The projected 2006 and actual 2005 creditable tax ratios were 11.40% and 25.25%, respectively.

Under tax regulations, the tax credits allocated to shareholders are based on the balance of the imputation credit account (ICA) on the dividend distribution date. Thus, the creditable tax ratio for the 2006 earnings may change depending on the actual ICA balance on the dividend distribution date.

There were no unappropriated earnings generated before 1997 as of December 31, 2006 and 2005.

g. The effective tax rate for deferred income tax was 25% in 2006 and 2005.

Income tax returns through 2004 had been examined and cleared by the tax authorities.

17. PERSONNEL, DEPRECIATION AND AMORTIZATION EXPENSES

	2006			2005		
	Classified as Operating Cost	Classified as Operating Expense	Total	Classified as Operating Cost	Classified as Operating Expense	Total
Personnel expenses						
Salary	\$ 130,615	\$ 47,876	\$ 178,491	\$ 100,280	\$ 38,761	\$ 139,041
Pension	8,667	2,217	10,884	5,608	1,482	7,090
Meal allowance	8,356	1,288	9,644	7,297	1,153	8,450
Employee insurance	12,318	2,836	15,154	9,188	2,367	11,555
Others	<u>72</u>	<u>121</u>	<u>193</u>	<u>160</u>	<u>118</u>	<u>278</u>
	<u>\$ 160,028</u>	<u>\$ 54,338</u>	<u>\$ 214,366</u>	<u>\$ 122,533</u>	<u>\$ 43,881</u>	<u>\$ 166,414</u>
Depreciation	\$ 25,165	\$ 3,874	\$ 29,039	\$ 19,546	\$ 3,673	\$ 23,219
Amortization	161	577	738	133	1,341	1,474

18. EARNINGS PER SHARE

The numerators and denominators used in computing earnings per share (EPS) were as follows:

	Amounts (Numerator)		Shares (Denominator) (Thousands)	EPS (Dollars)	
	Before Income Tax	After Income Tax		Before Income Tax	After Income Tax
<u>2006</u>					
Basic earnings per share					
Income of common shareholders	\$ 101,836	\$ 78,717	38,749	<u>\$ 2.63</u>	<u>\$ 2.03</u>
Effect of dilutive securities - convertible bonds	-	-	2,464		
Effect of dilutive securities - stock options	<u>-</u>	<u>-</u>	<u>742</u>		
Diluted earnings per share					
Income of common stock shareholders	<u>\$ 101,836</u>	<u>\$ 78,717</u>	<u>41,955</u>	<u>\$ 2.43</u>	<u>\$ 1.88</u>
<u>2005</u>					
Basic earnings per share					
Income of common shareholders	\$ 37,284	\$ 29,270	37,788	<u>\$ 0.99</u>	<u>\$ 0.77</u>
Effect of dilutive securities - convertible bonds	990	990	3,680		
Effect of dilutive securities - stock options	<u>-</u>	<u>-</u>	<u>1,364</u>		
Diluted earnings per share					
Income of common stock shareholders	<u>\$ 38,274</u>	<u>\$ 30,260</u>	<u>42,832</u>	<u>\$ 0.89</u>	<u>\$ 0.71</u>

The effect of dilutive stock options is calculated at the adjusted exercise prices of NT\$10.00 and NT\$10.10 for the 2002 and 2003 stock option plans, respectively, and at the average closing price of NT\$16.07 of the Company's stock in the Emerging Stock Market in 2006.

19. RELATED-PARTY TRANSACTIONS

- a. The Company's related parties were as follows:

<u>Related Party</u>	<u>Relationship with the Company</u>
Pacific Medical Engineering & Consultant Co., Ltd. (PME)	Equity-method investee
Pacific Hospital Supply Co., Ltd. ("Pacific-BVI")	Equity-method investee
Feng-Yang International Investment Co., Ltd. ("Feng-Yang")	Same chairman
Xin-Tai Investment Co., Ltd. ("Xin-Tai")	Company president is the chairman of Xin-Tai
Zhi-Qun Co., Ltd. ("Zhi-Qun")	Company president is the chairman of Zhi-Qun

- b. The significant transactions with the related parties were as follows:

	<u>2006</u>		<u>2005</u>	
	<u>Carrying Value</u>	<u>%</u>	<u>Carrying Value</u>	<u>%</u>
<u>For the year</u>				
Sales				
PME	\$ 30	-	\$ 532	-
Feng-Yang	<u>2</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 32</u>	<u>-</u>	<u>\$ 532</u>	<u>-</u>
Rental expense (included in operating expenses; related information is shown in Note 21c)				
Zhi-Qun	<u>\$ 6,710</u>	<u>6</u>	<u>\$ 6,705</u>	<u>7</u>
<u>At end of the year</u>				
Notes receivable				
PME	<u>\$ -</u>	<u>-</u>	<u>\$ 59</u>	<u>-</u>
Accounts receivable				
PME	<u>\$ -</u>	<u>-</u>	<u>\$ 102</u>	<u>-</u>
Refundable deposits				
Zhi-Qun	<u>\$ 1,200</u>	<u>18</u>	<u>\$ 1,200</u>	<u>22</u>

All related-party transactions were conducted on an arm's-length basis between two independent parties.

20. ASSETS PLEDGED OR MORTGAGED

The following assets had been pledged or mortgaged as collaterals for long-term and short-term bank loans, refundable construction warranties and for meeting requirements for hiring foreign labor:

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Time deposits	\$ 6,900	\$ 6,983
Land and buildings, net	<u>12,380</u>	<u>34,212</u>
	<u>\$ 19,280</u>	<u>\$ 41,195</u>

A portion of the above pledged time deposits, land and buildings had been temporarily placed under court restriction (see Note 21). The restricted assets were as follows:

	<u>December 31</u>	
	<u>2006</u>	<u>2005</u>
Current		
Pledged time deposits	\$ 6,900	\$ 6,983
Government bonds	<u>-</u>	<u>15,957</u>
	<u>\$ 6,900</u>	<u>\$ 22,940</u>
Noncurrent		
Cost		
Land	\$ -	\$ 13,072
Buildings	<u>-</u>	<u>32,066</u>
	-	45,138
Less: Accumulated depreciation	<u>-</u>	<u>10,926</u>
	<u>\$ -</u>	<u>\$ 34,212</u>

Land and buildings, temporarily placed under court restriction, had been mortgaged as collaterals for long-term bank loans.

21. CONTINGENCIES

- a. On November 23, 2001, the Kaohsiung factory had a fire, which affected two other companies nearby (companies X and Y). Company X had an estimated loss of \$128,540 thousand and sought compensation through the court. It obtained insurance indemnity of approximately \$48,249 thousand; in turn, the insurance company sought a \$48,249 thousand compensation from the Company. Company Y also sought \$5,144 thousand in damages. Thus, the Company's government bonds valued at \$15,957 thousand and properties valued at \$34,809 thousand were temporarily restricted by the court in February 2002 and May 2002, respectively.

In February and May of 2004, the court declared that the Company should pay Company X \$12,862 thousand as compensation plus guarantees. The rest of the claims, including those on the government bonds and properties, were rejected by the court. The Company and Company Y did not accept the adjudication and thus appealed to a higher court.

The Company have reached a settlement with company X, Y and the insurance company in 2006, and made settlement payment totaled \$18,450 thousand. The difference from the previous fire hazard reserves of \$20,376 thousand were reclassified as other income, and court restriction on government bonds and properties were released.

- b. The Company entered into contracts to build a factory and buy machinery and equipment. The total amount of these contracts is about \$69,739 thousand. As of December 31, 2006, the Company had paid \$49,209 thousand.
- c. Charges for the rental period from November 2003 to March 2010 for office, factory, and storage facilities were as follows:

Year	Amount
2007	\$ 7,264
2008	6,623
2009	833
2010	<u>175</u>
	<u>\$ 14,895</u>

22. FINANCIAL INSTRUMENTS

- a. The Company had no derivative transactions in 2006 and 2005.
- b. The fair values of nonderivative financial instruments were as follows:

	December 31			
	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<u>Assets</u>				
Financial assets - with fair values approximating carrying amounts	\$ 349,290	\$ 349,290	\$ 305,010	\$ 305,010
Restricted assets - current	6,900	6,900	22,940	24,483
Long-term investments	8,233	8,233	8,547	8,547
Refundable deposits	6,667	6,667	5,471	5,471
<u>Liabilities</u>				
Financial liabilities - with fair values approximating carrying amounts	123,680	123,680	105,162	105,162
Long-term bank loans (including current portion)	1,855	1,855	2,761	2,761
Bonds payable (including accrued interest compensation)	-	-	46,597	67,340
Guarantee deposits received	30	30	30	30

The assumptions and methods used in determining fair values are as follows:

- 1) The carrying values of cash and cash equivalents, notes and accounts receivable, other receivables, short-term bank loans and notes and accounts payable, approximate fair value because of the short maturities of these instruments.

- 2) Fair value of available-for-sale assets are based on their quoted market price if available.
- 3) Fair value of restricted assets - current is based on market prices. If market prices are unavailable, fair value is based on carrying amount.
- 4) Fair value of long-term investments is based on market prices. If market prices are unavailable, fair value is based on carrying amount.
- 5) Fair value of bonds payable is based on market prices.
- 6) Since long-term debts bear floating interest rates, the carrying amount approximates fair value.
- 7) For refundable deposits and guarantee deposits received, which have no maturity dates, their carrying amounts represent fair values.

23. ADDITIONAL DISCLOSURES

Except for Tables 1 and 2, no other information on major transactions, investees and investments in Mainland China are required by the Securities and Futures Bureau for disclosure by the Company.

24. SEGMENT INFORMATION

a. Industry

The Company manufactures, processes and sells medical disposable products and equipment and does medical engineering work on central gas piping systems. Thus, the Company is considered as engaging in a single industry.

b. Geographic

As of December 31, 2006, the Company had no foreign operating segments.

c. Export sales

Region	2006		2005	
	Amount	Percentage of Net Revenue	Amount	Percentage of Net Revenue
Asia	\$ 261,372	35	\$ 199,195	38
Europe	139,841	19	79,333	15
Others	<u>76,873</u>	<u>11</u>	<u>48,057</u>	<u>9</u>
	<u>\$ 478,086</u>	<u>65</u>	<u>\$ 326,585</u>	<u>62</u>

- d. There are no clients that accounted for at least 10% of the Company's total operating revenues.

PACIFIC HOSPITAL SUPPLY CO., LTD. AND INVESTEEES

**MARKETABLE SECURITIES HELD
DECEMBER 31, 2006
(In Thousands of New Taiwan Dollars)**

Holding Company Name	Marketable Securities Type and Issuer	Relationship with the Holding Company	Account	December 31, 2006				Note
				Shares	Carrying Value	Percentage of Ownership	Market Value or Net Asset Value	
Pacific Hospital Supply Co., Ltd.	<u>Common stock</u> Pacific Medical Engineering & Consultant Co., Ltd.	Equity-method investee	Long-term stock investments accounted for using equity method	1,499,940	\$ 8,078	99.996	\$ 8,078	(Note)
	Pacific Hospital Supply Co., Ltd. (BVI)	Equity-method investee	Long-term stock investments accounted for using equity method	10,000	155	100.000	155	(Note)

Note: Calculation was based on investees' audited financial statements.

PACIFIC HOSPITAL SUPPLY CO., LTD. AND INVESTEEES

NAMES, LOCATIONS, AND OTHER INFORMATION OF INVESTEEES ON WHICH THE COMPANY EXERCISES SIGNIFICANT INFLUENCE

YEAR ENDED DECEMBER 31, 2006

(In Thousands of New Taiwan Dollars)

Hold Company Name	Investee Company	Location	Main Businesses and Products	Investment Amount		Balance as of December 31, 2006			Net Income (Loss) of the Investee	Investment Gain (Loss)	Note
				Dec. 31, 2006	Dec. 31, 2005	Shares	Percentage of Ownership	Carrying Value			
Pacific Hospital Supply Co., Ltd.	Pacific Medical Engineering & Consultant Co., Ltd.	No. 53, Kuosin Neighborhood 21, Siuying Village, Miaoli City, Miaoli County, Taiwan, R.O.C.	Installation of medical equipment	\$ 18,300	\$ 18,300	1,499,940	99.996	\$ 8,078	\$ (262)	\$ (262)	(Note)
	Pacific Hospital Supply Co., Ltd. (BVI)	P.O. Box 957, Offshore Incorporations Centre, Road Town, Tortola, British Virgin Islands	Selling of medical products	349	349	10,000	100.000	155	(52)	(52)	(Note)

Note: Calculation was based on investees' audited financial statements.