

VII. Review of Financial Status, Operating Results, and Risk Management

7.1 Analysis of Financial Status

Unit: NT\$thousand

Item	Year	2014/12/31	2013/12/31	Difference		Remark
				Amount	%	
Current Assets		\$43,266,297	\$40,843,355	2,422,942	6	Note 1
Fixed Assets		14,738,703	15,132,587	(393,884)	(3)	Note 2
Intangible Assets		174,250	320,236	(145,986)	(46)	Note 3
Other Assets		24,592,417	20,593,875	3,998,542	19	Note 4
Total Assets		82,771,667	76,890,053	5,881,614	8	
Current Liabilities		18,134,449	19,983,776	(1,849,327)	(9)	Note 5
Long-term Liabilities		11,394,547	10,182,303	1,212,244	12	Note 6
Total Liabilities		29,528,996	30,166,079	(637,083)	(2)	Note 5-6
Equity attributable to owners of parent		49,224,022	42,863,434	6,360,588	15	Note 7-8
Capital stock		20,026,929	20,026,929	-	-	
Capital surplus		7,600,552	7,493,180	107,372	1	
Retained Earnings		18,398,540	16,606,382	1,792,158	11	Note 7
Other Comprehensive Income for the year		3,198,001	(1,263,057)	4,461,058	353	Note 8
Non Controlling Interest		4,018,649	3,860,540	158,109	4	
Total Stockholders' Equity		53,242,671	46,723,974	6,518,697	14	Note 7-8
<p>Note 1: Reason for increased current assets: The main reason is that Tong An Investment Co., Ltd. sold a piece of land and factory buildings in Wugu, so that cash and cash equivalents rose.</p> <p>Note 2: Reason for decreased fixed assets: The main reason is that Tong An Investment Co., Ltd. sold a piece of land and factory buildings in Wugu, so that fixed asset decreased.</p> <p>Note 3: Reason for decreased intangible assets: The main reason is that good will increased because of adding new entity, Kueling, in 2013, therefore goodwill in 2014 is adjusted based upon value of assets.</p> <p>Note 4: Reason for increased other assets: The market price of investing target of Tong An Investment raised, and the adjustment in financial assets in available-for-sale increased. Therefore, other assets increased.</p> <p>Note 5: Reason for decreased Current Liabilities: Both Rent payable of Jiangxi TECO and long term liability due in one year of TECOM decreased. Therefore, current liabilities declined.</p> <p>Note 6: Reason for increased Long-term Liabilities: To strengthen operating capital, long term liabilities increases</p> <p>Note 7: Reason for increased retained earnings and comprehensive income attributable to owners of the parent and total stockholders' equity: Profit in 2014 is more than 2013</p> <p>Note 8: Reason for increased Other Comprehensive Income for the year and comprehensive income attributable to owners of the parent and total stockholders' equity: The market price of investing target raised, therefore the adjustment of unrealized income and cumulative translation increased.</p>						

7.2 Analysis of Operating Results

7.2.1 Analysis of Operating Results

Unit: NT\$thousand

Item	Year	2014	2013	Difference		Remark
				Amount	%	
Sales Revenue		53,820,604	56,618,537	(2,797,933)	(5)	
Operating Costs		(40,442,637)	(43,137,921)	2,695,284	6	
Gross Profit		13,377,967	13,480,616	(102,649)	(1)	
Realized(Unrealized) Profit from Sales		64	4,110	(4,046)	(98)	
Gross Profit - Net		13,378,031	13,484,726	(106,695)	(1)	
Operating Expenses		(8,981,060)	(8,859,132)	(121,928)	(1)	
Operating Profit		4,396,971	4,625,594	(228,623)	(5)	
Non-operating Income and Gains		1,306,964	777,890	529,074	68	Remark 1
Profit before income tax		5,703,935	5,403,484	300,451	6	Remark 1
Tax Expense		(1,297,704)	(1,226,228)	(71,476)	(6)	Remark 2
Net Income		4,406,231	4,177,256	228,975	5	Remark 1-2
Other comprehensive income		4,593,197	774,035	3,819,162	493	Remark 3
Total comprehensive income		8,999,428	4,951,291	4,048,137	82	Remark 4

Analysis and explanation for changes:

1. Gain from Disposition of land and factory building in Wugu
2. Due to increased profit, tax expenses increased
3. The market price of investing target rose, therefore the adjustment of unrealized income increased.
4. In summary, total comprehensive income increased in the year.

7.2.2 Change in gross profit: No need of analysis since the change is less than 20%.

7.3 Analysis of Cash Flow

7.3.1 Cash Flow Analysis for the Current Two Years

Cash and Cash Equivalents, Beginning of Year (1)	Net Cash Flow from Operating Activities (2)	Cash Outflow (Inflow) (3)	Cash Surplus (Deficit) (1)+(2)-(3)	Remedy for Cash Deficit	
				Investment Plans	Financing Plans
14,908,571	4,784,127	2,486,287	17,206,411	-	-

A. Analysis of change in cash flow:

- a. Operating activities: Contributed by overseas profits, Profit of the year became major source of net cash flow for operating activities.
- b. Investing activities: Purchase of fixed assets and expansion of core business were major cash-outflow items for Investing activities.
- c. Financing activities: Repayment of borrowings and issuance of dividends for stocks was major cause for cash outflow for financing activities.

B. Remedy and liquidity analysis for insufficient cash: not applicable.

7.3.2 Cash Flow Analysis for the Coming Year

Unit: NT\$thousand

Cash and Cash Equivalents, Beginning of Year (1)	Estimated Net Cash Flow from Operating Activities (2)	Estimated Cash Outflow (Inflow) (3)	Cash Surplus (Deficit) (1)+(2)-(3)	Remedy for Cash Deficit	
				Investment Plans	Financing Plans
17,206,411	5,165,256	3,492,330	18,879,336	-	-
<p>A. Analysis of change in cash flow in the current year:</p> <p>a. Operating activities: Although the U.S. economy has been recovering gradually, the economic growth of other regions is weak and unstable. However, thanks to steady growth for core business, operation activities are expected to score net cash inflow this year.</p> <p>b. Investing activities: To expand core business, the company will adjust investment plan according to economic status and continue review long-term equity investment outside core business, for disposal at proper timing, so as to generate profits to support core-business investment. Investment activities are expected to continue generate net cash outflow this year. It's expected that investing activities will result in cash outflow.</p> <p>c. Financing activities: Since cash inflow from operation and self-owned capital will be used to expand core business and repay bank borrowings, it is expected that financing activities in the coming year will generate net cash outflow.</p> <p>B. Remedy for Cash Deficit and Liquidity Analysis: Not Applicable</p>					

7.4 Major Capital Expenditure Items

7.4.1 Major Capital Expenditure Items and Source of Capital

Unit: NT\$thousand

Project	Actual or Planned Source of Capital	Actual or Planned Date of Completion	Total Capital	Actual or Expected Capital Expenditure		
				2013	2014	2015~2016
2013 Capital Expenditure – Equipment Renewal	Working Capital	2013/12/31	797,726	797,726		
2014 Capital Expenditure – Equipment Renewal	Working Capital	2014/12/31	972,440	-	972,440	
2015 Capital Expenditure – Equipment Renewal	Working Capital	2015/12/31	1,201,090			1,201,090

7.4.2 Expected Benefits

In addition to increasing the output of industrial products and home appliances, the above equipment renewal projects are expected to help reduce production costs and improve the quality of products.

7.5 Investment Policy in Last Year, Main Causes for Profits or Losses, Improvement Plans and the Investment Plans for the Coming Year

7.5.1 Equity Investment Policy

In line with changes in domestic and global economies, as well as the current of energy conservation, carbon abatement, environment protection and automation development in global industries, the company focuses its new equity investment on its core businesses of industrial motor and home appliances, accompanies long-term development plan, and cautiously evaluate each investment plan.

7.5.2 Major reasons for profits or loss:

The company listed NT\$215,438 of investment returns on the basis of equity method in 2014. It mainly came from increased profits generated by investees related to industrial motors.

7.5.3 Investment plan for the next year

In the coming one year, investments will focus on core business, for new product development, high-efficiency motor, explosion-proof motor, and oil & electric-vehicle motor developed by industrial motor businesses, control element for receiving end developed by system automation business, and smart inverter air conditioners, whole-series first-grade machines, multi-unit household and commercial inverter duty air conditioner, smart cloud-end centrifugal chiller developed by home appliance business.

7.6 Analysis of Risk Management

7.6.1 Effects of Changes in Interest Rates, Foreign Exchange Rates and Inflation on Corporate Finance, and Future Response Measures

A. Effects of Changes in Interest Rates on Corporate Finance, and Future Response Measures

	2014	Unit: NT\$Thousand
Interest Gain or Loss(1)		-83,151
Revenues(2)		53,820,604
Operating Income(3)		4,396,971
(1)/(2)		-0.15%
(1)/(3)		-1.89%

The company's net interest expense amounted to NT\$83,151,000 in 2014, equivalent to -0.15% and -1.89%, respectively, of the revenues and operating profits, lower than 2013 level, due to decreased interest expense and deposit interest increased. It results into the net decreased interest expense. It's estimated that increase of every one percentage point in market interest rate would increase the company's annual interest expense by NT\$79,972,000.

With the U.S.'s job market picking up steadily, market players predict the Fed will begin to hike interest rate in the second half in 2015, possibly prompting the Central Bank of China to follow suit, in a gradual manner.

On the other hand, in order to combat deflation, Japan and the euro region will stick to QE (quantitative-easing) policy, perhaps at an even greater scale, minimizing interest rate-related risk, as further decline in oil prices cannot be excluded. China will also maintain a loose policy in the foreseeable future, lowering interest-related risk, due to declining wholesale prices on excess capacities and economic slowdown. In general, outlook for the global economic development is uncertain, due to such systematic risks as the outcome of the debt talk between Greece and international creditors and the threat of terrorist attacks of ISIS. The company will adjust timely positions for NT-dollar and foreign-currency borrowings and expand channels for fund raising, such as corporate bonds, in order to cut interest burden.

B. Effects of Changes in Foreign Exchange Rates and Inflation on Corporate Finance, and Future Response Measures

	2014	Unit: NT\$thousand
Exchange Gain or Loss(1)	-15,619	
Revenues(2)	53,820,604	
Operating Income(3)	4,396,971	
(1)/(2)	-0.03%	
(1)/(3)	-0.36%	

The company incurred net loss of NT\$15,619,000 from currency conversion in 2014, accounting for minuscule shares of -0.03% and -0.36%, respectively, of revenues and operating profit.

Should the U.S. hike interest rates, as expected, in the second half of 2015, Asian currencies and other international currencies will experience another round of depreciation. Chance for the NT dollar to devalue at a large scale is slim, as Taiwan's exports are expected to remain brisk and the central bank used to follow in the U.S. footsteps in adjusting monetary policy. Japanese yen and the euro will be under heavy pressure for devaluation, due to movement of funds from Japan and the euro region to the U.S., taking advantage to the widening interest differential, a result of the continuing low interest rates in the two former areas, in contrast to rising interest rates in the U.S. There also exists high exchange-rate risk for the Australian dollar, in view of sluggish mining investments, main source of its growth momentum, and difficulty to switch the growth model to one driven by exports or domestic demand in the short term, plus continuing high unemployment. In line with its persistent attention on swing in exchange rate in the past, the company will continue implementing following measures:

- In addition to natural risk hedging associated with positions of assets and liabilities, the company will undertake substantial risk hedging via forward forex transactions.
- The financial department will maintain close contact with the forex department of corresponding financial institutions and constantly collect information on change in exchange rate, so as firmly grasp trend and change in international exchange rates and respond actively, in forward forex transactions and foreign exchange settlement, to offset the adverse influence of exchange-rate swings.
- The financial department regularly produces internal evaluation report on risk-hedging positions for net forex assets (liabilities) as reference for the management in making decisions on risk-hedging measures.

Fluctuation in material prices has minimal effect on the company, whose procurements are mostly based on contracts enabling it to negotiate with suppliers to offset influence of price hike. The company, however, still has to watch and assess price trend for basic metals and formulate optimal procurement strategy accordingly.

7.6.2 Policies, Main Causes of Gain or Loss and Future Response Measures with Respect to High-risk, High-leveraged Investments, Lending or Endorsement Guarantees, and Derivatives Transactions

- A. The company abstains from high-risk and high leveraged investments.
- B. At the end of 2014, outstanding loans extended by the company amounted to NT\$216,500,000.
- C. In 2014, the outstanding amount of the endorsement and guarantee extended by the company reached NT\$227,069 thousand, for the company's subsidiaries, affiliates, and business partners. Since the company retains majority seats on the board of directors of its subsidiaries and appoints their management, it has absolute control and grasp of their operations, slashing the risk of endorsement and guarantee for them. In addition, the company regularly gets hold of its subsidiaries' financial statement and business status data for analysis of its profit level and evaluation of the risk for endorsement and guarantee, enabling it to embrace measures to cut risk in advance. In recent years, these subsidiaries gained steady profit growth, gradually lowering the risk of endorsement and guarantee extended by the company.
- D. In 2014, derivatives held by the company was forward exchange trading, whose corresponding traders were mainly international financial institutions with outstanding credit. In addition, the company traded with many financial institutions to diversify risks, minimizing the possibility for default. Therefore, credit risk for the company in derivatives trading is very low. Moreover, derivatives held by the company are mainly for the purpose of risk hedging and the ensuing income/loss can be offset by the income/loss in the risk-hedging category, minimizing the market risk.
- E. The company has formulated a number of investment guidelines for cutting risk, including "Procedure for the Acquisition and Disposal of Assets," "Procedure for Lending Capital to the Others," "Procedure for the Endorsement and Guarantee," and "Procedure for the Trading and Disposal of Derivatives."

7.6.3 Future Research & Development Projects and Corresponding Budget

TECO derives its growth momentum from R&D. In recent years, the company pooled the R&D strength and marketing experience of its R&D units all over the world, and cooperated with industrial, government, and academic units in strengthening its core businesses and stepping into the sector of green energy. The company has initiated a number of key R&D projects in the aspects of wind-power generation, PV inverter, rare-earth permanent magnet motor, and in-wheel motor and power generating unit of electric vehicle.

For the R&D of new technologies and new products in the medium- and long-term and the short-term business need of the improvement in price-performance ratio, the TECO R&D team has been actively cultivating its technological strength via the search of external resources, such as technological consultation, cooperation, and transfer.

On the basis of existing core technologies, such as rotated machinery and generator design, machinery drive and design, power/electronic control and design, and internet-related technology, integrate new market needs, industrial specifications, new-materials application, sensor-application technology, wireless-network technology, and green-industry technology, thereby coordinating overall R&D strategy and technological planning.

The company formulates its future R&D plan on the following bases:

- A. Grasp and analysis of industrial development, government policy, and market trend;
- B. The establishment and rooting of key technologies;
- C. Competitiveness relative to rivals in Europe, the U.S., and Japan;
- D. Global market positioning and technological integration;
- E. Grasp of R&D progress and quality.

Therefore, in 2015 TECO will dedicate to the R&D of:

- A. forward-looking technology consulting committee
- B. High-efficiency motor and servo motor
- C. Motors with mining application in America and Canada
- D. Reluctive motor and drive
- E. Low energy-consumption inverter refrigerator
- F. EV motor and drive as well as joint development of whole vehicle
- G. All series wind-power generator and drive
- H. Remote monitoring of motor and generator
- I. R&D on four-phase control for medium-voltage inverter and switch between industrial network and inverter
- J. High technology for system automation products
- K. Multiple commercial air-conditioners systems and smart air-conditioners

The goal is to develop products conforming to new European specifications in the existing market, seek high value-added innovative applications in existing sales channels, and strive for commercialization of emerging technologies and new market opportunities.

The company’s general research institute oversees the overall R&D strategy, technology deployment and ongoing product R&D, with an eye on technological deployment and product development in short-, medium-, and long-term, including:

Term of R&D	Focus	Major R&D items
Short-term	Develop new-product application market, Enhance performance of existing products & Enhance product profitability and market share	High-performance servo motor and drive
		Inverter DD washing machine
		Super premium motor
		Permanent-magnet motor and drive
		Control for servo system
		High rotational-speed motor
		Multi-unit commercial-use package air conditioning unit
		Technology of sinusoidal sensorless drive
		Servo parameter automatic adjusting technology
		Electric vehicle power package
		Intelligence battery and battery management system
		Break energy recharge technology
		Energy –saving electric vehicle certification technology
		Electric vehicle battery certification technology
Mid-term	Accumulation of core technological strength & Development of new technological strength	Medium- and high-voltage inverter
		Advanced inverter technology
		Large high-efficiency motor (FSR)
		Hydraulic motor for hybrid injection molding machine
		R&D of wind-power technology
		Application technology of digital home in smart phone
		Remote monitoring technology of motor and generator
		Internet-related technology for system automation products
Commercial air-conditioning for train		

Term of R&D	Focus	Major R&D items
Long-term	Deployment in new business scope	Rare-earth in-wheel motor and drive for electrical vehicle
		Electric passenger/farm oriented pedicab tricycle
		Super-conductivity motor and generator
		R&D for new-generation digital home appliances systems
		Micro-electric system in large high-efficiency power system
		R&D for new-generation industrial servo system
		Regional market oriented R&D for industrial technology
R&D for integrated and innovative technology		

It is expected that we will invest NT\$ 1.8 billion dollars into research and development within this 2 years.

7.6.4 Effects of and Response to Changes in Policies and Regulations Relating to Corporate Finance and Sales

None

7.6.5 Effects of and Response to Changes in Technology and in Industry Relating to Corporate Finance and Sales

In line with the social trend of decreasing population, as well as the need of green energy, the company has taken into account the global development trend, own technological strength, and growth potential of related industries. Therefore, in addition to strengthening its technological edges of high-performance motor, application of environment-friendly coolant in home appliances, and energy-saving inverter duty products, the company added the R&D of rare-earth permanent-magnet electric machinery in passenger/farm oriented vehicle, closely studied international technology trend's and market trend's reports, gave an impetus to innovative competition, supported green energy international competition, and planned technology forum in several areas and long-term technology development plan to accomplish planned-to-achieved strategies and time table.

In green energy, there include motor of electric vehicle, wind-power generators, peripheral equipments of smart grid, energy-saving home appliances and multiple air-conditioners systems.

The company has set up forward-looking technology consulting committee in 2015, to track cutting-edge forward-looking technologies. Add R&D on gateway technology for electric-control product series, R&D on remote-monitoring technology for motor and generator, R&D on high-end servo motor drive, and R&D on reluctance motor and drive, and R&D on digital-home and mobile communications-linked security products. In addition, the company will associate various business air conditioners with applications of the Internet of things, intensify intensity and depth of technological detection, further strengthen horizontal technological cooperation among affiliates, and actively seek foreign technological cooperation, so as to enrich R&D contents and meet long-term needs of the society.

7.6.6 The Impact of Changes in Corporate Image on Corporate Risk Management, and the Company's Response Measures

The company has been pursuing sustained growth via “pluralized management” and “global deployment,” and has been striving to project a quality corporate image for a globalized group by manifesting in-depth social care via TECO Technology Foundation and rigorous demand for quality and service. The company's crisis management plan covers its production bases worldwide and has helped the company respond properly to the ordeal of major incidents in recent years, thanks to the company's constant effort in fostering crisis-management capability. In the future, the company will continue simulating the outbreak of major incidents and formulate response plans, in order to safeguard the interests of shareholders.

7.6.7 Expected Benefits from Risks Relating to and Response to Merger and Acquisition Plans

The Company has no ongoing merger and acquisition activities.

7.6.8 Expected Benefits from Risks Relating to and Response to Factory Expansion Plans

The Company has no ongoing factory expansion projects.

7.6.9 Risks Relating to and Response to Excessive Concentration of Purchasing Sources and Excessive Customer Concentration

None

7.6.10 Effects of Risks Relating to and Response to Large Share Transfers or Changes in Shareholdings by Directors, Supervisors, or Shareholders with Shareholdings of over 10%

The company doesn't have a shareholder with over 10% of shareholding and there is no massive share transfer or swap among the company's directors and supervisors in the latest year.

7.6.11 Effects of Risks Relating to and Response to Changes in Control over the Company

None

7.6.12 For litigation and non-litigation cases, specify the company and directors, supervisors, president, chief executive, and major shareholders with over 10% of shareholding, as well as affiliates. For major litigation, non-litigation, or administrative disputes with major effects on the interests of shareholders or stock prices, disclose the facts, target value, starting dates for litigation, major parties involved, and the status of the cases up to the publication of the yearbook

None.

7.6.13 Other Major Risks

None