

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

### 7.1 Analysis of Financial Status

Unit: NT\$thousand

Item	Year	2017/12/31	2016/12/31	Difference		Remark
				Amount	%	
Current Assets		\$44,262,768	\$45,296,310	(1,033,542)	(2)	
Fixed Assets		17,922,299	18,463,450	(541,151)	(3)	
Intangible Assets		5,612,315	5,636,766	242,525	5	
Other Assets		24,219,575	22,977,430	975,169	4	
<b>Total Assets</b>		<b>92,016,957</b>	<b>92,373,956</b>	<b>(356,999)</b>	<b>(0)</b>	
Current Liabilities		18,742,356	18,958,845	(216,489)	(1)	Note 1
Long-term Liabilities		15,400,464	17,690,568	(2,290,104)	(13)	
<b>Total Liabilities</b>		<b>34,142,820</b>	<b>36,649,413</b>	<b>(2,506,593)</b>	<b>(7)</b>	
Equity attributable to owners of parent		51,829,765	49,731,567	2,098,198	4	
Capital stock		20,026,929	20,026,929	0	0	
Capital surplus		7,628,542	7,671,889	(43,347)	(1)	
Retained Earnings		22,469,336	21,187,539	1,281,797	6	
Other Comprehensive Income for the year		1,704,958	845,210	859,748	102	Note 2
Non Controlling Interest		6,044,372	5,992,976	51,396	1	
<b>Total Stockholders' Equity</b>		<b>57,874,137</b>	<b>55,724,543</b>	<b>2,149,594</b>	<b>4</b>	

Note 1: Reason for decreased Current Liabilities: The main reason is that repaying bank loan.

Note 2: Reason for increased Other Comprehensive Income for the year and comprehensive income attributable to owners of the parent and total stockholders' equity: Foreign exchange difference while transferring sales of overseas subsidiaries into New Taiwan Dollar. Euro dollar appreciates more than last year.

## 7.2 Analysis of Operating Results

### 7.2.1 Operating Results

Unit: NT\$thousand

Item	Year	2017	2016	Difference		Remark
				Amount	%	
Sales Revenue		50,942,521	49,923,836			
Operating Costs		(38,743,733)	(36,788,304)			
Gross Profit		12,198,788	13,135,532	(936,744)	(7)	
Realized(Unrealized) Profit from Sales		(2,520)	(1,137)	(1,383)	122	
Gross Profit - Net		12,196,268	13,134,395	(938,127)	(7)	Remark1
Operating Expenses		(8,700,068)	(8,944,914)	244,846	(3)	
Operating Profit		3,496,200	4,189,481	(693,281)	(17)	Remark1
Non-operating Income and Gains		857,704	743,810	113,894	15	
Profit before income tax		4,353,904	4,933,291	(579,387)	(12)	Remark1
Tax Expense		(809,656)	(896,293)	86,637	(10)	Remark2
Net Income		3,544,248	4,036,998	(492,750)	(12)	Remark1-2
Other comprehensive income		781,789	323,292	458,497	142	Remark3
Total comprehensive income		4,326,037	4,360,290	(34,253)	(1)	Remark4
Analysis and explanation for changes:						
1. Gross margin declined due to product mix and foreign exchange rate						
2. Tax expense decreased due to decreasing profit.						
3. Change in foreign exchange rate resulted into increasing currency translation differences of foreign operations.						
4. In summary, total comprehensive income decreased 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
13,989,826	5,891,652	5,752,148	14,129,330	-	-
<p>A. Analysis of change in cash flow:</p> <p>a. Operating activities: Contributed by overseas profits, Profit of the year became major source of net cash flow for operating activities.</p> <p>b. Investing activities: Purchase of fixed assets and expansion of core business were major cash-outflow items for investing activities.</p> <p>c. Financing activities: Repayment of bank loan is the main reason of cash outflow.</p> <p>B. Remedy and liquidity analysis for insufficient cash: not applicable.</p>					

### 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
14,129,330	4,960,477	2,262,847	16,826,960	-	-
<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 stably, 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 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		
				2016	2017	2018~2019
2016 Capital Expenditure – Equipment Renewal	Working Capital	2016/12/31	1,464,972	1,464,972		
2017 Capital Expenditure – Equipment Renewal	Working Capital	2017/12/31	1,021,817		1,021,817	
2018 Capital Expenditure – Equipment Renewal	Working Capital	2018/12/31	1,390,578			1,390,578

### 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 saving, emission reduction, intelligence and automation in global industries, the company focuses its new investment on its core businesses of industrial motor and home appliances, development in Vietnam, India and Africa, related construction of wind power and solar power generation, IIOT and AI, accompanies long-term development plan, and cautiously evaluate each investment plan.

### 7.5.2 Major reasons for profits or loss:

The company listed NT\$233,927 thousands of investment gain on the basis of equity method in 2017, and it is much more than NT\$90,260 thousands in 2016. It mainly came from Heavy Industrial Product and Green Electric Machine.

### 7.5.3 Investment plan for the next year

In the coming one year, investments will focus on energy saving, automation, automation intelligence. Business unit of motor will develop high efficiency motor, explosion proof motor, smart motor. Business unit of system automation will develop inverter with communication function, and Business unit of Home Appliance will develop intelligence control air conditioner, air cooling/ water cooling chiller. In addition, the main process and production line will be IoT.

## 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

	2017	Unit: NT\$Thousand
Interest Income or Loss(1)		(104,441)
Sales Revenues(2)		50,942,521
Operating Income(3)		3,496,200
(1)/(2)		(0.21%)
(1)/(3)		(2.99%)

The company's net interest expense amounted to NT\$104,441 thousands in 2017, equivalent to -0.21% and -2.99%, respectively, of the revenues and operating profits, similar to 2016 level.

Looking ahead at this year, the U.S. will continue interest-rate hike, Europe and Japan may scale down their loose money policy, and China will maintain stable neutral monetary policy. It is forecast that global finance will become tighter, with interest-rate cut rather unlikely.

In order to alleviate the influence of interest-rate change, the company will properly adjust NT dollar-loan position or increase investment in fixed-rate corporate bonds.

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

	2017	Unit: NT\$thousand
Exchange Gain or Loss(1)		(235,383)
Sales Revenues(2)		50,942,521
Operating Income(3)		3,496,200
(1)/(2)		(0.46%)
(1)/(3)		(6.73%)

The company suffered NT\$235,383,000 loss from exchange rates, due mainly to large-scale devaluation of U.S. dollar, which inflicted significant exchange-rate loss on its overseas affiliates for their U.S. dollar positions. In 2018, with interest-rate hike expected to bolster U.S. dollar, challenge to forex-risk management is high, as there will be many variables for the exchange rates of the currencies of major trading partners of the U.S., given emerging emergence of global trade protectionism due to the policy of the Trump Administration. The company will monitor exchange-rate fluctuation closely and execute following countermeasures:

- 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 do internal evaluation reports for hedge on net asset and liability of foreign currency, so that the management team can determine if the company do the hedge or not.

C. The impact on company's performance resulted from inflation and counter measures

The main material that the company mainly used are steel, copper and alumina. Oil price rebounds since second half in 2016, and the material price and metal price grows. It affects purchase cost to a certain extent, however, it is expected that the recovery of world economy and oil&gas, mining exploring will raise the company's operation.

TECO purchases materials using contract to negotiate prices. When the price grows, TECO can negotiate with the suppliers. In this case, there is no significant disadvantage toward company's performance based upon price vibration. However, the company will still evaluate cautiously the trend of metal price and match up the operation drafting the appropriate strategy.

### 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 2017, outstanding loans extended by the company amounted to NT\$222,661 thousands.
- C. In 2017, the outstanding amount of the endorsement and guarantee extended by the company reached NT\$7,026,930 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 2017, 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, power components of electric vehicle, drive motor for robotic arm, medium voltage inverter, and permanent magnet motor drive with free sensor, delicate servo motor, IE5 reluctance motor drive, high level algorithm and IOT.

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 2017 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) EV motor and drive as well as joint development of whole vehicle
- (f) R&D on generator and drive for offshore wind turbine
- (g) Remote monitoring of motor and generator
- (h) R&D on four-phase control for medium-voltage inverter and switch between industrial network and inverter
- (i) High technology for system automation products
- (j) R&D on KW-grade four-phase wind-power converter
- (k) Multiple commercial air-conditioners systems and smart air-conditioners
- (l) R&D on inverter air conditioner related products for specific occasion
- (m) Development of high-performance energy saving centrifugal icy-water machine
- (n) 2016 high-performance energy saving water-cooled packaged air conditioner
- (o) Development of high-performance energy saving variable-frequency air-cooled icy-water machine
- (p) Development of eliminating shaft voltage and shaft current
- (q) Development of high-performance compact servo motor
- (r) Development of IE5 comparable-grade magnetic-resistance motor drive

The goal is to develop products conforming to new 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. TECO Group expects to invest NT\$1.4 Billions as R&D expense in 2018.

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 drive with free sensor
		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		
Long-term	Deployment in new business scope	Integration of Internet of Machine
		Integration of micro smart grid system
		Precise servo system focusing on market
		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		

#### 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 2017, 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**

None

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

None

#### **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