I.Letter to Shareholders

Dear Shareholders,

Looking back at 2014, the global economy was overshadowed by deflation on a number of factors, including continuing structural adjustment worldwide triggered by the global financial tsunami, economic slowdown of China, financial turmoil resulting from strained political situation, and price plunge of raw materials. On the domestic front, Taiwan's GDP expanded by 3.74% in 2014, on a number of favorable factors, including expansion of mobile devices and smart-technological applications, demand for automated production equipment, and oil-price plunge, which more than offset the adverse factors of the depreciation of the Japanese and the food-safety turmoil. The company's order intake and revenue, however, was subject to the influence of a number of adverse factors, including decline in civil-engineering works and new housing starts and the impact of the gas explosion in Kaohsiung on petrochemical investments. In the face of the high uncertainty of the overall economic environment, the company, thanks to the concerted effort of staffers, however, still managed to rake in business benefits and current net profits at record-high level in recent years.

A. Review of Business Performance in 2014

Analysis of the company's business performance in 2014 follows:

a.Parent Company

Unit: NT$ thousand

	2014	2013	Change
Net revenue	24,256,762	25,604,449	(5%)
Operating income	1,953,819	1,712,416	14%
Net profits	4,066,924	3,759,872	8%
Comprehensive income	8,456,178	4,464,419	89%

The company's revenue dropped 5% in 2014, as international oil and raw-materials prices plunged, leading to decrease in the demand of industrial supply chains, which dampened order and sales of motors. Another factor is sluggish investment in domestic civil-engineering works and new housing starts, with budget for civil-engineering works dropping to 12-year low, which dampened sales of the company engineering and power equipment.

The company's gross margin raised by two percentage in 2014, thanks to the export of high-margin motors, commercial air conditioners, and energy-conserving home appliances, whose share in revenue advanced, plus the favorable effect of exchange rates. Even with less revenues, the company's operating income increased by 14% in 2014 over the 2013 level through the achievement in reducing expenses.

In nonoperating income/expense, the company's investment income under equity method, increased by NT$200 million in 2014 than the 2013 level, thanks to continuing improvement in the performances of invested companies. Overall, the company's current net profits grew 8%.

In R&D, the company also made extraordinary gains in 2014, successfully developed a number of new products, including whole-series IE3 motor, IE3 aluminum-enclosure motor, oil & gas industrial application motor, 1,000 KW medium-voltage inverter, 75V/690 inverter, ACB air circuit breaker, cloud-end air conditioning system, VRF (variable refrigerant flow) air conditioner, high-efficiency R-134a centrifugal chiller, electric-car power charging post, and 21-seat electric car. In addition, the company obtained Taiwan Excellence Award for 18 items and 21 patents certified domestically or abroad.

b.Consolidated Financial Statements

Unit: NT$ thousand

	2014	2013	change
Net Revenue	53,820,604	56,618,537	(5%)
Operating Income	4,396,971	4,625,594	(5%)
Net Profits	4,406,231	4,177,256	5%
Total Comprehensive Income	8,999,428	4,951,291	82%
Profit (loss), attributable to:Owners of the Parent	4,066,924	3,759,872	8%
Non-controlling Interest	339,307	417,384	(19%)
Comprehensive Income attributable to:Owners of the Parent	8,456,178	4,464,419	89%
Non-controlling Interest	543,250	486,872	12%

Due to decline in orders for motors, reduced revenue of engineering units, and business adjustment and order reduction of subsidiary TECOM, the consolidated revenue dropped 5%. Operating income declined by 5% versus the level of Year 2013 due to reduced revenue. The consolidated net nonoperating revenue increased, thanks to disposal of its factory land in Wugu of New Taipei city by subsidiary Dongan and increased investment returns under equity method. The other comprehensive income rose, due to increase in unrealized gain on valuation of available-for-sale financial assets. Overall, consolidated net profits grew 5.5% and consolidated comprehensive income soared 82%.

B. Outline of 2015 Business Plan

The Directorate General of Budget, Accounting, and Statistics, under the Executive Yuan, predicts that Taiwan's economy will grow 3.78% in 2015, slightly higher than 2014. However, the company still faces stern challenge for its business in the year, as the domestic civil-engineering market is expected to remain languid, housing starts will drop on the launch of consolidated housing/land tax and expected interest rate increase, and continuous drop in the international prices of international oil, metal, and other raw materials will impact the oil & gas and mining industry. To offset the impact, the company will actively develop new products and new markets, in addition to new business model, to augment growth momentum for revenue.

On the domestic front, in order to enhance the nation's overall energy utilization efficiency, the Ministry of Economic Affairs (MOEA), in addition to continuing subsidies for high-efficiency motors, has banned sales of IE1 motors from 2015. Thanks to the ban and the rollout of cloud-end monitoring and control technology for smart motors, sales of high-efficiency motors by the heavy machinery business is expected to grow conspicuously. The home-appliances business will launch cloud-end smart energy-saving home appliances, which, along with whole-series inverter duty household air conditioners and VRF air conditioners, will enable the company to raise its share in the home-appliances market.

Exports of high-efficiency motors are expected to increase further, as Europe, China, and Japan have publicized schedule for mandatory replacement of low-efficiency motors with high-efficiency models. A number of new products will also hit the market successively, including explosion-prof motor, aluminum-enclosure motor, 510 series inverter, and PLC/SVO. Wind power and electric cars will also begin contributing to revenue. The company has also delivered IDC (Internet Data center) and switchboards abroad. In America, the company's largest overseas outlet, despite the impact of oil price plunge on businesses connected with shale oil, the company's American subsidiary is still actively seeking other business opportunities, taking advantage of the robust economic growth of the U.S. With the European economy having bottomed out, the company will actively tap the replacement market for high-efficiency motors.

In sum, the company will face up to various challenges, both abroad and domestically, in seeking revenue and profit growth, while implementing norms of corporate governance and fulfilling corporate social responsibility. In 2014, the company was the nation's foremost electric-machinery manufacturer, according to the study on the Top 2,000 enterprises conducted by the Commonwealth magazine, in addition to being the champion, for the third year in row, in the traditional industry category for the corporate citizen award granted by the Commonwealth magazine, as well as the champion for the category of big-enterprise technology, the Taiwan Corporate Sustainability Awards. Adhering to the management concept of integrity and conforming to the global energy-conservation and carbon-abatement current, the company will dedicated to pushing energy-conserving and environment-friendly products, so as to maximize shareholders' interests and provide payback fully to shareholders and investing public, in return to their longtime support and patronage.

President Sophia

TECO Electric & Machinery Co., Ltd