

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

7.1 Analysis of Financial Status

Unit: NT\$thousand

Item	Year	2016/12/31	2015/12/31	Difference		Remark
				Amount	%	
Current Assets		\$45,296,310	\$42,292,402	3,003,908	7	
Fixed Assets		18,463,450	15,018,217	3,445,233	23	Note 1
Intangible Assets		5,636,766	5,541,844	94,922	2	
Other Assets		22,977,430	21,581,789	1,395,641	6	
Total Assets		92,373,956	84,434,252	7,939,704	9	
Current Liabilities		18,958,845	22,715,038	(3,756,193)	(17)	Note 2
Long-term Liabilities		17,690,568	10,286,710	7,403,858	72	Note 3
Total Liabilities		36,649,413	33,001,748	3,647,665	11	
Equity attributable to owners of parent		49,731,567	47,464,042	2,267,525	5	
Capital stock		20,026,929	20,026,929	0	0	
Capital surplus		7,671,889	7,638,417	33,472	0	
Retained Earnings		21,187,539	19,363,279	1,824,260	9	
Other Comprehensive Income for the year		845,210	435,417	409,793	94	Note 4
Non Controlling Interest		5,992,976	3,968,462	2,024,514	51	Note 5
Total Stockholders' Equity		55,724,543	51,432,504	4,292,039	8	

Note 1: Reason for increased fixed assets: because of adding new entity, Century Development, acquired in 2016.

Note 2: Reason for decreased Current Liabilities: The main reason is that repaying Formosa bond due within one year

Note 3: Reason for increased Long-term Liabilities: Contribution of New entity, Century Development

Note 4: 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 rose, therefore the adjustment of unrealized income and cumulative translation increased.

Note 5: Reason for increased Non Controlling Interest: because of New entity, Century Development, shareholding ratio is 52.75%, the rest 47.25% is Non Controlling Interest

7.2 Analysis of Operating Results

7.2.1 Operating Results

Unit: NT\$thousand

Item	Year	2016	2015	Difference		Remark
				Amount	%	
Sales Revenue		49,923,836	48,598,573			
Operating Costs		(36,788,304)	(36,203,039)			
Gross Profit		13,135,532	12,395,534	739,998	6	
Realized(Unrealized) Profit from Sales		(1,137)	4,777	(5,914)		
Gross Profit - Net		13,134,395	12,400,311	734,084	6	
Operating Expenses		(8,944,914)	(8,612,684)	(332,230)	4	
Operating Profit		4,189,481	3,787,627	401,854	11	Remark 1
Non-operating Income and Gains		743,810	775,644	(31,834)	(4)	
Profit before income tax		4,933,291	4,563,271	370,020	8	Remark 1
Tax Expense		(896,293)	(1,049,155)	152,862	(15)	Remark 2
Net Income		4,036,998	3,514,116	522,882	15	Remark 1-2
Other comprehensive income		323,292	(2,953,958)	3,277,250	(111)	Remark 3
Total comprehensive income		4,360,290	560,158	3,800,132	678	Remark 4
Analysis and explanation for changes:						
1. The main reason is the acquisition of Motovario, developing synergy, enhancing value added of products, so that net gross margin and operating profit are higher than last year						
2. Due to tax benefit resulted from capital reduction of overseas subsidiary						
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
14,919,042	4,850,429	5,779,645	13,989,826	-	-
<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 Formisa Bond and issuance of dividends for stocks was major cause for cash outflow for financing activities.</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
13,989,826	5,332,367	2,464,031	16,858,162	-	-
<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		
				2013	2014	2015~2016
2015 Capital Expenditure – Equipment Renewal	Working Capital	2015/12/31	1,696,681	1,696,681		
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	1,590,578			1,590,578

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 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\$90,260 thousands of investment loss on the basis of equity method in 2016, and it is much less than NT\$153,936 thousands in 2015. It mainly came from new entity, Century Development and the joint venture Synergy, which just starts and has not gotten things move.

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

	2016	Unit: NT\$Thousand
Interest Income or Loss(1)		(110,014)
Sales Revenues(2)		49,923,836
Operating Income(3)		4,189,481
(1)/(2)		(0.22%)
(1)/(3)		(2.63%)

The company's net interest expense amounted to NT\$110,014 thousands in 2016, equivalent to -0.22% and -2.63%, respectively, of the revenues and operating profits, higher than 2015 level, due to increased interest expense and deposit interest decreased.

Major raw materials used by the company are steel, copper, and aluminum. In the second half of 2016, global oil priced rebounded, inducing price hikes of raw materials and basic metals and boosting procurement costs. However, global economic growth and recovery of oil and mining prospecting may inject fresh momentum to the company's business.

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

	2016	Unit: NT\$thousand
Exchange Gain or Loss(1)		23,928
Sales Revenues(2)		49,923,836
Operating Income(3)		4,189,481
(1)/(2)		0.05%
(1)/(3)		0.57%

The company incurred net gain of NT\$23,928 thousands from currency conversion in 2016, accounting for minuscule shares of 0.05% and 0.57%, respectively of revenues and operating profit.

Although interest rate raised in the U.S. would support for the performance of US dollar, protectionism rises gradually after Trump got on board. The country that views the U.S. as main trading partner faces more variable on currency having more challenges and risk of exchange rate management. The company always notices the fluctuation of exchange rate, and keeps carrying out the following counter-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 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 2016, outstanding loans extended by the company amounted to NT\$55,071 thousands.
- C. In 2016, the outstanding amount of the endorsement and guarantee extended by the company reached NT\$171,198 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 2016, 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 2016 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) R&D on generator and drive for offshore wind turbine
- (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) R&D on KW-grade four-phase wind-power converter
- (l) Multiple commercial air-conditioners systems and smart air-conditioners
- (m) R&D on inverter air conditioner related products for specific occasion
- (n) Development of high-performance energy saving centrifugal icy-water machine
- (o) 2016 high-performance energy saving water-cooled packaged air conditioner
- (p) Development of high-performance energy saving variable-frequency air-cooled icy-water machine
- (q) Development of eliminating shaft voltage and shaft current
- (r) Development of high-performance compact servo motor
- (s) Development of IE5 comparable-grade magnetic-resistance motor drive

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 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 2016, 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 business group purchased 12.12% stake in Century Development Corp. with NT\$462,233,000 of cash on Feb. 5, 2016, boosting its interest in the latter to 52.75% and gaining a controlling power. In the wake of the takeover, the business group expects to intensify its realty development and management.

Risk managements for the aforementioned acquisitions were in the charge of the financial division and various business divisions at the headquarters.

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

The business group set up assembling line for small sized motor in India via joint venture in August 2016, controlling the cost by local supply chain to satisfy motor demand in Southeast Asia.

Risk management for project is in the charge of business unit and factory-construction task force.

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