

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

### 7.1 Analysis of Financial Status

Unit: NT\$thousand

Item	Year	2018/12/31	2017/12/31	Difference		Remark
				Amount	%	
Current Assets		43,760,371	\$44,262,768	(502,397)	(1)	
Fixed Assets		17,363,543	17,922,299	(558,756)	(3)	
Intangible Assets		5,557,343	5,612,315	(54,972)	(1)	
Other Assets		25,300,029	24,219,575	1,080,454	4	
<b>Total Assets</b>		<b>91,981,286</b>	<b>92,016,957</b>	<b>(35,671)</b>	<b>0</b>	
Current Liabilities		18,141,380	18,742,356	(600,976)	(3)	
Non Current Liabilities		15,348,991	15,400,464	(51,473)	0	
<b>Total Liabilities</b>		<b>33,490,371</b>	<b>34,142,820</b>	<b>(652,449)</b>	<b>(2)</b>	
Equity attributable to owners of parent		53,678,660	51,829,765	1,848,895	4	
Capital stock		20,026,929	20,026,929	0	0	
Capital surplus		7,647,215	7,628,542	18,673	0	
Retained Earnings		25,221,021	22,469,336	2,751,685	12	
Other equity		783,495	1,704,958	-921,463	(54)	Note 1
Non Controlling Interest		4,812,255	6,044,372	-1,232,117	(20)	Note 2
Total Stockholders' Equity		58,490,915	57,874,137	616,778	1	

Note 1: Reasons for reduction of other equity interests: mainly due to the application of IFRS 9 for the first time, leading to the transfer of the increased benefits, based on fair value, of financial assets available for sale from other equity interests to retained earnings.

Note 2: Reason for reduction of non-controlling interest, due mainly to loss of control of Kunling Freezing Machinery Co., Ltd. by the business group, following reelection of the subsidiary's board of directors and supervisors.

## 7.2 Analysis of Operating Results

### 7.2.1 Operating Results

Unit: NT\$thousand

Item	Year	2018	2017	Difference		Remark
				Amount	%	
Sales Revenue		50,104,927	50,942,521			
Operating Costs		(38,052,253)	(38,743,733)			
Gross Profit		12,052,674	12,198,788	(146,114)	(1)	
Realized(Unrealized) Profit from Sales		(15)	(2,520)	(2,505)	(99)	Remark1
Gross Profit - Net		12,052,659	12,196,268	(143,609)	(1)	
Operating Expenses		(8,532,173)	(8,700,068)	167,895	(2)	
Operating Profit		3,520,486	3,496,200	24,286	1	
Non-operating Income and Gains		765,802	857,704	(91,902)	(11)	
Profit before income tax		4,286,288	4,353,904	(67,616)	(2)	
Tax Expense		(810,319)	(809,656)	(663)	0	
Net Income		3,475,969	3,544,248	(68,279)	(2)	
Other comprehensive income		433,011	781,789	(348,778)	(45)	Remark2
Total comprehensive income		3,908,980	4,326,037	(417,057)	(10)	Remark3
Analysis and explanation for changes:						
1. Due mainly to the lack of the situation in 2017, when share of inventories unsold which was sold to affiliates increased at the end of the period.						
2. Due mainly to the reduction of unrealized gain on valuation of financial assets in the year, leading to reduction of other comprehensive income.						
3. In sum, total comprehensive income of the year dropped.						

### 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
14,129,330	4,328,692	922,456	17,535,566	-	-
<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: Reduction in investments in debt instruments for enlivening market is the main reason for decline in investments-related cash inflow</p> <p>c. Financing activities: Cash dividend payout 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
17,535,566	4,545,126	2,522,316	19,558,376	-	-
<p>A. Analysis of change in cash flow in the current year:</p> <p>a. Operating activities: Despite global economic slowdown and increased uncertainties for economic growth, the company's core business is expected to maintain steady growth in the year, thanks to actively sales campaign, as a result of which operating activities will continue generating cash inflow</p> <p>b. Investing activities: There will be net cash outflow for funding in the coming year, thanks to potential financial injection into expansion of core business and adjustment on non core long term investment.</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		
				2018	2019	2020
2018 Capital Expenditure – new equipment and equipment renewal	Working Capital	2018/12/31	970,000	970,000		
2019 Capital Expenditure – new equipment, equipment renewal and capacity expansion	Working Capital	2019/12/31	2,841,412		1,546,000	1,295,412

### 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 response to economic development trend and increasing competition, both on domestic and overseas fronts, investments are mainly for vertical or horizontal integration of the company's core businesses, including electric machinery, energy engineering, and home appliances, on top of offshore wind power and green energy-related engineering, for materialization of the corporate vision of "energy conservation, emission reduction, smart application, and automation," thereby gradually increasing overseas profits and market share, via global deployment for both production and sale.

### 7.5.2 Major reasons for profits or loss:

The company recognized NT\$114,143,000 of investment income based on equity method in 2018, less than 2017's NT\$233,927,000, due to decreased income from investments in TPI Bearings, Lien Chang Electronic Enterprises, and some foodstuff companies.

### 7.5.3 Investment plan for the next year

Investment plan for the coming year still focuses on energy conservation, emission reduction, intelligence and automation, both on domestic and overseas fronts, all related to the company's core business. For investments in National Biotechnology Research Park in Nangang, Taipei, and Bengaluru International Technology Park in India, construction for the park's infrastructural facilities and service

center will break ground in 2019 and 2020, including R&D and incubation facilities and automated factory buildings.

## 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

	2018	Unit: NT\$Thousand
Interest Income or Loss(1)		(2,554)
Sales Revenues(2)		50,104,927
Operating Income(3)		3,520,486
(1)/(2)		(0.0051%)
(1)/(3)		(0.072%)

The company's net interest expense amounted to NT\$12,544 thousands in 2018, equivalent to -0.0051% and -0.072%, respectively, of the revenues and operating profits, similar to 2017 level.

In 2019, led by rather loose monetary policy of the U.S., Europe, Japan, and China, global credit supply will be sufficient, with interest hike rather unlikely.

To offset the effect of change in interest rate, the company will adjust forex-denominated loan position timely or increase investments in fixed-rate corporate bonds.

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

	2018	Unit: NT\$thousand
Exchange Gain or Loss(1)		76,925
Sales Revenues(2)		50,104,927
Operating Income(3)		3,520,486
(1)/(2)		(0.15%)
(1)/(3)		(2.19%)

The company raked in NT\$76,925,000 of exchange-rate income in 2018, due mainly to exchange benefits from U.S.-dollar position of overseas affiliates, caused by appreciation of greenback. In 2019, despite interest-rate hike appears to stall, basic economic figures remain robust, as a result of which exchange rate of U.S. dollar may fluctuate within a range. However, due to emergence of protectionism sparked by Donald Trump's trade policy, outlook for the currencies of the major trade partners of the U.S. is precarious, posing major challenge to forex management:

- a. In addition to natural risk hedging associated with positions of assets and liabilities, the company will undertake substantial risk hedging via forward forex transactions.
- b. 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.

- c. 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 alumini. It affets 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 operarion.

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 compny 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 2018, outstanding loans extended by the company amounted to NT\$161,223 thousands.
- C. In 2018, the outstanding amount of the endorsement and guarantee extended by the company reached NT\$2,352,749 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 2018, 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) Very high power density induction motor and servo motor
- (c) Development of pump motor for North America
- (d) Development of high-speed permanent-magnet motor and driver
- (e) Development of ring-shape motor for steel plant
- (f) Reluctive motor and drive
- (g) Low power consumption inverter duty refrigerator
- (h) EV motor and drive as well as joint development of whole vehicle
- (i) R&D on generator and drive for offshore wind turbine
- (j) R&D on four-phase control for medium-voltage inverter and switch between industrial network and inverter
- (k) High end AEF and controller products
- (l) R&D on KW-grade four-phase wind-power converter
- (m) Development of high IPLV electromagnetic-suspension centrifugal machine
- (n) Development of HVAC air-conditioner energy conservation solution
- (o) Multiple commercial air-conditioners systems and smart air-conditioners
- (p) development of VRF whole direct-current variable-frequency multiple-connection main pipe/connection-in-parallel air conditioner
- (q) Development of VRF whole direct-current four-unit split air conditioner
- (r) Development of air-cooled sideward- and upward-blowing chiller
- (s) Development of air-cooled modularized chiller
- (t) Development of high-sensible/constant-temperature constant-humidity water-cooled packaged air conditioner

- (u) R&D on inverter air conditioner related products for specific occasion
- (v) Development of high-performance energy saving centrifugal icy-water machine
- (w) Direct current inverter duty packaged air conditioner
- (x) Development of whole series R32 one-to-one variable-frequency large split air conditioner
- (y) Development of whole series R32 variable-frequency window type air conditioner
- (z) Development of multiple TECO-Select premium air conditioner
- (aa) Development of multi-option air conditioners
- (bb) Development of variable-frequency air-conditioning air-cleaning/voice-control technology
- (cc) Development of high energy-performance variable-frequency commercial refrigerator
- (dd) Development of high energy-performance variable-frequency produce/freezing change-over refrigerator
- (ee) Development of high-performance compact servo motor
- (ff) Development of IE5 comparable-grade magnetic-resistance motor drive
- (gg) Development voice technology for meal-delivery robot
- (hh) Development of image recognition technology for meal-delivery robot
- (ii) Development of management technology for multiple AGVs
- (jj) Development of Matrix converter prototype
- (kk) Development of next-generation high-performance servo driver
- (ll) Development of multi-axis server technology
- (mm) Development of direct-current compact server
- (nn) Development of simplified EtherCat alternating-current server
- (oo) Development of ultra-thin simplified alternating-current server
- (pp) Development of integrated permanent-magnet motor and driver machine

The goal is to develop products conforming to 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. TECO Group expects to invest NT\$1.24 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
		Control for servo system
		High rotational-speed motor
		Development of high power-density motor series
		Multi-unit commercial-use package air conditioning unit
		High energy-performance variable-frequency commercial refrigerator
		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	Single-axis high-performance servo driver
		Development of matrix converter technology
		Development of AGV
		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
		Development of high IPLV electromagnet-suspension centrifugal machine
		Development of energy-conservation solution for HVAC air-conditioning system
Development of multi-axis servo driver technology		
Long-term	Deployment in new business scope	Development of next-generation frequency converter prototype
		Development of products deriving from indoor service machines
		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
Development of multi-axis server system integration		
Development of outdoor AGV		
Next-generation frequency converter series		

#### **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**

Given the trend of shrinking workforce and green energy, the company takes into account global development trend, the government's industrial policy, own technological level, and growth potential of related industries. In addition to consolidating the company's technological edge in high-performance motive-force motor, application of environment-friendly refrigerant in home applications, and variable-frequency energy conservation, the company will intensively study international technological development and market trend for introduction of innovative methodology. In response to the trend of shrinking employment population, the company will plan biotechnology forum, long-term technological development roadmap, and strategy and timetable for completion of development plan. In line with the need of green energy, the company will develop electric-car motor, wind turbine, peripherals of smart grid, energy-saving home appliances, and split air conditioning 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