

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

7.1 Analysis of Financial Status

Unit: NT\$thousand

Item	Year	2015/12/31	2014/12/31	Difference		Remark
				Amount	%	
Current Assets		\$42,292,402	\$43,266,297	(982,932)	(2)	
Fixed Assets		15,018,217	14,738,703	448,530	3	
Intangible Assets		5,541,844	174,250	5,367,594	3,080	Note 1
Other Assets		21,581,789	24,592,417	(3,111,985)	(13)	
Total Assets		84,434,252	82,771,667	1,721,207	2	
Current Liabilities		22,715,038	18,075,827	4,639,211	26	Note 2
Long-term Liabilities		10,286,710	11,394,547	(1,061,786)	(9)	
Total Liabilities		33,001,748	29,424,323	3,577,425	12	
Equity attributable to owners of parent		47,464,042	49,270,073	(1,806,031)	(4)	
Capital stock		20,026,929	20,026,929	0	0	
Capital surplus		7,638,417	7,600,552	37,865	0	
Retained Earnings		19,363,279	18,444,540	918,688	5	
Other Comprehensive Income for the year		435,417	3,198,001	(2,762,584)	(86)	Note 3
Non Controlling Interest		3,968,462	4,018,649	(50,187)	(1)	
Total Stockholders' Equity		51,432,504	53,288,722	(1,856,218)	(3)	

Note 1: Reason for increased intangible assets: The main reason is that good will increased because of adding new entity, Motovario S.p.A, acquired in 2015.

Note 2: Reason for increased Current Liabilities: The main reason is that short term bank loan of Motovario S.p.A.

Note 3: Reason for oncreased 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 fell, therefore the adjustment of unrealized income and cumulative translation decreased.

7.2 Analysis of Operating Results

7.2.1 Operating Results

Unit: NT\$thousand

Item	Year	2015	2014	Difference		Remark
				Amount	%	
Sales Revenue		48,598,573	53,748,466			
Operating Costs		(36,203,039)	(40,356,727)			
Gross Profit		12,395,534	13,391,739	(996,205)	(7)	
Realized(Unrealized) Profit from Sales		4,777	64	4,713		
Gross Profit - Net		12,400,311	13,391,803	(991,492)	(7)	
Operating Expenses		(8,612,684)	(8,968,967)	356,283	4	
Operating Profit		3,787,627	4,422,836	(635,209)	(14)	
Non-operating Income and Gains		775,644	1,277,135	(501,491)	(39)	Remark 1
Profit before income tax		4,563,271	5,699,971	(1,136,700)	(20)	Remark 1
Tax Expense		(1,049,155)	(1,297,704)	248,549	19	Remark 2
Net Income		3,514,116	4,402,267	(888,151)	(20)	Remark 1-2
Other comprehensive income		(2,953,958)	4,589,906	(7,543,864)	(164)	Remark 3
Total comprehensive income		560,158	8,992,173	(8,432,015)	(94)	Remark 4

Analysis and explanation for changes:

1. Gain from Disposition of land and factory building in Wugu last year.
2. Due to decreased profit, tax expenses decreased
3. The market price of investing target fall, therefore the adjustment of unrealized income decreased.
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
17,201,690	5,541,428	7,824,076	14,919,042	-	-

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
14,919,042	6,255,298	4,641,252	16,533,088	-	-

A. Analysis of change in cash flow in the current year:

- 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.
- 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.
- 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.

B. Remedy for Cash Deficit and Liquidity Analysis: Not Applicable

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
2014 Capital Expenditure – Equipment Renewal	Working Capital	2014/12/31	1,945,847	1,945,847		
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	1,598,576			1,598,576

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\$153,936 thousands of investment returns on the basis of equity method in 2015. In contrast to NT\$180,329 thousands in 2014, it decreased by 15%. It mainly came from decreased 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, smart motor & electric-vehicle motor developed by industrial motor businesses, the inverter with function of communication developed by system automation business, and smart inverter air conditioners, VRF system of outside inverter in parallel and commercial inverter duty air conditioner, low temperature logistics 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

	2015	Unit: NT\$Thousand
Interest Income or Loss(1)		(49,607)
Sales Revenues(2)		48,598,573
Operating Income(3)		3,787,627
(1)/(2)		-0.10%
(1)/(3)		-1.31%

The company's net interest expense amounted to NT\$49,607 thousands in 2015, equivalent to -0.10% and -1.31%, respectively, of the revenues and operating profits, lower than 2014 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\$80,133 thousands.

Although the U.S.'s job market picking up steadily, due to the effect of global economy, it is estimated that the speed of raising interest rate would not be fast as expected. On the other hand, in order to combat deflation, Japan and the euro region will stick to negative interest rate 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.

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

	2015	Unit: NT\$thousand
Exchange Gain or Loss(1)	170,002	
Sales Revenues(2)	48,598,573	
Operating Income(3)	3,787,627	
(1)/(2)	0.35%	
(1)/(3)	4.49%	

The company incurred net loss of NT\$170,002 thousands from currency conversion in 2015, accounting for minuscule shares of 0.35% and 4.49%, respectively, of revenues and operating profit.

Looking ahead at 2016, the greenback will remain relatively strong but other currencies will be propped up by expectation for slowdown of the pace of interest hike in the U.S. The likelihood for large-scale depreciation of the New Taiwan dollar is not high, due to the expectation of sustained growth for Taiwan's exports and the penchant of the Central Bank of China to adjust its monetary policy on the heels of the U.S. Despite the effect of carry trade, Japanese yen and the euro, however, will still be under the pressure of depreciation. Downside risk for the trading of Australian dollar is rather high, as it is difficult to change the reliance of the country's growth on mining investments to export or domestic demand in the short term.

- 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 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 2015, outstanding loans extended by the company amounted to NT\$271,571,000.

- C. In 2015, the outstanding amount of the endorsement and guarantee extended by the company reached NT\$175,109 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 2015, 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. 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. R&D on KW-grade four-phase wind-power converter
- L. Multiple commercial air-conditioners systems and smart air-conditioners
- M. R&D on machine-tool variable-frequency air-conditioning products
- 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 high speed-axis motor
- 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		

Term of R&D	Focus	Major R&D items
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		

It is expected that we will invest NT\$ 2.8 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 business group purchased 20% stake in YASKAWA TECO Motor Engineering Co. with NT\$23,667,000 of cash on March 2015, boosting the group's stake in the latter to 60% and giving the company a controlling power. The business group expects to boost its revenues in related markets following the acquisition.

The Group carried out 100% acquisition of Motovario S.p.A and its subsidiaries with NT\$3,939,850,000 (108,214,000 euros) on Oct. 15, 2015, thereby gaining a controlling power for the latter. In the wake of the takeover, the business group expects to extend its product lineup to power-transmission system and provide customers even more complete drive solutions, in addition to expanding the global deployment and customer groups of TECO products.

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 Wuxi TECO Precision Machinery via equity investment in April 2015, mainly for providing stamping parts to the group's motor factories in mainland China.

It is expected to strengthen price-negotiation clout for the united purchase of silicon steel plates and boost cost competitiveness, in addition to grasping various cutting-edge stamping process technologies and meeting the need of high-efficiency quality stamping parts on the market.

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