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

7.1 Analysis of Financial Status

Unit：NT$ Million

Item \ Year	2011.12.31	2010.12.31	Difference	
			Amount	%
Assets				
Cash & cash equivalents, Due from CBC and lent to banks	26,975	28,890	(1,915)	(Note 1) (6.63)
Financial assets at fair value through income statement	1,616	1,104	512	(Note 2) 46.38
Bills and bonds purchased under resale agreements	5,878	2,791	3,087	(Note 3) 110.61
Net accounts receivable	986	989	(3)	(0.30)
Net discounts & loans	166,216	162,194	4,022	(Note 4) 2.48
Net available-for-sale financial assets	11,748	5,094	6,654	(Note 5) 130.62
Net held-to-Maturity financial assets	5,567	7,695	(2,128)	(Note 6) (27.65)
Net equity method's investments	63	55	8	14.55
Net other financial assets	1,831	3,048	(1,217)	(Note 7) (39.93)
Net property and equipment cost	2,202	2,237	(35)	(1.56)
Net intangible assets	63	59	4	6.78
Net other assets	769	748	21	2.81
Total Assets	223,914	214,904	9,010	4.19
Liabilities				
Due to CBC & banks	11,512	12,606	(1,094)	(Note 8) (8.68)
Financial liabilities at fair value through income statement	4	15	(11)	(73.33)
Bills and bonds sold under repurchase agreements	103	141	(38)	(26.95)
Accounts payable	3,379	2,827	552	(Note 9) 19.53
Deposits & remittances	193,944	185,167	8,777	(Note 10) 4.74
Financial bonds payable	4,000	4,000	0	0.00
Pension payable	305	253	52	20.55
Other financial liabilities	195	207	(12)	(5.80)
Other liabilities	108	129	(21)	(16.28)
Total Liabilities	213,550	205,345	8,205	4.00
Stockholders' Equity				
Capital	7,069	5,258	1,811	(Note 11) 34.44
Capital reserve	2,018	2,543	(525)	(Note 12) (20.64)
Retained earnings	1,278	1,785	(507)	(Note 13) (28.40)
Other stockholder's equity	(1)	(27)	26	96.30
Total Stockholders' Equity	10,364	9,559	805	8.42

Note: Major reasons for change in assets, liabilities, and stockholders' equity during the past two years：

1. Caused by decrease of C.D. due from CBC.
2. Caused by increase of trade with bills and convertible corporate bonds.
3. Caused by increase of bills and bonds under resale agreement.
4. Caused by increase of mid-term guarantee loans.
5. Caused by increase of available-for-sale CBC negotiable certificate of deposit.
6. Caused by decrease of held-to-maturity foreign bonds.
7. Caused by decrease of bond investment without market price.
8. Caused by decrease of Inter-bank borrowing and lending.
9. Caused by increase of Checks for clearance.
10. Caused by increase of certificate of deposit.
11. Caused by capital increase in cash, recapitalization from capital surplus and earnings.
12. Caused by capital increase out of capital reserve.
13. Caused by the loss in 2011.

7.2 Analysis of Operating Results

Unit：NT$ Million

Item \ Year	2011.01.01-2011.12.31	2010.01.01-2010.12.31	Difference		
			Amount	%	
Net interest revenue	1,988	1,789	199	(Note 1)	11.12
Net non-interest revenue	330	554	(224)	(Note 2)	(40.43)
Credit loss expenses	899	308	591	(Note 3)	191.88
Operating expenses	1,848	1,829	19		1.04
Income before tax－operating department	(429)	206	(635)	(Note 4)	(308.25)
Income after tax－operating department	(433)	127	(560)	(Note 4)	(440.94)
Non-operating department income－after income tax	0	0	0		－
Special income－after income tax	0	0	0		－
Cumulative effect of changes on accounting principles－after income tax	0	0	0		－
Net income	(433)	127	(560)	(Note 4)	(440.94)

Note：1. Caused by increase of net interest revenue from loans.
2. Caused by increase of provision for impairment loss in foreign currency investments.
3. Caused by increase of provision for credit loss expenses from loans.
4. Caused by increase of provision cost from bad debt of loans and impairment loss in foreign currency investments.

7.3 Analysis of Cash Flow

7.3.1 Cash Flow Analysis for the Past Two Years

Unit：%

Item \ Year	2011	2010	Comparison %
Cash flow ratio (%)	6.37	6.36	0.01
Cash flow adequacy ratio (%)	1,407,94	1,231.87	176.07
Cash flow satisfied ratio (%)	10.66	3.23	7.43

Note：1. Increase of cash flow ratio was caused by Inter-bank borrowing and lending for FY 2010 less than FY 2009.
2. Increase of cash flow adequacy ratio was caused by decrease of capital expenditure and cash dividends for past five years.
3. Increase of cash flow satisfied ratio was caused by net cash provided used in investing activities for FY 2010 less than FY 2009.

7.3.2 Cash Flow Analysis for the Coming Year

Unit：NT$ Million

Estimated Cash and Cash Equivalents, Beginning of Year (1)	Estimated Net Cash Flow from Operating Activities (2)	Estimated Cash Outflow (3)	Cash Surplus (Deficit) (1) + (2) - (3)	Leverage of Cash Deficit	
				Investment Plans	Financing Plans
2,840,102	396,966	443,652	2,793,416	－	－

Note：1. Analyses on change of cash flow in the current year:
(1) Operating activities: due to decrease in adjustment on accounts payable.
(2) Cash outflow: due to increase in discounts and loans.
2. Correction action for deficit in cash and liquidity analyses:
(1) Investing plans: none.
(2) Financing plans: none.

7.4 The Impact of Major Capital Expenditures on Financial Operations in FY 2011

7.4.1 Utilization of Capital Expenditure and Source of Funds

Unit：NT$ Million

Capital Expenditure Project	Source of Fund	Projected Completion Date	Fund Needed	Utilization of Fund
None	None	None	None	None

7.4.2 Estimated potential effects：None

7.5 Investment Policy in Last Year, Main Causes for Profits or Losses, Improvement Plans and the Investment Plan for the Coming Year

7.5.1 The Transfer Investment Policy in FY 2011, and Investment Plan for the Coming Year

The Bank will continuously observe and understand the development trend of the market in accordance with active and stable investment policies, and proceed with trans-investment insofar as it is permitted by law upon appraisal of the cost and benefit subject to the needs for the development of the Bank's business and the whole industry.

7.5.2 The Gain on the Transfer Investment in the Last Two Years

Unit：NT$ Million

FY	Amount	Source
2011	70	Recognized earnings and cash Dividends
2010	91	Recognized earnings and cash Dividends

7.5.3 The Loss on the Transfer Investment in the Last Two Years

Unit：NT$ Million

FY	Amount	Source
2011	0	None
2010	0	None

7.6 Analysis of Risk Management

7.6.1 Qualitative and Quantitative Information of the Various Risks

A. Credit Risks Management System and Capital Charge

(a) Credit risks management system , please refer to page 105~109 for "This Bank's risk management systems are outlined B".

(b) Exposure and Capital Charge after Risk Mitigation under the Credit Risk Standard Approach

Unit：NT$ Million at 2012.03.31

Item	Exposure after Risk Mitigation	Capital Charge
Sovereign country	26,026	4
Non government — Public departments	46,016	800
Banks (including multi-development banks)	5,597	175
Enterprise (including securities and insurance)	64,910	5,061
Retail exposure	36,158	2,039
Real estate for residential	27,242	1,117
Equity securities investments	150	48
Other assets	5,413	237
Total	211,512	9,481

B. Asset Securitization Risk Management System, Exposure and Capital Charge：

(a) Asset securitization risk management system, please refer to page 112~113 for “This Bank’s risk management systems are outlined E”.

(b) Asset securitization：None.

(c) Exposure and Capital Charge after Asset Securitization Risk

Unit：NT$ Million at 2012.3.31

Item	Non-Originator bank	
	Exposure after Asset Securitization Risk under Buy In or Held	Capital Charge
Banks (including multi-development banks)	0	0
Enterprise (including securities and insurance)	499	49
Total	499	49

(d) Summarization of information about investment in securitization products

Unit：NT$ Million at 2012.03.31

Item	Account	Original Cost	Accumulated Value Income	Accumulated Impairment	Book Value
Collateralized Debt Obligation (CDO)	Bond investment without market price	1,051	0	950	101
Collateralized Loan Obligation (CLO)		293	0	0	293
Structured Investment Vehicle (SIV)		373	0	269	104

Note: Original Cost means the cost after discount/premium amortization (including exchange rate effect), not the original purchasing cost.

(e) Information about initial cost of single transaction for investment in securitization products amounting to more than NT$300 million: None

C. Operational Risks Management System and Capital Charge

(a) Operational risks management system, please refer to page 109~111 for ” This Bank’s risk management systems are outlined C”.

(b) Operational Risks Capital Charge

Unit：NT$ Million

FY	Gross Income	Capital Charge
2011	2,431	122
2010	2,331	117
2009	1,829	91
Total	6,591	330

D. Market Risks Management System and Capital Charge

(a) Market risks management system, Please refer to page 111~112 for ” This Bank’s risk management systems are outlined D”.

(b) Market risk capital charge

NT$ Million at 2012.03.31

Item	Capital Charge
Interest rate risks	172
Equity exposure risks	8
Foreign exchange risks	18
Product risks	0
Total	198

E. Liquidity Risks

(a) Maturity analysis of assets and liabilities：

1. Analyses of the Structure of the Maturity Date (NT$) please refer to page 120.
2. Analyses of the Structure of the Maturity Date (US$) as flow：

Analyses of the Structure of the Maturity Date (US$)

2011.12.31 Unit：US$ Thousand

Item	Total	Amount of the Residual Period from Maturity Date				
		1-30 days	31-90 days	91-180 days	181 days-1 year	Over 1 year
Assets	452,376	74,096	40,955	36,764	5,543	295,018
Liabilities	457,817	164,420	194,804	25,378	20,425	52,790
Gap	(5,441)	(90,324)	(153,849)	11,386	(14,882)	242,228
Accumulated Gap	(5,441)	(90,324)	(244,173)	(232,787)	(247,669)	(5,441)

2010.12.31 Unit：US$ Thousand

Item	Total	Amount of the Residual Period from Maturity Date				
		1-30 days	31-90 days	91-180 days	181 days-1 year	Over 1 year
Assets	465,457	58,654	57,147	50,828	41,013	257,815
Liabilities	483,164	208,692	174,293	27,546	22,689	49,944
Gap	(17,707)	(150,038)	(117,146)	23,282	18,324	207,871
Accumulated Gap	(17,707)	(150,038)	(267,184)	(243,902)	(225,578)	(17,707)

(b) Methods to manage the asset liquidity and funds gap liquidity

To help manage interest rate risk and liquidity risk,ensure the ability to pay, maintain financial stability and strengthen the ability to respond to emergencies, the Bank enacts the “Guidelines for Interest Rate Risk and Liquidity Risk Management” with respect to NT$ and major foreign currencies of which the assets account for more than 15% of all foreign currency assets.

In order to stabilize long-term profitability and maintain business growth, the Bank adopts a management strategy between active and defensive and defines various management indicators to measure and control NTD cash flow gap of various tenors, required reserve ratio, liquid reserve ratio, (net) loans to deposits ratio, liabilities purchased (issuance of negotiable certificates of deposit) and deposits ratio, to control the various indicators within the required scope at any time, and prepare and submit daily, monthly or quarterly statements to the management for review.

7.6.2 The Impact of International and Domestic Policies、Regulatory Changes on the Bank Financial & Business and the Responsive Measures

Changes	Impact	Responsive Measures
The competent authority promulgated and enforced the Statement of Financial Accounting Standards No. 34 and amended “Regulations Governing the Procedures for Banking Institutions to Evaluate Assets and Deal with Non-performing/Non-accrual Loans”.	The Bank deposited bad debt expenses NT$0.875 billion in January 2011 as required.	In order to offset the impact caused by the deposit of bad debt expenses to earnings, the Bank adjusted the asset and liability portfolio structure actively in order to increase high-interest spread loans, low-cost deposit and low-risk financial management revenue.
The competent authority promulgated and enforced the “Financial Consumer Protection Act” and related laws.	Fulfill the protection of customers' interest and rights.	Review, add and revise the Bank’s forms, contracts, operating procedures and rules to meet the relevant requirements and protect

		customers' interest and rights.
The competent authority announced to open the underwriting of RMB business by OBU and offshore branches.	Upon approval of the competent authority, the Bank's OBU may underwrite the RMB business to increase business income.	The Bank's OBU plans to underwrite the OBU RMB business to increase income.
The competent authority promulgated and enforced the "Regulations Governing the Banking Activity and the Establishment and the Investment by Financial Institution Between the Taiwan Area and Mainland Area".	The points of the Regulations are intended to adjust the body and business type of the banks wishing to launch into the Mainland China market, to enhance the risk control mechanism and to ease the scope of cross-strait banking business adequately. Above all, after the scope of counterparts of DBU foreign exchange is eased, the Bank is more likely to be able to expand the scope of foreign exchange business and increase the transaction volume. Meanwhile, after the scope of loan business in Mainland China is eased, it will help increase the Bank's OBU business income.	The Bank's OBU plans to underwrite OBU RMB business to increase its income.
The competent authority promulgated and enforced the provisions requiring that a listed (OTC) company of paid-in capital less than NT$10 billion shall establish the "Compensation Committee" before the end of 2011.	Fulfill and establish the Bank's well-founded corporate governance.	1. In October 2011, the Bank's Board of Directors resolved to establish the "Organizational Articles of Compensation Committee of Bank of Kaohsiung". 2. On December 29, 2011, the Bank established the "Compensation Committee".

7.6.3 The Impact of Technology Development and Industrial Changes on the Bank Finance & Business and the Responsive Measures

Changes	Impact	Responsive Measures
The significant of the security on technology information.	It is helpful to prevent information systems and clients' database from being intervened and destroyed illegally, to protect the clients' interest and business operation.	Continuously strengthen the information security management mechanism and emergency coping measures.
In order to exert the group's business performance, domestic large-scale financial organizations are intended to include small-scale financial holding companies.	The Bank is not subordinated to any finanical holding companies, the Bank must work more hard.	In order to cope with the development trend of the local financial market, the Bank dedicated to strengthening the quality of management and upgrading competitive strength.

7.6.4 The Impact of Image Change on the Bank and the Responsive Measures

The Bank shakes off the stiff operation as a state-run bank since the Bank was privatized. The operating policy has been made more flexible and with better assets quality. In response to the severe competition in the economic environment and financial markets, the Bank intend to reinforce operating constitution continuously and to reach

another peak in business with a good image and professional operating decision and method.

7.6.5 Expected Benefit, Potential Risk of Future Merger and the Responsive Measures：None.

7.6.6 Expected Benefit and Potential Risk of Expanding Business Locations

We will have business locations set up nationwide to improve our operating effectiveness and generate profits. The risk of damaging the operating constitution due to the setup of new branch offices is also considered.

7.6.7 Risk of Centralized Business Operation

Centralized business faces the challenge of credit risk, market risk, and operational risk. For the sake of reducing the impact of the risks, the risk is to be decentralized through the mechanism of a business station, source of customers, and diversified product lines.

7.6.8 The Impact and Risk of Business Ownership Change on The Bank：None.

7.6.9 Litigated or Non-Litigated Events

There were no major litigated or non-litigated events in progress other than business-related litigations.

7.6.10 Other Significant Risks and the Responsive Measures：None.

7.7 Responsive Mechanism for Crisis Management

We have regulations stipulated and executed for business processes in order to minimize daily operational risk. The setup of Credit Screening Committee, Business R&D Workshop, Bad Credit Monitoring Workshop, Assets / Liabilities and Risk Management Committee, Personnel Evaluation Committee, Long-term Stock Investment Panel, Trust Property Evaluation Committee and Emergency coping team; also, the regulations of “Regulations Governing Trust Risk Management”, “Regulations Governing Risk Management”, “Regulations Governing Investment Policy”, “Regulations Governing Legal Risk Management”, “Regulations for Compliance of Regulations & System Execution and Planning”, “Regulations for Disaster – Prevention and Rescue,” and Manual for emergency coping measures are the responsive mechanisms for risk management.

7.8 Other Significant Events：None.