Letter to Shareholders

Chen Toong Min

Chairman

Global economic performance in 2012 was still shadowed by the remnant of the global financial crisis of 2008. Major economies of the world have launched different forms of monetary easing policies with an attempt to stimulate economic recovery. After years of effort, there seems to be a gleam of light for recovery. Yet, the easing policies of major economies also yielded side effects. It is the recession in the Euro Zone and Japan. There was economic growth in the USA, but the size of growth lacked momentum. Economic recovery in the newly emerging markets was not strong and fast enough. Taiwan was also affected by the economic stagnancy worldwide, to the extent that the overall industrial sector lost its competitive power. As such, there was no increase of salary in real terms. It was coupled with the controversy over the remuneration to labor insurance, the military, civil servants and the teachers, and the rise of oil and electricity prices. Clouded by these factors, projected economic growth has been adjusted downward for 9 times to 1.26%. In 2013, Despite the critical factors to the economic performance worldwide are monetary policy, employment, budget deficit, and European debts. They also posed uncertainty to the financial market. Global economic recovery is still not fast enough. According to the economic forecast of the FED, economic growth worldwide will be 2 to 3% while economic growth in Taiwan will be 3%. This is yet to be seen.

Domestic housing prices have been on the rise for years. The corporate sector is also confronting structural adjustment. These intensified the operation risk of the Bank. At the same time, the government also launched a series of new policies in order to vitalize the banks in operation and intensify the control of credit risk, including the upward adjustment of the BIS ratio, debts coverage ratio, and return (loss) on assets. As such, the lending business of the Bank will inevitably be affected. The Bank is a small and medium size bank with a low level of capitalization. The influence from these policies will be obvious. Yet, the Bank seeks to diversify its risk and moves towards the diversification of operation for turning crisis into opportunity.

Huang Maan-sheng

President

Through the diligent efforts of the management team and all of the Bank's associates, the Bank has made timely adjustments to our business strategy. All business divisions are steadily growing and making profits.The Bank hereby reports its operation results in 2012, summary of business plan in 2013 as follows:

Operating Performance in 2012

1. Domestic and Foreign Economic and Financial Environment

(1) Economic Outlook

Due to the sovereign debt crises in Europe, the feeble economic growth in the US, and the deceleration of economic growth in China, worldwide economic growth rate slowed in 2012.

Impacted by factors ranging from gloomy international economic condition, continued weak export figures, to the price hikes of gasoline and electricity, capital gains tax on securities, and labor insurance annuities at home, domestic consumption has not rebounded in any meaningful way in the first three quarters of 2012. The result was depressed macroeconomic performance. During this period, the Directorate General of Budget, Accounting and Statistics (DGBAS) of Executive Yuan revised the full year economic growth rate projection downward nine times to 1.05%, the lowest of the year. However, in the fourth quarter, as the global economy stabilized and the domestic stock market began to rise, key financial and economic indicators improved, and the increase in consumer price moderated. As a result of these factors, private consumption began to pick up and the export sector grew more than expected. On 2013.2.22, the Directorate General of Budget, Accounting and Statistics (DGBAS) of Executive Yuan released the economic growth rate for the entire year of 2012, which was 1.26% and better than expected.

(2) Financial Situation

The Financial Supervisory Commission approved CNY business at domestic Offshore Banking Units (OBU) and overseas branches. As a result, the financial industry wholeheartedly promoted the OBU business, syndicated loans at overseas branches, and CNY related business. In addition, due to the increase of interest rate spread between deposits and loans, and the careful management of credit risks, many financial institutions showed significant profit growth last year.

2. Transformation of the Bank's Organization

(1) In Dec. 2012, the Bank relocated Chi Hsien Branch to Gang shan Ben jhou Industrial Park and renamed it as Gangshan Benjhou Branch.

(2) In 2013, the Bank will relocate the Tachang Branch to Taichung and rename it as “Tali Branch” and will approach the goal of emergence into a national bank.

(3) The Bank makes significant effort to develop the personal and property insurance agency services in supporting the cross-industry operation in banking, insurance, and trust, for organizational synergy.

3. Results of Business Plans and Operating Strategies for FY 2012

Unit: NTD/USD 100 Million, %

FY / Operating Item	2012	2011	Growth Rate (%)
Deposit Business	1,881.47	1,881.49	(0.001)
Loan Business	1,616.49	1,624.83	(0.51)
Foreign Exchange Business (USD)	47.35	44.01	7.59
Guarantee Business	78.05	112.40	(30.56)
Commission & service fees	3.94	4.00	(1.50)

Note 1: The decrease in the size of loans was mainly caused by the reduction of loans to Kaohsiung City Government amounting to NT$4.308 billion. With the increase in regular loans amounting to NT$3.474 billion, the size of loans reduced by NT$834 million or -0.51%.

Note 2: In the area of bank guarantee, an issue of commercial paper in jumbo size in 2011 was mature without renewal.

4. Execution of Business Target:

In 2012, the average deposits balance was NT$ 188.147 billion, or 94.07% of the deposits target; the average loans balance was NT$ 161.649 billion, or 95.09% of the loans target; foreign exchange Sales was US$4.735 billion, or 98.65% of the target; net income before tax was NT$ 419 million, or 72.90% of the target.

5. Analyses of Financial Revenue, Expenditure and Profitability

The changes in 2012 in budget settlement as compared with the same period of the previous year (2011) are shown below:

Unit : NTD Million,%

Item		2012	2011	Growth Rate (%)
Net interest revenue		2,103	1,988	5.78
Net non-interest revenue		881	330	166.97
Net revenue		2,984	2,318	28.73
Credit loss expenses		(579)	(899)	(35.60) (Note)
Operating expenses		(1,986)	(1,848)	7.47
Income before tax		419	(429)	197.67
Net income		386	(433)	189.15
ROA	Before income tax	0.19	(0.20)	195.00
	After income tax	0.17	(0.20)	185.00
ROE	Before income tax	3.94	(4.30)	191.63
	After income tax	3.63	(4.35)	183.45
Net profit margin on after income tax		12.94	(18.69)	169.23
EPS on before income tax		0.59	(0.71)	183.10
EPS on after income tax		0.55	(0.71)	177.46

Note : This was due to the application of SFAS No. 34 in accounting effective 2011, with the adjustment of recognition of provisions for bad debts.

6. Status of R & D

(1) The Bank's on-line automatic debit system of Kaohsiung City parking fees included Fengshan and Niensong Districts.

(2) The Bank Promote “excellent home mortgage project”, “home mortgage life insurance loan”, and “ATM card and personal finance planning loan”.

(3) Planning for CNY business

Business Plan in 2013

1.Business objectives and Important Operating Policies

(1) To increase BIS ratio and expand the revenue size: Issues subordinated debts to increase capital adequacy ratio; expand the scope of operation and bolster earnings in order to increase tier 1 capital.

(2) To increase the write off coverage ratio to strengthen risk tolerance.

A. Adjust the asset structure to increase engagement in loan operations that has low risk factor.

B. Strengthen quality of credit extension, speed up collection of non-performing loans and be familiar with borrowers to decrease overdue loans.

(3) To expand the revenue size: expand the revenue size by using an institutional client group and general consumer group as the main axis and promote the deposit and its derived business.

(4) Continuously increase asset profitability.

A. Increase in engagement of small-medium business loans and home mortgage. Decrease MML business, municipal government loans of lower profitability, adjust asset portfolio, improve the quality of assets and increase the profits.

B. Strengthen the promotion of participation in OBU business.

(5) Increase income of transaction fees: Increase promotion of foreign and domestic funds businesses, and increase trust fees of real estate trust business.

(6) Plan a variety of new businesses (such as gold passbook, CNY business for DBU) to satisfy customer's needs of "one stop fulfillment of purchase".

(7) Increase E-banking services items for strengthening competiveness and increase business volume of foreign exchange.

(8) Taking into consideration both security and liquidity, strengthen wealth management business and operate steadily to increase benefits of exercising funds.

(9) To decrease the capital cost and improve the deposit structure.

(10) Strengthen internal control and risk management framework for prevention and reducing frauds.

2. Expected Business Objective

(1) Average Deposits Balances: NT$ 193 billion

(2) Average Loans Balances: NT$ 166 billion

(3) Foreign Exchange Sales: US$ 5 billion

(4) Commission and Service Fees: NT$ 0.406 billion

Development Strategy in Future

1. Medium term goal: Transform our organization, expand operating size and grow to be an excellent bank among domestic banks. Our bank will promote organizational re-engineering, increase operational performances for expanding operating size, causing business and finances to be stronger, and then we will become an excellent bank among domestic banks.

2. Long term goal: We shall become an excellent bank in Asia pacific through consolidation and expanding our business territory. Through consolidation, we will expand our business territory and capital size while assuring shareholder's rights and to become an excellent bank in Asia Pacific.

The Impact of the external Competitive environment, regulatory environment, and macroeconomic environment

1. External competitive environment

Further deregulation of cross-strait financial transactions made way for 10 Taiwanese banks to establish branches in Mainland China. In addition, domestic financial institutions have already established 11 leasing companies in Mainland China. Besides, a few branches of Taiwanese banks in Mainland China have offered or applied for full-range CNY business. This will help to boost up business in the future. Mutual investment by banks on both sides into the equity shares of each other and the investment of the capital into the stock exchanges of each side is about to be institutionalized. This will contribute to the positive cooperation between banks in Taiwan and Mainland China in the areas of capital, loans, trade financing, and investment, and offers an excellent business opportunity for moving into the market of Mainland China. As such, the Bank will pursue the strategy of in-depth cultivation of local markets and emerge as a "small but perfect" commercial bank.

2. Regulatory environment

(1) Update (amend) relevant work procedures, tables according to amended or updated "additional articles 1 and 2 of article 12 of the Banking Act of the Republic of China", "Mandatory Provisions of Standard Form Contract for Personal Online Banking Services", "Prohibitory Provisions of Standard Form Contract for Personal Online Banking Services", "Standard Form Contract for Personal Online Banking Services", "Directions Governing Limitations on Types and Amounts of the Securities in which a Commercial Bank May Invest", "The

Capital Adequacy and Capital Category of Banks" and "The Methods for calculating Bank's regulatory capital and Risk Weighted Assets" announced by Financial Supervisory Commission, while establishing a customer information protection management committee and work group for our bank, for implementing customer information protection items, and estimating the capital adequacy ratio of our bank shall be increased again while planning to apply for the issuance of debts as a response measure.

(2) Financial Supervisory Commission abolish the "Direction for Banks engage in wealth management business", "Guidelines for Banks Selling Financial Products to Customers Other than Wealth Management Customers" and "The Self Disciplinary Rules for bank engage in wealth management and financial products selling", the internal operational procedures of our bank are amended accordingly. Also, The wealth management business added a section of "The management of Financial Consumers Protections" according to article 8 of the "Implementation Rules of Internal Audit and Internal Control System of Financial Holding Companies and Banking Industries".

3. Macroeconomic environment

In 2013, the USA can stay away from her fiscal cliff for a while. The real estate market and the confidence of the consumers will turn positive, and the fundamental aspects of the economy will also be improved, which in turn will affect disposable incomes. The final solution for the fiscal problem is still full of potential uncertainty, which hampered economic recovery. The countries of sovereign debts in Europe still face the pressure of the policy of budget tightening. Unemployment continues. Economic recovery is at bay. Yet, the Central Bank of Europe has made the best of its effort to stabilize the market and save the Euro. With the launch of the stabilization policy in Europe, the tensed financial situation appeared to be eased. In Q4 2012, the industrial production and exports of Mainland China rebounded significantly with economic growth at 7.9%.The urbanization and the launch of the basic construction of railways and highways in 2013, coupled with the proactive development of import substitution and the development of strategic industries in Mainland China, economic growth is projected at 8.0% in 2013 (upward adjustment of 0.2 percentage).

The Central Bank of the Republic of China (Taiwan) continued its policy of no change in interest rate in all four quarters of 2012. Under the pressure of the depreciation of JPY and KWN, NTD is expected to be depreciated to NT$30 in exchange rate in consideration of the effect on economic growth. This will help to ease the financial situation and boost up economic growth.

The Council of Economic Planning and Development will present the plan for Free Economic Experimental Zone to give rise to economic momentum. Kaohsiung has been included as part of the zone, which will help to accelerate economic growth in Kaohsiung.

In general, economic performance in 2013 is forecast to be promising incrementally quarter by quarter. Yet, there are far too many challenges and uncertainties, which require caution.

The Bank's Most Recent Credit Rating Result and Date of Rating

Taiwan Ratings Corp. announced that the Bank's long-term credit rating was "twBBB+", and short-term credit rating "twA-2". The outlook was rated as "stable".

Chen Toong-min

Chairman

Huang Maan-sheng

President