# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 20-F

**(Mark One)**

¨ **Registration statement pursuant to Section 12(b) or 12(g) of the Securities Exchange Act of 1934**

**or**

x **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the fiscal year ended** ***December 31, 2005***

**or**

¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the transition period from to**

**or**

¨ **Shell company report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**Date of event requiring this shell company report _________**

**Commission file number 001-31731**

# Chunghwa Telecom Co., Ltd.

**(Exact Name of Registrant as Specified in Its Charter)**

**Taiwan, Republic of China**

**(Jurisdiction of Incorporation or Organization)**

**21-3 Hsinyi Road, Section 1, Taipei,**

**Taiwan, Republic of China**

**(Address of Principal Executive Offices)**

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| **Common Shares, par value NT$10 per share** | **New York Stock Exchange*** |
| **American Depositary Shares, as evidenced by American Depositary Receipts, each representing 10 Common Shares** | **New York Stock Exchange** |

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

**None**

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

**None**

Indicate the number of outstanding shares of each of the Issuer s classes of capital or common stock as of the close of the period covered by the annual report.

**9,647,724,900 Common Shares**

**246,043,119 American Depositary Shares**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ¨ No x

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 ¨ Item 18 x

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ¨ No x

* Not for trading, but only in connection with the listing on the New York Stock Exchange of the American Depositary Shares

**Table of Contents**

**CHUNGHWA TELECOM CO., LTD.**

**FORM 20-F ANNUAL REPORT**

**FISCAL YEAR ENDED DECEMBER 31, 2005**

**TABLE OF CONTENTS**


| | | Page |
|---|---|---|
| SUPPLEMENTAL INFORMATION | | 1 |
| FORWARD-LOOKING STATEMENTS IN THIS ANNUAL REPORT MAY NOT BE REALIZED | | 1 |
| PART I | | 2 |
| ITEM 1. | IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS | 2 |
| ITEM 2. | OFFER STATISTICS AND EXPECTED TIMETABLE | 2 |
| ITEM 3. | KEY INFORMATION | 2 |
| ITEM 4. | INFORMATION ON THE COMPANY | 13 |
| ITEM 4A. | UNRESOLVED STAFF COMMENTS | 49 |
| ITEM 5. | OPERATING AND FINANCIAL REVIEW AND PROSPECTS | 50 |
| ITEM 6. | DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES | 71 |
| ITEM 7. | MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS | 78 |
| ITEM 8. | FINANCIAL INFORMATION | 79 |
| ITEM 9. | THE OFFER AND LISTING | 80 |
| ITEM 10. | ADDITIONAL INFORMATION | 81 |
| ITEM 11. | QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK | 96 |
| ITEM 12. | DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES | 97 |
| PART II | | 98 |
| ITEM 13. | DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES | 98 |
| ITEM 14. | MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS | 98 |
| ITEM 15. | CONTROLS AND PROCEDURES | 98 |
| ITEM 16A. | AUDIT COMMITTEE FINANCIAL EXPERT | 98 |
| ITEM 16B. | CODE OF ETHICS | 98 |
| ITEM 16C. | PRINCIPAL ACCOUNTANT FEES AND SERVICES | 98 |
| ITEM 16D. | EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES | 99 |
| ITEM 16E. | PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS | 99 |
| PART III | | 100 |
| ITEM 17. | FINANCIAL STATEMENTS | 100 |
| ITEM 18. | FINANCIAL STATEMENTS | 100 |
| ITEM 19. | EXHIBITS | 100 |

**Table of Contents**

## SUPPLEMENTAL INFORMATION

All references to we, us, our and our company in this annual report are to Chunghwa Telecom Co., Ltd. All references to shares and comm shares are to our common shares, par value NT$10 per share, and to ADSs are to our American depositary shares, each of which represents ten of our common shares. The ADSs are issued under the deposit agreement, as amended, supplemented or modified from time to time, dated as of July 17, 2003, among Chunghwa Telecom Co., Ltd., The Bank of New York, as depository, and the holders and beneficial owners from time to time of American Depositary Receipts issued thereunder. All references to Taiwan are to the island of Taiwan and other areas under the effective control of the Republic of China. All references to the government or the Republic of China government are to the government of the Republic of China. All references to the Ministry of Transportation and Communications are to the Ministry of Transportation and Communications of the Republic of China. All references to the Securities and Futures Bureau are to the Securities and Futures Bureau of the Republic of China or its predecessors, as applicable. ROC GAAP means the generally accepted accounting principles of the Republic of China, and US GAAP means the generally accepted accounting principles of the United States. Any discrepancies in any table between totals and sums of the amounts listed are due to rounding. Unless otherwise indicated, or the context otherwise requires, references in this annual report to financial and operational data of the Company for a particular year refer to the fiscal year of the Company ending December 31 of that year.

When we refer to our privatization or our being privatized in this annual report, we mean our status as a non-state-owned entity after the government reduces its ownership of our outstanding common shares, including our common shares owned by entities majority-owned by the government, to less than 50%. We were privatized in August 2005.

We publish our financial statements in New Taiwan dollars, the lawful currency of the Republic of China. In this annual report, NT$ and NT dollars mean New Taiwan dollars, $, US$ and U.S. dollars mean United States dollars.

## FORWARD-LOOKING STATEMENTS IN THIS ANNUAL REPORT MAY NOT BE REALIZED

This annual report contains forward-looking statements, including statements regarding:

- our business and operating strategy;
- our network expansion plans;
- our business, operations and prospects;
- our financial condition and results of operations;
- our dividend policy;
- the telecommunications industry regulatory environment in Taiwan; and
- future developments in the telecommunications industry in Taiwan.

These forward-looking statements are generally indicated by the use of forward-looking terminology such as believe, expect, anticipate, estimate, plan, project, may, will or other similar words that express an indication of actions or results of actions that may or are expected to occur in the future. These statements are subject to risks, uncertainties and assumptions, many of which are beyond our control. You should not place undue reliance on these statements, which apply only as of the date of this annual report. These forward-looking statements are based on our own information and on information from other sources we believe to be reliable. Actual results may differ materially from those expressed or implied by these forward-looking statements. Factors that could cause differences include, but are not limited to, those discussed under Item 3. Key Information D. Risk Factors. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this annual report might not occur and our actual results could differ materially from those anticipated in these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

**Table of Contents**

## PART I

### ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

### ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

### ITEM 3. KEY INFORMATION

The Company has been privatized as a result of secondary ADR offering and concurrent domestic auction of our common shares since August 12, 2005. The privatization enables us to develop our business and respond to changing market conditions more rapidly and efficiently.

#### A. Selected Financial Data

The selected income statement data and cash flow data for the years ended December 31, 2003, 2004 and 2005, and the selected balance sheet data as of December 31, 2004 and 2005, set forth below are derived from our audited financial statements included elsewhere in this annual report and should be read in conjunction with, and are qualified in their entirety by reference to these financial statements and the related notes. The selected income statement and cash flow data for the years ended December 31, 2001 and 2002, and the selected balance sheet data as of December 31, 2001, 2002 and 2003 set forth below are derived from our audited financial statements not included in this annual report.

| | As of or for the year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2001 | 2002 | 2003 | 2004 | 2005 | |
| | (in billions, except per share and per pro forma ADS information) | | | | | |
| | NT$ | NT$ | NT$ | NT$ | NT$ | US$ |
| **Income Statement Data:** | | | | | | |
| Revenues | 184.4 | 179.4 | 182.5 | 185.2 | 184.7 | 5.6 |
| Operating costs and expenses: | | | | | | |
| Costs of services[1] | 72.7 | 58.1 | 59.6 | 60.3 | 70.1 | 2.1 |
| Marketing[1] | 21.9 | 20.2 | 20.0 | 19.3 | 23.7 | 0.7 |
| General and administrative[1] | 3.5 | 2.7 | 2.7 | 2.5 | 3.5 | 0.1 |
| Research and development[1] | 2.8 | 2.4 | 2.6 | 2.5 | 3.1 | 0.1 |
| Depreciation and amortization costs of services | 36.6 | 37.9 | 39.2 | 38.4 | 38.8 | 1.2 |
| Depreciation and amortization operating expenses | 2.3 | 2.4 | 2.4 | 2.3 | 2.4 | 0.1 |
| Total operating costs and expenses | 139.8 | 123.7 | 126.5 | 125.3 | 141.6 | 4.3 |
| Operating income | 44.6 | 55.7 | 56.0 | 59.9 | 43.1 | 1.3 |
| Other income[2] | 3.7 | 2.5 | 2.2 | 2.7 | 4.0 | 0.1 |
| Other expenses[3] | 1.4 | 1.3 | 0.6 | 0.4 | 1.1 | |
| Income before income tax | 46.9 | 56.9 | 57.6 | 62.2 | 46.0 | 1.4 |
| Income tax | 9.5 | 12.8 | 10.3 | 11.3 | 12.7 | 0.4 |
| Net income | 37.4 | 44.1 | 47.3 | 50.9 | 33.3 | 1.0 |
| Net income per share[4] | 3.87 | 4.57 | 4.90 | 5.28 | 3.45 | 0.11 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net income per pro forma equivalent ADS[5] | 38.73 | 45.70 | 49.04 | 52.78 | 34.51 | 1.05 |
| **Balance Sheet Data:** | | | | | | |
| Cash and cash equivalents | 4.6 | 7.6 | 13.5 | 29.3 | 41.9 | 1.3 |
| Property, plant and equipment net | 336.4 | 338.4 | 329.7 | 311.6 | 293.5 | 8.9 |
| Total assets | 411.4 | 428.6 | 429.7 | 438.4 | 395.2 | 12.0 |
| Total debt | 17.0 | 17.7 | 0.7 | 0.7 | 0.5 | |
| Total liabilities | 121.7 | 128.6 | 118.9 | 119.7 | 67.4 | 2.0 |
| Capital stock | 96.5 | 96.5 | 96.5 | 96.5 | 96.5 | 2.9 |
| Total stockholders equity | 289.7 | 300.0 | 310.8 | 318.7 | 327.8 | 10.0 |
| **Cash Flow Data:** | | | | | | |
| Net cash provided by operating activities | 73.1 | 91.3 | 93.6 | 91.6 | 86.2 | 2.6 |
| Net cash used in investing activities | (53.7) | (55.3) | (32.2) | (32.4) | (28.0) | (0.8) |
| Net cash provided by (used in) financing activities | (38.9) | (33.0) | (55.5) | (43.4) | (45.5) | (1.4) |

Table of Contents

| | As of or for the year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2001 | 2002 | 2003 | 2004 | 2005 | |
| | (in billions, except per share and per pro forma ADS information) | | | | | |
| | NT$ | NT$ | NT$ | NT$ | NT$ | US$ |
| Capital expenditures | 52.9 | 43.3 | 32.2 | 22.9 | 22.9 | 0.7 |
| **Other:** (6) | | | | | | |
| Cash dividends declared per share | 3.50 | 4.00 | 4.50 | 4.70 | 4.30 | 0.13 |
| Stock dividends declared per share | | | | | 0.20 | 0.01 |

(1) Excludes related depreciation and amortization.
(2) Includes interest income of NT$649 million, NT$187 million, NT$100 million, NT$224 million and NT$452 million (US$14 million) for the years ended December 31, 2001, 2002, 2003, 2004 and 2005, respectively.
(3) Includes interest expense of NT$392 million, NT$171 million, NT$43 million, NT$5 million and NT$2 million (US$0.1 million) for the years ended December 31, 2001, 2002, 2003, 2004 and 2005, respectively.
(4) Net income per share is the same on both an undiluted and a fully diluted basis.
(5) Each equivalent ADS represents ten of our common shares.
(6) Dividend distributed under ROC GAAP.

**Currency Translations and Exchange Rates**

In portions of this annual report, we have translated New Taiwan dollar amounts into U.S. dollars for the convenience of readers. The rate we used for the translations was NT$32.80 = US$1.00, which was the noon buying rate in the City of New York for cable transfers of New Taiwan dollars as certified for customs purposes by the Federal Reserve Bank of New York on December 30, 2005. This translation does not mean that New Taiwan dollars could actually be converted into U.S. dollars at that or any other rate or at all. The following table shows the noon buying rates for New Taiwan dollars expressed in New Taiwan dollar per US$1.00.

| Year Ended December 31, | Average(1) | High | Low | At Period-End |
|---|---|---|---|---|
| 2001 | 33.91 | 35.13 | 32.23 | 35.00 |
| 2002 | 34.53 | 35.16 | 32.85 | 34.70 |
| 2003 | 34.40 | 34.98 | 33.72 | 33.99 |
| 2004 | 33.27 | 34.16 | 31.74 | 31.74 |
| 2005 | 32.13 | 33.77 | 30.65 | 32.80 |
| November | 33.29 | 33.71 | 33.39 | 33.51 |
| December | 33.58 | 33.56 | 32.80 | 32.80 |
| 2006 | | | | |
| January | 32.04 | 32.59 | 31.83 | 31.97 |
| February | 32.32 | 32.65 | 31.97 | 32.40 |
| March | 32.46 | 32.62 | 32.28 | 32.42 |
| April | 32.29 | 32.54 | 31.90 | 31.90 |
| May (through May 21) | 31.60 | 31.90 | 31.28 | 31.89 |

*Source: Federal Reserve Statistical Release, Board of Governors of the Federal Reserve System.*

(1) Annual averages are calculated using the average of the exchange rates on the last day of each month during the period. Monthly averages are calculated using the average of the daily rates during the relevant period.

**B. Capitalization and Indebtedness**

Not applicable.

**C. Reasons for the Offer and Use of Proceeds**

Not applicable.

**D. Risk Factors**

*Our business and operations are subject to various risks, many of which are beyond our control. If any of the risks described below actually occurs, our business, financial condition or results of operations could be seriously harmed.*

**Table of Contents**

**Risks Relating to Our Company and the Taiwan Telecommunications Industry**

***We were privatized in August 2005, so we have a very limited history of operations as a non-state-owned enterprise. We may not enjoy the benefits of privatization as quickly or at the level that we expect.***

Before we were privatized in August 2005, our business and operations were subject to extensive regulations under the applicable Republic of China laws, rules and regulations. As a result, we only have a very limited history of operations as a non-state-owned enterprise. We cannot assure you that we will be successful in achieving the benefits we expect from our privatization, such as increased management flexibility in implementing measures to improve our cost structure, efficiently operate our business and expand into new businesses in a timely manner or at all. Factors that may cause the actual benefits we may enjoy from privatization to deviate from our expectations include:

- adverse developments in our relations with our labor union that affect our costs, including with respect to pension and other benefits, and efficient management of our workforce;
- costs and inefficiencies associated with replacing employees who retire or depart from our company in connection with our privatization;
- increased costs with respect to our plans to incentivize employees through contributions to employee child education funds, performance-based cash bonuses and company subsidized purchases by employees of our common shares;
- changes in regulations affecting us following our privatization; and
- the speed with which we are able to implement more efficient procurement and other management systems, and the resulting levels of cost savings.

***If we fail to maintain a good relationship with our labor union, work stoppages or labor unrest could occur and the quality of our services as well as our reputation could suffer.***

We currently have the largest labor union in Taiwan. As of March 31, 2006, substantially all of our employees were members of our principal labor union. Since our incorporation in 1996, we have experienced disputes with our labor union on such issues as employee benefits and retirement benefits in connection with our privatization as well as the right to protest. In particular, our labor union initiated a demonstration in August 2000 to express concerns over job security after our privatization. Furthermore, following our failure to sign the collective agreement proposed by the labor union, the union resolved on December 5, 2004 to hold strikes anytime before our privatization. In response to our proposed privatization, the labor union held a strike on May 17, 2005. The labor union also strongly opposed our privatization and has threatened to launch a nationwide strike or take other forms of action to hinder our privatization. In addition, one of our 15 directors has been designated by the Republic of China government as a labor union representative on our board. Any deterioration of our relationship with our labor union could result in work stoppages or worker unrest. Any work stoppage or strike or any threat to take such an action could disrupt our business and operations, and materially and adversely affect the quality of our services and harm our reputation. In addition, we expect the collective agreement which was entered into between us and our labor union on January 6, 2006 and commenced in effect from March 3, 2006 will result in our having to incur higher costs in connection with the implementation of certain incentive programs, including employee skill development programs, as well as employee child education funds, company subsidized share purchases by employees, and discretionary, performance-based cash bonuses. We cannot accurately quantify the increase in costs at this time, but we expect that it may be material.

***Extensive regulation of our industry may limit our flexibility to respond to market conditions and competition, and our operations may suffer.***

As a telecommunications service provider in Taiwan, we are subject to extensive regulation by and under the supervision of the Ministry of Transportation and Communications and the Directorate General of Telecommunications of the Republic of China. We have been designated by the government as a dominant provider of fixed line and cellular services within the meaning of applicable telecommunications regulations, and as a result, we are subject to special additional requirements imposed by the Ministry of Transportation and Communications. For example, the regulation governing setting and changing of tariffs allows non-dominant telecommunications service providers greater freedom to set and change tariffs within the range set by the government. If we are unable to respond effectively to tariff changes by our competitors, then our competitiveness, market position and profitability will be materially and adversely affected.

**Table of Contents**

The regulatory framework within which we operate may limit our flexibility to respond to market conditions, competition or changes in our cost structure. In particular, future decreases in tariff policies and rates could immediately and substantially decrease our revenues. In addition, we operate our businesses with approvals and licenses granted by the government. If these approvals or licenses are revoked or suspended or are not renewed, or if we are unable to obtain any additional licenses that we may need to operate our business in the manner we desire, then our operations will suffer.

***Increasing competition resulting from the ongoing liberalization of the Taiwan telecommunications industry or from alternative means of communication may materially and adversely affect our growth and profitability by causing us to lose customers, charge lower tariffs or spend more on marketing.***

We have faced increasing competition from new entrants in the Taiwan telecommunications market in recent years. In particular, the Republic of China government enacted legislation in 1996 that sets the guidelines for competition in the Taiwan telecommunications industry. Multiple licenses to operate fixed line, cellular, paging and other services have been issued since 1996. Since June 2001, three additional operators have begun providing fixed line services, and since August 2001, licenses have been granted to four undersea cable operators to engage in the undersea cable leased-circuit business. In addition, the government awarded third generation cellular services concessions to five companies in February 2002, including two new cellular operators. Since early 2004, the government has also issued four mobile virtual network operator licenses that allow operators without a spectrum allocation to provide cellular services by leasing the network capacity and facilities from a licensed cellular service provider. Local loop unbundling of voice was completed in June 2004, and we completed negotiations on full unbundling local loop with one fixed line operation in July 2005. While we expect competition to intensify from local loop unbundling, we believe its impact will be limited. Many of our competitors are in alliances with leading international telecommunications service providers and have access to financial and other resources or technologies that may not be available to us. Further, as the government continues to liberalize the telecommunications market, such as through the issuance of new licenses or establishment of additional networks, our market position and competitiveness could be adversely affected.

Focus of competition among mobile service providers in Taiwan has gradually shifted from 2G to 3G as some mobile service providers currently offering 2G services, including our company, began offering 3G services in 2005 and one new 3G service provider also entered the market in that year.

We may also be subject to competition from providers of new telecommunications services as a result of technological development and the convergence of various telecommunications services. In particular, as a result of technological innovations and other factors, we have been facing competition from alternative means of communication, including voice over Internet protocol, high-speed cable Internet service, cable telephony, e-mail and wireless services. Providers of these products and services include cable television companies, direct broadcast satellite companies and digital subscriber line resellers.

Increasing competition may also cause the rate of our customer growth to reverse or decline, bring about further decreases in tariff rates and necessitate increases in our selling and promotional expenses. Any of these developments could materially and adversely affect our business growth and profitability.

***Changes in technology may render our current technologies obsolete or require us to obtain licenses for introducing new services or make substantial capital investments, financing for which may not be available to us on favorable commercial terms.***

The Taiwan telecommunications industry has been characterized by rapid increases in the diversity and sophistication of the technologies and services offered. As a result, we expect that we will need to constantly upgrade our telecommunications technologies and services in order to respond to competitive industry conditions and customer requirements. Developments of new technologies have rendered some less advanced technologies unpopular or obsolete. For example, our paging services have declined significantly since the introduction of the mobile services. As a result, we recognized an impairment charge of NT$343 million (US$10.5 million) in 2005. If we fail to develop, or to obtain timely access to, new technologies and equipment, or if we fail to obtain the necessary licenses to provide services using these new technologies, then we may lose our customers and market share and become less profitable. For example, we recently began offering multimedia on demand services on a limited basis. Although we were not, and are not, in compliance with some applicable ownership restrictions under the Cable Radio and Television Law of the Republic of China, we were nevertheless granted a cable operator license by the Government Information Office. However, we cannot assure you that fines will not be imposed and our cable operator license will not be revoked. Moreover, our plans to introduce voice over Internet protocol telephone services have also been delayed because the applicable regulatory authority has not issued the requisite approvals to any operator.

In addition, the cost of implementing new technologies, upgrading our networks or expanding capacity could be significant. In particular, we have made and will continue to make substantial capital expenditures in the near future in order for us to effectively respond to technological changes, such as the introduction of a third-generation cellular telecommunications platform. We will also need to make additional capital expenditures relating to the launch of new businesses, including multimedia on demand, asymmetrical digital subscriber line services, fiber-to-the-building services and voice over Internet protocol services, and the implementation of a network modernization program, including the planned migration of our fixed line networks to Internet protocol next generation networks. To the extent these expenditures exceed our cash resources, we will be required to seek additional debt or equity financing. Our ability to obtain additional financing on favorable commercial terms will depend on a number of factors. These factors include our financial condition, results of operations and cash flows, prevailing economic conditions in Taiwan and the prevailing market conditions in the Taiwan telecommunications industry, the cost of financing and conditions in the financial markets, and the issuance of relevant government and other regulatory approvals. The failure to obtain funding for our capital expenditures on commercially acceptable terms and on a timely basis, or at all, could jeopardize our expansion plans and materially and adversely affect our business, competitive position and prospects.

***We may not realize the benefits we expect from our investments, which may materially and adversely affect our business, financial condition, results of operations and prospects.***

We have made significant capital investments in our network infrastructure and information technology systems to provide the services we offer. In 2005, we had capital expenditures in relation to our network infrastructure and information technology systems of NT$22.9 billion. Of this amount, we had capital expenditures of NT$5.2 billion in our fixed line services, NT$4.4 billion in our cellular services, NT$12.7 billion in our Internet and data services and NT$0.6 billion in other areas. In order to continue to develop our business and offer new and more sophisticated services, we intend to continue to invest in these areas as well as new technologies. The launch of new and commercially viable products and services is important to the success of our business. We expect to incur substantial capital expenditures to further develop our range of services and products. Commercial acceptance by consumers of new and more sophisticated services we offer may not occur at the rate or level expected, and we may not be able to successfully adapt these services to effectively and economically meet customers demand, thus impairing our expected return from our investments.

We cannot assure you that services enabled by new technologies we implement, such as third generation cellular technology, will be accepted by the public to the extent required to generate an acceptable rate of return. In addition, we face the risk of unforeseen complications in the deployment of these new services and technologies, and we cannot assure you that our estimate of the necessary capital expenditure to offer such services will not be exceeded.

New services and technologies may not be developed and/or deployed according to expected schedules or may not achieve commercial acceptance or be cost effective. The failure of any of our services to achieve commercial acceptance could result in additional capital expenditures or a reduction in profitability to the extent that we are required under the applicable accounting standards to recognize a charge for the impairment of assets. Any such charge could materially and adversely affect our financial condition and results of operations.

We may also from time to time make equity investments in companies, but we cannot assure you of their profitability. For example, Chunghwa Investment Co., Ltd, a company in which we hold a 49% interest and which we account for using the equity method, suffered losses in 2004. As a result, the carrying value of Chunghwa Investment in our financial statements was reduced from NT$987 million in 2003 to NT$930 million in 2004. These losses were partially attributable to the write-off of certain short-term investments in the amount of NT$80 million that were not authorized by Chunghwa Investment, but were made by the then chairman of Chunghwa Investment, Mr. Jing-Biao Hu, who was removed from office on December 31, 2004. In addition, another of our investments, the Taipei Financial Center Corporation, in which we hold an 11.8% interest and which we account for using the cost method, has only recently commenced commercial operations after completion of construction in December 2004 of Taipei 101, which it owns and which is the tallest building in Taiwan. In 2005, we recognized a loss of NT$740 million (US$22.6 million) in relation to this investment. We cannot assure you that any unprofitable equity investments will not materially or adversely affect our results of operations or financial condition.

***Our ability to deliver services may be interrupted due to a systems failure or shutdown in our networks.***

Our services are currently carried through our fixed line and cellular telecommunications networks, as well as through our transmission networks comprised of optical fiber cable, microwave, submarine cable and satellite transmission links. Our networks may be vulnerable to damage or interruptions in operations due to adverse weather conditions, earthquakes, fires, power loss, telecommunications failures, software flaws, transmission cable cuts or similar events. Any

Table of Contents

failure of our networks, servers, or any link in the delivery chain that results in an interruption in our operations or an interruption in the provision of any of our services, whether from operational disruption, natural disaster, military or terrorist activity, or otherwise, could damage our ability to attract and retain subscribers and materially and adversely affect our financial condition, results of operations and prospects.

***If new technologies adopted by us do not perform as expected, or if we are unable to effectively deliver new services based on these technologies in a commercially viable manner, our revenue growth and profitability will decline.***

We are pursuing a number of new growth opportunities in the broader telecommunications industry, including wireless data services, multimedia on-demand services and voice over Internet protocol services. These opportunities involve new services for which there are no proven markets. Our ability to deploy and deliver these services will depend, in many instances, on new and unproven technologies. These new technologies, such as third generation cellular telecommunications technologies, may not perform as expected or generate an acceptable rate of return. In addition, we may not be able to successfully develop new technologies to effectively and economically deliver these services, or be able to compete successfully in the delivery of telecommunications services based on new technologies. Furthermore, the success of our wireless data services is substantially dependent on the availability of wireless data applications and devices that are being developed by third-party developers. These applications or devices may not be sufficiently developed to support the deployment of our wireless data services. If we are unable to deliver commercially viable services based on the new technologies that we adopt, then our revenue growth and profitability, as well as our financial condition and results of operations, will be materially and adversely affected.

***We depend on select personnel and could be affected by the loss of their services.***

We depend on the continued service of our executive officers and skilled technical and other personnel. Our business could suffer if we lose the services of any of these personnel and cannot adequately replace them. In particular, we are not insured against the loss of any of our personnel. Moreover, we may be required to increase substantially the number of these employees in connection with any expansion, and there is intense competition for experienced personnel in the Taiwan telecommunications industry. We may not be able to either retain our present personnel or attract additional qualified personnel as and when needed. In addition, we may need to increase employee compensation levels in order to attract and retain personnel. We cannot assure you that the loss of the services of any of these personnel would not disrupt our business and operations, and materially and adversely affect the quality of our services and harm our reputation.

***Our largest shareholder may take actions that conflict with our public shareholders best interests.***

As of April 26, 2006, the most recent practicable date, the Republic of China government, through the Ministry of Transportation and Communications, owned approximately 41.37% of our outstanding common shares. Accordingly, the government, through its control over our board, may continue to have the ability to control our business, including matters relating to:

- any sale of all or substantially all of our assets;
- the approval of our annual operation and projects budget;
- the composition of our senior management;
- the timing and distribution of dividends; and
- the election of a majority of our directors and supervisors.

In addition, pursuant to the Republic of China Telecommunications Act and our articles of incorporation, our board of directors approved the issuance of two preferred shares on March 28, 2006. The Ministry of Transportation and Communications, as the holder of these preferred shares, has the rights to veto any change in our name or our business and any transfer of the whole or the main part of our business or property and to act as a director and supervisor. These preferred shares are non-transferable and will be redeemed by us three years after the date of their issuance at their par value.

***The value of your investment may be reduced by future sales of our ADSs or common shares by us, by the Republic of China government or by other shareholders.***

The government may continue to sell our common shares following our privatization. Sales of substantial amounts of ADSs or common shares by the government or any other shareholder in the public market, or the perception that future sales may occur, could depress the prevailing market price of our ADSs and common shares.

***Actual or perceived health risks related to cellular handsets and base stations could lead to decreased cellular telephone usage and difficulties in increasing network coverage and could expose us to potential liability.***

According to some published reports, the electromagnetic signals from cellular handsets and cellular base stations may pose health risks or interfere with the operation of electronic equipment. Although the findings of those reports are disputed, actual or perceived risks of using cellular telecommunications devices or of base stations could have a material adverse effect on cellular service providers, including us. For example, our customer base could be reduced, our customers may reduce their usage of our cellular services or we could encounter difficulties in obtaining sites for additional cellular base stations required to expand our network coverage. As a result, our cellular business may generate less revenue and our financial condition and results of operations may be materially and adversely affected. In addition, we could be exposed to potential liability for any health problems caused by cellular handsets and base stations.

***The market value of your investment may fluctuate due to financial results released in the Republic of China that are prepared on a basis that is different from generally accepted accounting principles in the United States***

Our ongoing financial reporting with the U.S. Securities and Exchange Commission, or SEC, are currently under US GAAP and we plan to begin the preparation of our financial reporting with the SEC under generally accepted accounting principles in the Republic of China, or ROC GAAP, with reconciliation to US GAAP in accordance with the requirements of the SEC in 2008. Before we were privatized, under laws and regulations applicable to state-owned enterprises, our financial statements prepared for reporting purposes in the Republic of China were subject to government review and audit, and the government had required adjustments to be made to our internally prepared and audited financial statements prior to approving our official government audited financial statements. These adjustments had affected our reported revenues, expenses, income before tax and income available for distribution of dividends. However, these adjustments had not had any material impact on our financial statements presented in this annual report. The financial statements presented in this annual report were not subject to adjustment under the government review and audit process. Our reported financial condition and results of operations under US GAAP and under other accounting principles and standards may differ significantly. The price of our common shares trading on the Taiwan Stock Exchange may be based on, among other things, our financial statements prepared for ongoing reporting purposes in the Republic of China, and this in turn may affect the market price of our ADSs.

***We may be sanctioned or lose our licenses for violations of limits on foreign ownership of our common shares and these limits may materially and adversely affect our ability to obtain financing.***

The laws of the Republic of China limit foreign ownership of our common shares. Currently, the Ministry of Transportation and Communications limits direct and indirect foreign ownership of our common shares to 40%. If we fail to comply with the applicable foreign ownership limitations, our licenses to operate some of our businesses could be revoked. In addition, the Cable Radio and Television Law, under which we operate our multimedia on demand business, provides that direct foreign ownership in a cable operator may not exceed 20% of the total outstanding shares, and that the combined direct and indirect foreign ownership in a cable operator may not exceed 60% of the total outstanding shares. We were granted a license under this law, even though we were not, and are not, in compliance with this and other ownership restrictions. Since we are unable to control ownership of our common shares or ADSs representing our common shares, and because we have no ability to stop transfers among shareholders, to force particular shareholders to sell their shares, or otherwise remedy a breach of these foreign ownership limits, we may lose our licenses through no fault of our own and we do not have any effective means to protect our business from this risk. These limitations may also materially and adversely affect our ability to obtain adequate financing to fund our future capital requirements or to obtain strategic partners, and alternate forms of financing may not be available on terms favorable to us or at all.

***We are subject to litigation that could expose us to substantial liabilities.***

We are from time to time involved in litigation, arbitration or administrative proceedings in the ordinary course of our business. See Item 4. Information on the Company B. Business Overview Legal Proceedings. We cannot predict the outcome of these proceedings, and we cannot assure you that if a judgment is rendered against us in any or all of these proceedings, our financial condition and results of operations would not be materially and adversely affected.

***Investor confidence in us may be adversely impacted if we or our independent registered public accountants are unable to attest to the effectiveness of our internal control over financial reporting as of December 31, 2006 as required by Section 404 of the Sarbanes-Oxley Act of 2002.***

We are subject to the reporting requirements of the SEC. The SEC, as directed by Section 404 of the U.S. Sarbanes-Oxley Act of 2002, adopted rules requiring U.S. public companies to include a report of management on our internal control over financial reporting in its Annual Report on Form 20-F, as the case may be, that contains an assessment by management of the effectiveness of the company s internal control over financial reporting. In addition, the company s independent registered public accountants must attest to and report on the design and operating effectiveness of and management s assessment of the effectiveness of the company s internal control over financial reporting. These requirements will first apply to our Annual Report on Form 20-F for the fiscal year ending on December 31, 2006.

We cannot assure you that our management will be able to conclude that our internal control over financial reporting is effective when the requirements of Section 404 become applicable to us. Moreover, even if our management concludes that our internal control over financial reporting is effective, our independent registered public accounting firm may still conclude that our internal control is not effective due to any inability to fully remedy the material weaknesses already reported to our audit committee by our independent registered public accounting firm or additional material weaknesses that may be identified during the Section 404 audit process or other reasons. Furthermore, during the course of the evaluation, documentation and attestation, we may identify weaknesses and deficiencies that we may not be able to remedy in time to meet the deadline imposed by the Sarbanes-Oxley Act for compliance with the requirements of Section 404. If we fail to achieve and maintain effective internal control over financial reporting in accordance with the Sarbanes-Oxley Act, we could suffer a loss of investor confidence in the reliability of our financial statements, which in turn could negatively impact the trading price of our ADSs, result in lawsuits being filed against us by our shareholders or otherwise harm our reputation. Furthermore, we have incurred and anticipate that we will continue to incur considerable costs and use significant management time and other resources in an effort to comply with Section 404 and other requirements of the Sarbanes-Oxley Act.

***Implementation of the Alternative Minimum Tax may affect our effective tax rate.***

According to the recently implemented Alternative Minimum Tax, or the AMT, Act effective from January 1, 2006, a company will be subject to a 10% AMT if its alternative minimum taxable annual income exceeds NT$2 million, and an individual will be subject to a 20% AMT if his or her annual income exceeds NT$6 million. The imposition of the AMT is designed to remedy the current excessive tax incentives for individuals and businesses. For businesses, the income items that are exempted under relevant tax regulations, such as the Statute for the Establishment and Administration of the Science-Based Industrial Park (now known as the Hsinchu Science Park), or SEASIP, and the Statute for Upgrading Industries, or SUI , will now be subject to the new AMT system and added back into the calculation of business taxpayers aggregate incomes. We will pay AMT if our tax payable under this revised calculation at the AMT rate of 10% exceeds the tax which would otherwise have been payable under the ordinary taxable income calculation and the ordinary corporate tax rate of 25%. The AMT Act also provides that businesses already qualified for five-year tax holidays before December 31, 2005 may continue to enjoy tax incentives and not be subject to AMT, so long as the construction of their investment projects breaks ground within one year and is completed within three years of the implementation of the AMT Act.

## Risks Relating to the Republic of China

***Any further economic downturn or decline in the growth of the population in Taiwan may materially and adversely affect our financial condition, results of operations and prospects.***

We conduct most of our operations and generate most of our revenues in Taiwan. As a result, any decline in the Taiwan economy or a decline in the growth of the population in Taiwan may materially and adversely affect our financial condition, results of operations and prospects. In recent years, the banking and financial sectors in Taiwan have been seriously harmed by the general economic downturn in Taiwan and the rest of Asia, which has resulted in a depressed property market and an increase in the number of companies filing for corporate reorganization and bankruptcy protection. Although economic conditions in Taiwan improved since 2003, the global slowdown in technology expenditures has also from time to time adversely affected the Taiwan economy, which is highly dependent on the technology industry. We cannot assure you that economic conditions in Taiwan will continue to improve in the future or that our business and operations will not be materially and adversely affected by a deterioration in the Taiwan economy.

**Table of Contents**

***Any future outbreak of contagious diseases may materially and adversely affect our business and operations, as well as our financial condition and results of operations.***

Any future outbreak of contagious diseases, such as severe acute respiratory syndrome or avian influenza, may disrupt our ability to adequately staff our business and may generally disrupt our operations. If any of our employees is suspected of having contracted any contagious disease, we may under certain circumstances be required to quarantine such employees and the affected areas of our premises. As a result, we may have to temporarily suspend part or all of our operations. Furthermore, any future outbreak may restrict the level of economic activity in affected regions, including Taiwan, which may adversely affect our business and prospects. As a result, we cannot assure you that any future outbreak of contagious diseases would not have a material adverse effect on our financial condition and results of operations.

***We face substantial political risks associated with doing business in Taiwan, particularly due to the tense relationship between the Republic of China and the People s Republic of China that could negatively affect the value of your investment.***

Our principal executive offices and substantially all of our assets are located in Taiwan, and substantially all of our revenues are derived from our operations in Taiwan. Accordingly, our business, financial condition and results of operations and the market price of our common shares and the ADSs may be affected by changes in Republic of China governmental policies, taxation, inflation or interest rates and by social instability and diplomatic and social developments in or affecting Taiwan which are outside of our control. Taiwan has a unique international political status. Since 1949, Taiwan and the Chinese mainland have been separately governed. The People s Republic of China, or PRC, claims that it is the sole government in China and that Taiwan is part of China. Although significant economic and cultural relations have been established during recent years between the Republic of China and the PRC, relations have often been strained. The PRC government has refused to renounce the use of military force to gain control over Taiwan. Furthermore, the PRC government passed an Anti-Secession Law in March 2005, which authorizes non-peaceful means and other necessary measures should Taiwan move to gain independence from the PRC. In February 2006, the president of Taiwan ceased activities of the country s National Unification Council, a committee established to assist Taiwan in its efforts to reunite with the PRC. Such cease is commonly viewed as having a detrimental effect to reunification efforts between the two countries. Past developments in relations between the Republic of China and the PRC have on occasion depressed the market prices of the securities of companies in the Republic of China. Relations between the Republic of China and the PRC and other factors affecting military, political or economic conditions in Taiwan could materially and adversely affect our financial condition and results of operations, as well as the market price and the liquidity of our securities.

***Taiwan is susceptible to severe earthquakes and typhoons that could severely disrupt the normal operation of our business and adversely affect our earnings.***

All of our properties are located in Taiwan, which is susceptible to earthquakes and typhoons. On September 21, 1999, the central part of Taiwan experienced a severe earthquake that caused significant property damage and loss of life. This earthquake damaged our network facilities and adversely affected our operations. In particular, we suffered property losses totaling approximately NT$1 billion. Since that time, other parts of Taiwan have also experienced earthquakes that damaged or disrupted the businesses of many other companies. In addition, parts of our network were damaged, and our operations were disrupted, by two typhoons in 2001. As a result of these typhoons, we suffered property losses totaling approximately NT$200 million. We do not carry any insurance to cover damages caused by earthquakes or typhoons, or to cover any resulting business interruption. In the event of a major earthquake, typhoon or other natural disaster in Taiwan, our business could be severely disrupted and our business and results of operations could be materially and adversely affected.

***Shareholders may have more difficulty protecting their interests under the laws of the Republic of China than they would under the laws of the United States.***

Our corporate affairs are governed by our Articles of Incorporation, the Telecommunications Act, the Statute of Chunghwa Telecom Co., Ltd., and by the laws governing corporations incorporated in the Republic of China. The rights of shareholders and the responsibilities of management and the members of the board of directors of Taiwan companies are different from those applicable to a corporation incorporated in the United States. For example, controlling or major shareholders of Taiwan companies do not owe fiduciary duties to minority shareholders. In addition, before we were privatized, our corporate affairs are governed by laws and regulations not generally applicable to other Taiwan companies. Therefore, holders of our common shares and ADSs may have more difficulty in protecting their interests in connection with actions taken by our management or members of our board of directors than they would as public shareholders of a United States corporation.

**Table of Contents**

***The market value of your investment may fluctuate due to the volatility of, and government intervention in, the Taiwan securities market.***

Our common shares are traded on the Taiwan Stock Exchange, which has a smaller market capitalization and is more volatile than the securities markets in the United States and many European countries. The market value of our ADSs may fluctuate in response to the fluctuation of the trading price of our common shares on the Taiwan Stock Exchange. The Taiwan Stock Exchange has experienced substantial fluctuations in the prices and trading volumes of listed securities and there are currently limits on the range of daily price movements. In recent years, the Taiwan Stock Exchange Index reached a peak of 10,202.2 in February 2000 and subsequently fell to a low of 3,446.3 in October 2001. During 2005, the Taiwan Stock Exchange Index peaked at 6,575.53 on December 29, 2005, and reached a low of 5,632.97 on October 28, 2005. On April 28, 2006, the Taiwan Stock Exchange Index closed at 7,171.77. The Taiwan Stock Exchange has experienced certain problems, including market manipulation, insider trading and payment defaults. The recurrence of these or similar problems could have a material adverse effect on the market price and liquidity of the securities of Taiwan companies, including our ADSs and common shares, in both the domestic and the international markets.

In response to declines and volatility in the securities markets in Taiwan, the Republic of China government formed the National Financial Stabilization Fund to support these markets through open market purchases of shares in Taiwan companies from time to time. The details of the transactions of the National Financial Stabilization Fund have not been made public. In addition, the government s Labor Insurance Fund and other funds associated with the government have in the past purchased, and may from time to time purchase, shares of Taiwan companies listed on the Taiwan Stock Exchange or other markets. As a result of these activities, the market price of common shares of Taiwan companies may have been and may currently be higher than the prices that would otherwise prevail in the open market. Market intervention by government entities, or the perception that such activity is taking place, may take place or has ceased, may cause sudden movements in the market prices of the securities of Taiwan companies, which may affect the market price and liquidity of our common shares and ADSs.

**Risks Relating to Ownership of Our ADSs**

***Restrictions on the ability to deposit our common shares into our ADS program may adversely affect the liquidity and price of the ADSs.***

The ability to deposit shares into our ADS program is restricted by Republic of China law, under which no person or entity, including you and us, may deposit our common shares into our ADS program without specific approval of the Securities and Futures Bureau, except for the deposit of the common shares into our ADS program and for the issuance of additional ADSs in connection with:

- distribution of share dividends or free distribution of our common shares;
- exercise of preemptive rights of ADS holders applicable to the common shares evidenced by our ADSs in the event of capital increases for cash; or
- purchases of our common shares in the domestic market in Taiwan by the investor directly or through the depositary and delivery of such shares or delivery of our common shares held by such investors to the custodian for deposit into our ADS program, subject to the following conditions: (a) the depositary may accept deposit of those shares and issue the corresponding number of ADSs with regard to such deposits only if the total number of ADSs outstanding after the deposit does not exceed the number of ADSs previously approved by the Securities and Futures Bureau, plus any ADSs issued pursuant to the events described above; and (b) this deposit may only be made to the extent previously issued ADSs have been cancelled.

As a result of the limited ability to deposit common shares into our ADS program, the prevailing market price of our ADSs on the New York Stock Exchange may differ from the prevailing market price of the equivalent number of our common shares on the Taiwan Stock Exchange.

***You will be more restricted in your ability to exercise voting rights than the holders of our common shares, which may diminish your influence over our corporate affairs and may reduce the value of your ADSs.***

Holders of American depositary receipts evidencing our ADSs may exercise voting rights with respect to the common shares represented by these ADSs only in accordance with the provisions of our deposit agreement. The deposit

**Table of Contents**

agreement provides that, upon receipt of notice of any meeting of holders of our common shares, the depositary bank will, as soon as practicable thereafter if requested by us in writing, mail to ADS holders the notice of the meeting sent by us, voting instruction forms and a statement as to the manner in which instructions may be given by the holders.

ADS holders will not generally be able to exercise voting rights attaching to the deposited securities on an individual basis. Under the deposit agreement, the voting rights attaching to the deposited securities must be exercised as to all matters subject to a vote of shareholders collectively in the same manner, except in the case of an election of directors and supervisors. The election of our directors and supervisors is by means of cumulative voting. In the event the depositary does not receive voting instructions from ADS holders in accordance with the deposit agreement, our chairman or his or her designee will be entitled to vote the common shares represented by the ADSs in the manner he or she deems appropriate at his or her discretion, which may not be in your interest.

***Your right to participate in any future rights offerings may be limited, which may cause dilution to your holdings.***

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. Under the deposit agreement, the depositary will not offer you those rights unless the distribution to ADS holders of both the rights and any related securities are either registered under the U.S. Securities Act of 1933, as amended, or the Securities Act, or exempt from registration under the Securities Act. We are under no obligation to file a registration statement with respect to any such rights or securities or to endeavor to cause such a registration statement to be declared effective. Moreover, we may not be able to establish an exemption from registration under the Securities Act. Accordingly, you may be unable to participate in our rights offerings and may experience dilution in your holdings.

If the depositary is unable to sell rights that are not exercised or not distributed or if the sale is not lawful or reasonably practicable, it will allow the rights to lapse, in which case you will receive no value for these rights.

***Changes in exchange controls that restrict your ability to convert proceeds received from your ownership of ADSs may have an adverse effect on the value of your investment.***

Your ability to convert proceeds received from your ownership of ADSs depends on existing and future exchange control regulations of the Republic of China. Under the current laws of the Republic of China, an ADS holder or the depositary, without obtaining further approvals from the Central Bank of China or any other governmental authority or agency of the Republic of China, may convert NT dollars into other currencies, including U.S. dollars, in respect of:

- the proceeds of the sale of common shares represented by ADSs or received as share dividends with respect to the common shares and deposited into the depositary receipt facility; and

- any cash dividends or distributions received from the common shares represented by ADSs.

In addition, the depositary may also convert into NT dollars incoming payments for purchases of common shares for deposit in the depositary receipt facility against the creation of additional ADSs. If you withdraw the common shares underlying your ADSs and become a holder of our common shares, you may convert into NT dollars subscription payments for rights offerings. The depositary may be required to obtain foreign exchange approval from the Central Bank of China on a payment-by-payment basis for conversion from NT dollars into foreign currencies of the proceeds from the sale of subscription rights of new common shares. Although it is expected that the Central Bank of China will grant approval as a routine matter, required approvals may not be obtained in a timely manner, or at all.

Under the Republic of China Foreign Exchange Control Law, the Executive Yuan of the Republic of China may, without prior notice but subject to subsequent legislative approval rendered within ten days from such imposition, impose foreign exchange controls or other restrictions in the event of, among other things, a material change in domestic or international economic conditions which might threaten the stability of the domestic economy in Taiwan.

***You are required to register with the Taiwan Stock Exchange and appoint several local agents in Taiwan if you withdraw common shares from our ADS facility and become our shareholder, which may make your ownership burdensome.***

If you are a non-Republic of China person and wish to withdraw common shares represented by your ADSs from our ADS facility and hold those common shares, you are required under the current laws and regulations of the Republic of China to appoint an agent, also referred to as a tax guarantor, in the Republic of China for filing tax returns and making tax

Table of Contents

payment. A tax guarantor must meet certain qualifications set by the Ministry of Finance of the Republic of China and, upon appointment, becomes a guarantor of your Republic of China tax obligations. If you wish to repatriate profits derived from the sale of withdrawn common shares or cash dividends or interest on funds derived from the withdrawn common shares, you will be required to submit evidence of your appointment of a tax guarantor and the approval of the appointment by the Republic of China tax authorities. You may not be able to appoint and obtain approval for a tax guarantor in a timely manner.

In addition, under the current laws of the Republic of China, you will be required to be registered as a foreign investor with the Taiwan Stock Exchange for making investments in the Republic of China securities market prior to your withdrawal and holding of common shares represented by the ADSs. You will be required to appoint a local agent in Taiwan to, among other things, open a securities trading account with a local securities brokerage firm and a bank account to remit funds, exercise shareholders rights and perform other functions as holders of ADSs may designate. You must also appoint a local bank to act as custodian for handling confirmation and settlement of trades, safekeeping of securities and cash proceeds and reporting and declaration of information. Without the relevant registration and appointment of the local agent and custodian and the opening of the trading account and bank account, you will not be able to hold, subsequently sell or otherwise transfer our common shares withdrawn from the ADSs facilities on the Taiwan Stock Exchange.

***Our actual financial results in 2006 may differ materially from our announced full year guidance for 2006.***

On May 1, 2006, we announced our guidance for 2006 prepared in accordance with ROC GAAP and the requirements of the Taiwan Stock Exchange. In particular, we estimated that for the year ending December 31, 2006, our revenues will be NT$184.2 billion, income before income tax will be NT$55.7 billion, net income will be NT$44.2 billion and earnings per share will be NT$4.56. These projections were based on a number of estimates and assumptions and are inherently subject to significant uncertainties and contingencies, including the risks factors described in this annual report. These projections were not prepared with a view towards compliance with published guidelines of the SEC, the U.S. Public Company Accounting Oversight Board or generally accepted accounting principles and, accordingly, you should not rely on this information. In particular, projections are forward-looking statements that are necessarily speculative in nature, and it can be expected that one or more of the estimates on which the projections were based will not materialize or will vary significantly from actual results, and such variances will likely increase over time. You should not regard the inclusion of the projections described above as a representation by us, or any other person that these projections or the assumptions underlying the projections will be achieved.

## ITEM 4. INFORMATION ON THE COMPANY

### A. History and Development of the Company

Our legal and commercial name is Chunghwa Telecom Co., Ltd. Our shares have been listed on the Taiwan Stock Exchange under the number 2412 since October 27, 2000 and our ADSs have been listed on the New York Stock Exchange under the symbol CHT since July 17, 2003. Our principal executive offices are located at 21-3 Hsinyi Road, Section 1, Taipei, Taiwan, Republic of China, and our telephone number is (886) 2-2344-5488. Our website address is *http://www.cht.com.tw*. The information on our website does not form a part of this annual report.

We were established as a company on July 1, 1996 as a result of the separation of the business and regulatory functions of the Directorate General of Telecommunications. We were privatized in August 2005.

We are the largest telecommunications service provider in Taiwan and one of the largest in Asia in terms of revenues. As an integrated telecommunications service provider, our principal services include:

- fixed line services, including local, domestic long distance and international long distance telephone services;
- wireless services, including cellular and paging services; and
- Internet and data services, including HiNet, our Internet service provider, asymmetrical digital subscriber line services and leased line services.

As our traditional fixed line business has matured and new technologies have become available, we have pursued new growth opportunities in the cellular and Internet and data services markets. We are focusing on enhancing our leading position in each of our principal lines of business, and expanding into new lines of business such as third generation cellular services. We enjoy leading positions across a number of areas:

- we are Taiwan s largest provider of fixed line services in terms of both revenues and subscribers;

Table of Contents

- we are Taiwan s largest cellular service provider in terms of both revenues and subscribers, and are in the process of rolling out a third generation cellular network;

- we are Taiwan s largest broadband Internet access provider as well as Taiwan s largest Internet service provider in terms of both revenues and subscribers; and

- we are also a leading player in the data communications market in Taiwan.

In 2005, our revenues were NT$184.7 billion (US$5.6 billion), our net income was NT$33.3 billion (US$1.0 billion) and our net income per share was NT$3.45 (US$0.11).

We incurred capital expenditures totaling NT$22.9 billion (US$0.7 billion) in 2005, of which, 22.5% was spent on fixed line services, 19.4% on cellular services, 55.4% on Internet and data services and 2.7% on other items. See Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources Capital Expenditures for a discussion of our capital expenditures.

**Competitive Strengths**

We believe that we are well positioned to take advantage of growth opportunities in the telecommunications market in Taiwan as new technologies evolve. In particular, we have maintained our leading market share in cellular and Internet and data services since the opening of the Taiwan telecommunications market to competition in June 2001. Furthermore, we have enjoyed greater flexibility in making purchasing decisions after we were privatized in August 2005. In addition, our responsiveness to market conditions has been enhanced by the shortening in May 2002 of the approval period for primary tariff adjustments and promotional packages from 40 to 14 days.

We believe that further deregulation and market liberalization will continue to drive the growth of the overall market for telecommunications services in Taiwan, as well as the development of new products and services. We expect to benefit from additional opportunities as the telecommunications market in Taiwan continues to grow.

We believe that our primary competitive strengths are:

- our position as the only integrated, full-service telecommunications provider in Taiwan, and

- our capital resources and technology, which we believe we can build on to expand our leading position in the growing cellular and Internet and data services markets, including through our continued construction of a third generation cellular network, our Internet protocol-based multimedia on demand services and our rollout of voice over Internet protocol services.

***We are the only integrated full-service telecommunications provider in Taiwan.***

We are the largest telecommunications service provider in Taiwan with a leading position in local, domestic long distance and international long distance telephone services, wireless services and Internet and data services.

*Broad range of communications products and services.* We believe that our ability to provide an attractive and comprehensive range of telecommunications services uniquely positions us to provide bundled and value-added services to our business and residential customers. In addition, we are able to offer innovative bundled services and tariff packages to meet the specific needs of our customers.

*Broad network coverage.* The breadth of our network and our ownership of the so called last mile infrastructure in Taiwan, which comprises the connection between the local telephone service provider s switching centers to the end-users buildings or homes, provide us with access to existing and potential customers and creates a platform for expanding our services. As of December 31, 2005, substantially all of our installed telephone lines are capable of delivering asymmetrical digital subscriber line services. In addition, our cellular services network provides nationwide coverage. Our large cellular spectrum allocation together with our network of 8,413 base stations position us well for the continued expansion of our cellular services in Taiwan.

14

*Brand awareness, distribution channels and customer service.* Our principal brands Chunghwa Telecom and HiNet have a reputation for quality, reliability and technology. In particular, we are the leading Internet service provider in Taiwan through HiNet. We serve our large and well-established customer base through our extensive customer service network in Taiwan, including 27 operations offices, 312 service centers and six integrated call centers. We also offer comprehensive and high-quality point of sale and after sale services, and we provide web-based customer services. Moreover, our extensive sales and distribution channels help us attract additional customers and develop new business opportunities. In the Reader s Digest Super Brands Award 2005, we stood out and won Platinum Award of Telecom Company in Taiwan.

*Operational expertise.* Our management and employees have extensive operating experience and technical knowledge, which we believe cannot be easily replicated by competitors. We also believe we will continue to attract and retain high quality employees.

*Comprehensive customer billing infrastructure.* As Taiwan s leading telecommunications services provider, we have extensive resources and infrastructure relating to billing services. In particular, we issue, in the aggregate, approximately 16 million invoices, including integrated bills, every month. We intend to continue taking advantage of this unique attribute by offering bill collection services to Internet content providers and other entities that lack the necessary resources and infrastructure for effective customer billing.

***We have the capital resources and technology to enhance our leading position in the growing cellular and Internet services markets.***

*Established position in growing markets.* Revenues from our cellular and Internet and data services have increased from 55.8% of revenues in 2003 to 62.3% in 2005. We expect our cellular and Internet and data services to continue to be the key drivers of our future growth. With our leading market share, we enjoy substantial economies of scale in equipment procurement as well as the marketing of our products and services.

*Strong capital structure.* We believe we have greater financial resources than other telecommunications operators in Taiwan. In particular, our relatively low debt-to-equity capital structure, together with our high levels of cash and operating cash flows, provides us with the flexibility and resources to invest in capital intensive and growing businesses. In particular, we continue to invest in broadband Internet protocol networks, fiber-optic networks, and third generation cellular communications networks and services.

*Advanced network technology.* Since January 1, 2003, we have spent in excess of NT$11.5 billion on capital expenditures, including developing advanced networks, such as an asymmetrical digital subscriber line network, a high-speed Internet protocol backbone network and a third generation cellular services network. Our investment in network infrastructure places us in a position to capture a significant share of Internet-related and high-speed data transmission business.

*Research and development expertise.* We employ over 1,172 research professionals and engineers whose principal focus is to develop advanced network services and operations support systems and to build selected core technologies. In 2005, our research and development expenses, excluding depreciation and amortization, accounted for 1.7% of our revenues. We believe our focus on research and development will allow us to efficiently develop and deploy new technologies and services ahead of our competitors.

**Business Strategy**

Taiwan has one of the highest fixed line penetration rates in Asia and has also experienced rapid adoption of wireless communications and Internet services, including broadband access services. We believe that telecommunications services will evolve over the coming years, driven by a number of technological innovations. We also believe that the convergence of communications technologies will provide a significant competitive advantage to integrated telecommunications service providers that are able to design and construct sophisticated and scalable networks capable of serving as a common platform for a broad range of services.

Our key strategic objectives are to maintain our position as a leading integrated telecommunications services provider in Taiwan and to enhance our leadership position in growing markets, such as cellular and Internet and data markets, including broadband access services and value-added services.

Consistent with our strategic objectives, we have developed the following business strategies:

***Focus on our core strengths while expanding our scope of services to capture new growth opportunities***

Our core strengths are the management of telecommunication networks and the provision of services over these networks. We currently operate several networks linked by a core backbone infrastructure consisting of public switched telephone, cellular, asymmetrical digital subscriber line and Internet protocol networks. Our strategy for each network differs depending on the market dynamics and future growth prospects of services delivered over these networks. In general, we endeavor to maintain our strong market position in each of our business lines and seek to expand the scope of our business beyond network services by offering value-added services to generate growth and new opportunities.

*Fixed line*: Our strategy for fixed line services is to maintain our substantial market share of the local telephone market following deregulation of international and domestic long distance telephone services in June 2001 and local loop unbundling of voice in June 2004. We have introduced voice over Internet protocol services and plan to launch phone-to-phone and phone-to-PC voice over Internet protocol services in the second half of 2006, subject to our obtaining the approval of the Directorate General of Telecommunications. We plan to introduce value-added services for the local telephone market, such as personal ring back tone. We also seek to enhance customer loyalty by promoting virtual private network and information communication systems integration services targeted at our enterprise customers. We are currently developing a detailed business plan for the migration to next-generation networks. Although our core backbone and public switched telephone network is the initial focus of this migration, we expect our entire fixed line network to be eventually based on a fully integrated Internet protocol telephony system.

*Cellular*: Our strategy for our existing 2G cellular services, which uses the global system for mobile communications standard, is to continue to expand service offerings that take advantage of our strong customer base and extensive network coverage. In particular, we will focus on increasing our average revenue per subscriber by expanding our post-paid subscriber base and increasing take-up of wireless value-added services, such as our emome mobile Internet service, Java games, ring back tone services and video streaming. Furthermore, we launched our third generation cellular service based on a wideband code division multiple access technology on July 26, 2005. Our strategy with respect to our third generation cellular service includes the following initiatives:

- taking advantage of our ability to provide services using either the global system for mobile communications or wideband code division multiple access standards and offer seamless service to customers with dual mode handsets, which enable our customers to enjoy the benefits of network coverage while retaining their global system for mobile communications cellular phone number. In order to meet the demand from our customers for high-speed wireless data access, we adopted high-speed downlink packet access technology and continued developing third-generation cellular technology;

- encouraging our high-end customers, who are more likely to demand wireless Internet services with higher data speed access capabilities, to use our third generation cellular services by offering attractive service packages;

- converging fixed line and cellular services to provide customers with access to personalized information through personal computers, personal digital assistants or cellular handsets; and

- taking advantage of our superior brand and network quality to attract our competitors subscribers.

*Internet and data*: Our strategy for Internet and data services is to continue to build on the success of our HiNet Internet services and asymmetrical digital subscriber line access services. We seek to complement the Republic of China government s plan to grow the broadband subscriber base to 6 million subscribers by the end of 2007, of which we aim to capture at least an 80% share, or 4.8 million subscribers. We are the leading provider of broadband Internet access in Taiwan, with a significant market share as of December 31, 2005. We have successfully migrated many of our customers from low-speed to higher-speed Internet access services. Approximately 59% of our broadband customers subscribe for downlink speeds of over 2 megabits per second, and the average downlink speed of our Internet subscribers, defined as the total downlink speed subscribed divided by the total number of subscribers, increased from 0.6 Mbps as of December 31, 2002 to 2.14 Mbps as of December 31, 2005. We are developing new media to provide both higher-speed access as well as attractive content to our customers. We are continuing our build-out of fiber-to-the-building infrastructure, and continually enhancing our Internet value-added services, such as online gaming, Internet music, Internet banking and Internet protocol video services, including multimedia on demand and hiChannel. We are currently developing voice over Internet protocol services, including best effort and carrier class services.

*Bundled services*: We believe bundled services are effective in encouraging usage and enhancing customer loyalty. We intend to increase our offerings for bundled services. In particular, we believe we are uniquely positioned to provide our customers with fully integrated solutions across fixed line, cellular and Internet platforms. Our Friends and Family service, which offers customers preferential rates, has attracted over 1.6 million subscribers. In addition, we provide a wide range of bundled services customized to meet the needs of our enterprise customers.

***Emphasize quality of service and customer satisfaction***

Quality of service is critical in attracting and retaining customers and enhancing our long-term profitability. In order to continually enhance and improve the quality of our services, we have, in addition to the quality assurance function of our regular operating units, established a number of dedicated task forces to monitor our network performance. Our senior management sets our quality evaluation criteria and regularly reviews our performance quality.

In order to ensure that our quality of service will translate into strong customer loyalty, we plan to continue to focus on and invest in the provision of a full range of services that emphasize customer care from the point of sale onward. In particular, we have extended the focus of our business customer services group from major accounts to include small and medium enterprises. Our business customer service group is staffed by approximately 800 professionals and offers packaged and customized services, innovative telecommunications solutions and dedicated customer support. We have completed the integration of all of our call centers, which can now be reached by a single calling number 123. We offer 24-hour customer service, including the handling of service and billing inquiries with the assistance of an information system. We also offer consolidated billing for our customers who use multiple services. We began to provide an e-bill service option to our customers in August 2005. Moreover, we have put in place processes to enhance bill collection and improve the quality of our billing services. To improve the quality of our customer services, we implemented a customer relationship management system, which encompass, among other things, a customer complaint system, a business information database for the use of our call centers, and a data mining system to enhance our sales and market analysis efforts.

***Improve operational efficiency and cost structure***

We have historically been focused, and will continue to focus, on cost control, particularly in the areas of network efficiencies and personnel costs. We expect to be able to further improve our operational efficiency and cost structure by migrating to more advanced networks and sophisticated operational support systems, and efficiently managing our workforce.

*Capital expenditures*: Our long-term goal is to optimize our capital expenditures by focusing on investing in innovative products and services with attractive return profiles. We evaluate our investment opportunities by benchmarking them against internal return requirements. We are currently finalizing plans for the gradual upgrade of our entire public switched telephone network to a next-generation network. Next-generation Internet protocol switches will have substantially more capacity and greater upgrade flexibility, and should result in savings from a reduced number of switching centers, and related property, materials and personnel costs. We have also devoted resources toward the expansion of our third generation cellular network and the continuing build-out of our fiber-to-the-building infrastructure.

*Personnel costs:* We seek to improve our operational efficiency by reducing our personnel costs. For example, we offered a number of voluntary retirement programs between June 1, 2000 and December 31, 2001, which resulted in a reduction in our workforce of 6,480 employees, or approximately 20% of our total workforce before the implementations of these voluntary retirement programs. We also offered a number of voluntary retirement programs between July 1, 2003 and April 30, 2006 which resulted in reductions of 3,712 employees. On the other hand, we also hired more than 400 new employees after privatization. In addition, we will further align our organizational structure by integrating our various operating units and departments on the local level. We will also continue to reallocate our personnel from traditional fixed line services to our growing businesses and to our marketing and customer services departments, as well as exploring outsourcing opportunities where we deem appropriate.

***Expand our business through alliances and investments***

We plan to expand our business in high growth areas, such as interactive multimedia broadband services, content delivery services and value-added services, through alliances and investments. We believe that our experience, operational scale and large subscriber base make us an attractive ally for other service providers.

**Table of Contents**

*Alliances*. We have formed and will continue to pursue alliances with information content providers, multimedia service platform providers and customer premises equipment providers to diversify our business operations and enhance our service offerings. As of the date of this annual report, we have collaborated with more than 400 information content providers, more than 20 customer premises equipment providers, more than 10 Internet service providers and one Internet portal operator.

*Investments*. We have invested in several telecom-related businesses such as Chunghwa Investment Co. Ltd., which was established in 2002 to manage our investment activities. We will concentrate on investments that compliment our businesses. However, we will continue to focus on our core business and carefully evaluate any investment opportunity.

***Maintain focus on maximizing shareholder value***

We are committed to maximizing shareholder value, and intend to maintain our high dividend payout policy. We have historically maintained a conservative capital structure, and we were in a net cash position as of March 31, 2006. Following our privatization, we have more flexibility to implement capital management initiatives, including possible repurchases of our outstanding common shares and increases in our leverage through debt financing. We bought back 192,000,000 shares between February 10, 2006 and April 9, 2006 and plan to cancel those shares before August 9, 2006.

**B. Business Overview**

**Our Principal Lines of Business**

The following table sets forth our revenues from our principal lines of business for the periods indicated.

| | Year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2003 | | 2004 | | 2005 | |
| | (in billions, except percentages) | | | | | |
| | NT$ | | NT$ | | NT$ | |
| Fixed line: | | | | | | |
| Local | 48.4 | 26.5% | 44.9 | 24.3% | 40.7 | 22.1% |
| Domestic long distance | 13.4 | 7.4 | 12.0 | 6.4 | 11.0 | 5.9 |
| International long distance | 15.7 | 8.6 | 15.2 | 8.2 | 14.6 | 7.9 |
| Total fixed line | 77.5 | 42.5 | 72.1 | 38.9 | 66.3 | 35.9 |
| Wireless: | | | | | | |
| Cellular | 66.2 | 36.3 | 70.3 | 38.0 | 73.0 | 39.5 |
| Paging | 0.6 | 0.3 | 0.3 | 0.2 | 0.1 | 0.1 |
| Total wireless | 66.8 | 36.6 | 70.6 | 38.2 | 73.1 | 39.6 |
| Internet and data: | | | | | | |
| Internet | 25.9 | 14.2 | 29.5 | 15.9 | 32.1 | 17.3 |
| Data | 9.7 | 5.3 | 9.8 | 5.3 | 10.1 | 5.5 |
| Total Internet and data | 35.6 | 19.5 | 39.3 | 21.2 | 42.2 | 22.8 |
| Other | 2.6 | 1.4 | 3.2 | 1.7 | 3.1 | 1.7 |
| Total revenues | 182.5 | 100.0% | 185.2 | 100.0% | 184.7 | 100.0% |

**Fixed Line**

The provision of fixed line services is one of our principal business activities. We are the largest provider of local, domestic long distance and international long distance telephone services in Taiwan. We also provide interconnection with our fixed line network to other cellular and fixed line operators. Since June 2001, three new operators have begun offering fixed line services. Our revenues from fixed line services were NT$77.5 billion, or approximately 42.5% of our revenues, in 2003, NT$72.1 billion, or approximately 38.9% of our revenues, in 2004, and NT$66.3 billion, or approximately 35.9% of our revenues, in 2005. Owing primarily to the expansion of our broadband and cellular services, we expect that revenues from our fixed line business will continue to decline as a percentage of our total revenues.

***Local Telephone***

The following table sets forth our revenues from local telephone services for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | | (in billions) | |
| | NT$ | NT$ | NT$ |
| Local telephone revenues: | | | |
| Usage | 18.2 | 16.3 | 14.6 |
| Subscription | 17.6 | 18.0 | 18.2 |
| Interconnection | 3.6 | 3.1 | 3.0 |
| Pay telephone | 0.6 | 0.4 | 0.2 |
| Other | 8.4 | 7.1 | 4.7 |
| Total | 48.4 | 44.9 | 40.7 |

We provide local telephone services to over 13.2 million subscribers in Taiwan. Our fixed line network reaches virtually all homes and businesses in Taiwan. Revenues from local telephone services comprised approximately 26.5%, 24.3% and 22.1% of our revenues in 2003, 2004 and 2005, respectively. Approximately 75% of our local telephone subscribers as of December 31, 2005 were residential customers, accounting for approximately 61.8% of our local telephone revenues in 2005. We are currently the leader of the local telephone service market, with an average market share of approximately 98.4%, 97.9% and 97.4% in 2003, 2004 and 2005, respectively.

The following table sets forth information with respect to our local telephone subscribers and penetration rates as of the dates indicated.

| | As of December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | (in thousands, except percentages and per household data) | | |
| Taiwan population(1) | 22,605 | 22,689 | 22,770 |
| Fixed line subscribers: | | | |
| Residential | 9,892 | 9,950 | 9,942 |
| Business | 3,245 | 3,292 | 3,319 |
| Total | 13,137 | 13,242 | 13,261 |
| Growth rate (compared to the same period in the prior year) | 1.2% | 0.8% | 0.1% |
| Penetration rate (as a percentage of the population) | 58.1% | 58.4% | 58.2% |
| Lines in service per household | 1.40 | 1.39 | 1.36 |

(1) Data from the Department of Population, Ministry of the Interior, Republic of China.

Demand for local subscriber lines has historically been driven by population growth. In each of 2003, 2004 and 2005, fixed line subscriber growth slowed compared to prior periods, primarily due to market saturation and competition.

The following table sets forth information with respect to local telephone usage for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | (in millions, except percentages) | | |
| Minutes from local calls(1)(2) | 29,125 | 24,548 | 21,116 |
| Growth rate (compared to the same period in the prior year) | (15.0)% | (15.7)% | (14.0)% |

(1) Includes minutes from local calls made on pay telephones.

(2) Calls to our HiNet service, which are recorded as part of our Internet and data services, are not included in our local call minutes or revenues.

Minutes from local calls have declined as non-HiNet narrowband subscribers migrate to broadband Internet services, which do not require dial-up telephone access. This decline was also due to traffic migration to broadband and cellular services. As a result of our promotion in 2005 of lower speed asymmetrical digital subscriber line services, we have experienced that some non-HiNet dial-up customers migrated to asymmetrical digital subscriber line service, which has also contributed to a continued decline of minutes from local calls. However, we believe the rate of migration of traffic from fixed line services to broadband and cellular services is slowing.

We charge our local telephone service subscribers a monthly fee and a usage fee. We also charge separate fees for some value-added services. The monthly fees for our primary tariff plans are NT$70 with a deductible on usage fees of NT$25 for residential customers and NT$295 for business customers. Our primary peak time usage fee is NT$1.6 for three minutes or NT$2.7 for ten minutes, depending on the tariff plan selected by the subscriber, and our off-peak usage fee is NT$1.0 for ten minutes. Our usage fees are the same for residential and business customers. We reduced our local tariffs in April 1997, April 2000 and January 2001.

Table of Contents

The following table sets forth information with respect to the average local usage charge per minute for the periods indicated.

| | Year ended December 31, 2003 | 2004 | 2005 |
|---|---|---|---|
| Average local telephone usage fee (per minute) | NT$ 0.65 | NT$ 0.68 | NT$ 0.70 |
| Growth rate (compared to the same period in the prior year) | 3.2% | 4.6% | 2.9% |

Average per minute usage charges increased from NT$0.65 per minute in 2003 to NT$0.68 per minute in 2004 and to NT$0.7 per minute in 2005. The increases were primarily due to a decline in demand for our discounted Internet tariff packages as a result of a migration of non-HiNet dial-up subscribers to our asymmetrical digital subscriber line services.

Part of our competitive strategy is to offer customers innovative products and services intended to both secure customer loyalty and enhance revenues. In particular, our value-added services are designed to increase our call revenues by increasing the number of calls our customers make and by receiving fees for usage of the value-added services. These services include call waiting, caller identification, call forwarding, three-party calls and voicemail.

***Domestic Long Distance Telephone***

We provide domestic long distance telephone services in Taiwan. Revenues from domestic long distance telephone services comprised approximately 7.4%, 6.4%, and 5.9% of our revenues in 2003, 2004 and 2005, respectively. Our average market share in the domestic long distance market was 88.2%, 86.4% and 84.7% in 2003, 2004 and 2005, respectively. Residential customers accounted for approximately 62.4% of our domestic long distance revenues in 2005.

The following table sets forth information with respect to usage of our domestic long distance telephone services for the periods indicated.

| | Year ended December 31, 2003 | 2004 | 2005 |
|---|---|---|---|
| | (in millions, except percentages) | | |
| Minutes from domestic long distance calls | 6,195 | 5,621 | 5,131 |
| Growth rate (compared to the same period in the prior year) | (9.3)% | (9.3)% | (8.7)% |

Minutes of use for domestic long distance calls have been declining as a result of traffic migration to cellular services and competition from other fixed line operators. We expect the decline minutes of use for fixed line services to continue in the future because of the same reasons. However, we believe that the rate of migration to cellular services is slowing.

The following table sets forth information with respect to the average domestic long distance usage charge per minute for the periods indicated:

| | Year ended December 31, 2003 | 2004 | 2005 |
|---|---|---|---|
| Average domestic long distance usage charge (per minute) | NT$ 1.63 | NT$ 1.65 | NT$ 1.65 |
| Growth rate (compared to the same period in the prior year) | | 1.2% | 0% |

All domestic long distance calls, regardless of the distance between the calling parties, have the same tariff. We changed the unit of billing from a per-minute basis to a per-second basis effective February 1, 1999. In addition, we reduced our peak hour domestic long distance rate in April 2001 from NT$0.045 per second to our current rate of NT$0.035 per second. Our current domestic long distance rate for off peak hours is NT$0.025 per second. The rates for both peak hours and off peak hours are the same for residential and business customers. Our average domestic long distance usage charge per minute increased 1.2% from 2003 to 2004, mainly due to a greater decrease in minutes of use during off peak hours than during peak hours. Our average domestic long distance usage charge per minute remained flat between 2004 and 2005.

We provide so-called intelligent network services over our domestic long distance network, including toll free calling, universal number, televoting, premium rate service and virtual private networks. We also focus on offering our customers an increasing number of value-added services and flexible tariff packages.

Table of Contents

*International Long Distance Telephone*

We provide international long distance telephone services in Taiwan. Revenues from international long distance telephone services comprised approximately 8.6%, 8.2% and 7.9% of our revenues in 2003, 2004 and 2005, respectively. Residential customers generated approximately 35.8% of our international long distance revenues during 2005. In addition, we provide wholesale international long distance services to international simple resale operators who do not possess their own telephone network or infrastructure.

We believe other fixed line operators consider the international long distance market to be their primary focus. Our average market share of the international long distance market was approximately 60.1%, 61.3% and 57.8% in 2003, 2004 and 2005, respectively. Our market share declined in 2005 primarily because of competition and the inclusion by another operator of voice over Internet protocol interconnect minutes in its international long distance minutes. Since fixed line services have been open for competition since 2001, we expect competition in this line of business will continue to intensify in the near future.

Our international long distance services consist primarily of international direct dial services and our discounted Super eCall services, which we introduced in April 2000. Under Super eCall, we use voice over Internet protocol technology through international dedicated circuits which connect to our major correspondent carriers that route calls internationally. Super eCall customers are offered rates that are approximately 30% lower than those for our international direct dial service. Calls made over Super eCall represented approximately 11.4% and 7.2% of our total outgoing international traffic in 2004 and 2005, respectively.

We commenced the wholesale of international long distance minutes to licensed international resale operators and other international carriers in 2001. International resale operators require a fixed line operator in Taiwan to complete their long distance telephone services originating in Taiwan. In addition, other international carriers often find it less expensive to route international calls through Taiwan. These resale operators and carriers purchase from us large numbers of minutes at discounted rates. Our international long distance wholesale business has grown rapidly since its introduction. In 2003, 2004 and 2005, we sold 573.2 million, 595.4 million and 781.9 million of wholesale outgoing minutes, which represented approximately 31.0%, 32.1% and 39.0% of our total outgoing international long distance minutes, respectively. Revenues from the wholesale of international long distance minutes increased by approximately 28.9% from NT$872 million in 2004 to NT$1,124 million in 2005. As the international long distance market becomes more competitive, we believe the wholesale business will allow us to generate increases in international minutes without accelerating the decline in international long distance rates in the more profitable retail segment.

International calls to and from our top five destinations represented approximately 60.7% our international long distance call traffic in 2005.

The following table shows the percentage of total outgoing and incoming international long distance minutes for our top five outgoing destinations in 2005.

| **Destination** | **Percentage of total outgoing minutes** | **Percentage of total incoming minutes** |
|---|---|---|
| Mainland China | 32.6% | 33.7% |
| United States | 9.4 | 12.6 |
| Hong Kong | 6.8 | 6.2 |
| Japan | 3.9 | 6.0 |
| Philippines | 9.1 | 0.6 |
| Total of top five destinations | 61.8% | 59.1% |

The following table sets forth information with respect to usage of our international long distance services for the periods indicated.

| | **As of December 31,** | | |
|---|---|---|---|
| | **2003** | **2004** | **2005** |
| | **(in thousands, except percentages and incoming/outgoing ratio)** | | |

| | | | |
|---|---|---|---|
| Incoming minutes | 1,190 | 1,291 | 1,289 |
| Growth rate (compared to the same period in the prior year) | 21.9% | 8.5% | (0.2)% |
| Outgoing minutes | 1,848 | 1,855 | 2,004 |
| Growth rate (compared to the same period in the prior year) | 29.9% | 0.4% | 8.0% |
| Total minutes | 3,038 | 3,146 | 3,293 |
| Incoming/outgoing ratio | 0.64 | 0.70 | 0.64 |

Table of Contents

Total outgoing international long distance minutes increased slightly by 0.4% from 2003 to 2004 and by 8.0% from 2004 to 2005, primarily due to promotions and increased wholesale minutes. Our incoming call volume increased approximately 8.5% from 2003 to 2004 due to our efforts to increase sales of wholesale minutes and slightly decreased by 0.2% from 2004 to 2005 due to increased competition resulting from lower priced calls offered by our competitors, which reduced our incoming international call volume.

Outgoing calls made by customers in Taiwan and by customers from foreign destinations using Taiwan direct service are billed in accordance with our international long distance rate schedule for the destination called. Rates vary depending on the time of day at which a call is placed. Customers are billed on a per minute basis for Super eCall services, whereas customers are billed on a six second unit basis for international direct dial services.

The following table sets forth information with respect to the average international long distance usage charge per minute that we received for outgoing international calls during the periods indicated:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| Average international long distance usage charge (per minute) | NT$ 6.2 | NT$ 6.1 | NT$ 5.4 |
| Growth rate (compared to the same period in the prior year) | (21.5)% | (1.6)% | (11.5)% |

Tariffs for international long distance calls have generally been declining worldwide and we expect this trend to continue. We do not expect the increase in international call traffic to fully offset the decline in tariffs. In anticipation of new competition, we substantially reduced our international tariffs by an average of 37% in April 2001 to defend our business and market share. In addition, we offered our customers significant promotional packages and discounts during off-peak hours in 2003, 2004 and 2005 to maintain their loyalty. In particular, we increased the discounts offered to our high-usage international long distance customers in each of these three years.

We pay for the use of networks of carriers in foreign destinations for outgoing international calls and receive payments from foreign carriers for the use of our network for incoming international calls. Traditionally, these payments have been made pursuant to settlement arrangements under the general auspices of the International Telecommunications Union. Settlement payments are generally denominated in U.S. dollars and are made on a net basis.

The following table sets forth information with respect to our gross settlement receipts and payments during the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | (in billions) | | |
| | NT$ | NT$ | NT$ |
| Gross international settlement receipts | 3.8 | 3.5 | 3.3 |
| Gross international settlement payments | 5.6 | 5.3 | 3.4 |

Our payments on an aggregate basis to international carriers have been more than our receipts from these carriers, primarily because our customers outgoing minutes exceeded incoming minutes. As international settlement rates have fallen, our international settlement receipts and our international settlement payments have both declined.

In order to compete more effectively in the international long distance market, we have implemented innovative and customized discount calling plans and marketing campaigns directed at high-usage business customers. We also continue to promote our intelligent network services, including international virtual private networks, international toll free calling and calling card services, and our international long distance minutes wholesale business. We have introduced PC-to-phone and PC-to-PC voice over Internet protocol services and plan to launch phone-to-phone and phone-to-PC voice over Internet protocol services in the second half of 2006, subject to our obtaining the approval of the Directorate General of Telecommunications. We plan to target specific customers for these services and offer bundled services to increase customer retention in the competitive business environment.

Table of Contents

**Wireless Services**

The provision of wireless services, comprising cellular and paging services, is one of our principal business activities. We are Taiwan s largest cellular service provider in terms of both revenues and subscribers. In 2003, we generated revenues of NT$66.8 billion, or approximately 36.6% of our revenues, from wireless services. In 2004, we generated revenues of NT$70.6 billion, or approximately 38.2% of our revenues, from wireless services. In 2005, we generated revenues of NT$73.1 billion (US$2.2 billion), or approximately 39.6% of our revenues, from wireless services.

The following table sets forth our revenues from wireless services for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | | (in billions) | |
| | NT$ | NT$ | NT$ |
| **Wireless revenues:** | | | |
| Cellular | 66.2 | 70.3 | 73.0 |
| Paging | 0.6 | 0.3 | 0.1 |
| Total wireless | 66.8 | 70.6 | 73.1 |

***Cellular Services***

The following table sets forth our revenues from cellular services for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | | (in billions) | |
| | NT$ | NT$ | NT$ |
| **Cellular revenues:** | | | |
| Usage[(1)] | 57.6 | 60.0 | 60.8 |
| Interconnection | 5.3 | 6.3 | 7.0 |
| Mobile data | 1.6 | 2.3 | 3.2 |
| Other | 1.7 | 1.7 | 2.0 |
| Total cellular | 66.2 | 70.3 | 73.0 |

(1) Includes monthly fees.

As the market for cellular services has continued to expand, we have experienced substantial growth in our cellular customer base. We are the largest cellular operator in Taiwan in terms of revenues and number of subscribers. We had 8.16 million cellular subscribers, for a market share of approximately 39.6% of total cellular subscribers and approximately 35.0% of total cellular services revenues in Taiwan, as of December 31, 2005. Revenues from cellular services comprised approximately 36.3%, 38.0% and 39.5% of our revenues in 2003, 2004 and 2005, respectively. Mobile data revenues as a percentage of total cellular revenues were 2.4%, 3.3% and 4.4% for the years ended December 31, 2003, 2004 and 2005, respectively.

We offer digital cellular service through our dual band global system for mobile communications network. We are one of three national licensed providers of global system for mobile communications services. We have been allocated 15 MHz in the 900 MHz frequency band and 11.25 MHz in the 1800 MHz frequency band for global system for mobile communications services and general packet-switched radio services and 15 MHz paired spectrum plus 5 MHz unpaired spectrum in the 2 GHz frequency band for third generation cellular services. This is the largest frequency spectrum allocation to any cellular operator in Taiwan. In February 2002, the Ministry of Transportation and Communications granted third generation cellular services concessions to five companies, including us. In March 2002, we paid NT$10.2 billion to the government for our concession. We have received a third generation cellular services license, which is valid from May 26, 2005 to December 31, 2018. On

July 26, 2005, we launched our third generation cellular telephone services using wideband code division multiple access technology. We also offer the largest international roaming network. In particular, our 2G subscribers have access to 289 networks in 158 countries through our global system for mobile communications service roaming network and 96 networks in 54 countries through our general packet-switched radio service roaming network. In addition, our 3G service system includes 14 networks in seven counties. We discontinued offering analog cellular service through our advanced mobile phone service in December 2001, and returned the spectrum allocation in the 800 MHz frequency band to the government. All subscribers to this service have switched to our global system for mobile communications network.

**Table of Contents**

As of December 31, 2005, we had approximately 8,413 cellular base stations covering substantially all of Taiwan s population. We use these base stations to support both our global system for mobile communications network and our general packet-switched radio service network.

The following table sets forth information regarding our cellular service operations and our cellular subscriber base for the periods indicated.

| | As of or for the year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| Taiwan population (in thousands)(1) | 22,605 | 22,689 | 22,770 |
| Total cellular subscribers in Taiwan (in thousands)(2) | 25,090 | 21,528 | 19,876 |
| Penetration (as a percentage of the population)(3) | 111.0% | 94.9% | 87.3% |
| Total cellular revenues in Taiwan (in billions)(3) | NT$ 189.5 | NT$ 198.2 | NT$ 205.2 |
| Number of our cellular subscribers (in thousands)(2)(4) | 8,267 | 8,191 | 8,158 |
| Our market share by subscribers(2) (2G) | 33.0% | 38.0% | 39.6% |
| Our market share by revenues (2G) | 34.7% | 35.4% | 35.0% |
| Number of our prepaid subscribers (in thousands) | 1,417 | 968 | 603 |
| Our prepaid subscribers as a percentage of our total subscribers | 17.1% | 11.8% | 7.4% |
| Annualized churn rate(5) | 21.4% | 22.9% | 16.8% |
| Minutes of usage (in millions of minutes) | | | |
| Incoming | 8,641 | 9,352 | 9,720 |
| Outgoing | 7,737 | 8,668 | 8,921 |
| Average minutes of usage per cellular subscriber per month(2)(6) | 174 | 182 | 190 |
| Average revenue per cellular subscriber per month(2)(7) | NT$ 703 | NT$ 712 | NT$ 744 |

(1) Data from the Department of Population, Ministry of the Interior, Republic of China
(2) The number of cellular subscribers is based on the number of subscriber identification module cards. From 2004, the number of our cellular subscribers excludes prepaid subscription accounts that are inactive for more than three months. Before 2004, we did not generally exclude inactive prepaid accounts from our subscriber base.
(3) Data from the statistical monthly release by Ministry of Transportation and Communications, Republic of China.
(4) Includes general systems for mobile communication, general packet-switched radio services and advanced mobile phone services.
(5) Measures the rate of subscriber disconnections from cellular service, determined by dividing (a) our aggregate voluntary and involuntary deactivations (excluding deactivations due to subscribers switching from one of our cellular services to another) during the relevant period by (b) the average number of subscribers during the period (calculated by averaging the number of subscribers at the beginning of the period and the end of the period), and multiplying the result by the fraction where (c) the numerator is 12 and (d) the denominator is the number of months in that period.
(6) Average minutes of usage per cellular subscriber per month is calculated by dividing the total minutes of usage during the period by the average of the number of our cellular subscribers on the first and last days of the period and dividing the result by the number of months in the relevant period.
(7) Average revenue per subscriber per month is calculated by dividing our aggregate cellular telecommunications services revenue during the relevant period by the average of the number of our cellular subscribers on the first and last days of the period and dividing the result by the number of months in the relevant period.

The cellular market in Taiwan has grown rapidly since the liberalization of the market in 1997. Total cellular subscribers in Taiwan reached approximately 21.5 million as of December 31, 2004, but decreased to approximately 19.9 million as of December 31, 2005, primarily as a result of the increased attention to the closing of inactive prepaid accounts by cellular operators. Cellular penetration was approximately 87.3% on December 31, 2005, and is among the highest worldwide. We expect the number of cellular subscribers in Taiwan to decline in the short-term because of the net effect of slower subscriber growth as a result of market saturation, the decline in prepaid subscribers as a result of the closing of inactive accounts and new regulations prohibiting multiple prepaid subscriptions. We believe that any future growth in the number of cellular subscribers will depend largely upon continuing improvements in wireless technologies and wireless data applications and the availability of advanced cellular handsets.

We began offering prepaid card services in October 2000. As of December 31, 2005, we had approximately 0.6 million prepaid customers representing approximately 7.4% of our total cellular subscribers. Prepaid subscribers as a percentage of total cellular subscribers has declined to 7.1% in the first quarter of 2006. Prepaid customers do not pay monthly fees but pay a higher usage charge on a per second basis. Once the prepayment has been fully utilized, a prepaid customer can make additional prepayments to continue the services. Alternatively, the customer may convert to become a post-paid customer while retaining the same telephone number.

We offer handset subsidies to new subscribers that agree to sign a two-year contract with us, and to existing subscribers who renew their contracts with us for a period of two years. We generally offer subsidies on handsets equipped with more advanced data functions to promote the expansion of our general packet-switched radio services and third generation cellular services. In December 2005, the average handset subsidy we offered was NT$2,566 per subscriber. We expect the level of our average handset subsidy to remain at a similar level for the foreseeable future, with a decrease in subsidy for global system for mobile communications handsets generally offset by higher subsidies for third generation handsets.

Traffic growth has also been strong, as pricing has declined and the number of post-paid subscribers have increased. We have also experienced a significant increase in the number of short messaging service messages sent by our subscribers, which has had a positive impact on traffic volume. However, the average minutes of usage per subscriber declined in 2003 because of an increase in our prepaid customers, who tend to have lower minutes of usage, and increased usage of our short messaging services. The average minutes of usage per subscriber rose in 2004, which is attributable to a decline in prepaid customers as a percentage of total cellular customers, primarily as a result of accelerated deletion of inactive prepaid customer accounts. The average minutes of usage per subscriber increased in 2005 because of a decrease in the number of prepaid customers.

Our tariffs for post-paid cellular subscribers primarily consist of usage fees and monthly fees. When our subscribers are outside Taiwan, they pay roaming charges plus international long distance charges and, where applicable, local charges in roaming destinations. We charge a flat fee per transaction for our short messaging service and a fee per packet for our general packet-switched radio service based on the volume of data transmitted. We also offer discounts on usage fees for calls made between our cellular subscribers to encourage subscription to our cellular service. Our 3G service also provides a monthly flat rate service to our customers using our 3G service for Internet purposes.

Our average revenue per subscriber per month increased from NT$703 in 2003 to NT$712 in 2004 primarily due to a decrease in the number of our prepaid subscribers and, to a lesser extent, an increase in revenues from cellular value-added services. The decrease in the number of our prepaid subscribers in 2005 was primarily the result of our increased attention to closing inactive accounts. Our average revenue per subscriber per month increased to NT$744 in 2005, primarily due to an increase in the number of postpaid subscribers and an increase in the revenues of cellular value-added services. From December 2004, the number of our cellular subscribers excludes prepaid subscription accounts inactive for more than three months. Before 2004, we did not actively exclude inactive prepaid accounts from our subscriber base. In order to sustain the gradual increases in average revenue per subscriber, we intend to continue introducing new value-added services in order to generate additional sources of revenue and closing inactive prepaid subscriber accounts.

In addition to our basic cellular services, we also offer a broad range of value-added telecommunications and information services. We introduced in August 2001 a platform of integrated cellular value added services under the brand name emome. Our emome services offer a broad range of value-added services, including financial information, transaction services, emergency services access numbers, directory information, time, weather and traffic reports. In addition, we have launched other cellular value added services, such as JAVA games, unstructured supplementary service data, mobile Internet and multimedia messaging services. We believe these services enhance customer loyalty and satisfaction and increase cellular traffic. Revenues from mobile data services represented approximately 2.4%, 3.3% and 4.4% of our total cellular revenues in 2003, 2004 and 2005, respectively.

***Paging Services***

We offer nationwide and regional paging services in Taiwan. In addition to traditional paging services, we offer a broad range of wireless information services, including stock quotes on our InterMessenger service, weather information, news and agricultural information. We had approximately 35,520 paging subscribers as of December 31, 2005.

Revenues from paging services comprised approximately 0.3%, 0.2% and 0.1% of our revenues in 2003, 2004 and 2005, respectively. As cellular usage has increased, we have seen a sharp reduction in the number of our paging subscribers. We expect the number of our paging subscribers to continue to decline.

**Internet and Data Services**

We have experienced continued growth in our Internet and data services. Our Internet and data revenues represented approximately 19.5%, 21.2% and 22.8% of our revenues in 2003, 2004 and 2005, respectively. We provide:

- Internet services, including HiNet, our Internet service provider, asymmetrical digital subscriber line Internet access, Internet value-added services, wireless local area networks and fiber-to-the-building services; and

25

Table of Contents

Data services, including leased line services, managed data services and Internet data center services.
The following table sets forth our revenues from Internet and data services for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | (in billions) | | |
| | NT$ | NT$ | NT$ |
| **Internet and data revenues:** | | | |
| Internet | 25.9 | 29.5 | 32.1 |
| Data | 9.7 | 9.8 | 10.1 |
| Total Internet and data | 35.6 | 39.3 | 42.2 |

***Internet Services***

*HiNet and Internet Access*

The following table sets forth our revenues from Internet services for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | (in billions) | | |
| | NT$ | NT$ | NT$ |
| **Internet revenues:** | | | |
| Narrowband access | 1.4 | 0.7 | 0.3 |
| Narrowband Internet service | 1.1 | 0.7 | 0.5 |
| Broadband access (asymmetrical digital subscriber line only) | 13.3 | 14.7 | 16.2 |
| Broadband Internet service (asymmetrical digital subscriber line only) | 7.8 | 10.8 | 12.1 |
| Other Internet | 2.3 | 2.6 | 3.0 |
| Total Internet | 25.9 | 29.5 | 32.1 |

We are the largest Internet service provider in Taiwan, with a market share of 56.6% as of December 31, 2005. As of December 31, 2005, HiNet had approximately 4.1 million subscribers, and our number of subscribers increased by a 7.6% compound annual growth rate over the two years ended December 31, 2005.

The following table sets forth HiNet s subscribers as of each of the dates indicated.

| | As of December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | (in thousands, except percentages) | | |
| Total Internet access subscribers in Taiwan | 7,839 | 8,036 | 7,271 |
| HiNet subscribers | | | |
| HiNet dial-up subscribers | 1,616 | 1,376 | 1,166 |
| HiNet asymmetrical digital subscriber line subscribers | 1,902 | 2,413 | 2,909 |
| Other access technology subscribers | 32 | 32 | 38 |
| Total HiNet subscribers | 3,550 | 3,821 | 4,113 |
| Market share[1] | 45.3% | 47.5% | 56.6% |

(1) Based on data provided by the Ministry of Transportation and Communications.

We have maintained our leading market position despite a highly competitive market with over 186 Internet service providers in Taiwan. We expect the competitive conditions currently prevailing in the Internet service provider market to continue to intensify.

Customers can access HiNet through various technologies. We provide narrowband dial-up Internet access through connections based on standard telephone modems. We provide broadband Internet access through connections based on asymmetrical digital subscriber lines and our fiber-to-the-building technology. As of December 31, 2005, approximately 79.6%, or 2.9 million, of subscribers who access the Internet through our asymmetrical digital subscriber lines are our HiNet subscribers, and we expect this ratio to increase as a result of recent promotions to attract dial-up customers to upgrade to broadband Internet access.

**Table of Contents**

We are the largest broadband Internet access provider in Taiwan in terms of subscribers. We began providing our asymmetrical digital subscriber line service in August 1999, and we had approximately 3.7 million subscribers as of December 31, 2005. Our market share of Taiwan s broadband market was approximately 80.6%, 83.0% and 85.3% in 2003, 2004 and 2005, respectively. Our asymmetrical digital subscriber line service allows for transmission of data at high access rates and offers high- speed broadband Internet access services. We also provide asymmetrical digital subscriber line services to other Internet service providers that do not have their own network infrastructure.

The following table sets forth our asymmetrical digital subscriber line service subscribers as of each of the dates indicated.

| | As of December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| Our asymmetrical digital subscriber line service subscribers (in thousands) | 2,426 | 3,071 | 3,654 |
| Average downlink speed (Mbps)(1) | 0.82 | 1.60 | 2.14 |

(1) Average downlink speed is calculated by dividing the total downlink speed subscribed by the total number of subscribers as of the relevant date.

Our asymmetrical digital subscriber line service offers downlink speeds that range from 256 kilobits per second to 12 megabits per second and uplink speeds that range from 64 kilobits per second to 1 megabit per second. In December 2001, we began providing symmetrical digital service with uplink and downlink speeds of 512 kilobits per second. After our promotions in 2004 to increase customer access speeds, including our promotions for subscribers to upgrade to higher-speed access, the average uplink and downlink speeds of our subscribers have increased substantially. As of December 31, 2004, over 54% of our subscribers had subscribed for downlink speeds of 2 megabits per second and our average downlink speed was 1.6 Mbps. As of December 31, 2005, approximately 59% of our subscribers had subscribed for downlink speeds of over 2Mbps per second and our average downlink speed was 2.14 Mbps.

We have experienced limited competition in the asymmetrical digital subscriber line service market because other fixed line operators and cable operators have not established a nationwide network infrastructure to provide this service.

Our revenues from providing Internet access are generated from installation fees, monthly subscription fees and usage fees from fixed line telephone calls made to access HiNet, which are recorded as Internet services revenues rather than as fixed line revenues. Usage fees from fixed line telephone calls made to access Internet service providers other than HiNet are recorded as local fixed line revenues.

Charges for our HiNet dial-up service include a monthly fee entitling the subscriber to a fixed number of minutes of service, with an additional charge per minute when the fixed number of minutes is exceeded. Alternatively, we offer our subscribers an unlimited number of minutes for a fixed monthly fee. Charges for our asymmetrical digital subscriber line service include one-time installation charges and monthly subscription fees. These charges vary based on connection speed.

The following table sets forth our average revenues per user for each of the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | NT$ | NT$ | NT$ |
| Average revenue per HiNet dial-up subscriber per month(1) | 116 | 81 | 50 |
| Average revenue per asymmetrical digital subscriber line subscriber per month(2) | 940 | 863 | 780 |

(1) Average revenue per HiNet dial-up subscriber per month is calculated by dividing the total local telephone usage revenues generated by HiNet dial-up subscribers and Internet access revenues by the average of the number of our HiNet dial-up subscribers on the first and last days of the period and dividing the result by the number of months in the relevant period.

(2) Average revenue per asymmetrical digital subscriber line service subscriber per month is calculated as the sum of (a) asymmetrical digital subscriber line access revenues for the relevant period divided by the average of the number of our asymmetrical digital subscriber line service subscribers on the first and last days of the period divided by the number of months in the relevant period and (b) HiNet asymmetrical digital subscriber line Internet service provider revenue divided by the average of the number of HiNet asymmetrical digital subscriber line subscribers on the first and last days of the period divided by the number of months in the relevant period.

Table of Contents

Our average revenues per subscriber have declined over the last three years due to increasing competition. In addition, we were required by the Directorate General of Telecommunications to decrease our tariffs by an average of 24% in June 2004. However, we expect our average revenue per subscriber for broadband services to decline more gradually going forward, as subscribers migrate towards more expensive, higher bandwidth digital subscriber line services.

*Internet Value-added Services*

Our HiNet portal at *www.hinet.net* provides value-added services to our subscribers, such as gaming, e-learning, financial information and links to other portals. We charge fees for some of these services. We also receive commissions for transactions completed on some of these other portals. Our broadband Internet portal at *www.hichannel.hinet.net* offers online entertainment services through the Internet. In particular, our HiNet asymmetrical digital subscriber line customers can access music, television programs, movies and other multi-media content on demand. We charge access fees for some of this content. We expect the revenues generated from these value-added services to grow as a percentage of our total Internet and data services revenues. The information contained in our HiNet portal and broadband Internet portal is not a part of this annual report. Our Internet value-added services revenues as a percentage of total Internet revenues were 5.5%, 5.8% and 6.9% in 2003, 2004 and 2005, respectively.

*Wireless Local Area Network Service*

We launched our wireless local area network service in May 2002. As of December 31, 2005, we had a total of approximately 23,745 residential and business customers that lease our access points. In addition, we have established 977 hot spots in public areas, such as airports and international convention centers, where individuals can access our wireless local area network. We expect the revenues generated from our wireless local area network services to continue to grow.

***Data Services***

The following table sets forth our revenues from data services for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | | (in billions) | |
| | NT$ | NT$ | NT$ |
| **Data revenues:** | | | |
| Leased line | 7.7 | 7.6 | 7.6 |
| Other | 2.0 | 2.2 | 2.5 |
| Total data | 9.7 | 9.8 | 10.1 |

*Leased Line Services*

We are the leading provider of domestic leased line services in Taiwan. We are also a leading provider of overseas leased line services. Leased line services involve offering exclusive lines that allow point-to-point connection for voice and data traffic. Leased lines are used by business customers to assemble their own private networks and by telecommunications service providers to establish networks to offer telecommunications services.

We provide data transmission services to major business customers in Taiwan. We also provide leased lines to other cellular and fixed line service operators for interconnection with our fixed line network and for connection within their networks. Since August 2001, licenses have been awarded to four undersea cable operators to engage in leased line services. Demand for high-speed data transmission services has been growing rapidly, as a result of growing consumer demand and lower tariffs due to increased competition. In particular, the total bandwidth of our lines leased increased by 12.3% over the two years ended December 31, 2005.

Table of Contents

The following table shows the bandwidth of lines leased to third parties as of each of the dates indicated.

| | As of December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | (in gigabits per second) | | |
| Total bandwidth | 393.4 | 501.7 | 495.8 |

Rental fees for local leased lines are generally based on transmission speed while domestic long distance and international long distance leased line rental fees are generally based on transmission speed and distance.

We continue to experience a decline in rental fees for all of our leased line products. The decline in rental fees since 2000 has been substantial, particularly for international leased lines, partly as a result of our efforts to address competition from new international leased line service providers. We are actively implementing marketing and service campaigns to retain our high-value business customers.

*Managed Data Services*

We provide a wide range of managed data services, including frame relay services, asynchronous transfer mode services and virtual private network services. Frame relay services provide high-speed data communications linking remote sites. Asynchronous transfer mode services are used to handle high-bandwidth, integrated voice, video, data and Internet traffic between sites.

*Internet Data Center Services*

Internet data centers are facilities providing the physical environment necessary to keep computer network servers running at all times. These facilities are custom-designed with high-volume air conditioning temperature control systems, secure access, reliable electricity supply and connections to high-bandwidth Internet and data networks. Data centers house, protect and maintain network server computers that store and deliver Internet and other network content, such as web pages, applications and data.

We currently have 13 Internet data centers in Taiwan. We offer co-location, web hosting and application service provider services.

**Other Telecommunications Services**

We provide other telecommunications services, including multimedia on demand services, satellite services, telephone directories, corporate solution services and billing handling services. In 2003, we generated NT$2.6 billion, or approximately 1.4% of our revenues, from these various other telecommunications services. In 2004, we generated NT$3.2 billion, or approximately 1.7% of our revenues. In 2005, we generated NT$3.1 billion or approximately 1.7% of our revenues, from these various other telecommunications services.

*Multimedia on Demand Services*

We launched our multimedia on demand service in Taipei County and Keelung City in March 2004. We expanded this service to cover 13 counties and cities of Taiwan by the end of 2005. Using video streaming technology through a set top box that connects to our asymmetrical digital subscriber lines, our customers can access TV programs and other services. We had 33 broadcasting channels, over 1,600 on-demand programs and served approximately 118,000 subscribers as of March 31, 2006. In addition, our video-on-demand service provides movies, e-learning and music programs for home entertainment. We also plan to introduce popular channels and bundle them with other pay channels in order to enhance our service content and satisfy our customers needs.

*Satellite Services*

We are a 50% owner of the ST-1 telecommunications satellite. Singapore Telecommunications Ltd. owns the remaining 50%. ST-1 was launched on August 26, 1998 and began commercial operations on December 1, 1998. We lease out transponder capacity on ST-1 and provide satellite lease circuits. In addition, we have two satellite communication centers that enable us to provide satellite value-added services. We also provide satellite services to Southeast Asia.

Table of Contents

*Telephone Directories*

We are the largest provider of classified advertising directory and associated products and services in Taiwan with over 60 years of experience in publishing and distributing telephone directories to households and businesses in Taiwan. Our yearly circulation is approximately 6.3 million copies. To address the needs of advertisers and users for multiple platforms of directory search, we offer buyers and sellers related directory products and services through print, online the Internet Yellow pages (http://hipage.hinet.net) and voice an operator-assisted search service (City Search 1288).

**Interconnection**

We provide interconnection of our fixed line network with other cellular operators and, since July 2001, with other fixed line operators.

The following table sets forth our interconnection fee revenues and costs for the periods indicated. These revenues and costs are included, depending on the nature of the call made, in local, domestic long distance services or cellular revenues and expenses, respectively.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | | (in billions) | |
| | NT$ | NT$ | NT$ |
| **Interconnection fee revenues:** | | | |
| Local | 3.6 | 3.1 | 3.0 |
| Domestic long distance | 2.0 | 1.3 | 1.1 |
| Cellular | 5.3 | 6.3 | 7.0 |
| **Interconnection costs:** | | | |
| Fixed line | 0.9 | 0.7 | 0.4 |
| Cellular | 4.6 | 5.6 | 6.2 |

Currently, tariffs for telephone calls between our fixed line subscribers and cellular subscribers of other cellular operators are set by the cellular operators. The cellular operators pay us interconnection fees based on minutes of usage, regardless of who initiated the call. The Directorate General of Telecommunications has consulted the public regarding a change to the regulation that will allow us to set and collect the tariffs for telephone calls made by our fixed line subscribers to cellular subscribers of other cellular operators. For such calls, cellular operators will no longer pay us interconnection fees, but we will be required to pay them termination charges. However, the relevant regulation has not yet been changed.

In the interim, the Directorate General of Telecommunications has approved, effective January 2004, an interconnection rate of NT$0.59 per minute for calls initiated by cellular subscribers, and NT$0.814 per minute for calls initiated by fixed line subscribers. The interconnection rate between our fixed line subscribers and other fixed line subscribers is approximately NT$0.32 per minute. The interconnection rate between our cellular subscribers and other cellular subscribers is approximately NT$2.15 per minute.

All interconnections by the networks of cellular operators and other fixed line operators with our fixed line network are made through dedicated lines that these operators lease from us. We record the revenue for these leased lines as part of our Internet and data revenues.

We expect an increase in interconnection revenue due to an increase in traffic between different fixed line networks as a result of the competition from other fixed line operators.

In accordance with governmental regulations, the contracts governing our interconnection arrangements must specifically address a number of prescribed issues. For example, our interconnection charge should reflect our cost with respect to the network elements used. In addition, cost increases are subject to approval by the regulatory authorities. We expect that our interconnection contracts will generally be reviewed annually, although we may also enter into long-term contracts.

**Marketing, Sales and Distribution**

***Marketing Strategy***

In order to retain and expand our large customer base and to encourage our customers to increase their use of our services and products, we plan to focus our marketing strategy on the following areas.

*Services, Products and Bundled Offerings.* We continually develop new value-added services and products, and bundle our services and products based on different market segments, with the aim of increasing our high-usage customers and enhancing customer loyalty.

*Pricing and Promotions.* We design flexible pricing packages that allow customers to select structures best tailored to their usage patterns, and design special promotional packages to encourage usage. For example, we have provided our Friends and Family promotion package to attract cellular subscribers.

*Distribution Channels*. We seek to facilitate customer subscription by adding more service points. In addition, we seek to broaden our distribution reach by strengthening our cross-industry alliances and marketing relationships. Furthermore, we seek to expand our sales channels by implementation of a sales agent system. We have also developed staff incentive programs to better motivate our sales staff.

*Business Customers*. We have expanded our customer focus to include small- and medium-sized enterprises in addition to large corporations. We seek to serve the needs of large corporate customers by devoting a project manager or project engineer to service these customers. These account managers are responsible for developing customized solutions and tariff packages to meet the specific needs of our customers. We continually update and expand our service offerings so that we can remain a one-stop telecommunications services provider to our corporate customers and provide for all of their telecommunications needs. Our dedicated local teams serve the needs of small- and medium-sized enterprises. These teams also use our data bank to identify and target potential clients for promoting our e-commerce and cellular services. In addition, we help our corporate customers improve their efficiency and competitiveness by creating information systems for them.

*Advertising.* We are committed to further strengthening the Chunghwa Telecom brand and image as well as strengthening and expanding market recognition of our specialized product brands, such as HiNet and emome. We plan to leverage our leading market position and status to strengthen the overall advantage of our product brands.

***Sales and Distribution***

Our marketing department at our corporate headquarters in Taipei is responsible for central business planning and formulating our marketing strategies and objectives. We have six business divisions, each of which has its own marketing department that is responsible for business and marketing planning.

We also have 27 operations offices and 312 service centers located throughout Taiwan that are responsible for operations, sales and customer service in their local areas.

**Customer Service and Billing**

We believe our reputation for quality customer service has helped us attract new customers and maintain customer loyalty. We regularly survey our customers to improve our service and better understand market demand and subscriber preferences, and seek to develop products and services accordingly.

We provide the following services to our customers:

24-hour customer service and technical support through our service centers, call centers and website;

English billing documents available upon request;

free of charge itemized billing for international and domestic long distance calls;

Table of Contents

- bill payment services at 24-hour convenience stores, bank service counters, automatic teller machines, direct debit, over the phone, website (www.cht.com.tw), cellpone emome and service centers throughout Taiwan;

- online information and bill payment services at our website, *www.cht.com.tw*, and customer service hotline for telephone payment; and

- consolidated and automated billing for all services.

**Network Infrastructure**

Our network infrastructure consists of transmission networks that convey voice and data traffic, switching networks that route traffic between networks, and cellular, paging, Internet, leased line and data switching networks.

We purchase most of our network equipment from well-known international suppliers. As part of the purchase contract, these suppliers deliver and install the equipment for us. We also purchase from local suppliers a variety of components such as transmission lines, switches, telephone sets and radio transmitters.

Approximately 14,161 of our employees were engaged in network infrastructure development, maintenance, operation and planning as of December 31, 2005.

***Internet Protocol Broadband Backbone Network***

Our Internet protocol broadband backbone network consists of a core network and edge networks. We completed the construction of our high-speed Internet protocol backbone network at the end of 2005 with 14 sets of 640 Gbps giga switch routers for the core network and more than 56 sets of 320 Gbps gigabit switch routers for the edge networks. We believe this network will enable us to meet the increasing demand for broadband access and broadband multimedia services. Moreover, this network will also serve as the backbone for our third generation cellular services and voice over Internet protocol services.

***Transmission Networks***

As of December 31, 2005, our transmission networks consisted of 1,007,964 fiber kilometers of fiber optic cable for trunking and 925,671 fiber kilometers of fiber optic cable for local loop.

Between 1999 and 2002, we made significant progress in the upgrading of our plesiochronous digital hierarchy network transmission facilities to synchronous digital hierarchy network transmission facilities. Plesiochronous digital hierarchy is the traditional technology for voice network transmission systems. Synchronous digital hierarchy architecture is an advanced technology that allows for instantaneous rerouting and eliminates downtime in the event of a fiber cut. In addition, synchronous digital hierarchy offers better reliability and performance for optical fiber transmissions at a lower operating cost. In December 2002 we installed synchronous transport module 64 multiplexer and 10 gigabit capacity 32-wavelength dense wavelength division multiplexing equipment on our long-haul backbone network. Our synchronous transport module 64 multiplexer can multiplex several low speed signals into a 10 gigabit per second high-speed signal. Dense wavelength division multiplexing equipment uses a technology that puts data from different sources together on an optical fiber with each signal carried on its own separate wavelength. Both synchronous transport module 64 multiplexer and dense wavelength division multiplexing equipment can increase our network capacity. Furthermore, between 2003 and 2005, we completed the deployment of eighteen 32-wavelength optical add-drop multiplexer rings in the main metropolitan areas of Taipei, Taichung, Tainan and Kaohsiung in 2003, in order to provide new data services such as gigabit Ethernet, fiber channel, 2.5 gigabit packet over synchronous digital hierarchy and 10 gigabit Ethernet. To meet the demand for broadband services, we completed the deployment of a next generation synchronous digital hierarchy network in June 2005. The next generation synchronous digital hierarchy network will provide gigabit Ethernet over synchronous digital hierarchy service that is expected to leverage on our existing synchronous digital hierarchy network.

Based on the transmission network described above, we launched connection circuit service of 10 gigabit packet over synchronous digital hierarchy and 10 gigabit Ethernet to the government s Taiwan Advanced Research and Education Network in 2003.

As part of our strategic focus on the Internet and data markets, our local loop connections use asymmetrical digital subscriber line technology. This enables us to deliver high-speed Internet, multimedia and other data services to our

customers. As of March 31, 2006, substantially all of our installed telephone lines were capable of delivering asymmetrical digital subscriber line services. In addition, the Ethernet based Fiber to the Building system is also introduced into our access network to provide the broadband services, such as MOD, high speed Internet access and VPN, etc.

***Switching Networks***

***Domestic telecommunications network.*** Our domestic public switched telephone network consists of 14 message areas connected by a long distance network. As of December 31, 2005, we had 71 long distance exchanges, which are interconnection points between our telecommunications network.

We currently have intelligent networks installed over our public switched telephone networks for our domestic long distance and international networks, as well as a local intelligent network in the Taipei, Taichung and Kaohsiung metropolitan areas. Our intelligent network is designed to facilitate the use of value-added services by providing more information about calls and allowing greater management of those calls.

As of December 31, 2005, our domestic network included 17 million installed telephone lines, and reached virtually all homes and businesses in Taiwan.

***International network.*** Our international transmission infrastructure consists of both submarine cable and satellite transmission systems, which link our national network directly to 103 telecommunications service providers in 58 international destinations.

International calls are routed between Taiwan and international destinations through one of our two international switching centers, one located in Taipei and the other in Kaohsiung. Each center had two international gateway switches. In total, we had a trunks capacity of 85,040 channels as of December 31, 2005.

We currently have invested in 28 submarine cables, five of which land in Taiwan. Our aggregate total capacity in the undersea cables in which we have invested is 81 gigabits per second.

***Cellular Services Network***

Our cellular services network consists of:

- cell sites, which are physical locations equipped with a base station consisting of transmitters, receivers and other equipment used to communicate through radio channels with subscribers cellular telephone handsets within the range of a cell;

- base station controllers, which connect to, and control, the base station within each cell site;

- mobile switching service centers, which control the base station controllers and the processing and routing of telephone calls;

- gateway general packet-switched radio service support nodes, which connect our general packet-switched radio service network to the Internet;

- serving general packet-switched radio service support nodes, which connect the general packet-switched radio service network to the base station controllers; and transmission lines, which link (1) with respect to the global system for mobile communications network, the mobile switching service centers, base station controllers, base stations and the public switched telephone network, and (2) with respect to the general packet-switched radio service network, the base station controllers, the support nodes and the Internet.

The following table sets forth selected information regarding our cellular networks as of the dates indicated.

| | As of December 31, | | |
|---|---|---|---|
| | **2003** | **2004** | **2005** |
| GSM system | | | |
| Global system for mobile communications base stations | 7,791 | 8,207 | 8,413 |

Table of Contents

| | As of December 31, 2003 | 2004 | 2005 |
|---|---|---|---|
| GSM system | | | |
| Switches | 54 | 54 | 54 |
| Lines of capacity (in thousands) | 8,500 | 8,500 | 8,500 |
| Taiwan population coverage | 99.9% | 99.9% | 99.9% |
| Taiwan geographical coverage | 90.0% | 90.0% | 90.0% |
| General packet-switched radio service gateway support nodes | 25 | 25 | 25 |
| GPRS Serving support nodes | 20 | 20 | 20 |
| GPRS System capacity (in thousands) | 1,000 | 1,000 | 2,000 |

| | As of December 31, 2005 |
|---|---|
| 3G system | |
| Third generation cellular services base stations | 2,511 |
| Radio Network Controller (RNC) | 25 |
| Switches | 8 |
| Lines of capacity (in thousands) | 1,900 |
| Taiwan population coverage | 65% |
| General packet-switched radio service gateway support nodes | 16 |
| Serving support nodes | 8 |
| System capacity (in thousands) | 2,400 |

We provide cellular services based on the global system for mobile communications network standards. We have dual band 900 MHz and 1800 MHz frequency spectrums for our global system for mobile communications services. In addition, we have installed an intelligent network on our cellular services network infrastructure to enable us to provide prepaid services as well as a wide range of advanced call features and value-added services. We have also installed wireless application protocol gateways on our cellular services network that enable us to provide wireless application protocol services. We began providing cellular communications services based on the general packet-switched radio service network standards in August 2001, using emome as the portal name.

As our subscriber base has continued to grow, we have increased the capacity of our intelligent network to more than 1.5 million subscribers. We also completed a system expansion of our cellular services network to accommodate more than 8.5 million subscribers (including 2 million general packet-switched radio service subscribers) at the end of 2003. We have general packet-switched radio services and 15 MHz paired spectrum plus 5 MHz unpaired spectrum in the 2 GHz frequency band for our third generation cellular services. In preparation for the launch of third generation cellular services, we contracted with Nokia Corporation to provide the core network, radio access network, service network, transmission network and maintenance network. As of December 31, 2005, we have completed the construction of approximately 2,511 third generation base stations with a network capacity of 1.9 million lines. Our third generation network is comprised of 3,085 base stations, with a capacity of 2.4 million lines upon completion of contract. We launched our third generation cellular services on July 26, 2005. As of December 31, 2005, our third generation cellular services customers amounted to approximately 296,000.

***Paging Network***

The primary components of our paging network are:

- paging control systems, which receive and encode incoming messages; and
- base stations, which transmit messages to the subscriber s pager.

Our paging network uses, among other technologies, the open paging protocol developed by Motorola. This technology provides higher data rate, larger content capacity, longer battery life and better error correction capabilities than other existing paging technologies.

***Internet Network***

HiNet, our Internet service provider, has the largest Internet access network in Taiwan, with 35 points of presence, approximately 9,000 dial-up ports, approximately 4,040,000 broadband remote access server ports and a backbone bandwidth of approximately 294 gigabits per second as of December 31, 2005. We plan to increase HiNet s points of presence and backbone bandwidth to approximately 424 gigabits per second by the end of 2006.

Table of Contents

HiNet s total international connection bandwidth is 39.6 gigabits per second as of December 31, 2005. As we expect that Internet traffic flows to and from the United States will continue to increase, we plan to expand our bandwidth to the United States. We also plan to increase our links to other countries, including Japan, Korea, Hong Kong, Singapore, Mainland China, Malaysia and Australia.

**Leased Line and Data Switching Networks**

We operate leased line networks on both a managed and unmanaged basis. In addition, we operate a number of switched digital networks used principally for the provision of packet-switched, frame relay, asynchronous transfer mode technology and a multi protocol label switching internet protocol virtual private network. We have completed the construction of a digital cross connect system throughout Taiwan with a total of 53 nodes. As of December 31, 2005, we had 4,604 frame relay ports, 7,873 X.25 ports, 7,717 asynchronous transfer mode ports and approximately 50,000 multi protocol label switching internet protocol virtual private network virtual ports.

Our data networks support a variety of transmission technologies, including X.25 protocol, frame relay and asynchronous transfer mode technology. We have also built up our HiLink virtual private network that combines internet protocol and asynchronous transfer mode technologies. The advantage of a HiLink virtual private network based on multi protocol label switching technology is that it can carry different classes of services, such as video, voice and data together to provide services with various qualities of service**,** high performance transmission and fast forward solution in an enhanced security network. A HiLink virtual private network can be accessed by an asymmetrical digital subscriber line and can include built-in mechanisms that can deal with overlapping internet protocol addresses. Therefore, the network potentially is less costly and requires less management for business applications.

**Competition**

We face competition in virtually all aspects of our business.

***Fixed Line***

We are the largest fixed line service provider in Taiwan, with a market share of approximately 97.4% in terms of subscribers for local telephone services, approximately 84.7% in terms of traffic for domestic long distance telephone services and approximately 57.8% in terms of traffic for international long distance telephone services in 2005. Three new providers, namely, Taiwan Fixed Network, New Century Infocomm Tech. Co., Ltd., and Asia Pacific Broadband Telecom Co. Ltd., have provided fixed line services since June 2001. We believe these operators are primarily focused on international long distance services. In addition, we anticipate that these operators will focus on business customers, which typically generate higher profit margins than residential customers. Since August 2001, four undersea cable services licenses have been granted. These undersea cable operators, as well as Internet service providers and international simple resale operators, have begun offering international leased line services to other fixed line operators, Internet service providers and international simple resale operators.

We are required by Republic of China regulations to provide number portability and unbundled local loop access.

Our domestic long distance services compete with cellular services as people increasingly use cellular telephones. In addition, our international long distance services compete with international long distance resale services and alternative mediums for making international calls, including voice over Internet protocol technologies, such as those provided by Skype. One of our competitors has sought an alliance with Taiwan Railway Administration to use its infrastructure to deliver telecommunications services. We believe that the fixed line competition in Taiwan will be primarily based on price, quality of service, network coverage and customer services, such as call centers and unified billing.

***Wireless***

There are currently three major global system for mobile communications cellular operators in Taiwan, namely, Taiwan Mobile Co., Ltd., Far EasTone Telecommunications Co., Ltd. and us. Based on data provided by the Directorate General of Telecommunications, as of December 31, 2005, we were the largest cellular operator, with a 39.6% market share in terms of 2G subscribers. In addition, there are two new third generation cellular operators in Taiwan, namely Asia Pacific

Broadband Wireless Communications Inc., and Vibo Telecom Inc., as well as one personal handyphone system operator, First International Telecom. Furthermore, the government issued six mobile virtual network operator licenses to New Century InfoComm Tech. Co., Ltd., KGEx.com, Hicall Telecom Co., Ltd., China Motion Telecom (Taiwan) Limited, Taiwan Fixed Network and 10net which allow operators without a spectrum allocation to provide cellular services by leasing the capacity and facilities of a cellular service network from a licensed cellular service provider. We may cooperate with other mobile virtual network operators in Taiwan in future. We compete in the wireless services market primarily on the basis of price, quality of service, network reliability and attractiveness of service packages.

***Internet and Data***

Our primary competitors in Internet and data services include:

**Internet services:**

- Internet services providers: SeedNet, Asia Pacific Online, GigaMedia and So-net Taiwan;

- Broadband Internet access providers: Asia Pacific Broadband Telecom Co., Ltd., GigaMedia, Taiwan Fixed Network and New Century Infocomm Tech. Co., Ltd.; and

- Cable operators: Eastern Multimedia Co., Ltd., China Network Systems Co., Ltd., Taiwan Broadband Communications Co., Ltd., Pacific Broadband Co., Ltd., and Taiwan Infrastructure Technology Co., Ltd.

**Data services:**

- Leased line service providers: Taiwan Fixed Network, New Century Infocomm Tech. Co., Ltd., Asia Pacific Broadband Telecom Co. Ltd., Asia Netcom, Reach Global Services Ltd., FLAG Telecom and Taiwan International Gateway Corporation.

We are the largest provider of Internet services in Taiwan. As of December 31, 2005, we had a 56.6% share of the Internet service market in terms of subscribers and a 85.3% share of the broadband Internet access market in terms of subscribers. We compete in the Internet and data services market primarily on the basis of price, technology, speed of transmission, amount of bandwidth available for use, network coverage and value-added services.

**Properties**

Our properties consist mainly of land, land improvements and buildings located throughout Taiwan.

Our properties were deemed by the cabinet of the government of the Republic of China, or the Executive Yuan, to be vested in us as the successor to the telecommunications business formerly owned and operated by the Directorate General of Telecommunications. Under Republic of China law, we are required to register our title to the land, land improvements and buildings at the relevant local land bureaus. By the end of 2004, we had completed all the title registration of our land, land improvements and buildings.

**Insurance**

We do not carry comprehensive insurance for all properties. We maintain in-transit insurance for key materials, such as cables, equipment and components of equipment. We also carry insurance for the ST-1 satellite while it is in orbit.

As part of our efforts to enhance our risk management capabilities, we have been assessing our equipment that requires the most time and cost to repair or replace, in order to determine whether and to what extent we should carry fire insurance for such equipment.

**Employees**

Almost all of our employees are located in Taiwan and all are employed on a full-time basis. As of December 31, 2005, approximately 66.7% of our employees had university, graduate or post-graduate degrees. We intend to improve our operational efficiency by reducing personnel costs. We offered a number of voluntary retirement programs between June 1, 2000 and April 30, 2006, which resulted in a reduction in our workforce of approximately 10,192 employees.

**Table of Contents**

Please refer to Item 6. Directors, Senior Management and Employees D. Employees for a discussion of our employees.

**Our Pension Plans**

We maintained two non-contributory defined benefit pension plans prior to our privatization. The first plan, which we refer to as the civil service plan, covered our employees who qualify as civil servants and a limited number of other employees. The second plan, which was administered in accordance with the Republic of China Labor Standards Law and which we refer to as the labor standards plan, covered all other employees. Both plans provided for a lump-sum payment at an employee s retirement based on the employee s years of service and monthly salary. Employees with the same seniority and monthly salary would receive a greater lump sum payment under the labor standards plan than under the civil service plan. The civil service plan also provided for a monthly annuity payment to certain qualified employees after retirement based on the employee s years of service and monthly salary.

The Republic of China Labor Pension Act, which became effective on July 1, 2005, provides for a contributory defined pension plan. Under this new pension plan, we make a monthly contribution to each employee s pension fund account of at least 6% of an employee s monthly salary, matching the employee s own contribution of up to 6% of the monthly salary. Employees who were hired on or after July 1, 2005 are covered under the new pension plan. All of our other employees, including those who continue their employment after our privatization, were able to elect to be covered by the labor standards plan or the new pension plan. As of the date of this annual report, a substantial majority of our employees are covered under the labor standards plan.

We were required by the Statute Governing Privatization of State-Owned Enterprises to make severance payments to all employees at the date of our privatization as settlement of their accrued benefits under the pre-existing pension plans in the following manner:

- for employees who chose to continue their employment with us, a lump sum equal to the amount that they would have been entitled to if they had retired on the date of privatization under the labor standards plan, regardless of which pension plan they were covered under prior to our privatization; and

- for employees who chose not to continue their employment with us, in addition to the same lump sum payment described above, six months salary plus one month s wages (including salary, bonuses, allowances and other regular payments) in lieu of prior notice of termination.

On June 28, 2005, the Council of Labor Affairs issued an interpretation of the Labor Pension Act to the effect that our employees who were eligible to retire on the date of our privatization under the civil service plan were able to elect to retire on the date of our privatization and be re-hired by us on the same date and accordingly would be entitled to an option to retain their monthly annuity payments. Re-hired employees who chose not to forego the monthly annuity payments from the government would receive the lump sum due to them upon their retirement under the civil service plan. Re-hired employees who chose to forego the monthly annuity payments from the government would receive the lump sum due to them upon their retirement determined as if they were covered by the labor standards plan.

All continuing employees whose employment is terminated by us within five years of our privatization will be entitled to a payment equivalent to the pension plan benefit accrued from the date of our privatization to the date of termination, as well as six months salary plus one month s wages in lieu of notice of termination. Under the Statute Governing Privatization of State-Owned Enterprises, the Ministry of Transportation and Communications is responsible for paying the six months salary portion, while we are responsible for paying the remainder of the payments due to our employees.

Prior to the date of our privatization, eligible employees who retired under pre-existing pension plans would receive lump-sum payments from our pension plan funds. Employees who retired under the civil service plan would also be entitled to monthly annuity payments. Under relevant Republic of China regulations, the Ministry of Transportation and Communications is responsible for these monthly annuity payments after our privatization. On the date of our privatization, the Ministry of Transportation and Communications settled all employees past service costs. The portion of the pension obligations that was settled by the Ministry of Transportation and Communications, represented by the difference between the accrued pension liabilities and the deferred pension cost and related deferred income tax assets, amounted to NT$8,352 million (US$254 million) and was accounted for as contributed capital and recorded in stockholders equity as of August 12, 2005. The non-cash financial activities and related amounts of pension obligation settlement as of the date of our privatization are

37

disclosed on our statement of cash flows. In 2005, we implemented a special incentive retirement program that provides for a payment equal to six months salary plus one month s wages to employees who retire and are not re-hired upon our privatization. We are responsible for making these payments.

In 2005, we approved two special incentive retirement programs which allowed eligible employees who voluntarily left us on or prior to February 1, 2005 and August 11, 2005 respectively, to receive a payment equal to six months salary plus one month s wages. The special termination benefits totaled NT$2.1 billion and were expensed in 2005.

After privatization, in December 2005, our board of directors approved a principle of incentive retirement program which allowed eligible employees who voluntarily leave us to receive a payment equal to or greater than six months salary plus one month s wages. An incentive retirement program was conducted according to the abovementioned principle in the first quarter of 2006. The special termination benefits totaled NT$2.2 billion and were recognized as expense in the first quarter of 2006.

We intend to contribute NT$0.5 billion to our pension plans in 2006, of which contributions of NT$0.4 billion were made in the three months ended March 31, 2006. We believe that we have substantially funded all of our pension obligations. However, we determined our estimated pension obligations based on a number of actuarial assumptions. To the extent these assumptions are different from actual experience, our actual pension obligations could be significantly increased. Moreover, we cannot assure you that other events outside of our control, such as new laws, rules or regulations or interpretations of existing laws, rules or regulations, would not similarly result in a significant increase in our actual pension obligations.

After our privatization, our continuing employees are deemed to have begun employment on the date our privatization was completed for seniority purposes under our pension plans in effect after privatization. The civil service plan terminated after our privatization.

**Legal Proceedings**

We are involved in litigation, arbitration or administrative proceedings in the ordinary course of our business. Although we cannot accurately predict the outcome of these matters, we do not expect any proceeding, if determined adversely against us, to have a material adverse effect on our business, financial condition or results of operation.

**Capital Expenditures**

See Item 5. Operating and Financial Review and Prospects B. Liquidity and Capital Resources Capital Expenditures for a discussion of our capital expenditures.

**Enforceability of Judgments in Taiwan**

We are a company limited by shares and incorporated under the Republic of China Company Law and the Statute of Chunghwa Telecom Co., Ltd. All of our directors and executive officers, our supervisors and some of the experts named in this annual report are residents of Taiwan and a substantial portion of our assets and the assets of those persons are located in Taiwan. As a result, it may not be possible for investors to effect service of process upon us or those persons outside of Taiwan, or to enforce against them judgments obtained in courts outside of Taiwan. We have been advised by our Republic of China counsel that in their opinion any final judgment obtained against us in any court other than the courts of the Republic of China in connection with any legal suit or proceeding arising out of or relating to the ADSs will be enforced by the courts of the Republic of China without further review of the merits only if the court of the Republic of China in which enforcement is sought is satisfied that:

- the court rendering the judgment has jurisdiction over the subject matter according to the laws of the Republic of China;

- the judgment and the court procedure resulting in the judgment are not contrary to the public order or good morals of the Republic of China;

if the judgment was rendered by default by the court rendering the judgment, we were served within a reasonable period of time in accordance with the laws and regulations of the jurisdiction of the court or process was served on us with judicial assistance of the Republic of China; and

judgments at the courts of the Republic of China are recognized and enforceable in the court rendering the judgment on a reciprocal basis.

Table of Contents

A party seeking to enforce a foreign judgment in the Republic of China would be required to obtain foreign exchange approval from the Central Bank of China for the payment out of Taiwan of any amounts recovered in connection with the judgment denominated in a currency other than NT dollars if a conversion from NT dollars to a foreign currency is involved.

**Regulation**

***Overview***

Before March 1, 2006, the Taiwan telecommunications industry was subject to extensive regulation by and under the supervision of the former competent authorities, the Ministry of Transportation and Communications and the Directorate General of Telecommunications pursuant to the provisions of the Telecommunications Act and various other telecommunications laws and regulations, as well as regulations under various laws of general application. Since March 1, 2006, regulatory authority over the Taiwan telecommunications industry has been transferred from the Ministry of Transportation and Communications and the Directorate General of Telecommunications to the National Communications Commission.

In addition, we are subject to the Statute of Chunghwa Telecom Co., Ltd., which remains effective until it is formally abolished by the government.

***Regulatory Authorities***

The Communications and Broadcast Basic Law became effective on January 7, 2004. This law requires the establishment of the National Communications Commission, a new regulatory authority over the telecommunications industry, and the National Communications Commission shall exercise its powers independently of other government agencies. The Communications and Broadcast Basic Law also requires that related communications statutes be amended pursuant to the principles set forth in the Communications and Broadcast Basic Law within two years following the establishment of the National Communications Commission. Based on the Communications and Broadcast Basic Law, the NCC Organization Law governing the constitution and authority of the National Communications Commission became effective on November 9, 2005. The National Communication Commission currently comprises nine commissioners who have been recommended by the government and opposition political parties in the Legislative Yuan as well as the head of the Executive Yuan and approved by the Legislative Yuan.

Before March 1, 2006, the primary regulatory authority of the Taiwan telecommunications industry was the Ministry of Transportation and Communications. The Ministry of Transportation and Communications issued policy directives and telecommunications licenses and oversaw the activities of the Directorate General of Telecommunications, which was responsible for the implementation of these directives and the day-to-day supervision of the telecommunications industry. In addition, the television, radio, satellite television and cable industries were also regulated by the News and Broadcasting Division of the Government Information Office under the Executive Yuan before March 1, 2006. Internet access through cable was regulated by the Directorate General of Telecommunications.

The National Communications Commission is responsible for:

- formulating, implementing and interpreting telecommunications laws and regulations;
- issuing telecommunications licenses and regulating the operation of telecommunications industry participants;
- assessing and testing telecommunication systems and equipment;
- drafting and promulgating technical standards for telecommunications and broadcasting;
- classifying and censoring the contents of telecommunications and broadcasting;

managing telecommunications and media resources in Taiwan;

maintaining competition order in the telecommunication and broadcasting industries;

governing technical standards in connection with the safety of information communications;

- managing and facilitating the resolution of disputes pertaining to the Taiwan telecommunications and broadcasting industries;
- managing offshore matters relating to Taiwan s telecommunications and broadcasting industries including matters of international cooperation;
- managing funds allocated for the development of Taiwan s telecommunications and broadcasting industries;
- monitoring, investigating and determining matters in relating to Taiwan s telecommunications and broadcasting industries;
- enforcing restrictions under telecommunications and broadcasting laws and punishing violators; and
- supervising other matters in relation to communications and media.

Prior to our privatization, in each fiscal year, the Legislative Yuan approved the annual budget prepared by us, as a state-owned enterprise, and the Ministry of Audit under the Control Yuan audited, and adjusted, our financial statements, including our earnings and losses. Our annual budget is no longer subject to Legislative Yuan or Control Yuan approval or audit.

***Telecommunications Act***

The Telecommunications Act and the regulations under the Telecommunications Act establish the framework and govern the various aspects of the Taiwan telecommunications industry, including:

- licensing of telecommunications services;
- restrictions on dominant telecommunications service providers;
- tariff control and price cap regulation;
- accounting separation system;
- interconnection arrangements;
- bottleneck facilities;
- spectrum allocation;
- provision of universal services;

- equal access;
- number portability; and
- ownership limitations.

Each of these aspects is described below. The Telecommunications Act also establishes a non-auction pricing system for assignment of radio frequencies.

***Licensing of Telecommunications Services***

*Type I and Type II Service Providers*

Under the Telecommunications Act, telecommunications service providers are classified into two categories:

*Type I.* Type I service providers are providers that install network infrastructure, such as network transmission, switching and auxiliary equipment for the provision of telecommunications services. Type I services include fixed line services such as local, domestic long distance and international long distance services, as well as interconnection, leased line, asymmetrical digital subscriber line and satellite services and wireless services such as cellular, including third generation cellular, paging, mobile data and trunked radio services.

*Type II.* Type II service providers are defined as all telecommunications service providers other than Type I service providers. Type II services are divided into special services and general services. Special services include simple resale, voice over Internet protocol, international leased circuit and other services specified by the Ministry of Transportation and Communications before March 1, 2006 or by the National Communications Commission from March 1, 2006. General services include any Type II service other than special services.

Until 1996, we were the sole provider of Type I services in Taiwan. In 1996, the government opened the market for cellular, paging and trunked radio, mobile data and digital low power cordless telephone services. In 1998, the government opened the market for fixed line and mobile satellite services. In June 2001, the government granted licenses to three operators for establishing fixed line services, thereby opening the market for fixed line services. Since August 2000, the government has permitted four undersea cable operators to engage in the undersea cable leased-circuit business.

Beginning in September 2004, the government started to accept applications for integrated network services and circuit-leasing services (local, domestic long-distance and international undersea cable) in March and September of each year.

*Granting of Licenses*

*Type I*

Type I service providers are more closely regulated than Type II service providers. The government has broad powers to limit the number of providers and their business scope and to ensure that they meet their facilities roll-out obligations. Under the Telecommunications Act, Type I service providers are subject to pre-licensing merit review of their business plans and tariff rates.

Before March 1, 2006, licenses for Type I services were granted by the Ministry of Transportation and Communications through a three-step procedure. Applicants obtained a concession from the Ministry of Transportation and Communications. After obtaining a concession, the applicant obtained a network construction permit and an assignment of spectrum, in the case of cellular telephone services and satellite services, from the Directorate General of Telecommunications or the Ministry of Transportation and Communications prior to applying for a license. Upon completion of construction of its network and review by the Directorate General of Telecommunications, the applicant was granted a Type I license. The Ministry of Transportation and Communications had the authority to grant Type I licenses for each of fixed line services, wireless services and satellite services. Type I licenses have different minimum paid-in capital requirements for applicants and varying durations depending on the particular type of service.

Since March 1, 2006, the same procedure applies except that the licenses are granted by the National Communications Commission.

The Telecommunications Act further authorizes the competent authority, now the National Communications Commission to promulgate separate regulations governing each Type I service including the business scope of the Type I service provider, as well as the procedures and conditions for granting special permits and the length of the period of the special permits of each Type I service. Each holder of a Type I license will pay a fee ranging from 0.5% to 2% of the annual revenues generated from the particular Type I service for which a license has been granted.

*Fixed Line Services.* Under the Telecommunications Act, the Fixed Network Regulations adopted by the Ministry of Transportation and Communications continue to govern the issuance of fixed line service licenses and the business scope of fixed line providers. Fixed line service licenses are subdivided into the following categories:

- integrated services, including local, domestic long distance, international long-distance telephone services;

- local telephone services;

- domestic long distance telephone services;
- international long distance telephone services; and
- local, domestic long distance and international long distance leased line services.

We conduct our fixed line services through a license for integrated services.

Licenses for local telephone and integrated services are valid for 25 years. Licenses for domestic long distance and international long distance telephone services are valid for 20 years. Licenses for leased line services are valid for 15 years. The minimum paid-in capital requirement for integrated services providers and international undersea leased cable service providers is NT$40 billion and NT$800 million, respectively. The minimum paid-in capital requirement for both domestic and international long distance telephone service providers is NT$2 billion. The minimum paid-in capital requirement for local telephone service providers is NT$12 billion multiplied by the Local Network Operation Weights for the regions in which local network managerial rights have been granted to the service provider. The Local Network Operation Weights are calculated as the population of the region as a proportion of the entire population of Taiwan and are announced by the competent authority every three years.

In March 2000, the government granted three new concessions to fixed line services providers for integrated services. Recipients of these concessions are required to apply for a network construction permit to deploy broadband local access networks. Each recipient of these concessions is required to have capacity for 150,000 subscribers before they are able to apply for a fixed line license to launch their proposed services. The three fixed line service providers have since obtained fixed line licenses and are required to achieve capacity for one million subscribers by the sixth year following the date of the grant of the network construction permit awarded. Operators that applied for integrated service provider licenses after June 30, 2004 must achieve a capacity for 400,000 subscribers, ports or a combination of both by the fourth year following the date of the grant of the network construction permit.

*Wireless Services.* Under the Telecommunications Act, the Wireless Regulations promulgated by the Ministry of Transportation and Communications continue to govern the issuance of wireless services licenses and the business scope of wireless service providers. Wireless service licenses are subdivided into the following categories:

- cellular services;
- paging services;
- mobile data services;
- digital low-power cordless telephone services; and
- trunked radio services.

Wireless service licenses are granted to both regional and national service providers through review and bidding procedures.

Wireless services licenses for cellular and paging services are valid for 15 years, and licenses for mobile data, digital low-power cordless telephone and trunked radio are valid for ten years. The minimum paid-in capital requirement for regional cellular service providers and national cellular service providers is NT$2 billion and NT$6 billion, respectively.

We are licensed to provide cellular and paging services in Taiwan.

*Third Generation Cellular Services.* The Ministry of Transportation and Communications promulgated the Third Generation Mobile Telecommunications Services Regulations on October 15, 2001 and these regulations were last amended on November 17, 2005. The regulations govern voice and non-voice telecommunications services provided using the spectrum assigned by the Ministry of Transportation and Communications, and now governed by the National Communications Commission, that utilizes the IMT-2000 technical standards as announced by the International Telecommunications Union. Licenses for third generation cellular services were granted by the Ministry of Transportation and Communications. We have received our third generation cellular services license, which is valid from May 26, 2005 to December 31, 2018.

**Table of Contents**

*Satellite Services.* Under the Telecommunications Act, the Satellite Regulations promulgated by the Ministry of Transportation and Communications govern the issuance of satellite services licenses and the business scope of satellite service providers. Satellite services licenses are subdivided into fixed satellite services licenses and mobile satellite services licenses.

Satellite services licenses are valid for 10 years. Minimum paid-in capital requirements for fixed satellite services providers and mobile satellite services providers are NT$100 million and NT$500 million, respectively.

We currently hold a fixed satellite services license, valid from December 10, 1998 to December 9, 2008.

*Type II*

The Telecommunications Act was amended in 1996 to open the market for all Type II services. Under the Type II Services Regulations as last amended on November 15, 2005, Type II services are divided into special services and general services. Special services include simple resale, voice over Internet protocol, network telephone service of E.164 and non-E.164 user numbers (IP Phone Numbers), international leased circuit and other services previously specified by the Ministry of Transportation and Communications and now by the National Communications Commission. General services include any Type II service other than special services. The policy for granting a Type II service license is as follows:

- there is no limit on the number of licenses to be issued;
- licenses were granted by the Directorate General of Telecommunications before March 1, 2006 and are now granted by the National Communications Commission; and
- no bidding procedure is required.

We hold a license to operate all Type II services. Type II service licenses issued before November 15, 2005 are valid for ten years and may be renewed by application made two months prior to the expiration date. Type II service licenses issued or renewed on or after November 15, 2005 are valid for three years and may be renewed during the period commencing two months prior to the expiration date. There is no minimum paid-in capital requirement for Type II service providers. Our license to operate Type II services is included in our license to operate integrated services, and is valid from July 29, 2000 to July 28, 2025.

On December 27, 2005, the Ministry of Transportation and Communications promulgated regulations governing the fees payable for Type II licenses. Under these regulations, operators of simple resale or network telephone services of E.164 or non-E.164 user numbers must pay an annual license fee equal to 1% of annual revenues generated from these services during the previous year. Type II service operators providing services other than simple resale or network telephone services of E.164 or non-E.164 user numbers must pay license fees ranging from NT$6,000 to NT$150,000 depending on their respective paid-in capitals. The regulations do not apply to integrated services providers who are permitted to provide Type II services without additional Type II Licenses. The annual license fee for an integrated services provider operating Type II businesses is 1% of its annual revenues generated from its Type II services.

The Directorate General of Telecommunications started to process the applications for allocating E.164 and non-E.164 user numbers (IP phone numbers) on November 15, 2005. A few operators, including our company, have applied for IP phone numbers. We believe after these operators obtain the numbers and begin offering their services, competition in this area will become intense. We plan to provide VoIP service after we obtain IP phone numbers.

***Restrictions on Dominant Telecommunications Services Providers***

Under the Telecommunications Act, the regulations governing dominant telecommunications services providers apply only to Type I service providers. A Type I service provider is deemed to be dominant if it meets any of the following criteria and was declared by the Ministry of Transportation and Communications or now the National Communications Commission as dominant:

controls key basic telecommunications infrastructure;

has dominant power over market price; or has more than a 25% market share in terms of customers or revenues.

We have been declared by the former competent authority Ministry of Transportation and Communications as a dominant Type I service provider for fixed line and cellular services.

Under the Telecommunications Act, a dominant Type I service provider must not engage in the following activities:

- directly or indirectly hinder a request for interconnection with its proprietary technology by other Type I service providers;
- refuse to release to other Type I service providers the calculation methods of its interconnection fees and other relevant materials;
- improperly determine, maintain or change its tariffs or means of services;
- reject, without due cause, a request for leasing network components by other Type I service providers;
- reject, without due cause, a request for leasing lines by other service providers or subscribers;
- reject, without due cause, a request for negotiation or testing by other service providers or subscribers;
- reject, without due cause, a request for negotiation for co-location by other service providers;
- discriminate, without due cause, against other service providers or subscribers; or
- abuse its position as a dominant provider, or engage in other unfair competition activities as determined by the regulatory authorities.

In addition, a dominant Type I service provider is subject to special regulations limiting its tariff changes.

***Tariff Control and Price Cap Regulation***

In order to promote competition in the telecommunications market, and as part of the government s overall policy toward deregulation, the Telecommunications Act was amended in 1999 to abolish the former rate of return system on tariff setting in favor of price cap regulation of Type I services.

Under the Regulations Governing Tariffs of Type I Service Providers promulgated and last amended by the Ministry of Transportation and Communications on January 11, 2006, a dominant Type I service provider must submit its proposed adjustment in primary tariffs and promotional packages to the Directorate General of Telecommunications for onward submission to the Ministry of Transportation and Communications or, from March 1, 2006, directly to the National Communications Commission from for approval at least 14 days prior to the date of the proposed tariff changes and announce such change on media, website and business locations on the next day after the Ministry of Transportation and Communications or National Communications Commission grants the approval. The tariff change will come into effect seven days after the announcement.

Primary tariffs include:

for fixed line local telephone services: monthly fees, usage fees, monthly rental fees of leased lines and pay telephone usage fees;

for fixed line domestic long distance telephone services: usage fees and monthly rental fees of leased lines;

for fixed line international long distance telephone services: usage fees and leased line monthly rental fees;

for wireless services, including third generation cellular services: monthly rental fees and usage fees; and other fees or tariffs announced by the Directorate General of Telecommunications before March 1, 2006 or by the National Communications Commission from March 1, 2006.

In addition, a dominant Type I service provider is required to set wholesale prices for the provision of its telecommunication services to other telecommunication enterprises. The wholesale prices set by a dominant Type I service provider may be the retail price less fees and expenses which need not be incurred, but shall not higher than its promotional pricing. The Regulations Governing Tariffs of Type I Service Providers further prohibits a dominant Type I service provider from practising unfair competition against other telecommunication enterprises.

In comparison, all non-dominant Type I service providers are required to notify the Directorate General of Telecommunications or the National Communications Commission from March 1, 2006 and the public of their proposed tariff adjustments seven days prior to the date of the proposed tariff change with respect to all tariffs. In addition, changes in tariffs charged by Type I service providers (notwithstanding the type of their respective services) may not, in any event, be greater than the annual growth rate of the consumer price index in Taiwan adjusted by a set constant, which will be periodically determined and announced by the National Communications Commission. For example, if:

the annual growth rate of the consumer price index in Taiwan minus the set constant is positive, the increased percentage of tariffs must not exceed such positive figure;

the annual growth rate of the consumer price index in Taiwan minus the set constant is negative, the decreased percentage of tariffs must be at least the absolute value of such negative figure, and the tariffs used in the given year must not be higher than the decreased tariff; and

the annual growth rate of the consumer price index in Taiwan minus the set constant equals to zero, no increase in tariffs is allowed to be made by any Type I service providers.

In October 2000, the Directorate General of Telecommunications announced that effective from the date of the announcement, the set constant to be applied for all tariff adjustments, except tariffs for our fixed line local telephone services, will be equal to the annual growth rate of the consumer price index in Taiwan. Accordingly, for the time being, the adjustment would be equal to zero as calculated in (3) above and thus no increase in tariffs by Type I services providers will be allowed, except for increases in tariffs for fixed line local telephone services. The set constant to be applied for adjustments in fixed line local telephone services has yet to be announced by the Directorate General of Telecommunications or the National Communications Commission.

Type II service providers are free to establish their own tariff schemes, but are required to notify the Directorate General of Telecommunications or, from March 1, 2006 the National Communications Commission and the public upon adoption and upon any subsequent adjustments.

***Accounting Separation System***

The Telecommunications Act requires that a Type I service provider, including one who concurrently offers Type II services, separately calculate the profits and losses for its different services and prohibits any cross-subsidization among services that will impede fair competition.

***Interconnection Arrangements***

The Telecommunications Act requires all Type I service providers to allow other Type I service providers access to their networks. It further requires Type I service providers, within three months upon request by the other Type I service provider, to reach an agreement on the relevant terms for the interconnection. Prices charged for interconnection must be based on cost. If the parties fail to reach an agreement within three months, the National Communications Commission may, either at the request of the parties or on its own accord, arbitrate and determine the interconnection terms for the parties. According to the Administrative Rules for Network Interconnection Between Telecommunication Service Providers, the tariffs for communications (except for international communications) between a cellular telecommunications network and a fixed line telecommunications network) shall be collected by the call-originating services provider from its subscribers pursuant to the tariff schedules set by the cellular services provider, and the revenue or any uncollectible accounts from such tariffs shall go to the cellular services provider. In addition, tariffs for communications within cellular telecommunications networks shall be collected by the call-originating services provider from its subscribers pursuant to the tariff schedules set by such provider, and the revenue or any uncollectible accounts from such tariffs shall be for the account of to the call-originating services provider.

Table of Contents

When a Type I service provider leases unbundled network components to another Type I service provider, the parties are required to negotiate the rental fee. Unbundled network components include:

- local loops;
- local switch transmission equipment;
- local trunks;
- toll switch transmission equipment;
- long-distance trunks;
- international switch transmission equipment;
- network interfaces;
- directory equipment and services; and
- signaling network equipment.

The Telecommunications Act authorizes the Directorate General of Telecommunications or, from March 1, 2006, the National Communications Commission to issue rules and regulations pertaining to interconnection. Under the Administrative Rules for Network Interconnection issued by the Directorate General of Telecommunications, as last amended on November 17, 2005, we, as a dominant Telecommunication service provider for fixed line and cellular services, are required to unbundle our network and provide cost-based interconnection charges calculated with reference to the total element long-run incremental cost incurred by us. We are required to submit our proposed calculations of the total element long-run incremental cost to the Directorate General of Telecommunications or, from March 1, 2006, the National Communications Commission, for its approval each year. Local loop unbundlings for both voice and data have been completed.

***Bottleneck Facilities***

Under the Telecommunications Act, when a Type I service provider cannot construct bottleneck facilities within a reasonable period of time or substitute those facilities by other available technologies, it may request for co-location on a fee basis from the owner of the facilities located at the bottleneck of the relevant telecommunications network. The owner of the facilities so requested may not reject these requests without due cause. The Ministry of Transportation and Communications had the authority, now held by the National Communications Commission, to prescribe facilities as bottleneck facilities, and has prescribed bridges, tunnels, lead-in tubes and telecommunications chambers located within buildings and horizontal and vertical telecommunications cables and lines as bottleneck facilities in relation to fixed line telecommunications networks.

***Spectrum Allocation***

The Ministry of Transportation and Communications previously and now the National Communications Commission allocates all telecommunications related frequencies primarily according to the standards set by the International Telecommunications Union. The 900 MHz and 1,800 MHz frequency bands have been allocated for cellular applications. A total of 40 MHz spectrum around the 800 MHz frequency band

and a total of 130 MHz of spectrum around the 2 GHz band have been allocated for third generation cellular services.

Frequency allocation for fixed wireless platforms, such as wireless local loop and local multipoint distribution services, has already been set. Only some bands of the spectrum made available for these services are completely clear and there is partial usage in all other bands. The cost of frequency usage will be based on quantity.

Table of Contents

***Provision of Universal Services***

A Type I service provider may be required by the Ministry of Transportation and Communications previously and now the National Communications Commission under the Telecommunications Act, to provide universal telecommunications services in remote or unprofitable areas. All Type I service providers and certain Type II service providers designated by the Ministry of Transportation and Communications previously and now the National Communications Commission will be required to contribute a fixed portion of their annual revenues to a universal services fund. Such a fund will be used to compensate any losses and management fees incurred by the relevant Type I service provider in providing the universal services. In April 2005, the Ministry of Transportation and Communications amended the Regulations on Telecommunications Universal Services, pursuant to which Type I service providers are required to provide universal telecommunications services and contribute to the costs and expenses of providing such services on a pro rata basis according to their respective revenues.

***Equal Access***

As a result of the liberalization of Taiwan s telecommunications industry, a Type I service provider, including a third generation cellular services provider, is required to provide its subscribers with equal access to the domestic and international long distance telephone services provided by other service providers. A Type I service provider may provide equal access through pre-selection or call-by-call selection. Currently, all Type I service providers, including us, provide equal access only through call-by-call selection. When a subscriber makes a call using call-by-call selection, such subscriber has the option to select a service provider by dialing the network identification prefix assigned to the service provider of his choice. This will result in the automatic selection of the preferred service provider for the provision of relevant telecommunication services. Starting from July 1, 2005, all Type I service providers may also provide equal access through pre-selection in Keelung City, Taipei City/County, Taichung City/County and Kaohsiung City/County. Equal access through pre-selection is available throughout Taiwan since January 1, 2006. The pre-selection function allows any subscriber to select in advance a long distance or international service provider of his or her choice. When such subscriber makes a call using this function, the communications network will automatically interconnect to the long distance or international network previously selected by such subscriber.

***Number Portability***

The Ministry of Transportation and Communications has adopted principles on fixed line number portability to enable customers to migrate their local and toll free fixed line telephone numbers. Under these regulations, we are required to provide fixed line number portability in seven major cities and counties in Taiwan upon the grant of the first fixed line license to a new entrant. We are also required to provide such number portability in other service areas no later than 181 days from the grant of such license and upon six months advanced written notification received from the new fixed line service provider. Since May 2002, fixed line number portability has been made available to all customers in accordance with the then prevailing Fixed Network Regulations.

In November 2003, the Directorate General of Telecommunications promulgated the Administration Rules Governing Number Portability governing both fixed line and cellular services and the Fixed Network Regulations were revised to reflect such new regulation. Under the Administration Rules Governing Number Portability, which rules were amended on September 22, 2005, subscribers may migrate their telephone numbers when changing Type I service providers. The number portability for wireless services commenced on October 15, 2005.

***Cable Radio and Television Law***

Under the 1999 amendment of The Cable Television Law (the predecessor of Cable Radio and Television Law), telecommunications service providers may be licensed as cable radio and television operators. The Government Information Office also promulgated rules for integrated fixed line service providers to apply for licenses to engage in cable radio and television businesses. The competent authority of the Cable Radio and Television Law is now the National Communications Commission from March 1, 2006.

We have been granted a license to operate cable television business. The license is valid until February 3, 2013.

The tariff for cable television business is subject to annual prior review by the tariff committees of municipal governments.

***Ownership Limitations***

The Telecommunications Act provides that direct foreign ownership in Type I service providers, except for us, may not exceed 49%, and combined direct and indirect foreign ownership in Type I service providers, except for us, may not exceed 60%. The Telecommunications Act places no limitation on foreign ownership in Type II service providers. The Ministry of Transportation and Communications separately prescribed limits on our foreign ownership. Currently, direct and indirect foreign ownership of our common shares is limited to 40%. A fine of between NT$500,000 to NT$2,500,000 may be imposed on us if we fail to comply with this limitation within a prescribed period of time after receiving a notice to comply. If we fail to comply within a prescribed period of time after such further notification, our licenses to operate our Type I services may be revoked.

The Cable Radio and Television Law provides that direct foreign ownership in a cable operator may not exceed 20%, and combined direct and indirect foreign ownership in a cable operator may not exceed 60%. The Cable Radio and Television Law further prohibits direct and indirect government ownership in a cable operator and prohibits the government to act as the director or supervisor of a cable operator. Only institutional investors may directly hold the shares of a cable operator. A fine between NT$100,000 to NT$1,000,000 may be imposed on, and a notice to comply will be sent to, us if we fail to comply with such limitation. The fine may be imposed consecutively if we fail to comply. If the non-compliance is material, our license to operate cable television business may be revoked. We received our cable operator license on March 21, 2005, which is valid until February 3, 2013, and have recently begun offering multimedia on demand services on a limited basis. We have been granted the license even though we were not, and are not, in compliance with the applicable ownership restrictions. We cannot assure you that fines will not be imposed on us or that our license will not be revoked.

Under the current Telecommunications Act and the Cable Radio and Television Law, the Chairman of a Type I service provider and a cable operator is required to be a citizen of the Republic of China. Under the Cable Radio and Television Law, not less than two thirds of our directors are required to be citizens of the Republic of China.

***Administrative Fee Law***

According to the Administrative Fee Law promulgated in December 2002, central and local governments, government agencies and schools are empowered to collect administrative fees from us and other telecommunications services providers for the telecommunications facilities built on public roads and properties. Under the Administrative Fee Law and Local Road Act, road authorities of municipal governments may collect usage fees from users of local roads, including us, for establishing lines along with the local roads. The fee schedule is set up in the Standard for Usage Fees of Local Roads.

In addition, under the Public Road Law, as amended in July 2003, administrative authorities of public roads may collect usage fees from the users of public roads. According to the Rules Governing Collection of Usage Fees on Public Roads, the relevant collection agencies, including agencies designated by the Ministry of Transportation and Communications and municipal governments, depending on the types of public roads, may collect usage fees from users, including us, for establishing lines along with the public roads.

***Laws and Regulations Relating to State-Owned Enterprises and Our Privatization; Statute Governing Privatization of State-Owned Enterprises***

On the date of our privatization, we were required to make termination payments in accordance with the pension payment determined under the Labor Standards Law plus six months salary and one month s wages in lieu of prior notice of termination to our employees who chose not to continue their employment. The government is responsible for paying the six months salary to our employees who chose not to continue their employment.

Upon the completion of our privatization, we were required to make a settlement payment to our employees who chose to remain with us, based on their seniority and in accordance with the pension payment determined under the Labor Standards Law as if they have retired at the time of privatization. Those employees who remained with us and who are laid off within five years after the completion of our privatization will be entitled to a payment equal to the pension benefit accrued from the date of our privatization to the date of termination, six months salary and one month s wages (including salary, bonuses, allowances and other regular payments) in lieu of prior notice of termination. The government has agreed to assume the cost of paying the six months salary to the laid-off employees.

**Table of Contents**

The government will indemnify those employees who have suffered from any losses and damages due to our privatization, such as losses arising from change of an insurance program.

Part of the funds realized from our privatization will be allocated to the Privatization Fund, and the rest of the funds will go to the Treasury of the Republic of China. Indemnification payments by the government will be made from the Privatization Fund.

***Statute of Chunghwa Telecom Co., Ltd.***

In light of the privatization of our company, the Executive Yuan, on May 1, 2006, proposed a motion for the abolishment of the Statute of Chunghwa Telecom Co., Ltd. for legislative approval. We cannot determine when this motion will be approved by the Legislative Yuan. Under Republic of China law, the Statute of Chunghwa Telecom Co., Ltd will continue in effect until the Legislative Yuan formally approves the motion and the President of the Republic of China pronounces the abolishment of the law.

***Approval of Ministry of Transportation and Communications***

While the continued application of the Statute of Chunghwa Telecom Co., Ltd. remains unclear and it may be abolished in the near future, under that statute we are required to obtain approval of the Ministry of Transportation and Communications for:

- the adoption of and any changes to our articles of incorporation and board of directors organization rules;
- any changes to our authorized capital and any issuance of our common shares;
- any changes to primary tariffs for Type I services; and
- any changes to operational procedures of Type I services.

***Pension Obligation***

We are required to fund any shortfall in our pension fund reserves within eight years after our incorporation. Consequently, if we record any extra earnings over our previous estimated earnings approved by the Legislative Yuan, these extra earnings must be first allocated to pension fund reserves.

***Employee Subscription Rights for New Issues of Our Common Shares***

In accordance with the Statute of Chunghwa Telecom Co., Ltd., our employees have rights to subscribe for not more than 10% of a new issuance of our common shares at favorable terms in accordance with subscription rules which were to be announced by the Ministry of Transportation and Communications. However, no such rules were ever announced. In addition, under the Republic of China Company Law, employees of Republic of China companies have pre-emptive rights to subscribe for between 10-15% of any new issue of shares by the company.

**C. Organizational Structure**

We do not have any subsidiaries.

**D. Property, Plant and Equipment**

Please refer to B. Business Overview for a discussion of our property, plant and equipment.

**ITEM 4A. UNRESOLVED STAFF COMMENTS**

Not applicable.

Table of Contents

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

*You should read the following discussion of our financial condition and results of operations together with the consolidated financial statements and the notes to such statements included in this annual report.*

*For the convenience of readers, NT dollar amounts used in this section for, and as of, the year ended December 31, 2005 have been translated into U.S. dollar amounts using US$1.00=NT$32.80, the noon buying rate of the Federal Reserve Bank of New York on December 30, 2005. The US dollar translation appears in parentheses next to the relevant NT dollar amount.*

**Overview**

A number of recent and expected future developments have had, and in the future may have, a material impact on our financial condition and results of operations. These developments include:

- changes in our revenue composition and sources of revenue growth;
- increased competition in the fixed line, leased line and cellular services markets, including the third generation cellular services market;
- tariff adjustments;
- capital expenditures as a result of technological improvements and changes in our business;
- provisions for pension payments and other stock-based compensations to our employees; and
- taxation.

Each of these developments is discussed below.

***Changes in our revenue composition and sources of revenue growth***

Our fixed line revenues are derived primarily from the provision of local, domestic long distance and international long distance telephone services. In addition, we also derive fixed line revenues from providing interconnection services to other carriers. Our revenues from wireless services are derived primarily from the provision of cellular services. Our revenues from Internet and data services are generated principally from HiNet, our Internet service provider, from our asymmetrical digital subscriber line services, and from the provision of dedicated leased lines for our business customers and other operators.

The table below sets forth the revenues from our principal lines of business as a percentage of revenues for the periods indicated.

| | Year ended December 31, | | |
|---|---|---|---|
| | **2003** | **2004** | **2005** |
| **Revenues:** | | | |
| Fixed line | 42.5% | 38.9% | 35.9% |
| Wireless | 36.6 | 38.2 | 39.6 |
| Internet and data | 19.5 | 21.2 | 22.8 |

| | | | |
|---|---|---|---|
| Other | 1.4 | 1.7 | 1.7 |
| Total | 100.0% | 100.0% | 100.0% |

Over the past three years, the composition of our revenue base has undergone a significant change as a result of our strategy to diversify our revenues and focus on generating increased revenues from higher growth businesses, such as cellular and Internet and data services.

Cellular and Internet and data services have been our fastest growing sources of revenue over the last three years. Most of our increased revenues have come from our cellular and Internet access services, with our asymmetrical digital subscriber line services accounting for a significant portion of such increase. We launched our asymmetrical digital

Table of Contents

subscriber line services in August 1999, and we had approximately 3.7 million subscribers as of December 31, 2005. Increasing Internet penetration in Taiwan and higher data traffic have contributed to a significant increase in our revenues from Internet and data services over this period. Revenues from our local telephone and domestic long distance telephone and paging services have declined during this period, mainly due to traffic migration to cellular services. Revenues from our international long distance services have also declined, as international long distance tariffs have declined worldwide. We believe that wireless and Internet and data services will continue to generate an increasing percentage of our revenues.

***Increased competition in the fixed line, leased line and cellular services markets, including the third generation cellular services market***

Three operators in addition to us have been providing fixed line services in Taiwan since June 2001. We believe that these competitors are targeting largely business subscribers, which generally generate higher revenues per subscriber as compared with residential customers. We are facing significant competition, particularly in the international long distance telephone services market, from these competitors.

Since August 2001, the Ministry of Transportation and Communications has awarded undersea cable service licenses to four additional operators. Moreover, in February 2002, the Ministry of Transportation and Communications awarded five concessions to provide third generation cellular services. Two of these new concessions were awarded to new cellular operators. In addition, the government issued six mobile virtual network operator licenses in 2004, and began to allow mobile number portability services in October 2005. Our mobile number portability service attracted a large number of customers. We seek to minimize loss of customers from the increased competition by continuing to offer handset subsidies, more competitive pricing packages, our Friends and Family packages and mobile virtual private networks for our enterprise customers.

The increased competition in the areas of fixed line, leased line and cellular services has led to, and may continue to lead to, further declines in our tariffs, which may result in a decrease in our revenues from these services. At the same time, the increased competition has stimulated consumer demand for telecommunications services, with results including higher international telephone usage and increased international bandwidth demand.

***Tariff adjustments***

We adjust our tariffs and offer promotional packages from time to time primarily in response to market conditions, within the constraints of our budget requirements before we were privatized.

In July 2003, we reduced monthly rental fees for our asymmetrical digital subscriber line services by an average of 16%.

In June 2004, we:

- reduced monthly rental fees for our asymmetrical digital subscriber line services by an average of 24%;
- reduced the tariff for HiNet asymmetrical digital subscriber line services by an average of 22%; and
- reduced the short messaging service fee from NT$2 to NT$1.5 per message for messages sent between our customers and from NT$2.5 to NT$2 per message for messages sent to users of other service providers.

In April 2005, we reduced monthly rental fees for part of our asymmetrical digital subscriber line services by an average of 2%. For downlink speeds of 256k services, the reduction rate was as high as 47%.

In June 2005, we reduced short messaging service fees from NT$1.5 to NT$1.3 per message for messages sent between our customers and from NT$2 to NT$1.7 per message for messages sent to users of other service providers.

In December 2005, we reduced mobile dialing fees for calls to local telephone numbers by an average of 7%.

We expect to continue to adjust tariffs and offer a variety of promotional packages from time to time in response to increasing competition and in order to take advantage of our pricing power from economies of scale.

***Capital expenditures as a result of technological improvements and changes in our business***

In recent years, we have focused on modernizing and upgrading our cellular services network, and on developing our asymmetrical digital subscriber line network, which enables transmission of digital information at a high-bandwidth over existing telephone lines. In particular, we have enhanced our telecommunications services through:

- the introduction of a voice over Internet protocol exchange system in our long distance telephone network;
- the implementation of a network modernization program, including a gradual transfer from our public switched telephone network to a system based on Internet protocol, to remain at the forefront of new technologies;
- the development of an intelligent network for fixed line services;
- the deployment of a high-capacity long-haul dense wavelength division multiplexing system and a nationwide Internet protocol backbone network with 320 gigabits per second giga switching routers for Internet and Internet protocol virtual private network services;
- the expansion and upgrade of our cellular services network, including the rollout of general packet-switched radio services; and
- the construction of our third generation cellular services network.

As a result, we incurred aggregate capital expenditures of NT$78.0 billion over the period from January 1, 2003 to December 31, 2005.

Our long-term goal is to optimize our capital expenditures by focusing on investing in innovative products and services with attractive return profiles. We evaluate our investment opportunities by benchmarking them against internal return requirements. We are currently finalizing plans for the gradual upgrade of our entire public switched telephone network to a next-generation network. Next-generation Internet protocol switches will have substantially more capacity and greater upgrade flexibility, and should result in increased operational efficiencies from reduced switching centers, and related property, materials and personnel costs. We have also devoted resources toward the effective rollout of our third generation cellular network and the continuing build-out of our fiber-to-the-building infrastructure.

***Provisions for pension payments and other stock-based compensations to our employees***

Personnel expenses constitute a significant portion of our operating costs and expenses. In 2003, 2004 and 2005, personnel expenses represented 32.6%, 32.4% and 38.8%, respectively, of our total operating costs and expenses, and pension costs represented 10.3%, 11.3% and 7.8%, respectively, of our personnel expenses. The table below sets forth information regarding personnel expenses, depreciation and amortization and other operating costs and expenses in the aggregate and as a percentage of our total operating costs and expenses for the periods indicated.

| | **For the year ended December 31,** | | | | | |
|---|---|---|---|---|---|---|
| | **2003** | | **2004** | | **2005** | |
| | **(in billions of NT$, except for percentages)** | | | | | |
| **Operating costs and expenses:** | | | | | | |
| Personnel expenses | | | | | | |
| Pension[(1)] | 4.2 | 3.4% | 4.6 | 3.7% | 4.3 | 3.0% |
| Salaries and bonus | 37.0 | 29.2 | 36.0 | 28.7 | 50.6 | 35.8 |
| Total personnel expenses | 41.2 | 32.6 | 40.6 | 32.4 | 54.9 | 38.8 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Depreciation and amortization costs of services | 39.2 | 31.0 | 38.4 | 30.6 | 38.8 | 27.4 |
| Depreciation and amortization operating expenses | 2.4 | 1.9 | 2.3 | 1.9 | 2.4 | 1.7 |
| Other | 43.7 | 34.5 | 44.0 | 35.1 | 45.5 | 32.1 |
| Total operating costs and expenses | 126.5 | 100.0% | 125.3 | 100.0% | 141.6 | 100.0% |

(1) Does not include NT$37 million, NT$129 million and NT$183 million of pension costs associated with employees engaged in construction projects that were capitalized and not treated as personnel expenses in 2003, 2004 and 2005, respectively.

**Table of Contents**

The following table sets forth our personnel expenses (divided into pension and non-pension portions) allocated by categories of operating costs and expenses:

| | For the year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2003 | | 2004 | | 2005 | |
| | (in billions of NT$, except for percentages) | | | | | |
| **Personnel expenses** | | | | | | |
| Cost of Services | | | | | | |
| Pension | 2.5 | 6.2% | 2.8 | 6.9% | 2.5 | 4.6% |
| Non-pension | 23.3 | 56.6 | 22.5 | 55.4 | 30.8 | 56.1 |
| Total | 25.8 | 62.8 | 25.3 | 62.3 | 33.3 | 60.7 |
| Sales and Marketing | | | | | | |
| Pension | 1.2 | 2.9 | 1.2 | 3.1 | 1.3 | 2.3 |
| Non-pension | 9.5 | 23.0 | 9.6 | 23.6 | 14.4 | 26.2 |
| Total | 10.7 | 25.9 | 10.8 | 26.7 | 15.7 | 28.5 |
| General and Administration | | | | | | |
| Pension | 0.3 | 0.6 | 0.3 | 0.6 | 0.2 | 0.5 |
| Non-pension | 2.2 | 5.3 | 2.0 | 5.0 | 2.9 | 5.2 |
| Total | 2.5 | 5.9 | 2.3 | 5.6 | 3.1 | 5.7 |
| Research and Development | | | | | | |
| Pension | 0.2 | 0.6 | 0.3 | 0.6 | 0.2 | 0.4 |
| Non-pension | 2.0 | 4.8 | 1.9 | 4.8 | 2.6 | 4.7 |
| Total | 2.2 | 5.4 | 2.2 | 5.4 | 2.8 | 5.1 |
| Total personnel expenses | 41.2 | 100.0% | 40.6 | 100.0% | 54.9 | 100.0% |

At the time of our privatization, our then existing defined benefit pension obligations were settled in full. After completion of our privatization, our continuing employees were deemed to have commenced employment as of the date our privatization was completed for seniority purposes under our pension plans in effect after privatization. Under applicable Republic of China regulations, upon our privatization, the Ministry of Transportation and Communications assumed the obligation to make annuity payments to our employees who retired before our privatization. Under US GAAP reporting, the portion of the pension obligations that was settled by the Ministry of Transportation and Communications, was represented by the difference between the accrued pension liabilities, the deferred pension cost and related deferred income tax assets was accounted for as contributed capital and recorded under our stockholders equity as of August 12, 2005.

We expect our pension costs for the fiscal year 2006 to be approximately NT$3.4 billion.

Increases in our costs and expenses in recent years were also attributable to purchases of our common shares by our employees at discounts. We recognize compensation expenses when our employees purchase our common shares at discounts under the priority share subscription program. We recognized such compensation expenses in the amounts of NT$1.9 billion, NT$0.5 billion and NT$12.8 billion (US$0.4 billion) in 2003, 2004 and 2005, respectively.

Under a program established pursuant to a regulation adopted by the Ministry of Transportation and Communications, our employees may subscribe for up to 476,858,252 of our common shares from the Ministry of Transportation and Communications in offerings conducted by the Ministry of Transportation and Communications prior to our privatization. As long as our employees agree not to transfer or pledge these shares for two or three years, they will be eligible to receive a discount of 10% or 20%, respectively, from the offering price. Pursuant to June 2005 amendment to the terms of this program, a majority of our employees who continue their employment with us after our privatization will also be eligible to receive a 50% discount if they agree not to transfer or pledge the shares for four years.

At the time when we were privatized, the Ministry of Transportation and Communications implemented another stock subscription program, allocating up to 476,858,252 common shares, or 4.9% of our then outstanding common shares, for a one-time subscription by our employees.

Under this program, a majority of our employees will be eligible to receive a discount of 10%, 20% or 50% from the offering price of the shares if they agree not to transfer or pledge these shares for two, three or four years, respectively.

As of the date of this annual report, 762,886,886 of our common shares, representing 7.9% of our outstanding common shares were sold under the two programs mentioned above.

*Taxation*

The current corporate income tax rate in the Republic of China is 25%. We have benefited from tax incentives generally available to technology companies in the Republic of China, including tax credits of up to 30% (25% prior to February 2002) of the amount of some of our research and development, automation and employee training expenditures. Starting in 2001, we qualify for tax benefits at the rate of 5% to 20% for the amount of our investment in qualified equipment and technology. As a result, our effective tax rate was 17.9%, 18.1% and 27.7% in 2003, 2004 and 2005, respectively.

In 1997, the Income Tax Law of the Republic of China was amended to integrate corporate income tax and shareholder dividend tax to eliminate the double taxation effect for resident shareholders of Taiwan companies. Under the amendment, all retained earnings generated from January 1, 1998 and not distributed to shareholders as dividends in the following year are assessed with a 10% retained earnings tax. See Item 10. Additional Information E. Taxation Republic of China Taxation Dividends. Historically, this has not had an impact on our financial results of operations, because the major portion of our earnings was distributed to the government by way of dividends. If we decide to retain a substantial portion of our earnings in the future, we may be assessed with retained earnings tax and our effective tax rate may exceed the corporate income tax rate.

**Segment Operating Losses**

Our local telephone services had operating losses of NT$5.9 billion, NT$7.9 billion and NT$15.0 billion (US$0.5 billion) in 2003, 2004 and 2005, respectively. See Note 23 to our audited financial statements included elsewhere in this annual report. We expect our local telephone services to continue incurring operating losses as competition in the local telephone services market further intensifies and traffic continues to migrate from fixed line services to cellular and broadband services.

**Critical Accounting Policies**

Our financial statements are prepared in accordance with US GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses as well as the disclosure of contingent assets and liabilities. We continually evaluate these estimates and judgments, including those related to revenue recognition, allowance for doubtful accounts, estimated useful lives of long-lived assets, investments in unconsolidated companies, pension benefits and accounting for income taxes. We base these estimates and judgments on our historical experience and other factors that we believe to be reasonable under the circumstances. Actual results may differ from these estimates.

***Revenue Recognition***

We recognize revenues for our services in accordance with the Securities and Exchange Commission Staff Accounting Bulletin No. 104. We record service revenues over the periods they are earned. The costs of providing services are recognized as incurred. Handset subsidy costs are paid to a vendor that sells a handset to a customer who subscribes to the service, as an inducement to enter into a service contract, and are recognized as a cost of service when incurred. Usage revenues from fixed line services, cellular services, Internet and data services, and interconnection and call transfer fees from other telecommunications companies and carriers are billed in arrears and are recognized based upon minutes of traffic processed when the services are provided in accordance with contract terms.

One-time subscriber connection fees, primarily in relation to fixed line service revenues, are deferred and recognized over the average expected customer service periods, which we evaluate on a continual basis. For example, the average expected customer service period for fixed line service revenues has increased over time from 13 years at December 31, 2004 to 16 years at December 31, 2005, and the average expected customer service period for cellular service revenues has declined over time from five years at December 31, 2004 to four years at December 31, 2005 and the average expected customer service period for Internet service revenues increased from three years in 2004 to four years in 2005, while the average expected customer service periods for other service lines have remained relatively the same over the same period. If our estimates of these customer service periods become longer, the amortization of our deferred income could be materially and adversely affected. This deferred income is also dependent on the amount of one-time connection fees received from subscribers.

Table of Contents

***Allowance for Doubtful Accounts***

We maintain allowance for doubtful accounts for estimated losses that result from the inability of our customers to make required payments. We base our allowances on the likelihood of recoverability of accounts receivable by operating segment based on past experience and current collection trends that we expect to continue. Our evaluation also includes the length of time the receivables are past due, geographic concentrations and the general business environment. If changes in these factors occur, or the historical data we use to calculate the allowance provided for doubtful accounts does not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and our future results of operations could be materially and adversely affected.

***Estimated Useful Lives of Long-Lived Assets***

A significant portion of our total assets consists of long-lived assets, primarily property, plant and equipment and definite-lived intangibles. We estimate the useful lives of property, plant and equipment and other long-lived assets with finite lives in order to determine the amount of depreciation and amortization expense to be recorded during the reported period. The useful lives are estimated at the time assets are acquired and are based on historical experience with similar assets as well as the anticipated technological evolution or other environmental changes. If technological changes were to occur more rapidly than anticipated or in a different form than anticipated, the useful lives assigned to these assets may need to be shortened, resulting in the recognition of increased depreciation and amortization in the relevant periods. Alternatively, technological obsolescence could result in a write-down in the value of the assets to reflect impairment. We review these types of assets for impairment annually, or when events or circumstances indicate that the carrying amount may not be recoverable over the remaining life of an asset. In assessing impairments, we use estimated cash flows that take into account management s estimates of future operations.

If at January 1, 2005 we would have determined that the remaining useful lives for our property, plant and equipment were shorter or longer by one year than what we used in the preparation of our financial statements, our recorded depreciation expense in 2005 would have increased by approximately NT$12.5 billion or decreased by approximately NT$8.0 billion, respectively.

***Investments in Unconsolidated Companies***

We hold investments in other companies that we account for under the equity method or cost method of accounting, depending on our ability to exert significant influence over the investee company. The amounts for our equity method investments generally represent our cost of the initial investment adjusted for our share of the investee company s income or loss and any dividends received. The amounts for our cost method investments where the securities are not publicly traded generally represent our cost of the initial investment less any adjustments we make when we determine that an investment s net realizable value is less than its carrying cost.

The process of assessing whether a particular cost method investment s net realizable value is less than its carrying cost requires a significant amount of judgment. We periodically evaluate these long-term investments based on quoted market prices, if available, the financial condition of the investee company, economic conditions in the industry and our intent and ability to hold the investment for a long period of time. If quoted market prices are not available, we estimate the fair value using the net asset values as well as the financial condition of the investee company. This information may be based on information that we request from the investee companies and may not be subject to the same disclosure and audit requirements as required of U.S. companies, and as such, the reliability and accuracy of the information may vary. If we deem the fair value of an investment to be less than the book value based on the above factors, and the decline in value is deemed to be other than temporary, we record the difference as impairment in the period of occurrence.

Estimating the net realizable value of investments in privately held companies can be inherently subjective and may contribute to significant volatility in our reported results of operations. For example, if the investment environment worsens in 2006, we may incur an impairment in our equity or cost method investments.

***Pension Benefits***

The amounts recognized in our financial statements related to pension benefits are determined on an actuarial basis that utilizes several different assumptions in the calculation of such amounts. Significant assumptions used in determining our pension benefits are the discount rate, the expected long-term rate of return on plan assets, the rate of increase in compensation levels, and the average remaining years of service for employees, which prior to 2005 included an estimate for the number of employees that will retire upon our privatization. In addition, because we were required to fully fund our pension plans on or prior to the date of our privatization to enable us to meet the requirements of making full benefit payments to our then existing employees, prior to 2005 we made an assumption of our privatization date in determining the amount of the pension benefits.

We use long-term historical actual return information and estimate future long-term investment returns by reference to external sources to develop the expected long-term return on plan assets. The discount rate is assumed based on the rates available on high-quality fixed-income debt instruments with the same period to maturity as the estimated period to maturity of the pension benefit. We assume the rate of increase in compensation levels and average remaining years of service based on historical data. Any changes in one or more of these assumptions could impact our pension benefits.

A decrease in the discount rate or in the expected return on assets would increase the reported obligation. For example, if the discount rate in 2005 used in determining this obligation were 0.25% lower, it would generate a NT$41.2 million increase in the obligation reported on the balance sheet and a NT$69.1 million increase in the benefit costs. Similarly, if the expected return on assets assumption were 0.25% lower, it would generate a NT$4.6 million increase in benefit costs, and a similar increase in the obligation reported on the balance sheet. A minor change in the estimate of health care cost assumptions or a delay of the privatization date by one year would not materially affect our pension obligations or related benefit costs. See Item 3. Key Information D. Risk Factors Risks Relating to Our Company and the Taiwan Telecommunications Industry Our actual pension obligations may be significantly higher than what we have provided for under current actuarial assumptions and may also differ from actual experience, including as a result of events outside of our control.

*Accounting for Income Taxes*

Deferred income taxes represent the effect of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and the amounts recognized for income tax purposes. We measure deferred tax assets and liabilities using statutory tax rates that, if changed, would result in either an increase or a decrease in the provision for income taxes in the period of change. A one-percentage point increase in the statutory income tax rate as of December 31, 2005 would have decreased our net income by approximately NT$460.3 million.

We record a valuation allowance to reduce our deferred tax assets to the amount of future tax benefit that is more likely than not to be realized. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, we cannot assure you that we would not need to increase the valuation allowance to cover additional deferred tax assets that may not be realizable. Any increase in the valuation allowance could have a material adverse effect on our income tax provision and net income in the period in which such determination is made.

We had a valuation allowance of NT$2,499 million on our deferred tax asset balance as of December 31, 2005. We do not have a full valuation allowance on the deferred tax asset, as we believe these benefits will be fully realizable based on our projection of future operating income. If we experience a significant decrease in our future operating income, the realizability of our deferred tax assets could be negatively impacted, and thus an increase in the valuation allowance might be required.

**Our Financial Reporting Obligations**

Our audited financial statements included in this annual report are prepared under US GAAP. Prior to our privatization in August 2005, we prepared certain unaudited financial data on a monthly and quarterly basis and audited financial statements on a semiannual and annual basis in accordance with our internal accounting principles, which take into account ROC GAAP and relevant laws and regulations and government guidelines applicable to state-owned enterprises in the Republic of China. These internal accounting principles, which we refer to as Chunghwa Telecom Internal Accounting Principles, have been approved by the government.

Prior to our privatization in August 2005, we were also required to prepare on an annual basis audited financial statements subject to the review and adjustment of the Ministry of Audit in accordance with the Audit Law of the Republic of China and other relevant laws and regulations. As a result, prior to our privatization in August 2005, we may have published up to three separate audited annual financial statements, including financial statements prepared under US GAAP, the Chunghwa Telecom Internal Accounting Principles and the accounting standards used by the government.

Table of Contents

Prior to our privatization in August 2005, we made available the following unaudited financial statements prepared in accordance with US GAAP at the same time that we make available financial statements for the same periods prepared in accordance with Chunghwa Telecom Internal Accounting Principles as required by Republic of China law:

- financial statements for the three months ended March 31 of each fiscal year;
- financial statements for the three months and six months ended June 30 of each fiscal year; and
- financial statements for the three months and nine months ended September 30 of each fiscal year.

In addition, prior to our privatization in August 2005, we made available audited annual financial statements prepared in accordance with US GAAP at the same time that we make available our annual financial statements prepared in accordance with Chunghwa Telecom Internal Accounting Principles as required by Republic of China law.

The Chunghwa Telecom Internal Accounting Principles and the accounting standards used by the government differ in significant respects from each other and from US GAAP. In addition, the government may require that adjustments be made in accordance with the Audit Law of the Republic of China to our financial statements prepared under the Chunghwa Telecom Internal Accounting Principles. However, these adjustments did not have any material impact on our financial statements presented in this annual report. The financial statements presented in this annual report have been prepared in accordance with US GAAP and were not subject to adjustment under the government review and audit process. You should not rely on our audited financial statements prepared under the Chunghwa Telecom Internal Accounting Principles or our financial statements audited by the government for purposes of comparison with our financial statements prepared under US GAAP.

In addition, prior to our privatization in August 2005, dividends paid to our shareholders had historically been determined based on our net income determined in accordance with the Chunghwa Telecom Internal Accounting Principles, which take into account ROC GAAP and relevant laws and regulations and government guidelines applicable to state-owned enterprises. Dividends to be paid subsequent to our privatization will be determined in accordance with ROC GAAP.

After our privatization, we intend to transition into financial reporting under ROC GAAP, with reconciliation to US GAAP, beginning in 2008. In the interim, we expect we will continue to make available our quarterly and semi-annual financial statements prepared in accordance with US GAAP.

**A. Operating Results**

The following table sets forth our revenues, operating costs and expenses, income from operations and other financial data for the periods indicated.

| | For the year ended December 31, | | | |
|---|---|---|---|---|
| | 2003 | 2004 | 2005 | |
| | | (in billions) | | |
| | NT$ | NT$ | NT$ | US$ |
| **Revenues:** | | | | |
| Fixed line | | | | |
| Local | 48.4 | 44.9 | 40.7 | 1.2 |
| Domestic long distance | 13.4 | 12.0 | 11.0 | 0.3 |
| International long distance | 15.7 | 15.2 | 14.6 | 0.5 |
| Total fixed line | 77.5 | 72.1 | 66.3 | 2.0 |
| Wireless | | | | |
| Cellular | 66.2 | 70.3 | 73.0 | 2.2 |

| | | | | |
|---|---|---|---|---|
| Paging | 0.6 | 0.3 | 0.1 | |
| Total wireless | 66.8 | 70.6 | 73.1 | 2.2 |
| Internet and data: | | | | |
| Internet | 25.9 | 29.5 | 32.1 | 1.0 |
| Data | 9.7 | 9.8 | 10.1 | 0.3 |
| Total Internet and data | 35.6 | 39.3 | 42.2 | 1.3 |
| Other | 2.6 | 3.2 | 3.1 | 0.1 |
| Total revenues | 182.5 | 185.2 | 184.7 | 5.6 |
| Operating costs and expenses: | | | | |
| Costs of services(1) | 59.6 | 60.3 | 70.1 | 2.1 |

Table of Contents

| | For the year ended December 31, | | | |
|---|---|---|---|---|
| | 2003 | 2004 | 2005 | |
| | (in billions) | | | |
| | NT$ | NT$ | NT$ | US$ |
| Marketing[(1)] | 20.0 | 19.3 | 23.7 | 0.7 |
| General and administrative[(1)] | 2.7 | 2.5 | 3.5 | 0.1 |
| Research and development[(1)] | 2.6 | 2.5 | 3.1 | 0.1 |
| Depreciation and amortization costs of services | 39.2 | 38.4 | 38.8 | 1.2 |
| Depreciation and amortization operating expenses | 2.4 | 2.3 | 2.4 | 0.1 |
| Total operating costs and expenses | 126.5 | 125.3 | 141.6 | 4.3 |
| Income from operations | 56.0 | 59.9 | 43.1 | 1.3 |
| Other income | 2.2 | 2.7 | 4.0 | 0.1 |
| Other expenses | 0.6 | 0.4 | 1.1 | 0.0 |
| Income before income tax | 57.6 | 62.2 | 46.0 | 1.4 |
| Income tax | 10.3 | 11.3 | 12.7 | 0.4 |
| Net income | 47.3 | 50.9 | 33.3 | 1.0 |

(1) Excludes related depreciation and amortization.

The following table sets forth our revenues, operating costs and expenses, income from operations and other financial data as a percentage of our total revenues for the periods indicated.

| | For the year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| | (as percentages of total revenues) | | |
| **Revenues:** | | | |
| Fixed line | | | |
| Local | 26.5% | 24.3% | 22.1% |
| Domestic long distance | 7.4 | 6.4 | 5.9 |
| International long distance | 8.6 | 8.2 | 7.9 |
| Total fixed line | 42.5 | 38.9 | 35.9 |
| Wireless | | | |
| Cellular | 36.3 | 38.0 | 39.5 |
| Paging | 0.3 | 0.2 | 0.1 |
| Total wireless | 36.6 | 38.2 | 39.6 |
| Internet and data: | | | |
| Internet | 14.2 | 15.9 | 17.3 |
| Data | 5.3 | 5.3 | 5.5 |
| Total Internet and data | 19.5 | 21.2 | 22.8 |
| Other | 1.4 | 1.7 | 1.7 |
| Total revenues | 100.0 | 100.0 | 100.0 |
| Operating costs and expenses: | | | |

| | | | |
|---|---|---|---|
| Costs of services[1] | 32.7 | 32.6 | 38.0 |
| Marketing[1] | 10.9 | 10.4 | 12.8 |
| General and administrative[1] | 1.5 | 1.4 | 1.9 |
| Research and development[1] | 1.4 | 1.3 | 1.7 |
| Depreciation and amortization costs of services | 21.5 | 20.7 | 21.0 |
| Depreciation and amortization operating expenses | 1.3 | 1.3 | 1.3 |
| Total operating costs and expenses | 69.3 | 67.7 | 76.7 |
| Income from operations | 30.7 | 32.3 | 23.3 |
| Other income | 1.2 | 1.5 | 2.2 |
| Other expenses | 0.3 | 0.2 | 0.6 |
| Income before income tax | 31.6 | 33.6 | 24.9 |
| Income tax | 5.7 | 6.1 | 6.9 |
| Net income | 25.9% | 27.5% | 18.0% |

(1) Excludes related depreciation and amortization.

**Year ended December 31, 2004 compared with year ended December 31, 2005**

***Revenues***

Our revenues decreased by 0.3% from NT$185.2 million in 2004 to NT$184.7 billion (US$5.6 billion) in 2005. This decrease was primarily due to a continuous decline in fixed network business and an expansion of the average expected customer service period which affects the revenue from fixed network.

*Fixed Line Services*

Fixed line revenues comprised 38.9% and 35.9% of our revenues in 2004 and 2005, respectively. Our fixed line revenues decreased by 8.0% from NT$72.1 billion in 2004 to NT$66.3 billion (US$2.0 billion) in 2005.

*Local telephone services.* Our local telephone revenues decreased by 9.3% from NT$44.9 billion in 2004 to NT$40.7 billion (US$1.2 billion) in 2005. This decrease was principally a result of a 14.0% decline in traffic volume from 24.5 billion minutes in 2004 to 21.1 billion minutes in 2005. This decline in traffic volume was primarily due to the continued migration of non-HiNet Internet subscribers from dial-up to broadband Internet access, the continued traffic migration from fixed line services to broadband and cellular services, and increasing market competition. We expect this trend to continue as broadband and cellular services become more widely adopted in Taiwan. However, we believe the rate of traffic migration from fixed-line services to broadband and cellular services is slowing. This decline in traffic volume was partially offset by a 2.9% increase in average local usage fees, reflecting a continued decrease in the number of users of our discounted Internet tariff package. The decrease was also due to the expansion of the customer service period from an average of 13 years to 16 years, which has caused a substantial decline in revenues in local telephone connection fees. Our local interconnection revenues decreased by NT$0.1 billion between these two years because of a decrease in local interconnection volume.

*Domestic long distance telephone services.* Our domestic long distance telephone revenues decreased by 8.3% from NT$12.0 billion in 2004 to NT$11.0 billion (US$0.3 million) in 2005. This decrease was mainly due to a decrease in traffic volume from 5.6 billion minutes in 2004 to 5.1 billion minutes in 2005. The decrease in traffic volume was primarily due to the continued traffic migration from fixed line services to broadband and cellular services and increased competition from other fixed line operators. The rate of migration from fixed line services to cellular services has been slowing in the past two years as the cellular market becomes increasingly saturated. Our interconnection revenues also decreased as a result of more direct connections between private operators.

*International long distance telephone services.* Our international long distance telephone revenues decreased by 4.1% from NT$15.2 billion in 2004 to NT$14.6 billion (US$0.4 billion) in 2005. This decrease was mainly due to intense market competition and a decrease in the average per minute usage charge due to promotional packages to encourage usage. This was partially offset by an 8% increase in outgoing traffic volume from 2004 to 2005. Our international settlement revenues decreased by 5.6% from NT$3.5 billion in 2004 to NT$3.3 billion (US$0.1 billion) in 2005. This decrease was primarily due to the continued decline in international settlement rates and translation losses due to fluctuations in foreign exchange rates.

*Wireless Services*

Wireless revenues comprised 38.2% and 39.6% of our revenues in 2004 and 2005, respectively. Our wireless revenues increased by 3.6% from NT$70.6 billion in 2004 to NT$73.1 billion (US$2.2 billion) in 2005. Our cellular services grew as a percentage of our revenues from 38.0% in 2004 to 39.5% in 2005. Our paging services decreased as a percentage of our revenues from 0.2% in 2004 to 0.1% in 2005.

*Cellular services.* Our cellular services revenues increased by 3.9% from NT$70.3 billion in 2004 to NT$73.0 billion (US$2.2 billion) in 2005. This increase was mainly a result of an increase in outgoing traffic volume of 2.9% from 8.7 billion minutes in 2004 to 8.9 billion minutes in 2005, as a result of an increase in the number of customers using monthly rental service.

*Paging services.* Our paging revenues decreased by 55% from NT$0.3 billion in 2004 to NT$0.1 billion (US$4.1 million) in 2005. This decrease was primarily due to a 45.9% decrease in the number of paging subscribers, resulting from continued customer migration to cellular services, as cellular services become more widely adopted in Taiwan.

**Table of Contents**

*Internet and Data Services*

Internet and data revenues comprised 21.2% and 22.8% of our revenues in 2004 and 2005, respectively. Our Internet and data revenues increased by 7.2% from NT$39.3 billion in 2004 to NT$42.2 billion (US$1.3 million) in 2005 due primarily to an increase in our Internet services.

*Internet services.* Our revenues attributable to Internet services increased by 8.6% from NT$29.5 billion in 2004 to NT$32.1 billion (US$1.0 billion) in 2005. This increase was largely due to an increase in the number of our asymmetrical digital subscriber line subscribers from 3.1 million as of December 31, 2004 to 3.7 million as of December 31, 2005. This increase was also due to a 7.6% increase in the number of our HiNet subscribers from 3.8 million as of December 31, 2004 to 4.1 million as of December 31, 2005. Calls to HiNet are recorded as part of our Internet and data services and are not included in our local minutes or revenues. We include usage fees from fixed line telephone calls to access our HiNet service in our Internet and data revenues. Usage fees from fixed line telephone calls to access Internet service providers other than HiNet are recorded as fixed line revenues.

*Data services.* Revenues from our data services increased by 3.0% from NT$9.8 billion in 2004 to NT$10.0 billion (US$0.3 billion) in 2005. This increase was principally due to an increase in revenues from our hiLink virtual private network service. We continue to derive a substantial portion of our data revenues from leased line services. While demand for higher speed lease lines continues to increase, our overall leased line tariffs have continued to be adversely affected by competition from other fixed line operators and international leased line service providers, as well as the continued migration of domestic leased line users to asymmetrical digital subscriber line services. The effects of tariff decreases were generally offset by the continued increase in the usage of our leased line services in 2005.

*Other*

Other revenues comprised 1.7% and 1.7% of our revenues in 2004 and 2005, respectively.

Our other revenues decreased by 2.2% from NT$3.2 billion in 2004 to NT$3.1 billion (US$95.6 million) in 2005. This decrease in other revenues was primarily due to an NT$0.3 billion decrease in revenues from our corporate solution business.

***Operating Costs and Expenses***

Our operating costs and expenses increased by 13.0% from NT$125.3 billion in 2004 to NT$141.6 billion (US$4.3 billion) in 2005. This increase was primarily due to increases in stock compensation expenses and performance-based bonuses. As a percentage of revenues, operating costs and expenses increased from 67.7% in 2004 to 76.7% in 2005.

*Costs of Services*

Costs of services include personnel expenses, international settlement costs, handset subsidies, spectrum usage and license fees, costs of materials and maintenance and interconnection fees among cellular operators.

Our costs of services increased by 16.4% from NT$60.3 billion in 2004 to NT$70.1 billion (US$2.1 billion) in 2005. This increase was principally a result of: (1) an NT$7.2 billion increase in employees purchase of our common shares at discounts; (2) an NT$0.9 billion increase in our handset subsidies; (3) an NT$0.8 billion increase in performance-based bonuses; and (4) an NT$0.3 billion impairment loss on long-term assets. We recognize compensation expense when our employees purchase our common shares at discounts under the priority share subscription program.

*Marketing*

Our marketing expenses, which include personnel expenses, provisions for bad debt and expenses relating to advertising and other marketing-related activities, increased by 22.6% from to NT$19.3 billion in 2004 to NT$23.7 billion (US$0.7 billion) in 2005. This increase was mainly due to (1) an NT$4.0 billion increase in employees purchase of our common shares at discounts; and (2) an NT$0.4 billion increase in performance-based bonuses. We recognize compensation expense when our employees purchase our common shares at discounts under the priority share subscription program.

**Table of Contents**

*General and Administrative*

Our general and administrative expenses increased by 37.5% from NT$2.5 billion in 2004 to NT$3.5 billion (US$0.1 billion) in 2005. This increase was primarily due to (1) an increase of NT$0.7 billion in compensation expense arising under our employee priority share subscription program; and (2) an increase of NT$76 million in performance-based bonuses. We recognize compensation expense when our employees purchase our common shares at discounts under the priority share subscription program. The higher compensation expense in 2005 was largely due to an increase in such purchases by our employees compared to 2004.

*Research and Development*

Our research and development expenses increased by 27.0% from NT$2.5 billion in 2004 to NT$3.1 billion (US$0.1 billion) in 2005. This increase was primarily due to (1) an increase of NT$0.5 billion in compensation expense arising under our employee priority share subscription program, and (2) an increase of NT$74 million in performance-based bonuses. Our research and development expenses increased as a percentage of our revenues from 1.3% in 2004 to 1.7% in 2005. We recognize compensation expense when our employees purchase our common shares at discounts under the priority share subscription program. The higher compensation expense in 2005 was largely due to an increase in such purchases by our employees compared to 2004.

*Depreciation and Amortization*

Our depreciation and amortization expenses increased by 1.1% from NT$40.7 billion in 2004 to NT$41.2 billion (US$1.3 billion) in 2005. This increase was mainly due to the amortization of our 3G licence.

***Operating Costs and Expenses by Business Segment***

| | Local | Domestic Long Distance | International Long Distance | Wireless[1] | Internet and Data | Other | Total |
|---|---|---|---|---|---|---|---|
| | | | (in billions of NT$) | | | | |
| **As of and for the year ended December 31, 2005** | | | | | | | |
| Operating costs and expenses | 36.7 | 1.7 | 7.8 | 23.7 | 22.9 | 2.6 | 95.4 |
| Unallocated corporate expenses | | | | | | | 5 |
| Total operating costs and expenses | | | | | | | 100.4 |
| Depreciation and amortization | 19.0 | 0.7 | 0.7 | 7.6 | 12.4 | 0.6 | 41.0 |
| Unallocated corporate expenses | | | | | | | 0.1 |
| Total depreciation and amortization | | | | | | | 41.1 |
| **As of and for the year ended December 31, 2004** | | | | | | | |
| Operating costs and expenses | 32.8 | 1.4 | 7.7 | 20.4 | 16.6 | 1.7 | 80.6 |
| Unallocated corporate expenses | | | | | | | 4.0 |
| Total operating costs and expenses | | | | | | | 84.6 |
| Depreciation and amortization | 20.0 | 0.8 | 0.7 | 6.2 | 12.4 | 0.5 | 40.6 |
| Unallocated corporate expenses | | | | | | | 0.1 |

| | |
|---|---|
| Total depreciation and amortization | 40.7 |

---

(1) Includes cellular and paging services.

*Local telephone services*

Our local telephone operating expenses, excluding depreciation and amortization, increased by 11.9% from NT$32.8 billion in 2004 to NT$36.7 billion (US$1.1 billion) in 2005. This increase was primarily due to an NT$4.5 billion increase in employees purchase of our common shares at discount. Our depreciation and amortization expenses relating to local telephone services decreased by 4.9 % from NT$20.0 billion in 2004 to NT$19.0 billion (US$0.6 billion) in 2005. The decrease was a result of a decrease in depreciation and amortization expenses because of an increase in obsolete equipment.

*Domestic long distance telephone services*

Our domestic long distance telephone operating expenses, excluding depreciation and amortization, increased by 22.8% from NT$1.4 billion in 2004 to NT$1.7 billion (US$51.2 million) in 2005. The increase was primarily due to an NT$0.2 billion increase in the employees purchase of our common shares at discount. Our depreciation and amortization expenses relating to domestic long distance telephone services decreased by 12.7% from NT$0.8 billion in 2004 to NT$0.7 billion (US$21.9 million) in 2005. The decrease in depreciation and amortization expenses was mainly due to a slow-down of our upgrading equipment.

*International long distance telephone services*

Our international long distance telephone operating expenses, excluding depreciation and amortization, increased by 1.0% from NT$7.7 billion in 2004 to NT$7.8 billion (US$0.2 billion) in 2005. The increase was primarily due to an NT$0.35 billion increase in the employees purchase of our common shares at discounts. Our depreciation and amortization expenses relating to international long distance telephone services remained flat at NT$0.7 billion in 2004 and in 2005.

*Wireless Services*

Our wireless operating expenses, excluding depreciation and amortization, increased by 16.4% from NT$20.4 billion in 2004 to NT$23.7 billion (US$0.7 billion) in 2005. This increase was primarily due to (1) an NT$1.2 billion increase in the employees purchase of our common shares at discounts; (2) an NT$1 billion increase in marketing expenses. Our depreciation and amortization expenses relating to wireless services increased by 23% from NT$6.2 billion in 2004 to NT$7.6 billion (US$0.2 billion) in 2005. The increase was mainly due to (1) an NT$1.0 billion increase in depreciation caused by purchases of new equipment such as mobile exchangers and signal transmitters and receivers; and (2) an NT$0.4 billion increase in amortization of 3G license fees.

*Internet and Data Services*

Our Internet and data operating expenses, excluding depreciation and amortization, increased by 37.3% from NT$16.6 billion in 2004 tp NT$22.9 billion (US$0.7 billion) in 2005. This increase was primarily due to an NT$5.3 billion increase in the employees purchase of our common shares at discounts. Our depreciation and amortization expenses relating to Internet and data services increased by 0.2% from NT$12.4 billion in 2004 to NT$12.4 billion (US$0.4 billion) in 2005.

***Operating Income and Operating Margin***

As a result of the foregoing, our operating income decreased by 28% from NT$59.9 billion in 2004 to NT$43.1 billion (US$1.3 billion) in 2005. Our operating margin decreased from 32.3% in 2004 to 23.3% in 2005.

The following table sets forth certain information regarding our operating income by business segment for the periods indicated.

| | Local | Domestic Long Distance | International Long Distance | Wireless[1] | Internet and Data | Other | Total |
|---|---|---|---|---|---|---|---|
| | | | | (in billions) | | | |
| **As of and for the year ended December 31, 2005** | | | | | | | |
| **Income from operations** | (1.7) | 7.6 | 2.9 | 29.1 | 10.9 | (0.6) | 48.2 |
| Elimination of intersegment income | (13.3) | 1.0 | 3.2 | 12.7 | (4.0) | 0.4 | |
| | (15.0) | 8.6 | 6.1 | 41.8 | 6.9 | (0.2) | 48.2 |
| Unallocated corporate expenses | | | | | | | (5.1) |
| Total income from operations | | | | | | | 43.1 |
| **As of and for the year ended December 31, 2004** | | | | | | | |
| Income from operations | 5.4 | 8.4 | 3.8 | 32.2 | 13.5 | 0.7 | 64.0 |
| Elimination of intersegment income | (13.3) | 1.4 | 3.0 | 11.8 | (3.2) | 0.3 | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | (7.9) | 9.8 | 6.8 | 44.0 | 10.3 | 1.0 | 64.0 |
| Unallocated corporate expenses | | | | | | | (4.1) |
| Total income from operations | | | | | | | 59.9 |

(1) Includes cellular and paging services.

As a result of the foregoing, in 2004 compared to 2005 (1) operating loss for our local telephone services increased by 90.5% from NT$7.9 billion to NT$15.0 billion (US$457.9 million); (2) operating income for our domestic long distance telephone services decreased by 12.3% from NT$9.8 billion to NT$8.6 billion (US$260.7 million); (3) operating income for our international long distance telephone services decreased by 10.3% from NT$6.8 billion to NT$6.1 billion (US$187.4 million); (4) operating income for our wireless services decreased by 5% from NT$44.0 billion to NT$41.8 billion (US$1.3 billion); and (5) operating income for our Internet and data services decreased by 33.1% from NT$10.3 billion to NT$6.9 billion (US$209.7 million).

62

Table of Contents

Our management evaluates our business segments taking into account internal and inter-segment costs and revenues. All of our business lines, particularly local telephone, domestic long distance telephone and international long distance telephone services, operate as an integrated business unit. Therefore, we have shown the inter-segment income in the above table.

***Other Income and Other Expenses***

Our other income increased by 48.3% from NT$2.7 billion in 2004 to NT$4.0 billion (US$0.1 billion) in 2005. This increase was primarily due to (1) an NT$301 million gain on disposal of property, plant and equipment; (2) an NT$255 million increase in penalties income; and (3) an NT$228 million increase in interest income.

Our other expenses increased by 163.8% from NT$0.4 billion in 2004 to NT$1.1 billion (US$34 million) in 2005. This increase was largely due to a NT$740 million increase in impairment loss on our long-term investment in the Taipei 101 building.

***Income Tax***

Our income tax was NT$11.3 billion in 2004, compared to NT$12.7 billion (US$388 million) in 2005. Our effective tax rate was 18.1% in 2004 and 27.7% in 2005.

***Net Income***

As a result of the foregoing, our net income decreased by 34.6% from NT$50.9 billion in 2004 to NT$33.3 billion (US$1.0 billion) in 2005. Our net margin was 27.5% in 2004 and 18.0% in 2005.

**Year ended December 31, 2003 compared with year ended December 31, 2004**

***Revenues***

Our revenues increased by 1.5% from NT$182.5 billion in 2003 to NT$185.2 billion in 2004. This increase was primarily due to increases in revenues from our cellular services and our Internet and data services, which were partially offset by a continued decrease in revenues from our fixed line services.

*Fixed Line Services*

Fixed line revenues comprised 42.5% and 38.9% of our revenues in 2003 and 2004, respectively. Our fixed line revenues decreased by 7.0% from NT$77.5 billion in 2003 to NT$72.1 billion in 2004.

*Local telephone services.* Our local telephone revenues decreased by 7.2% from NT$48.4 billion in 2003 to NT$44.9 billion in 2004. This decrease was principally a result of a 15.7% decline in traffic volume from 29.1 billion minutes in 2003 to 24.5 billion minutes in 2004. This decline in traffic volume was primarily due to the continued migration of non-HiNet Internet subscribers from dial-up to broadband Internet access, the continued traffic migration from fixed line services to broadband and cellular services, and increasing market competition. We expect this trend to continue as broadband and cellular services become more widely adopted in Taiwan. However, we believe the rate of traffic migration from fixed-line services to broadband and cellular services is slowing. This decline in traffic volume was partially offset by a 4.6% increase in average local usage fees, reflecting a continued decrease in the number of users of our discounted Internet tariff package. Our local interconnection revenues decreased by NT$0.2 billion between these two periods because of a decrease in interconnection fee rates in early 2004.

*Domestic long distance telephone services.* Our domestic long distance telephone revenues decreased by 11.1% from NT$13.4 billion in 2003 to NT$12.0 billion in 2004. This decrease was mainly due to a decrease in traffic volume from 6.2 billion minutes in 2003 to 5.6 billion minutes in 2004. The decrease in traffic volume was primarily due to the continued traffic migration from fixed line services to broadband and cellular services and increased competition from other fixed line operators. The rate of migration from fixed line services to cellular services has been slowing in the past two years as the cellular market becomes increasingly saturated. Our interconnection revenues also decreased as a result of lower interconnection fee rates and more direct connections between private operators.

63

**Table of Contents**

*International long distance telephone services.* Our international long distance telephone revenues decreased by 2.9% from NT$15.7 billion in 2003 to NT$15.2 billion in 2004. This decrease was mainly due to intense market competition and a decrease in the average per minute usage charge due to promotional packages to encourage usage. This was partially offset by a slight increase in traffic volume from 2003 to 2004. Our international settlement revenues decreased by 7.5% from NT$3.8 billion in 2003 to NT$3.5 billion in 2004. This decrease was primarily due to the continued decline in international settlement rates and translation losses due to fluctuations in foreign exchange rates.

*Wireless Services*

Wireless revenues comprised 36.6% and 38.2% of our revenues in 2003 and 2004, respectively. Our wireless revenues increased by 5.7% from NT$66.8 billion in 2003 to NT$70.6 billion in 2004. Our cellular services grew as a percentage of our revenues from 36.3% in 2003 to 38.0% in 2004. Our paging services decreased as a percentage of our revenues from 0.3% in 2003 to 0.2% in 2004.

*Cellular services.* Our cellular services revenues increased by 6.2% from NT$66.2 billion in 2003 to NT$70.3 billion in 2004. This increase was mainly a result of an increase in outgoing traffic volume of 12.0%, from 7.7 billion minutes in 2003 to 8.7 billion minutes in 2004, as a result of various promotions and packaged rates.

*Paging services.* Our paging revenues decreased by 49.7% from NT$0.6 billion in 2003 to NT$0.3 billion in 2004. This decrease was primarily due to a 43.7% decrease in the number of paging subscribers, resulting from continued customer migration to cellular services, as cellular services become more widely adopted in Taiwan.

*Internet and Data Services*

Internet and data revenues comprised 19.5% and 21.2% of our revenues in 2003 and 2004, respectively. Our Internet and data revenues increased by 10.5% from NT$35.6 billion in 2003 to NT$39.3 billion in 2004. This increase was principally due to the continued growth of our Internet services business.

*Internet services.* Our revenues attributable to Internet services increased by 13.9% from NT$25.9 billion in 2003 to NT$29.5 billion in 2004. This increase was largely due to an increase in the number of our asymmetrical digital subscriber line subscribers from 2.4 million as of December 31, 2003 to 3.1 million as of December 31, 2004. This increase was also due to a 7.6% increase in the number of our HiNet subscribers from 3.6 million as of December 31, 2003 to 3.8 million as of December 31, 2004. Calls to HiNet are recorded as part of our Internet and data services and are not included in our local minutes or revenues. We include usage fees from fixed line telephone calls to access our HiNet service in our Internet and data revenues. Usage fees from fixed line telephone calls to access Internet service providers other than HiNet are recorded as fixed line revenues.

*Data services.* Revenues from our data services increased by 1.4% from NT$9.7 billion in 2003 to NT$9.8 billion in 2004. This increase was principally due to a slight increase in revenues from our hiLink virtual private network service. We continue to derive a substantial portion of our data revenues from leased line services. While demand for higher speed lease lines continues to increase, our overall leased line tariffs have continued to be adversely affected by competition from other fixed line operators and international leased line service providers, as well as the continued migration of domestic leased line users to asymmetrical digital subscriber line services. The effects of tariff decreases were generally offset by the continued increase in the usage of our leased line services in 2004.

*Other*

Other revenues comprised 1.4% and 1.7% of our revenues in 2003 and 2004, respectively.

Our other revenues increased by 23.6% from NT$2.6 billion in 2003 to NT$3.2 billion in 2004. This increase in other revenues was primarily due to an increase in revenues from our multimedia on demand services, which were launched in March 2004.

**Table of Contents**

***Operating Costs and Expenses***

Our operating costs and expenses decreased by 1.0% from NT$126.5 billion in 2003 to NT$125.3 billion in 2004. This decrease was primarily due to decreases in marketing expenses and depreciation and amortization. As a percentage of revenues, operating costs and expenses decreased from 69.3% in 2003 to 67.7% in 2004.

*Costs of Services*

Costs of services include personnel expenses, international settlement costs, handset subsidies, spectrum usage and license fees, costs of materials and maintenance and interconnection fees among cellular operators.

Our costs of services increased by 1.0% from NT$59.6 billion in 2003 to NT$60.3 billion in 2004. This increase was principally a result of: (1) an increase in our costs of services, other than personnel expenses, of 3.6% from NT$33.8 billion in 2003 to NT$35.0 billion in 2004, which was primarily due to a NT$1.0 billion increase in interconnection fees among cellular operators and a NT$0.6 billion increase in costs of materials; and (2) a decrease in our personnel expenses, excluding pension costs, of 3.7% from NT$23.3 billion in 2003 to NT$22.5 billion in 2004, which was primarily due to a decrease of NT$0.8 billion in compensation expense arising under our employee priority share subscription program. We recognize compensation expense when our employees purchase our common shares at certain discounted prices under the priority share subscription program. The lower compensation expense in 2004 was largely due to a decrease in such purchases by our employees compared to 2003.

*Marketing*

Our marketing expenses, which include personnel expenses, provisions for bad debt and expenses relating to advertising and other marketing-related activities, decreased by 3.5% from NT$20.0 billion in 2003 to NT$19.3 billion in 2004. Our personnel expenses, excluding pension costs, increased by 1.3% from NT$9.5 billion in 2003 to NT$9.6 billion in 2004. This increase was mainly due to a NT$0.6 billion increase in salaries and bonuses attributable to an increase in the number of marketing personnel, which was partially offset by a decrease of NT$0.4 billion in compensation expense arising under our employee priority share subscription program. We recognize compensation expense when our employees purchase our common shares at certain discounted prices under the priority share subscription program. The lower compensation expense in 2004 was largely due to a decrease in such purchases by our employees compared to 2003. Our marketing expenses, excluding personnel expenses, decreased by 9.3% from NT$9.3 billion in 2003 to NT$8.5 billion in 2004. This decrease was primarily due to: (1) a NT$1.7 billion decrease in provisions for bad debt due to better collection and stricter credit review of new clients; and (2) a NT$0.7 billion increase in business advertising fees for our cellular, HiNet and asymmetrical digital subscriber line services.

*General and Administrative*

Our general and administrative expenses decreased by 6.5% from NT$2.7 billion in 2003 to NT$2.5 billion in 2004. This decrease was primarily due to a decrease of NT$97 million in compensation expense arising under our employee priority share subscription program. We recognize compensation expense when our employees purchase our common shares at certain discounted prices under the priority share subscription program. The lower compensation expense in 2004 was largely due to a decrease in such purchases by our employees compared to 2003.

*Research and Development*

Our research and development expenses decreased by 4.1% from NT$2.6 billion in 2003 to NT$2.5 billion in 2004. This decrease was primarily due to a decrease of NT$94 million in compensation expense arising under our employee priority share subscription program. Our research and development expenses decreased as a percentage of our revenues from 1.4% in 2003 to 1.3% in 2004. We recognize compensation expense when our employees purchase our common shares at certain discounted prices under the priority share subscription program. The lower compensation expense in 2004 was largely due to a decrease in such purchases by our employees compared to 2003.

*Depreciation and Amortization*

Our depreciation and amortization expenses decreased by 2.1% from NT$41.6 billion in 2003 to NT$40.7 billion in 2004. This decrease was due to fewer purchases of new equipment and an increase in equipment retired in 2004 as compared to 2003.

***Operating Costs and Expenses by Business Segment***

| | Local | Domestic Long Distance | International Long Distance | Wireless[1] | Internet and Data | Other | Total |
|---|---|---|---|---|---|---|---|
| | | | (in billions of NT$) | | | | |
| **As of and for the year ended December 31, 2004** | | | | | | | |
| Operating costs and expenses | 32.8 | 1.4 | 7.7 | 20.4 | 16.6 | 1.7 | 80.6 |
| Unallocated corporate expenses | | | | | | | 4.0 |
| Total operating costs and expenses | | | | | | | 84.6 |
| Depreciation and amortization | 20.0 | 0.8 | 0.7 | 6.2 | 12.4 | 0.5 | 40.6 |
| Unallocated corporate expenses | | | | | | | 0.1 |
| Total depreciation and amortization | | | | | | | 40.7 |
| **As of and for the year ended December 31, 2003** | | | | | | | |
| Operating costs and expenses | 32.2 | 1.9 | 8.3 | 20.9 | 16.7 | 1.1 | 81.1 |
| Unallocated corporate expenses | | | | | | | 3.8 |
| Total operating costs and expenses | | | | | | | 84.9 |
| Depreciation and amortization | 22.1 | 1.3 | 0.6 | 5.8 | 10.8 | 0.8 | 41.4 |
| Unallocated corporate expenses | | | | | | | 0.2 |
| Total depreciation and amortization | | | | | | | 41.6 |

(1) Includes cellular and paging services.

*Local telephone services*

Our local telephone operating expenses, excluding depreciation and amortization, increased by 1.9% from NT$32.2 billion in 2003 to NT$32.8 billion in 2004. This increase was primarily due to an increase in our pension costs. Our depreciation and amortization expenses relating to local telephone services decreased by 9.4% from NT$22.1 billion in 2003 to NT$20.0 billion in 2004. The decrease was mainly as a result of the continued reallocation of network equipment originally dedicated to our local telephone services to our asymmetrical digital subscriber line services.

*Domestic long distance telephone services*

Our domestic long distance telephone operating expenses, excluding depreciation and amortization, decreased by 26.7% from NT$1.9 billion in 2003 to NT$1.4 billion in 2004. Our depreciation and amortization expenses relating to domestic long distance telephone services decreased by 37.4% from NT$1.3 billion in 2003 to NT$0.8 billion in 2004. These decreases were primarily due to a decrease in personnel as well as depreciation and amortization expenses allocated to our domestic long distance telephone services as a result of the decline in revenues from this business in 2004 compared to 2003, and a decrease in provisions for bad debt.

*International long distance telephone services*

Our international long distance telephone operating expenses, excluding depreciation and amortization, decreased by 7.1% from NT$8.3 billion in 2003 to NT$7.7 billion in 2004. This decrease was principally a result of: (1) a NT$0.3 billion decrease in usage charges as a result of lower international tariffs; and (2) a decrease of NT$0.1 billion in provisions for bad debt. Our depreciation and amortization expenses relating to international long distance telephone services increased by 9.1% from NT$0.6 billion in 2003 to NT$0.7 billion in 2004. This increase was primarily due to an increase in purchases of equipment related to international long distance telephone services.

*Wireless Services*

Our wireless operating expenses, excluding depreciation and amortization, decreased by 2.5% from NT$20.9 billion in 2003 to NT$20.4 billion in 2004. This decrease was primarily due to a NT$1.7 billion decrease in provisions for bad debt and a NT$0.2 billion decrease in paging costs, partially offset by a NT$0.3 billion increase in personnel expenses as a result of an increase in the number of staff allocated and a NT$0.8 billion increase in interconnection fees paid to other cellular operators. Our depreciation and amortization expenses relating to wireless services increased by 6.2% from NT$5.8 billion in 2003 to NT$6.2 billion in 2004. This increase was primarily due to new purchases of mobile exchanges and asymmetrical digital subscriber line signal transmitters and receivers.

**Table of Contents**

*Internet and Data Services*

Our Internet and data operating expenses, excluding depreciation and amortization, were relatively constant at NT$16.7 billion and NT$16.6 billion in 2003 and 2004, respectively. Our depreciation and amortization expenses relating to Internet and data services increased by 14.4% from NT$10.8 billion in 2003 to NT$12.4 billion in 2004. This increase was primarily due to an increase in purchases of Internet value-added equipment and asymmetrical digital subscriber line equipment.

***Operating Income and Operating Margin***

As a result of the foregoing, our operating income increased by 7.0% from NT$56.0 billion in 2003 to NT$59.9 billion in 2004. Our operating margin increased from 30.7% in 2003 to 32.3% in 2004.

The following table sets forth certain information regarding our operating income by business segment for the periods indicated.

| | Local | Domestic Long Distance | International Long Distance | Wireless[1] | Internet and Data | Other | Total |
|---|---|---|---|---|---|---|---|
| | | | (in billions) | | | | |
| **As of and for the year ended December 31, 2004** | | | | | | | |
| Income from operations | 5.4 | 8.4 | 3.8 | 32.2 | 13.5 | 0.7 | 64.0 |
| Elimination of intersegment income | (13.3) | 1.4 | 3.0 | 11.8 | (3.2) | 0.3 | |
| | (7.9) | 9.8 | 6.8 | 44.0 | 10.3 | 1.0 | 64.0 |
| Unallocated corporate expenses | | | | | | | (4.1) |
| Total income from operations | | | | | | | 59.9 |
| **As of and for the year ended December 31, 2003** | | | | | | | |
| Income from operations | 7.5 | 8.1 | 3.8 | 27.8 | 12.3 | 0.5 | 60.0 |
| Elimination of intersegment income | (13.4) | 2.1 | 3.0 | 12.3 | (4.2) | 0.2 | |
| | (5.9) | 10.2 | 6.8 | 40.1 | 8.1 | 0.7 | 60.0 |
| Unallocated corporate expenses | | | | | | | (4.0) |
| Total income from operations | | | | | | | 56.0 |

(1) Includes cellular and paging services.

As a result of the foregoing, in 2003 compared to 2004: (1) operating loss for our local telephone services increased by 34.4% from NT$5.9 billion to NT$7.9 billion; (2) operating income for our domestic long distance telephone services decreased by 4.9% from NT$10.2 billion to NT$9.8 billion; (3) operating income for our international long distance telephone services was NT$6.8 billion and NT$6.8 billion, respectively; (4) operating income for our wireless services increased by 9.9% from NT$40.1 billion to NT$44.0 billion; and (5) operating income for our Internet and data services increased by 27.5% from NT$8.1 billion to NT$10.3 billion.

Our management evaluates our business segments taking into account internal and inter-segment costs and revenues. All of our business lines, particularly local telephone, domestic long distance telephone and international long distance telephone services, operate as an integrated business unit. Therefore, we have shown the inter-segment income in the above table.

***Other Income and Other Expenses***

Our other income increased by 23.4% from NT$2.2 billion in 2003 to NT$2.7 billion in 2004. This increase was primarily due to (1) a NT$270 million increase in income from the sale of scrap materials and (2) a NT$124 million increase in interest income resulting from a combination of a rise in interest rates and our increased cash position.

Our other expenses decreased by 23.9% from NT$0.6 billion in 2003 to NT$0.4 billion in 2004. This decrease was largely due to a NT$143 million decrease in charitable donations.

***Income Tax***

Our income tax was NT$10.3 billion in 2003, compared to NT$11.3 billion in 2004. Our effective tax rate was 17.9% in 2003 and 18.1% in 2004.

Table of Contents

*Net Income*

As a result of the foregoing, our net income increased by 7.6% from NT$47.3 billion in 2003 to NT$50.9 billion in 2004. Our net margin was 25.9% in 2003 and 27.5% in 2004.

**B. Liquidity and Capital Resources**

**Liquidity**

The following table sets forth the summary of our cash flows for the periods indicated:

| | For the year ended December 31, | | | |
|---|---|---|---|---|
| | 2003 | 2004 | 2005 | |
| | (in billions) | | | |
| | NT$ | NT$ | NT$ | US$ |
| Net cash provided by operating activities | 93.6 | 91.6 | 86.2 | 2.6 |
| Net cash used in investing activities | (32.2) | (32.4) | (28.0) | (0.8) |
| Net cash used in financing activities | (55.5) | (43.4) | (45.6) | (1.4) |
| Net increase in cash and cash equivalents | 5.9 | 15.8 | 12.6 | 0.4 |
| Cash and cash equivalents at beginning of period | 7.6 | 13.5 | 29.3 | 0.9 |
| Cash and cash equivalents at end of period | 13.5 | 29.3 | 41.9 | 1.3 |

Our primary source of liquidity is cash flow from operations, which represents operating profit adjusted for non-cash items, primarily depreciation and amortization and changes in current assets and liabilities. We believe that our working capital is sufficient for our present requirements.

In 2005, our net cash provided by operating activities totaled NT$86.2 billion (US$2.6 billion), compared with NT$91.6 billion in 2004. This decrease was primarily due to a decrease in net income. In 2004, our net cash provided by operating activities totaled NT$91.6 billion compared with NT$93.6 billion in 2003. This decrease was primarily due to a decrease of NT$5.3 billion in accrued pension liabilities, partially offset by an increase of NT$3.6 billion in net income.

Historically, net cash provided by operating activities has been sufficient to cover our capital expenditures, including the ongoing expansion and modernization of our networks. Our net cash used in investing activities decreased from NT$32.4 billion in 2004 to NT$28.0 billion (US$0.8 billion) in 2005, principally as a result of an NT$4.3 billion decrease in purchases and sales of short-term investments. Our net cash used in investing activities increased from NT$32.2 billion in 2003 to NT$32.4 billion in 2004, principally as a result of a NT$9.1 billion increase in purchases and sales of short-term investments and a NT$0.5 billion increase in acquisition of investments in unconsolidated companies, offset by a NT$9.4 billion decrease in acquisition of property, plant and equipment.

In 2005, our net cash used in financing activities totaled NT$45.6 billion (US$1.4 billion), which reflected NT$45.3 billion of payment of dividends during that period. In 2004, our net cash used in financing activities totaled NT$43.4 billion, which reflected NT$43.4 billion of payment of dividends during that period. In 2003, our net cash used in financing activities totaled NT$55.5 billion, primarily due to NT$38.6 billion of payment of dividends and a NT$17.0 billion payment of long-term loans during that period.

**Capital Resources**

We have historically financed our capital expenditure requirements with our cash flows from operations.

In future years, we expect to have capital expenditure requirements for the ongoing expansion and upgrade of our networks combined with anticipated outlays for the introduction of new services, including our third generation cellular services. We also expect to make dividend payments on an ongoing basis. See Item 8. Financial Information A. Consolidated Statements and Other Financial Information. Furthermore, we may require working capital from time to time to finance purchases of materials for our maintenance and other overhead expenses. We expect to primarily rely on cash generated from operations and, to a lesser extent, loans from commercial banks to meet our planned capital expenditures, planned dividend payments, repay debts and fulfill other commitments over the next 12 months.

Table of Contents

As of December 31, 2005, our primary source of liquidity was NT$41.9 billion (US$1.3 billion) of cash and cash equivalents. Our long-term loans are revolving facilities with a term of five years ending in March 2007. We are not subject to any covenants under any of our long-term loan facilities.

In 1995, we and several other utilities in Taiwan that are controlled by the Republic of China government contributed to a fund that allows each of these utilities to borrow funds on an interest-free basis, up to the amount such utility contributed, for the purpose of pipeline construction in connection with its business. As of December 31, 2005, we have contributed NT$2.0 billion to this fund, and are not required to make any additional contributions in the future. As of December 31, 2005, we had total outstanding borrowings of NT$0.5 billion from this fund (including NT$0.2 billion due within one year). We are not required to provide any collateral to secure these borrowings.

We have a revolving credit facility with a term of one year. As of December 31, 2005, we had not made any drawdowns under this facility. We are not subject to any covenants for borrowings under this facility. In the past, we had from time to time issued commercial paper to fund our working capital needs. In 2005, we did not issue any commercial paper. We may issue commercial paper in the future for our short-term cash requirements.

We have not entered into any financial guarantees or similar commitments to guarantee the payment obligations of third parties. In addition, we do not have any written options on non-financial assets.

**Capital Expenditures**

The following table sets forth a summary of our capital expenditures, according to our principal lines of business, for the periods indicated.

| | For the year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2003 | | 2004 | | 2005 | |
| | (in billions of NT$, except percentages) | | | | | |
| **Capital Expenditures** | | | | | | |
| Fixed line | 9.3 | 28.8% | 5.0 | 22.0% | 5.2 | 22.5% |
| Cellular | 7.9 | 24.6 | 5.5 | 24.1 | 4.4 | 19.4 |
| Internet and data | 14.3 | 44.3 | 11.6 | 50.6 | 12.7 | 55.4 |
| Others | 0.7 | 2.3 | 0.8 | 3.3 | 0.6 | 2.7 |
| Total capital expenditures | 32.2 | 100.0% | 22.9 | 100.0% | 22.9 | 100.0% |

The following table sets forth a summary of our planned capital expenditures, according to our principal lines of business, for the year ending December 31, 2006.

| | For the Year ending December 31, 2006 (in billions of NT$, except percentages) | |
|---|---|---|
| **Capital Expenditures** | | |
| Fixed line | 4.71 | 18.0% |
| Cellular | 7.59 | 29.0 |
| Internet and data | 13.39 | 51.1 |
| Others | 0.49 | 1.9 |
| Total capital expenditures | 26.18 | 100.0% |

We expect fixed line investments to account for an increasingly smaller portion of our capital expenditures, and we expect cellular and Internet and data investments to account for an increasingly larger portion of our capital expenditures. We expect to incur aggregate expenses of NT$12.0 billion in connection with the construction of our third generation cellular network, which will include approximately 2,800 base stations and has a planned capacity for 2.4 million lines. Of these expected aggregate expenses of NT$12.0 billion, we incurred expenses of NT$3.3 billion and NT$205 billion in 2004 and 2005, respectively. We expect to incur another NT$4.68 billion of expenses in 2006.

We expect our total capital expenditures to rise in future periods, because of: (1) the launch of new businesses, including multimedia on demand, asymmetrical digital subscriber line, fiber-to-the-building services, voice over Internet protocol and third generation cellular telephone services; (2) the implementation of a network modernization program, including the planned migration of our fixed line networks to Internet protocol next generation networks; and (3) the need to replace outdated equipment.

Table of Contents

**Inflation/Deflation**

We do not believe that deflation or inflation in Taiwan has had a material impact on our results of operations.

**Recent Accounting Pronouncements**

In December 2004, the FASB issued SFAS No. 123(R) Share-Based Payment. SFAS No. 123(R) requires that companies recognize compensation expense equal to the fair value of stock options or other share based payments for the annual reporting period beginning after June 15, 2005. SFAS No. 123(R) applies to all awards granted after January 1, 2006, and prior periods awards that are modified, repurchased, or cancelled after January 1, 2006. There is no impact on us as a result of this standard as we do not currently issue stock options to our employees or others.

In May 2005, the FASB issued SFAS No. 154 Accounting Changes and Error Corrections. SFAS No. 154 requires that companies apply accounting changes and error corrections to financial statements retrospectively from previous period unless it is impracticable. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. There is no impact on us as a result of the adoption of this standard as we do not currently intend to change our accounting principles, estimate or reporting entity.

**C. Research, Development, Patents and Licenses, Etc.**

**Research and Development**

Our research and development efforts are focused on the development of advanced network services and operation technologies as well as the development of core technologies for the domestic telecommunications market. For 2003, 2004 and 2005, our research and development expenses excluding depreciation and amortization were approximately NT$2.6 billion, NT$2.5 billion and NT$3.1 billion (US$0.1 billion), respectively, or 1.4%, 1.3% and 1.7% of our revenues, respectively.

We currently have more than 1,170 researchers focusing on the following areas:

- wireless communication;
- broadband transmission and access;
- Internet and multimedia applications;
- network operation support;
- customer service information;
- advanced technologies research; and
- customer premises equipment.

We have developed a number of advanced network services, operation technologies and applications and value-added services, including our asymmetrical digital subscriber line deployment, Internet-based call center, e-commerce platform, global standard for mobile communications billing system, a new telecommunications operation service system for all business units of our company, government public key infrastructure, a leased line testing and monitoring system and an intelligent transportation system. As of December 31, 2005, we have been granted 270 domestic patents and 18 foreign patents.

**D. Trend Information**

See Overview for a discussion of the most significant recent trends that have had, and in the future may have, a material impact on our results of operations, financial condition and capital expenditures. In addition, see discussions

Table of Contents

included in this Item for a discussion of known trends, uncertainties, demands, commitments or events that we believe are reasonably likely to have a material effect on our net operating revenues, income from continuing operations, profitability, liquidity or capital resources, or that would cause reported financial information not necessarily to be indicative of future operating results or financial condition.

### E. Off-Balance Sheet Arrangements

We do not have any outstanding derivative financial instruments, off-balance sheet guarantees, interest rate swap transactions or foreign currency forward contracts. We do not engage in trading activities involving non-exchange traded contracts.

### F. Tabular Disclosure of Contractual Obligations

Set forth below are our total contractual obligations as of December 31, 2005.

| | Total | 2006 | 2007 | 2008 | 2009 | After 2009 |
|---|---|---|---|---|---|---|
| | | | (in billions of NT$) | | | |
| **Contractual Obligations** | | | | | | |
| Long-term debt | 0.5 | 0.2 | 0.3 | | | |
| Operating leases | 3.3 | 1.3 | 0.9 | 0.6 | 0.3 | 0.2 |

As of December 31, 2005, we had remaining commitments under non-cancelable contracts with various parties as follows: (1) acquisition of lands and buildings of NT$2.7 billion and (2) acquisition of telecommunications equipment of NT$16.4 billion.

### G. Foreign Exchange

Our revenues and costs and expenses are largely denominated in NT dollars. Our principal expenses denominated in foreign currencies are capital expenditures on telecommunications equipment and settlement payments for the use of networks of carriers in foreign countries for outgoing international calls. Settlement receipts have been a principal source of foreign currency for us. While future fluctuations of the NT dollar against foreign currencies could impact our financial condition and results of operations, we have not to date been materially affected by the fluctuation of the NT dollar against foreign currencies.

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### A. Directors and Senior Management

The following table sets forth the name, age, position and tenure of each of our directors, supervisors and executive officers and such person s position as of March 31, 2006. There is no family relationship among any of these persons. All of our directors and supervisors were elected at our annual general shareholders meeting held on June 25, 2004 and have terms from June 25, 2004 to June 24, 2007.

| Name | Age | Position | Tenure with us |
|---|---|---|---|
| Tan Ho Chen | 56 | Chairman and Chief Executive Officer | 3 years |
| Shyue-Ching Lu | 57 | Director and President | 28 years |
| Oliver F.L. Yu | 60 | Director | 4 years |
| Yu-Huei Jea | 63 | Director | 8 years |
| Jeng-Tsuen Liaw | 63 | Director | 2 years |
| Neng-Pai Lin | 53 | Director | 3 months |
| Chiu-Kuei Huang | 52 | Director | 3 years |
| Lo-Ming Chung | 55 | Director | 3 years |
| Chien-Cheng Lin | 49 | Director | 2 years |
| Jing-Twen Chen(1) | 52 | Director | 5 years |
| Zse-Hong Tsai(1) | 45 | Director | 4 years |
| Joyce H.Y. Jen(1) | 49 | Director | 2 years |
| Hsu-Chung Simon Chang | 47 | Director | 29 years |

| | | | |
|---|---|---|---|
| Judy Fu-meei Ju | 49 | Supervisor | 4 years |
| Ming-Daw Chang | 53 | Supervisor | 3 years |
| Yu-Hsien Lin | 49 | Supervisor | 3 years |

**Table of Contents**

| Name | Age | Position | Tenure with us |
|---|---|---|---|
| Yeong-Chwan Hwang | 51 | Supervisor | 7 years |
| Feng-Hsiung Chang | 61 | Senior Vice President | 36 years |
| Chin-Yi Yue | 64 | Senior Vice President | 39 years |
| Hank Han-Chao Wang | 56 | Chief Financial Officer and Senior Vice President | 31 years |
| Tsung-Yen Chang | 57 | Senior Vice President | 32 years |
| John C.C. Hsueh | 60 | Executive Vice President | 34 years |
| Chun-Ming Hsieh | 62 | Executive Vice President | 38 years |
| Jung-Ho Lee | 62 | Executive Vice President | 35 years |
| Shaio-Tung Chang | 59 | Executive Vice President | 37 years |
| Jen-Hung Lin | 60 | Executive Vice President | 37 years |
| Lai-Shi Chang | 63 | Executive Vice President | 34 years |

(1) Independent director.

**Tan Ho Chen** is our Chairman and Chief Executive Officer. Mr. Ho Chen is also currently an Executive Officer of The National Land Policy Advisory Committee, Office of the President, Republic of China. Mr. Ho Chen was the Executive Vice Minister of the Ministry of Transportation and Communications from 2000 to 2001. Mr. Ho Chen holds a Master s degree in regional and urban planning from Virginia Polytechnic Institute & State University and a Bachelor s degree in civil engineering from the National Chung-Hsing University in Taiwan and studied urban planning while on a Humphrey Fellowship at Hunter College in New York.

**Shyue-Ching Lu** is a director and the President of our company. Dr. Lu was the Director General of the Department of Posts and Communications of the Ministry of Transportation and Communications from 1993 to 1994 and the Deputy Director General of the Directorate General of Telecommunications from 1994 to 1996. Dr. Lu holds a Ph.D. degree in electrical engineering from the University of Hawaii and a Bachelor s degree in engineering from the National Cheng Kung University in Taiwan.

**Oliver F.L. Yu** is a director of our company. Mr. Yu is also currently the Vice Minister of the Ministry of Transportation and Communications. Mr. Yu was the Director of Kaohsiung Harbor Bureau from 1996 to 2001 and the Director General of Civil Aeronautics Administration, Ministry of Transportation and Communications from 2001 to 2002. Mr. Yu holds a Master of Business Administration degree from the Institute of Management Science, National Chiao Tung University and a Bachelor s degree in transportation and communications management science from the National Cheng Kung University in Taiwan.

**Yu-Huei Jea** is a director of our company. Dr. Jea is also a Senior Counselor of the Ministry of Transportation and Communications. Dr. Jea was the Director General of the Department of Posts and Telecommunications from 1994 to 1996 and the Director General of the Directorate General of Telecommunications from 1996 to 1997. Dr. Jea holds a Ph.D. degree from the University of Texas at Austin.

**Jeng-Tsuen Liaw** is a director of our company. Mr. Liaw is also a Director of Personnel Department, the Ministry of Transportation and Communications. He was the Director General of the Department of Manpower of Central Personnel Administration, Executive Yuan from 1995 to 2001. He graduated from the Department of Public Administration and Policy at the National Chung-Hsing University in Taiwan. His specialty field is human resources management.

**Neng-Pai Lin** is a director of our company. Mr. Lin is also a Professor of Health Care Organization Administration at the National Taiwan University. He holds a Ph.D. degree from Ohio State University, majored in Management.

**Chiu-Kuei Huang** is a director of our company. Ms. Huang is also currently the Director of Labor Relations, Department of the Council of Labor Affairs. Ms. Huang was the Director of the Labor Condition Department from 2002 to 2003. She graduated from the Institute of Labor Science, Chinese Culture University, with a Master s degree.

**Lo-Ming Chung** is a director of our company. Mr. Chung is also currently the Executive Vice President of China Steel Corporation. He holds a Master of Business Administration degree from Arizona State University and a Bachelor s degree from National Taiwan University.

**Chien-Cheng Lin** is a director of our company. Since 1991, Dr. Lin has been a Professor of the Department of Materials Science and Engineering, National Chiao Tung University. He is also the Dean of General Affairs at the National

**Table of Contents**

Chiao Tung University. He holds a Ph.D. degree in materials science and engineering from the University of Illinois at Urbana-Champaign, a Bachelor of Science degree in mechanical engineering from the National Taiwan University, and a Master of Science degree in materials science and engineering from the National Sun Yat-Sen University in Taiwan.

**Jing-Twen Chen** is a director of our company. Dr. Chen is also a Professor at the Department of Finance of the National Central University in Taiwan. Dr. Chen holds a Ph.D. degree in finance from the National Taiwan University of Science and Technology.

**Zse-Hong Tsai** is a director of our company. Dr. Tsai is also currently a Professor of Electrical Engineering at the National Taiwan University. His research interest includes broadband networking, performance evaluation and telecommunication regulations. Dr. Tsai holds a Ph.D. degree and a Master of Science degree in electrical engineering from the University of California, and a Bachelor of Science degree in electrical engineering from the National Taiwan University.

**Joyce H.Y. Jen** is a director of our company. Ms. Jen is the founder and a senior partner of Serenity Law Office. She graduated from the National Taiwan University with Bachelor s and Master s degrees in law. She also studied at the Law School of University College London, Great Britain, and the University of Wisconsin. She specializes in commercial law, business law and corporate transactions, construction and public contracts law, intellectual property law and real estate law.

**Hsu-Chung Simon Chang** is a director of our company. Mr. Chang is also President of Chunghwa Telecom Workers Union. He holds a Master s degree of Institute of Public Affair Management of National Sun Yat-Sen University, ROC and a Bachelor s degree in Foreign Languages & Literature, from National Cheng Kung University. Mr. Chang is currently a student in the Ph.D. program at the Institute of Public Affair Management of National Sun Yat-Sen University.

**Judy Fu-meei Ju** is a supervisor of our company. Ms. Ju also serves as the Third Department Director General of the Executive Yuan and as a public prosecutor in the Taiwan Superior Court Prosecutor s Office. Ms. Ju holds a Ph.D. degree in law from the National Taiwan University.

**Ming-Daw Chang** is a supervisor of our company. Mr. Chang is currently the Deputy Director General of Examination Bureau of Financial Supervisory Commission. Mr. Chang has worked for MOF since 1985, BOMA since 1991 and BOE since 2004. Mr. Chang holds a Master s degree in law from the Law Department of the Chinese Culture University in Taiwan.

**Yu-Hsien Lin** is a supervisor of our company. Mr. Lin is currently the Director of the Department of Accounting of the Ministry of Transportation and Communications. Mr. Lin was previously the Director of General Affairs of Directorate General of Budget, Accounting & Statistics, the Executive Yuan. Mr. Lin holds a master degree in Statistics from the National Chung-Hsing University in Taiwan.

**Yeong-Chwan Hwang** is a supervisor of our company. Mr. Hwang is also currently the Director of Accounting Office and the Deputy Director of Accounting Management Center of the Directorate General of Budget, Accounting and Statistics of the Executive Yuan. Mr. Hwang holds a Master s degree from Soochow University and a Bachelor s degree in accounting from the Fu Jen Catholic University, both in Taiwan.

**Feng-Hsiung Chang** is a Senior Vice President of our company. Mr. Chang is also a director of Siemens Telecommunications Systems and Chunghwa Investment Co., Ltd. Mr. Chang served as Deputy Managing Director of the Northern Taiwan Telecommunications Administration from 1994 to 1996. Mr. Chang holds a Bachelor s degree from Chung-Hsing University and a Master of Business Administration degree from the National Chiao Tung University, both in Taiwan.

**Chin-Yi Yue** is a Senior Vice President of our company. Mr. Yue is also a supervisor to the International Telecommunications Development Corp. Mr. Yue served as Vice President for our Long Distance and Mobile Division from 1996 to 2000. Mr. Yue was also a Vice President of our company and the manager of Han-Tong Branch from 2002 to 2004. Mr. Yue holds a Master s degree in electrical engineering from the National Taiwan University.

**Hank Han-Chao Wang** is the Chief Financial Officer and a Senior Vice President of our company. Mr. Wang is also a supervisor of Siemens Telecommunication System Limited and Chunghwa Investment Co., Ltd. Mr. Wang served as the Senior Managing Director of the Finance Department of our company from 2001 to 2005 and has a total working experience of 30 years in our company. Mr. Wang holds a Master s Degree in management science from the National Chiao Tung University in Taiwan.

Table of Contents

**Tsung-yen Chang** is a Senior Vice President of our company. Mr. Chang is also a director of the Taiwan International Standard Electronics Ltd. Mr. Chang served as Assistant Vice President of our company and deputy manager of north district branch from August 2003 to January 2006. Prior to that, he was a Manager of Banciao Operation Department. Mr. Chang holds a Master of Science degree from the National Chiao Tung University.

**John C.C. Hsueh** is an Executive Vice President of our company. Dr. Hsueh served as Vice President of our Northern Taiwan Business Division from 1996 to 1998 and as President of our Telecommunications Laboratories from 1998 to 2000. Dr. Hsueh holds a Ph.D. degree in electrical engineering and computer science from Northwestern University.

**Chun-Ming Hsieh** is an Executive Vice President of our company. Mr. Hsieh served as Deputy Managing Director of the Central Taiwan Telecommunications Administration from 1994 to 1996 and Vice President from 1996 to 2004. Mr. Hsieh holds a Bachelor s degree in electrical engineering from the National Cheng-Kung University and a Master s degree in management science from the National Chiao Tung University, both in Taiwan.

**Jung-Ho Lee** is an Executive Vice President and general manager of south district branch of our company. Mr. Lee is also a director of the International Telecommunications Development Corp. Mr. Lee served as Assistant Vice President and deputy manager of south district branch of our company from September 2004 to January 2006. Prior to that, he was the head of our Legal Department. Mr. Lee graduated from the National Taiwan University with a Master degree in law.

**Shaio-Tung Chang** is an Executive Vice President of our company. Mr. Chang is also a director of Chunghwa Investment Co., Ltd. Mr. Chang was the general manager of our Marketing Department from 1996 to 2001. Mr. Chang holds a Master of Business Administration degree from the National Chiao Tung University in Taiwan.

**Jen-Hung Lin** is an Executive Vice President and general manager of International Branch of our company. Mr. Lin is also a director of the RPTI International Co., Ltd. Mr. Lin served as Assistant Vice President and deputy manager of Mobile Communications branch from July 1996 to January 2006. Mr. Lin graduated from New York Institute of Technology with Master degree in electrical engineering.

**Lai-Shi Chang** is an Executive Vice President of our company. Mr. Chang was the President of our Telecommunication Training Center from 2002 to 2005. Mr. Chang has served in our company for 33 years. Mr. Chang holds a Ph.D. degree in electrical engineering from the National Chiao Tung University in Taiwan.

**B. Compensation**

Our directors and supervisors currently do not receive any compensation in their capacities as such, although they may be reimbursed certain expenses incurred in the performance of their services in accordance with certain administrative directives and rules. The aggregate amount of compensation that we paid to our directors, supervisors and executive officers for services performed as our directors, supervisors, officers or employees was NT$27.9 million, NT$33.2 million and NT$35.6 million (US$1.08 million) in 2003, 2004 and 2005, respectively. None of our directors receives any benefits upon expiration of his or her service as director. Under our articles of incorporation, following our privatization, the compensation of our directors and supervisors may not exceed 0.2% of our distributable earnings and may be approved only by a validly convened shareholders meeting.

The following table lists the total compensation paid to each of our directors, supervisors and executive officers in 2005.

| **Name** | **Position** | **Total Compensation (in NT$ thousands)** |
|---|---|---|
| Tan Ho Chen | Chairman and Chief Executive Officer | 2,729 |
| Shyue-Ching Lu | Director and President | 2,670 |
| Oliver F.L. Yu | Director | 88 |
| Yu-Huei Jea | Director | 110 |
| Jeng-Tsuen Liaw | Director | 86 |
| Yen-Pin Wang (1) | Director | 68 |
| Neng-Pai Lin (1) | Director | 34 |
| Chiu-Kuei Huang | Director | 92 |
| Lo-Ming Chung | Director | 94 |

| | | |
|---|---|---|
| Chien-Cheng Lin | Director | 88 |
| Jing-Twen Chen | Director | 100 |

| Name | Position | Total Compensation (in NT$ thousands) |
|---|---|---|
| Zse-Hong Tsai | Director | 126 |
| Joyce H.Y. Jen | Director | 343 |
| Shih-Peng Tsai | Director | 1,463 |
| Yauh-Hong Lin (2) | Director | 852 |
| Yen-Chung Lu (2) | Director | 1,009 |
| Judy Fu-meei Ju | Supervisor | 108 |
| Ming-Daw Chang | Supervisor | 90 |
| Yu-Hsien Lin | Supervisor | 96 |
| Yeong-Chwan Hwang | Supervisor | 96 |
| Feng-Hsiung Chang | Senior Vice President | 2,177 |
| Chin-Yi Yue | Senior Vice President | 2,177 |
| Hank Han-Chao Wang | Senior Vice President | 2,145 |
| John C.C. Hsueh | Executive Vice President | 2,177 |
| Chun-Ming Hsieh | Executive Vice President | 2,177 |
| Shaio-Tung Chang | Executive Vice President | 2,177 |
| Dian-Yin Lin | Executive Vice President | 2,183 |
| Cheng-Kann Wu | Chief Accounting Officer | 1,961 |
| Cheng-Luh Chen | Executive Vice President | 2,145 |
| Lang-Chee Chang | Executive Vice President | 2,185 |
| Yen-Sung Lee | President of Telecom Laboratories | 2,178 |
| Shan-Hsin Tsao | President of Telecom Training Institute | 1,578 |

(1) Director Yen-Pin Wang was replaced by Neng-pai Lin on September 19, 2005.

(2) After privatization on August 12, 2005, the number of directors represented by labor union was reduced from previous three to one. The two labor union representatives Yauh-Hong Lin and Yen-Chung Lu, were discharged by the Ministry of Transportation and Communications on August 16, 2005.

**C. Board Practices**

All of our directors were elected in June 2004 for a three-year term, which may be renewed for any number of consecutive terms. Pursuant to the Republic of China Company Law, however, the directors may be removed from office at any time by a resolution adopted at a shareholders meeting. The chairman of our board of directors is elected by our directors. Our chairman presides at all meetings of our board of directors and also has the authority to act as our representative. We have not entered into any contract with any of our directors and supervisors by which our directors or supervisors are expected to receive benefits upon termination of their employment.

Our articles of incorporation provide for a 15-member board of directors. Three independent directors were elected during our annual general shareholders meeting held on June 25, 2004. Pursuant to the Republic of China Securities and Exchange Act, as amended in January 2006, the Financial Supervisory Commission on March 28, 2006 published a rule requiring listed non-financial-institution companies with paid-in capital exceeding NT$50 billion to appoint independent directors to their board of directors in accordance with the Act. This requirement shall apply to us upon expiry of the current term of our directors. The term independent director may have a different meaning when used in Taiwan than in other jurisdictions. The number of independent directors shall be not less than one-fifth of the total number of directors and not less than two in number. Pursuant to the relevant Republic of China regulations, our company is required to adopt the candidate-nomination-system as specified in the Republic of China Company Law to elect independent directors and both the board and shareholders holding one percent of our total outstanding shares or more will have the right to submit names for inclusion in the roster of independent director candidates. With respect to certain material decisions to be made by our company as specified in the Republic of China Securities and Exchange Act, including the adoption or amendment to our internal control system, material loans or guarantees, the issuance of equity-type securities, matters in which directors and supervisors have personal interests, the appointment and discharge of auditors, approval of financial reports, the appointment and discharge of financial, accounting or internal auditing officers and other matters prescribed by the Republic of China Financial Supervisory Commission, the dissenting opinion or qualified opinion of an independent director is required to be noted in the minutes of the board of directors meeting. After our privatization on August 12, 2005, the number of labor union representatives on our board was reduced from three to one. As a result, our board currently is composed of 13 directors.

Our articles of incorporation provide that we should have four supervisors. In accordance with the Republic of China Company Law, our supervisors are elected by our shareholders and may not concurrently serve as our directors, executive officers or other staff members. The term of office for our supervisors is three years and their term may be renewed

for any number of consecutive terms. Supervisors duties and powers include, but are not limited to, supervision of our business operations, investigation of our financial condition, inspection of corporate records, verification of statements prepared by the board of directors prior to the annual general shareholders meeting, calling of and giving reports at shareholders meetings, representation of us in negotiations with our directors and giving notification, when appropriate, to the board of directors to cease acting in contravention of applicable law or regulations, our articles of incorporation or the resolutions adopted by our shareholders. The supervisors may be also removed from office at any time by a resolution adopted at a shareholders meeting.

In the event preferred shares are outstanding, the holder of these preferred shares will be entitled to appoint one director and one supervisor. Under the Telecommunications Act of the Republic of China, the preferred shares may only be issued to the Ministry of Transportation and Communications. See Item 10. Additional Information B. Memorandum and Articles of Association Preferred Shares.

Under the Republic of China Company Law, a person may serve as our director or supervisor in his personal capacity or as the representative of another legal entity. A director or supervisor who serves as the representative of a legal entity may be removed or replaced at any time at the discretion of that legal entity, and the replacement director or supervisor may serve the remainder of the term of office of the replaced director or supervisor. Except for our three independent directors, all of our directors and supervisors are representatives of the Ministry of Transportation and Communications. However, in accordance with the Republic of China Securities and Exchange Act, as amended, except with the approval of the Competent Authority (i.e. The National Communications Commission), a representative of the government or of a juristic person, as a shareholder of our company, may not be concurrently selected or serve as the director or supervisor from the time of expiration of the term currently being served by our directors or supervisors.

The business address of our directors, supervisors and executive officers is the same as our registered address.

Our audit committee was established in September 2004 and is comprised of our three independent directors: Joyce H.Y. Jen, Dr. Jing-Twen Chen and Dr. Zse-hong Tsai. Our audit committee is responsible for overseeing: (i) the review of and discussion with management regarding our financial statements and other financial reports and disclosure; (ii) the appointment of our principal accounting firm and approval of non-audit services provided by the principal accounting firm; (iii) the review and assessment of our internal control policy, procedures and functions; (iv) assisting management and our principal accounting firm to resolve any difficulties encountered in the course of audit work; (v) our compliance with legal and regulatory requirements impacting our financial reporting; (vi) the review and approval of procedures relating to major financial actions and related party transactions; and (vii) the assessment and management of our existing and potential risk exposure. Our board of directors has concluded that Dr. Jing-Twen Chen is our audit committee financial expert.

Pursuant to the Republic of China Securities and Exchange Act, from January 1, 2007, our company is required to choose to establish either (but not both) an audit committee or a board of supervisors provided that the Republic of China Financial Supervisory Commission has the authority to require certain companies to have an audit committee in view of the company s scale, type of operations and other considerations. If we opt for an audit committee, from January 1, 2007, material matters including material asset or derivatives transactions, the adoption or amendment of internal control system, material loans or guarantees, the issuance of equity-type securities, matters in which directors and supervisors have personal interests, the appointment and discharge of auditors, approval of financial reports, the appointment and discharge of financial, accounting or internal auditing officers and other matters prescribed by the Republic of China Financial Supervisory Commission are required to be subject to be approved by one-half or more of all audit committee members and then be submitted to the board of directors for resolution. With the exception of approval of financial reports, any materials matters that have not been approved by one-half or more of all audit committee members in accordance with this requirement may be undertaken with the approval of two-thirds or more of all directors, and the resolution of the audit committee is to be recorded in the minutes of the directors meeting. The provisions regarding supervisors in the Republic of China Securities and Exchange Act, the Republic of China Company Law, and other relevant laws and regulations shall apply mutatis mutandis to the audit committee.

In addition to our audit committee, we also have a corporate strategy committee and drafting committee. Our corporate strategy committee is composed of five directors and is responsible for reviewing and advising on the budgets, capital requirements, financial forecasts, matters related to investments, business license matters, corporate reorganization, development plans and other major issues affecting our development. The conclusions of the corporate strategy committee are considered at a subsequent board of directors meeting. Our drafting committee is composed of three directors and is responsible for reviewing proposals to be considered by the board of directors in advance of the board of directors meeting. Approved proposals will be reported, discussed and resolved at the subsequent board of directors meeting. The board of directors passed a resolution on November 8, 2005 to set up a compensation committee, which is composed of five directors. The compensation committee will draft compensation proposals for the chairman, vice chairman, directors, supervisors, chief executive officer and general manager.

76

Table of Contents

In November 2003, the Securities and Exchange Commission approved changes to the New York Stock Exchange s listing standards related to the corporate governance practices of listed companies. Under these rules, listed foreign private issuers, like us, must disclose any significant ways in which their corporate governance practices differ from those followed by New York Stock Exchange-listed U.S. companies under the New York Stock Exchange s listing standards. A copy of the significant differences between our corporate governance practices and New York Stock Exchange corporate governance rules applicable to U.S. companies is available on our website *http://www.cht.com.tw*. The information contained on our website is not a part of this annual report.

**D. Employees**

All of our employees are located in Taiwan and all are employed on a full-time basis. As of December 31, 2005, approximately 66.67% of our employees had university, graduate or post-graduate degrees. We intend to improve our operational efficiency by reducing personnel costs. We offered a number of voluntary retirement programs between June 1, 2000 and April 30, 2006, which resulted in a reduction in our workforce of approximately 10,190 employees.

| | As of December 31, | | |
|---|---|---|---|
| | **2003** | **2004** | **2005** |
| **Employees** | | | |
| Technical | 15,722 | 15,367 | 14,710 |
| Operations | 11,391 | 11,293 | 10,920 |
| Administrative | 1,959 | 1,858 | 1,779 |
| Total | 29,072 | 28,518 | 27,409 |

As of December 31, 2005, approximately 99% of our employees were members of our principal labor union. Our collective agreement sets forth work rules, grievance procedures and provides for union participation in performance evaluations and promotion decisions. Our union members also occupy a majority of the seats on our employee welfare and pension fund committees. In addition, we will continue to maintain a good relationship with our labor union.

We strive to have good communication with our employees and labor union by inviting representatives of our labor union to attend various meetings related to the performance of our employees. We continually enhance our communication with our employees.

Commencing in 2005, in which our privatization was completed, prior to distributing any dividends to our shareholders, we must first distribute (1) not less than 1% of the distributable earnings to employees as bonuses and (2) not more than 0.2% of the distributable earnings to directors and supervisors as compensation. On March 28, 2006, the board of directors approved a proposal for the distribution of 3% of unappropriated earnings as employee bonus which will be subject to the approval in the 2006 AGM scheduled on May 30, 2006. Distributions for 2005 will be distributed out of the profits generated from the date of privatization to the end of 2005. See Item 10. Additional Information B. Memorandum and Articles of Association Dividends and Distributions.

**Employee Stock Subscription Program**

Under the Statue Governing Privatization of State-Owned Enterprises, a certain portion of our shares were required to be reserved for purchase by our employees at favorable terms, in accordance with regulations issued by the Ministry of Transportation and Communications and approved by the Executive Yuan in the process of privatization.

Under a program established pursuant to a regulation adopted by the Ministry of Transportation and Communications, our employees may subscribe for up to 476,858,252 of our common shares from the Ministry of Transportation and Communications in offerings conducted by the Ministry of Transportation and Communications prior to our privatization. As long as our employees agree not to transfer or pledge these shares for two or three years, they will be eligible to receive a discount of 10% or 20%, respectively, from the offering price. Pursuant to an amendment in June 2005 to the terms of this program, a majority of our employees who continued their employment with us after our privatization will also be eligible to receive a 50% discount if they agree not to transfer or pledge the shares for four years.

At the time we were privatized, the Ministry of Transportation and Communications implemented another stock subscription program, allocating up to 476,858,252 common shares, or 4.9% of our then outstanding common shares, for a

Table of Contents

one-time subscription by our employees. Under this program, a majority of our employees will be eligible to receive a discount of 10%, 20% or 50% from the offering price of the shares if they agree not to transfer or pledge these shares for two, three or four years, respectively.

As of the date of this annual report, 762,886,886 of our common shares, representing 7.9% of our outstanding common shares, were sold under the two programs mentioned above.

In addition, the Ministry of Transportation and Communications has sold 13,793,467 of our common shares to our employees at par value, representing 0.14% of our outstanding shares.

Under the Statute of Chunghwa Telecom Co., Ltd. and our articles of incorporation, whenever we issue new shares for cash, we must reserve up to 10% of the new shares to be issued on a favorable term for subscription by our employees.

**E. Share Ownership**

As of December 31, 2005, our directors, supervisors and executive officers personally held an aggregate 834,013 of our common shares, representing less than 0.01% of our outstanding common shares. As of the same date, we do not have any outstanding or unexercised options.

**ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

**A. Major Shareholders**

The following table sets forth information known to us with respect to the beneficial ownership of our shares (i) as of April 1, 2006, the most recent practicable date and (ii) as of certain record dates in each of the preceding three years, for the shareholders known by us to own at least 5.0% of our outstanding common shares. Beneficial ownership is determined in accordance with Securities and Exchange Commission s rules.

| | As of August 5, 2003 | | As of July 9, 2004 | | As of April 20, 2005 | As of April 1, 2006 |
|---|---|---|---|---|---|---|
| **Name** | **Number** | **Percent** | **Number** | **Percent** | **Number** | |