D-LINK CORPORATION AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2002 and 2003
(With Independent Auditors' Report Thereon)

Independent Auditors' Report

The Board of Directors
D-Link Corporation:

We have audited the consolidated balance sheets of D-Link Corporation and subsidiaries as of December 31, 2002 and 2003, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of D-Link management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of certain consolidated subsidiaries included in the consolidated financial statements. The total assets of these subsidiaries were NT$552,749 thousand and NT$824,258 thousand as of December 31, 2002 and 2003, respectively, and their total revenue was NT$1,322,354 thousand and NT$1,955,336 thousand for the years ended December 31, 2002 and 2003, respectively. Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for those subsidiaries, is based solely on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the Republic of China. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of D-Link Corporation and subsidiaries as of December 31, 2002 and 2003, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the Republic of China.

KPMG

Hsinchu, Taiwan (the Republic of China)
March 19, 2004

The accompanying consolidated financial statements are not intended to present the financial position and results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than the Republic of China. The standards, procedures and practices to audit such consolidated financial statements are those generally accepted and applied in the Republic of China.

D-LINK CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2002 and 2003
(In thousands of New Taiwan dollars)

Assets	2002	2003
Current assets:		
Cash and cash equivalents (note 3)	$ 2,006,063	3,074,750
Short-term investments (note 4)	3,349,922	3,511,432
Notes and accounts receivable, net (note 5)	3,415,341	4,478,961
Receivables from related parties (note 18)	312,094	208,365
Other financial assets－current	72,764	150,866
Inventories (note 6)	3,697,408	5,082,165
Other current assets (note 16)	527,192	939,073
Restricted assets (note 19)	-	894,756
Total current assets	13,380,784	18,340,368
Long-term investments (notes 7 and 18):		
Long-term investments under equity method	1,682,367	1,411,268
Long-term investments under cost method	629,037	806,490
Total long-term investments	2,311,404	2,217,758
Other financial assets －noncurrent (note 19)	17,249	37,483
Property, plant and equipment (notes 9 and 19):		
Land	95,949	95,949
Buildings and improvements	2,006,719	2,183,773
Machinery and equipment	1,192,953	1,250,892
Other equipment	453,655	528,429
	3,749,276	4,059,043
Less: accumulated depreciation	1,079,926	1,315,717
Construction in progress and prepayment for purchases of machinery and equipment	15,983	4,258
Net property, plant and equipment	2,685,333	2,747,584
Other assets:		
Assets held for lease (note 8)	143,891	-
Others (note 16)	284,648	427,880
Total other assets	428,539	427,880
Total assets	$ 18,823,309	23,771,073

Liabilities and Stockholders' Equity	2002	2003
Current liabilities:		
Short-term borrowings (note 10)	$ 1,561,538	2,587,598
Notes and accounts payable	2,555,609	4,694,414
Payables to related parties (note 18)	553,470	718,177
Current portion of long-term debts (notes 11 and 12):	2,433	2,405,966
Other current liabilities	1,226,710	2,166,292
Total current liabilities	5,899,760	12,572,447
Long-term liabilities bearing interest:		
Bonds payable (note 11)	2,401,164	-
Long-term debts and lease obligations payable, excluding current installments (note 12)	607,565	223,266
Total long-term liabilities	3,008,729	223,266
Other liabilities:		
Accrued pension (note 13)	116,283	154,532
Deferred credit and others (note 16)	191,542	242,160
Advance receipts for capital increase from minority shareholders	-	435,240
Total other liabilities	307,825	831,932
Total liabilities	9,216,314	13,627,645
Stockholders' equity (note 14)**:**		
Common stock	5,163,307	5,137,771
Capital surplus	2,790,203	2,940,261
Retained earnings:		
Legal reserve	523,254	610,282
Special reserve	275,530	-
Unappropriated earnings	1,379,825	1,724,066
	2,178,609	2,334,348
Foreign currency translation adjustment	117,972	197,719
Treasury stock	(643,096)	(466,671)
Total stockholders' equity	9,606,995	10,143,428
Commitments and contingencies (note 20)		
Total liabilities and stockholders' equity	$ 18,823,309	23,771,073

See accompanying notes to consolidated financial statements.

D-LINK CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income

Years ended December 31, 2002 and 2003
(In thousands of New Taiwan dollars, except for net income per common share)

	2002		2003	
Sales (note 18)	$ 20,202,860		25,016,221	
Cost of goods sold (note 18)	14,934,373		17,201,907	
	5,268,487		7,814,314	
Net changes in unrealized profit on inter-company sales	26,913		362	
Gross profit	5,295,400		7,814,676	
Operating expenses (note 18)**:**				
Selling	3,326,180		4,688,883	
Administrative	497,446		585,967	
Research and development	822,827		936,721	
	4,646,453		6,211,571	
Operating income	648,947		1,603,105	
Nonoperating income:				
Interest income	43,349		36,329	
Gain on disposal of investments	370,525		311,732	
Investment income from long-term investments under equity method, net (note 7)	37,520		196,779	
Exchange gain, net	151,338		109,234	
Other income, net	134,786		49,622	
	737,518		703,696	
Nonoperating expenses:				
Interest expense (note 11)	135,275		157,974	
Investment loss on long-term investments under cost method, net (note 7)	121,982		174,799	
Loss on inventory obsolescence and devaluation	133,916		419,383	
	391,173		752,156	
Income before income taxes and minority interest	995,292		1,554,645	
Income tax expenses (note 16)	123,060		172,750	
Income before minority interest	872,232		1,381,895	
Net income attributed to minority interest	(4,133)		(7,760)	
Net income	$ 868,099		1,374,135	
	Before -taxes	**After -taxes**	**Before -taxes**	**After -taxes**
Net income per common share (note 15)				
Basic earnings per common share	$ 1.88	1.69	3.03	2.75
Diluted earnings per common share	$ 1.81	1.63	2.87	2.59
Basic earnings per common share－retroactive	$ 1.84	1.66		
Diluted earnings per common share－retroactive	$ 1.78	1.60		

See accompanying notes to consolidated financial statements.

D-LINK CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2002 and 2003

(In thousands of New Taiwan dollars)

	Common stock	Certificates for conversion of convertible bonds	Capital surplus	Retained Earnings: Legal reserve	Retained Earnings: Special reserve	Retained Earnings: Unappropriated earnings	Foreign currency translation adjustment	Treasury stock	Total stockholders' equity
Balance at January 1, 2002	$ 4,459,414	25	2,821,407	427,753	275,530	1,194,350	100,131	-	9,278,610
Appropriation of earnings:									
Legal reserve	-	-	-	95,501	-	(95,501)	-	-	-
Directors' and supervisors' remuneration	-	-	-	-	-	(17,190)	-	-	(17,190)
Cash dividends	-	-	-	-	-	(456,987)	-	-	(456,987)
Employees' bonuses	107,000	-	-	-	-	(107,438)	-	-	(438)
Capital surplus transferred to common stock	456,987	-	(456,987)	-	-	-	-	-	-
Gain on disposal of property and equipment transferred to retained earnings	-	-	(2,184)	-	-	2,184	-	-	-
Convertible bonds applying for conversion	139,906	(25)	452,768	-	-	-	-	-	592,649
Net income for 2002	-	-	-	-	-	868,099	-	-	868,099
Effect of disposal of long-term equity investments on capital surplus	-	-	(13,479)	-	-	-	-	-	(13,479)
Foreign currency translation adjustment	-	-	-	-	-	-	17,841	-	17,841
Purchase of treasury stock	-	-	-	-	-	-	-	(643,096)	(643,096)
Effect of disproportionate participation in investee's capital increase	-	-	(11,322)	-	-	(7,692)	-	-	(19,014)
Balance at December 31, 2002	5,163,307	-	2,790,203	523,254	275,530	1,379,825	117,972	(643,096)	9,606,995
Appropriation of earnings:									
Legal reserve	-	-	-	87,028	-	(87,028)	-	-	-
Directors' and supervisors' remuneration	-	-	-	-	-	(15,622)	-	-	(15,622)
Cash dividends	-	-	-	-	-	(735,466)	-	-	(735,466)
Employees' bonuses	96,000	-	-	-	-	(97,634)	-	-	(1,634)
Convertible bonds applying for conversion	138,664	-	270,719	-	-	-	-	-	409,383
Net income for 2003	-	-	-	-	-	1,374,135	-	-	1,374,135
Effect of disposal of long-term equity investments on capital surplus	-	-	(3,271)	-	-	-	-	-	(3,271)
Foreign currency translation adjustment	-	-	-	-	-	-	79,747	-	79,747
Purchase of treasury stock	-	-	-	-	-	-	-	(579,045)	(579,045)
Cancellation of treasury stock	(260,200)	-	(139,851)	-	-	(355,419)	-	755,470	-
Special reserve transferred to unappropriated earnings	-	-	-	-	(275,530)	275,530	-	-	-
Effect of disproportionate participation in investee's capital increase	-	-	22,461	-	-	(14,255)	-	-	8,206
Balance at December 31, 2003	$ 5,137,771	-	2,940,261	610,282	-	1,724,066	197,719	(466,671)	10,143,428

See accompanying notes to consolidated financial statements.

D-LINK CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2002 and 2003
(In thousands of New Taiwan dollars)

	2002	2003
Cash flows from operating activities:		
Net income	$ 868,099	1,374,135
Adjustments to reconcile net income to net cash provided by operating activities:		
Net gain attributed to minority interest	4,133	7,760
Depreciation and amortization	499,012	560,573
Provision for inventory obsolescence and devaluation loss, allowance for doubtful accounts, and accrued pension	371,513	489,367
Investment income on long-term investments under equity method	(37,520)	(196,779)
Investment loss on long-term investments under cost method	121,982	174,799
Cash dividend received	-	72,045
Gain on disposal of long-term investments	(289,971)	(264,085)
Other loss with no cash impacts	10,359	5,974
Net changes in unrealized inter-company profits	(26,913)	(362)
Provision for early redemption of convertible bonds	60,999	59,596
Increase in operation-related current assets	(1,740,469)	(2,649,066)
Increase in operation-related current liabilities	724,883	2,495,955
Cash provided by operating activities	566,107	2,129,912
Cash flows from investing activities:		
Decrease (increase) in receivables from related parties	(30,000)	30,000
Increase in short-term investments	(2,021,546)	(161,510)
Additions to property, plant and equipment	(276,212)	(381,179)
Proceeds from disposal of property and equipment	5,304	10,415
Increase in long-term equity investments	(110,359)	(157,142)
Proceeds from disposal of long-term equity investments	806,206	405,413
Increase in restricted assets	-	(896,256)
Increase in other assets	(76,321)	(106,685)
Cash used in investing activities	(1,702,928)	(1,256,944)
Cash flows from financing activities:		
Increase in minority interest	12,000	9,776
Advance receipts for capital increase from minority interest	-	435,240
Payments of cash dividends, directors' and supervisors' remuneration, and employees' bonuses	(474,615)	(752,722)
Increase in short-term borrowings	372,675	1,018,498
Increase (decrease) in long-term debt bearing interest	607,565	(2,178)
Purchase of treasury stock	(573,982)	(648,159)
Redemption of convertible bonds	-	(10,645)
Increase in deposits in and others	(1,400)	(44)
Cash provided by (used in) financing activities	(57,757)	49,766
Effect of exchange rate changes on cash	33,220	145,953
Net increase (decrease) in cash and cash equivalents	(1,161,358)	1,068,687
Cash and cash equivalents at beginning of year	3,167,421	2,006,063
Cash and cash equivalents at end of year	**$ 2,006,063**	**3,074,750**
Supplemental disclosures of cash flow information:		
Cash payments of interest (excluding capitalized interest)	**$ 60,933**	**97,335**
Cash payments of income tax	**$ 127,544**	**54,208**
Supplementary disclosures of noncash investing and financing activities:		
Convertible bonds applying for conversion	**$ 592,649**	**409,383**
Purchase of treasury stock	$ 643,096	579,045
Other payables	(69,114)	69,114
Cash paid in purchase of treasury stock	**$ 573,982**	**648,159**

See accompanying notes to consolidated financial statements.

D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2002 and 2003
(Amounts expressed in thousands of New Taiwan dollars, except for per share information and unless otherwise noted)

1. Organization and Principal Activities

D-Link Corporation ("D-Link") was founded in the Hsinchu Science Park in the Republic of China ("ROC") on June 20, 1987. D-Link's main activities include the research, development, production and sale of personal computers, local area network systems, and spare parts for integrated circuits.

On May 8, 2003, D-Link's shareholders' meeting resolved a spin-off whereby on August 16, 2003, D-Link separated its original design manufacturing and original equipment manufacturing ("ODM/OEM") operations from its D-Link brand business and transferred related operating assets and liabilities to establish Alpha Networks Inc. ("Alpha"). D-Link received 200 million common shares (par value NT$10) from Alpha at NT$11.77 per share.

As of December 31, 2003, D-Link had 181 employees after deducting the 1,351 employees transferred to Alpha due to the spin-off.

For the purpose of preparing the consolidated financial statements, an entity is deemed a subsidiary if D-Link directly or indirectly owns 50% or more of its voting stock. The consolidated subsidiaries are summarized below.

	Percentage of Ownership at December 31,	
	2002	**2003**
1. D-Link Systems, Inc. ("DSI")	93	93
2. D-Link Holding Company Ltd. ("DHCL")	100	100
(1) D-Link Europe Ltd. ("DEL")	100	100
• D-Link (Holding) Ltd. ("DHL") and subsidiaries	100	100
• D-Link Denmark A.S. ("DDAS")	100	100
• D-Link France ("DF")	100	100
• D-Link Scandinavia AB ("DSAB")	100	100
• D-Link Iberia ("DI")	100	100
• D-Link Mediterraneo SRL ("DMSRL")	100	100
• D-Link Netherlands ("DN")	100	100
• D-Link Deutschland ("DD") and subsidiaries	100	100
(2) D-Link China Inc. ("DC")	100	100
• D-Link Electronics (Wujiang) Co., Ltd ("DECL")	100	100

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D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

	Percentage of Ownership at December 31, 2002	Percentage of Ownership at December 31, 2003
(3) D-Link Shang-Hai Co., Ltd. ("DSCL")	100	100
• D-Link Electronics Equipment (Shang-Hai) Co., Ltd. ("DEECL")	100	100
(4) D-Link Mauritius ("DM")	100	100
(5) D-Link Brazil ("DB")	100	100
(6) D-Link Latin America ("DLA")	100	100
3. D-Link Canada Inc. ("DCI")	100	100
4. D-Link Australia Pty Ltd. ("DAPL")	100	100
5. D-Link Taiwan Inc. ("DTI")	98	82
6. D-Link International Pte. Ltd. ("DLI")	100	100
• D-Link Middle East FZCO ("DMEFZCO")	50	50
• D-Link Middle East ("DME")	51	-
• D-Link Sudamerica S.A. ("DSA")	100	100
7. Alpha Networks Inc. ("Alpha")	-	100
• Alpha Solutions Co., Ltd. ("Alpha Solutions") (former name D-Link Japan K.K.)	100	100
8. Alpha Holding Inc. ("AHI")	-	100
• D-Link Asia Investment Pte. Ltd. ("DAIPL")	100	100
- D-Link Dongguan Ltd. ("DDL")	100	100
9. Yeo-Chia Investment Ltd. ("YCI")	100	100
• Xtramus Technology Corporation ("XTC")	80	80
10. Yeo-Mao Investment Ltd. ("YMI")	100	100
11. D-Link Technology Venture Capital Investment Inc. ("DTVCI)	100	100

DLA and DEECL were the subsidiaries of the DHCL that were not consolidated in the accompanying consolidated financial statements as of and for the year ended December 31, 2002, since total assets and total revenue of DLA and DEECL were less than 10% of D-Link for 2002. DLA and DEECL were consolidated in the accompanying consolidated financial statements starting from year 2003. The 2002 consolidated financial statements were not restated to consolidate DLA and DEECL since the restatement does not impact consolidated net income and does not significantly impact total consolidated assets, liabilities and revenues.

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D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

DME and DSA were subsidiaries of DLI that transferred their operations to DMEFZCO and DLA in 2003. DME and DSA were not consolidated in the accompanying 2003 consolidated financial statements; on the contrary, DMEFZCO and DLA were consolidated in the accompanying consolidated financial statements as of and for the year ended December 31, 2003. From the economic substance point of view, there is no change in the consolidated entities.

2. Summary of Significant Accounting Policies

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the Republic of China (ROC). The major accounting policies and measurement basis adopted in preparing the accompanying consolidated financial statements are summarized as follows:

(1) Accounting principles and consolidation policy

These consolidated financial statements are not intended to present the financial position of D-Link and the related results of operations and cash flows based on accounting principles and practices generally accepted in countries and jurisdictions other than the ROC.

The consolidated financial statements include the accounts of D-Link and subsidiaries in which D-Link directly or indirectly owns greater than 50 percent of the subsidiary's voting shares and is able to exercise control over the subsidiary's operations and financial policies. However, if a subsidiary whose total assets and revenues do not exceed 10% of D-Link's total assets and revenues and the unconsolidated subsidiaries' total assets and revenues do not exceed 30% of D-Link's total assets and revenues, the subsidiaries could be excluded from consolidation. DHCL's subsidiaries, including D-Link Hong Kong, Netpro International Trading (Shang-Hai) Co., Ltd., DTI's subsidiaries, ViVa Wisdom Services Co. Ltd. and W-Link System Inc. etc. were not included in the 2002 and 2003 consolidated financial statements, accordingly.

The difference between the net purchase price and the net equity of the acquired subsidiary is accounted for as consolidated debit or credit (included in "other assets" or "other liabilities" on the accompanying consolidated balance sheet) and amortized from 5 to 10 years using the straight-line method.

All significant inter-company balances and transactions are eliminated in consolidation.

(2) The spin-off

The accounting treatment for D-Link's spin-off of ODM/OEM operations to establish Alpha and obtaining the common stock of Alpha in return was based on the net book values of the assets transferred (less impairment loss, if any) minus the liabilities as the cost of acquiring Alpha's common stock. There were no exchange gains or losses.

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(3) Cash equivalents

D-Link considers all highly liquid investments, such as investments in bonds with repurchase agreements, with a maturity of three months or less to be cash equivalents.

(4) Foreign currency transactions and translation

D-Link and its subsidiaries record transactions in their respective local currencies. Foreign currency transactions are recorded at the exchange rate prevailing on the transaction date. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated using the exchange rates on that date. The resulting exchange gains or losses from settlement of such transactions or translation of monetary assets and liabilities are reflected in the accompanying consolidated statements of income.

The financial statements of foreign subsidiaries are translated into New Taiwan dollars at the exchange rates prevailing on the balance sheet date, with the exception of stockholders' equity, which is translated at historical rates, and revenues, costs and expenses, which are translated at the weighted-average exchange rates during the reporting period. Translation differences resulting from the translation of such financial statements into New Taiwan dollars are recorded as a foreign currency translation adjustment, a separate component of stockholders' equity.

(5) Short-term investments

Short-term investments are stated at the lower of cost or market value. Market value is determined using the net asset value of open-end mutual funds on the last day of the period, and the average closing price of the last month of the period for domestic publicly listed securities and the closing price on the last day for foreign publicly listed securities.

(6) Allowance for doubtful accounts

The allowance for doubtful accounts is provided based on accounts receivable aging analysis and the expected collectibility of accounts receivable.

(7) Inventories

Inventories are stated at the lower of cost or market value. Except for DCI and DIL, D-Link and its subsidiaries determine cost by using the weighted-average method. DCI and DIL determine cost by using the first-in, first-out method (in November 2003, DCI changed to the weighted-average method). The market value of raw materials is determined on the basis of replacement cost, and the market values of finished goods and work in process are determined on the basis of net realizable value.

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D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(8) Long-term equity investments

Long-term equity investments in publicly traded companies whereby D-Link directly or indirectly, owns less than 20 percent of the investee's voting shares and is not able to exercise significant influence over the investee's operations and financial policies are accounted for by the lower-of-cost-or-market method. However, if such long-term equity investments whose shares are not traded publicly are accounted for by the cost method. If there is evidence indicating that a decline in the value of such an investment is other than temporary, then the carrying amount of the investment is reduced to reflect its net realizable value. The related loss is recognized in the accompanying consolidated statements of income.

Long-term equity investments in which D-Link, directly or indirectly, owns between 20 percent and 50 percent of the investee's voting shares, or less than 20 percent of the investee's voting shares but is able to exercise significant influence over the investee's operations and financial policies, are accounted for by the equity method. The difference between the acquisition cost and the net equity of the investee as of the acquisition date is deferred and amortized from five to ten years using the straight-line method, and the amortization is recorded as investment income or loss in the accompanying consolidated statements of income.

For long-term equity investments in which D-Link owns less than 50% of an investee's voting shares and is not able to obtain the investee's current year financial statements, D-Link shall recognize its share of the income or losses of the investee in the following year when such financial statements are obtained. Such delay in recording the investee's income or losses shall be consistently applied afterward.

All significant inter-company gains or losses with investees accounted for under the equity method are deferred. These gains or losses are recognized in the year that the gain or loss is realized through a third-party transaction or over the remaining useful life of property, plant and equipment sold through a related-party transaction.

(9) Property, plant and equipment

Property, plant and equipment are stated at cost. Costs associated with significant additions, improvements, and replacements to property, plant and equipment are capitalized. Repairs and maintenance are charged to expenses as incurred. Interest costs related to the construction of property, plant and equipment are capitalized and included in the cost of the related asset. Except for DCI's depreciation, which is calculated using the declining-balance method, depreciation of property, plant and equipment of D-Link and its subsidiaries is provided for by using the straight-line method over the estimated useful lives of the respective assets.

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The useful lives of property, plant and equipment are as follows:

(a) Buildings and improvements: 5~55 years.
(b) Machinery and equipment: 3~10 years.
(c) Transportation, office equipment and others: 2~8 years.

Gains or losses on the disposal of property, plant and equipment are accounted for as non-operating income or losses in the consolidated statements of income.

(10) Deferred expenses

The purchase costs of software and mold development cost are recorded as deferred expenses and are amortized over periods ranging from two to five years, on a straight-line basis.

Issuance costs of convertible bonds with a redemption right are amortized by using the straight-line method over the period from the bond issue date to the expiration date of the redemption right. When the bondholders exercise the conversion right or the redemption right of the bonds before maturity, the proportionate issuance costs not yet amortized are recognized at that date.

(11) Convertible bonds

For convertible bonds issued with an option allowing the bondholders to redeem their bonds for cash at a premium over par value, the premium is amortized over the period from the issuance of such bonds to the initial redemption date.

When the bondholders exercise their conversion right, the amounts of unamortized issuance costs, forfeited unpaid interest, reserve for redemption premium, and par value of the extinguished bonds are transferred to stockholders' equity. The excess of such amounts over the par value of the certificates for conversion of convertible bonds is recorded as capital surplus in the accompanying consolidated balance sheets.

(12) Financial derivatives

(a) Forward foreign currency exchange contracts

Forward foreign currency exchange contracts committed to hedge foreign currency receivables and payables are translated into New Taiwan dollars using exchange rates prevailing on the balance sheet date. The translation difference is recorded as an exchange gain or loss in the accompanying consolidated statements of income. The difference between the forward and the spot rate on the date the contract is entered into is amortized as an exchange gain or loss over the term of the contract.

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(b) Foreign currency option contracts

Foreign currency option premiums are deferred and recorded as an exchange gain or loss in the accompanying consolidated statements of income when the contract expires or is settled.

(13) Retirement plan

D-Link, DTI and Alpha have established employee noncontributory retirement plans (the "Plans") covering all regular employees in Taiwan. In accordance with the Plans, employees are eligible for retirement or are required to retire after reach certain age or service requirements. Payments of retirement benefits are based on years of service and the average salary for the six-month period before the employee's retirement. Each employee earns two months of salary for the first fifteen years of service, and one month of salary for each year of service thereafter. The maximum retirement benefit is 45 months of salary. D-Link, DTI and Alpha contribute 2 percent of wages and salaries to a pension fund maintained with the Central Trust of China on a monthly basis. Retirement benefits are paid to eligible participants on a lump-sum basis upon retirement.

D-Link, DTI and Alpha have adopted ROC Statement of Financial Accounting Standards ("SFAS") No. 18 "Accounting for Pensions." SFAS No. 18 requires D-Link, DTI and Alpha to perform an actuarial calculation of their pension obligation as of each fiscal year-end. Based on the actuarial calculation, D-Link, DTI and Alpha recognize net periodic pension costs. In certain cases, an additional minimum liability may be recognized through a direct charge to stockholders' equity.

Certain of D-Link's foreign subsidiaries have defined contribution retirement plans. These plans are funded in accordance with the regulations of their respective countries. Contributions to these plans are expensed as incurred.

(14) Revenue recognition

Revenue is recognized when title to the products and the risks and rewards of ownership are transferred to the customers, which occurs principally at the time of shipment. Allowances and related provisions for sales returns are estimated based on historical experience. Such provisions are deducted from sales in the year the products are sold.

(Continued)

(15) Income taxes

Income taxes are accounted for under the asset and liability method. Deferred income taxes are determined based on differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect during the years in which the differences are expected to reverse. The income tax effects resulting from taxable temporary differences are recognized as deferred income tax liabilities. The income tax effects resulting from deductible temporary differences, net operating loss carryforwards, and income tax credits are recognized as deferred income tax assets. The realization of deferred income tax assets is evaluated, and if it is considered more likely than not that the deferred tax assets will not be realized, a valuation allowance is recognized accordingly.

Classification of deferred income tax assets or liabilities as current or noncurrent is based on the classification of the related asset or liability. If the deferred income tax asset or liability is not directly related to a specific asset or liability, then the classification is based on the asset's or liability's expected realization date.

According to the ROC Income Tax Law, undistributed earnings of D-Link and its subsidiaries in the ROC are subject to an additional 10 percent corporate income surtax. The surtax is charged to income tax expense after the appropriation of earnings is approved by the stockholders in the following year.

(16) Treasury stock

Pursuant to ROC SFAS No. 30, "Accounting for Treasury Stock", the outstanding shares of D-Link purchased back by itself should be recorded as treasury stock at the purchasing cost before such shares are disposed of or retired.

If treasury stock is disposed of afterward, the difference is recorded as capital surplus when the disposal price is higher than the carrying amount; when the situation is reversed, the difference is recorded as a reduction in capital surplus generated from treasury stock transaction, and any insufficiency is applied to retained earnings. The carrying amount of the treasury stock is calculated by using the weighted-average method.

When retiring treasury stock, common stock and capital surplus derived from paid-in capital in excess of par value should be eliminated proportionally. If the carrying amount of retired treasury stock is higher than the eliminated amount of common stock and capital surplus, then the difference is recorded as a reduction in capital surplus derived from treasury stock with any insufficiency applied to retained earnings; when the situation is reversed, the difference is recorded as capital surplus.

(Continued)

(17) Net income per common share

Net income per common share are calculated based on the weighted-average number of common shares outstanding during the period. The effect on net income per common share from the increase in stock from the transfer of unappropriated earnings, capital surplus, and employee profit sharing is computed retroactively.

Overseas convertible bonds and domestic convertible bonds issued by D-Link in 2001 and 1999, respectively, are potential common stock. If there is a dilutive effect, both basic and dilutive net income per common share will be disclosed. For dilutive net income per common share, the net income and the weighted-average number of common shares outstanding during the period should be adjusted to include the dilutive effects of the potential common stock, assuming that they are outstanding during the whole period.

3. Cash and Cash Equivalents

	December31, 2002	December31, 2003
Cash on hand; checking and saving accounts	$ 592,222	2,561,926
Time deposits	1,294,141	497,824
Bonds with repurchase agreements	119,700	15,000
	$ 2,006,063	**3,074,750**

4. Short-term Investments

The components of short-term investments as of December 31, 2002 and 2003, are summarized below:

	December31, 2002	December31, 2003
Publicly listed stocks	$ 39,774	53,472
Mutual funds	3,274,668	3,474,089
Credit-linked deposits	69,460	-
Less: allowance for decline in market value	(33,980)	(16,129)
	$ 3,349,922	**3,511,432**
Market value	**$ 3,349,922**	**3,526,099**

(Continued)

D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

5. Notes and Accounts Receivable

The components of notes and accounts receivable as of December 31, 2002 and 2003, are summarized below:

	December31, 2002	2003
Notes receivable	$ 137,727	149,354
Accounts receivable	3,398,353	4,518,969
Less: allowance for doubtful accounts	(120,739)	(189,362)
	$ 3,415,341	**4,478,961**

6. Inventories

The components of inventories as of December 31, 2002 and 2003, are summarized below:

	December31, 2002	2003
Finished goods	$ 2,922,167	3,903,202
Work in process	358,551	514,863
Raw materials	930,158	1,333,526
Provision for obsolescence and devaluation	(513,468)	(669,426)
	$ 3,697,408	**5,082,165**
Insurance coverage on inventories	**$ 3,121,983**	**3,657,833**

(Continued)

D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

7. Long-term Investments

Long-term investments and related investment income or loss as of and for the years ended December 31, 2002 and 2003, are summarized below:

Investee	December 31, 2002				2002
	Percentage of ownership		Acquisition cost	Book value	Investment income (loss)
Equity method:					
D-Link India Ltd.	35	$	32,111	241,348	39,580
Cameo Communication, Inc. (CCI)	30		297,075	480,666	92,142
Abocom Systems, Inc. (ACS)	21		132,028	360,283	14,416
Dray Tek Corp.	24		102,962	143,108	37,242
Bothhand Enterprise Inc. (BEI)	33		198,125	198,933	1,512
Others			289,745	258,029	(147,372)
			1,052,046	1,682,367	37,520
Cost method:					
Z-Com, Inc. (Z-Com)	7		104,300	104,300	-
IC Plus Corp.	13		214,084	179,534	(46,002)
Others			370,366	345,203	(75,980)
			688,750	629,037	(121,982)
		$	**1,740,796**	**2,311,404**	**(84,462)**

(Continued)

D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Investee	December 31, 2003 Percentage of ownership	Acquisition cost	Book value	2003 Investment income (loss)
Equity method:				
D-Link India Ltd.	35	$ 32,111	267,801	73,511
Cameo Communication, Inc. (CCI)	30	297,075	524,300	77,730
Bothhand Enterprise Inc. (BEI)	33	198,125	203,350	25,544
Cellvision System Inc. (CSI)	36	97,934	136,656	10,983
Quie Tek Corp. (QTC)	37	121,876	130,281	26,088
Others		349,618	148,880	(23,982)
		1,096,739	1,411,268	189,874
Lower-of-cost-or-market method:				
Abocom Systems, Inc. (ACS)	13	110,085	278,346	(28,265)
Dray Tek Corp.	18	62,388	99,161	35,170
		172,473	377,507	6,905
Cost method:				
Z-Com, Inc. (Z-Com)	7	103,285	103,285	-
IC Plus Corp. (formally Tamarack Micro Electronics Inc.)	13	197,883	84,068	(68,788)
Others		428,518	241,630	(106,011)
		729,686	428,983	(174,799)
		$ 1,998,898	**2,217,758**	**21,980**

D-Link and its subsidiary YCI made additional investments in W-Link System Inc. (“W-Link”) in August 2003 through contribution of accounts receivable amounting to $95,000 and cash amounting to $25,000, respectively. D-Link had provided allowance of doubtful account amounting to $120,000 for its receivables due from W-Link previously, the provision was reversed when the capital increase of W-Link was concluded. The reversal was then offset with D-Link and YCI’s equity in loss of W-Link in 2003.

In 2003, D-Link found there was a permanent impairment in the value of its investment in Azure Venture Partners I, L.P. and Ewave System. An investment loss equal to their carrying amount of $69,022 was recognized to reflect such decline. In 2003, YCI, YMI and DTVCI found there was a permanent impairment in the value of their equity investment in IC Plus Corporation, MaxEdge Electronics Corporation and PowerCom Technology Co., Ltd., etc. An investment loss of $105,777 was recognized to reflect such decline.

In 2002, YCI, YMI and DTVCI found there was a permanent impairment in the value of their equity investment in Integrated Technology Express, Inc., IC Plus Corporation, MaxEdge Electronics Corporation and Power Com Technology Co., Ltd. An investment loss of $121,982 was recognized to reflect such decline.

(Continued)

D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

8. Assets Held for Lease

D-Link purchased a plant located in the Hsinchu Science Park and entered into a land lease agreement with the Science Park Bureau. The duration of the land lease agreement is from August 2001 to December 2020. Before the commencement of construction work, the plant was held for lease. In October 2003, the plant was transferred to D-Link's own use, and was recorded under property, plant and equipment. As of December 31, 2002, the components of the leased assets were as below:

	2002
Cost	
Building	$ 80,984
Building improvement	84,790
	165,774
Accumulated depreciation	
Building	2,099
Building improvement	19,784
	21,883
Net carrying amount	$ 143,891

9. Insurance Coverage of Property, Plant and Equipment

As of December 31, 2002 and 2003, insurance coverage of depreciable property, plant and equipment amounted to $3,585,143 and $3,337,060, respectively.

10. Short-term Borrowings

Short-term borrowings consisted of the following as of December 31, 2002 and 2003:

	2002		2003	
	Amount	Rate %	Amount	Rate %
Unsecured borrowings under lines of credit	$ 1,269,037	0.022%~ 5.04%	809,859	0.796%~ 2.005%
Secured loans	292,501	4.536~ 5.04%	1,312,279	1.41%~ 4.5%
Usance letters of credit	-	-	465,460	1.74%~ 2.00%
	$ 1,561,538		2,587,598	
Unused credit facilities	$ 4,872,297		2,121,456	

(Continued)

11. Bonds Payable

A summary of the major terms of the bonds payable outstanding as of December 31, 2002 and 2003, is as follows:

(1) The second issuance of domestic convertible bonds

- Par value: $1.5 billion.

- Issue date: September 28, 1999.

- Issue price: at par value.

- Duration: seven-years, maturing on September 27, 2006.

- Coupon rate: 0%

- Conversion objective: D-Link's common stock.

- Conversion price:

  The conversion price was 64.2 New Taiwan dollars per share when the bonds were issued. As of July 1, 2003, the conversion price was adjusted to 34.1 New Taiwan dollars per share based on the prescribed formula.

- Conversion period:

  The bondholders may exercise their conversion right at any time during the period from three months after the issuance date to ten days before the maturity date, by converting the bonds into a certificate for conversion of convertible bonds, and then converting the certificate into common stock.

- Redemption right:

  The bondholders may redeem their bonds within the first thirty days of the third year and the fifth year after the issuance date, at a redemption price of 121.82% and 143.56%, respectively, of the par value of the bonds at such dates. The bondholders may also redeem their bonds within the period from the beginning of the sixth year after the issuance date to ten days prior to the maturity date, at their par value.

(Continued)

(2) The first issuance of foreign convertible bonds

- Par value: US$40 million.
- Issue date: March 21, 2002.
- Issue price: at par value.
- Duration: five-years, maturing on March 21, 2006.
- Coupon rate: 0%
- Conversion objective: D-Link's common stock or global depository receipts (GDRs).
- Conversion period:

  The bondholders may exercise their conversion right at any time during the period from thirty days after the issuance date to thirty days before the maturity date, by converting the bonds into a certificate for conversion of convertible bonds, and then converting the certificates into common stock or GDRs.

- Conversion price:

  The conversion price was 50 New Taiwan dollars per share when the bonds were issued. On July 1, 2003, the conversion price was adjusted to 29.73 New Taiwan dollars per share based on the prescribed formula.

- Redemption right:

  The bondholders may redeem their bonds within the first thirty to sixty days of the first, second, third and the fourth year after the issuance date, at a redemption price equal to the par value of the bonds at such dates. If more than 90% of the bonds have been converted to common stock or redeemed by bondholders, D-Link has the right to redeem all the outstanding bonds at a redemption price equal to their par value.

  For consecutive consideration, D-Link needed the above-mentioned convertible bonds as current liabilities, which does not necessarily mean that D-Link should fully paid them off in the following year.

(Continued)

(3) The first issuance of domestic guaranteed straight bonds

- Par value: $600 million.
- Issue date: December 24, 2002.
- Issue price: at par value.
- Duration: three-years, maturing on December 24, 2004.
- Coupon rate: 2.65%, interest paid annually on December 24.
- Issue terms: The principal of the bonds will be fully paid at one time upon the maturity of the bonds.

(4) The components of bonds payable as of December 31, 2002 and 2003, are summarized below:

	2002	**2003**
Bonds payable	$ 2,221,322	1,763,867
Provision for early redemption	179,842	236,127
Less: current portion of bonds payable	-	(1,999,994)
	$ 2,401,164	-

Interest expense on bonds payable in 2002 and 2003 amounted to $76,899 and $75,496, respectively.

In 2002 and 2003, convertible bonds amounting to $575,684 and $412,378, respectively, were converted. The excess of the conversion price over the par value of the certificates for conversion of the convertible bonds issued amounted to $452,768 and $270,719 as of December 31, 2002 and 2003, respectively, and was included in capital surplus in the accompanying consolidated balance sheets.

(Continued)

D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

12. Long-term Debts and Lease Obligations Payable

(1) Long-term borrowings

Bank	Credit Line and Purpose	Period and Redemption	December 31, 2002	December 31, 2003	Pledged Assets
Chiao Tung Bank	$600,000 for the redemption of convertible bonds	Due by March 26, 2005; the principal will be paid in 3 half-yearly installments starting from March 26, 2004	$ 600,000	600,000	Plant (refer to note 19)
Less: current portion of long-term debts			-	400,000	
			$ 600,000	**200,000**	
Rate			**4.95%**	**5.20%**	

As of December 31, 2003, according to the agreement on long-term debt, repayments for future years were as follows:

Period	Amount
Jan. 1 ~ Dec. 31, 2004	$ 400,000
Jan. 1 ~ Mar. 26, 2005	200,000
	$ 600,000

(2) Lease obligations payable

The components of lease obligations payable as of December 31, 2002 and 2003, are summarized below:

	2002	2003
Lease obligations payable	$ 9,998	29,237
Less: current portion of lease payable	(2,433)	(5,972)
	$ 7,565	**23,265**

(Continued)

D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

According to the agreement, D-Link Systems issued some notes payable to the leasing company. The par value of the unpaid notes as of December 31, 2003, are summarized below:

Year ending December 31,		
2004	$	6,820
2005		6,209
2006		6,209
2007		3,902
2008		3,675
2009 and after		6,738
	$	**33,553**

13. Retirement Plans

The following table sets forth the benefit obligation and accrued pension balance related to D-Link's, Alpha's and DTI's retirement plan as of December 31, 2002 and 2003:

		2002	**2003**
Benefit obligation:			
Vested benefit obligation	$	(8,809)	(3,390)
Nonvested benefit obligation		(134,046)	(192,277)
Accumulated benefit obligation		(142,855)	(195,667)
Projected future salary increase		(97,547)	(133,068)
Projected benefit obligation		(240,402)	(328,735)
Fair value of plan assets		147,414	144,607
Funded status		(92,988)	(184,128)
Unrecognized net transition obligation		13,223	10,211
Unrecognized net gain (loss)		(35,148)	20,798
Additional minimum pension liability		(1,370)	(1,413)
Accrued pension cost	**$**	**(116,283)**	**(154,532)**

The components of D-Link's, DTI's and Alpha's net periodic pension cost for 2002 and 2003, are summarized as follows:

		2002	**2003**
Service cost	$	33,986	41,434
Interest expenses		9,891	9,223
Actual returns on pension fund		(3,088)	(2,019)
Amortization		(2,001)	(3,407)
	$	**38,788**	**45,231**

(Continued)

Actuarial assumptions at December 31, 2002 and 2003, are summarized as follows:

	2002	2003
Discount rate	3.75%	3.50%
Rate of increase in future compensation levels	3.00%	3.00%
Expected long-term rate of return on plan assets	3.75%	3.50%

To cope with the spin-off plan stated in note 1, D-Link transferred 1,351 ODM/OEM department employees to Alpha on August 16, 2003, and committed to compensate Alpha for relevant pension liability of $226,537 based on the actuarial calculation. In proportion to the number of employees transferred, D-Link recognized curtailment gain of $220,554. The net impact of the pension obligation amounted to $5,983, which was recorded under other losses.

14. Stockholders' Equity

(a) Common stock

In 1998, D-Link issued 5 million Global Depository Receipts ("GDRs"). Each GDR represents 5 common shares and was offered at ten U.S. dollars and thirteen cents per GDR. Net proceeds of approximately NT$1,674,042 were raised in September 1998. The GDRs are publicly listed on the Luxembourg Stock Exchange at September 24, 1998.

Pursuant to a stockholders' resolution on May 31, 2002, D-Link increased the authorized capital from $5,800,000 to $6,600,000 and increased its common stock by $563,987 through the transfer of capital surplus and employees' bonuses of $456,987 and $107,000, respectively. The capital increase was registered in July 2002.

Pursuant to a stockholders' resolution on May 8, 2003, D-Link increased its common stock by $96,000 through the transfer of employee bonuses. The capital increase was registered in July 2003.

As of December 31, 2002, the authorized capital totaled $6,600,000 (including $1,000,000 authorized for the conversion of convertible bonds). As of December 31, 2003, the authorized capital totaled $6,600,000 (including $1,000,000 authorized for the conversion of convertible bonds and $250,000 authorized for the issuance of the employee stock options). As of December 31, 2002 and 2003, the issued capital amounted to $5,163,307 and $5,137,771, respectively. The par value of D-Link's common stock is ten New Taiwan dollars per share.

(Continued)

D-Link applied to the Securities and Futures Commission (SFC) to issue 25,000 thousand units of employee stock options on May 27, 2003. Each unit of employee stock options can purchase one common share, and the total amount of common shares for employee stock options is 25,000 thousand shares. D-Link will issue new common shares to redeem the stock options. The application was approved by SFC on June 6, 2003, but the employee stock options had not been issued as of December 31, 2003.

(b) Capital surplus

Pursuant to the ROC Company Law, with the exception of capital surplus originating from long-term equity investments accounted for by the equity method, capital surplus can only be used to offset a deficit and cannot be used to declare cash dividends. However, capital surplus derived from additional paid-in capital and earnings from gifts received can be used to increase share capital if there is no accumulated deficit. According to current SFC regulations, capitalization of capital surplus cannot exceed a rate of ten percent and can be done only in years after the year in which such capital increase is registered with the authorities.

Pursuant to a stockholders' resolution on May 31, 2002, D-Link resolved to transfer the capital surplus that was derived from gain on disposal of property, plant and equipment earned in year 2002 and before amounting to $2,184 to unappropriated earnings.

(c) Distribution of earnings and dividends policy

After establishing the legal and special reserve, earnings may be distributed in the following order in accordance with D-Link's articles of incorporation: 2% as remuneration to directors and supervisors and 12.5% as employee bonuses. An additional reserve on certain earnings may also be retained. The remaining earnings may be distributed as stockholders' dividends.

According to the ROC Company Law, D-Link must retain 10% of its annual income as a legal reserve until such retention equals the amount of authorized common stock. The retention is accounted for by transfers to a legal reserve upon approval at a stockholders' meeting. The legal reserve can only be used to offset an accumulated deficit, and when it reaches an amount equal to one-half of the paid-in share capital, one-half of legal reserve may be transferred to common stock.

According to ROC SFC regulations, an ROC publicly listed company should retain a special reserve equal to any deductions made to stockholders' equity related to items such as foreign currency translation adjustments before distribution of earnings which were generated after 1999. If the aforementioned deduction of stockholders' equity is reversed, the same amount could be removed from special reserve and transferred to unappropriated earnings.

(Continued)

D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

D-Link has adopted the remaining dividend policy based on the industry environment, business growth, and long-term financial planning. D-Link considers the capital budget to determine the distribution of stock dividends, accompanied by cash dividends which should be no less than 10% of total dividends.

Information about directors' and supervisors' remuneration and employees' bonuses which were distributed from unappropriated earnings of 2001 and 2002 is as follows:

		2001	2002
Dividends per common share:			
Cash	$	1.00	1.50
Stock (per value)		-	-
	$	**1.00**	**1.50**

		2001	2002
Employees' bonuses—common stock (par value)	$	107,000	96,000
Employees' bonuses—cash		438	1,634
Directors' and supervisors' remuneration		17,190	15,622
	$	**124,628**	**113,256**

D-Link distributed employees' stock bonuses constituting 2.4% and 1.86% of its outstanding shares as of December 31, 2001 and 2002, respectively. Assuming that employees' bonuses and directors' and supervisors' remuneration were recognized as periodic expenses, net income per common share for 2001 and 2002 would be adjusted to $1.66 and $1.44, respectively, in New Taiwan dollars.

The actual distribution of employees' bonuses and directors' and supervisors' remuneration for 2003 is subject to the proposal of the board of directors and a resolution of the stockholders. Relevant information would be available on the Market Observation Post System of the Taiwan Stock Exchange after the above-mentioned meetings.

(d) Treasury stock

D-Link bought back 26,020 thousand common shares for $755,470 from October 2003 to February 2003, to maintain its credit and stockholders' equity. Based on the resolution of D-Link's board of directors, these treasury shares were cancelled on February 24, 2003, common stock of $260,200 and capital surplus of $139,851 were eliminated, and the insufficiency amounting to $355,419 was deducted from retained earnings.

Pursuant to the board of directors' resolution on October 28, 2003, D-Link bought back 12,000 thousand common shares for $466,671, to fulfill the purpose of its employee stock purchasing plan.

(Continued)

Pursuant to the ROC Securities and Exchange Law, treasury stock should not exceed 10% of a company's total issued shares, and the total amount of the treasury stock should not exceed the aggregation of retained earnings, capital surplus derived from paid-in capital in excess of par value, plus other realized capital surplus. Based on the financial statements of D-Link in 2003, the maximum number of shares and the maximum amount D-Link could buy back on December 31, 2003, were 51,378 thousand shares and $5,240,046, respectively.

According to SFC regulations, treasury stock cannot be pledged as collateral. Until the treasury stock is transferred, it does not carry any shareholder rights.

15. Net Income per Common Share

	2002		2003	
	Before taxes	**After taxes**	**Before taxes**	**After taxes**
Basic net income per common share:				
Income applicable to common stockholders	$ 964,099	868,099	1,512,144	1,374,135
Weighted-average common shares outstanding (thousand shares)	513,929	513,929	499,812	499,812
Basic net income per common share (New Taiwan dollars)	$ 1.88	1.69	3.03	2.75
Diluted net income per common share:				
Income applicable to common stockholders	$ 964,099	868,099	1,512,144	1,374,135
Dilutive effect of potential common stock: convertible bonds	-	-	59,596	44,697
	$ 964,099	868,099	1,571,740	1,418,832
Weighted-average common shares outstanding (thousand shares)	513,929	513,929	499,812	499,812
Convertible bonds assumed converted on issue day (thousand shares)	19,440	19,440	48,102	48,102
Diluted weighted-average common shares outstanding (thousand shares)	533,369	533,369	547,914	547,914
Diluted net income per common share (New Taiwan dollars)	$ 1.81	1.63	2.87	2.59

(Continued)

D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

16. Income Taxes

(1) D-Link is subject to a maximum income tax rate of 25 percent. D-Link's subsidiaries are subject to the current tax rate of the countries in which they operate.

Income tax benefit (expense) for 2002 and 2003 consisted of the following:

		2002	**2003**
Current	$	44,047	224,311
Deferred		22,447	(78,642)
Additional 10% income surtax on undistributed earnings		56,566	27,081
	$	**123,060**	**172,750**

(2) D-Link meets the requirements of a "scientific industry" as prescribed by the Statute for the Establishment and Administration of the Science Park. Therefore, D-Link is entitled to an income tax exemption on the profits generated from certain operations over a period of four or five years. Such operations relate to the expanded operations accompanying the following capital increases:

	Duration of tax exemption
2000 capital increase	January 1, 2001 ~ December 31, 2004
2001 capital increase	January 1, 2002 ~ December 31, 2005

In accordance with the "Business Merges and Acquisitions Act", D-Link separated its ODM/OEM operations from its D-Link brand business and transferred related operations' assets and liabilities to establish Alpha on August 16, 2003. The above-mentioned income tax exemption and other related to ODM/OEM business division tax benefits could be inherited by Alpha from August 16, 2003.

(Continued)

D-LINK CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(3) The components of deferred income tax assets (liabilities) as of December 31, 2002 and 2003, are summarized as follows:

		2002	2003
Deferred tax assets—current:			
Investment tax credits	$	49,208	163,460
Unrealized inter-company profits		141,356	117,491
Allowance for decline in value of inventories		119,298	162,376
Provision for doubtful accounts over statutory limitation		107,929	114,374
Others		4,204	11,728
		421,995	569,429
Less: valuation allowance		(194,834)	(212,531)
Net current deferred tax assets		227,161	356,898
Deferred tax liabilities—current:			
Unrealized foreign exchange gain, net		(12,918)	(25,468)
Net current deferred tax assets	$	**214,243**	**331,430**
Deferred tax assets—noncurrent:			
Investment tax credits		290,210	160,213
Loss carryforward		338,682	486,355
Investment loss on long-term equity investments in foreign entities		-	33,819
Accrued pension cost		28,728	63,388
Others		5,315	404
		662,935	744,179
Less: valuation allowance		(572,827)	(688,571)
		90,108	55,608
Deferred tax liabilities—noncurrent:			
Prepaid pension cost		-	(25,005)
Allowance for loss on foreign investment		(15,897)	(41,304)
Investment income on long-term equity investments in foreign entities		(34,142)	(910)
Foreign currency translation adjustment		(39,324)	(65,906)
		(89,363)	(133,125)
Net noncurrent deferred tax assets (liabilities)	$	**745**	**(77,517)**
Total deferred tax assets	$	**1,084,930**	**1,313,608**
Total deferred tax liabilities	$	**102,281**	**158,593**
Valuation allowance for deferred tax assets	$	**767,661**	**901,102**

Certain deferred income tax assets may not be realized in future years because D-Link is entitled to certain tax holidays as mentioned in point 2 of this note. Therefore, a valuation allowance has been provided if it is considered more likely than not that such assets will not be realized.

(Continued)

(4) D-Link's, Alpha's and YCI's investee Xtramus Technologies' investment credits due to purchase of machinery, research and development expenditure and training expenditure; YCI's, YMI's and DTVCI's investment credits derived form their investments in High-tech companies, Major Emerging Strategic Industries and Venture Capital as stipulated by the ROC Statute for Upgrading Industries, can be utilized per year is limited to 50 percent of the year's current tax expense. However, the foregoing limit does not apply to the last year of the investment tax credit's expiration period. As of December 31, 2003, the unused investment tax credits and related expiration dates were as follows:

Unused investment tax credit	**Expiration date**
$ 154,888	2004
63,160	2005
20,088	2006
85,537	2007
$ 323,673	

(5) As of the December 31, 2003, the ROC income tax authorities had examined and assessed the income tax returns of D-Link for all fiscal years through December 31, 1998.

(6) According to the local income tax law, losses of D-Link Europe as assessed by the tax authorities can be carried forward to offset future years' taxable profits. As of December 31, 2003, the unused loss carryforwards of D-Link Europe were $428,660.

(7) According to the ROC Income Tax Law, losses of Xtramus Technologies, YCI, YMI, and DTVCI as assessed by the tax authorities can be carried forward to offset the future 5 years' taxable profits. As of December 31, 2003, Xtramus Technologies', YCI's, YMI's and DTVCI's unused loss carryforwards and related expiration dates were as follows:

Year	**Expiry year**	**Amount**
2001	2006	$ 12,462
2002	2007	37,889
2003	2008	180,431
		$ 230,782

(8) In 1998, an integrated income tax system was implemented in the ROC. Under the new tax system, the income tax paid at the corporate level can be used to offset the ROC resident stockholders' individual income tax. D-link and its subsidiaries in the ROC are required to establish an imputation credit account ("ICA") to maintain a record of the corporate income taxes paid and imputation credit that can be allocated to each stockholder. The credit available to the ROC resident stockholders is calculated by multiplying the dividend by the creditable ratio. The creditable ratio is calculated as the balance of the ICA divided by earnings retained since January 1, 1998.

Information relating to the ICA of D-Link as of December 31, 2002 and 2003, is summarized as follows:

	2002	2003
Unappropriated retained earnings:		
Earned prior to January 1, 1998	$ 8,145	8,145
Earned after December 31, 1997	1,371,680	1,715,921
Total	**$ 1,379,825**	**1,724,066**
ICA balance	**$ 68,346**	**102,172**
Expected creditable ratio for earnings distribution to resident stockholders	10.73% (actual)	13.95% (estimated)

17. Financial Instruments

(1) Derivative financial instruments

D-Link and DTI used foreign currency option contracts and forward foreign currency exchange contracts to hedge existing assets and liabilities denominated in foreign currencies. The counter-parties of the derivative contracts are reputable financial institutions. Therefore, management believes that the risk of default by the counter-parties is remote.

(a)Nontrading-purpose derivative financial instruments

(i) Foreign currency option contracts

As of December 31, 2002 and 2003, D-Link had the following foreign currency option contracts outstanding:

Contract	2002 Contract Amount (in thousands)	Maturity
Call option (sell)	USD103,330	Jan. ~ Nov. 2003
Put option (sell)	USD36,137	Jan. ~ Oct. 2003
Call option (buy)	USD19,000	Jan. ~ Mar. 2003
Put option (buy)	USD11,010	Jan. ~ Mar. 2003

Contract	2003 Contract Amount (in thousands)	Maturity
Call option (sell)	USD34,000	Jan. ~ Mar. 2004
Put option (sell)	USD18,250	Jan. ~ Sept. 2004
Put option (buy)	USD22,000	Jan. 2004
Call option (sell)	EUR23,250	Jan. ~ Sept. 2004

As of December 31, 2002 and 2003, the aforementioned options' fair value was \$(78,577) and \$(2,234), respectively.

(ii) Forward foreign currency exchange contracts

As of December 31, 2002 and 2003, the notional principal of outstanding forward foreign currency exchange contracts D-Link and DTI entered into was USD11,026 thousand and USD43,807 thousand, respectively. The details of the above forward foreign currency exchange contracts' balance as of December 31, 2002 and 2003, are as follows:

		2002	2003
Forward contracts payable	$	381,722	1,488,890
Forward contracts receivable		383,061	1,486,459
	$	(1,339)	2,431
Fair value	$	(1,521)	(125)

(b)Trading-purpose derivative financial instruments

(i) Credit-linked deposits

Currency	Contract Amount (in thousands)	Contract Period	Interest Rate	Reference Entities	Issuer
USD	2,000	February~ March 2003	USD LIBOR+1.50%	D-Link (ECB)	Citibank

The carrying amount of the credit-linked deposits abovementioned as of December 31, 2002, was $69,460. In addition, the credit-linked deposits was released in February 2003.

(c)Fair value and risk

(i)Credit risk

Credit risk represents the accounting loss that would be recognized at the reporting date if counter-parties failed to perform as contracted. Credit risk will increase as the derivative instruments become more profitable. D-Link entered into the above derivative contracts with reputable financial institutions. The likelihood of default on the part of the counter-parties is remote.

Credit risk of credit-linked deposits depends upon the occurrence of the constraint events. The constraint events that apply to each reference entity include bankruptcy, restructuring, repudiation or moratorium, and failure to pay. The contracts will be settled and the banks will deliver all or part of the portfolio to D-Link if any constraint events occur. D-Link carefully chose the invested target according to the reference company’s creditworthiness. As a result, D-Link believes that there is no concentration of credit risk in such investments.

(ii)Market price risk

Market price risk represents the accounting loss that would be recognized at the reporting date for the derivative financial instruments due to the changes in market interest rates or foreign exchange rates. As D-Link’s derivative financial instruments are for hedging purposes, the gains or losses due to changes in the interest rates or foreign exchange rates will be naturally offset by the hedged items. As a result, market price risk is considered low.

(Continued)

(iii)Liquidity risk

Liquidity risk is the risk of being unable to settle derivative contracts on schedule. The purpose of these instruments held by D-Link and DTI was to manage and hedge the floating interest rates and foreign currency exchange rates. There is no significant liquidity risk for the related cash flows.

The notional principals of the above derivative contracts were only reflected in the unsettled contracts. The fair value of the financial instruments disclosed herein is not necessarily representative of the potential gain or loss that could be realized under current credit and market price risks. D-Link does not believe a significant loss on the above financial derivative contracts will occur.

(2) Non-derivative financial instruments

D-Link and subsidiaries' nonderivative financial assets include cash and cash equivalents, short-term investment, accounts receivable, receivables from related parties, restricted assets, other financial assets, and long-term investments. D-Link and subsidiaries' nonderivative financial liabilities consist of short-term borrowings, notes and accounts payable, payables to related parties, bonds payable, and long-term debts.

The following methods and assumptions were used to estimate the fair value of each class of non-derivative financial instruments:

(a) The carrying amounts of cash and cash equivalents, accounts receivable, restricted assets, other financial assets (pledged time deposits), accounts payable, and short-term borrowings approximate their fair value due to the short-term nature of these items.

(b) The fair value of short-term investments is based on publicly quoted market prices. Refer to note 4 for the fair value of short-term investments as of December 31, 2002 and 2003.

(c) It is not practicable to determine the fair value of long-term investments when these investments are not publicly traded.

(d) Except for the first issuance of domestic guaranteed straight bonds, the fair values of bonds payable are based on quoted market prices.

(e) The fair value of long-term debts is based on the discount value of expected and cash flows.

(f) The fair value of lease obligations payable approximates their carrying value.

(Continued)

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Except for those disclosed in relevant footnotes, the fair values of nonderivative financial instruments as of December 31, 2002 and 2003, are shown below:

	2002		2003	
	Carrying value	Fair value	Carrying value	Fair value
Financial asset:				
Long-term investments				
Fair value (available)	$ 1,095,581	1,551,330	1,241,137	3,589,660
Fair value (not available)	1,215,823	-	976,621	-
Financial liabilities:				
Bonds payable	2,401,164	2,503,102	1,999,994	2,004,915
Long-term borrowings	600,000	620,941	600,000	615,156
Lease payable	7,565	7,565	23,265	23,265

18. Related-party Transactions

(1) The name and relationship of the related parties with which D-Link and its subsidiaries had significant transactions are shown below:

Name	Relationship
D-Link India Ltd. (DIL)	Investee
Abocom Systems, Inc. (ACS)	Investee accounted for under lower-of-cost-or-market method by YCI and YMI (the disclosure in 2003 is for comparing with 2002 only)
Cameo Communications, Inc. (CCI)	Investee
Cellvision System Inc. (CSI)	Investee
PowerCom Technology Co., Ltd. (PCT)	YCI is a director of PCT, PCT is in liquidating procedure at year-end 2003
Dray Tek Corp. (DTC)	Investee accounted for under lower-of-cost-or-market method by YCI and YMI (the disclosure in 2003 is for comparing with 2002 only)
W-Link System Inc. (WSI)	Subsidiary

(Continued)

(2) Significant transactions with related parties as of and for the years ended December 31, 2002 and 2003, are summarized below:

(a) Sales

	2002 Amount	2002 Percentage of net sales	2003 Amount	2003 Percentage of net sales
CCI	$ 81,926	-	76,069	-
DIL	187,705	1	230,562	1
WSI	233,524	1	19	-
Others	361,353	2	550,348	2
	$ 864,508	**4**	**856,998**	**3**

The above-mentioned amount for CCI included the royalty income of $14,733 and $2,390 in the years 2002 and 2003, respectively.

The average credit terms extended to related parties and third-party customers were approximately 30-90 days. However, credit terms to related parties might be further extended when necessary.

(b) Purchases/and others

	2002 Amount	2002 Percentage of net purchases	2003 Amount	2003 Percentage of net purchases
CCI	$ 1,479,778	9	1,704,833	10
ACS	225,487	2	-	-
CSI	286,505	2	401,989	2
PCT	185,523	1	-	-
DTC	123,465	-	-	-
WSI	411,479	3	9,085	-
DIL	-	-	15,382	-
Others	294,606	2	165,216	-
	$ 3,006,843	**19**	**2,296,505**	**12**

There are no significant differences in purchasing terms between related parties and third-party suppliers.

(Continued)

D-Link's purchases from ACS and DTC for the year ended December 31, 2003, totaled $119,781 and $78,970, respectively. As of December 31, 2002, payables resulting from the purchases were $20,089 and $15,472, respectively, recorded under accounts payable.

(c) Accounts receivable/payable

	December 31,			
	2002		2003	
	Amount	Percentage	Amount	Percentage
Accounts receivable:				
DIL	$ 59,417	1	26,270	1
WSI	140,637	4	-	-
Others	202,040	6	182,095	2
	402,094	11	208,365	3
Less: allowance for doubtful accounts	(120,000)	(3)	-	-
	$ 282,094	8	208,365	3

	December 31,			
	2002		2003	
	Amount	Percentage	Amount	Percentage
Accounts payable:				
ACS	$ 41,123	1	-	-
CCI	354,992	11	489,740	9
CSI	23,175	1	129,324	2
PCT	7,768	1	-	-
DTC	16,950	-	-	-
Others	109,462	4	99,113	1
	$ 553,470	18	718,177	12

(d) Financing

As of December 31, 2003, D-Link's interest free loan lent to WSI in 2002 amounting to $25,272 (also the maximum amount in 2002 and 2003) had been received.

(e) Others

During the years ended December 31, 2002 and 2003, D-Link had purchased certain computer software from DIL for $36,415 and $25,272, respectively, which was recorded in other current assets.

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19. Pledged Assets

Assets pledged as collateral as of December 31, 2002 and 2003 are summarized as follows:

Pledged assets	Pledged to secure	2002	2003
Time deposit	Customs guarantees of the Science Park	$ 7,300	7,300
Time deposit	Guarantees of credit lines for DSI	-	564,756
Time deposit	The first issuance of domestic guaranteed convertible bonds	-	330,000
Plant	Long-term debts	717,103	-
		$ 724,403	902,056

20. Commitments and Contingencies

(1) Major operating leases

According to current leasing contracts, the minimum future leasing expenses for the land and offices leased by D-Link and subsidiaries are as below:

Years	Amount
2004	$ 161,306
2005	139,412
2006	120,357
2007	104,796
2008 and after	261,477
	$ 787,348

(2) As of December 31, 2002 and 2003, D-Link had outstanding letters of credit amounting to approximately $5,207 and $4,498, respectively.

(3) As of December 31, 2002 and 2003, D-Link had provided a guarantee for the payment of Javarock Ltd.'s bank loans amounting to $69,660 and $0, respectively. Javarock Ltd., a Hong Kong shipping agent, is responsible for D-Link's triangular trading activities with D-Link's affiliates located in the People's Republic of China ("PRC").

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(4) D-Link entered into several royalty agreements with certain companies. According to these agreements, D-Link is obligated to pay royalties when D-Link sells products using the technologies specified in the royalty agreements. Total royalty expenses incurred under these agreements for the years ended December 31, 2002 and 2003, amounted to $6,204 and $13,321, respectively.

(5) In 2002, D-Link filed a lawsuit alleging that a former employee infringed D-Link's copyright. VIA Technologies, Inc. ("VIA") and the relevant person involved in this case were prosecuted by the district attorney due to D-Link's accusation. D-Link also brought a suit against both VIA and the involved person for civil compensation. All the above-mentioned cases are still pending, and the outcome is not assessable.

(6) In November 2001, Clarent Corp. failed to comply with the listing requirements of NASDAQ, and its common stock ceased trading on NASDAQ. Due to this uncertainty over Clarent Corp.'s future, D-Link filed two lawsuits against Clarent Corp. in the Superior Court of the State of California and in the County of San Mateo. D-Link alleged that Clarent Corp. breached an OEM sales agreement, a purchase agreement, and a loan and guaranty agreement related to D-Link's investment in the convertible promissory note of Articula Corp. and requested Clarent Corp. to compensate D-Link for its damages.

As of December 31, 2001, receivables due from returns of purchases from Clarent Corp. amounted to USD6,000 thousand, the convertible promissory note guaranteed by Clarent Corp. amounted to USD9,000 thousand, and an advance from Clarent Corp. was USD3,000 thousand. D-Link and Clarent Corp. reached an agreement in July 2002, and Clarent Corp. paid cash, inventories, investments, and other assets amounting to USD8,473 thousand. After deducting the allowance for possible business dispute loss amounting to USD4,500 thousand recognized by D-Link in 2001, the paid assets were sufficient to cover the claim of D-Link.

(Continued)

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21. Other information

(1) The information on labor, depreciation, and amortization expenses by function for the years ended December 31, 2002 and 2003, is summarized as follows:

	2002			2003		
Account	**Cost of goods sold**	**Operating expense**	**Total**	**Cost of goods sold**	**Operating expense**	**Total**
Employee expenses						
Salaries	381,794	1,332,440	1,714,234	384,048	1,712,712	2,096,760
Labor and health insurance	42,625	57,369	99,994	26,014	91,959	117,973
Pension	16,303	40,581	56,884	14,949	54,047	68,996
Others	31,921	148,923	180,844	29,005	193,109	222,114
Depreciation	138,092	256,909	395,001	144,814	277,499	422,313
Amortization	964	103,047	104,011	10,926	127,334	138,260

(2) In accordance with the Statute for Upgrading industries, D-Link recorded a provision for loss on foreign investment equal on 20% of the foreign investment made and registered with the authority starting from 2001.

Such provision is not allowed by generally accepted accounting principles in the ROC. However, for local tax purposes, the adjustment is not posted to D-Link’s books. As a result, the unappropriated earnings shown in the accompanying 2002 and 2003 consolidated financial statements exceed that in D-Link’s books by $63,588 and $165,217, respectively.

22. Segment Financial Information

(1) Industry information

D-Link and its subsidiaries principally operate in one industry segment: network communication products.

(Continued)

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(2) Geographic information

The geographical breakdown of sales for the years ended December 31, 2002 and 2003, is summarized as follows:

	2002					
	Americas	**Europe**	**Asia**	**Australia**	**Adjustments and eliminations**	**Total**
Area revenue:						
Third-party customers	$ 5,910,806	4,028,147	9,687,096	576,811	-	20,202,860
Inter-company	209,331	45,225	10,429,419	829	(10,684,804)	-
	$ 6,120,137	**4,073,372**	**20,116,515**	**577,640**	**(10,684,804)**	**20,202,860**
Area profit (loss) before taxes and minority interest	**$ (63,064)**	**(285,760)**	**1,111,282**	**29,067**	**203,767**	**995,292**
Area identifiable assets	**$ 2,708,442**	**2,272,757**	**21,845,998**	**282,707**	**(8,286,595)**	**18,823,309**

	2003					
	Americas	**Europe**	**Asia**	**Australia**	**Adjustments and eliminations**	**Total**
Area revenue:						
Third-party customers	$ 7,612,503	6,171,897	10,403,000	828,821	-	25,016,221
Inter-company	376,268	22,408	16,455,448	3,734	(16,857,858)	-
	$ 7,988,771	**6,194,305**	**26,858,448**	**832,555**	**(16,857,858)**	**25,016,221**
Area profit before taxes and minority interest	**$ 27,667**	**40,105**	**1,023,177**	**28,465**	**435,231**	**1,554,645**
Area identifiable assets	**$ 4,119,554**	**2,506,335**	**30,847,263**	**351,756**	**(14,053,835)**	**23,771,073**

(3) Export sales

The export sales of D-Link and its domestic subsidiaries as of December 31, 2002 and 2003, are summarized below:

	2002	**2003**
Asia	$ 5,132,973	5,428,905
Americas	5,531,446	7,699,983
Europe	3,253,898	4,304,964
Others	703,542	878,110
	$ 14,621,859	**18,311,962**

(Continued)

D-LINK CORPORATION AND SUBSIDIARIES

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(4) Major customers

There are no individual customers representing greater than 10% of consolidated revenue in 2002 and 2003.