CHUNGHWA TELECOM CO LTD
Form 20-F
April 23, 2007
Table of Contents

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, 2006*

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.

9,667,845,093 Common Shares

307,398,771 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, 2006

TABLE OF CONTENTS

i

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 reduced 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 consolidated 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 was privatized as a result of a secondary ADR offering and concurrent domestic auction of our common shares on August 12, 2005. The privatization has enabled 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, 2004, 2005 and 2006, and the selected balance sheet data as of December 31, 2005 and 2006, set forth below have been prepared in accordance with US GAAP and are derived from our audited consolidated financial statements included elsewhere in this annual report and should be read in conjunction with, and are qualified in their entirety by reference to our consolidated financial statements and the related notes. The selected income statement and cash flow data for the years ended December 31, 2002 and 2003, and the selected balance sheet data as of December 31, 2002, 2003 and 2004 set forth below are derived from our audited consolidated financial statements not included in this annual report.

	As of or for the year ended December 31,					
	2002[1]	2003[1]	2004[1]	2005[1]	2006	
	(in billions, except per share and per pro forma ADS information)					
	NT$	NT$	NT$	NT$	NT$	US$
Income Statement Data:						
Revenues	179.4	182.5	185.2	184.7	186.3	5.7
Operating costs and expenses:						
Costs of revenues[2]	56.6	58.3	58.7	68.1	62.6	1.9
Marketing[2]	20.2	20.0	19.3	23.7	20.6	0.6
General and administrative[2]	2.6	2.7	2.5	3.5	3.3	0.1
Research and development[2]	2.4	2.6	2.5	3.1	2.8	0.1
Depreciation and amortization costs of revenues	37.9	39.2	38.4	38.8	38.4	1.2
Depreciation and amortization operating expenses	2.4	2.4	2.3	2.4	2.3	0.1
Total operating costs and expenses	122.1	125.2	123.7	139.6	130.0	4.0
Operating income	57.3	57.3	61.5	45.1	56.3	1.7
Other income[3]	0.7	0.8	1.1	2.0	1.6	0.1
Other expenses[4]	1.1	0.5	0.4	1.1	0.5	0.0
Income before income tax and minority interest	56.9	57.6	62.2	46.0	57.4	1.8
Income tax	12.8	10.3	11.3	12.7	15.3	0.5
Income before minority interest	44.1	47.3	50.9	33.3	42.1	1.3
Minority interest					0.013	

Net income	44.1	47.3	50.9	33.3	42.1	1.3
Net income per share[5]	4.48	4.81	5.18	3.39	4.34	0.13
Net income per pro forma equivalent ADS[6]	44.82	48.10	51.76	33.85	43.43	1.33

Table of Contents

	As of or for the year ended December 31, (in billions, except per share and per pro forma ADS information)					
	2002[1]	2003[1]	2004[1]	2005[1]	2006	
	NT$	NT$	NT$	NT$	NT$	US$
Balance Sheet Data:						
Cash and cash equivalents	7.7	13.6	29.3	41.9	70.7	2.2
Property, plant and equipment net	338.4	329.7	311.6	293.5	277.4	8.5
Total assets[7]	428.6	429.7	438.4	395.2	398.8	12.2
Total debt	17.7	0.7	0.7	0.5	0.4	0.0
Total liabilities[7]	128.6	118.9	119.7	67.4	78.6	2.4
Minority interest					0.1	0.0
Capital stock	96.5	96.5	96.5	96.5	96.7	3.0
Total stockholders equity[7]	300.0	310.8	318.7	327.8	320.1	9.8
Cash Flow Data:						
Net cash provided by operating activities	91.3	93.6	91.6	86.2	100.1	3.1
Net cash used in investing activities	(55.3)	(32.2)	(32.4)	(28.0)	(19.1)	(0.6)
Net cash used in financing activities	(33.0)	(55.5)	(43.4)	(45.6)	(52.2)	(1.6)

	As of or for the year ended December 31, (in billions, except per share and per pro forma ADS information)					
	2002	2003	2004	2005	2006	
	NT$	NT$	NT$	NT$	NT$	US$
Capital expenditures	43.3	32.2	22.9	22.9	27.7	0.8
Dividends:						
Cash dividends declared per share	4.00	4.50	4.70	4.30	(8)	(8)
Stock dividends declared per share				0.20	(8)	(8)

(1) Certain items have been reclassified in 2005 and prior years to conform to the presentation in 2006.
(2) Excludes related depreciation and amortization which is presented separately.
(3) Includes interest income of NT$187 million, NT$100 million, NT$224 million, NT$452 million and NT$804 million (US$25 million) for the years ended December 31, 2002, 2003, 2004, 2005 and 2006, respectively.
(4) Includes interest expense of NT$171 million, NT$43 million, NT$5 million, NT$2 million and NT$6 million (US$0.2 million) for the years ended December 31, 2002, 2003, 2004, 2005 and 2006, respectively.
(5) Net income per share is the same on both a basic and a diluted basis.
(6) Each equivalent ADS represents ten of our common shares.
(7) As of December 31, 2006, we adopted SFAS 158 Employers Accounting for Defined Benefit Pensions and Other Postretirement Benefits and recorded the under-funded status of our defined benefit pension plan as a liability of NT$3.34 billion (US$0.1 billion) with a corresponding offset, net of taxes, to deferred income tax assets of NT$1.08 billion (US$0.03 billion) and accumulated other comprehensive income within stockholders equity of NT$2.26 billion (US$0.07 billion).
(8) Dividends for 2006 are expected to be declared at our 2007 annual general shareholders meeting scheduled for June 2007.

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$32.59 = 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 29, 2006. 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	33.37	34.16	31.74	31.74
2005	32.13	33.77	30.65	32.80
2006	32.51	33.31	31.28	32.59
October	33.19	33.31	33.05	33.26
November	32.81	33.16	32.49	32.35
December	32.51	32.74	32.27	32.59
2007				
January	32.77	32.99	32.38	32.95
February	32.97	33.08	32.90	32.98
March	33.06	33.13	32.84	33.01
April (through April 20)	33.11	33.16	33.05	33.15

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.

Risks Relating to Our Company and the Taiwan Telecommunications Industry

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

Before we were privatized in August 2005, our business and operations were subject to extensive regulation under Republic of China laws, rules and regulations applicable to state-owned enterprises. 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, efficient operations of our business and expansion 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 compensation and other benefits, and efficient management of our workforce;

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;

Table of Contents

- 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.

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

As a telecommunications service provider in Taiwan, we are subject to extensive regulation. Any changes in the regulatory environment applicable to us may adversely affect our business, financial condition and results of operations.

Prior to March 1, 2006, we were under the supervision of the Ministry of Transportation and Communications and the Directorate General of Telecommunications. On March 1, 2006, the National Communications Commission was formed in accordance with the National Communications Commission Organization Law, or Organization Law, which was intended to transfer regulatory authority over the Taiwan telecommunications industry from the Ministry of Transportation and Communications and the Directorate General of Telecommunications to the National Communications Commission.

The National Communications Commission is currently comprised of nine commissioners who have been recommended by the government and opposition political parties in the Legislative Yuan, as well as recommended by the Executive Yuan and approved by the Legislative Yuan. However, the Executive Yuan considered the composition of the National Communications Commission unconstitutional and petitioned the Grand Justices of the Republic of China, or the Grand Justices, to interpret the constitutionality of the formation of the National Communications Commission and the procedure for nominating commissioners to serve on the National Communications Commission. On July 21, 2006, the Grand Justices rendered an interpretation and held that the relevant provisions under the Organization Law as to the nomination procedures for the commissioners of the National Communications Commission were unconstitutional. However, the Grand Justices granted a grace period allowing such provisions of the Organization Law to remain in effect until December 31, 2008. Consequently, the National Communications Commission will have the authority at least until the end of 2008. As of the date of this annual report, the Ministry of Transportation and Communications is responsible for determining the policies for the telecommunications industry while the National Communications Commission is responsible for supervising the telecommunications industry and maintaining fair competition. Any changes in the regulatory environment applicable to us may adversely affect our business, financial condition and results of operations.

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 National Communications Commission. 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. We were subject to the Statute of Chunghwa Telecom Co., Ltd. prior to our privatization. Although we have been privatized, the Legislative Yuan has not yet abolished the Statute of Chunghwa Telecom Co., Ltd., and at this time, the Statute of Chunghwa Telecom Co., Ltd. is still applicable to us. Under the Statute of Chunghwa Telecom Co., Ltd., the Ministry of Transportation and Communications has the authority to regulate aspects of our business. Any such regulation could be burdensome or conflict with regulations of the National Communications Commission or may otherwise adversely affect our business, financial condition and results of operations.

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 particular, as a Type I service provider under the

Table of Contents

Telecommunications Act, we are constrained in our ability to raise tariffs. Furthermore, the National Communications Commission adopted a price reduction plan on December 12, 2006 and is considering a number of changes to the tariff structures relating to our local telephone, cellular and leased line services. See Item 5 Operating and Financial Review and Prospects Overview Tariff Adjustments .

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 or expand our business in the manner we desire, then our financial condition and results of operations, as well as our prospects, will suffer. For example, in April 2007, the National Communications Commission began to accept license applications according to the Regulation Governing the Worldwide Interoperability for Microwave Access, or WiMAX, and announced that it planned to issue six WiMAX licenses. WiMAX is a standards-based technology providing high-speed mobile data and telecommunications services and enabling wireless delivery of last mile broadband access as an alternative to cable and digital subscriber line. We may be unable to obtain a WiMAX license that we may need to provide the next generation telecommunication services.

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, multiple licenses to operate fixed line, cellular, paging and other services have been issued by the Republic of China government since 1996. Furthermore, three additional operators began providing fixed line services in June 2001, and licenses were granted to four undersea cable operators to engage in the undersea cable leased-circuit business in August 2001. In addition, the government awarded third generation, or 3G, 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.

We also face increased competition from local loop unbundling. We first entered into agreements regarding local loop unbundling of voice with New Century InfoComm Tech. Co., Ltd., or Sparq, in March 2004, and with Taiwan Fixed Network and Asia Pacific Broadband Telecom in May 2004. We subsequently entered into an agreement for full local loop unbundling of both voice and data with Sparq in July 2005. In January 2007, the National Communications Commission requested each dominant integrated services operator, including us, to reserve fifteen percent of its local loop for leasing to other service operators unless the then remaining available local loop of the operator not leased out is less than fifteen percent, in which case the operator should reserve such remaining loop. In addition, the National Communications Commission had defined the local loop as facilities at the bottleneck of telecommunications networks in accordance with the Regulations Governing Fixed Network Telecommunications Businesses The National Communications Commission further amended the Administrative Rules for Network Interconnection Between Telecommunication Service Providers in April 2007 which provides that we can only charge other local telephone service providers at cost for local loop services instead of on the basis of commercial negotiations.

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. Moreover, 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 materially and adversely affected.

In addition, the focus of competition among cellular service providers in Taiwan has been shifting, as companies that traditionally offered second generation services, such as us, began offering 3G services, and as new 3G service providers started to enter the market. As a result, we expect competition in 3G services to continue to intensify. We may also be subject to competition from providers of new telecommunications services

Table of Contents

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, or VoIP, 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, or DSL, 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, as well as our financial condition and results of operations.

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.

As of the date of this annual report, almost 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 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, strikes or threats to take such an action, which could disrupt our business and operations, and materially and adversely affect the quality of our services and harm our reputation. The latest collective bargaining 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 us 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.

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, demand for our paging services has declined significantly since the introduction of GSM services, improvements in other technologies and changes in the market. As a result, we recognized an impairment charge of NT$343 million (US$10.5 million) relating to our paging business 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, we may lose our customers and market share and become less profitable. For example, we began offering multimedia on demand, or MOD, services in March 2004. 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, or the Cable Radio and Television Law, we were nevertheless granted a permit as a fixed line operator to offer cable television services by the Government Information Office, the regulatory authority previously governing the cable television industry. In January 2007, the National Communications Commission, after reviewing our improvement in opening of platform of the MOD service, held that we had complied with the request in its order and therefore we would not be considered a cable, radio or television system operator under the Cable Radio and Television Law with respect to this business. Consequently, we are not currently subject to such ownership restrictions. However, the National Communications Commission did announce that it would further amend the Regulation Governing Fixed Line Services in order to regulate the MOD service provided by fixed line operators and would then ask us to submit our operation rules, tariff and service agreement for MOD services for its review. We cannot predict the outcome of this review and cannot assure you that further amendments would not subject us to ownership restrictions or other limitations on our MOD business. Moreover, our plans to introduce VoIP telephone services have also been delayed because we have not received requisite approvals from the applicable regulatory authority.

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 continued expansion of our 3G cellular mobile network. We will also need to make additional capital expenditures relating to the launch of new businesses, including MOD, ADSL services, fiber-to-the-building services WiMAX and VoIP 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, cash flows and the prevailing market conditions in the Taiwan and international 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, financial condition, results of operations 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 2006, we had capital expenditures in relation to our network infrastructure and information technology systems of NT$27.7 billion. Of this amount, we had capital expenditures of NT$5.4 billion in our fixed line services, NT$9.4 billion in our cellular services, NT$12.5 billion in our internet and data services and NT$0.4 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 our customers demand, thus impairing our expected return from our investments.

We cannot assure you that services enabled by new technologies we implement, such as 3G 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 consolidated 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 a 12% interest and which we account for using the cost method, commenced commercial operations after completing construction of Taipei 101, which it owns and which is the tallest building in Taiwan. In 2005, we recognized a loss of NT$740 million in relation to this investment due to lower than expected leasing rates for office and retail space in Taipei 101. We cannot assure you that any unprofitable equity investments will not have a material adverse effect on our financial condition or results of operations.

Our ability to deliver services may be disrupted due to a systems failure, shutdown in our networks, earthquakes or other natural disasters.

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. For example, on December 26, 2006, a 6.9 magnitude earthquake in the southern seas of Taiwan caused significant damage to the undersea cable networks that connect Taiwan to the United States, Japan, Hong Kong, China and other countries in South East Asia. The earthquake resulted in major outages in telephone and internet services throughout the region. It took one week to restore 90% of the capacity and repairs were not completed until February 2, 2007, when all four affected undersea cables finally returned to normal operations. As a result of the December 2006 earthquake, we suffered repair costs of approximately NT$10 million. Taiwan is susceptible to earthquakes and typhoons, however, we do not carry any insurance to cover damages caused by earthquakes, typhoons or other natural disasters, or to cover any resulting business interruption. Any 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 business, 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, MOD services and VoIP, WiMAX. 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 3G 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 17, 2007, the Republic of China government, through the Ministry of Transportation and Communications, owned approximately 35.41% 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;
- the election of a majority of our directors and supervisors; and
- our business activities and direction.

In addition, pursuant to the Republic of China Telecommunications Act, or the Telecommunications Act, and our articles of incorporation, our board of directors approved the issuance of two preferred shares on March 28, 2006 to the Ministry of Transportation and Communications. As the holder of these preferred shares, the Ministry & Transportation and Communications has the right 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 on the basis of its preferred shareholding. Under our articles of incorporation, these preferred shares are non-transferable and will be redeemed by us three years after the record 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. 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.

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. Prior to March 1, 2006, the Ministry of Transportation and Communications, as the competent authority under the Telecommunications Act, had the power to prescribe the limits on foreign ownership of our common shares. After the formation of the National Communications Commission, on March 1, 2006, the National Communications Commission replaced the Ministry of Transportation and Communications as the competent authority under the Telecommunications Act pursuant to the Organization Law. However, it is unclear whether the National Communications Commission (instead of the Ministry of Transportation and Communications) has the authority to prescribe the limits of foreign ownership of our common shares. On July 19, 2006, the Ministry of Transportation and Communications increased our foreign ownership limitation from 40% to 49% pursuant to the Telecommunications Act. Since our foreign ownership is now above 40%, we could be deemed in violation of the foreign ownership limitations if it is determined that the Ministry of Transportation and Communications did not have authority to increase our foreign ownership limit to 49%

as it purported to do on July 19, 2006. If we fail to comply with the applicable foreign ownership limitations, our licenses to operate some of our businesses could be revoked. Moreover, we

Table of Contents

cannot predict the manner in which the National Communications Commission will exercise its authority over us, and the National Communications Commission could decline to raise, or determine to reduce, this foreign ownership limitation.

In addition, the Cable Radio and Television Law, under which we operate our MOD business, provides that direct foreign ownership in a cable operator may not exceed 20%, and that the combined direct and indirect foreign ownership in a cable operator may not exceed 60%. We were granted a license under this law, even though we were not, and are not, in compliance with this and other ownership restrictions. However, the National Communications Commission, which has been responsible for administering regulations in this area since March 1, 2006, issued an order on August 23, 2006 requesting us to open our MOD services platform to non-Chunghwa Telecom HiNet subscribers and other service operators and content providers by December 31, 2006. In January 2007, the National Communications Commission, after reviewing the opening in our platform for MOD service, held that we had complied with the request in its order and therefore we would not be considered a cable, radio or television system operator under the Cable Radio and Television Law with respect to this business. Consequently, we are not subject to such ownership restrictions. However, the National Communications Commission did announce that it would further amend the Regulation Governing Fixed Line Services in order to regulate the MOD service provided by fixed line operators and would then ask us to submit our operation rules, tariff and service agreement for MOD services for its review. We cannot predict the outcome of such review and we cannot assure you that further amendment would not subject us to ownership restrictions or other limitations on our MOD business.

Since it is unclear whether the National Communications Commission or the Ministry of Transportation and Communications has the authority to exercise power with respect to raising our foreign ownership limitations, we cannot assure you that we are not in violation of the limits on our foreign ownership under the Telecommunications Act. If we are deemed to be in violation of our foreign ownership limitations, any consequences arising from such violation may materially and adversely affect us. Moreover, 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, or force particular shareholders to sell their shares, we may be subject to monetary fine or lose our licenses through no fault of our own. In that event, our business could be disrupted, our reputation could be damaged and the market price of our ADSs and common shares could decline. 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.

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, we could encounter difficulties in obtaining sites for additional cellular base stations required to expand our network coverage or we may be requested to reduce the number of existing cellular base stations. 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 SEC is currently under US GAAP. Beginning in 2008, we plan to prepare our financial reporting with the SEC under generally accepted accounting principles in the Republic of

Table of Contents

China, or ROC GAAP, with reconciliation to US GAAP in accordance with the requirements of the SEC. Our reported financial condition and results of operations under US GAAP may differ significantly from ROC GAAP. The price of our common shares trading on the Taiwan Stock Exchange may be based on, among other things, our consolidated 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 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.

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 their annual reports that contain an assessment by management of the effectiveness of the company s internal control over financial reporting. In addition, each 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 first applied to us in connection with our annual report on Form 20-F for the fiscal year ending on December 31, 2006.

While the management report included in this annual report concluded that our internal control over financial reporting was effective, we cannot assure you that our management will be able to conclude that our internal control over financial reporting is effective in future years. 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. If in future years 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 consolidated 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 our efforts to comply with Section 404 and other requirements of the Sarbanes-Oxley Act.

Our investments in real estate projects may not be profitable and will subject us to additional risks not related to our core businesses.

We have recently begun investing in real estate revitalization projects as part of our efforts to make more productive use of certain undeveloped or underdeveloped properties that we own. Our revitalization projects include the development of high-tech residences, commercial offices and resorts. As of the date of this annual report, we have six such projects underway relating to properties in and around Taipei and other parts of Taiwan. We have no prior experience operating real estate development projects and cannot assure you that our investments will achieve their expected results. Operating or investing in real estate projects involves numerous risks for which we may not be adequately protected. Many of these risks are also beyond our control. For example, our projects may be delayed or never completed due to the failure of other parties with which we have contracted to fulfill their contractual obligations or because of unexpected problems that arise during the planning or construction phases of the projects. Any significant delay or any failure to complete our projects

Table of Contents

might result in our projects not achieving their expected return and could subject us to a loss on our investment. In addition, changes in the regulatory or economic environment relating to real estate, such as changes in interest rates affecting the financing of our projects, increases in the applicable property tax rates relating to our properties and decreases in demand for residential, commercial or resort properties, could adversely affect the value of our properties and/or reduce or eliminate the profitability of our projects. If our revitalization projects do not achieve their expected results or subject us to a significant financial loss, this could have a adverse effect on our financial condition and results of operations.

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.

We face substantial political risks associated with doing business in Taiwan, particularly due to domestic political events and 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. For example, in 2006 a mass movement formed calling for the resignation of the president of Taiwan over a series of alleged corruption scandals and staged dramatic protests. In addition, 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 cessation is commonly viewed as having a detrimental effect on relations 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.

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

Table of Contents

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.

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, and by the laws governing corporations incorporated in the Republic of China. In addition, our corporate affairs may remain governed by the Statute of Chunghwa Telecom Co., Ltd. See Extensive regulation of our industry may limit our flexibility to respond to market conditions and competition, and our business may suffer. 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. As a result, 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.

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 10,202.20 in February 2000 and subsequently fell to a low of 3,446.26 in October 2001. During 2006, the Taiwan Stock Exchange Index peaked at 7,823.72 on December 29, 2006, and reached a low of 6,257.80 on July 17, 2006. On April 20, 2007, the Taiwan Stock Exchange Index closed at 7,942.67. 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 unless the

Securities and Futures Bureau has not objected within a prescribed period following the filing with it of an application to do so, 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 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.

Table of Contents

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 the Republic of China (Taiwan) 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 the Republic of China (Taiwan) 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 the Republic of China (Taiwan) 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 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 a securities 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.

Table of Contents

Our actual financial results may differ materially from our announced full year guidance.

Each year, we announce guidance for the current fiscal year prepared in accordance with ROC GAAP and the requirements of the Taiwan Stock Exchange. These projections are 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 are 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.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

Our legal and commercial name is Chunghwa Telecom Co., Ltd. Our common 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;
- cellular services; and
- Internet and data services, including HiNet, our internet service provider, FTTB services, ADSL 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, or 3G, 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;
- we are Taiwan s largest cellular service provider in terms of both revenues and subscribers;
- 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 2006, our revenues were NT$186.3 billion (US$5.7 billion), our net income was NT$42.1 billion (US$1.3 billion) and our net income per share was NT$4.34 (US$0.13).

In 2006, we incurred capital expenditures totaling NT$27.7 billion (US$0.8 billion), of which 64.7% was related to wireline equipment, 34.0% was related to cellular equipment and 1.3% was related to 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.

Table of Contents

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 and other business 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 3G cellular network, fiber in the loop broadband access services, our IP-based MOD services and our rollout of VoIP 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, 2006, substantially all of our installed telephone lines are capable of delivering ADSL services. In addition, our cellular services network provides nationwide coverage. Our large cellular spectrum allocation together with our network of 8,597 base stations position us well for the continued expansion of our cellular services in Taiwan.

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 24 operations offices, 322 service centers, 121 exclusive services stores 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. We were also awarded Best Managed Company and Best Commitment to Strong Dividends in Taiwan by Finance Asia in 2006. In January 2007, the Standard & Poor s Ratings Services raised our long-term foreign currency credit rating to AA from AA- and removed us from CreditWatch, where it was placed with positive implications.

Table of Contents

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 64.1% in 2006. 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 3G cellular communications networks and services. We also have begun making investments in or acquiring other companies which provide complementary telecommunications and internet-related services to further expand our business and offer new products and services.

Advanced network technology. Since 2003, we have developed and upgraded our existing infrastructure for both mobile and fixed line networks. We developed a high-speed internet protocol backbone network and expanded the coverage of our ADSL network. In 2007, we launched a long-term next generation network construction project that will upgrade the local fixed line networks to high-speed packet-based digital networks with fiber in the loop. Our investment in network infrastructure places us in a position to capture a significant share of the internet and high-speed data transmission market.

Research and development expertise. We employ over 1,187 research professionals and engineers whose principal focus is to develop advanced network services and operations support systems and to build selected core technologies. In 2006, our research and development expenses, excluding depreciation and amortization, accounted for 1.5% 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.

Table of Contents

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, ADSL 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 is to maintain our position as the market leader in fixed line communications. In December 2006, we launched 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 corporate customers. In January 2007, we launched a long-term project to create our next generation network that will upgrade the local fixed line networks to high-speed packed-based digital networks with fiber in the loop. We expect our entire fixed line network to be eventually based on a fully integrated IP telephony system. We also plan to launch phone-to-phone voice VoIP after the National Communications Commission authorizes the 070 prefix for our phone-to-phone VoIP service.

Cellular: Our strategy for our existing 2G cellular services, which uses the GSM 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 promoting increased use 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 3G cellular service based on a wideband code division multiple access, or WCDMA, technology on July 26, 2005 and launched 3.5G services on September 12, 2006. Our strategy with respect to our 3G cellular service includes the following initiatives:

- taking advantage of our ability to provide services using either the GSM or WCDMA 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 GSM 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 3G and 3.5G 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.

- expanding our High-Speed Downlink Packet Access, or HSDPA, coverage to attract more 3.5G mobile internet users.

Internet and data: Our strategy for internet and data services is to continue to build on the success of our HiNet internet services and ADSL access services. We seek to complement the government s plan to grow Taiwan s broadband subscriber base to 6 million subscribers by the end of 2007. We are the leading provider of broadband internet access in Taiwan, with a significant market share as of December 31, 2006. We have successfully migrated many of our customers from low-speed to higher-speed internet access services. Approximately 62.5% 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 2.56 Mbps as of December 31, 2006. We are developing new media to provide both higher-speed access as well as attractive

Table of Contents

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, or MOD, and hiChannel. We will launch VoIP services, after the National Communications Commission authorizes the 070 prefix for our phone-to-phone VoIP service.

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 1.86 million mobile phone subscribers. In addition, we provide a wide range of bundled services customized to meet the needs of our corporate customers, such as integrated network management services, secure internet services and 3G mobile office.

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 the quality of our performance.

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. For example, we have extended the focus of our corporate customer services from major accounts to include small and medium enterprises and on January 2007 established our Enterprise Business Group. Our Enterprise Business Group is staffed by approximately 1,200 professionals and offers packaged and customized services, customer-oriented solutions and integrated information and communications services. We have completed the integration of our call centers, all of which can now be reached by calling a single number 123. We offer 24-hour customer service, including the handling of service and billing inquiries with the assistance of an Interactive Voice Response, or IVR, 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 have commenced a project for gradually upgrading 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 3G cellular network and the continuing build-out of our fiber in the loop 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 July 1, 2003 and April 30, 2006 which resulted in reductions of 3,712 employees. On the other hand, we also hired more than 593 new employees after privatization. In 2006, we further aligned our organizational structure by integrating various operating units and departments. 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. In 2007, we also plan to offer another preferential voluntary retirement plan for our employees.

Expand our business through alliances, acquisitions 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, acquisitions and investments. We believe that our experience, operational scale and large subscriber base make us an attractive ally for other service providers.

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 500 information content providers, more than 60 customer premises equipment providers, more than 6 internet service providers. We have signed cooperation memorandums with Microsoft and Intel to develop digital home services.

Acquisitions. We have focused our acquisition strategy on making acquisitions of companies that we believe to be complementary to our long-term strategic goals. During 2006, we acquired a 70% equity interest in Chief Telecom, a Type II operator and wholesaler of VoIP international voice traffic. This acquisition will complement our current telecommunications offerings by expanding our capacity. In order to facilitate any future overseas acquisitions, we have established New Prospect Investments Holdings Ltd. and Prime Asia Investments Group Ltd. in March 2006, which are wholly owned holding companies incorporated in the British Virgin Islands that operate as investment companies.

Investments. After the privatization, we have focused our investment strategy on the development of new business and the increase of our operation efficiency. We formed Chunghwa International Yellow Pages Corporation and invested a 30% stake in a content provider, Spring House Entertainment Inc. to help develop the content industry in Taiwan. In January 2007, we became a 31.3% shareholder of a mobile distributor, Senao International, by way of a public tender offer. Senao International is our largest cellular phone distributor with a significant market share of the total market in Taiwan. We expect that our investment in Senao will increase our competitiveness in the cellular business, and we expect to take a larger share of the cellular phone distribution market.

Going forward, we may consider making other equity investments and acquisitions that we believe are complementary to our business and other strategic goals. Our future investment will be aimed at expanding our business scale, making better use of our research and development resources and increasing our revenues through investing in online value-added services and digital content provision, technology development, distribution channels and wireless communication. We expect to expand the scope of our international investments from regional to global and plan on focusing on emerging markets and other high-growth enterprises while carefully evaluating the risks involved.

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, 2007. 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 cancelled those shares on June 30, 2006.

Table of Contents

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,					
	2004		2005		2006	
	(in billions, except percentages)					
	NT$		NT$		NT$	
Fixed line:						
Local	44.9	24.3%	40.7	22.1%	39.0	20.9%
Domestic long distance	12.0	6.4	11.0	5.9	9.9	5.3
International long distance	15.2	8.2	14.6	7.9	14.0	7.6
Total fixed line	72.1	38.9	66.3	35.9	62.9	33.8
Cellular	70.3	38.0	73.0	39.5	73.0	39.2
Internet and data:						
Internet	29.5	15.9	32.1	17.3	35.5	19.1
Data	9.8	5.3	10.1	5.5	10.8	5.8
Total Internet and data	39.3	21.2	42.2	22.8	46.3	24.9
Other	3.5	1.9	3.2	1.8	4.1	2.1
Total revenues	185.2	100.0%	184.7	100.0%	186.3	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$72.1 billion, or approximately 38.9% of our revenues, in 2004, NT$66.3 billion, or approximately 35.9% of our revenues, in 2005, and NT$62.9 billion, or approximately 33.8% of our revenues, in 2006. 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,		
	2004	2005	2006
	(in billions)		
	NT$	NT$	NT$
Local telephone revenues:			
Usage	16.3	14.6	13.3
Subscription	18.0	18.2	18.2
Interconnection	3.1	3.0	2.9
Pay telephone	0.4	0.2	0.1
Other	7.1	4.7	4.5

Total	44.9	40.7	39.0

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 24.3%, 22.1% and 20.9% of our revenues in 2004, 2005 and 2006, respectively. Approximately 75.2% of our local telephone subscribers as of December 31, 2006 were residential customers, accounting for approximately 60.5% of our local telephone revenues in 2006. We are currently the leader of the local telephone service market, with an average market share of approximately 97.9%, 97.4% and 97.4% in 2004, 2005 and 2006, 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,		
	2004	2005	2006
	(in thousands, except percentages and per household data)		
Taiwan population[1]	22,689	22,770	22,877
Fixed line subscribers:			
Residential	9,950	9,942	9,822
Business	3,292	3,319	3,300
Total	13,242	13,261	13,122
Growth rate (compared to the same period in the prior year)	0.8%	0.1%	(1.0)%
Penetration rate (as a percentage of the population)	58.4%	58.2%	57.4%
Lines in service per household	1.39	1.36	1.33

(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 2004 and 2005, fixed line subscriber growth slowed compared to prior periods, primarily due to market saturation and competition. In 2006, the number of fixed line subscribers decreased by 1% compared to 2005, primarily due to an increase in the number of cancellations of fixed line service.

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

	Year ended December 31,		
	2004	2005	2006
	(in millions, except percentages)		
Minutes from local calls[1][2]	24,548	21,116	18,575
Growth rate (compared to the same period in the prior year)	(15.7)%	(14.0)%	(12.0)%

(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 and 2006 of lower speed ADSL services, we have experienced that some non-HiNet dial-up customers migrated to ADSL 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.

24

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, 2004	2005	2006
Average local telephone usage fee (per minute)	NT$ 0.68	NT$ 0.70	NT$ 0.72
Growth rate (compared to the same period in the prior year)	4.6%	2.9%	2.9%

Average per minute usage charges increased from NT$0.68 per minute in 2004 to NT$0.7 per minute in 2005 and NT$0.72 per minute in 2006. 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 ADSL 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, ring back tone and voicemail.

Domestic Long Distance Telephone

We provide domestic long distance telephone services in Taiwan. Revenues from domestic long distance telephone services comprised approximately 6.4%, 5.9% and 5.3% of our revenues in 2004, 2005 and 2006, respectively. Our average market share in the domestic long distance market was 86.4%, 84.7% and 83.6% in 2004, 2005 and 2006, respectively. Residential customers accounted for approximately 61.3% of our domestic long distance revenues in 2006.

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, 2004	2005	2006
		(in millions, except percentages)	
Minutes from domestic long distance calls	5,621	5,131	4,643
Growth rate (compared to the same period in the prior year)	(9.3)%	(8.7)%	(9.5)%

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

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, 2004	2005	2006
Average domestic long distance usage charge (per minute)	NT$ 1.65	NT$ 1.65	NT$ 1.65
Growth rate (compared to the same period in the prior year)	1.2%	0%	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 remained flat between 2004, 2005 and 2006.

Table of Contents

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.

International Long Distance Telephone

We provide international long distance telephone services in Taiwan. Revenues from international long distance telephone services comprised approximately 8.2%, 7.9% and 7.6% of our revenues in 2004, 2005 and 2006, respectively. Residential customers generated approximately 33.0% of our international long distance revenues during 2006. In addition, we provide wholesale international long distance services to international simple resale operators who do not possess their own telephone network or infrastructure.

Since fixed line services have been open for competition since 2001, we expect competition in this line of business will continue to intensify. 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 61.3%, 57.8% and 58.3% in 2004, 2005 and 2006, respectively. Our market share increased in 2006 primarily because of a slight increase in our sales of wholesale minutes. 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 VoIP 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 7.2% and 7.8% of our total outgoing international traffic in 2005 and 2006, 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 2004, 2005 and 2006, we sold 595.4 million, 781.9 million and 1,041.5 million of wholesale outgoing minutes, which represented approximately 32.1%, 39.0% and 46.5% of our total outgoing international long distance minutes, respectively. Revenues from the wholesale of international long distance minutes increased by approximately 28.7% from NT$1,124 million in 2005 to NT$1,447 million in 2006 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 60.2% our international long distance call traffic in 2006.

The following table shows the percentage of total outgoing and incoming international long distance minutes for our top five outgoing destinations in 2006.

Destination	**Percentage of total outgoing minutes**	**Percentage of total incoming minutes**
Mainland China	31.8%	32.0%
United States	9.6	15.2
Hong Kong	6.0	4.9
Japan	3.3	5.6
Philippines	10.7	0.6
Total of top five destinations	61.4%	58.3%

Table of Contents

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

	As of December 31,		
	2004	2005	2006
	(in thousands, except percentages and incoming/outgoing ratio)		
Incoming minutes	1,291	1,289	1,354
Growth rate (compared to the same period in the prior year)	8.5%	(0.2)%	5.0%
Outgoing minutes	1,855	2,004	2,239
Growth rate (compared to the same period in the prior year)	0.4%	8.0%	11.7%
Total minutes	3,146	3,293	3,593
Incoming/outgoing ratio	0.70	0.64	0.60

Total outgoing international long distance minutes increased by 8.0% from 2004 to 2005 and by 11.7% from 2005 to 2006, primarily due to promotions and increased wholesale minutes. Our incoming call volume 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 and increased by 5.0% from 2005 to 2006 due to active expansion of international wholesale incoming call services through overseas points of presence.

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,		
	2004	2005	2006
Average international long distance usage charge (per minute)	NT$ 6.1	NT$ 5.4	NT$ 4.7
Growth rate (compared to the same period in the prior year)	(1.6)%	(11.5)%	(13.0)%

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 2004, 2005 and 2006 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,		
	2004	2005	2006
		(in billions)	
	NT$	NT$	NT$
Gross international settlement receipts	3.5	3.3	3.1
Gross international settlement payments	5.3	4.5	3.8

27

Table of Contents

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 also plan to launch phone-to-phone voice VoIP after the National Communications Commission authorizes the 070 prefix for our phone-to-phone VoIP service. We plan to target specific customers for these services and offer bundled services to increase customer retention in the competitive business environment.

Cellular Services

Cellular service, is one of our principal business activities. We are Taiwan s largest provider of cellular services in terms of both revenues and subscribers. In 2004, we generated revenues of NT$70.3 billion, or approximately 38.0% of our revenues, from cellular services. In 2005, we generated revenues of NT$73.0 billion, or approximately 39.5% of our revenues, from cellular services. In 2006, we generated revenues of NT$73.0 billion (US$2.3 billion), or approximately 39.2% of our revenues, from cellular services.

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

	Year ended December 31,		
	2004	**2005** (in billions)	**2006**
	NT$	**NT$**	**NT$**
Cellular revenues:			
Usage[1]	60.0	60.8	59.7
Interconnection	6.3	7.0	7.3
Mobile data	2.3	3.2	4.2
Other	1.7	2.0	1.8
Total cellular	70.3	73.0	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 8.49 million cellular subscribers, for a market share of approximately 36.5% of total 2G cellular subscribers and approximately 35.7% of total 2G cellular services revenues in Taiwan, as of December 31, 2006. Revenues from cellular services comprised approximately 38.0%, 39.5% and 39.2% of our revenues in 2004, 2005 and 2006, respectively. Mobile data revenues as a percentage of total cellular revenues were 3.3%, 4.4% and 5.7% for the years ended December 31, 2004, 2005 and 2006, respectively.

We offer digital cellular service through our dual band GSM network. We are one of the three national licensed providers of GSM services. We have been allocated 15 MHz in the 900 MHz frequency band and 11.25 MHz in the 1800 MHz frequency band for GSM services and general packet-switched radio services, or GPRS, and 15 MHz paired spectrum plus 5 MHz unpaired spectrum in the 2 GHz frequency band for 3G 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 3G cellular services concessions to five companies, including us. In March 2002, we paid NT$10.2 billion to the government for our concession. Our 3G cellular

Table of Contents

services license is valid to December 31, 2018. In July 2005, we launched our 3G cellular telephone services using WCDMA technology. We also offer the largest international roaming network among Taiwan cellular service providers. In particular, our 2G subscribers have access to 312 networks in 164 countries through our GSM service roaming network and 126 networks in 69 countries through our GPRS roaming network. In addition, our 3G service system includes 37 networks in 22 counties.

As of December 31, 2006, we had approximately 12,234 cellular base stations (including both GSM base stations and 3G cellular base stations) covering substantially all of Taiwan s population. We use these base stations to support both our GSM network and our GPRS network. In 2006, we also selectively upgraded 82 base stations in downtown Taipei, Taiwan Taoyuan International Airport and certain industrial parks areas with HSDPA capability. We will continue this process of implementing HSDPA upgrades in the following five major areas in Taiwan: Taipei City, Taipei County, Taoyuan County, Taichung City and Kaohsiung City.

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,		
	2004	**2005**	**2006**
Taiwan population (in thousands)[1]	22,689	22,770	22,877
Total cellular subscribers in Taiwan (in thousands)[2]	21,528	19,876	23,249
Penetration (as a percentage of the population)[2]	94.9%	87.3%	101.6%
Total cellular revenues in Taiwan 2G (in billions)[3]	NT$ 198.2	NT$ 205.2	NT$ 185.2
Number of our cellular subscribers (in thousands)[2][4]	8,191	8,158	8,487
Our market share by subscribers 2G[3]	38.0%	39.6%	40.9%
Our market share by revenues 2G	35.4%	35.0%	35.7%
Number of our prepaid subscribers (in thousands)	968	603	636
Our prepaid subscribers as a percentage of our total subscribers	11.8%	7.4%	7.5%
Annualized churn rate[5]	22.9%	16.8%	11.6%
Minutes of usage (in millions of minutes)			
Incoming	9,352	9,720	10,403
Outgoing	8,668	8,921	9,227
Average minutes of usage per cellular subscriber per month[2][6]	182	190	197
Average revenue per cellular subscriber per month[2][7]	NT$ 712	NT$ 744	NT$ 731

(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. In 2006, the total number of cellular subscribers in Taiwan included personal handy-phone system and 3G customers.
(3) Data from the statistical monthly release by Ministry of Transportation and Communications, Republic of China.
(4) Includes GSM, GPRS and 3G 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.

Table of Contents

The cellular market in Taiwan has grown rapidly since the liberalization of the market in 1997. Total cellular subscribers in Taiwan has reached approximately 23.2 million as of December 31, 2006. Cellular penetration was approximately 101.6% on the same date. We expect the subscriber growth to continue to slow as a result of market saturation. In addition, the overall cellular services market experienced a slowdown in terms of revenue in 2006. 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, 2006, we had approximately 0.6 million prepaid customers representing approximately 7.5% of our total cellular subscribers. 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 incentives to third party dealers when new subscribers agree to sign a two-year service contract with us or when existing subscribers renew their contracts with us for a period of two years. We generally offer incentives on handsets equipped with more advanced data functions to promote the expansion of our GPRS and 3G cellular services. In 2006, the average handset incentives we offered was NT$2,631 per subscriber up from NT$2,380 per subscriber in 2005 primarily due to an increase in the number of subsidized 3G customers. We expect the level of our average handset incentives to slightly decline in the foreseeable future, with a decrease in incentives for handsets generally offset by higher incentives for 3G 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 continued to have a positive impact on traffic volume. The average minutes of usage per subscriber rose in 2004 because of a decline in prepaid customers as a percentage of total cellular customers, primarily as a result of accelerated closing of inactive prepaid customer accounts. In contrast, the average minutes of usage per subscriber increased in 2005 because of a decrease in the number of prepaid customers. However, the average minutes of usage per subscriber increased in 2006 because of low pricing packages, such as the Energy Plan which have stimulated usage.

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 GPRS 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.

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 from NT$712 in 2004 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. In 2006, average revenue per subscriber further decreased to NT$731 due to price cuts in SMS, or short message service, reduction of the tariff for mobile calls to fixed-line numbers in 2005 and 3G promotion programs during 2006. In order to continue to increase average revenue per subscriber reduce the negative impact caused by the April 2007 GSM price adjustment, we intend to continue introducing new value-added services and promote our 3G and 3.5G and wireless internet services.

In addition to our basic cellular services, we also offer a broad range of value-added telecommunications and information services. In August 2001, we introduced 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

Table of Contents

games, unstructured supplementary service data, mobile internet and multimedia messaging services. After the launch of our 3G cellular services, we have provided video phone, video on demand and other related 3G cellular value-added services as well. In addition to creating additional sources of revenue, we believe these services enhance customer loyalty and satisfaction and increase cellular traffic. Revenues from mobile data services represented approximately 3.3%, 4.4% and 5.7% of our total cellular revenues in 2004, 2005 and 2006, respectively.

Internet and Data Services

We have experienced continued growth in our internet and data services. Our internet and data revenues represented approximately 21.2%, 22.8% and 24.9% of our revenues in 2004, 2005 and 2006, respectively. We provide:

- Internet services, including HiNet (our internet service provider), ADSL internet access, internet value-added services, wireless local area networks and fiber-to-the-building services; and

- 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,		
	2004	2005	2006
		(in billions)	
	NT$	NT$	NT$
Internet and data revenues:			
Internet	29.5	32.1	35.5
Data	9.8	10.1	10.8
Total Internet and data			