

Edgar Filing: BUY IT CHEAP COM INC /DE - Form 10KSB

BUY IT CHEAP COM INC /DE  
Form 10KSB  
September 29, 2003

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-KSB

(Mark One)

Annual report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended June 30, 2003

Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-13337

Buy It Cheap.com, Inc.

-----  
(Name of Small Business Issuer in Its Charter)

Delaware

22-2497491

-----  
(State or Other Jurisdiction of  
Incorporation or Organization)

(IRS Employer  
Identification No.)

1800 Bloomsbury Ave., Ocean, N.J.

07712

-----  
(Address of Principal Executive Offices)

-----  
(Zip Code)

732-922-3609

-----  
(Issuer's Telephone Number, Including Area Code)

Securities registered under Section 12(b) of the Exchange Act:

Title Of Each Class	Name Of Each Exchange On Which Registered
-----	-----
None	

Securities registered under Section 12(g) of the Exchange Act:

Common Stock; \$.001 par value per share  
-----  
(Title of Class)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and has been subject to such filing requirements for the past 90 days.

Yes  No

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Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [ ]

State issuer's revenues for its most recent fiscal year. \$0

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked prices of such common equity, as of a specified date within the past 60 days. (See definition of affiliate in Rule 12b-2 of the Exchange Act).

As of August 28, 2003, the aggregate market value of the Registrant's Common Stock (based on the closing bid price for the Common Stock as reported by the National Quotation Bureau on such date held by non-affiliates of the Registrant) was approximately \$57,000. For the purposes of this report, it has been assumed that all directors and officers of the Registrant are affiliates of the Registrant. However, the statements made herein shall not be construed as an admission for the purpose of determining the affiliate status of any person. As of August 28, 2003, the Registrant had 9,040,582 shares of Common Stock issued and outstanding.

Note. If determining whether a person is an affiliate will involve an unreasonable effort and expense, the issuer may calculate the aggregate market value of the common equity held by non-affiliates on the basis of reasonable assumptions, if the assumptions are stated.

### APPLICABLE ONLY TO CORPORATE REGISTRANTS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date. 9,040,582 shares of Common Stock, par value \$.001 per share, at August 28, 2003.

### DOCUMENTS INCORPORATED BY REFERENCE

None

### Notice on Forward-Looking Statements

The Company desires to take advantage of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995 and is making this cautionary statement in connection with such safe harbor legislation. This Form 10-KSB, and the Annual Report to Shareholders, Form 10-QSB or Form 8-K of the Company or any other written or oral statements made by or on behalf of the Company may include forward-looking statements which reflect the Company's current views with respect to future events and financial performance. The words "believe," "expect," "anticipate," "intends," "estimate," "forecast," "project," "should" and similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Report Act of 1995. All forecasts and projections in this Form 10-KSB are "forward-looking statements," and are based on management's current expectations of the Company's near-term results, based on current information available pertaining to the Company, including the risk factors noted below.

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The Company wishes to caution investors that any forward looking statements made by or on behalf of the Company are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. These uncertainties and other risk factors include, but are not limited to: changing economic and political conditions in the United States and in other countries, changes in governmental spending and budgetary policies, governmental laws and regulations surrounding various matters such as environmental remediation, contract pricing and international trading restrictions, customer product acceptance and continued access to capital markets and foreign currency risks. The Company wishes to caution investors that other factors may, in the future, prove to be important in affecting the Company's results of operations. New factors emerge from time to time and it is not possible for management to predict all such factors, nor can it assess the impact of each such factor on the business or the extent to which any factor, or a combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Investors are further cautioned not to place undue reliance on such forward-looking statements as they speak only to the Company's views as of the date the statement is made. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### PART I

#### Item 1. Description of Business

##### General

Buy It Cheap.com, Inc. (the "Company") was incorporated in Delaware on January 16, 1984 as Cellufone Corporation. From 1984 to 1991 the Company and/or its subsidiaries, were involved in several different businesses, including the reselling of cellular telephone service, radio paging (beeper) service, private pay telephone manufacture and private network switching. The Company subsequently changed its name to Celcor, Inc. Because growth and profitability of these operations fell short of expectations, the Company had either ceased operating or had sold off all its businesses by February, 1991.

Unable to obtain financing to repay debt or fund operations of any kind, the Company, in April 1991, filed for protection under Chapter 11 of the United States Bankruptcy Code. The Company was able to secure limited equity capital from an investor and the Company emerged from bankruptcy in 1992 with virtually no assets or liabilities.

The Company (then known as Celcor, Inc.) had virtually no operations from 1991 to early 1995 when it executed an Agreement and Plan of Merger with Northeast (USA) Corp., a New York corporation, ("Northeast NY"). Through this merger, which became effective August 1, 1996, the Company changed its name from Celcor, Inc. to Northeast (USA) Corp. and was the surviving entity in the merger. The Company consummated the merger in order to bring the business of Northeast NY into the Company. Northeast NY had a joint venture with the Chinese government to manufacture and distribute vitamins and beauty products. While limited production and sales were achieved, lack of funding caused cessation of activities in early 1997. Because the necessary funding for this operation could not be raised and because certain commitments by each

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party had not been met, the Company, in June of 1999, notified the Chinese that it was no longer interested in pursuing the joint venture. The Chinese have responded that they were not against dissolving the joint venture, although no formal liquidation has yet taken place. During the fiscal years ending June 30, 1996 through 1998 the Company, domestically, generated limited revenues from retail sales of a beauty supply line. Lack of funding for promotional activities, and subsequently for fixed overhead costs, caused cessation of this activity during the latter part of fiscal 1998.

In April of 1999, Robert Edwards, the Company's initial founder and former president approached the Company on the possibility of starting an Internet retailing business. Pursuing this proposal, the Company's Board of Directors approved the acquisition of Buy It Cheap.com, Inc., ("BUYC") a development stage company organized under Delaware law by two directors of the Company. BUYC had raised approximately \$100,000 in start-up investment capital. The Company issued 1,400,000 shares of its common stock to shareholders of BUYC upon consummation of the transaction (October 1999). Once the acquisition was consummated, the Company operated a website "Buyitcheap.com" and changed its corporate name to Buy It Cheap.com, Inc. For accounting purposes, the acquisition has been treated as an acquisition of the Company by Buy It Cheap.com, Inc. and as a recapitalization of Buy It Cheap.com, Inc.

The Company believes that there is a market for lower priced specialty merchandise on the Internet as strong competition for items new to the market has left a void in the market for lower cost items. With lower cost and specialty merchandise, the Company won't compete with the vast majority of Internet retailers and will benefit from the greater profit margins that are achievable with this type of merchandise.

### Current operating plan

#### Internet Retailing - Buyitcheap.com

The Company intends to operate a virtual store under the web address of "Buyitcheap.com" and will offer for sale various types of branded merchandise over the Internet. While the website has been partially functional, the Company has not yet promoted it and sales thus far have been negligible. Initial merchandise lines will consist of specially priced items in consumer electronics, luggage and giftware. The Company does not intend to inventory any merchandise, however it may do so in the future. The Company will post merchandise from various vendors on its website, takes orders and collect the funds. The order is routed to the applicable vendor for shipment to the customer. Upon shipment, the Company remits its cost of the item to the vendor. In keeping with the Company's website name, the theme of its merchandise offerings will be to offer merchandise at the lowest possible price. The Company plans to keep overhead low and will seek additional funding to expand the business. The Company has not officially launched its website as raising equity capital for dot com businesses has been less than favorable. The rate at which the Company can secure financing will be a determining factor in how fast the Company will grow. The Company believes that the overall economy is improving allowing for a more favorable business environment in which to launch its website store. At this time, the Company believes the store could open in the Spring of 2004.

### Competition

The Internet retailing business is a highly competitive industry. The Company, being a start-up in this business, faces competition from numerous sources, including established Internet retailers with greater financial resources and a longer operating history. However, the Company expects, in

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time, to establish a niche as a retailer of quality branded merchandise obtained from closeouts, surplus goods, odd lots, etc. offered at cheap prices, by which to distinguish itself from other Internet retailers and thus, to effectively compete in this industry. The Company's ability to successfully compete will be dependent upon its future ability to raise substantial additional capital.

### Supply of merchandise and Internet Infrastructure

The Company, through existing relationships developed by the Company's management, will display merchandise from various vendors. There is no charge for displaying the merchandise on the Company's website. The Company marks up the price charged to it by the vendor. There being no real risk to the vendor/supplier, the Company believes it will not experience any difficulty in obtaining merchandise for sale on its website.

While the Company owns its own hardware and software to generate its website, it currently relies on an outside organization to maintain this website infrastructure. In the near term future, the Company anticipates that it will perform these functions itself.

### Employees

The Company currently has no paid employees. Certain officers and directors of the Company have agreed to temporarily work without pay but have been reimbursed for some out-of-pocket expenditures.

## Item 2. Description of Property

The Company leases office space in Clifton, N.J. and maintains its principal office at 1800 Bloomsbury Ave., Ocean, N.J. 07712 at no cost to the Company. As the business expands, the Company will need to procure additional space.

## Item 3. Legal Proceedings

From its prior operations in selling beauty products (1995-1997) the Company (then called Northeast (USA) Corp.) is indebted to two suppliers who have filed suit against the Company. These filed claims total approximately \$89,000, of which \$11,000 is disputed by the Company. One of these creditors has obtained a judgement (with interest) against the Company for approximately \$60,000. The Company has attempted to settle these claims with issuance of its common stock and convertible notes. Depending on its financial status, the Company will attempt to settle these claims in the coming months.

Details of these suits are as follows: Supreme Court of the State of New York, County of Queens, filed July 15, 1997, plaintiff Laffon Design-Kree Plast S.P.A., defendant Northeast (USA) Corp. (judgement entered); Supreme Court of the State of New York, County of Queens, filed March 5, 1997, plaintiff R. P. Scherer Corporation, defendant Northeast (USA) Corp. (pending).

If the Company is unable to resolve these claims, it may be unable to proceed with its business plans.

## Item 4. Submission of Matters to a Vote of Security Holders

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None during the Company's fiscal year ended June 30, 2003.

### PART II

#### Item 5. Market for Common Equity and Related Stockholder Matters

The Company's Common Stock is traded on the OTC Bulletin Board, symbol BYCC.

The following table shows the range of high and low bid or last trade quotations for the Company's Common Stock as reported to the Company by Pink Sheets LLC's "OTC Market Report." No review of the daily quotations as provided by the OTC Bulletin Board has been undertaken by the Company. The quotations reflect prices between dealers, without retail mark-ups, mark-downs or commissions and may not necessarily represent actual transactions or be indicative of prices at which the Company's Common Stock was traded.

Fiscal year	Fiscal quarter ended	Low bid	High bid
2002	September 30, 2001	\$ .10	\$ .10
	December 31, 2001	.10	.11
	March 31, 2002	.06	.11
	June 30, 2002	.06	.06
2003	September 30, 2002	.05	.06
	December 31, 2002	.01	.05
	March 31, 2003	.01	.01
	June 30, 2003	.01	.03

The number of record holders of the Company's Common Stock as of August 31, 2003 was approximately 300, however, the Company believes that there are substantially more beneficial owners of the Common Stock.

#### Dividend policy

The Company has never paid any dividends on its common stock. The Company anticipates that in the foreseeable future, earnings, if any, will be retained for use in the business or for other corporate purposes, and it is not anticipated that cash dividends will ever be paid on its common stock.

#### Item 6. Management's Discussion and Analysis or Plan of Operation

The Company entered the Internet retailing business through the formation of an entity separate from the Company by two of its directors. The new entity was able to raise limited start-up capital for an Internet retailing business. The new entity then merged with the Company. For accounting purposes, the combination of the two companies was treated as an acquisition of the Company by this new entity. Subsequent to the completion of this acquisition the Company changed its name to Buy It Cheap.com, Inc. and commenced an Internet retailing operation under the website "Buyitcheap.com." The Company must still arrange settlement of its liabilities and raise substantial new investment capital in order to develop this business.

Financial and operating plan for the next 12 months

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The Company plans to continue building and improving its website over the next several months with a planned "opening" of the store in the Spring of 2004. The Company operates with little overhead. The Company plans to consume operating cash only to the extent that it has available cash on hand, or that it has investor commitments for. This may limit the rate at which the Company will grow. Until there is positive cash flow from its Internet business, or the Company is able to raise a substantial amount of new capital, there will be no paid employees or any significant fixed overhead. The sales transactions, for the most part, will be handled automatically over the Internet requiring little labor or office space requirements. The Company has experienced several delays in getting its web site functional, including economic conditions relating to dot com companies. The objective of the Company will be to establish the viability of its operations in order to attract substantial new investment capital to expand its business in the future.

### Item 7. Financial Statements

The financial statements of the Company, the notes thereto, and the Report of the Independent Auditors thereon required by this Item 7 appear in this report on the pages indicated in the following index.

	Page
Independent Auditors' Report.....	F-1
Balance Sheet at June 30, 2003 and 2002.....	F-2
Statement of Income for the fiscal year ended June 30, 2003 and 2002 and the period July 19, 1999 to June 30, 2003.....	F-3
Statement of Stockholders' Equity for period July 19, 1999 to June 30, 2003.....	F-4
Statement of Cash Flows for the fiscal years ended June 30, 2003 and 2002 and for the period July 19, 1999 to June 30, 2003.....	F-5
Notes to Financial Statements.....	F-6 - F-11

### Item 8. Changes in and Disagreements With Accountants or Accounting and Financial Disclosure

None

### Item 8A. Controls and Procedures

Anthony J. Consi, the Company's Chief Executive Officer and Stephen E. Roman, Jr. the Company's Chief Financial Officer, performed an evaluation of the Company's disclosure controls and procedures as of June 30, 2003. Based on their evaluation, they concluded that the controls and procedures in place are sufficient to assure that material information concerning the Company which could affect the disclosures in the Company's quarterly and annual reports is made known to them by other officers and employees of the Company, and that the communications occur with promptness sufficient to assure the inclusion of the information in the ten-current report.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect those controls subsequent to the date on which Messrs. Consi and Roman performed their evaluation.

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### Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act.

Directors are elected by the shareholders and serve until their successors are elected and have qualified or until a director's earlier death, resignation or removal. Directors were most recently elected on January 25, 1996 at the special meeting of shareholders held at such time. Robert Edwards became a director in May, 1999 and Anthony Consi became a director on September 26, 2000. Mr. Edwards and Mr. Consi were elected to fill seats left vacant by previous directors' resignations.

On August 16, 2001, Mr. Edwards was elected Chairman of the Board and Mr. Consi was elected President and CEO. The former President, Stephen Roman was elected Vice President, Secretary and CFO. Set forth below are the names and ages of the directors and executive officers of the Company, their positions with the Company, and their business experience, including their principal occupations at present and during the past five years.

Name	Age	Present Position	Director of the Company since
Robert Edwards (1)	83	Chairman of the Board	1999
Anthony J. Consi (2)	81	President, CEO and Director	2000
Stephen E. Roman, Jr. (3)	55	Director and Vice President	1994
Jennifer Lo (4)	50	Director and Vice President	1996
Michael Hsu (5)	63	Director	1996
David Chow (6)	43	Director	1993
Chin-Sung (Joe) Chen (7)	53	Director	1996

(1) Robert Edwards is the original founder of the Company in 1984. He had not been associated with the Company from 1992 to 1999. Mr. Edwards has been involved in retailing for the past five years with the Rumson China and Glass Shop, Inc., a family owned private corporation.

(2) Mr. Consi has served as President and General Partner of Sunrise Realty Associates and Brinkley Associates, major shopping center operators. He is also Vice President and Director of risk management for Arc Properties, Inc. a retail developer and President of Ol' Americ Associates, Inc., a risk management consulting firm.

(3) Stephen E. Roman, Jr. served as Vice President and Chief Financial Officer of the Company for the period from April, 1984 to June, 1994 and from August 2001 to present. He has also served as Secretary since 1994. From June, 1994 to January, 1996, and from May, 1999 to August 2001, Mr. Roman has served as President of the Company. In January, 1996, Ms. Lo succeeded Mr. Roman as President and Mr. Roman became Vice President and



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Chief Financial Officer. In May, 1999, Ms. Lo resigned as President and was succeeded by Mr. Roman. Mr. Consi succeeded Mr. Roman as President in August 2001. For the last five years, he has served on a part-time basis. Mr. Roman is a certified public accountant and performs similar services for other business entities.

- (4) Jennifer Lo is a trained pharmacist and from February, 1993 until May 1999 served as chairman and president of the Company. Ms. Lo is the sole stockholder of Lyncroft Corp., which owns 100,000 shares of the Company.
- (5) Michael W. Hsu served as Vice President-Finance from June, 1994 to January, 1996 on a part-time basis. He served as Treasurer (part-time) from January, 1996 to May, 1999. He has been a self-employed certified public accountant for the past ten years.
- (6) David Chow is Managing Director of Center Laboratories, Taiwan, and has held this position since 1980. He is also Managing Director of Center Pharmaceutical Co., Ltd., People's Republic of China and has served in this capacity since 1992. Additionally, in 1993 Mr. Chow became Chairman of the Taiwan Pharmaceutical Development Association and in 1995, Director of the GMP Committee of the China Pharmaceutical Industrial Association.
- (7) Chin-Sung (Joe) Chen is presently General Manager of Hyscios Pharmacy International, Co., Ltd., a distributor of pharmaceutical and skin care products based in Taipei, Taiwan, and has served in this capacity since 1994. Prior to his association with Hyscios, Mr. Chen was employed for approximately 16 years by Lederle, where he served in a variety of increasingly responsible positions. From April, 1991 to November, 1993, Mr. Chen was national marketing manager of Lederle, Taiwan.

The Board of Directors does not presently have an audit, compensation or nominating committee. There were no meetings of the Board of Directors during the fiscal year ended June 30, 2003.

No officer or director of the Company is currently involved in any legal proceeding, nor is any officer or director also an officer or director of any other publicly held company.

### Section 16 (a) Beneficial Ownership Reporting

Based solely upon a review of Forms 3 and 4 and amendments thereto, as well as Form 5 and amendments thereto, furnished to the Company during the period from July 1, 2001 to the present, the Company believes the following to be accurate and correct:

Person or entity required to file	Form required	Reason filing required	Date on which filing was required	Status of filing
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None for the 2 year period ended June 30, 2003

### Item 10. Executive Compensation

There was no compensation paid or accrued to any officer or director of the Company for the fiscal years ended June 30, 2002 and 2003.

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### Item 11. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth the number of shares of the Company's \$.001 par value common stock owned by each person who, as of August 28, 2001, owns of record, or is known by the Company to own beneficially, more than 5% of the Company's common stock, as well as the ownership of such shares by each director and executive officer of the Company and the shares beneficially owned by all officers and directors as a group.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
Majestic International Inc. No 3 14th Floor No 535 Cheng-Kuo Third Road Kaohszung, Taiwan ROC	633,400	6.89
Verchi Holdings Limited Room 312, Entrance 3, Bldg. 14 Compound 3, Jingouhe Road Wukesong-Haidian District Beijing, People's Republic of China	550,000	5.98
Anthony J. Consi 52 Buttel Drive Clifton, NJ 07013	350,000	3.81
Stephen E. Roman, Jr. (officer and director) 25 Hillside Road Shark River Hills, NJ 07753	308,153	3.35
David Chow (director) 4F No. 20, Lane 34 Sec 2, Pa Te Road, Taipei, Taiwan	15,000	-
Jennifer Lo (officer and director) 258-01 Pembroke Ave. Great Neck, NY 11021	421,405 (1)	4.59
Michael Hsu (director) 136-21 Roosevelt Ave Flushing, NY 11354	0	0
Chin-Sung (Joe) Chen (director) 7th Floor No 571 Ming Shui Road Taipei, Taiwan	420,000	4.57
Robert Edwards (director) 256 Clearbrook Court Little Silver, N.J. 07739	400,000 (2)	4.35 (2)
Current Executive Officers and Directors as a Group (6 persons)	1,914,558	20.83

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- (1) Includes 100,000 shares owned by Lyncroft Corp., a corporation of which Ms. Lo is the sole shareholder and 321,405 owned by Ms. Lo's son, J. Wu who lives with her.
- (2) Excludes 200,000 shares held by Mr. Edwards' wife to which he disclaims beneficial ownership.

The Company is not aware of any arrangements which may result in a change of control of the Company.

### Item 12. Certain Relationships and Related Transactions

Mr. Roman, formerly the Company's President, Secretary and Director and currently Vice President, CFO, Secretary and Director and Mr. Edwards, Chairman of the Board and Director, are the founders of Buy It Cheap.com, Inc., a corporation which merged into the Company in October 1999. Mr. Roman and Mr. Edwards received 100,000 and 150,000 shares, respectively, of the Company's stock in the merger for which they have paid a nominal price (see Item 1 - Description of Business).

### Item 13. Exhibits and Reports on Form 8-K

#### (a) Exhibits

- 2.1 Agreement and Plan of Merger among Celcor, Inc., Northeast (USA) Corp., and the Stockholders of Northeast (USA) Corp.(5)
- 3.1 Certificate of Incorporation, as amended, of the Company (1) (2) (4)
- 3.1 Amendments to the Certificate of Incorporation dated April, 1987 and October, 1996.
- 3.2 By-laws of the Company (1) (3)
- 4.1 Certificate of Designations, Preferences and Rights of Series C 8% Convertible Preferred Stock of Celcor, Inc.
- 10.1 Promissory Notes between the Company and Buy It Cheap.com, Inc.
- 10.2 Joint Venture Contract between China Northeast Pharmaceutical Company and U.S. Lyncroft Company (translated from the Chinese) creating United Vitatech.
- 10.3 Contract of Shenyang United Vitatech Pharmaceutical Ltd. (translated from the Chinese)
- 10.4 Regulations of Shenyang United Vitatech Pharmaceutical Ltd. (translated from the Chinese)
- 10.5 Agreement dated December 26, 1993 between Mannion Consultants Ltd and Northeast (USA) Corp.
31. Rule 13a-14(a) Certification
32. Rule 13a-14(b) Certification

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Footnotes

- (1) Incorporated by reference to the Company's Registration Statement on Form S-1, No. 294663.
- (2) Incorporated by reference to the Company's Form 10-K for the year ended June 30, 1986. ( File No. 000-13337).
- (3) Incorporated by reference to the Company's 1986 Proxy Statement dated November 7, 1986. (File No. 000-13337).
- (4) Incorporated by reference to the Company's Registration Statement on Form S-1, No. 3312084.
- (5) Incorporated by reference to the Company's Form 10-K for the year ended June 30, 1995. (File No. 000-13337)

(b) There were no reports on Form 8-K filed during the fiscal year ended June 30, 2003.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Buy It Cheap.com, Inc.

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(Registrant)

By \_\_\_\_\_  
Stephen E. Roman, Jr. - Principal financial officer

Title: Vice President, CFO and Director      Date: September 24, 2003

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By \_\_\_\_\_  
Robert Edwards

Title: Director      Date: September 24, 2003

By \_\_\_\_\_  
Jennifer Lo

Title: Director      Date: September 24, 2003

By \_\_\_\_\_

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Michael Hsu

Title: Director

Date: September 24, 2003

By \_\_\_\_\_

Anthony J. Consi, President and Director, Principal Executive Officer

Title: Director

Date: September 24, 2003

EXHIBIT 31: Rule 13a-14(a) CERTIFICATION

I, Anthony J. Consi, certify that:

1. I have reviewed this Annual Report on Form 10-KSB of Buy It Cheap. com, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;

4. The small business issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the small business issuer and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the small business issuer's internal controls over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and

5. The small business issuer's other certifying officers and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):

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a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal controls over financial reporting.

Date: September 24, 2003

/s/Anthony J. Consi

-----  
Anthony J. Consi, Chief Executive Officer

I, Stephen E. Roman, Jr. , certify that:

1. I have reviewed this Annual Report on Form 10-KSB of Buy It Cheap. com, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;

4. The small business issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the small business issuer and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the small business issuer's internal controls over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and

5. The small business issuer's other certifying officers and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):

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a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal controls over financial reporting.

Date: September 24, 2003 /s/ Stephen E. Roman, Jr.

-----  
Stephen E. Roman, Jr., Chief Financial Officer

\* \* \* \* \*

EXHIBIT 32: Rule 13a-14(b) CERTIFICATION

The undersigned officers certify that this report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, and that the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of Buy It Cheap.com, Inc.

A signed original of this written statement required by Section 906 has been provided to Buy It Cheap.com, Inc. and will be retained by Buy It Cheap.com, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

September 24, 2003

/s/ Anthony J. Consi

-----  
Anthony J. Consi  
(Chief executive officer)

/s/ Stephen E. Roman, Jr.

-----  
Stephen E. Roman, Jr.  
(Chief financial officer)

Buy It Cheap.com, Inc.  
(A Development Stage Company)

Financial Statements  
June 30, 2003 and 2002

Buy It Cheap.com, Inc.  
(A Development Stage Company)  
Index to the Financial Statements  
June 30, 2003 and 2002

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	Page
Independent Auditors' Report . . . . .	F-1
Balance Sheets . . . . .	F-2
Statements of Operations . . . . .	F-3
Statement of Stockholders' Equity . . . . .	F-4
Statements of Cash Flows . . . . .	F-5
Notes to the Financial Statements . . . . .	F-6 - F-12

Independent Auditors' Report

To the Board of Directors of  
Buy It Cheap.com, Inc.

We have audited the accompanying balance sheets of Buy It Cheap.com, Inc. (A Development Stage Company) as of June 30, 2003 and 2002 and the related statements of operations, stockholders' equity, and cash flows for the years ended June 30, 2003 and 2002, and the period July 19, 1999 (date of inception) to June 30, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Buy It Cheap.com, Inc. (A Development Stage Company) at June 30, 2003 and 2002, and the results of its operations and its cash flows for the years ended June 30, 2003, 2002, and the period July 19, 1999 (date of inception) to June 30, 2003 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in the notes to the financial statements, the Company has incurred losses, has no current sources of revenue or funds and has a working capital deficit as of June 30, 2003. These conditions raise substantial doubt about the Company's ability



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to continue as a going concern. Management's plans regarding those matters are also described in the notes to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Rosenberg, Rich, Baker, Berman & Company  
-----  
Rosenberg, Rich, Baker, Berman & Company

Bridgewater, NJ

August 18, 2003

F-1

Buy It Cheap.com, Inc.  
(A Development Stage Company)  
Balance Sheets

	June 30, 2003	2002
	-----	-----
<b>Assets</b>		
Current Assets		
Cash	\$ 563	\$ 6,371
Deposits	1,000	1,000
	-----	-----
Total Current Assets	1,563	7,371
	-----	-----
Property and equipment, net of accumulated depreciation of \$36,494 and \$29,917, respectively	1,781	8,358
Investment in joint venture	-	620,535
Reserve against investment in joint venture	-	(620,535)
	-----	-----
Total assets	\$ 3,344	\$ 15,729
	=====	=====
<b>Liabilities and Stockholders' Equity</b>		
Current Liabilities		
Accounts payable and accrued expenses	\$ 153,944	\$ 154,945
Due to officers and directors	5,559	5,559
Advance from shareholder	20,000	-
Convertible note payable	16,198	16,198
	-----	-----
Total Current Liabilities	195,701	176,702
Commitments and Contingencies	-	-
Stockholders' Equity		

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Preferred stock - \$.001 par value, Authorized 2,000,000 shares Issued and Outstanding - 10,000 shares	10	10
Common stock - \$.001 par Authorized - 20,000,000 shares Issued 9,190,802 and outstanding 9,040,582	9,190	9,190
Paid in capital	787,140	787,140
Treasury stock, 150,220 common shares at cost	(751,100)	(751,100)
Retained deficit, accumulated during the development stage	(237,597)	(206,213)
Total Stockholders' Equity	(192,357)	(160,973)
Total Liabilities and Stockholders' Equity	\$ 3,344	\$ 15,729

See notes to the financial statements.

F-2

Buy It Cheap.com, Inc.  
(A Development Stage Company)  
Statements of Operations

	Year Ended June 30, 2003	Year Ended June 30, 2002	Period From July 19, 1999 (Date of Inception) to June 30, 2003
Revenues	\$ -	\$ -	\$ -
Direct Operating Costs	(2,831)	(2,700)	(23,387)
General and Administrative Expenses	(28,553)	(55,074)	(214,210)
Net Loss	\$ (31,384)	\$ (57,774)	\$ (237,597)
Weighted average number of shares outstanding	9,040,427	8,990,016	8,224,582
Loss Per Common Share	\$ -	\$ (0.01)	\$ (0.03)
Loss Per Common Share - Assuming dilution	\$ -	\$ (0.01)	\$ (0.03)

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See notes to the financial statements.

F-3

Buy It Cheap.com, Inc.  
(A Development Stage Company)  
Statement of Stockholders' Equity  
June 30, 2003

	Preferred Stock		Common Stock		Paid in	Treasury	Stock	Retained Deficit
	Shares	Amount	Shares	Amount	Capital	Shares	Amount	Accumulated During the Development Stage
Balance at July 19, 1999 (date of inception)	-	\$ -	-	\$ -	\$ -	-	\$ -	\$ -
Issuance of stock in exchange for software	-	-	210,000	210	14,790	-	-	-
Issuance of stock for cash	-	-	1,190,000	1,190	83,810	-	-	-
Acquisition of Northeast (USA) Corp.	10,000	10	7,158,407	7,158	552,975	(150,220)	(751,100)	-
Issuance of stock for release of accounts payable obligation	-	-	32,395	32	16,165	-	-	-
Issuance of stock pursuant to private placement offering	-	-	150,000	150	74,850	-	-	-
Net loss for the period July 19, 1999 (date of inception) to June 30, 2000	-	-	-	-	-	-	-	(69,097)
Balance at June 30, 2000	10,000	\$ 10	8,740,802	\$8,740	\$742,590	(150,220)	\$ (751,100)	\$ (69,097)
Issuance of Stock for Cash	-	-	50,000	50	24,950	-	-	-
Net loss for the year ended June 30, 2001	-	-	-	-	-	-	-	(79,342)
Balance at June 30, 2001	10,000	\$ 10	8,790,802	\$8,790	\$767,540	(150,220)	\$ (751,100)	\$ (148,439)
Issuance of stock								

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for release of accounts payable obligation	-	-	400,000	400	19,600	-	-	-
Net loss for the year ended June 30, 2002								(57,774)
Balance at June 30, 2002	10,000	\$	10 9,190,802	\$9,190	\$787,140	(150,220)	\$(751,100)	\$(206,213)
Net loss for the year ended June 30, 2003	-	-	-	-	-	-	-	(31,384)
Balance at June 30, 2003	10,000	\$	10 9,190,802	\$9,190	\$787,140	(150,220)	\$(751,100)	\$(237,597)

See notes to the financial statements.

F-4

Buy It Cheap.com, Inc.  
(A Development Stage Company)  
Statements of Cash Flows

	Year Ended June 30, 2003	Year Ended June 30, 2002	Period From July 19, 1999 (Date of Inception) to June 30, 2003
Cash Flows From Operating Activities			
Net Loss	\$ (31,384)	\$ (57,774)	\$ (237,597)
Adjustments to Reconcile Net Loss to Net Cash Used by Operating Activities			
Depreciation and amortization	6,577	11,967	36,494
Changes in Assets and Liabilities			
Decrease (Increase) in other current assets	-	-	(1,000)
Increase in accounts payable and accrued expenses	(1,001)	10,936	19,014
Net Cash Used by Operating Activities	(25,808)	(34,871)	(183,089)
Cash Flows From Investing Activities			
Purchases of property and equipment	-	-	(23,275)
Decrease in due from officers/directors	-	28,790	-
Cash acquired	-	-	1,927

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Net Cash Provided (Used) by Investing Activities	-	28,790	(21,348)
Cash Flows From Financing Activities			
Proceeds from sale of common stock	-	-	185,000
Proceeds from shareholder advance	20,000	-	20,000
Net Cash Provided by Financing Activities	20,000	-	205,000
Net (Decrease) Increase in Cash	(5,808)	(6,081)	563
Cash at beginning of period	6,371	12,452	-
Cash at end of period	\$ 563	\$ 6,371	\$ 563

### SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

Liabilities assumed in the acquisition of Northeast (USA) Corp. for common stock	\$ -	\$ -	\$ (190,957)
Accounts payable satisfied by issuance of common stock and convertible note payable	\$ -	\$ 20,000	\$ 32,395
Software costs financed by issuance of common stock	\$ -	\$ -	\$ 15,000

See notes to the financial statements.

F-5

Buy It Cheap.com, Inc.  
(A Development Stage Company)  
Notes to the Financial Statements

### SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Nature of Organization

Buy It Cheap.com, Inc. (the "Company") is a Delaware corporation. On November 3, 1999, Northeast (USA) Corp. purchased all of the common stock of Buy It Cheap.com (a developmental stage company). For accounting purposes, the acquisition has been treated as an acquisition of Northeast (USA) Corp. by Buy It Cheap.com and as a recapitalization of Buy It Cheap.com. The Company will operate in the internet retailing industry. Since there have been no significant revenues generated from internet retailing, the Company is considered a Developmental Stage Company for financial reporting purposes.

The Company's financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and the

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satisfaction of liabilities in the normal course of business. The Company has incurred losses, has no current source of revenues or funds and has a working capital deficit as of June 30, 2003. The Company's continued existence is dependent upon its ability to secure adequate financing. The Company plans to raise additional capital in the future; however there are no assurances that such plan will be successful. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

### Joint Venture

Northeast (USA) Corp., in 1992, formed a joint venture agreement with the Northeast General Pharmaceutical Factory (NEGPF) a government owned pharmaceutical concern in Shenyang, China, whereby both companies established a joint venture company in China. Northeast (USA) Corp. and NEGPF were to have contributed certain assets to the joint venture. Northeast (USA) Corp. was to have contributed \$2.1 million in cash and \$1.15 million in technology for a total capital contribution of \$3.25 million. NEGPF was to have contributed \$750,000 in cash and a land-use right valued at \$1.75 million for a total contribution of \$2.5 million. Based upon the amount of contribution, Northeast (USA) Corp. owned 56.52% of the joint venture and NEGPF owned 43.48%. To date, Northeast (USA) Corp. has contributed \$1 million of cash and has contributed the technology. NEGPF has contributed \$750,000 of cash but has not contributed the land-use right. The joint venture had only limited start-up operations and operations effectively ceased in 1997 due to lack of funding. Northeast (USA) Corp. has communicated with NEGPF that it no longer has any interest in the joint venture. As such the Company had reserved \$620,535 against the investment the joint venture. During the year ended June 30, 2003, the Company determined the investment in joint venture to be permanently impaired and wrote off the asset and the associated reserve. This transaction did not have a material effect on the financial statements.

### Advertising Costs

Advertising costs are charged to operations when incurred. Advertising costs charged to expense were \$0 for the year ended June 30, 2003, \$1,360 for the year ended June 30, 2002, and \$6,216 for the period July 19, 1999 (date of inception) to June 30, 2003.

### Depreciation and Amortization

The cost of property and equipment is depreciated for financial reporting purposes on a straight-line basis over the estimated useful lives of the assets: 5 years for machinery and equipment and 3 years for software. Repairs and maintenance expenditures which do not extend the useful lives of the related assets are expensed as incurred.

F-6

Buy It Cheap.com, Inc.  
(A Development Stage Company)  
Notes to the Financial Statements

### SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

#### Income Taxes

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of assets and

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liabilities for financial and income tax reporting. Deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred taxes also are recognized for operating losses that are available to offset future federal and state income taxes.

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### NEW ACCOUNTING PRONOUNCEMENTS

In August 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS 144 supercedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, and provides guidance on classification and accounting for such assets when held for sale or abandonment. SFAS 144 is effective for fiscal years beginning after December 15, 2001. The adoption of SFAS No. 144 did not have a significant impact on the Company's results of operations or financial position.

In April 2002, the FASB issued SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections. This statement rescinds SFAS No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that statement, SFAS No. 44, Accounting for Intangible Assets of Motor Carriers, and SFAS No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. This statement amends SFAS No. 13, Accounting for Leases, to eliminate inconsistencies between the required accounting for sales-leaseback transactions and the require accounting for certain lease modifications that have economic effects that are similar to sales-leaseback transactions. Also, this statement amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. Provisions of SFAS No. 145 related to the rescissions of SFAS No. 4 were effective for the Company on November 1, 2002 and provisions affecting SFAS No. 13 were effective for transactions occurring after May 15, 2002. The adoption of SFAS No. 145 did not have a significant impact on the Company's results of operations or financial position.

In June 2003, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. This statement covers restructuring type activities beginning with plans initiated after December 31, 2002. Activities covered by this standard that are entered into after that date will be recorded in accordance with the provisions of SFAS No. 146. The adoption of SFAS No. 146 did not have a significant impact on the Company's results of operations or financial position.

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Buy It Cheap.com, Inc.  
(A Development Stage Company)  
Notes to the Financial Statements

### NEW ACCOUNTING PRONOUNCEMENTS, Continued

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure, which provides alternative methods of transition for a voluntary change to fair value based method of accounting for stock-based employee compensation as prescribed in SFAS 123, Accounting for Stock-Based Compensation. Additionally, SFAS No. 148 required more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The provisions of this Statement are effective for fiscal years ending after December 15, 2002, with early application permitted in certain circumstances. The Company has adopted the disclosure provisions.

In November 2002, the FASB issued Interpretation No. 45 ("FIN 45"), Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others. FIN 45 requires a company, at the time it issues a guarantee, to recognize an initial liability for the fair value of obligations assumed under the guarantees and elaborates on existing disclosure requirements related to guarantees and warranties. The initial recognition requirements are effective for the Company during the third quarter ending March 31, 2003. The adoption of FIN 45 did not have a significant impact on the Company's results of operations or financial position.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The adoption of FIN 46 did not have a significant impact on the Company's results of operations or financial position.

### DUE TO/FROM OFFICERS AND DIRECTORS

Amounts due to/from Officers and Directors represent unsecured, non-interest bearing loans, having no repayment terms.

### ADVANCE FROM SHAREHOLDER

Advance from shareholder represents an unsecured, non interest bearing advance, having no specific repayment terms.

F-8

Buy It Cheap.com, Inc.  
(A Development Stage Company)  
Notes to the Financial Statements

### PROPERTY AND EQUIPMENT



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Property and equipment at cost, less accumulated depreciation and amortization, consists of the following:

	June 30,	
	2003	2002
Equipment	\$ 5,935	\$ 5,935
Software	32,340	32,340
	-----	-----
Subtotal	38,275	38,275
Less accumulated depreciation and amortization	36,494	29,917
	-----	-----
Total	\$ 1,781	\$ 8,358
	=====	=====

Depreciation expense charged to operations was \$6,577 for the year ended June 30, 2003 and \$11,967 for the year ended June 30, 2002, and \$36,494 for the period July 19, 1999 (date of inception) to June 30, 2003.

### OPERATING LEASE COMMITMENTS

The Company leases office space on a month to month basis. Rent expense was \$1,500 for the year ended June 30, 2003 and \$1,800 for the year ended June 30, 2002, and \$3,750 for the period July 19, 1999 (date of inception) to June 30, 2003.

### INCOME TAXES

The Company's deferred tax asset is comprised of the following temporary differences:

	June 30,	
	2003	2002
Net operating losses	\$ 658,575	\$ 627,191
Differences between basis of reporting for book and tax	-	620,500
	-----	-----
Total	\$ 658,575	\$1,247,691
	=====	=====

The reconciliation of reported income tax expense to the amount of income tax expense that would result from applying domestic federal statutory tax rates to pretax income is as follows:

	June 30,	
	2003	2002
Tax (benefit) at the U.S. Federal Statutory rate	(34%)	(34%)
Valuation allowance - change	34%	34%
State income tax - net of federal tax benefit	-	-
	-----	-----
Provision for income taxes	-	-

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F-9

Buy It Cheap.com, Inc.  
 (A Development Stage Company)  
 Notes to the Financial Statements

INCOME TAXES, Continued

Deferred taxes are recognized for temporary differences between the bases of assets and liabilities for financial statement and income tax purposes. The differences relate primarily to the reserve against investment in Joint Venture (expensed for financial statement purposes but not deductible for income tax purposes).

The Company's provision for income taxes differs from applying the statutory U.S. federal income tax rate to income before income taxes. The primary difference results from providing for state income taxes and from deducting certain expenses for financial statement purposes but not for federal income tax purposes.

Those amounts have been presented in the Company's financial statements as follows:

	June 30,	
	2003	2002
	-----	-----
Deferred tax asset, noncurrent	\$ 224,000	\$ 214,000
Total valuation allowance recognized for deferred tax assets	(224,000)	(214,000)
Net deferred tax assets	\$ -	\$ -
	=====	=====

The Company has available net operating loss carry forwards which may be used to reduce Federal and State taxable income and tax liabilities in future years as follows:

	FEDERAL	STATE
	-----	-----
Available Through		
2004	\$	\$ 191,664
2005		181,950
2006		50,064
2007		69,097
2008		79,342
2009		57,774
2010		31,384
2017	191,664	
2018	181,950	
2019	50,064	
2020	69,097	

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2021	79,342	
2022	57,774	
2023	31,384	
	-----	-----
	\$ 661,275	\$ 661,275
	=====	=====

F-10

Buy It Cheap.com, Inc.  
(A Development Stage Company)  
Notes to the Financial Statements

LOSS PER SHARE

In accordance with Financial Accounting Standards Board Statement No. 128, "Earnings Per Share", basic earnings per share amounts are computed based on the weighted average number of shares outstanding. The number of shares used in the computations were 9,040,427 for the year ended June 30, 2003, 8,990,016 for the year ended June 30, 2002, and 8,224,582 for the period from July 19, 1999 (date of inception) to June 30, 2003.

The effect of assuming the conversion of the Series C convertible preferred stock as a common stock equivalent would be antidilutive, and was therefore not considered in the computation of diluted earnings per share.

The following is a reconciliation of net loss to net loss per share - basic and diluted.

	For the Year Ended June 30, 2003	For the Year Ended June 30, 2002	For the Period July 19, 1999 (date of inception) to June 30, 2003
Net Loss	\$ (31,384)	\$ (57,774)	\$ (237,597)
Less: Dividends on Preferred Stock net of tax benefit	(2,400)	(2,400)	(9,600)
Loss Applicable to common shareholders - basic	(33,784)	(60,174)	(247,197)
Loss Applicable to Common Shareholders - Assuming dilution	\$ (33,784)	\$ (60,174)	\$ (247,197)
Weighted Average Shares Outstanding	9,040,427	8,990,016	8,224,582

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount of cash, due to/from officers, accounts payable and

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accrued expenses and the convertible note payable approximates fair value because of the short maturity of these instruments.

### Limitations

Fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

### PREFERRED STOCK

In May 1994, Northeast (USA) Corp. issued 275,000 shares of its newly designated Series C convertible stock, \$.001 par value, for an aggregate amount of \$825,000 to a group of private investors. Except for \$30,000 (representing 10,000 shares) of the preferred stock, all had been converted according to their terms prior to July 1, 1998. The Company has the right to redeem the shares at \$4.50 per share. The shares carry a stated dividend rate of 8% per annum. Dividends are cumulative and are payable quarterly. No cash dividends have ever been paid. Some former preferred shareholders (prior to or simultaneous with their conversion) have accepted shares of the Company's common stock in lieu of cash dividends. Those that did not accept shares of common stock for dividends and those that did not convert their preferred shares are owed a total of \$111,190 of dividend arrearages at June 30, 2003 and \$108,790 of dividend arrearages at June 30, 2002.

F-11

Buy It Cheap.com, Inc.  
(A Development Stage Company)  
Notes to the Financial Statements

### CONVERTIBLE NOTE PAYABLE

During the period ended June 30, 2000 the Company entered into an agreement with one of its creditors whereby the amount of the creditor's claim (\$32,395) was settled through the issuance of 32,395 of the Company's common shares and a convertible note for \$16,198. The note is non-interest bearing and was due on December 31, 2002. The note may be converted at the creditor's option, into 32,395 shares of the Company's common stock prior to that date. The Company is in default on this note payable.

### COMMITMENTS AND CONTINGENCIES

The Company is indebted to two suppliers who have filed suit against the Company. These filed claims total approximately \$89,000, of which \$11,000 is disputed by the Company. One of these creditors has obtained a judgement (with interest) against the Company for approximately \$60,000. The Company has attempted to settle these claims with issuance of its common stock and convertible notes. Depending on its financial status, the Company will attempt to settle these claims in the coming months.

If the Company is unable to resolve these claims, it may be unable to proceed with its business.

certain. Philips has also announced that it does not expect that this offering will affect the strategic relationship between the two companies and that Philips anticipates remaining among our largest shareholders for the foreseeable future.

Other than as discussed above, we are not aware of any plans by any major shareholders to dispose of significant numbers of common shares.

**Table of Contents**

**FOREIGN INVESTMENT IN THE ROC**

Historically, foreign investment in the ROC securities market has been restricted. Since 1983, the ROC government has periodically enacted legislation and adopted regulations to permit foreign investment in the ROC securities market.

On September 30, 2003, the Executive Yuan approved an amendment to Regulations Governing Investment in Securities by Overseas Chinese and Foreign National, or the Regulations, which took effect on October 2, 2003. According to the Regulations, the SFC abolished the mechanism of the so-called qualified foreign institutional investors and general foreign investors as stipulated in the Regulations before the amendment.

Under the Regulations, foreign investors are classified as either onshore foreign investors or offshore foreign investors according to their respective geographical location. Both onshore and offshore foreign investors are allowed to invest in ROC securities after they register with the Taiwan Stock Exchange. The Regulations further classify foreign investors into foreign institutional investors and foreign individual investors. Foreign institutional investors refer to those investors incorporated and registered in accordance with foreign laws outside of the ROC (i.e., offshore foreign institutional investors) or their branches set up and recognized within the ROC (i.e., onshore foreign institutional investors). Offshore foreign institutional investors are required to apply for a prior approval from the Central Bank of China before they can register with the Taiwan Stock Exchange. Offshore overseas Chinese and foreign individual investors are not required to apply for Central Bank of China approval, but are subject to a maximum investment ceiling that will be separately determined by the SFC after consultation with the Central Bank of China. On the other hand, foreign institutional investors are not subject to any ceiling for investment in the ROC securities market.

Except for certain specified industries, such as telecommunications, investments in ROC-listed companies by foreign investors are not subject to individual or aggregate foreign ownership limits. Custodians for foreign investors are also required to submit to the Central Bank of China and the Taiwan Stock Exchange a monthly report of trading activities and status of assets under custody and other matters. Capital remitted to the ROC under these guidelines may be remitted out of the ROC at any time after the date the capital is remitted to the ROC. Capital gains and income on investments may be remitted out of the ROC at any time.

Foreign investors (other than foreign investors who have registered with the Taiwan Stock Exchange for making investments in the ROC securities market) who wish to make direct investments in the shares of ROC companies are required to submit a foreign investment approval application to the Investment Commission of the ROC Ministry of Economic Affairs or other applicable government authority. The Investment Commission or such other government authority reviews each foreign investment approval application and approves or disapproves each application after consultation with other governmental agencies (such as the Central Bank of China and the SFC).

Under current ROC law, any non-ROC person possessing a foreign investment approval may repatriate annual net profits, interest and cash dividends attributable to the approved investment. Stock dividends attributable to this investment, investment capital and capital gains attributable to this investment may be repatriated by the non-ROC person possessing a foreign investment approval after approvals of the Investment Commission or other government authorities have been obtained.

In addition to the general restriction against direct investment by non-ROC persons in securities of ROC companies, non-ROC persons (except in certain limited cases) are currently prohibited from investing in certain industries in the ROC pursuant to a negative list, as amended by the Executive Yuan. The prohibition on foreign investment in the prohibited industries specified in the

negative list is

## Table of Contents

absolute in the absence of a specific exemption from the application of the negative list. Pursuant to the negative list, certain other industries are restricted so that non-ROC persons (except in limited cases) may invest in these industries only up to a specified level and with the specific approval of the relevant competent authority that is responsible for enforcing the relevant legislation that the negative list is intended to implement.

**Depository Receipts.** In April 1992, the SFC enacted regulations permitting ROC companies with securities listed on the Taiwan Stock Exchange, with the prior approval of the SFC, to sponsor the issuance and sale to foreign investors of depository receipts. Depository receipts represent deposited shares of ROC companies. In December 1994, the Ministry of Finance allowed companies whose shares are traded on the ROC GreTai Securities Market or listed on the Taiwan Stock Exchange, upon approval of the SFC, to sponsor the issuance and sale of depository receipts.

In the past, for depository shares that represented new shares, three months after the issuance of the depository receipts, a holder of the depository receipts (other than citizens of the People's Republic of China and entities organized under the laws of the People's Republic of China) could request the depository to either cause the underlying shares to be sold in the ROC and to distribute the sale proceeds to the holder or to withdraw from the depository receipt facility the shares represented by the depository receipts and transfer the shares to the holder. For depository shares that represent previously issued and existing shares, a holder of the depository receipts (other than citizens of the People's Republic of China and entities organized under the laws of the People's Republic of China) could, immediately after the issuance of the depository receipts, request the depository to either cause the underlying shares to be sold in the ROC and to distribute the sale proceeds to the holder or to withdraw from the depository receipt facility the shares represented by the depository receipts and transfer the shares to the holder. The Executive Yuan and the SFC recently amended the relevant regulations such that the three-month withdrawal restriction has been removed. Accordingly, a holder of depository receipts (other than citizens of the People's Republic of China and entities organized under the laws of the People's Republic of China) may now withdraw shares after the issuance of the depository receipts representing new shares to the extent permitted under the deposit agreement (in practice, four to seven business days thereafter).

We or the foreign depository bank may not increase the number of depository receipts by depositing shares in a depository receipt facility or issuing additional depository receipts against these deposits without specific SFC approval, except in limited circumstances. These circumstances include issuances of additional depository receipts in connection with:

- (1) dividends on or free distributions of shares;
- (2) the exercise by holders of existing depository receipts of their pre-emptive rights in connection with capital increases for cash; or
- (3) if permitted under the deposit agreement and custody agreement, the deposit of common shares purchased by any person directly or through a depository bank on the Taiwan Stock Exchange or the GreTai Securities Market (as applicable) or held by such person for deposit in the depository receipt facility.

Under current ROC laws and regulations, the term "any person" referred to in clause (3) above may be interpreted to mean either (a) any foreign national or overseas Chinese investor (excluding any ROC investors) or (b) any foreign or ROC investor. It is expected that the SFC will clarify this issue in its forthcoming review and amendment of the Guidelines for Offering and Issuance of Overseas Securities by Issuers.



However, the total number of deposited shares outstanding after an issuance under the circumstances described in clause (3) above may not exceed the number of deposited shares

**Table of Contents**

previously approved by the SFC plus any depositary receipts created under the circumstances described in clauses (1) and (2) above. Issuances of additional depositary receipts under the circumstances described in clause (3) above will be permitted to the extent that previously issued depositary receipts have been canceled and the underlying shares have been withdrawn from the depositary receipt facility.

Under current ROC law, a non-ROC holder of ADSs who withdraws the underlying shares must appoint an eligible local agent to:

- (1) open a securities trading account with a local securities brokerage firm;
- (2) remit funds; and
- (3) exercise rights on securities and perform other matters as may be designated by the holder.

Under existing ROC laws and regulations, without this account, holders of ADSs that withdraw and hold the common shares represented by the ADSs would not be able to hold or transfer the common shares, whether on the Taiwan Stock Exchange or otherwise. In addition, a withdrawing non-ROC holder must appoint a local bank to act as custodian for handling confirmation and settlement of trades, safekeeping of securities and cash proceeds and reporting of information.

Holders of ADSs who are non-ROC persons withdrawing common shares represented by ADSs are required under current ROC law and regulations to appoint an agent in the ROC for filing tax returns and making tax payments. This agent, a tax guarantor, must meet certain qualifications set by the ROC Ministry of Finance and, upon appointment, becomes a guarantor of the withdrawing holder's ROC tax payment obligations. In addition, under current ROC law, repatriation of profits by a non-ROC withdrawing holder is subject to the submission of evidence of the appointment of a tax guarantor to, and approval thereof by, the tax authority, or submission of tax clearance certificates or submission of evidencing documents issued by such agent (so long as the capital gains from securities transactions are exempt from ROC income tax). As required by the Central Bank of China, if repatriation by a holder is based on a tax clearance certificate, the aggregate amount of the cash dividends or interest on bank deposits converted into foreign currencies to be repatriated by the holder shall not exceed the amount of:

- (1) the net payment indicated on the withholding tax voucher issued by the tax authority;
- (2) the net investment gains as indicated on the holder's certificate of tax payment; or
- (3) the aggregate transfer price as indicated on the income tax return for transfer of tax-deferred dividend shares, whichever is applicable.

Under existing ROC laws and regulations relating to foreign exchange control, a depositary may, without obtaining further approvals from the Central Bank of China or any other governmental authority or agency of the ROC, convert NT dollars into other currencies, including US dollars, in respect of the following: proceeds of the sale of shares represented by depositary receipts, proceeds of the sale of shares received as stock dividends and deposited into the depositary receipt facility and any cash dividends or cash distributions received. In addition, a depositary, also without any of these approvals, may convert inward remittances of payments into NT dollars for purchases of underlying shares for deposit into the depositary receipt facility against the creation of additional depositary receipts. A depositary may be required to obtain foreign exchange approval from the Central Bank of China

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on a payment-by-payment basis for conversion from NT dollars into other currencies relating to the sale of subscription rights for new shares. Proceeds from the sale of any underlying shares by holders of depositary receipts withdrawn from the depositary receipt facility may be converted into other currencies without obtaining Central Bank of China approval. Proceeds from the sale of the underlying

## **Table of Contents**

shares withdrawn from the depositary receipt facility may be used for reinvestment in the Taiwan Stock Exchange or the GreTai Securities Market, subject to first registering with the Taiwan Stock Exchange and, if applicable, subject to obtaining the approval from the Central Bank of China (if the holder of depositary receipts is a foreign company, that is, a company incorporated in a jurisdiction other than the ROC under the laws of such foreign jurisdiction).

## **Direct Share Offerings**

The ROC government has amended regulations to permit ROC companies listed on the Taiwan Stock Exchange or GreTai Securities Market to issue shares directly (not through depositary receipt facility) overseas.

**Overseas Corporate Bonds.** Since 1989, the ROC Securities and Futures Commission has approved a series of overseas bonds issued by ROC companies listed on the Taiwan Stock Exchange in offerings outside the ROC. Under current ROC law, these overseas corporate bonds can be:

- (1) converted by bondholders, other than citizens of the People's Republic of China and entities organized under the laws of the People's Republic of China, into shares of ROC companies; or
- (2) subject to SFC approval, may be converted into depositary receipts issued by the same ROC company or by the issuing company of the exchange shares, in the case of exchangeable bonds.

The relevant regulations also permit public issuing companies to issue corporate debt in offerings outside the ROC. Proceeds from the sale of the shares converted from overseas convertible bonds may be used for reinvestment in securities listed on the Taiwan Stock Exchange or traded on the GreTai Securities Market, subject to first registering with the Taiwan Stock Exchange and, if applicable, subject to obtaining the approval from the Central Bank of China (if the holder of overseas convertible bonds is a foreign company, that is, a company incorporated in a jurisdiction other than the ROC under the laws of such foreign jurisdiction).

**Table of Contents**

**TAXATION**

**ROC Taxation**

The following is a general summary of the principal ROC tax consequences of the ownership and disposition of ADSs representing common shares to a non-resident individual or entity. It applies only to a holder that is:

an individual who is not an ROC citizen, who owns ADSs and who is not physically present in the ROC for 183 days or more during any calendar year; or

a corporation or a non-corporate body that is organized under the laws of a jurisdiction other than the ROC for profit-making purposes and has no fixed place of business or other permanent establishment in the ROC.

Holders of ADSs are urged to consult their own tax advisors as to the particular ROC tax consequences of owning the ADSs which may affect them.

**Dividends.** Dividends declared by us out of our retained earnings and distributed to the holders are subject to ROC withholding tax, currently at the rate of 20%, on the amount of the distribution in the case of cash dividends or on the par value of the common shares in the case of stock dividends. However, a 10% ROC retained earnings tax paid by us on our undistributed after-tax earnings, if any, would provide a credit of up to 10% of the gross amount of any dividends declared out of those earnings that would reduce the 20% ROC tax imposed on those distributions.

It is currently unclear whether dividends paid by us out of our capital reserves are subject to ROC withholding tax because there are two possible interpretations of the relevant tax laws and regulations that lead to different conclusions on whether such dividends will be taxable, and there is currently no authoritative guidance on this issue.

**Capital Gains.** Under ROC law, capital gains on transactions in the common shares are currently exempt from income tax. In addition, transfers of ADSs are not regarded as a sale of an ROC security and, as a result, any gains on such transactions are not subject to ROC income tax.

**Subscription Rights.** Distributions of statutory subscription rights for common shares in compliance with ROC law are not subject to any ROC tax. Proceeds derived from sales of statutory subscription rights evidenced by securities are exempted from income tax but are subject to securities transaction tax at the rate of 0.3% of the gross amount received. Proceeds derived from sales of statutory subscription rights that are not evidenced by securities are subject to capital gains tax at the rate of:

35% of the gains realized if you are a natural person; or

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25% of the gains realized if you are an entity that is not a natural person.

Subject to compliance with ROC law, we, at our sole discretion, can determine whether statutory subscription rights shall be evidenced by issuance of securities.

**Securities Transaction Tax.** A securities transaction tax, at the rate of 0.3% of the sales proceeds, will be withheld upon a sale of common shares in the ROC. Transfers of ADSs are not subject to ROC securities transaction tax. Withdrawal of common shares from the deposit facility is not subject to ROC securities transaction tax.

**Estate and Gift Tax.** ROC estate tax is payable on any property within the ROC of a deceased who is an individual, and ROC gift tax is payable on any property within the ROC donated by any such

## **Table of Contents**

person. Estate tax is currently payable at rates ranging from 2% of the first NT\$600,000 to 50% of amounts over NT\$100,000,000. Gift tax is payable at rates ranging from 4% of the first NT\$600,000 to 50% of amounts over NT\$45,000,000. Under ROC estate and gift tax laws, common shares issued by ROC companies are deemed located in the ROC regardless of the location of the holder. It is unclear whether a holder of ADSs will be considered to hold common shares for this purpose.

**Tax Treaty.** The ROC does not have a double taxation treaty with the United States. On the other hand, the ROC has double taxation treaties with Indonesia, Singapore, South Africa, Australia, Vietnam, New Zealand, Malaysia, Macedonia, Swaziland, Gambia, The Netherlands and the United Kingdom, which may limit the rate of ROC withholding tax on dividends paid with respect to common shares in ROC companies. It is unclear whether the ADS holders will be considered to hold common shares for the purposes of these treaties. Accordingly, if the holders may otherwise be entitled to the benefits of the relevant income tax treaty, the holders should consult their tax advisors concerning their eligibility for the benefits with respect to the ADSs.

## **United States Federal Income Taxation**

This section discusses the material United States federal income tax consequences of owning and disposing of our common shares or ADSs. It is the opinion of Sullivan & Cromwell LLP, our special tax counsel. It applies to you only if you acquire your common shares or ADSs in this offering and you hold your common shares or ADSs as capital assets for tax purposes. This section does not apply to you if you are a member of a special class of holders subject to special rules, including:

dealers in securities;

traders in securities that elect to use a mark-to-market method of accounting for their securities holdings;

tax-exempt organizations;

life insurance companies;

persons liable for alternative minimum tax;

persons that actually or constructively own 10% or more of our voting stock;

persons that hold common shares or ADSs as part of a straddle or a hedging or conversion transaction; or

U.S. holders, as defined below, whose functional currency is not the U.S. dollar.

This section is based on the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations, published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis. In addition, this section is based in part upon the representations of the depository and the assumption that each obligation in the

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deposit agreement and any related agreement will be performed in accordance with its terms. In general, for United States federal income tax purposes, if you hold ADRs evidencing ADSs, you will be treated as the owner of the shares represented by those ADSs. Exchanges of shares for ADRs, and ADRs for shares, generally will not be subject to United States federal income tax.

You are a U.S. holder if you are a beneficial owner of common shares or ADSs and you are:

a citizen or resident of the United States;

a domestic corporation;



## Table of Contents

an estate whose income is subject to United States federal income tax regardless of its source; or

a trust if a United States court can exercise primary supervision over the trust's administration and one or more United States persons are authorized to control all substantial decisions of the trust.

A non-U.S. holder is a beneficial owner of common shares or ADSs that is not a United States person for United States federal income tax purposes.

**We urge you to consult your own tax advisor regarding the United States federal, state and local tax consequences of owning and disposing of common shares or ADSs in your particular circumstances.**

## **Taxation of Dividends**

*U.S. Holders.* Subject to the passive foreign investment company rules discussed below, if you are a U.S. holder, the gross amount of any dividend we pay in respect of your common shares or ADSs out of our current or accumulated earnings and profits (as determined for United States federal income tax purposes) including the amount of any ROC tax withheld reduced by any credit against such withholding tax on account of the 10% retained earnings tax imposed on us, is subject to United States federal taxation. If you are a noncorporate U.S. holder, dividends paid to you in taxable years beginning before January 1, 2009 that constitute qualified dividend income will be taxable to you at a maximum tax rate of 15% provided that you hold the common shares or ADSs for more than 60 days during the 120-day period beginning 60 days before the ex-dividend date and meet other holding period requirements. Dividends we pay with respect to the common shares or ADSs will be qualified dividend income provided that, in the year that you receive the dividend, the common shares or ADSs are readily tradable on an established securities market in the United States. The dividend is taxable to you when you, in the case of common shares, or the Depository, in the case of ADSs, receives the dividend. The dividend will not be eligible for the dividends-received deduction generally allowed to United States corporations in respect of dividends received from other United States corporations. The amount of the dividend distribution that you must include in your income as a U.S. holder will be the U.S. dollar value of the NT Dollar payments made, determined at the spot NT/U.S. dollar rate on the date the dividend distribution is includible in your income, regardless of whether the payment is in fact converted into U.S. dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date you include the dividend payment in income to the date you convert the payment into U.S. dollars will be treated as ordinary income or loss and will not be eligible for the special tax rate applicable to qualified dividend income. The gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes. Distributions in excess of current and accumulated earnings and profits, as determined for United States federal income tax purposes, will be treated as a non-taxable return of capital to the extent of your basis in the common shares or ADSs and thereafter as capital gain.

Subject to generally applicable limitations and restrictions, the ROC taxes withheld from dividend distributions and paid over to the ROC (reduced by any credit against such withholding tax on account of the 10% retained earnings tax) will be eligible for credit against your U.S. federal income tax liabilities. Special rules apply in determining the foreign tax credit limitation with respect to dividends that are subject to the maximum 15% tax rate. Dividends paid will generally constitute passive income or, in the case of some U.S. financial services providers, financial services income, which is treated separately from other types of income for purposes of computing the foreign tax credit allowable to you.

## **Table of Contents**

*Pro rata* distributions of common shares by us to holders of common shares or ADSs will generally not be subject to U.S. federal income tax. Accordingly, such distributions will generally not give rise to U.S. federal income against which the ROC tax imposed on such distributions may be credited. Any such ROC tax will generally only be creditable against a U.S. holder's U.S. federal income tax liability with respect to general limitation income and not passive income or financial services income, subject to generally applicable conditions and limitations.

In the event that the ex-dividend date on The New York Stock Exchange or other securities exchange or market for a dividend or distribution that gives rise to ROC withholding tax is after the record date for such dividend or distribution (during which period such ADSs may trade with due bills), a purchaser of ADSs during the period from the record date to the ex-dividend date likely would not be entitled to a foreign tax credit for ROC taxes paid in respect of such ADSs even if (i) the purchaser receives the equivalent of such dividend or distribution on the relevant distribution date, and (ii) an amount equivalent to the applicable ROC withholding tax is withheld therefrom or otherwise charged to the account of such purchaser.

*Non-U.S. Holders.* If you are a non-U.S. holder, dividends paid to you in respect of common shares or ADSs will not be subject to United States federal income tax unless the dividends are effectively connected with your conduct of a trade or business within the United States, and the dividends are attributable to a permanent establishment that you maintain in the United States if that is required by an applicable income tax treaty for which you are eligible as a condition for subjecting you to United States taxation on a net income basis. In such cases you will be taxed in the same manner as a U.S. holder. If you are a corporate non-U.S. holder, effectively connected dividends may, under certain circumstances, be subject to an additional branch profits tax at a 30% rate. You may be subject to a branch profits tax at a reduced rate if you are eligible for the benefits of an income tax treaty that provides for a reduced rate.

## **Taxation of Capital Gains**

*U.S. Holders.* Subject to the passive foreign investment company rules discussed below, if you are a U.S. holder and you sell or otherwise dispose of your common shares or ADSs, you will recognize capital gain or loss for United States federal income tax purposes equal to the difference between the U.S. dollar value of the amount that you realize and your tax basis, determined in U.S. dollars, in your common shares or ADSs. Capital gain of a noncorporate U.S. holder that is recognized before January 1, 2009 is generally taxed a maximum rate of 15% where the property is held more than one year. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

*Non-U.S. Holders.* If you are a non-U.S. holder, you will not be subject to United States federal income tax on gain recognized on the sale or other disposition of your common shares or ADSs unless:

the gain is effectively connected with your conduct of a trade or business in the United States and the gain is attributable to a permanent establishment that you maintain in the United States if that is required by an applicable income tax treaty as a condition for subjecting you to United States taxation on a net income basis;  
or

you are an individual and are present in the United States for 183 or more days in the taxable year of the sale and certain other conditions exist.

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If you are a corporate non-U.S. holder, effectively connected gains that you recognize may also, under certain circumstances, be subject to an additional branch profits tax at a 30% rate. You may be subject to a branch profits tax at a reduced rate if you are eligible for the benefits of an income tax treaty that provides for a reduced rate.

**Table of Contents**

**Passive Foreign Investment Company Rules**

We believe that common shares and ADSs should not be treated as stock of a passive foreign investment company, or PFIC, for United States federal income tax purposes, but this conclusion is a factual determination that is made annually and thus may be subject to change.

In general, if you are a U.S. holder, we will be a PFIC with respect to you if for any taxable year in which you held our common shares or ADSs:

at least 75% of our gross income for the taxable year is passive income; or

at least 50% of the value, determined on the basis of a quarterly average, of our assets is attributable to assets that produce or are held for the production of passive income.

Passive income generally includes dividends, interest, royalties, rents (other than certain rents and royalties derived in the active conduct of a trade or business), annuities and gains from assets that produce passive income. If a foreign corporation owns directly or indirectly at least 25% by value of the stock of another corporation, the foreign corporation is treated for purposes of the PFIC tests as owning its proportionate share of the assets of the other corporation, and as receiving directly its proportionate share of the other corporation's income.

If we are treated as a PFIC, and you are a U.S. holder that does not make a mark-to-market election, as described below, you will be subject to special rules with respect to:

any gain you realize on the sale or other disposition of your common shares or ADSs; and

any excess distribution that we make to you (generally, any distributions to you during a single taxable year that are greater than 125% of the average annual distributions received by you in respect of the common shares or ADSs during the three preceding taxable years or, if shorter, your holding period for the common shares or ADSs).

Under these rules:

the gain or excess distribution will be allocated ratably over your holding period for the common shares or ADSs,

the amount allocated to the taxable year in which you realized the gain or excess distribution will be taxed as ordinary income,

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the amount allocated to each prior year, with certain exceptions, will be taxed at the highest tax rate in effect for that year, and

the interest charge generally applicable to underpayments of tax will be imposed in respect of the tax attributable to each such year.

Special rules apply for calculating the amount of the foreign tax credit with respect to excess distributions by a PFIC.

If you own common shares or ADSs in a PFIC that are treated as marketable stock, you may make a mark-to-market election. If you make this election, you will not be subject to the PFIC rules described above. Instead, in general, you will include as ordinary income each year the excess, if any, of the fair market value of your common shares or ADSs at the end of the taxable year over your adjusted basis in your common shares or ADSs. These amounts of ordinary income will not be eligible for the favorable tax rates applicable to qualified dividend income or long-term capital gains. You will also be allowed to take an ordinary loss in respect of the excess, if any, of the adjusted basis of your common shares or ADSs over their fair market value at the end of the taxable year (but only to the extent of the net amount of previously included income as a result of the mark-to-market election).

## **Table of Contents**

Your basis in the common shares or ADSs will be adjusted to reflect any such income or loss amounts. Your gain, if any, recognized upon the sale of your common shares or ADSs will be taxed as ordinary income.

In addition, notwithstanding any election you make with regard to the common shares or ADSs, dividends that you receive from us will not constitute qualified dividend income to you if we are a PFIC either in the taxable year of the distribution or the preceding taxable year. Dividends that you receive that do not constitute qualified dividend income are not eligible for taxation at the 15% maximum rate applicable to qualified dividend income. Instead, you must include the gross amount of any such dividend paid by us out of our accumulated earnings and profits (as determined for United States federal income tax purposes) in your gross income, and it will be subject to tax at rates applicable to ordinary income as well as the special rules provided with respect to excess distributions, if applicable, as described above.

If you own common shares or ADSs during any year that we are a PFIC, you must file Internal Revenue Service Form 8621.

## **Backup Withholding and Information Reporting**

If you are a noncorporate U.S. holder, information reporting requirements, on Internal Revenue Service Form 1099, generally will apply to:

dividend payments or other taxable distributions made to you within the United States, and

the payment of proceeds to you from the sale of common shares or ADSs effected at a United States office of a broker.

Additionally, backup withholding may apply to such payments if you are a noncorporate U.S. holder that:

fails to provide an accurate taxpayer identification number,

is notified by the Internal Revenue Service that you have failed to report all interest and dividends required to be shown on your federal income tax returns, or

in certain circumstances, fails to comply with applicable certification requirements.

If you are a non-U.S. holder, you are generally exempt from backup withholding and information reporting requirements with respect to:

dividend payments made to you outside the United States by us or another non-United States payor and

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other dividend payments and the payment of the proceeds from the sale of common shares or ADSs effected at a United States office of a broker, as long as the income associated with such payments is otherwise exempt from United States federal income tax, and:

the payor or broker does not have actual knowledge or reason to know that you are a United States person and you have furnished the payor or broker:

an Internal Revenue Service Form W-8BEN or an acceptable substitute form upon which you certify, under penalties of perjury, that you are a non-United States person, or

other documentation upon which it may rely to treat the payments as made to a non-United States person in accordance with U.S. Treasury regulations, or

you otherwise establish an exemption.

**Table of Contents**

Payment of the proceeds from the sale of common shares or ADSs effected at a foreign office of a broker generally will not be subject to information reporting or backup withholding. However, a sale of common shares or ADSs that is effected at a foreign office of a broker will be subject to information reporting and backup withholding if:

the proceeds are transferred to an account maintained by you in the United States,

the payment of proceeds or the confirmation of the sale is mailed to you at a United States address, or

the sale has some other specified connection with the United States as provided in U.S. Treasury regulations,

unless the broker does not have actual knowledge or reason to know that you are a United States person and the documentation requirements described above are met or you otherwise establish an exemption.

In addition, a sale of common shares or ADSs effected at a foreign office of a broker will be subject to information reporting if the broker is:

a United States person,

a controlled foreign corporation for United States tax purposes,

a foreign person 50% or more of whose gross income is effectively connected with the conduct of a United States trade or business for a specified three-year period, or

a foreign partnership, if at any time during its tax year:

one or more of its partners are U.S. persons, as defined in U.S. Treasury regulations, who in the aggregate hold more than 50% of the income or capital interest in the partnership, or

such foreign partnership is engaged in the conduct of a United States trade or business,

unless the broker does not have actual knowledge or reason to know that you are a United States person and the documentation requirements described above are met or you otherwise establish an exemption. Backup withholding will apply if the sale is subject to information reporting and the broker has actual knowledge that you are a United States person.

You generally may obtain a refund of any amounts withheld under the backup withholding rules that exceed your income tax liability by filing a refund claim with the United States Internal Revenue Service.





**Table of Contents**

**ENFORCEABILITY OF CIVIL LIABILITIES**

We are a company limited by shares and incorporated under the ROC Company Law. Most of our directors and executive officers, our supervisors and some of the experts named in this prospectus are residents of the ROC and a substantial portion of our assets and our directors, supervisors or executive officers are located in the ROC. As a result, it may be difficult or may not be possible for investors to effect service of process upon us or our directors, supervisors or executive officers within the United States, or to enforce against them judgments obtained in the United States courts, including those predicated upon the civil liability provisions of the federal securities laws of the United States. We have been advised by our ROC counsel, Lee and Li, that in their opinion any final judgment obtained against us in any court other than the courts of the ROC in respect of any legal suit or proceeding arising out of or relating to the ADSs will be enforced by the courts of the ROC without further review of the merits only if the court of the ROC in which enforcement is sought is satisfied that:

the court rendering the judgment has jurisdiction over the subject matter according to the laws of the ROC;

the judgment and the court procedures based on which such judgment was rendered are not contrary to the public order or good morals of the ROC;

if the judgment was rendered by default by the court rendering the judgment, (x) we were duly served during a reasonable time within the jurisdiction of that court in accordance with the laws and regulations of such jurisdiction, or (y) process was served on us with judicial assistance of the ROC; and

judgments of the courts of the ROC are recognized and enforceable in the jurisdiction of the court rendering the judgment on a reciprocal basis.

A party seeking to enforce a foreign judgment in the ROC would be required to obtain foreign exchange approval from the Central Bank of China for the remittance out of the ROC of any amounts recovered in respect of a judgment denominated in a currency other than NT dollars.

**VALIDITY OF SECURITIES**

The validity of the ADSs is being passed upon for Philips and for us by Sullivan & Cromwell LLP, and for the underwriters by Cleary, Gottlieb, Steen & Hamilton. The validity of the common shares is being passed upon for Philips and for us by Lee and Li, Taipei, Taiwan, ROC, and for the underwriters by Tsar & Tsai, Taipei, Taiwan, ROC.

**EXPERTS**

Our consolidated balance sheets as of December 31, 2001 and 2002 and our consolidated statements of income, shareholders equity and cash flows for the years ended December 31, 2000, 2001 and 2002 incorporated by reference herein have been audited by TN Soong & Co., independent auditors, an associate member firm of Deloitte Touche Tohmatsu effective April 22, 2002, as indicated in their report, which expresses an unqualified opinion and includes explanatory paragraphs relating to the adoption of

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Statement of Financial Accounting Standards No. 30, Accounting for Treasury Stock , on January 1, 2002 and the reconciliation to accounting principles generally accepted in the United States of America, and have been so incorporated in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

TN Soong & Co and Deloitte & Touche (Taiwan) combined to establish Deloitte & Touche effective June 1, 2003.

The offices of Deloitte & Touche are located at 6th Floor, 2 Prosperity Road I, Science-Based Industrial Park, Hsinchu, ROC.

**Table of Contents****UNDERWRITING**

We, the selling shareholder and the underwriters for this offering named below have entered into an underwriting agreement with respect to the ADSs being offered both within and outside the United States. Subject to certain conditions, each underwriter has severally agreed to purchase the number of ADSs indicated in the following table. Goldman, Sachs & Co. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, the joint bookrunners for this offering, are the representatives of the underwriters. The address of Goldman, Sachs & Co. is 85 Broad Street, New York, New York 10004. The address of Merrill Lynch, Pierce, Fenner & Smith Incorporated is North Tower, World Financial Center, New York, New York, 10281.

<b><u>Underwriters</u></b>	<b><u>Number of ADSs</u></b>
Goldman, Sachs & Co.	
Merrill Lynch, Pierce, Fenner & Smith Incorporated	
<b>Total</b>	<b>100,000,000</b>

The underwriters are committed to take and pay for all of the ADSs being offered, if any are taken.

The following table shows the per ADS and total underwriting discounts and commissions to be paid to the underwriters by the selling shareholder.

	<b><u>Paid by the selling shareholder</u></b>
Per ADS	US\$
Total	US\$

Total expenses for this offering are estimated to be approximately US\$4.5 million, including depository bank fees and expenses of approximately US\$2.0 million, registration fees of US\$90,568, printing fees of approximately US\$70,000, legal fees of approximately US\$700,000 and accounting fees of approximately US\$700,000. The underwriters have agreed to reimburse us for or pay on our behalf the fees and expenses we incur in connection with this offering, and will also bear their own expenses and certain expenses of the selling shareholder in connection with this offering.

ADSs sold by the underwriters to the public will initially be offered at the initial price to public set forth on the cover of this prospectus. Any ADSs sold by the underwriters to securities dealers may be sold at a discount of up to US\$ per ADS from the initial price to public. Any such securities dealers may resell any ADSs purchased from the underwriters to certain other brokers or dealers at a discount of up to US\$ per ADS from the initial price to public. If all the ADSs are not sold at the initial price to public, the underwriters may change the offering price and the other selling terms.

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We have been advised by the underwriters that some of the underwriters are expected to make offers and sales both inside and outside of the United States through their respective selling agents. Any offers and sales in the United States will be conducted by broker-dealers registered with the Securities and Exchange Commission. Goldman, Sachs & Co. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, registered broker-dealers, shall make offers and sales in the United States.

The underwriters have entered into an agreement in which they agree to restrictions on where and to whom they and any dealer purchasing from them may offer shares or ADSs as a part of the distribution of the shares and ADSs. The underwriters also have agreed that they may sell shares and ADSs among themselves.

## **Table of Contents**

The selling shareholder and the Development Fund have agreed, with certain exceptions, during the period beginning from the date of this prospectus to and including the date 180 days after the date of this prospectus, with respect to the selling shareholder, and 90 days after the date of this prospectus, with respect to the Development Fund, not to, and not to announce an intention to, offer, sell, contract to sell or otherwise dispose of, or file a representation statement or similar document relating to, ADSs or common shares or any security convertible into or exchangeable for common shares or ADSs or other instruments representing interests in or the right to receive ADSs or common shares or any securities substantially similar thereto, without the prior written consent of representatives of the underwriters.

We have also agreed, during the period beginning from the date of this prospectus to and including the date 90 days after the date of this prospectus, not to, and not to announce an intention to, issue any common shares, including common shares represented by ADSs (other than pursuant to employee stock option plans that we may adopt or any common shares to be issued as an annual dividend or annual bonus to directors, supervisors and employees which is approved by our shareholders), without the prior written consent of representatives of the underwriters. Although we have no current plans to make any such issuance during this 90-day period, we are not precluded from issuing any securities that are convertible into or exchangeable for, or that represent the right to receive, our common shares. See [Common Shares Eligible for Future Sale](#) for a discussion of material transfer restrictions.

Prior to the expiry of a period of six months from the closing date of the issuance of the ADSs, no ADSs may be offered or sold to persons in the United Kingdom, except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances that have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995. Any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000) received in connection with the issue or sale of any ADSs may only be communicated or caused to be communicated in circumstances in which section 21(1) of the Financial Services and Markets Act 2000 does not apply to our company or the selling shareholder. All applicable provisions of the Financial Services and Markets Act 2000 and the Public Offers of Securities Regulations 1995 with respect to anything done in relation to the ADSs in, from or otherwise involving the United Kingdom must be complied with.

The ADSs have not been and will not be registered under the Securities and Exchange Law of Japan and may not be offered or sold, directly or indirectly, in Japan or to, or for the account or benefit of, any resident of Japan or to, or for the account or benefit of, any person for reoffering or resale, directly or indirectly, in Japan or to, or for the account or benefit of, any resident of Japan, except (1) pursuant to an exemption from the registration requirements of, or otherwise in compliance with, the Securities and Exchange Law of Japan and (2) in compliance with any other relevant laws and regulations of Japan.

The ADSs may not be offered or sold in Hong Kong, by means of any document, other than to persons whose ordinary business is to buy or sell shares or debentures, whether as principal or agent, or in circumstances which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap. 32) of Hong Kong. No advertisement, invitation or document relating to the ADSs, whether in Hong Kong or elsewhere, may be issued, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to ADSs which are or are intended to be disposed of only to persons outside Hong Kong or only to professional investors within the meaning of the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made thereunder.

## Table of Contents

This prospectus has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this prospectus and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the ADSs may not be circulated or distributed, nor may the ADSs be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (1) to an institutional investor or other person specified in Section 274 of the Securities and Futures Act, Chapter 289, of Singapore (the Securities and Futures Act ), (2) to a sophisticated investor, and in accordance with the conditions, specified in Section 275 of the Securities and Futures Act or (3) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the Securities and Futures Act.

Any ADSs that are offered, as part of their initial distribution or by way of re-offering, in The Netherlands shall, in order to comply with the Netherlands Securities Market Supervision Act 1995 (*Wet toezicht effectenverkeer 1995*), only be offered, and such an offer shall only be announced in writing (whether electronically or otherwise), to individuals or legal entities in The Netherlands who or which trade or invest in securities in the conduct of a business or profession (which includes banks, securities intermediaries (including dealers and brokers), insurance companies, pension funds, collective investment institutions, central governments, large international and supranational organizations, other institutional investors and other parties, including treasury departments of commercial enterprises, which as an ancillary activity regularly invest in securities (together, Professional Investors )), provided that in the offer and in any documents or advertisements in which a forthcoming offering of such ADSs is publicly announced (whether electronically or otherwise) it is stated that such offer is and will be exclusively made to such Professional Investors.

No action may be taken in any jurisdiction other than the United States that would permit a public offering of the ADSs or the possession, circulation or distribution of this prospectus in any jurisdiction where action for that purpose is required. Accordingly, the ADSs may not be offered or sold, directly or indirectly, and neither the prospectus nor any other offering material or advertisements in connection with the ADSs may be distributed or published, in or from any country or jurisdiction except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

The ADSs may not be offered or sold, directly or indirectly, in the Republic of China.

In connection with this offering, the underwriters may, subject to applicable laws and regulations, purchase and sell the ADSs or shares in the open market. These transactions may include short sales, stabilizing transactions and purchases to cover positions created by short sales. Short sales involve the sale by the underwriters of a greater number of shares or ADSs than they are required to purchase in this offering. Stabilizing transactions consist of certain bids or purchases made for the purpose of preventing or retarding a decline in the market price of the shares and ADSs while the offering is in progress.

The underwriters also may, subject to applicable laws and regulations, impose a penalty bid. This occurs when a particular underwriter repays to the underwriters a portion of the underwriting discount received by it because a representative of the underwriters has repurchased shares or ADSs sold by or for the account of that underwriter in stabilizing or covering short transactions.

These activities by the underwriters may stabilize, maintain or otherwise affect the market price of the shares or ADSs. As a result, the price of the shares or ADSs may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the underwriters at any time. These transactions may be effected on The New York Stock Exchange, in the over-the-counter market or otherwise.





**Table of Contents**

We and the selling shareholder have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act.

Purchasers of the ADSs offered in this offering may be required to pay stamp taxes and other charges in accordance with the laws and practices of the country of purchase in addition to the offering price set forth on the cover page of this prospectus.

This prospectus may be used by the underwriters and other dealers in connection with offers and sales of the ADSs, including sales of ADSs initially sold by the underwriters in this offering being made outside of the United States, to persons located in the United States.

A prospectus in electronic format may be made available on the Web sites maintained by the underwriter or one or more securities dealers. The underwriter may agree to allocate a number of ADSs for sale to its online brokerage account holders. ADSs to be sold pursuant to an internet distribution will be allocated on the same basis as other allocations. In addition, ADSs may be sold by the underwriter to securities dealers who resell ADSs to online brokerage account holders.

The underwriters have engaged in, and may in the future engage in, investment banking activities and other commercial dealings in the ordinary course of business with us. They have received customary fees and commissions for these transactions.

**Table of Contents**

**INDEX TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

<u>Unaudited Consolidated Balance Sheets</u>	F-2
<u>Unaudited Consolidated Statements of Income</u>	F-4
<u>Unaudited Consolidated Statements of Changes in Shareholders' Equity</u>	F-5
<u>Unaudited Consolidated Statements of Cash Flows</u>	F-6
<u>Notes to Unaudited Consolidated Financial Statements</u>	F-8

F-1

**Table of Contents****TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****UNAUDITED CONSOLIDATED BALANCE SHEETS**

(In Millions of New Taiwan and US Dollars, Except Shares and Par Value)

	Notes	June 30		
		2002	2003	2003
		NT\$ (Unaudited)	NT\$	US\$ (Note 4)
<b>ASSETS</b>				
<b>CURRENT ASSETS</b>				
Cash and cash equivalents	2, 5	72,395.5	72,084.7	2,082.8
Short-term investments	2, 6	213.2	4,065.7	117.5
Receivables net	2, 7	20,468.4	24,871.9	718.6
Receivable from related parties	21	347.8	687.9	19.9
Inventories net	2, 8	12,960.0	12,639.4	365.2
Deferred income tax assets net	2, 17	4,571.4	3,424.1	98.9
Prepaid expenses and other current assets	21, 24	3,126.0	2,560.3	74.0
<b>Total current assets</b>		<b>114,082.3</b>	<b>120,334.0</b>	<b>3,476.9</b>
<b>LONG-TERM INVESTMENTS</b>	2, 9, 19	<b>10,727.7</b>	<b>11,091.0</b>	<b>320.5</b>
<b>PROPERTY, PLANT AND EQUIPMENT NET</b>	2, 10, 13, 21	<b>242,616.7</b>	<b>221,691.6</b>	<b>6,405.4</b>
<b>GOODWILL</b>	2	<b>10,531.8</b>	<b>9,484.5</b>	<b>274.0</b>
<b>OTHER ASSETS</b>				
Deferred income tax assets net	2, 17	12,005.4	9,207.6	266.0
Deferred charges net	2, 11	5,431.0	8,794.4	254.1
Refundable deposits	21	599.7	398.5	11.5
Idle assets	2	51.3	154.3	4.5
Assets leased to others	2	88.7	85.8	2.5
Miscellaneous		27.8	25.5	0.7
<b>Total other assets</b>		<b>18,203.9</b>	<b>18,666.1</b>	<b>539.3</b>
<b>TOTAL ASSETS</b>		<b>396,162.4</b>	<b>381,267.2</b>	<b>11,016.1</b>

The accompanying notes are an integral part of the unaudited consolidated financial statements.



**Table of Contents****TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****UNAUDITED CONSOLIDATED BALANCE SHEETS**

(In Millions of New Taiwan and US Dollars, Except Shares and Par Value)

	Notes	June 30		
		2002	2003	2003
		NT\$ (Unaudited)	NT\$	US\$ (Note 4)
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>				
<b>CURRENT LIABILITIES</b>				
Short-term bank loans	12	536.9	553.8	16.0
Payable to related parties	21	1,827.9	2,552.5	73.8
Accounts payable		5,705.0	5,587.6	161.4
Payable to contractors and equipment suppliers		17,146.0	6,668.4	192.7
Accrued expenses and other current liabilities	24	7,723.1	8,674.1	250.6
Current portion of long-term liabilities	13	9,000.0	6,922.7	200.0
<b>Total current liabilities</b>		<b>41,938.9</b>	<b>30,959.1</b>	<b>894.5</b>
<b>LONG-TERM LIABILITIES</b>				
Long-term bank loans	13	19,463.6	9,276.0	268.0
Long-term bonds payable	14	35,000.0	35,000.0	1,011.3
Other long-term payables	15	1,470.0	3,921.5	113.3
<b>Total long-term liability</b>		<b>55,933.6</b>	<b>48,197.5</b>	<b>1,392.6</b>
<b>OTHER LIABILITY</b>				
Accrued pension cost	2, 16	2,050.0	2,433.1	70.3
Guarantee deposits	23	6,622.2	1,225.8	35.4
Deferred gain on sales and leaseback	2	191.5	38.3	1.1
Others		156.8	59.7	1.7
<b>Total other liabilities</b>		<b>9,020.5</b>	<b>3,756.9</b>	<b>108.5</b>
<b>COMMITMENTS AND CONTINGENCIES</b>				
MINORITY INTEREST IN SUBSIDIARIES	23	104.9	92.1	2.7
<b>SHAREHOLDERS EQUITY</b>				
Capital stock NT\$10 par value	2, 19			
Authorized: 24,600,000,000 shares				
Issued:				
Preferred 1,300,000,000 shares		13,000.0		
Common 18,622,886,745 shares		186,228.9	186,228.9	5,380.8
To be issued: 1,643,732,239 shares	19		16,437.3	474.9

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Capital surplus	2, 3, 19	57,004.8	56,840.8	1,642.3
Retained earnings		35,079.3	39,929.2	1,153.7
Unrealized loss on long-term investments	2		(8.0)	(0.2)
Cumulative translation adjustments	2	(233.8)	755.4	21.8
Treasury stock 42,001,461 shares in 2002, and 41,961,461 shares in 2003	2, 3, 20	(1,914.7)	(1,922.0)	(55.5)
Total shareholders equity		<u>289,164.5</u>	<u>298,261.6</u>	<u>8,617.8</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>		<u><b>396,162.4</b></u>	<u><b>381,267.2</b></u>	<u><b>11,016.1</b></u>

The accompanying notes are an integral part of the unaudited consolidated financial statements.

F-3

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

(In Millions of New Taiwan and US Dollars, Except Shares and Earnings Per Share)

		Six Months Ended June 30		
		2002	2003	
		NT\$ (Unaudited)	NT\$	US\$ (Note 4)
NET SALES	2, 7, 21, 25	80,266.9	89,695.1	2,591.6
COST OF SALES	21	50,823.4	60,733.9	1,754.8
<b>GROSS PROFIT</b>		<b>29,443.5</b>	<b>28,961.2</b>	<b>836.8</b>
<b>OPERATING EXPENSES</b>				
Research and development	21	5,237.1	5,589.2	161.5
General and administrative	21	3,443.8	3,794.6	109.6
Marketing	2, 7	1,090.0	1,470.2	42.5
<b>Total operating expenses</b>		<b>9,770.9</b>	<b>10,854.0</b>	<b>313.6</b>
<b>INCOME FROM OPERATIONS</b>		<b>19,672.6</b>	<b>18,107.2</b>	<b>523.2</b>
<b>NON-OPERATING INCOME</b>				
Gain on sales of short-term investments net	2	79.2	1,786.3	51.6
Interest		520.9	402.4	11.6
Gain on sales of property, plant, and equipment	2	250.8	295.8	8.6
Technical service income	21, 23	84.4	76.5	2.2
Gain on sales of long-term investments net	2		4.5	0.1
Royalty income	21	322.9		
Premium income from option contracts net	2, 24	11.8		
Others		192.6	318.5	9.2
<b>Total non-operating income</b>		<b>1,462.6</b>	<b>2,884.0</b>	<b>83.3</b>
<b>NON-OPERATING EXPENSES</b>				
Loss on sales of and provision for loss on property, plant and equipment	2	94.8	1,663.8	48.1
Interest	10, 24	1,363.9	1,146.8	33.1
Investment loss recognized by equity method net	2, 9	957.6	701.7	20.3
Permanent loss on long-term investments net	2	378.4	312.9	9.0
Casualty loss net	2	117.5		
Foreign exchange loss net	2, 24	60.4	246.9	7.1
Premium expenses from option contracts net	2, 24		96.7	2.8
Loss on sales of long-term investments net	2	37.9		
Others		87.3	23.5	0.7
<b>Total non-operating expenses</b>		<b>3,097.8</b>	<b>4,192.3</b>	<b>121.1</b>

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INCOME BEFORE INCOME TAX AND MINORITY INTEREST		18,037.4	16,798.9	485.4
INCOME TAX EXPENSE	2, 17	2,151.3	712.3	20.6
INCOME BEFORE MINORITY INTEREST		15,886.1	16,086.6	464.8
MINORITY INTEREST IN LOSS OF SUBSIDIARIES	2	11.2	1.2	
NET INCOME		15,897.3	16,087.8	464.8
BASIC AND DILUTED EARNINGS PER SHARE	2, 21			
Before income tax and minority interest		0.88	0.82	0.02
Net income		0.77	0.79	0.02
BASIC AND DILUTED EARNINGS PER EQUIVALENT ADS	2			
Before income tax and minority interest		4.40	4.11	0.12
Net income		3.87	3.93	0.11
BASIC AND DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	2, 20	20,220,853,000	20,221,270,000	

The accompanying notes are an integral part of the unaudited consolidated financial statements.



Table of Contents

TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In Millions of New Taiwan Dollars Except Shares and Par Value)

Capital Stock (NT\$10 Par Value)

Authorized Shares	Preferred Stock		Common Stock		To Be Issued		Capital Surplus	Retained Earnings	Unrealized Gain (Loss) on Long-term Investments	Cumulative Translation Adjustments	Treasury Stock
	Shares	Amount	Shares	Amount	Shares	Amount					
		NT\$		NT\$		NT\$	NT\$	NT\$	NT\$	NT\$	NT\$
24,600,000,000	1,300,000,000	13,000.0	16,832,553,051	168,325.6			57,128.4	37,507.5		1,228.7	
			107,078,388	1,070.8				(1,070.8)			
								(455.0)			
			1,683,255,306	16,832.5				(16,832.5)			
								(133.8)			
								15,897.3			
							(166.5)	166.5			
							(0.1)	0.1			
										(1,462.5)	

										(1,914.7)
							43.0			
24,600,000,000	1,300,000,000	13,000.0	18,622,886,745	186,228.9		57,004.8	35,079.3		(233.8)	(1,914.7)
24,600,000,000	1,300,000,000	13,000.0	18,622,886,745	186,228.9		57,004.8	40,792.2	(194.3)	945.1	(1,923.5)
						153,901,299	1,539.0	(1,539.0)		
								(455.0)		
						1,489,830,940	14,898.3	(14,898.3)		
								(58.5)		
								16,087.8		
(1,300,000,000)	(13,000.0)									
								20.6		
								165.7		
								(164.4)		
									(189.7)	
							0.4			1.5
24,600,000,000			18,622,886,745	186,228.9	1,643,732,239	16,437.3	56,840.8	39,929.2	(8.0)	755.4
				5,380.8		474.9	1,642.3	1,153.7	(0.2)	21.8
										(55.5)



The accompanying notes are an integral part of the unaudited consolidated financial statements.

F-5

**Table of Contents****TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In Millions of New Taiwan and US Dollars)

	Six Months Ended June 30		
	2002	2003	
	NT\$ (Unaudited)	NT\$	US\$ (Note 4)
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	15,897.3	16,087.8	464.8
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	30,450.8	34,586.1	999.3
Deferred income taxes	2,019.1	543.3	15.7
Investment loss recognized by equity method net	957.6	701.7	20.3
Loss (gain) on sales of long-term investments net	37.9	(4.5)	(0.1)
Permanent loss on long-term investments	378.4	312.9	9.0
Loss (gain) on sales of and provision for loss on property, plant and equipment net	(156.0)	1,368.0	39.5
Pension cost accrued	193.4	221.5	6.4
Allowance for doubtful receivables	72.6	47.1	1.4
Allowance for sales returns and others	755.4	(294.9)	(8.5)
Minority interest in loss of subsidiaries	(11.2)	(1.2)	
Changes in operating assets and liabilities:			
Decrease (increase) in:			
Forward exchange contract receivable	(1,128.1)	183.1	5.3
Receivables	(4,844.2)	(8,338.7)	(240.9)
Receivable from related parties	146.9	(248.3)	(7.2)
Inventories net	(3,131.7)	(1,437.9)	(41.5)
Prepaid expenses and other current assets	951.6	522.2	15.1
Increase (decrease) in:			
Payable to related parties	779.6	776.3	22.4
Accounts payables	4,307.1	449.0	13.0
Forward exchange contract payables	(306.5)	143.0	4.1
Accrued expenses and other current liabilities	1,013.7	420.2	12.1
<b>Net cash provided by operating activities</b>	<b>48,383.7</b>	<b>46,036.7</b>	<b>1,330.2</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Increase in short-term investments net	(708.9)	(3,816.8)	(110.3)
Acquisitions of:			
Long-term investments	(2,114.8)	(1,262.7)	(36.5)
Property, plant and equipment	(17,248.2)	(16,261.9)	(469.9)
Proceeds from sales of:			
Long-term investments	70.6	15.5	0.4
Property, plant and equipment	440.0	132.4	3.8
Increase in restricted cash	(15.5)	(1.0)	
Increase in deferred charges	(1,422.3)	(711.2)	(20.5)

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Decrease in refundable deposits	194.6	158.7	4.6
Decrease (increase) in other assets miscellaneous	(0.5)	9.3	0.3
Decrease in minority interest in subsidiaries	(75.7)	(2.2)	(0.1)
	<u>          </u>	<u>          </u>	<u>          </u>
Net cash used in investing activities	(20,880.7)	(21,739.9)	(628.2)
	<u>          </u>	<u>          </u>	<u>          </u>

(Continued)

F-6

**Table of Contents****TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In Millions of New Taiwan and US Dollars)

	Six Months Ended June 30		
	2002	2003	
	NT\$	NT\$	US\$ (Note 4)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Issuance of:			
Short-term bank loans	203.0		
Long-term bonds	15,000.0		
Payments on:			
Short-term bank loans	(5,745.2)	(173.1)	(5.0)
Long-term bonds		(4,000.0)	(115.6)
Long-term bank loans	(2,013.5)	(1,736.4)	(50.2)
Decrease in guarantee deposits and other liabilities	(590.5)	(169.2)	(4.9)
Redemption of preferred stock		(13,000.0)	(375.6)
Cash dividends paid on preferred stock	(455.0)	(455.0)	(13.1)
Remuneration to directors and supervisors	(133.8)	(58.5)	(1.7)
<b>Net cash provided by (used in) financing activities</b>	<b>6,265.0</b>	<b>(19,592.2)</b>	<b>(566.1)</b>
<b>EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>	<b>1,071.2</b>	<b>(410.1)</b>	<b>(11.8)</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>34,839.2</b>	<b>4,294.5</b>	<b>124.1</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>37,556.3</b>	<b>67,790.2</b>	<b>1,958.7</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>72,395.5</b>	<b>72,084.7</b>	<b>2,082.8</b>
<b>SUPPLEMENTAL INFORMATION</b>			
Interest paid (excluding the amounts capitalized)	498.8	872.7	25.2
Income tax paid	176.2	27.9	0.8
Noncash investing and financing activities:			
Transfer from long-term investments to short-term investments		93.2	2.7
Current portion of long-term liabilities	9,000.0	6,922.7	200.0
Reclassification of parent company stock held by subsidiaries from short/ long-term investments to treasury stock	1,914.7	(1.4)	

The accompanying notes are an integral part of the unaudited consolidated financial statements.



**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**1. GENERAL**

Taiwan Semiconductor Manufacturing Company Ltd. (TSMC), a Republic of China (ROC) corporation, was incorporated as a venture among the government of the ROC, acting through the Development Fund of the Executive Yuan, Koninklijke Philips Electronics N.V. and certain of its affiliates (Philips), and certain other private investors. In September 1994, its shares were listed on the Taiwan Stock Exchange (TSE). On October 8, 1997, TSMC listed its shares of stock on the New York Stock Exchange in the form of American Depositary Shares.

TSMC is engaged mainly in the manufacturing, selling, packaging, testing and designing of integrated circuits and other semiconductor devices, and the manufacturing of masks.

TSMC has five direct wholly-owned subsidiaries, namely, TSMC North America (TSMC-North America), Taiwan Semiconductor Manufacturing Company Europe B.V (TSMC-Europe), TSMC Japan K. K. (TSMC-Japan), TSMC International Investment Ltd. (TSMC International) and TSMC Partners Ltd. (TSMC Partners). In addition, TSMC also has a 99.5% owned subsidiary, Emerging Alliance Fund, LP (Emerging Alliance), and two 36% owned affiliates, Chi Cherng Investment Co., Ltd. (Chi Cherng, which is 36% owned by TSMC and 64% owned by Hsin Ruey Investment Co., Ltd.) and Hsin Ruey Investment Co., Ltd. (Hsin Ruey, which is 36% owned by TSMC and 64% owned by Chi Cherng). TSMC International has two wholly-owned subsidiaries, TSMC Development, Inc. (TSMC Development) and TSMC Technology, Inc. (TSMC Technology), and two 97%-owned subsidiaries, InveStar Semiconductor Development Fund, Inc. (InveStar) and InveStar Semiconductor Development Fund, Inc. (II) LDC (InveStar II). TSMC Development has an approximately 100% owned subsidiary, WaferTech, LLC (WaferTech).

The following diagram presents information regarding the relationship and ownership percentages among TSMC and its subsidiaries as of June 30, 2003:

TSMC-North America is engaged in the sales and marketing of integrated circuits and semiconductor devices. TSMC-Europe, TSMC-Japan, TSMC Development and TSMC Technology are engaged mainly in marketing and engineering support activities. TSMC Partners, Chi Cherng and Hsin Ruey are engaged in investments. TSMC International is engaged in investing in companies involved in design, manufacture, and other related business in the semiconductor industries. Emerging Alliance, InveStar and InveStar II are engaged in investing in new start-up companies in the fields of high technology. WaferTech is engaged in the manufacturing, selling, testing and designing of integrated circuits and other semiconductor devices.



**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Consolidation**

TSMC consolidates the accounts of all majority (directly and indirectly) owned subsidiaries. The consolidated financial statements include, as of and for the six months ended June 30, 2002 and 2003, the accounts of TSMC, TSMC-North America, TSMC-Europe, TSMC-Japan, TSMC Partners, Emerging Alliance, Chi Cherng, Hsin Ruey and TSMC International and its subsidiaries, InveStar, InveStar II, TSMC Development (including WaferTech) and TSMC Technology. TSMC and the foregoing subsidiaries are hereinafter referred to collectively as the Company. All significant intercompany balances and transactions have been eliminated in these consolidated financial statements.

TSMC's investees Hsin Ruey, Chi Hsin Investment Co., Ltd. (Chi Hsin) and Kung Cherng Investment, Co., Ltd. (Kung Cherng) were merged on October 30, 2002, with Hsin Ruey as the surviving company. In addition, TSMC's investees Chi Cherng, Cherng Huei Investment, Co., Ltd. (Cherng Huei) and Po Cherng Investment Co., Ltd. (Po Cherng) were merged on October 30, 2002, with Chi Cherng as the surviving company. The mergers were accounted for as combinations of entities under common control. Chi Hsin, Kung Cherng, Cherng Huei and Po Cherng were consolidated entities as of and for the six months ended June 30, 2002.

Minority interests in Emerging Alliance (0.5%), InveStar (3%), InveStar II (3%) and WaferTech (0.008% in 2002 and 0.004% in 2003) are presented separately in the consolidated financial statements.

**Classification of current and non-current assets and liabilities**

Current assets are those expected to be converted to cash, sold or consumed within one year. Current liabilities are obligations due on demand within one year from the balance sheet date. Assets and liabilities that are not classified as current are non-current assets and liabilities, respectively.

**Cash Equivalents**

Government bonds acquired with maturities less than three months from the date of purchase are classified as cash equivalents.

### **Short-term Investments**

Short-term investments are carried at the lower of cost or market value. The costs of investments sold are determined by the specific identification method.

### **Allowances for Doubtful Receivables**

Allowances for doubtful receivables are provided based on a review of the collectibility of accounts receivable. We determine the amount of allowance for doubtful accounts by examining our historical collection experience and current trends in the credit quality of our customers as well as our internal credit policies.

### **Revenue Recognition and Allowance for Sales Returns and Others**

The four criteria that we use to recognize revenue are the existence of evidence of a contractual arrangement, whether delivery or performance has occurred, whether the selling price is fixed or determinable and whether collectibility is reasonably assured. Allowance for sales returns and

**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

others is estimated based on historical experience and any known factors that would affect the allowance. Such provisions are deducted from sales in the year the products are sold and the estimated related costs are deducted from cost of sales.

Sales are determined using fair value taking into account related sales discounts agreed to by the Company and customers. Since the receivables from sales are collectible within one year and such transactions are frequent, the fair value of receivables is equivalent to the nominal amount of cash received.

**Inventories**

Inventories are stated at the lower of cost or market value. Inventories are recorded at standard cost and adjusted to approximate weighted-average cost at the end of each period. Market value represents net realizable value for finished goods and work in process, and replacement value for raw materials, supplies and spare parts.

**Long-term Investments**

Investments in shares of stock of companies wherein the Company exercises significant influence on the operating and financial policy decisions are accounted for using the equity method. The Company's proportionate share in the net income or net loss of investee companies is recognized as a component of the Investment income/loss recognized by equity method net account. When acquiring shares of stock, the difference between the cost of investment and the Company's proportionate share of the investee's net book value is amortized using the straight-line method over five years and is also recorded as a component of the investment income/loss recognized by equity method net. The Company adopted ROC Statement of Financial Accounting Standards (SFAS) No. 30, Accounting for Treasury Stock, on January 1, 2002. SFAS No. 30 requires a parent company to reclassify its capital stock held by its subsidiaries from short/long-term investments to treasury stock.

When the Company subscribes to additional investee shares at a percentage different from its existing equity interest, the resulting carrying amount of the investment in equity investee differs from the amount of Company's proportionate share in the investee's net equity. The Company records such difference as an adjustment to the capital surplus as well as the long-term investments accounts. In the event an investee uses its capital surplus (excluding reserve for asset revaluation) to offset its accumulated deficit, the Company will also record a corresponding entry equivalent to its proportionate share of the investee's adjustment.

Other stock investments are accounted for using the cost method. Cash dividends are recognized as income in the year received but are accounted for as reductions in the carrying values of the long-term investments if the dividends are received in the same year that the related investments are acquired. Stock dividends are recognized neither as investment income nor as increases in

long-term investment but are recorded only as increases in the number of shares held. An allowance is recognized for any decline in the market value of investments using quoted market prices with the corresponding amount charged to shareholders' equity. A reversal of the allowance will result from a subsequent recovery of the market value of such investments. The carrying values of investments with no quoted market price are reduced to reflect an other than temporary decline in their values, with the related impairment loss charged to income.

F-10

**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Investments in foreign mutual funds are stated at the lower of cost or net asset value (NAV). An allowance is recognized when the cost of the funds are lower than their net asset values, with the corresponding amount debited to shareholders' equity. A reversal of the allowance will result from a subsequent recovery of the net asset value.

Investment in convertible notes and stock purchase warrants are carried at cost.

The costs of investments sold are determined using the weighted-average method.

If an investee company recognizes an unrealized loss on a long-term investment based on the lower-of-cost-or-market method, the Company recognizes a corresponding unrealized loss in proportion to its equity interest and records the amount as a component of its own shareholders' equity.

Gains or losses on transactions with investee companies wherein the Company owns at least 20% of the outstanding common stock but less than a controlling interest are deferred in proportion to the ownership percentage until realized through a transaction with a third party. The entire amount of gains or losses on sales to majority-owned subsidiaries are deferred until such gains or losses are realized through the subsequent sale of the related products to third parties. Gains or losses from sales by investee companies to the Company are deferred in proportion to the ownership percentage until realized through transactions with third parties.

**Property, Plant and Equipment, Assets Leased to Others and Idle Assets**

Property, plant and equipment and assets leased to others are stated at cost less accumulated depreciation. When impairment loss occurs, the related assets are stated at the lower of fair value or book value. Idle assets are stated at the lower of book value or net realizable value. Significant additions, renewals, betterments and interest expense incurred during the construction period are capitalized. Maintenance and repairs are expensed in the period incurred. Property, plant and equipment covered by agreements qualifying as capital leases are carried at the lower of the present value of future minimum rent payments or the market value of the property at the inception dates of the leases. The effective interest method is used to allocate each lease payment between principal and interest expense.

Depreciation is computed using the straight-line method over the estimated service lives, which range as follows: Land improvements 20 years; buildings 10 to 20 years; machinery and equipment 5 to 10 years; and office equipment 3 to 7 years.

Upon sale or disposal of property, plant and equipment, the related cost and accumulated depreciation are removed from the corresponding accounts, and any gain or loss is charged to income in the period of disposal.

### **Goodwill**

Goodwill represents the excess of the consideration paid for acquisitions over the fair market value of identifiable net assets acquired. Goodwill is amortized using the straight-line method over the estimated life of 10 years.

F-11

**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Deferred Charges**

Deferred charges consist of software and system design costs, technology know-how, bond issuance costs and financing costs, and technology license fees. The amounts are amortized as follows: Software and system design costs 3 to 5 years; technology know-how 5 years; bond issuance costs and financing costs the term of the bonds or the related line of credit; technology license fees the shorter of the estimated life of the technology or the term of the technology transfer contract.

**Pension Costs**

Net periodic pension costs are recorded on the basis of actuarial calculations. Unrecognized net transition obligation and unrecognized net gain/loss are amortized over 25 years.

**Deferred Gain on Sale and Leaseback**

The gain on the sale of property that is simultaneously leased back is deferred by the Company. This deferred gain on sale and leaseback transactions is amortized as follows: (a) operating leases adjustment of rental expenses over the term of the leases and (b) capital leases adjustment of depreciation expenses over the estimated useful life of the property or the term of the lease, whichever is shorter.

**Casualty Loss**

Casualty losses mainly caused from the March 31, 2002 earthquake are recorded when incurred and any insurance recoveries are recorded when probable up to the amount of the loss. Recoveries in excess of the amount of the loss are recorded when realized.

**Income Tax**

The Company uses an inter-period tax allocation method for income tax. Deferred income tax assets and liabilities are recognized for the tax effects of temporary differences, unused tax credits and operating loss carry forwards. Valuation allowances are provided to the extent, if any, that it is more likely than not that deferred income tax assets will not be realized. A deferred tax asset

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or liability is, according to the classification of its related asset or liability, classified as current or non-current. However, if a deferred tax asset or liability does not relate to an asset or liability in the financial statements, then it is classified as current or non-current based on the expected length of time before it is realized.

Any tax credits arising from the purchase of machinery, equipment and technology, research and development expenditures, personnel training, marketing expenses for international branding and investments in important technology-based enterprises are recognized using the current method.

Adjustments to prior years' tax liabilities are added to or deducted from the current year's tax provision.

As of January 1, 1998, income taxes on unappropriated earnings (excluding earnings from foreign consolidating subsidiaries) of 10% are expensed in the year of shareholder approval, which is usually the year subsequent to the year incurred.

F-12



**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Concentration of Credit Risk**

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents, receivables, investments and deposits. The Company limits its exposure to credit loss by depositing its cash and cash equivalents with high credit quality financial institution. The Company's sales are primarily denominated in currencies other than NT Dollars, primarily US Dollars. One customer's revenue represented 24% and 16% of the consolidated revenue for the six months ended June 30, 2002 and 2003, respectively. The Company routinely assesses the financial strength of substantially all customers. The financial condition of the counter-party to investments and guarantee deposits is assessed by management on a regular basis.

**Foreign Currency Transactions**

Foreign currency transactions are recorded in New Taiwan dollars at the current rate of exchange in effect when the transaction occurs. Gains or losses derived from foreign currency transactions or monetary assets and liabilities denominated in a foreign currency are recognized in current operations. At the end of each period, foreign currency assets and liabilities are revalued at the prevailing exchange rate with the resulting gain or loss recognized in current operations.

**Derivative Financial Instruments**

The Company enters into foreign currency forward contracts to manage currency exposures in cash flow and in foreign currency-denominated assets and liabilities. The differences in the New Taiwan dollar amounts translated using the spot rate and the amounts translated using the contracted forward rates on the contract date are amortized over the terms of the forward contracts using the straight-line method. At the balance sheet dates, the receivables or payables arising from forward contracts are restated using the prevailing spot rate at the balance sheet date and the resulting differences are recognized and charged to income. Also, the receivables and payables related to the forward contract are netted with the resulting amount presented as either an asset or a liability. Any resulting gain or loss upon settlement is charged to income in the period of settlement.

The Company enters into interest rate swap transactions to manage exposures to changes in interest rates on existing liabilities. These transactions are accounted for on an accrual basis, in which the cash settlement receivable or payable is recorded as an adjustment to interest income or expense.

The notional amount of foreign currency option contracts entered into for hedging purposes are not recognized as an asset or liability on the contract dates. The premiums paid or received for the call or put options are amortized and charged to income on a

straight-line basis over the term of the related contract. Any resulting gain or loss upon settlement is charged to income in the period of settlement.

#### **Translation of Foreign Currency Financial Statements**

ROC SFAS No. 14, Accounting for Foreign Currency Transactions, applies to foreign subsidiaries that use the local foreign currency as its functional currency. The financial statements

F-13

**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

of foreign subsidiaries are translated into New Taiwan dollars at the following exchange rates: assets and liabilities current rate on balance sheet date; shareholders equity historical rate; income and expenses weighted average rate during the year. The resulting translation adjustment is recorded as a separate component of shareholders equity.

**Reclassification**

Certain accounts in the financial statements as of and for the six months ended June 30, 2002 have been reclassified to conform to the financial statements as of and for the six months ended June 30, 2003.

**Earnings Per Share**

Earnings per share is calculated by dividing net income by the average number of shares outstanding in each period, adjusted retroactively to the beginning of the year for stock dividends and stock bonuses issued subsequently. Earnings per equivalent American Depository Share (ADS) is calculated by multiplying earnings per share by five (one ADS represents five common shares).

**3. NEW ACCOUNTING PRONOUNCEMENTS**

In accordance with the ROC SFAS No. 30, Accounting for Treasury Stock, and other relevant regulations from the ROC Securities and Futures Commission (SFC), the Company is required to reclassify its common stock held by subsidiaries from short/long-term investments to treasury stock. The reclassification is based on the carrying value recorded by the Company's subsidiaries as of January 1, 2002. The adoption of SFAS No. 30 resulted in the decrease of long-term investments and the increase of treasury stock by NT\$1,922,049 thousand as of June 30, 2003, and the decrease in net income for the six months ended June 30, 2003 by NT\$255,016 thousand.

**4. US DOLLAR AMOUNTS**

The Company maintains its accounts and expresses its consolidated financial statements in New Taiwan dollars. For convenience only, US dollar amounts presented in the accompanying consolidated financial statements have been translated from New Taiwan dollars at the noon buying rate in The City of New York for cable transfers in New Taiwan dollars as certified for customs purposes by the Federal Reserve Bank of New York as of June 30, 2003, which was NT\$34.61 to US\$1.00. The convenience translations should not be construed as representations that the New Taiwan dollar amounts have been, could have been, or could in the future be, converted into US dollars at this or any other rate of exchange.

## 5. CASH AND CASH EQUIVALENTS

	June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Cash and bank deposits	71,097.7	69,051.9
Government bonds acquired under repurchase agreements	1,297.8	3,032.8
	<u>72,395.5</u>	<u>72,084.7</u>

F-14

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 6. SHORT-TERM INVESTMENTS

	June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Government bonds		3,054.1
Listed stocks-carry value	213.2	1,011.6
	<u>213.2</u>	<u>4,065.7</u>
Market value	<u>2,894.2</u>	<u>5,325.0</u>

The market values of listed stocks and government bonds as of June 30, 2002 and 2003 were based on the average closing price and the daily volume-weighted average yield/price conversion of Gre Tai Securities Market, respectively.

## 7. RECEIVABLES NET

	June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Notes receivable	124.5	13.5
Accounts receivable	24,854.0	27,916.2
	<u>24,978.5</u>	<u>27,929.7</u>
Less allowance for doubtful receivables	(1,173.1)	(980.1)
Less allowance for sales returns and others	(3,337.0)	(2,077.7)
	<u>(4,510.1)</u>	<u>(3,057.8)</u>
	<u>\$ 20,468.4</u>	<u>\$ 24,871.9</u>

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The changes in the allowances are summarized as follows:

	<b>Six Months Ended June 30</b>	
	<b>2002</b>	<b>2003</b>
	<b>NT\$ (Unaudited) (In Millions)</b>	<b>NT\$ (Unaudited) (In Millions)</b>
<b>Allowance for doubtful receivables</b>		
Balance, beginning of the period	1,100.5	933.0
Additions	88.6	48.4
Deductions	(16.0)	(1.3)
	<u>1,173.1</u>	<u>980.1</u>
<b>Allowance for sales returns and others</b>		
Balance, beginning of the period	2,581.6	2,372.5
Additions	2,002.9	1,817.8
Deductions	(1,247.5)	(2,112.6)
	<u>3,337.0</u>	<u>2,077.7</u>

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 8. INVENTORIES NET

	June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Finished goods	1,774.1	1,967.8
Work in process	10,951.7	11,439.1
Raw materials	530.7	526.7
Supplies and spare parts	1,040.2	950.0
	14,296.7	14,883.6
Less inventory reserve	(1,336.7)	(2,244.2)
	<u>12,960.0</u>	<u>12,639.4</u>

The changes in inventory reserve are summarized as follows:

	Six Months Ended June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Balance at beginning of the period	1,191.8	1,736.3
Additions	2,418.2	2,656.3
Write-offs	(2,273.3)	(2,148.4)
	<u>1,336.7</u>	<u>2,244.2</u>

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 9. LONG-TERM INVESTMENTS

	June 30			
	2002		2003	
	Carrying Value	% of Ownership	Carrying Value	% of Ownership
	NT\$		NT\$	
Equity method:				
Publicly traded stock				
Vanguard International Semiconductor Corporation (VIS)	3,102.9	25	3,848.0	28
Non-publicly traded stock				
Systems on Silicon Manufacturing Company Pte Ltd. (SSMC)	3,449.3	32	2,609.9	32
Global UniChip Corp. (GUC)			387.4	47
	<u>6,552.2</u>		<u>6,845.3</u>	
Cost method:				
Common stock				
Publicly traded stock				
Amkor Technology, Inc.	280.7		280.7	
Monolithic System Technology, Inc.	104.3	2	104.3	2
Taiwan Mask Corp.	32.1	2	32.1	2
Non-publicly traded stock				
United Gas Co., Ltd.	193.6	11	193.6	11
Global Testing Corp. (GTC)	180.0	10	180.0	10
Global Investment Holding	102.9	6	106.1	6
Shin-Etsu Handotai Co., Ltd.	105.0	7	105.0	7
EoNEX Technologies, Inc.			103.6	6
Hong Tung Venture Capital	150.0	10	83.9	10
Procoat Technology, Inc.	65.1	12	67.5	12
Goyatek Technology, Inc.			62.1	8
W.K. Technology, Fund IV	50.0	2	50.0	2
RichTek Technology Corp.	44.1	10	47.0	9
Advanced Power Electronics Corp.	46.8	6	46.8	6
Auden Technology MFG. Co., Ltd.	37.4	4	38.8	4
Conwise Technology Corp. Ltd.			33.6	14
Eon Technology, Inc.			33.6	10
TrendChip Technologies Corp.			30.0	5
Programmable Microelectronics (Taiwan) Corp.	59.1	4	20.8	5
ChipStrate Technology, Inc.	10.5	9	10.5	9
Signia Technologies, Inc.			10.5	10
eChannel Option Holding, Inc.			8.7	6
GeoVision, Inc.	4.4	2	4.5	2



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Capella Microsystems Inc.	4.5	2	3.0	2
Elcos Microdisplay Technology, Ltd.			0.9	2
Divio, Inc.	0.1		0.1	
EmpowerTel Networks, Inc.	1.2	1		
Equator Technologies, Inc.	3.0			
3DFX Interactive, Inc.	10.0			
	<u>1,484.8</u>	<u>          </u>	<u>1,657.7</u>	<u>          </u>

F-17

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	June 30			
	2002		2003	
	Carrying Value	% of Ownership	Carrying Value	% of Ownership
	NT\$		NT\$	
Preferred stock				
Non-publicly traded stock				
Sonics, Inc.	221.9	10	228.9	10
Tropian, Inc.	145.4	5	150.0	5
Reflectivity, Inc.	67.1	6	145.1	14
Monolithic Power Systems, Inc.	132.3	16	136.6	16
Atheros Communications, Inc.	120.6	3	124.3	3
Elcos Microdisplay Technology			121.1	16
Memsic, Inc.	102.7	24	105.9	22
Ikanos Communication	50.3	3	89.0	3
Pixim, Inc.	83.9	3	82.4	3
Quicksilver Technology, Inc.	139.3	30	81.0	4
Kilopass Technology, Inc.			69.2	19
Fang Tek, Inc.			69.2	44
NanoAmp Solutions, Inc.	62.2	4	64.1	4
NetLogic Microsystems	62.1	1	64.0	1
Alchip Technologies Ltd.			58.9	24
Newport Opticom, Inc.	73.9	15	55.4	16
Ralink Technologies, Inc.	50.3	7	52.1	5
SiRF Technology Holdings, Inc.	49.1	1	50.7	1
OEpic, Inc.	83.9	7	45.6	8
Advanced Analogic Technology, Inc.	42.3	2	43.6	2
Integrated Memory Logic, Inc.	60.7	12	42.2	12
Axiom Microdevices, Inc			34.7	5
Optichron			34.7	6
Litchfield Communications	33.6	6	34.6	6
Accelerant Networks	33.6	1	34.6	1
Quake Technology	33.6	1	34.6	1
IP Unity			34.0	2
Match Lab, Inc.	58.7	11	30.2	11
LightSpeed Semiconductor Corp.	102.8	3	28.7	2
Silicon Data, Inc.	33.6	7	26.0	7
XHP Microsystem			26.0	6
Angstrom Systems, Inc.	25.2	7	26.0	2
Iridigm Display	16.8	2	17.4	2
Mosaic Systems	16.8	6	17.4	6
Zenesis Technologies	16.8	4	17.4	4
Divio, Inc.	16.8	4	17.3	3

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Capella Microsystems, Inc.	77.1	9	12.0	9
Incentia Design Systems, Inc.	16.8	2	11.8	2
Sensory, Inc.	41.9	5	10.8	5
Oridus, Inc. (CreOsys, Inc.)	50.3	8	10.4	8
Signia Technologies, Inc.	75.5	22		
LeadTONE Wireless, Inc.	5.8	4	4.5	6
eBest!, Inc.			2.8	1
FormFactor, Inc.	67.1	1		
HiNT Corp.	33.6	5		
Equator Technologies, Inc.	95.3	2		

F-18

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	June 30			
	2002		2003	
	Carrying Value	% of Ownership	Carrying Value	% of Ownership
	NT\$	(Unaudited) (In Millions)	NT\$	
EmpowerTel Networks, Inc.	17.2	7		
Rise Technology Company	50.3	3		
OmegaBand, Inc. (Seagull Semiconductor, Inc.)	10.2	4		
	<u>2,477.4</u>		<u>2,345.2</u>	
Bonds				
Rise Technology Co.	10.0			
	<u>10.0</u>			
Funds				
Horizon Ventures	160.6		195.4	
Crimson Asia Capital	39.5		47.4	
	<u>200.1</u>		<u>242.8</u>	
Equity certificate				
OEpic, Inc.				
Warrant				
eBest!, Inc.	3.2			
	<u>10,727.7</u>		<u>11,091.0</u>	

On January 4, 2003, TSMC purchased 52% of the outstanding shares of GUC for NT\$341.2 million (US\$9.8 million). On February 26, 2003, GUC issued new shares and TSMC purchased 6,500 thousand of these new shares for NT\$ 68.7 million. As a result, its ownership in GUC decreased from 52% to 47%.

The investment losses of the equity-method investee companies consist of the following:

	Six Months Ended June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited) (In Millions)	
VIS	274.6	172.4
SSMC	683.0	515.2
GUC		14.1
	957.6	701.7

F-19

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The market value of publicly traded stocks accounted under the cost method was NT\$486.6 million and NT\$506.6 million as of June 30, 2002 and 2003, respectively.

## 10. PROPERTY, PLANT AND EQUIPMENT NET

	June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
Cost		
Land and land improvements	841.3	871.4
Buildings	72,922.8	78,250.2
Machinery and equipment	312,107.4	360,735.4
Office equipment	6,759.9	7,037.8
	<u>392,631.4</u>	<u>446,894.8</u>
Construction in progress	32,522.8	18,601.0
	<u>425,154.2</u>	<u>465,495.8</u>
Accumulated depreciation		
Land and improvements	276.2	430.3
Buildings	22,654.8	31,917.0
Machinery and equipment	156,076.3	207,404.7
Office equipment	3,530.2	4,052.2
	<u>182,537.5</u>	<u>243,804.2</u>
	<u>242,616.7</u>	<u>221,691.6</u>

Depreciation expense on property, plant and equipment was NT\$28,800.6 million and NT\$32,253.9 million in the six months ended June 30, 2002 and 2003, respectively.

Interest expense (before deducting capitalized amounts of NT\$48.6 million and NT\$2.9 million in the six months ended June 30, 2002 and 2003, respectively) was NT\$1,412.5 million and NT\$1,149.7 million in the six months ended June 30, 2002 and 2003, respectively. The interest rate used for purpose of calculating the capitalized amount was 5.283% for the six months ended June

30, 2002 and 2003, respectively.

Information on the status of the expansion or construction plans of TSMC's manufacturing facilities as of June 30, 2003, is as follows:

Construction/Expansion Plan	Estimated		Actual Date	Expected Date of Starting Operations
	Complete Cost	Accumulated Expenditures	of Starting Operations	
	NT\$	NT\$		
	(Unaudited)			
	(In Millions)			
Fab 6	93,932.0	87,699.4	March 2000	
Fab 12 phase 1	80,318.4	61,581.7	March 2002	
Fab 14 phase 1				second half of 2004 at the earliest
	30,411.0	13,690.4		

F-20

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 11. DEFERRED CHARGES NET

	June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
Technology license fees	2,305.0	5,711.4
Software and system design costs	2,876.0	2,956.0
Bond issuance costs and financing costs	152.4	101.7
Technology know-how	76.5	22.5
Others	21.1	2.8
	<u>5,431.0</u>	<u>8,794.4</u>

Amortization expense on deferred charges was NT\$1,090.7 million and NT\$1,790.4 million for the six months ended June 30, 2002 and 2003, respectively.

As of June 30, 2003, the Company's estimated aggregate amortization expense for each of the five succeeding fiscal years is as follows:

Year	Amount
	NT\$ (Unaudited) (In Millions)
July to December, 2003	1,171.0
2004	2,170.2
2005	1,967.1
2006	1,007.1
2007	508.2
2008 and thereafter	1,970.8
	<u>8,794.4</u>



**12. SHORT-TERM BANK LOANS**

	<u>June 30</u>	
	<u>2002</u>	<u>2003</u>
	<b>NT\$</b>	<b>NT\$</b>
	<b>(Unaudited)</b>	
	<b>(In Millions)</b>	
Unsecured loans in US dollars:		
US\$16.0 million, annual interest at 1.9125% and 1.73% in 2002 and 2003, respectively	536.9	553.8

As of June 30, 2003, TSMC provided a NT\$1,384.5 million (US\$40.0 million) guarantee for the above US\$16.0 million loan.

Unused credit lines as of June 30, 2003 aggregated approximately NT\$9,930.0 million and US\$361.0 million, respectively.

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 13. LONG-TERM BANK LOANS

	June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
Secured loan: US\$440.0 million, repayable by February 2005, US\$122.0 million and US\$50.0 million was repaid in 2002 and 2003, annual floating interest at 2.515% and 2.015% in 2002 and 2003, respectively	12,752.0	9,276.0
Unsecured loan: US\$200.0 million, repayable by December 2003, annual interest at 2.725% and 1.9125% in 2002 and 2003, respectively	6,711.6	6,922.7
	<u>19,463.6</u>	<u>16,198.7</u>

As of June 30, 2003, all of the loans above were guaranteed by TSMC. In addition, all assets of WaferTech with a carrying amount of approximately NT\$20,681.4 million (US\$597.5 million) were pledged for the US\$440.0 million secured loan. WaferTech is required to be in compliance with certain financial covenants beginning December 31, 2002 under the secured loan. As of June 30, 2003, WaferTech was in compliance with all such financial covenants. Under the unsecured loan, TSMC is required to maintain certain financial covenants which, if violated, could result in the payment of this obligation becoming due prior to the originally scheduled maturity date. These financial covenants require TSMC to, among other things, maintain minimum levels of working capital, earnings before interest, taxes, depreciation and amortization, and net worth. TSMC was in compliance with these financial covenants as of June 30, 2003.

As of June 30, 2003, future minimum principal payments under the Company's long-term bank loan arrangements are as follows:

Year	Amount
	NT\$ (Unaudited) (In Millions)
July to December 2003	6,922.7
2004	
2005	9,276.0
	<u>16,198.7</u>

Unused credit lines for long-term bank loans as of June 30, 2003 aggregated approximately NT\$27.5 million and US\$172.0 million, respectively.

F-22

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 14. BONDS

	June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	
Domestic unsecured bonds:		
Issued in March 1998 and payable in March 2003 in one lump sum payment, 7.71% annual interest payable semi-annually	4,000.0	
Issued in October 1999 and payable in October 2002 and 2004 in two equal payments, 5.67% and 5.95% annual interest payable annually, respectively	10,000.0	5,000.0
Issued in December 2000 and payable in December 2005 and 2007 in two installments, 5.25% and 5.36% annual interest payable annually, respectively	15,000.0	15,000.0
Issued in January 2002 and payable in January 2007, 2009 and 2012 in three installments, 2.6%, 2.75% and 3% annual interest payable annually, respectively	15,000.0	15,000.0
	<u>44,000.0</u>	<u>35,000.0</u>

As of June 30, 2003, future principal payments under the Company's bonds are as follows:

<u>Year of Repayment</u>	<u>Amount</u>
	NT\$ (Unaudited) (In Millions)
July to December, 2003	
2004	5,000.0
2005	10,500.0
2006	
2007	7,000.0
2008 and thereafter	12,500.0
	<u>35,000.0</u>

## 15. OTHER LONG-TERM PAYABLES

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TSMC entered into several license arrangements for certain semiconductor-related patents. Future payments under the agreements as of June 30, 2003 are as follows:

<u>Year</u>	<u>Amount</u>
	<b>NT\$ (Unaudited) (In Millions)</b>
July to December, 2003	809.9
2004	1,221.8
2005	983.0
2006	467.3
2007	484.5
2008 and thereafter	1,107.6
	<hr/>
	5,074.1
	<hr/>

F-23

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**16. PENSION PLAN**

TSMC has a pension plan for all regular employees that provides benefits based on length of service and average monthly salary for the six-month period prior to retirement.

TSMC contributes at an amount equal to 2% of salaries paid every month to a Pension Fund (the Fund). The Fund is administered by a pension fund monitoring committee (the Committee) and deposited in the Committee's name with the Central Trust of China.

The changes in the Fund and accrued pension cost for the six months ended June 30, 2002 and 2003 are summarized as follows:

	Six Months Ended June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	
Plan Assets		
Balance, beginning of the period	804.4	993.4
Contribution	87.3	91.0
Interest	29.6	20.7
Payment	(5.3)	(3.5)
	<u>916.0</u>	<u>1,101.6</u>
Unfunded accrued pension cost		
Balance, beginning of the period	1,856.6	2,211.6
Accruals	193.4	221.5
	<u>2,050.0</u>	<u>2,433.1</u>

**17. INCOME TAXES**

- a. A reconciliation of income tax expense before minority interest at the statutory rate and current income tax expense before income tax credits is shown below:

	Six Months Ended June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
Income tax expense based on income before minority interest at statutory rate	4,554.8	4,233.9
Tax-exempt income	(2,665.0)	(2,027.8)
Temporary and permanent differences	235.6	(43.7)
	<hr/>	<hr/>
Current income tax expense before income tax credits	2,125.4	2,162.4
	<hr/>	<hr/>

The ROC statutory rate for 2002 and 2003 was 25%.

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- b. Income tax expense consists of:

	Six Months Ended June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited) (In Millions)	
Current income tax expense before income tax credits	2,125.4	2,162.4
Additional 10% tax on the unappropriated earnings	164.7	1,273.5
Income tax credits	(2,163.8)	(3,269.2)
Other income tax	5.9	2.3
<b>Income tax expense</b>	<b>132.2</b>	<b>169.0</b>
Net change in deferred income tax assets (liabilities)		
Net operating loss carryforwards	1,854.1	(543.0)
Investment tax credits	(2,268.6)	(2,573.3)
Temporary differences	2,394.8	(1,529.9)
Valuation allowance	38.8	5,189.4
	<b>2,151.3</b>	<b>712.3</b>

- c. Deferred income tax assets (liabilities) consist of the following:

	June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited) (In Millions)	
<b>Current</b>		
Investment tax credits	4,547.1	3,320.0
Temporary differences	24.3	104.1
	<b>4,571.4</b>	<b>3,424.1</b>
<b>Noncurrent</b>		
Net operating loss	4,264.2	8,395.3



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Investment tax credits	21,778.9	25,820.9
Temporary differences	(4,779.8)	(6,845.1)
Valuation allowance	(9,257.9)	(18,163.5)
	<u>12,005.4</u>	<u>9,207.6</u>

d. Integrated income tax information:

The balances of the imputation credit account (ICA) as of June 30, 2002 and 2003 were NT\$2.5 million and NT\$14.7 million, respectively.

The actual creditable ratios for 2001 and 2002 were 0.04% and 0.08%, respectively.

e. All retained earnings generated prior to December 31, 1997 were appropriated as of June 30, 2002.

F-25

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- f. As of June 30, 2003, TSMC's investment tax credits consisted of the following:

Regulation	Items	Total	Remaining	Expiration
		Creditable	Creditable	
		Amounts	Amounts	Year
		NT\$	NT\$	
		(Unaudited)	(Unaudited)	
		(In Millions)	(In Millions)	
Statute for Upgrading Industries	Purchase of machinery and equipment	4,767.3	1,798.5	2003
		8,210.6	8,210.6	2004
		3,814.4	3,814.4	2005
		4,905.9	4,905.9	2006
		332.3	332.3	2007
		<u>22,030.5</u>	<u>19,061.7</u>	
Statute for Upgrading Industries	Research and development expenditures	671.5	376.6	2003
		1,974.3	1,974.3	2004
		3,111.5	3,111.5	2005
		3,322.4	3,322.4	2006
		836.3	836.3	2007
		<u>9,916.0</u>	<u>9,621.1</u>	
Statute for Upgrading Industries	Personnel training	16.1	16.1	2003
		43.3	43.3	2004
		28.9	28.9	2005
		27.3	27.3	2006
				<u>115.6</u>
Statute for Upgrading Industries	Marketing expenses for international branding	0.3	0.3	2003
Statute for Upgrading Industries	Investments in important technology-based enterprise	5.4		2003
		203.3	203.3	2004
		138.9	138.9	2005

	347.6	342.2
	<hr style="width: 50%; margin: 0 auto;"/>	<hr style="width: 50%; margin: 0 auto;"/>

- g. The sales generated from the following expansion and construction of TSMC's manufacturing plants are exempt from income tax:

	<u>Tax-exemption Period</u>
Construction of Fab 6	2001 to 2004
Construction of Fab 8 module B	2002 to 2005
Expansion of Fab 2 modules A and B, Fab 3 and Fab 4, Fab 5 and Fab 6	2003 to 2006

- h. The tax authorities have examined income tax returns of the Company through 1999. However, the Company is contesting the assessment by the tax authority for 1992, 1993,

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

1996, 1997 and 1998 and believes any additional assessment would not be significant. The Company believes the remaining unused tax credits would be sufficient to offset any additional tax expense that may arise from the assessment.

## 18. LABOR COST, DEPRECIATION AND AMORTIZATION EXPENSE

	Six Months Ended June 30, 2002		
	Classified as Cost of Sales	Classified as Operating Expense	Total
	NT\$	NT\$ (Unaudited) (In Millions)	NT\$
Labor cost			
Salary	3,987.1	2,179.6	6,166.7
Labor and health insurance	191.4	98.0	289.4
Pension	190.8	97.6	288.4
Other	138.7	130.0	268.7
Depreciation	27,430.8	1,369.8	28,800.6
Amortization	312.9	1,417.3	1,730.2
	<u>32,251.7</u>	<u>5,292.3</u>	<u>37,544.0</u>

	Six Months Ended June 30, 2003		
	Classified as Cost of Sales	Classified as Operating Expense	Total
	NT\$	NT\$ (Unaudited) (In Millions)	NT\$
Labor cost			
Salary	4,141.3	2,300.9	6,442.2
Labor and health insurance	223.6	115.2	338.8
Pension	207.0	105.9	312.9
Other	114.9	131.7	246.6
Depreciation	31,038.7	1,215.2	32,253.9
Amortization	755.8	1,679.9	2,435.7
	<u>37,516.2</u>	<u>5,442.7</u>	<u>42,958.9</u>

36,481.3	5,548.8	42,030.1
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## 19. SHAREHOLDERS EQUITY

TSMC has issued a total of 485,898 thousand American Depositary Shares (ADS), which trade on the New York Stock Exchange (NYSE), as of September 30, 2003. The total number of common shares represented by all issued ADSs is 2,429,491 thousand shares (one ADS represents five common shares).

Capital surplus can only be used to offset a deficit under the ROC Company Law. However, the components of capital surplus generated from donated capital and the excess of the issue price over the par value of capital stock (including stock issued for new capital, mergers and the purchase of treasury stock) can be transferred to capital stock as stock dividends.

F-27

**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

TSMC's Articles of Incorporation provide that the following shall be appropriated from annual net income if in excess of any cumulative deficit:

- a. 10% legal reserve;
- b. Special reserve in accordance with relevant laws or regulations;
- c. Remuneration to directors and supervisors and bonuses to employees equal to 0.3% and at least 1% of the remainder, respectively. Individuals eligible for the employee bonuses may include employees of affiliated companies as approved by the board of directors or a representative of the board of directors;
- d. Dividends to holders of preferred shares at a 3.5% annual rate, based on the period which the preferred shares have been outstanding. Following the redemption of all of its issued and outstanding preferred shares in May 2003, TSMC amended its Articles of Incorporation on June 3, 2003 to remove the provision for issuance of any future dividends to preferred shareholders as of that date;
- e. The appropriation of any remaining balance shall be approved by the shareholders.

Dividends are distributed in shares of common stock or a combination of cash and common stock. Distribution of profits is usually made in the form of a stock dividend. The total of cash dividends paid in any given year may not exceed 50% of total dividends distributed in that year.

Any appropriations of net income are recorded in the financial statements in the year of shareholder approval.

The appropriation for legal reserve is made until the reserve equals the aggregate par value of TSMC's outstanding capital stock. The reserve can only be used to offset a deficit or be distributed as a dividend up to half of the reserve balance when the balance has reached 50% of the aggregate par value of the outstanding capital stock of TSMC.

A special reserve equivalent to the debit balance of any account shown in the shareholder's equity section of the balance sheet (except for the recorded costs of treasury stocks held by subsidiaries), other than the deficit, shall be made from unappropriated retained earnings pursuant to existing regulations promulgated by the ROC SFC. The special reserve is allowed to be appropriated when the debit balance of such accounts is reversed.

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The appropriations of the earnings of 2001 and 2002 were approved in the shareholders meeting on May 7, 2002 and June 3, 2003, respectively. The appropriations and dividend per share are as follows:

	Appropriation of Earnings		Dividend Per Share (NT\$)	
	For Fiscal Year 2001	For Fiscal Year 2002	For Fiscal Year 2001	For Fiscal Year 2002
	NT\$	NT\$		
	(Unaudited)			
	(In Millions)			
Legal reserve	1,448.3	2,161.0		
Special reserve	(349.9)	69.0		
Bonus paid to employees-in stock	1,070.8	1,539.0		
Preferred stock dividend-in cash	455.0	455.0	0.35	0.35
Common stock dividend-in stock	16,832.6	14,898.3	1.00	0.80
Remuneration to directors and supervisors-in cash	133.8	58.5		
	<u>19,590.6</u>	<u>19,180.8</u>		

**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The above appropriation of the earnings in fiscal year 2001 and 2002 is consistent with the resolution of the meetings of board of directors on March 26, 2002 and March 4, 2003, respectively. If the above employee bonus and remuneration to directors and supervisors were paid in cash and charged against income for 2001 and 2002, the basic earnings per share for the years ended December 31, 2001 and 2002 would decrease from NT\$0.83 to NT\$0.76 and NT\$1.14 to NT\$1.05, respectively. The shares distributed as a bonus to employees represented 0.64% and 0.83% of the Company's total outstanding common shares as of December 31, 2001 and 2002, respectively.

Under the Integrated Income Tax System that became effective on January 1, 1998, ROC resident shareholders are allowed a tax credit for their proportionate share of the income tax paid by TSMC on earnings generated as of January 1, 1998. An Imputation Credit Account (ICA) is maintained by TSMC for such income tax and the tax credit allocated to each shareholder.

**Preferred Stock**

TSMC issued 1,300,000 thousand shares of unlisted Series A preferred stock to certain investors on November 29, 2000. All of the preferred stock was redeemed at par value and retired on May 29, 2003. Under TSMC's Articles of Incorporation, as amended on June 3, 2003, the Company is no longer authorized to issue preferred stock.

The following are the rights of the preferred shareholders and the related terms and conditions prior to redemption:

Preferred shareholders

- a. are entitled to receive cumulative cash dividends at an annual rate of 3.5%.
- b. are not entitled to receive any common stock dividends (whether declared out of unappropriated earnings or capital surplus).
- c. have priority over the holders of common shares to the assets of the Company available for distribution to shareholders upon liquidation or dissolution; however, the preemptive rights to the assets shall not exceed the issue value of the shares.
- d. have voting rights similar to that of the holders of common shares.



- e. have no right to convert their shares into common shares. The preferred shares are to be redeemed within thirty months from their issuance. The preferred shareholders have the aforementioned rights and the Company's related obligations remain the same until the preferred shares are redeemed by the Company.

## **Employee Stock Compensation**

### *Stock Option Plans*

On June 25, 2002, the SFC approved TSMC's Employee Stock Option Plan (Plan I). Plan I provides option rights with each unit representing one common share of stock to qualified employees of TSMC and its subsidiaries, including TSMC-North America and WaferTech. The option rights are valid for ten years and exercisable at certain percentages subsequent to the

Table of Contents**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

second anniversary of issuance. Under the terms of Plan I, stock options are granted at an exercise price equal to the closing price of TSMC's common shares listed on the Taiwan Stock Exchange (TSE) on the date of grant. The maximum number of shares authorized to be granted under Plan I is 100,000 thousand option rights. The options vest 50% two years after the grant date, 75% vest three years after the grant date and 100% vest four years after the grant date. Under Plan I, there were 52,820 thousand option rights that had never been granted, or had been granted but cancelled. These un-granted or cancelled option rights expired on June 25, 2003.

Options are generally exercisable when vested, and unvested options are cancelled and returned to Plan I upon termination of service. If employment is terminated by an option holder voluntarily or by the Company, any vested options must be exercised within 3 months from the employment termination date.

Information with respect to stock option rights activities under Plan I is as follows:

	<b>Outstanding Option Rights</b>	
	<b>Number of Option Rights</b>	<b>Range of Weighted Average Exercise Prices</b>
	<b>(In Thousands)</b>	<b>NT\$</b>
Balance, January 1, 2003	19,369	51.0~53.0
Options granted	28,411	41.6~58.5
Options cancelled	(600)	41.6~58.5
Balance, June 30, 2003	47,180	

The following table sets forth the range of exercise prices, number of options, weighted-average exercise price and remaining contractual life of options outstanding at June 30, 2003:

<b>Range of Exercise</b>	<b>Number of Options (in Thousands)</b>	<b>Remaining Contractual Life (Years)</b>	<b>Weighted Average Exercise</b>
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<u>Prices (NT\$)</u>	_____	_____	<u>Price (NT\$)</u>
41.6	6,483	9.68	41.6
51.0	1,075	9.35	51.0
53.0	17,851	9.14	53.0
58.5	21,771	9.93	58.5
_____	_____	_____	_____
41.6-58.5	47,180	9.58	53.9
_____	_____	_____	_____

No options were exercisable as of June 30, 2003.

On September 2, 2003, the Board of Directors approved the 2003 employee stock option plan (2003 Plan). The 2003 Plan has been submitted to the SFC for final approval. The 2003 Plan will provide option rights with each unit representing one common share of stock to qualified employees of TSMC and its subsidiaries. The option rights are valid for ten years and exercisable at certain percentages subsequent to the second anniversary of issuance. Under the terms of the 2003 Plan, stock options are granted at an exercise price equal to the closing price of TSMC s

F-30

**Table of Contents****TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

common shares listed on the TSE on the date of grant. The maximum number of shares authorized to be granted is 120,000 thousand option rights. The options vest 50% two years after the grant date, 75% vest three years after the grant date and 100% vest four years after the grant date.

In 1996, WaferTech adopted an Executive Incentive Plan, which was amended in 1997. Under the 1997 amendment, the Board of Directors approved the Senior Executive Incentive Plan and the Employee Incentive Plan (Plan II) under which officers, key employees and non-employee directors may be granted option rights, appreciation rights and/or performance units. As WaferTech is a limited liability company and does not have units of stock, each option right granted pursuant to Plan II provided grantees rights to purchase ownership interests in WaferTech. Plan II provides for a maximum of 15,150 thousand option rights. While WaferTech may grant employees option rights that are exercisable at different times or within different periods, it has generally granted option rights that are exercisable on a cumulative basis in annual installments of 25% each on the first, second, third and fourth anniversaries of the date of grant.

Information with respect to stock option rights activities under Plan II is as follows:

	Option Rights Available for Grant	Outstanding Option Rights	
		Number of Option Rights	Exercise Price
	(In Thousands)		US\$
Balance, January 1, 2002	4,608	3,062	1.43
Options granted			
Options exercised	(244)	(917)	1.22
Options cancelled		(117)	1.93
Balance, June 30, 2002	4,364	2,028	
Balance, January 1, 2003	4,824	1,586	1.53
Options exercised		(599)	1.33
Options cancelled	129	(129)	1.77
Balance, June 30, 2003	4,953	858	

The option rights granted will expire if not exercised at specified dates between May 2006 and June 2011.

*WaferTech Buyback Program*

In December 2000, WaferTech implemented the Stock Option Buyback Program (Buyback) with its employees. The Buyback program provides employees with the right to sell back all vested stock options and outstanding ownership interests granted prior to January 1, 2001 to WaferTech. The repurchase price for outstanding ownership interests is US\$6 per option. The repurchase price for vested stock options is US\$6 per option less the exercise price of the option. Unvested option rights continue to vest in accordance with the vesting schedule prescribed under Plan II and can be sold back to WaferTech once vested. As of June 30, 2002 and 2003, WaferTech had repurchased 2,581 thousand and 2,593 thousand outstanding ownership interests at a cost of US\$15.5 million and US\$15.6 million, respectively.

The difference between the share repurchase price of US\$6 and the exercise price is recognized as compensation expense over the vesting period of the option rights. As of June 30, 2002 and 2003, US\$6.8 million and US\$3.3 million remained as deferred compensation in connection with the stock option buyback program, respectively. For the six months ended June 30, 2002 and

Table of Contents**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

2003, US\$1.6 million and US\$0.1 million had been recognized as compensation expense, respectively. Of the 858 thousand shares outstanding as of June 30, 2003, 408 thousand shares have vested and may be resold to the Company.

*Stock Appreciation Rights*

Effective in December 2000, TSMC-North America adopted a stock appreciation rights program (SAR Plan) whereby employees are entitled to receive cash bonuses based on the appreciation of TSMC stock as quoted by the TSE. As of June 30, 2003, TSMC-North America had approximately 11.4 million stock appreciation rights outstanding, and no employees had elected to exercise their rights. During 2002, benefits under the SAR Plan were replaced by the 2002 Stock Option Plan (Plan I) and, accordingly, TSMC-North America does not intend to provide additional SAR Plan benefits subsequent to the adoption of Plan I.

In December 2000, in conjunction with WaferTech's Buyback program, WaferTech implemented the Employee Stock Appreciation Incentive Plan (Appreciation). The Appreciation plan is designed to provide employees with a long-term incentive plan that tracks the appreciation of TSMC common stock through stock appreciation rights (SARs). SARs provide each participant the right to receive, upon exercise, an amount in cash from WaferTech that is the excess of the market price of TSMC common stock on the date of exercise over the exercise price on the date of grant. The exercise price is equivalent to the per share price of TSMC common stock on the date of grant as quoted on the Taiwan Stock Exchange. SARs granted prior to March 10, 2001 vest 25% per year for four years and expire five years from the date of grant. In May 2001, the Board of Directors approved a reduction in the vesting period from four years to two years for SARs grants made after March 10, 2001. As of June 30, 2003, WaferTech had granted 11,380,655 SARs under the Appreciation plan at a weighted average exercise price of US\$1.75. As of June 30, 2003, there were 4.7 million vested SARs under the Appreciation plan.

Compensation expense is recorded based on the difference between the grant price and market price at the end of each period. This expense is recognized ratably over the vesting period and adjusted based on changes in TSMC's stock price on TSE. The Company recorded compensation expense of approximately US\$0.1 million and US\$1.3 million at June 30, 2002 and 2003, respectively.

**20. TREASURY STOCK (COMMON STOCK)**

<u>Purpose</u>	<u>Beginning Shares</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Shares</u>
	(Shares in Thousands)			
<i>Six months ended June 30, 2002</i>				
Reclassification of parent company stock held by subsidiaries from short/long-term investment	39,270	3,818	1,087	42,001

*Six months ended June 30, 2003*

Reclassification of parent company stock held by subsidiaries  
from short/long-term investment

	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
	42,001		40	41,961
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

F-32

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Proceeds from the sale of treasury stock for the six months ended June 30, 2002 and 2003 were NT\$96.5 million and NT\$1.9 million, respectively. As of June 30, 2002 and 2003, the book value of the treasury stock was NT\$1,914.7 million and NT\$1,922.0 million, respectively; the market value was NT\$3,120.4 million and NT\$2,463.7 million, respectively. Capital stock held by a subsidiary as an investment is recorded as treasury stock, with the holder having the same rights as other common shareholders.

**21. EARNINGS PER SHARE**

Earnings per share (EPS) are computed as follows:

	Amounts (Numerator)		Share (Denominator) (Thousands)	EPS (NT\$)	
	Income Before Income Tax And Minority Interest NT\$ (Unaudited) (In Millions)	Net Income NT\$		Income Before Income Tax And Minority Interest	Net Income
<i>Six months ended June 30, 2002</i>					
Income	18,037.4	15,897.3			
Less: preferred stock dividends	(227.5)	(227.5)			
	<u>17,809.9</u>	<u>15,669.8</u>			
Basic and diluted earnings per Share					
Income available to common Shareholders	<u>17,809.9</u>	<u>15,669.8</u>	<u>20,220,853</u>	<u>0.88</u>	<u>0.77</u>
<i>Six months ended June 30, 2003</i>					
Income	16,798.9	16,087.8			
Less: preferred stock dividends	(184.5)	(184.5)			
	<u>16,614.4</u>	<u>15,903.3</u>			
Basic and diluted earnings per Share					
Income available to common Shareholders	<u>16,614.4</u>	<u>15,903.3</u>	<u>20,221,270</u>	<u>0.82</u>	<u>0.79</u>



The potential common shares issuable under the employee stock option plans (see Note 19) are included in the denominator of the diluted EPS computation, but such shares result in a non-dilutive per share amount by using the treasury stock method under the ROC SFAS No. 24, Earnings Per Share . The average number of shares outstanding for purposes of the EPS calculation has been adjusted retroactively for issuance of stock dividends and stock bonuses. The retroactive adjustment caused the basic EPS before income tax and after income tax for the six months ended June 30, 2002 to decrease from NT\$0.96 to NT\$0.88 and from NT\$0.88 to NT\$0.77, respectively.

F-33

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**22. RELATED PARTY TRANSACTIONS**

The Company engaged in business transactions with the following related parties:

- a. Industrial Technology Research Institute (ITRI), one of whose directors is the Chairman of TSMC
- b. Koninklijke Philips Electronics N.V., (Philips), a major shareholder of TSMC
- c. Investees of TSMC

VIS

SSMC

GUC

The transactions with the aforementioned parties, in addition to those disclosed in other notes, are summarized as follows:

	<b>Six Months Ended June 30</b>	
	<b>2002</b>	<b>2003</b>
	<b>NT\$</b>	<b>NT\$</b>
	<b>(Unaudited)</b>	
	<b>(In Millions)</b>	
<i>During the period</i>		
Sales		
Philips and its affiliates	1,293.5	1,396.5
GUC		343.5
ITRI	31.2	24.6
SSMC	6.4	0.9
VIS	91.8	
	<b>1,422.9</b>	<b>1,765.5</b>
Purchases		

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SSMC	988.3	2,676.3
VIS	1,663.5	2,286.5
	<u>2,651.8</u>	<u>4,962.8</u>
Operating expense rental		
ITRI	40.4	
Manufacturing expenses technical service fee		
Philips (see Note 24a)	1,455.9	1,493.9
Sales of property, plant and equipment		
VIS		8.1
Non-operating income		
SSMC (technical service income mainly) (see Note 24f)	46.8	54.8
VIS		0.3
	<u>46.8</u>	<u>55.1</u>

F-34

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Six Months Ended June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
<i>At end of the period</i>		
Receivables		
Philips and its affiliates	253.3	508.5
GUC		149.4
SSMC	42.6	13.0
ITRI	9.2	11.5
VIS	42.7	5.5
	<u>347.8</u>	<u>687.9</u>
Payables		
Philips and its affiliates	651.5	1,160.4
VIS	1,165.3	996.8
SSMC	11.1	395.3
	<u>1,827.9</u>	<u>2,552.5</u>
Refundable deposits		
VIS (see Note 24i)	550.7	349.2

Sales to related parties are based on normal selling prices and collection terms, except for sales of property, plant and equipment and technical service fees, which were in accordance with the related contracts.

**23. SIGNIFICANT LONG-TERM LEASES**

TSMC leases land from the Science-Based Industrial Park (SBIP) Administration where its Fab 2 through Fab 14 manufacturing facilities reside. These agreements expire on various dates from March 2008 to December 2020 and have annual rent payments aggregating NT\$225.6 million. The agreements can be renewed upon their expiration.

TSMC-North America leases its office premises and certain equipment under non-cancelable operating agreements, which will expire in 2020. TSMC-Europe and TSMC-Japan entered into lease agreements for their office premises, which will expire in 2005. Current annual rent payments under these lease agreements aggregate to NT\$343.3 million.

Future remaining lease payments are as follows:

<u>Year</u>	<u>Amount</u>
	<b>NT\$</b>
	<b>(Unaudited)</b>
	<b>(In Millions)</b>
July to December, 2003	171.2
2004	344.3
2005	340.6
2006	339.3
2007	336.4
2008 and thereafter	2,071.9
	<hr/>
	3,603.7
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F-35

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**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Rental expense for the six months ended June 30, 2002 and 2003 was NT\$193.2 million and NT\$191.6 million, respectively.

**24. SIGNIFICANT COMMITMENTS AND CONTINGENCIES**

The significant commitments and contingencies of TSMC and its subsidiaries as of June 30, 2003 are as follows:

- a. Under a Technical Cooperation Agreement with Philips, as amended on May 12, 1997, TSMC shall pay technical assistance fees at a percentage of net sales (as defined in the agreement) with respect to certain products. The agreement shall remain in force through July 8, 2007 and may be automatically renewed for successive periods of three years thereafter. Under the amended agreement, starting from the fifth anniversary date of the amended agreement, the fees are subject to reduction by the amounts TSMC pays to any third party for settling any licensing/infringement disputes, provided that the fees to be paid after reduction will not be below a certain percentage of the net sales.
- b. Subject to certain equity ownership and notification requirements, Philips and its affiliates can avail themselves each year of up to 30% of TSMC's production capacity.
- c. Under a technical cooperation agreement with ITRI, TSMC shall reserve and allocate up to 35% of certain of its production capacity for use by the Ministry of Economic Affairs (MOEA) or any other party designated by the MOEA.
- d. Under several foundry agreements, TSMC shall reserve a portion of its production capacity for certain major customers who have made guarantee deposits to TSMC. As of June 30, 2003, TSMC had a total of US\$34.3 million of guarantee deposits.
- e. Under a Shareholders Agreement entered into with Philips and EDB Investments Pte Ltd. on March 30, 1999, the parties formed a joint venture company, SSMC, for the purpose of constructing an integrated circuit foundry in Singapore, and allowed TSMC to invest in 32% of SSMC's capital. TSMC and Philips committed to buy a specific percentage of the production capacity of SSMC. If any party defaults on the commitment and the capacity utilization of SSMC falls below a specific percentage of its total capacity, the defaulting party is required to compensate SSMC for all related unavoidable costs.
- f. TSMC provides technical services to SSMC under a Technical Cooperation Agreement (the Agreement) entered into on May 12, 1999. TSMC receives compensation for such services computed at a specific percentage of net selling prices of certain products sold by SSMC. The Agreement shall remain in force for ten years and may be automatically renewed for successive periods of five years unless pre-terminated by either party under certain conditions.
- g. TSMC provided guarantees on loans amounting to US\$200 million, US\$40 million and US\$440 million for TSMC Development, Inc., TSMC-North America and WaferTech, respectively.

- h. Under a Technology Transfer Agreement (TTA) with National Semiconductor Corporation (National) entered into on June 27, 2000, TSMC shall receive payments for license of certain technology to National. The agreement will remain in force for ten years and will be automatically renewed for successive periods of two years thereafter unless either party gives

F-36

**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

notice for early termination under certain conditions. In January 2003, TSMC and National entered into a Termination Agreement whereby the TTA was terminated for convenience. Under the termination agreement, TSMC will be relieved of any further obligation to transfer any additional technology. In addition, TSMC granted National an option to request additional technology transfers under the same terms and conditions as the terminated TTA through January 2008.

- i. TSMC entered into a Manufacturing Agreement with VIS. VIS agrees to reserve certain production capacity for TSMC to manufacture certain logic devices or other technologies required by TSMC's customers at selling prices as agreed upon by the parties. TSMC paid NT\$1,200.0 million to VIS as a guarantee deposit. VIS shall return portions of the guarantee deposit without any interest to TSMC upon reaching certain levels of purchase commitment by the Company. The contract will remain in force for five years. As of June 30, 2003, the refundable deposit was NT\$349.2 million.
- j. Starting from 2001, TSMC entered into several license arrangements for certain semiconductor patents. The terms of the contracts range from five to ten years with payments to be paid in the form of royalties over the term of the related contracts. TSMC has recorded the related amounts as a liability, which is amortized and charged to cost of sales on a straight-line basis over the estimated life of the technology or the term of the contract, whichever is shorter.
- k. TSMC-North America has an outstanding irrevocable standby letter of credit with a financial institution for US\$1.5 million. The standby letter of credit was entered into as security to the landlord of TSMC-North America's office spaces in San Jose, California. In the event TSMC-North America defaults under this lease agreement, the landlord will draw on the standby letter of credit up to the amount of the default, but not to exceed the amount of the standby letter of credit. The standby letter of credit expires on October 9, 2003, and is renewable on an annual basis.
- l. In November 2002, TSMC entered into an Amended and Restated Joint Technology Cooperation Agreement with Philips, Motorola, Inc. and ST-Microelectronics to jointly develop 90-nanometer to 65-nanometer advanced CMOS Logic and e-DRAM technologies. TSMC also agreed to align 0.12 micron CMOS Logic technology to enhance its foundry business opportunities. TSMC will contribute process technologies and share a portion of the costs associated with this joint development project.
- m. TSMC entered into investment related agreements with Shanghai Songjiang District People's Government on June 8, 2003. Subject to the ROC government's approval and market demands, the Company contemplates establishing semiconductor fabs in Shanghai Songjiang Science and Technology Park.
- n. Amounts available under unused letters of credit as of June 30, 2003 were NT\$6.5 million, US\$2.4 million, EUR0.1 million and Singapore dollar \$0.1 million.

**25. FINANCIAL INSTRUMENTS**

The Company entered into derivative financial instrument transactions for the six months ended June 30, 2002 and 2003 to manage exposures related to foreign-currency denominated





**Table of Contents****TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

receivables and payables, and interest rate fluctuations. Certain information on these contracts is as follows:

- a. Outstanding forward exchange contracts as of June 30, 2002 and 2003:

	<b>Currency To Be Received</b>	<b>Amounts (In Millions)</b>	<b>Currency To Pay</b>	<b>Amounts (In Millions)</b>	<b>Maturity</b>	<b>Fair Value (In Millions)</b>
<b>2002</b>						
Sell	EUR	EUR 71.0	US\$	US\$ 67.6	Jul. ~ Sep. 2002	NT\$ 2,357.8
Sell	JPY	JPY 10,375.9	US\$	US\$ 85.6	Jul. 2002	NT\$ 2,926.2
Sell	NT\$	NT\$ 45,097.7	US\$	US\$ 1,315.0	Jul. ~ Sep. 2002	NT\$ 45,134.1
Buy	US\$	US\$ 110.0	NT\$	NT\$ 3,778.3	Jul. ~ Aug. 2002	NT\$ 3,767.2
<b>2003</b>						
Sell	NT\$	NT\$ 44,543.3	US\$	US\$ 1,290.0	Jul. ~ Dec. 2003	NT\$ 44,583.7
Buy	EUR	EUR 14.0	US\$	US\$ 6.1	Jul. 2003	NT\$ 554.2
Buy	JPY	JPY 6,580.4	US\$	US\$ 56.0	Jul. ~ Aug. 2003	NT\$ 1,902.9

As of June 30, 2002 and 2003, receivables from forward exchange contracts (included in other current assets account) aggregated approximately NT\$1,128.1 million and NT\$16.5 million, respectively. As of June 30, 2002 and 2003, payables from forward exchange contracts (included in other current liabilities account) aggregated approximately NT\$90.6 million and NT\$160.5 million, respectively. Net exchange gain for the six months ended June 30, 2002 was NT\$2,215.4 million. Net exchange loss for the six months ended June 30, 2003 was NT\$144.0 million.

The net assets and liabilities related to the above forward exchange contracts are as follows:

	<b>June 30</b>	
	<b>2002</b>	<b>2003</b>
	<b>(Unaudited) (In Millions)</b>	
Accounts receivable	US\$ 678.2	US\$ 721.2
Accounts payable	JPY 12,084.9	JPY 8,040.1
Accounts payable	EUR 46.5	EUR 35.7
Accounts payable	US\$ 265.9	

- b. Interest rate swaps

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The Company has entered into interest rate swap transactions to manage exposures to rising interest rates on its floating rate long-term bank loans. Interest expense on these transactions for the six months ended June 30, 2002 and 2003 was NT\$127.0 million and NT\$114.1 million, respectively.

F-38

**Table of Contents****TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Outstanding contracts as of June 30, 2002 and 2003 were as follows:

<u>Contract Date</u>	<u>Contract Amount (Unaudited) (In Millions)</u>	<u>Contract Period</u>	<u>Interest Rate Received</u>	<u>Interest Rate paid</u>
<b>2002</b>				
April 28, 1998	NT\$2,000.0	May 21, 1998 to May 21, 2003	One month LIBOR	7.25%
April 29, 1998	NT\$1,000.0	May 21, 1998 to May 21, 2003	One month LIBOR	7.25%
June 26, 1998	NT\$1,000.0	June 26, 1998 to June 26, 2003	One month LIBOR	7.20%
June 26, 1998	NT\$1,000.0	July 6, 1998 to July 6, 2003	One month LIBOR	7.20%
July 1, 1999	US\$ 11.4	July 1, 1999 to June 28, 2004	One month LIBOR	5.95%
<b>2003</b>				
June 26, 1998	NT\$1,000.0	July 6, 1998 to July 6, 2003	One month LIBOR	7.20%
July 1, 1999	US\$ 8.6	July 1, 1999 to June 28, 2004	One month LIBOR	5.95%

c. Options contracts

The Company entered into foreign currency option contracts to manage exchange rate fluctuations arising from its anticipated US dollar cash receipts on export sales and its Yen currency obligations for purchases of machinery and equipment.

Outstanding option contracts as of June 30, 2002 and 2003 were as follows:

<u>Contract</u>	<u>Contract Amount (Unaudited) (In Millions)</u>	<u>Fair Value (Unaudited) (In Millions)</u>	<u>Strike Price</u>	<u>Maturity</u>
<b>2002</b>				
Put option bought	US\$ 410.0	NT\$ 40.8	33.465-34.57	Jul. ~ Sep. 2002
Call option written	US\$ 497.5	(NT\$ 5.1)	34.81-33.465	Jul. ~ Sep. 2002
Call option written	US\$ 60.0	(NT\$ 8.0)	33.47	Aug. ~ Sep. 2002

(US\$/NT\$)

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2003					
Put option bought	US\$	45.0	(NT\$72.7)	32.915-33.077	Jul. ~ Aug. 2003
				(US\$/NT\$)	
Put option bought	US\$	19.0	(NT\$14.7)	117-119	Jul. ~ Sep. 2003
				(US\$/JPY)	

For the six months ended June 30, 2002 and 2003, the Company realized premium income of NT\$160.3 million and NT\$50.2 million, and premium expenses of NT\$148.5 million and NT\$146.9 million, respectively.

Table of Contents**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

- d. The estimated fair values of the Company's financial instruments are as follows.

	June 30, 2002		June 30, 2003	
	Carrying/ Notional Amount	Fair Value	Carrying/ Notional Amount	Fair Value
	NT\$	NT\$	NT\$	NT\$
<b>(Unaudited) (In Millions)</b>				
<i>Non-derivative financial instruments</i>				
Short-term investments	213.2	2,894.2	4,065.7	5,328.6
Long-term investments	10,727.7	19,723.4	11,091.0	12,290.5
Bonds payable (including current portion)	44,000.0	44,755.3	35,000.0	35,838.3
<i>Derivative financial instruments</i>				
Forward exchange contracts (buy)	(86.9)	(11.1)	(39.8)	(39.6)
Forward exchange contracts (sell)	842.1	1,147.8	(104.2)	(65.8)
Interest rate swaps	23.7	(289.2)	1.0	(22.1)
Options	17.4	27.8	0.8	(87.4)

The above summary excludes cash and cash equivalents, receivables-net, receivables from related parties, refundable deposits, short-term bank loans, payable to related parties, accounts payable, payable to contractors and equipment suppliers and guarantee deposits that are carried at amounts that approximate fair value.

Fair values of financial instruments were determined as follows:

- a) Short-term investments market values.
- b) Long-term investments market value for traded companies and net equity value for non-traded companies.
- c) Long-term liabilities based on forecasted cash flows discounted at interest rates. Bonds payable is discounted to present value. Fair values of other long-term liabilities are also their carrying values as they use floating interest rate.
- d) Derivative financial instruments based on bank quotations.

The fair values of non-financial instruments were not included in the fair values disclosed above. Accordingly, the sum of the fair values of the financial instruments listed above does not represent the fair value of the Company and its subsidiaries as a whole.

**26. SEGMENT INFORMATION**

- a. The Company engages mainly in the manufacturing of integrated circuits and other semiconductor devices. The Company's chief operating decision maker is the Chief Executive Officer, who reviews consolidated results of manufacturing operations when making decisions about allocating resources and assessing performance of the Company. The Company believes it operates in one segment, and all financial segment information can be found in the consolidated financial statements.

F-40

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## b. Geographic information

	Overseas	Taiwan	Adjustments and Elimination	Consolidated
	NT\$	NT\$	NT\$ (Unaudited) (In Millions)	NT\$
<i>Six Months Ended June 30, 2002</i>				
Sales to unaffiliated customers	48,222.4	32,044.5		80,266.9
Transfers between geographic areas	5,819.0	47,927.6	(53,746.6)	
<b>Total sales</b>	<b>54,041.4</b>	<b>79,972.1</b>	<b>(53,746.6)</b>	<b>80,266.9</b>
<b>Gross profit</b>	<b>1,172.1</b>	<b>28,449.7</b>	<b>(178.3)</b>	<b>29,443.5</b>
Operating expenses				(9,770.9)
Non-operating income				1,462.6
Non-operating expenses				(3,097.8)
Income before income tax				18,037.4
<b>Identifiable assets</b>	<b>81,854.4</b>	<b>339,293.7</b>	<b>(35,713.4)</b>	<b>385,434.7</b>
Long-term investments				10,727.7
<b>Total assets</b>				<b>396,162.4</b>
<i>Six Month Ended June 30, 2003</i>				
Sales to unaffiliated customers	53,018.5	36,676.6		89,695.1
Transfers between geographic areas	4,733.2	52,570.9	(57,304.1)	
<b>Total sales</b>	<b>57,751.7</b>	<b>89,247.5</b>	<b>(57,304.1)</b>	<b>89,695.1</b>
<b>Gross profit</b>	<b>428.9</b>	<b>28,737.3</b>	<b>(205.0)</b>	<b>28,961.2</b>
Operating expenses				(10,854.0)
Non-operating income				2,884.0
Non-operating expenses				(4,192.3)



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Income before income tax				16,798.9
				<u>          </u>
Identifiable assets	78,808.0	328,735.6	(37,367.4)	370,176.2
	<u>          </u>	<u>          </u>	<u>          </u>	
Long-term investments				11,091.0
				<u>          </u>
Total assets				381,267.2
				<u>          </u>

The Company entered into an exclusive distribution agreement with TSMC-North America on January 1, 2002. Under the distribution agreement, TSMC-North America purchases inventory from the Company and in turn sells the inventory to third-party customers. Sales by location are based on billed regions.

**Table of Contents****42TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

## c. Gross revenues:

<u>Area</u>	<b>Six Months Ended June 30</b>	
	<b>2002</b>	<b>2003</b>
	<b>NT\$</b>	<b>NT\$</b>
	<b>(Unaudited)</b>	
	<b>(In Millions)</b>	
United States	42,233.4	43,783.0
Asia and others	24,359.8	28,457.3
ROC	9,046.2	11,609.8
Europe	4,538.5	5,171.1
North Americas	2,221.8	2,666.5
	82,399.7	91,687.7

The gross revenue information is presented by billed regions.

## d. Major customers representing at least 10% of total net sales:

The Company only has one customer that accounts for at least 10% of its total sales. The sales to such customer amounted to NT\$22,175.5 million and NT\$15,074.6 million for the six months ended June 30, 2002 and 2003, representing 27% and 16% of its total sales, respectively.

## e. Net sales by product categories:

<u>Products</u>	<b>Six Months Ended June 30</b>	
	<b>2002</b>	<b>2003</b>
	<b>NT\$</b>	<b>NT\$</b>
	<b>(Unaudited)</b>	
	<b>(In millions)</b>	
Wafer fabrication	72,623.1	80,709.6
Mask making	5,621.0	6,360.4
Others	2,022.8	2,625.1

80,266.9	89,695.1
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**27. SUMMARY OF SIGNIFICANT DIFFERENCES BETWEEN ACCOUNTING PRINCIPLES FOLLOWED BY TSMC AND GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN THE UNITED STATES**

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the Republic of China (ROC GAAP), which differ in the following respects from accounting principles generally accepted in the United States (US GAAP):

a. Marketable securities

Under ROC GAAP, marketable equity securities are carried at the lower of aggregate cost or market, and debt securities are carried at cost, with only unrealized losses recognized. Under US GAAP Statement of Financial Accounting Standard (US SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities, debt and equity securities that have

**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

readily determinable fair values are classified as either trading, available-for-sale or held-to-maturity securities. Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost. Debt and equity securities that are bought and traded for short-term profit are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings. Debt and equity securities not classified as either held-to-maturity or trading are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity. The adjustments below relate to the Company's securities that are classified as trading and available-for-sale securities.

b. Equity-method investees

The Company's proportionate share of the income (loss) from an equity investee may differ if the equity investee's net income (loss) under ROC GAAP differs from US GAAP. The difference between ROC GAAP and US GAAP for the equity investees would result in adjustments to long-term investments and net income (loss).

c. Impairment of long-lived assets

Under US GAAP, impairment losses are recorded in current period earnings and create a new cost basis for the impaired assets that cannot be reversed subsequently. If the sum of the expected future cash flows is less than the carrying amount of an asset or group of assets, an impairment loss is recognized for the difference between the carrying value and the fair value of the asset or group of assets. Long-lived assets (excluding goodwill and other indefinite-lived assets effective January 1, 2002) held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of evaluating the recoverability of long-lived assets under ROC GAAP, assets purchased for use in the business but subsequently determined to have no use are written down to fair value and recorded as idle assets. Long-lived assets impaired under US GAAP continue to be depreciated under ROC GAAP.

d. 10% Tax On Undistributed Earnings

Prior to 2002, for ROC GAAP purposes, the Company recorded the 10% tax on undistributed earnings in the year of shareholder's approval. The Company's accounting policy with respect to the 10% tax on undistributed earnings under US GAAP was consistent with the policy used under ROC GAAP. During 2002, the American Institute of Certified Public Accountants International Practices Task Force concluded that in accordance with EITF 95-10, Accounting for tax credits related to dividends in accordance with SFAS 109, the 10% tax on undistributed earnings should be accrued during the period the earnings arise and adjusted to the extent the shareholders approve distributions in the following year. In 2002, the Company modified its US GAAP accounting policy to comply with the Task Force's conclusion.

e. Goodwill and intangible assets

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Under ROC GAAP, goodwill was recorded and amortized over ten years for the excess of the purchase price over the net tangible assets for the purchase of 32% of TASMIC in 1999. Goodwill was not recorded under ROC GAAP for the acquisition of the remaining 68% of

F-43

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**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

TSMC in June 2000 since under ROC GAAP, goodwill generated from a business combination in the form of a share exchange is recorded in capital surplus. Under US GAAP, goodwill from the purchase of the 32% interest in TSMC is amortized over the estimated useful life of five years. In addition, purchase accounting requires that the cost of the acquisition be the fair value of the shares exchanged and the difference between the cost of an acquired company and the sum of the fair values of the net tangible and identifiable intangible assets be recorded as goodwill. Accordingly, goodwill from the acquisition of the remaining 68% of TSMC is adjusted for US GAAP and amortized over the estimated useful life of five years. Effective January 1, 2002, the Company adopted US SFAS No. 142, *Goodwill and Other Intangible Assets*. In accordance with the guidelines of this accounting standard, goodwill and indefinite-lived intangible assets are no longer amortized and instead are assessed for impairment on at least an annual basis. Purchased intangible assets other than goodwill and indefinite-lived intangible assets are amortized over their estimated useful lives and reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In conjunction with the implementation of US SFAS No. 142, the Company determined that it is comprised of one reporting unit and have completed a goodwill impairment test in accordance with the provisions of the standard and found no impairment. In addition, the Company performed its annual goodwill impairment test during the fourth quarter of 2002 and found no impairment. The Company has not yet performed a goodwill impairment test during 2003.

f. Capital stock issued for contributed technology

In 1998, certain employees received common shares of WSMC prior to its merger with TSMC in exchange for contributing technology related to the testing and packaging of integrated circuits. The value of the contributed technology was determined to be NT\$270 million. Under ROC GAAP, capital stock issued for the contributed technology is recorded as an intangible asset and amortized over the estimated life of the technology. As permitted under ROC GAAP, the Company amortizes such asset over a five-year period. Under US GAAP, the Company adjusted the carrying value of the technology to zero.

g. Derivative financial instruments

There are no specific accounting standards under ROC GAAP which address measurement for derivative instruments, except for foreign-currency forward contracts. Under ROC GAAP, foreign-currency forward contracts are accounted for in a manner similar to that required under US SFAS No. 52. All other derivatives are recorded upon settlement under ROC GAAP as described in Note 2. Under US GAAP, accounting for derivative instruments is covered under US SFAS No. 133, as amended, which requires that all entities recognize derivative instruments as assets and liabilities in the statement of financial position at fair value. If certain conditions are met, entities may elect to designate a derivative instrument as a hedge. The Company does not designate derivatives as hedges. Therefore, under US GAAP derivatives have historically been, and continue to be, recorded on the balance sheet at fair value, with the changes in fair values charged to current period earnings.

h. Bonuses to employees, directors and supervisors

According to ROC regulations and the Company's Articles of Incorporation, a portion of the Company's distributable earnings should be set aside as bonuses to employees, directors and supervisors. Bonuses to directors and supervisors are usually paid in cash. However,



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**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

bonuses to employees may be granted in cash or stock, or both. All of these appropriations, including stock bonuses, which are valued at par value of NT\$10, are charged against retained earnings under ROC GAAP after such appropriations are formally approved by the shareholders in the following year. Under US GAAP, such bonuses are charged against income. Shares issued as part of these bonuses are recorded at fair market value. Since the amount and form of such bonuses are not finally determinable until the shareholders' meeting in the subsequent year, the total amount of the aforementioned bonuses is initially accrued based on management's estimate regarding the amount to be paid pursuant to the Company's Articles of Incorporation. Any difference between the initially accrued amount and the fair market value of the bonuses upon the issuance of shares is recognized in the year of approval by shareholders.

i. Pension benefits

US SFAS No. 87, "Employer's Accounting for Pensions", is effective no later than the beginning of the first period for which a US GAAP reconciliation is required for foreign issuers and requires a portion of the unrecognized net transition obligation on the adoption date to be allocated directly to equity. The Company adopted US SFAS No. 87 at the beginning of 1993. Republic of China Statement of Financial Accounting Standards (ROC SFAS) No. 18, which is similar in many respects to SFAS No. 87, was effective in 1996 for ROC listed companies.

j. Treasury stock

Under US GAAP, when a subsidiary holds shares of its parents' capital stock as an investment, the shares are treated as treasury stock in the consolidated balance sheet and a reduction in shareholders' equity. Under ROC GAAP, for periods ending prior to January 1, 2002, shares of a parent company's capital stock held by its subsidiaries are accounted for as an investment on the parent company's balance sheet with realized gains and losses recorded to current earnings. As of January 1, 2002, the Company adopted, on a prospective basis, ROC SFAS No. 30, which is consistent with the accounting for treasury stock under US GAAP.

k. Stock-based compensation

For US GAAP reporting, the Company has elected to follow Accounting Principles Board Opinion (APB Opinion) No. 25, "Accounting for Stock Issued to Employees", which measures compensation expense based on the difference, if any, between the market price of the underlying common stock and the exercise price of the stock option on the date of the grant for stock option plans that are determined to be a fixed plan under the guidelines. TSMC's 2002 Employee Stock Option Plan (Plan I) includes a provision for a reduction in the exercise price in the event the Company issues additional common shares or issues ADSs at a price lower than the exercise price of a granted stock option. As such, under US GAAP APB No. 25, Plan I is deemed a variable plan and the Company is required to record compensation expense over the vesting period based on the difference between the exercise price and the current market price at each period end. ROC GAAP does not provide guidelines for the recognition of stock-based compensation for variable plans.

l. Earnings per share



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Under ROC GAAP, earnings per share is calculated as described in Note 2. Under US GAAP, earnings per share is calculated by dividing net income by the average number of shares outstanding in each period and adjusted retroactively to the beginning of the year for stock

F-45

**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

dividends and stock splits that are issued subsequently. Other shares issued from unappropriated earnings, such as stock bonuses to employees, are adjusted to earnings per share as of the date of occurrence. Earnings per equivalent American Depositary Share (ADS) is calculated by multiplying earnings per share by five as one ADS represents five common shares.

m. Mandatory redeemable preferred stock

Preferred stock subject to mandatory redemption at the option of the holder is included in shareholders' equity under ROC GAAP and classified as outside shareholders' equity under US GAAP.

n. Consolidated entities

Under ROC SFAS No. 7, an investee is consolidated into the enterprise if the ownership held by the enterprise is over 50% of the outstanding common shares of the investee. Under US GAAP, consolidation may be required when share ownership is less than 50% and there are various factors that indicate substantive control of an entity. In January and February of 2003, TSMC purchased an aggregate of 47% ownership interest in GUC. In addition to the share ownership, TSMC executives represent a majority of the directors on GUC's board of directors and several of TSMC's management team also hold management positions at GUC. As a result, TSMC will consolidate GUC financial statements for US GAAP purposes beginning on the acquisition date. The acquisition of GUC is accounted for as an equity method investee for ROC GAAP purposes with goodwill recorded for the excess purchase price over TSMC's proportionate share of GUC's net assets acquired. For US GAAP purposes, the acquisition is accounted for as a purchase under US SFAS No. 141, Business Combinations, with the excess purchase price over TSMC's proportionate share of GUC's net assets acquired recorded as identifiable intangible assets and goodwill.

Table of Contents**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following reconciles net income and shareholders' equity under ROC GAAP as reported in the consolidated financial statements to the net income and shareholders' equity amounts determined under US GAAP, giving effect to the differences listed above.

	Six Months Ended June 30		
	2002	2003	
	NT\$	NT\$ (Unaudited)	US\$
	(In Millions Except Shares and Per Share Amounts)		
<i>Net income</i>			
Net income based on ROC GAAP	15,897.3	16,087.8	464.8
<b>Adjustments:</b>			
Adjustment to market value for trading securities	(1,708.2)	(780.7)	(22.5)
US GAAP adjustments on equity-method investees	58.0	7.0	0.2
Reversal of depreciation on assets impaired under US GAAP	727.7	727.7	21.0
Income tax effect of US GAAP adjustments	(0.7)	(4.2)	(0.1)
Reversal of amortization of goodwill	639.5	645.0	18.6
Reverse of amortization of capital stock payment for technology transfer	27.0	27.0	0.8
Adjustment to market value for derivative financial instruments	1,041.3	443.6	12.8
Bonuses to employees, directors and supervisors			
Current year accrual	(1,187.5)	(1,201.8)	(34.7)
Fair market value adjustment of prior year accrual	(6,911.4)	(6,441.0)	(186.1)
Stock-based compensation		(36.5)	(1.0)
Pension expense	4.3	25.6	0.7
Minority interest effect of US GAAP adjustments	(63.6)	59.1	1.7
Net decrease in net income	(7,373.6)	(6,529.2)	(188.6)
Net income based on US GAAP	8,523.7	9,558.6	276.2
Cumulative preferred dividends	(227.5)	(184.5)	(5.3)
Income attributable to common shareholders	8,296.2	9,374.1	270.9
Basic and diluted earnings per common share	0.42	0.47	0.01
Basic and diluted number of weighted average shares outstanding under US GAAP	19,969,197,000	20,091,177,000	

Basic and diluted earnings per ADS	2.08	2.33
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F-47

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	June 30		
	2002	2003	
	NT\$	NT\$ (Unaudited) (In Millions)	US\$
<i>Shareholders equity</i>			
Shareholders equity based on ROC GAAP	289,164.5	298,261.6	8,617.8
Adjustments:			
Adjustment to market value for trading securities	2,164.4	1,332.1	38.5
U.S. GAAP adjustments on equity method investees	(1,418.4)	(1,407.8)	(40.7)
Adjustment to market value available-for-sale securities			
TSMC	44.9	125.4	3.6
Equity-method investees	211.4	136.1	3.9
Loss on impairment of assets	(10,916.1)	(10,916.1)	(315.4)
Reversal of depreciation on assets impaired under U.S. GAAP	2,183.2	3,638.7	105.2
Income tax differences	(3.4)	(8.3)	(0.2)
Goodwill			
Carrying value difference for 68% purchase of TSMC	52,212.7	52,212.7	1,508.5
Accumulated amortization	(15,546.8)	(14,250.6)	(411.7)
Capital stock payment for technology transfer	(76.5)	(22.5)	(0.6)
Derivative financial instruments	79.0	(72.6)	(2.1)
Bonuses to employees, directors and supervisors	(1,187.5)	(1,201.8)	(34.7)
Accrued pension expense	(44.1)	(14.2)	(0.4)
Mandatory redeemable preferred stock	(13,000.0)		
Net increase in shareholders equity	14,702.8	29,551.1	853.9
Shareholders equity based on U.S. GAAP	303,867.3	327,812.7	9,471.7

	Six Months Ended June 30		
	2002	2003	
	NT\$	NT\$ (Unaudited) (In Millions)	US\$
<i>Changes in shareholders equity based on US GAAP</i>			
Balance, beginning of period	289,449.9	310,622.7	8,974.9
Net income for year	8,523.7	9,558.6	276.2
Adjustment to market value available-for-sale securities			
TSMC	(124.0)	106.8	3.1
Equity investees	(287.9)	315.3	9.1

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Common shares issued as bonuses to employees	7,979.0	7,980.1	230.6
Proceeds from sales of treasury stock	244.1	1.9	0.1
Translation adjustment	(1,462.5)	(189.7)	(5.5)
Cash dividends preferred shares	(455.0)	(455.0)	(13.1)
Deferred stock-based compensation		36.5	1.0
Adjustment arising from changes in ownership percentage in investees		(164.5)	(4.7)
	<u>          </u>	<u>          </u>	<u>          </u>
Balance, end of year	303,867.3	327,812.7	9,471.7
	<u>          </u>	<u>          </u>	<u>          </u>

F-48

Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A reconciliation of the significant balance sheet accounts under ROC GAAP to the amounts determined under US GAAP is as follows:

	June 30		
	2002	2003	
	NT\$	NT\$ (Unaudited) (In Millions)	US\$
<i>Short-term investments</i>			
As reported under ROC GAAP	213.2	4,065.7	117.5
US GAAP adjustments			
Consolidation of GUC		108.1	3.1
Adjustment to market value trading securities	2,228.0	1,335.7	38.6
As adjusted	<u>2,441.2</u>	<u>5,509.5</u>	<u>159.2</u>
<i>Long-term investments</i>			
As reported under ROC GAAP	10,727.7	11,091.0	320.5
US GAAP adjustments			
Consolidation of GUC		(387.4)	(11.2)
Equity investments effect of US GAAP adjustments	(1,418.4)	(1,407.8)	(40.7)
Adjustment to market value available-for-sale securities			
TSMC	44.9	125.4	3.6
Equity-method investees	211.4	136.1	3.9
As adjusted	<u>9,565.6</u>	<u>9,557.3</u>	<u>276.1</u>
<i>Property, plant and equipment net</i>			
As reported under ROC GAAP	242,616.7	221,691.6	6,405.4
US GAAP adjustments			
Consolidation of GUC		159.5	4.6
Impairment loss	(10,916.1)	(10,916.1)	(315.4)
Reversal of depreciation of assets impaired under US GAAP	2,183.2	3,638.7	105.2
As adjusted	<u>233,883.8</u>	<u>214,573.7</u>	<u>6,199.8</u>
<i>Deferred income tax</i>			
As reported under ROC GAAP	16,576.8	12,631.7	364.9
US GAAP adjustments			
Effect of US GAAP adjustments on deferred income tax	(3.4)	(8.3)	(0.2)

As adjusted	16,573.4	12,623.4	364.7
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F-49



Table of Contents

## TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	June 30		
	2002	2003	
	NT\$	NT\$ (Unaudited)	US\$
	(In Millions)		
<i>Goodwill</i>			
As reported under ROC GAAP	10,531.8	9,484.5	274.0
US GAAP adjustments			
Carrying value difference for purchase of 68% TSMC	52,212.7	52,212.7	1,508.6
Accumulated amortization	(15,546.8)	(14,250.6)	(411.7)
<b>As adjusted</b>	<b>47,197.7</b>	<b>47,446.6</b>	<b>1,370.9</b>
<i>Deferred charge net and other intangible assets</i>			
As reported under ROC GAAP	5,431.0	8,794.4	254.1
US GAAP adjustments			
Consolidation of GUC		40.0	1.2
Capital stock payment for technology transfer	(76.5)	(22.5)	(0.7)
<b>As adjusted</b>	<b>5,354.5</b>	<b>8,811.9</b>	<b>254.6</b>
<i>Current liabilities</i>			
As reported under ROC GAAP	41,938.9	30,959.1	894.6
US GAAP adjustments			
Consolidation of GUC		180.5	5.2
Derivative financial instruments	(79.1)	72.7	2.1
Bonuses to employees, directors and supervisors	1,187.5	1,201.8	34.7
<b>As adjusted</b>	<b>43,047.3</b>	<b>32,414.1</b>	<b>936.6</b>
<i>Accrued pension cost</i>			
As reported under ROC GAAP	2,050.0	2,433.1	70.3
US GAAP adjustments			
Consolidation of GUC		6.5	0.2
Pension expenses	44.1	14.2	0.4
<b>As adjusted</b>	<b>2,094.1</b>	<b>2,453.8</b>	<b>70.9</b>
<i>Minority interest</i>			
As reported under ROC GAAP	104.9	92.1	2.7

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US GAAP adjustments			
Consolidation of GUC		475.7	13.7
Shareholders equity	63.6	3.6	0.1
	<u>        </u>	<u>        </u>	<u>        </u>
As adjusted	168.5	571.4	16.5
	<u>        </u>	<u>        </u>	<u>        </u>

F-50

**Table of Contents****TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following US GAAP condensed balance sheets as of June 30, 2002 and 2003 and statements of operations for the six months ended June 30, 2002 and 2003 have been derived from the reviewed financial statements and reflect the adjustments presented above.

Certain accounts have been reclassified to conform to US GAAP. Royalty income and technical service income are included as sales with the related costs included in cost of sales. Gains and losses on sales of and provisions for losses on property, plant and equipment are included as cost of sales or operating expenses depending on the classification of the property. Certain amounts in 2002 have been reclassified to conform to 2003 presentation.

	June 30		
	2002	2003	
	NT\$	NT\$ (Unaudited)	US\$
	(In Millions)		
<b>Assets</b>			
Current assets	116,310.3	122,487.3	3,539.1
Long-term investment	9,565.6	9,557.3	276.1
Property, plant and equipment net	233,883.8	214,573.7	6,199.8
Goodwill	47,197.7	47,446.6	1,370.9
Other assets	18,124.0	18,728.4	541.1
<b>Total assets</b>	<b>425,081.4</b>	<b>412,793.3</b>	<b>11,927.0</b>
<b>Liabilities</b>			
Current liabilities	43,047.3	32,414.1	936.5
Long-term liabilities	55,933.6	48,277.2	1,394.9
Other liabilities	9,064.7	3,717.9	107.4
Minority interest	168.5	571.4	16.5
Preferred shares	13,000.0		
Shareholders equity	303,867.3	327,812.7	9,471.7
<b>Total liabilities and shareholders equity</b>	<b>425,081.4</b>	<b>412,793.3</b>	<b>11,927.0</b>
	Six Months Ended June 30		
	2002	2003	
	NT\$	NT\$ (Unaudited)	US\$

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	(In Millions)		
Net sales	80,674.2	89,890.5	2,597.2
Cost of sales	56,292.5	66,087.4	1,909.5
Gross profit	24,381.7	23,803.1	687.7
Operating expenses	10,751.3	11,621.7	335.8
Income from operations	13,630.4	12,181.4	351.9
Non-operating income (expenses) net	(2,902.3)	(1,987.2)	(57.4)
Income before income tax	10,728.1	10,194.2	294.5
Net income	8,523.7	9,558.6	276.2
Cumulative preferred dividends	(227.5)	(184.5)	(5.3)
Income attributable to common shareholders	8,296.2	9,374.1	270.9

F-51

**Table of Contents**

**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**28. ADDITIONAL DISCLOSURES REQUIRED BY US GAAP**

a.