

GIGAMEDIA Ltd  
Form 20-F  
April 28, 2015  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D. C. 20549

**FORM 20-F**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2014**

**Commission File Number: 000-30540**

**GIGAMEDIA LIMITED**

**(Exact name of registrant as specified in its charter)**

**REPUBLIC OF SINGAPORE**

**(Jurisdiction of incorporation or organization)**

**8 TH FLOOR, NO. 22, LANE 407, SECTION 2 TIDING BOULEVARD, TAIPEI, TAIWAN, R.O.C.**

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(Address of principal executive offices)

**COLLIN HWANG, Chief Executive Officer**

**8 TH FLOOR, NO. 22, LANE 407, SECTION 2 TIDING BOULEVARD, TAIPEI, TAIWAN, R.O.C.**

**Tel: 886-2-2656-8000; Fax: 886-2-2656-8003**

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

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
<b>Ordinary Shares</b>	<b>The NASDAQ Stock Market LLC</b>

**Securities registered or to be registered pursuant to Section 12(g) of the Exchange Act: None**

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None**

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

**55,261,661 ordinary shares**

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

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

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

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U.S. GAAP  International Financial Reporting Standards as issued

Other

by the International Accounting Standards Board

If  Other  has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.  Item 17  Item 18

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

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**CERTAIN TERMS AND CONVENTIONS**

In this annual report, all references to

- (i) we, us, our, our Company or GigaMedia are to GigaMedia Limited and, unless the context requires otherwise, its subsidiaries, or where the context refers to any time prior to the incorporation of any of its subsidiaries, the businesses which predecessors of the present subsidiaries were engaged in and which were subsequently assumed by such subsidiaries;
- (ii) Shares are to ordinary shares of our Company;
- (iii) Hoshin GigaMedia are to Hoshin GigaMedia Center Inc., a company incorporated under the laws of Taiwan, Republic of China, ( Taiwan or R.O.C. );
- (iv) FunTown are to our Asian online game and service business operated through our two operating subsidiaries, Hoshin GigaMedia and FunTown World Limited, a company incorporated under the laws of the British Virgin Islands;
- (v) GigaMedia Cloud are to GigaMedia Cloud Services Co. Ltd., a company incorporated under the laws of Taiwan;
- (vi) GigaCloud are to the cloud computing services operated through our subsidiary GigaMedia Cloud;
- (vii) FingerRockz are to FingerRockz Co., Ltd., a company incorporated under the laws of Taiwan that develops and publishes mobile games and apps;
- (viii) IAH or IAHGames are to Infocomm Asia Holdings Pte. Ltd., an online game operator, publisher and distributor in Southeast Asia and incorporated under the laws of the Republic of Singapore;
- (ix) Monsoon are to Monsoon Online Pte. Ltd., a company incorporated under the laws of the Republic of Singapore and wholly owned by IAHGames;
- (x) T2CN are to T2CN Holding Limited, a company incorporated under the laws of the British Virgin Islands, and the T2CN Operating Entities;
- (xi) T2CN Operating Entities are to T2CN Holding Limited's two wholly owned subsidiaries, T2CN Information Technology (Shanghai) Co., Ltd. ( T2 Technology ) and J-Town Information (Shanghai) Co., Ltd. ( J-Town ), and three variable interest entities, Shanghai T2 Entertainment Co., Ltd. ( T2 Entertainment ), Shanghai T2 Advertisement Co., Ltd. ( T2 Advertisement ) and Shanghai Jinyou Network & Technology Co., Ltd. ( Jinyou );
- (xii) Internet access and service business are to an Internet access and service business that we historically operated through Koos Broadband Telecom Co., Ltd. ( KBT ) and completely disposed of in September 2008;

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- (xiii) UIM are to Ultra Internet Media S.A., a company incorporated under the laws of Nevis;
- (xiv) Everest Gaming are to Mangas Everest S.A.S, a société par actions simplifiée registered with the Trade and Companies Registry of Paris and organized under the laws of France;
- (xv) BetClic are to BetClic Everest Group, formerly named as Mangas Gaming S.A.S, a company organized under the laws of France;
- (xvi) JIDI are to JIDI Network Technology (Shanghai) Co., Ltd., our wholly owned subsidiary incorporated under the laws of the PRC;  
and

(xvii) Shanghai JIDI are to Shanghai JIDI Network Technology Co., Ltd., a company incorporated under the laws of the PRC. For the purpose of this annual report only, geographical references to China and the PRC are to the People's Republic of China and do not include Taiwan, the Hong Kong Special Administrative Region ( Hong Kong ) and the Macau Special Administrative Region ( Macau ). Except if the context otherwise requires, and for the purpose of this annual report only, references to Greater China include the PRC, Taiwan, Hong Kong and Macau. References to South Korea are to the Republic of Korea.

All references in this annual report to U.S. dollar, \$ and US\$ are to the legal currency of the United States; all references to NT dollar or NT\$ to the legal currency of Taiwan; all references to RMB, Rmb or Renminbi are to the legal currency of the PRC; all references to Hong Kong dollar are to the legal currency of Hong Kong and all references to Singapore dollar and S\$ are to the legal currency of the Republic of Singapore.

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We have approximated certain numbers in this annual report to their closest round numbers or a given number of decimal places. Due to rounding, figures shown as totals in tables may not be arithmetic aggregations of the figures preceding them.

### **DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS**

This annual report includes forward-looking statements within the meaning of, and intended to qualify for the safe harbor from liability established by, the United States Private Securities Litigation Reform Act of 1995. These statements, which are not statements of historical fact, may consist of or contain estimates, assumptions, projections and/or expectations regarding future events, which may or may not occur. These statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Some of the risks are listed under Item 3, Key Information D. Risk Factors and elsewhere in this annual report. In some cases, you can identify these forward-looking statements by words such as aim, anticipate, believe, estimate, expect, going forward, intend, ought to, plan, p seek, may, might, can, could, will, would, should, shall, is likely to or similar expressions, including their negatives. These fo statements include, without limitation, statements relating to:

our business plan and strategies;

our future business development and potential financial condition, results of operations and other projected financial information;

our ability to manage current and potential future growth;

expected continued acceptance of our revenue model;

our plans for strategic partnerships, licenses and alliances;

our acquisition and strategic investment, and our ability to successfully integrate any past, current, or future acquisitions into our operations;

our ability to protect our intellectual property rights and the security of our customers' information;

the launch of new online games according to our timetable;

expected continued acceptance of our online games, including expected growth of the online games industry, and consumer preferences for our products and services;

the in-house development of new online games;

our plans to license additional games from third parties, and the launch of these new games, including the timing of any such development, licenses or launches, in various geographic markets;

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our ability to maintain and strengthen our position as one of the largest online MahJong operators in Taiwan;

the potential entry of new competitors in any of our business lines;

changes in the global regulatory environment relating to the online gaming business;

changes or stability in certain regulatory environments relating to GigaCloud's operations;

changes in PRC laws and regulations, and future enforcement of those laws and regulations, including laws and regulations relating to Internet usage, advertising over the Internet, Internet content providers, foreign investment and ownership in online business, distribution of dividends and foreign exchange controls;

the outcome of ongoing, or any future, litigation or arbitration; and

our corporate classification by various governmental entities.

These forward-looking statements are based on our own information and on information from other sources we believe to be reliable. Our actual results may differ materially from those expressed or implied by these forward-looking statements as a result of risk factors and other factors noted throughout this annual report, including those described under Item 3, Key Information D. Risk Factors and those detailed from time to time in other filings with the United States Securities and Exchange Commission (the SEC). We do not guarantee that the transactions and events described in this annual report will happen as described or that they will happen at all. We undertake no obligation to update or revise any forward-looking statements to reflect events or circumstances after the date of this annual report or to reflect the occurrence of unanticipated events. Whether actual results will conform to our expectations and predictions is subject to a number of risks and uncertainties, many of which are beyond our control, and reflect future business decisions that are subject to change. Given this level of uncertainty, you are advised not to place undue reliance on such forward-looking statements.



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**PART I**

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

Not applicable, but see Item 6, Directors, Senior Management and Employees A. Directors and Senior Management in this annual report.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION**

**Exchange Rates**

Assets and liabilities reported in our consolidated balance sheets denominated in currencies other than U.S. dollars are translated into U.S. dollars using year-end exchange rates. Income and expense items reported in our consolidated statements of operations denominated in currencies other than U.S. dollars are translated into U.S. dollars using weighted-average exchange rates. Certain other operating financial information denominated in currencies other than U.S. dollars, not included in our consolidated financial statements and provided in this annual report, are translated using weighted-average exchange rates. We make no representation that any currencies, other than U.S. dollars, could be converted to U.S. dollars at such rate or any particular rates.

**A. Selected Financial Data**

The following selected consolidated balance sheet data as of December 31, 2013 and 2014 and the selected consolidated statement of operations data for the years ended December 31, 2012, 2013 and 2014 have been derived from our audited consolidated financial statements included in Item 18 in this annual report. The selected consolidated balance sheet data as of December 31, 2010, 2011 and 2012, and the selected consolidated statement of operations data for the years ended December 31, 2010 and 2011 have been derived from our audited consolidated financial statements for the years ended December 31, 2010, 2011 and 2012, which are not included in this annual report. The consolidated financial statements have been prepared and presented in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP. You should read the following selected consolidated financial data in conjunction with Item 5, Operating and Financial Review and Prospects, and the consolidated financial statements and the accompanying notes to those statements included in this annual report.

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For the Years Ended December 31,

(in thousands US\$, except for per share data)

	2010	2011	2012	2013	2014
<b>CONSOLIDATED STATEMENTS OF OPERATIONS DATA:</b>					
<b>OPERATING REVENUES</b>					
Gaming software and service revenues	25,820	0	0	0	0
Asian online game and service revenues	38,862	34,367	27,470	14,106	8,199
Other revenues	0	0	0	926	1,580
Total operating revenues	64,682	34,367	27,470	15,032	9,779
<b>COSTS OF REVENUES</b>					
Cost of gaming software and service revenues	(4,010)	0	0	0	0
Cost of Asian online game and service revenues	(17,103)	(14,413)	(11,388)	(6,425)	(6,010)
Cost of other revenues	0	0	0	(1,159)	(1,825)
Total costs of revenues	(21,113)	(14,413)	(11,388)	(7,584)	(7,835)
GROSS PROFIT	43,569	19,954	16,082	7,448	1,944
<b>OPERATING EXPENSES</b>					
Product development and engineering expenses	(7,301)	(1,956)	(1,471)	(1,698)	(892)
Selling and marketing expenses	(21,589)	(10,079)	(8,377)	(4,815)	(6,708)
General and administrative expenses	(31,780)	(18,101)	(13,384)	(6,324)	(6,378)
Bad debt expenses	(1,639)	(1,820)	(169)	(37)	(37)
Impairment loss on property, plant, and equipment	(278)	0	0	0	(28)
Impairment loss on goodwill	(2,255)	(5,097)	(12,489)	(17,054)	0
Impairment loss on intangible assets	(1,330)	(2,583)	(15)	(13,251)	(115)
Impairment loss on prepaid licensing and royalty fees	(870)	(247)	(702)	(2,752)	(1,259)
Impairment loss on deconsolidation of T2CN	(22,234)	0	0	0	0
Other	(1,989)	0	(49)	(4)	0
Total operating expense	(91,265)	(39,883)	(36,656)	(45,935)	(15,417)
Loss from operations	(47,696)	(19,929)	(20,574)	(38,487)	(13,473)
Income (loss) from continuing operations	1,408	(67,390)	(13,596)	(34,743)	(4,990)
Income (loss) from discontinued operations	(128)	(4,188)	(2,521)	(318)	0
Net income (loss)	1,280	(71,578)	(16,117)	(35,061)	(4,990)
Less: Net (income) loss attributable to the noncontrolling interest and subsidiary preferred shares	1,370	366	827	281	(165)
Net income (loss) attributable to shareholders of GigaMedia	2,650	(71,212)	(15,290)	(34,780)	(5,155)
<b>Earnings (loss) per share (in dollars):</b>					
<b>Basic:</b>					
Income (loss) from continuing operations	0.05	(1.23)	(0.25)	(0.68)	(0.10)
Income (loss) from discontinued operations	0.00	(0.08)	(0.05)	(0.01)	0

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Net income (loss)	0.05	(1.31)	(0.30)	(0.69)	(0.10)
Diluted:					
Income (loss) from continuing operations	0.04	(1.23)	(0.25)	(0.68)	(0.10)
Income (loss) from discontinued operations	0.00	(0.08)	(0.05)	(0.01)	0
Net income (loss)	0.04	(1.31)	(0.30)	(0.69)	(0.10)

There were no dividends declared in 2010, 2011, 2012, 2013 and 2014.

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As of December 31,

(US dollars in thousands except for number of issued shares)

	2010	2011	2012	2013	2014
<b>CONSOLIDATED BALANCE SHEET DATA:</b>					
Total current assets	93,088	118,920	85,135	83,331	91,158
Property, plant and equipment-net	5,301	4,288	1,949	1,677	1,663
Goodwill	39,493	28,437	16,934		
Intangible assets-net	19,769	15,534	15,675	1,461	222
Total assets	267,589	191,706	140,394	103,321	108,304
Total current liabilities	43,293	35,658	21,647	14,839	27,337
Total GigaMedia's shareholders' equity	217,521	156,072	118,231	88,448	79,019
Common shares, no par value, and additional paid-in capital	309,332	304,672	304,851	305,072	308,682
Number of issued shares (in thousands)	56,263	50,720	50,720	50,723	55,262

**B. Capitalization and Indebtedness**

Not applicable.

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

Not applicable.

**D. Risk Factors****Risks Related to Our Business and Industries**

**We may not be successful in operating and improving our existing online games to satisfy the changing demands and preferences of players.**

The level of demand and market acceptance of our existing online games is subject to a high degree of uncertainty. Our future operating results will depend on numerous factors, many of which are beyond our control. These factors include:

the popularity of existing and new online games operated by us;

the introduction of new online games by us or third parties, competing with or replacing our existing online games;

general economic conditions, particularly economic conditions adversely affecting discretionary consumer spending;

changes in our customer demands and preferences;

regulatory and other risks associated with our operations in Taiwan and Hong Kong;

the availability of other forms of entertainment; and

critical reviews and public tastes and preferences, all of which change rapidly and cannot be predicted.

Our ability to plan for product development and distribution and promotional activities will be significantly affected by how well we anticipate and adapt to relatively rapid changes in consumer tastes and preferences. Currently, a substantial portion of our online games revenue is derived from revenues from PC-based online games including MahJong games and other casual games offered in Taiwan and Hong Kong by FunTown and the licensed massively multi-player online ( MMO ) game Tales Runner. However, revenues from our PC-based games have been in decline, reflecting the overall shift in player preferences away from PC-based games to browser-based games and mobile games. This decline in the popularity of PC-based online games, and declines in the popularity of online games in general, is likely to adversely affect our business, financial condition and results of operations. To maintain competitiveness of our games, we must regularly invest in enhancing, improving, expanding or upgrading our games. If we fail to do so, revenues generated from our existing games will likely decline.

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**As our games are currently accessed primarily through PC and mobile devices, successful development of games for such devices will be imperative if we are to maintain or increase our revenues, and our inability to do so may result in lower growth of or a decline in revenues.**

Devices other than personal computers, such as mobile phones and tablets, are used increasingly to access the Internet. We believe that, for our business to be successful, we will need to develop versions of our existing games, our pipeline games and any future games that work well with such devices. Manufacturers of such devices may establish restrictive conditions for developers of applications to be used on such devices, and as a result our games may not work well, or at all, on such devices. As new devices are released or updated, we may encounter problems in developing versions of our games for use on such devices and we may need to devote significant resources to the creation, support, and maintenance of games for such devices. If we are unable to successfully expand the types of devices on which our existing and future games are available, or if the versions of our games that we create for such devices do not function well or are not attractive to game players, our revenues may fail to grow and may decline.

**The online games market is characterized by rapid technological change, and failure to respond quickly and effectively to new Internet technologies or standards may have a material adverse effect on our business.**

The online games industry is evolving rapidly. Any new technologies and new standards may require increases in expenditures for online game development and operations. In addition, we use internally developed software systems that support nearly all aspects of our billing and payment transactions in our Asian online game and service business. All of our businesses may be adversely affected if we are unable to upgrade our systems effectively to accommodate future traffic levels, to avoid obsolescence or to successfully integrate any newly developed or acquired technology with our existing systems. Capacity constraints could cause unanticipated system disruptions and slower responses, which could adversely affect data transmission and game play. These factors could, among other things, cause us to lose existing or potential users and existing or potential game development partners.

**In operating our Asian online game and service business, we may fail to launch new games according to our timetable, and our new games may not be commercially successful.**

In order for our Asian online game and service business strategy to succeed over time, we will need to license, acquire or develop new online games that can generate additional revenue and further diversify our revenue sources. A number of factors, including technical difficulties, government approvals and game licenses required for launching new games, lack of sufficient game development personnel and other resources, and adverse developments in our relationship with the licensors of our new licensed games could result in delay in launching our new games. Therefore, we cannot assure you that we will be able to meet our timetable for new game launches.

There are many factors that may adversely affect the popularity of our new games. For example, we may fail to anticipate and adapt to future technical trends and new business models, fail to satisfy game player preferences and requirements, fail to effectively plan and organize marketing and promotion activities, fail to effectively detect and prevent programming errors or defects in the games, and fail to operate our new games at acceptable costs. We cannot assure you that our new games will gain market acceptance and become commercially successful. If we are not able to license, develop or acquire additional online games that are commercially successful, our future revenues and profitability may decline.

Due to increased competition among online games operators in Greater China, license fees for online games have increased and most licensors are demanding upfront license fees and guaranteed minimum royalty payments. If any of the new games we license from third parties fails to appeal to players, we may not be able to fully recover upfront and/or minimum royalty licensing costs, which can be significant. As a result, our results of operations and financial condition may be materially and adversely affected.

**Our Asian online game and service business faces intense competition, which may adversely affect our revenues, profitability and planned business expansion.**

The online games market is highly competitive. Online casual game operators in Greater China are currently our primary competitors. We also compete with massively multi-player online role-playing game ( MMORPG ) operators throughout Greater China. Our major competitors in Taiwan include Gamania Digital Entertainment Co., Ltd. ( Gamania ), Soft-World International Corporation ( Soft-World ), International Games System, Co., Ltd. ( IGS ), UserJoy Technology Co., Ltd. ( UserJoy ) and GodGame Inc. ( GodGame ). Our major competitors in the PRC include Shanda Interactive Entertainment Ltd. ( Shanda ), Giant Interactive Group, Inc. ( Giant ), Changyou.com Limited ( Changyou ), Shanghai Everstar Online Entertainment Co., Ltd. ( Nineyou ), Tencent Holdings Limited ( Tencent ), Perfect World Co., Ltd. ( Perfect World ), Kingsoft Corporation Limited ( Kingsoft ) and Beijing Globalink Computer Technology Co., Ltd. ( Ourgames.com ). In addition, we compete for users against various offline games, such as console games, arcade games and handheld games, as well as various other forms of traditional or online entertainment.



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We expect more online games operating companies to enter the markets where we operate in Greater China, and a wider range of online games to be introduced to these markets, given the relatively low entry barriers to the online games industry and the increasing popularity of Internet-based businesses. Our competitors vary in size and include private and public companies, many of which have greater financial, marketing and technical resources as well as name brand recognition. We intend to continue to enhance our market position through providing competitive products and quality services that meet market trends and users' preferences, as well as strengthening sales effectiveness. As a result of the above, significant competition may reduce the number of our users or the growth rate of our user base, reduce the average number of hours played by our users, or cause us to reduce usage fees. All of these competitive factors could have a material adverse effect on our business, financial condition and results of operations.

**Our results of operations are subject to significant fluctuations. We have incurred operating and net losses in past years, and we may experience losses in the future.**

Our revenues, expenses and results of operations have varied in the past and may fluctuate significantly in the future due to a variety of factors, many of which are beyond our control. In 2012, 2013 and 2014, we incurred operating losses of US\$20.6 million, US\$38.5 million and US\$13.5 million as well as net losses of US\$15.3 million, US\$34.8 million and US\$5.2 million, respectively. Our future profitability will depend to a great extent upon the performance of our Asian online game and service business and the GigaCloud cloud computing business. The key factors affecting our businesses include:

Asian online game and service business: our ability to retain existing users; attract new users and maintain user satisfaction; the pace of rolling out new games or updating existing games by us or our competitors; the amount and timing of operating costs and capital expenditures relating to our business operations and expansion; seasonal trends in Internet use; price competition in the industry; regulatory and other risks associated from our operations in Taiwan and Hong Kong.

Cloud computing business: global economic conditions and general economic conditions of the markets that GigaCloud targets; the availability of the Internet infrastructure; and the technological and other competition from existing and new competitors, our ability to attract new users and maintain user satisfaction; the pace of rolling out new products and services or updating existing offerings by us or our competitors; the amount and timing of operating costs and capital expenditures relating to our business operations and expansion; and regulatory risks associated with our operations in Greater China.

In addition, our operating expenses are based on our expectations of the future demand for our services and are relatively fixed in the short term. We may be unable to adjust spending quickly enough to offset any unexpected demand shortfall. A decrease in revenues in relation to our expenses could have a material and adverse effect on our business, results of operations and financial condition. You should not place undue reliance on our financial guidance, nor should you rely on year-to-year or quarter-to-quarter comparisons of our results of operations as indicators of our future performance and we cannot assure you that we will not experience operating or net losses in future periods.

**Our business strategy, which contemplates growth through acquisitions and strategic investments, exposes us to significant risks.**

We have pursued and may continue to pursue growth through acquisitions and strategic investments. Any acquisition or investment is subject to a number of risks. Such risks include the diversion of management time and resources, disruption of our ongoing business, lack of familiarity with new markets, difficulties in supporting the acquired business, and dilution to existing stockholders if our common stock is issued in consideration for an acquisition or investment, incurring or assuming indebtedness or other liabilities in connection with an acquisition.

We entered into multiple strategic alliances in the past and later recognized related impairment losses on investments and goodwill. We may incur debts in the future upon an acquisition or suffer losses related to impairment of these investments. Any impairment on goodwill and marketable securities and investments in the future may have a negative impact on our financial results. We will continue to examine the merits, risks and feasibility of potential transactions, and expect to explore additional acquisition opportunities in the future. Such examination and exploration efforts, and any related discussions with third parties, may or may not lead to future acquisitions and investments. We may not be able to complete acquiring or investing transactions that we initiate. Our ability to grow through such acquisitions and investments will depend on many factors, including the availability of suitable acquisition candidates at an acceptable cost, our ability to reach agreement with acquisition candidates or investee companies on commercially reasonable terms, the availability of financing to complete transactions and our ability to obtain any required governmental approvals.

We also face challenges in integrating any acquired business. These challenges include eliminating redundant operations, facilities and systems, coordinating management and personnel, retaining key employees, managing different corporate cultures, maintaining the relationship with the



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suppliers, vendors and/or distributors of acquired businesses, and achieving cost reductions and cross-selling opportunities. There can be no assurance that we will be able to successfully integrate all aspects of acquired businesses. The process of integrating the acquired business may disrupt our business and divert our resources. In addition, the benefits of an acquisition or investment transaction may take considerable time to be fully realized and we cannot assure you that any particular acquisition or investment and the subsequent integration will produce the intended benefits.

**Our business could suffer if we do not successfully manage current growth and potential future growth.**

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We are pursuing a number of growth strategies. Some of these strategies relate to services, products or markets in which we lack experience and expertise. Anticipated expansion of our operations will place a significant strain on our management, operation systems and resources. In addition to training and managing our workforce, we will need to continue to develop and improve our financial and management controls and our reporting systems and procedures, including those of acquired businesses. We cannot assure you that we will be able to effectively manage the growth of our operations, and any failure to do so may limit our future growth and materially and adversely affect our business, financial condition and results of operations.

### **Dependence on network suppliers may adversely affect our operating results.**

Our success depends in part upon the capacity, reliability, and performance of our network infrastructure, including the capacity leased from our Internet bandwidth suppliers. We depend on these companies to provide uninterrupted and error-free service through their telecommunications networks. Some of these providers are also our competitors. We exercise little control over these providers, which increases our vulnerability to problems with the services they provide. We have experienced and expect to continue to experience interruptions or delays in network service. Any failure on our part or the part of our third-party suppliers to achieve or maintain high data transmission capacity, reliability or performance could significantly reduce customer demand for our services and damage our business. As our customer base grows and their usage of telecommunications capacity increases, we will be required to make additional investments in our capacity to maintain adequate data transmission speeds, the availability of which may be limited or the cost of which may be on terms unacceptable to us. If adequate capacity is not available to us as our customers' usage increases, our network may be unable to achieve or maintain sufficiently high data transmission capacity, reliability or performance. In addition, our business would suffer if our network suppliers increased the prices for their services and we were unable to pass along the increased costs to our customers.

### **Our Asian online game and service business depends on the reliability of the network infrastructure and related services provided by ourselves and third parties, which is subject to physical, technological, security and other risks.**

The development and operation of our online networks are subject to physical, technological, security and other risks which may result in interruption in service or reduced capacity. These risks include physical damage, power loss, telecommunications failure, capacity limitation, hardware or software failures or defects and breaches of physical and cybersecurity by computer viruses, system break-ins or otherwise. An increase in the volume of usage of online services could strain the capacity of the software and hardware employed, which could result in slower response time or system failures. We have a variety of backup servers at our primary site to deal with possible system failures. However, we do not have redundant facilities in the event of an emergency. The occurrence of any of these events could result in interruptions, delays or cessation in service to users of our online services, which could have a material adverse effect on our business and results of operations.

While we have implemented industry-standard physical and cybersecurity measures, our network may still be vulnerable to unauthorized access, computer viruses, denial of service and other disruptive problems. Our Internet-based services may be interrupted as a result of the accidental or intentional actions of Internet users, our current and former employees or others. A party that is able to circumvent security measures could misappropriate proprietary information, attack our security and network system, and, perhaps, most importantly, cause interruptions in our operations. We have experienced in the past, and may experience in the future, security breaches and attacks. We may be required to expend significant capital or other resources to protect against the threat of security breaches and attacks or to alleviate problems caused by such actions. There can be no assurance that any measures implemented will not be circumvented in the future. Furthermore, a successful security breach or attack may lead us to incur substantial costs to repair damage or restore data, implement substantial organizational changes and training to prevent future similar attacks and lost revenues and litigation costs due to misused sensitive information, and cause substantial reputational damage.

Our business is also vulnerable to delays or interruptions due to our reliance on infrastructure and related services provided by third parties. End-users of our offerings depend on ISPs and our system infrastructure for access to the Internet games and services we offer. Some of these services have experienced service outages in the past and could experience service outages, delays and other difficulties due to system failures, stability or interruption. For example, in February 2007, an earthquake off the coast of Taiwan, and in March 2011 an earthquake off the north-east coast of Japan, damaged several undersea fiber optic cables linking countries such as Malaysia, Singapore, Australia, Japan, South Korea, China, the United States and Europe, causing disruptions in Internet traffic worldwide. We may lose customers as a result of delays or interruption in service, including delays or interruptions relating to high volumes of traffic or technological problems, which may prevent communication over the Internet and could materially adversely affect our business, revenues, results of operations and financial condition.

### **Any failure to maintain a stable and efficient distribution and payment network could have a material and adverse impact on our Asian online game and service business, financial condition and results of operations.**

Our Asian online game and service business operation relies heavily on a multi-layer distribution and payment network composed of third-party distributors for our sales to, and collection of payment from, our users. As we do not enter into long-term agreements with any of our

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distributors, we cannot assure you that we will continue to maintain favorable relationships with them. If we fail to maintain a stable and efficient distribution and payment network, our business, financial condition and results of operations could be materially and adversely affected.

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In addition, our ability to process electronic commerce transactions depends on bank processing and credit card systems. In order to prepare for certain types of system problems, we have a formal disaster recovery plan. Nevertheless, any system failure, including network, software or hardware failure, which causes a delay or interruption in our e-commerce services could have a material adverse effect on our business, revenues, results of operations and financial condition.

### **Undetected programming errors or defects in our software, services and games and the proliferation of cheating programs could materially and adversely affect our Asian online game and service business and the cloud computing business, financial condition and results of operations.**

Our online games and cloud computing software and services may contain undetected programming errors or other defects. These errors or other defects could damage our reputation and subject us to liability. As to online games, parties unrelated to us may develop cheating programs that enable users to acquire superior features for their game characters that they would not have otherwise. Furthermore, certain cheating programs could cause the loss of a character's superior features acquired by a user. The occurrence of undetected errors or defects in our games, and our failure to discover and disable cheating programs affecting the fairness of our game environment, could disrupt our operations, damage our reputation and detract from the game experience of our users. As a result, such errors, defects and cheating programs could materially and adversely affect our business, financial condition and results of operations. If such errors, defects and cheating programs occur in software, services and games we operate, our business operations and, in turn, our business and financial condition, could be materially and adversely affected.

### **Operation of pirate game servers and the expenses incurred in protecting our Asian online game and service business operation against unlawful operations through pirate servers may adversely affect our business.**

We face challenges from pirate game servers, which are game servers that operate unauthorized copies of our online games and permit users to play those games without purchasing pre-paid game cards from us. The existence of unauthorized servers may attract game players away from our games and may result in decreases in our revenues. Although we have made efforts to detect and shutdown pirate servers in Greater China, we cannot assure you that such efforts will be successful in eliminating these unauthorized servers. In addition, detailed comparisons of software codes and litigation proceedings are often necessary to enforce the intellectual property rights, whether owned by or licensed by us, which sometimes result in substantial costs. The continued illegal operation of any of our existing games by pirate game servers, or the illegal operation of any of our new games by pirate servers, may materially and adversely affect our business, financial condition and results of operations.

### **We may be subject to claims of intellectual property right infringement by third parties, which could subject us to significant liabilities and other costs.**

Our success depends largely on our ability to use and develop our technology and know-how without infringing upon the intellectual property rights of third parties. There has been substantial litigation in the communications, VoIP services, semiconductor, electronics, and related industries regarding intellectual property rights and, from time to time, third parties may claim infringement by us of their intellectual property rights. Our broad range of current technology, including IP telephone systems, digital and analog circuits, software, and semiconductors, increases the likelihood that third parties may claim infringement by us of their intellectual property rights. The validity and scope of claims relating to the intellectual property may involve complex scientific, legal and factual questions and analysis, and tend to be uncertain. If third parties assert copyright or patent infringement or violation of other intellectual property rights against us, we have to defend ourselves in legal or administrative proceedings, which can be costly and time consuming and may significantly divert the efforts and resources of our technical and management personnel. An adverse determination in any such proceedings to which we may become a party could subject us to significant liability to third parties, require us to seek licenses from third parties, and prevent us from selling our products and services. The imposition of liabilities that are not covered by insurance, in excess of insurance coverage or for which we are not indemnified by a content provider, could have a material adverse effect on our business, results of operations and financial condition.

Certain technologies necessary for us to provide our services may, in fact, be patented by other parties either now or in the future. If such technology were held under patent by another person, we would have to negotiate a license for the use of that certain technology. We may not be able to negotiate such a license at a price that is acceptable. The existence of such patents, or our inability to negotiate a license for any such technology on acceptable terms, could force us to cease using such technology and offering products and services incorporating such technology. If we were found to be infringing on the intellectual property rights of any third party in lawsuits or other claims and proceedings that may be asserted against us in the future, we could be subject to liabilities for such infringement, which could be material. We could also be required to refrain from using, manufacturing or selling certain products or using certain processes, either of which could have a material adverse effect on our business and operating results. From time to time, we may receive in the future, notices of claims of infringement, misappropriation or misuse of other parties' proprietary rights. We cannot assure you that we will always prevail in these discussions and actions or that other actions alleging infringement by us of third-party patents will not be asserted or prosecuted against us. Furthermore, lawsuits like these may require significant time and expense to defend, may divert management's attention away from other aspects of our operations and,

upon resolution, may have an adverse effect on our business, results of operations, financial condition and cash flows.

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### **We may need to incur significant expenses to protect our intellectual property rights, and if we are unable to adequately protect our intellectual property rights, our competitive position could be harmed.**

We regard our copyrights, service marks, trademarks, trade secrets, patents and other intellectual property as critical to our success. We rely on a combination of copyright and trademark laws, trade secret protection, confidentiality and non-disclosure agreements, and other contractual provisions to protect our proprietary software, trade secrets and similar intellectual property. We have patents, copyrights and trademarks in certain jurisdictions and may apply for further trademark and copyright registrations and additional patents, which may provide such protection in relevant jurisdictions. However, we cannot assure you that our efforts will prove to be sufficient or that third parties will not infringe upon or misappropriate our proprietary rights. Unauthorized use of the intellectual property, whether owned by or licensed to us, could adversely affect our business and reputation.

The validity, enforceability and scope of protection of intellectual property in Internet-related industries are evolving, and therefore, uncertain. In particular, the laws and enforcement procedures of the PRC, Taiwan, and Hong Kong are uncertain or do not protect intellectual property rights to the same extent as the laws and enforcement procedures of the United States do. We may have to engage in litigation or other legal proceedings to enforce and protect our intellectual property rights, which could result in substantial costs and diversion of our resources, and have a material adverse effect on our business, financial condition and results of operations.

### **Our future results of operations or the growth of our business may suffer if we are unable to maintain satisfactory relationships with the licensors of our online games.**

While we are focused on strengthening our abilities to self-develop casual games, we have historically and may in the future source casual games, advanced casual games and MMOs through licensing from developers in various regions where online game development is relatively established. As of the date of this annual report, we have one licensed MMO in our online game portfolio, including the games we currently offer and the games in the pipeline. We need to maintain stable and satisfactory working relationships with our licensors in order to ensure the continued operation of our licensed online games and our continued access to new online game licenses. We depend on our licensors to provide the necessary technical support for the operation of the licensed games as well as expansion packs and upgrades that sustain continuing interest in the games. Our ability to maintain satisfactory working relationships with our licensors may also influence our ability to license new online games developed by the same or other licensors. If we are unable to maintain satisfactory relationships with our licensors, our financial condition, results of operations, future profitability and growth prospects may be materially and adversely affected.

### **We have a limited operating history in providing cloud computing services, which makes it difficult to predict our future operating results.**

We introduced our first cloud computing services in early April 2013. As a result of our limited operating history, our ability to forecast our future operating results is limited and subject to a number of uncertainties, including our ability to plan for and model future growth. We face risks and uncertainties frequently experienced by growing companies in rapidly changing industries, such as the risks and uncertainties described herein. If our assumptions regarding these risks and uncertainties (which we use to plan our business) are incorrect or change due to changes in our markets, or if we do not address these risks successfully, our operating and financial results could differ materially from our expectations and our business could suffer.

### **The success of our cloud computing business is dependent on the growth and public acceptance of our services.**

Our future success in cloud computing depends on our ability to significantly increase revenues generated from our services. In turn, the success of our cloud computing solutions and services depends, among other things, upon future demand for cloud-based communications systems and services. Because the use of our service requires that the user be a subscriber of an existing broadband Internet service, usually provided through a cable or digital subscriber line, or DSL, connection, slow or limited adoption of broadband Internet service could adversely affect the growth of our subscriber base and revenues. Although the number of broadband subscribers in Greater China has grown significantly over the last five years, cloud-based communications services have not yet been adopted by a majority of prospective business customers. To increase the deployment of broadband Internet services from broadband Internet service providers, telephone companies and cable companies must continue to invest in the deployment of high speed broadband networks to residential and business customers, over which we have no control. In addition, networks must improve quality of service for real-time communications, managing effects such as packet jitter, packet loss, and unreliable bandwidth, so that toll-quality service can be consistently provided. Cloud-based communications equipment and services must achieve a similar level of reliability that users of the public switched telephone network, or PSTN, have come to expect from their telephone service, and the cost and feature benefits of cloud-based communications must be sufficient to cause customers to switch away from traditional telephone service providers. We must devote substantial resources to educate customers and end users about the benefits of cloud-based communications solutions, in general, and our services in particular. Substantial, ongoing interaction with our customers in order to train and assist them with the deployment and use of our services over these networks is sometimes required. If any or all of these factors fail to occur, our business may be

adversely affected.

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**Our cloud computing business depends on continued and unimpeded access to the Internet by us and our users. Internet access providers and Internet backbone providers may be able to block, degrade or charge for access to or bandwidth use of certain of our products and services, which could lead to additional expenses and the loss of users.**

Our cloud computing solutions and services depend on the ability of our users to access the Internet, and certain of our products require significant bandwidth to work effectively. Currently, this access is provided by companies that have significant and increasing market power in the broadband and Internet access marketplace, including incumbent telephone companies, cable companies and mobile communications companies. Some of these providers offer products and services that directly compete with our own offerings, which give them a significant competitive advantage. Some of these providers have stated that they may take measures that could degrade, disrupt or increase the cost of user access to certain of our products by restricting or prohibiting the use of their infrastructure to support or facilitate our offerings, or by charging increased fees to us or our users to provide our offerings. While others, including some of the largest providers of broadband Internet access services, have committed to not engaging in such behavior, we cannot assure you that they will follow through on their commitments.

**Intense competition in the markets in which we compete in cloud computing could prevent us from increasing or sustaining our revenue and increasing or maintaining profitability.**

The cloud computing and telecommunications industries are highly competitive. We face intense competition from new cloud service providers, traditional telephone companies, wireless companies, cable companies, competitive local exchange carriers, alternative voice communication providers and independent VoIP providers.

Most of our current and potential competitors, particularly incumbent telephone and cable companies, have longer operating histories, significantly greater resources and name recognition, and a larger base of customers than we have. As a result, these competitors may have greater credibility with our existing and potential customers. They also may be able to adopt more aggressive pricing policies and devote greater resources to the development, promotion and sale of their products than we can to ours. Our competitors may also offer bundled service arrangements offering a more complete product despite the technical merits or advantages of our products. Competition could decrease our prices, reduce our sales, lower our gross profits or decrease our market share.

We also compete against established alternative voice communication providers and face competition from other large, well-capitalized Internet companies that have recently launched or plan to launch cloud-based services. In addition, we compete with independent cloud service providers. Some of these service providers may choose to sacrifice revenue in order to gain market share by offering their services at lower prices or for free. In order to compete with such service providers, we may have to significantly reduce our prices, which would affect our profitability.

We also are subject to the risk that new technologies may be developed that are able to deliver competing voice services at lower prices, better or more conveniently. Future competition from new technologies could have a material adverse effect on our growth and operating results.

Given the significant price competition in the markets for our products, we are at a significant disadvantage compared to many of our competitors, especially those with substantially greater resources, and therefore may be better able to withstand an extended period of downward pricing pressure. The adverse impact of a shortfall in our revenues may be magnified by our inability to adjust spending to compensate for such shortfall. Announcements of new products and technologies by our competitors or us could cause customers to defer purchases of our existing products, which also could have a material adverse effect on our business, financial condition or operating results.

**The cloud computing market is subject to rapid technological change, and we depend on new product and service introductions in order to maintain and grow our business.**

Cloud computing solutions and services is an emerging market that is characterized by rapid changes in customer requirements, frequent introductions of new and enhanced products, and continuing and rapid technological advancement. To compete successfully in this emerging market, we must continue to design, develop, manufacture, and sell new and enhanced cloud software products and services that provide increasingly higher levels of performance and reliability at lower cost.

**Decreasing telecommunications rates and increasing regulatory charges may diminish or eliminate our competitive pricing advantage of our communications offerings, which yield significant savings over traditional phone systems.**

Decreasing telecommunications rates may diminish or eliminate the competitive pricing advantage of our services, while increased regulation and the imposition of regulatory obligations could require us to either increase the retail price for our services, thus making us less competitive, or absorb such costs, thus decreasing our profit margins. International and domestic telecommunications rates have decreased significantly over



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the last few years in Greater China, and we anticipate these rates will continue to decline in all of the markets in which we do business or expect to do business. Users who select our services to take advantage of the current pricing differential between traditional telecommunications rates and our rates may switch to traditional telecommunications carriers if such pricing differentials diminish or disappear, however, and we will be unable to use such pricing differentials to attract new customers in the future. Continued rate decreases would require us to lower our rates to remain competitive and would reduce or possibly eliminate any gross profit from our services. In addition, we may lose subscribers for our services.

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**We rely on third-party network service providers to originate and terminate substantially all of our public switched telephone network calls.**

We leverage the infrastructure of third-party network service providers to provide telephone numbers, PSTN call termination and origination services, and local number portability for our customers rather than deploying our own network throughout Taiwan. This decision has resulted in lower capital and operating costs for our business in the short term but has reduced our operating flexibility and ability to make timely service changes. If any of these network service providers cease operations or otherwise terminate the services that we depend on, the delay in switching our technology to another network service provider, if available, and qualifying this new service could have a material adverse effect on our business, financial condition or operating results.

While we believe that relations with our current service providers are good, and we have contracts in place, there can be no assurance that these service providers will be able or willing to supply cost-effective services to us in the future or that we will be successful in signing up alternative or additional providers. New rules in Taiwan may impact charges that regulated telecommunications carriers assess each other for originating and terminating traffic and it is possible that we will be subject to increased charges. This may reduce our profitability and may also increase the retail price of our service, making our service less competitive with other providers of similar calling services. Although we could replace our current providers, if necessary, our ability to provide service to our subscribers could be impacted during this timeframe, and this could have an adverse effect on our business, financial condition or results of operations. The loss of access to, or requirement to change, the telephone numbers we provide to our customers also could have a material adverse effect on our business, financial condition or operating results.

Due to our reliance on these service providers, when problems occur in a network, it may be difficult to identify the source of the problem. The occurrence of hardware and software errors, whether caused by our service or another vendor's products, may result in the delay or loss of market acceptance of our products and any necessary revisions may force us to incur significant expenses. The occurrence of some of these types of problems may seriously harm our business, financial condition or operating results.

**Our physical infrastructure is concentrated in a few facilities and any failure in our physical infrastructure or our inability to handle a growing number of simultaneous calls and other services could lead to significant costs and disruptions and could reduce our revenue, harm our business reputation and have a material adverse effect on our financial results.**

Our leased network and data centers are subject to various points of failure. Problems with cooling equipment, generators, uninterruptible power supply, routers, switches, or other equipment, whether or not within our control, could result in service interruptions for our customers as well as equipment damage. Because our services do not require geographic proximity of our data centers to our customers, our infrastructure is consolidated into a few large facilities. Any failure or downtime in one of our data center facilities could affect a significant percentage of our customers. The total destruction or severe impairment of any of our data center facilities could result in significant downtime of our services and the loss of customer data. Because our ability to attract and retain customers depends on our ability to provide customers with highly reliable service, even minor interruptions in our service could harm our reputation. Additionally, in connection with the expansion or consolidation of our existing data center facilities from time to time, there is an increased risk that service interruptions may occur as a result of server relocation or other unforeseen construction-related issues.

We expect the volume of simultaneous calls to increase significantly as our subscriber base grows. Our systems may not be able to accommodate this additional volume. If we fail to maintain an appropriate level of operating performance, or if our service is disrupted, our reputation could be hurt and we could lose customers, all of which could have a material adverse effect on our business, financial condition or operating results.

Any future service interruptions could:

Cause our customers to seek damages for losses incurred;

Require us to replace existing equipment or add redundant facilities;

Affect our reputation as a reliable provider of hosting services;

Cause existing customers to cancel or elect to not renew their contracts; or

Make it more difficult for us to attract new customers.

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Any of these events could materially increase our expenses or reduce our revenue, which would have a material adverse effect on our operating results.

### **Increased energy costs, power outages, and limited availability of electrical resources may adversely affect our operating results.**

Our data centers are susceptible to increased costs of power and to electrical power outages. Our customer contracts do not contain provisions that would allow us to pass on any increased costs of energy to our customers, which could affect our operating margins. Any increases in the price of our services to recoup these costs could not be implemented until the end of a customer contract term. Further, power requirements at our data centers are increasing as a result of the increasing power demands of today's servers. Increases in our power costs could impact our operating results and financial condition. Since we rely on third parties to provide our data centers with power sufficient to meet our needs, our data centers could have a limited or inadequate amount of electrical resources necessary to meet our customer requirements. We attempt to limit exposure to system downtime due to power outages by using backup generators and power supplies. However, these protections may not limit our exposure to power shortages or outages entirely. Any system downtime resulting from insufficient power resources or power outages could damage our reputation and lead us to lose current and potential customers, which would harm our operating results and financial condition.

### **We depend on third-party vendors for mobile phones, IP phones, and video cameras, and any delay or interruption in manufacturing by these vendors would result in delayed or reduced shipments to our customers and may harm our business.**

We rely on third-party vendors for mobile phones, IP phones, and video cameras to utilize our services. We currently do not have long-term supply contracts with any of these vendors. As a result, most of these third-party vendors are not obligated to provide products or perform services to us for any specific period, in any specific quantities or at any specific price, except as may be provided in a particular purchase order. The inability of these third-party vendors to deliver IP phones of acceptable quality and in a timely manner, particularly the sole source vendors, could adversely affect our operating results or cause them to fluctuate more than anticipated. Additionally, some of our products may require specialized or high-performance component parts that may not be available in quantities or in time frames that meet our requirements.

### **We could be liable for breaches of security on our web site, fraudulent activities of our users, or the failure of third-party vendors to deliver credit card transaction processing services.**

A fundamental requirement for operating an Internet-based, international communications service and electronically billing our customers is the secure transmission of confidential information and media (such as customers' credit card numbers and expiration dates, personal information and billing addresses) over public networks. Although we have developed systems and processes that are designed to protect consumer information and prevent fraudulent credit card transactions and other security breaches and are not aware of any breaches of security on our websites having occurred, failure to mitigate such fraud or breaches may expose us to litigation and possible liability for failing to secure confidential customer information and could harm our reputation and ability to attract and retain customers, consequently adversely affect our operating results. The law relating to the liability of providers of online payment services is currently unsettled and certain jurisdictions may enact their own rules with which we may not comply. We rely on third-party providers to process and guarantee payments made by our subscribers up to certain limits, and we may be unable to prevent our customers from fraudulently receiving goods and services. Our liability risk will increase if a larger fraction of our transactions involve fraudulent or disputed credit card transactions. Any costs we incur as a result of fraudulent or disputed transactions could harm our business. In addition, the functionality of our current billing system relies on certain third-party vendors delivering services. If these vendors are unable or unwilling to provide services, we will not be able to charge for our services in a timely or scalable fashion, which could significantly decrease our revenue and have a material adverse effect on our business, financial condition and operating results.

### **We may experience losses due to subscriber fraud and theft of service.**

Subscribers may in the future obtain access to our service without paying for monthly service and international toll calls by unlawfully using our authorization codes or by submitting fraudulent credit card information. To date, such losses from unauthorized credit card transactions and theft of service have not occurred. We have implemented anti-fraud procedures in order to control losses relating to these practices, but these procedures may not be adequate to effectively limit all of our exposure in the future from fraud. If our procedures are not effective, consumer fraud and theft of service could significantly decrease our revenue and have a material adverse effect on our business, financial condition and operating results.

### **A high rate of customer terminations would negatively affect our business by reducing our revenue or requiring us to spend more money to grow our customer base.**

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We could experience a high customer termination or churn rate in the future if customers are not satisfied with our service. Other factors, including increased competition from VoIP providers, alternative technologies, and adverse business conditions may also influence our churn rate.

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Because of churn, we have to acquire new customers on an ongoing basis just to maintain our existing level of customers and revenues. As a result, marketing expenditures are an ongoing requirement of our business. If our churn rate is high and increases, we will have to acquire even more new customers in order to maintain our existing revenues. We incur significant costs to acquire new customers, and those costs are an important factor in determining our net profitability. Therefore, if we are unsuccessful in retaining customers or are required to spend significant amounts to acquire new customers beyond those budgeted, our revenue could decrease and our net income could decrease.

### **We depend on our key personnel, and our business and growth prospects may be severely disrupted if we lose their services or are unable to attract new key employees.**

The success of our business is heavily dependent upon the services of our management team and other key personnel who have critical industry experience and relationships that we rely on to implement our business plan. The development, marketing and growth of our services will continue to place a significant strain on our limited personnel, management and other resources. We have experienced substantial turnover among members of our board of directors and senior management team in recent years. Further turnover of directors, senior management or key personnel could harm our business and our growth prospects. In addition, we must successfully integrate all new management and other key personnel into our organization to achieve our operating objectives; failure to do so could adversely affect our business. None of our officers or key employees are bound by employment agreements for any specific term, and we also currently do not maintain key person life insurance policies on any of our employees. The loss of the services of any of our officers or key employees could delay the development and introduction of, and negatively impact our ability to sell our services which could adversely affect our financial results and impair our growth.

### **Our ability to offer services outside Taiwan is subject to different local regulatory environments, which may be unknown, complicated and uncertain.**

Regulatory treatment of cloud computing solutions and services outside Taiwan varies from country to country and often the applicable laws are unclear. We plan to distribute our products and services directly to consumers and through resellers that may be subject to telecommunications regulations in their home countries. Any failure by us or our customers and resellers to comply with these laws and regulations could reduce our revenue and profitability. Some countries may require us to register as a telecommunications provider based on our relationship with local resellers and may subject us to fines or penalties should we fail to do so. In addition, some countries are considering subjecting cloud-based communications services to the regulations applied to traditional telephone companies. Regulatory developments such as these could have a material adverse effect on the use of our services in international locations.

### **Our transactions with related parties may not benefit us and may harm our Company.**

We have entered into several transactions with certain related parties in the past. We believe that we have conducted our related-party transactions on an arm's-length basis and on terms comparable to, or more favorable to us than, similar transactions we would enter into with independent third parties. However, we cannot assure you that all our future transactions with related parties will be beneficial to us. See Item 7, Major Shareholders and Related-Party Transactions in this annual report.

### **We may need additional capital in the future, and it may not be available on acceptable terms.**

The development of our business may require significant additional capital in the future to:

fund our operations;

enhance and expand the range of products and services we offer; and

respond to competitive pressures and perceived opportunities, such as investment, acquisition and international expansion activities. We cannot assure you that additional financing will be available on terms favorable to us, if at all. If adequate funds are not available on acceptable terms, we may be forced to curtail or cease our operations. Moreover, even if we are able to continue our operations, any failure to obtain additional financing could have a material and adverse effect on our business, financial condition and results of operations, and we may need to delay the deployment of our services. See Item 5, Operating and Financial Review and Prospects B. Liquidity and Capital Resources.

**Our results of operations and financial condition are affected by political stability, as well as the occurrence of natural disasters and epidemics.**

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We operate our Asian online game and service business in Greater China. Political unrest, war, acts of terrorism and other instability, as well as natural disasters such as earthquakes and typhoons which are common in Greater China, can result in disruption to our business or the businesses of our customers. Our business could be adversely affected by natural disasters and the effects of influenza A virus subtypes, such as H1N1 and H5N1, SARS or other epidemics. Any prolonged recurrence of such adverse public health developments in the regions where we operate may have material adverse effects on our business operations. These could include illness and loss of our management and key employees. Natural disasters or outbreak of epidemics may result in a decrease in economic activities or temporary closure of many businesses and disruption in our operations. In addition, other major natural disasters may also adversely affect our business by, for example, causing disruptions of the Internet network or otherwise affecting access to our games.

### **Risks Related to Doing Business in Greater China**

**There are currently no clear laws or regulations governing virtual asset property rights, in particular, in Greater China, and therefore, it is not clear what liabilities, if any, online game operators may have in respect of virtual assets.**

In the course of playing online games, some virtual assets, such as special equipment, player experience grades and other features of our users game characters, are acquired and accumulated. Such virtual assets can be important to online game players. In practice, virtual assets can be lost for various reasons, often through unauthorized use of user identifications by other users and occasionally through data loss caused by delay of network service or by a network crash. Currently there are no clear laws or regulations governing virtual asset property rights, in particular, in Greater China where we operate our Asian online game and service business. As a result, it is unclear under PRC law whether an operator of online games such as us would have any liability (whether in contract, tort or otherwise) for loss of such virtual assets by game players. Based on several judgments regarding the liabilities of online game operators for loss of virtual assets by game players, the PRC courts have generally required online game operators to provide well-developed security systems to protect such virtual assets owned by game players. In the case of a loss of virtual assets, we may be sued by online game players and could be held liable for damages, which may negatively affect our business, financial condition and results of operations.

**There are economic risks associated with doing business in Taiwan, particularly due to the tense relationship between Taiwan and the PRC.**

Our principal executive offices and a significant portion of our assets are located in Taiwan and a major portion of our revenues of Asian online game and service business are derived from our operations in Taiwan. Taiwan, as part of the Republic of China, has a unique international political status. The PRC asserts sovereignty over mainland China and Taiwan and does not recognize the legitimacy of the Taiwan government. Relations between Taiwan and the PRC and other factors affecting the political or economic conditions of Taiwan could also affect our Asian online game and service and GigaCloud businesses.

**Fluctuations in the exchange rates between the U.S. dollar and other currencies in which we conduct our business could adversely affect our profitability.**

The operations of our Asian online game and service business are conducted in NT dollars and Hong Kong dollars and our cloud computing services are conducted in NT dollars. Accordingly, fluctuations in the exchange rates could have a positive or negative effect on our reported results. Generally, an appreciation of NT dollars or Hong Kong dollars against U.S. dollars results in a foreign exchange loss for monetary assets denominated in U.S. dollars, and a foreign exchange gain for monetary liabilities denominated in U.S. dollars. On the contrary, a devaluation of NT dollars, Hong Kong dollars, or Singapore dollars against U.S. dollars results in a foreign exchange gain for monetary assets denominated in U.S. dollars, and a foreign exchange loss for monetary liabilities denominated in U.S. dollars. Given the constantly changing currency exposures and the substantial volatility of currency exchange rates, we cannot predict the effect of exchange rate fluctuations upon future operating results. There can be no assurance that we will not experience currency losses in the future, which could have a material adverse effect on our business, revenues, results of operations and financial condition.

### **Risks Related to Ownership of our Shares**

**The price of our Shares has been volatile historically and may continue to be volatile, which may make it difficult for holders to resell our Shares when desired or at attractive prices.**

The trading price of our Shares has been and may continue to be subject to wide fluctuations. In 2014, the closing prices of our Shares on the NASDAQ Stock Market have ranged from US\$0.77 to US\$1.72 per share, and the closing price on March 31, 2015 was US\$0.7699. Our Share price may fluctuate in response to a number of events and factors. In addition, the financial markets in general, and the market prices for Internet-related companies in particular, have experienced extreme volatility that often has been unrelated to the operating performance of such



companies. These broad market and industry fluctuations may adversely affect the price of our Shares, regardless of our operating performance.

**Our Shares are listed on the NASDAQ Global Select Market and if we fail to meet the standards for continued listing of our Shares on NASDAQ, the Shares could be delisted from the NASDAQ Stock Market.**

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Our Shares are listed on the NASDAQ Global Select Market. The NASDAQ Global Select Market has several quantitative and qualitative requirements companies must comply with to maintain listing, including a US\$1.00 minimum bid price per share. The trading prices for our Shares in the year 2014 were around the US\$1.00 range and traded below US\$1.00 several times. As of March 31, 2015, the closing price for our Shares was US\$0.7699. We received a deficiency letter for the minimum bid price requirement for continued listing, dated January 14, 2015, from the NASDAQ Stock Market LLC (the "Nasdaq Letter"). In the letter, it indicated that we failed to meet the minimum bid price requirement. It has resulted from the fact that the bid price of our common stock closed below US\$1 per share for the last 30 consecutive business days. In accordance with Nasdaq Stock Market Rule, we have a grace period of 180 calendar days, or until July 13, 2015, to regain compliance. If at any time before July 13, 2015, the bid price of our common stock closes at \$1.00 per share or more for a minimum of 10 consecutive business days, NASDAQ Stock Market LLC will provide a written notification to us indicating that we complies with the minimum bid price rule.

Nasdaq Letter had no immediate impact on the listing of our common stock on the Nasdaq Stock Market. Our common stock continues to trade on the NASDAQ Global Select Market under the symbol "GIGM".

We continue to monitor the bid price for our common stock between January 14, 2015 and July 13, 2015, and are considering available options to resolve the deficiency and regain compliance with the NASDAQ minimum bid price requirement.

There can be no assurance that we will regain compliance and continue to meet all of the requirements for continued NASDAQ listing. If we fail to comply with the minimum bid price requirement, our Shares could be delisted from NASDAQ, which could have a material adverse effect on our stock prices and our standing with current and future investors.

**We are controlled by the Koo family, which has significant influence in determining the outcome of any corporate transaction or other matters submitted to our shareholders for approval, and their interests may conflict with your interests.**

As of March 31, 2015, a member of the Koo family beneficially owned 19.54% of our outstanding Shares. Accordingly, a member of the Koo family has significant influence in determining the outcome of any corporate transaction or other matters submitted to our shareholders for approval, including mergers, consolidations, the sale of all or substantially all of our assets and the power to prevent or cause a change in control. The interests of such member of the Koo family may differ from or conflict with your interests.

**The ability of our subsidiaries in Taiwan to distribute dividends to us may be subject to restrictions under the laws of Taiwan.**

We are a holding company, and some of our assets constitute our ownership interests in our subsidiaries in Taiwan, including Hoshin GigaMedia, which owns the Taiwan-based operations of our Asian online game and service business. Accordingly, part of our primary internal source of funds to meet our cash needs is our share of the dividends, if any, paid by our subsidiaries, including those in Taiwan. The distribution of dividends to us from these subsidiaries in Taiwan is subject to restrictions imposed by the applicable corporate and tax regulations in these countries, which are more fully described in Item 5, "Operating and Financial Review and Prospects" B. Liquidity and Capital Resources "Dividends from Our Subsidiaries" in this annual report. In addition, although there are currently no foreign exchange control regulations which restrict the ability of our subsidiaries in Taiwan to distribute dividends to us, the relevant regulations may be changed and the ability of these subsidiaries to distribute dividends to us may be restricted in the future.

**We are a Singapore company, and because the rights of shareholders under Singapore law differ from those under U.S. law, you may have difficulty in protecting your shareholder rights or enforcing any judgment obtained in the U.S. against us or our affiliates.**

Our corporate affairs are governed by our memorandum and articles of association and by the applicable laws governing corporations incorporated in Singapore. The rights of our shareholders and the responsibilities of members of our board of directors under Singapore law are different from those applicable to a corporation incorporated in the United States and, therefore, our shareholders may have more difficulty protecting their interests in connection with actions by the management, members of our board of directors or our controlling shareholders than they would as shareholders of a corporation incorporated in the United States.

Our Company is incorporated under the laws of the Republic of Singapore. Many of our directors and senior management reside outside the United States. As a result, it may be difficult for investors to effect service of process within the United States upon us or any of these persons or to enforce in the United States any judgment obtained in the U.S. courts against us or any of these persons, including judgments based upon the civil liability provisions of the U.S. federal securities laws or any state or territory of the United States. Judgments of the U.S. courts based upon the civil liability provisions of the U.S. federal securities laws may not be enforceable in Singapore courts, and it is unclear whether Singapore courts will enter judgments in original actions brought in Singapore courts based solely upon the civil liability provisions of the U.S. federal securities laws.



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### **Anti-takeover provisions under the Singapore Securities and Futures Act (Chapter 289) and the Singapore Code on Take-overs and Mergers may delay, deter or prevent a future takeover or change of control of our Company, which could adversely affect the price of our Shares.**

The Singapore Code on Take-overs and Mergers (the Code), issued pursuant to Section 321 of the Singapore Securities and Futures Act (Chapter 289) regulates the acquisition of ordinary shares of, inter alia, listed public companies and contains certain provisions that may delay, deter or prevent a future takeover or change of control of our Company. Any person acquiring an interest, either on his own or together with parties acting in concert with him, in 30% or more of the voting shares in our Company must, except with the prior consent of the Singapore Securities Industry Council (the SIC), extend a takeover offer for the remaining voting shares in our Company in accordance with the provisions of the Code. Likewise, any person holding between 30% and 50% of the voting shares in our Company, either on his own or together with parties acting in concert with him, must, except with the prior consent of the SIC, make a takeover offer in accordance with the provisions of the Code if that person together with parties acting in concert with him acquires additional voting shares in excess of one percent of the total number of voting shares in any six-month period.

Under the Code, an offeror must treat all shareholders of the same class in an offeree company equally. A fundamental requirement is that shareholders in the company subject to the takeover offer must be given sufficient information, advice and time to consider and decide on the offer.

These provisions contained in the Code may discourage or prevent transactions that involve an actual or threatened change of control of our Company. This may harm you because an acquisition bid may allow you to sell your Shares at a price above the prevailing market price.

### **Our shareholders may be subject to Singapore taxes.**

Singapore tax law may differ from the tax laws of other jurisdictions, including the United States. Gains from the sale of our Shares by a person not tax resident in Singapore may be taxable in Singapore if such gains are part of the profits of any business carried on in Singapore. For additional information, see Item 10, Additional Information E. Taxation Singapore Tax Consideration in this annual report. You should consult your tax advisors concerning the overall tax consequences of acquiring, owning or selling the Shares.

### **We may be deemed to be an investment company under the United States Investment Company Act of 1940, which could have a significant negative impact on our results of operations.**

We may be deemed to be an investment company under the United States Investment Company Act of 1940 (the 1940 Act), and may suffer adverse consequences as a result. Generally, the 1940 Act provides that a company is an investment company if the company (i) is, holds itself out as or proposes to be engaged primarily in the business of investing, reinvesting or trading in securities or (ii) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of its total assets (exclusive of U.S. government securities or cash items) on an unconsolidated basis. Under the 1940 Act, investment securities include, among other things, securities of non-majority owned businesses. However, a company that is primarily engaged, directly or through wholly-owned subsidiaries, in a business or businesses other than that of investing, reinvesting, owning, holding or trading in securities is not an investment company.

In the past, we disposed of our online gambling business and made several significant investments in online game developers and operators. As a result of these transactions, we have a significant amount of cash and securities. See Item 4, Information on the Company B. Business Overview Gaming Software and Service Business for additional information. Consequently, there is a risk that we could be deemed to be an investment company because our investment securities may be deemed to comprise more than 40% of our total assets (exclusive of U.S. government securities or cash items) on an unconsolidated basis pending investment of disposal proceeds into our businesses.

However, based on our historical and current business activities, our intentions, the manner in which we hold ourselves out to the public, the primary activities of our officers and directors and an analysis of our non-cash assets and income during 2014, the first quarter of 2015 and in prior periods, we believe that the better view is that we are not an investment company. Nevertheless, a part of the determination of whether we are an investment company is based upon the composition and value of our non-cash assets, a significant portion of which are presently comprised of our Strategic Investments. As a result, we could be deemed to be an investment company.

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We intend to continue to conduct our businesses and operations so as to avoid being required to register as an investment company. We have sought opportunities to deploy our capital in a manner which would result in the Company acquiring majority interests in entities or businesses that complement or enhance our remaining businesses or would otherwise assist the Company in achieving our current corporate objectives. We have also limited, and intend to continue to limit, new Strategic Investments to those opportunities which would present excellent opportunities to complement or enhance our remaining businesses or would otherwise assist the Company in achieving our current corporate objectives. If, nevertheless, we were to be required to register as an investment company, because we are a foreign company, the 1940 Act would prohibit us and any person deemed to be an underwriter of our securities from offering for sale, selling or delivering after sale, in connection with a public offering, any security issued by the Company in the United States. Additionally, we may be unable to continue operating as we currently do and might need to acquire or sell assets that we would not otherwise acquire or sell in order to avoid being treated as an investment company as defined under the 1940 Act. We may incur significant costs and management time in this regard, which could have a significant negative impact on our results of operations.

**We may be classified as a passive foreign investment company for U.S. federal income tax purposes. As a result, you may be subject to materially adverse tax consequences with respect to Shares.**

In light of our significant cash balances and portfolio of investment securities, we believe that it is likely that we were classified as a passive foreign investment company, or PFIC, for the taxable year ended December 31, 2014, and we will likely be a PFIC for our current taxable year ending December 31, 2015, unless our share value increases and/or we invest a substantial amount of the cash and other passive assets we hold in assets that produce or are held for the production of non-passive income. In addition, it is possible that one or more of our subsidiaries may be or become classified as a PFIC for U.S. federal income tax purposes. A non-United States corporation, such as us, will be classified as a PFIC for any taxable year in which 75% or more of its gross income consists of certain types of passive income or 50% or more of the average quarterly value of its assets (as generally determined on the basis of fair market value) during such year produce or are held for the production of passive income. For this purpose, cash and other assets readily convertible into cash are generally classified as passive and goodwill and other unbooked intangibles associated with active business activities may generally be classified as non-passive.

If we were to be classified as a PFIC in any taxable year during which a U.S. person (as defined in E. Taxation U.S. Tax Considerations Passive Foreign Investment Company ) holds our Shares, such U.S. person may incur significantly increased United States income tax on gain recognized on the sale or other disposition of the Shares and on the receipt of distributions on the Shares to the extent such gain or distribution is treated as an excess distribution under the U.S. federal income tax rules. Furthermore, a U.S. person will generally be treated as holding an equity interest in a PFIC in the first taxable year of the U.S. Person's holding period in which we become a PFIC and subsequent taxable years ( PFIC-Tainted Shares ) even if we cease to be a PFIC in subsequent taxable years. Accordingly, a U.S. person, who acquires our Shares during the current taxable year or subsequent taxable years, should, to the extent an election is available, consider making a mark-to-market election in the first taxable year of such holder's holding period to avoid owning PFIC-Tainted Shares. For more information, see the section entitled E. Taxation U.S. Tax Considerations Passive Foreign Investment Company .

## **ITEM 4. INFORMATION ON THE COMPANY**

### **A. History and Development of Our Company**

Our business was founded as Hoshin GigaMedia in Taiwan in October 1998. For the purpose of a public equity offering, GigaMedia Limited was incorporated in Singapore in September 1999 as a company limited by shares. We acquired 99.99% of equity interest in Hoshin GigaMedia in November 1999 and the remaining 0.01% in October 2002. In more recent years, we have established additional subsidiaries inside and outside Taiwan to conduct parts of our operations.

In February 2000, we completed the initial public offering of our Shares. Our Shares are traded on the NASDAQ Stock Market under the symbol GIGM.

In January 2006, we acquired FunTown, an Asian online game and service business operated in Taiwan and Hong Kong. In 2012, we began internal development of GigaCloud, a cloud computing software business focused on serving SMEs in Greater China. GigaCloud completed development of its first bundle of software and services in March 2013 and began commercial operations in April 2013. In 2013, we acquired a majority interest in FingerRockz, a mobile game/app developer and publisher based in Taiwan.

As part of plans to turn around the Company's financial performance, in 2012 we began implementation of a disposal and asset optimization program targeting non-strategic investments and underperforming assets. During 2012, we completed the sale of a remaining 33.66% interest we

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held in an underperforming legacy online gambling business, Everest Gaming. In 2015, we expect to continue to dispose of non-strategic game studio holdings.

Descriptions of our principal capital expenditures and divestitures and descriptions of acquisitions of material assets are found in our discussion and analysis of financial condition and results of operation and in the notes to our consolidated financial statements included elsewhere in this annual report. See Item 5, Operating and Financial Review and Prospects A. Operating Results Certain Significant Events Affecting Our Results of Operations for 2012, 2013 and 2014 .

There have been no public takeover offers by third parties in respect of our shares or by us in respect of other companies shares which have occurred during the last and current financial year.

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Our Singapore company registration number is 199905474H. Our principal executive offices are located at 8F, No. 22, Lane 407, Section 2, Tiding Boulevard, Taipei, Taiwan, and our telephone number is 886-2-2656-8000. Our website address is: <http://www.gigamedia.com>. Our agent in the U.S. is Computershare Limited and its office address is located at 480 Washington Blvd. Jersey City, the United States.

### **B. Business Overview**

We are a diversified growth company with online game operations in Taiwan, Hong Kong and Macau and a cloud computing software and services business based in Taipei. We do not utilize variable-interest entities ( VIEs ) in our operations.

In online games, we own 100% of and operate FunTown, a leading online game portal in Taiwan and Hong Kong. FunTown is focused on the high-growth mobile and browser-based casual games market in Asia. We also own a majority interest in FingerRockz, a Taiwan-based developer and publisher of mobile games and apps.

In cloud computing, we own 100% of and operate GigaCloud, a provider of cloud computing solutions and related services focused on the emerging cloud services market for SMEs in Greater China.

#### **Online Games Business**

##### *Overview*

FunTown is focused on the high-growth mobile and browser-based casual games and social casino games markets in Asia. FunTown has a strong track record of developing and monetizing PC-based casual games and social casino games, including by revenues one of the largest online casino platform in Taiwan. We plan to leverage that as we restructure the business and extend our offerings to mobile and browser-based games and social casino games in select areas and geographies going forward.

FingerRockz is focused on developing mobile gaming market in Asia. The company was founded in 2012; the first game it developed in 2012 has over 1 million downloads to date. We plan to leverage the development capability of FingerRockz to strengthen our mobile game offerings.

Most of our games are operated or expected to be operated under the item-billing revenue model ( Item-Billing ). Under the Item-Billing model, users are able to access the basic functions of a casual online game for free. Players may choose to purchase in-game value-added services as well as in-game virtual items and premium features to enhance the game experience. These services and items allow players to utilize more functions, improve performance and skills, and personalize the appearance of a game character. Game points are consumed as users purchase value-added services and in-game items.

We have experienced seasonality in the form of slower sales of FunTown's online game and service business in the second and third quarters, during which people tend to spend less time indoors and online as daylight hours increase and the weather conditions improve. Typically, our first and fourth quarters have been our strongest revenue periods.

To complement our offerings and strengthen their appeal, we focus on building community-based online platforms that cater to different social networking needs of our users and provide various channels to facilitate communications among them.

We intend to continue to seek growth and enhance our market position in the online games industry by increasing focus on mobile and browser-based games and social casino games and expect to drive growth both organically and via mergers and acquisitions.

##### *Our Games*

Our portfolio of online games includes predominantly PC-based, non-cash gambling or casino casual games, including MahJong and various card and table games. FunTown's offers over 40 PC-based non-cash gambling or casino casual games and one MMO, browser RPG and several mobile games. We have also launched one self-developed MahJong game application which uses a web or browser-based technology with no download required and one licensed mobile strategy card game.

##### *MahJong*

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MahJong is a traditional and highly popular Chinese tile game, which is widely played in Taiwan, Hong Kong, the PRC, Japan, South Korea and many other Asian regions. Similar to poker, MahJong involves skill, strategy, calculation, as well as a certain degree of chance.

Through our FunTown-branded platform, we develop and offer various local versions of MahJong for players in Asia, particularly for those from Taiwan and Hong Kong. To play our online MahJong games, players install the client-end software which can be downloaded free of charge from our game websites. Players can compete with anyone throughout the FunTown network. Our MahJong games are designed for players of all levels of skill and experience. To accommodate various needs of players, we offer different online MahJong rooms based on skill levels or stakes. We believe our online MahJong game site is one of the largest online MahJong networks in Taiwan.



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Players may play our online MahJong free of charge. To continue to play on a regular basis and establish a track record inside our online MahJong community, players may choose to purchase game points or game-playing time through various distribution channels, such as convenience stores and computer-based payment processing terminals. By purchasing our game points, players may exchange for virtual currency and deposit into their virtual bank accounts. The virtual currency may be used to play MahJong and other games in the FunTown game site or to purchase in-game virtual items, but may not be redeemed for cash.

Our PC-based MahJong offering faced strong competition in 2013 from the growth of mobile and browser-based online games, driven by the popularity of social networks and high mobile device usage in our markets. We responded by launching in February 2013 our MahJong game application which uses a web or browser-based technology with no download required. This simplified user sign-in procedures and enabled tighter integration with social networking platforms by allowing users to log into our game directly via their accounts at the social networking platform.

We organize offline events from time to time with a view to attract more players and enhance our leading position in the online MahJong market.

### *Non-cash Gambling or Casino Casual Games*

Through our FunTown-branded platform, we offer various non-cash gambling or casino casual games. These online games are Internet-based and developed through computer simulation and adaptation of non-computer games, which are traditionally played offline. The FunTown platform targets players from different regions, particularly Taiwan and Hong Kong.

We provide many different online card games, which are popular in various regions in Asia. Players can select their desired table based on the level of skill or stakes. These games are designed with online multiplayer features that allow players to compete against one another. We also offer chance-based games, including bingo, lotto, horse racing, Sic-Bo, slots and various simple casual games.

Like online MahJong, players may play our FunTown games for free. They may choose to purchase playing time or virtual currency to play on a continuous and regular basis. Virtual currencies may be used to play all the games in the FunTown game site or to purchase virtual items, but may not be redeemed for cash.

### *MMOs*

In Taiwan and Hong Kong, we offer one MMO through FunTown. In June 2006, we launched the MMO Tales Runner. Tales Runner is a multi-player obstacle running game in which players compete by running, jumping, dashing and using items. Since the launch, Tales Runner has become one of the most popular online sports games in Hong Kong.

Players download and install client software from our websites, except for browser-based games, where players can play directly from a web browser. Our MMO is offered free-of-charge to all players. In order to enhance their online game playing experience, players may purchase virtual items that enhance their characters' performance and game playing experience, or personalize their characters.

In October 2010, we acquired a non-controlling interest in XLGames, an online game developer in Korea, through an investment in XLGames. As a result of the transaction, we received certain strategic rights, including exclusive rights to operate the MMO game ArcheAge in Taiwan, Hong Kong, and Macau. XLGames launched the game in Korea in January 2013. As of March 31, 2015, GigaMedia has not scheduled the launch of ArcheAge in its markets.

### *RPGs*

In fourth quarter of 2014, we launched four Role-Playing games. King's Road is for PC-based players and the other three namely Fantasy Valkyrie, the Ring of the Lord and My Lord is Very Busy are for mobile game players.

## ***Game Sources***

### *In-house development of Non-cash Gambling or Casino Casual Games*

We develop the gambling or casino games offered on FunTown's game platform, including online MahJong, card games, and other simple casual games. Our in-house development enables us to have better control of the game features and allow for seamless integration into our FunTown

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platform. In order to support product development capabilities and develop our proprietary online games, we intend to expand our browser/mobile-based games and social casino games development capabilities. As of March 31, 2015, we have an in-house development team comprised of approximately 69 software and design engineers.

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### *Sources of MMOs and Mobile Games*

Historically we have sourced MMOs/Mobile Games through licensing from developers in various regions where game development is well established. We monitor each of the United States, South Korean, the PRC, Japanese, Southeast Asia and European markets and maintain communications with a number of leading game development studios to identify and source new online games.

In selecting games, we evaluate the key factors that indicate the market trend and player demand and interest in the regions where we operate. We believe that our market analysis enables us to better assess the quality, risks, costs and potential returns of the games.

Prior to negotiating a license agreement with a game developer, our game testing team evaluates the game and prepares detailed evaluation reports covering the theme, storyline, in-game culture and environment, character progression, system architecture, game art, design, virtual articles and items.

Based on the results of our evaluation, we may at times enter into a license agreement to operate select games. The cost of licensing games from developers generally consists of an upfront licensing fee, which we normally pay in several installments, and ongoing licensing fees, or royalties, which are equal to a percentage of revenues generated from operation of the game. We may also have to provide certain minimum guarantees in royalties to developers.

In preparing for the commercial launch of each new game, we cooperate with the game developer to localize the game to make it suitable for the target markets where we plan to launch. Once the developer completes the localization and provides the first-built version, we conduct closed beta testing of the game with a select group of users. During the test period, we identify and eliminate any technical problems, assess how likely users will be to play the game regularly over a period of time (referred to as user stickiness), and modify and add certain game features in order to increase user stickiness. The closed beta testing is followed by open beta testing, during which we operate our games under open market conditions and monitor the performance, consistency and stability of operational systems for the game.

Following the commercial launch of a game, we regularly implement improvements and upgrades to our games.

### *Fun Town Platform and Services*

Our FunTown platform provides many online game services for the users to enhance their playing and entertainment experiences, facilitate information communication among them and support the development of a strong player community. These services include:

**Player Clubs.** FunTown offers online club services in its game community. FunTown players can form their own clubs, invite other players with similar interests or skill levels to join, and organize online and offline events for club members. Player clubs complement the strong social features of online games by helping to maintain an online game community.

**Tournaments.** FunTown provides various tournaments for its online MahJong players. After players join a club, they can participate in biweekly online inter-club tournaments. On an annual basis, FunTown organizes large-scale tournaments, in which a large number of players are invited to the tournament premises and compete online via computers.

**Avatars.** To enhance players' overall entertainment experience, FunTown offers many in-game virtual items which may be purchased by players to customize their online personal graphic profiles, or avatars. Players use avatars to create their own unique look while participating in the online community. The virtual items for avatars include facial expressions, clothes and different accessories. These items are particularly popular with younger players, who customize their avatars to establish unique identities and pursue distinct fashions in the online community.

**Friends and Family Messenger.** The FunTown platform has a unique function designed for players' personal contacts, which is similar to the contact list of instant message programs. This enables players to see when their friends and family members are online and invite people in their personal network to play games together.

**Social Networking.** The FunTown platform provides an online social networking community called FunTown Village, in which players meet each other through their online avatars. In FunTown Village, players can interact and communicate, purchase virtual items, and even get married virtually. FunTown plans to introduce more virtual items within FunTown Village to address the strong social interests of its players and to help increase FunTown's overall appeal as a distinct online game community.

**Customer Services.** FunTown provides support and services to its customers primarily through walk-in customer service centers in Taipei and Hong Kong and e-mails and in-game report system where players can inquire and receive responses from FunTown.

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Other Platforms. FunTown expects to launch its current online games onto other platforms, including Android platform and Apple's iOS platform and to allow data synchronization between each of these platforms.

### ***Our Marketing***

Our marketing strategy is to capitalize on our established brand names and utilize our diverse distribution networks to retain our existing users and attract new users. We use various qualitative and quantitative market research methods to analyze our target market and to differentiate our product offerings from those of our competitors. We are engaged in a variety of traditional and online marketing programs and promotional activities, including the following:

#### *In-Game Events and Marketing*

We organize in-game events for our users, which we believe encourages the development of online communication and teamwork among our users and increases user interest in our games. Examples of in-game events include scheduled challenges or competitions for prizes. In addition, we use in-game events to introduce new features of our games.

#### *Open Beta Testing*

Our open beta testing is conducted under open market conditions. During open beta testing, we do not charge users to play the new game. Open beta testing serves important marketing functions, including instilling initial interests, establishing an initial user base, and generating word-of-mouth publicity to support the following commercial launch of the game.

#### *Advertisements and Offline Promotions*

We advertise our brand names and our games across a variety of media, including the Internet, television and outdoor advertisements. From time to time we distribute game-related posters, promotional prepaid cards for new users and souvenirs at trade shows, selected Internet cafés and other locations. We have contracted with various Internet café unions directly or via agents to promote our games in Internet cafés. We also conduct events at popular venues to stage exhibitions, distribute software and game content-related merchandise, and interact directly with our users.

#### *Magazines*

In addition to advertising certain games in various magazines, we also collaborate with certain entertainment magazines for various promotions, including giving away copies of certain games free of charge with each magazine sold.

#### *New Media Promotion*

In addition to advertising certain games in conventional channels described above, we also collaborate with certain new media channels, for example, with micro-blogging services provided with websites and search engine services.

#### *Direct Marketing*

We use telemarketing and e-mail correspondence to inform our users of new games, promotions and other game-related services.

### ***Our Distribution and Payment Channels***

We sell game points for our online games through various channels. Our distribution and payment channels include:

#### *Offline Physical Distribution Channels*

Physical distribution channels include convenience chain stores, gaming and related retail stores, supermarkets and Internet cafés. At these locations, users may purchase pre-paid game cards with varying amounts of game points. Alternatively, users may purchase game packs to play specific games on FunTown.

#### *Internet-Based Distribution Channels*

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Internet-based distribution channels consist of various websites, including the official website of FunTown. Users may purchase game points through these websites with their credit cards or computer-based payment processing terminals.

### *Telecommunication Network Operators*

We also distribute game points through cooperation with telecommunication network operators and their service providers. Our cooperating operators and service providers charge the fees to the purchasers' phone bills, which are prepared and collected by the network operators.

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### *Payment Aggregators*

We also work with established payment aggregators. These payment aggregators allow users to pay for a variety of products and services, such as mobile phone calls and game points of different game operators, using their pre-paid scratch cards, vouchers or codes printed on receipts.

We sell our game points to distributors at prices lower than the face value of the game points. The costs of distributing game points through Internet-based channels are generally lower than the costs involved in offline distribution of physical game cards. To encourage use of the Internet-based channels and provide more convenience for users, in certain markets we give our users the computer-based payment processing terminals for free so that they can purchase game points online.

### *Our Operation Architecture*

We have a scalable and modular operation architecture that enables us to support and expand our game offerings and services. The architecture consists of several key subsystems, including game services, central user database, billing and payment, online customer service, game telemetry and monitoring. FunTown, has its own unified user account system, which allows players to use a single account to access all FunTown games. Our billing and game management system supports various billing models and deposit options, and is sufficiently flexible to accommodate in-house developed games and licensed games. Our customer service system enables us to assist our players inside and outside the games. Our game telemetry and monitoring system allows us to track our concurrent online users in real time and effectively identify and fix technical problems in our server network.

### *Technology Infrastructure*

Due to the real-time interaction among thousands of users, the stable operation of our online games requires a significant number of servers and a significant amount of connectivity bandwidth. We have developed an extensive technology infrastructure that supports the operation of our online games.

We seek to adapt our infrastructure promptly in response to changing circumstances. This includes operating our games on servers in Macau, Hong Kong, and in the future the PRC.

### *Our Players*

In Taiwan and Hong Kong, as of March 31, 2015, we had an aggregate of about 12.5 million unique registered players of our online games, more than 97% of which were located in Taiwan. In the fourth quarter of 2014, we recorded approximately 40,000 active paying players and approximately 24,000 peak concurrent users.

### *Competition*

Our primary competitors in the Asian online/mobile game and service business are online game operators based in Taiwan and the PRC. Our major competitors in Taiwan include Gamania, Soft-World, IGS, UserJoy and GodGame. Our major competitors in the PRC include Shanda, Giant, Changyou, Nineyou, Tencent, Perfect World, Kingsoft and Ourgames.com.

In addition, we compete for users against various offline games, such as console games, arcade games and handheld games, as well as various other forms of traditional or other online entertainment.

We expect more online games operating companies to enter into the markets where we operate, and a wider range of online games to be introduced to these markets given the relatively low entry barriers to entry in the online games industry. Our competitors vary in size and include private and public companies, many of which have greater financial, marketing and technical resources as well as name recognition. We intend to continue to enhance our market position through providing competitive products and quality services that meet market trends and users preferences, as well as strengthening sales effectiveness.

## **Cloud Computing Business**

### *Overview*

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GigaCloud is a provider of cloud computing solutions and related services, which we launched in 2013. The business was founded on the concept of delivering via the Internet, or cloud, integrated tools and services designed to help the enterprises in Greater China effectively manage complex and dynamic operating environments. We provide our customers highly adaptable, accessible and reliable services and tools to manage critical business functions that enable them to optimize their financial and human capital resources.



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GigaCloud's mission is to simplify and improve the way the enterprises acquire, deploy and manage their hardware, software, security and data management technology needs. GigaCloud's offerings enable firms to either avoid deployment of a full-scale onsite IT infrastructure or replace an existing company's internal IT infrastructure with an externally managed and hosted IT function. This virtualization of the enterprises can eliminate excess costs and enhance return on investment, promoting the development of boutique businesses that might otherwise find it challenging to compete and grow.

Our initial offerings may be organized into two main product groups:

- a. Communication-oriented services, including hosted private branch exchange (PBX) telephone systems that create private telephone networks within an enterprise, and hosted Internet fax service enabling faxes to be sent via smart devices, as well as similar bundles of privately managed solutions for enterprises that prefer to manage their IT and data in-house; and
- b. Value-added services, including hosted video camera surveillance systems that enable users to view video via smart devices, hosted cloud storage, and other related services.

Our products are intuitive and easy to use, can be deployed rapidly, customized easily and integrated with other platforms and enterprise applications. We deliver our solutions as a service via all the major Internet browsers and on most major mobile device operating systems.

## ***Industry Information***

### *The Market is Large*

According to a survey completed in 2013 by Taiwan's Ministry of Economic Affairs, Taiwan's SME market size was estimated at approximately 1.33 million enterprises.

### *Changes in the Business Environment, User Expectations, and Technology are Driving Change*

We believe that the convergence of cloud, social, and mobile technologies is transforming how companies connect with their customers, employees, partners and products; as businesses look to operate their IT systems in a more cloud-like manner, they will seek to spend less time and effort on developing underlying infrastructure and focus more on re-imagining, re-platforming, and virtualizing their businesses. Our strategy of cloud infrastructure, application platform capabilities for new and renewed applications, and client management capabilities for the post-PC era will provide customers an extended suite of software to address the integration, automation, management, and development capabilities they need.

### ***Strategic Partnerships***

To address the market opportunity, we have formed strategic partnerships with a broad group of hardware, software and cloud computing service vendors to cooperatively advance virtualization technology for enterprises through joint marketing, product interoperability, collaboration and co-development. These partners include HP, Oracle, VMWare and FireEye. We create opportunity for partners and create differentiated value through joint solutions. The endorsement and support of our partners further enhances the awareness, reputation and adoption of our virtualization solutions.

We have also developed a multi-channel distribution model to expand our presence and reach various segments of the market. Besides, we are approaching and building up channels in IT ecosystem with our existing distribution partner Chailease Holding Co Ltd., which is Taiwan's number one leasing company with approximately 42% market share in the business leasing market.

### ***Intellectual Property***

We rely on a combination of patent, trademark, copyright and trade secret laws in the U.S. and Taiwan as well as confidentiality procedures and contractual provisions to protect our proprietary technology and our brand. We have applied for trademark registration in certain jurisdictions and may apply for further trademark and copyright registrations and additional patents, which may provide such protection in relevant jurisdictions. However, there is no assurance that this will be sufficient to fully protect our proprietary technology. In addition, our technologies may not be able to withstand any third-party claims or rights against their use.

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We also enter into confidentiality and invention assignment agreements with our employees and consultants and confidentiality agreements with other third parties, and we rigorously control access to proprietary technology.

### **Regulation**

Our business is subject to various laws and regulations in the jurisdictions we operate relating to the telecommunications industry, the internet and the online game industry, and is regulated by various government authorities.

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### **Regulations Relating to Online Games**

#### *Taiwan*

At present, there is no specific law in Taiwan governing online game services, nor are there any specific licensing requirements imposed on Internet content providers in connection with offering online game services. The National Communications Commission (the NCC) was established in March 2006. In December 2006, the NCC proposed the overhaul of the regulatory framework in the communications and broadcasting sectors by amending the Telecommunications Act, the Radio and Television Act, the Cable Radio and Television Act and the Satellite Radio and Television Act. Pursuant to the original proposal, the legislation at issue would be consolidated into a new legislative Act to be known as the Communications and Broadcasting Act. In December 2008, the NCC announced a change to its policy, stating that it had decided to delay enacting the Communication and Broadcasting Act for two to four years. According to the digital convergence plan adopted by the Executive Yuan in December 2010, digital convergence framework is expected to be approved in 2014 and digital convergence law is expected to be finalized in 2015.

#### *Rating of Internet Content*

The Regulations for the Rating of Internet Content was abolished by the NCC in 2012. At present, the rating of internet content is governed by Article 46 of the Protection of Children and Youths Welfare and Rights Act (last amended on January 22, 2014), which requires that all internet platform providers adopt their own rules implementing clear and practicable protection measures in accordance with the internet content supervisory institutions engaged by the NCC and other relevant authorities to prevent youth and children from having access to harmful internet contents. An internet platform provider is required to restrict children and youths from having access to internet content upon the relevant authority's notification that such internet contents may be harmful or that such internet platform provider failed to implement clear and practicable protection measures.

#### *Computer Software Ratings*

The Ministry of Economic Affairs announced in July 2006 the Regulations Governing Computer Software Rating pursuant to the Protection of Children and Youths Welfare and Rights Act, which took effect in January 2007. These regulations were last amended in May 29, 2012 and renamed the Regulations Governing Game Software Ratings. The definition of game software and the rating system have been significantly modified in the 2012 amendment. Game software means software that integrates digitalized text, sound, visual effects, music, pictures, images or animation which allows users to operate on electronic devices to achieve certain goals of the game, but excluding software installed upon the electronic game arcade as defined in the Electronic Game Arcade Business Regulation Act. Manufacturers, distributors, agents, sellers, rental service operators, disseminators, exhibitors and download providers are responsible for the administration of ratings. There are five ratings: (i) Restricted (allowed for ages 18 and above); (ii) Parental Guidance 15 (allowed for ages 15 and above); (iii) Parental Guidance 12 (allowed for ages 12 and above); (i) Parent Protection (allowed for ages 6 and above); and (v) General Audience (suitable for all ages). According to the 2012 amendment, game software that uses virtual currency to play simulated MahJong, poker, dice, steel ball, horse racing, roulette, slot machine and other games of similar nature, and the outcome of the games may result in increase or decrease of the virtual currency, must be rated as Parental Protection. If the contents of such game software meet the requirements under the rating criteria for Restricted, Parental Guidance 15 or Parental Guidance 12, such games must be rated accordingly.

#### *Online Game Contract Template*

The Ministry of Economic Affairs and the Consumer Protection Commission have published a model contract template which sets out permitted terms and limitations with respect to online game services offered in Taiwan, pursuant to the Consumer Protection Act. The contract template was last amended on December 7, 2010. Generally, consumers should be given at least three days to review such contract. Amendments or changes to fees payable for services offered must be publicly announced at least thirty days prior to such amendment, and notification provided to consumers. Consumer game records must be maintained by each online game operator for a minimum period of thirty days and shall be open to inspection by such consumers. Suspension periods for consumers who have breached the terms of their online game contracts may not exceed a period of seven days. Apart from gifts, the on-line game operator cannot limit the use period of the game points in the on-line game contract. Furthermore, the on-line game operator cannot specify in the on-line game contract that it has the right to interpret the contract terms and conditions.

#### *Personal Data Protection Act*

On April 27, 2010, the Legislative Yuan passed a bill to amend the Computer-processed Personal Data Protection Act, which was renamed as the Personal Data Protection Act. Whenever an entity collects personal data from any individual, it shall inform such individual about (i) the

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name and identity of the collecting entity; (ii) the purpose of collection; (iii) how the collected personal data will be used; (iv) his/her rights; and (v) the consequences of his/her failure to provide the required personal data. If personal data is not provided by individuals, in addition to the information required to be disclosed as described above, the collecting entity shall inform such individual of the source of the data before processing or using the data. In principle, prior consent from the individual is required for use of his/her personal data. These requirements shall be exempted if relevant personal data of the individual (i) is used for public interests; or (ii) is available from the public domain and the interest to be protected is more important than the privacy of such individual. Depending on the gravity of a violation, damages of NT\$500 to NT\$20,000 may be claimed against a person for each violation of the Personal Data Protection Act even if the actual damage cannot be proved. If there is more than one victim in a single violation, the maximum damages would be up to NT\$200,000,000. However, if the interests involved therein exceed NT\$200,000,000, restrictions on maximum amount for damages to be claimed and on minimum amount for damages to be claimed (NT\$500 per person for each violation) shall not apply. This new Personal Data Protection Act will take effect pursuant to the announcement of the Executive Yuan. Given that there may be some delay in the enactment of the enforcement rules, the new Personal Data Protection Act was enacted on October 1, 2012.

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### *Singapore*

Presently, there are no laws in Singapore which specifically govern the provision of online gaming. However, depending on the type of games offered and services rendered as part of our online gaming operations, the operations may be subject to regulation under various Singapore legislation. Relevant legislation includes:

the Broadcasting Act (Chapter 28) of Singapore (the Broadcasting Act ) and its subsidiary legislation, which regulates, inter alia, the operation of Internet websites;

the Telecommunications Act (Chapter 323) of Singapore (the Telecommunications Act ) and its subsidiary legislation, which regulates the operation of telecommunications systems and the provision of telecommunications services; and

the Common Gaming Houses Act (Chapter 49) of Singapore (the CGH Act ) and the Betting Act (Chapter 21) of Singapore (the Betting Act ) and subsidiary legislation, which regulate, inter alia, gaming and lotteries.

#### *Broadcasting Act*

The Broadcasting Act provides for the general legal framework to regulate media and Internet content and empowers the Media Development Authority ( MDA ) of Singapore with the authority to grant licenses and to regulate and monitor licensees in relation to such media and Internet content. In particular, section 8 of the Broadcasting Act provides that no person shall provide any licensable broadcasting service in or from Singapore without a broadcasting license granted by the Authority (MDA) . A licensable broadcasting service is defined in the Broadcasting Act to include computer on-line services .

The MDA also regulates online services through the Broadcasting (Class License) Notification (the BCLN ). Under the BCLN, VAN computer on-line services (as defined in the BCLN) and computer on-line services that are provided by Internet Content Providers and Internet Service Providers (as such terms are defined in the BCLN) are deemed automatically licensed, and the licensees under the class license must comply with the conditions of the class license under the BCLN. The definition of Internet Content Provider under the BCLN includes any corporation or group of individuals, whether registrable or incorporated under the laws of Singapore, who provides any programme on the World Wide Web through the Internet. A programme is defined under the Broadcasting Act to mean, broadly, any matter the primary purpose of which is to entertain, educate or inform all or part of the public, or any advertising whether commercial or not, excluding any matter that is wholly related to or connected with any private communication.

Pursuant to the BCLN, a licensee must use its best efforts to ensure that its service complies with the codes of practice which may be issued by the MDA from time to time (including the Internet Code of Practice), and is not used for any purpose and does not contain any programme that is against the public interest, public order, national harmony or offends against good taste or decency. Further, licensees must also ensure that its services are not used for, or in furtherance of, certain prohibited activities such as games and lotteries the conduct of which is an offence under the CGH Act, the advertisement or promotion of astrology, geomancy, palmistry or any other type of fortune telling device or the solicitation of prostitution or any other immoral activity.

Under the Internet Code of Practice issued by the MDA, an Internet Content Provider is required to ensure that it does not broadcast via the Internet to users in Singapore, programs which include material that is objectionable on the grounds of public interest, public morality, public order, public security, national harmony or is otherwise prohibited by applicable Singapore laws ( prohibited materials ). The Internet Content Provider is also required to deny access to such prohibited materials that he discovers in the normal course of exercising editorial duties, or is informed about.

#### *Telecommunications Act*

The provision and operation of telecommunication services and systems in Singapore is regulated by the Telecommunications Act, which provides the general legal framework for the provision and operation of telecommunication systems and services in Singapore.

Under the Telecommunications Act, all persons who, inter alia, establish, install, maintain, develop or hire a telecommunication system or service within Singapore must be licensed by the Info-communications Development Authority ( IDA ) of Singapore. A telecommunication

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system is defined as any system used or intended to be used for telecommunications, and telecommunication service is defined as any service for telecommunications but excludes any broadcasting service. Telecommunications is defined as a transmission, emission or reception of signs, signals, writing, images, sounds or intelligence of any nature by wire, radio, optical or other electro-magnetic systems whether or not such signs, signals, writing, images, sounds or intelligence have been subject to rearrangement, computation or other processes by any means in the course of their transmission, emission or reception.

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The existing telecommunications licensing framework provides for two broad categories of licenses – facilities based operator ( FBO ) licenses and services based operator ( SBO ) licenses. SBO licenses are, in turn, granted either on an individual or class license basis.

Pursuant to IDA’s published guidelines, the telecommunications services which are provided as licensable under an SBO license include store-and-retrieve value-added network services, examples of which include any online information and database retrieval services, online games or electronic chatting services, provided by telecommunication systems, built over and above the telecommunication systems operated by an FBO and accessed through public telecommunication systems or leased circuits, which allow telecommunication traffic between a user and the value-added network or between users.

### *CGH Act and Betting Act*

Depending on the type of games and services being offered, the online gaming operations may also be regulated by the CGH Act and the Betting Act. Generally, the CGH Act and the Betting Act prohibit the operation and patronization of unlicensed common gaming and betting houses as well as ancillary acts. In addition, the CGH Act prohibits the operation of and participation in a public lottery. The offences are wide-ranging in nature and encompass acts by the owner of the website, the player and assisting parties.

The CGH Act generally prohibits the engaging in gaming activities and arguably applies to gaming activities carried out online. In particular, the CGH Act prohibits, among other things, the following: (i) gaming in a common gaming house (as such term is defined in the CGH Act) or a public place; (ii) participation or assistance in any public lottery; (iii) advancing or furnishing money for the purpose of establishing or conducting the business of a common gaming house; and (iv) assisting in any manner in the management of a place kept or used as a common gaming house. Under the CGH Act, gaming is defined as the playing of any game of chance or of mixed chance and skill for money or money’s worth. Lottery includes any game, method, device, scheme or competition whereby money or money’s worth is distributed or allotted in any manner depending upon or to be determined by chance or lot, whether the same is held, drawn, exercised or managed within or without Singapore. A public lottery is defined as a lottery to which the public or any class of the public has or may have access, and every lottery shall, until the contrary is proved, be deemed to be a public lottery.

The Betting Act generally prohibits betting or wagering on any event or contingency of or relating to any horse-race or any other race, fight, game, sport or exercise, and would arguably also apply where such betting or wagering is conducted online. In particular, the Betting Act prohibits, inter alia, the following: (i) betting or wagering in a common betting-house or with a bookmaker (as such terms are defined in the Betting Act) in any place or by any means; (ii) the receipt (directly or indirectly) of any money or valuable thing for or in respect of any bet or wager on any such event or contingency in a common betting-house or betting information centre (as defined in the Betting Act); (iii) the advancing or furnishing of money for the purpose of establishing or conducting the business of a common betting-house; and (iv) assisting in any manner in the management or in the business of a place kept or used as a common betting-house or betting information centre.

### *Personal Data Protection Act*

Singapore enacted the Personal Data Protection Act (Act 26 of 2012) (the PDPA) to regulate how personal data is handled. The PDPA establishes an overarching data protection framework, setting out baseline rules on the collection, use, disclosure, and protection of personal data by private sector organizations. The PDPA applies to personal data, which means all types of personal data (whether true or not), from which an individual (whether living or deceased) can be identified. The PDPA complements the existing confidentiality obligations under common law, and other statutory requirements which may apply under sector specific rules on confidentiality of information. The PDPA data protection regime is one that is based on the key concepts of:

- (i) **Consent** – Organisations may collect, use or disclose personal data only with the individual’s knowledge and consent (with some exceptions);
- (ii) **Purpose** – Organisations may collect, use or disclose personal data in an appropriate manner for the circumstances, and only if they have informed the individual of purposes for the collection, use or disclosure; and
- (iii) **Reasonableness** – Organisations may collect, use or disclose personal data only for purposes that would be considered appropriate to a reasonable person in the given circumstances.

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Examples of data which may be considered personal data under the PDPA include telephone numbers and email addresses.



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**Regulations Relating to Cloud Computing**

***Telecommunications Act***

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

licensing of telecommunications services;

telecommunication numbers;

restrictions on dominant telecommunications service providers;

tariff control and price cap regulation;

accounting separation system;

interconnection arrangements;

bottleneck facilities;

spectrum allocation;

provision of universal services;

equal access;

number portability;

local loop unbundling;

co-location; and

ownership limitations.

The Telecommunications Act also establishes a non-auction pricing system for assignment of radio frequencies.

*Type I and Type II Service Providers*

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

Type I. Type I service providers are providers that install network infrastructure, such as network transmission, switching and auxiliary equipment for the provision of telecommunications services. Type I services include fixed-line services such as local, domestic long distance and international long distance services, as well as interconnection, leased line, ADSL and satellite services and wireless services such as mobile, including 3G mobile, paging, mobile data and trunked radio services.

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

*Granting of Licenses: Type II*

The Telecommunications Act was amended in 1996 to open the market for all Type II services. Under the Type II Services Regulations, Type II services are divided into special services and general services. Special services include simple resale, VoIP, network telephone service of E.164 and non-E.164 user numbers (IP Phone Numbers), international leased circuit and other services specified by governing authority. General services include any Type II service other than special services. The policy for granting a Type II service license is as follows:

there is no limit on the number of licenses to be issued;

licenses were granted by the Directorate General of Telecommunications before March 1, 2006 and are not granted by the NCC; and

no bidding procedure is required.

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We hold a license to operate general Type II services. Type II service licenses issued before November 15, 2005 are valid for ten years and may be renewed by application made two months prior to the expiration date. Type II service licenses issued or renewed on or after November 15, 2005 are valid for three years and may be renewed during the period commencing two months prior to the expiration date. There is no minimum paid-in capital requirement for Type II service providers. Our license to operate Type II services is valid from March 2013 to March 2016.

### **Dividends from Our Subsidiaries**

Under Singapore tax regulations, foreign-sourced dividend income used for capital expenditures, including investments, and repayment of borrowings, is not deemed as remitted to Singapore and is therefore not taxable.

### **Listing and Offering**

Under NASDAQ Rule 5210(c), as amended ( Rule 5210(c) ), all securities listed on NASDAQ must be eligible for a direct registration program, or DRS, operated by a registered clearing agency, unless the foreign private issuer is prohibited from complying by a law or regulation in its home country. In order to fulfill the direct registration program eligibility requirements, we are required to, among other provisions, amend our constitutional documents to allow for the issue of non-certificated securities.

Our Company is incorporated under the laws of the Republic of Singapore and is subject to the provisions of the Companies Act (Cap.50) of Singapore (the Companies Act ). Under the Companies Act, Singapore-incorporated companies are required to issue physical share certificates to registered shareholders as prima facie evidence of a registered shareholder s title to the Shares and there are no exceptions to or exemptions from this requirement that would enable us to amend our constitutional documents to allow for the issue of non-certificated shares. Therefore, we are not able to comply with the DRS eligibility provisions of Rule 5210(c).

Under the DRS eligibility provisions, as a foreign private issuer, we are allowed to follow our home country practice in lieu of the requirements set out in Rule 5210(c), subject to certain exceptions. We will be relying on this for an exemption from the DRS eligibility requirements under Rule 5210(c). We have informed the NASDAQ Stock Market about our election to comply with the laws of Singapore in lieu of the DRS eligibility provisions of Rule 5210(c).

### **C. Organizational Structure**

We were incorporated in Singapore as a company limited by shares on September 13, 1999. As of the date of this annual report, our principal operating subsidiaries include Hoshin GigaMedia, FunTown World Limited, and GigaMedia Cloud. Hoshin GigaMedia, our wholly-owned subsidiary incorporated in Taiwan, operates our Asian online game and service business in Taiwan. FunTown World Limited, our wholly-owned subsidiary incorporated in the British Virgin Islands, operates our Asian online game and service business in Hong Kong and Macau. GigaMedia Cloud, our wholly-owned subsidiary incorporated in Taiwan, operates our GigaCloud services in Taiwan.

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The following organization chart and table set forth our business structure and selected information for each of our principal subsidiaries as of the date of this annual report:

\* Includes our operating subsidiaries or companies holding material investments or contracts only. All subsidiaries are 100% owned unless otherwise indicated.

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Entity	Place of Incorporation	Relationship
<b>Held by our Company</b>		
GigaMedia International Holdings Limited	British Virgin Islands	Wholly-owned subsidiary
<b>Held by GigaMedia International Holdings Limited</b>		
GigaMedia Online Entertainment Corp.	Cayman Islands	Wholly-owned subsidiary
Cambridge Entertainment Software Limited	British Virgin Islands	Wholly-owned subsidiary
GigaMedia (HK) Limited	Hong Kong	Wholly-owned subsidiary
<b>Held by GigaMedia Online Entertainment Corp.</b>		
FunTown World Limited	British Virgin Islands	Wholly-owned subsidiary
GigaMedia Capital Limited	British Virgin Islands	Wholly-owned subsidiary
GigaMedia Freestyle Holdings Limited	British Virgin Islands	Wholly-owned subsidiary
GigaMedia (Labuan) Limited	Labuan	Wholly-owned subsidiary
<b>Held by FunTown World Limited</b>		
FunTown Hong Kong Limited	Hong Kong	Wholly-owned subsidiary (Dormant)
<b>Held by GigaMedia (Labuan) Limited</b>		
Leisure Alliance Sdn. Bhd.	Malaysia	Wholly-owned subsidiary
<b>Held by Leisure Alliance Sdn. Bhd.</b>		
Hoshin GigaMedia Center Inc.	Taiwan	Wholly-owned subsidiary
GigaMedia Cloud Services Co. Ltd.	Taiwan	Wholly-owned subsidiary
GigaMedia Development Corporation	Taiwan	Wholly-owned subsidiary (Dormant)
<b>Held by Hoshin GigaMedia Center Inc.</b>		
FingerRockz Co. Ltd.	Taiwan	Majority-owned subsidiary
Gaminfinity Publishing Co. Ltd.	Taiwan	Wholly-owned subsidiary
Play2gether Digital Technology Co. Ltd.	Taiwan	Wholly-owned subsidiary
PerfectPairs Gaming Co. Ltd.	Taiwan	Wholly-owned subsidiary
<b>Held by Giga Development Corporation</b>		
Wen He Investment Ltd.	Taiwan	Wholly-owned subsidiary
<b>Held by Cambridge Entertainment Software Limited</b>		
Cambridge Interactive Development Corporation	U.S.A.	Wholly-owned subsidiary
<b>Held by GigaMedia(HK) Limited</b>		
Shanghai Pontoon Networking Technology Co., Ltd.	China	Wholly-owned subsidiary

**D. Property, Plant and Equipment**

As of March 31, 2015, we leased 47,137 square feet as office premises as our corporate head office in Taipei, Taiwan and 4,831 square feet as office premises for FunTown's office in Hong Kong. In addition, we leased 1,265 square feet of warehouse space in Hong Kong.

**ITEM 4A. UNRESOLVED STAFF COMMENTS**

None.

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

Unless stated otherwise, the discussion and analysis of our financial condition and results of operations in this section apply to our consolidated financial statements as prepared in accordance with U.S. GAAP. You should read the following discussion of our financial condition and results of operations together with the consolidated financial statements and the notes to these statements included elsewhere in this annual report.

**A. Operating Results****Overview**

We are a diversified provider of online games and cloud computing services. Our principal businesses are as follows:

Our Asian online game and service business operates a portfolio of online games, primarily targeting online game players across Asia, including Greater China and Southeast Asia.

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Our cloud product and service business aims at providing an integrated platform of services and tools for medium to large enterprises in Greater China to increase flexibility, efficiency and competitiveness, as well as bidding for government contracts in Taiwan. The business launched in early April 2013

In 2014, we had total operating revenues of approximately US\$9.8 million, a decrease of approximately US\$5.3 million year-over-year, mainly resulting from a decline of US\$5.9 million in FunTown revenues. Our total costs and expenses decreased by approximately US\$30.2 million year-over-year to US\$23.3 million, primarily due to reduced impairment losses recognized during the year, which decreased by US\$31.7 million. We incurred an operating loss of approximately US\$13.5 million, a loss reduction of approximately US\$25.0 million year-over-year. We recognized a net loss attributable to us of approximately US\$5.2 million, a loss decrease of approximately US\$29.6 million year-over-year, primarily resulting from the aforementioned decrease in impairment losses.

*Asian Online Game and Service Business.* We operate our Asian online game and service business in Taiwan, Hong Kong and Macau through FunTown. We acquired FunTown in January 2006 and consolidated the financial results of FunTown into our consolidated financial statements starting from January 1, 2006. Previously, we operated in the PRC through a variable interest entity, JIDI, until our board of directors approved a plan to liquidate and dissolve JIDI in June 2012. The process of liquidation and dissolution was completed by the end of 2013. In Southeast Asia, we operated through IAHHGames. We increased our ownership percentage in IAHHGames from 32.26% in 2006 to 80% in 2010 through the acquisition of certain preferred shares and the subscription for new preferred shares and consolidated IAHHGames financial results into our consolidated financial statements starting from July 1, 2010. In July 2012, we entered an agreement to sell a 60% ownership in IAHHGames, and, upon the closing of the agreement, we deconsolidated the results of IAHHGames operations and began accounting for our remaining 20% interest under the equity method. We completed our divestiture of IAHHGames in May 2013.

In addition to our majority-controlled subsidiaries, we also entered into strategic alliances with XL Games, Access China, JoyCity Corporation (previously named JC Entertainment Corporation), and East Gate in December 2007, January 2008, September 2009, and August 2010, respectively. XL Games was founded by the creator of a world-renowned online game franchise, focuses on MMORPGs and has studios in Seoul, South Korea and Austin, Texas. Access China is an online game software developer in the PRC. JoyCity is a publicly-listed company which develops online games in Korea. East Gate is a Korean fund which invests in online game businesses and films.

Online casual game operators in Greater China and Southeast Asia are currently our primary competitors. We also compete with MMORPG operators throughout Greater China and Southeast Asia. Given the low barriers to entry in the online game industry and the increasing popularity of Internet-based businesses, there are a large number of potential competitors scattered throughout many different segments of the software and Internet industries. In addition to the aforementioned competitors, traditional entertainment service providers and other entities, many of which have significant financial resources and name brand recognition, may provide online game services in the future, and thus become our competitors.

Faced with our known competitors, and most likely several new competitors which may be established in the near future, we will continue to improve the principal competitive factors that we believe can differentiate our product offerings from those offered by our competitors, including: brand, technology, financial stability and resources, proven track record, independent oversight and transparency of business practices in our industry.

In 2014, our Asian online game and service business generated revenue of approximately US\$8.2 million, gross profit of approximately US\$2.2 million, operating loss of approximately US\$8.6 million, non-operating income of approximately US\$8.1 million, and net loss attributable to us of approximately US\$0.6 million.

*Cloud Product and Service Business.* We launched a cloud product and service business in April 2013. Our cloud product and service business made its first revenue contributions in the fourth quarter of 2013. In 2014, our cloud and service business generated revenue of US\$1.6 million, a gross loss of US\$0.2 million, and an operating loss of US\$1.5 million.

*Other Business.*

The holding and disposal of our investment in a non-controlling equity interest in the gaming software and service business generated a net gain of US\$2.5 million for the year ended December 31, 2012, which was directly related to the sale of our remaining ownership interest in such business in July 2012. This investment was accounted for under the equity method during 2012 until it was sold.

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### **Certain Significant Events Affecting Our Results of Operations for 2012, 2013 and 2014**

#### ***Divestiture of Gaming Software and Service Business***

On December 15, 2009, we entered into an agreement with BetClic to sell 60% of substantially all of the assets and liabilities of our gaming software and service business for US\$100 million in cash, subject to certain adjustments. The closing of the sale occurred on April 8, 2010. The sale resulted in the recognition of a gain of US\$79.1 million, net of transaction costs. The sale of the remaining 40% was subject to a put and call mechanism in place between us and BetClic, as defined in the agreement. We had the option to put all or part of our remaining 40% ownership interest to BetClic in each of 2013, 2014, and 2015 at a value considering all relevant facts and circumstances after the end of each year. If the put option owned was not fully exercised, BetClic would have the option to call the remaining interest held by us in each of 2015 and 2016.

We deconsolidated the gaming software and service business and recognized a gain when we completed the sale of 60% of substantially all of the assets and liabilities to BetClic on April 8, 2010, which was the date that we ceased to have a controlling financial interest. The remaining ownership interest we retained in the gaming software and service business, a 40% interest later diluted to 33.7%, was accounted for under the equity method starting from April 2010 to July 2012, when we entered into another agreement with BetClic to sell our remaining ownership interest in the gaming software and service business for a consideration of US\$1.7 million. Of this consideration, US\$985,000 was paid to us in cash, while the remainder related to the extinguishment of a 2009 tax liability. The closing of the sale occurred in August 2012. The sale resulted in the recognition of a gain of US\$2.5 million, net of transaction costs. In 2012, we recognized equity investment losses relating to our remaining non-controlling interest of US\$0.

#### ***Acquisition and Divestiture of IAHGAMES***

In July 2010, we began consolidating IAHGAMES, an online game operator, publisher and distributor in Southeast Asia. We acquired IAHGAMES in order to enhance our position in the online game market in Southeast Asia and strengthen our online entertainment product portfolio. This primary factor among others, contributed to a purchase price in excess of the fair market value of the net tangible assets and intangible assets acquired.

As of December 31, 2010 and 2011, we owned 5,982,230 Class A preferred shares and 1,208,881 Class B preferred shares of IAHGAMES, which represents a controlling financial interest of 80% of the total outstanding voting rights of IAHGAMES. The preferred shares (Class A) were convertible into ordinary shares of IAHGAMES at a conversion rate of 10 Class A shares for 1 ordinary share. The preferred shares (Class B) were convertible into ordinary shares of IAHGAMES at a conversion rate of 1 Class B share for 1 ordinary share.

In July 2012, we entered into agreements to sell 100% of the shares of Spring Asia, an investment holding company which owns 30% of the shares of Game First International Corporation ( GFI ), to IAHGAMES, as well as a 60% ownership in IAHGAMES (with a 20% ownership of IAHGAMES retained by us) to IAHGAMES management and Management Capital International Limited, a British Virgin Islands company owned by IAHGAMES management.

In consideration for sale of IAHGAMES and Spring Asia, we are to receive US\$3 million in cash consideration in four equal installments, with the first due upon closing, the second due on October 2, 2012, the third due on January 2, 2013 and the fourth due on April 2, 2013. The first installment of US\$750,000 was received upon the closing on August 15, 2012. However, the second, third, and fourth installments were deferred. The payments were collateralized by the shares of Spring Asia. In April 2013, we entered into the IAH Settlement Agreement to settle the deferred Spring Asia purchase price of US\$2.25 million. Under the IAH Settlement Agreement, we also sold all of our remaining shares in IAHGAMES to MCIL (approximately 20% of IAHGAMES total issued and outstanding shares) at a purchase price of US\$1 million. The settlement was completed in May 2013 when the deferred payment for the sale of Spring Asia and the amount for the sale of the remaining shares in IAHGAMES were received in full.

#### ***Divestitures of JIDI and Shanghai JIDI***

In June 2012, our board of directors approved a plan to liquidate and dissolve JIDI, a wholly-owned subsidiary, and Shanghai JIDI. Results for JIDI and Shanghai JIDI operations are reported as discontinued operations for all periods presented. The carrying amounts of the remaining assets and liabilities of JIDI and Shanghai JIDI were not significant to our consolidated financial statements as of December 31, 2012, and we recognized a loss of approximately US\$588,000 in connection with the disposal of property, plant and equipment, which is included within discontinued operations in 2012. The process of liquidation and dissolution was completed by the end of 2013. Summarized financial information for discontinued operations of JIDI and Shanghai JIDI are as follows:



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(in US\$ thousands)	2012	2013
Revenue	\$ 100	\$ 0
Loss from discontinued operations before tax	\$ (2,521)	\$ (318)
Income tax expense		
Loss from discontinued operations	\$ (2,521)	\$ (318)

**Table of Contents*****Acquisition of Wen He Investment Ltd.***

In June 2014, we acquired Wen He Investment Ltd. ( Wen He ), and in doing so acquired Wen He 's beneficial ownership in Gamania Digital Entertainment Co., Ltd. ( Gamania ). Gamania is a Taiwanese OTC-traded company, with its common shares traded on Taipei Exchange ( TPEX ). As a result of the acquisition of Wen He, we acquired beneficial ownership of 15 million common shares of Gamania, or approximately 9.5% of Gamania 's issued and outstanding common shares, at a cost of approximately US\$17.9 million. At the time of making such acquisition, we intended to establish a strategic business partnership with Gamania. However, the business collaboration model with Gamania had eventually altered to be with no investment involvement. Therefore, in April 2015, we disposed of all our shareholdings in Gamania through block trades on the open market in Taiwan, at an average price slightly higher than the acquisition cost. As a result, we received approximately US\$18 million in cash.

We have elected to account for this investment using the fair value option. Consequently, we measure the investment recognized in our consolidated balance sheets at fair value based on Gamania 's quoted share price. The changes in the fair value of this investment are recognized in non-operating income (loss) in our consolidated statements of operations.

***Impairment Losses Related to Underperforming Projects in Our Asian Online Game and Service Business and Cloud Product and Service business*****2012 Impairment Losses**

Due to decreased forecasts within our Asian online game and service business, we recognized an impairment loss of US\$13.2 million in our consolidated financial statements for the year ended December 31, 2012 as follows:

1) US\$12.5 million impairment loss on goodwill from the acquisition of FunTown. Goodwill from the acquisition of FunTown, which constitutes our Asian online game and service business, was written down to its estimated fair value of US\$16.9 million as of December 31, 2012, resulting in an impairment charge of US\$12.5 million in 2012, which is included within operating expenses in our consolidated statements of operations. As a result of the slowdown in the PC-based online game market on which we depend and an unfinished transition of FunTown to new browser/mobile games and social casino games markets, we estimated that the fair value of our Asian online game and service business had decreased and, as a result, impaired the goodwill related to FunTown as of December 31, 2012. The impairment charge was determined by our estimates of future cash flows from the FunTown business which have been reduced due to our change in strategic focus, indicating that the original carrying amount of the goodwill from the acquisition of FunTown could not be fully recovered as of December 31, 2012.

2) US\$702,000 impairment loss on prepaid licensing and royalty fees, which was related to certain licensed games that we stopped operating or for which the carrying amounts were determined not to be recoverable due to lower than expected performances. Prepaid licensing and royalty fees are valued using a discounted cash flow model to determine fair value, incorporating available market discount information, our estimate for liquidity risk and other cash flow model related assumptions based on unobservable inputs; and

3) US\$15,000 impairment loss on intangible assets for capitalized software costs, reflecting a full provision relating to certain projects that we have ceased to further develop.

**2013 Impairment Losses**

Due to certain underperforming game projects and decreased forecasts within our Asian online game and service business, we recognized an impairment loss of US\$33.1 million in our consolidated financial statements for the year ended December 31, 2013 as follows:

1) US\$17.1 million impairment loss on goodwill and US\$12.0 million impairment loss on intangible assets – specifically, trade names and trademarks, originally arising from the acquisition of FunTown. Goodwill and trade names and trademarks from the acquisition of FunTown, which constitutes our Asian online game and service business, were written down to nil as of December 31, 2013, resulting in an impairment charge of US\$29.1 million in 2013, which is included within operating expenses in our consolidated statements of operations. As a result of the further slowdown in the PC-based online game market on which we depend and an unfinished transition of FunTown to new browser/mobile games and social casino games markets, we estimated that the fair value of our Asian online game and service business had decreased and, as a result, impaired the goodwill related to FunTown as of December 31, 2013. The impairment charge was determined by our estimates of future cash flows from the FunTown business which have been reduced due to market conditions and our incomplete transition to new markets, indicating that the original carrying amount of the goodwill from the acquisition of FunTown could not be fully recovered as of December 31, 2013.

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2) US\$2.8 million impairment loss on prepaid licensing and royalty fees, which was related to certain licensed games for which the carrying amounts were determined not to be recoverable due to deferred development progress and remote possibility of commercial launch. Prepaid licensing and royalty fees are valued using a discounted cash flow model, when reasonable grounds exist for projections, to determine fair value, incorporating available market discount information, our estimate for liquidity risk and other cash flow model related assumptions based on unobservable inputs.

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3) US\$1.3 million impairment loss on intangible assets for capitalized software costs to reflect a full provision relating to certain projects that we have ceased to further develop.

### **2014 Impairment Losses**

We recognized an impairment loss of approximately US\$1.4 million in our consolidated financial statements for the year ended December 31, 2014 as follows:

1) US\$1.3 million impairment loss on prepaid licensing and royalty fees, which was related to certain licensed game for which the carrying amount were determined not to be fully recoverable due to the trend of gaming sector progressively shifts from PC based to mobile device based games, resulting in a significant impact to PC game. Prepaid licensing and royalty fees are valued using a discounted cash flow model, when reasonable grounds exist for projections, to determine fair value, incorporating available market discount information, our estimate for liquidity risk and other cash flow model related assumptions based on unobservable inputs.

2) US\$115 thousand impairment loss on intangible assets for capitalized software costs and US\$28 thousand impairment loss on property, plant and equipment to reflect the full write-down of the assets relating to certain projects that we have ceased to be utilized.

### ***Impairment Losses on Marketable Securities and Investments***

As a result of unsuccessful investments made by previous management in game studios and companies, we recognized impairment losses on marketable securities and investments of US\$1.2 million in 2012. The major impairments are listed below:

1) In 2009 we made an investment in common shares of Gorilla Banana Entertainment Corp. ( GBE ) of US\$700,000. As a result of accumulated loss, inability to meet its projections and forecasts, and cash shortage, we fully wrote down our investment in GBE in 2012 to zero.

2) In 2007, we made an investment in common shares of Soft Star Entertainment Inc. ( SoftStar ) of US\$1.9 million through a private placement. As a result of deteriorating earnings and considering the resulting lack of liquidity, we wrote down this investment to its estimated fair value of US\$1.6 million, resulting in an impairment charge of US\$493,000 in 2012.

### **Critical Accounting Policies**

The discussion and analysis of our financial condition and results of operations are derived from our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S., or U.S. GAAP. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Our significant accounting policies are closed in note 1(c) to our consolidated financial statements. We believe that the following discussion addresses the most critical accounting policies applicable to our Company, which are those that are most important to the portrayal of the financial condition and results of operations of our Company, and require management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

### ***Revenue Recognition***

Revenues are recognized revenue when persuasive evidence of an arrangement exists, delivery occurs and the customer takes ownership and assumes risks or services are rendered, the sales price is fixed or determinable and collectability is reasonably assured. Sales taxes assessed by governmental authorities on our revenue transactions are presented on a net basis and therefore are excluded from revenues in our consolidated financial statements.

Our Company has in the past entered into and may in the future enter into multiple-element revenue arrangements, which may include any combination of services, software, and/or products. To the extent that a deliverable in a multiple-element arrangement is subject to specific accounting guidance, whether and/or how to separate multiple deliverable arrangements into separate units of accounting (separability) and how to allocate the arrangement consideration among those separate units of accounting (allocation) for that deliverable is accounted for in accordance with such specific guidance.

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In addition to the aforementioned general policies, the following are the specific revenue recognition policies for each major category of revenue.

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### *Asian Online Game and Service Revenues*

Asian online game and service revenues are related to our Asian online game and service business that operates play-for-fun games online to players across Asia.

Asian online game revenues are earned through the sale of online game points, prepaid cards, game packs, through the sublicensing of certain games to distributors and through licensing fee revenues. Virtual online game points are sold to distributors or end-users who can make the payments through credit cards, Internet ATMs or telecommunication service operators. Physical prepaid cards and game packs are sold through distributors and convenience stores. Proceeds from sales of physical cards and game packs, net of sales discounts, and online game points are deferred when received and revenue is recognized upon the actual usage of the playing time or in-game virtual items by the end-users; over the estimated useful life of virtual items; or when the sold game points expire and can no longer be used to access the online games or products in accordance with our published game points expiration policy. Sublicensing revenues from the distributors are recognized based on end-users activation to the game system and when the performance obligations have been completed. Licensing fee revenues are recognized when the delivery of licensed products has occurred and the fee is fixed or determinable.

Sales of virtual online game points and licensing fee revenues are reported on a gross basis. In the sales of virtual online game points and game licenses, we act as principal and we have latitude in establishing price. Fixed percentage fees retained by service providers for payment processing related to our online game services are recognized as cost of online game revenues. We report sublicensing revenues on a net basis. In the sublicense agreements, we act as agent and the distributors are responsible for the operating and the marketing.

Asian online game and service revenues also include revenues derived from online advertising arrangements, sponsorship arrangements, or a combination of both. These service arrangements allow advertisers to place advertisements on particular areas of our Company's websites and online game platforms over a stated period of time. Service revenues from online advertising arrangements are recognized ratably over the period of the contract when the collectability is reasonably assured.

### *Other Revenues*

Other revenues include cloud service revenues, which are related to cloud computing services provided by our Company. Revenues are recorded net of discounts. Cloud service revenues are recognized for the period of time for which we provide services to the customers. Customers have a choice of paying either monthly or in advance for a certain period of time, for which they receive corresponding discounts. Our Company recognizes any such advanced payment receipts as other current liabilities and amortizes such revenues over the subscription period.

Revenues from the sales of equipment and other related products are recognized upon acceptance.

### *Deferred Revenues*

Deferred revenues consist mainly of the prepaid income related to our Asian online game and service business. Deferred revenue represents proceeds received relating to the sale of game points and in-game items which are activated or charged to the respective player game account by players, but which have not been consumed by the players or expired. Deferred revenue was US\$2.4 million and US\$1.9 million at December 31, 2013 and 2014, respectively. Pursuant to relevant new requirements in Taiwan, cash amounted to \$1.5 million as of December 31, 2014, have been deposited in an escrow account in bank as performance bond for the players' game points, and are presented as restricted cash in the consolidated balance sheet.

### *Prepaid Licensing and Royalty Fees*

Our Company, through our subsidiaries, routinely enters into agreements with licensors to acquire licenses for using, marketing, distributing, selling and publishing multi-player online games.

Prepaid licensing fees paid to licensors are capitalized when technological feasibility is achieved, and amortized on a straight-line basis over the shorter of the estimated useful economic life of the relevant online game or license period, which is usually within two to five years. The annual amortization is modified if the amount computed on the ratio of current gross revenues for a game license over the total of current and anticipated future gross revenues for that game license is greater than the amount computed using the straight-line method.

Prepaid royalty fees and related costs are initially deferred when paid to licensors and amortized as operating costs based on certain percentages of revenues generated by the licensee from operating the related online game in the specific country or region over the contract period.

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Whenever events or changes in circumstances indicate that the carrying amount of our prepaid licensing and royalty fees may not be recoverable, we test its recoverability by comparing the carrying value of the item in question to its undiscounted cash flows. If the carrying amounts of the related prepayments were determined to be greater than their expected future undiscounted cash flows, the estimated fair values of prepaid licensing and royalty fees are determined based on their discounted cash flows.

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Based on the analysis, we estimated the fair values of certain prepaid licensing and royalty fee assets to be impaired, and recognized impairment charges of US\$702 thousand, US\$2.8 million and US\$1.3 million on prepaid licensing and royalty fees in 2012, 2013 and 2014, respectively.

The impairment losses recognized in 2012, 2013 and 2014 were mainly due to lower than expected performances of products and services or resulted from the uncertain commercial viability of products and services, or from game development that did not successfully pass the testing phase and for which we fully wrote off the contractual value of related fees paid. In 2014, we recognized a US\$1.3 million impairment loss on prepaid licensing fees for certain game of which the trend of gaming sector progressively shifts from PC based to mobile device based games, resulting in a significant impact to PC game, and which we believed the commercial launch will generate less cash flows than originally expected, thus we concluded that the prepaid licensing fees were impaired and recognized an impairment loss of US\$1.3 million.

### ***Impairment of Intangible Assets with Indefinite Useful Life***

If the carrying amount of an intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

Our indefinite useful life intangible asset is our trade name, which resulted from the acquisition of FunTown in 2006. We perform an impairment test on our trade name annually on December 31, or more frequently when a triggering event occurs between annual impairment tests.

Late in 2013, due to a slowdown in the PC-based online game market and our new strategy to focus on social online casino games and mobile games in Greater China, we determined that triggering events had occurred requiring us to review our trade name associated with the Asian online game reporting unit, before testing this reporting unit for goodwill impairment. Based on our assessment, the profit margin generated from the Asian online games business was very low compared to our peer companies. The Asian online game business was projected to generate losses in the coming years as it was projected to be negatively impacted by the end of its game life cycles. Our trade name associated with our current gaming platform was considered to have no economic value because it could not contribute profit to us in consideration of our updated strategic plan to reposition our business. The strategic plan would result in a significant transfer of our resources. Meanwhile we have decided to retire the existing trade name at the end of the game life cycles and rebrand many developed games under new platforms unassociated with the existing trade mark. We therefore determined that the fair value of the trade name was zero and recognized an impairment loss of US\$12.0 million in 2013.

### ***Impairment of Long-lived Assets and Intangible Assets with Definite Useful Life***

We review our long-lived assets and intangible assets with definite useful life that are held and used for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. The determination of recoverability is based on an estimate of undiscounted cash flows expected to result from the use of the asset and its eventual disposition. The estimate of cash flows is based upon certain assumptions about expected future operating performance. If the sum of the expected undiscounted future cash flows is less than the carrying value, an impairment charge is recognized for the amount that the carrying value of the asset exceeds its fair value, based on the best information available, including discounted cash flow analysis. Prior to evaluating goodwill for impairment, we evaluated our long-lived assets and intangible assets with definite useful life for impairment. We determined that we have two asset groups for impairment testing purposes, one of which is associated with our online game operations, and the other is associated with our cloud services. In 2014, we found that the profit margin generated by certain cloud product and service lines was very low, and such product and service lines were projected to generate losses in the coming years. Therefore in strategic consideration of our cloud business plan we decided to reposition our business and fade out such services. And we have decided to retire the long-lived assets and intangible assets related to such products and services. We therefore determined that the fair value of those related long-lived assets and intangible assets was zero and recognized an impairment loss of US\$28 thousand on property, plant and equipment, and an impairment loss of US\$115 thousand on intangible assets in 2014.

### ***Impairment of Goodwill***

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. For 2013, we concluded that we had two reporting units, which are the same as our operating segments. Goodwill was assigned to our Asian Online Game reporting unit. In determining whether goodwill is impaired and measuring any loss resulting from the impairment, we first determine whether the fair value of the reporting unit is less than its carrying amount (including goodwill). The fair value of the reporting unit is determined using a discounted cash flows analysis. Second, if the fair value of the reporting unit does not exceed the carrying amount, we recognize an impairment loss for the excess of the carrying amount of the reporting unit goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. We perform an impairment test on goodwill annually on December 31, or more frequently when a triggering event occurs between annual impairment tests.





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We estimated the fair value of the Asian Online Game reporting unit by using the discounted cash flow approach, which uses Level 3 inputs of the fair value hierarchy. Unobservable inputs include, but are not limited to, (1) discount rates; (2) terminal year growth rates; (3) recent operating performance and forecasts; (4) growth anticipated in cash flow; (5) the state of the online game business in the respective geographic area; and (6) trends in average monthly users, paying users, pay rates and average revenue per user.

In 2012, the significant assumptions used to determine the estimated fair value of this reporting unit included five-year undiscounted cash inflow projections ranging from US\$2.9 million to US\$8.6 million (assuming an average revenue decline of 7% over the five-year period), with a terminal value (using a zero terminal growth rate) of US\$20.3 million at the end of the fifth year, and a discount rate of 17.1%. In 2012, the carrying value of the Asian Online Game reporting unit exceeded its estimated fair value. Thus we performed the second step and determined that the implied fair value of the goodwill was US\$16.9 million compared to its carrying value of US\$29.4 million. Consequently, we recognized a goodwill impairment charge of US\$12.5 million in 2012.

In 2013, our Asian Online Game reporting unit experienced a slowdown in the PC-based online game market. We also decided to reposition FunTown to focus on market growth in social casino games and browser/mobile games, as we have seen a significant shift in customer demand for these products and expected a corresponding effect to be reflected on the fair value of the Asian Online Game reporting unit. The decrease of total revenue in 2013 reflected an unfinished transition to social casino and mobile games and lower contributions from our currently PC-based online casual games as a result of the continuing shift in player preference for browser/mobile games. Our market capitalization had also fallen below our net book value based on the quoted market price of our common stock for a sustained period of time. Based on these qualitative factors, we determined it was more likely than not the current fair value of this reporting unit may be less than its carrying value, and the related recovery of the remaining goodwill could be impaired. Using the same methodology as in the past to determine the estimated fair value of this reporting unit, our projection for recurring revenue and costs has reflected the uncertain preference in the consumers' perspective. The assumptions used for our 2013 estimated fair value included six-year undiscounted cash flows projections ranging from (US\$4.0) million to US\$2.8 million and a discount rate of 13.0%. The decrease in the discount rate used for the goodwill impairment testing purpose from 2012 to 2013 resulted from changes of the Beta and small size risk premium. The carrying value of our Asian Online Game reporting exceeded its estimated fair value. Thus we performed the second step and determined that the implied fair value of the goodwill was US\$0 compared to its carrying value of US\$17.1 million. Consequently, we recognized a further goodwill impairment charge of US\$17.1 million in 2013. As of December 31, 2013 and 2014, there is no goodwill recognized in our consolidated balance sheets.

## ***Income Taxes***

As part of the process of preparing our consolidated financial statements, our management is required to estimate income taxes and tax bases of assets and liabilities for our Company. This process involves estimating current tax exposure together with assessing temporary differences resulting from differing treatments of items for tax and accounting purposes and the amount of tax credits and tax loss carry-forward. These differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheets. Management must then assess the likelihood that the deferred tax assets will be realized and, to the extent it believes that realization is not more likely than not, a valuation allowance is provided.

The ultimate realization of deferred tax assets and therefore the determination of the valuation allowance are dependent upon the generation of future taxable income by the taxable entity during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of different liabilities, projected future taxable income and tax planning strategies in determining the valuation allowance.

We recognize the effect of income tax positions only if those positions are more likely than not to be sustained. We have to recognize income tax expenses when the possibility of tax adjustments made by the tax authority is greater than 50% in the future period. Changes in income tax recognition or measurement of previous periods are reflected in the period in which the change in judgment occurs.

As of December 31, 2012, 2013 and 2014, we recognized valuation allowances of US\$18.3 million, US\$4.8 million and US\$7.1 million, respectively, on our deferred tax assets to reflect uncertainties related to our ability to utilize these deferred tax assets, which consist primarily of certain net operating loss carryforwards and loss on equity method investment. We considered both positive and negative evidence, including forecasts of future taxable income and our cumulative loss position, and continued to report a valuation allowance against our deferred tax assets as of December 31, 2012, 2013 and 2014. We continue to review all available positive and negative evidence in each jurisdiction and our valuation allowance may need to be adjusted in the future as a result of this ongoing review. Given the magnitude of our valuation allowance, future adjustments to this allowance based on actual results could result in a significant adjustment to our results of operations.

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In 2012 the valuation allowance on the deferred tax assets decreased by US\$6.9 million to US\$18.3 million primarily due to the deconsolidation of our controlling interests in IAHGames in which a full valuation allowance was provided. In 2013 the valuation allowance on the deferred tax assets decreased by US\$13.5 million to US\$4.8 million mainly due to the completion of liquidation processes for subsidiaries in Luxembourg and China, resulting in a reversal of US\$16.7 million on deferred tax assets (consisting primarily of operating loss carryforward) and related valuation allowance partially offset by an addition of US\$3.1 million of the valuation allowance to loss carryforward generated from our Taiwan and Hong Kong businesses. In 2014 the valuation allowance on the deferred tax assets increased by US\$2.3 million to US\$7.1 million mainly an addition of US\$2.2 million of the valuation allowance to loss carryforward generated from our Taiwan and Hong Kong businesses.

The effect of the changes of the valuation allowance increased our income tax expense for the years ended December 31, 2012, and 2013 by US\$0.2 million, US\$3.1 million, respectively and decreased our income tax benefit by US\$2.7 million, for the year ended December 31, 2014.

## **Recent Accounting Pronouncements**

In July 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. ASU 2013-11 requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. ASU 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. The new standard is to be applied prospectively. We implemented the provisions of ASU 2013-11 as of January 1, 2015, which had no impact on our consolidated operating results or consolidated total net equity.

The FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, in May 2014. ASU 2014-09 requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity should also disclose sufficient quantitative and qualitative information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new standard is effective for annual reporting periods beginning after December 15, 2016. We will implement the provisions of ASU 2014-09 as of January 1, 2017. We have yet to determine the impact of the new standard on our current policies for revenue recognition.

## **Taxation**

Our major tax jurisdictions are located in Taiwan, the PRC and Singapore.

The corporate income tax rate in Taiwan is 17% effective from 2010. In addition to the corporate income tax rate, all retained earnings generated beginning January 1, 1998 by our subsidiaries under Taiwan law and not distributed to us as dividends in the following year are assessed a 10% retained earnings tax. This rule applies primarily to our FunTown online games portal, whose principal operating entities are incorporated under Taiwan law.

On January 1, 2006, the Taiwanese government enacted the Alternative Minimum Tax ( AMT ) Act. Taxes imposed under the AMT Act are supplemental tax payable if the income tax payable pursuant to the R.O.C. Income Tax Act is below the minimum amount prescribed under the AMT Act. The AMT rate for business entities is 10%. The taxable income for calculating the AMT includes most income that is exempted from income tax under various legislation such as tax holidays and investment tax credits. For example, gains on disposal of marketable securities from our Taiwan-based entities were exempt from income tax based on Taiwan tax laws prior to the AMT Act. However, such gains will need to be included for the purpose of calculating the AMT.

The statutory enterprise income tax rate in the PRC is 25% unless the entities qualify under certain limited exceptions. Our Asian online games in the PRC applied this income tax rate before we ceased our operations in the PRC.

The corporate income tax rate in Singapore is 17%, which applied primarily to IAHGames acquired in July 2010 and up to August 2012 when we deconsolidated it.

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### **Discussion of Results of Operations**

#### ***Factors Affecting Our Performance***

We believe that the following are the principal factors affecting our results of operations:

*Acquisitions and disposals.* We have made several significant acquisitions and dispositions of businesses during the past several years, and may enter into additional acquisition and disposition transactions in the future. Past acquisitions and dispositions have had a significant impact on our results of operations over the past several years, and if we engage in such transactions in the future, the nature, amounts and timing of our revenues, expenses and cash flows and the nature and amounts our assets and liabilities are likely to be materially affected.

*Development of cloud computing and online games industries.* We began developing a new cloud computing business in the second half of 2012. The business launched in early April 2013. The cloud computing and online games industries are in relatively early stages of development. We believe that our results of operations are likely to be affected by developments in these industries, including:

the development and regulation of these industries;

our adaptation to technological change, such as the shift towards greater use of mobile phones and tablets for Internet access;

changing consumer preferences, including for mobile games;

legal development affecting these industries; and

general economic conditions in the markets where we or our licensees operate.

*Competition.* Our online games business operates in an extremely competitive industry and our cloud computing business may face strong future industry competition as the cloud computing industry grows in Asia. Our Asian online games business is characterized by rapid technological change and we face significant and intense competition from online game software design houses, application service providers and casual games operators. Our nascent cloud computing business also faces rapid technological change and potential intense future competition from major telecommunication service operators and Internet application providers.

*Divestiture of Gaming Software and Service Business .* When we sold a 60% ownership interest in our gaming software and service business on April 8, 2010, we ceased to consolidate its financial results and no longer have revenue from the gaming software and service business from April 2010 onwards. Our remaining ownership interest in the gaming software and service business was accounted for under the equity method until we sold such interest in July 2012.

For each of our businesses, we cannot assure you that we will be successful in adapting to technological developments and achieving widespread acceptance of our services before our competitors offer services similar to our current or prospective offerings. As a consequence, we may lose our existing customers and not expand our client base, which would have a material adverse effect on our revenues and financial condition.

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The table below presents, for the years indicated, information regarding our revenues, costs and expenses for our consolidated operations.

	For the Year Ended December 31,					
	2012		2013		2014	
	Amount in US\$ thousands	% of total revenues	Amount in US\$ thousands	% of total revenues	Amount in US\$ thousands	% of total revenues
<b>OPERATING REVENUES</b>						
Asian online game and service revenues	27,470	100.0	14,106	93.8	8,199	83.8
Other revenues			926	6.2	1,580	16.2
Total operating revenues	27,470	100.0	15,032	100.0	9,779	100.0
<b>COSTS OF REVENUES</b>						
Cost of Asian online game and service revenues	11,388	41.5	6,425	42.7	6,010	61.4
Cost of other revenues			1,159	7.7	1,825	18.7
Total costs of revenues	11,388	41.4	7,584	50.4	7,835	80.1
Gross profit	16,082	58.6	7,448	49.6	1,944	19.9
<b>OPERATING EXPENSES</b>						
Product development and engineering expenses	1,471	5.4	1,698	11.3	892	9.1
Selling and marketing expenses	8,377	30.5	4,815	32.0	6,708	68.6
General and administrative expenses	13,384	48.7	6,324	42.1	6,378	65.2
Bad debt expense	169	0.6	37	0.2	37	0.4
Impairment loss on property, plant and equipment					28	0.3
Impairment loss on goodwill	12,489	45.5	17,054	113.5		
Impairment loss on intangible assets	15		13,251	88.2	115	1.2
Impairment loss on prepaid licensing and royalty fees	702	2.6	2,752	18.3	1,259	12.9
Other	49	0.2	4			
Total operating expenses	36,656	133.5	45,935	305.6	15,417	157.7
Loss from operations	(20,574)	(74.9)	(38,487)	(256.0)	(13,473)	(137.8)
NON-OPERATING INCOME (EXPENSES), NET	7,649	27.8	3,805	25.3	8,410	86.0
<b>LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>						
TAXES	(12,925)	(47.1)	(34,682)	(230.7)	(5,063)	(51.8)
INCOME TAX BENEFIT (EXPENSE)	(671)	(2.4)	(61)	(0.4)	73	0.8
LOSS FROM CONTINUING OPERATIONS	(13,596)	(49.5)	(34,743)	(231.1)	(4,990)	(51.0)
LOSS FROM DISCONTINUED OPERATIONS -NET OF TAX	(2,521)	(9.2)	(318)	(2.1)		
NET LOSS	(16,117)	(58.7)	(35,061)	(233.2)	(4,990)	(51.0)
LESS: NET LOSS (INCOME) ATTRIBUTABLE TO NON-CONTROLLING INTERESTS	827	3.0	281	1.8	(165)	(1.7)
NET LOSS ATTRIBUTABLE TO SHAREHOLDERS OF GIGAMEDIA	(15,290)	(55.7)	(34,780)	(231.4)	(5,155)	(52.7)



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The key items included in our consolidated statements of operations are:

**OPERATING REVENUES.** Our operating revenues consist of revenues from our current Asian online game and service business and our nascent cloud product and service business. Asian online game and service revenues are related to our online and mobile games business in Asia and are collected through the sale of online game points, pre-paid cards and game packs, and through licensing fee revenues. Cloud service revenues are related to cloud computing services provided by our Company. Revenues are collected in accordance with contracts and through monthly payment or in advance payments with discounts, and are recognized upon acceptance or over periods as services are provided. Revenues from the sales of equipment and other related products are recognized upon acceptance.

**COSTS OF REVENUES.** Costs of revenues consist primarily of online/mobile game and cloud service processing costs, game royalties, bandwidth costs, production costs for prepaid game cards and game packs, amortization of intangible assets, cost of products, customer service department costs, operational department costs, depreciation, maintenance and other overhead expenses directly attributable to the provision of our Asian online game and services and cloud products and services.

**OPERATING EXPENSES.** Operating expenses include product development and engineering expenses, selling and marketing expenses, general and administrative expenses, bad debt expenses and impairment losses.

**NON-OPERATING INCOME (EXPENSES), NET.** Non-operating income and expenses consist of interest income and expenses, gain or loss on sales of marketable securities, foreign exchange gain or loss, income or loss on equity method investments, gain or loss on deconsolidation of business units, impairment loss on marketable securities and investments, unrealized gain or loss for changes in the fair value of our investment in Gamania, and dividend income.

**INCOME TAX EXPENSES (BENEFIT).** Taxes include current income tax in various jurisdictions in which our subsidiaries operate and deferred tax expenses related to temporary tax assets or liabilities that arise due to the timing differences between book profits and taxable profits that originate in one period and are capable of reversal in one or more subsequent periods. Taxes are measured using the tax rates and laws that have been enacted or subsequently enacted as of the date of the financial statements.

**NON-CONTROLLING INTEREST.** Noncontrolling interest represents the portion of net income allocated to the non-controlling voting shares of our majority-owned subsidiaries (IAHGames through August 15, 2012, Dragongate Enterprises Limited and FingerRockz). In May 2005, IAHGames issued redeemable preferred shares, which are redeemable at the option of the investors, and as such these preferred shares are classified as mezzanine equity on our balance sheet, through August 15, 2012.

**For the Years Ended December 31, 2014 and 2013**

***Consolidated Results of Operations***

**OPERATING REVENUES.** Operating revenues for 2014 declined by 34.9 percent to US\$9.8 million from US\$15.0 million in 2013. The decrease was primarily due to a decrease of US\$5.9 million in revenues from Asian online game and service segment, partially offset by an increase of US\$0.7 million in revenues from cloud service business. The decrease in revenues from Asian online game was attributed to a 39% decrease in revenue from MahJong and casino casual games to \$4 million in 2014 from \$7 million in 2013, primarily as a result from shrinking demand for legacy online games. The decrease was also attributed to a 73% decrease in revenue from MMOs to \$2 million in 2014 from \$7 million in 2013, primarily as a result from expiration of licensing term of a popular online game in late 2013. This decrease offset by an increase in revenue from RPG, which was operated by our new business mobile game began in 2014 with revenue \$2 million.

**COSTS OF REVENUES.** Costs of revenues in 2014 increased by US\$0.3 million, or 3.3 percent, to US\$7.8 million in 2014 from US\$7.6 million in 2013. The increase in costs of revenues, in spite of decrease in revenue, mainly reflected higher channel costs for mobile games, increased outsourcing development costs for new game titles in FunTown, and increased revenues in cloud service business.

**GROSS PROFIT.** Gross profit decreased by 73.9 percent to US\$1.9 million in 2014 from US\$7.4 million in 2013. Gross profit margin was 19.9 percent in 2014 compared with 49.5 percent in 2013, mainly due to FunTown's turning towards mobile device based games in 2014, which typically require higher channel costs and increased outsourcing development, without immediately deliver revenues to us. The decrease in consolidated gross profit mainly resulted from FunTown's decreased revenues, aggravated by narrowed gross profit margin.

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OPERATING EXPENSES. Total operating expenses decreased by 66.4 percent to US\$15.4 million in 2014 from US\$45.9 million in 2013. The decrease in total operating expenses was mainly due to a decrease in impairment losses of US\$31.7 million, partially offset by an increase of US\$1.9 million, or 39.3 percent, in selling and marketing operating expenses.

Consolidated product development and engineering expenses decreased by 47.5 percent in 2014 to US\$0.9 million from US\$1.7 million in 2013. This decrease was mainly due to reduced in-house development activities in our Asian online game and service business.

Consolidated selling and marketing expenses increased by 39.3 percent to US\$6.7 million in 2014 from US\$4.8 million in 2013, primarily due to developing of marketing presences for certain new arenas in FunTown.

Consolidated general and administrative expenses were f US\$6.4 million in 2014 compared to US\$6.3 million in 2013, and consists mainly of personnel expenses. These costs are generally fixed in nature and are not significantly impacted by revenue fluctuations.



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**OPERATING LOSS.** Operating loss for 2014 was US\$13.5 million as compared to US\$38.5 million in 2013. The US\$25.0 million decrease in operating loss was primarily a result of decreased impairment losses in 2014, partially offset by the decrease in gross profit and the increase in selling and marketing expenses.

**NON-OPERATING INCOME, NET.** Non-operating income, net was US\$8.4 million in 2014 compared to income of US\$3.8 million in 2013. The non-operating income, net in 2014 primarily included US\$8.6 million gain on sales of marketable securities. The non-operating income, net in 2013 primarily included (1) US\$0.5 million income on equity method investments, (2) US\$1.2 million gain on sales of equity method investments, and (3) US\$1.7 million gain on sales of marketable securities.

**NET LOSS ATTRIBUTABLE TO GIGAMEDIA.** Net loss attributable to us for 2014 was US\$5.2 million compared to US\$34.8 million in 2013. The decrease reflected the aforementioned factors affecting the decrease in the loss from operations and the increase in non-operating income, net in 2104.

### ***Operating Segment Results***

#### *Asian Online Game and Service Business*

**SEGMENT REVENUES.** Total segment revenues decreased by US\$5.9 million, or 41.9 percent, to US\$8.2 million in 2014 from approximately US\$14.1 million in 2013. Such decrease reflected an approximately US\$5.9 million decrease related to FunTown operations in Taiwan and Hong Kong, mainly due to declining demand for legacy online games, and the expiration of licensing term of a popular online game in late 2013.

As of December 31, 2014, FunTown's number of registered users was 12.5 million, representing a decrease of 30.6% compared with the fourth quarter of 2013. In the fourth quarter of 2014 the number of peak concurrent users was approximately 24,000, and the number of average monthly active paying accounts was about 40,000 in the fourth quarter of 2014.

**SEGMENT COSTS OF REVENUES.** Costs of our Asian online game and service segment revenue decreased by 6.5 percent to US\$6.0 million in 2014 from US\$6.4 million in 2013. The decrease reflected a decreased of US\$0.4 million related to FunTown, mainly from license, royalty and amortization costs, in line with the decreased revenues and expiration of certain game license, partially offset by increased costs for out-sourced development.

**SEGMENT GROSS PROFIT.** Segment gross profit decreased by 71.5 percent to US\$2.2 million in 2014 from US\$7.7 million in 2013. Gross profit margin declined to 26.7 percent in 2014, from 54.5 percent in 2013, mainly due to higher channel costs in 2014 for mobile games and increased out-sourcing development costs.

**SEGMENT OPERATING EXPENSES.** Total segment operating expenses decreased by US\$30.5 million to US\$10.8 million in 2014 from US\$41.4 million in 2013. The decrease was primarily due to a decrease in impairment loss of US\$31.8 million related to FunTown and US\$0.7 million in product development and engineering expenses, partially offset by increases of US\$1.6 million in selling and marketing expenses and US\$0.4 million in general and administrative expenses in 2014.

**Selling and marketing expenses.** Selling and marketing expenses increased by US\$1.6 million to US\$6.1 million in 2014 from US\$4.5 million in 2013. The increase reflected increased marketing activities in FunTown in developing market presences for certain new arenas in 2014.

**General and administrative expenses.** General and administrative expenses incurred in 2014 increased by US\$0.4 million to US\$2.7 million from US\$2.3 million in 2013. The increase was mainly due to higher stock-based compensation expense in 2014 in FunTown for new granted options.

**Impairment losses.** The impairment loss in 2014 was for a US\$1.3 million impairment loss on prepaid licensing and royalty fees. The impairment losses in 2013 were comprised of a US\$17.1 million impairment loss on goodwill mainly related to the acquisition of FunTown, a US\$12.0 million impairment loss on intangible assets for trade names and trademarks related to FunTown, a US\$1.3 million impairment loss on intangible assets for capitalized software costs, and a US\$2.8 million impairment loss on prepaid licensing and royalty fees.

**SEGMENT OPERATING LOSS.** Segment operating loss in 2014 was US\$8.6 million compared to US\$33.7 million in 2013. The decrease was due to the aforementioned factors.



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### *Cloud Product and Service Business*

We began developing a new cloud computing business in the second half of 2012. The business launched in April 2013.

#### SEGMENT REVENUES.

Total segment revenues increased by US\$0.7 million, or 70.7 percent, to US\$1.6 million in 2014 from US\$0.9 million in 2013. Such increase is mainly due to expanded marketing efforts into private and public sectors as well.

SEGMENT COSTS OF REVENUES. Costs of our cloud product and service segment revenues increased by 57.5 percent to US\$1.8 million in 2014 from US\$1.1 million in 2013.

SEGMENT GROSS LOSS. Gross loss was US\$0.2 million in 2014 as well as in 2013. Gross margin was approximately a negative 15.5 percent in 2014 compared with a negative 25.1 percent in 2013, mainly reflecting the strategy of market-share expansion. Our cloud product and service segment had yet to achieve its economies of scale, but we have narrowed the gap.

SEGMENT OPERATING EXPENSES. Total segment operating expenses increased by US\$0.3 million to US\$1.3 million in 2014 from US\$1.0 million in 2013. The increase was primarily due to increased marketing efforts along with an impairment loss of US\$0.1 million related to certain product lines within our cloud product and service business that we decided to shift focus from.

Selling and marketing expenses. Selling and marketing expenses increased by US\$0.3 million to US\$0.6 million in 2014 from US\$0.3 million in 2013. The increase reflected increased marketing efforts in developing of presences for certain new arenas in 2014.

General and administrative expenses. General and administrative expenses incurred in 2014 decreased by US\$0.1 million to US\$0.4 million from US\$0.5 million in 2013. The decrease was mainly due to rigorous control around expenses.

Impairment loss. Impairment loss incurred in 2014 amounting to US\$0.1 million was mainly on intangible assets for capitalized software costs and equipment that were dedicated to certain product lines that we decided to shift focus from.

SEGMENT OPERATING LOSS. Operating loss in 2014 was US\$1.5 million compared to US\$1.2 million in 2013. The increase was due to the aforementioned factors.

### **For the Years Ended December 31, 2013 and 2012**

#### *Consolidated Results of Operations*

OPERATING REVENUES. Operating revenues for 2013 decreased by 45.5% from US\$27.5 million in 2012 to US\$15.0 million in 2013. The decrease was primarily due to a decrease of US\$9.2 million in revenue from FunTown. The period comparison was also impacted by revenue contributions from former subsidiary IAHGames. We deconsolidated the results of IAHGames from August 2012 onwards and do not expect to generate revenue from IAHGames going forward. Therefore, revenue from IAHGames declined to nil in 2013 from US\$4.2 million in 2012.

COSTS OF REVENUES. Costs of revenues in 2013 decreased by 33.4% from US\$11.4 million in 2012 to US\$7.6 million in 2013. The decrease in costs of revenues mainly reflected the deconsolidation of IAHGames from August 2012.

GROSS PROFIT. Gross profit decreased by 53.7% from US\$16.1 million in 2012 to US\$7.4 million in 2013. The decrease in consolidated gross profit mainly resulted from decreased gross profit from FunTown. Gross profit margin decreased to 49.5 percent in 2013 from 58.5 percent in 2012, reflecting increased ratio of contribution from licensed games of which the margin rate was typically much lower than self-developed games.

OPERATING EXPENSES. Total operating expenses increased by 25.3% from US\$36.7 million in 2012 to US\$45.9 million in 2013. The increase in total operating expenses was mainly due to an increase in impairment losses of US\$19.9 million, partially offset by a decrease of US\$7.1 million, or 52.7%, in general and administrative operating expenses.



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Consolidated product development and engineering expenses increased by 15.4% from US\$1.5 million in 2012 to US\$1.7 million in 2013. This increase was mainly due to development of certain online game projects in our Asian online game and service business.

Consolidated selling and marketing expenses decreased by 42.5% from US\$8.4 million in 2012 to US\$4.8 million in 2013, primarily due to cost cutting and cost controls in FunTown. The period comparison was also impacted by expenses from former subsidiary IAHGAMES, which we deconsolidated from August 2012.

Consolidated general and administrative expenses decreased by 52.7% from US\$13.4 million in 2012 to US\$6.3 million in 2013, primarily as a result of stringent control in expenditures. Results also reflected the deconsolidation of IAHGAMES from August 2012.

**OPERATING LOSS.** Operating loss for 2013 was US\$38.5 million compared to US\$20.6 million in 2012. The US\$17.9 million increase in operating loss was primarily a result of increased impairment losses in 2013 and decreased gross profit from FunTown.

**NON-OPERATING INCOME, NET.** Non-operating income, net was US\$3.8 million in 2013 compared with income of US\$7.6 million in 2012. The non-operating income, net in 2013 primarily included (i) US\$0.5 million income on equity method investments, (ii) US\$1.2 million gain on sales of equity method investments, and (iii) US\$1.7 million gain on sales of marketable securities. The non-operating income, net in 2012 primarily included (i) US\$2.5 million gain on the sale of remaining non-controlling ownership interest in our gaming software and service business, (ii) US\$5.7 million gain on the sales of marketable securities, and (iii) US\$1.2 million impairment loss on marketable securities and investments.

**LOSS FROM DISCONTINUED OPERATIONS.** Loss from discontinued operations decreased by US\$2.2 million, from US\$2.5 million in 2012 to US\$0.3 million in 2013, primarily due to completion of our discontinuance of operations of JIDI.

**NET LOSS ATTRIBUTABLE TO GIGAMEDIA.** Net loss attributable to us for 2013 was US\$34.8 million compared with a loss of US\$15.3 million in 2012. The increase is primarily the result of the increase in asset impairment losses recognized in 2013.

### ***Operating Segment Results***

#### ***Asian Online Game and Service Business***

In July 2012, we entered into agreements to sell a 60% ownership interest in IAHGAMES. Upon the closing of the agreement in August 2012, we deconsolidated the results of IAHGAMES operations and began accounting for our remaining 20% interest under the equity method until the closing of the disposal transaction in July 2012 when we sold our remaining ownership. See Item 5. Operating and Financial Review and Prospects A. Operating Results Certain Significant Events Affecting Our Results of Operations for 2012, 2013 and 2014 Acquisition and Divestitures of IAHGAMES .

In June 2012, our board of directors approved a plan to liquidate and dissolve JIDI, a wholly-owned subsidiary, and Shanghai JIDI, a VIE controlled through a series of contractual arrangements. Results for JIDI and Shanghai JIDI operations are reported as discontinued operations for all periods presented. See Item 5. Operating and Financial Review and Prospects A. Operating Results Certain Significant Events Affecting Our Results of Operations for 2012, 2013 and 2014 Divestitures of JIDI and Shanghai JIDI .

In addition to these divestitures, financial results of our Asian online game and service business in 2013 were affected by several factors, including but not limited to strong competition from an increase of online games offered on social network platforms.

**SEGMENT REVENUES.** Total segment operating revenues decreased by US\$13.3 million, or 48.6%, from US\$27.5 million in 2012 to US\$14.1 million in 2013. Such decrease reflected (i) a US\$4.2 million decrease in contributions from IAHGAMES as a result of the deconsolidation of IAHGAMES from August 2012, and (ii) a US\$9.2 million decrease related to FunTown operations in Taiwan and Hong Kong, mainly due to declining demand for certain online games.

As of December 31, 2013, FunTown's number of registered users was 18.0 million, representing a decrease of 17% compared with the fourth quarter of 2012. However, in the fourth quarter of 2013 there was a decrease of 42% in the number of peak concurrent users compared with the fourth quarter of 2012, to 17,000, and the number of average monthly active paying accounts was about 30,000 in the fourth quarter of 2013, representing a decrease of 39% compared with the fourth quarter of 2012. The average revenue per paying user ( ARPU ) in the fourth quarter of 2013 was US\$28, representing a year-over-year decrease of 9%. The decreases in active paying accounts and in ARPU resulted in a year-over-year decrease in fourth-quarter revenue of 45%.

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SEGMENT COSTS OF REVENUES. Costs of our Asian online game and service segment revenue decreased by 43.6% from US\$11.4 million in 2012 to US\$6.4 million in 2013. The decrease reflected a decline of US\$3.4 million in operating costs related to IAHGames, which was deconsolidated from August 2012, as well as a decreased of US\$1.5 million related to FunTown, mainly from variable costs, in line with the decreased revenues.

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**SEGMENT GROSS PROFIT.** Segment gross profit decreased by 52.2%, from US\$16.1 million in 2012 to US\$7.7 million in 2013. Gross profit margin was 58.5% in 2012 compared with 54.5% in 2013, reflecting increased ratio of contribution from licensed games, of which the margin rate was typically much lower than self-developed games.

**SEGMENT OPERATING EXPENSES.** Total segment operating expenses increased by US\$13.0 million from US\$28.4 million in 2012 to US\$41.4 million in 2013. The increase was primarily due to an increase in impairment losses of US\$17.1 million related to FunTown, partially offset by decreases of US\$3.8 million in selling and marketing expenses and US\$3.0 million in general and administrative expenses in 2013.

**Selling and marketing expenses.** Selling and marketing expenses decreased by US\$3.8 million from US\$8.3 million in 2012 to US\$4.5 million in 2013. The decrease reflected cost cutting and cost controls in FunTown and the deconsolidation of IAHGames from August 2012.

**General and administrative expenses.** General and administrative expenses decreased by US\$3.0 million from US\$5.3 million in 2012 to US\$2.3 million in 2013. The decrease reflected the deconsolidation of IAHGames from August 2012, and expenditure reduction in FunTown.

**Impairment losses.** Segment impairment losses in 2013 were comprised of a US\$17.1 million impairment loss on goodwill mainly related to the acquisition of FunTown, a US\$12.0 million impairment loss on intangible assets for trade names and trademarks related to FunTown, a US\$1.3 million impairment loss on intangible assets for capitalized software costs, and a US\$2.8 million impairment loss on prepaid licensing and royalty fees. Segment impairment losses in 2012 were comprised of a US\$15,000 impairment loss on intangible assets for capitalized software costs, a US\$702,000 impairment loss on prepaid licensing and royalty fees, and a US\$12.5 million impairment loss on goodwill related to FunTown.

**SEGMENT OPERATING LOSS.** Segment operating loss in 2013 was US\$33.7 million compared with US\$12.3 million in 2012. The increase in segment operating loss was due to the aforementioned factors.

*Cloud Product and Service Business*

We began developing a new cloud computing business in the second half of 2012. The business launched in April 2013. Segment operating revenues and results of the cloud computing business did not have a material impact on GigaMedia's consolidated operating revenues and results in 2013.

**B. Liquidity and Capital Resources**

Our principal sources of liquidity in 2014 were from cash proceeds from 1) the sales of certain marketable securities, 2) proceeds from short-term bank borrowings, and 3) proceeds from the exercise of stock options. Our cash and cash equivalents are held primarily in U.S. dollars, RMB and NT dollars. Our policy with respect to liquidity management is to maintain sufficient cash and cash equivalents to fund operations and strategic transactions, while placing remaining funds in higher yield investment instruments.

Our future cash requirements will depend on a number of factors including:

the rate at which we enter into strategic transactions;

the rate at which we expand our operations and employee base;

the timing of entry into new markets and new services offered;

changes in revenues and cost splits with our business partners;

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the rate at which we invest in developing and licensing our products and upgrading and maintaining our network and future technologies; and

the rate at which we grow and monetize our customer bases.



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The following table set forth the summary of our cash flows for the years indicated:

(in US\$ thousands)	For the Year Ended December, 31		
	2012	2013	2014
Net cash used in operating activities	\$ (7,323)	\$ (4,305)	\$ (10,838)
Net cash provided by (used in) investing activities	11,117	2,954	(16,626)
Net cash provided by (used in) financing activities	(4,348)	(3,144)	18,825
Exchange difference	(712)	565	478
Net decrease in cash and cash equivalents	(1,266)	(3,930)	(8,161)
Cash and cash equivalents at beginning of year	63,997	62,731	58,801
Cash and cash equivalents at end of year	\$ 62,731	\$ 58,801	\$ 50,640

**OPERATING ACTIVITIES.** In 2014, our net cash used in operating activities was US\$10.8 million; we collected cash of US\$10.0 million from our customers, paid US\$7.6 million for license fees, royalties and channel costs, and paid US\$12.8 million to employees, suppliers and vendors. In 2013, our net cash used in operating activities was US\$4.3 million; we collected cash of US\$15.0 million from our customers, paid US\$4.1 million for license fees, royalties and channel costs, and paid US\$15.1 million to employees, suppliers and vendors. The increased net cash outflows reflected declined revenues in 2014 compared to 2013, and correspondingly our efforts in bidding for new game licenses and meanwhile streamlining our operations.

In 2012, our net cash used in operating activities was US\$7.3 million; we collected cash of US\$26.3 million from our customers, received US\$1.2 million from a licensee, paid US\$11.1 million for license fees, royalties and channel costs, and paid approximately US\$22.9 million to employees, suppliers and vendors. Comparing to 2012, the decreased net cash outflows reflected the deconsolidation of IAHGames from August 2012, and expenditure reduction in FunTown.

**INVESTING ACTIVITIES.** Our net cash used in investing activities was US\$16.6 million in 2014. This primarily reflected increased restricted cash of US\$9.0 million for pledged for borrowings from financial institutions and for deposits as performance bond for the players game points, along with purchases of investments of US\$19.6 million and marketable securities of US\$6.5 million, partly offset by proceeds from disposal of part of our holdings in marketable securities, which totaled US\$18.7 million, net of transaction costs. Our net cash provided by investing activities in 2013 was US\$3.0 million. This reflected the proceeds from the disposal of investments and the disposal of part of our holdings in marketable securities, which totaled US\$6.7 million, net of transaction costs, partially offset by the purchase of marketable securities of US\$2.5 million and capital expenditures of US\$1.5 million. Our net cash provided by investing activities in 2012 was US\$11.1 million. This primarily reflected proceeds from the disposal of businesses and disposal of part of our holdings in marketable securities, which totaled US\$10.3 million, net of transaction costs, as well as the release of US\$3.7 million from restricted cash, partially offset by capital expenditures of US\$2.1 million.

**FINANCING ACTIVITIES.** Our net cash provided by financing activities in 2014 was US\$18.8 million, mainly from net proceeds from short-term borrowings of US\$15.2 million and cash inflows from the exercise of stock options of US\$3.6 million. Our net cash used in financing activities in 2013 was US\$3.1 million, which was mainly due to net repayments of short-term borrowings of US\$3.1 million. Our net cash used in financing activities in 2012 was US\$4.3 million, which was mainly due to net repayments of short-term borrowings of approximately US\$4.3 million.

We believe that our existing cash, cash equivalents, marketable securities and our ability to renew or increase our short term borrowings will be sufficient to meet our capital expenditure, debt, and operating cash obligations through 2015. It is our opinion our working capital is sufficient for our present requirements. We continue to seek and review potential merger and acquisition opportunities on an ongoing basis, which may be funded through cash on our balance sheet, proceeds from sales of investments, bank borrowings or equity offerings. We do not believe that any potential merger or acquisition that we may be engaged in would alter our goal of preserving sufficient cash and cash equivalents to fund future operations. We continue to seek and review potential merger and acquisition opportunities on an ongoing basis, which may be funded through cash on our balance sheet, proceeds from sales of investments, bank borrowings or equity offerings. We do not believe that any potential merger or acquisition that we may be engaged in would alter our goal of preserving sufficient cash and cash equivalents to fund future operations.

**Capital Expenditures**

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We typically finance our capital expenditures through cash holdings. Our gross capital expenditures in continuing operations for equipment, furniture and fixtures, software, intangible assets and other deferred assets were US\$2.1 million, US\$1.5 million and US\$0.5 million for 2012, 2013, and 2014, respectively. Capital expenditures during 2014 were primarily for capitalized software development and computer hardware equipment for our Asian online game and service business. Our capital expenditure plans for 2015, primarily in software development and computer hardware equipment, will aim to support our lean growth initiatives in our Asian online game and service business and our cloud products and service business. We may adjust the amount of our capital expenditures upward or downward based on cash flow from operations, the progress of our expansion plans, and market conditions.

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### **Dividends from Our Subsidiaries**

Under Singapore tax regulations, foreign-sourced dividend income used for capital expenditures, including investments, and repayment of borrowings, is not deemed as remitted to Singapore and is therefore not taxable.

In accordance with R.O.C. law, an appropriation for legal reserve amounting to 10% of a company's net profit is required until the reserve equals the aggregate par value of such Taiwan company's issued capital stock. As of December 31, 2012, 2013 and 2014, the legal reserves of Hoshin GigaMedia were approximately US\$3.0 million, US\$3.0 million and US\$3.0 million, respectively. The reserve can only be used to offset a deficit or be distributed as a stock dividend of up to 50% of the reserve balance when the reserve balance has reached 50% of the aggregate paid-in capital of Hoshin GigaMedia.

### **C. Research, Development, Patents and Licenses, etc.**

We make investments in research and development to keep pace and remain competitive with technology advancements and product development relating to our Asian online game business and our new cloud computing business. For the years 2012, 2013 and 2014, we incurred US\$1.5 million, US\$1.7 million and US\$0.9 million, respectively, in research and development activities.

### **D. Trend Information**

In online games, the entire global business landscape is changing. Driven by the popularity of mobile phones and tablets and social networks, games are rapidly moving from PC-based formats to browser and mobile platforms. This in turn is causing changes in game content, as casual browser and mobile games require light content. In our market, Taiwan, the strongest demand is for casual browser/mobile games. Revenues clearly show this trend. Revenues for publishers of licensed PC-based games in Taiwan were basically flat in 2012 and profits declined. In contrast, revenues for companies focused on browser games grew at healthy double-digit rates and strong growth continued in 2013.

We are now in the process of extending GigaMedia's PC-based online games platform to browser/mobile light games. This will help us capitalize on the strong growth trends of browser/mobile games, particularly in Asia, and our expertise in casual or light games. We have a strong offering of casual games including Asian card-based games and MahJong and a good track record of developing and monetizing them, especially in the types of games that are most popular casino games, such as poker, slots and MahJong. We are now leveraging that expertise to transition our game portfolio from client-based games designed for PC usage to browser/mobile games and social casino games for social networks and mobile play.

In cloud computing, the convergence of cloud, social and mobile technologies is transforming how IT services are delivered to consumers and revolutionizing how companies connect internally and externally. Cloud solutions enable firms to either avoid deployment of a full-scale onsite IT infrastructure or replace an existing company's internal IT infrastructure with an externally managed and hosted IT function. This is what is sometimes called virtualization of businesses. It is particularly helpful for SMEs as it brings many business benefits, including going to market faster and easier with lower capital expenditures.

In North America and Europe, a growing number of companies like RingCentral and 8x8 Inc have built successful businesses providing cloud computing services for SMEs. They have demonstrated that services such as hosted VoIP and cloud faxing reduce costs, increase flexibility, and drive SME productivity. However, in Taiwan and Asia, cloud services for SMEs is a largely untapped opportunity and lag the US in adoption. There are over one million SMEs in Taiwan and strong growth of cloud services regionally is forecast, driven by SMEs. The market for one segment of cloud services business VoIP in Asia is expected to grow at a 17% CAGR over the next five years, according to research by Global Industry Analysts, Inc. in 2013.

In Greater China, SMEs often have no dedicated IT staff, cannot afford investment in IT systems, still rely on legacy phone and paper-based fax systems, and work outside the office. They need affordable, efficient and mobile services to conduct business in and out of the office. These customer needs point to opportunities for integrated cloud services such as those provided by GigaCloud.

Our GigaCloud team has deep and wide knowledge in the SME market in Taiwan. We have developed an initial suite of cloud services to address the most critical needs of SMEs, including telephone, fax and storage services, which are all accessible anywhere, anytime on any smart device. We launched service in early April 2013 with tiered service offerings and special rates.

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GigaCloud is an integrated platform of cloud services. Our software powers the front end and we integrate the backend solutions of our strategic technology partners.

Please see Item 3, Key Information D. Risk Factors and Item 5, Operating and Financial Review and Prospects A. Operating Results Certain Significant Events Affecting Our Results of Operations for 2012, 2013, and 2014 for a discussion of the most recent trends in our operating costs and revenues since the end of 2014. In addition, please refer to discussions included in this Item for a discussion of known trends, uncertainties, demands, commitments or events that we believe are reasonable likely to have a material effect on our net operating revenues, income from continuing operations, profitability or capital resources, or that would cause reported financial information not necessarily to be indicative of future operating results or financial condition.

**Table of Contents****E. Off-Balance Sheet Arrangements**

Other than as disclosed in note 27 to our consolidated financial statements, we currently do not have (a) any obligation under a guarantee contract that has any of the characteristics identified by the FASB Accounting Standards Codification; (b) a retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to such entity for such assets; (c) any obligation under a derivative instrument that is both indexed to our Company's own stock and classified in equity, or not reflected, in our Company's statement of financial position; or (d) any obligation, including a contingent obligation, arising out of a variable interest in an unconsolidated entity that is held by, and material to, our Company, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with, our Company.

**F. Tabular Disclosure of Contractual Obligations**

	As of December 31, 2014				Total
	Payment Due by Period (in US\$ thousands)				
	Within 1 year	1-3 years	3-5 years	>5 years	
1. Operating leases	910	239			1,149
2. License fees*	1,129				1,129
3. Minimum guarantees against royalties	1,300	1,500			2,800
Total contractual cash obligations	1,141	2,392			3,533

\* According to our license contracts, the total license fee payable, assuming all milestones or conditions under such license contracts were met, is US\$5.0 million. Considering game performance, industry environment and business situation, management determined that certain license fees will unlikely become payable and such amount have not been included in the above table.

The initial minimum guarantees against future royalties and license fees are not required to be paid until the licensed games are commercially released or until certain milestones are achieved, as stipulated in the individual license agreements. The remaining minimum guarantees are generally required to be paid within three years subsequent to the commercial release dates of the licensed games.

**G. Safe Harbor**

See Disclosure Regarding Forward-Looking Statements on page 4 of this annual report.

**ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES****A. Directors and Senior Management**

The following table sets forth information with respect to our directors and executive officers as of the date of this annual report:

Name	Age	Position	Year Appointed to Current Position
CHIEN, Mo Na	71	Chairman of the Board and Executive Director	2012 <sup>1</sup> /2012
HUANG, John Ping Chang	63	Chairman of the Compensation Committee of the Board and Independent Non-Executive Director	2012 <sup>2</sup> /2011
LIU, Nick Chia-En	53	Independent Non-Executive Director	2011 <sup>3</sup>

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WONG, King Wai Alfred	46	Non-Executive Director	2013 /2014 <sup>4</sup>
HONG, Chin Fock (Damian)	66	Independent Non-Executive Director	2013 <sup>5</sup>
TUNG, Casey K.	64	Chairman of the Audit Committee of the Board and Independent Non-Executive Director	2012 <sup>6</sup> /2011
HWANG, Collin	41	Chief Executive Officer and Director	2012 <sup>7</sup>
CHEN, Dirk Chi-Ching	57	Chief Financial Officer and Director	2012 <sup>8</sup> /2011
HUANG, Billy Bing-Yuan	57	Independent Non-Executive Director	2013 <sup>9</sup>
LEE, Cherng-Shiun (Simon)	41	Chief Executive Officer of GigaCloud	2013 <sup>10</sup>

- 1 Mr. Mo Na CHIEN was appointed as an Independent Non-Executive Director on August 2, 2010 and as an Executive Director on December 1, 2012. He was also appointed as Chairman of the Compensation Committee on March 15, 2011. Mr. Chien resigned as Chairman of the Compensation Committee on November 26, 2012 and was appointed as Chairman of the Board on December 1, 2012.
- 2 Mr. John Ping Chang HUANG was appointed as an Independent Non-Executive Director of the Board on January 31, 2011. He was also appointed as Chairman of the Compensation Committee on November 26, 2012.
- 3 Mr. Nick Chia-En LIU was appointed as an Independent Non-Executive Director of the Board on March 15, 2011. He was also appointed as a member of the Audit Committee on March 15, 2011.
- 4 Mr. Alfred WONG was appointed as a Non-Executive Director of the Board on July 29, 2014.
- 5 Mr. Damian HONG was appointed as an Independent Non-Executive Director of the Board on October 31, 2013.

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- 6 Mr. Casey K. TUNG was appointed as an Independent Non-Executive Director of the Board on November 24, 2011, and Chairman of the Audit Committee on November 5, 2012. He was also appointed as a member of the Compensation Committee on March 18, 2013.
- 7 Mr. Collin HWANG was appointed as Chief Executive Officer of our Company on November 26, 2012. Mr. Hwang was appointed as a Director of the Board on November 9, 2012.
- 8 Mr. Dirk Chi-Ching CHEN was appointed as Chief Financial Officer of our company on February 1, 2012. He was appointed as a Director of the Board on November 24, 2011.
- 9 Mr. Billy Bing-Yuan HUANG was appointed as an Independent Non-Executive Director of the Board and a member of the Audit Committee on April 18, 2013.
- 10 Mr. Cherng-Shiun LEE was appointed as Chief Executive Officer of GigaCloud on November 1, 2013.
- Biographical information with respect to each of our directors and executive officers is set forth below.

**Directors**

MO NA CHIEN is the Executive Chairman of the board of directors of our Company. He is currently the supervisor of the board of the Taiwan Stock Exchange-listed microelectronics firm Maxtek Technology Co., Ltd, and director of Lian Hua Foods Corporation. Mr. Chien completed the senior executive program of MIT Sloan School of Management and holds a Bachelor of Arts degree from National Taiwan University.

JOHN PING CHANG HUANG is an independent non-executive director of our Company. He is also currently the chairman of Taiwan-based Grand Pacific Investment & Development Co., Ltd., as well as the firms Chailease Resources Tech. Co., Ltd., Global Hospitality Group Inc., and Beijing He Qiao Property Management Co., Ltd. Mr. Huang holds a Bachelor of Arts degree from Soochow University in Taiwan. Mr. Huang is the elder brother of Mr. Billy Bing-Yuan Huang.

NICK CHIA-EN LIU is an independent non-executive director of our Company. He was the managing director in Taiwan for a U.S. based game development company. Mr. Liu holds an MBA degree from the Stern School of Business at NYU and a bachelor's degree from the University of Southern California.

KING WAI ALFRED WONG is a non-executive director of our Company. He currently serves as the managing director of CL Capital Management Co. Limited, a Shanghai-based private equity firm. He is also non-executive director of Philippine Grains International Corporation, owner and operator of the largest grain terminal in the Philippines. Previously, he was an advisor to Chailease Holding Co Ltd. From 2009 to 2010 Mr. Wong was the director of development for one of the largest agricultural product providers in the Philippines, La Filipina Uy Gongco Corporation, where, among other transactions, he advised the company and a consortium of strategic investors and private equity firms on a bid for the largest food company in the Philippines. Prior to that, he served as an advisor to MatlinPatterson Global Advisers, a global private equity firm focused on distressed investments with \$8.9 billion of assets under management, and was a partner at Pareto Partners, a joint venture with Hong Kong-listed Golden Resources Group (677.HK) to develop Vietnamese infrastructure. Mr. Wong was interim chief financial officer at Petrocom Energy Limited in Hong Kong in 2005; prior to that he held multiple senior management positions at AIF Capital Limited, Hong Kong, an Asia-based private equity firm with over \$1.3 billion in assets under management where he handled transactions involving a wide range of industries. He began his career at Emerging Markets Partnership, Hong Kong, the predecessor to EMP Global, principal advisor to the AIG Asian Infrastructure Funds, two funds totaling \$2.7 billion, where he helped grow and list in Hong Kong one of the largest toll road companies in China. Mr. Wong earned a master's degree from the Leonard N. Stern School of Business at New York University and a bachelor's degree in management/economics from Ateneo De Manila University in the Philippines.

CHIN FOCK (DAMIAN) HONG is an independent non-executive director of our Company. He has more than 37 years of experience in taxation and tax law. Damian began his career with the Inland Revenue Authority of Singapore before joining KPMG and working with the firm in various capacities, including post-retirement, for more than two decades. He was also a tax consultant to the law firm Allen & Gledhill in Singapore for 12 years. Damian currently serves as an independent director of Chailease Holding Co Ltd. and Riverstone Holdings Ltd. He also serves as a director of the charities Shared Services for Charities Limited and Binjaitree, as well as a non-executive director of Prima Limited. Mr. Hong lectured on a part-time basis at the Singapore Management University. He earned a bachelor's degree in social science at the University of Singapore and attended an international tax program at Harvard Law School.

CASEY K. TUNG is an independent non-executive director of our Company. Mr. Tung is the principal owner of the accounting offices of Casey Tung in California. Mr. Tung founded the business in 1991, which serves a number of publicly listed companies in Taiwan and in China and practices in the areas of assurance, taxation, and advisory on matters such as mergers and acquisitions, financing, and reorganizations. Mr. Tung is a member of the American Institute of Certified Public Accountants and the California Society of Certified Public Accountants. He holds a Master of Science in Business Administration from California State University, Long Beach and a Bachelor of Commerce degree from Soochow University in Taiwan.





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COLLIN HWANG is the CEO and a director of our Company. He currently serves as chairman of Datadot Technology Asia & Taiwan, a joint venture in Shanghai and Taipei with Australian-listed Datadot Technology Limited, a world-leading provider of identification technologies. He is also chairman of Taipei-based Cita Investment and Technology Development Co. Ltd., which invests in real estate, equities and business ventures across Asia. Mr. Hwang holds a Master of Transport Management degree from the University of Sydney and a Bachelor of Construction Management degree from the University of New South Wales, Australia.

DIRK CHI-CHING CHEN is the CFO and a director of our Company. He has extensive financial leadership experience in international business and an excellent record of delivering corporate growth and strong financial performance. During a 30-year career with Chailease Finance Co., Ltd., a leading financial firm based in Taiwan with business operation in the Greater China, South East Asia, and North America, Dirk served the company in different key roles, including senior advisor, president and chief financial officer, and successfully led several important initiatives. He spearheaded growth in China, tripling the firm's revenues in that market from 2005 to 2008. Following the 2008 financial crisis, he directed a turnaround team at the firm's New York operations in 2009, developing solutions that contributed to significant improvements in financial performance. Dirk currently serves as a non-executive director for Chailease Holdings Co., Ltd. starting from May 2014.

BILLY BING-YUAN HUANG is an independent non-executive director of our Company. He has over 20 years of experience as an executive in the technology/media industry and a proven track record of driving growth. At The Walt Disney Company, where he serves as vice president responsible for the China, Hong Kong and Taiwan markets, he launched Disney Channel and Disney Junior Channel and expanded services to new online media. At Taiwan's Videoland Communications, where he served as vice president from 1996-1998, Mr. Huang implemented a restructuring plan that transformed the business from an old production house into a modern cable television consortium distributing content for global television brands including CNN, Cartoon Network, and Discovery Channel. Prior to that, Mr. Huang was vice president of Fantasmic International, a public relations and advertising firm in Taipei, and held numerous positions with prominent advertising firms in Taipei. Mr. Huang earned a master's degree in mass communication from Texas Tech University and has a bachelor's degree in journalism from Chinese Culture University in Taipei. Mr. Huang is the younger brother of Mr. John Ping Chang Huang.

CHERNG-SHIUN (SIMON) LEE is the CEO of GigaCloud. Mr. Lee helped develop and grow the Taiwan branch of global technology services leader Atos from 2006 to 2013. During this time, Mr. Lee served in different key roles, including managing director, vice president of sales, and sales director. At Atos Taiwan, he spearheaded penetration of the telecom, warehouse, and government sectors, surpassing double-digit sales goals every year. Prior to working at Atos, Mr. Lee served as a sales manager at AdvancedTEK International Corporation, a consulting firm and major reseller and implementation partner of Oracle as well as other software, services and hardware, in Taiwan and China. Mr. Lee has a master's degree in industrial engineering and management from National Chiao-Tung University and a bachelor's degree from National Tsing-Hua University, both in Taiwan.

## **B. Compensation**

### **Compensation of Directors and Executive Officers**

For the year ended December 31, 2014, the aggregate cash compensation paid by us to our directors and executive officers was approximately US\$1.1 million. For information on total amounts set aside by our Company to provide pension and retirement benefits, see note 19 to our consolidated financial statements.

As of December 31, 2014, the total outstanding number of share options granted to our directors and officers was 840,000, of which 180,200 shares were vested and 659,800 shares were unvested. As of the same date, the total number of restricted stock units granted to our directors and officers was zero.

The following table summarizes, as of March 31, 2015, the outstanding options granted under our employee share option plans and equity incentive plans to our directors and executive officers as a group.

<b>Date of Grant</b>	<b>Ordinary Shares Underlying Outstanding Options</b>	<b>Exercise Price (\$/Share)</b>	<b>Date of Expiration</b>
May 20, 2011	60,000	1.25	May 20, 2021

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January 5, 2012	20,000	0.8101	January 5, 2022
November 26, 2012	500,000	0.955	November 26, 2022
October 28, 2013	20,000	1.01	October 28, 2023
November 1, 2013	200,000	1.04	November 1, 2023
March 28, 2014	40,000	1.43	March 28, 2024
<b>Total</b>	<b>840,000</b>		

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All options granted to our directors and executive officers were granted pursuant to the option plans and the equity incentive plans as described under Employee Share Option Plans and Equity Incentive Plans below.

### **Employee Share Option Plans and Equity Incentive Plans**

#### ***2002 Employee Share Option Plan***

At the June 2002 Annual General Meeting, the shareholders of our Company approved the GigaMedia Limited 2002 Employee Share Option Plan (the 2002 Plan ) under which up to 3,000,000 common shares of our Company were reserved for issuance. All employees, officers, directors, advisors and consultants of our Company are eligible to participate in the 2002 Plan. The 2002 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the exercise price for the option grants, to determine which eligible individuals are to receive option grants, the time or times when options grants are to be made, the number of shares subject to grant and vesting schedule. The maximum contractual term under the 2002 Plan is approximately 10 years. Termination of employment will not affect rights of exercise under vested options.

#### ***2004 Employee Share Option Plan***

At the June 2004 Annual General Meeting, the shareholders of our Company approved the GigaMedia Limited 2004 Employee Share Option Plan (the 2004 Plan ) under which up to 7,000,000 common shares of our Company were reserved for issuance. All employees, officers, directors, advisors and consultants of our Company are eligible to participate in the 2004 Plan. The 2004 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the exercise price for the option grants, to determine which eligible individuals are to receive option grants, the time or times when options grants are to be made and the number of shares subject to grant vesting schedule. The maximum contractual term under the 2004 Plan is 10 years. Options will be forfeited upon termination of employment, unless the relevant award agreement extends the exercisability of the outstanding options.

#### ***2006 Equity Incentive Plan***

At the June 2006 Annual General Meeting, the shareholders of our Company approved the GigaMedia Limited 2006 Equity Incentive Plan (the 2006 Plan ) under which up to 1,000,000 common shares of our Company have been reserved for issuance. The 2006 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the grant of awards under the 2006 Plan. The maximum contractual term under the 2006 Plan is 10 years. Options will be forfeited upon termination of employment, unless the relevant award agreement extends the exercisability of the outstanding options. In the event that the employee's employment with or service to our Company is terminated prior to the lapsing of restrictions with respect to any portion of the RSUs, such portion of the RSUs shall become forfeited.

#### ***2007 Equity Incentive Plan***

At the June 2007 Annual General Meeting, the shareholders of our Company approved the GigaMedia Limited 2007 Equity Incentive Plan (the 2007 Plan ) under which up to 2,000,000 common shares of our Company have been reserved for issuance. The 2007 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the grant of awards under the 2007 Plan. The maximum contractual term under the 2007 Plan is 10 years. Options will be forfeited upon termination of employment, unless the relevant award agreement extends the exercisability of the outstanding options.

#### ***2008 Equity Incentive Plan***

At the June 2008 Annual General Meeting, the shareholders of our Company approved the GigaMedia Limited 2008 Equity Incentive Plan (the 2008 Plan ) under which up to 1,000,000 common shares of our Company have been reserved for issuance. The 2008 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the grant of awards under the 2008 Plan. The maximum contractual term under the 2008 Plan is 10 years. Options will be forfeited upon termination of employment, unless the relevant award agreement extends the exercisability of the outstanding options. All options, RSUs and other share-based awards are expected to be settled by issuing new shares.

#### ***2009 Equity Incentive Plan***

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At the June 2009 Annual General Meeting, the shareholders of our Company approved the GigaMedia Limited 2009 Equity Incentive Plan (the 2009 Plan ) under which up to 1,500,000 common shares of our Company have been reserved for issuance. The 2009 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the grant of awards under the 2009 Plan. The maximum contractual term under the 2009 Plan is 10 years. Options will be forfeited upon termination of employment, unless the relevant award agreement extends the exercisability of the outstanding options. All options, RSUs and other share-based awards are expected to be settled by issuing new shares.

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### ***2010 Equity Incentive Plan***

At the June 2010 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2010 Equity Incentive Plan (the 2010 Plan ) under which up to 1,000,000 common shares of our Company have been reserved for issuance. The 2010 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the grant of awards under the 2010 Plan. The maximum contractual term for the options under the 2010 Plan is 10 years. Options will be forfeited upon termination of employment, unless the relevant award agreement extends the exercisability of the outstanding options. All options, RSUs and other share-based awards are expected to be settled by issuing new shares.

### ***Employee Share Purchase Plans***

At the June 2008 Annual General Meeting, the shareholders of our Company approved the GigaMedia Limited 2008 Employee Share Purchase Plan (the 2008 ESPP ) under which up to 200,000 common shares of our Company were reserved for issuance. Any person who is regularly employed by our Company or our designated subsidiaries shall be eligible to participate in the 2008 ESPP. Pursuant to the 2008 ESPP, our Company would offer the Shares to qualified employees on favorable terms. Employees are also subject to certain restrictions on the amount that may be invested to purchase the shares and to other terms and conditions of the 2008 ESPP. According to the 2008 ESPP, the plan will be administered by a committee designated by the board of directors.

At the June 2009 Annual General Meeting, the shareholders of our Company approved the GigaMedia Limited 2009 Employee Share Purchase Plan (the 2009 ESPP ) under which up to 200,000 common shares of our Company were reserved for issuance. Any person who is regularly employed by our Company or our designated subsidiaries shall be eligible to participate in the 2009 ESPP. Pursuant to the 2009 ESPP, our Company would offer the Shares to qualified employees on favorable terms. Employees are also subject to certain restrictions on the amount that may be invested to purchase the shares and to other terms and conditions of the 2009 ESPP. According to the 2009 ESPP, the plan will be administered by a committee designated by the board of directors.

At the June 2010 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2010 Employee Share Purchase Plan (the 2010 ESPP ) under which up to 200,000 common shares of our Company have been reserved for issuance. To be eligible, employees must be regularly employed by us or our designated subsidiaries. Employees are also subject to certain restrictions on the amount that may be invested to purchase the shares and to other terms and conditions of the 2010 ESPP. According to the 2010 ESPP, the plan will be administered by a committee designated by the board of directors.

As of March 31, 2015, none of the 2008 ESPP, the 2009 ESPP or the 2010 ESPP has been administered by our Company.

### **Employment of Executive Officers**

Officers are selected by and serve at the discretion of our board of directors. No executive officer is entitled to any severance benefits upon termination of his or her employment with our Company.

### **C. Board Practices**

Our board of directors is currently comprised of nine directors, including five independent non-executive members. Each of our directors is elected by our Company's shareholders or appointed by the directors pursuant to the Memorandum of Association and hold office until such director's successor is elected and duly qualified, or until such director's earlier death, bankruptcy, insanity, resignation or removal. No director is entitled to any severance benefits on termination of his or her service. We have established two committees of the board of directors, including the audit committee and the compensation committee.

Our audit committee currently consists of Casey K. TUNG, Nick Chia-En LIU and Billy Bing-Yuan HUANG. Our audit committee will select and evaluate, on our behalf, the independent public accountants who audit our annual financial statements, and will review and approve the planned scope of our annual audit, subject to the appointment, replacement or removal from office of our independent public accountants as has been approved by our shareholders at our Annual General Meeting. In accordance with our Articles of Association and our audit committee charter, all of the members of our audit committee must be persons who qualify as independent directors under the standards set forth in NASDAQ Rules 5605(c)(2)(A)(i) and (ii) and each of them is able to read and understand fundamental financial statements.

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Our compensation committee currently consists of Casey K. TUNG and John Ping Chang HUANG. Our compensation committee reviews and evaluates the compensation and performance of executive officers, our Company's general compensation plans and other employee benefit plans, and performs other duties and responsibilities pursuant to the compensation committee charter. In accordance with our compensation committee charter, all of the members of the compensation committee are qualified independent directors under the standards set forth in NASDAQ Rules 5605(c)(2)(A)(i) and (ii).

**Table of Contents****D. Employees**

In the years ended December 31, 2012, 2013 and 2014, our total employees were 287, 257 and 251, respectively.

As of March 31, 2015, we had a total of 245 employees, excluding part-time and temporary personnel and consultants. Of the total 245 employees as of March 31, 2015, 18 were located at our corporate headquarters, 17 were employed for our cloud services business, and 210 were employed for our online games business. All 245 employees were in Asia.

**E. Share Ownership****Share Ownership of Directors and Executive Officers**

The table below sets forth information as to our directors and executive officers share ownership in our Company as of March 31, 2015:

Person	Number of Common Shares	Number of Shares Issuable upon exercise of options
HWANG, Collin	1,458,138	500,000
CHIEN, Mo Na		*
HUANG, John Ping Chang		*
LIU, Nick Chia-En		*
CHEN, Dirk Chi-Ching		
TUNG, Casey K.		*
HUANG, Bing-Yuan		*
WONG, King Wai Alfred		*
HONG, Chin Fock		*
LEE, Cherng-Shiun		*
Directors and Officers as a group	1,458,138	840,000

\* Less than 1%

**ITEM 7. MAJOR SHAREHOLDERS AND RELATED-PARTY TRANSACTIONS****A. Major Shareholders**

The following table sets forth information known to us with respect to the ownership of our shares as of March 31, 2015 by each shareholder known by us to own more than 5% of our shares:

Name of Owner	Shares Owned	Percentage of Shares Owned
Best Method Limited <sup>(1)</sup>	10,799,999	19.54%

(1) Through Best Method Limited, a British Virgin Islands company, Andre Koo has a beneficial ownership of 10,799,999 common shares of our Company.

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As of March 31, 2015, we had 55,261,661 Shares outstanding, of which 44,461,662 Shares representing 80.46% of our total outstanding Shares were not held by our major shareholders as disclosed above. As of March 31, 2015, one shareholder of record with a registered address in the United States, Cede & Co., nominee of The Depository Trust Company, held 43,619,849 shares.

The amounts and percentages of common shares beneficially owned are reported on the basis of regulations of the SEC, governing the determination of beneficial ownership of securities. Under the rules of the SEC, a person is deemed to be a beneficial owner of a security if that person has or shares voting power, which includes the power to vote or to direct the voting of such security, or investment power, which includes the power to dispose of or to direct the disposition of such security. A person is also deemed to be a beneficial owner of any securities of which that person has a right to acquire beneficial ownership within 60 days. Under these rules, more than one person may be deemed a beneficial owner of securities as to which such person has no economic interest. None of our major shareholders have voting rights different from those of our other shareholders.

### **B. Related Party Transactions**

We have engaged from time to time in various transactions with related parties.

Except for the following transactions, we were not a party to any transaction with any related party that did not arise in the ordinary course of business or that was material to us.



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### **Loan Receivables**

During 2011, our Company entered into loan agreements in an aggregate of \$5.2 million with Everest Gaming, bearing interest at 3% per annum. As of December 31, 2011, the net book value of this loan receivable was nil after being reduced in connection with absorbing additional losses of Everest Gaming (as discussed in more detail in note 15 to our consolidated financial statements) and considering the financial status of Everest Gaming, from which we do not expect to collect all principal and interest. We also reversed the interest recognized previously on these loans and ceased to recognize interest income going forward. Upon the closing of the sale of our remaining ownership in the gaming software and service business in August 2012, the rights and interest in and to the loan agreements were also assigned to BEG. See note 5 to our consolidated financial statements for additional information.

### **Stock Option Grants and Employee Share Purchase**

See Item 6, Directors, Senior Management and Employees E. Share Ownership.

### **C. Interests of Experts and Counsel**

Not applicable.

## **ITEM 8. FINANCIAL INFORMATION**

### **A. Consolidated Statements and Other Financial Information Financial Statements**

See pages beginning on page F-1 in this annual report.

### **Dividend Policy**

We have neither declared nor paid any dividends on our Shares. We anticipate that we will continue to retain any earnings for use in the operation of our business, and we do not intend to pay dividends in the foreseeable future. See Item 10, Additional Information B. Memorandum and Articles of Association Dividends in this annual report.

### **B. Significant Changes**

Except as disclosed in this annual report, no significant change has occurred since the date of our consolidated financial statements.

## **ITEM 9. THE OFFER AND LISTING**

Not applicable, except for A. Offer and Listing Details 4. Information Regarding the Price History of the Stock and C. Markets as disclosed below.

Our Shares have been listed and traded on the NASDAQ Stock Market since February 18, 2000.

The following table shows, for the periods indicated, the high and low closing prices for our Shares as quoted on the NASDAQ Stock Market.

Common Shares

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<u>Year Ending December 31</u>	<b>High</b>	<b>Low</b>
	<b>(in US\$)</b>	
2010	\$ 3.32	\$ 1.40
2011	\$ 1.60	\$ 0.80
2012	\$ 1.49	\$ 0.81
2013	\$ 1.20	\$ 0.93
2014	\$ 1.72	\$ 0.77

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	Common Shares	
	High	Low
<b>Year Ending December 31, 2013</b>	(in US\$)	
First quarter	\$ 1.20	\$ 0.97
Second quarter	\$ 1.06	\$ 0.93
Third quarter	\$ 1.16	\$ 0.93
Fourth quarter	\$ 1.10	\$ 0.94

	Common Shares	
	High	Low
<b>Year Ending December 31, 2014</b>	(in US\$)	
First quarter	\$ 1.72	\$ 0.98
Second quarter	\$ 1.41	\$ 1.00
Third quarter	\$ 1.15	\$ 0.82
Fourth quarter	\$ 1.05	\$ 0.77

	Common Shares	
	High	Low
<b>Quarter Ending March 31, 2015</b>	(in US\$)	
	\$ 0.93	\$ 0.76

	Common Shares	
	High	Low
<b>Monthly Highs and Lows</b>	(in US\$)	
October 2014	\$ 1.05	\$ 0.77
November 2014	\$ 1.05	\$ 0.96
December 2014	\$ 1.00	\$ 0.91
January 2015	\$ 0.93	\$ 0.76
February 2015	\$ 0.83	\$ 0.77
March 2015	\$ 0.85	\$ 0.76
April 2015 (through April 15, 2015)	\$ 0.91	\$ 0.76

**ITEM 10. ADDITIONAL INFORMATION****A. Share Capital**

Not applicable.

**B. Memorandum and Articles of Association**

Our current memorandum and articles of association, filed with this annual report, were first adopted on our date of incorporation and have been amended since that date.

As of March 31, 2015, an aggregate of 55,261,661 shares have been issued and are outstanding.

There are no limitations imposed by Singapore law or by our Articles of Association on the right of a non-resident or foreign owner to hold or vote the Shares.

**C. Material Contracts**

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The following are summaries of our material contracts, other than contracts entered into in the ordinary course of business, for the two years immediately preceding the date of this annual report. However, these summaries may not contain all the information important to you. For more complete information, you should read the entire agreements, which have been included as exhibits to this annual report.

### **Sale of T2CN**

#### ***Sale and Purchase Agreement among GigaMedia China Limited, Hornfull Limited, and Hangzhou NewMargin Ventures Co. Ltd., dated December 2, 2011***

On December 2, 2011, GigaMedia China Limited, Hornfull Limited, and Hangzhou NewMargin Ventures Co. Ltd. ( Hangzhou NewMargin ) entered into an agreement whereby GigaMedia agreed to sell all of its ownership interest in T2CN to Hornfull Limited and Hangzhou NewMargin agreed to guarantee the payment and performance of Hornfull Limited under the agreement. Pursuant to the agreement, GigaMedia China Limited sold all of its 43,633,681 shares of T2CN, representing a 67.087% interest in the company, to Hornfull Limited for a cash payment of US\$4,738,588. Hornfull Limited also compensated GigaMedia China Limited US\$789,765 in cash for legal fees incurred by GigaMedia in connection with the T2CN disputes. Hornfull Limited and Hangzhou NewMargin are private companies incorporated in the British Virgin Islands and the PRC, respectively.

**Table of Contents****Sale of IAH**

***Share Purchase Agreement among Infocomm Asia Holdings Pte. Ltd., GigaMedia Asia Pacific Limited, Management Capital International Limited, and Roland Ong Toon Wah dated July 2, 2012, and***

***Share Purchase Agreement among Infocomm Asia Holdings Pte. Ltd., GigaMedia Asia Pacific Limited, Spring Asia Limited and Roland Ong Toon Wah dated July 2, 2012***

On July 2, 2012 GigaMedia Asia, IAH, MCIL, and ROTW entered into a series of agreements whereby GigaMedia Asia agreed to sell to MCIL 1,463,930 Class A shares of IAH (representing 6.48% of the issued and outstanding shares of IAH), 1,208,881 Class B shares of IAH (representing 53.52% issued and outstanding shares), and to IAH 100% of the shares in Spring Asia Limited ( Spring Asia ) held by GigaMedia through IAH. The total purchase price was US\$3 million for the Spring Asia shares, and US\$1.00 for the IAH shares, excluding taxes. All consideration for the Spring Asia shares was to be paid in four equal installments of US\$750,000 through a nine month period. The parties also executed other ancillary agreements on the same date, including the IAH Shareholders Agreement (among MCIL, GigaMedia Asia, ROTW and IAH), Share Charge Agreement (between IAH and GigaMedia Asia), and an Escrow Agreement (among IAH, GigaMedia Asia, and Trident Trust Company (Singapore) Pte. Limited).

***Settlement Agreement among Infocomm Asia Holdings Pte. Ltd., Management Capital International Ltd., GigaMedia Asia Pacific Limited, Spring Asia Limited, and Roland Ong Toon Wah dated April 17, 2013***

IAH, MCIL, GigaMedia Asia, Spring Asia, and ROTW entered into a Settlement Agreement, dated April 17, 2013, whereby IAH and/or ROTW agreed to pay GigaMedia Asia on or before May 2, 2013 all of the outstanding Spring Asia purchase price of US\$2.25 million plus interest of US\$8,390. In addition, MCIL will purchase all of the 451,830 IAH ordinary shares held by GigaMedia at a purchase price of US\$1 million on May 2, 2013. All outstanding amounts (including interests) were paid in full on May 7, 2013.

**Sale of XL Games**

***Share Purchase Agreement between GigaMedia Capital Limited ( GigaMedia Capital ) and Neowiz Corporation ( Neowiz ) dated August 8, 2012***

On August 8, 2012, GigaMedia Capital entered into a Share Purchase Agreement with Neowiz, whereby GigaMedia Capital sold to Neowiz 400,000 preferred shares of XL Games representing 7.2727% of the total number of issued and outstanding shares of XL Games, at a purchase price of US\$6,889,900. GigaMedia Capital and Neowiz also executed two license agreements, one for GigaMedia Capital to license to Neowiz certain game software for a fee of US\$1.5 million, and the other for Neowiz to grant GigaMedia a non-exclusive license in Taiwan, Hong Kong, Macau and Southeast Asia on certain game software free of any license fee for three years.

***Novation Agreement among Megabiz Limited, Blueark Global Co., Ltd, and Nickelodeon Asia Holdings Pte. Ltd. dated September 24, 2013***

On March 18, 2010, Megabiz Limited ( Megabiz ) and Nickelodeon Asia Holdings Pte. Ltd. ( Nickelodeon ) entered into a Game Development, Publishing and Distribution Agreement (the Game Development Agreement ) whereby Megabiz would acquire the rights from Nickelodeon to develop, publish and distribute in certain territories an online game based upon and branded with SpongeBob SquarePants (the Game ), and Megabiz was to develop the Game with Blueark Global Co., Ltd. ( Blueark ). Pursuant to the Game Development Agreement, we paid an initial development fee of US\$2.5 million and a set-up cost of US\$200,000. To that end, Megabiz also entered into a Developer Agreement on May 10, 2010, with Blueark under which Megabiz would pay Blueark a one-time recoupable (against future royalties) service fee of US\$2 million for joint development of the Game by Blueark and Megabiz.

In light of internal evaluations of the Game and estimated cash flows the Game would generate, our Company decided to impair our prepayments in relation to the Game and to assign the Game Development Agreement to Blueark by way of a Novation Agreement entered into among the three companies on September 24, 2013. A total of US\$2.8 million have been impaired as a result.

***Share Purchase Agreement between Hoshin GigaMedia Center Inc. and Angel Fund (Asia) Investments Limited dated October 30, 2013***

On October 30, 2013, Hoshin GigaMedia Center Inc. ( HGC ) and Angel Fund (Asia) Investments Limited ( Angel Fund ) entered into a Share Purchase Agreement whereby HGC sold all of its shareholdings (a total of 4,978,562 shares, 13.5%) in SoftStar Entertainment Inc. ( SoftStar ) to Angel Fund for US\$2.5 million. Angel Fund also agreed to grant HGC a right of first refusal to subscribe up to 15% of newly issued SoftStar shares or convertible bond in the event of a capital increase by SoftStar.



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### **Other Material Contracts**

Other material contracts are incorporated by reference to our annual reports for the year ended December 31, 2010, for the year ended December 31, 2011 and for the year ended December 31, 2012 on Form 20-F (File No. 000-30540) and for additional information on our material contracts, see Item 7, Major Shareholders and Related Party Transactions B. Related Party Transactions in this annual report.

### **D. Exchange Controls**

Foreign investment regulations of PRC may affect our ability to retrieve our capital investments in China. Under the current PRC regulations, conversion of Renminbi is permitted in China for routine current-account foreign exchange transactions, including trade and service related foreign exchange transactions, payment of dividends and service of foreign debts. Conversion of Renminbi for most capital-account items, such as direct investments, investments in PRC securities markets and repatriation of investments, however, is still subject to the approval of the State Administration of Foreign Exchange (SAFE) or its local competent branches. Foreign-invested enterprises, such as our PRC subsidiaries, may buy, sell and/or remit foreign currencies for current-account transactions at banks in the PRC with authorization to conduct foreign exchange business by complying with certain procedural requirements, such as presentment of valid commercial documents. For capital-account transactions involving foreign direct investment, foreign debts and outbound investment in securities and derivatives, approval from SAFE or its local competent branches is a pre-condition. Capital investments by foreign-invested enterprises outside the PRC are subject to limitations and requirements in the PRC, such as prior approvals from the Ministry of Commerce, or MOFCOM, SAFE and the National Development and Reform Commission of the PRC.

### **E. Taxation**

#### **Singapore Tax Considerations**

##### *Taxation of Dividends Received by Singapore Resident Shareholders*

On the basis that we are not tax resident in Singapore, dividends paid by us would be taxable in Singapore if they are received in Singapore or if they are considered, in the hands of a particular shareholder, to be derived in Singapore (for example if they constitute the income of a trade or business carried out in Singapore).

Foreign-sourced dividends received by a Singapore resident person on or after June 1, 2003 will be exempt from tax if certain conditions are met. The main conditions to be satisfied for such exemption are that:

the dividends are received from a jurisdiction with a maximum tax rate on the trade or business income of a company of at least 15%; and

the dividends themselves, or the income from which they are paid, have been subject to tax in the foreign jurisdiction or have been exempted from tax under an incentive granted for substantive business activities.

The normal tax rate for corporate profits in Singapore is 17% for the year of assessment 2012 and 2013 (i.e., for the income earned in the financial year or other basis period ended 2011 and 2012 respectively). Resident individuals are subject to tax at progressive rates of up to 20%.

If our shareholders are corporations, our shareholders will be regarded as being tax resident in Singapore if the control and management of our shareholders' business is exercised in Singapore. For example, if the board of directors of a company meets and conducts the business of such company in Singapore, such company would generally be regarded as tax resident in Singapore. An individual will be regarded as being tax resident in Singapore in a year of assessment if, in the preceding year, he was physically present in Singapore or exercised an employment in Singapore (other than as director of a company) for 183 days or more, or if he resides in Singapore.

All foreign-sourced income received in Singapore (except for income received through a partnership in Singapore) on or after January 1, 2004 by tax resident individuals will be exempt from tax.

*Gains on Disposal of Shares*

Singapore does not impose tax on capital gains. However, there are no specific laws or regulations which deal with the characterization of capital gains and hence, gains on disposal of shares may be construed to be of an income nature and subject to Singapore income tax if they arise from or are otherwise connected with the activities which the Inland Revenue Authority of Singapore regards as the carrying on of a trade or business in Singapore. You should consult your tax advisors concerning the Singapore tax consequences of acquiring, owning, selling or otherwise disposing the Shares.



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### ***Stamp Duty***

There is no stamp duty payable in respect of the issuance and holding of our Shares. Where existing shares are acquired in Singapore, stamp duty is payable on the instrument of transfer of the shares at the rate of S\$2.00 for every S\$1,000 or any part thereof, of the consideration for or market value of the shares, whichever is higher. The stamp duty is borne by the purchaser unless there is an agreement to the contrary. Where an instrument is executed outside Singapore, or no instrument of transfer is executed, no stamp duty is payable on the acquisition of existing shares. However, stamp duty would be payable if an instrument of transfer which is executed outside Singapore is received in Singapore.

Under Singapore law, our directors may not register a transfer of our Shares unless the instrument of transfer has been duly stamped.

### ***Singapore Estate Duty***

Estate duty has been abolished for deaths occurring on or after February 15, 2008.

You should consult your tax advisors regarding the non-Singapore estate duty consequences of your ownership of our Shares.

### ***Goods and Services Tax ( GST )***

The sale of our Shares by an investor belonging in Singapore to another person belonging in Singapore is an exempt supply not subject to GST. Any GST directly or indirectly incurred by the investor in respect of this exempt supply would be a cost to the investor.

Where our Shares are sold by a GST-registered investor to a person belonging outside Singapore and that person is outside Singapore when the sale is executed, the sale should generally be considered as a taxable supply subject to GST at zero-rate. Any GST incurred by the investor in the making of such a supply, if the same is a supply in the course of or furtherance of a business, may be fully recoverable from the Comptroller of GST.

Services such as brokerage, handling and clearing services rendered by a GST-registered person to an investor belonging in Singapore in connection with the investor's purchase, sale or holding of our Shares will be subject to GST at the rate of 7%. Similar services rendered to an investor belonging outside Singapore should generally be subject to GST at zero-rate.

## **U.S. Tax Considerations**

### ***U.S. Federal Income Tax Considerations for U.S. Persons***

The following is a discussion of certain U.S. federal income tax considerations for investors in Shares that are U.S. persons (as defined below). This discussion is based on U.S. federal income tax law as in effect on the date hereof, which is subject to differing interpretations or change, possibly on a retroactive basis. This discussion applies only to U.S. persons that will acquire the Shares and will hold the Shares as capital assets (generally, property held for investment). This discussion is for general information only and does not address all of the tax considerations that may be relevant to you in light of your particular circumstances or if you are subject to special treatment under the U.S. federal income tax laws, including if you are a:

bank;

broker-dealer;

financial institution or insurance company;

tax-exempt entity;

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person holding Shares as part of a straddle, hedge, conversion or other integrated investment;

a person owning, actually or constructively, 10% or more of the combined voting power of all classes of our stock;

a person whose functional currency is not the U.S. dollar;

a partnership or a partner of such partnership; or

a trader in securities that has elected the mark-to-market method of accounting for securities.

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This discussion does not address any U.S. state, local or non-United States tax considerations, or any U.S. federal estate, gift or alternative minimum tax considerations.

As used in this discussion, the term "U.S. person" means:

an individual who is a citizen or resident of the United States;

a corporation, or other entity treated as a corporation for U.S. federal income tax purposes, created in or organized under the laws of the United States or any political subdivision thereof;

an estate, the income of which is includible in gross income for U.S. federal income tax purposes regardless of its source; or

a trust if (1) it is subject to the primary supervision of a court within the United States and one or more U.S. persons have the authority to control all substantial decisions of the trust, or (2) it has otherwise elected to be treated as a U.S. person under the Internal Revenue Code.

If a partnership (including any entity treated as a partnership for U.S. federal income tax purposes) holds Shares, the tax treatment of a partner in such partnership will generally depend upon the status of the partner and the activities of the partnership. If you are a partner of a partnership holding Shares, you are urged to consult your tax advisor as to the particular U.S. federal income tax consequences of an investment in the Shares that is applicable to you.

You are urged to consult your tax advisor concerning the particular U.S. federal, state, local and non-United States income and other tax considerations regarding the ownership and disposition of the Shares, including the application of the passive foreign investment company rules discussed below. Investors should carefully review the discussion below under "Passive Foreign Investment Company."

***Passive Foreign Investment Company***

Due to the price of our Shares during 2014 and the composition of our assets (in particular, the retention of a large amount of cash and our significant portfolio of investment securities), we believe that it is likely that we were classified as a passive foreign investment company ("PFIC"), for United States federal income tax purposes, for the taxable year ended December 31, 2014, and we will likely be a PFIC for our current taxable year ending December 31, 2015 unless our share value increases and/or we invest a substantial amount of the cash and other passive assets we hold in assets that produce or are held for the production of non-passive income. In general, we will be classified as a PFIC for any taxable year if either (i) 75% or more of our gross income for such year is passive income or (ii) 50% or more of the average quarterly value of our assets (as generally determined on the basis of fair market value) produce or are held for the production of passive income. For this purpose, cash and assets readily convertible into cash are generally classified as passive and goodwill and other unbooked intangibles associated with active business activities may generally be classified as non-passive. We will be treated as owning a proportionate share of the assets and earning a proportionate share of the income of any other corporation in which we own, directly or indirectly, more than 25% (by value) of the stock.

If we are classified as a PFIC for any taxable year during which you hold Shares, and unless you make a mark-to-market election (as described below), you will generally be subject to special tax rules that have a penalizing effect, regardless of whether we remain a PFIC, on (i) any excess distribution that we make to you (which generally means any distribution received by you in a taxable year that is greater than 125% of the average annual distributions received by you in the three preceding taxable years or your holding period for the Shares, if shorter), and (ii) any gain realized on the sale or other disposition, including a pledge, of our Shares. Under the PFIC rules:

such excess distribution or gain will be allocated ratably over your holding period for the Shares;

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such amount allocated to the current taxable year and any taxable year prior to the first taxable year in which we are classified as a PFIC (a pre-PFIC year ) will be taxable as ordinary income;

such amount allocated to each prior taxable year, other than a pre-PFIC year, will be subject to tax at the highest tax rate in effect applicable to you for that year; and

an interest charge generally applicable to underpayments of tax will be imposed on the tax attributable to each prior taxable year, other than the current taxable year or a pre-PFIC year.

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As an alternative to the foregoing rules, a holder of marketable stock in a PFIC may make a mark-to-market election, provided that the Shares are regularly traded on a qualified exchange. Although we believe that, based on the current level of trading activity of our Shares on the NASDAQ Global Market, the Shares should qualify as being regularly traded on a qualified exchange, no assurance can be given that the Shares will continue to be readily tradable on an established securities market in the United States. If you make this election, you will generally (i) include in gross income for each taxable year the excess, if any, of the fair market value of your Shares at the end of the taxable year over the adjusted tax basis of the Shares and (ii) deduct as an ordinary loss the excess, if any, of the adjusted tax basis of the Shares over the fair market value of the Shares at the end of the taxable year, but only to the extent of the amount previously included in income as a result of the mark-to-market election. Your adjusted tax basis in the Shares would be adjusted to reflect any income or loss resulting from the mark-to-market election. If you make a mark-to-market election in respect of a corporation classified as a PFIC and such corporation ceases to be classified as a PFIC, you will generally not be required to take into account the gain or loss described above during any period that such corporation is not classified as a PFIC. If you make a mark-to-market election, any gain you recognize upon the sale or other disposition of Shares will be treated as ordinary income and any loss will be treated as ordinary loss, but such loss will only be treated as ordinary to the extent of the net amount previously included in income as a result of the mark-to-market election. In the case of a U.S. person who has held Shares during any taxable year in which we are classified as PFIC and continues to hold such Shares (or any portion thereof), and who is considering making a mark-to-market election, special tax rules may apply relating to purging the PFIC taint of such Shares. If a U.S. Holder makes a mark-to-market election, the tax rules that apply to distributions by corporations which are not PFICs would apply to distributions, except that the reduced tax rate applicable to qualified dividend income (as discussed below in Dividends) would not apply.

Because a mark-to-market election cannot be made for any lower-tier PFICs that we may own, a U.S. Holder may continue to be subject to the PFIC rules with respect to such U.S. Holder's indirect interest in any investment held by us that is treated as an equity interest in a PFIC for United States federal income tax purposes.

We do not intend to provide the U.S. persons with the information necessary to permit U.S. persons to make qualified electing fund elections, which, if available, would result in tax treatment different from (and generally less adverse than) the general tax treatment for PFICs described above.

Each U.S. person who holds an interest in a PFIC is required to file an annual report containing such information as the U.S. Treasury may require. In addition, if a U.S. person holds Shares in any year in which we are a PFIC, such holder will be required to file Internal Revenue Service Form 8621 regarding distributions received on the Shares, any gain realized on the disposition of the Shares, and any reportable election. You are urged to consult your tax advisor regarding the application of the PFIC rules, including the possibility of making a mark-to-market election.

### ***Taxation of Dividends***

Except as discussed above with respect to the passive foreign investment company tax rules, the amount of distributions you receive on your Shares (other than certain pro rata distributions of our Shares or rights to subscribe for Shares) will generally be reported as dividend income to you if the distributions are made from our current or accumulated earnings and profits as calculated according to U.S. federal income tax principles. Because we do not intend to determine our earnings and profits on the basis of U.S. federal income tax principles, any distribution paid will generally be reported as a dividend for U.S. federal income tax purposes. You will include such dividends in your gross income as ordinary income on the day you actually or constructively receive them. The amount of any distribution of property other than cash will be the fair market value of such property on the date it is distributed. A non-corporate recipient of dividend income will generally be subject to tax on dividend income from a qualified foreign corporation at a reduced United States federal tax rate rather than the marginal tax rates generally applicable to ordinary income, so long as certain holding period requirements are met. A non-U.S. corporation generally will be considered to be a qualified foreign corporation (i) if it is eligible for the benefits of a comprehensive tax treaty with the United States which the Secretary of Treasury of the United States determines is satisfactory for purposes of this provision and which includes an exchange of information program or with respect to any dividend it pays on stock which is readily tradable on an established securities market in the United States and (ii) the corporation is not a PFIC and is not treated as a PFIC with respect to you for the taxable year in which the dividend was paid and the preceding taxable year. There is currently no tax treaty in effect between the United States and Singapore. Although the Shares are currently tradable on the NASDAQ Global Market, which is an established securities market in the United States, no assurance can be given that the Shares will continue to be readily tradable on an established securities market in the United States. U.S. corporate holders will generally not be eligible for the dividends received deduction allowed to corporations.

The amount of any distribution paid in a currency other than the U.S. dollar will equal the U.S. dollar value of the foreign currency you receive, calculated by reference to the exchange rate in effect on the date you actually or constructively receive the distribution, regardless of whether the foreign currency is actually converted into U.S. dollars. If you do not convert the foreign currency you receive as a dividend on the date of receipt, you will have a basis in such foreign currency equal to its U.S. dollar value on the date of receipt. Any gain or loss you realize when you subsequently sell or otherwise dispose of such foreign currency generally will be ordinary income or loss from sources within the United States

for U.S. foreign tax credit limitation purposes.

Dividends on the shares will generally be treated as foreign source income for U.S. foreign tax credit purposes and generally will constitute passive category income. A U.S. person may be eligible, subject to a number of complex limitations, to claim a foreign tax credit in respect of any foreign withholding taxes imposed on dividends received on Shares. A U.S. person who does not elect to claim a foreign tax credit for foreign tax withheld may instead claim a deduction for U.S. federal income tax purposes, in respect of such withholding, but only for a year in which such holder elects to do so for all creditable foreign income taxes. The rules governing the foreign tax credits are complex. Accordingly, you are urged to consult your tax advisor regarding the availability of a foreign tax credit under your particular circumstances.

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### ***Sale or Other Disposition of Shares***

Except as discussed above with respect to the passive foreign investment company tax rules, a U.S. person generally will recognize capital gain or loss for U.S. federal income tax purposes upon a sale or other disposition of our Shares in an amount equal to the difference between the amount realized from the sale or disposition and the holder's adjusted tax basis in the Shares. Such gain or loss generally will be long-term (taxable at a reduced rate for individuals) if, on the date of sale or disposition, the Shares were held by the holder for more than one year and will generally be treated as gain or loss from U.S. sources for foreign tax credit purposes. The deductibility of a capital loss may be subject to limitations. You are urged to consult your tax advisor regarding the consequences if a foreign withholding tax is imposed on a disposition of Shares, including the availability of the foreign tax credit under your particular circumstances.

### ***Backup Withholding and Information Reporting***

U.S. persons may be subject to information reporting to the Internal Revenue Service with respect to dividends on and proceeds from the sale or other disposition of our ADSs or common shares. Dividend payments with respect to our ADSs or common shares and proceeds from the sale or other disposition of our ADSs or common shares are not generally subject to United States backup withholding (provided that certain certification requirements are satisfied). You are advised to consult your tax advisor regarding the application of the United States information reporting and backup withholding rules to your particular circumstances.

Individuals who are U.S. Holders, and who hold specified foreign financial assets, including stock of a non-U.S. corporation that is not held in an account maintained by a U.S. financial institution, whose aggregate value exceeds US\$50,000 during the tax year, may be required to attach to their tax returns for the year certain specified information. An individual who fails to timely furnish the required information may be subject to a penalty. Each U.S. person who is an individual is advised to consult its tax advisor regarding its reporting obligations under this legislation.

### **F. Dividends and Paying Agents**

Not applicable.

### **G. Statements by Experts**

Not applicable.

### **H. Documents on Display**

The SEC allows us to incorporate by reference the information we file with the SEC. This means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference in this annual report is considered to be part of this annual report. We therefore incorporate by reference in Item 19 of this annual report certain exhibits, which we filed with the SEC in prior filings. You may read and copy this annual report, including the exhibits incorporated by reference in this annual report, at the public reference room maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549. You can request copies of these documents upon payment of a duplicating fee, by writing to the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference rooms. Additional information may also be obtained over the Internet at the SEC's website at [www.sec.gov](http://www.sec.gov).

You may also request a copy of our SEC filings, at no cost, upon written request to our investor relations department at 8th Floor, No. 22, Lane 407, Section 2, Tiding Boulevard, Taipei 11492, Taiwan R.O.C, or by e-mail to: [Brad.Miller@Gigamedia.com](mailto:Brad.Miller@Gigamedia.com). A copy of each report submitted in accordance with applicable U.S. law is also available for public review at our principal executive offices.

As a foreign private issuer, we are exempt under the Securities Exchange Act from, among other things, the rules prescribing the furnishing and content of proxy statements, and our executive officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Securities Exchange Act. In addition, we will not be required under the Securities Exchange Act to file periodic reports and financial statements with the SEC as frequently or as promptly as U.S. companies whose securities are registered under the Securities Exchange Act.

**I. Subsidiary Information**

Not applicable.



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**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the risk of loss related to adverse changes in market prices, including interest rates and foreign exchange rates, of financial instruments. We are exposed to various types of market risks in the normal course of business, including changes in interest rates and foreign currency exchange rates.

**Foreign Currency Risk**

Our subsidiaries conduct most of their business transactions in their own measurement currencies; therefore the foreign currency risks derived from operations are not significant. However, we hold some assets or liabilities in foreign currencies other than measurement currency and the value of these assets and liabilities are subject to foreign currency risks resulting from fluctuations in exchange rates between the foreign-denominated currency and the measurement currency. We have not used hedging transactions to reduce our exposure to exchange rate fluctuations; however, we may choose to do so in the future. For more information on foreign currency translations for our financial reporting purposes, see note 1(b) to our audited consolidated financial statements beginning on page F-1 in this annual report.

As of December 31, 2014, we had bank deposits of approximately US\$6.6 million denominated in foreign currencies other than measurement currencies of the entities holding such assets. These assets are subject to foreign currency exchange risk. We recognized a realized foreign exchange loss of approximately US\$189 thousand and unrealized foreign exchange loss of approximately US\$367 thousand in the year ended December 31, 2014.

As of December 31, 2014, we had available-for-sale marketable securities and investments of US\$11.1 million which were denominated in foreign currencies other than measurement currencies of the entity holding such assets. Future fluctuation of the exchange rates could impact the periodic impairment assessment on other-than-temporary loss of these assets.

Based on the sensitivity analysis of our exposure to foreign currency exchange rate risk related our bank deposits and available-for-sale marketable securities which were denominated in a foreign currency other than functional currencies of the entities holding such assets, a hypothetical 10% change in the exchange rate between the U.S. dollar and the underlying currencies of those instruments subject to foreign currency exchange rate risk would result in a change of 2.0% in our total equity as of December 31, 2014.

**Interest Rate Risk**

Our exposure to interest rates relates primarily to our short-term loans from various banks. As of December 31, 2014, we had approximately US\$18.6 million of short-term loans, with a weighted average interest rate of approximately 1.72 %. Based on our sensitivity analysis with respect to our short-term loans, we have no significant exposure to fluctuations in interest rates. We have not entered into any interest rate swaps, caps or hedge contracts to modify our exposure to interest rate fluctuations.

We did not include a quantitative tabular disclosure regarding the foreign currency risk and the interest rate risk. As noted above, we believe that the magnitude of selected hypothetical changes to such market risks on the consolidated financial statements is not significant. However, we cannot assure you that we will not be affected by these risks in the future.

**Other Market Risks**

We are also exposed to other market risks, which are mainly derived from our investments. Changes in the stock price, performance or net asset value of the companies that we invested and investment funds might have significant impact on our financial positions or operating results.

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

**PART II**

**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

None.

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

**A. Material Modification to the Instruments Defining the Rights of Security Holders**

None.

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**B. Material Modification to the Rights of Registered Securities by Issuing or Modifying or any Other Class of Securities**

None.

**C. Withdrawal or Substitution of a Material Amount of the Assets Securing any Registered Securities**

Not applicable.

**D. Change of Trustees or Paying Agents for any Registered Securities**

None.

**E. Use of Proceeds**

Not applicable.

**ITEM 15. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

Our management, with the participation of our chief executive officer and our chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined by Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act) as of December 31, 2014. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, in designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable, rather than absolute, assurance of achieving the desired control objectives, and management was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Based upon that evaluation, and taking into account the foregoing, our chief executive officer and chief financial officer have concluded that, as of December 31, 2014, our disclosure controls and procedures were effective in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act was recorded, processed, summarized and reported on a timely basis, and these controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act was accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

**Management's Annual Report on Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined by Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States ( US GAAP ). Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with US GAAP and that receipts and expenditures are being made only in accordance with authorizations of our management and directors and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements. Also, projections of any evaluation of the effectiveness of internal control to future periods are subject to the risk that controls may become inadequate because of changes in conditions, and that the degree of compliance with the policies or procedures may deteriorate.

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Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2014. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO 2013 ) in Internal Control - Integrated Framework. Based on our assessment using those criteria, our management has concluded that our internal control over financial reporting as of December 31, 2014 was effective.

### **Attestation Report of the Independent Registered Public Accounting Firm**

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting, as we are a non-accelerated filer exempted from section 404(b) of the Sarbanes-Oxley Act.

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### **Changes in Internal Control Over Financial Reporting**

During the year ended December 31, 2014, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **ITEM 16. RESERVED**

#### **ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

Our board of directors has determined that Mr. Casey K. TUNG, an independent director and member of our audit committee, is the audit committee financial expert.

#### **ITEM 16B. CODE OF ETHICS**

We have adopted a code of ethics, as defined in Item 16B of Form 20-F. Our code of ethics applies to our chief executive officer, chief financial officer and persons performing similar functions, as well as to our directors, other officers, employees and consultants. The code of ethics was amended on December 19, 2005, May 10, 2006 and February 13, 2009 in order to conform certain provisions in it with our newly adopted anti-fraud policy. The code of ethics was also amended on April 30, 2010 to incorporate non-competition and non-solicitation provisions and on March 18, 2014 to change certain titles within our Company and update email addresses. The full text of our code of ethics is available on our website, [www.gigamedia.com](http://www.gigamedia.com). If we further amend any provisions of our code of ethics that apply to our chief executive officer, chief financial officer or persons performing similar functions, or if we grant any waiver of such provisions, we will disclose such amendment or waiver on our website at the same address. We will also provide any person without charge a copy of our code of ethics upon written request to our investor relations department at 8 th Floor, No. 22, Lane 407, Section 2, Tiding Boulevard, Taipei 114, Taiwan R.O.C., or by e-mail to: [Brad.Miller@Gigamedia.com](mailto:Brad.Miller@Gigamedia.com).

On December 19, 2005, our board of directors adopted an anti-fraud policy for the purpose of preventing fraud schemes, including fraudulent financial reporting misappropriation of assets, any fraud committed by senior management, and information technology fraud. According to our anti-fraud policy, our audit committee is responsible for monitoring the implementation of our anti-fraud policy and procedures, and an anti-fraud taskforce is assigned by our audit committee to be responsible for the anti-fraud hotline management, risk assessment, complaint investigation and resolution, and reporting to our chief executive officer, chief financial officer and audit committee.

On May 10, 2006, our audit committee adopted a whistleblower program pursuant to our anti-fraud policy. The whistleblower program enables all employees to know how and when to use the whistleblower hotline and communicate or report, on a confidential or anonymous basis, without fear of retribution, concerns related to wrongdoings or violations, and ensures that all reported incidents are properly investigated.

On April 30, 2010, our board of directors adopted a non-competition provision under which all of our employees, consultants, officers and directors may not participate, invest, license, employ or being employed, or cooperate with any company or entity engaged in a line of business which may be competitive with the business of the Company within three months after termination of their employment of the Company, except in cases where the local law or the contract states otherwise. The Company may take legal actions against such employees, consultants, officers or directors in the event that non-competition obligations are being violated. An amended non-solicitation provision was also adopted, under which all our employees, consultants, officers and directors may not, during their employment or within twelve months after termination of the employment, directly or indirectly, solicit, entice, or attempt to approach, solicit or entice any of the other employees of the Company or its affiliates to terminate the employment.

#### **ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The following table summarizes the aggregate fees billed to us by KPMG for the fiscal year ended December 31, 2014.

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<b>For the Years Ended December 31</b>	<b>2013</b>	<b>2014</b>
	<b>(in US\$)</b>	<b>(in US\$)</b>
Audit Fees	374,000	204,600
Audit-Related Fees	0	0
Tax Fees	25,000	15,400
All Other Fees	0	0

### **A. Audit Fees**

Audit fees consist of fees billed for the annual audit of our consolidated financial statements. Audit fees also include fees for services that are normally provided by the independent registered public accounting firm in connection with statutory and regulatory filings or engagements.

**Table of Contents****B. Tax Fees**

Tax fees include fees billed for tax compliance services, including the preparation of original and amended tax returns, and tax advisory services.

**C. Audit Committee Pre-Approval Policies and Procedures**

In May 2005, we adopted our audit committee charter. Consistent with the SEC's policies regarding auditor independence, our audit committee is directly responsible for the appointment, compensation, retention and oversight of the work of auditors engaged to provide us with audit, review or attest services. Our audit committee has sole discretion to review and pre-approve the appointment of auditors and to set their fees for the performance of audit and non-prohibited non-audit services in accordance with the Sarbanes-Oxley Act of 2002 and the SEC rules and regulations promulgated thereunder, subject to the appointment, replacement or removal from office of our independent public accountants as approved by our shareholders at our Annual General Meeting.

The appointment of our independent registered public accounting firm, KPMG, as well as the scope of each audit, audit-related or non-prohibited, as well as any non-audit services provided pursuant to such appointment, and our auditors' fees for all such services, were approved by our audit committee.

**ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

Not applicable.

**ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS**

On May 20, 2011, our board of directors approved an US\$11 million share repurchase program of GigaMedia's common stock. Under the terms of the share repurchase program, GigaMedia could repurchase up to US\$11 million worth of its issued and outstanding shares during the period starting from June 1, 2011 to November 30, 2011. The repurchases could be made from time to time on the open market at prevailing market prices pursuant to a Rule 10b5-1 plan, subject to restrictions relating to volume, pricing and timing. The timing and extent of any repurchases depended upon market conditions, the trading price of GigaMedia's shares and other factors. This share repurchase program was implemented in a manner consistent with market conditions, in the interests of our shareholders, and in compliance with GigaMedia's securities trading policy and relevant Singapore and U.S. laws and regulations. During 2011, repurchases under this program amounted to approximately 5.6 million shares at a cost of US\$6.0 million. All of the treasury shares under this program were cancelled by the end of 2011. We did not have any share repurchases in 2013 and 2014.

Period	Total Number of ADSs	Average Price Paid per ADS	Total Number of ADSs Purchased as Part of Publicly Announced Program	Approximate Dollar Value of
				ADSs that May Yet Be Purchased Under the Program
June 2011 (from June 1, 2011)	1,387,352	\$ 1.25	1,387,352	\$ 9,263,633
July 2011	758,274	\$ 1.26	758,274	\$ 8,306,977
August 2011	1,001,485	\$ 1.00	1,001,485	\$ 7,302,783
September 2011	1,503,829	\$ 0.90	1,503,829	\$ 5,951,085
October 2011	971,218	\$ 0.99	971,218	\$ 4,986,272
November 2011 (ended November 30, 2011)	0	\$	0	\$ 4,986,272

**ITEM 16F. CHANGES IN REGISTRANT'S CERTIFYING ACCOUNTANTS**

Not applicable.





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**ITEM 16G. CORPORATE GOVERNANCE**

**Summary of Significant Differences in Corporate Governance Practices**

Our Shares are currently listed on the NASDAQ Stock Market and, for so long as our securities continue to be listed, we will remain subject to the rules and regulations established by NASDAQ as being applicable to listed companies. Under NASDAQ Rule 5615(a)(3), a foreign private issuer such as our Company may follow its home country practice in lieu of the requirements of the NASDAQ Rule 5600 Series, with certain exceptions, provided that it discloses each requirement that it does not follow and describes the home country practice followed in lieu of such requirements. In addition, NASDAQ has amended its Rule 5615(a)(3) to permit foreign private issuers to follow certain home country corporate governance practices without the need to seek an individual exemption from NASDAQ. However, a foreign private issuer must disclose in its annual report filed with the SEC each requirement it does not follow and the alternative home country practice it does follow.

We are incorporated under the laws of Singapore. We currently comply with the specifically mandated provisions of NASDAQ Rule 5615(a)(3). We are currently exempt from the DRS eligibility provisions of NASDAQ Rule 5255(c) as we are not allowed to issue of non-certificated securities under Singapore law. See Item 9, *The Offer and Listing* in this annual report. We have elected to voluntarily comply with other requirements of NASDAQ Rule 5615(a)(3) in all material aspects, notwithstanding that our home country does not mandate compliance; although we may in the future determine to cease voluntary compliance with those provisions of NASDAQ Rule 5615(a)(3).

**ITEM 16H. MINE SAFETY DISCLOSURE**

Not applicable.

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

Not applicable.

**ITEM 18. FINANCIAL STATEMENTS**

Our consolidated financial statements and the reports thereon by our independent registered public accounting firms listed below are attached hereto as follows:

	<b>Page</b>
(a) Reports of Independent Registered Public Accounting Firms	F-1 F-2
(b) Consolidated Balance Sheets as of December 31, 2013 and 2014	F-3 F-4
(c) Consolidated Statements of Operations for the years ended December 31, 2012, 2013 and 2014	F-5
(d) Consolidated Statements of Comprehensive Loss for the years ended December 31, 2012, 2013 and 2014	F-6
(e) Consolidated Statements of Changes in Equity for the years ended December 31, 2012, 2013 and 2014	F-7
(f) Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2013 and 2014	F-8 F-9
(g) Notes to the consolidated financial statements	F-10 F-85

**Table of Contents****ITEM 19. EXHIBITS**

<b>EXHIBIT</b>	<b>INDEX</b>
1.1	Amended Memorandum and Articles of Association of our Company, incorporated by reference to Exhibit 1.1 to our annual report for the year 2013 on Form 20-F filed with the SEC on April 30, 2014
4.1	Share Purchase Agreement among Infocomm Asia Holdings Pte. Ltd., GigaMedia Asia Pacific Limited, Management Capital International Limited, and Roland Ong Toon Wah dated July 2, 2012, incorporated by reference to Exhibit 10.1 to our annual report for the year 2012 on Form 20-F filed with the SEC on April 30, 2013
4.2	Share Purchase Agreement among Infocomm Asia Holdings Pte. Ltd., GigaMedia Asia Pacific Limited, Spring Asia Limited and Roland Ong Toon Wah dated July 2, 2012, incorporated by reference to Exhibit 10.2 to our annual report for the year 2012 on Form 20-F filed with the SEC on April 30, 2013
4.3	Share Purchase Agreement between GigaMedia Capital Limited and Neowiz Corporation dated August 8, 2012, incorporated by reference to Exhibit 10.3 to our annual report for the year 2012 on Form 20-F filed with the SEC on April 30, 2013
4.4	Novation Agreement among Megabiz Limited, Blueark Global Co., Ltd, and Nickelodeon Asia Holdings Pte. Ltd. dated September 24, 2013, incorporated by reference to Exhibit 4.4 to our annual report for the year 2013 on Form 20-F filed with the SEC on April 30, 2014
4.5	Share Purchase Agreement between Hoshin GigaMedia Center Inc. and Angel Fund (Asia) Investments Limited dated October 30, 2013, incorporated by reference to Exhibit 4.5 to our annual report for the year 2013 on Form 20-F filed with the SEC on April 30, 2014
8.1*	List of Subsidiaries See Item 4, Information on the Company C. Organization Structure
11.1	Code of Ethics, as last amended by the board of directors on April 30, 2010, incorporated by reference to Exhibit 11.1 to our annual report for the year 2013 on Form 20-F filed with the SEC on April 30, 2014
12.1*	Certification by our Chief Executive Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act
12.2*	Certification by our Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act
13.1*	Certification by our Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2*	Certification by our Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
15.1*	Consent of KPMG, Independent Registered Public Accounting Firm
15.2*	Consent of GHP Horwath, P.C., Independent Registered Public Accounting Firm
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith

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**SIGNATURE**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

**GIGAMEDIA LIMITED**

By: /s/ Collin Hwang  
Collin Hwang

Chief Executive Officer

Date: April 28, 2015

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**GIGAMEDIA LIMITED AND SUBSIDIARIES**

**Index to Consolidated Financial Statements**

	Page
<u>Reports of Independent Registered Public Accounting Firms</u>	F-1
<u>Consolidated balance sheets as of December 31, 2013 and 2014</u>	F-3
<u>Consolidated statements of operations for the years ended December 31, 2012, 2013 and 2014</u>	F-5
<u>Consolidated statements of comprehensive loss for the years ended December 31, 2012, 2013 and 2014</u>	F-6
<u>Consolidated statements of changes in equity for the years ended December 31, 2012, 2013 and 2014</u>	F-7
<u>Consolidated statements of cash flows for the years ended December 31, 2012, 2013 and 2014</u>	F-8
<u>Notes to consolidated financial statements</u>	F-10

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders

GigaMedia Limited:

We have audited the accompanying consolidated balance sheets of GigaMedia Limited and subsidiaries (the Company ) as of December 31, 2013 and 2014, and the related consolidated statements of operations, comprehensive loss, changes in equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of GigaMedia Limited and subsidiaries as of December 31, 2013 and 2014, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

/S/ KPMG

Taipei, Taiwan (the Republic of China)

April 28, 2015

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders

GigaMedia Limited

We have audited the accompanying consolidated statements of operations, comprehensive loss, changes in equity and cash flows of GigaMedia Limited and subsidiaries (the Company) for the year ended December 31, 2012. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of GigaMedia Limited and subsidiaries for the year ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

/s/ GHP Horwath, P.C.

Denver, Colorado

April 30, 2013

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2013 AND 2014

(in thousands of US dollars)

	December 31	
	2013	2014
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents (Note 10)	\$ 58,801	\$ 50,640
Marketable securities - current (Note 11)	21,460	29,340
Accounts receivable - net (Note 12)	2,027	1,298
Prepaid expenses	750	564
Restricted cash (Notes 10 and 16)		8,991
Other current assets (Notes 13 and 25)	293	325
Total Current Assets	83,331	91,158
Marketable debt securities - noncurrent (Note 14)	6,048	4,744
Equity investments (Note 15)	5,822	5,781
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Land and buildings	1,211	1,141
Information and communication equipment	4,082	3,903
Office furniture and fixtures	184	176
Leasehold improvements	122	123
Other		72
	5,599	5,415
Less: Accumulated depreciation and amortization	(3,922)	(3,752)
	1,677	1,663
INTANGIBLE ASSETS - NET (Note 7)	1,461	222
<b>OTHER ASSETS</b>		
Refundable deposits	306	302
Prepaid licensing and royalty fees (Note 8)	4,666	4,383
Other (Note 19)	10	51

Total Other Assets	4,982	4,736
TOTAL ASSETS	\$ 103,321	\$ 108,304

(Continued)

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GIGAMEDIA LIMITED AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS - (Continued)

DECEMBER 31, 2013 AND 2014

(in thousands of US dollars, except share data)

	December 31	
	2013	2014
<b>LIABILITIES &amp; EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Short-term borrowings (Note 16)	\$ 4,361	\$ 18,641
Accounts payable	1,178	771
Accrued compensation	380	796
Accrued expenses (Note 17)	2,617	3,465
Deferred revenue	2,441	1,946
Other current liabilities (Note 18)	3,862	1,718
<b>Total Current Liabilities</b>	<b>14,839</b>	<b>27,337</b>
<b>OTHER LIABILITIES</b>		
Accrued pension liabilities (Note 19)	170	
Other (Notes 20 and 25)	11	1,938
<b>Total Other Liabilities</b>	<b>181</b>	<b>1,938</b>
<b>Total Liabilities</b>	<b>15,020</b>	<b>29,275</b>
<b>EQUITY (Note 22)</b>		
<b>GigaMedia Shareholders' Equity:</b>		
Common shares, no par value, and additional paid-in capital; issued and outstanding 50,723 thousand shares in 2013 and 55,262 thousand shares in 2014	305,072	308,682
Accumulated deficit	(213,021)	(218,176)
Accumulated other comprehensive loss	(3,603)	(11,487)
<b>Total GigaMedia shareholders' equity</b>	<b>88,448</b>	<b>79,019</b>
Noncontrolling interest	(147)	10
<b>Total Equity</b>	<b>88,301</b>	<b>79,029</b>

COMMITMENTS AND CONTINGENCIES (Note 27)

TOTAL LIABILITIES AND EQUITY	\$ 103,321	\$ 108,304
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The accompanying notes are an integral part of these consolidated financial statements.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(in thousands of US dollars, except for earnings per share amounts)

	2012	2013	2014
<b>OPERATING REVENUES</b>			
Asian online game and service revenues	\$ 27,470	\$ 14,106	\$ 8,199
Other revenues		926	1,580
	27,470	15,032	9,779
<b>COSTS OF REVENUES</b>			
Cost of Asian online game and service revenues	(11,388)	(6,425)	(6,010)
Cost of other revenues		(1,159)	(1,825)
	(11,388)	(7,584)	(7,835)
<b>GROSS PROFIT</b>	16,082	7,448	1,944
<b>OPERATING EXPENSES</b>			
Product development and engineering expenses	(1,471)	(1,698)	(892)
Selling and marketing expenses	(8,377)	(4,815)	(6,708)
General and administrative expenses	(13,384)	(6,324)	(6,378)
Bad debt expense (Note 12)	(169)	(37)	(37)
Impairment loss on property, plant and equipment (Note 9)			(28)
Impairment loss on goodwill (Notes 6 and 9)	(12,489)	(17,054)	
Impairment loss on intangible assets (Note 9)	(15)	(13,251)	(115)
Impairment loss on prepaid licensing and royalty fees (Notes 8 and 9)	(702)	(2,752)	(1,259)
Other	(49)	(4)	
	(36,656)	(45,935)	(15,417)
<b>LOSS FROM OPERATIONS</b>	(20,574)	(38,487)	(13,473)
<b>NON-OPERATING INCOME (EXPENSES)</b>			
Interest income	283	238	682
Gain on sales of marketable debt securities (Notes 11 and 14)	5,665	1,739	8,621
Interest expense	(247)	(49)	(243)
Foreign exchange gain (loss), net	434	45	(556)

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Equity in net earnings (losses) on equity investments- net (Note 15)	234	526	(531)
Impairment loss on marketable debt securities and investments (Note 9)	(1,193)		
Gain on sale of equity method investments (Note 5)	2,480	1,220	
Other	(7)	86	437
	7,649	3,805	8,410
<b>LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</b>	<b>(12,925)</b>	<b>(34,682)</b>	<b>(5,063)</b>
<b>INCOME TAX (EXPENSE) BENEFIT (Note 25)</b>	<b>(671)</b>	<b>(61)</b>	<b>73</b>
<b>LOSS FROM CONTINUING OPERATIONS</b>	<b>(13,596)</b>	<b>(34,743)</b>	<b>(4,990)</b>
<b>LOSS FROM DISCONTINUED OPERATIONS - NET OF TAX (Note 5)</b>	<b>(2,521)</b>	<b>(318)</b>	
<b>NET LOSS</b>	<b>(16,117)</b>	<b>(35,061)</b>	<b>(4,990)</b>
<b>LESS: NET LOSS (INCOME) ATTRIBUTABLE TO THE NONCONTROLLING INTERESTS</b>	<b>827</b>	<b>281</b>	<b>(165)</b>
<b>NET LOSS ATTRIBUTABLE TO SHAREHOLDERS OF GIGAMEDIA</b>	<b>(\$ 15,290)</b>	<b>(\$ 34,780)</b>	<b>(\$ 5,155)</b>
<b>NET LOSS ATTRIBUTABLE TO SHAREHOLDERS OF GIGAMEDIA</b>			
Loss from continuing operations - net of tax	(\$ 12,769)	(\$ 34,462)	(\$ 5,155)
Loss from discontinued operations - net of tax	(2,521)	(318)	
	(\$ 15,290)	(\$ 34,780)	(\$ 5,155)
<b>LOSS PER SHARE ATTRIBUTABLE TO GIGAMEDIA</b>			
<b>Basic:</b>			
Loss from continuing operations	(\$ 0.25)	(\$ 0.68)	(\$ 0.10)
Loss from discontinued operations	(0.05)	(0.01)	
<b>Net loss</b>	<b>(\$ 0.30)</b>	<b>(\$ 0.69)</b>	<b>(\$ 0.10)</b>
<b>Diluted:</b>			
Loss from continuing operations	(\$ 0.25)	(\$ 0.68)	(\$ 0.10)
Loss from discontinued operations	(0.05)	(0.01)	
<b>Net loss</b>	<b>(\$ 0.30)</b>	<b>(\$ 0.69)</b>	<b>(\$ 0.10)</b>
<b>WEIGHTED AVERAGE SHARES USED TO COMPUTE LOSS PER SHARE ATTRIBUTABLE TO GIGAMEDIA SHAREHOLDERS (Note 2)</b>			
<b>Basic</b>	<b>50,720</b>	<b>50,720</b>	<b>53,927</b>
<b>Diluted</b>	<b>50,720</b>	<b>50,720</b>	<b>53,927</b>

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

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GIGAMEDIA LIMITED AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS  
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014  
(in thousands of US dollars)

	2012	2013	2014
NET LOSS	(\$ 16,117)	(\$ 35,061)	(\$ 4,990)
OTHER COMPREHENSIVE INCOME (LOSS) - NET OF TAX:			
Unrealized gain (loss) on marketable debt securities	(24,004)	4,698	(7,715)
Defined benefit pension plan adjustment	(323)	15	
Foreign currency translation adjustments	1,814	57	(171)
Deconsolidation of subsidiaries	2,799		
	(\$ 19,714)	4,770	(7,886)
COMPREHENSIVE LOSS	(35,831)	(30,291)	(12,876)
COMPREHENSIVE (INCOME) LOSS ATTRIBUTABLE TO THE NONCONTROLLING INTERESTS	(2,189)	287	(163)
COMPREHENSIVE LOSS ATTRIBUTABLE TO GIGAMEDIA SHAREHOLDERS	(\$ 38,020)	(\$ 30,004)	(\$ 13,039)

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

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GIGAMEDIA LIMITED AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014  
(in thousands of US dollars and shares, except per share amounts)

	GIGAMEDIA SHAREHOLDERS					
	Common shares and additional Shares	paid-in capital Amount	Accumulated deficit (Note 22)	Accumulated other comprehensive income (loss)	Noncontrolling interest	Total
Balance as of January 1, 2012	50,720	\$ 304,672	(\$ 162,951)	14,351	(\$ 2,996)	\$ 153,076
Stock-based compensation		179				179
Reversal of cumulative dividend to subsidiary preferred shares (Note 21)					469	469
Net loss			(15,290)		(827)	(16,117)
Other comprehensive income (loss)				(22,730)	3,016	(19,714)
Balance as of December 31, 2012	50,720	304,851	(178,241)	(8,379)	(338)	117,893
Issuance of common shares from exercise of stock options and RSUs	3	2				2
Stock-based compensation		219				219
Acquisition of FingerRockz					478	478
Net loss			(34,780)		(281)	(35,061)
Other comprehensive income (loss)				4,776	(6)	4,770
Balance as of December 31, 2013	50,723	305,072	(213,021)	(3,603)	(147)	88,301
Issuance of common shares from exercise of stock options and RSUs	4,539	3,593				3,593
Stock-based compensation		17				17
Liquidation of Dragongate Enterprises Ltd.					(6)	(6)
Net income (loss)			(5,155)		165	(4,990)
Other comprehensive loss				(7,884)	(2)	(7,886)
Balance as of December 31, 2014	55,262	\$ 308,682	(\$ 218,176)	(\$ 11,487)	10	\$ 79,029

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

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GIGAMEDIA LIMITED AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014  
(in thousands of US dollars)

	2012	2013	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net loss	\$ (16,117)	(\$ 35,061)	(\$ 4,990)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	1,224	408	306
Amortization	2,204	1,907	1,211
Stock-based compensation	179	219	21
Gain on sales of equity method investments	(2,480)	(1,220)	
Impairment loss on property, plant and equipment			28
Impairment losses on goodwill	12,489	17,054	
Impairment losses on intangible assets	15	13,251	115
Impairment losses on prepaid licensing and royalty fees	702	2,752	1,259
Provision for bad debt expenses	169	37	37
Losses (gains) on disposals of property, plant and equipment	208	4	(2)
Gains on sales of marketable securities	(5,665)	(1,739)	(8,621)
Equity in net (earnings) losses on equity investments - net	(234)	(526)	531
Impairment losses on marketable securities and investments	1,193		
Other	377	(141)	(306)
Net changes in operating assets and liabilities, net of business acquisitions and divestitures:			
Accounts receivable	1,537	767	692
Prepaid expenses	755	52	186
Other current assets	(174)	708	(260)
Accounts payable	(515)	854	(407)
Accrued expenses	(59)	(2,223)	848
Accrued compensation	(831)	(853)	416
Other current liabilities	(467)	(1,017)	(711)
Accrued pension liabilities / Prepaid pension assets	110	(111)	(215)
Prepaid licensing and royalty fees	(2,397)	1,026	(976)
Other	454	(453)	
<b>Net cash used in operating activities</b>	<b>(7,323)</b>	<b>(4,305)</b>	<b>(10,838)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Decrease (increase) in restricted cash	3,694		(8,991)
Cash dividends received from investees			247
Proceeds from disposals of marketable debt securities	8,610	3,419	18,692



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Divestiture of business, net of cash transferred	(1,308)		
Purchases of property, plant and equipment	(429)	(225)	(420)
Proceeds from disposals of property, plant and equipment	76	35	2
Proceeds from disposals of businesses, net of transaction costs	1,735	3,258	
Purchases of marketable debt securities		(2,460)	(6,490)
Purchase of equity investments			(19,552)
Purchases of intangible assets	(1,679)	(1,227)	(110)
Acquisitions, net of cash acquired		73	
Decrease (increase) in refundable deposits	428	86	3
Other	(10)	(5)	(7)
Net cash provided by (used in) investing activities	11,117	2,954	(16,626)

(Continued)

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS - (Continued)

## FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(in thousands of US dollars)

	2012	2013	2014
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Net proceeds from (repayments of) short-term borrowings	(4,348)	(3,146)	15,232
Cash received from the exercise of stock options		2	3,593
Net cash provided by (used in) financing activities	(4,348)	(3,144)	18,825
Net foreign currency exchange differences on cash and cash equivalents	(712)	565	478
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(1,266)</b>	<b>(3,930)</b>	<b>(8,161)</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b>63,997</b>	<b>62,731</b>	<b>58,801</b>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>\$ 62,731</b>	<b>\$ 58,801</b>	<b>\$ 50,640</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>			
Interest paid during the year	\$ 248	\$ 53	\$ 237
Income tax paid (refunded) during the year	\$ 121	(\$ 285)	(\$ 84)

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

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GIGAMEDIA LIMITED AND SUBSIDIARIES

Notes To Consolidated Financial Statements

December 31, 2012, 2013 AND 2014

**NOTE 1. Principal Activities, Basis of Presentation, and Summary of Significant Accounting Policies**

***(a) Principal Activities***

GigaMedia Limited (referred to hereinafter as GigaMedia, our Company, we, us, or our) is a diversified provider of online and mobile games and cloud computing services, with headquarters in Taipei, Taiwan.

Our Asian online game and service business operates a suite of play-for-fun online games and provides related services, mainly targeting online and mobile game players across Asia, including Greater China and Southeast Asia.

We began developing a new cloud computing business in the second half of 2012. The cloud business aims at providing an integrated platform of services and tools for medium-to-larger enterprises in Greater China to increase flexibility, efficiency and competitiveness, as well as in bidding for government contracts in Taiwan. We launched the business in April 2013.

In July 2012 we sold a non-controlling interest we held in an online gaming software and service business to BetClic Everest Group ( BEG ). (See Note 5, *Divestitures* , for additional information.) Prior to the disposal, through our equity investment, the gaming software and service business offered software solutions for online gaming, which was licensed under a software license and support service contract.

***(b) Basis of Presentation***

The accompanying consolidated financial statements of our Company have been prepared in accordance with U.S. generally accepted accounting principles ( U.S. GAAP ).

Following the completion of the sale of 60 percent interest in our gaming software and service business in April 2010, we deconsolidated the results of the gaming software and service business and began accounting for the remaining interest under the equity method of accounting until the closing of the disposal transaction in July 2012 when we sold our remaining ownership. (See Note 5, *Divestitures* , for additional information.)

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

In June 2012, our board of directors approved a plan to liquidate and dissolve JIDI Network Technology (Shanghai) Co., Ltd. ( JIDI ), a wholly-owned subsidiary, and Shanghai JIDI Network Technology Co., Ltd. ( Shanghai JIDI ), a variable-interest entity controlled through a series of contractual arrangements. Therefore the results of these entities are reported as discontinued operations for all periods presented. (See Note 5, Divestitures , for additional information.)

*(c) Summary of significant accounting policies*

***Principles of Consolidation***

The consolidated financial statements include the accounts of GigaMedia and subsidiaries after elimination of all significant inter-company accounts and transactions. In addition, the accounts of our Company's variable-interest entities are included in the consolidated financial statements. (See Note 3, Variable-Interest Entities , for additional information.) The accounting policies for other less than majority-owned investments are described in Note 1 below within the paragraphs headed Marketable Securities and Investments .

***Foreign Currency Translation and Transactions***

Assets and liabilities denominated in non-U.S. dollars are translated to U.S. dollars at year-end exchange rates. Income and expense items are translated at weighted-average rates of exchange prevailing during the year. Cumulative translation adjustments resulting from this process are charged or credited to other comprehensive income. Gains and losses on foreign currency transactions are included in other income and expenses.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

***Use of Estimates***

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Management bases its estimates on historical experience and also on assumptions that it believes are reasonable. Management assesses these estimates on a regular basis; however, actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of property, plant and equipment; allowances for doubtful accounts; the valuation of deferred tax assets, long-lived assets, inventory, investments and share-based compensation; and accrued pension liabilities, income tax uncertainties and other contingencies.

***Revenue Recognition***

***General***

Revenues are recognized when persuasive evidence of an arrangement exists, delivery occurs and the customer takes ownership and assumes risks or services are rendered, the sales price is fixed or determinable and collectability is reasonably assured.

Sales taxes assessed by governmental authorities on our revenue transactions are presented on a net basis and therefore are excluded from revenues in our consolidated financial statements.

***Multiple-Element Arrangements***

Our Company enters into multiple-element revenue arrangements, which may include any combination of services, software, and/or products. To the extent that a deliverable in a multiple-element arrangement is subject to specific accounting guidance, whether and/or how to separate multiple deliverable arrangements into separate units of accounting (separability) and how to allocate the arrangement consideration among those separate units of accounting (allocation) for that deliverable is accounted for in accordance with such specific guidance.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

In addition to the aforementioned general policies, the following are the specific revenue recognition policies for each major category of revenue.

*Asian Online Game and Service Revenues*

Online game revenues are earned through the sale of online game points, prepaid cards, game packs, through the sublicensing of certain games to distributors and through licensing fee revenues. Virtual online game points are sold to distributors or end-users who can make the payments through credit cards, Internet ATMs or telecommunication service operators. Physical prepaid cards and game packs are sold through distributors and convenience stores. Proceeds from sales of physical cards and game packs, net of sales discounts, and online game points are deferred when received and revenue is recognized upon the actual usage of the playing time or in-game virtual items by the end-users; over the estimated useful life of virtual items; or when the sold game points expire and can no longer be used to access the online games or products in accordance with our published game points expiration policy. Sublicensing revenues from the distributors are recognized based on end-users' activation to the game system and when the performance obligations have been completed. Licensing fee revenues are recognized when the delivery of licensed products has occurred and the fee is fixed or determinable.

Sales of virtual online game points and licensing fee revenues are reported on a gross basis. In the sales of virtual online game points and game licenses, we act as principal and we have latitude in establishing price. Fixed percentage fees retained by service providers for payment processing related to our online game services are recognized as cost of online game revenues. We report sublicensing revenues on a net basis. In the sublicense agreements, we act as agent and the distributors are responsible for the operating and the marketing.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Online game and service revenues also include revenues derived from online advertising arrangements, sponsorship arrangements, or a combination of both. These service arrangements allow advertisers to place advertisements on particular areas of our Company's websites and online game platforms over a stated period of time. Service revenues from online advertising arrangements are recognized ratably over the period of the contract when the collectability is reasonably assured.

**Cloud Product and Service Revenues**

Cloud service revenues are related to cloud computing services provided by our Company. Revenues are recorded net of discounts. Cloud service revenues are recognized upon acceptance for project services provided, or for the period of time for which we provide services to the customer. Customers of subscriptions have a choice of paying either monthly or in advance for a certain period of time, for which they receive corresponding discounts. Our Company records any such advanced payment receipts as other current liabilities and amortizes such revenues over the subscription period.

Revenues from the sales of equipment and other related products are recognized upon acceptance.

***Deferred Revenues***

Deferred revenues consist mainly of the prepaid income related to our Asian online game and service business. Deferred revenue represents proceeds received relating to the sale of game points and in-game items which are activated or charged to the respective player game account by players, but which have not been consumed by the players or expired. Deferred revenue is credited to profit or loss when the game points and in-game items are consumed or expired. Pursuant to relevant new requirements in Taiwan, cash totaling \$1.5 million as of December 31, 2014, has been deposited in an escrow account in a bank as a performance bond for the players' game points, and is included within restricted cash in the consolidated balance sheets.

***Prepaid Licensing and Royalty Fees***

Our Company, through our subsidiaries, routinely enters into agreements with licensors to acquire licenses for using, marketing, distributing, selling and publishing multi-player online games.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Prepaid licensing fees paid to licensors are amortized on a straight-line basis over the shorter of the estimated useful economic life of the relevant online game or license period, which is usually within two to five years. The annual amortization is modified if the amount computed on the ratio of current gross revenues for a game license over the total of current and anticipated future gross revenues for that game license is greater than the amount computed using the straight-line method.

Prepaid royalty fees and related costs are initially deferred when paid to licensors and amortized as operating costs based on certain percentage of revenues generated by the licensee from operating the related online game in the specific country or region over the contract period.

***Fair Value Measurements***

Our Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. We determine fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.

Level 2 Inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.



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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Our Company generally determines or calculates the fair value of financial instruments using quoted market prices in active markets when such information is available; otherwise we apply appropriate present value or other valuation techniques, such as discounted cash flow analyses, incorporating adjusted available market discount rate information and our Company's estimates for non-performance and liquidity risk. These techniques rely extensively on the use of a number of assumptions, including the discount rate, credit spreads, and estimates of future cash flows. (See Note 9, Fair Value Measurements, for additional information.)

***Cash Equivalents***

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and so near to their maturity that they present relatively insignificant risk from changes in interest rates. Commercial paper, negotiable certificates of deposit, time deposits and bank acceptances with original maturities of three months or less are considered to be cash equivalents. Pledged time deposits are excluded from cash and cash equivalents for purposes of the consolidated statements of cash flows.

***Marketable Securities***

Our Company's investments in marketable securities are classified either as available-for-sale or trading. For the marketable securities classified as available-for-sale, the investments are stated at fair value with any unrealized gains or losses reported in accumulated other comprehensive income (loss) within equity until realized. For the marketable security classified as trading, we recognize the changes of the fair value of the investment in our consolidated statements of operations.

Other-than-temporary impairments, if any, are charged to non-operating expense in the period in which the loss occurs. In determining whether an other-than-temporary impairment has occurred, our Company primarily considers, among other factors, the length of the time and the extent to which the fair value of an investment has been at a value less than cost. When an other-than-temporary loss is recognized, the fair value of the investment becomes the new cost basis of the investment and is not adjusted for subsequent recoveries in fair value. Realized gains and losses also are included in non-operating income and expense in the consolidated statements of operations. (See Note 9, Fair Value Measurements, for additional information.)

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

***Investments***

Equity investments in non-publicly traded securities of companies over which our Company has no ability to exercise significant influence are accounted for under the cost method.

For equity investments accounted for as available-for-sale or trading, cash dividends are recognized as investment income. Stock dividends are recognized as an increase in the number of shares held and do not affect investment income. The cost per share is recalculated based on the new total number of shares.

For equity investments accounted under equity method, stock dividends received from investees as a result of appropriation of net earnings and additional paid-in capital are recognized as an increase in the number of shares held and do not affect investment income. The cost per share is recalculated based on the weighted-average method. Cash dividends are accounted for as a reduction to the carrying value of the investment.

Equity investments in companies over which our Company has the ability to exercise significant influence but does not hold a controlling financial interest are accounted for under the equity method. We recognize our share of the earnings or losses of the investee. Under the equity method, the difference between the cost of the acquisition and our Company's share of the fair value of the net identifiable assets is recognized as goodwill and is included in the carrying amount of the investment. When our Company's carrying value in an equity method investee is reduced to zero, no further losses are recorded in our consolidated financial statements unless our Company guaranteed obligations of the investee or has committed to additional funding. When the investee subsequently reports income, our Company will not record its share of such income until it equals the amount of its share of losses not previously recognized.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Unrealized losses that are considered other-than-temporary, if any, are charged to non-operating expenses. Realized gains and losses, measured against carrying amount, are also included in non-operating income and expenses. (See Note 9, Fair Value Measurements , for additional information.)

***Receivables***

Accounts receivable are recorded at the invoiced amount and do not bear interest. Amounts collected on accounts receivable are included in net cash provided by operating activities in the consolidated statements of cash flows. Our Company maintains an allowance for doubtful accounts for estimated losses inherent in its accounts receivable portfolio. In establishing the required allowance, management considers historical losses adjusted to take into account current market conditions and our customers' financial condition, the amount of receivables in dispute, and the current receivables aging and current payment patterns. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

***Property, Plant and Equipment***

Property, plant and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is recorded on a straight-line basis over useful lives that correspond to categories as follows:

Categories	Years
Buildings	50
Information and communication equipment	2 to 5
Office furniture and equipment	3 to 5
Leasehold improvements	3 to 5

Leasehold improvements are amortized over the shorter of the term of the lease or the economic useful life of the assets. Improvements and replacements are capitalized and depreciated over their estimated useful lives, while ordinary repairs and maintenance are expensed as incurred.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

We have entered into agreements to lease certain of our Company's land and buildings to a third party under operating leases, which were renewed in September and October 2013, and which expire no later than September 2016. As of December 31, 2013 and 2014, the carrying amount of the land and buildings under lease was \$1.2 million and \$1.1 million, respectively. The rental income under the operating lease amounted to \$74 thousand, \$74 thousand and \$73 thousand for 2012, 2013 and 2014, respectively. The minimum rental income to be received under this operating lease is \$124 thousand through September 2016.

***Business Acquisitions***

Our Company accounts for its business acquisitions using the acquisition method. Under this method, our Company recognizes and measures the identifiable assets acquired, the liabilities assumed and any noncontrolling interest at their acquisition-date fair values, with limited exceptions. Acquisition-related costs are generally expensed as incurred.

***Intangible Assets and Goodwill***

Intangible assets with finite lives are amortized by the straight-line method over their estimated useful lives, ranging from half a year to nine years. Intangible assets with indefinite useful lives are not amortized. Goodwill is not amortized.

***Impairment of Intangible Assets, Goodwill and Long-Lived Assets***

Goodwill is reviewed for impairment annually or sooner when circumstances indicate an impairment may exist, using a fair-value approach at the reporting unit level. A reporting unit is the operating segment, or a business, which is one level below that operating segment (the component level) if discrete financial information is prepared and regularly reviewed by management at the segment level. Components are aggregated as a single reporting unit if they have similar economic characteristics. In connection with our goodwill impairment test, we first assess qualitative factors as a basis for determining whether it is necessary to perform the two-step goodwill impairment test.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

If the two-step goodwill impairment test is required, first, the fair value of the reporting unit is compared with its carrying amount (including goodwill). If the fair value of the reporting unit is less than its carrying amount, an indication of goodwill impairment exists for the reporting unit and the entity must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying amount, step two does not need to be performed.

Intangible assets with indefinite useful lives are tested for impairment at the reporting unit level, at least annually, or whenever events or changes in circumstances indicate that the carrying value of an asset might not be recoverable from its related future discounted cash flows. Impairment is measured as the difference between the carrying amounts and the fair value of the assets, and is recognized as a loss from operations. In connection with our impairment test for the intangible assets with indefinite useful lives, we first assess qualitative factors as a basis for determining whether it is necessary to perform the quantitative impairment test.

Long-lived assets other than goodwill and intangible assets not being amortized are reviewed for impairment at least annually or whenever events or changes in circumstances indicate that the carrying value of an asset might not be recoverable from its related future undiscounted cash flows. If such assets are considered to be impaired, the impairment to be recognized is measured by the extent to which the carrying amount of the assets exceeds the fair value of the assets. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary. When impairment is identified, the carrying amount of the asset is reduced to its estimated fair value, and is recognized as a loss from operations.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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(See Note 9, Fair Value Measurements , for additional information.)

***Software Cost***

Costs to develop our Asian online game products are capitalized after technological feasibility has been established, and when the product is available for general release to customers, costs are expensed. Costs incurred prior to the establishment of technological feasibility are expensed when incurred and are included in product development and engineering expenses. Capitalized amounts are amortized using the straight-line method, which is applied over the estimated useful economic life of the software, ranging from half a year to three years. The annual amortization is modified if the amount computed using the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product is greater than the amount computed using the straight-line method.

We capitalize certain costs incurred to purchase or to internally create and implement internal-use computer software, which includes software coding, installation, testing and certain data conversion. These capitalized costs are amortized on a straight-line basis over the shorter of the useful economic life of the software or its contractual license period, which is typically three years.

***Product Development and Engineering***

Product development and engineering expenses primarily consist of research compensation, depreciation and amortization, and are expensed as incurred.

***Advertising***

Direct-response advertising costs incurred in relation to the acquisition or origination of a customer relationship are capitalized and deferred. The deferred costs are recognized as expense in the consolidated statements of operations over the estimated lives of customer relationships. Costs of broadcast advertising are recorded as expenses as advertising airtime is used. Other advertising expenditures are expensed as incurred.

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Advertising expenses incurred in 2012, 2013 and 2014 totaled \$3.2 million, \$676 thousand and \$888 thousand, respectively. As of December 31, 2013 and 2014, prepaid advertising amounted to \$1 thousand and \$12 thousand, respectively.

***Leases***

Leases for which substantially all of the risks and rewards of ownership remain with the leasing company are accounted for as operating leases. Payments made under operating leases, net of any incentives received by our Company from the leasing company, are charged to the consolidated statements of operations on a straight-line basis over the lease periods.

Leases are classified as capital leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. Assets held under capital leases are recognized as assets of our Company at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a lease obligation. Lease payments are apportioned between finance charges and a reduction of the lease obligation in order to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to profit or loss.

***Share-Based Compensation***

Share-based compensation represents the cost related to share-based awards granted to employees. We measure share-based compensation cost at the grant date, based on the estimated fair value of the award. Share-based compensation is recognized for the portion of the award that is ultimately expected to vest, and the cost is amortized on a straight-line basis (net of estimated forfeitures) over the vesting period. Our Company estimates the fair value of stock options using the Black-Scholes valuation model. The cost is recorded in operating costs and operating expenses in the consolidated statements of operations based on the employees' respective function.

For shares and stock options granted to non-employees, we measure the fair value of the equity instruments granted at the earlier of the performance commitment date or when the performance is completed.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

***Retirement Plan and Net Periodic Pension Cost***

Under our defined benefit pension plan, net periodic pension cost, which includes service cost, interest cost, expected return on plan assets, amortization of unrecognized net transition obligation and gains or losses on plan assets, is recognized based on an actuarial valuation report. We recognize the funded status of pension plans and non-pension post-retirement benefit plans (retirement-related benefit plans) as an asset or a liability in the consolidated balance sheets.

Under our defined contribution pension plans, net periodic pension cost is recognized as incurred.

***Income Taxes***

The asset and liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on the differences between financial reporting and tax bases of assets and liabilities. We recognize the investment tax credit associated with the purchase of intangible assets and technology, research and development expenditures, employee compensation and certain equity investments using the flow-through method. Deferred tax assets and liabilities are measured using the enacted tax rate and laws that will be in effect when the related temporary differences are expected to reverse. A valuation allowance is established when necessary to reduce deferred tax assets to the amount that will more-likely-than-not be realized. In assessing the likelihood of realization, management considers estimates of future taxable income.

In addition, we recognize the financial statement impact of a tax position when it is more-likely-than-not that the position will be sustained upon examination. If the tax position meets the more-likely-than-not recognition threshold, the tax effect is measured at the largest amount that is greater than a 50 percent likely of being realized upon settlement. Interest and penalties on an underpayment of income taxes are reflected as income tax expense in the consolidated financial statements.



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GIGAMEDIA LIMITED AND SUBSIDIARIES

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***Earnings (Loss) Per Share***

Basic earnings (loss) per share is computed by dividing the net income (loss) attributable to common shareholders for the period by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares and potential common shares outstanding during the period. Potential common shares, composed of incremental common shares issuable upon the exercise of warrants and options in all periods, are included in the computation of diluted earnings (loss) per share to the extent such shares are dilutive. Diluted earnings (loss) per share also takes into consideration the effect of dilutive securities issued by subsidiaries. In a period in which a loss is incurred, only the weighted average number of common shares issued and outstanding is used to compute the diluted loss per share, as the inclusion of potential common shares would be anti-dilutive. Therefore, for the years ended December 31, 2012, 2013 and 2014, basic and diluted loss per share are the same.

***Noncontrolling Interest***

Noncontrolling interest in the equity of a subsidiary is accounted for and reported as equity. Changes in our Company's ownership interest in a subsidiary that do not result in deconsolidation are accounted for as equity transactions. Any retained noncontrolling equity investment upon the deconsolidation of a subsidiary is initially measured at fair value.

***Segment Reporting***

We use the management approach in determining reportable operating segments. The management approach considers the internal organization and reporting used by our Company's chief operating decision maker for making operating decisions, allocating resources and assessing performance as the source for determining our operating segments. Our Company's chief operating decision maker ( CODM ) has been identified as the Chief Executive Officer.

Segment profit and loss is determined on a basis that is consistent with how our Company reports operating income (loss) in its consolidated statements of operations. Our Company does not report segment asset information to the CODM. Consequently, no asset information by segment is presented. There are no intersegment transactions.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

***Discontinued Operations***

Discontinued operations are reported when a component of an entity either has been disposed of, or is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations, (b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations or (c) is a subsidiary acquired exclusively with a view to resale. Discontinued operations are presented separately in the accompanying consolidated statements of operations and prior period financial statements are revised to present discontinued operations retrospectively.

***(d) Recent Accounting Pronouncements Not Yet Adopted***

The FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, in May 2014. ASU 2014-09 requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity should also disclose sufficient quantitative and qualitative information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new standard is effective for annual reporting periods beginning after December 15, 2016. Our Company will implement the provisions of ASU 2014-09 as of January 1, 2017. We have yet to determine the impact of the new standard on our current policies for revenue recognition.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 2. LOSS PER SHARE**

The following table provides a reconciliation of the denominators of the basic and diluted per share computations:

(in thousand shares)	2012	2013	2014
<b>Weighted average number of outstanding shares</b>			
Basic	50,720	50,720	53,927
Effect of dilutive securities			
Employee share-based compensation			
<b>Diluted</b>	<b>50,720</b>	<b>50,720</b>	<b>53,927</b>

Options to purchase 1,444 thousand, 1,149 thousand and 683 thousand shares of common stock were not included in dilutive securities for the years ended December 31, 2012, 2013 and 2014, respectively, as the effect would be anti-dilutive.

**NOTE 3. VARIABLE-INTEREST ENTITIES****Shanghai JIDI**

In order to comply with foreign ownership restrictions and to hold the necessary licenses required, through June 2012 we had operated our Asian online game and service business in the People's Republic of China ( PRC ) through our VIE, Shanghai JIDI. We had no ownership interest in Shanghai JIDI and relied on a series of contractual arrangements that were intended to give us effective control over Shanghai JIDI. Those contractual arrangements were duly executed and the share pledge agreements were registered with local government authority in compliance with PRC legal requirements. Therefore, we effectively controlled Shanghai JIDI, and were the primary beneficiary of Shanghai JIDI. Shanghai JIDI held an Internet Content Provider ( ICP ) license, an Internet cultural operation license and an Internet publishing license. In June 2012, our board of directors approved a plan to dispose of Shanghai JIDI. As a result, Shanghai JIDI's operations have been accounted for as discontinued operations. (See Note 5, "Divestitures", for additional information.) In May 2013, we were notified by the competent authority that Shanghai JIDI had completed the dissolution procedures and was duly deregistered.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

For the year ended December 31, 2012, and the period from January to May 2013, total revenues and net loss of Shanghai JIDI (which are included within discontinued operations) were as follows:

(in US\$ thousands)	2012	2013
Total revenues	\$ 100	\$
Net loss	\$ (888)	\$

**NOTE 4. ACQUISITIONS****FingerRockz**

On October 18, 2013, we subscribed in cash to 405 thousand new common shares of FingerRockz Co., Ltd. ( FingerRockz ), which represents a controlling financial interest of 51.6 percent of the ownership; thereupon we began consolidating FingerRockz. FingerRockz is a mobile game developer and publisher in Taiwan, and we acquired it purposely to enhance our research and development capabilities for mobile games. This primary factor among others, contributed to a purchase price in excess of the fair value of the net identifiable assets acquired and liabilities assumed, and intangible assets. In the acquisition, the most appealing asset to our Company was FingerRockz's creative team. Because the assembled workforce was not an identifiable asset to be recognized separately from goodwill, the value attributed to it was subsumed into goodwill. The goodwill related to this acquisition is not expected to be deductible for tax purpose.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

The following table summarizes the consideration paid for the acquisition and the amounts of estimated fair value of the assets acquired and liabilities assumed at the acquisition date.

(In US\$ thousands)	Amount
<b>Consideration and noncontrolling interest:</b>	
The consideration transferred	\$ 510
The fair value of noncontrolling interest in FingerRockz	478
	\$ 988
<b>Identifiable assets acquired and liabilities assumed:</b>	
Cash, receivables and other current assets	\$ 585
Customer contracts	67
Payables and other current liabilities	(160)
<b>Net</b>	<b>492</b>
Goodwill	496
	\$ 988

The following unaudited pro forma results of operations for the years ended December 31, 2012 and 2013 are presented as if the acquisition had been consummated on January 20, 2012, the inception of FingerRockz:

(in US\$ thousands, except for loss per share)	For the years ended December 31 (unaudited)	
	2012	2013
Net revenues	\$ 27,477	\$ 15,040
Net loss attributable to GigaMedia shareholders	\$ (15,334)	\$ (34,845)
Basic and diluted loss per share	\$ (0.30)	\$ (0.69)

The above unaudited pro forma information does not reflect any incremental direct costs, including any restructuring charges to be recorded in connection with the acquisition, or any potential cost savings that may result from the

consolidation of certain operations of our Company or FingerRockz. Accordingly, the unaudited pro forma financial information above not necessarily indicative the actual results that would have occurred had the acquisition of FingerRockz been combined during the periods presented, nor it necessarily indicative of future consolidated results of operations.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 5. DIVESTITURES**IAHGames

In July 2012, we entered into agreements to sell a 60 percent ownership in IAHGames, together with the sale of a 100 percent ownership in Spring Asia Limited ( Spring Asia ), which has a 30 percent interest in Game First International Corporation ( GFI ), to IAHGames management and Management Capital International Limited ( MCIL ), a British Virgin Islands company owned by IAHGames management. We retained a 20 percent ownership in IAHGames. Upon the closing of the agreements, we deconsolidated the results of IAHGames operations and began accounting for our remaining 20 percent interest under the equity method.

Our Company accounted for the deconsolidation of and the retained noncontrolling investment in IAHGames in August 2012 at fair value.

In consideration for the sale of IAHGames and Spring Asia, we were to receive \$3 million in cash. The consideration was to be collected in four equal installments, with the first due upon closing, the second due in October 2012, the third due in January 2013 and the fourth due in April 2013. The payments were collateralized by the shares of Spring Asia and were only released from the escrow in proportion to the payment made upon each installment. The first installment of \$750 thousand was received upon the closing on August 15, 2012. However, the buyer had defaulted on the remaining three installments. Considering the uncertainty as to the collectability of the remaining three installments, we had deferred the disposal gain of \$211 thousand against the consideration installments receivable of \$2,250 thousand as of December 31, 2012. The deferred gain was determined as follows:

(In US\$ thousand)	Amount
The fair value of consideration received and receivable, net of any transaction costs, plus	\$ 3,000
The fair value of the 20% retained noncontrolling investment in IAH at the date of deconsolidation	
	3,000
The carrying amount (credit balance) of IAHGames at the date of deconsolidation	(14,536)
Net receivables due to GigaMedia from IAHGames waived upon the closing of the sale	17,542
Other comprehensive income component of equity related to IAHGames at the date of the deconsolidation	(217)

	2,789
Deferred gain on deconsolidation of IAHGames	\$ 211

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

On April 17, 2013, we entered into a settlement agreement with IAHGames, IAHGames management, and MCIL. Pursuant to the settlement agreement, either IAHGames or IAHGames management was to pay us \$2,258 thousand, which included interest, to fulfill IAHGames obligation under the aforementioned sale of ownership in Spring Asia. In addition, MCIL was to purchase all of our remaining shares in IAHGames for a consideration of \$1,000 thousand. The payments were received in May 2013. Upon the receipt of these payments, the above deferred gain and disposal gain for the remaining shares which totaled approximately \$1.2 million, was recognized as non-operating income.

JIDI Network Technology (Shanghai) Co., Ltd. ( JIDI )

In June 2012, our board of directors approved a plan to liquidate and dissolve JIDI, a wholly-owned subsidiary, and Shanghai JIDI, a VIE controlled through a series of contractual arrangements.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Results for JIDI and Shanghai JIDI operations are reported as discontinued operations for all periods presented. The carrying amounts of the remaining assets and liabilities, if any, of JIDI and Shanghai JIDI were not significant to our consolidated financial statements as of December 31, 2013, and we recognized a loss of \$588 thousand in connection with the disposal of property, plant and equipment, which was included within discontinued operations in 2012. The process of liquidation and dissolution was completed by the end of 2013. Summarized financial information for discontinued operations of JIDI and Shanghai JIDI are as follows:

(in US\$ thousands)	2012	2013
Revenue	\$ 100	\$
Loss from discontinued operations before tax	\$ (2,521)	\$ (318)
Income tax expense		
Loss from discontinued operations	\$ (2,521)	\$ (318)

Non-controlling Interest in Gaming software and service business

We held a non-controlling equity interest in a gaming software and service business through July 2012, when we entered into another agreement with BEG to sell our non-controlling ownership interest, along with a shareholder loan, for consideration of \$1.7 million. Of this consideration, \$985 thousand was paid to us in cash, while the remainder related to the extinguishment of a 2009 tax liability. The closing of the sale occurred in August 2012. The sale resulted in the recognition of a gain of approximately \$2.5 million, net of transaction costs, which was recorded as non-operating income.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 6. GOODWILL**

The following table summarizes the changes to our Company's goodwill:

(In US\$ thousands)	2012	2013
Balance at beginning of year	\$ 28,437	\$ 16,934
Acquisition - FingerRockz (Note 4)		496
Impairment charge - FunTown and FingerRockz (Note 9)	(12,489)	(17,054)
Translation adjustment	986	(376)
Balance at end of year	\$ 16,934	\$

By the acquisition of FingerRockz in 2013, we obtained its mobile platform development experience which now constitutes an important complement to FunTown's R&D capacity in mobile games. We reassigned its role and developed our estimates of future cash flows from mobile games accordingly. Therefore, for the purpose of testing goodwill for impairment, we determined FingerRockz to be an integral part of FunTown with respect to determining reporting unit, and goodwill arising from the acquisition of FingerRockz was reassigned to FunTown.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 7. INTANGIBLE ASSETS - NET**

The following table summarizes our Company's intangible assets, by major asset class:

(In US\$ thousands)	December 31, 2014		
	Gross carrying amount	Accumulated amortization	Net
<b><u>With finite-life intangible assets</u></b>			
Capitalized software development cost	\$ 2,503	\$ 2,300	\$ 203
Customer relationships	5,757	5,757	
Other	71	52	19
	\$ 8,331	\$ 8,109	\$ 222

(In US\$ thousands)	December 31, 2013		
	Gross carrying amount	Accumulated amortization	Net
<b><u>With finite-life intangible assets</u></b>			
Completed technology	\$ 2,536	\$ 2,536	\$
Capitalized software development cost	3,130	2,471	659
Customer relationships	6,112	5,433	679
Other	141	18	123
	\$ 11,919	\$ 10,458	\$ 1,461

Intangible assets with finite lives are amortized over their estimated useful lives ranging from 0.5 to 9 years, with the overall weighted-average life of 5.5 years.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

For the years ended December 31, 2012, 2013 and 2014, total amortization expense of intangible assets were \$2.2 million, \$1.9 million and \$1.2 million, respectively, which includes amortization of capitalized software development costs of \$1.1 million, \$1.2 million and \$494 thousand. As of December 31, 2014, based on the current amount of intangibles subject to amortization, the estimated amortization expense for each of the following years is as follows:

(In US\$ thousands)	Amount
2015	\$ 132
2016	66
2017	24
	\$ 222

**NOTE 8. PREPAID LICENSING AND ROYALTY FEES**

The following table summarizes changes to our Company's prepaid licensing and royalty fees:

(in US\$ thousands)	2012	2013	2014
Balance at beginning of year	\$ 7,103	\$ 8,644	\$ 4,666
Addition	5,848	14	1,498
Amortization and usage	(3,671)	(706)	(264)
Exchange difference	218	(216)	(258)
Deconsolidation - IAHGames	(152)		
Impairment charges (Note 9)	(702)	(3,070)	(1,259)
Balance at end of year	\$ 8,644	\$ 4,666	\$ 4,383

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 9. FAIR VALUE MEASUREMENTS**

The following table presents the carrying amounts and estimated fair values of our Company's financial instruments at December 31, 2013 and 2014.

(in US\$ thousands)	2013		2014	
	Carrying amount	Fair value	Carrying amount	Fair value
<b><u>Financial assets</u></b>				
Cash and cash equivalents	\$ 58,801	\$ 58,801	\$ 50,640	\$ 50,640
Marketable securities - current	21,460	21,460	29,340	29,340
Accounts receivable	2,027	2,027	1,298	1,298
Restricted cash			8,991	8,991
Marketable debt securities - noncurrent	6,048	6,048	4,744	4,744
Refundable deposits	306	306	302	302
<b><u>Financial liabilities</u></b>				
Short-term borrowings	4,361	4,361	18,641	18,641
Accounts payable	1,178	1,178	771	771
Accrued compensation	380	380	796	796
Accrued expenses	2,617	2,617	3,465	3,465

The carrying amounts shown in the table are included in the consolidated balance sheets under the indicated captions.

The fair values of the financial instruments shown in the above table as of December 31, 2013 and 2014 represent the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an arm's length transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. In situations where there is little market activity for the asset or liability at the measurement date, the fair value measurement reflects our Company's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by us based on the best information available in the circumstances, including expected cash flows and appropriately risk-adjusted discount rates, available observable and unobservable inputs.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

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

Cash and cash equivalents, accounts receivable, restricted cash, accounts payable, accrued compensation and expenses, and short-term borrowings: The carrying amounts, at face value or cost plus accrued interest, approximate fair value because of the short maturity of these instruments.

Marketable securities: Open-end fund, debt and equity securities are measured using quoted market prices at the reporting date multiplied by the quantity held. Redeemable preferred shares are measured using valuation techniques.

Refundable deposits: Measurement of refundable deposits with no fixed maturities is based on carrying amounts.

**Significant Unobservable Inputs**

The table below presents the ranges of significant unobservable inputs used to value our Company's level 3 financial instruments. These ranges represent the significant unobservable inputs that were used in the valuation of each type of financial instrument. These inputs are not representative of the inputs that could have been used in the valuation of any one financial instrument. Accordingly, the ranges of inputs presented below do not represent uncertainty in, or possible ranges of, fair value measurements of our level 3 financial instruments.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

	<b>Significant Unobservable Inputs by</b>	<b>Range of Significant Unobservable Inputs as of December</b>
<b>Level 3 Financial Instruments</b>	<b>Valuation Technique</b>	<b>2014</b>
Debt securities Preferred shares with redemption rights	Price/Sales per share ratio for selective comparable companies	2.0 times ~ 14.0 times
	Discount for lack of marketability	25%
		<b>Range of Significant Unobservable Inputs as of December</b>
<b>Level 3 Financial Instruments</b>	<b>Valuation Technique</b>	<b>2013</b>
Debt securities Preferred shares with redemption rights	Price/Sales per share ratio for selective comparable companies	2.5 times ~ 5.9 times
	Discount for lack of marketability	25%

**Assets and Liabilities that are Measured at Fair Value on a Recurring Basis**

Our Company has segregated all financial assets and liabilities that are measured at fair value on a recurring basis (at least annually) into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date in the table below.



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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Assets and liabilities measured at fair value on a recurring basis are summarized as below:

(in US\$ thousands)	Fair Value Measurement Using			Year Ended December 31, 2014
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Cash equivalents - time deposits	\$	\$ 12,112	\$	\$ 12,112
Restricted cash - time deposits		8,991		8,991
Marketable securities - current				
Open-end fund	318			318
Equity securities	29,022			29,022
Marketable securities - noncurrent				
Debt securities			4,744	4,744
	\$ 29,340	\$ 21,103	\$ 4,744	\$ 55,187

(in US\$ thousands)	Fair Value Measurement Using			Year Ended December 31, 2013
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Cash equivalents - time deposits	\$	\$ 14,638	\$	\$ 14,638
Marketable securities - current				
Open-end fund	336			336
Equity securities	21,124			21,124
Marketable securities - noncurrent				
Debt securities		2,109	3,939	6,048
	\$ 21,460	\$ 16,747	\$ 3,939	\$ 42,146

Our Company's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of Level 1 for the years ended December 31, 2013 and 2014.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Level 1 and 2 measurements:

Cash equivalents time deposits and restricted cash time deposits are convertible into a known amount of cash and are subject to an insignificant risk of change in value. Certain marketable securities are valued using a market approach based on the quoted market prices of identical instruments when available, or other observable inputs such as trading prices of identical instruments in inactive markets. The fair values of the marketable equity securities that have publicly quoted trading prices are valued using those observable prices, unless adjustments are required to available observable inputs.

In 2012, 2013 and 2014, we recognized unrealized gains (losses) of (\$24.0) million, \$4.7 million and \$101 thousand, respectively, on marketable securities valued using market observable inputs, which are included in other comprehensive income.

Level 3 measurements:

For assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2013 and 2014, a reconciliation of the beginning and ending balances are presented as follows:

(in US\$ thousands)	Marketable Securities - Debt and Equity Securities	
	2013	2014
Balance at beginning of year	\$ 4,292	\$ 3,939
Total gains or (losses) (realized/unrealized) included in earnings	985	
included in other comprehensive income	1,212	805
Sale	(2,550)	
Balance at end of year	\$ 3,939	\$ 4,744
The amount of total gains or (losses) for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at the reporting date.	\$	\$

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Realized and unrealized gains (or losses) included in the consolidated financial statements for 2012, 2013 and 2014 for assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) are reported in the consolidated financial statements as follows:

(in US\$ thousands)	Gain on sales of marketable securities	Impairment loss on marketable securities and investments
Total gains (losses) included in earnings		
for 2012	\$ 3,370	\$ (493)
for 2013	985	
for 2014		
Change in unrealized gains (losses) relating to assets still held at the reporting date		
for 2012	\$	\$ (493)
for 2013		
for 2014		

The fair values of the marketable debt and equity securities are derived using a discounted cash flow method with unobservable inputs or adopting a market approach using observable inputs of guideline public companies that market participants would use in pricing the securities. The discounted cash flow method incorporates adjusted available market discount rate information and our Company's estimates of liquidity risk, and other cash flow model related assumptions.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

In 2012, 2013 and 2014, we recognized other-than-temporary impairments of \$493 thousand, \$0 and \$0, respectively, related to marketable debt and equity securities, which is included in non-operating expenses within impairment loss on marketable securities and investments in the consolidated statements of operations.

The unrealized gain recognized in our consolidated statement of operations due to the difference between fair value of the equity investment at December 31, 2014 and its acquisition cost in June 2014 was \$75 thousand.

**Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis**

Assets and liabilities measured at fair value on a nonrecurring basis include measuring impairment when required for long-lived assets. For GigaMedia, long-lived assets measured at fair value on a nonrecurring basis include investments accounted for under the equity method and cost method, property, plant, and equipment, intangible assets, prepaid licensing and royalty fees, and goodwill.

Assets and liabilities measured at fair value on a nonrecurring basis that were determined to be impaired as of December 31, 2013 and 2014 are summarized as below:

(in US\$ thousands)	Fair Value measurement Using			Year Ended December 31, 2014	Total Impairment Losses
	Level 1	Level 2	Level 3		
Assets					
(a) Property, plant and equipment - Information and communication equipment	\$	\$	\$	\$	\$ 28
(c) Intangible assets - Capitalized software cost					115
(d) Prepaid licensing and royalty fees			3,033	3,033	1,259
Total	\$	\$	\$ 3,033	\$ 3,033	\$ 1,402

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(in US\$ thousands)	Fair Value measurement Using			Year Ended December 31, 2013	Total Impairment Losses
	Level 1	Level 2	Level 3		
Assets					
(b) Goodwill - Resulting from acquisition of FunTown and FingerRockz	\$	\$	\$	\$	\$ 17,054
(c) Intangible assets - Trade name and Capitalized software cost					13,251
(d) Prepaid licensing and royalty fees					2,752
Total	\$	\$	\$	\$	\$ 33,057

(a) Impairment losses on certain property, plant, and equipment which were determined to be impaired: In 2014, we recognized an impairment loss of \$28 thousand against our information and communication equipment. The impairment charges are included in operating expenses within impairment losses on property, plant and equipment in the consolidated statements of operations. The impairment charge for the equipment was related to servers used for certain product and service lines within our cloud product and service business for which the carrying amount was determined not to be recoverable from its related future undiscounted cash flows. This equipment was valued using unobservable inputs such as discounted cash flows, incorporating adjusted available market discount rate information and our Company's estimates for liquidity risk, and other cash flow model - related assumptions.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

(b) Impairment losses on goodwill which was determined to be impaired:

The fair value of the Asian online game reporting unit was determined based on the present value of estimated future net cash flows discounted at the weighted average cost of capital. In 2013, due to a continued slowdown in demand for our casual online games and the loss of a key licensed game, we experienced significant decline in revenues and negative operating margin in Taiwan from our previous future cash flow expectations from this reporting unit. Further, in the Fall of 2013 we went through an internal restructuring of our operations and made a business decision to transition from PC-based games to browser/mobile games and social casino games. Also our market capitalization had also fallen below our net book value based on the quoted market price of our common stock for a sustained period of time. Based on these qualitative factors, we determined it was more likely than not the revised fair value of this reporting unit may be less than its carrying value, and the related recovery the remaining goodwill could be impaired. Using the same methodology as in the past to determine the estimated fair value of this reporting unit, we developed our expected future net cash flows based on historical data and internal developed estimates as part of our updated long-term strategic plan and included a terminal value of \$0. Other significant estimates and assumptions used in developing the future net cash flows included an assumed average revenue decline of 28% and a weighted average cost of capital to discount these expected future cash flows of 13%. As a result, the carrying value of this reporting unit exceeded its fair value, and the implied fair value of the goodwill was determined to be \$0. Consequently, a goodwill impairment charge of \$17.0 million was recognized in 2013.

(c) Impairment losses on certain intangible assets which were determined to be impaired:

In 2013, the trade name arising from the acquisition of FunTown and certain capitalized software development costs were fully written down, resulting in impairment charges of \$13.3 million, included in operating expenses within impairment loss on intangible assets in the consolidated statements of operations. The impairment charge for the trade name of FunTown is a result of our repositioning of it as described above, while the impairment charges for the capitalized software costs were the result of certain projects within our Asian online game and service business that we ceased further development on, and as a result, we recorded a full impairment of the carrying value of the assets related to these projects.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

In 2014, certain capitalized and prepaid software development costs for our cloud product and service business were fully written down, resulting in impairment charges of \$115 thousand, included in operating expenses within impairment loss on intangible assets in the consolidated statements of operations. The impairment charge is for certain product lines within our cloud product and service business that we decided to shift focus from, and as a result, we recorded a full impairment of the carrying value of the assets related to these items.

(d) Impairment losses on certain prepaid licensing and royalty fees which were determined to be impaired: In 2013 and 2014, certain prepaid licensing and royalty fees were written down to \$0 and \$3.0 million, respectively, resulting in impairment charges of \$2.8 million and \$1.3 million, respectively. This impairment is included in operating expenses in the consolidated statements of operations. The impairment charges for the prepaid licensing and royalty fees related to certain licensed games within our Asian online game and service business that we stopped operating or for which the carrying amounts of the related assets were determined not to be recoverable from their expected future undiscounted cash flows. The licensing fee games and related royalties are re-valued on when impairment exists, using unobservable inputs such as discounted cash flows, incorporating adjusted available market discount rate information and our Company's estimates for liquidity risk, along with other cash flow model related assumptions.

**NOTE 10. CASH AND CASH EQUIVALENTS**

Cash and cash equivalents consist of the following:

(in US\$ thousands)	December 31	
	2013	2014
Cash and savings accounts	\$ 44,163	\$ 38,529
Time deposits	14,638	21,102
<b>Total cash and cash equivalents</b>	<b>58,801</b>	<b>59,631</b>
Less: Cash restricted as collateral and performance bond		(8,991)
<b>Cash and cash equivalents reported on the consolidated statements of cash flows</b>	<b>\$ 58,801</b>	<b>\$ 50,640</b>

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

As of December 31, 2014, cash amounting to \$1.5 million has been deposited in an escrow account in a bank as a performance bond for our players' game points, and certain time deposits amounting to \$7.5 million have also been pledged as collateral for borrowings from financial institutions. These deposits are restricted and are included in restricted cash in the consolidated balance sheets.

We maintain cash and cash equivalents, as well as restricted cash, in bank accounts with major financial institutions with high credit ratings located in the following jurisdictions:

(in US\$ thousands)	December 31	
	2013	2014
Taiwan	\$ 55,661	\$ 49,829
China		6,055
Hong Kong	2,956	2,178
Singapore		1,418
Malaysia	133	
Others	51	151
	\$ 58,801	\$ 59,631



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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 11. MARKETABLE SECURITIES - CURRENT**

Marketable securities - current consist of the following:

(in US\$ thousands)	December 31	
	2013	2014
Equity securities	\$ 21,124	\$ 29,022
Open-end fund	336	318
	\$ 21,460	\$ 29,340

As of December 31, 2013 and 2014, the balances of unrealized gains for marketable securities - current were \$17.9 million and \$9.4 million, respectively. For 2014, unrealized gains of \$75 thousand on certain marketable securities held at year-end were included in Non-operating income - Other. During 2012, 2013 and 2014, realized gains from the disposal of marketable securities - current amounted to \$2.3 million, \$754 thousand, and \$8.8 million, respectively. The costs for calculating gains on disposal were based on each security's average cost.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 12. ACCOUNTS RECEIVABLE - NET**

Accounts receivable consist of the following:

(in US\$ thousands)	December 31	
	2013	2014
Accounts receivable	\$ 2,082	\$ 1,354
Less: Allowance for doubtful accounts	(55)	(56)
	\$ 2,027	\$ 1,298

The following is a summary of the changes in our Company's allowance for doubtful accounts during the years ended December 31, 2012, 2013 and 2014:

(in US\$ thousands)	2012	2013	2014
Balance at beginning of year	\$ 2,594	\$ 130	\$ 55
Additions: Provision for bad debt expense	169	37	37
Less: Write-offs	(269)	(109)	(33)
Deconsolidation - IAHGames	(2,370)		
Translation adjustment	6	(3)	(3)
Balance at end of year	\$ 130	\$ 55	\$ 56

**NOTE 13. OTHER CURRENT ASSETS**

Other current assets consist of the following:

(in US\$ thousands)	December 31	
	2013	2014
Loans receivable - current	\$ 3,394	\$ 27
Less: Allowance for loans receivable - current	(3,394)	(27)
Deferred income tax assets - current, net (Note 25)		
Other	293	325

	\$ 293	\$ 325
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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

The following is a reconciliation of changes in our Company's allowance for loans receivable - current during the years ended December 31, 2012, 2013 and 2014:

(in US\$ thousands)	2012	2013	2014
Balance at beginning of year	\$ 5,057	\$ 3,437	\$ 3,394
Less: Writes-offs	(1,620)		(3,359)
Less: Reversal for collection of bad debt		(54)	
Translation adjustment		11	(8)
Balance at end of year	\$ 3,437	\$ 3,394	\$ 27

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 14. MARKETABLE DEBT SECURITIES - NONCURRENT**

Marketable debt securities - noncurrent consist of the following:

(in US\$ thousands)	December 31	
	2013	2014
Available-for-sale securities		
Debt securities	\$ 6,048	\$ 4,744

Our Company's marketable securities - noncurrent are invested in convertible preferred shares and corporate bonds and are classified as available-for-sale securities.

The preferred shares are convertible into common shares on 1:1 basis, subject to certain adjustments, and shall be automatically converted upon certain conditions outlined in the agreements. The convertible preferred shares are all redeemable based upon certain agreed-upon conditions.

The embedded conversion options of the convertible preferred shares do not meet the definition of derivative instruments and therefore are not bifurcated from the preferred share investment.

We have also considered and determined whether our investments in preferred shares are in-substance common shares which should be accounted for under the equity method. Given that our convertible preferred shares have substantive redemption rights and thus do not meet the criteria of in-substance common shares, we have accounted for them as debt securities.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

As of December 31, 2013 and 2014, the balances of unrealized gains for marketable securities - noncurrent were \$1.2 million and \$2.0 million, respectively. During 2012, 2013 and 2014, realized gains (losses) from the disposal of marketable securities - non-current amounted to \$3.4 million, \$985 thousand and (\$171) thousand, respectively. Gains (losses) on disposal were based on the security's average cost.

**NOTE 15. EQUITY INVESTMENTS**

Equity investments consist of the following:

(in US\$ thousands)	December 31	
	2013	2014
Investments accounted for under the equity method	\$ 5,822	\$ 5,781

Our Company's investments accounted for under the equity method primarily consist of the following: (a) from July 2012 to May 2013, a 20 percent equity interest investment in Infocomm Asia Holdings Pte Ltd. ( IAHGames ), an online game operator, publisher and distributor in Southeast Asia (See Note 5 Divestitures, for additional information); (b) an 18 percent equity interest investment in East Gate Media Contents & Technology Fund ( East Gate ), a Korean Fund Limited Partnership that invests in online game businesses and films; and (c) a 22.86 percent equity interest investment in Double2 Network Technology Co., Ltd. ( Double2 ), a Taiwanese company that mainly engaged in development of causal gaming software.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

In July 2012, we entered into agreements to sell a 60 percent ownership in IAHGames to IAHGames management and Management Capital International Limited ( MCIL ), a British Virgin Islands company owned by IAHGames management. As we only retained a 20 percent ownership in IAHGames, upon the closing of the agreements, we deconsolidated the results of IAHGames operations and began accounting for our remaining 20 percent interest under the equity method up to May 2013 when we sold the remaining interest in IAHGames to IAHGames management and MCIL. (See Note 5, Divestitures for additional information.)

Our Company has an 18 percent interest in East Gate, a Korean Limited Partnership. We account for this limited partnership investment under the equity method accounting since we have the ability to exercise significant influence over partnership operating and financial policies based on the terms of the partnership agreement.

**NOTE 16. SHORT-TERM BORROWINGS**

As of December 31, 2013 and 2014, short-term borrowings totaled \$4.4 million and \$18.6 million, respectively. These amounts were borrowed from certain financial institutions. The annual interest rates on these borrowings ranged from 1.50 percent to 1.60 percent for 2013 and from 1.35 percent to 1.95 percent for 2014. The maturity dates fell in late January 2014 as of December 31, 2013, and fell in January and July 2015 as of December 31, 2014. As of December 31, 2013 and 2014, the weighted-average interest rate on total short-term borrowings was 1.52 percent and 1.72 percent, respectively.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

As of December 31, 2013 and 2014, the total amount of unused lines of credit available for borrowing under these agreements was approximately \$9.9 million and \$1.1 million, respectively.

We pledged certain time deposits as collateral for borrowings from financial institutions. The pledged time deposits amounted to \$0 and \$7.5 million as of December 31, 2013 and 2014, respectively, and are included in restricted cash in the consolidated balance sheets.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 17. ACCRUED EXPENSES**

Accrued expenses consist of the following:

(in US\$ thousands)	December 31	
	2013	2014
Accrued outsourced development	\$ 740	\$ 838
Accrued professional fees	128	603
Accrued royalties	421	308
Accrued advertising expenses	137	613
Accrued incentive to distributors	424	71
Accrued director compensation and liability insurance	767	155
Other		877
	\$ 2,617	\$ 3,465

**NOTE 18. OTHER CURRENT LIABILITIES**

Other current liabilities consist of the following:

(in US\$ thousands)	December 31	
	2013	2014
Income taxes payable	\$ 1,560	\$ 1,542
Deferred tax liabilities (Note 25)	1,987	
Other	315	176
	\$ 3,862	\$ 1,718

**NOTE 19. PENSION BENEFITS**

Our Company and our subsidiaries have defined benefit and defined contribution pension plans that cover substantially all of our employees.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

***Defined Benefit Pension Plan***

We have a defined benefit pension plan in accordance with the Labor Standards Law of the Republic of China (R.O.C.) for our employees located in Taiwan, covering substantially all full-time employees for services provided prior to July 1, 2005, and employees who have elected to remain in the defined benefit pension plan subsequent to the enactment of the Labor Pension Act on July 1, 2005. Under the defined benefit pension plan, employees are entitled to a lump sum retirement benefit upon retirement equivalent to the aggregate of 2 months' pensionable salary for each of the first 15 years of service and 1 month's pensionable salary for each year of service thereafter subject to a maximum of 45 months' pensionable salary. The pensionable salary is the monthly average salary or wage of the final six months prior to approved retirement.

We use a December 31 measurement date for our defined benefit pension plan. As of December 31, 2013 and 2014, the accumulated benefit obligation amounted to \$360 thousand and \$196 thousand, respectively, and the funded status of accrued pension liability (prepaid pension assets) amounted to \$170 thousand and (\$45) thousand, respectively. The fair value of plan assets amounted to \$300 thousand and \$303 thousand as of December 31, 2013 and 2014, respectively. The accumulated other comprehensive income amounted to \$0 and \$0 as of December 31, 2013 and 2014, respectively. The net periodic benefit cost (income) for 2012, 2013 and 2014 amounted to \$30 thousand, (\$77) thousand and (\$199) thousand, respectively.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

The following table sets forth the plan's benefit obligations, fair value of plan assets, and funded status at December 31, 2013 and 2014:

(in US\$ thousands)	December 31	
	2013	2014
Benefit Obligation	\$ 470	\$ 258
Fair value of plan assets	300	303
	\$ 170	\$ (45)
Amounts recognized in the balance sheet consist of:		
Noncurrent liabilities (assets)	\$ 170	\$ (45)
Accumulated other comprehensive income		
Net amount recognized	\$ 170	\$ (45)
Amounts recognized in accumulated comprehensive income consist of:		
Unrecognized net gain	\$	\$

For the years ended December 31, 2013 and 2014, the net period pension cost consisted of the following:

(in US\$ thousands)	December 31	
	2013	2014
Service cost	\$ 14	\$ 15
Interest cost	10	9
Expected return on plan assets	(5)	(6)
Amortization of prior service cost	(50)	
Amortization of net loss	1	
Curtailement gain	(47)	(217)
	\$ (77)	\$ (199)



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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Weighted average assumptions used to determine benefit obligations for 2013 and 2014 were as follows:

	December 31	
	2013	2014
Discount rate	2.00%	2.00%
Rate of compensation increase	1.50%	1.50%

Weighted average assumptions used to determine net periodic benefit cost for end of fiscal year were as follows:

	2013	2014
Discount rate	1.75%	2.00%
Rate of return on plan assets	1.75%	2.00%
Rate of compensation increase	1.50%	1.50%

Management determines the discount rate and rate of return on plan assets based on the yields of twenty year ROC central government bonds which is in line with the respective employees remaining service period and the historical rate of return on the above mentioned Fund mandated by the ROC Labor Standard Law.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

We have contributed an amount equal to 2 percent of the salaries and wages paid to all qualified employees located in Taiwan 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 in the Bank of Taiwan. Our Company makes pension payments from our account in the Fund unless the Fund is insufficient, in which case we make payments from internal funds as payments become due. We seek to maintain a normal, highly liquid working capital balance to ensure payments are made timely.

We expect to make a contribution of \$14 thousand to the Fund in 2015. We expect to make benefit payments of \$1 thousand from 2015 to 2019 and \$1 thousand from 2020 to 2024.

***Defined Contribution Pension Plans***

We have provided defined contribution plans for employees located in Taiwan and Hong Kong. Contributions to the plans are expensed as incurred.

***Taiwan***

Pursuant to the new Labor Pension Act enacted on July 1, 2005, our Company has a defined contribution pension plan for our employees located in Taiwan. For eligible employees who elect to participate in the defined contribution pension plan, we contribute no less than 6 percent of an employee's monthly salary and wage and up to the maximum amount of NT\$9 thousand (approximately \$284), to each of the eligible employees' individual pension accounts at the Bureau of Labor Insurance each month. Pension payments to employees are made either by monthly installments or in a lump sum from the accumulated contributions and earnings in employees' individual accounts.

***Hong Kong***

According to the relevant Hong Kong regulations, we provide a contribution plan for the eligible employees in Hong Kong. We must contribute at least 5 percent of the employees' total salaries. For this purpose, the monthly relevant contribution to their individual contribution accounts is subject to a cap of HK\$1.5 thousand (approximately \$193). After the termination of employment, the benefits still belong to the employees in any circumstances.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

The total amount of defined contribution pension expenses pursuant to our defined contribution plans for the years ended December 31, 2012, 2013, and 2014 were \$585 thousand, \$357 thousand, and \$364 thousand, respectively.

**NOTE 20. OTHER LIABILITIES - OTHER**

Other liabilities consist of the following:

(in US\$ thousands)	December 31	
	2013	2014
Deferred tax liabilities (Note 25)	\$	\$ 1,928
Other	11	10
	\$ 11	\$ 1,938

**NOTE 21. SUBSIDIARY PREFERRED SHARES**

In connection with our acquisition of a controlling financial interest in IAHGames, that subsidiary had Class A preferred shares, which were owned by the noncontrolling shareholders. As August 15, 2012 when we deconsolidated IAHGames, these Class A preferred shares were valued at \$1.3 million, and represented 8.9 percent of IAHGames accumulated voting interest. The holder of the Class A preferred shares was entitled to cumulative dividends at 10 percent per annum. The preferred shares were redeemable at the holder's option at any time after the expiration of certain licensed games, and were convertible into ordinary shares at any time. Pursuant to agreements entered into in connection with our acquisition of IAHGames in July 2010, all Class A preferred shares were to be converted to ordinary shares of IAHGames at the acquisition date. The preferred shares were fully converted into ordinary shares by the closing date when we sold 60 percent of IAHGames. (See Note 5, Divestitures, for additional information.)

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Since the Class A preferred shares were never currently redeemable and it was not probable that they would become redeemable as a result of our acquisition of IAHGames, the subsequent adjustment for accretion was not required. However, the cumulative dividends and the reversal of dividends upon the conversion described above for these Class A preferred shares of (\$469) thousand for the period from January 1, 2012 to July 31, 2012 are included as a component of net income (loss) attributable to the noncontrolling interest in the consolidated statement of operations.

**NOTE 22. EQUITY**

In accordance with Singapore law, the holders of ordinary shares that do not have par value, are entitled to receive dividends as declared from time to time and are entitled to one vote per share at the general meeting of our company. All shares rank equally with regard to our company's residual assets. In addition, we are not required to have a number of authorized common shares to be issued.

In accordance with R.O.C. law, an appropriation for legal reserve amounting to 10 percent of a company's net profit is required until the reserve equals the aggregate par value of such Taiwan company's issued capital stock. As of December 31, 2013 and 2014, the legal reserves of Hoshin GigaMedia Center Inc. ( Hoshin GigaMedia ) were \$3.0 million for each period. The reserve can only be used to offset a deficit or be distributed as a stock dividend of up to 50 percent of the reserve balance when the reserve balance has reached 50 percent of the aggregate paid-in capital of Hoshin GigaMedia.



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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 23. COMPREHENSIVE INCOME**

The accumulated balances for each classification of other comprehensive income are as follows:

(in US\$ thousands)	Foreign currency items	Unrealized gain on securities	Pension and post retirement benefit plans	Accumulated other comprehensive income (loss)
Balance at January 1, 2012	\$ (24,367)	\$ 38,410	\$ 308	\$ 14,351
Net current period change	1,814	(18,339)	(323)	(16,848)
Reclassification adjustments for gains reclassified into income		(5,665)		(5,665)
Deconsolidation of subsidiaries	(217)			(217)
<b>Balance at December 31, 2012</b>	<b>(22,770)</b>	<b>14,406</b>	<b>(15)</b>	<b>(8,379)</b>
Net current period change	(801)	6,437	15	5,651
Reclassification adjustments for gains reclassified into income	864	(1,739)		(875)
<b>Balance at December 31, 2013</b>	<b>(22,707)</b>	<b>19,104</b>		<b>(3,603)</b>
Net current period change	(176)	906		730
Reclassification adjustments for gains reclassified into income	7	(8,621)		(8,614)
<b>Balance at December 31, 2014</b>	<b>\$ (22,876)</b>	<b>\$ 11,389</b>	<b>\$</b>	<b>\$ (11,487)</b>

There were no significant tax effects allocated to each component of other comprehensive income for the years ended December 31, 2012, 2013 and 2014.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 24. SHARE-BASED COMPENSATION**

The following table summarizes the total stock-based compensation expense recognized in our consolidated statements of operations:

(in US\$ thousands)	2012	2013	2014
Cost of online game and service revenues	\$	\$	\$
Product development & engineering expenses			
Selling and marketing expenses	20		
General and administrative expenses	159	219	21
Pre-tax stock-based compensation expense	179	219	21
Income tax (benefit) expense	(41)	27	(17)
Total stock-based compensation expense reported in continuing operations	\$ 138	\$ 246	\$ 4
Total stock-based compensation expense reported in discontinued operations, net of tax	\$	\$	\$

There were no significant capitalized stock-based compensation costs at December 31, 2013 and 2014. There was no recognized stock-based compensation tax benefit for the years ended December 31, 2013 and 2014, as our Company recognized a full valuation allowance on net deferred tax assets as of December 31, 2013 and 2014.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

***(a) Overview of Stock-Based Compensation Plans***

***2002 Employee Share Option Plan***

At the June 2002 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2002 Employee Share Option Plan (the 2002 Plan ) under which up to three million common shares of our Company have been reserved for issuance. All employees, officers, directors, supervisors, advisors, and consultants of our Company are eligible to participate in the 2002 Plan. The 2002 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the exercise price for the option grants, the eligible individuals who are to receive option grants, the time or times when options grants are to be made, the number of shares subject to grant and the vesting schedule. The maximum contractual term for the options under the 2002 Plan is 10 years.

***2004 Employee Share Option Plan***

At the June 2004 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2004 Employee Share Option Plan (the 2004 Plan ) under which up to seven million common shares of our Company have been reserved for issuance. All employees, officers, directors, supervisors, advisors, and consultants of our Company are eligible to participate in the 2004 Plan. The 2004 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the exercise price for the option grants, the eligible individuals who are to receive option grants, the time or times when options grants are to be made, the number of shares subject to grant and the vesting schedule. The maximum contractual term for the options under the 2004 Plan is 10 years.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

***2006 Equity Incentive Plan***

At the June 2006 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2006 Equity Incentive Plan (the "2006 Plan") under which up to one million common shares of our Company have been reserved for issuance. The 2006 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the grant of awards under the 2006 Plan. The maximum contractual term for the options under the 2006 Plan is 10 years.

***2007 Equity Incentive Plan***

At the June 2007 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2007 Equity Incentive Plan (the "2007 Plan") under which up to two million common shares of our Company have been reserved for issuance. The 2007 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the grant of awards under the 2007 Plan. The maximum contractual term for the options under the 2007 Plan is 10 years.

***2008 Equity Incentive Plan***

At the June 2008 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2008 Equity Incentive Plan (the "2008 Plan") under which up to one million common shares of our Company have been reserved for issuance. The 2008 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the grant of awards under the 2008 Plan. The maximum contractual term for the options under the 2008 Plan is 10 years.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

***2008 Employee Share Purchase Plan***

At the June 2008 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2008 Employee Share Purchase Plan (the 2008 ESPP ) under which up to two hundred thousand common shares of our Company were reserved for issuance. Any person who is regularly employed by our Company or our designated subsidiaries shall be eligible to participate in the 2008 ESPP. Pursuant to the 2008 ESPP, our Company would offer the shares to qualified employees on favorable terms. Employees are also subject to certain restrictions on the amount that may be invested to purchase the shares and to other terms and conditions of the 2008 ESPP. The 2008 ESPP is administered by a committee designated by the board of directors. As of December 31, 2014, no shares have been subscribed by qualified employees under the 2008 ESPP.

***2009 Equity Incentive Plan***

At the June 2009 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2009 Equity Incentive Plan (the 2009 Plan ) under which up to one and a half million common shares of our Company have been reserved for issuance. The 2009 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the grant of awards under the 2009 Plan. The maximum contractual term for the options under the 2009 Plan is 10 years.

***2009 Employee Share Purchase Plan***

At the June 2009 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2009 Employee Share Purchase Plan (the 2009 ESPP ) under which up to two hundred thousand common shares of our Company have been reserved for issuance. To be eligible, employees must be regularly employed by us or our designated subsidiaries. Employees are also subject to certain restrictions on the amount that may be invested to purchase the shares and to other terms and conditions of the 2009 ESPP. The 2009 ESPP is administered by a committee designated by the board of directors. As of December 31, 2014, no shares have been issued to employees under the 2009 ESPP.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

***2010 Equity Incentive Plan***

At the June 2010 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2010 Equity Incentive Plan (the "2010 Plan") under which up to one million common shares of our Company have been reserved for issuance. The 2010 Plan is administered by a committee designated by the board of directors. The committee as plan administrator has complete discretion to determine the grant of awards under the 2010 Plan. The maximum contractual term for the options under the 2010 Plan is 10 years.

***2010 Employee Share Purchase Plan***

At the June 2010 annual general meeting of shareholders, the shareholders of our Company approved the GigaMedia Limited 2010 Employee Share Purchase Plan (the "2010 ESPP") under which up to two hundred thousand common shares of our Company have been reserved for issuance. To be eligible, employees must be regularly employed by us or our designated subsidiaries. Employees are also subject to certain restrictions on the amount that may be invested to purchase the shares and to other terms and conditions of the 2010 ESPP. The 2010 ESPP is administered by a committee designated by the board of directors. As of December 31, 2014, no shares have been issued to employees under the 2010 ESPP.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Summarized below are the general terms of our stock-based compensation plans, for which awards have been granted as of December 31, 2014.

Stock-Based compensation plan	Granted awards	Vesting schedule	Options exercise price	RSUs grant date fair value
2002 Plan	3,000,000	immediately upon granting	\$0.79	
2004 Plan	7,875,185 <sup>(1)</sup>	immediately upon granting to four years	\$0.79~\$2.55	
2006 Plan	1,223,333 <sup>(2)</sup>	immediately upon granting to four years	\$0.8101~\$16.60	\$2.91~\$16.01
2007 Plan	3,355,217 <sup>(3)</sup>	immediately upon granting to four years	\$1.20~\$18.17	\$2.47~\$15.35
2008 Plan	1,000,000	immediately upon granting to six years	\$2.47~\$4.24	
2009 Plan	2,500,000 <sup>(4)</sup>	immediately upon granting to four years	\$0.955~\$2.47	
2010 Plan	2,200,000 <sup>(5)</sup>	three years	\$0.8101~\$1.14	

(1) The granted awards, net of forfeited or canceled shares, were within reserved shares of 7 million common shares.

(2) The granted awards, net of forfeited or canceled shares, were within reserved shares of 1 million common shares.

(3) The granted awards, net of forfeited or canceled shares, were within reserved shares of 2 million common shares.

(4) The granted awards, net of forfeited or canceled shares, were within reserved shares of 1.5 million common shares.

(5) The granted awards, net of forfeited or canceled shares, were within reserved shares of 1 million common shares.

Options and Restricted Stock Units ( RSUs ) generally vest over the schedule described above. Certain RSUs provide for accelerated vesting if there is a change in control. All options and RSUs are expected to be settled by issuing new shares.

**(b) Options**

In 2012, 2013 and 2014, 0, 3,000 and 4,538,685 options were exercised, and cash received from the exercise of stock options was \$0, \$2 thousand and \$3.6 million, respectively, which resulted in no significant tax benefit realized on a consolidated basis.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Our Company uses the Black-Scholes option-pricing model to estimate the fair value of stock options granted to employees. The following table summarizes the assumptions used in the model for options granted during 2013 and 2014:

	2013	2014
Option term (years)	5.8	5.9
Volatility	59.46%~61.84%	58.75%~59.27%
Weighted-average volatility	61%	59%
Risk-free interest rate	0.930%~1.610%	1.968%~2.065%
Dividend yield	0%	0%
Weighted-average fair value of option granted	\$0.60	\$0.68

Option term. The expected term of the options granted represents the period of time that they are expected to be outstanding. Our Company estimates the expected term of options granted based on historical experience with grants and option exercises.

Expected volatility rate. An analysis of historical volatility was used to develop the estimate of expected volatility.

Risk-free interest rate. The risk-free interest rate is based on yields of U.S. Treasury bonds for the expected term of the options.

Expected dividend yield. The dividend yield is based on our Company's current dividend yield.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

Option transactions during the last three years are summarized as follows:

	2012		2013		2014			
	Weighted Avg. Exercise Price	No. of Shares (in thousands)	Weighted Avg. Exercise Price	No. of Shares (in thousands)	Weighted Avg. Exercise Price	No. of Shares (in thousands)	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Balance at January 31	\$ 2.13	9,493	\$ 1.97	9,210	\$ 1.95	9,223		
Options granted	0.96	2,070	1.09	620	1.23	328		
Options exercised			0.79	(3)	0.79	(4,539)		
Options Forfeited / canceled / expired	1.74	(2,353)	1.28	(604)	1.13	(1,882)		
Balance at December 31	\$ 1.97	9,210	\$ 1.95	9,223	\$ 4.06	3,130	5.21	\$ 1,998
Exercisable at December 31	\$ 2.15	7,584	\$ 2.13	7,770	\$ 4.67	2,595	4.53	\$ 1,339
Vested and expected to vest at December 31	\$ 1.97	9,210	\$ 1.95	9,223	\$ 4.06	3,130	5.21	\$ 1,998

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between GigaMedia's closing stock price on the last trading day of 2014 and the fair value of the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had they exercised their options on December 31, 2014. This amount changes based on the fair market value of GigaMedia's stock. The total intrinsic value of options exercised for the years ended December 31, 2012, 2013, and 2014 were \$0, \$1 thousand, and \$1,855 thousand, respectively.

As of December 31, 2014, there was approximately \$121 thousand of unrecognized compensation cost related to nonvested options. That cost is expected to be recognized over a period of 1.29 years.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

The following table sets forth information about stock options outstanding at December 31, 2014:

Exercise price	Options outstanding		Option currently exercisable	
	No. of Shares (in thousands)	Weighted average contractual life remaining	Exercise price	No. of Shares (in thousands)
Under \$1	520	7.88 years	Under \$1	264
\$1~\$10	1,994	5.31 years	\$1~\$10	1,715
\$10~\$20	616	2.65 years	\$10~\$20	616
	3,130			2,595

**(c) RSUs**

The fair value of RSUs is determined and fixed on the grant date based on our stock price. No RSUs were granted during the years ended December 31, 2012, 2013 and 2014.

As of December 31 2013 and 2014, there was no unrecognized compensation cost related to nonvested RSUs. Our Company received no cash from employees as a result of employee stock award vesting and the forfeiture of RSUs during 2012, 2013 and 2014.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 25. INCOME TAXES**

Income (loss) from continuing operations before income taxes by geographic location is as follows:

(in US\$ thousands )	2012	2013	2014
Taiwan operations	\$ (14,871)	\$ (33,077)	\$ (13,158)
Non-Taiwan operations	1,946	(1,605)	8,095
	\$ (12,925)	\$ (34,682)	\$ (5,063)

The components of income tax expense (benefit) from continuing operations by taxing jurisdiction are as follows:

( in US\$ thousands )	2012	2013	2014
<b>Taiwan:</b>			
Current	\$ 410	\$ (131)	\$ (74)
Deferred	46	379	
	\$ 456	\$ 248	\$ (74)
<b>Non-Taiwan:</b>			
Current	\$ 215	\$ (187)	\$ 1
Deferred			
	\$ 215	\$ (187)	\$ 1
<b>Total current income tax expense (benefit)</b>	<b>\$ 625</b>	<b>\$ (318)</b>	<b>\$ (73)</b>
<b>Total deferred income tax expense (benefit)</b>	<b>\$ 46</b>	<b>\$ 379</b>	<b>\$</b>
<b>Total income tax expense (benefit)</b>	<b>\$ 671</b>	<b>\$ 61</b>	<b>\$ (73)</b>

Our ultimate parent company is based in Singapore.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

A reconciliation of our effective tax rate related to continuing operations to the statutory tax rate in Taiwan, where our major operations are based, is as follows:

	2012	2013	2014
Taiwan statutory rate, including taxes on income and retained earnings	23.85%	23.85%	23.85%
Foreign tax differential	(0.17%)	(3.71%)	42.23%
Non-deductible items - impairment charges on goodwill	(16.43%)	(11.73%)	0.00%
Non-deductible - bad debts	0.00%	0.00%	(5.16%)
Changes in unrecognized tax benefits	0.00%	(4.12%)	(3.15%)
Tax-exempted income in foreign jurisdictions	0.00%	3.12%	0.00%
Adjustment for prior year payable	0.00%	0.54%	1.81%
Change in valuation allowance	(4.00%)	(8.83%)	(52.97%)
Tax effect of earnings for equity method investees and certain subsidiaries	(4.38%)	0.00%	0.00%
Other	(4.06%)	0.70%	(5.16%)
Effective rate	(5.19%)	(0.18%)	1.45%

The expense (benefit) for income taxes attributable to discontinued operations was \$0 for each of the years ended December 31, 2012, 2013 and 2014, respectively.

Significant components of our deferred tax assets consist of the following:

(in US\$ thousands)	December 31	
	2013	2014
Net operating loss carryforwards	\$ 3,610	\$ 5,895
Share-based compensation	267	242
Intangible assets and goodwill	738	509
Property, plant and equipment	86	6
Prepaid licensing and royalty fees	1	369
Other	108	126
	4,810	7,147
Less: valuation allowance	(4,754)	(7,147)

Deferred tax assets - net	\$	56	\$
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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

As of December 31, 2013 and 2014, \$0 and \$0, respectively, of the net deferred tax assets were reported as current and included in other current assets on the balance sheet.

Significant components of our deferred tax liabilities consist of the following:

(in US\$ thousands)	December 31	
	2013	2014
Investment in affiliated companies, principally due to undistributed income	\$ 1,987	\$ 1,928
Capitalized software development costs	56	
Deferred tax liabilities	\$ 2,043	\$ 1,928

As of December 31, 2013 and 2014, \$0 and \$1.9 million, respectively, of deferred tax liabilities were reported as non-current deferred tax liabilities and included in other liabilities.

A reconciliation of the beginning and ending amounts of our valuation allowance on deferred tax assets for the years ended December 31, 2012, 2013 and 2014 are as follows:

(in US\$ thousands)	2012	2013	2014
Balance at beginning of year	\$ 25,256	\$ 18,333	\$ 4,754
Subsequent utilization of valuation allowance	(4)	(7)	
Additions to valuation allowance	214	3,063	2,682
Divestitures	(7,026)	(16,616)	
Exchange differences	(107)	(19)	(289)
Balance at end of year	\$ 18,333	\$ 4,754	\$ 7,147

Under ROC Income Tax Acts, the tax loss carryforward in the preceding ten years would be deducted from income tax for Taiwan operations. The Statutory losses would be deducted from undistributed earnings tax and were not subject to expiration from Taiwan operations. As of December 31, 2014, we have net operating loss carryforward of our Taiwan operations for undistributed earnings tax purpose of \$21.1 million which are available to reduce future undistributed earnings, if any, over an indefinite period.





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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

As of December 31, 2014, we had net operating loss carryforwards available to offset future income, amounting to \$28.0 million. Below is the breakdown of the expiration of the net operating loss carryforwards in major jurisdictions:

Jurisdiction	Amount	Expiring year
Hong Kong	10,551	indefinite
Taiwan	17,417	2020~2024
	27,968	

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**Unrecognized Tax Benefits**

A reconciliation of the beginning and ending amount of unrecognized tax benefits (excluding the effects of accrued interest) for the years 2012, 2013 and 2014 are as follows:

(in US\$ thousands)	2012	2013	2014
Balance at beginning of year	\$ 4,714	\$ 4,202	\$ 8,798
Current year increase (decrease)		4,173	
Increase (decrease) related to prior year tax positions	573	375	
Deconsolidation of IAHGames	(1,072)		
Exchange differences	(13)	48	(511)
Balance at end of year	\$ 4,202	\$ 8,798	\$ 8,287

As of December 31, 2012, 2013 and 2014, there were \$4.2 million, \$8.8 million and \$8.3 million of unrecognized tax benefits that if recognized would affect the effective tax rate. As of December 31, 2012, 2013 and 2014, \$2.8 million, \$6.7 million and \$6.4 million of the total unrecognized tax benefit were presented as a reduction of a deferred tax asset that, if recognized, would be offset by a valuation allowance.

There were no interest and penalties related to income tax liabilities recognized for the years ended December 31, 2012, 2013 and 2014.

Our major tax paying components are all located in Taiwan. As of December 31, 2014, the income tax filings in Taiwan have been examined for the years through 2012, but we have filed appeals for the 2008, 2009, 2011 and 2012 tax filings.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

In 2012, 2013 and 2014, our unrecognized tax benefits were related to amortization of goodwill and intangible assets resulting from the acquisition of FunTown in 2006. The income tax authority has made decisions on the amortization for our tax filings through 2012. We have filed appeals against the unfavorable parts of the decision regarding these amortization adjustments, pending further response from the tax authority.

The amount of unrecognized tax benefits may increase or decrease in the future for various reasons such as current year tax positions, expiration of statutes of limitations, litigation, legislative activity, or other changes in facts regarding realizability. Taiwanese entities are customarily examined by the tax authorities and it is reasonably possible that a future examination may result in positive or negative adjustment to our unrecognized tax benefit within the next 12 months; however management does not expect that the total amount of unrecognized tax benefit will change significantly within the next 12 months of December 31, 2014.

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GIGAMEDIA LIMITED AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 26. RELATED-PARTY TRANSACTIONS**

During 2014, we have outsourced certain development of software to Double2 Network Technology Co., Ltd., an equity-method investee. The operating costs amounted to \$113 thousand for the year ended December 31, 2014.

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## GIGAMEDIA LIMITED AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014

**NOTE 27. COMMITMENTS AND CONTINGENCIES****Commitments*****(a) Operating Leases***

We rent certain properties which are used as office premises under lease agreements that expire at various dates through 2017. The following table sets forth our future aggregate minimum lease payments required under these operating leases, as of December 31, 2014:

(in US\$ thousands)	Amount		
2015		910	
2016	)	\$ (644)	\$ (1,428)
Investments available-for-sale	(184 )	64	(120 )
Interest-bearing deposits	—	(76 )	(76 )
Total net change in income on interest-earning assets	(968 )	(656 )	(1,624 )
Interest-bearing liabilities:			
NOW	—	1	1
Money market	(28 )	(15 )	(43 )
Certificates of deposit	(501 )	(505 )	(1,006 )
Advances from the FHLB	29	(284 )	(255 )
Total net change in expense on interest-bearing liabilities	(500 )	(803 )	(1,303 )
Net change in net interest income	\$ (468)	\$ 147	\$ (321 )

Interest Income. Total interest income for the first quarter of 2013 decreased \$1.6 million, or 14.6% to \$9.5 million from \$11.2 million, as compared to the first quarter of 2012.

The following table compares detailed average interest-earning asset balances, associated yields and resulting changes in interest and dividend income for the three months ended March 31, 2013 and 2012:

Three Months Ended March 31,		2012		Increase/(Decrease) in Interest and Dividend Income
2013		2012		
Average Balance	Yield	Average Balance	Yield	
(Dollars in thousands)				
\$650,955	5.56%	\$693,437	6.04%	\$ (1,428 )

Loans receivable, net						
Investments available-for-sale	151,013	1.25	136,234	1.74	(120	)
Interest-bearing deposits	33,880	0.25	155,377	0.25	(76	)
FHLB stock	7,271	—	7,413	—	—	
Total interest-earning assets	\$843,119	4.53	\$992,461	4.50	\$ (1,624	)

Interest income from net loans receivable decreased \$1.4 million to \$9.0 million during the first three months of 2013, as compared to the same period in 2012. The reason for the decline was due to a 48 basis point decrease in the average loan yield from the comparable quarter in 2012, resulting in a \$784,000 decrease in interest income and a \$42.5 million decrease in the average loan balance to \$651.0 million, resulting in a \$644,000 decrease in interest income.

Interest income from investments available-for-sale declined \$120,000 to \$473,000 for the three months ended March 31, 2013, as compared to \$593,000 for the comparable period in 2012. The primary reason for the decrease in interest income from investments available-for-sale was due to a decrease of 49 basis points in the average investment yield, resulting in a \$184,000 decrease in interest income reflecting the continued low interest rate environment, partially offset by a \$64,000 increase in interest income due to a \$14.8 million increase in the average balance of investments during the quarter compared to the same quarter in 2012.

Interest Expense. Total interest expense for the three months ended March 31, 2013 was \$2.2 million, a decrease of \$1.3 million compared to \$3.5 million for the first quarter of 2012.

The following table details average balances, cost of funds and the resulting decrease in interest expense for the three months ended March 31, 2013 and 2012:

	Three Months Ended March 31,				Increase/ (Decrease) in Interest Expense
	2013		2012		
	Average Balance	Cost	Average Balance	Cost	
	(Dollars in thousands)				
NOW	\$16,455	0.15%	\$14,026	0.14%	\$1
Statement savings	18,304	0.20	17,824	0.20	—
Money market	158,468	0.22	178,525	0.29	(43 )
Certificates of deposit	458,348	1.56	560,094	2.00	(1,006 )
Advances from the FHLB	37,007	2.77	83,066	2.46	(255 )
Total interest-bearing liabilities	\$688,582	1.25	\$853,535	1.62	\$(1,303 )

Interest expense on our certificates of deposit accounts decreased \$1.0 million, primarily due to the \$101.7 million decline in the average balance of certificates of deposit and a 44 basis point reduction in our cost of certificates.

Interest expense on our money market accounts decreased \$43,000, primarily as a result of a decrease in the average cost of these funds of seven basis points, or \$28,000 to 0.22% from 0.29% for the first quarter of 2013, as compared to the same quarter in 2012. Interest expense related to our FHLB advances decreased \$255,000, primarily as a result of the decrease of \$46.1 million in the average balance of our advances to \$37.0 million for the first quarter of 2013, as compared to \$83.1 million during the quarter ended March 31, 2012, resulting in a \$284,000 reduction in interest expense. In addition, our average cost of funds for FHLB advances increased 31 basis points to 2.77% from 2.46% for the first quarter of 2013 compared to the same quarter in 2012, increasing interest expense by \$29,000.

**Provision for Loan Losses.** Management recognizes that loan losses may occur over the life of a loan and that the ALLL must be maintained at a level necessary to absorb specific losses on impaired loans and probable losses inherent in the loan portfolio. Our methodology for analyzing the ALLL consists of two components: general and specific allowances. The general allowance is determined by applying factors to our various groups of loans. Management considers factors such as charge-off history, the prevailing economy, borrower's ability to repay, the regulatory environment, competition, geographic and loan type concentrations, policy and underwriting standards, nature and volume of the loan portfolio, managements' experience level, our loan review and grading systems, the value of underlying collateral and the level of problem loans in assessing the ALLL. The specific allowance component is created when management believes that the collectability of a specific loan, has been impaired and a loss is probable. The specific reserves are computed using current appraisals, listed sales prices and other available information less costs to complete, if any, and costs to sell the property. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events differ from predictions.

During the quarter ended March 31, 2013, management evaluated the adequacy of the ALLL and concluded that no provision was required for the quarter, compared to a \$1.7 million provision for the same quarter in 2012. The following items were considered in evaluating the loan loss provision for the quarter ended March 31, 2013:

• Delinquent loans, loans over 30 days past due, decreased \$4.2 million to \$16.7 million at March 31, 2013, from \$20.9 million at December 31, 2012 and \$25.0 million at March 31, 2012;

• Nonperforming loans decreased \$3.8 million to \$19.0 million at March 31, 2013, from \$22.8 million at December 31, 2012 and \$26.4 million at March 31, 2012, continuing the trend of improvement within the loan portfolio;

• Nonperforming loans as a percent of total loans was 2.9% at March 31, 2013, compared to 3.4% at December 31, 2012 and 3.8% at March 31, 2012, and

- The weighted-average historical loss factor, which is an element within the loss provision calculation, decreased over the prior three year period as charge-offs decreased.



The ALLL decreased \$540,000 to \$12.0 million at March 31, 2013 compared to \$12.5 million at December 31, 2012, as a result of net charge-offs during the quarter of \$540,000. The ALLL represented 63.3% of nonperforming loans and 1.8% of total loans at March 31, 2013 compared to 55.1% and 1.9%, respectively, at December 31, 2012.

We believe that the ALLL as of March 31, 2013 was adequate to absorb the probable and inherent risks of loss in the loan portfolio at that date. While we believe the estimates and assumptions used in our determination of the adequacy of the allowance are reasonable, there can be no assurance that such estimates and assumptions will be proven incorrect in the future, that the actual amount of future provisions will not exceed the amount of past provisions or that any increased provisions that may be required will not adversely impact our financial condition and results of operations. Future additions to the allowance may become necessary based upon changing economic conditions, the level of problem loans, business conditions, credit concentrations, increased loan balances, or changes in the underlying collateral of the loan portfolio. In addition, the determination of the amount of our ALLL is subject to review by bank regulators as part of the routine examination process, which may result in the establishment of additional loss reserves or the charge-off of specific loans against established loss reserves based upon their judgment of information available to them at the time of their examination.

The following table presents a breakdown of our nonperforming assets and as a percent of total assets at the dates indicated:

	March 31, 2013	December 31, 2012	March 31, 2012	Three Month Increase/(Decrease)	One Year Increase/ (Decrease)
	(In thousands)				
Nonperforming loans:					
One-to-four family residential	\$ 5,980	\$ 6,248	\$ 8,691	\$ (268 )	\$ (2,711 )
Multifamily	2,623	4,711	949	(2,088 )	1,674
Commercial real estate	4,883	6,274	7,588	(1,391 )	(2,705 )
Construction/land development	4,747	4,767	8,991	(20 )	(4,244 )
Consumer	732	759	164	(27 )	568
Total nonperforming loans	18,965	22,759	26,383	(3,794 )	(7,418 )
OREO	16,310	17,347	22,448	(1,037 )	(6,138 )
Total nonperforming assets	\$ 35,275	\$ 40,106	\$ 48,831	\$ (4,831 )	\$ (13,556 )
Nonperforming assets as a percent of total assets	3.98	% 4.25	% 4.71	%	

Nonperforming loans include loans to borrowers who are experiencing deteriorating financial conditions and there is doubt as to the ultimate recoverability of the full principal and interest due the Bank in accordance with the terms of the loan agreement. Nonperforming loans decreased \$3.8 million to \$19.0 million at March 31, 2013, from \$22.8 million at December 31, 2012. This decrease was the result of \$1.3 million of loans classified as nonperforming during the three months ended March 31, 2013, offset by \$619,000 in charge-offs, \$674,000 in short sales and \$3.4 million of loans transferred to OREO.

The three largest nonperforming loans in the loan portfolio at March 31, 2013 included a \$3.9 million construction/land development loan secured by 34 acres for a 251-unit residential development located in Whatcom County. The project consists of 77 detached condominium lots (single-family residences) and vacant land for 174 attached units (multifamily). All of the ground work has been completed and the property is ready for construction, although no vertical construction has taken place. In addition to this loan, the three largest nonperforming loans consisted of a \$2.6 million commercial real estate loan secured by a retail/office building and a \$2.4 million multifamily loan secured by a 31-unit attached three building residential complex, both located in Pierce County.

Nonperforming assets continued to decrease during the quarter. At their peak, nonperforming assets reached \$166.4 million at March 31, 2010, decreasing to \$35.3 million at March 31, 2013, representing a \$131.1 million, or 78.8% decrease.

The following table presents a breakdown of our TDRs:

	March 31, 2013	December 31, 2012	March 31, 2012	Three Month Increase/ (Decrease)	One Year Increase/ (Decrease)
(In thousands)					
Nonperforming TDRs:					
One-to-four family residential	\$2,679	\$3,422	\$2,999	\$(743)	\$(320)
Multifamily	—	1,058	—	(1,058)	—
Commercial real estate	—	—	462	—	(462)
Construction/land development	—	—	183	—	(183)
Consumer	47	48	—	(1)	47
Total nonperforming TDRs	2,726	4,528	3,644	(1,802)	(918)
Performing TDRs:					
One-to-four family residential	52,270	52,644	51,643	(374)	627
Multifamily	1,234	1,239	2,496	(5)	(1,262)
Commercial real estate	12,251	11,965	11,347	286	904
Consumer	—	—	70	—	(70)
Total performing TDRs	65,755	65,848	65,556	(93)	199
Total TDRs	\$68,481	\$70,376	\$69,200	\$(1,895)	\$(719)

Our TDRs decreased \$1.9 million, or 2.7% to \$68.5 million at March 31, 2013, compared to \$70.4 million at December 31, 2012 and decreased \$719,000, or 1.0% as compared to \$69.2 million at March 31, 2012. During the first three months of 2013, we added \$392,000 of new performing TDRs and transferred \$1.8 million of nonperforming TDRs to OREO, while \$243,000 of TDRs were paid off and \$293,000 in principal payments were received.

As we work with our borrowers to help them through this difficult economic cycle, we explore all options available to minimize our risk of loss. At times, the best option for our customers and the Bank is to modify the loan for a period of time, usually one year or less. These modifications have included lowering the interest rate on the loan for a period of time and/or extending the maturity date of the loan or allowing interest only payments for a specific time frame. These modifications are granted only when there is a reasonable and attainable restructured loan plan that has been agreed to by the borrower and is in the Bank's best interest. Of the \$68.5 million in TDRs at March 31, 2013, \$65.8 million were performing and \$2.7 million were not performing according to their restructured payment terms.

The largest TDR relationship at March 31, 2013 totaled \$13.1 million and was comprised of 84 one-to-four family residential rental properties located in King, Kitsap, Pierce and Thurston counties. At March 31, 2013, there were no LIP in connection with these restructured and impaired loans.

OREO includes properties acquired by the Bank through foreclosure or deed in lieu of foreclosure. The following table presents a breakdown of our OREO by county and number of properties at March 31, 2013.

	County				Total	Number of Properties	Percent of Total OREO	
	King	Pierce	Kitsap	All Other				
	(Dollars in thousands)							
OREO:								
One-to-four family residential	\$ 1,436	\$ 1,587	\$ 410	\$ 375	\$ 3,808	15	23.3	%
Multifamily	—	1,729	—	—	1,729	2	10.6	
Commercial real estate <sup>(1)</sup>	563	7,037	920	724	9,244	12	56.7	
Construction/land development	—	933	205	391	1,529	5	9.4	
Total OREO	\$ 1,999	\$ 11,286	\$ 1,535	\$ 1,490	\$ 16,310	34	100	%

<sup>(1)</sup> Of the 12 properties classified as commercial real estate, seven are office/retail buildings, two are mixed-use buildings and three are undeveloped lots.

The following table presents a breakdown of our OREO activity:

	Three Months Ended March 31,	
	2013	2012
	(In thousands)	
Balance at beginning of period	\$ 17,347	\$ 26,044
Loans transferred to OREO	3,376	1,846
Capitalized improvements	33	—
Dispositions of OREO	(4,301)	(5,132)
Market value adjustments	(145)	(310)
Balance at end of period	\$ 16,310	\$ 22,448

OREO decreased \$1.0 million, or 6.0% to \$16.3 million at March 31, 2013, from \$17.3 million at December 31, 2012, as sales and write-downs of OREO exceeded transfers of loans into OREO during the first quarter of 2013. We sold \$4.3 million of OREO during the first quarter of 2013, which was comprised of 20 properties and generated a net gain on sale of \$632,000. OREO at March 31, 2013 consisted of \$9.3 million in commercial real estate properties, \$1.5 million in construction/land development projects, \$3.8 million in one-to-four family residential homes and \$1.7 million in multifamily properties.

The three largest OREO properties at March 31, 2013 were an office/retail building valued at \$3.4 million, an office/retail building valued at \$1.2 million and a two building 19-unit apartment complex valued at \$1.1 million, all located in Pierce County.

We continue to focus our efforts on converting nonperforming loans to OREO through foreclosure or deeds in lieu of foreclosure and selling the properties. By taking ownership of these properties, we can convert nonearning assets into earning assets on a more timely basis. Our success in this area is reflected by the improved ratio of our average interest-earning assets to average interest-bearing liabilities of 122.4% at March 31, 2013 compared to 119.8% and 116.3% at December 31, 2012 and March 31, 2012, respectively.

The following table summarizes selected financial data related to our ALLL and loan portfolio. All loan balances and ratios are calculated using loan balances that are net of LIP.

	At or For the Three Months Ended March 31,			
	2013	2012		
	(Dollars in thousands)			
Provision for loan losses	\$—	\$1,700		
Charge-offs	619	3,699		
Recoveries	79	272		
ALLL	12,002	14,832		
ALLL as a percent of total loans	1.81	% 2.13		%
ALLL as a percent of nonperforming loans	63.28	56.22		
Total nonperforming loans	\$18,965	\$26,383		
Nonperforming loans as a percent of total loans	2.86	% 3.78		%
Total loans receivable	\$663,499	\$697,357		
Total loans originated	28,552	17,492		

Noninterest Income. Noninterest income decreased \$177,000 to \$104,000 for the first quarter of 2013 from \$281,000 for the same quarter in 2012. The following table provides a detailed analysis of the changes in the components of noninterest income:

	Three Months Ended March 31, 2013	Increase/(Decrease) from March 31, 2012	Percent Increase/(Decrease)	
	(Dollars in thousands)			
Service fees on deposit accounts	\$17	\$1	6.3	%
Loan service fees	35	5	16.7	
Gain on sale of investments	—	(194	) (100.0	)
Servicing rights, net	(3	) 7	(70.0	)
Other	55	4	7.8	
Total noninterest income	\$104	\$(177	) (63.0	)

The decrease in noninterest income for three months ended March 31, 2013 compared to the same period in 2012 was primarily due to no investment sales during the quarter ended March 31, 2013 compared to \$194,000 in net gains on the sales of investments during the first quarter of 2012.

Noninterest Expense. Noninterest expense increased \$257,000 to \$5.9 million for the first quarter of 2013 from \$5.6 million for the comparable quarter in 2012. The following table provides a detailed analysis of the changes in the components of noninterest expense:

	Three Months Ended March 31, 2013 (Dollars in thousands)	Increase/(Decrease) from March 31, 2012	Percent Increase/(Decrease)	
Salaries and employee benefits	\$3,614	\$187	5.5	%
Occupancy and equipment	354	(51)	(12.6)	)
Professional fees	356	(117)	(24.7)	)
Data processing	162	(19)	(10.5)	)
Gain on sales of OREO property, net	(632)	(411)	186.0	)
OREO market value adjustments	145	(165)	(53.2)	)
OREO-related expenses, net	334	(155)	(31.7)	)
Regulatory assessments	283	186	191.8	
Insurance and bond premiums	114	14	14.0	
Proxy contest and related litigation	89	89	100.0	
Marketing	18	(34)	(65.4)	)
Prepayment penalty on FHLB advances	679	679	100.0	
Other general and administrative	362	54	17.5	
Total noninterest expense	\$5,878	\$257	4.6	

The increase in noninterest expense for the three months ended March 31, 2013 compared to the same period in 2012 was primarily due to the FHLB prepayment penalty of \$679,000 incurred during the quarter ended March 31, 2013 on the refinance of a \$33.0 million advance with no comparable transaction during the same quarter in 2012. In addition, salaries and employee benefits increased \$187,000, as compared to the first quarter of last year due to personnel changes within the Bank. These increases were partially offset by a decrease in pension plan expenses as a result of the decision to freeze the pension plan, effective March 31, 2013. Our regulatory assessments increased \$186,000, primarily due to a one-time adjustment in the first quarter of 2012 related to the termination of the Bank's consent order. These increases were partially offset by a \$731,000 decrease in OREO-related expenses.

Federal Income Tax Expense. We recorded a \$59,000 federal income tax provision for the quarter ended March 31, 2013, as a result of our being subject to the alternative minimum tax.

## Liquidity

We are required to have enough cash flow in order to maintain sufficient liquidity to ensure a safe and sound operation. We maintain cash flows above the minimum level believed to be adequate to meet the requirements of normal operations, including potential deposit outflows. On a daily basis, we review and update cash flow projections to ensure that adequate liquidity is maintained.

Our primary sources of funds are customer deposits, loan and investment repayments, maturing investment securities and advances from the FHLB. These funds, together with equity, are used to make loans, acquire investment securities and other assets, and fund continuing operations. At March 31, 2013, certificates of deposit scheduled to mature in one year or less totaled \$218.5 million. Management's policy is to maintain deposit rates at levels that are competitive with other local financial institutions, although recently we have been less aggressive in competing for certificates of deposit and public funds in order to reduce our cost of funds. Historically, we have been able to retain a significant

amount of the deposits as they mature. While maturities and the scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by the level of interest rates, economic conditions and competition. We measure our liquidity based on our ability to fund our assets and to meet liability obligations when they come due. Liquidity (and funding) risk occurs when funds cannot be raised at reasonable prices or in a reasonable time frame to meet our normal or unanticipated obligations. We regularly monitor the mix between our assets and our liabilities to manage effectively our liquidity and funding requirements.

When deposits are not readily available and/or cost effective to provide the funds for our assets, we use alternative funding sources. These sources include, but are not limited to: advances from the FHLB, wholesale funding, brokered deposits, federal

funds purchased and dealer repurchase agreements, as well as other short-term alternatives. These funding sources are generally collateral dependent. We may also liquidate assets to meet our funding needs. At March 31, 2013, the Bank maintained credit facilities with the FHLB totaling \$233.6 million with an outstanding balance of \$34.0 million. At March 31, 2013, we also had available a \$10.0 million credit facility with another financial institution, with no balance outstanding. For additional information, see the Consolidated Statements of Cash Flow in Item 1 of this Form 10-Q.

On a monthly basis, we estimate our liquidity sources and needs for the next six months. Also, we determine funding concentrations and our need for sources of funds other than deposits. This information is used by our Asset/Liability Management Committee in forecasting funding needs and investing opportunities. We believe that our current liquidity position and our expected operating results are sufficient to fund all of our existing commitments

#### Commitments and Off-Balance Sheet Arrangements

We are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and the unused portions of lines of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition. Commitments to extend credit and lines of credit are not recorded as an asset or liability by us until the instrument is exercised. At March 31, 2013 and December 31, 2012, we had no commitments to originate loans for sale.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the loan agreement. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of the collateral obtained, if deemed necessary by us upon extension of credit, is based on our credit evaluation of the customer. The amount and type of collateral required varies, but may include real estate and income-producing commercial properties.

The following table summarizes our outstanding commitments to originate loans, to advance additional amounts pursuant to outstanding lines of credit and to disburse funds related to our construction loans at March 31, 2013.

	Amount of Commitment Expiration - Per Period				
	Total Amounts Committed	Through One Year	After One Through Three Years	After Three Through Five Years	After Five Years
	(In thousands)				
Commitments to originate loans	\$7,711	\$7,711	\$—	\$—	\$—
Unused portion of lines of credit	8,058	1,646	1,330	962	4,120
Undisbursed portion of construction loans	9,377	2,566	6,811	—	—
Total commitments	\$25,146	\$11,923	\$8,141	\$962	\$4,120

First Financial Northwest and its subsidiaries from time to time are involved in various claims and legal actions arising in the ordinary course of business. There are currently no matters that in the opinion of management, would have a material adverse effect on First Financial Northwest's consolidated financial position, results of operation or liquidity.



Among our contingent liabilities are exposures to limited recourse arrangements with respect to sales of whole loans and participation interests.

We anticipate that we will continue to have sufficient funds and alternative funding sources to meet our current commitments.

### Capital

At March 31, 2013, stockholders' equity totaled \$188.7 million, or 21.3% of total assets. Our book value per share of common stock was \$10.04 at March 31, 2013 compared to \$9.95 at December 31, 2012. Consistent with our goal to operate a sound and profitable financial organization, we actively seek to maintain a “well-capitalized” institution in accordance with regulatory standards. As of March 31, 2013, the Bank exceeded all regulatory capital requirements. Regulatory capital ratios for the Bank only were as follows at March 31, 2013: Tier 1 leverage capital 17.46%; Tier 1 risk-based capital 26.56%; and Total

risk-based capital 27.82%. The regulatory capital requirements to be considered well capitalized are 10%, 6% and 5%, respectively. The Bank met the financial ratios for “well-capitalized” status at March 31, 2013. In addition, at March 31, 2013, First Financial Northwest, the parent company of the Bank, had \$20.3 million of available cash to potentially increase its investment in the Bank.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

General. Our Board of Directors has approved an asset/liability management policy to guide management in maximizing interest rate spread by managing the differences in terms between interest-earning assets and interest-bearing liabilities while maintaining acceptable levels of liquidity, capital adequacy, interest rate sensitivity, credit risk and profitability. The policy established an Asset/Liability Management Committee comprised of certain members of senior management and the Board of Directors. The Committee's purpose is to communicate, coordinate and manage our asset/liability position consistent with our business plan and Board-approved policies. The Asset/Liability Management Committee meets quarterly to review various areas including:

- economic conditions;
- interest rate outlook;
- asset/liability mix;
- interest rate risk sensitivity;
- current market opportunities to promote specific products;
- historical financial results;
- projected financial results; and
- capital position.

The Committee also reviews current and projected liquidity needs. As part of its procedures, the Asset/Liability Management Committee regularly reviews interest rate risk by forecasting the impact that changes in interest rates may have on net interest income and the market value of portfolio equity, which is defined as the net present value of an institution's existing assets, liabilities and off-balance sheet instruments and evaluating such impacts against the maximum potential change in the market value of portfolio equity that is authorized by the Board of Directors.

Our Risk When Interest Rates Change. The rates of interest we earn on assets and pay on liabilities generally are established contractually for a period of time. Market interest rates change over time. Our loans generally have longer maturities than our deposits. Accordingly, our results of operations, like those of other financial institutions, are impacted by changes in interest rates and the interest rate sensitivity of our assets and liabilities. The risk associated with changes in interest rates and our ability to adapt to these changes is known as interest rate risk and is our most significant market risk.

We have utilized the following strategies in our efforts to manage interest rate risk:

- we have attempted, where possible, to extend the maturities of our deposits and FHLB advances, which typically fund our long-term assets;
- we have invested in securities with relatively short average lives, generally less than eight years; and
- we have added adjustable-rate securities to our investment portfolio.

During the first quarter of 2013, we purchased \$4.0 million of variable-rate investments. These purchases were of investment grade corporate bonds meeting our current investment objectives and continued our efforts to increase the level of interest sensitive assets on our balance sheet and to protect against the interest rate risk from our predominantly fixed-rate loan portfolio in anticipation of a rising interest rate environment. Additionally during the first quarter, a \$50.0 million advance from the FHLB matured and was repaid. In addition, we prepaid \$33.0 million of FHLB advances. Subsequently, we borrowed \$34.0 million at a fixed-rate from the FHLB during the quarter that provides a significant interest cost savings and extends the maturity for three years as compared to the advance that was prepaid.

**How We Measure the Risk of Interest Rate Changes.** We monitor our interest rate sensitivity on a quarterly basis to measure the change in net interest income as a percentage of net income in varying rate environments. Management uses various assumptions to evaluate the sensitivity of our operations to changes in interest rates. Although management believes these assumptions are reasonable, the interest rate sensitivity of our assets and liabilities on net interest income and the market value of portfolio equity could vary substantially if different assumptions were used or actual experience differs from these assumptions. Although certain assets and liabilities may have similar maturities or periods of repricing, they may react differently to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types of assets and liabilities lag behind changes in market interest rates. Non-uniform

changes and fluctuations in market interest rates across various maturities will also affect the results presented. In addition, certain assets, such as adjustable-rate mortgage loans, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. Further, a portion of our adjustable-rate loans have interest rate floors below which the loan's contractual interest rate may not adjust. Approximately 18% of our total loans were comprised of adjustable-rate loans at March 31, 2013. At that date, \$51.4 million, or 41.6% of these loans with a weighted-average interest rate of 4.8% were at their floor interest rate. The inability of our loans to adjust downward can contribute to increased income in periods of declining interest rates. Also, when loans are at their floors, there is a further risk that our interest income may not increase as rapidly as our cost of funds during periods of increasing interest rates. Further, in the event of a significant change in interest rates, prepayment and early withdrawal levels would likely deviate from those assumed. Finally, the ability of many borrowers to service their debt may decrease in the event of an interest rate increase. We consider all these factors in monitoring our interest rate exposure.

The assumptions we use are based upon a combination of proprietary and market data that reflect historical results and current market conditions. These assumptions relate to interest rates, prepayments, deposit decay rates and the market value of certain assets under the various interest rate scenarios. We use market data to determine prepayments and maturities of loans, investments and borrowings and use our own assumptions on deposit decay rates except for time deposits. Time deposits are modeled to reprice to market rates upon their stated maturities. We also assume that non-maturity deposits can be maintained with rate adjustments not directly proportionate to the change in market interest rates, based upon our historical deposit decay rates which are substantially lower than market decay rates. We have demonstrated in the past that the tiering structure of our deposit accounts during changing rate environments results in relatively lower volatility and less than market rate changes in our interest expense for deposits. We tier our deposit accounts by balance and rate, whereby higher balances within an account earn higher rates of interest. Therefore, deposits that are not very rate sensitive (generally, lower balance tiers) are separated from deposits that are rate sensitive (generally, higher balance tiers). When interest rates rise, we do not have to raise interest rates proportionately on less rate sensitive accounts to retain these deposits. These assumptions are based upon our analysis of our customer base, competitive factors and historical experience.

Our income simulation model examines changes in net interest income in which interest rates were assumed to remain at their base level, gradually increase by 100, 200 and 300 basis points over a 12 month period, or decline assuming a gradual 100 basis point reduction in rates. Reductions of rates by 200 and 300 basis points were not reported due to the very low rate environment. The current federal funds rate is 0.25% making a 200 and 300 basis point decrease impossible.

The following table illustrates the change in our net interest income at March 31, 2013 that would occur in the event of a gradual change in interest rates equally across all maturities, with no effect given to any steps that we might take to counter the effect of that interest rate movement.

Net Interest Income Change at March 31, 2013

Basis Point Change in Rates	% Change
+300	1.63%
+200	1.01
+100	0.26
Base	(1.19)
(100)	(1.34)

The following table illustrates the change in our net portfolio value (“NPV”) at March 31, 2013 that would occur in the event of an immediate change in interest rates equally across all maturities, with no effect given to any steps that we might take to counter the effect of that interest rate movement.

Basis Point Change in Rates <sup>(1)</sup>	Net Portfolio Value (2)			Net Portfolio as % of Portfolio Value of Assets		Market Value of Assets <sup>(6)</sup>
	Amount (Dollars in thousands)	\$ Change (3)	% Change	NPV Ratio <sup>(4)</sup>	% Change <sup>(5)</sup>	
+300	\$ 167,179	\$(52,519)	(23.91)	19.88	(5.71)	\$ 841,053
+200	187,683	(32,015)	(14.57)	21.58	(3.48)	869,795
+100	205,256	(14,442)	(6.57)	22.90	(1.57)	896,154
Base	219,698	—	—	23.87	—	920,275
(100	) 244,747	25,049	11.40	25.74	2.72	950,890

(1) The current federal funds rate is 0.25%, making a 200 and 300 basis point drop impossible.

(2) The net portfolio value is the difference between the present value of the discounted cash flows of assets and liabilities and represents the market value of the Company's equity for any given interest rate scenario. Net portfolio value is useful for determining, on a market value basis, how equity changes in response to various interest rate scenarios. Large changes in net portfolio value reflect increased interest rate sensitivity and generally more volatile earnings streams.

(3) The increase or decrease in the estimated net portfolio value at the indicated interest rates compared to the net portfolio value assuming no change in interest rates.

(4) Net portfolio value divided by the market value of assets.

(5) The increase or decrease in the net portfolio value divided by the market value of assets.

(6) The market value of assets represents the value of assets under the various interest rate scenarios and reflects the sensitivity of those assets to interest rate changes.

When interest rates rise by 100, 200 or 300 basis points, our net interest income initially increases because a significant portion (over 29%) of our interest-earning assets are based on indices that adjust frequently to changes in market interest rates. Our interest-earning assets are primarily fixed-rate, intermediate-term and long-term loans, and to a lesser extent, investment securities and loans with yields based on market indexes. An increasing percentage of our interest-bearing liabilities are relatively short-term deposits or FHLB borrowings. Deposits comprise the majority and their repricing is dependent upon management's response to increasing interest rates or, in the case of certificates of deposit, the contractual maturity of the deposit instrument.

When interest rates rise by 100, 200 or 300 basis points, our net portfolio value of equity declines. The decrease is primarily due to the impact of increasing interest rates on our loan portfolio which loses value in rising rate environments because of its predominately long-term, fixed-rate nature. Typically during a rising interest rate environment, interest-bearing deposits reprice more rapidly than our interest-earning assets. During 2011, we began to change the composition of our investment securities portfolio by selling fixed-rate investments and purchasing adjustable-rate investment products. This strategy had the benefit of increasing the sensitivity of our interest-earning assets to changes in market interest rates.

When interest rates decline by 100 basis points, our net interest income increases slightly because our loan portfolio is primarily fixed-rate and does not reprice lower, while our maturing deposits will reprice lower. Both cash and nonmaturity deposits reprice immediately but offset each other. A significant portion of our interest-bearing liabilities are certificates of deposit, which will reprice over the next twelve months.

When interest rates decline by 100 basis points, our net portfolio value of equity increases modestly. The increase is primarily due to the fixed-rate nature of our loan portfolio whose value appreciates in declining rate environments because the discounted present value increases as market rates decline.

The net interest income and net portfolio value tables presented above are predicated upon a stable balance sheet with no growth or change in asset or liability mix. In addition, the net portfolio value is based upon the present value of discounted cash flows using our estimates of current replacement rates to discount the cash flows. The effects of changes in interest rates in the net interest income table are based upon a cash flow simulation of our existing assets and liabilities and assuming that delinquency rates would not change as a result of changes in interest rates, although there can be no assurance that this will be the case. Delinquency rates may change when interest rates change as a result of changes in the loan portfolio mix, underwriting conditions,

loan terms or changes in economic conditions that have a delayed effect on the portfolio. Even if interest rates change in the designated amounts, there can be no assurance that our assets and liabilities would perform as set forth above. Also, a change in U.S. Treasury rates in the designated amounts accompanied by a change in the shape of the Treasury yield curve would cause changes to the net portfolio value and net interest income other than those indicated above.

At March 31, 2013, we did not have any derivative financial instruments or trading accounts for any class of financial instruments, nor have we engaged in hedging activities or purchased off-balance sheet derivative instruments. Interest rate risk continues to be one of our primary risks as other types of risks, such as foreign currency exchange risk and commodity pricing risk do not arise in the normal course of our business activities and operations.

#### Item 4. Controls and Procedures

The management of First Financial Northwest, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Securities Exchange Act of 1934 (“Exchange Act”). A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that its objectives are met. Also, because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Additionally, in designing disclosure controls and procedures, our management was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. As a result of these inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Further, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Evaluation of Disclosure Controls and Procedures: An evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) was carried out under the supervision and with the participation of our Chief Executive Officer, Chief Financial Officer (Principal Financial and Accounting Officer) and several other members of our senior management as of the end of the period covered by this report. Our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2013, our disclosure controls and procedures were effective in ensuring that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is (i) accumulated and communicated to our management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Changes in Internal Controls: In the quarter ended March 31, 2013, there was no change in our internal control (b)over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II

### Item 1. Legal Proceedings

From time to time, we are engaged in various legal proceedings in the ordinary course of business, none of which are currently considered to have a material impact on our financial position or results of operations.

#### Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

There were no repurchases of equity securities in the first quarter of 2013.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

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Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits and Financial Statement Schedules

(a) Exhibits

- 3.1 Articles of Incorporation of First Financial Northwest <sup>(1)</sup>
- 3.2 Amended and Restated Bylaws of First Financial Northwest <sup>(2)</sup>
- 4.0 Form of stock certificate of First Financial Northwest <sup>(1)</sup>
- 10.1 Form of Employment Agreement for the President and Chief Executive Officer <sup>(1)</sup>
- 10.1 Form of Employment Agreement for the President and Chief Executive Officer of First Savings Bank Northwest <sup>(1)</sup>
- 10.2 Form of Change in Control Severance Agreement for Executive Officers <sup>(1)</sup>
- 10.3 Form of First Savings Bank Employee Severance Compensation Plan <sup>(1)</sup>
- 10.4 Form of Supplemental Executive Retirement Agreement entered into by First Savings Bank with Victor Karpiak, Harry A. Blencoe, Robert H. Gagnier and Joseph W. Kiley III <sup>(1)</sup>
- 10.5 Form of Financial Institutions Retirement Fund <sup>(1)</sup>
- 10.6 Form of 401(k) Retirement Plan <sup>(2)</sup>
- 10.7 2008 Equity Incentive Plan <sup>(3)</sup>
- 10.8 Forms of incentive and non-qualified stock option award agreements <sup>(4)</sup>
- 10.9 Form of restricted stock award agreement <sup>(4)</sup>
- 10.10 Settlement Agreement and Mutual Release with the Stilwell Group <sup>(6)</sup>
- 10.11 Transition Agreement Modification Agreement for Victor Karpiak <sup>(6)</sup>
- 10.12 Amendment No. 1 to the Settlement and Mutual Release Agreement with the Stilwell Group <sup>(7)</sup>
- 10.13 Amendment No. 2 to the Settlement and Mutual Release Agreement with the Stilwell Group <sup>(8)</sup>
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act
- 101.0 The following materials from First Financial Northwest's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, formatted in Extensible Business Reporting Language (XBRL): (1) Consolidated Balance Sheets; (2) Consolidated Income Statements; (3) Consolidated Statements of Comprehensive Income; (4) Consolidated Statements of Stockholders' Equity; (5) Consolidated Statements of Cash Flows; and (6) Selected Notes to Consolidated Financial Statements.\*

\*Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

<sup>(1)</sup> Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated March 22, 2012.

<sup>(2)</sup> Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated March 21, 2013.

<sup>(3)</sup> Filed as Appendix A to First Financial Northwest's definitive proxy statement dated April 15, 2008.

<sup>(4)</sup> Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated March 22, 2012.

- (5) Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated April 2, 2012.
- (6) Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated December 20, 2012.
- (7) Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated January 17, 2013.
- (8) Filed as an amendment to First Financial Northwest's Current Report on Form 8-K dated February 26, 2013.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST FINANCIAL NORTHWEST, INC.

Date: May 9, 2013

By: /s/ Victor Karpiak  
Victor Karpiak  
President and Chief Executive Officer (Principal Executive Officer)

Date: May 9, 2013

By: /s/ Kari Stenslie  
Kari Stenslie  
Chief Financial Officer (Principal Financial and Accounting Officer)

Exhibit Index

Exhibit No. Description

31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
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