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Conference Call Transcript

TSM - Q1 2004 TSMC Earnings Conference Call

Event Date/Time: Apr. 30. 2004 / 8:00AM ET

Event Duration: 1 hr 16 min

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PRESENTATION

Operator

Welcome to the Taiwan Semiconductor manufacturing Company's First Quarter of 2004 results Webcast conference call. Today's event is chaired by Miss Dr. Lora Ho, Vice President and CFO, and Dr. Rick Tsai, President and COO. This conference call is being Webcast live via the TSMC website at www.tsmc.com and only in audio mode. The dial-in lines are also in listen-only mode. At the conclusion of the management presentation we'll be opening the floor for questions. At that time further instructions will be provided as to the procedure to follow if you would like to ask any questions. Please be advised for those participants who do not yet have a copy of the press release, you may download it from TSMC's website at www.tsmc.com. Please also download the summary slides in relation to today's quarterly review presentation. Once again the URL is www.tsmc.com. I would now like to turn the conference over to Dr. Elizabeth Sun TSMC head of investor relations for the cautionary statements before the main presentation by Miss Ho and Dr. Tsai. Please go ahead.

Dr. Elizabeth Sun - TSMC - IR

Good morning and good evening to all participants. This is Elizabeth Sun, head of Investor Relations for TSMC. Before we begin I would like to state that management's comments about TSMC's current expectations made during this conference call are forward-looking statement subject to significant risks and uncertainties, and that actual results may differ materially from those contained in the forward-looking statements. Information as to those factors that could cause actual results to differ materially from TSMC's forward-looking statements may be found in TSMC's Annual Report on Form 20-F filed with the United States Securities and Exchange Commission on June 23, 2003, TSMC's registration statement on Form F-3 filed with the SEC on October 21, 2003, and such other documents that TSMC may file with or submit to the SEC from time to time. Except as required by law, we undertake no obligation to update any forward-looking statement whether as a result of new information, future events or otherwise. And now I would like to turn the conference call over to Miss Dr. Lora Ho, our Vice President and Chief Financial Officer.

Dr. Lora Ho - TSMC - VP and CFO

Welcome to TSMC's first quarter conference call. We are pleased to be sharing some very positive results here with you. Overall, TSMC's first quarter marked the beginning of a year where we believe TSMC will once again deliver record-breaking financial performance. We have prepared some slides for you to look at as you listen to the call. These slides are available on TSMC's website.

During the call I will refer to these slides by their individual numbers.

To start with, let's take a look at some highlights of our first quarter 2004 operating results. These figures are shown on slide #4. As announced on April 8th, our first quarter total revenue amounted to NT\$57.5b which is on a similar level to that of Q4 2003. Net income after tax totaled NT\$18.8b, the highest since Q4 of the year 2000. Earnings per share reached NT\$0.93, an increase of 17% sequentially. TSMC ended the first quarter NT\$126.3b in cash and short-term investments. Our total interest bearing debt that remains unchanged at NT\$35b.

During the first quarter we shipped a total of 1,172,000 8" equivalent wafers. Our overall utilization rate, which included TSMC Fabs, wafer Fabs and SSMC was roughly 105% in the first quarter. As a result I am glad to announce that our ROE for the quarter has reached 22.2% exceeding our long-term target of 20%.

Now let's go to slide #5. Compared with Q4 2003, revenue of NT\$57.5b was the combined result of a 4% increase in wafer shipments, a 3% decrease in ASP and a 1.5% weaker US dollar exchange rate during the quarter. Overall utilization rate increased from 101% in Q4 2003 to 105% for the first quarter of 2004. As a result, gross margin improved from 39.3% to 39.5%. Operating expenses as a percentage of total net sales was 9% for the quarter, down from 11% in the previous quarter. This is due to a one-of R&D expense for 65 nanometers in Q4 2003.

Next non-operating items improved to an expense of NT\$.2b to an income of NT\$.1b. Investment income on the other hand decreased from NT\$1.1b in the 4th quarter to NT\$.8b in this quarter. The reasons were, firstly, TSMC did not realize any capital gains from the disposal of equity investments as it had in the previous quarter. Secondly, operating results from SSMC wafer Fabs and [inaudible] continue to show [less] improvement. Income tax for the quarter was a credit of NT\$.4b as opposed to an expense of NT\$1.6b in the previous quarter. Net income for the quarter thus became NT\$18.8b. Net margin also reached a record high since the year 2000 of 33% as opposed to the 28% achieved in Q4 2003 demonstrating yet another quarter of TSMC's outstanding performance.

Slide #6 demonstrates the tax effect of TSMC for Q4 2003 and Q1 2004. With Fab sales ramping up and improved utilization of Fabs 6 and 8, we expect the tax exemption rate to increase in 2004. As a result, provisional tax rate for this year should fall around 13% versus 18% in 2003. In addition to lower tax rates, higher capital investment also brought our tax credit up from NT\$1.6b in Q4 2003 to NT\$2.7b in Q1 2004. The overall tax effect for Q1 2004 was a credit of NT\$350m compared to an expense of NT\$1.57b for Q4 2003.

Now let's turn to slide #7. On a year-over-year basis our revenue increased by 46% primarily due to 69% wafer shipment increase,

partially weighted down by ASPs decline of 5%. Gross profit was NT\$22.7b, a 119% increase over Q1 last year. Meanwhile gross margin improved from 26.4% to 39.5%. Total operating expenses, although increased 24% from the same quarter last year, took up only 9% of total sales, down from 11% a year ago. Similarly, non-operating items improved from expenses totaling NT\$.5b to an income of NT\$.1b mainly due to lower interest rates after TSMC repaid NT\$9b corporate bonds, and gained from the disposal of certain fixed assets.

TSMC had a net investment income of NT\$.8b versus a net investment loss of NT\$1.5b a year ago. This is mainly due to significantly improved operating results from wafer fabs, [inaudible] and SSMC. Pre-tax income and net income were NT\$18.4b and NT\$18.8b respectively representing a year-over-year increase of 341% and 99% respectively. EPS was NT\$0.93, more than four times the EPS achieved for the same period last year. As a result, our net margins have improved by 11.1% in Q1 2003, to 32.7% in Q1 2004.

Slide #8 will provide you with a few selected items from TSMC's balance sheet, and some key financial ratios. TSMC continues to maintain a very solid balance sheet as we entered the quarter with cash and short-term investments of NT\$126.3b, with represented less than 30% of our total assets. Our accounts receivable and inventories were maintained at a very healthy level. Accounts receivable turnover was 42 days compared to 40 days in the previous quarter while total accounts receivable increased to NT\$27.2b reflecting higher March sales activity. Currently, our liabilities at the end of the quarter was NT\$38.1b which is NT\$7.6b higher than the end of 2003. This was mainly due to higher accounts payable to equipment vendors with our increased capital expenditure. As a result our current ratio went from 5.2 times in Q4 2003 to 4.6 times in this quarter. As for inventory, TSMC ended the quarter with NT\$11b in inventory, very similar to that of the previous quarter. Inventory turnover days were 37 days for the quarter, roughly the same as the 36 days for the last quarter. TSMC has remained virtually debt free and our total cash and cash equivalents far exceeded our total liabilities.

Slide #9 summarizes TSMC's cash flow for the quarter. As you can see, TSMC continued to generate some cash flow from operations despite higher capital expenditures, depreciation expense for the quarter reduced by NT\$.3b to NT\$15.1b. This is due to some of our [aged] [inaudible] coming off depreciation, and this effect outweighed the increased depreciation from our new facilities.

During the first quarter, cash flow generated from operation activities totaled NT\$32.7b and the cash used in investment activities increased from NT\$15.9b to NT\$23.9b during the quarter. This includes capital expenditure during the quarter that totaled NT\$16.4b and cash used in short-term and long-term investments totaling NT\$7.5b mainly in government bonds and money market funds.

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Now let us look at some business analysis. Slide #10 provides a quick look at our revenue breakdown by technology. .15 micron and .18 micron has now become rather a mature process for TSMC. Starting from Q1 2004, we redefined the various technologies. .13 micron, .11 micron and 90 nanometers. With 90 nanometer products we expect this to be commercialized before the end of 2004. The top portion of the box represents the revenue percentage from our advanced technologies now defined as .13 microns and below accounted for around 20% of our total wafer sales for this quarter, up from 18% in the fourth quarter last year.

Slide #11 provides a view by application. For the fourth quarter we saw robust growth in the communication sector during the quarter, mainly from mobile phones and wireless LANS. As the market continues its growing momentum, as a result, revenue from communication segments further increased to 45% of our total sales, a 3% increment from the last quarter. On the other hand revenue from computers accounted for 32% of our total sales, slightly down from 35% in the previous quarter. This is due to seasonal declines. Revenue from consumer segments maintained at 17% of our total sales. Slide #12 shows the geographical breakdown of our revenues. Revenue from North America, Asia Pacific, Europe and Japan now accounts for 74%, 13%, 7% and 6% of our total revenue for the first quarter respectively. The overall trend was still in line with the previous quarter. However, a trend towards Asian territory was also visible.

Slide #13 provides the revenue breakdown by customer kinds. In the first quarter, revenues generated from Fabless customers account for 59% of total sales, 2% down from Q4 last year, while IBM customers accounted for 30% of our total sales, 1% higher than that of 3rd quarter levels, in line with our normal patterns. Now let's move onto to slide #14. This slide shows our Fab utilization and ASP trend. TSMC's ASP declined by 3.2% from the previous quarter as we continue to honor our prior commitments. However, the slope of decline has been paced out. Our ASPs have actually started to go up since February, and will continue to improve in Q2. Overall utilization improved significantly to 105% from 101% which again demonstrated TSMC's superior manufacturing efficiency. Let's turn to slide #15. This slide summarizes our Installed Capacity by Fab. Our total capacity during the first quarter was 1,070,000 8" equivalent wafers, 3000 pieces higher than our quarter three guidance. Currently we expect our capacity for the second quarter 2004 to be 1,125,000 8" equivalent wafers. This is 5% higher than the first quarter. While the trend of shifting over to advanced technology continues, our capacity for the whole year 2004 is expected to be about 4.8m 8" equivalent wafers, representing 19% year over year growth, while 12" wafer capacity will increase by around 130%.

The last slide, #16, provides a recap of the major events during the first quarter. I will leave that for your own reference. Finally, let's quickly go over our guidance for Q2 2004. Coming off a very strong Q1, our second quarter 2004 guidance is as follows. Wafer shipments to increase by close to 10% sequentially. ASP to

improve by a low single-digit percentage point sequentially. Overall utilization rate may exceed 105%. Gross profit margins will jump a few points. Revenue from advanced technologies defined as .13 micron and below will exceed 25% of wafer sales. Demand to increase strongly in the consumer segment, modestly for communication segment, while declining modestly in the computer segment. This ends my presentation today. Thank you very much. Operator, please open the floor for questions.

Q AND A

Operator

If you would like to ask a question, please press the star then the one on your touch button phone now. Questions will be taken in the order in which they are received. If at any time you would like to remove yourself from the questioning queue, please press the star then the two. Please limit your questions to one at a time to allow all participants an opportunity to ask questions of the management members. One moment please for our first question. Our first question comes from Ali Irani [ph] please go ahead with your question.

Ali Irani - CIBC World Markets - Analyst

Yes, good morning, and congratulations on the strong results and the guidance. Looking at your capacity utilization and your capacity adds, it seems that clearly your bottlenecked in the Fabs, and I'm just wondering what the impact of the technology migrations is and the increase of [metalization] is on reducing your overall wafers out, and whether those trends will accelerate though the balance of the year, thank you.

Dr. Rick Tsai - TSMC - President and COO

Well, we buy equipment-before we talk about this capacity build up, you know we buy equipment based on the number of metal [layers], for instance. I'll give you an example, for .13 micron we buy equipment for [inaudible] metals so that we have some, we do have [inaudible]. Did I answer your question?

Operator

Thank you. Our next question comes from Michael McConnell with Pacific Crest Securities please go ahead with your question.

Michael McConnell - Pacific Crest Securities - Analyst

Thank you. I was curious to see on the pricing improvement in Q2, do you feel, considering you're already very highly weighted normally to PCs, which seem to be decreasing, is the pricing improvement coming more from better mix in terms of .13 micron sales, or is it from some of these contracts that you were honoring now, you'll be able to renegotiate them. Could you please provide some color there please?

Dr. Lora Ho - TSMC - VP and CFO

Actually the improving ASP is coming from both the program mix improvement and also the high technology price increase, and as we explained earlier, the program mix improvement is going to be 5%, below, .13 micron will account for 25%. Other than that we also see for each technology, ASP goes up.

Michael McConnell - Pacific Crest Securities - Analyst

Okay, so you're actively raising prices to your customers right now?

Dr. Rick Tsai - TSMC - President and COO

Well, we wouldn't put that such a [black and white], basically, the chairman actually said in the afternoon, we [inaudible] really raise prices. If we do [inaudible] very infrequent, it was a very selective set of customers. I think we do have some, in some cases we do have some increase in the ASP, within a certain technology group, but I think the increase mostly still comes from the mix.

Michael McConnell - Pacific Crest Securities - Analyst

Okay. And Lora, could you help us. I know tax rates are always difficult to forecast, but there's obviously a lot of fluctuation in that, but could you give us any, you know, your best guess at least for Q2 on the tax rates for the deferred tax credit?

Dr. Lora Ho - TSMC - VP and CFO

Okay, actually we calculate tax on a yearly basis rather than on quarterly basis. The tax regulations are quite complex in Taiwan. But putting it simple, this year we have seen very high utilization and higher portion of revenue which is so-called tax exempt revenue coming from the new fab. So the percentage of tax exemption is higher than last year. Therefore the tax rate will be lower than last year. So we have, using 13% as our calculation to estimate our tax. The number was 18% last year.

Michael McConnell - Pacific Crest Securities - Analyst

Okay, thank you very much.

Operator

Thank you. Our next question comes from Mark Fitzgerald [ph] with Bank of America, please go ahead with our question.

Mark Fitzgerald - Bank of America - Analyst

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I'm interested to know if given the mix shift that you're planning for the leading edge technologies to 25%, why are we not getting a bigger profit in ASPs at this point, given that mix shift? It's a pretty dramatic jump.

Dr. Lora Ho - TSMC - VP and CFO

The advanced technology accounts for 25% and that actually is a component of the ASP increase. As we guided, the ASP will increase by only low single-digits. And advanced technology we will see some mild increase for certain technologies. That's the [inaudible] and is another quantum jump increase.

Mark Fitzgerald - Bank of America - Analyst

Okay, maybe I can ask it another way. Is there still pricing pressure in the trailing edge technologies at this point? Would you expect declines in trailing edge technologies?

Dr. Rick Tsai - TSMC - President and COO

I would characterize it as very little right now. However, in some cases as also we said during the opening remarks that we did have some contractual agreements signed last year, so that will of course be implemented as we move on during the year. But basically from [inaudible] the pricing pressure from the [inaudible].

Mark Fitzgerald - Bank of America - Analyst

Okay, and can I just ask one big macro question-is any of the news that's come out of China about trying to slow their growth rates in China change any of your own plans in terms of investment strategies in China at all?

Dr. Lora Ho - TSMC - VP and CFO

We have not changed our plan in China.

Dr. Rick Tsai - TSMC - President and COO

[inaudible].

Mark Fitzgerald - Bank of America - Analyst

Thank you.

Operator

Thank you our next question comes from Perna Perusama [ph] with the Diawa Institute of Research [ph] please go ahead with your question.

Perna Perusama - Diawa Institute of Research - Analyst

Thank you. I have a first question the R&D expenses. How should I model for this year on the R&D expense for your company?

Dr. Lora Ho - TSMC - VP and CFO

I think for a long time our R&D expense has been about 5% of our total revenue.

Perna Perusama - Diawa Institute of Research - Analyst

And could you please elaborate a little bit on the equipment delivery schedule, I think someone said the delivery schedule [inaudible]. Are you seeing any problem on that side?

Dr. Rick Tsai - TSMC - President and COO

Yes, it's difficult to hear your question, but I assume your question is on the equipment [inaudible] at [DMI].

Perna Perusama - Diawa Institute of Research - Analyst

[inaudible] the equipment delivery has been postponed because of the key components [inaudible].

Dr. Rick Tsai - TSMC - President and COO

All right. I think we, we did hear in some cases, some of the key components have been delayed. However, [inaudible] we have seen little impact from such a delay. We did see sometimes a week, 10 day type of delay for our key tools, but those were short enough to not impact our ramp-up schedule.

Hello?

Operator

Pardon me sir, did you have any further questions?

Dr. Rick Tsai - TSMC - President and COO

Hello?

Perna Perusama - Diawa Institute of Research - Analyst

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Yes, could you give us the fab schedule and by what time you think that the Fab 14 will be at break even point?

Dr. Rick Tsai - TSMC - President and COO

Fab 14. Well, I think the, you know, Fab 14 will start production some time in late 3rd quarter, early 4th quarter time, but it will, I mean, this question has a lot to do with both demand and, but I think right now it's difficult to give you a specific number. But we believe the, we should be able to break even if we can run something like 6,000-7,000 wafers per month output.

Operator

Thank you. Our next question comes from Dan Hiler [ph] with Merrill Lynch, please go ahead with your question.

Dan Hiler - Merrill Lynch - Analyst

Hi, good evening. I have a follow-up from today when you talked about your computer segment being soft. Could you explain why it's soft? Do you think it's basically end markets, or is it product shift, or is it competition, what's causing that decline?

Dr. Rick Tsai - TSMC - President and COO

Well, Dan, we mentioned the computer, for the second quarter revenues are clearly-

Dan Hiler - Merrill Lynch - Analyst

Down a little bit.

Dr. Rick Tsai - TSMC - President and COO

Yes, they have a modest decline. And I think, and a lot of which comes from the seasonality factor. And we're going to see-we are seeing the pickup in the late 2nd quarter. So I'm not too, really, I don't see too much of a, really a [inaudible].

Dan Hiler - Merrill Lynch - Analyst

Right so following a normal seasonal pattern of a strong 4th quarter in those [graphics] and chip sets. Are there any areas that are new in computer that you are seeing new products, including displays and other items?

Dr. Rick Tsai - TSMC - President and COO

Meaning [in the last weeks].

Dan Hiler - Merrill Lynch - Analyst

Are you seeing any new growth opportunities within computer given that that's the slower growth segment? Are you seeing any new opportunities for growth?

Dr. Rick Tsai - TSMC - President and COO

Well, I think certainly anything that's related to [inaudible] for higher growth, and the, you know, [the chips for] regular PC component. So, you'll see the controller [inaudible], and that sort of thing.

Dan Hiler - Merrill Lynch - Analyst

Right. So given that there is strong demand for mainstream technologies in addition to your leading edge, how are you addressing the mainstream tightness? Is it through productivity or potentially could you see greater equipment additions there? And if so, how much-what percentage increase are you talking about for 8", would it be 5% or 10%?

Dr. Rick Tsai - TSMC - President and COO

Actually, for about the last 6 months or so, we have continuously put in incremental investment for tools, we try to get mostly [new tools], of course, as much as possible, to add incremental capacity for our [pure] technology. The percentage I would, I think [inaudible] we talking about maybe 5% or better, 5% and up. But we [inaudible] though the productivity improvement also.

Dan Hiler - Merrill Lynch - Analyst

Any potential that Fab 7, which you're planning to move to China, maybe gets delayed somewhat, based on immediate customer needs?

Dr. Rick Tsai - TSMC - President and COO

Well, we are going to move some equipment for Fab 7 to [inaudible], that's what we call the [inaudible] in China for sure, but I [inaudible], as we stated earlier we are going to have some wafer output by the end of the year. However we are going to also continue the Fab 7 operation at a somewhat lower capacity compared to [inaudible] here, but so we are not going to impact our customer's shipment as you just mentioned.

Dan Hiler - Merrill Lynch - Analyst

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Rick, I didn't hear you, did you say you were going to keep it where year-end capacity was last year? I didn't catch that.

Dr. Rick Tsai - TSMC - President and COO

Well, we'll have it somewhat lower, so that would be compared to that over the last year.

Dan Hiler - Merrill Lynch - Analyst

Got it, thank you.

Operator

Thank you, our next question comes from Johnny Chen [ph] with Deutsche Security Agent Limited [ph], please go ahead with your question.

Johnny Chen - Deutsche Security Agent Limited - Analyst

Hi Rick. Just two questions, the first is obviously you're seeing a very tight capacity, high utilization in your Fabs more mature technologies. Are you thinking about possibly working with some other IDMs or you know, the [inaudible] IDMs or possibly working with them on the mature technologies together with buying new equipment. That's the first question.

Dr. Rick Tsai - TSMC - President and COO

We have, of course, first of all, we are looking at our own wafer Fabs to see whether we can add more capacity, obviously. But I'd say we can [control ourselves], we do not rule out anything, but I don't think we have anything really to report here.

Johnny Chen - Deutsche Security Agent Limited - Analyst

Okay, the second question in the [inaudible] meeting in Tapei this afternoon, the Chairman obviously was kind of optimistic about 2005. And TSMC will be looking to have more capacity coming in. I wondering what kind of catalyst or driver are you seeing for 2005 at this moment?

Dr. Rick Tsai - TSMC - President and COO

Well, we believe actually, the main driver is the overall robust economy. We do not see any specific segment slowing down, if anything we-I believe our long-term modeling research people still view normal to maybe above normal growth for major segments. Overall robust economy.

Johnny Chen - Deutsche Security Agent Limited - Analyst

Is there any specific applications or is it more IDM outsourcing, or is it a combination of all those factors?

Dr. Rick Tsai - TSMC - President and COO

I would say, certain application definitely will grow faster than the other such as the more mature technologies, such as the [camar] chips or CIS chips, drivers, those kind of things for the-and for leading technology we believe [inaudible] the baseline chip will continue to grow and with higher computing power which will need probably more silicon. In general-and of course consumer application will continue to grow. First of all in home electronics will increase. I think as [inaudible] will continue as the price continues to go lower [inaudible] that really is [inaudible]. We have many customers working in that area.

Johnny Chen - Deutsche Security Agent Limited - Analyst

Okay, thanks.

Operator

Thank you. Our next question comes from Rea Lee [ph] with ABN Emerald Asia Limited [ph], please go ahead with your question.

Rea Lee - ABN Emerald Asia Limited - Analyst

Hi Rick, I would just like to ask a question and follow up the, Elizabeth's comment regarding the gross margin. Can you give more color there where you say the gross margin will jump a few points, does that mean from 39.5% in your first quarter to around 43-44% in the second quarter. You don't need to give me a detailed number, just a range, is that a correct indication?

Dr. Lora Ho - TSMC - VP and CFO

When we say jump a few points, we're talking about something 3-5% range.

Rea Lee - ABN Emerald Asia Limited - Analyst

Sequential?

Dr. Lora Ho - TSMC - VP and CFO

Yes.

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Rea Lee - ABN Emerald Asia Limited - Analyst

Versus the 39.5% in the first quarter.

Dr. Lora Ho - TSMC - VP and CFO

Yes, first quarter was 39.5%.

Rea Lee - ABN Emerald Asia Limited - Analyst

Okay, thank you very much, appreciate that.

Operator

Thank you. Our next question comes from Sunil Gupta [ph] with Morgan Stanley. Please go ahead with your question.

Sunil Gupta - Morgan Stanley - Analyst

Hi, I have two questions. First, could you talk about in Q1, what percent of the revenue came from non-wafer [inaudible].

Dr. Lora Ho - TSMC - VP and CFO

Non-wafer full revenue is something less than 10%, in the 7-8% range.

Sunil Gupta - Morgan Stanley - Analyst

Okay. And could you also talk about in Q1, how many wafers you sold which were produced by third party fabs such as Vanguard or any others?

Dr. Lora Ho - TSMC - VP and CFO

Okay, wafer-I won't talk about a quantity-the revenue produced by our affiliate fabs was roughly, slightly higher than 10%.

Sunil Gupta - Morgan Stanley - Analyst

Okay, and my last part of my question is, what kind of lead times are you seeing on your leading edge technologies and also the cycle times?

Dr. Rick Tsai - TSMC - President and COO

I think we're seeing roughly here 8 - 10 weeks.

Sunil Gupta - Morgan Stanley - Analyst

Thank you.

Operator

Thank you. Our next question comes from Ivan Go [ph] with Vesna, Kleinwort and Wasserstein [ph] please go ahead with your question.

Ivan Go - Vesna, Kleinwort and Wasserstein - Analyst

Hi, good evening. A couple of questions. First of all, I notice that you've increased the forecast for full-year capacity from 4.6 million to 4.8 million. I would just like to find out where the additional capacity will be added, which fabs will be added.

Dr. Lora Ho - TSMC - VP and CFO

They're all 8". They're 8" capacity. Across the board, we are increasing [inaudible] [every fab].

Ivan Go - Vesna, Kleinwort and Wasserstein - Analyst

Okay, second question is, given that you're going to start Fab 14 in late Q3 or early Q4, can you perhaps talk a bit about when you think that Fab 12b may start, and if you are going to build another Fab shell soon?

Dr. Rick Tsai - TSMC - President and COO

I think for Fab 12 the second week of October. We'd like to have start wafer output in the first quarter, '05 first quarter next year. The sooner the better. We actually, the second phase of Fab 14, we already have the shell pretty much built, although we have not done any of the facility work yet.

Ivan Go - Vesna, Kleinwort and Wasserstein - Analyst

Okay, so, beyond Fab Pro phase 2, and Fab 14, you are not building another shell.

Dr. Rick Tsai - TSMC - President and COO

No, not now.

Ivan Go - Vesna, Kleinwort and Wasserstein - Analyst

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And the third question is, I see that you spent about close to NT\$500m in CAPEX in the first quarter. Can you perhaps give an idea of how the CAPEX, the remaining CAPEX will be spread the rest of this year from Q2 to Q4?

Dr. Lora Ho - TSMC - VP and CFO

Okay, first half year is slightly more than half. It's front end loaded, first half year we have higher CAPEX than second half.

Ivan Go - Vesna, Kleinwort and Wasserstein - Analyst

Okay, and my last question is regards to the interest income and interest expense. Can you perhaps break down net interest income into the income and expense? Separate it out?

Dr. Lora Ho - TSMC - VP and CFO

Oh, we don't really know these different numbers, you see we have very little debt. So the interest expense is quite small.

Ivan Go - Vesna, Kleinwort and Wasserstein - Analyst

All right, thank you so much.

Operator

Thank you. Ladies and gentlemen if there are any additional questions please press the star followed by the one on your touchtone phone at this time. As a reminder if you are using speaker equipment you will need to lift the handset before pressing the numbers. Our next question comes from Matt Gable [ph] with Koritel Capital [ph], please go ahead with your question.

Matt Gable - Koritel Capital - Analyst

Hi. I might have missed a few of these answers. Is there any official guidance for 2004 CAPEX, or is the official guidance the same as the prior guidance? The second question, can you describe the strength or lack thereof of your wireless business in Q2 sequentially, and finally just generally, what are you seeing in terms of wafer start trends right now? Are they still on an increasing trend? Are they flat? Slowing down? Thank you.

Dr. Lora Ho - TSMC - VP and CFO

The CAPEX forecast for this year, we have guided last quarter is NT\$2b for the whole year. And we have not changed our guidance at this moment but I think the trend is, maybe it's more likely to be higher than that NT\$2b but we have not decided to change the guidance at this moment. Your second question is regarding--?

Matt Gable - Koritel Capital - Analyst

Wireless strength in Q2-sequentially what are you seeing? Is it continuing?

Dr. Rick Tsai - TSMC - President and COO

Yes. I think the, actually, yes, the [inaudible] has continued to be strong, to show good growth. We actually are also seeing a good growth on the part of the Bluetooth contingent. Your third question is about wafer starts?

Matt Gable - Koritel Capital - Analyst

Yes, just the general trend, are they still on a general uptrend? Are they flattening out now, or?

Dr. Rick Tsai - TSMC - President and COO

Okay. They continue to go up.

Matt Gable - Koritel Capital - Analyst

Okay, one more on the wireless strength. Are you still seeing the same percentage increases in orders, or has the rate of growth slowed? Is the rate of growth still the same?

Dr. Rick Tsai - TSMC - President and COO

I'd say the rate of growth is stronger in the second quarter than in our first quarter.

Matt Gable - Koritel Capital - Analyst

Okay, thank you very much, nice quarter.

Dr. Rick Tsai - TSMC - President and COO

Thank you.

Operator

Thank you, our next question comes from Ali Irani with CIBC World Markets, please go ahead with your question.

Ali Irani - CIBC World Markets - Analyst

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Yes, again, to your comments about the trend being to the upside on CAPEX, are there equipment bottlenecks at this point to prevent you from growing capacity stronger than the 19% year-over-year that you have guided, and what would it take if customer demand comes in stronger, into the seasonal second half build for TSM to strategically put in place more capacity?

Dr. Lora Ho - TSMC - VP and CFO

It's really NT\$2b CAPEX has pretty much taken care of the demand for 2004. A big chunk of the NT\$2b actually is to support 2005.

Ali Irani - CIBC World Markets - Analyst

But you still seem to be operating north of 100%, and there are reports of your customers needing to go to other suppliers for capacity, even here through the second quarter. I'm just wondering if at this point, if its a bottlenecked delivery for example of Lithography Systems that prevents you from strategically adding more capacity in the short term.

Dr. Rick Tsai - TSMC - President and COO

Really, I thought Lora was correct in stating, actually, we are getting the equipment that we need to ramp our capacity. We are somewhat limited by the, in the first half of the year, probably [inaudible]. The second phase of Fab 12 is, or Fab 14, will start production late 3rd quarter and phase 2 of Fab 12 will start production in the first quarter next year. So that's probably where the [limiting factor] is. But not [inaudible]. And in the meantime, of course, we are adding, as I said earlier, incremental equipment, bottleneck equipment relating to Fabs to add more capacity, and we're getting more output [inaudible] capacity.

Ali Irani - CIBC World Markets - Analyst

How much more capacity could you see added in your 8" Fabs to bring them to nominal capacity?

Dr. Rick Tsai - TSMC - President and COO

What do you mean by nominal capacity?

Ali Irani - CIBC World Markets - Analyst

Well, in terms of expansion, obviously availability of 300mm and 200mm equipment is different at this time. How much more room do you have to increase 200mm capacity available by year end?

Dr. Rick Tsai - TSMC - President and COO

Well, we're pretty much-we have ordered the equipment to fill the available space.

Ali Irani - CIBC World Markets - Analyst

Thank you.

Operator

Thank you, our next question is a follow-up from Mark Fitzgerald [ph], please go ahead with your follow-up.

Mark Fitzgerald - Bank of America - Analyst

Just a quick question. Can you give us some guidance on share count for the next quarter and just longer term, can you give us some idea of how annual bonuses impact your share count in terms of the timing, what quarter it hits?

Dr. Lora Ho - TSMC - VP and CFO

Okay, sorry. You're asking about the share increase through the compensation?

Mark Fitzgerald - Bank of America - Analyst

Yes.

Dr. Lora Ho - TSMC - VP and CFO

So even employee bonus. Okay. I think we have, the board has approved to make a proposal to a shareholder meeting to issue 14% plus dividends. So I think that the shares are going to increase 14%, well from employee bonuses, which is roughly, maybe, roughly 6%.

Mark Fitzgerald - Bank of America - Analyst

6% increase in the share count for the June quarter?

Dr. Lora Ho - TSMC - VP and CFO

No, I don't think that's what we mean.

Operator

Thank you Mr. Fitzgerald, did you have any additional questions?

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Mark Fitzgerald - Bank of America - Analyst

Actually I didn't get an answer there.

Dr. Lora Ho - TSMC - VP and CFO

Well Mark if you recall not too long ago when our board approved the proposal for the stock dividends and including bonus, I think at that time we had a fairly detailed press release where we actually showed the number of shares that will be coming out from stock dividends as well as from employee bonus shares. If you can go back to that press release you will have the exact numbers. Otherwise I can send you an email and give you the details later on.

Mark Fitzgerald - Bank of America - Analyst

Okay, but is there any specific guidance that we should use for our share count for the June quarter at this point that you can give us?

Dr. Lora Ho - TSMC - VP and CFO

Well, depending on the possibilities. So we have, we don't have any numbers at the moment.

Mark Fitzgerald - Bank of America - Analyst

Okay, thank you.

Operator

Thank you, our next question comes from Asish Kumar [ph] with Credit Suisse First Boston Corporation. Please go ahead with your question.

Asish Kumar - Credit Suisse First Boston Corporation - Analyst

Thank you. My first question is that you have provided full year capacity at about 4.8 million. If you could tell us what is the annualized capacity at which you exit '04?

Dr. Lora Ho - TSMC - VP and CFO

Are you asking-using our 4th quarter capacity times 4 is approximately 5.3 million pieces.

Asish Kumar - Credit Suisse First Boston Corporation - Analyst

Okay. And ma'am, I think earlier Rick explained but I couldn't hear clearly, what is the type of capacity you're looking to shift to China and which quarter do we do that? I just couldn't hear him clearly that time.

Dr. Rick Tsai - TSMC - President and COO

Oh, we're going to ship, the basically .25, ah, .35 micron capacity from Taiwan to China out in, probably this quarter. I think the government approved that this afternoon. So we going to start shifting this quarter.

Asish Kumar - Credit Suisse First Boston Corporation - Analyst

And how much capacity would the China Fab have perhaps by the end of this year?

Dr. Rick Tsai - TSMC - President and COO

It will be a few thousand.

Dr. Lora Ho - TSMC - VP and CFO

Yes, very small capacity.

Dr. Rick Tsai - TSMC - President and COO

Because [inaudible] just starting off.

Asish Kumar - Credit Suisse First Boston Corporation - Analyst

Sure, sure. And would it be fair to say that, you know clearly we have had, the ASP trend is improving. And Q2 will have some sequential growth. Would this growth accelerate into the 3rd quarter? That is, we'll see a stronger growth moving into Q3?

Dr. Rick Tsai - TSMC - President and COO

We believe the outlook for the ASPs remains favorable, however, I think it's somewhat early to give you a forecast right now. We'll talk about that at next [inaudible].

Asish Kumar - Credit Suisse First Boston Corporation - Analyst

Sure. Sure. And my final question is, I think for '04 and in the Taiwan conference the company guided to depreciation being flat over '03. I was wondering if you could tell us in '04 which quarter

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does depreciation bottom? I guess some point in time with increased CAPEX it will start to pick up again. So will it bottom in the second quarter? Or the third quarter?

Dr. Lora Ho - TSMC - VP and CFO

Okay, if you see the CAPEX it's coming from the first half, it's quite even. It's slightly front loaded the first half. Actually our [aged] depreciation is coming off quite evenly, through the whole year. So, if you are trying to differentiate which quarter you would see the depreciation goes up, it's not quite obvious. You don't see a very big impact on depreciation because of the new CAPEX. When we have new CAPEX and [aged] coming off depreciation quite [inaudible].

Asish Kumar - Credit Suisse First Boston Corporation - Analyst

Thank you very much.

Operator

Thank you, our next question comes from Bihavan Shaw [ph] from JP Morgan Securities, please go ahead with your question.

Bihavan Shaw - JP Morgan Securities - Analyst

Yes, thank you. I want to go back to some comment that you have made in the afternoon about expecting more than 40% volume growth in 2004. My question is, based on your analysis, out of 40%, how much is pure market growth, or [fair market]? How much is increased IDM outsourcing, and how much your customers simply building too much inventories because they're not getting enough capacity?

Dr. Rick Tsai - TSMC - President and COO

Well, we have, I don't think we can really answer your question accurately. We probably can go back and do some analysis, from the IDM point of view, but as to how much is going into inventory, I don't have that, it's a very difficult question to answer. We ask our customers [inaudible]. I think, [I feel], I mean, so inventory level is increasing somewhat, but mostly because of the level was in general very low during the past couple of quarters. So low that in some cases they were causing a line shutdown for our customers. That's why they are now putting into inventory, some inventory. But as far as I know, every customer is still very cautious because nobody really has forgotten about the last three years. But that's kind of qualitative answer to your question but I think it's very difficult to give you a quantitative one.

Bihavan Shaw - JP Morgan Securities - Analyst

Thanks for that. The second question is, could you comment on, in which quarter do you think you'll exceed 1% of your revenues in 90 nanometers and also 1% of revenues in .11 micron.

Dr. Rick Tsai - TSMC - President and COO

Um, for 90 nanometer 1%. What's 1% [inaudible] (laugh)

Bihavan Shaw - JP Morgan Securities - Analyst

Make it 2%.

Dr. Rick Tsai - TSMC - President and COO

(Laugh). Um, yeah. I think 4th quarter timeframe we'll probably, I mean [maybe] go to a [half] roughly 1% for 90 nanometers. But for .11 I think probably easily the second quarter. And the third quarter will be quite a bit higher.

Bihavan Shaw. I see. And, just one last question from me, I'm not sure if you can answer this, but assuming that the CAPEX is NT\$2b, and without obviously knowing what your CAPEX will be next year, based on the NT\$2b CAPEX this year, and based on all the historical depreciation [inaudible] what would be the 2005 depreciation? In other words, if you assume that, and yeah, without putting in the CAPEX for 2005.

Dr. Lora Ho - TSMC - VP and CFO

The 2005 we don't know any CAPEX. I think that depreciation will increase slightly, because we also have a lot of aged equipment coming off depreciation in 2005.

Bihavan Shaw - JP Morgan Securities - Analyst

So it will increase slightly or decrease slightly.

Dr. Lora Ho - TSMC - VP and CFO

Increase slightly.

Bihavan Shaw - JP Morgan Securities - Analyst

Okay, thank you.

Operator

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Thank you. Our next question comes from Donald Liu [ph] with Goldman Saks Asia LLC [ph], please go ahead with your question.

Donald Liu - Goldman Saks Asia LLC - Analyst

Thank you. I have a couple of questions. One is, can you give us, in terms of absolute incremental capacity increase by the 4th quarter versus the 4th quarter of last year? And secondly, for the Fab 12b equipment part, was that included in your original NT\$2b CAPEX or was that going to be an extra amount.

Dr. Lora Ho - TSMC - VP and CFO

The answer for your first question is 24%. And your second question is asking about the 7b?

Donald Liu - Goldman Saks Asia LLC - Analyst

No, I'm asking about the Fab 12b. The new 12" Fab you're going to be moving in equipment in October and November timeframe. I'm just trying to figure out whether the CAPEX for that part of the equipment was included in your original NT\$2b CAPEX forecast?

Dr. Lora Ho - TSMC - VP and CFO

I'd say, Donald, the NT\$2b including for 12, including many 12a, but not 12b. Initial [product] facility is included in this year.

Donald Liu - Goldman Saks Asia LLC - Analyst

Okay, great, thank you Lora.

Operator

Thank you. Our next question comes from Boris Pedersen [ph] with Capital International Incorporated, please go ahead with your question.

Dr. Lora Ho - TSMC - VP and CFO

We cannot hear Boris.

Operator

One moment ma'am. Mr. Pedersen?

Boris Pedersen - Capital International Incorporated - Analyst

Yes, I'm speaking.

Operator

Please go ahead with your question.

Boris Pedersen - Capital International Incorporated - Analyst

Thanks so much. Sorry to go on about the depreciation question. Depreciation in the first quarter was down I guess quite substantially from Q4, and the question would be, is it down again in Q2, or did we see the low end of the depreciation?

Dr. Lora Ho - TSMC - VP and CFO

I think it's probably at the same level with our CAPEX coming on line. Even-it will not a big degree.

Boris Pedersen - Capital International Incorporated - Analyst

Okay, so pretty much the same.

Dr. Lora Ho - TSMC - VP and CFO

Yes.

Boris Pedersen - Capital International Incorporated - Analyst

And the margin guidance on gross profits was for 300-500 basis points up in the 2nd quarter.

Dr. Lora Ho - TSMC - VP and CFO

A few points jump.

Boris Pedersen - Capital International Incorporated - Analyst

A two point jump. Got it.

Dr. Lora Ho - TSMC - VP and CFO

A few points.

Boris Pedersen - Capital International Incorporated - Analyst

A few points, okay. And lastly, you explained on the tax that the tax has been lowered from Q4 to Q1 from about 19% to 13%, but the end effect because of the credits was that there was a tax benefit, and that's a tax benefit.

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Dr. Lora Ho - TSMC - VP and CFO

Right.

Boris Pedersen - Capital International Incorporated - Analyst

And if we use 13% for the full-year tax rate, should we expect the tax credit for the full year to exceed that tax rate?

Dr. Lora Ho - TSMC - VP and CFO

That's possible.

Boris Pedersen - Capital International Incorporated - Analyst

Okay, thanks so much.

Operator

Thank you. Our next question is a follow-up from Mr. Dan Hiler, please go ahead with your follow-up.

Dan Hiler - Merrill Lynch - Analyst

Thanks, yes. I was wondering if you guys could talk more about more on the wireless space in the IDM business? You said, you commented that the IDM business had picked up, which was normal, is there seasonality in the IDM business? And why was that normal. Or are we seeing something else here that, in terms of drivers here? How should we think about that in the 2nd half. Given that capacity is pretty tight, I'm just wondering if you're seeing IDM starting to finally expand in capacity, or are they increasing output?

Dr. Rick Tsai - TSMC - President and COO

Dan, I'm not sure if we understand your question on the wireless relationship with IDM. Are you asking for, if the orders from IDM is increasing?

Dan Hiler - Merrill Lynch - Analyst

Yes, there are two questions there, yes. First an update on wireless, and to what extent can we continue to see that growth since that obviously is IDM driven. The second part of the question is can we expect to see IDM increasing continually in the 2nd half in general terms?

Dr. Rick Tsai - TSMC - President and COO

Wireless, we believe will continue to grow during the whole year. We do not think it's all driven by IDM. We have multiple customers [inaudible] point of view. But from IDM output point of view, my feeling is the, in a good year, everyone is looking at increasing CAPEX, or at least contemplating increasing CAPEX. I think a couple of the announcements from the Japanese companies are probably a good example. However, I do not believe they would not have an impact really on 2004.

Dan Hiler - Merrill Lynch - Analyst

Yeah, just wondering because the nature of the outsourcing seems to be much more leading edge than last upturn, and last upturn you had a major pop in outsourcing before the peak, which was opportunistic outsourcing. And what I'm wondering is right now, given that it is leading edge, is there as much as an incentive for IDM to have capacity as in the past? Or since they can get what they need on the leading edge, that there's less incentive for them to build at this point.

Dr. Rick Tsai - TSMC - President and COO

I'm not-you're talking about-since outsourcing now occurs more with IDM?

Dan Hiler - Merrill Lynch - Analyst

How does the fact that the nature of the outsourcing is now more leading edge? Does that change the typical pattern of IDM adding a lot of capacity in an upturn? Will they outsource more at the peak this time or less at the peak? Or will it be the same?

Dr. Rick Tsai - TSMC - President and COO

I think the jury is still out, but my feeling is, they will, the fact as you said, the fact that now they're outsourcing more with the leading edge technologies, we'll, I mean, we'll continue this outsourcing trend more than before. That would be my view.

Dan Hiler - Merrill Lynch - Analyst

Thank you.

Operator

Thank you. Our next question comes from Michael McConnell at Pacific Crest Securities. Please go ahead with your question.

Michael McConnell - Pacific Crest Securities - Analyst

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Rick, just a cycle kind of question here for you. Looking at the equipment constraints right now, with deliveries, just with you and your competitor, and in the foundry industry overall, and your customers inability to build inventory as quick as they'd like to, although they're trying to right now, do you think that this cycle could be more of a gradual cycle in terms of growth, and relatively looking out, than it would be longer, as well? What's kind of your look, your view in terms of what the dynamics are playing out with right now with your ability to build capacity versus your customer's ability to increase their inventories?

Dr. Rick Tsai - TSMC - President and COO

We believe, we're still early in the cycle, the Chairman was confident that, I think he said [early summer]. We do believe, the cycle really, I felt, in my view it started a couple of quarter or, you know [close to two] quarters ago, [inaudible] quarters ago, I think the impact coming up is not going to be that bad. Especially 300 million of capacity, you know, [inaudible] ramp up, it's not as, it's not going to be, at least, well I shouldn't say easy, it's not going to be as straight-forward as the [inaudible] capacity. I think you're going to see some difficulty in ramping up of the new 300 million facility, especially by companies with no prior experience. So, that's just one aspect of course, of the, from a supply point of view. But I also believe that the demand picture remains also fairly bright. Quite bright.

Michael McConnell - Pacific Crest Securities - Analyst

So right now there's no concerns with your customers, their inventory levels currently, and/or any type of double ordering? I imagine you're monitoring it. But right now there's no concerns at this point?

Dr. Rick Tsai - TSMC - President and COO

Yeah, I would say right now. You're right, there is no concerns. No, some customers I think are probably putting in orders earlier. For sure, because they're concerned that the capacities here are getting really very tight, and they want to make sure that [inaudible] can be started whenever there is an opportunity.

Michael McConnell - Pacific Crest Securities - Analyst

Okay, thank you very much.

Operator

Thank you. Miss Ho, there are no further questions at this time. Please continue.

Dr. Lora Ho - TSMC - VP and CFO

So if there is no questions, then thank you very much for this conference. Then we'll end this session. Goodbye everybody.

Operator

Thank you. Before we conclude TSMC's quarter one 2004 webcast conference call today, please be advised that the replay of this conference call will only be accessible through TSMC's website at www.tsmc.com. Thank you all.

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