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TSM - Q2 2010 TSMC Earnings Conference Call

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CORPORATE PARTICIPANTS

Elizabeth Sun
TSMC - Head - IR

Lora Ho
TSMC - VP and CFO

Morris Chang
TSMC - Chairman and CEO

CONFERENCE CALL PARTICIPANTS

Randy Abrams
Credit Suisse - Analyst

Dan Heyler
Bank of America-Merrill Lynch - Analyst

Michael Chou
Deutsche Bank - Analyst

Steven Pelayo
HSBC - Analyst

Satya Kumar
Credit Suisse - Analyst

PRESENTATION

Operator

Welcome to the TSMC Second Quarter 2010 Results Webcast Conference Call. This conference call is being webcast live via the TSMC website at www.tsmc.com and only in audio mode. Your dial-in lines are also in listen-only mode.

I would now like to turn the conference over to Dr. Elizabeth Sun, TSMC Head of Investor Relations.

Elizabeth Sun - TSMC - Head - IR

Thank you, Latisha. Good morning and good evening, everyone. Welcome to TSMC's Second Quarter 2010 Conference Call. Joining us on the call are Dr. Morris Chang, our Chairman and CEO, and Ms. Lora Ho, our Vice President and Chief Financial Officer.

The format for today's conference call will be as follows. First, Lora will summarize our operations in the second quarter and give you our guidance for the third quarter. Afterwards, TSMC's Chairman Dr. Chang will provide his general remarks on the business outlook and a couple of key messages. Then, we will open the floor to questions. 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.

I would like to remind all listeners that following discussions may contain forward-looking statements that subject to significant risks and uncertainties, which could cause actual results to 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 April 15, 2010, and such other documents as TSMC may file with or submit to the SEC from time to time.



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Except as required by law, we undertake no obligation to update any forward-looking statements, whether as a result of new information, future events, or otherwise.

And now, I would like to turn the call over to Lora.

Lora Ho - TSMC - VP and CFO

Thank you, Elizabeth. Good morning and good evening to everyone. Welcome to our Second Quarter 2010 Earnings Conference Call. I will start today's conference call with the highlights of the second quarter. Then, I will give you the outlook of our third quarter. Please refer to the quarterly financial summary slides on our website. All dollar figures are in NT dollars, unless otherwise stated.

Customer demand for TSMC wafers continue to be robust in the second quarter, which translated to revenue and shipment growth across all major segments, technologies, and geographic areas. Net sales reached TWD105 billion, up 13.9% from the first quarter and up 41.4% from the year-ago quarter. Wafer shipments were 2.93 billion eight-inch equivalent wafers, increased 14.9% from the prior quarter and 48.5% from the same quarter last year.

Gross margin was 49.5%, representing a 1.6 percentage point increase from the first quarter and a 3.3 percentage increase from the second quarter level. Operating margin of 38.6% was also up 1.6 percentage points sequentially and up 4.7 percentage points compared with second quarter '09. EPS for the second quarter 2010 reached TWD1.55. ROE was 31.6%.

Now, let's take a look at the income statement. Second quarter gross margin was 49.5%, up by 1.6 percentage points from 47.9% in the first quarter. The increase was mainly due to our higher capacity utilization rate and continued cost improvement, partially offset by an adverse inventory valuation adjustment and an increase in raw material cost.

Operating expense increased TWD1.4 billion from the first quarter as we accelerated the development for the most advanced technologies and expanded this in scale and activities to support future growth. Non-operating income increased by TWD415 million from first quarter, primarily due to the higher disposal gains from financial assets and the absence of earthquake scrap loss in first quarter.

Net investment gain was TWD529 million, up TWD352 million from the prior quarter, mostly due to the business improvement among certain invested companies. Net margin was 38.4%, up 1.9 percentage points sequentially and up 5.5 percentage points year-over-year.

On page six, let's now turn to revenue analysis. Revenue from all major segments increased sequentially. Consumer was the strongest with a 26% sequential growth. Communications, computer, and industrial applications grew 22%, 1%, and 14%, respectively. Overall, revenue from communications, computer, consumer, and industrial applications accounted for 41%, 29%, 15%, and 15%, respectively, of our wafer sales in second quarter '010.

Trends in consumer demand was also seen across all technologies. Rapid ramping of 40 nanometer continued to lead growth and it reached 16% of total wafer revenue in the second quarter. The revenue mix of 65 nanometer and 90 nanometer remained stable at 27% and 16% of total wafer sales, respectively. Revenue from 0.13 micron and below represented 72% of total wafer sales for this quarter.

Now, let's move on the balance sheet and cash flow statement. We ended the second quarter with TWD207 billion in cash and short-term investments, representing an increase of TWD15 billion from the first quarter. Total current liabilities increased by TWD88 billion, primarily due to the increase in cash dividend payable and an increase in short-term loans. Accounts receivable days was 39 days. Inventory turnover days stayed flat at 45 days. The fixed-asset turnover was 1.3 times.

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Cash generated from operating activities totaled TWD49 billion, representing an increase of TWD3 billion from the prior quarter, mainly due to increase in net income. Capital expenditure was TWD53 billion in the second quarter. Meanwhile, we borrowed TWD18 billion in short-term loans. The purpose was to hedge a portion of our net position in US dollars.

Meanwhile, during the second quarter, we also invested TWD1.6 billion for 21% ownership of Stion, a US-based solar company. In sum, the ending cash balance was TWD172 billion, increased TWD12.7 billion sequentially. Free cash flow was a net outflow of TWD3.8 billion.

Now, let's turn to capacity and capital expenditure. For the full year 2010, in order to meet continuing strong demand for TSMC's advanced technologies, we have accelerated our capacity expansion plan. Under the current plan, overall capacity is expected to increase by 14% year-over-year compared with a 13% increase planned in the last quarter. 12-inch wafer capacity is expected to increase by 36% in 2010 under the current plan.

The total installed capacity was about 2.75 million wafers in the second quarter, representing a 7.1% increase from the prior quarter. Now, we expect the capacity will continue to increase in third quarter by around 7% and further into the fourth quarter by around 3.5%. In terms of capital expenditure, we spent USD1.66 billion in the second quarter. Total capital expenditure in the first half of 2010 was USD3.1 billion.

Now, let's turn to the outlook for the third quarter of 2010. Based on the current business expectations and the forecast exchange rate of TWD31.87, we expect our consolidated revenue in third quarter to come in between TWD109 billion and TWD111 billion. In terms of margin, we expect our third quarter gross margin to be between 48% and 50%. Operating margin should be between 36% and 38%.

This concludes my remarks today. Now, I will turn the call over to Dr. Morris Chang, our Chairman and CEO, for his remarks.

Morris Chang - TSMC - Chairman and CEO

Hi, everybody. I'd like to make a few comments on market outlook and then supply chain inventory and then our technology and our CapEx and capacity plan and finally, a few comments about our new businesses.

First, on market outlook, our 2010 annual growth forecast for the end semiconductor system markets remain essentially unchanged. PC we predict will be 17% year-over-year growth this year. Handsets we predict will be about 13% year-over-year growth. And digital consumer electronics we predict will be 8% year-over-year, and that's one point higher than we predicted earlier.

Now, on the semiconductor market, our forecast now is 30% growth this year, and that's an upward revision from 22% that we made in April. The upward revision is primarily due to our reassessment of the strength of inventory restocking in the semiconductor supply chain. In the same time, we also forecast that the 2010 foundry market will grow by about 40%, and that's up from the 36% we forecasted in April.

Now, a few comments about supply chain inventory. Regarding supply chain inventories, based on the second quarter results reported so far, inventory dollar and DOI at most reported IC and the system companies have increased from first quarter. We estimate that supply chain inventories in aggregate are still below seasonal levels at the end of second quarter and in fact, will still be below seasonal levels at the end of third quarter.

For Fabless and IDM companies reported so far, inventory levels have increased at a rate close to the increase in sales. Aggregate DOI increased marginally but are still lower than seasonal for second quarter. We expect that chip companies' inventory levels and DOI will increase slowly and reach close to seasonal levels by fourth quarter. In other words, the chip companies' inventories

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run pretty much parallel to the supply chain inventories, perhaps a little lower than the supply -- than the total supply chain inventories.

Now on technology, our 40 -- TSMC's 40-nanometer technology is progressing well. It has already accounted for 16% of our total wafer revenues in the second quarter with gross margins in the mid-40s. We expect the margins of the 40-nanometer technology to further improve and will be very close to the corporate overall level by fourth quarter this year. On 28 nanometers, our offerings, which we have three high-k metal gate processes and one conventional silicon oxynitride process covering a full range of solutions for customers from high performance to low power to cost sensitive application.

We have 28 HP, which is high-performance, high-k metal gate, for high-speed A6 and multi-gigahertz processors. We have 28 HPM, which is the best high-k metal gate SoC technology with broadest range in speed leakage, best suited for smart books and other mobile internet devices. We have 28 HPL, which is lower standing by power high-k metal gate technology for mobile and consumer application. And then we have 28 LP, which is low-cost conventional CMOS for smart phones and consumer applications.

In the foundry market, we believe that we have the best 28 nanometer high-k metal gate SRAM yield and performance, while providing 2 times gate density improvement over our industry-leading 40-nanometer technology. Based on public data, TSMC's gate-last process outperforms competition's gate-first process by a good margin in both the low-power and the high-performance classes.

On 20-nanometer developments, we expect to roll out TSMC's 20-nanometer technology in the second half of 2012. Our 20-nanometer process will use planer bulk transistors, not SOI, coupled with a 20-nanometer, not 22-nanometer, solution. It offers best value per cost for our customers. Our 20 nanometers will have two times gate density over our 28 nanometers. With innovations in both immersion and topography and mobility enhancement techniques, TSMC's 20-nanometer technology is expected to deliver better performance and produce savings on intrinsic wafer cost.

Other than the Moore's Law progression, which I have talked about, we have spent a great deal of effort in developing specialty technologies to capture the market trend of integrating more specialty features with CMOS logic and the trend of continuing scaling down the geometries for cost and form factor advantages.

Our technology leadership in these specialty technologies include both feature improvement and the ability to further shrink the geometries. We have already achieved some of -- very good results. For example, for automotive, we plan to use 65 nanometer and 90 nanometer to deliver engine control processing. For CMOS image sensors, we use 65 nanometer and backside illumination to achieve the best quantum efficiency.

For embedded DRAM, we use 40 nanometers to deliver the fastest network processes. For embedded flash, we use 0.11 micron to enable ultra low leakage MCU, micro controller unit, of one picoAmp per micron. For MEMS, we use 0.18 micron to compete 3D CMOS MEMS integration. For power ICs, we use 0.18 micron to achieve the lowest turn-on resistance in the industry.

Our technology efforts, including both Moore's Law's progression and the more-than-more technologies have attracted many customers to expand their engagement with TSMC. I mentioned last time that our sales in China has overtaken our sales in Japan; but that was only true for last year. Now this year, because of the expanded customer engagement we have in Japan, Japan sales are again racing ahead of mainland China's. Of course, mainland China sales continue to grow at a very high rate. But we believe that Japan will also grow at a very high rate in the coming years.

Now, a few comments on our capacity plan. TSMC's business model is very importantly partnership with our customers. In fact, virtually all of our major customers are our partners and all important semiconductor houses are our major customers. We have a responsibility to them to do our utmost to respond to their demand. Our customers' demand for this year and their forecast demand for 2011 have both risen since January.



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Therefore, we have also accelerated our capital spending. We now forecast our 2010 capital expenditure for the foundry business to be approximately USD5.8 billion and the capital spending for new business to be approximately USD100 million. Therefore, total capital expenditure for 2010 is forecast to be approximately USD5.9 billion. I want to emphasize that TSMC builds capacity to customers' demand. We do not build capacity on speculation. In other words, we don't first build capacity and then look for customers' business.

A major part of the capital spending this year is to ramp up two of our existing 12-inch GigaFabs, fab trial Phase V and fab 14 Phase IV. Each GigaFab when fully loaded has a monthly capacity of around 150,000 12-inch wafers, which is 3 to 4 times the size of a regular wafer fab. Two weeks ago, we also broke ground on our -- for our third 12-inch GigaFab. We call it fab 15. It is in the Taichung Science Park. We expect to complete fab construction by early next year and begin installing tools shortly after that.

We have also experienced accelerated outsourcing by IBMs and growing presence of Fabris customers in specialty technologies, such as CMOS image sensors, embedded memories, high voltage, automotive, and power. Therefore, a part of the capital spending will include capacities for these more-than-more special technologies. We will support these technologies with both 8-inch and 12-inch capacities in the next few years.

Let me give you a more detailed breakdown of this year's capital spending for our foundry business. Spending for capacity for 28-nanometer, 40-nanometer, 65-nanometer technologies accounts for 79%. Spending for capacity for more-than-more technologies accounts for 13%. Spending for tools and equipment for R&D accounts for 8%.

Now, we increased our capital expenditure forecast from USD4.8 billion that we gave in January to USD5.9 billion now. Among the TWD1.1 billion increase in CapEx, the breakdown is as follows -- 20 and 28-nanometer capacity spending increased by about USD350 million, 65-nanometer capacity spending increased by about USD450 million, specialty technology spending increased by close to USD300 million.

Now, I'd like to turn to new businesses. I want to make some remarks on TSMC's initiatives in the solar and LED lighting market. As you may know, both markets have been growing fast and will continue their growth pattern for a long time due to their long-term economic values as well as the sustainable environmental benefits. However, technology advances together with efficient and large-scale manufacturing are essential to reap those benefits. Entering these markets, TSMC aims to differentiate ourselves in technology and manufacturing, as we have successfully done in the silicon IC industry.

On the solar front, TSMC has made significant moves during the last year to ensure ourselves a competitive technology and accelerate our entry to the market. Through the recent technology license and investment agreement with Stion Corporation, we are transferring and developing together a high-conversion efficiency CIGS thin-film technology with a very low intrinsic cost structure based on which both companies will aggressively build our manufacturing capacity to scale in the near future.

We strongly believe that CIGS technology will provide a long-term competitive solution to this high-growth market. An earlier strategic investment in Motech, which is a major crystalline silicon solar photovoltaic manufacturer, has accelerated our learning curve and with their solar sales support will enable our early entry in the solar market.

As to the LED lighting area, we are establishing our proprietary capabilities, utilizing TSMC's own technology expertise in semiconductor processing and silicon-based [practigen] techniques. These intensive technology development activities are progressing well, while our first LED lighting plant broken ground in March is expected to have equipment moving later in the year. In the meantime, we are working with Taiwan's very strong LED supply chain to design and develop LED lighting products so that we can go to market.

Longer term, we'll build our technologies with low-cost volume manufacturing and with innovative product design using these technology capabilities to provide various solutions to this very exciting market.



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Thank you and these are all my prepared comments. I believe we are open for questions now.

Elizabeth Sun - TSMC - Head - IR

Yes, Latisha, could you please open the floor to questions? Thank you.

QUESTIONS AND ANSWERS

Operator

At this time, we will open the floor for questions. (Operator Instructions).

Our first question comes from the line of Randy Abrams with Credit Suisse. Please proceed.

Randy Abrams - Credit Suisse - Analyst

Yes, hi. Good evening. Thanks for providing the additional detail on the additional CapEx split. A couple follow-ups on that -- on the USD1.1 billion additional spending, I noticed 40 nanometer was absent from that. Does that imply that you've seen just more demand stay on 65 and you feel comfortable with 40? Or is there anything to read into that? And then second question on it, you talked this afternoon about capital intensity rising. Do you have updated metrics on how much it's costing to add 1,000 wafer per month capacity on 28 nanometer versus 40 and 65 nanometer?

Lora Ho - TSMC - VP and CFO

Randy, your first question's regarding 40 nanometer. Actually --

Randy Abrams - Credit Suisse - Analyst

Yes.

Lora Ho - TSMC - VP and CFO

Yes, you're asking about the capital expenditure on 40 nanometer. Actually --

Randy Abrams - Credit Suisse - Analyst

Yes. Sounds like --

Lora Ho - TSMC - VP and CFO

Sorry?

Randy Abrams - Credit Suisse - Analyst

Go ahead.

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Lora Ho - TSMC - VP and CFO

Okay. Actually, when we built this 4.8 CapEx forecast, the biggest amount was going to the 40 nanometer. So, with that amount still remain high. So in this update, we did not change the number. But we are -- because we see very strong demand from 65 nanometers. That's why we increased capital expenditure. Also for 28 and 20 nanometer because we need to build very early scale so we can side with R&D and also fully implement earlier. So, that's why the CapEx for USD1.1 billion mainly attribute to 65 nanometer and 28 nanometer.

Randy Abrams - Credit Suisse - Analyst

Okay.

Operator

Our next question will come from the line of Dan Heyler with Bank of America-Merrill Lynch. Please proceed.

Morris Chang - TSMC - Chairman and CEO

Well, actually, I'm sorry. Randy --

Dan Heyler - Bank of America-Merrill Lynch - Analyst

Hi. Can --

Morris Chang - TSMC - Chairman and CEO

-- I think Lora did not answer the second part of your question, which had to do with the higher capital intensity and you're asking how many -- how much more capital intensive the 28 nanometer is. I think that's basically your question. Well, I also said this afternoon -- and I would say it again -- we pay very close attention to controlling the cost. We call it intrinsic cost. I used that term in my prepared comments.

And so, that cost is not yet stabilized. In other words, we're still trying very diligently and in fact quite successfully to reduce the cost. So far, the capital investment in 28 nanometer is still only in the initial stage. And so as I said, we're using the initial stage to also -- of course, we're using the initial stage to build up capacity for the risk production phase. But we're also using this experience to lower the capital intensity of the 28 nanometer. So, I cannot give you a number right now.

Lora Ho - TSMC - VP and CFO

Well, Randy, if you are happy with the answer, can we go to Dan Heyler now? Operator?

Dan Heyler - Bank of America-Merrill Lynch - Analyst

I think I have --



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Lora Ho - TSMC - VP and CFO

Yes. Okay.

Dan Heyler - Bank of America-Merrill Lynch - Analyst

I think I have -- this is Dan. Hi, I think I'm live already. So, a quick question on margins, guys. So on the second quarter outlook, you exceeded your revenue guidance by TWD104.9 billion or TWD105 billion versus the upper end of you guidance, which was TWD102 billion. And then, GP margin was just slightly below the upper end and OP margin was slightly above the upper end. So, I guess that's the first observation.

And the second observation is on the guidance. Despite your revenue growth of about 4% to 6%, you're guiding effectively a flat, dissimilar margin range of 48% to 50%. So, if you could elaborate and help us understand the margin dynamics here despite the rising revenue. Thank you.

Lora Ho - TSMC - VP and CFO

Okay, Dan. You're asking about the margin on second quarter and third quarter. On the second quarter, we have exceeded guidance in terms of revenue. But the margins stayed at high end of the guidance, not exceeding the guidance. We have observed two things in second quarter. Number one is there was increase in raw wafer price. So, that has some negative impact on second quarter margins. Also, the inventory variation have effect on second quarter because we build inventory for third quarter. So, that is the reason.

And similar reason on wafer pricing also goes to the third quarter. So, that will have continued impact on the margin. Also, Chairman commented this afternoon because we are under the very severe supply constraint. So, we have our most effort to satisfy our customers to get more output in second quarter and third quarter. So, we did not optimize the margin per se, but we do maximize the profitability.

Dan Heyler - Bank of America-Merrill Lynch - Analyst

Okay, great. And then, a follow-up on that would be in relation to the utilization with the capacity growing at 7% sequentially and you're guiding revenue of 4% to 6%. Assuming ASPs continue to be stable I guess, will utilization decline at all in the third quarter? And does that impact margins?

Lora Ho - TSMC - VP and CFO

Well, third quarter utilization is still high, but it will be slightly lower than second quarter. So, that does explain the margin stay at a flat level, as shown in our guidance.

Morris Chang - TSMC - Chairman and CEO

It is still high and it is still above 100%. But it's a bit lower than the second quarter I guess.

Dan Heyler - Bank of America-Merrill Lynch - Analyst

Great, okay. And then finally, a little bit of a follow-up on the one that I asked this afternoon on 40 -- would there be a descent to maybe an inflexion point where the -- i.e. a certain level of contribution to sales or scale where we should see an inflexion point on 40 or is it still a linear progression?

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Morris Chang - TSMC - Chairman and CEO

I think that -- well, I think that it's more a linear progression, as you put it. So, I expect that in the fourth quarter, it will be very close to the corporate average and I really think that in the early part of next year it will exceed the corporate average.

Dan Heyler - Bank of America-Merrill Lynch - Analyst

Great. Well, thanks for that color. Appreciate it.

Operator

Our next question comes from the line of Michael Chou with Deutsche Bank. Please proceed.

Michael Chou - Deutsche Bank - Analyst

Hi, good evening, Chairman, Dr. Chang. Could you give us some color for outlook by applications for Q3? Thank you.

Lora Ho - TSMC - VP and CFO

On Q3 relative to second quarter, we believe the consumer and communication segments in third quarter will increase, while computer segment will decline slightly.

Michael Chou - Deutsche Bank - Analyst

Is that possibly -- can separate wire line and the wireless?

Lora Ho - TSMC - VP and CFO

I'm afraid that's not appropriate because we are under the supply constraint situations. So, the segment by segment actually constrained by our capacity. So, I don't want to mislead you by providing the segment color and you may use that to drive the estimation of our customers' business.

Michael Chou - Deutsche Bank - Analyst

Thank you. I'll go back to the queue. Thank you.

Operator

And our next question comes from the line of Randy Abrams with Credit Suisse. Please proceed.

Randy Abrams - Credit Suisse - Analyst

Okay. Thanks for bringing me back in. On the -- I guess to follow up on the capital intensity question, maybe less specific to 28 nanometer, but if you could give metrics, say, on how expensive it's been to add additional capacity even this year or last year relative to prior cycles, if you could give a feel for how much capital intensity is rising.

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Operator

We have no further questions in the queue. At this time --

Lora Ho - TSMC - VP and CFO

Well, we're still deliberating on the answer to Randy. So, just give us a second. Randy, you're asking the capital parity between -- other than 28 nanometer. I will give you one example. Take 65 nanometer and 40 nanometer as example. In [Q sinsee], we believe the 40 nanometer capital per K is roughly about 20% to 25% as in that of 65 nanometer.

Randy Abrams - Credit Suisse - Analyst

Okay. And --

Morris Chang - TSMC - Chairman and CEO

Yes, and as I said, we are trying to reduce the intrinsic cost from the equipment side. And so, we're trying to control the capital intensity of 28 nanometers to at least similar to the 65-40 ratio if not better.

Randy Abrams - Credit Suisse - Analyst

Okay. And maybe two follow-ups -- and one is just on yields. I think you mentioned margin actually getting to the point it could be pretty close by year end. I guess the implication then, it's -- yields are actually also comparable. And the second question I had was on the 2010 foundry growth this afternoon, where you said it was 40% for foundry industry. I think if we took TSMC in line with that and your 5% growth in third quarter, are you thinking about a fourth quarter, like a low single-digit type of decline for TSMC? And are you taking into consideration you think TSMC grows in line with foundries or could actually outgrow the foundry sector?

Lora Ho - TSMC - VP and CFO

Randy, we do not give guidance on our fourth quarter.

Randy Abrams - Credit Suisse - Analyst

Okay.

Operator

Our next question comes from the line of Steven Pelayo with HSBC. Please proceed.

Steven Pelayo - HSBC - Analyst

Great, thank you. Thank you very much. Last earnings call, you talked about it was doubtful that you thought there was much double bookings going on. But you also said that demand was 30% to 40% above what you could supply. Now, here we are 90 days later. We've seen some incremental soft lines in PCs and mobile phones and even LCD areas.



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So, I guess I'm curious if you could talk a little bit about -- have you seen anything up at your level? Maybe talk a little bit about -- I think you said that the computing segment was soft in 2Q and it would remain soft in 3Q. Is that broad based or one customer? I guess the gist of the question is if you can go through the segments and talk about any incremental softness you may have also felt since last earnings season.

Elizabeth Sun - TSMC - Head - IR

Steven, this is Elizabeth. Well, as you know, we don't comment on that kind of detail because we cannot review our customers' business with us. And then, as Lora has mentioned, that both second quarter and third quarter were actually running at very tight capacity. Our customers are actually being constrained by our capacity. And so, by giving out these detailed color, we are actually mislead the market in terms of the true end market situation. So, if you can forgive us, we will not answer that question.

Steven Pelayo - HSBC - Analyst

Okay. Well, you did provide some color on your expectations for the segments in the third quarter. I think you said computing would remain relatively weak, I think would decline quarter-on-quarter. What were your expectations for the other segments?

Elizabeth Sun - TSMC - Head - IR

All right. In fact, we said third quarter computer-related applications will decline slightly. We did not say it remained relatively weak. In fact, second quarter, our computer-related applications actually went up by a low single digit, if you recall. And the other two, I think communication probably will be better than consumer. Both are growing moderately, probably in a range between mid to high-single digit in the third quarter.

Steven Pelayo - HSBC - Analyst

Excellent. And then, you talked also about a depreciation number, I think with the overall cash flow depreciation about TWD89 billion this year. I guess two questions on that -- the first one is when you look at depreciation that's in your cost of goods sold, can you get specific? Give me some help on what that'll be in the third and the fourth quarter. And I know you don't want to talk about 2011 capital spending, but at least we should have an idea for where do we think depreciation's going to be and what kind of run rate we're looking at for 2011 at this point. Can you help me out with those two things?

Lora Ho - TSMC - VP and CFO

Steven, depreciation for this year, you're right. I did say that the total 2010 depreciation would be roughly TWD89 billion and we believe the second half depreciation will be higher than first half. You have seen our management report we have shown first quarter and second quarter numbers. So, if you take the TWD89 billion, subtract those two numbers, you can have idea of the second half numbers.

Elizabeth Sun - TSMC - Head - IR

So, Steven, as I mentioned to you this afternoon, you can add about TWD1.5 billion from the second quarter level depreciation to the third quarter. And then, since you have the full-year depreciation, you can easily deduce the fourth quarter number.

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Steven Pelayo - HSBC - Analyst

No, I understand that. But the depreciation number in cost of goods sold is actually different than the cash flow depreciation, that TWD89 billion number that we were talking about. So, I was just trying to get some specifics.

Lora Ho - TSMC - VP and CFO

Yes, the difference is very little.

Steven Pelayo - HSBC - Analyst

Okay. And then, any thoughts on 2011? Are we going to continue to see that manufacturing depreciation go up and potentially govern gross margin?

Lora Ho - TSMC - VP and CFO

Steven, 2011 depreciation still needs to be worked out because -- since we don't have a 2011 CapEx. But with the high CapEx this year, I would say I estimate the 2011 depreciation will be higher, about 15% higher than this year.

Steven Pelayo - HSBC - Analyst

About 15%. Okay. Thank you.

Operator

Our next question comes from the line of Raffi Hassan with Susquehanna. Please proceed.

Elizabeth Sun - TSMC - Head - IR

I guess Raffi is not on the line. Maybe we can --

Operator

Yes, his line is open. He may check his mute feature. Your line is open at this time, sir.

Elizabeth Sun - TSMC - Head - IR

Operator, let's move to the next caller, please?

Operator

Okay. Your next question comes from the line of Dan Heyler with Bank of America. Please proceed.

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Dan Heyler - Bank of America-Merrill Lynch - Analyst

Yes, I thought it would be great if you could talk a little bit about the LED and the fuller business if possible. You've given more color and your investments are a lot more tangible now. When would we expect to see that start to contribute some revenue and we'd get a breakout on the businesses on a quarterly basis? When would that event begin?

Morris Chang - TSMC - Chairman and CEO

I don't think that it will contribute any significant revenue this year, and I believe it will begin to contribute revenue next year.

Dan Heyler - Bank of America-Merrill Lynch - Analyst

Any sense of the quarterly -- when we begin to see a quarterly breakout from TSMC financially?

Morris Chang - TSMC - Chairman and CEO

Oh, I think it's pretty hard to predict, Dan.

Dan Heyler - Bank of America-Merrill Lynch - Analyst

Okay. No worries. Thank you.

Morris Chang - TSMC - Chairman and CEO

I don't -- I mean, I have already predicted next year. But I think it's hard to predict which quarter.

Dan Heyler - Bank of America-Merrill Lynch - Analyst

Great.

Operator

Our next question comes from the line of Michael Chou with Deutsche Bank. Please proceed.

Michael Chou - Deutsche Bank - Analyst

Hi, Dr. Chang. Just a follow-up question for the foundry sector revenue growth, 40% year-on-year. Assuming TSMC revenue growth exceeds the foundry revenue growth by several single-digit points, so based on your Q3 guidance, is it fair to say that your Q4 revenue could be down single digits? I know you cannot give a guidance for Q4. But if based on your forecast for total foundry revenue growth, 40% growth for this year, is it fair to say that?

Lora Ho - TSMC - VP and CFO

Firstly, we cannot guide fourth quarter. But when you look at the 40% foundry growth in terms of revenue, we mean in US dollars. And the number we reported on quarterly basis was actually NT dollars and NT has been appreciating this year with more than 3%.

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Michael Chou - Deutsche Bank - Analyst

Yes, so if we assume the 6% quarter-on-quarter growth for Q3 and around 3% to 4% NT dollar appreciation for this year, so is that fair to say that it seems like Q4 could be down single digits quarter-on-quarter because if we factor in the NT dollar impact?

Elizabeth Sun - TSMC - Head - IR

Michael, we really appreciate your persistence. But as Lora said, we cannot give any guidance about fourth quarter at this point. You can make your own judgment. Thank you.

Michael Chou - Deutsche Bank - Analyst

Thank you. Thank you. I have no further questions. Thank you.

Operator

Our next question comes from the line of Satya Kumar with Credit Suisse. Please proceed.

Satya Kumar - Credit Suisse - Analyst

Yes, hi. Can you hear me?

Lora Ho - TSMC - VP and CFO

Yes.

Satya Kumar - Credit Suisse - Analyst

Thank you. I just wanted a little bit more clarity on the supply growth. I guess the CapEx increase, I appreciate the extra color that you gave today. But I'm just a little confused as to why the 300-millimeter capacity at the end of the year is not increasing by more, given the increase in CapEx that you talked about. I was wondering if you could provide a little bit more color on the capacity growth on 300 millimeter as we're going to the early part of next year. I was wondering if that is being paid for in the CapEx this year.

Lora Ho - TSMC - VP and CFO

Dr. Chang just talked about this CapEx increase. He mentioned about increase goes to 28, 20, and 65 nanometer and both of them are 12-inch. So actually, we add more CapEx on 12-inch in view of discretion.

Satya Kumar - Credit Suisse - Analyst

No, wait. I guess my question is why is that not showing up in the capacity number that you reported at the end of Q4? It should be a higher number, but it's only a little bit over your previous guidance.

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Lora Ho - TSMC - VP and CFO

Because you look at year-over-year. We said that from 13% to 14%, but if you look at quarter-over-quarter, our third quarter capacity will be 7% more than second quarter and will be another 3.5% more in fourth quarter. This two number was much higher than our previous guidance.

Satya Kumar - Credit Suisse - Analyst

Well, I guess -- sorry to ask another question on this topic. But if I look at the increase in 300-millimeter wafer stock capacity that you're now giving for Q4 compared to what you'd given earlier when your CapEx guidance was TWD4.8 billion, it's about a 5,000 wafer stock per month increase for fab 12 and fab 14 combined, whereas the increase in CapEx is more than TWD1 billion. So, that sounds like a very high number in increase in CapEx compared to increase in wafer stock per month relative to your prior guidance and that's what I'm trying to get a sense of.

Elizabeth Sun - TSMC - Head - IR

Okay, Satya. This is Elizabeth. Let me just say this. When you look at the capacity plan, you see fab 12, fab 14 and you see some numbers. What you do not see is the technology mix and so, not all the wafers are equal. And so, sometimes we increase more of the more advanced technologies and sometimes we make certain switches. And so, this is very difficult for you just to look at these numbers and draw a conclusion because there is indeed a dynamic of the product mix.

The second thing is even if we mention about the spending for the TWD1.1 billion, but some of the spending does not translate to capacity right away. So, you cannot say all the spendings are completely being reflected in the fourth quarter capacity that we have put out.

Satya Kumar - Credit Suisse - Analyst

Okay. That's very helpful. And I know you didn't want to comment on 2011, but because we have to sort of have an idea, if we thought that TSMC's supply growth next year needs to be --

Morris Chang - TSMC - Chairman and CEO

You're right. We don't want to comment on 2011.

Elizabeth Sun - TSMC - Head - IR

So, I think we'll wait. Couple of more months, we can talk about 2011.

Satya Kumar - Credit Suisse - Analyst

Okay, that's fair. I'll stop there then. Thanks.

Elizabeth Sun - TSMC - Head - IR

Thank you. Operator, since there's no more callers on the line, I think we can end this conference call.

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Operator

Before we conclude TSMC's Second Quarter 2010 Results Webcast Conference today, please be advised that the replay of the conference call will only be accessible through the TSMC's website at www.tsmc.com. Thank you all.

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