

FINAL TRANSCRIPT

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TSM - Q4 2010 Taiwan Semiconductor Manufacturing Co. Ltd. (TSMC) Earnings Conference Call

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Jan. 27. 2011 / 1:00PM, TSM - Q4 2010 Taiwan Semiconductor Manufacturing Co. Ltd. (TSMC) Earnings Conference Call

CORPORATE PARTICIPANTS

Dr. Elizabeth Sun

TSMC - Head, IR

Lora Ho

TSMC - SVP and CFO

Dr. Morris Chang

TSMC - Chairman and CEO

CONFERENCE CALL PARTICIPANTS

Randy Abrams

Credit Suisse - Analyst

Mehdi Hosseini

Susquehanna International - Analyst

Dan Heyler

Bank of America Merrill Lynch - Analyst

Pranab Sarmah

Daiwa Capital Markets - Analyst

Steven Pelayo

HSBC - Analyst

PRESENTATION

Operator

Welcome to the TSMC's fourth-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's Head of Investor Relations.

Dr. Elizabeth Sun - TSMC - Head, IR

Thank you, Diana. Good morning and good evening, everyone. Welcome to TSMC's fourth-quarter 2010 conference call. Let me wish all of you a very happy New Year. Joining us today on the call are Dr. Morris Chang, our Chairman and Chief Executive Officer, and Miss. Lora Ho, our Senior 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 fourth quarter and give you our guidance for the next quarter. Then TSMC's Chairman, Dr. Chang, will provide his general remark 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 the following discussions may contain forward-looking statements that are 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 statement, 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 - SVP and CFO

Thank you, Elizabeth. Good morning and good evening to everyone. Welcome to our fourth-quarter earnings conference call. This next week will be the Chinese New Year. Before I start, I want to send you my best wishes for a great Year of the Rabbit.

During today's call I will start with the financial highlights in fourth quarter, followed by a recap of 2010. Then we will move on to the outlook for the first-quarter 2011. You may also refer to the quarterly financial summary slides on our website. All dollar figures are in NT dollars unless otherwise stated.

In the fourth quarter, the NT dollar appreciated more than we originally expected. The actual exchange rate reached TWD30.4 to \$1, compared with the planned TWD30.60 when we gave our guidance in the last conference. However, our fourth-quarter revenue still exceeded our guidance, with the profit margins reaching the high end of our outlook.

Fourth-quarter revenue was TWD110b, representing a 1.9% sequentially decline. However, in US dollar terms the fourth quarter marked a 3% growth compared with the third quarter. Wafer shipments were 3.2m eight-inch equivalent Wafers, flat from the prior quarter and up 31.5% from the year-ago quarter.

Gross margin was 49.8%, down 0.2 percentage points from the third quarter, but up 1.3 percentage points from last year. Operating margin was 37.7%, down 0.7 percentage points sequentially, but up 1.2 percentage points compared with the year-ago quarter. EPS in the fourth quarter was TWD1.57. ROE was 23 -- 29.3%.

Now let's move on, on the income statement. The NT dollar appreciated roughly 5% in the fourth quarter and, thus, negatively impacts our margin. However, due to our continued cost improvements our gross margin managed to stay at 49.8%, slightly down 0.2 percentage points from the third quarter. Operating expenses increased TWD250m from the third quarter, primarily due to higher operating expenses, opening expenses for Fab 14 and Fab 12 phase five.

Non-operating income decreased by TWD5m from the third quarter, reflecting the absence of receipts of SMIC shares from the SMIC litigation settlement. Meanwhile, in December we acquired a partially constructed Fab from Powerchip with TWD2.9b, including a steel frame to be disposed and rebuilt to our Fab specification. Therefore, we recorded a net loss of TWD800m in this quarter.

Net investment gain was TWD690m, compared with TWD900m in the prior quarter, reflecting lower profit from certain invested companies. Net margin was 37%, down 4.8 percentage points sequentially and up 1.5 percentage points year over year.

Now let's look at our revenue by applications. In the fourth quarter we continue to see growth in Communications and Industrial-related applications, which grew 3% and 4% respectively. Computer declined 6% sequentially, while consumer was down 26% from last quarter. Revenue from Communications-related applications represents 47% of our total Wafer revenue in the fourth quarter. Meanwhile, Computer, Consumer and Industrial applications accounted for 24%, 11% and 18% of our Wafer sales.

By technology, 40 nanometer and 65 nanometer continued to grow and represented 21% and 31% of our total Wafer revenue respectively. These two nodes combined were 52% of our Wafer sales, up from 46% in the last quarter. Meanwhile, revenue from 0.13 micron and below accounted for 73% of total Wafer sales, from 72% in third-quarter '10.



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Now, since 40 nanometer and 65 nanometer combined represent more than half of our total Wafer sales, starting from this quarter we redefined the term 'advanced technologies 65 nanometer' and below, compared with '0.13 micron and below' in the past.

Now let me move on to the balance sheet. We conclude the fourth quarter with TWD182b in cash and short-term investments, representing an increase of TWD14b from prior quarter, mainly due to free cash flow generated during the quarter, partially offset by a decrease in short-term loans for hedging purpose. Total current liabilities increased by TWD14b, primarily due to an increase in accounts payable to contractors and equipment suppliers.

In sum, the current ratio in the fourth quarter was 2.1. Accounts receivable days came slightly down to 38 days. Inventory turnover days were 50 days, reflecting the increase in mix of advanced technologies and certain early orders from customers. Net fixed asset turnover day -- turnover was 1.2 times in fourth quarter.

Now let's proceed to cash flow. Cash flow generated from operating activity totaled TWD70.6b, representing an increase of TWD6.6b from prior quarter, mainly due to a decreased use in non-cash net working capital. Capital expenditure was TWD46b in the fourth quarter and, as I mentioned, we repaid a portion of the short-term loans resulting a TWD6.7b outflow. In sum, the ending cash balance was TWD148b, up TWD16b sequentially. Free cash flow was TWD24.6b in this quarter.

Now, in terms of installed capacity, in the fourth quarter total installed capacity was about 3.1m Wafers in the third quarter, representing a 4% sequential increase. For first-quarter 2011 we expect our overall capacity to remain flat. While the 12-inch capacity will continue to expand by 3% Q over Q, 6-inch and 8-inch capacity will decrease slightly due to annual maintenance. 2010 managed capacity increased 14% year over year, with 12-inch capacity up 37%, representing 50% of our total capacity.

With regard to capital expenditures, we spent \$1.5b in the fourth quarter. Total capital expenditure for 2010 were \$5.94b.

Now I have a few comments on cash flow and cash dividend. For the past few years TSMC had consistently generated ample operating cash flow to fund our capital expenditure. Now TSMC is very well positioned to more aggressively pursue higher growth while improving profitability. We plan to invest and expand our capacity at a much faster pace to capture that growth.

In the fourth-quarter 2007 earnings conference I stated that our dividend paid-out ratio will be no less than 80% of the distributable earnings. However, in order to achieve the Company's new growth objective, from now this statement has to change. We believe that timely CapEx investment will unlock the Company's growth potential and bring greater rewards to our shareholders.

Meanwhile, I believe TSMC will be able to maintain a minimum TWD3 per share dividend in the future, or consider to increase the cash dividend when our free cash flow increases. In addition to a dividend yield that is already among the highest in the industry, TSMC aims to reward its shareholders even more with share price appreciation.

Next, let me give you a recap of our performance in 2010. 2010 was a record year for TSMC in revenue, gross profit dollars and net income dollars. We also achieved near historical high profit margins. To accommodate a strong demand from customers we have been committed to provide the most advanced technologies and ramping up capacity, while we manage to be fully loaded throughout the year.

2010 revenue grew 42% year over year in NT dollars, or 48% if measured in US dollars. Gross margin reached 49.4% in 2010, with a 5.7 percentage-point increase from 2009. Operating margin hit 37.9%, representing a 6.8 percentage expansion from last year. Earnings per share for 2010 was TWD6.23, up 81%, from TWD3.44 in 2009. ROE of 30.2% was the highest in the past decade.

Now let's turn to the outlook for the first quarter 2011. Based on current business expectations and a forecast exchange rate of TWD29.26, we expect our consolidated revenue in the first quarter to come in between TWD105b and TWD107b. In terms of



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margins, we expect our fourth-quarter gross margin -- we expect our first-quarter gross margin to be between 47% and 49%, operating margin to be between 35% and 37%.

For the first quarter of 2011 we expect total demand to be stronger than seasonal, Communication is better than seasonal, while Computer and Consumer applications are weaker than seasonal. We further expect Semiconductor system unit growth for the full year of 2011 to be as follows; PC 12% growth year over year; Handsets 9% growth year over year; Digital Consumer Electronics 6% growth year over year.

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

Dr. Morris Chang - TSMC - Chairman and CEO

Hi. Good morning or good evening. We had a record year in 2010, both in revenue and in net income. We grew our revenue by 48% in US dollars. As a result, we believe our market share in the total Foundry segment has increased from 43.9% in 2009 to 45.5% in 2010. Our growth momentum is fueled by timely addition and fast ramp-up of capacity, wide adoption of our advanced technologies and a strong growth in the specialty technology revenue.

TSMC's mission is to be the trusted technology and capacity provider of the global Logic IC industry for years to come. Because we have the technologies, we have effective capacity, and we have earned the trust from customers, we believe that we will continue to gain market share. For 2011 we expect the overall Semiconductor market, excluding Memory, to grow by about 7%. We expect the Foundry market to grow by about 15%. And we believe TSMC will grow more than 20% in US dollars.

The forecast demand from our customers for 2011 outpaces the supply under our current capacity plan. We expect to continue to fully utilize our capacity this year. To support the strong growth we plan to spend about \$7.8b for capital expenditures for 2011. 81% of the total budget is for 65-, 40-, 28-nanometer technologies. Of the 81%, there's 9% for R&D and, there, capital expenditures are for 20 and 14 nanometers. With this CapEx we are able to increase our total annual capacity by roughly 20% to about 13.6m eight-inch equivalent Wafers per month.

Now I'd like to say a few words about our profitability in 2011. Exchange rate changes have been unfavorable in the last few months. Compared with the 2010 average exchange rate of TWD31.49 to \$1, the exchange rate assumption we are using for 2011 is TWD29.16 to \$1. The 2011 assumed exchange rate is 7.4% down from 2010. As our CFO has pointed out in the past, each percent fluctuation in the exchange rate results in a 0.4 percentage-point change in operating profit margin, therefore, between 2010 and 2011 we have a three-point operating profit degradation due just to the exchange rate.

To address this significant challenge we have taken various countermeasures, including faster ramp up of new capacity, fuller utilization of existing capacity and greater cost-reduction measures, in order to make sure that we leave no money on the table. Our strategic financial goal is to achieve compounded annual 10% profit before tax growth and minimum return on equity of 20% across cycle in the next five years. We are on track this year.

Now I'd like to make a few comments on our technology highlights. First, TSMC's 28 nanometer is industry first and ready for primetime. Customer products are already taped out and in prototyping. We have superior performance, superior reliability and density, the density being 2x over 40 nanometer with our gate-last high-k metal gate process.

We have the 28HPM technology that has gained enthusiastic adoption for tablets, smartphones and embedded SoC applications. The 28HPM has three gigahertz ARM CPU for multi-core application processes. The 28HPM has slow SRAM standby leakage and Vcc MiM for Cellular applications.

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The second highlight is that the 28-nanometer lead-free bumping, which is echo-friendly, is also ready and is compatible with superior low-resistance ELK interconnect. Third highlight, 800 volts high-voltage technology is production-ready and is in customer sampling.

Fourth, we plan to double R&D CapEx to over \$700m in 2011. And we plan to increase R&D budget by close to 20% to a total of over \$1.1b. Fifth, we have also acquired a new R&D Fab site in Hsinchu Science Park for sub-14 nanometer R&D.

Six, I want to say a few words about the 450 nano -- I'm sorry, 450mm Wafer manufacturing. Our first 450mm pilot line is planned at our Fab 12 phase six, starting with 20-nanometer technology. The timing of the pilot line will be around 2013/2014. Our first 450mm production line is planned in around 2015/2016.

Lastly, but not least, I want to talk about two recent developments which TSMC stands to benefit from in the future. The first recent development is that Microsoft has recently announced that it will port Windows 8 to ARM, probably by next year. Since many of our customers use ARM cores to design their products, the support from Microsoft will give our customers more opportunities to address new markets, such as mobile computing and PCs. Since we are many of our customers primary Foundry, we will have the opportunity to grow with our customers.

The second parallel development, along with the Microsoft announcement, is that mobile computing devices, such as smartphones and tablets, have gained wide acceptance and have become very popular in our daily lives. We estimate smartphones will reach 420m units in 2011 and the growth is estimated to be 45% year over year. We estimate tablets will be 40m units this year. The growth is very fast; 170% this year. But the overall size is still small. There is still a lot of room for the tablets to grow.

We estimate that 61% of the Logic IC from the non-iPad/non-GPad -- those are of course Apple and Samsung. 61% of Logic IC from the non-iPad/non-GPad tablets will be supplied by TSMC. These tablets, the non-iPad demand, will largely take off from 2011, the second half of 2011. For smartphones, many of its major IC contributors are TSMC's customers and we currently supply 45% of the Logic IC to smartphones. And we expect our contribution to go beyond 50% in the near future.

As Fabless companies tend to participate more in the fast-growing new markets and designs and new products, such as the mobile computing devices, their faster growth fuels TSMC's growth. The development and popularity of the mobile computing devices will speed up the technology migration of the leading nodes, such as 40, 28, 20 nanometers, in order to meet the processing speed and low power requirements, as well as the need for high integration of different IPs.

TSMC's 28HPM is very well positioned. We have the industry-leading three gigahertz operating frequency and the best performance/power ratio for low-power processes. Customers are adopting our 28HPM enthusiastically. We stand to benefit from the popularity of these mobile devices.

These are my prepared comments. We are now open for questions.

Dr. Elizabeth Sun - TSMC - Head, IR

Operator, please open the floor to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). And our first question comes from the line of Randy Abrams, Credit Suisse.

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Randy Abrams - *Credit Suisse - Analyst*

Okay, thank you. Good evening. I wanted to follow up on the cost-saving measures you mentioned to offset currency. One of those was running the Fab more full. I wanted to see is that a temporary measure due to currency pressure, or are you shifting back to a strategy of managing higher utilization through the cycle?

Dr. Morris Chang - *TSMC - Chairman and CEO*

No, we're not shutting anything back. Of course, running the Fabs full is a function of the demand. If there's no demand we can't run the Fabs full. But what we're saying is that we are running the Fabs fuller than we were planning to, to support some of the non-supported demand that we had in the past.

Randy Abrams - *Credit Suisse - Analyst*

Okay. Thanks for that. And a couple (multiple speakers) -- okay. Then a couple questions on the CapEx; one is for the China capacity. What your plans are to build that out and how your China business is progressing?

And then also, within the budget, if you could talk about how much of the \$7.8b goes to the new businesses, such as Solar and OED.

Dr. Morris Chang - *TSMC - Chairman and CEO*

Lora will answer that question.

Lora Ho - *TSMC - SVP and CFO*

Randy, as you know, we are aggressively expanding our Fab in Shanghai, the eight-inch Fab. We plan to double the size to 110K by early 2012, so we are expanding very fast. Out of this \$7.8b capital expenditure, around \$330m will go to the Fab in Shanghai. You also asked about the new business. It's --

Randy Abrams - *Credit Suisse - Analyst*

Yes.

Lora Ho - *TSMC - SVP and CFO*

-- around \$100m, \$140m CapEx goes to new business for this year.

Randy Abrams - *Credit Suisse - Analyst*

Okay, and just one quick follow up. The Power Chip facility; is that just land? Or how quickly do you expect to build that facility? And how much could you actually do in that [site] that you purchased from Power Chip?



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Dr. Morris Chang - TSMC - Chairman and CEO

That is actually for the R&D Fab that I've mentioned in my prepared comments. I said that we have acquired a new R&D Fab site in Hsinchu Science Park for 40 nanometer and below 40 nanometer R&D. And that's what the Power Chip site will be for. It's going to start -- we're going to start building I think, perhaps, next year?

Lora Ho - TSMC - SVP and CFO

Next year.

Dr. Morris Chang - TSMC - Chairman and CEO

Next year. It's going to be an R&D Fab site, yes.

Randy Abrams - Credit Suisse - Analyst

Okay. And one quick thing, you mentioned -- okay.

Dr. Morris Chang - TSMC - Chairman and CEO

For 40 nanometers, yes. Yes, go ahead.

Randy Abrams - Credit Suisse - Analyst

Okay. And you mentioned, I think, the eight inch you'll do normal maintenance for Chinese New Year. But the 12 inch implies that you're going to run through Chinese New Year. Is there any trade-offs where you skip the maintenance, or is that the plan to defer maintenance this year?

Lora Ho - TSMC - SVP and CFO

No, actually it's not. We will not skip the maintenance. Actually, our Fab -- the 12 inch, every one of them, is a Giga Fab. They have many, many phases of each Fab, so we do the maintenance for each by phase. We do not shut down the whole 12 inch for maintenance purpose.

Randy Abrams - Credit Suisse - Analyst

Okay, thanks a lot.

Operator

And the next question will come from the line of Mehdi Hosseini, Susquehanna International.

Mehdi Hosseini - Susquehanna International - Analyst

Yes, thanks for taking my question. Dr. Chang, could you help us understand how should we think about the mix of 40 nanometer and 28 nanometer as we exit this year, like in Q4 timeframe?



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And also how many tape outs do you actually have for 28 nanometer that will be volume ramp in the second half?

Dr. Morris Chang - TSMC - Chairman and CEO

All right. I'll try to answer your question. Now, we plan to have around 2% or 3% of our total revenue in the fourth quarter that will be 28 nanometer; 2% or 3% in the fourth quarter. The 40 nanometer, I don't have -- it's -- 40 nanometer is still increasing and -- but in the fourth quarter, as --

Lora Ho - TSMC - SVP and CFO

It's 21%.

Dr. Morris Chang - TSMC - Chairman and CEO

21% in the fourth quarter -- 21% of our revenue in the last fourth quarter. And so by fourth quarter of 2011 I think that that percentage will be higher, but I do not care to give the number now. That was a part of the question.

And another part of the question, the tape outs, volume ramping. The tape outs of the 28 nanometer they will start to ramp in the second half, in -- starting in the third quarter and more in the fourth quarter. But the real momentum we believe will be in the next year, yes.

Mehdi Hosseini - Susquehanna International - Analyst

Okay. Just as a follow up, do you see -- what are your thoughts in terms of the time it would take for Microsoft and the operating system to actually be adopted with the ARM processing eco-system, or to work out the details with the ARM-based application? Is there going to be a time where the software would have to be applied and debugged until that new architecture and the ramp is realized at TSM?

Dr. Morris Chang - TSMC - Chairman and CEO

Yes.

Lora Ho - TSMC - SVP and CFO

Well, this probably is a question that Microsoft needs to answer better than TSMC can. But as far as what we have obtained from publicly available information, I think the porting probably will start next year. Given that, I think for other third-party software developers it may still take some time to develop more software for the ARM core using the Windows as the platform. But this is really not a question that TSMC can answer.

Mehdi Hosseini - Susquehanna International - Analyst

Okay, thank you.

Operator

And the next question will come from the line of Dan Heyler, Bank of America Merrill Lynch.

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Dan Heyler - Bank of America Merrill Lynch - Analyst

Good evening, Dan Heyler here, guys. I wanted to ask back on the 40-nanometer question, if I may; the comments on very strong and broad demand for your advanced technology and the need for low power, plus the mobile bullishness in smartphones and tablets. Does this suggest that 40 nanometer should surge in demand mainly from here? Is that predominantly where the mobile demand is coming from?

Dr. Morris Chang - TSMC - Chairman and CEO

Yes, we do -- does the 40-nanometer demand come just from mobile? I don't think it comes just from mobile. But the total 40-nanometer demand is increasing faster than we expected even three months ago, Dan.

Dan Heyler - Bank of America Merrill Lynch - Analyst

All right, but what's driving the question is, if you look at your other major product cycles in terms of nodes, I'm wondering whether 40 potentially would be maybe a higher contributor to overall sales. On many of your cycles you've peaked at about 30% of contribution to total sales and, given your strength in demand that you're referring to, whether potentially 40 would be maybe a higher contributor potentially than some of the other nodes as net contribution to sales.

Dr. Morris Chang - TSMC - Chairman and CEO

I actually think that's possible, Dan. Of course, I think both of us would be just speculating. But really I think that we are pretty much seeing new things, new things that we didn't see even as late as six months or a year ago. Back then we thought that 65 was going to be a very, very important node and 40 might be actually less important in terms of the ultimate volume than the 65. But I think that we are revising that estimate now because there's a migration from 65 to 40, and then there are new applications in for the 40. And, actually, we now feel that 28 is going to be a very, very important node also, so all these are pretty exciting.

Dan Heyler - Bank of America Merrill Lynch - Analyst

Okay, great. And my second question is on the margin side, because with the implied utilization your shipment number over your capacity number goes from 106.8 in the third quarter down to 102.9, so about a four percentage-point decline in utilization. But your gross profit margin is almost flat; you're at only a 20 basis point decline.

Dr. Morris Chang - TSMC - Chairman and CEO

I don't think we're -- Dan, I don't think we're following you. Would you please start over again?

Dan Heyler - Bank of America Merrill Lynch - Analyst

Sure, sorry about that, yes. So you're seeing about a 4% decline in utilization from the third quarter to fourth quarter, but your margin -- gross profit margin is almost flat, only a 20 basis point decline. How are you able to -- in fact, depreciation is up. So could you talk about profitability, what's going on in your business? I guess when I look at your mix your ASPs are up, driven by 40 nanometers, so is this profitability driven by -- effectively driven by your contribution from 40 nanometer because, again, your margins are almost flat while utilization declined?



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Lora Ho - TSMC - SVP and CFO

Dan, I think the utilization you are seeing is probably higher than what we are seeing, because you take the shipments divided by our installed capacity. What we are seeing here is we use Wafer move, because the building versus installed capacity it has to do with inventory fluctuation on the back end among quarters. And we are measuring based on the equivalent utilization is how many move we can do in every Wafer Fab [that] we can use every piece of equipment.

So from that angle we are not that full as you expected. So if we do a very good job we can very well run above 100% utilization, though we still have some room, also depending on the demand as well.

Dan Heyler - Bank of America Merrill Lynch - Analyst

But there was a decline in utilization, right, because your capacity grew faster than shipments?

Dr. Elizabeth Sun - TSMC - Head, IR

You mean from third quarter to fourth quarter?

Dan Heyler - Bank of America Merrill Lynch - Analyst

Yes, did your utilization decline?

Lora Ho - TSMC - SVP and CFO

Well, yes (multiple speakers).

Unidentified Company Representative

Yes. From third quarter to fourth quarter, yes, there's a slight decline.

Dan Heyler - Bank of America Merrill Lynch - Analyst

And your margins are flat, so I guess I'm wondering what's driving this profitability. Is it the mix? And is there something happening on 40 nanometer in particular?

Dr. Morris Chang - TSMC - Chairman and CEO

Well, actually, 40 nanometer has been improving all through the year. So I believe that a pretty important -- it does -- it did play a very important role in keeping our margins up, but you're looking at the whole Company here. When you commented on the gross margin, the relatively level gross margin percentage, you are looking at the whole Company and there's a lot of factors in play.

Yes, depreciation increase was a factor, but there's a lot of costs. There's a lot of variable costs that we have been able to reduce also. And then there's also this mix question, so there's a lot of factors. I think you'll be oversimplifying it to just single out one or two factors, Dan.



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But, as I said this afternoon, we do manage margin through standard gross margin. But there are literally hundreds of people that work full time to try to maximize the standard gross margin. And the 100 literally -- well, I don't mean hundreds of pencil pushers. Well, we don't have any pencil pushers I guess. But we have dozens of analysts, cost analysts, and their conclusions, their recommendations get passed along to actually thousands of engineers in operation, in purchasing, etc, and all those work to bring the standard gross margin up.

Look, we haven't been the most profitable Foundry for years for nothing, all right? So if you start looking at us as a complex machinery that's working well, I think that would be a good start, rather than a company that just works on very simple issues. We spent years building up organizations, this cost organization and the market forecast organization that I mentioned to you. I'm sorry I went a little long, yes.

Dan Heyler - Bank of America Merrill Lynch - Analyst

No, that's okay. I just -- I'm assuming that these dynamics are going to continue to play out as the year progresses, so that was what I was driving at. But thanks very much.

Operator

And the next question will come from the line of Pranab Sarmah, Daiwa Capital Markets.

Pranab Sarmah - Daiwa Capital Markets - Analyst

Good afternoon, this is Pranab from Daiwa. Thank you for giving those numbers on your contribution to smartphone and tablet PCs' number. Could you give some little clarification point of view whether tablet PC will be included on the Computer side or on the mobile handset -- Communication side?

Dr. Elizabeth Sun - TSMC - Head, IR

Pranab, the tablets at this point is not being put into either Communication nor Computer. We actually have internally addressed them as Emerging applications. But if it is tablets for -- I think there's the computing. There's a portion of the tablets that are still in the Computer side but, generally speaking, if we are looking at the media tablets we basically currently put them under Emerging applications.

Pranab Sarmah - Daiwa Capital Markets - Analyst

Emerging applications. So that will be a new classification going from next year?

Dr. Morris Chang - TSMC - Chairman and CEO

Emerging, she said emerging markets.

Dr. Elizabeth Sun - TSMC - Head, IR

Emerging applications. So it's not we have not yet break it out into Computer or Communication, because you -- as you probably --

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Dr. Morris Chang - TSMC - Chairman and CEO

It's still pretty small.

Dr. Elizabeth Sun - TSMC - Head, IR

Right, it's still very small and it is --

Dr. Morris Chang - TSMC - Chairman and CEO

For us, it's still very small.

Dr. Elizabeth Sun - TSMC - Head, IR

Right. And it is in a category where we currently say Industrial and Others.

Pranab Sarmah - Daiwa Capital Markets - Analyst

Okay, it's under Industrial now, got it.

Then, secondly, could you give a little bit of update on the Automotive Semiconductor side, how the progress has been so far and what you are expecting in 2011?

Lora Ho - TSMC - SVP and CFO

Pranab, we are still -- continue growing our Automotive business. In the year of 2010 the Automotive Semiconductor business accounts for about 1.4% of our total Wafer revenue and we expect to remain at about the same level this year.

Pranab Sarmah - Daiwa Capital Markets - Analyst

Okay, got it.

And my last question is on the CapEx cycle. It looks like your CapEx cycle has gone up quite a bit. If I see the last five years' CapEx cycle, excluding 2010, average CapEx was \$2.5b roughly. Now you're moving average CapEx more than \$5b on the annual basis. And if you bring that 450 nanometer -- 450nm Fab tools by 2014, 2015, your CapEx cycle will be even higher when you move to there.

So does it mean your cash flow will have a little bit of constraint for the next five to 10 years, because what about cash you are going to get in? You have to keep on putting in the CapEx and that may lead to [no] upside for dividend -- a cash dividend.

Dr. Morris Chang - TSMC - Chairman and CEO

No, that's not true. Our five-year strategic plan calls for an increase of free cash flow before the five-year period ends, actually, well before the five-year period ends. We do expect a higher free cash flow in the 2000 --



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Lora Ho - TSMC - SVP and CFO

2013.

Dr. Morris Chang - TSMC - Chairman and CEO

-- 2013, 2014, 2015, yes.

Pranab Sarmah - Daiwa Capital Markets - Analyst

Okay, that's very clear now. Now I roughly got the idea. And your depreciation expense long term looks like it will be pretty high going forward. You are guiding for 30% up on this year and, given the high CapEx, probably to remain high for next couple of years I guess.

Lora Ho - TSMC - SVP and CFO

We don't know about what will be the depreciation for next year. We have not estimated a number so far.

Pranab Sarmah - Daiwa Capital Markets - Analyst

Okay, thank you, and have a good quarter ahead.

Dr. Elizabeth Sun - TSMC - Head, IR

Thank you.

Operator

And the next question will come from the line of Steven Pelayo, HSBC.

Steven Pelayo - HSBC - Analyst

Thank you. I'm curious about the overall Foundry market. Have you sized the total capacity out there? You're growing your capacity by about 20%. Global Foundries wants to add 60K in Dresden, 60K in New York the next couple of years. Samsung's building in Austin. I'm curious about the overall Foundry capacity growth. Have you sized that at all?

Lora Ho - TSMC - SVP and CFO

Our estimate of the overall Foundry capacity growth will increase about 15%, one five, and our capacity will grow bigger than that number. We estimate it will be 20% this year.

Dr. Morris Chang - TSMC - Chairman and CEO

In addition to that -- excuse me. In addition to what Lora said, I do want to call your attention to the concept of effective capacity, which I introduced two or three quarters ago. Effective capacity is what the customers will place orders on. You've got to have the right -- the mature -- the right technology, mature -- production mature technology. You've got to also have the sufficient



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customer trust, less effective capacity; that's different from nominal capacity. But the nominal capacity (multiple speakers) -- the nominal capacity of the Foundry industry, as Lora has estimated, will increase, did you say, 15%?

Lora Ho - TSMC - SVP and CFO

15%.

Dr. Morris Chang - TSMC - Chairman and CEO

Yes.

Steven Pelayo - HSBC - Analyst

Okay. That kind of answers my follow up a little bit. It sounds to me that you wouldn't expect these competitors building really aggressively as well to really disrupt the market, given that their effective Fab, either customer relationships, maybe their technology's just not as mature as TSMC. So am I correct in assuming you do not expect dislocation because of the CapEx that's going on out there?

Dr. Morris Chang - TSMC - Chairman and CEO

I have no expectation of what our competitors will do. I will not -- I mean I don't know.

Steven Pelayo - HSBC - Analyst

And then one final follow up on that is, are your competitors potentially at a competitive advantage in any way, given that a lot of this mobile strength is coming from US and European customers, where they both plan to, or currently have, Fabs? Does TSMC need to have Fabs in Europe and the US? Or does that help them in any way? Do you think it's geographically positive for them?

Dr. Morris Chang - TSMC - Chairman and CEO

I don't think so. I don't really think so. I think the geographical location of Fabs is a pretty minor factor, frankly. I think there are other factors that are far more important than the geographical location. For instance, if one Fab has a higher yield than another Fab, then I would choose the higher-yield Fab regardless of where it's located, so I think that. And there are many, many factors in this Foundry business. Location is, I think, a minor one.

Steven Pelayo - HSBC - Analyst

Great, I really appreciate that. And my one final would just be can you guys give us some thoughts on your tax rate? It was a little bit of a surprise in the fourth quarter. What is it for 2011? That's my final question.

Lora Ho - TSMC - SVP and CFO

Tax rate will go up in 2011. And in last year our effective tax rate was around 5%, but this year will go up to 10%, 11%.

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Steven Pelayo - HSBC - Analyst

Thank you.

Dr. Elizabeth Sun - TSMC - Head, IR

Okay. Well, in the interest of time I think we'll allow the last caller. Operator, please?

Operator

Yes, and it is a follow-up question from the line of Mehdi Hosseini, Susquehanna International.

Mehdi Hosseini - Susquehanna International - Analyst

Thank you. I just have a follow-up question -- actually, two follow-up questions. How should we think about the D&A in 2011, depreciation and amortization?

Lora Ho - TSMC - SVP and CFO

Depreciation for this year?

Mehdi Hosseini - Susquehanna International - Analyst

Yes.

Lora Ho - TSMC - SVP and CFO

The depreciation and amortization will go up by around 30% over last year.

Mehdi Hosseini - Susquehanna International - Analyst

Okay. And then in terms of capacity addition and cash outflow for the equipment purchase spending, is it going to be spread throughout the year or front-end loaded or back-end loaded?

Lora Ho - TSMC - SVP and CFO

The capital expenditure of the \$7.8b will be front-end loaded at around 60%/40% split.

Mehdi Hosseini - Susquehanna International - Analyst

All right, thank you very much.

Dr. Morris Chang - TSMC - Chairman and CEO

She said 60%/40%.

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Lora Ho - TSMC - SVP and CFO

Yes, 60% in first half.

Mehdi Hosseini - Susquehanna International - Analyst

Front-end loaded, okay.

Dr. Elizabeth Sun - TSMC - Head, IR

All right, so this concludes our Q&A session. Thank you for joining us today. We hope you will join us again next quarter. Goodbye.

Lora Ho - TSMC - SVP and CFO

Bye bye.

Operator

And before we conclude TSMC's 4Q '10 results webcast conference call, please be advised that the replay of the conference call will only be accessible through TSMC's website at www.tsmc.com. Thank you, all.

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