

2Q14

Quarterly Management Report
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Topics in This Report

- Revenue Analysis
- Profit & Expense Analysis
- Financial Condition Review
- Cash Flow
- CapEx & Capacity
- Recap of Recent Important Events & Announcements

Operating Results Review:

(Amounts are on consolidated basis and are in NT\$ billions unless otherwise noted)

	<u>2Q14</u>	<u>1Q14</u>	<u>2Q13</u>	<u>QoQ</u>	<u>YoY</u>
EPS (NT\$ per common share)	2.30	1.85	2.00	24.7%	15.2%
(US\$ per ADR unit)	0.38	0.31	0.33	24.7%	15.2%
Net Revenue	183.02	148.22	155.89	23.5%	17.4%
Gross Profit	91.19	70.40	76.42	29.5%	19.3%
<i>Gross Margin</i>	<i>49.8%</i>	<i>47.5%</i>	<i>49.0%</i>		
Operating Expenses	(20.25)	(17.88)	(18.79)	13.3%	7.8%
Other Operating Income and Expenses	(0.23)	(0.00)	(0.00)		
Operating Income	70.71	52.52	57.63	34.6%	22.7%
<i>Operating Margin</i>	<i>38.6%</i>	<i>35.4%</i>	<i>37.0%</i>		
Non-Operating Items	3.38	0.78	2.39		
Net Income Attributable to Shareholders of the Parent Company	59.70	47.87	51.81	24.7%	15.2%
<i>Net Profit Margin</i>	<i>32.6%</i>	<i>32.3%</i>	<i>33.2%</i>		
Wafer Shipment (kpcs 12 inch-equiv.)	2,053	1,718	1,793	19.5%	14.5%

Note: Diluted weighted average outstanding shares were 25,930mn units in 2Q14

Financial Highlights:**Second Quarter 2014**

- Net revenues were NT\$183.02 billion, representing a 23.5% increase from NT\$148.22 billion in 1Q14 and a 17.4% increase from NT\$155.89 billion in 2Q13.
- Gross margin was 49.8%, up 2.3 percentage points from 1Q14 and up 0.8 percentage points from 2Q13.
- Operating margin was 38.6%, up 3.2 percentage points from 1Q14 and up 1.6 percentage points from 2Q13.
- Non-operating items were a gain of NT\$3.38 billion, compared to a gain of NT\$0.78 billion in 1Q14 and a gain of NT\$2.39 billion in 2Q13.
- Effective tax rate increased from 10.4% in 1Q14 to 19.8% in 2Q14, reflecting a 9.4% unappropriated earnings tax incurred in the quarter.
- Net income attributable to shareholders of the parent company was NT\$59.70 billion, up 24.7% from 1Q14 and up 15.2% from 2Q13. Net profit margin was 32.6% and diluted EPS was NT\$2.30.

I. Revenue Analysis

I. Revenue Analysis			
Wafer Rev. by Application	2Q14	1Q14	2Q13
Computer	11%	13%	16%
Communication	54%	54%	57%
Consumer	12%	11%	7%
Industrial/Standard	23%	22%	20%
Wafer Rev. by Technology	2Q14	1Q14	2Q13
28nm	37%	34%	29%
40/45nm	19%	21%	21%
65nm	15%	16%	18%
90nm	7%	7%	8%
0.11/0.13um	3%	3%	4%
0.15/0.18um	14%	14%	15%
0.25/0.35um	4%	4%	4%
0.50um and above	1%	1%	1%
Wafer Rev. by Customer Type	2Q14	1Q14	2Q13
Fabless/System	85%	87%	87%
IDM	15%	13%	13%
Net Rev. by Geography	2Q14	1Q14	2Q13
North America	67%	66%	70%
Asia Pacific	14%	16%	13%
China	8%	8%	8%
EMEA	6%	6%	6%
Japan	5%	4%	3%

Revenue Analysis:

TSMC saw strength of demand for our wafers across all segments in the second quarter. By application, Computer, Communication, Consumer, and Industrial/Standard increased 14%, 19%, 31%, and 25%, respectively.

28nm process technology contributed 37% of total wafer revenues for the quarter. Advanced technologies (40/45nm and below) accounted for 56% of total wafer revenues, up from 55% in 1Q14.

Revenues from Fabless/System customers accounted for 85% of total wafer revenues in 2Q14.

From a geographic perspective, revenues from customers based in North America accounted for 67% of net revenues, while revenues from Asia Pacific, China, EMEA (Europe, Middle East, and Africa) and Japan accounted for 14%, 8%, 6%, and 5% of net revenues, respectively.

II. Profit & Expense Analysis

II - 1. Gross Profit Analysis			
(In NT\$ billions)	2Q14	1Q14	2Q13
Cost of Revenue	91.83	77.82	79.47
Gross Profit	91.19	70.40	76.42
Gross Margin	49.8%	47.5%	49.0%

Gross Profit Analysis:

Gross margin was 49.8% in 2Q14, 2.3 percentage points higher than 1Q14, mainly due to higher capacity utilization, partially offset by unfavorable inventory valuation adjustments due to changes in utilization rates and the margin dilution from 20nm ramp.

II - 2. Operating Income Analysis

(In NT\$ billions)	<u>2Q14</u>	<u>1Q14</u>	<u>2Q13</u>
Total Operating Expenses	20.25	17.88	18.79
Research & Development	13.61	12.07	11.94
SG&A	6.64	5.81	6.85
Other Operating Income and Expenses	(0.23)	(0.00)	(0.00)
Operating Income	70.71	52.52	57.63
Operating Margin	38.6%	35.4%	37.0%
Total Operating Expense as % of Net Revenue	11.1%	12.1%	12.0%

Operating Income Analysis:

Total operating expenses represented 11.1% of net revenues in 2Q14, down from 12.1% in the prior quarter, reflecting improvement in operating efficiency.

II - 3. Non-Operating Items

(In NT\$ billions)	<u>2Q14</u>	<u>1Q14</u>	<u>2Q13</u>
L-T Investments	1.05	0.96	1.06
SSMC	0.58	0.41	0.52
Others	0.47	0.55	0.54
Interest Expenses	(0.80)	(0.80)	(0.64)
Other Gains and Losses	3.13	0.62	1.97
Total Non-Operating Items	3.38	0.78	2.39

Non-Operating Items:

Total non-operating items were a gain of NT\$3.38 billion in 2Q14, compared to a gain of NT\$0.78 billion in 1Q14, mainly due to (1) a disposal gain of NT\$2.03 billion from the sell-down of 5% of Vanguard International Semiconductor Corp. shares and (2) dividend income of NT\$ 0.64 billion.

III. Financial Condition Review

III - 1. Liquidity Analysis (Balance Sheet Items)

(In NT\$ billions)	<u>2Q14</u>	<u>1Q14</u>	<u>2Q13</u>
Cash & Marketable Securities	314.59	234.95	227.62
Accounts Receivable	86.89	74.33	80.34
Inventories	50.95	43.48	38.62
Other Current Assets	6.77	3.13	5.88
Total Current Assets	459.20	355.89	352.46
Short-term Loans	34.71	24.84	31.47
Accounts Payable	56.35	70.17	76.08
Dividends Payable	77.79	0.00	77.77
Accrued Liabilities and Others	77.79	79.39	58.31
Total Current Liabilities	246.64	174.40	243.63
Current Ratio (x)	1.9	2.0	1.4
Net Working Capital	212.56	181.49	108.83

Liquidity Analysis:

At the end of 2Q14, cash and marketable securities increased by NT\$79.64 billion to NT\$314.59 billion, including an increase of NT\$23.35 billion in cash and reclassification of certain long-term investment into marketable securities of NT\$58.35 billion.

Total current liabilities increased by NT\$72.24 billion, mainly due to the accrual of NT\$77.79 billion cash dividend during the quarter.

Net working capital was NT\$212.56 billion and current ratio was 1.9x.

III - 2. Receivable/Inventory Days

(In Number of Days)

	<u>2Q14</u>	<u>1Q14</u>	<u>2Q13</u>
Days of Receivable	40	45	43
Days of Inventory	51	52	47

Receivable and Inventory Days:

Days of receivable decreased by 5 days to 40 days, mainly due to the much faster pace of increase in revenue compared to the rate of increase in the average accounts receivable.

Days of inventory slightly decreased by 1 day to 51 days.

III - 3. Debt Service

(In NT\$ billions)

	<u>2Q14</u>	<u>1Q14</u>	<u>2Q13</u>
Cash & Marketable Securities	314.59	234.95	227.62
Interest-Bearing Debts	<u>(246.37)</u>	<u>(237.47)</u>	<u>(202.90)</u>
Net Cash Reserves	68.22	(2.52)	24.72

Debt Service:

Net cash reserves increased NT\$70.74 billion to NT\$68.22 billion in 2Q14, reflecting an increase of NT\$79.64 billion in cash and marketable securities, partially offset by the increase of NT\$8.9 billion in interest-bearing debts.

IV. Cash Flow

IV - 1.1 Quarterly Cash Flow Analysis

(In NT\$ billions)

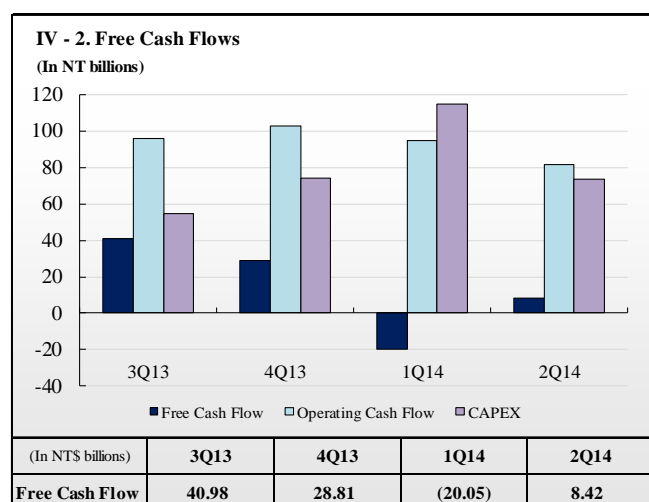
	<u>2Q14</u>	<u>1Q14</u>	<u>2Q13</u>
Income before Income Tax	74.10	53.30	60.02
Depreciation & Amortization	45.98	41.62	38.10
Other Operating Sources/(Uses)	(38.33)	(0.06)	(22.88)
Total Operating Sources/(Uses)	81.75	94.86	75.24
Capital Expenditures	(73.33)	(114.91)	(78.40)
Marketable Financial Instruments	2.42	(0.54)	2.46
Other Investing Sources/(Uses)	4.41	(0.41)	(0.69)
Net Investing Sources/(Uses)	(66.50)	(115.86)	(76.63)
Increase (Decrease) in Short-term Loans	10.40	8.82	(4.32)
Proceeds from Issuance of Bonds	0.00	0.00	44.65
Other Financing Sources/(Uses)	(0.05)	(0.87)	0.76
Net Financing Sources/(Uses)	10.35	7.95	41.09
Exchange Rate Changes	(2.25)	2.05	0.10
Net Cash Position Changes	23.35	(11.00)	39.80
Ending Cash Balance	255.05	231.70	225.83

Summary of Cash Flow:

During the second quarter, cash generated from operating activities totaled NT\$81.75 billion, including (1) NT\$45.98 billion from depreciation & amortization expense and (2) NT\$38.33 billion for other operating uses, which included income tax payment of NT\$22.42 billion and an increase of NT\$12.56 billion in accounts receivable.

The Company spent NT\$73.33 billion on capital expenditures, received NT\$3.47 billion proceeds from disposal of Vanguard shares, and borrowed NT\$10.40 billion in short-term loans for hedging purpose.

As a result, our cash position increased NT\$23.35 billion to NT\$255.05 billion at the end of 2Q14.



Free Cash Flows:

Free cash flow was NT\$8.42 billion in 2Q14, compared to a negative NT\$20.05 billion last quarter, reflecting lower capital expenditures, partially offset by lower operating cash flow during the second quarter.

V. CapEx & Capacity

V. Capital Expenditures and Capacity

	<u>2Q14</u>	<u>1Q14</u>	<u>YTD</u>
Capital Expenditures (in US\$ millions)	2,438	3,799	6,237
Capacity (kpcs 12 inch-equiv.)	1,949	1,870	3,819
Depreciation / Amortization (in NT\$ billions)	42.13	37.79	79.92

Capital Expenditures and Capacity:

Capital expenditures for TSMC on a consolidated basis totaled US\$2.44 billion in 2Q14.

Total capital expenditures in the first half of 2014 were US\$6.24 billion.

Total capacity increased 4.2% to 1,949K 12-inch equivalent wafers in 2Q14.

On a full year basis, total capacity is expected to increase 11% year-over-year to reach 8,132K 12-inch equivalent wafers in 2014.

VI. Recap of Recent Important Events & Announcements

- TSMC Sets July 14th as Ex-dividend Date and July 20th as Record Date for Common Share Dividends (2014/06/27)
- TSMC Shareholders Approve NT\$3.0 Cash Dividend (2014/06/24)
- Altera and TSMC Collaborate to Bring Advanced Packaging Technology to Arria 10 FPGAs and SoCs (2014/04/21)