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Conference Call Transcript

TSM - Q2 2002 Taiwan Semiconductor Manufacturing Company Limited Earnings Conference Call

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Lehman Brothers

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PRESENTATION

Operator

Welcome to Taiwan Semiconductor Manufacturing Company's Q2 2002 results webcast conference call. Today's event is hosted by Mr. Harvey Chang, Senior Vice President and Chief Information Officer and Dr. Tsai, President and Chief Operating Officer. 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 a listen-only mode. This call is being recorded at the request of TSMC. If there are any objections, you may disconnect at this time.

At the conclusion of management presentation we will 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 directly from the TSMC 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 Mr. Leon Chu (ph) Head of Investor Relations for TSMC, for the cautionary statement before the main presentation by Mr. Chang and Dr. Tsai.

Leon Chu - Taiwan Semiconductor Manufacturing Company - Head of Investor Relations

Good morning and good evening to all participants. This is Leon Chu, Head of Investor Relations for TSMC. Before we begin our conference call, I would like to state that the management's comments about TSMC's current expectations made during this conference call are forward-looking statements, 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-S, filed with the United States Security and Exchange Commission on May 9, 2002. And such other documents as the Company may file with or submit to the SEC from time to time. And now, I would like to turn the conference call over to Mr. Harvey Chang, our Senior Vice President and the Chief Financial Officer.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Thank you Leon. Hello everyone. I would like to welcome all of you to come to our second quarter results conference call. I will begin by making sort of a quick summary on our second quarter results, and then we will open the floor for questions.

To begin with, let me begin by giving you a very quick highlight of what happened during second quarter. For our second quarter this year, actually our total wafer shipment have reached 719,000 wafers, which has brought up our utilization to the level of 85%. This is roughly 20% growth versus our wafer shipment in the first quarter. Our total revenue for the second quarter is in the dollar 44 billion. Our net profit after tax, roughly 9.3 billion, which are equivalent to 49 cents in the dollar, per share.

If we compare these numbers to the same period last year, our second quarter revenue 44.1 billion has showed a much higher growth rate of 68%, and our gross profit 16.4 billion or 229% higher than the same period last year. Gross margin is 30% -- 37% versus last year's 19%. And our operating profits are 11.9 billion NT, and net profit after tax 9.3, versus last year which was only .3 billion. So all these numbers are way higher than what we had the same period last year.

If you take a look at balance sheet cash flow, we can see that our financial structure continues to remain sound, and we continue to have a very strong balance sheet. In terms of our cash positions, actually end of second quarter, our total cash on hand have reached 66.4 billion, which is roughly 28 billion higher than last year. Our debt has increased to 6 billion, and the total assets, which is roughly 37 -- 375 billion and it's about 11% higher than the same period last year. The depreciation amortization number for the second quarter is roughly 14 billion NT, compared to last year's 11.9. Total capital expenditure this quarter is roughly 10.4 billion compared to 18.3 last year. Our ROE for the second quarter long, after annualized, is around 11.2% versus 6.6 last year second quarter. And our return on asset is 9.5% versus 5.6% last year.

On the sequential comparison basis, if you compare to our -- our first quarter this year and our growth rate in terms of revenue is roughly 23%. This 23% basically is what we have stated that the wafer shipments have already grown 20%. Also we see a modest increase in terms of ASP that would compare the second quarter ASP versus the first quarter. Due to the increase of wafer shipment, our utilization grew from the first quarter's 67% to as high as 85% second quarter. And our gross margin grew from 34% first quarter to 37%. Gross profit also grew 37% from first quarter.

On the operating expenses. second quarter operating expenses is roughly 44.5 billion -- I'm sorry 4.45 billion which is roughly 10% of the total revenue versus 11% in the first quarter. Our operating income is 11.9 billion which is 46% higher than first quarter. After tax 5.3 which is also roughly 41% higher than first quarter.

Also let's take a look at the balance sheet and cash flow on a sequential basis. On a sequential basis, actually we don't see a significant change except that we see that we have a higher cash balance at end of second quarter. And also amortization, which increased from first quarter's 12.8 to 14 in the second quarter. Capital expenditure last quarter was 6.6 billion NT, and this

quarter is 10.4. ROE increased from first quarter 5.4 to a second quarter 11.2. ROA also increased from 8.1 to 9.5%.

Let's take a look at the business side in the second quarter. First we going to see is the revenue break down by terms of technology. As you can see from this graph, that actually our .13 is roughly one percent, which is the red color on the top. So one percent of total revenue in first quarter and second quarter also one percent. And almost 5 -- 30% first quarter, actually it was down a little bit to 29%.

In terms of absolute dollars, actually also continue to went up. Eventually they went up 19%. So on the .13, I just stated, although it stay at one percent, actually the actual dollar value does goes up roughly 23%. .18, stay flat 22%, which means dollar value 23% growth. .25 actually came down from 25% to 23%. Dollar wise, actually they went up 14%. .35 go up from 13% to 14%. So dollar wise it means it go up about 33%. And the .5 from 9% first quarter to 11%, so dollar wise went up roughly 51%. So that's the revenue breakdown by technology.

And if we look at the different applications in terms of computer communication and consumers, and we will see actually we see fairly significant change, actually in the second quarter. Here, let's see. At this time I wanted to [INAUDIBLE] from the bottom.. The bottom, the purple color. The first quarter was computer was 56%. We come to the second quarter this is 45% on the computer. And then the green color -- the green color which is the communications was 18% actually in first quarter, they go up quite a bit to 26% on the second quarter. When you go up to 26% dollar wise that means it went up close to 80%. Consumer from 21% to 23%. Memory from 2% to 3%. Others remain flat at roughly 3%. So that's very significant change in terms of the sales break down by computer and the communications.

Let me talk a little bit more about these segments. Actually, during the quarter we see, actually on the computer side, I think the weakening application side area of graphics and chip sets, the area that still show pretty good gross momentum is flat panel display as well as [INAUDIBLE]. On the communication segment, actually [INAUDIBLE] wireless. The wire line show good growth momentum during the second quarter. The strongest sub segment is still coming from the wireless segment. Primarily on the mobile phone hand set, on the wireless LAN, as well as cordless phone. The wireless have good gross. And their gross area are in the area of Ethernet switch, network interface card, as well as ADSL.

On the consumer side, actually have stated this from 21 to 23%. dollar wise it means it's 35% growth. The stronger sub segment are in the areas of the DVD, VCD, digital camera, set up box. These are the growth areas.

Let's go on to the next one in terms of geographic distribution. We don't see a lot of change in terms of geographical distribution. Actually, North American continues to be the dominant segment of

geographic distributions in second quarter. North American account for 79% of the total revenue. Europe stay at straight. Asia Pacific actually went down a little bit from 14 to 12. Japan go up from 5 to 6%.

Next if we look at distribution between Fabless and the IDMs, then we will see actually the IDM actually grow a little bit actually on the second quarter. The IDM actually grew from the first quarter's 21% to 26%, which actually is pretty good growth in terms of the distributions. The Fabless from 73 to 7 -- 78 down to 73. But still I think they are the dominant segment during the second quarter.

And then on the Fab utilization and the ASP trend, I have already indicated that the second quarter utilization was 85%, big jump from the 67%. And first quarter ASP was essentially flat. So we see a modest growth in terms of ASP in the second quarter versus the first quarter.

Next one we are going to give you this table which will outline the store capacity by different Fabs. We are going to tell you that what we have at end of June, and what we plan to have at end of December. You will see two columns of separate -- the right-hand side column on December is actually what we have gave you during last conference call, but I think we change modest in terms of our plans. The most noticeable I think for the Fab 12 originally it was meant to be 13,000 wafers per month end of this year. We actually revised that down a little bit to 10,000 wafers. Basically to cope with the demand situation, and I think it takes a little bit longer for the customers to jump into the 12-inch. So I think you have all those numbers and I will not bore you with that. I think you can look at that later on.

Last one we going to talk to you about are overall capacity plans. And basically this graph will give you an idea where we stand in terms of our most advanced technologies, which actually is the orange one there. Down on the bottom is .13 the blue one is .15. And the red one is .18. As you can see, they grew quite rapidly, actually in the last several quarters. For this quarter -- or for last quarter, actually for .18 and more advanced technology, they accounted for roughly 30% of our total capacity.

And as we indicated, at that time, we think that the .18 and advance would account for 47% of our total capacity by the end of this year. And we have also realized a little bit right now we plan to have about 42% of our total capacity in .18 advanced technology at the end of this year. With that, I think the last, actually we have a basically a recap of the major events that happened in the second quarter this year. And, again, I think I will not read through each one of them.

But I do want to mention the bullet point regarding the independent directors that in May, during our shareholder meetings, that we have elected two additional members of the board which are Mr. Lester Thurow a professor at MIT. And Peter Bonfield former CEO of British Telecom to serve as our independent

director. Also we have invited Mr. Michael Porter to join our supervisory group. And this are done, I think, certainly with the purpose or objective to further enhance our corporate governance structure.

Also, I think our chairman, Morris Chang, during today's conference call he has indicated that it is our plan to submit to the board that will be held in August this year, that we are going to form an audit committee under the board, at our August board meeting, and the audit committee will consist of three to four members. They will be primarily be independent directors as well as members of our supervisory board. [INAUDIBLE] and they were elected as the chairman for audit committee, so we don't know who that person is going to be. We will certainly, I think, keep all our shareholders posted on the development on their side. Now, I think actually we talk about second quarter also maybe I will let Rick talk a little bit about our coming quarter guidance. Rick, I hand over the floor to you.

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

All right. I think the - good morning, good evening. I think the guidance we are giving out for the third quarter is as follows. One, the shift in customer demand to communications and consumer applications during second quarter 2002 is expected to continue into the third quarter. Second, the amount of wafers shipped will be off modestly by about a low single digit percentage rate on a sequential basis. Three, ASP will be 5% lower sequential, due to the product mix shift. Four, gross margin will be adversely impacted by the depreciation in the U.S. dollar. We have assumed a U.S. dollar depreciation of 5% in the third quarter, compared to the second quarter. In that case our gross margin may be reduced by about 2.2% due to this factor alone.. Number 5, overall capacity utilization rate will be in the low 70's, due to both softening demand on the back of it, and also we also have an increase in our capacity by about 11.5%, compared to the second quarter. With the result of the softening demand, we have lowered our Cap-X in 2002 to below U.S. 2 billion. We also, the last one is that, July revenue will be seasonably lower compared to June. That's our guidance for the third quarter. We are ready to answer some questions.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

On the July revenue because, according to the Taiwan regulation, actually before the 10th of each following month, we will announce the revenue number of July which is roughly two weeks from now. And I think Morris has actually indicated that this afternoon that we, right now, our forecast show that July will be lower number, and -- but he asks people to relax. Don't get

panicked because on an overall basis, it is sort of turns out the percentage of falling is a little bit high, but is not going to be accelerated. So I think we just want to give you that forewarning and ask you not to panic about when you see the July number.

The other thing I think I can compliment on Rick's guidance, is that during the Q & A sessions that people further ask about these trends, the demand switching to communication and consumer and the weakening demand from computer segment and how significant is this. And we have seen that the computer first quarter 56% and fall to 45%. And I have indicated in the afternoon I think the computer segment weighting will probably fall to below 33%, and the weighting on communications will actually go up more than 1/3 during the second quarter I think that's an indication on the trend. So with all that I think that -- Rick I don't know, you have any other complimentary commentary? Otherwise we'll just open the floor for questions.

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

No, let's go to the questions I think.

QUESTION AND ANSWER

Operator

Thank you. At this time we will open the floor for questions. If you would like to ask a question, please press the star one keys on your touch tone phone now. Questions will be taken in the order in which they are received. Please limit your questions to one at a time to allow all participants an opportunity to ask questions of the management members. Our first question comes from Bavan Shaw of J.P. Morgan.

Bavan Shaw - J.P. Morgan

Yes. I just -- a couple of questions. In terms of the tax expense, would it be fair for me to assume that it's noncash? In other words your cash tax expenses is roughly one to two percent and this is just a matter of timing, in other words in some quarters you have tax credit, but this quarter you have tax expense. So I was wondering if you could add some more color on that? And second question was with respect to the change in the Cap-X plan, any thought you have on capacity outlook next year? That would be helpful. Thanks.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

We are having a big echo there.

Bavan Shaw - J.P. Morgan

Hello?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Hello?

Bavan Shaw - J.P. Morgan

hello?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Hello?

Bavan Shaw - J.P. Morgan

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Can you hear me now?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Yes.

Bavan Shaw - J.P. Morgan

Yes.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Okay. That's fine. I think -- I got your question, but there was a big echo there.

Bavan Shaw - J.P. Morgan

Okay.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

First of all I want to say I am impressed each time you must be waiting on the line for half an hour to get on first in the question line. I am very impressed with that. And so, let me say, your question is about tax expense, the other is about what?

Bavan Shaw - J.P. Morgan

Capacity.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

About capacity. Okay. Let me talk a little bit about the tax expense. Well, basically I think that the tax expense is going to be on an increasing mode primarily because that we have several fabs that continue to be graduating from the tax holidays. The tax benefit we got from -- during these new Fabs, they are two-fold. One is so-called tax credit. That is one-time credit when you [INAUDIBLE] a new investment. That the government will allow a certain percentages of the investment to be able to offset the tax you are going to pay.

And the second one is something like a five-year holiday. Tax holiday. And many of our fabs, for example Fab 3, Fab 4, actually also according to the different expansion stage, they are gradually graduating from big tax holidays. The rules of the tax holiday are fairly stringent, and they are quite ridged rules and not that flexible.

So whenever the demand I think pick up, I think if we are busy trying to coping with the customers' requests, and I think we try to get all the Fabs running and we can't really think too much of that. Therefore, those older Fabs -- not older, more maturing Fabs who are -- which will be able to afford some tax. And when that happens, they have to pay a little bit more tax. So I think looking forward, I think certainly I think you will see that our tax expense increasing. Hello?

Bavan Shaw - J.P. Morgan

Yes. I'm here.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Okay. Good. I have a strange sound here so bear with me for one minute. Can you hear me?

Bavan Shaw - J.P. Morgan

Yes. Hello? Okay? Are you okay? Hello?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Yes. Yes, Rick, can you talk about the Fabs?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

Yes. Yes. Sure. Can you hear me?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Yes, I can. Please.

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

Sure, this is not a trick. [LAUGHTER]. To avoid answering the question. We are, as you can imagine, we are actually right now looking at our capacity for next year, real time as Morris said earlier in the afternoon. Actually we had a meeting in the morning. So I don't really have a number for you, but what I can say is the -- we certainly will continue investing in 21 Micron in both 8-inch and 12-inch. But most of the investment will be in 12-inch next year because most of the 8-inch investment will be completed probably by end of this year or early next year. We do not really plan to invest in anything below or greater than [INAUDIBLE] .

We -- the pace of the 12 inch ramp up is also slowing down somewhat, really pending on the vicious environment. We need a little time to get some better visibility, we hope, into next year. So, again, these all constitute the basis for reduction of the Cap-X to below 2 billion this year. We will probably have a much better idea in our next conference call. Okay.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

But we need to come back to this tax expense. Basically they are gradually increasing up. So for --

Bavan Shaw - J.P. Morgan

Uh-huh.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

So forth year, I think on the -- on the tax expense, and I'm not sure what would be a very good number. I think maybe you can use something like, I say maybe 10%. I think you should not be too far from it.

Bavan Shaw - J.P. Morgan

I see. Would that 10% be close to the actual cash tax you would have to pay? Or that's -- that's my -- that's what I was trying to direct.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Yes, probably.

Bavan Shaw - J.P. Morgan

Thanks.

Operator

Thank you. Our next question comes from David Wu of Wedbush Morgan securities.

David Wu - Wedbush Morgan Securities

Good evening, gentlemen. Can you help us on two things? Number one is, what have you been seeing lately, i.e., in the month of May or June, in terms of customers scaling back their forecast

for the September quarter? And the second question I have is, at this point, given your lead times, do you have any first clue about the outlook for demand in the month of September?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

Um -- okay. The last couple months certainly the company in the PCs area is [INAUDIBLE] They have also a much less visibility going into the next quarter. People in general believe that the third quarter will be better than the second quarter by maybe 10%. Maybe a little better 10 to 15%. But they all believe that the growth for the third quarter will be weaker compared to the historical track record.

For the communications, I think because of the general business environment, and all the noises, all the issues from the corporate scandals, people are now also getting less certain compared to a couple months ago. With our lead time, our outlook for September is, you know, we still have about two months of visibility and that's why we are giving our guidance for third quarter as I just said earlier on.

David Wu - Wedbush Morgan Securities

Thank you.

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

All right.

Operator

Thank you. Our next question comes from Mark Fitzgerald of Banc of America Securities.

Mark Fitzgerald - Banc of America Securities

Thank you. I was wondering if you could make some comment about the outlook for 300 millimeter and pulling back on that. What that says about your view for the growth rate for the semiconductor business in '03, given the lead times for 300 millimeter?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Um -- your question is about the 300 millimeter lead time, or it's about --?

Mark Fitzgerald - Banc of America Securities

No, it's given -- I'm curious -- if you are pulling in 300 millimeter spending, obviously it has very long lead times. That must say something about your view of what the semi-conductor industry's growth rate and what your growth rates for 2003 are.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Oh. I want to be careful in my statement about 300 millimeter investment for next year. What I said, we will invest mostly in 300 millimeters and of course .13 micron technology. However the pace of our 300 millimeter ramp rate will be slower than what we planned say a few months earlier. Am I making that clear?

Mark Fitzgerald - Banc of America Securities

Yes. No, I understand. But, I mean if you are slowing it, that does say you are looking down the road and seeing you don't need as much capacity in '03 if you are slowing it today. So I was just wondering what that meant for your view of the growth rate for the industry and for TSMC's revenue opportunity in '03?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Well, Mark, you know, when you look at our capacity end of this year, we still have 10,000 wafers, which means that's 22,000 wafers in terms of 8-inch equipment. That's quite a bit of wafers. I think what we are saying here is that we have sort of slowed down, a little bit, in terms of coming up with the capacity in 12-inch for this year. And this is primarily because, in terms of customers' intent to switch, to jump into 12-inch they are not as enthusiastic as we think they are going to be. In a way it's also understandable because this is something new. And basically everybody is waiting for others to come in first. There's a Chinese proverb saying that the dumb bird will fly first. They are all waiting for the dumb bird, and then they can follow. And also I think they have less confidence. They really don't want to go through the hassle of trying to go through the qualification and try to wait for the year to get stabilized, which is all a lot of work. So basically, I think they are not as fast in responding to this switching to 12-inch. But I don't think that is real reflection on the 2003. Actually on the other hand, you can see that we have sensed this, actually, for awhile. That's one reason, why actually we have added a little bit more 8-inch. Because we worry that if people are not switching to 12-inch and if we don't have enough 8, they will go to others.

Mark Fitzgerald - Banc of America Securities

Do you still subscribe then to the SIA's forecast of I think it's 20 or 25% type of growth rates for the semi-conductor industry in '03 then? Is that what you are planning your own business around?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Yes, Rick, why don't you.

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

Yes. I think Morris commented in the afternoon, that the -- we now believe the growth rate for semi-conductor industry will be lower than that number you just mentioned from SIA. However, we continue to believe that the TSMC's growth rate will be higher than the semi-conductor growth rate. We will have shown you for this year.

Mark Fitzgerald - Banc of America Securities

Okay. And just one more question to follow-on. The comment that a lot of your customers are not willing to go through the expense and the heart ache of going to 300 millimeter. Is that a decision that on an outlook for their own business? Because obviously the cost advantages have been -- would suggest that it's pretty strong economic argument for going to 300 millimeters. So I don't quite understand given the pricing environment now, why they wouldn't want 300 millimeter technology?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

The cost environment, basically we are talking about when the thing get mature. When it has fully ramp. And so that's two years from now. That's why, I think that, we are talking about the dumb bird fly first. Everybody wants to enjoy the benefit, but nobody wants to pay the expense.

Mark Fitzgerald - Banc of America Securities

Okay. Fair enough. Thank you.

Operator

Thank you. Our next question comes from Shakar Prumanik of Prudential.

Shakar Prumanik - Prudential

Hi. Good evening. Just two questions. Do you still expect, at this point, that we should see a Q4 being somewhat better than Q3? At least some kind of a seasonal trend?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

We certainly don't have any reason to challenging that statement.

Shakar Prumanik - Prudential

Okay. Do you -- I mean, based on, you know, client viewpoint, I mean, are you seeing any kind of wafer starts which are improving from these levels in the next three or four weeks?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Wafer starting improvement is--

Shakar Prumanik - Prudential

Which will be out into Q4, or you -- currently you are not expecting your wafer starts to improve in the next few weeks?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

What do you think, Rick? I don't think so. What do you think, Rick?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

Well, our lead time is roughly two months. So our wafer start right now is in the September out period. We have some limited visibility into early fourth quarter, but I think it's too early to tell right now.

Shakar Prumanik - Prudential

But you are still hopeful that Q4 will be better than Q3?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Always.

Shakar Prumanik - Prudential

O.K. The second question, you know, on ASP trend, what needs to happen to see the, you know, ASP starts to move up? Is that of course more 1.3 loading. Could we start to see that in Q4?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

We don't know yet. We do have a number of customers that not only [INAUDIBLE] also we start to ship them commercial volume quantities on a .13. But I don't see that they can be sort of a holding factor to sort of hold up the ASP. Certainly the total volume of .13 I think, is still low compared to overall. And what we see here is primarily, I think, as you see, that the drop of .15 and .18. And hopefully that we will see more advanced application users coming back asking for more wafers.

Shakar Prumanik - Prudential

Great. And one more question. If you could update us a little bit on the copper and .13 yield issues, there's a lot of speculation on that front.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

You are asking me .13 yield issue?.

Shakar Prumanik - Prudential

No, I mean, whether the use of copper use of, you know at level which are normal at this point, or are they lower than normal? Some kind of commentary?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Oh, okay. I think the -- actually our .13 micron technology proposed, as you know, the use of copper and with the two kinds of dimetric material, FST material and the Lokay (ph) material. Both of the technology has been qualified completely. FST is seeing a pretty high volume production. They yield, you know, most copper [INAUDIBLE] is performing well, up to our expectation. However, also we also agree that as the yield weakens, we can still continue to improve. And we believe as the volume continue to go up, you know, our quarter-to-quarter volume will double during the last two quarters. We believe our learning curve will go down rather quickly. So we are quite confident about the .13 micron production.

Shakar Prumanik - Prudential

Thank you.

Operator

Thank you. Our next question comes from Dan Hayler of Merrill Lynch.

Dan Hayler - Merrill Lynch

Thanks. Can you guys hear me?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Yes.

Dan Hayler - Merrill Lynch

Great. Okay. Yeah, just wanted to follow-up on a couple things. First, on the 0.13 first, and 300 millimeter. Is it fair to say if -- on 300 millimeter to bring up that capacity, obviously you would like to bring that up and to utilize that Fab. Is it fair to assume that you may do other geometries other than 0.13 to do that?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

You mean for 300 end year?

Dan Hayler - Merrill Lynch

Right, 0.15, how high would you go?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

We're doing actually Dan, we are doing -- we are not just doing .12 on 300 millimeter.

Dan Hayler - Merrill Lynch

Right, you are doing .18, right.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

You know, .15 and .18's, we are in production for 300 millimeter. And --

Dan Hayler - Merrill Lynch

Right. And --

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Yep.

Dan Hayler - Merrill Lynch

Okay. So what I'm wondering is, given that, could you -- are you migrating -- can you migrate other customers forward on that to bring up that capacity in order to bring costs down for them?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

Um -- yes, we have some high volume customers we have already moved to 300 millimeter .15. And we also have customers actually being qualified for .12 micron production right now. It will be qualify the .12 microns, that's what I'm talking about, probably in the next month or at most two.

Dan Hayler - Merrill Lynch

Right. Okay. And then I guess what Harvey's point was, I didn't quite get that. It was just an inconvenience for them -- for these guys to switch over, that they wanted to stick on 8 inch to do that?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

It is inconvenient, as you can imagine. As for any new Fab, assume it's a 8 inch new Fab. Most, you know, customers would like to see other people to go in on that kind of [INAUDIBLE]. And, you know, they qualify and they have to qualify the products with their customers, and so forth and so on. So, you know, now is the 12 inch they have to do the same thing and with [INAUDIBLE]. Higher risk, at the beginning, and they also have to work on together, we are actually working with them together to also to be sure that the back end will be available for them, also.

Dan Hayler - Merrill Lynch

Okay.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

It's more infrastructure work compared to 8 inch as you can, again, imagine.

Dan Hayler - Merrill Lynch

O.K., and then what's going to drive you to the, you know to the 10K level with this capacity? What are your level of shipment expectation by the fourth quarter? And what do you think those products would be?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

I think the products will be, again, the high volume ones such as in the PC area, wireless area, some of the other communication products. That's what we move first. And usually what those customers would like to have because they also need flexibility for those technologies.

Dan Hayler - Merrill Lynch

Okay.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Bottom line, I think will be a significant amount of that 10K. I cannot say for sure right now, but the -- already now we are utilizing a significant portion of the capacity.

Dan Hayler - Merrill Lynch

Okay. Great. And just one more and then I'll go. Harvey, on the comments regarding the stock options today and stock grants, obviously this is a contentious, high-profile issue. The concerns that were raised that you would lose some competitive advantage by expensing your grants or -- I didn't quite understand why there was a pretty firm opinion to not start to, you know, change over to options or to start to account for these.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

I was joking to Leon this afternoon saying that if you ask that question again, I will tell people that if I'm an investor of your company, I'd like to see all the analyst [INAUDIBLE] cut by half, which will benefit the shareholders..

Dan Hayler - Merrill Lynch

Right.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

It's a little bit like that. Basically, let me -- now let me stop joking and tell you about what Morris means. What it means is that because we have been under -- our compensation system have been under this stock grant for some years --

Dan Hayler - Merrill Lynch

Right.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

And so actually and we are not the one who invented this, and actually a lot of the firms in the science park, they are all doing this. So he said -- what he said to the one who asked that question, is that if I follow your advice, I'm afraid 'm going to lose a lot of good people to our competitors. That's what he say.

Dan Hayler - Merrill Lynch

Okay. Would this be -- do you foresee -- what do you see the Taiwan regulatory environment going on this issue?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

I don't see the Taiwan regulatory environment is going to do anything about it. Actually not them. If you really want to look deeply into this, actually this stock bonuses involve a lot of the very fundamental system. And the biggest issue I think is on this [INAUDIBLE]. Our stock market operate on \$10 NT. [INAUDIBLE] And your stock market don't. That's the biggest difference. So as long as we operate on a par value system, I think there is a lot of difficulties in terms of doing what you guys have been suggesting. You are not getting stock dividend from the shares you invest in the U.S. But you are getting this from Taiwan. And actually that is basically the same thing.

So if you are looking at this year and what I read from the press watching from the T.V. Saying that look, TSMC is distributing 6.5 billion for bonuses to the employees. Meanwhile if you take another look. If that is true, then we have actually distributed 100 billion NT value to the shareholders this year in terms of the stock dividends. It's the same thing. Because we operate on a par value system. So this is actually -- this is not an easy issue. And I'm sure that the regulatory agencies want to talk to them about it, they try to stay away from it because they don't want to deal with it. It's not -- we don't have a perfect solution for it. But longer on basis, I actually think that there will be a gradual shift into the option system, but it just takes time to do it.

Dan Hayler - Merrill Lynch

From your perspective, if your competitors in the U.S. in the semiconductor business started to show these in terms of what it actually -- what the expense is and account for this expense, such that investors could understand it, would TSM, based on that, be willing to at least show on a pro forma basis -- you already do, of course on your ADR, but would you --

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Our ADR, Dan I'm sorry we do it under our U.S. GAAP.

Dan Hayler - Merrill Lynch

Right.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

We cannot change our GAAP unless they change it, okay?

Dan Hayler - Merrill Lynch

Gotcha. But on a quarterly basis, would you be willing to start to show these on your income statements?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Why? Why should we?

Dan Hayler - Merrill Lynch

I mean, assuming if your competitors started to do this in the U.S.?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

As I have explained, our competitor is operating -- they are operating in a country called the United States. So it's natural for them to report their account system under U.S. GAAP. We are operating in a country called ROC. So it's natural for us to operate our accounts under the ROC GAAP. But in order for help the shareholders to understand it, each year we actually spend quite a bit of money, and actually getting our CPAs to spend quite a bit of time to do the recalculations. It's more complex actually than you can imagine. It actually takes them quite a bit of time to do that.

Dan Hayler - Merrill Lynch

To go back to U.S. GAAP, I understand you do that every year. O.K. Thanks a lot.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

You're welcome.

Operator

Thank you. Our next question comes from Terrance Coke of Casanov.

Terrance Coke - Casanov

Hi, good evening. Just on average starting prices, your guiding for 5% decline, that's quite a big decline. Can you just tell us, is it primarily due to mix or is there some pricing pressure as well?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

It is primarily due to the change of the product mix as we have indicated, that the weakening of the computer segment, particularly I think those who use the more advance technology like graphics, chip sets and all that, I think. So actually we expect to see utilization of .18 and .15 to be lower in the third quarter. And as a result we see the weighted average selling price they will also be lower.

Terrance Coke - Casanov

Okay. You also saying obviously that the communication chips, at what -- at what [INAUDIBLE] are they fabricated under?.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Well, we are talking about a very high diversity of product. I think, Rick, maybe you can compliment that a little bit later. But basically, a couple years ago was when we were talking about communications, I think we are looking primarily at .35, but I think they are switching over to .25, actually a lot of them are being [INAUDIBLE] directly into .18. And, Rick, I think he has talked about it when you look at the .13 customer, actually very good percentage of them are actually in the communications segment. So actually, it's very difficult to generalize it.

Terrance Coke - Casanov

Okay. And just finally, on every selling price. I mean, looking at your capacity indications for quarter 4, it looks like you [INAUDIBLE] a lot of lagging edge capacity, for example at Vanguard.. So could we interpret that as you are going to see a lot of older technology growing -- driving your growth in quarter four and therefore average selling price to continue to weaken in quarter four? Thank you.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

No. That's not a good very good interpretation. Actually Vanguard is independent company. We cannot really dictate all their strategies, but basically what Vanguard did is they had convert some of their existing memory equipment production lines into more suitable [INAUDIBLE], which actually have a different configuration. And they are doing this, of course they have seeing that this year, that particularly, I think is very obvious in second quarter the more mature technology demands have picked up. Also I think during the past six to nine months, when we are adding more capacity to our .18, .15 we actually have converted quite a bit of the .35. So Vanguard, I think has sort of a strategic alliance of ours, they think there's an opportunity on the more mature products. So they made an independent decision. But I think once they have converted to say foundry friendly, and they are obviously, they want to make this available to us and they asked us to take these capacity into consideration. We do this, and actually, we will put them [INAUDIBLE], primarily because we want to be consistent, so that you know what's going on. But this is not an indication we think that we do see a serious demand, I think on the more mature technology.

Terrance Coke - Casanov

Okay. Thank you very much.

Operator

Thank you. Our next question comes from Teddy Tye of Morgan Stanley.

Teddy Tye - Morgan Stanley

Hi. Sorry [INAUDIBLE]. Just two quick questions just want to clarify. First one, when Morris comments on the topic of ROE in the afternoon session. When he mentioned 20%, is that the Company target average 20% return on equity? Or it's become like a pick target? This is the first one. I think, actually, lot of confusion out there and I'm asking is this the pick target or this is the average target? Second one actually also related to some of the information being disclosed by the company. We look our your sales [INAUDIBLE], actually .25 and above the sell actually percentage to sell increased from 47 -- I think 47 to 48% in the second quarter.

Your ASP actually increased so what's the reason behind it? Thank you.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Let me see. When you talk about ROE thing, [INAUDIBLE] you've been following us for many years and you should know better than I do what we are talking about. We are talking about -- I think we actually -- we are talking about this has been [INAUDIBLE]. And sort of our average basis, and I think for this year it's kind of hard if we try to make that a target.

Teddy Tye - Morgan Stanley

Yeah. Harvey, I would understand. But I think I have to [INAUDIBLE] know.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Just want to make sure.

Teddy Tye - Morgan Stanley

Yes. There's some concern from clients. Yes. Thank you.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Okay.

Teddy Tye - Morgan Stanley

And the second question is regarding the -- yeah, why is this improved under the condition that .25 and above sales increase?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Rick, do you have a good answer for that?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

Actually.. [INAUDIBLE] You are reading a bit too much into the T.V. I mean there's a very small increase in the percentage, and there are so many wafers, I think, you know we didn't reach technology node and we have also a spectrum of prices. So, I mean I think it's been very difficult to just -- to say it's a 47 to 48% for

the .25 micron and above and very modest increase into ASP, we try to derive the correlation. I think that's not possible. But basically what you can say is probably the ASP -- the price environment during this period of time has been fairly stable. I think that's probably something we can convert to.

Teddy Tye - Morgan Stanley

Thank you.

Operator

Thank you. Our next question comes from Michael McConnell of Pacific Press Securities.

Michael McConnell - Pacific Press Securities

Good evening guys. Was just curious looking at your Cap-X spent thus far in 2002. There's still a lot of room, obviously to come down from the, you know, the 2 billion you are expecting. So I was kind of wondering when you said less than 2 billion if you can kind of give us a range on your expectations at this point. A little bit more granularity in terms of where you think actually Cap-X will be for 2002? Thank you.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Well, if you remember that last time the indication was 2.5, now is 2 and, of course we continue to review all these numbers, but I'm afraid that the Cap-X number is such a dynamic number that I really can't give you fully information until we have made more decisions.

Michael McConnell - Pacific Press Securities

Okay. And just one other question I had. In terms of when you say graphics chip sets, do you put that in the PC bucket, or does that go into the consumer bucket?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

It's primarily in the PC.

Michael McConnell - Pacific Press Securities

Okay. Thank you very much.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

You're welcome.

Operator

Thank you. Our next question comes from David Van Hoitmah of Julius Bear.

David Van Hoitmah - Julius Bear

Yeah, Hi. Just actually very simple question. In your second half Cap-X, do you plan to push out any tool orders that you have in the books of the various equipment companies?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Rick, I'm not sure we should say about that. Well, usually, I think a reduction on a general basis the reduction is a combination of everything when you try to reduce the Cap-X. And certainly I think there's no reason we want to include the pushing out. But we, on the other hand talk about it too much it might make our vendors unhappy.

David Van Hoitmah - Julius Bear

I think my line went dead there for a bit. Would it be possible to repeat the last sentence? Sorry?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

You actually didn't miss anything because what I say is that if I talk too much about it my vendors will be on my back.

David Van Hoitmah - Julius Bear

Okay. [LAUGHTER]. I understand. Actually that's the -- that makes it clear. Thank you very much.

Operator

Thank you. Our next question comes from Chip Morris of Integral Capital.

Chip Morris - Integral Capital

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Hi. I was curious how much of the commentary about the decline in computer and the commentary of July is a function of a single graphics customer? Thank you.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Um -- we don't talk about single customers. I think that's all we can say.

Chip Morris - Integral Capital

I guess what I'm trying to get at is what we are seeing for July and your quarter, are your commentary on ASPs and wafer starts or shipments systemic to the computer industry, or quite frankly, just a function of a problem at a single customer or two?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Well, I can only repeat my same answer.

Chip Morris - Integral Capital

Okay. Thank you.

Operator

Thank you. Our next question comes from Chalice Jatley of Numera Securities.

Chalice Jatley - Numera Securities

Yeah, Hi. If you could just help me reconcile the numbers between your presentation slides and official press release. I was looking at the sales breakdown by applications. And in your press release it says that memory accounted for 12%, whereas your slide presentation says 3% and the corresponding numbers for computer communications and consumers and the presentation slide is much higher. Should I interpret that from your release -- press statement you have taken out the memory component which goes in the PC and communications and computers [INAUDIBLE] and basically classified it again?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

The 12% fall under second quarter last year. So that's one year ago.

Chalice Jatley - Numera Securities

Oh, okay. Sorry. That's a mistake. Secondly, I wanted to also just figure out this discussion about expensing the options. I fully agree with Harvey that probably the regulatory authorities would do nothing about it, simply because if all the companies start expensing it, the taxable fine for the authorities would go down significantly. But given the environment where your taxation is increasing, won't it make sense to expense -- start expensing and increase the cash flows accrued to the shareholders?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

I think you have to push [INAUDIBLE] a little bit harder. I certainly don't see that benefit right now. Right now, actually the expenses the so-called -- you are talking about, they are -- they don't have any cash flow, right. But I basically, I don't think it's going to happen.

Chalice Jatley - Numera Securities

Okay. And one last question about the revenue guidance you are giving for July because you would have seen the wafer starts coming down in the month of May. So what are the reasons that you basically held back your [INAUDIBLE] for 2, 2 1/2 months? And because you are stressing on July, does it mean that sequentially for the month of August and September we should see -- expect sequential improvements?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Well, I think maybe -- I think you have sort of a misunderstood and our friendly sort of warning on July. Basically we have already offered our third quarter guidance. Unfortunately, we no longer give you guidance on total quarter revenue basis because this is not allowed by our regulatory authority. So since we cannot give you that number, and then we sort of concerned that when you see the July number you will try to generalize that into all the three quarters, that's all we are saying here. So we are saying that yes, there will be a decrease, and when you see the July number, that, relax a little bit, try to push your pencil a little bit harder and try to figure out what the total quarter will look like. Because, don't try to generalize one quarter and then particularly don't try to think that that indicates a trend that is a sort of going downhill sign. That's not a case. That's all we try to say here.

Chalice Jatley - Numera Securities

Okay. Thank you.

Operator

Thank you. Our next question comes from Prenab Sarma of Diowa Securities.

Prenab Sarma - Diowa Securities

Hi. Good evening, gentlemen. Would it be possible for you to let us know in the second quarter of '02 how much of your -- how much losses you have incurred due to the foreign exchange, basically like you say the dollar has probably appreciated 1.5% up at first quarter '02 on average basis.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

We have give you a number for the third quarter because that number is significant. We tend to think that for the third quarter that any dollar versus U.S. foreign exchange rate will stay at the current level throughout the quarter. And so the extent of change is significant, roughly 5%. And then we have give you sort of 2.2%, translated into a 2.2% impact. And actually you can do the same thing. You know -- .

Prenab Sarma - Diowa Securities

I have that schedule, [INAUDIBLE] but it appears to me around \$300 million losses in the dollar, am I right in my assumption?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Can you repeat again? Because you sort of interrupted me and I'm not sure of that. Can you just --

Prenab Sarma - Diowa Securities

Sorry about that. Same we like 2.2% I have [INAUDIBLE] for second quarter '02, it appears around .7% margin losses on second quarter '02 if I assume like a 1.5% appreciation in the anti-dollar. And in that case it translates out around \$300 million anti-dollar for-x losses in second quarter.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

I think your in the ball park.

Prenab Sarma - Diowa Securities

Okay. And would it be possible to let us know a little bit about, in July book-to-bill ratio is lower than the June? Or are are you seeing

any stability in the book-to-bill ratio or improvement in the book-to-bill ratio now?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

We are seeing some improvement. Maybe Rick, Rick, maybe you can talk more about it. But I think we are seeing a little bit more, some improvement and gradually going back to one or close to one.

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

Yes. Yes. You are right, Harvey. We are moving gradually I think to one and a bit above.

Prenab Sarma - Diowa Securities

Okay. And my last question will be on the Cap-X side, about another \$1.5 billion you are supposed to spend in second half '02 based on current guidance. And how much of that will be for 12-inch Fab?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

We -- let me take a look at it. Okay. Right now we are looking roughly one-third on the 12 inch.

Prenab Sarma - Diowa Securities

Okay. On 500 million for 12-inch for second half. Thank you very much, gentlemen.

Operator

Thank you. Our next question comes from Leo Lee of Credit Suisse First Boston.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Well, we are hearing a lot from our old friends in the afternoon. I think in the interest of time we will take -- including this one we'll take two more questions.

Leo Lee - Credit Suisse First Boston

Hi, good evening Harvey. I think just two questions. One question is that for second quarter revenue breakdown, how much for your

top five customers account for your second quarter revenue percentage? And is any customer in the third quarter account for more than 10% of your budget revenue in the third quarter? That's my first question.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Leo, it's a very good try. We basically talk about our top ten. We really don't want to go too much details into that. But that the -- in terms of our top 10 customers, they are in a declining trend. And our top 10 include the first quarter, they are actually close to two-thirds, and the second quarter they fall to the mid-50 level. And I think will continue to fall in the third quarter. I think that's the best we can do.

Leo Lee - Credit Suisse First Boston

And thank you. My second question is that Motorola in the second quarter earning conference they mention that they are working with TSMC for the product called magnetic RAM. Can you comment a little bit on that kind of product? When do you think that it will be ready for mass production? Or hits the market. Thank you.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

We have to apologize. We have not learned from [INAUDIBLE]. Now we have, as you know, we do have manufacturing agreement with Motorola and the joint technology development relationship. So we are working on a multi-front in both technologies and the production. So as to the magnetic, when specifically, I don't think we can comment specifically. But there is something. [INAUDIBLE] in commercial use yet Last question.

Leo Lee - Credit Suisse First Boston

Thank you.

Operator

Thank you. Our next question comes from Ito Chang of Lehman Brothers.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Hello. My question is with regard to the strength you are seeing in the communication side. I was wondering if you could give us a bit more color on that in terms of whether this is due to more

outsourcing, new product launches, or whether it's perhaps inventory replenishment? I also have follow-up questions. What about communication with respect to outsourcing? Pardon me? Trying to understand your question. I think, Rick, the question is the demand pick up of the communications segment. Are they coming from replenishment of inventory or coming from more outsourcing?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

Oh. I believe more out -- well, it's a combination of outsourcing and also new product.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Okay.

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

And new product. I mean we do see some replenishment, but it's getting to be quite low now. Mostly new product.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Okay. As a follow-up, your communications segment grew considerably in the second quarter and you are also guiding for [INAUDIBLE] growth in the third quarter as well. Do you think this strength can be continued going into the fourth quarter?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

You know, we -- we believe our communication ratio communication we probably say -- probably at the third quarter level or may improve somewhat, but it's too early to say. Probably stay at the third quarter level, we can say that.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Okay. My last question, quick question on flat panel display segment. Did you say that this was part of the sub segments that were seeing growth or seeing declining growth? That's what I have said that's what we saw. We see some growth, I think this quarter. But for the next quarter, actually they are not as strong. Okay. Great. Thanks. This quarter means second quarter, okay? Okay. Thank you. Okay.

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Operator

Thank you. Our next question comes from Ashid Kumar of Credit Suisse First Boston.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Operator, after this one, this is definitely the last one, okay?

Ashid Kumar - Credit Suisse First Boston

Sorry, Harvey. Good evening to you.

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

Yeah, I know we can't stop, I know. [LAUGHTER].

Ashid Kumar - Credit Suisse First Boston

You know, I am just trying in sort of a different way to ask you two things and people have tried it earlier. First is that if hypothetically, you know, our company was to be without our top customer that is revenue excluding the top customer, would the revenue have shown a sequential improvement in quarter three or quarter two?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

I'm sorry, you have to repeat your question again.

Ashid Kumar - Credit Suisse First Boston

No problem. I was asking, Harvey, that, you know, our company without the top customer, that is a revenue without top customer, quarter two over quarter three or quarter three or quarter two actually would that be sequentially up?

Harvey Chang - Taiwan Semiconductor Manufacturing Company - Senior Vice President, Chief Financial Officer

You you lost me.

Ashid Kumar - Credit Suisse First Boston

Okay.

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

You're going to have to try again. I understand the question, but we have not -- Harvey, he's asking the revenue without the top customers how is the revenue doing from second quarter to third quarter? Am I right to say that?

Ashid Kumar - Credit Suisse First Boston

Yeah, and actually I'm not even asking for, you know, a magnitude or anything. I'm just trying to get a sense of direction that TSMC without the top customer, would the revenue in third quarter be higher than the second quarter?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

I really cannot respond to that. But I think I have dropped enough hints on that.

Ashid Kumar - Credit Suisse First Boston

Sure. Okay. Okay. And I think you did answer, but I couldn't hear it probably, so I -- I'll ask again. . After, you know, you did sort of in a friendly fashion, you know, warn us about the July month [INAUDIBLE], what the wafer the number might be, would August and September be, you know, sort of higher than the month of July to get to your full quarter guidance?

Rick Tsai - Taiwan Semiconductor Manufacturing Company - President, Chief Operating Officer

Um -- I can't really talk about it. I will get into trouble with the regulators. We actually -- I actually -- let me try to explain this. I think after -- I'm thinking our last quarter result they have already noticed that we stopped giving you guidance on the revenue and on the profitability side. In the past we give you a range. That is because, I think early January that we got a notice from our local SFC which is equivalent to the U.S. SEC. Basically saying that if companies are giving -- offering guidance, specific guidance on revenue or profits, then this will be perceived by the regulators that the company has the intent to voluntarily made their financial forecast for whole year available. So after they have done that, within 48 hours they have to make the whole year forecast available to everyone. Since we are not prepared to make forecasts for the whole year, and so I think we have to, somehow, modify our guidance.

Ashid Kumar - Credit Suisse First Boston

Sure. Sure. Thank you so much.

**Rick Tsai - Taiwan Semiconductor Manufacturing Company -
President, Chief Operating Officer**

Okay. I think that will conclude our today's conference call. And certainly want to thank everyone for patiently staying with us. Thank you very much.

Operator

Thank you. Before we conclude TSMC's second quarter 2002 earnings webcast conference call today, please be advised that the replay of the conference call will be accessible through TSMC's website at WWW.TSMC.com. Finally, for all participants who have not previously submitted their e-mail addresses to the company or would like to update their e-mail addresses and contact details please contact TSMC's IR team at invest @tsmc.com.gw, as soon as possible. Thank you all, you may disconnect at this time.

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