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## Conference Call Transcript

**TSM - Q4 2005 TSMC Earnings Conference Call**

**Event Date/Time: Jan. 26. 2006 / 9:00PM HKT**

Jan. 26. 2006 / 9:00PM HKT, TSM - Q4 2005 TSMC Earnings Conference Call

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Welcome to TSMC's fourth quarter 2005 results webcast conference call. Today's event is chaired by Ms. Lora Ho, Chief Financial Officer and Vice President, and Dr. Rick Tsai, Chief Executive Officer and President. This conference call is being webcast live via the TSMC website at [www.tsmc.com](http://www.tsmc.com), and only in audio mode. Your dial-in lines are also in listen-only mode.

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At the conclusion of the 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 from TSMC's website at [www.tsmc.com](http://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](http://www.tsmc.com).

I would now like to turn the conference over to Dr. Elizabeth Sun, TSMC's Head of Investor Relations, for the cautionary statement before the main presentation by Ms. Ho and Dr. Tsai.

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**Elizabeth Sun - Taiwan Semiconductor Manufacturing Company Limited - Head of IR**

Good morning and good evening to all participants. This is Elizabeth Sun. Before we begin, 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.

The 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 May 16, 2005, TSMC's registration statement on form F-3, filed with the SEC on July 5, 2005, and such other documents as TSMC may file with or submit to the SEC from time to time.

Except as required by law, we undertake no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise. Now I would like to turn the conference call over to Ms. Lora Ho, our Chief Financial Officer and Vice President.

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Thank you, Elizabeth. Good morning and good evening to everyone. Welcome to the TSMC fourth quarter earnings conference call. I will first go over the fourth quarter 2005 results and then our first-quarter 2006 guidance. I will keep my comments relatively brief to allow as much time as possible for Q&A.

We have prepared some slides on TSMC's website for you to reference as you listen to the conference call. The pages will be flipped automatically as I go through them. All dollar figures are in NT dollars in my presentation unless otherwise stated.

On the heels of a solid third quarter, we were able to deliver another set of strong results in the fourth quarter. Q4 revenue came in at slightly over NT\$81 [billion], above the high end of our previous guidance by approximately NT\$2 billion. The stronger result was mainly due to a stronger-than-expected demand across all major product segments. We also posted strong bottom-line results, with earnings per share coming in at NT\$1.37.

We achieved those results with a utilization rate of 104%, which was 8 percentage points higher than Q3. As a result of strong cash flow generated from our operations, we ended the fourth quarter with NT\$132 billion in cash and short-term investments. Our return on equity continued to rise with Q4 ROE of 31.7%.

Now let's take a closer look at our income statement. On a quarter-over-quarter basis, we posted 17% growth in net sales, driven by a 30% increase in revenue from computer applications, followed by an 18% increase in communications and a 6% increase in consumer applications.

Gross margin improved by 5 percentage points to 49.1%, which was at the high end of our guidance. This was largely due to higher utilization levels and a more variable exchange rate. Operating margin was slightly above 42%, which was about 2 percentage points higher than our guidance. Income from nonoperating assets, including investment income recognized on the equity method, was slightly over NT\$1 billion for the quarter, reflecting better operating results from all manufacturing affiliates, gains realized on sales of fixed assets, and settlement payment received from SMIC. As a result of strong revenue growth and operating efficiencies, our net income grew 38% sequentially, [while] net margin of 41.8%.

On page 6, our fourth-quarter results also compare favorably on a year-over-year basis. Let me just highlight a couple of key items. Gross margin improved by 6.6 percentage points, largely due to a 16 percentage point rise in utilization. Operating expenses declined in both absolute dollar terms and as a percentage of sales.

As we have increased our R&D spending on 65 nanometer, we have also reduced the need to spend on R&D related to 90 nanometer. In addition, we no longer need to carry any operating expense related to Fab 14.

Income from nonoperating items improved due to gain realized from sales of fixed assets and settlement payment received from SMIC. Meanwhile, investment income declined, in part due to lower operating profit from WaferTech and Vanguard. Due to higher income levels, our net tax expenses increased by \$1.6 billion.

Now let me turn to our balance sheet. Our financial position remained very strong. On a quarter-over-quarter basis, we substantially increased our cash and short-term investments, in spite of paying down \$10.5 billion in corporate bonds. In the meantime, we also kept our accounts receivable and inventory relatively flat on a combined basis.

During the fourth quarter of 2005, we further improved our accounts receivable turnover days by four days from the level in the previous quarter, reflecting better collection efforts. Our inventory turnover increased by two days Q-over-Q, but it was still well within our normal range. The increase in inventory turnover days was largely due to the increased percentage of sales for advanced technologies.

Now let me talk a little bit about our cash flows. We continue to generate strong operating cash flow. Operating cash flows generated during the fourth quarter was NT\$49 billion. We also paid down NT\$10.5 billion in corporate bonds and spent NT\$13.3 billion in capital expenditures during the fourth quarter. As a result, our overall cash increased by NT\$27 billion during the fourth quarter.

Our installed capacity came in 1.6 million 8-inch equivalent wafers in Q4, and we expect a small net increase in [fabs] in Q1 as we continue to ramp up our 12-inch capacity.

Now please turn to our capital expenditures. Our CapEx for the fourth quarter was US\$396 million. Total CapEx for the year came in at about US\$2.5 billion, which was within the range we guided at the beginning of 2005.

Now let me quickly go through the sales breakdown by technology, application, customer, and geography. For more detailed information, please refer to our management report.

We continue to make good progress on ramping up our 90 nanometers. Revenue from 90 nanometer accounted for 17% of the total wafer sales, up from 10% in the previous quarter. Revenue from advanced technologies was [the same] at 49% of total wafer sales during the quarter.

In terms of applications, we saw strength in our major product applications across the board. Computer applications had the strongest momentum. As a result, revenue from computer applications increased from 30% in Q3 to 32% of total wafer sales in Q4.

On page 13, let me turn to sales by geography. There was no significant change in this quarter. We saw a 2 percentage point increase for North America and a percentage point drop for Europe and Japan.

During the fourth quarter, business from fabless and system customer accounted for 72 percent of all total wafer revenue, whereas IDM customers account for 28%.

Before I go to the next quarter guidance, I would like to take a moment to do a quick recap of 2005. 2005 was another record year for TSMC. Following a very strong 2004, we managed to post another 3% top-line growth despite an inventory adjustment here in the first half of 2005. In the U.S. dollar terms, the year-over-year revenue growth was 7.5%, which was in line with the growth of the semiconductor industry, but higher than the growth of (indiscernible) segment.

Year-over-year, our 2005 gross margin improved by 0.6 percentage points compared to 2004, despite a drop of 8 percentage points in utilization rates for the whole year. This reflected our successful year ramp for advanced technologies and continued cost reduction efforts.

At the end of 2005, our total assets exceeded NT\$50 billion for the first time in our history. At the same time, we reduced our total liabilities by NT\$27 billion.

2005 was also our eighth consecutive year that TSMC delivered positive free cash flow. We generated [NT\$150 million] in operating cash flow and we also paid [NT\$46.5 million] in cash dividends to our shareholders.

With that, I will turn to our guidance for the first quarter of 2006. Based on our current business and foreign exchange rate expectations, we expect revenue to be between 73 to NT\$76 billion. This represents a quarter-over-quarter 6 to 10 percentage decline. However, we anticipate the U.S. dollar to depreciate by more than 4% in this quarter, and that accounts for half of the decline in revenue if we take the midpoint of our guidance. Otherwise, our operating performance should be better than our average seasonal pattern.

Our expectation for gross margin in the first quarter is between 46% and 48%. The operating profit margin is expected to be approximately 39%. Capital expenditures for the full 2006 will be in the range of 2.6 to US\$2.8 billion.

You probably noticed we did not guide in utilization this time. The reason is that since our last quarter earnings conference, we have received suggestions from two analysts asking us to stop giving out guidance on utilization. We pondered about this idea and have decided to try to experiment with the suggestion for this time. As you know, today TSMC runs a very complex operation and offers very wide [back channel] technologies.

The value contribution from different products or different technologies may vary quite a lot. Therefore, it is no longer meaningful to give out an overall utilization rate, which is an average of all these many different technologies. Since we are now able to give more guidance on profit than we could do before, we think it is more useful to investors in general that we guided profitability and not the average utilization rate.

Finally, we have also provided a recap of major TSMC events during the fourth quarter. I will list them for your own reference. This ends my presentation today. Thank you very much. Operator, please open the floor for questions.

## QUESTION AND ANSWER

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### Operator

(OPERATOR INSTRUCTIONS) Bhavin Shah, JPMorgan.

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### Bhavin Shah - JPMorgan Chase & Co. - Analyst

I want to go back to the question we discussed in the afternoon, if that's okay. And that is given 104% utilization, why were you not able to exceed your gross margin guidance? If you can perhaps explain that, that would be helpful. Thank you.

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### Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO

Let me try this one. As you remember, our guidance for the last quarter profit margin is ranging from 47 to 49%. If you take the midpoint of that range, that would be 48%. And our actual result for the fourth quarter was 49.1%, which is about a 1.1 percentage point difference than our midpoint of our guidance.

We also guided 100% utilization in the fourth quarter, which we actually achieved 104. So taking the 4 percentage difference in utilization, that is [probably] explaining the 1.1% in margin difference. I think the number is quite close.

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### Bhavin Shah - JPMorgan Chase & Co. - Analyst

So in other words, you did not face any unusual circumstances, such as scrap wafers or any such other factors that separates the margin upside?

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### Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President

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Well, we have some scrap wafers among our fabs, but I think there should not be any scrap wafer that will hurt our margins. But I think the extent of the scrap may have a couple of tens of points' impact, but definitely not to the extent of a 1 point type of impact.

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**Bhavin Shah - JPMorgan Chase & Co. - Analyst**

Okay, thank you.

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**Operator**

Timothy Arcuri, Citigroup.

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**Timothy Arcuri - Citigroup - Analyst**

Actually, I had two things. Number one, it looks like you changed the historical capital spending number for the third quarter. I thought the number was 440, and it looks like it got revised down to 320. Is that correct?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Which number that you are talking about?

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**Timothy Arcuri - Citigroup - Analyst**

That is the September quarter CapEx.

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

CapEx number?

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**Timothy Arcuri - Citigroup - Analyst**

I thought it was 440 when you reported it and now you list it as 320.

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Third quarter CapEx. Just give us a second and let's see. CapEx for 2005 -- my number shows in third quarter our CapEx was 320 million in third quarter. But in second quarter we spent 460. I am not sure where the number you're looking at -- it is for second quarter instead of third quarter?

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**Timothy Arcuri - Citigroup - Analyst**

Maybe I had that wrong. I will have to go back and look at that. I guess my other question is, as you look at your CapEx in 2006, two things. Number one, do you think it will be more front-half loaded or more back-half loaded?

And the second question is, relative to your overall guidance of 8 percent up year-over-year CapEx, if you focused on just the equipment piece, which is what is going to really add capacity, will that be up more than 8% or up less than 8%? Thanks.

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

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Okay, let me answer your first question first. You're asking whether the CapEx for 2006 is front-end loaded or back-end loaded. Actually it was quite evenly distributed within four quarters, probably slightly -- just slightly higher in second half.

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**Timothy Arcuri - Citigroup - Analyst**

Okay. And then relative to the equipment portion of that, will it be up more than the average CapEx or up less?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Equipment accounts for the majority of our CapEx, if that is what you're asking.

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**Timothy Arcuri - Citigroup - Analyst**

What I am actually asking is, is 2006, is there a bigger percentage of equipment in 2006 relative to 2005, or is it a similar percentage year-over-year?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Okay, let me see. I would say for both years, the percentage of equipment is very similar and also very, very high.

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**Timothy Arcuri - Citigroup - Analyst**

Great. Thank you very much.

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**Operator**

Ivan Goh, DRKW.

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**Ivan Goh - Dresdner Kleinwort Wasserstein - Analyst**

I have just two questions for now. Firstly, can you perhaps give some idea what kind of -- for sales mix you will see in first quarter, primarily what kind of leading-edge percentage would you expect going into the first quarter?

Second question is, given that utilization now has exceeded 100% and given what you have said about customers' current [stands], meaning that utilization could potentially be sustained at a very high level through 2006, do you expect -- in your CapEx plans, are you buying enough capacity to meet all your customers' demand or do you think you are actually maybe taking a discount off your customers' forecast at this point in time?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Let me answer your first question. You're asking about (indiscernible) percent of revenue, is that going to be growth in first quarter or not? In my presentation, I have mentioned in fourth quarter our 90 nanometer accounts for 17% of our total wafer revenue, which is 7 percentage points higher than third quarter. Now, we see that trend is going to continue in the first quarter. So the percentages from 90 nanometer is going to continue to improve.

Maybe, Rick, you can comment on the second question regarding capacity.

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

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We are definitely buying equipment for the 90 nanometer capacity such that we can meet all of our customers' demands. And we are also buying equipment for 65-nanometer production starting in mid this year, so that we can also in meet customers' demands.

And we do have some difficulty in meeting all our customers' demand at the 0.18 -- 0.15 micron technologies. What we're doing right now is, of course, we have started some outsourcing work with some (indiscernible) in Taiwan. And we are, of course, doing everything to add incremental capacity. And in addition, we do not rule out of looking for other capacity sources in order to fulfill our customers' needs.

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**Ivan Goh - Dresdner Kleinwort Wasserstein - Analyst**

Can you just elaborate that last point on what you mean by -- what other methods, what other ways would you think about -- could you be looking for other capacity sources?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Well, we will see what is available in the market. Basically, what tools are available which are cost-effective for our business needs?

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**Ivan Goh - Dresdner Kleinwort Wasserstein - Analyst**

I'd like to follow up to my first question. If you look at 0.13 micron, will that be going up in percentage terms as well in the first quarter?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

No. 0.13 and 0.11 micron technology percentage probably would stay about flat or even some minor decline in the first quarter.

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**Ivan Goh - Dresdner Kleinwort Wasserstein - Analyst**

This is as a percentage of revenue. Am I correct?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Yes.

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**Ivan Goh - Dresdner Kleinwort Wasserstein - Analyst**

Thank you very much.

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**Operator**

Sunil Gupta, Morgan Stanley.

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**Sunil Gupta - Morgan Stanley - Analyst**

Rick, (indiscernible), but I just wanted to follow up on one of the earlier questions about the margins. Since we have quite a bit of currency movement in Q4 and in Q1, could you (indiscernible) what is that due to your margin, particularly in Q1, where I think you're factoring in about 4% appreciation in NT dollars? What does that (indiscernible) do to your gross margin and does that dig into your guidance?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

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We have mentioned Q1 we anticipate NT dollars appreciate by about 4%. Take a very simple rule of thumb -- if you transfer that number to the [marketing base], approximately 2%.

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**Sunil Gupta - Morgan Stanley - Analyst**

And that is the reason for the decline from 49 to 47, not at the midpoint?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

That 4 percentage change in revenue will translate to 2 percentage points of margin change. Our guidance has already incorporated that impact.

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**Sunil Gupta - Morgan Stanley - Analyst**

And my follow-up question is on your capacity. I noticed that when you provided the Q1 capacity guidance, your capacity at fab 5 and fab 8 has actually gone up compared to Q4. Can you give me any sense how are you achieving that? Is it more equipment that you're adding or the change in mix or debottlenecking?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

We continue to debottleneck and we've got incremental capacity adjustments, so we can optimize -- let's say maximize capacity on the 0.18 (indiscernible). That's what we have been doing the last year.

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**Sunil Gupta - Morgan Stanley - Analyst**

And would you say that from the current level, do you have room to improve it further in the year, particularly on your 8-inch fabs?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

I would say yes. I cannot say exactly how much, but I would say yes, the fabs have the instruction definitely to begin to improve the throughput of the bottlenecked machine and also to improve the backup efficiency among different fabs in the HsinChu -- I mean, in Taiwan. So the productivity improvement and the backup efficiency, I think, will give us incremental capacity as the year goes on.

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**Sunil Gupta - Morgan Stanley - Analyst**

Okay. Thank you.

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**Operator**

Andrew Biggs, Susquehanna International Group.

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**Andrew Biggs - Susquehanna International Group - Analyst**

I see your forecast for 1.3% sequential growth in capacity in Q1, and I am assuming that is net of maintenance. I'm wondering what the actual number would be in Q1 in terms of incremental wafer starts over the quarter, or wafer capacity.

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

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We actually -- now we do not have our annual maintenance all concentrated in the first quarter. And frankly speaking, I don't have all the schedules of our annual maintenance at hand. I believe now they are more spread out over the year, a period of two to three quarters. So I think the impact for one particular quarter is not as big as we usually have, say --.

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**Andrew Biggs - Susquehanna International Group - Analyst**

If you were to amortize that over the course of the year then, what would be one quarter of that? Another way to put that, what would be the percentage of your capacity that would be potentially off-line during a given year?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

The way you calculate, probably, I think the average days for the year, annual maintenance probably two to three days. You can just amortize that over the four quarters.

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**Andrew Biggs - Susquehanna International Group - Analyst**

Okay, thank you very much.

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**Operator**

Fayad Abbasi, Neuberger Berman.

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**Fayad Abbasi - Neuberger Berman - Analyst**

A couple questions. Given that you have a full year forecast on the CapEx, I was wondering if you could maybe talk a little bit about what the full-year forecast could be for your depreciation and capacity as well.

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Okay. With the 2.6 to 2.8 billion CapEx, we expect the capacity will increase to 6.9 million pieces of TSMC managed wafer in total. This number compared to last year is about 1 million pieces increase, actually, representing around 16% increase in capacity.

In terms of depreciation, we do not see any major increase in depreciation in spite of 2.6 to 2.8 [billion] CapEx investment. The reason is that we still have some 8 inch coming down from depreciation. Although the CapEx will increase depreciation somewhat, we also have some reduction in depreciation. So net of that, the total depreciation will remain at a very similar level to 2005.

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**Fayad Abbasi - Neuberger Berman - Analyst**

Okay. Could you also talk about looking at your CapEx on a quarterly basis, and we had very little spending in TSMC Shanghai. Maybe you could talk a little bit about what the spending outlook would be for that fab in 2006.

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

We do not disclose quarterly CapEx, but I can tell you it is very much evenly distributed in different four quarters. Perhaps just slightly higher in the second half, but --

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**Fayad Abbasi - Neuberger Berman - Analyst**

For TSMC Shanghai specifically?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Let me see. For TSMC Shanghai -- of the 2.6 billion, TSMC Shanghai is a very small number -- it's only [13] million.

**Fayad Abbasi - Neuberger Berman - Analyst**

So are you deemphasizing, then, the ramp-up of capacity there? Maybe you could talk a little bit about what is happening with that.

**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

No, we are actually moving our equipment from Taiwan to Shanghai.

**Fayad Abbasi - Neuberger Berman - Analyst**

We shouldn't see it in the CapEx line then?

**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Yes.

**Fayad Abbasi - Neuberger Berman - Analyst**

Thank you.

**Operator**

Robert Maire, Needham.

**Robert Maire - Needham & Co. - Analyst**

Could you tell us about what you are seeing in terms of inventory out there going into the first quarter of '06, both die banks, finished goods, maybe if you could give us some idea by product type how that is holding up.

**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

It is difficult for us to really give you data from product type. What we are observing from our customers is after the fourth quarter, overall their inventory days have declined compared to three months earlier. And also, from talking to the customers directly, that's also the input we have been getting.

I think there is also -- there is some, of course, concern on the inventory at back end (indiscernible). I believe that that part is minor. So our outlook for the first quarter inventory is good. That is the major reason why we are looking -- we are seeing a pretty good first quarter (indiscernible).

**Robert Maire - Needham & Co. - Analyst**

Okay, I wasn't quite clear on that. So you think that the inventory level of semiconductors at your customers is actually a little bit lower in the first quarter than it was in the fourth quarter?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Yes.

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**Robert Maire - Needham & Co. - Analyst**

Okay, great. Thank you.

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**Operator**

Mehdi Hosseini, FBR.

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**Mehdi Hosseini - Friedman, Billings, Ramsey - Analyst**

I have a couple of questions. If you could elaborate on 65-nanometer capacity by the end of this year. And to that extent, would you expect capital intensity to increase as you bring on 65 nanometer? In other words, would you have to spend more for every increment of 1K capacity?

Second question has to do with some of the commentary from your presentation earlier this morning regarding ASP trends into Q1 and ASP going down. So with these kind of utilization rates, why would ASP go down?

And the third and last question, would you expect any kind of change to incoming wafer orders post lunar year? In other words, do you think that your customers are going to wait and see what the demand in Asia is going to be post lunar year and then, to that extent, make any changes?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Okay. First question is about the 65 nanometer investment. Well, we will be starting the 65 nanometer production capacity investment in mid-year. The capacity at the end of the year is, I think, still in the (indiscernible) 3K per month range -- maybe plus somewhat. So it is here not a big capacity number.

However, as you probably know also, for the capital intensity that is here, (indiscernible) per 1000 wafer per month capacity. That number is much higher when the overall capacity is low. That is, on 3K or (indiscernible) range, that is pretty high. But this number will go down very rapidly when we start to ramp into, for instance, 10K, 15K range. That is the first question, right?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

The second question asking about we have mentioned ASP going down, too now remember we have mentioned ASP trends. Actually since last quarter, we have stopped guiding any ASP trends.

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

I think we certainly comment more. Of course, because you're asking whether -- I think overall for the year, our industry, we do not raise prices when the capacity is tight. It is not a case like a DRAM. The pricing pressure, as we also said (indiscernible) a couple of times.

For instance, the pricing pressure for 90 nanometer remains high. It is still a very competitive environment in the industry. We are -- so that is why we said our 90 nanometer gross margin is lower than the Company overall gross margin. However the price of the 90 nanometer is still good enough for us to maintain our better than 20% target of ROE. (multiple speakers) your question?

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**Mehdi Hosseini - Friedman, Billings, Ramsey - Analyst**

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The last question has to do with your expectation about incoming wafer start orders post lunar year. Do you think that your customers are going to wait to see what the demand is going to be and to what extent they would have to change inventories? And that has an impact on your Q1 revenue guidance, which is down 8%.

**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

The ordering pattern, if you think about lunar Chinese New Year, which is actually two days from today -- or three days, the order for the Chinese New Year, the wafer [out] for the Chinese New Year, since this must be sometime late -- the latest -- probably sometime late December or at the latest early January. But the ordering pattern that we have been seeing through the Novembers/December into January time has been fairly steady, pretty good. So we do not see an abrupt change in the ordering pattern during the last three months.

**Mehdi Hosseini - Friedman, Billings, Ramsey - Analyst**

If I may have a follow-up, does that mean that with flattish ASPs for Q1, your wafer shipment is going to be down about 8%?

**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

No, that is not what we said. We just give guidance in the range of 6 to 10% decline in revenue, and exchange rates (indiscernible) roughly half of that number.

**Mehdi Hosseini - Friedman, Billings, Ramsey - Analyst**

Great. Thank you very much.

**Operator**

Michael McConnell, Pacific Crest Securities.

**Michael McConnell - Pacific Crest Securities - Analyst**

I was curious that it looks like you're not, obviously, providing wafer ASP trends anymore, wafer shipments utilization. Can you at least talk about Q1, what you're seeing from the end markets?

**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

End markets? I think the Q1, as we all know, is the seasonally declining quarter for most of the applications. What we are seeing from the computer segment and for the consumer segment, our demand is better than the normal seasonal patterns.

For the communications segment, both wireless and wireline, we are seeing a seasonal declining pattern, a normal seasonal declining pattern. So I would characterize a better-than-expected end market demand in this first quarter.

**Michael McConnell - Pacific Crest Securities - Analyst**

Within the PC market, is the majority of the demand coming from the chipset customers?

**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

I would not say majority, because in the PC segment, actually our largest demand has always been the graphic applications. Chipset of course is significant. We are feeling, I would say, pretty robust demand from graphics because of the many new product offerings from the customers.

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The chipset demand is also strong from our customer base, I believe mainly because of the change in the supply dynamic. As you know, one of the -- not one of the -- the largest chipset supplier has reduced their output for chipsets, and that creates a void which is actually quite difficult to fill.

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**Michael McConnell - Pacific Crest Securities - Analyst**

And then within consumer, we have been picking up DVD is a little bit weaker, but CMOS image sensors relatively strong. Can you comment there kind if those are the dynamics playing out in consumer in Q1?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

The consumer segment, we are seeing a very good demand from digital TV chips; we are seeing a strong pickup. We are seeing a pretty good digital camera demand. CMOS sensor (indiscernible) continue to do well. Even for DVD players, we're not seeing a weak demand. We're not seeing a weak demand. It is fairly good. It is pretty good, actually.

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**Michael McConnell - Pacific Crest Securities - Analyst**

And then in communications, and I will go away. Would you characterize the seasonality more acute on the wireless side or the wireline side?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Both are showing the seasonal decline. Wireless -- actually, some people were asking this afternoon -- I came back and took another look. I noticed during the last -- for both 2004 and 2005, for instance, the handset -- first quarter growth rate for the handset has been net around minus 5% to -10% from unit point of view.

We are -- I do not have the very quantitative number for our shipments, but my observation is our shipment for the handset type of devices is declining at a similar rate.

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**Michael McConnell - Pacific Crest Securities - Analyst**

Great. Thank you very much for the color.

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**Operator**

Shekhar Pramanick, Moors & Cabot.

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**Shekhar Pramanick - Moors & Cabot - Analyst**

Rick, couple of questions. You know, '05 was a year where TSMC, after a long time, the growth rate was in line with the semiconductor growth rate, particularly in dollar terms. Do you see '06 as you go back to the pattern, where you will be basically exceeding the semiconductor growth rate because you're picking up some extra outsourcing, which previously had been talked about? And then I have another question.

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Yes, we do expect TSMC to grow better in 2006 compared to the overall semiconductor industry. Yes, we fully expect that and we are fully committed to make that happen.

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**Shekhar Pramanick - Moors & Cabot - Analyst**

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Okay. And if that happens, where do you think the upside is going to come from? Is it going to come from memory or come from a particular handset -- 3G handsets -- or maybe sort of segment, if you could give us the color.

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Probably not from memory. We are doing some memory but I think the [margins] are not big enough to have such a strong impact to our business. I think we will continue seeing the strong demand, but the momentum in the second half of last year basically will carry themselves into this year.

I see them basically across the board. As an example, we were asked about here first quarter consumer products. We were quite happy to see that the digital TV chip demand as we come up quite nicely.

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**Shekhar Pramanick - Moors & Cabot - Analyst**

My last question, the CapEx of 2.6 to 2.8 billion, is that a more of a conservative call at your part at this point or would we expect that to upside? Or is it just right?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

As far as we can see now, it's about just right. We are not trying to be conservative. As I've said several times, we are -- we will be adding advanced technology capacity so that we will compete aggressively in the market. And we will meet all our customers' demands.

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**Shekhar Pramanick - Moors & Cabot - Analyst**

Thank you.

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**Operator**

Mark FitzGerald, Banc of America.

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**Mark FitzGerald - Banc of America Securities - Analyst**

And I was curious if you could give us a split on the CapEx spending between the advanced technology, the 65/90, and any spending that might happen in the older technologies in 2006.

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

I probably cannot give you a breakout among each technologies, but I can tell you that 95% of our CapEx in 2006 will be 12-inch product related. That includes the capacity, the equipment, R&D, and everything associated with 12 inch.

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**Mark FitzGerald - Banc of America Securities - Analyst**

It sounds like you're not going to add much capacity in the older technologies at this point then. I'm curious if there's any explanation given the kind of high utilization rates.

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

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I think that is a very good question. The truth [in margins] -- we had some discussion just earlier in the conference call. Right now, we are not budgeting much for the mature technology capacity, since we do not have a clear picture as to where to get them.

But what I can say here is if we can find a reasonable [force] of the mature technology capacity, we will go and acquire those.

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**Mark FitzGerald - Banc of America Securities - Analyst**

So basically, is it your view that there is plenty of capacity outside of TSMC and you would be more inclined to acquire it than to put it in place?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

That is something we're not sure of right now. There is probably still some outside, but it is not plenty, I don't think.

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**Mark FitzGerald - Banc of America Securities - Analyst**

Okay. Can you just give us an indication on the bonuses this year? Are we going to be heavily cash oriented? Have you moved over to that strategy or will there still be a big stock component?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

For this year, it will be 50-50 percent for each. As we have said, the policy of two years ago is 50-50 is going to continue for two years. This is the second year.

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**Mark FitzGerald - Banc of America Securities - Analyst**

Okay, thank you.

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**Operator**

Bhavin Shah, JPMorgan.

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**Bhavin Shah - JPMorgan Chase & Co. - Analyst**

Thank you. My question is answered.

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**Operator**

Sunil Gupta, Morgan Stanley.

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**Sunil Gupta - Morgan Stanley - Analyst**

Rick, I have two industry product questions for you, just given your (indiscernible) array of the end markets. You mentioned earlier about pricing pressure at the leading-edge. And you said in the afternoon call it's sort of the normal kind of pressure that you have been seeing for some time now.

On 90 nano and 110 nano, I also understand that given the whole range of services that you offer, you decided premium was (indiscernible) compared to also attempt to offer same services.

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So when you're talking about this pricing pressures, are you seeing the whole industry experiencing similar pressures or is it that in the premium pricing that you had or some of your competitors, that premium is mattering some more?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

I think we continue to get out, as you said, premium in pricing over that of our competitors. So I don't see that being impacted. I think we are getting probably in some cases better than our normal premium, as you said.

It is just -- I think you know, as well as we do, at least during the last year, many people were saying that they can do 90 nanometer production, and that definitely created the expectation among the customers, which, of course, in turn creates the pressure.

Basically, I think, we have performed very well during last year, both in ranking and in yields, in achieving the excellent yields. As a result, I think the impact on our gross margin was not as difficult as we thought it might be, and we see this trend going into the year 2006.

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**Sunil Gupta - Morgan Stanley - Analyst**

Okay, great. And another industry question just as a follow-up. You also mentioned earlier in the afternoon when you were asked about the industry outlook for 2006 that the global semiconductor market should grow by, I think, high single digits, low double digits. If I just take the 10% as maybe a midpoint, 10 or 11% a midpoint.

Since you have (indiscernible) to a whole range of customers, do you see any possibility based what you're hearing from your customers that the industry growth rate may turn out to be significantly different from this, such as maybe more than 15, 18% kind of a growth scenario?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Your question is on which segment?

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**Sunil Gupta - Morgan Stanley - Analyst**

For the global semiconductor. You mentioned earlier that this could grow by say perhaps 10% in 2006. And I'm wondering is there a possibility that the growth rate may be significantly higher, say, more than 15%? What would be required for that to happen?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

We don't see that now. We looked at -- we do have a model to look at these growth rate forecasts. You know, we still believe 2006 will be -- 10, 11% is a reasonably good growth year, considering some of the macroeconomic factors, such as oil price and the interest rate impact on the housing industry in the U.S.

So to answer your question, I do not really see a major upside to this 10% growth rate that we are talking about.

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**Sunil Gupta - Morgan Stanley - Analyst**

Okay. Thank you, Rick.

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**Operator**

Steven Pelayo, Soleil Securities.

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**Steven Pelayo - Soleil Securities - Analyst**

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We keep hearing about the manufacturing production plans of the major equipment suppliers are ramping fairly aggressively. I'm wondering if you have heard anything from those suppliers to suggest that their lead times and their ability to get tools to you has lengthened in any way.

My second question would simply be you're planning 2.6 to 2.8 billion in capital spending in 2007. Have you already gotten in line and booked a good, decent amount? How much of that 2.7 at the midpoint is actually booked in equipment at this point?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

I think to some extent the equipment suppliers during the past several years, to their credit, have improved their lead times. Not all of them, but many of them. For instance, we have had a very good progress, together with our lithography supplier. And this is something also we work very hard together to not only improve the lead time of the equipment shipment, but also improve the installation and the qualification time once the equipment gets to our wafer fab. So we are -- from the capacity installation point of view, we are not seeing any real (indiscernible) impact from that point of view.

As to the ordering, I think that Lora mentioned earlier that our CapEx will be fairly evenly distributed throughout the year. So I do not have really a visibility right now about our ordering status, but you can probably extrapolate from Lora's comments.

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**Steven Pelayo - Soleil Securities - Analyst**

Okay, thank you.

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**Operator**

Matt Gable, George Weiss Associates.

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**Matt Gable - George Weiss Associates - Analyst**

I was wondering if you could describe ordering patterns right now with customers, if you have any visibility -- obviously Q1 -- but any look into the first month of Q2, what wafer starts have been doing lately. Thank you.

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Ordering patterns pretty much consistent with what our guidance is for our first quarter business. Our orders are coming in with sufficient lead time for us to meet our first quarter business guidance.

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**Matt Gable - George Weiss Associates - Analyst**

I got on the call a little late. Was there any guidance for Q1 capacity utilization, what you think that is going to do?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

No, we did not provide guidance for utilization for this quarter.

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**Matt Gable - George Weiss Associates - Analyst**

Okay. Thank you very much. I appreciate it.

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**Operator**

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Pranab Sarmah, Daiwa Institute of Research.

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**Pranab Sarmah - Daiwa Institute of Research - Analyst**

My first question is on your 2006 CapEx. Does this CapEx include some equipment for your new fabs, the fab 15?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

The 15? No.

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

No, not yet.

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Merely for 12 and 14.

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

From equipment point of view.

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**Pranab Sarmah - Daiwa Institute of Research - Analyst**

That means your 12 and 14 will be fully ramped up by end of 2006. In that case, when you are going to move equipment to next fab?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Well, no. I don't think by the end of this year either 12 or 14 will be fully ramped up. Because keep in mind both fabs will be capable of doing 55 to 70,000 per month of capacity. However, we are planning on our next fab and we may start here some of the construction work for the next fab.

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**Steven Pelayo - Soleil Securities - Analyst**

Okay. And is it possible to give some color on that customer concentration now or just to give some idea, like how many of the customers are above, say, 5% at this point?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Top ten customers accounts for roughly 50% of our total revenue.

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**Pranab Sarmah - Daiwa Institute of Research - Analyst**

505%?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Yes.

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**Pranab Sarmah - Daiwa Institute of Research - Analyst**

And how the customers would be above 5%?

**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Sorry, we do not disclose that information.

**Pranab Sarmah - Daiwa Institute of Research - Analyst**

Okay, fine. And in this 2006 you are ramping your capacity a little higher speed on the second half and slightly lower speed on the first half. Is it mainly due to some bottleneck on the [back end] (indiscernible) industry or do how you read that part?

**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Actually, it depends on the demand patterns, so we see capacity ramping based on the customers' demand. So it is not related to other things.

**Pranab Sarmah - Daiwa Institute of Research - Analyst**

Some of your customers have reported -- at least one customer said they're facing some problem with back-end capacity. And is it affecting the front-end business because of the capacity constraint on the back-end side?

**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

I think the back-end capacity issue has been there since the second half last year. So I think that it may have some impact on the certain portion of the inventory. However, I don't think that is impacting the overall demand out of --because the end market demand has been quite strong since second half last year, and continuing into, we believe, the first quarter this year.

**Pranab Sarmah - Daiwa Institute of Research - Analyst**

Okay. Thank you very much, Rick.

**Operator**

Fayad Abbasi, Neuberger Berman.

**Fayad Abbasi - Neuberger Berman - Analyst**

I just wanted to maybe ask a little bit longer-term question. We have seen quite a bit of, as you've mentioned, pricing pressure at 90 nanometer. But if you look at profitability at some of your competitors and the technical challenges going to 65 and then going on to 45, at least at 65, what are your thoughts about what the pricing environment may look like? Again, it is a little bit further out, but if you could provide some insight on that, that would be great. Thanks.

**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

That is a bit further out. We hope that it is not at the (indiscernible). I do believe you're right in saying that 65 nanometer is definitely more difficult. It is not just the shrink of the 90 nanometer. Especially from a transistor design and point of view, there are a lot of difficulties -- technical difficulty there.

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So we are, I think, on the right track towards our schedule according to our road map, and we fully expect ourselves to be able to start and ramp this technology on time and fully. We have shipped some (indiscernible) wafers already to our customers.

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**Fayad Abbasi - Neuberger Berman - Analyst**

Would you characterize maybe that the pricing, whatever pricing pressure you may face at 65 may be more driven by your customers than your competitors, as opposed to 90?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

I don't think I really can say for sure right now. Our price for 65 nanometer, I believe now, has the right parity compared to our 90 nanometer price.

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**Fayad Abbasi - Neuberger Berman - Analyst**

Okay, that's great. Thank you.

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**Operator**

A follow-up from Ivan Goh, DRKW.

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**Ivan Goh - Dresdner Kleinwort Wasserstein - Analyst**

Another long-term question for you. Right now, basically, we know that your 90 nanometer gross margin is below your Company's average. And I think recently you were quoted to say that the (indiscernible) cost is growing by 20% year-on-year -- in a conference in the U.S.

I was just wondering, when you go to 65 nanometer and down to 45 nanometer, and that (indiscernible) cost continues to rise at 20% per annum, how much of an impact would that have on your ability to meet your long-term ROE target of 20%? And of course, the following question is what can TSMC do about that?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

Well, I think the [discovery] tool, of course, is obviously one of the most (indiscernible) investment. On the other hand, of course, at least our suppliers have delivered the throughput and the performance along the way. So far, we are [pleased] and together we have been able to migrate to the -- for instance, 65 nanometer, at a cost structure that will meet the [Moore's Law].

Going forward, the only way is for our partners and the key suppliers to collaborate with us, just like what we are doing with our key customers, to continue working on the productivity, on the overall cost structure, on the leadtime, on the performance, so that both of us can succeed in our business. I must say, for instance, we've been working very closely and very well with our lithography supplier in that regard.

It is a very high capital intensity, but I think TSMC, with our scale, this economy of scale affords us to continue in this very high, very heavy capital intensive business, and we can enjoy the return from such investment. And we view that as, naturally, one of our competitors' advantage long-term.

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**Ivan Goh - Dresdner Kleinwort Wasserstein - Analyst**

So you're quite confident of getting the right cost structure that would allow you to -- that would be similar if not better than 90 nanometer than what you have for 90 nanometer today?

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**Rick Tsai - Taiwan Semiconductor Manufacturing Company Limited - CEO, President**

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Yes, the 65 -- yes, for sure.

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**Ivan Goh - Dresdner Kleinwort Wasserstein - Analyst**

Thank you very much.

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**Elizabeth Sun - Taiwan Semiconductor Manufacturing Company Limited - Head of IR**

Operator, according to the time, we will only allow two more questions.

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**Operator**

Timothy Arcuri, Citigroup.

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**Timothy Arcuri - Citigroup - Analyst**

I seem to remember on this call last year as you were entering 2005, you had said that there was a pretty good portion of your full-year capital spending -- I seem to remember some number like 40, 50% -- that was already sitting in deferred payments to the suppliers, either in terms of down payment or in terms of full payments to your suppliers.

I'm wondering is that a similar phenomenon this year? I would think the percentage is much, much lower than that, given the much shorter lead times. Thanks.

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Actually, last year's condition was kind of unique because we were paying for capacity increase to support early this year demand. This year, the pattern is kind of more normal, and we do not see it will be a similar situation like last time.

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**Timothy Arcuri - Citigroup - Analyst**

So you see things ramping in a more linear fashion through the year?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Yes, that's true.

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**Timothy Arcuri - Citigroup - Analyst**

Okay, thanks.

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**Operator**

Michael McConnell, Pacific Crest Securities.

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**Michael McConnell - Pacific Crest Securities - Analyst**

These are easy -- just a little housekeeping. The net nonoperating income line, investment income -- what are we kind of thinking about for Q1?

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**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

I'm sorry -- say it again.

**Michael McConnell - Pacific Crest Securities - Analyst**

The net nonoperating income and investment income line items on the income statement, what are we expecting those to be in Q1?

**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

This part is actually quite difficult to forecast. But fortunately, if you look at TSM's history, this line number is (indiscernible).

**Michael McConnell - Pacific Crest Securities - Analyst**

Okay, so just --

**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

(multiple speakers) close to 2005 fourth quarter, that would not too much far away.

**Michael McConnell - Pacific Crest Securities - Analyst**

Okay. So kind of in the same vicinity as Q4.

**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Yes.

**Michael McConnell - Pacific Crest Securities - Analyst**

And then the tax rate for '06?

**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Okay. I want to make some comment on tax rate. In 2006, we estimate the tax rate will be within 5% of (indiscernible) net income before tax. That configures the tax expense minus the tax credit.

**Michael McConnell - Pacific Crest Securities - Analyst**

Okay. And then last one, can you give us at least for Q4 what wafer shipments were in Q4, or are we no longer doing that either?

**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

We are no longer doing that. Sorry.

**Michael McConnell - Pacific Crest Securities - Analyst**

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So we should just back into it, just with the utilization -- I know your utilization rate obviously (indiscernible) your actual wafer shipments. Is there a reason for this?

**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Yes.

**Michael McConnell - Pacific Crest Securities - Analyst**

Is it just you don't want to be this transparent anymore? I'm just trying to wonder why you're not doing wafer shipments anymore in Q4, because we all --.

**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

It's not we don't want to be transparent in the U.S. We have changed our guidance by directly giving you the top line, the revenue, the gross margin, and operating margin. So for you to figure out the profitability is actually much easier.

**Michael McConnell - Pacific Crest Securities - Analyst**

Okay, thank you.

**Lora Ho - Taiwan Semiconductor Manufacturing Company Limited - VP, CFO**

Let's conclude today's conference. Thank you very much. We're going to have a lunar new year and we should all have a very good year of 2006. Goodbye.

**Operator**

Ladies and gentlemen, we thank you for your participation in this conference. This concludes the presentation and you may now disconnect. Have a great day.

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