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## Conference Call Transcript

**TSM - Q3 2007 TSMC Earnings Conference Call**

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Oct. 25, 2007 / 8:00PM HKT, TSM - Q3 2007 TSMC Earnings Conference Call

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Welcome to TSMC's third quarter 2007 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's website at [www.tsmc.com](http://www.tsmc.com) and only in audio mode. Your dial-in lines are also in listen-only mode. 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 a

question. Please be advised for those participants who do not yet have a copy of the press release -- you may download it from TSMC's Web 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 - TSMC - Head of IR**

Good morning and good evening to all participants. This is Elizabeth Sun, Head of Investor Relations for TSMC.

Before we begin, I would like to state that 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-F, filed with the United States Securities and Exchange Commission on April 20, 2007, TSMC's registration statements on Form F-3, filed with the SEC on May 8, 2007, and such other documents that 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 statements, whether as a result of new information, future events or otherwise.

And 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 - TSMC - VP and CFO**

Thank you, Elizabeth. Good morning and good evening to everyone. Welcome to our third quarter 2007 earnings conference call.

First I will go over the highlights of our third quarter results. I will then give you the outlook for the fourth quarter. Please refer to the quarterly financial summary slides on our website. All dollar figures are in NT dollars unless otherwise stated.

First, the highlights of the quarter -- TSMC delivered a strong quarter in Q3 in which we set a record in terms of revenue and wafer shipments. We expanded our gross margin and operating margin. In the meantime we returned US\$3 billion to our investors through cash dividends.

Now let's turn to income statement -- during the third quarter, we saw stronger-than-expected demand across major market segments. As a result we delivered revenue of NT\$89 billion in the quarter, up 8% year-over-year and up 19% quarter-over-quarter.

Now let's take a closer look at our revenue. In terms of revenue by market segment, all three major segments delivered double-digit growth during the quarter with the strongest growth coming from computer segment followed by consumer and communications. On a quarter-over-quarter basis, revenue from computers, consumer and communication grew by 29%, 15%, and 12% respectively.

In terms of revenue by technology, we continue to ramp our 65 nanometer during the third quarter as revenue from 65 nanometer more than doubled from the previous quarter to account for 7% of weaker sales. We expect percentage of revenue from 65 nanometer further increase in the fourth quarter.

Total revenue for advanced technologies accounted for 56% of wafer sales, up 3 percentage points from the second quarter.

Gross margin was 45.8% for the quarter, up 2.8 percentage points quarter-over-quarter mainly due to an increased wafer shipment and a higher level of capacity utilization offset, in part, by a decline in field price.

Total operating expenses was higher than in the previous quarter largely due to higher legal fees and increased R&D spending on 65 and 55 nanometer-related projects.

Operating margin was 36.4% for the quarter. Income from non-operating items and long-term investment total NT\$1.9 billion, down NT\$1.4 billion from Q2 mostly due to accrual of litigation losses related to a UniRAM case.

Earnings per share were NT\$1.15 down 7% year-over-year and up 19% quarter-over-quarter.

Moving on to the balance sheet and cash flow statement -- we continue to have a strong balance sheet with ending the quarter with NT\$176 billion and short-term investments down from NT\$233 billion in the last quarter mostly due to an NT\$82 billion payout of cash dividend and employee profit-sharing offset, in part, by a NT\$26 billion free cash flow generated during the quarter.

Now let's turn to capacity and capex -- total installed capacity for third quarter was about 2.2 million 8-inch equivalent wafers. We slightly reduced our fourth quarter capacity bringing our total expected 2007 capacity to be about 8.3 million 8-inch equivalent wafers, a 17% increase year-over-year. We spent US\$756 million in capex during this quarter. We now expect our full year 2007 capex to be around US\$2.6 billion, which includes the US\$82 million purchase of 8-inch equipment from Atmel.

With that, let me give you the outlook for the fourth quarter of 2007. Based on our current business and foreign exchange rate expectations we expect our consolidated revenue to account in between NT\$92 billion to NT\$94 billion.

In terms of margins, we expect our fourth quarter gross margin to be between 46% and 48% and our operating profit margin to be between 37% to 39%.

That concludes my remarks today. Let me turn to our CEO, Dr. Tsai, for his remarks and followed by Q&A.

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**Rick Tsai - TSMC - President and CEO**

Thank you, Lora. Again, I'd like to spend a few minutes on a few topics that many people have shown great interest in. The three topics I'm going to talk about include, first, business outlook; second, capex, mainly capex for 2008; and, third, pricing.

Let me start with business outlook. As Lora just mentioned, the third quarter was a good quarter but recently we have performed better than we expected. I think the same can be said for the whole semiconductor industry. All the PC shipments and handset shipments, I think, exceeded expectation.

We are now looking at the year 2007. We are in better shape compared to three months earlier. Three months ago we were forecasting a 3% to 4% growth for the semiconductor industry in 2007. Now we are looking at 2007 at 4%, maybe somewhat higher.

Foundry sector, however, still will underperform in the semiconductor industry. We do not expect the foundry sector to grow much. Essentially it will be a flat year for the foundry sector of the semiconductor industry.

Moving forward to 2008, what we are looking at right now is a better year from semiconductor industry point of view. We expect, by now, for the 2008 to grow roughly between mid to high single-digit for the whole semiconductor industry. While the foundry sector should outperform the semiconductor industry.

I think in the year 2007, inventory correction in the early part of the year, first quarter very strongly and also, to a large degree, in the second quarter impacted the foundry sector much more severely compared to semiconductor industry hence the quite a bit lower growth for the foundry compared to semiconductor.

However, we are seeing the inventory effect to be quite clear now. Third quarter inventory reports from most of the companies have shown continuing improvement, and this will continue into fourth quarter. We expect fourth quarter days of inventory to continue going down compared to third quarter.

So with inventory effect gone, we believe the foundry sector will resume its previous pattern, which is the outperformance over the semiconductor industry. We certainly also expect TSMC to outperform the semiconductor industry.

Now let me talk about the capex. First let me comment on the 2007. Again, Lora just said our capex in 2007 will be about NT\$2.6 billion, which is a lot of money. This NT\$2.6 billion will have acquired a large chunk of the capacity that we will need in 2008. For example, the 90-nanometer technology capacity, we will be having, I believe, enough by the end of the fourth quarter this year, and we probably will not need more 90-nanometer capacity -- new capacity next year. However, we will continue purchasing equipment for 55 nanometer and 45 nanometer.

The key point here is a large part of the capacity for year 2008 will be covered already by the NT\$2.6 billion capex spend in 2007.

In addition, we have worked very hard over the year on the productivity improvement of all the tools that we have purchased, especially the 12-inch tools. We have improved, certainly, the productivity to the extent that also will help the lessening, the need, for the capex for year 2008.

Essentially, what we have done is to improve our capex activity in 2007, and we will be able to lessen the need for capex in 2008. As a result, our current expectation for the capex in 2008 will be significantly lower than the capex in 2007. We believe this capital investment will allow us to support the business growth in 2008.

Now let me go to the pricing part. TSMC's pricing, we have always aimed to reflect the total TSMC value proposition, and the value proposition includes the value of our long-term investment in technology development, manufacturing capacity, design services, backend services, mapmaking services, et cetera, et cetera.

However, our recent pricing trend was not consistent with our value proposition, and the statement I just made one minute ago. And we must then aim to keep the pricing trend in line with our value proposition. This is our plan for 2008.

This is the end of my remarks, thank you. We are happy to answer any questions that you have.

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**Elizabeth Sun - TSMC - Head of IR**

Before you raise your questions, let me remind you that please limit your questions to no more than two each time so that more people will have their chance to raise their questions. Thank you for your cooperation. Operator, you can start the floor now.

## QUESTION AND ANSWER

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**Operator**

(Operator Instructions) Shailesh Jaitly, Nomura Securities.

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**Shailesh Jaitly - Nomura Securities - Analyst**

First, you could help clarify last year comments in the prepared remarks about the inventory situation. It mentioned that inventories continue to improve across the board. Was something -- do you see any pockets where you still see excesses particularly if you can comment on the wireline communication segment, please.

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**Lora Ho - TSMC - VP and CFO**

Shailesh, could you please repeat your questions again, sorry, because we don't have a very good sound system to completely get your question.

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**Shailesh Jaitly - Nomura Securities - Analyst**

Yes, I just wanted to get a bit more color on the inventory situation across the board. One thing -- if there are any pockets of excesses, particularly if you can shed some more light on the wireline communication sector with respect to inventories.

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**Rick Tsai - TSMC - President and CEO**

Number one, we do not see that, however, I want to caution that I'm not sure we have that fine granularity. What I think I have that -- in my remarks earlier that we are seeing the inventory, double, in general, to go down at a very healthy level. And we certainly expect to see that

Oct. 25. 2007 / 8:00PM HKT, TSM - Q3 2007 TSMC Earnings Conference Call

continue into fourth quarter. And I might also add that from our output or from our shipment schedule in our customers' business expectation, we do not see concern of inventory buildup.

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**Shailesh Jaitly - Nomura Securities - Analyst**

So it is more or less, across the board, it has improved dramatically. You don't see any excesses anywhere?

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**Rick Tsai - TSMC - President and CEO**

I think there have been a continuous improvement profits over the last two to three quarters, so it's a continue process, so I wouldn't use the adjective of "dramatic." That would imply a sudden improvement. I think it's a continuing improvement with -- and also we see that, going forward, also.

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**Shailesh Jaitly - Nomura Securities - Analyst**

Understand, and finally if you could also comment on your strategy about the increasing stake at Vanguard, and would they be open to increases beyond 50%?

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**Rick Tsai - TSMC - President and CEO**

Okay, yes, we have increased our shareholding by 10 percentage points, reach about 37% of Vanguard shareholding. Our basic position with regard to Vanguard really has not changed. Vanguard has been and continues to be our strategic partner in the mature technology business. We have worked very closely with Vanguard both from technology covering all the way from 25 micron to 8 micron. Vanguard also can cover certain business that we have not been able to cover ourselves. But things are definitely a win-win situation, and the increase of the shareholding just further solidifies the relationship.

And, of course, as of now I cannot comment -- I mean -- really, we do not have a firm plan as to what we will do in the future as far as the shareholding is concerned.

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**Operator**

Timothy Arcuri, Citi.

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**Timothy Arcuri - Citi - Analyst**

A couple of things -- I guess, Rick, can you be a little more specific about what you think the '08 capex would be? I guess when I look this year, you grew capacity 19% last year with a similar capex -- you grew capacity 24% the year before with a similar capex. If you grew capacity 17% this year with a similar capex. So it would seem that it's not unreasonable that capex might come down 50% or so next year. Is that a reasonable number?

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**Rick Tsai - TSMC - President and CEO**

Well, right now I must say -- let me be, first, be straightforward. I would say it's a 50 -- what you just said --

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**Timothy Arcuri - Citi - Analyst**

Fifty, yes -- five-zero.

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**Rick Tsai - TSMC - President and CEO**

Oct. 25. 2007 / 8:00PM HKT, TSM - Q3 2007 TSMC Earnings Conference Call

Five-zero, right? I would say that's unreasonable because I don't want to create any confusion. But I will not comment further on any other numbers, all right -- from everybody, anybody, and not just you.

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**Timothy Arcuri - Citi - Analyst**

Okay.

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**Rick Tsai - TSMC - President and CEO**

Yes, but, while you have calculated a lot of numbers, as we have also, but to be also very frank, we continue to work on the numbers, and we really haven't made the final decision yet, but we are fairly sure that the number will be significantly lower.

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**Timothy Arcuri - Citi - Analyst**

Sure, okay, is there some particular -- I mean, it sounds like you've spent a lot on lithography this year and also last year. Is there some particular area of your capital spending where you think you're getting a lot of efficiencies? Is it in litho? Is that where you think you can scale back the most in '08 or is it something else?

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**Rick Tsai - TSMC - President and CEO**

I feel we have made progress in general, but litho is definitely one area that we have. We are putting a lot effort into the last, I would say, about 18 months for the simple reason that it's the most expensive part of the investment. But we, in general, look at the more bottleneck type of machine. Because that's a lot of work to do, we try to prioritize -- to ensure that we spend our resources most efficiently. But litho is definitely the number-one priority.

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**Operator**

[Prenup Sama], Daiwa Securities.

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**Prenup Sama - Daiwa Securities - Analyst**

Rick, you have mentioned about our capex productivity has been improving. Do you mean a particular target like, say, to add 1,000 more [carbons] of fab capacity in 2008, what type of capex do you have to put in? Or if you can give us some number like whether that capex will growth by 5% to 10%, any sort of target you have?

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**Rick Tsai - TSMC - President and CEO**

I think probably -- well -- let me put it this way. We put in the target -- I think you used 5% to 10%, it's probably not a bad range. We're putting a target improvement in productivity and, of course, we do not improve imprecise that earlier. We do not try to improve productivity of every tool. What we are doing is to improve productivity with certain tools so we can increase overall output capability from the same set of tools. I think 5% to 10% is -- well -- a fairly good range to work with.

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**Prenup Sama - Daiwa Securities - Analyst**

And the next one is because of your probably significant capex cut in 2008, do you foresee any market share loss in the foundry industry in 2008, or you'll be able to maintain the exact market share?

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**Rick Tsai - TSMC - President and CEO**

Well, we certainly, I believe, with our -- we did not say that we will not have capacity. We will continue -- we feel, we believe, we will have enough capacity to serve the needs of the business requirements. We certainly will keep our market share. Just, remember, the revenue is price times quantity.

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**Operator**

Mehdi Holloran, FBR.

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**Mehdi Hosseini - FBR - Analyst**

Two questions -- there is obviously a lot of confusion over your capacity requirement for next year, and, it seems to me, that we should expect the significant pricing increase next year given the significant decline in capex. Is that pricing premium driven by your expectation that you are able to continue to increase your market share or keep your lead at 65 and 45 nanometer processes?

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**Rick Tsai - TSMC - President and CEO**

Again, I hope we have not created confusion that we will have a low capacity next year. I think we tried to expand at the very beginning that we - the capital investment we have spent this year, together with the productivity improvement of the critical tools, we believe with this significant lower capex that we will still have enough capacity to sustain, to support, our business requirement next year.

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**Mehdi Hosseini - FBR - Analyst**

Sure. I'm just going back to your prepared remark that semiconductor industry revenue could be up 5% to 10% next year, and considering where your utilization rate is, above 90%, that productivity improvement must be significant. I guess that's where we're trying to understand how significant is this productivity improvement?

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**Rick Tsai - TSMC - President and CEO**

Well, we certainly aim to do the 90%.

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**Lora Ho - TSMC - VP and CFO**

I think there is one comment some analyst made this afternoon in our conference saying that even if TSMC were not to spend an extra penny of capex for next year, with whatever we have in the fourth quarter of this year, capacity, if you annualize that, already represented a 9% year-over-year capacity increase even without a penny spent.

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**Mehdi Hosseini - FBR - Analyst**

Okay, great, and just for clarification, did you say this morning or during your local conference call that capex could be down by as much as 50% -- five-zero?

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**Rick Tsai - TSMC - President and CEO**

No, we did not say that.

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**Mehdi Hosseini - FBR - Analyst**

Oct. 25. 2007 / 8:00PM HKT, TSM - Q3 2007 TSMC Earnings Conference Call

Okay, I just want to clarify -- where do you see 65, 45 nanometer tape outs and then given the kind of a tapeout you see at these two technology nodes, is it below where 90 nanometer tapeouts were a couple of years ago when 90 nanometer was first introduced?

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**Rick Tsai - TSMC - President and CEO**

I think 55 nanometer tapeout has been strong. I think our 65 nanometer business RAM has been, certainly, according to our schedule is somewhat better than that. So we have -- I forget the tape out number, but the tape out -- this is already late October. We should have more than 100 product tapeout for 65.

The 40 nanometer, we think it's now a bit early to talk about the product tapeout. We do have one, however, I think it's important to say that we have -- actually, compared to the same timeout of 65 nanometer and 90 nanometer we are engaged with, I would say, significantly more customers at the 45 nanometer technology.

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**Mehdi Hosseini - FBR - Analyst**

Is that one tapeout in the computing, from the computing, PC-related, or communication wireless?

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**Rick Tsai - TSMC - President and CEO**

Wireless communication.

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**Operator**

Randy Abrams, Credit Suisse.

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**Randy Abrams - Credit Suisse - Analyst**

I want to follow-up on the 45 nanometer and maybe talk about some of the new applications you are seeing coming there, and you're seeing more activity than 65 and 90. Do you expect the ramp to be faster or a greater amount if we go to 45 than we saw at 65 and 90?

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**Rick Tsai - TSMC - President and CEO**

I think I said, Randy, in the afternoon that the application that we are seeing for the 45 nanometer now is broader than 65. Also, with more customers, I really -- I would say now it's somewhat early to predict the ramp, but what I can say is if this situation continues, I will probably expect, yes, at least seeing more better ramp.

Basically, if you look at our 45 nanometer offering and the schedule of availability, it represents a very good value for the customers.

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**Randy Abrams - Credit Suisse - Analyst**

I wanted to ask -- given your comment about inventory days coming down in fourth quarter, what is your initial view of revenue trends in first quarter 08? And also with the macro uncertainty, have you seen any notable changes in the order book, whether cancellations or rush orders?

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**Rick Tsai - TSMC - President and CEO**

Of course, we are not guiding first quarter now. I guess what I can comment on is the -- we do not see now any abnormal pattern other than the yo-yo seasonal pattern. I mean, first quarter had such a seasonal pattern. Now I think continue for a few years.

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**Randy Abrams - Credit Suisse - Analyst**

Oct. 25. 2007 / 8:00PM HKT, TSM - Q3 2007 TSMC Earnings Conference Call

Okay, and have you seen any real changes in the order trends in terms of just cancellations for rush orders, either direction? Just given what the macro uncertainty out there?

**Rick Tsai - TSMC - President and CEO**

We are not really seeing cancellations now. We still see some requests for the polling of the wafers. But I wouldn't characterize that as -- I would not want to mislead you to think that we have a very strong situation, but it's normal and probably is a little better than normal.

**Operator**

Daniel Heyler, Merrill Lynch.

**Daniel Heyler - Merrill Lynch - Analyst**

Just a follow-up question, Rick, on 300 mm -- what percentage of your current capacity is capable of 65 nanometer at 7% of revenue, but I was wondering what percentage of your installed 300 mm, roughly, is 65 capable?

**Lora Ho - TSMC - VP and CFO**

Dan, we are increasing the capacity of 65 nanometers. We have seen the revenue continue to go up. Other than showing you our capacity allocates at 65, I can say that a big part of our capital expenditure for this year and going forward for next year will be aided with the 65 nanometer.

**Daniel Heyler - Merrill Lynch - Analyst**

Right, so is it fair to say that a big part of your productivity gain would be a lot of these fabs here that are running fairly full will be migrating forward from 90 to 65 so you have a huge die advantage, I guess, a [die] capability there. So is that where you're seeing the biggest gain in productivity or are there other factors that I'm missing?

**Lora Ho - TSMC - VP and CFO**

I think productivity improvement is across the board both for 8-inch and 12-inch. Twelve-inch seems to be adding capacity, so the productivity improvement has more phenomenon/ The fact getting to reach to economic scale, the productivity improvement is quite significant. So that also covers the 65 nanometer and also nanometer in 0.13 micron as well.

**Daniel Heyler - Merrill Lynch - Analyst**

Okay, so fair to say would that be a greater productivity gain, say, from 90 to 65 relative to 130 to 90 and, if so, why?

**Lora Ho - TSMC - VP and CFO**

You can say that a gain came from the area that we have add-in capacity because it's still effect so, in a sense, you are right as you do our add-in capacity at 65, it's probably true.

**Daniel Heyler - Merrill Lynch - Analyst**

Oct. 25. 2007 / 8:00PM HKT, TSM - Q3 2007 TSMC Earnings Conference Call

Okay, great, and then as you look out to '09, I guess, what's your capacity additions here in the second half of '07 or for your '08 growth. And it seems as though the industry is -- clearly, the growth rates, as Rick talked about, are less volatile. Do you have an ability or increased ability to start to think about a 9, or is that just crazy, or do you think the industry will be kind of in a 5% to 15% growth range, even out to a 9?

**Rick Tsai - TSMC - President and CEO**

I think no. I think the direct answer should be, no, we don't really have that kind of visibility, for sure, even for next year is what we forecast based on certain methods of profit that we have.

If we have to look at '09, we will have to use the macro kind of a trend -- trend line for the semiconductor industry -- trend line growth.

**Daniel Heyler - Merrill Lynch - Analyst**

Trend line, then, less likely to see massive kind of inventory swings that you've seen in the past are clearly the plus players, right? There's less producers. I'm wondering if you've thought through what that means in terms of volatility, going forward, and if that will be driving your returns further up?

**Lora Ho - TSMC - VP and CFO**

Can you repeat your question, because we don't quite understand your point.

**Operator**

Mark Fitzgerald, Bank of America Securities.

**Mark Fitzgerald - Bank of America Securities - Analyst**

Thank you, I was looking at the mix of IDM in fabless business, and over the last year that has declined for the fabless, and I was curious if that trend would continue, going forward? And the second part of the question -- is there any correlation between the pricing problems and that trend?

**Rick Tsai - TSMC - President and CEO**

I think probably -- you'll probably see a change in the first quarter this year, or fourth quarter last year, I forgot, but mainly that change came mostly because of the acquisition of AGI by A&D. So there is a significant reason. Otherwise, the ratio between IDM and the fabless casting authority consistent over the years.

**Mark Fitzgerald - Bank of America Securities - Analyst**

And is pricing in those segments similar? Do you do better in the fabless than you do in the IDM?

**Rick Tsai - TSMC - President and CEO**

I think the pricing is very much customer-specific. I wouldn't really comment from such a big group -- on such a group.

**Mark Fitzgerald - Bank of America Securities - Analyst**

Just one last question -- is there any evidence that your fabless companies have slowed their traditional technology shifts here as the cost of designing chips has gone up; that they're staying at a technology no longer?

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**Rick Tsai - TSMC - President and CEO**

This point has been raised by many people over a fairly long period of time. I think the dynamic we are seeing is you probably can say that going into 90 nanometer, but it seems to us that the time went down. People learned, and as I said just now, 45 nanometer engagement has been strong - has been stronger than the 55 nanometer.

So my thinking is, at the end of the day, economics rules.

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**Operator**

Steven Pelayo, HSBC.

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**Steven Pelayo - HSBC - Analyst**

Yeah, Rick, your lower capex next year is going to do wonders for your free cash flow, and I'm curious if this is just a -- do you think a one-time step down? I'm not going to try to pin you down on an absolute dollar number, but over the last three years, you've spent about 25% of revenues on capex. If capex is down about 20% next year, and you grow about 15%, that ratio is going to go down about 18%. Do you think that's kind of a new run rate for the next maybe three-year average on capex as a percentage of sales?

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**Rick Tsai - TSMC - President and CEO**

I think I want to answer your question very carefully. One, this is not a one-off phenomenon. Two, however, we also do not have, at least now, a set ratio based on which we will use for the coming few years. We still look at capex based on the business outlook as well as the strategic thinking.

You also need to realize the capex numbers can also -- annual capex has a good artificial end using. What we need to build, for instance, a shell for a new fab. That would definitely add significant capex, which will not turn into production for a longer period of time compare to capex for the incremental tools for now, for next year.

I cannot really promise you a set ratio, but this is definitely also not a one-off phenomenon, either.

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**Steven Pelayo - HSBC - Analyst**

Okay, then maybe if you could just comment in general about your pricing strategies here. How much of it is really making your customers understand the value proposition that you afford versus really the fact that capacity is just going to be growing at a much slower rate, and your utilization rate is going to be running much near a higher level, and so customers just need to understand it's going to be a little bit tighter. Are customers really -- are you focusing on it from the value proposition side or just the utilization rates running higher side?

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**Rick Tsai - TSMC - President and CEO**

It seems though you should raise the question with the customers. I think the reality is both. For any customer that would look at many factors just like -- for any customer, especially a large customer, a long-term customer who have worked with us, they have many factors they look at when they decide to work with TSMC long term, which includes the technology capability, long-term capacity support, assurance of supply, ability to ramp, a good reasonable die cut, (inaudible), all those things.

And, of course, price is always a function of supply and demand which, by the way, you know, TSMC is only a part of.

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**Operator**

William Dong, UBS.

Oct. 25. 2007 / 8:00PM HKT, TSM - Q3 2007 TSMC Earnings Conference Call

**William Dong - UBS - Analyst**

A quick question -- actually, I wanted to follow-up on the split between 8-inch and 12-inch. I want to just try to get an understanding how would you characterize the difference in demand growth, going forward, between 8-inch and 12-inch? And would you say -- obviously, advanced technology is always the demand driver, but how would 8-inch fit into this? Is that also in account for the portion of growth, going forward?

**Rick Tsai - TSMC - President and CEO**

I would say advanced technology certainly is the growth driver compared to mature technology. However, in the mature technology, we do have 5 million --

**Lora Ho - TSMC - VP and CFO**

Yes, 5 million capacity.

**Rick Tsai - TSMC - President and CEO**

Five million plus 8-inch capacity, which, certainly represents a very significant amount of our business. We continue to try to upgrade our business in that area, too.

**William Dong - UBS - Analyst**

Going forward, would you grow your 12- to 8-inch capacity at the same rate of 12-inch, or a little bit slower?

**Rick Tsai - TSMC - President and CEO**

I would say slower. I would say slower.

**William Dong - UBS - Analyst**

One last question -- in terms of the economy of scale in the Shanghai fab, is that fab right now running at a lower margin in overall business, or do we hope that the economy of scale over there improves so that can reach the apparent level.

**Rick Tsai - TSMC - President and CEO**

You are right. I think that right now the scale is not sufficient to render that as efficient and as profitable compared to our other 8-inch fabs in Taiwan. We are increasing -- we are further expanding the capacity there with the tools we just announced to purchase recently. I think that will certainly help that fab to be as competitive, going forward.

**Operator**

Matt Gable, Millennium Partners.

**Matt Gable - Millennium Partners - Analyst**

I just wondered if you have any color at all from customers about the general and demand trends in Q1?

**Rick Tsai - TSMC - President and CEO**

Not other than, I think maybe I am repeating myself -- nothing other than, I would say, a normal first quarter seasonal pattern.

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**Operator**

Bhavin Shah, JP Morgan.

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**Bhavin Shah - JP Morgan - Analyst**

What is embedded in the outlook for capex for next year, can you say how much is the capex for 200 mm or, put it another way, how much additional 200 mm capacity do you think you might need to add? Just a ballpark would be helpful, if at all.

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**Rick Tsai - TSMC - President and CEO**

I think there will be, at most, some incremental investment for 8-inch next year.

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**Bhavin Shah - JP Morgan - Analyst**

Can we have an indication of depreciation has started very slightly at a faster rate in 2007, but perhaps that pattern will change again in 2008. So any guidance on what percent increase in depreciation should be assumed for 2008?

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**Lora Ho - TSMC - VP and CFO**

Bhavin, since we have not finalized the 2008 impact, we'll just it will be submitted last. So I would factor the depreciation increase -- it will be less than 10%. So we compare this year versus last year, the degree of increase will be smaller.

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**Operator**

[Keril Seiskin], CAAM.

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**Keril Seiskin - CAAM - Analyst**

Just another question on capex. Actually, a clarification on the one you already answer, and the question was what particular areas of equipment you would consider priority or what areas you would consider tighten, and you mentioned [lisa] so I am not quite sure I understand whether you mentioned it is your number-one priority for new spend or whether you are saying that you have already spent enough and have capacity for another 18 months.

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**Rick Tsai - TSMC - President and CEO**

I think you probably have misunderstood. I said we were discussing on productivity improvement of certain tools. I was asked whether we have worked on the lithography tools. My answer was positive mainly because lithography tools are the most expensive ones, usually the bottleneck.

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**Keril Seiskin - CAAM - Analyst**

Okay, maybe I can ask, then, this question -- so if you were going to cut capex significantly in 2008, what areas would you consider strategically important in terms of equipment?

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**Rick Tsai - TSMC - President and CEO**

Oct. 25. 2007 / 8:00PM HKT, TSM - Q3 2007 TSMC Earnings Conference Call

Let me first say I do not know. I do not have a list of equipment that we need to purchase. But, on the other hand, it's basically -- you know, we have a certain target for the 65 nanometer, 45 nanometer capacity, and we have certain -- you know, a group of tools -- who will buy the balance of the tools. But I don't have the list myself.

**Keril Seiskin - CAAM - Analyst**

Maybe I can ask, then a completely different question. Could you possibly comment on the segment strength in Q4 and perhaps beyond that? So you were saying that in Q4 the growth will be driven by PCs. Could you maybe expand a little bit and comment on first half '08?

**Lora Ho - TSMC - VP and CFO**

Well, fourth quarter we think the computer-related application will growth the strongest and followed by a communication-related application, while consumer application will decline. Let's follow their seasonal patterns.

**Keril Seiskin - CAAM - Analyst**

What about first half '08?

**Rick Tsai - TSMC - President and CEO**

We have not separated in such fine detail, but I think we would expect -- from last year, we would expect PC unit growth to stay roughly the same as this year. Handset will continue to grow but not as strong as this year, unit-wise.

**Operator**

Mike McConnell, Pacific Crest Securities.

**Mike McConnell - Pacific Crest Securities - Analyst**

Not to beat a dead horse here, but on the significant capex revision next year, is this more driven by the productivity gains you've outlined, or is this a function or a strategy to essentially stabilize pricing, considering the comments that pricing is more supply/demand driven?

**Rick Tsai - TSMC - President and CEO**

Well, I think, Mike, just as I outlined in my opening statement, number one, together, the combination of the NT\$2.6 billion spend this year and the product taking improvement, we basically believe we should be able to invert less to get the capacity we need for next year. It's really what we've been saying.

Pricing, we must work out the value to ensure we get our value of our services. Supply/demand, as I said also, we are just part of the supply. So we cannot really -- we are not able to really talk about that.

**Mike McConnell - Pacific Crest Securities - Analyst**

It just looks like -- if you look at the backend assembling tests, they've obviously dropped their capacity additions considerably to try to stabilize their pricing and tighten up supply. Do you feel that given the pricing pressure maybe from an industry standpoint that we've seen in the foundry industry that yourself and others may start to tighten up on capacity allocations to try to firm up pricing -- drop depreciation and obviously get a higher return?

**Rick Tsai - TSMC - President and CEO**

Oct. 25. 2007 / 8:00PM HKT, TSM - Q3 2007 TSMC Earnings Conference Call

Well, Mike, I really can only comment on what TSMC plans to do, which we have done many times. There is absolutely no way that we can comment that we will know anything about our competitors.

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**Mike McConnell** - *Pacific Crest Securities - Analyst*

Fair enough, and then with respect -- I was not clear on, I think, an analyst before asked this question -- but we've seen the slower cadence to what your customers are migrating to 65 nanometers, say, than 90 nanometer for various reasons. What's your confidence, though, looking at 45 nanometer that cadence will accelerate and maybe we'll start to see the adoptions reflect more of what we've seen at 90 nanometer, and, if so, what's the difference between 45 and 65 nanometer if I'm a customer and trying to decide whether I migrate to it faster or slower?

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**Rick Tsai** - *TSMC - President and CEO*

We are feeling a stronger, I would say, a substantially stronger engagement from a higher number of customers, and if this situation continues, then I would say 45 nanometer will be a strong technology node.

Why? I think 45 nanometer, in our case, we accelerate the technology schedule, actually. For our G process, the 45 nanometer GS process, basically, is a 40 nanometer design so we offer an extra 15% maybe 20% area reduction. That's one, I would think, that's very attractive to customers. They will be available at the same time as the 45 nanometer was supposed to be availability. Ditto, I think, for the low-power part.

So I think we also have learned over the years to, for instance, to get the IP environment ecosystems ready, kind of in sync with the technology available time. The reason we've been doing to enable the customers to enhance their confidence. Let them have kind of a workout.

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**Mike McConnell** - *Pacific Crest Securities - Analyst*

I guess, though, if I look at 65 nanometer -- my last question -- you know, part of it was -- the slower migration wasn't really your fault, it's just the fact that there's a higher rate of complexity with designs, more integration so customers are taking a longer time to tapeout because it takes them a longer time to come out with their design.

So do you feel at 45 nanometer that even though you have this going on, these more complex designs coming from your customers, that you still could see maybe a migration to that node, that's going to be faster than what we saw 65 nanometer?

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**Rick Tsai** - *TSMC - President and CEO*

Mike, I'm not sure I totally agree with what you just -- at 65 nanometer. Yes, I mean, it is more difficult and a more complex design. On the other hand, I must say, I'd be impressed with some customer's ability to design and ramp also to shrink. I'm not everyone, but one thing is clear to me -- it's doable, quite doable. If you do your homework early, more completely, if you work with TSMC sooner, and you're utilizing our capability, [in sync] work.

And that's why we are seeing also more and higher intensity in the collaboration level.

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**Operator**

Elizabeth Sun: Operator, in the interest of time, we will only allow one last caller's question. Thank you. Satya Kumar, Credit Suisse.

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**Satya Kumar** - *Credit Suisse - Analyst*

I was wondering if you could provide some color on the pattern of spending for next year. I was looking at the last couple of years for TSMC, and capex seems to be concentrated in Q2 and Q3. Is that sort of a similar trend that we should expect for '08?

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**Lora Ho** - *TSMC - VP and CFO*

Oct. 25. 2007 / 8:00PM HKT, TSM - Q3 2007 TSMC Earnings Conference Call

We have not totally worked out yet. But I think for this year, it's directly backend loaded, but I believe for 2008, since we had that, you will be significantly last, I tend to think that you will be slightly front-end loaded in that case.

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**Satya Kumar** - *Credit Suisse - Analyst*

Will it be 60-40, is that a good estimate?

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**Lora Ho** - *TSMC - VP and CFO*

I don't have the number right now. We are still working on the number.

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**Satya Kumar** - *Credit Suisse - Analyst*

Would it be higher than the second half of '07, though, or are you looking at maintaining the second half of '07 then?

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**Lora Ho** - *TSMC - VP and CFO*

I don't have that resolution at this moment. Maybe we can show you more next quarter.

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**Operator**

Ms. Ho, there are no more questions at this time.

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**Lora Ho** - *TSMC - VP and CFO*

Thank you, everybody, for your participation. We are looking forward to talk to you next quarter, bye-bye.

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**Operator**

Before we conclude, TSMC's third quarter 2007 results webcast conference call today -- please be advised that the replay of this conference call will only be accessible through TSMC's website at [www.tsmc.com](http://www.tsmc.com). Thank you all. You may now disconnect.

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