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## Conference Call Transcript

**TSM - Q4 2007 TSMC Earnings Conference Call**

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Jan. 31. 2008 / 9:00PM HKT, TSM - Q4 2007 TSMC Earnings Conference Call

## CORPORATE PARTICIPANTS

**Elizabeth Sun**

*TSMC - Head of Investor Relations*

**Lora Ho**

*TSMC - VP, CFO*

**Rick Tsai**

*TSMC - President, CEO*

## CONFERENCE CALL PARTICIPANTS

**Mehdi Hosseini**

*FBR - Analyst*

**Timothy Arcuri**

*Citi - Analyst*

**Bill Liu**

*Morgan Stanley - Analyst*

**Steven Palao**

*HSBC - Analyst*

**Bhavin Shah**

*JPMorgan Chase & Co. - Analyst*

**Satish Athavale**

*KSA Capital Advisors - Analyst*

**Satya Kumar**

*Credit Suisse - Analyst*

## PRESENTATION

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### Operator

Good day, ladies and gentlemen. Welcome to TSMC's fourth 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 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 only in audio 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 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. Please proceed.

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### **Elizabeth Sun - TSMC - Head of Investor Relations**

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

Before we begin, I would like to state that management's comments made about TSMC's current expectations 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 20th, 2007, TSMC's registration statements on Form F-3, filed with the SEC on May 8, 2007, and such other documents at 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.

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, CFO**

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

First, I will go over the highlights from our fourth quarter and 2007 full year results. I will then give you the outlook of the first quarter 2008. Finally, I will go over a few items that have an impact on TSMC's 2008 financials.

Please refer to the quarterly financial summary slides on our website. All dollar figures are in NT dollars unless otherwise stated.

To begin with the highlights for the fourth quarter, we ended 2007 with a strong quarter, in which we set another record for revenue, wafer shipments, and net income. We delivered quarter over quarter and year over year improvements in all growth margin and operating margin.

And our earnings per share reached NT \$1.31 for the quarter. Free cash flow generated during the fourth quarter totaled NT \$40 billion, up 52%, Q over Q return of equity with--to 27.9% for the quarter.

In line with our guidance, demand for computer-related applications drew the strongest in the fourth quarter, followed by communications. Revenue from computer and communications increased by 15% and 5% Q over Q respectively. In the meantime, revenue from consumer applications declined by 7%, reflecting the seasonal pattern.

Overall, revenue from computer, communication and consumer applications accounted for 35%, 42%, and 15% of our wafer revenue sales in the fourth quarter 2007.

In terms of revenue by technology, we continue our strong ramp for 65-nanometer during the quarter, as revenue from 65-nanometer accounts for 10% of our wafer sales. We started out the year with 1% revenue contribution from 65-nanometer in the first quarter, and we ended the year with 10% revenue from 65-nanometer.

Our revenue dollars from 65-nanometer increased by more than 17 fold in the fourth quarter.

Total revenue from advanced technologies accounted for 59% of total wafer sales. Compared to the third quarter, it went up by three percentage points.

Now, let's take a closer look at our income statement. Revenue was NT \$94 billion in the quarter, up 25% year over year and 5.5% quarter over quarter. Gross margin was 47.8% for the quarter, up two percentage points Q over Q, mainly due to higher capacity utilizations and the cost in equipment, offset in part by a depreciated U.S. dollar.

Total operating expenses declined, both in absolute dollar terms, and as a percentage of sales, largely due to lower legal fee in fourth quarter. Operating margin was 39.2% for the quarter, up 2.8 percentage points from the previous quarter.

Income from non-operating items and long-term investments increased to NT \$2.6 billion. Net margin was 36.7%.

Moving on, balance sheet and cash flow statement. During the fourth quarter 2007, we completed our share buyback plan. We repurchased 800 million, or 3%, of our outstanding common shares, over the open market, on Taiwan Stock Exchange. We paid a total of NT \$48.5 billion, NT \$45 billion of which was paid in 2007, and the remaining was paid in early January 2008.

We also repaid NT \$4.5 billion in corporate bonds. As a result, we ended the quarter with NT \$175 billion in cash and short-term investments, essentially flat from NT \$176 billion the last quarter. Our asset productivity also improved to 1.4 times.

Now, let's turn to capex and capacity. Total installed capacity for the fourth quarter was about 2.3 million 8" equivalent wafers. Total 2007 capacity was 8.3 million wafers, (inaudible), a year over year increase of 17%.

We expect our first quarter 2008 capacity to be about 2.2 million wafers, down 4% Q over Q, largely due to scheduled annual maintenance and certain adjustments to capacity due to change in the product mix.

We spent 690--\$611 million U.S. dollars in capex during the fourth quarter. Our 2007 capex came in at US \$2.6 billion, with capex to sales ratio at 26% for the year, slightly up from 2006 level.

Now, let me go through our 2007 full year highlights. 2007 was a challenging year for us. We started off the year with weakened demand in the first quarter, due to inventory correction. However, our revenue recovered in the second quarter, with rising revenue and improving (technical difficulty, interference in audio), every single quarter. As a result, we delivered our sixth straight year of top-line growth in 2007.

We also achieved our financial target of ROE 20% or more, throughout the cycle, for the fourth straight year. However, due to lower utilization and lower ASP, our profitability declined. With our strong balance sheet and our consistent profitability, we believe that we are well positioned for our future growth, and for delivering increasing long-term return to our shareholders.

Starting from 2004, TSMC began returning cash to our shareholder through a combination of cash dividends and share buyback. We started with paying NT \$0.60 per share in cash dividend in 2004, and have since then raised the dividend level every single year, with 2007 cash dividend at NT \$3.00 a share. We also executed two share buyback plans, in 2004 and in 2007.

In 2007, we returned a record amount of cash to our shareholder, representing 126% of the free cash flow generated in the year. We have returned a total of NT \$253 billion, or US \$7.8 billion in cash, to our shareholder over the past four years.

With that, let me give you the outlook for the first quarter of '08.

Based on our current business and foreign exchange rate expectations, we expect our consolidated revenue to come in between NT \$87 billion to NT \$89 billion. In terms of margin, we expect our first quarter growth margin to be between 42% and 44%, including around 2.5 percentage point impact on the employee profit sharing expensing. In our operating profit margin to be between 32% to 34%, this number included around 4.7 percentage points impact on the employee profit sharing.

We also expect our 2008 capex to be around US \$1.8 billion.

The above is my report, but before I hand the call over to Rick, I would like to make a few comments on employee profit sharing, our capex of 2008, depreciation expense, and capital management.

Let me start first regarding the profit sharing expensing. As you all know, starting this year, Taiwan accounting rule require the expensing of employee profit sharing in companies' financial statement. We at TSMC, we accrue such expense in our quarterly financial reports.

As we have informed the market, as well as our employees back in November of 2006, that 2008 profit sharing expense will be at 15% of that year's net income. We now can inform you that based on our first quarter '08 business performance outlook, we expect this expansion to have an impact to our growth profit margin by about 2.5 percentage points, and to impact our operating profit margin by about 4.7 percentage point. Our first quarter '08 guidance has reflected both.

For the full year again, based on our forecast of our 2008 business performance today, we expect profit sharing expensing to impact our gross profit margin by 2.4 to 2.6 percentage points, and to our operating margin by 4.6 to 4.8 percentage points.

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By our next quarterly conference in April, we will provide you with the actual results from 2008 first quarter, and we will also provide you with comparable numbers for our 2007 results, such that you will be able to assess our performance on a like for like basis.

The next one is regarding capex and depreciation. Based on our current forecast of US \$1.8 billion capex this year, we expect depreciation and amortization together will only go up 1%, compared with 2007 number. As our CEO, Rick Tsai, will share with you, that this is the outlook shortly, after my remarks. We believe our wafer shipments and revenue growth this year will be at a higher rate than the increase in depreciation, which is 1%, as I just mentioned.

Therefore, depreciation for revenue and depreciation for wafer should both come down. This should improve our gross margin rate.

Other than the depreciation, we are also aware of the impact of a foreign exchange rate and impact of inflation to our margins. And we have filled our mid- and long-term financial plan, taking into consideration of those factors. In the meantime, we will monitor the impact and work hard to manage the downside, if there is any.

My third comment is regarding our capital management. Regarding how we use our free cash flow, and how we return the cash to shareholder, I want to share with you our thinking of cash dividends and share buybacks.

Our policy is to steadily increase the cash dividend per share. In the past three years, we have steadily increased the cash dividend per share. The average payout ratio was around 70%. I can tell you, in the future, we will maintain the cash dividend per share no less than the current level, and the payout ratio will not be less than 80% of the distributable earnings of each year.

Meanwhile, as part of the market-phased plan that we have jointly announced with Philips in early 2007, the remainder of Philips' holding, representing 5% of TSMC share, currently valued at US \$2.3 billion, will be either bought back by TSMC and cancelled in the next two years, or be placed with some long-term financial institutional investor.

Beyond Philips' holding of TSMC--beyond Philips' holding of TSMC shares, we may also conduct share buyback from the market on discretionally basis from time to time.

That is my remarks. Now let's turn the call to Rick, for his comments.

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**Rick Tsai - TSMC - President, CEO**

Hello, everyone. I'd like to make a few comments also, before the Q&A. First, on the outlook for this year, 2008, we believe that the semiconductor industry should grow by about mid single digit this year, compared to 2007.

If you were here listening to us a quarter ago, we were talking about mid single digit to high single digit growth for 2007. So the new number does reflect our feeling about the potential impact of the uncertain macroeconomic environment in the recent months, and going forward.

However, we still firmly believe that the growth of the foundry segment of the semiconductor industry will still outperform the semiconductor industry by at least a few points--a few percentage points. And TSMC, of course, will also grow faster than the semiconductor industry in 2008.

Then, the inventory situation. We have looked into the inventory situation, mainly within our customers' supply chain, and we have talked to our customers. What we have seen, and what we have observed--basically, I am shown that the supply chain inventory level at the customers is at a normal level--it's at a normal level.

Demand this year for our advanced technology, in particular, in 65-nanometer and 55-nanometer, remains very strong--remained very strong throughout the year.

In this environment, what are we doing? What is TSMC doing? I think, doing a lot. A couple of years, we have seen our price of our advanced technologies declining faster than that of our cost. Because of that, we have worked hard on our pricing starting this year. We expect, starting in 2008, and certainly into 2009, the price trend will be more in line with our cost trend.

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In addition, we are managing our capex and our capacity installation in such a way so that we can achieve high utilization rate, especially for the advanced technology throughout the year, while we can still meet our customers' demand. As a result, we will be able to continue improving our return on investment. The US \$1.8 billion that was just said, is basically a big part of our capex management.

We are also focusing on improving our structure profitability. What is the structure profitability? We divide our structure profitability--the profitability at a standard utilization rate. That is, profitability which is more or less independent of our utilization rate.

Now, we are working to improve our structure profitability, mainly by reducing our costs in a structured manner, by realizing our value to our customers, and by managing our prices.

Lastly, I also want to make a few remarks on the semiconductor foundry business model. While there has been--there were some talk in the press recently, I guess, questioning the viability of the foundry business model, and we figured we should respond to that.

TSMC, again, firmly believes that a win/win partnership and a seamless collaboration with our customers remains the cornerstone of the success of the foundry business model. And TSMC continues to developed advanced technology. If anything, we continue to invest aggressively for those advanced technologies development. We also continue to make long-term commitments in capacity for our partners, and our customers.

There is no question that if you look at the industry during the last year, the year before, you can see that the FAB-less industry, in particular, our partners, has grown robustly. They have outgrown the semiconductor industry consistently. And I'm happy to say, with also a very good growth margin.

Many IDMs, as you also know, have gone FAB-lite, and are relying on foundry. And more IDMs are in the process of going FAB-lite, and are relying more and more on foundry services, too.

As a result, we really believe that the foundry business model is strong, it's dynamic, and it's vibrant. It will be like that going forward for many, many more years.

That's my remarks for now, and we'd like to entertain your questions. Thank you.

## QUESTION AND ANSWER

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### Operator

At this time, we will open the floor for questions. (Operator instructions) Your first question comes from the line of Mehdi Hosseini with FBR. Please proceed.

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### Mehdi Hosseini - FBR - Analyst

Yes, thanks for taking my question. Regarding your capital intensity return as said, and so forth, and demand for 65-, 55-nanometer, does that imply that the 45-nanometer technology node may not be--may not gain much momentum in the near term, and we're seeing a dramatic change in the cost and benefit of (inaudible)?

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### Rick Tsai - TSMC - President, CEO

Hello. No, I don't think so. We--45-nanometer technology is moving along very well, for both low-power version and the generic version. Our customers--actually, we have really many customers working on the design, and the [takeouts] will occur starting second quarter, and go down.

Production--I think the production will start in the probably somewhat more volume in the fourth quarter timeframe, and certainly will, I think, will go into a much more--to a much more significant level in 2009.

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I think if you would look at the 65-nanometer ramping schedule and the 45-nanometer ramping schedule, there is really not too much difference from the time point of view.

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**Mehdi Hosseini - FBR - Analyst**

Sure. But for your customers to be able to afford to go down to 45 nanometers, and at the same time, you'll be able to improve the profit margin for this particular node, something has to give. Either you mass-produce them to reduce the costs, or your customers will be able to charge more from their customers. I just don't--I'm still not clear, the dynamics of the supply and demand for these expensive process nodes.

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**Rick Tsai - TSMC - President, CEO**

I think you can say that the--your question, if you think about it, you can ask this question when we started the ramping 65-nanometer, vis a vis 90-nanometer. A 65-nanometer--yes, more expensive from a cost point of view, compared to 90-nanometer. However, it also does provide more values in performance, in power, and in [die] cost. Really, not a whole lot difference of--if you look at 45-nanometer. I think replenishing--we put even more emphasis on working on the wafer cost right from the beginning, doing the technology development for 45-nanometer.

We have, as I said just now, we have customers, and those customers are volume users. They are not small quantity devices. These are being designed and scheduled to take off this year--later this year.

We will see a migration toward 45 nanometers. However, I'm not saying also that everyone is moving toward 45-nanometer, either.

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**Mehdi Hosseini - FBR - Analyst**

Does the marginal--marginal cost benefit change as they move from 65 to 90--I'm sorry, from 65 to 45, compared to 90 to 65? The marginal cost benefit?

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**Rick Tsai - TSMC - President, CEO**

All right, you understand the marginal cost benefit?

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**Mehdi Hosseini - FBR - Analyst**

I do agree with you, yes. You migrate to smaller node, you're still going to have benefit in terms of performance and so forth.

But would the margin of gain from 65 to 45 be comparable to marginal gain from 90 to 65?

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**Rick Tsai - TSMC - President, CEO**

I think, yes. If you--again, if you put it straightforwardly, if you look at the leading products that drove the 65-nanometer migration during the last couple of years, and if you apply those products in 45-nanometer, the benefit does justify the migration.

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**Mehdi Hosseini - FBR - Analyst**

Got you. Thank you very much.

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**Rick Tsai - TSMC - President, CEO**

Thank you.

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**Operator**

Your next question comes from the line of Timothy Arcuri with Citi. Please proceed.

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**Timothy Arcuri - Citi - Analyst**

Hi. A couple things. First of all, if I look at your capex, you spent--kind of, give or take, roughly US \$2.5 billion the last four years, so your capex has been pretty flat since '04. And you've added--capacity adds in those years have been, kind of, plus or minus 20%. It's been within a pretty tight band around 20%.

So I'm trying to figure out what the blend in '07 was that added capacity, and what the technology spending--so what the upgrade spending was in '07. I'm basically trying to figure out what your maintenance capex would be if you didn't add any wafer capacity.

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**Lora Ho - TSMC - VP, CFO**

I think typically, in '07, while we had to spend money basically on two things, the 90-nanometer on 12", and also the 65-nanometer on 12". Now, we have two 12". If we don't spend anything, the sustaining capital spending, R&D and other type of--sustaining type in nature, will be roughly three--14% of total spending. That translate into maybe \$300 million, \$400 million US dollar per year.

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**Timothy Arcuri - Citi - Analyst**

Okay, so that is the number--

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**Lora Ho - TSMC - VP, CFO**

The number doesn't change much--sorry. This number doesn't change much year over year, disregard of how much capex we spend on a yearly basis.

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**Timothy Arcuri - Citi - Analyst**

I see. Okay. So that's the number that, if you wanted to, in any given year, if you did not want to add any capacity--which is not to say you would do that, but if you did want to do that, you would only have to spend something less than \$500 million?

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**Lora Ho - TSMC - VP, CFO**

That's--basically, it is, yes.

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**Timothy Arcuri - Citi - Analyst**

Okay. And then, I guess, the other question is, all the big foundry customers, all the big FAB-less customers--Qualcomm, Broadcom, and Video--they're all talking about migrating designs pretty aggressively down to 65-nanometer this year. And I think they've done that, in recent quarters.

So it seems like demand at the leading edge this year is going to be up pretty significantly, and you did comment that pricing has come down quite a bit at the leading edge as well. It kind of seems like things have clicked a little bit recently at the leading edge, to allow these customers to actually migrate designs down there.

And yet, you're cutting capex pretty significantly, or you're signaling that you're going to cut it pretty significantly in '08. So it seems like maybe you can spend that little in '08. But it seems like there is somewhat of a change versus the last couple years at the leading edge, and that that could start to put upward pressure on your spending levels, since you don't have that much leading edge capacity.

Is that an accurate assessment?

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**Lora Ho - TSMC - VP, CFO**

If I may give you some color on this one point, [ABM]. Firstly, it's one point -- ABM is (inaudible) is 30% cap on last year. You give us year over year capacity increase of 13%. Majority of that number goes to 12", so the 12" itself, year over year capacity increase will be 24%, which is quite significant.

Now, 8", it will be 7%. And also, we have productivity improvement, which would drive the fact to contribute every year--that means, if we don't spend any money, capacity would go up by X percentage.

So the two things add together, will give us quite a significant capacity increase in 2008, even if capex is only US \$1.8 billion.

Another thing is, the US \$1.8 billion, actually, was pretty much front-end loaded. I mean, we put more capacity in the first half of the year. Straight up by first half--second half is--roughly 70% first half year, and 30% is second half year.

So that's how we feel that the US \$1.8 billion even--it's not as high as last year, and we are asking ourself to round very high utilization. With continued productivity improvements, it still represent a pretty significant capacity increase for the whole year.

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**Timothy Arcuri - Citi - Analyst**

Okay, I see. I guess I'm just trying to true up what you saying with--you know, some of the equipment suppliers are saying that you're getting more aggressive on actually ordering more leading edge equipment recently. So I'm trying to true up the fact that you're saying that capex is going to come down so much, with the fact that it seems like you're actually getting a little more aggressive at the leading edge.

So, thanks.

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**Lora Ho - TSMC - VP, CFO**

Yes.

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**Operator**

Your next question comes from the line of Bill [Liu] with Morgan Stanley. Please proceed.

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**Bill Liu - Morgan Stanley - Analyst**

Yeah, hi--good evening, Rick and Lora. I have two questions as well. I guess I'll start with the simple one.

Could you--I don't think I heard it on the call. Could you provide some comment on the ASP trends in the near term?

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**Lora Ho - TSMC - VP, CFO**

What trends?

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**Bill Liu - Morgan Stanley - Analyst**

ASP pricing trends.

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**Lora Ho - TSMC - VP, CFO**

Pricing trends.

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**Rick Tsai - TSMC - President, CEO**

Oh. Well, that's at the earlier on--if you look at 2008 pricing, a significant of the 2008 pricing was discussed and negotiated with the customer back in mid last year--third quarter timeframe. So we did have--we do have some price decline, because of that.

After that, well, we have worked to [erect] the decline of the pricing, so that the price decline would be more moderate. So for 2008, you would be combination. I think that 2008 certainly will represent a better decline rate compared to that of the 2008--ah, 2007, and 2006. Into 2009, we definitely believe that our price trend will be much more in line with our cost trend.

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**Bill Liu - Morgan Stanley - Analyst**

Okay, great. Rick, the second question is for you as well. I've heard you talk about improving the structural profitability now for a few months, and part of that is getting paid for the value as provided by TSMC. Now, that makes a lot of sense to me. But I've got to think that within your overall offerings, there are some things that offer more value, and some other things which offer maybe a little less value, for instance, at the trailing edge.

By having this plan in place, does that also necessarily change your strategy going forward as far as what business to take, what business not to take?

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**Rick Tsai - TSMC - President, CEO**

Excuse me, Bill. What is your question? I mean, I heard your advanced technology and trailing technology idea.

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**Bill Liu - Morgan Stanley - Analyst**

Yes, my question is that you want to get paid for the value provided. I've got to think that this value differs for the different offerings that TSMC has. So is there going to be a change in strategy, where part of the business is now going to be emphasized going forward? Are you going to focus more on certain business that you didn't have before, for instance?

I'm just wondering what this implies for your overall strategy going forward.

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**Rick Tsai - TSMC - President, CEO**

I think what we just talked about, probably in general, of course, to all our offerings, in terms of technology or otherwise--I also understand what you're saying about the differences in advanced and the more mature technologies. However, you also understand that the investment level for them is quite different. One needs a very large capital investment every year--the other one takes a relatively small. Also, with a much different cost structure.

So even then, I think we look at mature technology, it's not just a geometry difference. What we have been doing in mature technology area, really, is to develop differentiating modules, or you can say, derivative technologies, so that we can offer them to--for more--almost a more application specific technology.

We certainly--I think we certainly can get a reasonable pricing that--again, that is in line with our cost structure. And then still, also maintain a very strong relationship with our customers.

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**Bill Liu - Morgan Stanley - Analyst**

Okay, great. Thank you very much.

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**Rick Tsai - TSMC - President, CEO**

Sure.

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**Operator**

Your next question comes from the line of Steven Palao, with HSBC. Please proceed.

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**Steven Palao - HSBC - Analyst**

Yes, Rick. It's been about 90 days since you first talked about your significant cut to 2008 capex, and I'm kind of curious about customer reactions. I mean, after all, TSMC has been very successful here--in fact, just on the December quarter and the March quarter, you're really outperforming your peers, you're gaining a lot of market share.

Now, I combine that with your comments and your desire to hold firm on pricing, and your 30% capex cut--what's customer reaction been like? Does this force them to engage with your competition a little bit more, for fear of just how successful you're being, and how more successful you'd like to be in the future?

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**Rick Tsai - TSMC - President, CEO**

Well, I really--I don't think I can comment on my customers. But basically, also, as I said in the comments on the business model, at the end of the day, a win/win partnership and a seamless collaboration really remains the cornerstone. And I--we're not talking about this as the propaganda. It's not a marketing word. We live on that--we execute those things.

Again, the--looking at our customers, and the--I think they--I mean, most of them have done well. We will certainly just continue working with them on, provide--so that they get their value. They get the value out of our technology, our design services.

I think we will also continue investing in capacity, (technical difficulty, interference in audio), I think with the very competitive environment. We do need to manage our capex, so that we can maintain a higher utilization rate for a long period of time, so that we can get a reasonable return.

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**Steven Palao - HSBC - Analyst**

Okay. I just wanted to check that if the customers' tone had changed at all, if there were any things in light of your guys' just incredible success, yet plans to cut capex back.

My other question is really just related to--your 65-nanometer outlet this year, you had about 10% of revenue. I think you said you wanted to double it, about 20% of revenue by the end of this year.

What were your expectations 90 days ago? At one point, I was actually modeling, I think, even a greater contribution from 65-nanometer by the end of this year. Has your expectations actually increased what that concentration would be by the end of the year, or staying relatively stagnant the last 100 days?

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**Rick Tsai - TSMC - President, CEO**

I think improved--yes, improved somewhat, during the last quarter or so.

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**Steven Palao - HSBC - Analyst**

Okay.

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**Rick Tsai - TSMC - President, CEO**

I think they are--the demand for 65-nanometer has increased.

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**Steven Palao - HSBC - Analyst**

Okay, fair enough. Maybe my model is a little aggressive. Thank you.

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**Rick Tsai - TSMC - President, CEO**

Thank you.

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**Operator**

Your next question comes from the line of Bhavin Shah, with JPMorgan. Please proceed.

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

Yes, hi, Rick and Lora. First of all, I just wanted to congratulate TSMC for a--such a strong performance in spite of turbulence (technical difficulty, interference in audio) the world.

I wanted to ask a few questions. First, when you--in your opinion, when you look at your order book, you feel that customers are ordering with an intention of maintaining their inventory levels, existing first quarter? Or do you think that they are, sort of becoming even more cautious, and might even be trying to reduce their inventories at the end of first quarter? I mean, sort of a tough question for you to answer, but maybe you have a perspective.

Then I have some other questions.

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**Rick Tsai - TSMC - President, CEO**

All right, Bhavin--thank you. It is a difficult question, because we--I can give you my general signals, getting from the customers, the major customers.

Most of them are seeing business going forward to be normal. I really haven't seen many, if at all, who are having significant demand softening. I'm not saying it's not going to happen, it's just--that's what I have heard. However, of course, everyone is exercising caution.

I believe what you are asking is probably true for our customer mix. You know, we have so many customers, and some are--I think a few are ordering fairly aggressively, especially for their products which are setting well in the market. Everyone is looking at inventory carefully, but I really do not know whether they are reducing inventory, appropriately or not.

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

Thanks.

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**Operator**

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

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**Rick Tsai - TSMC - President, CEO**

Jan. 31. 2008 / 9:00PM HKT, TSM - Q4 2007 TSMC Earnings Conference Call

(inaudible), Bhavin? What about you, Bhavin? You had more questions?

**Operator**

My apologies. I am showing a question that just came into queue from the line of Satish Athavale with KSA Capital. Please proceed.

**Satish Athavale - KSA Capital Advisors - Analyst**

Hello, Lora and Rick. How are you?

**Rick Tsai - TSMC - President, CEO**

Hi.

**Satish Athavale - KSA Capital Advisors - Analyst**

Lora, can you give us the ending share count after all the share buybacks, at the end of the year?

**Lora Ho - TSMC - VP, CFO**

The 25.6 (technical difficulty, interference in audio).

**Satish Athavale - KSA Capital Advisors - Analyst**

Is that the ending share count?

**Lora Ho - TSMC - VP, CFO**

Sorry?

**Satish Athavale - KSA Capital Advisors - Analyst**

Is that the ending share count diluted, or is it the basic share count?

**Lora Ho - TSMC - VP, CFO**

The share as of December 31st--the number of outstanding shares.

**Satish Athavale - KSA Capital Advisors - Analyst**

Okay, great. And then, as I'm looking at next year, 2008, for you guys, I believe free cash flow is going to exceed probably net income, and that's a change compared to last several years. So have you given any thought as to stepping up the share buyback program, especially given the amount of cash you have on the balance sheet?

**Lora Ho - TSMC - VP, CFO**

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As I said in my comments earlier, other than the cash dividend, which will stay at at least the same level for this year, there's four phase of this program that will be carried out in the coming two years. Philips is still holding 5% of TSMC share now, and that's translating to US \$2.3 billion.

On the phase four program, we will either buy back from that US \$2.3 billion in the coming two years, or should they find the long-term financial investor, they can also sell to them. So with that in mind, then, we still anticipate there will be a (inaudible) way to do the buyback, at least for the (inaudible) or Philips in 2008.

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**Satish Athavale - KSA Capital Advisors - Analyst**

Okay, great. Thank you.

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**Operator**

Your next question is a follow-up from the line of Bhavin Shah with JPMorgan. Please proceed.

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

Oh, thank you. I was, I think, taken off. The other question I wanted to ask was, you have--you are doing much better than competitors in first quarter. Do you think it is a result of strength you're seeing from your customers, or you think that it--gain in share from the customers that you share with the competitor?

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**Rick Tsai - TSMC - President, CEO**

I think it's--Bhavin, it's more, I think, our customers. But strangely, in the first quarter--well, I don't know if I want to call that strange, because after all, we do have a decline. It's a question of decline, I wouldn't call it strange. But I--let me put it this way.

The business in first quarter is coming somewhat unevenly from customers' point of view. Some customers still coming very strong, and some customers are not doing as well.

But the--I--I mean, if you look at the differences, we--I would not put the differences in the category of that--our gaining that much share from our competitors.

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

And what is the trajectory of the quarter so far, January versus March?

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**Lora Ho - TSMC - VP, CFO**

It's probably too early to tell. You'll know.

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**Rick Tsai - TSMC - President, CEO**

Well, it's--I think we have a--we probably have a stronger--I think the quarter was a lot stronger, for first quarter.

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

Okay.

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**Operator**

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Your next question comes from the line of Satya Kumar with Credit Suisse. Please proceed.

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**Satya Kumar - Credit Suisse - Analyst**

Yes, hi--thanks. Is there an improvement on pricing that you're getting for equipment from your suppliers, which is also giving you, perhaps, more of a capacity increase for the given amount of capex?

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**Rick Tsai - TSMC - President, CEO**

Oh, you're asking the equipment pricing?

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**Satya Kumar - Credit Suisse - Analyst**

Yes.

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**Rick Tsai - TSMC - President, CEO**

I--well, let me put it this way. We work with our suppliers, both from pricing and productivity point of view. We have aggressive targets for productivity, and I think in most cases, we have cooperated with our suppliers quite well, and the--they usually achieve most of the targets, or at least close to them.

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**Satya Kumar - Credit Suisse - Analyst**

If I look at your end of the year utilization rate, or just looking at your shipment of wafer pieces and your wafer capacity at the end of last year, that level is significantly higher than you ended calendar '06.

I know you're adding capacity more in the first half of the year, but even if you get, sort of a 10% wafer shipment growth for you this year, you'll probably end up at a substantially higher utilization rate all of this year.

If '08 is a weaker year just because of your macro view, and you get some sort of a rebound in overall market next year, would you not have to increase your capital spending rather substantially in calendar '09?

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**Rick Tsai - TSMC - President, CEO**

Well, I certainly hope what you say will be true going forward. But right now, it's still not clear, so we really don't have a number for '09 for now.

But the--as I said earlier, we definitely will invest. The number--and also, as Lora said earlier, but we also expect to see the capex ratio to be lower in the next five years, compared to that of the past five years. The ratio.

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**Satya Kumar - Credit Suisse - Analyst**

Okay, thank you.

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**Rick Tsai - TSMC - President, CEO**

Sure.

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**Operator**

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There are no further questions in queue at this time.

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**Lora Ho - TSMC - VP, CFO**

Well, operator, if this is the case, let's conclude the conference call. Thank you, everybody, for your participation. Looking forward to see you next quarter. Thank you so much. Bye, bye.

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**Elizabeth Sun - TSMC - Head of Investor Relations**

Good night.

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**Operator**

Ladies and gentlemen, before we conclude TSMC's fourth quarter 2007 results webcast conference call today, please be advised that the replay of the conference call will only be accessible through TSMC's website at [www.tsmc.com](http://www.tsmc.com).

Thank you all, and have a great day.

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