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PRESENTATION

Jeff Su - *Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations*

(spoken in foreign language) Good afternoon, everyone, and welcome to TSMC's third quarter 2026 earnings conference call. This is Jeff Su, TSMC Director of Investor Relations and your host for today. TSMC is hosting our earnings conference call via live audio webcast through the company's website at www.tsmc.com, where you can also download the earnings release materials. (Operator Instructions)

The format for today's event will be as follows. First, TSMC's Senior Vice President and CFO, Mr. Wendell Huang, will summarize our operations in the third quarter 2026, followed by our guidance for the fourth quarter 2026. Then Ms. [Fam] and TSMC's Chairman and CEO, Dr. C.C. Wei will jointly provide the company's key messages. That will be followed -- then we will open the line for the Q&A session.

As usual, I'd like to -- I would like to remind everybody that today's discussions contain forward-looking statements that are subject to significant risks and uncertainties, which could cause the actual results to differ materially from those contained in the forward-looking statements. Please refer to the safe harbor notice that appears in our press release.

And now I would like to turn the call over to TSMC's CFO, Mr. Wendell Huang, for the summary of operations and the current quarter guidance.

Wendell Huang - *Taiwan Semiconductor Manufacturing Company Limited - Senior Vice President and Chief Financial Officer / Spokesperson*

Thank you, Jeff. Good afternoon, everyone. Thank you for joining us today. My presentation will start with financial highlights for the third quarter of 2026. After that, I will provide the guidance for the fourth quarter of 2026.

Third quarter revenue increased 17.6% sequentially in NT, supported by strong demand for our leading-edge process technologies. In US dollar term, revenue increased 16.2% sequentially to \$46.7 billion, above the high end of our third quarter guidance.

Gross margin decreased by 1.3 percentage points sequentially to 66.4%, primarily due to margin dilution from 2-nanometer ramp. Total operating expenses accounted for 7.8% of net revenue. Operating margin was 58.7%. Overall, our third quarter EPS reached TWD29.43, and ROE was 45.5%.

Now let's move on to revenue by technology. 2-nanometer process technology contributed 8% of wafer revenue in the third quarter, while 3-nanometer, 5-nanometer and 7-nanometer accounted for 33%, 28% and 10%, respectively. Advanced technologies, defined as 7-nanometer and below, accounted for 79% of wafer revenue.

Moving on to revenue contribution by platform. HPC increased 22% quarter-over-quarter to account for 68% of our third quarter revenue. Smartphone increased 10% to account for 21%. IoT increased 5% to account for 4%. Automotive increased 23% to account for 4%. While DCE declined 12% to account for 1%.

Moving on to the balance sheet. We ended the third quarter with cash and marketable securities of TWD4 trillion or USD126 billion. On the liability side, current liabilities increased by TWD110 billion quarter-over-quarter, mainly due to the increase of TWD46 billion in current portions of bond payable and bank loans, and TWD26 billion in dividend payable.

In terms of financial ratios, accounts receivable turnover days decreased by 1 day to 28 days. Inventory days decreased by 5 days to 82 days, primarily due to the increase in wafer shipment. Regarding cash flow and CapEx, during the third quarter, we generated about TWD920 billion in cash from operations, spent TWD443 billion in CapEx, and distributed TWD156 billion for fourth quarter 2025 cash dividends.

Overall, our cash balance increased TWD488 billion to TWD3.6 trillion at the end of the quarter. In US dollar terms, our third quarter capital expenditures totaled USD13.8 billion.

I have finished my financial summary. Now let's turn to our current quarter guidance. Based on the current business outlook, we expect our fourth quarter revenue to be between USD52.3 billion and USD54.3 billion, which represents a 14% sequential increase or a 58% year-over-year increase at the midpoint.

Based on the exchange rate assumption of USD1 to TWD31.8, gross margin is expected to be between 65% and 67%, operating margin between 56.5% and 58.5%. This concludes my financial presentation.

Now let me turn to our key messages. I will start by talking about our third quarter '26 and fourth quarter of '26 profitability. Compared to the second quarter, our third quarter gross margin decreased by 130 basis points sequentially to 66.4%, primarily due to the margin dilution from the initial ramp-up of our 2-nanometer technology.

We have just guided our fourth quarter gross margin to decrease by 40 basis points to 66% at the midpoint, primarily due to the continued margin dilution from the steep ramp-up of our 2-nanometer technology, as well as dilution from overseas fabs. These impacts are expected to be partially offset by cost improvement efforts, including productivity gains and across-node capacity optimization.

While the cost of overseas fabs remain higher, thanks to the company's overall larger scale and cost improvement efforts, we now expect the gross margin dilution from the ramp-up of our overseas fabs to be closer to 2% for the full year 2026.

As we put more effort to support the strong structural demand from our customers, more fabs will be ramping up in the US. Thus, we expect the dilution from our overseas fabs to widen to 3% to 4% in the next few years. We will leverage our increasing size in Arizona and work on our operations to improve the cost structure. We will also continue to work closely with our customers and suppliers to manage the impact.

Overall, with our fundamental competitive advantages of manufacturing technology leadership and large-scale production base, we are confident that TSMC continues to be the most cost-efficient manufacturer in every region that we operate.

Next, let me make some comments on our 2026 capital budget. At TSMC, a higher level of capital expenditures is always correlated with higher growth opportunities in the following years. Given the continued robust multiyear demand from our customers, including the emerging agentic AI market, we reiterate our full year 2026 capital budget to be between USD60 billion and USD64 billion.

We continue to expect our CapEx dollars investment from 2026 to 2028 and to be even more significantly higher than the past three years, as we continue to invest heavily to support our customers' growth.

Additionally, while the tool supply is tight, we always collaborate closely with our tool suppliers well in advance to prepare the capacity, just like our customers collaborate with us well in advance to plan our capacity. Even as we invest for the future growth with this level of CapEx spending in the next few years, we remain committed to delivering profitable growth to our shareholders. We also remain committed to a sustainable and steadily increasing cash dividend per share on both an annual and quarterly basis.

Now let me turn the microphone over to C. C.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Thank you, Wendell. Good afternoon, everyone. First, let me start with our near-term demand outlook. We concluded our third quarter with a revenue of USD46.7 billion higher than our guidance in US dollar terms, driven by strong demand for our leading-edge process technologies.

Moving into fourth quarter 2026, we expect our business to be supported by continued strong demand for our leading-edge process technologies, including the steep ramp-up of our 2-nanometer technology.

Looking ahead, we continue to observe consumer and price-sensitive end market segments are being challenged due to the impact of rising component prices and more economic uncertainties. As such, we are being prudent in our business planning going into 2027, while focusing on the fundamentals of our business to further strengthen our competitive position.

Having said that, demand for our leading-edge technologies continues to be extremely robust, supported by our strong technology differentiation and broader customer base. Therefore, we now expect our full year 2026 revenue growth to be around 44% year-over-year in US dollar terms.

Next, let me talk about the AI-related demand outlook. The AI market continues to be very strong. Recent developments are very positive to AI's long-term demand outlook. We observe increasing AI demand, fueled by the rising adoption of Agentic AI as we transition from chatbots to AI assistants. In addition, we are observing greater adoption of open-source AI models. This will drive greater efficiencies and help lower the barriers to future AI usage, and result in more and more demand for leading-edge silicon.

Thus, AI-related demand is being supported by strong underlying demand for AI accelerators. In addition, the emergence of agentic AI CPUs and continued demand for networking chips are driving further silicon demand. Therefore, semiconductor will remain essential in the AI megatrend.

The value of semiconductors in the global supply chain is set to continue to increase in our view. This will create more value opportunities for our customers to capture, and more value opportunities for TSMC as well.

No matter which approach is taken, it will require use of the most advanced semiconductor process technologies. With our technology leadership, manufacturing excellence, global capacity expansion, and customer trust, we are well positioned to capture the multiyear structural AI-related demand. Therefore, all the AI players are working with TSMC.

Next, let me talk about TSMC's capacity expansion strategies. As of foundry, our first responsibility is to provide our customer with the best technologies and effective capacity support to unleash their innovations. To address the structured increase in the long-term semiconductor market demand profile, TSMC collaborate closely with our customers and our customers are customers to plan for our capacity.

In addition, we are now going one step further and sending our own teams of people to check on the data center build-out progress and power supply situation in the U.S. The feedback is so far so good, and the CSPs have been well prepared. Internally, TSMC employs a disciplined capacity planning system to assess the market demand, from both a top-down and bottom-up approach. This is a continuous and ongoing process.

Given the fundamental complexity of leading-edge technologies and the design-in and lead time involved, we already have a very good idea of customers of multiyear product roadmap and production plans. Thus, we continue to hold strong conviction in the AI megatrend.

We are moving full speed ahead to increase our capacity to meet our assessed demand and stepping up our CapEx investment to support our customers' future growth. TSMC is expanding at an unprecedented pace with nearly 20 fabs worldwide in progress. We are building 13 leading edge and advanced packaging fabs in Taiwan over the next several years, and another five to six fabs overseas.

Our new node, N2, has already entered a high-volume manufacturing in the fourth quarter of 2025, with good yield. N2 is ramping successfully in multiple phases at both Hsinchu and Kaohsiung sites. We expect our N2 family technology's annual capacity to more than double in 2027, supported by strong demand from both smartphone and HPC/AI applications.

We are also leveraging our manufacturing excellence to generate more N2 wafer output, further increasing our capacity support to customers. In addition, we have already begun preparing the capacity for our A14 technology. Risk production is well on track for 2027, and volume production will start in 2028. Thus, TSMC's semiconductor technologies and manufacturing will continue to play a pivotal role in supporting the global semiconductor industry, while unleashing our customers' innovations.

Now let me talk about TSMC's global N3 capacity expansion update. As we said before, historically, we do not add additional capacity to a node once it reaches its targeted capacity. However, based on our assessment, we are executing well on our global capacity plan to add 3 new fabs to support the robust multiyear pipeline or demand for 3-nanometer technologies.

In Taiwan, volume production for our new 3-nanometer fab in Tainan Science Park is well on track to begin the first half of 2027. In addition, driven by the strong demand from our customers, we have decided to add on additional 3-nanometer fab in Tainan, volume production is scheduled for the first half of 2028.

In Arizona, we have completed the construction of our second fab and are in the process of tool move-in and installation. Volume production will begin in third quarter '27, slightly ahead of our previous schedule.

In Japan, we are progressing well to our plan to utilize 3-nanometer in our second fab and volume production is scheduled in 2028. In addition to all the new fabs, we continue to convert 5-nanometer tools to support 3-nanometer capacity in Tainan. We are also leveraging our manufacturing excellence to greater productivity across our fab in all locations to generate more wafer output.

We are also focusing on capacity optimization across nodes, which includes flexible capacity support among N7, N5 and N3 nodes. Thus, we are using multiple levers to do everything we can, wherever we can, as fast as we can to maximize the support to our customers.

We have no intention to leave food on the table for others, and we want to capture every piece of business possible. This concludes our key message, and thank you for your attention.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Thank you, C.C. This concludes our prepared statements. (Event Instructions)

Now let's begin the Q&A session. Operator, can we proceed with the first caller on the line, please?

QUESTIONS AND ANSWERS

Operator

Yes. First one, Laura Chen, Citi.

Laura Chen - Citigroup - Analyst

I appreciate C.C. for sharing with us the TSMC capacity expansion strategy. So may I follow up more on that? Given the increasing aggressive AI semiconductor demand, how does TSMC now see the AI revenue CAGR growth? And how does TSMC reconcile customers' capacity requirement with some of the potential concern on the data center power availability, and also maybe funding recently, and other critical components such as HBM, ABF advanced packaging. And also in the networking side, we see the tightness of laser as well. So if this constraint creates a mismatch between semiconductor supply and also actual AI development, how would TSMC adjust your capacity allocation and also the strategy to minimize the potential overbuilding in the supply chain. Thank you. That's my first question.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. Laura has a very involved first question. I think she's asking how do we see the AI demand outlook? The AI demand, as C.C. said, seems to be very strong, but she's worried or concerned. How do we reconcile the strong demand of chips, AI chips versus risks related to whether it be power supply. I think also like different bottlenecks within the supply chain et cetera, how do we make our assessment of what is the appropriate CapEx and capacity we need to prepare. Is that correct, Laura? .

Laura Chen - Citigroup - Analyst

Yes. Thank you.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

That's a long, long question. Laura, let me share with you. We have a very sophisticated capacity planning process. And we also have a very disciplined on our consideration. And let me share with you, we put every possibility we can, talking about the CSPs, CapEx, data centers' build-out, financial, power supply, and also other components' supply, et cetera, into our consideration.

And so we make our own judgment -- and then based on our assessed demand, we still think the demand is higher than the supply, and we are working very hard to narrow the gap. Did I answer your question, Laura?

Laura Chen - Citigroup - Analyst

Sure. Thank you. Thank you very much. So far from our -- like the comprehensive starting the supply chain, we are still quite positive on the demand in the longer term, right? So in that case, can you also give us like more color about that but any update on your AI CAGR growth? I recall previously, we're talking about like high 50%?

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

We -- sorry, sorry.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Yes. So part of Laura's question is then based on our assessment, we had previously guided our AI CAGR -- AI accelerator CAGR, which is a narrow definition to grow mid- to high 50s percentage from 2024 to 2029. So Laura wants to know, do we have any update to that number today.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Laura, all I can say right now is the demand is very extremely robust, okay? And we did not see any sign of slowdown whether it's high 50% CAGR, it doesn't matter, it probably will be higher.

Laura Chen - Citigroup - Analyst

Sure. Okay. Thank you. Yes. And my second question is also about the -- given the very strong demand in the CapEx cycle, we see that definitely this round will be much higher than before.

And TSMC also announced that earlier you will adopt High NA EUV around 2030. So should we think about that, that will be further improve the productivities thus will be more meaningful for further like accelerating revenue growth in the longer term. And also given that the CapEx intensity are also getting much higher how should we think about that the pricing power and also the long-term gross margin, the capital efficiency return.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. That's actually two questions, but okay, just very quickly. So Laura, part of it is on -- with the strong demand on our CapEx cycle, how do we view the adoption of High NA, which we said we will in 2030? And then her question is on profitability, long-term outlook.

Laura Chen - Citigroup - Analyst

Yes. Thank you.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Okay. Let me answer that question. Yes. For the long-term productivity, we continue to improve it, and High NA definitely is a very good tool. And so far, I think our plan is to use it in 2030. Again, our CapEx will be much higher than today. And so you're talking about the gross margin, or the profitability can be increased or not?

Let me say that there is no ceiling for TSMC's profitability, but a dramatic increase will not happen overnight either. So our philosophy or our strategy is always working with our customer, and we want to make them be successful, and then we can gain our value.

Laura Chen - Citigroup - Analyst

Appreciate and congratulate the great result.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Thank you. Operator, can we move on to the next participant, please?

Operator

Next one, Gokul Hariharan, JP Morgan.

Gokul Hariharan - *JPMorgan Securities - Analyst*

My first question, again, on capacity addition. It looks like the shortage situation next year could be even more than 2026. Just wanted to hear C.C. your view on this.

And I think it's been quite some time since we have seen TSMC add capacity at more than 10% every year. If you look at our annual report, it would be like about 10 years that you have added capacity of more than 10%.

Given this accelerated build-out, can we start getting wafer capacity growth closer to 10% or even higher than 10% in the next couple of years. Any comment on like what is your planned wafer capacity growth in the next couple of years? That's my first question.

Jeff Su - *Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations*

Okay. So Gokul's first question is regarding the capacity addition and the demand. So his question first is the tightness in the wafer supply, do we think that will be even more or greater in 2027 than 2026? And then along with that, how do we see our overall capacity addition. Although you say 10%, I think every year, we disclose in the annual report, it's been about mid- to high single digit and sometimes even lower.

But anyways, regardless, those are the two questions. So first on just the demand outlook and then the supply, will next year be even more tight than this year?

C.C. Wei - *Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer*

I just mentioned, the demand is extremely robust and getting higher and higher. Of course, we have our own judgment, and we look at every angle. As I said, we talk to customer, customers' customer, and then we do our own one more step to check the data centers' build-out.

All the result we put into our judgment and our assessment, the result is the demand is very, very high. And so the gap between demand and supply are still quite big, and that's why we put all our strengths to increase the capacity, as I just mentioned. Whether it's bigger or is the gap become bigger or the gap become narrow, we are working very hard. I cannot answer this question right now because of my customer continue to increase their demand.

Wendell Huang - *Taiwan Semiconductor Manufacturing Company Limited - Senior Vice President and Chief Financial Officer / Spokesperson*

Okay. Gokul, I think it's a bit too early to talk about capacity increase percentage going forward. But let me just remind you that the increase every year, although the number is -- even though the number may be small, but the increase in advanced packaging -- sorry, advanced nodes are really the main driver for the capacity increase, okay?

Gokul Hariharan - *JPMorgan Securities - Analyst*

Fair enough. Okay. Secondly, could you -- you alluded to more aggressive overseas expansion plan in the U.S. especially. And I think recently, there's been a lot of discussion with potentially a new fab cluster in Texas as well as I think one of your customers also talked about discussions with TSMC as well.

So C.C., could you talk a little bit about your overseas plan, like the more accelerated kind of capacity build out -- and also any engagement with SpaceX or Tesla given your customer did call you out last week in terms of some engagements you have, like what are the broad contours of this engagement likely to be? Is it similar to what you've done with some of the customers in Japan and ESMC as well?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. Thank you, Gokul. So Gokul's second question, he notes that C.C. said, we're expanding at unprecedented pace, doing everything we can, as fast as we can to increase the capacity.

So this question is particularly to the U.S. what is the status or update. There's been reports that we are looking to expand in Texas. There's been reports that one of our customers, we are engaging in discussions. He wants to know what kind of framework or parameters of any cooperative maybe? Or any comment on either of those two things?

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Okay. Gokul, we work very hard to expand our capacity in U.S. This is necessary because of all our customers, most of large customers in U.S. and they request that TSMC to increase the capacity. And also US government are very helpful. So that's a place we want to expand.

So recently, we did expand our capacity's consideration to see outside Arizona where we can get another chance to expand our capacity. That Texas is one. So we send the teams to Texas to do all the evaluation. And we also talk to one of our customers who try to build a fab, Terafab, let me be more specific. And we discussed with them to see whether that we can be utilizing that actual capacity also.

So we're still in discussion. If we have any solid conclusion, we will share with you. But today, and that's it. Yes, from Arizona to Texas, yes.

Gokul Hariharan - JPMorgan Securities - Analyst

Okay. But all of these are going to be TSMC-run fabs, right? I think you're not becoming part of the Terafab project or anything like that. Can you just help us understand what are the principles that you are using here? Is it a similar principle that you use for JASM or ESMC?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. So Gokul's question is not in particular to the potential cooperation with this customer. Would it be TSMC's owned? What's the principles that we have if anything?

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

We are still in discussion. Let me say that. It's not either way, it would be possible, but the fab got to be run by TSMC.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Operator, can we move on to the next participant, please?

Operator

Yes, next one, Krish Sankar, TD Cowen.

Krish Sankar - TD Cowen - Analyst

I have two of them. The first one, C.C., some customers talk about a secondary wafer market where one customer passes their wafer allocation to another? Is this like a very small portion of the business? Is it customer specific? Or do you see that an emerging trend where customers whose demand is weak, pass some of their allocation to stronger customers?

And then I had a quick follow-up.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

All right, Krish, thank you. So Krish's first question is asking some of our customers are talking about a resell or a secondary wafer market where they can pass their allocation on. So -- is this a very small portion of our business? Or is this more of a trend for us to do? And is this something that we allow our customers to do.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Well, let me answer that. To say whether this is a new strategy, new methodology, the answer is no. The principle of TSMC is we do not allow our customers to sublet or auction off the capacity. But in certain cases, customers can collaborate through mask licensing agreement, but this is not our common practice. And the amount is very, very small.

Krish, did I answer your question?

Krish Sankar - TD Cowen - Analyst

Yes. And then a quick follow-up. You did touch upon it the High NA agreement with ASML from 2030 onwards. I'm just curious to know historically TSMC was more ahead of the curve with the EUV adoption. It looks like by the time you adopt High NA EUV, be it 2030, 2031, but some of your competitors would already been using it by then. So do you see that as a disadvantage? Or you're not worried about competition getting ahead with High NA EUV?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. So Krish's second question is looking at High NA. He notes some of our competitors are both using already adopted or will adopt High NA earlier than TSMC. So his question, does this put us at a competitive disadvantage or risk compared to our competitors in terms of technology leadership.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Krish, let me answer that. We always evaluate a new tool -- and if we want to put into the mass production, it got to be the best technology with a very reasonable cost. And most important is the best maturity, okay? So we say in 2030, we'll start to use it because we also think at the time, High NA will be mature. And we're also working very closely with ASML to establish a 12-inch photomask by 2031.

And at that time, we think that the High NA's cost will be reasonable and for TSMC to make it into the mass production. And this is a very good tool. Let me emphasize that. And in the smaller geometry, it definitely has some advantages. Whether that our technology because we are using is later than our competitor, so a disadvantage to TSMC? No, because we have confidence that we are still the best company to offer the most advanced technology to our customers.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Krish, does that answer your question?

Krish Sankar - TD Cowen - Analyst

Thank you very much.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Operator, can we move on to the next participant, please?

Operator

Charlie Chan, Morgan Stanley.

Charlie Chan - Morgan Stanley - Analyst

And also glad to hear a very strong AI semi-demand amid some recent stock market correction. So my first question is really about your leading edge capacity expansion strategy. As far as I know one of your IDM customer is spending capex very aggressively. So there are some concern about this may insource more than outsource to you, right? So first of all, I'm not sure how you're going to deal with this sort of business opportunity?

And secondly, I remember, last time that C.C., you mentioned about A14 could be a bigger node than N2. May I know whether they assume big IDM company will outsource more CPU like server CPU at A14?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay, so Charlie's first question is around IDM competitor. He wants to know very specifically if we see this competitor moving to insource more. So his question is then our prior comment of A14 being a larger, bigger node than N2 has even been, does this include the server CPU from this IDM competitor?

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Well, Charlie, we treat every customer fairly. So whether it's IDM or is purely fabless, we treat them the same. But of course, we take into consideration of their internal capacity. So we calculate our support. We calculate our capacity build-up according to our own judgment. Actually, in our A14, we have seen more and more customers actually higher than the 2-nanometer activities so far. And we expect that the A14 will be a bigger node than our current N2 technologies.

Charlie Chan - Morgan Stanley - Analyst

I see. So it doesn't need to consider this IDM will also outsource more. We can still have A14 to be a bigger node than N2. Is that the right understanding?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Well, again, Charlie wants to know very specifically this customer's outsourcing plan, which you probably may need to ask them, but yes.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Well, Charlie, as I said, to be frank with you, I don't comment on a specific customer, but let me guarantee you that we take everything into consideration. Okay?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. Do you have a second question?

Charlie Chan - Morgan Stanley - Analyst

Yes, I do. Thanks. -- the second question is a kind of follow-up about your advanced packaging. From what we're seeing that the reticle size is getting much bigger. C.C. said last time or even two quarters ago about your response, SoW, 3.5D, so let's an initiative is going on.

So my question is that do you think those are kind of CoPoS, SoW, 3.5D can really catch customers' very rapid development of their larger reticle size chip like 14 reticle?

And secondly, if some customer, they eventually choose to use Intel's EMIB-T and for some reason, cannot get to sufficient demand. Are you okay to bail out to support customers for the CoWoS version or capacity.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

All right. So Charlie's second question is focused on the advanced packaging. I guess, Charlie, if I understand your question, summarize it, is, of course, customers are moving to larger and larger reticle size 14x. So he wants to know TSMC's roadmap and solutions and how competitive we can be against, I think he mentioned specifically our competitors, EMIB-T. So how do we view our solution? Is it as competitive as our competitor? That's the first part of his question.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

All right, Charlie. Actually, I still think that TSMC's advanced assembly or they say, packaging technology are very, very competitive. But the most important thing is that we help our customers' product can be introduced in the market smoothly. That's our number one priority. So we have to offer them the best technology with enough capacity.

So far, let me share with you our today's situation -- we are in the real world production of 5x reticle size. I don't believe that anybody can do that today, except the TSMC. And the yield is excellent. So our customers are very satisfied with the result. And then we are working on the 9x reticle size and moving into the 14x reticle size.

Of course, we are also working on the CoPoS part and to make sure that in the future, we can offer a reasonable cost reduction. But so far, the CoWoS is still the number one choice for our customers. As time goes by, yes, our competitors offer a very competitive solution. Still, I want to say that today's situation, we are the only one that makes sure that the advanced packaging is a 5x reticle size. And still, we are very competitive.

I want to emphasize that.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

And then Charlie's question, if the competitor cannot deliver on their solution, Charlie, I think you're saying we willing to be something like a backup plan?

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

I try to avoid to answer it directly, but let me say that. Yes, we will be number one priority. I already indicate that TSMC's customers product can be introduced into the market smoothly. That's the number one priority, okay? And that gives you enough hint.

Charlie Chan - Morgan Stanley - Analyst

Yes. Yes, indeed. Thanks for the answers. I hope that you don't give any food to others, including in the advanced packaging. Thank you.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Thank you. All right, operator, let's move on to the next participant, please.

Operator

Next one, Sunny Lin, UBS.

Sunny Lin - UBS - Analyst

After -- so my first question is to have a bit more color on how we should think about CapEx beyond 2026. Recall a few quarters ago, you mentioned if you are doing your job well, then you may be able to drive CapEx to grow a bit less than top line. But now obviously, the overall call activity may have further strengthened, and you also willing to support your clients with more substantial expansion. And we therefore wonder, at this point, when you look at maybe the coming two years, would you expect maybe CapEx to grow a bit faster, maybe in line with sales or even a bit faster just like for 2026?

And then meanwhile, obviously, the tool price is also increasing, given a very tight supply. And therefore, going to 2027, will a higher tool price also be a driver for higher CapEx as well.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Higher, sorry. What was the last part of your question, Sunny? Higher tool price, higher what the top?

Sunny Lin - UBS - Analyst

Well, so yeah, when we think about 2027 CapEx, should we also consider tool price inflation to be a meaningful variable for a lot higher CapEx compared with this year?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Understood. Okay. Sorry. Okay. So Sunny's first question, -- it's about our CapEx beyond '26, really, she's asking '27 and '28, the next two years.

With the strong, extremely robust demand that C. C. indicated, the question is around our capital intensity in the next 2 years. How do we see the capital intensity trending revenue growth versus a CapEx growth - part one, and then also the impact of tool inflation on the CapEx outlook as well.

Wendell Huang - Taiwan Semiconductor Manufacturing Company Limited - Senior Vice President and Chief Financial Officer / Spokesperson

Okay. Sunny, this is Wendell. It's a bit too early to share the CapEx number beyond this year. But as we said in the prepared remarks, we have a very strong conviction in the AI megatrend. Therefore, our CapEx from 2026 to 2028 and is expected to be significantly higher than the past three years.

And this is a step-up of our investment to support the customers' growth. We have no intention to leave any food on the table for others. The tool price inflation is real. The tool price, material, labor costs, et cetera. However, the majority of the CapEx is always related to the long-term demand. So that will be the composition going forward.

And capital intensity-wise -- as we always said, if we do our job right, the increase in revenue will outpace the increase in CapEx, and that is still the case from what we are looking at.

Sunny Lin - UBS - Analyst

Thank you very much. If I may have a very quick follow-up on the CapEx side. Earlier, Wendell, you raised the margin dilution from overseas to I think 3% to 4% starting from 2027, given a faster overseas expansion. But for the US, you're still so far focused on Arizona. Does that imply for Arizona, the expansion for the second phase will happen very quickly -- or you're actually accelerating the expansion for the third phase or even the other phases as well as therefore the result for higher margin dilution for next year?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. So Sunny's question is kind of about the puts and takes to next year's margin. She does note, as Wendell said in our prepared remarks that the overseas fabs will widen a bit to 3% to 4% in the next few years. So you wonder what's driving that wider dilution. C.C. did say we are pulling in the schedule for the second fab for 3-nanometer. Her question is, are we also pulling in third fab what's leading to this wider diluted? And maybe -- Yes.

Wendell Huang - Taiwan Semiconductor Manufacturing Company Limited - Senior Vice President and Chief Financial Officer / Spokesperson

Okay. Sunny, as we mentioned, we are doing everything we can, wherever we can to increase our capacity to meet the strong demand from the customers. And we are also accelerating everywhere, including in the U.S. We did mention before that the latter part of the five-year period, the dilution -- margin dilution from overseas fab will be 3 to 4 percentage points, and that still remains the case. So it's 3 to 4 percentage points in the second part of the five-year period.

Sunny Lin - UBS - Analyst

Thank you very much for the clarification. My second question, I like to follow up on the point.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

That was two questions, Sunny. That is already two questions. Can we -- sorry, but we probably just to accommodate as many as we can. We're going to move on. Operator, can we move to the next participant, please?

Operator

Next one, Haas Liu, Bank of America.

Haas Liu - BofA Securities - Analyst

Congrats on the great results. The first question would be on your view regarding the potential shift in AI demand mix. You mentioned in the prepared remarks that the AI accelerator chip set demand is proliferating into agentic AI demand, including CPUs and networking switches. We understand the overall AI investment is still pretty strong and even trending stronger across the board. But can we get more clarity that are you seeing your customers demand shifting toward more efficient compute solutions, especially as monetization gets more important? How should we think about the incremental opportunity for your manufacturing and packaging business?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

So Haas' first question is on the AI-related demand. His question is, are we seeing a shift in the AI-related demand more and more to CPU or networking switches and away from AI accelerators, or any type of comment.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Well, all I can say is AI's demand is extremely robust, okay? Whether it comes from accelerator or is more from the CPU side. It's not for me to make a comment, although we did see the demand from agent AI CPU continue to increase. Yes, that is a trend today.

And other than that, everything is very robust. And I want to emphasize again - in our judgment, we consider all the parameters, and the demand actually is still far above our capability today to supply. And we are working very hard to narrow the gap. That's all I can say.

Haas Liu - BofA Securities - Analyst

Okay. That's very clear. And my second question is just regarding the yield learning curve going forward for your dual technology tracks strategy going forward. So historically, I think you have been ramping up the yield of a new node through producing the chipsets with smaller die size and simpler design to improve the learning curve of new node. But for the future node plans are supporting both conventional power delivery for the applications like mobile and consumer applications and super power rail technology for HPC and AI chipsets, would operating two process architectures at the same make the learning curve more challenging or increased manufacturing complexity -- and how should we think about the implication to your gross margins from the yield and also cost control perspective?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. So Haas second question is -- his question is really about ramping a new node. -- the learning curve of yield and cost, and therefore, the implication to gross margin, really, I think, is what he's driving that. And his question is that in the past, new node is mostly ramped with smaller die size and simpler design. But -- so today, we have both the smartphone and also with the AI and HPC applications coming in, does that increase the complexity of the node process architecture, make the learning curve more challenging or difficult and therefore, the implication to the margin.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Well, today's a situation actually is a little bit different from previous years. Yes, we now have a very strong demand from smartphone and also AI/HPC applications. And so the smaller die size per se or the big die size in the accelerator, they happen at the same time. And this is to TSMC's advantage, let me say that. Because we are good.

We have been prepared for this kind of thing. And our results are very excellent, and customers are very happy to work with us. And so the learning curve, yes, but we are doing a reasonable job. And so all the customers are very happy today.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. Thank you. Operator let's move on to the next participant, please.

Operator

Arthur Lai, Macquarie.

Arthur Lai - Macquarie Securities - Analyst

I have a question on the power as a gating factor. So I want to understand, have power grid constraint led you reduce your customer forecast in the history? Also, could this tighter and tighter power grid supply make your customer actually accelerating adoption of your Super Power Rail product for the better performance per watt?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. So Arthur's first question is about the power supply or electricity supply. Is it a gating factor and have we seen that lead to a reduction in customers' forecast. On the other side or on the other hand, with the tighter power electricity supply, have we seen more customers' adoption of super power rail technologies?

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Well, let me update that definitely power supply situation is one of the consideration factor that we are looking into. And that's why also we do one more step to double check whether the power supply situation in the US, and we have done all the study and so far, so good, let me we say that.

And with this kind of a situation change our customers' behavior and move more into the backside power rail, the answer is no. Whether you use the backside power, those kind of metallization scheme, is based on your need for your product, okay? So some of the accelerator might be using it. Some of the product like mobile phones, they don't use it. So it depends on customers' product. Did I answer the question?

Arthur Lai - Macquarie Securities - Analyst

Yes. Thank you.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Do you have a second question?

Arthur Lai - Macquarie Securities - Analyst

Yes. Thanks, Jeff. So just to recall, the previous discussion on the agentic AI demand on the CPU. So I wonder, according to our previous framework, demand forecast framework, the mid-to high 50s% growth, including the CPU or not? And if we heard our clients increase the CPU forecast significantly, when is the next time we refresh our AI demand growth numbers?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. So Arthur's, second question is on -- his question is really on our -- we already stated by anyway, our AI accelerator definition -- he wants to know with the emergence of agentic AI and CPU, -- does that AI accelerator definition include CPUs or not? And if when we will provide inclusion for him.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Let me answer the question. It's not included in our AI demand's calculation -- the reason is very simple because we cannot identify which CPU used in the conventional server CPU or AI server CPU. And also that it depends on our customers' application and their own allocation also. So no, so far today, we stick to our initial, very narrow definition on the AI's demand.

Arthur Lai - Macquarie Securities - Analyst

Understand. And so if we have seen a very strong CPU driven demand, when we will revise up the --

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Arthur, I think we already said very clearly, it's not part of the AI accelerator definition, it's a narrow definition. But it is certainly part of our business, okay?

Okay. Operator, in the interest of time, can we take questions from the last participant on the line, please?

Operator

Sahej Singh, Stifel Financial.

Sahej Singh - Stifel Nicolaus & Company Inc - Equity Analyst

Into 2027, you have N3 turning accretive and now that's crossed over, and N2 is still in its diluted ramp, and the overseas dilution is widening. On the offset side, there have been reports of significant price increases across your mature and advanced nodes. Could you provide some color into perhaps some of that conversation and where pricing does move, does it typically apply across the existing contracted book? Or is it mainly being applied to incremental capacity above what customers have already committed to?

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Yes. Okay. So -- the first question is talking about -- I guess you're asking about the potential puts and takes for next year. Or you're asking specifically on pricing, sorry -- our pricing, specifically on pricing. Okay. So it's a very specific question that there's reports that we are increasing the price.

He wants to know does it apply across the existing contracted commitments from customers? Or is it mainly for the incremental capacity?

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Well, we have discussed this kind of thing before that our pricing strategy is very strategic. It also depends on the market segment, depends on the location, and depends on the technology and something. Once we offer the flexibility of the physical location that in the US, it will be a little bit different from the one we produce in Taiwan. So no matter what, when we try to get our value to be recognized, and we will give our shareholders the maximum value of our technologies.

Sahej Singh - Stifel Nicolaus & Company Inc - Equity Analyst

Understood. For the second question, something you said in your prepared remarks, which stuck out to me was we will not be leaving food on the table. And earlier, I think it was maybe one or two weeks ago, there was the announcement via GlobalFoundries that they would be providing silicon interposers to TSMC. And so I would love some color into how are you thinking through these strategic decisions in terms of procuring from some of the specialty foundries versus providing in-house.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. So the second question is, again, he notes that recently, we had an announcement with GlobalFoundries on interposers. How do we view these partnerships and what is our approach strategically.

C.C. Wei - Taiwan Semiconductor Manufacturing Company Limited - Chairman & Chief Executive Officer

Well, let me answer the question. We designed a deal with GlobalFoundries. And this is part of our overall strategy in the back-end supply. Actually, our number one priority is to help our customers to be successful in their market. We want them to be fully supported by all the supply, including the front end and back end. Definitely, we have a little bit shortage on the back end, and we'd like to work with our so-called partner with GlobalFoundries so that both TSMC and GlobalFoundries can support TSMC's customers for their product to be introduced with enough support and the capacity.

Jeff Su - Taiwan Semiconductor Manufacturing Company Limited - Director of Investor Relations

Okay. Thank you for your questions. Thank you for all the participants. This does conclude our question-and-answer session. Before we conclude today's conference, please be advised that the replay of the conference will be accessible within 30 minutes from now. The transcript will become available 24 hours from now, and you can find both will be available through TSMC's website at www.tsmc.com.

So again, thank you for joining us today. We hope everyone continues to stay well. Have a good autumn and we hope you will join us again next quarter. Thank you, and have a good day.

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