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## Conference Call Transcript

**TSM - Q1 2007 Taiwan Semiconductor Manufacturing Co. Ltd. (TSMC) Earnings  
Conference Call**

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## CORPORATE PARTICIPANTS

**Elizabeth Sun**

*TSMC - Head of Investor Relations*

**Lora Ho**

*TSMC - VP, CFO*

**Rick Tsai**

*TSMC - President, CEO*

## CONFERENCE CALL PARTICIPANTS

**Randy Abrams**

*Credit Suisse - Analyst*

**Sunil Gupta**

*Morgan Stanley - Analyst*

**Pranab Sarmah**

*Daiwa Securities - Analyst*

**Shailesh Jaitly**

*Nomura Securities - Analyst*

**Steven Palao**

*HSBC - Analyst*

**Daniel Heyler**

*Merrill Lynch - Analyst*

**William Dong**

*UBS - Analyst*

**Donald Lu**

*Goldman Sachs - Analyst*

**Ivan Goh**

*Dresdner Kleinwort - Analyst*

## PRESENTATION

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### Operator

Welcome to the TSMC's First Quarter 2007 Results Webcast Conference Call. Today's event is chaired by Ms. Lora Ho, Chief Financial Officer and Vice President, and Dr. Rick Tsai, Chief Executive Officer and President. This conference call is being webcast live via the TSMC website at [www.tsmc.com](http://www.tsmc.com) and only in auto mode. (Operator Instructions) 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 statements before the main presentation by Ms. Ho and Dr. Tsai.

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

Good morning and good evening to all participants. This is Elizabeth Sun, Head of Investor Relations for TSMC. Before we begin I would like to state that management's comments about TSMC's current expectations made during this conference call are forward-looking statements subject to significant risks and uncertainties and that actual results may differ materially from those contained in the forward-looking statements. Information as to those factors that could cause actual results to differ materially from TSMC's forward-looking statements may be found in TSMC's annual report on Form 20-F filed with the United States Securities and Exchange Commission on April 20th, 2007 and such other

documents at TSMC may file with or submit to the S.E.C. from time to time. Except as required by law we undertake no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

And now I would like to turn the conference call over to Ms. Lora Ho, our Chief Financial Officer and Vice President.

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

Thank you, Elizabeth. Good morning and good evening to everyone. Welcome to our first quarter 2007 earnings conference call. I will start today's call with highlights from our first quarter results and then give you an outlook for the second quarter 2007. Please also refer to the quarterly financial summary slide on our website. All dollar figures are in new NT dollars unless otherwise stated. With that, let me start with slide number five.

As we expected our first quarter business was affected by inventory corrections and seasonality. However, we believe a majority of our customers excess inventory has been worked through in the first quarter and a recovery of our business is already in place.

Total revenue for the quarter exceeded our guidance slightly to reach NT\$65 billion, down 17% year-over-year and down 13% sequentially for a quarter-over-quarter basis. Revenue from computer, communications and consumer applications declined by 21%, 15% and 12% respectively.

In terms of revenue by technology, revenue for advanced technologies accounted for 49% of our wafer revenues with 65-nanometer accounting for 1% and 90-nanometer accounting for 22% of total wafer sales.

Gross profit margin was 37.9% for the first quarter, 8.1 percentage points lower than the previous quarter, mainly due to lower utilization, a decline in ASP, an increase in depreciation expense and a lower provision for sales return in the last quarter.

Total operating expenses during the quarter were slightly lower than the previous quarter, mostly due to reduction in 65-nanometer related expenditures as we entered into volume production for 65-nanometers.

Operating margin was 27.5% for the quarter. Earnings per share were NT\$0.73, down 42% year-over-year and down 33% quarter-over-quarter.

Now let's turn to balance sheet. TSMC ended the quarter with NT\$217 billion in cash and marketable securities, NT\$22 billion higher than last quarter largely due to free cash flow generated from our operations. We also spent NT\$14 billion in capex.

Now let me turn to capex and capacity. Total installed capacity for the first quarter was 1.9 million 8 inch equivalent wafers. Our second quarter capacity will be about 4% higher than first quarter. We expect our 2007 capacity to be about 8.3 million 8 inch equivalent wafers, an 18% year-over-year increase. Our full year 2007 capex where we made in the range of U.S. dollars 2.6 billion to 2.8 billion.

Page ten through page thirteen of the slides breakdown our sales by technology, application, geography and customer, which I will not go through in detail.

With that let me turn to the outlook for the second quarter of '07. Based on our current business and foreign exchange rate expectations our consolidated revenue is expected to be between NT\$73 billion to NT\$75 billion. Gross profit margin is expected to be between 42 and 44%. Operating profit margin is expected to be between 32 to 34%.

That concludes my remarks today. Now we will open the conference call for Q and A.

## QUESTION AND ANSWER

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**Operator**

(Operator Instructions) Your first question comes from the line of Randy Abrams with Credit Suisse.

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**Randy Abrams - Credit Suisse - Analyst**

You cited a few factors in gross margins but wanted to understand in the quarter your revenues came in above the range. Gross margins came in at the mid point. Relative to your expectations what played out a bit differently to drive gross margins more or less in line despite slightly better revenue?

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

It's true that our first quarter revenue has exceeded our guidance slightly while the margin remained the middle point of our guidance. One thing to note is that starting from this year, starting from last year actually, we have tried to include a consolidation report. There are a few entities, for example, the TUC and [Hsin Chu]. Their revenue has been growing pretty significantly in the first quarter and their gross margin has been lowered in TSMC so with the growing of the real revenue total margin for TSMC's side will be diluted slightly because of that reason. So the first quarter is mainly because of this.

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**Randy Abrams - Credit Suisse - Analyst**

Okay and turning over to SOI it came up a bit this afternoon but wanted to talk about your expectations for other applications beyond processors such as base fabs to move to SOI or do you think it's still sees a niche to existing applications?

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

Randy, are you asking about the microprocessors?

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**Randy Abrams - Credit Suisse - Analyst**

Yes your expectations for SOI if you think it will remain a niche or do you think it will broaden out to other applications, like there's some talk about base band graphics moving over to SOI.

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

Well, I believe SOI will still be mainly for microprocessors, custom design type of applications. I think people will look at that just to ensure that they are not missing something but as I also said in the afternoon, I really don't see SOI playing a key role in the lower cost of various ID integrated applications.

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**Randy Abrams - Credit Suisse - Analyst**

Okay and one final question, you've a close partnership with Vanguard. With them purchasing a second fab do you start to-- does the relationship start to change where they compete a bit more into some of the accounts or do you-- are you fully behind that and still see it as the same type of partnership?

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

Yes you're quite right. We are fully in support of that. We were fully consulted before they made a decision. All through the communication was excellent. We believe that's a good move for Vanguard and for TSMC. We intend to utilize part of the capacity that they will purchase from [Winmont]. The relationship between the two companies is very strong. We are a technology provider. We also we're a big customer of theirs basically and they are essentially the only outsourcing partner for us.

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**Operator**

Sunil Gupta from Morgan Stanley.

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**Sunil Gupta - Morgan Stanley - Analyst**

I had a question on your capex and capacity plans. You had disclosed your capacity plans for Q3 and Q4 and in Q3 you had 11% increase in different capacity and in Q4 right now it shows 5% increase so two part question. First, for Q3 capacity, is this pretty firm and have most of the orders and deals been placed? And second, given where your (inaudible) rates are going to be in Q2, what is driving this very significant increase in capacity and I presume your expectations of business in Q3?

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

Okay, Sunil, I missed you right here this afternoon.

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**Sunil Gupta - Morgan Stanley - Analyst**

Yes I couldn't make it to Taiwan today. My apologies.

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

We for the Q3 actually for Q4 capacity I think we have placed our PO already and the I actually some of the equipment for Q3 should have been here already. We fully expect to utilize most of those capacities. I think the way we look at third quarter our assessment we will have-- we feel fairly comfortable with our assessment for just one or two.

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

If I may add one remark on that, the capex increase for the third quarter and fourth quarter were mainly because we were seeing very responsive demand for the nan technology. For example, 65-nanometer has already accounted for 1% of our total revenue in the first quarter. We are seeing the numbers continue to growing up. Same for the 90-nanometer where we will see a pretty good demand coming on the line the second half and so, therefore, the capacity will be utilized, what we currently believe.

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**Sunil Gupta - Morgan Stanley - Analyst**

Maybe just as a follow-up to that in terms of the utilization in Q3, could you provide us with some color on what end applications are likely to spell this? I presume your Q2 utilization will be in low 90% and then you are in 11% in Q3.

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

Sunil, as I said we continue to see good demand in computer communication consumers but in this case I think because of the relatively mild event from a computer in the first and second quarters, third and fourth quarter will be a more prominent compared to consumer communications but if you are even that those are very high based ones for communications. We're still expect to see good volume there. It will be more valid in third quarter among the three major (inaudible) compared to the second quarter.

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**Operator**

Pranab Sarmah with Daiwa Securities.

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**Pranab Sarmah - Daiwa Securities - Analyst**

The first question, Lora could you give us color on the percentage of revenue came from the subsidiary on the first quarter?

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

Okay, in the past the subsidiary revenue has been very small but in the first quarter, for example, the revenue from Hsin Chu you see is very close to about 2% of TSMC total revenue.

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**Pranab Sarmah - Daiwa Securities - Analyst**

Okay total including all the subsidiaries will be about 4 or 5%?

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

Yes 2% estimation is just for those two companies.

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**Pranab Sarmah - Daiwa Securities - Analyst**

Only for two companies okay. And second one is you have accelerated your technology migration to 45-nanometer. Is this acceleration is competition driven or demand driven and will it lead to some increased capex for 2008 because normally 45-nanometer equipments are quite expensive?

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

Pranab, I think with-- I think probably a combination of both. We have always been saying that technology leadership is one of our most important competitive advantages and we basically are doing what we've been saying and I think at 90-nanometer we're asking to have shrunk somewhat so we really made the effort to ensure that we enlarge the gap at 65 and even further at 45. I think both of the 45-nanometer low power technology and the 45-nanometer keyless technology approved to that. And we also invested heavily in the design environment in the collaterals to make sure that the technology can be utilized by our customers.

To the investment we will-- I mean we do not have a estimate for next year's capex yet. I think your question-- I look at the capex intensity for 45-nanometer and 65-nanometer and 90-nanometer. Of course, each generation takes nets capex in terms of the increase but in our case I think the degree of the increase between the technologies we met about the same, about the same so I believe we will be able to manage our capital investment but still provide the technology migration path and the advantage to our customers.

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**Pranab Sarmah - Daiwa Securities - Analyst**

Rick, any thought like when you expect 45-nanometer to account at least 5% of your revenue?

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

Well, why don't you ask me this question in another quarter or so or two from now? Right now it's a bit too early. Right now it's a bit too early, Pranab.

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**Pranab Sarmah - Daiwa Securities - Analyst**

And my last question is basically your capacity. Will you consider putting up any advance capacity outside Taiwan in near future?

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

Direct answer is probably not, not in the near future. However, let me tell you, elaborate a bit more. Advanced technology capacity see some of the critical factors for us are cost obviously, the cluster effect and engineering talent, not necessarily in this order but what are they all three are very important and we look around. We investigated this actually quite a bit. Taiwan if you look at all three of them, Taiwan still has a very strong vantage but of course I think some of those may-- well, but we want to make sure that mid term to long term we have different options too so we're looking at other places. We think we have an alternative but we haven't do anything in the near future.

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**Pranab Sarmah - Daiwa Securities - Analyst**

So it's basically long term means maybe two, three years down the line something might come in that way?

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

Yes, yes maybe.

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**Operator**

Shailesh Jaitly with Nomura Securities.

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**Shailesh Jaitly - Nomura Securities - Analyst**

Firstly, I just wanted to follow up on that capacity expansion question. You're expanding the capacity by about 18%. How do we view this in context of the growth rate for the Company you were targeting if I remember you said last time that industry is expected to grow at about 6% or so this year and for TSMC to grow at twice that growth rate will be very difficult perhaps. Matching that rate would be difficult so looking at the capacity expansion versus your growth expectations should we assume that you're preparing for quite a steep ASP cut going forward through the year?

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

There are two parts to that. One is of the volume. Yes I think our wafer shipment will increase quite a bit this year. However, you also need to look at our first quarter and second quarter. I mean our first quarter wafer shipment obviously is quite low but by the numbers we have show already. The shipment certainly will increase starting in second quarter, then extending to third quarter and fourth quarter. I think you from the profile of the capacity build you can see our view about third quarter and fourth quarter.

The second part of the equation is the pricing. Pricing as we said also during the last conference, pricing for this year has been pretty severe. We because of the (inaudible), the supply/demand situation. That-- of course, that pricing decline situation impacts the whole year so those two factors combined together really explain the growth situation for the Company this year.

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**Shailesh Jaitly - Nomura Securities - Analyst**

Okay and which nodes are you seeing he pricing pressure most aggressive?

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

I think at the 90-nanometer relatively speaking we're probably seeing a heavy-- well, we're seeing a decline there compared to--

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**Shailesh Jaitly - Nomura Securities - Analyst**

And would you be changing your expectations for the industry growth on what you talk about in terms of decency growth profile vis--vis industry at this stage?

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

Industry means the semiconductor industries?

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**Shailesh Jaitly - Nomura Securities - Analyst**

The whole semicon industry yes. I recall you said 6% last year and-- last quarter sorry. And you said that TSMC it would be difficult for TSMC to match this year, the growth rate given the slowdown in the first half so shall we assume that the expectations are the same or is there any change in those expectations?

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

I think the-- we basically for the whole semiconductor industry we would lower our growth rate somewhat but last time we talked about (inaudible) I think. In general we implied 4 to 6%. I think right now we're looking at-- I don't think we are looking at anything above 5% and we're probably looking more at 4 or 5% if that and TSMC's growth rate I think will still be difficult to match that.

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**Shailesh Jaitly - Nomura Securities - Analyst**

Okay and some sense of the entry barriers for the smaller players particularly getting into the 45-nanometer? I understand technologically there are going to be NP barriers but just the balance sheet muscle if you could provide some sense as to the total development expense required to move into 45-nanometer? That would be a process, R&D, mask and (inaudible), everything put together before you see the first revenue making wafer. How much investment is likely to be required?

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

We have made some rough estimates. I think for 45-nanometer development we're talking about roughly NT\$1 billion for everything together. I mean of course including some of the R&D tools with the accompanying depreciation.

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**Shailesh Jaitly - Nomura Securities - Analyst**

Okay and one last question if I could, your SOI roadmap, when are you likely to start your own SOI process?

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

We talk about that before. Again, we really do not have a really business for SOI process of ours. We are being investing some resources in SOI process technology to ensure that we have the capability but we're not really out marketing that technology in any force I guess. So I do not want to mislead you guys in thinking that we're going to have some SOI business. We really do not and the-- but we believe that the down the road in another couple of generations SOI may play an important role for the devices for the transistors. But that, even that statement remains to be proven.

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**Shailesh Jaitly - Nomura Securities - Analyst**

Okay so is it right to assume that as it plays dominant role in given TSMC is leading by then you will have your own SOI developed solution or not the right way to think?

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

Yes it really becomes critical for the next net net generation transistor points and certainly we'll be-- we will have our technology yes.

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**Operator**

[Steven Palao] with HSBC.

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**Steven Palao - HSBC - Analyst**

Some question on the profile of 2007 and maybe put it in a little historical perspective for me. To get to a low single digit growth rate this year it looks like in the third quarter you'd have to do kind of a high teens, maybe as much as a 20% sequential, follow that up by a low teens in the fourth quarter. You've done that before in the second half of a calendar year. I wonder if you can just compare the drivers for the second half of this year to past cycles and how you might be able to accomplish that type of strong sequentially growth rate. Furthermore if you compare it to with the pricing trends were in past cycles?

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

Actually I think we partially addressed that question earlier. We're seeing mostly assessments, major assessments, communications, computer and consumer to grow pretty strongly in the third quarter. We're also seeing actually some of the industrial applications to play a more significant role compared to before. Mainly, of course, we'll continue to have continuous growth so it just seems to us that I think that all cylinders will be on fire the time period and of course we believe that will happen yes.

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**Steven Palao - HSBC - Analyst**

And then could you just give us one more update on your memory concentration plans? I think there was a little confusion on where you guys thought you might be as a percentage of revenues by the end of the year and maybe talk a little bit about it looks like one of your partners, their expansion is really having their own struggles there. Do you perceive there could be any potential difficulties with that ramp?

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

No I think-- yes there was a little dip of computer in the afternoon. We basically what we have been saying is that somewhere between 5 to 10% exiting the year. We still hold that view. I think the demand is there. Demand is there but migration-- I mean that's why it is of course a very competitive market so both our partners and we are working very hard to migrate the technology to 90-nanometers once we can so we both have a better cost structure.

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**Steven Palao - HSBC - Analyst**

And then just my last question was really on the yield ramps here at 65-nanometer and 90-nanometer. Are they progressing as planned? Are you pleased with them, maybe any general comments? I understand there was some commentary in the Taiwan call earlier today about that and I missed those.

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

I think likely that we see in full production as our performance is very good. I think the importance in 65-nanometers. Again, the yield improvement is-- I think is more than good. It's excellent. I said in the afternoon this node we have done on the best we have over the past several generations from yield improvement point of view. Our customers are really very delighted so we see performance, the performance, the cost structure and the yield. I just think that just puts a very high example for the next generation of technology of what we intend to achieve there too.

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**Steven Palao - HSBC - Analyst**

Excellent, congratulations. Thank you.

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**Operator**

Daniel Heyler with Merrill Lynch.

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**Daniel Heyler - Merrill Lynch - Analyst**

I had a follow-up on my question today on the microprocessor market and your somewhat bullish comments on the opportunities for TSMC in that marketplace. Rick, you had mentioned your preparedness is certainly there. Could you elaborate a little more on how this will work because I would consider the microprocessor business is a very high volume, low mix type of environment versus your infrastructure, which is very much of a high mix environment. Is this something that would be used as potentially a process driver going forward and, if so, is this more of I guess a 45-nanometer type of product as well?

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

I think, Daniel, the first and first. We have low presence in this market. Certainly the motivation is very high for us. Next technology why we really believe that the our 45-nanometer GS bulk CMOS technology is very competitive, not necessarily for the high end CPU but is certainly I think the very competitive solution for a lower end, lower power, highly integrated type of application. Those are the basis for our high motivation. We certainly are working very hard with the potential customers to make that happen and this is not just talking also. Whether we want to or we can use that for the driver or for the ramp, I think that those are the second order in to [reaching ] for us right now. I mean if they can do that it's great but as I said, first and first. I said together technology working so that we can get a business, okay ramp. We can prove and demonstrate that we're capable to be a reliable supplier in that segment. I think that's the most important thing for us first.

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**Daniel Heyler - Merrill Lynch - Analyst**

Okay great and did you have at this point a time line-- I guess to remind you said your motivation is quite high so would you be looking to I guess 45-nanometer as a possible, the most likely generation or are we looking beyond that?

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

We start at 45 and definitely continue at a 32 or let's say you know this game. You cannot just play with one generation of technology. I think also that our commitment to continuing a very strong technology push also demonstrates our capability if I hope to our customers.

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**Daniel Heyler - Merrill Lynch - Analyst**

So it sounds like your differentiation in that venture, as you said, highly integration and low power whereas I guess the big player there is much more oriented towards performance? Is that a fair assessment of your differentiated position?

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

I think the common future hat I think is common perfection but I really do not have even if I look at their roadmap, Daniel, it's difficult for me to comment.

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**Operator**

William Dong with UBS.

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**William Dong - UBS - Analyst**

Just have a quick question, in terms of the mature technology node can you elaborate a bit more on your plan for capacity expansion? I think I'm just trying to get a better understanding how you aim to outsource in terms of amount you plan to outsource to the likes of Vanguard and how much you want to try to keep that internal?

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

I think, William, if you look at actually the capacity build for mature technology this year it's significant, close somewhat less, lower but close to 400,000 8 inch wafers for the whole year. If you divide that by 12 it's 30,000 plus 8 inch wafer per month capacity. That's one full task for conventional definition. So we're certainly very seriously building those capacity internally but also we have the plan to utilize Vanguard to continue using I think Vanguard as a long-term outsourcing partner. We don't see a conflict there. We believe our capability to not only build a capacity but even more importantly I think to generate the business, utilize those capacities.

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**William Dong - UBS - Analyst**

And one more follow-on on the 45-nanometer, for the introduction of 45 nano has the ramp in yield been faster than what you anticipated? I just want to get a sense of how difficult the ramp of 45 has been relative to previous generations jumps so especially now we're using the immersion you know [string] silicon, the ultra low (inaudible) here?

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

Well, William, I think the jury is still out. I think our 45-nanometer, the first technology that will be up is the low power, the LP technology, in the better part of the year, the fourth quarter time frame. I think the current yield of our test vehicles-- by that I mean a 32 megabit test ramp-- is quite good, very good. Certainly that cannot, of course, we also realize that cannot represent all the possible products of the customer. It's a necessary condition but not a sufficient one at least yet. But we remain pretty optimistic with the progress we are making now but, as I said earlier, 65-nanometer has done very well which that really very high (inaudible) with the 45-nanometer technology.

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**William Dong - UBS - Analyst**

One last one, do you see 45-nanometer as a way for you to pull further ahead versus your competitors or do you see competitors also kind of following quite close?

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

We believe our 45-nanometer technology both in LP and TS working quite well. We believe we're leading. Maybe you know better than I do whether we are really margined the gap. We believe we are. You can give me some insight.

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**William Dong - UBS - Analyst**

No I think you're probably leading definitely there.

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**Operator**

Donald Lu with Goldman Sachs.

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**Donald Lu - Goldman Sachs - Analyst**

Rick, I have a question. I look at your 12 inch capacity plan for by the end of this year. It seems like the 12 inch additional capacity is about 42K for this year compare Q for this year versus Q for last year but your capex is only still 2.6 billion. That sounds like it is equipment getting cheaper? I mean you can do the same math with all six. It seems like I ought to get a different number.

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

Donald, you should come to be our procurement head.

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**Donald Lu - Goldman Sachs - Analyst**

I am waiting for the offer letter.

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

I think there are several factors to the capex vis--vis the capacity. I think the scale, the productivity, of course price. I think I believe TSMC has all three of them. I certainly am not saying that we're getting very low price of our equipment suppliers and our chip at all. But we work very closely to improve the productivity. We certainly enjoy the benefit of the scale. I think if you think about it it's really the capital productivity that is working for us, hopefully for the shareholders too.

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**Donald Lu - Goldman Sachs - Analyst**

So is this trend going to be sustainable? Let's say if we forecast your capex and capacity for all 8 or 9 should we use the new capital intensity or should we go back to the old one?

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

I think the capital intensity or capital productivity you've got two different things. Our top productivity basically is, as I say if I'm hungry for dollars how much capacity can you buy? A higher productivity means a higher number of wafers, capacity you can buy right?

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**Donald Lu - Goldman Sachs - Analyst**

That's what I meant yes.

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

Yes I think the higher productivity number is sustainable yes. The capex number, of course, will change based on our asset plan.

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**Donald Lu - Goldman Sachs - Analyst**

Sure, can I also just follow-up? What is the depreciation trend for '07?

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

Depreciation will go up about 9% versus '06.

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**Donald Lu - Goldman Sachs - Analyst**

Is that 9% year-over-year?

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

Yes.

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**Operator**

Ivan Goh with Dresdner Kleinwort.

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**Ivan Goh - Dresdner Kleinwort - Analyst**

A couple of questions-- first of all, if I look at your capacity increase in the third quarter actually more than 60% of the increase going from Q2 to Q3 is actually at 8 inch. Can you perhaps detail what kind of products would drive that requirement? How much visibility do you have? You know given that these are probably leading edge?

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

I'm going to be a bit careful here to have the I think the (inaudible-highly accented language) will invite micron area, which has the broadest applications. Some of the large with almost everything are being done here but there are some of the large applications are (inaudible), image sensors, (inaudible) chips. I am sure there are more but we-- this trend has been going on for some time. We believe this will for third quarter our account is pretty high. A lot of our consumer applications are there, a lot of those still are TV chips, the DVD players, camera chips, this (inaudible) is quite popular.

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**Ivan Goh - Dresdner Kleinwort - Analyst**

Okay one question on the MPU microprocessor area, you said that you're working very hard. You're trying to turn that opportunity into actual business but one question I have is what is the difference requirements between these MPU players that you're targeting and other customers with other devices? I mean are there any exacting standards or any criteria that they look for besides those that your other customers normally look for?

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

I think for transistor performance wise their requirement is probably more stringent. I think from a density point of view probably the same but in our business it's not unusual for us to work with specific customers, different specific customers, on certain customization, be they performance or power IO [modish] to ensure that they can have certain, have an advantage in their market. So in a way this is another example of that.

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**Ivan Goh - Dresdner Kleinwort - Analyst**

And finally one question is what is the percentage of your capacity in the second quarter that is 45/65-nanometer capable and what will that percentage be by the fourth quarter of this year?

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

65 will probably need to take a look. 45-nanometer, I think I can say that the right now we have only development capacity. We're going to have a pilot line. By pilot line I mean that we can run roughly 1,000 plus wafer per month type of capacity by end of the year.

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**Ivan Goh - Dresdner Kleinwort - Analyst**

Okay and how about 65 in Q2 and in Q4?

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

In Q2 the 65 capacity will be significantly increased and that trend continues to Q4. In first quarter, as Tsai has said, revenue accounts for 1% but we're going to ramp up that 65 very fast going forward so second quarter giving example, the capacity for 65 will be four times our first quarter and that number will go double at third quarter and go double by fourth quarter.

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**Ivan Goh - Dresdner Kleinwort - Analyst**

So by the fourth quarter your 65-nanometer will be 16 times that of the first quarter.

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

Yes compared to a very small base in first quarter.

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**Ivan Goh - Dresdner Kleinwort - Analyst**

Okay great. That's useful. Thank you very much.

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**Operator**

Sunil Gupta with Morgan Stanley.

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**Sunil Gupta - Morgan Stanley - Analyst**

I have a question on your exit acquisition strategy. In the past we have talked about if TSMC would be interested in making any fab acquisitions or asset acquisitions either in Taiwan or overseas in Europe. You very kindly said you're open to those opportunities so I wanted to find out how that thinking on that front would have been. Is there anything likely, anything that could happen this year and what are the thoughts from that strategy?

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

Sunil, the thinking has not changed. Again, these are strong function of opportunities and the cost and the return. I think there are a couple opportunities that we are working on for those mature technology capacity, if we would announce them in due time when they work out.

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**Sunil Gupta - Morgan Stanley - Analyst**

And are these facilities likely to be in Taiwan or are they overseas or are these just asset acquisitions with all their chips or equipment gets moved across whether Taiwan or somewhere in Asia?

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

Not in Taiwan, better opportunities. And we need to I think we have places in Taiwan or China to endorse those capacities when it happens.

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

Operator, in the interest of time we will only open for two more callers.

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**Operator**

Shailesh Jaitly with Nomura Securities.

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**Shailesh Jaitly - Nomura Securities - Analyst**

You mentioned in the prepared remarks that the majority of the customers have worked through the inventories. Which segments in here have been and still has issues which would continue to impact in the second quarter?

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

I think right now relatively speaking the more uncertain area is being the PC area. I believe some of our customers have already a fairly low inventory but I think a couple others may still have some from their ordering pattern. I am saying that also based on the public's influence, information that we're seeing from the CPU suppliers inventory.

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**Shailesh Jaitly - Nomura Securities - Analyst**

But given that you directly are not involved in any processor business, the segments which you are in, that is your chipsets and graphics, do you see the inventory situation equally bad as the reported numbers are for CPU?

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

I suspect not, not as equally, not equally bad. I think they are very better situation.

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**Shailesh Jaitly - Nomura Securities - Analyst**

Okay and one other question right looking at your numbers and comparing them historically, particularly the fabless IDM split, when I compare it with four quarters back and, in fact, the piece numbers that you saw in 3Q if I compare with that if IDM numbers have been relatively flattish whereas for the fabless part of the business in absolute dollars revenue decline has been more like 12 billion. So I was wondering is it primarily it can be explained just because of the inventories dilution or there could be also some market share loss in any of the sub segments?

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

From our data here it seems the ratio between the fabless and the IDM remains almost the same at a 70/30 split so I really would not extrapolate much out of that. And we really do not have that datum either here.

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**Shailesh Jaitly - Nomura Securities - Analyst**

Okay because I am just looking at your numbers in 1Q '05 it was about 57.6 billion out of fabless gone down to 45 whereas your IDM was relatively flat and about NT20 billion, just looking at four quarters back

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

Your database right now is more extensive than what we have in front of our eyes. Let me be very frank so it's difficult for us to answer.

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**Shailesh Jaitly - Nomura Securities - Analyst**

I understand that so we shouldn't be reading too much into that right? That means there's no (inaudible) --?

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

I really would not. I mean really in two years things have changed a great deal but, again, I don't know whether I should use the price-- this 70/30 split seems to--

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

Has been there for many years.

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

It seems to last for a long time.

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**Shailesh Jaitly - Nomura Securities - Analyst**

Understand that. Thank you. One last question on your capex right out of this 2.7 billion roughly what proportion is likely to go for your 45-nanometer this year?

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

That's relatively small. As I said just now that we're going to build a pilot line in addition to what we have already from the development point of view but I don't have the exact figure but I don't think it will be 50. I think we have quite a bit of-- quite a few pieces of the equipment. We don't need to buy the whole complete line.

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

Yes I think the majority of number is 12 each and mainly for custom of 65-nanometers and some on 90-nanometers.

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**Operator**

And your final question comes from the line of Steven Palao with HSBC.

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**Steven Palao - HSBC - Analyst**

Yes just two quick ones here, I noticed that 180 nanometer revenue was down about 20% quarter-over-quarter. Is there anything to read in there? You had talked about pricing pressure more heavy I guess at the 90-nanometer node. Is there anything more to really read in that?

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

I guess you can tell from the silence here that we don't really feel that strongly. Basically the pricing situation applies to both of the technology nodes so we did comment earlier that 90-nanometer was heavier relatively so we certainly are also seeing pressure in the price decline in the (inaudible) and micron too but the demand I think had a dip but I think it's picking up pretty fast in second quarter and going forward.

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**Steven Palao - HSBC - Analyst**

Okay and my last question was it looks like you spent roughly about 15% of your capital spending budget in the first quarter. Yet you're talking about a pretty significant capacity increase in the third quarter so I assume that means your second quarter capex spend is going to be pretty high. Am I correct in understanding that? Do you think you'll be back on about 50% of the budget spent by mid year or is it still a little bit more back end loaded?

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

It's not likely it's going to be 50% of the whole year budget and I think it is slightly back end loaded. I would say it's 45% first half and 65% second half.

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

So that's second quarter, third quarter, the two quarters that was the heavily capex.

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**Operator**

And I would like to now turn the call back over to Ms. Ho.

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

Okay thank you very much for your participation and we're looking forward to seeing you next quarter. Good bye.

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

Thank you.

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**Operator**

Before the conclude the TSMC's first quarter 2007 results webcast conference call today, please be advised that the replay for the conference call will only be accessible through TSMC's website at [www.tsm.com](http://www.tsm.com). Thank you all. Have a good.

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