

FINAL TRANSCRIPT

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TSM - Q2 2008 TSMC Earnings Conference Call

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Schottenfeld Group - Analyst

Pranab Sarmah

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Timothy Arcuri

Citi - Analyst

Dan Malcolm

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PRESENTATION

Operator

Welcome to TSMC's Second Quarter 2008 Results Webcast Conference Call. Today's event is chaired by Ms. Lora Ho, Chief Financial Officer and Vice President, and Dr. Rick Tsai, Chief Executive Officer and President.

This conference is being webcasted live via TSMC website, www.tsmc.com, and only in audio mode. Your dial-in lines are also in listen-only mode.

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At the conclusion of management's presentation, we will be opening the floor for questions. At that time, further instructions will be given as to the procedure to follow if you would like to ask any questions.

Please be advised, for those participants who do not yet have a copy of the press release, you may download it from TSMC's website at www.tsmc.com. Please also download the summary slides in relation to today's quarterly review presentation. Once again, the URL is www.tsmc.com.

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

Elizabeth Sun - TSMC - Head of IR

Thank you, Lacy.

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 the management's comments about TSMC's current expectations made during this conference call are forward-looking statements subject to significant risks and uncertainties, and that actual results may differ materially from those contained in the forward-looking statements.

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 15, 2008, and such other documents as TSMC may file with or submit to the SEC from time to time.

Except as required by law, we undertake no obligation to update any forward-looking 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.

Lora Ho - TSMC - CFO and VP

Thank you, Elizabeth. Good morning and good evening to everyone. Welcome to our Second Quarter 2008 Earning Conference Call.

Today, I will first go over the highlights from our second quarter 2008 results, then I will give you the outlook for the third quarter 2008. Please refer to the quarterly financial summary slides on our Website. All dollar figures are in TWD dollars unless otherwise stated.

Now, I'm on page three. Let me go over some highlights for the quarter. Our second quarter business sees a solid improvement from the previous quarter.

We shipped 2.3 million eight-inch equivalent wafers, which was about 6% more compared to the previous quarter. TWD dollars appreciated 3.7% on average over the quarter, and it had a negative impact to our reported revenue and margins. In spite of that, we are still able to deliver the results that meet our guidance.

Our revenue was TWD88.1 billion, and our gross margin and operating margin were 45.6% and 34.5% respectively. EPS was TWD1.12 for the quarter, slightly up from first quarter. Free cash flow generated during the second quarter totaled TWD23 billion, down from last quarter by 46%, and return on equity was 24.2%.

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Let's take a closer look at our income statement for sequential and year-over-year comparisons. Please let me remind you that the accounting numbers reported for 2007 do not reflect the effects from the employee profit sharing expensing. This is a major difference from 2008.

That being said, our second quarter revenue increased 0.8% sequentially and 17.6% year-over-year. Gross margin rate compared with first quarter '08 increased 1.9 percentage points, and operating margin rate increased 1.2 points, mainly due to a significant cost improvement and a higher level of wafer movement, partially offset by the unfavorable exchange rate.

Non-operating income was TWD1.7 billion, and we booked TWD300 million long-term investment gains from the quarter. Net profit margin rate was 32.6%.

Now, let's examine our revenue by applications. On a quarter-over-quarter basis, revenue from Consumer Applications increased 24%, while revenue from Communication and Computer Applications declined 2% and 8% respectively. Overall, revenue from the Computer, Communication and Consumer Applications accounts for 31%, 41% and 21% of our wafer sales.

In terms of revenue by technology, we continue our strong ramp of 65-nanometer during the quarter. Revenue from 65-nanometer accounted for 18% of our wafer sales, up 3 percentage points sequentially. We expect to see continuing strength in the ramp-up of our 65-nanometer business of the year.

Total revenue from Advanced Technologies accounted for 63% of wafer sales, flat from the previous quarter.

One page eight, now let's move on to the balance sheet and the cash flow statement. We ended the quarter with TWD224 billion in cash and in short-term investments, up from TWD210 billion in the last quarter.

Average collection days of accounts receivable came down one day to 42 days, while days of inventory came up by one day to 47 days. Our net fixed asset turnover was 1.3 times.

Total cash inflow generated from operating activities in the second quarter reached TWD45 billion. Capital expenditure was TWD22.3 billion, which was TWD7 billion more than the first quarter.

Free cash flow went up to TWD23 billion, mainly due to a tax payment of TWD10 billion and the more capital expenditure in the quarter. There were a TWD6.6 billion spent for share buyback. Short-term investment increased by TWD25 billion. We ended the second quarter with TWD41 billion more cash.

Now, let's turn to capacity and CapEx. Total installed capacity for the second quarter was about 2.3 million 8-inch equivalent wafers, about 6% more compared with the first quarter.

We expect the third quarter capacity to be 2.4 million wafers, up 5% sequentially. 2008 capacity is expected to reach 9.4 million wafers, up 13% year-over-year, with 27% growth for 12-inch wafer capacity.

We spent US\$728 million in CapEx during the second quarter. Total CapEx for the first half of 2008 reached US\$1.2 billion. Our CapEx number for 2008 remains at around US\$1.8 billion, unchanged from previous guidance.

With that, let me give you the outlook of the third quarter of 2008. Based on current business expectations and a forecast exchange rate of TWD30.2, we expect our consolidated revenue to come in between TWD90 billion to TWD92 billion.

In terms of margins, we expect our third quarter gross margins to be between 45% and 47%. Operating profit margins will be between 34% to 36%.

This concludes my remarks today. Now, I will turn the call over to Dr. Rick Tsai, our CEO, for his remarks.



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Rick Tsai - TSMC - CEO and President

Hello, everyone. I have a few comments to make before we start our Q&A session.

First, I'd like to comment on the business outlook. Due to the slowing global economic outlook, we expect this year 2008, the growth in semiconductor industry, to be about 4% which is at the low end of our previous forecast. We previously forecasted 4% to 6% for the semiconductor industry.

We believe foundry industry skill will outperform the semiconductor industry by several points, and we believe TSMC will outperform the foundry industry in 2008.

Next, as our guidance indicated, the third quarter revenue in US dollar terms is expected to grow at about 3% to 5% sequentially. This is well below our seasonal average of 10% in the past five years. And we also expect our business to turn weaker as we exit the third quarter. However, we expect the strong momentum in the demand for 65-nanometer technology to continue.

Now, I'd also like to comment on the price adjustment and the customer reaction. Many of you have raised the question. In the last two months, we have communicated with our customers that we will firm up our prices for the advanced process technologies as of the first quarter 2009.

The action is taken for the purpose, as we have communicated several times before already with you, to protecting the structure profitability of TSMC and also to partially cover certain unexpected increases in our manufacturing costs; for instance, the price increase from the utility and the cost increase from the materials, etc., etc.

And for some pricing specifics, I would like to say that to any one specific technology, our average 2009 price across the year will not be higher than that of the 2008 average.

As to the customer, different customers responded differently to our new prices. We have worked hard and diligently with them. I think by now most of them have decided to continue to work with us on a long-term win/win business relationship.

Many of you also asked about the potential impact to our business. I believe the price action that we have proposed will not have much impact to our business in 2009.

In conclusion, I believe that through our capabilities and diligence TSMC will continue our position as the largest total value provider to our customers. We have their confidence, and we will make that happen.

Thank you.

QUESTIONS AND ANSWERS

Operator

At this time, we will open the floor to questions. (OPERATOR INSTRUCTIONS.) Randy Abrams, Credit Suisse. Please proceed.

Randy Abrams - Credit Suisse - Analyst

Yes, hi. Good evening.

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I wanted to ask a follow-up on the price income and where you mentioned 2009 won't be up versus 2008. Could you talk about-- is the pricing outcome what you were expecting coming into discussion with customers? And now, what were the implications? Should we expect slower price erosion on a node-for-node basis and potentially up for blended ASPs?

Rick Tsai - TSMC - CEO and President

Randy, I think you're right. I mean, I believe you're right.

For any specific technology, we have the pricing, as I just said, not higher than the average of 2008. We, of course, have slowed down the decline of the 2009 prices. And of course, as the mix continues to migrate, I think the blended pricing can go either way, yes.

Randy Abrams - Credit Suisse - Analyst

Okay.

And on the cost pressure where you talk about some inflationary pressures, maybe discuss the magnitude of some of the big variables we've heard, like energy costs, raw materials. And then, for operating expenses, do you see any inflationary pressures? How should we expect OpEx to trend the next few quarters?

Lora Ho - TSMC - CFO and VP

On the cost front, the inflation cost, many on the utility costs and also some other costs associated with utility cost increase. There were many forecast on the cost of sales area, not too much on the operating expenses.

In terms of the magnitude, we believe the impact will not be very significant. We were thinking about the low single digits in our range, and we are trying to do everything we can to manage our costs. So, we're trying to reduce the impact to our bottom line.

Randy Abrams - Credit Suisse - Analyst

Okay.

And one final question for 45 and--.

Operator

(--OPERATOR INSTRUCTIONS.) Shailesh Jaitly, Nomura Securities. Please proceed.

Shailesh Jaitly - Nomura Securities - Analyst

Yes, hi. Thanks for taking my question.

Firstly, for 0.11 and 0.13 micron, there was a quite a pronounced decline. So, if you could today, right, as to what product segments is it coming from? Is it more fabless of IDMs and [trick]?

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Rick Tsai - TSMC - CEO and President

I don't believe we have those numbers at hand. Most of the-- probably decreased as migration into 90-nanometer and 65-nanometer.

Lora, do you have that?

Lora Ho - TSMC - CFO and VP

We do not see it coming from fabless in IDM because our fabless percentage in IDM, it's maintained the same as first quarter. So, I would say it's not coming from specific areas.

Shailesh Jaitly - Nomura Securities - Analyst

And the price actions, you said they're instituted primarily for the advanced nodes. So, would you characterize this 0.11 and 0.13 micron also was underpriced in negotiations or no?

Rick Tsai - TSMC - CEO and President

Yes, the price action we just mentioned covered both 0.11 micron and the 0.13 micron.

Shailesh Jaitly - Nomura Securities - Analyst

Okay.

And is there any possible market shifts in that segment?

Rick Tsai - TSMC - CEO and President

No, we don't believe so, not because of the pricing action, no. I think it's more a mix shift from node-to-node.

Operator

(OPERATOR INSTRUCTIONS.) Mehdi Hosseini, FBR. Please proceed.

Mehdi Hosseini - FBR - Analyst

Yes, thank you. It's Mehdi Hosseini with FBR.

During your prepared remarks, you talked about Q3 ending on the weak side. If you could elaborate on it, and where is that weakness coming from? Is there any specific area, or is it across the board?

And then, also, if you could elaborate on utilization rate across difference technology nodes.

Thank you.



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Rick Tsai - TSMC - CEO and President

When we said it would turn weaker exiting Q3, we mean basically the impact will be significant in the month of September. I think we're seeing the impact across the board. It's demand in dues phenomena. I think the macro business environment is the main cause for that.

Lora Ho - TSMC - CFO and VP

Regarding the utilization by node, in general, our advanced technology we've had is still very, very high. And our mainstream utilization is high, but not as high as advanced technology.

Operator

Patrick Ho, Stifel Nicolaus. Please proceed.

Patrick Ho - Stifel Nicolaus - Analyst

Thank you very much.

Can you give us an update in your progress on the microprocessor front and how you plan to add capacity? Would it be for the 4X technology node or beyond that?

Thank you.

Rick Tsai - TSMC - CEO and President

Okay.

I think the status of the microprocessor area has not changed a great deal as we reported in the last quarter conference call. Basically, it's moving as we expected.

The products will start with the 40-nanometer technology. We are also working with the customers on the 32-nanometer technology node. Again, this is a fairly new application for TSMC. We have invested significantly in this area. We expect to this bear fruit. So, it'd probably be more toward late 2009.

Operator

Steven Pelayo. Please proceed.

Steven Pelayo - HSBC - Analyst

In your earlier meetings, you spoke a lot about how this is more of demand-driven. You didn't think your customers had much excess inventory. So, in past cycles, when we did have excess inventory, that would usually lead to one or two quarters of 10% sequential declines.

So, my question's really do you think we don't have to use history as a guide here, and do you think your fourth quarter or first quarter don't need to see those similar kind of magnitudes of decline?

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Rick Tsai - TSMC - CEO and President

It is very difficult for us to predict the decline in the upcoming quarters. The visibility for the fourth quarter right now is low.

It is correct, again, to say that the inventory level we saw customers face remains, I think, at a reasonable level. Now, the customers-- if you look at the days of inventory numbers for our customer base at the end of the second quarter, you'll see the number has actually come down a little bit compared to at the end of the first quarter.

Customers have certainly paid a lot of attention to their inventory, and they have managed their inventory in a very timely manner. And certainly, it's showing up in our third quarter guidance numbers.

For that, we feel relatively comfortable with the inventory situation. So, that's not what I can say about the demand picture because it's quite unpredictable.

As you know, the situation in the US has been weak for a period of time. And for the China market, this year, so far, it has been rather mute, I would say. But, if the demand picture turns somewhat better than we expected, then the situation can also turn better more quickly than before.

Steven Pelayo - HSBC - Analyst

Okay.

My second question is your capital spending came up a lot in the second quarter. It looks like you spent about two-thirds of your budget in the first half of the year, yet your guidance for the third quarter on gross margin really implies that maybe there's not a big increase in depreciation there. You guys are putting up some very impressive gross margins at these levels.

Can you talk about your depreciation, both overall as well as the portion in cost to goods sold for the remainder of 2008? And then, also, your competitor yesterday talked about their depreciation declining 10% next year. What is your early thoughts on depreciation impacts to margins next year?

Lora Ho - TSMC - CFO and VP

Steven, on depreciation, I don't have the number in front of me regarding how much in the third quarter and the fourth quarter. But, I can tell you this year's depreciation over last year is about a 2% increase.

And you also consider about 2009 depreciation would have to depend on our CapEx which we're actually watching now. Okay, okay. Let me finish that 2009 (inaudible). We believe even there is the increase in depreciation, it will be a very small increase for 2009.

And I just come back to you on the third quarter depreciation, I got a number in front of me. On a consolidation basis, our third quarter depreciation will be around 4% higher than second quarter.

Operator

Bill Lu, Morgan Stanley. Please proceed.



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Bill Lu - Morgan Stanley - Analyst

Yes, hi. Good evening.

My first question is I'm hoping you can just talk a little bit about what you see competitively because if I look at the results so far 2Q, it looks like the gap at profitability is getting bigger and bigger between you and your competitors. And yet, if I look at the growth weight, especially the trading edge, it also looks like some of your competitors have grown faster at the 0.13 and above.

Is it your view that your competitors are kind of pricing irrationally? What are you seeing out there?

Rick Tsai - TSMC - CEO and President

Let me think. The mainstream technology actually in the second quarter, capacity was fully loaded or close to very fully loaded. We have not increased our mainstream technology capacity this year.

Our firming-up pricing action is also up high to mainstream technology. We have-- but, on the other hand, I think the competitors for mainstream technology covers a wider spectrum, more than the usual ones we discuss.

So, it is more difficult to predict the pricing situation in the mainstream technology arena compared to the advanced technology area.

Bill Lu - Morgan Stanley - Analyst

I guess my question is you're talking about a structural profitability. When you look at your competitors, do you feel like they're kind of thinking about this the same way, or are they still acting the same of what they've acted in the previous years?

Rick Tsai - TSMC - CEO and President

It is very difficult for us to know right now, to be very frank, mainly because, as I said, the mainstream technology as a player, I mean, we can count more than 10 of them (inaudible). Not all of them think the same way, especially with respect to structure profitability, I think. It is more unpredictable compared to advanced technology.

Operator

Bhavin Shah, JP Morgan. Please proceed.

Bhavin Shah - JP Morgan - Analyst

Yes, just a clarification on the outlook for the industry in terms of growth exceeding, you said, 1 percentage point. I would assume that semiconductor industry growth is measured in US dollars. But, when you mentioned that comment on the foundry and your outperformance, is that in US dollars or Taiwan dollars?

Rick Tsai - TSMC - CEO and President

Bhavin, US dollars. When we talk about growth rate, we use US dollars as the basis.

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Bhavin Shah - JP Morgan - Analyst

Okay.

And I ask this question because if I translate several points into sort of a single-digit number, it would imply a very low growth in Taiwan dollars for TSMC and it would imply a big drop in revenues in Q4. So, that's why I asked that question.

Rick Tsai - TSMC - CEO and President

Well, we'll see whether it's a very low number or not later.

Bhavin Shah - JP Morgan - Analyst

Okay.

Lora Ho - TSMC - CFO and VP

Bhavin, we don't know what the exchange is going to be.

Bhavin Shah - JP Morgan - Analyst

Okay.

Well, I think it's just on a one-year basis, even if you assume flat exchanges from here on, that is a 5 to 6 percentage impact on your growth to differentiate, basically, between US dollar and Taiwan dollar. And then, in the year-end rates, growth rates are generally low anyway. That makes a big difference in (inaudible) in your comment. That's why I asked.

Lora Ho - TSMC - CFO and VP

Yes, exactly. For example, 2008, we are experiencing quite significant anti-dollar appreciation.

Bhavin Shah - JP Morgan - Analyst

Um-hmm.

Lora Ho - TSMC - CFO and VP

So, the growth rate between local currency and US dollar will be big.

Operator

Dan Heyler, Merrill Lynch. Please proceed.

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Dan Heyler - Merrill Lynch - Analyst

Hi, I had a question on the technology mix. You've talked about 65-nanometer ramping aggressively and that's on track. And leaving the year, I believe the fourth quarter is over 20%.

Given visibility in the business is fairly limited, what's driving your confidence that 65 will continue to ramp to year-end?

Rick Tsai - TSMC - CEO and President

We believe the major runner for the 65-nanometer or 55-nanometer, the migration from 90-nanometer or 80-nanometer is moving very smoothly and very rapidly, especially in the graphics areas, followed very closely by the handset wireless area, that we have other products actually taped out being either prototype or close to coming to production.

So, the momentum you can see, as I said earlier in the afternoon, we can see a strong and healthy backlog of the 65-nanometer tape-outs for productions. So, we're fairly confident about that.

Dan Heyler - Merrill Lynch - Analyst

Okay, great.

And on a follow-up on that then, I guess since there's a migration taking place, what would be the margin implications of products migrating forward from, say, 90 to 55 given the-- is there efficiency gains there inside TSMC that implies that you have some margin upside from that migration, or is that passed on? Are those gains passed on to your customers?

Rick Tsai - TSMC - CEO and President

Dan, on the-- from a margin point of view, our structure profitability improvement efforts, as you know, apply to both 90-nanometer and 65-nanometer. The objective is to have the margin at a similar level for either technology and also at a better level compared to before.

Operator

Matt Gabel, Schottenfeld Group. Please proceed.

Matt Gabel - Schottenfeld Group - Analyst

Hi, I missed the part about-- what is normal Q3 seasonality for you on a sequential basis?

Rick Tsai - TSMC - CEO and President

It should be about 10%. I don't know.

Matt Gabel - Schottenfeld Group - Analyst

Okay, that's--.

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Rick Tsai - TSMC - CEO and President

--During the last five years.

Matt Gabel - Schottenfeld Group - Analyst

Okay, thank you very much.

Rick Tsai - TSMC - CEO and President

Sure.

Operator

Shailesh Jaitly, Nomura Securities. Please proceed.

Shailesh Jaitly - Nomura Securities - Analyst

Yes, hi, thanks.

If you could just clarify the reasons for that margin expansion which is there in your statements, higher level of wafer movements, how exactly does it work?

Lora Ho - TSMC - CFO and VP

Okay, I can explain a little bit better about high level of wafer movements.

We're talking about on the same stat of equipment, same number of equipments. With additional investments, we can produce more wafers. Either coming off on our output, they move faster, so stay in the width.

So, by doing that, actually we are talking that we have higher productivity. So, then, the margin will be better considering construction is heavily fixed cost in nature.

Shailesh Jaitly - Nomura Securities - Analyst

So, it's just improvement in productivity.

Lora Ho - TSMC - CFO and VP

Yes.

Shailesh Jaitly - Nomura Securities - Analyst

I understand.

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And Rick, you normally provide some more color in terms of the products outlook, right? I do understand the computer has been weak, continues to be weak, but if you could also provide some more color, right, as to which products are doing all right as we go into 3Q, and where you see more pronounced weakness?

Rick Tsai - TSMC - CEO and President

So, for third quarter, computer has a slight growth in the third quarter compared to the second quarter. The hard disc drive area, I think, looks strong, at least for the third quarter. Other areas, it's fairly average, I would say.

Operator

Pranab Sarmah, Daiwa Securities. Please proceed.

Pranab Sarmah - Daiwa Securities - Analyst

Thank you.

I have, again, questions about the time quarter margins. I know you talk about the margin improvements is mainly (inaudible question - background noise).

Lora Ho - TSMC - CFO and VP

I can't hear you clearly. Can you say again?

Pranab Sarmah - Daiwa Securities - Analyst

Yes. The third quarter improvement margin, improvement guidance, is it also partly due to the improvement in utilizing (inaudible) for 8-inch span?

Lora Ho - TSMC - CFO and VP

In general, it's good in the third quarter for both 12-inch and 8-inch.

Pranab Sarmah - Daiwa Securities - Analyst

I'm just trying to figure out, like if due to some reason 8-inch utilization rate drops at some point, do you think that your margins would be adjusted to affect that? Just to give us color of whether your 8-inch margins are still better than that 12-inch margins.

Lora Ho - TSMC - CFO and VP

It's generally right. Our 8-inch product margin is generally better than 12-inch for a very simple reason. Most of our 8-inch has been fully depreciated.

Operator

Timothy Arcuri, Citi. Please proceed.

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Timothy Arcuri - Citi - Analyst

Hi, guys. Not sure if you actually commented on this because I actually joined late, but can you give some indication-- and it might be a little early. But, can you give some indication of what you're thinking in terms of kind of the trajectory of spending as you exit the year and you kind of move into next year?

I would think that your CapEx will be up next year at least a little bit. But, I'm just kind of wondering what you're thinking at this early stage.

Thanks.

Lora Ho - TSMC - CFO and VP

Our 2009 CapEx is still being worked out, and we don't have the number in front of me. But, if we talk about longer range, we believe in the longer range our capital expenditure versus our revenue will be lower than in the past five years. I mean, capital intensity will be lower in the future.

Timothy Arcuri - Citi - Analyst

Okay.

So, you think that even though you're aggressively pushing to 65 and soon 45-- so, you don't think capital intensity at those nodes is actually higher so that actually capital intensity will go up; rather, you think that it will go down?

Lora Ho - TSMC - CFO and VP

Yes, for a longer period of time, that's what we mean.

But, there's-- another factor is actually with the scale we have today and the productivity effort we've been putting on the fab, and we can gain productivity even without adding any capacity every year.

Operator

Bill Lu, Morgan Stanley.

Bill Lu - Morgan Stanley - Analyst

Yes, hi.

Just a quick question. I think this was asked earlier, but I don't think I heard the answer. OpEx in Q2 was up about 8% quarter-on-quarter. Can you just help me with how I should mumble that going forward?

Lora Ho - TSMC - CFO and VP

Operating expense you're talking about?

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Bill Lu - Morgan Stanley - Analyst

Yes.

Lora Ho - TSMC - CFO and VP

If you look at percentage to revenue, it was 10% in the first quarter; about 11% in the second quarter. So, I would think that that number won't change much as we have seen in our past history.

Bill Lu - Morgan Stanley - Analyst

Okay, great. Thank you.

Operator

Steven Pelayo, HSBC. Please proceed.

Steven Pelayo - HSBC - Analyst

Yes. I actually had a follow-up on the operating expense question. I'm curious about how much you can flex those in the event that your revenues did decline 5% to 10% in both the fourth and the first quarter? How much of that operating expense is just kind of fixed and how much of that can you actually scale down as well?

Lora Ho - TSMC - CFO and VP

I would say the scalability is not big because we've been running very stable operating expense, but we want to invest more in R&D. So, we will not reduce R&D expense to a big degree. Of course, when you talk about quarter-over-quarter, there are always-- has some more changes, but I don't expect the number is going to be big.

Steven Pelayo - HSBC - Analyst

Okay.

Well, just looking back here in the past then, on your SG&A line, they were 20% lower, I guess you could say, when you were at a revenue level of around TWD80 billion or so. I'm just curious if revenues did get back to there. Do you think your OpEx could get back to that level as well?

Lora Ho - TSMC - CFO and VP

There is a new factor. I have to tell you that because this year we start to expand employee profit sharing. Some of the expense goes to operating expense as well. If the profit goes down, driven by if revenue goes down, the operating expense will be smaller based on that factor. So, that's a new factor which we don't have in last year.

Operator

(OPERATOR INSTRUCTIONS.) Dan Heyler, Merrill Lynch. Please proceed.



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Dan Heyler - Merrill Lynch - Analyst

Hi, guys.

I had a follow-up on CapEx. With only about TWD600 million or so left to spend this year versus the first half of TWD1.2 billion, I'm wondering what the capacity growth will look like in the first or second quarter. Will there still be capacity growth, or will it be mostly flat or potentially down, I guess, since you're upgrading capacity?

Lora Ho - TSMC - CFO and VP

I think we see the second quarter capacity 6% and--.

Dan Heyler - Merrill Lynch - Analyst

--I meant next year, Lora.

Lora Ho - TSMC - CFO and VP

Next year, we have not decided yet.

Dan Heyler - Merrill Lynch - Analyst

Yes.

Rick Tsai - TSMC - CEO and President

But, Dan, you know that we're going to start ramping the 40, 45-nanometer capacity next year, first quarter and second quarter.

Dan Heyler - Merrill Lynch - Analyst

Okay.

So, the TWD600 million that you're spending in the second half is equipment, that that would start production and being turned in the first quarter?

Rick Tsai - TSMC - CEO and President

Some of that.

Lora Ho - TSMC - CFO and VP

Yes.

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Rick Tsai - TSMC - CEO and President

Yes, some of it will go to 45-nanometer. Of course, much of it will also be happening in the first half of next year.

By the way, I do have one thing to correct for my earlier comment on the third quarter business in the computer area. I said the hard disc drive business will grow. I was incorrect. Actually, hard disc drive business for us will decline. The graphics and the PC chip set will instead grow. I apologize for that.

Dan Heyler - Merrill Lynch - Analyst

Okay, thanks.

And I guess I'll ask my second question.

Rick Tsai - TSMC - CEO and President

Um-hmm.

Dan Heyler - Merrill Lynch - Analyst

It was relating to the follow on the 40 to 45 question, Rick. In the past, you guys have been pretty capable at adding a small amount of production initially.

So, what I'm wondering is under what circumstances would you make a bigger investment in a full production line on your 40 to 45? Because currently, you're producing that, I guess, in your existing facilities. So, before you move to your next full production line, would you move it a 10K scale, or would you want to revolve that out to kind of a full 20K scale quickly?

Rick Tsai - TSMC - CEO and President

This, of course, Dan, is a strong function of the customer demand. As I said in the afternoon earlier, that we're seeing a strong demand for our 40-nanometer process. We are building capacity with close cooperation with our customers.

Whether and when the 10K per month capacity will be installed remains to be seen. I don't think we have made the final decision on that yet. One thing we're sure, though, is we will put in the equipment for 45-nanometer production by the end of the year, this year.

We are rushing the building of our next wafer fab in Changzhou. We definitely plan to also start production of 45, 40-nanometer in that new fab, also, in the first half of next year.

Operator

Randy Abrams, Credit Suisse. Please proceed.

Randy Abrams - Credit Suisse - Analyst

Yes, I wanted to ask a question on the buyback earlier in the quarter. Talk about the rationale for pulling back on that amount. And do you still plan additional buybacks next year, or do you want to move back to purely dividend paths?

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Lora Ho - TSMC - CFO and VP

On the buyback, I think this year's buyback, as you know, is part of the program helping Philips to exit their holding in TSMC. So, the program started in the middle of May and ended end of June.

During that period, our share price actually outperformed. The major Index would say our share price's holding very well. So, we did not buy to the full amount as we had planned, so we only buy around less than 50%.

In the future, I think regarding our capital management, our preferred means is still returning cash to shareholder in cash dividend. Of course, we'll also consider buyback in addition, though, to offset Philips' sell down, also partially to remove some of the dilution from employee profit sharing on stock dividends when the share price is low.

Randy Abrams - Credit Suisse - Analyst

Okay, thank you.

And on graphics, a customer of yours discussed a recall in notebook graphics this past quarter from overheating. Could you discuss if there's any issues or areas you need to step in to help share the damage, or were you uninvolved in that issue?

Rick Tsai - TSMC - CEO and President

We are not responsible for that, but we cannot really comment on our customer's issues.

Operator

Dan Malcolm, Moore Capital. Please proceed.

Dan Malcolm - Moore Capital - Analyst

Hi, guys. Just a quick question on the 3Q guidance again, if you could clarify.

I know you went through computer and hard drive, but could you just-- normal seasonality is up 10% sequentially. You guys are guiding for less than that. Can you just walk through the puts and takes of what's better or what's worse versus normal seasonality on a segment basis?

Thanks.

Rick Tsai - TSMC - CEO and President

Hello? It is difficult for us to walk through all segments in comparison to the seasonality. However, what I can say is for the communications, the wireless, in general, will grow over the handset. It's not as strong. Wireline actually will be growing fairly well.

For the computer area, graphics and the chip set will grow, but hard drive and LCD monitor will not. In the consumer area, your game player and your set-up box will grow, but DVD will not grow.

Seasonality-wise, it's very difficult for us to compare.

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Operator

(OPERATOR INSTRUCTIONS.)

Elizabeth Sun - TSMC - Head of IR

Operator, if there is no more questions, I think we can end our conference call as of now. Thank you.

Operator

Before we conclude TSMC's 2008 Second Quarter Results Webcast Conference Call today, please be advised the replay for the conference call will only be accessible through TSMC's Website at www.tsmc.com. Thank you all.

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