FINAL TRANSCRIPT

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PRESENTATION

Operator

Welcome to TSMC's first quarter 2009 results webcast conference call. This conference call is being webcast live via the TSMC website at www.tsmc.com, and only in audio mode. Your dial-in lines are also in listen-only mode. I would now like to turn the conference over to Dr. Elizabeth Sun, TSMC's Head of Investor Relations.

Dr. Elizabeth Sun - *TSMC Ltd. - Head, IR*

Thank you, Dan. Good morning and good evening, everyone. Welcome to TSMC's first quarter 2009 conference call. Joining us on the call are Dr. Rick Tsai, our Chief Executive Officer and President and, Ms. Lora Ho, our Chief Financial Officer and Vice President.

The format for today's conference call will be as follows. First, Lora will summarize our operations in the first quarter and give you our guidance for the second quarter. Then Rick will provide more detailed remarks on the business outlook before we open the floor for questions. 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.

I would like to remind all listeners that the following discussions may contain forward-looking statements that are subject to significant risks and uncertainties which could cause actual results to 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 17, 2009, 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 statement, whether as a result of new information, future events or otherwise.

And now I'll turn the call over to Lora.

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

Thank you, Elizabeth. Good morning and good evening to everyone. Welcome to our first quarter 2009 earnings conference call. First, I will go over the highlights of our first quarter. Then I will give you the outlook for the second quarter 2009. Please refer to the quarterly financial summary slides on our website. All dollar figures are in NT dollars, unless otherwise stated.

First, the highlights of the fourth quarter are as following. In the first quarter we experienced the most severe sequential decline in sales since Company's inception. Profitability was also under challenge. However, starting from February, as the result of customer demand improvement, quick orders, along with stringent cost and expense control, our first quarter results were better than previously revised guidance and remained profitable.

Net sales were TWDD39.5b, 38.8% decline over last quarter. Wafer shipments was 892,000 8-inch equivalent Wafers, 42% decline over last quarter. Compared with the fourth quarter '08, both gross margin and operating margin were lowered. Each declined 12.4 percentage points and 15.5 percentage points. EPS declined to TWDD0.06. And our ROE for the first quarter was 1.3% in the first quarter.

I'm in page five now. Let's take a closer look at our income statement. As I said earlier, on a q-over-q and year-over-year basis, first quarter revenue declined 38.8% and 54.8% respectively. Gross margin also declined by 12.4 percentage points and 24.8 percentage points. Operating expenses declined TWD1.9b. It was primarily due to lower expenses in profit sharing, less a 40 nanometer R&D and the stringent expense control.

Non-operating income was also lowered by TWD1b, primarily due to low interest income as a result of decrease in interest rate and disposal and loss of the financial assets. For long-term investment, still in loss, it was TWD0.8b loss in the first quarter as the result of weak business conditions in our three key invested companies. For net margin it was 3.9%, representing 15.4 percentage points decline from last quarter -- from last quarter's 19.3%.

On page six, now let's examine our revenue by application. Across the board Wafer sales declined sequentially. It was 37%, 54% and 34% q-over-q decline rate for Communications, Computer and Consumer respectively. Overall, revenue from Communications, Computer and Consumer applications accounted for 46%, 26% and 21% respectively of our Wafer revenue in first quarter '09.

In terms of revenue by technology, total Wafer sales generated from advanced technologies remained at the same level, accounting for 65% of total Wafer sales. For 40 nanometer it reached 1% of our total Wafer sales in the first quarter. This is quicker than our earlier expectation.

Now let's move on to balance sheet and cash flow statements. We ended the first quarter with TWD230b in cash and short-term investment, TWD18b higher than last quarter. Accounts receivable continued to decline, to TWD13.8b. Days of receivable were also lowered by eight days. Both reflected low business activities in the first quarter.

For inventory, it slightly declined q over q, while inventory turnover days increased four days to 44 days, reflecting improved business outlook in the second quarter. Our balance sheet remained very strong. Current ratio increased to 5.96 in the first quarter.

In cash flow, total cash inflow generated by operating activities was TWD26.8b as a result of sales decline in the first quarter. CapEx expenditure was TWD5.6b, almost half cut from last quarter. In financing activities, we repaid TWD8b of corporate bonds. For other cash inflow it was mainly generated by selling short-term investments. In sum, the ending balance was TWD223b, TWD29b more than last quarter. Free cash flow was TWD21b, TWD30.8b lower than last quarter.

On page 10, now let's turn to capacity and CapEx. Total installed capacity was about 2.5m 8-inch equivalent Wafers in the first quarter, less than a 1% increase from last quarter. For 2009 overall capacity is forecasted to be about 9.95m 8-inch equivalent Wafers, a 6% increase over 2008. While advanced technology capacity is forecasted to be increased by 11% year over year, reaching 42% of our total capacity in 2009.

We spent $166m in CapEx during first quarter, almost cut half from last quarter.

Now let me give you our outlook for the second quarter of 2009. Although global economic conditions continue to decline, a few signs of economic stabilization begin to emerge. Consumptions of electronics in the last two quarters significantly exceeded production and surpassed semiconductor companies' low expectations.

The dynamics have resulted in a substantial increase in order level. After a sharp decline in two consecutive quarters, TSMC is seeing a strong rebound in its second quarter business. With that, based on our current business expectations and a forecast exchange rate of TWD33.62, we expect our consolidated revenue in second quarter of 2009 to come in between TWD71b and TWD74b.

In terms of margins, we expect our second quarter gross margin to be between 43% and -- 43.5% and 45.5%. Operating margin to be between 30.5% and 32.5%.

2009 capital expenditure will be around $1.5b.

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

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Hello. I'd like to make some comments on the first quarter business, the second quarter business and for the rest of the year. In addition, I will also comment on the progress we have made and some of the decisions we have made as far as the investment is concerned.

For the first quarter this year you have seen the numbers. Basically, back in January time, I think we have seen the bottom of the sharp decline. The booking started to improve and it continued also to improve into February, March and April.

Inventory on the customer side has been going down very quickly. If we look at some of the data the GDP report, for the fourth quarter 2008 in the US we could see the numbers showing the consumption of the electronics fell about 8% year over year. Shipments of the electronics fell about 10% year over year. And shipments of the semiconductor fell about 20% year over year, while the shipment from foundry fell 30% to 40%.

Looking back, it is not surprising that, with such imbalance in the shipment and the consumption for the semiconductors, that the orders would start to come back around late January, February timeframe.

Now for the second quarter, again, as you have seen from our guidance, we are having a very strong rebound in the second quarter compared to the first quarter of 2009. The revenue growth quarter over quarter is greater than 80%. It is the highest in our Company history. Again, we believe this reflects the very sharp and severe inventory management measures taken by our customers and their customers in the -- starting in, I think, October last year into the first quarter.

However, if we look at the picture in a different perspective, as strong as the second quarter looks from a quarter-over-quarter point of view, year over year the second quarter revenue is still about 18% -- 18% lower compared to the second quarter 2008.

We believe these numbers demonstrate that the order level, if you count the ordering during the last three quarters, that is the fourth quarter 2008, first quarter 2009 and the second quarter 2009, and compare it to the semiconductor Company shipment, they are roughly in line. The growth in the second quarter revenue is quite broad-based across all key segments.

We also have a look at the components of our second quarter shipment. We -- I'd like to share with you on what we have found. Basically, about 22% of our second quarter billings come from new products that our customers have launched since about the second half of last year.

And another 20%, 22% of the second quarter billing comes mainly because the Chinese market -- as many of you are aware, the China market has shown pretty strong pick-up in their electronics demand, possibly due to the many stimulus programs that the government have implemented in China. Of course, the rest is a combination of regular business needs as well as some of the inventory restocking.

As far as the pricing is concerned, certainly, in this kind of a very severe downturn, the pricing pressure is strong. But TSMC in the first quarter and going into second quarter has held, I think, our price reasonably well. We are seeing, certainly, some price decline, but we're not seeing abnormal price decline in 2009.

The cost, as Laura has described earlier, we have made very successful cost reduction over in the fourth quarter last year and first quarter this year. Some of the effort were more structured in nature and we, of course, continue doing that into second quarter. Plus the much improved utilization rate. So then we had a much lower unit cost and the pretty good gross margin for the second quarter.

Now let's look at the second half of the year. Following a strong rebound in the second quarter, we believe the second half of 2009 will be better than the first half of the year. Electronics sell through has been stronger than selling in the last six months. While there is inventory restocking we, however, believe that the inventory in aggregate is not excessive.

Our customers are still very cautious in their outlook for second half, however, have also been revising up their demand for the next two quarters. We now expect a slow improvement in the second half. We believe the third quarter should be flat or slightly better than the second quarter. And fourth quarter may be slightly slower than the second -- than the third quarter.

As far as the whole year 2009 is concerned, because of the sell through in the fourth quarter 2008 and the first quarter 2009 [it] was better than the previous, pretty conservative forecast, we now have revised our forecast for the system unit shipment to now minus 10%. We expect the electronic shipments, units wise, to be around negative 10% for the year of 2009. In more details, PC we expect unit shipment to decline by 8%, Handset to decline by about 12% and Digital Consumer Electronics about decline by 7%.

So, as a result, we also have revised the semiconductor industry revenue growth to decline by 20% in 2009 compared to 2008. Foundry, however, still will under-perform the semiconductor by five to 10 points.

Now let me update you on some of the progress we are making in the Company. First, 40 nanometer technology is ramping up, ramping very fast, ramping well. We have about 1% of our revenue in 40 nanometer in the first quarter of 2009. And we expect this revenue from 40 nanometer to be about 2% in the second quarter 2009. This has more than tripled from the first quarter and ahead of our earlier prediction.

Customers' adoption has been quite well. We now have -- we expect by the end of 2009 we will have engaged about 60 customers. We forecast to have over 100, 110, [take outs] from those customers in 40 nanometer technology.

28 nanometer technology is now being developed. The high-k metal gate technology we have also made some significant progress during the last couple -- the last few months. Our -- we -- for instance, we have now demonstrated functional [die] of very high density SRAM device using the high-k metal gate technology, a 64 megabit SRAM device. So it's quite a -- in my mind, quite an achievement.

While, then, the 55 and 65 nanometer process has been in production for quite some time, we are also seeing progress in that area. We believe the second quarter shipment from that technology will more than double that of in the first quarter.

Lastly, from a technology point of view, but we also have been investing heavily in our R&D into what we will call [more-than-more] technologies. Those are the ones like analog, high voltage embedded flash, CMOS image sensor and so on and so forth. We continue to invest in that and the -- we have also made pretty good progress. For instance, in the sensor technology we have developed, together with our key partner, what we call backside illumination technology, which will render a very high density sensor to be produced in a very low cost. This technology is now being moved into production.

So, overall, the TSMC also will invest this year very aggressively in R&D. And the R&D will cover, not only what we have been doing over the years, that is, investment in the leading edge process technologies. We are now, as I just said, also investing in the more-than-more technologies, also in the design technology and the back-end technologies.

We have decided this year, in this very difficult business environment, we are now in the process of hiring 30% more process R&D engineers as well as 15% more design engineers. This really demonstrates, I believe, TSMC's commitment in investing in R&D for our future.

On the CapEx side, we also said earlier that we are investing $1.5b this year. Most of the investment, over 70%, will be invested in Fab, in the 12-inch Fab for the 40 nanometer technology capacity expansion.

In the meanwhile, the construction and the facilitization of our newest Fab, Fab 12, phase four continues without any stoppage over in the several quarters. We now have all the clean rooms ready. We will start moving in process equipment for 40 nanometer capacity around mid this year. We also will start moving in R&D tools for 22 nanometer into that Fab.

So as you can see TSMC is very much committed to investing in the future, which includes both R&D and the capacity expansion. We certainly believe we will come out of this recession stronger and better.

That's my remarks. Thank you.

QUESTIONS AND ANSWERS

Dr. Elizabeth Sun - *TSMC Ltd. - Head, IR*

Operator, we can open the floor to questions now.

Operator

At this time, we will open the floor for questions. (Operator Instructions). Please limit your questions to two at a time with one follow up, to allow all participants an opportunity to ask questions to the management members. Your first question comes from the line of Randy Abrams from Credit Suisse. Please proceed.

Randy Abrams - *Credit Suisse - Analyst*

Yes, thank you. Good evening. First question on the gross margins. I want to see if you could outline some of the key changes on your gross margins to allow them to match where they got last year at much lower utilization.

And maybe a few things within that. If you could talk about depreciation, where you see it now running in 2009 based on $1.5b CapEx and, potentially, into 2010 directionally. And how do you see gross margins now if we were to get utilization to improve further?

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

Hi, Randy. On your question regarding margin, I think you see in our second quarter guidance, margin actually increased quite significantly. For these two quarters I think it's mainly contributed by the much higher utilization. And in first quarter our utilization was below 40%. In second quarter it was 70% plus. So, on these kind of conditions, every percentage of utilization is very sensitive to our gross margin. So this is the major contribution of the improvement.

In addition to that, we have done, as Rick just mentioned, some cost reduction activities, both structurally and also one-time cost reductions. We have been starting doing that in fourth quarter and also continue to the first quarter and second quarter. So this is another area that improved our margin in second quarter.

Your second question about depreciation for '09 and '10. For 2009, with the $1.5b capital expenditure, we expect the depreciation will be flattish to 2008. Last year our overall depreciation and amortization accounts for around TWD81b. The number for 2009 will be about the same.

For 2010, it's probably too early, but we think the overall depreciation will go down in 2010. And, in terms of what kind of magnitude, we have to -- it depends on the capital expenditure spending for 2010. But the trend [to] go down it's because the -- some of the equipments in 12-inch will be coming down from depreciation by 2010. So that is the overview of our depreciation status.

Randy Abrams - *Credit Suisse - Analyst*

Okay. And if you could talk about the capacity utilization. Where are you now on 12-inch versus 8-inch? And did you have to turn away business just due to lead times expanding or customers placing rush orders and wanting shorter lead times? And do you see any pockets of over-ordering, just as you've try to turn on capacity and not gotten the cycle times that customers demand?

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

The utilization for both 8-inch and 12-inch increased in second quarter, with 12-inch increased the most, much more than 8-inch. We are loading the Fab as much as possible. We will not turn down any customer request, and we have not.

Randy Abrams - *Credit Suisse - Analyst*

Okay. And do you -- are you close to the trigger point then, because I see your 12-inch capacity is actually going down a little bit sequentially and, I presume, from 40 nanometer ramping? But how close are you to the point? How much incremental business would it take to actually need to expand further?

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

Well, we are adding capacity right now. And our 12-inch utilization is very high, but it's not entirely full. So we've got $1.5b capital expenditure coming from second quarter. We will gradually increase our capacity mainly to support our 40 and 45 nanometer business. So that part contribute about 80% -- 75% to 80% of our total $1.5b capital expenditure. So we are aggressively increasing our capacity to serve our customers.

Randy Abrams - *Credit Suisse - Analyst*

Okay. Thank you.

Operator

Your next question comes from the line of Steven Pelayo from HSBC. Please proceed.

Steven Pelayo - *HSBC - Analyst*

Hi. I'm also very impressed with your gross margin guidance. It does look like you're making some pretty good longer-term structural improvements there. I'm more interested in the OpEx side.

If I put the middle point of your guidance in my model here, it implies your operating expenses were up pretty significantly quarter over quarter. And so, while you're doing a higher gross margin at a much lower utilization rate, it actually looks like you have a much higher OpEx than what you had before. Is there something going on there? Your guidance kind of suggest about a -- almost a 50% quarter-over-quarter increase in operating expenses.

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

Well, there are two reasons for the increase in operating expenses in second quarter. Number one, as Rick just mentioned, we are investing our R&D, both mainstream technology and also advanced technology. So that's the major part of the increase in second quarter.

In addition to that, because our second quarter profitability will go up significantly, so the employee profit sharing appropriation will be higher than first quarter. So these two contribute a majority part of our increase in OP expense in second quarter.

But if you look at it a percentage of revenue, the first quarter our percentage of revenue of operating expenses is roughly 15%, 16%. And this number -- percentage will go down in second quarter to 13%, though the total number dollar value will go up.

Steven Pelayo - *HSBC - Analyst*

Yes. And the last time you had around about TWD70b, TWD75b per quarter, it was under 10%. And so that's why I was trying to figure out why OpEx was so much higher as a percentage of revenue.

Okay. And then just one more quick question I just want to ask. Since your capital spending was down so significantly quarter over quarter, yet you're sticking to your plan of $1.5b this year, how does that spend look like on a quarterly basis [to] the end of the year? Is it pretty even, for a third, a third, a third for the remaining of the quarters, or is it pretty back-end loaded?

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

Pretty much back-end loaded, given the first quarter is only $166m. So I think, basically, the first half will be around 30% and remaining 70% will be in the second half.

Steven Pelayo - *HSBC - Analyst*

Okay, doubling in the second half. Okay. Thank you very much.

Operator

Your next question comes from the line of Mehdi Hosseini from FBR. Please proceed.

Mehdi Hosseini - *Friedman, Billings, Ramsey Group Inc. - Analyst*

Yes, thank you. Actually, as a follow up to the previous question, with this kind of increase in CapEx for the second half, should we assume that POs have already gone out and you've already secured the equipment? And I have a follow up.

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Yes, PO have been going out for the -- basically, the capacity expansion in third quarter and fourth quarter. So we're going to have equipment coming in some time later in the quarter, this quarter.

Mehdi Hosseini - *Friedman, Billings, Ramsey Group Inc. - Analyst*

But -- so POs are going out as we speak?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Yes.

Mehdi Hosseini - *Friedman, Billings, Ramsey Group Inc. - Analyst*

Okay. And then, regarding your commentary on bookings, you said that bookings improved in February and March. How has the bookings changed so far in April? And I'm trying to get a sense of, with your commentary on Q3 being flattish, at what point are we going to see that booking number, or rolling forecast, stopped being revised up?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Basically, I guess I can answer your question in this manner. Our visibility, from booking point of view, now extends into July timeframe. That's the visibility level. Of course, we have not -- you know our lead time, about where we are.

Mehdi Hosseini - *Friedman, Billings, Ramsey Group Inc. - Analyst*

Okay. Now since you have visibility into July, and if I were to look at data points from downstream, from packaging houses and the EMS, it seems like the sequential growth in unit is much lower than what you see. Is there a risk here that some of these Wafers are going to go to die banks and may never be packaged and tested as we roll into July August timeframe? Or how much of that risk is built into your Q3 commentary?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

We try our best to include that in our commentary on the third quarter, understanding the difficulty in doing that. What we have been looking at again from a -- let me use a Fabless company as an example, the large Fabless companies in aggregate. We've been of course following their revenue over the last couple of quarters and their forecast into this current quarter, the second quarter.

I believe during the three quarters, that is the fourth quarter last year, first quarter and second quarter this year, in aggregate, their revenue probably declined by about 30%.

We also -- this is the more difficult part, which involves more assumptions. That is, we also look at or try to calculate the Wafer purchase in terms of dollars that these Fabless companies have spent over the last two quarters, that is fourth quarter and the first quarter this year, plus the forecast for the second quarter this year based on the guidances that all the forecasts people have been giving in the foundry sector. Again, that came -- that comes out about dropping by 30% roughly. This is inexact.

But I think, from the ballpark point of view, what I'm trying to say the decline in our customer base revenues is not inconsistent with the decline of what they have been spending and what they [have] forecast to spend in the current quarter. So that's why we felt that there is, certainly, concern about some inventory build up, but it probably would be incremental rather than a drastic change.

Mehdi Hosseini - *Friedman, Billings, Ramsey Group Inc. - Analyst*

Just very quickly, especially with the 12-inch capacity becoming tight, I would imagine, as it happens with every cycle, some customers want to get into the queue and maybe order more than what they really need, just to make sure that they have the components for the back to school. Is that what you just referred to as a moderate inventory build out, just to make sure that there's enough components for August's build out?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

We certainly recognize the possibility of what you just described. Although, as Lora just said, the 12-inch Fab utilization, being quite a bit higher of course compared to the first quarter (inaudible), we are not at a stage of -- as the last gentlemen mentioned, of turning away orders by any means.

So, yes, the possibility is there. And the -- also inventory days are perceived -- well, at least can be perceived to increase by maybe a few days. But, like I said, we do not believe it will be a big drastic change.

Operator

Your next question comes from the line of Michael McConnell from Pacific Crest Securities. Please proceed.

Michael McConnell - *Pacific Crest Securities - Analyst*

Thank you.

Looking at the gross margin, which was quite impressive, if we move into the second half of the year, I understand the utilizations and the flow of utilization will be pinned to your margin improvement. With respect to the cost side, are some of these temporary reductions going to be alleviated in the second half of the year? I'm assuming some of that is employees that you're going to be adding back into the organization.

So should we still think about every 100 basis points of utilization equating to roughly about 300 to 400 basis points of gross margin? Is that still the -- what we should be thinking about with respect to modeling?

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

When the utilization reach to a normal level, 80%, 85%, what you describe is correct. 100 basis point utilization will give us about 30 basis point of profit margin. So the sensitivity goes down as the utilization is getting higher. So we have seen -- just like we have seen in the first quarter and second quarter, utilization was quite sensitive. But as the utilization is getting higher it will not be so sensitive going forward.

Michael McConnell - *Pacific Crest Securities - Analyst*

So I guess there is a possibility, though, off of whatever we're implying for your utilization in Q2, which is still substantially below 100%, that we still have a lot of room for further improvement in the back half of the year, should utilizations continue to improve.

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

That's true.

Michael McConnell - *Pacific Crest Securities - Analyst*

Okay. And then looking at 45 -- or 40 nanometer, could you talk about how yields are going? There's been some talk that yields have been problematic early on. And what percentage of revenue you're expecting 40 nanometer to be by the end of the year of total revenue?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

There has been some difficulty in the yields. 40 nanometer is difficult -- it's a difficult technology to manufacture. We have invested quite a bit into that technology. But we have understood the problem, the root cause of the yield and actually all the [fixes] have been implemented in the production line.

As to the percentage of revenue in fourth quarter, we do not usually disclose, but we do have a forecast for sure. But I think if -- let me put it this way. The ramp speed of the 40 nanometer compared to the ramp speed of the 65 nanometer technology, it will be at least as good. Our expectation is to be somewhat better than that of the 65 nanometer.

Michael McConnell - *Pacific Crest Securities - Analyst*

And with it being as good or better, is that due to stronger customer demand for 40 than there was 65? Or is that based on the improvement in -- or your yields like for like are better at this point than they were for -- on 65 at a similar point? Or both?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

I think -- I would think the first being more appropriate, your first reason.

Michael McConnell - *Pacific Crest Securities - Analyst*

Okay. And then the Company, before the downturn, was talking about instilling more pricing discipline into the organization. At what point should we look at -- well, one, is that still the intent once we get into more and more stable environment?

And what threshold should we think about, if that is still to occur, that happening? Is it a utilization closer to the 90s or how do you think about putting that discipline back into the organization? At what point should we be thinking about with respect to that occurring?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Mike, I think you're talking about discipline of the pricing and the structural [profitability]. I believe I said in the opening remarks that, for the second quarter, yes, for the first half of the year actually, as strong as the pricing pressure has been, we have held our price reasonably well. We do not expect the pricing decline to be worse compared to that of 2008. In another way, the gross margin in the second quarter is another demonstration.

Operator

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

Satya Kumar - *Credit Suisse - Analyst*

Hi, thanks for taking my question.

What is the linearity of your monthly sales looking like in the second quarter? Is there a steady increase from the March monthly sales levels, or is it more front-end weighted in the second quarter?

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

For second quarter we are seeing monthly -- every month will be higher than the previous month.

Satya Kumar - *Credit Suisse - Analyst*

So a steady pattern?

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

Yes, very steady.

Satya Kumar - *Credit Suisse - Analyst*

And earlier on I think you had mentioned that the third quarter you expect will be up a little bit from the second quarter.

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

Flat or slightly higher.

Satya Kumar - *Credit Suisse - Analyst*

Okay. So if I assume that you're up linearly in the second quarter, your monthly sales has to decline pretty substantially from the June levels to get to flat for the third quarter. And you mentioned that your bookings visibility only goes up to July. What makes you think that you will see a decline in monthly levels? What do you see out there that you feel that it will flatten out like that?

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

I do not see our monthly revenue will go [slower].

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Basically, I think we've been -- we are trying to give a picture for our third quarter. But I don't think we are really ready to comment from a monthly point of view.

Satya Kumar - *Credit Suisse - Analyst*

Okay, understood.

And, lastly, on the equipment orders that you are placing right now, are you placing a lot of orders in the second -- are you intending to place all the orders by the second quarter, or the order placement, is that going to be continuously increasing through the year? Are you worried at this point at all that the lead time for equipment may be a concern for you to add the capacity?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Well, of course, the PO issue time is a function of the lead time. But since we are expanding capacity in the third quarter and the fourth quarter -- early fourth quarter time, yes, most of the POs need to be out in this quarter.

Satya Kumar - *Credit Suisse - Analyst*

In the second quarter?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Yes.

Satya Kumar - *Credit Suisse - Analyst*

Okay, thank you.

Operator

Your next question comes from the line of Matt Gabel from Schonfeld Group. Please proceed.

Matt Gabel - *Schonfeld Group - Analyst*

Could you just -- I got on this call late. I don't know if you've covered this. Could you just speak to what Wafer starts are doing currently? Are they still increasing, are they flattening out, are they decreasing? Thank you very much.

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Yes, Wafer start is still increasing. Yes.

Matt Gabel - *Schonfeld Group - Analyst*

Do you see that continuing up through June, July? Is business that strong? It seems like it is. Thank you.

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

Well, with our guidance of a very strong quarter and you can expect the Wafer starts will increasing quite significantly.

Matt Gabel - *Schonfeld Group - Analyst*

Okay, thank you very much.

Operator

Your next question comes from the line of Bhavin Shah from JP Morgan. Please proceed.

Bhavin Shah - *JP Morgan - Analyst*

Yes, thank you, Rick and Lora.

My question is on return on capital. With this bounce in the second quarter and the gross margin you are guiding to, your return on capital will bounce back to more than 30%. So when you look at next several years or, say, the next few years, can we say that you can probably achieve a return of capital value in excess of 30%, because you're achieving 30% right near the bottom of the cycle?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

I think, Bhavin, TSMC's long-term financial return objective has been set in ROE, which we try to maintain a better than 20% average over a period of several years. That goal has not changed. We continue to strive towards -- for that goal. This year, for instance, will be difficult.

Bhavin Shah - *JP Morgan - Analyst*

Rick, but the ROE is low only because you have cash on the balance sheet. So I like to look at the return on capital. And it seems that you're achieving a much higher ROIC at the bottom of the cycle now than in the past. And that's why I was just wondering if the --

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Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

I understand, Bhavin. I think -- I believe we have done quite a bit of financial simulations. The 30% is not an unreasonable number from ROIC point of view.

Bhavin Shah - *JP Morgan - Analyst*

Okay. A second question I had was, let's say that a year from now you are operating at 70% -- a similar utilization as the second quarter, say, in first or second quarter 2010, will the gross margin be also similar, 45%? Or, if not, what would have changed to make it higher or lower?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

I think, certainly, exchange rate is the factor. It can be a quite strong factor, as we have observed last year. Structurally, I think we should be able to perform similarly from a fundamental business operation point of view.

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

Bhavin, your question is actually asking whether we can maintain the structural profitability, given the same utilization. I think that is certainly our intention, and we'll work hard to maintain that level.

Bhavin Shah - *JP Morgan - Analyst*

Okay, thank you.

Operator

Our next question comes from the line of Dan Heyler from Merrill Lynch. Please proceed.

Dan Heyler - *Merrill Lynch - Analyst*

Good evening. Hi, guys.

I had a question on your capacity. Because of your utilization coming down quite a bit in the first quarter, your capacity from the first quarter to the fourth quarter is only growing very slightly. Yet your capacity expansion, I believe, is focused heavily on conversions, as you've talked about. You have Fabs that are seeing capacity decline, actually, as a result of conversion and you're actually adding net capacity as well. So the combination of conversions plus new capacity is resulting in a flat -- relatively flat increase from the first quarter to the fourth quarter.

Given that's a relatively unusual situation, yet you're migrating a lot of customers on advanced technology, could you help me understand how that plays out in terms of margins? Is it there a greater margin benefit to increasing your mix on lower net capacity additions?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Overall, it is positive. We -- certainly, the incremental investment for the 40 nanometer capacity is lower because of the conversion. We -- but, of course, as some of the technology demands get higher we would need those capacity. But we're not fully -- we're not full. I think the benefits still exist. In another -- in addition, I think the intrinsic cost structure of the 40 nanometer is quite competitive also.

Dan Heyler - *Merrill Lynch - Analyst*

Okay. And are you getting a -- that is, are you getting a mix benefit from converting to 65 as well, with relatively low incremental expenditures versus previous migrations in other nodes?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Yes, you are right.

Dan Heyler - *Merrill Lynch - Analyst*

Great. And then on the -- the second question, I was -- I'm going to sneak in a couple of housekeeping questions to try to get -- if you could, Elizabeth or Lora, give us an update on the accounting rule change in Taiwan that you're proposing to the Taiwan Government for a change to pay out more of your capital surplus than allowed under the current policy.

And the other question relates to the employee bonuses, whether there's going to be a make-up payment in the following quarters or whether you'll just continue to stick with 15% of net income as your payout policy. Thanks.

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

Okay, your first question regarding the regulation change on the dividend payout, we had a very good few meetings with the government officials, including MOEA, FSC and SEC officials. I think, generally, they are all very positive and support the Company's position that the company law should be changed to relax the payout of [their] cash dividend.

We had a detailed working session and we are coming out with a detailed proposal in terms of the wording of the law that should be changed. And it will be further submitted to the Regulator for approval. So we hope everything can go smoothly and we can get approval by this year end. That is our hope.

Regarding your second question regarding the employee profit sharing, we had some one-time control on cost [starting] in fourth quarter and first quarter. Moving into the second quarter because utilization has gone up, so we have relaxed some of the [referral] programs, partially released. So the cost will go up a little bit because of that.

In terms of the profit sharing 15% of net income, this is what we're going to pay this year for the last year. Going forward, that 15% will be further reviewed by TSMC Board and compensation committee and, therefore, to decide whether there's a change to be needed.

Operator

Your next question comes from the line of Daniel Zhu from Lusight Research. Please proceed.

Daniel Zhu - *Lusight Research - Analyst*

Hi. I also have a question regarding your capacity. You mentioned earlier the 12-inch capacity to increase steadily, but why the total capacity for the next two quarters declined slightly? Is it because of the product mix or you're taking down more 8-inch equipment for conversion?

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

The capacity on 12-inch will -- as I just mentioned earlier, our CapEx expenditure for this year will be very much back-end loaded. So the capacity increase will come in mainly from the third quarter and fourth quarter. So second quarter and first quarter the capacity basically remains very similar level.

Daniel Zhu - *Lusight Research - Analyst*

Okay. And you also mentioned Q4 revenue to be flat or slightly lower. But Q4 has the highest capacity, which implies utilization rate [is] probably lower than 70%. This is significantly lower than the historical average. Can you comment on that? Is it because you're preparing for 2010, the future?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Yes. The fourth quarter, as we said in our current forecast, will be slightly lower compared to the third quarter. So we do expect some of the utilization to go down in that quarter. But the investment is mainly for the 40 nanometer capacity, which will be utilized very well.

Daniel Zhu - *Lusight Research - Analyst*

Okay, thank you. My second question is what is your expected R&D expenditure for 2009? Do you have a long-term target for R&D spending as a percentage of your revenues, like 5% or 6%?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

We are still working on that. It will be -- of course, assuming we're going back to the normal revenue pattern, [we'll] be running our R&D at about 6% plus of the revenue -- 6% to 7%. We expect that ratio to go up, but probably not in a huge number either. Maybe 7% plus.

Daniel Zhu - *Lusight Research - Analyst*

Okay, thank you. My last question, is based on your guidance, TMSC's 2009 revenue may decline [21%] year over year. Compared with the foundry industry decline like 25% to 30%, obviously, TSMC is gaining market share in 2009. Do you expect the trend to continue in the next couple of years?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Yes, we are the leader in the foundry sector, but I think the jury is still out for this year's market share. We certainly strive to gain more market share. But I think the -- we're trying to give some -- to share some of our observations for the foundry as a whole our TSMC guidance, but we'll give you next quarter and beyond.

Operator

Your next question comes from the line of Randy Abrams from Credit Suisse. Please proceed.

Randy Abrams - *Credit Suisse - Analyst*

Yes, I wanted to ask about the tax rate, how you see that trending in the next few quarters, and then even in the next couple of years, with the government investment credits coming off. I just want to see what you see on the tax rate just going forward.

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

The tax rate is a complex issue. For 2009, we believe the tax rate in terms of net income before tax will go up from 16% to around 18% to 19% level. The reason being, our tax holiday was mainly on 12-inch and this year, at least for the first half, our 12-inch will be loading lower. So we did not get the full benefit of that tax holiday. That's the one reason.

But in terms of net tax, that's including the tax credit, tax credit has to do with our capital expenditure. For this year I think our net tax will be around 10% -- 10%, 11%, which is quite similar to the previous year.

Randy Abrams - *Credit Suisse - Analyst*

Okay. And you made a separate announcement behind the scenes on the Fujitsu about a new partnership. Maybe talk about is that limited to 40 nanometer? Is that a push for Fujitsu as leading edge moves to a more Fabless model? And maybe talk about potential from that customer and then, even Japan in general, whether, that outsourcing, there's a bit finally starting to happen there.

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

Yes, we have been working with Fujitsu for some time on this announcement and the 40 nanometer business arrangement. We -- [the both] I fully expect the relation to extend into the next generation of technology. I believe Fujitsu said they will use TSMC as their partner in both manufacturing and technology.

To the Japan as a whole, I think it would be more difficult to predict. But we are certainly very excited and happy with the relationship with Fujitsu.

Randy Abrams - *Credit Suisse - Analyst*

Okay, thank you.

Operator

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

Steven Pelayo - *HSBC - Analyst*

I've two longer-term questions and -- well, maybe it's a near-term question.

There's been a fair amount of, certainly, PR in the last 90 days from Global Foundries. I'm just curious if you think that -- are they causing some increased pressure? Have they been successful in potentially taking any business away from you?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

We view every competitor very seriously, including Global Foundries, certainly. But we also have the tradition of not commenting on individual competitor.

Steven Pelayo - *HSBC - Analyst*

Okay. Well, with the addition of a new foundry competitor, have you seen the overall competitive environment intensifying?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

The foundry sector has been very competitive, very fierce for a long time. We do not have any different thinking about that. We will just continue to work hard and to compete and to gain our market share.

Steven Pelayo - *HSBC - Analyst*

Fair enough. One last question. I get a lot of questions from clients comparing today and this downturn and this recovery that we're seeing versus 2001. I'd really like to hear your thoughts.

On the positive side, maybe we don't have as much a supply problem as we didn't run high CapEx capacity right into the downturn. But maybe on the downside it would appear that, certainly, the global economy is worse, and maybe there's some questions about some killer applications, like we had I think maybe more in 2001. What do you think when you compare, contrast 2001 to today -- 2001, 2002?

Dr. Rick Tsai - *TSMC Ltd. - President and CEO*

I agree with your comments just now. In addition, I think the major difference being the speed of the inventory management, going up and down much faster compared to 2000 and 2001 time. So we're -- as a foundry supplier, we're seeing that impact very vividly.

Steven Pelayo - *HSBC - Analyst*

Understood, thank you.

Dr. Elizabeth Sun - *TSMC Ltd. - Head, IR*

Operator, in the interests of time, I think we'll allow just one last question.

Operator

Your last question in queue comes from the line of Michael McConnell from Pacific Crest Securities. Please proceed.

Michael McConnell - *Pacific Crest Securities - Analyst*

Yes, this is very quick housekeeping. The net non-operating income and investment income versus Q1, what should we model that for Q2?

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

Non-operating -- okay, you're saying non-operating income and investment income. In the second quarter, non-operating income will be better. The investment income will also improve.

Michael McConnell - *Pacific Crest Securities - Analyst*

Okay, great.

Dr. Elizabeth Sun - *TSMC Ltd. - Head, IR*

Okay. Operator, this concludes our Q&A session.

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

Thank you for your participation. We look forward to talk to you next quarter. Bye bye.

Operator

Before we conclude TSMC's first quarter 2009 results webcast conference call today, please be advised that the replay of the conference call will only be accessible through TSMC's website, at www.tsmc.com. Thank you, all.
