

TAIWAN
SEMICONDUCTOR
MANUFACTURING
COMPANY, LTD.
ANNUAL REPORT 1997



MAJOR FACILITIES

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TSMC SPOKESMAN

Name: Y.C. Huang
Title: Vice President

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Auditors: S.C. Huang, Edward Way
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STOCK TITLE TRANSFER

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Transfer Agency Department
Address: 5Fl., No.83, Sec.1, Chung-Ching
S. Rd., Taipei, Taiwan, R.O.C.

TEL: 886-2-2361-3033 FAX: 886-2-2311-6723

ADR DEPOSITARY BANK

Company: Citibank, N.A.
Depository Services Department
Address: 21 Fl., 111 Wall Street, New York,
NY 10043, U.S.A.

TEL: 1-212-657-1853 FAX: 1-212-825-2103

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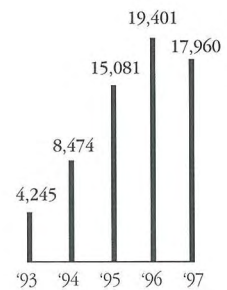
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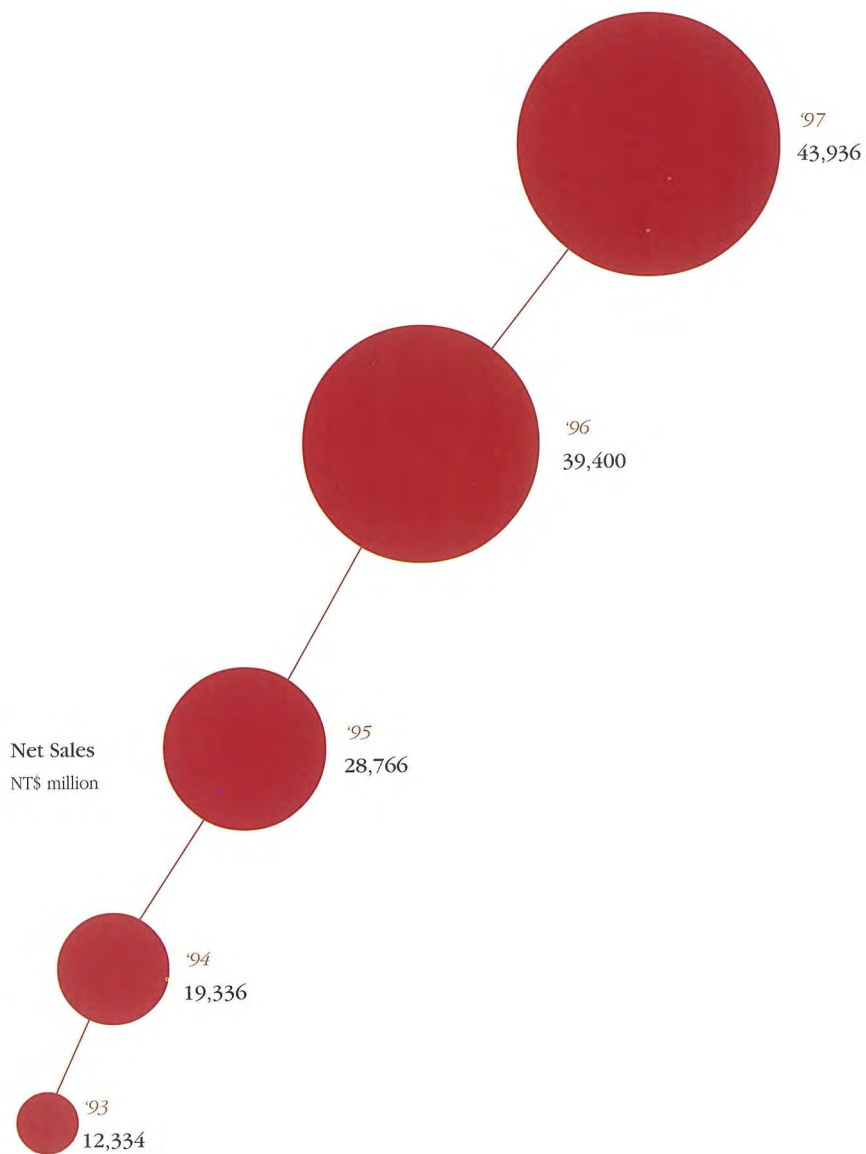
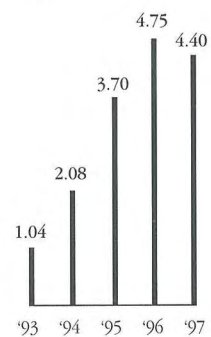
Net Income

NT\$ million



Earnings Per Share

NT\$



Business Philosophy

TSMC is committed to:

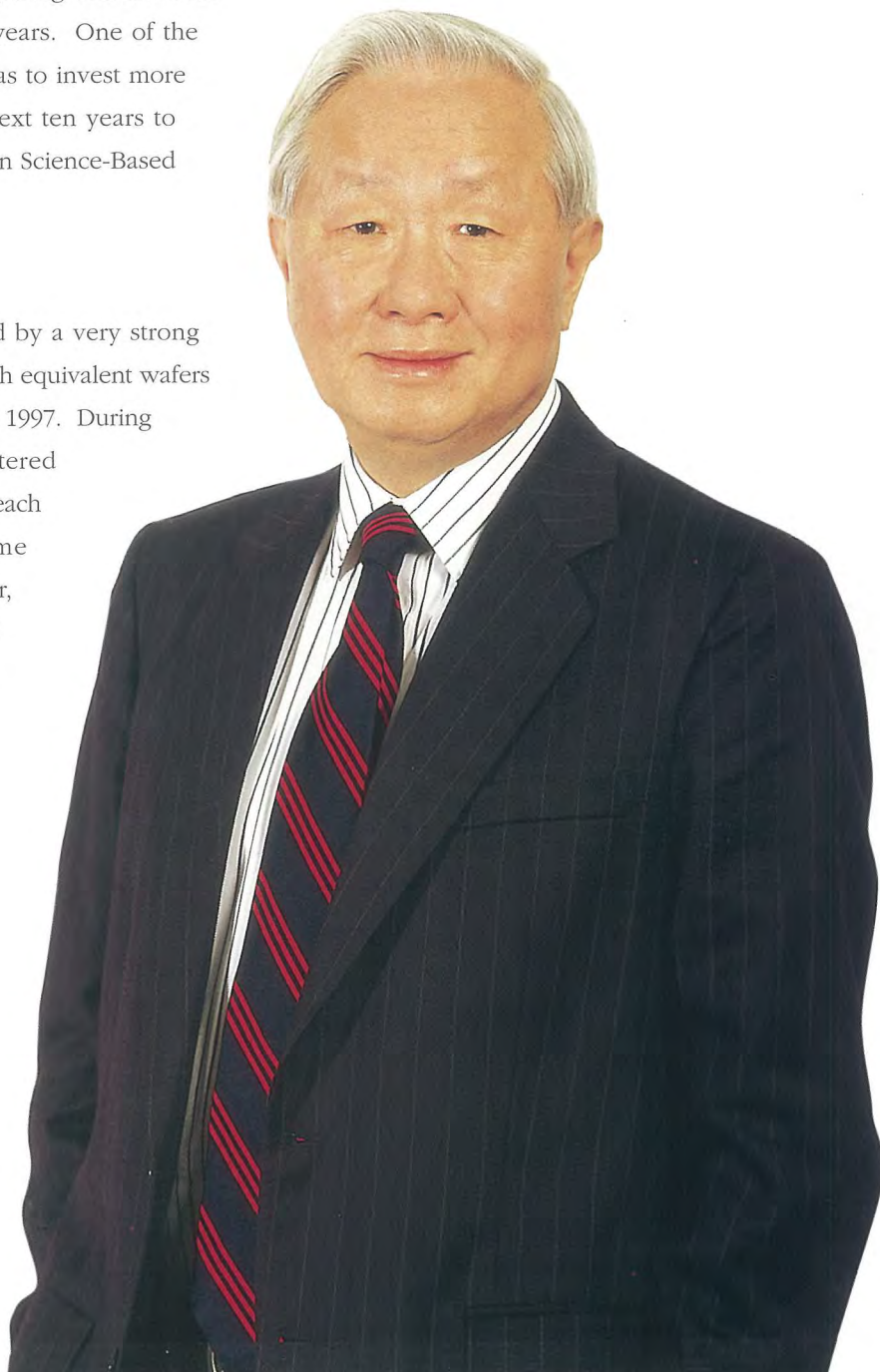
- Integrity
- Maintaining a Consistent Focus on Our Core Business-IC Foundry Manufacturing
- Globalization
- Long-term Vision and Strategies
- Treating Customers as Partners
- Building Quality into all Aspects of Our Business
- Unceasing Innovation
- Fostering a Dynamic, Open and Fun Work Environment
- Caring for Employees and Shareholders, and Being a Good Corporate Citizen

Dear Shareholders,

In 1997 TSMC celebrated its tenth anniversary. It was a fruitful year, filled with remarkable achievements. Sales climbed by 11.5% to hit NT\$43.9 billion, a new company record. Profits were NT\$17.9 billion. Two new 8-inch wafer fabs, Fab IV and Fab V entered volume production, together making a significant contribution to the company's total output capacity. As a result of our outstanding business performance and an excellent corporate image, our American Depository Shares (ADSs) representing TSMC's Common Shares were listed on the New York Stock Exchange (NYSE) in October. TSMC was the first and is still the only Taiwan company listed on the NYSE. While capping ten successful years of operation with these achievements, at the same time we were energetically preparing ourselves for the challenges of the next ten years. One of the plans we announced in 1997 was to invest more than NT\$400 billion over the next ten years to build six advanced fabs in Tainan Science-Based Industrial Park.

Capacity Expansion

Total output at TSMC expanded by a very strong 40% last year, from 844,000 8-inch equivalent wafers in 1996, to 1.19 million wafers in 1997. During 1997, Fab III and Fab IV registered steady growth in output capacity each month. Fab V began volume production in the fourth quarter, months ahead of schedule, and in July of 1997 we broke ground





From left to right:
Che-Chia Wei, VP
Yen-Chun Huang, VP

for Fab VI in Tainan Science-Based Industrial Park. Meanwhile, construction of our joint-venture fab in the United States, WaferTech, is also moving full steam ahead. We are on target to begin scheduled volume production at this plant in mid-1998.

Technology Leadership

In 1997 TSMC manufactured for its customers many new products using 0.35 μ m process technology, and volume production using 0.3 μ m technology commenced near the end of the year. Meanwhile, TSMC also completed development of 0.25 μ m process technology. Volume production of this is expected to begin early in 1998. Recognizing the potential market for various embedded technologies, we formed special project teams to develop embedded Flash memory, DRAM and SRAM.

As our industry moves into its next major evolutionary phase, 12-inch wafer technology, TSMC is the only Taiwan company that has joined SEMATECH to participate in the I300I project along with other world leaders in the semiconductor industry. All these efforts demonstrate our commitment to providing TSMC customers with the earliest possible access to the latest technology.

Market Development

TSMC's customer base remained solid around the globe in 1997. U.S. companies purchased 42% of TSMC's total output. The domestic market accounted for 26%, Europe-based companies 8%, Japanese companies 11%, and other Asian companies 13%. To improve service for our Japanese customers and to further develop business in this fast-growing market, in October of 1997 we established TSMC--Japan.

Management Team Building

The IC industry has no national boundaries. Since TSMC was founded, we have always aimed at the world market. We have worked to build sustainable competitive advantages and have maintained our leading position in the IC foundry market. As a globalized company, we recruit talented

*We have always aimed at the world market!
We recruit expert professionals, not only in the
semiconductor field, but also in other
management areas. Our elite team of world-
class experts will lead the company to an even
brighter future.*



professionals regardless of their nationality. They are experts in the semiconductor field as well as other management fields, and most importantly, they share a common vision with the company. In the past year, we have recruited several vice presidents, each with expertise and experience in specific areas. These senior officials further solidify our already strong management team to lead the company to the future.

Future Outlook

In 1996 we formulated the company's vision of the Virtual Fab and took action immediately. Our strategy is to develop long-term competitive advantages by strengthening the bond between TSMC and our customers. We will continue to advance in this direction through the coming years.

Although the overall IC industry is expected to register a growth of 10% or less in 1998, growth of the IC foundry market is predicted to surpass that of the industry as a whole. However, TSMC's success as the pioneer of the IC foundry industry has served as a model for many new entrants to the market, and as a result, competition has increased over the last few years. Facing another challenging year in 1998, we are confident that our Virtual Fab strategy will enable us to provide the best available service to our customers and to maintain our number one position in the IC foundry industry.

Finally I would like to express my deepest gratitude to all TSMC customers, shareholders, and employees for your continued support and dedication.



*From left to right:
Rick Tsai, EVP
Ping Yang, VP
Steve Tso, SVP
Jyan-Bang Chen, VP
Shang-Yi Chiang, VP*

Chairman/President

Standing, left to right:

Quincy Lin, SVP

Harvey Chang, SVP

K.C. Chen, SVP

Seated:

Ron Norris, President, TSMC-USA



1. Company Profile

Founded in 1987, Taiwan Semiconductor Manufacturing Company (TSMC) is a high-tech company based in Taiwan's "Silicon Valley," the Hsin-chu Science-Based Industrial Park. The company is listed on the Taiwan Stock Exchange (TSE) and the New York Stock Exchange (NYSE) under the symbol of TSM.

TSMC was the first pure integrated circuit ("IC") foundry company in the world. Since TSMC's founding, we have been dedicated to providing manufacturing services for advanced ICs. The company's charter prevents us from designing or making our own brand-name IC products. Hence, TSMC is a partner, not a competitor, for other semiconductor companies. TSMC's success in the foundry business has served as a model for many new entrants to the market. With TSMC as the engine of change, what was once only a concept—a pure foundry—is today a multi-billion dollar industry. As the semiconductor industry faces greater consolidation and spiralling costs for building new IC fabs, professional foundry companies like TSMC stand to become a primary source of IC manufacturing services to meet rising worldwide demand.

TSMC is the largest foundry in the world. As of the end of 1997, the company was operating two 6-inch wafer fabs (Fab I and II) and three 8-inch fabs (Fab III, IV and V), with annualized output of 1.19 million top-quality, high-yield 8-inch equivalent wafers. In response to increasing demand from integrated device manufacturers (IDMs)—the so-called "second wave" IC foundry phenomenon—TSMC has plans to invest NT\$400 billion over the next ten years to build six advanced fabs in the Tainan Science-Based Industrial Park (TSIP). In July, 1997, the company broke ground for Fab VI, its first fab in TSIP.

TSMC is an international company aiming at the world market, and consequently establishes facilities in other locations besides Taiwan. The company has sales and engineering offices in the U.S.A., Europe and Japan. WaferTech, TSMC's joint venture in the U.S.A. with several long-standing customers, is on schedule for ramp-up in mid-1998.

In addition to maintaining a competitive edge through continually increasing capacity, TSMC has beaten the competition by consistently providing volume production levels of new generation technologies. Moreover, TSMC is capable of offering a wide range of technology processes, including mixed-signal and embedded memory, in addition to the standard logic processes. TSMC's firm commitment to advanced technology ensures that the company will provide the best possible value-added services and truly be a partner to our customers.

TSMC focuses on process technology and manufacturing excellence, but places even more emphasis on customer service. The company's vision is to become the Virtual Fab for our customers. That is, to give





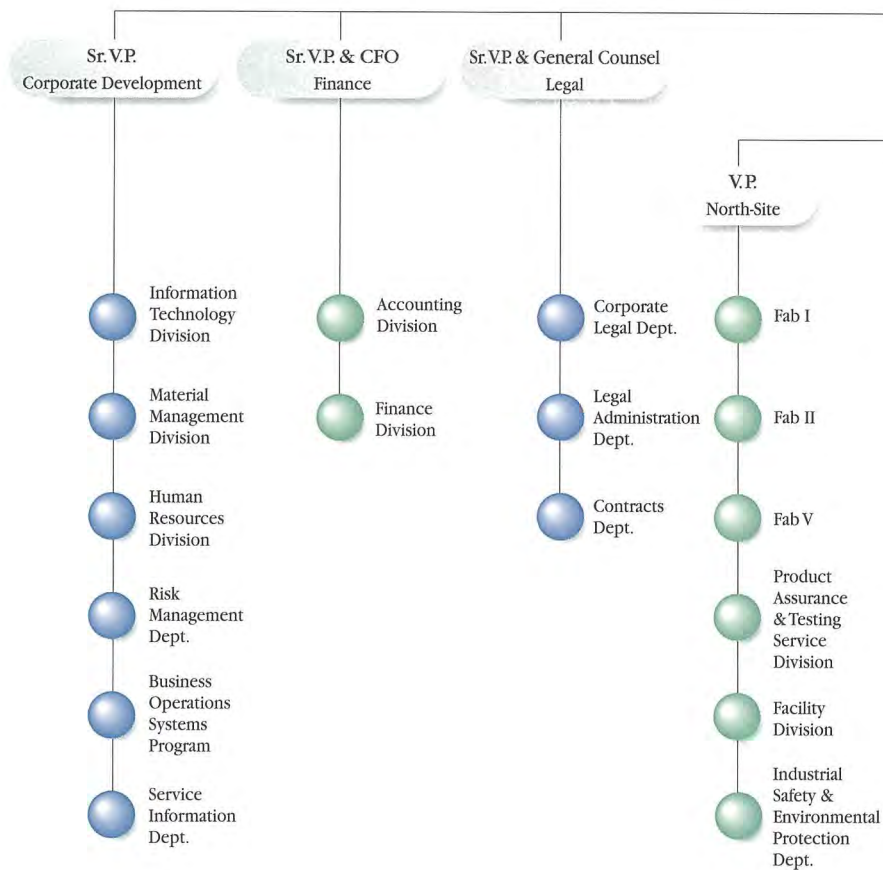
*We are building the world's Virtual Fab!
We provide the best quality technology, the
greatest capacity and the highest standard of
service. We are the most reliable choice as a
partner in semiconductor manufacturing.*

customers all the benefits of an in-house fabrication plant without the associated expense or organizational difficulty. TSMC's strategy is to improve service while at the same time developing long-term competitive advantages through strengthening the bond between TSMC and our customers, thereby ensuring TSMC's continued leadership in the global IC foundry business.

As a good corporate citizen, TSMC takes the job of community service and employee relations seriously. TSMC's concerted actions have earned the company several awards from the Taiwanese government in areas such as environmental protection, health and safety, employee welfare, employee training and social welfare. In addition, TSMC has been ranked among Taiwan's leading companies by Taiwan's most prestigious magazines as well as by highly regarded publications elsewhere in the world. *Business Week* magazine, in its January 12, 1998 issue, selected TSMC Chairman Dr. Morris Chang as one of the "Top 25 Managers of the Year"; at the same time, BancAmerica Robertson Stephens named Dr. Chang one of the most significant contributors in the 50 years of semiconductor industry.

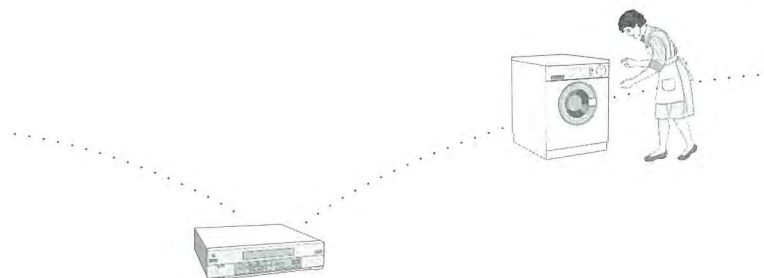


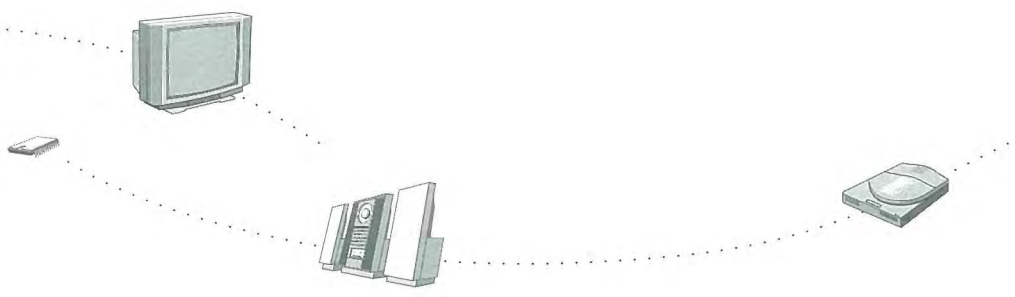
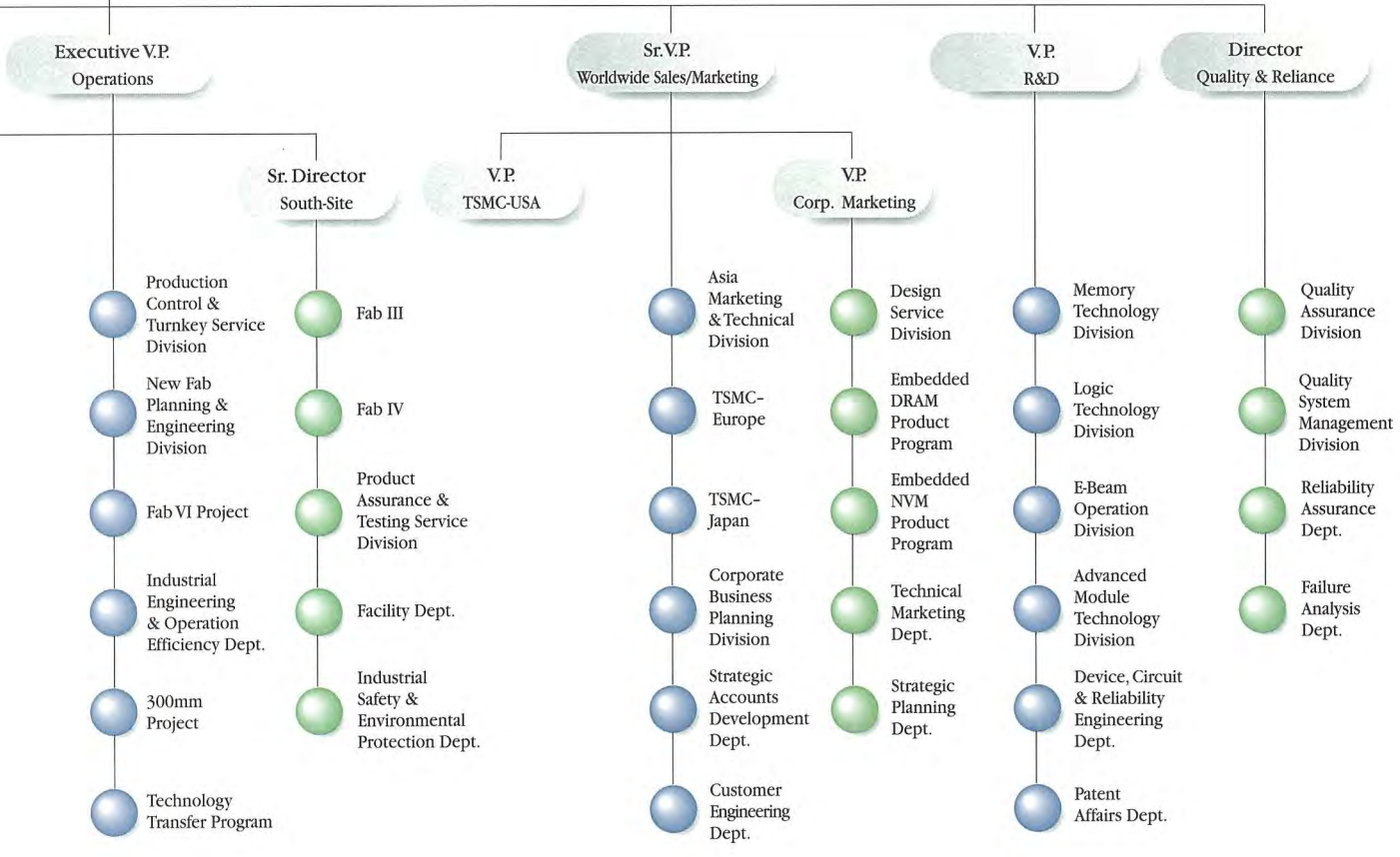
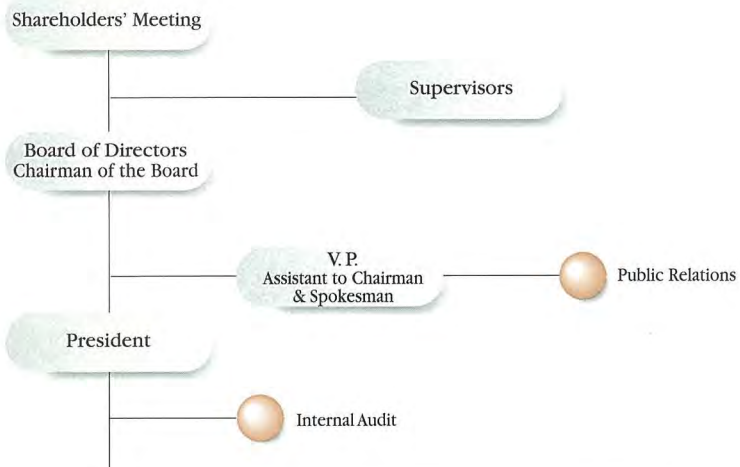
2. Organization



Making a Better Life

Enter your home and you are immediately embraced by music and images from your CD, DVD, Hi-Fi stereos and high-definition television sets. Around you, ICs are in every household appliance making your life more comfortable and convenient.





3. Directors and Supervisors

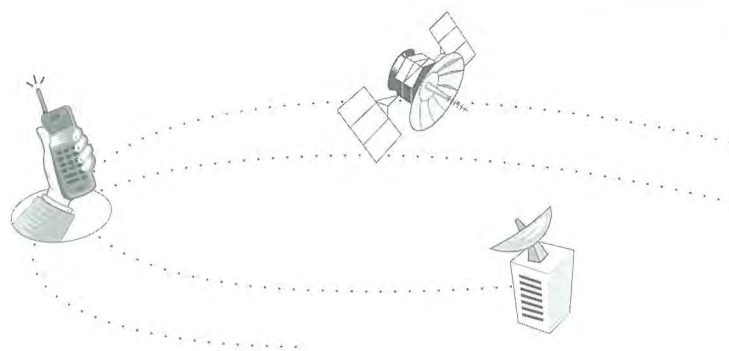
(As of February 28, 1998)

Title Name	Date Elected	Term (Year)	Shareholding (Note)	Spouse & Minor Shareholding	Education & Experience	Remarks
Chairman Morris Chang	1997.5.13	3	29,584,349	Nil	Ph.D. Electrical Engineering, Stanford University/ Chairman, Vanguard International Semiconductor Corp./ Chairman, WYSE Technology Inc./Chairman & President, TSMC	
Director A.P.M. van der Poel	1997.5.13	3	726,597,083	Nil	B.S. Electronic Engineering, Eindhoven Technical University/ Chairman and CEO, Philips Semiconductors International B.V.	Philips Electronics N.V. Representative of Legal Entity
Director J.C. Lobbezoo	1997.5.13	3	726,597,083	Nil	B.A. Business Economics, Erasmus University/ Chief Financial Officer, Philips Semiconductors International B.V.	Philips Electronics N.V. Representative of Legal Entity
Director G.J. Kleisterlee	1997.5.13	3	726,597,083	Nil	B.S. Electronic Engineering, Eindhoven Technical University/ President, Philips Taiwan	Philips Electronics N.V. Representative of Legal Entity
Director L.P. Hsu	1997.5.13	3	726,597,083	Nil	B.S. Physics, National Cheng-Kung University/ Executive Vice President, Philips Taiwan	Philips Electronics N.V. Representative of Legal Entity
Director Ming-Te Lin	1997.5.13	3	763,219,720	Nil	M.S. Earth-Science, Massachusetts Institute of Technology/ Vice Chairman, Seino Pharm Taiwan Ltd.	Development Fund, Executive Yuan Representative of Legal Entity
Director Ching-Chang Yen	1997.5.13	3	763,219,720	Nil	Master of Comparative Law, University of Michigan/ Deputy Minister, Ministry of Finance, R.O.C.	Development Fund, Executive Yuan Representative of Legal Entity
Director Chintay Shih	1997.5.13	3	763,219,720	Nil	Ph.D. Electrical Engineering, Princeton University/ President, Industrial Technology Research Institute	Development Fund, Executive Yuan Representative of Legal Entity
Director I-Kwei Wu	1997.5.13	3	14,250,000	Nil	China Junior College of Marine Technology/ Chairman, Swanson Plastics Corp.	Maw-Chong Investment Co., Ltd. Representative of Legal Entity
Director F.C. Tseng	1997.5.13	3	5,597,455	246,639	Ph.D. Electrical Engineering, National Cheng-Kung University/ President, Vanguard International Semiconductor Corp.	
Supervisor E. Th. Ausems	1997.5.13	3	726,597,083	Nil	B.A. Economics, Tilburg University/ Executive Vice President, Philips Taiwan	Philips Electronics N.V. Representative of Legal Entity
Supervisor Chung-Ying Hu	1997.5.13	3	763,219,720	Nil	Ph.D. Geophysics, National Central University/Director, Council for Economic Planning and Development, Executive Yuan	Development Fund, Executive Yuan Representative of Legal Entity
Supervisor Jerome S.N. Hu	1997.5.13	3	6,063	Nil	M.S. Chemical Engineering, University of Michigan/ Chairman, Chao Ting-Chen Cultural Education Foundation	

Note: As per the actual reported number of shares on February 28, 1998

Evolving Communications for the Entire World

New breakthroughs in IC technology, are rapidly improving the quality of mobile phones, and audio-video phones have started the next revolution in communications. Virtual reality and global zero-time-difference are enriching our lives.



4. Major Officers

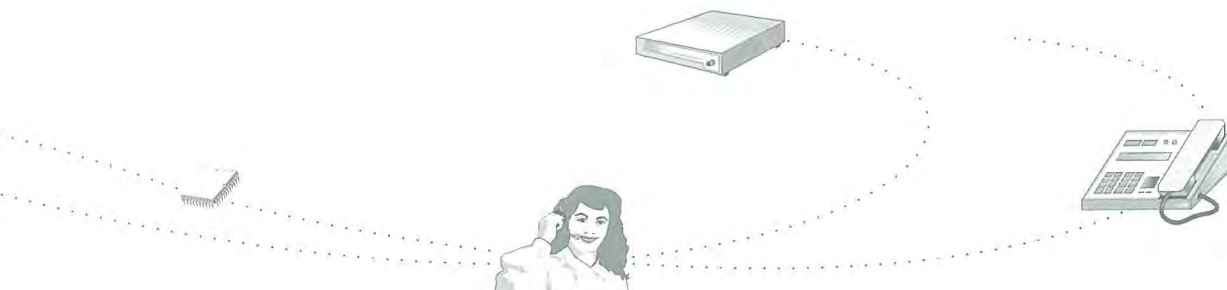
(As of February 28, 1998)

Title Name	Date Registered	Shareholding (Note)	Spouse & Minor Shareholding	Education & Experience
President Morris Chang	1997.05.01	29,584,349	Nil	Ph.D. Electrical Engineering, Stanford University, U. S. A./ Chairman, Vanguard International Semiconductor Corp./ Chairman, WYSE Technology Inc./Chairman & President, TSMC
Executive Vice President Rick Tsai	1995.09.01	2,620,527	Nil	Ph.D., Material Science, Cornell University, U. S. A./ Vice President, TSMC South-Site/ Executive Vice President, Operations, TSMC
Senior Vice President Quincy Lin	1995.09.01	3,119,728	805,489	Ph.D., Business Administration, University of Kentucky, U. S. A./ Vice President, Corp. Marketing & Sales, TSMC/ Senior Vice President, Corp. Development, TSMC
Senior Vice President Steve Tso	1997.03.04	710,000	Nil	Ph.D., Material Science, UC Berkeley, U. S. A./General Manager, CVD II-Advanced Technology, Applied Material Inc./Vice President, R & D, TSMC/ Senior Vice President, World-Wide Sales & Marketing, TSMC
Senior Vice President K.C. Chen	1997.11.24	1,000	Nil	Attorney-at-law (California)/Barrister-at-law (England)/ President, National Culture and Arts Foundations, Taiwan/ Senior Vice President & General Counsel, TSMC
Senior Vice President Harvey Chang	1998.02.03	0	Nil	MBA, Wharton School, University of Pennsylvania, U. S. A./Chairman, China Securities Investment Trust Corp./President, China Development Corp./ Senior Vice President & Chief Financial Officer, TSMC
Vice President Yen-Chun Huang	1995.09.01	2,788,888	136,797	MBA, Saginaw Valley State University, U. S. A./ Vice President, Corp. Services, TSMC/ Spokesman & Special Assistant to Chairman, TSMC
Vice President Jyan-Bang Chen	1997.05.13	575,377	Nil	M. S., Physics, National Tsing-Hua University/ Senior Director, TSMC North-Site/ Vice President, TSMC North-Site
Vice President Shang-Yi Chiang	1997.08.05	400,000	Nil	Ph.D., Electrical Engineering, Stanford University, U. S. A./Department Manager, Device Research & Applications, Hewlett-Packard Laboratories, Hewlett-Packard Company/Vice President, R&D, TSMC
Vice President Ping Yang	1997.11.18	0	Nil	Ph.D., Electrical Engineering, University of Illinois, Urbana-Champaign, U. S. A./ Director, Device and Flow Design in the Semiconductor Process & Device Center, Texas Instruments Incorporate/Vice President, Corporate Marketing, TSMC

Note. As per the actual reported number of shares on February 28, 1998

5. Status of Bond Issuance

On July 3, 1997, the company issued US\$350 million 5-year, zero-coupon European Convertible Bonds, which are repayable, if not converted, at 136.23% of the notional principal at maturity date. The bonds can be converted into common stocks of the company at NT\$144 per share from forty days after issuance to five days before maturity. As of February 28, 1998, none of the bonds has been converted or redeemed.



1. Business Activities

(1) Business Scope

TSMC is dedicated to high integrity in business and has a single-minded focus on the foundry industry. The company provides advanced IC manufacturing services of the highest quality to the worldwide semiconductor industry. Building on our core competencies of excellent manufacturing and attentive customer support, we offer a full range of manufacturing services, including ULSI and VLSI wafer manufacturing, wafer probing, assembly and testing, mask production and design services.

Over the past ten years, customers have utilized TSMC's manufacturing services for a variety of end-product applications, ranging from computers to Internet appliances, telecommunication equipment and consumer electronics. We estimate that in 1997 TSMC produced approximately 3% of the world's supply of ICs.

(2) Customer Applications

Advanced ICs produced for customers by TSMC are used in a diverse range of end-product applications, including computers, communication systems, consumer electronic products, and industrial equipment.

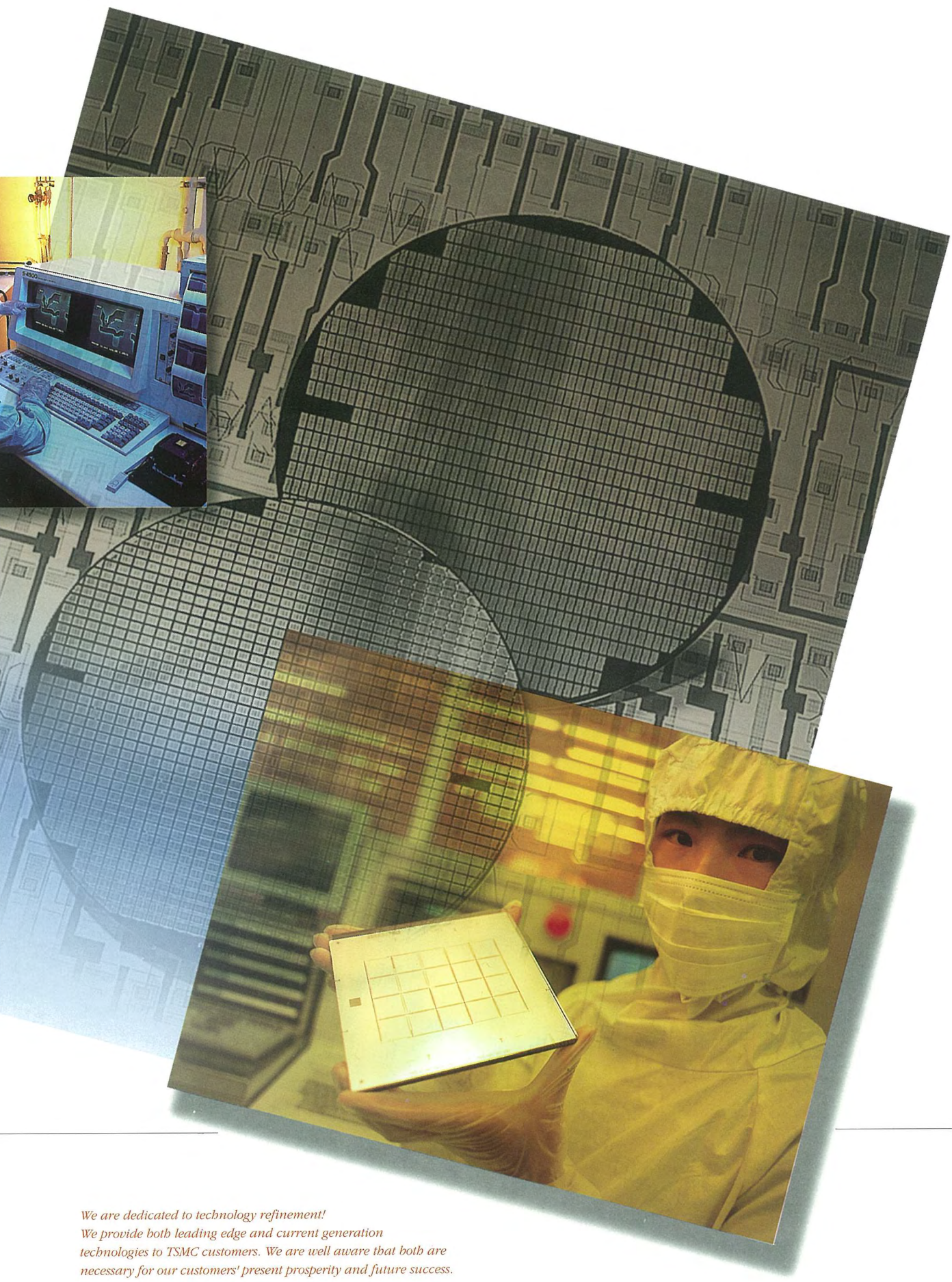
2. Marketing and Sales

Despite low growth in the worldwide IC market and high competition in the foundry industry in 1997, TSMC sales rose by 11.5% to hit **NT\$43,936 million, with profits of NT\$17,960 million.**

The company's performance can be attributed to three major factors. First, we established close relationships and signed capacity option agreements with our customers in 1996, which contributed stable orders in 1997. Second, we adhered to a strategy of limited exposure in the memory market, which reduced the negative impact of drops in memory prices. Third, we re-engineered our company, which gradually changed TSMC's structure and culture from production-orientation to service-orientation. Re-engineering is continuing this year with a goal of effectively building a barrier to competition and realizing TSMC's vision— to become our customers' Virtual Fab for semiconductor manufacturing.

These factors, combined with strong market position, increasing capacity, and the ability to produce the latest-generation technologies, allowed the company to maintain excellent results through a turbulent year.





*We are dedicated to technology refinement!
We provide both leading edge and current generation
technologies to TSMC customers. We are well aware that both are
necessary for our customers' present prosperity and future success.*

•Production over the Last Five Years

Unit: Capacity/Quantity(pcs) Amount(NT\$K)

Year	Wafers			Package			Others		
	Capacity	Quantity	Amount	Capacity	Quantity	Amount	Capacity	Quantity	Amount
1993	627,500	664,985	6,282,643	-	-	-	-	-	-
1994	915,360	942,617	8,699,044	-	-	-	-	-	-
1995	1,158,500	1,217,604	11,507,350	-	-	-	-	-	-
1996	1,567,890	1,501,884	16,721,361	-	-	-	-	-	-
1997	2,095,760	2,267,675	28,343,668	-	-	-	-	-	-

•Net Sales over the Last Five Years

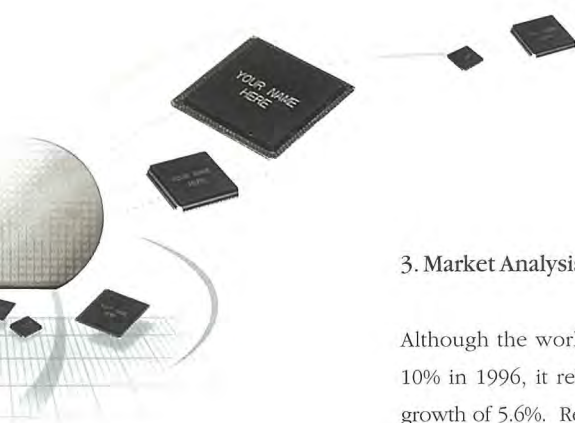
Unit: Quantity(pcs) Amount(NT\$K)

Year	Wafers				Package				Others				Total			
	Domestic		Exports		Domestic		Exports		Domestic		Exports		Domestic		Exports	
Quantity	Amount	Quantity	Amount	Quantity	Amount	Quantity	Amount	Quantity	Amount	Quantity	Amount	Quantity	Amount	Quantity	Amount	
1993	218,567	3,583,516	375,863	6,855,705	1,735	70,871	46,546	1,471,238	-	106,408	-	246,185	220,302	3,760,795	422,409	8,573,128
1994	282,590	5,526,433	578,784	10,748,451	2,883	99,647	56,356	2,212,963	-	312,873	-	435,704	285,473	5,938,953	635,140	13,397,118
1995	342,671	8,540,012	797,501	16,589,558	3,304	139,081	46,131	2,115,917	-	597,449	-	783,974	345,975	9,276,542	843,632	19,489,449
1996	439,965	9,735,637	980,386	26,278,058	7,399	378,020	25,497	1,119,274	-	886,343	-	1,002,847	447,364	11,000,000	1,005,883	28,400,179
1997	549,337	9,963,659	1,417,494	29,248,555	19,580	806,301	51,531	1,803,038	-	780,892	-	1,333,182	568,917	11,550,852	1,469,025	32,384,775

**Bringing the World Closer**

Technology brings the world closer together. Now whenever you leave home, electronic technology helps you. From automobiles to rapid transit systems and aircraft, advanced electronic technology shortens the distances between us.





3. Market Analysis

Although the worldwide IC market contracted 10% in 1996, it rebounded in 1997 to register growth of 5.6%. Revenue in the memory market continued to decline, slipping 13% due to falling per-bit prices. However, logic component markets had growth rates between 10% to 20%. In 1998 the worldwide IC market is predicted to register overall growth of around 5% to 10%. The memory market is forecast to grow in 1998, fueled by the emergence of new applications, and double-digit growth rates are expected in the logic component markets.

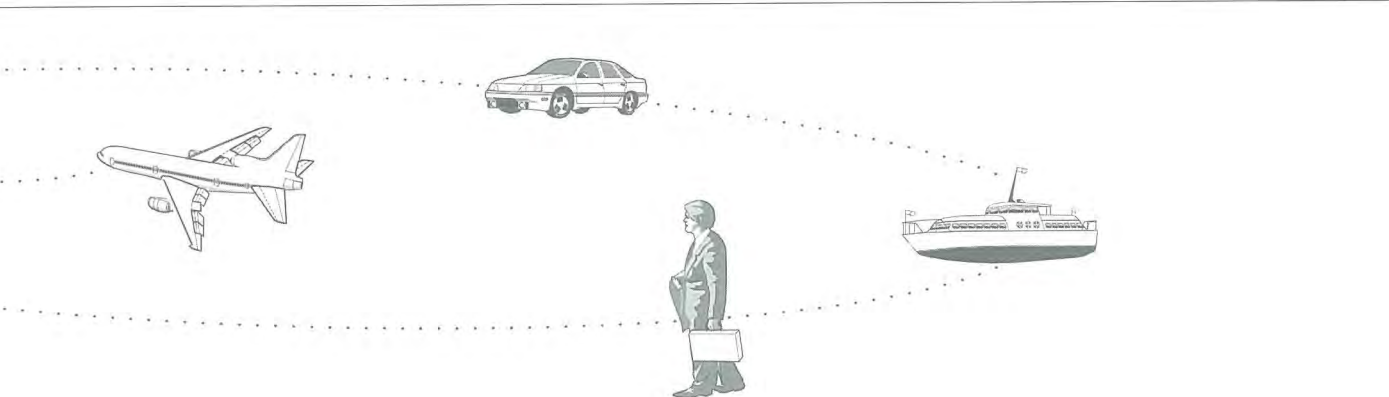
Over the years, TSMC has strategically managed its exposure in the memory market by limiting the proportion of memory manufacturing services to a certain percentage of total sales revenue. This policy has proven successful and in 1996 shielded the company from near free fall in the memory market. In 1997, the same policy also protected the company while the memory market continued to contract. TSMC will maintain this same policy in 1998 even as we work to expand our share of the emerging market for embedded memory products.

In 1997 TSMC's customer base increased in the markets for Internet, digital consumer electronics, and wireless communication markets. Some of these new customers utilized very large volumes of wafers in 1997 and are expected to benefit

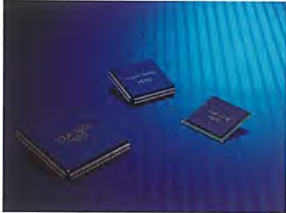
TSMC increasingly over the next several years. Through 1998, TSMC will continue its marketing efforts, targeting customers in high growth segments of the logic component markets.

In the long run, we at TSMC believe that foundry services will play an increasingly important role in the manufacturing sector of the worldwide IC industry. Fabless companies already depend on foundries, and integrated device manufacturers (IDMs) are expected to evolve into stronger and stronger business connections with foundries for IC manufacturing. Industry forecasts predict that by the year 2000, 15% of the world's IC production will come from foundries, and the level will reach 20%~25% by the year 2006.

TSMC believes that it is in an ideal position to benefit from the current trend toward disintegration and sales are expected to benefit positively from the rapid increase in sales of low-priced personal computers and multimedia products. Consumer demand is expected to impel our customers to integrate their chips and thus create a need for the higher capacity of our advanced technologies. TSMC hopes to be able



to maintain high average selling prices for wafers as the company's production capacity evolves through more and more advanced technologies.



T S M C f u l l y understands that we may face a serious competition in the future. Therefore, to ensure T S M C 's

continuing leadership and profitability in 1998 and beyond, we determine to establish closer partnerships with customers and to provide the most advanced technologies and the most comprehensive services.

In terms of the most state-of-the-art technologies, we will focus on the following technology offerings:

(1) Advanced CMOS Logic Process

TSMC began mass production using the 0.35 μm CMOS Logic process in early 1997 and by the end of the same year began using 0.3 μm . In early 1998, 0.25 μm CMOS Logic process will enter volume production, and the 0.18 μm CMOS Logic process will enter volume production in early 1999. The move into these advanced technologies will help TSMC customers develop extremely high performance highly-integrated chips and thus remain competitive in both performance and price.

(2) Advanced Mixed-Signal Process

To meet the demand for communication and consumer ICs in the mixed-signal market, by early 1997 TSMC had successfully developed the 0.35 μm double-poly, quadruple-metal process. This process makes it easier for TSMC customers to integrate digital-signal processors and/or media-processor chips with analog circuitry developed in the fast-growing multimedia market. The 0.25 μm mixed-signal process will be available in early 1998.

(3) Advanced SRAM/Embedded SRAM Processes

TSMC's 0.3 μm high-speed SRAM process became available to customers in 1997. The 0.25 μm process was ready in late 1997, and will begin mass-production in early 1998. On the embedded SRAM, the company has completed the development of the 0.35 μm triple-poly, quadruple-metal process and is already providing it to customers. The 0.25 μm Embedded SRAM will be ready at the same time as the 0.25 μm Logic.

(4) Advanced DRAM/Embedded DRAM Processes

In 1997, TSMC completed development of the 0.32 μm DRAM process. In the same year, TSMC also finished the development of the 0.35 μm embedded DRAM solution for production and will be formally released for production in 1998. This process offers great opportunities for TSMC customers in the markets of graphics, disk storage, communications, and consumer electronics. The 0.25 μm DRAM and embedded DRAM processes will also be introduced in second half of 1999.



Dissolving Boundaries Between People, Between Nations

Now, with the touch of a finger you have access to information all over the world. From Intranets within businesses to the Internet connecting the entire globe, computer networks have made the dream of a low-cost global information system come true.



(5) Advanced Flash/Embedded Flash Memory Processes

In 1997 TSMC finished the development of both the 0.5 μm logic-based double-poly, triple-metal, split-gate embedded Flash memory and the 0.5 μm mixed-mode triple-poly, triple-metal, split-gate embedded Flash memory processes. The embedded Flash memory process will help customers integrate Flash with logic, especially in μC , DSP, and other applications requiring high integration. The 0.35 μm Flash/embedded Flash

memory development will be completed and available for production in 1998. TSMC also will have the 0.25 μm Flash/embedded process available in early 1999.

(6) BiCMOS Process

For customers manufacturing devices used in mass storage and wireless communication, TSMC began offering 0.8 μm BiCMOS (12 GHz) in 1996.

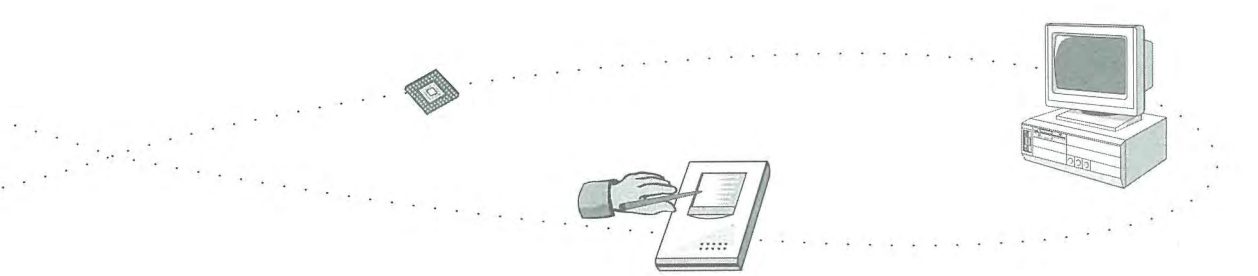
(7) Design Services

TSMC completed development of 0.35 μm standard-cell libraries in 1997. The 0.25 μm version will be ready in the first quarter of 1998. In addition, the 0.25 μm version of design kits and IP/megacells such as ADC/DAC, PLL, DSP core will be available in 1998 to help TSMC customers reduce time-to-the-market and to develop system-on-a-chip designs.



4. Personnel Growth over the Last Three Years

Year	Number of Employees				Average Age	Average Years of Service	Percentage by Education					
	Direct Labor	Engineer	Manager	Total			Ph.D.	MS/MA	BS/BA	High School	Other	Total
1995	1,578	1,372	462	3,412	28	3.3	1.6%	15.3%	38.7%	43.3%	1.1%	100.0%
1996	1,830	1,715	572	4,117	28	3.5	1.8%	19.0%	37.8%	41.3%	0.1%	100.0%
1997	2,712	2,200	681	5,593	28	3.3	1.8%	20.0%	37.6%	40.5%	0.1%	100.0%



5. Long-term Investments

(As of December 31, 1997)

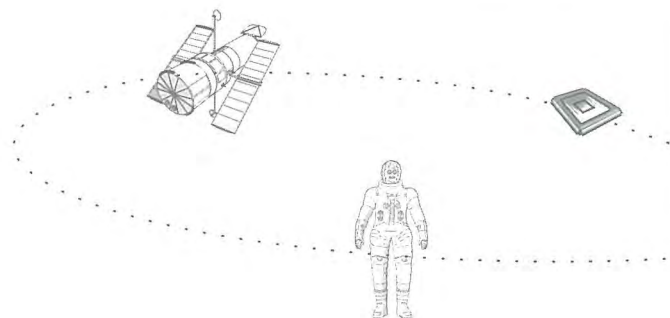
Unit:NT\$,k, except Investment Shares

Other Investments	Business Activities	Investment Costs	Book Value	Investment Shares		Net Worth	Market Value	Accounting Policy	Return on Investment		Investment to TSMC
				Number of Shares	Share (%)				Investment Income (loss)	Dividends	
Taiwan Mask Corp.	Mask Making	57,032	57,032	6,201,758	4.23	-	895,348	Cost Method	-	19,247	Nil
TSMC-USA	Marketing & Engineering Support	25,588	141,485	1,000,000	100.00	141,485	-	Equity Method	25,129	-	Nil
TSMC-Europe	Marketing & Engineering Support	2,960	22,114	200	100.00	22,114	-	Equity Method	8,820	-	Nil
TSMC-Japan	Marketing & Engineering Support	7,440	6,020	600	100.00	6,020	-	Equity Method	-	-	Nil
Caesar Technology Co., Ltd.**	IC Assembly & Testing	494,494	505,394	34,991,651	16.65	538,342	-	Cost Method	-	16,584	Nil
Vanguard Int'l Semiconductor Corp	IC Design & Manufacturing	5,256,440	5,697,114	520,658,181	27.11	5,499,556	-	Equity Method	(64,440)	-	Nil
TSMC International Investment Ltd.	Semiconductor related business investment	11,045,068	12,489,962	379,788,244	100.00	12,489,962	-	Equity Method	49,829	-	Nil
Lian Ya Corporation	Liquid nitrogen & nitrogen gas manufacturing & marketing	146,250	146,250	7,605,000	11.25	124,487	-	Cost Method	-	17,550	Nil
Shin-Etsu Handotai Taiwan Co., Ltd.	Raw wafer R&D, manufacturing & marketing	105,000	105,000	10,500,000	7.00	78,249	-	Cost Method	-	-	Nil
W. K. Technology Fund	Venture investment and related businesses	50,000	50,000	5,000,000	4.17	51,001	-	Cost Method	-	-	Nil

** On January 23, 1998, TSMC sold its stock investment in Caesar Technology Co. Ltd. of 34,991,651 shares at NT\$22.54 per share, or NT\$788,712 thousand.

Extending Human Vision

The earth seems huge to us, but our planet amounts to a tiny particle in the vast universe. From electronic telescopes to interplanetary spacecraft, progress in electronic technology is an expression of the greatest of human ambitions, to know infinity.





6. Environmental Protection Measures

1997 was a year of strong progress for TSMC in the area of environmental protection. ISO-14001 certification expanded from Fab II to Fab I, Fab III and Fab IV. In accordance with the ISO-14001 program, a variety of ongoing improvement programs were launched. These efforts not only reduced pollution, but also reduced expenses. Furthermore, TSMC's spirit of environmental protection and the principles of ISO-14001 have begun to extend to our suppliers. In 1997 TSMC began conducting site surveys on vendors and exchanging environmental information with suppliers and other appropriate organizations. At TSMC we will continue our dedication to environmental protection. We will work to expand ISO-14001, and we will encourage our vendors to promote environmental awareness while improving their own environmental protection programs.

TSMC joined SEMATECH's international "Fab energy survey" last year. This worldwide collaborative study of energy consumption by process equipment facilities and administrative offices will be used to develop international energy consumption benchmarks. SEMATECH will compile the data and use the research results to encourage energy-saving designs for process equipment.

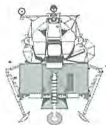
In 1997 TSMC earned several awards for outstanding effort in environmental protection. The honors included:

- National Outstanding Environmental Safety & Health Company, awarded by the Ministry of Economic Affairs;
- 1997 National Excellent Industrial Waste Minimization Plant, awarded by the EPA/MOEA Joint National Waste Reduction Task Force;
- Special award for Outstanding Performance in Environmental Protection, to honor TSMC's excellent performance for three consecutive years.

7. Labor Relations

TSMC management works to build trust among our staff and places equal emphasis on internal and external communication. This principle encourages TSMC managers to show respect for their subordinates. To build this positive environment, TSMC is dedicated to improving working conditions, upgrading recreational and leisure facilities, and to ensuring adequate health benefits. TSMC continues to work hard to promote the physical and psychological well-being of employees.

As part of TSMC's commitment to an open and communicative environment within the company, departmental meetings and round-table discussions are held each month. The company also provides an employee suggestion box, offers employee counseling and guidance services, and conducts employee opinion surveys as needed.



8. Important Contracts

Technology Cooperation Agreement

- (1) Term of Agreement: 7/9/1997~7/9/2007
- (2) Summary: Under this agreement, TSMC is obliged to pay a technical assistance fee to Philips Electronics N.V. of a certain percentage of net sales for certain products.
- (3) Contracting Party: Philips Electronics N.V.

Submicron Technology Licensing Agreement

- (1) Term of Agreement: 11/20/1990~12/31/2000
- (2) Summary: Under this agreement, TSMC is obliged to pay a licensing fee of NT\$129.4 million to the Industrial Technology Research Institute over a five-year period, plus a royalty fee of a certain percentage of net sales for certain products. As of December 31, 1995, TSMC had paid the entire licensing fee.
- (3) Contracting Party: The Industrial Technology Research Institute

Building and Equipment Leasing Agreement (FAB I)

- (1) Term of Agreement: 4/1/1997~3/31/2002
- (2) Summary: Under this agreement, TSMC leases certain buildings and equipment from the Ministry of Economic Affairs.
- (3) Contracting Party: Ministry of Economic Affairs

Land and Public Facility Leasing Agreement (FAB I)

- (1) Term of Agreement: 4/1/1997~3/31/2002
- (2) Summary: Under this agreement, TSMC leases certain land and public facilities from the Industrial Technology Research Institute.
- (3) Contracting Party: The Industrial Technology Research Institute

Syndicated Term Loan Agreement

- (1) Term of Agreement: 12/29/1994~12/15/2001
- (2) Summary: Under this contract with a consortium of 25 banks, TSMC may borrow up to US\$260 million to procure equipment and machinery for Fab III.
- (3) Contracting Parties: 25 banks, including ABN AMRO Bank, N.V., Taipei Branch, and China Trust Commercial Bank.

Option Agreements

- (1) Term of Agreement: 1995~2001
- (2) Summary: Under these agreements, TSMC guarantees a pre-determined capacity for a set number of years to customers in the United States, Europe, and Asia. As of the end of 1997, more than ten companies had signed option agreements with TSMC.
- (3) Contracting Parties: More than 10 companies in the U.S.A., Europe, and Asia.

Manufacturing Agreement

- (1) Term of Agreement: three years, upon commencement of production at WaferTech, LLC
- (2) Summary: Under this agreement, TSMC is obliged for three years, upon commencement of production at WaferTech, LLC to purchase a minimum of eighty-five percent of calculated installed production capacity of WaferTech, LLC. TSMC has the option to purchase up to one hundred percent of the calculated installed capacity. In the event that TSMC is unable or unwilling to purchase the minimum purchase allocation, TSMC will be obliged to pay compensation to WaferTech, LLC.
- (3) Contracting Party: WaferTech, LLC



Purchase Agreement

(1) Term of Agreement: three years upon commencement of production at WaferTech, LLC.

(2) Summary: Under this agreement, TSMC is obliged to supply, and the three customers are obliged to purchase, a certain portion of wafers produced by WaferTech, LLC. In the event that TSMC, or any of the customers, is unable or unwilling to supply or purchase the minimum purchase allocation, the defaulting party will be obliged to pay compensation to the opposite party.

(3) Contracting Parties: three customers

9. Status of Previous Cash Capital Call or Corporate Bond

In June, 1997, TSMC issued 5-year, zero-coupon European Convertible Bonds to finance company expansion. The total amount of the issuance was US\$350 million. As of December 31, 1997, US\$154 million of the funds had been spent to purchase manufacturing equipment for Fab IV. US\$152.58 million had been spent on Fab V. The

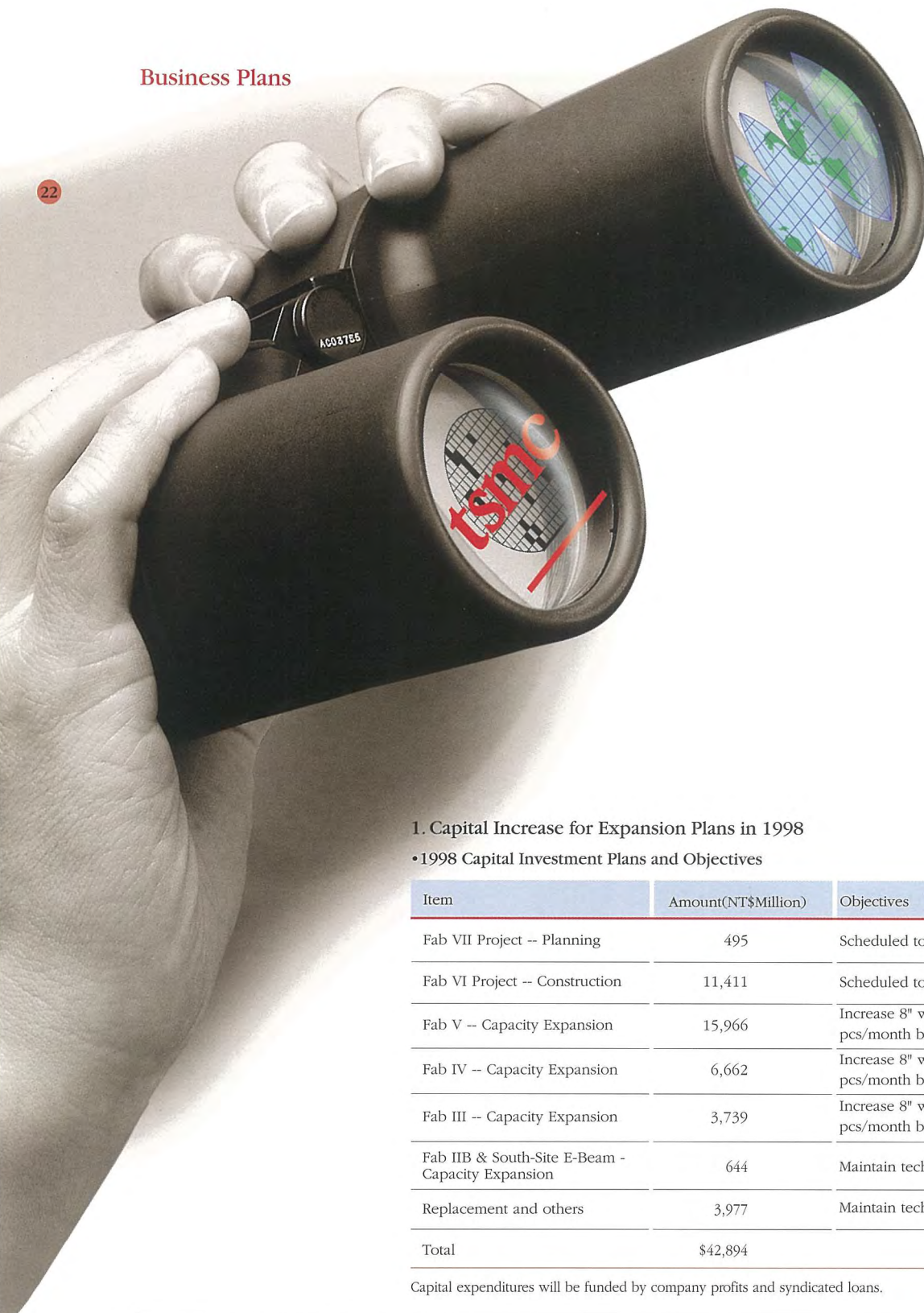
remainder is expected to be used by the end of the second quarter of 1998 to acquire more equipment for Fab V.

10. Litigation Proceedings

On February 25, 1997, Micron Technology filed a petition in the United States against SRAM manufacturers in Taiwan and Korea. The petition led to an investigation by the U.S. Department of Commerce (“DOC”), which resulted in the levying of across-the-board “dumping duties” on subject merchandise from Taiwan and Korea. TSMC’s foundry sales were excluded in the investigation but were nevertheless subject to the “all others” rate of 41.98%. The International Trade Commission (“ITC”) will make a final determination as to whether SRAM manufacturers in the U.S. were materially injured by imports from Korea and Taiwan. However, it is important to note that SRAM accounts for a very small portion of TSMC’s total sales, and direct sales to the U.S. accounts for even less. Thus, the impact of these punitive duties on TSMC is expected to be slight.

*We promote maximum flexibility!
Whenever a customer needs us, we are
always there. We stand in our
customers' shoes and devote ourselves
fully to satisfying their requirements,
just as though they owned the fab.*





1. Capital Increase for Expansion Plans in 1998

•1998 Capital Investment Plans and Objectives

Item	Amount(NT\$Million)	Objectives
Fab VII Project -- Planning	495	Scheduled to produce 12" wafers by the year 2000
Fab VI Project -- Construction	11,411	Scheduled to produce 8" wafers by mid-1999
Fab V -- Capacity Expansion	15,966	Increase 8" wafer output capacity to 22,000 pcs/month by the end of 1998
Fab IV -- Capacity Expansion	6,662	Increase 8" wafer output capacity to 31,000 pcs/month by the end of 1998
Fab III -- Capacity Expansion	3,739	Increase 8" wafer output capacity to 41,000 pcs/month by the end of 1998
Fab IIB & South-Site E-Beam - Capacity Expansion	644	Maintain technology superiority and competitiveness
Replacement and others	3,977	Maintain technology superiority and competitiveness
Total	\$42,894	

Capital expenditures will be funded by company profits and syndicated loans.

*We are building the future through innovation!
 With a vision for the future and the determination to surpass
 our present success, we will continue to innovate in all areas
 and thus continue to lead the IC foundry industry.*

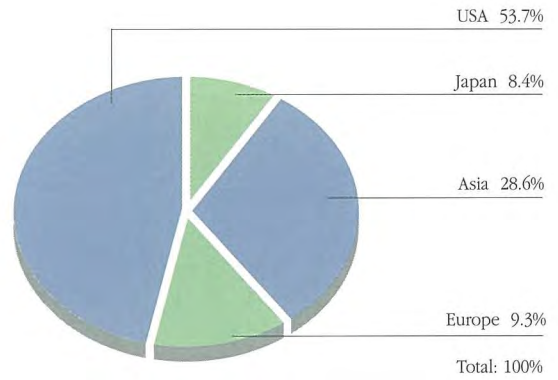
2. Production and Sales Plans for 1998

•Production Plan

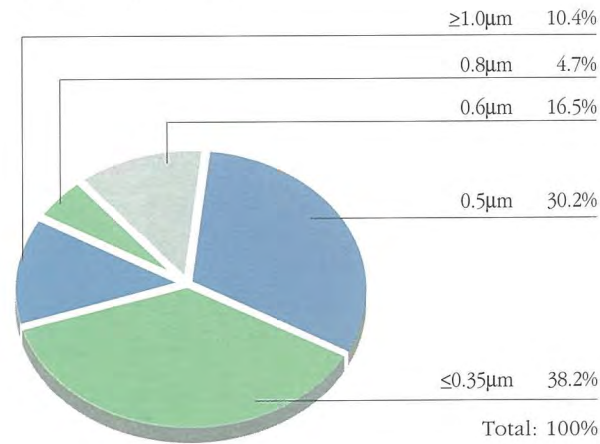


Total: 1,633 (Thousand pcs-8")

•Sales Plan by Area



•Sales Plan by Technology



3. Research and Development Plans

(1) R&D Investment and Achievements (from 1995~1997)

•R&D Investment



•R&D Achievements

The TSMC R&D team is one of the most outstanding technology development organizations in the semiconductor industry. Our team owns abundant engineering resources in logic technology, memory technology, advanced process modules, computer-aided-design, and photo mask technology. The TSMC R&D team is committed not only to remaining the technology champion in the foundry business, but also to becoming a world leader in IC processing technology.

In 1997, our R&D team introduced 0.25 μm five-layer metal logic technology. In the first few months after the introduction of this technology, TSMC attracted a record-breaking number of customers by our world-leading device performance and back-end metal rules.



During the same year, project on a wide variety of memory technologies were completed by our R&D team. First, our 0.25 μm four-transistor SRAM process outperforms competitors by offering the world's smallest memory cell size. As a result, TSMC customers gain an increase of over 30% in die count per wafer. Second, the 0.35 μm embedded SRAM process enables customers to embed a four-mega-bit memory, the large integration scale of which is unprecedented, into one logic chip. Third, the 0.35 μm embedded DRAM process has been proven successful in the fabrication of pioneering system-on-a-chip products, such as combining a high performance graphics engine with sixteen mega bit DRAM. Fourth, our 0.35 μm embedded Flash process, which merges non-volatile memory with high performance logic, opens the door to advanced micro-controllers and to communication products with many newly added functions.

(2) Direction of Future Developments

To stay ahead of the swiftly advancing technology, the TSMC R&D team strives to continuously introduce next generation processes to its production facilities. Process technologies currently under development include 0.18 μm logic, 0.25 μm mixed-signal, 0.18 μm SRAM, 0.25 μm Flash, and 0.25 μm embedded DRAM. In mid-1998, TSMC expects to begin developing 0.15 μm generation process technologies, including world-leading copper process modules. TSMC's commitment to spearheading R&D efforts ensures the timely availability of advanced technologies, which enables TSMC to satisfy customer requirements quickly, and in turn allows TSMC customers to introduce new products to the market with strong competitive advantages.

Financial Statements

All financial information discussed in this Annual Report is derived from the unconsolidated financial statements included herein that were prepared on the basis of generally accepted accounting principles in the Republic of China which differs significantly, in certain respects, from generally accepted accounting principles in the United States ("US GAAP") and certain other countries. Consolidated financial statements are also included herein. TSMC will file an Annual Report on Form 20-F with the United States Securities and Exchange Commission (the "SEC") prior to June 30, 1998 which will include consolidated financial statements that include a reconciliation of certain items to US GAAP, as required by applicable SEC regulations and the listing requirements of the New York Stock Exchange.

1. Brief Balance Sheet

Financial analysis from 1993 to 1997

Unit: NT\$K

Item	1993	1994	1995	1996	1997
Current assets	5,111,310	7,659,444	16,070,964	16,529,359	23,790,795
Long-term stock investments	161,156	3,074,147	4,989,037	12,608,506	19,220,371
Fixed assets	10,436,047	14,986,932	26,643,665	41,978,952	61,697,723
Other assets	290,639	386,580	599,369	2,018,827	3,804,923
Current liabilities					
Before distribution	2,046,034	2,897,189	5,075,481	5,357,895	10,088,672
After distribution	2,789,825	3,233,580	5,926,696	5,926,138	*
Long-term liabilities	2,546,644	3,259,206	5,556,381	5,720,000	20,009,357
Other liabilities	305,373	1,119,880	4,091,928	9,943,809	9,001,390
Capital stock	6,083,040	7,800,000	14,390,000	26,542,000	40,813,000
Capital surplus	822	875	19,428	59,086	62,082
Retained earnings					
Before distribution	5,016,046	11,029,256	19,165,640	25,523,456	28,641,292
After distribution	2,555,295	4,102,865	6,162,425	10,684,213	*
Total Assets	15,999,151	26,107,103	48,303,035	73,135,644	108,513,812
Total Liabilities					
Before distribution	4,898,050	7,276,275	14,723,790	21,021,704	39,099,419
After distribution	5,641,841	7,612,666	15,575,005	21,589,947	*
Total Equity					
Before distribution	11,101,101	18,830,828	33,579,245	52,113,940	69,414,393
After distribution	10,357,310	18,494,437	32,728,030	51,545,697	*

*Subject to change after shareholders' meeting resolution

2. Brief Statements of Income

Financial analysis from 1993 to 1997

Unit: NT\$K
(Except EPS: NT\$)

Item	1993	1994	1995	1996	1997
Net sales	12,333,923	19,336,071	28,765,991	39,400,179	43,935,627
Gross profit	5,410,167	10,091,902	16,104,950*	21,979,249*	21,094,156
Income from operation	4,419,143	8,615,119	13,897,006	18,235,246	15,489,780
Interest revenue	55,269	210,135	367,986	653,462	501,434
Interest expense	180,412	197,062	258,000	277,161	546,490
Profit before tax	4,245,106	8,580,744	14,314,528	18,972,932	15,517,103
Net profit	4,245,106	8,474,014	15,081,273	19,400,689	17,960,075
Earnings per share	6.98**	10.86**	10.48**	7.31**	4.40**
	1.04***	2.08***	3.70***	4.75***	
Capitalized interest	27,467	15,868	102,926	181,168	255,054

* Certain accounts in 1995 and 1996 have been reclassified to conform to 1997 classifications

** Based on weighted average shares outstanding in each year

*** Retroactive adjustment for capitalizations of unappropriated earnings and bonus to employees

3. Financial Analysis

Financial analysis from 1993 to 1997

Item	1993	1994	1995	1996	1997
Capital Structure Analysis					
Debts ratio(%)	30.61	27.87	30.48	28.74	36.03
Long-term fund to fixed assets(%)	130.78	147.40	146.89	137.77	144.94
Liquidity Analysis					
Current ratio(%)	249.82	264.38	316.64	308.50	235.82
Quick ratio(%)	189.88	214.33	257.83	247.77	185.78
Times interest earned (times)	21.29	41.22	40.38	42.40	20.04
Operating Performance Analysis					
Average collection turnover (times)	7.51	8.55	8.12	8.80	6.22
Average collection days	48.60	42.69	44.95	41.00	58.68
Average inventory turnover (times)	7.40	8.01	7.73	7.24*	6.12
Average inventory turnover days	49.32	45.57	47.22	50.43*	59.69
Fixed assets turnover (times)	1.18	1.29	1.08	0.94	0.71
Total assets turnover (times)	0.77	0.74	0.60	0.54	0.41
Profitability Analysis					
Return on total assets (%)	32.31	41.17	41.23	32.40	20.35
Return ratio on stockholders' equity (%)	46.74	56.62	57.55	45.28	29.56
Operating income to capital stock (%)	72.65	110.45	96.57	68.70	37.95
Profit before tax to capital stock (%)	69.79	110.01	99.48	71.48	38.02
Profit after tax to net sales (%)	34.42	43.82	52.43	49.24	40.88
Net worth per share (NTD)	18.25	24.14	23.34	19.63	17.01
Earnings per share (NTD)	1.04**	2.08**	3.70**	4.75**	4.40
Dividends per share (NTD)	3.48	8.00	8.00	5.00	***
Cash dividends (NTD)	1.00	-	-	-	***
Stock dividends (NTD)	2.48	8.00	8.00	5.00	***
Cash Flow					
Cash flow ratio (%)	299.84	394.12	348.45	452.74	201.55
Cash flow adequacy ratio (%)	69.78	103.20	111.94	113.70	97.96
Cash flow reinvestment ratio (%)	31.59	34.34	31.94	28.21	16.28
Leverage					
Operating leverage	2.08	1.70	1.69	1.79	2.15
Financial leverage	1.04	1.02	1.02	1.02	1.04

* Certain accounts in 1996 have been reclassified to conform to 1997 classifications

** Retroactive adjustment for capitalizations of unappropriated earnings and bonus to employees

*** Subject to change after shareholders' meeting resolution

4. Net Worth, Earnings, Dividends and Market Price Per Share

	1995	1996	1997
Market price per share			
Highest market price	196.00	106.00	173.00
Lowest market price	77.00	49.10	55.5
Average market price	128.43	63.83	109.35
Net worth per share			
Before distribution	23.34	19.63	17.01
After distribution	22.74	19.42	*
Earnings per share			
Weighted average shares	1,439,000,000	2,654,200,000	4,081,300,000
Earnings per share	10.48	7.31	4.40
Earnings per share ¹	3.70	4.75	
Dividends per share			
Cash dividends	-	-	*
Stock dividends			
Dividends from retained earnings	8.00	5.00	*
Dividends from capital surplus	-	-	
Return on investment			
Price/Earning ratio ²	12.25	8.73	24.85
Price/Dividend ratio ³	-	-	*
Cash dividend yield rate ⁴	0	0	*

*Subject to change after shareholders' meeting resolution

Note 1. Retroactive adjustment for capitalizations of unappropriated earnings and bonus to employees

Note 2. Price/Earning ratio=Average market price/Earnings per share

Note 3. Price/Dividend ratio=Average market price/Cash dividends per share

Note 4. Cash dividend yield rate=Cash dividends per share/Average market price

5. Auditors' Opinion from 1993 to 1997

Year	CPA	Audit Opinion
1993	Michael Chang, Jerry Tsai	An Unqualified Opinion
1994	S.C. Huang, Jerry Tsai	An Unqualified Opinion
1995	S.C. Huang, Edward Way	An Unqualified Opinion, except the adoption of Statement of Financial Accounting Standards No.22.
1996	S.C. Huang, Edward Way	An Unqualified Opinion
1997	S.C. Huang, Edward Way	An Unqualified Opinion

12F, No.156, Sec. 3, Min-Sheng E. Rd., Taipei, Taiwan, R.O.C.

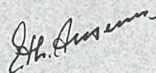
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6. Supervisors' Report

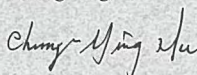
The Board of Directors have prepared and submitted to us the Company's 1997 business report, balance sheet, statement of profit and loss, inventories of major assets, statements of changes in shareholders' equity, statements of cash flows and proposal for allocating profit. The CPAs of TN SOONG & CO were retained to audit the balance sheet, inventories of major assets, statement of profit and loss, statements of changes in shareholders' equity and statements of cash flows and have submitted a report relating thereto. The above reports, statements and proposal have been further examined as being correct and accurate by the undersigned, the supervisors of Taiwan Semiconductor Manufacturing Co., Ltd. According to Article 219 of the Company Law, we hereby submit this report.

Taiwan Semiconductor Manufacturing Co., Ltd.

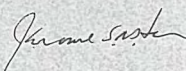
Supervisor E.Th.Ausems



Supervisor Chung-Ying Hu



Supervisor Jerome S.N. Hu



March 13, 1998

7. Financial Statements & Independent Auditors' Report

We have examined the balance sheets of Taiwan Semiconductor Manufacturing Company Ltd. as of December 31, 1997 and 1996, and the related statements of income, changes in shareholders' equity and cash flows for the years then ended. Our examinations were made in accordance with the regulations governing such examinations and generally accepted auditing standards in the Republic of China and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Taiwan Semiconductor Manufacturing Company Ltd. as of December 31, 1997 and 1996, and the results of its operations and its cash flows for the years then ended, in conformity with the regulations governing the preparation of financial statements of public companies and generally accepted accounting principles in the Republic of China applied on a consistent basis.



February 4, 1998

BALANCE SHEETS

December 31, 1997 and 1996

(In Thousand New Taiwan Dollars Except Par Value)

ASSETS	1997		1996	
	Amount	%	Amount	%
CURRENT ASSETS				
Cash and cash equivalents (Notes 2 and 3)	\$ 2,534,242	2	\$ 8,692,448	12
Short-term investments (Notes 2 and 4)	4,970,832	5	-	-
Receivable from related parties (Note 14)	503,040	-	351,889	1
Notes receivable	234,912	-	121,176	-
Accounts receivable	9,634,203	9	4,719,791	6
Allowance for doubtful receivables (Note 2)	(293,087)	-	(155,627)	-
Allowance for sales returns and allowances (Note 2)	(535,214)	-	(454,290)	(1)
Inventories (Notes 2 and 5)	4,720,031	4	2,750,536	4
Deferred income tax assets (Notes 2 and 13)	667,228	1	74,000	-
Prepayments and other (Note 14)	1,354,608	1	429,436	1
Total Current Assets	<u>23,790,795</u>	<u>22</u>	<u>16,529,359</u>	<u>23</u>
LONG-TERM STOCK INVESTMENTS (Notes 2 and 6)	<u>19,220,371</u>	<u>18</u>	<u>12,608,506</u>	<u>17</u>
PROPERTIES (Notes 2, 7 and 15)				
Cost				
Buildings	18,125,783	17	9,768,555	13
Machinery and equipment	64,525,249	59	35,073,892	48
Office equipment	791,462	1	654,723	1
Total cost	83,442,494	77	45,497,170	62
Accumulated depreciation	(26,502,409)	(24)	(18,225,695)	(25)
Prepayments and construction in progress	4,757,638	4	14,707,477	20
Net Properties	<u>61,697,723</u>	<u>57</u>	<u>41,978,952</u>	<u>57</u>
OTHER ASSETS				
Deferred charges - net (Note 2)	641,989	-	140,446	-
Deferred income tax assets (Notes 2 and 13)	3,080,099	3	1,744,263	3
Refundable deposits (Note 16)	73,585	-	124,868	-
Miscellaneous	9,250	-	9,250	-
Total Other Assets	<u>3,804,923</u>	<u>3</u>	<u>2,018,827</u>	<u>3</u>
TOTAL ASSETS	<u>\$108,513,812</u>	<u>100</u>	<u>\$73,135,644</u>	<u>100</u>

The accompanying notes are an integral part of the financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	1997		1996	
	Amount	%	Amount	%
CURRENT LIABILITIES				
Commercial papers payable (Note 8)	\$ 250,000	-	\$ -	-
Payable to related parties (Note 14)	794,313	1	453,098	1
Accounts payable	2,660,146	2	1,034,518	1
Accounts payable - construction and equipment	4,965,985	5	2,565,527	4
Income tax payable (Notes 2 and 13)	-	-	447,780	-
Accrued expenses and other	1,418,228	1	856,972	1
Total Current Liabilities	10,088,672	9	5,357,895	7
LONG-TERM BANK BORROWINGS (Notes 7 and 9)	8,025,900	7	5,720,000	8
CONVERTIBLE BONDS (Note 10)	11,983,457	11	-	-
ACCRUED PENSION COST (Notes 2 and 12)	487,705	1	328,729	-
OTHER LIABILITIES (Note 16)				
Guarantee deposits	8,513,685	8	8,819,322	12
Payments received in advance - equipment	-	-	795,758	1
Total Liabilities	39,099,419	36	21,021,704	28
SHAREHOLDERS' EQUITY				
Capital stock, \$10 par value; authorized - 8,500,000 thousand shares in 1997 and 3,000,000 thousand shares in 1996, issued - 4,081,300 thousand shares in 1997 and 2,654,200 thousand shares in 1996	40,813,000	38	26,542,000	37
Capital surplus	62,082	-	59,086	-
Legal reserve	4,928,532	4	2,992,429	4
Unappropriated earnings	23,712,760	22	22,531,027	31
Cumulative translation adjustment (Note 2)	(101,981)	-	(10,602)	-
Total Shareholders' Equity	69,414,393	64	52,113,940	72
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$108,513,812	100	\$73,135,644	100

STATEMENTS OF INCOME

For the Years Ended December 31, 1997 and 1996
(In Thousand New Taiwan Dollars, Except Earnings Per Share)

	1997		1996	
	Amount	%	Amount	%
GROSS SALES (Note 14)	\$44,765,428		\$39,836,725	
SALES RETURNS AND ALLOWANCES	(829,801)		(436,546)	
NET SALES	43,935,627	100	39,400,179	100
COST OF SALES (Note 14)	22,841,471	52	17,420,930	44
GROSS PROFIT	21,094,156	48	21,979,249	56
OPERATING EXPENSES				
General and administrative	1,583,228	4	1,597,461	4
Marketing (Note 14)	1,515,845	3	652,543	1
Research and development	2,505,303	6	1,493,999	4
Total Operating Expenses	5,604,376	13	3,744,003	9
INCOME FROM OPERATIONS	15,489,780	35	18,235,246	47
NON-OPERATING INCOME				
Interest	501,434	1	653,462	2
Investment income recognized by equity method (Notes 2 and 6)	17,804	-	156,152	-
Gain on sale of long-term stock investments	311,453	1	39,668	-
Gain on disposal of properties	3,131	-	40,759	-
Foreign exchange gain-net (Note 2)	-	-	107,398	-
Other	23,891	-	27,542	-
Total Non-Operating Income	857,713	2	1,024,981	2
NON-OPERATING EXPENSES				
Interest (Note 7)	546,490	1	277,161	1
Foreign exchange loss-net (Note 2)	188,884	1	-	-
Issuance costs of bonds	66,361	-	-	-
Loss on disposal of properties	7,722	-	10,071	-
Other	20,933	-	63	-
Total Non-Operating Expenses	830,390	2	287,295	1
INCOME BEFORE INCOME TAX	15,517,103	35	18,972,932	48
INCOME TAX CREDIT (Notes 2 and 13)	2,442,972	6	427,757	1
NET INCOME	\$17,960,075	41	\$19,400,689	49
EARNINGS PER SHARE				
Based on weighted-average shares				
outstanding of 4,081,300 thousand in 1997				
and 2,654,200 thousand in 1996	\$4.40		\$7.31	
Based on 4,081,300 thousand shares			\$4.75	

The accompanying notes are an integral part of the financial statements.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 1997 and 1996
(In Thousand New Taiwan Dollars)

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Financial Statements

	CAPITAL STOCK ISSUED		CAPITAL SURPLUS (Note 2)			RETAINED EARNINGS (Note 11)			CUMULATIVE TRANSLATION ADJUSTMENT (Note2)	TOTAL SHAREHOLD- ERS' EQUITY
	Thousand Shares	Amount	Gain on Disposal of Properties	Donation	Total	Legal Reserve	Unappropriated Earnings	Total		
BALANCE, JANUARY 1, 1996	1,439,000	\$14,390,000	\$19,373	\$55	\$19,428	\$1,486,151	\$17,679,489	\$19,165,640	\$ 4,177	\$33,579,245
Appropriations of prior year's earnings										
Legal reserve	-	-	-	-	-	1,506,278	(1,506,278)	-	-	-
Bonus to employees										
Cash	-	-	-	-	-	-	(715,650)	(715,650)	-	(715,650)
Stock	64,000	640,000	-	-	-	-	(640,000)	(640,000)	-	-
Stock dividends - 80%	1,151,200	11,512,000	-	-	-	-	(11,512,000)	(11,512,000)	-	-
Bonus to directors and supervisors	-	-	-	-	-	-	(135,565)	(135,565)	-	(135,565)
Net income for 1996	-	-	-	-	-	-	19,400,689	19,400,689	-	19,400,689
Gain on disposal of properties	-	-	39,658	-	39,658	-	(39,658)	(39,658)	-	-
Translation adjustment	-	-	-	-	-	-	-	-	(14,779)	(14,779)
BALANCE, DECEMBER 31, 1996	2,654,200	26,542,000	59,031	55	59,086	2,992,429	22,531,027	25,523,456	(10,602)	52,113,940
Appropriations of prior year's earnings										
Legal reserve	-	-	-	-	-	1,936,103	(1,936,103)	-	-	-
Bonus to employees										
Cash	-	-	-	-	-	-	(393,994)	(393,994)	-	(393,994)
Stock	100,000	1,000,000	-	-	-	-	(1,000,000)	(1,000,000)	-	-
Stock dividends - 50%	1,327,100	13,271,000	-	-	-	-	(13,271,000)	(13,271,000)	-	-
Bonus to directors and supervisors	-	-	-	-	-	-	(174,249)	(174,249)	-	(174,249)
Net income for 1997	-	-	-	-	-	-	17,960,075	17,960,075	-	17,960,075
Gain on disposal of properties	-	-	2,996	-	2,996	-	(2,996)	(2,996)	-	-
Translation adjustment	-	-	-	-	-	-	-	-	(91,379)	(91,379)
BALANCE, DECEMBER 31, 1997	<u>4,081,300</u>	<u>\$40,813,000</u>	<u>\$62,027</u>	<u>\$55</u>	<u>\$62,082</u>	<u>\$4,928,532</u>	<u>\$23,712,760</u>	<u>\$28,641,292</u>	<u>(\$101,981)</u>	<u>\$69,414,393</u>

The accompanying notes are an integral part of the financial statements.

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 1997 and 1996
(In Thousand New Taiwan Dollars)

	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$17,960,075	\$19,400,689
Depreciation and amortization	9,762,544	6,539,199
Deferred income tax assets	(1,929,064)	(903,872)
Investment income recognized by equity method	(17,804)	(156,152)
Gain on sale of long-term stock investments	(311,453)	(39,668)
Loss (gain) on disposal of properties - net	9,526	(18,726)
Accretion in redemption value of bonds	433,457	-
Changes in operating assets and liabilities		
Receivable from related parties	(151,151)	(99,093)
Notes receivable	(113,736)	18,770
Accounts receivable	(4,914,412)	(135,917)
Allowance for doubtful receivables	137,460	(1,000)
Allowance for sales returns and allowances	80,924	4,996
Inventories	(1,969,495)	(687,494)
Prepayments and other current assets	(970,741)	(92,653)
Payable to related parties	341,215	(143,057)
Accounts payable	1,687,186	(629,752)
Income tax payable	(447,780)	277,201
Accrued expenses and other current liabilities	588,188	(195,358)
Accrued pension costs	158,976	117,954
Other	-	(129)
Net Cash Provided by Operating Activities	<u>20,333,915</u>	<u>23,255,938</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in short-term investments	(4,970,832)	-
Acquisition of properties	(28,020,842)	(20,932,942)
Increase in long-term stock investments	(5,245,762)	(7,537,209)
Proceeds from disposal of properties	38,256	67,960
Proceeds from sale of long-term stock investments	341,786	114,651
Increase in deferred charges	(607,028)	(128,712)
Decrease in refundable deposits	45,531	91,184
Net Cash Used in Investing Activities	<u>(38,418,891)</u>	<u>(28,325,068)</u>

	1997	1996
CASH FLOWS FROM FINANCING ACTIVITIES		
Commercial papers payable	\$ 250,000	\$ -
Issuance of convertible bonds	11,550,000	-
Additions to long-term bank borrowings	2,877,900	6,868,841
Repayments of long-term bank borrowings	(572,000)	(6,705,222)
Bonus to directors and supervisors	(174,249)	(135,565)
Bonus to employees	(393,994)	(715,650)
Increase (decrease) in guarantee deposits	(305,637)	5,377,465
Increase in other liabilities (payment received in advance-equipment)	163,780	356,462
Adjustment for forward contract payable	(1,469,030)	-
Net Cash Provided by Financing Activities	<u>11,926,770</u>	<u>5,046,331</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(6,158,206)	(22,799)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>8,692,448</u>	<u>8,715,247</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 2,534,242</u>	<u>\$ 8,692,448</u>
SUPPLEMENTAL INFORMATION		
Interest paid (excluding capitalized interest)	<u>\$ 477,643</u>	<u>\$ 331,848</u>
Income tax paid	<u>\$ -</u>	<u>\$ 198,908</u>
Noncash investing and financing activities— effect of exchange rate changes on cash and cash equivalents	<u>\$ 43,774</u>	<u>\$ 40,975</u>
Cash paid for acquisition of properties		
Total acquisition	\$30,421,300	\$21,890,452
Accounts payable-construction and equipment	<u>(2,400,458)</u>	<u>(957,510)</u>
	<u>\$28,020,842</u>	<u>\$20,932,942</u>

NOTES TO FINANCIAL STATEMENTS

(Amounts in Thousand New Taiwan Dollars,
Unless Specified Otherwise)

(1) GENERAL

The Company is engaged mainly in a) manufacture, sale, packaging, testing and computer-aided design of integrated circuits and other semiconductor devices, and b) manufacture and design of masks.

The Company's shares have been listed and traded on the Taiwan Stock Exchange since September 1994.

On October 8, 1997, 120,000 thousand shares of capital stock previously held by Philips Electronics N.V. were listed on the New York Stock Exchange in the form of American Depositary Shares (ADS).

(2) SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies of the Company, which conform to generally accepted accounting principles in the Republic of China, are summarized as follows:

- **Cash equivalents**

Commercial papers and negotiable certificates of deposits with original maturities of less than three months are classified as cash equivalents.

- **Short-term investments**

Short-term investments are stated at the lower cost or market value. The costs of investments sold are determined individually.

- **Allowance for doubtful receivables**

Allowance for doubtful receivables is provided based on a review of the collectibility of individual receivables.

- **Sales and allowance for sales returns and allowances**

Sales are recognized when products are shipped to customers. Allowance for sales returns and allowances is provided based on experience.

- **Inventories**

Inventories are stated at the lower of standard cost (adjusted to approximate weighted average cost) or market value. Market value represents net realizable value for finished goods and work in process, and replacement value for raw materials, supplies and spare parts.

- **Long-term stock investments**

Investments representing at least 20% of the voting stock of each investee and for which the Company exercises significant influence on the investees are accounted for by equity method. The difference between the investment cost and the proportionate share in the equity of the investee at the date of acquisition is amortized on a straight-line basis over five years and is included in investment income or loss.

Other investments are accounted for by cost method.

The costs of investments sold are determined by the weighted average method.

- **Properties**

Major additions, renewals and betterments, and interest expense incurred during the construction period are capitalized, while maintenance and repairs are expensed currently.

Depreciation is provided on the straight-line method over estimated service lives which range as follows: buildings - 10 to 20 years; machinery and equipment - 5 to 10 years; office equipment - 3 to 5 years.

Upon sale or disposal of properties, the related cost and accumulated depreciation are removed from the accounts, and any gain or loss is credited or charged to income. Any such gain, less applicable income tax, is transferred to capital surplus at the end of the year.

- **Deferred charges**

Deferred charges, consisting of software and system design costs and issuance costs of convertible bonds, are amortized over three and five years, respectively.

- **Pension benefits**

The Company adopted Financial Accounting Standards (FAS) No. 18, "Accounting for Pensions", at the end of 1995. Starting 1996, the Company records net periodic pension costs based on actuarial calculations with December 31, 1995 as the initial measurement date. The unrecognized net transition obligation is amortized over 25 years. The adoption of FAS 18 had an insignificant effect on the Company's financial statements.

Monthly contributions to the pension fund and provisions for pension cost are charged to expense. Pension benefits are paid from the fund, and any excess of such benefits over the fund shall be charged to accrued pension cost first and the excess, if any, to expense.

- **Income tax**

The tax effects of deductible temporary differences and unused tax credits and operating loss carryforwards are recognized as deferred income tax assets, and those of taxable temporary differences are recognized as deferred income tax liabilities. Valuation allowance is provided for deferred income tax assets that are not certain to be realized.

Adjustments of prior years' tax liabilities are added to or deducted from the current year's tax provision.

- **Derivative financial instruments**

Forward exchange contracts for hedging purposes are recorded at the spot rates on the contract dates. The foreign-currency amount of each contract multiplied by the difference between the spot rate on the contract date and the contracted forward rate is amortized over the contract period. At year-end, the balances of forward exchange receivables or payables are translated based on prevailing exchange rates and the resulting gains or losses are credited or charged to income.

Gains or losses and discounts or premiums on forward exchange contracts entered into as hedges of commitments denominated in foreign currencies are deferred and included in the measurement of the bases of the related transactions when these are recorded.

Gains or losses and discounts or premiums on forward exchange contracts entered into as hedges of foreign investments are adjustments for shareholders' equity.

The Company enters into interest rate swap US Dollar Ratio Spread Collar transactions as a means of liability management. Such interest rate swaps are accounted for on an accrual basis, whereby cash settlement receivable or payable is recorded as an adjustment to interest income or expense.

- **Foreign-currency transactions**

Foreign-currency transactions, except derivative financial instruments, are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Gains or losses caused by the application of different foreign exchange rates when cash in foreign currency is converted into New Taiwan dollars, or when foreign-currency receivables and payables are settled are credited or charged to income in the year of conversion or settlement. At year-end, the balances of foreign-currency assets and liabilities are restated based on prevailing exchange rates and the resulting differences are recorded as follows:

- a. Long-term stock investments accounted for by equity method - as cumulative translation adjustment under shareholders' equity.
- b. Long-term stock investments accounted for by cost method - as translation adjustment (same as above) if the translated New Taiwan dollar amount is lower than cost; if higher, no adjustment is made.
- c. Other assets and liabilities - credited or charged to current income.

- **Reclassifications**

Certain accounts in 1996 have been reclassified to conform to 1997 classifications.

(3) CASH AND CASH EQUIVALENTS

	1997	1996
Bank deposit	\$1,942,051	\$8,461,166
Commercial papers	344,434	231,282
Negotiable certificate of deposit	<u>247,757</u>	-
	<u>\$2,534,242</u>	<u>\$8,692,448</u>

(4) SHORT-TERM INVESTMENTS

	1997	1996
U.S. Treasury bonds	\$4,582,672	\$ -
Bonds	<u>388,160</u>	-
	<u>\$4,970,832</u>	<u>\$ -</u>

(5) INVENTORIES

	1997	1996
Finished goods	\$ 521,950	\$ 247,124
Work in process	2,539,137	1,175,727
Raw materials	1,028,528	782,754
Supplies and spare parts	<u>737,216</u>	<u>619,423</u>
	4,826,831	2,825,028
Allowance for losses	<u>(106,800)</u>	<u>(74,492)</u>
	<u>\$4,720,031</u>	<u>\$2,750,536</u>

(6) LONG-TERM STOCK INVESTMENTS

	1997		1996	
	Carrying Value	% of Ownership	Carrying Value	% of Ownership
Accounted for by equity method				
TSMC International Investment	\$12,489,962	100	\$ 6,176,879	100
Vanguard International Semiconductor (VIS)	5,697,114	27	5,762,964	27
TSMC-U.S.A.	141,485	100	95,224	100
TSMC-Europe	22,114	100	12,299	100
TSMC-Japan	<u>6,020</u>	100	-	-
	<u>18,356,695</u>		<u>12,047,366</u>	
Accounted for by cost method				
Taiwan Mask (listed company)	57,032	4	55,988	8
Caesar Technology Inc.	505,394	17	203,902	18
Lian Ya Corporation	146,250	11	146,250	11
Shin-Etsu Handotai Taiwan	105,000	7	105,000	7
W.K. Technology Fund IV	<u>50,000</u>	4	<u>50,000</u>	13
	<u>863,676</u>		<u>561,140</u>	
	<u>\$19,220,371</u>		<u>\$12,608,506</u>	

The carrying values of the investments accounted for by equity method as of December 31, 1997 and 1996 and the related investment income for the years then ended are based on the audited financial statements of the investees in the same period, with the exception of TSMC-Japan.

Information on the investments accounted for by cost method are as follows:

	1997	1996
Market value of listed stocks	\$ 895,348	\$ 651,260
Equity in unlisted stocks	792,079	463,681

On January 23, 1998, the Company sold its stock investment in Caesar Technology Inc of 34,991 thousand shares at \$22.54 per share, or \$788,712.

(7) PROPERTIES

Accumulated depreciation consists of the following:

	1997	1996
Buildings	\$ 3,686,442	\$ 2,408,179
Machinery and equipment	22,387,187	15,486,317
Office equipment	428,780	331,199
	<u>\$26,502,409</u>	<u>\$18,225,695</u>

The status of the various expansion plans as of December 31, 1997 are as follows:

	Estimated	Accumulated	Expected
	Total Cost	Expenditures	Date of Start
			of Operations
Sixth manufacturing plant	\$22,750,000	\$1,007,638	July 1999

Interest expense capitalized in 1997 and 1996 are \$255,054 and \$181,168, respectively.

As of December 31, 1997, properties with an aggregate net book value of about \$4,749,145 are mortgaged as collateral for long-term bank borrowings.

(8) COMMERCIAL PAPERS PAYABLE

These are payable by March 1998, bear 8.4% interest, and are guaranteed by financial institutions.

As of December 31, 1997, unused credit for issuance of commercial papers is \$250,000.

(9) LONG-TERM BANK LOANS

	1997	1996
U.S. dollar loans (thousands)		
US\$156,000 in 1997 and US\$208,000 in 1996, repayable in semi-annual instalments from June 1997 to December 2001; 7.03% interest in 1997 and 6.63%-6.83% in 1996	\$5,148,000	\$5,720,000
US\$36,300, repayable in one lump-sum payment by October 1999, 5.96%-6.56% interest	1,197,900	-
New Taiwan dollar acceptances, repayable by October 2000, 8.25%-8.50% interest	<u>1,680,000</u>	-
	<u>\$8,025,900</u>	<u>\$5,720,000</u>

Unused credit lines as of December 31, 1997 aggregate about \$5,489,570.

(10) BONDS PAYABLE

On July 3, 1997, the Company issued foreign convertible non-interest bearing bonds with a total par value of US\$350,000 thousand (\$11,550,000), which are repayable, together with accretion of \$433,457 in redemption value on July 3, 2002. The bonds can be converted into common stocks of the Company at \$144 per share from forty days after issuance to five days before maturity. When certain conditions are met, the Company may redeem the bonds prior to maturity. As of December 31, 1997, none of the bonds has been converted or redeemed.

(11) SHAREHOLDERS' EQUITY

According to the Company Law, capital surplus can only be used to offset a deficit or transferred to capital.

The Company's Articles of Incorporation provide that the following shall be appropriated from the annual net income (less deficit, if any):

- a) 10% thereof as legal reserve;
- b) Bonus to directors and supervisors, and to employees equal to 1% and at least 1% of the remainder, respectively.

These appropriations and the disposition of the remaining net income shall be resolved by the shareholders in the following year and given effect to in the financial statements of that year.

Under the Company Law, the aforementioned appropriation for legal reserve shall be made until the reserve equals the Company's capital. Such reserve may be used to offset a deficit; also, when the reserve has reached 50% of the paid-in capital, up to 50% thereof can be transferred to capital.

(12) PENSION PLAN

The Company has a pension plan for all regular employees, which provides benefits based on length of service and average monthly salary at the time of retirement.

The Company makes monthly contributions, equal to 2% of salaries and wages, to a pension fund which is administered by the employees pension fund monitoring committee and deposited in the committee's name in the Central Trust of China which acts as trustee.

Certain pension information are summarized as follows:

	1997	1996
a. Pension cost	<u>\$244,492</u>	<u>\$154,415</u>
b. Reconciliation of the fund status of the plan and accrued pension cost		
Benefit obligation		
Vested benefit obligation	\$ 446	\$ -
Nonvested benefit obligation	<u>260,849</u>	<u>165,686</u>
Accumulated benefit obligation	261,295	165,686
Additional benefits based on future salaries	<u>729,989</u>	<u>556,663</u>
Projected benefit obligation	991,284	722,349
Fair value of plan assets	<u>(212,851)</u>	<u>(157,873)</u>
Funded status	778,433	564,476
Unrecognized prior service cost	-	-
Unrecognized net transitional obligation	(190,891)	(199,191)
Unrecognized net loss	(55,914)	(33,557)
Additional liability	<u>-</u>	<u>-</u>
Accrued pension cost	<u>\$531,628</u>	<u>\$331,728</u>
c. Actuarial assumptions		
Discount rate used in determining present values	7%	7%
Future salary increase rate	7%	7%
Expected rate of return plan on assets	7%	7%
d. Contributions to the pension fund	<u>\$ 44,747</u>	<u>\$ 36,461</u>

e. Payments from the pension fund	\$ -	\$ -
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The components of the 1997 pension cost are as follows:

Service cost	\$ 198,503
Interest cost	50,564
Projected return on plan assets	(12,875)
Amortization of prior period service cost	8,300
	<u>\$ 244,492</u>

(13) INCOME TAX CREDIT (EXPENSE)

	1997	1996
Currently payable		
Tax on pretax income at 20% statutory rate	(\$3,103,421)	(\$3,794,586)
Tax-exempt income	2,432,733	2,761,632
Other	5,688	5,229
	<u>(665,000)</u>	<u>(1,027,725)</u>
Tax credits	665,000	513,863
	<u>-</u>	<u>(513,862)</u>
Deferred		
Investment tax credits	2,579,214	1,623,872
Valuation allowance	(650,150)	(720,000)
Adjustment of prior years' taxes	513,908	37,747
	<u>\$2,442,972</u>	<u>\$ 427,757</u>

The income attributable to the following projects and services are exempt from income tax:

	Tax-Exemption Period
Second manufacturing plant - Module B	1993 to 1996
Computer-aided design services	1994 to 1997
Expansion of first and second manufacturing plants	1994 to 1997
Expansion of second manufacturing plant and computer-aided design services, and addition of third manufacturing plant	1996 to 1999
Expansion of first and second manufacturing plants—modules A and B, third manufacturing plant, and addition of fourth manufacturing plant (application for exemption in process)	1997 to 2000

Deferred income tax assets as of December 31, 1997 and 1996 mainly consist of tax credits arising from investments in machinery and equipment, and research and development expenditures. Unused investment tax credits as of December 31, 1997 will expire as follows:

Year of Expiry	Amount
1999	\$ 305,183
2000	2,170,254
2001	2,642,040

Income tax returns have been examined by the tax authorities through 1995.

(14) RELATED PARTY TRANSACTIONS

The Company engages in business transactions with the following related parties:

- a. Industrial Technology Research Institute (ITRI); its director is the Company's chairman.
- b. Philips Electronics N.V., a 28.19% shareholder.
- c. Subsidiaries:
 - TSMC International Investment (TSMC-BVI), TSMC-U.S.A., TSMC-Europe
- d. Caesar Technology Inc. (CTI), an investee.
- e. Vanguard International Semiconductor Corporation (VIS), an investee.
- f. WaferTech, LLC., an indirect investee of TSMC-BVI.

The transactions with the aforementioned parties, except those disclosed in other notes, are summarized as follows:

For the period	1997		1996	
	Amount	%	Amount	%
Sales				
ITRI	\$ 240,549	1	\$ 214,173	-
Philips and its affiliates	3,150,057	7	2,641,316	7
VIS	27,681	-	-	-
WaferTech, LLC	8,986	-	-	-
	<u>\$3,427,273</u>	<u>8</u>	<u>\$2,855,489</u>	<u>7</u>
Rental expense				
ITRI	\$ 161,023	80	\$ 124,551	76
Manufacturing expenses				
Technical assistance fee-Philips	\$ 777,144	100	\$1,031,010	100
Processing charges-CTI	\$ 282,675	42	\$ 151,197	44
Marketing expenses				
TSMC-U.S.A. (Commissions)	\$ 889,298	59	\$ 214,883	34
TSMC-U.S.A. (Service charge)	41,101	3	26,449	4
TSMC-Europe (Commissions)	150,964	10	25,302	4
	<u>\$1,081,363</u>	<u>72</u>	<u>\$ 266,634</u>	<u>42</u>
At end of period				
Receivable				
ITRI	\$ 50,781	10	\$ 53,760	15
Philips and its affiliates	362,576	72	268,430	76
VIS	3,532	1	529	-
WaferTech, LLC	86,141	17	-	-
TSMC-BVI	-	-	29,170	9
TSMC-Europe	10	-	-	-
	<u>\$ 503,040</u>	<u>100</u>	<u>\$ 351,889</u>	<u>100</u>
Prepayments and other current assets				
Prepaid rental-ITRI	\$ 42,277	2	\$ 41,694	18
Payable				
Philips and its affiliates	\$ 199,725	25	\$ 206,044	45
TSMC-U.S.A.	503,505	63	182,315	40
TSMC-Europe	88,903	12	24,296	5
CTI	2,180	-	35,436	8
ITRI	-	-	5,007	2
	<u>\$ 794,313</u>	<u>100</u>	<u>\$ 453,098</u>	<u>100</u>

Sales to related parties are based on normal selling prices and collection terms. Processing charges are also based on normal rates and payment terms.

(15) LONG-TERM OPERATING LEASES

The Company leases the land, building and certain machinery and equipment of its first manufacturing plant from ITRI under agreements which will expire on March 31, 2002, at annual rentals and other charges aggregating \$168,527. The agreements are renewable upon expiration.

The Company leases the land for its second through fifth manufacturing plants from the Science-Based Industrial Park Administration under agreements which will expire on various dates from March 2008 to May 2013, at annual rentals aggregating \$27,030. The agreements are also renewable upon expiration.

Future annual minimum rentals under the aforementioned leases are as follows:

Year	Amount
1998	\$ 201,323
1999	201,323
2000	201,323
2001	201,323
2002	74,490
2003-2013	248,845
	<u>\$1,128,627</u>

(16) COMMITMENTS AS OF DECEMBER 31, 1997

- a. Under a technical cooperation agreement with Philips, as amended on May 12, 1997, the Company shall pay technical assistance fee at a percentage of net sales of certain products, net of specified deductions. The agreement shall remain in force up to July 9, 2007 and thereafter automatically renewed for successive periods of three years. Under the amendment agreement, the fee is subject to reduction by the amounts the Company pays to any third party for settling any licensing/infringement issue after the first five-year period of the amendment agreement, provided that the fee after reduction will not be below a certain percentage of the net selling price.
- b. Subject to certain equity ownership and notice requirements, Philips and its affiliates can avail each year up to 30% of the Company's production capacity.
- c. The Company has entered into an agreement to pay submicron technology license fee of \$129,400 (including 5% value-added tax) to ITRI for five years, plus royalty fee at an agreed percentage of net sales of certain products through December 31, 2000. As of December 31, 1995, the Company has paid the entire license fee. Under a technical cooperation agreement with ITRI, the Company shall reserve and allocate up to 35% of its production capacity for use by the Ministry of Economic Affairs.
- d. Under a manufacturing agreement, the Company shall purchase at least 85% of the calculated installed capacity of the wafer-fabrication plant ("WaferTech, LLC") constructed by TSMC Development, Inc. for three years upon commencement of production. If the Company is unable or unwilling to purchase the minimum purchase allocation, it shall compensate TSMC Development, Inc. at the full price of the products less certain costs. TSMC Development, Inc. has assigned the agreement to WaferTech, LLC.
- e. Under a purchase agreement with three customers, the Company shall supply and the three customers shall purchase a certain portion of wafers produced by WaferTech, LLC for three years. If the Company or any of the customers is unable or unwilling to supply or purchase the minimum purchase allocation, the defaulting party shall compensate the opposite party at the full price of the products, less certain costs.
- f. Under several foundry agreements, the Company shall reserve certain production capacity to certain major customers from whom guaranty deposits of US\$257,342 thousand have been received as of December 31, 1997.

(17) DERIVATIVE FINANCIAL INSTRUMENTS

The Company entered into forward exchange contracts in 1997 to hedge foreign-currency denominated receivables and payables. Certain information on these contracts are as follows:

a. Contract amount and fair value of outstanding forward exchange contracts as of December 31, 1997:

	Currency	Contract Amount (in Thousands)	Fair Value	Maturity	Maturity Amount
Buy	US\$	US\$690,000	NT\$23,195,820	Jan. 1998 to Dec. 1998	NT\$22,418,570
Sell	US\$	US\$470,000	NT\$15,872,710	Jan. 1998 to Dec. 1998	NT\$15,256,960

The aforementioned fair values are determined based on outright rate in each contract.

Net gains realized on expired forward exchange contracts in 1997 were \$1,859,000.

The net assets or liabilities that have been hedged by the aforementioned forward exchange contracts are as follows:

	Amount (In Thousands)
Accounts receivable	US\$ 236,831
Accounts payable	US\$ 138,331
Bonds payable	US\$ 363,135
Long-term bank loans	US\$ 156,000
Long-term stock investment	US\$ 389,645

Net gains realized on such contracts in 1997 were \$103,920.

b. Transaction risk:

1) Credit risk: The banks with whom the Company has entered into the aforementioned contracts are reputable, and the Company is expected not to be exposed to significant credit risks.

2) Market risk: All forward exchange contracts are for hedging purposes, and therefore, markets risks are minimized.

c. Cash flow requirement:

The purpose of forward exchange contracts is to limit the Company's exposure to loss resulting from adverse fluctuations in assets, liabilities, and commitments dominated in foreign currency, and, therefore, no significant extra cash requirement is expected.

The Company had entered into forward exchange contracts to hedge foreign-currency denominated receivables, payables, and commitments. As of December 31, 1996, there were no outstanding forward exchange contracts. The realized losses on expired forward exchange contracts in 1996 were immaterial.

On May 12, 1994, the Company entered into a US dollar Ratio Spread Collar contract. The contract, which expires on May 17, 1999 and is based on a notional amount of US\$10 million, is intended to hedge the Company's exposure to rising interest rates, up to a ceiling, associated with certain floating rate bank loans. The contract was pre-terminated in June 1996, and resulting loss on the contract was insignificant.

(18) SEGMENT FINANCIAL INFORMATION

a. Export sales	1997	1996
Area		
U.S.A.	\$18,987,227	\$20,037,562
Europe	3,594,183	4,484,847
Singapore	5,000,890	-
Japan	4,730,973	1,078,459
Other	683,147	3,113,979
	<u>\$32,996,420</u>	<u>\$28,714,847</u>

b. No single customer accounts for more than 10% of total sales.

8. Review and Analysis of Financial Position and Operating Results

(1) Liquidity Analysis

Item	December 31 1997	December 31 1996	Unit: NT\$K Change%
Current ratio	235.82%	308.50%	-23.56%
Quick ratio	185.78%	247.77%	-25.02%

(2) Analysis of Operating Result

Item	1997	1996	Change Amount	Unit: NT\$K Change%
GROSS SALES	\$44,765,428	\$39,836,725	4,928,703	12.37%
SALES RETURNS AND ALLOWANCES	(829,801)	(436,546)	(393,255)	90.08%
NET SALES	43,935,627	39,400,179	4,535,448	11.51%
COST OF SALES	22,841,471	17,420,930	5,420,541	31.12%
GROSS PROFIT	21,094,156	21,979,249	(885,093)	(4.03%)
OPERATING EXPENSES	5,604,376	3,744,003	1,860,373	49.69%
INCOME FROM OPERATIONS	15,489,780	18,235,246	(2,745,466)	(15.06%)
NON-OPERATING INCOME				
Interest	501,434	653,462	(152,028)	(23.27%)
Investment income recognized by equity method	17,804	156,152	(138,348)	(88.60%)
Foreign exchange gain - net	-	107,398	(107,398)	(100.00%)
Gain on disposal of long-term stock investments	311,453	39,668	271,785	685.15%
Gain on disposal of properties	3,131	40,759	(37,628)	(92.32%)
Other	23,891	27,542	(3,651)	(13.26%)
Total Non-Operating Income	857,713	1,024,981	(167,268)	(16.32%)
NON-OPERATING EXPENSES				
Interest	546,490	277,161	269,329	97.17%
Loss on disposal of properties	7,722	10,071	(2,349)	(23.32%)
Foreign exchange loss - net	188,884	-	188,884	-
Issuance costs of bonds	66,361	-	66,361	-
Other	20,933	63	20,870	33,126.98%
Total Non-Operating Expenses	830,390	287,295	543,095	189.04%
INCOME BEFORE INCOME TAX	15,517,103	18,972,932	(3,455,829)	(18.21%)
INCOME TAX CREDIT	2,442,972	427,757	2,015,215	471.11%
NET INCOME	17,960,075	19,400,689	(1,440,614)	(7.43%)

9. Consolidated Financial Statements

CONSOLIDATED BALANCE SHEETS

December 31, 1997 and 1996

(Expressed in Thousand New Taiwan Dollars, Except Par Value)

ASSETS	1997		1996	
	Amount	%	Amount	%
CURRENT ASSETS				
Cash and cash equivalents	\$ 12,816,004	10	\$18,746,214	24
Short-term investments	5,046,150	4	-	-
Receivable from related parties	416,889	-	322,719	-
Notes receivable	234,912	-	121,176	-
Accounts receivable	9,478,009	8	4,719,958	6
Allowance for doubtful receivables	(293,087)	-	(155,627)	-
Allowance for sales returns and allowances	(535,214)	-	(454,290)	(1)
Inventories	4,876,292	4	2,750,536	4
Deferred income tax assets	816,788	1	137,948	-
Prepayments and other	1,463,931	1	536,059	1
Total Current Assets	<u>34,320,674</u>	<u>28</u>	<u>26,724,693</u>	<u>34</u>
LONG-TERM STOCK INVESTMENTS	<u>7,162,460</u>	<u>6</u>	<u>6,545,307</u>	<u>8</u>
PROPERTIES				
Cost				
Land	253,652	-	167,035	-
Buildings	18,125,783	14	9,768,555	12
Machinery and equipment	64,525,249	52	35,079,612	44
Office equipment	962,776	1	703,375	1
Total cost	83,867,460	67	45,718,577	57
Accumulated depreciation	(26,552,281)	(21)	(18,249,461)	(23)
Prepayments and construction in progress	21,789,463	17	16,117,787	21
Net Properties	<u>79,104,642</u>	<u>63</u>	<u>43,586,903</u>	<u>55</u>
OTHER ASSETS				
Deferred charges - net	641,989	1	140,446	-
Deferred income tax assets	3,276,063	2	1,752,843	3
Refundable deposits	73,585	-	125,067	-
Miscellaneous	22,734	-	9,250	-
Total Other Assets	<u>4,014,371</u>	<u>3</u>	<u>2,027,606</u>	<u>3</u>
TOTAL ASSETS	<u><u>\$124,602,147</u></u>	<u><u>100</u></u>	<u><u>\$78,884,509</u></u>	<u><u>100</u></u>

LIABILITIES AND SHAREHOLDERS' EQUITY	1997		1996	
	Amount	%	Amount	%
CURRENT LIABILITIES				
Commercial papers payable	\$ 250,000	-	\$ -	-
Payable to related parties	201,905	-	246,487	1
Accounts payable	3,136,944	3	1,045,637	1
Accounts payable - construction and equipment	10,099,466	8	2,763,885	3
Income tax payable	3,367	-	460,028	1
Accrued expenses and other	1,639,640	1	1,027,756	1
Total Current Liabilities	15,331,322	12	5,543,793	7
LONG-TERM BANK BORROWINGS	8,025,900	6	5,720,000	7
CONVERTIBLE BONDS	11,983,457	10	-	-
ACCRUED PENSION COST	489,117	-	328,729	-
OTHER LIABILITIES				
Guarantee deposits	8,516,482	7	8,820,276	11
Payments received in advance - equipment	-	-	795,758	1
MINORITY INTEREST	10,841,476	9	5,562,013	7
Total Liabilities	55,187,754	44	26,770,569	33
SHAREHOLDERS' EQUITY				
Capital stock, \$10 par value; authorized—8,500,000 thousand shares in 1997 and 3,000,000 thousand shares in 1996, issued—4,081,300 thousand shares in 1997 and 2,654,200 thousand shares in 1996	40,813,000	33	26,542,000	34
Capital surplus	62,082	-	59,086	-
Legal reserve	4,928,532	4	2,992,429	4
Unappropriated earnings	23,712,760	19	22,531,027	29
Cumulative translation adjustment	(101,981)	-	(10,602)	-
Total Shareholders' Equity	69,414,393	56	52,113,940	67
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$124,602,147	100	\$78,884,509	100

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 1997 and 1996
(Expressed in Thousand New Taiwan Dollars, Except Earnings Per Share)

	1997		1996	
	Amount	%	Amount	%
GROSS SALES	\$44,756,442		\$39,836,725	
SALES RETURNS AND ALLOWANCES	(829,801)		(436,546)	
NET SALES	43,926,641	100	39,400,179	100
COST OF SALES	22,841,471	52	17,420,930	44
GROSS PROFIT	21,085,170	48	21,979,249	56
OPERATING EXPENSES				
General and administrative	2,194,186	6	1,645,849	4
Marketing	1,457,281	2	604,494	1
Research and development	2,505,303	6	1,493,999	4
Total Operating Expenses	6,156,770	14	3,744,342	9
INCOME FROM OPERATIONS	14,928,400	34	18,234,907	47
NON-OPERATING INCOME				
Interest	954,748	2	802,959	2
Gain on sale of long-term stock investments	310,561	1	39,668	-
Investment income recognized by equity method	-	-	72,507	-
Foreign exchange gain - net	-	-	107,398	-
Gain on disposal of properties	3,131	-	40,759	-
Other	26,376	-	27,542	-
Total Non-Operating Income	1,294,816	3	1,090,833	2
NON-OPERATING EXPENSES				
Interest	546,591	1	277,161	1
Foreign exchange loss - net	188,884	1	-	-
Investment loss recognized by equity method	64,440	-	-	-
Issuance costs of bonds	66,361	-	-	-
Loss on disposal of properties	7,722	-	10,074	-
Other	20,932	-	63	-
Total Non-Operating Expenses	894,930	2	287,298	1
INCOME BEFORE INCOME TAX	15,328,286	35	19,038,442	48
INCOME TAX CREDIT	2,558,516	6	403,305	1
INCOME BEFORE MINORITY INTEREST	17,886,802	41	19,441,747	49
MINORITY INTEREST	73,273	-	(41,058)	-
NET INCOME	\$17,960,075	41	\$19,400,689	49
EARNINGS PER SHARE				
Based on weighed-average shares outstanding of				
4,081,300 thousand in 1997 and				
2,654,200 thousand in 1996	\$4.40		\$7.31	
Based on 4,081,300 thousand shares			\$4.75	

TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY, LTD.



Morris Chang, Chairman/President



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