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OVERVIEW:

Co. reported 3Q14 revenues of TWD209b and EPS of TWD2.94. Expects 4Q14 revenues to be TWD217-220b.



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PRESENTATION

Elizabeth Sun - *TSMC - Director of Corporate Communications*

Welcome to TSMC's third quarter 2014 earnings conference and conference call. This is Elizabeth Sun, TSMC's Director of Corporate Communications and your host for today. Today's event is webcast live via TSMC's website at www.tsmc.com. If you are joining us through the conference call, your dial-in lines are in listen-only mode. As this conference is being viewed by investors around the world, we will conduct this event in English only.

The format for today's event will be as follows. First, TSMC's Senior Vice President and CFO, Ms. Lora Ho, will summarize our operations in the third quarter, followed by our guidance for the current quarter. Afterwards, Lora and TSMC's two co-CEOs, Dr. Mark Liu and Dr. C.C. Wei, will jointly provide our key messages. Then we will open both the floor and the lines for the Q&A.

For those participants on the call, if you do not yet have a copy of the press release, you may download it from TSMC's website at www.tsmc.com. Please also download the summary slides in relation to today's earnings conference presentation.

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

And now, I would like to turn the podium to TSMC's CFO Ms. Lora Ho for the summary of our operations and current quarter guidance.



Lora Ho - TSMC - SVP & CFO

Thank you, Elizabeth. Good afternoon, everyone. Thank you for joining us today. I will start my presentation with financial highlights for the third quarter and followed by the guidance for the fourth quarter.

We had a good quarter. The third quarter we have set a new record of revenue and profitability, thanks to strong demand and our successful ramp of 20-nanometer. Our revenue increased 14% sequentially and 29% on year-over-year basis to reach TWD209b. Our gross margin exceeded 50% to reach 50.5% which is also a record since the second half of 2006. Compared with second quarter, gross margin improved 0.7 percentage point. The higher margin was contributed by consistent cost improvement, favorable inventory valuation adjustment, partially offset by 20-nanometer dilution as we are still in early stage of the production.

Operating margin was 40.4%, up 1.8 percentage points from the second quarter, reflecting an improving operating efficiency for the Company. After a big jump in tax rate in the second quarter, due to accruals of 10% retained earning tax, in the third quarter the effective tax rate fell back to normal level of about 11% of profit before tax versus the 20% in the second quarter.

Overall, the third quarter EPS increased 47% sequentially to TWD2.94. The single quarter ROE was 33.3%.

Let's take a look at revenue by application. Compared to the second quarter, communications showed the strongest growth. Revenue increased by 26%. Industrial-related revenue also increased 9% while computer and consumer declined 6% and 3% during the third quarter.

By technology, after two years of meticulous preparation we began volume shipments of 20-nanometer wafers. The revenue contribution went up from 0% to 9% of the third quarter wafer revenue. This is the fastest and the most successful ramp for a new technology in TSMC's history.

In addition, customer demand for 28-nanometer wafers continued to be strong. Our 28-nanometer wafer revenue continued to grow sequentially in the third quarter, representing 34% of total wafer revenue.

Accordingly the two advanced technologies, 20-nanometer plus 28-nanometer, represented 43% of our third quarter total wafer revenue, increased from 37% a quarter ago.

Now let's move on to the balance sheet. We ended the third quarter with cash and marketable securities of -- TWD290b. Current liabilities decreased by TWD74b, mainly due to we paid out the TWD78b of cash dividend in August.

On the financial ratios, accounts receivable turnover days is 44 days which is the normal level of our average days of receivables. Days of inventory increased 5 days to 56 days, mainly due to higher work-in-process inventories associated with the fast ramp and the longer cycle time for 20-nanometer.

Now let me make a few comments on cash flow and CapEx. During the third quarter we generated TWD91b of cash from operations, invested TWD48b in capital expenditure and paid out TWD78b in cash dividend. At the end of the third quarter, our cash balance decreased TWD29b to TWD226b (corrected by company after the call).

Free cash flow for the third quarter was an inflow of TWD43b, a big improvement versus previous quarters.

In US dollars, our [third] (corrected by company after the call) quarter CapEx was \$1.6b. This adds to the total of \$7.8b for the first three quarters.

Regarding our capacity, we expect to increase our capacity by 12% from last year. Total annual capacity will reach 8.2m 12-inch equivalent wafers this year, slightly higher than our previous estimate of 8.1m.

I have finished my report on the financial part. Now let me turn into the fourth quarter outlook. Based on our current business outlook and the forecast exchange rate of TWD30.31 (corrected by company after the call), we expect our fourth quarter revenue to be between TWD217b and TWD220b. This would translate into around 4% to 5% quarter-over-quarter increase.



On the margin side, we expect the fourth quarter gross margins to be between 48% and 50% and operating margins to be between 38% and 40%. You may ask why we guide slightly lower margin rate despite 4% to 5% revenue growth. This is because we will continue to ramp our 20-nanometer to more than 20% of our wafer revenues in the fourth quarter. We expect to see a mild margin dilution with our aggressive productivity improvement efforts.

This concludes my remarks. Thank you very much.

Elizabeth Sun - TSMC - Director of Corporate Communications

All right. Now we will deliver our key messages. They will be offered by our CFO as well as by the two Presidents and co-CEOs. We will start with CFO Lora Ho first.

Lora Ho - TSMC - SVP & CFO

I will talk about three items, the CapEx, free cash flow and supply chain inventory.

Let me start with CapEx. In January of this year we guided TSMC's 2014 CapEx budget to be between \$9.5b to \$10b. Today, we are able to provide a more specific number which is about \$9.6b. Majority of this year's CapEx budget is spent for 20-nanometer expansion. In 2015 we will continue our investment in 16-nanometer capacity installation and 10-nanometer engineering capacity. Based on our current plan for 2015, our CapEx budget for the next year is likely to be slightly higher than \$10b.

On free cash flow outlook, you may recall in the past four years TSMC has increased CapEx substantially to capture the growth opportunity brought by the mobile computing devices. As a result, our free cash flow dropped to about \$1b to \$2b per year which were below the cash dividend we paid. The cash dividend, TWD3 cash dividend, is about \$2.6b a year. However, with the substantial increase in operating cash flow this year and a similar level of capital expenditure compared to last year, we expect to more than double our free cash flow in 2014 (corrected by company after the call). And we are confident that the free cash flow level will rise further in the foreseeable future.

The sustainably higher free cash flow should enable TSMC to afford paying a higher level of dividend per share going forward. The Board of Directors will consider increase in cash dividend in February of next year.

Now, regarding the supply chain inventory, we have noted in our last quarterly conference that we estimate fabless DOI would increase and be 2 days above seasonal at the end of third quarter and then fabless DOI would decrease and be 2 days below seasonal level at the end of this year. Our data and model for the forecast still warrants the same estimate today.

You can see from this chart, we estimate 4Q, 2014 fabless DOI will be 2 days below seasonal. But compared with 4Q, 2013 last year which is one year ago, the fabless DOI was 6 days below seasonal. Based on our model, we anticipate a much milder inventory correction in fourth quarter this year.

With that, I will turn the podium to Mark who will share with you our view on the near-term demand.

Mark Liu - TSMC - Co-CEO

Good afternoon. I will continue to cover the near-term demand. The strong demand of our 20 SOC customers enabled our continued growth in the fourth quarter, overcoming our seasonal demand pattern of a sequentially weaker fourth quarter and the cautious inventory adjustment actions taken by some of our customers, rendering the slower 4Q demand.



This fourth quarter demand from our customers does not validate the recent forecast by Microchip. Our recent demand in China still appears normal, little deviation from their seasonal pattern. And we see China's 4G smartphone sales and infrastructure buildup remains to be very aggressive. So we are expecting another record-breaking quarter with a 4% to 5% growth in the fourth quarter.

On 10-nanometer development, our 10-nanometer development is progressing according to plan. Currently we are working on early customer collaboration for product tape-outs in 4Q of 2015. The risk production date remain targeted at the end of 2015.

Our goal is to enable our customers' production in 2016. To meet this goal, we are getting our 10-nanometer design ecosystem ready now. We have completed certification of over 35 EDA tools using ARM's CPU core as the vehicle. In addition, we have started the IP validation process six months earlier than previous nodes with our IP partners.

We are working with over 10 customers on their 10-nanometer product design. The product plans show wide range of applications, including application processors, baseband, CPU, server, graphics, network processor, FPGA and game console. Our 10-nanometer will achieve industry-leading speed, power and gate density.

Then I'll cover the -- say a few words -- I'll clarify next growth momentum of TSMC. We think the growth of smartphone and tablet in propelling our revenue growth will continue for at least several years. In addition, the recent innovations in wearable devices, including smartwatch, in cloud computing, in fog computing, in Internet of Things, including smartcar, smarthomes, all are very exciting. And we are currently closely working with our customers on all these applications to set the stage of the next growth wave to move us forward.

That's my comment. Now I turn the microphone to C.C.

C.C. Wei - TSMC - Co-CEO

Thanks, Mark. Good afternoon, ladies and gentlemen. This afternoon I will update you the 20-nanometer ramp-up status followed by 16-nanometer's progress and 28-nanometer's status.

First the 20-nanometer ramp status. We shipped 20-nanometer in high volume during third quarter. The yield is meeting our target. Revenue generated from 20-nanometer accounted for 9% of third quarter wafer revenue. And because of the strong demand from the high-end 4G smartphones, which are equipped with 64-bit cores, the LTE Cat 6 or Cat 7, and more advanced graphic and video performance, our 20-nanometer will continue to grow. And we expect it to contribute greater than 20% wafer revenue in fourth quarter.

We expect the strength of our 20-nanometer business to continue in year 2015. And we expect the revenue will account for roughly 20% of next year in wafer revenue.

Next, I'll talk about the 16-nanometer ramp and competitive status. In 16-nanometer, we have two versions, 16 FinFET and the 16 FinFET Plus. FinFET Plus has better performance and has been adopted by most of our customers.

16 FinFET we began the risk production in November last year and since then have passed all the reliability qual early this year. For the FinFET Plus, we also passed the first stage of the qualification on October 7 and since then entered the risk production. The full qualification, including the technology and product qual, is expected to be completed next month.

So right now we have more than 1,000 engineers working on ramp up for the FinFET Plus. On the yield learning side, the progress is much better than our original plan. This is because the 16-nanometer uses similar process to 20 SOC, except for the transistor. And since 20 SOC has been in mass production with a good yield, our 16 FinFET can leverage the yield learning from 20 SOC and enjoy a good and smooth progress. So we are happy to say that 16-nanometer has achieved the best technology maturity at the same corresponding stage as compared to all TSMC's previous nodes.



In addition to the process technologies, our 16 FinFET design ecosystem is ready also. It supports 43 EDA tools and greater than 700 process design kits with more than 100 IPs. All these are silicon validated. We believe this is the biggest ecosystem in the industry today.

On the performance side, compared with the 20 SOC, 16 FinFET is greater than 40% speed faster than the 20 SOC at the same total power or consumes less than 50% power at the same speed. So our data shows that in high-speed applications it can run up to 2.3 gigahertz. Or on the other hand, for low-power applications it consumes as low as 75 miniwatts per core.

This kind of a performance will give our customer a lot of flexibility to optimize their design for different market applications. So far we expect to have close to 60 tape-outs by the end of next year.

In summary, because of the excellent progress in yield learning and readiness in manufacturing maturity and also to meet customers' demand, we plan to pull in 16-nanometer volume production through the end of Q2 next year or early Q3 year 2015.

The yield performance and smooth progress of our 16 FinFET, FinFET Plus further validate our strategy of starting 20 SOC first, quickly follow with the 16 FinFET and FinFET Plus. We chose this sequence to maximize our market share in the 20-, 16-nanometer generation.

And I would like to repeat our Chairman stated last time, in combined 20- and 16-nanometer, TSMC will have an overwhelming leading share every year from year 2014. In total foundry market share, TSMC will lead several percentage points in 2014. He also said that he's happy to add that this trend, increasing the market share, will continue in year 2015.

Next, I'll talk about 28-nanometer status. We had strong growth in second quarter on 28-nanometer. And the business grew another quarter and accounted for 34% of TSMC's wafer revenue in third quarter. On the technology side, we continue our effort to improve yield and tighten the process corners, so that our customer can take advantage of these activities and shrink their die size and therefore reduce the cost.

Let me give you an example. On 28LP, the polysilicon gate version, we now offer a variety of enhanced processes to achieve better performance. We also offer a very competitive cost so that our customers can address the mid- to low-end smartphone market. In addition to the 28LP, we also provide a cost-effective high-K metal gate version, the 28HPC for customers to further optimize the performance and the cost. Recently, we added another 28-nanometer offering we called 28 Ultra Low Power, for ultra low power applications obviously. We believe this 28ULP will help TSMC customers to expand their business into the IoT area.

In summary, we expect our technology span in 28-nanometer node will enhance TSMC's competitiveness and ensure a good market share. We also expect the strength of the demand for our 28-nanometer will continue for multi years to come. In response, we are preparing sufficient capacities to meet our customers' future demand.

Thank you for your attention.

QUESTIONS AND ANSWERS

Elizabeth Sun - TSMC - Director of Corporate Communications

All right. This concludes our prepared statements. Before we begin the Q&A session, I would like to remind everybody to limit your questions to two at a time, to allow all participants an opportunity to ask their questions. Questions will be taken both from the floor and from the call. Should you wish to raise your questions in Chinese, I will translate it to English before our management answers your questions. (Operator Instructions). Now let's begin the Q&A session.

Our first question comes from the floor, of Deutsche Bank, Michael Chou.



Michael Chou - *Deutsche Bank - Analyst*

Hi, thank you. Two questions. First question, you mentioned you're pulling mass production by end of Q2 next year or early Q3. Does that imply you will have earlier schedule than you planned before?

C.C. Wei - *TSMC - Co-CEO*

Yes.

Michael Chou - *Deutsche Bank - Analyst*

Okay. Second question is do you have any comment for your market share for next year in 16-, 14-nanometer.

C.C. Wei - *TSMC - Co-CEO*

Very hard for me to comment on the whole market share but if there's any indication, I would say that we narrow the gap with our competitor.

Michael Chou - *Deutsche Bank - Analyst*

Okay. So you mean your view now is more positive than three months ago. Can we say that?

C.C. Wei - *TSMC - Co-CEO*

Yes.

Michael Chou - *Deutsche Bank - Analyst*

Thank you.

Elizabeth Sun - *TSMC - Director of Corporate Communications*

All right. Next question still comes from the floor. It will be from Nomura's -- sorry Daiwa -- musical chairs -- Daiwa's Rick Hsu.

Rick Hsu - *Daiwa Capital Markets - Analyst*

Okay, thank you. It's been a while so, well, so C.C., Mark, Lora, Elizabeth. [Spoken in Chinese] Sorry, in English. The first question is about your 20-nanometer ramp up. I think it's been progressing quite well and as Lora said it's gonna be around 20% by the end of Q4. So I wonder if by that level, 20% at the end of Q4 in terms of revenue, would that reach your corporate average margin?

Lora Ho - *TSMC - SVP & CFO*

No, it will not. We have talked about this several times. Any new leading-edge technology would take seven to eight quarters to reach corporate average. So if you count the 20-nanometer ramp starting from third quarter shipment starts it's by mid-2016 you will get to corporate level profitability.



Rick Hsu - *Daiwa Capital Markets - Analyst*

All right. Thank you so much. So that would be the same for 16-nanometer I assume right, in terms of progress?

Lora Ho - *TSMC - SVP & CFO*

Yes, we count the 20 and 16 as one node in terms of ramping and scheduled capacity and so on and so forth.

Rick Hsu - *Daiwa Capital Markets - Analyst*

This doesn't count as a second question, does it?

Lora Ho - *TSMC - SVP & CFO*

All right, you can have a second question, yes.

Rick Hsu - *Daiwa Capital Markets - Analyst*

Right, okay. So the second question is more about a picture of your of China competition. I think recently we had observed quite a lot of moves inside China, including privatization of RDA or Spreadtrum. And OmniVision could be another target to shoot for. Also, your competitor UMC last week announced that they're going to set up a 12-inch joint venture with the local government.

So I think my feeling is these guys seem to be aiming for the next growth potential market which is IoT. And by taking the leverage of the huge demand market in China, number one, and also the very favorable Chinese government policies in favor of the local production, so my feeling is -- will you worry about this potential competition in the longer term because you only operate an 8-inch fab in China. Or do you have any strategy to cope with this potential threat from China in the next couple of years? Thank you.

Mark Liu - *TSMC - Co-CEO*

Okay, this is a complicated question. Let me put this question to two parts. One is the China government's subsidy effects; secondly is the IoT opportunities. On China government's subsidy, the recent announcement about RMB1,200b subsidy, that's caused a lot of activities across the industry. For us, we think currently we have very strong penetration on our Chinese -- China design houses; many of them over 80%. And they are -- most of them are clinging towards leading-edge. And with this subsidy, they will be more aggressive. And we think that is -- we will be ready to capture the business, given the existing good penetration.

And this subsidy may also pro -- bring into a merger position because China government wants the small company bringing into big, to be more competitive. And I do think that is a healthy development for the industry, with the bigger, stronger design houses to compete with.

Of course, there will be downsides because on the back of the subsidy maybe some of the companies will under the influence of using local foundries and capacities and that is a threat; may I put it this way. So -- but putting us -- putting this positive and negative factor together, so long as we have technology leadership, so long as we have a strong manufacturing, so long as we have a good service, customer service, we think our business opportunity in China will grow, will be bigger with this development.

On the IoT, IoT, indeed IoT has been anticipated by many companies including us. For us, we have -- we are currently actively developing IoT-related technologies, okay, and including sensors, including processors, including wireless connectivity, advanced packaging. And all -- power management IC are included -- all we're striving for ultra low power; in the power, technology to provide a lower power design.



On the capacity, yes, we are increasing our mature technology capacities today. And we will continue to expand the mature technology capacity, deviating from our past strategy, increasing those capacity to capture the potential growth of demand.

In terms of -- further new fab, we don't exclude any possibility, including the fab in China. Okay?

Rick Hsu - *Daiwa Capital Markets - Analyst*

Thank you so much.

Elizabeth Sun - *TSMC - Director of Corporate Communications*

All right. Next question will also be coming from the floor. It will be from Bank of America - Merrill Lynch's Dan Heyler.

Dan Heyler - *BofA - Merrill Lynch - Analyst*

Thanks Elizabeth, thanks. Good afternoon. So a couple of questions. So as you're expanding your capacity in mature technologies for the IoTs and MEMS and NFC and a whole range of things, and you're expanding your advanced technology, TSMC has held a dominant position in 28-nanometer for almost four years and 28-nanometer accounts for 34% of revenue now. As your key customers are moving to 28 and 16 and competition is obviously heating up as well, I'm wondering what steps you guys are taking to keep your 28-nanometer fabs fully utilized? You talked about HPC as a cost-down version. Would this be a potential headwind to keep those fabs full in 2015 and if so are you able to address the competition as well? Thanks.

C.C. Wei - *TSMC - Co-CEO*

We believe the demand on 28-nanometer will continue as I stated in my statement.

Dan Heyler - *BofA - Merrill Lynch - Analyst*

From where?

C.C. Wei - *TSMC - Co-CEO*

From where? Okay. All the mobile devices and IoT and a lot of applications. Actually the 28-nanometer today we find out is a very cost-effective technology. This is the last node that you enter into the 2P2E, the double etch, double patterning. And so its application is very -- been widely adopted. So we expect that the demand for the next few years, or actually for a long time, it will continue to increase. And a lot of companies will take the advantage of the cost-effective and the performance also. So as we said, we are -- you said from where? It's from the application side. Application side also all the mobile devices and all the consumer, even on the industrial part we can find some applications.

Dan Heyler - *BofA - Merrill Lynch - Analyst*

Okay, great. And I presume you intend to hold market share? Do you need to hold the current market share in order to prevent a falling utilization?

C.C. Wei - *TSMC - Co-CEO*

You bet.

Dan Heyler - *BofA - Merrill Lynch - Analyst*

Okay, great. And then the second question is with regard to 20-nanometer margins; I guess for Lora. So since 20 will be over 20% of revenue in the fourth quarter and your guidance is for 20 to be about 20% contribution for all of next year, so that implies pretty much flat. How do you achieve margin expansion on flat revenue?

Lora Ho - *TSMC - SVP & CFO*

Dan, fourth quarter 20% is not equal to whole year 20%. So it's increased quite significantly, number one. For the whole year 2015 20% is a big number. How do we hold the profitability? I would say today's 20/16 profitability is acceptable. I won't say it's great, but it is acceptable. And we will continue to work on it as we have done for other nodes in the past. And the margin will gradually improve as we have more volume coming on the line. So I'm still staying what I said and we believe we can achieve corporate level margins in eight quarter timeframe, 2016.

Dan Heyler - *BofA - Merrill Lynch - Analyst*

Yes. My question was just specific on 28 margins, so yes. So will additional customers coming into 28 because you previously said you felt this was going to be a major node, so is part of this margin expansion or margin improvement a function of different, more products coming in that will help margin? Or is it more internal efficiencies and getting smarter and better about how you're doing things?

Mark Liu - *TSMC - Co-CEO*

Both. The -- our 28-nanometer currently 80% of them are high-K metal gate and 20% of them, roughly about, 28LP. And next year we'll compete on both fronts. We will compete on 28LP and we are planning to increase the capacity on 28LP also. That's (technical difficulty) the next year's 28-nanometer will be bigger than this year. Competition will always be there, of course. This is already -- from 2011 this is the fifth year of 28-nanometer production. The learning curve bring us to a very, very mature state that all the cost reduction and many of the yield improvement has been -- will be our competitive advantage and also increase our margins.

Elizabeth Sun - *TSMC - Director of Corporate Communications*

All right. I think we will now take our next question from the call. Operator, please proceed with the first caller on the line.

Operator

Thank you. Donald Lu, Goldman Sachs.

Donald Lu - *Goldman Sachs - Analyst*

Good afternoon. My first question is still on smartphones. Can you let us know what percent of revenue today, in Q4 for example is from smartphones? And also what would be the TSMC's addressable market per smartphones, i.e. like on average how many -- how much revenue TSMC can generate, on average, per smartphones this year and next year.

Elizabeth Sun - *TSMC - Director of Corporate Communications*

Okay, Donald. Let me repeat your question. Your question is how much percent of revenue TSMC derives from smartphone-related applications? Your second question is in terms of revenue per smartphone box, what is TSMC's revenue per smartphone on average?



Donald Lu - *Goldman Sachs - Analyst*

Yes.

Lora Ho - *TSMC - SVP & CFO*

Donald, we actually don't count on quarterly basis percentages of smartphone, but I can tell you I can see for the whole year 2014 there will be a little bit more than 50% of our revenue coming from smartphone.

Elizabeth Sun - *TSMC - Director of Corporate Communications*

And revenue per box.

Lora Ho - *TSMC - SVP & CFO*

Revenue per box, the average \$8 this year which is an improvement from last year's \$7.

Donald Lu - *Goldman Sachs - Analyst*

Okay. And how about the trend for next year? Do we have any estimate?

Lora Ho - *TSMC - SVP & CFO*

It's probably too premature to talk about next year, but I would think the percentage will be very similar to this year.

Donald Lu - *Goldman Sachs - Analyst*

Okay great. Just -- my second question is more on structural profitability? Given all the moving parts, depreciation trend, etc., for next year what would be the -- can TSMC still maintain a similar structural profitability with the 20-, 16-nanometer ramp (technical difficulty).

Lora Ho - *TSMC - SVP & CFO*

We continue to work on productivity and cost reductions. So from what we can see now, we believe we can maintain the same level of structural profitability next year versus this year.

Donald Lu - *Goldman Sachs - Analyst*

Great, thank you.

Elizabeth Sun - *TSMC - Director of Corporate Communications*

All right. So now we are coming back to the floor. Our next question comes from the floor from Credit Suisse, Randy Abrams.



Randy Abrams - *Credit Suisse - Analyst*

Yes, thank you. I want to ask one follow-up on the 16. If you could talk about what you expect the revenue contribution now, given you're pulling it in earlier. And do you still see any material swing factors that could swing that ramp up at this stage?

C.C. Wei - *TSMC - Co-CEO*

Excuse me. Randy, you're saying the 16 FinFET?

Randy Abrams - *Credit Suisse - Analyst*

For 16 FinFET for next year, when you ramp it up in the second half, percent of revenue. And also if there's any material swing factors up or down that could swing the magnitude of that ramp up.

C.C. Wei - *TSMC - Co-CEO*

Probably too early to comment on the revenue side. But I would think that -- give you a hint. The ramp up will be a little bit faster than 20 SoC. And we have a customer committed a high volume product tape-out already.

Randy Abrams - *Credit Suisse - Analyst*

Congratulations. My follow-up question, actually just more looking at your outlook. Given the comments you made on inventory I think you've put the chart it's not quite as lean coming out of fourth quarter, it's still coming down in Q4. But given you have a strong ramp up in 20, should we expect as we go into first quarter, I wonder if you think you'll use first quarter to build product again. Like if you have a lower utilization, you may build product early through the first quarter. And then also if you expect a little bit of a gap or slowdown coming out of fourth quarter.

Lora Ho - *TSMC - SVP & CFO*

I would prefer not getting into the first quarter next year. But as I just showed you, the inventory cycle is 2 days below seasonality and it's going to be a mild correction, not as severe as last year. So that should give you some idea about the first quarter.

Randy Abrams - *Credit Suisse - Analyst*

Thank you.

Elizabeth Sun - *TSMC - Director of Corporate Communications*

All right. The next question also comes from the floor. It will be from Morgan Stanley's Bill Lu.

Bill Lu - *Morgan Stanley - Analyst*

Hi, thank you. Can I just start with a housekeeping question? That inventory chart that you showed, could I just ask you if it includes -- you've got a big system house customer that we cannot track but perhaps you can, does that include the system house.

Lora Ho - TSMC - SVP & CFO

That's our fabless customers. The chart shows fabless only.

Bill Lu - Morgan Stanley - Analyst

Okay, great. The second question is a comment that I think Mark and Lora have both talked about which is smartphones are going to drive growth for multiple more years. I think that's a little bit different from what is the consensus view which is that you're going to get unit growth, a lot of it going forward is going to be more lower end. And Lora also said just now that percentage-wise, smartphone is going to be about the same next year. So can you talk about why do you think that's going to drive growth for a few more years? Where do you see that? What gives you that confidence?

Mark Liu - TSMC - Co-CEO

Yes, smartphone revenue next year appears flattening out total. But we see next year it's still going to be an increase. But our growth are propelling -- what TSMC can grow is mainly from the market share in that smartphone segment. That we think given the 20-nanometer going forward and 16 and 10, we think our market share in the smartphone will continue to grow.

Bill Lu - Morgan Stanley - Analyst

Sorry, I thought Lora's comment was as a percentage of total revenue, smartphone is not going up next year versus the last couple of years it's been increasing. So next year smartphone is not going to outgrow the overall company.

C.C. Wei - TSMC - Co-CEO

What Lora said is similar, actually there will be a little bit increase.

Bill Lu - Morgan Stanley - Analyst

All right, thanks.

Lora Ho - TSMC - SVP & CFO

Yes, you forget that we will grow -- we're going to grow next year the Company.

Bill Lu - Morgan Stanley - Analyst

Sure. No, I understand that.

Lora Ho - TSMC - SVP & CFO

So it's a growth above the average, yes.

Elizabeth Sun - TSMC - Director of Corporate Communications

All right. The next question comes from the floor and it will be from Citi's Roland Shu.



Roland Shu - Citigroup - Analyst

Hi, good afternoon. My first question is still on 20-nanometer gross margin. Lora, if I have read you right, you said the increasing volume after you ramp up the new technology actually will be key factor for bringing up the gross margin overall. And also I look at -- in the past, you said it takes about seven to eight quarters to bring up the new technology gross margin to corporate level. That actually seven to eight quarters also was around the time you ramp up the total revenue to above 20%, probably 23%, 25%.

So my question is for your 20-nanometer in 4Q I think the revenue guidance is above 20%. So is this 20% actually a big threshold level for you to bring up the gross margin? Because I think with the 20% total revenue contribution I think the volume is big enough. Or there's another factor to have a lower margin for 20-nanometer.

Lora Ho - TSMC - SVP & CFO

Okay, this is a unique way of associating the percentage of revenue to the gross margin. And you talked about 20-nanometer as a separate node. When we look at 20 and 16, we feel it's the same node because 16 is a continuation of 20-nanometer and they share a lot of the same equipment and same process almost.

So if you combine these two nodes together and -- well, I cannot say if 20% is a threshold or not. What we look in the Company is we're looking to the -- how efficient can we run this node and what will be the scale and what's our engagement with the customers and how effectively we bring down the capital efficiency -- we bring up the capital efficiency so on and so forth. So we don't usually link that to a percentage of contribution to Company revenue.

Roland Shu - Citigroup - Analyst

But for the volume-wise actually I think it is big enough now. So is it possible to 20-nanometer actually to bring up the 20-nanometer gross margin to corporate average in less than seven to eight quarters? Maybe not three quarters, four quarters.

Lora Ho - TSMC - SVP & CFO

It's not possible because with -- the 20-nanometer will be very soon migrate to 16 and 16 will take the momentum from 20. It's going to ramp very, very fast, not only on the volume also on the profitability side as well.

Roland Shu - Citigroup - Analyst

Okay, little bit complicated to me. Okay, I'll switch to the second question. The second question is on TSMC actually did a very good job. I think from 2010 to 2014 you had two strategic financial goals. One is for your PBT to grow more than 10% in CAGR. The other one is for ROE to be above 20%. I think from 2010 to 2014, I think TSMC has been -- the performance has been above your goal.

So how about expectation for the next five years, 2015 to 2018 or 2019. Are you still comfortable with this double-digit PBT growth going forward? Thank you.

Lora Ho - TSMC - SVP & CFO

We believe we will still grow faster than the semiconductor and as you know in the past few years, we have been growing 2X of semiconductor. We'll continue to gain foundry market share in the next five years, that's what we believe. So our financial objectives will remain unchanged. PBT, CAGR bigger, equal to 10% and ROE bigger than 20% from 2015 to 2019.

Roland Shu - Citigroup - Analyst

Thank you.

Elizabeth Sun - TSMC - Director of Corporate Communications

All right, let's go back to the call. We will take our next question from the call. Operator, please proceed with the next caller.

Operator

Brett Simpson, Arete Research.

Brett Simpson - Arete Research - Analyst

Thanks very much. So this is a question for Mark or CC. I'm just looking at the end markets focus for TSMC. PC is not -- has never been a big part of your business. But when I look at AP for next year, the transition to 64-bit and the introduction of FinFET, are we moving -- is the AP moving into a world where it can realistically address mainstream PCs now that we've got Windows 10 coming and with Chromebook ramping up and Android is moving to 64-bit. How do you see this AP evolving into mainstream computing?

And maybe just to follow up to that, can you maybe just compare and contrast. If you're an ARM fabless chipmaker building these APs for computing, how would you compare the cost and the performance using 64-bit ARM and your FinFET Plus versus Intel's Broadwell? Do you think it would be cost competitive versus Intel's Broadwell and do you think it would be performance competitive versus Intel's Broadwell?

Elizabeth Sun - TSMC - Director of Corporate Communications

All right, Brett, let me repeat your question. You basically are asking us whether or not the migration of technologies and then with the arrival of ARM based 64-bit core, the fabless today can design application processors that can go into the mainstream PC market. And if they could, how would they compare with existing incumbent players such as Intel in terms of cost and performance? That's your question, right?

Brett Simpson - Arete Research - Analyst

That's right, Elizabeth. And it's really comparing next year's AP to Intel Broadwell. Whether you think the new Broadwell platform from Intel, which is 14-nanometer, how does that -- how might we see fabless players running TSMC FinFET Plus and 64-bit ARM versus those platforms from Intel, from a cost and performance perspective.

Elizabeth Sun - TSMC - Director of Corporate Communications

So you're specific to 2015. You are asking 2015.

Brett Simpson - Arete Research - Analyst

That's right.

Mark Liu - TSMC - Co-CEO

Well, we certainly hope the ARM-based core can get into PC faster. However, the recent trend seems to be slowing down and we do not count on that. But our customers are continuing to make this ARM-based core into a mainstream PC application. And I think it's more than power and the performance of those chips. There are a lot to do with the ecosystem around the x86 core.

So it's up to our customers and their customers how we together get into this. But definitely this industry needs alternative in the PC world.

Brett Simpson - Arete Research - Analyst

Great. Maybe just a follow-up for Lora. If I look on the balance sheet of TSMC there's a large amount of construction in progress, so CapEx that's been spent that is not effective capacity. Can you maybe just give us a sense for how this trends over the next three or four quarters and how that -- how depreciation might trend as well on the back of that? Thank you.

Elizabeth Sun - TSMC - Director of Corporate Communications

So your question is looking at our balance sheet, there's a very large item called construction in progress which of course eventually will become capacity. And you want to know what is the trend leading from this large account in construction in progress into the impact of our depreciation.

Brett Simpson - Arete Research - Analyst

That's right, thanks.

Lora Ho - TSMC - SVP & CFO

We are building new facilities to ramp the 20 and 16-nanometer which will be located in our Tainan site. So the number you see in the balance sheet is associated with that building construction and some of them are equipment purchase.

So what I can tell you is the depreciation change. And this year with the TWD9.6b CapEx, the depreciation year-over-year change will be roughly 30% which has actually been lower. I was telling somebody 35% earlier, but it's come out to about 30%.

With slightly more CapEx for next year as I was talking about, the depreciation increase will be much smaller than this year versus last year. It will be in the mid-teens range and certainly below 20% increase year over year.

Brett Simpson - Arete Research - Analyst

Thank you very much.

Elizabeth Sun - TSMC - Director of Corporate Communications

Okay, now let's come back to the floor and Andrew is eagerly anticipating me. So we'll have Andrew Lu from Barclays.

Andrew Lu - Barclays - Analyst

(Spoken in Chinese).

Elizabeth Sun - TSMC - Director of Corporate Communications

Okay, I have to translate your questions into English. Andrew's question is given there will be a faster ramp of 16-nanometer, does this mean that next year's third quarter, fourth quarter revenue from 16-nanometer will be bigger than this year's third quarter, fourth quarter revenue from 20-nanometer?

C.C. Wei - TSMC - Co-CEO

No. So actually --

Andrew Lu - Barclays - Analyst

(Spoken in Chinese).

C.C. Wei - TSMC - Co-CEO

Actually if you look at what we announced this year, early this year we said that the 20 SoC is in production. That means we start our wafer production. And the shipment, the significant shipment actually is in the third quarter. So you know that for this kind of cycle time, run through the line, getting the packaging and then get the revenue.

16 FinFET actually is longer because they have more masking layers. So when we start at the end of second quarter, you can estimate that when you have the volume shipment translate into revenue. That's what I can (multiple speakers).

Andrew Lu - Barclays - Analyst

(Spoken in Chinese).

C.C. Wei - TSMC - Co-CEO

(Multiple speakers) It's two quarter late, two quarter difference.

Elizabeth Sun - TSMC - Director of Corporate Communications

The lead time or the shipments.

C.C. Wei - TSMC - Co-CEO

It's one and a half quarter to be exact. All right.

Andrew Lu - Barclays - Analyst

(Spoken in Chinese).



C.C. Wei - TSMC - Co-CEO

In the fourth quarter we will see a contribution.

Andrew Lu - Barclays - Analyst

(Spoken in Chinese).

C.C. Wei - TSMC - Co-CEO

High single digit.

Andrew Lu - Barclays - Analyst

Okay, thank you. That's all I want. The other question, this time I use English only. For 10-nanometer ramp-up, you mentioned you will be starting from year 2016. Is there a similar timeframe to ramp up like 16, 16-nanometer ramp up next year or further delay another one or two quarters, to generate revenue?

Mark Liu - TSMC - Co-CEO

Okay. I said we will try to enable our customers to do the ramp up in the 2016. I think it's toward the end of 2016 and really it's still up to the customer's ramp. But I think in terms of revenue it will be much lower than 16-nanometer in 2015. So the real volume will happen beginning of 2017 and on.

Andrew Lu - Barclays - Analyst

Thank you.

Elizabeth Sun - TSMC - Director of Corporate Communications

Next question also comes from the floor. It will be HSBC's Steven Pelayo.

Steven Pelayo - HSBC - Analyst

When I look back at 28-nanometer you've had seven quarters of solid absolute dollar growth sequentially. Now when I look at 20-nanometer you're already at 20% of revenue in two quarters. That's a steep ramp. Do you suspect that 20-nanometer in absolute dollars on a quarterly basis can continue to grow every quarter like the first seven quarters that you saw in 28-nanometer?

C.C. Wei - TSMC - Co-CEO

Yes, we still see the 20-nanometer continue to grow next year.

Steven Pelayo - HSBC - Analyst

So even quarterly in the first quarter, second quarter, with seasonality, you still will see sequential dollar-on-dollar growth (multiple speakers).

C.C. Wei - TSMC - Co-CEO

There might have some kind of seasonality but on the average yes, it's still growing.

Steven Pelayo - HSBC - Analyst

I understand, yes. And then, Lora, a question for you. I know the Board is going to talk about a dividend next year in February. You have about TWD300b in cash. You're generating about TWD40b a quarter. How much cash do you need to run this business? We're trying to all figure out what kind of magnitude? Could you afford TWD4, could you afford more even? It seems like you could. So maybe you can talk a little bit about what are the inputs that go into that decision on where you would like to take the dividend.

Lora Ho - TSMC - SVP & CFO

I think the key input is the sustainability of free cash flow generation, consider the potential CapEx for the future years and the operating cash flow we can generate with that kind of business growth. That's the key decision factor.

I probably cannot tell you what's the magnitude because we need to discuss with the Board. But as I said earlier in my comments, we feel that we are affordable to raise the dividend level and the Board will decide the numbers.

Steven Pelayo - HSBC - Analyst

I'm sorry, if I could just sneak in a follow up to that first question to you. If you do have some seasonality in 20-nanometer in the first half next year, do you worry at all about the margin implications there if you're not fully utilized on that very expensive capacity?

C.C. Wei - TSMC - Co-CEO

Very hard to answer your question. Although I say seasonality, but I don't expect too much of a drop, if there is a drop. You can see the smartphone are selling very well. I did not say which one, but --. I'll let Lora to answer this question because you know --

Lora Ho - TSMC - SVP & CFO

It's too early to give a guidance (multiple speakers) on margins.

Mark Liu - TSMC - Co-CEO

But we think the seasonality -- since last year we have this mechanism of pre-built, work with our customers to smooth out the utilization. And for the 20-nanometer we intend to do that and I think that in terms of product complexity it's much simpler and we should be able to minimize the impact.

Elizabeth Sun - TSMC - Director of Corporate Communications

All right. The next question comes from the floor. It will be from UBS, Eric Chen.

Eric Chen - UBS - Analyst

Hi. My first question is regarding to the 20 and 16 FinFET, the technology. You mentioned the equipment in between both FinFET are pretty similar. So I assume that yield rate -- of the 15, sorry 16 FinFET, even 16 FinFET PLUS is pretty high. So I'm just wondering why our equipment move-in is so conservative compared to our competitor. I mean compared to our competitor at 14 FinFET technology in terms of the equipment move-in.

Elizabeth Sun - TSMC - Director of Corporate Communications

So Eric's question is he assumes that we will have a very good yield rate on the 16-nanometer FinFET. I think that's correct. So given that, why are we so conservative in equipment move-in.

Eric Chen - UBS - Analyst

Or straightforward, like Samsung, Global Foundry, they mention they have around 50,000 wafers at the end of this year.

C.C. Wei - TSMC - Co-CEO

Let me answer your question. First your impression of we're slowly move-in 16 FinFET equipment. I think Lora just mentioned that we are going to spend also a big CapEx next year. And from this year, next year we invest on the 16 FinFET and 20 SoC also. And some of the tools, actually a high portion of the tool are common for these two nodes. So no, it's not a slowly move-in as you said.

Yes, we did ramp up the 16 FinFET behind our competitors, yes. And that's why our Chairman said that we are going to have a smaller market share. But our situation improved as time goes by because of our manufacturing maturity and good yield performance. And also the customer pull in their demand so we decide to pull in the ramp up schedule. And we are in a very high -- gung ho to bring up the 16 FinFET. I said we have more than 1,000 engineers preparing for the ramp up. So that's give you a hint that we are full speed actually preparing for that.

Eric Chen - UBS - Analyst

Okay. We believe that you are going to be very aggressive in the 16 capacity, the FinFET capacity for next year. And your comment around that is aggressive and probably you'll keep it aggressive. So internally the TSMC do have the scenario, the analysis that the 14, the 16 FinFET technology in terms of the capacity-wise is probably will overcapacity in the year 2006 --

Lora Ho - TSMC - SVP & CFO

2016?

Eric Chen - UBS - Analyst

2016, I'm sorry, the year 2016, the overcapacity (multiple speakers)?

C.C. Wei - TSMC - Co-CEO

Overcapacity? We build the capacity to meet the customer demand. And we have confidence. As I said we already have customer committed high volume tape-outs to us. And we build the capacity according to the demand and we have the confidence to gain a large market share in 2016.



Eric Chen - UBS - Analyst

The yield rate will be the key right?

C.C. Wei - TSMC - Co-CEO

Yes.

Eric Chen - UBS - Analyst

Okay. And also for Lora, regarding to 20 and 16 FinFET (inaudible), the equipment is not big different. So we assume that the depreciation pretty much locate for the 20-nanometer process. So in other words, can we expect the gross margin for 16 the PLUS FinFET the pickup time above average probably will be much faster than we thought.

Lora Ho - TSMC - SVP & CFO

That's the right assumption, yes.

Eric Chen - UBS - Analyst

Okay. So if we talk about seven quarter for 20, can we assume that probably four quarter for 16?

Lora Ho - TSMC - SVP & CFO

I don't know because we only look at the two nodes together.

Eric Chen - UBS - Analyst

Okay and my second question --

Elizabeth Sun - TSMC - Director of Corporate Communications

You already had two questions. Now we have to go to someone else. Sorry, Eric, we can come back to you.

Eric Chen - UBS - Analyst

Okay, sure. Thank you.

Elizabeth Sun - TSMC - Director of Corporate Communications

All right. Next will be from Dan Heyler.



Dan Heyler - BofA - Merrill Lynch - Analyst

Thank you. Just a few quick housekeeping. Lora, could you comment a little bit on the linearity of the CapEx next year in terms of first half versus second half? You normally share that with us.

Lora Ho - TSMC - SVP & CFO

Next year is not decided yet. Let's see.

Dan Heyler - BofA - Merrill Lynch - Analyst

I imagine front-end loaded.

Lora Ho - TSMC - SVP & CFO

Actually I don't have the number with me. I intuitively think it will be front-end loaded because we need to get the capacity ready for the 16-nanometer ramp.

Dan Heyler - BofA - Merrill Lynch - Analyst

Probably kind of similar to this year than prior year in terms of the weighting?

Lora Ho - TSMC - SVP & CFO

This year it's not that front-end loaded. Maybe slightly front-end loaded. I don't have the number with me.

Dan Heyler - BofA - Merrill Lynch - Analyst

Okay, great, thanks. So you'll come back to this. So on the capacity growth then this year you grew by 12%. Could you share with us what kind of capacity growth we should expect next year? Because you did allude to some 8-inch expansion and then you've also got -- which I'm sure is quite small, but in addition to that your 20- and 16-nanometer capacity growth? Thanks.

Lora Ho - TSMC - SVP & CFO

I said this year we will grow about 12% in total capacity. Next year about the same.

Dan Heyler - BofA - Merrill Lynch - Analyst

Great. And is it fair to assume that very little 8-inch addition, it's for peanuts or could we see bigger 8-inch?

Lora Ho - TSMC - SVP & CFO

A couple hundred million is not peanuts. More 8-inch than last year I would say.



Dan Heyler - BofA - Merrill Lynch - Analyst

Two million.

Lora Ho - TSMC - SVP & CFO

A couple hundred million.

Dan Heyler - BofA - Merrill Lynch - Analyst

A couple hundred million capacity.

Lora Ho - TSMC - SVP & CFO

A couple hundred million US dollars.

Dan Heyler - BofA - Merrill Lynch - Analyst

Okay. And then I guess then I wanted to think a little bit about the magnitude of the revenue trends. In the fourth quarter you're growing in low single digits. The non-20-nanometer capacity how much is that? Is that growing or is that down in the fourth quarter in terms of the non-20?

Mark Liu - TSMC - Co-CEO

Taking out 20 it's down, is down. Yes. More -- for our case a little bit more than seasonal because we are forecasting the DOI will be low.

Dan Heyler - BofA - Merrill Lynch - Analyst

Down low single-digit is what it looks like?

Mark Liu - TSMC - Co-CEO

We don't know. Probably close to double-digit size.

Dan Heyler - BofA - Merrill Lynch - Analyst

Double-digit decline for non-20.

Mark Liu - TSMC - Co-CEO

For non-20 yes.

Dan Heyler - BofA - Merrill Lynch - Analyst

Great. And then finally just short one, no -- she's cutting me off. Okay, I'll come back.



Elizabeth Sun - TSMC - Director of Corporate Communications

Right. Next one goes to -- the question will be coming from Credit Suisse, Randy.

Randy Abrams - Credit Suisse - Analyst

This one might be more for CC. I just wanted to see if you could give an update on the InFO and the fan-out wafer level packaging. Just your initiatives on doing some of the integration. Whether next year there's many applications or it'll take time to develop and would come more the following year? And in what type of applications you're seeing the first interest?

C.C. Wei - TSMC - Co-CEO

It takes time for the customers really to adopt the new packaging because that effect their design, architecture and also everything. So application-wise it will still be in the mobile devices. And your question is --

Randy Abrams - Credit Suisse - Analyst

So it's probably more the following year. Like next year probably not much revenue, but I guess to get to hundreds of millions in revenue or --

C.C. Wei - TSMC - Co-CEO

The significant volume will be in 2016. We already work with a customer on that.

Randy Abrams - Credit Suisse - Analyst

Okay. And then one quick follow up on the -- China. There was some discussion earlier about China and now your competitor foundry is putting a fab there. Does it make sense given the lot of attention on local manufacturing and even Qualcomm going to SMIC to have local China manufacturing, does it make sense at some point to consider a fab in China and are there restrictions or are those removed if you wanted to have a 12-inch fab in China?

Mark Liu - TSMC - Co-CEO

We have a fab in China today with 8-inch and we are expanding that capacity also. This actually is today and following months and we have space next to the fab also. So when the demand is needed, when the option is the most cost effective, that's one of the consideration. As to 12-inch, no. I think so long as N minus two and below I think at least for the -- in the local government restriction is not there.

Randy Abrams - Credit Suisse - Analyst

Thank you.

Elizabeth Sun - TSMC - Director of Corporate Communications

So now we are going back to Eric for his follow-up questions.



Eric Chen - UBS - Analyst

Elizabeth, thank you very much. Regarding to the 10-nano FinFET, the ASML have a conference call last night and indirectly they mentioned that TSMC is quite a leading player. So I just would like to know the -- what's your strategy. Your equipment move-in in the 16 probably not so aggressive, but your strategy at the 10-nano is so aggressive. So how do you look at that future outlook?

Mark Liu - TSMC - Co-CEO

On EUV you mean the question?

Eric Chen - UBS - Analyst

Yes, in terms of the 10-nano?

Mark Liu - TSMC - Co-CEO

Our current 10-nanometer it does not using EUV. All the technology developing for 10 is still using multiple patterning technology.

Eric Chen - UBS - Analyst

I thought you use two, right, EUV and the one you mentioned?

Mark Liu - TSMC - Co-CEO

We are working with ASML to develop EUV tools and the opportunity is to have a follow-on process simplification, using EUV, the masking layer simplification. But that has some way to go. It could not catch the -- our initial ramp of 10-nanometer. The current challenge will still be the power of the source and the availability. And -- but it's still very encouraging that power -- source power is continually increasing and other factors as mask, defects, mask technology and the photo resist have a lot of improvements. So we are looking at the follow-on insertion point after the 10-nanometer ramp for the cost reduction or for the process simplification.

Eric Chen - UBS - Analyst

Okay. So the way you go for the 10-nano FinFET is the same as the Intel way or different way from Intel?

Mark Liu - TSMC - Co-CEO

In terms of not using EUV?

Eric Chen - UBS - Analyst

Yes, in terms (multiple speakers).

Mark Liu - TSMC - Co-CEO

Yes, Intel appears -- announced they don't use the EUV on their 10.

Eric Chen - UBS - Analyst

So it's a different way, right?

Mark Liu - TSMC - Co-CEO

I'm sorry I don't know Intel technology that well.

Eric Chen - UBS - Analyst

Okay. The reason is I ask that there is one argument talking about the 14-nano FinFET. It's the way Intel to go and the Samsung go. So once they go to the 10-nano if they go the different way, probably we will see the two different way in the 10-nano FinFET for the client to choose. That probably will bring the risk on the either side. So I don't know this argument makes sense from your point of view. Does that make sense?

Mark Liu - TSMC - Co-CEO

That's our plan. I don't know what Intel's detailed plan is. And they haven't announced their ten-nanometer detail either. So we just make the best of what's into our most beneficial way to implement the EUV.

Eric Chen - UBS - Analyst

Okay, very clear. Thank you Dr. Liu.

Elizabeth Sun - TSMC - Director of Corporate Communications

Follow-on questions from Andrew Lu.

Andrew Lu - Barclays - Analyst

Very quick two questions. The first one is on 28-nanometer High-K Metal Gate versus Poly/SiON percentage on 28 in Q3 and Q4, any rough numbers?

C.C. Wei - TSMC - Co-CEO

Probably 70 to 30.

Andrew Lu - Barclays - Analyst

For both quarters?

Mark Liu - TSMC - Co-CEO

In Q3, it's probably more than 20 -- more than 80% High-K Metal Gate and less than 20% Poly/SiON. But getting into Q4 Poly/SiON has a big increase from our demand. So it's getting to -- temporarily get to 70/30 in the Q4 as CC just mentioned.



Andrew Lu - Barclays - Analyst

Because of the customers, right?

Mark Liu - TSMC - Co-CEO

Because of the customers.

Andrew Lu - Barclays - Analyst

Okay. The next one is I remember last time Lora mentioned the CapEx to sales for next year is going to be higher than this year. But this time changed the tone saying the CapEx next year will be slightly higher than this year. So I just want to ask whether the CapEx to sales also higher than this year for the next year?

Lora Ho - TSMC - SVP & CFO

I don't think I said last time that next year will be higher than this year. I didn't say that. I probably said it will be lower than --

Andrew Lu - Barclays - Analyst

The Chairman said that.

Lora Ho - TSMC - SVP & CFO

It will be lower than last year that's probably I have said. Given the total CapEx, as I just indicated, will be slightly higher than TWD10b but we have not decided how much it's going to be. We don't decide the revenue of 2015 so it's probably premature to comment on capital intensity for next year.

Andrew Lu - Barclays - Analyst

Thank you.

Elizabeth Sun - TSMC - Director of Corporate Communications

All right. A follow-on question from Daiwa's Rick Hsu.

Rick Hsu - Daiwa Capital Markets - Analyst

Hi. Thank you so much. It's Rick Hsu from Daiwa. Just a quick follow-up question because sometimes Dr. Morris Chang gave some color for beyond one quarter. So could you give a little bit color for your Q1 outlook because when we talk about inventory correction this year it's very mild and demand is still pretty strong especially for leading edge has been in good shape? So just some color for next year Q1.

Lora Ho - TSMC - SVP & CFO

Well, Q1 normally is a low season. You will see sequential decline for the experience we had before. I cannot comment more on that. I don't think Q1 will be very different from that pattern.



Mark Liu - TSMC - Co-CEO

Let me add some color for that if you want.

Rick Hsu - Daiwa Capital Markets - Analyst

Yes, sure. Of course.

Mark Liu - TSMC - Co-CEO

We don't expect strong inventory adjustment more than what we see in Q4. Okay this is -- I think this is what we see from our demand forecasting.

Elizabeth Sun - TSMC - Director of Corporate Communications

A follow-up question from HSBC, Steven Pelayo.

Steven Pelayo - HSBC - Analyst

Just a little bit, thinking about the next three years or so, the last three years you guys have clearly benefited, 28-nanometer dominance, smartphone industry growing at 40% compounded growth rates. You guys have grown 20%, 25% per year I think in the last three years or so. And I've got to do the calculation again for this year, maybe you're actually above that.

When you think about the next three years I think people are forecasting smartphone CAGRs may be more in the under 15% type range. Do you think -- and you guys gained a lot of market share I think in the last couple of years as well. Are laws of large numbers catching up to you guys? Without smartphone growth and that significant increase in silicon content for phones, do you think these growth rates that you've been enjoying of 20% plus for multiple years are headed lower over the next few years? And then to what magnitude?

Lora Ho - TSMC - SVP & CFO

You cannot expect 20% growth for every year. But we are confident we can grow double digit next two years.

Elizabeth Sun - TSMC - Director of Corporate Communications

Short follow-up questions from Dan Heyler.

Dan Heyler - BofA - Merrill Lynch - Analyst

That last one that you wouldn't let me sneak in there, I didn't forget it. So on the 20-nanometer coming back to that, the fourth quarter contribution for this year on this percentage of sales will this -- will 20 grow one year later. So fourth quarter next year what contribution of sales do you expect 20 per se to be? 20-nanometer next year? Because you've obviously pulled in 16-nanometer so there's new dynamics. So I'm wondering if you're going to see any growth year on year. From 4Q this year to 4Q next year will the dollar value grow year on year?



C.C. Wei - TSMC - Co-CEO

Good question. I think next year as we ramp up 16 FinFET, 20 SoC demand will be flat and the percentage will be lower. Does that answer your question?

Dan Heyler - BofA - Merrill Lynch - Analyst

Yes, it does. Thank you.

Elizabeth Sun - TSMC - Director of Corporate Communications

Okay, I think pretty much we have answered the most critical questions in your mind and we would like to conclude our conference and conference call right now. And thank you for attending our session today.

Before we conclude, please be advised the replay will be available within three hours from now. Transcripts will be available within 24 hours from now, both of which will be available through our website at www.tsmc.com.

Thank you for joining us today. We hope you will join us again next quarter. Goodbye and have a good day.

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