

SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORP

Form 6-K

October 03, 2005

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**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 6-K**

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**REPORT OF FOREIGN ISSUER**

**Pursuant to Rule 13a-16 or 15d-16 of  
the Securities Exchange Act of 1934**

**For the month of October 2005**

**Commission File Number 1-31994**

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**SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPORATION**

**(Translation of Registrant's Name Into English)**

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**18 Zhangjiang Road**

**Pudong New Area, Shanghai 201203**

**People's Republic of China**

**(Address of Principal Executive Offices)**

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(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F):

Form 20-F  Form 40-F

(Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1)):

Yes  No

(Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7)):

Yes  No

(Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934):

Yes  No

(If  Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-\_\_\_\_\_ )

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Semiconductor Manufacturing International Corporation (the Registrant ) is furnishing under the cover of Form 6-K:

- Exhibit 99.1: Press release, dated September 28, 2005, relating to the holding of the Registrant s inaugural technology symposium in Korea.
- Exhibit 99.2: Interim report of the Registrant for the six months ended June 30, 2005, published on September 30, 2005, as required by The Stock Exchange of Hong Kong Limited.

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Semiconductor Manufacturing  
International Corporation

By:         /s/ Richard R. Chang                

Name: Richard R. Chang  
Title: President and Chief Executive Officer

Date: October 3, 2005

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**EXHIBIT INDEX**

<b><u>Exhibit</u></b>	<b><u>Description</u></b>
Exhibit 99.1:	Press release, dated September 28, 2005, relating to the holding of the Registrant's inaugural technology symposium in Korea.
Exhibit 99.2:	Interim report of the Registrant for the six months ended June 30, 2005, published on September 30, 2005, as required by The Stock Exchange of Hong Kong Limited.

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**Exhibit 99.1**

**SMIC Holds Inaugural 2005 Technology Symposium in Korea**

**(Seoul, Korea, September 28, 2005)** Semiconductor Manufacturing International Corporation (SMIC; NYSE: SMI and HKSE: 981) will hold its inaugural technology symposium in Seoul, Korea on September 30<sup>th</sup>, 2005. Similar to the symposium held last month in Beijing, China, the symposium in Korea is aimed at IC designers, customers, technology partners, and equipment vendors. In particular, SMIC has invited many Korean IC companies to attend the symposium in order for them to gain a better understanding of SMIC's services and technologies.

In conjunction with the technology symposium, SMIC will also make its debut at the 2005 Korea Semiconductor & Display Exhibition (SEDEX). A key event for the Korea semiconductor industry, SEDEX is expected to attract more than 11,000 visitors and 150 exhibitors, including many SMIC customers. Among SMIC's booth displays will be an advanced 12-inch wafer made from SMIC's Fab 4 in Beijing.

Visitors can find SMIC at booth 520 of Pacific Hall in Seoul's COEX Center for the duration of SEDEX from September 28-30.

**About SMIC**

SMIC (NYSE: SMI, SEHK: 0981.HK) is one of the leading semiconductor foundries in the world, providing integrated circuit (IC) manufacturing at 0.35-micron to 0.11-micron and finer line technologies to customers worldwide. Established in 2000, SMIC has four 8-inch wafer fabrication facilities in volume production in Shanghai and Tianjin. In the first quarter of 2005, SMIC commenced commercial production at its 12-inch wafer fabrication facility in Beijing. SMIC also maintains customer service and marketing offices in the U.S., Europe, and Japan, and a representative office in Hong Kong. As part of its dedication towards providing high-quality services, SMIC has achieved ISO9001, ISO/TS16949, OHSAS18001, TL9000, BS7799 and ISO14001 certifications. For additional information, please visit <http://www.smics.com>.

For more information, please contact:

SMIC

Reiko Chang

86 (21) 5080-2000 ext 10544

PR@smics.com

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**Exhibit 99.2**

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The People's Republic of China

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Fax: +86 (21) 5080 2868

**SMIC - Beijing**

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Economic-Technological Development Area

Beijing 100176

The People's Republic of China

**SMIC - Tianjin**

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XiQing Economic Development Area

Tianjin 300381

The People's Republic of China

**SMIC - Chengdu**

8 Kexin Road

West District, High-Tech Zone

Chengdu, Sichuan 610731

The People's Republic of China



**SMIC - Hong Kong**

904, Tower B, Queen's Garden

9 Old Peak Road

Hong Kong

**SMIC - Japan**

5F, Arukai Building 1-23-13, Ebisu

Shibuya-ku

Tokyo 150-0013

Japan

**SMIC - Americas**

45757 Northport Loop West

Fremont, CA 94538

USA

**SMIC - Europe**

Via Archimede 31

20041 Agrate Brianza

Italy

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**CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

This interim report may contain, in addition to historical information, forward-looking statements within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on SMIC's current assumptions, expectations and projections about future events. SMIC uses words like believe, anticipate, intend, estimate, expect, project, similar expressions to identify forward-looking statements, although not all forward-looking statements contain these words. These forward-looking statements are necessarily estimates reflecting the best judgment of SMIC's senior management and involve significant risks, both known and unknown, uncertainties and other factors that may cause SMIC's actual performance, financial condition or results of operations to be materially different from those suggested by the forward-looking statements including, among others, risks associated with cyclical and market conditions in the semiconductor industry, intense competition, timely wafer acceptance by SMIC's customers, timely introduction of new technologies, SMIC's ability to ramp new products into volume, supply and demand for semiconductor foundry services, industry overcapacity, shortages in equipment, components and raw materials, availability of manufacturing capacity and financial stability in end markets.

Except as required by law, SMIC undertakes no obligation and does not intend to update any forward-looking statement, whether as a result of new information, future events or otherwise.

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**CHAIRMAN'S STATEMENT**

Dear Shareholders,

The evolution of the semiconductor industry represents the continuous pursuit of advanced technologies that benefit society and improve quality of life. To this end, SMIC has played an integral role in developing China's world-class semiconductor technologies and making China achieve recognition as a source for quality semiconductor manufacturing.

*By obtaining talent, you can gain the world. By winning the heart, you can achieve great success. - Chinese Proverb*

Since the commencement of production in 2001, SMIC has been a pioneer for China's semiconductor foundry industry. Under the leadership of Dr. Richard Chang, Chief Executive Officer, many world-class semiconductor engineers have been recruited to return to China with the vision and passion for developing China's semiconductor industry. This group of returnees has helped SMIC to achieve, within five years, many significant milestones in the history of semiconductor manufacturing in China, including the establishment of China's first 12-inch fab in Beijing and the planned offering of 90 nanometer process technology.

Since its initial public offering, SMIC has placed a priority on maintaining the highest levels of transparency and corporate governance. As a company listed on The Stock Exchange of Hong Kong and The New York Stock Exchange, SMIC is obligated to comply with corporate governance requirements of both jurisdictions. One such requirement is the separation of the roles of the Chairman and the Chief Executive Officer. As a result of this requirement, I was named Chairman of the Board in July 2005. As the Chairman of the Board, I together with the other Board members, will ensure that our supervisory responsibilities concerning corporate governance will remain a priority as we work together with the SMIC management team to continue helping SMIC to provide world-class foundry services to its customers and to generate economic value for its shareholders.

Sincerely,  
**Yang Yuan Wang**  
*Chairman of the Board*

Shanghai, the PRC

September 23, 2005

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### **CHIEF EXECUTIVE OFFICER'S STATEMENT**

Dear Shareholders,

I am pleased to report SMIC has been able to continue to grow its revenues for the first six months of 2005 by 30% to US\$528.3 million as compared to US\$407.9 million in the first six months of 2004. This was achieved despite difficult operating conditions for the semiconductor industry during this period of time. We weathered the industry downturn through our strong commitment to our IDM customers and our filler strategy to retain high utilization levels in the midst of industry wide inventory corrections. Consequently, we remain committed to diversifying our customer portfolio to serve a broad range of customers worldwide.

We saw our average selling prices decline due to the slowdown in the overall semiconductor industry, as well as general pricing softness. However, we began to see business conditions improving in the second quarter of 2005, a trend which we believe will continue through the rest of the year, as we improve our product mix and shift production towards more advanced technology nodes. In order to meet the additional demands from our customers we are increasing our 2005 capital expenditure budget to US\$1.1 billion. We will also continue to invest in improving our technology portfolio to consolidate our position among the top foundries.

Both our 200mm and 300mm fabs are running very smoothly and we are making good strides in our stated aim of deriving more revenue from advanced technology nodes. We commenced mass production in our first 300mm wafer fab in March of 2005 and will continue to ramp up this facility in Beijing.

Our first customer products at 90nm are currently under qualification which puts us in good stead to begin 90nm logic production by the end of this year. We have a very clear advanced technology roadmap and have secured equipment to begin work on developing a 65nm process flow. We will continue to invest strongly in our research and development capability and target to begin pilot production at 65nm by the end of next year.

Among the new customers that we added during the first half of 2005, more than half of them came from Mainland China. Encouragingly, we see a substantial portion of these new customers working with products taping out at 0.18 micron and below. We also see a growing demand for applications, such as 3G handsets, advanced LCD flat panel TVs, HDTVs, and portable music players. We look forward to seeing our Chinese customers contribute to a greater proportion of revenues in the future.

In addition to our core foundry competency, we are continuously looking for other ways to take advantage of our unique position here in Mainland China. Our CMOS imaging sensor module project with Toppan Printing Co., Ltd. began moving in equipment into our new Fab 9 facility in August 2005 and is scheduled to begin pilot production in October 2005. Our testing and assembly project with United Test and Assembly Center Ltd. in Chengdu is expected to begin moving in equipment later this month with the commencement of pilot production shortly thereafter. We have also initiated a project to rework reclaimed wafers into solar power modules in our new Fab 10 facility. We anticipate moving in equipment in the fourth quarter of 2005.

In July 2005, we formed a partnership with Saifun Semiconductors, Ltd. and have licensed their NROM<sup>®</sup> technology for the production of flash memory-based products. This new partnership will enable us to cater to the increasing demand for flash-based products in the consumer electronics and telecommunication sectors.

Finally, I would like to express my gratitude and appreciation to our customers, vendors, employees, advisers and members of the board of directors for their efforts to ensure that SMIC maintains its position at the forefront of providing leading edge semiconductor manufacturing and related services to customers in China and the rest of the world.

May God bless you and SMIC,

**Richard R. Chang**

*Chief Executive Officer*

Shanghai, the PRC

September 23, 2005

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**CORPORATE INFORMATION**

Registered name	Semiconductor Manufacturing International Corporation
Chinese name	
Registered office	PO Box 309 GT Ugland House George Town Cayman Islands
Head office and place of business in PRC	18 Zhangjiang Road Pudong New Area Shanghai 201203 PRC
Place of business in Hong Kong registered under Part XI of the Companies Ordinance	904 Tower B Queen s Garden 9 Old Peak Road Hong Kong
Website address	<a href="http://www.smics.com">http://www.smics.com</a>
Company secretary	Anne Wai Yui Chen
Authorized representatives	Richard R. Chang Anne Wai Yui Chen
Places of listing	Stock Exchange of Hong Kong New York Stock Exchange
Name of share	Semiconductor Manufacturing International Corporation
Stock code	0981 (SEHK) SMI (NYSE)

\* *For identification purposes only*

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The Board of Directors (the Board) of Semiconductor Manufacturing International Corporation (the Company) would like to announce the unaudited interim results of operations of the Company and its subsidiaries for the six months ended June 30, 2005, and would like to express their gratitude to the shareholders and their staff for their concern and support of the Company.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*Note:* The Company has retroactively reclassified certain expenses to disclose financial performance in a manner consistent with the practices of other high-technology companies (the Reclassification). All figures presented herein have given effect, where applicable, to the Reclassification. Amortization of acquired intangible assets expense, largely related to the patent cross-license agreement relating to the settlement of the litigation with Taiwan Semiconductor Manufacturing Company Limited (TSMC), and other license agreements, previously classified in cost of sales and research and development, have been reclassified into a single line item entitled amortization of acquired intangible assets under operating expenses. The impact of the Reclassification for the six months ended June 30, 2004 resulted in a decrease in cost of sales of US\$2.5 million, a decrease in research and development expenses of US\$4.3 million and an increase in amortization of intangible assets expenses of US\$6.8 million.

### ***Six months ended June 30, 2005 compared to six months ended June 30, 2004***

#### **Sales**

Sales increased by 29.5% from US\$407.9 million for the six months ended June 30, 2004 to US\$528.3 million for the six months ended June 30, 2005, primarily as a result of the increase in the Company's manufacturing capacity and ability to use such capacity to increase sales. The number of wafers the Company shipped increased by 63.7%, from 375,859 8-inch wafer equivalents to 615,411 8-inch wafer equivalents, between these two periods. The blended average selling price of all wafers the Company shipped during this period decreased by 20.1% from

US\$1,022 per wafer to US\$817 per wafer, while the average selling price of logic wafers the Company shipped decreased by 12.4% from US\$1,085 per wafer to US\$951 per wafer. The percentage of wafers shipped that used 0.18 micron and below process technology increased by 97.5%, from 71.0% of sales to 81.5% of sales between these two periods.

#### **Cost of Sales and Gross Profit (Loss)**

After giving effect to the Reclassification, cost of sales increased by 78.6% from US\$283.8 million for the six months ended June 30, 2004 to US\$506.8 million for the six months ended June 30, 2005. This increase was primarily due to the significant increases in sales volume, depreciation expenses as the Company continues to increase capacity due to the installation of new equipment and manufacturing labor expenses due to the increase in headcount. Other factors included an increase in the amount of direct and indirect materials purchased corresponding to the increase in wafers shipped. In addition, deferred stock compensation expenses relating to employees involved in the manufacturing of wafers increased to US\$6.2 million for the six months ended June 30, 2005 from US\$5.2 million for the six months ended June 30, 2004, primarily due to additional stock options granted and restricted share units awarded to new and existing employees involved in this activity. The Company amortizes the deferred stock compensation expense using the straight-line method over the applicable vesting period, which is typically four years.

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The Company had a gross profit of US\$21.5 million for the six months ended June 30, 2005 compared to a gross profit of US\$124.1 million for the six months ended June 30, 2004. Gross margins decreased to 4.1% for the six months ended June 30, 2005 from 30.4% for the six months ended June 30, 2004. The decrease in gross margin was primarily due to a decrease in the average selling price per wafer and a higher average cost per wafer resulting from an increase in depreciation expenses.



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### **Operating Expenses and Income (Loss) From Operations**

After giving effect to the Reclassification, operating expenses increased by 24.1% from US\$60.9 million for the six months ended June 30, 2004 to US\$75.6 million for the six months ended June 30, 2005 due primarily to increases in research and development expenses and amortization of acquired intangible assets.

As a part of the settlement with TSMC, as described in Item 16. Notes to the Unaudited Consolidated Financial Statements Litigation, the Company has allocated US\$10.3 million of the total settlement amount to amortization of acquired intangible assets for the six months ended June 30, 2005.

After giving effect to the Reclassification, research and development expenses increased by 20.1% from US\$25.8 million for the six months ended June 30, 2004 to US\$31.0 million for the six months ended June 30, 2005. This increase in research and development expenses resulted primarily from 90 nanometer and 65 nanometer research and development activities and an increase in depreciation and amortization expenses.

Selling and marketing expenses increased by 49.3% from US\$3.7 million for the six months ended June 30, 2004 to US\$5.5 million for the six months ended June 30, 2005, primarily due to an increase in engineering material costs associated with sales activities.

General and administrative expenses decreased by 28.2% to US\$12.0 million for the six months ended June 30, 2005 from US\$16.7 million for the six months ended June 30, 2004, primarily due to the foreign exchange gain relating to operating activities increasing from US\$3.2 million for the six months ended June 30, 2004 to US\$6.1 million for the six months ended June 30, 2005 and a decrease in the bad debt provision.

In addition, the Company's deferred stock compensation relating to employees involved in research and development, general and administrative and selling and marketing decreased slightly from US\$7.9 million to US\$7.1 million between these periods.

As a result, the Company's operating loss was US\$54.1 million for the six months ended June 30, 2005 compared to operating income of US\$63.2 million for the six months ended June 30, 2004. The Company's operating margin was negative 10.2% for the six months ended June 30, 2005 and 15.5% for the six months ended June 30, 2004.

### **Other Income (Expenses)**

Other expenses increased 905.4% from US\$1.6 million for the six months ended June 30, 2004 to US\$16.2 million for the six months ended June 30, 2005. This increase was primarily attributable to the increase in interest expense from US\$5.5 million for the six months ended June 30, 2004 to US\$16.7 million for the six months ended June 30, 2005. This interest expense was primarily due to the increase in interest rates relating the Company's long-term debt. In addition, the foreign exchange loss increased from a loss of US\$2.0 million for the six months ended June 30, 2004 to a loss of US\$4.0 million for the six months ended June 30, 2005 relating to financing and investing activities, particularly forward contracts.

The Company's net foreign exchange gain was US\$2.1 million for the six months ended June 30, 2005 and US\$1.2 million for the six months ended June 30, 2004.

**Net Income (Loss)**

Due to the factors described above, the Company had a net loss of US\$70.4 million for the six months ended June 30, 2005 compared to net income of US\$61.6 million for the six months ended June 30, 2004.

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### **Deemed Dividends on Preference Shares**

The Company did not record any deemed dividends on preference shares for the six months ended June 30, 2005 compared to deemed dividends on preference shares of US\$18.8 million for the six months ended June 30, 2004, representing the difference between the sale and conversion price of warrants to purchase Series D convertible preference shares issued in the first quarter of 2004 and their respective fair market values. All of these warrants expired unexercised upon the completion of the Company's global offering of its ordinary shares in March 2004 (the Global Offering).

### **Liquidity and Capital Resources**

The Company incurred capital expenditures of US\$1,314.7 million for the six months ended June 30, 2004 and US\$484.4 million for the six months ended June 30, 2005. The Company has financed substantial capital expenditure requirements through the proceeds received from the Global Offering, cash flows from operations, and bank borrowings.

As of June 30, 2005, the Company had US\$576.3 million in cash and cash equivalents. These cash and cash equivalents are held in the form of United States Dollars, Japanese Yen, European Euro, and Chinese Renminbi. The net cash provided by operating activities increased by 13.7% from US\$241.7 million for the six months ended June 30, 2004 to US\$274.9 million for the six months ended June 30, 2005. The net cash provided by operating activities for the six months ended June 30, 2005 was primarily due to an increase of US\$32.5 million in inventories as a result of an increase in commercial production, an increase of US\$25.9 million in accounts receivable as a result of an increase in sales, decrease of US\$7.4 million in accounts payable relating to the purchase of materials and inventories, US\$20.0 million in amortization of acquired intangible assets and the add-back of US\$352.2 million in depreciation and amortization relating to commercial production. The net cash provided by operating activities for the six months

ended June 30, 2004 was primarily due to US\$61.6 million from net income, to the add-backs of US\$186.1 million in depreciation and amortization and US\$6.8 million in amortization of acquired intangible assets as non-cash items.

The Company's net cash used in investing activities was US\$469.5 million for the six months ended June 30, 2005, primarily attributable to purchases of plant and equipment for Fab 1, Fab 2, Fab 3, Fab 4, Fab 6, and Fab 7, as well as costs associated with the construction of Fab 9, Fab 10, and the facility in Chengdu of US\$475.6 million. Net cash used in investing activities were US\$638.2 million for the six months ended June 30, 2004, primarily attributable to the purchases of plant and equipment and land use rights for Fab 1, Fab 2, Fab 3, Fab 4, Fab 6, and Fab 7 of US\$577.8 million.

The Company's net cash provided by financing activities was US\$164.1 million for the six months ended June 30, 2005. This was primarily derived from proceeds of US\$238.0 million in the form of short-term borrowings, proceeds of US\$128.4 million in the form of long-term debt borrowings, and proceeds of US\$39.0 million from minority interest shareholders. The net cash provided by financing activities was US\$1,149.6 million for the six months ended June 30, 2004. This was primarily derived from US\$1,017.1 million in proceeds received from the Global Offering, US\$30.0 million in proceeds from the issuance of Series D convertible preference shares, US\$105.4 million from the collection of subscription receivables, US\$33.9 million from the collection of notes receivables from employees, and US\$30.0 million in the form of long-term debt borrowings.

As of June 30, 2005, the Company's outstanding long-term liabilities primarily consisted of US\$740.4 million in secured bank loans, of which US\$228.6 million is classified as the current portion of long-term loans. The long-term loans are repayable in installments commencing in

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March 2005, March 2006, and December 2007 with the last payments due in March 2007, March 2009, and June 2010, respectively.

**Table of Contents****Liquidity and Capital Resources** *(continued)*

In December 2001, Semiconductor Manufacturing International (Shanghai) Corporation ( SMIC Shanghai ), the Company's wholly foreign-owned enterprise, entered into a long-term loan agreement with a syndicate of Chinese banks for US\$432.0 million. As of June 30, 2005, the Company had drawn down the full amount. The principal amount is repayable starting in March 2005 in five semi-annual installments of US\$86.4 million each. The interest rates on the loan ranged from 4.34% to 5.24% for the six months ended June 30, 2005. Interest is due on a semi-annual basis. The interest expenses incurred for the six months ended June 30, 2005 and for the six months ended June 30, 2004 were US\$8.5 million and US\$6.2 million, respectively, a significant portion of which was capitalized as additions to assets under construction.

As part of the same long-term loan arrangement, SMIC Shanghai has a line of credit for Rmb397.0 million (equivalent to approximately US\$48.0 million). As of June 30, 2005, SMIC Shanghai had fully drawn down this line of credit. The principal amount is repayable starting in March 2005 in five semi-annual installments of US\$9.6 million each. The interest rate on the loan ranged from 5.02% to 5.27% for the six months ended June 30, 2005. The interest expenses incurred for the six months ended June 30, 2005 and for the six months ended June 30, 2004 were US\$1.1 million and US\$1.2 million, respectively, a significant portion of which was capitalized as additions to the assets under construction.

These long-term loan agreements contained certain financial covenants, which were superseded by the financial covenants set forth in SMIC Shanghai's long-term agreements from January 2004 as described below.

In January 2004, SMIC Shanghai entered into two long-term loan agreements with four banks in the PRC for US\$256.5 million and Rmb 235.7 million (equivalent to approximately US\$28.5 million). These five-year bank

loans are collateralized by the Shanghai fabs and equipment. As of June 30, 2005, SMIC Shanghai had drawn down the full amount of the U.S. dollar facility. The principal amount on the U.S. dollar facility is repayable starting in March 2006 in seven semi-annual installments of US\$36.6 million each. The interest rates on the loan ranged from 4.34% to 5.24% for the six months ended June 30, 2005. The interest expense incurred for the six months ended June 30, 2005 and for the six months ended June 30, 2004 in connection with the U.S. dollar facility was US\$5.7 million and US\$0.2 million, respectively, a significant portion of which was capitalized as additions to assets under construction.

As of March 15, 2005, SMIC Shanghai had drawn down the full amount of the Renminbi facility, which was repaid in full on March 21, 2005. The interest rate on the Renminbi facility was 5.27% from January 1, 2005 through March 21, 2005. The interest expense incurred during this period of time was US\$0.02 million.

The financial covenants contained in the two long-term loan agreements entered into in January 2004 supersede the financial covenants contained in the long-term loan agreement entered into in December 2001. Any of the following would constitute an event of default for SMIC Shanghai beginning in March 2005, when the first payment of the loan from December 2001 is repayable:

(Total liability borrowings from shareholders, including principal and interest) / Total assets > 65%

(Current assets inventory) / Current liabilities < 100%

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Total liability / EBITDA > 2.98

(Funds available for loan repayment in current year + Funds available for loan repayment at the beginning of the current year) / Repayment amount during current year < 2.5

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**Liquidity and Capital Resources** *(continued)*

Any of the following would constitute an event of default for SMIC Shanghai during the term of the two long-term loan agreements:

Incurrence of any losses in 2005 as calculated on an annual basis;

Incurrence of losses in 2006 in excess of US\$21.9 million;

Incurrence of cumulative losses in 2007 in excess of US\$62.6 million;

Incurrence of any losses in 2008; or

Incurrence of research and development costs in any given year in excess of 15% of revenue for that year.

In May 2005, Semiconductor Manufacturing International (Beijing) Corporation ( SMIC Beijing ) entered into a five-year loan facility in the aggregate principal amount of US\$600.0 million, with a syndicate of banks based in the PRC. This facility is collateralized by SMIC Beijing's plant and equipment. The drawdown period of these facilities ends on the earlier of (i) twelve months after the execution of the agreement or (ii) the date on which the loans have been fully drawn down. As of June 30, 2005, SMIC Beijing had drawn down US\$99.8 million of this facility. The principal amount is repayable starting in December 2007 in six semi-annual installments of US\$100.0 million each. The interest rate on the facility

was 5.25% from May 26, 2005 to June 30, 2005. The interest expense incurred for the six months ended June 30, 2005 was US\$0.03 million.

Any of the following would constitute an event of default for SMIC Beijing during the term of the facility:

[Net profit + depreciation + amortization + financial expenses (increase of accounts receivable and advanced payments + increase of inventory increase in accounts payable and advanced receipts)] / financial expenses < 1; and

(Total liability borrowings from shareholders, including principal and interest)/Total assets > 60% (when SMIC Beijing's capacity is less than 20,000 twelve-inch wafers per month); and (Total liability borrowings from shareholders, including principal and interest) / Total assets > 50% (when SMIC Beijing's capacity exceeds 20,000 twelve-inch wafers per month).

As of June 30, 2005, the Company had an aggregate of US\$224.0 million in short-term loans outstanding with twelve different banks in the PRC. Approximately 31.7%, 32.6% and 35.7% of such aggregate amount were made available to SMIC Beijing, Semiconductor Manufacturing International (Tianjin) Corporation and the Company, respectively. The interest rates on the loan ranged from 3.67% to 4.85% for the six months ended June 30, 2005. The interest expense incurred for the six months ended June 30, 2005 and for the six months ended June 30, 2004 was US\$3.0 million and US\$0.03 million, respectively.





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### **Liquidity and Capital Resources** *(continued)*

The Company accepted promissory notes from employees exercising options to purchase either ordinary shares or Series A convertible preference shares under the Company's 2001 employee stock option plans (the "Stock Option Plans"). As of June 30, 2005 and 2004, the Company had notes receivable from employees for such a purpose related to the early exercise of employee stock options in the aggregate amount of US\$0.3 million and US\$0.4 million, respectively. During the six months ended June 30, 2004, the Company collected US\$33.9 million through the repayment of notes receivable by certain employees and the sale of the notes receivable to a third party bank. The notes are full recourse and are secured by the underlying ordinary shares.

### **Capitalized Interest**

Interest cost incurred on funds used to construct plant and equipment during the active construction period is capitalized, net of government subsidies received. The interest capitalized is determined by applying the borrowing interest rate to the average amount of accumulated capital expenditures for the assets under construction during the period. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful life of the assets. Capitalized interest of US\$3.7 million and US\$2.2 million has been added to the cost of the underlying assets during the six months ended June 30, 2005 and June 30, 2004, respectively, and is amortized over the respective useful life of the assets. For the six months ended June 30, 2005 and June 30, 2004, the Company recorded amortization expenses relating to the capitalized interest of US\$1.4 million and US\$0.7 million, respectively.

### **Commitments**

As of June 30, 2005, the Company had commitments of US\$7.0 million to purchase land use rights for the living quarters at SMIC Beijing, US\$106.0 million for construction obligations for the facility in Chengdu and the Beijing, Tianjin and Shanghai fabs, and US\$329.0 million to purchase machinery and equipment for the facility in Chengdu and the Beijing, Tianjin and Shanghai fabs. As of June 30, 2005, the Company had total commitments of US\$51.6 million to invest in certain projects. The Company expects to complete the cash injection of these projects in the next three years.

### **Debt to Equity Ratio**

As of June 30, 2005, the Company's debt to equity ratio was 31.2% calculated based on the short-term borrowings plus current portion of long-term debt plus long-term debt all divided by total shareholders' equity.

### **Contingent Liabilities**

As of June 30, 2005, the Company did not have any material contingent liabilities.

**Foreign Exchange Rate Fluctuation Risk**

The Company's revenues, expenses, and capital purchasing activities are primarily transacted in United States Dollars. However, since the Company has operations consisting of manufacturing, sales activities and capital purchasing outside of the U.S., the Company enters into transactions in other currencies and is primarily exposed to changes in exchange rates for the European Euro, Japanese Yen, and Chinese Renminbi.

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### **Foreign Exchange Rate Fluctuation Risk** *(continued)*

To minimize these risks, the Company purchases foreign-currency forward exchange contracts with contract terms normally lasting less than twelve months to protect against the adverse effect that exchange rate fluctuations may have on foreign-currency denominated activities. These forward exchange contracts are principally denominated in Chinese Renminbi, Japanese Yen or European Euro and do not qualify for hedge accounting in accordance with SFAS No. 133. As of June 30, 2005, the Company had outstanding foreign currency forward exchange contracts with a notional amount of US\$355.1 million. Notional amounts are stated in U.S. dollar equivalent spot market exchange rates, as of the respective dates. As of June 30, 2005, the fair value of foreign currency forward exchange contracts was a loss of approximately US\$0.4 million, which is recorded in accrued expenses and other current liabilities. The Company had US\$160.0 million of foreign currency exchange contracts outstanding as of June 30, 2004, all of which matured by December 31, 2004. The Company does not enter into foreign currency exchange contracts for speculative purposes.

### **Interest Rate Risk**

The Company's exposure to interest rate risks relates primarily to its long-term debt obligations, which the Company generally assumes to fund capital expenditures and working capital requirements. The Company's long-term debt obligations are all subject to variable interest rates. The interest rates on the Company's U.S. dollar-denominated loans are linked to the LIBOR rate and the Renminbi-denominated loans have interest rates determined by the People's Bank of China. As a result, the interest rates on the Company's loans are subject to fluctuations in the underlying interest rates to which they are linked. For the six months ended June 30, 2005, the Company entered into interest rate derivative contracts to hedge against rising U.S. dollar interest rates. For the six

months ended June 30, 2005, the mark-to-market result for interest rate swaps was a gain of US\$0.2 million.

### **Prospects and Future Plans**

Based on the demand forecasts provided by the Company's customers, the second half of 2005 looks to be a period of expansion as the Company continues to ramp up fabs in Shanghai, Beijing, and Tianjin and expands its service offering.

From a technology standpoint, the Company's first customer products at 90nm are currently under qualification and currently the 90nm logic products for both logic and SRAM are expected to be shipped to customers by as early as the end of the fourth quarter of 2005. Further along the technology roadmap, the Company is now developing its 65nm technology process flow at its 300mm fabs.

Furthermore, the Company will expand its service offerings with the ramp up of the following projects:

The project with Toppan Printing Co., Ltd. in Shanghai, Fab 9, to manufacture on-chip color filters and micro lens which started equipment move-in in early August 2005 with pilot production slated for October 2005.

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The project with United Test and Assembly Center Ltd. in Chengdu, to provide back-end testing and assembly services, which is scheduled for equipment move-in later this September with the commencement of pilot production shortly thereafter.

The wafer reclamation project to manufacture solar modules from recycled wafers in Fab 10 with equipment move-in slated for the fourth quarter of 2005.

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### **CORPORATE GOVERNANCE REPORT**

#### **Hong Kong Code on Corporate Governance Practices (the Code )**

For the six months ended June 30, 2005, the Company has adopted its own Corporate Governance Policy which mirrors with the Code Provisions as set out in the Code contained in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the Listing Rules ) except with respect to Code Provision A.2.1 which requires the roles of chairman and the chief executive officer be segregated and performed by different individuals. As of July 28, 2005, Yang Yuan Wang, a member of the Board since 2001, was elected as the independent non-executive chairman of the Board (the Chairman ). Richard Chang remains as the chief executive officer and an executive director of the Company. Professor Wang 's appointment as Chairman will terminate upon his ceasing to be a director of the Company. In accordance with the Articles of Association of the Company, Professor Wang will retire as a director at the annual general meeting of the Company 's shareholders in 2007 and will then be eligible for re-election to hold office for an additional three years.

In addition, the Company has adopted or put in place various policies, procedures and practices in compliance with the provisions of the Corporate Governance Policy.

#### **Model Code for Securities Transactions by Directors of Listed Issuers (the Model Code )**

The Company has adopted an Insider Trading Compliance Program (the Insider Trading Policy ) which encompasses the requirements of the Model Code as set out in Appendix 10 of the Listing Rules. The Company, having made specific enquiry of all directors, confirms that all members of the Board have complied with the Insider Trading Policy and the Model Code throughout the six months ended June 30, 2005. The senior management as well as all officers, directors, and employees of the Company and its subsidiaries are also required to comply with the provisions of the Insider Trading Policy.

#### **Board Committees**

The Board has established the following committees to assist it in exercising its obligations. These committees consist of independent non-executive Directors who have been invited to serve as members.

##### *Audit Committee*

The Audit Committee primarily oversees the accounting and financial reporting processes of the Company and audits of the financial statements of the Company. The Audit Committee is responsible for assisting the Board 's oversight of (1) the quality and integrity of the Company 's financial statements and related disclosure, (2) the Company 's compliance with legal and regulatory requirements, (3) the independent auditor 's qualifications and independence, and (4) the performance of the Company 's internal audit function and independent auditors. The Audit Committee meets regularly, and on at least a quarterly basis.

The members of the Audit Committee, all of whom are independent non-executive directors, are Henry Shaw, Lip-Bu Tan and Yang Yuan Wang. None of the current members of the Audit Committee has been an executive officer or employee of the Company or its subsidiaries.

The responsibilities of the Audit Committee include, among other things:

making recommendations to the Board concerning the appointment, reappointment, retention, evaluation, oversight and termination of the work of the Company's independent auditor, including reviewing the experience, qualifications and performance of the senior members of the independent auditor team and pre-approving all non-audit services to be provided by the Company's independent auditor;

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*Audit Committee (continued)*

approving the remuneration and terms of engagement of the Company's independent auditor;

reviewing reports from the Company's independent auditor regarding its internal quality-control procedures and any material issues raised in the most recent review or investigation of such procedures and regarding all relationships between the Company and the independent auditor;

pre-approving the hiring of any employee or former employee of the Company's independent auditor who was a member of the audit team during the preceding two years;

reviewing the Company's annual and interim financial statements, earnings releases, critical accounting policies and practices used to prepare financial statements, alternative treatments of financial information, the effectiveness of the Company's disclosure controls and procedures and important trends and developments in financial reporting practices and requirements;

reviewing the planning and staffing of internal audits, the organization, responsibilities, plans, results, budget and staffing of the Company's internal audit team and the quality and effectiveness of the Company's internal controls;

reviewing the Company's risk assessment and management policies;

reviewing any legal matters that may have a material impact and the adequacy and effectiveness of the Company's legal and regulatory compliance procedures;

establishing procedures for the treatment of complaints received by the Company regarding accounting, internal accounting controls, auditing matters, potential violations of law and questionable accounting or auditing matters; and

obtaining and reviewing reports from management, the Company's internal auditor and the Company's independent auditor regarding compliance with applicable legal and regulatory requirements, including the Foreign Corrupt Practices Act.

*Compensation Committee*

The Compensation Committee primarily oversees the matters relating to compensation of employees, including equity compensation, of the Company's senior management team. The Compensation Committee has overall responsibility for evaluating and making recommendations to the Board regarding (i) compensation of the Company's directors and (ii) equity-based and incentive compensation plans, policies and programs of the Company. The Compensation Committee meets regularly, and on at least a quarterly basis.

The members of the Compensation Committee, all of whom are independent non-executive directors, are Ta-Lin Hsu, Tsuyoshi Kawanishi and Lip-Bu Tan. None of these members of the Compensation Committee has been an executive officer or employee of the Company or its subsidiaries.

The responsibilities of the Compensation Committee include, among other things:

approving and overseeing the total compensation package for the Company's executive officers, evaluating the performance of and determining and approving the compensation to be paid to the Company's chief executive officer and reviewing the results of the chief executive officer's evaluation of the performance of the Company's other executive officers;



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### *Compensation Committee (continued)*

reviewing and making recommendations to the Board with respect to Director compensation, including equity-based compensation;

administering and periodically reviewing and making recommendations to the Board regarding the long-term incentive compensation or equity plans made available to the Directors, employees and consultants;

reviewing and making recommendations to the Board regarding executive compensation philosophy, strategy and principles and reviewing new and existing employment, consulting, retirement and severance agreements proposed for the Company's executive officers; and

ensuring appropriate oversight of the Company's human resources policies and reviewing strategies established to fulfill the Company's ethical, legal and human resources responsibilities.

### **Internal Audit**

The internal audit department works with and supports the Company's management team and the Audit Committee in monitoring the Company's compliance with its internal governance policies. On a regular basis, the internal audit department audits the practices, procedures, expenditure and internal controls of the various departments in the Company. After completing an audit, the internal audit department furnishes the Company's management team and the Audit Committee with analysis, appraisals, recommendations, counsel, and information concerning the activities reviewed. The internal audit department can also conduct reviews and investigations on an ad hoc basis.

### **Sarbanes-Oxley Act of 2002**

In June 2004, the Public Company Accounting Oversight Board, or PCAOB, adopted rules for purposes of implementing Section 404 of the United States Sarbanes-Oxley Act of 2002, or Sarbanes-Oxley Act. Pursuant to the Sarbanes-Oxley Act and the various rules and regulations adopted pursuant thereto or in conjunction therewith, the Company is required, for fiscal year 2006, to perform an evaluation of the Company's internal controls over financial reporting and file an assessment of its effectiveness with the United States Securities and Exchange Commission. For fiscal year 2006, the Company's external auditors are required to attest to such evaluation.

With the assistance of an independent consultant, the Company has begun to review its internal control systems in order to comply with the requirements of the Sarbanes-Oxley Act within the prescribed time.

### **Business ethics**

The Company is committed to maintaining a high level of corporate governance in order to protect the interests of its shareholders and to enhance its business reputation.

To this end, the Company has adopted various codes, charters and policies, including the Corporate Governance Policy, Audit Committee Charter, Compensation Committee Charter, Code of Business Conduct and Ethics, Insider-Trading Policy, Anti-Fraud Policy and Classified Information Protection Policy, which set forth the policies and procedures of corporate governance, internal control, protection of confidential information and other matters. To ensure that all employees adhere to and understand the Company's values and principles, the Company requires employees to comply, to the extent applicable, with its codes, charters and policies and provides them with periodic trainings or when the need arises.

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### **SOCIAL RESPONSIBILITY**

#### **A. The Company In the Community**

The Company has a tradition of supporting the communities in which it operates through the involvement of its management and employees, helping the local communities to grow and prosper with the Company.

#### **Support for Education**

In addition to building kindergartens and schools for its employees' children, the Company is also dedicated to supporting education initiatives in impoverished areas in China. The Company has been a long standing supporter of the Enyou Foundation and the Company's senior management team has been actively involved in the foundation and helped to build dozens of schools in China's inland provinces such as Yunnan and Jiangsu, and empowered rural educators with modernized teaching skills, methodologies and know-how.

#### **Support for the Needy**

The Company and many of its employees believe in compassion and care for the needy. During the SARS outbreak in 2003, the Company's employees donated a total of approximately RMB956,181 to Chinese medical agencies in aid of the victims and their families. When the catastrophic tsunamis hit Southeast Asia in 2004, the Company's employees again mobilized and contributed approximately RMB371,240 to the aid relieving efforts in

Indonesia. The Company continues to encourage employees to serve communities in need of care and aid.

#### **Protecting the Environment**

The Company is concerned about the global environment and recycles, reduces, and reuses energy and materials used in its manufacturing facilities and offices. The Company's manufacturing plants feature advanced water recycling systems with multiple applications to recycle and reuse sewage. At every fab, the Company has wastewater treatment plants which can recycle up to 70% of wastewater back into the fabs. In addition, the Beijing fabs have large rain water collection facilities and air cooling systems to take advantage of the cold air in the winter to help cool the manufacturing facilities with renewable resources. All office buildings contain recycling bins to encourage employee participation in recycling waste materials. These extensive projects assisted in the Company receiving its ISO14001 certifications from the British Standard Institute.

The Company's core belief in renewable energy is embedded directly in the future direction of its business. Specifically, Fab 10, will be used to manufacture solar cell panels and modules. The Company made the move not only because it believes the solar power market has great potential, but more importantly, the Company believes that it can assist the migration to renewable energy sources through technological advances, increasing manufacturing capacity, and material and manufacturing cost reductions.



**Table of Contents****OTHER INFORMATION****1. Dividends**

The board of directors of the Company (the Board) proposed not to declare an interim dividend for the period of the six months ended June 30, 2005.

**2. Share capital**

During the six months ended June 30, 2005, the Company issued 18,683,466 Ordinary Shares to certain of the Company's employees pursuant to the exercise of options to purchase Ordinary Shares by, and repurchased 5,027,500 Ordinary Shares from certain of the Company's employees, in accordance with the Company's employee stock option plans (the Stock Option Plans).

Outstanding Share Capital as of June 30, 2005

	<b>Number of Shares Outstanding</b>
Total Ordinary Shares Outstanding	18,246,615,105

Under the terms of the Company's 2004 Equity Incentive Plan, the Compensation Committee may grant restricted share units (Restricted Share Units) to eligible participants including employees, directors, officers and service providers of the Company. Each Restricted Share Unit represents the right to receive one Ordinary Share. Restricted Share Units granted to new employees generally vest at a rate of 10% upon the second anniversary of the vesting commencement date, an additional 20% on the third anniversary of the vesting commencement date and an additional 70% upon the fourth anniversary of the vesting commencement date. Restricted Share Units granted to existing employees generally vest at a rate of 25% upon the first, second, third and fourth anniversaries of the vesting commencement date. Upon vesting of the Restricted Share Units and subject to the terms of the Insider Trading Policy and the payment by the participants of applicable taxes, the Company will issue the relevant participants the number of Ordinary Shares underlying the awards of Restricted Share Units.

For the twelve months ended December 31, 2004, the Compensation Committee granted a total of 118,190,824 Restricted Share Units, pursuant to which the Company issued an aggregate of 18,536,451 Ordinary Shares to its employees on or around July 1, 2005. An additional 26,831,170 Restricted Share Units will vest on each of July 1, 2006, July 1, 2007, and July 1, 2008.

For the six months ended June 30, 2005, the Compensation Committee granted a total of 6,630,000 Restricted Share Units, most of which vest at a rate of 25% upon the first, second, third and fourth anniversaries of the vesting commencement date. On August 11, 2005, the Compensation Committee approved the grant of an aggregate of 70,503,740 Restricted Share Units, of which approximately 25% will vest on an annual basis beginning on September 1, 2006.



**Table of Contents****3. Substantial shareholders interest**

Set out below are the names of the parties (not being a Director or chief executive of the Company) which were interested in 5 percent or more of the nominal value of the share capital of the Company and the respective relevant numbers of shares in which they were interested as at June 30, 2005 as recorded in the register kept by the Company under section 336 of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) ( SFO ).

<u>Name of Shareholder</u>	<u>Number of Shares Held</u>	<u>Percentage Held</u>
Shanghai Industrial Investment (Holdings) Company Limited ( SIIC )	1,814,991,340 (long position) <sup>(1)</sup> 26,426,137 (long position) <sup>(2)</sup> 10,777,373 (long position) <sup>(3)</sup> 4,794,491 (short position) <sup>(4)</sup>	9.95% (long position) 0.15% (long position) 0.059% (long position) 0.03% (short position)
Total:	1,852,194,850 (long position) 4,794,491 (short position)	10.15% (long position) 0.03% (short position)
Credit Suisse Group <sup>(5)</sup>	48,430,000 (long position) <sup>(6)</sup> 136,790,000 (long position) <sup>(7)</sup> 1,148,745,000 (long position) <sup>(8)</sup> 745,000 (long position) <sup>(9)</sup> 301,500 (long position) <sup>(10)</sup> 48,435,000 (short position) <sup>(6)</sup> 36,570,000 (short position) <sup>(7)</sup> 1,741,061,000 (short position) <sup>(8)</sup>	0.27% (long position) 0.75% (long position) 6.30% (long position) 0.00% (long position) 0.00% (long position) 0.27% (short position) 0.20% (short position) 9.54% (short position)
Total:	1,335,011,500 (long position) 1,826,066,000 (short position)	7.32% (long position) 10.01% (short position)

*Notes:*

- (1) All such shares are held by S. I. Technology Production Holdings Limited ( SITPHL ) which is wholly-owned by Shanghai Industrial Holdings Limited ( SIHL ). SIHL is an indirect non-wholly owned subsidiary of SIIC which are holding SIHL s shares through its wholly-owned subsidiaries namely, SIIC Capital (B.V.I.) Limited, Shanghai Investment Holdings Limited and SIIC CM Development Limited, which together are entitled to exercise or control the exercise of more than one-third of the voting power at the general meetings of SIHL. By virtue of the SFO, SIIC and its subsidiaries namely, Shanghai Investment Holdings Limited and Shanghai Industrial Investment Treasury Company Limited are deemed to be interested in the 1,814,991,340 Shares held by SITPHL. The Company s Directors, Lai Xing Cai and his alternate director, Fang Yao, are chairman and executive director of SIHL respectively. Lai Xing Cai is also the Chairman of SIIC. It is the Company s understanding that voting and investment control over the Ordinary Shares beneficially owned by SIHL are maintained by the board of directors of SIHL.
- (2) 9,816,457 of such Ordinary Shares are held by SIIC CM Development Funds Limited which is owned as to 50% by each of SIIC CM Development Limited and Eternal Success Holdings Limited which are in turn wholly-owned by SIIC. 16,609,680 of such Ordinary Shares are held by SIIC Treasury (B.V.I.) Limited which is a wholly-owned subsidiary of SIIC.
- (3) All such Ordinary Shares are held by SIHL Treasury Limited which is a wholly-owned subsidiary of SIHL.

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- (4) All such Ordinary Shares are held by SIIC Treasury (B.V.I.) Limited which is wholly-owned by SIIC.
- (5) The information contained herein is based on the Forms 2 filed by Credit Suisse Group with the Company on September 2, 2005 to (i) amend and restate certain positions held as at June 30, 2005 which had been filed with, and recorded in the register kept by the Company, prior to June 30, 2005 and (ii) add further positions held as at June 30, 2005.
- (6) Such Ordinary Shares are held by Credit Suisse First Boston LLC which is a wholly-owned subsidiary of Credit Suisse First Boston (USA), Inc., which is in turn a wholly-owned subsidiary of Credit Suisse First Boston Inc. Credit Suisse First Boston Inc. is 57% owned by Credit Suisse and 43% owned by Credit Suisse Group. Credit Suisse is also a wholly-owned subsidiary of Credit Suisse Group.
- (7) Such Ordinary Shares are held by Credit Suisse First Boston International which is 24%, 56% and 20% owned by Credit Suisse First Boston (International) Holding AG, Credit Suisse and Credit Suisse Group, respectively. Credit Suisse First Boston (International) Holding AG is wholly-owned by Credit Suisse, which is in turn wholly-owned by Credit Suisse Group.
- (8) Such Ordinary Shares are held by Credit Suisse First Boston (Hong Kong) Limited which is 29.8% owned by Credit Suisse First Boston International (Guernsey) Limited and 70.2% owned by Credit Suisse First Boston (International) Holding AG. Credit Suisse First Boston International (Guernsey) Limited is wholly-owned by Credit Suisse First Boston (International) Holding AG. Credit Suisse First Boston (International) Holding AG is wholly-owned by Credit Suisse, which is in turn wholly-owned by Credit Suisse Group.
- (9) Such Ordinary Shares are held by Credit Suisse First Boston (Europe) Limited which is wholly-owned by Credit Suisse First Boston (UK) Investment Holdings, which is 98.07% owned by Credit Suisse First Boston (UK) Investments and 1.93% owned by Credit Suisse First Boston Management AG. Both Credit Suisse First Boston (UK) Investments and Credit Suisse First Boston Management AG are wholly-owned by Credit Suisse First Boston (International) Holding AG. Credit Suisse First Boston (International) Holding AG is wholly-owned by Credit Suisse, which is in turn wholly-owned by Credit Suisse Group.
- (10) Such Ordinary Shares are held by Credit Suisse, New York Branch, a wholly-owned subsidiary of Credit Suisse, which is in turn wholly-owned by Credit Suisse Group.

**4. Shareholding interests of the Directors of the Company**

As at June 30, 2005, the interests or short positions of the Directors in the Ordinary Shares, underlying shares and debentures of the Company (within the meaning of Part XV of the SFO), which were notified to the Company and the The Stock Exchange of Hong Kong Limited (the Stock Exchange ) pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO), and as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange) pursuant to the Model Code were as follows:

<u>Board Member</u>	<u>Nature of Interest</u>	<u>Number of Shares</u>	<b>Percentage of</b>
			<b>Aggregate Interests to Total Issued</b>
			<b>Share Capital</b>
Richard R. Chang	Personal Interest <sup>(1)</sup>	32,429,550	
	Personal Interest <sup>(2)</sup>	17,100,000	
	Corporate Interest <sup>(3)</sup>	20,000,000	
	Interest of Spouse	9,790,000	
	Interest of Child under 18	11,200,000	
Total:		90,519,550	*



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<b>Board Member</b>	<b>Nature of Interest</b>	<b>Number of Shares</b>	<b>Percentage of</b>
			<b>Aggregate Interests</b>
			<b>to Total Issued</b>
			<b>Share Capital</b>
Ta-Lin Hsu	Corporate Interest <sup>(4)</sup>	15,300,010	
	Personal Interest <sup>(5)</sup>	500,000	
Total:		15,800,010	*
Yen-Pong Jou	Personal Interest <sup>(5)</sup>	500,000	*
Tsuyoshi Kawanishi	Personal Interest <sup>(5)(6)</sup>	2,000,000	*
Henry Shaw	Personal Interest <sup>(5)</sup>	500,000	*
Lip-Bu Tan	Personal Interest <sup>(5)</sup>	500,000	*
Yang Yuan Wang	Personal Interest <sup>(5)</sup>	500,000	*

*Notes:*

\* Indicates less than 1%.

- (1) Pursuant to a Charitable Pledge Agreement dated December 1, 2003, Richard Ru Gin Chang and his spouse, Scarlett K. Chang (collectively, the Donors ) have pledged to transfer 10,000,000 of such Ordinary Shares as a charitable gift to The Richard and Scarlett Chang Family Foundation, a Delaware nonprofit nonstock corporation organized exclusively for religious, charitable, scientific, literary and education purposes within the meaning of Section 501(c)(3) of the US Internal Revenue Code of 1986, as amended, such transfer to be made in full at or prior to the death of the surviving Donor. In addition, 2,639,550 of such Ordinary Shares are jointly held by Richard Ru Gin Chang and his spouse, Scarlett K. Chang.
- (2) The Compensation Committee has granted Dr. Chang options to purchase an aggregate of 15,100,000 Ordinary Shares if fully exercised, and an award of 2,000,000 Restricted Share Units (each representing the right to receive one Ordinary Share). As of June 30, 2005, none of these options have been exercised.
- (3) Jade Capital Company, LLC, a Delaware limited liability company, of which Richard Ru Gin Chang and his spouse, Scarlett Chang, are the sole members, holds 20,000,000 Ordinary Shares. It is the current intent of the members that all or a portion of the net income of Jade Capital Company, LLC be used for philanthropic purposes, including but not limited to contributions to charitable organizations that are tax-exempt under Section 501(c)(3) of the US Internal Revenue Code of 1986, as amended.
- (4) Ta-Lin Hsu has a controlling interest in AP3 Co-Investment Partners, LDC, which holds 15,300,010 Ordinary Shares.
- (5) Each independent non-executive Director and non-executive Director was granted an option to purchase 500,000 Ordinary Shares, if fully exercised. Each option is 100% vested and remains unexercised as at June 30, 2005. Lai Xing Cai has declined such option.
- (6) Tsuyoshi Kawanishi has been granted options to purchase an aggregate of 1,500,000 Ordinary Shares, if fully exercised. As of June 30, 2005, these options have not been exercised.

**Table of Contents****2001 Stock Option Plans**

Name/Eligible	Date Granted	Period During which Rights Exercisable	No. of Options Granted	Exercise Price Per Share	Options Outstanding as of 1/1/05	Options Lapsed During Period	Options Lapsed Due to Repurchase	Options Exercised During Period	Options Cancelled During Period	Options Outstanding as of 6/30/05	Options Outstanding on which Options were Exercised	Weighted Average Closing Price immediately before Date on which Options were
												(US\$)
Kawanishi, Tsuyoshi	7/11/2002	7/11/2002-7/10/2012	500,000	\$ 0.05	500,000					500,000		\$ 0.07
Kawanishi, Tsuyoshi	1/15/2004	1/15/2004-1/14/2006	1,000,000	\$ 0.10	1,000,000					1,000,000		\$ 0.33
Senior Management	9/24/2001	9/24/2001-9/23/2011	1,450,000	\$ 0.01	600,000			600,000				\$ 0.21
Senior Management	4/10/2002	4/10/2002-4/09/2012	1,350,000	\$ 0.02	1,350,000					1,350,000		\$ 0.05
Senior Management	4/24/2003	4/24/2003-4/23/2013	1,500,000	\$ 0.05	1,500,000					1,500,000		\$ 0.14
Senior Management	1/15/2004	1/15/2004-1/14/2014	10,700,000	\$ 0.10	10,450,000	6,000,000		2,000,000		2,450,000		\$ 0.21
Senior Management	2/16/2004	2/16/2004-2/15/2014	900,000	\$ 0.25	900,000					900,000		\$ 0.33
Service Providers	9/26/2002	9/26/2002-9/25/2012	50,000	\$ 0.05	50,000					50,000		\$ 0.03
Service Providers	7/15/2003	7/15/2003-7/02/2005	20,000	\$ 0.05	20,000					20,000		\$ 0.14
Service Providers	1/15/2004	1/15/2004-3/01/2005	4,100,000	\$ 0.10	100,000					100,000		\$ 0.14
Others	1/15/2004	1/15/2004-1/14/2014	4,600,000	\$ 0.10	2,500,000					2,500,000		\$ 0.35
Others	2/16/2004	2/16/2004-2/15/2014	12,300,000	\$ 0.25	7,380,000					7,380,000		\$ 0.35
Employees	3/28/2001	3/28/2001-3/27/2011	89,385,000	\$ 0.01	8,096,000	135,000	2,322,334	433,000		7,528,000	\$ 0.20	\$ 0.03
Employees	4/1/2001	4/1/2001-3/31/2011	2,900,000	\$ 0.01			270,000					\$ 0.03
Employees	4/2/2001	4/02/2001-4/01/2011	2,216,000	\$ 0.01	416,000					416,000		\$ 0.03
Employees	4/16/2001	4/16/2001-4/15/2011	575,000	\$ 0.01	35,000					35,000		\$ 0.03
Employees	4/28/2001	4/28/2001-4/27/2011	60,000	\$ 0.01	42,000					42,000		\$ 0.03
Employees	5/14/2001	5/14/2001-5/13/2011	1,597,000	\$ 0.01	47,000		180,000	22,000		25,000	\$ 0.22	\$ 0.03
Employees	5/15/2001	5/15/2001-5/14/2011	95,000	\$ 0.01	35,000					35,000		\$ 0.03
Employees	5/24/2001	5/24/2001-5/23/2011	35,000	\$ 0.01	35,000			35,000			\$ 0.21	\$ 0.03
Employees	6/1/2001	6/01/2001-5/31/2011	80,000	\$ 0.01	40,000					40,000		\$ 0.03
Employees	7/1/2001	7/1/2001-6/30/2011	745,000	\$ 0.01	69,000		90,000			69,000		\$ 0.03
Employees	7/10/2001	7/10/2001-7/09/2011	20,000	\$ 0.01	20,000					20,000		\$ 0.03
Employees	7/15/2001	7/15/2001-7/14/2011	1,045,000	\$ 0.01	788,000			46,000		742,000	\$ 0.20	\$ 0.03

**Table of Contents****2001 Stock Option Plans (continued)**

Name/Eligible	Date Granted	Period During which Rights Exercisable	No. of Options Granted	Exercise Price Per Share	Options Outstanding as of 1/1/05	Options Lapsed During Period	Options Lapsed Due to Repurchase of Ordinary Shares During Period*	Options Exercised During Period	Options Cancelled During Period	Options Outstanding as of 6/30/05	Weighted Average Closing Price of Shares immediately before Dates on which Options were	Weighted Average Closing Price of Shares immediately before Dates on which Options were
											(US\$)	(US\$)
Employees	7/16/2001	7/16/2001-7/15/2011	2,220,000	\$ 0.01	128,000					128,000	\$ 0.03	\$ 0.03
Employees	7/20/2001	7/20/2001-7/19/2011	20,000	\$ 0.01	14,000					14,000	\$ 0.03	\$ 0.03
Employees	7/27/2001	7/27/2001-7/26/2011	50,000	\$ 0.01	50,000					50,000	\$ 0.03	\$ 0.03
Employees	7/30/2001	7/30/2001-7/29/2011	140,000	\$ 0.01	100,000					100,000	\$ 0.03	\$ 0.03
Employees	8/1/2001	8/01/2001-7/31/2011	195,000	\$ 0.01	189,000	14,000				175,000	\$ 0.03	\$ 0.03
Employees	8/7/2001	8/07/2001-8/06/2011	20,000	\$ 0.01	20,000					20,000	\$ 0.03	\$ 0.03
Employees	8/15/2001	8/15/2001-8/14/2011	100,000	\$ 0.01	100,000					100,000	\$ 0.03	\$ 0.03
Employees	8/20/2001	8/20/2001-8/19/2011	20,000	\$ 0.01	20,000					20,000	\$ 0.03	\$ 0.03
Employees	9/24/2001	9/24/2001-9/23/2011	99,158,500	\$ 0.01	51,448,300	14,000	1,421,000	1,701,600		49,732,700	\$ 0.21	\$ 0.03
Employees	9/28/2001	9/28/2001-9/27/2011	50,000	\$ 0.01	50,000					50,000	\$ 0.03	\$ 0.03
Employees	1/24/2002	1/24/2002-1/23/2012	47,653,000	\$ 0.01	36,934,500	406,000		2,190,000		34,338,500	\$ 0.21	\$ 0.03
Employees	1/24/2002	1/24/2002-1/23/2012	7,684,500	\$ 0.02	4,996,340	531,810	51,100	457,060		4,007,470	\$ 0.21	\$ 0.03
Employees	4/10/2002	4/10/2002-4/09/2012	1,315,000	\$ 0.01	65,000					65,000	\$ 0.05	\$ 0.05
Employees	4/10/2002	4/10/2002-4/09/2012	47,349,000	\$ 0.02	32,588,500	59,000	225,000	1,660,700		30,868,800	\$ 0.20	\$ 0.05
Employees	4/11/2002	4/11/2002-4/10/2012	4,100,000	\$ 0.01	2,100,000					2,100,000	\$ 0.05	\$ 0.05
Employees	6/28/2002	6/28/2002-6/27/2012	930,000	\$ 0.01	900,000					900,000	\$ 0.06	\$ 0.06
Employees	6/28/2002	6/28/2002-6/27/2012	39,740,000	\$ 0.02	29,312,000	900,000		963,000		27,449,000	\$ 0.20	\$ 0.06
Employees	6/28/2002	6/28/2002-6/27/2012	18,944,000	\$ 0.05	13,471,000	16,000		45,000		13,410,000	\$ 0.20	\$ 0.06
Employees	7/11/2002	7/11/2002-7/10/2012	250,000	\$ 0.01	250,000			250,000			\$ 0.20	\$ 0.07
Employees	7/11/2002	7/11/2002-7/10/2012	1,700,000	\$ 0.02	750,000					750,000	\$ 0.07	\$ 0.07
Employees	7/11/2002	7/11/2002-7/10/2012	2,780,000	\$ 0.05	830,000	750,000				80,000	\$ 0.07	\$ 0.07
Employees	9/26/2002	9/26/2002-9/25/2012	5,770,000	\$ 0.02	3,642,000					3,642,000	\$ 0.08	\$ 0.08
Employees	9/26/2002	9/26/2002-9/25/2012	65,948,300	\$ 0.05	47,276,150	636,500	48,150	199,960		46,439,690	\$ 0.20	\$ 0.08
Employees	1/9/2003	1/09/2003-1/08/2013	53,831,000	\$ 0.05	39,225,800	1,499,200	144,000	508,500		37,218,100	\$ 0.21	\$ 0.10

**Table of Contents****2001 Stock Option Plans (continued)**

Name/Eligible	Date Granted	Period During which Rights Exercisable	No. of Options Granted	Exercise Price Per Share	Options Outstanding as of 1/1/05	Options Lapsed During Period	Options Lapsed Due to Repurchase of Ordinary Shares During Period*	Options Exercised During Period	Options Cancelled During Period	Options Outstanding as of 6/30/05	Weighted Average Closing Price of Shares immediately before Dates on which Options were	Weighted Average Closing Price of Shares immediately before Dates on which Options were
											exercised	exercised
				(US\$)							(US\$)	(US\$)
Employees	1/10/2003	1/10/2003-1/09/2013	720,000	\$ 0.05	720,000					720,000	\$ 0.10	
Employees	1/22/2003	1/22/2003-1/21/2013	1,060,000	\$ 0.05	1,060,000					1,060,000	\$ 0.10	
Employees	4/1/2003	4/01/2003-3/31/2013	18,804,900	\$ 0.05	17,013,820	606,220		234,640		16,172,960	\$ 0.20	\$ 0.14
Employees	4/15/2003	4/15/2003-4/14/2013	550,000	\$ 0.05	550,000					550,000	\$ 0.14	
Employees	4/24/2003	4/24/2003-4/23/2013	58,838,000	\$ 0.05	38,921,500	1,180,600		873,200		36,867,700	\$ 0.21	\$ 0.14
Employees	7/15/2003	7/15/2003-7/14/2013	59,699,900	\$ 0.05	39,929,900	1,572,000		91,600		38,266,300	\$ 0.20	\$ 0.17
Employees	10/10/2003	10/10/2003-10/09/2013	49,535,400	\$ 0.10	37,989,600	440,000		25,000		37,524,600	\$ 0.20	\$ 0.29
Employees	1/5/2004	1/05/2004-1/04/2014	130,901,110	\$ 0.10	110,218,140	4,472,595		2,082,668		103,662,877	\$ 0.20	\$ 0.33
Employees	1/15/2004	1/15/2004-1/14/2014	20,885,000	\$ 0.10	10,735,000	150,000		450,000		10,135,000	\$ 0.21	\$ 0.33
Employees	1/15/2004	1/15/2004-1/14/2014	300,000	\$ 0.25	300,000	225,000				75,000		\$ 0.33
Employees	2/16/2004	2/16/2004-2/15/2014	14,948,600	\$ 0.10	7,581,900	962,750		646,850		5,972,300	\$ 0.20	\$ 0.33
Employees	2/16/2004	2/16/2004-2/15/2014	76,954,880	\$ 0.25	67,210,690	2,083,628				65,127,062		\$ 0.33

\* These represent Ordinary Shares repurchased by the Company pursuant to the terms of the Stock Option Plans.

# The above information on Senior Management includes information regarding options granted to (i) the Company's current Acting Chief Financial Officer, Ms. Morning Wu, and (ii) the Company's previous Chief Financial Officer, Ms. Jenny Wang, who, as the Company announced in March 2005, resigned as Chief Financial Officer to pursue other business interests, and was replaced by Ms. Morning Wu.

Options to purchase Ordinary Shares issued to new employees generally vest at a rate of 10% upon the second anniversary, an additional 20% upon the third anniversary and an additional 70% upon the fourth anniversary of the vesting commencement date. Beginning in January 2004, options to purchase Ordinary Shares issued to then-existing employees generally vest at a rate of 25% upon the first, second, third and fourth anniversaries of the vesting commencement date.

The Company has not issued stock options under the 2001 Stock Option Plans since the completion of the Global Offering.

**Table of Contents****2001 Preference Share Plans**

Name/Eligible Employees	Date Granted	Period During which Rights Exercisable	No. of Options Granted	Exercise Price Per Share	Options Outstanding as of 1/1/05	Options Lapsed During Period	Options Lapsed Due to Repurchase of Ordinary Shares During Period*	Options Exercised During Period	Options Cancelled During Period	Options Outstanding as of 6/30/05	Weighted Average Closing Price of Shares immediately before Dates on which Options were Exercised	Weighted Average Closing Price of Shares immediately before Dates on which Options were Granted
											(US\$)	(US\$)
Service Providers	7/11/2002	7/11/2002-7/10/2012	462,000	\$ 0.11	202,000					202,000	\$ 0.14	\$ 0.14
Service Providers	9/26/2002	9/26/2002-9/25/2012	50,000	\$ 0.11	50,000					50,000	\$ 0.15	\$ 0.15
Employees	9/24/2001	9/24/2001-9/23/2011	254,098,700	\$ 0.11	32,280,300	28,000		1,302,600		30,949,700	\$ 0.21	\$ 0.11
Employees	9/28/2001	9/28/2001-9/27/2011	50,000	\$ 0.11	50,000					50,000	\$ 0.11	\$ 0.11
Employees	11/3/2001	11/03/2001-11/02/2011	780,000	\$ 0.35	680,000	42,500				637,500	\$ 0.11	\$ 0.11
Employees	1/24/2002	1/24/2002-1/23/2012	58,357,500	\$ 0.11	9,201,340	256,090	135,000	176,550		8,768,700	\$ 0.20	\$ 0.12
Employees	4/10/2002	4/10/2002-4/09/2012	51,384,000	\$ 0.11	7,108,000	239,000		301,200		6,567,800	\$ 0.20	\$ 0.13
Employees	6/28/2002	6/28/2002-6/27/2012	63,332,000	\$ 0.11	16,926,000	511,000		170,000		16,245,000	\$ 0.20	\$ 0.14
Employees	7/11/2002	7/11/2002-7/10/2012	4,530,000	\$ 0.11	2,615,000	750,000		1,060,000		805,000	\$ 0.21	\$ 0.14
Employees	9/26/2002	9/26/2002-9/25/2012	73,804,800	\$ 0.11	20,363,320	422,550	189,750	107,160		19,833,610	\$ 0.21	\$ 0.15
Employees	1/9/2003	1/09/2003-1/08/2013	12,686,000	\$ 0.11	2,157,000					2,157,000	\$ 0.17	\$ 0.17

\* These represent Ordinary Shares repurchased by the Company pursuant to the terms of the Preference Share Plans.

Options to purchase preference shares issued to new employees generally vest at a rate of 10% upon the second anniversary, an additional 20% on the third anniversary and an additional 70% upon the fourth anniversary of the vesting commencement date. Employees may early exercise their options to purchase preference shares. If an employee early exercises 100% of his or her options, the options vest at a rate of 25% upon each of the first, second, third and fourth anniversary of the vesting commencement date. Furthermore, in this case, if the employee remains employed by the Company and the Company has completed its initial public offering as of the third anniversary of the vesting commencement date, all of the options shall vest.

The options to purchase preference shares converted into options to purchase Ordinary Shares immediately prior to the completion of the Global Offering.

The Company has not issued stock options under the 2001 Preference Share Plans since the completion of the Global Offering.

**Table of Contents****2004 Stock Option Plan**

Employee/Eligible	Date Granted	Period During which Rights Exercisable	No. of Options Granted	Exercise Price Per Share	Options Outstanding as of 1/1/05	Additional Options Granted During Period	Options Lapsed During Period	Options Lapsed Due to Repurchase of Ordinary Shares During Period*	Options Exercised During Period	Options Cancelled During Period	Options Outstanding as of 6/30/05	Weighted Average Closing Price of Shares immediately before Dates on which Options Exercised	Weighted Average Closing Price of Shares immediately before Dates on which Options Exercised
				(US\$)								(US\$)	(US\$)
g, ard	4/7/2004	4/07/2004-4/06/2014	100,000	\$ 0.31	100,000						100,000		
g, ard	5/11/2005	5/11/2005-5/10/2015	15,000,000	\$ 0.20		15,000,000					15,000,000		
Ta-Lin	11/10/2004	11/10/2004-11/09/2009	500,000	\$ 0.22	500,000						500,000		
Yen-Pon	11/10/2004	11/10/2004-11/09/2009	500,000	\$ 0.22	500,000						500,000		
anishi, oshi	11/10/2004	11/10/2004-11/09/2009	500,000	\$ 0.22	500,000						500,000		
y, Henry	11/10/2004	11/10/2004-11/09/2009	500,000	\$ 0.22	500,000						500,000		
Lip-Bu	11/10/2004	11/10/2004-11/09/2009	500,000	\$ 0.22	500,000						500,000		
g, Yang	11/10/2004	11/10/2004-11/09/2009	500,000	\$ 0.22	500,000						500,000		
or	3/18/2004	3/18/2004-3/17/2014	150,000	\$ 0.35	190,000		40,000				150,000		
agement	5/11/2005	5/11/2005-5/10/2015	900,000	\$ 0.20		900,000					900,000		
rs	3/18/2004	3/18/2004-3/17/2014	20,000	\$ 0.35	20,000						20,000		
rs	7/27/2004	7/27/2004-7/26/2014	200,000	\$ 0.20	200,000						200,000		
rs	5/11/2005	5/11/2005-5/10/2015	100,000	\$ 0.20		100,000					100,000		
loyees	3/18/2004	3/18/2004-3/17/2014	49,949,700	\$ 0.35	45,077,750		1,866,200				43,211,550		
loyees	4/25/2004	4/25/2004-4/24/2014	22,591,800	\$ 0.28	20,836,800		849,550				19,987,250		
loyees	7/27/2004	7/27/2004-7/26/2014	35,983,000	\$ 0.20	33,192,000		2,675,000				30,517,000		
loyees	11/10/2004	11/10/2004-11/09/2014	52,036,140	\$ 0.22	51,772,730		5,467,425				46,305,305		
loyees	5/11/2005	5/11/2005-5/10/2015	94,581,300	\$ 0.20		94,581,300	3,426,321				91,154,979		

\* These represent Ordinary Shares repurchased by the Company pursuant to the terms of the Stock Option Plans.

# The above information on Senior Management includes options granted to (i) the Company's current Acting Chief Financial Officer, Ms. Morning Wu, and (ii) the Company's previous Chief Financial Officer, Ms. Jenny Wang, who, as the Company announced in March 2005, resigned as Chief Financial Officer to pursue other business interests, and was replaced by Ms. Morning Wu.

Options to purchase Ordinary Shares issued to new employees generally vest at a rate of 10% upon the second anniversary, an additional 20% on the third anniversary and an additional 70% upon the fourth anniversary of the vesting commencement date. Options to purchase Ordinary Shares issued to then-existing employees generally vest at a rate of 25% upon the first, second, third and fourth anniversaries of the vesting commencement date.



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### **5. Repurchase, sale or redemption of securities**

Other than repurchases by the Company of Ordinary Shares from employees pursuant to the terms of the Stock Option Plans as disclosed in paragraph 2 (Share Capital) above, the Company has not repurchased, sold or redeemed any of its securities during the six months ended June 30, 2005.

### **6. Material litigation and arbitration**

In December 2003, the Company became the subject of a lawsuit in the U.S. federal district court brought by TSMC relating to alleged infringement of five U.S. patents and misappropriation of alleged trade secrets relating to methods for conducting semiconductor fab operations and manufacturing integrated circuits. After the dismissal without prejudice of the trade secret misappropriation claims by the U.S. federal district court on April 21, 2004, TSMC refiled the same claims in the California State Superior Court and alleged infringement of an additional 6 patents in the U.S. federal district court lawsuit. In August 2004, TSMC filed a complaint with the U.S. International Trade Commission ( ITC ) alleging similar trade secret misappropriation claims and asserting 3 new patent infringement claims and simultaneously filed another patent infringement suit in the U.S. federal district court on the same 3 patents as alleged in the ITC complaint.

On January 31, 2005, the Company entered into a settlement agreement, which provides for the dismissal of all pending legal actions without prejudice between the two companies in the U.S. federal district court, the California State Superior Court, the ITC, and the Taiwan District Court. Under the terms of the settlement agreement, TSMC covenants not to sue the Company for itemized acts of trade secret misappropriation as alleged in the complaints, although the settlement does not grant a license to use any of TSMC's trade secrets. Furthermore, the parties also entered into a patent cross-license agreement under which each party agreed to license the other party's patent portfolio through December 2010. As a part of the settlement, the Company also agreed to pay TSMC an aggregate of \$175 million, in installments of \$30 million for each of the first five years and \$25 million in the sixth year.

The Company engaged an external valuation company to determine the fair market value of the agreements relating to the intellectual property with respect to their pre-settlement and post-settlement values. Based on the valuation study, the Company recorded \$23.2 million of the settlement amount as an expense in 2004 and \$134.1 million of intangible assets associated with the licensed patents and trade secrets, which has been recorded in the first quarter of 2005 and will be amortized over the estimated remaining life of the technology.

### **7. Changes in the members of the Board of Directors**

At the Company's annual meeting of its shareholders on May 6, 2005, Richard Ru Gin Chang and Henry Shaw were re-elected as Class I directors of the Company.

At the meeting of the Board on July 26, 2005, the Board approved the resignation of Richard Ru Gin Chang and appointment of Professor Yang Yuan Wang as the Chairman, which appointment took effect as of July 28, 2005. Dr. Chang remains an executive director of the Company and Professor Wang remains an independent non-executive director of the Company.



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### **8. Waiver from compliance with the Listing Rules**

The Stock Exchange has granted the Company a conditional waiver (the *Waiver*) from the strict compliance with rule 3.24 of the Listing Rules. Under rule 3.24 of the Listing Rules, the Company must employ an individual on a full-time basis who, amongst other things, must be a qualified accountant and a fellow or associate member of the Hong Kong Institute of Certified Public Accountants (the *HKICPA*) (previously known as the Hong Kong Society of Accountants) or a similar body of accountants recognised by HKICPA for the purpose of granting exemptions from the examination requirement for membership of HKICPA.

The Waiver is subject to the following conditions:

1. Ms. Morning Wu ( *Ms. Wu* ), the Acting Chief Financial Officer of the Company, being a member of the senior management of the Company, being able to meet all the requirements set out in rule 3.24 of the Listing Rules, save for being a fellow or associate member of the HKICPA or a similar body of accountants recognised by the HKICPA for the purpose of granting exemptions from the examination requirement for membership of HKICPA; and
2. the Company maintaining arrangement(s) to provide Ms. Wu with access to the assistance of Ms. Marina Wong Yu Pok, who shall continue to be a fellow of the HKICPA and the Association of Chartered Certified Accountants, and who shall provide assistance to Ms. Wu in the discharge of her duties as the Qualified Accountant of the Company during the period of the Waiver.

The Waiver will cease on April 14, 2008 or when the Company fails to fulfill any of the above conditions to the Waiver, whichever is earlier.

Save as disclosed above and in the prospectus of the Company dated March 8, 2004, the Company has not received any waivers from compliance with the Listing Rules.

### **9. Review by Audit Committee**

The Audit Committee has reviewed with the management of the Company, the accounting principles and practices accepted by the Company and has discussed with the Directors matters concerning internal controls and financial reporting of the Company, including a review of the interim financial statements of the Company for the six months ended June 30, 2005.

By order of the Board of Directors  
**Semiconductor Manufacturing International Corporation**  
**Richard R. Chang**  
*Chief Executive Officer*

Shanghai, the PRC

September 23, 2005



**Table of Contents****CONSOLIDATED STATEMENT OF OPERATIONS**

FOR THE SIX MONTHS ENDED JUNE 30, 2005 AND 2004

(unaudited; in US\$ thousands, except per share data)

	<i>Notes</i>	Six months ended June 30,	
		2005	2004
Sales	<i>11</i>	528,308	407,926
Cost of sales	<i>17</i>	500,590	278,567
Cost of sales Amortization of deferred stock compensation		6,217	5,220
Gross profit		21,501	124,139
Operating expenses:			
Research and development	<i>17</i>	30,990	25,805
General and administrative		11,988	16,707
Selling and marketing		5,506	3,687
Amortization of acquired intangible assets	<i>17</i>	19,950	6,769
* Amortization of deferred stock compensation		7,121	7,937
Total operating expenses		75,555	60,905
(Loss) income from operations		(54,054)	63,234
Other income (expense):			
Interest income		3,958	4,216
Interest expense		(16,659)	(5,503)
Foreign currency exchange gain (loss)		(3,976)	(1,965)
Others, net		430	1,636
Total other, net		(16,247)	(1,616)
(Loss) income before income taxes		(70,301)	61,618
Income taxes current	<i>10</i>	127	
Minority interest		(12)	
Net (loss) income		(70,440)	61,618
Deemed dividends on preference shares	<i>13</i>		18,839
(Loss) income attributable to holders of ordinary shares		(70,440)	42,779
(Loss) income per ordinary share, basic		(0.00)	0.00
(Loss) income per ordinary share, diluted		(0.00)	0.00
Shares used in calculating basic (loss) income per ordinary share		18,055,410,063	10,269,399,903
Shares used in calculating diluted (loss) income per ordinary share		18,055,410,063	16,923,027,185
* Amortization of deferred stock compensation related to:			
Research and development		2,556	2,617
General and administrative		3,384	4,066
Selling and marketing		1,181	1,254
Total		7,121	7,937

See accompanying notes to consolidated financial statements.

**Table of Contents****CONSOLIDATED BALANCE SHEET**

AS OF JUNE 30, 2005 AND DECEMBER 31, 2004

(unaudited; in US\$ thousands)

	<i>Notes</i>	June 30, 2005	December 31, 2004
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents		576,292	607,173
Short-term investments		2,768	20,364
Accounts receivable, net of allowances of \$109,362 and of \$1,105,165 respectively	5	196,132	169,188
Inventories	6	176,502	144,018
Prepaid expense and other current assets		14,565	12,843
Assets held for sale		1,832	1,832
<b>Total current assets</b>		<b>968,091</b>	<b>955,418</b>
Land use rights, net		38,758	39,198
Plant and equipment, net		3,309,941	3,311,925
Acquired intangible assets, net		192,817	77,735
Long-term investments		9,525	
<b>TOTAL ASSETS</b>		<b>4,519,132</b>	<b>4,384,276</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>			
Current liabilities:			
Accounts payable	7	249,595	364,334
Accrued expenses and other current liabilities		77,656	82,858
Short-term borrowings	8	224,000	91,000
Current portion of promissory note	9	19,090	
Current portion of long-term debt	8	228,625	191,986
Income tax payable	10		152
<b>Total current liabilities</b>		<b>798,966</b>	<b>730,330</b>
Long-term liabilities:			
Promissory note	9	116,204	
Long-term debt	8	511,806	544,462
<b>Total long-term liabilities</b>		<b>628,010</b>	<b>544,462</b>
<b>Total liabilities</b>		<b>1,426,976</b>	<b>1,274,792</b>
Minority interest		39,045	

See accompanying notes to consolidated financial statements.

**Table of Contents****CONSOLIDATED BALANCE SHEET** *(continued)*

AS OF JUNE 30, 2005 AND DECEMBER 31, 2004

(unaudited; in US\$ thousands)

	<u>Notes</u>	<u>June 30, 2005</u>	<u>December 31, 2004</u>
<b>Commitments</b>	<i>13</i>		
Stockholders' equity:			
Ordinary shares, \$0.0004 par value, 50,000,000,000, shares authorized, shares issued and outstanding, 18,246,615,105 and 18,232,179,139 respectively		7,299	7,293
Warrants		32	32
Additional paid-in capital		3,289,932	3,289,725
Notes receivable from stockholders		(288)	(391)
Accumulated other comprehensive income		68	388
Deferred stock compensation		(37,107)	(51,178)
Accumulated deficit		(206,825)	(136,385)
Total stockholders' equity		3,053,111	3,109,484
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>		<b>4,519,132</b>	<b>4,384,276</b>
Net current assets		169,125	225,088
Total assets less current liabilities		3,720,166	3,653,946

See accompanying notes to consolidated financial statements.

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**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)**

FOR THE SIX MONTHS ENDED JUNE 30, 2005 AND 2004

(unaudited; in US\$ thousands)

Preference shares													
Series A		Series A-1		Series A-2		Series B		Series C		Series D		Ordinary	
convertible		non-convertible		convertible		convertible		convertible		convertible		shares	
shares		shares		shares		shares		shares		shares		shares	
Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount
												18,232,179,139	7,29
												18,683,466	
												(4,247,500)	(
												18,246,615,105	7,29
954,977,374	382	219,499,674	2	42,373,000	17	2,350,000	1	181,718,858	73	7,142,857	3	242,595,000	9
										95,714,286	38		

es es							914,285		1			
es s				750,000		1						
es						12,343						
e												
(954,922,624)	(381)		(42,373,000)	(17)	(3,112,343)	(2)	(181,718,858)	(73)	(103,771,428)	(42)	14,927,787,480	5,97
											3,030,303,000	1,21
es l		(219,499,674)		(2)								
											23,957,830	1
ck											2,473,200	
											(2,299,500)	(
es	(54,750)	(1)										
s s												
es												
y												
											18,224,817,010	7,29





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	<u>Additional paid-in capital</u>	<u>Subscription receivable from stockholders</u>	<u>Notes receivables from stockholders</u>	<u>Accumulated other comprehensive income (loss)</u>	<u>Deferred stock compensation, net</u>	<u>Accumulated deficit</u>	<u>Total stockholders equity</u>	<u>Comprehensive income (loss)</u>
Balance at January 1, 2005	3,289,725		(391)	388	(51,178)	(136,385)	3,109,484	
Decrease in equity in subsidiary resulting from subsidiary sale of shares	(33)						(33)	
Exercise of employee stock options	1,046						1,054	
Repurchase of restricted shares	(74)						(76)	
Collection of subscription receivables from stockholders			103				103	
Deferred stock compensation, net	(732)				14,071		13,339	
Net loss						(70,440)	(70,440)	(70,440)
Foreign currency translation adjustments				(382)			(382)	(382)
Unrealized loss on hedge contracts				142			142	142
Unrealized gain on short-term investments				(80)			(80)	(80)
Balance at June 30, 2005	3,289,932		(288)	68	(37,107)	(206,825)	3,053,111	(70,760)
Balance at January 1, 2004	1,835,820	(105,420)	(36,026)	200	(40,583)	(207,291)	1,485,115	
Issuance of Series D convertible preference shares and Series D warrants to Motorola and MCEL	308,142						335,844	
Issuance of Series D preference shares in exchange for software licenses	5,060						5,061	
Issuance of Series B convertible preference shares in exchange for intangible assets	2,739						2,740	
Issuance of Series B convertible preference shares to a service provider	46						46	
Conversion of preference share to ordinary shares upon initial public offering	59,918							
Issuance of ordinary shares	1,015,339						1,016,551	

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upon initial public offering (net of issuance cost of US\$37,007,406)							
Redemption of Series A-1 preference shares						(2)	
Warrants issued to technology partner						(5)	
Issuance of ordinary shares in exchange for equipment	5,213					5,223	
Exercise of stock options	656					657	
Repurchase of restricted ordinary shares	(189)					(190)	
Repurchase of restricted preference shares	(61)					(62)	
Collection of subscription receivable from stockholders		105,420				105,420	
Collection of note receivables from employees			34,134			34,134	
Deferred stock compensation, net	43,172			(30,015)		13,157	
Deemed dividend on preference shares	18,839				(18,839)		
Net income					61,618	61,618	61,618
Foreign currency translation adjustments			103			103	103
Unrealized gain on investments			97			97	97
Balance at June 30, 2004	3,294,694	(1,892)	400	(70,598)	(164,512)	3,065,507	61,818

**Table of Contents****CONSOLIDATED STATEMENT OF CASH FLOWS**

FOR THE SIX MONTHS ENDED JUNE 30, 2005 AND 2004

(unaudited; in US\$ thousands)

	Six months ended June 30,	
	2005	2004
Operating activities:		
(Loss) income attributable to holders of ordinary shares	(70,440)	42,779
Deemed dividends on preference shares		18,839
Net (loss) income	(70,440)	61,618
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Gain on disposal of plant and equipment	20	(177)
Minority interest	12	
(Reversal of) bad debt expense	(996)	242
Depreciation and amortization	352,221	186,053
Amortization of acquired intangible assets	19,950	6,769
Amortization of deferred stock compensation	13,338	13,157
Non-cash interest expense on promissory notes	2,325	
Loss on long-term investment	75	
Changes in operating assets and liabilities:		
Accounts receivable	(25,948)	(41,411)
Inventories	(32,484)	(43,639)
Prepaid expense and other current assets	(1,811)	8,928
Accounts payable	7,424	34,829
Income tax payable	(152)	
Accrued expenses and other current liabilities	11,320	15,372
Net cash provided by operating activities	274,854	241,741
Investing activities:		
Purchase of plant and equipment	(475,650)	(577,813)
Purchase of acquired intangible assets	(4,754)	(2,612)
Purchase of short-term investments	(2,416)	(66,225)
Sale of investments held to maturity		3,005
Proceeds paid for long-term investment	(9,600)	
Sale of short-term investments	19,933	3,024
Proceeds received for assets held for sale	2,990	1,976
Proceeds from disposal of plant and equipment	1	478
Net cash provided by investing activities	(469,496)	(638,167)

**Table of Contents****CONSOLIDATED STATEMENT OF CASH FLOWS** *(continued)*

FOR THE SIX MONTHS ENDED JUNE 30, 2005 AND 2004

(unaudited; in US\$ thousands)

	<b>Six months ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
Financing activities:		
Proceeds from short-term borrowings	<b>238,039</b>	
Repayment of short-term borrowings	<b>(105,000)</b>	
Repayment of promissory notes	<b>(25,000)</b>	
Repayment of note payable to stockholder for land use rights		(13,659)
Proceeds from long-term debt	<b>128,419</b>	29,996
Repayment of long-term debts	<b>(124,474)</b>	
Repayment of redeemable convertible promissory note		(15,000)
Proceeds from issuance of Series D convertible preference shares		29,975
Proceeds from issuance of ordinary shares from initial public offering		1,017,051
Collection of subscription receivables, net		105,420
Proceeds from exercise of employee stock options	<b>973</b>	123
Collection of notes receivables from employees	<b>104</b>	33,884
Change in deposits received from stockholders		(38,151)
Proceeds from government grant	<b>12,082</b>	
Proceeds from minority investor	<b>39,000</b>	
Net cash provided by financing activities	<b>164,143</b>	1,149,639
Effect of exchange rate changes	<b>(382)</b>	103
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(30,881)</b>	753,316
CASH AND CASH EQUIVALENTS, beginning of period	<b>607,173</b>	445,276
CASH AND CASH EQUIVALENTS, end of period	<b>576,292</b>	1,198,592
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Income taxes paid	<b>279</b>	15
Interest paid	<b>18,710</b>	7,616

**Table of Contents****CONSOLIDATED STATEMENT OF CASH FLOWS** *(continued)*

FOR THE SIX MONTHS ENDED JUNE 30, 2005 AND 2004

(unaudited; in US\$ thousands)

	<b>Six months ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
<b>SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES</b>		
Note payable waived by stockholder in exchange for land use rights		(14,239)
Series D convertible preference shares issued to acquire assets and assume liabilities from Motorola and MCEL		278,180
Issuance of Series D convertible preference share warrants		27,664
Deemed dividends on Series D convertible preference shares		18,839
Series D convertible preference shares issued in exchange for certain software licenses		5,060
Series B convertible preference shares issued in exchange for acquired intangible assets		2,740
Series B convertible preference shares issued to a service provider		46
Conversion of preference shares into ordinary shares upon initial public offering		5,971
Ordinary shares issued in exchange for equipment		5,222
Deferred stock compensation	<b>14,071</b>	30,015
Promissory notes issued in exchange of acquired intangible assets		<b>134,816</b>

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**1. Basis of presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with Accounting Policies Board Opinion 28, Interim Financial Reporting ( APB 28 ), issued by Accounting Principles Board under generally accepted accounting principles in the United States of America and Appendix 16, Disclosure of Financial Information , of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. In the opinion of management, the consolidated financial statements include all adjustments (consisting only of normal recurring accruals) that management considers necessary for a fair presentation of its financial position, operating results and cash flows for the interim periods presented. Operating results and cash flows for interim periods are not necessarily indicative of results for the entire year.

These interim consolidated financial statements and notes should be read in conjunction with our audited consolidated financial statements and notes thereto, as set forth in the Financial Section , appearing in the 2004 annual report of the Company dated March 28, 2005.

*Stock-based compensation*

The Company grants stock options to its employees and certain non-employees. The Company accounts for employee stock-based compensation in accordance with Accounting Principles Board Opinion No. 25 ( APB 25 ), Accounting for Stock Issued to Employees , which requires the Company to record as compensation charge, the excess of the fair value of the stock at the grant date or any other measurement date over the amount an employee must pay to acquire the stock. The compensation expense is recognized over the applicable service period, which is usually the vesting period. The Company accounts for stock-based awards to non-employees in accordance with Statement of Financial Accounting Standard ( SFAS ) No. 123, Accounting for Stock-Based Compensation ( SFAS 123 ), which requires the Company to record a charge for the services rendered by the non-employees using the Black-Scholes option pricing model. Since the employee stock-based compensation is accounted for under the intrinsic value-based method, the following disclosures are in accordance with SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure an amendment of FASB Statement No. 123 ( SFAS 148 ).

SFAS 148 amended the disclosure requirements of SFAS 123 to require more prominent disclosures in both annual and interim financial statements regarding the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS 123 requires the disclosure of pro forma net income (loss) and earnings (loss) per share had the Company adopted the fair value method. Under SFAS 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values.

See also Notes to the Consolidated Financial Statements No. 3 Recently issued accounting standards for details on the Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment.

**Table of Contents****1. Basis of presentation** *(continued)**Stock-based compensation (continued)*

Had compensation cost for options granted to employees under the Company's stock option plans been determined based on the fair value at the grant date, as prescribed in SFAS 123, the Company's pro forma (loss) income would have been as follows:

	<b>Six months ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
	<i>(in US\$ thousands, except per share data)</i>	
(Loss) income attributable to holders of ordinary shares	(70,440)	61,618
Add: Stock compensation as reported	13,338	13,157
Less: Stock compensation determined using the fair value method	(18,580)	(18,457)
Pro forma (loss) income	(75,682)	56,318
Deemed dividends on preference shares		(18,839)
Pro forma net (loss) income attributable to holders of ordinary shares	(75,682)	37,479
(Loss) income per ordinary share:		
Basic pro forma	(0.00)	0.00
Diluted pro forma	(0.00)	0.00
Basic as reported	(0.00)	0.00
Diluted as reported	(0.00)	0.00

The fair value of each option grant and share granted are estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions used for grants during the applicable period.

	<b>Six months ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
Option grants		
Average risk-free rate of return	3.75%	2.42%
Weighted average expected option life	4 years	3.5 years
Volatility rate	21.00%	54.37%
Dividend yield (Preference share only)	0%	0%

*Stock split*

On March 18, 2004, the Company effected a 10-for-1 share split in the form of a share dividend immediately after the conversion of preference shares into ordinary shares. All share information relating to ordinary shares of the Company in the accompanying financial statements,



including the conversion price relating to such shares, have been adjusted retroactively, which gives effect to the share split.

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**Table of Contents****2. Hedge Accounting**

The Company records derivative instruments as assets or liabilities, measured at fair value. The recognition of gains or losses resulting from changes in the values of those derivative instruments is based on the use of each derivative instrument and whether it qualifies for hedge accounting.

The Company uses financial instruments to mitigate interest rate risk and loan commitments related to mortgage loans, which will be held to maturity. The Company used interest rate swaps throughout the first half year of 2005 to manage its interest rate risk. The Company did not enter into derivative transactions for speculative or trading purposes. The plain vanilla interest rate swap qualifies for cash flow hedging and the notional amount is US\$50 million as of June 30, 2005.

**3. Recently issued accounting standards**

In March 2004, the Emerging Issues Task Force ( EITF ) reached a consensus on Issue No. 03-01, The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments . EITF No. 03-01 provides guidance on recording other-than-temporary impairments of cost method investments and requires additional disclosures for those investments. The recognition and measurement guidance in EITF No. 03-01 should be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. The disclosure requirements are effective for fiscal years ending after June 15, 2004 and are required only for annual periods. The adoption of this standard did not have a material impact on Company s financial positions or results of operations.

In November 2004, FASB issued SFAS No. 151, Inventory Costs an amendment of ARB No. 43, Chapter 4 ( SFAS 151 ). This statement amends the guidance in Accounting Research Board ( ARB ) No. 43, Chapter 4, Inventory Pricing to clarify the accounting for abnormal amounts of idle facility expenses, freight, handling costs, and wasted material (spoilage). SFAS 151 requires that those items be recognized as current period charges. In addition, SFAS 151 requires that allocation of fixed production overheads to the cost of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect the adoption of this Statement will have a material effect on the Company s financial position, cash flows or results of operations.

The Company accounts for stock-based compensation awards issued to employees using the intrinsic value measurement provisions of APB 25. Accordingly, no compensation expense has been recorded for stock options granted with exercise prices greater than or equal to the fair value of the underlying common stock at the option grant date. On December 16, 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ( SFAS 123R ). SFAS 123R eliminates the alternative of applying the intrinsic value measurement provisions of APB 25 to stock compensation awards issued to employees. Rather, SFAS 123R requires enterprises to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period).

The Company has not yet quantified the effects of the adoption of SFAS 123R, but it is expected that the new standard may result in significant stock-based compensation expenses. The pro forma effects on net income and earnings per share if the Company had applied the fair value recognition provisions of original SFAS 123 on stock compensation awards (rather than applying the intrinsic value measurement provisions of APB 25) are disclosed above. Although such pro forma effects of applying original SFAS 123 may be indicative of the effects of adopting SFAS 123R, the provisions of these two statements differ in some important respects. The actual effects of adopting SFAS 123R will be dependent on numerous factors including, but not limited to, the valuation model chosen by the Company to value stock-based awards; the assumed award forfeiture rate; the accounting policies adopted concerning the method of recognizing the fair value of awards over the requisite service period; and the transition method (as described below) chosen for adopting SFAS 123R.



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**Table of Contents****3. Recently issued accounting standards (continued)**

SFAS 123R will be effective for the Company's fiscal year beginning after June 15, 2005, and requires the use of the Modified Prospective Application Method. Under this method, SFAS 123R is applied to new awards and to awards, which are modified, repurchased, or cancelled after the effective date. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered (such as unvested options) that are outstanding as of the date of adoption shall be recognized as the remaining requisite services are rendered. The compensation cost relating to unvested awards at the date of adoption shall be based on the grant-date fair value of those awards as calculated for pro forma disclosures under the original SFAS 123. In addition, companies may use the Modified Retrospective Application Method. This method may be applied to all prior years for which the original SFAS 123 was effective or only to prior interim periods in the year of initial adoption. If the Modified Retrospective Application Method is applied, financial statements for prior periods shall be adjusted to give effect to the fair-value-based method of accounting for awards on a consistent basis with the pro forma disclosures required for those periods under the original SFAS 123.

In December 2004, the FASB issued SFAS No. 153, *Exchange of Nonmonetary Assets—An Amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions* (SFAS 153). SFAS 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for the fiscal periods beginning after June 15, 2005. The Company does not expect the adoption of SFAS 153 to have a material effect on its results of operations or financial condition.

In May 2005, the Financial Accounting Standards Board issued Statement No. 154, *Accounting Changes and Error Corrections*, (FASB 154) which changes the requirements for the accounting for and reporting of a change in accounting principles. This statement replaces APB Opinion No. 20, *Accounting Changes* (APB 20), and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and applies to all voluntary changes in accounting principles as well as changes required by an accounting pronouncement in the rare instance that a new pronouncement does not include specific transition provisions. APB Opinion No. 20 previously required that the cumulative effect of a voluntary change to a new accounting pronouncement be recognized in net income for the period of the change. FASB 154 now requires retrospective application of a voluntary change in accounting principle to prior periods' financial statements unless it is impracticable to determine either the period-specific effects of the cumulative effect of the change. Additionally, this Statement redefines the term *restatement* as the revising of previously issued financial statements to reflect the correction of the error. Reporting the correction of an error in previously issued financial statements and a change in accounting estimate is carried forward from the guidance provided in APB 20. FASB 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of FASB 154 is not expected to have a material impact on the Company's financial position, results of operations, or cash flows.

**4. Revenue recognition**

The Company manufactures semiconductor wafers for its customers based on the customers' designs and specifications pursuant to manufacturing agreements and/or purchase orders. The Company also sells certain semiconductor standard products to customers. Customers do not have any rights of return except pursuant to warranty provisions, which has been minimal. The Company typically performs tests of its products prior to shipment to identify yield rate per wafer. Occasionally, product tests performed after shipment identify yields below the level agreed with the customer. In those circumstances, the customer arrangement may provide for a reduction to the price paid or for its costs to ship replacement products. The Company estimates the amount of sales returns and the cost of replacement products based on the historical trend of returns and warranty replacements relative to sales as well as a consideration of any current information regarding specific known product defects at customers that may exceed historical trends. The Company recognizes revenue to customers upon shipment and title transfer. The Company also provides certain services, such as mask making and probing, and revenue is recognized when the services are completed.

**Table of Contents****5. Accounts receivable, net of allowances**

The Company determines credit terms for each customer on a case by case basis, based on its assessment of such customer's financial standing and business potential with the Company. In addition, for certain customers with long-established relationship and good past repayment histories, a longer credit period may be granted.

An aging analysis of trade debtors is as follows:

	June 30, 2005	December 31, 2004
	(in US\$ thousands)	
Current	177,123	148,503
Overdue:		
Within 30 days	9,202	15,901
Between 31 to 60 days	4,689	2,657
Over 60 days	5,118	2,127
	<b>196,132</b>	169,188

**6. Inventories**

	June 30, 2005	December 31, 2004
	(in US\$ thousands)	
Raw materials	53,660	39,337
Work in progress	100,961	83,954
Finished goods	21,881	20,727
	<b>176,502</b>	144,018

**7. Accounts payable**

An aging analysis of the accounts payable is as follows:

	June 30, 2005	December 31, 2004
	(in US\$ thousands)	
Current	197,975	307,397
Overdue:		
Within 30 days	25,633	38,804
Between 31 to 60 days	8,052	4,352
Over 60 days	17,935	13,781



**Table of Contents****8. Indebtedness**

Long-term and short-term debt is as follows:

	<u>Maturity</u>	<u>Interest rate</u>	<u>June 30, 2005</u>	<u>December 31, 2004</u>
(in US\$ thousands)				
US\$ denominated bank loan I	2005-2007	4.34%-5.24%	<b>345,600</b>	432,000
US\$ denominated bank loan II	2006-2009	4.34%-5.24%	<b>256,482</b>	256,482
US\$ denominated bank loan III	2007-2010	5.25%	<b>99,980</b>	
Rmb denominated bank loan	2005-2007	5.02%-5.27%	<b>38,369</b>	47,966
			<b>740,431</b>	736,448
Less: Current portion of long-term debt			<b>228,625</b>	191,986
<b>Long-term debt</b>			<b>511,806</b>	544,462
Short-term debt	2005-2006	3.67%-4.85%	<b>224,000</b>	91,000

**9. Promissory Notes**

The Company reached an agreement with Taiwan Semiconductor Manufacturing Company Ltd. ( TSMC ) regarding patent license and trade secrets litigation (see Note 16). Under the agreement, the Company issued thirteen non-interest bearing promissory notes with an aggregate amount of \$175,000,000 as the settlement consideration. The Company has recorded a discount of \$17,030,709 for the imputed interest on the notes, which was calculated using an effective interest rate of 3.45% and has been recorded as a reduction of the face amounts of the promissory notes. The Company repaid \$25,000,000 in the six months ended June 30, 2005 and the outstanding promissory notes are as follows:

	<b>June 30, 2005</b>	
	(in US\$ thousands)	
<u>Maturity</u>	<u>Face value</u>	<u>Discounted value</u>
2005	<b>5,000</b>	<b>4,916</b>
2006	<b>30,000</b>	<b>28,757</b>
2007	<b>30,000</b>	<b>27,799</b>
2008	<b>30,000</b>	<b>26,873</b>
2009	<b>30,000</b>	<b>25,977</b>
2010	<b>25,000</b>	<b>20,972</b>
	<b>150,000</b>	<b>135,294</b>
Less: Current portion of promissory notes	<b>20,000</b>	<b>19,090</b>
<b>Long-term portion of promissory notes</b>	<b>130,000</b>	<b>116,204</b>

**Table of Contents****10. Income Taxes**

The Company is a tax exempted company incorporated in the Cayman Islands. The subsidiaries incorporated in the PRC are governed by the Income Tax Law of the PRC Concerning Foreign Investment and Foreign Enterprises and various local income tax laws (the "Income Tax Laws"). Pursuant to the relevant regulation and upon approval by the governmental agency, the Company's Shanghai, Beijing and Tianjin subsidiaries are entitled to a full exemption from Foreign Enterprise Income Tax ( "FEIT" ) for five years starting with the first year of positive accumulated earnings and a 50% reduction for the following five years. The Company's other subsidiaries are subject to respective local country's income tax law, including those of Japan, the United States of America, Taiwan and Europe. The Company had minimal taxable income in Japan and Europe.

**11. Segment and geographic information**

The Company is engaged primarily in the computer-aided design, manufacturing, packaging, testing and trading of integrated circuits and other semiconductor services, and manufacturing design of semiconductor masks. In accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", the Company's chief operating decision maker has been identified as the Chief Executive Officer, who reviews consolidated results of manufacturing operations when making decisions about allocating resources and assessing performance of the Company. The Company believes it operates in one segment, and all financial segment information required by SFAS No. 131 can be found in the consolidated financial statements.

	<b>Six months ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(in US\$ thousands)</b>	
Total sales:		
North America	<b>214,419</b>	174,585
Europe	<b>136,862</b>	57,713
Taiwan	<b>69,626</b>	53,046
Korea	<b>41,666</b>	48,242
Japan	<b>36,606</b>	66,362
Asia Pacific (Excluding Japan, Korea and Taiwan)	<b>29,129</b>	7,978
	<b>528,308</b>	407,926

Revenue is attributed to countries based on the customer's headquarters of operation.

Substantially all of the Company's long lived assets are located in the PRC.

**12. (Loss) income from operations**

	<b>Six months ended June 30,</b>	
	<b>2005</b>	<b>2004</b>



	(in US\$ thousands)	
(Loss) income from operations is arrived at after charging:		
Depreciation and amortization of property, plant and equipment	<b>351,780</b>	185,662
Amortization of land use rights	<b>441</b>	391
Amortization of intangible assets	<b>19,950</b>	6,769

**Table of Contents****13. Dividend**

Deemed dividend represents the beneficial conversion feature relating to the preferential price of certain convertible equity instrument an investor receives when the effective conversion price of the equity instruments is lower than the fair market value of the ordinary shares to which the convertible equity instrument would have converted at the date of issuance. Accordingly, deemed dividend on preference shares represents the price difference between the effective conversion price of the convertible equity instrument and the ordinary share.

Other than the deemed dividend on preference shares which the Company issued in January 2004 and expired at the Global Offering, no dividend has been paid or declared by the Company during the six months ended June 30, 2005 and 2004, respectively.

**14. Commitments***(a) Purchase commitments*

As of June 30, 2005 the Company had the following commitments to purchase land use rights, machinery and equipment and construction obligations. The machinery and equipment is scheduled to be delivered at the Company's facility by June 30, 2006. The Company expects to obtain the land use rights and complete the facility construction no later than June 30, 2006.

	At June 30,	
	2005	2004
	(in US\$ thousands)	
Land use rights	7,000	10,000
Facility construction	106,000	173,049
Machinery and equipment	329,000	944,481
	<b>442,000</b>	1,127,530

*(b) Investment commitments*

As of June 30, 2005, the Company had total commitments of \$51,600,000 to invest in certain projects. The Company expects to complete the cash injection of these projects in the next three years.

*(c) Royalties*

Beginning in 2002, the Company has entered into several license and technology agreements with third parties. The terms of the contracts range from 3 to 10 years. The Company is subject to royalty payments based on a certain percentage of product sales, using the third parties technology or license. In the six months ended June 30, 2005 and 2004, the Company incurred royalty expenses of \$3,505,000 and \$2,221,000, respectively.

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Beginning in 2003, the Company has entered into several license agreements with third parties where the Company provides access to certain licensed technology. The Company will receive royalty payments based on a certain percentage of product sales using the Company's licensed technology. In the six months ended June 30, 2005 and 2004, the Company earned royalty income of \$345,000 and \$67,000, respectively, which is included as net revenue in the statement of operations.

**Table of Contents****14. Commitments** *(continued)**(d) Operating lease as lessor*

The Company owns apartment facilities that are leased to the Company's employees at negotiated prices. The apartment rental agreement is renewed on an annual basis. The Company leases office space to non-related third parties. Office lease agreements are renewed on an annual basis as well. The total amount of rental income recorded in the six months ended June 30, 2005 and 2004 was \$963,000 and \$873,000, respectively.

*(e) Operating lease as lessee*

The Company leases land use rights, gas tanks and other operational equipment under non-cancellable leases expiring at various times through 2053. Future minimum lease payments under these leases at June 30, 2005 are as follows:

<u>Year ending</u>	<u>(in US\$ thousands)</u>
2005	364
2006	714
2007	270
2008	74
2009	74
Thereafter	2,671
	4,167

The total operating lease expenses recorded in the six months ended June 30, 2005 and 2004 was \$84,000 and \$1,825,000, respectively.

**15. Reconciliation of basic and diluted (loss) income per ordinary share**

	<u>Six months ended June 30,</u>	
	<u>2005</u>	<u>2004</u>
	<u>(in US\$ thousands)</u>	
	<u>except per share data)</u>	
Net (loss) income attributable to holders of ordinary shares	<b>(70,440)</b>	42,779
Basic and diluted:		
Weighted average ordinary shares outstanding	<b>18,237,534,971</b>	10,506,146,416
Less: Weighted average ordinary shares outstanding subject to repurchase	<b>(182,124,908)</b>	(236,746,513)
Weighted average shares used in computing basic net (loss) income per ordinary share	<b>18,055,410,063</b>	10,269,399,903
Effect of dilutive securities:		
Weighted average preference shares outstanding		6,248,493,164

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Less: Weighted average preference shares outstanding subject to repurchase		(83,727,227)
Warrants		194,061,201
Stock options		294,800,144
Weighted average shares used in computing diluted net (loss) income per ordinary share	<b>18,055,410,063</b>	16,923,027,185
Basic net (loss) income per ordinary share	(0.00)	0.00
Diluted net (loss) income per ordinary share	(0.00)	0.00

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### **15. Reconciliation of basic and diluted (loss) income per ordinary share (continued)**

Ordinary share equivalents of warrant and stock options are calculated using the treasury stock method. Under the treasury stock method, the proceeds from the assumed conversion of options and warrants are used to repurchase outstanding ordinary shares using the average fair value for the periods.

As of June 30, 2005, the Company had 199,288,800 ordinary share equivalents outstanding that could have potentially diluted loss per share in the future which were excluded in the computation of diluted loss per share, as their effect would have been antidilutive due to the net loss reported in the period.

As of June 30, 2004, the Company had 55,325,980 ordinary shares equivalents outstanding which were excluded in the computation of diluted net income per share because these options were antidilutive in that period.

### **16. Litigation**

In December 2003, the Company became the subject of a lawsuit in the U.S. federal district court brought by TSMC relating to alleged infringement of five U.S. patents and misappropriation of alleged trade secrets relating to methods for conducting semiconductor fab operations and manufacturing integrated circuits. After the dismissal without prejudice of the trade secret misappropriation claims by the U.S. federal district court on April 21, 2004, TSMC refiled the same claims in the California State Superior Court and alleged infringement of an additional 6 patents in the U.S. federal district court lawsuit. In August 2004, TSMC filed a complaint with the U.S. International Trade Commission (ITC) alleging similar trade secret misappropriation claims and asserting 3 new patent infringement claims and simultaneously filed another patent infringement suit in the U.S. federal district court on the same 3 patents as alleged in the ITC complaint.

On January 31, 2005, the Company entered into a settlement agreement, which provides for the dismissal of all pending legal actions without prejudice between the two companies in the U.S. federal district court, the California State Superior Court, the ITC, and the Taiwan District Court. Under the terms of the settlement agreement, TSMC covenants not to sue the Company for itemized acts of trade secret misappropriation as alleged in the complaints, although the settlement does not grant a license to use any of TSMC's trade secrets. Furthermore, the parties also entered into a patent cross-license agreement under which each party agreed to license the other party's patent portfolio through December 2010. As a part of the settlement, the Company also agreed to pay TSMC an aggregate of \$175 million, in installments of \$30 million for each of the first five years and \$25 million in the sixth year.

The Company engaged an external valuation company to determine the fair market value of the agreements relating to the intellectual property with respect to their pre-settlement and postsettlement values. Based on the valuation study, the Company recorded \$23.2 million of the settlement amount as an expense in 2004 and \$134.1 million of intangible assets associated with the licensed patents and trade secrets was recorded in the first quarter of 2005 and amortized over the estimated remaining life of the technology.

### **17. Comparative Figures**

Certain comparative figures have been reclassified to conform to current period presentation.



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