

THOMSON REUTERS STREETEVENETS

EDITED TRANSCRIPT

981.HK - Q3 2015 Semiconductor Manufacturing International Corp
Earnings Call

EVENT DATE/TIME: NOVEMBER 11, 2015 / 12:30AM GMT



CORPORATE PARTICIPANTS

En-Ling Feng *Semiconductor Manufacturing International Corporation - VP IR*

T.Y. Chiu *Semiconductor Manufacturing International Corporation - CEO*

Yonggang Gao *Semiconductor Manufacturing International Corporation - CFO*

Gareth Kung *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

CONFERENCE CALL PARTICIPANTS

Randy Abrams *Credit Suisse - Analyst*

Steven Pelayo *HSBC - Analyst*

Leping Huang *Nomura - Analyst*

Ken Hui *Jefferies - Analyst*

Bill Lu *Morgan Stanley - Analyst*

Suji De Silva *Topeka Capital - Analyst*

Szeho Ng *BNP Paribas - Analyst*

Roland Shu *Citigroup - Analyst*

Rick Hsu *Daiwa Securities - Analyst*

PRESENTATION

Operator

Welcome to the Semiconductor Manufacturing International Corporation's third-quarter 2015 webcast conference call. Today's conference call is hosted by Dr. T.Y. Chiu, Chief Executive Officer; Dr. Yonggang Gao, Chief Financial Officer; Mr. Gareth Kung, Executive Vice President of Strategic Business Development, Finance, and Company Secretary; and Mr. En-Ling Feng, Vice President of Investor Relations. (Operator Instructions). The earnings press release is available for download at www.smics.com. Webcast playback will also be available approximately one hour after the event, at www.smics.com.

Without further ado, I would like to introduce to you Mr. En-Ling Feng, Vice President of Investor Relations, for the cautionary statement. Thank you, sir. Please go ahead.

En-Ling Feng - *Semiconductor Manufacturing International Corporation - VP IR*

Good morning and good evening. Welcome to SMIC's third-quarter 2015 earnings webcast conference call.

For today's call our CEO, Dr. T.Y. Chiu, will first provide some general remarks. Afterwards CFO, Dr. Gao Yonggang, will highlight our financial performance and give some -- next quarter's guidance. And then our Executive VP of Strategic Business Development, Finance and Company Secretary, Mr. Gareth Kung, will give the detailed financial commentary. This will then be followed by our Q&A session.

As usual, our call will be approximately 60 minutes in length. The earnings press release and the quarterly financial presentation are available for you to download at our website under Investor Relations, in the Events & Presentations section.



Before I turn the call over to Dr. T.Y. Chiu, let me remind you that the presentation we'll be making today includes forward-looking statements. These statements and other comments are not guarantees of future performance, but represent the Company's estimates and are subject to risk and uncertainty. Our actual results may differ significantly from those projected or suggested in any forward-looking statements.

For more a complete discussion of the risks and uncertainties that could impact our future operating results and financial condition, please see our filings with the US Securities and Exchange Commission and the Hong Kong Stock Exchange Limited, including our Annual Report on Form 20-F filed with the United States Securities and Exchange Commission on April 28, 2015.

During the call we will be making some references to financial measures that do not conform to Generally Accepted Accounting Principles, GAAP. These measures may be calculated differently than similar non-GAAP data presented by other companies. Please refer to the tables in our press release for a reconciliation of GAAP to the non-GAAP numbers we will be discussing. Please note that all currency figures are in US dollars, unless otherwise stated.

I will now turn the call over to our CEO, Dr. T.Y. Chiu, for the opening remarks.

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

Thank you, En-Ling. Greetings to everyone. Thank you all for joining us on this quarter's call. Today I am pleased to share with you SMIC's third-quarter achievements, our business update and the future outlook.

SMIC has achieved another quarter of record-high revenue and earning in Q3, undeterred by the industry corrections. Our utilizations remain high, as we guide an additional growth in quarter four. We have successfully diversified our products and shown resilience in the face of seasonally-weaker market trends.

In the third quarter of 2015 we've achieved record-high revenue of \$569.9m, a growth of 4.3% quarter over quarter, in line with our expectation and guidance. If excluding revenue from Wuhan, the revenue grew more than 2x -- 2 times compared to the third quarter 201.

Our record gross profit of \$182.4m represent a gross margin of 32%, which exceeded expectations and guidance due to higher than expected utilizations, indicating a strong start to Q4.

We continue to believe that our performance, compared to the industry, is largely the result of careful execution of our strategy, which includes the diversification of products, technology and a close partnership with customers.

Our strategy to grow our Company in a profitable manner is to maintain high utilizations, and differentiate and diversify our product mix, and advance our technology carefully on the leading edge, in preparation for the migration of the application that we serve. Profitability is our primary underlying objective.

To address our 28 nano status, we have started to book small 28 revenue contribution in Q3 this year. Our target for high-k metal gate is still the same, two to three quarters after PolySiON successfully ramped. Our technology development team and fab continue to generate an array of technology platforms, spanning from various flavors of 28 technologies, such as RF, to tailor-made technology to meet customers' unique applications. We currently have nine customers engaged in 28 nanometers.

In terms of differentiated technology on the mature line -- on the matured fabs, demand remains robust. Revenue from 0.13 to 0.35 grew 9.7% quarter over quarter in Q3.

We continue to expand our specialty technology portfolio. And I am pleased to announce our 95 ultra-low power SPOCULL technology, which stands for SMIC's poly contact for ultra-low leakage, and we currently are in MPW and NTO stage. This technology, comparing to conventional 0.13 low-leakage technology, it can pack two times the logic density and three times the SRAM density. And we believe has the lowest SRAM stand-by leakage as well as device leakage in the industry.



In addition, we are able to incorporate high-quality, non-volatile memory with only two additional mask. We believe this new technology will be very suitable for applications such as ultra-low power MCU, high performance analog, RF, and especially IOT-related applications. It is a clear demonstration of SMIC's ability to deliver industry-leading, innovative specialty technology that is unique and very competitive.

Utilization was still above 100% in the third quarter, with strength in communications-related application, such as for router, wireless, PMIC for phones, sensors for phones, domestic base band and optical networking. To address the strong utilization, we will continue to improve operational efficiencies and installing new capacities in order to grow our business.

Shenzhen began operation and full-flow production in September with a capacity of 11,000 8-inch wafers per months. By the end of this year, we target to have a total of 13,000 per-month capacity in Shenzhen. This is lower than what was mentioned last time, due to a change of planned product mix to products with higher layer counts.

As a result of operational efficiency improvements, our Shanghai 8-inch fab and Tianjin 8-inch fab each increased 1,000 -- 1K per month capacity in Q3 compared to the previous quarters.

Our 12-inch fab in Shanghai has remained unchanged at 14,000 per month capacity, mainly for 40/45 and R&D, of which 6,000 is capable for 28 nanometer. We plan to add another 2,000 28 capacity in Shanghai by the end of this year, as well as 6,000 per month capacity in Beijing joint-ventures fab.

We continue to implement prudence in our CapEx spending, and drive to improve structural profitability through capital efficiency. As an example of our emphasis on capital efficiency, our year-over-year growth in production capacity in 2015 is an estimated 6%, while revenue is expected to increase more than 10%.

Our position in China plays an important in SMIC's success in overall -- in all regions, with over 600 design houses in China and many international customers desiring to penetrate the large China market. SMIC has a long-standing relationship in the IT industry in China that has contributed significantly to our growth.

China revenue contribution has grown 24% year over year in Q3 2015 compared to Q3 last year. Eurasia revenue contribution has grown 41% year over year. Our Eurasia region includes Europa and Asia, but excluding Mainland China. Also after seven years -- several years of rebuilding our Japan business, we have started to book revenue from Japan in Q3. Meanwhile North America has declined 15.3% year over year, but has begun to recover with 10% -- 10.4% gain quarter over quarter.

I am also pleased to announce that we newly received an investment-grade credit rating from Moody's, in addition to an investment credit rating from S&P. Domestically, we have received a AAA rating from a Chinese rating agency, China Chengxin International Credit Rating Company. These signify the recognition and acknowledgement of SMIC's credible and improving financial health.

In conclusion, we have achieved a strong 2015 so far; our best historically in terms of revenue, profitability and utilization. We expect growth again in the fourth quarter, which would represent four consecutive quarters of growth in 2015.

When using Q4's low-end guidance, our 2015 revenue is expected to grow more than 10% year over year.

Our outperformance has been a result of SMIC's careful execution of our strategy which includes the diversification of products and technology. We believe our mix of products, customers and a dynamic fab backup makes SMIC nimble in this highly-competitive foundry market.

We are careful in the expansion of our fab and the CapEx intensity -- intensive advanced technology. Meanwhile we stay committed to maintaining sustainable profitability and building value for all stakeholders.

Thank you for your time. I will now hand the call over to Yonggang for the financial highlights and the 2015, Q4 guidance.



Yonggang Gao - *Semiconductor Manufacturing International Corporation - CFO*

Okay. Thank you T.Y. Greetings to our listeners. I will now highlight our third-quarter 2015 results and our fourth-quarter 2015 guidance.

Our revenue was a record high of \$569.9m in 3Q, 2015, an increase of 4.3% quarter over quarter and an increase of 9.2% year over year.

Gross profit was a record high of \$182.4m in 3Q, 2015, an increase of 3.4% quarter over quarter and an increase of 35% (sic - see press release "35.1%") year over year.

Gross margin was 32% in 3Q, 2015 compared to 32.3% in 2Q, 2015 and 25.9% in 3Q, 2014.

Profit for the period attributable to SMIC was \$82.6m in 3Q, 2015 compared to \$76.7m in 2Q, 2015 and \$47.5m in 3Q, 2014. Excluding the gain of commitment to grant shares and warrants in 2Q, 2010, profits for the period attributable to SMIC was a record high in 3Q, 2015.

Now looking ahead into the fourth quarter of 2015, our revenue is expected to increase by 3 points to 6 points -- 3% to 6% quarter over quarter.

Gross margin is expected to range from [28%] (corrected by company after the call) to 30%.

Non-GAAP operating expenses, excluding the effect of employee bonus accrual, government funding and the gain from the disposal of living quarters, are expected to range from \$142m to \$147m.

And non-controlling interest of our majority-owned subsidiaries are expected to range from positive \$33m to positive \$36m; which are losses to be borne by non-controlling interests.

I will now hand the call over to Gareth for more detailed financial commentary.

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

Thank you Gao-zong. And thank you everyone for joining us today. Before I start the comment on the detailed financials, I just want to repeat our gross margin is expected to range from 28% to 30%. Now I'll comment on the detailed financials.

On the income statement, revenue increased to \$569.9m in Q3, 2015, up 4.3% quarter on quarter from \$546.6m in Q2, 2015 mainly because of an increase of wafer shipments.

Cost of sales increased to \$387.5m in Q3, 2015, up 4.7% Q-on-Q from \$370.2m in the previous quarter, mainly because of an increase in other manufacturing costs in connection with an increase in wafer shipments.

Gross profit was a record high of \$182.4m in Q3, 2015, up 3.4% Q-on-Q from \$176.4m in the previous quarter.

Gross margin was 32% in Q3, 2015 compared to 32.3% in the previous quarter.

Operating expenses in Q3, 2015 were \$108.1m, a decrease of 6.6% Q-on-Q from \$115.7m in Q2, 2015.

R&D expenses increased by \$7.2m Q-on-Q to \$62.4m in Q3, 2015. Excluding the funding of R&D contracts from the government, R&D expenses increased by \$6.4m Q-on-Q to \$72m in Q3, 2015. The change was mainly due to higher R&D activities in Q3, 2015. Funding of R&D contracts from the government was \$9.6m in Q3, 2015 compared to \$10.4m in Q2, 2015.



NOVEMBER 11, 2015 / 12:30AM, 981.HK - Q3 2015 Semiconductor Manufacturing International Corp Earnings Call

G&A expenses decreased to \$51.4m in Q3, 2015, down 1.3% Q-on-Q from \$51.1m -- \$52.1m in Q2, 2015.

Other operating income increased to -- increased from \$0.7m in Q2, 2015 to \$16.8m in Q3, 2015, mainly because of the gain realized from a disposal of certain living quarters.

Excluding the effect of employee bonus accrual, government R&D funding and gain from a disposal of living quarters, non-GAAP operating expenses were \$121.4m in Q3, 2015 compared to \$110.9m in Q2, 2015.

Profit from operations in Q3, 2015 was \$74.2m compared to \$60.7m in Q2, 2015.

Other expenses was \$3.4m -- \$3.5m in Q3, 2015 compared to \$11.9m of other income in Q2, 2015.

Foreign exchange losses were \$26m in Q3, 2015 compared to \$5m of gain in the previous quarter, mainly due to a devaluation of RMB against the US dollar in Q3, 2015.

Other gains decreased to \$3.1m in Q3, 2015 from \$8.6m in the previous quarter. This is mainly caused by the lower revenue from our schools, due to summer holiday, and a lower gain from investments in financial products sold by banks in Q3, 2015.

The fair-value change was \$25.5m in Q3, 2015. The change in the fair value was due to gain arising from a put option, which was given by Jiangsu Changjiang Electronics Technology Company Limited in connection with the acquisition of STATS ChipPAC.

Non-controlling interests were \$13.7m of credit to SMIC's attributable profit in Q3, 2015 compared to \$5m in the previous quarter.

Moving to the balance sheet, at the end of the third quarter of 2015, cash and cash equivalents decreased to \$741.6m in Q3, 2015 from \$766.2m in Q2, 2015. If including other financial assets, we have approximately \$1.2b cash on hand at the end of Q3, 2015 compared to approximately \$1.3b in [Q2] (corrected by company after the call), 2015.

At the end of Q3 2015 the assets classified as held-for-sales balance of \$111.4m were living quarter units, which the Group has committed to sell to its employees in the future.

Our long-term borrowings increased by \$23.1m and short-term borrowing decreased by \$62.2m compared to the previous quarter.

At the end of Q3, 2015 our total debt to equity was 26.6% compared to 28.2% in the previous quarter.

In terms of cash flow, we generated \$180.2m of cash from operating activities in Q3, 2015 compared to \$154.6m in Q2, 2015, mainly because of change in working capital.

Cash used in investment activities increased to \$187.9m in Q3, 2015 compared to \$170.4m in Q2, 2015.

Cash from financing activities changed from an inflow of \$379.4m in Q2, 2015 to an outflow of \$8.9m in Q3, 2015, mainly because of new shares issued to China Integrated Circuit Industry Investment Fund in Q2, 2015.

To examine our revenue by application, the communication and consumer segments contributed 51% -- 55.1% and 31.9% in the revenue respectively in Q3, 2015 compared to 49.4% and 37.7% respectively in Q2, 2015.

Geographically, revenue from China contributed 47.9% of total revenue. Revenue from North America contributed 33.9% of total revenue. And revenue from Eurasia contributed 18.2%.



In terms of technology, revenue from 40 nano (sic - see presentation slide 10 "45nm and below") and below contributed 15.6%. Revenue from 55/65 and 90 contributed 22.2% and [4.4%] (corrected by company after the call) respectively. Meanwhile 0.13 micron and above contributed 57.8% of total revenue.

In terms of our overall capacity, total monthly capacity at the end of the third quarter was 268.8 thousand 8-inch equivalent wafers compared to 255.8 thousand wafers in the previous quarter. The change was mainly because of new 8-inch fab in Shenzhen entered into mass production in Q3, 2015.

The overall utilization rate was 100.5% in Q3, 2015 compared to 102.1% in Q2, 2015.

Our planned 2015 CapEx for foundry operations are expected to be approximately \$1.45b. The planned 2015 CapEx for non-foundry operations, mainly for the construction of living quarters, are expected to be approximately \$100m.

I now hand the call back to En-ling for the Q&A session.

En-Ling Feng - *Semiconductor Manufacturing International Corporation - VP IR*

Thank you, Gareth. I would now like to open up the call for Q&A. As usual, please be reminded to limit your questions to two per person. Thank you. And operator, please assist.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Randy Abrams, Credit Suisse.

Randy Abrams - *Credit Suisse - Analyst*

Okay. Yes, thank you. Good morning. I wanted to ask the first question, you've had a very strong performance on 8-inch and the mature 12-inch, full and with a lot of new applications. The 28, I guess it's the one area that's been slow to ramp up through this year. So maybe you could talk about some of the challenges you've had on 28, and then the opportunities as you go out; maybe starting with the initial volume in the fourth quarter, but how you see that ramp playing out over the next year, say, as a percentage of revenue and broadening of customer base, as we go through the next year. Or if you think it might be another slow year or a slow few quarters before it gets going.

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

Hi, Randy. Thanks for the question. We believe that our ramp actually is consistent with what we have stated to the street in the past earnings release. We consistently have said that we'll get PO in the second quarter, and have a small shipment in the third quarter, and increase our shipment in the fourth quarter. And so, in this quarter, indeed, we have shipped small volumes out. And next quarter we will increase our shipment significantly.

Indeed however, we are seeing some weaknesses in the market. And so, therefore, I think the ramp-up is not as strong as could be expected. But we do see that next year there'll be a significant ramp-up. By the end of the next year we should see about, as of fourth quarter, a double-digit as a part of -- percentage of revenue.



Randy Abrams - *Credit Suisse - Analyst*

Okay, great. So then with the 28, I guess it sounds like it will have a more material ramp. Could you go through again the -- how we should think about the cost structure side for -- because gross margins are holding up, and I think because you've kept all the existing capacity very full with the new applications. So, as 28 ramps up, just the impact that we should expect on the margin, and on how depreciation loading would increase through the next year.

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

Because -- Randy, as you know, we are in the process of ramping up two fabs concurrently, the Shenzhen fab. And in Q4 -- the Shenzhen fab actually gone into production in Q3, and our new Beijing fab will go into production in Q4. So there'll be increase in our depreciation. We expect in Q4 depreciation will grow by about \$15m. And then, next year, there will also be a substantial increase of depreciation. So inevitably there will be some downward pressure on our gross margin. But we are still very positive, because as we fully ramp-up the fabs, we're going to see a substantial increase in our revenue.

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

That's correct. I think that we will also be able to, as we increase the capacity, to fully load the capacity with a mixture of 40 as well as 28. And that is probably (multiple speakers).

Randy Abrams - *Credit Suisse - Analyst*

Okay. And for 8-inch, where you're running for even -- at max now, how fast do you plan to ramp the Shenzhen? How much additional capacity can you get on that?

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

Okay. Next year we plan to ramp up to 30,000 wafers per month, that is on that standard 0.18 layers. Of course if there are changes in the product mix that require higher layers count, then certainly it will be at a lower shipment amount. But I think the value still going to be there.

Randy Abrams - *Credit Suisse - Analyst*

Okay. Thanks a lot and good job on the results.

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

Thank you.

Operator

Steven Pelayo, HSBC.



Steven Pelayo - HSBC - Analyst

Yes. Can we start with the operating expenses. I think last quarter you guys guided roughly \$135m to \$140m and I think the actuals, under the (inaudible), you reported that, if you exclude a bunch of things, it was \$120m. So I guess [if you look at that] on an apples-to-apples basis, it was significantly lower. And now when I look at your guidance for the fourth quarter, it actually steps up quite a bit as well. So I guess I'm a little confused on what kind of ongoing operating expenses are here and why there is so much volatility versus your guidance in each quarter.

Gareth Kung - Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary

Yes. In Q4 we do expect our OpEx to be higher because we -- well, generally, if you look at all our Company in the last two years, Q4 tend to be -- tend to have a higher OpEx compared to other quarters. And secondly, we are actually working very hard in terms of R&D teams, in terms of trying to accelerate the R&D activities. So that's one reason for that.

And also because actually we're going to have quite a few new tapeouts in our new technologies in Q4. So there'll be some expenses relating to making the mask for the new tapeouts. So that accounts for the increase in OpEx in Q4.

Steven Pelayo - HSBC - Analyst

And do you expect any more property disposals or R&D grants in 4Q?

Gareth Kung - Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary

I think our R&D grant guidance for the year remains the same, which is about \$40m to \$45m. And then we're going to have -- as you can see from our balance sheet, we do have a -- certain living quarters that we have put as asset-for-sale, so that will going to take place over the course of one -- the next one or two quarters.

Steven Pelayo - HSBC - Analyst

Okay. And then the last question to you, Gareth. You mentioned 2016 depreciation would substantially increase. Can you give us a little bit more color on how much that means?

Gareth Kung - Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary

Okay. If you look at our CapEx this year, and I think the ramp-up for -- continued ramp-up in our Beijing fab and Shenzhen fab next year, I think the increase in the depreciation would be fairly substantial. Yes.

Steven Pelayo - HSBC - Analyst

Can you quantify it for us?

Gareth Kung - Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary

I think you should be looking at a -- probably in the range of about 30% to 40% increase. Yes.



Steven Pelayo - HSBC - Analyst

Okay. And the last question, just quickly for T.Y. As part of your specialty applications, I'm wondering if you can help us understand how big these are for you. I don't know; maybe run through a few of them. How big is CMOS image sensors? And with BSI growing, how big could it be? Talk a little bit about maybe some of your specialty memory areas and how much they contributed to the percentage of revenues; smart cards, fingerprint sensors. Can you just give us some color on some of these specialty areas and how big each of them may be?

T.Y. Chiu - Semiconductor Manufacturing International Corporation - CEO

Maybe I'll -- let me say that if we -- you are referring to the specialty technology that we have just mentioned, I can tell you that our gross die per wafer can increase about 80%. So that is a very, very competitive technology. So we look forward to apply this technology across the fab. And --

Steven Pelayo - HSBC - Analyst

And what -- just wanted --

T.Y. Chiu - Semiconductor Manufacturing International Corporation - CEO

Go ahead. (Multiple speakers).

Steven Pelayo - HSBC - Analyst

I was just asking for some specific areas, like how big is CMOS image sensors for you today, and how big is fingerprint sensors, and smart cards? Is there some color you can give us on what kind of revenue contribution these are having for you?

T.Y. Chiu - Semiconductor Manufacturing International Corporation - CEO

Okay. Adding together all the specialty technology, I think it's around 40% of our revenue.

Steven Pelayo - HSBC - Analyst

Okay. Fair enough. Thank you.

Operator

Leping Huang, Nomura.

Leping Huang - Nomura - Analyst

Thank you to taking my questions. So two questions. One, in last few months, we see quite a lot of the cross-border M&A in the China semiconductor industry, including Tsinghua Unigroup's RMB80b investment on the memory factory last week. So as the largest semiconductor company in China, I think you did very well in the ramping up your internal capacity. Do you also seek any non-organic growth opportunity, to leverage this favorable environment? This is the first question.



T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

Okay. In the last quarters, if you mean the inorganic growth, we continue to look for opportunity in this area. But we definitely are monitoring the situation. So yes, so we are interested in it. In the last quarters, indeed, we still were successful to buy a significant portion of the fab, to get hold of a significant set of secondhand equipment to outfit our Shenzhen fab.

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

I think just to add on to what T.Y. said, I think we have been fairly active, in terms of looking at opportunities in the past 12 to 24 months. But I think given the strong market actually, we do not find very attractive targets. But, depending on how the industry will pan out in the next few quarters, there could be a downturn in the industry. And that could be -- turn out to be a very good opportunity for us.

Leping Huang - *Nomura - Analyst*

So you are still focused on the foundry, the logic foundry business or -- because there's discussion whether China should do memory, or the DRAM, or [this]. So your key focus is on the logic foundry business. Is my understanding correct, or --

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

That's correct. Our main focus is still on our core business, which is logic foundry.

Leping Huang - *Nomura - Analyst*

Okay. Second question, in September, you established a semiconductor equipment leasing company, with the National IC Fund. So could you share your plan on how you leverage this? If I understand it correctly, they have quite a large funding source. So what's your plan to use -- leverage this leasing company, and what will impact our P&L?

I think this related question is, what is your plan on the 2016 CapEx, since whether -- including whether you can offload some of the CapEx to the leasing company? Yes, thank you.

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

Okay. First of all, for our investment in leasing company, we are just a minority shareholders in the leasing company. And I think, if you look at overall market for the leasing business in China, for the high-tech industry, not just for foundry, but overall for high-tech industry, I think there are very good opportunities there. We think that the leasing company should do well in the future.

Specifically for SMIC, I think the leasing company could potentially be an additional source of funding for us, as we found appropriate for our funding structure. So I think that is the rationale for us to participate in this investments.

Leping Huang - *Nomura - Analyst*

So do you have any color for the next year's CapEx now? Yes.



T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

We are looking at various options, including some of the leasing options, to fund our 2016 CapEx. But that option needs to be, how do say, favorable enough for SMIC.

Leping Huang - *Nomura - Analyst*

Okay. Thank you.

Operator

Ken Hui, Jefferies.

Ken Hui - *Jefferies - Analyst*

Good morning. Thank you for taking my questions. My first question is specifically on fingerprint sensor, which seems to be a strong growth driver for the Company. So can you talk about the revenue contribution from fingerprint sensor, and what is the outlook into next year? Would you find any capacity constraint to satisfy the demand from your customer? That is my first question.

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

We do think that the fingerprint sensor is going to be a very important application, because -- more than just hand phones. So we continue to invest in these technologies. But we don't usually -- we don't normally break out, in terms of our contribution by certain applications. So -- but this is one of the specialized technologies that we have been investing R&D in the past. And we are actually seeing a pretty strong business from this area. Yes.

Ken Hui - *Jefferies - Analyst*

Would you be able to comment that? Sorry.

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

I just wanted to say that as far as the capacity constraint, we are working full speed to make sure that our customer are fully served, but in all areas, as well.

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

And I do want to comment that as far as the fingerprint sensor is concerned, that you have quite a number of customer engagements.

Ken Hui - *Jefferies - Analyst*

Would you be able to comment that it will be more than or less than 10% of your revenue, going into next year?



Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

I'm sorry. We don't comment on that.

Ken Hui - *Jefferies - Analyst*

Okay. No problem. And then I think in the earlier comment, you mentioned that you begin to see contribution from your Japanese customer. Can you help us understand what kind of product is it?

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

We can mention that it is a specialty technology, as well as a conventional logic technology. So there are a number of customers, so they cover different portion and different stage of technology.

Ken Hui - *Jefferies - Analyst*

Okay. Thank you very much.

Operator

Bill Lu, Morgan Stanley.

Bill Lu - *Morgan Stanley - Analyst*

Yes, hi. Good morning and thanks for taking my question. Dr. Chiu talked about the change in the capacity plans for the Shenzhen fab, that you are seeing demand for more layer type of applications. Hello. Can you hear me okay?

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

Yes, yes.

Bill Lu - *Morgan Stanley - Analyst*

So can you give me some color on that, because if my notes are right, previously you had planned on 20,000 wafers by the end of the year. So it's a pretty material change in the capacity. What kind of application or applications are driving this change?

And also, financially, are you able to get payback, in terms of higher ASP, by making these wafers with more layers? And what's the margin implication as well? Thanks.

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

Yes. Mainly the number of metal layer has increased significantly. And so that has impacted the overall wafer out. But, however, I think that we get -- the ASP is based on a number of consideration, including the number of layers.



Bill Lu - Morgan Stanley - Analyst

I guess I'm just wondering, if you look at revenues out of [13,000] wafers, versus 20,000 previously, but more layers, is the revenue margin better or worse?

T.Y. Chiu - Semiconductor Manufacturing International Corporation - CEO

I think that the margin is actually equal or better, as we look into next year.

Bill Lu - Morgan Stanley - Analyst

And what about topline?

Gareth Kung - Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary

Yes, I think, as what TY said, should we re-price our services, one of the key determiners would be the number of layer. Yes. So obviously a high layer count --

Bill Lu - Morgan Stanley - Analyst

Got it.

Gareth Kung - Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary

A higher ASP, yes.

Bill Lu - Morgan Stanley - Analyst

Okay. I understand that your driver is a little bit different from some of your competitors outside of China. But if I talk to the foundries in Taiwan, it seems like many of them have seen rush orders recently, especially for 8-inch wafers for driver IC, for power management IC, etc. I'm wondering if you could just tell us what you've been seeing recently.

T.Y. Chiu - Semiconductor Manufacturing International Corporation - CEO

I think, as you can see, that now we have been relatively fully loaded over the last few quarters. And in the fourth quarter, we are still seeing a strong loading. And we see this fairly consistent loading into the first half [of] first quarter. So I think we are cautiously optimistic that the loading will remain the same.

Bill Lu - Morgan Stanley - Analyst

Okay, great. Thank you.



T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

Thank you.

Operator

Suji De Silva, Topeka Capital.

Suji De Silva - *Topeka Capital - Analyst*

Hi, guys. Congratulations on the strong results here. I think you started to answer this question, but the 130 nanometer and above products, would you expect that to have seasonal behavior in 2016? Or will program ramps be able to drive the sequential growth per quarter, similar to what you've seen in 2015?

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

Okay. Our growth, yes. Indeed, right now we are trying to install as much capacity in the 8-inch as we possibly can. And we expect that -- we hope and we target that the 8-inch capacity will remain fairly heavily loaded, throughout 2016.

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

Yes, if you look at our target end of the year 2016, 8-inch capacity, compared to our current 8-inch capacity, I think you're talking about a 20% increase.

Suji De Silva - *Topeka Capital - Analyst*

Great. That's helpful numbers. And then on the 28 nanometer, I know you talked about double digits by the end of 2016. Do you expect that to be a fairly linear ramp, or do you think that's more back-end loaded, as you get 28 nanometer going? Thank you.

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

I think we expect to be more back-end loaded, yes.

Suji De Silva - *Topeka Capital - Analyst*

Okay, terrific. Thanks, guys.

Operator

Szeho Ng, BNP.

Szeho Ng - *BNP Paribas - Analyst*

Hi. Good morning, gentlemen. Just wanted to touch upon the non-operating side and the change in the fair value change. Is this something tied to JCET share price or it will be based on a formula? I just want to have some idea how to model for that partner, going forward.

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

Okay. Let me explain a little bit because I'm sure this is confusing to a lot of people. When we invest in the consortium to acquire STATS ChipPAC, actually we have received a sort of a downside protection from Jiangyin Changdian in terms of guaranteeing a return for us, for this investment.

So actually, the behavior of these options, we're going to -- this is a -- stand-alone derivatives, so we need to value on a quarterly basis. But interestingly, I think that the behavior of this change in the fair value will work inversely with the performance of STATS ChipPAC. So in other words, when STATS ChipPAC's performance get worse, this value of option -- the option value will increase, and vice versa.

Szeho Ng - *BNP Paribas - Analyst*

Okay. You mean the financial performance of STATS ChipPAC, right?

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

Yes, financial performance. Yes.

Szeho Ng - *BNP Paribas - Analyst*

Okay. I got you. And second question, also on the non-op side. The entity ChangjiangXinke, what is that company's business?

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

That is the FPV that was set up for the acquisition of STATS ChipPAC.

Szeho Ng - *BNP Paribas - Analyst*

Oh, okay. All right. Got you. And last question, for the utilization, theoretically what would be the maximum utilization that you can derive from your capacity?

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

Yes,. We are very, very close to our theoretical maximum in our capacity now.

Szeho Ng - *BNP Paribas - Analyst*

Okay. Alright. Okay, thank you very much and congratulations.



T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

Thank you.

Operator

Roland Shu, Citigroup.

Roland Shu - *Citigroup - Analyst*

Hi. Sorry for the technical issue earlier. Yes. My first question is, when I look at your 3Q, the total wafer shipment increased by 5%. But the total non-depreciated cost of goods sold declined by 1%. So why was that? Is it mainly from this product mix change, or it's mainly due to your cost reduction effort, and how sustainable it will be, going forward?

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

Okay. I think the -- actually, if you look at our total depreciation, it did not change, quarter on quarter, okay? But I think what is being captured in the -- the depreciation being captured in the cost of goods sold, actually somewhat reflect the fab loading. The higher the fab loading, more depreciation is being absorbed into the fab. Okay? So what it means is that we are running at very, very high loading in the fab right now. So I think that explains the change in the depreciation.

Roland Shu - *Citigroup - Analyst*

Yes, but I talk about the non-depreciation cost, mainly (multiple speakers) the variable costs.

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

The non-depreciation costs -- actually it has gone up in Q3, compared to Q2.

Roland Shu - *Citigroup - Analyst*

Yes, but for the total--I think that actually it probably went up at a smaller magnitude, compared to the wafer shipment increase. So is that mainly due to you have more product mix on the 0.18 (inaudible) wafers, or is this due to you have these continuous cost reduction efforts on your fab?

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

Our increase in shipments is 5.4%. And then our increase in other manufacturing costs, within the cost of goods sold, is 6.9%. So actually, I think it's very much in line.



Roland Shu - Citigroup - Analyst

Okay, yes. Okay, yes, thank you very much for clarifying. And next question is for the recent on M&A in China, I think -- do you see any order flow change, according to these M&A? And also, going forward, how are you expecting the order flow change because of these M&A activities in China? Thank you.

Gareth Kung - Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary

Sorry, can you repeat your question again?

Roland Shu - Citigroup - Analyst

Yes. I think recently we have this lot of the industry consolidation happening in China. And do you see any order flow change, because of this industry consolidation? And going forward, are you expecting any order flow change because of this consolidation in the industry

Gareth Kung - Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary

Well first of all, I think -- we do see some consolidation in the industry, globally, for the semiconductor industry. Okay? But as far as we are concerned, we don't see any change in our business prospect. As a matter of fact, we see -- well, we see opportunity for us to penetrate into some new customer, through this M&A in the -- among our customers. Yes.

Roland Shu - Citigroup - Analyst

Okay. So you do expect, going forward, you probably will try to penetrate into this new M&A business in -- for your business, right?

Gareth Kung - Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary

Yes, definitely. As a matter of fact, not specifically relating to the M&A, but actually a lot of the global customers seen the value to have the production in China because of the -- right now, the China, the IC supply chain is a lot more robust now, than a few years ago.

Roland Shu - Citigroup - Analyst

Yes, that's understood. I think my last question is on your -- most of your peers, your foundry peers, they are seeing 4Q revenues to decline, quarter on quarter. However, you are guiding still growing 4Q, so where does this strength come from? Thank you.

T.Y. Chiu - Semiconductor Manufacturing International Corporation - CEO

I think that this strength comes from both a very strong loading in 8-inch, as well as our 12-inch fabs. As a matter of fact, indeed, some of our customers have been impacted by a inventory adjustment issues. But because of the -- our strategy to diversify in terms of our customers, and the product, and the technology, I think that we are seeing very strong orders coming from our new customers, leveraging new technologies. So that is the basic reason why we have continued to perform above industry peer.



Roland Shu - Citigroup - Analyst

Thank you. So you said some of your customers [have] been impacted by this inventory correction. Can you give us some -- more colors, what kind of these customers are? Thank you.

T.Y. Chiu - Semiconductor Manufacturing International Corporation - CEO

Let me give you an example. And we have 10 customers; those were 10 new customers. And these 10 customers has a -- give us a revenue of \$90m in 2012. These 10 customers, in 2015, it's forecasted to give us a revenue up to \$700m or above. And so, in that sense, that we were able to actually capture a lot of new, growing customers, that is really compensating to some of the weakness of smartphone inventory adjustments. And these customers come from all regions of the world.

Roland Shu - Citigroup - Analyst

And from all of the segment? Is this mainly from communication or from consumer or this is across the board?

T.Y. Chiu - Semiconductor Manufacturing International Corporation - CEO

Across segments.

Roland Shu - Citigroup - Analyst

Okay. Thank you. So how about these 10 customers' business projection next year?

T.Y. Chiu - Semiconductor Manufacturing International Corporation - CEO

I think we continue to believe that they will be performing very well.

Roland Shu - Citigroup - Analyst

Okay. Thank you very much. Thank you.

Operator

Rick Hsu, Daiwa Securities.

Rick Hsu - Daiwa Securities - Analyst

Yes, hi. Good morning, guys. And yes, congratulations for your strong results. Just one more question on your Q3 non-controlling interest. It's roughly about \$13m, but -- I think, can you explain this item a little bit more, because I think I missed out on your explanation earlier? And also, elaborate the guidance, \$33m to \$36m non-controlling interest in Q4. Would that be additional -- addition to your total bottomline or something?



Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

Okay. The non-controlling interest is relating to some of the joint venture that have been set up by SMIC, because we don't wholly own the subsidiary. So if the joint venture incurred losses, some of the losses will be attributable to the non-controlling interest, so that [would be] adding back to our net income. So I think that's why you see that actually, the number will be positive.

And then for the Q4, the increase is because, the same as end of last year, we do have an arrangement that we will share some of the R&D expenses with our B2 fabs. So there is a portion that is -- that will be attributable to the -- B2 other shareholders.

Rick Hsu - *Daiwa Securities - Analyst*

Well I think my real question is, going forward, how we're going to model this item, say in 2016 or 2017.

Gareth Kung - *Semiconductor Manufacturing International Corporation - EVP, Investment and Strategic Business Development & Finance, Company Secretary*

Well actually, no. The real model you should look at, the profitability of this joint venture. But understand there's some difficulties with how to enlist -- model it, especially in the beginning phase of these joint venture operations. So we have taken the step to give the guidance on this item on a quarterly basis. Yes.

Rick Hsu - *Daiwa Securities - Analyst*

I see. All right. Thank you so much.

Operator

Thank you. I would now like to hand the call back to CEO, Dr. Chiu, for closing remarks.

T.Y. Chiu - *Semiconductor Manufacturing International Corporation - CEO*

In closing, I would like to thank everyone who participated in today's call. And again, thank all of our shareholders, customers, employees, and suppliers for their trust and the support. And see you next time.

Operator

This is the end of SMIC's third quarter earnings conference call. We thank you for joining us today. Goodbye.



DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2015, Thomson Reuters. All Rights Reserved.