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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

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**FORM 20-F**

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**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2004

Commission file number 1-31994

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**Semiconductor Manufacturing International Corporation**

(Exact name of Registrant as specified in its charter)

(Translation of Registrant's name into English)

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**Cayman Islands**

(Jurisdiction of incorporation or organization)

**18 Zhangjiang Road, Pudong New Area, Shanghai, China 201203**

(Address of principal executive offices)

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**Securities registered or to be registered pursuant to Section 12(b) of the Act.**

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
<b>Ordinary Shares, par value US\$0.0004 American Depositary Shares</b>	<b>The Stock Exchange of Hong Kong Limited* The New York Stock Exchange, Inc.</b>

**Securities registered or to be registered pursuant to Section 12(g) of the Act.**

**None**  
(Title of Class)

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.**

**None**  
(Title of Class)

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Indicate the number of outstanding shares of each of the issuer's classes of capital or ordinary shares as of the close of the period covered by the annual report.

As of December 31, 2004, there were 18,232,959,139 ordinary shares, par value US\$0.0004 per share, outstanding, of which 1,082,173,250 ordinary shares were held in the form of 21,643,465 ADSs. The number of shares outstanding does not include 780,000 ordinary shares we repurchased from some of our employees pursuant to our employee stock option plans, but which for accounting purposes have been reflected in our consolidated statement of shareholders' equity and comprehensive income (loss). Each ADS represents 50 ordinary shares.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17  Item 18

\* Not for trading, but only in connection with the listing of American Depositary Shares on the New York Stock Exchange, Inc.

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## CAUTIONARY STATEMENT FOR PURPOSES OF THE “SAFE HARBOR” PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This annual 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” and 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 cyclicalities 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.

### ADDITIONAL INFORMATION

References in this annual report to:

- “China” or the “PRC” are to the People’s Republic of China, excluding for the purpose of this annual report, Hong Kong, Macau and Taiwan;
- “HK\$” are to Hong Kong dollars;
- “Rmb” are to Renminbi, the legal currency of China;
- “US\$” are to U.S. dollars;
- “SEHK” or “Hong Kong Stock Exchange” are to The Stock Exchange of Hong Kong Limited;
- “SEC” are to the U.S. Securities and Exchange Commission;
- “NYSE” or “New York Stock Exchange” are to the New York Stock Exchange, Inc.;
- “global offering” are to the initial public offering of our ADSs and our ordinary shares, which offering was completed on March 18, 2004; and
- “IPO registration statement” are to our registration statement on Form F-1 (File No. 333-112720), as filed with the Securities and Exchange Commission on March 11, 2004, sections of which are incorporated by reference into this annual report.

All references in this annual report to silicon wafer quantities are to 8-inch wafer equivalents, unless otherwise specified. Conversion of quantities of 12-inch wafers to 8-inch wafer equivalents is achieved by multiplying the number of 12-inch wafers by 2.25. When we refer to the capacity of wafer fabrication facilities, we are referring to the installed capacity based on specifications established by the manufacturers of the equipment used in those facilities. References to key process technology nodes, such as 0.35 micron, 0.25 micron, 0.18 micron, 0.15 micron, and 0.13 micron, include the stated resolution of the process technology, as well as intermediate resolutions down to but not including the next key process technology node of finer resolution. For example, when we state “0.25 micron process technology,” that also includes 0.22 micron, 0.21 micron, 0.20 micron and 0.19 micron technologies. “0.18 micron process technology” also includes 0.17 micron and 0.16 micron technologies; “0.15

micron process technology” includes 0.14 micron technology; and “0.13 micron process technology” includes 0.11 micron and 0.10 micron technologies. References to “U.S. GAAP” mean the generally accepted accounting principles in the United States. Unless otherwise indicated, our financial information presented in this annual report has been prepared in accordance with U.S. GAAP.

All references to our ordinary shares in this annual report gives effect to the 10-for-1 share split we affected in the form of a share dividend immediately prior to the completion of the global offering. All references to price per ordinary share and price per preference share reflect the share split referenced above.

The “Glossary of Technical Terms” contained in Annex A of this annual report sets forth the description of certain technical terms and definitions used in this annual report.

## **PART I**

### **Item 1. Identity of Directors, Senior Management and Advisers**

Not applicable.

### **Item 2. Offer Statistics and Expected Timetable**

Not applicable.

### **Item 3. Key Information**

#### **Selected Consolidated Financial Data**

The summary consolidated financial data presented below as of and for the years ended December 31, 2002, 2003 and 2004 are derived from, and should be read in conjunction with, and are qualified in their entirety by reference to, our audited consolidated financial statements, including the related notes, included elsewhere in this annual report. The selected consolidated financial data as of December 31, 2000 and 2001, and for the period from April 3, 2000 (inception) through December 31, 2000 and for the year ended December 31, 2001 is derived from audited consolidated financial statements not included in this annual report. The summary consolidated financial data presented below has been prepared in accordance with U.S. GAAP.



<b>Other Financial Data:</b>					
Gross margin	—	—	(109.2)%	0.7%	26.0%
Operating margin	—	—	(231.2)%	(19.9)%	8.5%
Net margin	—	—	(203.9)%	(18.1)%	9.2%
<b>Operating Data:</b>					
Wafers shipped (in units):					
Logic <sup>(6)</sup>	—	—	26,419	188,316	597,533
Total <sup>(7)</sup>	—	—	82,486	476,451	943,463
Average selling price (in US\$):					
Logic <sup>(6)</sup>	—	—	\$ 794	\$ 896	\$ 1,066
Total <sup>(7)</sup>	—	—	\$ 558	\$ 733	\$ 979

(1) Including amortization of deferred stock compensation for employees directly involved in manufacturing activities.



- (2) Deemed dividend represents the difference between the sale and conversion prices of warrants to purchase convertible preference shares we issued and their respective fair market values.
- (3) Anti-dilutive preference shares, options and warrants were excluded from the weighted average ordinary shares outstanding for the diluted per share calculation. For 2000, 2001, 2002 and 2003, basic income (loss) per share did not differ from diluted loss per share.
- (4) All share information has been adjusted retroactively to reflect the 10-for-1 share split effected upon completion of the Global Offering.
- (5) Fifty ordinary shares equals one American Depository Share (“ADS”).
- (6) Excluding copper interconnects and DRAM wafers.
- (7) Including logic, DRAM, copper interconnects and all other wafers.

	As of December 31,				
	2000	2001	2002	2003	2004
	(in US\$ thousands)				
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 94,290	\$178,920	\$ 91,864	\$ 445,276	\$ 607,173
Short-term investments	—	—	27,709	27,165	20,364
Accounts receivable, net of allowances	—	—	20,110	90,539	169,188
Inventories	—	4,749	39,826	69,924	144,018
Total current assets	102,949	235,196	185,067	680,882	955,418
Land use rights, net	—	48,913	49,354	41,935	39,198
Plant and equipment, net	14,284	478,950	1,290,910	1,523,564	3,311,925
Total assets	117,233	763,059	1,540,078	2,290,506	4,384,276
Total current liabilities	115,965	249,071	263,655	325,430	730,330
Total long-term liabilities	—	—	405,432	479,961	544,462
Total liabilities	115,965	249,071	669,087	805,391	1,274,792
Stockholders' equity	\$ 1,268	\$513,988	\$ 870,991	\$1,485,115	\$3,109,484

For the year ended December 31,

	2000	2001	2002	2003	2004
(in US\$ thousands)					
<b>Cash Flow Data:</b>					
Net income (loss)	\$ 1,226	\$ (2,652)	\$(102,603)	\$ (66,145)	\$ 89,745
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:					
Depreciation and amortization	10	1,445	84,537	233,905	456,961
Net cash provided by (used in) operating activities	904	3,360	(48,802)	114,270	518,662
Purchases of plant and equipment	(9,774)	(459,779)	(761,704)	(453,097)	(1,838,773)
Net cash used in investing activities	(17,774)	(501,779)	(751,144)	(454,498)	(1,826,787)
Net cash provided by financing activities	111,120	583,152	712,925	693,497	1,469,764
Net increase (decrease) in cash and cash equivalents	\$ 94,290	\$ 84,630	\$ (87,056)	\$ 353,412	\$ 161,896

## Risk Factors

### Risks Related to Our Financial Condition and Business

*Our short operating history makes it difficult to evaluate our business and prospects.*

We were founded in April 2000 and did not commence commercial production until January 2002. Because of our limited operating history, there may not be an adequate basis upon which to evaluate our future operating results and prospects, and we have only limited insight into the trends that may emerge that may adversely affect our business and operating results.

*We may not be able to maintain our level of profitability, primarily due to our high fixed costs and correspondingly high levels of depreciation expenses.*

After over three years of losses from operations totaling in excess of US\$216 million, we achieved profitability on an annual basis in 2004. We may not be able to maintain profitability on an annual or quarterly basis, primarily because our business is characterized by high fixed costs relating to equipment purchases, which result in correspondingly high levels of depreciation expenses. In the next two years, we will continue to incur high capital expenditures and depreciation expenses as we equip and ramp up additional fabs in Beijing and expand our capacity at our existing fabs in Shanghai, Beijing and Tianjin. We expect to continue to incur high capital expenditures and depreciation expenses as we expand our capacity and construct new fabs. Accordingly, we may not be able to maintain profitability.

*The cyclical nature of the semiconductor industry and periodic overcapacity in the industry make our business and operating results particularly vulnerable to economic downturns.*

The semiconductor industry has historically been highly cyclical and, at various times, has experienced significant downturns characterized by fluctuations in end-user demand, reduced demand for integrated circuits, rapid erosion of average selling prices and production overcapacity. Companies in the semiconductor industry have expanded aggressively during periods of increased demand in order to have the capacity needed to meet expected demand in the future. If actual demand does not increase or declines, or if companies in the industry expand too aggressively in light of the actual increase in demand, the industry will generally experience a period in which industry-wide capacity exceeds demand. If industry-wide capacity exceeds demand, our operations would be subject to more intense competition, and our results of operations may suffer because of the resulting pricing pressure and capacity underutilization. Severe pricing pressure could result in the overall foundry industry becoming less profitable, at least for the duration of the downturn, and could prevent us from maintaining our current level of profitability. For example, from 2001 to mid-2003, the semiconductor industry experienced a downturn due to a

number of factors, including a slowdown in the global economy and in the communications sector in particular. We expect that industry cyclicality will continue. In addition, a slowdown in the growth in demand for, or the continued reduction in selling prices of, devices that use semiconductors may decrease the demand for our services and reduce our profit margins. If we cannot take appropriate or effective actions in a timely manner during future downturns, such as reducing our costs to sufficiently offset declines in demand for our services, our business and operating results may be adversely affected.

***Our results of operations may fluctuate from year to year, which may make it difficult to predict our future performance and may result in a decline in the prices of our ordinary shares and ADSs if we fail to meet our expectations or those of the public market analysts and investors in these periods.***

Our sales, expenses and results of operations may fluctuate significantly from year to year due to a number of factors, many of which are outside our control. Our business and operations are subject to a number of factors, including:

- our customers' sales outlook, purchasing patterns and inventory adjustments based on general economic conditions or other factors;
- the loss of one or more key customers or the significant reduction or postponement of orders from such customers;
- timing of new technology development and the qualification of this technology by our customers;
- timing of our expansion and development of our facilities;
- our ability to obtain equipment and raw materials; and
- our ability to obtain financing in a timely manner.

Due to the factors noted above and other risks discussed in this section, many of which are beyond our control, you should not rely on year-to-year comparisons to predict our future performance. Unfavorable changes in any of the above factors may adversely affect our business and operating results. In addition, our operating results may be below the expectations of public market analysts and investors in some future periods.

***If the recent trend of increasing demand for foundry services reverses or slows down, we may achieve a lower rate of return on investments than anticipated and our business and operating results will be adversely affected.***

The demand for foundry services by IDMs, fabless semiconductor companies and systems companies has been increasing in recent years. We have made and are planning to make significant investments in anticipation of the continuation of this trend. A reversal of, or slowdown in, this trend will likely result in a lower rate of return on our investments than anticipated. For example, if IDMs change their strategy and target greater internal production or become dissatisfied with the services of independent foundry service providers, such as our company, they may reduce their outsourcing of wafer fabrication. In addition, in the event of an industry downturn, in order to maintain their equipment's utilization rates, these IDMs may allocate a smaller portion of their fabricating needs to foundry service providers and perform a greater amount of foundry services for system companies and fabless semiconductor companies. If this occurs, our business and operating results will be adversely affected.

***If we are unable to maintain high capacity utilization, optimize the technology and product mix of our services or improve our yields, our margins may substantially decline, thereby adversely affecting our operating results.***

Our ability to achieve and maintain profitability depends, in part, on our ability to:

- maintain high capacity utilization, which is the actual number of wafers we produce in relation to our capacity;
- optimize our technology and product mix, which is the relative number of wafers fabricated utilizing higher margin technologies as compared to commodity and lower margin technologies; and
- continuously maintain and improve our yield, which is the percentage of usable fabricated devices on a wafer.

Our capacity utilization affects our operating results because a large percentage of our costs are fixed. In general, more advanced technologies sell for higher prices and higher margins. Therefore, our technology and product mix has a direct impact upon our average selling prices and overall margins. Our yields directly affect our ability to attract and retain customers, as well as the price of our services. If we are unable to maintain high capacity utilization, optimize the technology and product mix of our wafer production and continuously improve our yields, our margins may substantially decline, thereby adversely affecting our operating results.

***Our rapid growth has presented significant challenges to our management and administrative systems and resources, and we may experience difficulties managing our growth, particularly as we handle the additional responsibilities of being a public company, which may adversely affect our business and operating results.***

Since our inception in 2000, we have grown rapidly. Our wafers shipped and sales grew from zero in 2000 to 943,463 wafers and US\$974.7 million in 2004. During this period, we commenced commercial production at four 8-inch fabs, and the range of process technologies we offered grew significantly. In addition, we commenced pilot production at our 12-inch fab in Beijing in July 2004. We are also in the process of constructing three additional 8-inch fabs at our Shanghai site. At December 31, 2000, we had 122 employees; at December 31, 2001, we had 1,476 employees; at December 31, 2002, we had 3,193 employees; at December 31, 2003, we had 4,443 employees; and at December 31, 2004, we had 7,640 employees. We plan to hire a significant number of additional employees as our fabs in Tianjin and Beijing ramp up and fabs currently under construction become operational. This expansion, as well as our participation in a joint venture with Toppan Printing Co., Ltd. and an assembly and testing facility in Chengdu, has presented, and continues to present, significant challenges for our management and administrative systems and resources. If we fail to develop and maintain management and administrative systems and resources sufficient to keep pace with our planned growth or to handle the additional responsibilities of becoming a public company, we may experience difficulties managing our growth and our business and operating results could be adversely affected.

***If we lose one or more of our key personnel without obtaining adequate replacements in a timely manner or if we are unable to retain and recruit skilled personnel, our operations could become disrupted and the growth of our business could be delayed or restricted.***

Our success depends on the continued service of our key executive officers, and in particular, Richard Ru Gin Chang, our President and Chief Executive Officer. We do not carry key person insurance on any of our personnel. If we lose the services of any of our key executive officers, it could be very difficult to find, relocate and integrate adequate replacement personnel into our operations, which could seriously harm our operations and the growth of our business.

We will require an increased number of experienced executives, engineers and other skilled employees in the future to implement our growth plans. There is intense competition for the services of these personnel in the semiconductor industry. In addition, we expect demand for skilled and experienced personnel in China to increase in the future as new wafer fabrication facilities and other similar high technology businesses are established there. If we are unable to retain our existing personnel or attract, assimilate and retain new experienced personnel in the future, our operations could become disrupted and the growth of our business could be delayed or restricted.

***Our customers generally do not place purchase orders far in advance, which makes it difficult for us to predict our future sales, adjust our production costs and efficiently allocate our capacity on a timely basis and could therefore have an adverse effect on our business and operating results.***

Our customers generally do not place purchase orders far in advance of the required shipping dates. In addition, due to the cyclical nature of the semiconductor industry, our customers' purchase orders have varied significantly from period to period. As a result, we do not typically operate with any significant backlog, which makes it difficult for us to forecast our sales in future periods. Also, since our cost of sales and operating expenses have high fixed cost components, including depreciation and employee costs, we may be unable to adjust our cost structure in a timely manner to compensate for shortfalls in sales. Our current and anticipated customers may not place orders with us in accordance with our expectations or at all. As a result, it may be difficult to plan our capacity, which requires significant lead time to ramp-up and cannot be altered easily. If our capacity does not match our customer demand, we will either be burdened with expensive and unutilized overcapacity or unable to support our customers' requirements, both of which would have an adverse effect on our business and results of operations.

***Our sales cycles can be long, which could adversely affect our operating results and cause our income stream to be unpredictable.***

Our sales cycles, which measure the time between our first contact with a customer and the first shipment of product orders to the customer, vary substantially and can last as long as one year or more, particularly for new technologies. Sales cycles to IDM customers typically take relatively longer since they usually require our engineers to become familiar with the customer's proprietary technology before production can commence. In addition, even after we make initial product shipments, it may take the customer several more months to reach full production of that product using our foundry services. As a result of these long sales cycles, we may be required to invest substantial time and incur significant expenses in advance of the receipt of any product order and related revenue. Orders ultimately received may not be in accordance with our expectation with respect to product, volume, price or other terms, which could adversely affect our operating results and cause our income stream to be unpredictable.

***We must consistently anticipate trends in technology development or else we will be unable to maintain or increase our business and operating margins.***

The semiconductor industry is developing rapidly and the related technology is constantly evolving. If we are unable to anticipate the trends in technology development and rapidly develop and implement new and innovative technology that our customers require, we may not be able to produce sufficiently advanced products at competitive prices. As the life cycle for a process technology matures, the average selling price falls. Accordingly, unless we continually upgrade our capability to manufacture any new products that our customers design, our customers may use the services of our competitors instead of ours and the average selling prices of our wafers may fall, which would adversely affect our business and operating margins.

***Our sales are dependent upon a small number of customers and any decrease in sales to any of them could adversely affect our results of operations.***

We have been dependent on a small number of customers for a substantial portion of our business. For the year ended December 31, 2004, our five largest customers accounted for 59.1% of our total sales. We expect that we will continue to be dependent upon a relatively limited number of customers for a significant portion of our sales. Sales generated from these customers, individually or in the aggregate, may not reach or exceed our expectations or historical levels in any future period. Our sales could be significantly reduced if any of these customers cancels or reduces its orders, significantly changes its product delivery schedule or demands lower prices, which would have an adverse effect on our results of operations.

***Since our operating cash flows will not be sufficient to cover our planned capital expenditures, we will require additional external financing, which may not be available on acceptable terms or at all. Any failure to raise adequate funds in a timely manner could adversely affect our business and operating results.***

In 2004, our capital expenditures totaled approximately US\$2,000 million and we currently expect our capital expenditures in 2005 to total approximately US\$1,000 million. These capital expenditures will be used primarily to expand our operations in Shanghai, Beijing and Tianjin and complete the construction, equipping and ramp-up of our Fab 4 in Beijing. In addition, our actual expenditures may exceed our planned expenditures for a variety of reasons, including changes in our business plan, our process technology, market conditions, equipment prices, customer requirements or interest rates. Future acquisitions, mergers, strategic investments, or other developments also may require additional financing. The amount of capital required to meet our growth and development targets is difficult to predict in the highly cyclical and rapidly changing semiconductor industry.

Our operating cash flows may not be sufficient to meet our capital expenditure requirements in 2005. If our operating cash flows are insufficient, we plan to fund the expected shortfall through bank loans. If necessary, we will also explore other forms of external financing. Our ability to obtain external financing is subject to a variety of uncertainties, including:

- our future financial condition, results of operations and cash flows;

- general market conditions for financing activities of semiconductor companies;
- our future stock price; and
- our future credit rating.

External financing may not be available in a timely manner, on acceptable terms, or at all. Since our capacity expansion is a key component of our overall business strategy, any failure to raise adequate funds could adversely affect our business and operating results.

***The construction and equipping of new fabs and the expansion of existing fabs are subject to certain risks that could result in delays or cost overruns, which could require us to expend additional capital and adversely affect our business and operating results.***

We plan to continue to expand our business through the development of new fabs, in particular using the additional land we have available at our Shanghai and Beijing sites. We also plan to expand significantly the capacity at our existing fab in Beijing. There are a number of events that could delay these expansion projects or increase the costs of building and equipping these or future fabs in accordance with our plans. Such potential events include, but are not limited to:

- shortages and late delivery of building materials and facility equipment;
- delays in the delivery, installation, commissioning and qualification of our manufacturing equipment;
- seasonal factors, such as a long and intensive wet season that limits construction;
- labor disputes;
- design or construction changes with respect to building spaces or equipment layout;
- delays in securing the necessary governmental approvals and land use rights; and
- technological, capacity and other changes to our plans for new fabs necessitated by changes in market conditions.

As a result, our projections relating to capacity, process technology capabilities or technology developments may significantly differ from actual capacity, process technology capabilities or technology developments.

Delays in the construction and equipping or expansion of any of our fabs could result in the loss or delayed receipt of earnings, an increase in financing costs, or the failure to meet profit and earnings projections, any of which would adversely affect our business and operating results.

***If we cannot compete successfully in our industry, particularly in China, our results of operations and financial condition will be adversely affected.***

The worldwide semiconductor foundry industry is highly competitive. We compete with other foundries, such as Taiwan Semiconductor Manufacturing Company, Ltd., or TSMC, United Microelectronics Corporation, or UMC, and Chartered Semiconductor Manufacturing Ltd., or Chartered Semiconductor, as well as the foundry services offered by some IDMs, such as IBM. We also compete with smaller semiconductor foundries in China, Korea, Malaysia and other countries. Some of our competitors have greater access to capital and substantially higher capacity, longer or more established relationships with their customers, superior research and development capability, and greater marketing and other resources than we do. As a result, these companies may be able to compete more aggressively over a longer period of time than we can.

Both TSMC and UMC have announced plans to establish operations in mainland China in order to compete for the growing domestic market in China. TSMC has announced the commencement of pilot production at its fab in China, and UMC has established a relationship with a fab in commercial production in China. We understand that the ability of these fabs to manufacture wafers using certain more advanced technologies is subject to restrictions by the home jurisdiction of TSMC and UMC. Such restrictions could be reduced or lifted at any time, which may lead to increased domestic competition with such competitors and adversely affect our business and operating results.

Our ability to compete successfully depends to some extent upon factors outside of our control, including import and export controls, exchange controls, exchange rate fluctuations, interest rate fluctuations and political developments. If we cannot compete successfully in our industry and are unable to maintain our position as a leading foundry in China, our results of operations and financial condition will be adversely affected.

***We may be unable to obtain in a timely manner and at a reasonable cost the equipment necessary for our business and therefore may be unable to achieve our expansion plans or meet our customers' orders, which could negatively impact our competitiveness, financial condition and results of operations.***

The semiconductor industry is capital-intensive and requires investment in advanced equipment that is available from a limited number of manufacturers. The market for equipment used in semiconductor foundries is characterized, from time to time, by significant demand, limited supply and long delivery cycles. Our business plan depends upon our ability to obtain our required equipment in a timely manner and at acceptable prices. During times of significant demand for the types of equipment we use, lead times for delivery can be as long as one year. Shortages of equipment could result in an increase in equipment prices and longer delivery times. If we are unable to obtain equipment in a timely manner and at a reasonable cost, we may be unable to achieve our expansion plans or meet our customers' orders, which could negatively impact our competitiveness, financial condition and results of operations.

***We expect to have an ongoing need to obtain licenses for the proprietary technology of others, which subjects us to the payment of license fees and potential delays in the development and marketing of our products.***

While we continue to develop and pursue patent protection for our own technologies, we expect to continue to rely on third party license arrangements to enable us to manufacture certain advanced wafers. As of December 31, 2004, we had been granted twenty-three patents, twenty-one in Taiwan and two in the U.S., whereas we believe our competitors and other industry participants have been issued numerous patents concerning wafer fabrication in multiple jurisdictions. Our limited patent portfolio may in the future adversely affect our ability to obtain licenses to the proprietary technology of others on favorable license terms due to our inability to offer cross-licensing arrangements. The fees associated with such licenses could adversely affect our financial condition and operating results. They might also render our services less competitive. If for any reason we are unable to license necessary technology on acceptable terms, it may become necessary for us to develop alternative technology internally, which could be costly and delay the marketing and delivery of key products and therefore have an adverse effect on our business and operating results. In addition, we may be unable to independently develop the technology required by our customers on a timely basis or at all, in which case our customers may purchase wafers from our competitors.

***We may be subject to claims of intellectual property rights infringement owing to the nature of our industry, our limited patent portfolio and limitations of the indemnification provisions in our technology license agreements. These claims could adversely affect our business and operating results.***

There is frequent intellectual property litigation, involving patents, copyrights, trade secrets, mask works and other intellectual property subject matter, in our industry. In some cases, a company can avoid or settle litigation on favorable terms because it possesses patents that can be asserted against the plaintiff. The limited size of our current patent portfolio will not likely place us in such a bargaining position. Moreover, some of our technology license agreements with our major technology partners do not provide for us to be indemnified in the event that the processes we license pursuant to such agreements infringe third party intellectual property rights. We could be sued for allegedly infringing one or more patents as to which we will be unable to obtain a license and unable to design around. As a result, we would be foreclosed from manufacturing or selling the products which are dependent upon such technology, which could have a material adverse effect on our business. We may litigate the issues of whether these patents are valid or infringed, but in the event of a loss we could be required to pay substantial monetary damages and be enjoined from further production or sale of such products.

***If we breach the terms and conditions of the settlement agreement regarding the patent and trade secret litigation with TSMC, we may be required to accelerate the payment of the then outstanding amounts due under the settlement agreement and the litigation proceedings may be recommenced or re-filed. If the litigation is recommenced and we are unable to successfully defend ourselves, we may be required to pay damages, obtain a license from TSMC or discontinue sales of certain of our products in the United States.***

In December 2003, we became the subject of a lawsuit in 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 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 federal district court on the same 3 patents as alleged in the ITC complaint. Prior to the start of the initial lawsuit in the United States, TSMC had instituted a legal proceeding in Taiwan in January 2002 that alleged improper hiring practices and trade secret misappropriation. In the Taiwan proceeding, the Hsinchu District Court in Taiwan issued an ex parte provisional injunction that prohibits our wholly owned subsidiary, Semiconductor Manufacturing International (Shanghai) Corporation, or SMIC Shanghai, and Richard Ru Gin Chang, our president and chief executive officer, from improperly soliciting or hiring certain categories of employees of TSMC or causing such employees to divulge to us, or use, trade secrets of TSMC.

On January 31, 2005, we entered into a settlement agreement with TSMC that provides for the dismissal of all pending legal actions without prejudice between TSMC and our company in U.S. federal district court, California State Superior Court, the ITC and Taiwan District Court. In the settlement agreement, TSMC covenants not to sue us 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 will license the other party’s patent portfolio through December 2010. As a part of the settlement, we also agreed to pay TSMC an aggregate amount of US\$175 million, in installments of US\$30 million each year for five years and US\$25 million in the sixth year.

The patent cross-license agreement and settlement agreement are terminable upon a breach of the settlement agreement by SMIC. Any such breach may result in the filing of a lawsuit relating to such breach, recommencement or re-filing of the legal proceedings and acceleration of the outstanding monetary payment obligations under the settlement agreement. If the legal proceedings were reinstated or refiled and TSMC were to succeed on its patent infringement claims in the United States, we may be ordered to pay damages for past infringement, discontinue sales of certain of our products in the United States and, as to future sales, either enter into a license agreement with TSMC or incur the cost of designing around the patents that were found to have been infringed, if any. If TSMC were to succeed on its trade secret claim, it could seek damages or an injunction, the materiality of which would depend on the amount, nature and significance of the trade secrets we would be found to have misappropriated, if any. The occurrence of any of these events could have a material adverse effect on our business and operating results and, in any event, the cost of litigation could be substantial.

***If our relationships with our technology partners deteriorate or we are unable to enter into new technology alliances, we may not be able to continue providing our customers with leading edge process technology, which could adversely affect our competitive position and operating results.***

Enhancing our process technologies is critical to our ability to provide high quality services for our customers. We intend to continue to advance our process technologies through internal research and development efforts and technology alliances with other companies. Although we have an internal research and development team focused on developing new process technologies, we depend upon our technology partners to advance our portfolio of process technologies. We currently have joint technology development arrangements and technology sharing arrangements with several companies and research institutes. If we are unable to continue our technology alliances with these entities, or maintain on mutually beneficial terms any of our other joint development arrangements, research and development alliances and other similar agreements, or are unable to enter into new technology alliances with other leading developers of semiconductor technology, we may not be able to continue providing our customers with leading edge process technology, which could adversely affect our competitive position and operating results.



***We may be unable to integrate successfully the Beijing fabs and Fab 7 with our existing operations in Shanghai in a timely manner, which could adversely affect our operating results.***

The ramp-up of our Beijing fabs and Fab 7 in Tianjin involve the integration of new facilities with our existing operations in Shanghai. These facilities are located in three different locations and have different operating configurations. We are currently in the process of implementing this integration.

The challenges of combining our Beijing and Tianjin fabs' operations with our Shanghai operations include integrating technologies with different wafer sizes, integrating personnel with diverse business backgrounds, combining different corporate cultures and managing a geographically dispersed organization. Since most of our Tianjin employees previously worked for Motorola (China) Electronics Limited ("MCEL"), it will require additional time for them to become familiar with our corporate culture and become fully integrated. Operating in three different locations also requires us to liaise with three different sets of local and municipal governmental authorities, which places additional administrative burdens on our management. In addition, we are currently in the process of obtaining the approval of the Chinese governmental authorities to defer our capital contribution to the registered capital of our wholly owned subsidiary Semiconductor Manufacturing International (Tianjin) Corporation, or SMIC Tianjin, until such time as the transfer of title to the land use rights, buildings and equipment of SMIC Tianjin has been approved by or registered with the relevant Chinese governmental authorities. If such approval to defer our capital contribution is not granted, the validity of SMIC Tianjin's certificate of approval under Chinese law could be affected, and SMIC Tianjin could be subject to various administrative sanctions, including the possible revocation of its business license.

As a result of these factors, we may be unable to complete successfully this integration in a timely manner, which could adversely affect our operating results.

***Our internal controls and management systems are not currently consistent with international practices in certain respects and we are in the process of improving these controls and systems to enable us to certify the effectiveness of our internal controls under the Sarbanes-Oxley Act of 2002. Our failure to timely and successfully upgrade these controls and systems could subject us to regulatory actions and affect the price of our ordinary shares and ADSs.***

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

We have engaged PricewaterhouseCoopers LLC as an outside consultant to review our current internal controls and assist us in implementing measures to comply with Section 404 of the Sarbanes-Oxley Act. Although we are not currently subject to Section 404, we have examined the definitions contained in PCAOB pronouncement. The PCAOB rules describe certain circumstances as being both significant deficiencies and strong indicators that a material weakness in internal control over financial reporting exists. PricewaterhouseCoopers has brought to our attention a number of areas in which our current internal controls and management systems may not reduce to a relatively low level the risk of undetected material errors or fraud and could adversely affect our ability to accurately and timely record, process, summarize and report financial data. We have taken and continue to take steps to correct these internal control deficiencies. The efficacy of the steps we have taken to date and the steps we are still in the process of taking to improve the reliability of our financial statements is subject to continued management review supported by confirmation and testing by our internal auditors, as well as audit committee oversight. We cannot be certain that these measures will ensure that we implement and maintain adequate controls over our financial processes and reporting in the future. Any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. In addition, we cannot assure you that we will not in the future identify further material weaknesses or significant deficiencies in our internal control over financial reporting that we have not discovered to date.

Beginning with the year ending December 31, 2006, pursuant to Section 404 of the Sarbanes-Oxley Act, our management will be required to deliver a report that assesses the effectiveness of our internal control over

financial reporting, and we will be required to deliver an attestation report of our auditors on our management's assessment of and operating effectiveness of internal controls. An inability to complete and document this assessment could result in a scope limitation qualification or a scope limitation disclaimer by our auditors on their attestation of our internal controls. If a material weakness were identified with respect to our internal control over financial reporting, we would not be able to conclude that our internal controls over financial reporting were effective, which could result in the inability of our external auditors to deliver an unqualified report, or any report, on our internal controls. Moreover, even if our management does conclude that our internal controls over financial reporting are effective, if as of the end of fiscal year 2006, our external auditors are not satisfied with our internal controls, the level at which our controls are documented, designed, operated or reviewed, or if our external auditors interpret the requirements, rules or regulations differently from us, then they may decline to attest to our management's assessment or may issue a report that is qualified. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our securities.

***Global or regional economic, political and social conditions could adversely affect our business and operating results.***

External factors such as potential terrorist attacks, acts of war, financial crises or geopolitical and social turmoil in those parts of the world that serve as markets for our products could significantly adversely affect our business and operating results in ways that cannot presently be predicted. These uncertainties could make it difficult for our customers and us to accurately plan future business activities. More generally, these geopolitical, social and economic conditions could result in increased volatility in worldwide financial markets and economies that could adversely impact our sales. We are not insured for losses and interruptions caused by terrorist acts or acts of war. Therefore, any of these events or circumstances could adversely affect our business and operating results.

***Exchange rate fluctuations could increase our costs, which could adversely affect our operating results and the value of our ADSs.***

Our financial statements are prepared in U.S. dollars. Our sales are generally denominated in U.S. dollars and our operating expenses and capital expenditures are generally denominated in U.S. dollars, Japanese Yen, Euros and Renminbi. Although we enter into foreign currency forward exchange contracts, we are still affected by fluctuations in exchange rates between the U.S. dollar and each of the Japanese Yen and the Euro. Any significant fluctuations among these currencies may lead to an increase in our costs, which could adversely affect our operating results. See “—Risks Related to Conducting Operations in China—Devaluation or appreciation in the value of the Renminbi or restrictions on convertibility of the Renminbi could adversely affect our business and operating results” for a discussion of risks relating to the Renminbi.

Fluctuations in the exchange rate of the Hong Kong dollar against the U.S. dollar will affect the U.S. dollar value of the ADSs, since our ordinary shares are listed and traded on the Hong Kong Stock Exchange and the price of such shares are denominated in Hong Kong dollars. While the Hong Kong government has continued to pursue a fixed exchange rate policy, with the Hong Kong dollar trading in the range of HK\$7.75 to HK\$7.85 per US\$1.00, we cannot assure you that such policy will be maintained. Exchange rate fluctuations also will affect the amount of U.S. dollars received upon the payment of any cash dividends or other distributions paid in Hong Kong dollars and the Hong Kong dollar proceeds received from any sales of ordinary shares. Therefore, such fluctuations could also adversely affect the value of our ADSs.

***Our earnings may be adversely affected once we change our accounting policies with respect to the expensing of stock options.***

We currently account for share-based compensation transactions, such as stock option grants, using the intrinsic value method (based on the discount to fair market value on the date of grant) as prescribed by Accounting Principles Board, or APB, Opinion No. 25, *Accounting for Stock Issued to Employees*. On December 16, 2004, the Financial Accounting Standards Board, FASB, issued FAS 123R, *Share-Based Payment, an amendment of FASB Statements No. 123 and 95*, which, as amended in April 2005, requires that such transactions be accounted for using a fair value based method and recognized as expenses in our consolidated statement of income, effective as of the start of our fiscal reporting period commencing after June 15, 2005, the effective date. FAS 123R requires that a

modified prospective method be used to account for share-based compensation transactions. Under FAS 123R, we will be required to expense the fair value of our stock option grants rather than expensing the intrinsic value of stock options as we do now. This means that the fair value of new awards granted on or after the effective date (plus unvested awards as of the effective date) will be expensed over the remaining vesting period. This change in the accounting policy with respect to the treatment of employee stock option grants may adversely affect our earnings and may have a significant impact on our consolidated statement of income.

***Implementation of FAS 123R may result in inconsistent financial disclosure.***

Under FAS 123R, we have the option of adopting a modified retrospective application. This means that we generally may restate previously reported financial results so that our results reflect a consistent treatment of share-based compensation transactions, regardless of the accounting rules that were in effect at the time of the initial report. If we decide to adopt a modified retrospective application of FAS 123R, our previously reported financial results may be significantly affected. If we decide not to adopt a modified retrospective application, or if we adopt a modified retrospective application commencing with the start of our 2006 fiscal year, our financial performance for periods when FAS 123R accounting is not applied will not be comparable with the performance for periods when FAS 123R accounting is applied. If a comparison is made, performance for periods when FAS 123R is applied may appear to be significantly below performance for earlier periods.

In addition, under FAS 123R we have the option of selecting an appropriate option pricing model. For purposes of pro forma disclosure under the provisions of FAS 123, we currently use a Black-Scholes option pricing model. FAS 123R expresses a preference for a lattice model. In the event we choose to use a lattice model, previously reported pro forma disclosure and future share-based compensation reporting will be inconsistent.

**Risks Related to Manufacturing**

***Our manufacturing processes are highly complex, costly and potentially vulnerable to impurities and other disruptions, which could significantly increase our costs and delay product shipments to our customers.***

Our manufacturing processes are highly complex, require advanced and costly equipment, demand a high degree of precision and may have to be modified to improve yields and product performance. Dust and other impurities, difficulties in the fabrication process or defects with respect to the equipment or facilities used can lower yields, cause quality control problems, interrupt production or result in losses of products in process. As system complexity has increased and process technology has become more advanced, manufacturing tolerances have been reduced and requirements for precision have become even more demanding. As a result, we may experience production difficulties, which could significantly increase our costs and delay product shipments to our customers.

***We may have difficulty in ramping up production, which could cause delays in product deliveries and loss of customers and adversely affect our business and operating results.***

As is common in the semiconductor industry, we may experience difficulty in ramping up production at new or existing facilities, such as Fab 4, Fab 5 and Fab 6C in Beijing and Fab 7 in Tianjin in which we expect to add a significant amount of new equipment. This could be due to a variety of factors, including hiring and training of new personnel, implementing new fabrication processes, recalibrating and requalifying existing processes and the inability to achieve required yield levels.

In the future, we may face construction delays or interruptions, infrastructure failure, or delays in upgrading or expanding existing facilities or changing our process technologies, which may adversely affect our ability to ramp up production in accordance with our plans. Our failure to ramp up our production on a timely basis could cause delays in product deliveries, which may result in the loss of customers and sales. It could also prevent us from recouping our investments in a timely manner or at all, and adversely affect our business and operating results.

***We have announced agreements to form joint ventures that, if not successful, may adversely impact our business and operating results.***

In July 2004, we announced an agreement with Toppan Printing Co., Ltd., to establish Toppan SMIC Electronics (Shanghai) Co., Ltd., a joint venture in Shanghai, to manufacture color filters and micro-lenses for CMOS image sensors. In May 2005, we announced an agreement with United Test and Assembly Center Ltd. to establish a joint venture in Chengdu to provide assembly and testing services for memory and logic devices.

The results of the joint ventures may be reflected in our operating results to the extent of our ownership interest, and losses of the joint ventures could adversely impact our operating results. Operational challenges confront the joint ventures. Integration of assets and operations being contributed by each partner will involve complex activities that must be completed in a short period of time. The new joint ventures are likely to confront numerous challenges in commencing their operations and operating successfully. The business of the joint ventures will be subject to operational risks that would normally arise for these types of businesses pertaining to manufacturing, sales, service, marketing, and corporate functions. Competition in the CMOS image sensor market and semiconductor assembly and testing industry will involve challenges from numerous, well-established companies with substantial resources and significant market share.

If the joint ventures are not successful or less successful than we anticipate, we may incur higher costs for performing assembly and testing services through our current partners or for manufacturing color filters and micro-lenses, which typically require mature technologies and thus command a lower wafer price and generate lower margins, at our existing fabs. Either result may adversely affect our business and operating results.

***If we are unable to obtain raw materials and spare parts in a timely manner, our production schedules could be delayed and our costs could increase.***

We depend on suppliers of raw materials, such as silicon wafers, gases and chemicals, and spare equipment parts, in order to maintain our production processes. To maintain operations, we must obtain from our suppliers sufficient quantities of quality raw materials and spare equipment parts at acceptable prices and in a timely manner. The most important raw material used in our production is silicon in the form of raw wafers. We currently purchase approximately 69.5% of our overall raw wafer requirements from our top three raw wafer suppliers. In addition, a portion of our gas and chemical requirements currently must be sourced from outside China. We may not be able to obtain adequate supplies of raw materials and spare parts in a timely manner and at a reasonable cost. In addition, from time to time, we may need to reject raw materials and parts that do not meet our specifications, resulting in potential delays or declines in output. If the supply of raw materials and necessary spare parts is substantially reduced or if there are significant increases in their prices, we may incur additional costs to acquire sufficient quantities of these parts and materials to maintain our production schedules and commitments to customers.

***Our production may be interrupted, limited or delayed if we cannot maintain sufficient sources of fresh water and electricity, which could adversely affect our business and operating results.***

The semiconductor fabrication process requires extensive amounts of fresh water and a stable source of electricity. As our production capabilities increase and our business grows, our requirements for these factors will grow substantially. While we have not, to date, experienced any instances of lack of sufficient supplies of water or material disruptions in the electricity supply to any of our fabs, we may not have access to sufficient supplies of water and electricity to accommodate our planned growth. Droughts, pipeline interruptions, power interruptions, electricity shortages or government intervention, particularly in the form of rationing, are factors that could restrict our access to these utilities in the areas in which our fabs are located. In particular, our Fab 7 in Tianjin and our fabs in Beijing are located in areas that are susceptible to severe water shortages during the summer months. If there is an insufficient supply of fresh water or electricity to satisfy our requirements, we may need to limit or delay our production, which could adversely affect our business and operating results. In addition, a power outage, even of very limited duration, could result in a loss of wafers in production and a deterioration in yield.

***We are subject to the risk of damage due to fires or explosions because the materials we use in our manufacturing processes are highly flammable. Such damage could temporarily reduce our manufacturing capacity, thereby adversely affecting our business and operating results.***

We use highly flammable materials such as silane and hydrogen in our manufacturing processes and are therefore subject to the risk of loss arising from explosions and fires. While we have not, to date, experienced any explosion or fire due to the nature of our raw materials, the risk of explosion and fire associated with these materials cannot be completely eliminated. Although we maintain comprehensive fire insurance and insurance for loss of property and loss of profit resulting from business interruption, our insurance coverage may not be sufficient to cover all of our potential losses due to an explosion or fire. If any of our fabs were to be damaged or cease operations as a result of an explosion or fire, it would temporarily reduce our manufacturing capacity, which could adversely affect our business and operating results.

***Our Beijing fabs are located in an area that is susceptible to seasonal dust storms, which could create impurities in the production process at these facilities and require us to take additional measures or spend additional capital to further insulate these fabs from dust, thereby adversely affecting our business and operating results.***

The location of our fabs in Beijing makes them susceptible to seasonal dust storms, which could cause dust particles to enter the buildings and affect the production process. Although we are constructing precautionary filtration systems, these may not adequately insulate the fabs against dust contamination. If dust were to affect production in the Beijing fabs, we could experience quality control problems, losses of products in process and delays in shipping products to our customers. In addition, we may have to spend additional capital to further insulate the Beijing fabs from dust if our current precautionary measures are insufficient. The occurrence of any of these events could adversely affect our business and operating results.

***Our operations may be delayed or interrupted and our business could suffer as a result of steps we may be required to take in order to comply with environmental regulations.***

We are subject to a variety of Chinese environmental regulations relating to the use, discharge and disposal of toxic or otherwise hazardous materials used in our production processes. Any failure or any claim that we have failed to comply with these regulations could cause delays in our production and capacity expansion and affect our company's public image, either of which could harm our business. In addition, any failure to comply with these regulations could subject us to substantial fines or other liabilities or require us to suspend or adversely modify our operations.

#### **Risks Related to Conducting Operations in China**

***Our business is subject to extensive government regulation and benefits from certain government incentives, and changes in these regulations or incentives could adversely affect our business and operating results.***

The Chinese government has broad discretion and authority to regulate the technology industry in China. China's government has also implemented policies from time to time to regulate economic expansion in China. The economy of China has been transitioning from a planned economy to a market-oriented economy. Although in recent years the Chinese government has implemented measures emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, a substantial portion of productive assets in China is still owned by the Chinese government. In addition, the Chinese government continues to play a significant role in regulating industrial development. It also exercises significant control over China's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. New regulations or the readjustment of previously implemented regulations could require us to change our business plan, increase our costs or limit our ability to sell products and conduct activities in China, which could adversely affect our business and operating results.

In addition, the Chinese government and provincial and local governments have provided, and continue to provide, various incentives to domestic companies in the semiconductor industry, including our company, in order to encourage development of the industry. Such incentives include tax rebates, reduced tax rates, favorable lending policies and other measures. Any of these incentives could be reduced or eliminated by governmental authorities at any time. For example, in 2004, the Chinese government announced that by April 1, 2005, the preferential value-added tax policies, which previously entitled certain qualified companies to receive a refund of the amount exceeding 3% of the actual value-added tax burden relating to self-made integrated circuit product sales, would be

eliminated. While we have not previously benefited materially from such preferential value-added tax policies, any reduction or elimination of other incentives currently provided to us could adversely affect our business and operating results.

***Because our business model depends on growth in the electronics manufacturing supply chain in China, any slowdown in this growth could adversely affect our business and operating results.***

Our business is dependent upon the economy and the business environment in China. In particular, our growth strategy is based upon the assumption that demand in China for devices that use semiconductors will continue to grow. Therefore, any slowdown in the growth of consumer demand in China for products that use semiconductors, such as computers, mobile phones or other consumer electronics, could have a serious adverse effect on our business. In addition, our business plan assumes that an increasing number of non-domestic IDMs, fabless semiconductor companies and systems companies will establish operations in China. Any decline in the rate of migration to China of semiconductor design companies or companies that require semiconductors as components for their products could adversely affect our business and operating results.

***Limits placed on exports into China could substantially harm our business and operating results.***

The growth of our business will depend on the ability of our suppliers to export, and our ability to import, equipment, materials, spare parts, process know-how and other technologies and hardware into China. Any restrictions placed on the import and export of these products and technologies could adversely impact our growth and substantially harm our business. In particular, the United States requires our suppliers and us to obtain licenses to export certain products, equipment, materials, spare parts and technologies from that country. If we or our suppliers are unable to obtain export licenses in a timely manner, our business and operating results could be adversely affected.

In July 1996, thirty-three countries ratified the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies, which established a worldwide arrangement to restrict the transfer of conventional arms and dual-use goods and technologies. Under the terms of the Wassenaar Arrangement, the participating countries, including the United States, have restricted exports to China of technology, equipment, materials and spare parts that potentially may be used for military purposes in addition to their commercial applications. To the extent that technology, equipment, materials or spare parts used in our manufacturing processes are or become subject to the restrictions of the arrangement, our ability to procure these products and technology could be impaired, which could adversely affect our business and operating results. There could also be a change in the export license regulatory regime in the countries from which we purchase our equipment, materials and spare parts that could delay our ability to obtain export licenses for the equipment, materials, spare parts and technology we require to conduct our business.

***Devaluation or appreciation in the value of the Renminbi or restrictions on convertibility of the Renminbi could adversely affect our business and operating results.***

The value of the Renminbi is subject to changes in China's governmental policies and to international economic and political developments. Since 1994, the conversion of Renminbi into foreign currencies, including Hong Kong and U.S. dollars, has been based on rates set by the People's Bank of China, which are set daily based on the previous day's interbank foreign exchange market rates and current exchange rates on the world financial markets. The Renminbi to U.S. dollar exchange rate experienced significant volatility prior to 1994, including periods of sharp devaluation, and the Chinese government remains under international pressure to allow this rate to float. The exchange rate may become volatile and the Renminbi may be devalued again against the U.S. dollar or other currencies, or the Renminbi may be permitted to enter into a full or limited free float, which may result in an appreciation in the value of the Renminbi against the U.S. dollar, any of which could have an adverse affect on our business and operating results.

In the past, financial markets in many Asian countries have experienced severe volatility and, as a result, some Asian currencies have experienced significant devaluation from time to time. The devaluation of some Asian currencies may have the effect of rendering exports from China more expensive and less competitive and therefore place pressure on China's government to devalue the Renminbi. An appreciation in the value of the Renminbi could

have a similar effect. Any devaluation of the Renminbi could result in an increase in volatility of Asian currency and capital markets. Future volatility of Asian financial markets could have an adverse impact on our ability to expand our product sales into Asian markets outside of China.

We receive a portion of our sales in Renminbi, which is currently not a freely convertible currency. For the year ended December 31, 2003, approximately 2.0% of our sales were denominated in Renminbi, while approximately 1.7 % of our sales were denominated in Renminbi for the year ended December 31, 2004. While we have used these proceeds for the payment of our Renminbi expenses, we may in the future need to convert these sales into foreign currencies to allow us to purchase imported materials and equipment, particularly as we expect the proportion of our sales to China-based companies to increase in the future. Under China's existing foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade may be made in foreign currencies without government approval, except for certain procedural requirements. The Chinese government may, however, at its discretion, restrict access in the future to foreign currencies for current account transactions and prohibit us from converting our Renminbi sales into foreign currencies. If this were to occur, we might not be able to meet our foreign currency payment obligations.

***China's entry into the World Trade Organization has resulted in lower Chinese tariff levels, which benefit our competitors from outside China and could adversely affect our business and operating results.***

As a result of joining the World Trade Organization, or WTO, China has reduced its average rate of import tariffs to 11.5% in 2003 and will further reduce it to 10% by 2008. The import tariff for some information technology-related products has been reduced to zero. As a consequence, we expect stronger competition in China from our foreign competitors, particularly in terms of product pricing, which could adversely affect our business and operating results.

***China's legal system embodies uncertainties that could adversely affect our business and operating results.***

Since 1979, many new laws and regulations covering general economic matters have been promulgated in China. Despite this activity to develop the legal system, China's system of laws is not yet complete. Even where adequate law exists in China, enforcement of existing laws or contracts based on existing law may be uncertain and sporadic, and it may be difficult to obtain swift and equitable enforcement or to obtain enforcement of a judgment by a court of another jurisdiction. The relative inexperience of China's judiciary in many cases creates additional uncertainty as to the outcome of any litigation. In addition, interpretation of statutes and regulations may be subject to government policies reflecting domestic political changes.

Our activities in China will be subject to administrative review and approval by various national and local agencies of China's government. See "Item 4—Information on the Company—Regulation." Because of the changes occurring in China's legal and regulatory structure, we may not be able to secure the requisite governmental approval for our activities. Failure to obtain the requisite governmental approval for any of our activities could adversely affect our business and operating results.

***Our corporate structure may restrict our ability to receive dividends from, and transfer funds to, our Chinese operating subsidiaries, which could restrict our ability to act in response to changing market conditions and reallocate funds from one Chinese subsidiary to another in a timely manner.***

We are a Cayman Islands holding company and substantially all of our operations are conducted through our Chinese operating subsidiaries, SMIC Shanghai, Semiconductor Manufacturing International (Beijing) Corporation, or SMIC Beijing, and SMIC Tianjin. The ability of these subsidiaries to make dividend and other payments to us may be restricted by factors that include changes in applicable foreign exchange and other laws and regulations. In particular, under Chinese law, these operating subsidiaries may only pay dividends after 10% of their net profit has been set aside as reserve funds, unless such reserves have reached at least 50% of their respective registered capital. In addition, the profit available for distribution from our Chinese operating subsidiaries is determined in accordance with generally accepted accounting principles in China. This calculation may differ from one performed in accordance with U.S. GAAP. As a result, we may not have sufficient distributions from our Chinese subsidiaries to enable necessary profit distributions to us or any distributions to our shareholders in the future, which calculation would be based upon our financial statements prepared under U.S. GAAP.

Distributions by our Chinese subsidiaries to us other than as dividends may be subject to governmental approval and taxation. Any transfer of funds from our company to our Chinese subsidiaries, either as a shareholder loan or as an increase in registered capital, is subject to registration or approval of Chinese governmental authorities, including the relevant administration of foreign exchange and/or the relevant examining and approval authority. In addition, it is not permitted under Chinese law for our Chinese subsidiaries to directly lend money to each other. Therefore, it is difficult to change our capital expenditure plans once the relevant funds have been remitted from our company to our Chinese subsidiaries. These limitations on the free flow of funds between us and our Chinese subsidiaries could restrict our ability to act in response to changing market conditions and reallocate funds from one Chinese subsidiary to another in a timely manner.

### **Risks Related to Ownership of Our Shares and ADSs and Our Trading Markets**

#### ***Future sales of securities by us or our shareholders may decrease the value of your investment.***

Future sales by us or our existing shareholders of substantial amounts of our ordinary shares or ADSs in the public markets could adversely affect market prices prevailing from time to time. In connection with our global offering, we entered into an amended and restated registration rights agreement with Richard Ru Gin Chang and our securityholders prior to our global offering. Under the terms of this agreement, every 180-day period, substantially all of our securityholders that beneficially own, directly or indirectly and whether individually or as a group with its affiliates, more than 7,500,000 of our ordinary shares immediately prior to the global offering, whom we collectively refer to as our large securityholders, may sell 15% of the shares held by such large securityholder immediately prior to the completion of the global offering in an annual, demand or incidental offering or without our consent in the open market or in privately negotiated transactions. We refer to the shares sold as released shares and these sales as permitted sales/transfers. The 15% limit for each 180-day period is cumulative, such that if any large securityholder does not sell or transfer the 15% released shares from a previous 180-day period, any unsold or non-transferred released shares will roll over and may be sold or transferred at any time in the future, together with all other accumulated released shares from previous periods.

In addition, we have entered into an agreement with each of Motorola and MCEL, which are deemed to be large securityholders under the amended and restated registration rights agreement, pursuant to which we have consented to release from the monetization restrictions described above an additional 15% of the shares they each held immediately prior to the completion of the global offering commencing on the date of expiration of the 180-day post-global offering lock-up period and an additional 15% every 180 days thereafter.

Like the 15% limit for each 180-day period applicable to other large securityholders, such 30% limit applicable to Motorola and MCEL is cumulative. In addition, such additional released shares may only be sold or transferred by Motorola or MCEL pursuant to the same terms and conditions applicable to the sale or transfer of their released shares under the amended and restated registration rights agreement. In addition, to the extent that at any time during the term of the amended and restated registration rights agreement we increase the percentage of released shares that may be transferred or sold by any large securityholder who holds more than 1% of our outstanding shares (on a pre-global offering basis) to more than the percentage of released shares that may be transferred or sold by Motorola and MCEL (regardless of whether or not Motorola or MCEL actually sold any released shares), we have consented to increase the percentage of released shares for Motorola and MCEL to match the increased percentage for such large securityholder. We have also agreed with each of Motorola and MCEL that we will not consent to any amendment or waiver of any provision of the amended and restated registration rights agreement that adversely affects either Motorola or MCEL but does not so adversely affect all other parties to the amended and restated registration rights agreement unless such amendment or waiver is approved in writing by Motorola.

An example of a permitted sale pursuant to the terms of the amended and restated registration rights agreement and the agreement we signed with Motorola was the reported sale on or about February 28, 2005 by Motorola and MCEL of an aggregate of 517,489,221 of our ordinary shares, representing approximately 2.8% of our total outstanding shares as of December 31, 2004. Subsequent to the completion of this permitted sale, our price per ordinary share decreased by HK\$0.06.



We cannot predict the effect, if any, of a permitted sale or the perception that a permitted sale will occur, on the market price for our ordinary shares or ADSs.

***Holders of our ADSs will not have the same voting rights as the holders of our shares and may not receive voting materials in time to be able to exercise their right to vote.***

Holders of our ADSs may not be able to exercise voting rights attaching to the shares evidenced by our ADSs on an individual basis. Holders of our ADSs have appointed the depository or its nominee as their representative to exercise the voting rights attaching to the shares represented by the ADSs. You may not receive voting materials in time to instruct the depository to vote, and it is possible that you, or persons who hold their ADSs through brokers, dealers or other third parties, will not have the opportunity to exercise a right to vote.

***You may not be able to participate in rights offerings and may experience dilution of your holdings as a result.***

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. Under the deposit agreement for the ADSs, the depository will not offer those rights to ADS holders unless both the rights and the underlying securities to be distributed to ADS holders are either registered under the Securities Act or exempt from registration under the Securities Act with respect to all holders of ADSs. We are under no obligation to file a registration statement with respect to any such rights or underlying securities or to endeavor to cause such a registration statement to be declared effective. In addition, we may not be able to take advantage of any exemptions from registration under the Securities Act. Accordingly, holders of our ADSs may be unable to participate in our rights offerings and may experience dilution in their holdings as a result.

***The laws of the Cayman Islands and China may not provide our shareholders with benefits provided to shareholders of corporations incorporated in the United States.***

Our corporate affairs are governed by our memorandum and articles of association, by the Companies Law (2004 Revision) and the common law of the Cayman Islands. The rights of shareholders to take action against our directors, actions by minority shareholders and the fiduciary responsibilities of our directors to us under Cayman Islands law are to a large extent governed by the common law of the Cayman Islands. The common law in the Cayman Islands is derived in part from comparatively limited judicial precedent in the Cayman Islands and from English common law, the decisions of whose courts are of persuasive authority but are not binding on a court in the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedents in the United States. In particular, the Cayman Islands has a less developed body of securities laws as compared to the United States. Therefore, our public shareholders may have more difficulty protecting their interests in the face of actions by our management, directors or controlling shareholders than would shareholders of a corporation incorporated in a jurisdiction in the United States. In addition, Cayman Islands companies may not have standing to initiate a shareholder derivative action before the federal courts of the United States.

***It may be difficult for you to enforce any judgment obtained in the United States against our company, which may limit the remedies otherwise available to our shareholders.***

Substantially all of our assets are located outside the United States. Almost all of our current operations are conducted in China. Moreover, a number of our directors and officers are nationals or residents of countries other than the United States. All or a substantial portion of the assets of these persons are located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon these persons. In addition, there is uncertainty as to whether the courts of the Cayman Islands or China would recognize or enforce judgments of United States courts obtained against us or such persons predicated upon the civil liability provisions of the securities law of the United States or any state thereof, or be competent to hear original actions brought in the Cayman Islands or China, respectively, against us or such persons predicated upon the securities laws of the United States or any state thereof. See “Item 4—Information on the Company—Business Overview—Enforceability of Civil Liabilities.”

## **Item 4. Information on the Company**

### **History and Development of the Company**

We were established as an exempted company under the laws of the Cayman Islands on April 3, 2000. Our legal name is Semiconductor Manufacturing International Corporation. Our principal place of business is 18 Zhangjiang Road, Pudong New Area, Shanghai, China 201203, telephone number: (86) 21-5080-2000. Our registered agent is M&C Corporate Services Limited, located at P.O. Box 309 GT, Uglund House, South Church Street, George Town, Grand Cayman, Cayman Islands. After several rounds of equity funding with venture capitalists and other strategic investors, with total funds invested amounting to approximately US\$1.7 billion, we completed the global offering of our ADSs and ordinary shares on the New York Stock Exchange and the Stock Exchange of Hong Kong in March 2004. We raised an aggregate of US\$1,017 million in the global offering. We have been listed on the New York Stock Exchange under the symbol “SMI” and the Stock Exchange of Hong Kong under the stock code “0981.”

We were founded by Dr. Richard Ru Gin Chang, our Chairman, Chief Executive Officer and President, who has more than 26 years of experience in the semiconductor industry. In August 2000, we started construction of our first fab, which we refer to as Fab 1, in the Zhangjiang High-Tech Park in Shanghai and commenced pilot production in September 2001. We achieved internal qualification of our 0.18 micron CMOS logic at Fab 1 in December 2001. Our Fab 1 and Fab 3B-A commenced commercial production in January 2002 and our Fab 2 and Fab 3B-C commenced commercial production in January 2003. Fab 3B-A and Fab 3B-C constitute the two halves of our Fab 3B, with Fab 3B-A providing aluminum interconnects and Fab 3B-C providing copper interconnects. Fab 2 and Fab 3B are also located in the Zhangjiang High-Tech Park. In January 2004, we completed the acquisition of our Fab 7, an 8-inch wafer fab located in the Xiqing Economic Development Area in Tianjin, China, and commenced mass production in May 2004. We commenced construction in the Beijing Economic and Technological Development Area of our Fab 4, which is China’s first 12-inch fab and our fifth fab overall, in December 2002 and commenced commercial production at that fab in March 2005. We are also constructing two additional 12-inch fabs in Beijing, which we refer to as Fab 5 and Fab 6C. We have entered into an agreement with Toppan Printing Co., Ltd., to establish Toppan SMIC Electronics (Shanghai) Co., Ltd., to manufacture color filters and micro-lenses for CMOS image sensors and a joint venture agreement with United Test and Assembly Center Ltd. to provide assembly and testing services in Chengdu focusing on memory and logic devices. We maintain operations in Japan, Europe and the United States to perform marketing-related activities.

The foundry industry requires a significant amount of capital expenditures in order to construct, equip and ramp up fabs. We incurred capital expenditures of US\$897 million, US\$492 million and US\$2,000 million in 2002, 2003 and 2004, respectively, for these purposes. We anticipate that in 2005, we will incur US\$1,000 million of capital expenditures to expand our operations at our existing fabs and complete the construction, equipping and ramp-up of our Fab 4 in Beijing. If our operating cash flows are insufficient, we plan to fund the expected shortfall through bank loans. If necessary, we will also explore other forms of external financing.

Our fabs had an aggregate capacity as of December 31, 2004 of 102,615 8-inch wafer equivalents per month for wafer fabrication and 17,802 wafers per month for copper interconnects. We anticipate that as of the end of 2005, we will have an aggregate capacity of 147,000 8-inch wafer equivalents per month.

For additional information, see “Item 5—Operating and Financial Review and Prospects—Factors that Impact Our Results of Operations—Substantial Capital Expenditures” and “—Capacity Expansion.”

### **Business Overview**

We are one of the leading semiconductor foundries in the world. We operate three 8-inch wafer fabrication facilities in the Zhangjiang High-Tech Park in Shanghai, China, an 8-inch wafer fab in Tianjin, China and a 12-inch wafer fab in the Beijing Economic and Technological Development Area in Beijing, China. These fabs had an aggregate capacity as of December 31, 2004 of 102,615 8-inch wafer equivalents per month for wafer fabrication and 17,802 wafers per month for copper interconnects, which positions us as the leading foundry in China. In addition, we are currently constructing two additional 12-inch fabs in Beijing and three additional 8-inch fabs in Shanghai.

We currently provide semiconductor fabrication services using 0.35 micron to 0.10 micron process technology for the following devices:

- logic technologies, including standard logic, mixed-signal, RF and high voltage circuits;
- memory technologies, including DRAM, SRAM, Flash, and EEPROM; and
- specialty technologies, including LCoS, and CIS.

We also have developed internally a 90 nanometer prototype SRAM chip. We expect to commercially offer manufacturing services using 90 nanometer process technology to our customers in 2005.

In addition to wafer fabrication, our service offerings include a comprehensive portfolio of intellectual property consisting of libraries and circuit design blocks, design support, mask-making, wafer probing, gold/solder bumping and redistribution layer manufacturing. We also work with our partners to provide assembly and testing services.

We have a global and diversified customer base that includes some of the world's leading IDMs and fabless semiconductor companies.

## **Our Industry**

### ***The Semiconductor Industry***

Since the invention of the first semiconductor transistor in 1948, integrated circuits have become critical components in an increasingly broad range of electronics applications, including personal computers, wired and wireless communications equipment, televisions, consumer electronics and automotive and industrial control applications. Advancements in semiconductor design techniques and process technologies have allowed for the mass production of increasingly smaller and more powerful semiconductor devices at lower costs. This has resulted in the availability and proliferation of more complex integrated circuits with higher functionality. These integrated circuits may now each contain up to many millions of transistors.

The key raw material for a semiconductor foundry is a "raw wafer," which is a circular silicon plate. Raw wafers are available in different diameters (e.g., 5-inch, 6-inch, 8-inch or 12-inch) to meet the capabilities of different equipment. A fab capable of manufacturing integrated circuits on an 8-inch raw wafer is commonly described as an 8-inch fab. A raw wafer with a larger diameter has a greater surface area and consequently yields a greater number of integrated circuit dies. One method that foundries attempt to use to maintain their competitiveness is to increase the diameter of the wafers they use in manufacturing, such as the recent trend toward developing 12-inch wafers, each of which has approximately 2.25 times the number of gross dies achievable on an 8-inch wafer. IC Insights estimates that foundries with 12-inch facilities are expected to realize economies of scale from the increased number of dies per wafer and yield a manufacturing cost savings of approximately 30% on a per square centimeter basis once they enter into volume production. In addition, since 12-inch fabs have been constructed more recently, the equipment used in these fabs permits smaller line-width process technologies to be utilized. However, this equipment is more expensive than equipment for the fabrication of 8-inch wafers as the market for this equipment is less mature with fewer suppliers and the technology involved is more complex.

Process technologies are the set of specifications and parameters implemented for manufacturing the circuitry on integrated circuits. The transistor circuitry on an integrated circuit typically follows lines that are less than one micron wide (1/1,000,000 of a meter). The linewidths of the circuitry, or the minimum physical dimensions of the transistor gate of integrated circuits in production, is used as a general rule for classifying generations of process technology of integrated circuits. Progress in the advancement of the integrated circuit has been driven by the scaling, or downsizing, of its components, primarily the transistors. By systematically shrinking the size of the transistors, the number of allowable transistors per die increases, and thus the number of dies on a given wafer, has also increased. Our current process technology ranges from 0.35 micron to 0.10 micron.

### ***Importance of Integrated Circuits for China's Domestic Market and Its Emergence as a Global Electronics Manufacturing Center***

China has emerged as a global manufacturing center for electronic products that are sold both within China and abroad. In recent years, numerous international companies have established facilities in China for the manufacture of a variety of electronic products, including household appliances, computers, mobile phones, telecommunications equipment, digital consumer products and products with industrial applications. An increasing number of electronic systems manufacturers, such as Flextronics and Solectron, are relocating production facilities from the United States, Taiwan, Southeast Asia and Mexico to China. China is establishing itself as a favorable manufacturing location due to its well educated labor force, significantly lower costs of operations, large domestic market for semiconductors and cultural similarities and geographical proximity to Japan, Hong Kong, Taiwan, Singapore and Korea, among other factors. According to International Finance Corporation, the private investment arm of the World Bank, US\$46 billion, or 77%, of emerging markets production growth through 2005 will be attributable to China, at which point China would become the world's third largest manufacturing region behind North America and Japan. Such production growth represents additional potential demand for semiconductors manufactured in China. We believe that these electronics manufacturers will be likely to source a greater portion of their demand for integrated circuits from domestic integrated circuit suppliers in order to reduce production cycle time, lower costs, simplify supply chain logistics and meet local content requirements.

### ***Increasing Importance of the Semiconductor Foundry Industry***

As the cost of establishing new fabrication capacity has continued to rise, foundries have progressed from simply providing manufacturing capacity to becoming key strategic partners offering research and development capabilities and manufacturing process technologies. There have historically been a limited number of semiconductor foundries in the industry due to the high barriers to entry, which include significant capital commitments, scarcity of qualified engineers and advanced intellectual property and technology requirements. Many IDMs, such as Elpida, Infineon and Motorola, have begun outsourcing their fabrication requirements for complex and high performance semiconductor devices to foundries in order to supplement their own internal capacities and become more cost competitive. In addition, fabless semiconductor companies have shifted from relying on the excess fabrication capacity of IDMs to utilizing independent foundries to meet the majority of their wafer production needs. We believe that we are well positioned to benefit from the growth of fabless semiconductor companies and the increase in outsourcing by IDMs, particularly because our facilities are equipped to manufacture integrated circuits using leading edge technologies at competitive costs.

The increasing trend in IDM outsourcing and the further development of fabless semiconductor companies are the two key drivers for the growth of the foundry industry, which is expected to significantly outpace the growth of the overall semiconductor industry. According to IC Insights, the size of the foundry industry in terms of worldwide sales reached US\$14.0 billion in 2003, representing a 20.5% compound annual growth rate from US\$5.5 billion in 1998, and is projected to reach US\$39.5 billion by 2008, representing a compound annual growth rate of 21.8% since 1998. In contrast, the overall semiconductor industry is expected to grow at a compound annual rate of 9.5% over the same time period.

### ***Our Strategy***

Our goal is to maintain our position as one of the leading semiconductor foundries in the world. We plan to continue to offer our services to leading semiconductor suppliers worldwide while maintaining our leadership position in China. The key elements of our strategy include the following:

#### ***Capitalize on Our Early Mover Advantage to Capture Semiconductor Industry Growth Opportunities in China***

We are a leader and an early mover in the advanced semiconductor foundry industry in China. According to the China Center for Information Industry Development, there are more than 463 fabless semiconductor companies and design centers in China. The majority of these potential customers are located around the Greater Shanghai and Beijing metropolitan areas in the vicinity of our existing fabs. Most of these domestic fabless companies focus on the design of integrated circuits in an attempt to meet the needs of domestic market demand in

terms of features and functionality. We believe that as the fabless integrated circuit industry in China matures, there will be an increased demand for foundry services in China. We are committed to offering them best-in-class services and solutions that are customized for their particular technological capabilities and financial resources. We have already established foundry relationships with a significant number of leading local fabless semiconductor companies in China. We believe that by establishing our company as a key foundry partner to local semiconductor companies at an early stage of their development, we will be well positioned to take advantage of the potential semiconductor industry growth in China.

We believe we currently have the largest installed 8-inch wafer fabrication capacity and the only 12-inch wafer fabrication capacity in China. Our location in China allows us to develop close relationships with the increasing number of IDMs and systems companies that are, or whose customers are, moving their existing manufacturing facilities to, or establishing new facilities in, China. Similar to our strategy regarding fabless semiconductor companies, we believe our close proximity to these IDMs and systems companies will allow us to form close partnerships with them to meet the growing demand for electronic devices both within China and around the world.

#### ***Target a Diversified and Global Customer Base***

We have a global customer base consisting of leading IDMs, fabless semiconductor companies, and systems and other companies. We believe these customers have high growth potential and business plans that are directed towards utilizing our manufacturing services and solutions. In order to maximize the utilization of our fabs and optimize our process technology offerings, we plan to focus on attracting potential customers with advanced design capabilities that require leading edge foundry services in high volumes. The semiconductor industry is developing rapidly and demand for products associated with different applications and technical standards continues to grow. We intend to maintain a diversified customer mix in terms of end-market applications, processes and geographical focus in order to manage our exposure to each market segment.

#### ***Maintain Leading Edge Technology and Innovation through Internal Research and Development and Strategic Alliances and Partnerships***

In order to serve our customers' diverse needs, we intend to continue to expand our portfolio of leading edge process technology capabilities in logic, mixed signal, RF, memory and specialty semiconductor devices. An expanded portfolio of process technologies is a key factor in being able to produce a wide spectrum of semiconductor devices while minimizing production volume fluctuations. To achieve this strategic goal in technology and innovation, we rely on our internal research and development team, as well as our leading global technology partners. This two-pronged strategy allows us to shorten the development cycle and provide our customers with quality manufacturing capabilities while also sharing development costs with other parties. As a result, we were, for example, among the first foundries to offer customers the option of outsourcing their 0.13 micron copper interconnects.

We have established partnerships with leading semiconductor companies and research institutes, such as Fujitsu Limited, Infineon Technologies AG, Interuniversitair Micro-Elektronica Centrum vzw, or IMEC, Motorola and Toshiba, and intend to continue to maintain and broaden our list of technology partners. Our partnerships with leading semiconductor companies have not only provided us with access to a diverse portfolio of technologies, but have also helped to strengthen our relationships with these companies, some of which are our customers. We believe our relationships with these customers have, in turn, helped us establish credibility in the market and attract new customers.

### ***Provide High Quality Customer Service***

We believe that our focus on offering high quality customer service is an important factor in attracting and retaining leading semiconductor companies as our customers, and has been a key contributor to our growth. We have established a strong customer- and teamwork-oriented culture that focuses on maintaining close interactions with our customers at multiple levels and functional areas within our organization. The key areas of our customer service are:

- responsiveness to customers' requirements in terms of lead times and product cycle time;
- flexibility in providing customized solutions and in production scheduling;
- timely delivery of products in the required volumes;
- strict adherence to high quality technical specifications;
- confidentiality and protection of customer intellectual property and proprietary information;
- cost effectiveness;
- real time online information; and
- integrated 24-hour customer support.

### ***Shift Product Mix to Logic Wafers While Maintaining Expertise in DRAM Technology***

We believe we are the only foundry among our key competitors to have adopted the strategy of offering leading edge technology for both DRAM and logic semiconductors. We believe our strategy of maintaining core competency in manufacturing both logic and DRAM semiconductors is particularly important in the development of system-on-chip product technology. We have historically utilized a relatively high percentage of our total capacity for the production of DRAM wafers for shipment to certain of our strategic partners on a foundry basis and for sale to our distributors. DRAM wafers produced for sale to our distributors are essentially commodity-type DRAM wafers we manufacture "on spec" without a purchase order or a specific customer in mind. These wafers are sold into the market to various customers through our distributors.

Through the production of DRAM wafers, we have been able to quickly ramp up our production facilities, debug our production processes and equipment, and train our personnel in a high volume, advanced process fabrication environment. We will continue to manufacture DRAM wafers for our customers on a foundry basis and expect that our production of DRAM wafers "on spec" will decrease. At the same time, we have increased in 2004, and intend to continue increasing, the relative production volume of logic wafers since these products generally have more stable prices and margins than commodity-type DRAM. As a result, we expect that our production of DRAM wafers as a percentage of overall production will decrease.

## Our Fabs

The table below sets forth a summary of our current fabs and fabs under construction:

	Shanghai				Beijing			Tianjin
	Fab 1	Fab 2	Fab 3B <sup>(1)</sup>		Fab 4	Fab 5	Fab 6C	Fab 7
			Fab 3B-A	Fab 3B-C				
Type of fab	(actual) Pre-metalization wafer fabrication <sup>(2)</sup>	(actual) Pre-metalization wafer fabrication <sup>(2)</sup>	(actual) Aluminum interconnects	(actual) Copper interconnects	(actual) Wafer fabrication with aluminum interconnects	(estimated) Pre-metalization wafer fabrication <sup>(2)</sup>	(estimated) Copper interconnects	(actual) Wafer fabrication with aluminum interconnects
Pilot production commencement	September 2001	July 2002	September 2001	September 2002	July 2004	2006 or thereafter	2005	February 2004
Commercial production commencement	January 2002	January 2003	January 2002	January 2003	March 2005	2006 or thereafter	2005	May 2004
Wafer size	8-inch	8-inch	8-inch	8-inch	12-inch	12-inch	12-inch	8-inch
Production clean room size	8,555 m <sup>2</sup>	8,555 m <sup>2</sup>	2,800 m <sup>2</sup>	3,400 m <sup>2</sup>	7,366 m <sup>2</sup>	7,366 m <sup>2</sup>	3,213 m <sup>2</sup>	8,463 m <sup>2</sup>

- (1) Fab 3B contains both an aluminum interconnects line, referred to as Fab 3B-A, that provides the aluminum interconnects for wafers fabricated at Fab 1 and Fab 2, as well as a copper interconnects line, referred to as Fab 3B-C. Fab 3B-A utilizes some steppers and scanners from Fab 1 for its aluminum interconnects process, while Fab 3B-C uses its own steppers and scanners for the copper interconnects process.
- (2) Pre-metalization wafer fabrication refers to all of the manufacturing steps in the fabrication of a semiconductor wafer from a raw silicon wafer until, but not including, the attachment of metal interconnects, such as aluminum or copper.

A portion of our Fab 9 in Shanghai will be leased to Toppan SMIC Electronics (Shanghai) Co., Ltd., which will manufacture color filters and micro-lenses for CMOS image sensors.

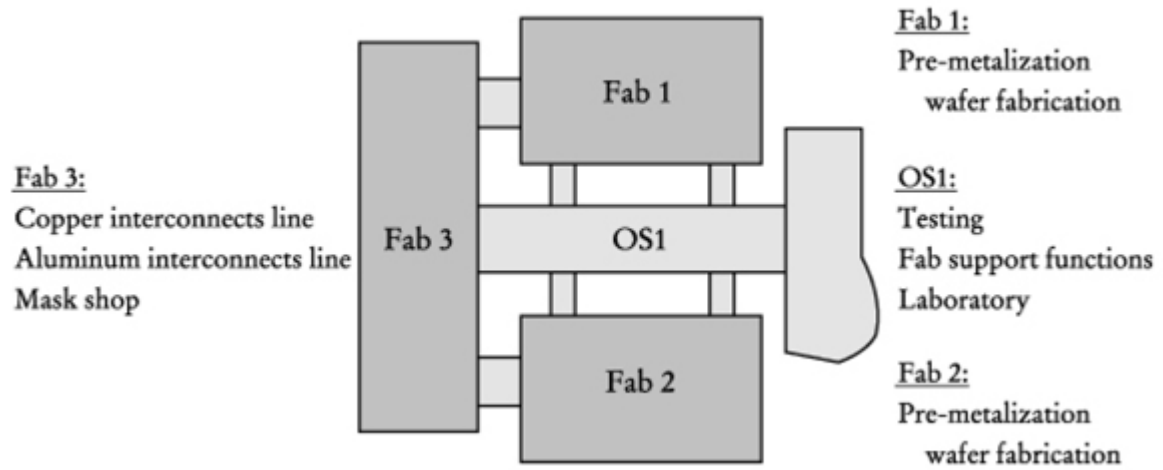
Most of the administrative and management functions of our fabs are centralized at our corporate headquarters in the Zhangjiang High-Tech Park in the Pudong New Area of Shanghai.

We have begun to implement a “One Mega Fab” project to align the capabilities of our fabs by standardizing our equipment and processes. Our goal is for a semiconductor wafer produced at any of our fabs to have statistically the same wafer acceptance test results and wafer yields as a semiconductor wafer produced at any of our other fabs that are producing the same product. This increases the flexibility of our total capacity and allows us to avoid costs and delays relating to additional customer qualifications when we shift production from one fab to another.

Our fabs are organized into bays grouped by function. The general production environment consists of class 1000 or class 100 “clean rooms.” Within the larger clean rooms, the actual fabrication steps are performed in a class 1 clean standard mechanical interface box, within which the wafers are also transferred between each step in the fabrication process. The use of these boxes and other “mini-environments” results in reductions of building structure costs, mechanical and electrical system requirements and operating costs, allows flexibility with respect to the layout and reconfiguration of equipment and facilitates the ramping-up process during capacity expansions.

### Shanghai Operations

The diagram below illustrates our distinctive “tri-fab” architecture utilized for our current Shanghai fabs:





Our current fab configuration in Shanghai consists of two pre-metalization wafer fabs, Fab 1 and Fab 2, attached to a separate metal interconnects fab, Fab 3B. Fab 3B contains both an aluminum interconnects line, referred to as Fab 3B-A, that provides the aluminum interconnects for wafers fabricated at Fab 1 and Fab 2, as well as a copper interconnects line, referred to as Fab 3B-C, that currently provides copper interconnects. Our Shanghai fabs are located in the Zhangjiang High-Tech Park in Shanghai, China. They have a total floor space of 164,795 square meters, of which approximately 23,310 square meters is occupied by the production clean room area. These fabs had an aggregate wafer fabrication capacity, as of December 31, 2004, of 81,406 wafers per month and, through Fab 3B-C, an aggregate capacity for copper interconnects of 17,802 wafers per month.

Our “tri-fab” design offers complete operational redundancy between Fab 1 and Fab 2 with respect to the equipment that represents the main bottlenecks in production. The hallways connecting these two fabs permit wafers in production to be easily switched from one fab to the other to take advantage of unused equipment and reduce overall production cycle time. In addition, our configuration offers our customers the option to use copper interconnects for the wafers they have fabricated in-house at their own facilities or through other third parties. It also prevents metal line contamination to the wafer fabrication processes while allowing for more flexibility with respect to our capacity and loading capabilities. All of these fabs are automated and equipped with inter-bay automatic material handling systems.

Our Fab 1 was selected as one of the two “Top Fabs of 2003” by Semiconductor International, a leading industry publication. This award was based on fabrication capabilities, ramp-up time, degree of automation, contamination control procedures, worker health and safety and environmental concerns. In addition, we were ranked second in a readers’ poll of top global foundries of 2003 conducted by Silicon Strategies, another leading semiconductor industry publication. In 2004, we received the “Shanghai Industrial Exhibition Organization Silver Award” from the Shanghai Industrial Exhibition Organization Committee for being the first company in China to manufacture a 12-inch wafer.

In July 2004, we entered into an agreement with Toppan Printing Co., Ltd., to establish Toppan SMIC Electronics (Shanghai) Co., Ltd., a joint venture in Shanghai, for the manufacture of color filters and micro-lenses for CMOS image sensors. We will lease a portion of Fab 9 to Toppan SMIC Electronics (Shanghai) Co., Ltd.

### ***Tianjin Operations***

In January 2004, we acquired assets constituting, and assumed certain obligations relating to, a wafer fab located in Tianjin, China from Motorola (China) Electronics Limited, or MCEL, a wholly owned subsidiary of Motorola. Our Tianjin fab, which we refer to as Fab 7, is located in the Xiqing Economic Development Area and has an estimated total floor space of 49,463 square meters, including approximately 8,463 square meters of production clean room area. Fab 7 performs pre-metalization fabrication of 8-inch wafers as well as provides aluminum interconnects for such wafers. As of December 31, 2004, Fab 7 had increased its capacity to 14,182 wafers per month and produces primarily logic, mixed-signal, high voltage and other memory products. Given our current product mix and sales forecast, we anticipate that Fab 7’s capacity will reach 15,000 wafers per month in the fourth quarter of 2005. We are currently in the process of seeking the approval of the Chinese governmental authorities to defer our capital contribution to SMIC Tianjin’s registered capital until such time as the transfer of title to the land use rights, buildings and equipment of SMIC Tianjin has been approved by or registered with the relevant Chinese governmental authorities.

### ***Beijing Operations***

Our Fab 4 is the first 12-inch fab in production in China. We recently completed construction at our Fab 5 and Fab 6C, which will also be 12-inch fabs. All of these fabs are located in the Beijing Economic and Technological Development Area. Twelve-inch wafers have a surface area that is 2.25 times larger than the current industry standard 8-inch wafers, thereby enabling us to manufacture more integrated circuits on each wafer with lower per die costs. Fab 6C is being situated between the two wafer fabs, Fab 4 and Fab 5, and will provide the copper interconnects for the 0.13 micron and below logic wafers produced by both of these fabs. This design is intended to prevent metal line contamination to the wafer fabrication processes while achieving greater flexibility in production. Our fab layout in Beijing is more compact than in Shanghai, which helps to reduce the risk of dust contamination.

Our Beijing fabs have a total floor space of 179,858 square meters, 17,945 square meters of which will consist of production clean room areas. We commenced commercial production at Fab 4 in March of 2005. As of December 31, 2004, Fab 4 had a capacity of 7,027 8-inch wafer equivalents per month. Given our current product mix and sales forecast, we plan to have wafer fabrication capacity of 29,000 8-inch wafer equivalents by the end of 2005. We plan to commence commercial production at Fab 6C in late 2005 and at Fab 5 in 2006 or thereafter.

## **Our Services**

### ***Wafer Fabrication Services***

We currently provide semiconductor fabrication services using 0.35 micron to 0.10 micron process technology for the following devices:

- logic technologies, including standard logic, mixed-signal, RF and high voltage circuits;
- memory technologies, including DRAM, SRAM, Flash, EEPROM and Mask ROM; and
- specialty technologies, including LCoS, and CIS.

These semiconductors are used in various computing, communications, consumer and industrial applications, such as computers, mobile telephones, digital televisions, digital cameras, DVD players, entertainment devices, other consumer electronics devices and automotive and industrial applications.

We believe we are one of the few foundries in the world to offer copper interconnects technologies to our global customers. We believe we are also the first fab in China to introduce copper technology on a 0.13 micron production line. The capacity for our copper interconnects line was 17,802 wafers per month as of December 31, 2004.

### ***Our Technologies***

We manufacture the following types of semiconductors:

- *Logic Semiconductors.* Logic semiconductors process digital data to control the operation of electronic systems. The largest segment of the logic market, standard logic devices, includes microprocessors, microcontrollers, DSPs and graphic chips. Logic semiconductors are used in communications devices, computers and consumer products, with the most advanced logic semiconductors dedicated primarily to computing applications.
- *Mixed-Signal and RF.* Analog/digital semiconductors combine analog and digital devices on a single semiconductor to process both analog signals and digital data. We make 0.35 micron to 0.18 micron mixed-signal and RF semiconductors using the CMOS process. The primary uses of mixed-signal semiconductors are in hard disk drives, wireless communications equipment and network communications equipment, while RF semiconductors are primarily used in communications devices, such as cell phones.
- *High Voltage.* High voltage semiconductors are semiconductor devices that can drive high voltage electricity to systems that require voltage of between five volts to several hundred volts. Our high voltage technologies provide solutions for display driver integrated circuits, power supplies, power management, telecommunications, automotive electronics and industrial controls.
- *Memory Semiconductors.* Memory semiconductors, which are used in electronic systems to store data and program instructions, are generally classified as either volatile memory, which lose their data content when power supplies are switched off, or non-volatile memory, which retain their data content without the need for a constant power supply. Examples of volatile memory include SRAM and DRAM, and examples of non-volatile memory include electrically erasable programmable read-only memory, or EEPROM, NAND Flash and OTP. Memory semiconductors are used in communications devices, computers and many consumer products.
- *Specialty Semiconductors.*
  - *LCoS.* LCoS microdisplays are tiny, high resolution, low power displays designed for high definition televisions, projectors and other products that use or rely on displays. Compared with other display technologies, such as liquid crystal and plasma, LCoS displays have higher

resolution and higher fill factor, resulting in superior images, colors and performance. LCoS process technology represents an enhancement of mixed-signal CMOS process technology with the addition of a highly reflective mirror layer.

- *CIS*. CIS devices are sensors that are used in a wide range of camera-related systems, such as digital cameras, digital video cameras, handset cameras, personal computer cameras and surveillance cameras, which integrate image-capturing capabilities onto a chip. CIS is rapidly becoming a cost-effective and low power replacement for competing charged-coupled devices, or CCDs. Since CIS devices are fabricated with CMOS technology, they are easier to produce and more cost-effective than CCDs. By combining camera functions on a chip, from the capture of photos to the output of digital bits, CMOS image sensors reduce the parts required for a digital camera system, which in turn enhances reliability, facilitates miniaturization, and enables on-chip programming. Our CIS process is based on our CIS array technology.

We are one of the leading foundries in the world in terms of the process technologies that we are capable of using in the manufacturing of semiconductors: 68.5% of our wafer sales in 2004 were from products that utilized advanced technology of 0.18 micron and below.

The following table sets forth the actual and projected range of process technology capabilities of our fabs:

Fab <sup>(1)</sup>	Month and year of commencement of commercial production	Process technology (in microns)			
		2002	2003	2004	2005 (estimated)
<b>Wafer fabrication<sup>(2)</sup>:</b>					
Fab 1	January 2002	0.35/0.25/ 0.18/0.15	0.35/0.25/ 0.18/0.15/0.13	0.35/0.25/ 0.18/0.15/ 0.13/0.11	0.35/0.25/ 0.18/0.15/ 0.13/0.11/0.09
Fab 2	January 2003	0.35/0.25/ 0.18/0.15	0.35/0.25/ 0.18/0.15/0.13	0.35/0.25/ 0.18/0.15/0.13	0.35/0.25/ 0.18/0.15/ 0.13/0.11/0.09
Fab 4	March 2005	—	—	0.15/0.13/ 0.10 <sup>(3)</sup>	0.15/0.13/0.11/ 0.10/0.09
Fab 5	2006 or thereafter	—	—	—	—
Fab 7	May 2004	—	—	0.35/0.18 <sup>(4)</sup>	0.35/0.25/ 0.18 <sup>(4)</sup>
<b>Metal Interconnects (aluminum and copper):</b>					
Fab 3B-A <sup>(5)</sup>	January 2002	0.35/0.25/ 0.18/0.15	0.35/0.25/ 0.18/0.15/0.13	0.35/0.25/ 0.18/0.15/0.11	0.35/0.25/ 0.18/0.15/0.11
Fab 3B-C	January 2002	0.13	0.13	0.13	0.13/0.09
Fab 6C <sup>(6)</sup>	Second half of 2005	—	—	—	0.13/0.09

(1) Fabs 1, 2 and 3B are located in Shanghai and produce 8-inch wafers, while Fabs 4, 5 and 6C are located in Beijing and produce or will produce 12-inch wafers. Fab 7 in Tianjin produces 8-inch wafers.

(2) Fab 1, Fab 2, Fab 4 and Fab 5 perform pre-metalization wafer fabrication.

(3) Fab 4 commenced pilot production using 0.11 micron process technology in July 2004.

(4) Aluminum interconnects only.

- (5) Fab 3B-A is only utilized to provide aluminum interconnects for wafers produced by Fab 1 and Fab 2 and therefore has the same technology range as Fab 1 and Fab 2.
- (6) Copper interconnects for Fab 4 and Fab 5 will be provided by Fab 6C, and therefore Fab 6C will have the same technology range as Fab 4 and Fab5. Fab 6C will also provide aluminum interconnects.

The following table sets forth a percentage breakdown of wafer sales by process technology for the years ended December 31, 2002, 2003 and 2004, and each of the quarters in the year ended December 31, 2004:

Process Technologies	For the year ended December 31,		For the three months ended				For the year ended
	2002	2003	March 31, 2004	June 30, 2004	September 30, 2004	December 31, 2004	December 31, 2004
	(based on sales in US\$)						
0.13 micron	0.0%	11.8%	10.1%	9.9%	11.9%	13.8%	11.7%
0.15 micron	0.0%	9.9%	15.7%	13.3%	13.2%	14.9%	14.2%
0.18 micron	4.7%	22.0%	44.4%	48.6%	46.2%	33.6%	42.6%
0.25 micron	74.2%	34.5%	8.3%	8.3%	6.4%	6.0%	7.1%
0.35 micron	21.1%	21.8%	21.5%	19.9%	22.3%	31.7%	24.4%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

### Technology Partners

Our technology partners have licensed to us leading process technology and design intellectual property. Our technology partners include the following:

- Chartered Semiconductor for 0.18 micron logic;
- Fujitsu Limited for 0.22 micron DRAM and 0.18 micron FCRAM™;
- Infineon Technologies AG for 0.14 micron and 0.11 micron DRAM;
- Elpida Memory, Inc. for 0.10 micron DRAM; and
- Toshiba for 0.21 micron and 0.15 micron SRAM.

Two of these technology partners, specifically Fujitsu Limited and Infineon Technologies AG, are among our five largest customers in 2004.

Our other technology partners include Aplus Flash Technology, Inc., ARM Limited, Artisan Components, Inc., IMEC, Motorola, VeriSilicon Holdings, Ltd. and Virage Logic Corporation. Some of these technology arrangements involve corresponding foundry or supply agreements in which we agree to guarantee a minimum capacity for the fabrication of specific products for these technology partners. Certain of our technology partners only allow us to use their technology to manufacture wafers for them.

### Manufacturing Capacity

We currently manufacture 8-inch silicon wafers based on proprietary designs provided by our customers or third party designers. Since commencing commercial production, we believe we have the largest 8-inch wafer fabrication capacity among semiconductor foundries in China. We believe we have the most advanced process technology among foundries in China and were the first fab to use 0.18 micron process technology. In January 2003, we commenced commercial production using 0.13 micron copper interconnects process technology. We believe we are currently the only fab in China to offer 0.13 micron copper interconnects process technology, and we began offering 0.13 micron wafer fabrication process technology in the first quarter of 2004.

The following table sets forth the historical and projected capacity of our current and planned wafer fabrication and copper interconnects fabs:

Fab	2002	2003	2004	2005 (estimated) <sup>(1)</sup>
<b>Wafer Fabrication:</b>				
Wafer fabrication capacity as of year-end <sup>(2)</sup> :				
Fab 1 <sup>(3)</sup>	22,000	28,000	45,536	45,000
Fab 2 <sup>(3)</sup>	—	21,000	35,870	45,000
Fab 4 <sup>(4)</sup>	—	—	7,027	29,000
Fab 5 <sup>(4)(5)</sup>	—	—	—	—
Fab 7	—	—	14,182	15,000
Total monthly wafer fabrication capacity as of year-end <sup>(2)</sup>	22,000	49,000	102,615	134,000
Total annual wafer fabrication capacity <sup>(2)</sup>	117,000	503,000	1,036,173	1,500,000
Wafer fabrication capacity utilization	94%	94%	98%	95%
<b>Copper Interconnects:</b>				
Copper interconnects capacity as of year-end <sup>(2)</sup> :				
Fab 3B-C <sup>(6)</sup>	—	9,000	17,802	13,000
Fab 6C	—	—	—	—
Total monthly copper interconnects capacity as of year-end <sup>(2)</sup>	—	9,000	17,802	13,000

- (1) Actual capacity and output for future periods may vary significantly from the projected data set forth in the table above, particularly in the event of a change in the projected product mix.
- (2) All output and capacity data is provided as 8-inch wafers or 8-inch wafer equivalents per month. Conversion of 12-inch wafers to 8-inch wafer equivalents is achieved by multiplying the number of 12-inch wafers by 2.25.
- (3) Aluminum interconnects for Fab 1 and Fab 2 are provided by Fab 3B-A. Thus, capacity data for Fab 3B-A is not separately presented.
- (4) Aluminum and copper interconnects for Fab 4 and Fab 5 will be provided by Fab 6C.
- (5) We plan to commence commercial production at Fab 5 in 2006 or thereafter.
- (6) Reflects wafers fabricated using the copper interconnects line of Fab 3B-C and does not include wafers fabricated using the aluminum interconnects line of Fab 3B-A. As a small number of wafers produced by Fab 1 and Fab 2 also utilize the copper interconnects capabilities of Fab 3B-C, our reported capacity and output data for Fab 3B overlaps to a limited extent with such data for Fab 1 and Fab 2.

As of December 31, 2004, our aggregate wafer fabrication capacity was 102,615 8-inch wafer equivalents per month, and our copper interconnects capacity was 17,802 wafers per month.

A key factor influencing our profit margins is our capacity utilization. Because a high percentage of our cost of sales is of a fixed nature, operations at or near full capacity have a significant positive effect on output and profitability. In both 2002 and 2003, our wafer fabs had an average annual utilization rate of 94% and in 2004, our wafer fabs had an average annual utilization rate of 98%. Factors affecting utilization rates are our ability to manage the production facilities and product flows efficiently, the percentage line yield of wafers during the fabrication process, the complexity of the wafer produced and the actual product mix. In addition, we have manufactured DRAM to fill our production lines when the volume demand of other products does not fully utilize our available capacity. As a result, our utilization rate has historically remained high.

We determine the capacity of a fab based on the capacity ratings given by manufacturers of the equipment used in the fab, adjusted for, among other factors, actual output during uninterrupted trial runs, expected down time due to setup for production runs and approximately one to two days of scheduled annual maintenance, and expected product mix. All of our fabs currently operate 24 hours per day, seven days per week, except during periods of annual maintenance. Employees work shifts of 12 hours each day on a two-days-on, two-days-off basis.

We often use DRAM as the initial product to test the production capabilities at a new fab. This is because DRAM requires higher process accuracy, more precise process control and a higher degree of engineering skills and operational disciplines, and can therefore assist in early identification of any potential process, equipment or

fab-related production problems. This DRAM is either manufactured on a foundry basis for our customers or sold by us to the market through our distributors under technology licensing and royalty arrangements. However, the market for DRAM devices has also been more volatile and susceptible to sudden price drops in recent years. We expect that our production of DRAM wafers as a percentage of our overall production will decrease.

### ***Capacity Expansion Plans***

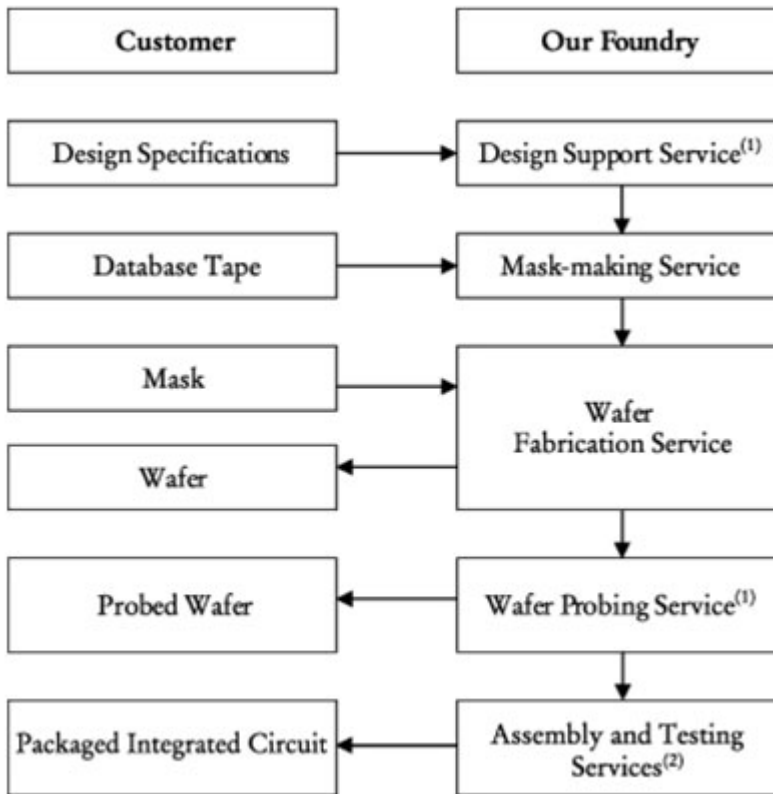
We intend to maintain our strategy of expanding capacity and improving our process technology to meet both the capacity requirements and the technological needs of our customers. Our capital expenditures in 2004 were US\$2,000 million. We currently expect that our capital expenditures in 2005 will be approximately US\$1,000 million, which we plan to fund through our operating cash flows and bank loans. If necessary, we will also explore other forms of external financing. We plan to use this capital primarily to continue the ramp up of our existing fabs in Shanghai, Tianjin and Beijing and complete the construction, equipping and ramp-up of our Fab 4 in Beijing. In addition, our actual expenditures may exceed our planned expenditures for a variety of reasons, including changes in our business plan, our process technology, market conditions, equipment prices, customer requirements or interest rates. We will monitor the global economy, the semiconductor industry, the demands of our customers, and our cash flow from operations to adjust our capital expenditure plans.

We also will seek to participate in strategic partnerships to meet the demands of our customers. For example, in July 2004, we entered into an agreement with Toppan Printing Co., Ltd., to establish Toppan SMIC Electronics (Shanghai) Co., Ltd., a joint venture in Shanghai, for the manufacture of color filters and micro-lenses for CMOS image sensors. These products are increasingly being used in consumer products such as mobile phone cameras, digital cameras and automobile and home security applications. In 2004, we commenced construction of Fab 9, which we will lease to Toppan SMIC Electronics (Shanghai) Co., Ltd. We understand that Toppan SMIC Electronics (Shanghai) Co., Ltd. plans to commence pilot production by the end of 2005. We hold a 30% equity interest in Toppan SMIC Electronics (Shanghai) Co., Ltd.

### ***Our Integrated Solutions***

In addition to wafer fabrication, we provide our customers with a range of complementary services, from circuit design support and mask-making to wafer level probing and testing. This range of services is supported by our network of partners that assist in providing design, probing, final testing, packaging, assembly and distribution services. Our main goal in the provision of these services is to help our customers achieve higher performance products and greater yield in the most cost-effective and timely manner. Because of our ability to provide an array of services in addition to wafer fabrication, we are able to accommodate customers with a variety of needs. Many of our customers choose to have us make the masks to be used during the fabrication process, as this decreases the risk of damage to the masks that can result from having to transport them. The flexibility in input stages allows us to cater to a variety of customers with different in-house capabilities and thus to service a wider class of customers as compared to a foundry that cannot offer design support or mask-making services.

The diagram below sets forth our service model and our key points of interaction with our customers:



(1) A portion of this work is outsourced to our service partners.

(2) All of these services are outsourced to our service partners.

### *Design Support Services*

Our design support services include providing our customers with access to the fundamental technology files and intellectual property libraries that facilitate customers' own integrated circuit design. We also offer design reference flows and access to our design center alliance, as well as layout services. In addition, we collaborate with industry leaders in electronic design automation, library and intellectual property services to create a worldwide network of expertise, resources and services that are available to implement and produce a customer's designs. As of December 31, 2004, we employed over 117 engineers devoted solely to design support services.

### *Libraries*

As part of the necessary building blocks for our customers' semiconductor designs, we offer libraries of compatible designs for portions of semiconductors, such as standard cells, I/O and selected memory blocks, in addition to technology files. We have a dedicated team of engineers who work with our research and development department to develop, license or acquire from third parties selected key libraries early on in the development of new process technologies so that our customers can quickly design sophisticated integrated circuits that utilize the new process technologies. We also have arrangements with other providers of libraries to provide our customers with access to a broad library portfolio for their designs. In particular, we offer a portfolio of ASIC library and design kits for a wide range of tested and verified circuit applications and design-flow implementation. These include standard cell, I/O and memory compilers in 0.35 micron, 0.25 micron, 0.18 micron, 0.15 micron and 0.13 micron process technologies. They have been developed primarily through our third party alliances, as well as by our internal research and development team, to facilitate easy design reuse and fast integration into the overall design system. We are currently developing additional libraries. Our library partners include Artisan, VeriSilicon and Virage Logic.

### *Intellectual Property*

As semiconductors grow in complexity and time-to-market pressures mount, the intellectual property designs that we offer can assist our customers to attain faster cycle times. Together with the intellectual property developed by our internal design team, our alliances with intellectual property providers enable us to offer foundational designs ranging from 0.35 micron to 0.13 micron and relating to mixed-signal, embedded memory, high-speed interface, digital peripheral device controllers and embedded processors, among others. We use our own and third party design expertise to realize the functions of these various types of intellectual property. Our intellectual property partners include Aplus, ARM and Mosys, Inc.

### *Design Reference Flows*

Customers implementing designs on our processes can utilize our design reference flows to achieve a smooth process from semiconductor design to production. These flows have been created using design tools developed by our electronic design automation partners, including Cadence Design Systems, Inc., Magma Design Automation, Inc., Mentor Graphics Corporation, and Synopsys, Inc. These methodologies are designed to shorten time-to-market. They include training guides and sample test cases to provide a step-by-step explanation on how the hierarchical design flow works.

### *Design Center Alliance*

If a customer requires assistance in designing its semiconductors, we are able to recommend design partners from among our extensive design services network. This network consists of design companies that we have successfully worked with in the past, thereby helping to improve coordination and expedite the design process. If required, we are also able to offer our own internal design team members to help our clients to complete their designs.

### *Mask-making Services*

We believe we are currently the most advanced mask supplier in China and are one of the few foundries in the world to offer in-house mask-making services. Many of our foundry customers utilize our mask-making services. We believe that having our own mask facility ensures a seamless flow of service from design to mask to wafer. This in-house capability facilitates the interaction of our mask and wafer engineers, thereby optimizing photo mask specifications for the achievement of high yield and quality and minimal cycle times. We believe this capability results in cost reductions for our customers and enables them to shorten their time-to-market.

While most of our mask-making services are for customers that also utilize our wafer fabrication services as part of our overall foundry service, we also produce masks for other domestic and overseas fabs as a separate revenue-generating service. For 2004, our management estimates that these mask-only customers constituted approximately 35% of our mask-related business. Our mask shop also cooperates with our research and development department to develop new technologies and designs.

Our mask-making facility, which is located in Shanghai, includes 2,750 square meters of class 1 clean room area. It is designed for flexible expansion and is equipped with advanced equipment. We believe that much of this equipment is the most advanced in the world. At present, our mask shop offers both five-inch by five-inch and six-inch by six-inch reticles. Our facility is capable of producing binary masks, optical proximity correction masks and phase shift masks. Our mask facility also offers mask repair services. As of December 31, 2004, we had 137 personnel employed in our mask shop.

We also offer a multi-project wafer service that allows the cost of manufacturing one mask set to be shared among several customers. See “—Customers and Markets” for more details regarding this service.

Intellectual property protection is a key focus of our mask-making services. See “—Intellectual Property” for more details regarding the intellectual property protection measures we have instituted in our mask facility.



### Wafer Probing, Assembly and Testing Services

We have our own probing facilities in Shanghai and Beijing that provide test program development, probe card fabrication, wafer probing, failure analysis and failure testing. We do not perform final testing and packaging at our facilities, but instead outsource these services to our partners for those customers that request them.

Our probing facility in Shanghai occupies a clean room space of 3,000 square meters, and our probing facility in Beijing occupies a clean room space of 1,400 square meters. Both facilities are rated at class 1,000 cleanliness and are equipped with advanced testers, probers and laser repair machines for logic, memory and mixed-signal products. The probing facility in Beijing supports testing of Beijing's 12-inch wafers and Tianjin's 8-inch wafers. We estimate that these facilities' current aggregate capacity for the probing of memory and logic devices is 65,500 wafers per month. We employ more than 190 personnel to provide these probing services. We have testing equipment for memory, logic and mixed signal applications, including some equipment that has been consigned to our Shanghai facility by our customers. This consigned testing equipment has been specially designed and built by our customers in order to probe their particular products at our facility.

We have also established a network of partners that provide additional probing services, as well as assembly and testing services, for our customers that request these additional services. We have relationships with assembly and testing partners, including Amkor Assembly & Test (Shanghai) Co., Ltd. and ST Assembly Test Services Ltd., which have helped to enhance the range of services that we are able to offer our customers. We estimate that as of December 31, 2004, approximately 50% of the wafers we fabricated were probed at our in-house probing facility, with the remainder being outsourced to our partners.

On May 3, 2005, we entered into a joint venture agreement with United Test and Assembly Center Ltd. to provide assembly and testing services in Chengdu, Sichuan Province, focusing on memory and logic devices. We will invest US\$51 million through cash and own 51% of the joint venture company and UTAC will invest US\$30 million through a combination of cash and other consideration, including intellectual property, for a 30% stake. UTAC and other investors (except the company and the joint venture's employees) will be granted a right to require the joint venture to buy back its shares under certain circumstances starting in 2009, subject to any applicable laws and regulations. Commercial production is expected to commence in the fourth quarter of 2005.

### Customers and Markets

Our customers include IDMs, fabless semiconductor companies and systems companies. The following table sets forth the breakdown of our sales by customer type for 2002, 2003 and 2004:

Customer Type	For the year ended December 31,					
	2002		2003		2004	
	Sales	Percentage	Sales	Percentage	Sales	Percentage
	(in US\$ thousands, except percentages)					
Fabless semiconductor companies	\$26,244	52.2%	\$125,416	34.3%	\$391,788	40.2%
Integrated device manufacturers	8,877	17.6%	169,329	46.3%	515,282	52.9%
Systems companies and others	15,194	30.2%	71,078	19.4%	67,595	6.9%
<b>Total</b>	<b>\$50,315</b>	<b>100.0%</b>	<b>\$365,823</b>	<b>100.0%</b>	<b>\$974,665</b>	<b>100.0%</b>

We categorize our sales geographically based on the headquarters of the customer that issues the purchase order. The following table sets forth the geographical distribution of our sales and percentage of sales for 2002, 2003 and 2004:

Region	For the year ended December 31,					
	2002		2003		2004	
	Sales	Percentage	Sales	Percentage	Sales	Percentage
	(in US\$ thousands, except percentages)					
North America	\$15,425	30.7%	\$134,080	36.7%	\$391,433	40.2%
Taiwan	23,980	47.7%	97,820	26.7%	120,652	12.4%
South Korea	60	0.1%	45,876	12.5%	140,933	14.5%
Japan	8,044	16.0%	40,982	11.2%	135,101	13.9%
Europe	120	0.2%	40,251	11.0%	125,596	12.7%
Asia Pacific (excluding Japan, South Korea and Taiwan) <sup>(1)</sup>	2,686	5.3%	6,814	1.9%	60,950	6.3%
<b>Total</b>	<b>\$50,315</b>	<b>100.0%</b>	<b>\$365,823</b>	<b>100.0%</b>	<b>\$974,665</b>	<b>100.0%</b>

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(1) We believe a significant portion of the semiconductors ordered from customers headquartered in China are eventually exported as components in electronic products assembled in China.

We have a global and diversified customer base that includes IDMs, namely Fujitsu Limited, Infineon Technologies AG, Samsung Electronics Co., Ltd., STMicroelectronics Pte. Ltd. and Texas Instruments Incorporated, and fabless semiconductor companies, namely Broadcom Corporation, Elite Semiconductor Memory Technology Inc. and Marvell Semiconductor, Inc. The foregoing is not intended to identify our top customers, but rather to provide a representative sampling of our customer base. IDMs generally provide more stable and longer term purchase contracts, have higher order volumes and license process technology to us. Although we are not dependent on any single customer, a significant portion of our sales is attributable to a relatively small number of our customers. Our sales could be significantly reduced if any of these customers cancels or reduces its orders, significantly changes its product delivery schedule or demands lower prices. In 2002, 2003, and 2004, our five largest customers accounted for approximately 68.8%, 57.0%, and 59.1% of our sales, respectively. In 2002, our largest customer, ISSI, accounted for approximately 24.9% of our sales. Our second largest customer in 2002, Fujitsu, accounted for approximately 16.0% of our sales. Our two largest customers in 2003, Samsung Electronics and Texas Instruments, accounted for approximately 12.1% and 11.7% of our sales in that year, respectively. Our two largest customers in 2004, Broadcom and Fujitsu accounted for approximately 13.4% and 12.7% of our sales in that year, respectively.

Our director, Lip-Bu Tan, is also a director of, and holds a shareholding interest of less than 1.0% in, ISSI, one of our five largest customers in 2003. In 2003, ISSI accounted for approximately 10.7% of our sales. In 2004, ISSI accounted for less than 6% of our sales.

Our Chairman, President and Chief Executive Officer, Richard Ru Gin Chang, and his wife together hold shareholding interests of less than 0.1% in one of our five largest customers in 2003 and 2004, Texas Instruments.

Our initial sales after commencing commercial operations in 2002 were mainly of DRAM that was fabricated and sold on a foundry basis, as well as commodity-type DRAM fabricated using technology licensed from Fujitsu and sold by us to distributors. This commodity-type DRAM was fabricated during our start-up phase in order to test and ramp up our facilities and train our personnel. As our business has grown and our fabs have matured, we have produced less commodity-type DRAM and more higher margin logic and advanced memory products. However, we intend to continue to produce commodity-type DRAM to maintain full utilization of our capacity.

The following table sets forth a breakdown of our sales by application type for 2002, 2003 and 2004:

Application Type <sup>(1)</sup>	For the year ended December 31,					
	2002		2003		2004	
	Sales	Percentage	Sales	Percentage	Sales	Percentage
	(in US\$ thousands, except percentages)					
Computing	\$24,084	47.9%	\$139,375	38.1%	\$231,235	23.7%
Communications	11,614	23.1%	162,520	44.4%	551,635	56.6%
Consumer	9,929	19.7%	44,339	12.1%	138,314	14.2%
Others	4,688	9.3%	19,589	5.4%	53,481	5.5%
<b>Total</b>	<b>\$50,315</b>	<b>100.0%</b>	<b>\$365,823</b>	<b>100.0%</b>	<b>\$974,665</b>	<b>100.0%</b>

(1) "Computing" consists of integrated circuits such as hard disk drive controllers, DVD-ROM/CD-ROM driver integrated circuits, graphic processors and other components lines, digital signal processors, wireless LAN, LAN controllers, LCD drivers, handset components and caller ID devices. "Consumer" consists of integrated circuits used for DVD players, game consoles, digital cameras, smart cards and toys.

The following table sets forth a breakdown of our sales by service type for 2002, 2003 and 2004:

Service Type	For the year ended December 31,					
	2002		2003		2004	
	Sales	Percentage	Sales	Percentage	Sales	Percentage
	(in US\$ thousands, except percentages)					
Fabrication of memory wafers <sup>(1)</sup>	\$25,047	49.8%	\$139,553	38.2%	\$193,950	19.9%
Fabrication of logic wafers <sup>(2)</sup>	20,974	41.7%	209,914	57.3%	730,160	74.9%
Other <sup>(3)</sup>	4,294	8.5%	16,356	4.5%	50,555	5.2%
<b>Total</b>	<b>\$50,315</b>	<b>100.0%</b>	<b>\$365,823</b>	<b>100.0%</b>	<b>\$974,665</b>	<b>100.0%</b>

(1) “Memory” includes only DRAM devices.

(2) “Logic” includes all other devices, including memory devices whose manufacturing process is similar to that for a logic device.

(3) Includes mask-making and probing.

We have marketing offices located in California, Milan, Shanghai and Tokyo. Our Shanghai office serves China and other non-Japan Asian markets, our California office serves the North American market, and our Milan and Tokyo offices serve the European and Japanese markets, respectively. We also sell some products through sales agents in selected markets.

We believe that the most effective means of marketing our foundry services is by developing direct relationships with our customers. Our customer engineers work closely with our sales force by providing detailed technical advice and specifications to customers. We believe a significant portion of our business also arises through customer referrals. We believe that our focus on customer service has been an important factor in attracting leading semiconductor companies as customers. The key elements of our customer service are our customer-oriented culture, responsiveness, flexibility and delivery accuracy. We offer the advantage of a short lead time and product cycle to customers who need finished products within a short time frame.

We also provide our customers with the ability to share costs through our multi-project wafer processing “shuttle service.” This service allows customers to share costs with other customers by processing multiple designs on a single mask set. In addition to the significant cost savings, this “shuttle service” also provides fast turnaround time for customers that need to verify and/or redesign their products and allows us to perform low-volume test production runs for customers in the prototype stage. This service also helps to eliminate costly and time-consuming repetitive mask and wafer production runs, resulting in accelerated time-to-market for our customers.

We provide our customers with 24-hour online access to necessary information to conduct business with us. From our technical capabilities to a customer’s order status, we provide an online solution for our customers. From wafer fabrication, wafer sorting and assembly to final testing and shipping, our data center electronically transfers data, work-in-progress tracking, yield/cycle-time reports and quality/engineering data to customers.

Our sales cycle, meaning the time between our first contact with a customer in relation to a particular product and our first shipment of that product to the customer, typically lasts between three months to one year, depending on the type of process and product technology involved in the product we are requested to fabricate. Because of the fast-changing technology and functionality in integrated circuit design, foundry customers generally do not place purchase orders far in advance to fabricate a particular type of product. However, we engage in discussions with customers commencing in advance of the placement of purchase orders regarding customers’ expected fabrication requirements. See “Risk Factors—Risks Related to Our Financial Condition and Business—Our sales cycles can be long, which could adversely affect our operating results and cause our income stream to be unpredictable.”

See “Item 5—Operating and Financial Review and Prospects—Sales” for a description of the seasonality of our business.

## **Research and Development**

Our research and development activities are principally directed toward the development and implementation of more advanced and lower cost process technology. We spent US\$37.5 million in 2002, US\$32.1 million in 2003 and US\$78.2 million in 2004 on research and development expenses, which represented 74.4%, 8.8%, and 8.0%, respectively, of our sales in those respective years. Our research and development costs in 2004 include non-recurring engineering costs associated with the ramp-up of Fab 4 and Fab 7. We plan to continue to invest significant amounts in research and development in 2005. In order to increase the efficiency of our research and development efforts, we have formed separate logic and memory technology development centers.

We employ over 600 research and development personnel. This research and development team includes many experienced semiconductor engineers with advanced degrees from leading universities around the world, as well as top graduates from the leading universities in China. We believe this combination has enabled us to quickly bring our technology in line with the semiconductor industry technology roadmap and ensures that we will have skilled personnel to lead our technology advancement in the future.

## **Intellectual Property**

While we continue to develop and patent our own technologies, we expect to have an ongoing need to obtain licenses for the proprietary technologies of third parties to enable us to manufacture certain advanced wafers for our customers. To date, we have been granted thirty-five patents, twenty-nine in Taiwan, two in the U.S. and one in China, and have more than 300 patent applications pending in the United States, China and Taiwan. We believe our competitors and other industry participants have numerous patents concerning wafer fabrication and related technologies in multiple countries.

To obtain patent protection in Taiwan, an inventor must file an application with the Intellectual Property Office, which will subject the application to procedural and substantive reviews. If a patent application is preliminarily approved, it will be published in an official gazette for a three-month opposition period. If there are no oppositions or if the inventor is able to overcome opposition actions, then the patent will be granted. Assuming no opposition actions, the patent application process may be completed in approximately twelve to eighteen months. The validity period for the ten patents we have been granted is 20 years from the date the application is filed. As with patent rights in most other jurisdictions, a patentholder in Taiwan enjoys the exclusive right to exclude others from using, licensing, and otherwise exploiting the patent within Taiwan.

We believe it is customary in the semiconductor industry for companies with large patent portfolios to have greater leverage in negotiating license arrangements with third parties due to their ability to offer cross-licensing arrangements. We believe that, to date, the disparity between our patent portfolio and the substantially larger portfolios of our competitors has not had a material impact on our ability to negotiate license arrangements on terms acceptable to us. For example, as a part of the settlement agreement of the patent infringement claims with TSMC, we and TSMC entered into a patent cross-license agreement under which each party will license the other party's patent portfolio through December 2010. However, in the future, we may not have the ability to negotiate license agreements on terms acceptable to us, and thus we may have to accept unfavorable and more costly licensing terms, which could adversely affect our margins, operating results and competitiveness. If for any reason we are unable to license necessary technology on acceptable terms, it may become necessary for us to develop alternative technology internally, which could be costly and delay the marketing and delivery of key products and therefore have an adverse effect on our business and operating results. In addition, we may be unable to independently develop the technology required by our customers on a timely basis or at all, in which case our customers may purchase wafers from our competitors.

In order to minimize risks to us from any intellectual property infringement claims, we have implemented a screening procedure whereby customers are evaluated for infringement risk based on size, reputation and product specifications, and those that are identified as high-risk are examined closely for potential infringement. Some of our technology partners do not indemnify us for losses arising out of infringement of intellectual property rights relating to licensed-in processes they provide to us, but we are indemnified by most of our customers for losses arising out of infringement of intellectual property rights relating to the integrated circuit designs they provide to us.

We implement a variety of measures to protect the intellectual property and related interests of our company, customers and technology partners. We require our employees to execute a confidential information and invention assignment agreement relating to non-competition and intellectual property protection issues prior to commencing their employment at our company. Other measures include internal document and network control and a separate dedicated server for technical data. In our mask facility, we track all masks daily, delete all mask data after each project is completed and securely store all tapes and reticles. Access to customer information is granted to employees strictly on a need-to-know basis both during and after mask tooling.

We have applied for trademarks relating to our corporate logo and trade name “SMIC” in the United States, China and Taiwan, although there can be no assurance that such trademarks will be granted.

## **Competition**

We compete internationally and domestically with dedicated foundry service providers, as well as with semiconductor companies that allocate a portion of their fabrication capacity to foundry operations. While the principal elements of competition in the wafer foundry market include technical competence, production speed and cycle time, time-to-market, research and development quality, available capacity, yields, customer service and price, we seek to compete on the basis of process technology capabilities, performance, quality and service, rather than solely on price. The level of competition differs according to the process technology involved. In more advanced technologies, the competition tends to be greater.

Our competitors and potential competitors include TSMC, UMC and Chartered Semiconductor. According to IC Insights, TSMC, UMC and Chartered Semiconductor had market shares of approximately 47%, 23% and 7%, respectively, in the semiconductor foundry industry in 2004. We had a market share of approximately 6% in 2004. Both TSMC and UMC have announced plans to build and acquire fabs in mainland China in order to compete for the growing domestic market in China. See “Risk Factors—Risks Related to Our Financial Condition and Business—If we cannot compete successfully in our industry, particularly in China, our results of operations and financial condition will be adversely affected.”

We believe we are the only emerging semiconductor foundry to have reached foundry capacity in excess of 100,000 8-inch wafers per month. We aim to use our competitive advantages of geographic location, scale and technology partnerships to maintain and enhance our position in the global market.

Another group of potential competitors consists of IDMs that have established their own foundry capabilities. These include Fujitsu Limited, Hynix, MagnaChip, IBM, Samsung Electronics Co., Ltd. and Toshiba. IDMs are primarily dedicated to fabricating integrated circuits for the end products of their respective affiliates.

## **Quality and Reliability**

We have implemented quality assurance measures relating to material quality control, monitoring of our in-line processes and wafer-level reliability control at every stage of our operations from technology development to production. By combining advanced quality assurance procedures and e-commerce technology, we monitor all processes, services and materials in our mask-making, wafer fabrication and probing facilities. These quality assurance measures include inspection of incoming materials, supplier and subcontractor management, manufacturing environmental control and monitoring, in-line defect monitoring, engineering change control, calibration monitoring, chemical analysis and visual inspection. Quality assurance measures also include on-going process and product reliability monitors and failure tracking for early identification of production problems.

As a result of these quality assurance measures, we have achieved a visual die defect rate that we believe is consistent with industry standards. We believe that wafers fabricated at our fabs provide consistently high die yield, which allows our customers to determine with greater certainty the appropriate number of wafers to order.

We incorporate reliability control in our entire production process and have adopted a system that enables us to track and record wafer-, package- and product-level reliability data throughout the development, qualification and production stages of the relevant process or device. This data enables us to identify problems at an early stage and provide an immediate diagnosis and solution, so as to further reduce our failure rate.

We achieved ISO 9001:2000 certification from the British Standards Institute with zero-defect performance for our Fab 1 in July 2002 and for our Fab 2 and Fab 3B in March 2003. The ISO 9001 quality standards were established by the International Standards Organization, an organization formed by delegates from member countries to establish international quality assurance standards for products and manufacturing processes. International Standards Organization certification is required in connection with sales of industrial products in many countries. To further enhance our quality management system, we obtained TS 16949:2002 certification from the British Standards Institute (BSI) in February 2004. This is an International Standards Organization quality management certification that relates to automobile applications and primarily measures a device's ability to handle extreme changes in temperature. In January 2005, we obtained TL9000 Quality Management System certification from BSI. This is a management certification relating to the telecommunications industry and evaluates research and development, production and installation and maintenance of communication product and services.

### **Raw Materials**

Our fabrication processes use many raw materials, primarily silicon wafers, chemicals, gases and various types of precious and other metals. Raw material costs constituted 23.2% of our cost of sales in 2002, 21.7% of our cost of sales in 2003, and 19.6% of our cost of sales in 2004. The three largest components of raw material costs—raw wafers, chemicals and gases—accounted for approximately 45%, 24% and 7%, respectively, of our raw material costs in 2002, approximately 41%, 32% and 9%, respectively, of our raw material costs in 2003 and approximately 41%, 20% and 11%, respectively, of our raw material costs in 2004. Most of our raw materials generally are available from several suppliers, but substantially all of our principal materials requirements must currently be sourced from outside China. Our raw material procurement policy is to select only those vendors who have demonstrated quality control and reliability with respect to delivery time and to maintain multiple sources for each raw material so that a quality or delivery problem with any one vendor will not adversely affect our operations. The quality and delivery performance of each vendor is evaluated on a quarterly basis and quantity allocations are adjusted for subsequent periods based on these evaluations and on the prices offered by these vendors. To date, we have not experienced any shortages in the supply of our raw materials, and we do not expect to experience any such shortages in the foreseeable future.

The most important raw material used in our production is silicon in the form of raw wafers. The principal suppliers of our raw wafers are Hong Kong Topco Scientific Co., Ltd., Komatsu Electronic Metals Co., Ltd. and MEMC Electronic Materials, Inc. We purchase approximately 69.5% of our overall raw wafer requirements from these three raw wafer suppliers. We have in the past obtained sufficient quantities of 8-inch wafers and believe we will continue to be able to obtain a sufficient supply of 8-inch and 12-inch raw wafers.

For 2004, our largest and five largest raw materials suppliers accounted for approximately 10.6% and 40.7%, respectively, of our overall raw materials purchases. For 2003, our largest and five largest raw materials suppliers accounted for approximately 12% and 46%, respectively, of our overall raw materials purchases. In 2002, our largest and five largest raw materials suppliers accounted for approximately 13% and 51%, respectively, of our overall raw materials purchases. None of our directors or shareholders which to the knowledge of our directors own more than 5% of our issued share capital, or their respective associates, had shareholding interests in any of our five largest suppliers. Almost all of our materials are imported free of value-added tax and import duties due to concessions granted to our industry in China.

### **Electricity and Water**

We use substantial amounts of electricity in our manufacturing process. This electricity is sourced for our three locations from the Pudong Electricity Corporation, the Beijing Municipal Electricity Department and the Tianjin Municipal Electricity Department. We enjoy a preferential electricity supply for our Shanghai fabs due to our location in the Zhangjiang High-Tech Park. We have not experienced any material disruptions in the electricity supply to any of our fabs to date, and also maintain emergency back-up generators to power safety and emergency systems.

The semiconductor manufacturing process uses extensive amounts of fresh water. We source our fresh water for our Shanghai fabs from Pudong Vivendi Water Corporation Limited, for our Beijing fabs from Beijing Waterworks Group Co. Ltd. and for our Tianjin fab from the Tianjin municipal water department. We believe these water supplies are adequate for our requirements and are not subject to any seasonal or periodic shortages. Because Beijing and Tianjin are subject to potential water shortages in the summer, our fabs in Beijing and Tianjin are equipped with back-up reservoirs. We have taken steps to reduce fresh water consumption in our fabs and capture rainwater for use at our Beijing facilities, and our water recycling systems in each of our fabs allow us to recycle 40% to 70% of the water used during the manufacturing process.

## **Regulation**

Integrated circuit industry in China is subject to substantial regulation by the Chinese government. This section sets forth a summary of the most significant Chinese regulations that affect our business in China.

### ***Scope of Regulation***

The *Several Policies to Encourage the Development of Software and Integrated Circuit Industry*, or the Integrated Circuit Policies, promulgated by the State Council on June 24, 2000, together with other ancillary laws and regulations, regulate integrated circuit production enterprises, or ICPEs. The State Council issued the Integrated Circuit Policies in order to encourage the development of the software and integrated circuits industry in China. The Integrated Circuit Policies form the basis for a series of laws and regulations that set out in detail the preferential policies relating to ICPEs. Such laws and regulations include:

- the *Notice of the Ministry of Finance, the State Administration of Taxation and the General Administration of Customs on Relevant Taxation Policy Issues Concerning the Further Development of the Software Industry and the Integrated Circuit Industry*, or the Integrated Circuit Notice, jointly issued by the Ministry of Finance, the State Administration of Taxation and the General Administration of Customs on September 22, 2000;
- the *Notice on Taxation Policies Concerning the Further Development of the Software and the Integrated Circuit Industry*, or the Further Development Taxation Notice, jointly issued by the Ministry of Finance and the State Administration of Taxation on October 10, 2002, as amended by *Notice on Termination of Value-added Tax Refund Policies for Integrated Circuits*, or the Termination Notice, jointly issued by the Ministry of Finance and the State Administration of Taxation on September 30, 2004;
- the *Notice on Taxation Policies Concerning the Import of Raw Materials and Consumables Used for Production by Some Integrated Circuit Production Enterprises for Their Own Use*, or the Raw Materials Taxation Notice, issued by the Ministry of Finance on August 24, 2002;
- the *Notice on Taxation Policies Concerning the Import of Construction Materials Specially used for Clean Rooms by Some Integrated Circuit Production Enterprises*, or the Construction Materials Taxation Notice, issued by the Ministry of Finance on September 26, 2002; and
- the *Notice by the Ministry of Finance and the State Administration of Taxation on Increasing Tax Refund Rate for Export of Certain Information Technology Products*, or the Export Notice, issued on December 10, 2004.

### ***Preferential Industrial Policies Relating to ICPEs***

ICPEs duly accredited in accordance with relevant laws and regulations may qualify for preferential industrial policies. Under the Integrated Circuit Policies, accreditation of ICPEs is determined by the competent examination and approval authorities responsible for integrated circuit projects after consultation with relevant taxation authorities. Specific provisions and procedures for accreditation of ICPEs are not set forth in current laws and regulations, and actual accreditation of ICPEs is conducted on a case-by-case basis.



SMIC Shanghai, SMIC Beijing and SMIC Tianjin have received accreditation as ICPEs entitling them to the preferential industrial policies described below.

#### *Encouragement of Domestic Investment in ICPEs*

Pursuant to the *Catalogue of Key Industries, Products and Technology Currently Encouraged for Development in China*, or the Domestic Catalogue, issued by the former State Planning Commission and the former State Economic and Trade Commission on September 1, 2000, the Chinese government encourages the design and fabrication of integrated circuits with a linewidth of less than 1.2 micron and of mixed integrated circuits. Under the Domestic Catalogue, imported equipment used for a qualifying domestic investment project and that falls within such project's approved total investment amount is exempt from customs duties and import-linked value-added tax, except for those goods included in the *Catalogue of Import Commodities for Domestic Investment Projects Not Subject to Tax Exemptions*, as stipulated by the State Council.

#### *Encouragement of Foreign Investment in ICPEs*

Pursuant to the Integrated Circuit Policies and the *Guideline Catalogue of Foreign Investment Industries* promulgated jointly by the former State Development and Planning Commission, the former State Economic and Trade Commission and the former Ministry of Foreign Trade and Economic Relations on March 11, 2002, as amended by the State Development and Reform Commission and the Ministry of Commerce on November 30, 2004, the following foreign investment categories are encouraged:

- design and fabrication of integrated circuits with a linewidth of less than 0.35 micron;
- development and fabrication of semiconductors and special materials for semiconductors; and
- fabrication of mixed integrated circuits.

Foreign investment in such encouraged projects may enjoy preferential treatment as stipulated by the laws and regulations.

#### *Preferential Taxation Policies*

##### *Preferential Value-added Tax Policy*

Under Article 1 of the Further Development Taxation Notice, from January 1, 2002 to the end of 2010, the sale of integrated circuits (including monocrystalline silicon chips) is subject to a value-added tax levy of 17%. After the value-added tax is levied, the taxpayer was to be entitled to a refund for the portion exceeding 3% of the actual value-added tax burden. The tax refund was required to be used by the enterprise for the research and development of integrated circuits and to increase production.

Under the Termination Notice, as of April 1, 2005, implementation of Article 1 of the Further Development Taxation Notice was terminated.

Under the Export Notice, as of November 1, 2004, the tax refund rate for exports of electronic integrated circuits and microassemblies is to increase from 13% to 17%.

##### *Preferential Enterprise Income Tax Policies*

Under the Integrated Circuit Policies and the Integrated Circuit Notice, ICPEs whose total investment exceeds Rmb 8,000 million (approximately US\$967 million) or whose integrated circuits have a linewidth of less than 0.25 micron are entitled to preferential tax treatment similar to that granted for foreign investment in the energy and communications industries. The Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises, or the Income Tax Law, and the Implementation Rules for the Income Tax Law provide preferential treatment of, exemption from or reduction of foreign enterprise income tax, or FEIT, for enterprises with foreign investment engaged in the energy and communications industries. After approval by the relevant taxation authorities, each of SMIC Shanghai, SMIC Beijing and SMIC Tianjin will become entitled to a full exemption from FEIT for five years starting with the first year of positive accumulated earnings and a 50% reduction for the following five years.

From January 1, 2002 to the end of 2010, investors in ICPEs and integrated circuit packaging enterprises that reinvest their after-income-tax profits from ICPEs for the purpose of increasing the registered capital in the ICPEs, or to establish other ICPEs and integrated circuit packaging enterprises for a period of operation of not less than five years, are entitled to a refund of 40% of the total amount of enterprise income tax paid on the reinvested portion. If the investment is withdrawn before the period of operation reaches five years, the amount of enterprise income tax refunded shall be repaid. From January 1, 2002 to the end of 2010, domestic or foreign investors that reinvest their after income-tax profits from sources within China in order to establish ICPEs or integrated circuit package enterprises in China's western regions for a period of operation of not less than five years are entitled to a refund of 80% of total amount of enterprise income tax paid on the reinvested portion. If the investment is withdrawn before the period of operation reaches five years, the amount of enterprise income tax refunded shall be repaid.

#### *Preferential Time Limit for Depreciation of Equipment Used in Production*

Under the Integrated Circuit Notice, upon approval by the State Administration of Taxation of foreign investment enterprises whose total investment exceeds US\$30 million, and upon approval by the relevant local or provincial taxation authorities of foreign investment enterprises whose total investment is less than US\$30.0 million, the time limit for depreciation of equipment used by an ICPE for production purposes may be shortened to not less than three years.

#### *Exemption of Customs Duties and Import-related Value-added Tax*

Under the Integrated Circuit Policies and the Integrated Circuit Notice, ICPEs whose total investment exceeds Rmb 8,000 million or whose integrated circuits have a linewidth of less than 0.25 micron are exempt from customs duties and import-related value-added tax.

The Raw Materials Taxation Notice further sets forth a detailed list of the raw materials and consumables used for production that are subject to the preferential tax treatment set forth above.

Under the Integrated Circuit Notice, integrated circuit technology, production equipment, and equipment and instruments specialized for use in fabricating integrated circuits that are imported by a duly accredited ICPE are, with the exception of commodities listed in the *Catalogue of Imported Commodities for Foreign Investment Projects Not Subject to Tax Exemptions* and the *Catalogue of Imported Commodities for Domestic Investment Projects Not Subject to Tax Exemptions* as stipulated by the State Council, exempt from customs duties and import-related value-added tax.

Under the Construction Materials Taxation Notice, commencing January 1, 2001, the importation of construction materials, auxiliary equipment and spare parts for the production of integrated circuits, specifically for clean rooms (as listed in the annex to the Construction Materials Taxation Notice), by ICPEs whose total investment exceeds Rmb 8,000 million or whose integrated circuits have a linewidth of less than 0.25 micron is exempt from customs duties and import-related value-added tax.

#### ***Legal Framework Concerning the Protection of Intellectual Property Relating to Integrated Circuits***

China has formulated various laws and regulations on intellectual property protection in respect of integrated circuits including:

- the *Patent Law of the People's Republic of China*, adopted at the fourth meeting of the Standing Committee of the Sixth National People's Congress on March 12, 1984, effective April 1, 1985
- the *Paris Convention for the Protection of Industrial Property* of the World Intellectual Property Organization, in which China became a member state as of March 19, 1985;

- the *General Principles of the Civil Law of the People's Republic of China* adopted at the fourth session of the Sixth National People's Congress on April 12, 1986, effective January 1, 1987. In this legislation, intellectual property rights were defined in China's basic civil law for the first time as the civil rights of citizens and legal persons;
- the *Copyright Law of the People's Republic of China*, adopted by the 15th meeting of the Seventh National People's Congress Standing Committee on September 7, 1990, effective June 1, 1991;
- the *Regulations for the Protection of the Layout Design of Integrated Circuits*, or the Layout Design Regulations, adopted March 28, 2001 at the thirty-sixth session of the executive meeting of the State Council, effective October 1, 2001; and
- the World Intellectual Property Organization's *Washington Treaty on Intellectual Property in Respect of Integrated Circuits*, for which China was among the first signatory states in 1990.

#### ***Protection of the Layout Design of Integrated Circuits***

Under the Layout Design Regulations, layout design of an integrated circuit refers to a three dimensional configuration in an integrated circuit that has two or more components, with at least one of these being an active component, and part or all of the interconnected circuitry or the three-dimensional configuration prepared for the production of integrated circuits.

Chinese natural persons, legal persons or other organizations that create layout designs are entitled to the proprietary rights in the layout designs in accordance with the Layout Design Regulations. Foreign persons or enterprises that create layout designs and have them first put into commercial use in China are entitled to the proprietary rights in the layout designs in accordance with the Layout Design Regulations. Foreign persons or enterprises that create layout designs and that are from a country that has signed agreements with China regarding the protection of layout designs, or is a party to an international treaty concerning the protection of layout designs to which China is also a party, are entitled to the proprietary rights of the layout designs in accordance with the Layout Design Regulations.

#### ***Proprietary Rights in Layout Design of Integrated Circuits***

Holders of proprietary rights in a layout design are entitled to the following proprietary rights:

- to duplicate the whole protected layout design or any part of the design that is original; and
- to make commercial use of the protected layout design, the integrated circuit containing the layout design, or commodities containing the integrated circuit.

Proprietary rights in layout designs become valid after being registered with the administrative department of the State Council responsible for intellectual property. Unregistered layout designs are not protected by the Layout Design Regulations.

The protection period of the proprietary rights in a layout design is ten years, commencing from the date of the application for registration of the layout design or the date that it is put into commercial use anywhere in the world, whichever is earlier. However, regardless of whether or not a layout design is registered, or whether or not it is put into commercial use, it is not protected after 15 years from the time of its creation.

#### ***Registration of a Layout Design***

The administrative departments of the State Council responsible for intellectual property are responsible for the registration of layout designs and accepting applications for the registration of layout designs. If an application for a layout design registration is not made with the administrative department of the State Council responsible for intellectual property within two years after it has been put into commercial use anywhere in the world, the administrative department of the State Council responsible for intellectual property will not register the application. A holder of proprietary rights in a layout design may transfer the proprietary rights or give permission for other parties to use the layout design.

### ***Compulsory Licenses for Exploitation of Patents in Respect of Semiconductor Technology***

Under the Patent Law and the Implementing Regulations of the Patent Law, after three years from the date of granting the patent rights, any person or enterprise that has made good faith reasonable proposals to the holder of proprietary rights seeking a license to those rights, but has been unable to obtain such license after an extended period of time, may request the administrative department responsible for patents under the State Council to grant a compulsory license for the relevant patent. However, where a compulsory license involves semiconductor technology, the implementation of a compulsory license is restricted to public and non-commercial uses, or to uses that counteract anti-competitive actions, as determined by judicial or administrative procedures.

### ***Income Tax on Fees for the Use of Proprietary Technology***

Under the *Provisional Regulations Concerning the Reduction and Exemption of Income Tax on Fees for the Use of Proprietary Technology*, issued by the Ministry of Finance on January 1, 1983, preferential income tax treatment is granted with respect to fees for the use of proprietary technology concerning certain integrated circuit production technologies. With respect to fees for the use of the proprietary technology (including fees for blueprints and documentation, fees for technical services and fees for personnel training relating to the right of use of the transferred proprietary technology), such as technology for fabricating integrated circuits, income tax may be levied at a reduced rate of 10%. Income tax may be exempted if the relevant technology is deemed to be advanced and the terms for use of the proprietary technology are preferential.

### ***Environmental Regulation***

Our Chinese subsidiaries are subject to a variety of Chinese environmental laws and regulations promulgated by the central and local governments concerning examination and acceptance of environmental protection measures in construction projects, the use, discharge and disposal of toxic and hazardous materials, the discharge and disposal of waste water, solid waste, and waste gases, control of industrial noise and fire prevention. These laws and regulations set out detailed procedures that must be implemented throughout a project's construction and operation phases.

A key document that must be submitted for the approval of a project's construction is an environmental impact assessment report that is reviewed by the relevant environmental protection authorities. Upon completion of construction, and prior to commencement of operations, an additional examination and acceptance by the relevant environmental authority of such projects is also required. Within one month after receiving approval of the environmental impact assessment report, a semiconductor manufacturer is required to apply to and register with the competent environmental authority the types and quantities of liquid, solid and gaseous wastes it plans to discharge, the manner of discharge or disposal, as well as the level of industrial noise and other related factors. If the above wastes and noise are found by the authorities to have been managed within regulatory levels, renewable discharge registrations for the above wastes and noise are then issued for a specified period of time. At present, SMIC Shanghai has received approval with respect to the relevant environmental impact assessment report and is in the process of applying for a discharge registration. SMIC Tianjin has received approval with respect to the relevant environmental impact assessment report and discharge registration. SMIC Beijing has received approval with respect to the relevant environmental impact assessment report in relation to its construction, and is expected to apply for a discharge registration prior to its operation.

From time to time during the operation of our Chinese subsidiaries, and also prior to renewal of the necessary discharge registrations, the relevant environmental protection authority will monitor and audit the level of environmental protection compliance of these subsidiaries. Discharge of liquid, solid or gaseous waste over permitted levels may result in imposition of fines, imposition of a time period within which rectification must occur or even suspension of operations.

## Enforceability Of Civil Liabilities

We are a Cayman Islands holding company. We are incorporated in the Cayman Islands because of the following benefits associated with being a Cayman Islands corporation:

- political and economic stability;
- an effective judicial system;
- a favorable tax system;
- the absence of exchange control or currency restrictions; and
- the availability of professional and support services.

However, the Cayman Islands have a less developed body of securities laws as compared to the United States and provides significantly less protection for investors. In addition, Cayman Islands companies may not have standing to sue before the federal courts of the United States. Substantially all of our assets are located outside the United States. In addition, most of our directors and officers are nationals and/or residents of countries other than the United States, and all or a substantial portion of our or such persons' assets are located outside the United States. As a result, it may be difficult for a shareholder to effect service of process within the United States upon us or such persons or to enforce against them or against us, judgments obtained in United States courts, including judgments predicated upon the civil liability provisions of the securities laws of the United States or any state thereof.

Maples and Calder, our counsel as to Cayman Islands law, Slaughter and May, our counsel as to Hong Kong law, and Jingtian & Gongcheng, our counsel as to Chinese law, have advised us that there is uncertainty as to whether the courts of the Cayman Islands, Hong Kong and China, respectively, would:

- recognize or enforce judgments of United States courts obtained against us or our directors or officers predicated upon the civil liability provisions of the securities laws of the United States or any state thereof, or
- be competent to hear original actions brought in each respective jurisdiction, against us or our directors or officers predicated upon the securities laws of the United States or any state thereof.

Maples and Calder has further advised us that a final and conclusive judgment in the federal or state courts of the United States under which a sum of money is payable, other than a sum payable in respect of taxes, fines, penalties or similar charges, may be subject to enforcement proceedings as a debt in the Courts of the Cayman Islands under the common law doctrine of obligation.

## Organizational Structure

We operate primarily through three wholly owned subsidiaries in China. The chart below sets forth our significant operating subsidiaries or affiliates, including their jurisdictions of incorporation and principal activities:

<u>Name of company</u>	<u>Place and date of incorporation/establishment</u>	<u>Attributable equity interest held</u>	<u>Principal Activity</u>
Semiconductor Manufacturing International (Shanghai) Corporation	The People's Republic of China (the "PRC") December 21, 2000	100%	Manufacturing and trading of semiconductor products
Semiconductor Manufacturing International (Beijing) Corporation	The PRC July 25, 2002	100%	Manufacturing and trading of semiconductor products
Semiconductor Manufacturing International (Tianjin) Corporation	The PRC November 3, 2003	100%	Manufacturing and trading of semiconductor products
SMIC Japan Corporation	Japan October 8, 2002	100%	Provision of marketing related activities
SMIC Europe S.R.L.	Italy July 3, 2003	100%	Provision of marketing related activities
SMIC, Americas	United States of America June 22, 2001	100%	Provision of marketing related activities
Semiconductor Manufacturing International (AT) Corporation	Cayman Islands July 26, 2004	51%	Investment holding
Semiconductor Manufacturing International (Chengdu) Corporation	The PRC August 16, 2004	51%	Manufacturing and trading of semiconductor products

Toppan SMIC Electronics (Shanghai) Co., Ltd.	The PRC November 24, 2004	30%	Manufacturing and trading of semiconductor products
SMIC Consulting Corporation	The PRC September 30, 2003	100%	Inactive

## Property and equipment

### Equipment

The quality and level of technology of the equipment used in the semiconductor fabrication process are important because they dictate the limits of the process technology that we use. Advances in process technology cannot be achieved without corresponding advances in equipment technology. The principal pieces of equipment used by us to fabricate semiconductors are scanners, cleaners and track equipment, inspection equipment, etchers, furnaces, wet stations, strippers, implanters, sputterers, CVD equipment, testers and probers. We source substantially all of our equipment from vendors located in the United States, Europe and Japan. Our main equipment vendors include Applied Materials Asia-Pacific, Ltd., ASML Holding NV, KLA Tencor Corporation, Lam Research Corporation, Novellus Systems, Inc. and Tokyo Electron Limited.

In implementing our capacity expansion and technology advancement plans, particularly the ramp-up of our Beijing facilities, we expect to make significant purchases of equipment required for semiconductor fabrication. Some of the equipment is available from a limited number of vendors and/or is manufactured in relatively limited quantities, and in some cases has only recently become commercially available. Our ability to obtain certain kinds of equipment from outside of China may be subject to restrictions. See “Risk Factors—Risks Related to Conducting Operations in China—Limits placed on exports into China could substantially harm our business and operating results.” To date, however, we have not experienced any major difficulties or delays in sourcing, purchasing and installing the equipment we need to fabricate wafers for our customers.

We maintain our equipment through a combination of in-house maintenance and outside contracting to our equipment vendors. We decide whether to maintain ourselves, or subcontract the maintenance of, a particular piece of equipment based on a variety of factors, including cost, complexity and regularity of the required periodic maintenance and the availability of maintenance personnel in China. Most of our equipment vendors offer maintenance services through technicians based in China.

### Property

Our corporate headquarters and our fabs currently in production in Shanghai occupy 367,895 square meters of land, for which we hold valid land use rights certificates. These fabs currently occupy approximately 45% of this total land area. We also hold valid land use rights for the 240,140 square meters of land that comprise our Beijing site, approximately 75% of which will be occupied by Fab 4, Fab 5 and Fab 6C. In 2005, we received land use rights certificates for 215,733 square meters of land in Tianjin, which is occupied by the Tianjin fab. We own all of the buildings and equipment for our fabs, except for certain customer-owned tooling provided to our Shanghai operations for test production on a consignment basis from our customers.

The following table sets forth the location, size and primary use of our real properties and whether such real properties are owned or leased.

Location	Size (Land/Building)	Primary Use	Owned <sup>(1)</sup> or Leased (Land/Building)
	(in square meters)		
Zhangjiang High-Tech Park, Pudong New Area, Shanghai	367,895/164,795	Wafer fabrication	owned/owned
Beijing Economic and Technological Development Area <sup>(2)</sup>	240,140/179,858	Wafer fabrication	owned/owned
Xiqing Economic Development Area, Tianjin	215,733/61,990	Wafer fabrication	owned/owned
Japan	na/55	Marketing activities	na/leased
USA	na/743	Marketing activities	na/leased
Italy	na/280	Marketing activities	na/leased

- (1) With respect to land located in China, “ownership” refers to holding a valid land use rights certificate. All land within municipal zones in China is owned by the Chinese government. Limited liability companies, joint stock companies, foreign-invested enterprises, privately held companies and individual natural persons must pay fees to be granted rights to use land within municipal zones. Legal use of land is evidenced and sanctioned by land use certificates issued by the local municipal administration of land resources. Land use rights granted for industrial purposes are limited to a term of no more than 50 years.

- (2) With respect to the buildings located in the Beijing Economic and Technological Development Area, we are in the process of constructing the buildings and expect to own the same upon completion of construction and amendment of the relevant land use right and building ownership certificates. The exact size of the buildings located at Beijing Economic and Technological Development Area is to be ascertained upon completion of the construction of the buildings and the issue of the relevant building ownership certificates.

Our right to continued use of the land is subject to our continued compliance with the land use agreement that each of our Chinese subsidiaries has executed. The Chinese government has reserved the right to revoke our land use rights for special eminent domain purposes, in which case the government will compensate us. In addition, if SMIC Shanghai breaches its bank loan agreements, our land use right for the land in Shanghai may be transferred to the lender pursuant to the guaranty agreement. See “Item 5—Operating and Financial Review and Prospects—Liquidity and Capital Resources.”

Chesterton Petty Limited, an independent property valuer, has valued our property interests as of December 31, 2003 at Rmb 2,454.4 million (approximately US\$296.5 million).

### **Risk Management and Insurance**

Our safety management philosophy is based on incident prevention and frequent safety audits. Incident prevention is achieved through:

- mandatory staff and vendor safety training;
- compliance of equipment and facilities to safety criteria, including the Semiconductor Equipment and Materials International and Chinese National Fire Protection Association standards; and
- standard management procedures established by our environmental, health and safety committee.

Regularly scheduled safety audits are performed in accordance with established world standards, and we have been qualified under OHSAS 18001 internal auditing standards as of September 2003.

We have established a risk management committee and an emergency response center to respond to all emergencies. The facility monitoring and control system and security monitoring room located within our emergency response center are where all emergency responses begin. These rooms are equipped with 24-hour safety and security monitoring systems such as closed circuit television, gas monitoring systems, chemical dispensing systems, very early smoke detection apparatus, public announcement systems and fire alarm systems.

Each department conducts emergency drills on a quarterly basis in accordance with our emergency response plan to address all possible emergency situations that could arise. These emergency scenarios include fires, gas leakages, chemical spills and power losses.

We maintain insurance with respect to our facilities, equipment and inventories. The insurance for the fabs and their equipment covers, subject to some limitations, various risks, including industrial accidents and natural disasters, generally up to their respective replacement values and lost profits due to business interruption. We have not made any significant claims under these insurance policies. Equipment and inventories in transit are also insured. We believe that our overall insurance coverage is adequate.



## **Environmental Matters**

The semiconductor production process generates gaseous chemical wastes, liquid waste, waste water and other industrial wastes in various stages of the fabrication process. We have installed various types of pollution control equipment for the treatment of gaseous chemical waste and liquid waste and equipment for the recycling of treated water in our fabs, and of recycling equipment. Our operations are subject to regulation and periodic monitoring by China's State Environmental Protection Bureau, as well as local environmental protection authorities, including those under the Pudong Municipal Government, the Tianjin Municipal Government and the Beijing Municipal Government, which may in some cases establish stricter standards than those imposed by the State Environmental Protection Bureau. The Chinese national and local environmental laws and regulations impose fees for the discharge of waste substances above prescribed levels, require the payment of fines for serious violations and provide that the Chinese national and local governments may at their own discretion close or suspend any facility that fails to comply with orders requiring it to cease or remedy operations causing environmental damage. No such penalties have been imposed on us or any of our subsidiaries, and we believe that we have been in material compliance with applicable environmental regulations and standards.

We believe that we have adopted pollution control measures for the effective maintenance of environmental protection standards consistent with the requirements applicable to the semiconductor industry in China. Waste generated from our operations, including acid waste, alkaline waste, flammable waste, toxic waste, oxide waste and self-igniting waste, are collected and sorted for proper disposal. Furthermore, we have in many cases implemented waste reduction steps beyond the scope of current regulatory requirements.

We received ISO 14001 certification for our Fab 1 in August 2002 from the British Standards Institute and continue to implement improvement programs in connection with this certification. Our Fab 2 and Fab 3B achieved ISO 14001 certification in February 2003. The ISO 14001 quality standard is a voluntary standard and part of a comprehensive series of quality standards for environmental management published by the International Standards Organization. The ISO 14001 quality standards cover environmental management principles, systems and supporting techniques.

## **Item 5. Operating and Financial Review and Prospects**

### **Overview**

We were founded in April 2000. In 2000 and 2001, our company was in its development stage and did not have any sales. During this period, we established our management structure, acquired land use rights, constructed, equipped and commenced the ramp-up of production at our 8-inch wafer facilities in Shanghai consisting of Fab 1, Fab 2 and Fab 3B and began our research and development activities. Our Fab 1 and Fab 3B-A began commercial production in January 2002, and Fab 2 and Fab 3B-C began commercial production in January 2003. In January 2004, we acquired an 8-inch fab in Tianjin, China, which we refer to as our Fab 7, from MCEL, a wholly owned subsidiary of Motorola. Our Fab 4, China's first 12-inch fab, commercial production in March of 2005. By December 31, 2004, approximately four years after commencing construction of our Fab 1, we had reached total wafer fabrication capacity of 102,615 8-inch wafer equivalents per month and copper interconnects capacity of 17,802 wafers per month. We believe that this speed of capacity ramp-up represents one of the fastest in the semiconductor industry. Our wafers shipped and sales increased from 82,486 wafers and US\$50.3 million for 2002 to 476,451 wafers and US\$365.8 million for 2003 to 943,463 wafers and US\$974.6 million for 2004.

We manage our business and measure our results of operations based on a single operating segment. We plan to have aggregate monthly wafer fabrication capacity of 134,000 8-inch wafer equivalents and 13,000 copper interconnects by the end of 2005. As we increase our capacity and corresponding wafer production, we benefit from economies of scale. When our capacity utilization is high, these economies of scale enable us to reduce our per wafer production cost and improve our margins. On the other hand, when our capacity utilization rate is low, our unused capacity results in higher per wafer production cost and decreased margins.

## **Factors that Impact our Results of Operations**

### ***Cyclicality of the Semiconductor Industry***

The semiconductor industry is highly cyclical due mainly to the cyclicality of demand in the markets of the products that use semiconductors. As these markets fluctuate, the semiconductor market also fluctuates. This fluctuation in the semiconductor market is exacerbated by the tendency of semiconductor companies, including foundries, to make capital investments in plant and equipment during periods of high demand since it may require several years to plan, construct and commence operations at a fab. Absent sustained growth in demand, this increase in capacity often leads to overcapacity in the semiconductor market, which in the past has led to a significant underutilization of capacity and a sharp drop in semiconductor prices. The semiconductor industry is generally slow to react to declines in demand due to its capital-intensive nature and the need to make commitments for equipment purchases well in advance of the planned expansion.

The semiconductor industry has experienced a period of declining demand since 2001, mainly due to a downturn in the global economy and in the communications sector in particular. At the same time, the semiconductor industry has faced significant overcapacity due to capacity increases that were initiated prior to the downturn, as well as technological advancements in process technology and wafer sizes that have allowed for more chips to be fabricated per wafer. These conditions led to inventory build-up and a reduction in overall average selling prices for foundry services during this period. We believe the semiconductor industry is currently experiencing an increase in demand due to improving global economic conditions and a resulting strengthening in consumer confidence.

### ***Substantial Capital Expenditures***

The semiconductor foundry industry is characterized by substantial capital expenditures. This is particularly true for our company as we have recently constructed and equipped fabs and are continuing to construct and equip new fabs. In connection with the construction and ramp-up of our capacity since our inception, we incurred capital expenditures of US\$897 million, US\$492 million and US\$2,000 million in 2002, 2003 and 2004, respectively. We depreciate our manufacturing machinery and equipment on a straight-line basis over an estimated useful life of five years. We recorded depreciation and amortization of US\$84.5 million, US\$233.9 million and US\$457.0 million in 2002, 2003 and 2004, respectively.

The semiconductor industry is also characterized by rapid changes in technology, frequently resulting in obsolescence of process technologies and products. As a result, our research and development efforts are essential to our overall success. We spent approximately US\$37.5 million in 2002, US\$32.1 million in 2003 and US\$78.2 million in 2004 for research and development, which represented 74.4%, 8.8% and 8.0%, respectively, of our sales for 2002, 2003 and 2004. Our research and development costs in 2004 include non-recurring engineering costs associated with the ramp-up of Fab 4 and Fab 7.

We currently expect that our capital expenditures in 2005 will reach approximately US\$1,000 million, which we plan to fund through our operating cash flows and bank loans in order to expand our existing operations in Shanghai, Beijing and Tianjin and complete the construction, equipping and ramp-up of our Fab 4 in Beijing. As of May 26, 2005, SMIC Beijing entered into a US\$600 million loan facility with a syndicate of banks based in the PRC. If necessary, we will also explore other forms of external financing. We plan to use this capital primarily to continue the ramp up of our fabs in Shanghai, Tianjin and Beijing. In addition, our actual expenditures may exceed our planned expenditures for a variety of reasons, including changes in our business plan, our process technology, market conditions, equipment prices, customer requirements or interest rates. We will monitor the global economy, the semiconductor industry, the demands of our customers, and our cash flow from operations to adjust our capital expenditure plans.

### ***Capacity Expansion***

We have expanded, and plan to continue to expand, our capacity through internal growth and acquisitions. An increase in capacity may have a significant effect on our results of operations, both by allowing us to produce and sell more wafers and achieve higher sales, and as a cost component in the form of acquisition costs and depreciation expenses. We have increased our capacity in Shanghai and Tianjin to 95,588 8-inch wafers per month as of December 31, 2004 and plan to continue increasing capacity at our fabs there. We will increase our capacity in Fab 4 and plan to equip Fab 5, another 12-inch wafer fab in Beijing, in 2005. We plan to have aggregate wafer fabrication capacity of 147,000 8-inch wafer equivalents per month by the end of 2005.

As an example of our capacity acquisition strategy, in September 2003, we entered into an agreement to purchase the assets constituting a wafer fab located in Tianjin, China from MCEL, a wholly owned subsidiary of Motorola. This acquisition was completed in January 2004. Under our asset purchase agreement with MCEL, we acquired substantially all of that fab's assets and assumed certain contractual obligations. These assets and obligations were contributed to and assumed by our newly formed wholly owned subsidiary, SMIC Tianjin, on the closing date of the acquisition.

We also will seek to participate in strategic partnerships to expand our capacity. For example, in July 2004, we entered into an agreement with Toppan Printing Co., Ltd., to establish Toppan SMIC Electronics (Shanghai) Co., Ltd. to manufacture color filters and micro lenses for CMOS image sensors. In 2004, we commenced construction of Fab 9, which we will lease to Toppan SMIC Electronics (Shanghai) Co., Ltd. We understand that Toppan SMIC Electronics (Shanghai) Co., Ltd. plans to commence pilot production by the end of 2005.

### ***Pricing***

We price our foundry services on either a per wafer or a per die basis, taking into account the complexity of the technology, the prevailing market conditions, the order size, the cycle time, the strength and history of our relationship with the customer and our capacity utilization. Since a majority of our costs and expenses are fixed or semi-fixed, fluctuations in the average selling prices of semiconductor wafers have historically had a substantial impact on our margins. The average selling price of the wafers we shipped increased 33.6% from US\$733 per wafer in 2003 to US\$979 per wafer in 2004, mainly due to our shift to producing more logic and less DRAM wafers, our adoption of more advanced and higher margin process technologies, and because our company became more established in the market. Prices of our different process technologies vary significantly and, in general, the prices of the specific process technologies we provide decrease over time as the technology employed gradually becomes more mature and commoditized. Therefore, it is necessary to continually introduce new higher margin and more technologically advanced services to help counteract this trend of decreasing price levels.

### ***Change in Process Mix and Technology Migration***

Because the price of wafers processed with different technologies varies significantly, the mix of wafers that we produce is among the primary factors that affect our sales and profitability. The value of a wafer is determined principally by the complexity of the process technology used to fabricate the wafer. In addition, production of devices with higher levels of functionality and greater system-level integration requires more fabrication steps, and these devices generally sell for higher prices.

Prices for wafers of a given level of technology generally decline over the relevant process technology life cycle. As a result, we and our competitors are continuously in the process of developing and acquiring advanced process technologies and migrating our customers to use such technologies to maintain or improve our profit margins. This technology migration requires continuous investment in research and development and technology-related acquisitions, and we expect to continue to spend a substantial amount of capital on upgrading our technologies.

Our initial sales after commencing commercial operations in 2002 consisted mainly of DRAM fabricated and sold on a foundry basis, as well as commodity-type DRAM fabricated using technology licensed from Fujitsu Limited and sold by us to distributors. This commodity-type DRAM was fabricated during our start-up phase in order to test and ramp up our facilities and train our personnel. As our business has grown and our fabs have matured, we have produced proportionately less commodity-type DRAM and more logic products and memory products utilizing more advanced technologies, which generally command a higher margin. However, we intend to continue to produce commodity-type DRAM to maintain high utilization of our capacity in the future.

The following table sets forth a percentage breakdown of wafer sales by process technology for the years ended December 31, 2002, 2003 and 2004:

Process Technologies	For the year ended December 31,		For the three months ended				For the year ended December 31, 2004
	2002	2003	March 31, 2004	June 30, 2004	September 30, 2004	December 31, 2004	
	(based on sales in US\$)						
0.13 micron	0.0%	11.8%	10.1%	9.9%	11.9%	13.8%	11.7%
0.15 micron	0.0%	9.9%	15.7%	13.3%	13.2%	14.9%	14.2%
0.18 micron	4.7%	22.0%	44.4%	48.6%	46.2%	33.6%	42.6%
0.25 micron	74.2%	34.5%	8.3%	8.3%	6.4%	6.0%	7.1%
0.35 micron	21.1%	21.8%	21.5%	19.9%	22.3%	31.7%	24.4%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

The following table sets forth a breakdown of our sales by service type for the years ended December 31, 2002, 2003 and 2004:

Service Type	For the year ended December 31					
	2002		2003		2004	
	Sales	Percentage	Sales	Percentage	Sales	Percentage
	(in US\$ thousands, except percentages)					
Fabrication of memory wafers <sup>(1)</sup>	\$25,047	49.8%	\$139,553	38.2%	\$193,950	19.9%
Fabrication of logic wafers <sup>(2)</sup>	20,974	41.7%	209,914	57.3%	730,160	74.9%
Other <sup>(3)</sup>	4,294	8.5%	16,357	4.5%	50,554	5.2%
Total	\$50,315	100.0%	\$365,824	100.0%	\$974,664	100.0%

(1) "Memory" includes only DRAM devices.

(2) "Logic" includes all other devices, including memory devices whose manufacturing process is similar to that for a logic device.

(3) Includes mask-making and probing.

### Capacity Utilization Rates

Operations at or near full capacity have a significant positive effect on our profitability because a substantial percentage of our cost of sales is of a fixed nature. In 2003 and 2004, approximately 48% and 54%, respectively, of our cost of sales consisted of depreciation expenses, which are fixed costs. If we increase our utilization rates, the number of wafers we fabricate will increase, and therefore our average fixed costs per wafer will decrease. Therefore, our capacity utilization rates have a significant effect on our margins. Our utilization rates have varied from period to period due to capacity ramp-ups and fluctuations in customer orders. Our annual capacity utilization rate was 94% in both 2002 and 2003 and 98% in 2004. Factors affecting utilization rates are the complexity and mix of the wafers produced, overall industry conditions, the level of customer orders and mechanical failures and other operational disruptions, such as those relating to capacity expansions or relocation of equipment.

In addition, we fabricate DRAM wafers for sale to distributors using technology licensed from our technology partners, as well as under foundry arrangements for our customers using licensed technology. Through the fabrication of DRAM wafers, we have been able to quickly ramp up our production facilities, test and stabilize the process technologies and train our personnel. We expect that as we continue to ramp up our fabrication of logic wafers over time, the portion of our capacity utilized for DRAM production will become smaller relative to logic wafer production. This practice also has the added benefit of raising our ability to fabricate higher margin system-on-chip devices that incorporate elements of both memory and logic functions on a single chip.

Our capacity is determined by us based on the capacity ratings for each piece of equipment, as specified by the manufacturers of such equipment, adjusted for, among other factors, actual output during uninterrupted trial runs, expected down time due to set up for production runs and maintenance and expected product mix. Because these factors include subjective elements, our measurement of capacity utilization rates may not be comparable to those of our competitors.

### Yield Rates

Yield per wafer is the ratio of the number of functional dies on that wafer to the maximum number of dies that can be produced on that wafer. A significant portion of our services, particularly our memory semiconductor wafer fabrication services, is priced on a per die basis, and our high yields have assisted us in achieving higher margins.



We continuously upgrade the process technologies that we use. At the beginning of each technology migration, the yield utilizing the new technology is generally lower, sometimes substantially lower, than the yield under the then-current technology. This is because it requires time to stabilize, optimize and test a new process technology. We do not ship wafers to a customer until we have achieved that customer's minimum yield requirements. Yield is generally improved through the expertise and cooperation of our research and development personnel, process engineers and equipment suppliers.

### **Critical Accounting Policies**

The methods, estimates and judgments we use in applying our accounting policies have a significant impact on the results we report in our financial statements. Some of our accounting policies require us to make difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Below we have summarized our accounting policies that we believe are both important to the portrayal of our financial results and involve the need to make estimates about the effect of matters that are inherently uncertain. We also have other policies that we consider to be key accounting policies. However, these policies do not meet the definition of critical accounting estimates because they do not generally require us to make estimates or judgments that are difficult or subjective.

### ***Inventory***

Inventories are stated at the lower of cost or market. Market represents the net realizable value for finished goods and work-in-progress, and replacement cost for raw materials. For products manufactured pursuant to customer purchase orders, we are not typically exposed to the risk that the selling price will be lower than the inventory carrying value. We also use available manufacturing capacity to produce commodity-type DRAM that we hold in inventory until sold. We are exposed to the risk that the ultimate selling price of such commodity-type DRAM may be less than the inventory carrying value. We estimate the net realizable value for such finished goods and work-in-progress based primarily upon the latest invoice prices and current market conditions. If the market value of a good drops below its carrying value, we record a write-off to cost of sales for the difference between the carrying cost and the market value. As of December 31, 2003 and December 31, 2004, we carried a lower of cost or market reserve of US\$nil and US\$10.5 million, respectively, to reflect a decline in the estimated market value of the inventory we held on that date. We carry out an inventory review on an item-by-item basis at each quarter-end.

We do not anticipate slow moving inventory exposures. Our inventory consists of inventory built pursuant to firm customer orders and, accordingly, we have limited exposure to slow moving inventory adjustments. In addition, our inventory consists of commodity-type memory wafers for which an active market exists. These wafers are adjusted to lower of cost or market and sold to customers at the market price and, since we do not typically hold this inventory for more than nine months, we have limited exposure to slow moving inventory.

### ***Depreciation and Amortization***

We operate in a capital-intensive business. The net book value of our plant and equipment, including land use rights, at December 31, 2004 was US\$3,351.1 million. Depreciation of manufacturing buildings and related improvements is provided on a straight-line basis over the estimated useful life of 25 years and commences from the date the facility is ready for its intended use. Depreciation of our manufacturing machinery and equipment, as well as our facility, machinery and equipment, is provided on a straight-line basis over the estimated useful life of 5 to 10 years, commencing from the date that the equipment is placed into productive use. Amortization of land use rights is over the term of the land use right agreement, which ranges from 50 to 70 years. The estimated useful life and dates that the equipment is placed into productive use reflects our estimate of the periods that we intend to derive future economic benefits from the use of our plant and equipment and land use rights.

### ***Long-lived Assets***

We assess the impairment of long-lived assets when events or changes in circumstances indicate that the carrying value of the assets or the asset grouping may not be recoverable. Factors we consider in deciding when to perform an impairment review include significant under-performance of a manufacturing facility relative to expectations, significant underutilization of specific equipment relative to expectations, significant negative industry or economic trends, and significant changes or planned changes in our use of the assets. Recoverability of assets to be held and used is measured by comparing the carrying amount of the asset grouping to its future undiscounted cash flows. If such assets are considered to be impaired, an impairment charge is recognized for the amount that the carrying value of the asset exceeds its fair value. Assets held for sale are reported at the lower of their carrying amount or fair value less related selling costs.

In order to remain technologically competitive in our industry, we have entered into technology transfer and technology license arrangements with third parties in an attempt to advance our process technologies. The payments made for such technology licenses are recorded as an intangible asset and amortized on a straight-line basis over the estimated useful life of the asset. We routinely review the remaining estimated useful lives of these intangible assets. We also evaluate these intangible assets for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable.

We have continued to construct, acquire and expand our manufacturing facilities since our inception and, to date, have not experienced any factors that would indicate potential impairment of our long-lived assets. We will continue to review impairment factors as described above and, as a result, impairment charges may be necessary in the future as circumstances change.

### ***Revenue Recognition***

We manufacture semiconductor wafers for our customers based on the customers' designs and specifications pursuant to manufacturing agreements and purchase orders. We also sell certain semiconductor standard products to customers. Customers do not have any rights of return except pursuant to warranty provisions, which returns have been minimal. We typically perform tests of our products prior to shipment to identify yield of acceptable products 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. We estimate the amount of sales returns and the cost of replacement products based on the historical trend of returns and warranty replacements relative to sales and any current information regarding specific customer yield issues that may exceed historical trends. We recognize revenue upon shipment and title transfer. We also provide certain services such as mask making and probing and revenue is recognized when our services are completed.

### ***Stock-based Compensation Expense***

Our stock-based employee compensation plans are described in more detail under “—Share Ownership.” We grant stock options to our employees and we record a compensation charge for the excess of the fair value of the stock at the measurement date over the amount an employee must pay to acquire the stock. We amortize stock-based compensation using the straight-line method over the vesting periods of the related options, which are generally four years.

We have recorded deferred stock-based compensation representing the difference between the fair value of our ordinary shares for accounting purposes and the option exercise price. Prior to the completion of our global offering, we determined the fair value of our ordinary shares based upon several factors, including a valuation report from an independent appraiser and the price of our then most recent preference share placement. Following the completion of our global offering, we have determined the fair value of our ordinary shares based on the closing price of our ADSs on the NYSE. We recorded deferred stock-based compensation of US\$31.2 million and US\$37.6 million for stock options granted to employees during the years ended December 31, 2003 and 2004, respectively, and we amortized US\$11.4 million and US\$27.0 million for the years ended December 31, 2003 and 2004, respectively. Had different assumptions or criteria been used to determine the fair value of our ordinary shares, materially different amounts of stock-based compensation could have been reported.

Pro forma information regarding net income (loss) and net income (loss) per share is required in order to show our net income (loss) as if we had accounted for employee stock options under the fair value method. We use the Black-Scholes option pricing model to compute the fair value. The fair value of options and shares issued pursuant to our option plans at the grant date was estimated using this Black-Scholes option pricing model. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of highly subjective assumptions, including the expected stock price volatility. We use projected volatility rates, which are based upon historical volatility rates experienced by comparable public companies. Because our employee stock options issued under our 2001 Stock Plan, 2001 Regulation S Stock Plan, 2001 Preference Shares Stock Plan and 2001 Regulation S Preference Shares Stock Plan had characteristics significantly different from those of publicly traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of our stock options.

The effects of applying pro forma disclosures of net income (loss) and net income (loss) per share are not likely to be representative of the pro forma effects on net income and earnings per share in the future years for the following reasons:

- the number of future shares to be issued under these plans is not known; and
- the assumptions used to determine the fair value can vary significantly.

### **Inflation**

Although there can be no assurance as to the impact in future periods, we believe that, to date, inflation in China has not had a material impact on our results of operations. Inflation in China was approximately negative 0.8%, 1.2%, and 3.9% in 2002, 2003, and 2004, respectively.

### **Income Tax**

As an exempted company incorporated in the Cayman Islands, we are exempt from Cayman Islands taxation. Our Chinese subsidiaries are subject to taxation pursuant to the Income Tax Law of the PRC Concerning Foreign Investment and Foreign Enterprises and various local income tax laws. Under relevant regulations and after approval by the local Tax Bureau, our Shanghai, Beijing and Tianjin subsidiaries will become entitled to a full exemption from foreign enterprise income tax, or FEIT, for five years starting with the first year of positive accumulated earnings, and a 50% reduction for the following five years. Our Shanghai subsidiary had positive accumulated earnings during the year ended December 31, 2004. Our other subsidiaries are subject to their respective jurisdictions' income tax laws, including Japan and the United States. Our income tax obligations to date have been minimal.

We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." SFAS No. 109 requires an asset and liability approach for financial accounting and reporting for income tax purposes. Under the asset and liability method, deferred income taxes are recognized for temporary differences, net operating loss carryforwards and credits by applying enacted statutory tax rates applicable to future years. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

### **Recent Accounting Pronouncements**

Our adoption of the following recently issued accounting pronouncements did not have a material impact on our financial position, cash flows or results of operations. We have reflected all disclosure requirements of these pronouncements in our financial statements.

- FASB Interpretation (FIN), No. 46, "Consolidation of Variable Interest Entities."
- Staff Accounting Bulletin, No. 104, "Revenue Recognition" ("SAB 104"), which codifies, revises and rescinds certain sections of SAB 101, "Revenue Recognition in Financial Statements."
- EITF Issue No. 03-01, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments."



We have not yet adopted the following recently issued accounting pronouncements because they are not yet applicable in part or in total:

- SFAS No. 151, “Inventory Costs – an amendment of ARB No. 43 Chapter 43”, which is effective for inventory costs incurred during the fiscal years beginning after June 15, 2005.
- SFAS No. 123R (revised 2004), “Share Based Payment,” applicable commencing with our fiscal quarter beginning January 1, 2006.

Our adoption of SFAS No. 123R (revised 2004) may have a material effect on our financial position and results of operations as is disclosed in the section “Risks related to Our Financial Condition and Business.”

### *Incentives from the Chinese government*

The chart below sets forth a brief summary of the material incentives received by our Chinese subsidiaries from the Chinese government. Our Shanghai, Beijing and Tianjin subsidiaries are qualified as integrated circuit production enterprises under the Chinese government’s *Several Policies to Encourage the Development of Software and Integrated Circuit Industry*. Under these policies, any company that engages in the semiconductor industry in China and has a total investment size in excess of 8,000 million Renminbi (approximately US\$964 million) and fabricates integrated circuits that have a linewidth of less than 0.25 micron are entitled to the last three benefits listed below. We believe that our Shanghai, Beijing and Tianjin subsidiaries are among only a few companies in China that have qualified for these benefits. For a more detailed discussion of these incentives, see “Item 4—Information on the Company—Regulation.”

Incentive	SMIC Shanghai	SMIC Beijing	SMIC Tianjin
Preferential Value-added Tax Policies	- 17% VAT rate - 17% tax refund rate for exports reduced to 13% as of January 1, 2004 - 13% tax refund rate for exports increased to 17% as of November 1, 2004	- 17% VAT rate - 17% tax refund rate for exports reduced to 13% as of January 1, 2004 - 13% tax refund rate for exports increased to 17% as of November 1, 2004	- 17% VAT rate - 17% tax refund rate for exports reduced to 13% as of January 1, 2004 - 13% tax refund rate for exports increased to 17% as of November 1, 2004
Preferential Enterprise Income Tax Policies	Five-year full exemption and five-year 50% reduction upon approval from the local tax bureau	Five-year full exemption and five-year 50% reduction upon approval from the local tax bureau	Five-year full exemption and five-year 50% reduction upon approval from the local tax bureau
Preferential Customs Duties and Import-related VAT Policies	Exemption from customs duties and import-related VAT with respect to its imported equipment, spare parts and raw materials	Exemption from customs duties and import-related VAT with respect to its imported equipment, spare parts and raw materials	Exemption from customs duties and import-related VAT with respect to its imported equipment, spare parts and raw materials
Preferential Time Limit for Depreciation of Equipment Used in Production (applicable to foreign investments exceeding US\$30 million)	- No less than three years - According to industry standards, SMIC Shanghai uses 5-year basis	- No less than three years - According to industry standards, SMIC Beijing uses 5-year basis	- No less than three years - According to industry standards, SMIC Tianjin uses 5-year basis

## Operating Results

### Sales

We generate our sales primarily from fabricating semiconductors. We also derive a relatively small portion of our sales from the mask-making and wafer probing services that we perform for third parties separately from our foundry services.

In 2004, fabless semiconductor companies accounted for 40.3 %, IDMs accounted for 52.9% and systems and other companies accounted for 6.9%, respectively, of our sales. Although we are not dependent on any single customer, a significant portion of our net sales is attributable to a relatively small number of our customers. In 2002, 2003 and 2004, our five largest customers accounted for approximately 68.8%, 57.0% and 59.1% of our sales, respectively. In 2002, our largest customer, Integrated Silicon Solution, Inc., or ISSI, accounted for approximately 24.9% of our sales. Our second largest customer in 2002, Fujitsu Limited, accounted for approximately 16.0% of our sales. Our two largest customers in 2003, Samsung Electronics and Texas Instruments, accounted for approximately 12.1% and 11.7% of our sales in that year, respectively. Our two largest customers in 2004, Broadcom and Fujitsu accounted for approximately 13.4% and 12.7% of our sales, respectively.

The semiconductor industry generally experiences seasonality in which sales are strongest in the third quarter and weakest in the first quarter. This is driven by the seasonal demand fluctuations for the products that incorporate semiconductors. Our rapid capacity ramp-up has significantly outweighed any effects from this seasonality. Once our initial capacity expansion stabilizes, however, we may be more susceptible to these seasonal changes in demand.

### Cost of sales

Our cost of sales consists principally of:

- depreciation and amortization;
- overhead, including maintenance of production equipment, indirect materials, including chemicals, gases and various types of precious and other metals, utilities and royalties;
- direct materials, which consist of raw wafer costs;
- labor, including amortization of deferred stock compensation for employees directly involved in manufacturing activities; and
- production support, including facilities, utilities, quality control, automated systems and management functions.

As an increasing portion of our equipment has come on line, our depreciation expenses attributable to cost of sales have gradually increased from US\$37.6 million in 2002, to US\$172.7 million in 2003 and to US\$387.5 million in 2004.

### Operating expenses

Our operating expenses consist of:

- *Research and development expenses.* Research and development expenses consist primarily of salaries and benefits of research and development personnel, materials costs, depreciation and maintenance on the equipment used in our research and development efforts and contracted technology development costs. Research and development expenses also include costs relating to pilot production activities prior to the commencement of commercial production.
- *General and administrative expenses.* General and administrative expenses consist primarily of salaries and benefits for our administrative, finance and human resource personnel, commercial insurance, fees for professional services, foreign exchange gains and losses from operating activities and costs incurred in connection with developing production capabilities at new fabs, including facility costs and employee costs. Foreign exchange gains and losses relate primarily to period-end translation adjustments due to exchange rate fluctuations that affect payables and receivables directly related to our operations.

- *Selling and marketing expenses.* Selling and marketing expenses consist primarily of salaries and benefits of personnel engaged in sales and marketing activities, costs of customer wafer samples, other marketing incentives and related marketing expenses.
- *Amortization of deferred stock compensation expenses.* Amortization of deferred stock compensation expenses relates to stock compensation for those employees who are not directly involved in manufacturing activities and who receive incentives in the form of options on the shares of our company. Deferred stock compensation expenses are the excess of the deemed fair value of shares over the option exercise price at the time of grant, and are amortized on a straight-line basis generally over the four-year vesting period.

In addition, in 2004, we incurred operating expenses relating to the resolution of the patent and trade secret litigations with TSMC. According to the settlement's terms, TSMC and our company have a cross license to each other's patent portfolio through 2010. As a part of the settlement with TSMC, as described in "Item 8—Financial Information—Litigation," we have allocated US\$23.2 million of the total settlement amount to our litigation settlement costs in 2004.

#### ***Other income (expenses)***

Our other income (expenses) consists of:

- interest income, which has been primarily derived from cash equivalents and short-term investments and interest on share purchase receivables;
- interest expenses, net of capitalized portions and government interest subsidies, which have been primarily attributable to our bank loans and the imputed interest rate on an outstanding interest-free promissory note; and
- other income and expense items, such as those relating to the employee living quarters and school; and
- foreign exchange gains and losses relating to financing and investing activities, particularly forward contracts.

#### **Comparisons of Results of Operations**

##### **Consolidated Financial Data**

The summary consolidated financial data presented below as of and for the years ended December 31, 2002, 2003 and 2004 are derived from, and should be read in conjunction with, and are qualified in their entirety by reference to, the audited consolidated financial statements, including the related notes, included elsewhere in this annual report. The selected consolidated financial data as of December 31, 2000 and 2001, and for the period from April 3, 2000 (inception) through December 31, 2000 and for the year ended December 31, 2001 is derived from audited consolidated financial statements not included in this annual report. The summary consolidated financial data presented below has been prepared in accordance with U.S. GAAP.

	For the period from April 3, 2000 (inception) through December 31, 2000	For the year ended December 31,			
		2001	2002	2003	2004

(in US\$ thousands, except for per share, per ADS data, percentages and operating data)

### Statement of Operations Data:

Sales	\$ —	\$ —	\$ 50,315	\$ 365,823	\$ 974,665
Cost of sales <sup>(1)</sup>	—	—	105,238	363,241	721,401
Gross profit (loss)	—	—	(54,923)	2,582	253,264
Operating expenses:					
Research and development	—	9,326	37,459	32,070	78,167
General and administrative	929	16,870	17,782	27,912	46,015
Selling and marketing	—	751	4,371	9,447	8,130
Litigation settlement	—	—	—	—	23,153
Amortization of deferred stock compensation	—	712	1,769	5,900	15,416
Total operating expenses	929	27,659	61,381	75,329	170,881
Income (loss) from operations	(929)	(27,659)	(116,304)	(72,747)	82,383
Other income (expenses):					
Interest income	2,153	18,681	10,980	5,616	10,587
Interest expense	—	—	(176)	(1,425)	(13,698)
Foreign currency exchange gain	2	197	247	1,523	8,218
Other, net	—	187	2,650	888	2,441
Subsidy income	—	5,942	—	—	—
Total other income, net	2,155	25,007	13,701	6,602	7,547
Income (loss) before income tax	1,226	(2,652)	(102,603)	(66,145)	89,930
Income tax — current	—	—	—	—	186
Net income (loss)	1,226	(2,652)	(102,603)	(66,145)	89,744
Deemed dividend on preference shares <sup>(2)</sup>	—	—	—	37,117	18,839
Income (loss) attributable to holders of ordinary shares	\$ 1,226	\$ (2,652)	\$ (102,603)	\$ (103,262)	\$ 70,905
Income (loss) per ordinary share, basic	\$ 0.02	\$ (0.03)	\$ (1.27)	\$ (1.14)	\$ 0.01
Income (loss) per ordinary share, diluted	\$ 0.02	\$ (0.03)	\$ (1.27)	\$ (1.14)	\$ 0.00
Ordinary shares used in calculating basic income (loss) per ordinary share <sup>(3)(4)</sup>	80,000,000	80,000,000	80,535,800	90,983,200	14,199,163,517
Ordinary shares used in calculating diluted income (loss) per ordinary share <sup>(3)(4)</sup>	80,000,000	80,000,000	80,535,800	90,983,200	17,934,393,066
Income (loss) per ADS, basic <sup>(5)</sup>					\$ 0.25
Income (loss) per ADS, diluted <sup>(5)</sup>					\$ 0.20
ADS used in calculating basic income (loss) per ADS <sup>(5)</sup>					283,983,290
ADS used in calculating diluted income (loss) per ADS <sup>(5)</sup>					358,687,861

### Other Financial Data:

Gross margin	—	—	(109.2)%	0.7%	26.0%
Operating margin	—	—	(231.2)%	(19.9)%	8.5%
Net margin	—	—	(203.9)%	(18.1)%	9.2%

### Operating Data:

Wafers shipped (in 8” equivalents)					
Logic <sup>(6)</sup>	—	—	26,419	188,316	597,533
Total <sup>(7)</sup>	—	—	82,486	476,451	943,463

Average selling price (in US\$)						
Logic <sup>(6)</sup>	—	—	\$ 794	\$ 896	\$ 1,066	
Total <sup>(7)</sup>	—	—	\$ 558	\$ 733	\$ 979	

(1) Including amortization of deferred stock compensation for employees directly involved in manufacturing activities.

- (2) Deemed dividend represents the difference between the sale and conversion prices of warrants to purchase convertible preference shares we issued and their respective fair market values.
- (3) Anti-dilutive preference shares, options and warrants were excluded from the weighted average ordinary shares outstanding for the diluted per share calculation. For 2000, 2001, 2002 and 2003, basic income (loss) per share did not differ from diluted loss per share.
- (4) All share information have been adjusted retroactively to reflect the 10-for-1 share split effected upon completion of the Global Offering.
- (5) Fifty ordinary shares equals one ADS.
- (6) Excluding copper interconnects and DRAM wafers.
- (7) Including logic, DRAM, copper interconnects and all other wafers.

### ***Comparisons of the Years Ended December 31, 2002, 2003 and 2004***

#### *Year Ended December 31, 2004 Compared to Year Ended December 31, 2003*

**Sales.** Sales increased by 166.4% from US\$365.8 million for 2003 to US\$974.7 million for 2004, primarily as a result of the increase in our manufacturing capacity and our ability to use such capacity to increase sales. The number of wafers we shipped increased by 98.0%, from 476,451 8-inch wafer equivalents to 943,463 8-inch wafer equivalents, between these two periods. The average selling price of the wafers we shipped also increased by 33.5% from US\$733 per wafer to US\$979 per wafer, while the average selling price of the logic wafers we shipped increased by 19.0% from US\$896 per wafer to US\$1,066 per wafer. The percentage of wafers shipped that used 0.18 micron and below process technology also increased from 43.6% to 68.5% between these two periods.

**Cost of sales and gross profit (loss).** Cost of sales increased by 98.6% from US\$363.2 million for 2003 to US\$721.4 million for 2004. This increase was primarily due to the significant increase in sales volume, depreciation and manufacturing labor expenses. 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\$11.6 million in 2004 from US\$5.5 million in 2003, primarily due to additional stock options granted and restricted share units awarded to new and existing employees involved in this activity. We amortize the deferred stock compensation expense using the straight-line method over the applicable vesting periods, which is typically four years.

We had gross profit of US\$253.3 million for 2004 compared to gross profit of US\$2.6 million in 2003. Gross margins improved to 26.0% in 2004 from 0.7% in 2003. The increase in gross margin was primarily due to an increase in the average selling price per wafer, a shift in production to more logic and less DRAM wafers, migration towards more advanced and higher margin process technology and a lower average cost per wafer resulting from our ability to leverage fixed costs over a greater number of wafers manufactured.

**Operating expenses and income (loss) from operations.** Our operating expenses increased by 126.8% from US\$75.3 million for 2003 to US\$170.9 million for 2004 due to the increase in research and development expenses, general and administrative expenses, amortization of deferred stock compensation and the litigation settlement.

Our research and development expenses increased by 143.7% from US\$32.1 million for 2003 to US\$78.2 million for 2004. This increase in research and development expenses resulted primarily from non-recurring startup engineering costs associated with the ramp-up of Fab 4 and the commencement of commercial production at Fab 7, 90 nanometer research and development activities and an increase in depreciation and amortization expenses.

Furthermore, as a part of the settlement with TSMC, as described in “Item 8—Financial Information—Litigation,” we have allocated US\$23.2 million of the total settlement amount to litigation settlement costs in 2004.

General and administrative expenses increased by 64.9% to US\$46.0 million for 2004 from US\$27.9 million for 2003, primarily due to an increase in salaries due to increased personnel of US\$5.2 million and legal fees of US\$8.8 million.

Selling and marketing expenses decreased by 13.9% from US\$9.4 million for 2003 to US\$8.1 million for 2004, which was primarily due to a decrease in engineering material costs relating to sales activities.

In addition, our deferred stock compensation relating to employees involved in research and development, general and administrative and selling and marketing increased from US\$5.9 million to US\$15.4 million between these periods, primarily due to additional stock options granted and restricted share units awarded to new and existing employees involved in these activities. We amortize the deferred stock compensation expense over the applicable vesting periods, which is typically four years.

As a result, our income from operations increased to US\$82.4 million in 2004 from a loss of US\$72.7 million in 2003. Our operating margin was 8.5% and negative 19.9%, respectively, for these two years.

**Other income (expenses).** Our other income (expenses) increased 14.3% from US\$6.6 million in 2003 to US\$7.5 million in 2004. This increase was primarily attributable to the increase in interest income from US\$5.6 million in 2003 to US\$10.6 million in 2004. This interest income was primarily derived from bank deposits relating to the proceeds received from the global offering. The foreign currency exchange gains increased from US\$1.5 million in 2003 to US\$8.2 million in 2004 relating to financing and investing activities, particularly forward contracts.

**Net income (loss).** Due to the factors described above, we had net income of US\$89.7 million in 2004 compared to a net loss of US\$66.1 million for 2003.

**Deemed dividends on preference shares.** In 2004, we recorded aggregate deemed dividends on preference shares of US\$18.8 million, 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. In 2003, we recorded deemed dividends on preference shares of US\$35.2 million, representing the difference between the sale and conversion prices of warrants to purchase Series C convertible preference shares we issued in the third and fourth quarters of 2003 and their respective fair market values. We also recorded deemed dividends on preference shares of US\$1.9 million in 2003, representing the difference between the sale and conversion prices of a warrant to purchase Series D convertible preference shares we issued in the fourth quarter of 2003 and their respective fair market values. All of these warrants expired unexercised upon the completion of our global offering.

*Year Ended December 31, 2003 Compared to Year Ended December 31, 2002*

**Sales.** Sales increased by 627.1% from US\$50.3 million for 2002 to US\$365.8 million for 2003, primarily as a result of the increase in our manufacturing capacity and our ability to use such capacity to increase sales. The number of wafers we shipped increased by 477.6%, from 82,486 to 476,451, between these two periods. The average selling price of the wafers we shipped also increased by 31.4% from US\$558 per wafer to US\$733 per wafer, while the average selling price of the logic wafers we shipped increased by 12.8%. The relative percentage of wafers shipped that were 0.18 micron and below also increased from 4.7% to 43.6% between these two periods.

**Cost of sales and gross profit (loss).** Cost of sales increased by 245.2% from US\$105.2 million for 2002 to US\$363.2 million for 2003. This increase was primarily due to the significant increase in sales, offset to a lesser degree by an increase in economies of scale due to the allocation of fixed costs over a larger number of wafers manufactured. In addition, we had an increase in deferred stock compensation expenses from US\$2.1 million to US\$5.5 million. The increase in the stock compensation expenses resulted from an increase in the fair market value of our ordinary shares and preference shares, as well as an increase in stock options grants due to the addition of

new personnel during 2003. We had a gross loss of US\$54.9 million for 2002 compared to gross profit of US\$2.6 million in 2003. The transition to gross profit was due to lower average cost per wafer, as a result of allocating fixed costs over a larger number of wafers manufactured. This was also attributable in part to the US\$1.8 million in gross profit that we realized from our sales of US\$31.9 million of reserved inventory items during 2003. Reserved inventory items consist of DRAM inventory, the carrying value of which we wrote down in 2002 to a market value that was lower than its cost. Gross margin improved from negative 109.2% for 2002 to 0.7% for 2003. The gross loss would have been approximately 0.2% of sales had the sales of the reserved inventory items not occurred. Accordingly, the sale of the reserved inventory items improved the gross profit margin by approximately 0.5%.

**Operating expenses and loss from operations.** Our operating expenses increased by 22.7% from US\$61.4 million for 2002 to US\$75.3 million for 2003 due to the increase in general and administrative expenses and selling and marketing expenses, which offset a decrease in research and development expenses. Our research and development expenses decreased by 14.4% from US\$37.5 million for 2002 to US\$32.1 million for 2003. This decrease in research and development expenses resulted primarily from the decrease in pilot production costs incurred in 2002 for Fab 2 and Fab 3B-C as such facilities commenced commercial production at the beginning of 2003, at which point we began to record these expenses as costs of sales. In addition, general and administrative expenses increased by 57.0% from US\$17.8 million for 2002 to US\$27.9 million for 2003, largely due to the US\$3.0 million increase in personnel expenses, the US\$2.8 million increase in property insurance and the US\$1.1 million increase in depreciation and amortization expenses relating to office equipment and enterprise software. Selling and marketing expenses increased by 116.1% from US\$4.4 million for 2002 to US\$9.4 million for 2003. The increase in selling and marketing expenses was mainly due to the US\$2.8 million increase in personnel expenses as a result of an increase in sales and the grants of preference shares to sales and marketing personnel at below market value, as well as the US\$1.9 million increase in customer sample expenditures and related research and development expenses. In addition, our deferred stock compensation expenses increased from US\$1.8 million to US\$5.9 million between these periods. The increase in stock compensation expenses resulted from an increase in the fair market value of our ordinary and preference share and an increase in our headcount. Our stock compensation expenses are expected to continue to increase in 2004 as we experience a full year of amortization of stock compensation for outstanding grants, as well as for future grants at less than fair market value.

As a result, our loss from operations decreased by 37.5% from US\$116.3 million in 2002 to US\$72.7 million in 2003. Our operating margin was negative 231.2% and negative 19.9%, respectively, for these two years.

**Other income (expenses).** Our other income (expenses) decreased 51.8% from US\$13.7 million in 2002 to US\$6.6 million in 2003. This decrease was primarily attributable to the 48.9% decrease in interest income from US\$11.0 million to US\$5.6 million. This interest income was primarily derived from interest on shareholders' subscription receivables, as well as from interest on bank deposits.

**Net loss.** Due to the factors described above, our net loss of US\$102.6 million for 2002 decreased by 35.5% to US\$66.1 million in 2003.

**Deemed dividends on preference shares.** In 2003, we recorded aggregate deemed dividends on preference shares of US\$37.1 million. The deemed dividends were due to the difference between the sale and conversion prices of warrants to purchase Series C convertible preference shares we issued in the third and fourth quarters of 2003 and their respective fair market values.



## Liquidity and Capital Resources

The following table sets forth a condensed summary of our audited statements of cash flows for the periods indicated:

	For the year ended December 31,		
	2002	2003	2004
	(in US\$ thousands)		
<b>Net cash provided by (used in) operating activities:</b>			
Net income (loss)	\$(102,603)	\$ (66,145)	\$ 89,745
Depreciation and amortization	84,537	233,905	456,961
Total	(48,802)	114,270	518,662
<b>Net cash used in investing activities:</b>			
Purchase of property, plant and equipment	(761,704)	(453,097)	(1,838,773)
Total	(751,144)	(454,498)	(1,826,787)
<b>Net cash provided by financing activities:</b>			
Proceeds from long-term debt	391,227	88,734	256,488
Proceeds from issuance of ordinary shares at initial public offering	—	—	1,016,859
Proceeds from issuance of Series A convertible preferred stock	15,000	—	—
Proceeds from issuance of Series C convertible preferred stock	—	530,216	—
Proceeds from issuance of Series D convertible preferred stock	—	—	30,000
Collection of subscription receivables	357,549	107,010	105,420
Total	712,925	693,497	1,469,764
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>\$ (87,056)</b>	<b>\$ 353,412</b>	<b>\$ 161,896</b>

We incurred capital expenditures of US\$897 million, US\$492 million and US\$2,000 million in 2002, 2003 and 2004, respectively. We have financed our substantial capital expenditure requirements through the proceeds received in our global offering, several rounds of private financing, cash flows from operations, and bank borrowings. From inception through 2004, we had received net proceeds of US\$1,017 million in our global offering, US\$1,606 million in cash through private equity financings and US\$544.5 million through long-term debt financings. Once a fab is in operation at acceptable capacity and yield rates, it can provide significant cash flows. Our cash flows from operations have historically exceeded operating income, reflecting our significant non-cash depreciation expenses. Our operating cash flows may not be sufficient to meet our capital expenditure requirements in 2005. If our operating cash flows are insufficient, we plan to fund the expected shortfall through bank loans. If necessary, we will also explore other forms of external financing.

Any transfer of funds from our company to our Chinese subsidiaries, either as a shareholder loan or as an increase in registered capital, is subject to registration or approval of Chinese governmental authorities, including the relevant administration of foreign exchange and/or the relevant examining and approval authority. In addition, it is not permitted under Chinese law for our Chinese subsidiaries to directly lend money to each other. Therefore, it is difficult to change our capital expenditure plans once the relevant funds have been remitted from our company to our Chinese subsidiaries. These limitations on the free flow of funds between us and our Chinese subsidiaries could restrict our ability to act in response to changing market conditions and reallocate funds from one Chinese subsidiary to another in a timely manner.

As of December 31, 2004, we had US\$607.2 million in cash and cash equivalents. These cash and cash equivalents are held in the form of United States dollars, Japanese Yen, European Euros, and Chinese Renminbi. Our net cash used in operating activities in 2004 was US\$518.7 million, which was primarily due to an increase of US\$74.1 million in inventories due to the increase in commercial production, an increase of US\$79.6 million in accounts receivable due to an increase in sales and an increase of US\$49.2 million in accounts payable relating to the purchase of materials and inventories, and the add-back of US\$457.0 million in depreciation and amortization relating to commercial production. Our net cash used in operating activities in 2003 was US\$114.3 million, which was primarily due to the add-backs of US\$233.9 million and US\$11.4 million in depreciation and amortization and amortization of deferred stock compensation as non-cash items, respectively. Our net cash provided by operating activities in 2002 was US\$48.8 million, which was primarily due to the add-backs of US\$84.5 million and US\$3.9 million in depreciation and amortization and amortization of deferred stock compensation as non-cash items, respectively.

Our net cash used in investing activities was US\$1,826.8 million in 2004, US\$454.5 million in 2003, and US\$751.1 million in 2002. This was primarily attributable to purchases of plant and equipment and land use rights for Fab 1, Fab 2, Fab 3, Fab 4 and Fab 7 in these periods of US\$2,00.0 million includes intangible assets, US\$492.0 million, and US\$896.9 million, respectively.

Our net cash provided by financing activities in 2004 was US\$1,469.8 million. This was primarily derived from US\$1,016.9 million in proceeds generated from our global offering, US\$30.0 million in proceeds from the issuance of Series D convertible preference shares, US\$105.4 from the collection of subscription receivables, and US\$256.5 million in the form of long-term debt borrowings. Our net cash provided by financing activities in 2003 was US\$693.5 million. This was primarily derived from US\$530.2 million in proceeds from our issuance of Series C convertible preference shares, US\$107.0 million from the collection of subscription receivables and US\$88.7 million in the form of long-term debt borrowings. Our net cash provided by financing activities in 2002 was US\$712.9 million, which was mainly derived from US\$391.2 million in long-term borrowings and US\$357.5 million from the collection of subscription receivables, as offset by US\$103.0 million for the repayment of short-term loans.

As of December 31, 2004, we had commitments of US\$7.0 million to purchase land use rights for the living quarters at SMIC Beijing, US\$127.0 million for facilities construction obligations for our Beijing, Tianjin and Shanghai fabs and US\$419.0 million to purchase machinery and equipment for our Beijing, Tianjin and Shanghai fabs. For additional information, see “Item 5—Operating and Financial Review and Prospects—Factors that Impact Our Results of Operations—Substantial Capital Expenditures” and “—Capacity Expansion.”

As of December 31, 2004, our outstanding long-term liabilities primarily consisted of US\$736.4 million in secured bank loans, of which US\$192.0 million is classified as the current portion of long-term loans. The long-term loans are repayable in installments commencing in March 2005, with the last payment in March 2009.

In December 2001, Semiconductor Manufacturing International (Shanghai) Corporation (“SMIC Shanghai”), our wholly foreign-owned enterprise, entered into a long-term loan agreement with a syndicate of Chinese banks for US\$432.0 million. The drawdown period of the facility is 18 months starting from the loan agreement date. As of December 31, 2004, we had drawn down the full amount. The interest rates on the loan ranged from 2.82% to 4.34% in 2004. Interest is due on a semi-annual basis. The principal amount is repayable starting in March 2005 in five semi-annual installments of US\$86.4 million each. The interest expenses incurred in 2002, 2003 and 2004 were US\$6.6 million, US\$12.3 million and US\$14.0 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 in Renminbi equivalent to US\$48.0 million (equivalent to approximately Rmb 397.0 million). As of December 31, 2004, 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 was 5.02% in 2004. The interest expenses incurred in 2002, 2003 and 2004 were US\$0.4 million, US\$2.4 million and US\$2.5 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 Chinese banks for US\$256.5 million and Rmb 235.7 million (equivalent to approximately US\$28.5 million), respectively. The drawdown period of these facilities ends on the earliest of (i) twelve months after the date of the first drawdown, (ii) March 28, 2005 and (iii) the date on which the loans have been fully drawn down. As of December 31, 2004, SMIC Shanghai had drawn down the full amount of the U.S. dollar facility while the Renminbi facility has yet to be drawn. The interest rates on the loan ranged from 2.75% to 4.34% in 2004. 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 expense incurred in 2004 in connection with the U.S. dollar facility was US\$3.9 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:

- $(\text{Total liability} - \text{borrowings from shareholders, including principal and interest}) / \text{Total assets} > 65\%$
- $(\text{Current assets} - \text{inventory}) / \text{Current liabilities} < 100\%$
- $\text{Total liability} / \text{EBITDA} > 2.98$
- $(\text{Funds available for loan repayment in current year} + \text{Funds available for loan repayment in prior year}) / \text{Repayment amount during current year} < 2.5$

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;
- 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.

These five-year bank loans will be used to expand the capacity of the fabs in Shanghai and are collateralized by the Shanghai fabs and equipment.

On May 26, 2005, SMIC Beijing entered into a five year loan facility in the aggregate principal amount of US\$600 million, with a syndicate of banks based in the PRC. The draw-down period under the facility is one year. The facility is repayable in six semi-annual installments beginning in November 2007. Our company has guaranteed SMIC Beijing's obligations under the facility.

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

- $[\text{Net profit} + \text{depreciation} + \text{amortization} + \text{financial expenses} - (\text{increase of accounts receivable and advanced payments} + \text{increase of inventory} - \text{increase in accounts payable and advanced receipts})] / \text{financial expenses} < 1$ ; and
- $(\text{Total liability} - \text{borrowings from shareholders, including principal and interest}) / \text{Total assets} > 60\%$  (when SMIC Beijing's capacity is less than 20,000 twelve-inch wafers per month); and  $(\text{Total liability} - \text{borrowings from shareholders, including principal and interest}) / \text{Total assets} > 50\%$  (when SMIC Beijing's capacity exceeds 20,000 twelve-inch wafers per month).

This facility will be used to expand the capacity of the fabs in Beijing and is secured by SMIC Beijing's existing fixed assets. As of December 31, 2004, we had an aggregate of US\$253.0 million in bank loans available to us through short-term loan facilities from seven different banks. As of December 31, 2004, we had drawn down US\$91.0 million of this amount. Approximately 27%, 38% and 35% were made available to SMIC Beijing, SMIC Tianjin and our company, respectively.

We accepted promissory notes from employees exercising options to purchase either ordinary shares or Series A convertible preference shares under our 2001 employee stock option plans (the "Stock Option Plans"). As of December 31, 2004, 2003 and 2002, we had notes receivable from employees related to the early exercise of employee stock options in the aggregate amount of US\$0.4 million, US\$36.0 million and US\$37.0 million, respectively. In 2004, we collected US\$35.2 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 and preference shares. The notes are due at various dates from 2006 to 2008 and are payable at varying rates from 3.02% to 4.28% per annum.

In August 2002, we entered into a technology transfer agreement with a third party whereby we acquired technology and patent licenses in exchange for 1,666,667 Series B convertible preference shares, a US\$15.0 million non-interest bearing redeemable convertible promissory note and US\$15.0 million in cash. The convertible note was redeemable for US\$15.0 million in cash, convertible into Series B convertible preference shares or convertible into a combination of cash and Series B convertible preference shares. This note was redeemed for cash in January 2004.

On September 23, 2003, we entered into contracts with two technology partners to acquire “wafer bumping” machinery and equipment and design reference technology in exchange for an aggregate of 2,342,856 Series D convertible preference shares that are convertible into our ordinary shares. These transactions closed in the first and third quarters of 2004.

As of December 31, 2004, we did not have any material contingent liabilities.

### Research and Development, Patents and Licenses, etc.

Our research and development activities are principally directed toward the development and implementation of more advanced and lower cost process technology. We spent US\$37.5 million in 2002, US\$32.1 million in 2003, and US\$78.2 million in 2004 on research and development expenses, which represented 74.4%, 8.8%, and 8.0%, respectively, of our sales in those respective years. Our research and development costs in 2004 include non-recurring engineering costs associated with the ramp-up of Fab 4 and Fab 7. We plan to continue to invest significant amounts in research and development in 2005.

See “Item 4—Information on the Company—Research and Development” for more details relating to our research and development activities.

### Trend Information

See “Item 5—Operating and Financial Review and Prospects—Factors that Impact Our Results of Operations” for a discussion of the most significant recent trends affecting our operations.

### Off-Balance Sheet Arrangements

We have not entered into any off-balance sheet transactions.

### Tabular Disclosure of Contractual Obligations

Set forth in the table below are the aggregate amounts, as of December 31, 2004, of our future cash payment obligations under our existing debt arrangements on a consolidated basis:

Contractual obligations	Payments due by period				
	Total	Less than 1 year	1 - 2 years	3 - 5 years	After 5 years
	(consolidated) (in US\$ thousands)				
Short-Term Debt	\$ 91,000	\$ 91,000	\$ —	\$ —	\$ —
Long-Term Debt					
Secured Long-Term Loans	736,448	191,986	265,267	279,195	—
Operating Lease Obligations <sup>(1)</sup>	4,434	711	938	116	2,669
Purchase Obligations <sup>(2)</sup>	553,000	553,000	—	—	—
Investment Commitments <sup>(3)</sup>	79,200	47,200	32,000	—	—
Other Long-Term Obligations <sup>(4)</sup>	175,000	30,000	30,000	90,000	25,000
<b>Total Contractual Obligations</b>	<b>\$1,559,882</b>	<b>\$ 866,697</b>	<b>\$465,480</b>	<b>\$200,036</b>	<b>\$ 27,669</b>

(1) Represents our obligations to make lease payments to use the land on which our fabs are located in Shanghai and other office equipment we have leased.

(2) Represents commitments for construction or purchase of semiconductor equipment, and other property or services.

(3) Represents commitments to invest in certain joint venture projects.

(4) Includes the settlement with TSMC for an aggregate of \$175 million payable in installments over six years.

## Item 6. Directors, Senior Management and Employees

### Directors and Senior Management

Members of our board of directors are elected by our shareholders. Our board of directors consists of eight directors.

The following table sets forth the names of our directors and executive officers, including our founder, as of May 31, 2005. Our executive officers are appointed by, and serve at the discretion of, our board of directors.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Richard Ru Gin Chang	57	Chairman of the Board, Executive Director, Founder, President and Chief Executive Officer
Lai Xing Cai	62	Non-Executive Director
Ta-Lin Hsu	61	Independent Non-Executive Director
Yen-Pong Jou	44	Independent Non-Executive Director
Tsuyoshi Kawanishi	75	Independent Non-Executive Director
Henry Shaw	51	Independent Non-Executive Director
Lip-Bu Tan	45	Independent Non-Executive Director
Yang Yuan Wang	70	Independent Non-Executive Director
Fang Yao	35	Alternate Director (to Lai Xing Cai)
Morning Wu	48	Acting Chief Financial Officer and Chief Accounting Officer and Qualified Accountant
Marco Mora	46	Chief Operating Officer
Toshiaki Ikoma	63	Chief Technology Officer
Akio Kawabata	59	Vice President, Marketing
Jason Ting Chih Hsien	47	Vice President, Human Resources and General Affairs and Joint Compliance Officer
Anne Wai Yui Chen	43	Company Secretary, Hong Kong Representative and Joint Compliance Officer

\* In March 2005, we named Ms. Wu as our Acting Chief Financial Officer, Chief Accounting Officer and Qualified Accountant.

**Richard Ru Gin Chang** founded our company in April 2000 and is currently the Chairman of our Board, President and Chief Executive Officer of our company. Dr. Chang is also a director of our wholly owned subsidiaries, Semiconductor Manufacturing International (Shanghai) Corporation, Semiconductor Manufacturing International (Beijing) Corporation, Semiconductor Manufacturing International (Tianjin) Corporation and Semiconductor Manufacturing International (AT) Corporation. Dr. Chang has over 26 years of semiconductor experience in foundry operations, wafer fabrication and research and development. From 1998 to 1999, Dr. Chang was President of Worldwide Semiconductor Manufacturing Corp., or WSMC, after joining the company in 1997. Prior to joining WSMC, Dr. Chang worked for 20 years at Texas Instruments Incorporated, where he helped build and manage the technology development and operations of ten semiconductor fabs and integrated circuit operations in the United States, Japan, Singapore, Italy and Taiwan. Dr. Chang received a PhD in Electrical Engineering from Southern Methodist University and a master's degree in Engineering Science from the State University of New York. In December 2003, Dr. Chang was selected by the China Center of Information Development as one of the ten "China IT Economic People of 2003" for his role in influencing and contributing to the development of China's information technology industry. In February 2004, Dr. Chang received The Magnolia Silver Award, which is generally recognized as the highest award an individual may receive from the Shanghai Municipal Foreign Affairs Office. The award recognizes Dr. Chang's contributions to Shanghai's economy, social development and interchange and cooperation with foreign companies.

**Lai Xing Cai** has been a director of our company since March 2004. Mr. Cai is the Chairman and a member of the board of directors of Shanghai Industrial Holdings Limited and the Chairman and a member of the board of directors of Shanghai Industrial Investment (Holdings) Company Limited. Mr. Cai graduated from Tong Ji University and was a Deputy Secretary of the Shanghai Government responsible for economic planning, finance and research. He was also the Deputy Director of the Shanghai Planning Committee and Pudong Development Office, and was in charge of the city government's research office. In 1988, he was awarded the title of State-Class Economist. Mr. Cai is also a member of the National Committee of The Chinese People's Political Consultative Conference.

**Ta-Lin Hsu** has been a director of our company since 2001 and is a director of SMIC Beijing. Dr. Hsu is the founder and chairman of H&Q Asia Pacific. Prior to founding H&Q Asia Pacific in 1986, Dr. Hsu was a General Partner at Hambrecht & Quist and held the position of Senior Manager in the Corporate Research Division of IBM. Dr. Hsu has served on the boards of a number of public and private companies, and he currently serves on the Board of Trustees of the Asia Foundation and as a member of the Council of Foreign Relations. Dr. Hsu received his PhD in Electrical Engineering from the University of California at Berkeley and his undergraduate degree in Physics from National Taiwan University. Dr. Hsu is a member of the Advisory Board of the Haas School of Business at the University of California at Berkeley.

**Yen-Pong Jou** has been a director of our company since 2001. Mr. Jou is the Senior Partner of Jou & Associates. Between 1985 and November 2003, Mr. Jou was General Counsel of a public company. Mr. Jou received a law degree from the FuJen Catholic University School of Law in Taiwan.

**Tsuyoshi Kawanishi** has been a director of our company since 2001 and is also the Chairman of SMIC Japan Corporation. Mr. Kawanishi has more than 50 years of experience in the electronics industry with Toshiba Corporation, where he served as, among other positions, Senior Executive Vice President and Senior Advisor. Mr. Kawanishi currently serves on the board of directors of Asyst Technologies, Inc., FTD Technology Pte. Ltd. and T.C.S. Japan, and acts as an advisor to Accenture Ltd., Kinetic Holdings Corporation and a number of private companies. Mr. Kawanishi is also the Chairman of the Society of Semiconductor Industry Seniors in Japan and the Chairman of the SIP Consortium of Japan.

**Henry Shaw** has been a director of our company since 2001. Mr. Shaw is currently the Senior Partner of AsiaVest Partners TCW/YFY Ltd. Prior to joining AsiaVest Partners, Mr. Shaw was a Vice President at Transpac Capital Pte. Ltd. and founded and served as Chief Financial Officer of Mosel Vitelic Inc. Mr. Shaw serves on the board of directors of InterVideo, Inc. Mr. Shaw received a master's degree in Business Administration from National Cheng-Chi University in Taiwan.

**Lip-Bu Tan** has been a director of our company since 2002 and is a director of SMIC Tianjin. Mr. Tan is the founder and Chairman of Walden International, a venture capital firm. Mr. Tan currently serves on the board of directors of Cadence Design Systems, Inc., Centillum Communications, Inc., Creative Technology Ltd., Flextronics International Ltd., Integrated Silicon Solution, Inc., Leadis Technology, Inc. and SINA Corporation, as well as a number of private companies. Mr. Tan received a master's degree in Nuclear Engineering from the Massachusetts Institute of Technology and a master's degree in Business Administration from the University of San Francisco.

**Yang Yuan Wang** has been a director of our company since 2001. Professor Wang has more than 40 years of experience related to the semiconductor industry. He is the Chairman of SMIC Shanghai, SMIC Beijing and SMIC Tianjin and is also the Chief Scientist of the Microelectronics Research Institute at Beijing University. He is a fellow of the Chinese Academy of Sciences and The Institute of Electrical and Electronics Engineers.

**Fang Yao** has been an alternate director of Lai Xing Cai, a director, since July 2004. Mr. Yao is an executive director of Shanghai Industrial Holdings Limited. Mr. Yao also serves as a director and general manager of SIIC Management (Shanghai) Limited, a director of Shanghai S.I. Capital Company Limited, Shanghai Industrial Development Company Limited, Shanghai Hu-Ning Expressway (Shanghai Section) Company Limited, Shanghai Information Investment Inc. and Shanghai Communication Technologies Center, chairman of Shanghai Optical Communications Development Corp., and vice chairman of Bright Dairy and Food Company Limited. He graduated from Chinese University of Hong Kong with a master's degree in Business Administration.

**Morning Wu** joined our company as Associate Vice President of Finance and Accounting in January 2003 and was appointed as Acting Chief Financial Officer, Chief Accounting Officer and Qualified Accountant of the Company as of March 28, 2005. Ms. Wu has over 25 years experience in the investment and finance field. Prior to joining our company, Ms. Wu held management positions with First Taiwan Securities Inc. and Grand Cathay Securities Co.

Ltd. Her responsibilities at these companies included strategic planning, mergers & acquisitions and designing and monitoring risk management systems. She holds a license for Accounting and Auditor with the Senior Civil Service Examinations of Taiwan. Ms. Wu obtained a bachelor's degree in Accounting from the National Chengchi University, Taiwan and received a master's degree in Accounting from National Taiwan University.

**Marco Mora** joined our company in 2000 as Vice President of Operations and since November 2003 has been our Chief Operating Officer. Mr. Mora has more than 19 years of experience in the semiconductor industry. Prior to joining our company, Mr. Mora held management positions with STMicroelectronics N.V., Texas Instruments Italia S.p.A, Micron Technology Italia S.p.A and WSMC. Mr. Mora received a master's degree in Physics from the University of Milan.

**Toshiaki Ikoma** joined our company as Chief Technology Officer in January 2004. Dr. Ikoma has extensive semiconductor experience in both academia and industry. Dr. Ikoma was the President of Texas Instruments Japan, Inc. for five years and, prior to that position, served as a professor of Electronics at the Institute of Industrial Science at the University of Tokyo from 1968 to 1994. Prior to joining our company, he was a professor of Technology Management at the Graduate School of International Corporate Strategy of Hitotsubashi University, Tokyo, beginning in 2002. Dr. Ikoma received a PhD in Electronics from the University of Tokyo.

**Akio Kawabata** joined our company in 2002 and is currently our Vice President of Marketing. Mr. Kawabata has over 32 years of experience in the semiconductor industry. Prior to joining our company, Mr. Kawabata held various management positions with Toshiba Corporation, including General Manager of Toshiba's International Division, President of Toshiba Electronics Europe GmbH and Managing Director of Toshiba Asia Pacific. Mr. Kawabata received a master's degree in Electrical Engineering from Stanford University.

**Jason Ting Chih Hsien** joined our company in January 2002 and became our Vice President for Human Resources and General Affairs in January 2004. Dr. Ting also serves as our Joint Compliance Officer. He previously served as our Senior Director of sales and marketing. Prior to joining our company, Dr. Ting served as a Director of Walsin Lihwa Corporation in Taiwan. Dr. Ting received a PhD in Material Science from the University of Illinois.

**Anne Wai Yui Chen** joined our company in 2001 and is our Hong Kong representative, Corporate Secretary and Joint Compliance Officer. Ms. Chen is admitted as a Solicitor in Hong Kong, England and Wales and Australia and was admitted as an advocate and solicitor in Singapore. She had served as a Deputy Adjudicator of the Small Claims Tribunal in Hong Kong in 1999 and had served as the President from 2000 to 2002 and is currently a Council Member of the Hong Kong Federation of Women Lawyers. Prior to joining the Company in 2001, she had been a practicing solicitor in Hong Kong since 1987.

No shareholder has a contractual right to designate a person to be elected to our board of directors.

There are no family relationships among any of our directors and executive officers, including our founder.

### **Director and Executive Compensation**

The aggregate cash compensation that we paid to all of our executive officers as of December 31, 2004 for services rendered to us and our subsidiaries during 2004 was approximately US\$554,418. Of this amount, we paid our president and chief executive officer US\$190,343 in salary, discretionary bonuses, housing allowances, other allowances and benefits in kind in 2004. We currently do not provide cash compensation to directors that are not employees. Pursuant to an incentive program involving the offering for sale of housing constructed by us to all our directors, employees and certain service providers, we sold one property to our president and chief executive officer at the same price at which other properties of the same type have been sold by us to other employees under the program. We do not provide pension, retirement or similar benefits to our executive officers and directors.

We granted options to purchase an aggregate of 16,600,000 ordinary shares under our 2001 Regulation S Stock Plan, and options to purchase an aggregate of 450,000 preference shares which converted into options to

purchase an aggregate of 4,500,000 ordinary shares upon the completion of the global offering, under our 2001 Regulation S Preference Shares Stock Plan to certain of our directors and executive officers. No options have been granted under our 2001 Stock Plan or 2001 Preference Shares Stock Plan to our directors or executive officers. Both our 2001 Regulation S Stock Plan and 2001 Regulation S Preference Shares Stock Plan are described below in “—Share Ownership.” The exercise prices of the options granted to our directors and executive officers to purchase ordinary shares range from US\$0.005 to US\$0.25, and the exercise prices of the options granted to our directors and executive officers to purchase preference shares are equal to US\$1.1111. The expiration dates of the options range from March 2011 to September 2012.

As of December 31, 2004, we have granted options to purchase an aggregate of 4,210,000 ordinary shares under our 2004 Stock Option Plan, and an aggregate of 980,000 restricted share units under our 2004 Equity Incentive Plan to certain of our directors and executive officers as of such date. Both our 2004 Stock Option Plan and the 2004 Equity Incentive Plan are described below. On November 10, 2004, our board of directors issued each independent non-executive and non-executive director an option to purchase 500,000 ordinary shares at a price per ordinary share of USD\$0.22. These options vested on March 19, 2005, subject to the director continuing to serve on our board on that date. These options expire on November 9, 2009. Lai Xing Cai has declined this option. No director exercised any option to purchase ordinary shares in 2004.

The exercise price of the options granted to our executive officers to purchase ordinary shares under the 2004 Stock Option Plan range from US\$0.31 to US\$0.35 per share. The expiration dates of the options range from March 17, 2014 to April 6, 2014. On May 11, 2005, the compensation committee issued to Richard Ru Gin Chang an option to purchase 15,000,000 ordinary shares and an award of 2,000,000 restricted share units. The exercise price per ordinary share underlying the option is US\$0.196. The option and the award of restricted share units will expire on May 11, 2015.

On April 25, 2004, the compensation committee approved a profit-sharing plan for the benefit of our employees, including our executive officers. Under the Company’s profit-sharing plan, a participant who is an employee of the Company at the end of a fiscal quarter will be eligible to receive a percentage of the Company’s profits for that quarter. In 2004, the Company’s executive officers received an aggregate of US\$27,580 as a result of their participation in the Company’s profit-sharing plan.

## **Board Practices**

### ***Board of Directors***

Our board of directors consists of eight directors. Directors may be elected to hold office until the expiration of their respective terms upon a resolution passed at a duly convened shareholders meeting by holders of a majority of our outstanding shares being entitled to vote in person or by proxy at such meeting. Our board is divided into three classes with no more than one class eligible for re-election at any annual shareholders meeting.

The Class I directors were elected for a term of one year following the completion of the global offering and thereafter will serve terms of three years. The Class II directors were elected for a term of two years following the completion of the global offering and thereafter will serve terms of three years. The Class III directors were elected for a term of three years following the completion of the global offering and thereafter will serve terms of three years. We completed our global offering on March 18, 2004.

The following table sets forth the names and classes of our directors:

<u>Class I</u>	<u>Class II</u>	<u>Class III</u>
Richard Ru Gin Chang Henry Shaw	Ta-Lin Hsu Yen-Pong Jou Lip-Bu Tan	Lai Xing Cai Tsuyoshi Kawanishi Yang Yuan Wang



In connection with the acquisition of Fab 7, we granted Motorola the right to designate and have elected one member to our board of directors, which right terminated upon the completion of the global offering. On April 25, 2004, Sean Hunkler, the vice president of Fab Operations for Freescale Semiconductor, Inc. (“Freescale”), which was an affiliate of Motorola, Inc., joined our board of directors. Mr. Hunkler resigned from our board as of December 2, 2004. Subsequently, our board, in accordance with our articles of association, approved the reduction in the number of board members from nine to eight. None of our directors has any employment or service contract with our company.

The Class I directors were re-elected by our shareholders on May 6, 2005.

### **Committees of Our Board of Directors**

Our board of directors has an audit committee and a compensation committee. The composition and responsibilities of these committees are described below.

*Audit Committee.* As of December 31, 2004, the members of our audit committee, all of whom were independent non-executive directors, were Yen-Pong Jou, Henry Shaw, Lip-Bu Tan and Yang Yuan Wang. At the meeting of the board of directors on January 25, 2005, Mr. Jou resigned from our audit committee. None of the current members of our audit committee has been an executive officer or employee of the company or any of its subsidiaries. See “Related Party Transactions” for a description of transactions between us and our current audit committee members.

The responsibilities of our audit committee include, among other things:

- making recommendations to our board of directors concerning the appointment, reappointment, retention, evaluation, oversight and termination of the work of our 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 our independent auditor;
- approving the remuneration and terms of engagement of our independent auditor;
- reviewing reports from our 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 us and the independent auditor;
- pre-approving the hiring of any employee or former employee of our independent auditor who was a member of the audit team during the preceding two years;
- reviewing our 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 our 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 our internal audit team and the quality and effectiveness of our internal controls;
- reviewing our risk assessment and management policies;
- reviewing any legal matters that may have a material impact and the adequacy and effectiveness of our legal and regulatory compliance procedures;
- establishing procedures for the treatment of complaints received by us regarding accounting, internal accounting controls, auditing matters, potential violations of law and questionable accounting or auditing matters; and
- obtaining and reviewing reports from management, our internal auditor and our independent auditor regarding compliance with applicable legal and regulatory requirements, including the Foreign Corrupt Practices Act.

We believe that the composition and functioning of our audit committee complies with the applicable requirements of the U.S. Sarbanes-Oxley Act of 2002, the New York Stock Exchange, the U.S. Securities and Exchange Commission and the Hong Kong Stock Exchange. We intend to comply with future requirements to the extent they become applicable to us.

*Compensation Committee.* As of December 31, 2004, the members of our compensation committee, all of whom were independent non-executive directors, were Ta-Lin Hsu, Tsuyoshi Kawanishi and Lip-Bu Tan. None of these members of our compensation committee has been an executive officer or employee of our company or any of its subsidiaries. See “Related Party Transactions” for a description of transactions between us and our current compensation committee members.

The responsibilities of our compensation committee include, among other things:

- approving and overseeing the total compensation package for our executive officers and any other officer, evaluating the performance of and determining and approving the compensation to be paid to our chief executive officer and reviewing the results of our chief executive officer’s evaluation of the performance of our other executive officers;
- reviewing and making recommendations to our board of directors with respect to director compensation, including equity-based compensation;
- administering and periodically reviewing and making recommendations to our board of directors regarding the long-term incentive compensation or equity plans made available to our directors, employees and consultants;
- reviewing and making recommendations to our board of directors regarding executive compensation philosophy, strategy and principles and reviewing new and existing employment, consulting, retirement and severance agreements proposed for our executive officers; and
- ensuring appropriate oversight of our human resources policies and reviewing strategies established to fulfill our ethical, legal and human resources responsibilities.

### **Corporate Governance Practices**

Companies listed on the New York Stock Exchange must comply with certain standards regarding corporate governance under Section 303A of the New York Listed Company Manual. However, foreign private issuers such as us, are permitted to follow home country practices in lieu of the provisions of Section 303A, except that such companies are required to comply with the rules relating to the audit committee. In addition, foreign private issuers must disclose any significant ways in which their corporate governance practices differ from NYSE listing standards.

#### **NYSE Rules**

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The NYSE listing standards require non-management directors to meet at regularly scheduled executive meetings not attended by management.

The NYSE listing standards require companies to have a nominating/corporate governance committee comprised of independent directors governed by a written charter establishing certain minimum requirements.

#### **The Companies Law (2004 Revision) For Companies Limited By Shares in the Cayman Islands**

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There is no requirement under Cayman Islands law for us to hold on a regular basis an executive session of the non-management directors. Under our Articles of Association, our board of directors may meet together for the dispatch of business as they think fit.

Under our Articles of Association, our board of directors may establish one or more committees, each consisting of one or more directors. Our board of directors may delegate its powers as our board of directors deems appropriate to this committee. However, we have not established a nominating/corporate governance committee.

## Employees

The following table sets forth, as of the dates indicated, the number of our employees serving in the capacities indicated:

Function	As of December 31,		
	2002	2003	2004
Managers	224	338	570
Professionals <sup>(1)</sup>	817	961	3,109
Technicians	1,837	2,746	3,389
Clerical staff	315	398	572
Total <sup>(2)</sup>	3,193	4,443	7,640

(1) Professionals include engineers, lawyers, accountants and other personnel with specialized qualifications, excluding managers.

(2) Includes 99, 38 and 14 temporary and part-time employees in 2002, 2003 and 2004, respectively.

The following table sets forth, as of the dates indicated, a breakdown of the number of our employees by geographic location:

Location of Facility	As of December 31,		
	2002	2003	2004
Shanghai	3,146	4,033	5,481
Beijing	40	341	1,026
Tianjin	—	49	1,107
United States	5	13	16
Europe	—	4	5
Japan	2	3	3
Hong Kong	—	—	2
Total	3,193	4,443	7,640

Our success depends to a significant extent upon, among other factors, our ability to attract, retain and motivate qualified personnel. As of December 31, 2004, 920 and 133 of our employees held master's degrees and doctorate degrees, respectively. As of the same date, 2,408 of our employees possessed a bachelor's degree. Our engineers received an average of 40 hours of continuing training per person in 2004. We have also entered into agreements with Shanghai University to offer a bachelor's degree program and Shanghai's Fudan University and Jiaotong University to offer graduate degree programs for our technicians. These employees can earn these degrees in either Microelectronics or Solid-state Circuitry. In addition, we employ many qualified personnel that have relocated back to China after receiving valuable industry experience overseas.

As a supplement to their salaries, our employees have the opportunity to earn additional merit-based bonuses on a quarterly basis according to our overall performance, each individual and his or her department. Furthermore, our employees are eligible to participate on a quarterly basis in our profit-sharing plan. Additional benefits include participation in our 2004 global equity incentive compensation program, social welfare benefits for qualified Chinese employees, a global medical insurance plan for overseas employees and optional housing benefits and educational programs for employees with families.

We provide occupational health and hygiene management for the welfare of our employees. This includes the monitoring of air quality, illumination, radiation, noise and drinking water. Our employees are not covered by any collective bargaining agreements.

## Share Ownership

The table below sets forth the ordinary shares beneficially owned by each of our directors and options to purchase ordinary shares as of December 31, 2004:

Name of Director	Current Shareholding	Options to Purchase Ordinary Shares	
		Number of Options	Exercise Price
Richard Ru Gin Chang	73,419,550 <sup>(1)(2)</sup>	100,000	US\$ 0.31
Lai Xing Cai	0	0	—
Ta-Lin Hsu	15,300,010 <sup>(3)</sup>	500,000	US\$ 0.22
Yen-Pong Jou	0	500,000	US\$ 0.22
Tsuyoshi Kawanishi	0	2,000,000	US\$0.05 –US\$0.22
Henry Shaw	0	500,000	US\$ 0.22
Lip-Bu Tan	0	500,000	US\$ 0.22
Yang Yuan Wang	0	500,000	US\$ 0.22
Fang Yao	0	0	—

<sup>1</sup> Includes the following:

- a. Pursuant to a Charitable Pledge Agreement dated December 1, 2003, Richard Ru Gin Chang and his spouse, Scarlett Chang (collectively, the “Donors”), have pledged to transfer 10,000,000 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.
  - b. 20,000,000 of the ordinary shares held as a corporate interest are held by Jade Capital Company, LLC, a Delaware limited liability company, of which Richard Ru Gin Chang and his spouse, Scarlett Chang, are the sole members. 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 Internal Revenue Code of 1986, as amended.
- <sup>2</sup> Does not include an option to purchase 15,000,000 ordinary shares if fully exercised, and an award of 2,000,000 restricted share units granted by the compensation committee on May 11, 2005.
- <sup>3</sup> Ta-Lin Hsu has a controlling interest in AP3 Co-Investment Partners, LDC, which holds 15,300,010 ordinary shares.

The shareholdings set forth above excludes shares beneficially owned by entities affiliated with our directors. Each of our directors disclaims beneficial ownership of the shares beneficially owned by such affiliated entity, except to the extent of such director’s pecuniary interest therein as disclosed above.

On July 11, 2002, the compensation committee issued Mr. Kawanishi an option to purchase 500,000 ordinary shares pursuant to the terms of the 2001 Stock Option Plan. This option will expire on July 10, 2012. On January 15, 2004, the board issued him an option to purchase 1,000,000 ordinary shares pursuant to the terms of the 2001 Stock Option Plan. This option will expire on January 14, 2014. The exercise prices of the options are US\$0.05 and US\$0.10, respectively.

On November 10, 2004, the Board granted to each independent non-executive director and non-executive director, an option to purchase 500,000 Ordinary Shares at a price per ordinary share of US\$0.22. These options vested on March 19, 2005, subject to the director continuing to serve on the Board on that date. These options expire on November 9, 2009. Lai Xing Cai has declined this option.

On May 11, 2005, the compensation committee issued to Richard Ru Gin Chang an option to purchase 15,000,000 ordinary shares and an award of 2,000,000 restricted share units. The exercise price per ordinary share underlying the option is US\$0.196. The option and the award of restricted share units will expire on May 11, 2015.

The compensation committee has issued each of our executive officers options to purchase ordinary shares pursuant to our 2001 Regulation S Stock Option Plan, 2001 Regulation S Preference Shares Stock Plan and the 2004 Stock Option Plan and restricted share units that represent rights to receive ordinary shares pursuant to our 2004 Equity Incentive Plan. The exercise price of the options range from US\$0.01 to US\$0.11. The options expire between March 28, 2011 and April 7, 2014. The restricted share units expire on July 1, 2014. The majority of the options and restricted share units are subject to a four-year vesting period. Each executive officer owns less than 1% of the total outstanding shares of the company.

### 2001 Stock Plan and 2001 Regulation S Stock Plan

On March 28, 2001, our board of directors and shareholders adopted our 2001 Stock Plan and our 2001 Regulation S Stock Plan.

Under these plans, our directors, employees and consultants are eligible to acquire ordinary shares pursuant to options. At the time of adoption, 250,000,000 post-split ordinary shares were reserved for

issuance under the 2001 Stock Plan and 470,000,000 post-split ordinary shares were reserved for issuance under the 2001 Regulation S Stock Plan. On August 27, 2003, our shareholders approved an increase in the number of authorized shares reserved under the plans of 3,438,900 post-split ordinary shares, increasing the total number of authorized shares reserved under the plans to 723,438,900 post-split ordinary shares. On August 27, 2003, September 22, 2003 and December 4, 2003, our shareholders approved additional increases in the number of shares reserved under our 2001 Regulation S Stock Plan of up to 325,000,000, 21,499,990 and 235,089,480 post-split ordinary shares, respectively, which amounts were to be adjusted from time to time to equal 10% of the post-split ordinary shares issuable upon the conversion of all Series C convertible preference shares and Series D convertible preference shares then outstanding. As of December 31, 2004, there were 998,675,840 post-split ordinary shares authorized for issuance under the plans, 632,664,140 post-split ordinary shares subject to outstanding options under the plans and 193,315,679 post-split ordinary shares outstanding from the exercise of options granted under the plans. We issued an aggregate of 15,004,679 ordinary shares in 2004 under the 2001 Stock Plan and the 2001 Regulation S Stock Plan. These plans terminate on December 4, 2013 but may be terminated earlier by our board of directors.

Stock options granted under the 2001 Stock Plan may be incentive stock options, or ISOs, which are intended to qualify for favorable U.S. federal income tax treatment under the provisions of Section 422 of the U.S. Internal Revenue Code of 1986, as amended, or U.S. Internal Revenue Code, or non-qualified stock options, or NSOs, which do not so qualify. Stock options granted under the 2001 Regulation S Stock Plan are NSOs. The aggregate fair market value of the ordinary shares represented by any given optionee's ISOs that become exercisable in any calendar year may not exceed US\$100,000. Stock options in excess of this limit are treated as NSOs.

The board of directors, the compensation committee and the non-executive option grant committee administer the 2001 Stock Plan and 2001 Regulations S Stock Plan. The compensation committee selected the eligible persons above a certain compensation grade to whom options were granted and determined the grant date, amounts, exercise prices, vesting periods and other relevant terms of the stock options, including whether the options will be ISOs or NSOs. The non-executive option grant committee selected the eligible persons below a certain compensation grade to whom options were granted and determined the grant date, amounts, exercise prices, vesting periods and other relevant terms of stock options within parameters established by the compensation committee and subject to compensation committee ratification. The exercise price of ISOs granted under the 2001 Stock Plan and NSOs granted to residents of California under the 2001 Stock Plan may not be less than 100% and 85%, respectively, of the fair market value of our ordinary shares on the grant date. The exercise price of NSOs not granted to residents of California under either our 2001 Stock Plan or our 2001 Regulation S Stock Plan can be determined by the board of directors, the compensation committee or the non-executive option grant committee in their discretion.

Stock options granted under the 2001 Stock Plan and 2001 Regulation S Stock Plan may be exercised at any time after they vest, and, in certain instances, prior to vesting. Shares purchased when an option is exercised prior to vesting are subject to our right of repurchase to the extent unvested in the event of the termination of service of the optionee. In the event of the termination of service of an optionee, the unvested portion of a stock option is forfeited and the vested portion terminates six months after a termination of service due to the death or permanent disability of the optionee or 30 days after termination of service for any other reason or such longer periods as may be provided for in option agreements with our optionees. Stock options are generally not transferable during the life of the optionee.

In the event of a change of control (as defined in the plans) or a merger of our company, each outstanding stock option may be assumed or an equivalent stock option or right may be substituted by the successor corporation. In the event that no such substitution or assumption occurs, the outstanding stock options will automatically vest and become exercisable for a period of 15 days, after which the stock options will terminate.

We have not issued stock options under the 2001 Stock Plan or the 2001 Regulation S Stock Plan since the completion of the global offering.

### ***2001 Preference Shares Stock Plan and 2001 Regulation S Preference Shares Stock Plan***

On April 12, 2001, our board of directors and shareholders adopted our 2001 Preference Shares Stock Plan and our 2001 Regulation S Preference Shares Stock Plan. Under these plans, our directors, employees and consultants were eligible to acquire Series A convertible preference shares prior to the completion of the global offering and ordinary shares upon or following the completion of the global offering, pursuant to options. At the time of adoption, 16,000,000 Series A preference shares and ten times that number of ordinary shares (on a post-split basis) were reserved for issuance under the 2001 Preference Shares Stock Plan, and 20,000,360 Series A convertible preference shares and ten times that number of ordinary shares (on a post-split basis) were reserved for issuance under the 2001 Regulation S Preference Shares Stock Plan. On August 19, 2002, our shareholders approved an increase in the number of shares issuable under the plans of 18,000,180 Series A convertible preference shares, increasing the total number of authorized shares reserved under the plans to 54,000,540 Series A convertible preference shares. On August 27, 2003, our shareholders approved a net decrease in the number of shares issuable under the plans of 343,890 Series A convertible preference shares, decreasing the total number of authorized shares reserved under the plans to 53,656,650 Series A convertible preference shares. Upon the conversion of our preference shares into ordinary shares in connection with the global offering, options granted under the 2001 Preference Shares Stock Plan and the 2001 Regulation S Preference Shares Stock Plan converted into options to purchase ordinary shares. As of December 31, 2004, there were 91,632,960 ordinary shares subject to outstanding options under the plans, and there were 400,340,710 ordinary shares outstanding from the exercise of options granted under the plans. We issued an aggregate of 4,362,010 ordinary shares in 2004 under the 2001 Preference Shares Stock Plan and the 2001 Regulation S Preference Shares Stock Plan. Our board of directors has elected not to grant any further options under these plans.

Stock options granted under the 2001 Preference Shares Stock Plan may be ISOs, which are intended to qualify for favorable U.S. federal income tax treatment under the provisions of the U.S. Internal Revenue Code, or NSOs, which do not so qualify. Stock options granted under the 2001 Regulation S Preference Shares Stock Plan are NSOs. The aggregate fair market value of the shares represented by any given optionee's ISOs that become exercisable in any calendar year may not exceed US\$100,000. Stock options in excess of this limit are treated as NSOs.

The board of directors, the compensation committee and the non-executive option grant committee administer the 2001 Preference Shares Stock Plan and 2001 Regulation S Preference Shares Stock Plan. The compensation committee selected the eligible persons above a certain compensation grade to whom options were granted and determined the grant date, amounts, exercise prices, vesting periods and other relevant terms of the stock options, including whether the options will be ISOs or NSOs. The non-executive option grant committee selected the eligible persons below a certain compensation grade to whom options were granted and determined the grant date, amounts, exercise prices, vesting periods and other relevant terms of stock options within parameters established by the compensation committee and subject to compensation committee ratification. The exercise price of ISOs granted under the 2001 Preference Shares Stock Plan and NSOs granted to residents of California under the 2001 Preference Shares Stock Plan may not be less than 100% and 85%, respectively, of the fair market value of our Series A convertible preference shares on the grant date. The exercise price of NSOs not granted to California residents under either our 2001 Preference Shares Stock Plan or our 2001 Regulation S Preference Shares Stock Plan can be determined by the board of directors, the compensation committee or the non-executive option grant committee in their discretion.

Stock options granted under the 2001 Preference Shares Stock Plan and 2001 Regulation S Preference Shares Stock Plan may be exercised at any time after they vest, and, in certain instances, prior to vesting. Shares purchased when an option is exercised prior to vesting are subject to our right of repurchase to the extent unvested in the event of the termination of service of the optionee. In the event of the termination of service of an optionee, the unvested portion of a stock option is forfeited and the vested portion terminates six months after a termination of service due to the death or permanent disability of the optionee or 30 days after termination of service for any other reason or such longer periods as may be provided for in option agreements with our optionees. Stock options are generally not transferable during the life of the optionee.

In the event of a change of control (as defined in the plans) or a merger of our company, each outstanding stock option may be assumed or an equivalent stock option or right may be substituted by the successor corporation. In the event that no such substitution or assumption occurs, the outstanding stock options will automatically vest and become exercisable for a period of 15 days, after which the stock options will terminate.

### ***2004 Global Equity Incentive Compensation Program***

Our board of directors adopted our 2004 Stock Option Plan, our 2004 Employee Stock Purchase Plan and our 2004 Equity Incentive Plan on January 16, 2004. Our shareholders approved our 2004 Stock Option Plan and 2004 Employee Stock Purchase Plan on February 16, 2004 and our 2004 Equity Incentive Plan on March 10, 2004.

The purpose of these plans is to allow our employees, directors and service providers to have the opportunity to share in the growth and profitability of our company following the global offering and to provide a non-cash means of incentivizing and retaining these individuals. An aggregate maximum of 1,317,000,000 ordinary shares were reserved for issuance under the 2004 Stock Option Plan and the 2004 Employee Stock Purchase Plan, to be allocated between the plans at the discretion of our board of directors and compensation committee. In no event may a stock option or a purchase right be granted under the 2004 Stock Option Plan or the 2004 Employee Stock Purchase Plan, respectively, if such grant would result in the total aggregate number of ordinary shares subject to all then outstanding stock options or purchase rights granted by us pursuant to the 2004 Stock Option Plan, the 2004 Employee Stock Purchase Plan or any other of our plans or schemes exceeding 30% of the issued and outstanding ordinary shares in issuance from time to time.

A maximum of 2.5% of the ordinary shares that were issued and outstanding immediately following the closing of the global offering, or 455,409,330 ordinary shares, were reserved for issuance under the 2004 Equity Incentive Plan. The number of ordinary shares or ADSs issued upon the settlement of a stock appreciation right that is granted in connection with a stock option granted under the 2004 Stock Option Plan will reduce the plan limit under the 2004 Equity Incentive Plan.

*2004 Stock Option Plan.* Under the 2004 Stock Option Plan, employees and service providers are eligible to acquire ordinary shares or ADSs pursuant to stock options. The 2004 Stock Option Plan also provides for grants of stock options to non-employee directors at our board of directors' discretion.

The 2004 Stock Option Plan will terminate on the tenth anniversary of the date of shareholder approval but may be terminated earlier by our board of directors. The 2004 Stock Option Plan provides for the grant of incentive stock options (ISOs) and non-qualified stock options (NSOs). Any awards of director stock options to non-employee directors are NSOs. The aggregate fair market value of the ordinary shares represented by any given optionee's ISOs that become exercisable in any calendar year may not exceed US\$100,000. Stock options in excess of this limit are treated as NSOs.

The compensation committee and the non-executive option grant committee administer the 2004 Stock Option Plan. The compensation committee selects the persons (other than non-employee directors) above a certain compensation grade to whom stock options are granted and determines the grant date, number of underlying ordinary shares or ADSs, exercise prices, vesting periods and other relevant terms of the stock options, including whether the stock options will be ISOs or NSOs, except that ISOs may be granted only to employees and director stock options may be granted only to non-employee directors. The non-executive option grant committee selects the eligible persons below a certain compensation grade to whom options are granted and determines the grant date, amounts, exercise prices, vesting periods and other relevant terms of stock options within parameters established by the compensation committee and subject to compensation committee ratification. The exercise price of a stock option granted under the 2004 Stock Option Plan shall be no less than the higher of (i) the closing price of an ordinary share on the Hong Kong Stock Exchange (or, in the case of an ADS, of an ADS on the New York Stock Exchange) and (ii) the average closing price of an ordinary share on the Hong Kong Stock Exchange (or, in the case of an ADS, of an ADS on the New York Stock Exchange) for the five business days immediately preceding the date of grant. The compensation committee determines the effect of a termination of employment on a stock option awarded under the 2004 Stock Option Plan except that if employment is terminated for cause, as defined in the plan, all unexercised stock options of an optionee are forfeited. Our board of directors exercises all authority and responsibility with respect to any stock options granted to non-employee directors. Stock options are generally not transferable during the life of the optionee.

The compensation committee will specify the effect that a merger or change in control (as defined in the 2004 Stock Option Plan) will have on grants of stock options, which may include the acceleration of vesting of stock options prior to the date of the change of control.



As of December 31, 2004, options to purchase an aggregate of 165,030, 640 ordinary shares in our company had been issued to employees, directors, and other service providers of our company under the 2004 Stock Option Plan. We did not issue any ordinary shares in 2004 under the 2004 Stock Option Plan.

*2004 Equity Incentive Plan.* Under the 2004 Equity Incentive Plan, our employees, officers and service providers are eligible to acquire equity-based awards other than stock options. The 2004 Equity Incentive Plan will terminate on the tenth anniversary of the date of shareholder approval but may be terminated earlier by our board of directors.

The compensation committee and the non-executive option grant committee administer the 2004 Equity Incentive Plan. The compensation committee selects the persons above a certain compensation grade to whom awards are granted and determines the type of award, grant date, amounts, vesting periods and other relevant terms of the awards. The non-executive option grant committee selects the eligible persons below a certain compensation grade to whom awards are granted and determines the type of award, grant date, amounts, vesting periods and other relevant terms of the awards within parameters established by the compensation committee and subject to compensation committee ratification.

As of December 31, 2004, awards to receive an aggregate of up to 118,190,824 ordinary shares in our company pursuant to grants of restricted share units had been issued to employees and other service providers of our company under the 2004 Equity Incentive Plan. We did not issue any ordinary shares in 2004 under the 2004 Equity Incentive Plan.

*Stock Appreciation Rights.* Under the 2004 Equity Incentive Plan, the compensation committee and the non-executive option grant committee may grant stock appreciation rights independent of or in connection with a stock option granted under the 2004 Stock Option Plan. Generally, each stock appreciation right will entitle a participant upon settlement to an amount equal to (1) the excess of (A) the market value on the exercise date of one ordinary share or ADS, divided by (B) the exercise price, multiplied by (2) the number of ordinary shares or ADSs covered by the stock appreciation right. Payment will be made in ordinary shares or ADSs or in cash, or partly in ordinary shares or ADSs and partly in cash, all as determined by the compensation committee and the non-executive option grant committee.

*Other Equity-Based Awards.* Under the 2004 Equity Incentive Plan, the compensation committee and the non-executive option grant committee may grant awards of restricted shares, restricted share units, dividend equivalents, deferred shares and other awards that are valued in whole or in part by reference to, or are otherwise based on the fair market value of, ordinary shares. The other share-based awards are subject to the terms and conditions established by the compensation committee and the non-executive option grant committee. The compensation committee will specify the effect that a merger or change in control will have on grants of stock options, which may include acceleration of vesting of stock options prior to the date of the change of control.

*2004 Employee Stock Purchase Plan.* The 2004 Employee Stock Purchase Plan is intended to qualify for favorable federal income tax treatment under the provisions of Section 423 of the U.S. Internal Revenue Code. Under the 2004 Employee Stock Purchase Plan, all employees of our participating subsidiaries are eligible (subject to limited exceptions set forth in the U.S. Internal Revenue Code) to elect through payroll deductions to purchase ADSs at a discount. The 2004 Employee Stock Purchase Plan will terminate on the tenth anniversary of the date of shareholder approval but may be terminated earlier by our board of directors. The compensation committee administers the 2004 Employee Stock Purchase Plan. The compensation committee may delegate some or all of its authority (with certain restrictions) under the 2004 Employee Stock Purchase Plan to one or more of its members or one or more of our officers.

The 2004 Employee Stock Purchase Plan will be implemented by a series of offering periods. The compensation committee will determine the starting and ending dates of each offering period, but no offering period can be shorter than 6 months or longer than 27 months.

An eligible employee may elect to participate in the 2004 Employee Stock Purchase Plan for any offering period by filing the enrollment documents with the appropriate human resources group. A participant will elect to have payroll deductions made on each payday during the offering period in a dollar amount specified in the employee's enrollment documents. These deductions will be placed into an account on behalf of a participant.

The compensation committee will determine the maximum amount that any employee may contribute to his or her account under the 2004 Employee Stock Purchase Plan during any calendar year. A participant may not accrue share purchase rights at a rate that exceeds US\$25,000, based on the fair market value of the plan shares or such lower amount as the compensation committee may determine for each calendar year in which the share purchase right is outstanding.

A participant may terminate participation in the 2004 Employee Stock Purchase Plan and withdraw from an offering by submitting a withdrawal notice and receiving all of his or her accumulated payroll deductions from that offering. Upon withdrawal, the participant's right to purchase ADSs for the current offering period will be terminated, and the participant can no longer participate in the current offering.

On the last day of the offering period, a participant's accumulated contributions are used to purchase ADSs at a price equal to the lesser of 85% of the fair market value of such ADSs on the date the offering period commenced or 85% of the fair market value of such ADSs on the date the offering period concluded. The ADSs are then deposited to an account established in the participant's name with a broker designated by us.

If a participant's employment terminates prior to the end of an offering period for any reason (subject to the limited exception set forth below), we will pay to the participant his or her account balance and the participant's right to purchase ADSs under the 2004 Employee Stock Purchase Plan will automatically terminate. If a participant's employment terminates less than three months prior to the end of the offering period for certain "non-cause" triggers, the participant will continue to participate in the 2004 Employee Stock Purchase Plan for the offering period then in progress, except that the participant's contributions will cease with the contribution made from such participant's final paycheck.

As of December 31, 2004, no ADSs had been issued pursuant to the 2004 Employee Stock Purchase Plan.

## Item 7. Major Shareholders

### Major Shareholders

The following table sets forth information regarding the beneficial ownership as of December 31, 2004 of our ordinary shares, by each shareholder who is known by us to beneficially own more than 5% of our outstanding shares as of such date.

Name of Shareholder	Number of Shares Owned	Percentage Owned
Shanghai Industrial Holdings Limited <sup>(1)</sup>	1,814,991,340	9.95%
Motorola, Inc. and Motorola (China) Electronics Limited <sup>(2)</sup>	1,427,915,070 <sup>(3)</sup>	7.8%
Blessington Services Limited <sup>(4)</sup>	1,051,493,250	5.8%

- (1) All of the shares beneficially owned by Shanghai Industrial Holdings Limited are registered in the name of S.I. Technology Production Holdings Limited, its wholly owned subsidiary. Shanghai Industrial Holdings Limited is a Hong Kong publicly listed company majority-owned by Shanghai Industrial Investment (Holdings) Company Limited, which is wholly beneficially owned and controlled by the Shanghai municipal government. Our current director, Lai Xing Cai, is Chairman of Shanghai Industrial Holdings Limited. It is our understanding that voting and investment control over our shares beneficially owned by Shanghai Industrial Holdings Limited are maintained by the board of directors of Shanghai Industrial Holdings Limited.
- (2) It is our understanding that voting and investment control over our shares beneficially owned by Motorola and MCEL are maintained by the respective boards of directors of Motorola and MCEL, which have the power to delegate such authority. All such delegations are revocable by the Motorola and MCEL boards at any time.
- (3) On or about February 28, 2005, Motorola and MCEL sold an aggregate of 517,489,221 ordinary shares. Upon completion of this transaction, Motorola and MCEL owned an aggregate of 910,425,849 ordinary shares. The Company is unable to confirm the current shareholdings of Motorola and MCEL.
- (4) Consists of 195,594,250 ordinary shares registered in the name of Homer Investment Holdings Ltd., 171,179,800 ordinary shares registered in the name of Asset Success Investments Limited, 171,179,800 ordinary shares registered in the name of Easy Street Investments Limited, 171,179,800 ordinary shares registered in the name of Seaboard Investments Limited, 171,179,800 ordinary shares.

shares registered in the name of Visible Profit Investments Limited and 171,179,800 ordinary shares registered in the name of Whole Gain Investments Limited. Our director, Yen-Pong Jou, is a director of each of these entities, all of which are wholly owned subsidiaries of Blessington Services Limited. Blessington Services Limited is accustomed to act in accordance with the instructions from the directors of its shareholder, Deutsche International Corporation Services Limited, who currently holds 84% of the shareholding in Blessington Services Limited. Under the listing rules of the Hong Kong Stock Exchange, if a person or an entity controls more than 30% of a corporate shareholders' voting shares, that corporate shareholder is considered "as accustomed to act" in accordance with the instructions of such person/entity.

The shareholdings of the shareholders listed above have changed during the past three years. Shanghai Industrial Holdings Limited and Blessington Services Limited were among the investors who purchased an aggregate of 917,439,166 of our Series A convertible preference shares in September 2001. After the consummation of our sale of the Series A convertible preference shares, Shanghai Industrial Holdings Limited and Blessington Services Limited owned approximately 15.7% and 10.7%, respectively, of our then outstanding shares on a fully diluted basis. In January 2002, we entered into an agreement to sell an aggregate of 42,373,000 of our Series A-2 convertible preference shares to an investor. In September 2003, we entered into an agreement to sell an aggregate of up to 180,000,000 of our Series C convertible preference shares to investors, which agreement was amended in December 2003 to provide for the sale of up to 15,714,285 additional Series C convertible preference shares. After the issuance by us of Series C convertible preference shares, Shanghai Industrial Holdings and Blessington Services Limited owned approximately 11.9% and 8.1%, respectively, of our then outstanding shares on a fully diluted basis. In December 2003 and January 2004, we issued an aggregate of 105,199,999 Series D convertible preference shares to Motorola and MCEL. After the issuance by us of Series D convertible preference shares, Shanghai Industrial Holdings and Blessington Services Limited owned approximately 10.4% and 7.1%, respectively, of our then outstanding shares on a fully diluted basis.

Each ordinary share is entitled to one vote on all matters upon which the ordinary shares are entitled to vote, including the election of directors. No shareholder has voting rights that are different from those of other shareholders.

As of December 31, 2004, a total of 21,643,465 ADSs and 18,232,959,139 ordinary shares of our company were outstanding. Of these ordinary shares, 1,082,173,250 were registered in the name of JPMorgan Chase Bank, the depository under the deposit agreement. JPMorgan has advised us that, as of December 31, 2004, these 21,643,465 ADSs, representing 1,082,173,250 ordinary shares, were held of record by seven U.S. persons. We have no further information as to shares held or beneficially owned by U.S. persons. The number of shares outstanding does not include 780,000 ordinary shares we repurchased from some of our employees pursuant to our employee stock option plans, but which for accounting purposes have been reflected in our consolidated statement of shareholders' equity and comprehensive income (loss). Each ADS represents 50 ordinary shares.

We do not believe that we are directly or indirectly owned or controlled by another corporation, by any foreign government or by any other natural or legal person severally or jointly.

## **Related Party Transactions**

### **Motorola, Inc.**

In September 2003, we entered into agreements with Motorola and its wholly owned subsidiary, MCEL, providing for our acquisition of the assets constituting a fab in Tianjin, the assumption of certain obligations, the transfer of certain technology to us from Motorola, our exchange of certain licenses with Motorola, the provision by Motorola of US\$30 million in cash to us and our issuance to Motorola and MCEL of our Series D convertible preference shares and warrants to purchase Series D convertible preference shares in exchange for the foregoing. Upon completion of these transactions, which occurred in January 2004, Motorola, together with MCEL, became the beneficial owner of more than 10% of our ordinary shares outstanding and issuable upon conversion of outstanding preference shares and Motorola became entitled to appoint a director to our board. Motorola's right to appoint a director to our board terminated upon the completion of our global offering.

In connection with this acquisition, we entered into certain intellectual property agreements with Motorola. Under these agreements, we and Motorola each granted to the other a five-year license to certain specified patents. We also agreed to license from Motorola certain intellectual property relating to certain CMOS process technology.

In connection with the closing of the transactions described above, we also entered into a semiconductor foundry agreement with Motorola to provide wafer fabrication and associated services to Motorola. Under this agreement, Motorola has agreed to use good faith efforts to purchase a minimum number of wafers per month over a fifteen-month period, provided that we meet applicable production and quality standards. In addition to the agreements described above, we, Motorola and MCEL have entered into several ancillary agreements relating to the acquisition. These agreements relate to, among other things, transition services to be provided to us by MCEL to assist in transitioning the Tianjin fab's operations to us and long-term services to be provided between us and MCEL. We and MCEL have also executed a real property transfer agreement providing for the transfer of MCEL's real property rights associated with the Tianjin fab to us. Motorola has also agreed to guarantee the indemnification obligations of MCEL under the asset purchase agreement. See also "Item 4—Information on the Company—Business Overview—Tianjin Operations."

#### **Integrated Silicon Solution, Inc.**

From time to time, we provide foundry services to Integrated Silicon Solution, Inc., or ISSI, one of our shareholders. One of our directors, Lip-Bu Tan, is a director of ISSI. In 2002, 2003 and 2004, we had total wafer sales to ISSI of US\$12.5 million, US\$38.3 million and US\$49.7 million, respectively, and accounts receivable from ISSI of US\$6.7 million, US\$1.7 million and US\$13.2 million as of December 31, 2002, 2003 and 2004, respectively. In addition, we have entered into intellectual property and library license agreements with ISSI pursuant to which we license intellectual property to ISSI so that ISSI can develop integrated circuit designs for fabrication by us. We also entered into a memorandum of understanding on May 15, 2003 with ISSI providing that we will jointly develop a process to manufacture products designed by or for ISSI.

#### **Indemnification Agreements**

On March 18, 2004, upon completion of the global offering, we entered into identical indemnification agreements with each member of our board of directors and our executive officers, whereby we agreed to (inter alia) indemnify our board of directors and executive officers in respect of liability arising from their capacity as our directors and executive officers. At the annual general meeting of our shareholders held on May 6, 2005, our shareholders approved amendments to the indemnification agreements in order to comply with changes in the listing rules of the Hong Kong Stock Exchange. The revised indemnification agreements will limit the term of the indemnification agreements to three (3) years and our aggregate annual liability to US\$20,000,000; provided that our liability to indemnify a particular director or executive officer shall not exceed the amount payable to a director or officer under the directors' and officer's liability insurance policy.

Pursuant to the revised indemnification agreements, we are obligated to indemnify each director and executive officer, to the fullest extent permitted by law, against all costs, charges, expenses, liabilities, losses and obligations incurred in connection with any threatened, pending or completed action, suit, proceeding or alternative dispute resolution mechanism, or any hearing, inquiry or investigation which might lead to any of the foregoing by reason of or arising out of any event or occurrence relating to the fact that he is or was director or executive officer of our company or any of its subsidiaries, or is or was serving at our request at another corporation or enterprise, or by reason of any activity or inactivity while serving in such capacity. However, we will not be liable to indemnify any such person:

- for expenses resulting from matters for which such person is prohibited from being indemnified under our Memorandum and Articles of Association or applicable law;
- in respect of any claim initiated or brought voluntarily by such person (other than in limited specified circumstances);
- for expenses incurred in relation to any proceedings to enforce the agreement in which material assertions in such proceedings made by such director are finally determined by a court to be not made in good faith or to be frivolous;
- in respect of any claim if a court determines that such person acted in a manner that was willfully or grossly negligent; or

- for expenses and payment of profits arising from securities transactions carried out by such person in violation of Section 16 (b) of the U.S. Securities Exchange Act of 1934, as amended.

The revised indemnification agreements will become effective upon execution and will supersede any previous indemnification agreement between the same parties. The indemnification agreements will continue in effect during the three year term regardless of whether the relevant director or executive officer continues to serve as our director or executive officer or to serve at any other enterprise at our request.

For the year ended December 31, 2004, no payment was made to any director or executive officer under the indemnification agreements.

### **Registration Rights Agreement**

In connection with the global offering, we entered into an amended and restated registration rights agreement which currently remains in effect. Substantially all of our securityholders, other than our employees and certain original investors, are a party to the agreement, except that Richard Ru Gin Chang, our Chairman, President and Chief Executive Officer, is also a party to the agreement.

### ***Monetization Restrictions***

Each of Richard Ru Gin Chang and substantially all other parties to the agreement that beneficially own, directly or indirectly and whether individually or as a group with its affiliates, more than 7,500,000 of our ordinary shares immediately prior to the global offering, whom we collectively refer to as our large securityholders, have agreed that their securities would continue to be subject to certain transfer restrictions for a period equal to the shorter of three years from the expiration of the 180-day lock-up period in connection with the global offering and such time when all large securityholders own collectively less than 10% of our ordinary shares on a fully diluted basis. Pursuant to these transfer restrictions, Richard Chang and the large securityholders may not offer, sell, contract to sell, pledge, sell any option or contract to purchase, purchase any option or contract to sell, grant or agree to grant any option, right or warrant to purchase, lend or otherwise transfer or dispose of, directly or indirectly, or file with the U.S. Securities and Exchange Commission a registration statement under the Securities Act relating to any ADSs, ordinary shares or securities convertible into or exchangeable or exercisable for, or that represents the right to receive, ADSs or ordinary shares, or enter into any swap, hedge or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of our ADSs or ordinary shares, or publicly disclose that he, she or it will or may enter into any transaction described above, without the prior written consent of the representatives of the underwriters, whether any transaction described above is to be settled by delivery of ADSs, ordinary shares or such other securities, in cash or otherwise, subject to customary exceptions. At any time during this period, large securityholders will only be permitted to transfer their securities or enter into any of the activities described in the preceding paragraph with respect to their securities if:

- we give our prior written consent to any such transfer or activity;
- the transfer is to affiliates or family members or for estate planning purposes, as long as the transferee agrees to become bound by the provisions in the agreement; or
- the transfer amount is within the permitted sales/transfers rule as described below.

We refer to these additional transfer restrictions that only apply to our large securityholders as monetization restrictions. The monetization restrictions only apply to securities held by large securityholders prior to the global offering or to securities issuable to large securityholders upon conversion or exercise of securities that were issued to large securityholders prior to the global offering. The monetization restrictions do not apply to parties to the agreement that directly or indirectly beneficially own less than or equal to 7,500,000 of our ordinary shares immediately prior to the global offering.

### ***Permitted Sales/Transfers***

Commencing on the date of expiration of the 180-day post-global offering lock-up period and every 180 days thereafter until the termination of the amended and restated registration rights agreement by its terms, 15% of the shares of each large securityholder held immediately prior to the completion of the global offering, which we refer to as released shares, will be released from the monetization restrictions described above, and may be sold in an annual, demand or incidental offering, as described below, or without our consent in the open market or in privately negotiated transactions. We refer to any such sales as permitted sales/transfers. The 15% limit for each 180-day period is cumulative, such that if any large securityholder does not sell or transfer the 15% released shares from a previous 180-day period, any unsold or non-transferred released shares will roll over and may be sold or transferred at any time in the future, together with all other accumulated released shares from previous periods.

In addition:

- any transferee of released shares will not be subject to the provisions of the amended and restated registration rights agreement with respect to those shares;
- no such sales or transfers will be permitted during any post-offering lock-up period, as described below; and
- all such sales or transfers must be made in accordance with applicable securities laws.

In addition, we have entered into an agreement with each of Motorola and MCEL, which are large securityholders under the amended and restated registration rights agreement, pursuant to which we have consented to release from the monetization restrictions described above an additional 15% of the shares they each held immediately prior to the completion of the global offering commencing on the date of expiration of the 180-day post-global offering lock-up period and an additional 15% every 180 days thereafter.

Like the 15% limit for each 180-day period applicable to other large securityholders, such 30% limit applicable to Motorola and MCEL is cumulative. In addition, such additional released shares may only be sold or transferred by Motorola or MCEL pursuant to the same terms and conditions applicable to the sale or transfer of their released shares under the amended and restated registration rights agreement. In addition, to the extent that at any time during the term of the amended and restated registration rights agreement we increase the percentage of released shares that may be transferred or sold by any large securityholder who holds more than 1% of our outstanding shares (on a pre-global offering basis) to more than the percentage of released shares that may be transferred or sold by Motorola and MCEL (regardless of whether or not Motorola or MCEL actually sold any released shares), we have consented to increase the percentage of released shares for Motorola and MCEL to match the increased percentage for such large securityholder. We have also agreed with each of Motorola and MCEL that we will not consent to any amendment or waiver of any provision of the amended and restated registration rights agreement that adversely affects either Motorola or MCEL but does not so adversely affect all other parties to the amended and restated registration rights agreement unless such amendment or waiver is approved in writing by Motorola.

### ***Offerings***

It is our current plan, subject to market conditions, to raise primary capital in the next few years to further expand our business operations. We have committed to our large securityholders to include a secondary component in our follow-on offerings to permit such securityholders who are subject to the monetization restrictions to sell their securities under the following circumstances:

- *Annual Offerings:* We will use reasonable commercial efforts to effect an offering once in each calendar year, each of which will include a secondary component for the benefit of large securityholders;
- *Demand Offerings:* If large securityholders request, either individually or in the aggregate, to publicly sell securities having an aggregate offering size of not less than US\$400 million at the time of such request, we will use reasonable commercial efforts to facilitate the public sale of such securities as promptly as practicable, provided that we will not be required to effect more than one such demand offering during any 12-month period and not more than three in the aggregate during the term of the amended and restated registration rights agreement and we will also not be required to effect any such demand offering within 90 days of any previous offering, whether annual, demand or incidental; and

- *Incidental Offerings*: If at any time we plan to issue primary shares in a public offering other than pursuant to an annual offering, our large securityholders may participate pro rata in the secondary component of such offering according to their selling interest, provided that we must also offer all of our other securityholders who are parties to the agreement but who are not large securityholders the opportunity to participate in such offering.

Decisions with respect to any offerings, including any offerings to be made in accordance with and pursuant to the amended and restated registration rights agreement, will be made by our board of directors or a duly appointed committee thereof. The timing and size of any offering, including any secondary component to be included therein, will always be at our sole discretion upon advice from our financial advisors. Each large securityholder (and other securityholders, for primary offerings only) will be able to participate in an offering on a pro rata basis based on its selling interest, provided, however, that we will always have the right to cut back on a pro rata basis all proposed secondary sales by securityholders if our financial advisors so advise based on market conditions, including if we plan to issue primary shares in the offering. However, we are not permitted through these cutbacks to reduce the size of the secondary component of any offering to less than 10% of the total size of the offering. Large securityholders will also not be permitted to sell in any offering more than the number of released shares available for sale as of the time of such offering, as described above under “— Permitted Sales/Transfers.” In addition, we will always have the right to postpone (for up to 180 days in any 12-month period) any offering if, upon the advice of counsel or our financial advisors, it would be disadvantageous for us to proceed in light of pending corporate or other developments, potential acquisitions, or disclosure issues, provided that we will endeavor to remove the disadvantageous condition as promptly as practicable. We have also agreed that in the event of any such offerings, we will indemnify selling securityholders against losses and damages suffered by them arising out of untrue or allegedly untrue statements in any prospectus or other similar document issued in relation to such offerings, unless such statements were provided to us by the selling securityholders.

We will also have sole discretion, upon advice from our financial advisors and based on then-prevailing market conditions and the proposed timing and size of each offering, to determine the manner of effecting the offering, including whether it should be registered with the U.S. Securities and Exchange Commission or effected over the Hong Kong Stock Exchange, whether it should be underwritten or not, and whether it should be effected on a fully marketed basis, or by a block trade, bought deal or otherwise. However, we will not effect any unregistered or non-underwritten offering for our securityholders unless the other securities to be sold in the offering are also sold in the same manner.

Large securityholders, except for Motorola and MCEL, have also agreed, for a period following the completion of any future offering, which period is to be negotiated in good faith between us, the underwriters for such offering and the large securityholders, not to transfer any of their shares not sold in such offering. We refer to each such period as a post-offering lock-up period.

After the expiration of the amended and restated registration rights agreement, large securityholders will be free to sell their securities, subject to any applicable securities laws, and we will not have any more obligations to facilitate offerings on behalf of these securityholders.

#### ***Notice of Certain Developments***

In addition, the amended and restated registration rights agreement also provides that each large securityholders or group of large securityholders that owns at least 5% of our outstanding ordinary shares that receives a bona fide firm offer, proposal or other indication of interest to acquire more than 5% of our outstanding shares, or to effect a merger, acquisition, purchase of assets or other extraordinary transaction involving us, will agree to notify our board of directors of such potential transaction. Upon the completion of such transaction, the acquiror of such interest will also be subject to the remaining term of the monetization restrictions.

## **Item 8. Financial Information**

### **Consolidated Statements and Other Financial Information**

Please see “Item 18. Financial Statements.”

See “Item 4—Information on the Company—Business Overview—Customers and Markets” regarding the percentage of our sales which are exported from China.

### **Litigation**

As is the case with many companies in the semiconductor industry, we have received from time to time communications from third parties asserting that our technologies, fabrication processes, design of the semiconductors made by us or use by our customers of semiconductors made by us may infringe upon patents or other intellectual property rights of others. Irrespective of the validity of such claims, we could incur significant costs in the defense thereof or could suffer adverse effects on our operations.

In December 2003, we became the subject of a lawsuit in U.S. federal district court brought by TSMC relating to alleged infringement of five U.S. patents and misappropriation of alleged technical and operational 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 California State Superior Court and claimed alleged infringement of an additional 6 patents in the U.S. federal district court lawsuit. In August 2004, TSMC filed a complaint with the ITC alleging similar trade secret misappropriation claims and asserting 3 new patent infringement claims and simultaneously filed another patent infringement suit in federal district court on the same 3 patents as alleged in the ITC complaint. Prior to the start of the initial lawsuit in the United States, TSMC had instituted a legal proceeding in Taiwan in January 2002 that alleged improper hiring practices and trade secret misappropriation. In the Taiwan proceeding, the Hsinchu District Court in Taiwan issued an ex parte provisional injunction that prohibits our wholly owned subsidiary, Semiconductor Manufacturing International (Shanghai) Corporation, or SMIC Shanghai, from improperly soliciting or hiring certain categories of employees of TSMC or causing such employees to divulge to us, or use, trade secrets of TSMC. According to TSMC’s initial complaint filed in the United States, the Taiwan provisional injunction has no territorial effect outside of Taiwan. The provisional injunction may be challenged by us at any time, but we have thus far seen no cause for challenging that ruling, and to date the provisional injunction has not adversely affected our operations.

On January 31, 2005, we entered into a settlement agreement with TSMC that provides for the dismissal of all pending legal actions without prejudice between TSMC and our company in U.S. federal district court, California State Superior Court, the ITC and Taiwan District Court. In 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 will license the other party’s patent portfolio through December 2010. As a part of the settlement, we also agreed to pay TSMC an aggregate amount of US\$175 million, in installments of US\$30 million each year for five years and US\$25 million in the sixth year.

The patent cross-license agreement and settlement agreement are terminable upon a breach of the settlement agreement by SMIC. Any such breach may result in the filing of a lawsuit relating to such breach, recommencement or re-filing of the legal proceedings and acceleration of the outstanding monetary payment obligations under the settlement agreement.

One of our technology partners, Infineon, was involved in litigation with Rambus Inc., which had filed separate actions against Infineon in the U.S. and Germany for alleged patent infringement by Infineon relating to its SDRAM, Double Data Rate SDRAM and GDDR products. In the United States, Rambus had filed suit in the U.S. District Court for the Eastern District of Virginia and the U.S. District Court for the Northern District of California. On March 21, 2005, Infineon and Rambus reached an agreement settling all claims between them and licensing the Rambus patent portfolio to Infineon for use in current and future Infineon products. Rambus has granted to Infineon a worldwide license to existing and future Rambus patents and patent applications for use in Infineon memory products. The two companies have also agreed to the immediate dismissal of all pending litigation and have released each other from all existing legal claims.



In addition to the litigation matters described above, we are occasionally involved in routine litigation matters that are common for our industry, none of which we believe has been or is material.

### **Dividends and Dividend Policy**

Since our inception, we have not declared or paid any cash dividends on our ordinary shares. We intend to retain any earnings for use in our business and do not currently intend to pay cash dividends on our ordinary shares. Dividends, if any, on the outstanding shares will be declared by and subject to the discretion of our board of directors and must be approved at our annual general meeting of shareholders. The timing, amount and form of future dividends, if any, will also depend, among other things, on:

- our results of operations and cash flow;
- our future prospects;
- our capital requirements and surplus;
- our financial condition;
- general business conditions;
- contractual restrictions on the payment of dividends by us to our shareholders or by our subsidiaries to us; and
- other factors deemed relevant by our board of directors.

Our ability to pay cash dividends will also depend upon the amount of distributions, if any, received by us from our three wholly owned Chinese operating subsidiaries. Under the applicable requirements of Chinese Company Law, our Chinese subsidiaries may only distribute dividends after they have made allowances for:

- recovery of losses, if any;
- allocation to the statutory common reserve funds;
- allocation to staff and workers' bonus and welfare funds; and
- allocation to a discretionary common reserve fund if approved by our shareholders.

More specifically, these operating subsidiaries may only pay dividends after 10% of their net profit has been set aside as statutory common reserves and a discretionary percentage of their net profit has been set aside for the staff and workers' bonus and welfare funds. These operating subsidiaries are not required to set aside any of their net profit as statutory common reserves if such reserves are at least 50% of their respective registered capital. Furthermore, if they record no net income for a year, they generally may not distribute dividends for that year.

### **Significant Changes**

Please see the section entitled "Litigation" above.

### **Item 9. The Offer and listing**

Our ordinary shares are principally traded on the Stock Exchange of Hong Kong under the symbol "981.HK." Our ordinary shares began trading on the Stock Exchange of Hong Kong on March 18, 2004. Our American Depositary Shares, which began trading on the New York Stock Exchange on March 17, 2004, are traded under the symbol "SMI."

The table below sets forth the high and low closing prices on the Stock Exchange of Hong Kong and the New York Stock Exchange for the ordinary shares represented by the ADSs since the completion of the global offering.

	Stock Exchange of Hong Kong		New York Stock Exchange <sup>(1)</sup>	
	Closing price per ordinary share		Closing price per ADS	
	High Price	Low Price	High Price	Low Price
<b>2004</b>				
March 17 – March 31	HK\$ 2.47	HK\$ 2.12	US\$ 15.50	US\$ 13.59
April	HK\$ 2.45	HK\$ 1.88	US\$ 15.60	US\$ 11.69
May	HK\$ 1.96	HK\$ 1.60	US\$ 12.60	US\$ 10.47
June	HK\$ 1.90	HK\$ 1.64	US\$ 12.17	US\$ 10.71
July	HK\$ 1.68	HK\$ 1.49	US\$ 10.84	US\$ 9.42
August	HK\$ 1.66	HK\$ 1.48	US\$ 10.65	US\$ 9.59
September	HK\$ 1.66	HK\$ 1.53	US\$ 10.66	US\$ 9.86
October	HK\$ 1.82	HK\$ 1.59	US\$ 11.31	US\$ 10.14
November	HK\$ 1.91	HK\$ 1.68	US\$ 12.21	US\$ 10.78
December	HK\$ 1.94	HK\$ 1.66	US\$ 12.40	US\$ 10.57
<b>2005</b>				
January	HK\$ 1.69	HK\$ 1.48	US\$ 10.59	US\$ 9.35
February	HK\$ 1.75	HK\$ 1.54	US\$ 11.14	US\$ 9.97
March	HK\$ 1.63	HK\$ 1.50	US\$ 10.45	US\$ 9.49
April	HK\$ 1.60	HK\$ 1.50	US\$ 10.09	US\$ 9.52
May	HK\$ 1.55	HK\$ 1.48	US\$ 9.99	US\$ 9.63
June 1 – June 21	HK\$ 1.71	HK\$ 1.52	US\$ 10.90	US\$ 9.75

(1) Each ADS represents 50 ordinary shares.

## Item 10. Additional Information

### Memorandum and Articles of Association

The section entitled “Description of Share Capital” in our IPO registration statement is incorporated by reference into this annual report.

At the annual general meeting of our shareholders held on May 6, 2005, our shareholders agreed to amend the Articles of Association to reflect the amendments to Appendix 3 to the Rules Governing the Listing of Securities on the Hong Kong Stock Exchange (the “Listing Rules”) which came into effect on March 31, 2004 (which Appendix stipulates certain provisions as being required to be included in the articles of association of listed companies in Hong Kong) and certain other matters. These amendments:

- remove the requirement for us to deliver a repurchase notice to a shareholder whose shares we are repurchasing, so long as the repurchase is in accordance with applicable law, rules or regulations;
- remove the minimum period for any closure of the register of members in connection with any annual general meeting of our shareholders;
- reflect the new requirements in Appendix 3 to the Listing Rules which stipulates a minimum period for allowing a shareholder to nominate a person for election as a director of the Company by serving the requisite notices. Such minimum period for lodgment for the said notice shall be a period of not less than seven days and shall commence no earlier than the day after the dispatch of the notice of the meeting appointed for such election and end no later than seven days prior to the date of such meeting;

- reflect the restriction on voting by members as required by the new requirements in Appendix 3 to the Listing Rules;
- clarify the notice periods for summoning any regular meeting of our board and for any other meeting of our board;
- define a quorum of our board to be at least two (2) directors, one of whom shall be an executive director, provided that if at any time there shall be only a sole director in office, then the quorum shall be one;
- clarify the rights of a proxy of any of our directors at any meeting of our board;
- provide for methods of distribution of certain of our financial information to our shareholders;
- reflect the new requirements in Appendix 3 to the Listing Rules which require the interests held by a director's associate(s) to be taken into account when considering the interests of that director. Accordingly, a director is not allowed to vote on any resolution of the board of directors approving any contract or arrangement or any other proposal in which he or any of his associate has a material interest nor shall he be counted in the quorum present at the meeting; and
- provide that a notice sent by post to our shareholders will be deemed to be delivered on the day following the day on which such notice was posted.

### **Material Contracts**

Please see the section entitled "Related Party Transactions" above regarding the agreements into which we entered with Motorola and its wholly owned subsidiary, MCEL. Please also see the section entitled "Litigation" above regarding the settlement agreement into which the Company entered with TSMC.

### **Exchange Controls**

We receive a portion of our sales in Renminbi, which is currently not a freely convertible currency. For the year ended December 31, 2003, approximately 2.2% of our sales were denominated in Renminbi, while approximately 1.7% of our sales were denominated in Renminbi for the year ended December 31, 2004. While we have used these proceeds for the payment of our Renminbi expenses, we may in the future need to convert these sales into foreign currencies to allow us to purchase imported materials and equipment, particularly as we expect the proportion of our sales to China-based companies to increase in the future. Under China's existing foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade may be made in foreign currencies without government approval, except for certain procedural requirements. The Chinese government may, however, at its discretion, restrict access in the future to foreign currencies for current account transactions and prohibit us from converting our Renminbi sales into foreign currencies.

### **Taxation**

#### **United States Federal Income Taxation**

Except where noted, this summary deals only with the ownership and disposition of the ADSs and ordinary shares that are held as capital assets by U.S. Holders. This summary does not represent a detailed description of the U.S. federal income tax consequences applicable to U.S. Holders that are subject to special treatment under the U.S. federal income tax laws, including:

- banks;
- dealers in securities or currencies;
- financial institutions;

- real estate investment trusts;
- insurance companies;
- tax-exempt organizations;
- persons holding ADSs or ordinary shares as part of a hedging, integrated or conversion transaction, constructive sale or straddle;
- traders in securities that have elected the mark-to-market method of accounting;
- persons liable for the alternative minimum tax;
- persons who own more than 10% of our voting shares; or
- U.S. persons whose “functional currency” is not the U.S. dollar.

This summary is based in part on representations by the depository and assumes that each obligation under the deposit agreement and any related agreement will be performed in accordance with its terms. Furthermore, the discussion below is based upon the provisions of the Internal Revenue Code of 1986, as amended, or the Code, and U.S. Treasury regulations, rulings and judicial decisions thereunder as of the date hereof, and such authorities may be replaced, revoked or modified, possibly on a retroactive basis, so as to result in U.S. federal income tax consequences different from those discussed below.

A U.S. Holder that holds ADSs or ordinary shares is urged to consult its own tax advisor concerning the U.S. federal income tax consequences as well as any consequences arising under the laws of any other taxing jurisdiction in light of the particular circumstances of the U.S. Holder.

A U.S. Holder is a beneficial owner of ADSs or ordinary shares that is a U.S. person. A U.S. person is:

- a citizen or resident of the United States;
- a corporation or other entity taxable as a corporation created or organized in or under the laws of the United States, any state thereof, or the District of Columbia;
- an estate the income of which is subject to U.S. federal income taxation, regardless of its source; or
- a trust if it is subject to the primary supervision of a court within the United States and one or more U.S. persons have the authority to control all substantial decisions of the trust or has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

If a partnership holds ADSs or ordinary shares, the tax treatment of a partner will generally depend on the status of the partner and the activities of the partnership. A U.S. Holder that is a partner of a partnership holding ADSs or ordinary shares is urged to consult its own tax advisors.

*ADSs or Ordinary Shares.* In general, for U.S. federal income tax purposes, a U.S. Holder of ADSs will be treated as the owner of the underlying ordinary shares that are represented by such ADSs. Deposits and withdrawals of ordinary shares in exchange for ADSs will not be subject to U.S. federal income taxation.

*Distributions on ADSs or Ordinary Shares.* Subject to the discussion under “—Passive Foreign Investment Company Rules” below, the gross amount of the cash distributions on the ADSs or ordinary shares will be taxable to a U.S. Holder as dividends to the extent of our current and accumulated earnings and profits, as determined under U.S. federal income tax principles. Subject to certain limitations, dividends paid to noncorporate U.S. Holders, including individuals, may be eligible for a reduced rate of taxation if we are deemed to be a “qualified foreign corporation” for U.S. federal income tax purposes. A qualified foreign corporation includes:

- a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the United States that includes an exchange of information program; and
- a foreign corporation if its stock with respect to which a dividend is paid or its ADSs backed by such stock are readily tradable on an established securities market within the United States,

but does not include an otherwise qualified corporation that is a passive foreign investment company. We believe that we will be a qualified foreign corporation for so long as we are not a passive foreign investment company and the ordinary shares or ADSs are considered to be readily tradable on an established securities market within the United States. A U.S. Holder that exchanges its ADSs for ordinary shares may not be eligible for the reduced rate of taxation on dividends if the ordinary shares are not readily tradable on an established securities market within the United States. Our status as a qualified foreign corporation, however, may change.

Dividends will be includable in a U.S. Holder's gross income on the date actually or constructively received by such U.S. Holder, in the case of ordinary shares, or by the depository, in the case of ADSs. These dividends will not be eligible for the dividends-received deduction generally allowed to U.S. corporations in respect of dividends received from other U.S. corporations.

To the extent that the amount of any cash distribution exceeds our current and accumulated earnings and profits, the distribution will first be treated as a tax-free return of capital, causing a reduction in the adjusted basis of the ADSs or ordinary shares (thereby increasing the amount of gain, or decreasing the amount of loss, a U.S. Holder would recognize on a subsequent disposition of the ADSs or ordinary shares), and the balance in excess of adjusted basis will be subject to tax as capital gain.

To the extent we pay dividends on the ADSs or the ordinary shares in Hong Kong dollars, the U.S. dollar value of such dividends should be calculated by reference to the exchange rate prevailing on the date of actual or constructive receipt of the dividend, regardless of whether the Hong Kong dollars are converted into U.S. dollars at that time. If Hong Kong dollars are converted into U.S. dollars on the date of actual or constructive receipt of such dividends, the tax basis of the U.S. holder in such Hong Kong dollars will be equal to their U.S. dollar value on that date and, as a result, the U.S. Holder generally should not be required to recognize any foreign currency exchange gain or loss. Any gain or loss recognized on a subsequent conversion or other disposition of the Hong Kong dollars generally will be treated as U.S. source ordinary income or loss.

It is possible that distributions of ADSs or ordinary shares that are received as part of a pro rata distribution to all of our ordinary shareholders may not be subject to U.S. federal income tax. The basis of the new ADSs or ordinary shares so received will be determined by allocating a U.S. Holder's basis in the old ADSs or ordinary shares between the old ADSs or ordinary shares and the new ADSs or ordinary shares received, based on their relative fair market values on the date of distribution.

Dividends paid on the ADSs or ordinary shares will be income from sources outside of the United States and for tax years beginning before January 1, 2007, generally will constitute "passive income" or, in the case of certain U.S. Holders, "financial services income" and for tax years beginning after December 31, 2006, generally will constitute "passive category income" or, in the case of certain U.S. Holders, "general category income" for U.S. foreign tax credit limitation purposes.

*Sale, Exchange or Other Disposition of ADSs or Ordinary Shares.* Subject to the discussion under "—Passive Foreign Investment Company Rules" below, upon the sale, exchange or other disposition of ADSs or ordinary shares, a U.S. Holder generally will recognize capital gain or loss equal to the difference between the amount realized upon the sale, exchange or other disposition and the adjusted tax basis of the U.S. Holder in the ADSs or ordinary shares. A U.S. Holder's tax basis in an ADS or an ordinary share will be, in general, the price it paid for that ADS or ordinary share. The capital gain or loss generally will be long-term capital gain or loss if, at the time of sale, exchange or other disposition, the U.S. Holder has held the ADS or ordinary share for more than one year. Net long-term capital gains of noncorporate U.S. Holders, including individuals, are eligible for reduced rates of taxation. The deductibility of capital loss is subject to limitations. Any gain or loss that a U.S. Holder recognizes generally will be treated as gain or loss from sources within the United States for U.S. foreign tax credit limitation purposes.

*Passive Foreign Investment Company Rules.* We believe that we were not a passive foreign investment company for 2004. Based on the projected composition of our income, the timing of our anticipated capital expenditures and valuation of our assets, we do not expect to be a passive foreign investment company for 2005 and do not expect to become one in the future, although this may change.

In general, we will be deemed to be a passive foreign investment company for any taxable year in which either (i) at least 75% of our gross income is passive income or (ii) at least 50% of the value (determined on the

basis of a quarterly average) of our assets is attributable to assets that produce or are held for the production of passive income. For this purpose, passive income generally includes dividends, interest, royalties, rents (other than rents and royalties derived in the active conduct of a trade or business and not derived from a related person), annuities and gains from assets that produce passive income.

If we are a passive foreign investment company for any taxable year (i) dividends paid by us to U.S. Holders would not be eligible for the reduced rate of taxation applicable to non-corporate U.S. Holders, including individuals (see “—Distributions on ADSs or Ordinary Shares” above) and could also be subject to an interest charge, and (ii) U.S. Holders that hold ADSs or ordinary shares would generally be required to treat any gain on the sale of the ADSs or ordinary shares held by them as ordinary income and pay an interest charge on the value of the deferral of their U.S. federal income tax attributable to such gain.

If a U.S. Holder owns ADSs or ordinary shares during any year that we are a passive foreign investment company, the U.S. Holder must file Internal Revenue Service Form 8621.

A U.S. Holder is urged to consult its own tax advisors concerning the availability of making a mark-to-market election or a qualified electing fund election and the U.S. federal income tax consequences of holding the ADSs or ordinary shares if we are deemed to be a passive foreign investment company in any taxable year.

*Information Reporting and Backup Withholding.* In general, unless a U.S. Holder belongs to a category of certain exempt recipients (such as corporations), information reporting requirements will apply to distributions on ADSs or ordinary shares made within the United States and to the proceeds of sales of ADSs or ordinary shares that are effected through the U.S. office of a broker or the non-U.S. office of a broker that has certain connections with the United States. Backup withholding may apply to these payments if a U.S. Holder fails to provide a correct taxpayer identification number or certification of exempt status, fails to report in full dividend and interest income or, in certain circumstances, fails to comply with applicable certification requirements.

Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against a U.S. Holder's U.S. federal income tax, provided the U.S. Holder furnishes the required information to the Internal Revenue Service in a timely manner.

### **Cayman Islands Taxation**

The following summary constitutes the opinion of Maples and Calder as to the material Cayman Islands tax consequences of acquiring, owning and transferring our ADSs and ordinary shares.

The Cayman Islands currently levy no taxes on individuals or corporations based upon profits, income, gains or appreciation and there is no taxation in the nature of inheritance tax or estate duty. You will not be subject to Cayman Islands taxation on payments of dividends or upon the repurchase by us of your ADSs or ordinary shares. In addition, you will not be subject to withholding tax on payments of dividends or distributions, including upon a return of capital, nor will gains derived from the disposal of ADSs or ordinary shares be subject to Cayman Islands income or corporation tax.

No Cayman Islands stamp duty will be payable by you in respect of the issue or transfer of ADSs or ordinary shares. However, an instrument transferring title to an ADS, if brought to or executed in the Cayman Islands, would be subject to Cayman Islands stamp duty. The Cayman Islands are not party to any double taxation treaties. There are no exchange control regulations or currency restrictions in the Cayman Islands.

We were incorporated under the laws of the Cayman Islands as an exempted company and, as such, obtained an undertaking in April 2000 from the Governor in Council of the Cayman Islands substantially that, for a period of twenty years from the date of such undertaking, no law which is enacted in the Cayman Islands imposing any tax to be levied on profit or income or gains or appreciation shall apply to us and no such tax and no tax in the nature of estate duty or inheritance tax will be payable, either directly or by way of withholding, on our ADSs or ordinary shares.

## **Documents on Display**

We are subject to the information requirements of the Securities Exchange Act of 1934, as amended. In accordance with these requirements, we file reports and other information with the Securities and Exchange Commission. These materials, including this annual report and the exhibits thereto, may be inspected and copied at the Commission's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. The public may obtain information on the operation of the Commission's Public Reference Room by calling the Commission in the United States at 1-800-SEC-0330. The Commission also maintains a website at <http://www.sec.gov> that contains reports, proxy statements and other information regarding registrants that file electronically with the Commission. In addition, material filed by us can be inspected at the offices of the New York Stock Exchange at 20 Broad Street, New York, New York 10005.

## **Item 11. Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the risk of loss related to adverse changes in market prices, including foreign currency exchange rates and interest rates of financial instruments. We are exposed to these risks in the ordinary course of our business. Our exposure to financial risks derives primarily from changes in interest rates and foreign currency exchange rates. To mitigate some of these risks, we utilize spot, forward, and derivative financial instruments. We do not engage in any speculative activities.

### ***Foreign Exchange Rate Fluctuation Risk***

Our revenue, expense, and capital purchasing activities are primarily transacted in U.S. dollars. However, since we have operations consisting of manufacturing, sales activities and capital purchasing outside of the U.S., we enter into transactions in other currencies. We are primarily exposed to changes in exchange rate for the Euro, Japanese Yen, and Rmb.

To minimize these risks, we purchase foreign-currency forward exchange contracts with contract terms normally lasting less than six 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 Rmb, Japanese Yen or Euros and do not qualify for hedge accounting in accordance with SFAS No. 133. As of December 31, 2004, we had outstanding foreign currency forward exchange contracts with notional amounts of US\$61.0 million. Notional amounts are stated in the U.S. dollar equivalents at spot exchange rates as of the respective dates. As of December 31, 2004, the fair value of foreign currency forward exchange contracts was approximately a loss of US\$0.3 million, which is recorded in accrued expenses and other current liabilities. We had US\$133.0 million of foreign currency exchange contracts outstanding as of December 31, 2003, all of which matured during the first ten months of 2004.

We had US\$43.1 million of foreign currency exchange contracts outstanding as of December 31, 2002, all of which matured during the first nine months of 2003.

We do not enter into foreign currency exchange contracts for speculative purposes. See "Risk Factors—Risks Related to Our Financial Condition and Business—Exchange rate fluctuations could increase our costs, which could adversely affect our operating results and the value of our ADSs" and "—Risks Related to Conducting Operations in China—Devaluation or appreciation in the value of the Renminbi or restrictions on convertibility of the Renminbi could adversely affect our business and operating results."

	As of December 31, 2004 Expected maturity date (in US\$ thousands)	
	2005	Fair Value
<b>Forward Exchange Agreement</b>		
(Receive JPY/Pay US\$)		
Contract Amount	28,111	211.25
Average Contractual Exchange Rate	109.073	103.72
(Receive Euro/Pay US\$)		
Contract Amount	27,313	(117.29)
Average Contractual Exchange Rate	1.2499	1.3628
(Receive US\$/Pay Rmb)		
Contract Amount	5,610	(377.30)
Average Contractual Exchange Rate	6.6326	8.2764
<b>Total Contract Amount</b>	<b>61,034</b>	<b>(283.34)</b>

### Interest Rate Risk

Our exposure to interest rate risks relates primarily to our long-term debt obligations, which we generally assume to fund capital expenditures and working capital requirements. The table below presents annual principal amounts due and related weighted average implied forward interest rates by year of maturity for our debt obligations outstanding as of December 31, 2004. Our long-term debt obligations are all subject to variable interest rates. The interest rates on our U.S. dollar-denominated loans are linked to the LIBOR rate, while our Renminbi-denominated loans have interest rates linked to the rates determined by the People's Bank of China. As a result, the interest rates on our loans are subject to fluctuations in the underlying interest rates to which they are linked. We have not entered into any interest rate hedging contracts.

	As of December 31,			
	2005	2006	2007	2008
	(Forecast) (in US\$ thousands, except percentages)			
<b>Redeemable promissory notes</b>				
Average balance	—	—	—	—
Average interest rate	—	—	—	—
<b>US\$ denominated</b>				
Average balance	515,662	269,602	109,921	36,640
Average interest rate	5.2%	5.6%	5.9%	6.3%
<b>Rmb denominated</b>				
Average balance	28,800	9,593	—	—
Average interest rate	5.3%	5.8%	—	—
<b>Weighted average forward interest rate</b>	<b>5.2%</b>	<b>5.6%</b>	<b>5.9%</b>	<b>6.3%</b>

### Item 12. Description of Securities other than equity securities

Not applicable.

## PART II

### Item 13. Defaults, Dividend Arrearages, and Delinquencies

None.

### Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

On March 17 and 18, 2004, we completed our initial public offering of our ADSs on the New York Stock Exchange and our ordinary shares on the Hong Kong Stock Exchange, respectively. We sold an aggregate of 5,151,515,000 ordinary shares, including 97,878,780 ADSs representing 4,893,939,000 ordinary shares, through our



joint book-runners, Credit Suisse First Boston LLC and Deutsche Bank Securities, Inc. Our selling shareholders sold an aggregate of 42,424,240 ADSs of this aggregate amount. The price per ADS was US\$17.50 and the aggregate amount raised in the global offering was US\$1,799 million, of which we received US\$1,017 million.

The following use of proceeds information relates to our registration statement on Form F-1 (File No. 333- 112720), filed by us in connection with our initial public offering. Our ADSs commenced trading on the New York Stock Exchange on March 17, 2004 and our ordinary shares began trading on the Stock Exchange of Hong Kong on March 18, 2004. Credit Suisse First Boston LLC and Deutsche Bank Securities Inc. acted as U.S. representatives for the U.S. underwriters and Credit Suisse First Boston (Hong Kong) Limited and Deutsche Bank AG, Hong Kong Branch acted as international representatives for the international underwriters.

The amount of expenses incurred by us in connection with the issuance and distribution of the registered securities totaled US\$45.7 million, including US\$36.8 million for underwriting discounts and commissions, and approximately US\$8.9 million for other expenses. The amount of expenses incurred by the selling shareholders, which were underwriting discounts and commissions, in connection with the global offering totaled US\$25.6 million. None of the payments were direct or indirect payments to our directors, officers, general partners of our associates, persons owning 10% or more of any class of our shares, or any of our affiliates.

The net proceeds from the global offering, after deduction of fees and expenses, amounted to US\$1,017 million and were received in the form of Hong Kong dollars or U.S. dollars. As of December 31, 2004, US\$938.5 million had been used to construct and equip our fabs in Beijing, and upgrade and increase our capacity at our fabs in Shanghai and Tianjin. The remaining proceeds from the global offering were held in bank deposit accounts. We expect to use such proceeds for general corporate purposes.

#### **Item 15. Controls and Procedures**

Our Chief Executive Officer and our Acting Chief Financial and Accounting Officer have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). They have concluded that as of December 31, 2004, our disclosure controls and procedures were adequate and effective to ensure that material information relating to us and our consolidated subsidiaries was made known to them by others within our company and our consolidated subsidiaries.

#### **Item 16A. Audit Committee Financial Expert**

Our board has determined that Mr. Henry Shaw and Mr. Lip-Bu Tan are audit committee financial experts as defined under the applicable rules of the SEC issued pursuant to Section 407 of the Sarbanes-Oxley Act of 2002. Each of Mr. Shaw and Mr. Tan are independent as such term is defined under Section 303A.02 of the New York Stock Exchange Listed Company Manual.

#### **Item 16B. Code of Ethics**

We have adopted a Code of Business Conduct and Ethics which is applicable to all of our employees, including our Chief Executive Officer, Acting Chief Financial and Accounting Officer and any other persons performing similar functions.

Our Code of Business Conduct and Ethics is available, free of charge, to any person who sends a request for a paper copy to us at Semiconductor Manufacturing International Corporation, 18 Zhangjiang Road, Pudong New Area, Shanghai, China 201203, Attention: Investor Relations.

#### **Item 16C. Principal Accountant Fees and Services**

The following table sets forth the aggregate audit fees, audit-related fees, tax fees and all other fees we paid or incurred for audit services, audit-related services, tax services and other services rendered by our principal accountants during the fiscal years ended December 31, 2003 and December 31, 2004.

	2003	2004
Audit Fees	US\$ 940,000	US\$250,000
Audit-Related Fees	US\$1,000,000	US\$264,306
Tax Fees	US\$ 55,000	US\$115,694
All Other Fees	US\$ 0	US\$ 63,986
<b>Total</b>	<b>US\$1,995,000</b>	<b>US\$693,986</b>

Audit fees consist of the standard work associated with U.S. GAAP and statutory audits of our annual financial statements.

Audit-related fees include review of our quarterly financial results and regulatory filings, including filings with the Securities and Exchange Commission and Hong Kong Stock Exchange.

Tax services include tax compliance, tax advice and tax planning with respect to the various regulations to which we are subject.

Other fees include consultation service charges relating to our information technology security compliance project.

The audit committee has approved all audit-related services performed by Deloitte Touche Tohmatsu. The audit committee has also approved and will continue to consider, on a case-by-case basis, all non-audit services. Accordingly, the charter of the audit committee does not contain any pre-approval policies and procedures. According to the charter of our audit committee, before our principal accountants are engaged by us to render audit or non-audit services, the engagement, including the nature and scope of the work to be performed and the associated fees, must be approved by our audit committee.

#### **Item 16D. Exemptions from the Listing Standards of the Audit Committees**

Not applicable.

#### **Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

The following table sets for the number of ordinary shares we repurchased from our employees, directors and service providers pursuant to the terms of our 2001 Stock Plan, 2001 Preference Shares Stock Plan, 2001 Regulation S Stock Plan and 2001 Regulation S Preference Shares Stock Plan. Pursuant to the terms of these plans, recipients of stock options to purchase our ordinary shares are entitled to early exercise their options, subject to the Company's right of repurchase. When employees, directors, or service providers who have early exercised their options terminate their employment with the Company, the Company may repurchase the unvested shares subject to the option, at a price which is the lower of the exercise price of the option and the fair market value of our ordinary shares as of the date of repurchase. Other than repurchases pursuant to our employee stock option plans, the Company has not repurchased any of its outstanding capital stock.

<u>Period</u>	<u>Total Number of Shares Repurchased</u>	<u>Average Price Paid per Share</u>
January 2004	337,500	US\$0.1111
February 2004	0	—
March 2004	210,000	US\$0.1111
April 2004	859,750	US\$0.1111
May 2004	890,000	US\$0.0372
June 2004	1,022,250	US\$0.1111
July 2004	842,500	US\$0.1111
August 2004	2,793,000	US\$0.0886
September 2004	0	—
October 2004	1,540,000	US\$0.1111
November 2004	365,000	US\$0.1111
December 2004	4,275,000	US\$0.0056
<b>TOTAL</b>	<b>13,135,000</b>	

### **PART III**

#### **Item 17. Financial Statements**

We have elected to provide the financial statements and related information specified in Item 18 in lieu of Item 17.

#### **Item 18. Financial Statements**

See pages F-1 to F-57.

#### **Item 19. Exhibits**

- Exhibit 1.1 Tenth Amended and Restated Articles of Association, as adopted at the Registrant's annual general meeting of shareholders on May 6, 2005
- Exhibit 4.1 Asset Purchase Agreement dated September 23, 2003 among Semiconductor Manufacturing International Corporation, Motorola, Inc. and Motorola (China) Electronics Limited\*
- Exhibit 4.2 Sixth Amended and Restated Registration Rights Agreement dated February 23, 2003 among Semiconductor Manufacturing International Corporation and the shareholders listed therein\*\*
- Exhibit 4.3 Settlement Agreement dated January 31, 2005 by and between Semiconductor Manufacturing International Corporation and Taiwan Semiconductor Manufacturing Corporation, Ltd., including Patent License Agreement
- Exhibit 4.4 English language summary of Chinese language Syndicate Loan Agreement dated May 26, 2005, between Semiconductor Manufacturing International (Beijing) Corporation, Semiconductor Manufacturing International Corporation, as guarantor, and China Development Bank, China Construction Bank, Bank of China, Agricultural Bank of China, China Merchants Bank, HuaXia Bank, China Mingsheng Bank, Bank of Communications, Bank of Beijing, Industrial and Commercial Bank of China (Asia) and CITIC Ka Wah Bank
- Exhibit 4.5 Form of Indemnification Agreement, as adopted at the Registrant's annual general meeting of shareholders on May 6, 2005
- Exhibit 8.1 List of Subsidiaries
- Exhibit 12.1 Certification of CEO under Section 302 of the U.S. Sarbanes-Oxley Act of 2002
- Exhibit 12.2 Certification of Acting CFO under Section 302 of the U.S. Sarbanes-Oxley Act of 2002
- Exhibit 13.1 Certification of CEO and Acting CFO under Section 906 of the U.S. Sarbanes-Oxley Act of 2002
- Exhibit 99.1 Consent of Deloitte Touche Tohmatsu

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\* Previously filed as an exhibit to the Registrant's Form F-1 dated February 11, 2004.

\*\* Previously filed as an exhibit to the Registrant's Form F-1/A dated February 25, 2004.

## SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

SEMICONDUCTOR MANUFACTURING  
INTERNATIONAL CORPORATION

Date: June 28, 2005

By: /s/ Richard Ru Gin Chang

Name: Richard Ru Gin Chang

Title: President and Chief Executive Officer

## Annex A

### GLOSSARY OF TECHNICAL TERMS

ASIC	Application Specific Integrated Circuit. A proprietary integrated circuit designed and manufactured to meet a customer's specific functional requirements.
Cell	A primary unit that normally repeats many times in an integrated circuit. Cells represent individual functional design units or circuits that may be reused as blocks in designs. For example, a memory cell represents a storage unit in a memory array.
CIS	CMOS Image Sensor. CIS can be used in applications such as still and video cameras and embedded cameras in mobile telephones. It is a fast growing imaging sensor technology. The fabrication of CIS is fully compatible with the mainstream CMOS process, which enables system-on-chip capability, low power consumption and low cost of fabrication.
Clean room	Area within a fab in which the wafer fabrication takes place. The classification of a clean room relates to the maximum number of particles of contaminants per cubic foot within that room. For example, a class 100 clean room contains less than 100 particles of contaminants per cubic foot.
CMOS	Complementary Metal Oxide Silicon. A fabrication process that incorporates n-channel and p-channel CMOS transistors within the same silicon substrate. Currently, this is the most commonly used integrated circuit fabrication process technology and is one of the latest fabrication techniques to use metal oxide semiconductor transistors.
CVD	Chemical Vapor Deposition. A process in which gaseous chemicals react on a heated wafer surface to form solid film.
Die	One individual chip cut from a wafer before being packaged.
Dielectric material	A type of non-conducting material used for isolation purposes between conductors, such as metals.
DRAM	Dynamic Random Access Memory. A device that temporarily stores digital information but requires regular refreshing to ensure data is not lost.
DSP	Digital Signal Processor. A type of integrated circuit that processes and manipulates digital information after it has been converted from an analog source.
EEPROM	Electrically Erasable Programmable Read-Only Memory. An integrated circuit that can be electrically erased and electrically programmed with user-defined information.
EPROM	Erasable Programmable Read-Only Memory. A form of PROM that is programmable electrically yet erasable using ultraviolet light.
FCRAM™	Fast Cycle Random Access Memory. A proprietary form of RAM developed by Fujitsu Limited.
Fill factor	The percentage of LCOS metal surface area used for light reflection as compared to the total surface area. The higher the fill factor, the more light will be reflected from a given surface area.
Flash memory	A type of non-volatile memory where data is erased in blocks. The name "flash" is derived from the rapid block erase operation. Flash memory requires only one transistor per memory cell versus two transistors per memory cell for EEPROMs, making flash memory less expensive to produce. Flash memory is the most popular form of non-volatile semiconductor memory currently available.
Gold Bumping	The fabrication process of forming gold bump termination electrodes on a finished wafer.
High voltage semiconductor	High voltage semiconductors are semiconductor devices that can drive relatively high voltage potential to systems that require higher voltage of between five volts to several hundred volts.
IDM	Integrated Device Manufacturer.
Integrated circuit	An electronic circuit where all the elements of the circuit are integrated together on a single semiconductor substrate.

Interconnect	Conductive materials such as aluminum, doped polysilicon or copper that form the wiring circuitry to carry electrical signals to different parts of the chip.
I/O	Inputs/Outputs.
LCOS	Liquid Crystal On Silicon. A type of micro-display technology.
Logic device	A device that contains digital integrated circuits that perform a function rather than store information.
Low leakage	Characteristic of a transistor that has a low amount of current leakage. Low leakage allows for power-saving. Low leakage semiconductors are primarily used in applications such as cellular telephones, calculators and automotive applications.
Mask	A glass plate with a pattern of transparent and opaque areas used to create patterns on wafers. "Mask" is commonly used to refer to a plate that has a pattern large enough to pattern a whole wafer at one time, as compared to a reticle, where a glass plate can contain the pattern for one or more dies but is not large enough to transfer a wafer-sized pattern all at once.
Mask ROM	A type of non-volatile memory that is programmed during fabrication (mask-defined) and the data can be read but not erased.
Memory	A device that can store information for later retrieval.
Micro-display	A small display that is of such high resolution that it is only practically viewed or projected with lenses or mirrors. A micro-display is typically magnified by optics to enlarge the image viewed by the user. For example, a miniature display smaller than one inch in size may be magnified to provide a 12-inch to 60-inch viewing area.
Micron	A term for micrometer, which is a unit of linear measure that equals one one-millionth (1/1,000,000) of a meter. There are 25.4 microns in one one-thousandth of an inch.
Mixed-signal	The combination of analog and digital circuitry in a single semiconductor.
MOS	Metal Oxide Semiconductor. A type of semiconductor device fabricated with a conducting layer and a semiconducting layer separated by an insulating layer.
NAND Flash	A type of flash memory commonly used for mass storage applications such as MP3 players and digital cameras.
Nanometer	A term for micrometer, which is a unit of linear measure that equals one thousandth (1/1,000) of a micron.
Non-volatile memory	Memory products that maintain their content when the power supply is switched off.
OTP	One-time programmable memory used for program and data storage, usually used in applications that require only a one-time data change.
PROM	Programmable Read-Only Memory. Memory that can be reprogrammed once after manufacturing.
RAM	Random Access Memory. Memory devices where any memory cell in a large memory array may be accessed in any order at random.
RF	Radio Frequency. Radio frequency semiconductors are primarily used in communications devices such as cell phones.
Redistribution Layer Manufacturing	The manufacturing process of fabricating additional dielectric and copper interconnect layers to redistribute the pads to new locations on a finished wafer.
Reticle	See "Mask" above.
ROM	Read-Only Memory. See "Mask ROM" above.
Scanner	An aligner that scans light through a slit across a mask to produce an image on a wafer.
Semiconductor	An element with an electrical resistivity within the range of an insulator and a conductor. A semiconductor can conduct or block the flow of electric current depending on the direction and magnitude of applied electrical biases.
Solder bumping	The fabrication processes of forming solder bump termination electrodes, which are elevated metal structures, or lead free bump termination electrodes.

SRAM	Static Random Access Memory. A type of volatile memory product that is used in electronic systems to store data and program instructions. Unlike the more common DRAM, it does not need to be refreshed.
Stepper	A machine used in the photolithography process in making wafers. With a stepper, a small portion of the wafer is aligned with the mask upon which the circuitry design is laid out and is then exposed to strong light. The machine then “steps” to the next area, repeating the process until the entire wafer has been done. Exposing only a small area of a wafer at a time allows the light to be focused more strongly, which gives better resolution of the circuitry design.
System-on-chip	A chip that incorporates functions usually performed by several different devices and therefore generally offers better performance and lower cost.
Systems companies	Companies that design and manufacture complete end market products or systems for sale to the market.
Transistor	An individual circuit that can amplify or switch electric current. This is the building block of all integrated circuits.
Volatile memory	Memory products that lose their content when the power supply is switched off.
Wafer	A thin, round, flat piece of silicon that is the base of most integrated circuits.

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**THE COMPANIES LAW (REVISED)**  
**COMPANY LIMITED BY SHARES**  
**TENTH AMENDED AND RESTATED ARTICLES OF ASSOCIATION**  
**OF**  
**SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPORATION**

(As adopted by special resolution passed on May 6, 2005)

**INTERPRETATION**

1. In these Articles Table A in the Schedule to the Statute does not apply and, unless there be something in the subject or context inconsistent therewith,
- |                            |   |
|----------------------------|---|
| <b>“Articles”</b>          | means these articles of association of the Company, as amended from time to time by Special Resolution.   |
| <b>“Auditors”</b>          | means the persons for the time being performing the duties of auditors of the Company.  |
| <b>“Board”</b>             | means the board of directors of the Company.  |
| <b>“Common Shares”</b>     | has the meaning given in the Company’s Memorandum of Association.   |
| <b>“Company”</b>           | means the above-named company.  |
| <b>“Directors”</b>         | means the directors for the time being of the Company.  |
| <b>“dividend”</b>          | includes interim dividends and bonus dividends.   |
| <b>“Electronic Record”</b> | has the same meaning as in the Electronic Transactions Law (2003 Revision).   |
| <b>“Exchange”</b>          | shall mean any securities exchange or other system on which the Shares of the Company may be listed or otherwise authorised for trading from time to time.                |
| <b>“Exchange Rules”</b>    | means the relevant code, rules and regulations, as amended from time to time, applicable as a result of the original and continued listing of any Shares on any Exchange. |

<b>“Hong Kong”</b>	means the Hong Kong Special Administrative Region of the People’s Republic of China.
<b>“Independent Director”</b>	shall mean a person recognised as such by applicable law, rules or regulations and the Exchange Rules.
<b>“Member”</b>	has the same meaning as in the Statute.
<b>“Memorandum”</b>	means the memorandum of association of the Company as amended from time to time by Special Resolution.
<b>“month”</b>	means calendar month.
<b>“Ordinary Resolution”</b>	means a resolution passed by a simple majority of the Members as, being entitled to do so, vote in person or, where proxies are allowed, by proxy, or, in the case of corporations, by their duly authorized representatives, at a general meeting. In computing the majority when a poll is demanded regard shall be had to the number of votes to which each Member is entitled by the Articles.
<b>“paid-up”</b>	means paid-up and/or credited as paid-up.
<b>“Preferred Shares”</b>	has the meaning given in the Company’s Memorandum of Association.
<b>“recognised clearing house”</b>	shall have the meaning ascribed thereto in Part I of Schedule I of the Securities and Futures Ordinance of Hong Kong (Cap. 571 of the Laws of Hong Kong) and any amendments thereto or re-enactments thereof for the time being in force and includes every other law incorporated therewith or substituted therefor.
<b>“Register of Members”</b>	means the register maintained in accordance with the Statute and includes (except where otherwise stated) any duplicate Register of Members.
<b>“registered office”</b>	means the registered office for the time being of the Company.

<b>“Seal”</b>	means the common seal of the Company and includes every duplicate seal.
<b>“Secretary”</b>	includes an assistant secretary and any person appointed to perform the duties of secretary of the Company.
<b>“Share” and “Shares”</b>	means a share or shares in the Company and includes a fraction of a share.
<b>“Special Resolution”</b>	means (i) a resolution passed by at least three-fourths (3/4) of the Members as, being entitled to do so, vote in person or, where proxies are allowed, by proxy, or, in the case of corporations, by their duly authorized representatives, at a general meeting of which notice specifying the intention to propose the resolution as a Special Resolution has been duly given or (ii) a resolution approved in writing by all of the Members entitled to vote at a general meeting of the Company. In computing such three-fourths requirement when a poll is demanded regard shall be had to the number of votes to which each Member is entitled by the Articles.
<b>“Statute”</b>	means the Companies Law (Revised) Cap. 22 of the Cayman Islands and any amendments thereto or re-enactments thereof for the time being in force and includes every other law incorporated therewith or substituted therefor.

2. In the Articles:
  - 2.1 words importing the singular number include the plural number and vice-versa;
  - 2.2 words importing the masculine gender include the feminine gender;
  - 2.3 words importing persons include corporations;
  - 2.4 “written” and “in writing” include all modes of representing or reproducing words in visible form, including in the form of an Electronic Record;
  - 2.5 references to provisions of any law or regulation shall be construed as references to those provisions as amended, modified, re-enacted or replaced from time to time;
  - 2.6 any phrase introduced by the terms “including”, “include”, “in particular” or any similar expression shall be construed as illustrative and shall not limit the sense of the words preceding those terms;

- 2.7 headings are inserted for reference only and shall be ignored in construing these Articles;
- 2.8 references in these Articles to a document being “executed” include references to its being executed under hand or under seal or by any other method authorised by the Company;
- 2.9 any words or expressions defined in the Statute and any other applicable law in force when these Articles or any part of these Articles are adopted will (if not inconsistent with the subject or context in which they appear) have the same meaning in these Articles or that part save the word “company” includes any body corporate;
- 2.10 references to a meeting will not be taken as requiring more than one person to be present if any quorum requirement can be satisfied by one person;
- 2.11 where these Articles refer to months or years, these are all calendar months or years; and
- 2.12 where these Articles give any power or authority to any person, this power or authority can be used on any number of occasions, unless the way in which the words are used does not allow this meaning.

### **FORM OF RESOLUTION**

3. Where anything can be done by passing an Ordinary Resolution, this can also be done by passing a Special Resolution.
4. Subject to applicable law, rules or regulations and the Exchange Rules, a written resolution signed by or on behalf of each Member who would have been entitled to vote on it at a general meeting will be as effective as a resolution passed at a general meeting which is properly called and held. The resolution may be passed using several copies of a document if each document is signed by one or more Members. These copies can be fax copies.

### **SHARE CAPITAL: ISSUE OF SHARES**

App 3  
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5. The authorised share capital of the Company at the date of the adoption of these Articles is US\$22,000,000.00 divided into 50,000,000,000 Common Shares of a nominal or par value of US\$0.0004 each and 5,000,000,000 Preferred Shares of a nominal or par value of US\$0.0004 each.
6. Subject to the provisions, if any, in the Memorandum and these Articles and to any direction that may be given by the Company in a general meeting and without prejudice to any rights attached to any existing Shares, the Board may allot, issue, grant options, rights or warrants over or otherwise dispose of any Shares (including fractions of any Share) with or without preferred, deferred, qualified or other rights or restrictions, whether in regard to dividend, voting, return of capital or otherwise, and to such persons at such times and on such other terms as they think proper. Notwithstanding and without prejudice to the generality of the foregoing, the Board is expressly authorised and empowered to implement or effect at its sole discretion the issuance of a preferred share

purchase right to be issued on a pro rata basis to each holder of a Common Share with such terms and for such purposes, including the influencing of takeovers, as may be described in a rights agreement between the Company and a rights agent.

7. Upon approval of the Board, such number of Common Shares, or other shares or securities of the Company, as may be required for such purposes shall be reserved for issuance in connection with an option, right, warrant or other security of the Company or any other person that is exercisable for, convertible into, exchangeable for or otherwise issuable in respect of such Common Shares or other shares or securities of the Company.
8. All Shares shall be issued fully paid as to their nominal value and any premium determined by the Board at the time of issue and shall be non-assessable. Any amount paid in advance of calls on any Share may carry interest but shall not entitle the holder of the Share to participate in respect thereof in a dividend subsequently declared. The Company shall have no lien over fully paid Shares.
9. The Company shall not issue Shares to bearer.

App 3  
r.1(2) and  
r.3(1)

### COMMON SHARES

10. The holders of the Common Shares shall be:
  - 10.1 entitled to dividends in accordance with the relevant provisions of these Articles;
  - 10.2 entitled to and are subject to the provisions in relation to winding up of the Company provided for in these Articles;
  - 10.3 entitled to attend general meetings of the Company and shall be entitled to one vote for each Common Share registered in his name in the Register of Members, both in accordance with the relevant provisions of these Articles.
11. All Common Shares shall rank *pari passu* with each other in all respects.

App 3  
r.9

### PREFERRED SHARES

12. Preferred Shares may be issued from time to time in one or more series, each of such series to have such voting powers (full or limited or without voting powers; provided that the designation of such Shares shall include words indicating the voting powers attached thereto (including the words “restricted voting” or “limited voting” where the Preferred Shares have voting rights which are not the most favourable)), designations, preferences and relative, participating, optional or other special rights and qualifications, limitations or restrictions thereof as are stated and expressed, or in any resolution or resolutions providing for the issue of such series adopted by the Board as hereinafter provided.
13. Authority is hereby granted to the Board, subject to the provisions of the Memorandum, these Articles and applicable law, to create one or more series of Preferred Shares and, with respect to each such series, to fix by resolution or resolutions, without any further vote or action by the Members of the Company providing for the issue of such series:
  - 13.1 the number of Preferred Shares to constitute such series and the distinctive designation thereof;

App 3  
r.6(1), r.9, r.10(1)  
and (2)

App 3  
r.9

- 13.2 the dividend rate on the Preferred Shares of such series, the dividend payment dates, the periods in respect of which dividends are payable (“**Dividend Periods**”), whether such dividends shall be preferred over Common Shares and whether they shall be cumulative and, if cumulative, the date or dates from which dividends shall accumulate;
- 13.3 whether the Preferred Shares of such series shall be convertible into, or exchangeable for, Shares of any other class or classes or any other series of the same or any other class or classes of Shares of the Company and the conversion price or prices or rate or rates, or the rate or rates at which such exchange may be made, with such adjustments, if any, as shall be stated and expressed or provided in such resolution or resolutions;
- 13.4 the preferences, if any, and the amounts thereof, which the Preferred Shares of such series shall be entitled to receive upon the winding up of the Company;
- 13.5 the voting power, if any, of the Preferred Shares of such series;
- 13.6 transfer restrictions and rights of first refusal with respect to the Preferred Shares of such series; and
- 13.7 such other terms, conditions, special rights and provisions as may seem advisable to the Board. Notwithstanding the fixing of the number of Preferred Shares constituting a particular series upon the issuance thereof, the Board at any time thereafter may authorise the issuance of additional Preferred Shares of the same series subject always to the Statute and the Memorandum.

App 3  
r.9

- 14. No dividend shall be declared and set apart for payment on any series of Preferred Shares in respect of any Dividend Period unless there shall likewise be or have been paid, or declared and set apart for payment, on all Preferred Shares of each other series entitled to cumulative dividends at the time outstanding which rank senior or equally as to dividends with the series in question, dividends ratably in accordance with the sums which would be payable on the said Preferred Shares through the end of the last preceding Dividend Period if all dividends were declared and paid in full.

App 3  
r.9

- 15. If, upon the winding up of the Company, the assets of the Company distributable among the holders of any one or more series of Preferred Shares which (i) are entitled to a preference over the holders of the Common Shares upon such winding up, and (ii) rank equally in connection with any such distribution, shall be insufficient to pay in full the preferential amount to which the holders of such Preferred Shares shall be entitled, then such assets, or the proceeds thereof, shall be distributed among the holders of each such series of the Preferred Shares ratably in accordance with the sums which would be payable on such distribution if all sums payable were discharged in full.

## ISSUE OF WARRANTS

- App 3  
r.2(2)
- 16.** The Board may issue warrants to subscribe for any class of Shares or other securities of the Company on such terms as it may from time to time determine. No warrants shall be issued to bearer.

## CERTIFICATES FOR SHARES

- App 3  
r.1(1)
- 17.** Every person whose name is entered as a Member in the Register of Members shall be entitled without payment to receive, within twenty (20) days, after allotment or lodgment of transfer (or within such other period as the conditions of issue shall provide), one certificate for all his Shares of each class or, upon payment of such reasonable fee as the Board shall prescribe, such number of certificates for Shares held as that person may request, provided that in respect of a Share or Shares held jointly by several persons the Company shall not be bound to issue a certificate or certificates to each such person, and the issue and delivery of a certificate or certificates to one of several joint holders shall be sufficient delivery to all such holders. The fee or fees shall not exceed the maximum fees prescribed by applicable law, rules or regulations or the Exchange Rules.
- App 3  
r.2(1)
- 18.** Every share certificate shall specify the number of Shares in respect of which it is issued and the amount paid thereon or the fact that they are fully paid, as the case may be, and may otherwise be in such form as shall be determined by the Board. Every certificate shall be issued under the Seal of the Company, which shall only be affixed with the authority of the Board. All certificates for Shares shall be consecutively numbered or otherwise identified and shall specify the Shares to which they relate. The name and address of the person to whom the Shares represented thereby are issued, with the number of Shares and date of issue, shall be entered in the Register of Members of the Company. All certificates surrendered to the Company for transfer shall be cancelled and no new certificate shall be issued until the former certificate for a like number of Shares shall have been surrendered and cancelled. The Board may authorise certificates to be issued with the seal and authorised signature(s) affixed by some method or system of mechanical process.
- App 3  
r.1(1)
- 19.** If a share certificate is defaced, worn out, lost or destroyed, it may be renewed on such terms (if any) as to evidence and indemnity and on the payment of such expenses reasonably incurred by the Company in investigating evidence, as the Board may prescribe, and (in the case of defacement or wearing out) upon delivery of the old certificate. The fee or fees shall not exceed the maximum fees prescribed by applicable law, rules or regulations or the Exchange Rules.

## REGISTER OF MEMBERS

- App 3  
r.1(1)
- 20.** The Company shall maintain or caused to be maintained a Register of its Members in accordance with the Statute and any applicable Exchange Rules.
- 21.** If the Board considers it necessary or appropriate, the Company may establish and maintain a duplicate Register or Registers of Members at such location or locations within or outside the Cayman Islands as the Board thinks fit. The original Register of Members shall be treated as the Register of Members for the purposes of these Articles and the Statute.

- App 13 –  
Part B  
r.3(2)
22. Except when a Register of Members is closed and, if applicable, subject to the additional provisions of Article 24 below, the principal Register of Members and any duplicate Register shall during business hours be kept open to the inspection of any Member without charge. The reference to business hours in the preceding sentence is subject to such reasonable restrictions as the Company in general business may impose, but so that not less than two hours in each business day is to be allowed for inspections.
- App 13 –  
Part B  
r.3(2)
23. The Register of Members may, on fourteen (14) days' notice being given in accordance with applicable law, rules or regulations and the Exchange Rules, be closed at such times and for such periods as the Board may from time to time determine, either generally or in respect of any class of Shares, provided that the Register of Members shall not be closed for more than thirty (30) days in any year (or such longer period as the Members may by Ordinary Resolution determine provided that such period shall not be extended beyond sixty (60) days in any year). The Company shall, on demand, furnish any person seeking to inspect the Register of Members or part thereof which is closed by virtue of this Article with a certificate under the hand of the Secretary stating the period for which, and by whose authority, it is closed.
- App 13 –  
Part B  
r.3(2)
24. Any Register of Members held in Hong Kong shall during normal business hours (subject to such reasonable restrictions as the Board may impose) be open to inspection by a Member without charge and any other person on payment of such fee not exceeding HK\$1.00 (or such higher amount as may from time to time be permitted under the Exchange Rules) as the Board may determine for each inspection. Any Member may require a copy of the Register of Members, or any part thereof, on payment of HK\$0.25 (or such higher amount as may from time to time be permitted under the Exchange Rules), or such lesser sum as the Company may prescribe, for every 100 words or fractional part thereof required to be copied. The Company shall cause any copy so required by any person to be sent to that person within a period of ten days commencing on the date next after the day on which the request is received by the Company.
25. The Company, or any agent(s) appointed by it to maintain the duplicate Register of Members in accordance with these Articles, shall as soon as practicable and on a regular basis record or procure the recording in the original Register of Members all transfers of Shares effected on any duplicate Register of Members and shall at all times maintain the original Register of Members in such manner as to show at all times the Members for the time being and the Shares respectively held by them, in all respects in accordance with the Statute.
26. The Company shall not be bound to register more than four persons as joint holders of any Share. If any Share shall stand in the names of two or more persons, the person first named in the Register of Members shall be deemed the sole holder thereof as regards service of notices and, subject to the provisions of these Articles, all or any other matters connected with the Company.



## TRANSFER OF SHARES

- App 3  
r.1(2)
- 27.** Unless the Articles say otherwise, any Member may transfer one or all of his Shares to another person free from restriction or lien. All transfers of Shares may be effected by an instrument of transfer in the usual common form or in such other form as the Board may approve. All instruments of transfer must be left at the registered office of the Company or at such other place as the Board may appoint and all such instruments of transfer shall be retained by the Company.
- 28.** The instrument of transfer shall be executed by or on behalf of the transferor and by or on behalf of the transferee, provided that the Board may dispense with the execution of the instrument of transfer by the transferee in any case which it thinks fit in its discretion to do so. The instrument of transfer of any Share shall be in writing and shall be executed with a manual signature or facsimile signature (which may be machine imprinted or otherwise) by or on behalf of the transferor and transferee, provided that in the case of execution by facsimile signature such facsimile signature shall be reasonably satisfactory to the Board. The transferor shall be deemed to remain the holder of a Share until the name of the transferee is entered in the Register of Members in respect thereof.
- 29.** The Board may, in its absolute discretion, and without assigning any reason, refuse to register a transfer of any Share which is not fully paid up or upon which the Company has a lien.
- 30.** The Board may also decline to register any transfer of any Share unless:
- 30.1 the instrument of transfer is lodged with the Company accompanied by the certificate for the Shares to which it relates (which shall upon registration of the transfer be cancelled) and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer;
- 30.2 the instrument of transfer is in respect of only one class of Shares;
- 30.3 the instrument of transfer is properly stamped (in circumstances where stamping is required);
- App 3  
r.1(3)
- 30.4 in the case of a transfer to joint holders, the number of joint holders to which the Share is to be transferred does not exceed four;
- 30.5 the Shares concerned are free of any lien in favour of the Company; and
- App 3  
r.1(1)
- 30.6 a fee of such maximum amount as any Exchange may from time to time determine to be payable (or such lesser sum as the Board may from time to time require) is paid to the Company in respect thereof.
- 31.** If the Board shall refuse to register a transfer of any Share, it shall, within two months after the date on which the transfer was lodged with the Company, send to each of the transferor and the transferee notice of such refusal.

32. The Company shall not be obligated to make any transfer to an infant or to a person in respect of whom an order has been made by a competent court or official on the grounds that he is or may be suffering from mental disorder or is otherwise incapable of managing his affairs or under other legal disability.
33. Upon every transfer of Shares the certificate held by the transferor shall be given up to be cancelled, and shall forthwith be cancelled accordingly, and a new certificate shall be issued without charge to the transferee in respect of the Shares transferred to him, and if any of the Shares included in the certificate so given up shall be retained by the transferor, a new certificate in respect thereof shall be issued to him without charge. The Company shall also retain the instrument(s) of transfer.
34. The registration of any transfers may, on fourteen (14) days' notice being given in accordance with applicable law, rules or regulations and the Exchange Rules, be suspended and the Register closed at such times and for such periods as the Board may from time to time determine, provided always that such registration shall not be suspended or the Register closed for more than thirty (30) days in any year (or such longer period as the Members may by Ordinary Resolution determine provided that such period shall not be extended beyond sixty (60) days in any year).

### **REDEMPTION AND REPURCHASE OF SHARES**

35. Subject to the provisions of the Statute, the Company may issue Shares that are to be redeemed or are liable to be redeemed at the option of the Member or the Company. The redemption of Common Shares shall be effected in such manner as the Company may, by Special Resolution, determine before the issue of the Common Shares and the redemption of Preferred Shares shall be effected in such manner as the Board may, by resolution, determine before the issue of the Preferred Shares (this authorisation is in accordance with Section 37(1) of the Statute or any modification or re-enactment thereof for the time being in force).
36. Subject to the provisions of the Statute, the Company may purchase its own Shares (including any redeemable Shares), provided that the Members shall have approved the manner of purchase by Ordinary Resolution or that the manner of purchase is in accordance with the following Articles (and this authorisation is in accordance with Section 37(2) of the Statute or any modification or re-enactment thereof for the time being in force) and such repurchase is in accordance with applicable law, rules or regulations and the Exchange Rules.
37. The Company is authorised to purchase any Common Share listed on any Exchange in accordance with the following manner of purchase: The maximum number of Common Shares that may be repurchased shall be equal to the number of issued and outstanding Common Shares less one Common Share; at such time, at such price and on such other terms as determined and agreed by the Board in their sole discretion, provided, however, that (i) such repurchase transactions shall be in accordance with applicable law, rules or regulations and the Exchange Rules; and (ii) at the time of the repurchase the Company is able to pay its debts as they fall due in the ordinary course of its business.

38. The Company is authorised to purchase any Common Share not listed on an Exchange in accordance with the following manner of purchase: the price for the Common Shares being repurchased shall be such price agreed between the Board and the applicable Member; and the repurchase shall be on such other terms as determined and agreed by the Board and the applicable Member in their sole discretion, provided however, that such repurchase transactions shall be in accordance with applicable law, rules and regulations.
- App 3  
r.8(1) and  
(2)
39. Where the Company purchases for redemption a redeemable Share, purchases not made through the market or by tender shall be limited to a maximum price, and if purchases are by tender, tenders shall be available to all Members alike.
40. The purchase of any Share shall not oblige the Company to purchase any other Share other than as may be required pursuant to applicable law, rules or regulations or the Exchange Rules and any other contractual obligations of the Company.
41. The Company may make a payment in respect of the redemption or purchase of its own Shares in any manner permitted by the Statute, including out of capital.
42. The holder of the Shares being purchased shall be bound to deliver up to the Company at its registered office or such other place as the Board shall specify, the certificate(s) (if any) thereof for cancellation and thereupon the Company shall pay to him the purchase or redemption monies or consideration in respect thereof.

#### **VARIATION OF RIGHTS OF SHARES**

- App 3  
r.6(2) and  
App 13 –  
Part B  
r.2(1)
43. If at any time the share capital of the Company is divided into different classes of Shares, the rights attached to any class (unless otherwise provided by the terms of issue of the Shares of that class) may be varied with the consent in writing of the holders of three-fourths of the issued Shares of that class, or with the sanction of a Special Resolution passed at a separate general meeting of the holders of the Shares of that class.
- App 13 –  
Part B  
r.2(1)
44. The provisions of these Articles relating to general meetings shall apply to every such separate general meeting of the holders of one class of Shares (so that references to Shares shall be deemed to be references to such class of Shares) except that the following provisions shall apply:
- App 3  
r.6(2)
- 44.1 a quorum will be present if at least two holders of Shares who own at least one-third in nominal value of the issued Shares of the class are present in person or by proxy; and
- 44.2 at an adjourned meeting, one person who holds Shares of the class, or his proxy, will be a quorum.
- The provisions of this Article will apply to any change or abrogation of rights of Shares forming part of a separate class. Each part of the class which is being treated differently is treated as a separate class in operating this Article.

45. The rights conferred upon the holders of the Shares of any class issued with preferred or other rights shall not, unless otherwise expressly provided by the terms of issue of the Shares of that class, be deemed to be varied by the creation or issue of further Shares ranking pari passu therewith. The rights of holders of Common Shares shall not be deemed to be varied by the creation or issue of Shares with preferred or other rights which may be effected by the Board as provided in these Articles without any vote or consent of the holders of Common Shares.

#### **COMMISSION ON SALE OF SHARES**

46. The Company may in so far as the Statute from time to time permits pay a commission to any person in consideration of his subscribing or agreeing to subscribe whether absolutely or conditionally for any Shares of the Company. Such commissions may be satisfied by the payment of cash or the lodgement of fully or partly paid-up Shares or partly in one way and partly in the other. The Company may also on any issue of Shares pay such brokerage as may be lawful.

#### **NON-RECOGNITION OF TRUSTS**

47. The Company shall not be obligated to recognise any person as holding any Share upon any trust and the Company shall not be bound by or be compelled in any way to recognise (even when having notice thereof) any equitable, contingent, future, or partial interest in any Share, or any interest in any fractional part of a Share, or (except only as is otherwise provided by these Articles or the Statute) any other rights in respect of any Share except an absolute right to the entirety thereof in the registered holder.

#### **DISCLOSURE OF SHARE INTEREST**

App 3  
r.12

48. No power shall be taken to freeze or otherwise impair any of the rights attaching to any Shares by reason only that the person or persons who are interested directly or indirectly therein have failed to disclose their interest to the Company.

#### **TRANSMISSION OF SHARES**

49. In case of the death of a Member, the survivor or survivors where the deceased was a joint holder, and the legal personal representatives of the deceased where he was a sole holder, shall be the only persons recognised by the Company as having any title to his interest in the Shares, but nothing herein contained shall release the estate of any such deceased holder from any liability in respect of any Shares which had been held by him solely or jointly with other persons.
50. Any person becoming entitled to a Share in consequence of the death or bankruptcy or liquidation or dissolution of a Member (or in any other way than by transfer) may, upon such evidence being produced as may from time to time be required by the Board and subject as hereinafter provided, elect either to be registered himself as holder of the Share or to make such transfer of the Share to such other person nominated by him and to have such person registered as the transferee thereof, but the Board shall, in either case, have the same right to decline or suspend registration as it would have had in the case of a transfer of the Share by that Member before his death or bankruptcy as the case may be.

App 3  
r.13(2)(a)  
and (b)

- 51.** If the person so becoming entitled shall elect to be registered himself as holder he shall deliver or send to the Company a notice in writing signed by him stating that he so elects.
- 52.** A person becoming entitled to a Share by reason of the death or bankruptcy or liquidation or dissolution of the holder (or in any other case than by transfer) shall be entitled to the same dividends and other advantages to which he would be entitled if he were the registered holder of the Share, except that he shall not, before being registered as a Member in respect of the Share, be entitled in respect of it to exercise any right conferred by membership in relation to meetings of the Company, provided, however, that the Board may at any time give notice requiring any such person to elect either to be registered himself or to transfer the Share and if the notice is not complied with within ninety (90) days, the Board may thereafter withhold payment of all dividends, bonuses or other monies payable in respect of the Share until the requirements of the notice have been complied with.
- 53.** The Company shall be entitled to sell any Shares of a Member or the Shares to which a person is entitled by virtue of transmission on death or bankruptcy or operation of law if and provided that:
  - 53.1** All cheques or warrants, not being less than three (3) in number, for any sums payable in cash to the holder of such Shares have remained uncashed for a period of twelve (12) years;
  - 53.2** The Company has not during that time or before the expiry of the three-month period referred to in Article 53.4 below received any indication of the whereabouts or existence of the Member or person entitled to such shares by death, bankruptcy or operation of law;
  - 53.3** During the 12-year period, at least three (3) dividends in respect of the Shares in question have become payable and no dividend during that period has been claimed by the Member; and
  - 53.4** Upon expiry of the 12-year period, the Company has caused notice to be given in accordance with applicable law, rules or regulations and the Exchange Rules, of its intention to sell such Shares, and a period of three (3) months has elapsed since such notice and the relevant Exchange has been notified of such intention.
- 54.** The net proceeds of any such sale pursuant to Article 53 above shall belong to the Company and upon receipt by the Company of such net proceeds it shall become indebted to the former Member for an amount equal to such net proceeds.
- 55.** To give effect to any sale contemplated pursuant to Article 53 above, the Company may appoint any person to execute as transferor an instrument of transfer of the said Shares and such other documents as are necessary to effect the transfer, and such documents shall be as effective as if they had been executed by the registered holder of or person entitled by transmission to such Shares, and the title of the transferee shall not be affected

by any irregularity or invalidity in the proceedings relating thereto. The net proceeds of sale shall belong to the Company which shall be obliged to account to the former Member or other person previously entitled as aforesaid for an amount equal to such net proceeds and shall enter the name of such former Member or other person in the books of the Company as a creditor for such amount. No trust shall be created in respect of the debt, no interest shall be payable in respect of the same and the Company shall not be required to account for any money earned on the net proceeds, which may be employed in the business of the Company or invested in such investments (other than Shares or other securities in or of the Company or its holding company if any) or as the Board may from time to time determine.

**AMENDMENT OF MEMORANDUM OF ASSOCIATION,  
CHANGE OF LOCATION OF REGISTERED OFFICE, AND  
ALTERATION OF CAPITAL**

- 56.** The Company may by Ordinary Resolution:
- 56.1.1 increase the share capital by such sum as the resolution shall prescribe and with such rights, priorities and privileges annexed thereto, as the Company in general meeting may determine;
  - 56.1.2 consolidate and divide all or any of its share capital into Shares of larger amount than its existing Shares;
  - 56.1.3 by subdivision of its existing Shares or any of them divide the whole or any part of its share capital into Shares of smaller amount than is fixed by the Memorandum or into Shares without par value; and
  - 56.1.4 cancel any Shares that at the date of the passing of the resolution have not been taken or agreed to be taken by any person.
- App 13 - 56.2 Subject to the provisions of the Statute, the Company may by Special Resolution change its name, alter or add to Part B r.1 the Memorandum with respect to any objects, powers or other matters specified therein or alter or add to these Articles.
- 56.3 Subject to the provisions of the Statute, the Company may by Special Resolution reduce its share capital and any capital redemption reserve fund.
- 56.4 Subject to the provisions of the Statute, the Company may by resolution of the Board change the location of its registered office.

**CLOSING REGISTER OF MEMBERS OR FIXING RECORD DATE**

- 57.** For the purpose of determining Members entitled to notice of or to vote at any meeting of Members or any adjournment thereof, or Members entitled to receive payment of any dividend, or in order to make a determination of Members for any other proper purpose, the Board may provide that the Register of Members shall be closed for transfers for a stated period in accordance with Article 23 above. If the Register of Members shall be so

closed for the purpose of determining Members entitled to notice of or to vote at a meeting of Members, the record date for such determination shall be the date of the last day of the relevant closure period of the Register of Members.

- 58.** In lieu of, or apart from, closing the Register of Members, the Board may fix in advance or arrears a date as the record date for any such determination of Members entitled to notice of or to vote at a meeting of the Members or any adjournment thereof, and for the purpose of determining the Members entitled to receive payment of any dividend. Such record date shall not be more than sixty (60) days before the date of such meeting, nor more than sixty (60) days prior to any other action. A determination of the Members entitled to notice of or to vote at a meeting of Members shall apply to any adjournment of such meeting; provided, however, that the Board may fix a new record date for the adjourned meeting.
- 59.** If the Register of Members is not so closed and no record date is fixed for the determination of Members entitled to notice of or to vote at a meeting of Members or Members entitled to receive payment of a dividend, the date on which notice of the meeting is mailed or the date on which the resolution of the Board declaring such dividend is adopted, as the case may be, shall be the record date for such determination of Members. When a determination of Members entitled to vote at any meeting of Members has been made as provided in this section, such determination shall apply to any adjournment thereof.

### GENERAL MEETINGS

App 13 –  
Part B  
r.3(3) and  
r.4(2)

- 60.** The Company shall, if required by the Statute, other applicable law, rules or regulations or the Exchange Rules, hold a general meeting as its annual general meeting each year, and shall specify the meeting as such in the notices calling it. The annual general meeting shall be held at such time and place as the Board shall appoint, provided that the period between the date of one annual general meeting of the Company and that of the next shall not be longer than such period as applicable law, rules or regulations or the Exchange Rules permit. At these meetings the report of the Board (if any) shall be presented.
- 61.** The Board or the Chairman of the Board may whenever they or he think fit proceed to convene a general meeting of the Company. The ability of Members to call any general meeting of the Company is specifically denied. General meetings of the Company may be held at such place, either within or without the Cayman Islands, as determined by the Board. The Board may, in its sole discretion, determine that the meeting shall not be held at any place, but may instead be held solely by means of remote communication as follows:
- 61.1 if authorized by the Board in its sole discretion, and subject to such guidelines and procedures as the Board may adopt, Members and proxies entitled to attend and vote but not physically present at a meeting of Members may, by means of remote communication:
- 61.1.1 participate in a meeting of Members; and

- 61.1.2 be deemed present in person and vote at a meeting of Members whether such meeting is to be held at a designated place or solely by means of remote communication.
- 61.2 if authorised by the Board, any vote taken by written ballot may be satisfied by a ballot submitted by electronic transmission, provided that any such electronic transmission must either set forth or be submitted with information from which it can be determined that the electronic transmission was authorized by the Member or proxy.

#### NOTICE OF GENERAL MEETINGS

- App 13 –  
Part B  
r.3(1)
- 62.** At least twenty-one (21) days' notice (but not more than sixty (60) days' notice) shall be given of any annual general meeting and any extraordinary general meeting calling for the passing of a special resolution, and at least fourteen (14) days' notice (but not more than sixty (60) days' notice) shall be given of any other extraordinary general meeting. Every notice shall be exclusive of the day on which it is given or deemed to be given and of the day for which it is given and shall specify such details as are required by applicable law, rules or regulations and the Exchange Rules.
- 63.** A general meeting of the Company shall, whether or not the notice specified in Article 62 has been given and whether or not the provisions of the Articles regarding general meetings have been complied with, be deemed to have been duly convened if applicable law, rules or regulations and the Exchange Rules so permit and it is so agreed:
- 63.1 in the case of a general meeting called as an annual general meeting, by all the Members entitled to attend and vote thereat or their proxies; and
- 63.2 in the case of any other general meeting, by such number of the Members having a right to attend and vote at the meeting, being a majority together holding not less than three-fourths (3/4) of the Shares in issue that carry a right to vote or their proxies.
- 64.** The notice convening an annual general meeting shall specify the meeting as such, and the notice convening a meeting to pass a special resolution shall specify the intention to propose the resolution as a special resolution. Notice of every general meeting shall be given to all Members other than such as, under the provisions hereof or the terms of issue of the Shares they hold, are not entitled to receive such notice from the Company.
- 65.** There shall appear with reasonable prominence in every notice of general meetings of the Company a statement that a Member entitled to attend and vote is entitled to appoint a proxy to attend and vote instead of him and that a proxy need not be a Member of the Company.
- 66.** The accidental omission to give notice of a general meeting to, or the non-receipt of notice of a meeting by any person entitled to receive notice shall not invalidate the proceedings of that meeting.



67. In cases where instruments of proxy are sent out with notices, the accidental omission to send such instrument of proxy to, or the non-receipt of such instrument of proxy by, any person entitled to receive notice shall not invalidate any resolution passed or any proceeding at any such meeting.
68. No business may be transacted at any general meeting, other than business that is either (A) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board (or any duly authorized committee thereof), (B) otherwise properly brought before an annual general meeting by or at the direction of the Board (or any duly authorized committee thereof) or (C) otherwise properly brought before an annual general meeting by any Member of the Company who (i) is a Member of record on both (x) the date of the giving of the notice by such Member provided for in this Article 68 and (y) the record date for the determination of Members entitled to vote at such annual general meeting and (ii) complies with the notice procedures set forth in this Article 68.
- 68.1 In addition to any other applicable requirements, for business to be properly brought before an annual general meeting by a Member, such Member must have given timely notice thereof in proper written form to the Secretary of the Company.
- 68.2 For all matters other than for the nomination for election of a Director to be made by a Member of the Company, to be timely, such Member's notice shall be delivered to the Secretary at the principal executive offices of the Company not less than sixty (60) days nor more than ninety (90) days prior to the first anniversary of the preceding year's annual general meeting; provided, however, that in the event that the date of the annual general meeting is advanced by more than thirty (30) days or delayed by more than sixty (60) days from such anniversary date, notice by the Member to be timely must be delivered not earlier than the ninetieth (90th) day prior to such annual general meeting and not later than the close of business on the later of the sixtieth (60th) day prior to such annual general meeting or the tenth (10th) day following the day on which public announcement of the date of such meeting is first made.
- 68.3 To be in proper written form, a Member's notice to the Secretary must set forth as to each matter such Member proposes to bring before the annual general meeting (1) a brief description of the business desired to be brought before the annual general meeting and the reasons for conducting such business at the annual general meeting, (2) the name and record address of such Member, (3) the class or series and number of Shares of the Company which are owned beneficially or of record by such Member, (4) a description of all arrangements or understandings between such Member and any other person or persons (including their names) in connection with the proposal of such business by such Member and any material interest of such Member in such business and (5) a representation that such Member intends to appear in person or by proxy at the annual general meeting to bring such business before the meeting.
- 68.4 No business shall be conducted at the annual general meeting except business brought before the annual general meeting in accordance with the procedures set forth in this Article 68, provided, however, that, once business has been properly brought before the annual general meeting in accordance with such procedures, nothing in this Article 68

shall be deemed to preclude discussion by any Member of any such business. If the Chairman of an annual general meeting determines that business was not properly brought before the annual general meeting in accordance with the foregoing procedures, the Chairman shall declare to the meeting that the business was not properly brought before the meeting and such business shall not be transacted.

68.5 In addition to any other applicable requirements, for a nomination for election of a Director to be made by a Member of the Company, such Member must (A) be a Member of record on both (x) the date of the giving of the notice by such Member provided for in this Article 68 and (y) the record date for the determination of Members entitled to vote at such annual general meeting and (B) have given timely notice thereof in proper written form to the Secretary of the Corporation. If a Member is entitled to vote only for a specific class or category of directors at a meeting of the Members, such Member's right to nominate one or more persons for election as a director at the meeting shall be limited to such class or category of directors.

App 3  
r.4(4) and  
(5)

68.6 To be timely for purposes of Article 68.5 in connection with the annual general meeting, a Member's notice shall be delivered to the Secretary at the principal executive offices of the Company. In the event the Company calls an extraordinary general meeting for the purpose of electing one or more directors to the Board, any Member entitled to vote for the election of such director(s) at such meeting and satisfying the requirements specified above may nominate a person or persons (as the case may be) for election to such position(s) as are specified in the Company's notice of such meeting, but only if the Member notice required hereof shall be delivered to the Secretary at the principal executive office of the Company, The period for lodgment of the notices by a Member referred to in this Article shall commence no earlier than the day after the dispatch of the notice of the meeting appointed for such election and end no later than (7) days prior to the date of such meeting and shall be for a minimum period of seven (7) days.

68.7 To be in proper written form for purposes of Article 68.5, a Member's notice to the Secretary must be set forth (A) as to each person whom the Member proposes to nominate for election as a director (1) the name, age, business address and residence address of the person, (2) the principal occupation or employment of the person, (3) the class or series and number of Shares of the Company, if any, which are owned beneficially or of record by the person and (4) any other information relating to the person that would be required to be disclosed pursuant to any Exchange Rules; and (B) as to the Member giving notice (1) the name and record address of such Member, (2) the class or series and number of Shares of the Company which are owned beneficially or of record by such Member, (3) a description of all arrangements or understandings between such Member and each proposed nominee and any other person or persons (including their names) pursuant to which the nomination(s) are to be made by such Member, (4) a representation that such Member intends to appear in person or by proxy at the annual meeting to nominate the person(s) named in its notice and (5) any other information relating to such Member that would be required to be disclosed pursuant to any Exchange Rules. Such notice must be accompanied by a written consent of each proposed nominee to being named as a nominee and to serve as a director if elected.

- 68.8 No person shall be eligible for election as a director of the Company unless nominated in accordance with the procedures set forth in the Articles under this heading of “**NOTICE OF GENERAL MEETINGS**”. If the Chairman of an annual general meeting determines that a nomination was not made in accordance with the foregoing procedures, the Chairman shall declare to the meeting that the nomination was defective and such defective nomination shall be disregarded. This Article 68 shall not apply to any nomination of a director in an election in which only the holders of one or more series of Preferred Shares of the Company are entitled to vote (unless otherwise provided in the terms of such series of Preferred Shares).

#### **PROCEEDINGS AT GENERAL MEETINGS**

69. No business shall be transacted at any general meeting unless a quorum is present. One or more Members present in person or by proxy holding not less than thirty-three percent (33%) of the issued and outstanding Shares of the Company entitled to vote at the meeting in question shall be a quorum.
70. If within one hour from the time appointed for the meeting a quorum is not present, the meeting, if convened upon the requisition of Members, shall be dissolved and in any other case it shall stand adjourned to the same day in the next week at the same time and place or to such other time or such other place as the Board may determine.
71. The Chairman, if any, of the Board shall preside as Chairman at every general meeting of the Company, or if there is no such Chairman, or if he shall not be present within one hour after the time appointed for the holding of the meeting, or is unwilling to act, the Directors present shall elect one of their number to be Chairman of the meeting or if all of the Directors present decline to take the chair, then the Members present shall choose one of their own number to be Chairman of the meeting.
72. If at any general meeting no Director is willing to act as Chairman or if no Director is present within one hour after the time appointed for holding the meeting, the Members present shall choose one of their number to be Chairman of the meeting.
73. The Chairman may, with the consent of any general meeting duly constituted hereunder, and shall if so directed by the meeting, adjourn the meeting from time to time and from place to place, but no business shall be transacted at any adjourned meeting other than the business left unfinished at the meeting from which the adjournment took place. When a general meeting is adjourned for thirty (30) days or more, notice of the adjourned meeting shall be given as in the case of an original meeting; save as aforesaid it shall not be necessary to give any notice of an adjournment or of the business to be transacted at an adjourned general meeting. No business shall be transacted at any adjourned meeting other than the business which might have been transacted at the meeting from which the adjournment took place.
- App 13 – Part B r.2(3) 74. At any general meeting a resolution put to the vote of the meeting may be decided on a poll. A poll may be demanded by (i) the Chairman of the meeting, (ii) at least five Members present or (iii) Members holding one-tenth (1/10) of the voting rights of the total voting rights of all Members having the right to attend and vote at the Meeting. A demand for a poll may be withdrawn if the Chairman of the meeting agrees to this.

75. A poll shall be taken in such manner and at such time and place, not being more than thirty (30) days from the date of the meeting or adjourned meeting at which the vote was taken, as the Chairman directs. No notice need be given of a poll not taken immediately. The result of the poll shall be deemed to be the resolution of the general meeting at which the poll was demanded. Any other business other than that upon which a poll is to be taken or is contingent thereon may be proceeded with pending the taking of the poll. For the avoidance of doubt, all Members, whether or not present in person or by proxy at the meeting at which the poll is called, may participate in the poll, where the poll takes place after the meeting.
76. In the case of an equality of votes, the Chairman of the general meeting at which the poll is taken shall not be entitled to a second or casting vote.

#### **VOTES OF MEMBERS**

77. Subject to any rights or restrictions for the time being attached to any class or classes of Shares, every Member of record present in person or by proxy shall have one vote for each Share registered in his name in the Register of Members. The ability of the Members to engage in cumulative voting is hereby specifically denied. Where the Company has knowledge that any Member is, under the rules of the Exchange, required to abstain from voting on any particular resolution of the Company or restricted to voting only for or only against any particular resolution of the Company, any votes cast by or on behalf of such Member in contravention of such requirement or restriction shall not be counted.
78. In the case of joint holders of record the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders, and for this purpose seniority shall be determined by the order in which the names stand in the Register of Members.
79. A Member of unsound mind, or in respect of whom an order has been made by any court, having jurisdiction in lunacy, may vote by his committee, receiver, curator bonis, or other person in the nature of a committee, receiver or curator bonis appointed by that court, and any such committee, receiver, curator bonis or other persons may vote by proxy.
80. No Member shall be entitled to vote at any general meeting unless he is registered as a Member of the Company on the record date for such meeting.
81. No objection shall be raised to the qualification of any voter except at the general meeting or adjourned general meeting at which the vote objected to is given or tendered and every vote not disallowed at such general meeting shall be valid for all purposes. Any such objection made in due time shall be referred to the Chairman of the general meeting whose decision shall be final and conclusive.

82. Votes may be given either personally or by proxy. A Member may appoint more than one proxy or the same proxy under one or more instruments to attend and vote at a meeting and may appoint one proxy to vote both in favour of and against the same resolution in such proportion as specified in the instrument appointing the proxy. Where a Member appoints more than one proxy the instrument of proxy shall state which proxy is entitled to vote on a show of hands.

### PROXIES

83. The rules and procedures relating to the form of a proxy, the depositing or filing of proxies and voting pursuant to a proxy and any other matter incidental thereto shall be approved by the Board, subject to such rules and procedures as required by applicable law, rules or regulations or the Exchange Rules and as provided in the following Articles under this heading of “**PROXIES**”.

App 3  
r.11(2) and  
App 13 –  
Part B  
r.2(2)

84. The instrument appointing a proxy shall be in writing and shall be executed under the hand of the appointor or of his attorney duly authorised in writing, or, if the appointor is a corporation under the hand of an officer or attorney duly authorised in that behalf; provided, however, that a Member may also authorise the casting of a vote by proxy pursuant to telephonic or electronically transmitted instructions (including, without limitation, instructions transmitted over the internet) obtained pursuant to procedures approved by the Board which are reasonably designed to verify that such instructions have been authorised by such Member. A proxy need not be a Member of the Company.

App 3  
r.11(1)

85. The instrument appointing a proxy may be in any usual or common form and may be expressed to be for a particular meeting or any adjournment thereof or generally until revoked; provided that it shall enable a Member, according to his intention, to instruct his proxy to vote in favour of or against (or in default of instructions or in the event of conflicting instructions, to exercise his discretion in respect of) each resolution to be proposed at the meeting to which the form of proxy relates. An instrument appointing a proxy shall be deemed to include the power to demand or join or concur in demanding a poll. Further, each form of proxy shall be deemed to include the power to vote on an adjournment or any other procedural matter put to a resolution at the meeting.

### CORPORATE MEMBERS

App 13 –  
Part B  
r.2(2)

86. Any corporation or other non-natural person which is a Member may in accordance with its constitutional documents, or in the absence of such provision by resolution of its directors or other governing body, authorise such person as it thinks fit to act as its representative at any meeting of the Company or of any class of Members, and the person so authorised shall be entitled to exercise the same powers on behalf of the corporation which he represents as the corporation could exercise if it were an individual Member.

App 13 –  
Part B r.6

87. If a recognised clearing house (or its nominee) is a Member of the Company it may, by resolution of its directors or other governing body or by power of attorney, authorise such person or persons as it thinks fit to act as its proxy (ies) or representative(s) at any general meeting of the Company or at any general meeting of any class of Members of the

Company; provided that, if more than one person is so authorised, the proxy form or authorisation shall specify the number and class of Shares in respect of which each such person is so authorised. A person so authorised pursuant to this provision shall be entitled to exercise the same rights and powers on behalf of the recognised clearing house (or its nominee) which he represents as that recognised clearing house (or its nominee) could exercise as if such person were an individual Member of the Company holding the number and class of Shares specified in such proxy form or authorisation, including the right to vote individually on a show of hands, notwithstanding any contrary provision contained in these Articles.

#### **SHARES THAT MAY NOT BE VOTED**

88. Shares in the Company that are beneficially owned by the Company shall not be voted, directly or indirectly, at any meeting and shall not be counted in determining the total number of outstanding Shares at any given time.

#### **DIRECTORS**

89. The number of Directors shall be nine (9) or such other number as shall be fixed from time to time by the Board; provided, however, that so long as Shares of the Company are listed on any Exchange, the Board shall include such number of Independent Directors as applicable law, rules or regulations or the Exchange Rules require.
90. Subject to the rights of the holders of any series of Preferred Shares to elect additional Directors under specified circumstances, the Directors shall be divided into three classes designated as Class I, Class II and Class III, respectively. Directors shall be assigned to each class in accordance with a resolution or resolutions adopted by the Board. At the first annual general meeting of Members following the initial meeting after the adoption of these Articles, the term of office of the Class I Directors shall expire and Class I Directors shall be elected for a full term of three years. At the second annual general meeting of Members following the initial meeting, the term of office of the Class II Directors shall expire and Class II Directors shall be elected for a full term of three years. At the third annual general meeting of Members following the initial meeting, the term of office of the Class III Directors shall expire and Class III Directors shall be elected for a full term of three years. At each succeeding annual general meeting of Members, Directors shall be elected for a full term of three years to succeed the Directors of the class whose terms expire at such annual general meeting. Notwithstanding the foregoing provisions of this Article 90, each Director shall serve until his successor is duly elected and qualified or until his death, resignation or removal. No decrease in the number of Directors constituting the Board shall shorten the term of any incumbent Director.

#### **REMUNERATION OF DIRECTORS**

91. The remuneration to be paid to the Directors shall be such remuneration as the Board shall determine. Such remuneration shall be deemed to accrue from day to day. The Directors shall also be entitled to be paid their travelling, hotel and other expenses properly incurred by them in going to, attending and returning from meetings of the

Board, or any committee of the Board, or general meetings of the Company, or otherwise in connection with the business of the Company, or to receive a fixed allowance in respect thereof as may be determined by the Board from time to time, or a combination partly of one such method and partly the other.

92. The Board may by resolution approve additional remuneration to any Director of the Company undertaking any special work or services for, or undertaking any special mission on behalf of, the Company other than his ordinary routine work as a Director. Any fees paid to a Director who is also counsel or solicitor to the Company, or otherwise serves it in a professional capacity shall be in addition to his remuneration as a Director.

App 13 – Part B r.5(4) 93. Payment to any Director or past Director of any sum by way of compensation for loss of office or as consideration for or in connection with his retirement from office (not being a payment to which the Director is contractually entitled) must first be approved by the Company in general meeting.

#### **NO MINIMUM SHAREHOLDING**

94. No shareholding qualification is required to be held by a Director.

#### **DIRECTORS' INTERESTS**

95. A Director may hold any other office or place of profit under the Company (other than the office of Auditor) in conjunction with his office of Director for such period and on such terms as to remuneration and otherwise as the Board may determine.

96. A Director may act by himself or his firm in a professional capacity for the Company and he or his firm shall be entitled to remuneration for professional services as if he were not a Director or alternate Director.

97. A Director or alternate Director of the Company may be or become a director, managing director, joint managing director, deputy managing director, executive director, manager or other officer or member of any other company or otherwise interested in any company promoted by the Company or in which the Company may be interested as shareholder or otherwise, and no such Director or alternate Director shall be accountable to the Company for any remuneration or other benefits received by him as a director, managing director, joint managing director, deputy managing director, executive director, manager or other officer or member of such other company.

App 3 r.4(1), App 13 – Part B r.5(2), (3) and (4) 98. Any contract or transaction between the Company or any of its subsidiaries and one or more of the Company's Directors or any of their associates (as defined under the Exchange Rules), officers or Members (or the affiliates of any Member), or between the Company or any of its subsidiaries and any other corporation, partnership, limited liability company, joint venture, trust, association or other organization or other entity in which one or more of the Company's Directors or any of their associates (as defined under the Exchange Rules), officers or Members (or the affiliates of any Member) serve as directors, officers, trustees or in a similar capacity or have a financial interest, shall be approved in accordance with applicable law, rules or regulations and the Exchange Rules.

The making of any loans to any of the Company's Directors and their associates (as defined under the Exchange Rules) shall be subject to the requirements of Hong Kong law and any other applicable law, rules or regulations and the Exchange Rules. For purposes of the preceding two sentences, if any such contract, transaction or loan is to be approved by the Board, the quorum necessary for the Board to vote on such contract, transaction or loan shall be a majority of the disinterested Directors in such contract, transaction or loan (such "disinterested Directors" shall not include a Director whose associate(s) (as defined under the Exchange Rules) has a material interest in any such contract, transaction or loan). Further, Directors shall declare their material interests in any contracts with the Company at the earliest meeting of the Board of Directors at which it is practicable for them to do so either specifically or by way of a general notice stating that, by reason of facts specified in the notice, they are to be regarded as interested in any contracts of a specified description which may subsequently be made by the Company.

99. A general notice that a Director or alternate Director is a shareholder, director, officer or employee of any specified firm or company and is to be regarded as interested in any transaction with such firm or company shall be sufficient disclosure for the purposes of voting on a resolution in respect of a contract or transaction in which he has an interest, and after such general notice it shall not be necessary to give special notice relating to any particular transaction.

#### **ALTERNATE DIRECTORS**

100. Any Director (other than an alternate Director) may by writing appoint any other Director, or any other person willing to act, to be an alternate Director and by writing may remove from office an alternate Director so appointed by him.
101. An alternate Director shall be entitled to receive notice of all meetings of the Board and of all meetings of committees of the Board of which his appointor is a member, to attend and vote at every such meeting at which the Director appointing him is not personally present, and generally to perform all the functions of his appointor as a Director in his absence.
102. An alternate Director shall cease to be an alternate Director if his appointor ceases to be a Director.
103. Any appointment or removal of an alternate Director shall be by notice to the Company signed by the Director making or revoking the appointment or in any other manner approved by the Board.
104. An alternate Director shall be deemed for all purposes to be a Director. The alternate Director, as well as the Director appointing such alternate Director, shall be responsible for the alternate Director's own acts and defaults.

#### **POWERS AND DUTIES OF DIRECTORS**

105. Subject to the provisions of the Statute, the Memorandum and the Articles and to any directions given by Special Resolution, the business of the Company shall be managed by



the Board who may exercise all the powers of the Company. No alteration of the Memorandum or Articles and no such direction shall invalidate any prior act of the Board which would have been valid if that alteration had not been made or that direction had not been given. A duly convened meeting of the Board at which a quorum is present may exercise all powers exercisable by the Board.

106. All cheques, promissory notes, drafts, bills of exchange and other negotiable instruments and all receipts for monies paid to the Company shall be signed, drawn, accepted, endorsed or otherwise executed as the case may be in such manner as the Board shall determine by resolution.
107. Subject to the provisions of Article 93, the Board on behalf of the Company may pay a gratuity or pension or allowance on retirement to any Director who has held any other salaried office or place of profit with the Company or to his widow or dependants and may make contributions to any fund and pay premiums for the purchase or provision of any such gratuity, pension or allowance.
108. The Board may exercise all the powers of the Company to borrow money and to mortgage or charge its undertaking, property and uncalled capital or any part thereof and to issue debentures, debenture stock, mortgages, bonds and other such securities whether outright or as security for any debt, liability or obligation of the Company or of any third party.

#### **MINUTES**

109. The Board shall cause minutes to be made in books kept for the purpose of all appointments of officers made by the Board, all proceedings at meetings of the Company or the holders of any class of Shares and of the Board, and of committees of the Board including the names of the Directors or alternate Directors present at each meeting.

#### **DELEGATION OF DIRECTORS' POWERS**

110. The Board may delegate any of their powers to any committee consisting of one or more Directors. They may also delegate to any Director holding any executive office such of their powers as they consider desirable to be exercised by him. Any such delegation may be made subject to any conditions the Board may impose, and either collaterally with or to the exclusion of their own powers and may be revoked or altered. Subject to any such conditions, the proceedings of a committee of the Board shall be governed by the Articles regulating the proceedings of the Board, so far as they are capable of applying.
111. The Board may establish any committees, local boards or agencies or appoint any person to be a manager or agent for managing the affairs of the Company and may appoint any person to be a member of such committees or local boards.
112. The Board may by power of attorney or otherwise appoint any person to be the agent of the Company on such conditions as the Board may determine, provided that the delegation is not to the exclusion of their own powers and may be revoked by the Board at any time.

113. The Board may by power of attorney or otherwise appoint any company, firm, person or body of persons, whether nominated directly or indirectly by the Board, to be the attorney or authorised signatory of the Company for such purpose and with such powers, authorities and discretions (not exceeding those vested in or exercisable by the Board under these Articles) and for such period and subject to such conditions as they may think fit, and any such powers of attorney or other appointment may contain such provisions for the protection and convenience of persons dealing with any such attorneys or authorised signatories as the Board may think fit and may also authorise any such attorney or authorised signatory to delegate all or any of the powers, authorities and discretions vested in him.

#### **EXECUTIVE OFFICERS**

114. The Board may from time to time appoint one or more Chairman of the Board, President, Chief Executive Officer, Chief Financial Officer and such other officers as it considers necessary in the management of the business of the Company and as it may decide for such period and upon such terms as it thinks fit and upon such terms as to remuneration as it may decide in accordance with these Articles. Such officers need not also be a Director.
115. Every Director appointed to an office under the above Article hereof shall, without prejudice to any claim for damages that such Director may have against the Company or the Company may have against such Director for any breach of any contract of service between him and the Company, be liable to be dismissed or removed from such executive office by the Board. A Director appointed to an office under the above Article shall *ipso facto* and immediately cease to hold such executive office if he shall cease to hold the office of Director for any cause.

#### **PROCEEDINGS OF DIRECTORS**

116. Except as otherwise provided by these Articles, the Board shall meet together for the dispatch of business, convening, adjourning and otherwise regulating their meetings as they think fit. Questions arising at any meeting shall be decided by a majority of votes of the Directors and alternate Directors present at a meeting at which there is a quorum, the vote of an alternate Director not being counted if his appointor be present at such meeting.
117. The Chairman of the Board or any two Directors may, and the Secretary on the requisition of such persons, shall, at any time summon a meeting of the Board by notice to each Director and alternate Director by telephone, facsimile, electronic email, telegraph or telex, during normal business hours, or by sending notice in writing to each Director and alternate Director by first class mail, charges prepaid, at least two (2) days before the date of the meeting, which notice shall set forth the general nature of the business to be considered unless notice is waived by all the Directors (or their alternates) either at, before or after the meeting is held and provided further if notice is given in person, by telephone, facsimile, electronic email, telegraph or telex the same shall be deemed to have been given on the day it is delivered to the Directors or transmitting

organisation as the case may be. Notice of at least fourteen (14) days shall be given to each Director and alternate Director for any regular Board meeting. The accidental omission to give notice of a meeting of the Board to, or the non-receipt of notice of a meeting by any person entitled to receive notice shall not invalidate the proceedings of that meeting.

- 118.** The quorum necessary for the transaction of the business of the Board shall be established if two (2) Directors, of whom at least one shall be executive Director, are present in person or by proxy provided always that if there shall at any time be only a sole Director in office, the quorum shall be one. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of Directors, if any action taken is approved by at least a majority of the required quorum for that meeting. For the purposes of this Article an alternate Director or proxy appointed by a Director shall be counted in a quorum at a meeting at which the Director appointing him is not present.
- 119.** The continuing Directors may act notwithstanding any vacancy in their body, but if and so long as their number is reduced below the number fixed by or pursuant to these Articles as the necessary quorum of Directors, the continuing Directors or Director may act for the purpose of increasing the number of Directors to that number, or of summoning a general meeting of the Company, but for no other purpose.
- 120.** The Board may elect a Chairman of their Board and determine the period for which he is to hold office; but if no such Chairman is elected, or if at any meeting the Chairman is not present within five minutes after the time appointed for holding the same, the Directors present may choose one of their number to be Chairman of the meeting.
- 121.** All acts done by any meeting of the Board or of a committee of the Board (including any person acting as an alternate Director) shall, notwithstanding that it be afterwards discovered that there was some defect in the appointment of any Director or alternate Director, or that they or any of them were disqualified, be as valid as if every such person had been duly appointed and qualified to be a Director or alternate Director as the case may be.
- 122.** Members of the Board or of any committee thereof may participate in a meeting of the Board or of such committee by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can speak to and hear each other and participation in a meeting pursuant to this provision shall constitute presence in person at such meeting. A person taking part in this way will be treated as being present at the meeting and will be entitled to vote and be counted in the quorum. Unless otherwise determined by the Board the meeting shall be deemed to be held at the place where the Chairman is at the start of the meeting. A resolution in writing (in one or more counterparts), signed by all the Directors or all the members of a committee of the Board (an alternate Director being entitled to sign such resolution on behalf of his appointor) who at the time are entitled to receive notice of a Directors' meeting and who would be able to vote on the resolution at a Directors' meeting shall be as valid and effectual as if it had been passed at a meeting of the Board or committee (as the case may be) duly convened and held.

- 123.** A Director but not an alternate Director may be represented at any meetings of the Board by a proxy appointed in writing by him. The proxy shall count towards the quorum and the vote of the proxy shall for all purposes be deemed to be that of the appointing Director. However, a person appointed as a proxy pursuant to this Article shall have no right to attend a meeting of the Board or vote thereat unless (i) such person is himself a Director or (ii) the chairman of that meeting (the “relevant chairman”) is satisfied that (a) such person has entered into an agreement with the Company pursuant to which he has given appropriate undertakings with regard to the Company’s confidential information and such other matters as the relevant chairman shall determine and (b) it is appropriate for such person to attend the meeting. A proxy (unless he is a Director in his own right) shall have no right to speak at a meeting of the Board unless permitted to do so generally or on a specific occasion by the relevant chairman. A proxy shall produce all such evidence as the relevant chairman may reasonably require to demonstrate his appointment as proxy for a Director in respect of the meeting.

#### **VACATION OF OFFICE OF DIRECTOR**

- 124.** The office of a Director shall be vacated:

- 124.1 if he gives notice in writing to the Company that he resigns the office of Director;
- 124.2 if all of the Directors (other than the one to be removed) pass a resolution or sign a notice effecting the removal of such one Director from his office as such, provided that the Board shall, immediately prior to such notice being delivered, comprise at least four persons (including, for the avoidance of doubt, the one Director to be removed);
- 124.3 if he is prohibited from being a Director under any applicable law, rules or regulations and the Exchange Rules;
- 124.4 if he absents himself (without being represented by proxy or an alternate Director appointed by him) from three consecutive meetings of the Board without special leave of absence from the Board, and the Board passes a resolution that he has by reason of such absence vacated office;
- 124.5 if he dies, becomes bankrupt or makes any arrangement or composition with his creditors generally; or
- 124.6 if he is found a lunatic or becomes of unsound mind.

#### **APPOINTMENT AND REMOVAL OF DIRECTORS**

- App 3  
r.4(3)  
App 13 –  
Part B  
r.5(1)
- 125.** The Company may by Ordinary Resolution appoint any person to be a Director and may by Special Resolution remove any Director (including a Managing Director or other executive Director) and may by Ordinary Resolution appoint another person in his stead. Any Director appointed upon the removal of another Director in accordance with the

preceding sentence shall hold office for the remainder of the full term of the removed Director and until such appointed Director's successor shall have been elected and qualified.

App 3  
r.4(2)

- 126.** The Directors shall have power at any time and from time to time to appoint any person to be a Director, either to fill a casual vacancy or as an addition to the existing Directors but so that the total amount of Directors (exclusive of alternate Directors) shall not at any time exceed the number fixed in accordance with these Articles. Any Director appointed in accordance with the preceding sentence shall hold office only until the next following annual general meeting of the Company and shall then be eligible for re-election at that meeting. Any Director appointed by the Company at such annual general meeting to fill the vacancy that was created or occurred shall hold office for the remainder of the full term of the Director for which the vacancy was created or occurred and until such appointed Director's successor shall have been elected and qualified.

App 3  
r.4(3)

- 127.** Nothing in these Articles should be taken as depriving a Director removed under any provisions of these Articles of compensation or damages payable to him in respect of the termination of his appointment as Director or of any other appointment or office as a result of the termination of his appointment as Director or derived from any power to remove a Director which may exist apart from the provisions of these Articles.

#### **PRESUMPTION OF ASSENT**

- 128.** A Director of the Company who is present at a meeting of the Board at which action on any Company matter is taken shall be presumed to have assented to the action taken unless his dissent shall be entered in the Minutes of the meeting or unless he shall file his written dissent from such action with the person acting as the Secretary of the meeting before the adjournment thereof or shall forward such dissent by registered mail to such person immediately after the adjournment of the meeting. Such right to dissent shall not apply to a Director who voted in favour of such action.

#### **APPOINTMENT OR REMOVAL OF SECRETARY**

- 129.** Subject to the Statute and any applicable law, rule or regulation and the Exchange Rules, the Directors may appoint the Secretary of the Company for such term and on such conditions as they see fit.

#### **SEAL**

- 130.** The Company may, if the Board so determines, have a Seal which shall only be used by the authority of the Board or of a committee of the Board authorised by the Board in that behalf and every instrument to which the Seal has been affixed shall be signed by one person who shall be either a Director or the Secretary or Secretary-Treasurer or some person appointed by the Board for the purpose.
- 131.** The Company may have for use in any place or places outside the Cayman Islands a duplicate Seal or Seals each of which shall be a facsimile of the Common Seal of the Company and, if the Board so determines, with the addition on its face of the name of every place where it is to be used.

132. A Director, Secretary or other officer or representative or attorney may without further authority of the Board affix the Seal of the Company over his signature alone to any document of the Company required to be authenticated by him under Seal or to be filed with the Registrar of Companies in the Cayman Islands or elsewhere wheresoever.

#### **DIVIDENDS, DISTRIBUTIONS AND RESERVE**

133. Subject to the Statute, the Board may from time to time declare dividends (including interim dividends) and distributions on Shares of the Company outstanding and authorise payment of the same out of the funds of the Company lawfully available therefor.
134. The Board may, before declaring any dividends or distributions, set aside such sums as they think proper as a reserve or reserves which shall at the discretion of the Board, be applicable for any purpose of the Company and pending such application may, at the like discretion, be employed in the business of the Company.
135. No dividend or distribution shall be payable except out of the profits of the Company, realised or unrealised, or out of the share premium account or as otherwise permitted by the Statute.
136. Subject to the rights of persons, if any, entitled to Shares with special rights as to dividends or distributions, if dividends or distributions are to be declared on a class of Shares they shall be declared and paid according to the amounts paid or credited as paid on the Shares of such class outstanding on the record date for such dividend or distribution as determined in accordance with these Articles but no amount paid or credited as paid on a Share in advance of calls shall be treated for the purpose of this Article as paid on the Share.
137. The Board may deduct from any dividend or distribution payable to any Member all sums of money (if any) presently payable by him to the Company on account of calls or otherwise.
138. The Board may declare that any dividend or distribution be paid wholly or partly by the distribution of specific assets and in particular of paid up Shares, debentures, or debenture stock of any other company or in any one or more of such ways and where any difficulty arises in regard to such distribution, the Board may settle the same as they think expedient and in particular may issue fractional certificates and fix the value for distribution of such specific assets or any part thereof and may determine that cash payments shall be made to any Members upon the footing of the value so fixed in order to adjust the rights of all Members and may vest any such specific assets in trustees as may seem expedient to the Board.
139. Any dividend, distribution, interest or other monies payable in cash in respect of Shares may be paid by cheque or warrant sent through the post directed to the registered address of the holder or, in the case of joint holders, to the holder who is first named on the

Register of Members or to such person and to such address as such holder or joint holders may in writing direct. Every such cheque or warrant shall be made payable to the order of the person to whom it is sent. The Company may cease sending such cheques for dividend entitlements or dividend warrants to post if such cheques or warrants have been left uncashed on two (2) consecutive occasions. However, the Company may exercise its power to cease sending cheques for dividend entitlements or dividend warrants after the first occasion on which such a cheque or warrant is returned undelivered. Any one of two or more joint holders may give effectual receipts for any dividends, bonuses, or other monies payable in respect of the Share held by them as joint holders.

**140.** No dividend or distribution shall bear interest against the Company.

App 3  
r.3(2)

**141.** All dividends or bonuses unclaimed for one year after having been declared may be invested or otherwise made use of by the Board for the exclusive benefit of the Company until claimed, and the Company shall not be constituted a trustee in respect thereof or be required to account for any money earned thereon. All dividends or bonuses unclaimed for six (6) years after having been declared may be forfeited by the Board and shall revert to the Company and after such forfeiture no Member or other person shall have any right to or claim in respect of such dividends or bonuses.

### CAPITALISATION

**142.** Upon the recommendation of the Board, the Company may by Ordinary Resolution authorise the Board to capitalise any sum standing to the credit of any of the Company's reserve accounts (including Share premium account and capital redemption reserve fund) or any sum standing to the credit of profit and loss account or otherwise available for distribution and to appropriate such sum to Members in the proportions in which such sum would have been divisible amongst them had the same been a distribution of profits by way of dividend and to apply such sum on their behalf in paying up in full unissued Shares for allotment and distribution credited as fully paid up to and amongst them in the proportion aforesaid. In such event the Board shall do all acts and things required to give effect to such capitalisation, with full power to the Board to make such provisions as they think fit for the case of Shares becoming distributable in fractions (including provisions whereby the benefit of fractional entitlements accrue to the Company rather than to the Members concerned). The Board may authorise any person to enter on behalf of all of the Members interested into an agreement with the Company providing for such capitalisation and matters incidental thereto and any agreement made under such authority shall be effective and binding on all concerned.

### BOOKS OF ACCOUNT

App 13 –  
Part B  
r.4(1)

**143.** The Board shall cause proper books of account to be kept with respect to all sums of money received and expended by the Company and the matters in respect of which the receipt or expenditure takes place, all sales and purchases of goods by the Company and the assets and liabilities of the Company. Proper books shall not be deemed to be kept if there are not kept such books of account as are necessary to give a true and fair view of the state of the Company's affairs and to explain its transactions.

144. The Board shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulations the accounts and books of the Company or any of them shall be open to the inspection of Members not being Directors and no Member (not being a Director) shall have any right of inspecting any account or book or document of the Company except as conferred by Statute or authorised by the Board or by the Company in a general meeting.
- App 13 –  
Part B  
r.4(2) 145. The Board shall cause to be prepared and to be laid before the Members of the Company at every annual general meeting a profit and loss account for the period since the preceding account, together with a balance sheet as at the date to which the profit and loss account is made up and a management’s report with respect to the profit or loss of the Company for the period covered by the profit and loss account and the state of the Company’s affairs as at the end of such period, an Auditors’ report on such accounts prepared pursuant to these Articles and such other reports and accounts as may be required by applicable law, rules or regulations or the Exchange Rules.
- App 3  
r.5 and  
App 13 –  
Part B  
r.3(3) 146. Copies of such documents to be laid before the Members of the Company at an annual general meeting shall not less than twenty-one (21) days before the date of the meeting (and at the same time at which the notice of annual general meeting is sent) be sent in the manner in which notices may be served by the Company as provided herein to every Member of the Company and every holder of debentures of the Company, provided that the Company shall not be required to send printed copies of such documents to any person of whose address the Company is not aware or to more than one of the joint holders of any Shares or debentures.
147. To the extent permitted by and subject to due compliance with these Articles, the Statute and any other applicable law, rules or regulations or the Exchange Rules, and to obtaining all necessary consents, if any, required thereunder, the requirements of these Articles shall be deemed satisfied in relation to any Member or any holder of debentures of the Company by sending to the registered address of such person instead of such copies, not less than twenty-one (21) days before the date of the annual general meeting, in any manner not prohibited by these Articles and the Statute and any other applicable law, rules or regulations or the Exchange Rules, a summary financial statement derived from the Company’s annual accounts, together with the management’s report and the Auditor’s report on such accounts, which shall be in the form and containing the information required by these Articles, the Statute and any other applicable law, rules or regulations or the Exchange Rules, provided that any person who is otherwise entitled to the annual accounts of the Company, together with the management’s report and the Auditor’s report thereon may, if he so requires, by notice in writing served on the Company, demand that the Company send to him, in addition to the summary financial statement, a complete printed copy of the Company’s annual accounts, together with the management’s report and the Auditor’s report thereon.
- 147A. The requirement to send to a person such documents as referred to in these Articles under the heading of “**BOOKS OF ACCOUNT**” shall be deemed satisfied where, in accordance with all applicable Statutes, rules and regulations, including, without limitation, the Exchange Rules, the Company publishes copies of the documents referred



to in Article 146 and, if applicable, a summary financial report complying with Article 147, on the Company's computer network or in any other permitted manner (including by sending any form of electronic communication), and that person has agreed to treat the publication or receipt of such documents in such manner as discharging the Company's obligation to send to him a copy of such documents.

#### AUDIT

- App 13 –  
Part B  
r.4(2)
- 148.** The Auditors shall audit the profit and loss account and balance sheet of the Company in each year and shall prepare a report thereon to be annexed thereto. Such report shall be laid before the Company at its annual general meeting in each year and shall be open to inspection by any Member. The Auditors shall at the next annual general meeting following their appointment and at any other time during their term of office, upon request of the Board or any general meeting of the Members, make a report on the accounts of the Company in general meeting during their tenure of office.
- 149.** The appointment of and provisions relating to Auditors shall be in accordance with applicable law, rules or regulations and the Exchange Rules.
- 150.** In the event that no such code, rules and regulations referred to in the above Article apply, the appointment of and provisions relating to Auditors shall be in accordance with the following resolutions:
- 150.1 The Board may appoint an Auditor who shall hold office until removed from office by a resolution of the Board, and may fix his or their remuneration.
- 150.2 Every Auditor shall have a right of access at all times to the books and accounts and vouchers of the Company and shall be entitled to require from the Board and officers of the Company such information and explanation as may be necessary for the performance of the duties of the Auditor.
- 150.3 Auditors shall, if so required by the Board, make a report on the accounts of the Company during their tenure of office at the next extraordinary general meeting following their appointment and at any other time during their term of office, upon request of the Board or any general meeting of Members.

#### NOTICES

- App 3  
r.7(1)
- 151.** Notices shall be in writing and shall be given by the Company in accordance with applicable law, rules or regulations and the Exchange Rules.
- 152.** In the event that no such code, rules and regulations referred to in the above Article applies, notice shall be given in accordance with the following provisions:
- 152.1 notices to any Member shall be given either personally or by sending it by post, cable, telex, fax or e-mail to him or to his address as shown in the Register of Members (or where the notice is given by e-mail by sending it to the e-mail address provided by such Member);

- 152.2 where a notice is sent by post, service of the notice shall be deemed to be effected by properly addressing, pre-paying and posting a letter containing the notice, and shall be deemed to have been received on the day following that on which the notice was posted. Where a notice is sent by cable, telex or fax, service of the notice shall be deemed to be effected by properly addressing and sending such notice and shall be deemed to have been received on the same day that it was transmitted. Where a notice is given by e-mail service shall be deemed to be effected by transmitting the e-mail to the e-mail address provided by the intended recipient and shall be deemed to have been received on the same day that it was sent, and it shall not be necessary for the receipt of the e-mail to be acknowledged by the recipient;
- 152.3 a notice may be given by the Company to the person or persons which the Company has been advised are entitled to a Share or Shares in consequence of the death or bankruptcy of a Member in the same manner as other notices which are required to be given under these Articles and shall be addressed to them by name, or by the title of representatives of the deceased, or trustee of the bankrupt, or by any like description at the address supplied for that purpose by the persons claiming to be so entitled, or at the option of the Company by giving the notice in any manner in which the same might have been given if the death or bankruptcy had not occurred.
- App 3  
r.7(2) and  
(3) 153. A Member shall be entitled to have notice served on him at any address in Hong Kong which he notifies to the Company. Nothing in these Articles shall be construed as prohibiting the Company from sending notices or other documents of the Company to any Member whose registered address is outside Hong Kong.

#### **WINDING UP**

154. If the Company shall be wound up the liquidator may, with the sanction of a Special Resolution of the Company and any other sanction required by the Statute, divide amongst the Members in kind the whole or any part of the assets of the Company (whether they shall consist of property of the same kind or not) and may for that purpose value any assets and determine how the division shall be carried out as between the Members or different classes of Members. The liquidator may, with the like sanction, vest the whole or any part of such assets in trustees upon such trusts for the benefit of the Members as the liquidator, with the like sanction, shall think fit, but so that no Member shall be compelled to accept any asset upon which there is a liability.
155. If the Company shall be wound up, and the assets available for distribution amongst the Members shall be insufficient to repay the whole of the share capital, such assets shall be distributed so that, as nearly as may be, the losses shall be borne by the Members in proportion to the par value of the Shares held by them. If in a winding up the assets available for distribution amongst the Members shall be more than sufficient to repay the whole of the share capital at the commencement of the winding up, the surplus shall be distributed amongst the Members in proportion to the par value of the Shares held by them at the commencement of the winding up subject to a deduction from those Shares in respect of which there are monies due, of all monies payable to the Company for unpaid calls or otherwise. This Article is without prejudice to the rights of the holders of Shares issued upon special terms and conditions.

## INDEMNITY

156. The Company may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the Company) by reason of the fact that the person is or was a director, officer, employee or agent of the Company, or is or was serving at the request of the Company as a director, officer, employee or agent of another Company, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action, suit or proceeding if the person acted in good faith, in a manner the person reasonably believed to be in, or not opposed to, the best interests of the Company, in a manner that was not willfully or grossly negligent, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith, in a manner which the person reasonably believed to be in or not opposed to the best interests of the Company, in a manner that was willfully or grossly negligent, and, with respect to any criminal action or proceeding, had reasonable cause to believe that the person's conduct was unlawful.
- 156.1 The Company may indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the Company to procure a judgment in its favor by reason of the fact that the person is or was a director, officer, employee or agent of the Company, or is or was serving at the request of the Company as a director, officer, employee or agent of another Company, partnership, joint venture, trust or other enterprise against expenses (including attorneys' fees) actually and reasonably incurred by the person in connection with the defense or settlement of such action or suit if the person acted in good faith, in a manner the person reasonably believed to be in or not opposed to the best interests of the Company and in a manner that was not willfully or grossly negligent, except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the Company unless and only to the extent that the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which such court shall deem proper.
- 156.2 To the extent that a present or former director or officer of the Company has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in Articles 156 and 156.1 above, or in defense of any claim, issue or matter therein, such person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection therewith.

- 156.3 Any indemnification under Articles 156 and 156.1 above (unless ordered by a court) shall be made by the Company only as authorized in the specific case upon a determination that indemnification of the present or former director, officer, employee or agent is proper in the circumstances, including whether or not the person has met the applicable standard of conduct set forth in Articles 156 and 156.1 above. Such determination shall be made, with respect to a person who is a director or officer at the time of such determination, (i) by a majority vote of the directors who are not parties to such action, suit or proceeding, even though less than a quorum, or (ii) by a committee of such directors designated by majority vote of such directors, even though less than a quorum, or (iii) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion or (iv) by the Members of the Company.
- 156.4 Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the Company in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified by the Company pursuant to this Article 156. Such expenses (including attorneys' fees) incurred by former directors and officers or other employees and agents may be so paid upon such terms and conditions, if any, as the Company deems appropriate.
- 156.5 The indemnification and advancement of expenses provided by, or granted pursuant to, this Article 156 shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any law, by-law, agreement, vote of Members or disinterested directors or otherwise, both as to action in such person's official capacity and as to action in another capacity while holding such office.
- 156.6 For purposes of this Article 156, references to "other enterprises" shall include employee benefit plans; references to "fines" shall include any excise taxes assessed on a person with respect to an employee benefit plan; and references to "serving at the request of the Company" shall include any service as a director, officer, employee or agent of the Company which imposes duties on, or involves service by, such director, officer, employee or agent with respect to an employee benefit plan, its participants, or beneficiaries; and a person who acted in good faith, in a manner such person reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan and in a manner that was not willfully or grossly negligent shall be deemed to have acted in a manner "not opposed to the best interests of the Company" as referred to in this Article 156.
- 156.7 The indemnification and advancement of expenses provided by, or granted pursuant to, this Article 156 shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.
157. The Board may, notwithstanding any interest of the Directors in such action, authorize the Company to purchase and maintain insurance on behalf of any person described in the

above Article, against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the Company would have the power to indemnify him against such liability under the provisions of the above Article.

#### **FINANCIAL YEAR**

- 158.** The financial year of the Company shall be as prescribed by the Board from time to time.

#### **TRANSFER BY WAY OF CONTINUATION**

- 159.** If the Company is exempted as defined in the Statute, it shall, subject to the provisions of the Statute and with the approval of a Special Resolution, have the power to register by way of continuation as a body corporate under the laws of any jurisdiction outside the Cayman Islands and to be deregistered in the Cayman Islands.

**TENTH AMENDED AND RESTATED ARTICLES OF ASSOCIATION  
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SETTLEMENT AGREEMENT

This Settlement Agreement (“Agreement”) is executed on January 30, 2005 by and between Taiwan Semiconductor Manufacturing Company, Ltd., (“TSMC, Ltd.”) a Taiwanese corporation, having a place of business located at No. 8 Li-Hsin Road 6, Hsin-Chu Science Park, Hsin-Chu, Taiwan, Republic of China, on behalf of itself and all of its Related Companies (collectively “TSMC”); and Semiconductor Manufacturing International Corporation, (“SMIC Cayman”) a Cayman Island Corporation, having a place of business located at No.18 Zhang Jiang Road, Pudong New Area, Shanghai 201203, People’s Republic of China, on behalf of itself and all of its Related Companies (collectively “SMIC”) including Semiconductor Manufacturing International (Shanghai) Co. Ltd. and SMIC Americas. TSMC and SMIC may be collectively referred to hereinafter as the “Parties.”

WHEREAS there is a federal district court action in the United States District Court for the Northern District of California, Civil Action No. C03-5761 MMC, between TSMC Ltd. and SMIC alleging infringement of U.S. Patent No. 5,923,088, U.S. Patent No. 6,107,206, U.S. Patent No. 6,174,797, U.S. Patent No. 6,268,274, U.S. Patent No. 6,272,514, U.S. Patent No. 6,171,896, U.S. Patent No. 6,350,662, U.S. Patent No. 6,287,172, U.S. Patent No. 6,399,522, U.S. Patent No. 6,569,723, and U.S. Patent No. 6,417,032 (“First District Court Action”).

WHEREAS there is a California state court action in Alameda County Superior Court in Oakland, California, Civil Action No. RG04156932, between TSMC, on the one hand, and SMIC and Hiang C. Chan, an individual, on the other hand, alleging *inter alia* misappropriation of trade secrets, unfair competition, and interference with business relations. (“California State Court Action”)



WHEREAS there is a federal district court action in the United States District Court for the Northern District of California, Civil Action No. C04-3390, between TSMC Ltd. and WaferTech and SMIC alleging infringement of U.S. Patent No. 6,251,795, U.S. Patent No. 6,121,091, and U.S. Patent No. 6,235,653 (“Second District Court Action”).

WHEREAS, there is an investigation before the U.S. International Trade Commission, Investigation No. 337-TA-525, against SMIC in which TSMC alleges violations of Section 337 arising from the unlawful importation into the United States, the sale for importation, or the sale within the United States after importation of certain semiconductor devices and products containing the same, that were made, produced or processed by a means covered by or infringe or induce infringement of one or more claims of U.S. Patent No. 6,121,091, U.S. Patent No. 6,251,795, and U.S. Patent No. 6,235,653 and the misappropriation of TSMC’s trade secrets (“ITC Action”).

WHEREAS TSMC, Ltd. obtained a provisional injunction (the “Taiwan Injunction”) in the Hsin-Chu District Court of Taiwan against Semiconductor Manufacturing International Corporation and Richard Ru Gin Zhang (“Richard Chang”), Case No. 91-Chai-Chuan-235, on May 14, 2002 (“Taiwan Action”).

WHEREAS, SMIC neither admits nor denies liability on the claims asserted in the First District Court Action, the California State Court Action, the Second District Court Action, the Taiwan Action and/or the ITC Action (collectively the “Pending Actions”).

WHEREAS, the Parties desire to settle all the Pending Actions and enter into the Patent License Agreement, attached as Exhibit F, on the terms and conditions set forth below.

NOW, THEREFORE, in consideration of the following rights and obligations granted and undertaken by the Parties in this Agreement and Patent License Agreement, and for other good and valuable consideration, the adequacy and sufficiency of which is hereby acknowledged, the Parties agree as follows:

**I. PAYMENTS**

1. In consideration of this Settlement Agreement and the Patent License, SMIC (Cayman) shall pay to the entity(ies) designated by TSMC the aggregate sum set forth in Exhibit A.

2. The Parties agree that of the aggregate sum to be paid under the previous paragraph, U.S. \$20million is allocated to the past, and as to the balance the Parties agree that they will be free to decide such allocations independently of each other, without any further consultation or agreement with the other Party.

3. The above amount shall be paid to TSMC net of any withholding tax obligations, if any, that may attach to such payments, which obligations SMIC shall bear. The Parties shall reasonably cooperate to seek a refund or release of any such withheld amounts.

4. SMIC's obligation to make the above payments is irrevocable and will be secured by a series of promissory notes provided to TSMC in the form attached as Exhibit B.

5. Except for the first payment to be paid upon signing of this Agreement, TSMC shall provide SMIC with: (i) an invoice (to the address identified in paragraph 46) specifying the specific amount due under each installment payment set forth in Exhibit A thirty (30) days prior

to the payment date; and (ii) wire transfer instructions not less than fifteen (15) business days before any payments are due. Unless new wire transfer instructions are timely received by SMIC, the last such instructions shall be used.

**II. THE PENDING ACTIONS.**

6. The Parties shall execute and file a stipulation of dismissal without prejudice of TSMC’s claims in the California State Court Action substantially in the form attached hereto as Exhibit C-1. The Parties shall execute and file a stipulated dismissal with prejudice of TSMC’s claims in the California State Court Action against Hiang C. Chan, in exchange for which SMIC hereby agrees that SMIC shall be liable for any conduct of Hiang C. Chan that was or could have been the subject of the claims of the California State Court Action, and shall ensure, to the fullest extent possible, that Hiang C. Chan complies with his obligations to appear in the County of the State of California for deposition and/or trial in any Refiled action. The Parties agree to execute an “undertaking” to settle the California State Court Action against Hiang C. Chan substantially in the form of Exhibit C-2.

7. The Parties shall execute and file an executed stipulation of dismissal without prejudice of TSMC’s claims in the First District Court Action substantially in the form attached hereto as Exhibit D. The stipulation of dismissal filed in the First District Court Action shall include a dismissal without prejudice of SMIC’s Counterclaims.

8. The Parties shall execute and file an executed stipulation of dismissal without prejudice of TSMC’s claims in the Second District Court Action substantially in the form attached hereto as Exhibit E. The stipulation of dismissal filed in the Second District Court Action shall include a dismissal without prejudice of SMIC’s Counterclaims.

9. The Parties shall execute and file a joint motion and related papers to vacate the Taiwan Injunction and terminate the Taiwan Action substantially in the form attached hereto as Exhibit F. The parties shall cooperate to ensure that the existing bond posted by TSMC for the Taiwan Injunction shall be refunded to TSMC.

10. The Parties shall file a Joint Motion to Terminate the ITC Action based on the Settlement Agreement substantially in the form attached as Exhibit G, along with a public version of the Joint Motion to Terminate the ITC Action and a public version of this Agreement. The Parties shall cooperate both in the preparation of such public versions so that any sensitive commercial information is not publicly disclosed, and in requesting confidential treatment for such version of this Agreement in connection with the filing of the same before any government authority.

11. The parties shall share equally any court-related costs incurred in the settlement of the matters described in Paragraphs 6,7,8, 9 and 10. All other costs associated with the settlement of these matters and not otherwise provided in this agreement shall be borne respectively by the party incurring such costs, including but not limited to attorney fees and costs.

**III. PATENT LICENSE.**

12. The Parties hereby agree to enter into the Patent License Agreement attached hereto as Exhibit H.

**IV. TSMC INFORMATION ACQUIRED PRIOR TO THE EFFECTIVE DATE.**

13. SMIC acknowledges that, other than the Patent License Agreement, neither this Agreement, nor any agreement referenced herein, grants SMIC any right, title, or interest in any TSMC Information. SMIC acknowledges and agrees that it is not licensed or authorized to possess, disclose or to use in any way or to any extent, TSMC Information, including any TSMC Information that was obtained or used by SMIC or its employees prior to the Effective Date.

14. TSMC provides SMIC a "Grace Period" commencing on the Effective Date and ending on July 31, 2005, during which Grace Period TSMC will not sue SMIC for any alleged continued possession or use by SMIC of TSMC Information acquired prior to the Effective Date in or for SMIC's 0.13um or smaller processes, nor conduct an Audit (as hereinafter defined). TSMC provides this Grace Period on the understanding that SMIC will use the Grace Period to ensure that SMIC neither possesses nor uses TSMC Information in SMIC's 0.13um or smaller processes and related business activities.

15. Upon execution of this Agreement, SMIC shall use reasonable efforts separately to identify and return to TSMC's counsel, Kecker & Van Nest, each and every document or material (whether in paper or digital format) that SMIC knows or has reason to believe based on a good faith investigation, might contain TSMC Information, except that one copy of such TSMC Information may be retained by SMIC's legal counsel (Paul Hastings) and shall only be used in accordance with the terms of this Agreement, and one copy will be placed into the escrow to be established pursuant to Article V herein. SMIC's identification and return of such information shall not be deemed an admission of liability.

16. SMIC shall not be in breach of the obligation in paragraph 15 above because it possesses and uses SMIC Information relating to, or sells products using SMIC's existing 0.15um and larger Process Technologies that may contain or be derived from TSMC Information. Nor shall SMIC be in breach of said obligation because it manufactures a product for a customer and in conjunction with manufacturing such product receives TSMC Information from such customer, without knowing or having any reason to know that the customer has disclosed TSMC Information, was under a duty not to disclose TSMC Information or used improper means to acquire TSMC Information.

**V. ESCROW AND AUDIT.**

17. TSMC and SMIC agree to enter into the Escrow Agreement attached hereto as Exhibit I.

18. SMIC agrees to deposit a copy of all of the documents identified in Exhibit A Mandatory Deposit Materials to the Escrow Agreement by July 31, 2005.

19. To the extent that, within thirty (30) days of the Effective Date, any Counsel to the Parties has not deposited into Escrow all of the documents produced by the other Party during discovery in the several litigation matters, then, within such thirty (30) day period, such Counsel will use its reasonable, good faith efforts to return to the producing Party, all but one copy of the documents produced by the other Party in the Pending Actions and provide a certification that all such documents either have been returned or deposited into Escrow. During this process, any documents produced by third parties in any action shall be governed by the existing protective order in that action or local laws of the governing jurisdiction.

20. Two years after the Effective Date, the respective General Counsels of the Parties and a representative of each of the Parties' senior management shall meet to discuss the necessity of maintaining the ongoing escrow process. In the event that there have been no major issues concerning possible breach of this Agreement during said two year period, and without any obligation of the Parties, during such meeting the Parties may consider the possible termination or modification of the Escrow Agreement.

21. The Parties will split the costs 50/50 for setting up the initial escrow.

22. SMIC will bear its own costs for depositing material into the escrow.

23. After July 31, 2005, TSMC may at any time at its own discretion decide to audit the information that SMIC has deposited into the escrow to (i) ensure that SMIC has complied with its obligations to deposit and update the materials described in Exhibit A of the Escrow Agreement, and/or (ii) verify that SMIC is not using TSMC Information in a 0.13um or smaller Process Technology (an "Audit").

a. The Audit may only be performed by TSMC's outside counsel who may retain one or more outside consultants selected by TSMC to consult with TSMC's outside counsel. Such consultants shall be among those previously identified by TSMC in the ITC action, State Court action or the First District Court action, and shall be bound by any undertaking executed by them in such action. In addition, TSMC will make sure that such consultants are not currently or previously associated with SMIC as its employees or consultants, and SMIC shall not hire or retain as consultants any of the consultants previously disclosed by TSMC in any of the Pending Actions.

b. TSMC's outside counsel will notify the Escrow Company which documents or material it wishes to inspect and will provide a copy of the request to SMIC.

c. SMIC will have no right to object to the release of any requested material to TSMC's outside counsel or outside consultant(s) for purposes of any Audits.

24. TSMC shall bear the costs for its Audit(s), provided, however, that it shall be entitled to recover such costs, including TSMC's legal fees and costs, if SMIC is found in a legal proceeding to have been using after the Grace Period TSMC Information in any of its 0.13um or smaller Process Technology. SMIC shall bear its costs and fees for any work necessary because of the obligations SMIC undertakes herein to modify or develop Process Technologies.

25. During the Grace Period, SMIC and SMIC's counsel may only examine the materials deposited in escrow for the purpose of identifying SMIC's 0.13um or smaller Process Technology or related information, if any, that may need to be purged of TSMC Information ("SMIC 0.13um Information").

26. On or before the conclusion of the Grace Period, SMIC's outside counsel may communicate to SMIC the identification of any SMIC 0.13um Information that may need to be purged of TSMC Information, provided, however, that SMIC's outside counsel shall not communicate or disclose to SMIC any TSMC Information; and further provided that within five (5) days of the end of the Grace period, SMIC's counsel shall provide to TSMC a report identifying any TSMC Information discovered during the Grace Period; such provision of information by SMIC's outside counsel to TSMC's outside counsel shall not be asserted by TSMC to be a waiver of SMIC's attorney client privilege rights as to such communication or any related communications between SMIC and its outside counsel



27. The retention, use and disclosure of all documents retained by the Parties' respective legal counsel under Article V of this Agreement shall be governed by the stipulated protective order entered in the First District Court Action, which protective order shall continue in force and effect as between the Parties so long as any legal counsel retains such documents or of SMIC's counsel's work product.

**VI. COVENANTS AND WARRANTIES**

28. Except in the event of a Termination, as defined in paragraph 43, TSMC hereby covenants not to sue SMIC for SMIC's acquisition and use of Previously Acquired TSMC Information before the Effective Date and for any continuing use of such Previously Acquired TSMC Information in SMIC's existing 0.15um and larger processes and related business activities after the Effective Date, subject to the following:

- a. This covenant does not extend to SMIC's use after the Effective Date of any TSMC Information in, or relating to, any 0.13um or smaller SMIC Process Technologies or related business activities;
- b. This covenant does not extend to any oral or written disclosure by SMIC after the Effective Date of any TSMC Information acquired before the Effective Date; and
- c. This covenant does not extend to any TSMC Information acquired by, disclosed to, or first used by SMIC after the Effective Date, including the use of any previously acquired TSMC Information to develop a new SMIC process(es) after the Effective Date.

29. SMIC warrants and represents that, should it become aware after the Effective Date of any acquisition, use, or disclosure of TSMC Information that is subject of paragraph 28 above,

it shall treat the TSMC Information as strictly confidential, deposit a copy of such information into the escrow account, and immediately notify TSMC's counsel and return to TSMC's counsel all remaining copies of the TSMC Information.

30. For so long as there is no Refiled Action (as defined below in paragraph 41), SMIC covenants not to sue TSMC based upon or relating to the appropriateness or basis of any claim or cause of action that TSMC has asserted in the Pending Actions, including but not limited to claims for malicious prosecution, sanctions, or abuse of process.

31. SMIC warrants and represents that it will not make any statements that will suggest or imply to any third party (including but not limited to customers) that SMIC's processes use or are derived from TSMC Information, or are "based on TSMC's processes," are "TSMC compatible," are "TSMC-like," or otherwise suggest a use of or a derivation from TSMC Information, compatibility with TSMC's processes or technology arising from TSMC Information, or endorsement by TSMC. However, SMIC may state that its operations are "foundry compatible" according to generally accepted industry standards.

## **VII. NON-SOLICITATION OF EMPLOYEES**

32. SMIC agrees not to solicit TSMC Information from current or former employees of TSMC.

33. SMIC agrees to maintain appropriate measures to require any employees, including new hires from TSMC, not to bring to, or use at SMIC, any TSMC Information or unlicensed TSMC intellectual property.

34. SMIC agrees not to solicit for employment on its own initiative, directly or indirectly, or use improper means to hire employees of TSMC. However, normal recruiting program implemented by SMIC addressed to the general public and not specifically targeting any TSMC employees shall not be deemed as a violation of this section.

**VIII. CONFIDENTIALITY**

35. The Parties agree that all provisions, terms and conditions of this Agreement are and will remain confidential, and that they shall not disclose such terms and conditions, in whole or in part, under any circumstances to any person not a party hereto, except

- 1 as expressly provided herein, pursuant to paragraph 36;
- 2 with the prior written consent of the other party;
- 3 to the extent such disclosure may be required in judicial, administrative or regulatory proceedings in response to a valid subpoena or as may otherwise be required by law, subject to protective order or other similar protections as applicable;
- 4 for the purposes of disclosure in connection with the U.S. Securities and Exchange Act of 1934, as amended, the Securities Act of 1933, as amended, and any other disclosures or reports filed with the U.S. Securities and Exchange Commission, the NYSE, The Hong Kong Stock Exchange, and comparable PRC, Taiwan, and other securities authorities where applicable;
- 5 to either Party's accountants, auditors, legal counsel, insurers or bankers subject to an obligation of confidentiality and/or privilege as applicable;

provided, however, that prior to any such disclosure pursuant to subparagraphs (3) or (4) hereof, the party seeking to make a disclosure shall notify the other party and consult with the other party and otherwise take all reasonable actions in an effort to minimize the nature and extent of such disclosure.

**IX. FUTURE STATEMENTS.**

36. The Parties agree to each issue mutually agreed press release upon consummation of this Agreement on January 30, 2005. Except as otherwise agreed by the Parties, the Parties: (i) will endeavor to keep the contents of this Agreement confidential, and (ii) will endeavor not to disclose the specific terms of this Agreement to the media, investment community, or public at large, except as may be needed to correct an inaccurate report or description of the settlement. The Parties agree that in the event of an action for breach of his Agreement or any Exhibit hereto, either party may disclose the specific terms of this Agreement in connection with litigation concerning this Agreement or any Exhibit thereto, on the condition that the terms of settlement be kept as confidential as the applicable court will allow, except as provided in paragraph 35.

37. So long as this Agreement is not breached, neither party, nor their officers or directors, will make any public statements asserting or denying the merits of the claims previously asserted in any of the actions settled herein.

**X. CHOICE OF LAW, JURISDICTION, ENFORCEMENT.**

38. This Agreement, its validity, its interpretation, enforcement and performance shall be governed by the substantive laws of the State of California, USA (without application of its conflict of law rules), as if this Agreement were wholly executed and wholly performed in the State of California, USA and the substantive laws of California shall apply to any dispute arising out of this Agreement.

39. The Parties agree to personal jurisdiction and venue of the California Courts with regard to any dispute arising out of the interpretation, enforcement or breach of this Agreement.

**XI. BREACH.**

40. Should either party believe that the other party has breached this Agreement, the party believing that there has been a breach shall notify the other party of the breach and the basis for the belief that there has been a breach. Within ten (10) business days of receipt of notice of breach, the Parties' General Counsels shall meet in a neutral location and attempt in good faith to resolve the breach. If their attempt is unsuccessful, a meeting to reach a good faith resolution of the breach shall take place in a neutral location within five (5) business days after the last meeting of the Parties' General Counsels, and shall include at least one senior business and/or technical representative from each party and the Parties' General Counsels. The conciliation process set forth in this paragraph shall be referred to as "Meet and Confer". It is the intention of the Parties to make reasonable efforts to try to resolve any disputes it may have using this Meet and Confer to try to avoid future litigation.

41. In the event that the during Meet and Confer the Parties have not agreed on some remedial action and appropriate compensation or if the breach is not cured to the satisfaction of the non-breaching party following conclusion of the Meet and Confer, the non-breaching party may declare a breach of this Agreement and may avail itself of all rights and remedies with respect to such breach, including filing a new action for breach of this Agreement and asserting any of the causes of action in any of the Pending Actions and/or refile any of the Pending Actions ("Refiled Action" or "Refiled Actions") in the California Courts, State or Federal, and/or the ITC. SMIC and TSMC hereby (a) expressly consent to personal jurisdiction in the California Courts, State or Federal, and/or the ITC in the event of such a new or Refiled Action; (b) agree to accept service of process as if it were a California corporation; (c) expressly waive

any requirements for service under the Hague or any convention between the US and China or Taiwan, and (d) agree that any judgment entered against SMIC or TSMC in a new or Refiled Action will be enforceable against SMIC in China as if the judgment had been entered by a Chinese court or against TSMC in Taiwan as if the judgment had been entered by a Taiwan court.

42. Following the conclusion of the Meet and Confer set forth in paragraph 40 above, In the event of (i) SMIC's failure to make any payment required by this Agreement when due; (ii) SMIC's or TSMC's breach of the Patent License Agreement; or (iii) an assignment that is prohibited by this Agreement, or (iv) SMIC's acquisition or disclosure of any TSMC Information after the Effective Date; or (v) SMIC's acquisition, use or disclosure of TSMC Information in 0.13 um or smaller SMIC processes or related business activities after the conclusion of the Grace Period, or to develop a new SMIC Process Technology after the Effective Date, all rights, releases and licenses granted to the breaching party under this Agreement and the Patent License Agreement shall immediately terminate as of the date of the breach ("Termination"). The date of the breach is the date of the act constituting the breach, not the date that a party learns of the breach or the date a court or other tribunal determines that there has been a breach, and the breaching party shall be liable for all unauthorized actions occurring after the date of the breach. The Parties agree that in the event of a breach, the breaching party shall be liable for pre-judgment interest beginning no later than the date of the breach.

43. In the event of a Termination due to the fault of SMIC, any payments in paragraph 1 not already paid by SMIC shall become immediately due and payable. Except as provided herein, any defenses raised or available to either of the Parties in each of the Pending Actions as

of the date of the termination of such action, shall be available in any Refiled Action. In any Refiled Action, the computation of the time to commence the action, for purposes of the statute of limitations, laches, waiver or estoppel defenses shall not be deemed to include the time from the commencement of the original action to a date one year after the date of termination of this Agreement. In any such Refiled Action, any party may assert, in addition to any other defenses it may have in law or equity, that it has not breached this Agreement. Further, in any Refiled Action related to SMIC's misappropriation of TSMC Information, SMIC agrees to waive the benefits of and not to assert the applicability of the single claim doctrine described in Cadence Design Systems v. Avant! Corp., 29 Cal. 4<sup>th</sup> 215 (2002) for any reason based upon this Settlement Agreement, or upon any other term or obligation or action set forth in or required by this Agreement.

44. In any Refiled Action, the amount paid by SMIC under this Agreement may be allocated and credited against and up to any amount awarded as damages against SMIC, as justice requires.

45. In the event of a breach of this Agreement by any Party hereto, the prevailing party in any action to enforce its rights hereunder shall be entitled to recover all costs and expenses, including reasonable attorney's fees incurred in connection with enforcing this Agreement.

## **XII. NOTICE**

46. Any notice or other communication hereunder shall be sufficiently given to: (i) SMIC when sent by overnight or certified mail addressed to Chief Legal Officer, Semiconductor Manufacturing International Corporation, No.18 Zhang Jiang Road, Pudong New Area, Shanghai 201203, People's Republic of China the address set out above; or (ii) TSMC when

sent by overnight or certified mail addressed to General Counsel, Taiwan Semiconductor Manufacturing Company, Ltd., a Taiwanese corporation, having a place of business located at No. 8 Li-Hsin Road 6, Hsin-Chu Science Park, Hsinchu, 300-77, Taiwan, Republic of China. Changes in such addresses may be specified by written notice.

**XIII. MISCELLANEOUS.**

47. This Agreement is a compromise between many complex issues and disputes between the Parties. The Parties may not, and agree that it will not use this Agreement in any way as a measure of damages, or evidence therefore, of any claim between TSMC and SMIC or any valuation of rights granted hereunder.

48. This Agreement and the agreements and licenses referred to herein represent the only agreements of the Parties with respect to the Pending Actions and supercedes all prior and contemporaneous agreements, understandings, negotiations and discussions, whether oral or written, concerning the subject matter of the Agreement. This Agreement may not be altered or amended without the express written consent of the Parties.

49. Neither this Agreement nor any licenses or rights granted hereunder shall be assignable or transferable (in insolvency proceedings; by reason of an asset transfer such as a corporate merger, acquisition, or reorganization; or otherwise) by either Party without the express written consent of the other Party. Any attempted unauthorized transfer or assignment shall be null and void and unenforceable in law or equity and constitute a breach of this Agreement.

50. The failure of a Party to insist upon strict adherence to any term of the Agreement on any occasion shall not be considered a waiver nor deprive that Party of the right thereafter to insist upon strict adherence to that term or any term of this Agreement. Any waiver must be in writing.



51. This Agreement shall be binding on all of the parties identified above, and any and all Subsidiaries, Related Companies, parents or affiliates of the Parties as well as their officers, agents, servants, employees, attorneys and all others sitting in concert or participation with any of the foregoing.

52. The headings included in this Agreement are for reference only and shall not affect in any way the meaning or interpretation of this Agreement.

53. Should one or more of the provisions of this Agreement be found invalid, illegal or deemed unenforceable by any court, the remaining terms and provisions of the Agreement shall remain in full force and effect unless the deletion of the invalid, illegal or unenforceable terms materially alters the scope of the Agreement and/or the obligations of one or more the Parties.

54. The rights and remedies provided herein are cumulative and not exclusive of any rights or remedies provided by law.

55. Any defined term used in this Agreement or any of the agreements or other documents referenced herein shall have the meaning ascribed to it in such definition.

56. Each party will bear its own legal fees, expenses, and costs in connection with the Pending Actions and the settlement negotiations.

57. No party shall be liable for any delay or non-performance of its obligations hereunder in the event and to the extent that such delay or non-performance is due to an event of Force Majeure, defined below. "Force Majeure" means war, civil unrest, terrorist acts, strikes, lock-out and other general labor disputes, acts of government, natural disasters, breakdown or general unavailability of transport facilities, general shortages of energy, general shortages of

materials, accidents, fire, earthquakes, explosions and Acts of God. The party affected by an event of force majeure shall inform the other party in writing without delay of its occurrence, probable duration and cessation.

58. Each Party represents and warrants that it is under no legal impediment to the entry into and confirmation of this Agreement and this agreement is effective and enforceable.

59. This Agreement may be executed in two or more counterparts, each of which is deemed an original but all of which together constitute one and the same instrument.

60. The parties hereby acknowledge that each has been represented by independent legal counsel throughout all negotiations which preceded the execution of this Agreement and that this Agreement has been executed with the consent and advice of such counsel.

Each party represents and warrants for himself or itself that the individual executing this Agreement on his or its behalf is authorized to do so and to bind the party on whose behalf the individual is signing. The parties further represent and warrant that each is the sole holder of the claims being released in this Agreement, that he or it has not assigned those Claims to any other person, and that no one else has any claim, title or interest in or to the claims being released herein.

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**CONFIDENTIAL  
Settlement Agreement  
Execution Copy**

**Confidential Settlement Document**

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IN WITNESS WHEREOF, the Parties have themselves through their duly authorized representatives caused this Agreement to be executed:

Date: January 30, 2005

TSMC, Ltd.

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By: FC Tseng  
Date: January 30, 2005

WaferTech LLC

---

By: Steve Tso  
Date: January 30, 2005

TSMC -NA

---

By: FC Tseng  
Date: January 30, 2005

**CONFIDENTIAL  
Settlement Agreement  
Execution Copy**

**Confidential Settlement Document**

SMIC Americas

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By: Richard R. Chang  
Date: January 30, 2005

SMIC Shanghai.

---

By: Richard R. Chang  
Date: January 30, 2005

SMIC Cayman.

---

By: Richard R. Chang  
Date: January 30, 2005

**APPENDIX A  
DEFINITIONS**

**Effective Date** means January 31, 2005.

**Execution** means the date on which the last party signs this Agreement.

**Patents** means and include any and all patents (including patents of importation, patents of confirmation, improvement patents, patents and certificates of addition and utility models, as well as divisions, reissues, continuations, continuations-in-part, renewals and extensions of any of the foregoing) having an issuance or grant date prior to the Expiration Date and existing at any time in any or all countries of the world.

**Parties** means the signatories hereto.

**Previously Acquired TSMC Information** means TSMC Information acquired by SMIC prior to the Effective Date.

**Process Technology(ies)** means information used in the manufacture of one or more Semiconductor Devices having a specified geometry (i.e., 0.13um).

**Related Companies** means, with respect to TSMC: its SUBSIDIARIES; Systems on Silicon Manufacturing Company Pte. Ltd; and Vanguard International Semiconductor Corporation; and with respect to SMIC, its SUBSIDIARIES.

**Semiconductor Device(s)** means a unitary or integrated silicon electronic device, such device being either in wafer, die, or finished form. A SEMICONDUCTOR DEVICE in finished form shall include any terminals and housing (and any environmental control elements within the housing) integral to such device. A SEMICONDUCTOR DEVICE shall not lose its character as such whether or not it is part of an assemblage of such electronic devices or other devices, but the term does not mean such assemblage nor does it include circuits formed by the assemblage.

**Subsidiary(ies)** of a company means a corporation or other legal entity: (i) the majority of whose shares or other securities entitled to vote for election of directors (or other managing authority) is now or hereafter controlled by such company either directly or indirectly; or (ii) which does not have outstanding shares or securities but the majority of whose ownership interest representing the right to manage such corporation or other legal entity is now or hereafter owned and controlled by such company either directly or indirectly; but any such corporation or other legal entity shall be deemed to be a SUBSIDIARY of such company only as long as such control or ownership and control exists.

**TSMC Information** means non-public information, know-how, technology or trade secrets developed or owned by TSMC, but shall not include information the following information:

(a) information which is generally known or freely available for use by other competitors of TSMC; (b) the general knowledge, skill and experience acquired by former TSMC employees during the course of their employment that is retained in the unaided memories of TSMC's employees ; (c) industry standards or other information that is generally known or widely used in the semiconductor manufacturing industry; (d) information that is contained in publicly available documents, including patents, published articles and textbooks, equipment manuals, and seminar presentations that are generally available to TSMC's competitors.

**EXHIBIT A  
PAYMENT SCHEDULE**

SMIC (Cayman) shall pay to TSMC the aggregate sum of one hundred seventy-five million dollars (\$175,000,000.00) in U.S. dollars, payable by wire transfer to TSMC's designated account, as follows:

Effective Date	-	\$20 million.
April 1, 2005	-	\$ 5 million.
December 31, 2005	-	\$ 5 million.
June 30, 2006	-	\$15 million.
December 31, 2006	-	\$15 million.
June 30, 2007	-	\$15 million.
December 31, 2007	-	\$15 million.
June 30, 2008	-	\$15 million.
December 31, 2008	-	\$15 million.
June 30, 2009	-	\$15 million.
December 31, 2009	-	\$15 million.
June 30, 2010	-	\$15 million.
December 31, 2010	-	\$10 million.

**TSMC – SMIC Patent License Agreement  
DOCUMENT  
Exhibit H to Settlement Agreement  
Execution Copy**

**CONFIDENTIAL SETTLEMENT**

**PATENT LICENSE AGREEMENT**

**between**

**Taiwan Semiconductor Manufacturing Company, LTD.**

**and**

**Semiconductor Manufacturing International Corporation**



**PATENT LICENSE AGREEMENT**

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**Appendix A - Definitions**

## **PATENT LICENSE AGREEMENT**

This Agreement (the "Agreement") is entered into this 30th day of January 2005 by and among TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY, LTD., a Taiwanese corporation, having a place of business located at No. 8 Li-Hsin Road 6, Hsin-Chu Science Park, Hsinchu, Taiwan, Republic of China and WaferTech, LLC, a limited liability company organized and existing under the laws of Delaware, having a principal place of business at 5509 N.W. Parker Street, Camas, Washington 98608, (collectively, "TSMC") on behalf of themselves and all of their SUBSIDIARIES on the one hand; and SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPORATION, a Cayman Island Corporation, having a place of business located at No. 18, Zhang Jiang Road, Pudong New Area, Shanghai 201203, People's Republic of China on behalf of itself and all of its SUBSIDIARIES (collectively, "SMIC").

For good and adequate consideration, including the promises and obligations undertaken in the Settlement Agreement, the Parties hereby agree as follows:

### **ARTICLE I GRANT OF LICENSES**

#### **1.01 Grant of Licenses.**

- (a) TSMC grants to SMIC under the Manufacturing Inventions of TSMC's Patents, a personal, non-exclusive, indivisible, non-transferable, worldwide license to make, have made, use, lease, sell, offer to sell, and export/import Semiconductor Devices during the Term (as hereinafter defined in Section 1.02), provided, however, that no express or implied license is granted to make, have made, use, lease, sell, offer to sell or export/import any Semiconductor Devices for a third party under any non-Manufacturing Invention of TSMC Patent. It is expressly understood and agreed that this license is not intended to grant, and does not grant, any license rights to any third party under any TSMC Patent.

- (b) SMIC grants to TSMC under the Manufacturing Inventions of SMIC's Patents a personal, non-exclusive, indivisible, non-transferable, worldwide license to make, have made, use, lease, sell, offer to sell, and export/import Semiconductor Devices during the Term, provided, however, that no express or implied license is granted to make, have made, use, lease, sell, offer to sell or export/import any Semiconductor Device for a third party under any non-Manufacturing Invention SMIC Patent. It is expressly understood and agreed that this license is not intended to grant, and does not grant, any license rights to any third party under any SMIC patents.

(c) TSMC hereby grants to SMIC, under TSMC's Patents, a personal, nonexclusive and non-transferable, license to make, have made, use, lease, sell, offer to sell and import any circuit on a Semiconductor Device manufactured by or for SMIC, to the extent that such circuit is included in the standard library of SMIC, provided that the license granted under this section does not extend to a circuit that is developed for a customer as part of a proprietary device, the design of which circuit will not be included in SMIC's standard library. For purposes of clarification, the Parties agree that no rights are granted to any circuits of a third party design, including circuits that may be included on the same Semiconductor Device as circuits licensed under this subsection.

(d) SMIC hereby grants to TSMC, under SMIC's Patents, a personal, nonexclusive and non-transferable, license to make, have made, use, lease, sell, offer to sell and import any circuit on a Semiconductor Device manufactured by or for TSMC, to the extent that such circuit is included in the standard library of SMIC, provided that the license granted under this section does not extend to a circuit that is developed for a customer as part of a proprietary device, the design of which circuit will not be included in SMIC's standard library. For purposes of clarification, the Parties agree that no rights are granted to any circuits of a third party design including circuits that may be included on the same Semiconductor Device as circuits licensed under this subsection.

(e) The licenses granted herein to have made Semiconductor Devices shall include the right to have products made by another manufacturer, provided that such products are made according to the specifications of the Party operating under its have made rights and such devices are being manufactured for bona fide customers of that Party.

**1.02 Term.**

(a) All licenses granted herein shall be in effect from the Effective Date until December 31, 2010 (the "Expiration Date").

(b) Not less than six months before the Expiration Date, either Party may send a written notice to the other Party stating its intention to seek a renewal of this Agreement. Within thirty days following such notice, the Party receiving the notice shall respond to the notice stating whether it is willing to enter into discussions concerning such renewal. The entry into any such discussions shall not obligate any Party to agree to a renewal of this Agreement or to any particular terms and conditions with respect thereto.

**1.03 Other License Provisions.**

(a) Licenses granted herein are not to be construed as consent by the grantor to any act that may be performed by the grantee, except to the extent impacted by a Patent licensed herein to the grantee.

(b) The licenses granted hereunder are extended to each Party's SUBSIDIARIES but only during the period such entities are SUBSIDIARIES. Each Party shall cause its SUBSIDIARIES to extend licenses consistent in scope with section 1.01 to the other Party under all of its SUBSIDIARIES' patents from the date such company became a SUBSIDIARY through the end of the Term. The Parties agree that if either Party forms a holding company for any Patents within the scope of this license, that Party shall cause such holding company to grant licenses under such Patents, of the scope and duration granted herein, to the other Party.

(c) The licenses granted hereunder are not transferable, in that the sale or transfer by one Party of all or substantially all of its assets to any third party shall not include any of the licenses granted hereunder.

**1.04 Joint Inventions.**

(a) There are countries which require all inventors or their assignees to expressly consent to the grant of licenses or rights under patents issued in such countries for joint inventions.

(b) Each Party shall give such consent, or shall obtain such consent from its SUBSIDIARIES, its employees, or employees of any of its SUBSIDIARIES, as required to make full and effective grant of licenses and rights respecting any patent on a joint invention in which that Party has an interest within the scope of this Agreement.

(c) Each Party shall take steps which are reasonable under the circumstances to obtain from assignees or inventors of joint inventions who are not SUBSIDIARIES or employees of such party or its SUBSIDIARIES whatever consents are necessary to make full and effective the grant of licenses and rights respecting any patent on joint invention in which that Party has an interest within the scope of this license. If, in spite of such reasonable steps, such Party is unable to obtain the requisite consents from such third parties, the resulting inability of such Party to make full and effective its purported grant of such licenses and rights shall not be considered to be a breach of this Agreement and such Party shall not itself take any action to enforce the patent against the grantee or otherwise act in any manner inconsistent with the rights granted in this Agreement.

**1.05 Publicity.**

Nothing in this Agreement shall be construed as conferring upon either Party or its SUBSIDIARIES any right to include in advertising, packaging or other commercial activities related to a Semiconductor Device, any reference to the other Party (or any of its SUBSIDIARIES), its trade names, trademarks or service marks in a manner which would be likely to cause confusion or to indicate that such Semiconductor Device is in any way certified by the other party hereto or its SUBSIDIARIES.

**1.06 Confidentiality.**

The terms and conditions, but not the existence, of this Agreement shall be treated as confidential information by the Parties, and neither Party shall disclose the terms or conditions of this Agreement to any third party (other than to its SUBSIDIARIES licensed pursuant to this Agreement) without the prior written permission of the other Party. Each Party, however, shall have: (i) the right to represent to third parties that such Party is licensed for the Patents as provided by this Agreement; and (ii) the right to make disclosures to the extent required by an order of court, regulation of another governmental body, or otherwise by law or by a stock exchange, provided that the Party shall promptly provide written notice to the non-disclosing Party of the intended disclosure and of the court order or regulation prior to such disclosure and that the Party takes all reasonable steps to minimize such disclosure by, for example, obtaining a protective order and/or appropriate confidentiality provisions requiring that such information to be disclosed be used only for the purpose for which such law, order, regulation or requirement was issued. Additionally, each Party may disclose this Agreement or its contents to the extent reasonably necessary, under a suitable confidentiality agreement, to its accountants, attorneys, financial advisors and in connection with due diligence activities relating to the sale of the stock or a portion of the business of a Party or its SUBSIDIARIES, provided that said Party consult with the other Party as to any terms and conditions that such Party desires to have redacted.

**1.07 Non-Manufacturing Patents/Covenant Not to Sue.**

(a) TSMC agrees during the term of this Agreement not to bring any action against SMIC or its SUBSIDIARIES for making, having made, using, selling, or importing any third party product arising out of infringement of TSMC's non-Manufacturing Patents; provided, however, that this agreement is personal as to SMIC, is non-transferable, and does not grant any rights or license to any third party under TSMC's non-Manufacturing Patents, nor does it inure to the benefit of any third party in any way.

(b) SMIC agrees during the term of this Agreement not to bring any action against TSMC or its SUBSIDIARIES for making, having made, using, selling, or importing any third party product arising out of infringement of SMIC's non-Manufacturing Patents; provided, however, that this agreement is personal as to TSMC, is non-transferable, and does not grant any rights or license to any third party under SMIC's non-Manufacturing Patents, nor does it inure to the benefit of any third party in any way.

**ARTICLE II  
LICENSE FEE**

**2.01** A portion of the payment required under the terms of the Settlement Agreement constitutes consideration for the rights granted by TSMC to SMIC pursuant to this Agreement.

**ARTICLE III  
TERMINATION**

**3.01 Termination for Breach.**

(a) Upon an event of Termination as set forth in Paragraph 40 of the Settlement Agreement, the breaching Party's rights (including the releases hereunder) under this Agreement shall immediately terminate, and the non-breaching Party's rights shall remain unaffected.

(b) The waiver by any Party of a breach or default in any of the provisions of this Agreement by another Party shall not be construed as a waiver by such Party of any succeeding breach of the same or other provisions, nor shall any delay or omission on the part of any Party to exercise or avail itself of any right, power or privilege that it has or may have hereunder, operate as a waiver of any right, power or privilege by such Party.

**3.02 Survival.**

Any termination under the provisions of this Article III of the licenses and rights of a Party shall not affect such Party's licenses, rights and obligations with respect to any Semiconductor Devices made or furnished during the period of this license and prior to such termination.

**ARTICLE IV  
MISCELLANEOUS PROVISIONS**

**4.01 Warranties and Disclaimers.**

(a) *Neither Party nor any of its SUBSIDIARIES makes any representations, extends any warranties of any kind, assumes any responsibility or obligations whatever, or confers any right by implication, estoppel or otherwise, other than the licenses, rights and warranties herein expressly granted.*

- (b) No Party, nor any of their SUBSIDIARIES, shall knowingly and willingly enter into any arrangement by which it disposes of its right to grant, or limits in any way, any of the licenses, rights and privileges granted under its Patents.
- (c) Nothing contained in this Agreement shall be construed as:
  - (i) a warranty or representation by any of the Parties to this Agreement as to the validity or scope of any Patent licensed hereunder; or
  - (ii) a warranty or representation that any manufacture, sale, lease, use or other disposition of any products hereunder will be free from infringement of Patents or other industrial or intellectual property rights under which no express licenses have been granted under and pursuant to this Agreement; or
  - (iii) an obligation on any of the Parties to file any patent application or to secure any Patents or maintain any Patents in force; or
  - (iv) an agreement to bring or prosecute actions or suits against outside third parties for infringement or conferring any rights to bring or prosecute actions or suits against third parties for infringement; or
  - (v) conferring any right to use in advertising, publicity or otherwise, any trademark, trade name or names, or any contraction, abbreviation or simulation thereof, of any Party; or
  - (vi) conferring by implication, estoppel or otherwise, upon any Party licensed hereunder, any license or other right under any Patents or other industrial or intellectual property rights except for the licenses and rights expressly granted hereunder; or
  - (vii) an obligation by one Party to furnish any technical information or know-how the other Party, its SUBSIDIARIES or to any Third Party.

**4.02 Limited Assignability.**

- (a) The Parties have entered into this Agreement in contemplation of personal performance, each by the other, and intend that the licenses and rights granted hereunder to a Party may not be extended by such Party to entities other than such Party's SUBSIDIARIES without the other Party's express written consent.
- (b) Neither this Agreement nor any licenses or rights granted hereunder shall be otherwise assignable or transferable (in insolvency proceedings; by reason of an asset transfer such as a corporate merger, acquisition, or reorganization; or otherwise) by either Party without the express written consent of the other Party. Any attempted unauthorized transfer or assignment shall be null and void and unenforceable in law or equity. Any attempted unauthorized transfer or assignment shall result in the immediate termination of the licenses granted hereunder to the Party attempting such transfer or assignment.
- (c) No Party shall transfer the ownership of any patent subject to the license grants in section 1.01 to a third party during the Term of this Agreement unless such transfer is subject to the licenses granted hereunder to the non-transferring Party.
- (d) No Party shall transfer any ownership in an invention within the scope of the license grants in section 1.01 during the Term of this Agreement unless the transferee agrees in writing that any patent issued with respect to such invention will be subject to the licenses granted hereunder to the non-transferring Party.

**4.03 Notice.**

(a) Any notice or other communication hereunder shall be sufficiently given to: (i) SMIC when sent by overnight or certified mail addressed to Chief Legal Officer, Semiconductor Manufacturing International Corporation, No. 18, Zhang Jiang Road, Pudong New Area, Shanghai 201203, People's Republic of China the address set out above; or (ii) TSMC when sent by overnight or certified mail addressed to General Counsel, Taiwan Semiconductor Manufacturing Company, Ltd., a Taiwanese corporation, having a place of business located at No. 8 Li-Hsin Road 6, Hsin-Chu Science Park, Hsinchu, 300-77, Taiwan, Republic of China. Changes in such addresses may be specified by written notice.

(b) Upon the execution of this Agreement, each Party shall furnish to the other Party a complete list in writing of the names and addresses of its SUBSIDIARIES and shall thereafter notify the other Party in writing of any changes to the lists within sixty (60) days after each such change. Furthermore, each Party shall reply promptly and accurately in writing to any enquiry by another Party as to whether it has a controlling interest in a particular company.



**4.04 Choice of Law, Validity, Interpretation.**

(b) (a) This Agreement, its validity, its interpretation and performance, including any dispute arising under this Agreement, shall be governed by the substantive laws of the State of California, USA (without application of its conflict of law rules), as if this Agreement were wholly executed and wholly performed in the State of California, USA.

(b) If any non-material term, clause or provision of this Agreement shall be judged to be invalid, the validity of any other term, clause or provision shall not be thereby affected and such invalid term, clause or provision shall be deemed deleted from this Agreement.

(c) The Parties consent to personal and subject matter jurisdictions and venue, in Courts located in the State of California for any disputes pertaining to this Patent License Agreement.

**4.05 Integration.**

This Agreement and the Settlement Agreement set forth the entire agreement and understanding between the Parties as to the grant of Patent licenses and merges all prior discussions between them. The Parties will not be bound by any modifications, warranties, understandings or representations with respect to such subject matter other than as expressly provided herein or in a writing signed with or subsequent to execution hereof by an authorized representative of the bound Party.

**4.06 Pre-Issuance Liability.**

To the extent an owner of an invention is entitled to compensation, damages or other monetary award for another's unlicensed manufacture, sale, lease, use or importation involving such invention on or after a date prior to the issuance of a patent on such an invention, hereinafter referred to as the invention's "protection commencement date" (e.g., the date of publication of allowed claims or the date of publication or "laying open" of the filed patent application), the Parties agree that such invention may be used during the Term of this Agreement to the same extent as if such invention were licensed on the protection commencement date pursuant to the terms of this Agreement.

**4.07 No Grant of Rights Against Third Parties**

There may be countries in which a Party may have, as a consequence of this Agreement, rights against infringers of the other Party's Patents licensed hereunder. Each Party hereby waives any such right it may have by reason of any third party's infringement or alleged infringement of the other Party's Patents.

**4.08 Releases.**

- (a) TSMC, for itself and for its SUBSIDIARIES, hereby releases, acquits and forever discharges, to the extent of its right to do so, SMIC and its SUBSIDIARIES from any and all claims, known or unknown, for liability arising out of infringement prior to the Effective Date of TSMC's Patents, for which the rights and licenses expressly granted under this Agreement to SMIC and its SUBSIDIARIES would be a complete defense had this Agreement been in effect at the time such patent infringement arose.

(b) SMIC, for itself and for its SUBSIDIARIES, hereby releases, acquits and forever discharges, to the extent of its right to do so, TSMC and its SUBSIDIARIES from any and all claims, known or unknown, for liability arising out of infringement prior to the Effective Date of SMIC's Patents, for which the rights and licenses expressly granted under this Agreement to SMIC and its SUBSIDIARIES would be a complete defense had this Agreement been in effect at the time such patent infringement arose.

**4.09 Counterparts and Facsimile.**

This Agreement may be executed on facsimile copies in any number of counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

**4.10 English Language.**

This Agreement is in the English language, which language shall be controlling in all respects, and all versions in any other language shall be for ease of reference only and shall not be binding upon the Parties. All communications to be made or given pursuant to this Agreement shall be in the English language as well.

**4.11 Legal Representation**

The Parties hereby acknowledge that each has been represented by independent legal counsel throughout all negotiations which preceded the execution of this Agreement and that this Agreement has been executed with the consent and advice of such counsel.

**4.12 Headings**

The headings included in this Agreement are for reference only and shall not affect in any way the meaning or interpretation of this Agreement.

**[Intentionally Blank Space]**

**IN WITNESS WHEREOF**, each of the Parties has caused this Agreement to be executed in duplicate originals by its duly authorized representatives having authority to bind the respective Party on the respective dates entered below.

**Taiwan Semiconductor Manufacturing  
Company, LTD.**

By: \_\_\_\_\_

FC Tseng  
Deputy CEO

Date: January 30, 2005

**Semiconductor Manufacturing International  
Corporation**

By: \_\_\_\_\_

Richard R. Chang  
Chairman and CEO

Date: January 30, 2005

**APPENDIX A  
DEFINITIONS**

**Effective Date** means January 31, 2005.

**Patents** means and include any and all patents (including patents of importation, patents of confirmation, improvement patents, patents and certificates of addition and utility models, as well as divisions, reissues, continuations, continuations-in-part, renewals and extensions of any of the foregoing) having an issuance or grant date prior to the Expiration Date and existing at any time in any or all countries of the world

**Semiconductor Device(s)** means a unitary or integrated silicon electronic device, such device being either in wafer, die, or finished form. A Semiconductor Device in finished form shall include any terminals and housing (and any environmental control elements within the housing) integral to such device. A Semiconductor Device shall not lose its character as such whether or not it is part of an assemblage of such electronic devices or other devices, but the term does not mean such assemblage nor does it include circuits formed by the assemblage.

**Settlement Agreement** means the agreement entitled “Settlement Agreement” between the parties executed on the same date as this Patent License.

**SUBSIDIARY(ies)** of a company means a corporation or other legal entity: (i) the majority of whose shares or other securities entitled to vote for election of directors (or other managing authority) is now or hereafter controlled by such company either directly or indirectly; or (ii) which does not have outstanding shares or securities but the majority of whose ownership interest representing the right to manage such corporation or other legal entity is now or hereafter owned and controlled by such company either directly or indirectly; but any such corporation or other legal entity shall be deemed to be a SUBSIDIARY of such company only as long as such control or ownership and control exists.

**SMIC’s Patents** means all patents issued or having enforceable rights in any country of the world on or before the termination of this Agreement and any patents claiming priority therefrom, which SMIC (or any company while a SUBSIDIARY of SMIC), during the Term, owns or acquires or has the right to grant any licenses of the type herein granted, but only to the extent of such right.

**TSMC’s Patents** means all patents issued or having enforceable rights in any country of the world on or before the termination of this Agreement and any patent claiming priority therefrom, which TSMC (or any company while a SUBSIDIARY of TSMC), during the Term, owns or acquires or has the right to grant any licenses of the type herein granted, but only to the extent of such right.

**Manufacturing Inventions** means an invention that is directed to a process for the manufacture of Semiconductor Devices, including but not limited to devices such as transistors, diodes, capacitors, resistors, conductors, dielectrics, and housings. The term Manufacturing Invention does not mean (1) apparatus useful in the implementation of the process by a manufacturer of a Semiconductor Device, or (2) a Semiconductor Device itself, or (3) the functional operation of the Semiconductor Device.

**Party** means either TSMC or SMIC. **Parties** means both TSMC and SMIC.

Summary of Syndicate Loan Agreement dated May 26, 2005, between Semiconductor Manufacturing International (Beijing) Corporation, Semiconductor Manufacturing International Corporation, as guarantor, and China Development Bank, China Construction Bank, Bank of China, Agricultural Bank of China, China Merchants Bank, HuaXia Bank, China Mingsheng Bank, Bank of Communications, Bank of Beijing, Industrial and Commercial Bank of China (Asia) and CITIC Ka Wah Bank

On May 26, 2005, Semiconductor Manufacturing International (Beijing) Corporation (“SMIC Beijing”) entered into a five-year loan agreement with an aggregate principal amount of US\$600 million with a syndicate of banks based in The People’s Republic of China. China Development Bank and China Construction Bank co-led the arrangement of the loan. Other participants in the syndicate include Bank of China, Agricultural Bank of China, China Merchants Bank, HuaXia Bank, China Mingsheng Bank, Bank of Communications, Bank of Beijing, Industrial and Commercial Bank of China (Asia) and CITIC Ka Wah Bank.

The draw-down period under the loan is one year. The loan is repayable in six semi-annual installments beginning in November 2007. The Registrant has guaranteed SMIC Beijing’s obligations under the loan, which is also secured by SMIC Beijing’s existing fixed assets.

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

1.  $[\text{Net Profit} + \text{depreciation} + \text{amortization} + \text{financial expenses} - (\text{increase of accounts receivable and advanced payments} + \text{increase of inventory} - \text{increase in accounts payable and advanced receipts})] / \text{financial expenses} < 1$ ; and

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

**SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPORATION**  
**INDEMNIFICATION AGREEMENT**

This Indemnification Agreement (“Agreement”) is entered into on the \_\_\_\_\_ day of \_\_\_\_\_, 2005 by and between Semiconductor Manufacturing International Corporation, a Cayman Islands company (the “Company”), and \_\_\_\_\_ (“Indemnitee”) and is deemed to be effective as of the 6<sup>th</sup> day of May, 2005.

RECITALS

A. The Company and Indemnitee recognize the continued difficulty in obtaining liability insurance for its directors, officers, employees, agents and fiduciaries, the significant increases in the cost of such insurance and the general reductions in the coverage of such insurance.

B. The Company and Indemnitee further recognize the substantial increase in corporate litigation in general, subjecting directors, officers, employees, agents and fiduciaries to expensive litigation risks while the availability and coverage of liability insurance has become severely limited.

C. The Company desires to attract and retain the services of highly qualified individuals, such as Indemnitee, to serve the Company and, in part, in order to induce Indemnitee to continue to provide services to the Company, wishes to provide for the indemnification and advancing of expenses to Indemnitee to the maximum extent permitted by law.

D. In view of the considerations set forth above, the Company desires that Indemnitee be indemnified by the Company as set forth herein.

NOW, THEREFORE, the Company and Indemnitee hereby agree as follows:

1. Indemnification

(a) General Right to Indemnification. The Company shall indemnify Indemnitee to the fullest extent permitted by Applicable Law (as defined in Section 9(g) hereof) if Indemnitee was or is or becomes a party to or witness or other participant in, or is threatened to be made a party to or witness or other participant in, any threatened, pending or completed action, suit, proceeding or alternative dispute resolution mechanism, or any hearing, inquiry or investigation that Indemnitee in good faith believes might lead to the institution of any such action, suit, proceeding or alternative dispute resolution mechanism, whether civil, criminal, administrative, investigative or other (hereinafter a “Claim”), by reason of (or arising in whole or in part out of) any event or occurrence related to the fact that Indemnitee is or was a director, officer, employee, agent or fiduciary of the Company, or any subsidiary of the Company, or is or was serving at the request of the Company as a director, officer, employee, agent or fiduciary of another corporation, partnership, joint venture, trust or other enterprise, or by reason of any action or inaction on the part of Indemnitee while serving in such capacity (hereinafter an “Indemnifiable Event”), and the Indemnitee shall be indemnified and held harmless by the Company to the fullest extent permitted by law, against any and all costs, charges, expenses,

liabilities, losses, (including attorneys' fees and expenses and all other costs, expenses and obligations (including any travel related expenses) incurred in connection with investigating, defending, being a witness in or participating in (including on appeal), or preparing to defend, be a witness in or participate in, any such action, suit, proceeding, alternative dispute resolution mechanism, hearing, inquiry or investigation), judgments, fines, penalties and amounts paid in settlement (if such settlement is approved in advance by the Company, which approval shall not be unreasonably withheld) of such Claim and any federal, state, local or foreign taxes imposed on Indemnitee as a result of the actual or deemed receipt of any payments under this Agreement (collectively, hereinafter "Expenses"), including all interest, assessments and other charges paid or payable in connection with or in respect of such Expenses. Such indemnification shall terminate three (3) years after the date on which the relevant approval by the Company's shareholders has been obtained in accordance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "SEHK Listing Rules") (the "Termination Date") and shall continue to be effective as to the Indemnitee even if the Indemnitee ceases to be a director, officer, employee, agent or fiduciary of the Company or any subsidiary of the Company (or to serve another entity at the request of the Company) at any time prior to the Termination Date. Such indemnification shall inure to the benefit of the Indemnitee's heirs, personal representatives and estate. Such payment of Expenses shall be made by the Company as soon as practicable but in any event no later than twenty days after written demand by Indemnitee therefor is presented to the Company. The indemnification referred to in this Agreement is however subject to a maximum aggregate annual value of US\$20,000,000 which is the maximum amount which the Company's directors' and officers' liability insurance ("D&O Insurance") will currently cover per annum for all claims against the Company's directors and officers, provided that the Company's liability to indemnify a particular director or chief executive officer shall not exceed the amount payable in respect of such director or officer under the D&O Insurance.

(b) Reviewing Party. Notwithstanding the foregoing, (i) the obligations of the Company under Section 1(a) shall be subject to the condition that the Reviewing Party (as defined in Section 9(e) hereof) shall not have determined (in a written opinion, in any case in which the Independent Legal Counsel referred to in Section 1(c) hereof is involved) that Indemnitee would not be permitted to be indemnified under Applicable Law, and (ii) the obligation of the Company to make an advance payment of Expenses to Indemnitee pursuant to Section 2(a) (an "Expense Advance") shall be subject to the condition that, if, when and to the extent that the Reviewing Party determines that Indemnitee would not be permitted to be so indemnified under Applicable Law, the Company shall be entitled to be reimbursed by Indemnitee (who hereby agrees to reimburse the Company) for all such amounts theretofore paid; *provided, however*, that if Indemnitee has commenced or thereafter commences legal proceedings in a court of competent jurisdiction to secure a determination that Indemnitee should be indemnified under Applicable Law, any determination made by the Reviewing Party that Indemnitee would not be permitted to be indemnified under Applicable Law shall not be binding and Indemnitee shall not be required to reimburse the Company for any Expense Advance until a final judicial determination is made with respect thereto (as to which all rights of appeal therefrom have been exhausted or lapsed). The Indemnitee's obligation to reimburse the Company for any Expense Advance shall be unsecured and no interest shall be charged thereon. If there has not been a Change in Control (as defined in Section 9(c) hereof), the Reviewing Party shall be selected by the Company's Board of Directors (the "Board of Directors"), and if



there has been such a Change in Control (other than a Change in Control in which a majority of the members of the board of directors of the surviving company consists of members of the Board of Directors immediately prior to such Change in Control), the Reviewing Party shall be the Independent Legal Counsel as selected in accordance with Section 1(c) hereof. If there has been no determination by the Reviewing Party or if the Reviewing Party determines that Indemnitee substantively would not be permitted to be indemnified in whole or in part under Applicable Law, Indemnitee shall have the right to commence litigation seeking an initial determination by the court or challenging any such determination by the Reviewing Party or any aspect thereof, including the legal or factual bases therefor, and the Company hereby consents to service of process and to appear in any such proceeding. Any determination by the Reviewing Party otherwise shall be conclusive and binding on the Company and Indemnitee.

(c) Change in Control. The Company agrees that if there is a Change in Control of the Company (other than a Change in Control in which a majority of the members of the board of directors of the surviving company consists of members of the Board of Directors immediately prior to such Change in Control) then, with respect to all matters thereafter arising concerning the right of Indemnitee to payments of Expenses and Expense Advances under this Agreement or any other agreement or under the Company's Memorandum and Articles of Association as now or hereafter in effect, Independent Legal Counsel (as defined in Section 9(d) hereof) shall be selected by the Indemnitee and approved by the Company (which approval shall not be unreasonably withheld or delayed). Such counsel, among other things, shall render its written opinion to the Company and Indemnitee as to whether and to what extent Indemnitee would be permitted to be indemnified under Applicable Law, and the Company agrees to abide by such opinion. The Company agrees to pay the reasonable fees and expenses of the Independent Legal Counsel referred to above and to fully indemnify such counsel against any and all expenses (including attorneys' fees and expenses), claims, liabilities and damages arising out of or relating to this Agreement or its engagement pursuant hereto.

(d) Mandatory Payment of Expenses. Subject to Sections 1(a) and 8 hereof, to the extent that Indemnitee has been successful on the merits or otherwise, including, without limitation, the dismissal of an action without prejudice, in defense of any action, suit, proceeding, inquiry, alternative dispute resolution mechanism or investigation referred to in Section (1)(a) hereof or in the defense of any Claim, issue or matter covered by this Agreement, or in defense of any Claim, issue or matter therein, Indemnitee shall be indemnified against all Expenses incurred by Indemnitee or on Indemnitee's behalf in connection therewith.

## 2. Expenses; Indemnification Procedure.

(a) Advancement of Expenses. The Company shall advance all Expenses incurred by Indemnitee subject to the limit set forth in Section 1(a). The advances to be made hereunder shall be paid by the Company to Indemnitee as soon as practicable but in any event no later than twenty days after written demand by Indemnitee therefor to the Company.

(b) Notice/Cooperation by Indemnitee. Indemnitee shall, as a condition precedent to Indemnitee's right to be indemnified under this Agreement, give the Company notice in writing as soon as practicable of any Claim made against Indemnitee for which indemnification will or could be sought under this Agreement, *provided, however*, that failure to provide such

notice in accordance with this Section 2(b) shall not affect Indemnitee's rights to receive any Expenses or Expense Advances hereunder unless and except to the extent that the Company did not otherwise receive notice of such Claim and such failure of Indemnitee to provide such notice results in the forfeiture by the Company of substantial rights and defenses. Notice to the Company shall be directed to the Chief Executive Officer of the Company at the address shown on the signature page of this Agreement (or such other address as the Company shall designate in writing to Indemnitee). In addition, Indemnitee shall give the Company such information (in the possession of, or reasonably obtainable without material expense by, Indemnitee) and cooperation as it may reasonably require and as shall be within Indemnitee's reasonable power and control.

(c) No Presumptions; Burden of Proof. For purposes of this Agreement, the termination of any Claim by judgment, order, settlement (whether with or without court approval) or conviction, or upon a plea of nolo contendere, or its equivalent, shall not create a presumption that Indemnitee did not meet any particular standard of conduct or have any particular belief or that a court has determined that indemnification is not permitted by Applicable Law. In addition, neither the failure of the Reviewing Party to have made a determination as to whether Indemnitee has met any particular standard of conduct or had any particular belief, nor an actual determination by the Reviewing Party that Indemnitee has not met such standard of conduct or did not have such belief, prior to the commencement of legal proceedings by Indemnitee to secure a judicial determination that Indemnitee should be indemnified under Applicable Law, shall be a defense to Indemnitee's claim or create a presumption that Indemnitee has not met any particular standard of conduct or did not have any particular belief. In connection with any determination by the Reviewing Party or otherwise as to whether Indemnitee is entitled to be indemnified hereunder, the burden of proof shall be on the Company to establish that Indemnitee is not so entitled.

(d) Notice to Insurers. If, at the time of the receipt by the Company of a notice of a Claim pursuant to Section 2(b) hereof, the Company has liability insurance in effect which may cover such Claim, the Company shall give prompt notice of the commencement of such Claim to the insurers in accordance with the procedures set forth in the respective policies. The Company shall thereafter take all necessary or desirable action to cause such insurers to pay, on behalf of Indemnitee, all amounts payable as a result of such action, suit, proceeding, inquiry or investigation in accordance with the terms of such policies, *provided, however*, that nothing contained in this Section 2(d) shall excuse the Company from its obligations to pay Expenses or Expense Advances to Indemnitee as provided herein.

(e) Selection of Counsel. In the event the Company shall be obligated hereunder to pay the Expenses of any Claim, the Company shall be entitled to assume the defense of such Claim with counsel approved by Indemnitee, which approval shall not be unreasonably withheld, upon the delivery to Indemnitee of written notice of its election so to do. After delivery of such notice, approval of such counsel by Indemnitee and the retention of such counsel by the Company, the Company will not be liable to Indemnitee under this Agreement for any fees of counsel subsequently incurred by Indemnitee with respect to the same Claim; *provided that*, (i) Indemnitee shall have the right to employ Indemnitee's counsel in any such Claim at Indemnitee's expense and (ii) if (A) the employment of counsel by Indemnitee has been previously authorized by the Company, (B) Indemnitee shall have reasonably concluded that

there may be a conflict of interest between the Company and Indemnitee in the conduct of any such defense, or (C) the Company shall not continue to retain such counsel to defend such Claim, then the reasonable fees and expenses of Indemnitee's counsel shall be at the expense of the Company. The Company shall have the right to conduct such defense as it sees fit in its sole discretion, including the right to settle any claim against Indemnitee without the consent of the Indemnitee, *provided, however*, that the Company shall not settle any Claim requiring the admission of guilt or responsibility by Indemnitee without Indemnitee's prior written consent, such consent to not be unreasonably withheld.

3. Additional Indemnification Rights; NonexclusivityScope. The Company hereby agrees to indemnify Indemnitee to the fullest extent permitted by Applicable Law, notwithstanding that such indemnification is not specifically authorized by the other provisions of this Agreement, the Company's Memorandum and Articles of Association or by statute. In the event of any change after the date of this Agreement in any Applicable Law, statute or rule which expands the right of a Delaware corporation to indemnify a member of its board of directors or an officer, employee, agent or fiduciary, it is the intent of the parties hereto that Indemnitee shall enjoy by this Agreement the greater benefits afforded by such change to the extent such change is not inconsistent with the law of the Cayman Islands. In the event of any change in any Applicable Law, statute or rule which narrows the right of a Delaware corporation to indemnify a member of its board of directors or an officer, employee, agent or fiduciary, such change, to the extent not otherwise required by such law, statute or rule to be applied to this Agreement, shall have no effect on this Agreement or the parties' rights and obligations hereunder except as set forth in Section 8(a) hereof.

(b) Nonexclusivity. The indemnification and advances provided by this Agreement shall be in addition to any rights to which Indemnitee may be entitled under the Company's Memorandum and Articles of Association, any agreement, any vote of stockholders or disinterested directors, or otherwise.

4. No Duplication of Payments. The Company shall not be liable under this Agreement to make any payment in connection with any Claim made against Indemnitee to the extent Indemnitee has otherwise actually received payment (under any insurance policy, Memorandum and Articles of Association or otherwise) of the amounts otherwise indemnifiable hereunder.

5. Partial Indemnification. If Indemnitee is entitled under any provision of this Agreement to indemnification by the Company for some or a portion of Expenses incurred in connection with any Claim, but not, however, for all of the total amount thereof, the Company shall nevertheless indemnify Indemnitee for the portion of such Expenses to which Indemnitee is entitled.

6. Mutual Acknowledgment. Both the Company and Indemnitee acknowledge that in certain instances, Federal law or applicable public policy may prohibit the Company from indemnifying its directors, officers, employees, agents or fiduciaries under this Agreement or otherwise. Indemnitee understands and acknowledges that as long as the Company is subject to the informational requirements of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"), the Company may be required to undertake with the Securities

and Exchange Commission to submit the question of indemnification to a court in certain circumstances for a determination of the Company's right under public policy to indemnify Indemnitee.

7. Liability Insurance. The Company shall, from time to time, make a good faith determination of whether or not it is practicable to obtain and maintain a policy or policies of insurance with reputable insurance companies providing the officers and directors of the Company with coverage for losses from wrongful acts, or to ensure the Company's performance of its indemnification obligations under this Agreement. In all policies of directors' and officers' liability insurance, Indemnitee shall be named as an insured in such a manner as to provide Indemnitee the same rights and benefits as are accorded to the most favorably insured of the Company's directors, if Indemnitee is a director; or of the Company's officers, if Indemnitee is not a director of the Company but is an officer; or of the Company's key employees, if Indemnitee is not an officer or director but is a key employee. Notwithstanding the foregoing, the Company shall have no obligation to obtain or maintain such insurance if the Company reasonably determines that such insurance is not reasonably available, if the premium costs for such insurance are disproportionate to the amount of coverage provided, if the coverage provided by such insurance is limited by exclusions so as to provide an insufficient benefit, or if Indemnitee is covered by similar insurance maintained by a subsidiary or parent of the Company. Among other considerations, the Company will weigh the costs of obtaining such insurance coverage against the protection afforded by such coverage.

8. Exceptions. Any other provision herein to the contrary notwithstanding, the Company shall not be obligated pursuant to the terms of this Agreement:

(a) Excluded Action or Omissions. To indemnify Indemnitee for Expenses resulting from acts, omissions or transactions for which Indemnitee is prohibited from receiving indemnification under this Agreement, the Company's Memorandum and Articles of Association, the law of the Cayman Islands, or Applicable Law; *provided, however*, that notwithstanding any limitation set forth in this Section 8(a) regarding the Company's obligation to provide indemnification and subject to Section 1(b), Indemnitee shall be entitled under Section 2 to receive Expense Advances hereunder with respect to any such Claim unless and until a court having jurisdiction over the Claim shall have made a final judicial determination (as to which all rights of appeal therefrom have been exhausted or lapsed) that Indemnitee has engaged in acts, omissions or transactions for which Indemnitee is prohibited from receiving indemnification under this Agreement or Applicable Law.

(b) Claims Initiated by Indemnitee. To indemnify or advance Expenses to Indemnitee with respect to Claims initiated or brought voluntarily by Indemnitee and not by way of defense, counterclaim or crossclaim, except (i) with respect to actions or proceedings brought to establish or enforce a right to indemnification under this Agreement or any other agreement or insurance policy or under the Company's Memorandum and Articles of Association now or hereafter in effect relating to Claims for Indemnifiable Events, (ii) in specific cases if the Board of Directors has approved the initiation or bringing of such Claim, or (iii) as otherwise required under the law of the Cayman Islands, regardless of whether Indemnitee ultimately is determined to be entitled to such indemnification, advance expense payment or insurance recovery, as the case may be;

(c) Lack of Good Faith. To indemnify Indemnitee for any expenses incurred by Indemnitee with respect to any proceeding instituted by Indemnitee to enforce or interpret this Agreement, if a court of competent jurisdiction in a final non-appealable decision determines that each and every of the material assertions made by Indemnitee in such proceeding was not made in good faith or was frivolous;

(d) Willful or Gross Negligence. To indemnify or advance Expenses to Indemnitee with respect to any Claim for an Indemnifiable Event if a court of competent jurisdiction in a final non-appealable decision determines that Indemnitee acted in a manner that was willfully or grossly negligent.

(e) Claims Under Section 16(b). To indemnify Indemnitee for expenses and the payment of profits arising from the purchase and sale by Indemnitee of securities in violation of Section 16(b) of the Exchange Act, or any similar successor statute if the Company is subject to the informational requirements of the Exchange Act and the provisions of Section 16(b) of the Exchange Act; *provided, however*, that notwithstanding any limitation set forth in this Section 8(d) regarding the Company's obligation to provide indemnification and subject to Section 1(b), Indemnitee shall be entitled under Section 2 to receive Expense Advances hereunder with respect to any such Claim unless and until a court having jurisdiction over the Claim shall have made a final judicial determination (as to which all rights of appeal therefrom have been exhausted or lapsed) that Indemnitee has violated said statute.

#### 9. Construction of Certain Phrases.

(a) For purposes of this Agreement, references to the "Company" shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger or other transaction which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, employees, agents or fiduciaries, so that if Indemnitee is or was a director, officer, employee, agent or fiduciary of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee, agent or fiduciary of another corporation, partnership, joint venture, employee benefit plan, trust or other enterprise, Indemnitee shall stand in the same position under the provisions of this Agreement with respect to the resulting or surviving corporation as Indemnitee would have with respect to such constituent corporation if its separate existence had continued.

(b) For purposes of this Agreement, references to "other enterprises" shall include employee benefit plans; references to "fines" shall include any excise taxes assessed on Indemnitee with respect to an employee benefit plan; and references to "serving at the request of the Company" shall include any service as a director, officer, employee, agent or fiduciary of the Company which imposes duties on, or involves services by, such director, officer, employee, agent or fiduciary with respect to an employee benefit plan, its participants or its beneficiaries; and if Indemnitee acted in good faith and in a manner Indemnitee reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan, Indemnitee shall be deemed to have acted in a manner "not opposed to the best interests of the Company" as referred to in this Agreement.

(c) For purposes of this Agreement a “Change in Control” shall be deemed to have occurred if, on or after the date of this Agreement, (i) any “person” (as such term is used in Sections 13(d) and 14(d) of the Exchange Act), other than a trustee or other fiduciary holding securities under an employee benefit plan of the Company acting in such capacity or a corporation owned directly or indirectly by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company, becomes the “beneficial owner” (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing more than 50% of the total voting power represented by the Company’s then outstanding Voting Securities, (ii) during any period of two consecutive years, individuals who at the beginning of such period constitute the Board of Directors of the Company and any new director whose election by the Board of Directors or nomination for election by the Company’s stockholders was approved by a vote of at least two thirds (2/3) of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof, or (iii) the stockholders of the Company approve a merger, consolidation or other transaction of the Company with any other corporation other than a merger, consolidation or other transaction which would result in the Voting Securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into Voting Securities of the surviving entity) at least 50% of the total voting power represented by the Voting Securities of the Company or such surviving entity outstanding immediately after such merger, consolidation or other transaction, or the stockholders of the Company approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of (in one transaction or a series of related transactions) all or substantially all of the Company’s assets.

(d) For purposes of this Agreement, “Independent Legal Counsel” shall mean an attorney or firm of attorneys, selected in accordance with the provisions of Section 1(c) hereof, who shall not have otherwise performed services for the Company or Indemnitee within the last three years (other than with respect to matters concerning the rights of Indemnitee under this Agreement, or of other indemnitees under similar indemnity agreements).

(e) For purposes of this Agreement, a “Reviewing Party” shall mean any appropriate person or body consisting of a member or members of the Company’s Board of Directors or any other person or body appointed by the Board of Directors who is not a party to the particular Claim for which Indemnitee is seeking indemnification, or Independent Legal Counsel.

(f) For purposes of this Agreement, “Voting Securities” shall mean any securities of the Company that vote generally in the election of directors.

(g) For the purposes of this Agreement, “Applicable Law” shall mean the General Corporation Law of the State of Delaware or any Federal statute, law, rule or regulation imposed on the parties by a Delaware court of law, in each case to the extent not inconsistent with the law of the Cayman Islands or the SEHK Listing Rules.

10. Period of Limitations. No legal action shall be brought and no cause of action shall be asserted by or in the right of the Company against Indemnitee, Indemnitee's estate, spouse, heirs, executors or personal or legal representatives after the expiration of two years from the date of accrual of such cause of action, and any claim or cause of action of the Company shall be extinguished and deemed released unless asserted by the timely filing of a legal action within such two-year period; *provided, however*, that if any shorter period of limitations is otherwise applicable to any such cause of action, such shorter period shall govern.

11. Counterparts. This Agreement may be executed in one or more counterparts, each of which shall constitute an original.

12. Binding Effect; Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of and be enforceable by the parties hereto and their respective successors, assigns, including any direct or indirect successor by purchase, merger, consolidation or otherwise to all or substantially all of the business and/or assets of the Company, spouses, heirs, and personal and legal representatives. The Company shall require and cause any successor (whether direct or indirect by purchase, merger, consolidation or otherwise) to all, substantially all, or a substantial part, of the business and/or assets of the Company, by written agreement in form and substance satisfactory to Indemnitee, expressly to assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform if no such succession had taken place. This Agreement shall continue in effect with respect to Claims relating to Indemnifiable Events regardless of whether Indemnitee continues to serve as a director, officer, employee, agent or fiduciary of the Company or of any other enterprise at the Company's request.

13. Attorneys' Fees. In the event that any action is instituted by Indemnitee under this Agreement or under any liability insurance policies maintained by the Company to enforce or interpret any of the terms hereof or thereof, Indemnitee shall be entitled to be paid all Expenses incurred by Indemnitee with respect to such action, regardless of whether Indemnitee is ultimately successful in such action, and shall be entitled to the advancement of Expenses with respect to such action, unless, as a part of such action, a court of competent jurisdiction over such action in a final non-appealable decision determines that each and every of the material assertions made by Indemnitee as a basis for such action was not made in good faith or was frivolous. In the event of an action instituted by or in the name of the Company under this Agreement to enforce or interpret any of the terms of this Agreement, Indemnitee shall be entitled to be paid all Expenses incurred by Indemnitee in defense of such action (including costs and expenses incurred with respect to Indemnitee's counterclaims and cross-claims made in such action), and shall be entitled to the advancement of Expenses with respect to such action, unless, as a part of such action, a court having jurisdiction over such action in a final non-appealable decision determines that each and every of Indemnitee's material defenses to such action was made in bad faith or was frivolous.

14. Notice. All notices and other communications required or permitted hereunder shall be in writing, shall be effective when given, and shall in any event be deemed to be given (a) five (5) days after deposit with the U.S. Postal Service or other applicable postal service, if delivered by first class mail, postage prepaid, (b) upon delivery, if delivered by hand, (c) one business day after the business day of deposit with Federal Express or similar overnight

courier, freight prepaid, or (d) one day after the business day of delivery by facsimile transmission, if delivered by facsimile transmission, with copy by first class mail, postage prepaid, and shall be addressed if to Indemnitee, at the Indemnitee's address as set forth beneath Indemnitee's signature to this Agreement and if to the Company at the address of its principal corporate offices (attention: Chief Executive Officer) or at such other address as such party may designate by ten days' advance written notice to the other party hereto.

15. Consent to Jurisdiction; Agent for Service of Process. Each of the parties hereto irrevocably (a) agrees that any legal suit, action or proceeding arising out of or based upon this Agreement or the transactions contemplated hereby may be instituted in any state or federal court in the State of New York ("New York Court"), (b) waives, to the fullest extent it may effectively do so, any objection which it may now or hereafter have to the laying of venue of any such proceeding, and (c) submits to the exclusive jurisdiction of such courts in any such suit, action or proceeding. Each of the parties hereto irrevocably waives any immunity to jurisdiction to which it may otherwise be entitled or become entitled (including sovereign immunity, immunity to pre-judgment attachment, post-judgment attachment and execution) in any legal suit, action or proceeding against it arising out of or based on this Agreement or the transactions contemplated hereby which is instituted in any New York Court or in any competent court in Hong Kong or the People's Republic of China. The Company has appointed CT Corporation at 111 Eighth Avenue, New York, New York 10011, as its authorized agent (the "Authorized Agent") upon whom process may be served in any such action arising out of or based on this Agreement or the transactions contemplated hereby which may be instituted in any New York Court by Indemnitee, expressly consents to the jurisdiction of any such court in respect of any such action, and waives any other requirements of or objections to personal jurisdiction with respect thereto. Such appointment shall be irrevocable unless and until the Board of Directors appoints another entity to act as the Authorized Agent of the Company. The Company represents and warrants that the Authorized Agent has agreed to act as such agent for service of process and agrees to take any and all action, including the filing of any and all documents and instruments, that may be necessary to continue such appointment in full force and effect as aforesaid. Service of process upon the Authorized Agent and written notice of such service to the Company, shall be deemed, in every respect, effective service of process upon the Company.

16. Severability. The provisions of this Agreement shall be severable in the event that any of the provisions hereof (including any provision within a single section, paragraph or sentence) are held by a court of competent jurisdiction to be invalid, void or otherwise unenforceable, and the remaining provisions shall remain enforceable to the fullest extent permitted by law. Furthermore, to the fullest extent possible, the provisions of this Agreement (including, without limitations, each portion of this Agreement containing any provision held to be invalid, void or otherwise unenforceable, that is not itself invalid, void or unenforceable) shall be construed so as to give effect to the intent manifested by the provision held invalid, illegal or unenforceable.

17. Choice of Law. This Agreement shall be governed by and its provisions construed and enforced in accordance with the laws of the State of New York, as applied to contracts between New York residents, entered into and to be performed entirely within the State of New York, without regard to the conflict of laws principles thereof.



18. Subrogation. In the event of payment under this Agreement, the Company shall be subrogated to the extent of such payment to all of the rights of recovery of Indemnitee who shall execute all documents required and shall do all acts that may be necessary to secure such rights and to enable the Company effectively to bring suit to enforce such rights.

19. Amendment and Termination. Other than as provided herein, no amendment, modification, termination or cancellation of this Agreement shall be effective unless it is in writing signed by both the parties hereto, provided that any amendment to this Agreement must be made in compliance with the SEHK Listing Rules. No waiver of any of the provisions of this Agreement shall be deemed or shall constitute a waiver of any other provisions hereof (whether or not similar) nor shall such waiver constitute a continuing waiver.

20. Integration and Entire Agreement. This Agreement sets forth the entire understanding between the parties hereto and supersedes and merges all previous written and oral negotiations, commitments, understandings and agreements relating to the subject matter hereof between the parties hereto.

21. No Construction as Employment Agreement. Nothing contained in this Agreement shall be construed as giving Indemnitee any right to be retained in the employ of the Company or any of its subsidiaries.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first above written and agree that this Agreement supersedes the previous Indemnification Agreement between the same parties hereto dated the 18<sup>th</sup> Day of March, 2004, which is hereby terminated and shall hereafter be of no further force or effect.

SEMICONDUCTOR MANUFACTURING  
INTERNATIONAL CORPORATION,  
a Cayman Islands company

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Name:  
Title:  
Address:

AGREED TO AND ACCEPTED BY:

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(Signature of Indemnitee)

Name:

Address:

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List of Subsidiaries

<b>Name of Subsidiary</b>	<b>Jurisdiction of Incorporation</b>	<b>Names Under Which Subsidiary Does Business</b>
Semiconductor Manufacturing International (Shanghai) Corporation	PRC	Semiconductor Manufacturing International (Shanghai) Corporation
Semiconductor Manufacturing International (Beijing) Corporation	PRC	Semiconductor Manufacturing International (Beijing) Corporation
Semiconductor Manufacturing International (Tianjin) Corporation	PRC	Semiconductor Manufacturing International (Tianjin) Corporation

CERTIFICATIONS

I, Richard Ru Gin Chang, certify that:

1. I have reviewed this annual report on Form 20-F of Semiconductor Manufacturing International Corporation (the “Company”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b. [omitted pursuant to the guidance of Release No. 33-8238 (June 5, 2003), Release No. 33-8392 (February 2, 2004) and Release No. 33-8545 (March 2, 2005)];
  - c. Evaluated the effectiveness of the Company’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the Company’s internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting; and
5. The Company’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company’s auditors and the audit committee of Company’s board of directors (or persons performing the equivalent function):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company’s internal control over financial reporting.

Date: June 28, 2005

/s/ Richard Ru Gin Chang

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Name: Richard Ru Gin Chang  
Title: Chairman, Chief Executive Officer  
and President

CERTIFICATIONS

I, Morning Wu, certify that:

1. I have reviewed this annual report on Form 20-F of Semiconductor Manufacturing International Corporation (the “Company”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b. [omitted pursuant to the guidance of Release No. 33-8238 (June 5, 2003), Release No. 33-8392 (February 2, 2004) and Release No. 33-8545 (March 2, 2005)];
  - c. Evaluated the effectiveness of the Company’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation.
  - d. Disclosed in this report any change in the Company’s internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.; and
5. The Company’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company’s auditors and the audit committee of Company’s board of directors (or persons performing the equivalent function):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company’s internal control over financial reporting.

Date: June 28, 2005

/s/ Morning Wu

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Name: Morning Wu  
Title: Acting Chief Financial Officer

**EXHIBIT 13.1**

Pursuant to 18 United States Code §1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned hereby certify that, to the best of our knowledge, the annual report on Form 20-F for the fiscal year ended December 31, 2004 of Semiconductor Manufacturing International Corporation (the "Company") filed with the Securities and Exchange Commission on the date hereof (the "Report") fully complies with the requirements of Section 13(a), as applicable of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 28, 2005

/s/ Richard Ru Gin Chang

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Name: Richard Ru Gin Chang  
Title: Chairman, Chief Executive Officer and  
President

/s/ Morning Wu

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Name: Morning Wu  
Title: Acting Chief Financial Officer

The foregoing certification is being furnished solely pursuant to 18 United States Code §1350 and is not being filed as part of the Report.

SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPORATION

Report of Independent Registered Public Accounting Firm and Consolidated Financial Statements for the years ended December 31, 2004, 2003 and 2002

## INDEX TO FINANCIAL STATEMENTS

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## **Report of Independent Registered Public Accounting Firm**

To the Stockholders of Semiconductor Manufacturing International Corporation:

We have audited the accompanying consolidated balance sheets of Semiconductor Manufacturing International Corporation and its subsidiaries (the "Company") as of December 31, 2004, 2003 and 2002 and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for the years ended December 31, 2004, 2003 and 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2004, 2003 and 2002 and the results of its operations and its cash flows for the years ended December 31, 2004, 2003 and 2002 in conformity with accounting principles generally accepted in the United States of America.

*Certified Public Accountants*  
Hong Kong  
March 28, 2005  
(June 17, 2005 as to Note 29)

## Semiconductor Manufacturing International Corporation

CONSOLIDATED BALANCE SHEETS  
(In US dollars)

	NOTES	December 31,		
		2004	2003	2002
<b>ASSETS</b>				
Current assets:				
Cash and cash equivalents		\$ 607,172,570	\$ 445,276,334	\$ 91,864,301
Short-term investments	5	20,364,184	27,164,603	27,709,258
Accounts receivable, net of allowances of \$1,105,165 in 2004, \$114,473 in 2003 and \$236,851 in 2002	4	169,188,287	90,538,517	20,110,115
Inventories	6	144,017,852	69,923,879	39,825,934
Prepaid expense and other current assets		12,842,994	15,387,319	5,557,196
Assets held for sale	7	1,831,972	32,591,363	—
<b>Total current assets</b>		<b>955,417,859</b>	<b>680,882,015</b>	<b>185,066,804</b>
Land use rights, net	8	39,197,774	41,935,460	49,354,292
Plant and equipment, net	9	3,311,924,599	1,523,564,055	1,290,909,507
Acquired intangible assets, net	10	77,735,299	41,120,465	14,747,500
Investments held to maturity	5	—	3,004,724	—
<b>TOTAL ASSETS</b>		<b>\$4,384,275,531</b>	<b>\$2,290,506,719</b>	<b>\$1,540,078,103</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>				
Current liabilities:				
Accounts payable	11	\$ 364,333,613	\$ 211,762,334	\$ 154,208,515
Accrued expenses and other current liabilities		82,857,551	33,298,915	9,979,342
Short-term borrowings	14	91,000,000	—	3,624,597
Redeemable convertible promissory note	13	—	15,000,000	—
Current portion of long-term debt	14	191,986,372	—	—
Note payable to stockholder	12	—	27,018,043	50,000,000
Deposit received from stockholders	12	—	38,351,407	45,842,551
Income tax payable		152,000	—	—
<b>Total current liabilities</b>		<b>730,329,536</b>	<b>325,430,699</b>	<b>263,655,005</b>
Long-term liabilities:				
Redeemable convertible promissory note	13	—	—	14,204,721
Long-term debt	14	544,462,074	479,960,575	391,226,808
<b>Total long-term liabilities</b>		<b>544,462,074</b>	<b>479,960,575</b>	<b>405,431,529</b>
<b>Total liabilities</b>		<b>1,274,791,610</b>	<b>805,391,274</b>	<b>669,086,534</b>
Commitments	19			
Stockholders' equity:				
Series A convertible preference shares, \$0.0004 par value, nil, 1,000,000,000 and 1,000,000,000 shares authorized in 2004, 2003 and 2002, shares issued and outstanding nil in 2004, 954,977,374 in 2003 and 953,750,786 in 2002, respectively	16	—	381,990	381,499
Series A-1 non-convertible preference shares, \$0.00001 par value, nil, 1,000,000,000 and 1,000,000,000 shares authorized in 2004, 2003 and 2002, shares issued and outstanding nil in 2004, 219,499,674 in 2003 and 2002, respectively	16	—	2,195	2,195
Series A-2 convertible preference shares, \$0.0004 par				

value, nil, 42,373,000 and 42,373,000 authorized in 2004, 2003 and 2002 shares issued and outstanding and nil in 2004, 42,373,000 in 2003 and 2002, respectively	16	—	16,949	16,949
Series B convertible preference shares, \$0.0004 par value, nil, 50,000,000 and 50,000,000 authorized in 2004, 2003 and 2002, shares issued and outstanding nil in 2004, 2,350,000 in 2003 and 2002, respectively	16	—	940	940
Series C convertible preference shares, \$0.0004 par value, nil, 215,285,714 and nil authorized in 2004, 2003 and 2002, shares issued and outstanding nil in 2004, 181,718,858 in 2003 and nil in 2002, respectively	16	—	72,688	—
Series D convertible preference shares, \$0.0004 par value, nil, 122,142,857 and nil authorized in 2004, 2003 and 2002, shares issued and outstanding nil in 2004, 7,142,857 in 2003 and nil in 2002, respectively	16	—	2,857	—
Ordinary shares, \$0.0004 par value, 50,000,000,000, 22,454,944,800 and 14,423,730,000 shares authorized, shares in 2004, 2003 and 2002, shares issued and outstanding 18,232,179,139 in 2004, 242,595,000 in 2003 and 241,435,500 in 2002, respectively	16	7,292,872	97,038	96,570
Warrants	17	32,387	37,839,931	—
Additional paid-in capital		3,289,724,885	1,835,820,085	1,139,760,359
Subscription receivable from stockholders		—	(105,420,031)	(107,430,000)
Notes receivable from stockholders	17	(391,375)	(36,026,073)	(36,994,608)
Accumulated other comprehensive income		387,776	199,827	30,004
Deferred stock compensation		(51,177,675)	(40,582,596)	(20,843,113)
Accumulated deficit		(136,384,949)	(207,290,355)	(104,029,226)
<b>Total stockholders' equity</b>		<b>3,109,483,921</b>	<b>1,485,115,445</b>	<b>870,991,569</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>		<b>\$4,384,275,531</b>	<b>\$2,290,506,719</b>	<b>\$1,540,078,103</b>
Net current assets (liabilities)		\$ 225,088,323	\$ 355,451,316	\$ (78,588,201)
Total assets less current liabilities		\$3,653,945,995	\$1,965,076,020	\$1,276,423,098

The accompanying notes are an integral part of these consolidated financial statements.

Semiconductor Manufacturing International Corporation  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In US dollars)

	NOTES	Year ended December 31,		
		2004	2003	2002
Sales	20	\$ 974,664,696	\$ 365,823,504	\$ 50,315,345
Cost of sales		709,805,644	357,701,498	103,110,116
Cost of sales—Amortization of deferred stock compensation	17	11,595,131	5,539,275	2,127,822
<b>Gross profit (loss)</b>		<b>253,263,921</b>	<b>2,582,731</b>	<b>(54,922,593)</b>
<b>Operating expenses:</b>				
Research and development		78,167,336	32,070,123	37,459,380
General and administrative		46,015,039	27,911,791	17,781,998
Selling and marketing		8,129,592	9,446,819	4,371,243
Litigation settlement	22	23,153,105	—	—
Amortization of deferred stock compensation *	17	15,415,947	5,900,239	1,769,105
<b>Total operating expenses</b>		<b>170,881,019</b>	<b>75,328,972</b>	<b>61,381,726</b>
<b>Income (loss) from operations</b>	<b>25</b>	<b>82,382,902</b>	<b>(72,746,241)</b>	<b>(116,304,319)</b>
<b>Other income (expense):</b>				
Interest income		10,587,244	5,615,631	10,980,041
Interest expense		(13,697,894)	(1,424,740)	(176,091)
Foreign currency exchange gain		8,217,567	1,522,661	247,407
Others, net		2,441,057	888,189	2,650,049
<b>Total other income, net</b>		<b>7,547,974</b>	<b>6,601,741</b>	<b>13,701,406</b>
<b>Income (loss) before income tax</b>		<b>89,930,876</b>	<b>(66,144,500)</b>	<b>(102,602,913)</b>
Income tax – current	15	186,044	—	—
<b>Net income (loss)</b>		<b>89,744,832</b>	<b>(66,144,500)</b>	<b>(102,602,913)</b>
Deemed dividends on preference shares	27	18,839,426	37,116,629	—
<b>Income (loss) attributable to holders of ordinary shares</b>		<b>\$ 70,905,406</b>	<b>\$(103,261,129)</b>	<b>\$(102,602,913)</b>
<b>Income (loss) per share, basic</b>	<b>18</b>	<b>\$ 0.01</b>	<b>\$ (1.14)</b>	<b>\$ (1.27)</b>
<b>Income (loss) per share, diluted</b>	<b>18</b>	<b>\$ 0.00</b>	<b>\$ (1.14)</b>	<b>\$ (1.27)</b>
Shares used in calculating basic income (loss) per share	18	14,199,163,517	90,983,200	80,535,800
Shares used in calculating diluted income (loss) per share	18	17,934,393,066	90,983,200	80,535,800
<b>* Amortization of deferred stock compensation related to:</b>				
Research and development		\$ 5,138,402	\$ 2,842,775	\$ 794,506
General and administrative		8,023,343	1,793,185	569,419
Selling and marketing		2,254,202	1,264,279	405,180
<b>Total</b>		<b>\$ 15,415,947</b>	<b>\$ 5,900,239</b>	<b>\$ 1,769,105</b>

The accompanying notes are an integral part of these consolidated financial statements.





convertible preference share and Series D warrant for license agreements	—	—	2,064,419	22,932,724	—	—	—	—	—	25,000,000	
Exercise of employee stock options	12,000,500	4,800	—	4,129,250	—	968,535	—	—	—	5,103,572	
Repurchases of restricted shares	(10,841,000)	(4,332)	—	(1,502,889)	—	—	—	—	—	(1,507,717)	
Collection of subscription receivables from stockholders	—	—	—	—	107,009,969	—	—	—	—	107,009,969	
Deferred stock compensation, net	—	—	—	31,178,997	—	—	—	(19,739,483)	—	11,439,514	
Deemed dividend on preference shares	—	—	—	37,116,629	—	—	—	—	(37,116,629)	—	
Net loss	—	—	—	—	—	—	—	—	(66,144,500)	(66,144,500)	\$ (66,144,500)
Foreign currency translation adjustments	—	—	—	—	—	—	143,570	—	—	143,570	143,570
Unrealized gain on short-term investments	—	—	—	—	—	—	26,253	—	—	26,253	26,253
<b>Balance at December 31, 2003</b>	<b>242,595,000</b>	<b>97,038</b>	<b>37,839,931</b>	<b>1,835,820,085</b>	<b>(105,420,031)</b>	<b>(36,026,073)</b>	<b>199,827</b>	<b>(40,582,596)</b>	<b>(207,290,355)</b>	<b>1,485,115,445</b>	<b>\$ (65,974,677)</b>
Issuance of Series D convertible preference shares and Series D warrants to Motorola and MCEL	—	—	27,663,780	308,141,738	—	—	—	—	—	335,843,804	
Issuance of Series D preference shares in exchange for software licenses	—	—	—	5,059,891	—	—	—	—	—	5,060,256	
Issuance of series B convertible preference shares in exchange for intangible assets	—	—	—	2,739,553	—	—	—	—	—	2,739,853	
Issuance of Series B convertible preference shares to a service provider	—	—	—	45,085	—	—	—	—	—	45,090	
Conversion of preference share to ordinary shares upon initial public offering	14,927,787,480	5,971,115	(65,373,769)	59,917,012	—	—	—	—	—	—	
Issuance of ordinary shares upon initial public offering (net of issuance cost of US\$37,007,406)	3,030,303,000	1,212,121	—	1,015,647,030	—	—	—	—	—	1,016,859,151	
Redemption of Series A-1 preference shares	—	—	—	—	—	—	—	—	—	(2,195)	
Shares and warrants issued to a service provider	136,640	55	(97,555)	17,910	—	—	—	—	—	(79,590)	
Issuance of ordinary shares in exchange for equipment	23,957,830	9,583	—	5,212,597	—	—	—	—	—	5,222,180	
Exercise of stock options	20,766,689	8,307	—	1,590,804	—	—	—	—	—	1,599,111	
Repurchase of restricted ordinary shares	(13,367,500)	(5,347)	—	(851,592)	—	—	—	—	—	(856,939)	
Repurchase of restricted preference shares	—	—	—	(60,811)	—	—	—	—	—	(60,833)	



Collection of subscription receivable from stockholders	—	—	—	—	105,420,031	—	—	—	—	—	105,420,031	
Collection of note receivables from employees	—	—	—	—	—	35,634,698	—	—	—	—	35,634,698	
Deferred stock compensation, net	—	—	—	37,606,157	—	—	—	(10,595,079)	—	—	27,011,078	
Deemed dividend on preference shares	—	—	—	18,839,426	—	—	—	—	(18,839,426)	—	—	
Net income	—	—	—	—	—	—	—	—	—	89,744,832	89,744,832	\$ 89,744,832
Foreign currency translation adjustments	—	—	—	—	—	—	256,391	—	—	—	256,391	256,391
Unrealized gain on investments	—	—	—	—	—	—	(68,442)	—	—	—	(68,442)	(68,442)
<b>Balance at December 31, 2004</b>	<b>18,232,179,139</b>	<b>\$7,292,872</b>	<b>\$ 32,387</b>	<b>\$3,289,724,885</b>	<b>\$ —</b>	<b>\$ (391,375)</b>	<b>\$ 387,776</b>	<b>\$ (51,177,675)</b>	<b>\$(136,384,949)</b>	<b>\$3,109,483,921</b>	<b>\$ 89,932,781</b>	

Semiconductor Manufacturing International Corporation  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In US dollars)

	Year ended December 31,		
	2004	2003	2002
<b>Operating activities:</b>			
Income (loss) attributable to holders of ordinary shares	\$ 70,905,406	\$(103,261,129)	\$(102,602,913)
Deemed dividends on preference shares	18,839,426	37,116,629	—
<b>Net income (loss)</b>	<b>89,744,832</b>	<b>(66,144,500)</b>	<b>(102,602,913)</b>
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Gain on disposal of plant and equipment	(733,822)	(8,029)	—
(Reversal of) bad debt expense	990,692	(122,378)	236,851
Depreciation and amortization	456,960,522	233,904,866	84,536,761
Non-cash interest expense	—	795,279	176,091
Amortization of acquired intangible assets	14,368,025	3,461,977	990,000
Amortization of deferred stock compensation	27,011,078	11,439,514	3,896,927
Stock compensation from Series C convertible preference shares	—	2,707,201	—
Changes in operating assets and liabilities:			
Accounts receivable	(79,640,462)	(70,306,024)	(20,346,966)
Inventories	(74,093,973)	(30,097,945)	(35,076,935)
Prepaid expense and other current assets	2,551,664	(8,868,710)	(4,030,763)
Accounts payable	49,235,998	18,752,474	19,676,776
Income tax payable	152,000	—	—
Accrued expenses and other current liabilities	32,115,883	18,756,638	3,742,295
<b>Net cash provided by (used in) operating activities</b>	<b>518,662,437</b>	<b>114,270,363</b>	<b>(48,801,876)</b>
<b>Investing activities:</b>			
Purchase of plant and equipment	(1,838,773,389)	(453,097,184)	(761,704,038)
Purchase of acquired intangible assets	(7,307,996)	(3,585,000)	(11,860,000)
Purchase of short-term investments	(66,224,919)	(23,985,420)	(27,580,266)
Sale (purchase) of investments held to maturity	3,004,297	(3,004,724)	—
Sale of short-term investments	72,957,324	24,556,329	—
Proceeds received from sale of assets held for sale	8,215,128	4,562,934	—
Proceeds from disposal of plant and equipment	1,343,003	54,613	—
Decrease in restricted cash	—	—	50,000,000
<b>Net cash used in investing activities</b>	<b>(1,826,786,552)</b>	<b>(454,498,452)</b>	<b>(751,144,304)</b>

(Continued)

Semiconductor Manufacturing International Corporation  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In US dollars)

	Year ended December 31,		
	2004	2003	2002
<b>Financing activities:</b>			
Proceeds from short-term borrowings	91,000,000	30,000,000	3,624,597
Repayment of short-term borrowings	—	(33,624,597)	(102,973,518)
Repayment of note payable to stockholder for land use rights	(12,778,797)	(23,981,957)	—
Proceeds from long-term debt	256,487,871	88,733,767	391,226,808
Repayment of redeemable convertible promissory note	(15,000,000)	—	—
Proceeds from issuance of Series A convertible preference shares	—	—	15,000,000
Proceeds from issuance of Series A-2 convertible preference shares	—	—	50,000,140
Proceeds from exercise of Series A convertible preference share options	—	—	25,000,000
Proceeds from issuance of Series C convertible preference shares	—	530,216,072	—
Proceeds from issuance of Series D convertible preference shares	30,000,000	—	—
Proceeds from issuance of ordinary shares from initial public offering	1,016,859,151	—	—
Collection of subscription receivables, net	105,420,031	107,009,969	357,549,172
Proceeds from exercise of employee stock options	681,339	2,634,442	4,188,531
Collection of notes receivables from employees	35,245,774	—	—
Change in deposits received from stockholders	(38,151,407)	(7,491,144)	(30,690,470)
<b>Net cash provided by financing activities</b>	<b>1,469,763,962</b>	<b>693,496,552</b>	<b>712,925,260</b>
<b>Effect of exchange rate changes</b>	<b>256,389</b>	<b>143,570</b>	<b>(35,147)</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>161,896,236</b>	<b>353,412,033</b>	<b>(87,056,067)</b>
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<b>445,276,334</b>	<b>91,864,301</b>	<b>178,920,368</b>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<b>\$ 607,172,570</b>	<b>\$445,276,334</b>	<b>\$ 91,864,301</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>			
Income taxes paid	\$ 34,044	\$ 8,379	\$ 2,500
Interest paid	\$ 20,104,223	\$ 14,732,932	\$ 7,291,168

Semiconductor Manufacturing International Corporation  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In US dollars)

	Year ended December 31,		
	2004	2003	2002
<b>SUPPLEMENTAL DISCLOSURES OF NON - CASH INVESTING AND FINANCING ACTIVITIES</b>			
Series A convertible preference shares issued to investors for subscription receivable	\$ —	\$ —	\$95,500,000
Series B convertible preference shares issued in exchange for research and development technology	\$ —	\$ —	\$ 990,000
Redeemable convertible promissory note issued in exchange for equipment and intangible assets	\$ —	\$ —	\$15,000,000
Series C convertible preference shares issued to investors for subscription receivable	\$ —	\$105,000,000	\$ —
Issuance of Series C convertible preference share warrants	\$ —	\$ 35,645,570	\$ —
Note payable waived by stockholder in exchange for land use rights	\$ (14,239,246)	\$ —	\$ —
Series D convertible preference shares issued to acquire assets and assume liabilities from Motorola and MCEL	\$278,180,024	\$ 25,000,000	\$ —
Issuance of Series D convertible preference share warrants	\$ 27,663,780	\$ 2,064,419	\$ —
Deemed dividends on Series C and Series D convertible preference shares	\$ 18,839,426	\$ 37,116,629	\$ —
Series D convertible preference shares issued in exchange for certain software licenses	\$ 5,060,256	\$ —	\$ —
Series B convertible preference shares issued in exchange for acquired intangible assets	\$ 2,739,853	\$ —	\$ 2,887,500
Series B convertible preference shares issued to a service provider	\$ 45,090	\$ —	\$ —
Conversion of preference shares into ordinary shares upon initial public offering	\$ 5,971,115	\$ —	\$ —
Ordinary shares and warrants issued to a service provider	\$ (79,590)	\$ —	\$ —
Ordinary shares issued in exchange for equipment	\$ 5,222,180	\$ —	\$ —
Deferred stock compensation	\$ 10,595,079	\$ 19,739,483	\$16,157,784
Ordinary and preference shares issued in exchange for employee note receivable	\$ (388,924)	\$ (968,535)	\$29,101,441

The accompanying notes are an integral part of these consolidated financial statements.

Semiconductor Manufacturing International Corporation

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002  
(In US dollars)**

1. Organization and Principal Activities

Semiconductor Manufacturing International Corporation was incorporated under the laws of the Cayman Islands on April 3, 2000 and its subsidiaries as of December 31, 2004 include the following:

<u>Name of company</u>	<u>Place and date of incorporation/ establishment</u>	<u>Attributable equity interest held</u>	<u>Principal activity</u>
Garrison Consultants Limited ("Garrison")	Western Samoa April 3, 2000	100%	Provision of consultancy services
Betterway Enterprises Limited ("Betterway")	Western Samoa April 5, 2000	100%	Provision of marketing related activities
Semiconductor Manufacturing International (Shanghai) Corporation ("SMIS")*	The People's Republic of China (the "PRC") December 21, 2000	100%	Manufacturing and trading of semiconductor products
SMIC, Americas	United States of America June 22, 2001	100%	Provision of marketing related activities
Semiconductor Manufacturing International (Beijing) Corporation ("SMIB")*	The PRC July 25, 2002	100%	Manufacturing and trading of semiconductor products
SMIC Japan Corporation	Japan October 8, 2002	100%	Provision of marketing related activities
SMIC Europe S.R.L	Italy July 3, 2003	100%	Provision of marketing related activities
SMIC Consulting Corporation*	The PRC September 30, 2003	100%	Inactive
Semiconductor Manufacturing International (Tianjin) Corporation ("SMIT")*	The PRC November 3, 2003	100%	Manufacturing and trading of semiconductor products
Semiconductor Manufacturing International (AT) Corporation	Cayman Islands July 26, 2004	100%	Investment holding
Semiconductor Manufacturing International (Chengdu) Corporation ("SMICD")*	The PRC August 16, 2004	100%	Manufacturing and trading of semiconductor products

\* Companies registered as wholly foreign-owned enterprises in the PRC.

Semiconductor Manufacturing International Corporation and its subsidiaries (hereinafter collectively referred to as the "Company" or "SMIC") is mainly engaged in the computer-aided design, manufacturing, packaging, testing and trading of integrated circuits and other semiconductor services, and manufacturing design of semiconductor masks.

Semiconductor Manufacturing International Corporation

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002  
(In US dollars)**

2. Summary of significant accounting policies

(a) Basis of presentation

The consolidated financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

(b) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated upon consolidation.

(c) Use of estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenue and expenses in the financial statements and accompanying notes. Significant accounting estimates reflected in the Company's financial statements include inventory valuation, useful lives and commencement of productive use for plant and equipment and acquired intangible assets, accruals for sales adjustments and warranties, other liabilities and stock compensation expense.

(d) Certain significant risks and uncertainties

The Company participates in a dynamic high technology industry and believes that changes in any of the following areas could have a material adverse effect on the Company's future financial position, results of operations, or cash flows: changes in the overall demand for semiconductor manufacturing services; competitive pressures due to excess capacity or price reductions; advances and trends in new technologies and industry standards; changes in key suppliers; changes in certain strategic relationships or customer relationships; regulatory or other factors; risks associated with the ability to obtain necessary raw materials; and risks associated with the Company's ability to attract and retain employees necessary to support its growth.

(e) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and highly liquid investments which are unrestricted as to withdrawal or use, and which have maturities of three months or less when purchased.

Semiconductor Manufacturing International Corporation

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002  
(In US dollars)**

2. Summary of significant accounting policies - continued

(f) Investments

Short-term investments consisting primarily of mutual funds, corporate notes and corporate bonds are classified as available for sale and have been recorded at fair market value. Unrealized gains and losses are recorded as accumulated other comprehensive income (loss). Unrealized losses, which are deemed other than temporary, are recorded in the statement of operations as other expenses.

Debt securities with original maturities greater than one year are classified as long-term investments held to maturity.

(g) Concentration of credit risk

Financial instruments that potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short-term investments and accounts receivable. The Company places its cash and cash equivalents with reputable financial institutions.

The Company conducts credit evaluations of customers and generally does not require collateral or other security from its customers. The Company establishes an allowance for doubtful accounts based upon estimates, factors surrounding the credit risk of specific customers and other information.

(h) Inventories

Inventories are stated at the lower of cost (weighted average) or market.

Available manufacturing capacity is used to manufacture certain standard products. Adjustments are recorded to write down the cost of obsolete and excess inventory to the estimated market value based on historical and forecast demand. In 2004, 2003 and 2002, inventory was written down by \$10,506,374, \$nil and \$16,485,080, respectively, to reflect the lower of cost or market.

(i) Land use rights, net

Land use rights are recorded at cost less accumulated amortization. Amortization is provided over the term of the land use right agreement on a straight-line basis over the term of the agreements, which range from 50 to 70 years.

Semiconductor Manufacturing International Corporation

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002  
(In US dollars)**

2. Summary of significant accounting policies - continued

(j) Plant and equipment, net

Plant and equipment are carried at cost less accumulated depreciation and are depreciated on a straight-line basis over the following estimated useful lives:

Buildings	25 years
Facility, machinery and equipment	10 years
Manufacturing machinery and equipment	5 years
Furniture and office equipment	3-5 years
Transportation equipment	5 years

The Company constructs certain of its plant and equipment. In addition to costs under the construction contracts, external costs directly related to the construction of such facilities, including duties and tariffs, equipment installation and shipping costs, are capitalized. Depreciation is recorded at the time assets are placed in service.

(k) Acquired intangible assets

Acquired intangible assets, which consist primarily of technology and licenses, are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the expected useful lives of the assets of 5 to 10 years. The Company has determined that its intangible assets were not impaired at December 31, 2004. The Company has no goodwill as of December 31, 2004, 2003 and 2002.

(l) Impairment of long-lived assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may no longer be recoverable. When these events occur, the Company measures impairment by comparing the carrying value of the long-lived assets to the estimated undiscounted future cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flow is less than the carrying amount of the assets, the Company would recognize an impairment loss based on the fair value of the assets.



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002  
(In US dollars)**

2. Summary of significant accounting policies - continued

(m) 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.

(n) Capitalization of interest

Interest 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 \$7,531,038, \$7,090,635 and \$353,696, net of government subsidies of \$nil, \$7,220,000 and \$7,220,000 in 2004, 2003 and 2002, respectively, has been added to the cost of the underlying assets during the year and is amortized over the respective useful life of the assets. In 2004, 2003 and 2002, the Company recorded amortization expenses relating to the capitalized interest of \$1,681,089, \$307,954 and \$nil, respectively.

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(o) Government subsidies

The Company receives government subsidies in the following four forms:

(1) Reimbursement of certain interest costs incurred on borrowings

The Company has received government subsidies of \$nil, \$7,220,000 and \$7,220,000 in 2004, 2003 and 2002, respectively, which were calculated based on the interest expense on the Company's estimated borrowings. The Company records government subsidies as a reduction of capitalized interest for the year and any excess is recorded as other income in the year the cash is received from the government.

(2) Value added tax refunds

The Company has received subsidies of \$1,949,265, \$nil and \$nil in 2004, 2003 and 2002, respectively, for value added taxes paid by the Company in respect of export sales of semiconductor products. The value added tax refunds have been recorded as a reduction of the costs of sales.

(3) Government awards

The Company has received government awards of \$1,449,888, \$nil and \$nil in 2004, 2003 and 2002, respectively in recognition of the Company's efforts to attract and retain individuals with overseas experience in the high technology industry. The government recognition awards are recorded as other income in the statements of operations.

(4) Sales tax refunds

The Company has received sales tax refunds of \$573,992, \$nil and \$nil in 2004, 2003 and 2002, respectively, which are recorded as an offset of the general and administrative expenses.

(p) Research and development costs

Research and development costs are expensed as incurred.

(q) Start-up costs

In accordance with Statement of Position No. 98-5, "Reporting on the costs of start-up activities," the Company expenses all costs incurred in connection with start-up activities, including preproduction costs associated with new manufacturing facilities and costs incurred with the formation of the Company such as organization costs. Preproduction costs including the design, formulation and testing of new products or process alternatives are included in research and development expenses. Preproduction costs including facility and employee costs incurred in connection with constructing new manufacturing plants are included in general and administrative expenses.

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2. Summary of significant accounting policies - continued

(r) Foreign currency translation

The United States dollar ("US dollar") is used as the functional and reporting currency. Monetary assets and liabilities denominated in currencies other than the US dollar are translated into US dollar at the rates of exchange ruling at the balance sheet date. Transactions in currencies other than the US dollar during the year are converted into the US dollar at the applicable rates of exchange prevailing on the day transactions occurred. Transaction gains and losses are recognized in the statements of operations.

The financial records of certain of the Company's subsidiaries are maintained in local currencies other than the US dollar, such as Japanese Yen, which are their functional currencies. Assets and liabilities are translated at the exchange rates at the balance sheet date, equity accounts are translated at historical exchange rates and revenues, expenses, gains and losses are translated using the average rate for the year. Translation adjustments are reported as cumulative translation adjustments and are shown as a separate component of other comprehensive income (loss) in the statement of stockholders' equity.

(s) Income taxes

Deferred income taxes are recognized for temporary differences between the tax basis of assets and liabilities and their reported amount in the financial statements, net operating loss carry forwards and credits by applying enacted statutory tax rates applicable to future years. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Current income taxes are provided for in accordance with the laws of the relevant taxing authorities.

(t) Comprehensive income (loss)

Comprehensive income (loss) includes such items as foreign currency translation adjustments and unrealized gains/losses on short-term investments. Comprehensive income (loss) is reported in the statement of stockholders' equity.

(u) Fair value of financial instruments

Financial instruments include cash and cash equivalents, short-term investments, short-term borrowings and long-term debt. The carrying values of cash and cash equivalents, short-term investments and short-term borrowings approximate their fair values based on quoted market values or due to their short-term maturities. The carrying value of long-term debt approximates fair value due to variable interest rates that approximate market rates.

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2. Summary of significant accounting policies - continued

(v) 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 a compensation charge for 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 SFAS No. 123, "Accounting for Stock-Based Compensation," which requires the Company to record a charge for the services rendered by the non-employees using the Black-Scholes option pricing model. The Company's disclosures are in accordance with SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure."

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 No. 123, the Company's pro forma income (loss) would have been as follows:

	Year ended December 31,		
	2004	2003	2002
Income (loss) attributable to holders of ordinary shares	\$ 70,905,406	\$(103,261,129)	\$(102,602,913)
Add: Stock compensation as reported	27,011,078	11,439,514	3,896,927
Less: Stock compensation determined using the fair value method	(37,486,703)	(17,253,078)	(8,605,238)
Pro forma income (loss) attributable to holders of ordinary shares	\$ 60,429,781	\$(109,074,693)	\$(107,311,224)
Income (loss) per share:			
Basic-pro forma	\$ 0.00	\$ (1.20)	\$ (1.33)
Diluted-pro forma	\$ 0.00	\$ (1.20)	\$ (1.33)
Basic-as reported	\$ 0.01	\$ (1.14)	\$ (1.27)
Diluted-as reported	\$ 0.00	\$ (1.14)	\$ (1.27)

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.

	2004	2003	2002
Average risk-free rate of return	2.64%	2.94%	3.68%
Weighted average expected option life	0.5-4 years	4.0 years	4.0 years
Volatility rate	52.45%	67.99%	76.32%
Dividend yield (Preference share only)	0%	8%	8%

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2. Summary of significant accounting policies - continued

(w) Derivative financial instruments

The Company purchases foreign-currency forward exchange contracts with contract terms expiring within one year to protect against the adverse effect that exchange rate fluctuations may have on foreign-currency denominated purchase activities, principally the US dollar, Japanese Yen or European Euro. The foreign-currency forward exchange contracts do not qualify for hedge accounting. In 2004, 2003 and 2002, gains and losses on the foreign currency forward exchange contracts are recognized in the statement of operations. As of December 31, 2004, 2003 and 2002, the Company had outstanding foreign-currency forward exchange contracts with notional amounts of \$61,034,335, \$133,010,951 and \$43,111,666, respectively. Notional amounts are stated in the US dollar equivalents at spot exchange rates at the respective dates. As of December 31, 2004, the fair value of foreign-currency forward exchange contracts, which approximates \$283,344, is recorded in accrued expenses and other current liabilities.

Settlement currency	Notional amount	US dollar equivalents
<b>As of December 31, 2004</b>		
Japanese Yen	2,915,714,899	\$ 28,111,405
European Euro	20,042,037	27,313,288
US Dollar	46,428,200	5,609,642
		<b>\$ 61,034,335</b>
<b>As of December 31, 2003</b>		
Japanese Yen	6,250,900,000	\$ 58,445,915
European Euro	39,652,028	49,565,036
Renminbi	206,917,500	25,000,000
		<b>\$133,010,951</b>
<b>As of December 31, 2002</b>		
Japanese Yen	2,224,000,000	\$ 18,192,229
European Euro	25,079,949	24,919,437
		<b>\$ 43,111,666</b>

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2. Summary of significant accounting policies - continued

(x) Recently issued accounting standards

In January 2003, the Financial Accounting Standard Boards (“FASB”) issued FASB Interpretation No. 46, “Consolidation of Variable Interest Entities” (“FIN 46”). FIN 46 clarifies the application of Accounting Research Bulletin No. 51, “Consolidated Financial Statements” and provides guidance on the identification of entities for which control is achieved through means other than voting rights (“variable interest entities” or “VIEs”) and how to determine when and which business enterprise should consolidate the VIEs. This new model for consolidation applies to an entity in which either: (1) the equity investors (if any) lack one or more characteristics deemed essential to a controlling financial interest or (2) the equity investment at risk is insufficient to finance that entity’s activities without receiving additional subordinated financial support from other parties. Certain disclosure requirements of FIN 46 were effective for financial statements issued after January 31, 2003. In December 2003, the FASB issued FIN 46 (R) (Revised to address certain FIN 46 implementation issues). The Company did not have a special purpose entity and adopted the provisions in December 2004.

In December 2003, the Security and Exchange Commission (“SEC”) issued Staff Accounting Bulletin No.104, “Revenue Recognition” (“SAB 104”), which codifies, revises and rescinds certain sections of SAB 101, “Revenue Recognition in Financial Statements” in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB 104 did not have a material effect on the Company’s consolidated results of operations, financial position or cash flows.

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, Chapters 4”. This statement amends the guidance in Accounting Research Board (“ARB”) No.43, Chapters 4, “Inventory Pricing” to clarify the accounting for abnormal amounts of idle facility expenses, freight, handling costs, and wasted material (spoilage). This Statement requires that those items be recognized as current period charges. In addition, this Statement requires that allocation of fixed production overheads to the cost of conversion be based on the normal capacity of the production facilities. This Statement 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.

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2. Summary of significant accounting policies - continued

(x) Recently issued accounting standards - continued

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 expense. 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.

SFAS 123R will be effective for the Company's fiscal quarter beginning July 1, 2005, and requires the use of the Modified Prospective Application Method. Under this method SFAS 123R is applied to new awards and to awards 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.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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2. Summary of significant accounting policies - continued

(y) Income (loss) per share

Basic income (loss) per share is computed by dividing income (loss) attributable to holders of ordinary shares by the weighted average number of ordinary shares outstanding (excluding shares subject to repurchase) for the period. Diluted income (loss) per ordinary share reflects the potential dilution that could occur if securities or other contracts to issue ordinary shares were exercised or converted into ordinary shares. Ordinary share equivalents are excluded from the computation in loss periods as their effects would be antidilutive.

(z) Share 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 ordinary shares and stock options, have been adjusted retroactively, which gives effect to the share split.

3. Motorola Asset Purchase and License Agreements

On September 23, 2003, the Company entered into an agreement to acquire certain assets and assumed certain obligations from Motorola, Inc. ("Motorola") and Motorola (China) Electronics Limited ("MCEL"), a wholly owned subsidiary of Motorola in exchange for 82,857,143 Series D convertible preference shares convertible into ordinary shares at a conversion price of \$0.2087 per share and a warrant to purchase 8,285,714 Series D convertible preference shares for \$0.01 per share (the "Asset Purchase"). In addition, the Company issued 8,571,429 Series D convertible preference shares convertible into ordinary shares at a conversion price of US\$0.2087 per share and a warrant to purchase 857,143 Series D convertible preference shares for \$0.01 per share in exchange for \$30,000,000. The Company and Motorola completed the Asset Purchase on January 16, 2004.

In conjunction with the Asset Purchase, the Company and Motorola entered into an agreement to license certain technology and intellectual property. In exchange for these licenses, the Company agreed to issue Motorola an aggregate of 11,428,571 Series D convertible preference shares convertible into ordinary shares at a conversion price of \$0.2087 per share and a warrant to purchase 1,142,857 Series D convertible preference shares for \$0.01 per share. On December 5, 2003, the Company partially closed this license agreement with Motorola and issued to Motorola 7,142,857 Series D convertible preference shares and a warrant to purchase 714,286 Series D convertible preference shares at \$0.01 per share to. On January 16, 2004, the Company closed the license agreement with Motorola and issued to Motorola 4,285,714 series D convertible preference share and a warrant to purchase 428,571 Series D convertible preference shares at \$0.01 per share.



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4. 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 aged analysis of trade debtors is as follows:

	2004	2003	2002
Current	\$148,502,815	\$74,273,846	\$12,476,422
Overdue:			
Within 30 days	15,901,323	16,114,311	4,421,174
Between 31 to 60 days	2,656,964	118,220	2,929,532
Over 60 days	2,127,185	32,140	282,987
	<u>\$169,188,287</u>	<u>\$90,538,517</u>	<u>\$20,110,115</u>

5. Investments

The following is a summary of short-term available-for-sale securities:

December 31, 2004				
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Corporate note	\$10,000,000	\$ —	\$ —	\$10,000,000
Mutual fund	10,277,379	86,805	—	10,364,184
	<u>\$20,277,379</u>	<u>\$ 86,805</u>	<u>\$ —</u>	<u>\$20,364,184</u>
December 31, 2003				
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Corporate bond	\$ 3,023,938	\$ 12,462	\$ —	\$ 3,036,400
Mutual fund	23,985,420	142,783	—	24,128,203
	<u>\$27,009,358</u>	<u>\$155,245</u>	<u>\$ —</u>	<u>\$27,164,603</u>

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5. Investments - continued

	December 31, 2002			Fair value
	Cost	Gross unrealized gains	Gross unrealized losses	
Range note	\$10,000,000	\$109,500	\$ —	\$10,109,500
Corporate bond	3,125,414	26,814	—	3,152,228
Mutual fund	14,454,852	—	(7,322)	14,447,530
	\$27,580,266	\$136,314	\$ (7,322)	\$27,709,258

The cost and estimated fair value of the long-term debt securities held to maturity by contractual maturity, were as follows:

Maturity Date

	December 31, 2003	
	Cost	Estimated Fair Value
Due in 2-5 years	\$3,004,724	\$2,992,160

As of December 31, 2004 and 2002, the Company did not have any long-term debt securities.

6. Inventories

	2004	2003	2002
Raw materials	\$ 39,336,929	\$15,799,636	\$ 6,315,375
Work in progress	83,953,481	50,079,252	21,670,790
Finished goods	20,727,442	4,044,991	11,839,769
	\$144,017,852	\$69,923,879	\$39,825,934

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7. Assets held for sale

Assets held for sale represent residential real estate that the Company has constructed for its employees. During 2003, the Company decided to offer to sell this real estate to its employees over the next twelve months. Accordingly, the Company has classified the \$32,591,363 carrying value as assets held for sale. As of December 31, 2004, the Company has sold residential real estate with a carrying value of \$12,089,113 to employees and received cash payments of \$12,778,062, which resulted in a gain on disposition of \$688,949. The remaining balance of \$1,831,972 is pending receipt of the final government approvals for the sales. The Company has reclassified the unsold real estate units of \$18,670,278 to plant and equipment and recorded a cumulative adjustment for depreciation expense of \$1,155,623, representing depreciation that would have been recognized had the unsold real estate units been continuously classified as plant and equipment. The management has determined that the carrying value of assets reclassified did not exceed their fair value.

8. Land use rights, net

	2004	2003	2002
Land use rights (50-70 years)	\$42,412,453	\$44,136,870	\$50,999,055
Less: accumulated amortization	(3,214,679)	(2,201,410)	(1,644,763)
	<u>\$39,197,774</u>	<u>\$41,935,460</u>	<u>\$49,354,292</u>

9. Plant and equipment, net

	2004	2003	2002
Buildings	\$ 203,375,644	\$ 91,436,319	\$ 101,796,645
Facility, machinery and equipment	339,852,626	112,611,314	62,704,850
Manufacturing machinery and equipment	2,838,231,084	1,331,916,555	525,826,486
Furniture and office equipment	51,932,370	27,840,169	18,852,348
Transportation equipment	1,324,144	769,227	727,565
	<u>3,434,715,868</u>	<u>1,564,573,584</u>	<u>709,907,894</u>
Less: accumulated depreciation and amortization	(772,416,194)	(315,993,086)	(84,346,253)
Construction in progress	649,624,925	274,983,557	665,347,866
	<u>\$3,311,924,599</u>	<u>\$1,523,564,055</u>	<u>\$1,290,909,507</u>

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10. Acquired intangible assets, net

	2004	2003	2002
<b>Cost:</b>			
Technology	\$ 5,782,943	\$ 5,817,442	\$ 6,677,500
Licenses	85,719,858	34,702,500	4,997,500
Patent licenses	4,062,500	4,062,500	4,062,500
	<u>\$ 95,565,301</u>	<u>\$44,582,442</u>	<u>\$15,737,500</u>
<b>Accumulated Amortization:</b>			
Technology	(2,451,817)	(1,218,750)	(990,000)
Licenses	(13,637,114)	(870,536)	—
Patent licenses	(1,741,071)	(1,372,691)	—
	<u>(17,830,002)</u>	<u>(3,461,977)</u>	<u>(990,000)</u>
<b>Acquired intangible assets, net</b>	<u>\$ 77,735,299</u>	<u>\$41,120,465</u>	<u>\$14,747,500</u>

2004

The Company issued 4,285,714 Series D convertible preference shares and a warrant to purchase 428,571 Series D convertible preference shares at \$0.01 per share in exchange for certain licenses from Motorola, which was valued at \$15,000,000 (see Note 3).

The Company issued 914,285 Series D convertible preference shares to a strategic technology partner in exchange for certain software licenses, which was valued at \$5,060,256.

The Company entered into various other license agreements with third parties whereby the Company purchased licenses for \$28,217,249.

2003

The Company issued a warrant to purchase 57,143 Series B convertible preference shares for an intellectual property development license which was valued at \$129,942 as of December 31, 2003. In conjunction with the intellectual property development license agreement, the Company would redeem the warrant in increments when the contractual party (“service provider”) meets certain predetermined milestones stipulated in the agreement. In 2004, upon attaining certain milestones, the Company issued 12,343 shares of Series B convertible preference shares valued at \$45,090 and 136,640 ordinary shares valued at \$17,965, respectively, to the service provider. As of December 31, 2004, the warrant to purchase 359,300 ordinary shares was valued at \$32,387.

The Company issued 7,142,857 Series D convertible preference shares and a warrant to purchase 714,286 Series D convertible preference shares at \$0.01 per share in exchange for certain licenses from Motorola, which was valued at \$25,000,000 (see Note 13).

The Company entered into various other license agreements with strategic partners whereby the Company purchased licenses \$4,705,000.

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10. Acquired intangible assets, net - continued

2002

The Company entered into a technology agreement with a strategic partner. The Company paid \$110,000 for the rights to certain software products.

The Company entered into a technology agreement with a strategic partner. The Company issued 600,000 Series B convertible preference shares with an estimated fair value of \$990,000 in exchange for development of process technology by the strategic partner and expensed this amount over the development period in 2002.

The Company entered into a technology license transfer agreement with a strategic partner. The Company paid \$4,750,000 and issued 83,333 Series B convertible preference shares valued at \$137,500 in exchange for certain licenses. Upon the earlier to occur of (i) achievement of accumulated sales of an agreed upon number of wafers using this technology or (ii) the Company's filing of its registration statement relating to its initial public offering, the Company is required under the technology license transfer agreement to pay the strategic partner an additional \$250,000 and issue 750,000 Series B convertible preference shares with an exercise price of \$3.00 per share. Upon the achievement of accumulated sales of an additional number of wafers using this technology, the Company is further required under the agreement to issue the strategic partner 833,334 Series B convertible preference shares with an exercise price of \$3.00 per share. In March 2004, the Company paid \$250,000 and issued 750,000 shares of Series B convertible preference shares with a fair value of \$2,739,853 upon attaining certain milestones.

The Company entered into an agreement with a strategic partner whereby the Company purchased equipment and technology and patent licenses in exchange for a cash payment of \$15,000,000, 1,666,667 shares of Series B convertible preference shares valued at \$2,750,000 and a \$15,000,000 redeemable convertible promissory note (see Note 13).

All acquired technology intangible assets are generally amortized over a period of 5 years. Occasionally, licenses for advanced technologies are amortized over longer periods up to 10 years. The Company recorded amortization expense of \$14,368,025, \$3,461,977 and \$990,000 in 2004, 2003 and 2002, respectively. The Company will record amortization expenses related to the acquired intangible assets of \$19,732,972, \$19,732,972, \$18,553,305, \$15,039,744 and \$4,676,306 for 2005, 2006, 2007, 2008 and 2009, respectively.

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11. Accounts payable

An aged analysis of the accounts payable is as follows:

	2004	2003	2002
Current	\$307,396,991	\$184,834,802	\$140,368,129
Overdue:			
Within 30 days	38,803,625	17,666,570	3,194,757
Between 31 to 60 days	4,351,844	3,397,082	6,764,627
Over 60 days	13,781,153	5,863,880	3,881,002
	<u>\$364,333,613</u>	<u>\$211,762,334</u>	<u>\$154,208,515</u>

12. Deposit received from stockholders and note payable to stockholder

During 2003 and 2002, the Company received subscription deposits from existing and potential investors to secure the future purchase of the Company's convertible preference shares. The Company converted the deposits as partial purchase consideration of convertible preference shares. The Company incurred interest expense of \$nil, \$147,779 and \$nil in 2004, 2003 and 2002.

During 2001, the Company purchased land use rights from a stockholder for \$50,000,000 in exchange for a note payable. The Company has repaid \$22,981,957 in 2003 and \$12,778,797 in 2004. The remaining balance was waived by the stockholder.

13. Redeemable convertible promissory note

In 2002, the Company entered into a technology transfer agreement with a third party whereby the Company acquired technology and patent licenses in exchange for \$15,000,000, 1,666,667 Series B convertible preference shares valued at \$2,750,000 and a \$15,000,000 non-interest bearing redeemable convertible promissory note which is callable by the holder. The Company has recorded a discount for the imputed interest on the redeemable convertible promissory note which has been recorded as a direct reduction of the face amount of the note. The Company calculated the discount using an effective interest rate of 3.69%, resulting in a discount of \$971,370. In January 2004, the Company redeemed the convertible promissory note in cash. In 2004, 2003 and 2002, the Company recorded interest expense of \$nil, \$795,279 and \$176,091 relating to the amortization of the discount, respectively.

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14. Indebtedness

Short-term and long-term debt is as follows:

	2004	2003	2002
Short-term borrowings from commercial bank (a)	\$ 91,000,000	\$ —	\$ —
Short-term borrowings from government (b)	—	—	3,624,597
	<u>\$ 91,000,000</u>	<u>\$ —</u>	<u>\$ 3,624,597</u>
Long-term debt(c):			
2005	\$191,986,372	\$191,984,230	\$156,490,723
2006	265,267,355	191,984,230	156,490,723
2007	169,273,861	95,992,115	78,245,362
2008	73,280,572	—	—
2009	36,640,286	—	—
	<u>736,448,446</u>	<u>479,960,575</u>	<u>391,226,808</u>
Less: current maturities of long-term debt	191,986,372	—	—
Non-current maturities of long-term debt	<u>\$544,462,074</u>	<u>\$479,960,575</u>	<u>\$391,226,808</u>

(a) Short-term borrowings from commercial bank

As of December 31, 2003, the Company had five short-term agreements that provided borrowings totalling up to \$210,615,750 on a revolving credit basis. At December 31, 2003, the Company has not borrowed under these agreements. Borrowings under the credit agreements are unsecured. The interest expense incurred in 2003 was \$111,533, which was capitalized as additions to assets under construction. The average interest rate on the loan was 2.47% in 2003.

As of December 31, 2004, the Company had seven short-term credit agreements that provided total credit facilities up to \$253,000,000 on a revolving credit basis. As of December 31, 2004, the Company had drawn down \$91,000,000 under these credit agreements and \$162,000,000 is available for future borrowings. The outstanding borrowings under the credit agreements are unsecured. The interest expense incurred in 2004 was \$360,071. The interest rate on the loan ranged from 1.77% to 3.57% in 2004.

(b) Short-term borrowings from government

In 2002, the Company entered into an interest free short-term loan with Beijing Economic Technological Investment Development Corp., in an amount of \$3,624,597. As of December 31, 2003, the loan has been repaid. The Company has not recorded a discount resulting from the imputed interest on the non-interest bearing short-term borrowings as management believes it does not materially impact the Company's financial position, cash flows and results of operations.

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14. Indebtedness - continued

(c) Long-term debt

In December 2001, the Company entered into a long-term debt agreement for \$432,000,000. The withdrawal period of the facility was 18 months starting from the loan agreement date. As of December 31, 2004, the Company has fully utilized the loan amount. In 2004, the interest rate on the loan ranges from 2.82% to 4.34%. The interest payment is due on a semi-annual basis. The principal amount is repayable starting in March 2005 in five semi-annual installments of \$86,400,000. The interest expense incurred in 2004, 2003 and 2002 was \$14,014,698, \$12,326,043 and \$6,618,541, respectively, of which \$6,396,254, \$11,921,430 and \$6,618,541 was capitalized as additions to assets under construction in 2004, 2003 and 2002, respectively.

The Company had a RMB denominated line of credit of RMB396,960,000 (\$47,966,466) in 2001, with the same financial institutions. As of December 31, 2004, the Company has fully drawn on the line of credit. The interest rate for the loan is calculated based on the basic rate of a five-year term loan published by the People's Bank of China. The principal amount is repayable starting in March 2005 in five semi-annual installments of \$9,593,289. The annual interest rate on the loan was 5.02% in 2004. The interest expense incurred in 2004, 2003 and 2002 was \$2,451,885, \$2,354,741 and \$428,334, respectively, of which \$1,134,784, \$2,277,672 and \$428,334 was capitalized as additions to assets under construction in 2004, 2003 and 2002, respectively.

In January 2004, the Company entered into the second phase long-term facility arrangement for \$256,482,000 with the same financial institutions. As of December 31, 2004, the Company has fully utilized the loan. In 2004, the interest rate on the loan ranged from 2.75% to 4.34%. The interest payment is due on a semi-annual basis. The principal amount is repayable starting in March 2006 in seven semi-annual installments of \$36,640,286. The interest expense incurred in 2004 was \$3,890,105, of which nil was capitalized as additions to assets under construction in 2004.

In connection with the second phase long-term facility arrangement, the Company has a RMB denominated line of credit of RMB235,678,000 (\$28,476,030). As of December 31, 2004, the Company has no borrowings on this line of credit.

The long-term debt arrangements contain financial covenants as defined in the loan agreement. The Company has met these covenants at December 31, 2004.

The total outstanding balance of long-term debt is collateralized by certain plant and equipment at the original cost of \$2,024,799,202 at December 31, 2004.



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15. 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. In 2004, the Company's US subsidiary has recorded current income tax expense of \$186,044 resulting from certain non-deductible stock-based compensation being allocated to such entity. The Company had minimal taxable income in Japan and Europe.

The principal components of the temporary differences are as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Temporary differences may generate deferred tax assets are as follows:			
Allowances and reserves	\$ 11,824,717	\$ 328,558	\$16,721,931
Warranty reserve	1,875,476	—	—
Capitalized interest	—	—	892,210
Start-up costs	32,490,503	6,878,762	6,441,242
Net operating loss carry forwards	32,216,296	84,473,312	67,282,681
Other	56,622	—	326,917
	<u>\$ 78,463,614</u>	<u>\$91,680,632</u>	<u>\$91,664,981</u>
Temporary differences may generate deferred tax liabilities are as follows:			
Capitalized interest	\$(11,753,459)	\$(5,890,472)	\$ —
Unrealized exchange gain	—	(275,783)	—
Other	(146,767)	(53,430)	—
	<u>\$(11,900,226)</u>	<u>\$ (6,219,685)</u>	<u>\$ —</u>

No deferred taxes have been recorded relating to these differences as they are expected to reverse during the tax exemption period. The tax losses carried forward as at December 31, 2004 amounted to \$32,216,296 which were solely generated in PRC and will expire in 2009.

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16. Capital stock

In 2004, the Company issued:

- (1) 95,714,286 Series D convertible preference shares and a warrant to purchase 9,571,429 Series D convertible preference shares to acquire certain assets and assume certain obligations from Motorola with a fair value of \$335,843,804. The accounting treatment requires a beneficial conversion feature on the Series D convertible preference shares to be calculated. The consideration received in the Series D offering was first allocated between the convertible instrument and the Series D warrant on a relative fair value basis. A calculation was then performed to determine the difference between the effective conversion price and the fair market value of the ordinary shares at the commitment date resulting in the recognition of a deemed dividend of \$18,839,426.
- (2) 914,285 Series D convertible preference shares to acquire certain software licenses with a fair value of \$5,060,256 from a strategic technology partner. (see Note 10)
- (3) 750,000 Series B convertible preference shares to a strategic partner with a fair value of \$2,739,853. (see Note 10)
- (4) 12,343 Series B convertible preference shares to a service provider which was valued at \$45,090. (see Note 10)
- (5) 3,030,303,000 ordinary shares in connection with the Initial Public Offering (the "IPO")
- (6) 136,640 ordinary shares to a service provider with a fair value of \$17,965. (see Note 10)
- (7) 23,957,830 ordinary shares to a supplier in exchange for certain equipment with a fair value of \$5,222,180.

In 2003, the Company issued:

- (1) 179,667,007 shares of Series C convertible preference shares and a warrant to purchase 17,966,662 Series C convertible preference shares to investors for \$628,034,568 (net of issuance costs of \$800,000), of which \$105,000,000 was outstanding as subscriptions receivable at December 31, 2003 representing 30,000,000 Series C convertible preference shares. In 2004, the Company received a cash payment of \$105,000,000 relating to the outstanding subscription receivable. The accounting treatment requires a beneficial conversion feature on the Series C convertible preference shares to be calculated. The proceeds received in the Series C offering were first allocated between the convertible instrument and the Series C warrant on a relative fair value basis. A calculation was then performed to determine the difference between the effective conversion price and the fair market value of the ordinary share at the commitment date resulting in the recognition of a deemed dividend of \$34,585,897.

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16. Capital stock - continued

- (2) 7,142,857 shares of Series D convertible preference shares and a warrant to purchase 714,286 Series D convertible preference shares for a license agreement with an estimated fair value of \$25,000,000. The accounting treatment requires a beneficial conversion feature on the Series D convertible preference shares to be calculated. The consideration received in the Series D offering were first allocated between the convertible instrument and the Series D warrant on a relative fair value basis. A calculation was then performed to determine the difference between the effective conversion price and the fair market value of the ordinary shares at the commitment date resulting in the recognition of a deemed dividend of \$1,942,163.
- (3) 332,993 shares of Series C convertible preference shares and a warrant to purchase 33,299 Series C convertible preference shares to investors for \$1,165,432. The accounting treatment requires a beneficial conversion feature on the Series C convertible preference shares to be calculated. The proceeds received in the Series C offering were first allocated between the convertible instrument and the Series C warrant on a relative fair value basis. A calculation was then performed to determine the difference between the effective conversion price and the fair market value of the ordinary share at the commitment date resulting in the recognition of a deemed dividend of \$588,569.
- (4) 1,718,858 shares of Series C convertible preference shares were issued to certain employees for \$6,016,072. These shares were issued at a price below their estimated fair-market value and, accordingly, the Company has recorded a compensation charge of \$2,707,201.

In 2002, the Company issued:

- (1) 99,450,994 shares of Series A convertible preference shares for \$110,500,000, of which \$95,500,000 was outstanding as subscription receivable at December 31, 2002 representing 85,950,859 Series A convertible preference shares. In 2003, the Company received a cash payment of \$95,079,969 relating to the outstanding subscription receivable leaving a balance of \$420,031 at December 31, 2003, representing 378,032 Series A convertible preference shares. In 2004, the Company received the remaining balance of \$420,031.
- (2) 42,373,000 shares of Series A-2 convertible preference shares for \$50,000,140.
- (3) 2,350,000 shares of Series B convertible preference shares as partial consideration for the purchase of certain intangible assets.
- (4) 22,500,222 shares of Series A convertible preference shares for cash consideration of \$25,000,000.

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16. Capital stock - continued

The outstanding Series A, Series A-2, Series B, Series C and Series D convertible preference shares (“convertible preference shares”) automatically converted into an aggregate of 14,927,787,480 shares of ordinary shares, upon the IPO. All outstanding warrants and options to purchase convertible preference shares automatically converted into warrants and options to purchase ordinary shares upon completions of the IOP. Prior to their conversion into ordinary shares, the holders of convertible preference shares were entitled to participate in all dividends paid to the common stockholders on an as converted base, when and if such dividends were declared by the Board. While the convertible preference shares were outstanding, the Company was not permitted to pay any dividend with regard to any share of ordinary shares of the Company unless and until all dividends on the convertible preference shares had been paid. The holders of convertible preference shares were entitled to the same voting rights as that of holders of ordinary shares. The Series A convertible preference share, Series A-2 convertible preference shares, Series B convertible preference shares, Series C convertible preference shares and Series D convertible preference shares had aggregate liquidation preference of \$1,302,060,139, \$58,000,162, \$7,050,000, \$686,897,283 and \$27,000,000, respectively, as of December 31, 2003 and had preferential rights relating to all ordinary shares.

Each Series A-1 preference share constitutes a separate class of non-transferable, non-voting, non-convertible, dividend-bearing, redeemable preference shares. The Company redeemed 219,499,674 shares of Series A-1 preference shares immediately prior to the completion of the initial public offering at the total redemption price of \$2,195.

17. Stock options

The Company’s employee stock option plans (the “Plans”) allow the Company to offer a variety of incentive awards to employees, consultants or external service advisors of the Company. Options to purchase 998,675,840 ordinary shares and 536,566,500 of Series A convertible preference shares are authorized under the Plans. Under the terms of the plans, options are generally granted at prices equal to the fair market value as estimated by the Board of Directors, expire 10 years from the date of grant and are amortized on a straight-line basis generally over 4 years. The Company has not issued stock options under the plans since the IPO. As of December 31, 2004, options to purchase 724,297,100 shares of ordinary shares were outstanding. As of December 31, 2004, options to purchase 267,516,471 ordinary shares were available for future grant.

In 2004, the Company adopted the 2004 Stock Option Plan (“2004 Option Plan”) whereby the Company grants stock options to attract, retain and motivate employees, directors and service providers. Following the completion of the IPO, the Company began issuing stock options solely through the 2004 Option Plan. Options to purchase 1,317,000,000 ordinary shares are authorized under the 2004 Option Plan. Under the terms of the 2004 Option Plan options are granted at the fair market value of the Company’s ordinary shares and expire 10 years from the date of grant. As of December 31, 2004, options to purchase 154,389,280 ordinary shares were outstanding. As of December 31, 2004, options to purchase 1,162,110,720 ordinary shares were available for future grants.

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17. Stock options - continued

In January 2004, the Company adopted the 2004 Equity Incentive Plan ("2004 EIP") whereby the Company provides additional incentives to the Company's employees, directors and external consultants through the issuance of restricted shares, restricted share units and stock appreciation rights to the participants at the discretion of the Board of Directors. Under the 2004 EIP, the Company is authorized to issue up to 2.5% of the issued and outstanding ordinary shares immediately following the closing of its initial public offering in March 2004, which was 455,409,330 ordinary shares. As of December 31, 2004, 111,953,914 restricted share units were outstanding and 343,455,416 ordinary shares were available for future grant through the issuance of restricted shares, restricted share units and stock appreciation rights.

For stock options granted prior to the initial public offering, the Company has obtained a valuation analysis performed by an independent appraiser to reassess the determination of the market value of the Company's ordinary and preference shares. The valuation analysis utilizes generally accepted valuation methodologies such as the income and market approach and discounted cash flow approach to value the Company's business. As a result, stock compensation expense was recorded for the difference between the market value of the ordinary and preference shares and the exercise price of the employee stock options. Subsequent to the initial public offering, options are granted at the fair market value of the ordinary share at the date of grant. Accordingly, there was no compensation charges generated from these option grants under APB 25.

The Company recorded a stock compensation expense of \$23,930,766, \$11,439,514 and \$3,896,927 in 2004, 2003 and 2002, respectively.

A summary of the stock option activity is as follows:

	Ordinary shares		Preference shares	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Options outstanding at January 1, 2002	129,906,500	\$ 0.01	18,862,150	\$ 1.12
Granted	248,413,800	\$ 0.03	25,893,280	\$ 1.11
Exercised	(68,032,000)	\$ 0.01	(30,154,250)	\$ 1.11
Cancelled	(19,989,900)	\$ 0.02	(1,740,090)	\$ 1.11
Options outstanding at December 31, 2002	290,298,400	\$ 0.02	12,861,090	\$ 1.12
Granted	244,001,200	\$ 0.06	1,289,350	\$ 1.11
Exercised	(12,000,500)	\$ 0.04	(2,467,900)	\$ 1.11
Cancelled	(41,518,620)	\$ 0.05	(1,379,200)	\$ 1.11
Options outstanding at December 31, 2003	480,780,480	\$ 0.04	10,303,340	\$ 1.12
Conversion from preference shares into ordinary shares upon initial public offering	103,033,400	\$ 0.11	(10,303,340)	\$ 1.11
Granted	437,160,230	\$ 0.19	—	—
Exercised	(19,366,689)	\$ 0.05	—	—
Cancelled	(122,921,041)	\$ 0.10	—	—
Options outstanding at December 31, 2004	878,686,380	\$ 0.10	—	—

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17. Stock options - continued

The weighted average per-share fair value of options as of the grant date was as follows:

	2004	2003	2002
Ordinary shares	\$0.17	\$0.13	\$0.04
Preference shares	—	\$0.70	\$0.55

The following table summarizes information with respect to stock options outstanding at December 31, 2004:

	Options outstanding			Options exercisable	
	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercise price
Ordinary shares:					
\$0.01	102,342,800	6.82 years	\$ 0.01	28,732,650	\$ 0.01
\$0.02	72,638,840	7.37 years	\$ 0.02	7,409,930	\$ 0.02
\$0.05	201,317,170	8.09 years	\$ 0.05	10,230,750	\$ 0.05
\$0.10-0.11	271,527,600	8.38 years	\$ 0.10	47,493,718	\$ 0.11
\$0.20-0.28	184,792,220	9.45 years	\$ 0.24	125,000	\$ 0.26
\$0.31-0.35	46,067,750	9.18 years	\$ 0.35	45,466,750	\$ 0.34
	878,686,380			139,458,798	

*Options to non-employees*

The Company granted 23,960,000, 200,000 and 1,300,000 options to purchase ordinary shares and Nil, 15,750 and 51,200 options to purchase preference shares to its external consultants in exchange for certain services in 2004, 2003 and 2002, respectively. The Company recorded a stock compensation expense of \$765,557, \$26,296 and \$23,383 in 2004, 2003 and 2002, respectively, estimated on the basis of the Black-Scholes option pricing model with the following assumptions:

	2004	2003	2002
Average risk free rate of return	2.64%	2.94%	3.68%
Weighted average contractual option life	0.5-4 years	4 years	4 years
Volatility rate	52.45%	67.99%	76.32%
Dividend yield (Preference shares only)	—	8%	8%

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17. Stock options - continued

*Restricted share units*

In 2004 pursuant to the 2004 EIP, the Company granted 118,190,824 restricted share units, most of which vest over a period of 4 years. The fair value of the restricted share units at the date of grant was \$26,001,981, which is expensed over the vesting period. As a result, the Company has recorded a compensation expense of \$3,080,312 in 2004. The total restricted share units outstanding and unvested as December 31, 2004 were 111,953,914.

*Warrants to investors*

- (1) In January 2004, the Company granted Motorola a warrant to purchase 9,571,428 Series D convertible preference shares (see Notes 3&10). The warrant had an exercise price of \$0.01 per share and shall become exercisable after March 31, 2005, but only if a qualified public offering was not completed prior to such date. The fair value of the warrant was approximately \$27,663,780 at the grant date, estimated on the basis of the Black-Scholes option pricing model with the following assumptions:

	<u>2004</u>
Expected volatility	57%
Risk-free interest rate	2%
Expected dividend payment rate as a percentage of the stock price on the date of grant	Nil
Contractual life of the warrant	1.25 years

In March 2004, the Company completed its initial public offering with an offering price of \$0.35 per share. Accordingly, the warrant expired without being exercised.

- (2) Pursuant to the license agreements dated December 5, 2003 between the Company and Motorola (see Notes 3 & 10), the Company granted Motorola a warrant to purchase 714,286 Series D convertible preference shares. The warrants have an exercise price of \$0.01 per share and shall become exercisable after March 31, 2005, but only if a qualified public offering is not completed prior to such. The fair value of the warrant was approximately \$2,064,419 at the grant date, estimated on the basis of the Black-Scholes option pricing model with the following assumptions:

	<u>2003</u>
Expected volatility	57%
Risk-free interest rate	2%
Expected dividend payment rate as a percentage of the stock price on the date of grant	Nil
Contractual life of the warrant	1.25 years

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17. Stock options - continued

*Warrants to investors - continued*

In March 2004, the Company completed its initial public offering with an offering price of \$0.35 per share. Accordingly, the warrant expired without being exercised.

- (3) On November 20, 2003, the Company granted to one of its stockholders a warrant to purchase 33,299 Series C convertible preference shares. The warrant has an exercise price of \$0.01 per share and becomes exercisable after March 31, 2005, but only if a qualified public offering is not completed prior to such date. The fair value of the warrant was approximately \$93,743 at the grant date, estimated on the basis of the Black-Scholes option pricing model with the following assumptions:

	<u>2003</u>
Expected volatility	57%
Risk-free interest rate	2%
Expected dividend payment rate as a percentage of the stock price on the date of grant	Nil
Contractual life of the warrant	1.25 years

In February 2005, holders of the warrants to purchase Series C convertible preference shares agreed to amend such warrants to provide that the warrants were terminated effective upon completion of the IPO.

- (4) Pursuant to the terms of the Series C convertible preference share agreement dated on September 8, 2003 between the Company and its stockholders, the Company has granted warrants to purchase 17,966,662 Series C convertible preference shares. The warrants have an exercise price of \$0.01 per share and shall become exercisable after March 31, 2005, but only if a qualified public offering is not completed prior to such date. The fair value of the warrants was approximately \$35,551,827 at the grant date, estimated on the basis of the Black-Scholes option pricing model with the following assumptions:

	<u>2003</u>
Expected volatility	70%
Risk-free interest rate	3%
Expected dividend payment rate as a percentage of the stock price on the date of grant	Nil
Contractual life of the warrant	1.50 years



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18. Stock options - continued

In February 2005, holders of the Company's Series C convertible preference shares agreed to amend such warrants to provide that the warrants were terminated effective upon completion of the initial public offering in March 2004.

*Other warrants*

In 2003, the Company entered into an intellectual property development license agreement with a service provider. The service provider has granted the Company a 10 year license to use its related technology in connection with the design of certain products. In exchange for the license SMIC granted a warrant to purchase 57,143 Series B convertible preference shares at \$0.35 per share. SMIC will issue the Series B convertible preference shares upon the achievement of certain test results, delivery of certain design and circuit schematics and certain other predetermined development milestones. In 2004, the Company issued 12,343 Series B convertible preference shares and 136,640 ordinary shares valued at \$45,090 and \$17,965, respectively, upon attaining certain milestones. As of December 31, 2004, the warrant to purchase 359,300 ordinary shares is outstanding. Accordingly, the fair market value of the warrant has been recorded at December 31, 2004 and will continue to be recorded until the service provider completes the remaining milestone, at which time each warrant relating to the completed milestone is adjusted for the last time to its then-current fair value.

The fair value of the warrant was approximately \$32,387 and \$129,942 at December 31, 2004 and 2003 estimated on the basis of the Black-Scholes option pricing model with the following assumptions:

	<u>2004</u>	<u>2003</u>
Expected price volatility range	52%	60%
Risk-free interest rate	4.1%	4.5%
Expected dividend payment rate as a percentage of the stock price on the date of grant	Nil	Nil
Contractual life of the warrant	8.53 years	10 years

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17. Stock options - continued

*Option to investors*

Pursuant to the terms of the Series A convertible preference share agreement dated in September 2001 between the Company and certain of its shareholders, as amended (the "Purchase Agreement"), the Company granted to certain investors an option (the "Option") to purchase an aggregate of \$35,000,000 worth of Series A convertible preference shares on the same terms and conditions as those purchased by the other investors (as defined in the Purchase Agreement). The fair value of the Option was approximately \$5,757,881 at the grant date, estimated on the basis of the Black-Scholes option pricing model with the following assumptions.

	<u>2003</u>
Expected volatility	60%
Risk-free interest rate	3%
Expected dividend payment rate as a percentage of the stock price on the date of grant	Nil
Contractual life of stock option	0.75 year

In 2002, the investors exercised an option for cash consideration of \$25,000,000 for 22,500,222 of Series A convertible preference shares. The remaining outstanding options expired on June 30, 2002.

*Notes receivable from employees*

At December 31, 2004, 2003 and 2002, the Company had notes receivable from employees related to the early exercise of employee stock options in the aggregate amount of \$391,375, \$36,026,073 and \$36,994,608, respectively. In 2004, the Company collected \$35,245,774 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 and preference shares. The notes are due at various dates from year 2006 to 2008 and payable at varying rates from 3.02% to 4.28% per annum.

In 2004, 2003 and 2002, the notes earned interest in the aggregate amount of \$641,173, \$1,223,552 and \$669,714, respectively. At December 31, 2004, 2003 and 2002 the Company has the following shares subject to repurchase:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Ordinary shares	203,973,224	159,288,650	144,676,450
Preference shares	Nil	28,890,560	20,318,093

Semiconductor Manufacturing International Corporation

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18. Income (loss) per share

The following table sets forth the computation of basic and diluted income (loss) per share for the years indicated:

	2004	2003	2002
Income (loss) attributable to holders of ordinary shares	\$ 70,905,406	\$(103,261,129)	\$(102,602,913)
Basic and diluted:			
Weighted average ordinary shares outstanding	14,441,917,246	241,594,670	219,117,580
Less: Weighted average ordinary shares outstanding subject to repurchase	(242,753,729)	(150,611,470)	(138,581,780)
Weighted average shares used in computing basic income (loss) per share	14,199,163,517	90,983,200	80,535,800
Effect of dilutive securities:			
Weighted average preference shares outstanding	3,070,765,738	—	—
Weighted average ordinary shares outstanding subject to repurchase	242,753,729	—	—
Warrants	102,323,432	—	—
Stock options	264,409,484	—	—
Restricted shares units	54,977,166	—	—
Weighted average shares used in computing diluted income (loss) per share	17,934,393,066	90,983,200	80,535,800
Basic income (loss) per share	\$ 0.01	\$ (1.14)	\$ (1.27)
Diluted income (loss) per share	\$ 0.00	\$ (1.14)	\$ (1.27)

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.

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18. Reconciliation of basic and diluted income (loss) per share - continued

As of December 31, 2004, the Company had 75,769,953 ordinary share equivalents outstanding that could have potentially diluted income per share in the future, but which were excluded in the computation of diluted income per share in the period, as their exercise prices were above the average market values in such period.

As of December 31, 2003 and 2002, the Company had 14,210,425,630 and 10,450,524,300 of ordinary share equivalents outstanding, respectively, that could have potentially diluted loss per share in the future, but which were excluded in the computation of diluted loss per share in 2003 and 2002, as their effect would have been antidilutive due to the net loss reported in these years.

The following table sets forth the securities comprising of these antidilutive ordinary share equivalents for the years indicated:

	December 31		
	2004	2003	2002
Series A convertible preference shares	—	9,549,773,740	9,537,507,860
Series A-2 convertible preference shares	—	423,730,000	423,730,000
Series B convertible preference shares	—	25,636,360	27,520,000
Series C convertible preference shares	—	3,180,080,180	—
Series D preference shares	—	119,789,170	—
Convertible Promissory Note	—	—	42,857,140
Warrants to purchase Series B convertible preference shares	—	623,380	—
Warrants to purchase Series C convertible preference shares	—	315,000,000	—
Warrants to purchase Series D convertible preference shares	—	11,978,920	—
Warrants to purchase ordinary shares	9,584,403	—	—
Outstanding options to purchase ordinary shares	66,185,550	480,780,480	290,298,400
Outstanding options to purchase Series A convertible preference shares	—	103,033,400	128,610,900
	<b>75,769,953</b>	<b>14,210,425,630</b>	<b>10,450,524,300</b>

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19. Commitments

(a) Purchase commitments

As of December 31, 2004 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 December 31, 2005. The Company expects to obtain the land use rights and complete the facility construction no later than December 31, 2005.

Land use rights	\$ 7,000,000
Facility construction	127,000,000
Machinery and equipment	419,000,000
	<u>\$553,000,000</u>

(b) Investment commitments

As of December 31, 2004, the Company had total commitments of \$79,200,000 to invest in certain joint venture projects. The Company expects to complete the cash injection of these joint venture 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 2004, 2003 and 2002, the Company incurred royalty expense of \$6,258,709, \$2,626,916 and \$420,545, respectively.

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 2004 and 2003, the Company earned royalty income of \$336,216 and \$nil, respectively, which is included as net revenue in the statement of operations.

(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 2004, 2003 and 2002 was \$1,740,283, \$2,059,986 and \$1,148,641, respectively.

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19. Commitments - continued

(e) Operating lease as lessee

The Company leases land use rights, gas tanks and other operational equipment under non-cancelable leases expiring at various times through 2053. Future minimum lease payments under these leases at December 31, 2004 are as follows:

<u>Year ending</u>	
2005	\$ 711,233
2006	684,977
2007	252,708
2008	58,030
2009	58,030
Thereafter	2,669,390
	<u>\$4,434,368</u>

The total operating lease expenses recorded in 2004, 2003 and 2002 was \$2,712,909, \$2,744,842 and \$2,342,199, respectively.

20. 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.

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Total sales:			
United States	\$391,433,443	\$134,080,431	\$15,424,733
Asia Pacific (Excluding Japan and Taiwan)	201,881,809	52,689,834	2,746,284
Japan	135,100,765	40,981,995	8,044,122
Europe	125,596,424	40,251,482	120,000
Taiwan	120,652,255	97,819,762	23,980,206
	<u>\$974,664,696</u>	<u>\$365,823,504</u>	<u>\$50,315,345</u>

Revenue is attributed to countries based on headquarter of operation.

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

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21. Significant customers

The following table summarizes net revenue and accounts receivable for customers which accounted for 10% or more of our accounts receivable and net sales:

	Net revenue			Accounts receivable		
	Year ended December 31,			December 31,		
	2004	2003	2002	2004	2003	2002
A	13%	11%	—	8%	21%	—
B	13%	11%	17%	10%	17%	—
C	12%	12%	—	7%	9%	14%
D	11%	8%	—	15%	19%	—
E	10%	12%	1%	6%	11%	—
F	6%	—	—	15%	—	1%
G	5%	10%	25%	8%	2%	—
H	4%	—	—	12%	—	34%

22. 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.

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22. Litigation - continued

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 which will be recorded in the first quarter of 2005 and amortized over the estimated remaining life of the technology.

23. Retirement Benefit

The Company's local Chinese employees are entitled to a retirement benefit based on their basic salary upon retirement and their length of service in accordance with a state-managed pension plan. The PRC government is responsible for the pension liability to these retired staff. The Company is required to make contributions to the state-managed retirement plan equivalent to 20%-22.5% of the monthly basic salary of current employees. Employees are required to make contributions equivalent to 6%-8% of their basic salary. The contribution of such an arrangement is approximately \$2,502,521, \$1,464,332 and \$951,434 for the years ended December 31, 2004, 2003 and 2002, respectively. The retirement benefits do not apply to expatriate employees.

24. Distribution of Profits

As stipulated by the relevant laws and regulations applicable to China's foreign investment enterprise, the Company's PRC subsidiaries are required to make appropriations from net income as determined under accounting principles generally accepted in the PRC ("PRC GAAP") to non distributable reserves which include a general reserve, an enterprise expansion reserve and a staff welfare and bonus reserve. Wholly-owned PRC subsidiaries are not required to make appropriations to the enterprise expansion reserve but appropriations to the general reserve are required to be made at not less than 10% of the profit after tax as determined under PRC GAAP. The staff welfare and bonus reserve is determined by the board of directors.

The general reserve is used to offset future extraordinary losses. The subsidiaries may, upon a resolution passed by the stockholders, convert the general reserve into capital. The staff welfare and bonus reserve is used for the collective welfare of the employee of the subsidiaries. The enterprise expansion reserve is for the expansion of the subsidiaries' operations and can be converted to capital subject to approval by the relevant authorities. These reserves represent appropriations of the retained earnings determined in accordance with Chinese law. Appropriations to general reserve by the Company's PRC subsidiaries were \$12,655,906 in 2004. There were no appropriations to reserves in 2003 and 2002.



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25. Income (loss) from operations

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Income (loss) from operations is arrived at after charging (crediting):			
Auditors' remuneration	\$ 695,990	\$ 134,781	\$ 34,210
Depreciation and amortisation of property, plant and equipment	455,947,253	233,037,403	83,975,267
Amortisation of land use rights	1,013,269	867,463	561,494
Amortisation of intangible assets	14,368,025	3,461,977	990,000
Foreign currency exchange loss	1,446,113	3,418,619	2,325,473
Gain on disposal of plant and equipment	(733,822)	(8,029)	—
(Reversal of) bad debt expense	990,692	(122,378)	236,851
Inventory write-down	10,506,374	—	16,485,080
Staff costs inclusive of directors' remuneration	\$ 88,417,658	\$ 61,416,841	\$36,142,401

26. Directors' remuneration and five highest paid individuals

**Directors**

Details of emoluments paid by the Company to the directors of the Company in 2004, 2003 and 2002 are as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>Non-Executive Directors</b>			
Fees	—	—	—
Salaries and other benefits	—	—	—
Stock option benefits	\$221,464	\$ 5,000	\$ 3,000
<b>Total emoluments</b>	<u>\$221,464</u>	<u>\$ 5,000</u>	<u>\$ 3,000</u>
	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>Executive Directors</b>			
Fees	—	—	—
Stock option benefits	—	—	—
Salaries and other benefits	\$190,343	\$191,621	\$179,579
<b>Total emoluments</b>	<u>\$190,343</u>	<u>\$191,621</u>	<u>\$179,579</u>

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26. Directors' remuneration and five highest paid individuals - continued

The emoluments of the directors were within the following bands:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
	Number of directors	Number of directors	Number of directors
Nil to HK\$1,000,000 (\$128,596)	6	11	9
HK\$1,000,001 (\$128,596) to HK\$1,500,000 (\$192,894)	1	1	1
HK\$1,500,001 to HK\$2,000,000 (\$257,192)	1	—	—

The Company granted 5,100,000, nil and 500,000 options to purchase ordinary shares of the Company to the directors in 2004, 2003 and 2002, respectively. As of December 31, 2004, nil stock option was exercised and 500,000 stock options were cancelled.

Stock option benefits were generated from granting stock options to an independent non-executive director of the Company. Other than this, none of the non-executive directors received fees or other remuneration in 2004, 2003 and 2002.

**Five highest paid employees' emoluments**

The emoluments of the five highest paid individuals of the Company, one (2003: one; 2002: one) of which is a director, in 2004, 2003 and 2002 are as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Salaries and other benefits	\$ 573,662	\$553,658	\$553,658
Bonus	152,490	141,294	102,706
Stock option benefits	620,060	120,314	54,529
<b>Total emoluments</b>	<b>\$1,346,212</b>	<b>\$815,266</b>	<b>\$710,893</b>

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26. Directors' remuneration and five highest paid individuals - continued

Their emoluments of the five highest paid individuals were within the following bands:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
	<u>Number of individuals</u>	<u>Number of individuals</u>	<u>Number of individuals</u>
Nil to HK\$1,000,000 (\$128,296)	—	—	2
HK\$1,000,001 (\$128,596) to HK\$1,500,000 (\$192,894)	4	5	3
HK\$4,500,001 (\$578,681) to HK\$5,000,000 (642,979)	1	—	—
	<u>          </u>	<u>          </u>	<u>          </u>

In 2004, 2003 and 2002, no emoluments were paid by the Company to any of the directors or the five highest paid individuals as an inducement to join or upon joining the Company or as compensation for loss of office. One director has declined an option to purchase 500,000 Ordinary Shares which the Board granted in November 2004.

27. Dividend

Deemed dividend represents beneficial conversion feature relating to the preferential price of certain convertible equity instrument investor receives when the effective conversion price of the equity instruments is lower than the fair market value of the common stock 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 as described above, no dividend has been paid or declared by the Company in 2004, 2003 and 2002.

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28. Differences between US GAAP and International Financial Reporting Standards

The consolidated financial statements are prepared in accordance with US GAAP, which differ in certain significant respects from International Financial Reporting Standards (“IFRS”). The significant difference relates principally to convertible financial instruments and assets held for sale.

- (I) IFRS requires an issuer of convertible debt instruments to classify and recognize separately the instrument’s liability and equity elements. An issuer of such instrument creates a financial liability (a contractual arrangement to deliver cash or other financial assets) and has issued an equity instrument (a call option granting the holder the right to convert into preferred stock of the issuer). Under US GAAP, the entire instruments are classified as liability. The convertible debt instrument was issued in exchange for plant and equipment. Accordingly, adjustments are made to discount on the convertible promissory note, cost of plant and equipment and to stockholder’s equity. In January 2004, the Company redeemed the convertible promissory note in cash. The increment in the costs allocated to plant and equipment was fully amortized in 2004.
- (ii) Under US GAAP, beneficial conversion feature refers to the preferential price of certain convertible equity instruments an investor receives when the effective conversion price of the equity instruments is lower than the fair market value of the common stock to which the convertible equity instrument is convertible into at the date of issuance. US GAAP requires the recognition of the difference between the effective conversion price of the convertible equity instrument and the fair market value of the common stock as a deemed dividend.

Under IFRS, this deemed dividend is not required to be recorded.

- (iii) Under IFRS, plant and equipment is initially measured at cost. Under a cost model, plant and equipment are accounted for at cost less accumulated depreciation and accumulated impairment losses. Plant and equipment will continue to be depreciated even though the Company has determined that it will be disposed of within specified period.

Under US GAAP, a long-lived asset (disposal group) to be sold is classified as held for sale in the period in which certain specified criteria are met. A long-lived asset (disposal group) classified as held for sale is measured at the lower of its carrying amount or fair value less cost to sell and is not depreciated (amortized) while it is classified as held for sale. A long-lived asset that is reclassified as held and used shall be measured individually at the lower of its (a) carrying amount before the asset (disposal group) was classified as held for sale, adjusted for any depreciation (amortization) expense that would have been recognized had the asset (disposal group) been continuously classified as held and used, or (b) fair value at the date of the subsequent decision not to sell.

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28. Differences between US GAAP and International Financial Reporting Standards - continued

(iii) Accordingly, adjustments are made to reclassify assets held for sale to land use rights and plant and equipment, and to record relevant depreciation expenses in the Statement of Operations in 2003.

In 2004, IFRIC issued IFRS 5 “Non-current Assets Held for Sale and Discontinued Operation”. Pursuant to IFRS 5, assets or disposal groups that are classified as held for sale are carried at the lower of carrying amount and fair value less costs to sell and are not depreciated. IFRS 5 shall be applied prospectively for annual periods beginning on or after January 1, 2005. The Company early adopted IFRS 5 and the accumulated difference between IFRS and US GAAP was reversed in 2004.

The adjustments necessary to restate net income (loss) attributable to holders of ordinary shares and stockholders’ equity in accordance with IFRS are shown in the tables set out below.

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Net income (loss) attributable to holders of ordinary shares as reported under US GAAP	\$70,905,406	\$(103,261,129)	\$(102,602,913)
IFRS adjustments:			
i) Amortisation of discount on convertible promissory notes		102,749	22,195
ii) Depreciation of incremental costs allocated to plant and equipment	(124,944)	—	—
iii) Depreciation related to assets held for sale	—	(674,117)	—
iv) Depreciation related to reclassification of unsold assets held for sale	674,117	—	—
v) Deemed dividend	18,839,426	37,116,625	—
Net income (loss) attributable to holders of ordinary shares under IFRS	<u>\$90,294,005</u>	<u>\$ (66,715,872)</u>	<u>\$(102,580,718)</u>
Net income (loss) per share under IFRS	<u>\$ 0.01</u>	<u>\$ (7.33)</u>	<u>\$ (12.74)</u>

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28. Differences between US GAAP and International Financial Reporting Standards - continued

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Stockholders' equity as reported under US GAAP	\$3,109,483,921	\$1,485,115,445	\$ 870,991,569
i) Depreciation of incremental costs allocated to plant and equipment	(124,944)	—	—
ii) Classification of equity portion of promissory notes	—	1,833,022	1,833,022
iii) Accumulated amortisation of discount on promissory notes	124,944	124,944	22,195
iv) Additional depreciation in respect of assets held for sale	—	(674,117)	—
Stockholders' equity under IFRS	<u>\$3,109,483,921</u>	<u>\$1,486,399,294</u>	<u>\$ 872,846,786</u>
	<u>2004</u>	<u>2003</u>	<u>2002</u>
Assets held for sale			
As reported	\$ 1,831,972	\$ 32,591,363	\$ —
IFRS adjustment			
Reclassification to			
- land use rights, net	—	(6,744,622)	—
- plant and equipment, net	—	(25,172,624)	—
Additional depreciation	—	(674,117)	—
Under IFRS	<u>1,831,972</u>	<u>—</u>	<u>—</u>
Land use rights, net			
As reported	39,197,774	41,935,460	49,354,292
IFRS adjustment			
Reclassification from assets held for sale	—	6,744,622	—
Under IFRS	<u>39,197,774</u>	<u>48,680,082</u>	<u>49,354,292</u>
Plant and equipment, net			
As reported	3,311,924,599	1,523,564,055	1,290,909,507
IFRS adjustment			
Depreciation of incremental costs allocated to plant and equipment	(124,944)	—	—
Reclassification from assets held for sale	—	25,172,624	—
Incremental costs allocated to plant and equipment	124,944	124,944	124,944
Under IFRS	<u>3,311,924,599</u>	<u>1,548,861,623</u>	<u>1,291,034,451</u>
Redeemable convertible promissory note (current liability)			
As reported	—	15,000,000	—
IFRS adjustment			
Classification of equity portion of promissory notes	—	(1,833,022)	—
Under IFRS	<u>—</u>	<u>13,166,978</u>	<u>—</u>

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28. Differences between US GAAP and International Financial Reporting Standards - continued

	2004	2003	2002
<b>Redeemable convertible promissory note (Long-term liabilities)</b>			
As reported	—	—	14,204,721
IFRS adjustment			
Classification of equity portion of promissory notes	—	—	(1,730,273)
<b>Under IFRS</b>	<b>—</b>	<b>—</b>	<b>12,474,448</b>
<b>Additional paid-in capital</b>			
As reported	3,289,724,885	1,835,820,085	1,139,760,359
IFRS adjustment			
Classification of equity portion of promissory notes	—	1,833,022	1,833,022
Deemed dividend	(18,839,426)	(37,116,625)	—
Carry forward prior year's adjustment on deemed dividend	(37,116,625)	—	—
<b>Under IFRS</b>	<b>\$3,233,768,834</b>	<b>\$1,800,536,482</b>	<b>\$1,141,593,381</b>
<b>Accumulated deficit</b>			
As reported	\$ 136,384,949	\$ 207,290,355	\$ 104,029,226
IFRS adjustment			
Accumulated amortisation of discount on promissory notes	(124,944)	(124,944)	(22,195)
Depreciation of incremental costs allocated to plant and equipment	124,944	—	—
Additional depreciation related to assets held for sale	—	674,117	—
Deemed dividend	(18,839,426)	37,116,625	—
Carry forward prior year's adjustment on deemed dividend	(37,116,625)	—	—
<b>Under IFRS</b>	<b>80,428,898</b>	<b>170,722,903</b>	<b>104,007,031</b>
<b>Other income</b>			
As reported	7,547,974	6,601,741	13,701,406
IFRS adjustment			
Amortisation of discount on promissory notes	—	102,749	22,195
Additional depreciation related to assets held for sale	—	(674,117)	—
Depreciation related to reclassification of unsold assets held for sale	674,117	—	—
<b>Under IFRS</b>	<b>\$ 8,222,091</b>	<b>\$ 6,030,373</b>	<b>\$ 13,723,601</b>

In respect of accounting treatment for stock option, an IFRS has recently been issued to specify recognition, measurement and disclosure for equity compensation (such as stock option issued to employees). IFRS requires all share-based payment to be recognised in the financial statements using a fair value measurement basis. An expense should be recognised when good or services received are consumed. This IFRS will be effective for periods beginning on or after January 1, 2005.

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28. Differences between US GAAP and International Financial Reporting Standards - continued

Under US GAAP the Company can account for stock-based compensation issued to employees using one of the two following methods.

(i) Intrinsic value based method

Under the intrinsic value based method, compensation expense is the excess, if any, of the fair value of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. Compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period.

(ii) Fair value based method

For stock options, fair value is determined using an option pricing model that takes into account the stock price at the grant date, the exercise price, the expected life of the option and the annual rate of quarterly dividends.

Under either approach compensation expense, if any, is recognized over the applicable service period, which is usually the vesting period.

The Company has adopted the intrinsic value method of accounting for its stock options and the compensation charge recorded by the Company \$27,011,078 for the year ended December 31, 2004 (2003: \$11,439,514; 2002: \$3,896,927). The fair value of the stock options is presented for disclosure purpose (see Note 2(v)).

Had the Company prepared the financial statements under IFRS, the Company would adopt the same policy in accounting for stock options.

In addition to the above, there are also other differences between US GAAP and IFRS relevant to the accounting policies of the Company. These differences have not led to any material differences in 2004, 2003 and 2002, and details of which are set out as below:

(a) Inventory valuation

Inventories are carried at cost under both US GAAP and IFRS. However, if there is evidence that the net realisable value of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to physical obsolescence, changes in price levels, or other causes, the difference should be recognized as a loss of the current period. This is generally accomplished by stating such goods at a lower level commonly known as "market".



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
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28. Differences between US GAAP and International Financial Reporting Standards - continued

(a) Inventory valuation - continued

Under US GAAP, a write-down of inventories to the lower of cost or market at the close of a fiscal period creates a new cost basis that subsequently cannot be marked up based on changes in underlying facts and circumstances. Market under US GAAP is the lower of the replacement cost and net realizable value minus normal profit margin.

Under IFRS, a write-down of inventories to the lower of cost or market at the close of a fiscal period is a valuation allowance that can be subsequently reversed if the underlying facts and circumstances changes. Market under IFRS is net realizable value.

No significant GAAP difference is noted in 2004, 2003 and 2002.

(b) Deferred income taxes

Deferred tax liabilities and assets are recognized for the estimated future tax effects of all temporary differences between the financial statements carrying amounts of assets and liabilities and their respective tax bases under both US GAAP and IFRS.

Under IFRS, a deferred tax asset is recognized to the extent that it is probable that future profits will be available to offset the deductible temporary differences or carry forward of unused tax losses and unused tax credits. Deferred tax assets and liabilities are always classified as non-currents. Under US GAAP, all deferred tax assets are recognized, subject to a valuation allowance, to the extent that it is "more likely than not" that some portion or all of the deferred tax assets will not be realized. "More likely than not" is defined as a likelihood of more than 50%.

With respect of the measurement of the deferred tax, IFRS requires recognition of the effects of a change in tax laws or rates when the change is "substantively enacted". US GAAP requires measurement using tax laws and rates enacted at the balance sheet date.

Under IFRS, deferred tax assets and liabilities are always classified as non-current items. Under US GAAP, deferred tax liabilities and assets are classified as current or non-current based on the classification of the related asset or liability for financial reporting.

No significant GAAP difference is noted in 2004, 2003 and 2002.

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28. Differences between US GAAP and International Financial Reporting Standards - continued

(c) Segment reporting

Under IFRS, a listed enterprise is required to determine its primary and secondary segments on the basis of lines of business and geographical areas, and to disclose results, assets and liabilities and certain other prescribed information for each segments. The determination of primary and secondary segment is based on the dominant source of the enterprise's business risks and returns. Accounting policies adopted for preparing and presenting the financial statements of the Company should also be adopted in reporting the segmental results and assets.

Under US GAAP, a public business enterprise is required to report financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. US GAAP also permits the use of the accounting polices used for internal reporting purposes that are not necessarily consistent with the accounting policies used in consolidated financial statements.

No significant difference on reportable segment is noted.

(d) Borrowing costs

IFRS and US GAAP requires capitalization of borrowing costs for those borrowings that are directly attributable to acquisition, construction or production of assets that necessarily take a substantial period of time to get ready for their intended use or sale. The amount to be capitalized is the borrowing cost which could theoretically have been avoided if the expenditure on the qualifying asset were not made.

Under IFRS, to the extent that funds are borrowed specifically for the purpose of obtaining a qualified asset, the amount of borrowing costs eligible for capitalization is determined as the actual borrowing costs incurred on the borrowing during the period less any investment income on the temporary investment of those borrowing. The amount of borrowing costs capitalized during the period should not exceed the amount of borrowing costs incurred during that period. The amount of borrowing costs to be capitalized under US GAAP is based solely on actual interest incurred related to actual expenditure incurred.

No significant GAAP difference is noted in 2004, 2003 and 2002.

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28. Differences between US GAAP and International Financial Reporting Standards - continued

(e) Impairment of asset

IFRS requires an enterprise to evaluate at each balance sheet date whether there is any indication that a long-lived asset may be impaired. If any such indication exists, an enterprise should estimate the recoverable amount of the long-lived asset. Recoverable amount is the higher of a long-lived asset's net selling price and its value in use. Value in use is measured on a discounted present value basis. An impairment loss is recognized for the excess of the carrying amount of such assets over their recoverable amounts. A reversal of previous provision of impairment is allowed to the extent of the loss previously recognised as expense in the income statement.

Under US GAAP, long-lived assets and certain identifiable intangibles (excluding goodwill) held and used by an entity are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of a long-lived asset and certain identifiable intangibles (excluding goodwill) may not be recoverable. An impairment loss is recognized if the expected future cash flows (undiscounted) are less than the carrying amount of the assets. The impairment loss is measured based on the fair value of the long-lived assets and certain identifiable intangibles (excluding goodwill). Subsequent reversal of the loss is prohibited. Long-lived assets and certain identifiable intangibles (excluding goodwill) to be disposed of are reported at the lower of carrying amount or fair value less cost to sell.

The Company had no impairment loss under either US GAAP or IFRS in 2004, 2003 and 2002.

(f) Research and development costs

IFRS requires, it requires classification of the costs associated with the creation of intangible assets by research phase and development phase. Costs in the research phase must always be expensed. Costs in the development phase are expensed unless the entity can demonstrate all of the following:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete the intangible asset and use or sell it;
- its ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits. Among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

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28. Differences between US GAAP and International Financial Reporting Standards - continued

(f) Research and development costs - continued

- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- its ability to measure the expenditure attributable to the intangible asset during the development phase.

Under US GAAP, research and development costs are expensed as incurred except for:

- those incurred on behalf of other parties under contractual arrangements;
- those that are unique for enterprises in the extractive industries;
- certain costs incurred internally in creating a computer software product to be sold, leased or otherwise marketed, whose technological feasibility is established, i.e. upon completion of a detailed program design or, in its absence, upon completion of a working model; and
- certain costs related to the computer software developed or obtained for internal use.

The general requirement to write off expenditure on research and development as incurred is extended to research and development acquired in a business combination.

No significant difference is noted in 2004, 2003 and 2002.

(g) Statements of cash flows

There are no material differences on statements of cash flows between US GAAP and IFRS. Under the US GAAP, interest received and paid must be classified as an operating activity. Under IFRS, interest received and paid may be classified as an operating, investing, or financing activity.

29. Subsequent events

On May 3, 2005, the Company entered into a joint venture agreement with United Test and Assembly Center Ltd. ("UTAC") to provide assembly and testing services in Chengdu, Sichuan Province, focusing on memory and logic devices. The Company will invest US\$51 million through cash and own 51% of the joint venture company ("JV") and UTAC will invest US\$30 million through a combination of cash and other considerations including intellectual properties for a 30% stake.

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29 Subsequent events - continued

On May 26, 2005, SMIB entered into a five year loan facility in the aggregate principal amount of US\$600 million with a syndicate of banks based in The People's Republic of China. The draw-down period under the facility is one year. The facility is repayable in six semi-annual installments beginning in November 2007. The Company has guaranteed SMIB's obligations under the facility, which is also secured by some of SMIB's assets.