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981.HK - Q4 2015 Semiconductor Manufacturing International Corp
Earnings Call

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PRESENTATION

Operator

Welcome to the Semiconductor Manufacturing International Corporation's fourth quarter 2015 webcast conference call. Today's conference call is hosted by Dr. T.Y. Chiu, Chief Executive Officer; Dr. Yonggang Gao, Chief Financial Officer; Mr. Gareth Kung, Executive Vice President of Strategic Business Development, Finance, and Company Secretary, and Mr. En-Ling Feng, Vice President of Investor Relations. (Operator Instructions).

Without further ado, I would like to introduce you to Mr. En-Ling Feng, Vice President of Investor Relations, for a cautionary statement.

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

Good morning and good evening. Welcome to SMIC's fourth quarter 2015 earnings webcast conference call. For today's call, our CEO, Dr. T.Y. Chiu, will first provide some general remarks. Afterwards, our CFO, Gao Yonggang will highlight our financial performance and give guidance on the next quarter.

And then, our Executive VP of Strategic Business Development, Finance, and Company Secretary, Mr. Gareth Kung, will give the detailed financial commentary. This will then followed by our Q&A session. As usual, our call will be approximately 60 minutes in length.

The earnings press release and quarterly financial presentation are available for you to download, at www.smics.com, under Investor Relations, in the Events and Presentations section.

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

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



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

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

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

Thank you, En-Ling. Greetings to everyone. Happy Lunar New Year, and thank you all for joining us for this quarter's call. Today I'm pleased to report on SMIC's outstanding fourth quarter and 2015 full-year achievements. We will also share with you our outlook for 2016 and other business updates.

SMIC has achieved another quarter of record-high revenue in Q4, with an expectation of another growth quarter in Q1. SMIC's utilization remains high, as we continue to expand our capabilities, to meet strong customer demand.

In the fourth quarter of 2015, we achieved record-high revenue of \$610m, a growth of 25.6% year over year and 7.1% quarter over quarter, surpassing our original expectations and guidance, and outperforming typical seasonality.

This outstanding growth was paired with a 6 percentage point increase in gross margin in Q4 2015, compared to Q4 2014, and an operating profit of \$41.6m in Q4 2015, compared to \$1.6m in Q4 2014.

Overall, 2015 was a stellar year for SMIC. We demonstrated resilience in the face of industry slowdown. On an annual basis, our revenue hit a record high of \$2.24b, a growth of 13.5%, compared to 2014. When measured in RMB, 2015 growth reached 20%.

In 2015 we also achieved historical highs on all measures of profitability, including gross margin, operating profit, and the net profit.

Despite the inventory correction in the industry during the year, we maintained full utilization throughout 2015. We attribute this performance to the careful execution of our strategy.

In 2015 we nurtured new customers, introduced new technologies, and grew with existing, but growing applications, including various sensor-related technology, embedded memory, networking, Bluetooth, and others.

We also began to manufacture 28-nano technology and introduced SMIC's new ultra-low-leakage SPOCULL technology.

With a great year behind us, we are well-positioned to have a strong 2016. Following our acceleration of R&D investments in the past few years and in response to strong customer demand, we target an annual revenue growth of 20%, which is significantly higher than the foundry industry growth.

Consistently, we are adding significant new capacities. Our target 2016 year-end installed capacity is 341,000 8-inch equivalent wafers per month, an increase of 20% over 2015 year-end capacity.

Our full-year 2016 CapEx is projected to be \$2.1b. As a result, our annual depreciation and amortization is expected to increase by approximately \$260m to \$280m.

Due to the fact that we are simultaneously ramping up two new fabs in 2016, we target the annual -- the average annual gross margin in 2016 is expected to decline to low to mid-20s. However, we target to maintain a healthy EBITDA margin of approximately 35% in 2016. This is similar to 2015.

As announced previously, on February 1, Beijing fab experienced a temporarily-- temporary power supply suspension. On February 3, power supply resumed and on the 4th, shipment resumed. We estimate that the impact to most customers, related to this incident, was limited.

I'm pleased with our team's speedy response to the incident, controlling the situation and communicating with customers. Despite the incident, we are still targeting quarterly growth in Q1, contrary to typical Q1 seasonality in the industry.

We continue to grow and target new markets, using existing and newly-developed technology. We remain determined to capture the growth opportunities stemming from our customers' strong demand and China's growing semiconductor industry. We will work diligently to better capture these opportunities in the coming years.

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Our Beijing joint venture fab began production in Q4 2015, and ended the year with a capacity of 6,000 12-inch wafer per month. We target to increase this to 15,000 per month, by the end of this year.

Our Shanghai 12-inch fab ended the year with 14,000 12-inch wafer per month and is planned to expand to 20,000 by the end of this year.

We continue to implement prudence in our CapEx spending, and strive to improve structural profitability through capital efficiency.

Being in China has presented us with many opportunities, customers, relationships, and options for funding. Many customers, domestic and international, prefer to have a foundry partner in China.

Regionally, our China revenue contribution has grown more than 25% year over year, in 2015, compared to 2014.

Eurasia revenue contribution has grown more than 50% year over year. Our Eurasia region includes Europe and Asia, excluding mainland China.

Meanwhile, North America has declined 9.3% year over year, but has begun to recover in the second half of 2015.

With the large opportunities presented to us being in China, we strive to capture attractive prospects, with profitability as our underlying objective. In order to address many of the opportunities at hand, we will consider accelerating growth through both organic and inorganic means.

In conclusion, SMIC demonstrated strength in 2015, achieving historical highs in revenue, profitability, and the utilization. We expect growth again in the first quarter of 2016, and target 20% annual revenue growth in 2016.

Despite uncertain market outlook in the industry, SMIC is optimistic, given our strategy and execution track record. So far, the first half looks strong, and we stay committed to maintaining sustainable profitability and building value for all our shareholders.

Thank you for listening, for your support, and for your time. I will now hand the call over to Yonggang, for the financial highlights and 2016 Q1 guidance.

Yonggang Gao - *Semiconductor Manufacturing International Corporation - CFO*

Okay. Thank you, T.Y. Greetings to all our listeners. First, I will highlight our 2015 full-year unaudited results and our fourth quarter 2015 results. And then will give our first quarter 2016 guidance.

Revenue in 2015 was \$2.24b, a record high, compared to \$1.97b in 2014. The increase was mainly due to an increase of wafer shipments.

Gross margin in 2015 reached a record high of 30.5%, compared to 24.5% in 2014. The increase was primarily due to improvements in fab efficiency in 2015.

Profits for the period attributable to SMIC in 2015 was \$253.4m, a record high, compared to \$153m in 2014.

Net profit margin was 11.3%, a record high, compared to 7.8% in 2014.

The 2015 capital expenditures for foundry operations were \$1.4b and \$172.2m for non-foundry operations.

Our year-end cash on hand was \$1.3b in 2015, compared to \$1.2b in 2014.

Utilization rates in 2015 was 100.7%, a record high, compared to 91% in 2014.

Now I will highlight our fourth quarter 2015 results.



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Our revenue was a record high of \$610m in 4Q 2015, an increase of 7.1%, quarter over quarter and an increase of 25.6% year over year.

Gross profit was \$173.9m in 4Q 2015, compared to \$182.4m in 3Q 2015 and \$109.3m in 4Q 2014.

Gross margin was 28.5% in 4Q 2015, compared to 32% in 3Q 2015 and 22.5% in 4Q 2014.

Profits for the period, attributable to SMIC was \$38.6m in 4Q 2015, compared to \$82.6m in 3Q 2015 and \$28.4m in 4Q 2014.

Now looking ahead into the first quarter of 2016, our revenue is expected to increase by 1% to 3% quarter over quarter.

Gross margin is expected to range from 22% to 25%.

Non-GAAP operating expense, excluding the effects of employee bonus accrual, government funding, and gain from the disposal of living quarters, are expected to range from \$121m to \$126m.

And the non-controlling interest of our majority-owned subsidiaries are expected to range from positive \$16m to positive \$18m, which are losses to be borne by non-controlling interests.

The planned 2016 capital expenditures for foundry operations are approximately \$2.1b, while our planned 2016 capital expenditures for non-foundry operations are approximately \$60m.

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

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

Thank you, Yonggang, and thank you everyone for joining us today. I will now comment on the details of our last quarter financial results.

On the income statement, revenue increased to \$610.1m in Q4 2015, up 7.1% Q-on-Q, from \$569.9m in Q3 2015, mainly because of an increase of wafer shipment.

Cost of sales increased to \$436.2m in Q4 2015, up 12.6% Q-on-Q, from \$387.5m in the previous quarter, mainly due to an increase of wafer shipments, and two, additional manufacturing costs associated with the commencement of mass production of our new Beijing and Shenzhen fabs.

Gross profit was \$173.9m in Q4 2015, down 4.6% Q-on-Q, from \$182.4m in the previous quarter.

Gross margin was 28.5% in Q4 2015, compared to 32% in the previous quarter. The decline in gross margin was mainly due to the ramp-up costs associated with the new Beijing and Shenzhen fabs.

Operating expenses in Q4 2015 were \$132.3m, an increase of 22.4% Q-on-Q, from \$108.1m in Q3 2015.

R&D expenses increased by \$3.7m Q-on-Q, to \$66.1m in Q4 2015, compared to \$62.4m in Q3 2015.

Excluding the funding of R&D contracts from the government, R&D expenses increased to \$75.2m in Q4 2015. Funding of R&D contracts from the government was \$9.1m in Q4 2015, compared to \$9.6m in Q3 2015.

General and administrative expenses increased to \$67.3m in Q4 2015, up 30.9% Q-on-Q, from \$51.4m in Q3 2015, mainly due to an increase in accrued employee bonus in Q4 2015, an increase of government tax surcharges in Q4 2015, and the startup cost relating to our majority-owned project for bumping services in Jiangyin.



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Other operating income decreased by -- decreased from \$16.8m in Q3 2015 to \$13.4m in Q4 2015, mainly because of the lower gain realized from the disposal of certain living quarters in Q4 2015.

Excluding the effect of employee bonus accrual, government funding, and gain from the disposal of living quarters, non-GAAP operating expenses were \$134.6m in Q4 2015, compared to \$121.4m in Q3 2015.

Profit from operations in Q4 2015 was \$41.6m, compared to \$74.2m in Q3 2015. Other expenses was \$5.7m in Q4 2015, compared to \$3.5m in Q3 2015.

Foreign exchange losses was \$5.5m in Q4 2015, compared to \$26m in Q3 2015, mainly due to a devaluation of RMB against the US dollar in Q4 2015.

The fair-value change was \$3.4m in Q4 2015, compared to \$25.5m in Q3 2015. The change in the fair value was -- the fair-value change was mainly due to gain arising from the put option, which was given by Jiangsu Changjiang Electronics Technology Company Limited, in connection with the acquisition of STATS ChipPAC.

The income tax expenses was \$5.8m in Q4 2015, compared to \$1.8m in Q3 2015. The change in income tax expense was mainly due to the recognition of deferred tax expenses, resulted from tax and accounting temporary differences.

Non-controlling interest was \$8.5m of credit to SMIC's attributable profit in Q4 2015, compared to \$13.7m in the previous quarter.

Moving to the balance sheet, at the end of the fourth quarter 2015, cash and cash equivalents increased to \$1b in Q4 2015 from \$741.6m in Q3 2015. If including other financial assets, we had approximately \$1.3b cash on hand at the end of Q4 2015, compared to approximately \$1.2b in Q3 2015.

Restricted cash was \$302.4m in Q4 2015, compared to \$88.7m in Q3 2015. The increase was mainly due to a low-interest cost [entrusted] loan from CDB Development Fund, through China Development Bank, which will be used for future capacity expansion.

Our long-term borrowing increased by \$307.5m, and short-term borrowing increased by \$55.6m, compared to the previous quarter.

At the end of Q4 2015, our total debt to equity was 33.8%, compared to 26.6% in the previous quarter.

In terms of cash flow, we generated \$200.2m of cash from operating activities in Q4 2015, compared to \$180.2m in Q3 2015.

On a full-year basis, we generated \$669m of cash from operations in 2015, compared to \$608m in 2014.

Cash used in investment activities increased to \$282.4m in Q4 2015, compared to \$187.9m in Q3 2015.

Cash from financing activities changed from an [outflow of \$8.9m in Q3 2015, to an inflow of \$352.4m in Q4 2015] (corrected by company after the call).

To examine our revenue by application, the communication and consumer segments contributed 56.2% and 30% of our revenue, respectively in Q4 2015, compared to 55.1% and 31.9% of revenue, respectively in Q3 2015.

On a full-year basis, the communication and consumer segments contributed 51.5% and 36.1% of our revenue, respectively in 2015.

Geographically, revenue from China contributed 45% of total revenue, and revenue from North America contributed 32.6% of total revenue.

Revenue from Eurasia contributed 22.4% on a full year basis. Revenue from China contributed 47.7% of total revenue. And revenue from North America contributed 34.7% of total revenue. Revenue from Eurasia contributed 17.6%.

In terms of technology, revenue from 28-nano contributed 0.3%. Revenue from 40/45 nanometers contributed 16.6%. Revenue from 55/65 nanometers and 90 nanometer contributed 24% and 2.9%, respectively. Meanwhile, 0.13 micron and above contributed 56.2% of total revenue.

On a full-year basis, revenue from 45-nanometers and below contributed 16.1%. Revenue from 55/65 nanometers and 90 nanometers contributed 24.3% and 4.1%, respectively. 0.13 micron [and above] (corrected by company after the call) contributed 55.5% of total revenue.

In terms of our overall capacity, total monthly capacity at the end of fourth quarter was 284.3 thousand 8-inch equivalent wafers, compared to 268.8 thousand wafers in the previous quarter. The change was mainly because of our Beijing majority-owned 12-inch fab entered into mass production and our Shenzhen 8-inch fab expanded its capacity in Q4 2015.

The overall utilization was 100.4% in Q4 2015, compared to 100.5% in Q3 2015.

The overall utilization rate was 110 -- 100.7% in 2015 compared to 91% in 2014.

The planned capital expenditure for foundry operations for 2016 are approximately \$2.1b, which are mainly for the expansion of capacity in our new Beijing fab, our 8-inch fab in Shenzhen, our 12-inch fab in Shanghai and our new 12-inch joint venture with bumping services in Jiangyin as well as on R&D equipments, mask shops and intellectual property acquisitions.

Of the \$2.1b CapEx, \$1.1b is attributable to our new Beijing fab which is a joint venture of which SMIC will fund 0.6 -- \$600m CapEx to that fab.

The planned 2016 capital expenditure for non-foundry operations are approximately \$60m, mainly for the construction of living quarters.

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

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

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Randy Abrams, Credit Suisse.

Randy Abrams - *Credit Suisse - Analyst*

Okay. Yes. Thank you. I wanted to ask the first question on the robust growth outlook for the 20% and to go through just a few more details behind what's driving the growth. If you could go into what you expect -- the key growth drivers, how much looks like it's coming from China versus the overseas customers and also the profile, how much coming from 8-inch versus 12-inch or 28-nanometer.

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

I think in terms of the target growth in our revenue, the main drivers are two -- actually three. We are expanding our 12-inch fab capacity in both our new Beijing fab and also in the Shanghai fab. So we expect -- the fab will be relatively fully loaded for the rest of this year. So that will be a major growth driver.

And at the same time, we are also expanding our 8-inch fab in Shenzhen. And we expect that it'll be also be fully loaded. So that will contribute to the top line growth.

In terms of the -- geographically we expect actually pretty balanced growth among all the regions.

Randy Abrams - *Credit Suisse - Analyst*

Okay. And could you talk a little on the applications you see driving that above industry growth?

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

I think we are still very much in the mobile space. As we know -- as you know, for our 12-inch capacity will be mainly used for the 28-nano and also 40-nano production. And then for the 8-inch there'll be a whole broad range of applications, including sensors, power management. All this will be a growth driver for us.

Randy Abrams - *Credit Suisse - Analyst*

Okay. And if I could follow up just on the fund-raising, like with the increase in CapEx. You'll get some from the JV, but you are generating about \$800m operating cash flow and maybe raise a bit. Could you talk about additional funding source if you need to do more for the higher CapEx? And it looks like the Development Bank is a new option. If -- maybe talk about that option. Is that also lowering some of the borrowing costs and you have an additional way in?

As part of that, you mentioned acquisitions, if you also see some pretty good opportunities out there, then you may also have an acquisition that could be in the near term.

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

Okay. Let me comment on the funding side first. So we are projecting \$2.1b CapEx. But as you know, right now we have about \$1.3b cash on hand which we can use to finance this CapEx.

At the same time this year we are forecasting to generate about \$900m to \$1b cash from operations. So together with the contribution from our partners in our Beijing fabs we don't see any problem for us to fund this CapEx.

And moreover, we have a relatively low gearing at this point in time. So we have multiple options to raise debt financing, including potentially from some policy banks in China. So I think we are in a pretty comfortable funding position.

In terms of -- you mentioned about this M&A. As mentioned in our -- by T.Y. in his script, we are actively looking at new opportunities for growth. So we are evaluating a whole range of opportunities. But I don't think we are at liberty to comment on it at this point in time.



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Randy Abrams - *Credit Suisse - Analyst*

Okay. Great. And [since it affects] like the growth profile and also the margin profile, could you talk full year, I think, Q4 to Q4 you're growing capacity, 20%. How should the capacity step up through the year?

And then also for depreciation, the margins are coming down for the first quarter. How much depreciation steps up through the year. Like do you see most of it ahead in the first quarter and then your expectation would add a trough for margin or a stabilization point for margins?

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

Okay. In terms of depreciation, we are forecasting this year 2016 will increase to about \$800m. And the increase will be quite steady throughout the year. And yes, you will see increase in every quarter more or less in a linear fashion.

Randy Abrams - *Credit Suisse - Analyst*

Okay. And I guess the capacity, we should assume linear capacity. And then is the implication for margin, we've had the reset and were pretty stable on margin from this level or, with depreciation still coming down, we could see another -- a little bit more pressure on margin?

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

Well, I think, as you know, one of the key drivers for the gross margins are the utilizations. So I think right now we are looking at an average annual gross margin that we can target to be low- to mid-twenties. But in terms of the quarterly fluctuation it all depends on the utilization I think.

Randy Abrams - *Credit Suisse - Analyst*

Okay. Okay, great. Thanks a lot.

Operator

Steven Pelayo, HSBC.

Steven Pelayo - *HSBC - Analyst*

Yes. Gareth, amazing guidance, the 20% year-on-year revenue growth was significantly outperforming, but also with depreciation and amortization of about 50% year on year. It seems like you have to do -- if you hit over 30% gross margin in the last year, relative low- to mid-twenties, it seems like you'd have to do 25% for the full year just to have flat gross profit this year. So are you going to have down gross profit in 2016, if --?

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

Look, well, we don't guide for the net income first of all. So I think I'm sure the analysts can do a very good job in terms of modeling the net income. But we feel that right now for this year the focus is really driving the growth. And I think SMIC is fortunate in terms of being opened up to a lot of growth opportunities this year.

So we are investing a substantial amount of CapEx, so that we can capture the growth. So I think this is a phase that, from a strategic point of view, I think that the Company has decided to move forward in terms of capturing growth for this year and next year.



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Steven Pelayo - HSBC - Analyst

Forecasting the bottom line is very difficult. There's a lot of other things that are moving there. But I guess I was just trying to look at the gross line and the EBIT lines, given such a -- 500 basis points or more gross margin decline this year, despite 20% revenue growth. Have you thought a little bit on what kind of operating margins or operating profit targets for 2016?

Gareth Kung - Semiconductor Manufacturing International Corporation - EVP, Strategic Business Development, Finance, and Company Secretary
No, we are not guiding for that.

Steven Pelayo - HSBC - Analyst

Okay. Last question, it's a struggle for me to figure out the model is the non-controlling interest line. I would assume, as you ramp up more in this Beijing 2 fab, that there is more of a kind of an add-back that happens there. It was actually down quarter on quarter. But can you think -- give us some guidance on at least the first quarter but hopefully more than the full year for the non-controlling interest line. That would really help me.

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

Yes. I think we guided the Q1 non-controlling interest in our guidance. So for the full year you are right. We do see that -- because this non-controlling interest [add-on] is mainly because of the losses that we share with our joint venture partner for new fabs. So I expect this number on a year-on-year basis to increase compared to last year.

Steven Pelayo - HSBC - Analyst

It's absolutely going to increase. But in the first quarter you've said it's \$16m/\$18m number. How big could that get by the end of the year?

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

Yes. We are not guiding that for now.

Steven Pelayo - HSBC - Analyst

All right. Then let me just sneak in one more then. R&D credits were down year on year despite 28-nanometer investments and maybe a more favorable policy environment behind that. I was a little bit surprised by that. Did your R&D credits fall short of your expectations and what do you think about it for 2016?

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

Yes. I think we have some delay in Q4 in terms of the R&D grant, because, as you say, this is all depending on -- it's all project-based and it's all depending on a number of factors, including the completion of our projects and also the funding availability at the government.

So we do think that this grant will increase in 2016. So right now we are looking at a quite substantial increase in 2016.

Steven Pelayo

If my argument is correct, is there a risk if there is maybe one or two quarters of mis-execution, then you may not be able to meet your revenue growth guidance?

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

Not really, because actually we are not assuming 100% utilization for all quarters here. So but based on -- as I said, this is really a full-year outlook based on our -- full-year guidance based on the current outlook. So that will be -- as I said, we do need to execute the plan to ensure that this is achievable. So yes.

Ken Hui - *Jefferies - Analyst*

Okay. And finally, I want to, again, ask about the non-controlling interest. Particularly for 4Q last year, I think your guidance was actually over \$30m but it ended up to be only like \$8.5m. So could you please explain the differences over there?

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

Yes. The difference in Q4 that is relating to the R&D cost sharing with our Beijing fab. I think when we gave the guidance we expected the R&D cost sharing would be finalized by the time we announced the Q4 results. But I think there's some delay in terms of reaching this agreement with our joint venture partners. But the negotiation is still going on and we expect that it will be booked in 2016.

Ken Hui - *Jefferies - Analyst*

Is that included in the 1Q guidance already or not?

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

Not yet.

Ken Hui - *Jefferies - Analyst*

Okay. Okay. I see. So that means the non-controlling interest may go up sometime in one of the subsequent quarters?

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

Yes.

Ken Hui - *Jefferies - Analyst*

Okay. Okay. Thank you very much.

Operator

Rick Hsu, Daiwa Securities.



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Rick Hsu - *Daiwa Securities - Analyst*

Yes. Hi. Good morning. Sorry for my voice, a little bit [sore] today. Got a cold here. So I try to make myself as clear as possible.

Starting with your depreciation, you say it's going to increase by \$260m to \$280m this year. So roughly it's how much increase year on year for this year?

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

Yes. It's roughly about 50%.

Rick Hsu - *Daiwa Securities - Analyst*

All right. So just (inaudible) by 50%. So that's actually a big increase.

Do you see any upside to your depreciation? [I'm thinking] is there any source area -- any source which we can save on depreciation cost to make it smaller?

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

Well, the depreciation cost, actually it all depends on the CapEx and the move-in schedule for the equipment. So this is based on right now our outlook, our plan for the rest of this year in terms of the move-in schedule for our new equipment and when our new capacity will come online. But if there's any adjustment in this schedule, obviously that will impact the depreciation schedules.

Rick Hsu - *Daiwa Securities - Analyst*

Right. Okay. Fair enough. One more question is about your CapEx this year, \$2.1b. Can you give us a more detailed breakdown? I know you are targeting a \$1.1b for the Beijing joint venture fab. Can you give us a more detailed breakdown for the rest?

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

The majority of that, actually that would be for the 12-inch fab for both our Beijing and our Shanghai fabs. And then a smaller portion would be for our Shenzhen fab. So I'm not sure exactly what do you expect.

Rick Hsu - *Daiwa Securities - Analyst*

Yes. Because you're talking about [strict] breakdown here in your release. One is clearly for the fab capacity bill. The second is for the new joint venture you set up for R&D of 14 nanometer.

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

Right.

Rick Hsu - *Daiwa Securities - Analyst*

And the third is for R&D equipment and tools. I'm looking at a more detailed breakdown between capacity build and R&D purpose.

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

Okay. In terms of the R&D purpose, that would be about \$160m in terms of R&D out of the \$2.1b.

Rick Hsu - *Daiwa Securities - Analyst*

So \$160m?

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

Yes.

Rick Hsu - *Daiwa Securities - Analyst*

That includes the new joint venture company that you set up to develop 14-nanometer. Right or not?

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

That's right. That's right. That's right, yes.

Rick Hsu - *Daiwa Securities - Analyst*

I see. Okay. That's clear. Thank you so much.

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

Thank you.

Operator

Szeho Ng, BNP.

Szeho Ng - *BNP Paribas - Analyst*

Hi. Good morning. By end of this year, what would be the revenue mix between high-k metal gate and for your 28-nano business?

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

I think on a quarter basis high-k metal gate is probably maybe one-eighth to one-quarter of the total 28 revenue.

Szeho Ng - *BNP Paribas - Analyst*

That's for which quarter?

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

Fourth quarter.

Szeho Ng - *BNP Paribas - Analyst*

Fourth quarter. Okay. All right. Okay, thanks. And the second question, actually for the \$2.1b CapEx this year what would be the amount for all your JVs?

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

We mentioned that for our Beijing JV, it's \$1.1b. And then we have another JV which is for our bumping services in Jiangyin, so that is about \$80m.

Szeho Ng - *BNP Paribas - Analyst*

80, 8-0, right?

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

That's right.

Szeho Ng - *BNP Paribas - Analyst*

Okay. And what's your holding in the wafer bumping JV right now?

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

It's 51%.

Szeho Ng - *BNP Paribas - Analyst*

Okay. All right. Okay. Thank you very much.

Operator

Roland Shu, Citigroup.

Roland Shu - *Citigroup - Analyst*

Hi. Good morning.

First question to me is for your depreciation schedule. Are you still using five years for 8-inch and seven years for 12-inch for depreciation schedule?



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

No, we have seven years for our 12-inch and six years for 8-inch.

Roland Shu - *Citigroup - Analyst*

Okay. Six years for 8-inch.

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

And that (multiple speakers) --

Roland Shu - *Citigroup - Analyst*

So.

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

That has been the --

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

That has been the policy consistently.

Roland Shu - *Citigroup - Analyst*

Okay. Yes. So now we are speaking with this depreciation schedule. So that means then this year we have about 50% year-on-year depreciation cost increase and with this depreciation schedule and with \$1.5b in CapEx spending last year and \$2.1b this year, so that means that depreciation next year or even 2018 definitely will continue to increase. And also under almost 100% [gross] utilization now, so I'm worried about the longer-term gross margin. So is the gross margin next year or 2018 -- is there any room for the gross margin to be higher than this mid-20 percentage points?

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

As we ramp up our new fab, both the Shenzhen as well as our Beijing, as their scale increases, we see that on the -- definitely the cost it should come down. So in that sense, even though there is an increase in the depreciation part, I think the various variable costs and other costs should come down as well. So there are such an opportunity as we look into the new fab to get to that scale.

Roland Shu - *Citigroup - Analyst*

Yes. Understood. Yes. But -- so can we assume last year the more than 30% gross margin probably will be the peak gross margin in the near term, and maybe in the near -- coming years?

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

Well, I think conservatively speaking, yes, you can expect that. But we will try to work our way to reduce our various other costs.



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

Yes, but I think, as what T.Y. mentioned, I think right now for the near term, the focus for the Company is really driving the growth. And right now I think we have tremendous opportunity open to us. So we are reinvesting for the future.

Roland Shu - *Citigroup - Analyst*

Okay. Understood. Yes. Okay. Thank you. My second question is for your high-k metal gate 28-nanometer technology. Can you remind us is your high-k metal gate gate-first or gate-last technology?

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

High-k metal gate is a gate-last technology.

Roland Shu - *Citigroup - Analyst*

Okay. Yes. So for gate-last I think this is what -- the leading foundry is using this gate-last technology and the majority of the customers are also adapting this gate-last technology. So the question is right now, how are you going to differentiate your high-k metal gate technology with these leading foundries, especially like TSMC that have the enhanced version for the HPC or even HPC plus high-k metal gate technology. So I think that actually TSMC has continued to improve the cost and also performance for its high-k metal gate. So how are going to differentiate your high-k metal gate technology with the leading foundries? Thank you.

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

I think this is a very good question. I think that the same question can be asked on our 40 and -- a few years ago. And basically I think that looking at our 40, 40 has been a very, very successful technology node. And we see that 28 is also a very, very long technology node. And we will be doing more work to add in additional features to our high-k metal gate to differentiate.

So at this point it's -- I'm not at liberty to tell you exactly what we are planning to do, but for sure that we will find a path to really make it a successful technology.

Roland Shu - *Citigroup - Analyst*

Okay. So it sounds like actually your position, your high-k metal gate is a performance enhancement and not just because the cost savings or cost benefits to customers. Am I reading you right or --?

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

We in the past had come out with various innovations in terms of the differentiation. And I think that you can be sure that we will try to do that.

Roland Shu - *Citigroup - Analyst*

Okay. Understood. Thank you.

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

And this is -- what you have made is a good suggestion as well.

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

Roland, before you drop off I want to also address you about the concern about the gross margin. Just that in the last one/two years I think a lot of concern has been expressed in terms of our gross margin trend by our new 12-inch fab in Shanghai. But actually we were pleased to say that, as we ramp up the fab and the fab becomes more stable in terms of operations, right now the fab operating at -- fairly close to our corporate gross margin.

So I think it's just a -- as I said, we are very confident, as we continue to ramp up our two new fabs in Beijing and in Shenzhen, it will go -- it will eventually go close to our average corporate margins.

Roland Shu - *Citigroup - Analyst*

Okay. Understood. Actually, I think this is a -- another concern is that for the last year I think the Company or its focus, let's say, you are looking for the profitability, growth on the profit, and also I think [SMIC] reached your targets, so you have a very good gross margin. And I think that you said that starting from year and next year actually you are looking for the revenue growth.

But I'm just concerned how are you going to focus on revenue growth and also at the meantime you can also maintain a gross margin growth. Because I think last year 30% and this year low 20 to -- a low- to mid-20 percentage. But I think this is a big difference on that. So this is I think is our concern on that. I think that if you can grow your gross margin above this, I think that probably will be appreciated.

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

Yes. I think that it is clear that, as we grow, there will be some, in the initial phase, especially when we ramp our new fab, there is pressure on the gross margin. Such is the case -- such was the case when we turned our fab 8 -- no -- yes, fab 8, our Shanghai 12-inch fab from an R&D fab to a production fab. And we do see at that time, maybe two years ago, a significant drop in the margin. And -- but then, as we ramp it up, you can see that our margins recover and it sets new records.

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

(Multiple speakers). Yes. I want to clarify that when we said that we are focused for growth in the near term, but we are not sacrificing our long-term profitability. It's just that I think in the near term, because of the new CapEx, we particularly see it on the gross margin. But we think that it's going to pick up in the future.

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

Roland, we need to go to the next --.

Roland Shu - *Citigroup - Analyst*

(Multiple speakers). Okay. Thank you. Yes, I will follow up later. Yes. Thank you.



Operator

Patrick Liao, Macquarie.

Patrick Liao - Macquarie - Analyst

Okay, my questions, I have a few questions.

Firstly, about the new factory going to be built up in China for UMC and TSMC. Do you think -- how is the view for the competition for the new joiners? And how likely -- do you think there's likely a subsidy to every semiconductor fab built in China, including Intel, Samsung, Hynix, so in essence TSMC/UMC also might get a subsidy?

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

First of all, I think that the fact that our peers in the industry are coming into China really proves that it is a strategic to be present in China. And SMIC as a whole has most of our operation in China. And in that sense that we have really had the longest period of cultivating the customer relationships. And so we believe that we still will retain that local advantage, despite the fact that our industry peers will be entering this market.

It is difficult to say that -- how much subsidy all these companies will get from the central government. But I would refrain from commenting on that.

Patrick Liao - Macquarie - Analyst

Okay. So if we are assuming that because there's so many [challenge], do you (inaudible) that SMIC has been getting so much subsidy. I'm a little bit doubt that -- I think everyone will get a subsidy, so everyone will be the same. Do you think that will be the likely case and the likely right case? What I'm saying is that -- okay, fine, that's actually [a fact], then are you -- sorry, there is a noise for fire alert, so I'm going to have to hang up right now. Sorry.

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

Okay.

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

Okay. I hope that everything is safe and sound.

Operator

Thank you, ladies and gentlemen. Allow me to now hand the call back to the CEO, Dr. Chiu, for closing remarks.

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

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

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

Thank you.

Operator

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

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