Client Id: 77

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981.HK - Q3 2016 Semiconductor Manufacturing International Corp Earnings Call

EVENT DATE/TIME: NOVEMBER 08, 2016 / 12:30AM GMT

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PRESENTATION

Operator

Ladies and gentlemen, welcome to the Semiconductor Manufacturing International Corporation's third quarter 2016 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.

Today's webcast conference call will be simultaneously streamed through the Internet at SMIC's website. Please be advised that your dial-ins are in listen-only mode. However, at the conclusion of the management presentation, we will be having a question and answer session, at which time, you will receive further instructions as to how to participate.

The earnings press release is available for download at www.smics.com. Webcast playback will also be available approximately one hour after the event at www.smics.com.

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

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

Good morning and good evening. Welcome to SMIC's third quarter 2016 earnings webcast conference call.

For today's call, our CEO, Dr. T.Y. Chiu, will first provide some general remarks. Afterwards our CFO, Dr. 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 be 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 our website under Investor Relations, in the Events and Presentations section.

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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 US Securities and Exchange Commission and the Hong Kong Stock Exchange Limited, including our annual report on Form 20-F, filed with the US Securities and Exchange Commission on April 25, 2016.

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. Thank you for joining us. 2016 has been an exciting year thus far for SMIC, marked by robust customer demand, growth and good execution of our strategy. Over the past two years, SMIC's utilization and growth rate have exceeded the global foundry industry and we target to outpace the industry in the next few years.

We maintained our drive to grow profitably, execute precisely and expand value for our stakeholders. We are still experiencing robust demand from various regions, applications, and technology nodes.

We are addressing the demand opportunities by laying the foundation for continuous growth with prudent expansion to meet our customer's demands. I'm very pleased to announce our excellent third quarter results, which have been the result of our team's strategy and execution, and the expanding position in the China market.

We had our 7th consecutive quarter of revenue growth and 18th consecutive quarter of profitability. Our revenue was a record high of $774.8 million, representing a growth of 36% year-over-year, and 12.3% quarter-over-quarter. Our net profit attributable to SMIC was also a record high of $113.6 million, a growth of 37.4% year-over-year, and 16.3% quarter-over-quarter. This marks the first time that our quarterly net profit exceeded $100 million, and the second consecutive quarter to have ROE exceeding 10%. We are also happy to report that our 28-nanometer shipment exceeded US $10 million, accounting for 1.4% of revenue.

Furthermore, we are guiding another strong Q4. Q4 is targeted to grow at 5% to 7% quarter-over-quarter. For the moment, 2016 annual revenue is targeted to grow more than 28% year-over-year. Moreover, with our current visibility, we see continued growth in Q1, which would represent our 9th consecutive quarter of growth. We maintain the target to grow at an annual compounded rate of 20% from 2016 to 2019. Meanwhile, we expand capacity carefully with preparation in the pipeline to meet our customer's demand.

Analyzing our growth from the regional perspective, all regions grew healthily in the third quarter. Beginning with China, where revenue grew 46.5% year-over-year, and 11.2% quarter-over-quarter. North America grew 13.6% year-over-year, and 20% quarter-over-quarter. Eurasia grew 50% year-over-year, and 5.2% quarter-over-quarter. On the 28-nanometer, we nearly tripled revenue to more than $10 million, representing 1.4% wafer contribution in Q3. Our 28-nanometer revenue is set to double again in Q4.

We believe that our flexible 28/40-nanometer capacity strategy has enabled us to best ser9y su2speaferWe besfabpressaly, execut8 Tw 130 1 36 298.45

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65-55-nanometer demand has also far exceeded our current capacity, growing at 30% year-over-year, and 15% quarter-over-quarter. We are therefore adding additional 65/55 capacity in our Beijing B1 fab and initiating a new 12-inch fab in Shenzhen to meet expanding demand in 55-nanometer.

0.13 micron grew at 58.8% year-over-year, and 46.8% quarter-over-quarter, with new contribution from LFoundry in this area. 0.18-micron technology grew 20% year-over-year and 3.2% quarter-to-quarter, from existing and new customers ramping in PMIC and sensors.

We continue to broaden and diversify our technology offerings. Our collaboration with customers on various phone components -- IoT, auto, AR/VR, and industrial applications -- will propel SMIC's growth into the future.

To address the robust demand at hand for new and existing products, we are increasing this year's CapEx for foundry operation from $2.5 billion to $2.6 billion. This increment is primarily for second-hand 55-nano tools. We believe this year's CapEx intensity as a percentage of revenue is at a peak and will come down in subsequent years.

Beijing J.V. 12-inch fab, we have a total installed capacity of 18,000 by year end. We are expanding Beijing 12-inch fab for mature technology to around 45,000 wafers by the end of the year. In addition, we have secured a significant amount of second-hand equipment for additional 55-nano capacity to be installed in our recently announced Shenzhen 12-inch fab.

Shenzhen 8-inch fab ramped smoothly and will be at 31,000 per month 8-inch by year end. LFoundry is now fully consolidated financially with 40,000 8-inch capacity. We are investing additional CapEx in LFoundry to enable SMIC's technology transfer to expand LFoundry's capability.

In the past few years, SMIC was able to respond to market opportunity due to availability of unused cleanroom. Without this available space, our growth would have been constrained significantly. As the available cleanroom is now quickly being depleted, we are now preparing new fabs for the next phase of growth.

In the last month, we announced several new fab constructnd a.- Is area.iantyFle.iaT5.00m $ify our teTj[illegible].099 hand f. Fnalacity.ow preparbuilng 12ble Tw

We have depleted our available cleanroom and are prudently preparing for the next phase of growth with new civil construction.

We are working to bring growth opportunity in China to the global semiconductor industry, as in LFoundry Avezzano, Italy, and striving to serve customers worldwide.

SMIC is vigilant in balancing profitability, growth, building shareholder value, and serving our customers for the benefit of our stakeholders.

We appreciate your ongoing support. Thank you for your time.

I will now hand the call over to Yonggang for the financial highlights and 2016 Q4 guidance.

Yonggang Gao - *Semiconductor Manufacturing International Corporation - CFO*

Thank you, T.Y.

Greetings to all our listeners. I will highlight our last quarter's results first, and then give our fourth quarter 2016 guidance.

Last quarter, our revenue, gross profit and net profit were all record highs. Revenue was $775 million, an increase of 12.3% quarter-over-quarter, exceeding our guidance of 8% to 11% growth increase.

Gross profit was $232 million. Gross margin was 30% at the high end of the guidance range of 28% to 30%. Profit for the period attributable to SMIC was $114 million.

Now, looking into the fourth quarter of 2016. Our revenue is expected to increase by 5% to 7% quarter-over-quarter. Gross margin is expected to range from 28% to 30%. Non-GAAP operating expenses are expected to range from $179 million to $184 million, and the non-controlling interest of our majority owned subsidiaries are expected to range from positive $37 million to $39 million, which are losses to be borne by non-controlling interests.

Our planned 2016 capital expenditures for foundry operations are up from approximately $2.5 billion to approximately $2.6 billion, the increase is mainly for the acquisition of used equipment for Shenzhen's new 12-inch fab.

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

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

Thank you Gao Zong, 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 $775 million above the guided range, mainly because of the increase in wafer shipment and the revenue contribution from the acquisition of LFoundry.

Cost of sales increased to $543 million. Gross margin was 30% in the high end of the guided range but declined slightly from 31.6% in Q2 2016. This was mainly due to first, the receipt of insurance compensation in Q2 2016, and secondly, the acquisition of LFoundry in Q3 2016.

Operating expenses increased to $124 million in Q3 2016. R&D expenses increased by $17.4 million Q-on-Q to $82 million. The change was mainly due to the high level of R&D activities. Funding of R&D contracts from the government was $9.6 million in Q3 2016. Excluding the effect of employee bonus accrual, government funding, and gain from disposal in the living quarter, non-GAAP operating expenses were $121 million in Q3 2016.

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Profit from operation was $109 million. Profit for the period attributable to SMIC increased to $114 million, while non-controlling interests were $1.4 million of credit to SMIC's attributable profit in Q3 2016.

If excluding the impact of finance costs, depreciation and amortization, and income tax expense, our EBITDA margin was 38.7% in Q3 2016.

Moving to the balance sheet at the end of the third quarter 2016, cash and cash equivalents increased to $1.63 billion. If including other financial assets, we had approximately $1.8 billion cash on hand at the end of Q3 2016.

Our total debt increased to $2.9 billion in Q3 2016, compared to $2.5 billion in the previous quarter. By the end of Q3 2016, our gross debt to equity ratio was 54.7%, our net debt to equity ratio was 21.3%.

In terms of cash flow, we generated $200 million of cash from operating activities. Cash used in investing activities decreased to $688 million. Cash from financing activities was $539 million.

To examine our revenue by application, the communication and consumer segments contributed 46.1% and 40.7% of our revenue respectively. Geographically, revenue from China, North America, and Eurasia contributed 51.6%, 28.3%, and 20.1% of total revenue respectively.

In terms of technology, revenue from 28-nanometer contributed 1.4%. Revenue from 40/45-nanometers contributed 22.6%. And revenue from 55/65-nanometers and 90-nanometer contributed 20.8% and 2.2%, respectively. Meanwhile, 0.13 micron and above line width contributed 53% of our wafer revenue.

In terms of our overall capacity, total monthly capacity at the end of third quarter increased to 391,000 8-inch equivalent wafers, an increase of 15% Q-on-Q. The change was mainly because of the capacity expansion in our Shanghai 8-inch fab, Shenzhen 8-inch fab, Beijing 12-inch mega fab and our majority-owned Beijing 12-inch fab, as well as the acquisition of LFoundry in Q3 2016.

Our planned 2016 capital expenditure for foundry operations are approximately $2.6 billion, an increase from $2.5 billion based on an early estimate. The increase is mainly for the acquisition of used tools for the Shenzhen new 12-inch fab.

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

QUESTIONS AND ANSWERS

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, please be reminded to limit your questions to two, number two, two per person. Operator, please assist.

Operator

Thank you. (Operator Instructions).

The first question comes from the line of Randy Abrams from Credit Suisse. Please go ahead.

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Randy Abrams - *Credit Suisse - Analyst*

Thank you. Good results. I wanted to ask the first question about the fab plans in the CapEx. If you could give an initial view on 2017 CapEx and how that split of funding would be between operations, the JV partners, or debt. And also if you would consider a leasing company for a portion of that CapEx, and then if you could talk a bit about the priorities for the fabs, for the build-out between the different fabs you've announced.

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

Okay. Randy, right now we are still working on the 2017 budget, so we cannot say for sure in terms of the CapEx next year. But as mentioned in T.Y.'s script, we do expect the CapEx next year in terms of intensity will definitely come down. Our feeling is that most certainly the CapEx will be at or below current year level.

In terms of source of funding, I think we are in a very comfortable situation. We have a net debt to equity of about 25%. So we have room to leverage to continue to fund our expansion with debt.

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

Okay. As far as the priority of capacity expansion, I think, firstly, it's our Beijing JV fab. We are still expanding our capacity to address our customer demand in 40 as well as 28. So that's one thing. The second one is to expand our 55-nano capacity, which is also we will adding additional 5,000 of capacity in our Beijing Fab 1, which is wholly SMIC owned.

In addition, we are still expanding our 8-inch capacity, which will be in Shenzhen next year. At the end of the year we will start to set up and pilot our Shenzhen 12-inch mature fab, which will address the very strong demand in 65/55 area.

Another important effort is to add additional capability in LFoundry and so that we can transfer additional loading into LFoundry, since there are a lot of customer interests to use that particular fab.

Randy Abrams - *Credit Suisse - Analyst*

Okay. Thank you. One quick follow-up, for the funding, if you expect much use of the leasing company or you'll still evaluate that.

Then the second question I wanted to ask was on the growth drivers as you look out over the next year, if you think it's similar drivers to what drove this year in terms of the 8-inch and then on 40 and 55. If you can expand a bit, it sounds like you're getting a lot more aggressive on the 55/65-nanometer, so the applications that are driving that node, pretty aggressive expansion there.

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

Okay. First of all, as far as the leasing is concerned, at this moment, SMIC has very, very minimal leasing program and indeed we have only very small program in our testing house, that is we do use leasing, very, very small amount. We are looking at that particular option, but only if that really brings in significant economic advantage to SMIC as well as our customers.

So this is at the moment still under a lot of scrutiny and, yes, we are studying it. Yes.

The growth driver for 55. We see both very -- a lot of interest, and our new technology, the ultra-low power, as well as our present process for connectivity. And as for the low-power, it will be for the IoT. So the rest of the application is in connectivity, TV and set-top box, as well as RF.

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Randy Abrams - *Credit Suisse - Analyst*

Great. If I could ask just for beyond the broader growth drivers for next year, if you see any expanding out, this year grew high 20s and I think was on some of those areas in consumer plus 8-inch, the fingerprint and power management, but if you see any kind of new things emerging as you look out, or if it's similar drivers for next year.

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

Could you say that again? I didn't quite catch it. Yes.

Randy Abrams - *Credit Suisse - Analyst*

I was just asking for your growth drivers. This year you saw a lot from the sensors and then also on the 12-inch on some of these consumer and connectivity. If you see some new growth drivers emerging to make the net 20% CAGR.

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

Okay. Yes. Definitely we -- a lot of the customers, present customers, are coming in with a new product and we are seeing also new area in sensors, especially in CIS, that is showing a lot of interest in 12-inch capacity.

Randy Abrams - *Credit Suisse - Analyst*

Great. Thank you.

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

Thank you, Randy.

Operator

Next question comes from the line of Sebastian Hou from CLSA. Please go ahead.

Sebastian Hou - *CLSA - Analyst*

Hi. Thanks for taking my questions. So my first question is on 28-nanometers. Congratulations on finally you reached over 1% of the total revenue contribution in the quarter. So I think T.Y. also guided for this revenue to double in 4Q. So if my math is right, so that will probably account for like [3]% of the total revenue. So, can you give us more colors on what type of application is this and how do you see the ramping curve into 2017, and how the profitability of that?

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

Okay. The applications is still in a lot of the communication, mobile phone area, and we are also seeing some other such as the AP. I think that it can still ramp very strongly. Right now we are still in our advanced technology area, capacity limited. And so that's why we are still targeting to build our Beijing JV as our priority CapEx.

So, does that answer you?

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Sebastian Hou - *CLSA - Analyst*

Yes, mostly. So, T.Y., can I get more your thoughts on, so, in 4Q, probably around 3% total revenue contribution. So, how about for next year? And say, by the end of next year, do you see that 28 will account for, like say, more than 10% of revenue?

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

Right now it's difficult to project because it definitely depends on the CapEx we intend to spend. Because in addition, it also depends a balancing between the 40-nano demand as well as our 28-nano demand. But we think it does have potential to ramp significantly way -- yes.

Sebastian Hou - *CLSA - Analyst*

Okay. In terms of the profitability or, I would assume, maybe the new process usually carry lower than corporate average margins. Do you see that when you see the chance that when it ramps more aggressively in 2017, how do you see that impact your overall gross margin?

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

I think this applies to every technology. As we first do the initial ramp, usually the profitability is low. So as we bring the node to a more economic scale, we do expect the profitability to improve.

Sebastian Hou - *CLSA - Analyst*

Okay. My second question is more on the 65/55-nanometers. I think earlier in the prepared remarks you talked about going to already secure a lot of second-hand equipment on this one, but I think probably in the first [and you're going to build a new Shenzhen fab] to do that. So probably you see the great demand right now for the next few years, but how do you see to monetize that in, like say, in three to four years, or a longer term perspective? Because I -- presumably, some of the or majority of the customer there probably will migrate to 40-nanometers, particularly when T.Y. talked about the application is by set-top box, TV, RF. It's my understanding, a lot of that are already manufactured on 40-nanometers right now. So how do you see to monetize that and how do you see that kind of impact when say it's three or four years beyond -- when those customers migrate to 40? Will those 55/65-nanometers capacity become idle?

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

Okay. The decision to build a 65/55 is made with a lot of our consultation with our customers and market surveys. We believe that there are certain sectors of the market, even in the Wi-Fi, that will always be using 65/55. So we have -- we are quite confident that this particular node will see a lot of application, especially when IoT is ramping up.

Secondly, we are also looking into new applications such as various sensors, as well as drivers. So these are areas that have a huge demand for capacities and we see that there's a lot of future potential for this particular technology node.

Sebastian Hou - *CLSA - Analyst*

Thank you. Just want to follow up on what you just mentioned, T.Y., but you mentioned about your application include driver. Is that driver IC?

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

Yes, especially the AMOLED drivers.

Sebastian Hou - *CLSA - Analyst*

Okay. Got it. Thank you.

Operator

Thank you for the questions. Next question comes from the line of Steven Pelayo from HSBC. Please go ahead.

Steven Pelayo - *HSBC - Analyst*

Yes, great, guys. Let's start I guess with depreciation, and obviously it's stepping up each quarter here. What does it look like for the fourth quarter and then for 2017?

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

We are still keeping the guidance for our depreciation for this year. For the whole year, we are still expecting around -- about $735 million being the whole year. So you're going to see there's some step-up in Q4.

For next year, as what we mentioned earlier, we're still working on the planning. So we do not guide for next year depreciation at this point in time.

Steven Pelayo - *HSBC - Analyst*

I guess I just want to make sure there isn't a step function in the first quarter coming as far as we know, is there?

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

I think given our expansion trend in the last two years, you're going to see some increase. Yes.

Steven Pelayo - *HSBC - Analyst*

Okay. Then another question on the OpEx guidance. I guess you said kind of on a non-GAAP basis adding back in the R&D credit, there was about $123 million, and now you're guiding over $180 million it looks like at the midpoint. So, what's going on in OpEx? And could you also address your full year expectations for R&D credits as potential offsets there as well?

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

Yes. We're guiding the non-GAAP OpEx to go up in Q4. First of all, Q3 was low for some reasons. For example, we have recovered about $10 million doubtful debts in Q3. So actually, that actually reduced the number for Q3. In Q4 we are looking at some increase in both R&D and also in the G&A area. For R&D, it's mainly because, as you know, we have some government projects to work on, and many of these projects will come to completion in Q4.

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So we're going to see some step-up in the R&D expenses. At the same time, we're going to see some step-up in the R&D funding. We're going to talk more about it later on.

Secondly, for the G&A expenses, there's also some increase because of various reasons, some consulting fees, some indirect taxes, and some stock option expenses. So which is why we are guiding up the non-GAAP OpEx.

In terms of R&D funding, we are forecasting for whole year to be about $65 million to $67 million, which is working out to be about in the $37 million, $38 million range in Q4.

Steven Pelayo - *HSBC - Analyst*

$37 million, $38 million in the fourth quarter. Okay.

And then I just want to -- last quick question is I want to clarify. Before you had said capital intensity is going or it's peaking now, so that goes down as a percentage of sales, but then I think you answered Randy's question about CapEx being lower year on year. I want to make sure, are you talking about intensity again there or are we talking about dollars being lower next year?

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

First of all, we are very certain about that capital intensity is going to come down, okay, because of the -- we do expect (inaudible)our revenue continued growth. In terms of the absolute amount of CapEx, as I say, right now we are not giving any guidance for next year. But our feeling is that probably the CapEx will remain around the same level or slightly below.

Steven Pelayo - *HSBC - Analyst*

What kind of capacity increase do you think a year from today that that's going to get you?

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

Is that number four question, Steve? Is that number four question?

Steven Pelayo - *HSBC - Analyst*

That's all right. Randy asked four questions as well so I'm sneaking one more. (laughter)

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

Okay. I think, because as T.Y. said that we're going to forecast about 20% year-on-year in the next two, three years, so you're going to see the capacity will grow in line with our growth in the revenue projections.

Steven Pelayo - *HSBC - Analyst*

Okay. Excellent, guys. Thanks a lot.

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

Thank you.

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

Thank you.

Operator

Thank you for the questions. Next question comes from the line of Roland Shu from Citigroup. Please go ahead.

Roland Shu - *Citigroup - Analyst*

Hi, good morning. First question is you expect first quarter next year will be continue a growing quarter based on your current visibility. How is it compared to Vanguard's two months order visibility? So, what kind of demand over such longer visibility and how confident you are for this long visibility?

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

Yes, I think partly because as Gao said, we're very full right now, so, we do have a very long backlog in terms of serving our customers. So they give us a longer visibility in terms of the customer demand.

I think for Q1, we are very confident that the revenue will go up. But I think as you rightly said, we are still in the process of targeting demand for our -- from our customers. So we are not giving any precise guidance.

Roland Shu - *Citigroup - Analyst*

Yes, but you are still very confident about the revenue in Q1 definitely will be go up, right?

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

Yes.

Roland Shu - *Citigroup - Analyst*

Okay. So this is also I think a part of this, you know, a follow-up question. UMC is using lower price to get more 8-inch business. And also I look at TSMC, TSMC this year its 8-inch revenue is declining. So I've seen that you continue to build your 8-inch capacity and also you continue growing your 8-inch revenue. But what will continue driving this trend going forward for your 8-inch business?

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

Okay. The 8-inch, indeed we still see very strong demand in the Bluetooth and some consumer area, also to make power management as well as sensors. We continue also to see new application, especially requiring low-powered applications, I think that is mostly probably going for the IoT market.

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

I think the strength for each business has been around for about two years. I think that is really attribute to the strength of our China market position as well as I think the R&D work we have done in the past two years in terms of differentiating our technology.

Roland Shu - *Citigroup - Analyst*

Okay. So for next year, are you going to continue to build 8-inch capacity? And any risk for this continued increase for 8-inch capacity going forward?

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

Yes, we continue to expand our Shenzhen 8-inch fab to add about 10,000 wafer to Shenzhen. We are also trying to optimize our LFoundry capability as well as its capacity, so that it can receive a lot of customers who would like to use LFoundry capacity.

Roland Shu - *Citigroup - Analyst*

Okay, yes, understood. Thank you.

Okay, second question, just for you. You are now building your new --

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

Third question.

Roland Shu - *Citigroup - Analyst*

-- 12-inch fab -- okay, this will be very short, yes. So what is depreciation this year for your new 12-inch fab capacity in Shenzhen? Thank you.

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

I think for the new 12-inch fab in Shenzhen, I think the impact for depreciation this year will be very small because, first of all, we have plan only for mini-line in this stage. Secondly, we, based on the current schedule, the mini-line next year will only be up and running in -- towards the end of the year.

Roland Shu - *Citigroup - Analyst*

But for the depreciation period, how long will it be, for five years or seven years?

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

For our 12-inch line, our normal depreciation is for seven years.

Roland Shu - *Citigroup - Analyst*

Okay. So this one will be the same, right?

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

Yes.

Roland Shu - *Citigroup - Analyst*

Okay. Thank you.

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

Thank you.

Operator

Thank you. Next question comes from the line of Gokul Hariharan from JPMorgan. Please go ahead.

Gokul Hariharan - *JPMorgan - Analyst*

Yes, hi. Thanks for taking my questions, and great quarter as well. A couple of questions.

First of all, could you comment a bit on the profitability trend? I think this year gross margin has held up very well, even with the increase in depreciation. Now, more 12-inch investments coming through, how should we think about profitability going into the next couple of years -- sorry, next year given that your utilization is already pretty close to 100% and there is a fair bit of 12-inch as well as 28-nanometer coming in? Maybe you could address it both from maybe a gross margin perspective as well as maybe an EBITDA perspective, stripping out the depreciation expenses. Thanks.

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

I think that the key for the profitability, as in all foundries, is still utilization. Okay. So as we expand our fab, our strategy was to keep our fab fully

Gokul Hariharan - *JPMorgan - Analyst*

Okay. Second question, on the funding, I think, Gareth, you mentioned you're primarily taking debt funding. Could we talk a little bit about the financing plan for next year? It looks like there is still going to be a little bit of a gap in terms of your EBITDA versus the CapEx. Is it going to be almost 100% debt funding for next year? Do you have visibility into that at this point?

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

Well, one point is that, as we mentioned in our script, we are fairly comfortable in terms of funding. We have about $1.8 billion cash on hand right now. We're going to generate next year I'm sure more than $1 billion from EBITDA. Okay. At the same time, don't forget, a big part of our CapEx next year will still be for our joint venture fab in Beijing. That will be 49% funded through our joint venture partners.

So our intention is continue to fund it through our -- through straight debt.

Gokul Hariharan - *JPMorgan - Analyst*

Okay. That's all. Thank you.

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

Thank you.

Operator

Thank you for the questions. Next question comes from the line of Charlie Chan from Morgan Stanley. Please go ahead.

Charlie Chan - *Morgan Stanley - Analyst*

Hi. Congratulations for a great result. My first question is your growth drivers. Apparently you are outgrowing your industry peers especially in the 8 inch business. So I want to clarify that your outgrowth comes from your position to China domestic customers, or are you also getting more outsourcing from foreign companies as well? Thanks.

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

I think that in all areas we are growing. As I reported we see revenue growth in all areas. Perhaps there are stronger growth year-over-year in China as well as in Europe, but we think this year, with our 28-nano ramping up, the US revenue will also be very strong. So I think this is not a single region or single technology growth.

Charlie Chan - *Morgan Stanley - Analyst*

Okay, so fundamentally I can understand that your outgrowth is coming from China and local customers, but for you to gain more market share from foreign companies, what would be SMIC's advantage?

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

For example, I think some of our customers, even in the overseas areas that have been working with us for a long time on certain sensors, and I think we have provided them with great service and great technology, so they were able to grow tremendously over the last few years. The things that we have grown, we have proved that we are able to serve our customers well. At this moment, even in all regions there is lots of interest from new customers that are trying SMIC's technologies. I can give several examples. Some of the touch sensors, some of them are just drivers. These are areas which SMIC does not have a large presence in the past, and I think that our customers are very promising customers, with a lot of potential to expand in China.

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

Just to give you an indication about the spread of our customers, if you look at our top five customers in Q3, we have three from US, one from China, one from Europe. So we have a well-diversified customer base that we are working for.

Charlie Chan - *Morgan Stanley - Analyst*

Thanks, that's very helpful. My second question is on the supply side. So it feels like to me your key risk to the growth is really how are you going to be able to source more second-hand tools for those 12-inch tools or 65-nanometer tools. So do you think that is a risk and how can the Company can ensure sustainable supply from those second-hand tools?

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

Certainly there is always some risk to sourcing. We have a combination of second-hand tools, and we have steady partners in some of these big companies who are upgrading their manufacturing into more advanced technology. In addition, we are also sourcing some of the new tools from the original equipment suppliers, so in addition we also have access to domestic equipment vendors that can really, very well address the mature technology part. I think we have proven in our very smooth and quick ramp-up in Shenzhen that we have access to a combination of equipment. So I think we are relatively confident that we can do this job quite well.

Charlie Chan - *Morgan Stanley - Analyst*

Okay, understood. I think it's very impressive you can source those tools and monetize from those second-hand tools that your industry peers cannot. So congratulations again. Thanks.

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

Thank you.

Operator

Our next question comes from the line of Ken Hui from Huatai. Please go ahead.

Ken Hui - *Huatai - Analyst*

Thank you for taking my question. I will deliver my question to Chiu. The first question is I think Tsinghua has accumulated over 8% of a stake in SMIC. Any comments on that? Any cooperation with the company that you are discussing? That is my first question. Thank you.

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

As far as we know, they have purchased between 5% and 6% of SMIC stock. This comes as also quite a bit of a surprise recently, and I think that we believe this is a confirmation of our performance, and there are lots of investors who have come in touch with our investor relations department that show interest. As far as having discussions with Tsinghua, there was no discussions or no invitation for them to come in. We intend to keep

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