



EAST ASIA SECURITIES COMPANY LIMITED

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HONG KONG RESEARCH

8th March 2004

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Mainboard Listing - Research

中芯國際集成電路製造有限公司

Semiconductor Manufacturing International Corporation [Stock Code: 0981]

Joint Bookrunners : CSFB

Deutsche Bank

Joint Sponsors &

Joint Lead Managers : CSFB (Hong Kong) Limited

Deutsche Bank AG, Hong Kong Branch

Sector: Technology

Business: Provision of semiconductor-fabrication services

Total share offer: 5,151,515,000 shares
(28.3% of the enlarged share capital)

HK public offering: 257,576,000 shares (5%)
Int'l offering: 4,893,939,000 shares (95%)

Greenshoe: 772,727,000 shares

Note: 1 ADS = 50 shares

Price: HK\$2.39-HK\$2.69 per share
Market cap.: HK\$43,556 mln-HK\$49,024 mln

Estimated FY2004 P/B: 2.1x-2.4x
Adjusted net tangible asset per share: US\$0.15

Staffing: 4,443

Public offer opens: 8th March 2004
Public offer closes: 11th March 2004

Receiving banks: HSBC, BOC (HK) and
Standard Chartered Bank
Share registrar: Computershare Hong Kong
Investor Services Limited

Listing date: 18th March 2004

Business of SMIC

The Company is one of the leading semiconductor foundries in the world. Since founded in April 2000, it has developed the capabilities to offer a wide range of integrated wafer-manufacturing services. It operates 8-inch wafer fabrication facilities in the Zhangjiang High-Tech Park in Shanghai as well as an 8-inch wafer fab in Tianjin (recent acquisition). As of 31st December 2003, these fabs had an aggregate capacity of 49,000 8-inch wafers per month for wafer fabrication and 9,000 wafers per month for copper interconnects. In addition, it is currently constructing 12-inch wafer fabrication facilities in Beijing, which will be the first 12-inch fabs in China. In fact, Fab 1 at the Shanghai facility has been selected as 1 of the 2 "Top Fabs of 2003" by *Semiconductor International*. In addition, the Company ranked 2nd in a poll of top global foundries of 2003 conducted by *Silicon Strategies*.

SMIC currently provides semiconductor-fabrication services using 0.35µm-0.13µm (micron) process technology for devices including logic technologies, memory technologies and specialty technologies. It also intends to expand capabilities in the fabrication of semiconductor wafers using both high-end logic and memory technologies. In addition to wafer fabrication, SMIC's service offerings include a portfolio of intellectual property consisting of libraries and circuit design blocks, design support, mask-making and wafer-probing. It also works with its partners to provide assembly and testing services.

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Major Shareholders after Listing

(Assuming the over-allotment option is not exercised)

Shanghai Industrial Holdings Limited (stock code: 0363)	10.2%
Motorola and its subsidiary MCEL	7.2%
2 funds managed by Deutsche Bank AG	5.7%
Beijing Beida Jade Bird Software System Company, which partly owns Beijing Beida Jade Bird	
Universal Sci-Tech Co. Ltd (stock code: 8095)	4.4%
	<u>27.5%</u>

Use of Proceeds

Net proceeds from the offer are estimated to be US\$970 million

(Assuming that the over-allotment option is not exercised and an issue price of HK\$2.54 per share, being the midpoint of the proposed price range of HK\$2.39-HK\$2.69 per share)

	US\$ million
To construct and ramp up the Company's Beijing fabs	403
To upgrade the technology and increase the capacity at the Company's Shanghai and Tianjin fabs	567

Financial Highlights

	Year ended 31 st December	
	2003 US\$'000	2002 US\$'000
Turnover		
<i>Manufacturing of integrated circuits, semiconductor services and design masks</i>	<u>365,823</u>	<u>50,315</u>
Operating profit / (loss)	(72,747)	(116,304)
Net profit / (loss)	<u>(66,145)</u>	<u>(102,603)</u>
Earnings / (Loss) per share	<u>(US\$11.35)</u>	<u>(US\$12.74)</u>

Strengths

- ✓ The global semiconductor market is forecasted to grow by over 20% in 2004 while a CAGR of 10% is expected for the overall period of 2003-2007. Near-term demand is indeed driven by a strong handset market, with further strength underlined by a corporate-PC replacement cycle as well as a broad-based upturn powered by the global economic recovery and an increased demand for electronic equipment.
- ✓ Currently, 38% of the global consumption of semiconductor chips stems from the Asia-Pacific region. As a matter of fact, the region's growth is expected to outpace that of the global market, with the China market being particularly promising. Chinese domestic demand still far outstrips supply at the moment, while the nation remains heavily reliant on imports. In 2002, equipment manufacturers in China/Hong Kong consumed about US\$23 billion worth of semiconductors, versus total imports of US\$16.9 billion. This gap is anticipated to grow even wider in the years ahead with surging mainland demand.
- ✓ Despite its short operational history, SMIC has become one of the leading foundries in the mainland with its advanced technology as well as a still-far-from-established supply chain in the country. Its turnover jumped more than 7-folds in 2003. Besides, SMIC has been producing more and more high-end and high-value products. Products of 0.18μm or below exceeded 50% of total sales in 4Q2003 and the leading 0.13μm products accounted for 10.4%. This has helped the Company achieve ASP (average selling price) per wafer close to its peer's levels.



- ✓ SMIC has a list of prestigious clientele. Its major customers include integrated device makers like Fujitsu, Infineon, Samsung, ST Microelectronics and Texas Instruments as well as fabless companies like Broadcom, Elite and Marvell.
- ✓ The Company has a sound shareholder backing while it has also established partnerships with leading semiconductor companies and research institutes like AG, Fujitsu, IMEC, Infineon, Motorola and Toshiba.
- ✓ SMIC is rapidly gaining economies of scale. Since mass production commenced in January 2002, it has successfully ramped up volume output. Quarterly wafer shipment reached 153K units in 4Q2003, which is equivalent to 13%, 24% and 65% already of those at rivals TSMC, UMC and Chartered Semiconductor. Capacity utilization has been maintained at above 88% since 2Q2002, higher than industry averages.
- ✓ All SMIC's wafer fabs in Beijing, Shanghai and Tianjin do enjoy a 5-year tax holiday from their respective local governments, followed by another 5 years of 50% off the standard tax rate of 15%.

Weaknesses

- × SMIC has incurred significant operating losses since it was founded in 2000, with operational losses of US\$27.7 million in 2001, US\$116.3 million in 2002 and US\$72.7 million respectively in 2003. We foresee high capex and depreciation charges for SMIC in the next 2 years as it ramps up its new fabs in Beijing and Tianjin as well as expands its capacity in Shanghai. And further on, the Company will likely continue incurring substantial operating losses, especially with high fixed costs relating to equipment purchases. Even if profitability is achieved, the cyclical nature of the semiconductor industry and periodic overcapacity in the industry may well make SMIC's operational results vulnerable to economic downturns.
- × SMIC (Cayman Islands) and SMIC Americas are involved in a legal action in the US brought by TSMC in 2003, relating to alleged infringement of 5 US patents and misappropriation of alleged technical and operational trade secrets. In the event TSMC were to succeed on its patent-infringement claim in the US, SMIC may be ordered to pay damages for past infringement and, as to future sales, enter into a licence agreement.
- × SMIC is dependent on a small number of customers for a substantial portion of its business. For the year ended 31st December 2003, its 5 largest customers accounted for approximately 57% of total sales. Should any of these customers cancel or reduce its orders, there would be an adverse effect on SMIC's operations.

Recommendation: Subscribe (Hit and Run – Prefer UMC in Taiwan)