

TAIWAN SEMICONDUCTOR MANUFACTURING CO LTD

Form 6-K

November 01, 2004

1934 Act Registration No. 1-14700

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 6-K

**REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16 OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the month of October 2004

Taiwan Semiconductor Manufacturing Company Ltd.

(Translation of Registrant's Name Into English)

**No. 8, Li-Hsin Rd. 6,
Hsinchu Science Park,
Taiwan**

(Address of Principal Executive Offices)

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.)

Form 20-F

Form 40-F

(Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.)

Yes

No

(If "Yes" is marked, indicated below the file number assigned to the registrant in connection with Rule 12g3-2(b):
82: _____.)

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Taiwan Semiconductor Manufacturing Company Ltd.

Financial Statements for the Nine Months Ended

September 30, 2004 and 2003

Together with Independent Accountants' Review Report

Readers are advised that the original version of these financial statements is in Chinese. This English translation is solely for the readers' convenience. If there is any conflict between these financial statements and the Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail.

English Translation of a Report Originally Issued in Chinese

INDEPENDENT ACCOUNTANTS' REVIEW REPORT

The Board of Directors and Shareholders
Taiwan Semiconductor Manufacturing Company Ltd.

We have reviewed the accompanying balance sheets of Taiwan Semiconductor Manufacturing Company Ltd. as of September 30, 2004 and 2003 and the related statements of income and cash flows for the nine months then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to issue a report on these financial statements based on our reviews.

We conducted our reviews in accordance with Statement of Auditing Standards No. 36 "Review of Financial Statements" issued by the Auditing Committee of the Accounting Research and Development Foundation of the Republic of China. A review consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the Republic of China, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with the Guidelines Governing the Preparation of Financial Reports by for Securities Issuers' Financial Reporting and accounting principles generally accepted in the Republic of China.

October 12, 2004

Notice to Readers

The accompanying financial statements are intended only to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in the Republic of China and not those of any other jurisdictions. The standards, procedures and practices to review such financial statements are those generally accepted and applied in the Republic of China.

English Translation of Financial Statements Originally Issued in Chinese

TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LTD.

BALANCE SHEETS

SEPTEMBER 30, 2004 AND 2003

(In Thousand New Taiwan Dollars, Except Par Value)

(Reviewed, Not Audited)

ASSETS	2004		2003	
	Amount	%	Amount	%
CURRENT ASSETS				
Cash and cash equivalents (Notes 2, 3 and 4)	\$ 78,289,897	17	\$ 82,730,782	22
Short-term investments (Notes 2 and 4)	46,128,381	10	11,664,302	3
Receivables from related parties (Note 18)	19,974,807	4	15,186,373	4
Notes receivable	76,183		43,709	
Accounts receivable	17,689,511	4	12,704,943	3
Allowance for doubtful receivables (Note 2)	(983,077)		(1,021,399)	
Allowance for sales returns and others (Note 2)	(3,342,566)	(1)	(2,055,142)	(1)
Other receivables from related parties (Note 18)	3,004,113	1	108,692	
Other financial assets (Notes 2 and 21)	1,307,965		1,192,351	
Inventories net (Notes 2 and 5)	12,628,465	3	11,813,455	3
Deferred income taxes assets (Notes 2 and 12)	2,471,000		2,117,000	1
Prepaid expenses and other current assets	437,243		688,212	
Total current assets	177,681,922	38	135,173,278	35
FUNDS AND LONG-TERM INVESTMENTS (Notes 2, 6, 16 and 21)				
Equity method	45,792,238	10	33,932,303	9
Cost method	717,299		736,653	
Long-term bonds	11,676,396	3		
Total funds and long-term investments	58,185,933	13	34,668,956	9
PROPERTY, PLANT AND EQUIPMENT (Notes 2, 7 and 18)				
Cost				
Buildings	82,012,404	18	70,767,593	18
Machinery and equipment	374,207,513	81	324,426,114	85
Office equipment	6,853,204	1	6,077,495	2

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	463,073,121	100	401,271,202	105
Accumulated depreciation	(285,808,476)	(61)	(233,609,935)	(61)
Advance payments and construction in progress	29,891,273	6	24,632,558	6
Net property, plant and equipment	207,155,918	45	192,293,825	50
GOODWILL (Note 2)	2,003,244		2,351,634	1
OTHER ASSETS				
Deferred charges net (Notes 2, 8 and 20)	9,520,310	2	8,415,357	2
Deferred income taxes assets (Notes 2 and 12)	7,796,174	2	8,841,310	3
Assets leased to others net (Note 2)	80,047		85,072	
Idle assets (Note 2)	54,791		74,644	
Refundable deposits (Note 18)	29,353		287,403	
Total other assets	17,480,675	4	17,703,786	5
TOTAL ASSETS	\$ 462,507,692	100	\$ 382,191,479	100

	2004		2003	
LIABILITIES AND SHAREHOLDERS EQUITY	Amount	%	Amount	%
CURRENT LIABILITIES				
Payables to related parties (Notes 18 and 20)	\$ 5,639,023	1	\$ 3,790,399	1
Accounts payable	7,357,718	2	5,596,631	1
Payables to contractors and equipment suppliers	15,260,860	3	9,480,795	3
Accrued expenses and other current liabilities (Notes 2, 10, 20 and 21)	10,974,741	2	8,319,012	2
Current portion of long-term bonds payable (Note 9)	5,000,000	1		
Total current liabilities	44,232,342	9	27,186,837	7
LONG-TERM LIABILITIES				
Bonds payable (Note 9)	30,000,000	6	35,000,000	9
Other long-term payable (Notes 10 and 20)	2,446,848	1	3,660,493	1
Other payables to related parties (Notes 18 and 20)	2,468,088	1		

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LTD.

STATEMENTS OF INCOME
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(In Thousand New Taiwan Dollars, Except Earnings Per Share)
(Reviewed, Not Audited)

	2004		2003	
	Amount	%	Amount	%
GROSS SALES (Notes 2 and 18)	\$195,779,620		\$147,294,673	
SALES RETURNS AND ALLOWANCES (Note 2)	(3,662,137)		(3,169,937)	
NET SALES	192,117,483	100	144,124,736	100
COST OF SALES (Notes 13 and 18)	109,109,645	57	93,940,362	65
GROSS PROFIT	83,007,838	43	50,184,374	35
OPERATING EXPENSES (Notes 13 and 18)				
Research and development	8,947,939	4	8,657,300	6
General and administrative	7,214,420	4	4,572,503	3
Marketing	1,050,619	1	932,482	1
Total operating expenses	17,212,978	9	14,162,285	10
INCOME FROM OPERATIONS	65,794,860	34	36,022,089	25
NON-OPERATING INCOME AND GAINS				
Investment income recognized by equity method net (Notes 2 and 6)	3,431,747	2		
Interest	1,060,412	1	580,879	1
Technical service income (Notes 18 and 20)	327,583		158,925	
Gain on disposal of property, plant and equipment (Notes 2 and 18)	144,899		347,656	
Gain on sales of investments (Note 2)	111,771		66,428	
Other (Note 18)	322,958		273,013	

Total non-operating income and gains	<u>5,399,370</u>	<u>3</u>	<u>1,426,901</u>	<u>1</u>
 NON-OPERATING EXPENSES AND LOSSES				
Interest (Notes 2, 7 and 21)	877,772	1	1,323,510	1
Foreign exchange loss net (Notes 2 and 21)	538,765		426,256	1
Loss on disposal of property, plant and equipment (Note 2)	63,476		291,077	
Loss on property, plant and equipment and idle assets (Note 2)			1,430,763	1
Investment loss recognized by equity method net (Notes 2 and 6)			343,951	
Other	<u>29,262</u>		<u>173,223</u>	
Total non-operating expenses and losses	<u>1,509,275</u>	<u>1</u>	<u>3,988,780</u>	<u>3</u>

(Continued)

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	2004		2003	
	Amount	%	Amount	%
INCOME BEFORE INCOME TAX	\$69,684,955	36	\$33,460,210	23
INCOME TAX BENEFIT (EXPENSE) (Notes 2 and 12)	447,026		(2,203,861)	(1)
NET INCOME	\$70,131,981	36	\$31,256,349	22

	2004		2003	
	Before Income Tax	After Income Tax	Before Income Tax	After Income Tax
EARNINGS PER SHARE (NT\$, Note 17)				
Basic earnings per share	\$ 3.00	\$ 3.01	\$ 1.43	\$ 1.33
Diluted earnings per share	\$ 2.99	\$ 3.01	\$ 1.43	\$ 1.33

The pro forma net income and earnings per share (after income tax) are based on the assumption that the stock of parent company held by its subsidiaries is treated as an investment instead of the treasury stock, and are shown as follows (Notes 2 and 16):

	2004	2003
NET INCOME	\$70,145,749	\$31,332,102
EARNINGS PER SHARE (NT\$)		
Basic earnings per share	\$ 3.01	\$ 1.33
Diluted earnings per share	\$ 3.01	\$ 1.33

The accompanying notes are an integral part of the financial statements.

(Concluded)

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LTD.

STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(In Thousand New Taiwan Dollars)
(Reviewed, Not Audited)

	<u>2004</u>	<u>2003</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 70,131,981	\$ 31,256,349
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	46,456,739	46,290,739
Deferred income taxes	(874,578)	2,074,257
Investment loss (income) recognized by equity method net	(3,431,747)	343,951
Gain on sales of long-term investments net	(2,150)	(66,428)
Amortization of discount of long-term bond investments	3,347	
Loss on property, plant, and equipment, and idle assets		1,430,763
Gain on disposal of property, plant and equipment net	(81,423)	(56,579)
Pension cost accrued	374,755	323,322
Allowance for doubtful receivables	(32,945)	91,535
Allowance for sales returns and others	1,216,541	(307,925)
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Receivables from related parties	(5,107,145)	(5,071,409)
Notes receivable	(66,290)	16,531
Accounts receivable	(3,781,597)	(3,209,496)
Other receivables from related parties	(64,688)	(40,168)
Other financial assets	(226,223)	(222,682)
Inventories net	(1,721,307)	(1,473,119)
Prepaid expenses and other current assets	1,154,723	1,326,149
Increase (decrease) in:		
Payables to related parties	(224,782)	1,323,401
Accounts payable	1,273,842	747,397
Accrued expenses and other current liabilities	1,949,179	2,408,255
	<u>106,946,232</u>	<u>77,184,843</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in short-term investments net	(36,971,775)	(11,664,302)
Acquisitions of:		
Long-term investments	(13,281,844)	(1,050,942)
Property, plant and equipment	(55,650,076)	(24,415,743)

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Proceeds from disposal of:		
Long-term investments	7,552	458,308
Property, plant and equipment	310,038	158,858
Increase in deferred charges	(1,053,342)	(1,792,664)
Decrease in refundable deposits	148,026	256,066
Decrease in other assets miscellaneous		9,250
	<u> </u>	<u> </u>
Net cash used in investing activities	<u>(106,491,421)</u>	<u>(38,041,169)</u>

(Continued)

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	2004	2003
	<u> </u>	<u> </u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash dividends paid for common stock	\$(12,159,971)	\$
Purchase of treasury stock	(7,059,798)	
Cash bonus paid to employees	(681,628)	
Decrease in guarantee deposits	(239,221)	(556,202)
Remuneration to directors and supervisors	(127,805)	(58,485)
Cash dividends paid for preferred stock	(184,493)	(455,000)
Repayment on long-term bonds		(4,000,000)
Redemption of preferred stock		(13,000,000)
	<u> </u>	<u> </u>
Cash used in financing activities	(20,452,916)	(18,069,687)
	<u> </u>	<u> </u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(19,998,105)	21,073,987
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD	98,288,002	61,656,795
	<u> </u>	<u> </u>
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	<u>\$ 78,289,897</u>	<u>\$ 82,730,782</u>
 SUPPLEMENTAL INFORMATION		
Interest paid (excluding the amounts capitalized of NT\$262,109 thousand and NT\$4,020 thousand in 2004 and 2003, respectively, Note 7)	\$ 169,670	\$ 687,283
	<u> </u>	<u> </u>
Income tax paid	\$ 309,552	\$ 2,500
	<u> </u>	<u> </u>
 NON-CASH INVESTING AND FINANCING ACTIVITIES		
Current portion of long-term bonds payable	\$ 5,000,000	\$
	<u> </u>	<u> </u>
Current portion of other payables to related parties (under payables to related parties)	\$ 1,914,915	\$
	<u> </u>	<u> </u>
Current portion of other long-term payable (under accrued expenses and other current liabilities)	\$ 1,817,542	\$ 1,228,568
	<u> </u>	<u> </u>
Reclassification of short-term investments to long-term investments	\$ 3,402,413	\$

The accompanying notes are an integral part of the financial statements.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LTD.

NOTES TO FINANCIAL STATEMENTS

**(Amounts in Thousand New Taiwan Dollars, Unless Specified Otherwise)
(Reviewed, Not Audited)**

1. GENERAL

Taiwan Semiconductor Manufacturing Company Ltd. (The Company or TSMC), a Republic of China (R.O.C.) corporation, was incorporated as a venture among the Government of the R.O.C., acting through the Development Fund of the Executive Yuan; Philips Electronics N.V. and certain of its affiliates (Philips); and certain other private investors. In September 1994, its shares were listed on the Taiwan Stock Exchange (TSE). On October 8, 1997, TSMC listed its shares of stock on the New York Stock Exchange (NYSE) in the form of American Depositary Shares (ADSs).

The Company is engaged mainly in the manufacturing, selling, packaging, testing and designing of integrated circuits and other semiconductor devices, and the manufacturing of masks.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements are presented in conformity with Guidelines Governing in Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the R.O.C. Significant accounting policies are summarized as follows:

Use of Estimates

The preparation of financial statements in conformity with the aforementioned guidelines and principles requires management to make reasonable assumptions and estimates of matters that are inherently uncertain. The actual results may differ from management's estimates.

Classification of Current and Non-current Assets and Liabilities

Current assets are those expected to be converted to cash, sold or consumed within one year from the balance sheet date. Current liabilities are obligations due on demand within one year from the balance sheet date. Assets and liabilities that are not classified as current are non-current assets and liabilities, respectively.

Cash Equivalents

Government bonds under repurchase agreements and notes acquired with maturities less than three months from the date of purchase are classified as cash equivalents.

Short-term Investments

Short-term investments consist of corporate bonds, bond funds, asset-backed securities, agency bonds, government bonds, government bonds acquired under repurchase agreements, commercial papers, notes, listed stocks and money market funds.

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Short-term investments are recorded at historical cost and are carried at the lower of cost or market value. An allowance for decline in value is provided and is charged to current period earnings when the aggregate carrying value of the investments exceeds the aggregate market value. A reversal of the allowance is recorded for a subsequent recovery of the market value. Cash dividends are recorded as investment income when earned.

The cost of the asset-backed securities and the bonds sold is accounted for using the specific identification method, whereas the cost of bond funds and listed stocks sold is accounted for using the weighted-average method.

The market values of asset-backed securities and the bonds are determined using the average of bid and ask prices as of the balance sheet date. The market value of bond funds is determined using the net asset value of the funds at the end of the period, and the market value of listed stocks is determined using the average-closing price of the listed stocks for the last month of the period.

Allowance for Doubtful Receivables

Allowance for doubtful receivables are provided based on a review of the collectibility of accounts receivables. The Company determines the amount of allowance for doubtful accounts by examining the historical collection experience and current trends in the credit quality of its customers as well as its internal credit policies.

Revenue Recognition and Allowance for Sales Returns and Others

The Company recognizes net sales when the earnings process is complete, as evidenced by an agreement with the customer, transfer of title and acceptance, if applicable, have occurred, as well as the price is fixed or determinable

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and the collectibility is reasonably assured. An allowance is provided for any sales return and pricing discounts. Allowance for sales returns and pricing discounts is estimated based on historical experience and any known factors that would affect the allowance. Such provisions are deducted from sales in the year the products are sold and the estimated related costs are deducted from cost of sales.

Sales are determined using the fair value taking into account related sales discounts agreed to by the Company and its customers. Sales agreements typically provide that payment is due 30 days from invoice date for majority of the customers and 30 to 45 days after the end of the month in which the sales occur for some customers. Since the receivables from sales are collectible within one year and such transactions are frequent, the fair value of receivables is equivalent to the nominal amount of cash received.

Inventories

Inventories are stated at the lower of cost or market value. Inventories are recorded at standard cost and adjusted to the approximate weighted-average cost at the end of each period. Market value represents net realizable value for finished goods and work in process. Replacement value represents net realizable value for raw materials, supplies and spare parts. The Company assesses the impact of changing technology on its inventory on-hand and writes off inventories that are considered obsolete. Ending inventories are evaluated for estimated excess quantities and obsolescence based on demand forecast within a specific time horizon, generally 180 days or less, and the estimated scrap and slow-moving items are recognized in the allowance for losses.

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Long-term Investments

Investments in companies wherein the Company exercises significant influence on the operating and financial policy decisions are accounted for using the equity method of accounting. The Company's proportionate share in the net income or net loss of investee companies is recognized as components of the investment income/loss recognized by equity method net account. When equity investments are made, the difference, if any, between the cost of investment and the Company's proportionate share of investee's net book value is amortized using the straight-line method over five years and is recorded as a component of the investment income/loss recognized by equity method net account.

When the Company subscribes to additional investee shares at a percentage different from its existing equity interest, the resulting carrying amount of the investment in the equity investee differs from the amount of Company's proportionate share in the investee's net equity. The Company records such difference as an adjustment to long-term investments with the corresponding amount charged to capital surplus. If investee's functional currency is a foreign currency, cumulative translation adjustments will result from the process of translating the investee's financial statements into the reporting currency of the Company.

Investments in companies wherein the Company does not exercise significant influence are recorded at historical cost. Cash dividends are recognized as income in the year received but are accounted for as reduction in the carrying values of the long-term investments if the dividends are received in the same year that the related investments are acquired. Stock dividends are recorded as an increase in the number of shares held and do not affect investment income or the carrying amount of the investment. An

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allowance is recognized for any decline in the market value of investments with readily ascertainable fair market value with the corresponding amount recorded as an unrealized loss, a component of shareholders' equity. A reversal of the allowance will result from a subsequent recovery of the market value of such investments. The market value of such investment is determined using the average-closing price of the listed stocks for the last month of the period. The carrying values of investments whose fair market values are not readily ascertainable are reduced to reflect an other-than-temporary decline in their values, with the related impairment loss charged to income.

Investments in foreign mutual funds are stated at the lower of aggregate cost or net asset value. An allowance is recognized when the net asset value of the funds is lower than their cost, with the corresponding amount recorded as a reduction to shareholders' equity. A reversal of the allowance will result from a subsequent recovery of the net asset value.

The costs of stocks and mutual funds sold are determined using the weighted-average method.

Investments in long-term bonds are stated at amortized cost. The discount or premium is amortized over the duration period using the interest method, and recorded as an adjustment to the interest income.

When investments in publicly-traded stocks are reclassified from short-term investments to long-term investments or from long-term investments to short-term investments, the Company recognizes a loss to the extent, if any, that the market value of such investments is lower than the carrying value.

If an investee company recognizes an unrealized loss on its long-term investment using the lower-of-cost-or-market

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method, the Company also recognizes a corresponding unrealized loss in proportion to its equity interest in the investee company and records the amount as a component of its shareholders' equity.

Gains or losses on sales from the Company to investee companies accounted for using the equity method are deferred in proportion to the Company's ownership percentage in the investee companies until realized through transactions with third parties. The entire amount of the gains or losses on sales to majority-owned subsidiaries is deferred until such gains or losses are realized through the subsequent sale of the related products to third parties.

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Gains or losses on sales from investee companies to the Company are deferred in proportion to the Company's ownership percentages in the investee companies until realized through transactions with third parties.

Property, Plant and Equipment, Assets Leased to Others and Idle Assets

Property, plant and equipment and assets leased to others are stated at cost less accumulated depreciation. When an impairment is determined, the related assets are stated at the lower of fair value or book value. Idle assets are stated at the lower of book value or net realizable value. Significant additions, renewals and betterments incurred during the construction period are capitalized. Maintenance and repairs are expensed in the period incurred. Interest expense incurred for the project during the purchase and construction period is also capitalized.

Depreciation is computed using the straight-line method over the following estimated service lives: buildings 10 to 20 years; machinery and equipment 5 years; and office equipment 3 to 5 years.

Upon sale or disposal of property, plant and equipment, the related cost and accumulated depreciation are removed from the corresponding accounts, with any gain or loss charged to income in the period of sale or disposal.

Goodwill

Goodwill represents the excess of the consideration paid for acquisitions over the fair market value of identifiable net assets acquired and acquisition costs. Goodwill is amortized using the straight-line method over the estimated life of 10 years.

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Deferred Charges

Deferred charges consist of technology license fees and software and system design costs and other charges. The amounts are amortized as follows: Technology license fees the shorter of the estimated life of the technology or the term of the technology transfer contract, software and system design costs 3 or 5 years.

Pension Costs

The Company records net periodic pension costs on the basis of actuarial calculations. Unrecognized net transition obligation and unrecognized net gains or losses are amortized over 25 years.

Income Tax

The Company uses an inter-period tax allocation method for income tax. Deferred income tax assets and liabilities are recognized for the tax effects of temporary differences, unused tax credits, and net operating loss carry forwards. Valuation allowances are provided to the extent, if any, that it is more likely than not that deferred income tax assets will not be realized. A deferred tax asset or liability is classified as current or non-current in accordance with the classification of its related asset or liability. However, if a deferred tax asset or liability does not relate to an asset or liability in the financial statements, then it is classified as either current or non-current based on the expected length of time before it is realized.

Any tax credit arising from the purchases of machinery, equipment and technology, research and development expenditures, personnel training, and investments in important technology-based enterprise are recognized using the current method.

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Adjustments to prior years' tax liabilities are added to or deducted from the current year's tax provision.
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As of January 1, 1998, income taxes on unappropriated earnings (excluding earnings from foreign consolidating subsidiaries) of 10% are expensed in the year of shareholder approval which is usually the year subsequent to the year incurred.

Stock-based Compensation

Compensatory employee stock option plans that are amended or have options granted on or after January 1, 2004 must be accounted for by the interpretations issued by Accounting Research and Development Foundation. The Company adopted the intrinsic value method and any compensation cost is charged to expense over the employee vesting period as specified in the stock option plans.

Treasury Stock

When the Company purchases its outstanding common stock, the cost of the reacquired stock is recorded as treasury stock which is a reduction to shareholders' equity. The Company's stock held by its subsidiaries is also treated as treasury stock and reclassified from long-term investments to treasury stock.

Foreign Currency Transactions

Foreign currency transactions are recorded in New Taiwan dollars at the current rate of exchange in effect when the transactions occur. Exchange gains or losses derived from foreign currency transactions or monetary assets and liabilities denominated in a foreign currency are recognized in current operations. At the end of each period, assets and liabilities denominated in foreign currencies are revalued at the prevailing exchange rate with the resulting gains or losses recognized in current operations.

Derivative Financial Instruments

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The Company enters into foreign currency forward contracts to manage its currency exposures in cash flow and in foreign currency-denominated assets and liabilities. The differences in the New Taiwan dollar amounts translated using the spot rate and the amounts translated using the contracted forward rates on the contract date are amortized over the terms of the forward contracts using the straight-line method. At the end of each period, the receivables or payables arising from forward contracts are restated using the prevailing spot rate at the balance sheet date with the resulting differences charged to income. In addition, the receivables and payables related to forward contracts are netted with the resulting amount presented as either an asset or a liability. Any resulting gains or losses upon settlement are charged to income in the period of settlement.

The Company enters into interest rate swap transactions to manage its exposures to changes in interest rates on existing liabilities. These transactions are accounted for on an accrual basis, in which the cash settlement receivable or payable is recorded as an adjustment to interest income or expense.

The notional amount of foreign currency option contracts entered into for hedging purposes are not recognized as an asset or liability on the contract dates. The premiums paid or received for the call or put options are amortized and charged to income on a straight-line basis over the term of the related contract. Any resulting gains or losses upon settlement are charged to income in the period of settlement.

Reclassifications

Certain accounts in the financial statements as of and for the nine months ended September 30, 2003 have been

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reclassified to conform to the financial statements as of and for the nine months ended September 30, 2004.

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3. CASH AND CASH EQUIVALENTS

	September 30	
	2004	2003
Cash and bank deposits	\$66,556,701	\$79,403,491
Government bonds acquired under repurchase agreements	11,534,485	3,327,291
Corporate issued notes	112,077	
Agency notes	86,634	
	<u>\$78,289,897</u>	<u>\$82,730,782</u>

4. SHORT-TERM INVESTMENTS

	September 30	
	2004	2003
Corporate bonds	\$11,237,187	\$
Bond funds	10,407,891	1,000,000
Corporate issued asset-backed securities	10,398,842	
Agency bonds	6,170,661	
Government bonds	5,160,321	7,437,502
Government bonds acquired under repurchase agreements	2,577,163	1,200,000
Commercial papers	101,861	
Corporate issued notes	67,927	
Listed stocks	6,528	
Money market funds		2,026,800
	<u>\$46,128,381</u>	<u>\$11,664,302</u>
Market value	<u>\$46,201,834</u>	<u>\$11,664,302</u>

The Company entered into investment management agreements with two well-known financial institutions (fund managers) to manage investment portfolios for the Company. In accordance with the investment guidelines and terms in these agreements, the securities invested by the fund managers should reach certain level of credit rating. As of September 30, 2004, the Company invested these investment portfolios in an aggregate amount of

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US\$800,000 thousand. The investment portfolios included securities such as corporate bonds, asset-backed securities, agency bonds, government bonds, commercial papers and notes. The securities acquired with maturities less than three months from the date of purchase had been reclassified to cash equivalents.

5. INVENTORIES NET

	September 30	
	2004	2003
Finished goods	\$ 2,463,121	\$ 2,535,207
Work in process	10,324,213	9,891,487
Raw materials	721,880	373,404
Supplies and spare parts	851,071	712,492
	<hr/>	<hr/>
	14,360,285	13,512,590
Allowance for losses	(1,731,820)	(1,699,135)
	<hr/>	<hr/>
	\$12,628,465	\$11,813,455
	<hr/>	<hr/>

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6. FUNDS AND LONG-TERM INVESTMENTS

	September 30			
	2004		2003	
	Carrying Value	% of Owner- ship	Carrying Value	% of Owner- ship
Equity method:				
TSMC International Investment Ltd. (TSMC International)	\$24,904,849	100	\$21,646,213	100
TSMC (Shanghai) Company Limited (TSMC Shanghai)	5,947,953	100		
Vanguard International Semiconductor Corporation (VIS)	4,993,394	28	3,968,395	28
TSMC Partners, Ltd. (TSMC Partners)	4,150,226	100	4,089,066	100
Systems on Silicon Manufacturing Company Pte Ltd. (SSMC)	3,469,018	32	2,616,143	32
Emerging Alliance Fund, L.P. (Emerging Alliance)	865,937	99	755,364	99
TSMC North America (TSMC North America)	473,629	100	286,061	100
Global Unichip Corporation (GUC)	375,466	47	377,758	47
VentureTech Alliance Fund II, L.P. (VTAF II)	327,876	98		
TSMC Japan K. K. (TSMC Japan)	100,901	100	97,567	100
VisEra Technology Company, Limited (VisEra)	56,212	25		
Chi Cherng Investment Co., Ltd. (Chi Cherng)	51,314	36	43,028	36
Hsin Ruey Investment Co., Ltd. (Hsin Ruey)	50,999	36	41,787	36
Taiwan Semiconductor Manufacturing Company Europe B.V. (TSMC Europe)	24,464	100	10,921	100
	<u>45,792,238</u>		<u>33,932,303</u>	
Cost method:				
Publicly traded stock				
Taiwan Mask Co., Ltd.			32,129	2
Non-publicly traded stock				
United Industrial Gases Co., Ltd.	193,584	10	193,584	11
Shin-Etsu Handotai Taiwan Co., Ltd.	105,000	7	105,000	7
Hontung Venture Capital Co., Ltd.	83,916	10	83,916	10
W.K. Technology Fund IV	50,000	2	50,000	2
Funds				
Horizon Venture Fund I, L.P.	246,485		229,669	
Crimson Asia Capital Ltd., L.P.	38,314		42,355	

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	September 30			
	2004		2003	
	Carrying Value	% of Owner- ship	Carrying Value	% of Owner- ship
	717,299		736,653	
Long-term bonds				
Government bonds				
2004 Government Bond Series E	3,892,641			
2003 Government Bond Series I	3,399,371			
2004 Government Bond Series A	1,750,231			
2004 Kaohsiung Municipal Bond Series A	620,000			
	9,662,243			
Corporate bonds				
China Steel Corporation	1,095,503			
Taiwan Power Company	918,650			
	2,014,153			
	\$58,185,933		\$34,668,956	

In August 2003, November 2003 and May 2004, the Company established TSMC Shanghai and invested in VisEra and VTAF II, respectively.

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The Company's investee, VIS, reduced its capital on August 11, 2004 in order to decrease its accumulated deficits and improve the financial structure. The number of shares of VIS held by the Company after the capital reduction decreases from 787,016 thousand shares to 409,532 thousand shares. The ownership percentage remains the same.

For the nine months ended September 30, 2004 and 2003, net investment income and losses recognized by equity method were NT\$3,431,747 thousand and NT\$343,951 thousand, respectively. The carrying value of investments accounted for under the equity method and the related investment income or losses were determined based on the reviewed financial statements of the investees for the same periods as the Company.

7. PROPERTY, PLANT AND EQUIPMENT

Accumulated depreciation consisted of the following:

	September 30	
	2004	2003
Buildings	\$ 33,972,806	\$ 27,881,029
Machinery and equipment	247,397,596	202,126,641
Office equipment	4,438,074	3,602,265
	\$285,808,476	\$233,609,935

Information on the status of the expansion or construction plans of the Company's manufacturing facilities as of September 30, 2004 is as follows:

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Construction/Expansion Plan	Estimated Complete Cost	Accumulated Expenditures	Expected Date of Commencement
Fab 14 construction	\$ 69,516,200	\$ 62,572,308	Fourth quarter of 2004
Fab 12 expansion	58,744,200	37,529,881	First quarter of 2005

Interest expense for the nine months ended September 30, 2004 and 2003 was NT\$1,139,881 thousand and NT\$1,327,530 thousand, respectively (before deducting capitalized amounts of NT\$262,109 thousand in 2004 and NT\$4,020 thousand in 2003, respectively). The interest rate used for purposes of calculating the capitalized amount was 2.80% and 5.283% for the nine months ended September 30, 2004 and 2003, respectively.

8. DEFERRED CHARGES NET

	September 30	
	2004	2003
Technology license fees	\$7,024,803	\$5,396,897
Software and system design costs	2,248,598	2,844,212
Others	246,909	174,248
	\$9,520,310	\$8,415,357

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	September 30	
	2004	2003
Domestic unsecured bonds:		
Issued in October 1999 and payable in October 2004, 5.95% interest payable annually	5,000,000	5,000,000
Issued in December 2000 and payable in December 2005 and 2007 in two equal payments, 5.25% and 5.36% interest payable annually, respectively	15,000,000	15,000,000
Issued in January 2002 and payable in January 2007, 2009 and 2012 in three equal payments, 2.60%, 2.75% and 3.00% interest payable annually, respectively	15,000,000	15,000,000
	<u>\$35,000,000</u>	<u>\$35,000,000</u>

As of September 30, 2004, future principal payments arrangements for the Company's bonds are as follows:

Year of Repayment	Amount
2004 4th quarter	\$ 5,000,000
2005	10,500,000
2007	7,000,000
2008 and thereafter	12,500,000
	<u>35,000,000</u>
Less: Current portion	5,000,000
	<u>\$30,000,000</u>

10. OTHER LONG-TERM PAYABLE

The Company entered into several license agreements for certain semiconductor-related patents. Future payments under the agreements as of September 30, 2004 are as follows:

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Year	Amount
2004 4th quarter	\$ 945,986
2005	1,296,356
2006	458,784
2007	475,776
2008 and thereafter	1,087,488
	4,264,390
Less: Current portion (under accrued expenses and other current liabilities)	1,817,542
	\$2,446,848

11. PENSION PLAN

The Company has a defined benefit pension plan for all regular employees that provides benefits based on length of service and average monthly salaries and wages for the six-month period prior to retirement.

The Company contributes at an amount equal to 2% of salaries paid every month to a Pension Fund (the Fund). The Fund is administered by a pension fund monitoring committee (the Committee) and the amounts in the Fund are deposited in the Committee's name in the Central Trust of China.

Accrued pension costs based on actuarial calculation for the nine months ended September 30, 2004 and 2003 were NT\$547,934 thousand and NT\$459,287 thousand, respectively. The balances of the Fund were NT\$1,376,527 thousand and NT\$1,146,853 thousand as of September 30, 2004 and 2003, respectively.

12. INCOME TAX

- a. A reconciliation of income tax expense on income

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before income tax at the statutory rate and current income tax expense before income tax credits is as follows:

	Nine Months Ended September 30	
	2004	2003
Income tax expense based on income before income tax at statutory rate (25%)	\$(17,421,239)	\$(8,365,053)
Tax-exempt income	10,261,110	3,598,750
Temporary and permanent differences	83,509	334,828
	<hr/>	<hr/>
Current income tax expense before income tax credits	\$ (7,076,620)	\$(4,431,475)
	<hr/>	<hr/>
b. Income tax benefit (expense) consists of the following:		
Current income tax expense before income tax credits	\$ (7,076,620)	\$(4,431,475)
Additional 10% tax on the unappropriated earnings	(821,767)	(1,271,759)
Income tax credits	7,898,387	5,703,234
Other income tax	(427,552)	(2,500)
Net change in deferred income tax assets and liabilities		
Investment tax credits	266,173	1,351,106
Temporary differences	755,306	(340,310)
Valuation allowances	(146,901)	(3,212,157)
	<hr/>	<hr/>
Income tax benefit (expense)	\$ 447,026	\$(2,203,861)
	<hr/>	<hr/>

c. Deferred income tax assets (liabilities) consist of the following:

	September 30	
	2004	2003
Current:		
Investment tax credits	\$ 2,471,000	\$ 2,117,000
	<hr/>	<hr/>
Non-current:		
Investment tax credits	\$23,445,067	\$25,801,759

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	September 30	
	2004	2003
Temporary differences	(2,730,145)	(3,906,151)
Valuation allowances	(12,918,748)	(13,054,298)
	<u>\$ 7,796,174</u>	<u>\$ 8,841,310</u>

d. Integrated income tax information:

The balances of the imputation credit account (ICA) as of September 30, 2004 and 2003 were zero and NT\$14,748 thousand, respectively.

The actual creditable ratio for 2003 and 2002 were 0.03% and 0.08%, respectively.

e. All retained earnings generated prior to December 31, 1997 had been appropriated.

f. As of September 30, 2004, investment tax credits consist of the following:

Regulation	Items	Total Creditable Amounts	Remaining Creditable Amounts	Expire Year
Statute for Upgrading Industries	Purchase of machinery and equipment	\$ 4,448,442	\$ 20,936	2004
		3,819,936	2,665,518	2005
		4,925,775	4,925,775	2006
		4,140,462	4,140,462	2007
		4,200,106	4,200,106	2008
		<u>\$21,534,721</u>	<u>\$15,952,797</u>	
Statute for Upgrading Industries	Research and development expenditures	\$ 2,270,013	\$	2004
		3,147,071	3,147,071	2005
		3,342,952	3,342,952	2006
		1,976,913	1,976,913	2007
		<u>1,372,550</u>	<u>1,372,550</u>	2008

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Regulation	Items	Total Creditable Amounts	Remaining Creditable Amounts	Expire Year
		\$ 12,109,499	\$ 9,839,486	
Statute for Upgrading Industries	Personnel training	\$ 48,659	\$ 2,209	2004
		29,448	29,448	2005
		27,311	27,311	2006
		26,780	26,780	2007
		\$ 132,198	\$ 85,748	
Statute for Upgrading Industries	Investments in important technology-based enterprise	\$ 38,036	\$ 38,036	2005

- g. The sales generated from the following expansion and construction of the Company's manufacturing plants are exempt from income tax:

	Tax-Exemption Period
Construction of Fab 6	2001 to 2004
Construction of Fab 8 module B	2002 to 2005
Expansion of Fab 2 modules A and B, Fab 3, Fab 4, Fab 5 and Fab 6	2003 to 2006
Construction of Fab 12	2004 to 2007

- h. The tax authorities have examined income tax returns of the Company through 2000. However, the Company is contesting the assessment by the tax authority for 1992 and 1998. The Company believes that any additional assessment will not have a material adverse effect on the Company.

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13. LABOR COST, DEPRECIATION AND AMORTIZATION EXPENSE

	Nine Months Ended September 30, 2004			Nine Months Ended September 30, 2003		
	Classified as Cost of Sales	Classified as Operating Expense	Total	Classified as Cost of Sales	Classified as Operating Expense	Total
Labor cost						
Salary	\$ 6,597,662	\$ 3,148,152	\$ 9,745,814	\$ 5,437,931	\$ 2,273,059	\$ 7,710,990
Labor and health insurance	418,441	230,945	649,386	349,560	174,175	523,735
Pension	353,123	194,811	547,934	306,331	152,956	459,287
Other	283,701	302,580	586,281	160,399	84,203	244,602
	<u>\$ 7,652,927</u>	<u>\$ 3,876,488</u>	<u>\$ 11,529,415</u>	<u>\$ 6,254,221</u>	<u>\$ 2,684,393</u>	<u>\$ 8,938,614</u>
Depreciation	\$ 41,070,901	\$ 1,823,129	\$ 42,894,030	\$ 41,815,245	\$ 1,735,170	\$ 43,550,415
Amortization	\$ 1,904,560	\$ 1,653,849	\$ 3,558,409	\$ 1,074,049	\$ 1,807,137	\$ 2,881,186

14. SHAREHOLDERS EQUITY

The Company has issued 668,351 thousand ADSs which are traded on the NYSE as of September 30, 2004. The number of common shares represented by the ADSs is 3,341,754 thousand shares (one ADS represents five common shares).

Capital surplus can only be used to offset a deficit under the ROC Company Law. However, the capital surplus generated from donated capital and the excess of the issue price over the par value of capital stock (including the stock issued for new capital, mergers, convertible bonds and the transaction of treasury stock) is allowed to be appropriated under the restriction of certain percentage as stock dividends based on shareholders' ownerships.

As of September 30, 2004 and 2003, the capital surplus consisted of the following:

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	2004	2003
From merger	\$24,003,546	\$24,132,297
Additional paid-in capital	23,048,918	23,172,550
From long-term investments	116,157	81,746
From convertible bonds	9,360,424	9,410,632
Donation	55	55
Treasury stock		50,137
	<hr/>	<hr/>
Total	\$56,529,100	\$56,847,417
	<hr/>	<hr/>

The Company's Articles of Incorporation provide that the following shall be appropriated from annual earnings to the extent that the annual earnings exceed any accumulated deficit:

- a. 10% legal reserve; until the amount of total legal reserve equals to the Company's total paid-in capital;
- b. Special reserve in accordance with relevant laws or regulations;
- c. Remuneration to directors and supervisors and bonuses to employees equals to 0.3% and at least 1% of the remainder, respectively. Individuals eligible for the employee bonuses may include employees of affiliated companies as approved by the board of directors or a representative of the board of directors;

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- d. Dividends to holders of preferred shares at a 3.5% annual rate are based on the period which the preferred shares have been outstanding. Following the redemption of all its issued and outstanding preferred shares on May 29, 2003, the Company amended its Article of Incorporation on June 3, 2003 to remove the provision for issuance of any future dividends to preferred shareholders as of that date; and
- e. The appropriation of any remaining balance shall be approved by the shareholders.

Dividends may be distributed in shares of common stock or a combination of cash and common stock. Distributions of profits are preferably made in the form of stock dividend. The total of cash dividends paid in any given year may not exceed 50% of total dividends distributed in that year.

Any appropriations of net income are recorded in the financial statement in the year of shareholder approval.

The appropriation for legal reserve shall be made until the reserve equals the aggregate par value of the Company's issued capital stock. The reserve can only be used to offset an accumulated deficit or be distributed as a stock dividend up to 50% of the reserve balance when the reserve balance has reached 50% of the aggregate par value of the issued capital stock of the Company.

A special reserve equivalent to the debit balance of any account shown in the shareholder's equity section of the balance sheet (for example, unrealized loss on long-term investments and cumulative translation adjustments), shall be made from unappropriated retained earnings pursuant to existing regulations promulgated by the R.O.C. Securities and Futures Bureau (SFB). The special reserve is allowed to be appropriated to the extent that the debit balance of

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such accounts is reversed.

The appropriations of earnings for 2003 and 2002 were approved in the shareholders' meeting on May 11, 2004 and June 3, 2003, respectively. The appropriations and dividend per share are as follows:

	Appropriation of Earnings		Dividend Per Share (NT\$)	
	For Fiscal Year 2003	For Fiscal Year 2002	For Fiscal Year 2003	For Fiscal Year 2002
Legal reserve	\$ 4,725,870	\$ 2,161,029		
Special reserve	(68,945)	68,945		
Bonus paid to employees in cash	681,628			
Bonus paid to employees-in stock	2,726,514	1,539,013		
Preferred stock dividend in cash	184,493	455,000	\$ 0.35	\$ 0.35
Common stock dividend in cash	12,159,971		0.60	
Common stock dividend-in stock	28,373,267	14,898,309	1.41	0.80
Remuneration to directors and supervisors in cash	127,805	58,485		
	\$48,910,603	\$19,180,781		

The amount of above appropriation of earnings for 2003 and 2002 is consistent with the resolution of the meetings of board of directors on February 17, 2004 and March 4, 2003, respectively. However, the Company Law of R.O.C. states that treasury stock shall not participate in the appropriation of earnings. Therefore, the actual cash dividend per share and stock dividend per share are slightly more than those in the aforementioned resolution. If the above employee bonus and remuneration to directors and supervisors have been paid in cash and charged against income for 2003 and 2002, the basic earnings per share for the years ended December 31, 2003 and 2002 would decrease from NT\$2.33 to NT\$2.15 and NT\$1.14 to NT\$1.05, respectively. The shares distributed as a bonus

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to employees represented 1.35% and 0.83% of the Company's total outstanding common shares as of December 31, 2003 and 2002, respectively.

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The above information associated with the appropriations of bonus to employees and remuneration to directors and supervisors is available at Market Observation System website.

Under the Integrated Income Tax System that became effective on January 1, 1998, R.O.C. resident shareholders are allowed a tax credit for their proportionate share of the income tax paid by the Company on earnings generated as of January 1, 1998. An imputation credit account is maintained by the Company for such income tax and the tax credit allocated to each shareholder.

Preferred Shareholders

The Company issued 1,300,000 thousand shares of unlisted Series A preferred stock to certain investors on November 29, 2000. All of the preferred stock was redeemed at par value and retired on May 29, 2003. Under the Company's Articles of Incorporation, as amended on June 3, 2003, the Company is no longer authorized to issue preferred stock.

The preferred shareholders had the following rights and related terms and conditions prior to redemption:

Preferred shareholders

- a. Are entitled to receive cumulative cash dividends at an annual rate of 3.5%.
- b. Are not entitled to receive any common stock dividends (whether declared out of unappropriated earnings or capital surplus).
- c. Have priority over the holders of common shares to the assets of TSMC available for distribution to shareholders upon liquidation or dissolution; however, the pre-emptive rights to the assets shall not exceed the

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issue value of the shares.

- d. Have voting rights similar to that of the holders of common shares.
- e. Have no right to convert their shares into common shares. The preferred shares are to be redeemed within thirty months from their issuance. The preferred shareholders have the aforementioned rights and the Company's related obligations remain the same until the preferred shares are redeemed by the Company.

15. STOCK-BASED COMPENSATION PLANS

The Company's Employee Stock Option Plans the 2003 Plan and the 2002 Plan, were approved on October 29, 2003 and June 25, 2002, respectively. The maximum number of units authorized to be granted under the 2003 Plan and the 2002 Plan is 120,000 thousand and 100,000 thousand, respectively, with each unit representing one common share of stock. The option rights may be granted to qualified employees of the Company, TSMC North America, and WaferTech, LLC, (WaferTech, an indirectly owned subsidiary of the Company). The option rights of both plans are valid for ten years and exercisable at certain percentages subsequent to the second anniversary of the grant date. Under the terms of both plans, stock option rights are granted at an exercise price equal to the closing price of the Company's common shares listed on the TSE on the date of grant. Under the 2002 Plan, there were 58,271 thousand option rights that were never granted, or had been granted and subsequently cancelled. These un-granted or cancelled option rights were expired as of September 30, 2004.

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Information of outstanding stock options for the nine months ended September 30, 2004 and 2003 under the 2003 Plan and the 2002 Plan is as follows:

	2003 Plan		2002 Plan	
	Number of Outstanding Stock Option Rights (in Thousands)	Weighted-Average Exercise Price (NT\$)	Number of Outstanding Stock Option Rights (in Thousands)	Weighted-Average Exercise Prices (NT\$)
Nine months ended September 30, 2004				
Beginning balance	842	57.8	48,515	42.7
Options granted	13,199	49.9	7,200	42.6
Options cancelled	(1,090)	51.1	(3,165)	44.1
Ending balance	<u>12,951</u>		<u>52,550</u>	
Nine months ended September 30, 2003				
Beginning balance			19,369	48.6
Options granted			32,031	50.3
Options cancelled			(1,778)	48.0
Ending balance			<u>49,622</u>	

The number of outstanding option rights and exercise prices have been adjusted to reflect the appropriations of dividends in accordance with the plans.

As of September 30, 2004, information on outstanding option rights is as follows:

	Option Outstanding		Option Exercisable		
	Range of Exercise Price (NT\$)	Number of Outstanding Options (in Thousands)	Weighted-Average Remaining Contractual Exercise Price	Number of Exercisable Option (in Thousands)	Weighted-Average Exercise Price

			Life (Years)	Price (NT\$)		Price (NT\$)
2003 plan	(43.8-57.8)	12,951	9.59	50.3		
2002 plan	(32.8-46.2)	<u>52,550</u>	8.34	42.6	<u>9,811</u>	41.8
Total	(32.8-57.8)	<u>65,501</u>	8.59	44.1	<u>9,811</u>	41.8

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The compensation cost recognized for the nine months ended September 30, 2004 was zero. If the Company uses fair-value based method to evaluate the options granted, the method, assumptions and pro forma results of the Company for the nine months ended September 30, 2004 would be as follows:

	Black Scholes Model
	NT\$
Method	
Assumptions:	
Expected dividend yield	1.00%
Expected volatility	43.19%-43.25%
Risk free interest rate	3.07%-3.85%
Expected life	5 years
Net income:	
Net income as reported	\$ 70,131,981
Pro forma net income	70,092,754
	NT\$
Earnings per share (EPS):	
Basic EPS as reported	3.01
Pro forma basic EPS	3.01
Diluted EPS as reported	3.01
Pro forma diluted EPS	3.01

The estimated weighted average fair value for the options granted under the 2003 Plan during the nine-month period ended September 30, 2004 was NT\$19.73 per option.

16. TREASURY STOCK (COMMON STOCK)

	(Shares in Thousand)			
Purpose	Beginning Shares	Increase/ Dividend	Decrease	Ending Shares
Nine months ended September 30, 2004				
Reclassification of parent company stock held by subsidiaries from long-term investment	40,597	5,676	303	45,970
Maintaining the shareholders' equity		124,720	124,720	
	<u>40,597</u>	<u>130,396</u>	<u>125,023</u>	<u>45,970</u>
Nine months ended September 30, 2003				
Reclassification of parent company stock held by subsidiaries from long-term investment	42,001	3,357	4,574	40,784

Proceeds from the sales of treasury stock for the nine months ended September 30, 2004 and 2003 were NT\$18,218 thousand and NT\$318,850 thousand, respectively. As of September 30, 2004 and 2003, the book value of the treasury stock was NT\$1,616,669 thousand and NT\$1,643,404 thousand, respectively; the market value was NT\$2,056,707 thousand and NT\$2,776,198 thousand, respectively. Capital stock held by subsidiaries as an investment is recorded as treasury stock, with the holder having the same rights as other common shareholders.

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In order to maintain the shareholders' equity, the Company held a special meeting of the Board of Directors and approved a share buyback plan to repurchase the Company's common shares listed on the TSE from its shareholders during the period from March 24, 2004 to May 23, 2004. The Company has repurchased 124,720 thousand common shares for a total of NT\$7,059,798 thousand. All the treasury stock repurchased under the buyback plan was retired on August 16, 2004.

17. EARNINGS PER SHARE

EPS is computed as follows:

	Amounts (Numerator)		Shares (Denominator) (Thousand)	EPS (NT\$)	
	Before Income Tax	After Income Tax		Before Income Tax	After Income Tax
Nine months ended September 30, 2004					
Basic EPS					
Income available to common shareholders	\$69,684,955	\$70,131,981	23,262,992	\$ 3.00	\$ 3.01
Effect of diluted securities - stock option			7,032		
Diluted EPS					
Income available to common shareholders (including effect of diluted securities)	\$69,684,955	\$70,131,981	23,270,024	\$ 2.99	\$ 3.01
Nine months ended September 30, 2003					
Basic EPS					
Net income	\$33,460,210	\$31,256,349			
Less - preferred stock dividends	(184,493)	(184,493)			
Income available to common shareholders	\$33,275,717	\$31,071,856	23,326,379	\$ 1.43	\$ 1.33
Effect of diluted securities - stock options			4,913		
Diluted EPS					
Income available to common shareholders (including effect of diluted securities)	\$33,275,717	\$31,071,856	23,331,292	\$ 1.43	\$ 1.33

18. RELATED PARTY TRANSACTIONS

The Company engages in business transactions with the following related parties:

- a. Industrial Technology Research Institute (ITRI), the Chairman of the Company is one of its directors
- b. Philips, a major shareholder of the Company
- c. Subsidiaries

- TSMC North America
 - TSMC Europe
 - TSMC Japan
 - TSMC Shanghai

- d. Investees

- VIS
 - GUC
 - SSMC
 - VisEra

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e. Indirect subsidiaries

WaferTech

TSMC Technology Inc. (TSMC Technology)

The significant transactions with the aforementioned parties in addition to those disclosed in other notes are summarized as follows:

	Nine Months Ended September 30			
	2004		2003	
	Amount	%	Amount	%
For the period				
Sales				
TSMC North America	\$ 107,409,697	55	\$ 84,777,377	58
Philips and its affiliates	3,980,051	2	2,370,142	2
Others	325,335		496,652	
	<u>\$ 111,715,083</u>	<u>57</u>	<u>\$ 87,644,171</u>	<u>60</u>
Purchases				
WaferTech	\$ 11,576,543	34	\$ 7,815,373	35
VIS	6,912,218	21	3,454,704	16
SSMC	4,604,370	14	3,805,999	17
	<u>\$ 23,093,131</u>	<u>69</u>	<u>\$ 15,076,076</u>	<u>68</u>
Manufacturing expenses technical assistance fee (see Note 20a)				
Philips	\$ 1,022,446	1	\$ 2,250,285	3
Marketing expenses commission				
TSMC Japan	\$ 193,748	18	\$ 158,717	17
TSMC Europe	157,833	15	111,780	12
	<u>\$ 351,581</u>	<u>33</u>	<u>\$ 270,497</u>	<u>29</u>
Sale of property, plant, and equipment				

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TSMC Shanghai	\$ 2,806,462	90	\$	
VIS	32,960	1	8,098	5
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	\$ 2,839,422	91	\$ 8,098	5
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Non-operating income and gain				
SSMC (technical service income mainly, see Note 20e)	\$ 293,727	5	\$ 119,041	8
VIS (technical service income mainly, see Note 20n)	111,983	2	271	
VisEra	22,876	1		
WaferTech	2,901		1,528	
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	\$ 431,487	8	\$ 120,840	8
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

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	Nine Months Ended September 30			
	2004		2003	
	Amount	%	Amount	%
At end of the period				
Receivables				
TSMC North America	\$ 19,481,557	98	\$ 14,337,121	94
Philips and its affiliates	432,040	2	752,568	5
Others	61,210		96,684	1
	<u>19,974,807</u>		<u>15,186,373</u>	
	\$ 19,974,807	100	\$ 15,186,373	100
Other receivables				
TSMC Shanghai	\$ 2,807,784	94	\$	
VIS (technical service income mainly, see Note 20n)	101,707	3	95,092	88
TSMC Technology	3,039		12,103	11
Others	91,583	3	1,497	1
	<u>3,004,113</u>		<u>108,692</u>	
	\$ 3,004,113	100	\$ 108,692	100
Payables				
Philips and its affiliates	\$ 1,923,537	34	\$ 1,481,653	39
VIS	1,916,758	34	796,865	21
WaferTech	1,104,866	20	964,659	26
SSMC	637,115	11	501,281	14
Others	56,747	1	45,941	
	<u>5,639,023</u>		<u>3,790,399</u>	
	\$ 5,639,023	100	\$ 3,790,399	100
Other payables to related parties (excluding current portion which is under payables to related parties. See Note 20a)				
Philips and its affiliates	\$ 2,468,088	100	\$	
	<u>2,468,088</u>		<u></u>	
Deferred credits gain on intercompany				
TSMC Shanghai	\$ 598,350	100	\$	

	_____	_____	_____	_____
Refundable deposits VIS	\$		\$ 260,992	91
	_____	_____	_____	_____

The terms of sales to related parties are not significantly different from those to third parties. For other related parties transactions, since no other similar transactions to follow, the prices are determined in accordance with the related contractual agreements.

19. SIGNIFICANT LONG-TERM OPERATING LEASES

The Company leases land from the Science-Based Industrial Park Administration. These agreements expire on various dates from March 2008 to December 2020. The agreements can be renewed upon their expiration.

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As of September 30, 2004, future remaining lease payments are as follows:

Year	Amount
2004 4th quarter	\$ 58,837
2005	235,348
2006	235,348
2007	235,348
2008	210,687
2009 and thereafter	1,617,858
	\$2,593,426

20. SIGNIFICANT COMMITMENTS AND CONTINGENCIES

The significant commitments and contingencies as of September 30, 2004 are as follows:

- a. On June 20, 2004, the Company and Philips revised the Technical Cooperation Agreement, which was originally signed on May 12, 1997, with effective date from January 1, 2004 for five years. Upon expiration, this amended Technical Cooperation Agreement will be terminated at the expiration date and will not be automatically renewed. Under this amended Technical Cooperation Agreement, the Company will pay Philips royalties based on fixed amounts mutually agreed-on, rather than under certain percentage of the Company's annual net sales. The Company and Philips also agree to cross license the patents owned by each party.
- b. Under a technical cooperation agreement with ITRI, the Company shall reserve and allocate up to 35% of certain of its production capacity for use by the Ministry of Economic Affairs (MOEA) or any other party designated by the MOEA.
- c. Under several foundry agreements, the Company shall reserve a portion of its production capacity for certain major customers that have guarantee deposits with the Company. As of September 30, 2004, the Company had a total of US\$15,314 thousand of guarantee deposits.
- d. Under a Shareholders Agreement entered into with Philips and EDB Investments Pte Ltd. on March 30, 1999, the parties formed a joint venture company, SSMC, for the purpose of constructing an integrated circuit foundry in Singapore. As of September 30, 2004, the Company's equity interest in SSMC was 32%. The Company and Philips committed to buy specific percentages of the production capacity of SSMC. If any party defaults on the commitment and the capacity utilization of SSMC falls below a specific percentage of its total capacity, the defaulting party is required to compensate SSMC for all related unavoidable costs.
- e. The Company provides technical services to SSMC under a Technical Cooperation Agreement (the Agreement) entered into on May 12, 1999. The Company receives compensation for such services computed at a specific percentage of net selling price of certain products sold by SSMC. The Agreement shall remain in force for ten years and may be automatically renewed for successive periods of five years unless pre-terminated by either party under certain conditions.

- f. The Company provided guarantees on loans amounting to US\$60,000 thousand, US\$40,000 thousand and US\$440,000 thousand for TSMC Development, Inc. (TSMC Development), TSMC North America and WaferTech, respectively.

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- g. Under a Technology Transfer Agreement (TTA) with National Semiconductor Corporation (National) entered into on June 27, 2000, the Company shall receive payments for the licensing of certain technology to National. The agreement was to remain in force for ten years and could be automatically renewed for successive periods of two years thereafter unless either party gives notice for early termination under certain conditions. In January 2003, the Company and National entered into a Termination Agreement whereby the TTA was terminated for convenience. Under the termination agreement, the Company will be relieved of any further obligation to transfer any additional technology. In addition, the Company granted National an option to request the transfer of certain technologies under the same terms and conditions as the terminated TTA. The option will expire in January 2008.
- h. Beginning in 2001, the Company entered into several licensing arrangements for certain semiconductor patents. The terms of the contracts range from five to ten years with payments to be made in the form of royalties over the term of the related contracts. The Company has recorded the related amounts as a liability with the corresponding amounts recorded as deferred charges which are amortized and charged to cost of sales on a straight-line basis over the estimated life of the technology or the term of the contract, whichever is shorter.
- i. In November 2002, the Company entered into an Amended and Restated Joint Technology Cooperation Agreement with Philips, Motorola, Inc. and STMicroelectronics to jointly develop 90-nm to 65-nm advanced CMOS Logic and e-DRAM technologies. The Company also agreed to align 0.12 micron CMOS Logic technology to enhance its foundry business opportunities. The Company will contribute process technologies and share a portion of the costs associated with this joint development project.
- j. In December 2003, the Company entered into a Technology Development and License Agreement with Motorola, Inc. to jointly develop 65-nm SOI (silicon on insulator) technology. The Company will also license related 90-nm SOI technology from Motorola, Inc. Any intellectual properties arising out of the co-development project shall be jointly owned by the parties. In accordance with the agreement, the Company will pay royalty to Motorola, Inc. and will share a portion of the costs associated with the joint development project.
- k. In December 2003, the Company filed a lawsuit in the US District Court for the Northern District of California against Semiconductor Manufacturing International Corporation and certain of its subsidiaries (SMIC) for patent infringement seeking injunctive relief and monetary damages. The probable outcome in the above forum cannot be reasonably estimated.
- l. In May 2004, the Company filed a separate suit against SMIC in Alameda County of California for trade secret misappropriation seeking injunctive relief and monetary damages. The probable outcome in the above forum cannot be reasonably estimated.
- m. In August 2004, the Company and certain of its subsidiaries filed a Complaint with the United States International Trade Commission (ITC) against SMIC for infringing the Company's U.S. patents, and misappropriation the Company's trade secrets. The Company requested the ITC to institute an immediate investigation and issue a permanent exclusion order from entry into the United States all unlicensed semiconductor devices and products containing the same fabricated by SMIC that infringing the Company's patents or were fabricated using TSMC's trade secrets. The Company subsequently filed a patent infringement lawsuit in the U.S. District Court of Northern California on the patents alleged in the ITC action, and sought injunctive relief as well as treble damages and associated costs for SMIC's willful infringement of the asserted

patents. The probable outcome in the above forum cannot be reasonably estimated.

- n. The Company provides technology transfer to VIS under a Manufacturing License and Technology Transfer Agreement entered into in August 2004. The Company receives compensation for such technology transfer in the form of royalty payments from VIS computed at a specific percentage of net selling price of certain products sold by VIS.

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- o. Amounts available under unused letters of credit as of September 30, 2004 were NT\$6,480 thousand, US\$15 thousand and SG\$85 thousand.

21. ADDITIONAL DISCLOSURES

Following are the additional disclosures required by the SFB for the Company and its investees:

- a. Financing provided: Please see Table 1 attached;
- b. Endorsement/guarantee provided: Please see Table 2 attached;
- c. Marketable securities held: Please see Table 3 attached;
- d. Marketable securities acquired or disposed of at costs or prices of at least NT\$100 million or 20% of the paid-in capital: Please see Table 4 attached;
- e. Acquisition of individual real estate properties at costs of at least NT\$100 million or 20% of the paid-in capital: Please see Table 5 attached;
- f. Disposal of individual real estate properties at prices of at least NT\$100 million or 20% of the paid-in capital: None;
- g. Total purchases from or sales to related parties of at least NT\$100 million or 20% of the capital: Please see Table 6 attached;
- h. Receivables from related parties amounting to at least NT\$100 million or 20% of the capital: Please see Table 7 attached;
- i. Names, locations, and related information of investee on which the Company exercises significant influence: Please see Table 8 attached;
- j. Financial instrument transactions:

1) Derivative financial instruments

The Company entered into derivative financial instrument transactions for the nine-month period ended September 30, 2004 to manage exposures related to foreign-currency denominated receivables or payables, and interest rate fluctuations. Certain information on these contracts is as follows:

- a) Outstanding forward exchange contracts as of September 30, 2004 are as follows:

Financial Instruments	Maturity Period	Contract Amount (Nominal) (in Thousand)	
Sell	October 2004	US\$ 33,723	(US\$/EUR)
Sell	October 2004 to April 2005	US\$ 2,351,000	(US\$/NT\$)

Sell	November 2004	EUR	58,500	(EUR/US\$)
------	---------------	-----	--------	------------

As of September 30, 2004, receivables from forward exchange contracts (included in the other financial assets account) aggregate approximately NT\$27,881 thousand, and payables from forward exchange contracts (included in the other current liabilities account) aggregate approximately NT\$887,272 thousand. Net exchange loss for the nine months ended September 30, 2004 was NT\$190,846 thousand.

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b) Interest rate swaps

The Company entered into interest rate swap contracts to manage related interest rates on its long-term loans. Net interest income on these transactions for the nine months ended September 30, 2004 was NT\$6,966 thousand.

Outstanding contracts as of September 30, 2004 are as follows:

Contract Date	Period	Contract Amount (Nominal)
September 19, 2003	September 22, 2003 to December 15, 2005	\$ 500,000
October 16, 2003	October 20, 2003 to December 15, 2005	500,000
October 16, 2003	October 20, 2003 to December 15, 2005	500,000
October 17, 2003	October 21, 2003 to December 15, 2005	500,000
October 17, 2003	October 20, 2003 to December 15, 2005	500,000
November 7, 2003	November 11, 2003 to December 15, 2005	500,000

c) Transaction risk

- i) Credit risk. Credit risk represents the positive net settlement amount of those contracts with positive fair values at the balance sheet date. The positive net settlement amount represents the loss incurred by the Company if the counter-parties breached the contracts. The banks, which are the counter-parties to the foregoing derivative financial instruments, are reputable financial institutions. Management believes its exposures related to the potential default by those counter-parties are low.
- ii) Market price risk. All derivative financial instruments are intended as hedges for fluctuations in currency exchange rates on the Company's foreign currency denominated receivables or payables and interest rate fluctuations on its floating rate long-term loans. Gains or losses from forward exchange contracts are likely to be offset by gains or losses from the hedged receivables and payables. Interest rate risks are also controlled as the expected cost of capital is fixed. Thus, market price risks are believed to be minimal.
- iii) Liquidity and cash flow risk and uncertainty of amount and term of future cash demand.

As of September 30, 2004, the Company's future cash demand for outstanding forward exchange contracts are as follows:

Term	Inflow (In Thousand)	Outflow (In Thousand)
Within one year	NT\$79,033,789	US\$2,384,723
	US\$ 72,065	EUR 58,500
	EUR 27,500	

The Company has sufficient operating capital to meet the above cash demand. The interest rate of the interest rate swaps has taken the Company's cost of capital into account. In addition, the

exchange rates of forward foreign exchange contracts and interest swap contracts are fixed. Therefore, there is no material fund raising risk and cash flow risk.

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2) The fair value of financial instruments were as follows:

	September 30, 2004		September 30, 2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Non-derivative financial instruments				
Assets				
Short-term investments	\$46,128,381	\$46,201,834	\$11,664,302	\$11,664,302
Long-term investments	58,185,933	62,904,359	34,668,956	39,200,246
Liabilities				
Bonds payable (includes current portion)	35,000,000	35,655,089	35,000,000	35,641,304
Derivative financial instruments				
Forward exchange contracts (buy)			45,189	52,376
Forward exchange contracts (sell)	(787,029)	(349,631)	334,407	540,975
Interest rate swaps	4,361	1,391		(5,812)

The above financial instruments do not include cash and cash equivalents, receivables, other financial assets, payables, and payable to contractors and equipment suppliers. The carrying amounts of aforementioned instruments reported in the balance sheet are approximate to their fair values.

The above financial instruments also exclude refundable deposits, guarantee deposits and other long-term payables. The future cash inflow and outflow of the deposits approximate to their fair values. The fair value of other long-term payables is determined using the expected discounted cash flows, which approximate to the carrying value.

Fair values of financial instruments were determined as follows:

- a) Fair value of short-term and long-term investments is based on quoted market prices. If quoted market prices are unavailable, fair value is based on net asset value or book value of investment.
- b) The fair value of bonds payable is the quoted market value.
- c) Fair value of derivative financial instruments is the estimated net receivable (payable) if the contracts are terminated on the relevant balance sheet date.

The fair values of some financial and non-financial instruments are not included in the fair values disclosed above. Accordingly, the sum of the fair values of the financial instruments listed above does not represent the fair value of the Company as a whole.

k. Information on investment in mainland China

- 1) The name of the investee company in mainland China, the main businesses and products, its issued capital, method of investment, information on inflow or outflow of capital, ratio of ownership, equity in the net gain or net loss, ending balance, amount received as earnings distributions from the investment, and the limitation on investment: Please see Table 9 attached.

- 2) Significant direct or indirect transactions with the investee company, its prices and terms of payment, unrealized gain or loss, and other related information which is helpful to understand the impact of investment in mainland China on financial reports: Please see Note 18.

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TABLE 1

TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LTD. AND INVESTEEES

FINANCING PROVIDED

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004

(Amounts in Thousand New Taiwan Dollars, Unless Otherwise Specified)

No. Financing	Name of Company	Account	Maximum Balance for the Period (US\$ in Thousand)	Ending Balance (US\$ in Thousand)	Interest Rate	Type of Financing	Reasons for Allowance	Collateral	Financing Limit for Each Company	Financing Company's Limits (US\$ in Thousand)
1	TSMC International	TSMC Other Development	2,039,040 US\$ (60,000)	\$2,039,040 US\$ (60,000)	1.50%	2	Operating capital		\$ N/A	\$33,575,113 US\$ (987,968) (Note 2)
		TSMC Other Technology	339,840 US\$ (10,000)							
2	TSMC Partners	TSMC Other Development	2,718,720 US\$ (80,000)	2,718,720 US\$ (80,000)	1.50%	2	Operating capital		N/A	(Note 3)

Note 1: The No. 2 represents necessary for short-term financing.

Note 2: Not exceeding the issued capital of the Company.

Note 3: Generally not exceeding the issued capital of the Company, unless approved by all members of the board.

TABLE 2

TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LTD. AND INVESTEEES

**ENDORSEMENT/GUARANTEE PROVIDED
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004
(Amounts in Thousand New Taiwan Dollars, Unless Otherwise Specified)**

No.	Endorsement/ Guarantee Provider	Counter-party		Limits on Each Counter-party's Endorsement/ Guarantee Amounts	Maximum Balance for the Period (US\$ in Thousand)	Ending Balance (US\$ in Thousand)	Ratio of Accumulated Amount of Collateral to Net Equity of the Plant and Financial Statement	Maximum Collateral/ Guarantee Amounts Allowable (Note 1)
		Name	Nature of Relationship (Note 2)					
0	The Company	TSMC Development	3	Not exceed 10% of the net worth of the Company, and also limiting to the total capital issued of the endorsement/guarantee company, unless otherwise approved by Board of Directors.	\$ 2,039,040 US\$ (60,000)	\$ 2,039,040 US\$ (60,000)	0.54%	\$94,815,698
		TSMC North America	2		1,359,360 US\$ (40,000)	1,359,360 US\$ (40,000)	0.36%	
		WaferTech	3		14,952,960 US\$ (440,000)	14,952,960 US\$ (440,000)	3.94%	

Note 1: 25% of the net worth of the Company as of September 30, 2004.

Note 2: The No. 2 represents a subsidiary in which the Company holds directly over 50% of the equity interest..

The No. 3 represents an investee in which the Company holds directly and indirectly over 50% of the equity interest.

TABLE 3

TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LTD. AND INVESTEEES

MARKETABLE SECURITIES HELD

SEPTEMBER 30, 2004

(Amounts in Thousand New Taiwan Dollars, Unless Otherwise Specified)

Held Company Name	Marketable Securities Type and Name	Relationship with the Company	Financial Statement Accounts	September 30, 2004		Ownership Percentage	Notes
				Shares/Units (In thousands)	Carrying Value (US\$ in thousands)		
The Company	Government bonds 2003 Government Bond Series A		Short-term investment		\$1,207,409	N/A	