

**TAIWAN SEMICONDUCTOR
MANUFACTURING COMPANY LTD.**

1996
ANNUAL REPORT



MAJOR FACILITIES

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TSMC SPOKESMAN

Name: Gary T.L. Tseng
Title: Vice President
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AUDITORS

Company: T N SOONG & CO
Auditors: S.C. Huang, Edward Way
Address: 12Fl., No.156, Sec.3, Min-Sheng
E. Rd., Taipei, Taiwan, R.O.C.
TEL: 886-2-545-9988
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STOCK TITLE TRANSFER

Company: China Trust Commercial Bank
Transfer Agency Department
Address: 5Fl., No.83, Sec.1, Chung-Ching
S. Rd., Taipei, Taiwan, R.O.C.
TEL: 886-2-361-3033
FAX: 886-2-311-6723

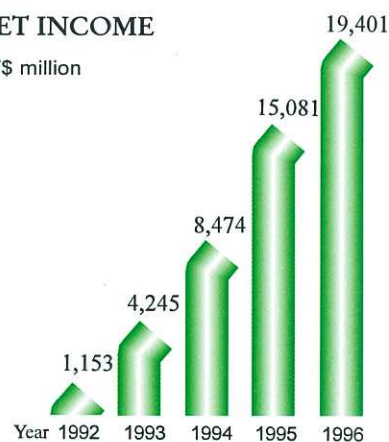
NET SALES

NT\$ million



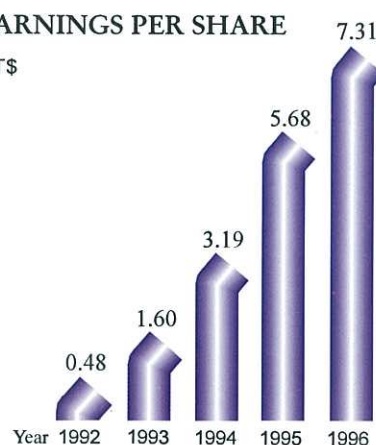
NET INCOME

NT\$ million



EARNINGS PER SHARE

NT\$



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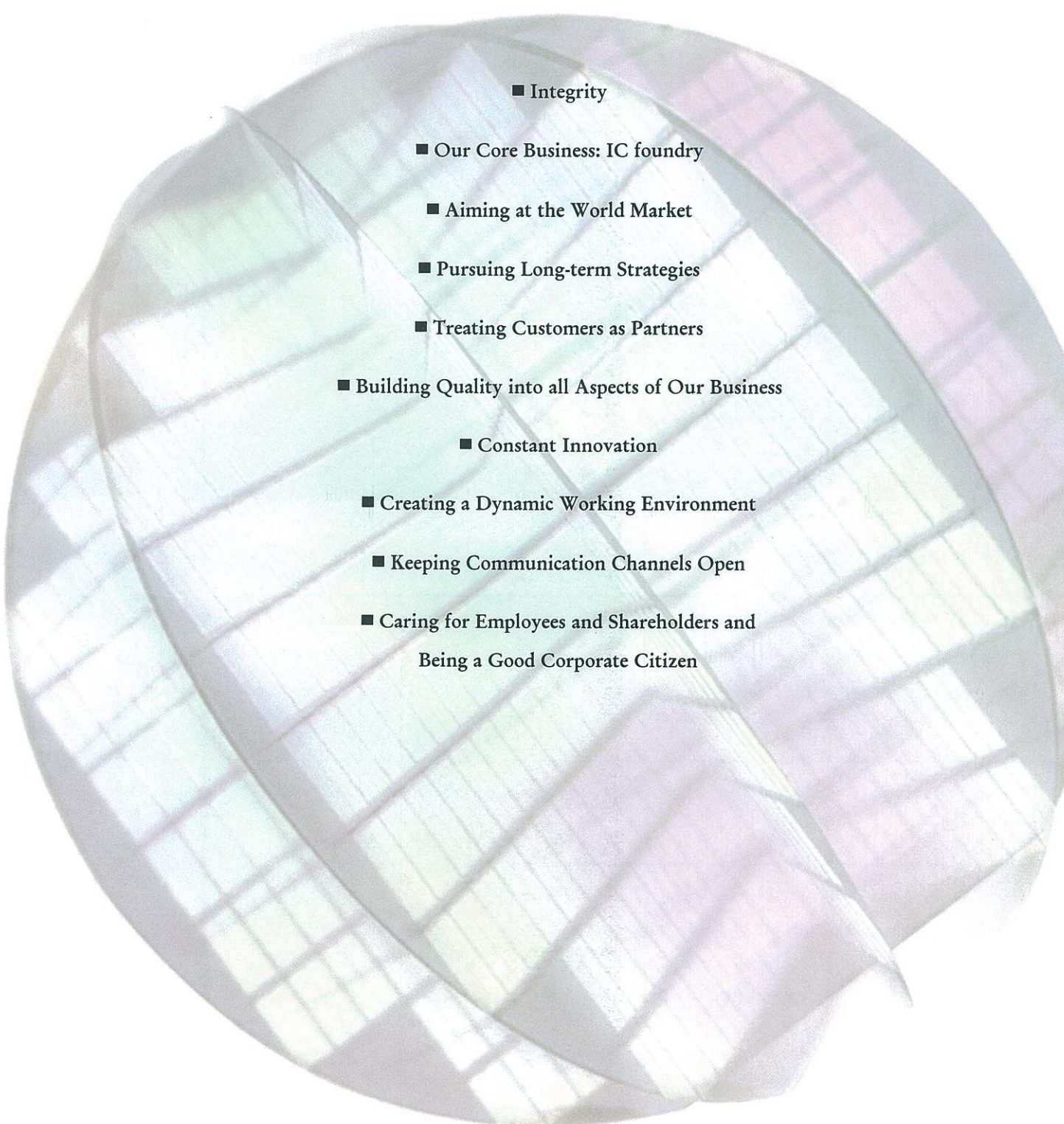
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TSMC's Business Philosophy

TSMC is committed to:

- 
- Integrity
 - Our Core Business: IC foundry
 - Aiming at the World Market
 - Pursuing Long-term Strategies
 - Treating Customers as Partners
 - Building Quality into all Aspects of Our Business
 - Constant Innovation
 - Creating a Dynamic Working Environment
 - Keeping Communication Channels Open
 - Caring for Employees and Shareholders and
Being a Good Corporate Citizen



Morris Chang, Chairman

Dear Shareholders,

Following three consecutive years of strong growth, the world-wide IC market experienced a downturn in 1996. In many ways, last year was two years in one for TSMC. During the first half, sales and profits soared, ensuring our record-breaking year overall. However, anticipated competitive elements in the second half of the year created significant price deterioration, which understandably affected our bottom line. This increasingly competitive environment can be attributed primarily to TSMC's success. The entrants in the foundry business are hoping to follow in TSMC's footsteps and match our success. We believe that we are not only meeting this competitive environment well, we are maintaining our leadership position. In 1997, we will continue to be the leader in technology and capacity and to provide our customers the ultimate service with our focus on the Virtual Fab.

Technology Leadership

1996 was the year of 0.35 micron logic process, and TSMC led the way in the tech race by converting our production to this next generation of technology. TSMC is now the only foundry to offer volume levels of 0.35 micron technology. Moreover, we are quickly moving to the next step, focusing on the development of quarter micron technology (0.25 μ m) and embedded memories in both DRAM, SRAM, and non-volatile Flash memory ICs. TSMC is committed to providing its customers with the earliest possible access to the latest technology.

Capacity Expansion

Total output last year grew significantly, expanding 21% overall, from 1.2 million wafers in 1995 to 1.45 million wafers in 1996. The strength of TSMC's customer base and our accomplishments give us the confidence to move forward with our plans to expand capacity and build new fabrication plants. Fab III went into full production last year, and by December was turning out 25,000 wafers per month. Fab IV will enter into volume production during the first quarter of 1997, and construction of



Donald W. Brooks, President



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LETTER TO THE SHAREHOLDERS

Fab V is nearing completion. Meanwhile, construction is also moving full steam ahead at our facility in Camas, Washington, in the United States. We are on target to begin production at this plant by mid-1998. We have also finalized agreements with our joint venture partners in the new company, called WaferTech. These partners are U.S.-based Altera, Analog Devices, and Integrated Silicon Systems, Inc. (ISSI). They all bring to the relationship years of success and a strong commitment to technology advancement.

Market Development

As the numbers show, TSMC had a great year, especially in contrast to the industry as a whole, which suffered a 10% decline in sales. TSMC's sales climbed 37% to hit NT\$39.4 billion, a new company record. Profits also rose strongly to NT\$19.4 billion.

TSMC's customer base remained solid around the globe, with U.S. companies continuing to purchase half of TSMC's total output. The Asian market (including Japan) showed fast growth last year. We are especially pleased with our clients in Japan, who are not only valued customers but provide essential technology transfer. For example, through our relationship with Fujitsu, TSMC has received the technology to produce 0.35um DRAM ICs. In 1996 European-based companies accounted for 15% of TSMC's total sales and they continue to turn to us for high-end communications ICs and micro-controllers.

Virtual Fab Concept

The Virtual Fab is the cornerstone of our customer service program. Started in 1996 and in full-swing this year, the Virtual Fab gives customers all the benefits of an in-house fabrication plant without the expense or organizational difficulties. All

aspects of communications and procedures are automated and easily accessible to the customers, keeping them constantly informed and up-to-date on shipments, technology, inventory, etc. For example, with TSMC's Total Order Management System, customers make inquiries directly from their computer to our information system and receive immediate data about their order or work in progress. The key point here is that the customers are not disadvantaged by working with TSMC instead of having their own Fabs.

Future Outlook

Although the industry is expected to register overall growth of 10% to 15% in the coming year, growth of the IC foundry market is predicted to surpass that of the industry as a whole. Rapidly increasing supply will thus keep foundry prices under pressure. Facing another challenging year in 1997, at TSMC we will utilize our competitive advantages in capacity expansion, technology leadership, customer service and cost control to maintain our leading market share. We are assertively moving forward to hold onto our number one position in the foundry market.

Thank you to our customers, shareholders, and employees for your continued support and dedication.

Chairman

President



台灣積體電路

三廠·四廠

Ten Years of Progress at TSMC (1)

- Feb. 1987 **TSMC founded...**
Initially proposed by Dr. Morris Chang, at that time president of the Industrial Technology Research Institute, TSMC was founded jointly by the government of Taiwan, Philips Electronics N.V. and private investors to become the world's first IC foundry company. Dr. Chang subsequently became chairman of the board of TSMC.
- Feb. 1988 **TSMC sets up TSMC-USA...**
To provide better service to customers in North America, the company set up its first subsidiary in the U.S..
- Dec. 1988 **TSMC begins to make a profit...**
As a result of hard work by all its employees, TSMC began to make a profit just two years after its founding.
- Aug. 1989 **TSMC sets up TSMC-Europe...**
To increase TSMC's global exposure and to enhance service to customers in Europe, the company set up a representative office in Amsterdam, the Netherlands.
- Apr. 1990 **Grand opening of Fab II...**
At a grand opening ceremony held in Hsin-chu, TSMC launched its second 6-inch wafer fab - TSMC Fab II.
- Jun. 1991 **TSMC forms TQC committee...**
To realize the goal of "building quality into all aspects of business", the company formed the Total Quality Committee (TQC).
- Apr. 1993 **TSMC awarded ISO-9001 certification...**
In a clear recognition of TSMC's quality control system, the company was awarded ISO-9001 certification.
- Dec. 1993 **TSMC breaks ground for Fab III...**
Commencing construction of its first 8-inch wafer fab, TSMC broke ground for its Fab III in Hsin-chu Science-Based Industrial Park.
- Sep. 1994 **TSMC goes public...**
In a move that indicated coming of age, TSMC became a public company, and its stock began trading on the Taiwan Stock Exchange.



1. Company Profile

Founded in 1987, Taiwan Semiconductor Manufacturing Company (TSMC) was the first pure integrated circuit (IC) foundry in the world. The company is based in Taiwan's "Silicon Valley", the Hsin-Chu Science-Based Industrial Park, located about an hour outside of Taipei. TSMC is a joint venture between the government of the Republic of China on Taiwan, Philips Electronics N.V., and other private investors. In 1994, the company was listed on the Taiwan Stock Exchange.

TSMC is dedicated to providing manufacturing services for advanced ICs. The company's charter prevents it from designing or making its own brandname IC products. Therefore, TSMC is a partner, and not a competitor, for other semiconductor companies. TSMC's success in the foundry business has served as a model for the many new entrants in the market. With TSMC as the engine of change, what was once just a concept of a pure foundry is today a multi-billion dollar industry. As the semiconductor industry faces greater consolidation and spiraling costs in building new IC fabs, professional foundry companies, such as TSMC, stand to become a major source of IC manufacturing services for the rising worldwide demand.

TSMC is the largest foundry in the world. By the end of 1996, the company was operating two 6-inch wafer fabs (Fab I and II) and one 8-inch fab (Fab III), putting out 1.15 million top-quality, high-yield 6-inch wafers and 180 thousand 8-inch wafers per year in 1996. Fab IV started pilot production in the fourth quarter of 1996 and will begin volume production in 1997. Construction of Fab V was nearing completion at the end of 1996, and this fab will commence volume production early in 1998. WaferTech, TSMC's joint venture with several long-standing customers in the U.S., broke ground in July, 1996, and is on schedule for ramp-up in mid-1998.

In addition to maintaining a competitive edge with continually-increasing capacity, TSMC beats the competition by consistently providing volume production levels of new generation technologies. The company is also capable of offering a wide-range of technology processes, including mixed-mode and embedded memory technologies as well as standard logic processes.

While TSMC focuses on process technology and manufacturing excellence, it places equal emphasis on customer service. Since TSMC was founded, the company has treated its customers as partners. In order to provide even higher-quality service and further differentiate itself from other foundries, TSMC has launched its Total Order Management System. This is the first step in realizing its ultimate goal of achieving the Virtual Fab concept. In addition, a program called MUST (MIS Upgraded System for TSMC) is also being implemented. This advanced information system will more effectively integrate TSMC's business operations, such as finance and logistics, and improve decision making. All of these efforts will ensure TSMC's continued leadership in the global foundry business.

As a good corporate citizen, TSMC takes the job of community and employee relations seriously. As a result of its concerted actions in this area, the company has received several awards from the Taiwan government in areas such as environmental protection, employee benefits, employee training, and social welfare. In addition, TSMC has been ranked among Taiwan's leading companies by *Far Eastern Economic Review* for two consecutive years.





2. Directors and Supervisors

Title Name	Date Elected	Term (Year)	Shareholding ¹	Spouse & Minor Shareholding
Chairman Morris Chang	1994.1.28	3	20,157,443	Nil
Director G.J. Kleisterlee	1994.1.28	3	631,064,722	Nil
Director A.P.M. van der Poel	1994.1.28	3	631,064,722	Nil
Director J.C. Lobbezoo	1994.1.28	3	631,064,722	Nil
Director L.P. Hsu	1994.1.28	3	631,064,722	Nil
Director Ming-Te Lin	1994.1.28	3	562,308,147	Nil
Director Ching-Chang Yen	1994.1.28	3	562,308,147	Nil
Director Chintay Shih	1994.1.28	3	562,308,147	Nil
Director Donald W. Brooks	1994.1.28	3	4,002,614	Nil
Director I-Kwei Wu	1994.1.28	3	9,499,680	Nil
Supervisor E.Th. Ausems	1994.1.28	3	631,064,722	Nil
Supervisor Chung-Ying Hu	1994.1.28	3	562,308,147	Nil
Supervisor Jerome S.N. Hu	1994.1.28	3	4,042	Nil

3. Major Officers

President Donald W. Brooks	1991.3.15	4,002,614	Nil
Vice President Gary T. L. Tseng	1991.10.15	586,111	450
Vice President Y. C. Huang	1995.8.15	1,628,457	212,556
Vice President Quincy Lin	1995.8.15	1,884,388	535,993
Vice President Rick Tsai	1995.8.15	1,501,669	Nil
Vice President John Y. Chen	1995.8.15	672,256	Nil

Note1. As per the actual reported number of shares on December 31, 1996

(As of December 31,1996)

Education & Experience	Remarks
Ph.D. Electrical Engineering, Stanford University / Chairman,Vanguard International Semiconductor Corp. / Chairman, WYSE Technology Inc.	
Eindhoven Technical University, Electronic Engineering/ President, Philips Taiwan	Philips Electronics N.V. Representative of Legal Entity
Eindhoven Technical University, Electronic Engineering/ Chairman and CEO, Philips Semiconductors International B.V.	Philips Electronics N.V. Representative of Legal Entity
Erasmus University, Business Economics / Chief Finance Officer, Philips Semiconductors International B.V.	Philips Electronics N.V. Representative of Legal Entity
B.S. Physics,National Cheng-Kung University / Executive Vice President, Philips Taiwan	Philips Electronics N.V. Representative of Legal Entity
M.S. Earth-Science, Massachusetts Institute of Technology / Vice President, Metal Industrial Development Center / Deputy Executive Secretary, Development Fund, Executive Yuan	Development Fund, Executive Yuan Representative of Legal Entity
Master of Comparative Law, University of Michigan / Deputy Minister, Ministry of Finance, R.O.C.	Development Fund, Executive Yuan Representative of Legal Entity
Ph.D. Electrical Engineering, Princeton University / President, Industrial Technology Research Institute	Development Fund, Executive Yuan Representative of Legal Entity
B.S. Electrical Engineering, Southern Methodist University / Vice President, Texas Instruments, Inc. / President, Fairchild Semiconductors, Inc.	
China Junior College of Marine Technology / Chairman, Swanson Plastics Corp.	Maw-Chong Investment Company, Ltd. Representative of Legal Entity
Tilburg University, Economics / Executive Vice President, Philips Taiwan	Philips Electronics N.V. Representative of Legal Entity
Ph.D. Geophysics, National Central University / Director, Council for Economic Planning and Development, Executive Yuan	Development Fund, Executive Yuan Representative of Legal Entity
M.S. Chemical Engineering, University of Michigan / Chairman, Chao Ting-Chen Cultural Education Foundation	
B.S. Electrical Engineering, Southern Methodist University, USA / Vice President, Texas Instruments, Inc. / President, Fairchild Semiconductors, Inc.	
M.B.A., University of Missouri, Columbia, USA / Accounting & Finance Manager, Philips Electronic Building Element Industries	
M.B.A., Saginaw Valley State University, USA / Senior Director, TSMC Fab I / Senior Director, Corp. Services, TSMC	
Ph. D., Business Administration, University of Kentucky, USA / Director, Strategy Planning & Development, TSMC / Senior Director, Corp. Marketing & Sales, TSMC	
Ph.D., Material Science, Cornell University, USA / Director, TSMC Fab II Module A / Sr. Director, TSMC Fab II	
Ph.D., Electrical Engineering & MBA, UCLA, USA / Director of Technology, Cypress Semiconductor Corp., USA / Sr. Director, Engineering Manufacturing Services, TSMC	

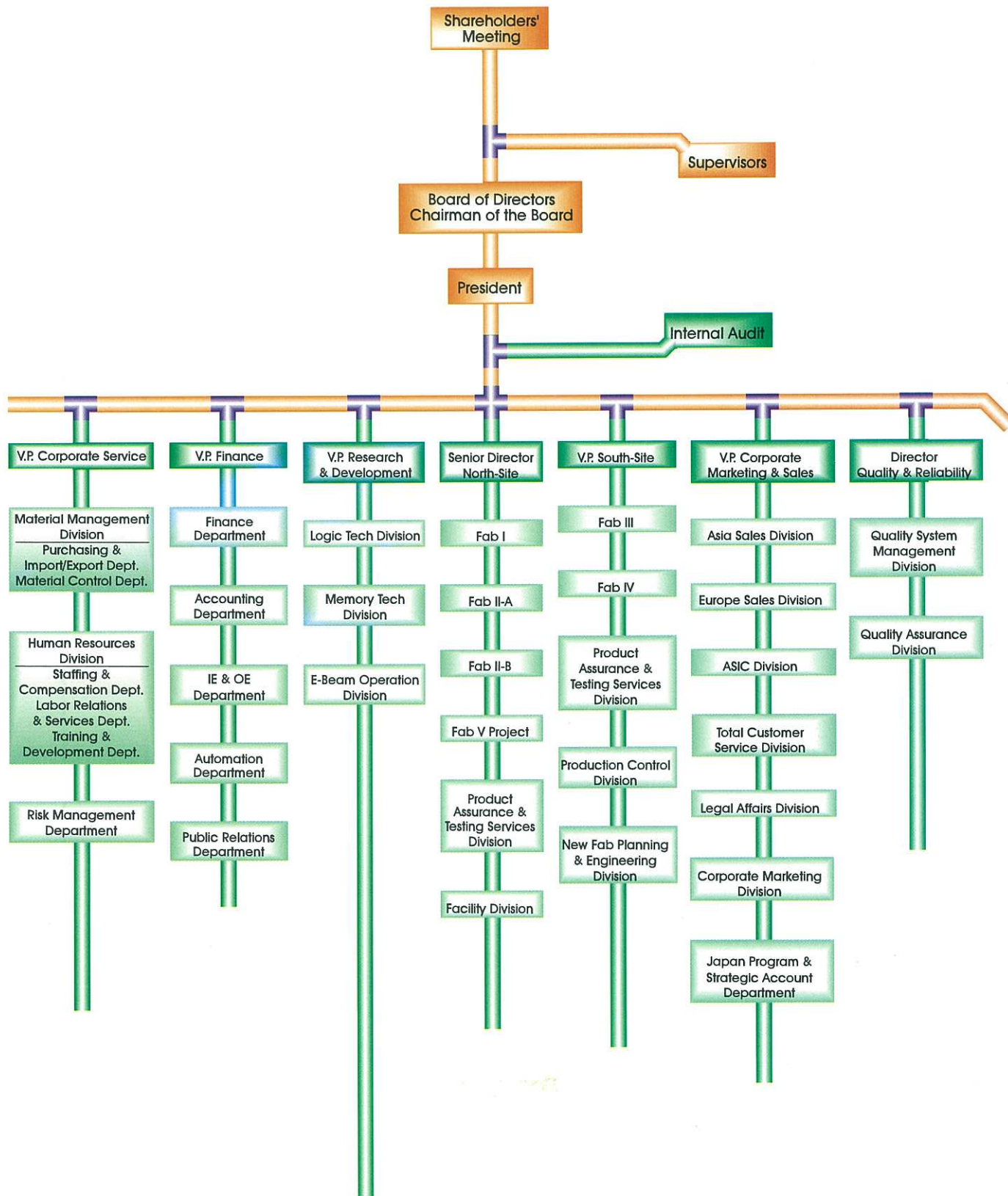


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A BRIEF INTRODUCTION TO TSMC



4. Organization



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Ten Years of Progress at TSMC (2)

Apr. 1995 TSMC breaks ground for Fab IV. As part of TSMC's ongoing commitment to expand production capacity and embrace new process technology, the company broke ground for construction of its second 8-inch wafer fab. TSMC Fab IV.

Aug. 1995 Grand opening of Fab III. TSMC commemorated the beginning of production at its first 8-inch wafer fab, TSMC Fab III.

Nov. 1995 TSMC launches joint venture to build its first fab in the U.S.

To meet increasing demand for its products, TSMC formed a joint venture with several long-standing customers to build a fab in the U.S. The new facility, known as U-TECH, is based in Camarillo, California.

Nov. 1995 TSMC begins construction of Fab V. Utilizing a "stacked" design, TSMC completed construction of its third 8-inch wafer fab.

Nov. 1995 TSMC reaches \$2.1 billion in sales. One year after its founding, TSMC surpassed \$2 billion in sales and the billion-dollar mark.

Nov. 1995 TSMC begins implementing the "Virtual Fab" concept.

As the first step toward transforming itself into a virtual fab, TSMC is launching a program to reduce inventory levels.

Other measures include reducing the number of inventory locations and increasing the number of inventory locations.

Aug. 1995 TSMC reaches \$2.1 billion in sales. One year after its founding, TSMC surpassed \$2 billion in sales and the billion-dollar mark.

Nov. 1995 TSMC begins implementing the "Virtual Fab" concept.

Ten Years of Progress at TSMC (2)

- Apr. 1995 **TSMC breaks ground for Fab IV...**
As part of TSMC's ongoing commitment to expand production capacity and embrace new process technology, the company broke ground for construction of its second 8-inch wafer fab - TSMC Fab IV.
- Aug. 1995 **Grand opening of Fab III...**
TSMC commemorated the beginning of production at its first 8-inch wafer fab - TSMC Fab III.
- Nov. 1995 **TSMC launches joint venture to build its first fab in the U.S....**
To meet increasing demand for its products, TSMC formed a joint venture with several long-standing customers to build a foundry in the U.S. The new company, named WaferTech, is based in Camas, Washington.
- Nov. 1995 **TSMC begins construction of Fab V...**
Utilizing a unique "stacked" design, TSMC commenced construction of its third 8-inch wafer fab - TSMC Fab V.
- Dec. 1995 **TSMC surpasses US\$1 billion in sales...**
Less than 10 years after its founding, TSMC surpassed both the million wafer and the billion dollar mark.
- Jul. 1996 **TSMC begins implementing the "Virtual Fab" concept...**
As the first step toward transforming itself into a customer's "Virtual fab", TSMC launched its Total Order Management System. Realization of the "Virtual fab" concept will give TSMC's customers direct access to production procedures and information without the cost and headaches of owning their own fabs.
- Aug. 1996 **TSMC awarded ISO-14001 certification...**
As a tangible recognition of TSMC's compliance with international standards for environmental protection, the company was awarded the coveted ISO-14001 certification.



1. Business Activities

(1) Business Scope

Based on a strong foundation of manufacturing and service excellence, TSMC is committed to providing dedicated, quality IC manufacturing services to the world-wide semiconductor industry. We offer a full range of manufacturing services, including:

- ULSI and VLSI Wafer Manufacturing
- Wafer Probing
- Assembly and Testing
- Mask Production
- ASIC Service

TSMC's customers utilize our IC manufacturing services for a variety of end-product applications, from personal computers and the Internet to digital entertainment. It is estimated that TSMC produced around 3% of the world-wide supply of ICs in 1996.

(2) Customer Applications

The advanced ICs produced for TSMC's customers are used in a diverse range of end-product applications, including computers, communication systems, consumer goods, and industrial products.

2. Marketing and Sales

Despite the overall decline in the world-wide IC market in 1996, TSMC's sales rose 37% to NT\$39.4 billion, while profits hit a record high of NT\$19.4 billion. The company's outstanding performance can be attributed to two major factors: the capacity option agreements we signed with our customers the previous year and our managed limited exposure to the memory market. These factors, combined with our strong market share, increased capacity, and ability to produce the latest generation technologies, allowed the company to emerge from a turbulent year in a strong position.

Production over the Last Five Years

Unit: Capacity/Quantity(pcs) Amount(NT\$K)

Year	Wafers			Package			Others		
	Capacity	Quantity	Amount	Capacity	Quantity	Amount	Capacity	Quantity	Amount
1992	439,800	405,916	4,213,577	-	-	-	-	-	-
1993	627,500	664,985	6,282,643	-	-	-	-	-	-
1994	915,360	942,617	8,699,044	-	-	-	-	-	-
1995	1,158,500	1,217,604	11,507,350	-	-	-	-	-	-
1996	1,567,890	1,501,884	16,721,361	-	-	-	-	-	-

Net Sales over the Last Five Years

Unit: Quantity(pcs) Amount(NT\$K)

Year	Wafers				Package				Others				Total			
	Domestic		Exports		Domestic		Exports		Domestic		Exports		Domestic		Exports	
	Quantity	Amount	Quantity	Amount	Quantity	Amount	Quantity	Amount	Quantity	Amount	Quantity	Amount	Quantity	Amount	Quantity	Amount
1992	183,139	2,469,661	169,157	2,756,970	4,129	136,185	32,015	921,878	-	25,614	-	200,459	187,268	2,631,460	201,172	3,879,307
1993	218,567	3,583,516	375,863	6,855,705	1,735	70,871	46,546	1,471,238	-	106,408	-	246,185	220,302	3,760,795	422,409	8,573,128
1994	282,590	5,526,433	578,784	10,748,451	2,883	99,647	56,356	2,212,963	-	312,873	-	435,704	285,473	5,938,953	635,140	13,397,118
1995	342,671	8,540,012	797,501	16,589,558	3,304	139,081	46,131	2,115,917	-	597,449	-	783,974	345,975	9,276,542	843,632	19,489,449
1996	439,965	9,735,637	980,386	26,278,058	7,399	378,020	25,497	1,119,274	-	886,343	-	1,002,847	447,364	11,000,000	1,005,883	28,400,179



3. Market Outlook

What happened in 1996 with the world-wide IC market can easily be characterized as unpredictable. Following three consecutive years of more than 30% growth, from 1993 to 1995, the market in 1996 contracted 10%. The memory market alone saw overall revenues decline a substantial 34%, with the per bit price plummeting more than 70%. In addition to technology advancement, the dramatic price pressure experienced in 1996 was primarily due to excess inventory accumulated in 1995. In contrast, the microcomponent market grew by a healthy 14% in 1996 and is expected to rise 16% in 1997. The overall IC market is forecast to grow by 10% to 15% in 1997.

Over the years, TSMC has managed its exposure to the memory market by limiting its proportion of memory manufacturing services to 15% or less of total sales revenue. This strategy has proven successful and in 1996 shielded the company from near free fall in the memory market. In 1997, the company will maintain this strategy and will continue to target customers in the high growth segments of the micro-component market. In 1996 TSMC successfully increased its customer base in the Internet, digital entertainment, and wireless communication markets. By continuing to focus on these types of customers, TSMC will remain in the high-growth segment of the foundry market.

Over the long term, TSMC believes that foundry manufacturing services will play an increasingly important role in the IC industry. Each year, more companies, both fabless and integrated device manufacturers (IDM), are turning to foundries for IC manufacturing services. It is forecast that by the year 2000, 17% of the world's IC production capacity will be in foundries. To ensure TSMC's continued leadership position in the industry in 1997 and beyond, the company will focus on the following technology offerings:

(1) Advanced CMOS Logic Process

TSMC began offering 0.35 μm CMOS Logic process in 1996 and will commence mass-production of this technology in 1997. 0.25 μm CMOS design rules will be available in early 1997. The move into these advanced technologies will help TSMC's customers remain competitive in both performance and price in the high-density and high-performance IC markets.

(2) Advanced Mixed-Mode Process

TSMC has successfully developed the 0.35 μm double-poly, quadruple-metal process to meet the demands of the mixed digital-and-analog market. This process will make it easier for TSMC's customers to integrate digital-signal processors and/or data-compression chips with analog circuitry for the fast-growing multimedia market.

(3) Advanced High-Speed SRAM Process

TSMC's 0.35 μm high-speed SRAM process was made available to customers in 1996. The shrink version 0.30 μm process is under development and will be ready for production in 1997. This process will enable TSMC customers to further reduce their costs.

(4) Advanced DRAM/Embedded DRAM Processes

TSMC has developed the 0.35 μm DRAM process and is preparing for embedded DRAM opportunities in the graphics, disk storage, and communications markets. The 0.35 μm embedded DRAM process will be available by the end of 1997.

(5) Advanced Flash/Embedded Flash Processes

The company is developing the 0.5 μm Flash and 0.5 μm embedded Flash processes. They both will be ready for production in 1997. The embedded Flash process will help customers integrate Flash with Logic, especially in the μC , DSP and other applications requiring high integration. The 0.35 μm Flash/embedded Flash is also under development and will be available in 1998.



(6) BiCMOS Process

For customers in the mass storage and wireless communication markets, in 1996 TSMC offered 0.8 um BiCMOS (12 GHz).

(7) ASIC Technology

TSMC's ASIC group has developed 0.35 um standard cells libraries and now provides various megacells, such as uC, DSP, and UART, to help customers to get their products on the market more quickly.

4. Long-term Investments

Unit: NT\$K, except Investment Shares

Other Investments	Business Activities	Investment Costs	Book Value	Investment Shares		Net Worth	Market Value	Accounting Policy	Return on Investment		Investment to TSMC
				Number of Shares	Share (%)				Investment Income	Dividends	
Taiwan Mask Corp.	Mask Making	55,988	55,988	7,220,176	8.20	—	651,260	Cost Method	—	20,015	Nil
TSMC-USA	Marketing & Engineering Support	25,588	95,224	1,000,000	100.00	95,224	—	Equity Method	25,302	—	Nil
TSMC-Europe	Marketing & Engineering Support	2,960	12,299	200	100.00	12,299	—	Equity Method	4,267	—	Nil
Caesar Technology Co., Ltd.	IC Assembly & Testing	193,002	203,902	16,583,721	18.14	200,969*	—	Cost Method	—	15,076	Nil
Vanguard Int'l Semiconductor Corp.	IC Design & Manufacturing	5,257,638	5,762,964	520,800,621	27.12	5,510,563	—	Equity Method	72,495	—	Nil
TSMC International Investment Ltd.	Semiconductor related business investment	6,137,226	6,176,879	222,641,920	100.00	6,176,879	—	Equity Method	54,088	—	Nil
Lian Ya Corporation	Liquid nitrogen & nitrogen gas manufacturing & marketing	146,250	146,250	5,850,000	11.25	111,346*	—	Cost Method	—	—	Nil
Shin-Etsu Handotai Taiwan Co., Ltd.	Raw wafer R&D, manufacturing & marketing	105,000	105,000	10,500,000	7.00	101,318*	—	Cost Method	—	—	Nil
W.K. Technology Fund	Venture investment and related businesses	50,000	50,000	5,000,000	12.50	50,048*	—	Cost Method	—	—	Nil

*Based on the company's 1996 unaudited financial reports.



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5. Personnel Growth over the Last Three Years

Year	Number of Employees				Average Age	Average Years of Service	Percentage by Education					
	Direct Labor	Engineer	Manager	Total			Ph.D.	MS/MA	BS/BA	High School	Other	Total
1994	1,241	1,066	374	2,681	28	3.2	1.5%	13.0%	38.1%	46.7%	0.7%	100.0%
1995	1,578	1,372	462	3,412	28	3.3	1.6%	15.3%	38.7%	43.3%	1.1%	100.0%
1996	1,830	1,715	572	4,117	28	3.5	1.8%	19.0%	37.8%	41.3%	0.1%	100.0%

6. Environmental Protection Measures

1996 was also a successful year for TSMC in the area of environmental protection. In order to keep pace with the evolution of ever-more-exacting international environmental protection standards, TSMC implemented an environmental management system based on the international standard ISO14001 and received the respective certification in August, 1996. TSMC has also worked with the Taiwan government to promote ISO14001 through the sponsorship of several seminars and workshops. A paper on "ISO14001 in TSMC" was presented at the 1996 Waste Minimization Conference in Taiwan, where TSMC received an outstanding presentation award.

TSMC continues to devote maximum effort to the implementation and promotion of waste minimization and pollution prevention. To make environmental protection a part of everyone's daily life, TSMC implements a variety of activities each year, such as "earth week", office waste recycling, and tree-planting. Also in 1996, TSMC began working with the Resource Recycling Foundation and joined the "NGO-Business Environmental Partnership Program". The program is sponsored by the United States-Asia Environmental Partnership and the Asia Foundation and was developed to improve office recycling practices.

These efforts not only increased environmental awareness at TSMC and in the community at large, but also produced tangible results, earning TSMC many awards. Among them were the "Excellent Environmental Protection Company", awarded by the Environmental Protection Administration and the "Outstanding Energy Conservation Company", given by the Ministry of Economic Affairs.

7. Labor Relations

TSMC's management works to build trust among all its staff, and places equal emphasis on internal and external communication. This principle encourages employees to give each other the same respect and service attitude they give to outside customers. To foster this attitude and to improve both the physical and psychological well-being of its employees, TSMC is dedicated to upgrading recreational facilities, enhancing leisure activities and ensuring adequate medical benefits.

TSMC is committed to an open communication environment and promotes a variety of practices designed to fulfill this goal. The company holds monthly departmental meetings and round-table discussions, provides an employee suggestion box, offers employee counseling and guidance services, and conducts regular employee opinion surveys.



10

8. Important Contracts

Technology Cooperation Agreement

- (1) Term of Agreement: 7/9/1987 - 7/8/1997
- (2) Summary: Under the agreement, TSMC is committed to paying a technical assistance fee to N.V. Philips' Gloeilampenfabrieken (N.V.P.G.) of 3% of net sales for certain products.
- (3) Contracting Party: N.V. Philips' Gloeilampenfabrieken (now Philips Electronics N.V.)

Submicron Technology Licensing Agreement

- (1) Term of Agreement: 11/20/1990 - 12/31/2000
- (2) Summary: Under the agreement, TSMC is committed to paying a licensing fee of NT\$129.4 million to the Industrial Technology Research Institute over a five-year period, plus a royalty fee of 0.5% to 3.5% of net sales for certain products. As of December 31, 1995, TSMC has paid the entire license fee.
- (3) Contracting Party: The Industrial Technology Research Institute

Building and Equipment Leasing Agreement

- (FAB 1)
- (1) Term of Agreement: 4/1/1987 - 3/31/1997
 - (2) Summary: Under the agreement, TSMC is leasing certain buildings and equipment from the Industrial Technology Research Institute.
 - (3) Contracting Party: The Industrial Technology Research Institute

Land and Public Facility Leasing Agreement

- (FAB 1)
- (1) Term of Agreement: 4/1/1987 - 3/31/1997
 - (2) Summary: Under the agreement, TSMC is leasing certain land and public facilities from the Industrial Technology Research Institute.
 - (3) Contracting Party: The Industrial Technology Research Institute

Building and Equipment Leasing Agreement

- (FAB 1)
- (1) Term of Agreement: 4/1/1997 - 3/31/2002
 - (2) Summary: Under the agreement, TSMC is leasing certain buildings and equipment from the Ministry of Economic Affairs.
 - (3) Contracting Party: Ministry of Economic Affairs

Land and Public Facility Leasing Agreement

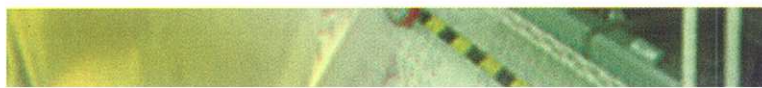
- (FAB 1)
- (1) Term of Agreement: 4/1/1997 - 3/31/2002
 - (2) Summary: Under the agreement, TSMC is leasing certain land and public facilities from the Industrial Technology Research Institute.
 - (3) Contracting Party: The Industrial Technology Research Institute

Manufacturing Agreement

- (1) Term of Agreement: 11/1/1993 - 6/30/1997
- (2) Summary: TSMC has provided certain equipment to Macronix, while Macronix has in turn manufactured wafer products for TSMC since May, 1994.
- (3) Contracting Party: Macronix International Co., Ltd.

Deposit and Supply Agreement

- (1) Term of Agreement: 9/23/1993 - 5/31/1997
- (2) Summary: TSMC is committed to manufacturing a certain quantity of wafer products for Cirrus Logic, while Cirrus Logic agrees to place a certain amount of deposit.
- (3) Contracting Party: Cirrus Logic International, Ltd.



Deposit and Supply Agreement

- (1) Term of Agreement: 10/29/1993 - 5/31/1997
- (2) Summary: Under the agreement, TSMC is committed to manufacturing a certain quantity of wafer products for Adaptec, while Adaptec agrees to place a certain amount of deposit.
- (3) Contracting Party: Adaptec Manufacturing Pte., Ltd.

Syndicated Term Loan Agreement

- (1) Term of Agreement: 12/29/1994 - 12/15/2001
- (2) Summary: Under a contract with a consortium of 25 banks, TSMC can borrow up to US\$260 million to procure equipment and machinery for Fab III.
- (3) Contracting Party: 25 banks, including ABN AMRO Bank, N.V., Taipei Branch, and the China Trust Commercial Bank.

Option Agreement

- (1) Term of Agreement: 1995 - 2001
- (2) Summary: Under this agreement, TSMC guarantees a determined capacity for a set number of years to customers in the United States, Europe, and Asia. More than ten companies had signed an option agreement with TSMC as of December, 1996.
- (3) Contracting Party: More than 10 companies in U.S.A., Europe, and Asia.

9. Status of Previous Cash Capital Call or Corporate Bond

The recent cash capital call was approved on October 30, 1992, and completed in the second quarter of 1993.

10. Litigation Proceedings

Nintendo of America, Inc., filed a suit against TSMC and TSMC-USA at the United States District Court Northern District of California in September, 1994. The suit alleged that TSMC and TSMC-USA infringed upon Nintendo's intellectual property rights and requested that TSMC halt production of the alleged products and pay damages. In September, 1995, the case against TSMC-USA was dismissed. TSMC and Nintendo of America, Inc., reached a settlement in March, 1996.



12



Process Technology Milestones

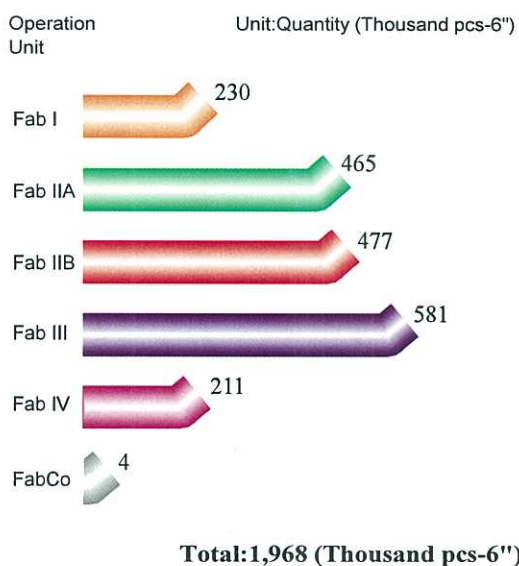
Dec.	1988	1.5 um process technology volume production begins
May.	1989	1.2 um process technology volume production begins
Jan.	1991	1.0 um process technology volume production begins
Jan.	1992	0.8 um process technology volume production begins
Apr.	1993	0.6 um process technology volume production begins
Sep.	1994	0.5 um process technology volume production begins
Aug.	1996	0.35 um process technology volume production begins

Awards and Honors (1)

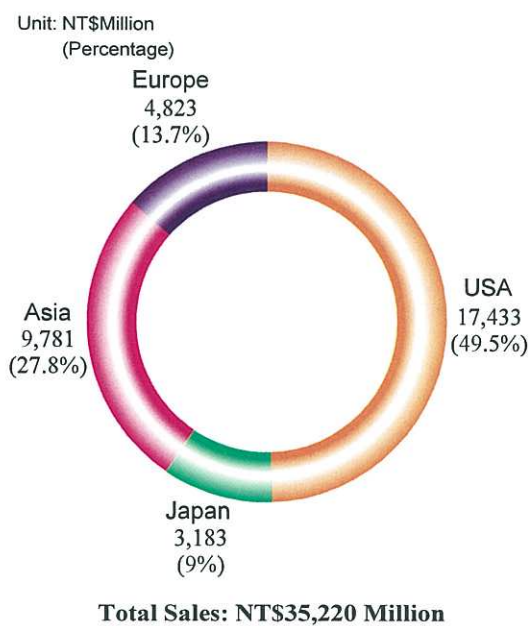
Jan.	1992	National Invention Award, presented by representatives of the government of Taiwan in the award's inaugural year
Mar.	1992	Ranked as the 38 th most reputable enterprises in Taiwan by <i>Excellent</i> magazine
Jun.	1992	The Employee Benefits Award and the Labor Training Award, presented by the Labor Commission of the Executive Yuan
Nov.	1992	Personnel Training Award, presented by the National Industry Association
Dec.	1992	National Enterprise Environmental Protection Award, presented by the Environmental Protection Administration in the award's inaugural year
May.	1993	Good Working Condition Award, presented by the Labor Commission of the Executive Yuan
Nov.	1993	National Pollution Prevention Award, presented by the National Industry Association
Jun.	1994	Ranked as the 35 th largest manufacturing company in Taiwan by <i>CommonWealth</i> magazine
Oct.	1994	Ranked third most competitive company in Taiwan by <i>CommonWealth</i> magazine, and highest in the area of "Quality of products and service"
Dec.	1994	Technology Development Award, presented by the ROC Technology Development Association

1. Production and Sales Projections for 1997

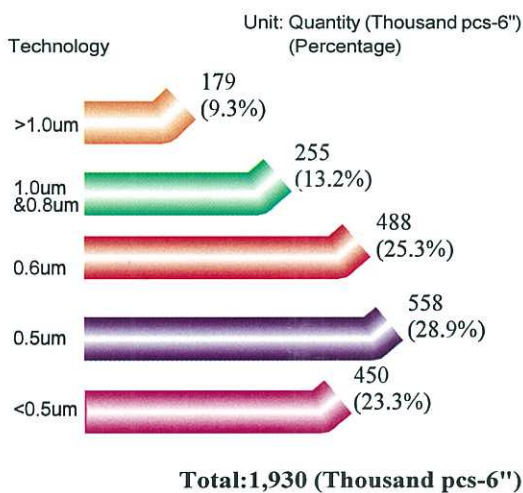
Production Plan



Net Sales Analysis by Area



Sales Plan



13

BUSINESS PLANS



2. Capital Increase for Expansion Plans in 1997

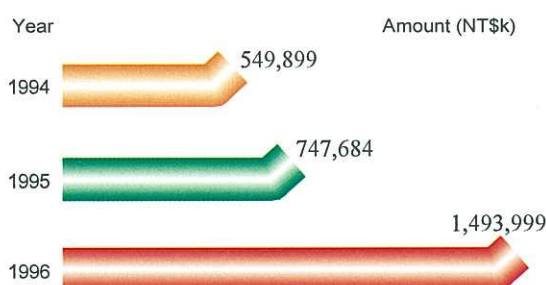
1997 Capital Investment Plans and Projected Results

Item	Amount (NT\$Million)	Projected Results
Fab V Project	10,288	Scheduled for operation in January 1998
Fab IV Capacity Expansion	8,355	Increase 8"wafer output capacity to 22,000 pcs/month by the end of 1997
Fab III Capacity Expansion	4,433	Increase 8"wafer output capacity to 37,000 pcs/month by the end of 1997
Replacement and others	1,857	Maintain technology superiority
Total	24,933	

3. Research and Development Plans

(1) R&D Investment and Achievements (from 1994 to 1996)

R&D Investment



R&D Achievements

TSMC's research and development work is crucial to the company's goal of maintaining its leadership position in technology advancement. In 1996, TSMC's Research and Development Area worked closely with the company's customers and launched production of the following new technology processes: 0.35um triple-metal and quadruple-metal Logic, 0.35um Mixed-Mode, and 0.35um SRAM. All processes are achieving a high and steady yield. Also now in pilot production is the 0.35um DRAM process, which is in preparation for the embedded application to the Logic process.

(2) Direction of Future Developments

To stay ahead of the swift upgrades in technology, TSMC continuously introduces next generation processes to its production facilities. Currently, technologies under development include: 0.25um Logic/ASIC, 0.25um Mixed-Mode, 0.3/0.25um SRAM, 0.3/0.25um DRAM, and 0.35/0.25um embedded DRAM processes. In early 1997, TSMC will begin development of 0.18um process technology, thereby increasing its investment in R&D efforts and working with its customers more closely than ever. TSMC's commitment to R&D not only ensures timely availability of advanced technologies but also supports the customer's need to quickly introduce new products to the market.





tsmc



Awards and Honors (2)

- Dec. 1994 TSMC Chairman, Dr. Morris Chang named as one of the ten most excellent entrepreneurs in Asia by *Electronic Business Asia* magazine
- Aug. 1995 Ranked number two in Taiwan by the China Credit Information Service, Ltd., using composite performance indicators
- Nov. 1995 Fab I receives 1995 Industrial Waste Minimization Award, presented by the Joint National Waste Reduction Task Force
- Nov. 1995 National Pollution Prevention Award, presented by the Ministry of Economic Affairs
- Nov. 1995 Named Taiwan's model company for "Professionalizing Management" in a report on "Asia's New Giants" by *Business Week*
- Dec. 1995 Ranked number one for "Working Environment" and "Employee Benefits" in a survey of the "Best High-Tech Company" published in *Career* magazine
- Dec. 1995 Ranked 8th in Taiwan by *Far Eastern Economic Review's* "Review 200: Asia's leading companies"
- May. 1996 Ranked the second most preferred employer in Taiwan in a survey conducted by *Business Weekly*
- May. 1996 Fab III receives National Energy Conservation Award, presented by the Ministry of Economic Affairs
- May. 1996 Good Working Condition Award, presented by the Labor Commission of the Executive Yuan
- Oct. 1996 Ranked best semiconductor company in Taiwan and third best overall by *CommonWealth* magazine in a survey of "Taiwan's Benchmarking Enterprises"
- Nov. 1996 Fab I receives National Enterprise Environmental Protection Award, presented by the Environmental Protection Administration
- Dec. 1996 Ranked 6th in Taiwan by *Far Eastern Economic Review's* "Review 200: Asia's leading companies"

1. Brief Balance Sheet

Financial analysis from 1992 to 1996

UNIT:NT\$K

Item	1992	1993	1994	1995	1996
Current assets	2,494,159	5,111,310	7,659,444	16,070,964	16,529,359
Long-term stock investments	67,835	161,156	3,074,147	4,989,037	12,608,506
Fixed assets	8,719,163	10,436,047	14,986,932	26,643,665	41,978,952
Other assets	110,269	290,639	386,580	599,369	2,018,827
Current liabilities					
Before distribution	2,557,733	2,046,034	2,897,189	5,075,481	5,357,895
After distribution	2,765,256	2,789,825	3,233,580	5,926,696	*
Long-term liabilities	1,770,713	2,546,644	3,259,206	5,556,381	5,720,000
Other liabilities	656	305,373	1,119,880	4,091,928	9,943,809
Capital stock	5,510,000	6,083,040	7,800,000	14,390,000	26,542,000
Capital surplus	817	822	875	19,428	59,086
Retained earnings					
Before distribution	1,551,508	5,016,046	11,029,256	19,165,640	25,523,456
After distribution	770,944	2,555,295	4,102,865	6,162,425	*
Total Assets	11,391,426	15,999,151	26,107,103	48,303,035	73,135,644
Total Liabilities					
Before distribution	4,329,101	4,898,050	7,276,275	14,723,790	21,021,704
After distribution	4,536,624	5,641,841	7,612,666	15,575,005	*
Total Equity					
Before distribution	7,062,325	11,101,101	18,830,828	33,579,245	52,113,940
After distribution	6,854,802	10,357,310	18,494,437	32,728,030	*

* Subject to change after shareholders' meeting resolution

2. Brief Statements of Income

Financial analysis from 1992 to 1996

UNIT:NT\$K
(EXCEPT EPS:NT\$)

Item	1992	1993	1994	1995	1996
Net sales	6,510,767	12,333,923	19,336,071	28,765,991	39,400,179
Gross profit	1,828,657*	5,410,167*	10,091,902*	16,095,775*	21,952,800
Income from operation	1,242,860	4,419,143	8,615,119	13,897,006	18,235,246
Interest revenue	2,495	55,269	210,135	367,986	653,462
Interest expense	152,081	180,412	197,062	258,000	277,161
Profit before tax	1,152,906	4,245,106	8,580,744	14,314,528	18,972,932
Net profit	1,152,906	4,245,106	8,474,014	15,081,273	19,400,689
Earnings per share	2.33**	6.98**	10.86**	10.48**	7.31**
	0.48***	1.60***	3.19***	5.68***	
Capitalized interest	57,050	27,467	15,868	102,926	181,168

* Certain accounts in 1992 to 1995 have been reclassified to conform to 1996 classifications

** Based on weighted average shares outstanding in each year

*** Retroactive adjustment for capitalizations of unappropriated earnings and bonus to employees

3. Financial Analysis

Financial analysis from 1992 to 1996

Item	1992	1993	1994	1995	1996
Capital Structure Analysis					
Debts ratio(%)	38.00	30.61	27.87	30.48	28.74
Long-term fund to fixed assets(%)	101.31	130.78	147.40	146.89	137.77
Liquidity Analysis					
Current ratio(%)	97.51	249.82	264.38	316.64	308.50
Quick ratio(%)	64.12	189.88	214.33	257.83	247.77
Times interest earned (times)	6.24	21.29	41.22	40.38	42.40
Operating Performance Analysis					
Average collection turnover (times)	5.60	7.51	8.55	8.12	8.80
Average collection days	65.18	48.60	42.69	44.95	41.00
Average inventory turnover (times)	7.00*	7.40*	8.01*	7.73*	7.25
Average inventory turnover days	52.14*	49.32*	45.57*	47.22*	50.34
Fixed assets turnover (times)	0.75	1.18	1.29	1.08	0.94
Total assets turnover (times)	0.57	0.77	0.74	0.60	0.54
Profitability Analysis					
Return on total assets(%)	12.66	32.31	41.17	41.23	32.40
Return ratio on stockholders' equity(%)	18.40	46.74	56.62	57.55	45.28
Operating income to capital stock(%)	22.56	72.65	110.45	96.57	68.70
Profit before tax to capital stock(%)	20.92	69.79	110.01	99.48	71.48
Profit after tax to net sales(%)	17.71	34.42	43.82	52.43	49.24
Net worth per share(NTD)	12.80	18.20	24.10	23.34	19.63
Earnings per share(NTD)	0.48**	1.60**	3.19**	5.68**	7.31
Dividends per share(NTD)	1.04	3.48	8.00	8.00	***
Cash dividends(NTD)	--	1.00	--	--	***
Stock dividends(NTD)	1.04	2.48	8.00	8.00	***
Cash Flow					
Cash flow ratio(%)	93.68	299.84	394.12	348.45	452.74
Cash flow adequacy ratio(%)	41.53	69.78	103.20	111.94	113.70
Cash flow reinvestment ratio(%)	19.09	31.59	34.34	31.94	28.21
Leverage					
Operating leverage	3.66	2.08	1.70	1.69	1.79
Financial leverage	1.14	1.04	1.02	1.02	1.02

* Certain accounts in 1992 to 1995 have been reclassified to conform to 1996 classifications

** Retroactive adjustment for capitalizations of unappropriated earnings and bonus to employees

*** Subject to change after shareholders' meeting resolution

4. Net Worth, Earnings, Dividends and Market Price Per Share

Please see page 33 for detailed information

5. Auditors' Opinion from 1992 to 1996

Year	CPA	Audit Opinion
1992	Michael Chang, Jerry Tsai	An Unqualified Opinion
1993	Michael Chang, Jerry Tsai	An Unqualified Opinion
1994	S.C. Huang, Jerry Tsai	An Unqualified Opinion
1995	S.C. Huang, Edward Way	An Unqualified Opinion, except the adoption of Statement of Financial Accounting Standards No.22.
1996	S.C. Huang, Edward Way	An Unqualified Opinion

12F, No.156, Sec.3, Min-Sheng E.Rd., Taipei, Taiwan, R.O.C.
Tel: 886-2-545-9988

6. Supervisors' Report

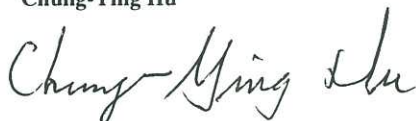
The Board of Directors have prepared and submitted to us the Company's 1996 business report, balance sheet, statement of profit and loss, inventories of major assets, statements of changes in shareholders' equity, statements of cash flows and proposal for allocating profit. The CPAs of T N SOONG & CO were retained to audit the balance sheet, inventories of major assets, statement of profit and loss, statements of changes in shareholders' equity and statements of cash flows and have submitted a report relating thereto. The above reports, statements and proposal have been further examined as being correct and accurate by the undersigned, the supervisors of Taiwan Semiconductor Manufacturing Co., Ltd.. According to Article 219 of the Company Law, we hereby submit this report.

Taiwan Semiconductor Manufacturing Co., Ltd.

Supervisor E. Th. Ausems



Supervisor Chung-Ying Hu



Supervisor Jerome S.N. Hu

March 13, 1997



7. Financial Statements & Independent Auditors' Report

We have examined the balance sheets of Taiwan Semiconductor Manufacturing Company Ltd. as of December 31, 1996 and 1995, and the related statements of income, changes in shareholders' equity and cash flows for the years then ended. Our examinations were made in accordance with the regulations governing such examinations and generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed in Note 3, effective 1995, the Company adopted Financial Accounting Standards No. 22, "Accounting for Income Taxes", resulting in an increase of NT\$914,391 thousand in 1995 net income.

In our opinion, the financial statements referred to above present fairly the financial position of Taiwan Semiconductor Manufacturing Company Ltd. as of December 31, 1996 and 1995, and the results of its operations and its cash flows for the years then ended, in conformity with the regulations governing the preparation of financial statements of public companies and generally accepted accounting principles applied on a consistent basis, subsequent to the change in 1995, with which we concur, in the method of accounting for income taxes as stated in the preceding paragraph.



January 23, 1997

BALANCE SHEETS

December 31, 1996 and 1995
(Expressed in Thousand New Taiwan Dollars, Except Par Value)

ASSETS	1996		1995	
	Amount	%	Amount	%
CURRENT ASSETS				
Cash and cash equivalents (Notes 2 and 4)	\$ 8,692,448	12	\$ 8,715,247	18
Receivable from related parties (Note 12)	351,889	1	252,796	1
Notes receivable	121,176	-	139,946	-
Accounts receivable	4,719,791	6	4,583,874	10
Allowance for doubtful receivables (Note 2)	(155,627)	-	(156,627)	-
Allowance for sales returns and allowances (Note 2)	(454,290)	(1)	(449,294)	(1)
Inventories (Notes 2 and 5)	2,750,536	4	2,063,042	4
Deferred income tax assets (Notes 2, 3 and 11)	74,000	-	585,197	1
Prepayments and other (Note 12)	429,436	1	336,783	1
Total Current Assets	16,529,359	23	16,070,964	34
 LONG-TERM STOCK INVESTMENTS (Notes 2 and 6)	 12,608,506	 17	 4,989,037	 10
 PROPERTIES (Notes 2, 7 and 14)				
Cost				
Buildings	9,768,555	13	8,269,121	17
Machinery and equipment	35,073,892	48	27,430,238	57
Office equipment	654,723	1	542,979	1
Total cost	45,497,170	62	36,242,338	75
Accumulated depreciation	(18,225,695)	(25)	(12,001,086)	(25)
Prepayments and construction in progress	14,707,477	20	2,402,413	5
Net Properties	41,978,952	57	26,643,665	55
 OTHER ASSETS				
Deferred charges - net (Note 2)	140,446	-	44,873	-
Deferred income tax assets (Notes 2, 3 and 11)	1,744,263	3	329,194	1
Refundable deposits (Note 14)	124,868	-	216,052	-
Miscellaneous	9,250	-	9,250	-
Total Other Assets	2,018,827	3	599,369	1
 TOTAL ASSETS	 \$ 73,135,644	 100	 \$ 48,303,035	 100

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

	1996		1995	
LIABILITIES AND SHAREHOLDERS' EQUITY	Amount	%	Amount	%
CURRENT LIABILITIES				
Payable to related parties (Note 12)	\$ 453,098	1	\$ 596,155	1
Accounts payable	3,600,045	5	3,272,287	7
Income tax payable (Notes 2 and 11)	447,780	-	170,579	-
Accrued expenses and other	856,972	1	1,036,460	2
Total Current Liabilities	5,357,895	7	5,075,481	10
 LONG-TERM BANK LOANS (Notes 7 and 8)	 5,720,000	 8	 5,556,381	 12
 ACCRUED PENSION LIABILITIES(Notes 2 and 10)	 328,729	 -	 210,775	 1
 OTHER LIABILITIES (Note 14)	 9,615,080	 13	 3,881,153	 8
 Total Liabilities	 21,021,704	 28	 14,723,790	 31
 SHAREHOLDERS' EQUITY				
Capital stock, \$10 par value; authorized - 3,000,000 thousand shares, issued - 2,654,200 thousand shares in 1996 and 1,439,000 thousand shares in 1995	26,542,000	37	14,390,000	30
Capital surplus	59,086	-	19,428	-
Legal reserve	2,992,429	4	1,486,151	3
Unappropriated earnings	22,531,027	31	17,679,489	36
Cumulative translation adjustment (Note 2)	(10,602)	-	4,177	-
Total Shareholders' Equity	52,113,940	72	33,579,245	69
 TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	 \$ 73,135,644	 100	 \$ 48,303,035	 100

STATEMENTS OF INCOME

For the Years Ended December 31, 1996 and 1995
(Expressed in Thousand New Taiwan Dollars, Except Earnings Per Share)

	1996		1995	
	Amount	%	Amount	%
GROSS SALES (Note 12)	\$ 39,836,725		\$ 29,180,217	
SALES RETURNS AND ALLOWANCES	(436,546)		(414,226)	
NET SALES	39,400,179	100	28,765,991	100
COST OF SALES (Note 12)	17,447,379	44	12,670,216	44
GROSS PROFIT	21,952,800	56	16,095,775	56
OPERATING EXPENSES				
General and administrative	1,597,461	4	924,553	3
Selling (Note 12)	626,094	1	526,532	2
Research and development (Note 12)	1,493,999	4	747,684	2
Total Operating Expenses	3,717,554	9	2,198,769	7
INCOME FROM OPERATIONS	18,235,246	47	13,897,006	49
NON-OPERATING INCOME				
Interest	653,462	2	367,986	1
Investment income recognized by equity method (Notes 2 and 6)	156,152	-	530,207	2
Foreign exchange gain - net (Note 2)	107,398	-	-	-
Gain on sale of long-term stock investments	39,668	-	35,526	-
Gain on disposal of properties	40,759	-	24,663	-
Other	27,542	-	12,127	-
Total Non-Operating Income	1,024,981	2	970,509	3
NON-OPERATING EXPENSES				
Interest (Note 7)	277,161	1	258,000	1
Loss on disposal of properties	10,071	-	2,011	-
Foreign exchange loss - net (Note 2)	-	-	197,928	1
Other	63	-	95,048	-
Total Non-Operating Expenses	287,295	1	552,987	2
INCOME BEFORE INCOME TAX	18,972,932	48	14,314,528	50
INCOME TAX CREDIT (Notes 2, 3 and 11)	427,757	1	766,745	2
NET INCOME	\$ 19,400,689	49	\$ 15,081,273	52
EARNINGS PER SHARE				
Based on weighted-average shares outstanding				
- 2,654,200 thousand in 1996 and				
1,439,000 thousand in 1995	\$ 7.31		\$ 10.48	
Based on 2,654,200 thousand shares			\$ 5.68	

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 1996 and 1995
(Expressed in Thousand New Taiwan Dollars)

	CAPITAL STOCK ISSUED		CAPITAL SURPLUS (Note 2)			RETAINED EARNINGS (Note 9)			CUMULATIVE TRANSLATION ADJUSTMENT (Note 2)	TOTAL SHAREHOLDERS' EQUITY
	Thousand Shares	Amount	Gain on Disposal of Properties	Donation	Total	Legal Reserve	Unappropriated Earnings	Total		
BALANCE, JANUARY 1, 1995	780,000	\$ 7,800,000	\$ 875	\$ -	\$ 875	\$ 638,755	\$10,390,501	\$11,029,256	\$ 697	\$18,830,828
Appropriations of prior year's earnings										
Legal reserve	-	-	-	-	-	847,396	(847,396)	-	-	-
Stock dividends-80%	624,000	6,240,000	-	-	-	-	(6,240,000)	(6,240,000)	-	-
Bonus to employees										
Cash	-	-	-	-	-	-	(260,125)	(260,125)	-	(260,125)
Stock	35,000	350,000	-	-	-	-	(350,000)	(350,000)	-	-
Bonus to directors and supervisors	-	-	-	-	-	-	(76,266)	(76,266)	-	(76,266)
Net income for 1995	-	-	-	-	-	-	15,081,273	15,081,273	-	15,081,273
Gain on disposal of properties	-	-	18,498	-	18,498	-	(18,498)	(18,498)	-	-
Dividends unclaimed over five years	-	-	-	55	55	-	-	-	-	55
Translation adjustment	-	-	-	-	-	-	-	-	3,480	3,480
BALANCE, DECEMBER 31, 1995	1,439,000	14,390,000	19,373	55	19,428	1,486,151	17,679,489	19,165,640	4,177	33,579,245
Appropriations of prior year's earnings										
Legal reserve	-	-	-	-	-	1,506,278	(1,506,278)	-	-	-
Stock dividends - 80%	1,151,200	11,512,000	-	-	-	-	(11,512,000)	(11,512,000)	-	-
Bonus to employees										
Cash	-	-	-	-	-	-	(715,650)	(715,650)	-	(715,650)
Stock	64,000	640,000	-	-	-	-	(640,000)	(640,000)	-	-
Bonus to directors and supervisors	-	-	-	-	-	-	(135,565)	(135,565)	-	(135,565)
Net income for 1996	-	-	-	-	-	-	19,400,689	19,400,689	-	19,400,689
Gain on disposal of properties	-	-	39,658	-	39,658	-	(39,658)	(39,658)	-	-
Translation adjustment	-	-	-	-	-	-	-	-	(14,779)	(14,779)
BALANCE, DECEMBER 31, 1996	2,654,200	\$26,542,000	\$59,031	\$55	\$59,086	\$2,992,429	\$22,531,027	\$25,523,456	\$(10,602)	\$52,113,940

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

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 1996 and 1995
(Expressed in Thousand New Taiwan Dollars)

	1996	1995
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 19,400,689	\$ 15,081,273
Depreciation and amortization	6,539,199	4,120,234
Deferred income tax	(903,872)	(914,391)
Investment income recognized by equity method	(156,152)	(530,207)
Foreign exchange loss on long-term bank loans	43,886	210,191
Gain on disposal of long-term stock investments	(39,668)	(35,526)
Gain on disposal of properties - net	(18,726)	(22,652)
Other	(129)	776
Changes in operating assets and liabilities		
Receivable from related parties	(99,093)	137,369
Notes receivable	18,770	(91,326)
Accounts receivable	(135,917)	(1,907,568)
Allowance for doubtful receivables	(1,000)	48,813
Allowance for sales returns and allowances	4,996	160,382
Inventories	(687,494)	(846,218)
Prepayments and other current assets	(92,653)	(103,817)
Payable to related parties	(143,057)	235,811
Accounts payable	327,758	1,522,722
Income tax payable	277,201	81,030
Accrued expenses and other current liabilities	(195,358)	441,784
Accrued pension liabilities	117,954	96,775
Net Cash Provided by Operating Activities	<u>24,257,334</u>	<u>17,685,455</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of properties	\$ (21,890,452)	\$ (15,765,286)
Increase in long-term stock investments	(7,537,209)	(1,388,413)
Decrease in refundable deposits	91,184	104,970
Proceeds from disposal of properties	67,960	45,690
Proceeds from sale of long-term stock investments	114,651	42,735
Increase in deferred charges	(128,712)	(24,059)
Net Cash Used in Investing Activities	<u>(29,282,578)</u>	<u>(16,984,363)</u>

	1996	1995
CASH FLOWS FROM FINANCING ACTIVITIES		
Additions to long-term bank loans	\$ 6,824,955	\$ 6,045,412
Repayments of long-term bank loans	(6,705,222)	(4,061,428)
Increase in other liabilities	5,733,927	2,875,273
Bonus to employees	(715,650)	(260,125)
Bonus to directors and supervisors	(135,565)	(76,266)
Net Cash Provided by Financing Activities	<u>5,002,445</u>	<u>4,522,866</u>
 NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	 (22,799)	 5,223,958
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>8,715,247</u>	<u>3,491,289</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 8,692,448</u>	<u>\$ 8,715,247</u>
 SUPPLEMENTAL INFORMATION		
Interest paid (excluding capitalized interest)	\$ 331,848	\$ 211,348
Income tax paid	198,908	66,570
Noncash investing and financing activities - effect of exchange rate changes on cash and cash equivalents	40,975	181,914

NOTES TO FINANCIAL STATEMENTS

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

(1) ORGANIZATION AND OPERATIONS

The Company was initially established as a venture among the Development Fund of the Executive Yuan, Philips Electronics N.V. (Philips) and certain of its affiliates, and certain other private investors. In September 1994, its shares were listed on the Taiwan Stock Exchange.

The Company is engaged mainly in the manufacture, sale, testing and computer-aided design of integrated circuits and other semiconductor devices, and the manufacture and design of masks.

(2) SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies of the Company, which conform to generally accepted accounting principles in the Republic of China, are summarized as follows:

■ Cash equivalents

Government bonds and commercial papers acquired under resale agreements with original maturities of less than three months are classified as cash equivalents.

■ Allowance for doubtful receivables

Allowance for doubtful receivables is provided based on a review of the collectibility of individual receivables.

■ Sales and allowance for sales returns and allowances

Sales are recognized when products are shipped to customers. Allowance for sales returns and allowances is provided based on experience.

■ Inventories

Inventories are stated at the lower of standard cost (adjusted to approximate weighted average cost) or market value. Market value represents net realizable value for finished goods and work in process, and replacement value for raw materials, supplies and spare parts.

■ Long-term stock investments

Investments representing at least 20% of the voting stock of each investee and for which the Company exercises significant influence on the investees are accounted for by the equity method. The difference between the investment cost and the proportionate share in the equity of the investee at the date of acquisition is amortized on a straight-line method over 5 years and is included in investment income or loss.

Other investments are accounted for by the cost method.

The costs of investment sold are determined by the weighted average method.

■ Properties

Major additions, renewals and betterments, and interest expense incurred during the construction period are capitalized, while maintenance and repairs are expensed currently.

Depreciation is provided on the straight-line method over estimated service lives which range as follows: buildings - 10 to 20 years; machinery and equipment - 5 to 10 years; office equipment - 3 to 5 years.

Upon sale or disposal of properties, the related cost and accumulated depreciation are removed from the accounts, and any gain or loss is credited or charged to income. Any such gain, less applicable income tax, is transferred to capital surplus at the end of the year.

■ Deferred charges

Deferred charges, consisting of software and system design costs, are amortized over three years.

■ Pension benefits

Effective December 31, 1995, the Company adopted Financial Accounting Standards No. 18, "Accounting for Pensions," which requires: (a) actuarial calculations of pension assets and obligation, (b) recognition of additional pension liability as of the end of each year starting 1995 as both asset and liability and (c) recognition of annual pension costs as actuarially calculated starting 1996. In 1995 and prior years, monthly accruals for pension fund contributions and pension reserve were charged to expense. This accounting change did not have a material impact on the Company.

Pension benefits paid in excess of the fund and reserve are charged to expense.

■ Income tax

Effective 1995, the Company adopted Financial Accounting Standards No. 22, "Accounting for Income Taxes," under which the tax effects of deductible temporary differences, unused tax credits, and operating loss carryforwards are recognized as deferred tax assets, and those of taxable temporary differences are recognized as deferred tax liabilities; valuation allowance is provided for deferred tax assets that are not certain to be realized.

Investment tax credits utilized are recognized as reduction of income tax expense.

Adjustments of prior years' tax liabilities are added to or deducted from the current year's tax provision.

■ Derivative financial instruments

Forward exchange contracts for hedging purposes are recorded at the spot rates on the contract dates. The foreign - currency amount of each contract multiplied by the difference between the spot rate on the contract date and the contracted forward rate is amortized over the contract period. At year - end, the balances of forward exchange receivables or payables are translated based on prevailing exchange rates and the resulting gains or losses are credited or charged to income.

Gains or losses and discounts or premiums on forward exchange contracts entered into as hedges of commitments denominated in foreign currency are deferred and included in the measurement of the bases of the related transactions when these are recorded.

The Company enters into interest rate swap US Dollar Ratio Spread Collar transactions as a means of liability management. Such interest rate swaps are accounted for on an accrual basis, whereby cash settlement receivable or payable is recorded as an adjustment to interest income or expense.

■ Foreign - currency transactions

Foreign - currency transactions, except derivative financial instruments, are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Gains or losses caused by the application of different foreign exchange rates when cash in foreign currency is converted into New Taiwan dollars, or when foreign - currency receivables and payables are settled are credited or charged to income in the year of conversion or settlement. At year-end, the balances of foreign - currency assets and liabilities are restated based on prevailing exchange rates and the resulting differences are recorded as follows:

- a. Long-term stock investments accounted for by the equity method - as cumulative translation adjustment under shareholders' equity.
- b. Long-term stock investments accounted for by the cost method - as translation adjustment (same as above) if the translated New Taiwan Dollar amount is lower than cost; if higher, no adjustment is made.
- c. Other assets and liabilities - credited or charged to current income.

■ Reclassifications

Certain accounts in 1995 have been reclassified to conform to 1996 classifications.

(3) CHANGE IN ACCOUNTING PRINCIPLE

In 1995, the Company adopted FAS No.22 "Accounting for Income Tax". The accumulated income tax credit at the beginning of 1995 of \$398,202 has been recognized as deferred tax assets and income tax credit, of which \$235,282 has been reversed. This accounting change resulted in the recognition of deferred income tax assets as of December 31, 1995 and an increase in net income for the year then ended of \$914,391 each.

(4) CASH AND CASH EQUIVALENTS

	1996	1995
Bank deposit	\$ 8,461,166	\$ 8,439,645
Commercial papers	231,282	2,352
Government bonds acquired under resale agreements	-	273,250
	<u>\$ 8,692,448</u>	<u>\$ 8,715,247</u>

(5) INVENTORIES

	1996	1995
Finished goods	\$ 247,124	\$ 108,580
Work in process	1,175,727	1,234,076
Raw materials	782,754	322,020
Supplies and spare parts	619,423	447,076
	<u>2,825,028</u>	<u>2,111,752</u>
Allowance for losses	(74,492)	(48,710)
	<u>\$ 2,750,536</u>	<u>\$ 2,063,042</u>

(6) LONG-TERM STOCK INVESTMENTS

	1996		1995	
	Carrying Value	% of Ownership	Carrying Value	% of Ownership
Accounted for by equity method				
TSMC International Investment	\$ 6,176,879	100	\$ -	-
Vanguard International Semiconductor (VIS)	5,762,964	27	4,674,546	24
TSMC - U.S.A.	95,224	100	69,350	100
TSMC - Europe	12,299	100	8,949	100
	<u>12,047,366</u>		<u>4,752,845</u>	
Accounted for by cost method				
CTI	203,902	18	203,902	18
Lian Ya Corporation	146,250	11	-	-
Shin-Etsu Handotai Taiwan	105,000	7	-	-
Taiwan Mask	55,988	8	32,290	9
W.K. Technology Fund IV	50,000	13	-	-
	<u>561,140</u>		<u>236,192</u>	
	<u>\$ 12,608,506</u>		<u>\$ 4,989,037</u>	

Accounted for by equity method, the related investment income in 1996 and 1995 are based on the financial statements of the investees in the same period which were audited.

Accounted for by cost method, the listed common stocks market value and the Company's prorata ownership of unlisted common stocks are as follows:

	1996	1995
Listed common stocks	\$ 651,260	\$ 309,318
Unlisted common stocks ownership	<u>463,681</u>	<u>196,257</u>
	<u>\$ 1,114,941</u>	<u>\$ 505,575</u>

The Company's prorata ownership of unlisted common stocks are calculated based on the unaudited financial statements.

(7) PROPERTIES

Accumulated depreciation consists of the following:

	1996	1995
Buildings	\$ 2,408,179	\$ 1,575,384
Machinery and equipment	15,486,317	10,138,909
Office equipment	<u>331,199</u>	<u>286,793</u>
	<u>\$ 18,225,695</u>	<u>\$ 12,001,086</u>

As of December 31, 1996, the status of the various expansion plans are as follows:

Expansion Plan	Estimated Total Cost	Accumulated Expenditures	Date of Start of Operations
Third manufacturing plant	\$ 26,357,500	\$ 17,663,070	Aug. 1995
Fourth manufacturing plant	24,464,000	9,651,147	Feb. 1997
Fifth manufacturing plant	32,071,000	1,033,826	Jan. 1998

Interest expense capitalized in 1996 and 1995 are \$181,168 and \$102,926, respectively.

As of December 31, 1996, properties with an aggregate net book value of about \$3,764,123 are mortgaged as collateral for long - term bank loans.

(8) LONG-TERM BANK LOANS

	1996	1995
U.S. dollar loans (thousands)		
US\$208,000 in 1996 and 130,000 in 1995, repayable in semi-annual installments through December 2001; 6.63%~6.83% interest in 1996 and 6.83% - 7.56% in 1995	\$ 5,720,000	\$ 3,549,000
US\$48,912, repayable in semi-annual installments on various dates through December 2001 (prepaid in 1996); 6.51%~7.56% interest	-	1,335,264
New Taiwan dollar loans		
Repayable in quarterly or semi-annual installments on various dates through April 2002; 6.45%-6.75% interest in 1996 and 6.7%-7.25% in 1995 (prepaid in 1996)	-	672,117
	<u>\$ 5,720,000</u>	<u>\$ 5,556,381</u>

Unused long-term and short-term credit lines as of December 31, 1996 aggregate about \$1,270,000 and \$2,625,000, respectively.

(9) SHAREHOLDERS' EQUITY

According to the Company Law, capital surplus can only be used to offset a deficit or transferred to capital.

The Company's Articles of Incorporation provide that the following shall be appropriated from the annual net income (less deficit, if any):

a) 10% thereof as legal reserve;

b) Bonus to directors and supervisors, and to employees equal to 1% and at least 1% of the remainder, respectively.

These appropriations and the disposition of the remaining net income shall be resolved by the shareholders in the following year and given effect to in the financial statements of that year.

Under the Company Law, the aforementioned appropriation for legal reserve shall be made until the reserve equals the Company's capital. Such reserve may be used to offset a deficit; also, when the reserve has reached 50% of the paid-in capital, up to 50% thereof can be transferred to capital.

(10) PENSION PLAN

The Company has a pension plan for all regular employees, which provides benefits based on length of service and average monthly salary at the time of retirement.

The Company makes monthly contributions, equal to 2% of salaries and wages, to a pension fund which is administered by the employees retirement fund monitoring committee and deposited in the committee's name in the Central Trust of China which acts as trustee.

Pension information are summarized as follows:

	1996	1995
Pension cost	<u>\$ 154,415</u>	<u>\$ 123,536</u>
Reconciliation of the fund status of the plan and accrued pension cost		
Benefit obligation		
Vested benefit obligation	-	-
Nonvested benefit obligation	<u>165,686</u>	<u>122,995</u>
Accumulated benefit obligation	<u>165,686</u>	<u>122,995</u>
Additional benefits based on future salaries	<u>556,663</u>	<u>411,030</u>
Projected benefit obligation	<u>722,349</u>	<u>534,025</u>
Fair value of plan assets	<u>(160,872)</u>	<u>(115,759)</u>
Funded status	<u>561,477</u>	<u>418,266</u>
Unrecognized prior service cost	-	-
Unrecognized net transitional obligation	<u>(199,191)</u>	<u>(207,491)</u>
Unrecognized net loss	<u>(33,557)</u>	-
Additional liability	-	-
Accrued pension cost	<u>\$ 328,729</u>	<u>\$ 210,775</u>
Vested benefits	<u>\$ -</u>	<u>\$ -</u>
Actuarial assumptions		
Discount rates used in determining present values	7.5%	7.5%
Future salary increase rate	7.5%	7.5%
Expected rate of return plan on assets	7.5%	7.5%

Changes in the pension fund

Balance, beginning of year	\$ 111,914	\$ 79,495
Contributions	36,461	26,761
Interest income	7,532	5,658
Balance, end of year	<u>\$ 155,907</u>	<u>\$ 111,914</u>

The components of the 1996 pension cost are as follows:

Service cost	\$ 115,911
Interest cost	40,052
Projected return on plan assets	(9,848)
Amortization of prior period service cost	8,300
	<u>\$ 154,415</u>

(11) INCOME TAX

A reconciliation of the income tax calculated on pretax financial statement income based on the statutory tax rate and the income tax credit is as follows:

	1996	1995
Tax on pretax income at 20% statutory rate	\$3,794,586	\$ 2,862,906
Add (deduct) tax effects of Tax-exempt income	(2,761,632)	(2,425,155)
Other	(5,229)	(5,322)
	<u>1,027,725</u>	<u>432,429</u>
Tax credits	(513,863)	(235,282)
Currently payable	513,862	197,147
Deferred investment tax credits	(1,623,872)	(914,391)
Valuation allowance	720,000	-
Prior years' adjustment	(37,747)	(49,501)
Income tax credit	<u>(\$ 427,757)</u>	<u>(\$ 766,745)</u>

The income attributable to the following projects and services are exempt from income tax:

	Tax-Exemption Period
Second manufacturing plant - Module B	1993 to 1996
Computer-aided design services	1994 to 1997
Expansion of first and second manufacturing plants	1994 to 1997
Expansion of second manufacturing plant and computer-aided design services, and addition of third manufacturing plant	1996 to 1999

Deferred income tax assets as of December 31, 1996 mainly consist of tax credits arising from investments in machinery and equipments, and research and development expenditures. Unused investment tax credits as of December 31, 1996 will expire as follows:

Year of Expiry	Amount
1999	\$ 542,378
2000	1,995,885

Income tax returns have been examined by the tax authorities through 1994.

(12) RELATED PARTY TRANSACTIONS

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

a. Industrial Technology Research Institute (ITRI); its supervisor is the Company's chairman.

b. Philips, a 34.42% shareholder.

c. Subsidiaries

TSMC International Investment (TSMC - BVI)

TSMC - U.S.A.

TSMC - Europe

d. Caesar Technology Inc. (CTI), an investee.

e. Vanguard International Semiconductor Corporation (VIS), an investee.

The transactions with the aforementioned parties, except those disclosed in other notes, are summarized as follows:

	1996		1995	
	Amount	%	Amount	%
During the year				
Sales				
ITRI	\$ 214,173	-	\$ 168,370	-
Philips and its affiliates	2,641,316	7	2,880,828	10
	<u>\$ 2,855,489</u>	<u>7</u>	<u>\$ 3,049,198</u>	<u>10</u>
Rental expense				
ITRI	\$ 124,551	76	\$ 130,634	68
Manufacturing expenses				
Technical assistance fee - Philips	\$ 1,031,010	100	\$ 707,074	100
Processing charges - CTI	\$ 151,197	44	\$ 86,929	27
Service Charges - TSMC - U.S.A.	\$ 26,449	100	\$ 9,175	100
Selling expenses (commissions)				
TSMC - U.S.A.	\$ 214,883	34	\$ 287,922	55
TSMC - Europe	25,302	4	38,934	7
	<u>\$ 240,185</u>	<u>38</u>	<u>\$ 326,856</u>	<u>62</u>
Research and development expenses				
License fee - ITRI	\$ -	-	\$ 17,143	2
Nonoperating income				
VIS	\$ 3,011	-	\$ -	-
CTI	200	-	-	-
ITRI	16	-	-	-
	<u>\$ 3,227</u>	<u>-</u>	<u>\$ -</u>	<u>-</u>
At end of year				
Receivable				
ITRI	\$ 53,760	15	\$ 32,782	13
Philips and its affiliates	268,430	76	219,971	87
TSMC-BVI	29,170	9	-	-
VIS	529	-	43	-
	<u>\$ 351,889</u>	<u>100</u>	<u>\$ 252,796</u>	<u>100</u>

	1996		1995	
	Amount	%	Amount	%
Prepayments and other current assets				
Prepaid rental - ITRI	\$ 41,694	18	\$ 22,768	7
Payable				
Philips and its affiliates	\$ 206,044	45	\$ 276,799	46
TSMC - U.S.A.	182,315	40	218,485	37
TSMC - Europe	24,296	5	16,858	3
CTI	35,436	8	28,443	5
ITRI	5,007	2	55,570	9
	<u>\$ 453,098</u>	<u>100</u>	<u>\$ 596,155</u>	<u>100</u>

Sales to related parties are based on normal selling prices and collection terms. Processing charges are also based on normal rates and payment terms.

(13) LONG-TERM OPERATING LEASES

The Company leases the land, building and certain machinery and equipment of its first manufacturing plant from the Industrial Technology Research Institute under agreements which will expire on March 31, 2002, at annual rentals aggregating \$166,216 (including service and administration charges). The agreements are renewable upon expiration.

The Company leases the land for its second, third, fourth and fifth manufacturing plants from the Science-Based Industrial Park Administration under agreements which will expire on various dates from March 2008 to May 2013, at annual rentals aggregating \$23,329. The agreements are renewable upon expiration.

Future minimum rentals under the aforementioned leases are as follows:

Year	Amount
1997	\$ 190,855
1998	191,105
1999	191,105
2000	191,105
2001	191,105
2002 - 2013	246,363
	<u>\$ 1,201,638</u>

(14) COMMITMENTS AS OF DECEMBER 31, 1996

a. The Company has entered into a ten-year technical cooperation agreement with Philips, under which the Company shall pay technical assistance fee at an agreed percentage of net sales of certain products starting January 1, 1988. At expiration, the agreement shall automatically continue for successive periods of five years, unless terminated by either party under certain circumstances. The Company shall continue to pay the fee for three years after the final expiration of the agreement.

b. Subject to certain equity ownership requirement, Philips and its affiliates are entitled to avail each year up to 30% of the Company's capacity, provided that sufficient and timely notice is given to the Company.

c. The Company has entered into an agreement to pay submicron technology license fee of \$129,400 (including 5% value-added tax) to ITRI for five years, plus royalty fee at an agreed percentage of net sales of certain products through December 31, 2000. As of December 31, 1995, the Company has paid the entire license fee. In addition, the Company has entered into another technical cooperation agreement with ITRI, under which the Company shall reserve and allocate up to 35% of its production capacity for use by the Ministry of Economic Affairs.

d. In September and October 1993, the Company entered into two guaranty deposits and supply agreements with two customers under which a) the customers shall make available US\$34,200 thousand to the Company as guarantee deposits (included in other liabilities), b) the Company shall use these deposits to purchase machinery in order to supply the customers with 252,000 wafers from May 1994 to June 1997 at most favored prices, and c) if the customers are unable to purchase the agreed quantity and the Company is also unable to sell such quantity to other customers, the customers shall compensate the Company at most favored prices or specified prices, whichever is less.

In order to supply the abovementioned wafers, the Company entered into a manufacturing agreement with a contractor in October 1993 under which a) the Company shall purchase machinery valued at about \$2,000,000 which shall be installed in the contractor's plant (as of December 31, 1996, about \$1,999,206 had been purchased), b) the contractor shall supply the Company with 252,000 wafers from May 1994 to June 1997, c) the contractor shall purchase about 2,000 wafers per month for its own account from the Company at a specified price, d) the contractor shall purchase the machinery at its net book value in June 1997 and make monthly advance payments to the Company from May 1994 to June 1997 (as of December 31, 1996, such payments aggregated \$795,758 which are included in other liabilities) and e) if the Company is unable to purchase the agreed quantity and the contractor is also unable to sell or use the unused capacity, the Company shall compensate the contractor at a specified price per wafer. In October 1993, the Company placed a guaranty deposit of \$200,000 with the contractor, to be refunded based on quantities produced by the contractor during the contract period.

e. The Company has entered into several foundary agreements with certain major customers, under which the Company shall reserve certain production capacity to customers who have placed guaranty deposits. As of December 31, 1996, such deposits aggregated US\$286,261 thousand which are accounted for under other liabilities.

(15) DERIVATIVE FINANCIAL INSTRUMENTS

The Company enters into forward exchange contracts to hedge foreign currency denominated receivables, payables and commitments. As of December 31, 1996, there were no such contracts outstanding. The realized gains or losses on expired forward exchange contracts in 1996 were immaterial.

On May 12, 1994, the Company entered into a US Dollar Ratio Spread Collar transaction. The contract, which will expire on May 17, 1999 and was based on a notional amount of US\$10 million, was intended to hedge the Company's exposure to rising interest rates, up to a ceiling, associated with certain floating rate bank loans. The contract was pre-terminated in June 1996, and resulting gain or loss on the contract was insignificant.

(16) SEGMENT FINANCIAL INFORMATION

a. Export sales

	1996	1995
Area		
U.S.A.	\$ 20,037,562	\$ 14,879,665
Europe	4,484,847	4,028,326
Other	4,192,438	862,107
	<u>\$ 28,714,847</u>	<u>\$ 19,770,098</u>

b. Sales to customers whose sales exceed 10% of the total sales.

	1996		1995	
	Amount	% of Total	Amount	% of Total
CIRRUS	\$ 3,245,023	8	\$ 3,186,783	11
Philips and its affiliates	2,641,316	7	2,880,316	10

Net Worth, Earnings, Dividends and Market Price Per Share

	1994	1995	1996
Market price per share			
Highest market price	177.00	196.00	106.00
Lowest market price	96.00	77.00	49.10
Average market price	159.04	128.43	63.83
Net worth per share			
Before distribution	24.14	23.34	19.63
After distribution	23.71	22.74	*
Earnings per share			
Weighted average shares	780,000,000	1,439,000,000	2,654,200,000
Earnings per share	10.86	10.48	7.31
Earnings per share ¹	3.19	5.68	*
Dividends per share			
Cash dividends	-	-	*
Stock dividends			
Dividends from retained earnings	8.00	8.00	*
Dividends from capital surplus	-	-	-
Return on investment			
Price/Earning ratio ²	14.64	12.25	8.73
Price/Dividend ratio ³	-	-	*
Cash dividend yield rate ⁴	0	0	*

* Subject to change after shareholders' meeting resolution

Note 1. Retroactive adjustment for capitalizations of unappropriated earnings and bonus to employees

Note 2. Price / Earning ratio = Average market price / Earnings per share

Note 3. Price / Dividend ratio = Average market price / Cash dividends per share

Note 4. Cash dividend yield rate = Cash dividends per share / Average market price

8. Consolidated Financial Statements

CONSOLIDATED BALANCE SHEETS

December 31, 1996 and 1995

(Expressed in Thousand New Taiwan Dollars, Except Par Value)

ASSETS	1996		1995	
	Amount	%	Amount	%
CURRENT ASSETS				
Cash and cash equivalents	\$18,689,441	24	\$ 8,715,247	18
Receivable from related parties	322,719	-	252,796	1
Notes receivable	121,176	-	139,946	-
Accounts receivable	4,719,791	6	4,583,874	10
Allowance for doubtful receivables	(155,627)	-	(156,627)	-
Allowance for sales returns and allowances	(454,290)	(1)	(449,294)	(1)
Inventories	2,750,536	4	2,063,042	4
Deferred income tax assets	136,673	-	585,197	1
Prepayments and other	533,914	1	336,783	1
Total Current Assets	26,664,333	34	16,070,964	34
LONG-TERM STOCK INVESTMENTS				
	6,652,830	8	4,989,037	10
PROPERTIES				
Cost				
Land	167,035	-	-	-
Buildings	9,768,555	12	8,269,121	17
Machinery and equipment	35,079,612	44	27,430,238	57
Office equipment	659,591	1	542,979	1
Total cost	45,674,793	57	36,242,338	75
Accumulated depreciation	(18,226,245)	(23)	(12,001,086)	(25)
Prepayments and construction in progress	16,117,787	21	2,402,413	5
Net Properties	43,566,335	55	26,643,665	55
OTHER ASSETS				
Deferred charges - net	140,446	-	44,873	-
Deferred income tax assets	1,752,843	3	329,194	1
Refundable deposits	124,868	-	216,052	-
Miscellaneous	9,250	-	9,250	-
Total Other Assets	2,027,407	3	599,369	1
TOTAL ASSETS	\$78,910,905	100	\$ 48,303,035	100

LIABILITIES AND SHAREHOLDERS' EQUITY	1996		1995	
	Amount	%	Amount	%
CURRENT LIABILITIES				
Payable to related parties	\$ 453,098	1	\$ 596,155	1
Accounts payable	3,802,060	4	3,272,287	7
Income tax payable	458,670	1	170,579	-
Accrued expenses and other	857,327	1	1,036,460	2
Total Current Liabilities	5,571,155	7	5,075,481	10
 LONG-TERM BANK LOANS	 5,720,000	 7	 5,556,381	 12
 ACCRUED PENSION LIABILITIES	 328,729	 -	 210,775	 1
 OTHER LIABILITIES	 9,615,068	 12	 3,881,153	 8
 MINORITY INTEREST	 5,562,013	 7	 -	 -
 Total Liabilities	 26,796,965	 33	 14,723,790	 31
 SHAREHOLDERS' EQUITY				
Capital stock, \$10 par value; authorized - 3,000,000 thousand shares, issued - 2,654,200 thousand shares in 1996 and 1,439,000 thousand shares in 1995	26,542,000	34	14,390,000	30
Capital surplus	59,086	-	19,428	-
Legal reserve	2,992,429	4	1,486,151	3
Unappropriated earnings	22,531,027	29	17,679,489	36
Cumulative translation adjustment	(10,602)	-	4,177	-
Total Shareholders' Equity	52,113,940	67	33,579,245	69
 TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	 \$ 78,910,905	 100	 \$ 48,303,035	 100

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 1996 and 1995
(Expressed in Thousand New Taiwan Dollars, Except Earnings Per Share)

	1996		1995	
	Amount	%	Amount	%
GROSS SALES	\$ 39,836,725		\$ 29,180,217	
SALES RETURNS AND ALLOWANCES	(436,546)		(414,226)	
NET SALES	39,400,179	100	28,765,991	100
COST OF SALES	17,447,379	44	12,670,216	44
GROSS PROFIT	21,952,800	56	16,095,775	56
OPERATING EXPENSES				
General and administrative	1,645,849	4	924,553	3
Selling	626,094	1	526,532	2
Research and development	1,493,999	4	747,684	2
Total Operating Expenses	3,765,942	9	2,198,769	7
INCOME FROM OPERATIONS	18,186,858	47	13,897,006	49
NON-OPERATING INCOME				
Interest	801,510	2	367,986	1
Investment income recognized by equity method	102,076	-	530,207	2
Foreign exchange gain - net	107,398	-	-	-
Gain on sale of long-term stock investments	39,668	-	35,526	-
Gain on disposal of properties	40,759	-	24,663	-
Other	27,542	-	12,127	-
Total Non-Operating Income	1,118,953	2	970,509	3
NON-OPERATING EXPENSES				
Interest	277,161	1	258,000	1
Loss on disposal of properties	10,071	-	2,011	-
Foreign exchange loss - net	-	-	197,928	1
Other	63	-	95,048	-
Total Non-Operating Expenses	287,295	1	552,987	2
INCOME BEFORE INCOME TAX	19,018,516	48	14,314,528	50
INCOME TAX CREDIT	423,231	1	766,745	2
INCOME BEFORE MINORITY INTEREST	19,441,747	49	\$ 15,081,273	52
MINORITY INTEREST	(41,058)	-	-	-
NET INCOME	\$ 19,400,689	49	\$ 15,081,273	52
EARNINGS PER SHARE				
Based on weighted-average shares outstanding				
- 2,654,200 thousand in 1996 and				
1,439,000 thousand in 1995	\$ 7.31		\$ 10.48	
Based on 2,654,200 thousand shares			\$ 5.68	

9. Review and Analysis of Financial Position and Operating Results

(1) Liquidity Analysis

Item	December 31, 1996	December 31, 1995	Change%
Current ratio	308.50%	316.64%	-0.03%
Quick ratio	247.77%	257.83%	-0.04%

(2) Analysis of Operating Results

Unit: Thousand New Taiwan Dollars

Item	1996	1995	Change Amount	Change%
GROSS SALES	\$ 39,836,725	\$ 29,180,217	\$ 10,656,508	36.52%
SALES RETURNS AND ALLOWANCES	(436,546)	(414,226)	(22,320)	5.39%
NET SALES	39,400,179	28,765,991	10,634,188	36.97%
COST OF SALES	17,447,379	12,670,216	4,777,163	37.70%
GROSS PROFIT	21,952,800	16,095,775	5,857,025	36.39%
OPERATING EXPENSES	3,717,554	2,198,769	1,518,785	69.07%
INCOME FROM OPERATIONS	18,235,246	13,897,006	4,338,240	31.22%
NON-OPERATING INCOME				
Interest	653,462	367,986	285,476	77.58%
Investment income recognized by equity method	156,152	530,207	(374,055)	(70.55%)
Foreign exchange gain - net	107,398	-	107,398	-
Gain on disposal of long-term stock investments	39,668	35,526	4,142	11.66%
Gain on disposal of properties	40,759	24,663	16,096	65.26%
Other	27,542	12,127	15,415	127.11%
Total Non-Operating Income	1,024,981	970,509	54,472	5.61%
NON-OPERATING EXPENSES				
Interest	277,161	258,000	19,161	7.43%
Loss on disposal of properties	10,071	2,011	8,060	400.80%
Foreign exchange loss - net	-	197,928	(197,928)	(100.00%)
Other	63	95,048	(94,985)	(99.93%)
Total Non-Operating Expenses	287,295	552,987	(265,692)	(48.05%)
INCOME BEFORE INCOME TAX	18,972,932	14,314,528	4,658,404	32.54%
INCOME TAX CREDIT	427,757	766,745	(338,988)	(44.21%)
NET INCOME	19,400,689	15,081,273	4,319,416	28.64%

Taiwan Semiconductor Manufacturing Company Ltd.



Morris Chang, Chairman



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