



Executive Summary

Semiconductor Quarterly Report First Quarter, 2005

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INTRODUCTION

The US-Taiwan Business Council is committed to providing our members with tactical and strategic advice on how to succeed in the Taiwan market. As part of a suite of information products distributed to our members, the Council publishes several analysis reports each year. These reports are published each quarter, with an expanded report in the fourth quarter that covers the entire previous year.

The Semiconductor report focuses on the semiconductor industry as it relates to Taiwan, China, and the U.S., and provides up-to-date analysis of developments during each quarter. Each report also contains contact information valuable in initiating and maintaining a relationship with Taiwan private and government entities, as well as other useful information including organization charts and a glossary.

The US-Taiwan Business Council's Semiconductor Report has been published since the first quarter of 2002. Although these reports are distributed exclusively to members and to U.S. government employees, this executive summary provides some insight into the focus and contents of the report.

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QUARTERLY SEMICONDUCTOR ANALYSIS

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The first quarter of this year has been a turbulent period for the Taiwan semiconductor industry. The passage of China's anti-secession law on March 14 – which allows the government to use military force against Taiwan if it declares independence – and the political fallout from that law, has had a detrimental effect on the cross-Strait business environment. Over the last few months, we have also seen intensified pressure by Taiwan prosecutors on the island's second biggest chipmaker, United Microelectronics Corporation (UMC), over alleged misconduct involving investments in a Chinese semiconductor company.

Together, these two issues have stalled the opening of Taiwan high tech investment in China. Taiwan officials had been prepared to allow semiconductor packaging and testing investment in China, as well as 0.18-micron manufacturing process technology for foundries. Unfortunately, these proposals will have to wait for the political environment to return to a more normal state – and that could take months.

In the meantime, companies on the island will continue to work themselves out of an industry downturn caused by high inventories throughout the semiconductor supply chain. Taiwan's foundries, DRAM makers, and packaging and testing companies all face slimmer margins and lower sales because of the downturn. Integrated circuit (IC) design firms are stumbling under the inventory problems as well, but also from increased competition from overseas rivals, mainly in the U.S.

Nevertheless, there are opportunities on the horizon. Taiwan chipmaker Winbond Electronics bought a chip unit from National Semiconductor of the U.S. that developed semiconductors mainly for personal computer applications. It is another sign that U.S. companies will continue to sell computer industry related divisions similar to the major deal struck by China's Lenovo and IBM. The crashing U.S. dollar will likely help boost the sale of PC related assets since it makes U.S. assets cheaper to overseas companies.

There are many opportunities for U.S. semiconductor equipment makers as well, particularly due to the continued growth of the Taiwan and China markets. However, the contract for US\$769 million (NT\$24.14 billion) worth of equipment to China's largest chipmaker, Semiconductor Manufacturing International Corporation (SMIC) was recently put on hold for U.S. suppliers. The Export Import Bank of the United States shelved its decision regarding much-needed loans for SMIC, a missed opportunity that could have a significant and long-term impact on the industry as a whole.

The focus of this report will be on the UMC case, as well as on the political troubles between Taiwan and China after Beijing's passage of the anti-secession law. The report will also detail how the IBM-Lenovo deal could cause a quick move of the U.S. PC industry to China, as other companies buy up PC-related businesses and intellectual property. Finally, the report will discuss the failure of the U.S. government to adequately understand and support its semiconductor industry – as most recently witnessed by the US\$769 million (NT\$24.14 billion) SMIC case.

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