



Executive Summary

Semiconductor Quarterly Report Third Quarter, 2006

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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

PUBLISHED OCTOBER 1, 2006

The recent launch of a "Red Army" protest against the presidential palace in Taipei reflects the turmoil and stagnation that the island's chip industry has faced over the past few months - and will likely continue to face, at least politically, as the year progresses.

What began ostensibly as a movement to pressure the ruling Democratic Progressive Party (DPP) to relax laws regarding trade with China, and to boost the economy, has transformed into an open protest against presidential corruption. Masses of protesters dressed in red remain huddled on the streets and squares around Taipei's presidential palace, a space they have occupied off and on for nearly a month, demanding that the president resign.

Although the protagonists in the current movement are related to those demanding more open access to China earlier this year, the tone is very different. A move by the opposition Nationalists to strengthen trade ties with China via high-level talks - talks that openly undermined the ruling party in Taipei - has now turned into a protest against "corruption", and seems aimed at forcing Taiwan President Chen Shui-bian to step down.

What does this have to do with the chip industry? It halts any chance Taipei will move forward on any China-related investment issues. Facing a wave of protests against alleged corruption, the president has dug in his heels and his ruling party has retrenched with their core base of supporters - the anti-China countryside of Taiwan.

One segment where this foot dragging is already showing is in the chip packaging and testing industry. In April, Taipei announced the lifting of a ban on investment by Taiwan chipmakers in low-end assembly factories in China. Now, six months later, there has been no progress on the issue. The government still has not even established an application process for such investments. Siliconware Precision Industries (SPIL), the second largest chip packaging and testing company in Taiwan and the third largest globally, saw its application rejected a few months ago. Now, SPIL and its rivals in Taiwan plan to wait until application requirements are announced before taking another crack at it. It may well be two more years before a single chip assembly investment is made in China by a Taiwan company.

Other developments beneficial to Taiwan's chip industry - including the government allowing chipmakers to transfer 0.18-micron manufacturing process technology to China, as well as progress on applications by Powerchip Semiconductor and ProMOS Technologies to build chip fabs in China - are also under threat of remaining in limbo for the foreseeable future due to the political atmosphere in Taipei.

The story for the business side of Taiwan's chip industry is far different. Chipmakers on the island are prospering this year, thanks to a boom in demand for electronic devices and PCs worldwide, in addition to heavy investments by its memory chipmakers. A few major trends in the global chip industry are also influencing Taiwan, with the consolidation of some segments. These include the purchase of ATI Technologies by Advanced Micro Devices (AMD) of the U.S., the sale of Philips Electronics' chip unit to a group of private investors, as well as the global fight between Intel Corporation and AMD for market share in central processing units (CPUs).

This report will discuss the current domestic political situation in Taiwan and its impact on chip investment to China. It will also examine in depth when Taipei will likely ease chip investment rules. Finally, the report will look at a number of broader and local industry specific issues facing Taiwan's chipmakers, including the AMD-Intel tiff and a number of investment deals between Taiwan companies.

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