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PRESENTATION

Operator

Welcome to the Semiconductor Manufacturing International Corporation's first-quarter 2016 webcast conference call. Today's conference call is hosted by Dr. T.Y. Chiu, Chief Executive Officer; Dr. Yonggang Gao, Chief Financial Officer; Mr. Gareth Kung, Executive Vice President of Strategic Business Development, Finance, and Company Secretary; and Mr. En-Ling Feng, Vice President of Investor Relations. (Operator Instructions).

The earnings press release is available for download at www.smics.com. Webcast playback will also be available approximately one hour after the event at www.smics.com.

Without further ado, I would like to introduce you to Mr. En-Ling Feng, Vice President of Investor Relations, for the cautionary statement.

En-Ling Feng - *Semiconductor Manufacturing International Corp. - VP of IR*

Good morning and good evening. Welcome to SMIC's first quarter 2016 earnings webcast conference call. For today's call, our CEO, Dr. T.Y. Chiu, will first provide some general remarks. Afterwards, our CFO, Dr. Gao Yonggang will highlight our financial performance and give guidance on the next quarter. And then, our Executive VP of Strategic Business Development, Finance, and Company Secretary, Mr. Gareth Kung, will give the detailed financial commentary. This will then followed by our Q&A session. As usual, our call will be approximately 60 minutes in length.

The earnings press release and quarterly financial presentation are available for you to download, at www.smics.com, under investor relations, in the events and presentations section.

Before I turn the call over to Dr. T.Y. Chiu, let me remind you that the presentation we'll be making today includes forward-looking statements. These statements and other comments are not guarantees of future performance, but represent the Company's estimates, and are subject to risk and uncertainty. Our actual results may differ significantly from those projected or suggested in any forward-looking statements. For a more complete discussion of the risks and uncertainties that could impact our future operating results and financial condition, please see our filings and submissions with the US Securities and Exchange Commission and the Hong Kong Stock Exchange Limited, including our annual report on Form 20-F, filed with the US Securities and Exchange Commission on April 25, 2016.

During the call, we will make reference to financial measures that do not conform to Generally Accepted Accounting Principles, GAAP. These measures may be calculated differently than similar non-GAAP data presented by other companies. Please refer to the tables in our press release for a reconciliation of GAAP to the non-GAAP numbers we will be discussing. Please note that all currency figures are in US dollars, unless otherwise stated.

I will now turn the call over to our CEO, Dr. T.Y. Chiu, for the opening remarks.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Thank you, En-Ling. Greetings to everyone, and thank you for joining us for this quarter's call. Q1 was another quarter of record high revenue, and 16th consecutive quarter of profitability.

We continued to experience increasing demand. Purchasing order from our customers continued to strengthen, and are being driven by our diversified products and customer exposures, which commenced full utilization of all our fabs, including the newly ramping facilities. We now target to grow more than 20% this year, given the present demand upturn.

We are witnessing customer market share gain, and their demand for more capacity stretch beyond our present expansion plan.

We are confident in our customer partnership, and our execution on quality, service, and technology, which enable us to continue to capture many of the growth potentials in China and globally, in the years to come.

The first quarter of 2016 was another great quarter for SMIC. We surpassed the industry's average revenue growth and expanded more than 24% year over year, and 4% quarter over quarter, on a seasonally weaker quarter, and exceeded our guidance of 1% to 3% quarter-over-quarter growth.

Our flexible 28/40 capacity has enabled us to address our customers' production ramp, and the revenue from 40 nanometer and below expanded 64.9% year over year and 26.4% quarter over quarter.

We anticipate revenue from 40 nanometer and below continue to more than double in Q4 this year, compared to Q4 last year.

With new capacity in Shenzhen ramping, overall wafer revenue, from 0.13 micron and above grew 29% year over year, and 4.8% quarter over quarter.

Overall utilization was 99% in the first quarter, including the newly ramping fabs. Apart from continued strength in our overall product mix, there was increased demand in consumer application in the first quarter from television and set-top box related applications.

Having successfully demonstrated full 16 consecutive quarters of profitability and consistent customer demand increase, we are now targeting to expedite revenue growth and build manufacturing scale. With today's momentum, we target to achieve an annual revenue growth of 20% during the next three to four years.

In the meantime, our commitment to growth and profitability remains solid. Our strategy to fully utilize our investment, differentiate and diversify our product mix, and advance technology developments still are being carefully executed.

Our strategy to build manufacturing scale is well supported by our China positioning. Being in China has presented us with many opportunities, customers, and relationships. China's semiconductor market has a growth rate higher than the global average. Many customers, domestic and international, prefer to have a foundry partner located in China, due to market and customer proximity.

Our China revenue contribution grew [7.6%] (corrected by company after the call) quarter over quarter, and 24.8% year over year. Meanwhile, Eurasia revenue contribution also grew at 9% quarter over quarter, and 145% year over year.

Given our high utilization and the strong customer demand, we continued to strive to improve operational efficiency and expand our capacity. We have adjusted our CapEx from $2.1b, upward to $2.5b. And we will use every dollar wisely. Our past record show that we can generate $1 revenue per $3 investment, and we continue to target at this rate of capital efficiency.

This additional CapEx is primarily for additional capacity in Beijing fabs, for both 28 and 65/55 production.

In addition, Shenzhen's fab is targeted to have around 30,000 8-inch wafer per month installed, by the end of this year. Our Shanghai 12-inch fab is planned to expand to 20,000 per month, by the end of this year.

Our Beijing B-1 fab is now planned to expand to 45,000 wafer per month, by the end of this year, too. Our Beijing joint venture fab is now targeted to increase to 18,000 per month, by the end of this year.

Furthermore, we are happy to have announced recently that the China IC fund has joined in investing into our Beijing joint venture. We're pleased to have an additional committed partner to shoulder the investment responsibility of building an advanced fab.

In terms of inorganic growth, we continue to see horizontal mergers and acquisition undertakings. We are actively pursuing M&A targets that can provide additional capacity for existing customers, and for providing opportunity to penetrate new markets and win new customers.

In terms of vertical partnership, given the current industry trend and our customers' request, there's a need for closer partnership between front-end and back-end IC manufacturing. Last month, we made a strategic investment into JCET which will draw us closer together to better serve our customers' need.

Overall, SMIC is strategically building competitiveness globally, and further optimizing our position as the preferred foundry provider in mainland China.

The 28 revenue in Q1 2016 grew 33%, quarter over quarter as we gradually ramp up 28, our 28 -- flexible 28/40 capacity facilitate optimization, in balancing customer demand with capturing new markets. Demand from our customers for 28 nanometer is strong, with a number of new engagements. And demand for 40 nano is much stronger. Revenue from 40 nano grew 52% year over year, and 24% quarter over quarter.

In terms of differentiated technology, demand remained robust. Sensor-related revenue grew 180% year over year, compared to Q1 2015, and at 3% quarter over quarter in Q1 2016. Current demand is high, and we work to -- as we work to increase capacity to meet our customers' needs. We continue to expand our differentiated portfolio to address the future opportunity, including new mobile application, IOT, and automotive.

In conclusion, we are embarking on a new phase of exciting growth for SMIC. We are witnessing customers eager to secure capacity across every node with SMIC. Customers are still working on new designs in both our 8-inch and 12-inch fabs. We expect continued growth in the second quarter but remain constrained by the pace of our capacity growth.

SMIC is optimistic in the long term, given our strategy, strong customer partnership, and execution track record. And we stay committed to maintaining sustainable profitability and building value for all stakeholders.

Thank you for participating, and for your support, and for your time. I will hand over the call to Yonggang for the financial highlights and 2016 Q2 guidance.

Yonggang Gao - *Semiconductor Manufacturing International Corp. - CFO*

Okay. Thank you, T.Y. Greetings to all our listeners. I will highlight our last quarter results first, and then give our second quarter 2016 guidance.

Last quarter, revenue was record high again, $634.3m in 1Q 2016, an increase of 4%, quarter over quarter, exceeding our guided 1% to 3% increase. Gross margin was 24.2%.

Profit for the period, attributable to SMIC was $61.4m in 1Q 2016, compared to $38.6m in 4Q 2015 and $55.5m in 1Q 2015.

Capacity utilization remained high, 99% in 1Q 2016.

Now look ahead into the second quarter of 2016. Our revenue is expected to increase by 3% to 7% quarter over quarter. Gross margin is expected to range from 25% to 27%. Non-GAAP operating expenses are expected to range from $115m to $120m.

Our planned 2016 capital expenditures for foundry operations are up from $2.1b to $2.5b. Our planned 2016 capital expenditures for non-foundry operations are $50m.

I will now hand the call over to Gareth, for more a more detailed financial commentary.

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

Thank you, Yonggang. And thank you, everyone, for joining us today. I will now comment on the details of our last quarterly financials.

On the income statement, revenue increased to $634.3m, above the guided range, mainly because of increase of customer -- mainly because of increase of wafer shipment.

Cost of sales increased to $480.6m, mainly due to an increase of wafer shipments and increased manufacturing costs from our majority-owned fab in Beijing.

Gross margin was 24.2%. The decline was mainly because increased manufacturing costs from our majority-owned fab in Beijing, which entered into mass production in December 2015, and impact of a temporary power supply suspension occurred at our fabs in Beijing in February 2016.

Operating expenses were $87.6m, a decrease of 33.8% q-on-q, from $132.3m in the previous quarter.

R&D expenses decreased by $12.6m q-on-q, to $53.5m. The change was mainly due to lower number of -- lower amount of R&D activities. Funding of R&D contracts from the government was $8m in Q1 2016.

General and administrative expenses decreased to $27.5m, mainly due to a decrease of accrued employee bonus and our majority-owned fab in Beijing entered into mass production in December 2015. And as a result, the pre-operating-related expenses largely decreased in Q1 2016, compared to 4Q 2015.

Other operating income decreased to $3.1m, mainly because of lower gain realized from disposal of living quarters.

Excluding the effect of employee bonus accrual, government funding, and gain from the disposal of living quarters, non-GAAP operating expenses were $92.2m.

Profit from operation was $66.1m, compared to $41.6m in the previous quarter.

Other expense was $13.6m. The income expense -- the income tax expense decreased to $0.7m, mainly due to a decrease of deferred tax expenses. Non-controlling interests were $9.7m of credit to SMIC's attributable profit, compared to $8.5m in the previous quarter.

Moving to the balance sheet, at the end of the first quarter of 2016, cash and cash equivalents increased by $30m, to [$1. 0b] (corrected by company after the call). If including other financial assets, we have approximately $1.14b cash on hand, at the end of Q1 2016.

Our long-term borrowings increased to $655m, and short-term borrowing increased to $126m. Overall, our financial leverage is still at a relatively low level. At the end of Q1 2016, our gross debt-to-equity ratio was 39.3%. Our net-debt-to-equity ratio was 12.4%.

In terms of cash flow, we generated $126m of cash from operating activities. We targeted generally approximately $900m of cash from operating activities this year. Cash used in investing activities increased to $416m. Cash from financing activities was $323m.

To examine our revenue by application, the communication and consumer segments contributed 51.8% and 35.4% of our revenue, respectively.

Geographically, revenue from China, North America, and Eurasia contributed 47.2%, 29.4%, and 23.4% of total revenue, respectively.

In terms of technology, revenue from 20 nanometers contributed 0.4%. Revenue from 40/45 nanometers contributed 19.7%. Revenue from 55/65 nanometers and 90 nanometers contributed 21.6% and 3.3%, respectively. Meanwhile, 0.13 micron and above contributed 55% of total revenue.

In terms of our overall capacity, total monthly capacity at the end of the first quarter increased to 303,000-inch equivalent wafers per month, increase of 20% year on year. The change was mainly because of the capacity expansion of our Beijing majority-owned 12-inch fab, Shenzhen 8-inch fab, and our Shanghai 12-inch fab.

The planned 2016 capital expenditure for foundry operations are up, from approximately $2.1b to approximately $2.5b, which are mainly for the expansion of capacity of our majority-owned 12-inch fab in Beijing, our 8-inch fab in Shenzhen, 12-inch fab in Shanghai, and the majority-owned 12-inch joint venture fab for bumping service in Jiangyin. A new majority-owned joint-venture fab -- a new majority-owned joint venture company, which will focus on the research and development on 14-nano logic technology and also CapEx for research/development tools, mask shops and intellectual property.

The planned 2016 capital expenditure for non-foundry operations of approximately $50m, mainly for the construction of living quarters.

I will now hand the call back to En-Ling for the Q&A session.

En-Ling Feng - *Semiconductor Manufacturing International Corp. - VP of IR*

Thank you, Gareth. I would now like to open up the call for Q&A. As usual, please be reminded, and please be reminded to limit you question to two per person. Operator, please assist.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Randy Abrams, Credit Suisse.

Randy Abrams - *Credit Suisse - Analyst*

Okay. Yes, thank you. Good morning. I wanted to ask a first question for the gross margin. You're guiding improvement in the second quarter. I think your original sense was it might stay low to mid-20s, just factoring the higher CapEx and depreciation. So could you talk about the driver for the improvement?

And then, looking into second half, if we factor, or if you could give us an indication where depreciation is moving, and what the right expectation for margin, as some of that depreciation comes on.

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

I think last call, we were saying for the whole year, we're looking at mid to low 20s. I think the -- based on the customer demand situation that we are seeing Q1, and our forecast of still very strong demand for the rest of this year, which means that we're going to maintain a fairly high utilization, I think we are right now targeting a gross margin for the whole year to be about 25%.

Randy Abrams - *Credit Suisse - Analyst*

Okay. And can you comment on depreciation now, with the higher CapEx, and how that may come on or how to model it through the year, for the increase?

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

Yes. We are still looking at our depreciation to be about $780m for the whole year, which is about 50% increased from last year.

In terms of the -- I think your next question is how would that profile it for the rest of the year? I think the increase will be more back-end loaded.

Randy Abrams - *Credit Suisse - Analyst*

Okay. And then if I could then ask for the OpEx -- the normalized OpEx. The G&A was down substantially, from $67m to $27m. I guess wanted to understand how much was the Beijing fab impact, to understand the normalized G&A spending or maybe target.

And then for R&D and also -- it looks like it came down from lower spending, normalized R&D. Just if we exclude bonus, how both of these lines should look, and how you target to grow OpEx to fund some of the developments.

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

Yes, we are looking at a -- first of all, overall, we're looking at a normalized OpEx for this year, about 15% to 17%. And then you're -- when you talk about the G&A, I think it should be around 5%, on a normalized basis.

Randy Abrams - *Credit Suisse - Analyst*

Okay. And then sales and marketing, constant. So R&D, it looks like only a one quarter impact, where it came down, just due to timing of R&D. So that will be most of the balance.

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

That's right. I think we are still looking at increased spending R&D this year, which I think is very important for us, as we're investing in our future technology.

Randy Abrams - *Credit Suisse - Analyst*

Okay. All right. Thank you.

Operator

Leping Huang, Nomura.

Leping Huang - *Nomura - Analyst*

Thank you to taking my question. My first question is that in the call, you mentioned that you are confident to maintain around 20% revenue growth in the next three to four year. So it seems you are quite confident to maintain a profitability due to this strong growth (inaudible). Elaborate more, so where is the confidence coming from? And -- yes.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Okay. We are getting the long-term forecast from some of the major customers that is increasing their demand. And several of our customers, they are forecasting a very, very strong growth, and also the diversification into their market area. From their track record, from their published growth results, we think that these forecasts are quite conservative. And we believe that a number of our customers will be growing strongly, over the next three to four years. And this is the basis of our confidence, where SMIC will be growing with these very successful customers.

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

I want add to what T.Y. said. I think the key to maintaining growth with profitability is the capital efficiency. As mentioned in T.Y., historically, at least in the last three, four years, we've been maintaining a ratio that with $3 investment can generate $1 revenue, on an annual basis. And we intend to maintain this momentum.

And I think -- I also have to caution that I think this quite a long-term forecast. It's based on our discussion with the customers. And we will only invest those capacity, based on the real customer demand from our customers.

Leping Huang - *Nomura - Analyst*

Okay. So the second question from me is that you -- now you become the -- you have become the largest shareholder of the Jiangsu Changjiang -- JCET. So what's your plan to -- in the JCET or what's the synergy to your current foundry business? Or do you plan, for example, to send some people to turn around their STATsChip because in my knowledge that's still in loss-making status. Thank you.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Okay, this investment is strategic. It's driven by a lot of our customers' request that would like complete solutions, front end and back end integrated in China. And so we are looking at this collaboration in the long term. This does not exclude SMIC's collaboration with other back-end companies.

So indeed we will work closely with JCET in optimizing their overall efficiency, but at this moment we do not have any plans to send any operational personnel to JCET.

Leping Huang - *Nomura - Analyst*

Thank you.

Operator

Rick Hsu, Daiwa Securities.

Rick Hsu - *Daiwa Securities - Analyst*

Hi. Good morning. Congratulations to your strong results for Q1. Okay, basically I've got two questions here. The first one is about your Q1 OpEx. I'm still a little bit confused because I remember you guided about -- actually above $120m for your OpEx in Q1 and it turned out to be only $91m. And can you walk for -- walk with me what's the difference?

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

Yes, I think we -- I've mentioned here that mainly the reduction in the OpEx is because of the lower bonus provisions and also in terms of the lower pre-operating expenses because we have our 12-inch fab in Beijing move into full production. And also because I think we're also able to manage a tighter cost control in the Q1. So I think that is the main reason for that.

Rick Hsu - *Daiwa Securities - Analyst*

Okay, thank you. And could you remind me the number because I think probably I missed the number. What's the government funding for R&D in Q1? How much is it?

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

$8m.

Rick Hsu - *Daiwa Securities - Analyst*

$8m.

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

$8m.

Rick Hsu - *Daiwa Securities - Analyst*

I see, thank you. Okay, the second question is can you elaborate a little bit about your 28-nanometer ramp-up schedule because the last time, you -- I think Dr. Chiu talking about in term of revenue ramp-up it's going to hit double digit by the end of this year. Is that still on track? Or given your increase of your CapEx, can I read that through as maybe your 28-nanometer is going to have some breakthrough and ramp up above your original expectations?

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Okay, let me say we have a continued increase in the 28 output. But at this moment, at this moment we are going through a customer's product transition and so the volume product coming in will be ramping up in Q3 and Q4. So therefore we expect that the 28 revenue will slightly be reduced to from above 10% to maybe around 5% to 8% due to this new product introduction. In addition, a lot of our new capacity has been really been put on to the production of 40-nano because of extremely high 40-nano demand.

Rick Hsu - *Daiwa Securities - Analyst*

Okay. So in this case, by the way, just a bit of a clarification, so you're talking like 8% of the revenue contribution from 28 by the end of this year, right?

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Right 5% to 8%.

Rick Hsu - *Daiwa Securities - Analyst*

All right. So can I fairly assume actually the majority of the CapEx increase for this year is going to take care of the strong demand for 40-nanometer rather than 28. Am I correct?

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

That will be -- yes. It will be actually taking care of the, both the 40-nano as well as preparing for 28-nano ramp next year.

Rick Hsu - *Daiwa Securities - Analyst*

Understood. All right, so one quick follow up.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

(multiple speakers) 28. Yes.

Rick Hsu - *Daiwa Securities - Analyst*

Sure.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Further 28-nano.

Rick Hsu - *Daiwa Securities - Analyst*

Okay. Just one quick follow up. What's the main demand application for 40-nanometer throughout the whole year?

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Right now the majority is still PolySiON but we expect to -- we are targeting to have some small shipments started for High K next quarter.

Rick Hsu - *Daiwa Securities - Analyst*

Sorry, I was talking about the main demand application for 40, for 40-nanometer.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Oh sorry. Okay, the main demand for 40 are for Wi-Fi, digital TV, RF, set-top box and some of the access points like PON, etc.

Rick Hsu - *Daiwa Securities - Analyst*

Okay, got you. Thank you so much.

Operator

Bill Lu, UBS.

Bill Lu - *UBS - Analyst*

Yes, hi. Good morning. Going back to T.Y.'s comments on the 20% growth for the next several years, I'm hoping you can provide a little bit more color on that as far as whether the growth comes from China or non-Chinese customers; what are some of the key applications that will drive that, 8-inch versus 12-inch, etc.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Okay. We are seeing this very strong customer demand across all nodes. So -- and also across all regions. Therefore certainly China will continue to grow very fast. But this year we are also seeing new customers ramping from Europe and next year we'll be seeing additional customers ramping, a customer from Japan ramping. And so we are very excited that our customers are now coming in from all over the world, across all the technology nodes.

Bill Lu - *UBS - Analyst*

I guess I'm just trying to understand because that outlook is certainly better than -- you're seeing better growth so are you doing something right strategically? Is it customers wanting to do more production in China? What exactly is driving that bullish forecast?

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

I think we have noticed that we have a particularly good customer set that are gaining market share even in the smartphone area. So despite the fact that smartphone growth is slowing down, we think that there is still substantial room for our customer base to grow. And of course we are also seeing application in other areas such as TV, such as access point and consumer.

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

Yes, Bill, I think as you can -- I'm sure you know that actually the China IC market growth has been outpacing the rest of the world. And given our China positioning, I think we also expected that -- we're also expecting that we're going to outgrow the industry.

Bill Lu - *UBS - Analyst*

Okay. Secondly, so, that 20% guidance is very helpful. Is there any way you can give us a gross margin outlook for the next three or four years as well?

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

Bill, I think this is a very good question, but I think at this point in time -- actually we mentioned about this, this is a really long-term target that we are shooting for. And I think it's a bit premature for us to comment on the gross margin. But enough to say that maintaining sustainable profitability is our overriding objective.

Bill Lu - *UBS - Analyst*

So I guess the baseline is the margin we're looking at today. We shouldn't expect it go down significantly but maybe going up is more of a question for a lot of different things. But this is a decent baseline?

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

Yes, we always try our best to maintain a good margin.

Bill Lu - *UBS - Analyst*

Okay, great. Thank you very much.

Operator

Steven Pelayo, HSBC.

Steven Pelayo - *HSBC - Analyst*

Yes, first just a quick follow-up to Bill's there. So I'm just trying to understand the target model for SMIC, margin model for SMIC. Is it a mid 20s with a gross margin with a mid upper teens OpEx ratio, so we're doing high single digit OP margin? Or do you see a scenario when you're growing revenues 20% per year, when we start talking about back to 30% and above gross margins and then dropping through the mid teens to the operating margin line? Help us understand that a little bit better.

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

I think assuming we can grow to 20% per annum, I think we would still target at least a mid 20 margin. But at the same time we should see a good increase -- a good decrease in our OpEx because of the much bigger scale operation. So that should be helpful for our overall profitability.

Steven Pelayo - *HSBC - Analyst*

Okay, I understand. And then just two quick accounting questions. R&D has been running quarterly in the $8m to $10m per quarter run range -- run rate. I remember last quarter you talked about it, the amount increasing this year a pretty -- I think you said a pretty sizeable amount. I know it's difficult to call the timing on that, but could you give us an idea on what type of R&D credit targets you're thinking about for this year? And when would it likely fall, what quarters it might increase significantly if it does?

And then the last question is just relative to the -- the other most unpredictable line for us is this non-controlling interest line. Have you any thoughts on kind of a full-year target for that as well?

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

Yes, I think last year the R&D funding is about $34m. And this year we're looking at maybe about $60m to $65m.

Steven Pelayo - *HSBC - Analyst*

Thank you. And on the non-controlling interest line, what do you think there for this year?

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

In Q1 it was about $8.2m. And I think this number may -- sorry, Q1 is about $9.7m. So probably we are looking at a slight increase in the next two, three quarters.

Steven Pelayo - *HSBC - Analyst*

So even if that fab ramps in bigger volumes, it's still only a slight increase? You don't see a much more significant add-back in the second half of the year?

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

Well, which means that you know, we have to maintain a pretty good utilization of the fab.

Steven Pelayo - *HSBC - Analyst*

Okay. All right, great. Thank you.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Steve, I think that for the -- to answer that question, we'll have to try very hard to maintain the good utilization and cost control in our Beijing joint venture to -- so that the loss is minimized. And therefore the add-back will be minimized as well.

Steven Pelayo - *HSBC - Analyst*

No, I certainly understand that. Thank you very much.

Operator

Suji De Silva, Topeka.

Suji De Silva - *Topeka - Analyst*

Hello. Nice job on the quarter. So the 20% growth target you've put out there, I'm wondering if you could support that with organic capacity increases or would it require inorganic capacity increases to continue the growth (technical difficulty).

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

So indeed as I mentioned we are always looking at the potential merger and acquisition target. And part of the difficulty in projecting the margin in the future is on the proportion of the new revenue coming out of the merger and acquisition to that of the organic growth. And so we think that this -- the opportunity to do a merger and acquisition is actually quite good as time proceeds.

Suji De Silva - *Topeka - Analyst*

Understood. We'll look for the (inaudible) to come in. And then on 28-nanometer can you talk about the number of customers that are ramping today and how many you'd expect to ramp towards the exiting 2016, early 2017 timeframe.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Okay, there are about 4 customers ramping at this moment. So one major customer that is really coming in with fairly high volumes. The other are still in the product risk production stage.

Suji De Silva - *Topeka - Analyst*

And it would be a similar amount, number towards the end of the year and early 2017 or would it scale up?

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

So we are seeing an increasing number of our customer doing the new product tape out.

Suji De Silva - *Topeka - Analyst*

Got it. Then the last question, a bigger picture question. With all the consolidation going on in the semiconductor industry, are you seeing any impact or even opportunities from that or is it not as impactful to you because a lot of the China demand is driving it?

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Right now, yes, indeed we have seen some of our customers merging. These actually could bring in additional opportunities because they bring in exposures to potential new customers. So it's not all -- even when -- for the US where there are a lot of mergers and acquisitions actually we see more opportunity rather than reduction in the order.

Suji De Silva - *Topeka - Analyst*

Thank you, TY.

Operator

Gokul Hariharan, JP Morgan.

Gokul Hariharan - *JPMorgan - Analyst*

Yes, hi. Thanks for taking my question. My first question is on margins. I think back in February you had indicated that this year the margins could be in the low to mid 20s because of the depreciation increase. Obviously the margins look like shaping up better in Q2. Could you talk a little bit about how we should think about the margins in the second half of the year? Are we still going to be in that 25% to 27% range? And what has contributed to the margin expansion compared to your view about three months back?

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

Yes, I think, Gokul, as I mentioned in my earlier response we are targeting for the whole year to be mid 20s gross margin. And the reason for this somewhat improved outlook is because of, one, we are looking at very strong demand from a customer, which means that we can maintain -- we believe that we can maintain a fairly high utilization for our fabs, both the new fabs and old fabs.

And secondly, we're also exercising very tight cost control to make sure that our profitability will be less impacted by the ramp-up.

Gokul Hariharan - *JPMorgan - Analyst*

Okay. And just going back to this longer-term growth target in the region of 20%, are you baking in any M&A related stuff also into this?

And second is do we need to have a credible and sizeable 14-nanometer offering in that two- to three-year context to get to your 20% growth targets?

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

SMIC is committed to advanced technology development and so our present road map calls for 14-nano to be ready in 2018 to 2019 range. So for sure that 14-nano technology will be an offering within the next five years.

Now we do not think that the 20% growth is absolutely dependent on the status of the 14-nano technology and so the -- with the present technology we see opportunity that will generate this growth as well. Of course we also think that there will be opportunities in the merger and acquisition and this will contribute to the 20% growth.

Gokul Hariharan - *JPMorgan - Analyst*

Okay. Just the last question. Based on your formula of $3 investment bringing in a dollar of revenue each year, it looks like the CapEx is going to be comfortably above $2b to get this 20% for the next few years. So could you talk a little about the funding? How should we think about funding this CapEx? I think your net debt is already about 35%. Are we thinking about equity financing at some point in the near term or are you still comfortable with debt financing?

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

First of all, Gokul, I just want to correct what you said. Our net gearing right now is only about below 20% now.

Gokul Hariharan - *JPMorgan - Analyst*

Sorry, total debt yes.

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

Yes. So okay, first of all, our preference always to fund through our operations. This year as I mentioned in the script we are looking at cash flow from operations to be about $900m which is about $200m more than last year. And as we continue to grow the revenue, we believe our cash from operations will certainly increase. That's point number one.

And secondly, right now we believe that we have a pretty healthy balance sheet and I think there would still be room for us to increase the leverage for us. So I think our preference is always to fund through debt. And in the future, you talk about five years, so we'll also be looking at different kind of financing that would make sense for us.

Gokul Hariharan - *JPMorgan - Analyst*

Okay, got it. Thank you.

Operator

Ken Hui, Jefferies.

Ken Hui - *Jefferies - Analyst*

Thank you for taking my questions. My first question is regarding your recent reduction in your ownership in the Beijing JV. Would there be any impact on your P&L for this quarter due to the transaction such as disposal gain or loss? That's my first question. Thank you.

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

No, there will not be any -- yes, there won't be any impact on our P&L.

Ken Hui - *Jefferies - Analyst*

Okay, thank you. My second question is regarding your 20% annual growth target for the next few years. My personal concern is actually about the fingerprint sensor which is now a big part of your revenue. But I do see that it's potentially some risk regarding the change of technology from chip-based technology to, for example, camera or flexible print circuit. Are you concerned about that or you are not worried about it at all?

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

I think that the application for fingerprint certainly is expanding. We see that there are applications in all sorts of security-related products, not just in the mobile phone as well as in the -- perhaps in the credit card area. And so we think that there may be other technology that is applicable in the mobile, but there will be certainly other opportunities that come up with the fingerprint sensors.

Ken Hui - *Jefferies - Analyst*

Okay, thank you very much.

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

I think adding on what T.Y. said, I think the strength for SMIC is that we don't depend on one single customer or one single technology. We try to develop a very diversified business portfolio and that we have been quite successful in the past and we maintain the same strategy going forward.

Ken Hui - *Jefferies - Analyst*

Okay. Thank you very much. Thank you.

Operator

Sebastian Hou, CLSA.

Sebastian Hou - *CLSA - Analyst*

Hi, guys. Thanks for squeezing me in. So I have a couple of questions. The first one is looking at your blended wafer ASP because wafer shipment up by 6%, revenue up 4% in the first quarter, so that means your blended wafer ASP actually declined. But if I -- if we look at your product mix by node, actually the 40-nanometer increased a lot and overall 12-inch wafer as a percentage of the revenue increased compared -- the percentage increased compared to 8-inch. So supposedly the higher wafer price. So I'm just wondering is there any other reason or factor that I miss or the huge product mix change or the pricing pressure?

Gareth Kung - *Semiconductor Manufacturing International Corp. - EVP of Strategic Business Development, Finance, and Company Secretary*

What happen is that usually we will have some kind of a price negotiation with the customers at the beginning of each year. That may have some impact on the Q1 blended ASP. But we are looking at -- as our product mix more shifting towards the high end for the rest of the year, we think that the ASP should go, should be stable or maybe increased slightly.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Let me add to that. There is another factor that comes in. We have a, in the past a significant portion of our customers that do turnkey including the back-end turnkey. The back-end turnkey give us additional ASP per wafer.

Now due to the product mix change we have -- actually that customer has actually has more product in the non-full turnkey wafers than turnkey wafers in the recent quarters. And so that take out certain amount of ASP. But it really does not impact our profitability.

I don't know whether -- because the turnkey, the back-end turnkey part is basically just a almost full transfer pricing.

Sebastian Hou - *CLSA - Analyst*

Okay, thank you. And my second question is on your 28-nanometers progress. So I think earlier you guys mentioned about that it seems like the demand on the 40-nanometer is stronger. So that means more of the capacity will be allocated to the 40-nanometer supposedly.

So based on my understanding, if I'm understanding correctly, the 40-nanometer and 28-nanometer is based on your switchable strategy is I think more likely for the PolySiON on 28-nanometers. So does that mean that at least for most of the second half this year or even in 2017,the majority of your 28-nanometers revenue contribution will still be on the PolySiON while the High K metal gate will still be relatively much smaller?

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

We are starting to ramp up High K and we will be starting to see some small amount of High K in the second quarter. So indeed our PolySiON volume will be still ahead of our High K. So this will be the case for the second half of the year, as well as the first half of next year.

Sebastian Hou - *CLSA - Analyst*

Okay, thank you. Can I just add a follow-up on this one is that how is the yield rate performance on the PolySiON and High K metal gate if you can give some indication?

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

I think that both technology are performing up to our expectation.

Sebastian Hou - *CLSA - Analyst*

Okay. Thank you, guys. A good quarter.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

Thank you.

Operator

I would now like to hand the call back to the CEO, Dr. Chiu, for closing remarks.

T.Y. Chiu - *Semiconductor Manufacturing International Corp. - CEO*

In closing I would like to thank everyone who participated in today's call and again thank all of our shareholders, customers, employees and suppliers for their trust and support. See you next time. Thank you.

Operator

This is the end of SMIC's first quarter earnings conference call. We thank you for joining us today.
