TAIWAN SEMICONDUCTOR MANUFACTURING CO LTD
Form 20-F
April 14, 2014
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SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934**
OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2013

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

OR

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission file number 1-14700

(Exact Name of Registrant as Specified in Its Charter)

Taiwan Semiconductor Manufacturing Company Limited
(Translation of Registrant s Name Into English)

Republic of China
(Jurisdiction of Incorporation or Organization)

No. 8, Li-Hsin Road 6

Hsinchu Science Park

Hsinchu, Taiwan

Republic of China

(Address of Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange

	on Which Registered
Common Shares, par value NT$10.00 each*	The New York Stock Exchange, Inc.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report.

As of December 31, 2013, 25,928,617,140 Common Shares, par value NT$10 each were outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ü No ___

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or (15)(d) of the Securities Exchange Act of 1934. Yes ___ No ü

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ü No ___

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ___ No ___

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ü Accelerated Filer ___ Non-Accelerated Filer ___

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ___ International Financial Reporting Standards as issued ü Other ___

by the International Accounting Standards Board

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 ___ Item 18 ___

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ___ No ü

* Not for trading, but only in connection with the listing on the New York Stock Exchange, Inc. of American Depositary Shares representing such Common Shares

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This annual report includes statements that are, or may be deemed to be, forward-looking statements within the meaning of U.S. securities laws. The terms anticipates, expects, may, will, could, should and other similar expressions identify forward-looking statements. These stateme appear in a number of places throughout this annual report and include statements regarding our intentions, beliefs or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the industries in which we operate.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. Forward-looking statements are not guarantees of future performance and our actual results of operations, financial condition and liquidity, and the development of the industries in which we operate may differ materially from those made in or suggested by the forward-looking statements contained in this annual report. Important factors that could cause those differences include, but are not limited to:

- the volatility of the semiconductor and electronics industry;
- overcapacity in the semiconductor industry;
- the increased competition from other companies and our ability to retain and increase our market share;
- our ability to develop new technologies successfully and remain a technological leader;
- our ability to maintain control over expansion and facility modifications;
- our ability to generate growth and profitability;
- our ability to hire and retain qualified personnel;
- our ability to acquire required equipment and supplies necessary to meet business needs;
- our reliance on certain major customers;
- the political stability of our local region; and
- general local and global economic conditions.

Forward-looking statements include, but are not limited to, statements regarding our strategy and future plans, future business condition and financial results, our capital expenditure plans, our capacity management plans, expectations as to the commercial production using 16-nanometer and more advanced technologies, technological upgrades, investment in research and development, future market demand, future regulatory or other developments in our industry as well as business acquisitions and financing plans. Please see Item 3. Key Information Risk Factors for a further discussion of certain factors that may cause actual results to differ materially from those indicated by our forward-looking statements.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

Selected Financial and Operating Data

The selected consolidated statements of profit or loss and other comprehensive income data and other consolidated financial data for the years ended December 31, 2012 and 2013, and the selected consolidated statements of financial position data as of December 31, 2012 and 2013, set forth below, are derived from our audited consolidated financial statements included herein, and should be read in conjunction with, and are qualified in their entirety by reference to, these consolidated financial statements, including the notes thereto, which have been prepared in accordance with International Financial Reporting Standards, or IFRSs, as issued by the International Accounting Standards Board, or IASB. Since these are our first audited consolidated financial statements prepared in accordance with IFRSs, pursuant to the transitional relief granted by the U.S. Securities and Exchange Commission in respect of the first-time adoption of IFRSs, we have only provided financial statements and financial information for the financial years ended December 31, 2012 and 2013. Additionally, financial data as of and for the years ended December 31, 2009, 2010 and 2011 derived from our consolidated financial statements prepared in accordance with accounting principles generally accepted (GAAP or R.O.C. GAAP) in the Republic of China (R.O.C. or Taiwan) have not been included below.

In addition to preparing financial statements in accordance with IFRSs as issued by the IASB included in this annual report, we also prepare financial statements in accordance with the IFRSs as adopted for use in Taiwan (Taiwan-IFRSs), which we are required to file with the Financial Supervisory Commission (FSC) of R.O.C. and Taiwan Stock Exchange (TWSE) under the applicable regulations and listing rules of the TWSE. Please see Item 5. Operating and Financial Reviews and Prospects First Time Adoption of IFRSs for more details. English translations of such financial statements are furnished to the SEC on Form 6-K, which are not incorporated by reference to this or any of our previous annual reports on Form 20-F.

	Year ended and as of December 31,		
	2012	2013	2013
	NT$	NT$	US$
	(in millions, except for percentages, earnings per share and per ADS)		
Consolidated Statements of Profit or Loss and Other Comprehensive Income Data:			
Net revenue	506,745	597,024	20,014
Cost of revenue	(262,592)	(315,642)	(10,581)
Gross profit before unrealized gross profit on sales to associates	244,153	281,382	9,433
Unrealized gross profit on sales to associates	(25)	(21)	(1)
Gross profit	244,128	281,361	9,432
Operating expenses	(62,517)	(71,339)	(2,392)
Other operating income and expenses, net	(449)	47	2
Income from operations	181,162	210,069	7,042
Non-operating income and expenses	499	5,893	198
Income before income tax	181,661	215,962	7,240
Income tax expense	(22,375)	(32,112)	(1,077)
Net income	159,286	183,850	6,163

Other comprehensive income for the year, net of income tax	4,261	16,359	549
Total comprehensive income for the year	163,547	200,209	6,712
Net income attributable to shareholders of the parent	159,481	183,978	6,167
Net loss attributable to noncontrolling interests	(195)	(128)	(4)

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	Year ended and as of December 31, 2012	2013	2013
	NT$	NT$	US$
	(in millions, except for percentages, earnings per share and per ADS)		
Total comprehensive income attributable to shareholders of the parent	163,692	200,343	6,716
Total comprehensive loss attributable to noncontrolling interests	(145)	(134)	(4)
Basic earnings per share	6.15	7.10	0.24
Diluted earnings per share	6.15	7.10	0.24
Basic earnings per ADS equivalent	30.76	35.48	1.19
Diluted earnings per ADS equivalent	30.75	35.48	1.19
Basic weighted average shares outstanding	25,921	25,928	25,928
Diluted weighted average shares outstanding	25,928	25,930	25,930

	Year ended and as of December 31, 2012	2013	2013
	NT$	NT$	US$
	(in millions, except for cash dividend per common share)		
Consolidated Statements of Financial Position Data:			
Working capital	92,223	154,513	5,180
Long-term investments[1]	65,723	89,024	2,984
Property, plant and equipment	617,562	792,666	26,573
Intangible assets	10,960	11,490	385
Total assets	961,344	1,262,801	42,333
Hedging derivative financial liabilities	-	5,482	184
Long-term bonds payable	80,000	210,768	7,066
Accrued pension cost	6,781	6,802	228
Total liabilities	247,749	428,688	14,371
Capital stock	259,245	259,286	8,692
Equity attributable to shareholders of the parent	711,052	833,846	27,953
Noncontrolling interests	2,543	267	9
Cash dividend per common share[2]	3.0	3.0	0.1

	Year ended and as of December 31, 2012	2013	2013
	NT$	NT$	US$
	(in millions, except for percentages and operating data)		
Other Financial Data:			
Gross margin	48%	47%	47%
Operating margin	36%	35%	35%
Net margin	31%	31%	31%
Capital expenditures	246,137	287,595	9,641
Depreciation and amortization	131,349	156,182	5,236
Cash generated by operating activities	284,963	347,384	11,645
Cash used in investing activities	(269,318)	(281,054)	(9,422)
Cash generated by (used in) financing activities	(13,589)	32,106	1,076
Effect of exchange rate changes	(2,118)	849	29
Net cash inflow (outflow)	(62)	99,285	3,328
Operating Data:			
Wafer (200mm equivalent) shipment[3]	14,044	15,666	15,666
Billing Utilization Rate[4]	91%	91%	91%

(1) Investments accounted for using equity method, and noncurrent available-for-sale financial assets.

(2) In one decimal point.

(3) In thousands.

(4) Billing Utilization Rate is equal to annual wafer shipment divided by annual capacity, which includes wafers committed by Vanguard International Semiconductor Corporation (VIS) and Systems on Silicon Manufacturing Company Pte. Ltd. (SSMC). Please see Item 7. Major Shareholders and Related Party Transactions Related Party Transactions .

Exchange Rates

We publish our financial statements in New Taiwan dollars, the lawful currency of the R.O.C. In this annual report, $, US$ and U.S. dollars mean United States dollars, the lawful currency of the United States, and NT$ and NT dollars mean New Taiwan dollars. This annual report contains translations of certain NT dollar amounts into U.S. dollars at specified rates solely for the convenience of the reader. The translations from NT dollars to U.S. dollars and from U.S. dollars to NT dollars were made by the exchange rate as set forth in the statistical release of the Federal Reserve Board. Unless otherwise noted, all translations for the year 2013 were made at the exchange rate as of December 31, 2013, which was NT$29.83 to US$1.00. On April 4, 2014, the exchange rate was NT$30.20 to US$1.00.

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The following table sets forth, for the periods indicated, information concerning the number of NT dollars for which one U.S. dollar could be exchanged.

	NT dollars per U.S. dollar			
	Average[1]	High	Low	Period-End
2012	29.47	29.91	29.05	29.05
2013	29.73	30.03	29.42	29.83
October 2013	29.38	29.49	29.32	29.42
November 2013	29.52	29.65	29.37	29.59
December 2013	29.72	30.03	29.53	29.83
January 2014	30.14	30.31	29.90	30.31
February 2014	30.31	30.37	30.25	30.29
March 2014	30.40	30.65	30.24	30.45
April 2014 (through April 4, 2014)	30.26	30.29	30.20	30.20

(1) Annual averages calculated from month-end rates and monthly averages calculated from daily closing rates.

No representation is made that the NT dollar or U.S. dollar amounts referred to herein could have been or could be converted into U.S. dollars or NT dollars, as the case may be, at any particular rate or at all.

Capitalization and Indebtedness

Not applicable.

Reasons for the Offer and Use of Proceeds

Not applicable.

Risk Factors

We wish to caution readers that the following important factors, and those important factors described in other reports submitted to, or filed with, the Securities and Exchange Commission, among other factors, could affect our actual results and could cause our actual results to differ materially from those expressed in any forward-looking statements made by us or on our behalf, and that such factors may adversely affect our business and financial status and therefore the value of your investment:

Risks Relating to Our Business

Any global systemic political, economic and financial crisis or catastrophic natural disasters (as well as the indirect effects flowing therefrom) could negatively affect our business, results of operations, and financial condition.

In recent times, several major systemic economic and financial crises and natural disasters negatively affected global business, banking and financial sectors, including the semiconductor industry and markets. These types of crises cause turmoil in global markets that often result in declines in electronic products sales from which we generate our income through our products and services. In addition, these crises may cause a number of indirect effects such as undermining the ability of our customers to remain competitive vis-à-vis the financial and economic challenges created by insolvent countries and companies still struggling to survive in the wake of these crises. For example, there could be in the future knock-on effects from these types of crises on our business, including significant decreases in orders from our customers; insolvency of key suppliers resulting in product delays; inability of customers to obtain credit to finance purchases of our products; customer insolvencies; and

counterparty failures negatively impacting our treasury operations. Any future systemic political, economic or financial crisis or catastrophic natural disaster (as well as the indirect effects flowing from these crises or disasters) could cause revenues for the semiconductor industry as a whole to decline dramatically, and if the economic conditions or financial condition of our customers were to deteriorate, additional accounting related allowances may be required in the future and such additional allowances could increase our operating expenses and therefore reduce our operating income and net income. Thus, any future global economic crisis or catastrophic natural disaster (and their indirect effects) could materially and adversely affect our results of operations.

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Since we are dependent on the highly cyclical semiconductor and electronics industries, which have experienced significant and sometimes prolonged periods of downturns and overcapacity, our revenues, earnings and margins may fluctuate significantly.

The electronics industries and semiconductor market are cyclical and subject to significant and often rapid increases and decreases in product demand. Our semiconductor foundry business is affected by market conditions in such highly cyclical electronics and semiconductor industries. Most of our customers operate in these industries. Variations in order levels from our customers may result in volatility in our revenues and earnings. From time to time, the electronics and semiconductor industries have experienced significant and sometimes prolonged periods of downturns and overcapacity. Any systemic economic, political, or financial crisis, such as the one that occurred in 2008-2009, could create significant volatility and uncertainty within the electronics and semiconductor industries which may disrupt traditional notions of cyclicality within such industries. As such, the nature, extent and scope of such periods of downturns and overcapacity may vary drastically in accordance with the degree of volatility of market demand. Because we are, and will continue to be, dependent on the requirements of electronics and semiconductor companies for our services, periods of downturns and overcapacity in the general electronics and semiconductor industries could lead to reduced demand for overall semiconductor foundry services, including our services. If we cannot take appropriate actions such as reducing our costs to sufficiently offset declines in demand, our revenues, margin and earnings will suffer during periods of downturns and overcapacity. Furthermore, due to the increasingly complex technological nature of our foundry services, the amount of our accounting provisions may also need to be provided and adjusted for potential sales returns and allowances to customers that may adversely affect the results of our operations.

Decreases in demand and average selling prices for products that contain semiconductors may adversely affect demand for our products and may result in a decrease in our revenues and earnings.

A vast majority of our revenue is derived from customers who use our services in communication devices, personal computers, consumer electronics products and industrial/standard products. Any decrease in the demand for any one of these products may decrease the demand for such other products as well as overall global semiconductor foundry services, including our services and may adversely affect our revenues. Further, because we own most of our manufacturing capacities, a significant portion of our operating costs is fixed. In general, these costs do not decline when customer demand or our capacity utilization rates drop, and thus declines in customer demand, among other factors, may significantly decrease our margins. Conversely, as product demand rises and factory utilization increases, the fixed costs are spread over increased output, which can improve our margins. In addition, the historical and current trend of declining average selling prices (or ASP) of end use applications places downward pressure on the prices of the components that go into such applications. If the ASP of end use applications continues decreasing, the pricing pressure on components produced by us may lead to a reduction of our revenues, margin and earnings.

In light of the rise of new foundry service providers worldwide, if we are unable to compete effectively in the highly competitive foundry segment of the semiconductor industry, we may lose customers and our profit margin and earnings may decrease.

The markets for our foundry services are highly competitive. We compete with other foundry service providers, as well as integrated device manufacturers that devote a significant portion of their manufacturing capacity to foundry operations. Some of these companies may have access to more advanced technologies and greater financial and other resources than us, such as the possibility of receiving direct or indirect government bailout/economic stimulus funds or other incentives that may be unavailable to us. Our competition may, from time to time, also decide to undertake aggressive pricing initiatives in one or more technology nodes. Increases in these competitive activities may decrease our customer base, or our ASP, or both. For example, over the past few years, we have seen the rise of certain firms with the capability of providing foundry services. These firms are committed to try to attract our customers. If we are unable to compete with any and each of these new competitors with better technologies and manufacturing capacity and capabilities, we risk losing customers to these new contenders.

If we are unable to remain a technological leader in the semiconductor industry or if we are unable to timely respond to fast-changing semiconductor market dynamics, we may become less competitive.

The semiconductor industry and its technologies are constantly changing. We compete by developing process technologies using increasingly advanced nodes and on manufacturing products with more functions. We also compete by developing new derivative technologies. If we do not anticipate these changes in technologies and rapidly develop new and innovative technologies, or our competitors unforeseeably gain sudden access to additional technologies, we may not be able to provide foundry services on competitive terms. In addition, our customers have significantly decreased the time in which their products or services are launched into the market. If we are unable to meet these shorter product time-to-market, we risk losing these customers. These factors have also been intensified by the shift of the global technology market to consumer driven products such as mobile devices, and increasing concentration of customers and competition (all further discussed among these risk factors). These challenges also place greater demands on our research and development capabilities. If we are unable to innovate new technologies that meet the demands of our customers or overcome the above factors, our revenues may decline significantly. Although we have concentrated on maintaining a competitive edge in research and development, if we fail to achieve advances in technologies or processes, or to obtain access to advanced technologies or processes developed by others, we may become less competitive.

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If we are unable to manage our capacity and the streamlining of our production facilities effectively, our competitiveness may be weakened.

We perform long term market demand forecasts to estimate general economic and market conditions for our products and services. Based upon these estimates, we manage our overall capacity in accordance with market demand. Because market conditions may vary significantly and unexpectedly, our market demand forecast may change significantly at any time. Further, since certain manufacturing lines or tools in some of our manufacturing facilities may be suspended or shut down temporarily during periods of decreased demand, we may not be able to ramp up in a timely manner during periods of increased demand. During periods of continued decline in demand, our operating facilities may not be able to absorb and complete in a timely manner outstanding orders re-directed from shuttered facilities. Recently, we have been adding capacity to our 300mm wafer fabs in the Hsinchu Science Park, Southern Taiwan Science Park and Central Taiwan Science Park, based on our market demand forecasts taking into account the demand forecasts of our customers. As a result, our total monthly capacity for 300mm wafer fabs was increased from 366,800 wafers as of December 31, 2012 to 414,700 wafers as of December 31, 2013. Expansion and modification of our production facilities will, among other factors, increase our costs. For example, we will need to purchase additional equipment, train personnel to operate the new equipment or hire additional personnel. If we do not increase our net revenue accordingly, in order to offset these higher costs, our financial performance may be adversely affected. See Item 4. Information on the Company Capacity Management and Technology Upgrade Plans for a further discussion.

We may not be able to implement our planned growth or development if we are unable to obtain sufficient financial resources to meet our future capital requirements.

Capital requirements are difficult to plan in the highly dynamic, cyclical and rapidly changing semiconductor industry. From time to time and increasingly so for the foreseeable next few years, we will continue to need significant capital to fund our operations and manage our capacity in accordance with market demand. Our continued ability to obtain sufficient external financing is subject to a variety of uncertainties, including:

- our future financial condition, results of operations and cash flow;
- general market conditions for financing activities;
- market conditions for financing activities of semiconductor companies; and
- social, economic, financial, political and other conditions in Taiwan and elsewhere.

Sufficient external financing may not be available to us on a timely basis, on reasonable market terms, or at all. As a result, we may be forced to curtail our expansion and modification plans or delay the deployment of new or expanded services until we obtain such financing.

We may not be able to implement our planned growth and development or maintain our leading position if we are unable to recruit and retain qualified executives, managers and skilled technical and service personnel.

We depend on the continued services and contributions of our executive officers and skilled technical and other personnel. Our business could suffer if we lose, for whatever reasons, the services and contributions of some of these personnel and we cannot adequately replace them. We may be required to increase or reduce the number of employees in connection with any business expansion or contraction in accordance with market demand for our products and services. Since there is intense competition for the recruitment of these personnel, we cannot ensure that we will be able to fulfill our personnel requirements in a timely manner during an economic upturn.

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We may be unable to obtain in a timely manner and at a reasonable cost equipment currently proven and existing that are necessary for us to remain competitive.

Our operations and ongoing expansion plans depend on our ability to obtain an appropriate amount of equipment and related services from a limited number of suppliers in a market that is characterized from time to time by limited supply and long delivery cycles. During such times, supplier-specific or industry-wide lead times for delivery can be as long as six months or more. To better manage our supply chain, we have implemented various business models and risk management contingencies with suppliers to shorten the procurement lead time. We also provide our projected demand for various items to many of our equipment suppliers to help them plan their production in advance. We have purchased used tools and continue to seek opportunities to acquire relevant used tools. Further, the growing complexities especially in next-generation lithographic technologies may delay the timely availability of the equipments and parts needed to exploit time sensitive business opportunities and also increase the market price for such equipment and parts. If we are unable to obtain equipment in a timely manner to fulfill our customers orders, or at a reasonable cost, our financial condition and results of operations could be negatively impacted.

Our revenue and profitability may decline if we are unable to obtain adequate supplies of raw materials in a timely manner and at reasonable prices.

Our production operations require that we obtain adequate supplies of raw materials, such as silicon wafers, gases, chemicals, and photoresist, on a timely basis. In the past, shortages in the supply of some materials, whether by specific vendors or by the semiconductor industry generally, have resulted in occasional industry-wide price adjustments and delivery delays. Also, since we procure some of our raw materials from sole-source suppliers, there is a risk that our need for such raw materials may not be met or that back-up supplies may not be readily available. Our revenue and earnings could decline if we are unable to obtain adequate supplies of the necessary raw materials in a timely manner or if there are significant increases in the costs of raw materials that we cannot pass on to our customers.

If the Ministry of Economic Affairs uses a substantial portion of our production capacity, we will not be able to service our other customers.

According to our agreement with the Industrial Technology Research Institute of Taiwan, or ITRI, the Ministry of Economic Affairs of the R.O.C., or an entity designated by the Ministry of Economic Affairs, has an option to purchase up to 35% of certain of our capacity, if our outstanding commitments to our customers are not prejudiced. Although the Ministry of Economic Affairs has never exercised this option, if this option is exercised to any significant degree during tight market conditions, we may not be able to provide services to all of our other customers unless we are able to increase our capacity accordingly or outsource such increased demand in a timely manner.

Any inability to obtain, preserve, enforce, defend and protect our technologies and intellectual property rights and third-party licenses could harm our competitive position.

Our ability to compete successfully and to achieve future growth will depend in part on the continued strength of our intellectual property portfolio. While we actively obtain, preserve, enforce, defend and protect our intellectual property rights, there can be no assurance that our efforts will be adequate to prevent the misappropriation or improper use of our proprietary technologies, trade secrets, software or know-how. Also, we cannot assure you that, as our business or business models expand into new areas, or otherwise, we will be able to develop independently the technologies, trade secrets, patents, software or know-how necessary to conduct our business or that we can do so without unknowingly infringing the intellectual property rights of others. As a result, we may have to rely increasingly on licensed technologies and patent licenses from others. To the extent that we rely on licenses from others, there can be no assurance that we will be able to obtain any or all of the necessary licenses in the future on terms we consider reasonable or at all. The lack of necessary licenses could expose us to claims for damages and/or injunctions from third parties, as well as claims for indemnification by our customers in instances where we have contractually agreed to indemnify our customers against damages resulting from infringement claims.

We have received, from time-to-time, communications from third parties asserting that our technologies, manufacturing processes, the design of the integrated circuits made by us or the use by our customers of semiconductors made by us may infringe upon their patents or other intellectual property rights. Because of the nature of the industry, we may continue to receive such communications in the future. In some instances, these disputes have resulted in litigation. Recently, there has been a notable increase in the number of claims or lawsuits initiated by certain patent assertion entities and these entities are also becoming more aggressive in their monetary demands and requests for court-issued injunctions. Such lawsuits or claims may increase our cost of doing business and may potentially be extremely disruptive if the plaintiffs succeed in blocking the trade of our products and services. If we fail to obtain or maintain certain government, technologies or intellectual property licenses and, if litigation relating to alleged intellectual property matters occurs, it could prevent us from manufacturing or selling particular products or applying particular technologies, which could reduce our opportunities to generate revenues. See Item 8. Financial Information Legal Proceedings for a further discussion.

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We are subject to the risk of loss due to explosion and fire because some of the materials we use in our manufacturing processes are highly combustible.

We and many of our suppliers use highly combustible and toxic materials in our manufacturing processes and are therefore subject to the risk of loss arising from explosion, fire, or environmental influences which cannot be completely eliminated. Although we maintain many overlapping risk prevention and protection systems, as well as comprehensive fire and casualty insurance, including insurance for loss of property and loss of profit resulting from business interruption, our risk management and insurance coverage may not be sufficient to cover all of our potential losses. If any of our fabs or vendor facilities were to be damaged, or cease operations as a result of an explosion, fire, or environmental influences, it could reduce our manufacturing capacity and may cause us to lose important customers, thereby having a potentially adverse and material impact on our financial performance.

Any impairment charges may have a material adverse effect on our net income.

Under IFRSs, we are required to evaluate our investments, tangible assets and intangible assets for impairment whenever triggering events or changes in circumstances indicate that the asset may be impaired. If certain criteria are met, we are required to record an impairment charge. We are also required under IFRSs to evaluate goodwill for impairment at least on an annual basis or more frequently whenever triggering events or changes in circumstances indicate that goodwill may be impaired and the carrying value may not be recoverable. For example, we hold investments in certain publicly listed and private companies, some of which have incurred certain impairment charges as discussed further in our financial statements. We are not able to estimate the extent or timing of any impairment charge for future years. Any impairment charge required may have a material adverse effect on our net income.

The determination of an impairment charge at any given time is based significantly on our expected results of operations over a number of years subsequent to that time. As a result, an impairment charge is more likely to occur during a period when our operating results are otherwise already depressed. See Item 5. Operating and Financial Reviews and Prospects Critical Accounting Policies And Judgments for a discussion of how we assess if an impairment charge is required and, if so, how the amount is determined.

Having one or more large customers that account for a significant percentage of our revenues may render us vulnerable to the loss of or significant curtailment of purchases by one or more large customers that could in turn adversely affect our results of operations.

Over the years, our customer profile and the nature of our customers business have changed dramatically. While we generate revenue from hundreds of customers worldwide, our ten largest customers accounted for approximately 60% and 62% of our net revenue in 2012 and 2013, respectively. Our largest customer accounted for 17% and 22% of our net revenue in 2012 and 2013, respectively. This customer concentration results in part from the changing dynamics of the electronics industry with the structural shift to mobile devices and applications and software that provide the content for such devices. There are only a limited number of customers who are successfully exploiting this new business model paradigm. Also, in order to respond to the new business model paradigm, we have seen the nature of changes in our customers business models. For example, there is a growing trend toward the rise of system houses that operate in a manner which make their products and services more marketable in a changing consumer market. The loss of, or significant curtailment of purchases by, one or more of our top customers, including curtailments due to increased competitive pressures, industrial consolidation, a change in their designs, or change in their manufacturing sourcing policies or practices of these customers, or the timing of customer or distributor inventory adjustments, or change in our major customers business models may adversely affect our results of operations and financial condition.

Any failure to achieve and maintain effective internal controls could have a material adverse effect on our business and results of operations.

Effective internal controls are necessary for us to provide reasonable assurance with respect to our financial reports and to effectively prevent fraud. If we cannot provide reasonable assurance with respect to our financial reports and effectively prevent fraud and corruption, our reputation and results of operations could be harmed.

We are required to comply with various R.O.C. and U.S. laws and regulations on internal controls. For example, pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to furnish a report by management on our internal control over financial reporting, including management s assessment of the effectiveness of our internal control over financial reporting. Moreover, R.O.C. law requires us to establish internal control systems that would reasonably ensure the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. We are also required under R.O.C. law to file an internal control declaration within four months of the end of each fiscal year.

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Internal controls may not prevent or detect misstatements because of their inherent limitations, including the possibility of human error, the circumvention or overriding of controls, fraud or corruption. Therefore, even effective internal controls can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. In addition, projections of any evaluation of effectiveness of internal controls to future periods are subject to the risk that the internal controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. If we fail to maintain the adequacy of our internal controls, including any failure to implement required new or improved controls, or if we experience difficulties in their implementation, our business and operating results could be harmed, we could fail to meet our reporting obligations, and there could be a material adverse effect on the market price of our common shares and ADSs.

Our global manufacturing, design and sales activities subject us to risks associated with legal, political, economic or other conditions or developments in various jurisdictions, including in particular the R.O.C., which could negatively affect our business and financial status and therefore the market value of your investment.

The majority of our principal executive officers and our principal production facilities are located in the R.O.C., and a substantial majority of our net revenues are derived from our operations in the R.O.C. In addition, we have operations worldwide and a significant percentage of our revenue comes from sales to locations outside the R.O.C. Operating in the R.O.C. and overseas exposes us to changes in policies and laws, as well as the general political and economic conditions, security risks, health conditions and possible disruptions in transportation networks, in the various countries in which we operate, which could result in an adverse effect on our business operations in such countries and our results of operations as well as the market price and the liquidity of our ADSs and common shares.

For example, even though the R.O.C. and the PRC have co-existed for more than six decades and significant economic and cultural relations have been established during that time, the financial markets have viewed certain past developments in relations between the two sides as occasions to depress general market prices of the securities of Taiwanese companies, including our own. In addition, the R.O.C. government has not lifted some trade and investment restrictions imposed on Taiwanese companies on the amount and types of certain investments that can be made in Mainland China. In addition to the above factors, future expansions of our operations in Taiwan will likely be handicapped by the limited availability of commercial-use land, industrial-quantities of natural resources such as water (needed for our foundry processes) and experienced human resources.

Our operational results could also be materially and adversely affected by natural disasters or interruptions in the supply of utilities (such as water or electricity), in the locations in which we, our customers or our suppliers operate.

The frequency and severity of natural disasters has been increasing. We have manufacturing and other operations in locations subject to natural disasters, such as severe weather, flooding, earthquakes and tsunamis, as well as interruptions or shortages in the supply of utilities, such as water and electricity, which could disrupt operations. We have operations in earthquake-prone locations and any major natural disaster occurring in any such locations may cause severe disruptions to our business operations and financial performance. In addition, our suppliers and customers also have operations in such locations. For example, most of our production facilities, as well as those of many of our suppliers and customers and upstream providers of complementary semiconductor manufacturing services, are located in Taiwan and Japan, which are susceptible to earthquakes, tsunamis, flooding, typhoons, and droughts from time to time. In addition, we have occasionally suffered power outages or surges in Taiwan caused by difficulties encountered by our electricity supplier, the Taiwan Power Company, or other power consumers on the same power grid, which have resulted in interruptions to our production schedule. While our business continuity management and emergency response plans are intended to prevent or minimize losses in the future, there is no assurance that the measures will fully eliminate the losses or the insurance will fully cover any losses. One or more natural disasters or interruptions to the supply of utilities that results in a prolonged disruption to our operations, or the operations of our customers or suppliers, may adversely affect the results of our operations and financial conditions.

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Our failure to comply with applicable environmental and climate related laws and regulations, as well as international laws, regulations and accords to which we are subject, could also harm our business and operational results.

The manufacturing, assembling and testing of our products require the use of metals, chemicals, minerals and materials that are subject to environmental, climate-related, health and safety and humanitarian, conflict-free sourcing laws, regulations and guidelines issued worldwide. For example, the U.S. SEC implemented the final rule mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act to require companies to publicly disclose their use of conflict minerals that originated in the Democratic Republic of the Congo (DRC) or an adjoining country. We take our responsibility to comply with applicable legal requirements on conflict minerals very seriously. For further information about our conflict mineral status under applicable U.S. SEC law, please see our Form SD to be filed with the U.S. SEC. (After the filing of this document, please also visit our Corporate Social Responsibility section of our website at www.tsmc.com for further details about our conflict-free status). The final applicable legal rule as well as non-binding guidelines on conflict minerals imposes substantial supply chain verification requirements in the event that conflict minerals originates from the Democratic Republic of the Congo, adjoining countries or any geographic territory that may be specified by the relevant authorities at a future date. These new rules and verification requirements, which apply to our activities in 2013 and beyond, impose additional costs on us and on our suppliers and may limit the sources or increase the prices of materials used in our products. Further, if we are unable to certify that our products are conflict free under applicable law or non-binding guidelines or if we are unable to comply with any material provisions of such laws or guidelines, we may face challenges with our customers that place us at a significant competitive disadvantage, and our goodwill and reputation may be irreparably damaged. Often times, our customers have imposed upon us legally non-binding conditions or guidelines on sourcing conflict minerals that exceed those imposed under relevant legal requirements. For example, many of our customers have been asking us to apply the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals in Conflict-Affected and High-Risk Areas. These guidelines while legally non-binding may impose requirements that well exceed those mandated by applicable law. If we agree to apply these guidelines as requested by our customers, there is the risk that the prices we charge for our products and services will increase (to reflect the added cost in complying with such conditions or guidelines), resulting in the loss of actual and potential customers. Conversely, any failure on our part to comply with such customer-imposed legally non-binding conditions or guidelines may result in us suffering significant competitive harms such as the loss of actual or potential customers that will likely have a material adverse impact on our financial statements. Although we may be eligible for various exemptions and/or extensions of time for compliance, our failure to comply with any of these applicable laws or regulations could result in:

- significant penalties and legal liabilities, such as the denial of import permits;
- the temporary or permanent suspension of production of the affected products;
- unfavorable alterations in our manufacturing, fabrication and assembly and test processes;
- loss of actual or potential sales contracts in case we are unable to satisfy the conditions regarding conflict-free minerals sourcing laws or requirements by our customers; and
- restrictions on our operations or sales.

Existing and future environmental and climate related laws and regulations as well as applicable international accords to which we are subject, could also require us, among other things, to do the following: (a) purchase, use or install expensive pollution control, reduction or remediation equipment; (b) implement climate change mitigation programs and abatement or reduction of greenhouse gas emissions programs, or carbon credit trading programs; (c) modify our product designs and manufacturing processes, or incur other significant expenses associated with such laws and regulations such as obtaining substitute raw materials or chemicals that may cost more or be less available for our operations. It is still unclear whether such necessary actions would affect the reliability or efficiency of our products and services.

Any of the above contingencies resulting from the actual and potential impact of local or international laws and regulations, as well as international accords on environmental or climate change, could harm our business and operational results by increasing our expenses or requiring us to alter our manufacturing and assembly and test processes. For further details, please see our compliance record with Taiwan and international environmental and climate related laws and regulations in Item 4. Information on the Company Environmental Regulations .

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Climate change, other environmental concerns and green initiatives also present other commercial challenges, economic risks and physical risks that could harm our operational results or affect the manner in which we conduct our business.

Increasing climate change and environmental concerns could affect the results of our operations if any of our customers request that we provide products and services that exceed any existing standard(s) of environmental compliance. For example, we have been working on an on-going basis with our suppliers, customers, and several industry consortia to develop and provide products that are compliant with the European Union Restriction of Hazardous Substances Directive (RoHS). Even though we are entitled to rely on various exemptions under RoHS, some of our customers may request that we provide products that exceed the legal standard set by RoHS without using any of the exemptions still permitted under RoHS. If we are unable to offer such products or offer products that are compliant, but are not as reliable due to the lack of reasonably available alternative technologies or materials, we may lose market share to our competitors.

Further, energy costs in general could increase significantly due to climate change and other regulations. Therefore, our energy costs may increase significantly if utility or power companies pass on their costs, either fully or partially, such as those associated with carbon taxes, emission caps and carbon credit trading programs. For further details, please see details of our business continuity management of climate change policy in Item 4. Information on the Company Environmental Regulation .

To mitigate risks resulting from climate change, we continue to actively carry out energy conservation measures and voluntary perfluorinated compounds (PFC) emission reduction projects, and conduct greenhouse gas inventories verification every year. Since 2005, we have publicly disclosed climate change information every year through participation in the annual survey conducted by the nonprofit carbon disclosure project, which includes greenhouse gas emission and reduction information for all of our fabs.

Adverse fluctuations in exchange rates could decrease our operating margin.

Over one-half of our capital expenditures and manufacturing costs are denominated in currencies other than NT dollars, primarily in U.S. dollars, Japanese yen and Euros. In 2013, more than 90% of our revenue were denominated in U.S. dollars and currencies other than NT dollars. Therefore, any significant fluctuation to our disadvantage in such exchange rates would have an adverse effect on our financial condition. For example, during the period from September 1, 2010 to December 30, 2010, the U.S. dollar depreciated 8.9% against the NT dollar, which had a negative impact on our results of operations. Specifically, based on our 2013 results, every 1% depreciation of the U.S. dollar against the NT dollar exchange rate may result in approximately 0.4 percentage point decrease in our operating margin. In addition, fluctuations in the exchange rate between the U.S. dollar and the NT dollar may affect the U.S. dollar value of our common shares and the market price of the ADSs and of any cash dividends paid in NT dollars on our common shares represented by ADSs. Please see Item 11. Quantitative and Qualitative Disclosures About Market Risk for a further discussion on the possible impact of other market factors on our results of operations.

Fluctuations in inflationary and deflationary market expectations could negatively affect costs of and demand for our products and services, which may harm our financial results.

The world economy is becoming more vulnerable to sudden unexpected fluctuations in inflationary and deflationary market expectations and conditions. For example, certain structural changes that resulted from the global financial crisis in 2008-2009 and EU sovereign debt crises, such as highly accommodative monetary policies by major central banks worldwide, may cause variations in the expectation of inflation or deflation. Both high inflation and deflation adversely affect an economy, at both the macro and micro levels, by reducing economic efficiency, disrupting saving and investment decisions and reducing the efficiency of the market prices as a mechanism to allocate resources. Such fluctuations may negatively affect the costs of our operations and the business operations of our customers who may be forced to plan their purchases of our goods and services within an uncertain macro and micro economy. Therefore, the demand for our products and services could unexpectedly fluctuate severely in accordance with market and consumer expectations of inflation or deflation. Please see Item 5. Operating and Financial Reviews and Prospects Inflation & Deflation for a further discussion.

Amendments to existing tax regulations or new tax legislation in the R.O.C. may have an adverse effect on our net income.

While we are subject to tax laws and regulations in various jurisdictions in which we operate or conduct business, our principal operations are conducted in the R.O.C. and we are exposed primarily to taxes levied by the government of the R.O.C. Any changes of tax laws and regulations in this jurisdiction could affect our effective tax rate and profitability of our operating results. See Item 5. Operating and Financial Reviews and Prospects Taxation for further discussion of significant tax regulation changes.

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If certain of our strategic investments fail to achieve their respective forecasted returns or objectives, we may suffer financial losses that may materially lower our profit margin and distributable earnings.

From time to time, we have made or will make a series of strategic investments that serve two major purposes. Firstly, some of our major strategic investments were (or will be) made to help us open new sources of revenues and innovate alternative business models that target to generate additional shareholders value going forward in the future. For example, in order to help us grow into next generation business areas, we have invested to develop potential businesses in solid state lighting, solar power and other renewable sources of energy. We believe these investments into these areas will generate new sources of revenues as the gradual transition into consuming cleaner sources of power is generally expected. For further information on these investments, please see Item 4. Information on the Company Our Subsidiaries and Affiliates . Secondly, some of our significant strategic investments were (or will be) made to help us grow our existing business by augmenting key technology development. For example, to accelerate the development of next-generation lithographic technology, in August 2012, TSMC joined the ASML Holding N.V. Customer Co-Investment Program (along with other major technology firms). The program s scope includes development of extreme ultraviolet (EUV) lithography technology and 450-millimeter (450mm) lithography tools. Under the agreement with ASML Holding N.V. (ASML), TSMC invested EUR838 million to acquire 5% of ASML s equity and has committed EUR276 million, to be spread over five years, to ASML s research and development program. As a result, we are exposed to share price fluctuations arising from the investment in ASML. In the future, we may make more strategic investments in various forms, whether through stock purchases, assets purchases, licensing of major intellectual property rights, joint investments or research and development projects, outright mergers and acquisitions, private equity transactions and other similar transactions. Any such investment will incur risks, which may result in losses if not carefully managed. Any such loss resulting from such investments may result in significant impairment charges, lower profit margin and ultimately lower distributable earnings.

Risks Relating to Ownership of ADSs

Your voting rights as a holder of ADSs will be limited.

Holders of American Depositary Receipts (ADRs) evidencing ADSs may exercise voting rights with respect to the common shares represented by these ADSs only in accordance with the provisions of our ADS deposit agreement. The deposit agreement provides that, upon receipt of notice of any meeting of holders of our common shares, the depositary bank will, as soon as practicable thereafter, mail to the holders (i) the notice of the meeting sent by us, (ii) voting instruction forms and (iii) a statement as to the manner in which instructions may be given by the holders.

ADS holders will not generally be able to exercise the voting rights attaching to the deposited securities on an individual basis. According to the provisions of our ADS deposit agreement, the voting rights attaching to the deposited securities must be exercised as to all matters subject to a vote of shareholders collectively in the same manner, except in the case of an election of directors. Election of directors is by means of cumulative voting. See Item 10. Additional Information Voting of Deposited Securities for a more detailed discussion of the manner in which a holder of ADSs can exercise its voting rights.

You may not be able to participate in rights offerings and may experience dilution of your holdings.

We may, from time to time, distribute rights to our shareholders, including rights to acquire securities. Under our ADS deposit agreement, the depositary bank will not distribute rights to holders of ADSs unless the distribution and sale of rights and the securities to which these rights relate are either exempt from registration under the United States Securities Act of 1933, as amended, (the Securities Act), with respect to all holders of ADSs, or are registered under the provisions of the Securities Act. Although we may be eligible to take advantage of certain exemptions for rights offerings by certain foreign companies, we can give no assurance that we can establish an exemption from registration under the Securities Act, and we are under no obligation to file a registration statement with respect to any such rights or underlying securities or to endeavor to have such a registration statement declared effective. Accordingly, holders of ADSs may be unable to participate in our rights offerings and may experience dilution of their holdings as a result.

If the depositary bank is unable to sell rights that are not exercised or not distributed or if the sale is not lawful or reasonably practicable, it will allow the rights to lapse, in which case you will receive no value for these rights.

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The value of your investment may be reduced by possible future sales of common shares or ADSs by us or our shareholders.

One or more of our existing shareholders may, from time to time, dispose of significant numbers of our common shares or ADSs. For example, the National Development Fund of Taiwan, R.O.C. which owned 6.4% of TSMC s outstanding shares as of February 28, 2014, has from time to time in the past sold our shares in the form of ADSs in several transactions.

We cannot predict the effect, if any, that future sales of ADSs or common shares, or the availability of ADSs or common shares for future sale, will have on the market price of ADSs or common shares prevailing from time to time. Sales of substantial amounts of ADSs or common shares in the public market, or the perception that such sales may occur, could depress the prevailing market price of our ADSs or common shares.

The market value of our shares may fluctuate due to the volatility of, and government intervention in, the R.O.C. securities market.

The Taiwan Stock Exchange experiences from time to time substantial fluctuations in the prices and volumes of sales of listed securities. There are currently limits on the range of daily price movements on the Taiwan Stock Exchange. In response to past declines and volatility in the securities markets in Taiwan, and in line with similar activities by other countries in Asia, the government of the R.O.C. formed the Stabilization Fund, which has purchased and may from time to time purchase shares of Taiwan companies to support these markets. In addition, other funds associated with the R.O.C. government have in the past purchased, and may from time to time purchase, shares of Taiwan companies on the Taiwan Stock Exchange or other markets. These funds have disposed and may from time to time dispose shares of Taiwan companies so purchased at a later time. In the future, market activity by government entities, or the perception that such activity is taking place, may take place or has ceased, may cause fluctuations in the market prices of our ADSs and common shares.

ITEM 4. INFORMATION ON THE COMPANY

Our History and Structure

Our legal and commercial name is (Taiwan Semiconductor Manufacturing Company Limited). We believe we are currently the world s largest dedicated foundry in the semiconductor industry. We were founded in 1987 as a joint venture among the R.O.C. government and other private investors and were incorporated in the R.O.C. on February 21, 1987. Our common shares have been listed on the Taiwan Stock Exchange since September 5, 1994, and our ADSs have been listed on the New York Stock Exchange since October 8, 1997.

Our Principal Office

Our principal executive office is located at No. 8, Li-Hsin Road 6, Hsinchu Science Park, Hsinchu, Taiwan, Republic of China. Our telephone number at that office is (886-3) 563-6688. Our web site is www.tsmc.com. Information contained on our website is not incorporated herein by reference and does not constitute part of this annual report.

Business Overview of the Company

As a foundry, we manufacture semiconductors using our manufacturing processes for our customers based on their own or third parties proprietary integrated circuit designs. We offer a comprehensive range of wafer fabrication processes, including processes to manufacture CMOS logic, mixed-signal, radio frequency, embedded memory, BiCMOS mixed-signal and other semiconductors. We estimate that our revenue market segment share among total foundries worldwide was 49% in 2013. We also offer design, mask making, bumping, probing, and assembly and testing services.

We believe that our large capacity, particularly for advanced technologies, is a major competitive advantage. Please see Manufacturing Capacity and Technology and Capacity Management and Technology Upgrade Plans for a further discussion of our capacity.

We count among our customers many of the world s leading semiconductor companies, ranging from fabless semiconductor and system companies such as Advanced Micro Devices, Inc., Broadcom Corporation, Marvell Semiconductor Inc., MediaTek Inc., NVIDIA Corporation, OmniVision Technologies and Qualcomm Incorporated, to integrated device manufacturers such as Renesas Electronics Corporation, STMicroelectronics and Texas Instruments Inc. Fabless semiconductor and system companies accounted for approximately 87%, and integrated device manufacturers accounted for approximately 13% of our net revenue in 2013.

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Our Semiconductor Facilities

We currently operate one 150mm wafer fab, six 200mm wafer fabs and three 300mm wafer fabs. Our corporate headquarters and five of our fabs are located in the Hsinchu Science Park, two fabs are located in the Southern Taiwan Science Park, one fab is located in the Central Taiwan Science Park, one fab is located in the United States, and one fab is located in Shanghai. Our corporate headquarters and our five fabs in Hsinchu occupy parcels of land of a total of approximately 555,304 square meters. We lease these parcels from the Hsinchu Science Park Administration in Hsinchu under agreements that will be up for renewal between June 2015 and December 2032. We have leased from the Central Taiwan Science Park Administration a parcel of land of approximately 184,408 square meters for our Taichung fabs under agreements that will be up for renewal in December 2028. We have leased from the Southern Taiwan Science Park Development Office approximately 764,158 square meters of land for our fabs in the Southern Taiwan Science Park under agreements that will be up for renewal between July 2017 and July 2032. We also own approximately 143,215 square meters of land located in Miaoli, Taiwan. WaferTech owns a parcel of land of approximately 1,052,186 square meters in the State of Washington in the United States, where the WaferTech fab and related offices are located. TSMC China owns the land use rights of 369,087 square meters of land in Shanghai, where Fab 10 and related offices are located. Other than certain equipment under leases located at testing areas, we own all of the buildings and equipment for our fabs. We are expanding our 300mm fabrication capacity and research and development through Fab 12 in the Hsinchu Science Park, Fab 14 in the Southern Taiwan Science Park and Fab 15 in the Central Taiwan Science Park. Total monthly capacity for 300mm wafer fabs was increased from 366,800 wafers as of December 31, 2012 to 414,700 wafers as of December 31, 2013. We will continuously evaluate our capacity in light of prevailing market conditions.

Semiconductor Manufacturing Capacity and Technology

We manufacture semiconductors on silicon wafers based on proprietary circuitry designs provided by our customers or third party designers. Two key factors that characterize a foundry s manufacturing capabilities are output capacity and fabrication process technologies. Since our establishment, we have possessed the largest capacity among the world s dedicated foundries. We also believe that we are the technology leader among the dedicated foundries in terms of our net revenue of advanced semiconductors with a resolution of 40/45-nanometer and below, and are one of the leaders in the semiconductor manufacturing industry generally. We are the first dedicated foundry with proven low-k interconnect technology in commercial production from the 0.13 micron node down to 28-nanometer node. Following our commercial production based on 65-nanometer process technology in 2006, we also unveiled 55-nanometer process technology in 2007. Our 65-nanometer and 55-nanometer technologies are the third-generation proprietary processes that employ low-k dielectrics. In 2008, we also qualified our 45-nanometer and 40-nanometer process technologies with ultra low-k dielectrics and advanced immersion lithography. In the fourth quarter of 2011, we began volume production of 28-nanometer products with first-generation high-k/metal gate transistor. In 2012, we continued 20-nanometer technology development to provide a migration path from 28-nanometer for both performance driven products and mobile computing applications. In 2013, we continued our 16-nanometer technology development.

The following table lists our fabs and those of our affiliates, together with the year of commencement of commercial production, technology and capacity during the last two years:

Fab[1]	Year of commencement	Current most advanced technology for volume production[2]	Monthly capacity[3][4][5]	
			2012	2013
2	1990	450	48,412	48,650
3	1995	150	103,023	96,693
5	1997	150	49,849	33,506
6	2000	110	100,440	144,100
8	1998	110	89,587	72,784
10	2004	150	80,300	83,700
11	1998	150	37,500	38,000
12	2001	28	289,747	281,052
14	2004	40	418,862	427,502
15	2012	28	116,782	224,476
Total[5]			1,334,502	1,450,463

(1) Fab 2 produces 150mm wafers. Fabs 3, 5, 6, 8, 10 and Fab 11 (WaferTech) produce 200mm wafers. Fab 12, Fab 14 and Fab 15 produce 300mm wafers. Fabs 2, 3, 5, 8 and 12 are located in Hsinchu Science Park. Fab 6 and Fab 14 are located in the Southern Taiwan Science Park. Fab 15 is located in Central Taiwan Science Park. WaferTech is located in the United States and Fab 10 is located in Shanghai.

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(2) In nanometers, as of year-end.

(3) Estimated capacity in 200mm equivalent wafers as of year-end for the total technology ranges available for production.

(4) Under an agreement with VIS, TSMC is required to use its best commercial efforts to maintain utilization of a certain amount of reserved capacity as agreed by both parties. Please see Item 7. Major Shareholders and Related Party Transactions Related Party Transactions Vanguard International Semiconductor Corporation for a discussion of certain of the VIS contract terms. The amounts to be used at VIS are not included in our monthly capacity figures.

(5) Starting 2013, TSMC no longer included the capacity of our joint venture, SSMC, in this capacity table. However, TSMC still has the access to SSMC s capacity. Under an agreement with SSMC, TSMC is required to maintain utilization of a certain amount of reserved capacity as agreed by the parties. Please see Item 7. Major Shareholders and Related Party Transactions Related Party Transactions Systems on Silicon Manufacturing Company Pte. Ltd. for a discussion of certain of the SSMC contract terms.

As of December 31, 2013, our monthly capacity (in 200mm equivalent wafers) was 1,450,463 wafers, compared to 1,334,502 wafers at the end of 2012. This increase was primarily due to the expansion of our 28-nanometer advanced technology. Our semiconductor manufacturing facilities require substantial investment to construct and are largely fixed-cost assets once they are in operation. Because we own most of our manufacturing capacity, a significant portion of our operating costs is fixed. In general, these costs do not decline when customer demand or our capacity utilization rates drop, and thus declines in customer demand, among other factors, may significantly decrease our margins. Conversely, as product demand rises and factory utilization increases, the fixed costs are spread over increased output, which can improve our margins.

Capacity Management and Technology Upgrade Plans

We perform long term market demand forecasts to estimate general economic and market conditions for our products and services. Based upon these estimates, we manage our overall capacity in accordance with market demand. For example, such planning enables us to match significant customer demands for our services with the corresponding capacity increase needed to fulfill such demands. Since market conditions may vary significantly and unexpectedly, our market demand forecast may change significantly at any time. Based on our current market demand forecasts, we intend to maintain our strategy of expanding manufacturing capacity and improving manufacturing process technologies to meet both the fabrication and the technological needs of our customers.

Our capital expenditures in 2012 and 2013 were NT$246,137 million and NT$287,595 million (US$9,688 million, translated from a weighted average exchange rate of NT$29.687 to US$1.00), respectively. Our capital expenditures in 2014 are expected to be approximately US$9.5 billion to US$10 billion, which, depending on market conditions, may be adjusted later. Starting from 2012, our capital expenditures were funded by our operating cash flow and the issuance of corporate bonds. Our capital expenditures for 2014 are expected to be funded primarily by our operating cash flow. In 2014, we anticipate our capital expenditures to focus primarily on the following:

- adding production capacity to our 300mm wafer fabs;
- developing new process technologies in 16-nanometer and 10-nanometer nodes;
- expanding buildings/facilities for Fab 12, Fab 14 and Fab 15;
- other research and development projects;
- capacity expansion for mask and backend operations; and
- solar and solid state lighting businesses.

These investment plans are still preliminary and may change according to market conditions.

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Markets and Customers

The primary customers of our foundry services are fabless semiconductor companies, systems companies and integrated device manufacturers. The following table presents the breakdown of net revenue, including foundry services and others, by type of customers during the last two years:

	Year ended December 31,			
	2012		2013	
Customer Type	**Net Revenue**	**Percentage**	**Net Revenue**	**Percentage**
	(NT$ in millions, except percentages)			
Fabless semiconductor companies/systems companies	432,090	85.3%	519,142	87.0%
Integrated device manufacturers	74,007	14.6%	76,967	12.9%
Others	648	0.1%	915	0.1%
Total	506,745	100.0%	597,024	100.0%

We categorize our net revenue based on the country in which the customer is headquartered, which may be different from the net revenue for the countries to which we actually sell or ship our products or different from where products are actually ordered. Under this approach, the following table presents a regional geographic breakdown of our net revenue during the last two years:

	Year ended December 31,			
	2012		2013	
Region	**Net Revenue**	**Percentage**	**Net Revenue**	**Percentage**
	(NT$ in millions, except percentages)			
North America	345,478	68.2%	425,053	71.2%
Asia Pacific	73,381	14.5%	78,500	13.2%
Europe	46,430	9.1%	41,230	6.9%
China	24,674	4.9%	37,646	6.3%
Japan	16,782	3.3%	14,537	2.4%
Other	-	-	58	0.0%
Total	506,745	100.0%	597,024	100.0%

We provide worldwide customer support. Our office in Hsinchu and wholly-owned subsidiaries in the United States, Canada, Japan, Mainland China, the Netherlands and South Korea are dedicated to serving our customers worldwide. Foundry services, which are both technologically and logistically intensive, involve frequent and in-depth interaction with customers. We believe that the most effective means of providing foundry services is by developing direct and close relationships with our customers. Our customer service and technical support managers work closely with the sales force to offer integrated services to customers. To facilitate customer interaction and information access on a real-time basis, a suite of web-based applications have also been offered to provide more active interactions with customers in design, engineering and logistics.

Purchase Orders by Customers. Because of the fast-changing technology and functionality in semiconductor design, foundry customers generally do not place purchase orders far in advance to manufacture a particular type of product. However, we engage in discussions with customers regarding their expected manufacturing requirements in advance of the placement of purchase orders.

The Semiconductor Fabrication Process

In general, the semiconductor manufacturing process begins with a thin silicon wafer on which an array of semiconductor devices is fabricated. The wafer is then tested, cut into dice, and assembled into packages that are then individually retested. Our focus is on wafer fabrication although we also provide all other services either directly or through outsourcing arrangements.

Our Foundry Services

Range of Services. Because of our ability to provide a full array of services, we are able to accommodate customers with a variety of needs at every stage of the overall foundry process. The flexibility in input stages allows us to cater to a variety of customers with different in-house capabilities and thus to service a wider class of customers as compared to a foundry that cannot offer design or mask making services, for example.

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Fabrication Processes. We manufacture semiconductors using the complementary metal oxide silicon (CMOS) and the bipolar complementary metal oxide silicon (BiCMOS , which uses CMOS transistors in conjunction with bipolar junction transistor) processes. The CMOS process is currently the dominant semiconductor manufacturing process. The BiCMOS process combines the high speed of the bipolar circuitry and the low power consumption and high density of the CMOS circuitry. We use the CMOS process to manufacture logic semiconductors, mixed-signal/radio frequency (RF) semiconductors, which combine analog and digital circuitry in a single semiconductor, micro-electro-mechanical-system (MEMS), which combines micrometer featured mechanical parts, analog and digital circuitry in a single semiconductor, and embedded memory semiconductors, which combine logic and memory in a single semiconductor. The BiCMOS process is used to make high-end mixed-signal and other types of semiconductors.

Types of Semiconductors We Manufacture. We manufacture different types of semiconductors with different specific functions by changing the number and the combinations of conducting, insulating and semiconducting layers and by defining different patterns in which such layers are applied on the wafer. At any given point in time, there are thousands of different products in various stages of fabrication at our fabs. We believe that the keys to maintaining high production quality and utilization rates are our effective management and control of the manufacturing process technologies which comes from our extensive experience as the longest existing dedicated foundry and our dedication to quality control and process improvements.

The following is a general, non-exhaustive description of the key types of semiconductors that we currently manufacture. Depending on future market conditions, we may provide other services or manufacture other types of products that may be additive to or differ significantly from the following:

Logic Semiconductors. Logic semiconductors process digital data to control the operation of electronic systems. The largest segment of the logic market, standard logic devices, includes mobile computing chips, application processors, microcontrollers, digital signal processors (DSP), graphic chips and chipsets.

Mixed-Signal/RF Semiconductors. Analog/digital semiconductors combine analog and digital devices on a single semiconductor to process both analog and digital data. We make mixed-signal/RF semiconductors using both the CMOS and BiCMOS processes. We currently offer CMOS mixed-signal process down to the 28-nanometer technology for manufacturing mixed-signal/RF semiconductors. The primary uses of mixed-signal/RF semiconductors are in hard disk drives, wireless communications equipment and network communications equipment, with those made with the BiCMOS process occupying the higher end of the mixed-signal/RF market.

CMOS Image Sensor Semiconductors. Image sensors are primarily used in camera phones and tablets. We are currently the leading foundry for the production of CMOS image sensors, characterized by technology features including low dark current, high sensitivity, small pixel size and high dynamic range achieved through integration with mixed mode processes.

High Voltage Semiconductors. We currently offer a range of high-voltage processes including high voltage CMOS (HVCMOS), bipolar-CMOS-DMOS (Diffusion Metal Oxide Semiconductor) (BCD) and ultra-high voltage technology (UHV), ranging from 5V to 700V, which are suitable for various panel-size display driver and power IC applications.

The table below presents a breakdown of our net revenue during the last two years by each semiconductor type:

	Year ended December 31,			
	2012		2013	
	(NT$ in millions, except percentages)			
Semiconductor Type	**Net Revenue**	**Percentage**	**Net Revenue**	**Percentage**
CMOS				
Logic	352,139	69.5%	424,868	71.2%
Mixed-Signal[1]	150,905	29.8%	167,333	28.0%
BiCMOS[2]	1,924	0.4%	1,615	0.3%
Others	1,777	0.3%	3,208	0.5%
Total	506,745	100.0%	597,024	100.0%

(1) Mixed-signal semiconductors made with the CMOS process.
(2) Mixed-signal and other semiconductors made with the BiCMOS process.

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Design and Technology Platforms. Modern IC designers need sophisticated design infrastructure to optimize productivity and cycle time. Such infrastructure includes design flow for electronic design automation (EDA), silicon proven building blocks such as libraries and intellectual properties, simulation and verification design kits such as process design kit (PDK) and technology files. All of this infrastructure is built on top of the technology foundation, and each technology needs its own design infrastructure to be usable for designers. This is the concept of our technology platforms.

For years, we and our alliance partners have spent considerable effort, time and resources to build our technology platforms. We unveiled an open innovation platform® (OIP) initiative in 2008 to further enhance our technologies offerings. More OIP deliverables were introduced in 2013. In the design methodology area, we announced the release of 16-nanometer Fin Field-Effect Transistor (FinFET) and three dimensional integrated circuit (3D-IC) reference flows for design enablement through OIP.

Multi-project Wafers Program (CyberShuttle). To help our customers reduce costs, we offer a dedicated multi-project wafer processing service that allows us to provide multiple customers with circuits produced with the same mask. This program reduces mask costs by a very significant amount, resulting in accelerated time-to-market for our customers. We have extended this program to all of our customers and library and intellectual property partners using our broad selection of process technologies, ranging from the latest 20-, 28-, 40-, 45-, 55- and 65-nanometer processes to 0.18-, 0.25-, 0.35- and 0.5-micron. This extension offers a routinely scheduled multi-project wafer run to customers on a shared-cost basis for prototyping and verification.

We developed our multi-project wafer program in response to the current system-on-chip development methodologies, which often require the independent development, prototyping and validation of several intellectual properties before they can be integrated onto a single device. By sharing mask costs among our customers to the extent permissible, the system-on-chip supplier can enjoy reduced prototyping costs and greater confidence that the design will be successful.

Customer Service

We believe that our dedication to customer service has been an indispensable factor in attracting new customers, helping to ensure the satisfaction of existing customers, and building a mutually beneficial relationship with our customers. The key elements are our:

- customer-oriented culture through multi-level interaction with customers;
- ability to deliver products of consistent quality, competitive ramp-up speed and fast yield improvement;
- responsiveness to customer s issues and requirements, such as engineering change and special wafer handling requests;
- flexibility in manufacturing processes, supported by our competitive technical capability and production planning;
- dedication to help reduce customer costs through collaboration and services, such as our multi-project wafer program, which combines multiple designs on a single mask set for cost-saving; and
- availability of our online service which provides real-time necessary information in design, engineering and logistics to ensure seamless services to our customers throughout product life cycle.

We also conduct an annual customer satisfaction survey to assess customer satisfaction and to ensure that their needs are adequately understood and addressed. Continual improvement plans based upon customer feedback are an integral part of this business process. We use data derived from the survey as a key indicator of our corporate performance as well as a leading indicator of future performance. We believe that satisfaction leads to better customer relationships, which would result in more business opportunities.

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Research and Development

The semiconductor industry is characterized by rapid changes in technology, frequently resulting in the introduction of new technologies to meet customers demands and in the obsolescence of recently introduced technology and products. We believe that, in order to stay technologically ahead of our competitors and to maintain our market position in the foundry segment of the semiconductor industry, we need to maintain our position as a technology leader not only in the foundry segment but in the semiconductor industry in general. We spent NT$40,387 million and NT$47,952 million (US$1,608 million) in 2012 and 2013, respectively, on research and development, which represented 8.0% of our net revenue for both periods. We plan to continue to invest significant amounts on research and development in 2014, with the goal of maintaining a leading position in the development of advanced process technologies. Our research and development efforts have allowed us to provide our customers access to certain advanced process technologies, such as 45-nanometer, 40-nanometer, 28-nanometer and 20-nanometer technology for volume production, prior to the implementation of those advanced process technologies by many integrated device manufacturers and our competitors. In addition, we expect to advance our process technologies further down to 16/10-nanometer and below in the coming years to maintain our technology leadership. We will also continue to invest in research and development for our mainstream technologies offerings to provide function-rich process capabilities to our customers. Our research and development efforts are divided into centralized research and development activities and research and development activities undertaken by each of our fabs. Our centralized research and development activities are principally directed toward developing new Logic, system-on-chip (SOC), derivatives and package/system-in-package (SIP) technologies, and cost-effective 3D-IC Chip on Wafer on Substrate (CoWoS) solutions. Fab-related research and development activities mostly focus on upgrading the manufacturing process technologies.

In continuing to advance our process technologies, we intend to rely primarily on our internal engineering capability and know-how and our research and development efforts, including collaboration with our customers, equipment vendors and research and development consortia.

We also continuously create in-house inventions and know-how. Since our inception, we have applied for and have been issued a substantial number of United States and other patents, the majority of which are semiconductor-related.

Equipment

The quality and technology of the equipment used in the semiconductor manufacturing process are important in that they effectively define the limits of our process technologies. Advances in process technologies cannot be brought about without commensurate advances in equipment technology. To accelerate the development of next-generation lithographic technology, in August 2012 TSMC joined the ASML Holding N.V. Customer Co-Investment Program. The program s scope includes development of extreme ultraviolet (EUV) lithography technology and 450mm lithography tools. Under the agreement with ASML, TSMC made an investment of EUR838 million to acquire 5% of ASML s equity, and has committed EUR276 million, to be spread over five years, to ASML s research and development program.

The principal pieces of equipment used by us to manufacture semiconductors are scanners, cleaners and track equipment, inspection equipment, etchers, furnaces, wet stations, strippers, implanters, sputterers, chemical vapor deposition (CVD) equipment, testers and probers. Other than certain equipment under leases located at testing areas, we own all of the equipment used at our fabs.

In implementing our capacity management and technology advancement plans, we expect to make significant purchases of equipment required for semiconductor manufacturing. Some of the equipment is available from a limited number of vendors and/or is manufactured in relatively limited quantities, and certain equipment has only recently been developed. We believe that our relationships with our equipment suppliers are good and that we have enjoyed the advantages of being a major purchaser of semiconductor fabrication equipment. We work closely with manufacturers to provide equipment customized to our needs for certain advanced technologies.

Raw Materials

Our manufacturing processes use many raw materials, primarily silicon wafers, chemicals, gases and various types of precious metals. Raw materials costs constituted 13.6% and 12.5% of our net revenue in 2012 and 2013, respectively. Although most of our raw materials are available from multiple suppliers, some materials are purchased through sole-sourced vendors. Our raw material procurement policy is to select only those vendors who have demonstrated quality control and reliability on delivery time and to maintain multiple sources for each raw material whenever possible so that a quality or delivery problem with any one vendor will not adversely affect our operations. The quality and delivery performance of each vendor is evaluated quarterly and quantity allocations are adjusted for subsequent periods based on the evaluation.

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The most important raw material used in our production is silicon wafers, which is the basic raw material from which integrated circuits are made. The principal suppliers for our wafers are Shin-Etsu Handotai and SUMCO Corporation of Japan, MEMC Electronic Materials, Inc. of the United States, Siltronic AG of Germany and Formosa Sumco Technology Corporation of Taiwan. Together they supplied approximately 94.2% and 93.3% of our total wafer needs in 2012 and 2013, respectively. We have in the past obtained, and believe we will continue to be able to obtain, a sufficient supply of wafers. Please see Item 3. Key Information - Risk Factors - Risks Relating to Our Business for a discussion of the risk related to raw materials. In order to secure a reliable and flexible supply of high quality wafers, we have entered into long-term agreements and intend to continue to develop strategic relationships with major wafer vendors to cover our anticipated wafer needs for future years. Also, we actively address supply chain issues and bring together fab operations, materials management, quality system and risk management teams to mitigate potential supply chain risks and enhance supply chain agility. This taskforce works with our primary suppliers to review their business continuity plans, qualify their dual-plant materials, prepare safety inventories, improve the quality of their products and manage the supply chain risk of their suppliers.

Competition

We compete internationally and domestically with foundry service providers, as well as with integrated device manufacturers that devote a significant or exclusive portion of their manufacturing capacity to foundry operations. We compete primarily on the basis of process technologies, manufacturing excellence and customer trust. The level of competition differs according to the process technologies involved. For example, in more mature technologies, the competition tends to be more intense. Some companies compete with us in selected geographic regions or application end markets. In recent years, substantial investments have been made by others to establish new foundry capacities worldwide, or to transform certain manufacturing operations of integrated device manufacturers (IDMs) into foundry capacities to compete with us.

Environmental Regulations

The semiconductor production process generates gaseous chemical wastes, liquid wastes, wastewater and other industrial wastes in various stages of the manufacturing process. We have installed in our fabs various types of pollution control equipment for the treatment of gaseous chemical wastes and wastewater and equipment for the recycling of treated water. Operations at our fabs are subject to regulation and periodic monitoring by the R.O.C. Environmental Protection Administration, the U.S. Environmental Protection Agency and the State Environmental Protection Administration of mainland China, and local environmental protection authorities, including the various science park administrations in the R.O.C., the Washington State Department of Ecology and the Shanghai Environmental Protection Bureau.

We have adopted pollution control measures that are expected to result in the effective maintenance of environmental protection standards consistent with the practice of the semiconductor industry in Taiwan, the U.S. and mainland China. We conduct environmental audits at least once annually to ensure that we are in compliance in all material respects with, and we believe that we are in compliance in all material respects with, applicable environmental laws and regulations. An environmental, safety and health (ESH) team operates at the corporate level that is responsible for policy establishment and enforcement, coordination with ESH teams located at each manufacturing facility and for coordinating and interacting with government agencies worldwide.

Electricity and Water

We use electricity supplied by the Taiwan Power Company in our manufacturing process. Businesses in the Hsinchu Science Park, Southern Taiwan Science Park and Central Taiwan Science Park, such as ours, enjoy preferential electricity supply. We have occasionally suffered power outages or surges caused by difficulties encountered by the Taiwan Power Company, which have led to interruptions in our production schedule. The semiconductor manufacturing process also uses extensive amounts of fresh water. Due to the growth of manufacturers in the Hsinchu Science Park, Southern Taiwan Science Park and Central Taiwan Science Park, and the droughts that Taiwan experiences from time to time, there is concern regarding future availability of sufficient fresh water and the potential impact that insufficient water supplies may have on our semiconductor production. To help address these potential shortages, we have adopted various natural resources conservation methodologies.

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Risk Management

We employ an enterprise risk management system to integrate the prevention and control of risk that we or our subsidiaries may face. We have also prepared emergency response and business continuity plans to respond to natural disasters and other disruptive events that could interrupt the operation of our business. These plans have been developed in order to prevent or minimize the loss of personnel or damage to our facilities, equipment and machinery caused by natural disasters and other disruptive events. We also maintain insurance with respect to our facilities, equipment and inventories. The insurance for the fabs and their equipment covers, subject to some limitations, various risks, including fire, typhoons, earthquakes and other risks generally up to the respective policy limits for their replacement values and lost profits due to business interruption. In addition, we have insurance policies covering losses with respect to the construction of all our fabs. Equipment and inventories in transit are also insured. No assurance can be given, however, that insurance will fully cover any losses and our emergency response plans will be effective in preventing or minimizing losses in the future. To further help mitigate our major operational and financial risks, our enterprise risk management (ERM) group reports regularly to our Audit Committee composed of independent board directors.

For further information, please see detailed risk factors related to the impact of climate change regulations and international accords, and business trends on our operations in Item 3. Key Information - Risk Factors - Risks Relating to Our Business .

Our Subsidiaries and Affiliates

Vanguard International Semiconductor Corporation (VIS). In 1994, we, the R.O.C. Ministry of Economic Affairs and other investors established VIS, then an integrated dynamic random access memory (DRAM) manufacturer. VIS commenced volume commercial production in 1995 and listed its shares on the GreTai Securities Market in March 1998. In 2004, VIS completely terminated its DRAM production and became a dedicated foundry company. As of February 28, 2014, we owned approximately 39.3% of the equity interest in VIS. On April 14, 2014, we sold 82 million common shares of VIS. After this sale, we owned approximately 33.7% of the equity interest in VIS. Please see Item 7. Major Shareholders and Related Party Transactions for a further discussion.

WaferTech in the United States. In 1996, we entered into a joint venture called WaferTech (of which the manufacturing entity is Fab 11) with several U.S.-based investors to construct and operate a US$1.2 billion foundry in the United States. Initial trial production at WaferTech commenced in July 1998 and commercial production commenced in October 1998. As of February 28, 2014, we owned 100% of the equity interest in WaferTech.

Systems on Silicon Manufacturing Company Pte. Ltd. (SSMC). In March 1999, we entered into an agreement with Philips and EDB Investment Pte. Ltd. to found a joint venture, SSMC, and build a fab in Singapore. The SSMC fab commenced production in December 2000. As of February 28, 2014, we owned approximately 38.8% of the equity interest in SSMC. Please see Item 7. Major Shareholders and Related Party Transactions for a further discussion.

Global Unichip Corporation (GUC). In January 2003, we acquired a 52.0% equity interest in GUC, a System-on-Chip (SoC) design service company that provides large scale SOC implementation services. GUC has been listed on Taiwan Stock Exchange since November 3, 2006. Since July 2011, we were no longer deemed to be a controlling entity of GUC and its subsidiaries due to the termination of a Shareholders Agreement. As a result, we no longer consolidated GUC and its subsidiaries in our financial statements. As of February 28, 2014, we owned approximately 34.8% of the equity interest in GUC.

TSMC China. In August 2003, we established TSMC China (of which the manufacturing entity is Fab 10), a wholly-owned subsidiary primarily engaged in the manufacturing and selling of integrated circuits. TSMC China commenced production in late 2004.

VisEra Technologies Company, Ltd. (VisEra). In October 2003, we and OmniVision Technologies Inc., entered into a shareholders agreement to form VisEra Technologies Company, Ltd., a joint venture in Taiwan, for the purpose of providing back-end manufacturing service. As of February 28, 2014, we owned approximately 42.7% of the equity interest in VisEra Technologies Company Ltd.

Xintec, Inc. (Xintec). In January 2007, we acquired a 51.2% equity interest in Xintec, a supplier of wafer level packaging service, to support our CMOS image sensor manufacturing business. Since June 2013, we were no longer deemed to be a controlling entity of Xintec due to the addition of independent directors to Xintec s board, which resulted in our appointed directors on its board representing less than a majority. As a result, we no longer consolidated Xintec in our financial statements. As of February 28, 2014, we owned approximately 40.2% equity interest in Xintec.

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Motech Industries, Inc. (Motech). In February 2010, we acquired a 20.0% equity interest in Motech, a Taiwan solar cell manufacturer. Motech has been a publicly traded company on Taiwan s GreTai Security Market since May 2003. In August 2011, we transferred our 20.0% equity interest in Motech to TSMC Solar Ltd. As of February 28, 2014, we owned approximately 19.7% equity interest in Motech.

TSMC Solar Ltd. (TSMC Solar). We transferred our solar businesses into our subsidiary, TSMC Solar, in August 2011. TSMC Solar is engaged in research, development, design, manufacture and sales of technologies and products related to renewable energy and energy saving. As of February 28, 2014, we owned approximately 99.0% equity interest in TSMC Solar.

TSMC Solid State Lighting Ltd. (TSMC SSL). We transferred our solid state lighting businesses into our subsidiary, TSMC SSL, in August 2011. TSMC SSL is engaged in research, development, design, manufacture and sales of solid state lighting devices and related application products and systems. As of February 28, 2014, we owned approximately 93.4% equity interest in TSMC SSL.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEWS AND PROSPECTS

Overview

We manufacture a variety of semiconductors based on designs provided by our customers. Our business model is commonly called a dedicated semiconductor foundry. The foundry segment of the semiconductor industry as a whole experienced rapid growth over the last 27 years since our inception. As the leader of the foundry segment of the semiconductor industry, our net revenue and net income attributable to shareholders of the parent were NT$506,745 million and NT$159,481 million in 2012 and NT$597,024 million (US$20,014 million) and NT$183,978 million (US$6,167 million) in 2013, respectively. Our net revenue in 2013 increased by 17.8% from 2012, mainly due to continuous growth in customer demand and increase in sales of our 28-nanometer products, which commanded a higher selling price.

The principal source of our revenue is wafer fabrication, which accounted for approximately 93.9% of our net revenue in 2013. The rest of our net revenue was majorly derived from mask making, design, and royalty income. Factors that significantly impact our revenue include:

- the worldwide demand and capacity supply for semiconductor products;
- pricing;
- capacity utilization;
- availability of raw materials and supplies;
- technology migration; and
- fluctuation in foreign currency exchange rate.

Though equally important, three of the above factors are discussed as follows:

Pricing. We establish pricing levels for specific periods of time with our customers, usually subject to adjustment during the course of that period to take into account market developments and other factors. Not all prices are subject to such adjustments though. We believe that our

large capacity, flexible manufacturing capabilities, focus on customer service and ability to deliver high yields in a timely manner have contributed to our ability to obtain premium pricing for our wafer production.

Production Capacity. We currently own and operate our semiconductor manufacturing facilities, the aggregate production capacity for which had been expanded from 1,334,502 200mm equivalent wafers per month as of the end of 2012 to 1,450,463 200mm equivalent wafers per month as of the end of 2013.

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Technology Migration.

Our operations utilize a variety of process technologies, ranging from mainstream process technologies of 0.5 micron or above circuit resolutions to advanced process technologies of 28-nanometer circuit resolutions. The table below presents a breakdown of wafer revenue by circuit resolution during the last two years:

	Year ended December 31,	
	2012	2013
Resolution	Percentage of total wafer revenue[1]	Percentage of total wafer revenue[1]
28-nanometer	12%	30%
40/45-nanometer	27%	20%
65-nanometer	23%	16%
90-nanometer	9%	8%
0.11/0.13 micron	6%	4%
0.15 micron	4%	4%
0.18 micron	11%	12%
0.25 micron	4%	3%
0.35 micron	2%	2%
³0.5 micron	2%	1%
Total	100%	100%

(1) Percentages represent wafer revenue by technology as a percentage of total revenue from wafer revenue, which excludes revenue associated with mask making, design, royalty income, etc. Total wafer revenue excludes sales returns and allowances.

First-Time Adoption of IFRSs

On May 14, 2009, the R.O.C. FSC announced that all companies with shares listed on the TWSE, including us, were required to prepare the consolidated financial statements in accordance with the IFRSs adopted for use in Taiwan (Taiwan-IFRSs) starting January 1, 2013, with a transition date of January 1, 2012. We have prepared and reported our consolidated financial statements under Taiwan-IFRSs and published such financial statements as required under the applicable regulations and listing rules of the TWSE since the first quarter of 2013. Prior to 2013, we prepared and reported our consolidated financial statements in accordance with R.O.C. GAAP.

In addition, for our continuing US SEC reporting obligations, we are required to report our financial statements under IFRSs as issued by the IASB. See note 42 to our consolidated financial statements for the explanation of how the transition from R.O.C. GAAP to IFRSs has affected the reported financial position, financial performance, and cash flows.

Critical Accounting Policies And Judgments

Summarized below are our accounting policies that we believe are important to the portrayal of our financial results and also involve the need for management to make estimates about the effect of matters that are uncertain in nature. Actual results may differ from these estimates, judgments and assumptions. Certain accounting policies are particularly critical because of their significance to our reported financial results and the possibility that future events may differ significantly from the conditions and assumptions underlying the estimates used and judgments made by our management in preparing our financial statements. The following discussion should be read in conjunction with the consolidated financial statements and related notes, which are included in this annual report.

Revenue Recognition. We recognize revenue from the sale of goods when the goods are delivered and titles have passed, at which time all the following conditions are satisfied:

We have transferred to the buyer the significant risks and rewards of ownership of the goods;

We retain neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

The amount of revenue can be measured reliably;

It is probable that the economic benefits associated with the transaction will flow to us; and

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The costs incurred or to be incurred in respect of the transaction can be measured reliably.

We record a provision for estimated future returns and other allowances in the same period the related revenue is recorded. Provision for estimated sales returns and allowances is generally made and adjusted at a specific percentage based on historical experience, management judgment, and any known factors that would significantly affect the returns and allowances, and our management periodically reviews the adequacy of the percentage used. However, because of the inherent nature of estimates, actual returns and allowances could be different from our estimates. If the actual returns are greater than our estimated amount, we could be required to record an additional provision, which would have a negative impact on our recorded revenue and gross margin.

As of December 31, 2012 and 2013, the provision recorded as the deduction of revenue was NT$7,187 million and NT$6,633 million (US$223 million), respectively, representing 1.4% and 1.1% of our gross revenue for the years ended December 31, 2012 and 2013.

Allowance for Doubtful Accounts. We assess the allowance for doubtful accounts by examining our historical collection experience and current trends in the credit quality of our customers as well as our internal credit policies. If economic conditions or financial conditions of our customers deteriorate, additional allowance may be required in the future and such additional allowance would increase our operating expenses and therefore reduce our operating income and net income.

We evaluate indication of impairment of accounts receivable based on an individual and collective basis at the end of each reporting period. When objective evidence indicates that the estimated future cash flow of accounts receivable decreases as a result of one or more events that occurred after the initial recognition of the accounts receivable, such accounts receivable are deemed to be impaired.

Because of the short average collection period, the amount of the impairment loss recognized is the difference between the carrying amount of accounts receivable and estimated future cash flows without considering the discounting effect. Changes in the carrying amount of the allowance account are recognized as bad debt expense which is recorded in the operating expenses - general and administrative. When accounts receivable are considered uncollectable, the amount is written off against the allowance account.

As of December 31, 2012 and 2013, the allowance set aside for doubtful receivables was NT$480 million and NT$487 million (US$16 million), respectively, representing 0.8% and 0.7% of our gross notes and accounts receivables as of those dates.

Inventory valuation. Inventories are stated at the lower of cost or net realizable value for finished goods, work-in-progress, raw materials, supplies and spare parts. Inventory write-downs are made on an item-by-item basis, except where it may be appropriate to group similar or related items.

A significant amount of our manufacturing costs are fixed because our extensive manufacturing facilities (which provide us such large production capacity) require substantial investment to construct and are largely fixed-cost assets once they become operational. When the capacity utilization increases, the fixed manufacturing costs are spread over a larger amount of output, which would lower the inventory cost per unit thereby improving our gross margin.

We evaluate our ending inventory based on standard cost under normal capacity utilization, and reduce the carrying value of our inventory when the actual capacity utilization is higher than normal capacity utilization. No adjustment is made to the carrying value of inventory when the actual capacity utilization is at or lower than normal capacity utilization. Normal capacity utilization is established based on historic loadings compared to total available capacity in our wafer manufacturing fabs.

Due to rapid technology changes, we also evaluate our ending inventory and reduce the carrying value of inventory for estimated obsolescence and unmarketable inventory by an amount that is the difference between the cost of the inventory and the net realizable value. The net realizable value of the inventory is mainly determined based on assumptions of future demand within a specific time horizon, which is generally 180 days or less.

Realization of Deferred Income Tax Assets. When we have net operating loss carry forwards, investment tax credits or temporary differences in the amount of tax recorded for tax purposes and accounting purposes, we may be able to reduce the amount of tax that we would otherwise be required to pay in future periods. We generally recognize deferred tax assets to the extent that it is probable that sufficient taxable benefits will be available to utilize. The income tax benefit or expense is recorded when there is a net change in our total deferred tax assets and liabilities in a period. The ultimate realization of the deferred tax assets depends upon the generation of future taxable income during the periods in which the net operating losses and temporary differences become deductible or the investment tax credits may be utilized. Specifically, our realization of deferred income tax assets is impacted by our expected future revenue growth and profitability, tax holidays, Alternative Minimum Tax (AMT), 10% tax imposed on unappropriated earnings and the amount of tax credits that can be utilized within the statutory period. In determining the amount of deferred tax assets as of December 31, 2013, we considered past performance, the general outlook of the semiconductor industry,

business conditions, future taxable income and prudent and feasible tax planning strategies.

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Because the determination of the amount of realization of the deferred tax assets is based, in part, on our forecast of future profitability, it is inherently uncertain and subjective. Changes in market conditions and our assumptions may cause the actual future profitability to differ materially from our current expectation, which may require us to increase or decrease the realization of the deferred tax assets that we have recorded. As of December 31, 2012 and 2013, the deferred tax assets were NT$13,111 million and NT$7,145 million (US$240 million), respectively. The deferred tax assets decreased by NT$5,966 million in 2013, mainly due to the utilization of the deferred tax assets relating to investment tax credits.

Impairment of Tangible and Intangible Assets Other than Goodwill. We assess the impairment of tangible and intangible assets other than goodwill whenever triggering events or changes in circumstances indicate that the asset may be impaired and carrying value may not be recoverable. Our tangible and intangible assets other than goodwill subject to this evaluation include property, plant and equipment and amortizable intangible assets.

Indicators we consider important which could trigger an impairment review include, but are not limited to, the following:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or our overall business strategy; and
- significant unfavorable industry or economic trends.

When we determine that the carrying value of tangible and intangible assets may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment for tangible and intangible assets based on a projected future cash flow. If the tangible or intangible assets are determined to be impaired, we recognize an impairment loss through a charge to our operating results to the extent the recoverable amount, measured at the present value of discounted cash flows attributable to the assets, is less than their carrying value. Such cash flow analysis includes assumptions about expected future economic and market conditions, the applicable discount rate, and the future revenue generation from the use or disposition of the assets. We also perform a periodic review to identify assets that are no longer used and are not expected to be used in future periods and record an impairment charge to the extent that the carrying amount of the tangible and intangible assets exceeds the recoverable amount. If the recoverable amount subsequently increases, the impairment loss previously recognized will be reversed to the extent of the increase in the recoverable amount, provided that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years.

The process of evaluating the potential impairment of tangible and intangible assets other than goodwill requires significant judgment. We are required to review for impairment groups of assets related to the lowest level of identifiable independent cash flows. Due to our asset usage model and the interchangeable nature of our semiconductor manufacturing capacity, we must make subjective judgment in determining the independent cash flows that can be related to specific asset groups. In addition, because we must make subjective judgment regarding the remaining useful lives of assets and the expected future revenue and expenses associated with the assets, changes in these estimates based on changed economic conditions or business strategies could result in material impairment charges in future periods. Our projection for future cash flow is generally lower during periods of reduced earnings. As a result, an impairment charge is more likely to occur during a period when our operating results are already otherwise depressed.

For purposes of evaluating the recoverability of tangible and intangible assets other than goodwill, assets purchased for use in the business but subsequently determined to have no future economic benefits are written down to their recoverable amount. For the years ended December 31, 2012 and 2013, we recognized the impairment loss of NT$445 million and nil, respectively. As of December 31, 2012 and 2013, net tangible and intangible assets amounted to NT$622,998 million and NT$798,529 million (US$26,769 million), respectively.

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Impairment of Goodwill. Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business less accumulated impairment losses, if any. We assess the impairment of goodwill on an annual basis, or more frequently when there is an indication that goodwill may be impaired. Indicators we consider important which could trigger an impairment review include, but are not limited to, the following:

- significant decline in our stock price for a sustained period; and
- significant decline in our market capitalization relative to net book value.

Application of the goodwill impairment test is also highly subjective and requires significant judgment, including the identification of cash generating units, assigning assets and liabilities to the relevant cash generating units, assigning goodwill to the relevant cash generating units, and determining the recoverable amount of the relevant cash generating units. Our assessment of recoverable amount is based upon a cash flow analysis that includes assumptions about expected future operating performance, such as revenue growth rates and operating margins, risk-adjusted discount rates, future economic and market conditions, and determination of appropriate market comparables. The recoverable amount of the cash generating units is compared to the associated carrying value including goodwill and an impairment charge is recorded to the extent, if any, that the carrying value exceeds the recoverable amount.

Goodwill recorded from the acquisition of TSMC-Acer and WaferTech is evaluated for impairment on an annual basis. Based on our most recent evaluation, the recoverable amount calculated by discounting projected cash flow in five years was higher than the associated carrying value. As a result, we did not record any impairment charge. As of December 31, 2012 and 2013, goodwill amounted to NT$5,524 million and NT$5,627 million (US$189 million), respectively. The change in the NT dollar amount of goodwill was due to changes in the exchange rate between NT dollar and U.S. dollar.

Impairment assessment on investments accounted for using equity method. We assess the impairment of investments accounted for using equity method whenever triggering events or changes in circumstances indicate that an investment may be impaired and its carrying value may not be recoverable. The recoverable amount is determined by taking into consideration the discounted cash flow projections of the investee and the investee s market price, if available. The underlying assumptions of the future cash flow projections of the investees are formulated by the investees internal management team, taking into account market conditions for the industries which the investees operate in to ensure the reasonableness of such assumptions. An impairment charge is recorded to the extent, if any, that the carrying amount of the investments accounted for using equity method exceeds the recoverable amount. If the recoverable amount subsequently increases, the impairment loss previously recognized will be reversed to the extent of the increase in the recoverable amount.

In 2012, an impairment loss of NT$1,187 million was recorded from a certain invested company. In 2013, because the recoverable amount of the aforementioned investment had increased to be higher than its carrying amount before the 2012 impairment, the impairment loss of NT$1,187 million recognized in prior year was reversed. As of December 31, 2012 and 2013, investments accounted for using equity method amounted to NT$23,367 million and NT$28,157 million (US$944 million), respectively.

Accounting for investments in private and publicly-traded securities. We hold equity interests in companies, some of which are publicly traded and have highly volatile share prices. We also hold investments in debt securities. We review all of our investments for impairment on a quarterly basis and record an impairment charge when we believe an investment has experienced a significant or prolonged decline in fair value. Determining whether a significant or prolonged decline in fair value of the investment has occurred is highly subjective. Such evaluation is dependent on the specific facts and circumstances. Factors we consider include, but are not limited to, the following: the market value of the security in relation to its cost basis, the duration of the decline in fair value, the financial condition of the investees and our intent and ability to retain the investment for a sufficient period of time to allow for recovery in the market value of the investment. Impairment reviews with respect to private security investments also require significant judgment. Factors indicative of a significant or prolonged decline in fair value include recurring operating losses, credit defaults and subsequent rounds of financing at valuation below the cost basis of the investment.

We have experienced declines in the fair value of certain privately held investments and publicly traded securities and recorded impairment loss of NT$3,045 million and NT$1,540 million (US$52 million) in 2012 and 2013, respectively. While we have recognized all declines that are currently believed to be significant or prolonged as a charge to income, adverse changes in market conditions or poor operating results of underlying investments could result in further losses in future periods.

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Recognition and Measurement of Defined Benefit Plans. We use the Projected Unit Credit Method for accrued pension costs and the resulting pension expenses under defined benefit pension plans. The discount rate, rate of employee turnover, and long-term average future salary increase are included in actuarial assumptions. The discount rate assumption is determined by reference to yields on government bonds of appropriate duration at the end of the maturity of the pension benefits. We assume the average remaining years of service and rate of increase in compensation levels based on historical data. Due to changing market and economic conditions, the underlying key assumptions may differ from actual developments and may lead to significant changes in pension and defined benefit obligations.

As of December 31, 2012 and 2013, the accrued pension costs were NT$6,781 million and NT$6,802 million (US$228 million), respectively.

Results of Operations

The following table sets forth, for the periods indicated, certain financial data from our consolidated statements of profit or loss and other comprehensive income, expressed in each case as a percentage of net revenue:

	For the year ended December 31,	
	2012	**2013**
Net revenue	100.0%	100.0%
Cost of revenue	(51.8)%	(52.9)%
Gross profit	48.2%	47.1%
Operating expenses		
Research and development	(8.0)%	(8.0)%
General and administrative	(3.4)%	(3.1)%
Marketing	(0.9)%	(0.8)%
Total operating expenses	(12.3)%	(11.9)%
Other operating income and expenses, net	(0.1)%	0.0%
Income from operations	35.8%	35.2%
Income before income tax	35.8%	36.2%
Income tax expense	(4.4)%	(5.4)%
Net income	31.4%	30.8%
Other comprehensive income for the period, net of income tax	0.9%	2.7%
Total comprehensive income for the period	32.3%	33.5%
Net income attributable to shareholders of the parent	31.5%	30.8%
Net loss attributable to noncontrolling interests	(0.1)%	(0.0)%

Year to Year Comparisons

Net Revenue and Gross Margin

	For the year ended December 31,			% Change
	2012	**2013**		**from 2012**
	NT$	**NT$**	**US$**	
	(in millions, except percentages)			
Net revenue	506,745	597,024	20,014	17.8%
Cost of revenue	(262,592)	(315,642)	(10,581)	20.2%
Gross profit before unrealized gross profit on sales to associates	244,153	281,382	9,433	15.2%
Unrealized gross profit on sales to associates	(25)	(21)	(1)	(16.0)%

Gross profit	244,128	281,361	9,432	15.3%
Gross margin percentage	48.2%	47.1%	47.1%	

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Net Revenue

Our net revenue in 2013 increased by 17.8% from 2012, which was largely attributable to continuing growth in customer demand, resulting in a 11.5% increase in wafer shipments. We shipped approximately 15.7 million 200mm equivalent wafers in 2013 compared to 14.0 million in 2012. In addition, sales of our 28-nanometer products, which commanded a higher selling price, also increased to 30% of our total wafer revenue in 2013 compared to 12% in 2012.

Gross Margin

Our gross margin fluctuates with the level of capacity utilization, price change and product mix, among other factors. In 2013, our gross margin was 47.1%, down 1.1 percentage points from 2012, mainly reflecting lower capacity utilization.

Operating Expenses

	For the year ended December 31,			
	2012	2013		% Change from 2012
	NT$	NT$	US$	
	(in millions, except percentages)			
Research and development	40,387	47,952	1,608	18.7%
General and administrative	17,633	18,882	633	7.1%
Marketing	4,497	4,505	151	0.2%
Total operating expenses	62,517	71,339	2,392	14.1%
Percentage of net revenue	12.3%	11.9%	11.9%	
Other operating income and expenses, net	(449)	47	2	
Income from operations	181,162	210,069	7,042	16.0%
Operating Margin	35.8%	35.2%	35.2%	

Operating expenses increased by NT$8,822 million in 2013, or 14.1%, from NT$62,517 million in 2012.

Research and Development Expenses

We remain strongly committed to being the leader in developing advanced process technologies. We believe that continuing investments in process technologies are essential for us to remain competitive in the markets we serve. Research and development expenditures increased by NT$7,565 million in 2013, or 18.7%, from $40,387 million in 2012, mainly due to a higher level of research activities for 16-nanometer and 10-nanometer technologies, partially offset by decreased research activities for 20-nanometer. We plan to continue to invest a significant amount in research and development in 2014.

General and Administrative and Marketing Expenses

General and administrative, and marketing expenses in 2013 increased by NT$1,257 million, or 5.7%, from 2012, mainly due to higher opening expenses for ramping up 20-nanometer capacity.

Non-Operating Income and Expenses

	For the year ended December 31,	
	2012	2013

	NT$	NT$	US$	% Change from 2012
	(in millions, except percentages)			
Share of profits of associates and joint venture	2,073	3,807	128	83.6%
Other income	1,716	2,342	79	36.5%
Foreign exchange gain, net	582	285	10	(51.0)%
Finance costs	(1,020)	(2,646)	(89)	159.4%
Other gains and losses	(2,852)	2,105	70	
Net non-operating income (expenses)	499	5,893	198	1,081.0%

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Net non-operating income in 2013 increased by NT$5,394 million, or 1,081.0% from NT$499 million in 2012 primarily attributable to a lower impairment loss of NT$3,879 million recognized for financial assets. Please see Item 5- Critical Accounting Policies And Judgments - Impairment assessment on investments accounted for using equity method where the improvement of the financial condition of an invested company allowed us to reverse an impairment loss recorded in 2012. The increase is also attributable to a smaller impairment loss in private and publicly-traded securities. See Item 5- Critical Accounting Policies And Judgments - Accounting for investments in private and publicly-traded securities for further details. We also had a NT$1,734 million increase in share of profits of associates and joint venture investees reflecting their better operating results in 2013 and a NT$771 million increase in gains on disposal of financial assets in 2013. These increases are partially offset by a NT$1,626 million increase in finance costs due to further issuance of corporate bonds in 2013.

Income Tax Benefit (Expense)

	For the year ended December 31,			
	2012	2013		% Change from 2012
	NT$	NT$	US$	
	(in millions, except percentages)			
Income tax expense	(22,375)	(32,112)	(1,077)	43.5%
Net income	159,286	183,850	6,163	15.4%
Net income attributable to shareholders of the parent	159,481	183,978	6,167	15.4%
Net margin attributable to shareholders of the parent	31.5%	30.8%	30.8%	

Income tax expenses increased by NT$9,737 million in 2013, or 43.5%, from 2012. The increase was mainly due to higher taxable income, and effective tax rate. The effective tax rate in 2013 was higher than 2012 primarily due to an increase in AMT from 10% to 12%, and an increase in tax on unappropriated earnings as a result of higher unappropriated earnings.

Liquidity and Capital Resources

Our sources of liquidity include cash flow from operations, cash and cash equivalents, short-term investments, and revolving credit facilities provided by multiple banks. Issuance of corporate bonds is another source of fund.

Our primary source of liquidity is cash flow from operations. Cash flow from operations for 2013 was NT$347,384 million (US$11,645 million), an increase of NT$62,421 million from 2012.

Our cash, cash equivalents and short-term investments in financial instruments increased to NT$245,343 million (US$8,225 million) as of December 31, 2013, from NT$150,918 million as of December 31, 2012. The short-term investments in financial instruments primarily consist of publicly-traded stocks and money market instruments.

As of December 31, 2013, we also had aggregate unused short-term credit lines of approximately NT$76,690 million (US$2,571 million).

We believe that our cash generated from operations, cash and cash equivalents, short-term investments, ability to access capital market and revolving credit facilities will be sufficient to fund our working capital needs, capital expenditures, dividend payments and other business requirements associated with existing operations over the next 12 months.

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	For the year ended December 31,		
	2012	2013	
	NT$	NT$	US$
		(in millions)	
Net cash provided by operating activities	284,963	347,384	11,645
Net cash used in investing activities	(269,318)	(281,054)	(9,422)
Net cash generated by (used in) financing activities	(13,589)	32,106	1,076
Effect of exchange rate changes	(2,118)	849	29
Net increase (decrease) in cash	(62)	99,285	3,328

Cash and cash equivalents increased by NT$99,285 million in 2013, following a decrease of NT$62 million in 2012.

Operating Activities

In 2013, we generated NT$347,384 million (US$11,645 million) net cash from operating activities, as compared to NT$284,963 million in 2012. The increase in 2013 was primarily due to an increase of NT$34,301 million in net income before tax, an increase of NT$24,833 million in non-cash depreciation and amortization expenses, and change in working capital and others resulting in an in-flow of NT$3,287 million.

In 2013, depreciation and amortization expenses were NT$156,182 million (US$5,236 million), as compared to NT$131,349 million in 2012. The higher depreciation and amortization expenses in 2013 were mainly attributable to expansion of production capacity in advanced technologies.

Investing Activities

In 2013, net cash used in investing activities was NT$281,054 million (US$9,422 million), as compared to NT$269,318 million in 2012. The increase in 2013 was primarily due to higher spending on capital expenditures during the year, partially offset by the absence of EUR838 million investment in ASML in 2012.

Capital expenditures in 2013 were primarily related to:

- adding production capacity to 300mm wafer fabs;
- developing process technologies including 20-nanometer node and below;
- expanding buildings/facilities for Fab 12, Fab 14 and Fab 15;
- other research and development projects;
- capacity expansion for mask and backend operations; and
- solar and solid state lighting businesses.

Starting from 2012, our capital expenditures were funded by our operating cash flow and the issuance of corporate bonds. The capital expenditures for 2014 are expected to be funded mainly by our operating cash flow. See Item 3. Risk Factors section for the risks associated with the inability of raising the requisite funding for our expansion programs. Please also see Item 4. Information on the Company Capacity Management and Technology Upgrade Plans for discussion of our capacity management and capital expenditures.

Financing Activities

In 2013, net cash generated by financing activities was NT$32,106 million (US$1,076 million), as compared to net cash of NT$13,589 million used in 2012. Net cash increased in financing activities was primarily the result of higher proceeds from issuance of corporate bonds of NT$68,845 million in 2013, and the absence of corporate bonds repayment of NT$4,500 million in 2012, partially offset by a decrease of short-term loans of NT$29,383 million.

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As of December 31, 2013, our short-term loans were NT$15,645 million (US$524 million), and our aggregate long-term debt was NT$210,808 million (US$7,067 million). The short-term loans were denominated in U.S. dollars. The purpose of the short-term loans was mainly to naturally hedge a portion of our receivables. As a substantial portion of our receivables was denominated in U.S. dollars, we use short-term loans denominated in U.S. dollars to naturally hedge the fluctuation of foreign exchanges rates. See Item 11. Quantitative and Qualitative Disclosures About Market Risk for a discussion of the hedging instruments used. The long-term debt primarily included NT$210,768 million of the long-term corporate bonds with fixed interest rates ranging from 0.95% to 2.10% and tenors ranging from 3 years to 10 years.

Cash Requirements

The following table sets forth the maturity of our long-term debt (bank loans and bonds) including relevant interest payments outstanding as of December 31, 2013:

	Long-term debt (in NT$ millions)
During 2014	3,038
During 2015	3,039
During 2016	25,360
During 2017	40,636
During 2018 and thereafter	154,589

The following table sets forth information on our material contractually obligated payments (including principal and interest) for the periods indicated as of December 31, 2013:

		Payments Due by Period			
Contractual Obligations	**Total**	**Less than 1 Year**	**1-3 Years**	**4-5 Years**	**More than 5 Years**
			(in NT$ millions)		
Short-Term Loans[1]	15,647	15,647	-	-	-
Long-Term Debt[2]	226,662	3,038	28,399	100,852	94,373
Capital Lease Obligations[3]	879	28	57	794	-
Operating Leases[4]	9,447	859	1,634	1,419	5,535
Other Payments[5]	9,115	1,699	4,874	2,542	-
Capital Purchase or Other Purchase Obligations[6]	167,512	161,304	5,752	237	219
Total Contractual Cash Obligations	429,262				