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Before I turn the call over to Dr. T.Y. Chiu, let me remind you that the presentation we're making today is including forward-looking statements. These statements and other comments are not guarantees of future performance, but represent the company's estimates, and are subject to risk and uncertainty. Our actual results may differ significantly from those projected or suggested in any forward-looking statements.

For a more complete discussion of the risks and uncertainties that could impact our future operating results and financial condition, please see our filings and submissions with the US Securities and Exchange Commission and the Hong Kong Stock Exchange Limited, including our annual report on Form 20-F, filed with the US Securities and Exchange Commission on April 25, 2016.

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

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

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

Thank you, En-Ling.

Greetings to everyone. Thank you for joining us. For SMIC, Q2 was another excellent quarter, with record high revenue, record high gross profit and operating profit as well as record high net profit, and marks our 17th consecutive quarters of profitability.

Revenue reached a historical high of $690 million, a growth of 26.3% year-over-year, and 8.8% quarter-over-quarter. Gross profit and operating profit both hit all time high growing 23.5% and then 90.2% year-over-year, and 41.7% and 74.5% quarter-over-quarter.

On a quarterly basis, Q2 ROE hit 10% and our utilization was 98%. We are guiding another strong quarter of growth in Q3. In addition, we foresee continued growth in Q4 contrary to seasonality and target another record year for 2016. Demand continues to be exceedingly strong, POs are not slowing down and customer continues to demand more capacity.

With a great demand and recent acquisition of LFoundry, we now raise our annual revenue growth percentage target to mid to high 20s this year. We also raised our gross margin target to the high 20s for the year, factoring in our increased visibility and confidence in the high utilization for the rest of this year.

So what has been driving SMIC's growth? From a technology perspective, it is clear that most of the revenue growth this quarter came from 40 nano, wafer revenue from 40 nano grew 92% year-over-year and 27% quarter-over-quarter. With a surge in 40 nano demand, in particular for products single-sourced to SMIC, a lot of new capacity in Shanghai 12 inch and Beijing JV fabs are allocated to ensure our customers successful product launch.

As SMIC continues to bring on new capacities, we are now targeting 28 revenue to surpass 1% in Q3 and reaching low to mid single digit percentage by Q4. We believe this advanced node allocation arrangement is in fact, in the best interest of all our customers.

Driving our growth from an application point of view, this past quarter was primarily from applications including set top box, Bluetooth, sensors, smartphones, and networking.

From a regional perspective, growth in Q2 was primarily from our China region clients. Our China revenue grew 28.5% year-over-year and 20.1% quarter-over-quarter. There are three components to this large growth in China. The Chinese system houses winning end-product market share that are capturing market globally from their branded smartphones and networking in emerging countries to consumer emerging countries, to consumer set top box and others.

They are also innovating new devices for the Chinese consumers and increasingly designing their own ICs and partnering with foundries.

Second, Chinese fables growth is robust and they are capturing content in an increasingly diverse mix of products. As an example, Bluetooth for headphones, speakers, selfie sticks, and others are now dominated by Chinese players. As a result, SMIC has become the leading suppliers for consumer Bluetooth in China.

Third, SMIC is increasing market share with diversified technology portfolios being the preferred foundry partner in China and a strong China positioning, SMIC has effectively captured many, many opportunities.

Diversification and the differentiation of our technology continues to be a priority. We believe that this has already proven to be the right strategy for SMIC feeding us numerous new opportunities for growth, we continue to work with the new and existing customers for fresh products and new tape-outs. Some recent roll-out include SMIC's MEMS for microphone, which has entered risk production in Q2. Our production of microcontrollers using embedded flash for smartcard for home appliance, hover boards, and e-bikes.

We are now working with the customers in new area of IOT, auto, AR, and VR, since the acquisition of LFoundry, we have officially entered into the auto IC market. LFoundry manufacturers above 25% of world's auto CIS.

By combining our resources, we can continue to expand our presence in the fast-growing Auto IC market, we maintained our consolidated CapEx of $2.5 billion for the year. Shanghai 12-inch fab has already reached its installed capacity of 20,000 wafers per month. The Beijing JV fab hits 15,000 wafer per month at the end of Q2 and is targeted to attain 18,000 by year end.

We are expanding our B1 capacity leveraging on use tools from 37k now to 45k by the end of the year, mostly in 55 technology node. Our Shenzhen fab is ramping smoothly and the capacity will increase from the present 26k to the 31k by the end of the year.

We anticipate that all our newly installed capacity would have higher utilization and better productivity than anticipated throughout this year leading to our record high net margin.

On the mergers and acquisition front, we are pleased to report that we have closed LFoundry acquisition at the end of July, the challenge ahead is to identify the right products and the process to be transferred into this new JV and bring up the utilization as soon as possible.

As well as in the longer-term, to bring in technology and system alignment. We will keep you updated on this effort. As always, we are committed to the increase of shareholder value through sustainable and profitable growth.

Q2, currently, ROE reached 10%, it is our long-term target to achieve a double-digit ROE on a sustainable basis. Secondly, we are increasing value through increasing our cash generation. Our EBITDA is in fact, getting stronger, in 2015, our EBITDA margin was around 35%. We are now targeting EBITDA margin to increase over the full year of 2016 compared to 2015. Thirdly, we have efficient funding strategy to finance our capital needs, aiming for low-cost and the minimal share dilution. This include the use of JV Partnership for the expansion of advanced logic fab such as our Beijing JV.

Another method we have utilized is taking advantage of low-cost debt from domestic bond, low-interest bank loans, and others.

Fourthly, we are also exploring share buybacks. In terms of share buybacks, if our share price is below book value, we will consider share buybacks through a trust for issuing employee RSUs instead of issuing new shares which will cost -- create dilutions.

All in all, we are doing our best to expand our shareholder value through profitable growth, cash generation, and careful funding selections. In conclusion, SMIC is encountering an exciting time of great demand and growth. We are witnessing strength across the board with robust revenue growth, strong cash position, advantageous market position, enormous demand, and great opportunities.

We are working hard to balance our profitability, growth, building share value and servicing our customers for the benefit of all stakeholders. We will be on the road to continue to communicate our strategy and status to elicit our comment, we continue to appreciate your ongoing support.

Thank you.

I will now hand the call over to Yonggang for the financial highlight and the 2016 Q3 guidance.

Yonggang Gao - *Semiconductor Manufacturing International Corporation - CFO*

Okay, thank you, T.Y.

Greetings to all our listeners, I will highlight our last quarter results first, and then give our third quarter 2016 guidance.

Last quarter, our revenue gross profit, operating profit and net profit were all record high. The revenue was $690.2 million, an increase of 8.8% quarter-over-quarter exceeding our guided 3% to 7% increase. Gross profit was $217.8 million, gross margin was 31.6% exceeding our guided range from 25% to 27%.

Profit from operations were $115.4 million. Profit for the period attributable to SMIC was $97.6 million, and the China-based revenue grew to a record high of 52% of overall revenue in 2Q 2016.

Now, looking out into the third quarter of 2016. Our revenue is expected to increase by 8% to 11% quarter-over-quarter. Gross margin is expected to range from 28% to 30%. Non-GAAP operating expenses are expected to range from $140 million to $145 million.

The non-controlling interests of our majority owned subsidiaries are expected to range from positive $4 million to positive $6 million which are losses to be borne by non-controlling interests.

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

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

Thank you, Gao, and thank you everyone for joining us today.

I will now comment on the details of our last quarter financial results.

On the income statement, revenue increased to $690.2 million above the guided range, mainly because of the increase of wafer shipment. The cost of sales decreased to $472.4 million. Gross margin was 31.6% above the guided range primarily due to an insurance compensation recognizing Q2 2016 in respect of the losses incurred in Q1 2016 as a result of the power failure suspension at our Beijing fabs, two an increase in fab productivities, and three, product mix change.

Operating expenses increased to $102.4 million in Q2 2016, R&D expenses increased by $11 million quarter-on-quarter to $64.5 million, the change is mainly due to the high number of R&D activities, funding R&D contracts from the government was $12 million in Q2 2016 compared to $8 million in Q1 2016.

General and administrative expenses increased to $33.5 million mainly due to first of all, salary increase for some employees in Q2 2016 and also an increase in legal and consulting fees. Excluding the effect of employee bonus accrual, government funding and gain from disposal of living quarters. Non-GAAP operating expense were $113.4 million, below our guided range. Profit from operations increased to $115.4 million, profit for the period attributable to SMIC increased to $97.6 million while non-controlling interests were $3.2 million of credit to SMIC's attributable profits in Q2 2016.

Moving to the balance sheet at the end of the second quarter of 2016, cash and cash equivalents increased to $1.6 billion. If including other financial assets, we had approximately $1.9 billion cash on hand at the end of Q2 2016. The increase was mainly due to, first of all, capital contribution from non-controlling interest of Semiconductor Manufacturing North China Corporation in Q2 2016 as well as other capital raising activities completed during the quarter.

Our long-term borrowings increased to $1.2 billion and short term borrowings decreased o $91 million. At the end of Q2 2016, our gross debt to equity was 50.9% and our net debt to equity ratio was 12.9%. in terms of cash flow, we generated $246 million of cash from operations. We are still targeting to generate approximately $900 million of cash from operating activities this year.

Cash used in investing activities increased to $1.2 billion, cash from financing activities was $1.5 billion. To examine our revenue by application, the communications and consumer segments contributed 49.9% and 38.8% to our revenue respectively.

Geographically, revenue from China, North America and Euro Asia contributed 52%, 26.5% and 21.5% of total revenue respectively. In terms of technology, revenue from 28 nanometers contributed 0.6%, revenue from 40/45 nanometers contributed 23.1%, revenue from 55/65 nanometers and 90 nanometers contributed 20.4% and 2.3% respectively.

Meanwhile, 0.13 micron and above line contributed 53.6% of total revenue. In terms of overall capacity, total monthly capacity at the end of the second quarter increased to 339,000 8-inch equivalent wafers, an increase of 12% quarter-on-quarter.

The change was primarily because the capacity expansion of the majority owned Beijing 12-inch fab, Shanghai's 12-inch fab, and Shenzhen 8-inch fab, we reiterate our Plan 2016 capital expenditure for foundry operations to be approximately $2.5 billion, while Plan 2016 capital expenditure for non-foundry operations are approximately $50 million.

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

En-Ling Feng - *Semiconductor Manufacturing International Corporation - VP of IR*

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Your first question comes from the line of Randy Abrams from Credit Suisse. Please ask your question.

Randy Abrams - *Credit Suisse - Analyst*

Yes, thank you, this is Randy Abrams. The first question, I wanted to ask the 8-inch has been doing very well, I wanted to see how the sustainability looks just from the front, you have been tight on the capacity for an extended time, some of your Taiwan foundries are not as tight, and seem to be targeting some of the applications you've had strength such as the fingerprint sensors.

I want to see outlook just beyond this year for 8-inch, how you see the strength continuing and also the competition there?

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

I think that there are a number of areas which requires 8-inch capacity, fingerprint is one of them and PMIC, power management IC, as well as CIS. I think that there are a number of customers, new customers still requiring additional capacities in this area, so we are reasonably optimistic that the 8-inch utilization will remain tight and at the high range.

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

Randy, I just have two points add on to what T.Y. said. I think as mentioned in T.Y.'s script, I think the other area of strength we see for the 8-inch applications is in the Bluetooth area. And this area actually is basically dominated by the Chinese design company, and many of them are manufacturing in our fabs. So I think that is something that we want to highlight.

The other thing is that actually, in terms of fingerprint, I'm sure you know the biggest customer for us, but actually we are also gaining many new customers in the fingerprint area as well.

Randy Abrams - *Credit Suisse - Analyst*

Okay, great. And the other, I want to ask about the 28-nanometer, which is still very small this year. I think one strategy is to take your customers as they migrate from 40 down to 28. I'm curious if you see that happening next year, if you have an early view on ramp-up pace for next year, and how that -- just how that would change your profitability if -- existing applications migration, if you can ramp that at near similar margins or we should expect some gross margin dilution with 28 less mature.

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

As a matter of fact, we have said repeatedly, certainly our present allocation is to meet the critical demands of single source of product in the 40-nano. As we ramp up our additional capacities, we will have more resource to ramp up 28-nano products. And we think that it should have a very minimal impact on our overall profitability as we ramp the 28, since I think that we are seeing an improving performance of our 28 along the path of our expectation.

Randy Abrams - *Credit Suisse - Analyst*

Okay. Is there an early expectation for ramp on 28? I think this year you said low to mid-single-digit by fourth quarter for maybe timing to get to 10% of revenue.

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

Right now it depends very much on the trade-off on the demand of 40 and as well as the how fast we can increase our new capacity. So it is difficult to project at this point of time.

Randy Abrams - *Credit Suisse - Analyst*

Okay. My last question, about the gross margin. First, if you could quantify those three factors for gross margin, the insurance claim and the productivity, just to have a feel for the baseline excluding the insurance claim. And then if you could provide an update on the depreciation ramp following this CapEx for second half and for next year.

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

Yes. I think last quarter we guided gross margin to be 25% to 27%, and the actual result is about 31.6%. I will say about -- between 1% to 2% is actually contributed by the insurance compensation, which we did not factor into our guidance.

And then the other major reason for the improvement in gross margin is that actually our fab right now is very full, but because of this pressure, actually we see a very tremendous improvement in our fab productivity. Actually the output came out actually more than what we anticipated. So I think, thanks to our strong performance from our fabs.

And the other reason is also because of the -- there's some margin -- there's some product mix changes. Actually we are seeing us ship out more higher-margin products, compared to what we forecast earlier. So I think that contributed to the gross margin outperformance.

Randy Abrams - *Credit Suisse - Analyst*

Okay. And then, can you give an update just depreciation for second half and next year? Okay. Thank you.

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

We are looking at -- there are some changes in our equipment moving schedule. We are looking at -- right now the new forecast for the full year depreciation to be about $740 million. So we're going to see some major increase in the second half this year.

Randy Abrams - *Credit Suisse - Analyst*

Okay. Seven-fourteen, one four, seven one four?

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

Four zero.

Randy Abrams - *Credit Suisse - Analyst*

Seven four zero. Okay. Okay. Is there an early take -- after spending $2.5 billion this year, a rough feel for how much it may increase next year?

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

I don't have the number with us, but also depends on the CapEx for next year as well, so -- which I think we still have not really finalized. But right now I don't have the number for next year, yes.

Randy Abrams - *Credit Suisse - Analyst*

Okay. Thanks a lot, and good results.

Operator

Your next question comes from the line of Steven Pelayo from HSBC. Please ask your question.

Steven Pelayo - *HSBC - Analyst*

Hi guys. Congrats on the results. I guess I first want to know the LFoundry impacts in your guidance from a revenue and a margin and maybe ASP perspective.

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

Yes. LFoundry, we -- because we completed the acquisition at the end of July, so we are starting to consolidate the results from August onwards. So they would contribute two months of revenue to us in Q3, which is roughly about $20 million to $30 million. In terms of the profit contributions, because right now actually they are running at not high utilization right now, so we expect the contribution to our profit is quite minimal.

Steven Pelayo - *HSBC - Analyst*

Okay. And Gareth, year to date it looks like you had about $20 million in R&D subsidies. Last quarter you talked about that number being $60 million to $65 million for this year. Do you still think that number? Because if so, we're going to double in the second half of the year versus the first half of the year.

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

The good news is that actually we have -- get more contracts, R&D contracts from the government. We're just informed quite recently. So this year we are looking at the total R&D contract funding will reach about $72 million for the whole year.

Steven Pelayo - *HSBC - Analyst*

Okay. How is that going to split in the second half? That's pretty significant to the full year.

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

Yes. I think will be mostly concentrated in the Q4, I think.

Steven Pelayo - *HSBC - Analyst*

In 4Q. All right. And then just two last questions. Help me understand, where do you think SMIC's capital structure is going to be let's say at yearend? I'm trying to understand, more financing, debt --

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

I think we are done with most of the capital raising this year. As you can see from our balance sheet, actually we took on quite a lot of new debt this year.

Steven Pelayo - *HSBC - Analyst*

Yes.

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

And the reason we did that is because there is a very good market opportunity this year for us to raise relatively cheap debt, because a lot of debt raised this year are actually RMB debt, but right now there's macro opportunity for us to really swap this RMB debt into US dollar funding at a very low cost. Right now, maybe after swapping into our US dollar funding, is about 2% to 2.5%.

So we took this opportunity to, really, to lock in some of this low-cost funding to refinance our CapEx this year and next year.

Steven Pelayo - *HSBC - Analyst*

Okay. My last question --

En-Ling Feng - *Semiconductor Manufacturing International Corporation - VP of IR*

That's number four.

Steven Pelayo - *HSBC - Analyst*

I'm impressed with -- I'm sorry, last one, I promise. You guys have this greater than 20% revenue growth goal for the next few years with high 20s this year. You're generating $900 million in cash flow from operations, but you are still spending $2.5 billion in CapEx. I think you've been negative free cash flow for the last couple of years. When do you think you could maybe be positive free cash flow?

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

Well, this is a good question. Maybe I should -- well, I should respond another way. We believe, as we grow our revenue, I think T.Y. already set the target to be over 20% quarter on -- year over year. Our CapEx intensity would reduce, even if we maintain -- assuming we are maintaining our CapEx at a same level next year.

So we feel that -- if you ask me about getting into net cash flow positive including CapEx, I think we are still some time off, but we do think that the capital intensity would come down in next few years.

Steven Pelayo - *HSBC - Analyst*

Okay. I'll get back in the queue. Thanks guys.

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

Thank you.

Operator

Your next question comes from the line of Bill Lu from UBS. Please ask your question.

Bill Lu - *UBS - Analyst*

Yes, hi. Good morning and congrats on the good results.

Can you give me some help as far as 3Q is going to grow by about 10%, what application is driving the growth? And related to that, you said that 4Q is going to grow again. Can you tell me what gives you the confidence looking out into 4Q?

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

On Q3, let me detail for you the growth drivers here. First of all, as mentioned, we're going to consolidate LFoundry from August onwards, so there's about $20 million to $30 million contribution from LFoundry activities. And then our 40 nanometers is still growing very strong. And as what T.Y. said, many of them are single source. And then we also started to ship in greater volume for our 28 nanometers. So all this will contribute to growth in Q3. Okay.

In terms of the Q4 outlook, right now, based on the forecast from the customers, we still think that it's still going to be a growth quarter for us. And I think our fab will still be fully loaded.

Bill Lu - *UBS - Analyst*

And I guess I'm just wondering what kind of applications is driving the Q4 growth.

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

Maybe let me add a couple of added highlights. Certainly, and we have a very strong system house driving the 40-nano, and this is not only just in the smart phone but also in the other areas such as connectivity infrastructures. In addition, we are also ramping up a second very large customer in the connectivity area as well. So our 40-nano demand, we see that as a continued strong demand that will sustain this high-end growth.

Secondly, we see that-- from Europe, we continue to see a very strong demand. That as we expand our 8-inch capacity, that will be fairly highly utilized.

Bill Lu - *UBS - Analyst*

I'm just curious, that second connectivity customer, is that Chinese or non-Chinese?

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

It's a global customer.

Bill Lu - *UBS - Analyst*

Okay. Okay, got it.

So as 40 continues to drive your growth, at least in the next couple of quarters, I know depreciation is going up, but can margin still improve looking out into 4Q?

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

Yes. I think as mentioned in T.Y.'s script, right now we are targeting for the whole year the average margin to be in the high 20s.

Bill Lu - *UBS - Analyst*

Yes. But I'm just thinking logically, why shouldn't it go up in 4Q?

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

I'm sorry?

Bill Lu - *UBS - Analyst*

I'm just thinking that mix should get better and better, so it just seems to me like 4Q should even go up a little bit more.

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

Yes, but at the same time, actually our depreciation is going to increase quite substantially in the second half.

Bill Lu - *UBS - Analyst*

Okay. I guess related to that, what is your margin outlook for 2017?

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

We are still optimistic, but I think it's too early for us to guide for 2017 gross margin.

Bill Lu - *UBS - Analyst*

Okay. Can you at least help me with the moving pieces? It -- I would assume that 28 nanometers is going to start contributing, so that will be maybe somewhat negative. We should probably assume that CapEx stays at current levels. I don't know what the outlook is for your other businesses. Can you maybe kind of run me through the key variables for you?

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

Well, I think the key -- okay. The key variables impacting next year's gross margin is, first of all, the revenue growth and the fab utilization. And then also, as we mentioned, with also the product mix change because we're going to have more 28 nanometers coming into production. And also of course our depreciation will also go up next year.

But as we increase the revenue base, our OpEx as a percentage of revenue will come down. So I think there'll be some positive and negative impact. And we'll see how it's going to work out for the overall net margins.

Bill Lu - *UBS - Analyst*

Great. Thanks. One last question, on LFoundry, given that the current utilization rate is fairly low, is it fair to assume that you don't need to spend CapEx on LFoundry, at least not right now?

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

There will be a limited amount of our CapEx in LFoundry to bring technology that is aligned to SMIC. So there are a few missing tools in LFoundry that we need to procure to ensure the technology alignment. But the total CapEx for the next year will be fairly limited. We'll be trying to leverage the present unused capacity in the most efficient way.

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

Yes. Let me just also comment a little bit more on LFoundry. Right now we actually have identified some technology and products that we're going to transfer to LFoundry, that hopefully would help to bring up the utilization in the next three to four quarters. At the same time, we are also leveraging the strength of LFoundry in the auto and CIS area, to re-cross-sell the technologies to our own customer set in China. So we believe actually this acquisition will be -- would create good value for us.

Bill Lu - *UBS - Analyst*

Great. Thank you very much.

En-Ling Feng - *Semiconductor Manufacturing International Corporation - VP of IR*

Thank you.

Operator

Your next question comes from the line of Leping Huang from Nomura. Please ask your question.

Leping Huang - *Nomura - Analyst*

Okay. Thank you to taking my question. I have two questions.

First is, I see you expand your capacity very quick, for year-over-year growth by 30%, but you still maintain a very high utilization rate, close to 100%. What's the current order situation? You have much stronger order than you can deliver or how you can achieve such optimal operation status? Yes, so this is the first question.

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

So I need to pay tribute to our sales marketing team as well as our operation team. This is the first time in our history when we build our capacity and all of them are fully utilized as soon as the capacity has been available. So at this moment, still that we have a lot of orders that has not been fulfilled, and so we need to still expedite our tool installations, as well as look. And that's the reason we have to look for external expansion through merger and acquisition. And we have been very, very fortunate to find a good partner such as LFoundry.

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

So I think we want to emphasize that I think despite the increase in the CapEx in the last one year, I think the management team have not changed our philosophy, which is highly efficient in use of capital. And we feel that this is core to how we can create value for our shareholders.

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Leping Huang - *Nomura - Analyst*

Okay. So, should we expect the incoming few quarters, you still have a very high utilization rate? I think next few quarters you're still in a very fast capacity expansion phase, so that the -- so, do you expect that the, yeah, utilization will remain high during the expansion?

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

It is, emphatically, yes.

Leping Huang - *Nomura - Analyst*

Okay, great. So the second question is about the EBITDA margin. So you guide for the EBITDA margin to expand this year versus last year. So, can you also share some insight which products, which process actually drive the margin expansion for this year and how we should look for the next year's EBITDA margin outlook? Thank you.

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

Yes. I think the improvement in the EBITDA margin is really a function of the increase in scale of production. As we increase the revenue base, actually our cash cost, including OpEx, as a percentage of revenue, will come down. So, which is reflected in the higher EBITDA margin.

Leping Huang - *Nomura - Analyst*

Okay. Yes. Thank you.

Operator

Your next question comes from the line of Gokul Hariharan from JPMorgan. Please ask your question.

Gokul Hariharan - *JPMorgan - Analyst*

Yes, hi. Congrats on the great results.

My first question is on the CapEx needs and potential funding programs. As Gareth mentioned, I think we're expecting CapEx to at least stay at the similar level and potentially some added funding for M&A. Now, I think some of the Chinese, National IC Fund, et cetera, have talked about potential equipment leasing programs and stuff like that. Would you consider that as a significant component in terms of satisfying your funding requirements, or potentially aligning your timing of CapEx to revenue a little bit better, especially given we are still running at negative operating cash flow for at least looks like the next near-term future? That's my first question.

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

Yes. I think we are in a very comfortable cash situation right now. We have about $2 billion cash on hand right now. And this year we are looking at generating close to $1 billion cash from operations. And then we expect next year probably will generate similar amount of, if not more, in terms of cash flow from operations.

So -- at the same time, we are actually open to consider different types of financial opportunities, so, as it is low cost and value-added to us. And obviously we have -- we will do -- we are open to explore, for example, some leasing program with the partners as well.

Gokul Hariharan - *JPMorgan - Analyst*

And is that something that right now -- or is that something that is significantly planned into your cash -- use of cash as well as proceeds of cash, in terms of the next couple of years, or is that -- that is not something that is built into your planning?

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

As I said, we are under discussion with a partner for some leasing program. But likely, I think we'll start with a small program, and as we -- and we'll see how it goes. If it works very well for us, we'll expand the program in the future.

Gokul Hariharan - *JPMorgan - Analyst*

Okay. Great. For the 40-nanometer product, it's been a great revenue trajectory. Given that, as we mentioned, the two customers were driving a bulk of that growth, could we have a little bit of more detail in terms of what your view is in terms of when they are eventually going to migrate to 28-nanometer, as well as that eventual migration would be going to high-K metal gate or poly SiON, and -- yes.

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

Okay. I think the -- in our capacity planning, certainly right now we are making sure that capacity is used in 40-nano. Most of it can be also efficiently converted to 28. And so this will -- our setup will also be able to handle a robust 28 ramp-up.

As far as 40-nanometer demand is concerned, we see new customer coming in and there are additional customers lining up in the pipeline. So we think this is still a very robust technology node here. Certainly a lot of the customers using the 40-nano are working with us in the 28-nano transition, and indeed most of the 28-nano transition into the high-K metal gate technology.

Gokul Hariharan - *JPMorgan - Analyst*

Okay, great. Just one quick one, on inventory. Some of your peers have commented about this inventory correction going into Q4, whereas you have a view that Q4 could be still a growth quarter. I just wanted to understand whether you're factoring in overall inventory correction in the industry still into your assumption and most of your Q4 growth is coming primarily from your own market share gains? Is that how we should read it?

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

Yes, I think so. I think as far as our own customer group is concerned, we are still seeing a very strong demand from customers and we don't notice any inventory issues here.

Gokul Hariharan - *JPMorgan - Analyst*

Got it. Thanks.

En-Ling Feng - *Semiconductor Manufacturing International Corporation - VP of IR*

Thank you.

Operator

Your next question comes from the line of Charlie Chan from Morgan Stanley. Please ask your question.

Charlie Chan - *Morgan Stanley - Analyst*

Hi, good morning. Congratulations for great results.

So my first question is really on the future competition in the 28-nanometer node, because some of your industry peers like UMC is doing a joint venture with Xiamen, and HLMC, they will build up another fab for 28-nanometer in Shanghai. So, going forward, how are you going to address this competition? And will that ROI from your 28-nanometer investment would be similar to your thought previously? Thank you.

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

Okay. I think that indeed we constantly have to work within this competitive environment in the foundry scenario. We always believe that the competition will be here, but the market is big enough for all to grow profitably and this is in a similar situation from the early 2000s they're our very strong, respectable competitors, set up the (inaudible)8 inch Fab in China but that has not really impacted our growth and strong demand going into our (inaudible)8 inch operations. So I think that -- and the same analogy, as long as SMIC can deliver on the right technology with the right service and with good quality I think we will be able to have a good customer set and good business opportunities.

Charlie Chan - *Morgan Stanley - Analyst*

Okay, thanks for that and my second question is really on the IOT exposure because China is quite aggressively developing the IOT infrastructure. So by your definition what is your rough revenue exposure to IOT? I guess it could include some sensors, MCU connectivity and some Pro IC business and if you compare this revenue exposure this year versus last year, what is the growth trajectory? Thanks.

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

Yes, I think the IOT definitely is a very fragmented market segment. So it is very much depending on how we categorize what product is in IOT. I presume that the Bluetooth for the earphones, speakers and a lot of the RF connectivity device can all be used in IOT applications. So really at this moment we have not set up a particular category such as IOT for the exact numbers but I think roughly these areas, such as Bluetooth, the RF connectivities and sensors are taking up about, let me see, about 20% to 30% of our revenue and it is growing at a very, very high rate.

Yes, I don't know. I'm sorry that is not a very precise number but that is not -- at this moment not a -- we have not checked or categorized our revenue in that manner.

Charlie Chan - *Morgan Stanley - Analyst*

That's already very helpful. So what is the company's exposure in MCU and would you think there is IOT created as well? So I do want to get a sense how well is the company in position for IOT and whether it is happening and when it is going to accelerate or we already at stable growth. Thank you.

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

Okay. I think that we have coupled technology prepared for the very low power and low leakage application in IOT. These applications -- these technologies not only contain some low power features but it has RF, it has embedded (inaudible)Non-volatile features and these are two technologies, one is in our 55 embedded non-volatile, one is our 95SPOCULL, all are getting a lot of customer interest and gaining new customer design. So we are in the initial phase of demonstration and the ramp up.

So at this moment the contribution is -- if you look at these two new technologies they're still at the initial phase but we think that from our feedback from the customers all of them are giving good comments and good credit to these new technologies that is coming up.

Charlie Chan - *Morgan Stanley - Analyst*

Okay, thanks.

Operator

Your next question comes from the line of Ken Hui from Jefferies. Please ask your question.

Ken Hui - *Jefferies - Analyst*

Thank you for taking my question. Looking to 3Q, I think you mentioned that you expect growth to drive the one of them is actually from Europe but Europe appears to be relatively flattish in second quarter compared to first quarter. Was it due to capacity constraint or some other reason?

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

Yes, I think that is because of the capacity constraint.

Ken Hui - *Jefferies - Analyst*

Then related to that, regarding your sensor customer, you mentioned that you are also adding more customer. Have you seen meaningful contribution already in second quarter or is it something going to happen in the second half?

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

Yes, I think it's going to happen in the second half because frankly speaking we just cannot take on all the customers that we have in the second quarter but as you know we are still expanding our (inaudible) 8 inch as well as 12 inch capacity for the mature nodes(inaudible) in second half so hopefully we are able to meet some of this customer demand which we could not meet in the first half.

Ken Hui - *Jefferies - Analyst*

Okay and then my final question is regarding the leasing program and also you talk about the target of achieving double digit ROE. Would you consider the leasing program as a way to achieve your double digit ROE or I think I meant would you consider trying to excel your target by being more aggressive in doing this kind of leasing program and do you have a timeframe on when you are going to achieve double digit ROE?

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

As I said we are exploring different kinds of financing programs that could improve our profitability and leasing program obviously is one option that we are looking at very seriously. As mentioned we are already in discussion with some partners that we're going to start some programs in a smaller scale and if we find it works well for us we're going to expand the program in the future.

So you're right, I mean as mentioned by Tzu-Yin it is still a long term target to achieve a double digit ROE on a sustained basis.

Ken Hui - *Jefferies - Analyst*

Okay, thank you.

Operator

Your next question comes from the line of Rick Hsu from Daiwa. Please ask your question.

Rick Hsu - *Daiwa Institute of Research Hong Kong Limited - Analyst*

Hi, yes, good morning guys. My first question is regarding your LFoundry because in Q4 you cannot be fully -- you cannot be fully consolidated in the revenue in Q4. So if I were to exclude LFoundry contribution in Q4 then how much of your business will -- I assume it will actually decline away seasonally in Q4, by how much?

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

No, actually we're looking at even excluding LFoundry contribution we're still looking at growth.

Rick Hsu - *Daiwa Institute of Research Hong Kong Limited - Analyst*

All right, wonderful. That's good. Well then the second question is if I don't remember wrong, I think your LFoundry right now upwards around 40K -- 40,000 wafers capacity and last year utilization rate on average was about 70% and I think you guys told me before in first half the utilization rate dropped to about 60% plus. So could you update, what's the utilization rate progress right now in second half and when do you expect this operation to be margin accretive?

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

Right now I think the company is still running about 60% utilization although we're seeing actually the customers increasing the loading in the second half but I think this year, I think to be realistic, I think the profit contribution to SMIC will be relatively modest but as what I said earlier we already have an active program in terms of transferring our processes and also our product to LFoundry over the next two to three quarters and hopefully we can gradually bring up the utilization and also improving the profitability for LFoundry.

Rick Hsu - *Daiwa Institute of Research Hong Kong Limited - Analyst*

Okay, great. So one last question, just a quick follow up, when do you expect this -- sorry, LFoundry's operations to meet your corporate average in term of profit margins? When do you expect this to happen?

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

In our experience in terms of -- you understand -- no, actually it take about three to four quarters to fully quantify a fab for a new process, okay? So expect in about one year we're able to transfer enough processes and products to the fab in LFoundry to bring up the utilization to close to our other eight inch fab and at the time you have to think about whether we need to expand the capacity, if there's still room for us to expand capacity at LFoundry.

So we believe that conservatively, I think in about 18 months, we should be able to bring the gross margin for the fab to the average of our 8 inch fabs.

Rick Hsu - *Daiwa Institute of Research Hong Kong Limited - Analyst*

All right, thank you so much and just quickly remind me, what's the maximum capacity of this LFoundry that you can join?

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

Depending on the number of metal layers, I think it can go to about 45,000 to 50,000.

Rick Hsu - *Daiwa Institute of Research Hong Kong Limited - Analyst*

All right, thank you so much.

Operator

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

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

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

Operator

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