SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORP
Form 6-K
September 18, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 6-K

REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16
UNDER THE SECURITIES EXCHANGE ACT OF 1934

For the month of September, 2014

Commission File Number: 001-31994

Semiconductor Manufacturing International Corporation

(Translation of registrant s name into English)

18 Zhangjiang Road

Pudong New Area, Shanghai 201203

People s Republic of China

(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

x Form 20-F o Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): o

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): o

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

o Yes x No

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): n/a

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This announcement does not constitute or form a part of any offer or solicitation to purchase or subscribe for securities in the United States. The Bonds mentioned herein have not been, and will not be, registered under the Securities Act, and may not be offered or sold in the United States except pursuant to registration or an exemption from the registration requirements of the Securities Act. No public offering of the Bonds will be made in the United States.

SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPORATION

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(Incorporated in the Cayman Islands with limited liability)

(Stock code: 0981)

PROPOSED ISSUE OF BONDS

Joint Lead Managers

PROPOSED ISSUE OF BONDS

The Company proposes to conduct an international offering of the Bonds to professional investors only. The Bonds will only be offered and sold in an institutional offering in the United States in reliance on Rule 144A and outside the United States in reliance on Regulation S.

Deutsche Bank and J.P. Morgan are the Joint Lead Managers in connection with the issue of the Bonds. Pricing of the Bonds, including the aggregate principal amount, the offer price and the interest rate, will be determined through a book building exercise to be coordinated by the Joint Lead Managers. As at the date of this announcement, the principal amount, the interest and other terms and conditions of the Proposed Bonds Issue have yet to be determined. Upon finalisation of the terms of the Proposed Bonds Issue, the Company and the Joint Lead Managers are expected to enter into a subscription agreement and other ancillary documents in relation to the Proposed Bonds Issue.

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* For identification purposes only

The Company intends to use the net proceeds for (i) the Company s debt repayment, and (ii) capital expenditure in relation to capacity expansion associated with 8-inch and 12-inch manufacturing facilities and general corporate purposes.

In connection with the Proposed Bonds Issue, the Company will provide certain professional investors with certain corporate and financial information regarding the Group, which information may not necessarily have been made public previously. For purposes of equal, effective and timely dissemination of information to the Shareholders and the investment community, an extract of such information is attached to this announcement, and this announcement will be available on the Company s website at www.smics.com.

Approval in-principle has been received for the listing and quotation of the Bonds on the SGX-ST. The SGX-ST assumes no responsibility for the correctness of any statements made or opinions expressed in this announcement. The approval in-principle granted for the listing and quotation of the Bonds on the SGX-ST is not to be taken as an indication of the merits of the Company or the Bonds.

As no binding agreement in relation to the Proposed Bonds Issue has been entered into as at the date of this announcement, the Proposed Bonds Issue may or may not materialise. Completion of the Proposed Bonds Issue is subject to a number of conditions, including but not limited to global market conditions and investor interest. Investor and Shareholders are urged to exercise caution when dealing in the securities of the Company.

Further announcement(s) in respect of the Proposed Bonds Issue will be made by the Company as and when appropriate.

THE PROPOSED BONDS ISSUE

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The Bonds have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States. The Bonds will be offered and sold in an institutional offering in the United States in reliance on Rule 144A and outside the United States in reliance on Regulation S. The Bonds will be issued to persons in Hong Kong who are professional investors. None of the Bonds will be offered or sold to the public in Hong Kong or placed with any connected persons of the Company.

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In connection with the Proposed Bonds Issue, the Company will provide certain professional investors with certain corporate and financial information regarding the Group, which information may not necessarily have been made public previously. For purposes of equal, effective and timely dissemination of information to shareholders and the investment community, an extract of such information is attached to this announcement, and this announcement will be available on the Company s website at www.smics.com.

Proposed Use of Proceeds

The Company intends to use the net proceeds for (i) the Company s debt repayment, and (ii) capital expenditure in relation to capacity expansion associated with 8-inch and 12-inch manufacturing facilities and general corporate purposes.

Listing

Approval in-principle has been received for the listing and quotation of the Bonds on the SGX-ST. The SGX-ST assumes no responsibility for the correctness of any statements made or opinions expressed in this announcement. The approval in-principle granted for the listing and quotation of the Bonds on the SGX-ST is not to be taken as an indication of the merits of the Company or the Bonds.

Information about the Company

The Company is one of the leading semiconductor foundries in the world and the largest and most advanced foundry in the PRC, providing integrated circuit (IC) foundry and technology services at 0.35-micron to 28-nanometer. Headquartered in Shanghai, the PRC, the Company has a 300mm wafer fabrication facility (fab) and a 200mm mega-fab in Shanghai, a 300mm mega-fab and a majority-owned 300mm fab in Beijing for advanced nodes under development, a 200mm fab in Tianjin, and a 200mm fab project under development in Shenzhen. The Company also has customer service and marketing offices in the U.S., Europe, Japan, and Taiwan, and a representative office in Hong Kong.

General

As no binding agreement in relation to the Proposed Bonds Issue has been entered into as at the date of this announcement, the Proposed Bonds Issue may or may not materialise. Completion of the Proposed Bonds Issue is subject to a number of conditions, including but not limited to global market conditions and investor interest. Investor and Shareholders are urged to exercise caution when dealing in the securities of the Company.

Further announcement(s) in respect of the Proposed Bonds Issue will be made by the Company as and when appropriate.

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DEFINITIONS

In this announcement, the following expressions have the meanings set out below unless the context otherwise requires:

ADS(s)	American depositary share(s) of the Company, each of which represents 50 Shares;
Board	the board of Directors;
Bonds	the US$ denominated bonds proposed to be issued by the Company;
Company	Semiconductor Manufacturing International Corporation, a company incorporated in the Cayman Islands with limited liability, the Shares of which are listed on the main board of the Hong Kong Stock Exchange and the ADSs of which are listed on the New York Stock Exchange, Inc.;
connected person(s)	has the meaning ascribed to it under the Listing Rules;
Deutsche Bank	Deutsche Bank AG, Singapore Branch;
Director(s)	director(s) of the Company;
Group	the Company and its subsidiaries;
Hong Kong	Hong Kong Special Administrative Region of the PRC;
Hong Kong Stock Exchange	The Stock Exchange of Hong Kong Limited;
Joint Lead Managers	Deutsche Bank and J.P. Morgan;
J.P. Morgan	J.P. Morgan Securities plc;
Listing Rules	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited;
PRC	the People s Republic of China (for the purpose of this announcement excluding Hong Kong, Macau Special Administrative Region of the People s Republic of China and Taiwan);
Proposed Bonds Issue	the proposed issue of the Bonds as described in this announcement;
Regulation S	Regulation S under the Securities Act;
Rule 144A	Rule 144A under the Securities Act;
Securities Act	the U.S. Securities Act of 1933, as amended;
SGX-ST	Singapore Exchange Securities Trading Limited;

Share(s)	share(s) of US$0.0004 each in the share capital of the Company;
Shareholder(s)	the holder(s) of the Shares;
US or United States	the United States of America;
US$, USD or US Dollars	United States dollars, the lawful currency of the United States; and
%	per cent.

By order of the Board
Semiconductor Manufacturing International Corporation

Tzu-Yin Chiu
Chief Executive Officer and Executive Director

Shanghai, 17 September 2014

As at the date of this announcement, the Directors are:

Executive Directors

Zhang Wenyi (Chairman)

Tzu-Yin Chiu (Chief Executive Officer)

Gao Yonggang (Chief Financial Officer)

Non-executive Directors

Chen Shanzhi (Li Yonghua as his Alternate)

Lawrence Juen-Yee Lau (Datong Chen as his Alternate)

Zhou Jie

Independent Non-executive Directors

William Tudor Brown

Sean Maloney

Frank Meng

Lip-Bu Tan

Carman I-Hua Chang

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APPENDIX

EXTRACT OF OFFERING CIRCULAR

CERTAIN DEFINITIONS AND CONVENTIONS USED IN THIS APPENDIX

As used in this appendix to this announcement, references to we , us , our , Issuer and the Company are to Semico Manufacturing International Corporation, a company incorporated in the Cayman Islands with limited liability, and its subsidiaries, as the context requires.

In this appendix, unless otherwise specified or required by the context, the following expressions shall have the meanings indicated:

Brite	Brite Semiconductor Corporation
fab or fabs	semiconductor fabrication plants
HK$	Hong Kong dollars, the lawful currency of Hong Kong
PRC	the People s Republic of China
RMB	Renminbi, the lawful currency of the PRC
SEC	the U.S. Securities and Exchange Commission
SMIB	Semiconductor Manufacturing International (Beijing) Corporation
SMIC Shenzhen	Semiconductor Manufacturing International (Shenzhen) Corporation
SMIS	Semiconductor Manufacturing International (Shanghai) Corporation
SMNC	Semiconductor Manufacturing North China (Beijing) Corporation
US$ or USD	United States dollars, the lawful currency of the United States
wafer	a thin, round, flat piece of silicon that is the base of most integrated circuits

Market data and certain industry forecasts and statistics in this appendix to this announcement have been obtained from both public and private sources, including market research, publicly available information and industry publications. Although we believe this information to be reliable, it has not been independent verified by us or our directors and advisors, and neither we, nor our directors and advisors make any representation as to the accuracy or completeness of that information. Such information may not be consistent with other information compiled within or outside the PRC. In addition, third party information providers may have obtained information from market participants and such information may not have been independently verified. This appendix to this announcement summarises certain documents and other information, and investors should refer to them for a more complete understanding of what is discussed in those documents. In making an investment decision, each investor must rely on its own examination of us, including the merits and risks involved.

The risk factors appended to this announcement should be read in conjunction with the Company s 2013 Form 20-F which was the Company s annual report filed with the SEC on 14 April 2014.

Risk Factors Related to Our Financial Condition and Business

We may not be able to achieve or maintain a level of profitability, primarily due to the possibility of increasing fixed costs and market competition reflected in price erosion in the average selling prices of our products.

Our profit totaled US$174.5 million in 2013 and US$22.5 million in 2012. However, with the offsetting impact of such profits, we still have net accumulated losses of US$1,693.9 million as at the end of 2013. We may not be able to achieve or maintain profitability on an annual or quarterly basis, primarily because our business is characterised by high fixed costs relating to advanced technology equipment purchases, which result in correspondingly high levels of depreciation expenses. We will continue to incur capital expenditures and depreciation expenses as we equip and ramp-up additional fabs and expand our capacity at our existing fabs. This may result in an increase of our fixed costs and possibly reduce our chances of achieving or maintaining profitability. Currently, the planned capital expenditure in 2014 for foundry operations is approximately US$1.1 billion as disclosed in our unaudited interim report for the six months ended 30 June 2014, which is an increase from US$880 million disclosed in our 2013 Form 20-F (our annual report filed with the SEC on 14 April 2014 (2013 Form 20-F)). The capital expenditures are mainly for (i) SMNC, our majority owned subsidiary in Beijing, which is 55% funded by us and 45% funded by other shareholders of SMNC, (ii) the acquisition of used equipment for our Shenzhen 8-inch fab, (iii) the product mix change including conversion from 40/45nm to 28nm in our Shanghai 12-inch fab and (iv) the expansion of capacity in our Tianjin 8-inch fab from 39K to 42K. In addition, we also budgeted approximately US$110 million as the 2014 capital expenditures for non-foundry operations mainly for the construction of living quarters for employees as part of our employee retention program.

In addition, we are competing in the same technology environment as a number of other foundries and our competitors who operate these foundries often use price as a means of securing business, resulting in erosion of the average selling price of our product portfolio, which adversely affects our ability to achieve or maintain profitability.

Our sales are dependent upon a small number of customers and any decrease in sales to any of them could adversely affect our results of operations.

We have been dependent on a small number of customers for a substantial portion of our business. For the years ended 31 December 2012 and 2013, our five largest customers accounted for 56.1% and 52.3% of our total sales, respectively. For the six months ended 30 June 2014, our five largest customers accounted for 51.0% of our total sales. We expect that we will continue to be dependent upon a relatively limited number of customers for a significant portion of our sales. Sales generated from these customers, individually or in the aggregate, may not reach our expectations or historical levels in any future period. Our sales could be significantly reduced if any of these customers cancels or reduces its orders, significantly changes its product delivery schedule, or demands lower prices, which could have an adverse effect on our results of operations.

We maintain a certain level of indebtedness which may adversely affect our financial health and our operating results.

We have incurred and may continue to incur, indebtedness to finance our developments and working capital which may adversely affect our financial health and our operating results. As at 30 June 2014, we had a total indebtedness of approximately US$1.15 billion.

Our indebtedness may increase our exposure to a number of risks associated with debt financing, including but not limited to the following:

- we will be required to dedicate a portion of our cash flow towards repayment of our existing debt and interest, which will reduce the availability of our cash flow to fund working capital, capital expenditures, acquisitions and other general corporate requirements;
- our ability to obtain additional financing in the future on favourable terms may be impaired;
- our ability to take advantage of significant new business opportunities may be limited;
- it will be more difficult for us to satisfy our payment obligations if market or operational conditions deteriorate; and
- there could be an adverse effect on our business, financial condition and results of operations if we are unable to service our indebtedness.

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We expect to have an ongoing need to obtain licenses for the proprietary technology of others, which subjects us to the payment of license fees and potential delays in the development and marketing of our products.

While we continue to develop and pursue patent protection for our own technologies, we expect to continue to rely on third party license arrangements to enable us to manufacture certain advanced wafers. As at 30 June 2014, we had been granted 4,233 patents worldwide, of which, 60 were in Taiwan, 380 were in the U.S., 3,780 were in China and 13 were in other jurisdictions. In comparison, we believe our competitors and other industry participants have been issued numerous more patents concerning wafer fabrication in multiple jurisdictions. Our limited patent portfolio may in the future adversely affect our ability to obtain licenses to the proprietary technology of others on favorable license terms due to our inability to offer cross- licensing arrangements. The fees associated with such licenses could adversely affect our financial condition and operating results. They might also render our services less competitive. If for any reason we are unable to license necessary technology on acceptable terms, it may become necessary for us to develop alternative technology internally, which could be costly and delay the marketing and delivery of key products and therefore have an adverse effect on our business and operating results. In addition, we may be unable to independently develop the technology required by our customers on a timely basis or at all, in which case our customers may purchase wafers from our competitors.

Our Beijing mega-fab is located in an area that is susceptible to seasonal dust storms, which could create impurities in the production process at these facilities and require us to spend additional capital to further insulate these fabs from dust, thereby affecting our business, financial condition and operating results.

The location of our fabs in Beijing makes them susceptible to seasonal dust storms, which could cause dust particles to enter the buildings and affect the production process. Although we are constructing precautionary filtration systems, these may not adequately insulate the fabs against dust contamination. If dust were to affect production in the Beijing fabs, we could experience quality control problems, losses of products in process and delays in shipping products to our customers. In addition, we may have to spend additional capital to further insulate the Beijing fabs from dust if our current precautionary measures are insufficient. The occurrence of any of these events could adversely affect our business, financial condition and operating results.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our annual consolidated financial statements, selected consolidated financial data and interim condensed consolidated financial statements, in each case together with their accompanying notes.

This section includes forward-looking statements that involve risks and uncertainties. Other than statements of historical facts, all statements included in this section that address activities, events or developments which we expect or anticipate will or may occur in the future are forward-looking statements. These statements are based on assumptions and analyses we made in light of experience, together with our perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate under the circumstances.

Unless the context otherwise requires, references to 2011 , 2012 and 2013 in this appendix are to our financial years ended 3 December 2011, 2012 and 2013, respectively.

Overview

We are one of the leading semiconductor foundries in the world and the largest foundry in the PRC by revenue and capacity. We are also the most technologically advanced foundry in the PRC, providing IC foundry and technology services from 0.35-micron down to 28-nanometer.

Our operations are primarily based in China. In 2013 we achieved total sales of US$2,069 million, compared to US$1,701.6 million in 2012. We recorded annual profit of US$174.5 million and generated US$738.0 million in cash from operating activities in 2013, compared to annual profit of US$22.5 million and US$435.2 million in cash from operating activities in 2012. Our sales were US$962.4 million for the six months ended 30 June 2014, compared to US$1,042.9 million for the six months ended 30 June 2013. We recorded profit of US$76.1 million and generated US$278.7 million in cash from operating activities for the six months ended 30 June 2014, compared to profit of US$115.8 million and US$263.0 million in cash from operating activities for the six months ended 30 June 2013.

The major factors affecting our results of operations and financial condition are discussed below.

Factors that Impact Our Results of Operations

Cyclicality of the Semiconductor Industry

The semiconductor industry is highly cyclical due mainly to the cyclicality of demand in the markets of the products that use semiconductors. As these markets fluctuate, the semiconductor market also fluctuates. This fluctuation in the semiconductor market is exacerbated by the tendency of semiconductor companies, including foundries, to make capital investments in plant and equipment during periods of high demand since it may require several years to plan, construct and commence operations at a fab. Absent sustained growth in demand, this increase in capacity often leads to overcapacity in the semiconductor market, which in the past has led to a significant underutilisation of capacity and a sharp drop in semiconductor prices. The semiconductor industry is generally slow to react to declines in demand due to its capital-intensive nature and the need to make commitments for equipment purchases well in advance of the planned expansion. See Risk Factors Risks Related to Our Financial Condition and Business. in the offering circular relating to the Proposed Bonds Issue.

Substantial Capital Expenditures

The semiconductor foundry industry is characterised by substantial capital expenditures. This is particularly true for our Company as we have recently constructed and equipped fabs and are continuing to construct and equip new fabs. In connection with the construction and ramp-up of our capacity, we incurred capital expenditures of US$765 million, US$499 million and US$770 million in 2011, 2012 and 2013, respectively. We depreciate our manufacturing machinery and equipment on a straight-line basis over an estimated useful life of five to seven years. We recorded depreciation of US$518.8 million, US$531.8 million and US$501.9 million in 2011, 2012 and 2013, respectively.

The semiconductor industry is also characterised by rapid changes in technology, frequently resulting in obsolescence of process technologies and products. As a result, our research and development efforts are essential to our overall success. We spent US$191.5 million in 2011, US$193.6 million in 2012 and US$145.3 million in 2013 on research and development expenses, which represented 14.5%, 11.4% and 7.0%, respectively, of our sales for 2011, 2012 and 2013. Our research and development costs are partially offset by related government fundings and include the costs associated with the ramp-up of a new wafer facility.

We currently expect that our capital expenditures in 2014 for foundry operations will be approximately US$1.1 billion, subject to adjustment based on market conditions, which is an increase from US$880 million disclosed in our 2013 Form 20-F. We estimate that these capital expenditures will be used for (i) SMNC, our majority owned subsidiary in Beijing, which is 55% funded by us and 45% funded by the other shareholders of SMNC; (ii) the acquisition of used equipment for our Shenzhen 8-inch fab, (iii) the product-mix change including conversion from 40/45nm to 28nm in our Shanghai 12-inch fab and (iv) the expansion of capacity in our Tianjin 8-inch fab from 39K to 42K. In addition, we also budgeted approximately US$110 million in 2014 for non-foundry operations mainly for the construction of living quarters for employees as part of our employee retention program. Our actual expenditures may differ from our planned expenditures for a variety of reasons, including changes in our business plan, our process technology, market conditions, equipment prices or customer requirements. We will monitor the global economy, the semiconductor industry, the demands of our customers and our cash flow from operations, and will adjust our capital expenditures plans as necessary.

Capacity Expansion

We have expanded, and plan to continue to expand, our capacity through internal growth, joint ventures and acquisitions. An increase in capacity may have a significant effect on our results of operations, both by allowing us to produce and sell more wafers and achieve higher sales, and as a cost component in the form of acquisition costs and depreciation expenses. We have increased our existing 8-inch capacities from 126,000 wafers per month in 2013 to 135,000 wafers per month in the first half of 2014 and increased the capacity of our Shanghai 12-inch facility from 12,000 12-inch wafers per month in 2013 to 14,000 12-inch wafers per month in the first half of 2014.

Pricing

We price our foundry services on either a per wafer or a per die basis, taking into account the complexity of the technology, the prevailing market conditions, the order size, the cycle time, the strength and history of our relationship with the customer, and our capacity utilisation. Since a majority of our costs and expenses are fixed or semi-fixed, fluctuations in the average

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selling prices of semiconductor wafers have historically had a substantial impact on our margins. The average selling price of the wafers we shipped increased from US$767 per wafer in 2012 to US$804 per wafer in 2013.

Change in Process Mix and Technology Migration

Because the price of wafers processed with different technologies varies significantly, the mix of wafers that we produce is among the primary factors that affect our sales and profitability. The value of a wafer is determined principally by the complexity of the process technology used to fabricate the wafer. In addition, production of devices with higher levels of functionality and greater system-level integration requires more fabrication steps, and these devices generally sell for higher prices.

Prices for wafers of a given level of technology generally decline over the relevant process technology life cycle. As a result, we are continuously in the process of developing and acquiring more advanced process technologies and migrating our customers to use such technologies to maintain or improve our profit margins. This technology migration requires continuous investment in research and development and technology-related acquisitions, and we may spend a substantial amount of capital on upgrading our technologies.

Capacity Utilisation Rates

Operations at or near full capacity utilisation have a significant positive effect on our profitability because a substantial percentage of our cost of sales is of a fixed or semi-fixed nature. If we increase our utilisation rates, the number of wafers we fabricate will increase, and therefore our average fixed costs per wafer will decrease. Therefore, our capacity utilisation rates have a significant effect on our margins. Our capacity utilisation rates have varied from period to period mainly due to the mix of wafers produced and fluctuations in customer orders. Our capacity utilisation rate was 68.9% in 2011, 88.3% in 2012 and 90.7% in 2013. Factors affecting capacity utilisation rates are the overall industry conditions, the level of customer orders, the complexity of the wafers and of the mix of wafers produced, mechanical failures and other operational disruptions such as the expansion of capacity or the relocation of equipment, and our ability to manage the production facilities and product flows efficiently.

Our capacity is determined by us based on the capacity ratings for each piece of equipment, as specified by the manufacturers of such equipment, adjusted for, among other factors, actual output during uninterrupted trial runs, expected down time due to set up for production runs and maintenance, and expected product mix. Because these factors include subjective elements, our measurement of capacity utilisation rates may not be comparable to those of our competitors.

Yield Rates

Yield per wafer is the ratio of the number of functional dies on that wafer to the maximum number of dies that can be produced on that wafer. We continuously upgrade the process technologies that we use. At the beginning of each technology migration, the yield utilising the new technology is generally lower, sometimes substantially lower, than the yield under the then-current technology. This is because it requires time to stabilize, optimise and test a new process technology. We do not ship wafers to a customer until we have achieved that customer s minimum yield requirements. Yield is generally improved through the expertise and cooperation of our research and development personnel, process engineers, and equipment suppliers.

Critical Accounting Policies

We prepare our financial statements in conformity with IFRS, which requires us to make judgments, estimates and assumptions. We regularly evaluate these estimates and assumptions based on the most recently available information, our own historical experience and various other assumptions that we believe to be reasonable under the circumstances. Since the use of estimates is an integral component of the financial reporting process, actual results could differ from our expectations as a result of changes in our estimates.

An accounting policy is considered critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time such estimate is made, and if different accounting estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the consolidated financial statements. We believe that the following accounting policies involve a higher degree of judgment and complexity in their applications and require us to make significant accounting estimates. You should read the following descriptions of critical accounting policies, judgments and estimates in conjunction with our consolidated financial statements and other disclosures included in the offering circular in respect of the Proposed Bonds Issue.

Inventories

Inventories are stated at the lower of cost (weighted average) or net realisable value (NRV), with NRV being the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale . We estimate the recoverability for such finished goods and work-in-progress based primarily upon the latest invoice prices and current market conditions. If the NRV of an inventory item is determined to be below its carrying value, we record a write-down to cost of sales for the difference between the carrying cost and NRV.

Long-lived assets

We assess the impairment of long-lived assets when events or changes in circumstances indicate that the carrying value of asset or cash-generating unit (CGU) may not be recoverable. Factors that we consider in deciding when to perform an impairment review include, but are not limited to, significant under-performance of a business or product line in relation to expectations, significant negative industry or economic trends, and significant changes or planned changes in the use of the assets.

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An impairment analysis is performed at the lowest level of identifiable independent cash flows for an asset or CGU. An impairment exists when the carrying value of an asset or cash- generating unit exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The fair value less costs to sell calculation is based on available data from binding sales transactions, conducted at arm s length, for similar assets or observable market prices less incremental costs for disposing of the asset. The value in use calculation is based on a discounted cash flow model. Currently we are not able to estimate the amount of impairment loss or when the loss will occur for future years. Any potential changes of the business assumptions, such as forecasted sales, selling prices, utilisations, may have a material adverse effect on our net income.

We make subjective judgments in determining the independent cash flows that can be related to a specific CGU based on its asset usage model and manufacturing capabilities. We measure the recoverability of assets that will continue to be used in our operations by comparing the carrying value of CGU to our estimate of the related total future discounted cash flows. If a CGU s carrying value is not recoverable through the related discounted cash flows, the impairment loss is measured by comparing the difference between the CGU s carrying value and its recoverable amount, based on the best information available, including market prices or discounted cash flow analysis. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash-inflows and the growth rate used for extrapolation purposes.

In order to remain technologically competitive in the semiconductor industry, we have entered into technology transfer and technology license arrangements with third parties in an attempt to advance our process technologies. The payments made for such technology licenses are recorded as an intangible asset or as a deferred cost and amortized on a straight-line basis over the estimated useful life of the asset. We routinely review the remaining estimated useful lives of these intangible assets and deferred costs. We also evaluate these intangible assets and deferred costs for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. When the carrying amounts of such assets are determined to exceed their recoverable amounts, we will impair such assets and write down their carrying amounts to recoverable amount in the year when such determination was made.

Share-based Compensation Expense

The fair value of options and shares issued pursuant to our option plans at the grant date was estimated using the Black-Scholes option pricing model. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of highly subjective assumptions, including the expected term of the options, the estimated forfeiture rates and the expected stock price volatility. The expected term of options granted represents the period of time that options granted are expected to be outstanding. We estimated forfeiture rates using historical data to estimate option exercise and employee termination within the pricing formula. We use projected volatility rates based upon our historical volatility rates. These assumptions are inherently uncertain. Different assumptions and judgments would affect our calculation of the fair value of the underlying ordinary shares for the options granted, and the valuation results and the amount of share-based compensation would also vary accordingly.

Taxes

As an exempted company incorporated in the Cayman Islands, we are not subject to taxation in the Cayman Islands. Our other subsidiaries are subject to their respective jurisdictions income tax laws, including the PRC, Japan, the United States, Taiwan and Europe. Our income tax obligations in the periods under review have been minimal.

Uncertainties exist with respect to the interpretation of complex tax regulations, changes in tax laws, and the amount and timing of future taxable income. Given the wide range of international business relationships and the long-term nature and complexity of existing contractual agreements, differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate future adjustments to tax income and expense already recorded. We established provisions, based on reasonable estimates, for possible consequences of audits by the tax authorities of the respective countries in which it operates. The amount of such provisions is based on various factors, such as experience of previous tax audits and differing interpretations of tax regulations by the taxable entity and the responsible tax authority. Such differences of interpretation may arise on a wide variety of issues depending on the conditions prevailing in the respective domicile of us.

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits together with tax planning strategies.

A deferred tax asset of US$0.4 million and nil has been recognised in our consolidated statement of financial position as at 31 December 2012 and 2013, respectively, in relation to unused tax losses. The realisability of the deferred tax asset mainly depends on whether sufficient profits or taxable temporary differences will be available in the future. In cases where the actual future profits generated are less than expected, a material reversal of deferred tax assets may arise, which would be recognised in profit or loss for the period in which such a reversal takes place.

Fair value measurements and valuat