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Dear Shareholders,

2004 was a headline year for SMIC! In March 2004, we completed our initial public offering on the Stock Exchange of Hong Kong and the New York Stock Exchange, in which we raised over US\$1 billion. We have continued our expansion plan and by the end of the year, became the third largest foundry in the world.

## Sales and Marketing

We are very pleased to have achieved revenues of US\$974.7 million in 2004, representing a 166% increase over last year. Taking advantage of the continuing trend by integrated device manufacturers (“IDMs”) of outsourcing their chip fabrication for complex and high performance devices to semiconductor foundries, we continued to gain market share in the foundry industry. According to *IC Insights*, a leading IC industry market research company, we increased our market share by approximately 3% in 2004, the largest increase among all of the world’s foundries. We achieved this growth by offering our leading edge technology offerings and world-class customer service to a balanced customer portfolio of IDMs and fabless companies.

Another key factor to our growth has been the rapid development of the semiconductor industry in China. We currently have over 50 customers from the Greater China region, all of which are either design houses or fabless companies. Five

of these are among the ten largest fabless companies in China based on their revenues in 2004, according to the China Center for Information Industry Development. Sales from the Greater China region increased to over 10% in 2004 from less than 2% in 2003.

The potential growth of this region is exacerbated when considering that many of our China-based customers initially begin their product development at more mature technologies, such as 0.35 micron process technology. In August 2004, we successfully developed a 0.18 micron high voltage device and process technology specifically targeted for these customers. We are working closely with our customers to implement this technology within their product offerings, which will enable them to reap economies of scale at the lower technology nodes. As the entire supply chain infrastructure in China for integrated circuits develops further, we aim to generate approximately 15% of our total sales from the Greater China region by the end of 2005, by capitalizing on the rapid growth of domestic fabless semiconductor companies and IC design houses.

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# Chairman Statement

## Technology Offerings and Manufacturing Capability

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We have increased our research and development to develop process technologies at a wide range of nodes. We have successfully developed and qualified our first SRAM memory device using our internally developed 90 nanometer process technology, which is currently the world's most advanced technology node in mass production. We are scheduling to begin to offer 90 nanometer process technology for logic devices by the end of 2005.

In July 2004, we commenced pilot production at Fab 4 — our first 12-inch fab and also the first 12-inch fab in China. Fab 4 will initially produce advanced high-speed low power 512Mb DDR2 DRAM using 0.11 micron and 0.10 micron manufacturing processes. Fab 6, which is our 300mm copper interconnect wafer fab also located in Beijing, China, will supplement Fab 4's production of logic products at advanced process technology nodes down to 90 nanometer towards the end of the year.

## Increased Capacity and Capital Expenditure

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At the end of 2004, our monthly capacity totaled 120,417 8-inch wafer equivalents. In 2005, we intend to continue to increase our capacity, in order to meet the demands of our customers. We

anticipate that by the end of 2005, our monthly capacity will be 147,000 8-inch wafer equivalents.

We plan to fund our 2005 capital expenditures of approximately US\$1 billion through operating cash flows and additional bank loans. We are working closely with our banks on the latter and would like to thank them for their continued support of SMIC. If necessary, we will also explore other forms of external financing, such as offerings of non-convertible debt securities. In light of the cyclical nature of the semiconductor industry, we will continue to study the market trends closely and formulate suitable expansion strategies in order to best serve our customers and maximize returns for our shareholders.

## Additional Business Opportunities

Building on our first mover advantage in China, we intend to leverage our position as one of China's leading semiconductor manufacturers to participate in strategic investments. In July 2004, we entered into an agreement with Toppan Printing Co., Ltd. to form a joint venture located in Shanghai, China named Toppan SMIC Electronics (Shanghai) Co., Ltd., which will combine our CMOS image sensor front-end process technology with Toppan's industry leading know-how in color filters and micro-lenses. We believe this joint venture will enable us to capture the growing demand in China for image sensor modules used in mobile phones, digital still cameras, and security and automobile applications. We believe that this facility will commence pilot production in the second half of 2005.

In July 2004, we also entered into an agreement to establish an assembly and testing facility in Chengdu, China. This facility will provide back-end assembly and testing to complete our turnkey service offerings and to better serve

our customers. We believe that this facility will commence pilot production in the second half of 2005.

## Settlement of Lawsuit with TSMC

On January 31, 2005, we announced that we had resolved the pending patent and trade secret litigations with Taiwan Semiconductor Manufacturing Company Limited ("TSMC"). Under the terms of the settlement, among other items, the two parties will cross license each other's patent portfolio through to December 2010 and we will pay TSMC an aggregate of US\$175 million, payable in installments over six years (US\$30 million in each of the first five years and US\$25 million in the sixth year).

The agreement also provides for the dismissal of all pending legal actions without prejudice between the two companies in the U.S. Federal District Court, the California State Superior Court, the U.S. International Trade Commission, and the Taiwan District Court. In the settlement agreement, TSMC covenants not to sue SMIC for itemized acts of trade secret misappropriation as alleged in the complaints, although the settlement neither grants a license to use any of TSMC's trade secrets nor results in TSMC transferring any technology or providing any technical assistance to SMIC. The patent cross license and settlement agreement are terminable upon a breach by SMIC, which may result in the reinstatement of the legal proceedings and acceleration of the outstanding payments under the settlement agreement.

Based on an independent valuation report, there will be an accounting charge relating to the settlement of the litigation of US\$23 million to our operating expense account in 2004. We anticipate the accounting charges from 2005 to 2010 will be between US\$20 million to US\$25 million per year and from 2011 to 2015 will be less than US\$3 million per year.

We are pleased that the litigation has been settled peacefully and believe that the settlement is in the best interests of SMIC's long-term development. As a young and growing company, we will continue to cooperate with international companies and focus our resources on providing world-class foundry services to our customers.

## Awards of Outstanding Performance and Contributions

We are the proud recipients of several awards in 2004 that recognized SMIC's outstanding performance and contributions to China.

We received the Shanghai Industrial Exhibition Organization Silver Award in recognition of a historical milestone in China's semiconductor industry, specifically, our Fab 4 which is also China's first 12-inch fab. We also received the Technology Fast 500 Asia Pacific Award from Deloitte & Touche, in recognition of our annual revenue growth in the Asia Pacific region over the past three years.

Our management team has received numerous awards for its contribution to the development of the semiconductor industry in China. In February, we received the 2003 China Semiconductor Industry Leadership Award for demonstrating excellence in leadership as demonstrated by SMIC's contributions made to the procurement, infrastructure and development in the semiconductor industry in China. We are also honored to have received the prestigious Magnolia Silver Award, the highest award issued by the Shanghai government for special contributions made to the economic development in Shanghai. We are also very pleased to have received the Great Contribution Award from the Beijing Economic and Technological Development Area for SMIC's contribution to the Beijing Development Area.

# Chairman Statement

## Outlook for 2005

We look forward to build upon our success in 2004 by continuing to offer leading edge technology and manufacturing services. With our advanced offerings, we will help our customers expand their businesses in China and the rest of the world. We will also continue to consider other strategic alliances and partnerships that will enable us to leverage our unique position in China to maximize shareholder return.

At the same time, we will carefully monitor the global semiconductor industry and adjust our expansion plans accordingly. The semiconductor industry, and thus the foundry business, is cyclical. In 2004, the global semiconductor industry witnessed strong growth. We anticipate

global demand for integrated circuits to remain flat in 2005 with demand improving as the year progresses. We believe that our unique position in China will allow us to take advantage of the demand for integrated circuits in China, and thereby enable us to continue to deliver top line growth in 2005.

Finally, I would like to express my gratitude and appreciation to the members of our board of directors (the "Board") and our staff for their work during the past year, and to our shareholders for showing their unwavering interest in and invaluable support of SMIC.

May God bless you and SMIC,  
**Richard R. Chang**  
*Chairman, Executive Director,  
President and CEO*