

## Chief Executive Officer's Statement

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Dear Shareholders,

I am pleased to report SMIC has been able to continue to grow its revenues strongly despite a difficult environment for the semiconductor industry in early 2005. Revenue for the year increased to \$1,171 million as we continued to add capacity as demanded by our customers. Because we are a new foundry with only four years of commercial operations, and continue to expand our capacity to meet the increasing capacity demands of our customers, our depreciation expense as a percentage of revenues remains the highest in the foundry industry. Despite these high depreciation expenses, we believe that we will become profitable by improving our product mix, thereby increasing our average selling price. It is particularly significant that our team in Beijing was able to ramp the yield of our customer's leading edge DDR2 DRAM product to industry leading levels, only nine months after our first 12-inch wafer fab began commercial production in March 2005.

As part of our multi-prong approach to improve our product mix, our first logic product manufactured at the advanced 90 nanometer technology node is being qualified by our customer. We anticipate that we will begin producing this product commercially in Beijing in the second quarter of 2006. This advanced logic product will actually be the first 90 nanometer product out of our wafer fab in Beijing, and will be followed by DDR2 DRAM products for our foundry DRAM customers a short while later. This marks a very important milestone for the semiconductor industry in China and is a testament to the skills and knowledge of our world-class R&D and operations team in SMIC.

The last piece of the 90 nanometer puzzle is the cutting edge NAND flash product that we are developing in conjunction with Saifun Technologies Limited. I am very excited to see SMIC's product lines expanding into areas with such high growth potential. We will be utilizing a 90 nanometer production process, which is fully compatible with our logic wafer production lines. They will form an ideal advanced technology filler in our wafer fabs. We are looking to wrap up our design of our first NAND flash chip with a capacity of 2 gigabit by the middle of the year, and look to begin limited production on our 8-inch production lines at the end of the year. The design is very advanced and the size of these chips is extremely small and competitive with the ones being produced by the industry leaders, making them ideal for use in removable storage in wireless handsets, which we believe is a market with one of the highest growth potential in the next few years.

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During the second half of 2005 we have seen the semiconductor industry recover very strongly, and consequently we made the decision to ramp up our fabs in 2006 to take advantage of this cycle. In order to serve our customers better for general logic products at mainstream and advanced nodes, we will continue to ramp out the front end fabs in Shanghai to their maximum designed capacity, and also continue to build out our copper interconnect capacity on 8-inch wafer, according to customer demand. We are seeing very substantial demand for our advanced copper interconnect services on 8-inch wafers. We expect this trend to continue for the rest of 2006 and aim to derive 35% of our logic products revenue from 0.13 micron and below in the fourth quarter of 2006. Shanghai continues to form the cornerstone of our main foundry operations and I thank our colleagues for keeping our megafab a world-class fab.

As I mentioned previously our Beijing operations have been successfully producing DDR2 DRAM at 0.11 micron technology node for almost one year, and by the middle of this year all our DRAM products produced on 12-inch wafers will have been transferred to a smaller and more advanced 90 nanometer node. We are planning for our Beijing fab and a new facility in Shanghai to spearhead SMIC's future expansion into 12-inch wafer manufacturing. We have witnessed the tremendous progress of IC design houses in China with their technical design capability improving by leaps and bounds, and we are anticipating even greater cooperation with the rising stars in China in 2006.

Cumulatively we are anticipating a very exciting year for SMIC. We have spent a lot of effort in making sure SMIC is well positioned to take advantage of the many opportunities that lie ahead. Our capital expenditure target for 2006 of US\$1.1 billion is based on anticipated customer demand for our services this year and beyond. We have taken on management contracts to operate wafer fabs in Chengdu and Wuhan, and are building a shell to house our first 12-inch in Shanghai, in order to take advantage of anticipated demand from our customers from China and the rest of the world. Our testing and assembly facility in Chengdu has commenced production in March this year, which enables SMIC to offer a complete turnkey service for customers' products in China. Our

joint venture with Toppan Printing Co. Ltd. in the manufacture of on-chip color filters and micro lenses for CMOS image sensors has also entered commercial production to take advantage of the fact that China has already become the largest market for mobile handsets in 2005. Our foray into solar power is also going extremely well. We have constructed a facility for this project and are in discussions regarding a separate facility to manufacture the raw materials to support the solar cell venture. Together with the growth in the traditional foundry business I hope it would enable SMIC to overcome its depreciation expenses, which as a percentage of revenues remains the highest in the foundry industry.

I am proud that SMIC has been able to attract so many dedicated professionals both from abroad and within China. Last year we promoted two of our very experienced employees to the positions of Vice President of Logic Technology Development to lead our 65 nanometer and below R&D efforts, and Senior Vice President of Fab Operations in Shanghai which has been turned into a "mega-fab" consisting of all of our fabs at that location. The dedication of the management and staff of SMIC is an important ingredient necessary to meet the challenges and opportunities ahead here in China. We would like to take this opportunity to record our cordial thanks to them.

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May God bless you and SMIC,  
**Richard R. Chang**  
Chief Executive Officer

Shanghai, the PRC  
April 27, 2006