

SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORP

Form 6-K

January 19, 2018

THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

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 January, 2018

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)

Edgar Filing: SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORP - Form 6-K

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

Form 20-F 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):

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):

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:

Yes No

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

THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Semiconductor Manufacturing International Corporation

Date: January 18, 2018 By: /s/ Dr. Gao Yonggang

Name: Dr. Gao Yonggang

Title: Executive Director, Chief Financial Officer and Joint Company Secretary

THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt as to any aspect of this circular, you should consult a stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in Semiconductor Manufacturing International Corporation (the “Company”), you should at once hand this circular and the accompanying form of proxy to the purchaser(s) or the transferee(s) or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser(s) or the transferee(s).

Hong Kong Exchanges and Clearing Limited and The Stock Exchange of Hong Kong Limited take no responsibility for the contents of this circular, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this circular.

Semiconductor Manufacturing International Corporation

*

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 981)

(1)DISCLOSEABLE AND CONTINUING CONNECTED TRANSACTIONS IN RELATION TO FRAMEWORK AGREEMENT

AND

(2)NOTICE OF EXTRAORDINARY GENERAL MEETING

Independent Financial Adviser to

the Independent Board Committee and the Independent Shareholders

A letter from the Independent Board Committee to the Independent Shareholders is set out on pages 35 to 36 of this circular. A letter from Messis Capital Limited, the Independent Financial Adviser, containing its advice to the Independent Board Committee and the Independent Shareholders, is set out on pages 37 to 78 of this circular.

The notice convening the EGM to be held at 18 Zhangjiang Road, Pu Dong New Area, Shanghai, People's Republic of China on 8 February 2018 at 12 : 00 noon (the "EGM") is contained in this circular. Shareholders are advised to read the notice and to complete and return the enclosed form of proxy for use at the EGM in accordance with the instructions printed thereon.

Whether you are able to attend the EGM or not, please complete and return the enclosed form of proxy to the branch share registrar of the Company, Computershare Hong Kong Investor Services Limited, at 17M Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong as soon as possible and in any event not less than 48 hours before the time appointed for the holding of the EGM or any adjournment thereof. The completion and delivery of a form of proxy will not preclude you from attending and voting at the EGM in person should you wish. Only Shareholders of record on 8 February 2018 are entitled to attend and vote at the EGM.

* For identification purpose only

18 January 2018

CONTENTS

	Page
<u>Definitions</u>	1
<u>Letter from the Board</u>	5
<u>Letter from the Independent Board Committee</u>	35
Letter from Messis Capital	
Appendix I — General Information	
Notice of Extraordinary General Meeting	

DEFINITIONS

In this circular, the following expressions have the following meanings unless the context requires otherwise:

“2016 Framework Agreement” the framework agreement entered into between the Company and SMNC on 30 September 2016 in relation to the supply of goods, rendering of or receiving services, leasing of assets, acquisition and disposal of equipment and provision of technical authorisation or licensing and subject to the terms and conditions provided therein

“Annual Caps” the proposed annual caps for the period ending 31 December, 2018, 2019 and 2020 in relation to each type of Continuing Connected Transaction which are more fully set out in the section headed “The Annual Caps and Basis of Determination — Annual Caps” in this circular

“Beijing Semi Fund” Investment Center (Limited Partnership)*, (Beijing Semiconductor Manufacturing and Equipment Investment Center (Limited Partnership)*), a company established under the laws of the PRC

“Board” the board of Directors

“Capital Contribution” the US\$636 million cash contribution by China IC Fund into the registered capital of SMNC and the corresponding deemed disposal of equity interest of the Company and SMIC Beijing in SMNC pursuant to an amendment joint venture agreement entered in between the Company, SMIC Beijing, China IC Fund and other third parties on 10 May 2016

“China IC Fund” China Integrated Circuit Industry Investment Fund Co., Ltd.* (China Integrated Circuit Industry Investment Fund Co., Ltd.*), a company established under the laws of the PRC

“Company” Semiconductor Manufacturing International Corporation (SMI), a company incorporated in the Cayman Islands with limited liability, the shares of which are listed on the main board of the Stock Exchange and the American depositary shares of which are listed on the New York Stock Exchange, Inc.

“connected person(s)” has the same meaning as ascribed to it under the Listing Rules

“Continuing the non-exempt continuing transactions contemplated under the Framework Agreement, which
Connected include Type I CCT, Type II CCT, Type III CCT, Type IV CCT, Type V CCT and Type VI CCT
Transactions”

1

DEFINITIONS

- “Director(s)” the director(s) of the Company
- “E-Town Capital” 20134;33674; 30332;23637; (Beijing E-Town International Investment & Development Co., Ltd.*), a limited liability company established under the laws of the PRC
- “EGM” the extraordinary general meeting of the Company proposed to be held to approve, among other things, the Framework Agreement and the Specific Non-Exempt CCT
- “Framework Agreement” the framework agreement entered into between the Company and SMNC on 6 December 2017 in relation to Continuing Connected Transactions
- “Group” the Company and its subsidiaries
- “Group A” the Company and/or its subsidiaries (other than SMNC and its subsidiaries)
- “Group B” SMNC and/or its subsidiaries
- “HK\$” Hong Kong dollars, the lawful currency of Hong Kong
- “Hong Kong” Hong Kong Special Administrative Region of the PRC
- “IDIMC” 24037;26989;30332;23637; 31649;29702; (Beijing Industrial Developing Investment Management Co., Ltd.*), a company established under the laws of the PRC
- “Independent Board Committee” the independent committee of the Board that consists of all independent non-executive Directors who have no direct or indirect interest in the Framework Agreement, other than, where applicable, being a Shareholder
- “Independent Financial Adviser” or “Messian Capital” Messis Capital Limited, a licensed corporation to carry out type 1 (dealing in securities) and type 6 (advising on corporate finance) regulated activities under the SFO and being the independent financial adviser appointed by the Company to advise the Independent Board Committee and the Independent Shareholders in respect of the Framework Agreement, the Continuing Connected Transactions and their Annual Caps

DEFINITIONS

- “Independent Shareholders” the Shareholders who are not required under the Listing Rules to abstain from voting at the EGM to approve the Framework Agreement and the Specific Non-Exempt CCT and their Annual Caps, which shall include Shareholders other than Xinxin (Hongkong) Capital Co., Limited and other associates of China IC Fund (as defined in the Listing Rules) in relation to the Framework Agreement
- “Latest Practicable Date” 30 November 2017, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained herein
- “Listing Rules” the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
- “Ordinary Share(s)” the ordinary Share(s) of US\$0.004 each in the share capital of the Company
- “PRC” the People’s Republic of China, but for the purposes of this circular only, excludes Hong Kong, Macau and Taiwan
- “SFO” the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
- “Shareholders” holder(s) of issued Shares
- “Shares” shares of all classes in the capital of the Company (including but not limited to Ordinary Shares and preferred shares) and warrants and other securities which carry a right to subscribe for or purchase shares of the Company
- “SMIC Beijing” [#65289](#); (Semiconductor Manufacturing International (Beijing) Corporation*), a wholly foreign-owned enterprise established under the laws of the PRC and a wholly-owned subsidiary of the Company
- “SMIC Holdings” [#25511](#); (SMIC Holdings Corporation*), a limited liability company established under the laws of the PRC and a wholly-owned subsidiary of the Company;
- “SMNC” [#26041](#); [#65289](#); (Semiconductor Manufacturing North China (Beijing) Corporation*)

company established under the laws of the PRC pursuant to the joint venture agreement dated 3 June 2013

“Specific Non-Exempt CCT” Type I CCT, Type II CCT, Type III CCT, Type IV CCT and Type VI CCT

“Stock Exchange” The Stock Exchange of Hong Kong Limited

DEFINITIONS

“Type I CCT” the transactions contemplated under the Framework

Agreement in relation to purchase and sale of goods

“Type II CCT” the transactions contemplated under the Framework

Agreement in relation to rendering of or receiving services

“Type III CCT” the transactions contemplated under the Framework

Agreement in relation to leasing of assets

“Type IV CCT” the transactions contemplated under the Framework

Agreement in relation to transfer of assets

“Type V CCT” the transactions contemplated under the Framework

Agreement in relation to provision of technical authorisation or licensing

“Type VI CCT” the transactions contemplated under the Framework

Agreement in relation to provision of guarantee

“U.S.” or the United States of America, its territories, its possessions

“United States”

and all areas subject to its jurisdiction

“US\$” United States dollar, the lawful currency of the United States of America

“Xun Xin” 上海新信投资有限公司 (Xun Xin (Shanghai) Investment Co. Ltd.*), a limited liability company established under the

laws of the PRC and a wholly-owned subsidiary of China IC Fund

“ZDG” 中广村发展集团有限公司 (Zhongguancun Development Group*), company incorporated in the PRC

“%” per cent.

* For identification purpose only

LETTER FROM THE BOARD

Semiconductor Manufacturing International Corporation

*

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 981)

Executive Directors:

Zhou Zixue (Chairman)

Zhao HaiJun (Co-Chief Executive Officer) Liang Mong Song (Co-Chief Executive Officer) Gao Yonggang (Chief Financial Officer and

Joint Company Secretary)

Non-executive Directors:

Tzu-Yin Chiu (Vice Chairman)

Chen Shanzhi Zhou Jie

Ren Kai Lu Jun

Tong Guohua

Independent non-executive Directors:

Lip-Bu Tan

William Tudor Brown Carman I-Hua Chang Shang-yi Chiang Jason
Jingsheng Cong
18 January 2018

Registered Office:

PO Box 309, Ugland House Grand
Cayman, KY1-1104 Cayman Islands

Principal Place of Business: 18
Zhangjiang Road PuDong New Area
Shanghai 201203

People's Republic of China

To the Shareholders

Dear Sir or Madam,

INTRODUCTION

The purpose of this circular is to provide you with information on the businesses to be transacted at the EGM in respect of the Framework Agreement in relation to the supply of goods, rendering of or receiving services, leasing of assets, transfer of assets, provision of technical authorisation or licensing and provision of guarantee, between the Company and SMNC and any transactions contemplated hereunder.

*For identification purpose only

LETTER FROM THE BOARD

FRAMEWORK AGREEMENT

THE FRAMEWORK AGREEMENT

Reference is made to (i) the Company's announcement dated 3 June 2013 in relation to the establishment of SMNC in the PRC pursuant to a joint venture agreement dated 3 June 2013 entered into among the Company and its wholly-owned subsidiary SMIC Beijing, IDIMC and ZDG (the "2013 Joint Venture Agreement"); (ii) the Company's announcement dated 10 May 2016, the circular dated 7 June 2016 and the extraordinary general meeting poll results announcement dated 24 June 2016 of the Company in relation to the Capital Contribution, which was completed on 30 June 2016. Following the completion of the Capital Contribution, China IC Fund acquired 26.5% equity interest in the registered capital of SMNC. As China IC Fund is a connected person of the Company at the issuer level under the Listing Rules, following the completion of the Capital Contribution, SMNC became a connected subsidiary of the Company as defined under Rule 14A.16 of the Listing Rules and thus a connected person of the Company under the Listing Rules. The transactions between the Company and SMNC have, since 30 June 2016, become connected transactions. As at the date of this circular, the registered capital of SMNC is held as to approximately 51% and 32% by the Group and China IC Fund, respectively.

Reference is also made to the Company's announcement dated 15 July 2016 regarding the arrangement between the Company and SMNC in relation to the supply of goods and services, leasing of assets, acquisition and disposal of equipment and provision of technical authorisation or licensing, as well as the expectation that the Company and SMNC will enter into a framework agreement in relation to the aforementioned transactions.

Reference is also made to the Company's announcement dated 30 September 2016, the circular dated 18 November 2016 and the extraordinary general meeting poll results announcement dated 6 December 2016 in relation to the execution of the 2016 Framework Agreement between the Company (on behalf of itself and its subsidiaries, other than SMNC) and SMNC (on behalf of itself and its subsidiaries).

Reference is also made to the Company's announcement dated 7 December 2017 in relation to the Company (on behalf of itself and its subsidiaries, other than SMNC) and SMNC (on behalf of itself and its subsidiaries) entering into the Framework Agreement in relation to the supply of goods, rendering of or receiving services, leasing of assets, transfer of assets, provision of technical authorisation or licensing and provision of guarantee with a term for three years commencing on 1 January 2018 and ending on 31 December 2020 and subject to the terms and conditions provided therein.

LETTER FROM THE BOARD

Summary of Principal Terms of the Framework Agreement

Execution date: 6 December 2017

Effective period: Commencing on 1 January 2018 and ending on 31 December

2020. Two months before the expiry date of the Framework Agreement, the parties will consider whether to renew the Framework Agreement.

Parties: (i) Group A; and

(ii) Group B

Continuing Connected Transactions

Types of transactions

The Company and SMNC agree to enter into one or more of the following types of transactions with each other including the supply of goods, rendering of or receiving services, leasing of assets, transfer of assets, provision of technical authorisation or licensing and provision of guarantee:

1. Purchase and sale of spare parts, raw materials, photomasks and finished products: Group A and Group B will sell spare parts and raw materials to each other to efficiently utilise each other's resources from time to time. Group A will sell photomasks to Group B. Group B will sell finished products to Group A, which may resell such finished products to its clients directly or after reprocessing;
2. Rendering of or receiving services including, without limitation: (a) processing and testing service; (b) sales service; (c) overseas market promotion and customer service; (d) procurement service; (e) research, development and experiment support service; (f) comprehensive administration, logistics, production management, IT and other service; and (g) water, electricity, gas and heat provision service. Group A and Group B may both provide processing and testing service to the other, although it is expected that Group A would primarily be the service provider and that Group B would primarily be the service recipient. For the other aforementioned categories of services, Group A would be the service provider and Group B would be the service recipient;

3.

Leasing of assets such as plant, office premises and equipment between Group A and Group B. For the leasing of equipment, each party can either be the lessor or the lessee depending on the business need at the relevant time, whereas for the leasing of plant and office premises, Group A will be the lessor and Group B will be the lessee;

4. Transfer of assets: Group A and Group B both engage in the manufacturing of wafers. For certain processes in wafer manufacturing, Group A and Group B can use the same equipment for production. Where required, each party may acquire equipment from the other party or dispose of equipment to the other party in order to meet production needs and optimise production efficiency;

LETTER FROM THE BOARD

5. Provision of technical authorisation or licensing by Group A to Group B for use of its technologies and manufacturing system in relation to 40–28 nanometer, as well as the sharing of research and development costs in relation to 28-nanometer technologies based on their respective plans on future production capacity; and

6. Provision of guarantee: Group A will provide guarantee for Group B's financing activities, including but not limited to bank loans, financial lease and operating leases.

Pricing of the Continuing Connected Transactions

The price of the Continuing Connected Transactions will be determined in accordance with the following general principles in ascending order:

- (1) the price prescribed or approved by state or local price control department (if any);
- (2) a reasonable price in accordance with the industry guided price (if any);
- (3) the comparable local market price, which shall be determined after arm's length negotiation between both parties with reference to (a) the market price charged by independent third parties for comparable product or services at the same time and in the same region; and (b) the lowest quotation that the purchaser can obtain by way of public tender;
- (4) where there is no comparable local market price, the price based on the principle of cost plus a fair and reasonable profit rate, being the aggregate sum of (a) the actual reasonable cost; and (b) a fair and reasonable profit rate; and
- (5) where none of the above general pricing principles (1) to (4) are applicable, the price determined by other reasonable means as agreed upon by both parties on the condition that the relevant costs are identifiable and are allocated to each party involved on a fair and equitable basis.

Where general pricing principles (2) to (5) apply, where possible each of the Group A and Group B will obtain at least two pricing and other terms from independent third parties in relation to transactions with similar nature and size before agreeing upon the applicable price.

As to the price prescribed by the state or local price control department, state-prescribed fees apply to water and electricity, which are relevant to the cost of such services and are determined by prices published from time by time by the relevant PRC government authority. Under the Pricing Law of the PRC, the PRC government may implement a state-prescribed or guidance price for specific goods and services if necessary, and such price will be promulgated in accordance with the requirements of relevant laws, regulations or administrative rules from time to time. If any state-prescribed price or guidance price becomes available to the Continuing Connected Transactions in the future, the parties will execute such price first in accordance with pricing principle (1) above.

Based on the above general principles and the actual circumstances when entering into the Framework Agreement, the parties further agree to the following specific pricing policies for the Continuing Connected Transactions. If any particular Continuing Connected Transaction is not covered by the following policies, or any of the following policies is no longer applicable, the parties will use the above general principles to determine the price for the relevant transaction.

LETTER FROM THE BOARD

I. Purchase and sale of goods

Group A as the seller of spare parts, raw materials and photomasks (general principle (3) above): The personnel in the Corporate Supply Planning Management (“SPM”) department of Group A are responsible for setting the price of the goods. Based on the Group’s “Intercompany Transfer of Goods” policy, the transfer price for material, parts and equipment must be based on market price which is determined by comparing against price quoted by independent third parties for comparable product at the same time and in the same region. As the prices of second-hand tools and equipment in the semiconductor industry vary depending on timing and market supply status, Group A also engages two to three independent brokers, as appropriate depending on the circumstances, to provide quotation based on the specific configurations of a tool or equipment, the selling price is based on the prices provided by these brokers and is not less favourable to Group A.

Group A as the purchaser of spare parts, raw materials and finished products (general principle (3) above): In respect of buying of spare parts and raw materials, the personnel in the SPM of Group A carry out the same procedure as above based on the same policy to ensure purchasing prices are not less favourable to Group A.

In respect of buying finished products from Group B, the transaction involves Group A passing through customers’ orders it receives to Group B. It is a one-way sale of finished product from Group B to Group A. The sales team of Group A is responsible for negotiation with the customers to ensure the prices are at market value and favourable to the Group as a whole. Once a customer’s order is identified as appropriate for production by Group B based on the customer’s request, technology nodes, type of applications and fab availability, the system of Group A will generate a purchase order from Group A to Group B based on the same price, terms and conditions of the purchase order of the customer. According to the arrangement between Group A and Group B, there is no difference between the sales prices from Group A to the customers and the transaction price from Group B to Group A with respect to finished products, since Group B will ultimately undertake all risks associated with the product liability and/or any legal claims arising from the products and will fully cover all potential losses suffered by Group A due to the products supplied by Group B. Upon receiving the payment from customers by Group A, the finance and accounting team of Group A arranges to pay Group B for the finished products. If the customer requires further backend services such as bumping and testing, Group A would perform the services or outsource to other service providers. Group A charges its customers for the total of product costs and services performed.

LETTER FROM THE BOARD

II. Rendering of or receiving services

Each of Group A and Group B is subject to the following general control procedures:

1. Entry into service contract must be in accordance with the Group's regulation rules for intra-group related party transactions and the Framework Agreement;
2. The main department of the service provider will obtain data about the services provided, calculate the amount of charges in accordance with the consideration provisions stipulated in the relevant service contract taking into account of the cost;
3. The service provider will then request payment from the service recipient through the Group's system; and
4. The service recipient will, upon verification of the relevant information, request for payment to be made through the Group's system.

Type of transaction Pricing policy

1. Processing and testing service Group A as the service provider (general principle

(3) above): The SMIC and SMNC Wafer Cost Valuation System can automatically fetch data from the production system and get the basic information of production steps for the services (including information about the type of machine, the process and the standard cost). The manufacturing department of Group B will check such data and the calculation basis together with the person in charge of production costs, and send the service requests to Group A after the review by related party transaction office from time to time. In accordance with the pricing policies under the Framework Agreement (general pricing principle (3) above), officers of different levels of manufacturing department and factories of Group A will review the service requests and calculate the charges with reference to market price and charges to independent third party customers (bearing in mind the actual cost and profit margin involved).

LETTER FROM THE BOARD

Group A as the service recipient (general principle (3) above): The SMIC and SMNC Wafer Cost Valuation System can automatically fetch data from the production system and get the basic information of production steps for the services (including information about the type of machine, the process and the standard cost). The manufacturing department of Group A will check such data and the calculation basis together with the person in charge of production costs, and send the service requests to Group B. In accordance with the pricing policies under the Framework Agreement (general pricing principle (3) above), officers of different levels of manufacturing department and factories of Group B will review the service requests and calculate the charges with reference to market price and charges to independent third party customers (bearing in mind the actual cost and profit margin involved).

2. Sales Service provided by Group A to Group B The sales department of Group A will provide the nature of the relevant sale service and the costs such as labour costs and office expenses. In accordance with the pricing policy of the Framework Agreement (general pricing principle (4) above), the related party transaction team of Group A will calculate the charges based on allocation of the sales expenses according to the revenue from the sales plus a reasonable profit rate of 8%. After the review of finance and accounting department of Group A, Group A will then request for payment from Group B through the Group's system. The business administration or other department(s) designated by the management of Group B will check the data together with the sales department of Group A and submit the relevant payment requests to the related party transaction office for review and approval for payment. The officers of different levels of aforementioned departments of Group B will also further check when transacting the payment.

LETTER FROM THE BOARD

3. Overseas market promotion and customer service provided by Group A to Group B
- The overseas offices of Group A will provide the nature of the relevant sales service and the costs such as labour costs and office expenses. In accordance with the pricing policy of the Framework Agreement (general pricing principle (4) above), the related party transaction team of Group A will calculate the charges based on allocation of the sales expenses according to the revenue from the sales plus a reasonable profit rate of 8%. After the review by finance and accounting department, Group A will then request for payment from Group B through the Group's system. The business administration or other department designated by the management of Group B will check the data together with the relevant department(s) of Group A which provide overseas market promotion and customer service and submit the relevant payment requests to the related party transaction office for review and approval for payment. The officers of different levels of the aforementioned departments of Group B will also further check when transacting the payment.

LETTER FROM THE BOARD

4. Procurement service provided by Group A to Group B
- The procurement service department of Group A will provide the nature of the relevant procurement service and the costs such as labour costs and office expenses. In accordance with the pricing policy of the Framework Agreement (general pricing principle (4) above), the related party transaction team of Group A will calculate the charges based on allocation of procurement department expenses according to working hours or workload plus a reasonable profit rate of 5%. After the review by finance and accounting department, Group A will then request for payment from Group B through the Group's system. The procurement department or other department designated by the management of Group B will check the data together with the procurement department of Group A and submit the relevant payment requests to the related party transaction office for review and approval for payment. The officers of different levels of the aforementioned department of Group B will also further check when transacting the payment.

LETTER FROM THE BOARD

5. Research, development and experiment support service provided by Group A to Group B
- The research and development department of Group A will provide the nature of the relevant service and the costs such as labour costs and office expenses. In accordance with the pricing policies under the Framework Agreement (general pricing principle (3) above), Group A will calculate the charges with reference to market price. The reliability laboratory and/or the product department of Group B will check the data together with the reliability laboratory and/or product department of Group A and submit the relevant payment requests to the related party transaction office for review and approval for payment. The officers of different levels of the aforementioned department of Group B will also further check when transacting the payment request. Market price is assessed using quotes obtained from two or more independent third party providers for similar services. Group A may subcontract certain orders to comparable independent third party providers from time to time as needed. The pricing of services provided by Group A to Group B is based on the quotes obtained from such third party providers. Group A will then request for payment from Group B through the Group's system.

LETTER FROM THE BOARD

6. Comprehensive administration, logistics, production management and IT, and other service provided by the Group A to Group B

The human resources department of Group A will calculate the working hours spent on providing services to Group B by the various departments in Group A. In accordance with the pricing policies under the Framework Agreement (general pricing principle (4) above), the related party transaction team of Group A will calculate the charges based on allocation of labour costs and relevant resources consumption according to the proportion of working hours or workload plus a reasonable profit rate of 5%. After the review by finance and accounting department, Group A will then request for payment from Group B through the Group's system. Group A may also refer to market prices assessed by obtaining quotes from independent third party providers in respect of similar services. The general affairs office, logistics function, manufacturing department and other relevant department(s) (where applicable) of Group B will check the data together with the relevant department(s) of Group A and submit the relevant payment requests to the related party transaction office for review and approval for payment. The officers of different levels of the aforementioned department(s) of Group B will also further check when transacting the payment.

LETTER FROM THE BOARD

7. Water, electricity, gas and heat provision service provided by Group A to Group B
- The facilities department of Group A will record the monthly consumption of water, electricity, gas and heat. In accordance with the pricing policies under the Framework Agreement (general pricing principle (1) above), Group A will calculate the charges based on the price prescribed by Beijing Municipal Commission of Development and Reform published on its website from time to time or with reference to market price. Upon the review and approval by the officer(s) of the relevant business department, Group A will then request for payment from Group B through the Group's system. Group A may also use market prices assessed by obtaining at least two quotes from independent third party providers in respect of similar services. The request for payment shall be reviewed and approved by the officers of the relevant departments of Group A. The facilities department of Group B will further check the unit price of various types of service and the basis of consumption amount in the payment requests and upon the review by the department officer(s), submit to the related party transaction office for review and approval. The officers of different levels of the facilities department of Group B will also need to further check when transacting the payment.

LETTER FROM THE BOARD

III. Leasing of assets

Type of transaction	Pricing policy
1. Leasing of Group A's plant and office premises by Group B	The plant and office premises lease agreement entered into between Group A and Group B for leasing of plant and office premises from Group A to Group B is renewable annually. The agreement was negotiated on arm's length basis. When determining the price Group A made references to the prevailing prices of comparable plants and offices in the same district during the same period (general principle (3) above). As the plant has a built-in clean room, a unique feature of a wafer fab, an additional reasonable charge of 8% of the rental price is charged to Group B to ensure the rental is fair and reasonable and not less favourable to Group A.
2. Mutual leasing of equipment	With respect to mutual leasing of equipment, the rental charge will be determined by reference to the nature of lease, current market conditions and will be on comparable terms with the quotes from independent third parties providing services of a similar nature and comparable scale (general principle (3) above). In terms of leasing of equipment by Group B to Group A, the finance and accounting department of Group A will seek quotation from two or more comparable independent third parties to ensure the rental charged by Group B is not less favourable than those submitted by the independent third parties. In terms of leasing of equipment by Group A to Group B, the finance and accounting department of Group B will seek quotation from two or more comparable independent third parties to ensure the rental charged to Group B is not less favourable than those submitted by the independent third parties.

LETTER FROM THE BOARD

IV. Transfer of assets

Type of transaction	Pricing policy
---------------------	----------------

Mutual acquisition and disposal of equipment	<p>Group A as seller of equipment (general principle)</p> <p>(3) above): In respect of selling equipment, the personnel in the SPM of Group A are responsible for setting the price of equipment. Based on the Group's "Intercompany Transfer of Goods" policy, the transfer price for material, parts, and equipment must be based on market price which is determined by comparing against independent third parties for comparable product at the same time and in the same region. As the prices of second-hand tools and equipment in the semiconductor industry vary depending on timing and market supply status, Group A also engages two to three independent brokers, as appropriate depending on the circumstances, to provide quotation based on the specific configurations of a tool or equipment, the selling price is based on the prices provided by these brokers and is not less favourable to Group A.</p>
--	--

Group A as buyer of equipment (general principle)

(3) above): In respect of buying equipment, the personnel in the SPM of Group A carry out the same procedure as above based on the same policy to ensure purchasing prices are not less favourable to Group A.

LETTER FROM THE BOARD

V. Provision of technical authorisation or licensing

Type of transaction	Pricing policy
1. Provision of technical authorization or licensing by Group A to Group B	The fee for any technical authorisation or licensing will be based on comparable local market price (general principle (3) above). Group B will engage a qualified valuer (as agreed by Group A and Group B) to perform a fair value assessment of the fees relating to the Group A's provision of technical authorisation or licensing to Group B.
2. Sharing of research and development costs in relation to 28-nanometer technologies	The costs are agreed upon by both parties on the condition that the relevant costs are identifiable and are allocated to each party involved on a fair and equitable basis (general principle (5) above). The Company and SMNC entered into a technical authorisation and licensing agreement on 22 December 2014, which specifies that the research and development costs during each calendar year will be proportionally shared by the parties based on the percentage calculated by comparing the number of 28-nanometer nodes that each of them plans to produce during the relevant calendar year against the total number of 28-nanometer nodes both parties plan to produce during the same period. Furthermore, Group B will engage an external auditor (as agreed by Group A and Group B) to provide an independent auditor's report regarding the recognition of the sharing of costs to ensure that it is a fair representation of the incurred costs. Furthermore, the Board of the Company and the Board of SMNC conduct an annual review separately of each of their production plans and the consequential proportion of costs to be shared.

LETTER FROM THE BOARD

VI. Provision of guarantee for financing activities

Type of transaction	Pricing policy
Guarantee provided by Group A for Group B's financing activities	<p>With respect to provision of guarantee by Group A in respect of Group B's financing activities, the service fee for such guarantee will be determined by reference to the market conditions and quotes from independent third parties providing services of a similar nature and comparable scale (general pricing principle</p> <p>(3) above). The finance and accounting department of Group A will seek quotation from two or more comparable independent third parties to ensure the service fee is fair and reasonable and not less favourable to Group A.</p>

The Continuing Connected Transactions will be settled in accordance with the relevant agreement for each transaction. The Company has in place a series of internal control measures to ensure that the terms of the Framework Agreement are fair and reasonable and that the Continuing Connected Transactions will be conducted on normal commercial terms. As the Continuing Connected Transactions also constitute related party transactions for the Company, they will be subject to the related party transaction policy of the Group, which is further explained below.

1. SMNC has established a related party transaction review committee, which is comprised of four non-executive directors of SMNC of which two of them, namely Dr. Zhao HaiJun, the executive Director and Co-Chief Executive Officer of the Company and Dr. Gao Yonggang, the executive Director, Chief Financial Officer and Joint Company Secretary of the Company, were appointed by the Company and the other two were appointed by each of China IC Fund and ZDG. The related party transaction review committee is responsible for reviewing and approving the framework agreement and pricing policy of connected transactions entered into by the SMNC and the Company, with the assistance from the related party transaction office of SMNC. The committee has meeting at least once annually to monitor and review related party transactions between SMNC and the Company;
2. The Company has also established a related party transaction review team, consisting of members from the finance, legal and other related departments of the Company, which reviews the terms of specific connected transaction agreements and reports its findings to the related party transaction review committee;
3. Group A and Group B each employs and maintains separate business, operation and accounting personnel of its own. There is clear segregation of approval authority and duty between the two entities. In general, for each type of the Continuing Connected Transactions under the Framework Agreement, either the Company or SMNC would propose the transaction price after the review and approval by the relevant department(s), such as the manufacturing department, business administration department, the finance and accounting department, depending on the type of the transaction. The counter party of the relevant department(s) will then, also review and

LETTER FROM THE BOARD

approve the pricing of the transaction before acceptance. As the Company and SMNC maintains separate business units and separate personnel, the relevant department(s) that proposes the transaction price and the relevant department(s) of the counter party that accepts such transaction price would be different persons and under different departmental management;

4. The Company's compliance office will perform quarterly check on transactions entered under the Framework Agreement to ensure compliance with pricing policies and annual caps are not exceeded; and

5. The Company's external auditors will conduct an annual review of the transactions entered into under the Framework Agreements to ensure the transaction amounts are within the annual caps and the transactions are in accordance with the terms set out in the Framework Agreements.

In accordance with the Listing Rules, the independent non-executive Directors and the auditors of the Company will also perform an annual review of the terms of the Continuing Connected Transactions to ensure that the pricing policy and the annual caps remain fair and reasonable and that appropriate internal control procedures are in place, and will confirm so each year in the annual report published by the Company.

Considering the general principles and the detailed pricing policies, as well as the internal control procedures in place, the Directors (excluding the independent non-executive Directors) are of the view that the methods and procedures are sufficient to ensure that the Continuing Connected Transactions will be conducted on normal commercial terms or better and not prejudicial to the interests of the Company and its minority Shareholders.

Payment

The consideration of the Continuing Connected Transactions will be paid in accordance with the separate agreement for each specific transaction contemplated under the Framework Agreement and will be funded by the relevant party's internal resources. It is expected that the payment for most of the Continuing Connected Transactions would be settled within 30 days of, or other reasonable period of time after, the specific transaction taking place.

Other Terms

The terms of the Framework Agreement are subject to applicable laws and regulations including the requirements of any regulatory authorities (including but not limited to the Stock Exchange and the New York Stock Exchange, Inc.).

LETTER FROM THE BOARD

THE ANNUAL CAPS AND BASIS OF DETERMINATION

Historical Transaction Amounts

The historical transaction amounts between Group A and Group B for the transactions contemplated under the 2016 Framework Agreement in 2016 and 2017 are as follows:

Nature of Continuing Connected Transactions	Continuing	Connected	From 1 January
	Transactions For the Year Ended 31 December 2016 ⁽¹⁾	Transactions For the Year Ended 31 December 2016 ⁽²⁾	2017 to the Latest Practicable Date ⁽³⁾
	(US\$ million)	(US\$ million)	(US\$ million)
Type I CCT	168.7	249.8	452.3
Type II CCT	23.8	87.6	40.0
Type III CCT	0.4	0.9	0.6
Type IV CCT	—	—	—
Type V CCT	69.1	69.1	76.7

Notes:

(1) Representing the amounts of transactions constituting continuing connected transactions (as defined in the Listing Rules) upon the completion of Capital Contribution on 30 June 2016.

(2) Representing the amounts of all transactions between Group A and Group B for the year ended 31 December 2016.

(3) Unaudited.

Guarantees Provided by the Company to SMNC

The Company has also provided guarantees in respect of certain rental payable by SMNC with respect to its operating lease of equipment to support SMNC's daily operation and business development. As at 31 December 2016 and the Latest Practicable Date, the total amount of financial liabilities of SMNC in respect of which the Company provided guarantee was approximately US\$59.4 million and US\$218 million, respectively.

22

LETTER FROM THE BOARD

Annual Caps

The breakdown for the proposed Annual Caps for the Continuing Connected Transactions is set out below.

Nature of Continuing Connected Transactions	For the Year Ending 31 December		
	2018	2019	2020
	(US\$ million)	(US\$ million)	(US\$ million)
Type I CCT	900	1,100	1,500
Type II CCT	100	150	200
Type III CCT	200	200	200
Type IV CCT	200	200	200
Type V CCT	100	100	100
Type VI CCT	1,000		