SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORP
Form 6-K
June 19, 2009

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 June, 2009
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:

þ 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 þ No

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

SEMICONDUCTOR MANUFACTURING INTERNATIONAL CORPORATION

(Incorporated in Cayman Islands with limited liability)

(Stock Code: 0981)

ANNOUNCEMENT OF 2008 ANNUAL RESULTS

SUMMARY

The Board of Directors is pleased to announce the audited results of the Company for the year ended December 31, 2008.

Highlights include:

Sales decreased by 12.7% from US$1,549.8 million for 2007 to US$1,353.7 million for 2008, primarily due to the transition of DRAM production to logic production in our Beijing fab and the sharp market downturn experienced in the fourth quarter. However, consistent with our stated strategy of focusing on the non-DRAM business, non-DRAM revenue has grown by 14.3% for the same period. The overall number of wafers the Company shipped decreased by 12.9%, from 1,849,957 units of 8-inch equivalent wafers to 1,611,208 units of 8-inch equivalent wafers between these two periods; while, logic only wafer shipments increased 24.9% between these two periods. The average selling price[1] of the wafers the Company shipped remained relatively flat, with a slight increase of 0.2% from US$838 per wafer to US$840. Excluding DRAM revenue, the percentage of wafer revenues that used 0.13 micron and below process technology increased from 24.9% to 38.2% between these two periods.

This announcement is made pursuant to Rules 13.09(1) and 13.49(1) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

1 Based on simplified average selling price which is calculated as total revenue divided by total shipments.

The Directors of Semiconductor Manufacturing International Corporation (SMIC or the Company) are pleased to announce the audited consolidated results of the Company and its subsidiaries (the Group) for the year ended December 31, 2008 as follows:

CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This annual report may contain, in addition to historical information, forward-looking statements within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on SMIC s current assumptions, expectations and projections about future events. SMIC uses words like believe, anticipate, intend, estimate, expect, project and similar expressions to identify forward statements, although not all forward-looking statements contain these words. These forward-looking statements are necessarily estimates reflecting the best judgment of SMIC s senior management and involve significant risks, both known and unknown, uncertainties and other factors that may cause SMIC s actual performance, financial condition or results of operations to be materially different from those suggested by the forward-looking statements including, among others, risks associated with cyclicality and market conditions in the semiconductor industry, intense competition, timely wafer acceptance by SMIC s customers, timely introduction of new technologies, SMIC s ability to ramp new products into volume, supply and demand for semiconductor foundry services, industry overcapacity, shortages in equipment, components and raw materials, availability of manufacturing capacity and financial stability in end markets.

Except as required by law, SMIC undertakes no obligation and does not intend to update any forward-looking statement, whether as a result of new information, future events or otherwise.

BUSINESS REVIEW

In 2008, SMIC continued to focus on improving its product offering, cash position, and strategic partnerships. At the beginning of 2008 SMIC exited the DRAM market, and at the close of 2008 we witnessed a worldwide economic downturn. Despite these challenges, SMIC managed to grow non-DRAM revenue by 14.3% year-on-year, which represents one of the highest growth rate among foundries. In addition, leveraging our strategic position in China, the largest and fastest growing semiconductor market globally, we have also increased our sales to the domestic IC companies by 28% in 2008 over 2007.

Financial Overview

During the first quarter of 2008, the Company reached an agreement with our customers to completely exit the commodity DRAM business. The conversion of DRAM capacity into logic production was completed on schedule in the fourth quarter. As a result, our Beijing 300mm logic capacity has increased by more than 50% by end of 2008 as compared to a year ago. The expansion of our 300mm logic capacity has placed us in a better position to serve our global and China customers. In connection with the decision to exit the commodity DRAM business, we recorded an impairment loss of $105.8 million on long-lived assets during the first quarter of 2008.

Due to the transitioning of the majority DRAM production to logic production in our Beijing fab as well as the sharp market downturn experienced in the fourth quarter, the Company s total revenue declined by 12.7% year-on-year in 2008. However, consistent with our stated strategy of focusing on the non-DRAM business, non-DRAM revenue has grown by 14.3% for the same period. Average selling price[1] for 2008 was $840 as compared to $838 per wafer for 2007.

During 2008, we generated US$569.8 million in cash from operations. In December 2008, we closed the equity transaction with our strategic partner, Datang Telecom Technology & Industry Holdings Co., Ltd. (Datang), and successfully raised US$168.1 million of equity capital at the midst of a difficult market environment. As a result of the new equity and debt repayment, our debt equity ratio has remained at a healthy level of around 40%.

1 Based on simplified average selling price which is calculated as total revenue divided by total shipments.

Capital expenditures in 2008 totaled $666 million, which was mainly allocated to 45nanometer research & development, capacity expansion of 200mm fabs in Shanghai and Tianjin, DRAM to logic capacity conversion in our Beijing fab, and land-use rights and equipment acquired for the Shenzhen project.

Customers and Markets

SMIC serves a global customer base, comprising of leading IDMs, fabless semiconductor companies, and system companies. Leveraging our strategic position in China, we have seen our Greater China business grow strongly during the year, contributing 31% to the overall revenue for 2008, an increase from 24% in 2007. We expect that the strategic partnership with Datang, a leader in the China s mobile telecommunication technologies, will further strengthen our position as one of the leading semiconductor foundries serving the fast growing communications market in China.

Geographically, North American customers, which contributed 57% of the overall revenue, comprised the largest customer group for SMIC in 2008, followed by Asia Pacific at 36%, and Europe at 7%. Our revenue from North American customers has grown strongly in 2008, recording a 17% growth year-on-year. Our North American customers, which include leading IDM and fabless IC companies, showed strong demand in communications products (mainly in mobile), networking and WLAN (Wireless Local Area Network) applications. Our Chinese customers, on the other hand, showed strong demand for consumer and communications products including DTV, MP3, MP4, mobile, PMP, and PDA applications. Contribution from our European customers has dropped significantly in 2008 due to our exit from the commodity DRAM business.

Our consumer and communications contributions grew significantly in 2008. Communication applications, which contributed 51% of our overall revenue, continued to be our strongest sector. Contribution from consumer applications grew from 21% of revenue in 2007 to 32% in 2008. Revenue from consumer application experienced a 33% growth during the year, which we attribute to the growth in our China business. In 2008 contribution to revenue from computing applications dropped to 8% from 26% due to our exit from the commodity DRAM business.

In terms of revenue breakdown by technology node, revenue contribution from the 0.13-micron and below business has dropped to 44% in 2008 as compared to 53% in 2007. However, if we exclude the DRAM revenue, revenue contribution from 0.13micron and below increased to 38% in 2008 from 25% in 2007.

In 2008, we engaged 115 new customers, bringing the total number of customers to 516. A majority of these new customers are Chinese fabless companies. Notably our China business has been growing steadily not only from a revenue perspective, but also from the number of new designs using more advanced technology nodes some pursuing 65-nanometer designs. We are producing a broad range of applications including CIS, Moblie CMMB, HDTV, RFID, and LCOS products for a host of promising new players with innovative designs and applications that are emerging among the Chinese fabless companies.

Research and Development

In 2008, our research and development expenses were $102.2 million, which represented 7.6% of our sales. If we include the amortization of acquired intangible assets, which consist mostly of technology related intellectual properties and technology related cross licenses, the total expenses in research and development were $134.4 million, which represented 9.9% of our sales.

The research and development efforts were focused primarily on our logic and system-on-chip (SOC) business. 2008 marked many milestones for SMIC. Early in the year, Synopsis and SMIC released an enhanced 90-nanometer hierarchical, multi-voltage RTL-to-GDSII reference design flow that will benefit advanced synthesis with built-in capability of design-for-test and design-for-manufacturing. In April 2008, working with a leading China domestic fabless company, we developed a 90-nanometer digital photo frame chip, which is the most integrated multimedia SOC in the market. For advanced CMOS logic, the Company demonstrated a silicon success in the 45-nanometer process ahead of schedule, and also added new intellectual properties in 65-nanometer and 90-nanometer technology services. In addition, the Company successfully developed a 0.11 micron CMOS image sensor (CIS) process technology, one of the most advanced process technologies for CIS currently available in the industry. In Non-Volatile Memory (NVM) technology, the 0.13um ETox went into production in early 2008 and 90-nanometer ETox is currently in risk production now. Our research and development in Micro-Electromechanical System (MEMS) areas also advanced to risk production for our first customer in 2008. Other areas of phase-change memory, HV, mix-signal-signal, and RF technologies were also successfully advanced for smaller size, less power, and lower cost to meet customer demands.

We employ over 800 research and development personnel, combining experienced semiconductor engineers with advanced degrees from leading universities around the world together with top graduates from the leading universities in China.

Outlook for 2009

We expect a challenging year for our business due to the global economic slowdown. However, we are taking proactive steps to manage our business and preserve cash flow during this downturn. We plan to scale back our capital expenditure from $666 million in 2008 to approximately $190 million in 2009. In addition, we target to reduce our payroll costs by 15% in 2009 without any workforce reduction. At the same time, we will continue our efforts in the following areas, which we believe are critical for our long-term success:

- Research and development on advanced SOC technologies
- Ramp-up of our 65-nanometer volume production
- Expand market share by leveraging our advanced HV, CIS, LCOS, RF, EEPROM, and NOR Flash technologies
- 45-nanometer bulk-CMOS technology process qualification for customers production

We will also continue to explore opportunities with our Chinese customers and closely follow the China Economic Stimulus plans to capture potential benefits.

MANAGEMENT DISCUSSION AND ANALYSIS

Consolidated Financial Data

The summary consolidated financial data presented below as of and for the years ended December 31, 2006, 2007 and 2008 is derived from, and should be read in conjunction with, and is qualified in its entirety by reference to, the audited consolidated financial statements, including the related notes, included elsewhere in this Annual Report. The selected consolidated financial data as of December 31, 2004 and 2005 and for the two years then ended is derived from audited consolidated financial statements not included in this Annual Report. The summary consolidated financial data presented below has been prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP).

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

	For the year ended December 31,				
	2004	2005	2006	2007	**2008**
	(in US$ thousands, except for per share and per ADS data)				
Income Statement Data:					
Sales	$ 974,664	$ 1,171,319	$ 1,465,323	$ 1,549,765	$ 1,353,711
Cost of sales(1)	716,225	1,105,134	1,338,155	1,397,038	1,412,851
Gross profit (loss)	258,439	66,185	127,168	152,727	(59,140)
Operating expenses (income):					
Research and development	74,113	78,865	94,171	97,034	102,240
General and administrative	54,038	35,701	47,365	74,490	58,841
Selling and marketing	10,384	17,713	18,231	18,716	20,661
Litigation settlement					
Amortization of acquired intangible assets	14,368	20,946	24,393	27,071	32,191
Impairment loss of long-lived assets					106,741
Income from sale of equipment and other fixed assets			(43,122)	(28,651)	(2,877)
Total operating expenses, net	169,598	153,225	141,038	188,659	317,797
Income (loss) from operations	88,841	(87,040)	(13,870)	(35,932)	(376,937)
Other income (expenses):					
Interest income	10,587	11,356	14,916	12,349	11,542
Interest expense	(13,698)	(38,784)	(50,926)	(37,936)	(50,767)
Foreign currency exchange gain (loss)	8,218	(3,355)	(21,912)	11,250	3,230
Others, net	2,441	4,462	1,821	2,238	7,429
Total other income (expense), net	7,548	(26,322)	(56,101)	(12,100)	(28,566)
Income(Loss) before income tax	96,389	(113,362)	(69,971)	(48,032)	(405,503)
Income tax benefit (expense)	(186)	(285)	24,928	29,720	(26,433)
Minority interest		251	(19)	2,856	(7,851)
		(1,379)	(4,201)	(4,013)	(444)

Loss from equity investment					
Net income (loss) before cumulative effect of a change in accounting principle	96,203	(114,775)	(49,263)	(19,468)	(440,231)
Cumulative effect of a change in accounting principle			5,154		
Net income(loss)	96,203	(114,775)	(44,109)	(19,468)	(440,231)
Deemed dividend on preference shares(2)	18,840				
Income (loss) attributable to holders of ordinary shares	77,363	(114,775)	(44,109)	(19,468)	(440,231)
Income (loss) per share, basic	$ 0.01	$ (0.00)	$ (0.00)	$ (0.00)	$ (0.02)
Income (loss) per share, diluted	$ 0.00	$ (0.00)	$ (0.00)	$ (0.00)	$ (0.02)
Shares used in calculating basic income (loss) per share(3)(4)	14,199,163,517	18,184,429,255	18,334,498,923	18,501,940,489	18,682,544,866
Shares used in calculating diluted income (loss) per share(3)(4)	17,934,393,066	18,184,429,255	18,334,498,923	18,501,940,489	18,682,544,866

(1) Including amortization of deferred stock compensation for employees directly involved in manufacturing activities.

(2) Deemed dividend represents the difference between the sale and conversion prices of warrants to purchase convertible preference shares we issued and their respective fair market values.

(3) Anti-dilutive preference shares, options and warrants were excluded from the weighted average ordinary shares outstanding for the diluted per share calculation. For 2005, 2006, 2007 and 2008, basic income (loss) per share did not differ from diluted loss per share.

(4)

All share information has been adjusted retroactively to reflect the 10-for-1 share split effected upon completion of the global offering of ordinary shares in March 2004 (the Global Offering).

	As of December 31,				
	2004	2005	2006	2007	2008
	(in US$ thousands)				
Balance Sheet Data:					
Cash and cash equivalents	$ 607,173	$ 585,797	$ 363,620	$ 469,284	$ 450,230
Restricted Cash					6,255
Short-term investments	20,364	13,796	57,951	7,638	19,928
Accounts receivable, net of allowances	169,188	241,334	252,185	298,388	199,372
Inventories	144,018	191,238	275,179	248,310	171,637
Total current assets	955,418	1,047,465	1,049,666	1,075,302	926,858
Land use rights, net	39,198	34,768	38,323	57,552	74,293
Plant and equipment, net	3,311,925	3,285,631	3,244,401	3,202,958	2,963,386
Total assets	4,384,276	4,586,633	4,541,292	4,708,444	4,270,622
Total current liabilities	723,871	896,038	677,362	930,190	899,773
Total long-term liabilities	544,462	622,497	817,710	730,790	578,689
Total liabilities	1,268,333	1,518,535	1,495,072	1,660,980	1,478,462
Minority Interest		38,782	38,800	34,944	42,795
Total stockholders equity	$ 3,115,942	$ 3,029,316	$ 3,007,420	$ 3,012,519	$ 2,749,365

	For the year ended December 31,				
	2004	2005	2006	2007	2008
	(in US$ thousands, except percentages and operating data)				
Cash Flow Data:					
Net income (loss)	$ 96,203	$ (114,775)	$ (49,263)	$ (19,468)	$ (440,231)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Depreciation and amortization	456,961	769,472	919,616	706,277	761,809
Net cash provided by (used in) operating activities	518,662	648,105	769,649	672,465	569,782
Purchases of plant and Equipment	(1,838,773)	(872,519)	(882,580)	(717,171)	(669,055)
Net cash used in investing Activities	(1,826,787)	(859,652)	(917,369)	(643,344)	(761,713)
Net cash provided by financing activities	1,469,764	190,364	(74,440)	76,637	173,314
Net increase (decrease) in cash and cash equivalents	$ 161,896	$ (21,376)	$ (222,177)	$ 105,664	$ (19,054)
Other Financial Data:					
Gross margin	26.5%	5.7%	8.7%	9.9%	-4.4%
Operating margin	9.1%	-7.4%	-0.9%	-2.3%	-27.8%
Net margin	9.9%	-9.8%	-3.0%	-1.3%	-32.5%
Operating Data					
Wafers shipped (in units):					
Total(1)	943,463	1,347,302	1,614,888	1,849,957	1,611,208

(1) Including logic, DRAM, copper interconnects and all other wafers.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

Sales

Sales decreased by 12.7% from US$1,549.8 million for 2007 to US$1,353.7 million for 2008, primarily due to the transition of DRAM production to logic production in our Beijing fab and the sharp market downturn experienced in the fourth quarter. However, consistent with our stated strategy of focusing on the non-DRAM business, non-DRAM revenue has grown by 14.3% for the same period. For the full year 2008, the overall wafer shipments were 1,611,208 units of 8-inch equivalent wafers, down 12.9% year-on-year while logic only wafer shipments increased 24.9% year-on-year.

The average selling price[1] of the wafers the Company shipped remained relatively flat, with a slight increase of 0.2% from US$838 per wafer to US$840. Due to the exit from the commodity DRAM business, the percentage of wafer revenues that used 0.13 micron and below process technology decreased from 53.1% to 43.9% between these two periods. However, if we exclude DRAM revenue, the percentage of wafer revenues that used 0.13 micron and below process technology increased from 24.9% to 38.2% between these two periods.

Cost of sales and gross profit (loss)

Cost of sales increased by 1.1% from US$1,397.0 million for 2007 to US$1,412.9 million for 2008. Out of the total cost of sales for 2008, US$663.1 million was attributable to depreciation of plant and equipment and another $28.4 million was attributable to amortization of deferred costs and share-based compensation costs. Out of the total cost of sales for 2007, US$657.8 million was attributable to depreciation of plant and equipment and another $33.8 million was attributable to amortization of deferred costs and share-based compensation costs.

The Company had a gross loss of US$59.1 million for 2008 compared to a gross profit of US$152.7 million in 2007. Gross margins were -4.4% in 2008 compared to 9.9% in 2007. The decrease in gross margins was due to the transition of DRAM production to logic production in our Beijing fab and the sharp market downturn experienced in the fourth quarter.

Operating income, expenses and loss from operations

Operating expenses increased by 68.4% from US$188.7 million for 2007 to US$317.8 million for 2008 primarily due to the impairment charge recorded in 2008 in connection with the decision to exit the commodity DRAM business, as described below. The Company received less income from the sale of equipment and other fixed assets, which was US$28.7 million in 2007 compared to $2.9 million in 2008.

Research and development expenses increased by 5.4% from US$97.0 million for 2007 to US$102.2 million for 2008. The Company received an increase in government subsidies for research & development expenses in 2008; however, expenses associated with 45-nanometer and 65-nanometer technology development, as well as expenses incurred for the Shanghai 12-inch project, also increased in 2008.

[1] Based on simplified average selling price which is calculated as total revenue divided by total shipments.

General and administrative expenses decreased by 21.1% to US$58.8 million for 2008 from US$74.5 million for 2007, primarily due to a decrease in legal fees as well as a foreign exchange gain from operating activities of $8.2 million recorded in 2008, while a foreign exchange loss from operating activities of $3.1 million was recorded in 2007.

Selling and marketing expenses increased by 10.7% from US$18.7 million for 2007 to US$20.7 million for 2008, due to an increase in sales and marketing activities.

As described in Note 13. Acquired intangible assets, net , the amortization of acquired intangible assets increased from US$27.1 million for 2007 to US$32.2 million for 2008.

We assess the impairment of long-lived assets when events or changes in circumstances indicate that the carrying value of the assets or the asset group 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 our use of the assets. An impairment analysis is performed at the lowest level of identifiable independent cash flows for an asset or asset group. We make subjective judgments in determining the independent cash flows that can be related to specific asset group based on our 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 the asset group to our estimate of the related total future undiscounted cash flows. If an asset group s carrying value is not recoverable through the related undiscounted cash flows, the impairment loss is measured by comparing the difference between the asset group s carrying value and its fair value, based on the best information available, including market prices or discounted cash flow analysis.

During the first quarter of 2008, the Company reached an agreement with certain customers to discontinue production of DRAM products and subsequently the Company decided to exit the commodity DRAM business. The Company considered these actions to be an indicator of impairment in regard to plant and equipment of the Company s Beijing facilities. The Company recorded an impairment loss of $105.8 million during the first quarter of 2008, equal to the excess of the carrying value over the fair value of the plant and equipment utilizing a discounted cash flow approach. For the purpose of the analysis, a discount rate of 9% has been used on the expected cash flows to be generated over the remaining useful lives of primary manufacturing machinery and equipments of approximately 5 years.

As a result, the Company s loss from operations was US$376.9 million in 2008 compared to loss from operations of US$35.9 million in 2007. Operating margin was (27.8)% and (2.3)%, respectively, for these two years.

Other income (expenses)

Other expenses increased from US$12.1 million in 2007 to US$28.6 million in 2008 primarily due to an increase in interest expense. This increase in interest expense, from US$37.9 million in 2007 to US$50.8 million in 2008, was primarily due to a decrease in interest subsidy. Foreign exchange gain from non-operating activities decreased from US$11.3 million in 2007 to US$3.2 million in 2008. Total foreign exchange gain, combining the operating and non-operating activities, was US$11.4 million in 2008 as compared to US$8.1 million in 2007.

Net income (loss)

Due to the factors described above, the Company recorded a net loss of US$440.2 million in 2008 compared to a net loss of US$19.5 million in 2007.

Bad debt provision

The Company determines its bad debt provision based on the Company s historical experience and the relative aging of receivables. The Company s bad debt provision excludes receivables from a limited number of customers due to a high level of collection confidence. The Company provides bad debt provision based on the age category of the remaining receivables. A fixed percentage of the total amount receivable is applicable to receivables in each past due age category, ranging from 1% for the shortest past due age category to 100% for the longest past due age category. Any receivables deemed non-collectible will be written off against the relevant amount of provision. The Company s bad debt provision made in 2008, 2007 and 2006 amounted to US$1.3 million, US$0.5 million, and US$3.0 million, respectively. The Company reviews, analyzes and adjusts bad debt provisions on a monthly basis.

Debt Arrangements

Set forth in the table below are the aggregate amounts, as of December 31, 2008, of the Company s future cash payment obligations under the Company s existing contractual arrangements on a consolidated basis:

	Payments due by period				
Contractual obligations	Total	Less than 1 year	1-2 years	3-5 years	After 5 years
	(consolidated, in US$ thousands)				
Short-term borrowings	$ 201,258	$ 201,258	$	$	$
Long-term debt secured long-term loans	897,147	360,629	305,569	230,949	
Operating lease obligations(1)	9,721	6,056	270	441	2,954
Purchase obligations(2)	59,594	59,594			
Other long-term obligations(3)	120,204	78,446	37,204	4,554	
Total contractual obligations	$ 1,287,924	$ 705,983	$ 343,043	$ 235,944	$ 2,954

(1) Represents our obligations to make lease payments to use the land on which our fabs are located and other office equipment we have leased.

(2) Represents commitments for construction or purchase of semiconductor equipment, and other property or services.

(3) Includes the settlement with TSMC for an aggregate of $175 million payable in installments over six years and the other

long-term
liabilities
relating to
certain license
agreements.

As of December 31, 2008, the Company s outstanding long-term liabilities primarily consisted of US$897.1 million in secured bank loans, which are repayable in installments which commenced in June 2006, with the last payment in August 2012.

2006 Loan Facility (SMIC Shanghai). In June 2006, SMIC Shanghai entered into a USD denominated long-term facility arrangement for US$600.0 million with a consortium of international and PRC banks. Of this principal amount, US$393.0 million was used to repay the principal amount outstanding under SMIC Shanghai s bank facilities from December 2001 and January 2004. The remaining principal amount will be used to finance future expansion and general corporate requirement for SMIC Shanghai. This facility is secured by the manufacturing equipment located in SMIC Shanghai 8-inch fabs. As of December 31, 2007, SMIC Shanghai had fully drawn down on this loan facility. The principal amount is repayable starting from December 2006 in ten semi-annual installments. As of December 31, 2008, SMIC Shanghai had repaid US$334 million according to the repayment schedule. In 2008, the interest rate on the loan ranged from 2.47% to 5.76%. The interest expense incurred in 2008 and 2007 were US$17.0 million and US$17.3 million, of which US$5.4 million and US$3.3 million were capitalized as additions to assets under construction in 2008 and 2007, respectively.

The total outstanding balance of these long-term facilities is collateralized by certain plant and equipment at the original cost of US$1,871 million as of December 31, 2008.

The long-term loan agreement entered into in June 2006 contains the following covenants:

Any of the following in respect of SMIC Shanghai would constitute an event of default during the term of the loan agreement (unless otherwise waived by the lenders to such agreement):

Financial covenants for the Borrower including:

1. Consolidated Tangible Net Worth of no less than US$1,200 million;
2. Consolidated Total Borrowings to Consolidated Tangible Net Worth of:
(a) no more than 60% for periods up to and including 31 December 2008; and
(b) no more than 45% thereafter;
3. Consolidated Total Borrowings to trailing preceding four quarters EBITDA not to exceed 1.50x; and
4. Debt Service Coverage Ratio of no less than 1.5x. Debt Service Coverage Ratio means trailing four quarters EBITDA divided by scheduled principal repayments and interest expense for all bank borrowings (including hire purchases, leases and other borrowed monies) for the same period.

Financial covenants for the Guarantor including:
1. Consolidated Tangible Net Worth of no less than US$2,300 million;
2. Consolidated Net Borrowings to Consolidated Tangible Net Worth of:
(a) no more than 50% for period up to and including 30 June 2009;
(b) no more than 40% thereafter; and
3. Consolidated Net Borrowings to trailing four quarters EBITDA of:
(a) no more than 1.50x for periods up to and including 30 June 2009; and
(b) no more than 1.30x thereafter.

2005 Loan Facility (SMIC Beijing). In May 2005, Semiconductor Manufacturing International (Beijing) Corporation (SMIC Beijing) entered into a five year USD denominated loan facility in the aggregate principal amount of US$600.0 million, with a syndicate of financial institutions based in the PRC. This five-year bank loan will be used to expand the capacity of SMIC Beijing s fabs. The drawdown period of this facility was twelve months from the sign off date of the agreement. As of December 31, 2006, SMIC Beijing had fully drawn-down US$600.0 million on this loan facility. The interest rate on this loan facility in 2008 ranged from 3.46% to 6.38%. The principal amount is repayable starting in December 2007 in six semi-annual installments. As of December 2008, SMIC Beijing had repaid an aggregated amount of US$300.0 million according to the repayment schedule. The interest expense incurred in 2008 and 2007 were US$25.6 million and US$42.2 million, of which US$1.6 million and US$2.3 million were capitalized as additions to assets under construction in 2008 and 2007, respectively.

The total outstanding balance of SMIC Beijing USD syndicate loan is collateralized by certain plant and equipment at the original cost of US$1,047 million as of December 31, 2008.

Any of the following in respect of SMIC Beijing would constitute an event of default during the term of the loan agreement (unless otherwise waived by the lenders to such agreement):

Where Net profit + depreciation + amortization + financial expenses (increase of accounts receivable and advanced payments + increase of inventory increase in accounts payable and advanced receipts) divided by financial expenses is less than 1; and

(Total liability borrowings from shareholders, including principal and interest)/ Total assets > 60% (when SMIC Beijing s capacity is less than 20,000 12-inch wafers per month); and (Total liability borrowings from shareholders, including principal and interest)/Total assets > 50% (when SMIC Beijing s capacity exceeds 20,000 12-inch wafers per month).

2005 EUR Loan Facility. On December 15, 2005, the Company entered into a EUR denominated long-term loan facility agreement in the aggregate principal amount of EUR 85 million (equivalent to approximately US$105 million) with ABN Amro Bank N.V. Commerz Bank N.V., Shanghai Branch. The drawdown period of the facility ends on the earlier of (i) thirty six months after the execution of the agreement or (ii) the date which the loans have been fully drawn down. Each draw down made under the facility shall be repaid in full by the Company in ten equal semi-annual installments. SMIC Tianjin had drawn down in 2006 and SMIC Shanghai had drawn down in 2007 and 2008.

As of December 31, 2008, SMIC Tianjin had drawn down EUR15.1 million and repaid an aggregate amount of EUR 9.1 million. As of December 31, 2008, the remaining balance is EUR6.0 million, the equivalent of US$8.6 million. In 2008, the interest rate on the loan ranged from 3.59% to 5.87%. The interest expenses incurred in 2008 and 2007 were US$0.6 million and US$0.7 million of which US$0.1 million and US$0.06 million were capitalized as additions to assets under construction in 2008 and 2007, respectively.

The total outstanding balance of the facility is collateralized by SMIC Tianjin s certain plant and equipment at the original cost of US$21.8 million as of December 31, 2008.

As of December 31, 2008, SMIC Shanghai had drawn down EUR 56.9 million and repaid an aggregate amount of EUR 12.1 million. As of December 31, 2008, the remaining balance is EUR 44.8 million, the equivalent of US$63.4 million. In 2008, the interest rate on the loan ranged from 3.01% to 6.12%. The interest expenses incurred in 2008 and 2007 were US$2.1 million and US$0.3 million of which US$0.7 million and US$0.02 million were capitalized as additions to assets under construction in 2008 and 2007, respectively.

The total outstanding balance of the facility is collateralized by SMIC Shanghai s certain plant and equipment at the original cost of US$114.5 million as of December 31, 2008.

2006 Loan Facility (SMIC Tianjin). In May 2006, SMIC Tianjin entered into a loan facility in the aggregate principal amount of US$300.0 million from a consortium of international and Chinese banks. This facility is secured by the manufacturing equipment located in our Tianjin fab, except for the manufacturing equipment purchased using the EUR denominated loan, and our land use rights and plant in proportion to the principal amount outstanding under this facility and the EUR denominated loan. We have guaranteed SMIC Tianjin s obligations under this facility. As of December 31, 2008 SMIC Tianjin had drawn down US$259.0 million from the facility. The principal amount is repayable starting from 2010 in six semi-annual installments. In 2008, the interest rate on the loan ranged from 3.11% to 6.03%. The interest expenses incurred for the years ended December 31, 2008 and 2007 were US$9.1 million and US$0.3 million, of which US$1.8 million and US$0.02 million were capitalized as additions to assets under construction in 2008 and 2007, respectively.

The total outstanding balance of the facility is collateralized by certain plant and equipment with an original cost of US$627.4 million as of December 31, 2008.

Any of the following in respect of SMIC Tianjin would constitute an event of default during the term of the loan agreement (unless otherwise waived by the lenders to such agreement):

Where Net profit + depreciation + amortization + financial expenses (increase of accounts receivable and advanced payments + increase of inventory increase in accounts payable and advanced receipts) divided by financial expenses is less than 1; and

The ratio of total debt to total assets is more than 60% during the ramp up period of SMIC Tianjin and more than 40% after the facility is at full capacity.

Short-term Credit Agreements. As of December 31, 2008, the Company had ten short-term credit agreements that provided total credit facilities up to US$267.8 million on a revolving credit basis. As of December 31, 2008, the Company had drawn down US$201.2 million under these credit agreements and US$66.6 million is available for future borrowings. The outstanding borrowings under the credit agreements are unsecured. The interest expense incurred in 2008 was US$9.4 million. The interest rate on the loans ranged from 1.88% to 8.75% in 2008.

Capitalized Interest

Interest incurred on funds used to construct plant and equipment during the active construction period is capitalized, net of government subsidies received. The interest capitalized is determined by applying the borrowing interest rate to the average amount of accumulated capital expenditures for the assets under construction during the period. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful life of the assets. Capitalized interest of US$10.7 million, US$7.7 million and US$4.8 million in 2008, 2007, and 2006, respectively, net of government subsidies, has been added to the cost of the underlying assets during the year and is amortized over the respective useful life of the assets. In 2008, 2007, and 2006, the Company recorded amortization expenses relating to the capitalized interest of US$6.9 million, US$5.4 million, and US$4.7 million, respectively.

Commitments

As of December 31, 2008, the Company had commitments of US$7.4 million for facilities construction obligations in Chengdu, Beijing, Tianjin and Shanghai. The Company had commitments of US$52.2 million to purchase machinery and equipment for the testing facility in Chengdu and for the Beijing, Tianjin and Shanghai fabs.

Debt to Equity Ratio

As of December 31, 2008, the Company s debt to equity ratio was approximately 40.0% calculated based on the sum of the short-term borrowings, current portion of long-term debt and long-term debt divided by total shareholders equity.

Foreign Exchange Rate Fluctuation Risk

The Company s revenue, expense, and capital expenditures are primarily transacted in U.S. dollars. However, since the Company has operations consisting of manufacturing, sales and purchasing activities outside of the U.S., the Company enters into transactions in other currencies. The Company is primarily exposed to changes in exchange rate for the Euro, Japanese Yen, and Rmb.

To minimize these risks, the Company purchases foreign-currency forward exchange contracts with contract terms normally lasting less than twelve months to protect against the adverse effect that exchange rate fluctuations may have on foreign-currency denominated activities. These forward exchange contracts are principally denominated in Rmb, Japanese Yen or Euros and do not qualify for hedge accounting in accordance with SFAS No. 133.

Cross Currency Swap Fluctuation Risk

On December 15, 2005, the Company entered into a long-term loan facility agreement in the aggregate principal amount of EUR 85 million. The company is primarily exposed to changes in the exchange rate for the Euro.

To minimize the currency risk, the company entered into cross currency swap contracts with a contract term fully matching the repayment schedule of part of this Euro long-term loan to protect against the adverse effect that exchange rate fluctuations arising from foreign-currency denominated loans. The cross currency swap contracts do not qualify for hedge accounting in accordance with SFAS No. 133.

For the portion of the Euro long-term loan that is not covered by cross currency swap contracts, we have separately entered to into foreign exchange forward contracts to minimize the currency risk. These foreign exchange forward contracts do not qualify for hedge accounting in accordance with SFAS No. 133.

Outstanding Foreign Exchange Contracts

As of December 31, 2008, the Company had outstanding foreign currency forward exchange contracts with notional amounts of US$220.7 million. As of December 31, 2008, the fair value of foreign currency forward exchange contracts was approximately a loss of US$3.5 million, which is recorded in other income and other current assets. The Company had US$220.7 million of foreign currency exchange contracts outstanding as of December 31, 2008, all of which will mature during 2009.

The Company had US$0.4 million of foreign currency exchange contracts outstanding as of December 31,2007, all of which matured in 2008.

The Company had US$35.7 million of foreign currency exchange contracts outstanding as of December 31,2006, all of which matured in 2007.

The Company does not enter into foreign currency exchange contracts for speculative purposes.

	As of December 31, 2008 (in US$ thousands)		As of December 31, 2007 (in US$ thousands)		As of December 31, 2006 (in US$ thousands)	
	2008	Fair Value	2007	Fair Value	2006	Fair Value
Forward Exchange Agreement						
(Receive Jpy/Pay US$)						
Contract Amount					35,660	(2,694)
(Receive Eur/Pay US$)						
Contract Amount	31,144	(440.8)				
(Receive Rmb/Pay US$)						
Contract Amount	189,543	(3,069.5)	404	530.4		
Total Contract Amount	220,687	(3,510.3)	404	530.4	35,660	(2,694)

Outstanding Cross Currency Swap Contracts

As of December 31,2008, the Company had outstanding cross currency swap contracts with notional amounts of US$36.7 million. Notional amounts are stated in the U.S. dollar equivalents at spot exchange rates as of the respective dates. As of December 31, 2008, the fair value of cross currency swap contracts was approximately a loss of US$0.36 million, which is recorded in other income (expenses), net and accrued expenses and other current liabilities. We had US$36.7 million of cross currency swap contracts outstanding as of December 31, 2008, all of which will mature in 2012.

Interest Rate Risk

The Company s exposure to interest rate risks relates primarily to the Company s long-term debt obligations, which the Company generally assumes to fund capital expenditures and working capital requirements. The table below presents annual principal amounts due and related weighted average implied forward interest rates by year of maturity for the Company s debt obligations outstanding as of December 31, 2008. The Company s long-term debt obligations are all subject to variable interest rates. The interest rates on the Company s U.S. dollar-denominated loans are linked to the LIBOR. The interest rates on the Company s EUR-denominated loan is linked to the EURIBOR. As a result, the interest rates on the Company s loans are subject to fluctuations in the underlying interest rates to which they are linked.

	As of December 31,				
	2009	2010	2011	2012	2013
	(Forecast) (in US$ thousands, except percentages)				
US$ denominated					
Average balance	754,059	361,029	133,435	37,225	
Average interest rate	1.83%	1.81%	2.03%	2.22%	
EUR denominated					
Average balance	46,551	29,789	16,201	3,245	
Average interest rate	1.99%	2.01%	2.10%	2.48%	
Weighted average forward interest rate	1.89%	1.89%	2.13%	2.32%	

CONSOLIDATED BALANCE SHEETS

(In US dollars, except share data)

	NOTES	December 31, 2008	December 31, 2007	2006
ASSETS				
Current assets:				
Cash and cash equivalents		$ 450,229,569	$ 469,284,013	$ 363,619,731
Restricted Cash		6,254,813		
Short-term investments	5	19,928,289	7,637,870	57,950,603
Accounts receivable, net of allowances of $5,680,658, $4,492,090 and $4,048,845 at December 31, 2008, 2007 and 2006, respectively	7	199,371,694	298,387,652	252,184,975
Inventories	8	171,636,868	248,309,765	275,178,952
Prepaid expense and other current assets		56,299,086	31,237,755	20,766,945
Receivable for sale of manufacturing equipment		23,137,764	17,321,000	70,544,560
Assets held for sale	9		3,123,567	9,420,729
Total current assets		926,858,083	1,075,301,622	1,049,666,495
Land use rights, net	10	74,293,284	57,551,991	38,323,333
Plant and equipment, net	11	2,963,385,840	3,202,957,665	3,244,400,822
Acquired intangible assets, net	13	200,059,106	232,195,132	71,692,498
Deferred cost, net	28	47,091,516	70,637,275	94,183,034
Equity investment	14	11,352,186	9,896,398	13,619,643
Other long-term prepayments		1,895,337	2,988,404	4,119,433
Deferred tax assets	19	45,686,470	56,915,172	25,286,900
TOTAL ASSETS		$ 4,270,621,822	$ 4,708,443,659	$ 4,541,292,158
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Accounts payable	15	$ 185,918,539	$ 301,992,739	$ 309,129,199
Accrued expenses and other current liabilities		122,173,803	150,109,963	97,121,231
Short-term borrowings	17	201,257,773	107,000,000	71,000,000
Current portion of promissory note	16	29,242,001	29,242,000	29,242,001
Current portion of long-term debt	17	360,628,789	340,692,788	170,796,968
Income tax payable		552,006	1,152,630	72,417
Total current liabilities		899,772,911	930,190,120	677,361,816

	NOTES	2008	2007	2006
Long-term liabilities:				
Promissory notes	16	23,589,958	51,057,163	77,601,657
Long-term debt	17	536,518,281	616,294,743	719,570,905
Long-term payables relating to license agreements	18	18,169,006	62,833,433	16,992,950
Other long term liabilities				3,333,333
Deferred tax liabilities	19	411,877	604,770	210,913
Total long-term liabilities		578,689,122	730,790,109	817,709,758
Total liabilities		1,478,462,033	1,660,980,229	1,495,071,574
Commitments	25			
Minority interest	20	42,795,288	34,944,408	38,800,666
Stockholders equity:				
Ordinary shares, $0.0004 par value, 50,000,000,000 shares authorized, 22,327,784,827, 18,558,919,712 and 18,432,756,463 shares issued and outstanding at December 31, 2008, 2007 and 2006, respectively	21	8,931,114	7,423,568	7,373,103
Additional paid-in capital		3,489,382,267	3,313,375,972	3,288,765,465
Accumulated other comprehensive (loss) income		(439,123)	(1,881)	91,840
Accumulated deficit		(748,509,757)	(308,278,637)	(288,810,490)
Total stockholders equity		2,749,364,501	3,012,519,022	3,007,419,918
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY		$ 4,270,621,822	$ 4,708,443,659	$ 4,541,292,158
Net current assets		$ 27,085,172	$ 145,111,502	$ 372,304,679
Total assets less current liabilities		$ 3,370,848,911	$ 3,778,253,539	$ 3,863,930,342

CONSOLIDATED STATEMENTS OF OPERATIONS
(In US dollars, except share data)

		Year ended December 31,		
	NOTES	2008	2007	2006
Sales	26	$ 1,353,711,299	$ 1,549,765,288	$ 1,465,322,867
Cost of sales		1,412,851,079	1,397,037,881	1,338,155004
Gross (loss) profit		(59,139,780)	152,727,407	127,167,863
Operating expenses (income):				
Research and development		102,239,779	97,034,208	94,170,750
General and administrative		58,841,103	74,489,877	47,364,533
Selling and marketing		20,661,254	18,715,961	18,231,048
Amortization of acquired intangible assets		32,191,440	27,070,617	24,393,561
Impairment loss of long-lived assets	12,13	106,740,667		
Income from sale of equipment and other fixed assets	9,11	(2,877,175)	(28,651,446)	(43,121,929)
Total operating expenses, net		317,797,068	188,659,217	141,037,963
Loss from operations	31	(376,936,848)	(35,931,810)	(13,870,100)
Other income (expense):				
Interest income		11,542,339	12,348,630	14,916,323
Interest expense		(50,766,958)	(37,936,126)	(50,926,084)
Foreign currency exchange gain (loss)		3,229,710	11,249,889	(21,912,234)
Others, net		7,428,721	2,237,902	1,821,337
Total other expense, net		(28,566,188)	(12,099,705)	(56,100,658)
Loss before income tax		(405,503,036)	(48,031,515)	(69,970,758)
Income tax benefit (expense)	19	(26,432,993)	29,719,775	24,927,744
Minority interest		(7,850,880)	2,856,258	(18,803)
Loss from equity investment	14	(444,211)	(4,012,665)	(4,201,247)
Net loss before cumulative effect of a change in accounting principle		(440,231,120)	(19,468,147)	(49,263,064)
Cumulative effect of a change in accounting principle				5,153,986
Net loss		$ (440,231,120)	$ (19,468,147)	$ (44,109,078)
On the basis of net loss before accounting change per share, basic and diluted	23	$ (0.02)	$ (0.00)	$ (0.00)
	23	$	$	$ 0.00

Cumulative effect of an accounting change per share, basic and diluted				
Loss per share, basic and diluted	23	$ (0.02)	$ (0.00)	$ (0.00)
Shares used in calculating basic and diluted loss per share	23	18,682,544,866	18,501,940,489	18,334,498,923

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME (LOSS)
(In US dollars, except share data)

	Share	Ordinary Amount	Additional paid-in capital	Accumulated other comprehensive income (loss)	Deferred stock compensation, net	Accumulated deficit	Total stockholders equity	Comprehen loss
nce at ary 1,	18,301,680,867	$ 7,320,673	$ 3,291,439,835	$ 138,978	$ (24,881,919)	$ (244,701,412)	$ 3,029,316,155	
cise of options	132,744,596	53,098	3,912,210				3,965,308	
rchase of cted ary es	(1,669,000)	(668)	(57,522)				(58,190)	
rred stock pensation tment			(24,881,919)		24,881,919			
e-based pensation			23,506,847				23,506,847	
ulative t of a ge in unting iple			(5,153,986)				(5,153,986)	
oss						(44,109,078)	(44,109,078)	$ (44,109,
gn ncy lation tments				(16,885)			(16,885)	(16,
ized gain tments				(30,253)			(30,253)	(30,
	18,432,756,463	$ 7,373,103	$ 3,288,765,465	$ 91,840	$	$ (288,810,490)	$ 3,007,419,918	$ (44,156,

nce at mber 31,								
cise of options	126,455,749	50,582	3,988,549				4,039,131	
rchase of cted nary es	(292,500)	(117)	(21,383)				(21,500)	
e-based pensation			20,643,341				20,643,341	
oss						(19,468,147)	(19,468,147)	$ (19,468,
gn ncy lation stments				(93,721)			(93,721)	(93,
nce at mber 31,	18,558,919,712	$ 7,423,568	$ 3,313,375,972	$ (1,881)	$	$ (308,278,637)	$ 3,012,519,022	$ (19,561,
cise of options	69,770,815	27,908	768,361				796,269	
nce of nary es to a holder	3,699,094,300	1,479,638	163,620,362				165,100,000	
e-based pensation			11,617,572				11,617,572	
oss						(440,231,120)	(440,231,120)	$ (440,231,
gn ncy lation stments				(437,242)			(437,242)	(437,
nce at mber 31,	22,327,784,827	$ 8,931,114	$ 3,489,382,267	$ (439,123)	$	$ (748,509,757)	$ 2,749,364,501	$ (440,668,

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In US dollars)

	Year ended December 31, 2008	2007	2006
Operating activities:			
Net Loss	$ (440,231,120)	$ (19,468,147)	$ (44,109,078)
Less: Cumulative effect of a change in accounting principle			(5,153,986)
Net loss before cumulative effect of a change in accounting principle	(440,231,120)	(19,468,147)	(49,263,064)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Minority interest	7,850,880	(2,856,258)	18,803
Deferred taxes	11,035,809	(31,234,415)	(25,075,987)
Income from sale of equipment and other fixed assets	(2,877,175)	(28,651,446)	(43,121,929)
Depreciation and amortization	761,808,822	706,277,464	919,616,493
Non-cash interest expense on promissory note and long-term payable relating to license agreements	6,915,567	4,762,343	5,702,607
Amortization of acquired intangible assets	32,191,440	27,070,616	24,393,561
Share-based compensation	11,617,572	20,643,341	23,506,847
Loss from equity investment	444,211	4,012,665	4,201,247
Impairment loss of long-lived assets	106,740,667		
Changes in operating assets and liabilities:			
Accounts receivable, net	99,015,958	(46,202,677)	(10,851,061)
Inventories	76,672,897	26,869,187	(83,941,316)
Prepaid expense and other current assets	(23,968,264)	(9,339,779)	(8,926,442)
Accounts payable	(76,827,049)	19,852,824	24,705,615
Accrued expenses and other current liabilities	(7,487)	2,982,369	(14,722,249)
Income tax payable	(600,624)	1,080,213	72,417
Other long term liabilities		(3,333,333)	3,333,333
Net cash provided by operating activities	569,782,104	672,464,967	769,648,875
Investing activities:			
Purchase of plant and equipment	(669,054,599)	(717,170,957)	(882,580,833)
Proceeds from government grant to purchase plant and equipment	4,181,922		2,208,758
Proceeds from sale of equipment	2,319,597	98,128,041	4,044,702
Proceeds received from sale of assets held for sale	563,008	16,476,045	12,716,742
Purchase of acquired intangible assets	(79,277,586)	(90,090,114)	(9,573,524)
Acquisition of minority interest		(1,000,000)	
Purchase of short-term investments	(291,007,766)	(135,241,799)	(135,058,817)
Sale of short-term investments	278,717,347	185,554,532	90,873,820
Change in restricted cash	(6,254,813)		
Purchase of equity investment	(1,900,000)		

Net cash used in investing activities	(761,712,890)	(643,344,252)	(917,369,152)

	Year ended December 31,		
	2008	2007	2006
Financing activities:			
Proceeds from short-term borrowings	422,575,386	201,658,000	255,003,999
Repayment of short-term borrowings	(328,317,613)	(165,658,000)	(449,485,081)
Proceeds from long-term debt	285,929,954	262,247,672	785,344,546
Repayment of long-term debt	(345,770,415)	(195,628,015)	(635,613,638)
Repayment of promissory note	(30,000,000)	(30,000,000)	(30,000,000)
Payment of loan initiation fee			(3,596,938)
Proceeds from exercise of employee stock options	796,269	4,039,131	3,965,308
Proceeds from issuance of ordinary shares	168,100,000		
Repurchase of restricted ordinary shares		(21,500)	(58,190)
Net cash provided by (used in) financing activities	173,313,581	76,637,288	(74,439,994)
Effect of exchange rate changes	(437,239)	(93,721)	(16,885)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(19,054,444)	105,664,282	(222,177,156)
CASH AND CASH EQUIVALENTS, beginning of year	469,284,013	363,619,731	585,796,887
CASH AND CASH EQUIVALENTS, end of year	$ 450,229,569	$ 469,284,013	$ 363,619,731
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Income taxes paid	$ 15,997,808	$ 435,109	$ 164,409
Interest paid	$ 54,423,059	$ 45,322,891	$ 46,808,533
SUPPLEMENTAL DISCLOSURES OF INVESTING AND FINANCING ACTIVITIES			
Accounts payable for plant and equipment	$ (99,592,362)	$ (138,839,513)	$ (165,828,795)
Long-term payable for acquired intangible assets	$ (18,169,006)	$ (62,833,433)	$ (16,992,950)
Receivables for sales of manufacturing equipment	$ 23,137,764	$ 17,321,000	$ 70,544,560

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 2008, 2007 and 2006
(In US dollars, except where otherwise stated)

1. Organization and Principal Activities

Semiconductor Manufacturing International Corporation was incorporated under the laws of the Cayman Islands on April 3, 2000. As of December 31, 2008, the Company operates primarily through the following subsidiaries:

Name of company	Place and date of incorporation/ establishment	Attributable equity interest held	Principal activity
Better Way Enterprises Limited (Better Way)	Samoa April 5, 2000	100%	Provision of marketing related activities
Semiconductor Manufacturing International (Shanghai) Corporation (SMIS)*#	PRC December 21, 2000	100%	Manufacturing and trading of semiconductor products
SMIC, Americas	United States of America June 22, 2001	100%	Provision of marketing related activities
Semiconductor Manufacturing International (Beijing) Corporation (SMIB)*#	PRC July 25, 2002	100%	Manufacturing and trading of semiconductor products
SMIC Japan Corporation*	Japan October 8, 2002	100%	Provision of marketing related activities
SMIC Europe S.R.L	Italy July 3, 2003	100%	Provision of marketing related activities
SMIC Commercial (Shanghai) Limited Company (formerly SMIC Consulting Corporation)*#	PRC September 30, 2003	100%	Operation of a convenience store
Semiconductor Manufacturing International (Tianjin) Corporation (SMIT)*#	PRC November 3, 2003	100%	Manufacturing and trading of semiconductor products
Semiconductor Manufacturing International (AT) Corporation (AT)*	Cayman Islands July 26, 2004	57.3%	Investment holding
Semiconductor Manufacturing International (Chengdu) Corporation (SMICD)*#	PRC December 28, 2004	57.3%	Manufacturing and trading of semiconductor products
		100%	

SMIC Energy Technology (Shanghai) Corporation (Energy Science)*#	PRC September 9, 2005	Manufacturing and trading of solar cell related semiconductor products

Name of company	Place and date of incorporation/ establishment	Attributable equity interest held	Principal activity
SMIC Development (Chengdu) Corporation*#	PRC December 29, 2005	100%	Construction, operation, and management of SMICD s living quarter, schools, and supermarket
Magnificent Tower Limited	British Virgin Islands January 5, 2006	100%	Investment holding
Semiconductor Manufacturing International	British Virgin Islands April 26, 2007	100%	Investment holding (BVI) Corporation
Admiral Investment Holdings Limited	British Virgin Islands October 10, 2007	100%	Investment holding
SMIC Shenzhen (HK) Company Limited	Hong Kong January 29, 2008	100%	Investment holding
Semiconductor Manufacturing International(Shenzhen) Corporation*#	PRC March 20, 2008	100%	Manufacturing and trading of semiconductor products

\# *Companies registered as wholly foreign-owned enterprises in the People s Republic of China (PRC), excluding for the purpose of this annual report, Hong Kong, Macau and Taiwan.*

* *For identification purposes only*

In addition to the above, the Company has a number of wholly-owned subsidiaries in the

PRC, Hong Kong,
Samoa, the British
Virgin Islands and
Cayman Islands.

Semiconductor Manufacturing International Corporation and its subsidiaries (hereinafter collectively referred to as the Company or SMIC) are mainly engaged in the computer-aided design, manufacturing, packaging, testing and trading of integrated circuits and other semiconductor services, as well as manufacturing and designing semiconductor masks.

2. Summary of Significant Accounting Policies

(a) Basis of presentation

The consolidated financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP).

(b) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its majority owned subsidiaries. All inter-company transactions and balances have been eliminated upon consolidation.

(c) Use of estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenue and expenses in the financial statements and accompanying notes. Significant accounting estimates reflected in the Company s financial statements include valuation allowance for deferred tax assets, allowance for doubtful accounts, inventory valuation, non-marketable equity investment valuation, useful lives and commencement of productive use for plant and equipment and acquired intangible assets, impairment of long-lived assets, accruals for sales adjustments, accrued expenses, contingencies and assumptions related to the valuation of share-based compensation and related forfeiture rates.

(d) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and highly liquid investments which are unrestricted as to withdrawal or use, and which have maturities of three months or less when purchased.

(e) Restricted Cash

Restricted cash consists of bank deposits pledged against short-term credit facilities and unused government grants for fab construction.

(f) Investments

Short-term investments consist primarily of debt instruments and mutual funds are classified either as held-to-maturity, available-for-sale or trading securities.

Held-to-maturity securities are recorded at amortized cost.

Available-for-sale securities are recorded at fair market value. Unrealized gains and losses are recorded as part of accumulated other comprehensive income (loss). The unrealized gains and losses are reclassified to earnings once the available-for-sale investments are settled. Unrealized losses, which are deemed other than temporary, are recorded in the statement of operations as other expenses.

Trading securities are recorded at fair value with unrealized gains and losses classified in earnings.

Equity investments are recorded in long-term assets and accounted for under the equity method when the Company has the ability to exercise significant influence, but not control, over the investee or under the cost method when the investment does not qualify for the equity method. Equity method investments only include non-marketable investments.

Available-for-sale and non-marketable equity investments are evaluated for impairment when the Company identifies indicator of impairment. Investments are considered to be impaired when a decline in fair value is judged to be other than temporary, when events or circumstances are identified that would significantly harm the fair value of the investment and the fair value is significantly below cost basis and /or the significant decline has lasted for an extended period of time. If the investment is other than temporarily impaired, the investment would be written down to its fair value.

(g) Concentration of credit risk

Financial instruments that potentially expose the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short-term investments, accounts receivable, other current assets and receivable for sale of manufacturing equipment. The Company places its cash and cash equivalents with reputable financial institutions.

The Company conducts credit evaluations of customers and generally does not require collateral or other security from its customers. The Company establishes an allowance for doubtful accounts based upon estimates, factors surrounding the credit risk of specific customers and other information.

(h) Inventories

Inventories are stated at the lower of cost (weighted average) or market. Cost comprises direct materials, direct labor costs and those overheads costs that were incurred in bringing the inventories to their present location and condition.

Adjustments are recorded to write down the cost of obsolete and excess inventory to the estimated market value based on historical and forecasted demand. In 2008, 2007 and 2006, inventory was written down by $40,818,979, $22,676,608 and $16,106,471, respectively, and recorded in cost of sales to reflect the lower of cost or market adjustments.

(i) Land use rights, net

Land use rights are recorded at cost less accumulated amortization. Amortization is provided over the term of the land use right agreement on a straight-line basis over the terms of the agreements, which range from 50 to 70 years.

(j) Plant and equipment, net

Plant and equipment are carried at cost less accumulated depreciation and are depreciated on a straight-line basis over the following estimated useful lives:

Buildings	25 years
Facility, machinery and equipment	10 years
Manufacturing machinery and equipment	5-7 years
Furniture and office equipment	3-5 years
Transportation equipment	5 years

The Company constructs certain of its plant and equipment. In addition to costs under the construction contracts, external costs directly related to the construction of such facilities, including duties and tariffs, equipment installation and shipping costs, are capitalized. Interest incurred on funds used to construct plant and equipment during the active construction period is capitalized, net of government subsidies received. See Note 2(n). Depreciation is recorded at the time assets are ready for their intended use.

(k) Acquired intangible assets

Acquired intangible assets, which consist primarily of technology, licenses and patents, are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the expected useful lives of the assets of 3 to 10 years.

(l) Impairment of long-lived assets

The Company assesses the impairment of long-lived assets when events or changes in circumstances indicate that the carrying value of the assets or the asset group 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 our use of the assets. An impairment analysis is performed at the lowest level of identifiable independent cash flows for an asset or asset group. We make subjective judgments in determining the independent cash flows that can be related to specific asset group based on our 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 the asset group to our estimate of the related total future undiscounted cash flows. If an asset group s carrying value is not recoverable through the related undiscounted cash flows, the impairment loss is measured by comparing the difference between the asset group s carrying value and its fair value, based on the best information available, including market prices or discounted cash flow analysis.

(m) Revenue recognition

The Company manufactures semiconductor wafers for its customers based on the customers designs and specifications pursuant to manufacturing agreements and/or purchase orders. The Company also sells certain semiconductor standard products to customers. Revenue is recognized when persuasive evidence of an arrangement exists, service has been performed, the fee is fixed or determinable and collectability is reasonably assured. Sales to customers are recognized upon shipment and title transfer, if all other criteria have been met. The Company also provides certain services, such as mask making, testing and probing. Revenue is recognized when the services are completed or upon shipment of semiconductor products, if all other criteria have been met.

Customers have the right of return within one year pursuant to warranty and sales return provisions. The Company typically performs tests of its products prior to shipment to identify yield rate per wafer. Occasionally, product tests performed after shipment identify yields below the level agreed with the customer. In those circumstances, the customer arrangement may provide for a reduction to the price paid by the customer or for the costs to return products and to ship replacement products to the customer. The Company estimates the amount of sales returns and the cost of replacement products based on the historical trend of returns and warranty replacements relative to sales as well as a consideration of any current information regarding specific known product defects that may exceed historical trends.

The Company provides management services to certain government-owned foundries. Service revenue is recognized when persuasive evidence of an arrangement exists, service has been performed, the fee is fixed or determinable, and collectability is reasonably assured.

(n) Capitalization of interest

Interest incurred on funds used to construct plant and equipment during the active construction period is capitalized, net of government subsidies received. The interest capitalized is determined by applying the borrowing interest rate to the average amount of accumulated capital expenditures for the assets under construction during the period. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful life of the assets. Government subsidies, capitalized interest and net interest expense are as follows:

	For the year ended December 31,		
	2008	2007	2006
Total actual interest expense	$ 70,735,520	$ 72,686,950	$ 78,120,699
Less: Government subsidy	9,308,764	27,083,604	22,396,613
Less: Capitalized interest	10,659,798	7,667,220	4,798,002
Net interest expense	$ 50,766,958	$ 37,936,126	$ 50,926,084

(o) Government subsidies

The Company received the following types of government subsidies:

(1) Reimbursement of certain interest costs incurred on borrowings

The Company received government subsidies in cash of $9,308,764, $27,083,604 and $22,396,613 in 2008, 2007 and 2006, respectively, which were based on the interest expense on the Company s budgeted borrowings. The Company records government subsidies as a reduction of interest expense on an accrual basis.

(2) Government awards

The Company received government awards of $56,967,187, $5,058,722 and $11,886,551 in the form of reimbursement of certain expenses in 2008, 2007 and 2006, respectively. These awards were recorded as reductions of related expenses, primarily research and development.

(3) Government subsidy for fab construction

Certain local governments provided subsidies to encourage the Company to participate and manage new plants relating to the integrated circuit industry.

As of December 31, 2008, the Company received $7,324,792, of which $4,181,922 has been used to offset the cost of construction in progress. The unused balance of $3,142,870 is recorded in restricted cash.

In 2006, the Company received a government subsidy of $2,208,758 as a reimbursement of land use right payment, which has been used to offset the cost of the land use rights.

(p) Research and development costs

Research and development costs are expensed as incurred and reported net of related government subsidies.

(q) Start-up costs

In accordance with Statement of Position No. 98-5, Reporting on the costs of start-up activities, the Company expenses all costs incurred in connection with start-up activities, including preproduction costs associated with new manufacturing facilities and costs incurred with the formation of these facilities such as organization costs. Preproduction costs including the design, formulation and testing of new products or process alternatives are included in research and development expenses. Preproduction costs including facility and employee costs incurred in connection with constructing new manufacturing plants are included in general and administrative expenses.

(r) Foreign currency translation

The United States dollar (US dollar), the currency in which a substantial portion of the Company s transactions are denominated, is used as the functional and reporting currency of the Company. Monetary assets and liabilities denominated in currencies other than the US dollar are translated into US dollar at the rates of exchange ruling at the balance sheet date. Transactions in currencies other than the US dollar during the year are converted into the US dollar at the applicable rates of exchange prevailing on the transaction dates. Transaction gains and losses are recognized in the statements of operations.

The financial records of certain of the Company s subsidiaries are maintained in local currencies other than the US dollar, such as Japanese Yen, which are their functional currencies. Assets and liabilities are translated at the exchange rates at the balance sheet date. Equity accounts are translated at historical exchange rates, and revenues, expenses, gains and losses are translated using the monthly weighted average exchange rates. Translation adjustments are reported as cumulative translation adjustments and are shown as a separate component of other comprehensive income (loss) in the statements of stockholders equity and comprehensive income (loss).

(s) Income taxes

Current income taxes are provided for in accordance with the laws of the relevant taxing authorities.

As part of the process of preparing financial statements, the Company is required to estimate its income taxes in each of the jurisdictions in which it operates. The Company accounts for income taxes using the liability method. Under this method, deferred income taxes are recognized for tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year-end, based on enacted laws and statutory tax rates applicable for the difference that are expected to affect taxable income. Valuation allowances are provided if, based on available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

On January 1, 2007, the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN 48), which prescribes a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods and income tax disclosures.

(t) Comprehensive income (loss)

Comprehensive income (loss) includes such items as net loss, foreign currency translation adjustments and unrealized income (loss) on available-for-sales securities. Comprehensive income (loss) is reported in the statements of stockholders equity and comprehensive income (loss).

(u) Fair value of financial instruments

On January 1, 2008, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 157 Fair Value Measurements (SFAS 157) for all financial assets and financial liabilities recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company has deferred its implementation of the provisions of SFAS No. 157 for all non-financial assets and liabilities in accordance with FASB Staff Position (FSP) FAS 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2), SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and enhances fair value measurement disclosure. The adoption of SFAS No. 157 did not have a significant impact on our consolidated financial statements, and the resulting fair values calculated under SFAS No. 157 after adoption were not significantly different than the fair values that would have been calculated under previous guidance.

In October 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP 157-3). FSP 157-3 clarifies the application of SFAS No. 157 in a market that is not active, and addresses application issues such as the use of internal assumptions when relevant observable data does not exist, the use of observable market information when the market is not active, and the use of market quotes when assessing the relevance of observable and unobservable data. FSP 157-3 is effective for all periods presented in accordance with SFAS No. 157. The adoption of FSP 157-3 did not have a significant impact on our consolidated financial statements or the fair values of our financial assets and liabilities.

When available, the Company measures the fair value of financial instruments based on quoted market prices in active markets, valuation techniques that use observable market-based inputs or unobservable inputs that are corroborated by market data. Pricing information the Company obtains from third parties is internally validated for reasonableness prior to use in the consolidated financial statements. When observable market prices are not readily available, the Company generally estimates the fair value using valuation techniques that rely on alternate market data or inputs that are generally less readily observable from objective sources and are estimated based on pertinent information available at the time of the applicable reporting periods. In certain cases, fair values are not subject to precise quantification or verification and may fluctuate as economic and market factors vary and the Company s evaluation of those factors changes. Although the Company uses its best judgment in estimating the fair value of these financial instruments, there are inherent limitations in any estimation technique. In these cases, a minor change in an assumption could result in a significant change in its estimate of fair value, thereby increasing or decreasing the amounts of the Company s consolidated assets, liabilities, stockholders equity (deficit) and net income or loss. See Note 4, Fair Value , for further details.

On January 1, 2008, the Company adopted SFAS No. 159, Fair Value of Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No.115 (SFAS 159). SFAS 159 permits companies to choose to measure certain financial instruments and other items at fair value using an instrument-by-instrument election. The Company does not elect to use the fair value option and therefore, the adoption of SFAS 159 did not have a material impact on the Company s consolidated financial position or result of operations.

(v) Share-based compensation

The Company grants stock options to its employees and certain non-employees. Under the provisions of SFAS 123(R), share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee s requisite service period (generally the vesting period of the equity grant).

The Company s total actual share-based compensation expense for the years ended December 31, 2008, 2007 and 2006 was $11,617,572, $20,643,341 and $23,506,847, respectively.

(w) Derivative financial instruments

The Company s primary objective for holding derivative financial instruments is to manage currency and interest rate risks. The Company records derivative instruments as assets or liabilities, measured at fair value. The Company does not offset the carrying amounts of derivatives with the same counterparty in accordance with FASB Interpretation (FIN) No. 39, Offsetting of Amounts Related to Certain Contracts an interpretation of APB Opinion No. 10 and FASB Statement No. 105 (FIN 39) as amended. The recognition of gains or losses resulting from changes in the values of those derivative instruments is based on the use of each derivative instrument. The Company does not have any derivative instruments that qualify for hedge accounting.

(x) Recently issued accounting standards

In December 2007, the FASB issued SFAS No. 141, Business Combinations: (Revised 2007) (SFAS 141R). SFAS 141R is relevant to all transactions or events in which one entity obtains control over one or more other businesses. SFAS 141R requires an acquirer to recognize any assets and noncontrolling interest acquired and liabilities assumed to be measured at fair value as of the acquisition date. Liabilities related to contingent consideration are recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of the consideration may be resolved beyond a reasonable doubt. This revised approach replaces SFAS 141 s cost allocation process in which the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their respective fair value. SFAS 141R requires any acquisition-related costs and restructuring costs to be expensed as incurred as opposed to allocating such costs to the assets acquired and liabilities assumed as previously required by SFAS 141. Under SFAS 141R, an acquirer recognizes liabilities for a restructuring plan in purchase accounting only if the requirements of SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities , are met. SFAS 141R allows for the recognition of pre-acquisition contingencies at fair value only if these contingencies are likely to materialize. If this criterion is not met at the acquisition date, then the acquirer accounts for the non-contractual contingency in accordance with recognition criteria set forth under SFAS 5, Accounting for Contingencies , in which case no amount should be recognized in purchase accounting. SFAS 141R is effective as of the beginning of an entity s first fiscal year that begins after December 15, 2008. The adoption of SFAS 141R will change the Company s accounting treatment for business combination on a prospective basis beginning on January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51 (SFAS 160). This Statement amends ARB 51, Consolidated Financial Statements, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity and should be reported as equity on the financial statements. SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. Furthermore, disclosure of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest is required on the face of the financial statements. SFAS 160 is effective as of the beginning of an entity s first fiscal year that begins after December 15, 2008. The Company will incorporate the presentation requirements outlined by SFAS No. 160 on January 1, 2009.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 enhances the required disclosures under SFAS 133, Accounting for Derivative Instruments and Hedging Activities , in order to provide the investing community additional transparency in an entity s financial statements and to more adequately disclose the impact investments in derivative instruments and use of hedging have on financial position, operating results and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early application allowed. SFAS 161 does not change the accounting treatment for derivative instruments and will change the Company s disclosure for derivative instruments and hedging activities on January 1, 2009.

In April, 2008, the FASB issued FSP. FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP 142-3). In determining the useful life of acquired intangible assets, FSP 142-3 removes the requirement to consider whether an intangible asset can be renewed without substantial cost of material modifications to the existing terms and conditions and, instead, requires an entity to consider its own historical experience in renewing similar arrangements. FSP 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. FSP 142-3 is effective for fiscal years beginning after December 15, 2008. The guidance for determining the useful life of a recognized intangible asset must be applied prospectively to intangible assets acquired after the effective date. Early adoption is prohibited. The adoption of FSP 142-3 will not have a material impact on the Company s consolidated financial position or result of operations.

In November 2008, the Emerging Issues Task Force issued EITF No. 08-6, Equity Method Investment Accounting Considerations (EITF 08-6) that addresses how the initial carrying value of an equity method investment should be determined, how an impairment assessment of an underlying indefinite-lived intangible asset of an equity method investment should be performed, how an equity method investee s issuance of shares should be accounted for, and how to account for a change in an investment from the equity method to the cost method. EITF 08-6 shall be effective in fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years. EITF 08-6 shall be applied prospectively with early application prohibited. The impact of adopting EITF 08-6 will not have a material impact on our consolidated financial condition or results of operations.

(y) Loss per share

Basic loss per share is computed by dividing loss attributable to holders of ordinary shares by the weighted average number of ordinary shares outstanding (excluding shares subject to repurchase) for the year. Diluted loss per ordinary share reflects the potential dilution that could occur if securities or other contracts to issue ordinary shares were exercised or converted into ordinary shares. Ordinary share equivalents are excluded from the computation in loss periods as their effects would be anti-dilutive.

3. Change in Accounting Estimate in 2007

Prior to January 2007, all manufacturing machinery and equipment were depreciated over estimated useful lives of 5 years. From January 1, 2007 onward, the Company re-evaluated the periods over which the equipment is available to use and extended the estimated useful lives of the manufacturing machinery and equipment based on historical usage experience and industry practices. The useful lives of the manufacturing machinery and equipment used in the wafer manufacturing processing were changed from 5 years to a 5 to 7 year range. The change in accounting estimate resulted in lower depreciation expense of $248,218,139 for the year ended December 31, 2007.

4. Fair Value

SFAS No. 157 defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, we consider the principal or most advantageous market in which we would transact and we consider assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of non-performance.

Fair Value Hierarchy

SFAS No. 157 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs are obtained from independent sources and can be validated by a third party, whereas unobservable inputs reflect assumptions regarding what a third party would use in pricing an asset or liability. A financial instrument s categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. SFAS No. 157 establishes three levels of inputs that may be used to measure fair value that gives the highest priority to observable inputs and the lowest priority to unobservable inputs as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than quoted market prices in active markets that are observable, either directly or indirectly.

Level 3 Unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities.

The Company uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The Company performs a thorough analysis of the assets and liabilities within the scope of SFAS 157 to determine the appropriate level based on the observability of the inputs used in the valuation techniques. Assets and liabilities carried at fair value as of December 31, 2008 are classified in the categories described above based on the lowest level input that is significant to the fair value measurement in its entirety.

Financial Instruments Measured at Fair Value on a Recurring Basis

Financial instruments measured on the Company s balance sheet at fair value on a recurring basis subsequent to initial recognition consisted of the following:

	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance
Liabilities:				
Forward foreign exchange contracts	$	$ 3,510,305	$	$ 3,510,305
Cross-currency interest swap contracts		360,089		360,089
Derivative liabilities measured at fair value	$	$ 3,870,394	$	$ 3,870,394

The derivatives were priced by models that use readily observable market inputs, such as time value, forward interest rates, volatility factors, and current and forward market prices for foreign currency.

Financial Instruments not Recorded at Fair Value

The Company discloses the fair value of financial instruments that are not carried at fair value in accordance with SFAS 107, Disclosure of Fair Value of Financial Instruments . Financial instruments include cash and cash equivalents, restricted cash, held-to-maturity investments, equity and cost method investments, short-term borrowings, promissory note, long-term payables relating to license agreements, long-term debt, accounts payables, accounts receivables, other current assets and receivables for sale of manufacturing equipment. The fair values of cash and cash equivalents, restricted cash and short-term borrowings approximate their carrying values due to their short-term maturities. The fair value of long-term promissory notes and payables relating to license agreements was approximately $42,253,031 which was calculated based on current interest rates over the remaining payment terms. The fair value of long-term debt approximates its carrying value due to variable interest rates that approximate market rates. The fair value of cost method investment could not be practically estimated due to its non-marketability.

5. Short-term Investments

As of December 31, 2008 and 2007, the Company has the following held-to-maturity security, respectively:

	Debt instruments maturing in one year			
	Amortized Cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2008	$ 19,928,289	$	$	$ 19,928,289
December 31, 2007	$ 7,637,870	$	$	$ 7,637,870

As of December 31, 2006, the Company has available-for-sale security as follows:

	December 31, 2006			
	Cost	Gross Unrealized gains	Gross Unrealized losses	Fair value
Mutual fund	$ 52,866,825	$	$	$ 52,866,825

As of December 31, 2006, the Company held certain trading securities with cost of $5,000,000 and fair value of $5,083,778.

6. Derivative Financial Instruments

The Company has the following notional amount of derivative instruments:

	December 31		
	2008	2007	2006
Forward foreign exchange contracts	$ 220,687,295	$ 404,103	$ 35,660,177
Interest rate swap contracts			250,000,000
Cross-currency interest rate swap contracts	36,731,630	51,057,531	15,947,874
	$ 257,418,925	$ 51,461,634	$ 301,608,051

The Company purchases foreign-currency forward exchange contracts with contract terms expiring within one year to protect against the adverse effect that exchange rate fluctuations may have on foreign-currency denominated purchase activities, principally the Renminbi, the Japanese Yen and the European Euro. The foreign-currency forward exchange contracts do not qualify for hedge accounting. Notional amounts are stated in the US dollar equivalents at spot exchange rates at the respective dates.

Settlement currency	**Notional amount**	**US dollar equivalents**
As of December 31, 2008		
European Euro	21,979,034	$ 31,144,291
Renminbi	1,294,294,400	189,543,004
		$ 220,687,295
As of December 31, 2007		
Renminbi	2,950,400	$ 404,103
As of December 31, 2006		
Japanese Yen	4,235,537,500	$ 35,660,177

In 2007 and 2006, the Company entered into various cross-currency interest rate swap agreements to protect against volatility of future cash flows caused by the changes in both interest rates and exchange rates associated with outstanding long-term debt that are denominated in a currency other than the US dollar. The cross-currency interest rate swap agreements did not qualify for hedge accounting. Notional amounts are stated in the US dollar equivalents at spot exchange rates at the respective dates.

Settlement currency	Notional amount	US dollar equivalents
As of December 31, 2008		
Euro	25,922,110	$ 36,731,630
As of December 31, 2007		
Euro	34,624,665	$ 51,057,531
As of December 31, 2006		
Euro	12,098,220	$ 15,947,874

In 2006, the Company entered into various interest rates swap contracts to protect against volatility of future cash flows caused by the changes in interest rates associated with outstanding debt. The interest rate swap contracts did not qualify for hedge accounting. In 2006, gains or losses on the interest rate swap contracts of $(5,641,467) were recognized in interest expense, respectively. As of December 31, 2006, the Company had outstanding interest rate swap contracts with notional amounts of $250,000,000.

The fair values of each derivative instrument are as follows:

	December 31		
	2008	2007	2006
Forward foreign exchange contracts	$ (3,510,305)	$ 530,354	$ (2,694,415)
Interest rate swap contracts			(5,641,467)
Cross-currency interest rate swap contracts	(360,089)	1,003,275	323,630
	$ (3,870,394)	$ 1,533,629	$ (8,012,252)

As of December 31, 2008, 2007 and 2006, the fair value of the derivative instruments was recorded in accrued expenses and other current liabilities, prepaid expense and other current assets, and accrued expenses and other current liabilities, respectively, with the change in fair value of forward foreign exchange contracts recorded in other income (expense) and the change in fair value of interest rate swap contract and cross currency interest rate swap contracts recorded in interest expense.

7. Accounts Receivable, Net of Allowances

The Company determines credit terms for each customer on a case-by-case basis, based on its assessment of such customer s financial standing and business potential with the Company.

An aging analysis of accounts receivable, net of allowance for doubtful accounts, is as follows:

	2008	2007	2006
Current	$ 108,109,977	$ 249,489,644	$ 213,539,198
Overdue:			
Within 30 days	18,211,498	39,131,577	31,611,729
Between 31 to 60 days	6,073,500	6,107,866	5,879,705
Over 60 days	66,976,719	3,658,565	1,154,343
	$ 199,371,694	$ 298,387,652	$ 252,184,975
Allowance for doubtful accounts	$ (5,680,658)	$ (4,492,090)	$ (4,048,845)

The change in the allowance for doubtful accounts is as follows:

	2008	2007	2006
Balance, beginning of year	$ 4,492,090	$ 4,048,845	$ 1,091,340
Provision recorded during the year	1,301,556	486,920	2,957,505
Write-offs in the year	(112,988)	(43,675)	
Balance, end of year	$ 5,680,658	$ 4,492,090	$ 4,048,845

8. Inventories

	2008	2007	2006
Raw materials	$ 76,299,347	$ 83,645,656	$ 89,431,781
Work in progress	53,674,794	139,959,481	150,506,509
Finished goods	41,662,727	24,704,628	35,240,662
	$ 171,636,868	$ 248,309,765	$ 275,178,952

9. Assets Held For Sale

Assets held for sale represent residential real estate that the Company has constructed for its employees.

In 2008, the Company sold residential real estate units with a carrying value of $1,594,508 for $2,283,375, which resulted in a gain on sale of $688,867. The Company reclassified the remaining unsold real estate units of $1,529,057 to land use rights and plant and equipment.

In 2007, the Company sold residential real estate units with a carrying value of $8,402,962 for $12,599,790, which resulted in a gain on sale of $4,196,828. Meanwhile, the Company reclassified the remaining unsold real estate units of $1,017,767 of 2007 to land use rights and plant and equipment. In addition, the Company decided to offer employees another 42 residential real estate units, and classified the $3,123,567 carrying value as assets held for sale, among which, none have been sold out up to December 31, 2007.

In 2006, the Company offered to sell employees 381 residential real estate units, and classified the $17,097,675 carrying value as assets held for sale. The Company sold residential real estate units with a carrying value of $7,676,946 for $8,934,560, which resulted in a gain on sale of $1,257,614. The remaining balances of assets held for sale as of December 31, 2006 was $9,420,729, representing 213 residential real estate units.

10. Land Use Rights, Net

	2008	2007	2006
Land use rights (50 70 years)	$ 80,079,885	$ 62,410,846	$ 42,485,856
Less: accumulated amortization	(5,786,601)	(4,858,855)	(4,162,523)
	$ 74,293,284	$ 57,551,991	$ 38,323,333

11. Plant and Equipment, Net

	2008	2007	2006
Buildings	$ 292,572,075	$ 283,153,927	$ 269,721,109
Facility, machinery and equipment	540,021,636	470,434,074	435,112,058
Manufacturing machinery and equipment	5,467,846,683	5,035,366,468	4,539,566,491
Furniture and office equipment	76,210,542	67,835,774	61,979,029
Transportation equipment	1,768,949	1,750,734	1,666,185
	6,378,419,885	5,858,540,977	5,308,044,872
Less: accumulated depreciation and impairment	(3,763,083,884)	(2,930,088,762)	(2,314,667,455)
Construction in progress	348,049,839	274,505,450	251,023,405
	$ 2,963,385,840	$ 3,202,957,665	$ 3,244,400,822

The Company recorded depreciation expense of $760,881,076, $705,391,171 and $919,038,915 for the years ended December 31, 2008, 2007 and 2006, respectively. In 2008, the Company sold equipment with a carrying value of $5,948,053 for $8,136,361, which resulted in a gain on sale of $2,188,308. In 2007, the Company sold equipment with a carrying value of $26,920,427 for $51,375,045, which resulted in a gain on sale of $24,454,618. In 2006, the Company sold equipment with a carrying value of $26,554,170 for $68,418,485, which resulted in a gain on sale of $41,864,315.

12. Impairment of plant and equipment

In 2008, the Company reached an agreement with certain customers to discontinue production of DRAM products and subsequently the Company decided to exit the commodity DRAM business as a whole. The Company considered these actions to be an indicator of impairment in regard to certain plant and equipment of the Company s Beijing facilities. The Company recorded an impairment loss of $105,774,000, equal to the excess of the carrying value over the fair value of the associated assets. The Company computed the fair value of the plant and equipment utilizing a discounted cash flow approach. For the purpose of the analysis, the Company applied a discount rate of 9% to the expected cash flows to be generated over the remaining useful lives of primary manufacturing machinery and equipment of approximately 5 years.

13. Acquired Intangible Assets, Net

	2008	2007	2006
Technology, Licenses and Patents			
Cost:	$ 323,457,444	$ 322,435,363	$ 134,862,112
Accumulated Amortization and Impairment	(123,398,338)	(90,240,231)	(63,169,614)
Acquired intangible assets, net	$ 200,059,106	$ 232,195,132	$ 71,692,498

The Company entered into several technology, patent and license agreements with third parties whereby the Company purchased intangible assets for $1,022,081, $187,573,251 and $15,418,322 in 2008, 2007 and 2006, respectively.

In 2008, the Company recorded an impairment loss of $966,667 for licenses related to DRAM products that are no longer in use.

The Company recorded amortization expense of $32,191,440, $27,070,617 and $24,393,561 in 2008, 2007 and 2006 respectively. The Company will record amortization expenses related to the acquired intangible assets of $37,634,121, $28,557,689, $24,479,980, $18,858,581 and $17,130,688 for 2009, 2010, 2011, 2012 and 2013, respectively.

14. Equity Investment

	December 31, 2008	
	Carrying Amount	%of Ownership
Equity method investment		
Toppan SMIC Electronics (Shanghai) Co., Ltd.	$ 9,162,766	30.0
Cost method investments	$ 2,189,420	Less than 20.0
	$ 11,352,186	

On July 6, 2004, the Company and Toppan Printing Co., Ltd (Toppan) entered into an agreement to form Toppan SMIC Electronics (Shanghai) Co., Ltd. (Toppan SMIC) in Shanghai, to manufacture on-chip color filters and micro lenses for CMOS image sensors.

In 2005, the Company injected cash of $19,200,000 into Toppan SMIC, representing 30% equity ownership. In 2008, 2007 and 2006, the Company recorded $444,211, $4,012,665 and $4,201,247, respectively, as its share of the net loss of the equity investment.

15. Accounts Payable

An aging analysis of the accounts payable is as follows:

	2008	2007	2006
Current	$ 126,149,360	$ 223,527,856	$ 238,864,239
Overdue:			
Within 30 days	26,524,678	46,571,502	43,364,820
Between 31 to 60 days	9,510,883	10,226,533	9,594,873
Over 60 days	23,733,618	21,666,848	17,305,267
	$ 185,918,539	$ 301,992,739	$ 309,129,199

16. Promissory Note

In 2005, the Company reached a settlement and license agreement with TSMC as detailed in Note 28. Under this agreement, the Company issued thirteen non-interest bearing promissory notes with an aggregate amount of $175,000,000 as the settlement consideration. The Company has recorded a discount of $17,030,709 for the imputed interest on the notes, which was calculated using an effective interest rate of 3.45% and was recorded as a reduction of the face amounts of the promissory notes. The Company repaid $30,000,000, $30,000,000 and $30,000,000 in 2008, 2007 and 2006, respectively. The outstanding promissory notes are as follows:

	December 31, 2008	
Maturity	Face value	Discounted value
2009	$ 30,000,000	$ 29,242,001
2010	25,000,000	23,589,958
Less: Current portion of promissory notes	30,000,000	29,242,001
Long-term portion of promissory notes	$ 25,000,000	$ 23,589,958

In 2008, 2007 and 2006, the Company recorded interest expense of $2,532,795, $3,455,506 and $4,347,221, respectively, relating to the amortization of the discount.

17. Indebtedness

Short-term and long-term debts are as follows:

	2008	2007	2006
Short-term borrowings from commercial banks (a)	$ 201,257,773	$ 107,000,000	$ 71,000,000
Long-term debt by contracts (b):			
Shanghai new USD syndicate loan	$ 266,050,000	$ 393,910,000	$ 274,420,000
Beijing USD syndicate loan	300,060,000	500,020,000	600,000,000
EUR syndicate loan	72,037,070	51,057,531	15,947,873
Tianjin USD syndicate loan	259,000,000	12,000,000	
	$ 897,147,070	$ 956,987,531	$ 890,367,873
Long-term debt by repayment schedule:			
2009	$ 360,628,789		
2010	305,568,789		
2011	135,482,995		
2012	95,466,497		
	897,147,070		
Less: current maturities of long-term debt	360,628,789		
Non-current maturities of long-term debt	$ 536,518,281		

(a) Short-term borrowings from commercial banks

As of December 31, 2008, the Company had ten short-term credit agreements that provided total credit facilities of up to $268 million on a revolving credit basis. As of December 31, 2008, the Company had drawn down $201 million under these credit agreements and $67 million is available for future borrowings. The outstanding borrowings under the credit agreements are unsecured. The interest expense incurred in 2008 was $9,411,024, of which $1,103,335 was capitalized as additions to assets under construction. The interest rate on the loan ranged from 1.88% to 8.75% in 2008.

As of December 31, 2007, the Company had fifteen short-term credit agreements that provided total credit facilities of up to $484 million on a revolving credit basis. As of December 31, 2007, the Company had drawn down $107 million under these credit agreements and $377 million was available for future borrowings. The outstanding borrowings under the credit agreements were unsecured. The interest expense incurred in 2007 was $4,537,200, of which $1,909,602 was capitalized as additions to assets under construction. The interest rate on the loan ranged from 5.37% to 6.44% in 2007.

As of December 31, 2006, the Company had fifteen short-term credit agreements that provided total credit facilities of up to $474 million on a revolving credit basis. As of December 31, 2006, the Company had drawn down $71 million under these credit agreements and $403 million was available for future borrowings. The outstanding borrowings under the credit agreements were unsecured. The interest expense incurred in 2006 was $8,471,823, of which $1,019,903 was capitalized as additions to assets under construction. The interest rate on the loans ranged from 3.62% to 6.52% in 2006.

(b) Long-term debt

Shanghai USD syndicate loan

In June, 2006, SMIS entered into the Shanghai USD syndicate loan with the aggregate principal amount of $600,000,000, with a consortium of international and PRC banks. Of this principal amount, $393,000,000 was used to repay the principal amount outstanding under SMIS s previous USD syndicate loans. The remaining principal amount was available to be used to finance future expansion and general corporate requirements of SMIS. As of December 31, 2007 and 2006, SMIS had drawn down $600,000,000 and $393,000,000 from this facility. The principal amount is repayable starting from December 2006 in ten semi-annual installments. In 2008, 2007 and 2006, SMIS had repaid $127,860,000, $87,510,000 and $118,580,000, respectively, according to the repayment schedule. As of December 31, 2008 and 2007 and 2006, the outstanding balance of this borrowing was $266,050,000, $393,910,000 and $274,420,000, respectively. In 2008, the interest rate on the loan ranged from 2.47% to 5.76%. The interest expense incurred in 2008, 2007 and 2006 was $16,979,883, $17,260,814 and $13,522,886, respectively, of which $5,358,081, $3,308,444 and $1,624,224 was capitalized as additions to assets under construction in 2008, 2007 and 2006, respectively.

The total outstanding balance of SMIS s long-term debt is collateralized by certain plant and equipment with an original cost of $1,871 million as of December 31, 2008.

The Shanghai USD syndicate loan contains covenants relating to the minimum consolidated tangible net worth, limits total borrowings compared to tangible net worth and EBITDA for the prior four quarters, and requires minimum debt service coverage ratios. SMIS has complied with these covenants (unless otherwise waived by the lenders to such agreement) as of December 31, 2008.

Beijing USD syndicate loan

In May 2005, SMIB entered into the Beijing USD syndicate loan, a five-year loan facility in the aggregate principal amount of $600,000,000, with a syndicate of financial institutions based in the PRC. This five-year bank loan was used to expand the capacity of SMIB s fabs. The withdrawal period of the facility was twelve months from date of signing the agreement. As of December 31, 2008, 2007 and 2006, the outstanding balance was $300,060,000, $500,020,000 and $600,000,000, respectively, on this loan facility. The principal amount is repayable starting from December 2007 in six equal semi-annual installments. In 2008 and 2007, SMIB had repaid $199,960,000 and $99,980,000, respectively, according to the repayment schedule. In 2008, the interest rate on the loan ranged from 3.46% to 6.38%. The interest expense incurred in 2008, 2007 and 2006 was $25,599,360, $42,183,106 and $28,525,628, of which $1,599,175, $2,342,794 and $450,516 was capitalized as additions to assets under construction in 2008, 2007 and 2006, respectively.

The total outstanding balance of the Beijing USD syndicate loan is collateralized by certain plant and equipment with an original cost of $1,047 million as of December 31, 2008.

The Beijing USD syndicate loan contains covenants to maintain minimum cash flows as a percentage of non-cash expenses and to limit total liabilities, excluding shareholder loans, as a percentage of total assets. SMIB has complied with these covenants (unless otherwise waived by the lenders to such agreement) as of December 31, 2008.

EUR loan

On December 15, 2005, the Company entered into the EUR loan, a long-term loan facility agreement in the aggregate principal amount of EUR 85 million with ABN Amro Bank N.V. Commerz Bank N.V., Shanghai Branch. The proceeds from the facility were used to purchase lithography equipment to support the expansion of the Company s manufacturing facilities. The drawdown period of the facility ends on the earlier of (i) the date on which the loans have been fully drawn down; or (ii) 36 months after the date of the agreement. Each drawdown made under the facility shall be repaid in full by the Company in ten equal semi-annual installments starting from May 6, 2006.

In 2008, 2007 and 2006, SMIS and SMIT had drawn down EUR 28,475,000 ($38,929,954), EUR 28,390,000 ($41,863,894) and EUR 15,122,775 ($19,934,841), respectively. SMIS and SMIT repaid an aggregated amount of EUR12,261,930 ($17,950,415), EUR 5,863,555 ($8,173,357) and EUR 3,024,555 ($3,986,968) in 2008, 2007 and 2006, respectively. As of December 31, 2008, 2007 and 2006, the outstanding balance is EUR 50,837,735 ($72,037,070), EUR 34,624,665 ($51,057,531) and EUR 12,098,220 ($15,947,873). In 2008, the interest rate on the loan ranged from 3.01% to 6.12%. The interest expense incurred in 2008, 2007 and 2006 was $2,682,195, $996,706 and $279,908, respectively, of which $810,495, $82,036 and $65,072 was capitalized as additions to assets under construction in 2008, 2007 and 2006, respectively.

The total outstanding balance of the facility is collateralized by certain plant and equipment with an original cost of $21.8 million for SMIT and $114.5 million for SMIS as of December 31, 2008.

Tianjin USD syndicate loan

On May 31, 2006, SMIT entered into the Tianjin USD syndicate loan, a five-year loan facility in the aggregate principal amount of $300,000,000, with a syndicate of financial institutions based in the PRC. This five-year bank loan was used to expand the capacity of SMIT s fab. In 2008 and 2007, SMIT drew down $247,000,000 and $12,000,000 of the facility amount, respectively. The principal amount is repayable starting from 2010 in six semi-annual installments. In 2008, the interest rate on the loan ranged from 3.11% to 6.03%. The interest expense incurred in 2008 and 2007 was $9,147,490 and $285,253, respectively, of which $1,788,712 and $24,344 was capitalized as additions to assets under construction in 2008 and 2007, respectively.

The total outstanding balance of the facility is collateralized by certain plant and equipment with an original cost of $627.4 million as of December 31, 2008.

The Tianjin USD syndicate loan contains covenants to maintain minimum cash flows as a percentage of non-cash expenses and to limit total liabilities as a percentage of total assets. SMIT has complied with these covenants (unless otherwise waived by the lenders to such agreement) as of December 31, 2008.

18. Long-term Payables Relating to License Agreements

The Company entered into several license agreements for acquired intangible assets to be settled by installment payments. Installments payable under the agreements as of December 31, 2008 are as follows:

	December 31, 2008	
Maturity	Face value	Discounted value
2009	$ 50,133,334	$ 49,203,521
2010	14,766,666	13,614,440
2011	5,200,000	4,554,566
	70,100,000	67,372,527
Less: Current portion of long-term payables	50,133,334	49,203,521
Long-term portion of long-term payables	$ 19,966,666	$ 18,169,006

These long-term payables were interest free, and the present value was discounted using the Company s weighted-average borrowing rates ranging from 3.45% to 4.94%.

The current portion of other long-term payables is recorded in accrued expenses and other current liabilities.

In 2008, 2007 and 2006, the Company recorded interest expense of $4,382,772, $1,511,880 and $1,355,386 relating to the amortization of the discount.

19. Income Taxes

The Company is a tax exempted company incorporated in the Cayman Islands.

In 2008, the Company recorded withholding income tax expense of $15,400,000 for license income generated from its PRC subsidiaries.

Subsidiaries in PRC

Prior to January 1, 2008, the subsidiaries incorporated in the PRC were governed by the Income Tax Law of the PRC Concerning Foreign Investment and Foreign Enterprises and various relevant income tax laws, regulations and policies (the FEIT Laws).

On March 16, 2007, the National People s Congress of China enacted a new Enterprise Income Tax Law (New EIT Law) which became effective January 1, 2008. Under the New EIT Law, domestically-owned enterprises and foreign invested enterprises (FIEs) are subject to a uniform tax rate of 25%. The New EIT Law also provides a transition period starting from its effective date for those enterprises which were established before the promulgation date of the New EIT Law and which are entitled to a preferential lower tax rate and/or tax holiday under the FEIT Law or other related regulations. Based on the New EIT Law, the tax rate of such enterprises will transition to the uniform tax rate throughout a five-year period. Tax holidays that were enjoyed under the FEIT Laws may continue to be enjoyed until the end of the holiday. Tax holidays that have not started because the enterprise is not profitable will take effect regardless whether the FIEs are profitable in 2008.

According to Guofa (2007) No. 39 the Notice of the State Council Concerning Implementation of Transitional Rules for Enterprise Income Tax Incentives (Circular 39) issued on December 26, 2007, enterprises that enjoyed preferential tax rates shall gradually transit to the statutory tax rate over 5 years after the new EIT Law is effective. Enterprises that enjoyed a tax rate of 15% under the FEIT Law shall be levied of rates of 18% in 2008, 20% in 2009, 22% in 2010, 24% in 2011 and 25% in 2012.

On February 22, 2008, the PRC government promulgated Caishui (2008) No.1, the Notice of the Ministry of Finance and State Administration of Tax concerning Certain Enterprise Income Tax Preferential Policies (Caishui No.1). Pursuant to Caishui No.1, integrated circuit production enterprises whose total investment exceeds RMB8,000 million (approximately $1,095 million) or whose integrated circuits have a line width of less than 0.25 micron are entitled to preferential tax rate of 15%. If the operation period is more than 15 years, those enterprises are entitled to a full exemption from income tax for five years starting from the first profitable year after utilizing all prior years tax losses and 50% reduction for the following five years. SMIS, SMIB and SMIT have met such accreditation requirements.

The detailed tax status of SMIC s PRC entities is elaborated as follows:

1) SMIS

Pursuant to the preferential tax policy available under the FEIT law as well as other related tax regulation, SMIS was subject to a preferential income tax rate of 15% . According to Circular Guofa (2000) No. 18 New Policy Implemented for Software and Semiconductor Industries (Circular 18) issued by the State Council of China, SMIS is entitled to a 10-year tax holiday (5-year full exemption followed by 5-year half reduction) for FEIT rate starting from the first profit-making year after utilizing all prior years tax losses. The tax holiday enjoyed by SMIS took effect in 2004 when the SMIS completed its first profit-making year.

In accordance with the New EIT Law and Caishui No.1, SMIS is eligible to continue enjoying 15% income tax rate and its tax holiday through its expiry in 2013.

2) SMIB and SMIT

In accordance with the Circular 18 and Caishui No.1, SMIB and SMIT are currently entitled to the preferential tax rate of 15% and will be entitled to a 10-year tax holiday (5-year full exemption followed by 5-year half reduction) subsequent to their first profit-making years after utilizing all prior tax losses. Both entities were in loss positions as of December 31, 2008 and as a result the tax holiday has not yet taken effect.

3) SMICD

Under the FEIT Laws, SMICD was qualified for a 5-year tax holiday (2-year full exemption followed by 3-year half reduction) subsequent to its first profit-making year after utilizing all prior tax losses. As of December 31, 2008, SMICD was still in a loss position. Pursuant to the New EIT Law, the tax holiday began in 2008 at the statutory tax rate of 25% despite the fact that SMICD had yet to be profitable. The applicable income tax rates for the years ended December 31, 2008, 2009, 2010, 2011, 2012 and thereafter are 0%, 0%, 12.5% 12.5%, 12.5% and 25%, respectively.

4) Energy Science

Energy Science is a manufacturing enterprise located in the Shanghai Pudong New Area. Pursuant to the preferential tax policy granted to the Pudong New Area under the FEIT Law, Energy Science was subject to a preferential tax rate of 15% and qualified for a 5-year tax holiday (2-year full exemption followed by 3-year half reduction in FEIT rate) subsequent to its first profit-making year after utilizing all prior years tax losses or 2008 in accordance with the New EIT Law. The tax holiday commenced in 2007 and would continue until 2011. The statutory tax rate is gradually transiting to 25% within a 5-year transition period starting from 2008. The applicable income tax rates for the year ended December 31, 2008, 2009, 2010, 2011 and thereafter are 0%, 10%, 11%, 12% and 25%, respectively.

Subsidiaries in other jurisdictions

The Company s other subsidiaries are subject to the respective local country s income tax laws, including those of Japan, the United States of America, Taiwan, Europe and Hong Kong. In 2008, 2007 and 2006, the Company s US subsidiary had recorded current income tax expense of $223,812, $163,604 and $31,030, respectively. In 2008, 2007 and 2006, the Company s European subsidiary had recorded current income tax expense of $128,010, $181,451 and $112,671, respectively. In 2008, 2007 and 2006, the Company recorded income tax expense of $405,000, $1,149,983 and $nil and income tax refund of $774,744, $nil, $nil for the service income generated in Japan. In 2008, 2007 and 2006, the Company had minimal taxable income in Hong Kong.

The Company estimates its income taxes in each of the jurisdictions in which it operates. The Company accounts for income taxes by the liability method. Under this method, deferred income taxes are recognized for tax consequences in future years of differences between the tax basis of assets and liabilities and their financial reporting amounts at each year-end, based on enacted laws and statutory tax rates applicable for temporary differences that are expected to affect taxable income. Valuation allowances are provided if based on available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

The provision for income taxes by tax jurisdiction is as follows:

	December 31		
	2008	2007	2006
PRC			
Current	$ 15,106	$ 19,602	$ 4,542
Adjustments on deferred tax assets and liabilities for enacted changes in tax rate	20,542,716	(20,542,716)	
Deferred	(9,506,907)	(10,691,699)	(25,075,987)
Other jurisdictions			
Current	15,382,078	1,495,038	143,701
Deferred			
	$ 26,432,993	$ (29,719,775)	$ (24,927,744)

The income (loss) before income taxes by tax jurisdiction is as follows:

	December 31		
	2008	2007	2006
PRC	$ (291,664,135)	$ 51,906,337	$ 46,806,662
Other jurisdictions	(113,838,901)	(99,937,852)	(116,777,420)
	$ (405,503,036)	$ (48,031,515)	$ (69,970,758)

Details of deferred tax assets and liabilities are as follows:

	2008	2007	2006
Deferred tax assets:			
Allowances and reserves	$ 4,732,017	$	$ 1,962,410
Start-up costs	929,991	53,698	958,105
Net operating loss carry forwards	55,476,943		5,201,545
Unrealized exchange loss	33,228		47,860
Depreciation of fixed assets	59,224,163	75,886,896	33,715,867
Subsidy on long lived assets	479,817	479,817	295,654
Accrued sales return	603,274		137,719
Total deferred tax assets	121,479,433	76,420,411	42,319,160
Valuation allowance	(75,792,963)	(19,505,239)	(17,032,260)
Net deferred tax assets non-current	$ 45,686,470	$ 56,915,172	$ 25,286,900
Deferred tax liability:			
Capitalized interest	(411,877)	(604,770)	(210,913)

As a result of strategic tax planning that became effective in 2006, a temporary difference between the tax and book basis of certain assets was created. Under SFAS 109 Accounting for Income Taxes , the Company recognized a valuation allowance of $20.3 million, $19.5 million and $8.4 million to reduce the deferred tax asset of $59.2 million, $75.9 million and $33.7 million to an amount that is more-likely-than-not to be realized as of December 31, 2008, 2007 and 2006, respectively. Accordingly, income tax expense of $17.5 million and income tax benefits of $31.1 million and $25.3 million were recorded in 2008, 2007 and 2006, respectively. The deferred tax asset recognized relates specially to one of the Company s subsidiaries on the basis that this subsidiary has achieved profitability in prior years and is expected to continue to be profitable based on the current forecast.

As of December 31, 2008, the Company s Beijing, Tianjin and Chengdu subsidiaries had net operating loss carry forward of $917.1 million, of which $117.8 million, $174.9 million, $271.8 million and $352.6 million will expire in 2011, 2012, 2013 and 2014, respectively.

Under the New EIT Law, profits earned subsequent to January 1, 2008 from a foreign invested enterprise that are distributed to a non-resident enterprise outside of China, will be subject to a withholding tax rate of 10%. A lower withholding tax rate may be applied if there is a favorable tax treaty between mainland China and the jurisdiction of the non-resident enterprise. For example, holding companies in Hong Kong that are also tax residents in Hong Kong are eligible for a 5% withholding tax (for the Hong Kong holding company which directly holds at least 25% of the capital of the foreign invested enterprise) on dividends under the Tax Memorandum between China and the Hong Kong Special Administrative Region. However, under Guoshuihan (2009) No. 81, a transaction or arrangement entered into for the primary purpose of being qualified for a preferential tax rate on dividends under a tax agreement would not be a valid reason for qualifying for such preferential treatment. Where a taxpayer inappropriately enjoyed the tax agreement treatment due to such a transaction or arrangement, the competent tax authorities are empowered to make appropriate adjustments that they deem appropriate.

Since the Company intends to reinvest its earnings to expand its businesses in mainland China, its PRC subsidiaries do not intend to distribute profits to their immediate foreign holding companies in the foreseeable future. Accordingly, as of December 31, 2008, the Company has not recorded any withholding tax on the retained earnings of its PRC subsidiaries.

Uncertainties exist with respect to how China s current income tax law applies to our overall operations, and more specifically, with regard to tax residency status. New EIT Law includes a provision specifying that legal entities organized outside of China will be considered residents for Chinese income tax purposes if their place of effective management or control is within China. The Implementation Rules to the EIT Law provide that non-resident legal entities will be considered China residents if substantial and overall management and control over the manufacturing and business operations, personnel, accounting, properties, etc. occurs within China. Additional guidance is expected to be released by the Chinese government in the near future that may clarify how to apply the rules to taxpayers. Despite the present uncertainties resulting from the limited PRC tax guidance on the issue, we do not believe that our legal entities organized outside of China should be treated as residents for EIT Law purposes. If one or more of our legal entities organized outside of China were characterized as China tax residents for the year ended December 31, 2008, the impact would adversely affect our results of operation.

Income tax expense computed by applying the applicable EIT tax rate of 15% is reconciled to income before income taxes and minority interest as follows:

	2008	2007	2006
Applicable enterprise income tax rate	15.0%	15.0%	15.0%
Expenses (credit) not deductible for tax purpose	(1.8%)	(0.9%)	3.1%
Effect of tax holiday and tax concession	0.0%	48.7%	25.0%
Expense (credit) to be recognized in future periods	8.2%	(19.2%)	29.3%
Changes in valuation allowances	(15.6%)	9.3%	(11.9%)
Effect of different tax rate of subsidiaries operating in other jurisdictions	(7.2%)	(33.8%)	(24.9%)
Changes of tax rate	(5.1%)	42.8%	
Effective tax rate	(6.5%)	61.9%	35.6%

The aggregate amount and per share effect of the tax holiday are as follows:

	2008	2007	2006
The aggregate dollar effect	$ 10,572	$ 23,415,370	$ 17,472,283
Per share effect- basic and diluted	$ 0.00	$ 0.00	$ 0.00

The Company adopted FIN 48 on January 1, 2007. The Company made its assessment of the level of tax authority for each tax position (including the potential application of interest and penalties) based on its technical merits. FIN 48 did not have any impact on the Company total liabilities or stockholders equity as of January 1, 2007. The Company has no material uncertain tax positions as of December 31, 2008 or unrecognized tax benefit which would favorably affect the effective income tax rate in future periods. The Company classifies interest and/or penalties related to income tax matters in income tax expense. As of December 31, 2008, the amount of interest and penalties related to uncertain tax positions is immaterial. The Company does not anticipate any significant increases or decreases to its liability for unrecognized tax benefits within the next 12 months.

20. Minority Interest

In 2004, the Company incorporated AT and SMICD, a wholly-owned subsidiary of AT.

In 2005, AT issued Series A redeemable convertible preference shares (Series A shares) to certain third parties for cash consideration of $39 million, representing 43.3% equity interest of AT. In 2007, AT repurchased 1 million preference shares with $1 million from a minority stockholder, and equity interest of the minority stockholders in AT decreased to 42.7% as of December 31, 2007. No share transaction occurred in 2008.

At any time after January 1, 2009, if AT has not filed its initial registration statement relating its initial public offering as of such date, the holders of Series A shares (other than SMIC) shall have the right to require AT to redeem such holders shares upon redemption request by paying cash in an amount per share equal to the initial purchase price at $1.00 for such Series A shares plus the product of (i) purchase price relating to the Series A shares and (ii) 3.5% per annum calculated on a daily basis from May 23, 2005. As of December 31, 2008, 38 million preferred shares are outstanding to minority interest holders and will be redeemable beginning January 1, 2009. The Series A shares are not considered participating securities and have been recorded at their redemption amount as a non-controlling interest in the consolidated balance sheets. Adjustments to the carrying value of the Series A shares have been recorded as a minority interest expense in the consolidated statements of operations.

21. Capital Stock

In November 2008, the Company issued 3,699,094,300 ordinary shares to a stockholder at HK$0.36 per share and received consideration of $165,100,000, net of issuance costs of approximately $3,000,000.

22. Share-based Compensation

Stock options

The Company s employee stock option plans (the Plans) allow the Company to offer a variety of incentive awards to employees, consultants or external service advisors of the Company. In 2004, the Company adopted the 2004 Stock Option Plan (2004 Option Plan) whereby the Company grants stock options to attract, retain and motivate employees, directors and service providers. Following the Company s IPO in March 2004, the Company issued stock options solely through the 2004 Option Plan. Options to purchase 1,317,000,000 ordinary shares are authorized under the 2004 Option Plan. Under the terms of the 2004, Option Plan options are granted at the fair market value of the Company s ordinary shares, and expire 10 years from the date of grant and vest over a requisite service period of four years. Any compensation expense is recognized on a straight-line basis over the employee service period. As of December 31, 2008, options to purchase 786,071,676 ordinary shares were outstanding, and options to purchase 530,428,324 ordinary shares were available for future grants.

In 2001, the Company adopted the 2001 Stock Option Plan (2001 Option Plan). Options to purchase 998,675,840 ordinary shares and 536,566,500 of Series A convertible preference shares are authorized under the 2001 Option Plan. Options to purchase Series A convertible preference shares were converted into options to purchase ordinary shares immediately prior to the completion of the IPO. Under the terms of the 2001 Option Plan, options are generally granted at prices equal to the fair market value, expire 10 years from the date of grant and vest over a requisite service period of four years. Following the IPO, the Company no longer issues stock options under the 2001 Option Plan. As of December 31, 2008, options to purchase 338,084,318 ordinary shares were outstanding.

A summary of the stock option activity is as follows:

	Ordinary shares		Weighted Average	
	Number Of options	Weighted Average exercise price	Remaining Contractual Term	Aggregated Intrinsic Value
Options outstanding at January 1, 2008	1,042,398,482	$ 0.14		
Granted	248,840,090	$ 0.05		
Exercised	(22,730,522)	$ 0.03		
Forfeited or cancelled	(144,352,056)	$ 0.13		
Options outstanding at December 31, 2008	1,124,155,994	$ 0.12	6.79 years	$ 34,499,475
Vested or expected to vest at December 31, 2008	1,080,819,321	$ 0.12	6.87 years	$ 30,288,832
Exercisable at December 31, 2008	491,098,679	$ 0.13	4.89 years	$ 28,604,914

The total intrinsic value of options exercised in the year ended December 31, 2008, 2007 and 2006 was $1,434,758, $5,679,680 and $5,240,221, respectively.

Certain options were granted to non-employees that resulted in a share-based compensation expense of $374,967, $665,787 and $584,283 in 2008, 2007 and 2006, respectively.

The weighted-average grant-date fair value of options granted during the year 2008, 2007 and 2006 was $0.05, $0.04 and $0.05, respectively.

The fair value of each option and share grant is estimated on the date of grant using the Black-Scholes option pricing model with the assumptions noted below. The Company uses historical data to estimate option exercise and employee termination within the pricing formula. The risk-free rate for periods within the contractual life of the option is based on the yield of the US Treasury Bond. The expected term of options granted represents the period of time that options granted are expected to be outstanding. Expected volatilities are based on the average volatility of the Company with the time period commensurate with the expected time of the options. The dividend yield is based on the Company s intended future dividend plan.

	2008	2007	2006
Average risk-free rate of return	2.13%	3.98%	4.72%
Expected term	1-4 years	1-4 years	2-4 years
Volatility rate	46.82%	35.28%	32.69%
Expected dividend yield			

Restricted share units (RSU)

In January 2004, the Company adopted the 2004 Equity Incentive Plan (2004 EIP) whereby the Company provided additional incentives to the Company s employees, directors and external consultants through the issuance of restricted shares, restricted share units (RSU) and stock appreciation rights to the participants at the discretion of the Board of Directors. Under the 2004 EIP, the Company was authorized to issue up to 2.5% of the issued and outstanding ordinary shares immediately following the closing of its IPO, which were 455,409,330 ordinary shares. As of December 31, 2008, 95,620,762 RSU were outstanding and 200,948,509 ordinary shares were available for future grant. The RSU vest over a requisite service period of 4 years and expire 10 years from the date of grant. No stock appreciation rights have been issued. Any compensation expense is recognized on a straight-line basis over the vesting period.

A summary of RSU activity is as follows:

	Restricted share units		Weighted Average	
	Number of Share Units	Weighted Average Fair Value	Remaining Contractual Term	Aggregated Fair Value
Outstanding at January 1, 2008	119,442,808	$ 0.14		
Granted	41,907,100	$ 0.08		
Exercised	(49,953,525)	$ 0.13		
Forfeited or cancelled	(15,775,621)	$ 0.13		
Outstanding at December 31, 2008	95,620,762	$ 0.12	8.19 years	$ 11,970,507
Vested or expected to vest at December 31, 2008	29,485,303	$ 0.12	8.29 years	$ 4,047,455

Pursuant to the 2004 EIP, the Company granted 41,907,100, 40,519,720 and 16,058,864 RSU in 2008, 2007, and 2006, respectively. The fair value of the RSU at the date of grant was $3,313,114, $5,631,263 and $2,055,597 in 2008, 2007, and 2006, respectively. The Company recorded compensation expense of $5,644,789, $7,216,799 and $5,452,148 in 2008, 2007, and 2006, respectively.

Unrecognized compensation cost related to non-vested share-based compensation

As of December 31, 2008, there was $13,996,655 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the 2001 Stock Option Plan, 2004 Stock Option Plan and 2004 EIP. The cost is expected to be recognized over a weighted-average period of 1.15 years.

As of December 31, 2008, 2007, and 2006 the Company had the following shares subject to repurchase:

	2008	2007	2006
Ordinary shares		90,000	16,498,871

23. Reconciliation of Basic and Diluted Loss per Share

The following table sets forth the computation of basic and diluted loss per share for the years indicated:

	2008	2007	2006
Net Loss	$ (440,231,120)	$ (19,468,147)	$ (44,109,078)
Less: Cumulative effect of a change in accounting principle			(5,153,986)
Net loss before cumulative effect of a change in accounting principle	(440,231,120)	(19,468,147)	(49,263,064)
Basic and diluted:			
Weighted average ordinary shares outstanding	18,682,585,932	18,505,650,171	18,361,910,033
Less: Weighted average ordinary shares outstanding subject to repurchase	(41,066)	(3,709,682)	(27,411,110)
Weighted average shares used in computing basic and diluted income per share	18,682,544,866	18,501,940,489	18,334,498,923
On the basis of loss per share before cumulative effect of a change in accounting principle, basic and diluted	$ (0.02)	$ (0.00)	$ (0.00)
Cumulative effect of a change in accounting principle per share, basic and diluted	$	$	$ 0.00
Basic and diluted loss per share	$ (0.02)	$ (0.00)	$ (0.00)

Ordinary share equivalents of share options and restricted share units are calculated using the treasury stock method. Under the treasury stock method, the proceeds from the assumed conversion of share options and restricted share units are used to repurchase outstanding ordinary shares using the average fair value for the periods.

As of December 31, 2008, 2007 and 2006, the Company had 189,478,507, 147,988,221 and 223,818,877, respectively, ordinary share equivalents outstanding which were excluded in the computation of diluted loss per share, as their effect would have been anti-dilutive due to the net loss reported in such periods. They include:

	December 31		
	2008	2007	2006
Outstanding options to purchase ordinary shares	128,361,312	72,685,282	62,339,207
Outstanding unvested restricted share units to purchase ordinary shares	61,117,195	75,302,939	161,479,670
	189,478,507	147,988,221	223,818,877

24. Transactions with Managed Government-Owned Foundries

The Company provides management services to Cension Semiconductor Manufacturing Corporation (Cension) and Wuhan Xinxin Semiconductor Manufacturing Corporation (Xinxin), which are government-owned foundries. Management service revenues under these arrangements for 2008, 2007 and 2006 were $33,000,000, $42,000,000 and $4,151,238, respectively.

In 2008, 2007 and 2006, the Company sold equipment with carrying value of $7,688, $19,530,909 and $19,411,553 to Cension for $175,300, $42,300,258 and $61,182,653, which resulted in gains on sale of $167,612, $22,769,349 and $41,771,099, respectively.

In 2008, the Company sold equipment with carrying value of $3,629,605 to Xinxin for $3,944,204, which resulted in a gain on sale of $314,599.

On April 10, 2007, Cension entered into an Asset Purchase Agreement (the Agreement) with Elpida Memory, Inc. (Elpida), a Japan based memory chip manufacturer, for the purchase of Elpida s 200mm wafer processing equipment currently located in Hiroshima, Japan for the total price of approximately $320 million.

As part of the Agreement, the Company provided a corporate guarantee for a maximum guarantee liability of $163.2 million on behalf of Cension in favour of Elpida. The Company s guarantee liability will terminate upon full payment of the purchase price by Cension to Elpida. In return for providing the above corporate guarantee, the Company received a guarantee fee from Cension based on 1.5% of the guarantee amount, or $2.4 million. Approximately $160 million in 200mm wafer processing equipment purchased under the Agreement was held as collateral under the guarantee.

The Company is entitled to the net profit (loss) associated with the ongoing operations of this equipment, net of a guaranteed fixed share of revenue for Elpida, during the transitional period prior to when the equipment was relocated from Hiroshima to Chengdu. Such relocation was completed in 2008.

On August 30, 2007, Cension negotiated with Elpida and subsequently reduced the purchase price to US$309.5 million.

In April 2008, SMIC entered into an agreement with Cension to purchase approximately half of the Equipment from Cension for approximately $152 million. The equipment acquired by the Company will be used for the Company s future expansion. The corporate guarantee was released after this purchase.

25. Commitments

(a) Purchase commitments

As of December 31, 2008 the Company had the following commitments to purchase machinery, equipment and construction obligations. The machinery and equipment is scheduled to be delivered at the Company s facility by December 31, 2009.

Facility construction	$ 7,359,374
Machinery and equipment	52,235,105
	$ 59,594,479

(b) Royalties

The Company has entered into several license and technology agreements with third parties. The terms of the contracts range from 3 to 10 years. The Company is subject to royalty payments based on a certain percentage of product sales, using the third parties technology or license. In 2008, 2007 and 2006, the Company incurred royalty expense of $18,867,409, $13,118,570 and $7,724,704, respectively, which was included in cost of sales.

The Company has entered into several license agreements with third parties where the Company provides access to certain licensed technology. The Company will receive royalty payments based on a certain percentage of product sales using the Company s licensed technology. In 2008, 2007 and 2006, the Company earned royalty income of $1,192,537, $1,428,603 and $1,384,137, respectively, which was included in sales. Royalty income is recognized one quarter in arrears when reports are received.

(c) Operating lease as lessor

The Company owns apartment facilities that are leased to the Company s employees at negotiated prices. The apartment rental agreement is renewed on an annual basis. The Company also leases office space to non-related third parties. Office lease agreements are renewed on an annual basis as well. The total amount of rental income recorded in 2008, 2007 and 2006 was $5,818,655, $6,937,107 and $6,142,692, respectively, and is recorded in other income in the statement of operations.

(d) Operating lease as lessee

The Company has various operating leases including land use rights, under non-cancellable leases expiring at various times through 2053. Future minimum lease payments under these leases as of December 31, 2008 are as follows:

Year ending	
2009	$ 6,055,605
2010	269,868
2011	202,580
2012	168,153
Thereafter	3,024,384
	$ 9,720,590

The total operating lease expense recorded in 2008, 2007 and 2006 was $1,084,894, $643,621 and $410,193 respectively.

26. Segment and Geographic Information

The Company is engaged principally in the computer-aided design, manufacturing and trading of integrated circuits. In accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, the Company s chief operating decision maker has been identified as the Chief Executive Officer, who reviews consolidated results of manufacturing operations when making decisions about allocating resources and assessing performance of the Company. The Company believes it operates in one segment, and all financial segment information required by SFAS No. 131 can be found in the consolidated financial statements. The following table summarizes the Company s net revenues generated from different geographic locations:

	2008	2007	2006
Total sales:			
United States	$ 767,966,660	$ 657,603,189	$ 602,506,213
Europe	92,572,683	328,710,235	440,327,872
Asia Pacific (Excluding Japan and Taiwan)	269,616,334	227,973,648	168,607,598
Taiwan	185,848,747	183,113,880	153,057,616
Japan	37,706,875	152,364,336	100,823,568
	$ 1,353,711,299	$ 1,549,765,288	$ 1,465,322,867

Revenue is attributed to countries based on headquarter of customer operations and is not related to the shipment destination.

Substantially all of the Company s long-lived assets are located in the PRC.

27. Significant Customers

The following table summarizes net revenue and receivable from customers which accounted for 10% or more of our net revenue, accounts receivable, other current assets or receivable for sale of manufacturing equipment:

	Net revenue Year ended December 31,			Accounts receivable December 31,		
	2008	2007	2006	2008	2007	2006
A	22%	16%	17%	23%	14%	14%
B	14%	*	*	*	*	*
C	13%	*	*	*	*	*
D	*	18%	28%	*	15%	29%
E	*	*	*	*	13%	*
F	*	*	*	16%	*	*
G	*	*	*	18%	*	*

	Other current assets December 31,			Receivable for sale of manufacturing equipment December 31,		
	2008	2007	2006	2008	2007	2006
F	50%	29%	*	83%	100%	100%
G	*	*	*	17%	*	*

* Less than 10%

28. Litigation

Overview of TSMC Litigation:

Beginning in December 2003 through August 2004, the Company became subject to several lawsuits brought by Taiwan Semiconductor Manufacturing Company, Limited (TSMC) relating to alleged infringement of certain patents and misappropriation of alleged trade secrets relating to methods for conducting semiconductor fab operations and manufacturing integrated circuits.

On January 30, 2005, the Company and TSMC exchanged signature pages later attached to a settlement agreement. Terms were added to the agreement subsequent to the exchange of signatures. The identification of the exact terms of the agreement were determined at a preliminary trial in 2009, as described below under Recent TSMC Legal Developments. As found by the California Superior Court, SMIC and TSMC agreed, without admission of liability, to dismiss all pending legal actions without prejudice between the two companies (the Settlement Agreement). The terms of the Settlement Agreement also were determined to include the following:

1) The Company and TSMC agreed to cross-license each other s patent portfolio for all semiconductor device products, effective from January 2005 through December 2010.
2) TSMC covenanted not to sue the Company for trade secret misappropriation as alleged in TSMC s legal actions as it related to .15µm and larger processes subject to certain conditions (TSMC Covenant). The TSMC Covenant did not cover .13µm and smaller technologies after 6 months following execution of the Settlement Agreement (July 31, 2005). Excluding the .13µm and smaller technologies, the TSMC Covenant remains in effect indefinitely, terminable upon a breach by the Company.
3) The Company is required to deposit certain Company materials relating to .13µm and smaller technologies into an escrow account until December 31, 2006 or under certain circumstances for a longer period of time.
4) The Company agreed to pay TSMC an aggregate of $175 million in installments of $30 million for each of the first five years and $25 million in the sixth year.

Accounting under the Settlement Agreement:

In accounting for the Settlement Agreement, the Company determined that there were several components of the Settlement Agreement settlement of litigation, covenant not to sue, patents licensed by us to TSMC and the use of TSMC s patent license portfolio both prior and subsequent to the settlement date.

The Company does not believe that the settlement of litigation, covenant not to sue or patents licensed by us to TSMC qualify as accounting elements. In regard to the settlement of litigation, the Company cites the following:

1) The settlement agreement reached between TSMC and SMIC clearly stated that there was no admission of liability by either party;
2) The settlement agreement required all parties to bear their own legal costs;

3) There were no other damages associated with the Settlement Agreement;

4) There was a provision in the Settlement Agreement for a grace period to resolve any misappropriation issues had they existed;

5) Albeit a complaint had been filed by TSMC on trade secret infringement, TSMC has never identified to the Company which trade secrets it claimed were being infringed upon by the Company;

6) The Settlement Agreement was concluded when the litigation process was still at a relatively early stage and the outcome of the litigation was therefore highly uncertain.

The TSMC covenant not to sue for alleged trade secrets misappropriation does not qualify as a separable asset in accordance with either SFAS 141 or SFAS 142 as TSMC had never specified the exact trade secrets that it claimed were misappropriated, the Company s belief that TSMC s trade secrets may be obtained within the marketplace by other legal means and the Company never obtained the legal right to use TSMC s trade secrets.

In addition, the Company did not attribute any value to the patents licensed to TSMC under the Settlement Agreement due to the limited number of patents held by the Company at the time of the Settlement Agreement.

As a result, the Company determined that only the use of TSMC s patent license portfolio prior and subsequent to the settlement date were considered elements of an arrangement for accounting purposes. In attributing value to these two elements, the Company first discounted the payment terms of the $175 million settlement amount using an annual 3.4464% interest rate to arrive at a net present value of $158 million. This amount was then allocated to the pre- and post-settlement periods based on relative fair value, as further described below.

Based on this approach, $16.7 million was allocated to the pre-settlement period, reflecting the amount that the Company would have paid for use of the patent license portfolio prior to the date of the Settlement Agreement. The remaining $141.3 million, representing the relative fair value of the licensed patent license portfolio, was recorded on the Company s consolidated balance sheets as a deferred cost and is being amortized over a six-year period, which represents the life of the licensed patent license portfolio. The amortization of the deferred cost is included as a component of cost of sales in the consolidated statements of operations.

Valuation of Deferred Cost:

The fair value of the patent license portfolio was calculated by applying the estimated royalty rate to the specific revenue generated and expected to be generated from the specific products associated with the patent license portfolio. The selected royalty rate was based on the review of median and mean royalty rates for the following categories of licensing arrangements:

a) existing third-party license agreements with SMIC;

b) the analysis of comparable industry royalty rates related to semiconductor chip/integrated circuit (IC) related technology; and

c) the analysis of comparable industry royalty rates related to semiconductor fabrication.

On an annualized basis, the amounts allocated to past periods was lower than that allocated to future periods as the Company assumed increases in revenues relating to the specific products associated with the patent license portfolio. As the total estimated fair value of the patent license portfolio exceeded the present value of the settlement amount, the Company allocated the present value of the settlement amount based on the relative fair value of the amounts calculated prior and subsequent to the settlement date.

Recent TSMC Legal Developments:

On August 25, 2006, TSMC filed a lawsuit against the Company and certain subsidiaries, namely SMIC (Shanghai), SMIC (Beijing) and SMIC (Americas) in the Superior Court of the State of California, County of Alameda for alleged breach of the Settlement Agreement, alleged breach of promissory notes and alleged trade secret misappropriation by the Company. TSMC seeks, among other things, damages, injunctive relief, attorneys fees, and the acceleration of the remaining payments outstanding under the Settlement Agreement.

In the present litigation, TSMC alleges that the Company has incorporated TSMC trade secrets in the manufacture of the Company s 0.13 micron or smaller process

2004

2005

MDC Partners

100

45

56

152

142

85

S&P 500 Index

100

88

69

88

98

103

Peer Group

100

90

62

87

86

88

21

Report of the Human Resources & Compensation Committee

Composition of the Human Resources & Compensation Committee

The Human Resources & Compensation Committee of the Board (the **Compensation Committee**) is composed of five independent, non-employee directors. The Compensation Committee oversees the Company s executive compensation and benefit plans and practices, including its incentive-compensation and equity-based plans, and reviews and approves the Company s management succession plans. Specifically, the Compensation Committee determines the salaries and the performance and awards under the annual bonus incentive program for the Chief Executive Officer and other executive officers. The Compensation Committee also provides long-term incentives by granting options or other interests, including shares of restricted stock or restricted stock units, under the 2005 Stock Incentive Plan and SARs under the SARs Plan.

Overview and Compensation Philosophy

MDC Partners has used a number of elements in compensating its executives: base salary; annual bonus incentives; incentives in form of SARs granted under the SARs Plan; and most recently (in 2006) in the form of financial performance-based restricted stock and restricted stock units under the 2005 Stock Incentive Plan.

In 2005 and 2006, the Compensation Committee engaged Mercer Human Resource Consulting LLC (**Mercer**) to review and evaluate the Company s executive compensation levels, and to make recommendations for compensation of the Company s executives officers based on comparable industry levels, which recommendations have been implemented by the Compensation Committee. In particular, the Compensation Committee worked with Mercer to structure performance-based annual and long-term incentive programs designed to retain the Company s executive management team and to motivate them to achieve goals that increase stockholder value. The Compensation Committee sought to ensure that its incentive plans properly align management incentive compensation targets with the performance targets relevant to stockholders. The Compensation Committee also considered recent trends in executive compensation.

To that end, the Compensation Committee re-examined and reaffirmed its compensation strategy to:

- appropriately link compensation levels with the creation of stockholder value;
- provide total compensation capable of attracting, motivating and retaining executives of outstanding talent; and
- emphasize at risk pay tied to performance as a meaningful component of total compensation potential.

The Compensation Committee believes that this strategy results in a substantial portion of total compensation being at risk and appropriately relates to the achievement of increased shareholder value through profitable growth.

Base Salary

The base salary of each particular executive officer is determined by an assessment by the Board of such executive s performance, a consideration of competitive compensation levels in companies similar to MDC Partners, and a review of the performance of MDC Partners as a whole and the role such executive officer played in such corporate performance. For certain executives, the base salary is set forth in their respective employment agreements. See Employment Agreements and Management Agreement .

Annual Cash Bonus

Annual cash bonus incentive awards are based upon achieving profitability criteria which are established by the Compensation Committee, as well as certain of the individual performance criteria used to calculate base salary. This establishes a direct link between executive compensation and MDC Partners operating performance. For certain executives, the target amount of the bonus, or a formula to be used to determine the amount of bonus, is contained in their respective employment agreements. See Employment Agreements .

Long-Term Incentive Awards

In 2004 and 2005, the Compensation Committee did not grant or make any long term incentive awards to its existing executive officers.

In 2006, the Compensation Committee worked with Mercer to structure financial performance-based long-term incentive awards designed to retain the Company s executive management team and to motivate them to achieve goals that drive stockholder value. Based in part on recommendations made by Mercer, the Compensation Committee made grants to its executive officers in February 2006 of restricted stock and restricted stock units. These awards will not vest unless (i) the executive is an employee of the Company on the applicable vesting date and (ii) the Company achieves the specified financial performance criteria in fiscal years 200, 2007 and/or 2008. These financial performance criteria include 15% EBITDA growth in 2006 as compared to 2005; cumulative EBITDA growth in 2006 and 2007 of 15%, as compared to 2005; and cumulative EBITDA growth in 2006, 2007 and 2008 of 10%, as compared to the 2006/2007 cumulative growth target.

Compensation of the Chief Executive Officer

The compensation of Miles Nadal is based upon the same criteria as that used in determining the compensation payable to MDC Partners executive officers. He is compensated by Nadal Financial Corporation (NFC), which is paid management fees by MDC Partners pursuant to the Management Agreement. See Management Agreement . The compensation listed in the summary compensation table reflects the fees paid to NFC pursuant to the terms of the Management Agreement. In determining the annual incentive bonus amount paid to NFC during the past fiscal year, an amount equal to 75% of the incentive amount was based upon the achievement by the Company of specified financial criteria, and 25% of the incentive amount was based upon individual performance criteria established by the Compensation Committee. The Compensation Committee specifically noted the following in evaluating Mr. Nadal s performance as Chairman and Chief Executive Officer:

(a) financial performance that met performance targets for operating income;

(b) assisted in identifying and closing Zyman acquisition, without an agent;

(c) improved the organizational structure of the Company; and

(d) instrumental in winning new business for certain agencies, and instrumental in promoting cross-selling efforts which led to significant new client accounts.

Stock Ownership Requirements

The Compensation Committee believes that stock ownership by senior managers strengthens their commitment to the future of the Company and further aligns their interests with shareholders. Effective March 2006, the Board adopted the following stock ownership guidelines for all officers commensurate with their level of seniority and base salary:

Position	**Base Salary Multiple**	**Time to Attain**
CEO	5x	4 Years
President and CFO	4x	4 Years
Managing Directors, General Counsel and Chief Accounting Officer	3x	4 Years
Vice Presidents	2x	4 Years

Mr. Nadal currently owns 1.86 million shares of MDC Partners Class A stock, more than satisfying his stock ownership requirement.

Conclusion

Through the programs described above, a very significant portion of MDC Partners executive compensation is linked directly to achievement of financial performance targets and stock price appreciation. The Compensation Committee intends to continue the policy of linking executive compensation to corporate performance and returns to shareholders, recognizing that the ups and downs of the business cycle from time to time may result in an imbalance for a particular period.

Compensation Committee
Richard R. Hylland (Chair)
Thomas N. Davidson
Robert Kamerschen
Michael Kirby
Thomas E. Weigman

ITEM 2 APPOINTMENT OF AUDITORS

Subject to the action of the shareholders, upon recommendation of the Audit Committee, the Board has recommended to the shareholders the appointment of BDO Seidman, LLP, independent registered public accountants, to audit and report on the consolidated financial statements of MDC Partners for the fiscal year ending December 31, 2006 and to perform such other services as may be required of them. BDO Seidman, LLP has served as independent public accountants for MDC Partners since April 1, 2006. The Board has directed that management submit the appointment of the auditors for approval by the shareholders at the Meeting. Representatives of BDO Seidman, LLP are expected to be present at the meeting, will have the opportunity to make a statement if they desire to do so and will be available to respond to appropriate shareholder questions.

Unless otherwise instructed, the persons named in the accompanying proxy (provided the same is duly executed in their favor and is duly deposited) intend to vote FOR the appointment of BDO Seidman, LLP, independent registered public accountants, as auditors of MDC Partners, to hold office until the close of the next annual meeting of shareholders of MDC Partners, at a remuneration to be fixed by the directors of MDC Partners.

Effective March 31, 2006, the Board resolved not to propose the re-appointment of MDC Partners previous principal accountants, KPMG LLP, as auditors for MDC Partners at the 2006 Annual Meeting of Shareholders, and requested the resignation of KPMG LLP as auditors. KPMG LLP resigned effective March 31, 2006. There were no disagreements with KPMG on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, or reportable events, except that KPMG advised the Company that it did not maintain effective internal controls over financial reporting due to identified material weaknesses (as more fully disclosed in Item 9A (Controls and Procedures) of the Company s Annual Report on Form 10-K for the year ended December 31, 2005). KPMG LLP served as MDC Partners auditors from June 2004 to March 31, 2006.

In addition to retaining KMPG LLP to audit MDC Partners consolidated financial statements for 2005, the company retained KPMG LLP and other accounting and consulting firms to provide advisory, auditing and consulting services in 2005. These services included audit services, audit-related services, tax services and other services. The following table sets forth the aggregate fees billed to MDC Partners by KPMG LLP for professional services in fiscal year 2005 and 2004 and by BDO Dunwoody LLP in fiscal year 2005 and 2004, were as follows:

KPMG LLP

	2004	2005
Audit Fees (1)	$ 1,852,000	$ 2,969,000
Audit Related Fees (2)	$ 128,000	223,000
Tax Fees (3)	$ 5,000	
All Other Fees (4)	$ 172,000	
Total	$ 2,157,000	$ 3,192,000

(1) Fees for services rendered in connection with: the annual financial statement audit, including internal control over financial reporting assessment; quarterly financial statement reviews; consent in connection with the Company s issuance of its 8% Convertible Unsecured Subordinated Debentures due June 2010; and involvement with the Form 8-K and BAR filings in connection with an acquisition in April 2005.

(2) Fees for services rendered in connection with: consultation on internal control over financial reporting; assistance with regulatory comment letters; and audits of non-statutory subsidiary financial statements.

(3) Fees for review of potential restructuring of the Company s Secure Products International Group.

(4) Fees for services rendered in connection with: accounting impact of SARs plan; acquisition due diligence assistance; and other services.

BDO Dunwoody LLP

	2004	2005
Audit Fees (1)	$ 38,000	$ 22,000
Audit Related Fees (2)	$ 172,000	
All Other Fees (3)	$ 12,000	$ 24,000
Total	$ 222,000	$ 46,000

(1) Fees for the annual financial statement audit.

(2) Fees for services related to the audit or review of financial statements, including fees for services rendered for the review of third quarter financial statements and restatement of prior period financial statements.

(3) Includes fees for services rendered in connection with the Company s issuance of its 8% Convertible Unsecured Subordinated Debentures due June 2010.

All fees listed above have been pre-approved by the Audit Committee. The Audit Committee has, however, delegated to the Chairman of the Audit Committee the authority to pre-approve permitted non-audit services (as such services are defined by the Sarbanes-Oxley Act of 2002) provided that (i) the aggregate estimated amount of such fees will not exceed Cdn $25,000 and (ii) the Chairman of the Audit Committee reports any pre-approval so granted at the next scheduled meeting of the Audit Committee.

The Audit Committee Charter provides for the Audit Committee to establish the auditors fees. Such fees have been based upon the complexity of the matters in question and the time incurred by the auditors.

YOUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS
A VOTE FOR APPOINTMENT OF BDO SEIDMAN, LLP AS MDC PARTNERS AUDITORS.

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SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Under Section 16(a) of the Exchange Act, the Company s directors, executive officers and any persons holding 10% or more of the common stock are required to report their ownership of common stock and any changes in that ownership to the U.S. Securities and Exchange Commission (the SEC) and to furnish the Company with copies of such reports. Specific due dates for these reports have been established and the Company is required to report in this Proxy Statement any failure to file on a timely basis by such persons. To the Company s knowledge, based solely upon a review of copies of such reports received by the Company which were filed with the SEC from January 1, 2005 through the Record Date, and upon written representations from such persons that no other reports were required, the Company has been advised that all reports required to be filed under Section 16(a) have been timely filed with the SEC, with the exception of the following items: (i) Report on Form 3 (Initial Statement of Beneficial Ownership of Securities) that was filed, untimely, on April 1, 2005 for Michael Sabatino; (ii) Report on Form 4 that was filed, untimely, on September 6, 2005, for Miles Nadal; and (iii) Report on Form 4 that was filed, untimely, on August 11, 2005, for Charles Porter.

ADDITIONAL INFORMATION

A copy of the Annual Report on Form 10-K filed by MDC Partners with the Securities and Exchange Commission for its latest fiscal year is available, without charge, to shareholders at MDC Partners website at www.mdc-partners.com, on the Securities and Exchange Commission s website at www.sec.gov, on the SEDAR website at www.sedar.com, or upon written request to 950 Third Avenue, New York, N.Y. 10022, Attention: Investor Relations. Financial information is provided in MDC Partners comparative financial statements and MD&A for the year ended December 31, 2005. A copy of MDC Partners most recent consolidated financial statements, interim financial statements, Annual Information Form and proxy statement and management information circular may also be obtained by shareholders, without charge, upon written request from the Secretary of MDC Partners or from the Securities and Exchange Commission s website at www.sec.gov or the SEDAR website at www.sedar.com.

SHAREHOLDER PROPOSALS FOR 2007 ANNUAL GENERAL MEETING

Under certain circumstances, stockholders are entitled to present proposals at stockholder meetings. The 2007 Annual Meeting of Stockholders will be held on or about May 25, 2007. Proposals of stockholders intended to be included in the proxy materials for the 2007 Annual Meeting of Stockholders must be received by the Secretary of the Company, 950 Third Avenue, New York, N.Y. 10022, by December 21, 2006 in a form that complies with the Company s Bylaws and applicable requirements.

GENERAL

Management knows of no matters to come before the Meeting other than the matters referred to in the accompanying Notice. If any matters which are not now known should properly come before the Meeting, the accompanying proxy instrument will be voted on such matters in accordance with the best judgment of the person voting it.

The contents and sending of this Proxy Statement and Management Information Circular have been approved by the Board as of the date hereof.

By order of the Board

Toronto, Ontario	Mitchell Gendel
April 28, 2006	General Counsel and Corporate Secretary

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EXHIBIT A

MDC PARTNERS INC.

CHARTER
OF THE
AUDIT COMMITTEE
OF THE
BOARD OF DIRECTORS OF MDC PARTNERS INC.
AS ADOPTED BY THE BOARD
ON FEBRUARY 26, 2004

I. AUTHORITY

The Audit Committee (the Committee) of the Board of Directors (the Board) of MDC Partners Inc. (the Corporation) is established pursuant to Section 42 of the Corporation s Bylaw No. A-l and Section 158 of the Ontario Business Corporations Act. The Committee shall be comprised of three or more directors, as determined from time to time by resolution of the Board. Consistent with the appointment of other Board committees, the members of the Committee shall be elected by the Board at the annual organizational meeting of the Board or at such other time as may be determined by the Board. The Chairman of the Committee shall be designated by the Board, *provided* that if the Board does not so designate a Chairman, the members of the Committee, by majority vote, may designate a Chairman. The presence in person or by telephone of a majority of the Committee s members shall constitute a quorum for any meeting of the Committee. All actions of the Committee will require the vote of a majority of its members present at a meeting of the Committee at which a quorum is present.

II. PURPOSE OF THE COMMITTEE

The Committee s purpose is to provide assistance to the Board in fulfilling its legal and fiduciary obligations with respect to matters involving the accounting, auditing, financial reporting, internal control and legal compliance functions of the Corporation and its subsidiaries.

The Committee is directly responsible for the appointment (subject to shareholder approval), compensation, retention and oversight of the work of the Corporation s independent auditor engaged for the purpose of preparing or issuing an audit report or related work or performing other audit, review or attest services for the Corporation. In accordance with the requirements of the Sarbanes-Oxley Act of 2002 (the SOA), the Securities Exchange Act of 1934 (the Exchange Act) and the rules promulgated thereunder by the Securities and Exchange Commission (the SEC), the rules of the National Association of Securities Dealers, Inc. (the NASD), the rules of the Toronto Stock Exchange (the TSX) and the rules and instruments promulgated by the Ontario Securities Commission (the OSC), the independent auditor must report directly to the Committee and is accountable to the Committee (as representatives of the shareholders of the Corporation). The Committee s oversight responsibilities include the authority to approve all audit engagement fees and terms, as well as all permitted non-audit engagements and resolution of disagreements between management and the independent auditor regarding financial reporting.

It is the objective of the Committee to maintain free and open means of communications among the Board, the independent auditor, and the financial and senior management of the Corporation.

III. COMPOSITION OF THE COMMITTEE

Independence

Each member of the Committee shall be an independent director within the meaning of Section 10A(m)(3) of the Exchange Act, Rule 10A-3(b)(1) thereunder, and Rule 4200(a)(15) of the

NASD, and an unrelated director within the meaning of section 472 of the TSX Listed Company Manual, subject to applicable exceptions.

Financial Literacy and Expertise

All members of the Committee must be able to read and understand fundamental financial statements, including a company s balance sheet, income statement and cash flow statement. At least one member of the Committee shall be an audit committee financial expert within the meaning of applicable SEC and OSC rules and at least one member shall have accounting or related financial experience as required under applicable TSX and NASD rules. Specifically, the audit committee financial expert and the member with accounting or related financial experience must have the following attributes:

(a) An understanding and ability to analyze and interpret a full set of financial statements, including the notes attached thereto, prepared in accordance with the generally accepted accounting principles used to prepare those statements;

(b) An ability to assess the general application of generally accepted accounting principles in connection with the accounting for estimates, accruals and reserves;

(c) Experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant s financial statements, or experience actively supervising one or more persons engaged in such activities;

(d) An understanding of internal controls and procedures for financial reporting; and

(e) An understanding of audit committee functions.

The Committee shall ensure that the Corporation provides to applicable regulatory authorities any required certification relating to adequacy of this Charter and composition of the Committee.

IV. DUTIES AND RESPONSIBILITIES OF THE COMMITTEE

In carrying out its duties and responsibilities, the Committee s policies and procedures should remain flexible, so that it may be in a position to best react or respond to changing circumstances or conditions. While there is no blueprint to be followed by the Committee in carrying out its duties and responsibilities, the following should be considered within the authority of the Committee (it being understood that the Committee may diverge from such matters as considered appropriate given the circumstances):

Selection and Evaluation of Auditors

(a) Select the firm of independent public accountants to audit the books and accounts of the Corporation and its subsidiaries for each fiscal year;

(b) Annually Review and approve the terms of engagement and determine the remuneration of Corporation s independent auditor; and

(c) Review the performance of the Corporation s independent auditor and terminate or replace the independent auditor when circumstances warrant.

Independence of Auditors

(a) Ensure that the Corporation s independent auditor is independent and capable of exercising impartial judgment on all issues encompassed within its engagement. Regard shall be had to all applicable rules and regulations relating to independence, including those with respect to

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financial relationships, employment relationships, business relationships, the provision of non-audit services, contingent fees, partner rotation and compensation.

(b) Ensure that the independent auditor delivers to the Committee on a periodic basis a formal written statement delineating all relationships between the independent auditor and the Corporation, consistent with Independence Standards Board Standard 1;

(c) Actively engage in a dialogue with the independent auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the independent auditor; and

(d) Take appropriate action to satisfy itself of the auditor s independence.

General Responsibility for Oversight of Auditors

(a) The Corporation s independent auditor shall be ultimately accountable to the Committee and the Committee shall be responsible for the appointment (subject to shareholder approval), compensation, retention and oversight of the work of the Corporation s independent auditor;

(b) Pre-approve all audit and permitted non-audit services to be provided by the independent auditor. The Committee may approve policies and procedures for the pre-approval of services to be rendered by the independent auditor, which policies and procedures are detailed as to the particular service. All non-audit services to be provided to the Corporation or any of its subsidiaries by the independent auditor or any of its subsidiaries which are not covered by pre-approval policies and procedures approved by the Committee shall be subject to pre-approval by the Committee; and

(c) Resolve all disagreements between management and the independent auditor regarding financial reporting.

Oversight of Annual Audit and Quarterly Financial Statements

(a) Review and approve the annual audit plan of the Corporation s independent auditor, including the audit and non-audit services that the auditor is providing for the Corporation and its subsidiaries, the level of responsibility assumed by the auditor under generally accepted auditing standards and a summary of the audit approach;

(b) Before the release of annual financial statements, discuss with the independent auditor all matters required by SAS 61 (including the independent auditor s responsibility under GAAP, the selection of and changes in significant accounting policies or their application, management judgments and accounting estimates, significant audit adjustments, the independent auditor s responsibility for information other than financial statements, disagreements with management, consultation with other accountants, and difficulties encountered in performing the audit) and CICA Handbook section 5751 (which governs the communications between the independent auditors and the Committee);

(c) Receive a report from the Corporation s independent auditor, prior to the filing of the audit report with the SEC or the OSC, regarding:

(i) all critical accounting policies and practices used by the Corporation;

(ii) all material alternative accounting treatments of financial information within Canadian GAAP that have been discussed with management, including the ramifications of the use of such alternative treatments, and the treatment preferred by the independent auditor; and

(iii) other material communications between the independent auditor and management;

(d) Review and discuss with management the quarterly financial statements. Discuss with the independent auditor the results of its procedures on the statements.

(e) Prior to any disclosure, review and recommend to the Board for approval:

(i) the annual financial statements and related documents (MD&A, AIF, etc.);

(ii) the quarterly financial reports and related documents (including MD&A); and

(iii) other disclosure documents containing financial information that would likely be material to either the quarterly or annual financial statements.

Oversight and Monitoring of Other Financial Disclosures

(a) Review and recommend to the Board for approval all financial information of the Corporation contained in any prospectus, annual information form, information circular or similar document of the Corporation, and any earnings press release to be issued in conjunction with the annual and quarterly results;

(b) Annually or more frequently as required, discuss with management the types of financial and operational information and earnings guidance to be disclosed to credit rating agencies that are subject to confidentiality agreements. The Committee need not discuss in advance with management each instance in which the Corporation gives earnings guidance to credit rating agencies, unless the substance of a presentation to any credit rating agency constitutes a material shift in the Corporation strategy not previously approved by the Board;

(c) Annually or more frequently as required, discuss with management the types of financial and operational information and earnings guidance to be disclosed to analysts or shareholders (in groups or one-on-one) and the processes for ensuring that new material information is first or simultaneously disseminated in the public domain and subsequently included on the Corporation s website. The Committee need not discuss in advance with management each instance in which the Corporation gives earnings guidance to analysts, unless the substance of a presentation to any analyst constitutes a material shift in the Corporation strategy not previously approved by the Board; and

(d) Review the public disclosure required in connection with the Committee s pre-approval of audit and non-audit services provided by the independent auditor.

Oversight of Financial Reporting Processes and Internal Controls

(a) Review with management and the independent auditor the adequacy and effectiveness of the Corporation s accounting and internal control policies and procedures, including controls and security of the computerized information systems.

(b) Review with management its compliance with prescribed policies, procedures and internal control;

(c) Review with management and the independent auditor any reportable conditions and material weaknesses affecting internal control;

(d) Establish and maintain free and open means of communication between and among the Board, the Committee, the Corporation s independent auditor and the Corporation s management; and

(e) Review with management major financial and asset related risks and the steps taken to monitor and control such risks.

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Other Matters

(a) Meet with outside counsel when appropriate, to review legal and regulatory matters, including any matters that may have a material impact on the financial statements of the Corporation;

(b) Establish procedures for the receipt, retention and treatment of complaints received by the Corporation regarding accounting, internal controls or auditing matters and the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters;

(c) Review and approve all related party transactions with any director or nominee, executive officer, holder of more than 5% of any class of the Corporations voting securities or any family member of the foregoing persons, other than those related party transactions in respect of which the Board has delegated review and approval to a special committee of independent directors.

(d) Conduct or authorize investigations into any matters within the Committee s scope of responsibilities, including retaining outside counsel or other consultants or experts for this purpose; and

(e) Perform such additional activities, and consider such other matters, within the scope of its responsibilities, as the Committee or the Board deems necessary or appropriate.

With respect to the duties and responsibilities listed above, the Committee should:

(a) Report regularly to the Board on its activities, as appropriate;

(b) Exercise reasonable diligence in gathering and considering all material information;

(c) Understand and weigh alternative courses of conduct that may be available;

(d) Focus on weighing the benefit versus harm to the Corporation and its shareholders when considering alternative recommendations or courses of action;

(e) If the Committee deems it appropriate, secure independent expert advice and understand the expert s findings and the basis for such findings, including retaining independent counsel, accountants or others to assist the Committee in fulfilling its duties and responsibilities;

(f) Provide management and the Corporation s independent auditor with appropriate opportunities to meet privately with the Committee; and

(g) Review the Charter of the Audit Committee annually and recommend it to the Board.

V. MEETINGS OF THE COMMITTEE

The Committee shall meet with such frequency and at such intervals as it shall determine is necessary to carry out its duties and responsibilities. As part of its purpose to foster open communications, the Committee shall meet at least annually with management and the Corporation s independent auditor in separate executive sessions to discuss any matters that the Committee or each of these groups or persons believe should be discussed privately. The Chairman should work with the Chief Financial Officer and management to establish the agendas for Committee meetings. The Committee, in its discretion, may ask members of management or others to attend its meetings (or portions thereof) and to provide pertinent information as necessary. The Committee shall maintain minutes of its meetings and records relating to those meetings and the Committee s activities and provide copies of such minutes to the Board.

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VI. ADVISORS AND FUNDING

The Committee shall have the authority to engage independent counsel and other advisors as it determines necessary to carry out its duties and responsibilities. The Corporation shall provide for appropriate funding, as determined by the Committee, for payment of any compensation (i) to any independent auditor engaged for the purpose of rendering or issuing an audit report or related work or performing other audit, review or attest services for the Corporation, and (ii) to any independent advisors employed by the Committee.

VII. DISCLOSURE AND REVIEW OF CHARTER

The charter shall be (1) published in the Corporation s annual report or information circular once every three years or following a material amendment to it; or (2) be posted in an up-to-date format on the Corporation s web site. The Committee should review and reassess annually the adequacy of this Charter as required by the applicable rules of Nasdaq or the TSX.

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While the Committee has the duties and responsibilities set forth in this Charter, the Committee is not responsible for planning or conducting the audit or for determining whether the Corporation s financial statements are complete and accurate and are in accordance with generally accepted accounting principles. Management has the responsibility for preparing the financial statements and implementing internal controls and the independent auditor have the responsibility of auditing the financial statements. Similarly, it is not the responsibility of the Committee to resolve disagreements, if any, between management and the independent auditor or to ensure that the Corporation complies with all laws and regulations.

EXHIBIT B

CORPORATE GOVERNANCE
DISCLOSURE OF CORPORATE GOVERNANCE PRACTICES
(CANADIAN NATIONAL INSTRUMENT 58-101)

The directors MDC Partners Inc. consider good corporate governance to be central to the effective and efficient operation of the Corporation. The business of the Corporation is supervised by its board of directors, directly and through its committees. The Canadian Securities Administrators require disclosure on an annual basis of the Corporation s corporate governance practices in accordance with Form 58-101 *Disclosure of Corporate Governance Practices*. The Corporation s corporate governance practices are set out below.

The Board of Directors

In determining whether a particular director is independent, the Board examines the factual circumstances in the context of that particular year. From and after November 3, 2005, the Board was comprised of ten members, seven of whom were independent directors. The Board proposed for election in this Circular is composed of ten members, all of whom are considered to be independent directors with the exception of Messrs. Nadal, Berns and Pustil who are members of management, Mr. Pustil having assumed additional responsibilities in the affairs of MDC Partners since 2001. The following directors of MDC Partners also serve as a director of any other issuer that is a reporting issuer (or the equivalent) in a jurisdiction or a foreign jurisdiction:

Thomas N. Davidson: serves as Chairman of NuTech Precision Metals, Inc.; serves on the Board of Directors of TLC Vision Corporation and on the Board of Occulogix, Inc., and is the non-executive Chairman of Azure Dynamics Corporation.

Steven Berns: serves on the Board of Directors of LivePerson, Inc. and LQ Corporation, Inc..

Richard R. Hylland: serves on the Board of Directors of LodgeNet Entertainment Corporation (LNET).

Robert J. Kamerschen: serves on the board of directors of Radio Shack Corporation, IMS Health Inc., R.H. Donnelley Corporation and Vertrue, Inc.

Senator Michael J.L. Kirby: serves as a director of The Bank of Nova Scotia, Extendicare, Ontario Energy Savings Corporation, Indigo, CPI Plastics and Brainhunter, Inc.

Stephen M. Pustil: serves as Chairman and Director of Custom Direct Income Fund.

François R. Roy: serves on the board of directors of the following Canadian companies: Macquarie Power Income Fund, and SFK Pulp Fund.

All independent directors frequently meet at the beginning or end of each regularly scheduled quarterly Board or Committee meeting without management present. The Board has access to information independent of management through MDC Partners auditor who reports to the Audit Committee. The specific responsibilities of the Board include reviewing and approving all major strategic decisions, including any change in the strategic direction of MDC Partners and acquisitions and/or divestitures and other matters (such as guarantees) in excess of Cdn$5 million; reviewing and approving annual budgets, including capital expenditure plans; reviewing and approving operating results for each quarter and year to date. As part of its ongoing activities, the Board regularly receives and comments upon reports of management as to the performance of MDC Partners business and management s expectations. The

Board is therefore of the view that the appropriate structures and procedures are in place to ensure that it can function independent of management.

The Board has selected Mr. Robert Kamerschen as the Presiding Director of the Board. Mr. Kamerschen is independent.

Board Mandate

The Board of Directors recently adopted a set of Corporate Governance Guidelines as a framework within which the Board and its Committees will conduct its business. A copy of the Guidelines is available free of charge at MDC Partners website at http://www.mdc-partners.com/ir/governance.asp.

Position Descriptions

The Company s bylaws and the Charters of each Board committee provide a detailed description of the roles and responsibilities of the Board, management and committees of the Board. The Human Resources & Compensation Committee (described below) is responsible for establishing, monitoring and evaluating objectives and standards of performance for the Chief Executive Officer and other executive officers on an annual basis. Salary, bonus, loans or other payments for the benefit of the Chief Executive Officer must be reviewed and approved by the Human Resources & Compensation Committee. Related party expenses for services rendered and in the nature of expense reimbursement must also be approved by the Human Resources & Compensation Committee.

Orientation and Continuing Education

New directors to MDC Partners have generally been executives with extensive business experience and directorship responsibilities on the boards of other public and private institutions. Orientation for these individuals is provided through a review of past Board materials and other private and public documents concerning MDC Partners. In addition, Board members are encouraged to attend (at the cost and expense of the Company) continuing education programs identified by the Nominating and Corporate Governance Committee each year to ensure that they maintain the skills necessary for them to meet their obligations as directors.

Ethical Business Conduct

The Company has adopted a Code of Conduct, which applies to all directors, officers (including the Company s Chief Executive Officer and Chief Financial Officer) and employees of the Company and its subsidiaries. The Code of Conduct was adopted in order to help directors, officers and employees resolve ethical issues. The Code of Conduct covers topics including, but not limited to, conflicts of interest, confidentiality of information and compliance with laws. The Company s policy is to not permit any waiver of the Code of Conduct for any director or executive officer, except in extremely limited circumstances. Any waiver of this Code of Conduct for directors or officers of the Company must be approved by the Company s Board of Directors. Amendments to and waivers of the Code of Conduct will be publicly disclosed as required by applicable laws, rules and regulations. The Code of Conduct is available free of charge on the Company s website at http://www.mdc-partners.com, or by writing to MDC Partners Inc., 950 Third Avenue, New York, NY, 10022, Attention: Investor Relations.

Nomination of Directors

The Nominating and Corporate Governance Committee is composed of five members, all of whom are considered to be independent. The Nominating and Corporate Governance Committee is responsible for reviewing and making recommendations to the full Board with respect to developments in the area of corporate governance and the practices of the Board. The Nominating and Corporate Governance

Committee is also responsible for evaluating the performance of the Board as a whole as well as individual board members and for reporting to the Board with respect to appropriate candidates for nominations to the Board. The current members of the Nominating and Corporate Governance Committee are Messrs. Robert J. Kamerschen (Chairman), Thomas N. Davidson, Michael Kirby, François R. Roy and Thomas E. Weigman. The Nominating and Corporate Governance Committee s current charter is available at www.mdc-partners.com/ir/governance.asp.

The Nominating and Corporate Governance Committee identifies, selects and recommends to the Board individuals qualified to serve both on the Board and on Board committees, including persons suggested by shareholders and others. The Nominating and Corporate Governance Committee reviews the background and qualifications of those individuals who are chosen for consideration, including the following attributes and criteria of candidates: experience, skills, expertise, diversity, personal and professional integrity, character, business judgment, time availability in light of other commitments, dedication, conflicts of interest and any other relevant factors deemed appropriate. Following that review, the Nominating and Corporate Governance Committee then selects nominees and recommends them to the Board for election by the shareholders or appointment by the Board, as the case may be. The Nominating and Corporate Governance Committee also reviews the suitability of each Board member for continued service as a director when that member s term expires or that member experiences a significant change in status (for example, a change in employment). The Nominating and Corporate Governance Committee has not implemented any particular additional policies or procedures with respect to suggestions received from shareholders with respect to Board or committee nominees.

Pursuant to its charter, the Nominating and Corporate Governance Committee may conduct or authorize investigations or studies into matters with its scope of responsibilities and may retain, at the Company s expense, such independent counsel or other consultants or advisers at it may deem necessary from time to time. The Nominating and Corporate Governance Committee has the sole authority to retain or terminate any search firm to be used to identify director candidates, including the sole authority to approve its fees and retention terms, with the Company bearing the cost of such fees.

Compensation

The Human Resources & Compensation Committee is composed of five members, all of whom are considered to be independent. The Human Resources & Compensation Committee makes recommendations to the Board on, among other things, the compensation of senior executives. The Human Resources & Compensation Committee discusses personnel and human resources matters including recruitment and development, management succession and benefits plans and grants awards under the 2005 Stock Incentive Plan and the SARs Plan. Salary, bonus or other payments for the benefit of senior management are reviewed and approved by the Human Resources & Compensation Committee. The Human Resources & Compensation Committee reviews the compensation of members of the Board on an annual basis and makes recommendations to the Board. The Board considers their remuneration appropriate given the time commitment, risk and responsibilities associated with the position. The current members of the Human Resources & Compensation Committee are Messrs. Richard R. Hylland (Chairman), Thomas N. Davidson, Robert J. Kamerschen, Scott L. Kauffman, Senator Michael J.L. Kirby and Thomas E. Weigman. The Human Resources & Compensation Committee s current charter is available at www.mdc-partners.com/ir/governance.asp.

Other Board Committees

The Board conducts its business through meetings of the Board and three standing committees: the Audit Committee, the Human Resources & Compensation Committee and the Nominating and Corporate Governance Committee. Copies of the charters of these committees are available, free of charge at MDC Partners website located at http://www.mdc-partners.com/ir/governance.asp.

In addition, from time to time, special committees may be established under the direction of the Board when necessary to address specific issues.

Assessments

The Nominating and Corporate Governance Committee is responsible for developing and recommending standards of performance of the Board, its committees and the individual directors through administration of an annual questionnaire. It is the responsibility of the Nominating and Corporate Governance Committee to assess the effectiveness of the Board as a whole and the committees of the Board. Participation of directors is expected at all Board and committee meetings. Directors are asked to notify MDC Partners if they are unable to attend, and attendance at meetings is duly recorded.

MDC PARTNERS INC.
FORM OF PROXY
(Class A subordinate voting shares)

THIS PROXY IS SOLICITED BY THE MANAGEMENT OF MDC PARTNERS INC. (**MDC PARTNERS**) FOR USE AT THE ANNUAL MEETING OF THE SHAREHOLDERS TO BE HELD ON JUNE 1, 2006.

The undersigned, a shareholder of MDC Partners, hereby nominates, constitutes and appoints as his or her nominee Mr. Miles S. Nadal, or failing him, Mr. Steven Berns, or instead of any of the foregoing (strike out preceding names and print name of alternative nominee), ____ with full power of substitution, to attend and vote all of the common shares of MDC Partners held by the undersigned for and on behalf of the undersigned at the annual meeting of shareholders of MDC Partners to be held on Thursday, June 1, 2006 at The Muse Hotel, 130 West 46th Street, New York, N.Y. commencing at 10:00 a.m. (New York City time) (the **Meeting**) and at any adjournment or postponement thereof in the manner indicated:

1. The nominees proposed by management to act as directors of MDC Partners, to hold office until successors are elected at the next annual meeting of MDC Partners, or any adjournment or postponement thereof, or until his successor is otherwise elected, are:

Miles S. Nadal
Thomas N. Davidson
Steven Berns
Richard R. Hylland
Robert J. Kamerschen
Scott Kauffman
Senator Michael J.L. Kirby
Stephen M. Pustil
François R. Roy
Thomas E. Weigman

to Vote **FOR** [ ] all nominees listed above (except for the following nominees from whom I withold my vote): ___________________________________ or to [ ] **WITHOLD** from voting for all nominees

2. to Vote **FOR** [ ] or to [ ] **WITHHOLD** from Voting, (or, if no specification is made, **FOR**), a resolution appointing BDO Seidman, LLP to act as auditors of MDC Partners and to authorize the directors to fix their remuneration.

I HEREBY REVOKE ANY PRIOR PROXY OR PROXIES. WITH RESPECT TO AMENDMENTS OR VARIATIONS TO ANY MATTER IN THE NOTICE OF MEETING AND ANY OTHER MATTERS WHICH MAY PROPERLY COME BEFORE THE MEETING, I HEREBY CONFER DISCRETIONARY AUTHORITY ON THE PERSON WHO VOTES AND ACTS ON MY BEHALF HEREUNDER TO VOTE WITH RESPECT TO AMENDMENTS OR VARIATIONS TO THE ABOVE MATTERS AND ON SUCH OTHER BUSINESS AS MAY PROPERLY COME BEFORE THE MEETING, AS HE OR SHE THINKS FIT. THE SHARES REPRESENTED BY THIS PROXY WILL BE VOTED IN ACCORDANCE WITH THE INSTRUCTIONS GIVEN ON ANY VOTE OR BALLOT CALLED.

DATED this ______________ day of ____________________________ , 2006.

PRINT NAME: ____

Signature of Registered Shareholder:

____

Number of Class A subordinate voting shares Represented Hereby:

____

INSTRUCTIONS FOR PROXY:

1. This proxy must be dated and signed by a shareholder or his or her attorney duly authorized in writing, or if the shareholder is a corporation, by the proper officers or directors under its corporate seal, or by an officer or attorney thereof duly authorized. When signing in a fiduciary or representative capacity, please give full title as such.

2. **A shareholder has the right to appoint a person to attend and act for him or her and on his or her behalf at the Meeting other than the persons designated in this form of proxy.** Such right may be exercised by filling in the name of such person in the blank space provided and striking out the names of management s nominees. A person appointed as nominee to represent a shareholder need not be a shareholder of MDC Partners. **A person appointed as your proxy holder must be present at the Meeting to vote.**

3. If not dated, this proxy is deemed to bear the date on which it was mailed on behalf of the management of MDC Partners.

4. Each shareholder who is unable to attend the Meeting is respectfully requested to date and sign this form of proxy and return it using the self-addressed envelope provided.

5. To be valid, this proxy must be received by the proxy department of CIBC Mellon Trust Company, 200 Queen s Quay East, Unit 6, Toronto, Ontario M5A 4K9 not later than 4:30 pm (Eastern Daylight Time) on Tuesday, May 30, 2006, or 48 hours before the time of the holding of any adjourned or postponed Meeting, or delivered to the Chairman on the day of the Meeting or any adjournment or postponement thereof.

6. Any of the joint holders of common shares of MDC Partners may sign a form of proxy in respect of such common shares but, if more than one of them is present at the Meeting or represented by proxy holder, then that one of them whose name appears first in the register of the holders of such common shares, or that one s proxy holder will alone be entitled to vote in respect thereof.

MDC PARTNERS INC.
FORM OF PROXY
(Class B multiple voting shares)

THIS PROXY IS SOLICITED BY THE MANAGEMENT OF MDC PARTNERS INC. (**MDC PARTNERS**) FOR USE AT THE ANNUAL MEETING OF THE SHAREHOLDERS TO BE HELD ON JUNE 1, 2006.

The undersigned, a shareholder of MDC Partners, hereby nominates, constitutes and appoints as his or her nominee Mr. Miles S. Nadal, or failing him, Mr. Steven Berns, or instead of any of the foregoing (strike out preceding names and print name of alternative nominee), ____ with full power of substitution, to attend and vote all of the common shares of MDC Partners held by the undersigned for and on behalf of the undersigned at the annual meeting of shareholders of MDC Partners to be held on Thursday, June 1, 2006 at The Muse Hotel, 130 West 46th Street, New York, N.Y. commencing at 10:00 a.m. (New York City time) (the **Meeting**) and at any adjournment or postponement thereof in the manner indicated:

1. The nominees proposed by management to act as directors of MDC Partners, to hold office until successors are elected at the next annual meeting of MDC Partners, or any adjournment or postponement thereof, or until his successor is otherwise elected, are:

Miles S. Nadal
Thomas N. Davidson
Steven Berns
Richard R. Hylland
Robert J. Kamerschen
Scott Kauffman
Senator Michael J.L. Kirby
Stephen M. Pustil
François R. Roy
Thomas E. Weigman

to Vote **FOR** [ ] all nominees listed above (except for the following nominees from whom I withold my vote): ____________________________________ or to [ ] **WITHOLD** from voting for all nominees

2. to Vote **FOR** [ ] or to [ ] **WITHHOLD** from Voting, (or, if no specification is made, **FOR**), a resolution appointing BDO Seidman, LLP to act as auditors of MDC Partners and to authorize the directors to fix their remuneration.

I HEREBY REVOKE ANY PRIOR PROXY OR PROXIES. WITH RESPECT TO AMENDMENTS OR VARIATIONS TO ANY MATTER IN THE NOTICE OF MEETING AND ANY OTHER MATTERS WHICH MAY PROPERLY COME BEFORE THE MEETING, I HEREBY CONFER DISCRETIONARY AUTHORITY ON THE PERSON WHO VOTES AND ACTS ON MY BEHALF HEREUNDER TO VOTE WITH RESPECT TO AMENDMENTS OR VARIATIONS TO THE ABOVE MATTERS AND ON SUCH OTHER BUSINESS AS MAY PROPERLY COME BEFORE THE MEETING, AS HE OR SHE THINKS FIT. THE SHARES REPRESENTED BY THIS PROXY WILL BE VOTED IN ACCORDANCE WITH THE INSTRUCTIONS GIVEN ON ANY VOTE OR BALLOT CALLED.

DATED this ______________ day of _____________________________ , 2006.

PRINT NAME: ____

Signature of Registered Shareholder:

____

Number of Class B multiple voting shares Represented Hereby:

____

INSTRUCTIONS FOR PROXY:

1. This proxy must be dated and signed by a shareholder or his or her attorney duly authorized in writing, or if the shareholder is a corporation, by the proper officers or directors under its corporate seal, or by an officer or attorney thereof duly authorized. When signing in a fiduciary or representative capacity, please give full title as such.

2. **A shareholder has the right to appoint a person to attend and act for him or her and on his or her behalf at the Meeting other than the persons designated in this form of proxy.** Such right may be exercised by filling in the name of such person in the blank space provided and striking out the names of management s nominees. A person appointed as nominee to represent a shareholder need not be a shareholder of MDC Partners. **A person appointed as your proxy holder must be present at the Meeting to vote.**

3. If not dated, this proxy is deemed to bear the date on which it was mailed on behalf of the management of MDC Partners.

4. Each shareholder who is unable to attend the Meeting is respectfully requested to date and sign this form of proxy and return it using the self-addressed envelope provided.

5. To be valid, this proxy must be received by the proxy department of CIBC Mellon Trust Company, 200 Queen s Quay East, Unit 6, Toronto, Ontario M5A 4K9 not later than 4:30 pm (Eastern Daylight Time) on Tuesday, May 30, 2006, or 48 hours before the time of the holding of any adjourned or postponed Meeting, or delivered to the Chairman on the day of the Meeting or any adjournment or postponement thereof.

6. Any of the joint holders of common shares of MDC Partners may sign a form of proxy in respect of such common shares but, if more than one of them is present at the Meeting or represented by proxy holder, then that one of them whose name appears first in the register of the holders of such common shares, or that one s proxy holder will alone be entitled to vote in respect thereof.