INITIATION OF COVERAGE | AI COMPUTE | 1 NOVEMBER 2026

Taiwan Semiconductor Manufacturing Company

NYSE: TSM | TWSE: 2330

Technology leadership. Capital discipline.

A critical supplier to AI computing. The value of that position depends on sustained customer demand and cash returns after the next wave of fab investment.

Recommendation	Base target	Reference close	Implied return
HOLD · High risk	$405.00 / 12–18 months	$406.13 / 30 Oct 2026	-0.3%

Investment conclusion

We initiate coverage with HOLD - High risk. Our Base valuation is $406.28 per ADR, rounded to a $405.00 target. Probability-weighted value is $376.77. TSMC's manufacturing and packaging position supports substantial growth, but the reference price already reflects much of the modeled Base outcome. A stronger return requires more durable growth, higher cash margins or a lower return requirement.

The target uses current intrinsic value as a 12–18 month research realization convention; it is not mechanically compounded to a future date. One ADR represents five ordinary shares. The target excludes dividends. HOLD applies to target-price returns between -15% and +15%; BUY applies above +15% and SELL below -15%.

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Investment thesis

The manufacturing advantage matters only if it converts into durable free cash flow.

A qualified manufacturing platform

TSMC supplies advanced manufacturing and packaging to a broad range of chip designers. Its value proposition rests on process execution, yield, customer qualification and the ability to deliver at scale. Advanced packaging supports that platform; the model includes it within consolidated platform revenue rather than adding a second AI revenue stream.

Demand visibility is not perpetual growth

HPC includes both AI accelerators and other high-performance computing products. The model does not treat all HPC revenue as AI revenue. Base FY27 HPC growth of 40% is a Dilikoglu Research estimate, constrained by modeled capacity growth of 34% and price/mix improvement of 5%. Smartphone and other-platform revenue grow 8%. These assumptions are not contracted revenue or management guidance.

Margins require normalization

Q3 operating margin was 58.7%; Q4 guidance spans 56.5–58.5%. Base begins FY27 at 57%, then converges to 50% by FY32. Management's overseas-fab dilution commentary is already partly reflected in current margins. The forecast allows an incremental burden and wider normalization; it does not subtract the full overseas cost twice. [1, 2]

The valuation is sensitive to duration

Base FY27 revenue is $228.0bn, rising to $519.7bn in FY36. Excess platform growth fades to terminal growth by FY32. Longer duration can support materially higher values, but it also raises dependence on sustained AI spending, technology leadership and reinvestment returns.

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Reported evidence and forecast

The near-term forecast starts with reported results and management's next-quarter range.

Evidence	Value	Treatment
Q3 2026 revenue	$46.72bn	Reported
Q3 operating margin	58.7%	Reported
Q4 revenue	$52.3–54.3bn	Management guidance
Q4 operating margin	56.5–58.5%	Management guidance
FY26 cash capex	$60–64bn	Management guidance
Base FY26 revenue	$176.12bn	DR derived
Base FY27 revenue	$227.97bn	DR estimate

The Base case sums H1 reported revenue, reported Q3 and the Q4 guidance midpoint. FY27 growth is applied to the full FY26 platform base, not to annualized second-half revenue. The estimated FY26 platform mix is 67% HPC, 22% smartphone and 11% other. [1, 2]

FY	Revenue $bn	Operating margin	Cash capex $bn	FCFF $bn
2027	228.0	57.0%	72.9	67.4
2028	286.4	55.6%	91.7	80.7
2030	399.6	52.8%	127.9	118.3
2032	452.9	50.0%	144.9	128.7
2034	485.2	50.0%	154.6	167.8
2036	519.7	50.0%	175.2	181.2

All forecast values are Dilikoglu Research estimates. The consolidated model avoids separate price increases for already-embedded packaging revenue. Initial wafer capacity and price/mix assumptions are aggregate delivery proxies, not physical wafer commitments.

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Capital, depreciation and cash

A growing asset base does not make capital expenditure a free source of earnings.

September PP&E; anchors the asset schedule. Opening remaining life is calibrated to the latest quarterly D&A; run rate after removing the separately modeled lease depreciation. This is an analyst proxy, not a company-disclosed remaining life. Intangible amortization remains unseparated. New investment uses a seven-year blended life and half-year commissioning; shorter-life sensitivities reduce operating profit before adding back depreciation.

Base investment begins at the greater of 32% of revenue and $70bn. In FY34–36, a disclosed late-year capital adjustment transitions net reinvestment to the amount required by terminal growth and return on invested capital. That adjustment enters the asset roll-forward and begins depreciating in subsequent periods. This assumes a gradual normalization of capital efficiency as growth matures. The resulting terminal cash flow remains sensitive to the assumed return on incremental investment.

Valuation-date equity bridge	USD bn
September cash and securities	126.00
Funded debt	32.36
Tax, customer, dividend, pension and NCI claims	25.29
Estimated elapsed-Q4 FCFF	2.50
Elapsed after-tax financing cost	-0.08
Adjusted opening net cash	70.78
Noncore recovery value	5.64

The September balance rolls to October 30 using the elapsed portion of estimated Q4 cash flow. Only the remaining portion is discounted. Selected tax, customer-deposit, pension and operating-accrual components are carried forward from June disclosures and retranslated at September balance-sheet FX. They are estimates, not reported September balances. A further $10bn of claims lowers value by approximately $1.93 per ADR. [1, 3]

Equipment creditors are settled through cash capex, not deducted again. Lease cash is modeled as an operating outflow with the associated depreciation addback; lease debt is not subtracted a second time. The already-ex dividend is removed from September cash once; later-ex dividends remain attributable to the buyer. [6, 7]

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Valuation and scenario range

A cash-flow framework separates operating success from the price paid for it.

Scenario	Probability	IV / ADR	FY27 revenue $bn
Failure	10%	$41.14	156.8
Bear	25%	$177.79	193.9
Base	45%	$406.28	228.0
Bull	20%	$726.90	243.5

Base uses 9.5% WACC, 3.5% terminal growth and 24% terminal ROIC. These are DR judgments, not market guarantees. Terminal value contributes 61.2% of enterprise value. The implied terminal cash flow deducts growth reinvestment and lease cash net of lease depreciation.

Failure combines weaker operating delivery with a 55% enterprise-value recovery factor. It is a stylized severe-disruption scenario, not a complete model of a Taiwan conflict. The 10/25/45/20% scenario probabilities are analyst judgments. They are not empirically estimated event probabilities.

Separate sensitivity	Base IV / ADR
WACC +1pp	$346.90
Operating margins -5pp	$361.75
Cash capex +20%	$378.26
Depreciation life 5 years (capex unchanged)	$407.59
Terminal ROIC 15%	$378.56
Growth fades to terminal by FY30	$329.03

The discounted exit EV/EBIT cross-check is $604.87 and is not blended into the target. It reuses the same earnings forecast and assumes a 22x exit multiple; its higher value shows the importance of terminal valuation, not independent confirmation of upside. We place greater weight on the cash-flow valuation because it explicitly accounts for reinvestment. Sustained growth and cash conversion above our mature-state assumptions would support reconsidering that preference.

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Distribution and thesis tests

The central estimate is only one outcome in a wide distribution.

Monte Carlo measure	USD / ADR
MEAN	$377.26
MEDIAN	$356.53
P10	$105.25
P25	$184.27
P75	$495.38
P90	$710.47

The model runs 12,000 draws with seed 20261101. It samples all four scenarios and correlates demand with delivery, margins, working capital and the discount rate; capital costs, FX and investment recovery also vary. The mean is +0.1% from deterministic probability-weighted value. 39.5% of draws exceed the reference price. These frequencies describe the chosen model, not objective return probabilities. P10 lies near the 10% Failure-scenario boundary and is particularly sensitive to the random sample; it is not a precise downside floor.

Conditional scenario	Median / ADR
Failure	$40.94
Bear	$173.03
Base	$391.46
Bull	$699.95

Catalysts and falsifiers

Monthly revenue, the next annual capital budget, customer qualification and evidence of advanced-node and packaging delivery can change confidence in the forecast. Durable margins despite overseas expansion would support stronger cash returns. Conversely, persistent delivery shortfalls, margin erosion beyond the modeled fade, or capital growth without corresponding revenue would weaken the thesis.

Growth duration is the central debate. The model would merit revision if reported delivery and cash conversion support a materially different path. A share-price move alone is not evidence that operating assumptions should change.

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Sources, limitations and disclosures

Evidence and estimates are identified separately throughout the model.

[1] **Q3 2026 consolidated condensed financial statements** | 2026-10-15
Open source

[2] **Q3 2026 official earnings transcript** | 2026-10-15
Open source

[3] **H1 2026 consolidated financial statement notes** | 2026-08-11
Open source

[4] **TSM regular-session closing price** | 2026-10-30
Open source

[5] **FT historical closing-price cross-check** | 2026-10-30
Open source

[6] **Q3 2026 management report and cash-flow bridge** | 2026-10-15
Open source

[7] **First-quarter 2026 dividend entitlement and payment dates** | 2026-05-12
Open source

Analytical limitations

Detailed September liability composition remains estimated from June notes. Opening asset-life calibration includes unseparated intangible amortization, while new-fab commissioning, subsidies and overseas costs can differ materially from the assumed schedules. The quarterly forecast is an annual allocation, not a detailed physical capacity model. The depreciation-life sensitivity holds cash capex fixed; it is not a forecast of replacement costs. Separate capex stresses test additional investment. No unannounced future subsidy is credited; cash already received is embedded in reported liquidity.

Most enterprise value is terminal. The 24% terminal ROIC and convergence of net reinvestment are significant judgments. WACC, currency exposure, technology competition, customer concentration and geopolitical disruption can produce outcomes outside the scenario range. EPS is an operating proxy after debt interest, not a full forecast of investment income or accounting net earnings.

Conflicts and use of research

Tugay Dilikoğlu reports no TSMC securities holdings, other material interest in TSMC, or compensation from TSMC or any third party for this research.

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