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Taiwan Semiconductor Manufacturing (NYSE: TSM)

The toll booth on the entire AI build-out, marked down while earnings doubled

RATING	PRICE (7/31/26)	FAIR VALUE	12-MO TOTAL RETURN	KEY RISK
BUY	\$404.25	\$485	+20.4%	Taiwan

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We are initiating on Taiwan Semiconductor with a BUY and a \$485 fair value.

Nearly every advanced AI chip in the world (Nvidia's accelerators, Apple's silicon, the custom parts designed by Amazon and Google) is physically manufactured by one company. TSMC holds roughly 70% of the dedicated foundry market and a near-monopoly at the leading edge. It does not have to pick the winner of the AI race. It collects a toll from every entrant.

In the quarter reported July 16, that toll booth produced **\$40.2B of revenue, up 33.7%**, at a 67.7% gross margin, with **diluted earnings per ADR of \$4.31, up 77.4% year over year**. Management then raised full-year 2026 revenue growth guidance to **above 40%**, from 30% previously. Earnings nearly doubled and the outlook went up.

The stock fell anyway. A sector-wide selloff, plus a capital-expenditure guidance raise to **\$60–\$64B** from \$52–\$56B, shifted the market's attention from growth to free-cash-flow compression. Shares now sit around \$404.25, roughly 16% below the 52-week high. That leaves a business compounding earnings at a double-digit-plus rate trading near **23x our FY2026 estimate and ~18x FY2027**, at or below its own five- and ten-year average multiples, despite far faster growth than either period.

We think that is the opportunity, and we are explicit about the reason to say no: this is a Taiwanese company, and a military event in the strait is a permanent-impairment risk that no multiple captures. That risk is real, unquantifiable, and the reason this is a position to size carefully rather than concentrate in.

SNAPSHOT	
Market cap	~\$2.1T
ADR ratio	1 ADR = 5 shares
Q2'26 EPS / ADR	\$4.31 (+77.4%)
Q2'26 revenue	\$40.20B (+33.7%)
Gross margin	67.7%
Operating margin	60.3%
Fwd P/E (FY26E)	~23x
Fwd P/E (FY27E)	~18x
10-yr average P/E	~22x
ROE / ROIC	~40% / ~55%
Net cash	~\$80B
Dividend / yield	\$2.76 / 0.7%
52-week range	\$223.70–\$479.00
Street consensus	Buy, ~\$490–\$532

Price as of the July 31, 2026 close. TSMC reports in New Taiwan dollars; per-ADR figures are the company's own U.S. dollar conversions. One ADR represents five ordinary shares (TWSE: 2330).

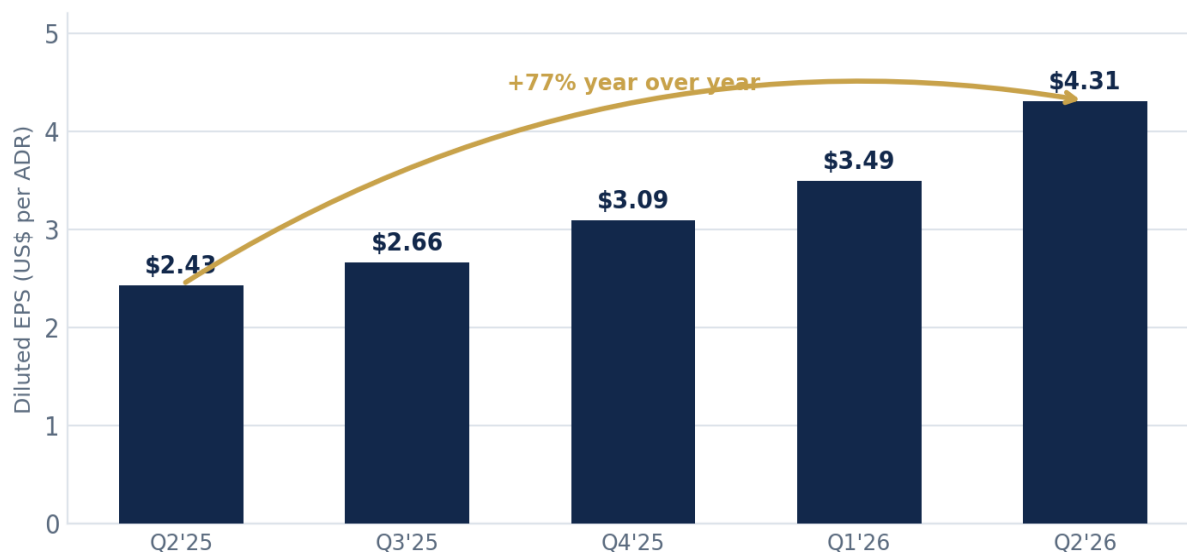
1 · The toll booth

Why the foundry beats the chip designer

Investing in the AI build-out usually means picking which chip designer wins: Nvidia against AMD, custom silicon against merchant parts. That is a genuinely hard call, and getting it wrong is expensive. TSMC sidesteps the question entirely. All of those designs are fabless; someone has to actually etch them into silicon, and at the leading edge there is effectively one company that can. Roughly 70% of the dedicated foundry market, and a far higher share of advanced nodes, runs through TSMC's fabs.

That is a structurally better position than the one we underwrote at Qualcomm two weeks ago. Qualcomm is a designer competing for sockets. TSMC is the road every design has to drive on. Advanced nodes at 7nm and below now generate roughly 77% of wafer revenue, and the moat is capital, not brand: a leading-edge fab costs tens of billions and years to build, which is precisely why the competitive set has thinned rather than widened.

Fig. 1 — Earnings are compounding faster than the multiple



Source: TSMC quarterly earnings releases. Q2 2026 diluted EPS US\$4.31 per ADR unit (NT\$27.25), up 77.4% year over year. Interim quarters derived from reported growth rates; figures rounded.

The economics of a monopoly at the choke point

The pricing power shows up in the margin structure. Second-quarter gross margin was **67.7%** and operating margin **60.3%**, numbers that belong to a software company, earned by a business that runs the most capital-intensive factories on earth. Return on equity is near 40% and return on invested capital near 55%. The balance sheet carries roughly \$80B of net cash. Reports of wafer price increases of up to 10% beginning in 2027 tell you who holds the leverage in these negotiations.

2 · What actually happened in July

The setup here is a disagreement between the operating results and the share price, so it is worth being precise about both.

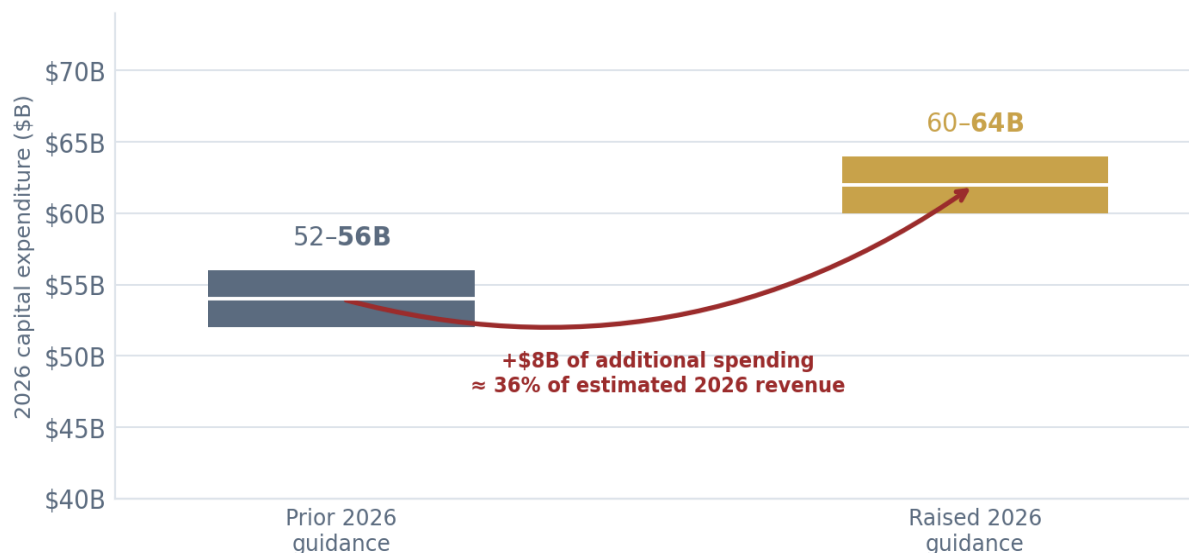
The results

- **Revenue \$40.20B**, up 33.7% year over year and 12.0% sequentially, above the midpoint of guidance.
- **Net income NT\$706.56B**, up 77.4%; **diluted EPS of NT\$27.25, or \$4.31 per ADR unit**, also up 77.4%.
- **Gross margin 67.7%, operating margin 60.3%, net margin 55.6%.**
- **Guidance raised:** Q3 revenue of \$44.6–\$45.8B (roughly 37% growth at the midpoint), and full-year 2026 revenue growth lifted to above 40%, from 30% previously.

The reaction

Shares fell. Three things drove it. First, management raised 2026 capital expenditure guidance to \$60–\$64B from \$52–\$56B, roughly \$8B of additional spending, on the order of 36% of estimated 2026 revenue. Second, third-quarter gross margin guidance of 65–67% came in modestly below consensus, reflecting the cost of ramping 2-nanometer production and building fabs overseas. Third, and largest, a sector-wide correction hit semiconductors generally, on profit-taking after a historic run and renewed questions about how long AI capital spending can compound.

Fig. 2 — The bear case in one chart: capex went up, not down



Source: TSMC Q2 2026 earnings call, July 16, 2026. 2026 capex guidance raised to 60–64B from 52–56B; roughly 70–80% to advanced process, 10–20% advanced packaging, 10% specialty.

We take the capex concern seriously, and we think the market has the sign wrong. TSMC is not raising capital spending because costs ran away from it; it is raising spending because customers are asking for capacity it does not yet have, and management said the next three years of capital spending will significantly exceed the last three. Heavy capex does compress free cash flow in the near term; that part is true and unavoidable. But capacity added at 60%+ operating margins into demand that is visibly present is the good kind of spending. The bad kind is capacity built into demand you are hoping shows up.

3 · The debate, adjudicated

This is the most two-sided name we have covered. The bear case is not a strawman; one branch of it is genuinely unanswerable, and we say so.

THE BEAR CASE	OUR RESPONSE
Taiwan. A blockade or conflict in the strait would impair the asset base directly and re-rate the entire foundry complex. No amount of operating excellence protects against it.	We concede this one. It cannot be modeled, hedged, or diversified away inside the position, and our bear case deliberately does <i>not</i> attempt to price it; a conflict is a permanent-impairment risk, not a multiple. This is the single best reason not to own TSM, and it is why we treat this as a carefully-sized position rather than a concentrated one.
The capex is out of control. Guidance jumped to \$60–\$64B. Free cash flow gets compressed, and history says semiconductor capex cycles end in overcapacity and price collapse.	Fair on the near-term cash flow, which will be pressured. But the classic bust follows capacity built speculatively into hoped-for demand. Here the demand is contracted and visible, the added capacity carries 60%+ operating margins, and pricing power is strong enough to push through increases in 2027. We would be far more worried about a foundry cutting capex into this backdrop.
Customer concentration. Roughly 85% of accounts receivable sits with the top ten customers. A pause from one or two hyperscalers hits results hard.	Real, and worth monitoring. But the concentration reflects that TSMC's customers <i>are</i> the industry's largest firms; there is no version of this business with a long tail of leading-edge buyers. The mitigation is that those customers compete with each other, which sustains demand even as share shifts among them.
AI spending is a bubble. Growth of 40% is a cycle peak, not a run rate. Multiples compress fastest exactly when growth rolls over.	Possibly, and this is precisely what our bear case models: 15x on lower earnings, roughly 29% below spot. We own that outcome as a real probability. The point is that at ~18x FY2027 estimates, a meaningful slowdown is already partly in the price, which is not something you could say at the June highs.

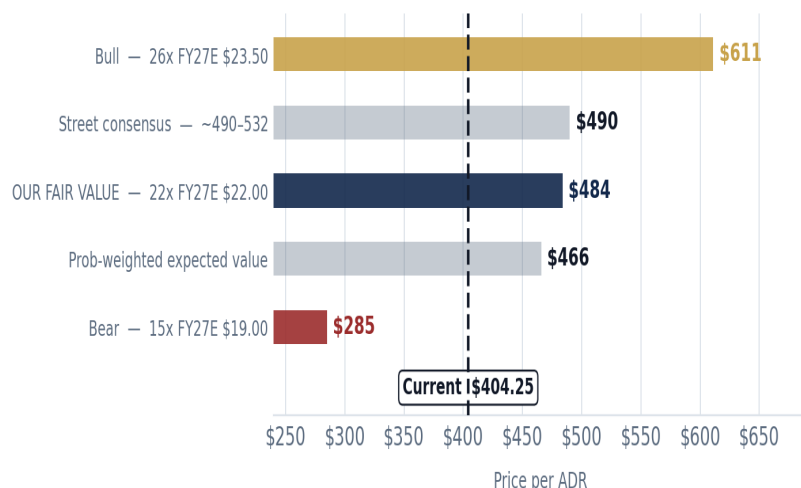
How we hold both ideas at once. The business quality and the entry price both argue for owning TSMC. The geopolitical tail argues for owning less of it than the numbers alone would suggest. Those are not contradictory conclusions; they are what position sizing is for. A BUY rating is a statement about expected value, not a recommendation to concentrate.

4 · Valuation and scenarios

A word on mechanics first, because this is where TSM analysis most often goes wrong. TSMC reports in New Taiwan dollars on its Taiwan-listed ordinary shares (TWSE: 2330). **One NYSE ADR represents five ordinary shares.** Quoted price-to-earnings ratios for TSM vary wildly across data providers because some divide a U.S. dollar price by a New Taiwan dollar earnings figure. We use the company's own per-ADR U.S. dollar conversions throughout: reported Q2 2026 diluted EPS of **\$4.31 per ADR**.

Building forward: we estimate **~\$17.80 per ADR for FY2026** and **~\$22.00 for FY2027**, derived from company revenue guidance and reported margin structure. At \$404.25 that is roughly **23x FY2026E** and **~18x FY2027E**, against a ten-year average multiple near 22x and a five-year average near 23x, for a business growing considerably faster now than it did across either of those periods.

Fig. 3 — Valuation football field: upside with a real tail risk



Source: 2 Comma Investor estimates; street targets per third-party consensus data, July 2026. Weights: 50% base, 25% bull, 25% bear. The bear case models multiple compression, not a Taiwan conflict, which is a permanent-impairment risk no multiple captures. Not a price prediction.

Scenario	Wt.	FY27E EPS	Mult.	Value	Return	What has to happen
Bull	25%	\$23.50	26.0x	\$611	+51%	AI demand proves durable, 2027 wafer price increases stick, 2nm ramps cleanly, and the multiple re-rates toward the growth rate.
Base	50%	\$22.00	22.0x	\$484	+20%	Growth moderates from 40% toward the mid-20s, margins absorb the overseas-fab and 2nm ramp costs, and the multiple simply holds near its own long-run average.
Bear	25%	\$19.00	15.0x	\$285	-29%	AI capital spending digests, utilization slips, and the multiple compresses to a cycle trough. Note: this models a demand and margin cycle, not a Taiwan conflict.
Weighted EV	100%	n/a	n/a	\$466	+15%	Expected value sits ~16% above spot even after weighting the bear case at one in four. The distribution is positively skewed.

Our fair value is the base case: \$485, roughly 20% above the current price including the ~0.7% dividend. Note that we sit *below* the street, whose average target clusters around \$490–\$532; our bear weighting is heavier than consensus. The spread between the bull and bear outcomes here is unusually wide, which is an honest reflection of the uncertainty rather than a modeling artifact. Position size accordingly.

Financial summary

Metric	Q2 FY26A	Q1 FY26A	FY2026E	FY2027E
Revenue (US\$)	\$40.20B	~\$35.9B	~\$172B	~\$215B
Revenue growth (YoY)	+33.7%	n/a	~+41%	~+25%
Gross margin	67.7%	n/a	~66–68%	~65–67%
Operating margin	60.3%	n/a	~59–60%	~58–60%
Net margin	55.6%	~50.5%	~54%	~53%
Diluted EPS / ADR	\$4.31	~\$3.49	~\$17.80	~\$22.00
EPS growth (YoY)	+77.4%	n/a	n/a	~+24%
Capital expenditure	n/a	n/a	\$60–\$64B	n/a
Net cash	~\$80B	n/a	n/a	n/a
Dividend / ADR	\$2.76/yr	n/a	n/a	n/a

A = actual, E = 2 Comma Investor estimate. Fiscal year ends December 31. Per-ADR figures are the company's own U.S. dollar conversions; one ADR = five ordinary shares. Q1 FY26 figures are derived from reported sequential growth rates. Full-year estimates are built from company revenue guidance and reported margin structure, and are rounded.

5 · What we're watching

- **Monthly revenue releases.** TSMC reports revenue every month, the fastest available read on whether AI demand is holding. June 2026 revenue rose 67.9% year over year; a deceleration here would show up long before it reaches an earnings report.
- **Q3 2026 results (October).** Guidance is \$44.6–\$45.8B with gross margin of 65–67%. We watch whether the 2nm ramp and overseas fabs pressure margins more than guided.
- **The 2027 price increases.** Reported wafer price hikes of up to 10% are the cleanest test of pricing power. If customers absorb them, the moat is confirmed; if they push back, the bear case on margins gains force.
- **Capital-expenditure discipline.** Spending above the \$60–\$64B envelope without a matching demand signal would be the first real warning that this cycle is turning into the classic semiconductor overbuild.
- **Cross-strait developments.** Not a variable we can forecast, but the one that most changes the appropriate size of the position.

6 · Risks to the thesis

Sev.	Risk	Assessment
HIGH	Taiwan geopolitical conflict	The dominant risk and the reason for careful sizing. A blockade or military action would impair the asset base and re-rate the sector regardless of operating performance. We deliberately exclude this from our bear case because it is a permanent-impairment scenario, not a multiple scenario. Readers unwilling to carry unhedgeable tail risk should not own this security at any price.
HIGH	AI capital-spending digestion	Growth above 40% is not a perpetual run rate. If hyperscaler spending pauses, utilization and pricing fall together and the multiple compresses fastest at exactly that moment. This is our modeled bear case: roughly 29% downside.
MED	Margin dilution from overseas fabs	U.S., Japanese and European fabs carry structurally higher costs than Taiwanese ones, and political pressure to onshore is increasing. A \$200B-scale overseas footprint pressures the 67%+ gross margin that underwrites the valuation.
MED	Free-cash-flow compression from capex	Capital spending of \$60–\$64B against roughly \$172B of estimated revenue absorbs a large share of operating cash flow. Even in the bull case, near-term free cash flow is materially lower than earnings alone would suggest.
MED	Customer concentration	The top ten customers represent roughly 85% of accounts receivable. A pause from one or two of the largest buyers would move results meaningfully.
LOW	Currency translation	Results are reported in New Taiwan dollars while the ADR is priced in U.S. dollars. Exchange-rate moves affect reported growth rates and per-ADR figures independently of operating performance.

The bottom line

TSMC manufactures nearly every advanced AI chip on earth, holds roughly 70% of the foundry market, earns software-like margins on the most capital-intensive factories in the world, and just grew earnings 77% year over year while raising full-year guidance. The stock fell anyway, on a capex raise and a sector-wide correction, and now trades near 23x this year's estimate and ~18x next year's, at or below its own long-run average multiples, with growth well above its long-run average.

The reason it is cheap is not a mystery, and we will not pretend otherwise: this is a Taiwanese company, and that risk cannot be modeled away. Our answer is to own it with clear eyes and a sensible position size rather than to demand a price that compensates for a risk no price can compensate for.

Rating: BUY. Fair value: \$485. Sized carefully.

Methodology, sources & disclosures

Methodology

Fair value derived from a probability-weighted scenario analysis applying an exit multiple to estimated fiscal 2027 earnings of ~\$22.00 per ADR. Per-ADR earnings estimates are built from company revenue guidance (Q3 2026 of \$44.6–\$45.8B; full-year 2026 growth above 40%) and the reported margin structure, using the company's own U.S. dollar per-ADR conversions and an ADR ratio of five ordinary shares per ADR. The base-case 22x multiple approximates TSMC's own ten-year average. Bull (26x) assumes a re-rating toward the growth rate; bear (15x on lower earnings) assumes a demand-and-margin cycle, and deliberately does not attempt to price a Taiwan military conflict, which is a permanent-impairment risk rather than a multiple scenario. Total return combines the price change to fair value with the ~0.7% dividend yield. This is an opinion of value, not a price prediction.

Primary sources

TSMC second-quarter 2026 earnings release and Form 6-K filed with the SEC (quarter ended June 30, 2026; reported July 16, 2026); TSMC Q2 2026 earnings conference call and management guidance; TSMC monthly revenue releases; TSMC investor relations financial calendar. Price, multiple history and consensus data per third-party providers including stockanalysis.com, GuruFocus, financecharts, macrotrends and investing.com (July 2026). Reference price of \$404.25 is the July 31, 2026 close. All figures are subject to revision; readers should verify the current price and any developments after that date before acting.

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