

UBS Investment Research

MEMC Electronic Materials

Fourth Quarter 2004 Results

■ EPS Ahead of Consensus, Driven by Below the Line Items

MEMC reported proforma EPS of \$0.26, above the Street's and our estimate of \$0.24. The upside to our estimate was given by below the line items, which offset a lower than expected GM of 36.6% (vs. guidance of 38.2% and GM of 40.2% in 3Q-04). GAAP EPS of \$0.31 included a non-operating gain of \$0.05.

■ Some Pricing Pressure Reported; 300 mm Expansions Announced

MEMC is seeing some pricing pressure, which is no surprise given the current environment. The company announced 300 mm expansion plans for 2005. While we remain concerned about the possibility of 300 mm overcapacity, the plan includes adding capacity at Taisil, MEMC's Taiwanese subsidiary. Given Taisil's low production costs, this could provide upside to our estimates in the future.

■ EPS Estimates Revised

We revised our EPS estimates to reflect 4Q-04 results, guidance, and the redemption of the \$50M notes completed in Dec 2004. Our 1Q05 EPS estimate remains unchanged at \$0.24, given guidance of flat Q/Q revs and gross margin; our CY05 EPS estimate goes to \$1.02 (from \$0.98); our CY06 EPS estimate goes to \$1.06 (from \$0.98).

■ Valuation: Maintaining Neutral 2 Rating, \$12 Target Price

We continue to expect a pick-up in demand in 2H05, but remain cautious given industry conditions. Our TP is based on an 8.5x EV/EBITDA multiple applied to our CY05 EBITDA estimate of \$347 M.

| Highlights (US\$m) | 12/03 | 12/04 | 12/05E | 12/06E | 12/07E |
|---------------------|-------|-------|--------|--------|--------|
| Revenues | 781 | 1,028 | 1,101 | 1,165 | - |
| EBIT | 143 | 259 | 302 | 319 | - |
| Net income (UBS) | 117 | 224 | 231 | 247 | - |
| EPS (UBS, US\$) | 0.53 | 0.90 | 1.02 | 1.06 | - |
| Net DPS (UBS, US\$) | 0.00 | 0.00 | 0.00 | 0.00 | - |

| Profitability & Valuation | 5-yr hist. av. | 12/04 | 12/05E | 12/06E | 12/07E |
|---------------------------|----------------|-------|--------|--------|--------|
| EBIT margin % | -3.7 | 25.2 | 27.4 | 27.3 | - |
| ROIC (EBIT) % | -3.6 | 58.4 | 48.6 | 41.8 | - |
| EV/EBITDA x | 18.2 | 7.3 | 7.8 | 7.2 | - |
| PE (UBS) x | -7.3 | 10.5 | 11.8 | 11.4 | - |
| Dividend yield % | 0.0 | 0.0 | 0.0 | 0.0 | - |

Source: UBS adjusted EPS is stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement.

Valuations: based on an average share price that year, (E): based on a share price of US\$12.04 on 27 Jan 2005

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Global Equity Research

Americas

Electric Components & Equipment

Rating **Neutral 2**
Unchanged

Price target **US\$12.00**
Unchanged

Price **US\$12.04**

RIC: WFR.N BBG: WFR US

28 January 2005

Trading data

| | |
|--------------------------|----------------|
| 52-wk. range | US\$13.25-7.39 |
| Market cap. | US\$2.50bn |
| Shares o/s | 208m |
| Free float | 37% |
| Avg. daily volume ('000) | 659 |
| Avg. daily value (US\$m) | 7.3 |

Balance sheet data 12/05E

| | |
|----------------------|------------|
| Shareholders' equity | US\$0.67bn |
| P/BV (UBS) | 4.0x |
| Net cash (debt) | US\$0.05bn |

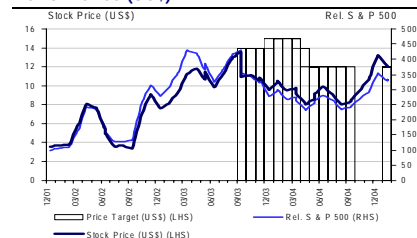
Forecast returns

| | |
|-----------------------------|-------|
| Forecast price appreciation | -0.3% |
| Forecast dividend yield | 0.0% |
| Forecast stock return | -0.3% |
| Market return assumption | 8.3% |
| Forecast excess return | -8.6% |

EPS (UBS, US\$)

| | UBS | Cons. | 12/04 Actual |
|--------|------|-------|--------------|
| Q1E | 0.24 | 0.23 | 0.16 |
| Q2E | 0.24 | 0.25 | 0.20 |
| Q3E | 0.26 | 0.28 | 0.27 |
| Q4E | 0.28 | 0.30 | 0.26 |
| 12/05E | 1.02 | 1.07 | |
| 12/06E | 1.06 | 1.19 | |

Performance (US\$)



Source: UBS

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 5

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Investment Summary

MEMC reported proforma EPS of \$0.26, above the Street's and our estimate of \$0.24. The upside to our estimate was given by below the line items, which offset a lower than expected GM. The guidance of flat revenues and margins for the March quarter results in EPS of \$0.24 (by our calculations), which is in line with our pre-call estimate, and one penny ahead of pre-call consensus of \$0.23.

MEMC reported that it is seeing some pricing pressure, given the inventory correction underway at semiconductor fabs and lower wafer capacity utilization rates. We believe this pricing pressure could have an impact later in 2005, as MEMC is in the process of renegotiating contracts; this is in line with our expectations and not surprising given the current conditions in the semiconductor industry. For the March quarter, the company expects to realize flat ASPs.

Management indicated it plans to reach 200,000 300 mm wafers per month capacity in the summer of 2005, ahead of our initial estimate of 150,000 wpm by the end of 2005. We remain concerned about potential oversupply in the 300 mm market; MEMC management remains confident that this will not be an issue in the current year. Notably, the company indicated that a portion of the expansion will take place at Taisil, its Taiwanese subsidiary. Given Taisil's low production costs, this could be a source of earnings surprise in the future.

We revised our EPS estimates to reflect the December quarter results, company guidance, and the redemption of the company's \$50M senior subordinated notes due in 2007 completed in December 2004. Our 1Q05 EPS estimate remains unchanged at \$0.24, given guidance of flat Q/Q revs, ASPs and margins; our CY05 EPS estimate goes to \$1.02 (from \$0.98); our CY06 EPS estimate goes to \$1.06 (from \$0.98).

We continue to expect wafer demand to be soft in 1H-05, and believe we can see a pick-up in the second half of the year. However, we remain cautious given industry conditions, and higher than expected 300 mm wafer capacity expansion plans. We maintain our Neutral 2 rating based on valuation.

Key Take Aways

■ December 2004 EPS ahead of consensus, driven by below the line items.

MEMC reported proforma EPS of \$0.26 for 4Q-04, exceeding the pre-call consensus and our estimate of \$0.24. The better proforma EPS was driven by below the line items: other non operating income of \$5M (pre-tax basis) and lower than expected effective tax rate of 17% (vs. our estimate of 25%).

- GAAP EPS of \$0.31 included a non-operating gain of \$0.05 per share corresponding to a reversal of tax valuation allowances and a reduction of the effective tax rate that added \$0.28 to the bottom line, offset by a loss of \$0.23 from the recognition of debt extinguishment. The latter refers to

the \$50 M senior subordinated notes that were repaid on December 30, 2004.

- Revenues of \$268 M were 2.5% down Q/Q, versus guidance of flat to down 5%.
- Gross margin of 36.6% was 365 bps below the third quarter's margin of 40.2% and below the company's guidance of about 200 bps decrease. The lower than expected gross margin was attributed to an unfavorable product mix as a result of significant inventory correction by customers.

Table 1: MEMC – Summary of 4Q04 Results

| SUMMARY INCOME STATEMENT | 4Q 04 | 3Q 04 | QoQ % Chg | 4Q 03 | YoY % Chg |
|--|-------|-------|-----------|-------|-----------|
| Total Revenues | 268 | 275 | -3% | 205 | 31% |
| Gross Profit | 98 | 111 | -11% | 64 | 52% |
| Operating Profit | 70 | 84 | -17% | 40 | 75% |
| Non Operating Income | (59) | (0) | 14644% | 4 | nm |
| Provision for Taxes | 61 | (21) | nm | (9) | nm |
| Other | (2) | (3) | -8% | (0) | 1161% |
| Net Income to Common Shareholders | 69 | 60 | 16% | 34 | 1 |
| EPS (Diluted, reported) | 0.31 | 0.27 | 16% | 0.15 | 102% |
| EBITDA (Operating Profit + Depreciation) | 81 | 95 | -15% | 47 | 71% |
| Margins | 4Q 04 | 3Q 04 | QoQ Diff | 4Q 03 | YoY Diff |
| Gross Margin | 36.6% | 40.2% | -3.7% | 31.4% | 5.2% |
| Operating Margin | 25.9% | 30.4% | -4.4% | 19.4% | 6.6% |
| Net Margin | 25.8% | 21.7% | 4.1% | 16.8% | 9.0% |
| EBITDA margin | 30.2% | 34.5% | -4.3% | 23.2% | 7.1% |
| RATIOS | 4Q 04 | 3Q 04 | QoQ % Chg | 4Q 03 | YoY % Chg |
| Days A/R | 47 | 50 | -5% | 45 | 4% |
| Days Inventories | 67 | 66 | 3% | 70 | -4% |
| Current Ratio (CA/CL) | 1.8 | 2.1 | -13% | 1.5 | 21% |

Source: Company Reports and UBS.

- **March 2005 quarter guidance: flat revenues and gross margin.** MEMC guided 1Q-05 revenues and gross margin to be flat quarter on quarter. By our calculations, this results in EPS of \$0.24, in line with our pre-call estimate, and one penny ahead of pre-call consensus of \$0.23.
- **CUR below 90%.** MEMC indicated its capacity utilization rate has fallen to under 90%. The company added that there is currently some pricing pressure given the inventory correction underway at semiconductor fabs.

- **ASPs expected to be flat in 1Q-05.** Management expects average selling prices (ASPs) to be flat sequentially in 1Q05. During 4Q-04, ASPs were flat to slightly up on a mix-adjusted basis. Without considering the mix effect, ASPs in 4Q-04 were about flat.
- **300 mm capacity expansions announced.** MEMC expects to reach 300 mm capacity of 150,000 wafers per month by the end of 1Q-05, and 200,000 wafers per month in the summer of 2005. The company reiterated its goal of achieving 350,000 300 mm wafers per month capacity by the end of 2006. Part of the incremental capacity will be put in place at Taisil, the company's Taiwanese subsidiary.
- **Balance sheet continues to improve.** In December 2004, MEMC paid down its senior subordinated notes due in 2007. The payment of principal and accrued interest amounted to \$67.7 M, but cash on the balance sheet decreased by \$11 M only (to \$92 M) given the strong cash from operations generated during the quarter. Cash flow from operations in 4Q-04 was \$107 M, capex amounted to \$52 M and debt repaid was \$68 M. Days receivables declined to 47 (from 50), and inventory days increased by one day to 67 days.
- **EPS estimate revisions.** We have updated our model to reflect the December quarter results, company guidance, and the redemption of the \$50 M senior subordinated notes completed on December 30, 2004. Our March 2005 EPS estimate remains unchanged at \$0.24; our CY 2005 EPS estimate goes to \$1.02 (from \$0.98); our CY 2006 EPS estimate goes to \$1.06 (from \$0.98).

■ MEMC Electronic Materials

MEMC, headquartered in St Peters, MO, is the world's only publicly traded pure-play silicon wafer manufacturer. The company produces and sells silicon wafers for the semiconductor industry, and is fourth in market share. MEMC sells its products to most semiconductor device manufacturers. Products include prime polished, epitaxial and test/monitor wafers in diameters ranging from 100mm to 300mm. The company operates nine plants that are strategically located close to the major semiconductor markets in the U.S., Europe, and Asia. Texas Pacific Group, a private equity company, controls MEMC.

■ Statement of Risk

MEMC's business is subject to the cyclical nature of semiconductor demand, which can result in share price volatility. There is a risk of overcapacity of 300mm wafers in the future, which can result in price and margin erosion. In addition, continued investment in R&D and infrastructure are needed to ensure the long-term viability of the business which could limit EPS upside.

MEMC shares have low liquidity, as 63% are held by the company's controlling shareholder Texas Pacific Group (TPG). Potential share sales by TPG could increase the supply of shares in the market and limit appreciation in MEMC's share price. MEMC has historically used stock options to compensate its employees. As highlighted in our valuation section, we estimate that the company's potential stock option expense in CY06 is -\$0.03 or 3% of our official \$1.06 EPS estimate.

■ Analyst Certification

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| UBS rating | Definition | UBS rating | Definition | Rating category | Coverage ¹ | IB services ² |
|------------------|---|------------------|--|---------------------|-----------------------|--------------------------|
| Buy 1 | FSR is > 10% above the MRA, higher degree of predictability | Buy 2 | FSR is > 10% above the MRA, lower degree of predictability | Buy | 36% | 32% |
| Neutral 1 | FSR is between -10% and 10% of the MRA, higher degree of predictability | Neutral 2 | FSR is between -10% and 10% of the MRA, lower degree of predictability | Hold/Neutral | 53% | 35% |
| Reduce 1 | FSR is > 10% below the MRA, higher degree of predictability | Reduce 2 | FSR is > 10% below the MRA, lower degree of predictability | Sell | 11% | 29% |

1: Percentage of companies under coverage globally within this rating category.

2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS; as of 31 December 2004.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (an approximation of the equity risk premium).

Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Rating/Return Divergence (RRD) This qualifier is automatically appended to the rating when stock price movement has caused the prevailing rating to differ from that which would be assigned according to the rating system and will be removed when there is no longer a divergence, either through market movement or analyst intervention.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.

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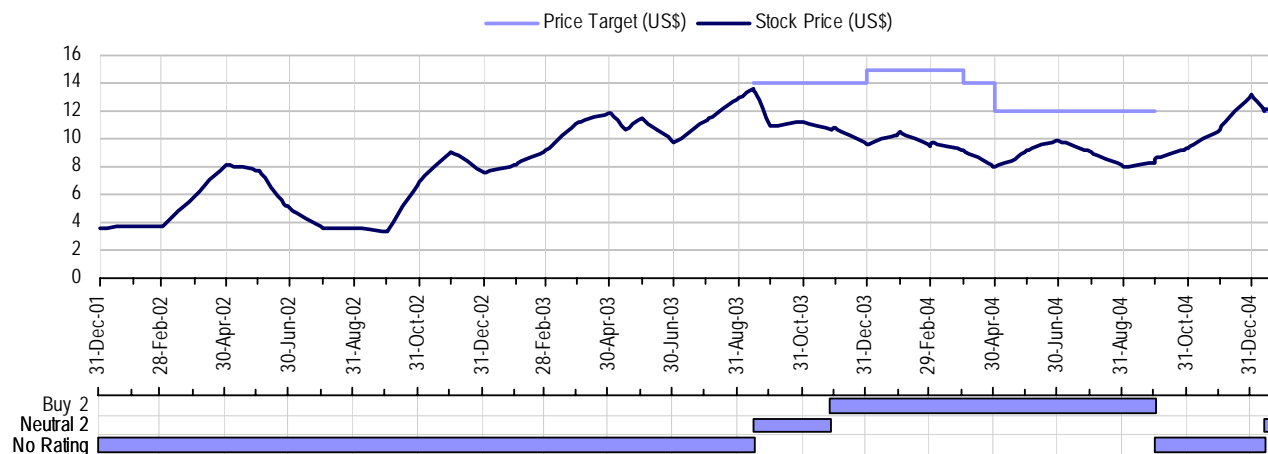
Companies mentioned

| Company Name | Reuters | Rating | Price |
|--|---------|-----------|-----------|
| MEMC Electronic ^{2,4,6,16} | WFR.N | Neutral 2 | US\$12.04 |

Price(s) as of 27 January 2005. Source: UBS.

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MEMC Electronic Materials (US\$)



Source: UBS; as of 27 January 2005.

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