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MEMC Electronic Materials

Reuters: **WFR.N** Bloomberg: **WFR UN** Exchange: **NYSE** Ticker: **WFR.N**

MEMC has some insurance against weaker wafer starts

Stephen O'Rourke
(1) 212 250-8670
stephen.orourke@db.com

Hari P. Chandra
(1) 212 250-2076
hari.chandra@db.com

Peter D. Kim
(1) 415 617-4246
peter-d.kim@db.com

C1Q wafer starts incrementally weaker

We believe wafer starts in C1Q-05 came in weaker than expected in Taiwan, noting recent foundry performance, but were at least partially offset by additional strength in Korea and at Intel. We believe leading edge and 300mm wafer starts remained comparatively strong overall, and should help support materials companies leveraged to leading edge production.

C2Q wafer starts outlook expectations have come down

We expect C2Q wafer starts to grow approximately 2%, below prior expectations, raising the specter of potentially weaker guidance from semiconductor materials companies. Despite any potential near-term impact from wafer starts weakness our longer term outlook for materials companies leveraged to leading edge and 300mm wafers starts remains intact.

MEMC's insurance

We are less concerned with MEMC's near term performance and remain confident in its longer term performance as we believe the company has some competitive advantages that can drive out-performance. We believe the company has insurance to weaker industry fundamentals from incremental market share gains, segment leading capital efficiency, captive production of polysilicon, and strong cash flow pointing to a debt free balance sheet by the end of 2005.

Valuation

At \$13.18 WFR trades at 12.6x our 2005 EPS estimate of \$1.05 and 10.6x our 2006 EPS estimate of \$1.24, a significant discount to peers. With the turnaround largely complete, a model margin structure, strong cash generation capability, and incremental share gains, we believe the discount should erode over the course of the year. We reiterate our price target of \$16 or approximately 15x our 2005 EPS estimate.

Risks

Risks include (1) a high degree of industry cyclicality, (2) competitive pressures and market share shifts, (3) delayed adoption of new technologies, (4) operational execution missteps, and (5) general economic risk.

Forecasts and ratios

Year End Dec 31	2004A	2005E	2006E
1Q EPS (USD)	0.16	0.25	NA
2Q EPS (USD)	0.20	0.25	NA
3Q EPS (USD)	0.27	0.27	NA
4Q EPS (USD)	0.25	0.28	NA
FY EPS (USD)	0.89	1.05	1.24
P/E (x)	10.6	12.4	10.4
Revenue (USDm)	1,028.0	1,103.4	1,201.9

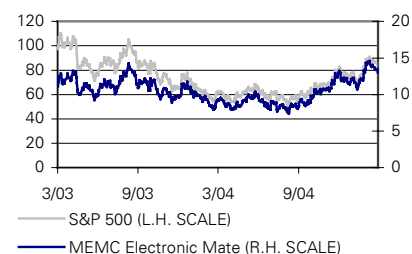
Source: Deutsche Bank

Results Preview

Buy

Price at 8 Apr 2005	13.19
Price target	16.00
52-week range	14.56-7.39

Price/price relative



Performance(%)	1m	3m	12m
Absolute	0.1	0.3	40.6
S&P 500	-3.2	-4.0	3.8

Stock data

Market Cap (USDm)	2,720.2
Shares outstanding (m)	209.4
Volume	1,881,200
S&P 500	1,165.36

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MEMC's insurance

We are less concerned with MEMC's near term performance and remain confident in its longer term performance as we believe the company has some competitive advantages that can help drive out-performance

- **Share gains:** we believe MEMC is gaining incremental share from weaker competitors and is likely to continue to do so at least in the near term. We expect share gains to provide incremental insurance against a weaker business environment in the near-term.
- **Capital efficiency:** we believe MEMC has a competitive advantage in capital efficiency, with the ability to drive well over a dollar of revenue for every dollar of capital spending through expansion of existing facilities, first in Taiwan then in Japan, equipment re-use in the transition from 200mm to 300mm production, and continuous cost reduction. We believe the only comparable comparison would be industry leader Shin-Etsu.
 - **How do they compare?** Both MEMC and Shin-Etsu announced 200k wafers per month capacity increases for 300mm wafers by the end of 2006. MEMC estimates capital spending at 15% of revenue through 2006 should suffice (this equates to ~\$346M by our revenue estimates, and ~\$362M by consensus estimates), and Shin-Etsu announced \$1B in spending through 2006. We estimate that of Shin-Etsu's \$1B in announced spending, upwards of \$450M would be used for similar purposes in a similar sized capacity expansion.
- **Captive production of polysilicon:** there has been much speculation on the potential benefits of captive polysilicon production by MEMC, most notably in relation to solar panel production. We view MEMC's captive polysilicon production as a competitive advantage that generates a comparative cost advantage in times of tight supply, and could generate more meaningful incremental revenue should solar panel market demand accelerate. (Polysilicon is a raw material used in the manufacture of both wafers and solar panels.)
- **Strong cash flow pointing to a debt-free balance sheet:** we note that MEMC has demonstrated strong cash flow since its turnaround, and should be able to eliminate debt by the end of 2005 using cash generated from operations. Financial strength should constitute a competitive advantage in industry consolidation, incremental share gains, and production expansion to meet market opportunity.

Where are the risks besides the general market outlook?

Aside from the macro industry risks of wafer starts growth, and company specific risks of market positioning and share shifts, we believe the primary risk of concern is accelerated price erosion.

- **Temporary periods of oversupply could accelerate ASP erosion:** all the major wafer manufacturers have announced significant production expansion plans through 2006 for 300mm wafers. Although the 300mm ramp should accelerate through 2005 and 2006, we expect periods of overcapacity which could periodically accelerate ASP erosion.
- **Irrational price competition:** in prior cycles the wafer manufacturing industry has been subject to irrational pricing due to efforts to grab market share. We have not seen such behavior through this latest cycle, and believe that the risk of such a thing is lower due to a more rationalized industry.

MEMC near term outlook

F1Q (Mar) expectations: we expect F1Q revenue and EPS of \$268M and \$0.25, in line with revenue guidance of flat. Consensus revenue and EPS are \$267M and \$0.24.

F2Q (Jun) expectations: we expect F2Q revenue guidance to be flat to nominally up. We are forecasting revenue and EPS of \$271M and \$0.25 respectively, versus consensus estimates of \$277M and \$0.26.

Valuation

At \$13.18 WFR trades at 12.6x our 2005 EPS estimate of \$1.05 and 10.6x our 2006 EPS estimate of \$1.24, a significant discount to peers. With the turnaround largely complete, a model margin structure, strong cash generation capability, and incremental share gains, we believe the discount should erode over the course of the year. We believe a modest discount to "materials" company peers can be justified noting the commodity nature of the wafer manufacturing business. We estimate peak multiples for the broader group to range between 15x and 21x and conservatively value WFR at the lower end of the range. We reiterate our \$16 price target or 15x our 2005 EPS estimate.

Appendix 1

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Additional information available upon request

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Company	Ticker	Recent price	Disclosure
MEMC Electronic Materials	WFR.N	12.99 (USD)	9

9. Deutsche Bank and/or its affiliate(s) was a member of a syndicate which has underwritten, within the last five years, the last offering of this company.

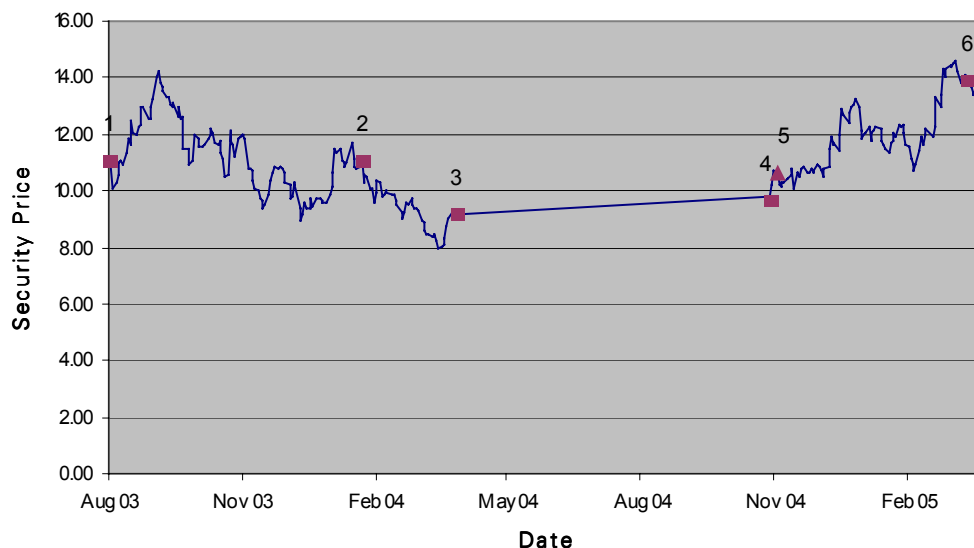
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Historical recommendations and target price: MEMC Electronic Materials (WFR.N)

(as of 3/29/2005)

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Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

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Buy
Hold
Sell
Not Rated
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*New Recommendation Structure
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- | | |
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| 1. 8/6/2003: Rating Initiated Buy, Target Price Change USD15.00 | 4. 11/2/2004: Rating Initiated Hold, Target Price Change USD10.00 |
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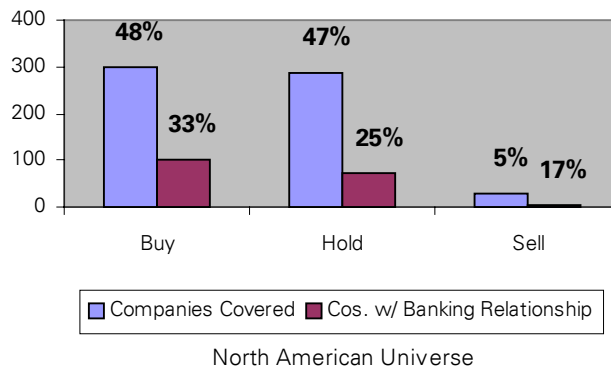
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Deutsche Bank Securities Inc.

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Deutsche Bank Securities Inc.

60 Wall Street
New York, NY 10005
(212) 250 2500

Deutsche Bank Securities Inc.

225 Franklin Street
25th Floor
Boston, MA 02110
(617) 988 8600

Deutsche Bank Securities Inc.

222 West Adams Street
Suite 1900
Chicago, IL 60606
(312) 424 6000

Deutsche Bank Securities Inc.

3033 East First Avenue
Suite 303, Third Floor
Denver, CO 80206
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1735 Market Street
24th Floor
Philadelphia, PA 19103
(215) 854 1546

Deutsche Bank Securities Inc.

101 California Street
46th Floor
San Francisco, CA 94111
(415) 617 2800

International locations

Deutsche Bank Securities Inc.

60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500

Deutsche Bank AG London

1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000
Fax: (44) 20 7545 6155

Deutsche Bank AG

Große Gallusstraße 10-14
60272 Frankfurt am Main
Germany
Tel: (49) 69 910 41339

Deutsche Bank AG

Level 18, Grosvenor Place
225 George Street
Sydney, NSW 2000
Australia
Tel: (61) 2 9258 1555
Fax: (61) 2 9258 1550

Deutsche Bank AG

Level 55
Cheung Kong Center
2 Queen's Road Central
Hong Kong
Tel: (852) 2203 8888
Fax: (852) 2203 6921

Deutsche Securities Limited

Tokyo Branch
Level 20, 2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6701
Fax: (81) 3 5156 6700

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