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MEMC Electronic Materials

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

Near term weakness; long term strength

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

Long-term fundamentals align well

Despite F1Q (Mar) revenue weakness from a slower than anticipated inventory correction and one time customer issues, we believe company fundamentals align well for MEMC. We believe captive polysilicon production, soon to be exclusive 300mm wafer production in Taiwan, incremental share gains, and industry leading capital efficiency add insurance for strong long-term performance. We maintain our Buy rating on WFR, noting near-term incremental weakness, but a positive long-term risk to reward profile.

F1Q (Mar) revenue miss

MEMC posted revenue and EPS of \$258M and \$0.23 versus our estimate of \$268M and \$0.25 and consensus of \$267M and \$0.24. The 3.5% revenue shortfall was due to two resolved customer issues and a slower inventory correction than previously anticipated. ASPs were negatively impacted by mix (lesser 300mm, and lower 200mm utilization). We believe the operating model is intact with gross margin steady at 36% and net margins of 19.9% versus our expectation of 20.4% on slightly higher revenue.

Outlook

We expect F2Q revenue of \$267M versus guidance of \$263M to \$271M, slightly below our prior estimate of \$271M. The lower estimates stem from a conservative view of the present inventory correction and are largely in line with tepid wafer starts growth forecasts from the foundries. In view of the revised outlook, our new 2005 and 2006 revenue estimates are \$1.08 billion and \$1.18 billion, respectively with EPS estimates at \$1.02 and \$1.14, respectively.

Valuation

At \$11.62 WFR trades at 11.4x our 2005 EPS estimate of \$1.02 and 10.2x our 2006 EPS estimate of \$1.14, a significant discount to peers mostly due to relatively low TBV. With tangible evidence of continued operational execution, incremental share gains, captive polysilicon production, and strong cash flow, we believe the discount should erode over the coming quarters. We anticipate near term share price weakness, but believe the risk to reward is quite positive, and reiterate our \$16 price target, or 14.1x our 2006 EPS estimate of 1.14.

Forecasts and ratios

Year End Dec 31	2004A	2005E	2006E
1Q EPS (USD)	0.16	0.23	NA
2Q EPS (USD)	0.20	0.25	NA
3Q EPS (USD)	0.27	0.26	NA
4Q EPS (USD)	0.25	0.28	NA
FY EPS (USD)	0.89	1.02	1.14
OLD FY EPS (USD)	0.89	1.05	1.24
P/E (x)	10.6	11.4	10.2
Revenue (USDm)	1,028.0	1,079.2	1,184.1

Source: Deutsche Bank

Deutsche Bank



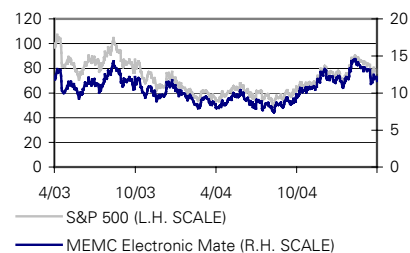
Results Review

Buy

Price at 29 Apr 2005(USD)	11.62
Price target	16.00
52-week range	14.56-7.39

Key changes

Price/price relative



Performance(%)	1m	3m	12m
Absolute	-13.2	-2.7	45.3
S&P 500	-2.6	-2.4	1.9

Stock data

Market Cap (USDm)	2,431.7
Shares outstanding (m)	209.3
Volume	1,103,000
S&P 500	1,143.22

Key indicators

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F1Q (Mar) customer issues

MEMC experienced two customer related issues that impacted revenue in the quarter. We believe these issues have been resolved and customer production ramps should generate anticipated revenue in F2Q (Jun).

- First, a customer production issue was isolated to other than MEMC wafers. The interruption of production impacted MEMC's revenue in the March timeframe. With resolution of volume manufacturing, we anticipate revenue to ramp in the June quarter.
- Second, we believe a customer production issue arose related to MEMC wafers in specific tools. This was corrected, but production interruption impacted F1Q revenue. We believe this issue has been resolved, and production ramped.

The advantage of polysilicon production

We have viewed captive polysilicon production as a cost advantage in periods of tight supply, and a potential incremental boost to revenue should ancillary markets (i.e. solar power) present exploitable opportunities. With present utilization rates, we do not believe this will impact near-term results, but offers incremental upside late in 2005 and in 2006 as wafer starts grow and ancillary markets present additional opportunities. We believe this present upside potential to both earnings and revenue as we look to 2006.

ASPs

ASPs declined in the low single digit range in F1Q (Mar) largely due to weaker than anticipated 300mm shipments as inventory continued to correct, and lower utilization at the lagging edge creating pricing pressures for smaller diameter wafers. We anticipate F2Q (Jun) should show similar ASP declines, largely offset by continued cost reduction. We believe that a shifting mix in the second half of the year should help support ASPs, and potential shortages of polysilicon toward the end of 2005 or in 2006 could further improve pricing should periodic shortages occur.

Revising FY 2005 and FY 2006 estimates

In view of the revenue miss in 1Q05 and slower than expected wafer starts going into 2Q05, we are revising our 2005 and 2006 estimates. Our revenue estimates move from \$1.10 billion and \$1.20 billion to \$1.08 billion and \$1.18 billion, respectively. EPS estimate for 2005 move from \$1.05 to \$1.02, with a lower tax rate at 15% versus 20% earlier providing a \$0.07 cushion. Our 2006 EPS estimate is based on 20% tax rate and accordingly moves from \$1.24 to \$1.14. Despite lower revisions in the near term, we believe MEMC is well positioned to gain market share and leverage its cost structure with improved wafer starts outlook and an expected tighter supply of polysilicon over the coming quarters.

Risks

Risk include (1) a high degree of industry cyclicality, (2) an over- or under-estimation of excess capacity, (3) end market demand shifts, (4) delayed adoption of new technologies, (5) rapid technology changes and product cycles, (6) operational execution missteps, (7) competitive pressures and market share shifts, and (8) general economic risk.

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	11.62 (USD)	7,9,13

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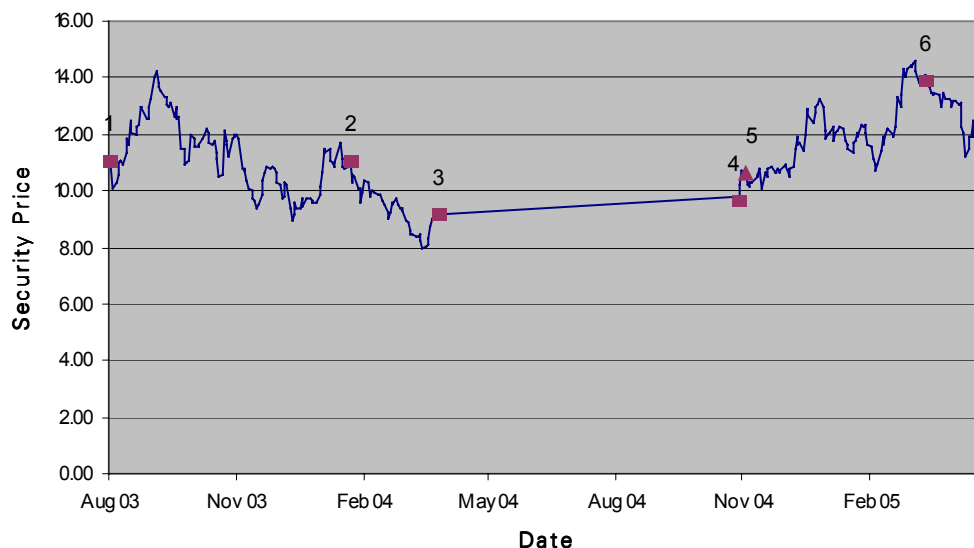
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Historical recommendations and target price: MEMC Electronic Materials (WFR.N)

(as of 4/28/2005)

Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure
as of September 9, 2002

- | | |
|---|---|
| 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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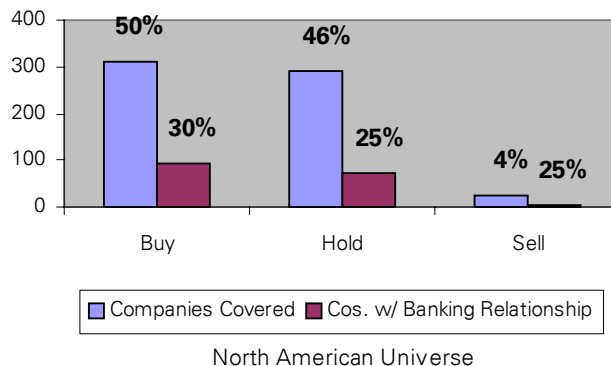
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Deutsche Bank Securities Inc.

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

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3033 East First Avenue
Suite 303, Third Floor
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(303) 394 6800

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1735 Market Street
24th Floor
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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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