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MEMC Electronic Materials

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Cutting through the hype; tweaking estimates

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F2Q (Jun) upside to numbers

We believe wafer sales are tracking above expectations for C2Q. We believe incremental strength at TSMC and UMC is being driven more by lagging edge technology, and that the mix could shift toward 200mm wafers in the near term, driving incrementally lower gross margin on higher revenue. We believe polysilicon prices have increased substantially in C2Q, and although we have not seen wafer ASP improvement, we believe the sale of raw polysilicon could drive incremental revenue, but likely at a lower gross margin than the company average.

Discounting the polysilicon hype

Potential polysilicon shortages present opportunity for MEMC: (1) a comparative cost advantage as a captive supplier of raw polysilicon, (2) a potential pricing advantage should polysilicon shortages drive wafer ASP increases in 2006, (3) incremental revenue with the sale of excess polysilicon to ancillary markets at increasing prices, (4) the potential of selling higher margin wafers to the solar panel industry, and (5) the possibility of locking in share gains with long term supply agreements. (Also see our June 9 note "Factors converging positively..."). We view the majority of these points as upside potential in 2006, and hesitate to build upside into earnings estimates. We prefer to maintain a more conservative view on potential contributions to earnings and believe our 2006 EPS estimate of \$1.26 is quite realistic. We do not view nominal, mix related gross margin degradation as a negative, but as a simple market dynamic.

Raising estimates

We are raising our C2Q (Jun) revenue and EPS estimates to \$274M and \$0.26 from \$268M and \$0.25 to reflect the stronger wafer demand environment and polysilicon price increases. Furthermore, we are adjusting our 2006 revenue and EPS estimates to \$1,291M and \$1.28 from \$1,276M and \$1.26.

Valuation

At \$15.89 WFR trades at 12.4x our 2006 EPS estimate of \$1.28, a discount to peers. As a commodity supplier offset by operational performance and positively converging company and industry fundamentals, we believe a modest discount could be justified, and maintain our price target of \$19 or 15x our C2006 EPS estimate.

Forecasts and ratios

Year End Dec 31	2004A	2005E	2006E
1Q EPS (USD)	0.16	0.23	0.29
2Q EPS (USD)	0.20	0.26	0.31
3Q EPS (USD)	0.27	0.29	0.33
4Q EPS (USD)	0.25	0.31	0.35
FY EPS (USD)	0.89	1.09	1.28
Revenue (USDm)	1,028.0	1,127.0	1,291.4

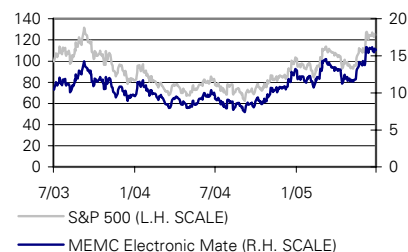
Source: Deutsche Bank

Channel Check

Buy

Price at 4 Jul 2005 (USD)	15.82
Price target	19.00
52-week range	16.19-7.39

Price/price relative



Performance(%)	1m	3m	12m
Absolute	15.1	19.4	65.7
S&P 500	-0.6	1.8	5.8

Stock data

Market Cap (USDm)	3,310.6
Shares outstanding (m)	209.3
Volume	955,000
S&P 500	1,194.44

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Long term contracts before the hype turns into reality?

We believe MEMC has entertained contract pricing discussions with at least one very large customer for 2006. We believe these negotiations typically take place in C4Q. Does it make sense to lock in 2006 pricing under present expectations that polysilicon could experience shortages in 2006? We believe yes, provided the company gains market share with a continually improving cost structure. Furthermore, industry supply/demand forecasts for polysilicon are simply that, and although we do anticipate polysilicon shortages in 2006, we are hesitant to quantify the impact of such shortages as guaranteed contributions to future estimates.

In what way can MEMC beat the top two suppliers?

We believe MEMC is now the number three wafer supplier to the semiconductor industry, and do not believe it is realistic to think the company could displace ShinEtsu or SUMCO in the rankings. Capacity plans, market positioning and financial strength should secure leading market shares for the top two suppliers in the foreseeable future, but we believe MEMC can compete more effectively on cost, delivering an industry leading margin structure and commensurate earnings. We believe a growing track record of operational performance should help lift a comparative valuation discount.

As a supplier to the solar panel industry what makes the most sense?

We believe little more than 10% of revenue comes from polysilicon sales to the solar power industry. MEMC is a wafer supplier; we do not believe that selling raw polysilicon is or should be a primary business focus. We believe the sale of excess polysilicon to solar panel manufacturers should and will continue opportunistically provided it does not impede the sale of wafers to the semiconductor industry. Selling polysilicon is lower margin business than selling silicon ingots, which is lower margin business than selling finished wafers. We believe the company only just began selling ingots to solar panel manufacturers in C1Q, but that selling higher margin wafers (MEMC's business focus) to solar panel manufacturers is still some time well into the future. We do not believe that MEMC will have significant incentive to aggressively increase polysilicon production for solar panel industry demand unless the industry begins buying higher margin wafers rather than raw polysilicon or ingots.

TPG ownership overhang

Texas Pacific Group still owns ~37% of MEMC, and we expect TPG to divest this ownership stake opportunistically. We believe that the overhang of this divestiture can limit potential upside, but that the convergence of company positioning and potential market forces should compensate and drive additional appreciation in the stock.

Risks

Risks include (1) a high degree of industry cyclicality, (2) competitive pressures and market share shifts, (3) operational execution missteps, (4) delayed adoption of new technologies, (5) rapid product life cycles, and (6) general economic risk.

Appendix 1

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Additional information available upon request

Disclosure checklist			
Company	Ticker	Recent price	Disclosure
MEMC Electronic Materials	WFR.N	15.82 (USD)	7,13

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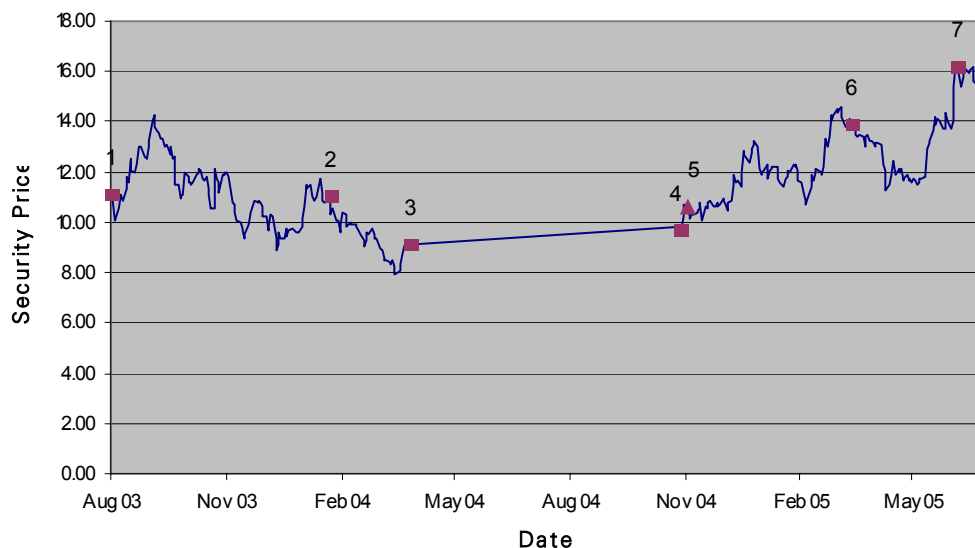
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Historical recommendations and target price: MEMC Electronic Materials (WFR.N)

(as of 7/1/2005)

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 | 5. 11/8/2004: Upgrade to Buy, Target Price Change USD14.00 |
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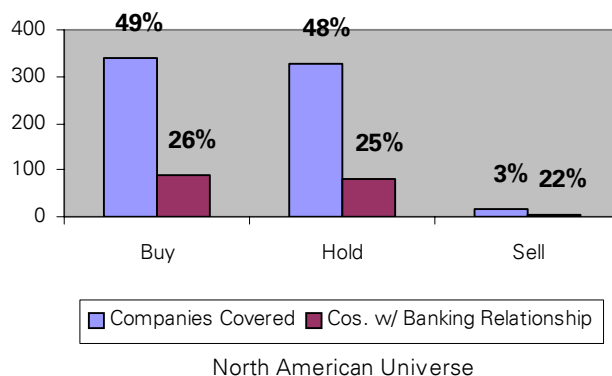
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