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Stock Rating
Overweight-V

Industry View
Cautious

Inotera Memories, Inc. The Survivor Pick

Quick Comment – Conclusion: On superior business model, Inotera is the only DRAM maker in Taiwan with positive cash margin in downturn. Cash is king. Cost of capital is no longer cheap in Taiwan. But Taiwan still has a laborious talented human capital. Production cost difference is what attracts technology partners to Taiwan. As all DRAM makers are cutting wafers production to reduce cash loss; the best time for Inotera to transition from trench to stacked in a downturn. Capacity loss leads to less losses overall. We expect ~30% Y/Y bits growth for Inotera in 2009. Inotera should benefit from next DRAM upcycle in 2010 with good cost structure on more certain stacked technology roadmap.

What's New: Inotera reported in line 3Q08 LPS NT\$1.21 (net loss NT\$4.1 bn) on GM (-23%), OM (-24%), EBITDA margin 43%. **Value Added Data:** 3Q08 DRAM bit growth 28% Q/Q (wafers increased 3% Q/Q), DRAM ASP declined 12% Q/Q (Revenue/wafer increased 6% Q/Q), bit cost declined 22% Q/Q (wafer cost declined 2% Q/Q). 1 gigabit on 70 nm accounts for 95-97% of output at 80%+ yield. **Guidance:** 10% Q/Q bits growth for 4Q08; 60% Y/Y bits growth for 2008. Inotera will cut 20% of production output in 4Q08 that will impact 1Q09 shipments. Inotera will cut 2008 capex to NT\$21 bn, down 64% Y/Y. 2008 depreciation NT\$28 bn; 2009 depreciation NT\$30-32 bn. **Operational Insights:** 1. Qimonda procurement will phase out by July 2008. We expect fast conversion to Micron stacked technology in 1H09 on input for majority of output by 4Q09. 2. Meiya's clean room will complete in November 2008. Post Micron's closing on acquiring Inotera stake from Qimonda in late November, we expect Meiya to merge into Inotera. Meiya facility will help to de-bottleneck/re-balance Inotera stacked technology migration in our view.

Implications: 1. Stacked transition plan – Inotera will take a cost-effective approach on 68 nm stacked transition. We estimate 70 nm Qimonda trench transition to 68 nm Micron stacked technology will increase gross die/wafer by ~45% on ~10% wafer cost increase. Majority of equipment will retrofit from trench

Key Ratios and Statistics

Reuters: 3474.TW Bloomberg: 3474 TT

Taiwan DRAM

Price target	NT\$15.00
Upside to price target (%)	62
Shr price, close (Oct 22, 2008)	NT\$9.24
52-Week Range	NT\$31.80-7.87
Sh out, dil, curr (mn)	3,313
Mkt cap, curr (mn)	NT\$30,610
Avg daily trading volume (mn)	NT\$174

Fiscal Year ending	12/07	12/08e	12/09e	12/10e
ModelWare EPS (NT\$)	0.26	(4.70)	(1.21)	2.17
EPS, basic (NT\$)*	0.29	(4.61)	(1.14)	2.22
Consensus EPS (NT\$)§	0.27	(3.47)	(1.55)	4.88
Revenue, net (NT\$ mn)	45,865	39,287	48,535	60,098
EBITDA (NT\$ mn)	23,616	13,589	25,984	38,706
ModelWare net inc (NT\$ mn)	845	(15,690)	(4,050)	7,257
P/E	100.7	NM	NM	4.2
P/BV	1.2	0.5	0.6	0.5
RNOA (%)	2.5	(7.8)	(1.5)	5.9
ROE (%)	1.1	(21.8)	(7.2)	13.8
Div yld (%)	9.1	0.0	0.0	0.0
FCF yld ratio (%)	(38.8)	(51.2)	3.9	(6.7)
Leverage (EOP) (%)	77.9	122.3	128.0	114.7

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

§ = Consensus data is provided by FactSet Estimates.

* = GAAP or approximated based on GAAP

e = Morgan Stanley Research estimates

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to stacked except the obsolescence of deep trench etching machines (i.e. Tokyo Electron). We think Inotera will phase in 50 nm in 4Q09/1Q10 for 2010 transition as Immersion machine costs ~\$US50 mn for 7-8K wafers/mth capacity (still evaluating Nikon vs ASML).

2. DDR III accounts for ~10% of Inotera capacity. Trench technology requires three metal layers for DDR III that will negatively impact fab output if DDR III accounts for more than 10-15% of total capacity. Further DDR III output increase will rely on 68 nm stacked technology output in 2H09.

Exhibit 1

3Q08: Actual Results vs Morgan Stanley Estimates

(NT\$m)	3Q08 Actual	3Q08 MS	Variance	Q/Q	Y/Y
Total Revenue	10,786	10,786	0%	11%	-15%
Cost of goods sold	13,287	13,067	2%	3%	15%
Depreciation	6,751	6,790	-1%	0%	20%
Gross Profit	(2,501)	(2,281)	nm	nm	nm
Operating Expense	136	205	-34%	-36%	-28%
R&D	51	108	-53%	-59%	-45%
SG&A	85	97	-12%	-3%	-12%
Operating Profit	(2,637)	(2,486)	nm	nm	nm
Non Operating Income (Loss)	(1,525)	(1,380)	nm	nm	nm
Pre-Tax Profit	(4,162)	(3,866)	nm	nm	nm
Net Profit	(4,051)	(3,866)	nm	nm	nm
EPS	(1.21)	(1.16)	nm	nm	nm
Shares (mn)	3,338	3,338	0%	0%	1%
Gross Margin	-23.2%	-21.1%	-200 bps	1030 bps	-3220 bps
Operating Margin	-24.4%	-23.0%	-140 bps	1120 bps	-3200 bps
Net Margin	-37.6%	-35.8%	-170 bps	-390 bps	-4100 bps
12" Wafers Shipment (K)	358	369	3%	3%	5%
Total Die Shipments (512 mb eqv mn)	436	450	3%	30%	52%
Avg Wafer Price (\$USD)	972	943	3%	6%	-14%
Avg Wafer Price/Chip (512 mb eqv)	0.84	0.81	3%	-16%	-41%
Inventories	4,769	4,690	2%	3%	-17%
FX (NT/\$)	31.0	31.0	0%	2%	-6%

Source: Company data, Morgan Stanley Research

Company Description

Inotera is uniquely positioned in Taiwan as a pure foundry manufacturer of memory wafer. It was established in 2003 as a joint venture between Infineon and Nanya Technology, and achieved profitability in 2004. It currently manufactures primarily DDR II DRAM products, which are the most advanced DRAM products on the market.

Taiwan DRAM

Industry View: Cautious

MSCI Country: Taiwan

Asia Strategist's Recommended Weight: 11.9%
MSCI Asia/Pac All Country Ex Jp Weight: 12.0%

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Inotera Memories, Inc.

Exhibit 2

Inotera Memories: Quarterly Income Statement – Reported Basis with Employee Bonus Expense

	(NT\$m)	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08E	1Q09E	2Q09E	3Q09E	4Q09E	2007	2008E	2009E	2010E
Net Sales		12,270	10,845	12,690	10,059	8,802	9,699	10,786	9,847	11,430	11,024	12,007	13,411	45,865	39,134	47,872	59,416
COGS		7,772	10,213	11,541	12,297	12,272	12,948	13,287	13,133	13,138	13,029	12,943	12,879	41,822	51,641	51,989	51,079
Gross Profits		4,498	632	1,149	(2,237)	(3,470)	(3,249)	(2,501)	(3,287)	(1,708)	(2,005)	(936)	532	4,042	(12,507)	(4,117)	8,336
Operating Expense		176	237	190	276	375	211	136	177	263	215	234	255	878	900	967	1,346
SG&A		97	102	97	96	87	87	85	98	126	105	114	121	391	358	465	635
R&D		79	135	93	180	288	124	51	79	137	110	120	134	487	542	502	712
Operating Income		4,322	396	959	(2,513)	(3,846)	(3,460)	(2,637)	(3,464)	(1,970)	(2,220)	(1,170)	277	3,164	(13,407)	(5,084)	6,990
Total Non-Op. Income/(Loss)		(118)	(103)	(491)	(1,383)	(255)	231	(1,525)	(420)	(285)	419	516	615	(2,095)	(1,970)	1,266	1,237
Net Interest		(177)	(293)	(445)	(487)	(460)	(454)	(475)	(454)	(445)	(443)	(434)	(422)	(1,402)	(1,843)	(1,743)	(1,675)
Investment Income/(Loss)		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other Non Ops		59	190	(46)	(896)	205	685	(1,050)	34	160	862	950	1,037	(693)	(127)	3,009	2,912
Pre-tax Income		4,204	293	469	(3,896)	(4,101)	(3,229)	(4,162)	(3,885)	(2,255)	(1,801)	(654)	892	1,069	(15,376)	(3,818)	8,227
Income Tax (Expense)/Credit		329	(5)	26	(232)	81	36	(111)	-	-	-	-	-	117	6	-	823
Net Income		3,875	298	443	(3,664)	(4,182)	(3,265)	(4,051)	(3,885)	(2,255)	(1,801)	(654)	892	951	(15,382)	(3,818)	7,404
Reported EPS		1.17	0.09	0.13	(1.10)	(1.25)	(0.98)	(1.21)	(1.16)	(0.68)	(0.54)	(0.20)	0.27	0.29	(4.61)	(1.14)	2.22
Weighted Avg Shares		3,298	3,298	3,318	3,338	3,338	3,338	3,338	3,338	3,338	3,338	3,338	3,338	3,313	3,338	3,338	3,338
EBITDA		8,175	5,434	6,593	3,555	2,565	3,310	4,133	3,800	5,472	5,399	6,634	8,275	23,758	13,808	25,780	37,788
Margins(%)																	
Gross Margin		36.7%	5.8%	9.1%	-22.2%	-39.4%	-33.5%	-23.2%	-33.4%	-39.4%	-39.4%	-39.4%	-39.4%	8.8%	-32.0%	-8.6%	14.0%
Operating Expense		1.4%	2.2%	1.5%	2.7%	4.3%	2.2%	1.3%	1.8%	4.3%	4.3%	4.3%	4.3%	1.9%	2.3%	2.0%	2.3%
SG&A		0.8%	0.9%	0.8%	0.9%	1.0%	0.9%	0.8%	1.0%	1.0%	1.0%	1.0%	1.0%	0.9%	0.9%	1.0%	1.1%
R&D		0.6%	1.2%	0.7%	1.8%	3.3%	1.3%	0.5%	0.8%	3.3%	3.3%	3.3%	3.3%	1.1%	1.4%	1.0%	1.2%
Operating Margin		35.2%	3.6%	7.6%	-25.0%	-43.7%	-35.7%	-24.4%	-35.2%	-43.7%	-43.7%	-43.7%	-43.7%	6.9%	-34.3%	-10.6%	11.8%
Tax Rate		7.8%	-1.8%	5.5%	6.0%	-2.0%	-1.1%	2.7%	0.0%	-2.0%	-2.0%	-2.0%	-2.0%	11.0%	0.0%	0.0%	10.0%
Net Margin		31.6%	2.7%	3.5%	-36.4%	-47.5%	-33.7%	-37.6%	-39.5%	-47.5%	-47.5%	-47.5%	-47.5%	2.1%	-39.3%	-8.0%	12.5%
EBITDA Margin		66.6%	50.1%	52.0%	35.3%	29.1%	34.1%	38.3%	38.6%	29.1%	29.1%	29.1%	29.1%	51.8%	35.3%	53.9%	63.6%
QoQ %																	
Net revenues		5%	-12%	17%	-21%	-12%	10%	11%	-9%								
Gross profit		-14%	-86%	82%	nm	nm	nm	nm	nm								
Operating income		-16%	-91%	143%	nm	nm	nm	nm	nm								
Net income		-21%	-92%	49%	nm	nm	nm	nm	nm								
YoY %																	
Sales		44%	4%	25%	-14%	-28%	-11%	-15%	-2%	-28%	-28%	-28%	-28%	12%	-15%	22%	24%
Gross profit		53%	-85%	-71%	nm	nm	nm	nm	nm	nm	nm	nm	nm	-75%	nm	nm	nm
Operating income		55%	-90%	-75%	nm	nm	nm	nm	nm	nm	nm	nm	nm	-80%	nm	nm	nm
Net income		59%	-93%	-90%	nm	nm	nm	nm	nm	nm	nm	nm	nm	-94%	nm	nm	nm
Reported EPS		31%	-93%	-90%	nm	nm	nm	nm	nm	nm	nm	nm	nm	-94%	nm	nm	nm

Source: Company data, Morgan Stanley Research. E=Morgan Stanley Research estimates

	<p>Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations. For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.</p>
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(as of September 30, 2008)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	892	40%	292	44%	33%
Equal-weight/Hold	937	42%	278	42%	30%
Underweight/Sell	387	17%	90	14%	23%
Total	2,216		660		

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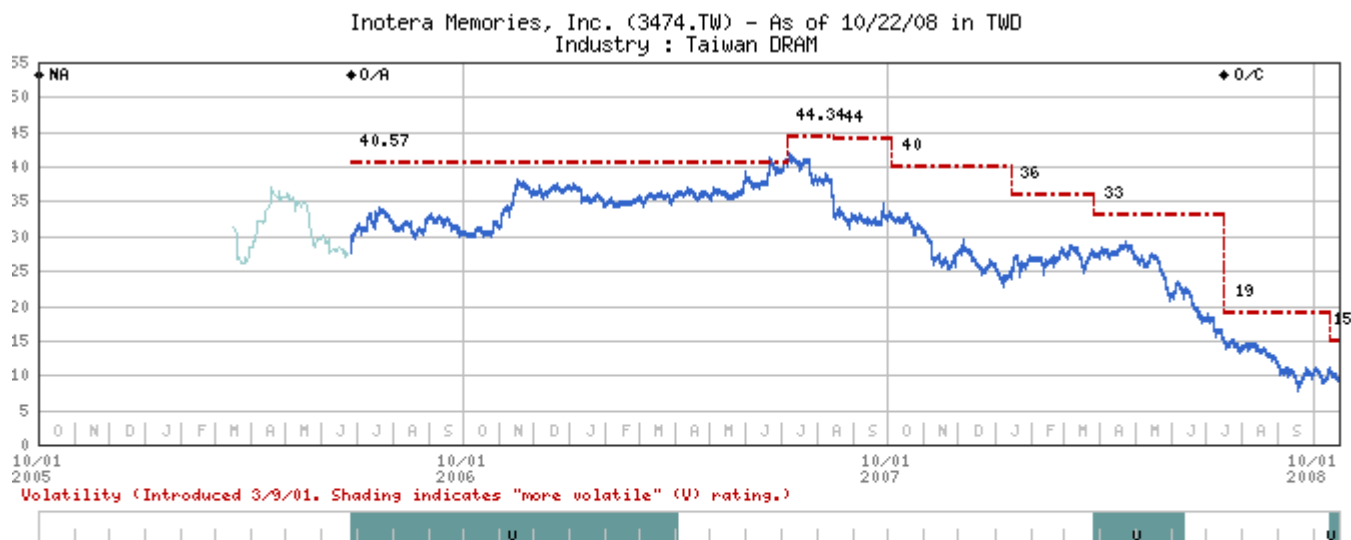
Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

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Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

Stock Price, Price Target and Rating History (See Rating Definitions)



Stock Rating History: 10/1/05 : NA; 6/26/06 : O/A; 7/17/08 : O/C

Price Target History: 6/26/06 : 40.57; 7/6/07 : 44.34; 8/15/07 : 44; 10/4/07 : 40; 1/15/08 : 36; 3/27/08 : 33; 7/17/08 : 19; 10/16/08 : 15

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■
 Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) ♦
 Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (V) No Rating Available (NAU)
 Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAU)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage: Taiwan DRAM

Company (Ticker)	Rating (as of)	Price (10/22/2008)
Frank A.Y. Wang		
Inotera Memories, Inc. (3474.TW)	O-V (06/26/2006)	NT\$9.24
Nanya Technology Corp. (2408.TW)	U-V (07/17/2008)	NT\$6.83
Powerchip (5346.TWO)	U-V (07/17/2008)	NT\$4.61
Winbond Electronics (2344.TW)	E-V (11/24/2005)	NT\$3.59

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