

Morgan Stanley Taiwan Limited+

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October 22, 2008

Stock Rating
Underweight-V

Industry View
Cautious

Nanya Technology Corp.

Banks Own More Than Investors

Quick Comment – Conclusion: On ~70% liabilities/assets ratio, 0.8x P/B, Nanya is ~75% owned by creditors and only 25% owned by investors (Formosa group ~50% shareholder). Timing is everything. It's better for Nanya to transition from Qimonda's vanishing trench technology to Micron's stacked technology in a DRAM downturn. Nanya will lose some fab capacity during transition in 4Q08/1Q09 (just like other DRAM makers shut down some capacities for recess to reduce bleeding). In a DRAM downturn; less shipments will lead to a smaller loss although variable cost will first increase initially until crossover in 2H09.

What's New: Nanya reported in line 3Q08 LPS NT\$1.87 (net loss NT\$8.8 bn) on (31%) GM, (52%) OM, 22% EBITDA margin. Nanya wrote down ~NT\$1 bn inventory loss on weak DRAM pricing. **Value Added Data:** 3Q08 bits growth 30% Q/Q with 9% Q/Q ASP decline. Inventories grew by 7-10 days to 3 weeks.

Guidance: 4Q08 bits growth flat Q/Q on Inotera's 20% production cut and Nanya's stacked transition (capacity loss). 1Q09 bits growth flat to down Q/Q. **Operational Insights:** 1. Meiya for Inotera - Meiya's clean room will be completed in November 2008. Post Micron's closing on acquiring Inotera stake from Qimonda in late-Nov, we expect Meiya to merge into Inotera. Meiya facility will help to de-bottleneck/re-balance Inotera stacked technology migration in our view. 2. Stacked transition plan - Nanya 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. Nanya will start stacked wafers in February 2009 for output in 2Q09. We estimate the transition for 30K 12" wafers/mth will cost ~\$US100 mn. New equipment addition will be copper process related (i.e. Novellus). Majority of equipment will retrofit from trench to stacked except the obsolescence of deep trench etching machines (i.e. Tokyo Electron).

Key Ratios and Statistics

Reuters: 2408.TW Bloomberg: 2408 TT

Taiwan DRAM

Price target	NT\$6.00
Upside to price target (%)	(12)
Shr price, close (Oct 22, 2008)	NT\$6.83
52-Week Range	NT\$21.55-6.78
Sh out, dil, curr (mn)	4,329
Mkt cap, curr (mn)	NT\$29,565
Avg daily trading volume (mn)	NT\$233

Fiscal Year ending	12/07	12/08e	12/09e	12/10e
ModelWare EPS (NT\$)	(3.02)	(6.89)	(2.26)	1.95
EPS, basic (NT\$)*	(2.88)	(6.86)	(2.25)	1.95
Consensus EPS (NT\$)§	(2.37)	(5.64)	(2.94)	2.69
Revenue, net (NT\$ mn)	52,894	39,401	49,257	74,414
EBITDA (NT\$ mn)	(658)	(10,633)	6,418	24,477
ModelWare net inc (NT\$ mn)	(13,069)	(32,368)	(10,636)	9,181
P/E	NM	NM	NM	3.5
P/BV	1.2	1.0	1.4	1.0
RNOA (%)	(14.7)	(22.3)	(9.0)	6.0
ROE (%)	(16.9)	(49.6)	(32.4)	41.2
Div yld (%)	16.6	0.0	0.0	0.0
FCF yld ratio (%)	(55.2)	(86.2)	(60.8)	12.6
Leverage (EOP) (%)	31.3	153.1	308.9	195.3

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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Nanya will phase in 50 nm in 4Q09/1Q10 for 2010 production as Immersion machine costs ~\$US50 mn for 7-8K wafers/mth capacity (Nanya is still evaluating Nikon vs ASML). 3. Capex cut - We expect Nanya to only spend ~NT\$13 bn in 2008, down 72% Y/Y (vs NT\$20 bn guidance).

Downside Risks - 1. Nanya indicates that all PC, LCD TV, handsets, digital still cameras customers have revised down 4Q08 demand forecasts. DRAM inventories are increasing with most at DRAM vendors and system makers. Channel inventories are lean as they are reluctant to procure more on low demand visibility. This leads to weak DRAM spot pricing on lack of spot demand. 2. To improve the balance sheet, Nanya looks to issue more equity by 1H09. It has outstanding funding plan of ~600 mn shares (~13% dilution). 3. DRAM leader is still relentlessly migrating to 56 nm technology. Potential technology gap widen with tier one as the capital cost of Immersion tool could become the gate keeper. 4. No exit strategy for the weaker? Taiwan DRAM makers are debt ridden on cash losses. Larger capacity leads to larger losses. Weaker DRAM makers can't exit through consolidation.

Upside risk: Material suppliers are looking to cut supplies to weaker DRAM makers on extended payments. Weaker DRAM makers will be forced out if they can't access capital to pay down ECB put. Weaker exit by 1Q09 will be positive to surviving DRAM makers.

DDR III progress – DDR III will be important by 2H09 in our view as 1) it's a value added solution for both graphics memory and main memory market. 2) Intel will introduce DDR III only chipsets to force migration. 3) Compared to the past DDR and DDR II transition, DDR III cost increase is minimal for backend given no change in package and minimal in front end on ~5% die penalty. 4) "Green PC" concept will push DDR III proliferation on lower power consumption. 5) All DRAM makers will make effort on DDR III for differentiation in DDR II DRAM downturn.

DDR III will account for ~5-6% of Nanya shipments in 4Q08 as most of production comes from Inotera (10% of Inotera capacity; Inotera accounts for 60% of Nanya capacity). Nanya targets 30-40% of shipments in DDR III by 4Q09. Most of DDR III increase in 2H09 could come from stacked technology as trench technology requires three metal layers that will negatively impact fab output if DDR III accounts more than 10-15% of total capacity. Majority of 68 nm stacked technology will be for 1 gigabit DDR III chips in 2H09. 50 nm will focus on 2 gigabit DDR III chip.

Fab utilization down

We estimate Nanya only runs ~15K wafers/mth or 50% of its 8" fab (30K wafers/mth capacity) mainly for specialty memories and foundry (i.e. Macronix). Nanya will consider 8" fab retirement in 2H09. For 12" fab, we estimate Nanya only runs 20K+ wafers/mth in its 12" fab (30K wafers/mth) mostly due to stacked process migration. By product mix - 35% in desktop, 50-55% notebook, 10% servers, 3-5% for consumers.

Company Description

Nanya Technology is one of the largest DRAM makers in Taiwan. Its parent Formosa Group is a petrochemical leader globally, with strong balance sheets and cash flows to support Nanya Technology's long-term commitment to DRAM.

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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Exhibit 1

3Q08: Actual Results vs Morgan Stanley Estimates

(NT\$m)	3Q08		Variance	Q/Q	Y/Y
	Actual	MS			
Total Revenue	11,504	11,504	0%	21%	-14%
Cost of goods sold	15,090	15,655	-4%	16%	15%
Depreciation	2,876	2,876	0%	3%	106%
Gross Profit	(3,586)	(4,151)	nm	nm	nm
Operating Expense	2,390	2,646	-10%	1%	-1%
R&D	1,800	1,956	-8%	-2%	10%
SG&A	590	690	-15%	11%	-24%
Operating Profit	(5,976)	(6,797)	nm	nm	nm
Non Operating Income (Loss)	(2,792)	(1,600)	nm	nm	nm
Pre-Tax Profit	(8,768)	(8,397)	nm	nm	nm
Net Profit	(8,771)	(8,397)	nm	nm	nm
EPS	(1.87)	(1.79)	nm	nm	nm
Shares (mn)	4,701	4,701	0%	0%	8%
Gross Margin	-31.2%	-36.1%	490 bp	550 bp	-3310 bp
Operating Margin	-51.9%	-59.1%	710 bp	960 bp	-3580 bp
Net Margin	-76.2%	-73.0%	-330 bp	30 bp	-6390 bp
DRAM revenues (NT\$m)	11,323	11,323	0%	21%	-9%
DRAM shipments-512mb eqv. (mn units)	304.8	293.1	4%	19%	66%
DRAM ASP-512mb eqv. (US\$)	1.11	1.15	-4%	-8%	-46%
FX (NT/\$)	31.0	31.0	0%	2%	-6%

Source: Company data, Morgan Stanley Research


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Exhibit 2

Nanya Technology: Quarterly Income Statements-Reported

NT\$(mn)	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08E	1Q09E	2Q09E	3Q09E	4Q09E	2007	2008E	2009E	2010E
Sales	17,115	12,003	13,403	10,373	9,143	9,530	11,504	8,999	8,836	10,254	12,545	14,470	52,894	39,177	46,105	72,617
COGS	13,248	12,597	13,151	13,476	13,513	13,025	15,090	12,970	11,206	11,699	11,275	11,763	52,472	54,597	45,942	56,081
Depreciation	1,432	1,415	1,396	1,532	2,567	2,791	2,866	2,926	2,827	2,758	2,703	2,759	5,776	11,150	11,047	11,391
Amortization	778	875	879	823	509	1,045	1,045	1,045	1,045	1,045	1,045	1,045	3,355	3,645	4,180	4,180
Non Depreciation/Amortization																
COGS	11,038	10,308	10,875	11,121	10,436	9,188	11,179	8,999	7,334	7,895	7,527	7,959	43,342	39,802	30,715	40,509
Gross Profit	3,867	(594)	252	(3,103)	(4,369)	(3,494)	(3,586)	(3,971)	(2,370)	(1,445)	1,270	2,707	422	(15,420)	163	16,536
Operating Expense	1,810	2,599	2,416	2,570	2,156	2,371	2,390	2,070	1,988	2,358	2,885	2,894	9,396	8,987	10,126	10,458
R&D	1,529	1,503	1,642	1,805	1,404	1,838	1,800	1,530	1,502	1,743	2,133	2,026	6,479	6,571	7,404	7,354
SG&A	281	1,097	775	765	752	533	590	540	486	615	753	868	2,917	2,415	2,722	3,104
Operating Profit	2,057	(3,193)	(2,164)	(5,673)	(6,525)	(5,866)	(5,976)	(6,040)	(4,358)	(3,804)	(1,615)	(187)	(8,974)	(24,407)	(9,963)	6,078
Non Operating Items	1,747	(144)	504	(5,591)	(2,258)	(1,426)	(2,792)	(1,350)	(900)	(700)	-	1,000	(3,484)	(7,826)	(600)	3,100
Pretax Income	3,803	(3,337)	(1,660)	(11,264)	(8,783)	(7,292)	(8,768)	(7,390)	(5,258)	(4,504)	(1,615)	813	(12,458)	(32,233)	(10,563)	9,178
Income Taxes Exp. /(Gains)	510	(511)	0	-	-	0	3	-	-	-	-	-	(1)	3	-	-
Extraordinaries	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Income after Extraord.	3,293	(2,826)	(1,660)	(11,264)	(8,783)	(7,292)	(8,771)	(7,390)	(5,258)	(4,504)	(1,615)	813	(12,457)	(32,236)	(10,563)	9,178
EBITDA	4,267	(903)	111	(3,318)	(3,448)	(2,029)	(2,065)	(2,070)	(486)	-	2,133	3,618	156	(9,612)	5,264	21,650
Reported EPS	0.80	(0.68)	(0.38)	(2.39)	(1.87)	(1.55)	(1.87)	(1.57)	(1.12)	(0.96)	(0.34)	0.17	(2.88)	(6.86)	(2.25)	1.95
Average shares	4,106	4,128	4,364	4,705	4,697	4,699	4,701	4,701	4,701	4,701	4,701	4,701	4,329	4,699	4,701	4,701
EBITDA Margin	24.9%	-7.5%	0.8%	-32.0%	-37.7%	-21.3%	-17.9%	-23.0%	-5.5%	0.0%	17.0%	25.0%	0%	-25%	11%	30%
Gross Margin	22.6%	-4.9%	1.9%	-29.9%	-47.8%	-36.7%	-31.2%	-44.1%	-26.8%	-14.1%	10.1%	18.7%	0.8%	-39%	0%	23%
Operating Margin	12.0%	-26.6%	-16.1%	-54.7%	-71.4%	-61.5%	-51.9%	-67.1%	-49.3%	-37.1%	-12.9%	-1.3%	-17.0%	-62.3%	-21.6%	8.4%
Tax Rate	13.4%	15.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0%	0%	0%
Net Margin	19.2%	-23.5%	-12.4%	-108.6%	-96.1%	-76.5%	-76.2%	-82.1%	-59.5%	-43.9%	-12.9%	5.6%	-23.6%	-82%	-23%	13%
Sales QoQ	-23%	-30%	12%	-23%	-12%	4%	21%	-22%	-2%	16%	22%	15%				
COGS QoQ	0%	0%	0%	0%	0%	-4%	16%	-14%	-14%	4%	-4%	4%				
Gross Profit QoQ	-54%	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	113%				
Operating Profit QoQ	-65%	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm				
Net Profit QoQ	-49%	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm				
Sales YoY	15%	-31%	-34%	-54%	-47%	-21%	-14%	-13%	-3%	8%	9%	61%	-30%	-26%	18%	58%
COGS YoY	0%	0%	0%	0%	2%	3%	15%	-4%	-17%	-10%	-25%	-9%	-2%	4%	-16%	22%
Gross Profit YoY	8%	nm	-96%	nm	nm	nm	nm	nm	nm	nm	nm	nm	-98%	nm	nm	10066%
Operating Profit YoY	30%	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	13%	3%
Net Profit YoY	61%	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	13%	-1%

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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Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

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More volatile (V) - We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

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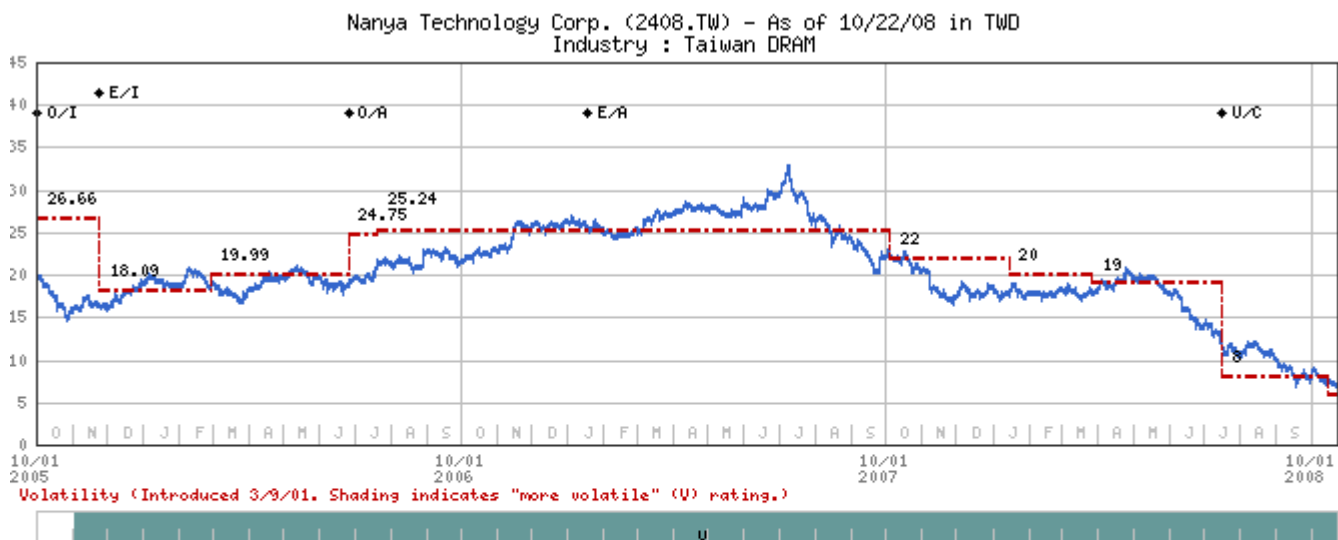
Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

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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 : O/I; 11/24/05 : E/I; 6/26/06 : O/A; 1/17/07 : E/A; 7/17/08 : U/C

Price Target History: 7/13/05 : 26.66; 11/24/05 : 18.09; 2/27/06 : 19.99; 6/26/06 : 24.75; 7/21/06 : 25.24; 10/4/07 : 22; 1/15/08 : 20; 3/27/08 : 19; 7/17/08 : 8; 10/16/08 : 6

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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