Williams, Kelsey

From: Parmigiani, Ted [redacted]
Sent: Thursday, June 02, 2005 8:04 AM
To: [redacted]
Cc: [redacted]
Subject: Request for IPC meeting re AMKR upgrade to 2-EW

AMKR060305.doc
(860 KB)

[redacted],

As per conversation with [redacted] this morning, would like to schedule IPC meeting on AMKR upgrade as soon as the IPC committee is available - today would be great if possible, otherwise available tomorrow, Monday, etc. I've enclosed the first call note as requested.

Thanks for all your help,

Ted

<<AMKR060305.doc>>

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June 03, 2005

North America
Technology
Semiconductors

Amkor Technology (AMKR - $3.85) 2-Equal weight

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Recommendation Change

Upgrade to 2-EW on 2H05 Profitability

Investment Conclusion

- Based on checks with key suppliers & customers, we blv AMKR's factories have been experiencing increasing levels of util. & mix improvement in Q2. More specifically, our research suggests ASP pressure is <2% & company-wide util. is roughly 80% today (vs. prior est of 75%) & poised to jump to mid-to-high 80's in Q3, 90%+ in Q4 - making 2H:05 profitability a likely scenario, in our opinion. We are upgrading AMKR fm 3-EW to 2-EW & adjusting price tgt fm $2.75 to $6.00 to reflect AMKR's return to profitability almost 1-yr earlier than our former ests (see note dtd 6/1/05). We look to become more constructive beyond our new $6 price target & 2-EW rating after tangible evidence of debt reduction.

Summary

- We expect high utilization, improving product mix & benign ASP pressure to accelerate profit recovery by 1-yr, or 2H:05 vs prior 2H:06 forecast.
- Our new price target of $6.00 is based on 1.2x C06 EV Target /C06E Sales & 0.4x Price Target/ C06E Sales.

EPS ($) (FY Dec)

	2004		2005			2006			% Change	
	Actual	Old	New	St. Est.	Old	New	St. Est.		2005	2006
1Q	0.08A	-0.39A	[illegible]	-0.39A	0.04E	[illegible]	-0.18E		-588%	110%
2Q	-0.04A	-0.23E	[illegible]	-0.30E	0.08E	[illegible]	-0.11E		-475%	135%
3Q	-0.13A	0.00E	[illegible]	-0.18E	0.14E	[illegible]	-0.02E		100%	14%
4Q	-0.21A	0.06E	[illegible]	-0.12E	0.16E	[illegible]	0.04E		129%	167%
Year	-0.29A	-0.57E	[illegible]	-0.99E	0.42E	[illegible]	-0.23E		-97%	174%
P/E			N/A			[illegible]				

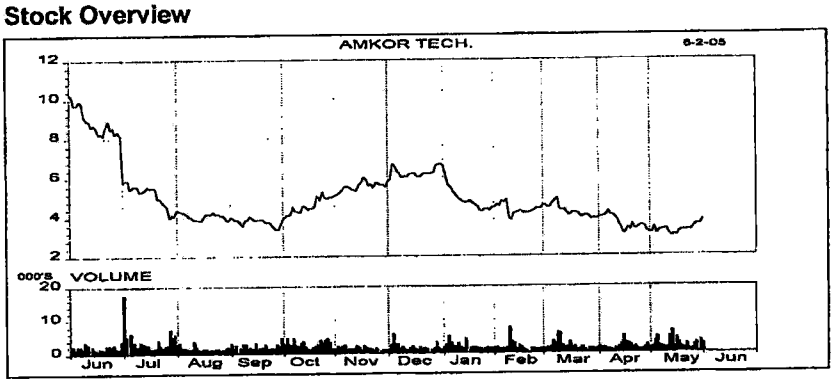
Market Data

Market Cap	0.68B
Shares Outstanding (Mil)	175.70
Float	57.00
Dividend Yield	N/A
Convertible	Yes
52 wk Range	10.81 - 2.87

Financial Summary

Revenue FY05	1995.0 B
Five-Year EPS CAGR	999.90%
Return on Equity	-112.00%
Current BVPS	1.41
Debt To Capital	89.21%

Stock Overview



Stock Rating:

New: 2-Equal weight
Old: 3-Underweight

Target:

New: 6.00
Old: 2.75

Sector View: 1-Positive

Valuation, Rating and Price Target

Upgrading from 3-UW to 2-EW and raising price target from $2.75 to $6.00. While our prior $2.75 price target was driven by our nearer-term concern of balance sheet deterioration, we believe greater certainty with respect to near-term visibility & sooner-than-expected profitability. Our new price target of $6.00 is based on 1.2x C06 EV Target /C06E Sales & 0.4x Price Target/ C06E Sales -- essentially the same multiples AMKR trades at today on our estimated C05 EV & Sales.

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Investors should consider this report as only a single factor in making their investment decisions.

PLEASE SEE ANALYST(S) CERTIFICATION(S) ON PAGE 3 AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 4

Figure 1: AMKR Valuation & Price Target

Price/Sales, EV/Sales, EV/EBITDA, P/Book Metrics					
Current Stock Price		$3.82	Target Stock Price		$6.00
P/S	C05E	0.3x	P/S	C05E	0.5x
	C06E	0.3x		C06E	0.4x
EV/S	C05E	1.3x	EV/S	C05E	1.5x
	C06E	1.0x		C06E	1.2x
EV/EBITDA	C05E	7.8x	EV/EBITDA	C05E	9.0x
	C06E	4.5x		C06E	5.2x
P/CY Book	C05E	3.9x	P/CY Book	C05E	6.1x
	C06E	3.0x		C06E	4.7x

Sources: Company Reports and Lehman Brothers Estimates

Figure 2: Amkor Technology P&L Model

Amkor Technology
P&L Model ($ millions)

Current version: 6/1/05
Last version: 5/5/05

FILE: AMKRWKSH	Fiscal 2004					Fiscal 2005E					Fiscal 2006E				
FYE: December	Q1	Q2	Q3	Q4	2004	Q1	Q2E	Q3E	Q4E	2005E	Q1E	Q2E	Q3E	Q4E	2006E
Revenue	$464.6	$492.5	$490.8	$453.3	$1,901.3	$417.5	$471.0	$535.0	$571.5	$1,995.0	$560.0	$590.0	$628.0	$637.0	$2,415.0
Sequential Change	1.3%	6.0%	-0.3%	-7.7%		-7.9%	12.8%	13.6%	6.8%		-2.0%	5.4%	6.4%	1.4%	
Change Vs Year Ago	35.4%	30.3%	15.8%	-1.2%	18.6%	-10.2%	-4.4%	9.0%	26.1%	4.9%	34.1%	25.3%	17.4%	11.5%	21.1%
Cost of Goods	$352.8	$397.8	$403.1	$379.8	$1,533.4	$374.1	$398.0	$422.7	$448.6	$1,643.4	$439.6	$460.2	$486.1	$492.1	$1,878.0
Percent of Revenue	75.9%	80.8%	82.1%	83.8%	80.7%	89.6%	84.5%	79.0%	78.5%	82.4%	78.5%	78.0%	77.4%	77.3%	77.8%
Gross Margin	$111.8	$94.8	$87.8	$73.4	$367.8	$43.4	$73.0	$112.4	$122.9	$351.6	$120.4	$129.8	$141.9	$144.9	$537.0
Percent of Revenue	24.1%	19.2%	17.9%	16.2%	19.3%	10.4%	15.5%	21.0%	21.5%	17.6%	21.5%	22.0%	22.6%	22.8%	22.2%
Incremental GM	-41.3%	-61.2%	NM	38.1%		84.0%	55.3%	61.5%	28.8%		21.5%	31.3%	31.9%	33.2%	
R&D	$9.0	$9.9	$8.7	$9.2	$36.7	$8.9	$9.1	$9.0	$9.0	$36.0	$10.0	$10.0	$10.0	$10.0	$40.0
Percent of Revenue	1.9%	2.0%	1.8%	2.0%		2.1%	1.9%	1.7%	1.6%	1.8%	1.8%	1.7%	1.6%	1.6%	1.7%
Amortization of Acq. Int.	$1.3	$1.6	$1.6	$1.5	$6.1	$2.0	$2.0	$2.0	$2.0	$8.0	$2.0	$2.0	$2.0	$2.0	$8.0
General, Admin. & Mktg.	$52.2	$54.1	$53.2	$54.8	$214.3	$58.5	$58.5	$56.0	$56.0	$229.0	$55.0	$56.5	$57.5	$58.0	$227.0
Percent of Revenue	11.2%	11.0%	10.8%	12.1%	11.3%	14.0%	12.4%	10.5%	9.8%	11.5%	9.8%	9.6%	9.2%	9.1%	9.4%
Operating Expenses	$62.5	$65.6	$63.5	$65.5	$257.1	$69.4	$69.6	$67.0	$67.0	$273.0	$67.0	$68.5	$69.5	$70.0	$275.0
Percent of Revenue	13.4%	13.3%	12.9%	14.5%	13.5%	16.6%	14.8%	12.5%	11.7%	13.7%	12.0%	11.6%	11.1%	11.0%	11.4%
Operating Income	$49.4	$29.2	$24.3	$7.9	$110.7	($26.0)	$3.4	$45.4	$55.9	$78.7	$53.4	$61.3	$72.4	$74.9	$262.0
Percent of Revenue	10.6%	5.9%	4.9%	1.7%	5.8%	-6.2%	0.7%	8.5%	9.8%	3.9%	9.5%	10.4%	11.5%	11.8%	10.9%
Other Income (Exp)	($32.4)	($13.7)	($39.0)	($42.8)	($127.9)	($42.9)	($43.5)	($44.0)	($45.0)	($175.4)	($45.0)	($45.0)	($45.0)	($45.0)	($180.0)
Percent of Revenue	-7.0%	-2.8%	-8.0%	-9.4%	-6.7%	-10.3%	-9.2%	-8.2%	-7.9%	-8.8%	-8.0%	-7.6%	-7.2%	-7.1%	-7.5%
Extraordinary Items (tax adj.)	$2.7	$22.7	$0.0	$0.0	$25.4	($50.0)	$0.0	$0.0	$0.0	($50.0)	$0.0	$0.0	$0.0	$0.0	$0.0
Profit Before Taxes	$17.0	$15.5	($14.8)	($34.9)	($17.2)	($68.9)	($40.1)	$1.3	$10.9	($96.8)	$8.4	$16.3	$27.4	$29.9	$82.0
Percent of Revenue	3.7%	3.2%	-3.0%	-7.7%	-0.9%	-16.5%	-8.5%	0.3%	1.9%	-4.9%	1.5%	2.8%	4.4%	4.7%	3.4%
Taxes	$1.6	$0.0	$6.3	$1.9	$9.8	$1.2	$2.0	$2.0	$2.0	$7.2	$2.0	$2.0	$2.0	$2.0	$8.0
Tax Rate	9.5%	0.0%	NM	NM	-57.2%	-1.7%	-5.0%	148.1%	18.4%	-7.4%	23.8%	12.3%	7.3%	6.7%	9.8%
Minority Interest	($0.4)	$0.0	($1.3)	$0.7	($0.9)	$1.0	$1.0	$1.0	$1.0	$4.0	$0.0	$0.0	$0.0	$0.0	$0.0
Net Income-Operations	$15.0	($7.2)	($22.3)	($36.1)	($50.6)	($69.1)	($41.1)	$0.4	$9.9	($99.9)	$6.4	$14.3	$25.4	$27.9	$74.0
Percent of Revenue	3.2%	(1.5%)	(4.6%)	(8.0%)	(2.7%)	(16.5%)	(8.7%)	0.1%	1.7%	(5.0%)	1.1%	2.4%	4.0%	4.4%	3.1%
Net Income incl. Extra. Items	$17.7	$15.5	($22.3)	($36.1)	($25.2)	($119.1)	($41.1)	$0.4	$9.9	($149.9)	$6.4	$14.3	$25.4	$27.9	$74.0
Average Shares - Fully Dil. (mil)	180.2	175.9	175.7	175.7	176.9	175.7	175.7	175.7	175.7	175.7	175.7	175.7	176.2	176.7	176.1
Operating EPS (fully diluted)	$0.08	($0.04)	($0.13)	($0.21)	($0.29)	($0.39)	($0.23)	$0.00	$0.06	($0.57)	$0.04	$0.08	$0.14	$0.16	$0.42
% Change Y/Y	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
% Change Q/Q	NM	NM	NM	NM		NM	NM	NM	NM		NM	NM	77.3%	9.5%	

Sources: Company reports and Lehman Brothers estimates

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Figure 3: Amkor Technology Balance Sheet Model

Amkor Technology
Balance Sheet Model ($ millions)

Current version: 6/1/05
Last version: 5/5/05

FILE: AMKRWKSH	Fiscal 2004				Fiscal 2005E				Fiscal 2006E			
FYE: December	Q1	Q2	Q3	Q4	Q1	Q2E	Q3E	Q4E	Q1E	Q2E	Q3E	Q4E
Balance Sheet												
ASSETS												
Cash & Securities	$345	$295	$231	$372	$287	$211	$320	$330	$327	$375	$412	$469
Accounts Receivable	$290	$277	$277	$269	$265	$287	$326	$320	$314	$330	$352	$357
Total Inventories	$112	$120	$120	$112	$112	$120	$120	$124	$115	$120	$128	$130
Other Current Assets	$38	$37	$32	$33	$39	$39	$39	$39	$39	$39	$39	$39
Total Current Assets	$787	$728	$661	$786	$703	$657	$805	$813	$795	$864	$930	$995
Net PP&E	$1,132	$1,329	$1,388	$1,380	$1,372	$1,390	$1,430	$1,396	$1,365	$1,334	$1,307	$1,279
Other Assets	$797	$760	$786	$799	$791	$791	$791	$791	$791	$791	$791	$791
Total Assets	$2,715	$2,818	$2,834	$2,965	$2,866	$2,838	$3,027	$3,001	$2,952	$2,990	$3,028	$3,065
LIAB. & SHRHLDRS' EQUITY												
Accounts Payable	$280	$264	$236	$212	$202	$236	$268	$286	$280	$295	$314	$319
Short-Term Debt	$23	$144	$171	$52	$42	$42	$42	$42	$0	$0	$0	$0
Other Current Liabilities	$165	$165	$183	$175	$210	$185	$185	$185	$170	$185	$200	$210
Total Current Liabilities	$469	$572	$590	$439	$453	$463	$495	$513	$450	$480	$514	$529
Long-Term Debt	$1,734	$1,733	$1,745	$2,041	$2,042	$2,042	$2,192	$2,192	$2,192	$2,192	$2,192	$2,192
Other Liabilities	$87	$91	$97	$109	$118	$118	$118	$118	$118	$118	$118	$118
Total Liabilities	$2,291	$2,397	$2,432	$2,589	$2,614	$2,623	$2,805	$2,823	$2,760	$2,790	$2,824	$2,839
Minority Interest	$2	$2	$7	$7	$6	$6	$6	$6	$0	$0	$0	$0
Shareholders' Equity	$423	$419	$395	$370	$247	$210	$216	$172	$192	$200	$204	$227
Total Liab. and Equity	$2,715	$2,818	$2,834	$2,965	$2,866	$2,838	$3,027	$3,001	$2,952	$2,990	$3,028	$3,065

Sources: Company reports and Lehman Brothers estimates

Figure 4: Amkor Technology Performance Metrics

Amkor Technology
Performance Metrics

Current version: 6/1/05
Last version: 5/5/05

FILE: AMKRWKSH	Fiscal 2004				Fiscal 2005E				Fiscal 2006E			
FYE: December	Q1	Q2	Q3	Q4	Q1	Q2E	Q3E	Q4E	Q1E	Q2E	Q3E	Q4E
Profitability Ratios												
Return On Equity	14%	(7%)	(23%)	(39%)	(112%)	(78%)	1%	23%	13%	29%	50%	49%
Return on Avg Equity *	7%	(3%)	3%	(13%)	(40%)	(48%)	(48%)	(37%)	(11%)	(37%)	27%	37%
Return On Assets	2%	(1%)	(3%)	(5%)	(10%)	(6%)	0%	1%	1%	2%	3%	4%
Return On Net Assets	3%	(1%)	(3%)	(6%)	(11%)	(6%)	0%	1%	1%	2%	4%	4%
Return On Sales	3%	(1%)	(5%)	(8%)	(17%)	(9%)	0%	2%	1%	2%	4%	4%
* Avg Over Last 4 Qtrs												
Efficiency Ratios												
Sales / Total Assets	0.68	0.70	0.69	0.61	0.58	0.66	0.71	0.76	0.76	0.79	0.83	0.83
A/R Days Sales Out	57	51	52	54	58	56	56	51	51	51	51	51
Inventory Turns	12.6	13.3	13.5	13.6	13.4	13.3	14.1	14.5	15.3	15.4	15.3	15.2
Days of Inventory	29	27	27	27	27	27	26	25	24	24	24	24
Liquidity Ratios												
Current Ratio	1.7	1.3	1.1	1.8	1.5	1.4	1.6	1.6	1.8	1.8	1.8	1.9
Quick Ratio	3.6	2.0	1.5	3.0	2.3	2.4	3.0	3.0	4.0	4.0	4.0	4.1
Net Working Capital	$598	$420	$307	$559	$451	$430	$578	$586	$625	$679	$730	$785
Long-Term Debt / Equity	410.2%	413.3%	441.7%	552.3%	827.0%	973.3%	1014.1%	1276.0%	1144.4%	1098.0%	1074.1%	966.5%
Debt/Capital	80.6%	81.7%	82.9%	85.0%	89.4%	90.9%	91.2%	92.9%	92.0%	91.7%	91.5%	90.6%
Total Debt / Equity	415.6%	447.6%	485.0%	566.4%	844.1%	993.4%	1033.6%	1300.6%	1144.4%	1098.0%	1074.1%	966.5%
EBITDA/Interest	3.1	6.4	2.1	1.6	0.8	1.5	2.5	2.7	2.7	2.8	3.1	3.2
EBITDA- Capex/Interest	-2.1	-2.7	0.3	0.7	-0.3	-0.3	0.1	2.0	1.9	2.1	2.2	2.3
Op Inc / Assets, exc. Cash	8.3%	4.6%	3.7%	1.2%	-4.0%	0.5%	6.7%	8.4%	8.1%	9.4%	11.1%	11.5%
Book & Cash Value												
Book Value Per Share	$2.35	$2.38	$2.25	$2.10	$1.41	$1.19	$1.23	$0.98	$1.09	$1.14	$1.16	$1.28
Cash Per Share	$1.92	$1.68	$1.32	$2.12	$1.63	$1.20	$1.82	$1.88	$1.86	$2.13	$2.34	$2.66
Net Cash Per Share	($7.84)	($9.00)	($9.59)	($9.79)	($10.23)	($10.66)	($10.90)	($10.84)	($10.61)	($10.35)	($10.11)	($9.75)

Sources: Company reports and Lehman Brothers estimates

Company Description:

Amkor Technology is the world's leading subcontractor of semiconductor packaging assembly and test services, a sub-segment of the semiconductor industry.

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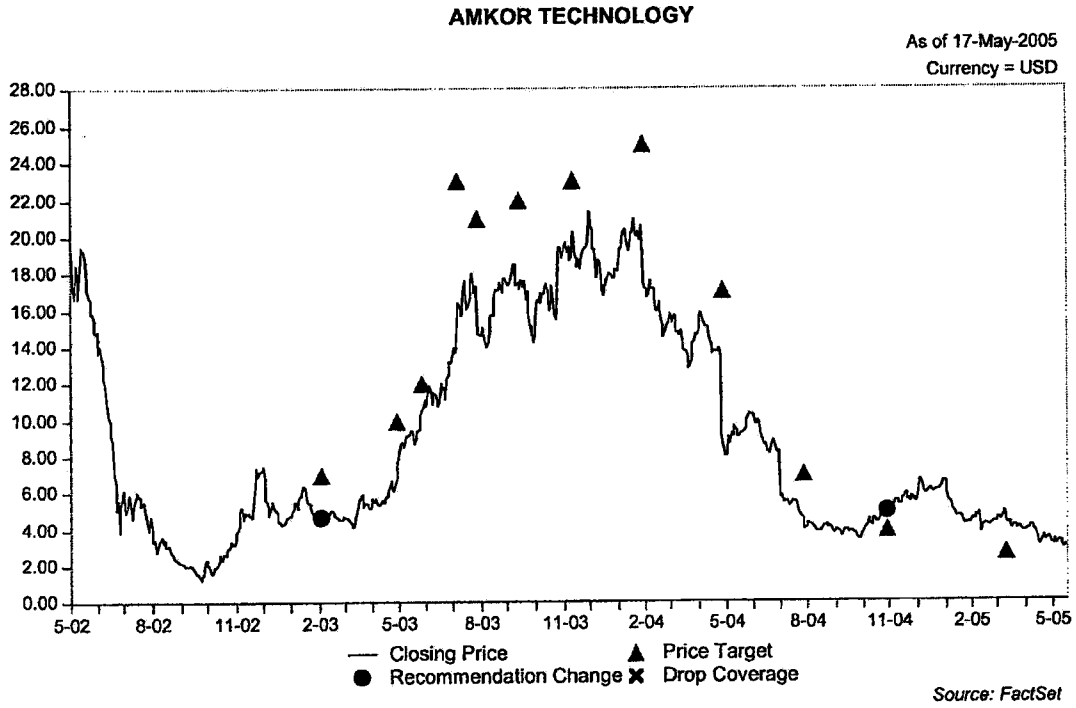
Important Disclosures

Rating and Price Target Chart: AMKR



Date	Closing Price	Rating	Price Target
10-Mar-05	4.35		2.75
28-Oct-04	5.00		4.00
28-Oct-04	5.00	3-Underweight	
28-Jul-04	3.98		7.00
28-Apr-04	8.63		17.00
29-Jan-04	17.45		25.00
12-Nov-03	20.32		23.00

Date	Closing Price	Rating	Price Target
12-Sep-03	17.57		22.00
29-Jul-03	14.93		21.00
07-Jul-03	16.24		23.00
28-May-03	10.56		12.00
30-Apr-03	7.57		10.00
04-Feb-03	4.64		7.00
04-Feb-03	4.64	1-Overweight	

FOR EXPLANATION OF RATINGS REFER TO THE STOCK RATING KEYS LOCATED ON THE PAGE FOLLOWING THE LAST PRICE CHART

Important Disclosures:
The analysts responsible for preparing this report have received compensation based upon various factors including the Firm's total revenues, a portion of which is generated by investment banking activities.

Company Name:	Disclosures	Ticker	Price (06/02)	Rating
Amkor Technology	C,J	AMKR	3.85	2-Equal weight

C - Lehman Brothers Inc. makes a market in the securities of this company.
J - Lehman Brothers Inc. or an affiliate trade(s) regularly in the shares of the subject company.

Risks Which May Impede the Achievement of the Price Target:
AMKR: Amkor's financial results are dependent on and may vary with: global demand for electronic devices and products, growth of its broad customer base and the semiconductor industry, competitive issues, factory yields and capacity utilization, and the availability and pricing of packaging materials used to manufacture a wide variety of customer products. Additionally, Amkor's manufacturing facilities are located in regions where there is currently an above-average level of geopolitical risk.

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Our coverage analysts use a relative rating system in which they rate stocks as 1-Overweight, 2-Equal weight or 3-Underweight (see definitions below) relative to other companies covered by the analyst or a team of analysts that are deemed to be in the same industry sector (the "sector coverage universe"). To see a list of the companies that comprise a particular sector coverage universe, please go to www.lehman.com/disclosures

In addition to the stock rating, we provide sector views which rate the outlook for the sector coverage universe as 1-Positive, 2-Neutral or 3-Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating
1-Overweight - The stock is expected to outperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.
2-Equal weight - The stock is expected to perform in line with the unweighted expected total return of the sector coverage universe over a 12- month investment horizon.
3-Underweight - The stock is expected to underperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.
RS-Rating Suspended - The rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Lehman Brothers is acting in an advisory capacity in a merger or strategic transaction involving the company.

Sector View
1-Positive - sector coverage universe fundamentals/valuations are improving.
2-Neutral - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.
3-Negative - sector coverage universe fundamentals/valuations are deteriorating.

Stock Ratings From February 2001 to August 5, 2002 (sector view did not exist):
This is a guide to expected total return (price performance plus dividend) relative to the total return of the stocks' local market (i.e. the market where the stock primarily trades) over the next 12 months.
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2-Buy - expected to outperform the market by 5-15 percentage points.
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Williams, Kelsey

From: [redacted]
Sent: Thursday, June 02, 2005 8:51 AM
To: Midday Notes [MiddayNotes@lehman.com]
Cc: Parmigiani, Ted [redacted]; [redacted]
Subject: Upgrade to 2-EW on 2H05 Profitability; For MANUAL INTRADAY Distribution.

AMKR060305.doc
(868 KB)

Ticker: AMKR
Note type: Company Note.

Status: APPROVE for MANUAL INTRADAY Distribution.

HOLD FOR 11AM

Please use this one.

SA approved. -- [redacted]

LBEMAIL 04531

Williams, Kelsey

From: [redacted]
Sent: Wednesday, March 30, 2005 10:00 AM
To: Parmigiani, Ted [redacted]
Subject: Go to the Moore meeting without me, we have big ratings change looming...

[redacted]
Vice President
New York Institutional Equity Sales
Lehman Brothers
phone: [redacted]
email: [redacted]

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>
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>
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LBEMAIL 03815

March 30, 2005

North America
Basic Industries
Commodity Chemicals

Commodity Chemicals

Recommendation Change

First Hill of the Ethylene Cycle

Sector View:

New: 3-Negative
Old: 2-Neutral

Investment conclusion

- Ethylene contract prices settled flat at 41.5 c/lb. in March, according to CMAI. The net result is a 4 c/lb reduction in ethylene cash margins, due to rising cash production costs. With U.S. spot ethylene trading 6.5 c/lb below contract price, we expect to see additional pressure on ethylene cash margin in the forthcoming months.

Summary

- PE prices and therefore margins are expected to decline 1-2 c/lb. for March contract (although this has not been settled yet), as discussed in our previous notes on 3/17 and 3/28. The data on the PE producer and consumer inventory indicates that the inventory level is at a 2 year high and is likely to take the next 3-5 months to de-stock, thereby putting further pressure on polyethylene demand and prices. Essentially, U.S. PE producers are faced with a tough choice: to cut operating rates or to cut PE prices. One of the two actions is necessary to bring excess inventory down to a more normal level.
- We are lowering our commodity sector rating from 2-neutral to 3-negative, due to the expected pressure on the sector because of weakness amongst the ethylene/PE producers. However, clearly believe that not all commodity chemical product cycles are equal. We remain bullish on the chlor-alkali cycle and stocks.

Ethylene cycle at the short-term inflection point

We are lowering our sector ratings on the U.S. Commodity chemicals sector from 2–Neutral to 3–Negative due to the expected near term pressure on ethylene / Polyethylene (PE) producers. The recent data on negative ethylene/PE pricing and margins trends do not signal the end of the chemicals cycle. This short term inflection point in the ethylene cycle could result in a stock price correction amongst most of the ethylene leveraged stocks. This trend relates primarily to the ethylene / PE producers (LYO, NCX, DOW, WLK, HUN). In contrast, cl-alkali chain remains fundamentally very strong and we continue to recommend PPG and GGC (both 1-O.W.).

In the next 6 months, we believe ethylene/PE chain profit momentum will likely reverse from the previous 8 months of upward trend. The ethylene/PE chain is expected to remain weak through the summer until the Aug./Sept. time frame by when the ethylene/PE producers could have worked through their inventory levels. The ethylene prices could be pressured in forth coming months due to the 6.5 c/lb gap between the spot and contract ethylene prices in March and also the producer inventory buildup. If raw materials costs (oil and natural gas) continue to escalate, then ethylene prices might actually stay flat or even increase slightly. Regardless of that, the cash margins (the true measure of profitability of commodity chemical companies) are likely to be under pressure over the next 6 months, and thus possibly pressure stock prices for the major ethylene producers (LYO, NCX, DOW, WLK, HUN). **We are lowering our near term outlook on NCX from 1-Overweight to 2 – Equal weight and our outlook on WLK from 2-Equal weight to 3- Underweight. Please review our individual notes on WLK and NCX for more details.**

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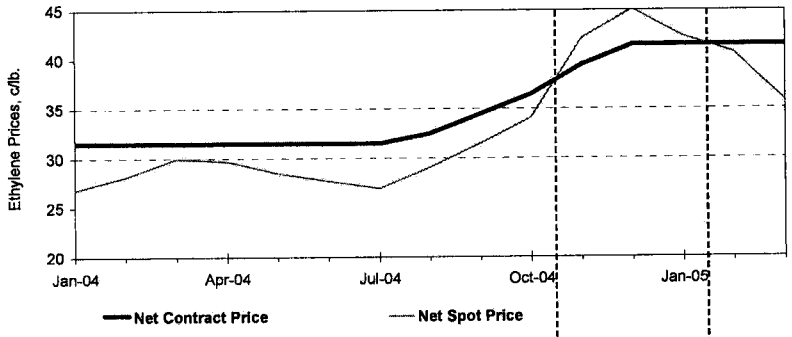
We view the cl-alkali cycle as inherently longer and stronger due to supply fundamentals, the short product chain, and an inability to store large amounts of caustic, chlorine inventory throughout the chain. This makes the current operating rate of 99% more genuine and more sustainable as long as industrial demand continues to grow in 2005-06 even at a modest pace. **Thus, we remain positive on PPG and GGC (both 1–OW).**

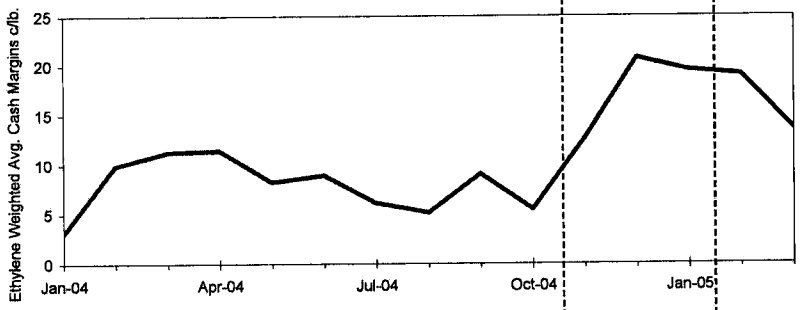
As a follow-up to our previous notes (published on March 17th and March 28th), this report aims to provide an updated view of the current ethylene / PE market, based on review and analysis of similar previous situations. For example, based on review of the past 20 years, it is apparent that inflection points (larger than normal gaps on the plus or minus side) between ethylene spot and contract prices can be leading indicators to the near-term directional changes in ethylene cash margins.

So far in 2005, the U.S. ethylene market has seen some softness. Through industry sources, we have confirmed that **last week (when oil price was $56/barrel) the spot price of ethylene traded at 35 c/lb, 6.5 c/lb LOWER than the March contract price which settled flat to the previous month at 41.5 c/lb.** While spot market is only about 10-15% of the total volume, the change in US ethylene spot price does serve as a leading indicator for the contract prices. With the delta between the contract and spot price is so large at 6.5 c/lb (or 15%), it is reasonable to expect the ethylene prices and (much more importantly) cash profit margins to be under pressure in April and possibly through the summer.

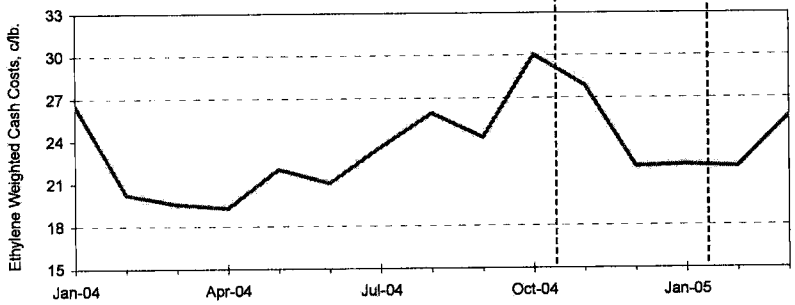
US Ethylene Contract vs. Spot Prices, c/lb.



Ethylene Contract Cash Margins, c/lb. (weighted Avg. of oil, nat gas as feedstocks)



Ethylene Weighted Average Cash Costs, c/lb.



Source: CMAI

The Current Ethylene Peak of 2004-06. The chart above shows our expectations for the inflection points in the current ethylene cycle. The first cross-over point in late 2004 (spot is above contract price = very tight market), followed by the second

inflection point in early 2005, with spot ethylene dropping below the contract price, indicating sequential weakness. We expect this to lead to lower contract prices and cash margins through mid-2005.

We believe that if after a 3-4 months adjustment of producer inventories the end-market PE demand remains strong, we could see yet another inflection point where spot prices are once again higher than contract prices, suggesting a positive momentum in higher prices and profit margins. Obviously, all the above considerations assume fairly stable energy prices (i.e. oil prices within $50-58 range). A larger decline in oil prices could either accelerate a downtrend in PE prices, while sharp increase could put provide support to higher PE prices, while eating into profit margins.

- So far, ethylene and PE demand in 2005 has been weaker than expected by the market. **U.S. PE inventories have increased 750 M lbs over the past 4 months and are currently at their highest level in 2 years.** It appears that U.S. producers have recently been undisciplined in their high rates of production and have significantly overestimated the amount of export demand to the Asian region. The result has been lower than expected total demand and increased producer-level inventories. Data on US polyethylene producer and consumer inventory data is available upon request.

Impact of US HDPE Producer Inventory on Prices and Cash Margins

	Highest PE Producer Inventory Level	HDPE Price, c/lb.	Margin, c/lb.	Oil, WTI $/barrell	Nat Gas $/mBtu
Apr-03		51	8.0	28.3	5.2
May-03	***	49	6.0	28.1	5.2
Jun-03		47	5.8	30.7	6.0
Jul-03		46	6.5	30.7	5.4
Aug-03		46	6.6	31.6	4.8
Oct-04		59	11.3	53.2	5.7
Nov-04		65	12.9	48.4	7.6
Dec-04		65	10.9	43.2	7.4
Jan-05		65	11.2	46.8	6.1
Feb-05	***	65	11.8	47.9	6.2
Mar-05		64	10.8	54.4	6.3

Source: Lehman Brothers Estimates

- What do we believe this means to the near-term direction of ethylene and PE prices and cash margins? **DOWN.** For example, the table above shows that the last time of high producer inventories in April-May '03, the price of PE decreased 5 c/lb over 3 months, despite flat-to higher energy prices. **Hence, we believe PE contract prices will settle DOWN 1-2 c/lb in March as opposed to increasing the proposed 3-5 c/lb,** which were announced a few months ago, but then went sideways a couple of months without actual implementation.

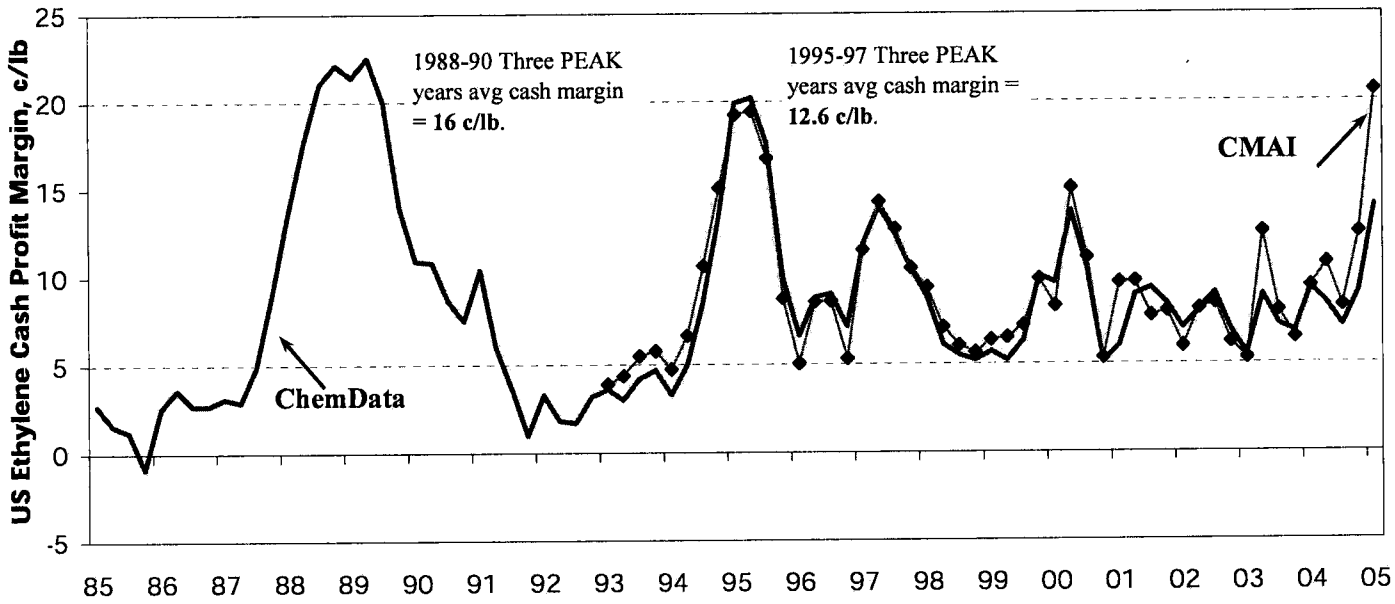
To summarize, the two main causes for concern for the ethylene/PE cycle are the currently high level of PE producer inventory and a large delta between contract and spot ethylene prices. Obviously, the two factors are interrelated. Despite a slowdown in PE demand since December 2004, US producers continued to run facilities at high operating rates. Producers expected the PE demand to pick up in February, with the Chinese buyers returning after the Lunar year holidays and US packaging companies increasing purchases in anticipation of 5+4 c/lb price increases. As both demand assumptions did not play out, the PE producers faced higher inventories.

The shape of the next Ethylene Peak: a Tale of Two Camels

In recent discussions with numerous investors, we faced the questions about the shape, timing and magnitude of the next cyclical peak. The chart below should provide a useful reference to the two previous peaks: a large, single peak of 1988-89 and a smaller, "double-hump" peak of 1995-97. Ten years ago, the 1995 peak was fairly similar in form to the current peak, followed by a sequential weakness in 1996 (due to an economic slowdown), and then another peak in 1997, caused by an improving economy and a large extended shutdown of Shell Chemical plant (2.4% of ethylene capacity shut down for more than 10 months).

So the question is whether the current peak will resemble a one-hump camel of 1988 or a two hump-camel of 1995-97? While the exact answer will not be known until after the peak is seen in the rear-view mirror, a two hump-camel scenario is more likely, in our view. The incremental data points over the next six weeks (contract and spot prices, consumer and producer PE inventory, run-rate of PE demand and export trends) should provide a bit more clarity for the formation of the first hump of this cycle.

U.S. Ethylene Cash Profit Margin



Source: ChemData and CMAI * CMAI = Avg costs (Oil + Gas) ** ChemData = Ethylene Production by Ethane Cracking

- Will the current peak be similar to 1988 (single) or 1995-97 (double) shape?
- •What will be the timing and duration of the peak?

The answers to the above questions will be critical for peak EPS, and thus valuation of DOW, HUN, LYO, NCX and WLK.

We continue to believe it is time to lock-in the profits in LYO and WLK.

At this time, our RELATIVE ranking of ethylene stocks (from top pick to least attractive) is as follows:

We believe NCX (2-EW) is the best stock in the group but the stock price could see pressure along with the rest of the group; DOW, HUN, (both rated as 2-EW), while WLK and LYO (both, rated as 3-UW) has the highest risk and lowest forward return, in our view. For LYO, the arguments are stretched valuation, very high financial leverage and hence risk. Meanwhile, WLK has enjoyed a very rich run-up from the IPO. Although WLK has a strong chlor-alkali contribution, relatively low leverage and thus modest risk, a very shallow liquidity in the stock would make the stock vulnerable to sharp downward correction.

Producers' Sensitivity Analysis and Outlook for Major Chemical Commodities

	Ethylene	HDPE	LLDPE	LDPE	Cl-alkali	VCM	PVC	Styrene	PS	PET	PP
Historical Perspective											
Peak margins, 1995	17.4	7.5	6.9	8.6	$257	2.7	4.8	11.1	8.1	27.8	10.5
Trough margins, 2001	7.2 (2002)	(0.4)	(2.7)	(0.2)	14 (1999)	(2.1)	0.4	3.7	0.9 (2002)	2.4 (2003)	3.1
Next Expected Peak	2006	2006	2006	2006	2005	2005	2005	2006	2006	2007	2006

PRODUCER LEVERAGE		Ethylene	HDPE	LLDPE	LDPE	Cl-alkali	VCM	PVC	Styrene	PS	PET	PP
DuPont	*EPS, in cts*	--	--	--	0.5	--	--	--	--	--	--	--
PPG	*EPS, in cts*	--	--	--	--	6.6	2.7	--	--	--	--	--
Dow Chemical	*EPS, in cts*	14.9	4.0	2.9	2.5	4.4	4.3	--	2.8	2.9	--	1.3
NOVA	*EPS, in cts*	37.9	8.3	14.2	2.2	--	--	--	20.8	24.6	--	--
Huntsman	*EPS, in cts*	13.6	--	2.1	1.2	--	--	--	0.7	0.8	--	3.1
New Lyondell	*EPS, in cts*	28.4	8.6	2.9	3.9	--	--	--	7.3	--	--	--
Westlake	*EPS, in cts*	28.2	--	14.4	8.4	3.6	13.4	9.9	4.6	--	--	--
Eastman	*EPS, in cts*	--	--	3.5	5.4	--	--	--	--	--	27.6	--
Wellman	*EPS, in cts*	--	--	--	--	--	--	--	--	--	27.1	--
Georgia Gulf	*EPS, in cts*	--	--	--	--	9.1	61.1	50.8	--	--	--	--
Olin Corp	*EPS, in cts*	--	--	--	--	11.1	--	--	--	--	--	--

Source: CMAI, company reports, Lehman Brothers

Please see our company-specific research notes on WLK and NCX for stock-specific analysis and implications.

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Du Pont	DD	51.24	2-Equal weight
Dow Chemical	DOW	51.10	2-Equal weight
Eastman Chemical	EMN	59.38	3-Underweight
Georgia Gulf Corp	GGC	47.88	1-Overweight
Huntsman Corp.	HUN	23.73	2-Equal weight
Lyondell Chemical	LYO	28.86	3-Underweight
Monsanto Co	MON	60.10	3-Underweight
NOVA Chemicals	NCX	43.50	2-Equal weight
NL Industries	NL	23.27	3-Underweight
Nalco Holding	NLC	18.50	2-Equal weight
Olin Corp	OLN	22.77	2-Equal weight
PPG Industries	PPG	70.62	1-Overweight
Praxair Inc.	PX	47.95	1-Overweight
Rohm & Haas	ROH	47.83	2-Equal weight
Ultrapar Participacoes S.A.	UGP	16.24	3-Underweight
Valspar Corp	VAL	46.51	1-Overweight
Westlake Corp.	WLK	32.40	3-Underweight

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