

MU Gets Inotera DRAM Capacity

Micron Technology (MU, \$7.81 +0.14, Buy, Target \$15, FY13: (\$0.74) on \$7,887M, FY14: \$0.67 on \$9,175M)

MU Gets Inotera Capacity: Micron announced late yesterday that it will now be receiving 100% instead of 50% of the manufacturing capacity from its Inotera Memories joint venture after renegotiations with partner Nanya. I consider this good news for MU: it will double its manufacturing output of PC-based commodity DRAM effective immediately at a very opportune time when spot market prices are rallying on industry-wide supply constraints despite PC market softness.

Rumors had started just before its late-December earnings call that Nanya in Taiwan wanted out of DRAMs and its Inotera joint-venture with Micron. And now the renegotiations are complete. Micron and Nanya are keeping their respective ownership positions, but Nanya is giving up its right to half of Inotera's output. Inotera manufactures 100% of Micron's PC DRAMs (or pretty close to 100%). Last quarter DRAMs accounted for 39% of Micron's total sales, and PC DRAMs/Inotera accounted for 47% of total DRAMs. So basically, Micron gets another 20% upside in total sales capacity.

The bad news is that Micron will now have to pay full freight on technology development costs instead of sharing those costs with Nanya, and Nanya keeps its technology license—although it continues to be obligated to its royalties. And the worse news is that the purchase agreement for product from Inotera will now be market price-based instead of manufacturing margin-based. This wrinkle could go either way to benefit or encumber Micron compared to its prior arrangement depending on the direction and magnitude of market price changes as well as the manufacturing performance of Inotera's wafer fab. While such details were not disclosed in the announcement, I will attempt to find out what I can from management. My experience with Micron over the years gives me confidence that there is at least some kind of market and production environment scenario where MU will benefit under this new arrangement—and that management is willing to bet that such a scenario is at least somewhat more likely than whatever an adverse scenario would be for the foreseeable future.

I am not going to revise my earnings model for the company until the sales timing of this output and the nature of the cost change become better understood. While the magnitude and timing of this change on potential revenue and earnings is uncertain, it appears to be moving in a favorable direction for the company, in my opinion.

—**Dan K. Scovel**
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