

SEMICON WEST 2004: SMILES IN THE AISLES FOR NOW, BUT WHO WILL HAVE LAST LAUGH?

OEM Capital recently participated in Semicon West 2004 in San Francisco and San Jose and we would like to present our views on the current state of M&A in the semiconductor equipment industry.

Compared to the past few years, there were many more ‘smiles in the aisles,’ as many companies were reporting sales growth of 100% or more over the same period in 2003. For more CEOs, the main concern at the show was how to get product out the door. Looking towards the future, there are some theories in the industry that this current cycle is a ‘boomlet’ of pent up demand and a ramp up to 300mm. Revenue growth is predicted to plateau over the second half of 2004, before moving to new highs in 2005 (Applied Material’s recent projections seem to echo these sentiments). Many industry participants are predicting a smoother economic cycle moving forward compared to previous cycles. However, recent earnings announcements, such as that of Kulicke & Soffa, point to what perhaps may be a sharper and quicker decline than previously thought for companies in certain sectors.

For M&A observers, one of the key statements came from Applied Materials, who announced that they were in the market for acquisitions again. We predict that the trend towards consolidation will accelerate now that buyers have appetites and sellers can expect reasonable, albeit lower than Year 2000 valuations. Some of the key factors in this trend include the following.

Semiconductor Fabs are cautious about buying new technologies, but will buy from

large, public companies with global support networks.

Cost-of-ownership is the most critical factor in almost all purchasing decisions.

Sarbanes-Oxley and other factors have made it very costly to be a small, public company.

Acquirers are primarily looking for new technology, not simply market share gains or empire building, and for companies that will fill gaps in their product offerings.

The move to ‘one stop shopping’ and support will be an increasingly important factor for fabs. (Applied Material’s recent acquisition of Metron is a move to solidify their position in service and consumables.)

IPOs are still not attractive as an exit strategy, so being acquire will be the primary liquidity outlet for the foreseeable future.

Outsourcing to merchant fabs and testing facilities will be an increasing phenomenon in the future. This will lead to larger and larger fabs that will make purchases from fewer and fewer equipment manufacturers.

Manufacturers have reached peak 2000 sales, but with 30%+ fewer employees. Lean and mean is the way to survive and prosper. (Note, for instance, Asyst’s recent announcement of a sales increase of 211% and a workforce reduction of 10%.)

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COMMENTARY

The R&D budgets required to stay at the cutting edge are only affordable by the larger companies. The push towards 65nm gate widths can only be pursued by those companies with very deep pockets. (Or rich corporate sponsors, such as Intel's investment in Extreme Ultra Violet lithography development).

It is increasingly important to have global sales and service support as Asian fabs become a larger purchaser of semiconductor equipment.

Due to the above and other factors, we continue to believe that consolidation will lead to a 'Super 20' in the semiconductor equipment industry, all of which will have revenues and market capitalizations of more than \$500 million. Promising young companies will be snapped up by the larger players as soon as they start to show traction. A recent example of this trend is Applied Material's acquisition of Torrex.

The middle market of public companies with market capitalizations between \$10 million and \$500 million will mostly dry up, and the number of small, private companies will be reduced substantially. Bucking this trend will be smaller, private, niche players that will focus on profitable sectors of the market that are under the radar of the major players. The exit strategy for these companies will be strategic mergers and acquisitions within the industry or with firms in other sectors of electronics.

OEM Capital works with medium and small public and private companies in the pursuit of the best strategy to increase shareholder value. OEM Capital is currently engaged by a seller of CMP consumables and is currently engaged by two manufacturers of test equipment to assist in a merger. Some examples of our recent transactions include representing Temptronic and Anatel in their sale. Additional details are available at www.oemcapital.com.



Thomas G. Kastner has over ten years of experience in the electronics industry specializing in semiconductors, semiconductor equipment, wireless and electro-optics components. Mr. Kastner is fluent in Japanese. He spent eight years in Japan as a senior executive for Hakuto Co., Ltd., a publicly-traded (Tokyo Stock Exchange) distributor of semiconductors and associated equipment, reporting to the company's chairman and CEO. More recently, he managed Hakuto's investment program in the US as President of Hakuto America, Inc., where he identified new opportunities, negotiated investment terms and monitored investments in eleven companies. These included Newport Corporation, a supplier of test, measurement and automation systems; Emcore Corporation, a manufacturer of compound semiconductor materials, and production systems; and Micronic Laser Systems, a manufacturer of laser pattern generators for photomasks. Mr. Kastner also served as a director of two private US semiconductor equipment manufacturers that were successfully sold to larger public corporations. He is co-founder of Strategic Switch and Audio, Inc. a distributor of electronic components and remains a member of its board of directors.

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OEM Capital specializes in the sale or divestiture of electronics, communications and computer related companies. The firm also helps to secure capital to complete an acquisition or to refinance a company with minimum dilution to existing shareholders.

Since 1985, the firm has initiated and completed numerous transactions for New York Stock Exchange listed, American Stock Exchange listed, NASDAQ listed, and a variety of over-the-counter and privately held companies located throughout the United States. Typically, the companies, subsidiaries or divisions we are asked to help have annual revenues between US\$10 and 50 million. Where we have been financial advisors in the sale of a division or subsidiary, some of our clients have had annual revenues in excess of US\$2 billion.

The firm has been able to realize exceptional results because its senior staff is comprised of professionals who have had extensive prior experience as operating executives in the industry and continue to maintain extensive contacts throughout the world. Our clients have included companies

engaged in a wide variety of areas including software publishing and services, computers and peripherals, microwave and rf components, communication equipment, instrumentation, defense electronics, electronic materials, entertainment electronics, electronic and electromechanical components, electrical motors, power supplies, and product distribution and servicing.

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