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Chip slowdown expected for '05

ANALYSTS: CAPACITY OUTPACED DEMAND IN '04

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The semiconductor industry is headed for a slowdown, but a relatively soft and short one before it bounces back in 2006, according to most analysts speaking at an industry event Monday.

The industry is headed for a fall this year after peaking in 2004 mainly because of big increases in chip-factory capacity that overshot market demand. The downturn is expected to come even if the industry is out of step with the growing worldwide economy, according to speakers at a conference sponsored by Semiconductor Equipment and Materials International, an industry trade group.

As if on cue, Advanced Micro Devices reported Monday that it will miss its financial targets for the quarter ended Dec. 26. The Sunnyvale chip maker said its flash-memory business, supplying chips used in everything from cars to cell phones, generated less revenue than expected.

Most analysts believe chip-industry growth will slow due to overcapacity, causing prices to fall and revenue to slacken.

“It's clear that 2004 was the peak,” said Bill McLean, president of IC Insights, a market analyst in Scottsdale, Ariz. “But no one is expecting the 33 percent decline that we saw in 2001.”

Semiconductors are chips that are the core of the electronics industry, serving as the brains in everything from computers to cell phones to digital cameras and handheld music players.

McLean estimates the chip industry will shrink 2 percent in sales in 2005, after growing 28.5 percent in 2004. He expects growth to resume in 2006 at 9 percent. The downturn will likely be shorter, he said, because chip makers have refrained from investing in too many factories relative to past cycles.

Makers of chip-manufacturing equipment are likely to see a bigger drop in 2005.

The soft landing has been predicted since chip sales growth started slowing in July. But analysts differ in how severe the slowdown will be. Klaus-Dieter Rinnen, an analyst at Gartner Dataquest, believes the downturn won't be as deep because chip makers haven't overspent as much as they did in 2001.

Jim Feldhan, an analyst at Semico Research in Phoenix, estimates the chip industry will shrink 4.7 percent in 2005 before it bounces back to 14.6 percent growth in 2006. He foresees a slower worldwide economy due to the normal cycle following a U.S. presidential election, high oil prices, higher interest rates, a weak dollar and an uncertain geopolitical situation.

He also believes the tech industry peaked in 2004. Cell phone growth, for instance, is expected to slow from 26 percent in 2004 to 9 percent in 2005.

Others were more optimistic. Rinnen estimates the chip industry will grow 5 percent in 2005. But he says the chip-equipment industry will shrink 15 percent in 2005 after growing 61 percent in 2004. That's because chip makers have scaled back orders dramatically on fears of a downturn.

And Risto Puhakka, an analyst at VLSI Research, believes the industry will grow 8 percent in 2005, with equipment sales growing 4 percent, thanks mainly to continuing strength in the worldwide economy. He notes the inventories are lower than normal for the industry's economic cycle.

“It will take a total of four quarters to work off inventory, not the eight quarters that it took last time,” Puhakka said.

The Semiconductor Industry Association's official forecast in November estimated that industry sales in 2005 would be flat at \$214 billion after growing 28.5 percent in 2004.

AMD said its sales of microprocessors for personal computers increased in the fourth quarter ended Dec. 26, but its flash-memory division would report lower sales and an operating loss.

Overall, AMD expects fourth-quarter sales to be above \$1.24 billion it reported in the third quarter, while fourth-quarter operating income would be below the \$68.4 million it reported in the third quarter.

Ben Lynch, an analyst at Deutsche Bank Equity Research, cut his revenue forecast on AMD earlier Monday, citing expected weakness in flash chips, to \$5.7 billion for 2005 total revenue, down from \$5.9 billion previously.

AMD reports final results next Tuesday, while Intel reports today.