

THE ARIZONA REPUBLIC

After a record-setting 2004, a letdown is likely this year

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The Arizona Republic

Jan. 19, 2005 12:00 AM

<http://www.azcentral.com/arizonarepublic/business/articles/0119Chipforecast19.html#>

The computer-chip industry posted record sales in 2004, thanks to consumers' insatiable demand for electronic gadgets and a recovering corporate computer market. But most analysts aren't betting on back-to-back record years.

Even with the most optimistic forecast of 5 percent growth in worldwide sales, 2005 is going to qualify as a slump in the notoriously cyclical semiconductor business.

The industry's fortunes matter to Arizona, which is the third-largest state for semiconductor manufacturing jobs, behind California and Texas. Though chipmakers shed thousands of jobs in the last downturn, most analysts say companies' cautious approach during the upturn will lessen the impact of this year's slowdown.

Most analysts are forecasting that worldwide sales of computer chips will decline between 2 percent and nearly 6 percent this year after gaining more than 27 percent last year. They blame aggressive spending on new factories and equipment, inventories still being burned off, and a slower worldwide economy.

"The theme for 2005 is we pay back some of the excesses from 2004," Bill McClean, president of Scottsdale-based IC Insights Inc., said Tuesday at the research company's annual forecast seminar.

McClean expects semiconductor sales to drop 2 percent this year, to \$209.5 billion from an estimated \$212.9 billion last year.

Chipmakers spent heavily last year on new plants and equipment, creating excess capacity and thus softer prices for this year and next year, McClean said. There also continues to be excess inventory, which IC Insights expects the industry to burn off in the first half of the year. Higher oil prices and a slowing economy will also hurt chip sales, the company said.

Such dropoffs are to be expected, McClean said. Semiconductor sales have jumped an average of 27 percent in U.S. presidential election years, as presidents spur the economy, and sales then fall to modest levels the following years, McClean said.

Chips for cellphones and notebook computers continue to be among the bright spots, though.

Cellphone unit shipments rose 24 percent and 29 percent the past two years, but IC Insights expects shipments to rise just 5 percent this year, to 705 million units. One plus for the industry will be cameras and other new features being added to cellphones, which require more memory and thus more computer chips.

Notebook computers will show stronger growth rates than desktop computers or servers, rising 8.5 percent this year to 49.5 million units, IC Insights said.

At In-Stat, another Scottsdale-based research firm, analyst Frank Dickson is predicting that worldwide sales of computer chips will fall 5.7 percent this year, to \$199.3 billion.

"It's good and bad," Dickson said. "Revenues are at a record level, but the growth rates aren't what they once were."

Dickson said the decline is coming because supplies of chips will run ahead of demand. Companies are building new plants or switching to technologies that crank out more chips than before.

And the higher production is coming at a time when there is no "must-have" product in the market, like personal computers were in the 1990s and cellphones were after 2000.

"There's nothing now that demands you purchase it," Dickson said. "There are a lot of little things."

Semico Research Corp. in Phoenix expects sales to slip 4.7 percent this year, also because of slowing electronics sales, excess capacity and a weaker economy.

"You end up with a scenario of falling prices and units that aren't growing fast enough," Semico President Jim Feldhan said.

The Semiconductor Industry Association, based in San Jose, predicts a flat year for the industry, with sales holding at around \$214 billion for last year and this year. Research company Gartner Inc. thinks chip sales could grow 5 percent.

Some Arizona chipmakers are well-positioned to ride out a down year, while others will have a tougher time, the analysts said.

Intel Corp., with its high-end chips, huge capital investments and constant innovation, can weather a downturn, In-Stat's Dickson said. So can companies with broad-based products and markets, such as STMicroelectronics Inc., Freescale Semiconductor Inc. and Microchip Technology Inc., he said.

But companies with smaller profit margins, such as ON Semiconductor Corp., will feel the pressure, he said.

The latest "bust" in the industry's boom-and-bust cycle will be short-lived and less severe than usual, though, most analysts say. It will not be as bad as 2001, when sales fell 32 percent in the industry's worst downturn ever.

Most analysts expect the chip market to bounce back in 2006, with sales increases of 6 percent to 14 percent.

"We think it is going to be a short and shallow downturn," Semico's Feldhan said, with the consumer market recovering by year-end.

Digital cameras and cellphones sell in much bigger volumes than they did in 2000, a plus for the industry, he said.