



Semiconductor industry in the perfect calm!

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Future Horizons, Malcolm Penn hosted his annual forecast meeting in London, England yesterday, highlighting that the conditions for a very strong upturn in 2006 couldn't be better. As an opposite to the "perfect storm" scenario, Penn believes that the key fundamental factors that drive the semiconductor industry to strong growth are now in alignment producing a "perfect calm" picture of what looks set to produce growth rates of at least 20 percent this year!

Indeed, the market analyst went further, suggesting that growth for 2006 could far exceed his 20 percent growth projections! This is way out of step with the vast majority of market forecasts (around 8 percent) with only Semico Research Corp's bullish 17 percent growth in semiconductors for 2006 following Penn's projections.

Penn's perfect calm scenario is down to several key factors. Firstly, the world economy in 2006 is expected to grow GDP by 4.3 percent, according to the consistently accurate IMF projections. Penn noted that the IMF figures showed no region or large country posting negative GDP's for the year, which as Penn put it "has not been seen for many years."

Indeed the continued strong GDP growth for China and India combined with the new but small assistance from Japan and Europe, especially for the second half of the year means that strong growth is expected. This should also be understood in the face of oil prices and geo-political issues from last year that have failed to make a real impact on GDP growth rates. This he believes will remain so this year, dispelling the gloom merchants reasoning to remain either cautious about the semiconductor upturn or pessimistic about the growth potential this year.

Penn also commented on the IMF's view that a key economic driver that has been missing since the dot com bust will be a significant growth driver in 2006, taking over from the consumer driven growth we have experienced in the last few years. That driver is the business sector. Penn noted that spending by businesses will return in 06 as overall production capacity is very tight. Spending by businesses will return as they have been accruing cash for several years.

If this indeed happens I have the feeling the softening in consumer markets will be read wrongly by some, happy to cast doubt over a meaningful recovery, while forgetting to realise that business spending is back!

The second key factor Penn noted was that IC unit demand is on the rise while inventory levels remain in balance with historical levels required for a period of unit demand growth. In fact unit demand has been growing since last July when the inventory correction had been made.

The third factor cited was fab capacity. Penn highlighted that fab capacity both in trailing and leading edge was basically "tight" at around the 90 percent utilization rate and would continue that way due to the under investment in new fab capacity over the last year. Indeed a tight capacity realm could exist for the next 8 quarters as capital expenditure has been below the average in 2005 and is still expected to be below the average in 2006, according to Penn.

Part of the reason for this is that he feels industry executives still can't believe that a strong upturn is ahead of them and so capital spending remains muted. Penn cited the news from Texas Instruments the day before that showed that the company was hit by back-end assembly capacity

constraints that impacted revenues. Indeed, TI also gave guidance on capital spending for 2006, which was exactly the same as its spending in 2005. Clearly a sign that supports Penn's view on non-believers!

The fourth and only key factor that hadn't yet shown the conditions for perfect calm was Average Selling Prices (ASP's). The data available only indicates that ASP's are trending down, a key limiting factor to stellar growth numbers being made.

Penn noted that ASP's have yet to recover from the peaks of 2000, but they are about to do just that, though that data is not yet out. He asked for faith in his reasoning that ASP's will halt their decline and start an upward trend in 2006. This he argued is due to the fact that ASP's lag unit demand growth by as much as one year. Another pointer for rising ASP's was that unit demand was strong across a very wide range of IC devices with the market "awash with killer products," making ASP improvements inevitable, even if they haven't happened just yet!

Penn summed up the perfect calm with IC unit growth for 2006 coming in at 12 percent, ASP's up 8 percent, capex still below that required at 10 percent and world GDP growth of 4.3 percent, all contributing to a 20 percent increase in semiconductor sales revenue. "This is a dream not a nightmare," Penn enthused.