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Memory Makers' Balancing Act

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Memory-chip stocks have lagged other semiconductor names this year because of falling prices, but a turn could be coming for an industry that's learning how to better navigate a volatile field.

Executives from both Samsung Electronics and Micron Technology (MU:NYSE) have recently made bullish comments about the market for dynamic random access memory (DRAM) chips, citing a thirst for computers as well as an improved balance in supply and demand.

Although part of the expected better conditions will be due to a seasonal second-half increase spurred by greater demand for electronics gear during the holiday and back-to-school shopping seasons, another factor stems from ongoing, long-term structural changes in the industry.

"I think we've hit a bottom, and [DRAM] will grow slowly but steadily for the next couple of years," says Bob Merritt, DRAM analyst with Semico Research. "We're seeing a very healthy trend within the DRAM area where suppliers are committing to ship a wider range of products than they have ever done in the past. This is a very necessary, and very large, change."

For the year, shares of Boise, Idaho-based Micron have dropped 15% to \$10.49; those of German rival Infineon Technologies (IFX:NYSE ADR) have sunk 18% to \$8.89.

Having spent years diversifying their production capabilities, the world's largest memory makers are starting to see the benefits. The vicious price swings in the sector brought on by demand-and-supply imbalances can now be better avoided by manufacturers who are more able to shift production from oversupplied market segments into undersupplied segments.

Samsung, the world's largest DRAM producer with 31% market share, and second-largest chipmaker overall, makes a wide array of memory chips beyond the highly commoditized DRAM space, including NAND flash, SRAM and NOR flash.

Similarly, Micron, Infineon and South Korea's Hynix Semiconductor also make a variety of memory devices in addition to DRAM, and all are in the process of further diversifying from DRAM. Together, the four companies account for 76% of all DRAM chips sold in the world, according to researcher IC Insights.

"For the first time in history, the largest DRAM guys can go build something else," said Kipp Bedard, vice president of investor relations at Micron, during a presentation last week.

And that's exactly what they've been doing. NAND flash has accounted for one of the fastest growth rates in the semiconductor industry in decades, due to rising demand for digital cameras and MP3 players. Samsung, as the largest NAND supplier and thus major beneficiary of the growth, has had to stretch capacity to keep pace with demand.

Although the potential for oversupply looms in NAND, the DRAM market still seems positioned to benefit from broadening memory demand. During the first half of this year, DRAM prices dropped sharply, but this was after a slight price rise in 2004. Now, prices have again begun to stabilize, and market participants are becoming more positive.

"We're very, very bullish on the back half of this year," says Tom Quinn, senior vice president of memory sales and marketing for Samsung Semiconductor. "We see continued increases in the demand for DRAM and it's for the right reasons, not just because the price is low."

Fast and cheap, DRAM has become prevalent in a wide range of devices, including handheld computers, cell phones and portable music players. In addition, Quinn says, increased demand is coming from advanced computer operating systems built to work with 64-bit processors; processors with multiple cores; and advanced computer games.

"With these operating systems and sophisticated microprocessors, to really get the system to perform, you need more memory," Quinn says. "We love it because it's a true value proposition."

But despite growing DRAM demand, its commodity status means supply has to be kept in check. This is where demand for other types of memory helps to balance the entire market.

"DRAM manufacturers have had to run flat out to capacity, and that was the only way to stay alive. This contributed to the supply-and-demand imbalances before," says Semico's Merritt. "The impact of NAND technology is that Samsung and the other companies looking at the same model have a way now to balance that load with something other than DRAM."

Merritt says DRAM prices may continue to fall simply because it is a commodity product, but increased predictability and consistency in the market should prove more important to all participants.

These trends will ultimately benefit investors. Past uncertainty had investors shying away from the segment as bottom lines took extreme hits from wide price swings. If some level of predictability can be built into the DRAM market, look for investor money to follow.
