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Outsourcing Agreements Could Portend Continued  
Pricing Pressure For 32" + LCD Panels

A number of recent reports from LCD panel makers suggest to us that pricing pressure continues for large size LCD TV panels. It appears that the major panel manufacturers are finding it increasingly difficult to turn a profit on 32" LCD panels and are outsourcing production of those panels to second-tier players in order to focus on larger, ostensibly more profitable panels. We are concerned that as manufacturers shift production to larger LCD panel sizes, supply of very large (greater than 32") panels will expand faster than expected, leading to increased pressure on both pricing and profits. Among the companies outsourcing production of 32" LCD panels:

- Philips has awarded a contract to Chunghwa Picture Tubes (CPT) for 32" LCD TV panels. They expect to deliver as many as 30,000 – 40,000 units per month to Philips.
- LG has contracted the production of 32" LCD TV panels to Ya Hsin Industrial Co. of Taiwan. This move was done in part to avoid heavy import duties in Taiwan, but we also believe that LG is anxious to free up capacity for larger LCD TV panel production.
- Samsung Electronics has outsourced production of 32" LCD panels to AU Optronics and Chi Mei Optoelectronics. This may be in part to a slower than expected ramp-up of its 7G plant, but the Commercial Times reports that Samsung has indicated that it cannot make a profit at the 32" size and that 40" and above is more optimal.

LCD TV panel pricing declines show no sign of abating, particularly at larger screen sizes. If the tier one makers are indeed finding it difficult to make money at the 32" level, we suspect they are shifting production to larger panel sizes as they search for a "sweet spot" in the market. We are concerned that supply of very large LCD TV panels will grow faster than expected as a result. While the impact on pricing will ultimately depend on demand for very large LCD TV's, we are inclined to believe that it will become even difficult to make money from LCD TV panels than investors already believe.

The very large TV space is dangerous territory for LCD players, as it impinges directly on other, strong technologies. Competing technologies such as PDP and RPTV will vie for market share at the larger TV sizes, putting continued pressure on very large LCD panel prices. PDP continues to dominate the 32"-42"+ flat panel space and manufacturers will likely respond to LCD incursion into this space by lowering prices. We note that LCD was able to "take over" the 32" space from PDP, but plasma technology is better suited to larger screen sizes and we think it will be much harder for LCD to muscle PDP sets out of the very large TV space. RPTV's continue to offer excellent value at larger screen sizes and the growth of LCoS technology should keep quality high and pricing low. These factors should contribute to pricing instability at the larger LCD TV panel sizes.

We continue to suggest avoiding LCD panel and TV makers, particularly **Philips, LG, Philips LCD** and **Samsung**. While the outsourcing from tier one manufacturers looks on its face to be good for **AU Optronics, Chunghwa Picture Tubes**, etc., we suspect they are making very little money on the additional volume, as they likely competed aggressively for the business. On the plus side, **Corning**

should continue to benefit from the increase in demand for glass as next generation plants come on line and average TV sizes continue to grow. Other component makers, like **Genesis Microchip** will do better than expected if lower prices bring increased demand for LCD TV's.