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As Q2 Earnings Come In, LCD TV Panel Outlook Is A
Jump Ball – We Remain Less Optimistic Than Most

Looking at recent quarterly earnings for LCD panel makers, there appears to be some evidence that panel prices are stabilizing and that H2'05 will see a return to a more balanced supply/demand picture. Certainly, comments by various company management teams would suggest this, with Samsung and LG.Philips LCD both looking for percentage unit shipment growth in the mid teens and LCD panel prices to rise in the mid single digits. As a result, **we sense that investors may be beginning to warm to shares of LCD panel makers. We are less inclined to be optimistic at this point.**

- First, early snags in the ramp up of next generation LCD plants appear to have abated, setting the stage for greater panel production volumes. Samsung, for instance, appears have put the delays at its G7 line that hurt Q2 volumes and operating margins behind it. LG.Philips's P6 and P7 plants continue to increase production, and AUO's G6 plant continues to ramp after being slightly behind schedule in Q2. **While the new plants will be more efficient, they will also allow manufacturers to maximize production volumes in H2 as they reach for market share.**
- As volume ramps and manufacturers look out to more plants coming on line in late 2005 through 2006, **we believe manufacturers will sacrifice pricing for market share.** We believe that this will keep a lid on price increases, particularly at the large LCD TV panel sizes, where prices continue to fall.
- Certainly there is plenty of evidence that LCD monitor prices have stabilized for now, and we agree that pricing at this end of the market will be more stable than that of LCD TV's. However, as more next-generation plants come on-line, more capacity will free up for monitors. Samsung, for instance, was forced to use its two 5G lines to produce TV panels in Q2. Some of that capacity will be freed up for smaller panels as the 7G line continues to ramp.
- Even as volumes ramp, **panel makers continue to shift production towards large LCD TV panels, which have shown the highest unit growth in recent quarters. However, prices remain highly unstable in this segment of the market.** For instance Samsung reported that 32" TV panel prices fell 12% from the first quarter, versus a 3% increase for 17" monitors. With the volumes at the 7G plant (expected to focus on 32"-46" TV panels) ramping towards 60K/month by October, large TV panels will be an increasingly important part of the company's business, despite unstable prices.
- Demand expectations continue to improve, on the back of lower prices. While we agree that demand should strengthen as prices continue to fall, we are worried about warning signs that may portend weaker than expected demand. Certainly, Philips encountered weak consumer demand in Europe, prompting them to pre-announce a weaker than expected quarter in mid-June. Demand tends to be driven by pricing, in our view. It seems to be a contradiction to expect increasing demand concurrent with stable pricing. **We think demand will continue to be strong in H2, but it will be driven by declining prices.**

- **Competing technologies such as PDP and RPTV will vie for market share at the larger TV sizes.** PDP continues to dominate the 32"-42"+ flat panel space and will likely respond to LCD incursion into this space by lowering prices. 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.

It does appear that there has been some recent stabilization in LCD panel pricing. Our concern is that expectations of a recovery are a bit too optimistic, setting investors up for disappointment if sales and/or profitability remain soft. We continue to be cautious on **LG.Philips**, **AUO Optronics** and **Chi Mei Optoelectronics** for their heavy exposure to the LCD panel markets. **Samsung** and **Sharp** are also areas of concern, but less so given the smaller proportion of revenue represented by LCD panels. Sharp's LCD operations continue to perform well relative to its peers, although it continues to lose market share to lower-priced competitors. Nevertheless, Sharp is likely weather any continued softness better than its peers and may be a good defensive play in the space. 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** should also perform well.