Planar Systems, Inc.
Fourth Quarter Fiscal Year 2004 Analyst and Investor Conference Call
October 20, 2004

BK: Good afternoon and thank you for joining us. I'm Balaji Krishnamurthy, Planar's Chairman, President and Chief Executive Officer. I will review Fiscal Year 2004's fourth quarter which ended September 24th, and our CFO will summarize the financial results. I will then make my closing comments, before welcoming your questions.

With me here today in Beaverton, Oregon, are Steve Buhaly, Planar's Chief Financial Officer, Jeff Siegal, Corporate Controller, and Stewart Clark, Director of Investor Relations.

For your convenience, the script of this call's prepared comments will be posted on the Planar web site later today.

I will first let Steve cover the Safe Harbor Provisions.

SB: Thanks Balaji and good afternoon everyone. The press release we issued today includes a Business Outlook section that contains forward-looking statements about our business. On this conference call we are going to be commenting on our business outlook and making other forward-looking statements based on our current expectations. Words such as expects, anticipates, intends, plans, believes, sees, estimates and variations of such words and similar expressions are intended to identify such forward-looking statements. All of our forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially. Please refer to the press release we issued earlier today for a description of factors that could cause actual results to differ materially from those forecast. The forward-looking statements we make today speak only as of today and we do not undertake any obligation to update any such statements to reflect events or circumstances occurring after today.

Back to you, Balaji.

BK: Thank-you, Steve.

I'm pleased to announce today the appointment of Steve Buhaly as Planar's chief operating officer. I'll have more to say about this in a few moments, but let us first review the company's performance in the quarter.

Our results for the fourth quarter were consistent with our outlook for both sales and net income. We generated quarterly sales of $68.0M, up sequentially $1.4M or 2%, due to growth in the medical and industrial segments, offset by a decline in the commercial segment. Year-on-year sales in the fourth quarter decreased $4.2M, or 6%, due to declines in our commercial and industrial businesses, offset by growth in the medical segment.

Net income per diluted share was 19 cents in the fourth quarter, up 1 cent from the prior quarter but down from 30 cents a year ago. Net income benefited from improved medical segment performance and a significant change to our FY04 tax rate but was lowered by weak performance in the commercial segment. In addition to a lower-than-expected tax rate, there were a number of unusual items and reserve adjustments that had a net positive impact of about 1 cent per diluted share.

Due to operating income below target levels, bonuses were not paid during fiscal 2004. Our variable compensation payout requires operating income to achieve a budgeted level before bonuses can be paid to employees, with rank-and-file employees first in line and senior management last.

Normal fluctuations in orders for EL components lowered fourth quarter backlog to $48.3M, down from $50.5M at the end of the third quarter.

Sales outside of the US were 13% of total sales in the fourth quarter, down from 14% in both the previous quarter and the quarter a year ago. Excluding the commercial business, which only sells product in North America, about 24% of our remaining sales came from outside the US.

Now I'll highlight activities in each of our three business units. First, the medical segment, where fourth quarter sales of $22.7M were up $2.5M, or 12%, sequentially and $1.2M, or 6%, over last year's fourth quarter. Growth in digital imaging revenue, driven by our strategic offensive launched last February and a series of subsequent marketing campaigns, created the sequential increase.

A recent survey of hospital CFOs showed over 70% view investment in picture archival and communications systems, called PACS, and the associated digital imaging displays, as their top priority for capital spending. Additionally, there is a trend in the healthcare industry to unbundle the PACS software investment from the associated investments in computer and monitor hardware. The CIOs and IT departments in hospitals are playing a greater role in the procurement of monitors and are increasingly looking to traditional IT channels for that procurement. Our recent emphasis on making our digital imaging monitors available through a variety of resellers has paid off with much of our growth coming through increased penetration of this channel. We now have over twenty resellers that carry our digital imaging products worldwide.

Our message of affordable excellence helped us regain share from the lower-cost entrants in the market. Our Fat-to-Flat campaign caused some hospitals with CRTs to accelerate their switch to flat-panel solutions. We are cautiously optimistic that many of these trends will continue into the coming quarters.

In the fourth quarter we began to see the effect of the FDA approval of our flat-panel solution for use in mammography. The conversion from film to digital imaging has been slower in mammography due to the high-resolution nature of this application. Even those that moved to digital mammography viewed their images on high resolution CRTs with a very large footprint. A quarter ago we reported that we were the first to receive FDA approval of our 5 mega-pixel flat-panel solution for use in mammography applications. We have begun seeing the results of that competitive advantage. While the market is currently small for this application, the underlying market of mammography is large and we are positioned well as it transitions to digital mammography.

Part of the gain in digital imaging was offset this quarter by weakness in our point-of-care business, mainly due to a couple of key OEM accounts. Our dependency on these OEM accounts, in terms of the revenue and gross margin, has become insignificant to our medical business.

Now on to our industrial business unit, where sales of $14.2M for the fourth quarter grew by $1.1M, or 8%, on a sequential basis but declined $1.2M year-on-year. Strong demand for our custom color displays drove the sequential growth while the year-on-year decline was driven by product consolidation across the business.

During the quarter we received strong orders from our commercial avionics customers and design wins in the ATM and transportation segments. Good demand for products in this segment is partially driven by a strong economy.

We launched our new interactive marketing system designed for brand managers, the DS15, while continuing to ship to Nike and other customers. The need to modernize the delivery of information to consumers at the point of purchase should provide excellent growth opportunities.

Planar's commercial business recorded sales in the fourth quarter of $31.2M, down $2.2M sequentially and $4.3M year-on-year. As panel supplies shifted from scarcity to surplus, we took in more inventory than we needed. During the fourth quarter we sold much of this at below-target margins due to a sharp drop in retail prices.

Over the last few quarters, the portion of our business going through stocking distributors has increased significantly. As a result, we believe we can effectively operate with less inventory and reduce our exposure to panel cost and market price fluctuations.

Our North America market share numbers continue to be very respectable: number five in the independent monitor category and number nine overall. We are confident we can clean up the inventory problems that led to this quarter's disappointing results and extract good value from our strong market position.

Turning back to Planar as a whole and looking forward, Fiscal 2005 will be a year of investments to create profitable growth. In addition to maintaining the momentum in digital imaging and returning our commercial business to its traditional levels of performance, we will be making some focused investments. We intend to make additional sales and marketing investments over the coming quarters in Europe and China. We have moved one of our executives to Europe, have hired new sales and marketing professionals in Germany and have established a stronger presence in China. We believe we can achieve significant market share gains through targeted investments in these markets.

Last quarter we reported on our strategy to serve a new and emerging market in retail applications. We believe customers at retail establishments will increasingly be served through direct interactions with digital devices, many of which will be enabled by new display technologies. Our strategy is to serve these emerging applications by providing total solutions that include hardware, software and associated services. Our recent DS-15 product, now used by Nike in their Nike Town stores for product customization by customers, is an example of such a total solution that includes as much software as hardware.

Last quarter we purchased certain assets of a startup software company engaged in the development of a new point-of-sale system. While the in-development software from this company is still to be completed, our strategy is to combine it with our DS-15 product and create a total solution for quick-service restaurants that combines customer ordering stations with point-of-sale stations. We are also pursuing digital signage applications in the retail environment and will be reporting more on this at a future date.

We will be making investments in the development of significant software addressing these retail applications. To this end we have established a software development capability in India, through one of our partners, and have a dozen software developers currently deployed there. Going forward, software functionality in our products will form a key component of value addition and differentiation. Between our medical business and our investments in the retail market, we now employ more software engineers than hardware engineers.

Our investments in geographic expansion and pursuit of emerging markets in retail applications will increase our operating expenses in fiscal 2005. We believe these are prudent investments that will serve the shareholder in the long run.

Now Steve will cover the financials.

SB: Thank-you, Balaji.

Planar's fourth quarter sales of $68.0M grew sequentially by $1.4M or 2% due to strength in our medical and industrial segments. Year-on-year sales declined $4.2M or 6% driven by declines in our commercial and industrial businesses offset by growth in our medical business.

Fourth quarter gross margin was 21.0% which was below third quarter gross margin of 23.0%. Charges for excess inventory and increased warranty obligations impacted gross margin by about 1% in the fourth quarter. Poor gross margin in the commercial business impacted fourth quarter aggregate margins by about 3%.

Fourth quarter operating expenses at 17.4% of sales were level with the third quarter. Results were favorably impacted by a reduction in the restructuring reserve but were partially offset by the write-off of purchased in-development software and an increase in bad debt expense.

Equipment and property assets associated with the reserve taken in fiscal 2002's fourth quarter remain listed for sale.

Fourth quarter income from operations was $2.5M or 3.6% of sales, compared to third quarter income from operations of $3.7M or 5.6% of sales.

During the fourth quarter, the company sold its interest in a private display company for $1.0M creating a non-operating gain of the full amount. Planar also reduced the carrying value of its investment in Topvision Technologies by $245k reflecting a further decline in this publicly traded firm's market value. This adjustment leaves the remaining book value of our investment in Topvision at $0.9M.

A favorable tax ruling and the normal year-end computation of taxes reduced the full-year tax-rate to 28%. Compared to earlier tax-rate expectations, the favorable impact to net income in the fourth quarter was a little over five cents per diluted share.

Fourth quarter net income per diluted share was 19 cents, up from 18 cents in the third quarter but down from 30 cents in the fourth quarter of fiscal 2003.

Our balance sheet remains strong with a good cash balance and minimal debt. However, the growth in our inventory was disappointing and we are taking actions across the company to achieve reduced levels during the current quarter. Elsewhere on the balance sheet, our accounts receivable continues to be well managed. The decrease in accounts payable was a timing coincidence and not the result of new policies or practices.

Fourth quarter return on equity was 6.8%, up slightly from 6.6% in the third quarter.

Turning to the business outlook, our expectations for the first quarter of fiscal 2005 are as follows:

Sales of about $65 million, half of which are expected to come from the commercial segment.

Gross margin of about 23% of sales, anticipating the absence of the inventory and warranty adjustments made in the fourth quarter and improved commercial segment margins.

Operating expense, and to a lesser degree gross margin, will be impacted by an expected resumption of targeted variable compensation for all employees. As the company did not meet its targets in fiscal 2004, no bonuses were paid. At target, such compensation would reduce earnings by five cents per share per quarter. Management and the board agree that resuming a competitive compensation package for all employees is critical to retention of key talent and, therefore, Planar's long-term success.

R&D investment is expected to be 4% to 5% of overall sales. With R&D spending in our commercial business negligible, this spending level is about 9% of our combined Medical and Industrial segment sales.

Increased investments are planned in sales and marketing designed to stimulate profitable growth in Europe and China.

Operating income is expected to be about 1% of sales and the tax rate is assumed to be 34%. This equates to net income between zero and five cents per diluted share based on an average share count of about 15 million diluted shares.

BK: Thank you, Steve.

Last fiscal year was a difficult one for Planar. Early in the year we saw an onslaught of competition in our digital imaging business. The speed and agility with which we responded has paid off, as we've seen healthy trends in sales growth and market share in that business.

In our commercial business, volatility in supply and pricing characterized the second half of the year, but we weathered that storm too.

These businesses both accomplished much during the year, but when we look back a few years from now, I think Planar's most important accomplishment of 2004 will be the start of our efforts to penetrate the new growth opportunity for technology in the retail environment.

In fiscal 2005 our focus is going to be on generating profitable growth. I will be devoted to this mission. To enable me to do so, we have appointed Steve Buhaly as the Chief Operating Officer. Over the last four years Steve has been a collaborative CFO with close involvement with the operations of the company. With this change, he will manage the ongoing businesses, with the segment and functional leaders reporting directly to him. Steve and his team will focus on generating profitable growth within our businesses. They will build on the momentum we now have in our digital imaging business, improve the efficiency of our commercial business, and maintain the profitability of our industrial business. I am confident that Steve's understanding of the business and his operational skills will enable him to deliver the results we depend on. Steve will continue to serve as CFO while we actively explore our options for a new CFO.

For my part, I am eager to go after new opportunities that lie ahead for the company. I am particularly excited about the opportunities in retail applications. Flat-panel displays are both the catalyst and the mechanism that delivers value in this market, but the larger value proposition we will offer must go far beyond just the hardware. We are building new capability in this company that will deliver value beyond the display hardware, such as the seamless integration of software and services. We have made considerable progress towards these goals already.

As we considered our plans for fiscal 2005 we made conscious decisions to make some focused investments accepting that these investments will constrain our fiscal 2005 profitability. We believe that our shareholders are better served in the long run if we capitalize on the present circumstances and make these investments for future profitable growth.

Finally, I speak for all Planar employees in stating that it feels much better to be back in the mode of delivering on our promises in the quarter just ended. It allows me to close with my usual refrain, we will only promise what we can deliver and deliver all that we promise.

Now, I will be happy to take your questions.