Planar Systems, Inc.
Third Quarter Fiscal Year 2004 Conference Call
July 14, 2004

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 third quarter which ended June 25th, 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 transcript 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

Our results for the third quarter exceeded expectations for both sales and net income. We generated quarterly sales of $66.7M, up sequentially $8.1M or 14%, due to a strong recovery in our commercial business and solid growth in the medical segment. Year-on-year, sales in the third quarter grew $3.8M or 6% due to growth in our commercial business.

Net income per diluted share was 18 cents in the third quarter, up from 5 cents in the prior quarter but down from 30 cents a year ago. Net income benefited from improved sales this quarter, continued strong earnings in the industrial business and a small change to our expected FY04 tax rate. The sequential comparison benefited from the presence of unusual expenses and a $0.4M non-operating charge in the second quarter.

Due to operating income below target levels, bonuses were not paid during the third quarter and have not been paid during fiscal 2004.

Strong orders for EL components lifted backlog for the third quarter to $50.5M, up significantly from $45.2M at the end of the second quarter. But over the long run, we expect backlog to decline as a percent of sales as we ship against last-time orders and because our commercial and digital imaging products generally ship to order and therefore do not generate significant backlog.

Sales outside of the US were 14% of total sales in the third quarter, down from 18% in the previous quarter and 20% a year ago. Excluding the commercial business which only sells product in North America, about 29% of our remaining sales came from outside the US.

In our medical segment, third quarter sales of $20.2M were up $1.2M or 7% sequentially and down $1.0M, or 5%, year-on-year. Growth in digital imaging and service revenue drove the sequential increase. The largest portion of the year-on-year decline was in point-of-care products.

Our medical business enjoyed the first full-quarter benefit from our new strategy in digital imaging. Our marketing campaign of affordable excellence, launched in the second quarter, took hold in the marketplace and delivered expected results this quarter, including increased volume and penetration through our reseller channel partners. We believe we have gained market share in digital imaging through this strategic shift. While our competitors have not overtly reacted to our moves, they continue to fight aggressively on individual opportunities.

This past quarter we launched a follow-on offensive move with a new marketing campaign, called Fat to Flat, which encourages hospitals to upgrade their aging CRTs and enjoy the benefits of flat-panel displays. This campaign will run into our fourth quarter and its positive results are already apparent.

Also during the quarter we received FDA 510k approval for the use of our 5-megapixel flat panel solution in mammography, one of the most demanding and pervasive radiological applications. This made ours the first flat panel approved by the FDA for this application demonstrating our pursuit of adjacent markets. Until now radiologists have read mammogram images predominantly on film with a small fraction using CRTs. The benefits of flat panels over CRTs are underscored in this application because of the large footprint of 5-megapixel CRTs.

We are also seeing the effect of our new focus on software and services for healthcare customers. Our extended warranty and rapid response customer service offerings have been well received by the healthcare marketplace. We have also been successful with clinical viewing stations that combine our industry leading DICOM calibration software with select Planar desktop monitors, and are offering them through our reseller channel partners.

With these strategic initiatives, we believe we are driving growth in digital imaging. This was the right time to make these strategic changes to ensure our continued leadership in this market as hospitals transition from film-based radiology to digital radiology.

In our industrial business unit, sales of $13.1M for the third quarter declined by $0.4M on a sequential basis and $3.1M year-on-year. The year-on-year decline was driven by product consolidation across the business.

Over the last year we have been redirecting our industrial investment focus away from components and toward fully integrated solutions in chosen markets. We have identified front-office applications in retail establishments as a market opportunity with considerable potential growth. While digital technologies have had a profound impact on back-office functions behind the scenes in retail establishments, customer interactions remain dominated by old technologies.

We believe digital technology, catalyzed by flat-panel displays, will increasingly be used to inform and interact with customers in retail establishments. During the third quarter, we closed a deal with our first major customer and shipped initial units for a front-office application in the retail space. Note that this involves selling solutions to retailers, not creating a new retail channel for our products. During the fourth quarter, we will formally launch this product into the marketplace and elaborate on the broader market opportunities.

Planar's commercial business recorded sales in the third quarter of $33.4M, up $7.2M sequentially and $7.9M year-on-year. We enjoyed strong growth and improved diversification across our channel partners during the quarter. Sequential growth in the commercial segment was particularly strong since the business was impacted in the second quarter by the difficult panel supply conditions that prevailed last Fall.

The supply of panels improved over the course of the third quarter. While there was a residual amount of higher-cost products sold in the quarter, the effects of last Fall's tight supply are now completely behind us.

Our value proposition and brand continue to resonate with our channel partners and their customers. During the quarter, our commercial products received numerous favorable reviews in Business Week, E-Gear, CNET.com and other publications. We are building a strong brand around customer satisfaction that will benefit this segment and the entire company long term. Our success growing sales of our medical products through this channel demonstrates an important synergistic benefit.

Turning back to Planar as a whole, we intend to make additional sales and marketing investments over the coming quarters in both Europe and China. We are moving one of our executives to Europe, have hired new sales and marketing professionals in Germany and are establishing a stronger presence in China.

Now Steve will cover the financials.

SB: Thank-you Balaji

Planar's third quarter sales of $66.7M were above the sales recorded in the same quarter of the previous fiscal year by 6% due to growth in the commercial segment. Sales were up 14% sequentially due to strong growth in the commercial and medical segments.

During the third quarter, our mix of business continued to be dominated by AMLCD products. EL sales were 20% of the total and the remainder was primarily AMLCD.

Third quarter gross margin was 23.0%, slightly above second quarter gross margin of 22.7%. Second quarter margin was impacted by unusual expenses in the medical segment. In the third quarter, strong commercial sales at relatively low margins impacted aggregate margins.

Third quarter operating expenses were 17.4% of sales, down from 20.0% in the second quarter. The decrease was due to sales growth in the commercial segment where operating expenses are low and good discipline across the company. Both quarters had $0.7M of amortization expense.

There was no impact to the income statement during the quarter from changes to previously taken restructuring reserves. Equipment and property assets associated with the reserve taken in fiscal 2002's fourth quarter are currently listed for sale.

Third quarter income from operations was $3.7M or 5.6% of sales, compared to second quarter income from operations of $1.5M or 2.6% of sales.

After reviewing the company's expected tax expense for the fiscal year, we revised the estimated full-year tax rate from 35% to 33%. The favorable impact to net income in the third quarter was a little over one cent per share.

Third quarter net income per diluted share was 18 cents, up from 5 cents in the second quarter but down from 30 cents in the third quarter of fiscal 2003.

Our balance sheet remains strong. During the quarter, we paid off substantially all of the company's remaining debt and continue to enjoy access to a $50M line of credit. Excluding the repayment of debt, cash grew $4.2M from the prior quarter. Inventory turns declined slightly to 4.4 as the company reacted to increasing component lead times. Days sales outstanding improved to a very strong 43 days. Our capital expenditures are up modestly year-on-year as we complete upgrades to our information systems supporting operations.

Third quarter return on equity was 6.6%, up substantially from 1.9% in the second quarter.

I'll now turn to our business outlook:

Our fiscal 2004 guidance is consistent with last quarter, calling for sales of about $260M, of which approximately $125M is expected to be from the commercial segment. We also continue to expect net income per diluted share to be about 60 cents. This guidance reflects our belief that the fourth quarter will be comparable to the quarter just completed in both sales and net income.

During fiscal 2004 our variable compensation program has not provided its usual buffer function as operating income expectations have been below target levels. When paid at target, these bonuses have a net income impact of about five cents per share each quarter. New targets will be established for fiscal year 2005 and we expect to pay targeted bonuses in the new fiscal year.

For the fourth quarter, our expectations are as follows:

Sales of about $70 million, of which commercial segment sales are expected to be about $35 million.

Gross margin of about 23% of sales, reflecting a higher percentage of commercial business in the mix.

R&D investment at 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.

Operating income will be between 5% and 6% of sales.

A tax rate of 33% and a full-year average share count of slightly less than 15 million fully diluted shares.

Cash from operations, defined as net income plus depreciation and amortization less capital expenditures, of $3 million to $4 million.

Finally, regarding our practice of issuing guidance, we plan to make a change to improve near-term clarity but decrease the specifics within the long-term outlook. As our business has shifted from selling primarily to OEMs to selling primarily to end users, our visibility has decreased dramatically. Short customer lead times and project-oriented sales do not offer the insight into future business levels that selling components into our customer's products once did. Accordingly, we will shift our emphasis from annual guidance to providing guidance for the next quarter during our quarterly earnings conference calls.

BK: Thank you, Steve

We are delighted to return to a winning atmosphere of growth and success throughout our company. In our medical business, our bold and aggressive strategy shift has energized our team, especially the sales force. Returning our commercial business to strong levels of growth has given that team a boost as well. And in our industrial segment, our new strategy of developing solutions for retail establishments has created a lot of activity with strong prospects going forward.

By design, our portfolio of business segments has resulted in valuable synergies. Our medical products are now available through many of our commercial segment's channel partners. Likewise, we have made our commercial products available to the healthcare market by bundling them with medical applications. Such breadth of channel and products has created a lot of excitement within our sales organization and our resellers, and along with it a sense of energy within the company.

Looking forward, we are making strategic investments for growth. Some of this is already reflected in our current sales and marketing investment in the US. Additional investments for geographic expansion in Europe and China are underway. We will also be more aggressive in some of our entrepreneurial projects, which we call Quantum programs. We believe all of this will lead to a growth-oriented company that demonstrates solid profitability.

But, most important of all, it has been very satisfying to reaffirm our company value of delivering on our promises. We met and beat our own expectations for this past quarter and we intend to deliver on the expectations we have set for this coming quarter. I am personally pleased to be able to say that we will only promise what we can deliver and deliver all that we promise.

Let me also personally invite you all to our annual investor and analyst meeting, a month from now on August 19th. This year, it's being held in conjunction with seven other Portland-area technology companies' meetings that week, so I hope you'll find the trip especially valuable. All of you are welcome to visit us here in our building, see a number of our demo products, and meet many more members of our management team who will detail their business units and help distinguish Planar and its growth prospects. Please let us know if you'll be coming.

Now, I'm happy take any questions.