Daewoo Securities Co., LTD

Equity Research for International Investors (ERII)

Korea

11 July 2003

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Not Rated

Initiated

Ticker: 56000.KQ

Price target (6mos): W20,000

Public Offering Price: W14,000

Par Value: W500

Shared Issued:4.2mn shr. (before POP)

5.3mn shr. (after POP)

Major Shareholders:

Nam Kyu, Park and related parties (53.6%)

Cowon Systems

Attractive growth and profitability potential

- We have set our **6-month price target** of Cowon System at **W20,000**, applying the average KOSDAQ P/E of 15x. We believe the company deserves a premium to the market, given the company's growth and profitability potential. However, we have applied a conservative market P/E due to the increasing competition in the wireless internet content market.
- We estimate Cowon System's 2003E sales and net profit to increase by 98.2% (to W33.3bn) and 53.7% (to W5.5bn) yoy, respectively. Key drivers will be MP3 players and wireless internet services. We expect MP3 player sales to surge by 92% yoy to W21.5bn in 2003E on the back of increasing exports, global recognition of its superior technology, and introduction of new models. We expect its wireless internet services sales to increase by 110% yoy to W11.8bn in 2003E, buoyed by the increasing number of subscribers for SK Telecom's (17670.KS) JUNE service where the company provides music technologies.
- A future risk for the company is the conversion of the currently free MP3 file-downloading sites to paid services.

Forecasts/Valuation

FY	Sales (W bn)	NP (W bn)	EPS (W)	P/E (x)	BVPS (W)	ROIC (%)	ROE (%)
12/00	3.8	1.2	207	-	738	151.9	37.3
12/01	8.5	1.8	588	-	2,111	68.8	31.6
12/02	16.8	3.6	853	-	1,999	75.2	42.6
12/03E	33.3	5.5	1,159	5.6	3,542	101.8	32.9
12/04E	46.4	8.2	1,527	4.3	4,549	85.1	30.0

Note: P/E based on public offering price

Source: Company data, Daewoo Securities estimates

Recommendation and Valuation

We have set our **6-month price target** of Cowon System at **W20,000**, applying the average KOSDAQ P/E of 15x. We believe the company deserves a premium to the market, given the company's growth and profitability potential. However, we have applied a conservative market P/E due to the increasing competition in the wireless internet content market.

We believe Cowon's competitiveness comes from the following:

1) Global recognition for superior technology in its key product, the MP3 player.
2) We expect an earnings momentum for MP3 players from 2H03E on the back of increasing exports and introduction of new models.
3) Buoyed by the increasing number of subscribers for SK Telecom's JUNE service (SKT; 17670.KS) in which the company provides music technologies, we expect the company's wireless internet content sales to increase by 120% yoy to W9bn in 2003E.

4) We estimate a margin expansion on the back of the continuous growth of the profitable wireless internet content division. In particular, the company's emphasis on selling a high-end product mix lowers its earnings sensitivity to the rapidly declining ASP of MP3 players. Consequently, we expect the company to sustain a high ROE of over 30% through 2004E.

Figure 1. Comparison with KOSDAQ

	Cowon System		KOSDAQ avg.	
	2003E	2004E	2003E	2004E
Sales Growth (%)	98.2	39.2	-5.2	13.1
Operating margin (%)	19.8	20.4	13.2	13.8
ROIC (%)	101.8	85.1	10.6	11.1
ROE (%)	32.9	30	14.1	15.7
Debt to equity (%)	16.1	15.6	123	105.4
P/E (x)	5.6	4.3	15.1	11.7

Note: P/E based on public offering price
Source: Daewoo Securities estimates

Financial Outlook

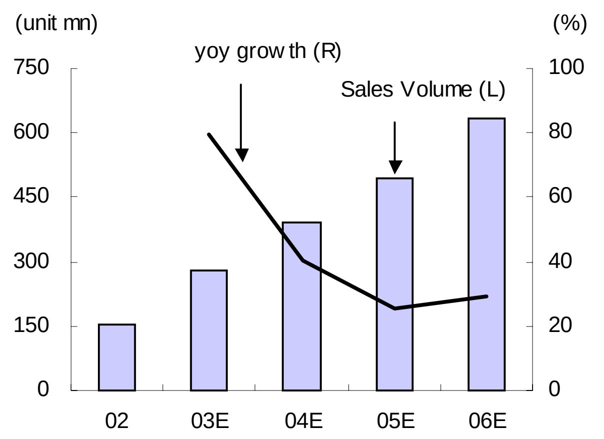
We estimate Cowon System's 2003E sales and net profit to increase by 98.2% (to W33.3bn) and 53.7% (to W5.5bn) yoy, respectively. For 2004E, we project sales and net profit to surge by 40.9% and 47.5% to W47.0bn and W8.1bn, respectively.

Cowon's main business lines are MP3 players and wireless internet services. In 2002, the two lines of business accounted for 67% and 25%, respectively, of the company's total sales.

MP3 Player

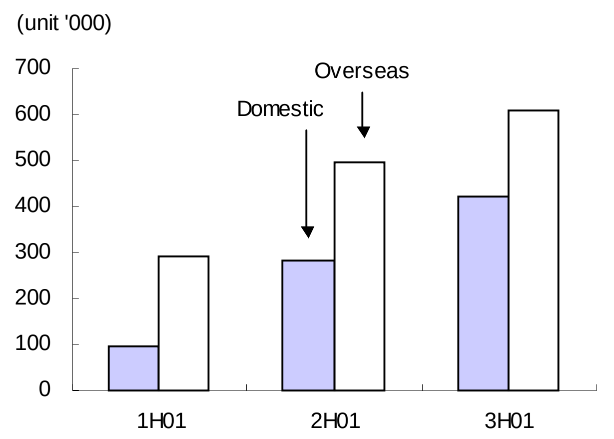
The MP3 player market, first launched in Korea by MPMan.com in 1997, is rapidly emerging as a new format for recorded music players, replacing the existing portable cassette players. IDC projects that the global MP3 player market will grow by 61% pa through 2006E. In fact, the Korean MP3 player market has grown by 49% yoy in 1H03.

Figure 1. Global MP3 Player Sales Volume Outlook



Source: IDC

Figure 2. Domestic MP3 Player Makers Sales Volume



Source: Company data, inew24, Daewoo Securities estimates

In 2002, Cowon's MP3 player sales were impressive with an increase of 522.2% yoy to W11.2bn in 2002 from a mere W1.8bn in 2001. We expect the growth momentum to continue in 2003E and project sales to increase by 92.4% yoy to W21.5bn due to:

1) We expect the global MP3 player market to grow by 79% yoy in 2003E while the domestic market will continue to grow, surpassing 1mn units of sales in 2003E. Thanks to the enhanced qualities of the player (increased memory to 128MB), diversified functions (recording, radio player etc), improved designs, and reduced size, MP3 Player is rapidly replacing the walkman market.

2) Cowon's MP3 player has received rave reviews from global consumers and experts. In 2002, the CW200 has maintained the No. 1 position in the customer review section of Amazon.com, the largest online shopping mall in the U.S. Furthermore, CNET, a major IT portal, gave the top grade to Cowon's MP3 player in its Editors' Choice product review section.

3) We expect Cowon to see a significant increase in sales from 2H03E as the company plans to roll out new models (CW400 and CW500) in September and October. In the past, the company's revenue surged by 3~4 times after an introduction of a new model.

Figure 3. MP3 Player Monthly Sales

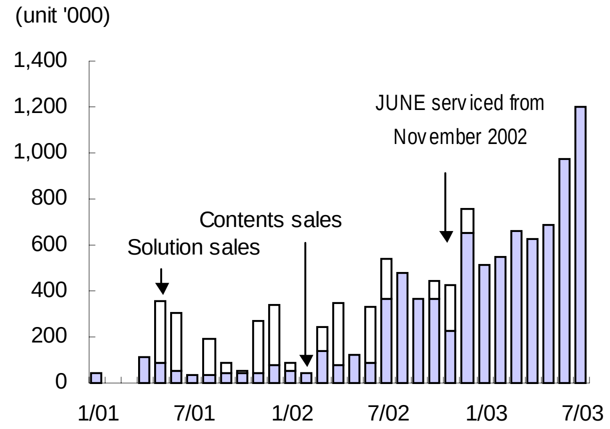
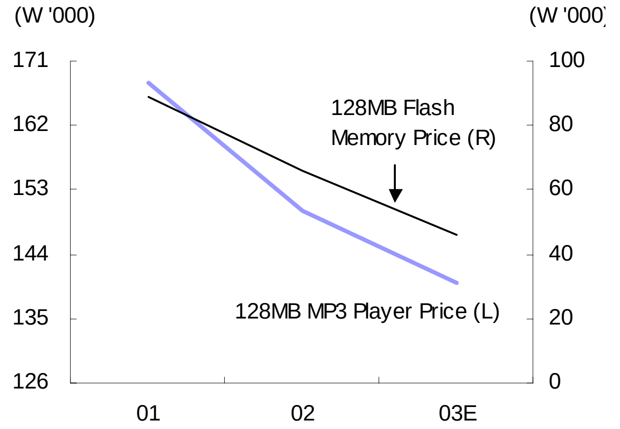


Figure 4. Cowon MP3 Player & Flash Memory Price Trend



Source: Company data, Daewoo Securities estimates

Wireless Internet Services

We expect wireless internet service (content and solution) sales to increase by 110% yoy to W11.8bn in 2003E. The majority of Cowon's wireless internet service sales are derived from content sales. Currently the company provides multimedia content service (including Live Bell[1]), Live Screen[2]), MOD(Music On Demand)) to SKT's JUNE service. JUNE accounts for approximately 65% of Cowon's wireless internet content sales. Cowon also provides color ring, bell sound, and karaoke/game services to SKT's Nate.

1) Live Bell: Currently most of the bell sound services are based on the MIDI format, whereas Live Bell provides music which also includes the singer's voice

2) Live Screen is a background screen cut from a motion video (unlike graphic images offered by rivals). Ex: With this service, we can actually see a real dog running around in the background screen

We believe the company's wireless internet contents sales will surge by 120% to W9bn in 2003E, boosted by the increasing number of JUNE subscribers (we estimate the number to reach 2 mn from the current 830,000) and the growing sales of its color ring service, following the expansion of this service to other mobile telcos including LG Telecom (32640.KQ) and KTF (32390.KQ) from June.

In spite of its sluggish performance in 1H03, we expect wireless solution sales to increase by 85% to W2.8bn in 2003E as Cowon begins to pursue overseas market opportunities jointly with SK Telecom.

Figure 5. Wireless Internet (Solution + Contents) Sales

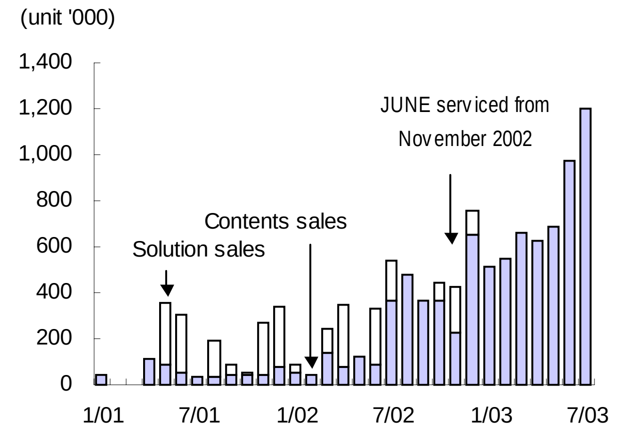
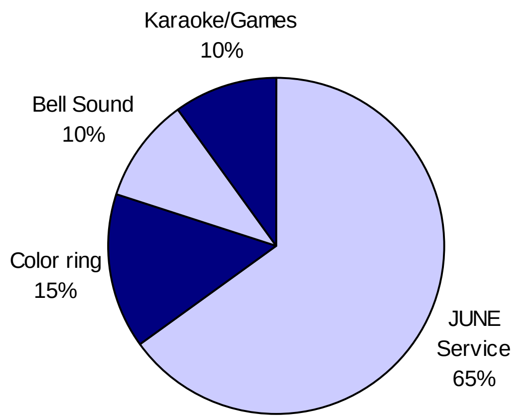


Figure 6. Wireless Internet Contents Sales Breakdown



Source: Company data, Daewoo Securities estimates

Figure 7. June Service Monthly Subscribers

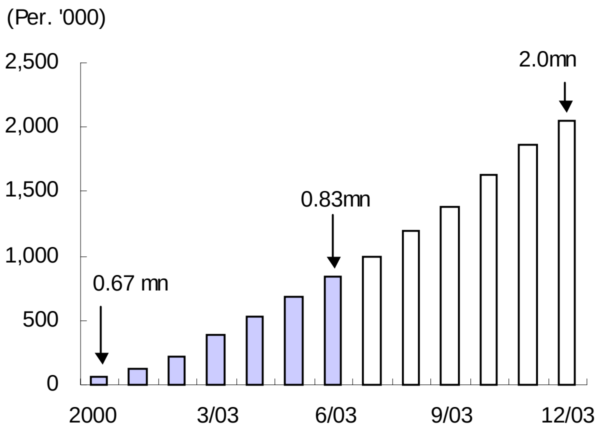
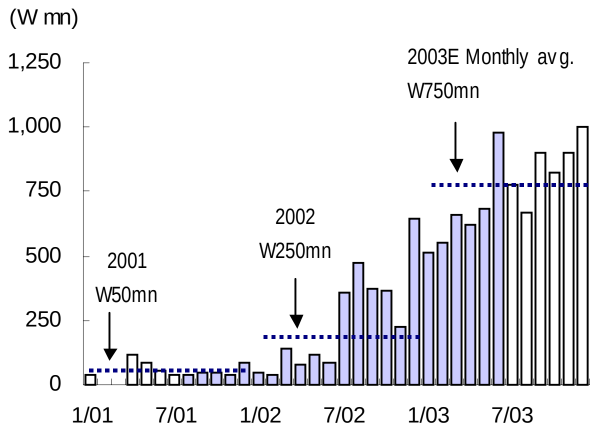
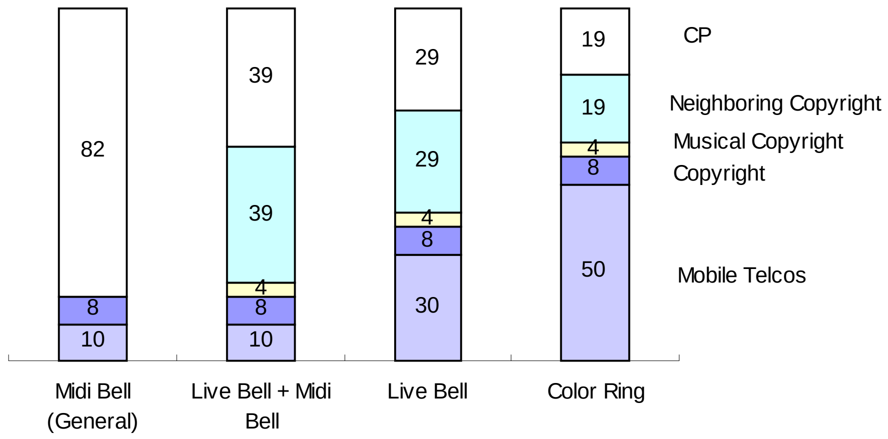


Figure 8. Wireless Internet Contents Monthly Sales



Source: Company data, SK Telecom Daewoo Securities estimates

Figure 9. Major Sound Contents Revenue Structure



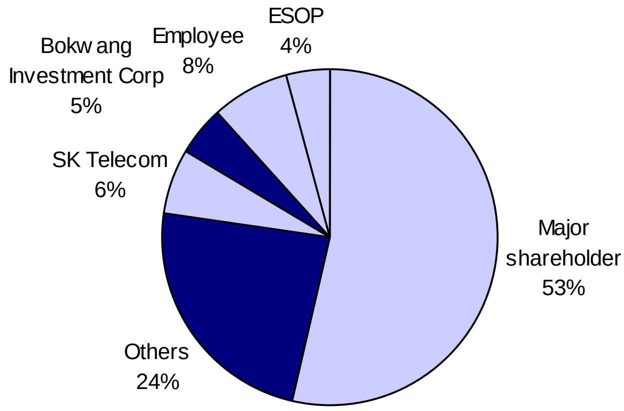
Source: Yahoh Communication, Daewoo Securities estimates

Risk

A future risk for the company is the commercialization of the currently free MP3 file downloading sites. We believe the company will be negatively impacted if MP3 downloading is shifted to a paid service, given that the free service has fueled the rapid expansion of the MP3 Player market. In addition, the company faces cutthroat competition in the market following the opening of the wireless internet network.

Shareholders' Structure

Figure 10. S/H structure (After public offer)



Source: Company Data, Daewoo Securities estimates

Figure 11. Safeguard Deposit

	Shar. Stock	Weight (%)	Safeguard Deposit
Major shareholder	2,863,842	53.6	12mos
Employee Stock Ownership Plan	231,861	4.3	12mos
Employee	399,966	7.5	6mos
SK Telecom	335,886	6.3	6mos
Bokwang Investment Corp	248,310	4.7	6mos
Total	4,079,865	76.3	

Source: Company data, Daewoo Securities estimates

Figure 12. Cowon Systems - Financial Statement

BALANCE SHEET PROJECTION

(W bn)	2001	2002	2003E	2004E
Current Assets	4.4	5.9	17.2	22.7
Cash & Bank Deposits	0.6	1.6	2.6	1.9
ST Financial Instruments	0.0	0.0	5.5	7.5
Receivables	3.0	2.4	5.0	7.3
Inventories	0.7	1.7	4.0	5.7
Fixed Assets	3.3	6.1	9.6	13.5
Investment Asset	2.9	3.9	4.7	5.5
Tangible Assets	0.3	0.3	0.6	0.9
Total Assets	7.7	12.0	26.8	36.1
Current Liabilities	1.1	1.6	3.7	4.8
Payables	0.7	0.1	0.5	0.6
ST Bor. & Curr. Port. of LTD	-	-	-	-
Long-term Liabilities	0.0	0.1	0.0	0.0
Bonds & LT Borrowings	-	-	-	-
Total Liabilities	1.1	1.7	3.7	4.9
Paid-in Capital	1.5	2.1	2.7	2.7
Surplus	5.0	8.0	20.3	28.5
Total Shareholders' Equity	6.6	10.2	23.2	31.3

PRO FORMA INCOME STATEMENT

(W bn)	2001	2002	2003E	2004E
Sales	8.5	16.8	33.3	46.4
Gross Profit	3.6	5.9	12.3	17.3
OP. Profit	2.0	3.2	6.6	9.5
Net Non-Oper. Exp	-0.1	0.0	0.2	0.0
Net Forex Exp.	0.0	0.1	0.2	0.1
Net Financial Exp.	-0.1	0.0	0.0	-0.1
Rec. Profit	2.1	3.1	6.4	9.5
Net Extraordinaries	0.0	0.0	0.0	0.0
Pretax Profit	2.1	3.1	6.4	9.5
Net Profit	1.8	3.6	5.5	8.2
Free Cash Flow	-0.2	1.4	3.3	7.0
EBITDA	2.3	3.5	8.1	12.2
EBITDA Margin(%)	26.7	21.0	24.2	26.3
Gross Profit to Sales(%)	42.0	35.3	36.8	37.3
OP. Profit to Sales(%)	23.8	18.9	19.8	20.4
Rec. Profit to Sales(%)	24.6	18.7	19.2	20.4
Net Profit to Sales(%)	21.2	21.3	16.5	17.6

Note: Free Cash Flow = Cash flow from Oper. - CAPEX

CASH FLOW PROJECTION

(W bn)	2001	2002	2003E	2004E
Cash Flow from Oper.	0.4	3.4	4.0	8.0
Net Profit	1.8	3.6	5.5	8.2
Depreciation	0.3	0.3	0.4	0.7
Amortization	0.0	0.1	1.1	2.0
Change in Net W/C	-2.0	-0.9	-4.5	-3.9
Others	0.3	0.4	1.6	1.0
Cash Flow from Inv.	-2.1	-2.5	-10.5	-8.6
CAPEX	-0.5	-2.1	-0.7	-1.0
Asset Disposal	-	-	-	-
Chg. in Investment Assets	-1.6	-0.2	-0.8	-0.8
Others	0.0	-0.2	-9.0	-6.8
Cash Flow from Financing	0.0	0.0	7.4	0.0
Borrowings	-	-	-	-
Right Issues	0.0	0.0	7.4	0.0
Dividend	-	-	-	-
Others	-	-	-	-
Chg. in Cash	-1.8	1.0	1.0	-0.7

VALUATION

(W, %, x)	2001	2002	2003E	2004E
EPS (W)	588	853	1,159	1,527
SPS (W)	2,778	4,003	7,025	8,685
BVPS (W)	2,111	1,999	3,542	4,549
P/E (x)	-	-	5.6	4.3
P/S (x)	-	-	1.6	0.9
P/BV (x)	-	-	1.8	1.4
Dividend Ratio(%)	-	-	-	-
Dividend Yield(%)	-	-	-	-
EV/EBITDA (x)	-	-	-	-
Interest Coverage Ratio(x)	2,440.6	0.0	439.7	0.0
D/E Ratio (%)	17.2	17.0	16.1	15.6
Borrowings to Sales (%)	-	-	-	-
ROE(%)	31.6	42.6	32.9	30.0
ROIC(%)	68.8	75.2	101.8	85.1

Interest Coverage Ratio: OP. Profit / Interest Expenses
Stock Price: (not liste)

Source: Company data, Daewoo Securities estimates

Analyst of the subject company or member of the analyst's household does not have any financial interest in the securities of the subject company and the nature of the financial interest (including without limitation, whether it consists of any option, right, warrant, future, long or short position)

This report is a translation of the Cowon Systems report written by Jin-hyuk Lee, analyst for research division of Daewoo Securities Co., Ltd publicly released on 10 July 2003

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Summarized version of this report available in Daewoo Securities, 'Korea Daily Focus' on 14 July 2003

Record of Ratings and Target Prices of the Subject Company

Code	Date	Recommendation	Target price (6M)
56000.KQ	10 July 2003 (before listing)	Overweight	W20,000

Rating Allocation

	% of companies under coverage	% for which IB services have been provided
Overweight	48.51%	2.10%
Equal-weight	50.99%	1.90%
Underweight	0.50%	0.00%

As of 4 July 2003, Source: Equity Research for International Investors, Daewoo Securities

Analyst Stock Ratings of ERII (Equity Research for International Investors), Daewoo Securities Co., Ltd

Risk Rating	Target Return
Overweight	> +15%
Equal-weight	-15% - +15%
Underweight	< -15%

- Rank is a guide to the expected total return over the next 6-12 months unless separately specified otherwise.
- The target return is relative to the market index, which is assumed to be constant at current level.
- Although it is not part of the official ratings at ERII, we may call a trading opportunity in case there is a technical or short-term material development.

Analyst Industry Ratings of ERII, Daewoo Securities

Positive	Industry fundamentals are improving
Neutral	Industry fundamentals are steady without any material changes
Negative	Industry fundamentals are worsening