17 October 2003

Cowon Systems

BUY

Computer hardware

More than an MP3 player

Price (15 Oct.) **W21,500**
Fair Value W30,000

Fair value of W30,000 with 39.5% upside potential We initiate our coverage on Cowon Systems with a BUY rating and fair value of W30,000, which is derived by DCF valuation based on the following assumptions: beta at 1.1, risk premium at 5.5% and terminal growth rate at 3%. The fair value implies a P/E multiple of 15.5x 2004E earnings, which compares to the historic average P/E of 22.1x for the small cap tech sector.

MP3 player on the verge of becoming a mainstream consumer product With improved performance and features, MP3 players are on the verge of becoming a mainstream product in the domestic and global markets, replacing portable CD players.

Reuters code: 56000.KQ
Bloomberg code: 056000 KS

High profitability to be maintained based on unique business structure Cowon is expected to enjoy strong earnings growth over the next three years, propelled by: 1) a focus on the high end segment of the MP3 player market, 2) declining flash memory prices, 3) limited growth in SG&A cost, and 4) sustained high margin of the mobile Internet division.

Year to Dec	Sales (W bn)	OP (W bn)	RP (W bn)	NP (W bn)	EPS (won)	Growth (%)	PER (x)	PCR (x)	EV/EBITDA (x)	PBR (x)	ROE (%)	Div. Yield (%)
2001	8.5	2.0	2.1	1.8	426	37.6	50.5	44.2	49.8	9.93	31.6	0.0
2002	16.8	3.2	3.1	3.6	853	100.2	25.2	22.9	31.7	8.81	42.6	0.0
2003E	33.3	5.6	5.6	4.7	1,000	17.2	21.5	19.2	17.0	5.58	30.8	1.2
2004E	56.8	12.3	12.1	10.3	1,933	93.3	11.1	10.3	7.7	4.04	42.1	2.1
2005E	81.6	15.0	14.8	12.6	2,360	22.1	9.1	8.3	6.0	3.07	38.3	3.2

KOSPI :	764.23p
KOSDAQ :	48.14p
Market Cap. :	W114.8bn/ US$98.0mn
Par Value :	W500
Outstanding Shares :	5.3mn
Free Floating Shares :	2.5mn (46.4%)
52-Week High/Low :	W25,100/ W14,550
60-Day. Avg. Trading Volume :	228,034 shrs
60-Day. Avg. Trading T/O :	W4,675mn

Foreign Ownership :		0.1%
Major Shareholders :	Park Nam-kyu	23.4%
	Jung Jae-wook	22.4%
	SK Telecom	6.3%
Absolute Performance :	3M	18.1%
	6M	n/a
	12M	n/a
Relative Performance to KOSDAQ:	3M	27.8%
	6M	n/a
	12M	n/a

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Key Assumptions

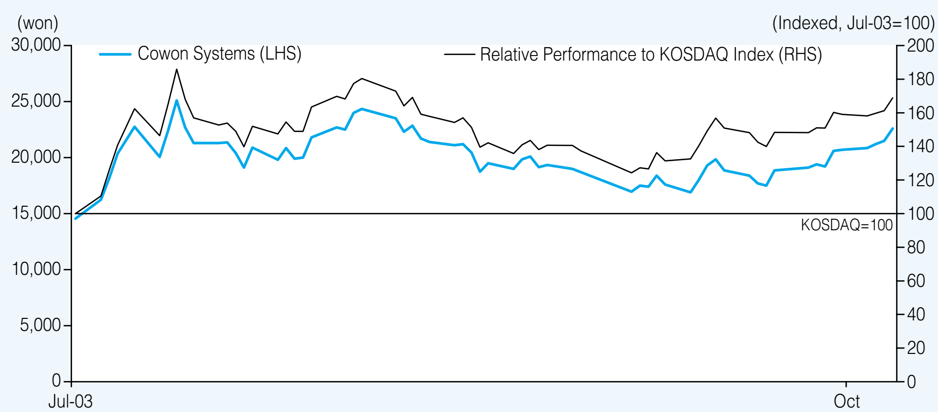
	2001	2002	2003E	2004E	2005E
Won/US$					
Year-average	1,290.9	1,251.5	1,184.6	1,113.8	1,040.0
Year-end	1,326.1	1,200.4	1,150.0	1,080.0	1,000.0
Real GDP Growth (%)	3.1	6.3	3.0	5.3	5.6
Private Consumption Growth (%)	4.1	2.7	3.6	3.1	1.8
3-yr Corporate Bond Yield (%)	7.0	6.6	5.6	6.1	5.9

Key Statistics

Year to Dec	2001	2002	2003E	2004E	2005E
Growth (%YoY)					
Sales	122.3	98.8	98.2	70.5	43.6
EBITDA	57.3	56.0	76.4	110.0	24.1
OP	55.4	57.9	78.1	117.4	22.2
RP	46.4	51.5	77.8	117.3	22.1
EPS	37.6	100.2	17.2	93.3	22.1
Profitability (%)					
EBITDA Margin	26.7	21.0	18.7	23.0	19.9
Operating Margin	23.7	18.8	16.9	21.6	18.4
Recurring Margin	24.5	18.7	16.8	21.4	18.2
ROA	28.0	36.3	26.1	34.6	30.6
ROCE	48.3	43.3	51.6	85.2	80.9
ROE	31.6	42.6	30.8	42.1	38.3
Stability					
Debt/Equity (%)	0.0	0.0	0.0	0.0	0.0
Net Debt/Equity (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Current Ratio (%)	402.0	358.7	482.0	407.1	392.0
Interest Coverage (x)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Net Debt (W bn)	(0.6)	(1.6)	(7.4)	(12.9)	(15.9)
Per Share Data (won)					
EPS	426	853	1,000	1,933	2,360
CFPS	486	938	1,121	2,082	2,587
BPS	2,165	2,439	3,850	5,324	6,996
SPS	2,013	4,003	7,012	10,637	15,279
EBITDA/Share	538	839	1,309	2,445	3,034
DPS	0	0	259	460	688

Source: Company data, Goodmorning Shinhan Securities estimates

Relative Share Price Performance



Investment summary

EPS to grow at 40% CAGR until 2005

We expect Cowon's earnings to grow at a CAGR of 40% over the next two years. The global and domestic MP3 player markets should experience strong growth, capturing a significant portion of the US$9.6bn global CD player market, given the MP3 player's superior portability, capacity and multiple features. By 2007, Cowon is expected to increase its share of the global market to 5% (vs. 1.8% in 2002) and that of the domestic market to 15% (vs. 9% in 2002).

Four risks, but not to pose a significant burden

We have identified four major risks regarding Cowon but don't believe they will impose a significant burden on the company:

1) Price competition and potential squeeze on margins: The anticipated rapid drop in flash memory prices, differentiation through the promotion of its brand, and a focus on the high end market segment should enable the company to avoid any squeeze on margins caused by price competition.

2) Convergence to handset: In the short term, handsets will not pose a serious competitive threat because of their limited battery and memory capacity. Even in the long run, handsets are unlikely to incorporate an MP3 player of sufficient quality that could threaten a standalone product

3) Threat from China: Because labor takes up only about 5% of the total manufacturing cost, the cost advantage of manufacturing in China is limited.

4) Listing of market leader Reigncom: Should Reigncom be listed on the stock market, investor interest in Cowon may diminish in the short term. However, given Cowon's long-term growth prospects, we believe any weakness in the stock price will be short-lived.

Our estimation is largely in line with consensus

The variance between consensus and our estimates for the fair value and earnings is not significant. The fair value consensus is W23,700, which is 21% lower than our estimate of W30,000, but it is distorted by an outlier of W14,300. The EPS consensus is W1,274 for 2003 and W1,858 for 2004, which are respectively 27.4% and 4% lower than our forecasts.

Fair value of W30,000 by DCF valuation

We estimate Cowon's fair value to be W30,000, implying a 39.5% upside potential from the current share price. We derived our fair value by DCF valuation based on the following assumptions: beta at 1.1, market risk premium at 5.5%, and terminal growth rate at 3%. Due to the lack of historical data – the company was listed on July 11, 2003 – we derived a beta of 1.08 by applying Hamada model to the domestic and foreign peers' historical betas as proxies. The fair value implies a P/E of 15.5x 2004E earnings, which compares to the historic average P/E for the small cap tech sector of 22.1x.

Catalysts

New product launches and the securing of a contract with a major overseas retail chain in the coming months should provide impetus to Cowon's share price in the short term. Cowon plans to launch two new products before the end of this year: a more compact player in October and a hard disk product in November. We are particularly optimistic about the prospects for the hard disk type product given its superior design and reasonable price of under W400,000. Meanwhile, Cowon is currently in the process of negotiating a contract with a large overseas retail chain. We have not included any contribution from the potential contract in our earnings estimates.

Valuation

Initiating coverage with BUY rating and fair value of W30,000

We estimate the fair value of Cowon Systems to be W30,000 based on DCF and the following assumptions: beta at 1.1, market risk premium at 5.5%, and terminal growth rate at 3%. As the company was listed on July 11, 2003, the historical beta could not be derived. So, we derived a beta of 1.08 by applying Hamada model to domestic and foreign peers' historical betas as proxies. The fair value implies a P/E multiple of 15.5x 2004E earnings, which compares to the historic average P/E for the small cap tech sector of 22.1x.

Fair value of W30,000 using DCF valuation

(W bn)	2003E	2004E	2005E	2006E	2007E
NOPLAT	4.6	10.1	12.2	16.2	23.2
Depreciation	0.4	0.4	0.6	0.8	1.1
Amortization & Non Cash Items	0.8	0.7	0.9	0.7	0.9
Gross Cash Flow	5.8	11.2	13.7	17.7	25.2
Increase in Working Capital	5.3	2.4	6.2	4.6	7
Increase in Tangible Assets	0.4	0.6	0.8	1.2	1.5
Increase in Intangible Assets	0.5	0.8	1.1	1.6	2.1
Increase in Investment Assets	0.2	1	0.8	0.7	0.7
Gross Investment	6.4	4.8	9	8	11.4
Free Cash Flow	(0.6)	6.4	4.7	9.7	13.8
NPV	(0.6)	5.8	3.9	7.2	9.2
Sum of NPV		152			
Net Debt		(7.4)			
Terminal Growth Rate (%)		3			
Firm Value		159.3			
Fair value (Won)		**29,840**			
Assumptions					
Beta (Adj.)		1.1			
Risk Free Rate (%)		4.9			
Risk Premium (%)		5.5			
WACC (%)		10.8			
Terminal Growth Rate (%)		3			

Source: Goodmorning Shinhan Securities estimates

DCF sensitivity analysis

WACC/Terminal Growth Rate	0%	1%	2%	3%	4%	5%	6%
7.8%	32,215	36,453	42,229	50,565	63,649	87,147	141,725
8.8%	28,241	31,395	35,517	41,134	49,242	61,967	84,822
9.8%	25,112	27,535	30,603	34,614	40,079	47,967	60,346
10.8%	22,588	24,497	26,855	29,840	33,743	39,061	46,736
11.8%	20,509	22,045	23,903	26,198	29,104	32,902	38,079
12.8%	18,770	20,026	21,521	23,330	25,564	28,393	32,091
13.8%	17,294	18,336	19,559	21,015	22,777	24,952	27,707

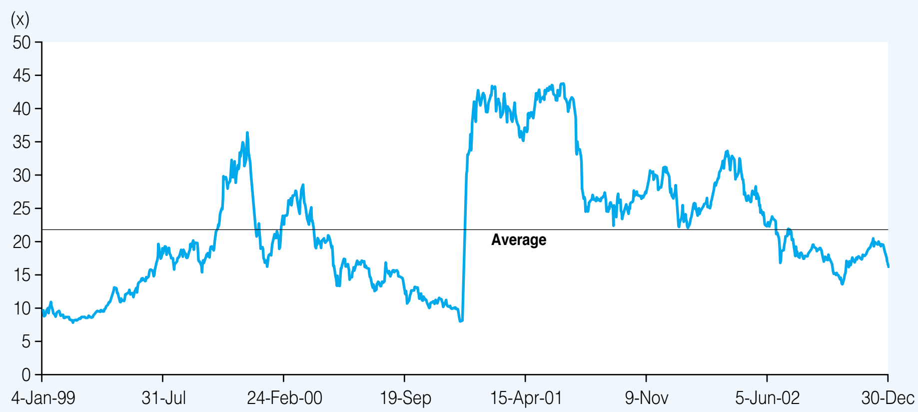
Source: Goodmorning Shinhan Securities estimates

Proxy beta calculation compared with peers

Peers	Beta	Tax rate (%)	Debt-equity ratio (%)	Unlevered beta
Creative Technology	1.46	8.10	10.40	1.33
Feelingk	1.07	13.70	0.00	1.07
Gaeasoft	1.04	12.80	0.00	1.04
Yaho Communication	1.11	17.30	0.00	1.11
Omnitel	0.91	15.90	8.40	0.85
Cowon's beta				1.08

Source: Bloomberg, Goodmorning Shinhan Securities

Historic average P/E for the small cap tech sector



Source: Goodmorning Shinhan Securities estimates

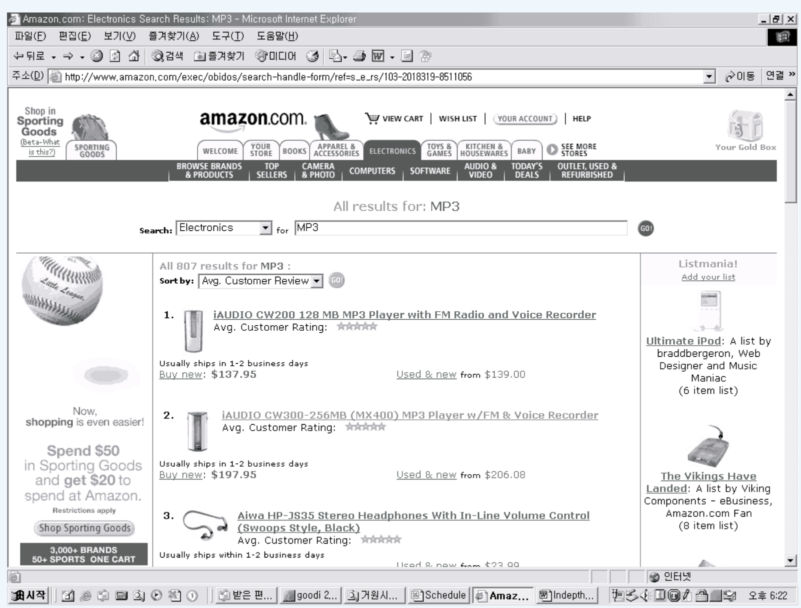
Background

Highest product quality proven by Amazon and CNet

Cowon's MP3 player (MP3P) brand is 'iAudio,' which has already achieved a high degree of brand recognition among early adaptors of the MP3P. The company has established a reputation for excellent sound quality based on its sophisticated digital audio technology, oriented from the multimedia software, 'JetAudio.' The strength of the company's brand and product quality is reflected in Cowon's high ranking by Amazon.com's customers and by CNet.

The domestic MP3P sector has undergone a major shakeout in recent years, with the number of manufacturers declining from 300 to 15~20 at present. In 2002, Cowon was the fourth largest producer in Korea with a 9% share of the domestic market. Its domestic MP3P sales accounted for 38% of its total sales. Cowon has targeted the overseas market since 2001, and in 2002 posted W4.8bn of export sales, mainly to the US, China/Hong Kong, and Europe. Exports of MP3P accounted for 28% of the company's total sales.

iAudio is No.1 in Amazon.com's customer rating

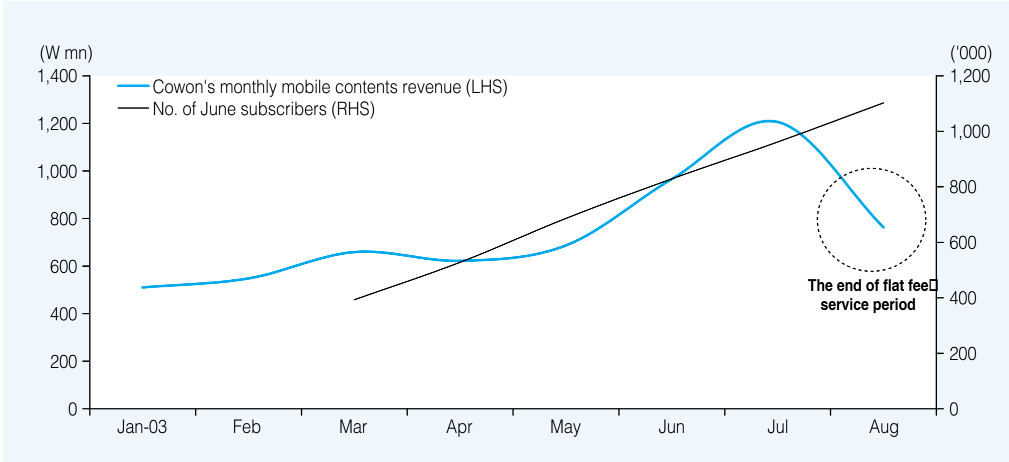


Source: Amazon.com

A major mobile Internet contents provider for SKT's June service

Cowon's other main business is the provision of mobile Internet contents, mainly for SKT's EV-DO service named 'June.' The mobile Internet contents division accounted for only 12% of operating profit as of 2002, but the figure should rise to 67% in 2003 due to high operating leverage. Cowon's ring tone and ring back tone download service named 'Live Bell' has been very successful, with monthly revenues exceeding W1.0bn in July propelled by the surge in the number of subscribers of 'June.' Unlike other mobile Internet contents providers, Cowon has established a high entry barrier for its 'Live Bell' service by entering into exclusive contracts with approximately 100 domestic music publishers for SKT's mobile Internet service. Since SKT is a major shareholder with a 6.29% stake, we expect the relationship between the two companies to remain solid, but growth will likely be limited due to competition with SKT's other subsidiaries such as Widerthan.com and the reluctance of other telecom companies to forge contracts with Cowon.

Cowon's revenue of mobile Internet contents and SKT's June subscribers



Source: SK Telecom, Company data

Unique marketing strategy with free software and Internet site

As do other suppliers, Cowon operates a website, 'iAudio.com' to promote its players and build customer loyalty. Available on the site is product information, downloads of its digital audio software 'JetAudio,' free contents for studying English, and a community chat room. Recently, Cowon released a new version of 'JetAudio' with limited functions for free.

'JetAudio' provides convenient functions such as audio CD burning and ripping, file format conversion, recording and Internet broadcasting, coupled with a high sound quality. All of Cowon's product sites and community contents are related with the promotion of MP3P.

Potential contracts with big retailers essential to stronger growth

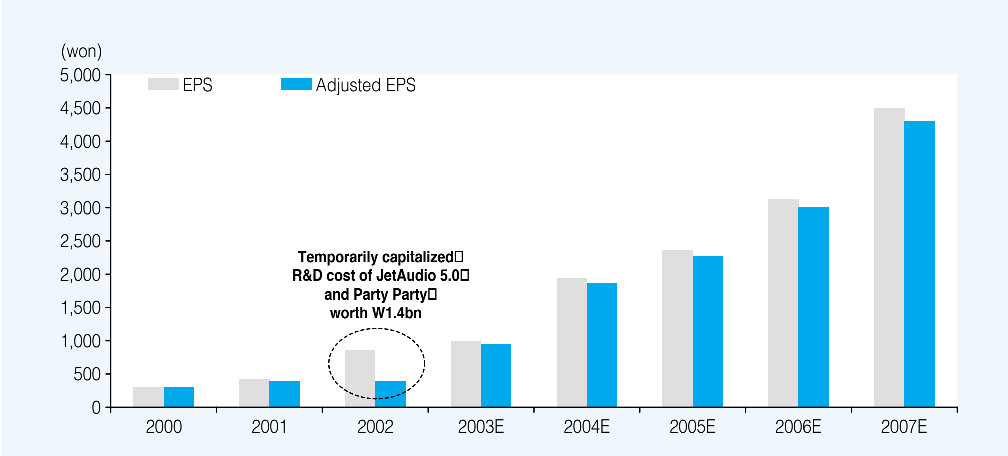
In order to expand its market coverage and maintain top-line growth, Cowon is seeking to widen its distribution channel in order to penetrate into the mainstream market. This could squeeze the margin slightly in the short term. The company is negotiating with a large retail outlet in a major overseas market. If Cowon concludes a contract with the retailer, it will be a catalyst for the share price because top-line growth should be strong enough to offset the short-term margin deterioration.

Earnings estimates

EPS to grow at 40% CAGR until 2005

We forecast the company's net profit to grow at a CAGR of 52% and EPS to grow at a CAGR of 40% for the period 2002~2005, driven by strong growth in demand for MP3Ps as this product gains popularity with mainstream consumers and eats into the market for CD players. Adjusted EPS reflecting capitalized R&D cost is expected to be just 3~5% lower than normal EPS. But in 2002, adjusted EPS was 53% lower than normal EPS because the R&D cost for the new version of 'JetAudio' and 'Party Party' amounting to W1.4bn was capitalized.

EPS and adjusted EPS forecast



Source: Goodmorning Shinhan Securities estimates

High profitability sustained by high price strategy and mobile Internet

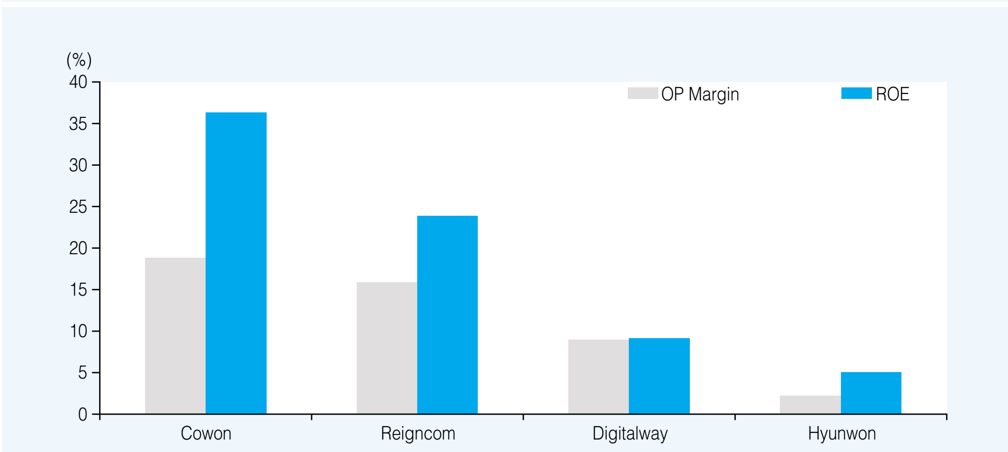
Cowon's profitability is the highest among Korean MP3P companies due to:

1) High end pricing strategy enabled by high quality, brand and time-to-market functions;

2) The mobile Internet contents business maintaining a more than 50% gross profit margin based on the high entry barrier and high operating leverage;

3) Cost effective marketing and R&D process resulting in lower SG&A growth than gross profit growth.

Profitability comparison with domestic competitors



Source: KISLINE

Exports to reach W40.7bn in 2005

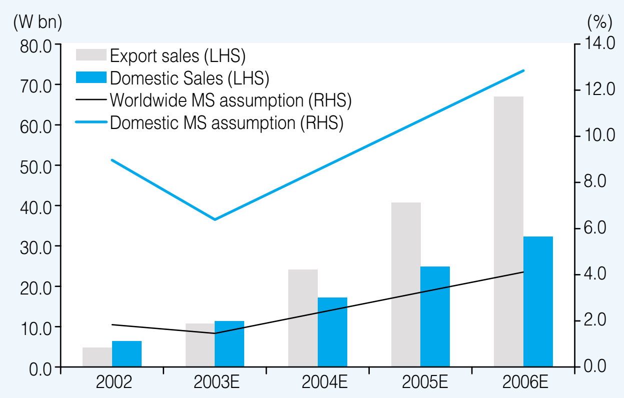
We expect Cowon's MP3 player exports to reach W40.7bn in 2005, growing at 104% CAGR, while domestic sales are forecast to reach W24.9bn for a CAGR of 57% based on the following assumptions:

1) We estimate Cowon's worldwide market share will climb to 3.2% in 2005 from 1.8% in 2002. Our view is conservative when compared with the expected global market share of domestic competitor Reigncom (over 20% in 2003).

2) Cowon's domestic market share is likely to shrink to 6.8% this year from last year's 9% due to the aggressive marketing by Reigncom. But it should recover to 8.9% in 2003 and reach around 15% in the long term given its high product quality, brand and design.

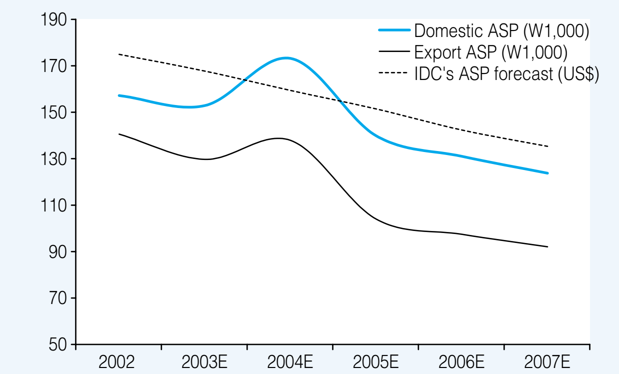
3) The company's domestic average sales price (ASP) is expected to decrease at 5% CAGR until 2007. This is similar to the worldwide average level projected by IDC. However, we conservatively expect Cowon's export ASP will decline at 8% CAGR during the same period by reflecting our house view for a continuous drop of the won/US$ rate.

Market share assumption and MP3 player sales forecast



Source: Goodmorning Shinhan Securities estimates

ASP forecast in domestic and overseas market



Source: Goodmorning Shinhan Securities estimates

Mobile Internet contents growth to be limited

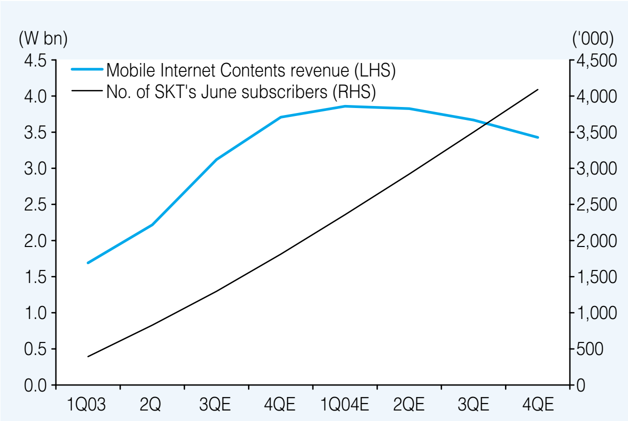
Despite the recent surge in SKT's 'June' subscriber base, we do not foresee continued growth in Cowon's mobile Internet contents revenue due to the following:

1) The 'June' service is in its early stage; therefore there are only a few contents providers, most of which are subsidiaries of SKT. If more contents providers link up with SKT as the subscriber base expands, this could weaken Cowon's position.

2) The potential competition with SKT's subsidiaries such as Widerthan.com and the difficulties with landing contracts with other telcos will crimp the growth of Cowon's mobile Internet division revenue.

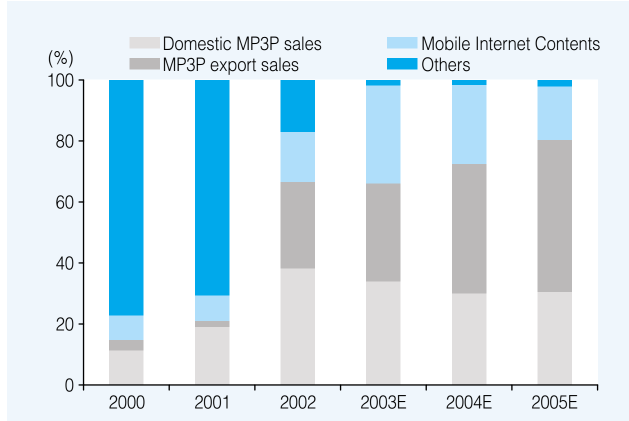
Therefore, we estimate the mobile Internet content sales to be W14.8bn in 2004 and sales thereafter to be flat. For 2005, we estimate that MP3P export sales will account for about 50% of total sales, domestic MP3P sales about 30% and mobile Internet contents about 18%.

Quarterly revenue of mobile Internet contents



Source: Goodmorning Shinhan Securities estimates

Sales portion by product

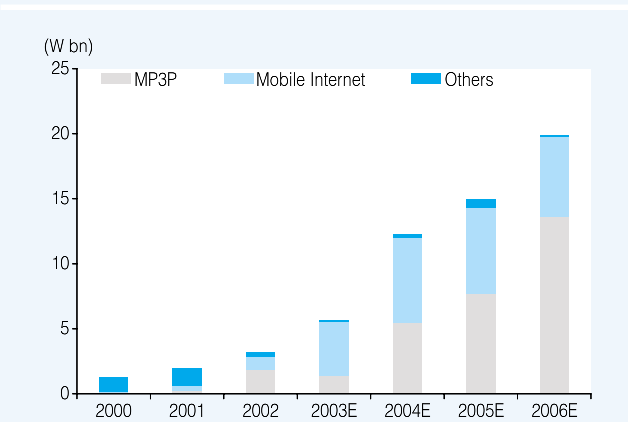


Source: Goodmorning Shinhan Securities estimates

Cowon's business portfolio should keep its OP margin stable

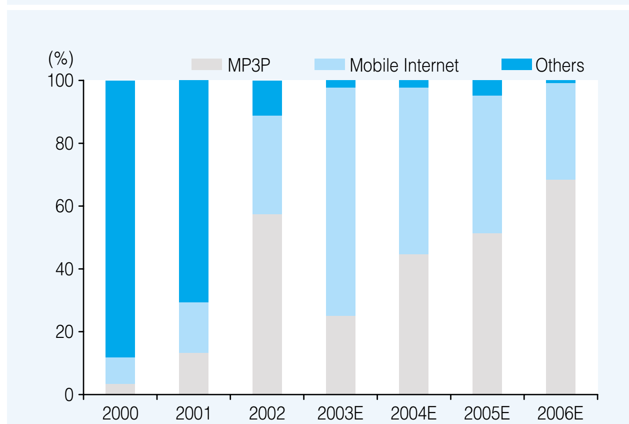
Cowon is expected to maintain a stable OP margin due to the different nature of its two businesses, MP3P and mobile Internet. The continuous GP margin squeeze and sharply rising marketing expenses will pressure the OP margin of the MP3P business in the short term. We expect the OP margin of MP3P to tumble to the 6% level this year, down by 10%p from 16% in 2002. But this should be offset by the mobile Internet division's high OP margin of 38%, leading to only a slight decline in the overall OP margin to the 17% level in 2003. However, we expect that the OP margin of MP3P will recover to 13% to enable a total OP margin recovery to 22% in 2004.

Operating profit by product



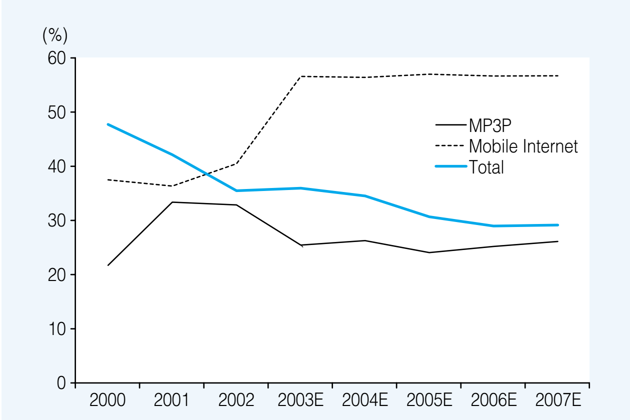
Source: Goodmorning Shinhan Securities estimates

Operating profit contribution by product



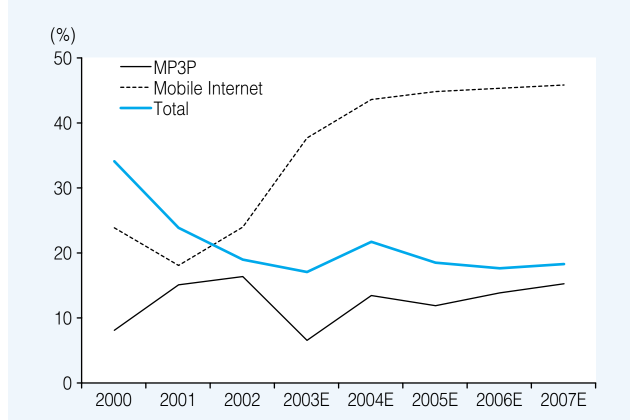
Source: Goodmorning Shinhan Securities estimates

GP margin by product



Source: Goodmorning Shinhan Securities estimates

OP margin by product



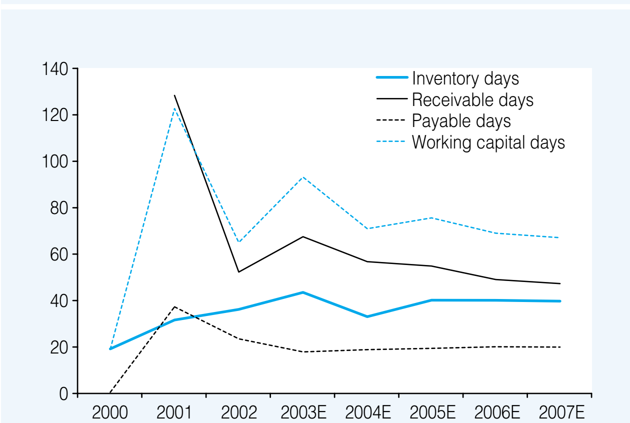
Source: Goodmorning Shinhan Securities estimates

High activity ratio due to production-on-demand and growing exports

One of Cowon's strong points is its efficient working capital management based on production-on-demand and short working capital days of 65 as of 2002. Having two outsourcing partners for manufacturing, Cowon has adopted production-on-demand, which allows it to respond flexibly to demand and tight production schedules. This method is enabled by the company's just-in-time raw material procurement, short inventory days of 36 as of 2002, and relations with stable component suppliers such as Samsung Electronics.

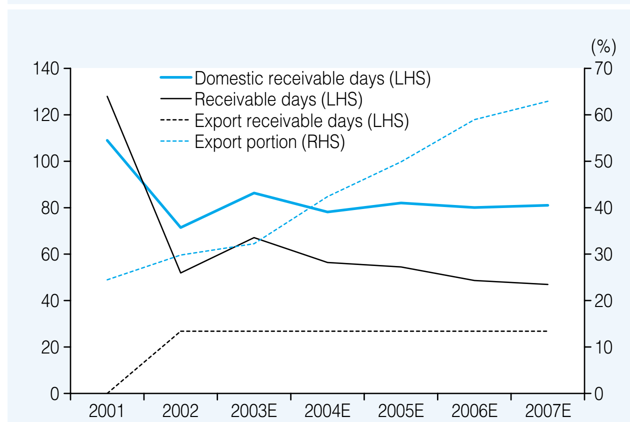
Receivable days have fluctuated depending on payments for the mobile Internet service. Although some receivables from SKT are collected after 60 days, the company has little difficulty in collecting receivables. And they could decrease, as the sales contribution of exports is expected to rise and export sales' receivable days is less than 30 days.

Working capital days forecast



Source: Goodmorning Shinhan Securities estimates

Receivable days breakdown and export ratio



Source: Goodmorning Shinhan Securities estimates

3Q results likely to present a good buying opportunity

We expect that 3Q results will slightly deteriorate because of the following:

1) Cowon's new products will be released in October and November, therefore MP3 player sales in 3Q are expected to be sluggish.

2) Cowon decided to cut the prices of existing products before the new product launch. This will also be negative for 3Q earnings.

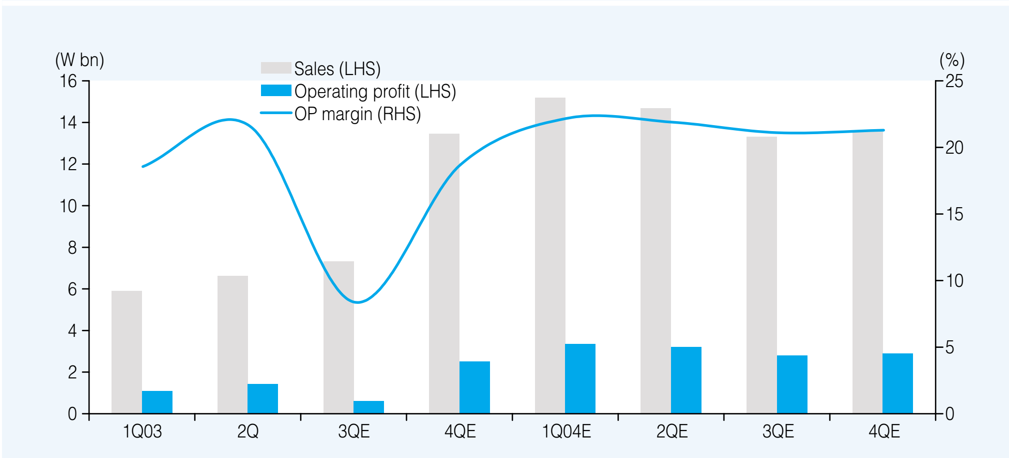
3) The price of flash memory temporarily rose in 3Q. Although Cowon procures flash memory at contract price, the margin should slightly deteriorate.

However, we have a sanguine outlook for 4Q earnings considering the seasonal effect and the launching of new products.

1) Christmas and graduation demand: Since MP3P is a very popular item among teenagers, they make good Christmas and graduation gifts; thus 1Q and 4Q are the peak demand seasons.

2) Reasonable price and attractive design of new products: Cowon plans to launch two new products within this year. The first one, which will be the most compact among Cowon's products, is scheduled for October launching. The second one, scheduled for November, is a hard disk type product that is cheaper and slimmer than competing products supplied by Apple and Reigncom. We are particularly optimistic about the hard disk type product due to its superior design and reasonable price.

Quarterly sales and OP forecast



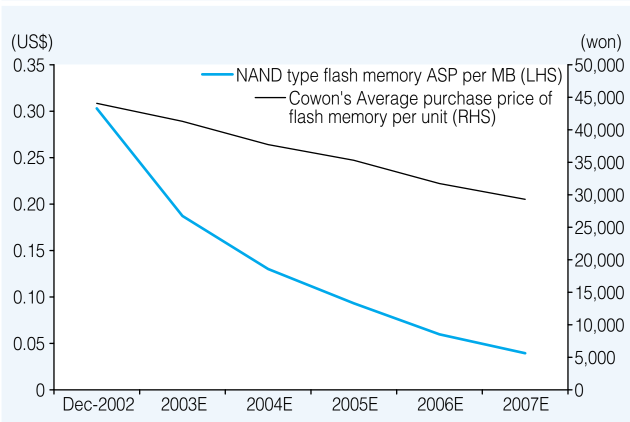
Source: inews24

A major concern regarding the MP3P market is fierce price competition and the potential for margins being compressed due to low entry barriers. However, as the market evolves, the gap between the leading companies and the chasers will likely widen. We expect the market leaders to maintain their profitability levels helped by the following factors:

1) The most critical factors for success in the mainstream market are brand, marketing and design. The leading companies are expected to generate sufficient cash flow to invest in these areas.

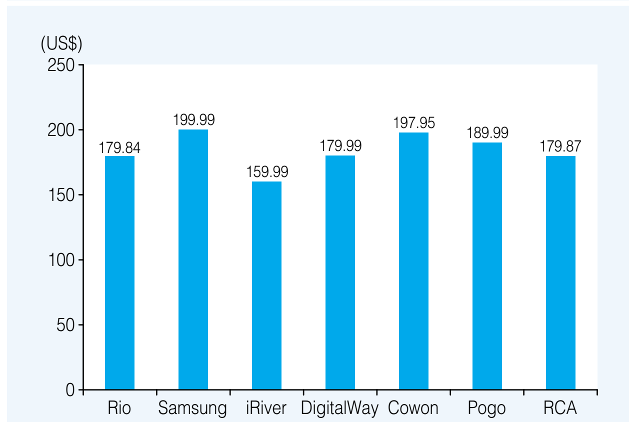
2) Flash memory prices continue to fall due to technological advances. The decline is expected to be of sufficient magnitude to offset the product price decline to some extent. Leading companies have an advantage with their long-term contracts with Samsung Electronics.

Forecast for flash memory ASP per MB and Cowon's purchase price



Source: Gartner Dataquest, Goodmorning Shinhan Securities estimates

Price comparison of 256MB MP3 players



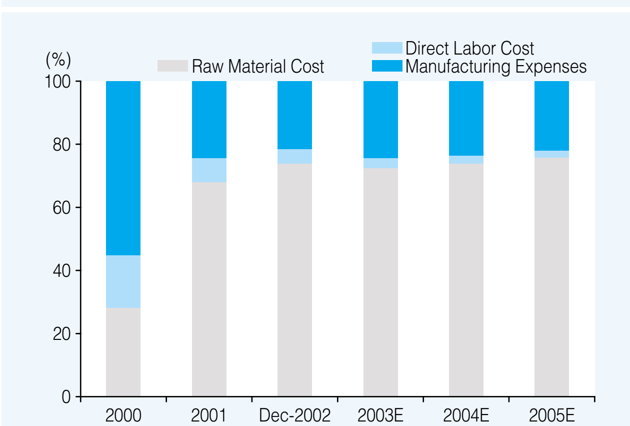
Source: Amazon.com

Note: Based on the most expensive product sold by vendors.

China's low cost labor poses a limited threat

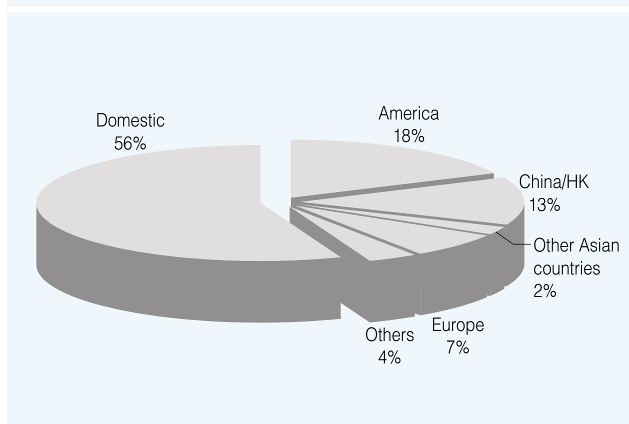
China does not represent a significant threat at this stage because labor accounts for only a small proportion of cost (5%). On the contrary, China will be a significant market for MP3 players and already was Cowon's second largest export market in 1H03.

COGS structure



Source: Company data, Goodmorning Shinhan Securities estimates

MP3P sales breakdown by destination in 1H03



Source: Company data

Industry outlook

Worldwide MP3 player market to reach US$3.4bn in 2007

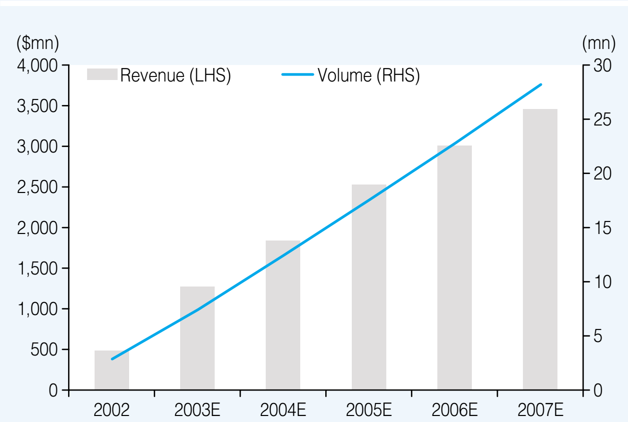
We expect the worldwide MP3 player market to reach US$3.4bn (W3.6tr) in 2007, growing at 48% CAGR. The domestic MP3 market is forecast to reach W278.5bn, for a CAGR of 31% for the same period. The projections are based on the following assumptions:

1) In the worldwide market, MP3 players will replace about 22.5% of the total CD player market in 2007. The replacement rate should reach that level earlier in the domestic market, probably in 2005.

2) In the domestic market, MP3 players will replace about 30% of the CD player market in 2007, which implies a replacement rate of 2x in 2003.

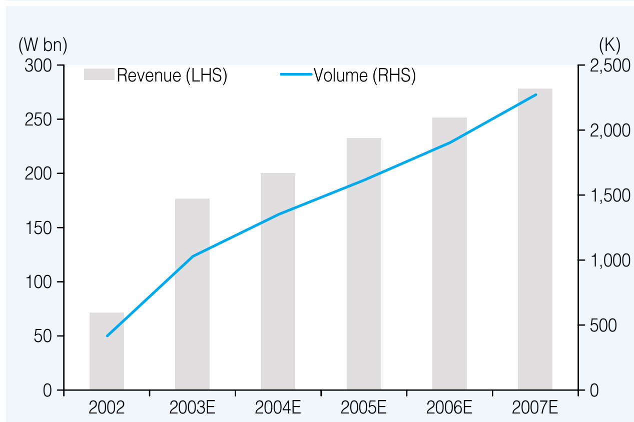
3) Average price per unit of MP3 players will decrease at 5% CAGR until 2007.

Worldwide MP3P market revenue and volume



Source: Goodmorning Shinhan Securities estimates

Domestic MP3P market revenue and volume



Source: Goodmorning Shinhan Securities estimates

Explosive growth of the domestic market

We expect the domestic MP3 player market to grow at 31% CAGR until 2007, which is higher than the 24% growth forecast by research firms. Garter Dataquest predicted that the Korean digital audio market will be worth US$54mn in 2003, but it is estimated that this figure was already surpassed in the first half of 2003. We estimate the domestic MP3 market in 2003 will increase by 131% YoY to reach W165.6bn on the following premises:

1) The number of MP3 players sold by Reigncom (brand: iRiver) in only the domestic market was 217,000 in 1H03.

2) Reigncom estimates its domestic market share to be about 50%. Based on this figure, we expect that about 1 million MP3 units will be sold in Korea in 2003.

3) Reigncom's growth was helped by the home shopping channels. We believe this is the signal of a transition from the early market to the mainstream market.

No. of units sold by the top-five Korean MP3 player companies in 1H03

('000)	Domestic	Export	Sum
iRiver	217	258	475
Digitalway	60	140	200
Samsung Electronics	60	120	180
Hyunwon	46	68	114
Cowon	37	24	61
Sum	420	610	1,030

Source: iNews24

MP3P, a substitute for portable CD players

We expect that MP3 players will replace portable CD players.

1) MP3 players are much smaller and lighter than portable CD players. When jogging or hiking, MP3 players are much preferred to portable CD players or cassette tape recorders.

2) Although free MP3 file download sites such as Napster were shut down, free files can be still acquired by peer-to-peer (P2P) software with security.

3) MP3 players have a large memory and reasonable price due to the continuous drop of flash memory price. Over 50 songs can be saved in a 256MB MP3 player.

4) MP3 players have various functions such as FM radio, voice recorder, portable storage, etc. More and more functions will be added to MP3 players, as is the case with handsets.

Crackdown on P2P exchanges not to impact the proliferation of MP3

We believe the recent crackdown on free MP3 exchanges using P2P software such as Kazaa, Morpheus and iMesh will not have a significant impact on the MP3 player market.

1) By adopting security functions, free MP3 exchanges using P2P software are becoming harder to investigate.

2) The number of people using P2P MP3 exchanges may drop due to the complex method of secure transaction. In that case, people will not revert to using CD players or cassette tape recorders because they are already accustomed to the convenience of the MP3P. Instead, they are likely to use legal fee-paying MP3 download sites if the prices are reasonable and there is a wide selection.

HDD type player, a new market opportunity

Another new opportunity in the MP3 player market is the hard disk driver (HDD) type MP3 player. Apple's iPod is the dominant product and Apple is the pioneer in this market. Korean companies are trying to penetrate into this market by releasing new HDD type products. iRiver already released its new HDD type product and Samsung, Cowon and Digitalway are on the verge of launching the same type of products. The HDD type market is expected to grow faster than the flash memory type market due to the following:

1) The HDD type player adopts over 10GB HDD, so it will replace external HDD (portable storage device) as well as portable audio devices.

2) Some people are using HDD type players in place of automotive CD changers because the HDD type player can carry more than 2,000 songs.

3) HDD type players are likely to evolve into portable multimedia players by adopting MPEG and DVD player functions.

Hard disk type products from Apple and Reigncom

Source: Amazon.com

Convergence to handset limited for the time being

Another critical risk is the potential convergence to handset or PDA. We believe this risk will not be significant within the next 2~3 years and even thereafter, as MP3 player companies will be able to confront the challenge.

1) Due to the limited battery and memory capacity, the threat posed by handsets containing the MP3 player function looks limited for now. There are several handsets playing MP3 files in the market, but they usually run out of battery in only 2~3 hours.

2) The biggest strength of the MP3 player is that it's small and light enough to carry while engaging in sports activity. However, scaling down the size of a handset to that of an MP3 player isn't easy due to the basic phone function and keypad.

3) Even if the convergence is near at hand due to technological advance, most leading MP3 player companies are preparing for this and will be able to meet the challenge by various methods such as alliances with handset companies.

Company profile

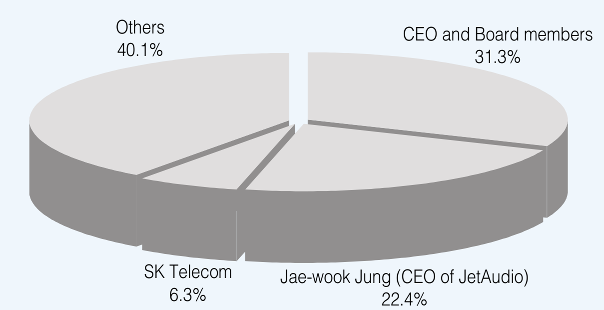
Digital audio specialist famous for 'JetAudio' software

Cowon Systems has changed its business focus since its incorporation in 1995 in response to the changing market. It currently specializes in digital audio technology including digital audio software/hardware and contents. The company started its business with voice recognition and text-to-speech (TTS) software technology. In 1997, it changed the main business to digital audio software due to the lack of profitability in the voice recognition market and developed its well-known software 'JetAudio.' About 10 million people are estimated to have used 'JetAudio' which is still popular in WAREZ sites (illegal free download sites). However, Microsoft and Nullsoft (Winamp) made their digital audio software and made them available for free, forcing Cowon to change its business focus to hardware and mobile Internet. The company released its first MP3 player named 'iAudio' in October 2000 and posted W11.2bn of sales in the domestic and worldwide market in 2002.

Management and shareholder structure

Half of Cowon's board members are alumni who graduated from the same department of the technical college at Seoul National University. The CEO and two technical directors have served in Samsung Electronics and LG Electronics. Cowon's management philosophy: Where there is competition, there is something to gain. Four of the six board members and the CEO of the US subsidiary named 'JetAudio' are major shareholders owning 68.2% of total shares. SKT has a 6.3% stake but is likely to cash out sometime in the future because SKT's main investment objective is capital gain. It seems that the overhanging shares that domestic institutional investors acquired through the IPO already came out into the market, which resulted in a temporary weakness in the share price.

Shareholder structure



Source: Company data (as of 1H03)

Appendix : Financial Statements

Balance Sheet

Year to Dec (W bn)	2001	2002	2003E	2004E	2005E
Total Assets	**7.7**	**12.0**	**24.4**	**35.3**	**47.1**
Current Assets	4.4	5.9	17.7	27.1	37.4
Cash & Cash Equivalent	0.6	1.6	7.4	12.9	15.9
Financial Goods	0.0	0.0	0.0	0.0	0.0
Marketable Securities	0.0	0.0	0.0	0.0	0.0
Acc'ts & Notes Rec.	3.0	2.4	6.1	8.8	12.2
Inventories	0.7	1.7	3.9	5.1	8.9
Others	0.1	0.2	0.3	0.4	0.4
Fixed Assets	3.3	6.1	6.6	8.2	9.7
Investment Assets	2.8	3.9	4.1	5.1	5.9
Tangible Assets	0.3	0.3	0.4	0.6	0.8
Others	0.2	1.9	2.1	2.5	3.0
Total Liabilities	**1.1**	**1.7**	**3.8**	**6.8**	**9.8**
Current Liabilities	1.1	1.6	3.7	6.7	9.5
Acc'ts & Notes Pay.	0.7	0.1	1.0	1.5	2.4
S-T Borrowings	0.0	0.0	0.0	0.0	0.0
Cur. Por. of L-T Debt	0.0	0.0	0.0	0.0	0.0
Others	0.4	1.5	2.7	5.2	7.2
Long-Term Liabilities	0.0	0.1	0.1	0.2	0.2
Bonds	0.0	0.0	0.0	0.0	0.0
L-T Debt	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.1	0.1	0.2	0.2
Shareholders' Equity	**6.6**	**10.2**	**20.6**	**28.4**	**37.4**
Paid-In Capital	1.5	2.1	2.7	2.7	2.7
Capital Surplus	1.5	0.9	7.2	7.2	7.2
Retained Earnings	3.5	7.1	10.5	18.3	27.3
Capital Adjustment	0.1	0.2	0.2	0.2	0.2

Source: Company data, Goodmorning Shinhan Securities estimates

Profit and Loss

Year to Dec (W bn)	2001	2002	2003E	2004E	2005E
Sales	**8.5**	**16.8**	**33.3**	**56.8**	**81.6**
Cost of Sales	4.9	10.9	21.4	37.3	56.7
Cost of Goods Manuf.	5.1	10.9	21.5	37.4	56.7
Material Cost	3.5	8.6	15.0	28.5	47.0
Labor Cost	0.4	0.6	0.8	1.0	1.2
Depreciation Cost	0.2	0.3	0.3	0.4	0.5
Others	1.0	1.4	5.3	7.5	8.1
Gross Profit	**3.5**	**5.9**	**11.9**	**19.5**	**24.9**
SG & A Expenses	1.5	2.8	6.3	7.3	9.9
Personnel Expense	0.4	0.6	0.8	1.0	1.2
Depreciation Expense	0.0	0.0	0.0	0.1	0.1
Sales Expense	0.2	0.4	2.9	2.7	3.9
Admin. Exp. & Others	0.9	1.7	2.6	3.5	4.8
Operating Profit	**2.0**	**3.2**	**5.6**	**12.3**	**15.0**
Non-Operating Items	0.1	(0.0)	(0.1)	(0.1)	(0.2)
Interest Received	0.1	0.0	0.2	0.3	0.5
Interest Paid	0.0	0.0	0.0	0.0	0.0
Disposal of Assets	0.0	(0.0)	(0.0)	(0.0)	(0.0)
Net FX Gain	(0.0)	(0.1)	(0.2)	(0.5)	(0.7)
Net Equity Method Gain	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.1	0.0	0.0	0.1
Recurring Profit	**2.1**	**3.1**	**5.6**	**12.1**	**14.8**
Net Extraordinaries	0.0	0.0	0.0	0.0	0.0
Pretax Profit	2.1	3.1	5.6	12.1	14.8
Taxes	0.3	(0.4)	0.8	1.8	2.2
Net Profit	**1.8**	**3.6**	**4.7**	**10.3**	**12.6**
EBITDA	2.3	3.5	6.2	13.1	16.2

Source: Company data, Goodmorning Shinhan Securities estimates

Cash Flow

Year to Dec (W bn)	2001	2002	2003E	2004E	2005E
Operating Cash Flow	**0.4**	**3.4**	**0.6**	**9.2**	**8.1**
Net Profit	1.8	3.6	4.7	10.3	12.6
Depreciation&Amortization	0.3	0.4	0.6	0.8	1.2
FX Amortization&Translation	(0.0)	0.0	0.0	0.0	0.1
Change in Working Capital	(1.9)	(1.0)	(5.3)	(2.4)	(6.2)
Others	0.2	0.5	0.6	0.5	0.5
Investment Cash Flow	**(2.1)**	**(2.5)**	**(1.8)**	**(2.3)**	**(2.7)**
CAPEX	(0.5)	(2.1)	(0.9)	(1.4)	(2.0)
Asset Disposal	0.0	0.0	0.0	0.0	0.0
Net Investment	(1.7)	(0.3)	(0.9)	(0.9)	(0.7)
Others	0.1	(0.1)	(0.1)	(0.0)	(0.1)
Free Cash Flow	**(1.8)**	**1.0**	**(1.1)**	**6.8**	**5.4**
Financing Cash Flow	**0.0**	**(0.0)**	**6.9**	**(1.4)**	**(2.5)**
Dividend	0.0	0.0	0.0	(1.4)	(2.5)
Change in Share Capital	0.0	0.0	6.9	0.0	0.0
Net Change in Debt	0.0	0.0	0.0	0.0	0.0
Others	0.0	(0.0)	0.0	0.0	0.0
Change in Cash	**(1.8)**	**1.0**	**5.8**	**5.5**	**2.9**
Change in Net Debt	**1.8**	**(1.0)**	**(5.8)**	**(5.5)**	**(3.0)**

Source: Company data, Goodmorning Shinhan Securities estimates

GOODMORNING SHINHAN NETWORK

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GMSH Rating Classifications: BUY; Over +15%, HOLD; -15% to +15%, REDUCE; -15% or More (As of 10 Feb. 2003)