

6 May 2004

Cowon Systems (056000)

Analyst Jong Gil Hong (768-5828)
jonggil@truefriend.com

Rising trend for MP3 exports to continue

Rating : Buy Closing price 4 May 2004: W16,350 Price target: W20,000

- **Maintain Buy with a target price of W20,000:** We cite the following reasons: 1) Cowon Systems' sales and operating profit in 1Q04 increased sharply qoq and yoy, recovering from its slump in 2H03; 2) rising exports are expected due to improving sales of the HDD (hard disk) type MP3 player 'iAudio M3' in the Japanese market; and 3) the diversification in the product lineup with the launch of the miniature Flash memory type 'iAudio U2' MP3 player in May 2004.
- Sales and net profit in 1Q04 surged 183.0% and 101.2% yoy to reach W16.7bn and W2.0bn. Improved sales of wireless Internet and MP3 players led to strong operating results for 1Q04. However, the operating profit margin of 12.6% fell short of our estimate due to increased COGS and SG&A expenses, which included the exchange cost for defects (initial volume for iAudio4 launched in December 2003), R&D, labor, and advertising.
- The sales jump of 451.7% yoy in wireless Internet contents stood out in 1Q04 as Cowon's main client, SK Telecom, stepped up its marketing campaign in December 2003 and March 2004, promoting wireless Internet use, which bolstered contents sales. However, despite the high sales growth for contents, with its minor sales weight, sales profitability for wireless Internet came in rather low. We view that number portability should allow SK Telecom to lure KTF subscribers from July 2004. We also expect SK Telecom to boost its marketing activity by the introduction of a fixed monthly fee system for wireless Internet use and by discounting rates. As such, we anticipate Cowon's wireless Internet contents sales to increase, reflecting SK Telecom's elevated marketing efforts.
- MP3 player sales was up 75.4% yoy in 1Q04, recovering from product defects for 'iAudio4' MP3 player, which hampered earnings in 4Q03. In particular, exports surged 198.5% yoy in 1Q04. We view the visible sales of the HDD MP3 player in the Japanese market, launched in March 2004, to be encouraging. We expect the exports uptrend to continue in 2Q04, further aided by the launch of 'iAudio U2' in May 2004.
- Reflecting strong 1Q04 operating results, we upgrade our 2004-2005 earnings forecast. Sales and net profit forecasts for 2004 were revised up 2.8% and 1.1%.

Cowon Systems		May 4, 2004 / W16,350 / Mkt cap: US\$75.1mn, KRW88.1bn									
Yr to Dec	Sales (W bn)	OP (W bn)	RP (W bn)	NP (W bn)	EPS (Won)	chg. yoy (%)	EBITDA (W bn)	P/E (x)	EV/EBITDA (x)	PBR (x)	ROE (%)
2002A	16.8	3.2	3.1	3.6	853	45.1	3.4	NM	NM	NM	42.6
2003A	26.4	3.3	3.4	3.0	640	-25.0	3.7	31.2	29.4	6.6	19.8
2004F	48.5	7.7	7.7	6.6	1,224	91.2	8.1	13.4	10.4	4.1	27.8
2005F	62.8	9.0	9.3	8.0	1,480	20.9	9.5	11.0	8.5	3.1	25.7
2006F	80.0	11.0	11.4	9.1	1,687	14.0	9.5	9.7	6.7	2.5	23.0

Source: Company data, Dongwon Securities estimates

Quarterly earnings results

(W 100mn, %)	1Q03	4Q03	FY03	1Q04P	1Q04F	Diff.	Diff. %	2Q04F
Sales	5,912	7,066	26,401	16,734	11,207	5,527	49.3	10,910
chg. yoy	89.4	61.2	57.0	183.1	89.6			64.9
OP	1,093	383	3,267	2,114	1,871	243	13.0	1,364
chg. yoy	238.9		3.2	93.4	71.2			-4.5
RP	1,152	545	3,445	2,264	1,925	339	17.6	1,381
chg. yoy	239.5		9.6	96.5	67.1			-0.1
NP	993	379	3,040	1,998	1,639	359	21.9	1,176
chg. yoy	193.1		-15.1	101.2	65.1			5.9
OP margin	18.5	5.4	12.4	12.6	16.7	4.4	26.3	12.5
RP margin	19.5	7.7	13.0	13.5	17.2	6.1	35.7	12.7
NP margin	16.8	5.4	11.5	11.9	14.6	6.5	44.4	10.8

Source: Company data, Dongwon Securities estimates

Quarterly sales by division

(W 100mn, %)	FY02	1Q03	2Q03	3Q03	4Q03	FY03	1Q04
MP3 players	12,186	4,091	4,273	3,955	4,817	17,136	7,176
chg. yoy	189.5					40.6	75.4
Exports	4,767	1,084	2,445	1,023	1,958	6,511	3,236
chg. yoy	2,686.7					36.6	198.5
Domestic	7,419	3,008	1,827	2,932	2,858	10,625	3,940
chg. yoy	83.7					43.2	31.0
Wireless Internet	3,901	1,717	2,275	2,782	2,169	8,944	9,475
chg. yoy	283.0					129.3	451.7
Others	725	103	66	69	80	321	83
chg. yoy	-77.5					-55.7	-19.7
Total	16,811	5,912	6,613	6,807	7,066	26,401	16,734
chg. yoy	98.8					57.0	183.0

Source: Company data

Adjusted earnings forecast (2004~2005)

(W bn, W, %)	Before		After		chg. Yoy	
	2004F	2005F	2004F	2005F	2004F	2005F
Sale	47.2	60.4	48.5	62.8	2.8	3.9
OP	7.4	9.3	7.7	9.0	3.2	-3.0
RP	7.7	9.7	7.7	9.3	1.1	-4.4
NP	6.5	8.3	6.6	8.0	1.1	-4.4
EPS	1,211	1,548	1,224	1,480	1.1	-4.4
OP margin	15.8	15.4	15.8	14.3		
RP margin	16.2	16.0	16.0	14.7		
NP margin	13.8	13.8	13.6	12.7		

Source: Dongwon Securities estimates

Change in recommendation & target price

Company (Code)	Date	Recommendation	Target price
Cowon Systems	08/12/03	Buy	W29,000
(056000)	09/23/03	Strong Buy	W29,000
	11/06/03	Strong Buy	W26,300
	12/19/03	Buy	W26,300
	02/16/04	Buy	W20,000

Balance Sheet

Year to Dec. (Wbn)	2001A	2002A	2003A	2004F	2005F	2006F
Current Assets	4.4	5.9	16.4	24.0	32.2	40.6
Cash & Cash Equivalent	0.6	1.6	1.6	6.5	10.2	12.9
Accounts Receivable	3.0	2.4	4.7	8.6	11.1	14.2
Inventory	0.7	1.7	8.9	6.8	8.2	10.0
Fixed Assets	3.3	6.1	11.8	12.2	13.8	15.9
Investments	2.8	3.9	6.9	5.9	5.9	5.9
Tangible Assets	0.3	0.3	0.8	1.0	1.1	1.3
Intangible Assets	0.2	1.9	4.1	5.3	6.8	8.7
Total Assets	7.7	12.0	28.2	36.2	46.1	56.5
Current Liabilities	1.1	1.6	7.6	8.9	10.8	12.0
Accounts Payable	0.7	0.1	1.7	2.9	4.4	5.6
Short-term Borrowing	0.0	0.0	4.8	4.8	4.8	4.8
Cur. Por. of LTD	0.0	0.0	0.0	0.0	0.0	0.0
Fixed Liabilities	0.0	0.1	0.1	0.2	0.3	0.4
Debentures	0.0	0.0	0.0	0.0	0.0	0.0
Long-term Borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Total Liabilities	1.1	1.7	7.7	9.1	11.1	12.4
Paid-in Capital	1.5	2.1	2.7	2.7	2.7	2.7
Capital Surplus	1.5	0.9	7.6	7.6	7.6	7.6
Retained Earnings	3.5	7.1	10.1	16.7	24.7	33.8
Capital adjustment	0.1	0.2	0.0	0.0	0.0	0.0
Shareholders' equity	6.6	10.2	20.4	27.0	35.0	44.1

Income Statement

Year to Dec. (Wbn)	2001A	2002A	2003A	2004F	2005F	2006F
Total Sales	8.5	16.8	26.4	48.5	62.8	80.0
Gross Profit	3.5	5.9	7.5	14.5	17.2	20.9
SG&A Expenses	1.5	2.8	4.3	6.8	8.2	9.9
Operating Profit	2.0	3.2	3.3	7.7	9.0	11.0
Non-OP Profit	0.1	0.2	0.3	0.3	0.4	0.6
Interest income	0.1	0.0	0.2	0.2	0.4	0.5
F/X Gains	0.0	0.0	0.1	0.0	0.0	0.0
Equity gains	0.0	0.0	0.0	0.0	0.0	0.0
Non-OP Losses	0.1	0.2	0.1	0.2	0.2	0.2
Interest expenses	0.0	0.0	0.0	0.0	0.0	0.0
F/X Losses	0.1	0.2	0.1	0.2	0.2	0.2
Equity losses	0.0	0.0	0.0	0.0	0.0	0.0
Recurring Profit	2.1	3.1	3.4	7.7	9.3	11.4
EBT	2.1	3.1	3.4	7.7	9.3	11.4
Income Tax	0.3	-0.4	0.4	1.2	1.3	2.3
Net Profits	1.8	3.6	3.0	6.6	8.0	9.1
EBIT (adjusted)	2.0	3.1	3.3	7.5	8.9	10.8
EBITDA	2.3	3.4	3.7	8.1	9.5	11.6

Cash Flow

Year to Dec. (Wbn)	2001A	2002A	2003A	2004F	2005F	2006F
C/F from Operating	0.4	3.4	-5.7	7.2	6.6	6.2
Net Profit	1.8	3.6	3.0	6.6	8.0	9.1
Depreciation	0.3	0.3	0.4	0.6	0.7	0.8
Amortization	0.0	0.1	0.3	0.4	0.5	0.6
Net inc. in W/C	-1.9	-1.0	-9.7	-1.6	-2.7	-4.5
Others	0.2	0.5	0.2	1.2	0.2	0.2
C/F from Investing	-2.1	-2.5	-6.2	-2.3	-2.8	-3.4
Inv. for fixed assets	-0.4	-0.3	-0.9	-0.7	-0.8	-0.9
Sale of fixed assets	0.0	0.0	0.0	0.0	0.0	0.0
Net inc. of current assets	0.1	-0.1	0.0	0.0	0.0	0.0
Inc. of inv. Assets	-1.7	-0.3	-2.6	0.0	0.0	0.0
Others	-0.2	-1.8	-2.7	-1.6	-2.0	-2.5
C/F from Financing	0.0	0.0	11.8	-0.1	-0.1	-0.1
Increase in Equity	0.0	0.0	6.9	0.0	0.0	0.0
Incr. in borrowing	0.0	0.0	4.7	1.1	1.2	2.2
Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.1	-1.2	-1.3	-2.3
Increase in Cash	-1.8	1.0	-0.1	4.8	3.7	2.8

Key Financial Data

Year to Dec.	2001A	2002A	2003A	2004F	2005F	2006F
Per share data (Won)						
EPS (W)	588	853	640	1,224	1,480	1,687
BPS (W)	2,112	1,999	3,033	4,029	5,233	6,575
DPS (W)	0	0	0	0	0	0
SPS (W)	2,778	4,003	5,554	8,995	11,640	14,830
Growth (% YoY)						
Sales	122.3	98.8	57.0	83.7	29.4	27.4
OP	55.4	57.9	3.2	134.8	17.3	22.1
NP	45.2	100.2	-15.1	117.0	20.9	14.0
EPS	33.6	45.1	-25.0	91.2	20.9	14.0
EBITDA	53.9	51.1	8.1	120.6	17.6	21.9
Profitability (%)						
OP margin	23.7	18.8	12.4	15.8	14.3	13.7
NP margin	21.2	21.3	11.5	13.6	12.7	11.4
EBITDA margin	26.6	20.2	13.9	16.7	15.2	14.5
ROA	31.4	32.1	16.3	23.8	21.9	21.4
ROE	31.6	42.6	19.8	27.8	25.7	23.0
Dividend yield	0.0	0.0	0.0	0.0	0.0	0.0
Stability						
Net debt (W bn)	-1	-2	3	-2	-5	-8
Interest coverage	2,440.6	NM	320.7	376.5	441.7	539.3
Debt/equity ratio	17.2	17.0	37.9	33.8	31.6	28.1
Valuation (X)						
PER (X)	NM	NM	31.2	13.4	11.0	9.7
PBR (X)	NM	NM	6.6	4.1	3.1	2.5
PSR (X)	NM	NM	3.6	1.8	1.4	1.1
EV/EBITDA	NM	NM	29.4	10.4	8.5	6.7

Dongwon Securities does not own over 1% of the shares of the companies mentioned in this report as of 6 May 2004. Dongwon Securities has provided this report to various third parties. Neither the analysts covering these companies or their spouses own any shares of the companies mentioned in this report as of 6 May 2004.

This report has been prepared by Dongwon Securities and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy. We make no representation as to its accuracy or completeness and it should not be relied upon as such. The company accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.