

**Zinwell (2485 TT)**

Communications

Not rated

Company Update

ML Research Team**Tech Analyst**

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Recommendation

Not rated

Date:	Jul 20, 2005
Share Price (NT\$):	36.05
Price Target (NT\$):	N/A
Percent Change:	N/A
52-wk range (NT\$):	18.90-36.95
TWSE:	6,423.81

Company Data

Capital Size (NT\$):	1.98bn
Market Cap (NT\$):	7.15bn
Market Cap (US\$):	224.1mn
Outstanding Shrs:	198.4mn
Free Floating Shrs:	16.6mn
PER ('05E):	15.74x
PBR ('05E):	2.17x
Foreign Ownership:	8.43%
Major Shareholder:	CR Huang (21.5%)

Performance	1-m	3-m	6-m
Absolute	6.3%	21.2%	60.2%
Relative to TAIEX	29.9%	34.2%	83.6%

Key Changes	Current	Prev.
Recommendation	NA	NA
Price Target (NT\$)	NA	NA
Revenue (NT\$bn)	4.2	NA
Gross Margin (%)	23%	NA
Oper. Margin (%)	10%	NA
EPS (NT\$)	2.29	NA

Price Catalysts (+,-)

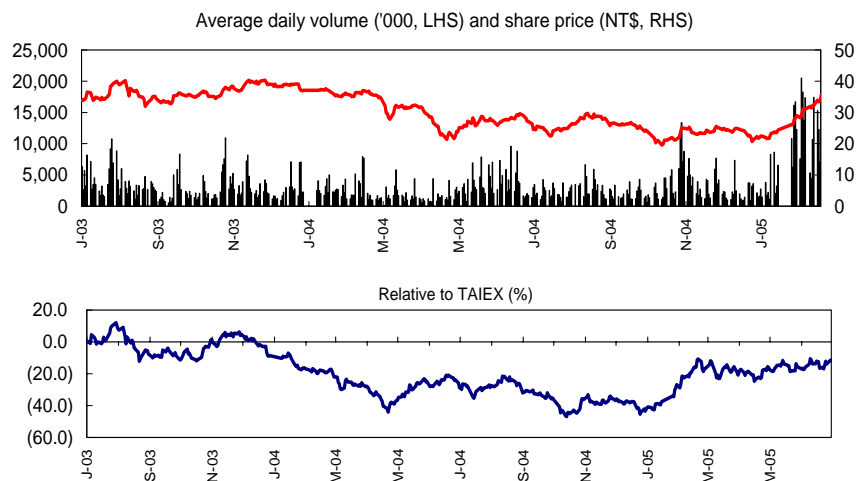
- (+) Positive STB/tuner sales
- (+) LNB recovery in 2H05
- (+) Sales and earnings improvements

Related Research

N/A

Digitally prosperous

- **A digital TV concept play.** Zinwell traditionally specializes in satellite communication solutions. However, we think digital TV (DTV) should be the firm's next big thing from 2005 and beyond, as its development in digital set-up-boxes (STBs) and embedded tuners should start to bear fruit.
- **Positive STB/tuner outlook.** Digital STBs and embedded tuners are expected to propel the Zinwell's growth in 2005. Growth catalyst will come from a more aggressive push to digital TV by the US government, and steady customer gains. The embedded tuner shipment could double in 3Q05. We expect STB and tuners to jointly contribute 40% of revenues in 2H05, up from 30-35% in 1H05.
- **LNB to see seasonal recovery.** Zinwell's low noise blockers (LNBs) accounts for 50% of DirecTV's (DTV, US\$15.70, NR) usage. Shipments should see a seasonal rebound in 2H05 after a 52% sequential drop in 2Q05. Revenue contribution should drop from 40% at the end of 2004 to 30-32% by the end of 2005.
- **Significant top-line, bottom line growth.** 3Q05 sales should increase 30-35% QoQ (up 20-24% YoY) on the back of increasing STB/tuner and LNB sales. Overall, Zinwell may see 2005E top-line to grow 26% YoY, with EPS up 127% YoY to NT\$2.29.
- **Long term positive.** Zinwell has been trading between 8.91-38.16x PER from July 2002 to date, and it is currently trading at 15.74x the consensus 2005E EPS of NT\$2.29 and just 10.73x 2006E EPS of NT\$3.36. Given its 1) strong STB/tuner business potential, 2) positive 2H05 LNB outlook, and 3) strong 2005E overall earnings momentum, we are positive on Zinwell's long-term prospects.



Investment Keynotes

Company Profile

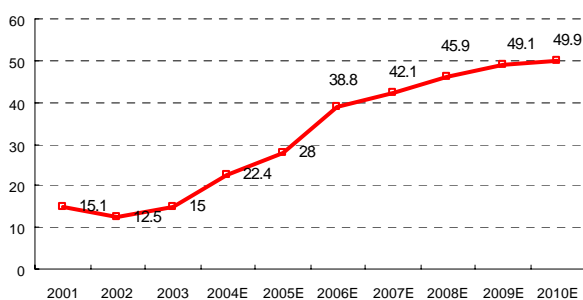
Founded in 1981, Zinwell specializes in the design and manufacture of transmission products and digital STBs used in satellite, communications and CATVs. The company also provides solution for system integration in 3C and internet appliance (IA) applications. Its main products include LNBs, very small aperture terminals (VSATs), STBs and embedded tuners for DTVs, and wireless communication components.

Zinwell has been labeled more as a satellite communication concept play, given LNB generated 57% and 41% of its 2003 and 2004 sales, respectively. However, we think digital TV should be the firm's next big thing from 2005 and beyond.

Digital TV: a fast growing market

Digital TV (DTV), a method of broadcasting TV programs using digital signal rather than the conventional analog frequency, is growing fast, as countries across the globe set deadlines to fully implement the service and consumers being attracted by the better image quality and wide variety of channel. There should be about 28mn new DTV subscription in 2005, up from 22.4mn in 2004, and the pace will accelerate over the next five years.

Figure 1: Worldwide new DTV subscription (mn subscriptions)



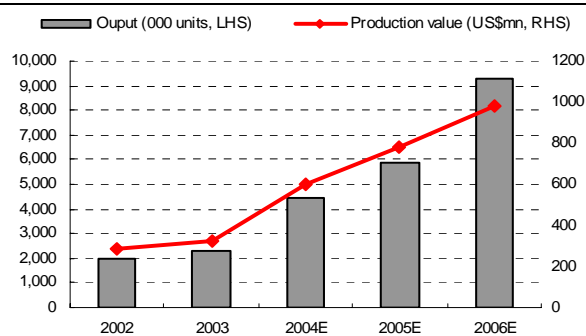
Source: Informa Media Group; MasterLink Securities

Digital STB: a growing industry in Taiwan

Consumers can receive digital TV signal with an external STB with their old TVs or with new TVs that embed tuners. Driven the global push toward digital TV broadcast, Taiwan's digital STB industry is growing rapidly. Taiwan's shipments for digital STB should grow

33% YoY to 5.9mn units in 2005, with production value increasing 30% to US\$783mn. 2006 should be an even stronger year, with shipments surging 56% YoY and production value up 25% YoY. Europe, due to its early adoption of DTV, is currently the biggest market for the Taiwanese makers, followed by the US, China and other Asian countries.

Figure 2: Taiwan's STB industry growth



Source: ITIS; MasterLink Securities

Zinwell focuses on terrestrial STB

Digital STB consists of three major sub-categories: satellite, cable, terrestrial and xDSL). Zinwell focuses on terrestrial STBs, which are mostly used in the US. The firm offers both external STB sets as well as embedded tuners. Zinwell's competitive niche is its expertise in solutions for high-definition TVs (HDTVs; i.e. TVs that offer an image resolution of 1920x1080 pixels or 1280x720 pixels). Other local STB suppliers such as Peisi (6152 TT, NT\$22.70, NR) currently offer solutions for "standard resolution" TV sets (720x480 pixels). We believe STBs, in particular the embedded tuners, will propel Zinwell's growth this year. We spot two near-term growth catalysts: an aggressive push to DTVs by the Federal Communication Committee (FCC) in the US, and Zinwell's customer gains.

FCC's "must have" policy

The FCC recently moved forward its deadline to mandate all 25-to-35-inch TVs and 50% of 13-to-24-inch TVs sold in the US embed digital tuners from July 2006 and July 2007, respectively to March 2006 and December 2007, respectively.

To comply with FCC's new rule, the Taiwanese TV OEM companies will have to accelerate their adoption of embedded digital tuners. Since Zinwell is currently the only Taiwanese supplier of embedded tuners used in HDTVs, we believe these potential orders will inevitably

flow to Zinwell.

Figure 3: FCC's digital TV tuner phase-in plan

	Jul 04	Jul 05	Mar 06	Dec 06
>36-inch	50%	100%	100%	100%
25-35-inch	-	50%	100%	100%
13-24-inch	-	-	50%	100%

Source: Company data; MasterLink Securities

Customer-base broadening

Zinwell began shipping embedded tuners (for over 36-inch TVs) to its first customer at the beginning of this year. According to our checks, the company has gained three more customers year-to-date and it is in the process of qualifying its products with five to six potential customers. We believe most of these companies are Taiwan-based TV OEM companies, which produce TVs for some US brand names.

We also understand that current shipments are mostly modules used in 36-inch TVs, and solutions for smaller-size TVs are in the process of qualification, which will take three to six months. As a result, Zinwell should begin shipping in early 2006, in-line with FCC's schedule.

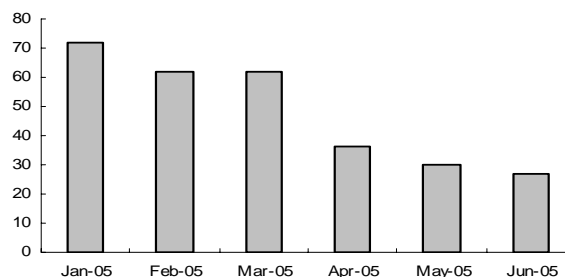
Monthly shipments on the rise

The FCC's push in the US, coupled with Zinwell's customer gains, should propel the firm's tuner shipment in the next few quarters. Our checks suggest monthly shipment for embedded tuners doubled to 20,000 sets in 2Q05, and the company aims to double the figure again in 3Q05. In terms of revenue contribution, STB and tuners are expected to jointly contribute about 40% of Zinwell's revenue in 2H05, up from 30-35% in 1H05.

LNB to rebound amid seasonal pickup

Zinwell is a major LNB contributor to DirecTV, accounting for 50% of DirecTV's LNB usage, according to the management. Due to the seasonal slowdown, LNB sales were dismal in 2Q05, with shipments dropped from 196,000 sets in 1Q05 to 93,000 sets in 2Q05. Our checks suggest shipments should resume growth in 2H05 due to seasonal rebound and new product launch. Investors in general project LNB and other satellite related products to contribute 30-32% of total sales by year-end, down from over 40% in 2004.

Figure 4: Zinwell's LNB shipment (thousand units)



Source: Company data; MasterLink Securities

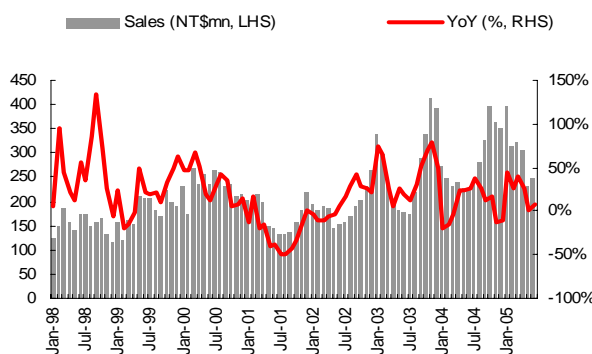
Sales momentum to rebound

The 2Q05 momentum was dismal due to seasonal trough of LNB offsetting growth in STB and tuners. Net sales went down 24% QoQ (but up 10% YoY) to NT\$780mn, larger than the consensus of 20-25% drop. Despite the worse-than-expected sequential drop, the company was still growing, with YoY up 12%.

Our checks also suggest the QoQ sales momentum will rebound in 2H05 on the back of recovering LNB sales and steady STB growth. Currently, the market forecast 3Q05 sales to increase 30-35% QoQ, implying a 20-24% YoY growth. 4Q05 should outperform 3Q05, as LNB will enter its seasonal peak.

Overall, 2005 should be a strong year, with the consensus 2005E sales of NT\$4.2bn, up 26% YoY, and 2005E EPS of NT\$2.29, up 127% YoY.

Figure 5: Monthly sales



Source: TEJ; MasterLink Securities

Risk concerns

Possible gross margin pressure in 2Q05

We note there are concerns on gross margin pressure in 2Q05 as a result of a possible 10-15% ASP erosion on embedded tuners. However, our checks indicate a flat margin and a flat tuner ASP. In the worst case, margin may drop by only one-percentage points to 21%. There could be some pressure to the stock price until Zinwell announces its 2Q05 results. However, we expect the pressure to be short-lived. Pricing environment may favor Zinwell in 2H05, since its customers should rely more and more on Zinwell's tuner supply to meet FCC's policy.

Is the consensus reasonable?

The market currently expects 2005E sales to increase 26% YoY to NT\$4.2bn. If Zinwell's progress on embedded tuners falls short of the market's expectations or if its LNB sales do not follow the seasonal pattern, the actual 2005 results may disappoint the market. However, Zinwell's top-line so far reached 43% of the 2005E sales, which is consistent with its 3-year average of 44%. As a result, we think the consensus sales figure should be reasonable.

Valuations and recommendation

Zinwell has been trading between 8.91-38.16x PER from July 2002 to date, and it is currently trading at 15.74x the consensus 2005E EPS of NT\$2.29 and just 10.73x 2006E EPS of NT\$3.36. Given its 1) strong STB/tuner business potential, 2) positive 2H05 LNB outlook, and 3) strong 2005E overall earnings momentum, we are long-term positive on Zinwell's long-term prospects.

Figure 6: P/E band



Source: TEJ; MasterLink Securities

Figure 7: Income Statement (NT\$m)

Item/Year	2002	2003	2004	2005E	2006E
Revenue	2,259	3,262	3,343	4,215	5,377
Cost of Goods Sold	1,692	2,424	2,614	3,227	4,139
Gross Profit	567	838	729	988	1,238
Oper. Exp.	305	356	326	406	503
Oper. Income	262	482	403	582	735
Pretax Income	219	478	264	524	727
Net Income	162	384	198	454	667
EPS (NT\$)	1.02	2.25	1.01	2.29	3.36

Source: I/B/E's

Figure 8: Income Statement (%)

Item/Year	2002	2003	2004	2005E	2006E
Gross Profit	25%	26%	22%	23%	23%
Oper. Exp.	14%	11%	10%	10%	9%
Oper. Income	12%	15%	12%	14%	14%
Pretax Income	10%	15%	8%	12%	14%

Source: I/B/E's

Figure 9: Income Statement (Growth)

Item/Year	2002	2003	2004	2005E	2006E
Revenue	9%	44%	2%	26%	28%
Operating Income	27%	84%	-16%	44%	26%
Pretax Income	18%	118%	-45%	98%	39%

Source: I/B/E's

Figure 10: 2005 Quarterly Earnings Estimates (NT\$m)

Item/Year	4Q04	1Q05	2Q05E	3Q05E	4Q05E
Revenue	1,050	1,032	780	1,053	1,350
Cost of Goods Sold	803	802	608	805	1,012
Gross Profit	247	230	172	248	338
Oper. Profit	161	135	97	137	213
Pretax Income	69	104	85	133	202
Net Income	50	87	72	118	176
After Tax EPS (NT\$)	0.25	0.44	0.36	0.60	0.89

MasterLink Securities – Stock Rating System**BUY:** Total return expected to appreciate 10% or more over a 3-month period.**HOLD:** Total return expected to be between 10% to -10% over a 3-month period.**SELL:** Total return expected to depreciate 10% or more over a 3-month period.

Additional Information Available on Request

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