



## Inventec Appliances Corporation (3367 TT)

BUY

iPod, GPS, VoIP, Handset

IPO

## ML Research Team

Tech Analyst

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Note: Historical price data based on GreTai Securities Market

## Recommendation

BUY

Date: October 19, 2005

IPO Price (NT\$): 108.0

Price Target (NT\$): 185.3

Percent Change: 71.6%

52-wk Range (NT\$): 55.0-165.0

TWSE: 5694.16

## Company Data

Capital Size (NT\$): 28bn

Market Cap (NT\$): 302bn

Market Cap (US\$): 9.2bn

Outstanding Shrs: 2.8bn

PER ('06E): 8.7X

PBR ('06E): 2.5X

Foreign Ownership: 0 %

Major Shareholder: Inventec Corp. 48.8%

## Performance

	1-m	3-m	6-m
Absolute (%)	-5.96	65.12	56.91
Relative to TAIEX	-0.32	86.06	58.40

## Key Changes

	Current	Prev.
Recommendation	BUY	N/A
Price Target (NT\$)	185.0	N/A
'06E Revenue (NT\$bn)	138.0	N/A
'06E Gross Margin (%)	9.7	N/A
'06E Oper. Margin (%)	3.8	N/A
'06E EPS (NT\$)	12.35	N/A

## Price Catalysts (+,-)

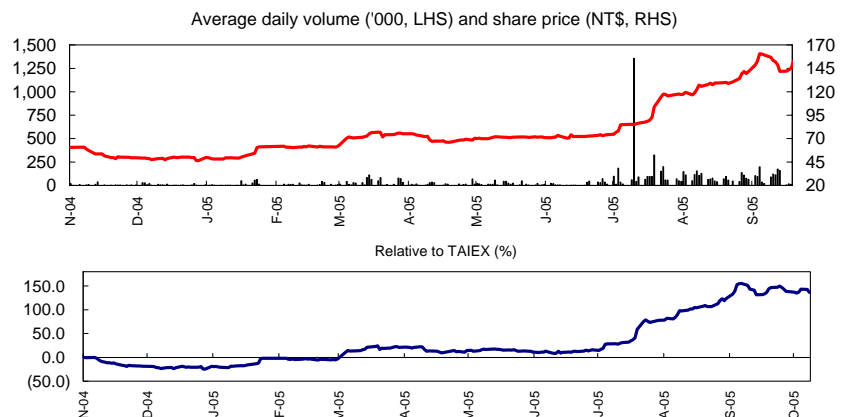
- (+) Video iPod to boost Q405 revenue
- (+) Strong growth for all the product lines
- (-) Seesaw effect between two iPod products

## Related Research

Mitac (2315TT) Sept 21,'05

## iPod Fevers, GPS Fuels and VoIP Rockets

- **Strong video iPod expects to uplift revenue in 4Q05.** Apple has dominated the HDD-based MP3 player market with nearly 80% penetration. The approaching holiday season is expected to boost up the video iPod sales, which implies a strong avail to IAC. IAC is the sole manufacturer for this "gadget in vogue" and we believe its revenue will upspring in 4Q05.
- **GPS business to fuel up by TomTom.** We expect the GPS business for IAC to thrive as TomTom's market position strengthen. With TomTom's vast growth primarily driven by the integrated solutions, we anticipate a stellar growth for IAC from TomTom's strong business outlook.
- **VoIP on the optimistic side.** The forecast by Frost & Sullivan indicates the global VoIP equipment market will reach US\$8.5bn by 2008, a strong growth with CAGR 41.5%. Cisco is confirmed to be one of IAC's VoIP customers. We hold an optimistic view on IAC's VoIP potential as Cisco still leads the VoIP server market.
- **Bright overall business outlook.** We think the highly diversified product mix for IAC is a remarkable advantage for its growth dynamic due to, 1) the ability to go against the downfall impact from specific product and industry cycle, and 2) major product lines are in global growth trend. We are positive to the IAC's business model and expect the momentum to remain in 2006.
- **BUY recommendation based on the strong upside potential.** IAC will be the first company to adopt the new Taiwan Stock Exchange underwriting regulation. Under the new regulation, there will be no restriction for the price limit move on the first five trading days. IPO is scheduled on October 25, 2005 with the share priced at NT\$108.0. We believe the stock should trade at a fair valuation of 15X PER given its growth prospects. We set our target price at NT\$185.3, based on 2006 EPS NT\$12.35.



## Investment Keynotes

### Company Profile

Inventec Appliance Corporation (IAC) designs and manufactures products that lead the global trends. Spun off from Inventec (2356 TT, NT\$16.70, HOLD) in 2000, IAC has earned high recognition of its own name and surpassed the earning performance of Inventec. The substantial customer pool has ushered the robust growth for IAC. Major products like iPod and TomTom Go (Handheld GPS device) are the key growth momentum in 2005, and we foresee this momentum to continue throughout 2006.

Figure 1: IAC Customers vs. Products

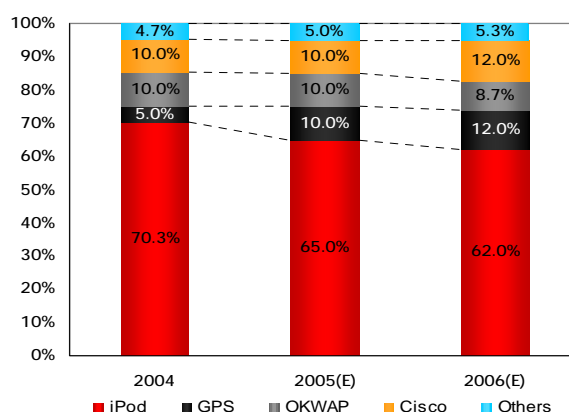
Customer	Product
	media player iPod (released Oct 12, 2005) 
	Handheld GPS Device 
	Graphical Calculator 
	PDA 
	GSM Phone (Original Brand) 
	Wireless VoIP Gateway 

Source: IAC, MasterLink Securities

IAC has enjoyed the handsome revenue resulting from the "iPod fever" as the revolutionary iPod has captured the world of consumer digital music. The contribution from Apple weighted 70.3% of the total revenue for IAC in 2004. On October 12, 2005, Apple (AAPL, US\$52.21, NR) has further impressed its fans by the new video iPod. IAC has begun the shipment in October, therefore, we expect this new Apple-hit to boost the Q405 revenue for IAC and will continue its strong growth dynamic in 2006.

IAC has hopped on the GPS bandwagon in 2004. The partnership with TomTom (tom2, €35.19, NR) is the door that leads IAC to the fast growing GPS sector. IAC is currently the only manufacturer for TomTom's integrated handheld device. TomTom, the leading provider of personal navigation products in Europe, has shipped 371 thousand sets of integrated handheld GPS device in 1H05, with €114.8mn revenue, up YoY 221%. The company expects the 2005 sales to be at least tripled from €119.2mn in 2004. We believe the booming GPS market will be a critical factor to the IAC revenue growth.

Figure 2: IAC Product Mix

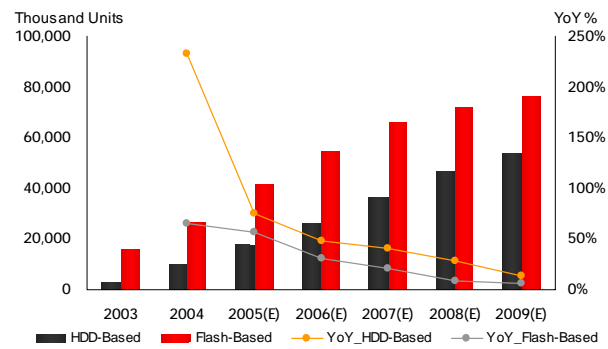


Source: IAC, MasterLink Securities

### The whopping growth of MP3 player market

The overwhelming success of iPod is a big factor for the mushroomed digital music sector, shipment of MP3 players rose 116% in 2004. The total MP3 player shipment was 36.8mn units in 2004, and will expand to 132mn units in 2009, with CAGR of 29.1%. Shipment of HDD-based MP3 player was 9.8mn units in 2004, and iSuppli predicts the number of HDD-based units will rise to 56.2mn units in 2009, grow by a CAGR of 41.8%. By 2009, the HDD-based MP3 player will account for 42.6% of the total MP3 shipments, up from only 26.6% in 2004.

Figure 3: Portable MP3 Player Market Forecast



Source: iSuppli, MasterLink Securities

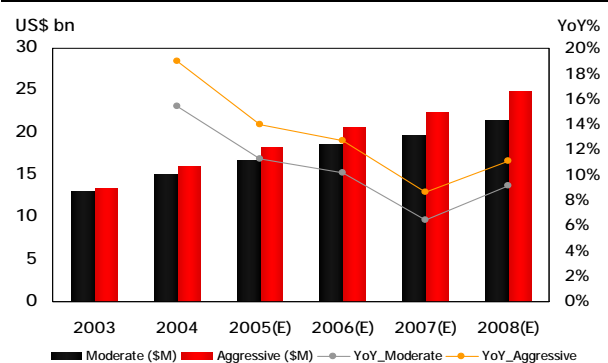
Video iPod expects to uplift revenue in Q405

Apple has dominated the HDD-based MP3 player market with nearly 80% penetration since the first release of iPod in 2002. Under the lead of the legendary CEO Steve Jobs, Apple is now highly recognized as the vogue of consumer electronics. Successions of iPod are all of great victory in the digital music player market. The approaching holiday season is expected to boost up the video iPod sales, which implies a strong avail to IAC. IAC is the sole manufacturer for this "gadget in vogue" and we believe its revenue will upspring in 4Q05.

The sizzling GPS market

The improving precision of GPS technology has created significant market opportunity for the personal navigation business. Research Institute ABI predicts global GPS market will grow from the current US\$16.7bn to US\$21.5bn by 2008, with 8.8% CAGR. Considering the 418m cars in Europe and US, only about 4% are equipped with satellite navigation system and merely 10% of the new cars sold have GPS navigation system. The aftermarket will be the key growth dynamic to the soaring GPS industry.

Figure 4: Global GPS Market Forecast

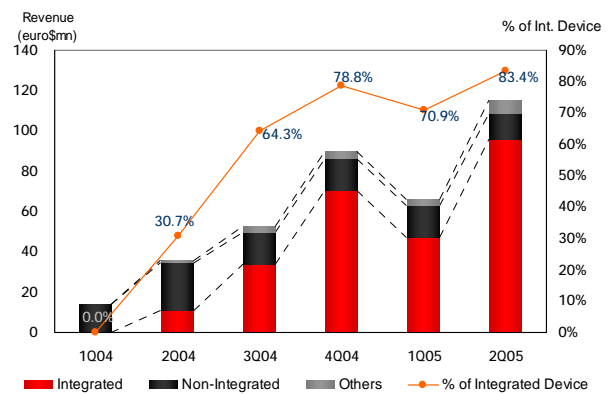


Source: ABI, MasterLink Securities

GPS business to fuel up by TomTom

We expect the GPS business for IAC to thrive as TomTom's market position strengthens. TomTom owns 52% of the European integrated GPS device market share, and is aggressively expanding its distribution network in US. Revenue forecast for TomTom are estimated to be €620mn in 2005 (up YoY 222%) and €1,022mn in 2006 (up YoY 65%). IAC has the advantage of being the only contract manufacturer for all TomTom's integrated products. With TomTom's vast growth primarily driven by the integrated solutions, we anticipate a stellar growth for IAC from TomTom's strong business outlook.

Figure 5: TomTom Revenue Analysis

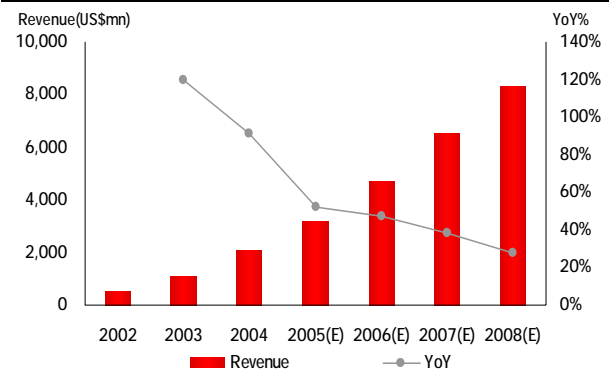


Source: TomTom, MasterLink Securities

Voice-over-Internet Protocol (VoIP) on the optimistic side

VoIP is expected to rocket with the increasing popularity of IP telephony (such as Skype). The forecast by Frost & Sullivan indicates the global VoIP equipment market will reach US\$8.5bn by 2008 from the current US\$3.0bn, a strong growth with CAGR 41.5%. Another sign for the VoIP growth can be found in the sales of the VoIP semiconductors. IDC predicts sales to reach US\$1.7bn by 2005, with CAGR of 48% from 2003 to 2008. IAC did not disclose the complete list of its VoIP customers; nevertheless, Cisco (CSCO, US\$16.98, NR) is confirmed to be one of the names. We hold an optimistic view on IAC's VoIP potential as Cisco still leads the VoIP server market.

Figure 6: VoIP Market Forecast



Source: Frost &Sullivan, MasterLink Securities

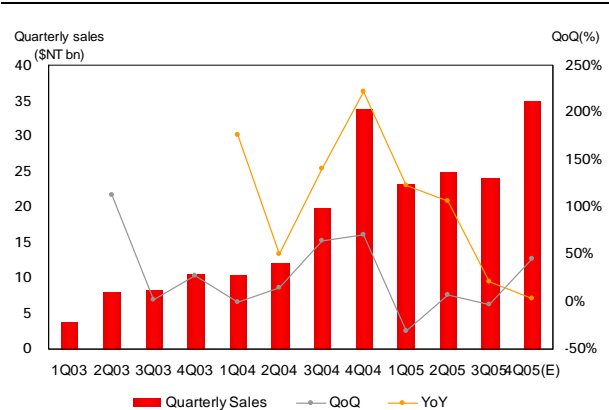
**OKWAP without excitement**

As the handset market being dominated by top brands like Nokia and Motorola, second tier companies are faced with continuously decreasing ASP and market share. IAC has shift the OKWAP focus to the greater China area. The current handset capacity in China is estimated to be 200mn units per year with demand of only 70mn units. Handset inventory in China remains high as more players continue to join. From the fierce competition and dreadful oversupply problem in the Chinese handset sector, we do not expect IAC to have outstanding performance from the handset business.

**Bright overall business outlook**

We think the highly diversified product mix for IAC is a remarkable advantage for its growth dynamic due to 1) the ability to go against the downfall impact from specific product and industry cycle, and 2) major product lines are in growth global trend. We are positive to the IAC business model and expect the momentum to remain in 2006.

Figure 7: IAC Revenue Analysis



Source: TEJ, MasterLink Securities

**Earning Forecast**

We project IAC's 2005 revenue to arrive at NT\$110bn, up YoY 39.4%, with gross margin of 9.5% and estimated EPS of NT\$9.52. From the growth prospects of each product line, we forecast the revenue in 2006 to reach NT\$138bn, up YoY 25.5%, and a forward EPS of NT\$12.35.

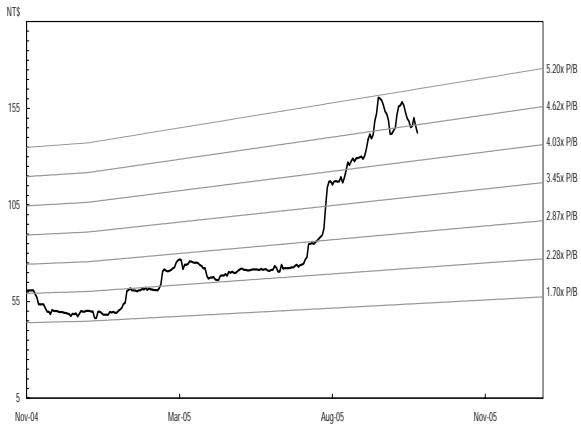
**Risk Factors**

We believe the 4Q05 revenue will remain heavily dependent on iPod. The long-term consumer acceptance toward video on the go is still to be determined. Apple released the two new iPod series in just one-month period and each with different contract manufacturer. IAC wins the video iPod orders where Hon Hai Precision (2317TT, NT\$147.0, HOLD) gets to enjoy the cake of iPod nano. The consumer preference between video iPod and iPod nano ought to be closely watched, since the specific favor toward either the nano or the video iPod will negatively impact the growth in revenue of the other.

**Valuations and Recommendation**

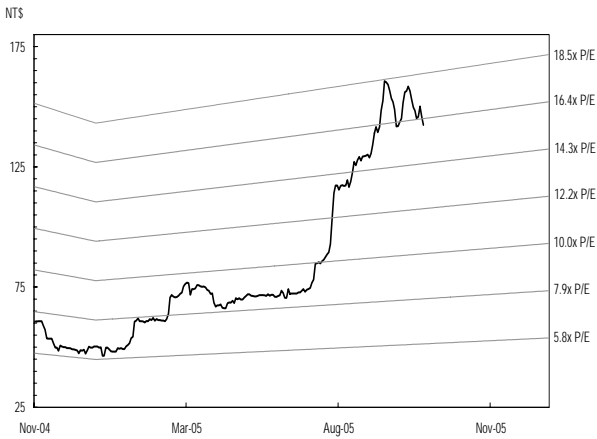
IAC will be the first company to adopt the new underwriting regulation. Under the new Taiwan Stock Exchange regulation, there will be no restriction for the price limit move on the first five trading days, and will resume the 7% limit from the 6<sup>th</sup> trading day. IPO is scheduled on October 25, 2005 with the share priced at NT\$108. We believe the stock should trade at a fair valuation of 15x PER given its growth prospects. We set our target price at NT\$185.3, based on 2006E EPS NT\$12.35. We propose a BUY recommendation based on the strong upside potential from the current pricing of the stock.

Figure 8: IAC P/B Band



Source: TEJ, MasterLink Securities

Figure 9: IAC P/E Band



Source: TEJ, MasterLink Securities

Income Statement (IAC, 3367TT)						NT\$m
Year to December	2001	2002	2003	2004	2005(E)	2006(E)
Net sales	7,099	14,057	30,655	79,026	110,016	137,957
Operating cost	6,461	12,497	25,745	71,595	99,576	124,575
Unrealized sales to subsidiaries	-39	-9	0	0	0	0
Gross profits	598	1,551	4,910	7,430	10,439	13,382
Operating expenses	531	908	2,553	5,033	6,403	8,139
Sales expenses	60	308	1,193	2,474	3,120	4,139
Administrative expenses	173	184	681	839	789	1,242
R&D	299	416	679	1,719	2,493	2,759
Operating profits	67	643	2,357	2,397	4,036	5,242
Total non-op. profits	185	3	-95	183	-54	-49
Net interest	-12	13	4	-27	25	30
Investment income	21	0	-247	-12	0.6	0.8
FX gains (loss)	39	9	-43	-48	-50	-50
Others	136	-19	192	270	-30	-30
Pre-tax profits	252	645	2,262	2,580	3,982	5,173
Tax	-9	54	340	455	810	1,060
Net profits	261	591	1,923	2,091	3,172	4,113
EPS (NT\$)	2.37	2.52	8.18	7.47	9.52	12.35
Adj. EPS (NT\$)	0.78	1.78	5.77	6.28	9.52	12.35
Shares outstanding (mn)		235	235	280	333	333
Depreciation & amortization	123	170	580	620	870	1,204
EBITDA	395	827	2,858	3,268	5,783	7,641
<b>Year-on-year change (%)</b>						
Sales		98.02	118.07	157.79	39.21	25.40
Gross profits		159.28	216.59	51.35	40.49	28.19
Operating profits		863.13	266.77	1.71	68.36	29.88
Pretax profits		156.60	250.56	14.06	54.32	29.92
Net profits		126.87	225.13	8.73	51.70	29.69
EBITDA		109.24	245.66	14.37	76.93	32.13
<b>Ratios (%)</b>						
ROE	19.49	13.17	31.55	28.30	27.64	24.31
ROA	6.34	7.77	12.45	6.05	6.87	6.91
Gross margin	8.43	11.03	16.02	9.40	9.49	9.70
Operating margin	0.94	4.57	7.69	3.03	3.67	3.80
Net margin	3.67	4.21	6.27	2.65	2.88	2.98
EBITDA margin	5.57	5.88	9.32	4.14	5.26	5.54

Balance Sheet (IAC, 3367TT)						NT\$m
Year to December	2001	2002	2003	2004	2005(E)	2006(E)
Cash	84	3,223	5,095	7,214	9,819	12,765
Marketable securities	0	0	0	0	0	0
AR and NR	1,993	2,438	5,273	16,766	22,003	29,352
Inventory	779	503	2,247	5,915	8,911	10,761
Other	118	168	311	640	640	640
Current assets	2,975	6,332	12,925	30,535	41,373	53,518
Long-term investments	122	248	37	97	198	499
Fixed assets	891	935	2,115	3,135	3,765	4,561
Other assets	127	95	370	774	834	934
Total assets	4,114	7,610	15,448	34,542	46,170	59,512
ST borrowings	700	0	1,511	3,176	2,376	1,576
AP and NP	1,638	2,371	5,751	20,564	29,704	38,628
Other ST liabilities	252	509	1,369	1,746	1,746	1,746
Other liabilities	187	225	718	1,669	869	639
LT debt	0	14	5	0	0	0
Total liabilities	2,776	3,118	9,353	27,155	34,695	42,589
Common shares	110	235	235	280	333	390
Other shareholders' equity	237	2,142	3,745	4,587	8,205	13,127
Total equity	1,337	4,492	6,095	7,387	11,475	16,923
Total liab. & equity	4,114	7,610	15,448	34,542	46,170	59,512
<b>Ratios</b>						
Net debt/equity (%)	78.86	(55.11)	(24.49)	(8.44)	(42.08)	(52.02)
Current ratio (%)	114.86	219.88	149.75	119.82	122.31	127.58
Quick ratio (%)	84.77	202.40	123.72	96.60	95.97	101.93
Sales/fixed assets (%)	797.10	1,503.60	1,449.13	2,520.45	2,922.10	3,024.58
Inventory turns (x)	9	28	14	13	12	13
Receivable turns (x)	3.56	5.77	5.81	4.71	5.00	4.70
Collection period (Days)	102.49	63.31	62.78	77.44	73.00	77.66

\* Note: 2001 and 2002 are non-consolidated data

<b>Cash Flow Statement (IAC, 3367TT)</b>						<b>NT\$mn</b>
<b>Year to December</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005(E)</b>	<b>2006(E)</b>
<b>Cash flow from operating activities</b>	-258	1,583	2,618	3,323	4,149	4,811
Net profits	261	591	1,923	2,091	3,172	4,113
Add: Depreciation	123	170	580	620	870	1,204
Less: Associate/ Plus: Dividends	-14	0	247	12	(1)	(1)
Other adjustments	-628	822	(132)	600	108	(505)
<b>Cash flow from investing activities</b>	-289	(288)	(1,830)	(1,869)	(1,517)	(2,100)
Purchase of fixed assets (Capex)	-133	(96)	(614)	(1,426)	(673)	(1,200)
Proceeds from sales of fixed assets	1	7	6	118	0	0
Investment in associates	-83	(199)	(989)	(304)	(564)	(600)
Sale of investments	0	73	0	0	0	0
Other adjustments	-75	(74)	(233)	(259)	(280)	(300)
<b>Cash flow from financing activities</b>	157	1,825	1,044	806	(52)	358
Short term borrowings	157	(700)	0	1,664	(800)	(800)
Long term loans	0	14	0	(5)	0	0
Corporate bond	0	0	0	0	0	0
Dividend paid	0	0	(235)	(1,316)	(1,568)	(1,665)
Shares issued	0	2,533	0	780	2,484	3,000
Other adjustments	0	(21)	1,279	(318)	(168)	(177)
FX effect	0	0	(12)	(140)	(60)	(100)
<b>Net changes in cash</b>	-390	3,120	1,820	2,119	2,580	3,069
<b>Cash at the end of the period</b>	84	3,223	5,095	7,214	9,819	12,765

\* **Note:** 2001 and 2002 are non-consolidated data

#### 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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