

# Coway (021240)

Above

In line

Below

12M rating **Hold (Maintain)**

## Stagnant domestic business, overseas potential

### Stock Data

KOSPI (Aug 1, pt)	2,423
Stock price (Aug 1, KRW)	97,900
Market cap (USD mn)	6,532
Shares outstanding (mn)	75
52-Week high/low (KRW)	111,000/81,300
6M avg. daily turnover (USD mn)	17.2
Free float / Foreign ownership (%)	70.3/59.3
Major shareholders (%)	
Coway Holdings, Inc. and 8 others	26.9
GIC Private Limited	7.3

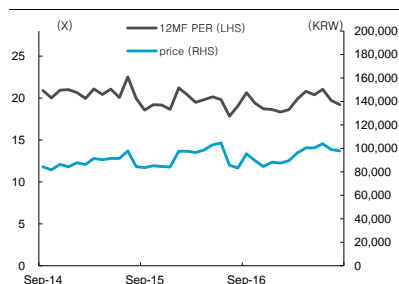
### Valuation

	2016A	2017F	2018F
PE (x)	26.9	20.2	19.3
PB (x)	4.9	5.0	4.8
ROE (%)	20.1	30.0	29.9
DY (%)	3.6	3.7	4.1
EV/EBITDA (x)	11.8	10.2	9.8
EPS (KRW)	3,280	4,857	5,074
BPS (KRW)	17,891	19,532	20,552

### Performance

	1M	6M	12M
Absolute (%)	(5.9)	11.4	14.8
Relative to KOSPI (%p)	(7.2)	(5.1)	(4.6)

### 12MF PE trend



Source: WISEfn consensus

### What's new: Earnings normalize

2Q17 consolidated sales grew to W623bn (+12% YoY), and OP surged to W121bn (+919% YoY, OPM of 19.3%). Considering that sales reductions and costs from the recall of nickel-contaminated water purifiers in 2Q16 lowered sales by W67.9bn, adjusted sales growth would have been only 0.1% YoY. Furthermore 2Q16 OP would have been around W120bn. Rental-related sales (rental + membership) grew 16% YoY (-2.4% YoY stripping off recall effects), while non-rental sales declined 5% YoY. For non-rentals, lump-sum and exports dropped 7% YoY while cosmetics grew. The number of accounts reached 574.6 million (+3.3 million QoQ), while the cancellation rate was 1.19% (-0.1%p YoY).

### Pros: Overseas business potential, rental stability and shareholder-return policy

We recommend focusing on overseas growth. The number of rental accounts in Malaysia rose to 0.54mn, up 57,000 accounts QoQ, and the Malaysian subsidiary's sales grew 42% QoQ. Of note, we forecast Malaysia will comprise about 10% of the total accounts in 2017. While the full-year OP contribution should only be about 3%, the potential long-term growth is attractive. Meanwhile, the stability of the rental business, which has little fluctuation in terms of subscribers or ARPU, was confirmed via 2Q17 results following the recall issue and response since 2Q16. Management is also actively pursuing shareholder-return policies, such as quarterly dividends, a high dividend payout ratio and treasury share buybacks and cancellations.

### Cons: Strong competition in domestic market, stagnant earnings

Competition in the domestic market is intensifying. And, Coway's market share of key segments, including water purifiers, is eroding. Although total accounts fell 1.7% YoY in 2Q17, high-growth products, such as air-purifiers, offset some of the sluggish water purifier sales. However, the net increase in rental accounts reached only 73,000 in 1H17, suggesting it will be difficult to reach management's full-year guidance of 230,000. In the water purifier market, Cuckoo and SK Magic are growing rapidly. The air purifier market is growing rapidly, but the market is focused on lump-sum payments and large, existing home appliance companies are securing more market share. Going forward, significant earnings improvements at the domestic business appear difficult.

(W bn, %, %p)

	2Q17P				Change		2017F	
	KIS est.	Actual	Diff.	Consensus	QoQ	YoY	KIS	Consensus
Sales	633	623	(1.5)	635	2.2	12.3	2,531	2,569
OP	125	121	(3.8)	121	(0.3)	919.4	482	492
OP margin	19.3	19.3	0.0	19.0	-0.5	17.2	19.0	19.2
EBT	114	126	10.4	117	25.3	2,308.1	471	469
NP	86	95	11.2	88	26.2	3,310.7	353	353

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### Conclusion: Earnings stability and dividend policy to be highlighted as overseas potential firms

As the current valuation of 20x 12MF PE reflects the stagnant growth at the domestic division, we maintain Hold. If the Malaysian business continues to grow rapidly and the outlook is solid for the water purifier and bidet operations set to launch in China, rental-based earnings visibility and dividend merit (3.7% yield in 2017) should be highlighted.

**Table 1. Coway earnings**

(W bn, %, % YoY)

	2016				2017				Annual				
	1Q	2Q	3Q	4Q	1Q	2QP	3QF	4QF	2015	2016	2017F	2018F	2019F
Sales	624	555	584	614	610	623	636	662	2,315	2,376	2,531	2,683	2,826
% YoY	13.8	(0.1)	0.5	(2.7)	(2.2)	12.3	8.9	7.8	7.2	2.6	6.5	6.0	5.3
Rental related	423	359	409	401	407	416	423	422	1,671	1,592	1,668	1,715	1,753
% YoY	3.3	3.0	(2.8)	(5.4)	(3.7)	16.0	3.4	5.2	5.5	(4.7)	4.8	2.8	2.2
Rentals	380	316	367	361	370	380	386	386	1,491	1,424	1,521	1,578	1,626
% YoY	4.6	(14.8)	(2.5)	(5.1)	(2.8)	20.0	5.2	6.8	6.5	(4.5)	6.8	3.8	3.0
Membership	43	43	42	40	38	37	37	36	180	168	148	137	128
% YoY	(6.7)	(6.4)	(5.4)	(8.5)	(11.9)	(13.6)	(12.8)	(9.2)	(2.1)	(6.7)	(11.9)	(7.3)	(6.7)
Finance lease	22	29	27	28	26	30	30	29	41	106	116	120	120
% YoY	NM	NM	NM	8.8	20.5	5.6	11.9	3.6		157.9	9.7	3.4	0.0
Lump-sum	51	54	43	49	46	50	49	56	171	196	201	208	217
% YoY	68.3	30.7	(6.6)	(10.1)	(9.1)	(6.8)	15.0	14.7	38.6	14.4	2.7	3.2	4.3
Cosmetics	20	17	18	19	21	19	19	20	83	74	79	85	91
% YoY	(13.0)	(18.0)	(2.7)	(7.9)	4.0	8.1	7.0	9.2	3.4	(10.7)	7.0	7.0	7.0
Exports	57	60	48	52	68	56	60	61	149	217	245	281	324
% YoY	71.8	53.3	34.4	25.3	19.9	(7.2)	25.0	17.6	(10.8)	45.1	13.0	15.0	15.0
Others	6	4	6	5	4	4	6	5	89	21	19	19	19
% YoY	(45.8)	(52.4)	(43.4)	(70.6)	(32.6)	(10.6)	0.0	6.7	52.2	(76.7)	(10.0)	0.0	1.0
Subsidiaries	64	62	61	87	72	84	80	104	239	274	339.1	425.5	503.7
% YoY	20.4	20.5	6.3	12.6	11.2	36.4	30.0	19.8	18.0	14.5	23.8	25.5	18.4
OP	124	12	107	96	121	121	121	120	463	339	482	503	519
% YoY	23.2	(89.3)	(13.7)	(25.0)	(2.2)	919.4	12.9	24.1	27.1	(26.9)	42.3	4.3	3.2
OPM (%)	19.8	2.1	18.3	15.7	19.8	19.3	19.0	18.1	20.0	14.3	19.0	18.7	18.4

Source: Company data, Korea Investment &amp; Securities

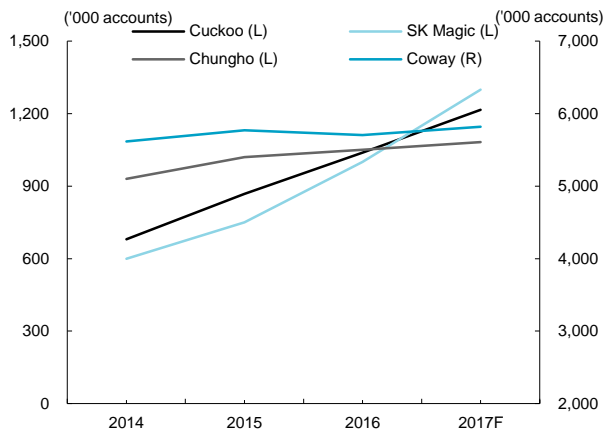
**Table 2. Rental business key assumptions**

('000 accounts, % YoY, %)

	2016				2017				Annual				
	1Q	2Q	3Q	4Q	1Q	2QP	3QF	4QF	2015	2016	2017F	2018F	2019F
Total accounts	5,794	5,846	5,732	5,704	5,713	5,746	5,766	5,794	5,771	5,704	5,794	5,931	6,037
Net additions	23	51	(114)	(28)	9	33	20	28	155	(68)	90	137	106
% YoY	2.4	2.3	0.1	(1.2)	(1.4)	(1.7)	0.6	1.6	2.8	(1.2)	1.6	2.4	1.8
Rental accounts (year-end)	4,861	4,921	4,823	4,849	4,875	4,923	4,948	4,977	4,832	4,849	4,977	5,151	5,282
% YoY	4.2	3.7	0.9	0.4	0.3	0.0	2.6	2.6	5.0	0.4	2.6	3.5	2.5
Net additions	29	60	(98)	26	26	48	25	30	232	17	128	173	131
Membership accounts (year-end)	933	924	908	854	838	823	818	817	939	854	817	780	755
% YoY	(6.2)	(4.4)	(3.8)	(9.0)	(10.2)	(11.0)	(9.9)	(4.4)	(7.6)	(9.0)	(4.4)	(4.5)	(3.3)
Net additions	(6)	(9)	(16)	(54)	(17)	(15)	(5.0)	(1)	(77)	(85)	(38)	(36)	(25)
New rental sales	351	385	285	381	350	397	356	415	1,409	1,401	1,518	1,547	1,558
% YoY	2.9	3.8	(15.6)	5.8	(0)	3	25	9	5.9	(0.5)	8.3	1.9	0.7
Churn rate (%)	1.0	1.0	1.5	1.3	1.19	1.19	1.12	1.03	1.00	1.21	1.13	1.16	1.18
Rental ARPU	26,140	21,548	25,108	24,871	25,331	25,822	26,080	25,896	26,345	24,516	25,791	25,971	25,971
% YoY	0.0	(18.0)	(4.7)	(5.7)	(3.1)	19.8	3.9	4.1	2.0	(6.9)	5.2	0.7	0.0
Membership ARPU	15,279	15,256	15,317	15,131	14,895	14,734	14,587	14,805	15,311	15,568	14,712	14,270	13,842
% YoY	0.2	(1.1)	(1.3)	(2.2)	(2.5)	(3.4)	(4.8)	(2.2)	1.6	1.7	(5.5)	(3.0)	(3.0)

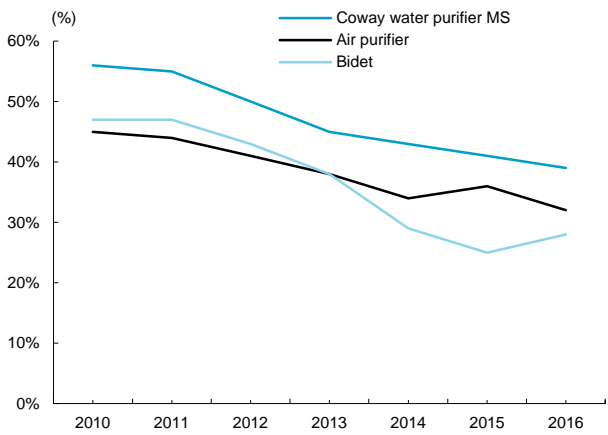
Source: Company data, Korea Investment &amp; Securities

**Figure 1. High growth of second tiers**



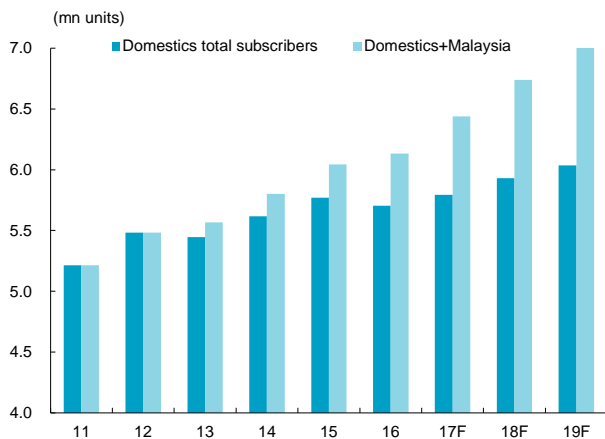
Source: Company data, Korea Investment & Securities

**Figure 2. Domestic MS is decreasing**



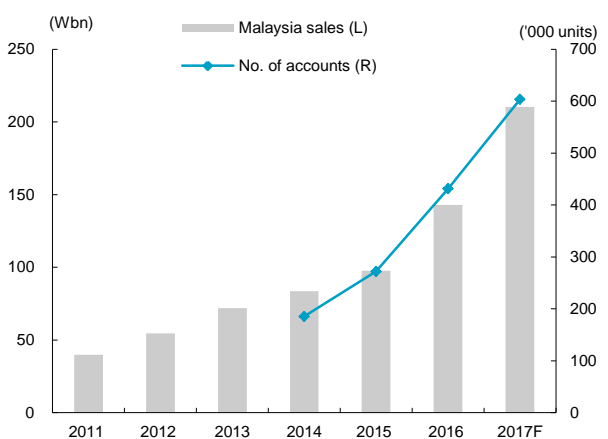
Source: Company data, Korea Investment & Securities

**Figure 3. Domestic subscribers are stagnant, having overseas opportunity**



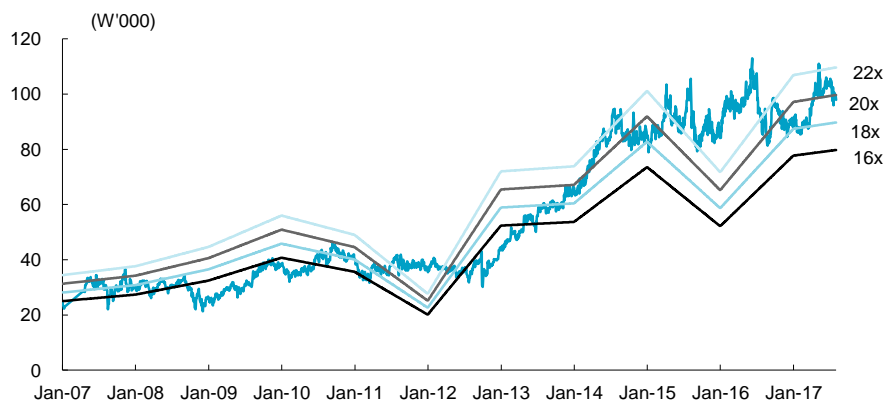
Source: Company data, Korea Investment & Securities

**Figure 4. Malaysia subsidiary sales**



Source: Company data, Korea Investment & Securities

**Figure 5. PE band**



Source: WISEfn, Korea Investment & Securities

**Company overview & Glossary**

Established in 1989, Coway is specialized in environmental home appliances (EHA) such as water purifiers, air purifiers and bidets, and has brought EHAs into people's daily lives. Coway was the industry's first to introduce the EHA rental business in 1998. Coway also introduced the maintenance and technician managers (called Cody) to offer standout onsite services. Coway is the leader in Korea with 45% market share for water purifiers, 44% air purifiers, 38% bidets and 62% water softeners, and has strong brand awareness. Coway had approximately 57.7mn accounts (rental + membership) as of end-2015. Coway continues to expand its product lineup to water softeners, food waste treatment systems, mattresses and so on and is stepping up its business drive abroad.

- Rental: Consumers may use the products in exchange for a monthly rental fee along with a one-off registration fee; Contracts usually have a mandatory subscription period of three years while ownership is transferred to the consumer after five years of use; By paying rental fees, consumers are granted access to product use and maintenance services
- Membership: Customers retain product ownership and are offered maintenance services
- ARPU (average sales per user): Monthly average of rental or membership charges paid by customers

**Balance sheet**

FY-ending Dec. (W bn)	2015A	2016A	2017F	2018F	2019F
Current assets	653	733	834	898	946
Cash & cash equivalent	116	66	139	161	170
Accounts & other receivables	283	323	329	349	367
Inventory	70	70	75	79	83
Non-current assets	1,122	1,235	1,313	1,371	1,427
Investment assets	51	52	56	59	62
Tangible assets	700	669	711	733	755
Intangible assets	169	183	195	207	218
Total assets	1,775	1,968	2,148	2,269	2,373
Current liabilities	473	735	848	887	911
Accounts & other payables	259	255	286	303	319
ST debt & bond	80	340	440	440	440
Current portion of LT debt	0	0	0	0	0
Non-current liabilities	64	49	121	124	126
Debentures	0	0	0	0	0
LT debt & financial liabilities	8	12	82	82	82
Total liabilities	537	784	969	1,011	1,037
Controlling interest	1,237	1,183	1,178	1,259	1,337
Capital stock	41	41	41	41	41
Capital surplus	127	127	127	127	127
Other Reserves	(103)	(159)	(258)	(258)	(258)
Retained earnings	1,177	1,180	1,275	1,356	1,435
Minority interest	1	1	0	(0)	(1)
Shareholders' equity	1,238	1,183	1,178	1,258	1,336

**Cash flow**

FY-ending Dec. (W bn)	2015A	2016A	2017F	2018F	2019F
C/F from operating	513	358	578	618	624
Net profit	343	243	353	368	380
Depreciation	220	225	229	239	246
Amortization	8	8	9	10	10
Net incr. in W/C	(195)	(232)	(12)	1	(12)
Others	137	114	(1)	0	0
C/F from investing	(329)	(367)	(319)	(309)	(315)
CAPEX	(329)	(328)	(270)	(261)	(268)
Decr. in fixed assets	9	15	0	0	0
Incr. in investment	0	(43)	(4)	(4)	(4)
Net incr. in intangible assets	(5)	(13)	(21)	(21)	(21)
Others	(4)	2	(24)	(23)	(22)
C/F from financing	(213)	(40)	(187)	(287)	(301)
Incr. in equity	5	5	0	0	0
Incr. in debts	(77)	264	170	0	0
Dividends	(148)	(208)	(235)	(258)	(287)
Others	7	(101)	(122)	(29)	(14)
C/F from others	(1)	(0)	0	0	0
Increase in cash	(31)	(50)	73	22	9

Note: Based on K-IFRS (consolidated)

**Income statement**

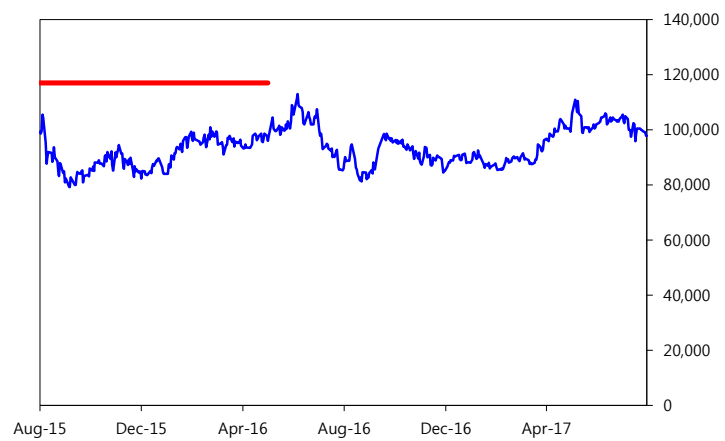
FY-ending Dec. (W bn)	2015A	2016A	2017F	2018F	2019F
Sales	2,315	2,376	2,531	2,683	2,826
COGS	729	812	818	869	921
Gross profit	1,586	1,564	1,714	1,814	1,905
SG&A expense	1,123	1,225	1,232	1,311	1,386
Operating profit	463	339	482	503	519
Financial income	1	1	2	2	2
Interest income	1	1	2	2	2
Financial expense	4	6	27	14	14
Interest expense	4	6	12	14	14
Other non-operating profit	(6)	(10)	14	0	0
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	0
Earnings before tax	454	324	471	490	507
Income taxes	111	80	118	123	127
Net profit	343	243	353	368	380
Net profit of controlling interest	343	244	353	368	380
Other comprehensive profit	(9)	(1)	(1)	(1)	(1)
Total comprehensive profit	334	243	352	367	379
Total comprehensive profit of controlling interest	334	243	353	367	380
EBITDA	691	572	720	752	775

**Key financial data**

FY-ending Dec.	2015A	2016A	2017F	2018F	2019F
per share data (KRW)					
EPS	4,621	3,280	4,850	5,132	5,302
BPS	17,654	17,891	19,526	20,601	21,647
DPS	2,800	3,200	3,600	4,000	4,200
Growth (%)					
Sales growth	7.2	2.6	6.5	6.0	5.3
OP growth	27.1	(26.9)	42.3	4.3	3.2
NP growth	37.4	(29.0)	45.1	4.2	3.3
EPS growth	37.5	(29.0)	47.9	5.8	3.3
EBITDA growth	19.5	(17.2)	25.8	4.4	3.2
Profitability (%)					
OP margin	20.0	14.3	19.0	18.7	18.4
NP margin	14.8	10.3	14.0	13.7	13.5
EBITDA margin	29.8	24.1	28.4	28.0	27.4
ROA	20.2	13.0	17.2	16.7	16.4
ROE	30.2	20.1	29.9	30.2	29.3
Dividend yield	3.3	3.6	3.7	4.1	4.3
Dividend payout ratio	60.6	96.3	73.1	77.9	79.2
Stability					
Net debt (W bn)	(37)	210	302	276	262
Int.-bearing debt/equity (%)	7.1	29.7	44.3	41.5	39.1
Valuation (X)					
PE	18.2	26.9	20.2	19.1	18.5
PB	4.8	4.9	5.0	4.8	4.5
EV/EBITDA	9.2	11.8	10.2	9.7	9.4

**Changes to recommendation and price target**

Company (Code)	Date	Recommendation	Price target
Coway (021240)	08-04-15	BUY	W117,000
	05-04-16	Hold	-



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BUY	Hold	Underweight (Sell)
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Note: % of companies under coverage with this rating

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Prepared by: Eun-chaе Na

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