

April 6, 2018

Coway (021240)

1Q18 preview: Potential to be realized

1Q18 to satisfy consensus, domestic accounts to grow

We estimate 1Q18 sales will grow 8% YoY to W656bn and OP 6% YoY to W128bn (OPM 19.5%). Domestic rental sales (rental + membership, 64% of total sales) should improve 3% YoY. With rental sales expected to gain 5% YoY and the cancellation rate stabilizing around 1%, net rental additions should reach 60,000; the highest in two years. And, the total number of accounts should gain 1.1% YoY. Non-rental sales (exports, lump-sum, cosmetics) are estimated to increase 4% YoY. Meanwhile, sales at the core subsidiary in Malaysia should surge 40% YoY while US subsidiary sales should grow more than 15% YoY.

Overseas expansion gaining traction

Solid overseas results should contribute to earnings. The overseas business, including China and the US, should account for 21% of total sales this year. And, average full-year sales growth should reach 7.5% in 2018-2019, while Malaysia should lift overall growth by almost 3%p. Total overseas accounts should grow 6% YoY and ARPU 2% YoY, ending a two-year stagnation. Of note, water quality is poor in Malaysia, but water purifier penetration is only about 20%. Coway secured 650,000 accounts in the country as of end-2017, equivalent to more than 10% of the company's total global accounts. And, Coway should secure more than 200,000 more accounts this year. Meanwhile, ODM exports of air purifiers to China are growing steadily. As demand peaks in 2H, air purifier ODM exports should ramp up later this year. In addition, we recommend closely monitoring lump-sum payment sales via Amazon, the reinforced rental business in Thailand and the potential entry into the Chinese water purifier market over the mid to long term.

Better domestic competitiveness, solid market growth

Domestic rental accounts should grow 4.4% YoY and total accounts 2.2% YoY this year. After eroding on more competition and quality issues, water purifier accounts should rebound. Air purifiers and mattress rentals are robust on growing markets, and new water and air purifier products are scheduled to roll out in 2Q18. Going forward, Coway should launch new rental categories, such as clothes cleaners and water softeners.

Yr to Dec	Sales (W bn)	OP (W bn)	NP (W bn)	EPS (KRW)	% chg (YoY)	EBITDA (W bn)	PE (x)	EV/EBITDA (x)	PB (x)	ROE (%)	DY (%)
2016A	2,376	339	244	3,280	(29.0)	572	26.9	11.8	4.9	20.1	3.6
2017A	2,517	473	326	4,484	36.7	708	21.8	10.8	6.3	30.1	3.3
2018F	2,697	516	375	5,205	16.1	767	17.0	9.0	5.1	35.8	3.8
2019F	2,908	554	403	5,588	7.4	819	15.9	8.4	4.6	34.1	4.1
2020F	3,130	605	442	6,130	9.7	885	14.5	7.7	4.1	32.8	4.1

Note: Net profit and EPS are based on figures attributed to controlling interest

12M rating **BUY (Maintain)**

12M TP **W110,000** from W110,000

Up/downside **+24%**

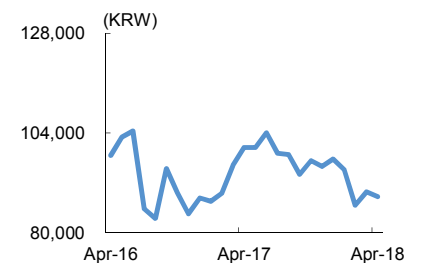
Stock Data

KOSPI (Apr 5, pt)	2,438
Stock price (Apr 5, KRW)	88,600
Market cap (USD mn)	6,170
Shares outstanding (mn)	74
52-Week high/low (KRW)	111,000/83,000
6M avg. daily turnover (USD mn)	14.3
Free float / Foreign ownership (%)	70.4/59.9
Major shareholders (%)	
Coway Holdings, Inc. and 7 others	27.4
GIC Private Limited	7.4

Performance

	1M	6M	12M
Absolute (%)	4.2	(5.7)	(7.9)
Relative to KOSPI (%p)	1.6	(7.5)	(20.7)

Stock price trend



Source: WISEfn

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Maintain BUY with TP of W110,000

Over the next two years, we forecast sales will grow at a CAGR of 8%, OP of 8% and EPS of 12%. Dividend yield reaches 3.8%, and management has adopted a robust shareholder return policy centered on share buybacks and cancellations. We believe the growth outlook is robust for environmental appliances, such as water purifiers and air purifiers, across not only Korea but all of Asia, where air quality and water pollution are serious concerns. Meanwhile, shares trade at 17x 12MF PE, near the bottom of the three-year band. Given the steady earnings growth, domestic and overseas expansion and attractive dividend yield, we expect shares to climb gradually.

Table 1. Earnings breakdown

(W bn, %, % YoY)

	2017				2018				Annual				
	1Q	2Q	3Q	4Q	1QF	2QF	3QF	4QF	2015	2016	2017	2018F	2019F
Sales	610	623	630	654	656	659	677	705	2,315	2,376	2,517	2,697	2,908
% YoY	(2.2)	12.3	7.9	6.4	7.5	5.7	7.5	7.8	7.2	2.6	5.9	7.1	7.9
Rental related	407	416	414	413	417	424	429	430	1,671	1,592	1,651	1,701	1,775
% YoY	(3.7)	16.0	1.3	3.0	2.5	1.9	3.5	4.2	5.5	(4.7)	3.7	3.0	4.4
Rental	370	380	379	379	384	392	398	400	1,491	1,424	1,506	1,574	1,660
% YoY	(2.8)	20.0	3.1	4.9	4.0	3.3	5.1	5.7	6.5	(4.5)	5.7	4.5	5.4
Membership	38	37	36	34	33	32	31	30	180	168	145	127	115
% YoY	(11.9)	(13.6)	(14.7)	(14.3)	(12.0)	(12.1)	(12.8)	(12.4)	(2.1)	(6.7)	(13.6)	(12.3)	(9.1)
Financial lease	26	30	35	32	28	31	33	32	41	106	123	124	124
% YoY	20.5	5.6	30.0	11.3	10.0	2.0	(5.0)	0.8	0.0	157.9	16.4	1.4	0.0
Lump-sum	46	50	47	49	47	51	50	51	171	196	192	200	208
% YoY	(9.1)	(6.8)	11.0	(0.2)	3.0	2.0	5.0	5.4	38.6	14.4	(1.9)	3.8	4.2
Cosmetics	21	19	19	21	22	20	20	22	83	74	80	85	91
% YoY	4.0	8.1	7.2	10.7	5.0	8.0	5.0	8.4	3.4	(10.7)	7.4	6.6	7.0
Export	68	56	69	68	71	64	79	82	149	217	260	296	341
% YoY	19.9	(7.2)	42.6	30.0	5.0	15.0	15.0	21.7	(10.8)	45.1	19.9	14.1	15.0
Others	4	4	4	3	4	4	5	6	89	21	15	19	19
% YoY	(32.6)	(9.9)	(27.4)	(29.0)	7.0	7.0	10.0	66.7	52.2	(76.7)	(25.5)	20.8	1.0
Subsidiaries	72	84	82	99	101	103	105	138	239	274	337.2	448.3	562.2
% YoY	11.2	36.4	33.8	14.7	41.7	22.6	28.7	39.3	18.0	14.5	23.1	32.9	25.4
OP	121	121	124	107	128	128	131	130	463	339	473	516	554
% YoY	(2.2)	919.4	16.1	11.1	5.8	5.7	5.2	21.6	27.1	(26.9)	39.5	9.2	7.2
OPM	19.8	19.3	19.7	16.4	19.5	19.3	19.3	18.5	20.0	14.3	18.8	19.1	19.0

Source: Company data, Korea Investment & Securities

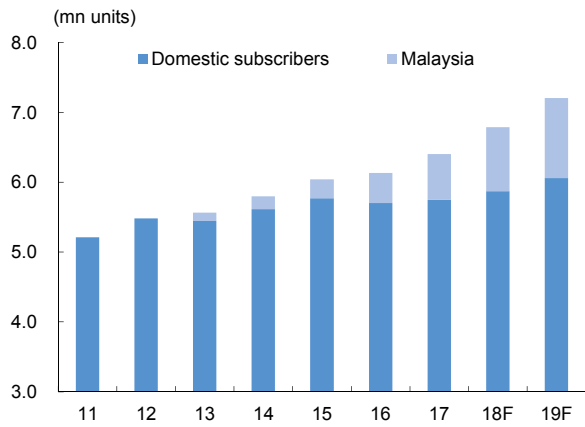
Table 2. Rental business key assumptions

('000 accounts, % YoY, %)

	2017				2018				Annual				
	1Q	2Q	3Q	4Q	1QF	2QF	3QF	4QF	2015	2016	2017	2018F	2019F
Total no. of accounts	5,713	5,746	5,745.1	5,748.3	5,778	5,828	5,848	5,873	5,771	5,704	5,748	5,873	6,062
Increase in total no. of accounts	9	33	(1)	3	30	50	20	25	155	(68)	45	125	189
%YoY	(1.4)	(1.7)	0.2	0.8	1.1	1.4	1.8	2.2	2.8	(1.2)	0.8	2.2	3.2
No. of rental account (year-end)	4,875	4,923	4,935	4,970	5,030	5,100	5,140	5,191	4,832	4,849	4,970	5,191	5,417
%YoY	0.3	0.0	2.3	2.5	3.2	3.6	4.1	4.4	5.0	0.4	2.5	4.4	4.4
Net adds in rental account	26	48	13	35	60	70	40	51	232	17	120	221	226
No. of membership account (year-end)	838	823	810	778	748	728	708	683	939	854	778	683	645
%YoY	(10.2)	(11.0)	(10.8)	(8.9)	(10.6)	(11.5)	(12.5)	(12.3)	(7.6)	(9.0)	(8.9)	(12.3)	(5.5)
Net adds in membership account	(17)	(15)	(13)	(32)	(30)	(20)	(20)	(26)	(77)	(85)	(76)	(96)	(37)
No. of new rental sales	350	397	318	317	367	425	334	361	1,409	1,401	1,382	1,487	1,525
%YoY	(0.3)	3.2	11.5	(16.6)	5.0	7.0	5.0	13.8	5.9	(0.5)	(1.4)	7.6	2.6
Cancel rate (%)	1.19	1.19	1.00	0.86	0.97	1.02	0.96	0.72	1.00	1.21	1.06	0.98	0.98
Rental ARPU	25,331	25,822	25,597	25,475	25,612	25,789	25,895	25,823	26,345	24,516	25,562	25,817	26,075
% YoY	(3.1)	19.8	1.9	2.4	1.1	(0.1)	1.2	1.4	2.0	(6.9)	4.3	1.0	1.0
Membership ARPU	14,895	14,734	14,657	14,397	14,528	14,569	14,526	14,403	15,311	15,568	14,771	14,476	14,476
% YoY	(2.5)	(3.4)	(4.3)	(4.8)	(2.5)	(1.1)	(0.9)	0.0	1.6	1.7	(5.1)	(2.0)	0.0

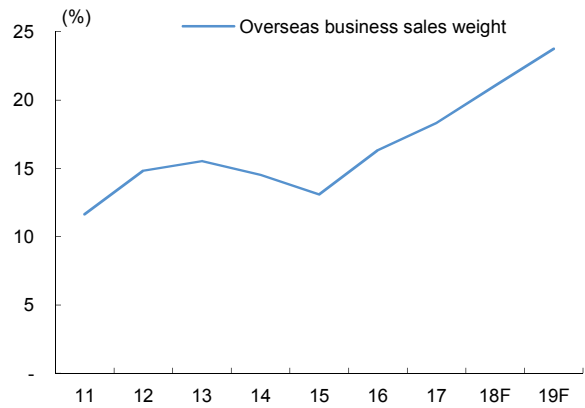
Source: Company data, Korea Investment & Securities

Figure 1. Stagnant domestic subscribers vs. Growing overseas business



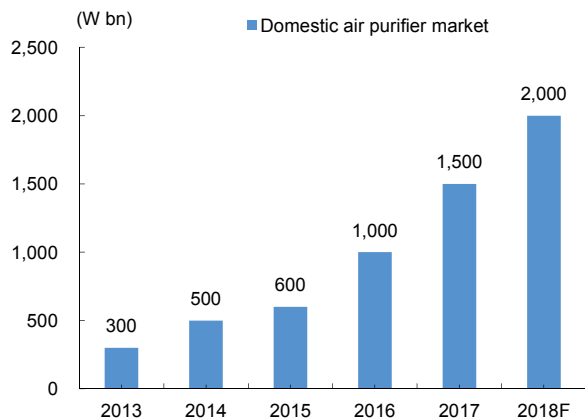
Source: Company data, Korea Investment & Securities

Figure 2. Overseas business sales weight



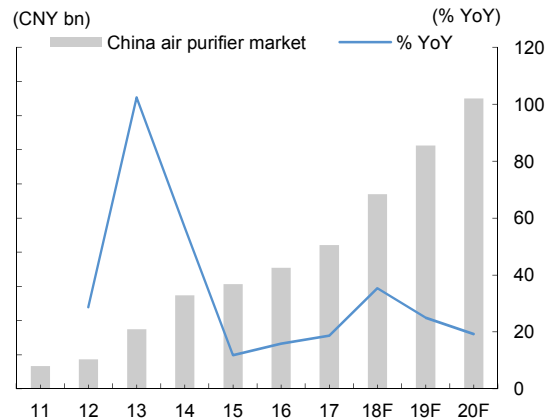
Source: Company data, Korea Investment & Securities

Figure 3. Domestic air purifier market to reach W2tn in 2018



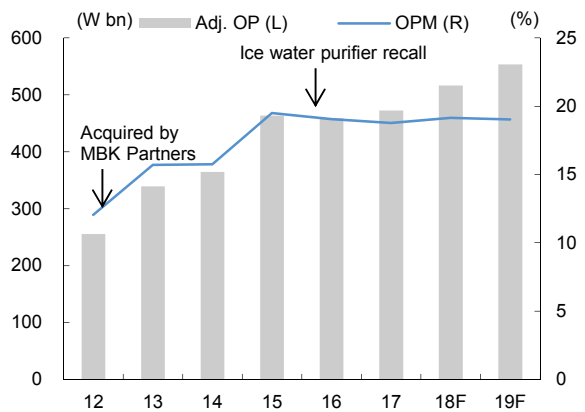
Source: Industry data, Korea Investment & Securities

Figure 4. China air purifier business



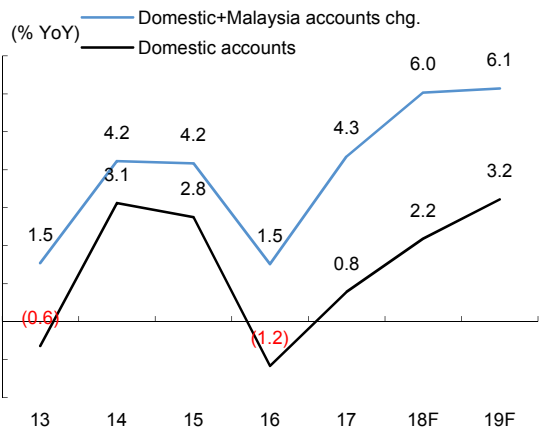
Source: China Information Industry Network, Korea Investment & Securities

Figure 5. Growth to resume in 2018 after flattening in 2016-2017

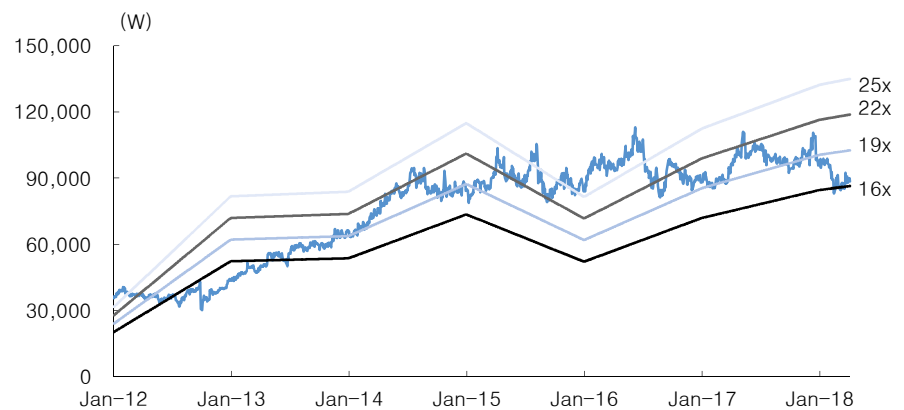


Source: Company data, Korea Investment & Securities

Figure 6. Global accounts picking up since 2017



Source: Company data, Korea Investment & Securities

Figure 7. PE band

Source: WISEfn, Korea Investment & Securities

Company overview

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.

Balance sheet

(W bn)

FY-ending Dec.	2016A	2017A	2018F	2019F	2020F
Current assets	733	791	811	874	1,004
Cash & cash equivalent	66	110	81	87	156
Accounts & other receivables	323	340	364	393	423
Inventory	70	75	80	87	93
Non-current assets	1,235	1,367	1,476	1,572	1,671
Investment assets	55	56	60	65	70
Tangible assets	669	712	774	815	856
Intangible assets	183	184	197	213	229
Total assets	1,968	2,159	2,286	2,446	2,674
Current liabilities	735	1,125	1,120	1,134	1,177
Accounts & other payables	255	268	287	309	333
ST debt & bond	340	670	670	670	670
Current portion of LT debt	0	0	0	0	0
Non-current liabilities	49	52	55	58	61
Debentures	0	0	0	0	0
LT debt & financial liabilities	12	12	12	12	12
Total liabilities	784	1,177	1,175	1,192	1,238
Controlling interest	1,183	982	1,112	1,255	1,438
Capital stock	41	41	41	41	41
Capital surplus	127	129	129	129	129
Other Reserves	(159)	(146)	(146)	(146)	(146)
Retained earnings	1,180	963	1,093	1,236	1,419
Minority interest	1	0	(0)	(1)	(2)
Shareholders' equity	1,183	982	1,112	1,254	1,436

Cash flow

(W bn)

FY-ending Dec.	2016A	2017A	2018F	2019F	2020F
C/F from operating	358	554	574	627	707
Net profit	243	326	375	403	442
Depreciation	225	227	242	256	270
Amortization	8	8	9	9	10
Net incr. in W/C	(232)	(148)	(51)	(40)	(14)
Others	114	141	(1)	(1)	(1)
C/F from investing	(367)	(290)	(359)	(362)	(379)
CAPEX	(328)	(337)	(317)	(311)	(325)
Decr. in fixed assets	15	14	14	14	14
Incr. in investment	(43)	41	(4)	(5)	(5)
Net incr. in intangible assets	(13)	(8)	(22)	(25)	(26)
Others	2	0	(30)	(35)	(37)
C/F from financing	(40)	(218)	(245)	(259)	(259)
Incr. in equity	5	15	0	0	0
Incr. in debts	264	330	(0)	(0)	(0)
Dividends	(208)	(409)	(232)	(245)	(260)
Others	(101)	(154)	(13)	(14)	1
C/F from others	(0)	(2)	0	0	0
Increase in cash	(50)	44	(29)	6	69

Note: Based on K-IFRS (consolidated)

Income statement

(W bn)

FY-ending Dec.	2016A	2017A	2018F	2019F	2020F
Sales	2,376	2,517	2,697	2,908	3,130
COGS	812	798	849	919	986
Gross profit	1,564	1,718	1,847	1,989	2,144
SG&A expense	1,225	1,246	1,331	1,436	1,538
Operating profit	339	473	516	554	605
Financial income	1	1	1	1	1
Interest income	1	1	1	1	1
Financial expense	6	12	18	18	18
Interest expense	6	12	18	18	18
Other non-operating profit	(10)	(22)	0	0	0
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	0
Earnings before tax	324	440	499	537	589
Income taxes	80	114	125	134	147
Net profit	243	326	375	403	442
Net profit of controlling interest	244	326	375	403	442
Other comprehensive profit	(1)	7	0	0	0
Total comprehensive profit	243	333	375	403	442
Total comprehensive profit of controlling interest	243	333	375	403	442
EBITDA	572	708	767	819	885

Key financial data

FY-ending Dec.	2016A	2017A	2018F	2019F	2020F
per share data (KRW)					
EPS	3,280	4,484	5,205	5,588	6,130
BPS	17,891	15,397	17,369	19,312	21,786
DPS	3,200	3,200	3,400	3,600	3,600
Growth (%)					
Sales growth	2.6	5.9	7.1	7.9	7.6
OP growth	(26.9)	39.5	9.2	7.2	9.4
NP growth	(29.0)	33.8	15.1	7.5	9.7
EPS growth	(29.0)	36.7	16.1	7.4	9.7
EBITDA growth	(17.2)	23.8	8.2	6.8	8.1
Profitability (%)					
OP margin	14.3	18.8	19.1	19.0	19.3
NP margin	10.3	13.0	13.9	13.9	14.1
EBITDA margin	24.1	28.1	28.4	28.1	28.3
ROA	13.0	15.8	16.9	17.0	17.2
ROE	20.1	30.1	35.8	34.1	32.8
Dividend yield	3.6	3.3	3.8	4.1	4.1
Dividend payout ratio	96.3	71.2	65.4	64.4	58.7
Stability					
Net debt (W bn)	210	512	537	526	451
Int-bearing debt/equity (%)	29.7	69.5	61.4	54.4	47.5
Valuation (X)					
PE	26.9	21.8	17.0	15.9	14.5
PB	4.9	6.3	5.1	4.6	4.1
EV/EBITDA	11.8	10.8	9.0	8.4	7.7

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target	% vs. avg. price	% vs. high (low)
Coway(021240)	18-02-16	BUY	W117,000	-17.9	-13.7
	04-05-16	Hold	-	-	-
	04-05-17	1YR later	-	-	-
	25-02-18	BUY	W110,000	-	-



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- BUY: Expected to outperform the market index by 15%p or more
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■ **Guide to Korea Investment & Securities Co., Ltd. stock rating allocation (as of Dec 31, 2017)**

BUY	Hold	Underweight (Sell)
79.6%	19.9%	0.5%

Note: % of companies under coverage with this rating

■ **Guide to Korea Investment & Securities Co., Ltd. sector ratings for the next 12 months**

- Overweight: Recommend increasing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.
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- Underweight: Recommend reducing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.

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Prepared by: Eun-cha Na

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