

May 2, 2018

## Coway (021240)

### Fading competition concerns at home and outstanding performance abroad

- Total rental accounts up 5% YoY led by strength in Korea and Malaysia
- Global rental sales to grow 8% over next two years
- Time to buy given 3.9% dividend yield and valuations at bottom of historic band

#### Facts: In line with consensus; Better in details

Coway's 1Q18 results were in line with the consensus with sales up 6% YoY to W647.8bn and OP up 9% YoY to W131.3bn (OPM 20.3%, up 0.5%p YoY). By division, domestic rental sales rose 1% YoY and mattress financial leasing jumped 49% YoY. Non-rental sales (lump-sum, cosmetics, exports, etc.) shrank 12% YoY but overall revenue grew as the combined sales at overseas and core subsidiaries increased 48% YoY. Robust sales and significant account additions in Malaysia and Korea were particularly impressive. Lump-sum sales and China-bound exports were sluggish but this will only be temporary. Weak lump-sum sales were due to revamped water softener selling practices. Exports to China should pick up in 2H18 when inventory is cleared at a major customer.

#### Pros & cons: Confirmed overseas expandability; Domestic competition concerns fading

Growth is upbeat at the overseas business. Coway secured 708,000 accounts in Malaysia, a QoQ net increase of 55,000. Malaysia accounted for 11% of all accounts and when also combining the US and Thailand, overseas accounts reach 836,000, making up 13% of the total. Coway commands a solid no. 1 position in Malaysia's water purifier market, taking 35-40% market share for new products. Given that water purifier penetration in the country is only ~20%, we expect the market to achieve lofty growth. We recommend closely monitoring 1) air purifier ODM exports to China, 2) broader selling channels in the US via Amazon, 3) rental operation expansion in Thailand and 4) the potential entry to China's water purifier market over the mid to long-term. And in terms of domestic rental accounts, net additions reached 62,000, the most in two years. Of note, new rental sales are up a brisk 8% YoY. In addition to water purifiers entering the peak-demand season from 2Q18, a product lineup reinforced by the effects of new models and the release of a clothing care system should help further accelerate sales growth.

Below	In line	Above
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vs. OP consensus

12M rating **BUY (Maintain)**

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

Up/downside **+26%**

#### Stock data

KOSPI (Apr 30, pt)	2,515
Stock price (Apr 30, KRW)	87,500
Market cap (USD mn)	6,046
Shares outstanding (mn)	74
52-Week high/low (KRW)	111,000/83,000
6M avg. daily turnover (USD mn)	13.7
Free float / Foreign ownership (%)	70.4/60.0
Major shareholders (%)	
Coway Holdings Inc. and 7 others	27.4
GIC Private Limited	7.4

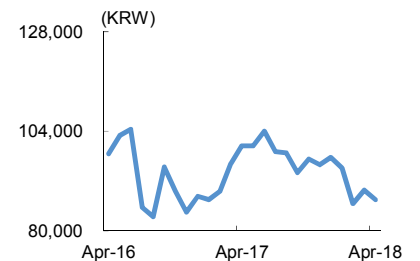
#### Valuation

	2017A	2018F	2019F
PE (x)	21.8	16.8	15.7
PB (x)	6.3	5.0	4.5
ROE (%)	30.1	35.8	34.1
DY (%)	3.3	3.9	4.1
EV/EBITDA (x)	10.8	8.9	8.3
EPS (KRW)	4,484	5,205	5,588
BPS (KRW)	15,397	17,369	19,312

#### Performance

	1M	6M	12M
Absolute (%)	(2.6)	(8.1)	(12.9)
Relative to KOSPI (%p)	(5.4)	(8.6)	(27.0)

#### Stock price



Source: WISEfn

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### Action: Concerns about domestic operations to wind down; Focus on overseas expansion and dividend appeal

Coway should end a stagnant period with total overseas accounts up 6% YoY and ARPU up 2% YoY. The dividend yield is estimated at 3.9% while shares trade at 16x 12MF PE, touching the lower end of the three-year band. We believe the growth outlook is upbeat for environmental home appliances such as water and air purifiers across not only Korea but all Asian countries where air quality and water pollution are serious concerns. Given overseas expansion, domestic recovery and attractive dividend yield, we maintain BUY.

**Table 1. 1Q18 earnings**

(W bn)

	1Q17	2Q17	3Q17	4Q17	1Q18P	QoQ (%)	YoY (%)	Consensus
Sales	610.2	623.4	629.6	653.6	647.8	(0.9)	6.2	656
OP	120.9	120.6	124.2	107.1	131.3	22.6	8.6	132
OP margin (%)	19.8	19.3	19.7	16.4	20.3	3.9	0.5	20.0
EBT	100.6	126.0	124.2	89.1	127.8	43.5	27.0	125
NP	75.5	95.3	93.5	61.8	95.2	54.1	26.1	93

Source: Company data, Korea Investment & Securities

**Table 2. Earnings breakdown**

(W bn, %, % YoY)

	2017				2018				Annual				
	1Q	2Q	3Q	4Q	1QP	2QF	3QF	4QF	2016	2017	2018F	2019F	2020F
Sales	610	623	630	654	648	660	682	706	2,376	2,517	2,696	2,912	3,109
% YoY	(2.2)	12.3	7.9	6.4	6.2	5.9	8.3	8.1	2.6	5.9	7.1	8.0	6.8
Rental related	407	416	414	413	411	420	429	441	1,592	1,651	1,701	1,775	1,854
% YoY	(3.7)	16.0	1.3	3.0	0.9	0.8	3.5	6.9	(4.7)	3.7	3.0	4.4	4.4
Rentals	370	380	379	379	379	388	398	409	1,424	1,506	1,574	1,660	1,744
% YoY	(2.8)	20.0	3.1	4.9	2.5	2.3	5.1	8.1	(4.5)	5.7	4.5	5.4	5.1
Memberships	38	37	36	34	32	32	31	32	168	145	127	115	110
% YoY	(11.9)	(13.6)	(14.7)	(14.3)	(14.8)	(14.0)	(13.9)	(6.1)	(6.7)	(13.6)	(12.3)	(9.1)	(4.9)
Financial lease	26	30	35	32	39	31	33	34	106	123	137	143	124
% YoY	20.5	5.6	30.0	11.3	49.0	3.0	(5.0)	7.2	157.9	16.4	11.5	4.5	(13.0)
Lump-sum	46	50	47	49	44	51	50	55	196	192	200	208	219
% YoY	(9.1)	(6.8)	11.0	(0.2)	(4.4)	2.0	5.0	12.4	14.4	(1.9)	3.8	4.2	5.3
Cosmetics	21	19	19	21	21	20	21	23	74	80	85	91	98
% YoY	4.0	8.1	7.2	10.7	(1.4)	8.0	8.0	12.1	(10.7)	7.4	6.6	7.0	8.0
Exports	68	56	69	68	54	64	79	87	217	260	284	326	375
% YoY	19.9	(7.2)	42.6	30.0	(20.1)	15.0	15.0	28.0	45.1	19.9	9.2	15.0	15.0
Others	4	4	4	3	3	4	5	7	21	15	19	19	19
% YoY	(32.6)	(9.9)	(27.4)	(29.0)	(18.2)	7.0	10.0	96.1	(76.7)	(25.5)	20.8	1.0	2.0
Subsidiaries	72	84	82	99	106	108	110	124	274	337.0	448.2	562.1	673.8
% YoY	11.2	36.4	33.8	14.7	48.3	28.3	34.7	24.6	14.5	23.0	33.0	25.4	19.9
OP	121	121	124	107	131	129	132	125	339	473	516	554	595
% YoY	(2.2)	919.4	16.1	11.1	8.6	6.7	6.0	16.3	(26.9)	39.5	9.2	7.4	7.3
OPM (%)	19.8	19.3	19.7	16.4	20.3	19.5	19.3	17.6	14.3	18.8	19.1	19.0	19.1

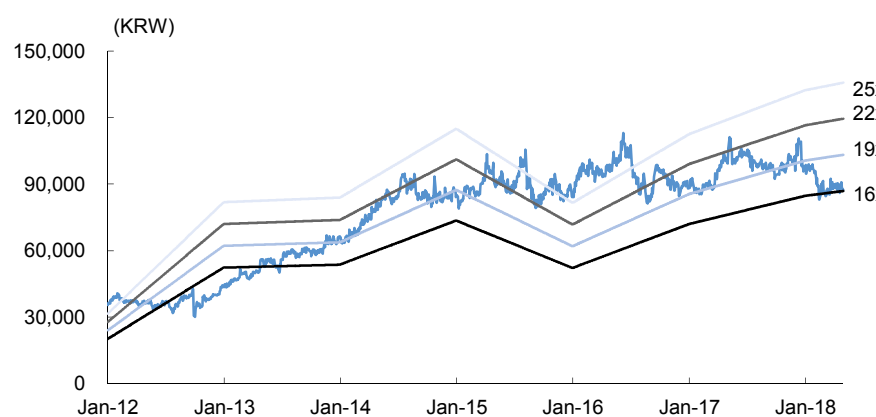
Source: Company data, Korea Investment & Securities

**Table 3. Rental business key assumptions**

('000 accounts, % YoY, %)

	2017				2018				Annual				
	1Q	2Q	3Q	4Q	1QP	2QF	3QF	4QF	2016	2017	2018F	2019F	2020F
Total accounts	5,713	5,746	5,745	5,748	5,784	5,834	5,854	5,873	5,704	5,748	5,873	6,062	6,238
Net additions	9	33	(1)	3	36	50	20	19	(68)	45	125	189	176
% YoY	(1.4)	(1.7)	0.2	0.8	1.3	1.5	1.9	2.2	(1.2)	0.8	2.2	3.2	2.9
Rental accounts (year-end)	4,875	4,923	4,935	4,970	5,032	5,102	5,142	5,191	4,849	4,970	5,191	5,417	5,620
% YoY	0.3	0.0	2.3	2.5	3.2	3.6	4.2	4.4	0.4	2.5	4.4	4.4	3.8
Net additions	26	48	13	35	62	70	40	48	17	120	221	226	204
Membership accounts (year-end)	838	823	810	778	752	732	712	683	854	778	683	645	617
% YoY	(10.2)	(11.0)	(10.8)	(8.9)	(10.2)	(11.0)	(12.1)	(12.3)	(9.0)	(8.9)	(12.3)	(5.5)	(4.3)
Net additions	(17)	(15)	(13)	(32)	(26)	(20)	(20)	(29)	(85)	(76)	(96)	(37)	(28)
New rental sales	350	397	318	317	377	425	334	351	1,401	1,382	1,487	1,525	1,584
% YoY	(0.3)	3.2	11.5	(16.6)	7.9	7.0	5.0	10.6	(0.5)	(1.4)	7.6	2.6	3.8
Churn rate (%)	1.19	1.19	1.00	0.86	1.01	1.06	0.96	0.77	1.21	1.06	0.98	0.98	0.99
Rental ARPU	25,331	25,822	25,597	25,475	25,241	25,534	25,892	26,400	24,516	25,562	25,817	26,075	26,336
% YoY	(3.1)	19.8	1.9	2.4	(0.4)	(1.1)	1.2	3.6	(6.9)	4.3	1.0	1.0	1.0
Membership ARPU	14,895	14,734	14,657	14,397	14,026	14,174	14,275	15,400	15,568	14,771	14,476	14,476	14,476
% YoY	(2.5)	(3.4)	(4.3)	(4.8)	(5.8)	(3.8)	(2.6)	7.0	1.7	(5.1)	(2.0)	0.0	0.0

Source: Company data, Korea Investment &amp; Securities

**Figure 1. PE band**

Source: WISEfn, Korea Investment &amp; Securities

**Company overview**

Established in 1989, Coway specializes 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 equivalents	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 & bonds	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 operations	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 debt	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: 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 expenses	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 expenses	6	12	18	18	18
Interest expenses	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	3.9	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	16.8	15.7	14.3
PB	4.9	6.3	5.0	4.5	4.0
EV/EBITDA	11.8	10.8	8.9	8.3	7.6

**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	Hold	Underweight (Sell)
80.3%	19.2%	0.5%

Note: % of companies under coverage with this rating

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